**BEFORE THE**

**PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA**

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| **In Re:** | ) | |
| | ) | |
| **BellSouth Telecommunications, Incorporated d/b/a AT&T Southeast d/b/a AT&T South Carolina v. Affordable Phone Services, Incorporated d/b/a High Tech Communications** | ) | **Docket No. 2010-14-C** |
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| **BellSouth Telecommunications, Incorporated d/b/a AT&T Southeast d/b/a AT&T South Carolina v. Dialtone & More, Incorporated** | ) | **Docket No. 2010-15-C** |
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| **BellSouth Telecommunications, Incorporated d/b/a AT&T Southeast d/b/a AT&T South Carolina v. Tennessee Telephone Service, LLC d/b/a Freedom Telecommunications USA, LLC** | ) | **Docket No. 2010-16-C** |
| | ) | |
| **BellSouth Telecommunications, Incorporated d/b/a AT&T Southeast d/b/a AT&T South Carolina v. OneTone Telecom, Incorporated** | ) | **Docket No. 2010-17-C** |
| | ) | |
| **BellSouth Telecommunications, Incorporated d/b/a AT&T Southeast d/b/a AT&T South Carolina v. dPi Teleconnect, LLC** | ) | **Docket No. 2010-18-C** |
| | ) | |
| **BellSouth Telecommunications, Incorporated d/b/a AT&T Southeast d/b/a AT&T South Carolina v. Image Access, Inc. d/b/a NewPhone** | ) | **Docket No. 2010-19-C** |

**POST-HEARING BRIEF OF RESELLERS**

This Post-Hearing Brief is jointly filed by Affordable Phone Services, Incorporated d/b/a High Tech Communications, Dialtone & More, Incorporated, Tennessee Telephone Service, LLC d/b/a Freedom Telecommunications USA, LLC, OneTone Telecom, Incorporated, dPi Teleconnect, LLC, and Image Access, Inc. d/b/a NewPhone (collectively the "Resellers").

## I. INTRODUCTION

This case is about preserving the viability of wholesale competition and the efficacy of federal pricing rules. At issue is whether ***retail*** should be ***less*** than ***wholesale*** – that is, whether

AT&T's retail price for telecommunication services should ever be less than the wholesale price at which AT&T resells those services to competitive local exchange carriers ("CLECs") such as the Resellers. Obviously, it should not: the entire rationale for requiring incumbent local exchange carriers ("ILECs") like AT&T to resell their services at wholesale rates hinges on retail rates being *greater* than wholesale rates. Nevertheless, AT&T's use of "cash back" promotions, combined with its failure to extend the full value of those promotions to the Resellers, results in retail prices *less* than wholesale rates. AT&T's promotional pricing practices are unreasonable, discriminatory, and contrary to the requirements and purposes of the Federal Telecommunications Act of 1996 ("Act")[1] and the Federal Communications Commission's (FCC's rules) on resale.

Under federal law, AT&T is required to offer service to the Resellers under the same terms and conditions as AT&T offers service to its retail customers. Here, AT&T requires both retail and wholesale customers to purchase service at the regular retail or wholesale rate. The wholesale rate paid by the Reseller is the regular retail rate less the 14.8% avoided cost discount established by the Public Service Commission of South Carolina ("Commission"). AT&T then offers both retail and wholesale customers the opportunity to apply for and receive a "cash back" rebate. The retail customer is offered a $50 rebate, but AT&T argues that it only must offer the Reseller a rebate of about $40 ($50 less a deduction of 14.8% for "avoided costs"). In other words, even though the avoided costs have already been subtracted once (when the Reseller purchases the service at the normal wholesale rate), AT&T argues that the avoided costs should be deducted a second time when AT&T pays the cash back amount.

[1] Federal Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (codified as amended in scattered sections of 15 and 47 U.S.C. § 251 et seq.).

AT&T's theory makes no sense. Federal law requires that the avoided costs be deducted once, not twice. But even if the Commission were to hold that the Reseller is not entitled to the full $50 cash back amount, the Commission must, at the very least, modify AT&T's approach so that the wholesale price is always less than the retail price of the same service. As Reseller witness Mr. Joseph Gillan testified, AT&T's formula can be "corrected" so that even if the Reseller does not get the full $50 rebate, the wholesale price will still be lower than the retail price. (Gillan Pre Filed Rebuttal Testimony at pp. 15 – 19)

In the absence of such a ruling, AT&T will continue to violate the FCC's rules on resale requiring that wholesale rates be *lower* than retail rates, by wrongfully applying the wholesale discount twice and raising wholesale rates *above* retail rates.

## II. BACKGROUND HISTORY AND FACTS

### A. Procedural History.

This consolidated proceeding before the Commission arises out of a series of complaints filed by AT&T in the above-referenced Dockets against the Resellers. In these complaints, AT&T alleges, among other things, that the individual Resellers owe amounts relating to certain promotional offerings which AT&T offers to its end-use customers.

Pursuant to the parties' Joint Motion on Procedural Issues filed May 20, 2010, as granted by Commission Hearing Officer Directive dated August 20, 2010, these Dockets were consolidated for the limited purpose of addressing the following common issues (the "Consolidated Phase"): (1) how cash back credits to Resellers should be calculated; (2) whether the word-of-mouth promotion is available for resale, and if so, how the credits to Resellers should be calculated; and (3) how credits to Resellers for waiver of the line connection charge should be calculated. The parties jointly filed Stipulations for Consolidated Phase on July 23, 2010. AT&T and the Resellers filed direct and rebuttal testimony in the Consolidated Phase, and

a hearing on this matter was held on December 16, 2010.

The issues presented in the Consolidated Phase relate to the calculation of credits owed to Resellers for certain cash back, line connection charge waiver, and referral (or word-of-mouth) promotional offerings which AT&T offers to its resale customers. For the reasons set forth herein, in the pre-filed direct and rebuttal testimony of Mr. Joseph Gillan and Dr. Christopher Klein, each of the promotional offerings at issue in this proceeding are subject to resale by AT&T to the Resellers, and the Resellers are entitled to the full value of these promotional offerings to the same extent as offered by AT&T to its end-user retail customers.

**B. Regulatory Background.**

The Act opens up the local exchange telephone service market by, among other things, requiring the ILECs, such as AT&T, to offer their retail services at wholesale rates to CLECs, such as the Resellers.[1] The wholesale rate is calculated by subtracting from AT&T's retail price AT&T's costs avoided in providing the service at wholesale rather than retail.[2]

**C. Facts of the Case.**

The Resellers resell AT&T's retail residential telephone services. AT&T often offers its retail customers promotional discounts and rebates which AT&T is required to make available to Resellers. This dispute centers on credits which are owed to the Resellers as a result of the Resellers purchasing these promotional offerings from AT&T.

For several years, AT&T has provided various "cash back" promotions to its retail customers. Although the Resellers met the same qualifications as AT&T's retail end users and applied for cash back rebates, the Resellers were not paid the full value of the cash back

[1] 47 U.S.C. § 251(c)(4).
[2] 47 U.S.C. § 252(d)(3) and 47 C.F.R. § 51.607.

amounts. In most cases, this allowed an AT&T retail customer to buy service from AT&T at a rate lower than the wholesale rate paid by a Reseller for the same service.

**D. Controlling Law.**

Federal law provides, among other things, the following with respect to the terms and condition of resale, including the obligation to make promotions available to resellers:

- 47 U.S.C. § 251(c)(4)(A). ILECs have the duty to "offer for resale at wholesale rates any telecommunications service that the carrier provides at retail to subscribers who are not telecommunications carriers."

- 47 C.F.R. § 51.605(a). ILECs "shall ***offer*** to any requesting telecommunications carrier any telecommunications service that the [ILEC] ***offers*** on a retail basis to subscribers that are not telecommunications carriers for resale at wholesale rates...." [Emphasis added.]

- 47 U.S.C. § 251(c)(4)(B). ILECs have a duty not to "prohibit, and not to impose unreasonable or discriminatory conditions or limitations on, the resale of such telecommunications service."

- 47 C.F.R. § 51.603(b). "A LEC must provide services to requesting telecommunications carriers for resale that are equal in quality, ***subject to the same conditions***, and provided within the same provisioning time intervals that the LEC provides these services to others, including end users." [Emphasis added.]

- 47 C.F.R. § 51.613(a)(2). "The following types of restrictions on resale may be imposed: Short term promotions. An incumbent LEC shall apply the wholesale discount to the ordinary rate for a retail service rather than a special promotional rate only if:

  (i) Such promotions involve rates that will be in effect for no more than 90 days; and

  (ii) The incumbent LEC does not use such promotional offerings to evade the wholesale rate obligation, for example by making available a sequential series of 90-day promotional rates."

Federal law provides, among other things, the following with respect to calculating the wholesale price of retail services which must be resold:

- 47 U.S.C. § 252(d)(3). "Wholesale prices for telecommunications services. For the purposes of section 251(c)(4) of this title, a State commission shall determine ***wholesale*** rates on the basis of ***retail*** rates charged to subscribers for the telecommunications service requested, ***excluding the portion thereof attributable to any marketing, billing, collection, and other <u>costs that will be avoided</u>*** by the local exchange carrier." [Emphasis added.]

- 47 C.F.R. § 51.607. "The wholesale rate that an incumbent LEC may charge for a telecommunications service provided for resale to other telecommunications carriers shall equal the rate for the telecommunications service, ***less avoided retail costs***, as described in section 51.609." [Emphasis added.]

## III. ANALYSIS

The overriding principle controlling this proceeding is that the Act and the FCC rules require that ***wholesale prices should always be less than retail prices***. This principle serves as the basis for CLECs to compete with ILECs such as AT&T as contemplated by the Act, and recognition of this principle is critical in promoting competition in the telecommunications market. This competition, in turn, benefits customers by providing increased choice of providers, lower prices and greater access to telecommunications services.[3]

AT&T claims that its erroneous method of calculating the credit due to the Resellers for cash back promotions is consistent with applicable FCC rules. However, AT&T fails to recognize in its arguments and examples that in many cash back promotions at issue, AT&T offers a cash back promotion in an amount that exceeds the retail price of the underlying

[3] Although the parties have stipulated that Resellers qualify for the cash back promotions, leaving at issue only the question of what the avoided cost discount and thus how much the wholesale price should be when promotions are in play, AT&T argues that the Resellers do not directly compete with AT&T for the same customers, when questioned at the hearing in this case, AT&T witness, Dr. William Taylor admitted that: "[t]here may be full resale competitors to AT&T. There have been such things in the past. But whether they have them today, or not, I don't know." See Transcript of Testimony and Proceedings at p. 141, lines 21-24. In fact, the Resellers actively compete with AT&T for customers, as evidenced by the fact that a large portion of the Resellers' current customers are former customers of AT&T.

telecommunications service. Applying AT&T's method to these promotions creates a wholesale price which is ***greater than*** the retail price to end-users, circumventing a core principle inherent in the Act – namely, that wholesale prices should always be less than retail prices.[4] None of AT&T's arguments justify charging the Resellers, as wholesale customers of AT&T, a price in excess of what AT&T charges its retail customers, as such an arrangement would render CLECs unable to compete with AT&T's retail prices and would stifle competition in the telecommunications market—in clear conflict with and violation ofthe foundation of the Act.

## A. How to correctly calculate the wholesale price: subtracting the known avoided costs from the net retail rate.

The question before the Commission is how to determine the amount Resellers are entitled to when reselling services subject to cash back promotions for that single month when the promotion is processed. No other months are in dispute. In making this determination, the Commission must keep two key principles in mind.

First, the Act[5] and federal regulations (particularly 47 C.F.R. § 51.607) set the resale rate for telecommunications services that an ILEC may charge at "the rate for the

[4] AT&T equates the term "discount" with "percentage." However, the law does not define the wholesale discount in terms of a "percentage" reduction, but as a subtraction problem: the wholesale discount is determined by reducing the avoided costs from the retail rate. *See* 47 C.F.R. § 51.607: "The wholesale rate…shall equal the rate for the telecommunications service, ***less avoided retail costs*** …." Under AT&T's method, applying the Commission's wholesale discount of 14.8% to an effective retail rate that is negative ***increases*** the wholesale rate (i.e., moves that rate toward zero)... As explained throughout this proceeding, nowhere in the FTA or FCC regulations is an ILEC allowed to use an avoided cost discount to increase the wholesale rate and charge a wholesaler ***more than*** a retail customer.

[5] 47 U.S.C. § 252(d)(3): Wholesale prices for telecommunications services
For the purposes of section 251(c)(4) of this title, a State commission shall determine wholesale rates on the basis of retail rates charged to subscribers for the telecommunications service requested, excluding the portion thereof attributable to any marketing, billing, collection, and other costs that will be avoided by the local exchange carrier.

telecommunications service, less avoided retail costs, as described in section 51.609."[6] Thus, ***the "wholesale discount" must by law be calculated as the avoided cost***.

Second, it is clear from context that the FTA and the rules promulgated thereunder expect that the ***wholesale price should be less than the retail price***. Again, there is no dispute on this, as AT&T's witness Dr. Taylor concedes that the Act and the FCC's rules presume that the wholesale price must be less than the retail price.[7]

When considering the wholesale – that is, cost avoided – discount, keep in mind that while the statute bases the wholesale discount on certain costs avoided, costs are not necessarily directly related to the price for the service. Remember, "cost" and "price" are two very different concepts. as AT&T witness Dr. William Taylor admits:

> **MR. MALISH:** …. [T]here is a difference between cost and price, and you're nodding your head. Do you recognize a distinction between those two terms?
> **MR. TAYLOR:** Yes.
> **MR. MALISH:** Can you explain the difference, please.
> **MR. TAYLOR:** Sure. Two different sides of the market. Cost is the value of the products and services which are necessary to produce a unit of output.
> **MR. MALISH:** Uh-huh.
> **MR. TAYLOR:** Price is the value or what a customer has to give up in order to acquire that. Those are two very different concepts.
> **….**
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> **MR. TAYLOR:** Well, let me answer it this way. That simply because a price changes –
> **MR. MALISH:** Uh-huh.

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[6] "Avoided retail costs shall be those costs that reasonably can be avoided when an incumbent LEC provides a telecommunications service for resale at wholesale rates to a requesting carrier." 47 C.F.R. § 51.609(b). Further, "the amount of avoided retail costs shall be determined on the basis of a cost study…." 47 C.F.R. § 51.609(a).

[7] Transcript of Testimony and Proceedings, p. 129, lines 5 – 14, *e.g.*:

> **MR. GUARISCO:** And there's a discussion at the bottom of page 12 and into page 13 with regard to the overarching principles involved in the resale obligations of the [federal Telecommunications] Act [of 1996] and that the resale price to the CLECs would be less than the retail price of the ILEC?
> **MR. TAYLOR:** Yes.
> **MR. GUARISCO:** Do you see that at the bottom of page 12?
> **MR. TAYLOR:** Right. My answer is that's certainly the expectation of the Act, because the Act and the FCC never contemplate that a price would be negative.

**MR. TAYLOR:** – does not necessarily mean that a cost has changed.[8]

Obviously, there will always be ***costs*** associated with providing service, regardless of the level of the retail ***sales price*** – even if the service is given away for free, of if the customer is given cash to take the service for one of the months that it is offered. Moreover, the costs of providing a particular service do not change, even if some purchasers of that service may be able to purchase the service at a special sale, or promotional, prices.[9] In other words, the avoided cost is the same for both a service sold at the standard retail rate, and that same service sold pursuant to a special sale, or promotional rate.

The principle that wholesale rates should always be lower than retail rates is noted by the Fourth Circuit Court of Appeals in *BellSouth Telecommunications, Inc. v. Sanford*,[3] which indicates that the wholesale discount should be employed to create a lower charge to a reseller when compared to a retail customer. In *Sanford*, the Fourth Circuit reversed a federal district court ruling and restored a North Carolina Utilities Commission order which held that promotional offers extending for more than 90 days created a "promotional retail rate" to which the avoided cost discount must be applied.[4] The Fourth Circuit held that for these long-term

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[8] Deposition of William E. Taylor, Ph.D., October 21, 2010, p. 8, line 19 through p. 9, line 6 and p. 10, lines 7 – 11.

[9] Deposition of William E. Taylor, Ph.D., October 21, 2010, p. 104, lines 8 – 23:

> **MR. MALISH:** The cost of providing the service doesn't change just because there's a promotion that's made applicable to that service, does it?
> **MR. TAYLOR:** It certainly doesn't. That cost of providing the service doesn't change if the company for whatever reason decided to change the price from 50 to 40.
> **MR. MALISH:** Okay..
> **MR. TAYLOR:** (Indicating).
> **MR. MALISH:** So that the – changing the – Whether there's a promotion of 50 or a hundred or no promotion at all, the costs of providing under the – the underlying service does not change?
> **MR. TAYLOR:** Correct. And as the price of the service changes, the underlying costs don't change because the price changed.

3 *BellSouth Telecommunications, Inc. v. Sanford*, 494 F.3d 439 (4th Cir. 2007).

4 This "promotional retail rate" is referred to herein as the "effective retail rate."

promotional offerings, the avoided cost or wholesale discount must be applied to the actual, or effective, retail rate created by applying the value of the promotional offering to the retail rate of the underlying service.[5] The *Sanford* decision, therefore, makes it clear that ILECs cannot use long-term promotional offerings to unfairly discriminate against resellers and to avoid their resale obligations; these promotional offerings must be made available to resellers as well, subject to the costs avoided wholesale discount set by each state Commission. The Fourth Circuit recognized that in order for resellers to be able to effectively compete in the telecommunications market, resellers must be subject to a lower, wholesale charge as compared to retail customers.

So what is the avoided cost associated with providing a service? The Commission has set AT&T's avoided costs in the wholesale context at 14.8% of the retail price of the respective telecommunications service.[10] This Commission (like its counterparts in every other state) chose the standard/tariffed retail rate, to which it applied a wholesale discount percentage. Therefore, to determine "avoided costs," the wholesale discount must be applied to the standard/tariffed retail rate, not the discounted promotional rates. In light of this, resellers are entitled to the full, dollar-for-dollar value of an ILEC's promotional offerings to the same extent as retail customers. Thus, the appropriate method for determining the wholesale price is to first calculate the amount of the avoided cost, then subtract the avoided cost from the actual sales price.

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[5] *Sanford* at 442.

[10] Order on Arbitration, Docket No. 96-358-C, Order No. 97-189 (March 10, 1997).

Three methods have been identified for determining the avoided cost discount (wholesale discount) when promotions are involved:

(1) calculating the wholesale (cost avoided) discount associated with a service from the standard/tariffed cost avoided for that service; this is the method advocated by Resellers;

(2) calculating the wholesale (cost avoided) discount associated with a service as a percentage of the standard/tariffed price less a percentage of the cash back promotion amount. This is the method advocated by AT&T under the theory that it resulted in "reducing" the net retail price by the wholesale discount (*see e.g.* Taylor Direct at 16, 18, 20, 22); and

(3) calculating the wholesale (cost avoided) discount associated with a service as a percentage ***less than*** the net retail price for that service; or, stated in algebraic form, the wholesale price is made equal to the effective retail rate reduced by the amount arrived at by multiplying the ***absolute value*** of the effective retail rate by the discount percentage rate:

**Wholesale = (retail price – cash back) – % *ABS(retail – cash back)**

This is how one would correctly express mathematically the concept of having the effective retail rate being ***reduced*** by a particular percentage. So this method could be thought of as AT&T's method "as corrected."

Of these methods, the first (the Resellers') most closely conforms to the key principles underlying the Act, because it uniformly produces a wholesale price that is lower than the retail rates. The second method (advanced by AT&T as "reducing" the effective retail rate by a fixed percentage) cannot be correct because it results in situations where the wholesale rate is higher than the retail rate, and the costs avoided in providing the service are not subtracted from the net retail rate. If the intent is truly to reduce the effective rate by a given percentage, the mathematically correct way to do so is to apply the third method.

**1. Proper method for calculating the avoided costs: subtracting the known avoided costs from the net retail rate.**

As shown from the above references to AT&T's expert witness, Dr. Taylor, it is undisputed that the costs of providing a particular service do not change, even if purchasers of

that service may be able to purchase the service at a special sale, or promotional, prices. In other words, the avoided cost is the same for both a service sold at the standard retail rate, and the same service sold pursuant to a special sale, or promotional rate. This is because the ***costs*** associated with the service are the same, even if the retail ***price*** is temporarily changed (for a single month) for a particular customer pursuant to a special sale or promotion. Just as this estimate is correct for every other month for the service – and for every other customer, including those that are not eligible for the promotion – the estimate remains appropriate to the single month that the promotional credit is processed.

As we know from the statutes, the wholesale discount is supposed to be the net retail price less the avoided costs involved with providing the service. However, the Commission has already determined how to calculate the avoided costs associated with these services: to properly determine the avoided cost, one multiplies the resale discount factor (the avoided cost percentage of 14.8% set by the Commission) by the standard/tariffed price.[11] This gives one the base amount of the avoided cost, and thus the amount by which the wholesale amount should be less than the retail price.

Thus, the ***price*** to which the avoided cost is applied is the lower of the tariffed standard price, or, if any, the promotional price in effect for the services in question. Stated another way, the three steps to finding the wholesale price are:

STEP 1: Find the pre-promotion standard/tariffed retail price.

[11] At the time this Commission established its wholesale discount rate at a percent of the retail rate of telecommunications services, it focused on the tariffed, retail rate of services provided to calculate a wholesale discount percentage based on the methodology that the avoided costs for each products is proportional to its price. This methodology need not change just because AT&Thas offered a promotion – the best estimate of a product's avoided retail cost is still best estimated by applying the discount to its pre-promotion retail price. Such an approach also ensures that resellers are entitled to the full, dollar-for-dollar value of an ILEC's promotional offerings to the same extent as retail, end-use customers.

STEP 2: Find the avoided cost: multiply the standard/tariffed retail price by the wholesale discount factor.

STEP 3: Subtract the avoided cost from the effective retail sales price, which is the standard tariffed price, or, if a promotion applies, the price after applying the promotion.

By applying this method, the wholesale price is always the same amount less than the retail price, which is a better reflection of the fact that the cost to provide the services is constant regardless of temporary fluctuations in the sales price caused by non-standard special sales. Table 1, below, shows how this works.

**Table 1.**
**Results of applying avoided cost discount based on standard/tariff retail price.**

| Standard Retail Price | Standard Wholesale Discount Percentage | Promotion Amount | Net Retail Price[1] | Net Wholesale Price[2] assuming avoided cost calculated as % of standard retail price |
|---|---|---|---|---|
| $25 | 20% | – | $25 | $20 ($5 less than net retail) |
| $25 | 20% | $25 | $0 | -$5 ($5 less than net retail) |
| $25 | 20% | $50 | -$25 | -$30 ($5 less than net retail) |
| $25 | 20% | $100 | -$75 | -$80 ($5 less than net retail) |

1. Standard Retail Price - Promotional Discount = Net Retail Price

2. Standard Retail Price x Wholesale Discount Percentage = Avoided Costs
Standard Retail Price - Promotional Discount - [Avoided Costs] = Net Wholesale Price

Note that calculating the wholesale discount – that is, the avoided cost discount – from the standard or tariffed rates in this manner conforms to the principle that ***wholesale price should always be less than retail price***. As will be shown, other methods of determining the cost avoided discount do not produce such results, and in fact AT&T's proposed method actually results in a situation ***where the wholesale rates are higher than retail***.

Another reason for adopting this method is that the Act and FCC regulations require AT&T to offer certain promotions for resale "subject to the same terms and conditions" as offered to retail customers. Thus, CLECs are entitled to the full value of AT&T's cash back promotions. According to the Act and pertinent FCC regulations, AT&T is required to offer its services for resale "subject to the same conditions" that AT&T offers its own end-users and at "the rate for the telecommunications service less avoided retail costs."[12] For example, when AT&T offers retail telephone service in conjunction with a "$50 cash back" rebate to new customers, AT&T must make that offer available to CLECs "under the same conditions," that is, with a $50 cash rebate, and "at the rate for such telecommunications services less the avoided retail costs," that is, at the tariffed retail price less the wholesale discount. FCC rules unambiguously place the reseller in the shoes of the retail customer when it acquires a service for resale. The FCC rules make clear that no additional conditions can be placed on the reseller, particularly any condition that would have the effect of imposing some restriction on the reseller that does not apply to AT&T retail customers. As such, resellers are fully entitled to the cash-back payment as an end-user. To provide any less – or to impose any other qualifying requirements – violates the Act and FCC rules prohibiting any additional conditions or restrictions on the reseller.

**2. Improper Method for Determining Avoided Cost: Reducing the Cash Back Amount by the Wholesale Discount.**

AT&T argues that if AT&T is required to extend cash back promotions to CLECs at all, then it should not be required to extend to CLECs the entire amount of the promotion, but rather a lesser amount derived by reducing the promotional amount by the resale discount. AT&T

[12] *See* 47 C.F.R. § 51.603(b) and 47 C.F.R. § 51.607. Furthermore, other than in limited circumstances not applicable here, AT&Tcannot impose any restrictions on the resale of its services unless AT&T"proves to the state commission that the restriction is reasonable and non-discriminatory." 47 C.F.R. §51.613.

claims that its formula correctly resulted in reducing the effective retail rate by the fixed percentage.

In fact, AT&T's formula does ***not*** uniformly result in ***reducing*** the effective retail rate for resellers: in the situations at hand, this methodology results in a situation where its calculation of the wholesale price produces ***a wholesale price greater than the retail price***. This flaw is dramatically illustrated by the promotions in question as shown in Table 2, below:

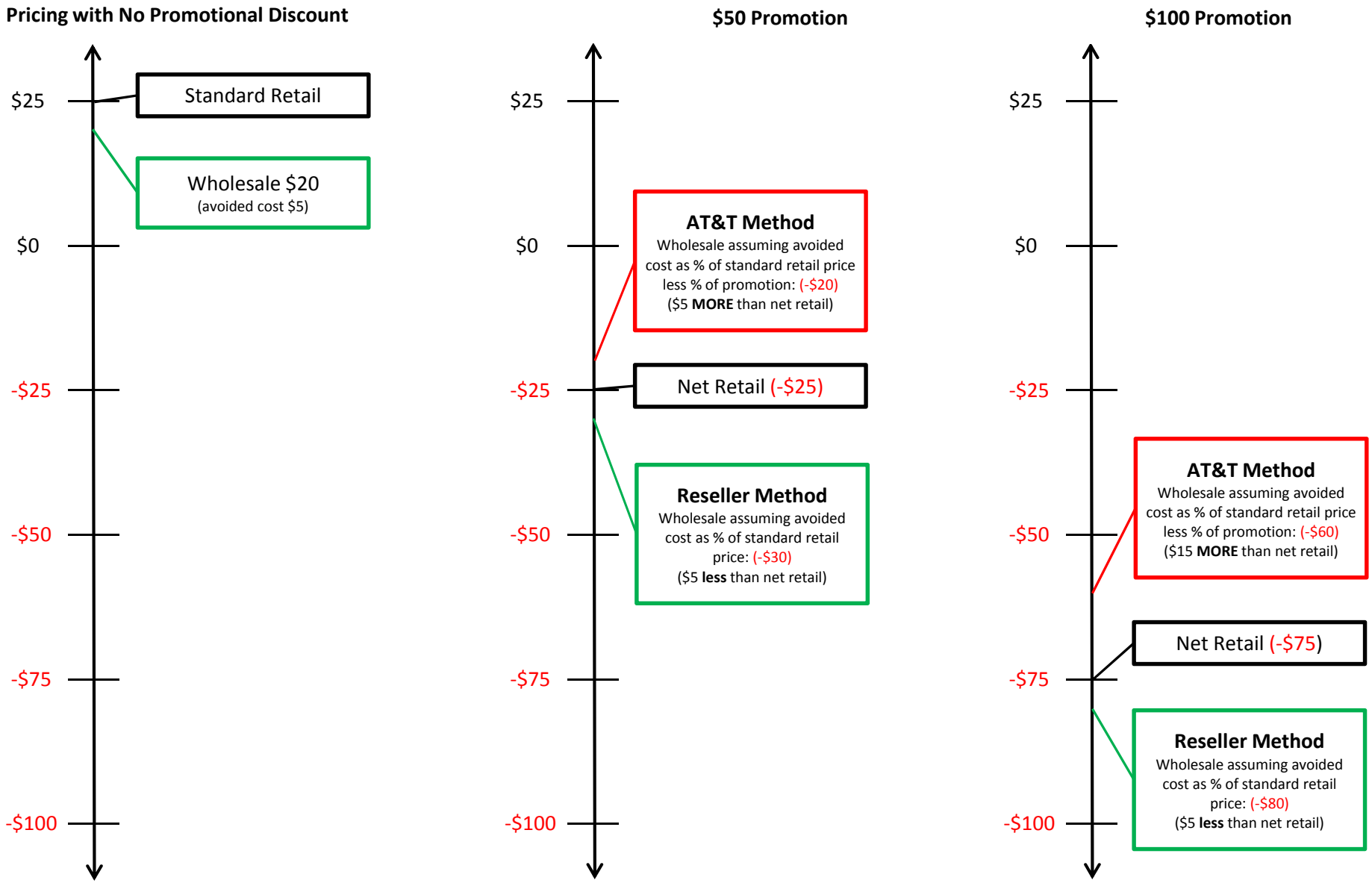
**Table 2.**
**Results of applying AT&T's proposed method for calculating promotion amount due resellers (applying hypothetical 20% wholesale discount to both standard/tariff price and to promotional price).**

| Standard Retail Price | Standard Wholesale Discount Percentage | Promotion Amount | Net Retail Price[1] | Net Wholesale Price[2] assuming avoided cost calculated as % of standard retail price less % of promotion |
|---|---|---|---|---|
| $25 | 20% | – | $25 | $20<br>($5 less than Net Retail) |
| $25 | 20% | $25 | $0 | $0<br>(**same** as Net Retail) |
| $25 | 20% | $50 | -$25 | -$20<br>($5 **MORE** than Net Retail) |
| $25 | 20% | $100 | -$75 | -$60<br>($15 **MORE** than Net Retail) |

1. Standard Retail Price - Promotional Discount = Net Retail Price
2. (Standard Retail Price x Wholesale Discount Percentage) - (Promotional Discount x Wholesale Discount Percentage) = Net Wholesale Price

This disparity – where AT&T's method results in the retail price being higher than the wholesale price -- is even more glaring when portrayed graphically, as shown on the next page.

## FIGURE 1: AT&T's METHOD RESULTS IN WHOLESALE PRICES BEING HIGHER THAN RETAIL PRICES



A comparison of the results from using the various methodologies is produced in Table 4, below. Note that the Resellers' method results in the same amount of avoided costs being deducted from the effective retail rate regardless of what promotion is in play, which makes sense since we know that the costs associated with providing the service do not change even if the service may be subject to special promotion or rebate. AT&T's method clearly results in the wholesale price being higher than retail.

**Table 4.**
**Comparison of results using various methods.**

| **Standard Retail Price** | **Standard Wholesale Discount Percentage** | **Promotion Amount** | **Net Retail Price**[1] | **Method 1: Resellers: Net Wholesale Price assuming avoided cost calculated as % of standard retail price**[2] | **Method 2: AT&T 'less than': Net Wholesale Price assuming avoided cost calculated as % of standard retail price less % of promotion**[3] | **Method 3: TRUE 'less than:' Net Wholesale Price assuming avoided cost calculated as % "less than" net retail price**[4] |
|---|---|---|---|---|---|---|
| $25 | 20% | – | $25 | $20 ($5 less than net retail) | $20 ($5 less than net retail) | $20 ($5 less than net retail) |
| $25 | 20% | $25 | $0 | -$5 ($5 less than net retail) | $0 (**same** as net retail) | $0 (**same** as net retail) |
| $25 | 20% | $50 | -$25 | -$30 ($5 less than net retail) | -$20 ($5 **MORE** than net retail) | -$30 ($5 less than net retail) |
| $25 | 20% | $100 | -$75 | -$80 ($5 less than net retail) | -$60 ($15 **MORE** than net retail) | -$90 ($15 less than net retail) |

1. Standard Retail Price - Promotional Discount = Net Retail Price

2. Standard Retail Price x Wholesale Discount Percentage = Avoided Costs
   Standard Retail Price- Promotional Discount - [Avoided Costs] = Net Wholesale Price

3. (Standard Retail Price x Wholesale Discount Percentage) -
   (Promotional Discount x Wholesale Discount Percentage) = Avoided Costs

4. Wholesale Discount Percentage "Less Than" Net Retail Price = Net Wholesale Price; that is,
   Wholesale = (retail price – cash back) – % *ABS(retail – cash back)

Table 4 clearly shows that the AT&T method results in a higher charge (through a lower credit) to resellers when compared to the retail rate paid by end-use customers. Obviously, adopting a

model which results in a wholesale price that is greater than the retail price guts the purpose of the FTA, and violates federal (and Commission) pricing rules. The AT&T methodology produces an absurd result – a wholesale price that is higher than the retail price. Accordingly, AT&T's model cannot be correct. It is not possible to comply with the federal wholesale pricing standard with a wholesale price that is ***greater*** than the retail rate as proposed by AT&T. The only way that the wholesale pricing standard could be satisfied by a wholesale rate greater than the retail rate is if there are negative avoided costs that when subtracted from the retail rate, produce a higher number.[13] However, there is no such thing as a "negative avoided cost;" as conceded by Dr. Taylor, the retail price of a telecommunications service is never negative.[14]

As explained by Reseller witness Gillan:

> [T]he purpose of the wholesale discount is to *remove* marketing and customer-care costs from a retail price so that the wholesale price is lower than the retail price (by the estimate of avoided cost). This requirement is *fully* accomplished when the discount is applied to the retail rate (which is the first term of the equation); there is no continuing role for the wholesale discount in the calculation. Once applied to the retail rate, the proper estimate of the avoided cost is removed and the full purpose of the wholesale discount is achieved.
>
> AT&T's calculation is the perfect example of an algebraic equation disconnected from reality. The way AT&T applies the discount [to both the retail rate and promotion], it is artificially reducing the avoided-cost estimate, as though there are negative avoided costs that can be "added-back" to the calculation. But there is no such thing as a "negative avoided cost." Significantly, there is nothing in AT&T's testimony that tries to explain what changed during the promotional month that would justify AT&T removing fewer avoided costs in that month than in every other month for the same service.[15]

Note that by "discounting" the promotions- and thereby effectively reducing the amount of the wholesale discount – AT&T turns the key holding from *Sanford* on its head. In nearly all instances involving the cash back promotional offering at issue in this proceeding, AT&T has

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[13] *Id*.
[14] Transcript of Testimony and Proceedings, pp. 123 – 124.
[15] Gillan Rebuttal Testimony, p. 10, lines 4 – 19.

used the Commission's wholesale discount to subject resellers to a *higher* price for the underlying telecommunications service when compared to the effective retail rate to end-use customers, as shown in Table 4, above. If the retail rate of an AT&T telecommunications service is $25, and AT&T offers a $50 cash back promotion in the first month to customers who order that service, a AT&T retail customer would receive a credit of $25 as a result of the promotion at the normal retail rate ($25 service less the $50 cash back, resulting in a -$25 effective retail rate). In the resale context, however, AT&T has been *increasing* the -$25 received by its customers by the 20% discount factor normally applied to the standard rates to arrive at a price of -$20 (-$25 *increased* by 20%), or a credit of $20 to resellers. The effect of AT&T's methodology is to increase the cost to CLECs, through a smaller promotion credit, as compared to the same service purchased by an AT&T customer. Thus, the AT&T method is contrary to the purpose underlying the Commission's wholesale discount and the rationale of *Sanford*. By applying the "discount" to a negative price (*i.e.*, the cash-back component), the "discount" becomes a benefit to AT&T (not the reseller).

Interestingly, while AT&T recognizes that its method can produce a wholesale rate which is higher than the retail rate, AT&T never provides justification for this illogical result. Instead, AT&T attempts to argue that over a period of months, the retail price to end-users will eventually exceed the wholesale price to the Resellers.[16] AT&T's argument is irrelevant and a red herring: as discussed above, the promotions at issue are not paid out over a series of months, but in a single month in a lump sum; furthermore, the end user is not required to maintain service for more than 30 days, so there is no guarantee that the service will last more than 30 days. As long as these are the terms under which the promotional offer is made to AT&T's retail customers, it is improper in include additional conditions or assumptions – such as that the end

[16] See, e.g., Taylor Direct at 28-29.

user will remain on the platform for an extended period -- when deciding how to extend the offer to resellers. In this context, as it is with the retail customer, so should it be with the Resellers. The cash back promotion is provided a single time in a lump sum in a single month, and it is the pricing in *this* month that must be examined for compliance with the rules; there is no dispute between the parties concerning the pricing in all other months. With a single month affected – and only a single month's price at issue – it is immaterial what is happening in other months that are, by definition, unrelated to the promotion. To comply with the rules, the Resellers must be able to secure the service at the net retail rate less the costs avoided with providing the service.

Condensed to its essentials, AT&T's argument here is that during this one month in question it is appropriate for AT&T to not extend the Resellers the service at the effective retail rate less the avoided costs associated with the service (even though doing so will result in a situation where the wholesale price is greater than the effective retail rate) because if one averages out the effect of AT&T's overcharges to the Resellers over time, it will eventually be diluted to the point where the total amounts charged at resale would be less than the total amount paid at retail. While it is mathematically true in that the impact of charging an unlawfully higher price for the service in one month compared to the total amount charged for the service over the life of the account is increasingly diluted the longer the customer stays, this argument does not justify AT&T's violation of the law in the first instance.[17]

Further, applying AT&T's method results in a lower calculation of avoided costs in the promotional month as compared to the avoided costs calculated for the same service in all other months. As explained previously, the estimated avoided costs are the same whether or not a

[17] AT&T's dilution argument is no different than pointing out that adding cold water to a pot of boiling water will reduce the temperature, ultimately to the point where the water is no longer boiling. But if the relevant question is "is the pot boiling?," the fact that sufficient cold water can be added to hide the fact is simply not material. There is no difference here, where the sole question is "what is the wholesale price for the month the cash back is paid?" The fact that the competitive harm can be diluted by adding additional months where the correct price is *not* at issue does not help answer the question at hand.

promotion is offered with or applied to an AT&T telecommunications service offering.

Ultimately, under AT&T's method, there would be no benefit (in fact, there would be a deterrent) for a reseller to purchase at wholesale any telecommunications service which is accompanied by a promotional offering with a value that exceeds the cost for the underlying service; it would be more beneficial in such situations to pay the full retail price. If AT&T's method is espoused, AT&T (and similarly situated ILECs) could effectively price the Resellers out of the market by offering similar promotions for all of the ILEC's telecommunications services and charging the resellers more (by providing them with a smaller credit) for the services and accompanying promotions. This form of regulatory arbitrage is both anti-competitive and unlawfully discriminatory.

**3. Third method for calculating the avoided costs: correcting AT&T's method to ensure that wholesale price actually is a fixed percentage *less than* the net retail price.**

AT&T's theory that it should deduct avoided costs twice (once when the Reseller pays for the service and again when the Reseller gets the cash back amount) is clearly wrong. But even if the Commission adopts AT&T's theory in part, it must correct the application of that theory so that the resulting wholesale price is always lower (in the above case, more negative) than the retail price. If the Commission determines that it should apply the discount to the cash back promotion (and it should not, as explained above), then it must make clear in the implementation of that decision that the wholesale price is always lower (in the above case, more negative) than the retail price. For example the wholesale price that is 14.8% l***ess than*** the retail rate of negative $25 is negative $28.70. It is not possible to comply with the federal wholesale

pricing standard with a wholesale price that is greater than the retail rate as proposed by AT&T and Dr. Taylor.[18]

If the intent is truly to make the wholesale price less than the retail price by ***reducing the retail price*** by a particular percentage, the correct method for calculating the wholesale (cost avoided) discount associated with a service is to simply make the wholesale price a percentage less than the net retail price for that service. Table 3 shows how this works under various scenarios.

**Table 3.**
**Results of applying "percentage less" calculation to effective retail rate.**

| Standard Retail Price | Standard Wholesale Discount Percentage | Promotional Discount | Net Retail Price[1] | Net Wholesale Price[2] assuming avoided cost calculated as % "less than" net retail price |
|---|---|---|---|---|
| $25 | 20% | – | $25 | $20 ($5 less than net retail) |
| $25 | 20% | $25 | $0 | $25 (**same** as net retail) |
| $25 | 20% | $50 | -$25 | $25 ($5 less than net retail) |
| $25 | 20% | $100 | -$75 | $25 ($15 less than net retail) |

1. Standard Retail Price - Promotional Discount = Net Retail Price

2. Wholesale Discount Percentage "Less Than" Net Retail Price = Net holesale Price; that is, Wholesale = (retail price – cash back) – % *ABS(retail – cash back)

This method is mostly consistent with the principle that wholesale rates should always be lower than retail rates and the rationale set forth by the Fourth Circuit Court of Appeals in *Sanford*, which indicates that the wholesale discount should be employed to create a lower charge to a reseller when compared to a retail customer. The only potential problem with this method is that when the net effective retail rate approaches zero, so does the avoided cost

[18] Gillan Rebuttal Testimony, p. 18.

discount – even though we know that certain costs are always avoided in resale, and an avoided cost discount of zero would thus not be appropriate.

In fact, the Louisiana Public Service Commission Staff has recognized the inherent flaw in AT&T's methodology, and recommended that if applied, it should be corrected as noted above. This took place in one of the proceedings[19] AT&T is currently involved in against similarly situated resellers (including some or all of the Resellers in this proceeding) in seven other states in the former BellSouth region. On February 9, 2011, LPSC Staff filed its Post-Hearing Brief, in which the LPSC Staff recognized the inherent flaw and inconsistency with AT&T's methodology in situations where the promotion amount exceeds the retail price of the underlying service. LPSC Staff used the following example to illustrate the "corrected" AT&T approach in these situations:

> AT&T's retail service is $40 a month, and it offers a one-time "cash-back" rebate of $50. Under this scenario, the effective retail price of the service for the first month is a $10 credit. Resellers should be entitled to this service, subject to the wholesale discount. Assuming the discount is 20%, the effect would be a discount of $2.00, i.e. 20% of $10. ***However, since the number is negative, the discount is properly added, thus resulting in a one-time credit of $12 to the reseller customer***, and preserving the 20% avoided cost on the effective retail price of the service.[20]

The intent of and rationale for LPSC Staff's method is obvious: wholesale should always be less than retail by at least the Commission's *discount percentage*. LPSC Staff's method correctly applies the *Sanford* rationale – that wholesale should be less than retail – and, more importantly, rejects the clearly erroneous approach taken by AT&T in instances where the "effective retail rate"[21] of a telecommunications service is negative (*i.e.*, where the promotional value exceeds the retail price). LPSC Staff correctly recognized the inconsistency in AT&T's method, which

[19] LPSC Docket No. U-31364.
[20] LPSC Docket No. U-31364, Staff's Post-Hearing Brief, p. 7 (emphasis added).
[21] The "effective retail rate," a term used in *Sanford* decision, is the retail rate for a service less the promotion value associated with such service.

results in a higher price to the Resellers (when compared to AT&T's retail customers) in instances where the cash back promotion amount exceeds the retail price for the underlying service. According to LPSC Staff:

> Staff's proposal also addresses the concerns raised by the resellers wherein AT&T's "Discounted Cash Back" proposal results in a greater credit for its retail customers. In conclusion, Staff believes this position is consistent with the Act and Federal rules, the LPSC's rules and the limited jurisprudence on this topic and thus should be adopted.[22]

As shown by LPSC Staff, AT&T is clearly attempting to employ a methodology which results in a greater charge to the Resellers when compared to AT&T's retail customers, a methodology that is completely inconsistent with the Act and FCC rules.

**B. Properly Considering the Cash Back Amount as a Rebate Instead of a Discount also Produces the Correct Result.**

The Resellers' position is also supported by the testimony of Dr. Christopher Klein, former chief economist at the Tennessee Regulatory Authority who now teaches economics at Middle Tennessee State University. As Dr. Klein pointed out, AT&T's entire case is based on the assumption that, for purposes of calculating the wholesale price paid by the Resellers, a "discount" of $50 in the retail price is the same thing as a $50 "rebate" which the customer may (or may not) collect weeks after the purchase. As Dr. Klein testified, and as all scholarly research supports (see Appendix A-D), "rebates" and "discounts" are not the same thing.

AT&T's cash back offer is not a discount; it is a rebate. Discounts and rebates are two different kinds of promotions and have different impacts on both retail and wholesale customers. A discount is simply a reduction in the purchase price. No one has to ask for a discount; every buyer gets it at the time of sale. A rebate, on the other hand, does not affect the purchase price. The buyer pays the regular retail rate and then applies for and, if eligible, receives a partial

[22] LPSC Docket No. U-31364, Staff's Post-Hearing Brief, p. 8.

refund of the purchase price. Rebates are popular with retailers because many customers may be persuaded by the promotion to buy a product but later often forget to submit the claim for a rebate or decide it is not worth the time and effort. [23]

Because many customers neglect to claim their rebate, it is to AT&T's financial advantage to offer a $50 rebate rather than a straightforward $50 discount in the retail price. Nevertheless, AT&T argues that its $50 cash back promotion should be treated as if it were a price discount for purposes of calculating the amount owed to resellers. AT&T cannot have it both ways.

As previously noted, AT&T "must provide services . . . for resale that are . . . subject to the same conditions that the LEC provides these services to others, including end users."[24] Therefore, discounts and rebates offered to retail customers must also be offered under "the same conditions" to wholesale customers. If AT&T offers a rate discount to retail customers, AT&T must offer the same discount to wholesale customers. A rebate, of course, works differently. [25] An AT&T retail customer pays the regular retail rate at the time of purchase and later applies for the $50 cash rebate. Similarly, the wholesale customer pays the regular wholesale rate (the retail price less the wholesale discount) at the time of sale and later applies for the $50 rebate. As long as the reseller has complied with the rebate requirements, he should receive the full amount of the rebate without any deduction for avoided costs. By mischaracterizing the $50 cash back

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[23] Research indicates that often fewer than half of eligible retail customers actually collect post-sale rebates. Marketing experts call this "slippage." Retailers also favor rebates over discounts because a rebate, unlike a discount, typically does not effect a salesman's commission on the transaction. Furthermore, a rebate promotion can be cancelled with less adverse customer reaction than eliminating a discount. Attached to this brief are four scholarly articles discussing, in various contexts, the differences between rebates and discounts and the concept of "slippage" (sometimes called "breakage"). See Appendix A-D. These and the other articles cited by Dr. Klein describe how rebates are more profitable than discounts for many reasons, including "slippage." These articles conclusively establish that rebates are <u>not</u> the same as discounts.

[24] 47 C.F.R. § 51.603(b).

[25] The majority decision in *Sanford* discussed AT&T's cash back promotion but did not address the difference between a rebate and a discount. The concurring opinion by Chief Judge Williams said that the majority had reached the correct result but noted expressly that AT&T's cash back promotions are not "price discounts." See *Sanford*, 494 F.3d at 454-458.

rebate as a discount, AT&T is just trying to pick up a $10 windfall each time the company sells a line to a Reseller.[26]

As Dr. Klein testified, his "rebate" analysis produces exactly the same result as the recommendation of Mr. Gillan. In each case, the Reseller receives the entire $50 rebate, not the $40 payment supported by Dr. Taylor.

Finally, it should be noted that AT&T itself describes the $50 cash back payment to retail customers as a "Rebate." In Attachment E of the "Stipulations" jointly filed by AT&T and the Resellers, AT&T responds to "Frequently Asked Questions" and repeatedly refers to the Cash Back payments as a "rebate." On these pages, AT&T instructs customers how to apply for the "rebate" which the customer may receive "4 to 6 weeks" after purchasing AT&T's service. In other words, the $50 cash back promotion is a true rebate, as AT&T acknowledges, <u>not</u> a discount and it should not be treated as a discount when AT&T calculates how to pass on these promotional credits to the Reseller. Just like retail customers, a Reseller must pay the standard rate at the time of purchase and then must apply for and receive the rebate weeks afterwards. Many resellers never even bother to apply for the rebates. Others apply for it but do not receive it because of some error in the application. In other words, there is "slippage" or "breakage" at the wholesale level just as there is at the retail level.

Wholesale customers ***do not*** receive a $50 discount in the wholesale rate. Instead, they receive the opportunity to apply for a $50 rebate which, if they properly make the request, they

[26] Here is how AT&T transforms a $50 rebate program into a $40 wholesale discount. First, AT&T asserts that a reseller should receive no more of a financial benefit from a $50 rebate than the reseller gets from a $50 discount. This assertion disingenuously ignores the fact that AT&T structured its "cash back" promotion as a rebate rather than a discount in the first place because a rebate-type promotion is more profitable to AT&T.
Second, AT&T's calculation simply reduces the sale price and ***then*** applies the 20% discount. Here, however, we are dealing with a rebate, not a price discount, and a rebate does ***not*** reduce the sale price. In other words, in a rebate, the "avoided costs" are 20% of the regular retail rate; with a discount, the "avoided costs" are 20% of the ***reduced*** retail rate. The difference between those two amounts, (*i.e.*, the difference between applying the 20% discount to the regular retail rate and applying it to the reduced retail rate) is the difference between paying a reseller $50 or $40.

may receive weeks later. The fundamental assumption of AT&T's entire argument – that a $50 rebate should be treated the same as a $50 discount in the sale price – is simply incorrect.

### C. Line Connection Charge Waiver Promotions are Subject to Resale to the Same Extent as Cash Back Promotions.

Similar to the cash back promotion fully discussed herein, AT&T also offers a line connection charge waiver ("LCCW") promotion to its end-users. As explained by Reseller witness Dr. Christopher Klein:

> The LCCW waives the line connection charge for select customers. Those customers are not charged for and do not pay the connection charge. The Stipulations describe the resale of the LCCW as requiring the reseller to pay the standard wholesale rate up front, then to apply for the waiver. If the reseller's customer qualifies for the LCCW, then the reseller receives a credit. From the reseller's perspective, the LCCW also functions as a rebate. Dr. Taylor makes the same point in likening the LCCW to a cash back offer.[27]

In other words, the LCCW promotion takes the same form as the cash back promotion as it applies to resellers. As AT&T's witness Dr. William Taylor agreed, the cash back arguments described in the testimony of Mr. Joseph Gillan and Dr. Christopher Klein are equally applicable to the calculation of the LCCW amount. As Dr. Taylor stated in his pre-filed testimony:

> Alternatively, one could treat the $40 LCCW as a cashback promotion because the value of that promotion is relatively unambiguous (the $40 the retail customer saves) and all customers are likely to value that benefit similarly – like cash.[28]

As in the case of cash back promotions, a Reseller is entitled to the LCCW promotion to the same extent as AT&T's retail customers. As correctly recognized by Dr. Klein when explaining rebates such as the LCCW promotion:

[27] Klein Rebuttal Testimony, p. 7, lines 5 – 10.
[28] Taylor Direct Testimony, p. 31, lines 10 – 12.

> A rebate does not change the standard or "tariffed retail rate paid by the consumer, so the wholesale rate for the service is not changed. That is, the wholesale rate remains the standard retail rate less the avoided cost discount…. The rebate is credited to the reseller when it applies for the rebate for a qualifying customer in the same way the rebate is credited to a qualifying AT&T retail customer. Thus, the FCC's rules that require a service to be offered under the same terms and conditions at wholesale as at retail are satisfied.
>
> **….**
>
> For the reseller, the LCCW is also in the form of a rebate. The wholesale rate for the LCCW should be calculated by applying the avoided cost discount to the standard retail rate, and giving the reseller the same rebate that the retail customer receives. [29]

**D. The Referral (or "Word-of-Mouth") Promotion is Subject to Resale to the Same Extent as Cash Back and LCCW Promotions.**

The Referral or Word-of-Mouth promotion allows an AT&T customer to receive a $50 rebate for referring a new customer to AT&T. The benefit to AT&T is no different than when a new customer signs up for AT&T service and receives a $50 cash rebate directly from AT&T.

As a result of the *Sanford* decision, AT&T is required to offer the Resellers the benefit of a $50 cash back promotion, but AT&T unreasonably refuses to offer the Resellers the benefit of the $50 Referral promotion. Legally and logically, the two promotions are exactly the same. In both cases, AT&T offers a $50 rebate in exchange for gaining a new customer. In one case, the money is paid to the new customer himself. In the other case, the rebate is paid to an existing AT&T customer who persuades someone else to purchase AT&T's service. There is no reason that one promotion is available for resale and the other is not. AT&T is simply trying to limit the application of *Sanford* to promotions which are expressly described in the Court's opinion and not apply the Court's holding to other, very similar promotions.

Dr. Taylor attempts to argue that the Referral promotion is a "marketing expense" for AT&T and therefore that this promotion is not subject to the Act's resale provisions. This is

[29] Klein Rebuttal Testimony at p. 8, line 19 through p. 9, line 2 and p. 9, lines 8 – 10.

exactly the same argument that AT&T made – and lost – in the *Sanford* case. This promotion is a condition of service, subject to the Act's resale obligations to the same extent as provided to retail customers. As correctly pointed out by Reseller witness Dr. Christopher Klein:

> The Word-of-Mouth referral is just a rebate for which a customer must qualify by referring another customer to AT&T. FCC rules require rebates to be available for resale…. Dr. Taylor's objections to the resale of this offering are just attempts to obscure the simplicity of the rebate or to complicate the analysis by referring to the rebate as a marketing expense. AT&T's classification of the rebate for its own internal purposes is irrelevant. The Word-of-Mouth referral rebate is offered to AT&T customers as a term or condition of service and should be made available for resale. Otherwise, AT&T is evading its resale obligations.[30]

As such, this promotion is subject to the same resale obligation as cash back and LCCW promotions. AT&T must offer the full value of the word-of-mouth promotion to the Resellers.

## IV. CONCLUSION

The Resellers are entitled to the cash back, LCCW and word-of-mouth promotional offerings at issue in this proceeding to the same extent and under the same terms and conditions as provided to AT&T retail customers. AT&T must resell its telecommunications services to the Resellers at the effective retail rate less the Commission's estimate of avoided cost (which is the same for the month in which the promotional credit is processed as every other month), and the promotional offerings associated with these telecommunications services must be made available to the Resellers on a dollar-for-dollar basis when compared to retail customers. In no event should the value of these resold promotions result in a wholesale rate to the Resellers which is greater than the retail rate to end-users, which results from AT&T's erroneous methodology and defeats the underlying purpose of resale and directly undermines the competitive balance sought by the FTA and FCC regulations.

[30] Klein Rebuttal Testimony, p. 13, lines 2 – 11.

Respectfully submitted this 21st day of March, 2011.

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## CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the foregoing has been served by electronic mail service on the following this 21st day of March, 2011:

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