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September 22, 2011

The Honorable Jocelyn Boyd
Chief Clerk of the Commission
Public Service Commission of South Carolina
Post Office Drawer 11649
Columbia, South Carolina 29211

Re: Complaint and Petition for Relief of BellSouth Telecommunications, Inc. d/b/a AT&T Southeast d/b/a AT&T South Carolina v. Affordable Phone Services, Inc. d/b/a High Tech Communications, Dialtone & More, Inc., Tennessee Telephone Service, LLC d/b/a Freedom Communications USA, LLC, OneTone Telecom, Inc., dPi Teleconnect, LLC and Image Access, Inc., d/b/a New Phone
Docket No. 2010-14-C, Docket No. 2010-15-C, Docket No. 2010-16-C, Docket No. 2010-17-C, Docket No. 2010-18-C, & Docket No. 2010-19-C

Dear Ms. Boyd:

Attached for the Commission's consideration is the Order the North Carolina Commission entered today in the companion Consolidated Phase proceedings in that State. The Order adopts AT&T North Carolina's position on each of the three issues in the proceeding.

With regard to the cashback promotional credits that were the focus of the Resellers' oral arguments before this Commission on August 24, 2011, the North Carolina Commission found, among other things:

> AT&T North Carolina's method of providing cashback credits to qualifying Resellers "complies with applicable law and appropriately applies the Commission-approved 21.5% resale discount percentage to the retail rate of the promotion-qualifying service." (p. 5);
>
> AT&T North Carolina's method is supported by the Fourth Circuit's *Sanford* decision. (p. 6);
>
> Each of the Resellers' "alternative proposals overstates the avoided cost estimate, which in turn distorts the established 21.5% resale discount rate and understates the wholesale price Resellers are required to pay for the services they order from AT&T." (p. 7);

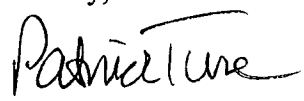
The Resellers' fundamental assumption that the cashback credit calculation should be based on "that single month when the promotion is processed" cannot be accepted. (p. 8); and

The Reseller's "rebate" argument "is likewise not persuasive." (p. 9).

The North Carolina Commission also found that AT&T's method of providing LCCW credits to qualifying Resellers is appropriate (pp. 10-11) and that AT&T is not required to resell the Word-of-Mouth promotion. (p. 11).

AT&T South Carolina respectfully requests that the Commission consider this recent development in resolving the issues presented in these consolidated dockets.

Sincerely,



Patrick W. Turner

PWT/nml
Attachment
cc: All Parties of Record
926803

STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH

DOCKET NO. P-836, SUB 5
DOCKET NO. P-908, SUB 2
DOCKET NO. P-1272, SUB 1
DOCKET NO. P-1415, SUB 2
DOCKET NO. P-1439, SUB 2

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

In the Matter of BellSouth Telecommunications, Inc., d/b/a AT&T Southeast, d/b/a AT&T North Carolina, Complainant	)	
v.	)	ORDER RESOLVING CREDIT CALCULATION DISPUTE
dPi Teleconnect, LLC, Image Access, Inc., d/b/a NewPhone, Affordable Phone Services, Inc., BLC Management, LLC, d/b/a Angles Communications Solutions, and LifeConnex Telecom, Inc., f/k/a Swiftel, Respondents	)	

HEARD IN: Commission Hearing Room 2115, Dobbs, Building, Raleigh, North Carolina, on April 15, 2011

BEFORE: Commissioner William T. Culpepper, III, Presiding; Chairman Edward S. Finley, Jr.; and Commissioners Lorinzo L. Joyner, Bryan E. Beatty, Susan Warren Rabon, and ToNola D. Brown-Bland

APPEARANCES:

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For the Using and Consuming Public:

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For dPi Teleconnect, LLC, Image Access, Inc., d/b/a NewPhone, Affordable Phone Services, Inc., and BLC Management, LLC d/b/a Angles Communications Services:

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For Image Access, Inc. d/b/a NewPhone:

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For Affordable Phone Services, Inc., and BLC Management, LLC, d/b/a Angles Communications Solutions:

Henry Walker, Brantley Arant Boult Cummings, LLP, 1600 Division Street, Suite 700, Nashville, Tennessee 37203

BY THE COMMISSION: On January 8, 2010, BellSouth Telecommunications, Inc., d/b/a AT&T Southeast, d/b/a AT&T North Carolina (AT&T or Complainant) filed in separate dockets complaints and petitions for relief against dPi Teleconnect, LLC (dPi), Image Access, Inc., d/b/a NewPhone (NewPhone), Affordable Phone Services, Inc. (Affordable Phone), and BLC Management, LLC, d/b/a Angles Communications Services (Angles) (collectively Respondents or Resellers), requesting that the Commission resolve outstanding billing disputes that exist between Complainant and Respondents, determine the amount that each Respondent owes Complainant under its respective interconnection agreement with AT&T, and require each Respondent to pay the amount to Complainant.

On February 25, 2010, Respondents dPi, NewPhone, Affordable Phone and Angles each filed defensive pleadings to AT&T's complaints. On April 9, 2010, Complainant filed responses to each of the defensive pleadings. On April 30, 2010, Respondents dPi, NewPhone, Affordable Phone and Angles each filed reply pleadings to Complainant's April 9, 2010, responsive pleadings.

On May 14, 2010, the Respondents and Complainant filed a Joint Motion on Procedural Issues in which the parties requested that the Commission hold all other pending motions in abeyance and convene a consolidated proceeding (Consolidated Phase) to which the Complainants and all Respondents are parties to resolve the following issues: how credits to resellers for the Cashback and Line Connection Charge Waiver (LCCW) promotions should be calculated; and whether the Word-of-Mouth promotion is available for resale and, if so, how the credits to resellers for the Word-of-Mouth promotion should be calculated. This Joint Motion was granted by Commission Order issued May 20, 2010.

On July 23, 2010, Complainant filed stipulations entered into by Complainant and Respondents for the Consolidated Phase. On August 3, 2010, the Commission issued its Order Allowing Intervention by LifeConnex Telecom, LLC, f/k/a Swiftel (LifeConnex), in the Consolidated Proceeding.

On August 27, 2010, Complainant prefiled the direct testimony and exhibits of William E. Taylor, and Respondents prefiled the direct testimonies and exhibits of Joseph Gillan and Christopher C. Klein. On October 1, 2010, Complainant filed the rebuttal testimony of William E. Taylor, and Respondents filed the rebuttal testimonies of Joseph Gillan and Christopher C. Klein.

On February 8, 2011, the Commission issued its Order Scheduling Hearing. On April 11, 2011, dPi filed Objections to and Motion to Strike Portions of Dr. William Taylor's Testimony. On April 13, 2011, Complainant filed a Response to Motion to Strike. The matter came on for hearing as scheduled on April 15, 2011. dPi's motion to strike was denied from the bench by Presiding Commissioner Culpepper.

WHEREUPON, based upon the foregoing and the entire record in this matter, the Commission makes the following

FINDINGS OF FACT

1. This matter is properly before the Commission on the Complaint of AT&T, and the Commission has jurisdiction over the parties in this Consolidated Phase and over the subject matter of the issues raised in this proceeding.

2. Pursuant to federal law, the Commission has previously reviewed avoided cost studies presented to the Commission and found a uniform discount rate of 21.5% to be just and reasonable for the residential services at issue in this Consolidated Phase.

3. AT&T's two-step process for determining credits that a reseller is entitled to receive when a telecommunications service which is subject to a retail cashback promotion is sold appropriately applies the Commission-approved 21.5% discount to the promotional price of the service and is therefore reasonable, in compliance with applicable laws, and otherwise appropriate.

4. The alternative proposals offered by the Respondents in this matter overstate the avoided cost estimate, which distorts the 21.5% discount rate set by the Commission and thus understates the wholesale prices that the Resellers are required to pay.

5. In comparing retail prices to wholesale prices, it is appropriate to consider the prices over a reasonable period of time, which is consistent with how customers subscribe to services.

6. AT&T's process of providing a discounted credit to Resellers for the LCCW results in both the retail customer and the wholesale customer paying a net amount of zero for the line connection charge, which is the appropriate result.

7. The Word-of-Mouth promotion is a marketing effort that is not required to be made available for resale.

DISCUSSION OF EVIDENCE AND CONCLUSIONS

Federal law provides that prices for resold telecommunications services shall be set on the basis of retail rates charged to subscribers for the service requested, excluding the portion thereof attributable to costs that are avoided when an incumbent local exchange carrier ("ILEC") like AT&T provides a service on a wholesale basis rather than on a retail basis.[1] In 1996, the Commission used cost studies and other evidence presented in a contested proceeding to determine the aggregate amount of "avoided costs" associated with AT&T's retail services. The Commission then divided that aggregate "avoided cost" figure by the aggregate revenue generated by those services to determine the uniform resale discount rate of 21.5% for the residential services at issue in this docket. *See* Recommended Arbitration Order, *In the Matter of Petition of AT&T Communications of the Southern States, Inc. for Arbitration of Interconnection with BellSouth Telecommunications, Inc.*, Docket No. P-140, Sub 50 at 43 (December 23, 1996); Order Ruling on Objections, Comments, Unresolved Issues, and Composite Agreement, *In the Matter of Petition of AT&T Communications of the Southern States, Inc. for Arbitration of Interconnection with BellSouth Telecommunications, Inc.*, Docket No. P-140, Sub 50 (April 11, 1997). The issues in this Consolidated Phase involve: how credits to resellers for the Cashback and LCCW promotions should be calculated; and whether the Word-of-Mouth promotion is available for resale and, if so, how the credits to resellers for the Word-of-Mouth promotion should be calculated.

A. CASHBACK PROMOTIONS

AT&T uses the following two-step process to sell a telecommunications service that is subject to a retail cashback promotion to Resellers at wholesale: (1) a Reseller orders the requested telecommunications service and is billed the standard wholesale price of the service (which is the standard retail price of the service discounted by the

[1] 47 U.S.C. 252(d)(3).

21.5% resale discount rate established by the Commission); and (2) the Reseller requests a cashback promotional credit which, if verified as valid by AT&T, results in the Reseller receiving a bill credit in the amount of the face value of the retail cashback benefit discounted by the 21.5% resale discount rate established by the Commission. (*See* Stipulations for Consolidated Phase at ¶¶7-9; Taylor Direct, Tr. at 29-30). To illustrate AT&T's method, assume a promotion that provides qualifying retail customers a one-time $50 cashback benefit when they purchase a service with a monthly price of $80. The effective price for the service to the retail customer is $30 ($80 standard price less $50 cashback) for the month that the customer receives the promotional cashback benefit. The same service is available for purchase by a Reseller at a monthly price of $62.80 ($80 discounted by 21.5%). If the Reseller also qualifies to purchase the promotion for resale, AT&T gives the Reseller a $39.25 ($50 discounted by 21.5%) promotional cashback credit. This results in the Reseller paying an effective price of $23.55 ($62.80 less $39.25) for the month that the Reseller receives the cashback credit, which amount is 21.5% less than the $30 price to the retail customer for the cashback month.

In this proceeding, the Resellers have contended that AT&T's two-step method is impermissible, does not appropriately apply the Commission approved discount and improperly calculates the credit that the Resellers are due to the Resellers' disadvantage. For the reasons explained below, the Commission concludes that AT&T's previously described two-step method complies with applicable law and appropriately applies the Commission-approved 21.5% resale discount percentage to the retail rate of the promotion-qualifying service.

In its *Local Competition Order,*[2] the FCC anticipated that state commissions would implement the "avoided cost" requirements of Section 252(d)(3) by adopting resale discount percentage rates like the 21.5% rate previously established. The FCC explained that, when avoided costs are determined in this manner, state commissions "may then calculate the portion of a retail price that is attributable to avoided costs by multiplying the retail price by the discount rate." *See Local Competition Order* at ¶ 908. The FCC went on to explain that when a promotional offering is available for more than 90 days (as is the case with the promotions at issue in this Consolidated Phase), the "promotional price ceases to be short-term ***and must therefore be treated as a retail rate for an underlying service.***" *Id.* at ¶¶949-50 (emphasis added). As the example illustrated above demonstrates, in AT&T's two step method, AT&T multiplies the retail rate when a reseller qualifies to purchase the promotion by the discount price to determine the wholesale price (i.e., the retail rate minus the avoided costs) that the telecommunications product is made available to Respondents. The Commission therefore concludes that AT&T's two-step method described above is appropriate

[2] *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, FCC Docket No. 96-98, First Report and Order, 11 FCC Rcd 15499, (1996)(*Local Competition Order*), *subsequent history omitted.* In this Order, the FCC concluded that it was "especially important to promulgate national rules for use by state commissions in setting wholesale rates" that will "produce results that satisfy the intent of the 1996 Act," and it stated that "[t]he rules we adopt and the determinations we make in this area are crafted to achieve these purposes," *Id.* at ¶907.

because it correctly applies the 21.5% resale discount rate to the retail rate, i.e., the promotional price, for the underlying service.

The Fourth Circuit's decision in *BellSouth Telecom, Inc. v Sanford*, 494 F.3d 439 (4th Cir.) 2007, supports the Commission's decision. In *Sanford,* the Fourth Circuit concluded that the Commission "correctly ruled that 'long-term promotional offerings offered to customers in the marketplace for a period of time exceeding 90 days have the effect of changing the actual retail rate to which a wholesale requirement or discount must be applied.'"[3] Noting the FCC's finding that a promotion or discount offered for more than 90 days became part of a retail rate that had to be offered to competing LECs, the Fourth Circuit affirmed the conclusion "that when such incentives [like cashback or gift cards] are offered, the nominal tariff (the charge that appears on the subscriber's bill) is not the 'retail rate charged to subscribers' under §252(d)(3) because the nominal tariff does not reflect the value of the incentives."[4] The Fourth Circuit then provided the following example to explain its decision:

> Suppose BellSouth offers its subscribers residential telephone service for $20 per month. Assuming a 20% discount for avoided costs, BellSouth must resell this service to competitive LECs for $16 per month, enabling the competitive LEC to compete with BellSouth's $20 retail fee. Now suppose that BellSouth offers its subscribers telephone service for $120 per month, but sends the customer a coupon for a monthly rebate check for $100. According to the NC Commission's orders, the appropriate wholesale rate is still $16, because that is the net price paid by the retail customer ($20), less the wholesale discount (20%).[5]

This $16 wholesale price that the Fourth Circuit affirmed is exactly the price that results when AT&T's method is applied to this scenario. (Taylor Rebuttal, Tr. at 68-69).

Finally, the decision rendered in Docket P-55, Sub 1744 (*dPi Recommended Order*) also is supportive of the credit calculation methodology proposed by AT&T in this case. In that docket, the Commission adopted a discount promotion credit calculation methodology advanced by AT&T that was based upon the example set forth in the *Sanford* decision. In that docket, the Commission held that AT&T should calculate the value of the promotional discount by deducting the wholesale discount from the retail value of the promotion. Finding of Fact 26, *dPi Recommended Order.* The methodology proposed in this proceeding is mathematically identical to the formula advanced by AT&T and adopted by this Commission in that docket.

In addition to being consistent with applicable law, AT&T's method also is consistent with economic reality. The Resellers' witnesses testified that a $50 one-time

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[3] *Id.* at 442.

[4] *Id.* at 450.

[5] *Id.* at 450.

cashback benefit reduces the effective retail price of a resold telecommunications service by $50. (Gillan Cross, Tr. at 244; Klein Evid. Hrg. Exh. No. 1 at 44). As a result of the "avoided cost" pricing standard in Section 252(d)(3), however, changes in the retail price of a telecommunications service do not flow through to a reseller on a dollar-for-dollar basis. For example, if the standard retail price of a service is increased by $50 (from $30 to $80, for example), the wholesale price for the service does not increase by $50. Instead, it increases by only $39.25:

	Retail	**Wholesale**
New Price	$80	$62.80 ($80 discounted by 21.5%)
Initial Price	$30	$23.55 ($30 discounted by 21.5%)
Difference	$50	$39.25 ($50 retail difference discounted by 21.5%)

The Resellers' witnesses testified that, conversely, a $50 reduction in the standard retail price of a service does not result in a $50 reduction in the wholesale price of the service, but instead results in a $39.25 reduction in the wholesale price of the service. (Gillan Cross, Tr. at 235; Gillan Cross Exam. Exh. No. 1; Klein Cross, Tr. at 307-08).[6] In the Commission's view, it is appropriate that AT&T provides the Resellers the same $39.25 wholesale price reduction when the retail price reduction takes the form of a cashback benefit as the resellers would receive if it took the form of a $50 reduction to the "standard price." (*See* Taylor Direct, Tr. at 30-31). Further, this conclusion is consistent with the Commission's prior determination that a reseller is only entitled to the price lowering impact of the promotion and not the face value. *See dPi Recommended Order,* p. 22.

The Commission has reviewed and rejects each of the various alternative methods the Resellers proposed to use in applying the 21.5% resale discount to cashback offerings. Our review reveals that each method is inconsistent with the *Local Competition Order,* the *Sanford* decision, and the *dPi Recommended Order.* The Commission is persuaded that each of the Resellers' alternative proposals overstates the avoided cost estimate, which in turn distorts the established 21.5% resale discount rate and understates the wholesale price Resellers are required to pay for the services they order from AT&T.

In reaching this decision, the Commission notes that the Resellers have spent considerable time and resources in this proceeding arguing that AT&T's credit calculation method produces wholesale prices that are higher than retail prices. The evidence presented in this proceeding clearly indicates that the vast majority of the promotions that are the subject of this hearing have one-time cashback promotional benefits that exceed the monthly retail price of the service. In those situations, the Respondents have clearly demonstrated that resellers receive less money from AT&T for keeping the service for only a month or two than a retail customer would receive

[6] To simplify the math, Gillan Cross Exam. Exh. No. 1 assumed a 20% wholesale discount, which resulted in a $40 reduction in the wholesale price. When the actual 21.5% wholesale discount rate is used, the reduction is $39.25.

from AT&T for keeping the service only a month or two. (*See* Gillan Cross Exam. Exh. No. 8; Attachments P and Q to AT&T's Brief).

Although the Commission accepts that the result produced by this calculation shows that the Resellers receive less money from AT&T for keeping the service for only a month or two than a retail customer would receive, the Commission is not persuaded that this fact demonstrates that AT&T's method causes the Resellers' wholesale purchase price to exceed the retail price that AT&T offers to its retail customers. To reach such a conclusion, the Commission would be required to accept the fundamental assumption embraced by Respondents that the pricing practices in this case, i.e., the wholesale price determination and/or the credit calculation should be based upon "that single month when the promotion is processed." Post Hearing Brief of the Respondents, p. 5. This, the Commission cannot do for the following reasons.

First, the Commission cannot accept this assumption because the wholesale discount is an average for all of AT&T's retail services. As such, it was never intended to represent the avoided costs for a particular service for an individual month. Second, and more importantly, the Commission cannot accept this assumption because the evidence presented in this hearing shows that, on average, both AT&T's customers and the Resellers' customers keep service more than a month or two. AT&T's witness Dr. Taylor testified that on average, AT&T's retail customers who take cashback promotions stay "much, much longer" than one or two months, (Taylor Redirect, Tr. at 184), and relying on the sworn testimony of dPi's CEO, Dr. Taylor testified that on average, Resellers' end users keep service from between three and ten months. (*Id.*, Tr. at 184-85). Resellers' witness Dr. Klein, for instance, testified that in considering whether pricing practices are below cost or predatory, "you would have to look at more than only one month of service." (Klein Cross, Tr. at 306; *See also* Klein Depo., Klein Evid. Hrg. Exh. No. 1. at 57-58).

Because of this evidence, it is not reasonable to consider a single month's financial data to determine the price of a product when the customer who purchases that product is reasonably expected to remain a customer of the seller of that product for enough months to make the promotion profitable. Taylor Direct, Tr. at 41. Instead, in these circumstances, it is appropriate for Cashbacks to be considered over a reasonable period of time in order to determine the ultimate price of the promotion based product. Such an approach is consistent with the Commission's historic practice which has allowed companies to recover their "up front" costs over a reasonable period of time instead of requiring that all such costs be recovered in the first month of service. The *Sanford* Court also looked favorably upon a similar approach.[7]

When considered in this manner, a reseller that keeps the service for more than a month or two always pays a net amount that is not only *less* than what the retail customer pays, but that is less by the 21.5% resale discount rate that the Commission

[7] See *Sanford,* 494 F.3d at p. 454 where the Court stated: "[W]hen a promotion is given on a one-time basis in connection with an initial offering of service, its value must be distributed over the customer's expected future tenure with the carrier and discounted to present value.

established. (*See* Gillan Cross Exam. Exh. No. 8; Attachments P and Q to AT&T's Brief). Based on this evidence, the Commission concludes that over a reasonable period of time, the wholesale price of the cashback product is less than the retail price that the retail customer pays. That is, the Resellers appropriately pay 21.5% less than retail customers pay under AT&T's method over time. Thus, there is no merit to the Resellers argument the credit calculation proposed by AT&T and accepted by this Commission results in the wholesale price of the telecommunications service being higher than the retail price.

In conclusion, the Commission notes that while the Commission has considered the issue of the proper methodology for calculation of the amount to be credited to resellers for promotions in greater detail in this proceeding than in prior dockets, the Commission's decisions in Docket No. P-100, Sub 72(b) (*Restriction on Resale Orders I and II),* and in the *dPi Recommended Order* respectively make clear that the face value of a promotion is not required to be passed through to a reseller. Rather, only the benefit of such a reduction must be passed on to resellers by subtracting the properly determined wholesale discount from the lower actual retail price. Consistent with these decisions, the Commission, therefore, finds and concludes that AT&T's two-step process properly passes on the price lowering benefit of a cashback promotion to the Resellers by subtracting the properly determined wholesale discount from the lower actual retail price.

Similarly, the Commission is not persuaded by the Resellers' "price squeeze" arguments. Reseller witness Dr. Klein conceded that: he is not claiming that AT&T is trying to force the resellers out of business by creating a price squeeze; he is not claiming that AT&T has any sort of predatory intent; he is not claiming a violation of Section 2 of the Sherman Act; and in his view as an economist, there is not sufficient evidence in this docket to show a violation of section 2 of the Sherman Act. (Klein Cross, Tr. at 305-06). While Dr. Klein stated that he is testifying about a price squeeze in the regulatory context of the 1996 Act and the FCC's Rules and Orders implementing the 1996 Act, (Klein Cross, Tr. at 306-07), he conceded that if this Commission determines and the courts affirm that AT&T's method complies with the resale provisions of federal law, there would be no price squeeze in the "regulatory context" about which he testifies. (*See* Klein Cross, Tr. at 309). Since AT&T's method does, in fact, comply with federal law, no price squeeze has been evidenced in this proceeding.

Finally, the Resellers' "rebate" argument is likewise not persuasive. Resellers' witness Dr. Klein conceded that end users who receive a cashback "rebate" receive the same features, functionality, and quality of service as end users who do not receive the cashback "rebate," (Klein Cross, Tr. at 313), and that "the only thing that the rebate in and of itself affects" about the service is "the net amount paid for the service." (*Id.*).[8] The 1996 Act requires AT&T to pass certain aspects of a service along to the Resellers

[8] *See also* Klein Depo., Klein Evid. Hrg. Ex. No. 1 at 83 ("what we're arguing about on these promotions is the price that should be charged"); *id.* at 84 ("as far as I know about what's at issue here, that's correct. It's just the monetary arrangements.").

in the same manner as provided to retail customers, but price is not one of them. Instead, the 1996 Act as implemented by this Commission authorizes AT&T to establish the wholesale price of a service by applying the 21.5% resale discount rate to the retail price of the service.

This point is confirmed by the *Sanford* decision, which generally characterizes cashback promotions as "rebates."[9] Additionally, in addressing the example of a $120 standard monthly price and a $100 monthly cashback benefit, *Sanford* specifically refers to "a coupon for a monthly ***rebate*** check for $100."[10] Calling the check a "rebate," however, did not lead the Fourth Circuit to apply its hypothetical 20% resale discount to the $120 "standard" price as the Resellers propose. To the contrary, the Fourth Circuit confirmed this Commission's reasoning that the resale discount must be applied to the promotional price of $20 that results when the "monthly rebate check for $100" is applied to the $120 standard price for the offering.

B. LCCW PROMOTIONS

The LCCW promotion waives the nonrecurring installation charge for new retail customers who are eligible for the promotion. AT&T witness Taylor testified that resellers are initially billed the retail charge for the line connection less the standard wholesale discount. If a timely request for a promotional credit is submitted, AT&T credits the reseller with the amount it initially billed the reseller. As a result, neither the retail customer nor the wholesale customer pays the line connection charge. (Tr. p. 45)

Witness Taylor testified that the line connection charge should be regarded as a telecommunications service since customers generally must buy it with their local exchange service. Thus, he contended that the two services should be treated as a single retail telecommunications service consisting of an upfront, one-time price and a monthly recurring charge, to which the wholesale discount is applied. (Tr. p. 46) Alternatively, Dr. Taylor proposed treating the LCCW as a cashback promotion and providing it for resale at the retail price less the wholesale discount. (Tr. pp. 46-47)

Respondent witness Klein contended that AT&T should credit the reseller with the avoided cost of line connection when the reseller's customer qualifies for the LCCW. (Tr. pp. 276-278, 280) He argued that the LCCW is in the form of a rebate for the reseller and 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. (Tr. p. 288).

The Commission finds that AT&T's methodology of crediting Resellers with the wholesale price of the LCCW does not differ from that determined as proper for the cashback promotion. In regard to the LCCW, the effective retail rate is zero, so the

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[9] *See Sanford*, 494 F.3d at 442, 449.

[10] *Id.* at 450.

effect of the promotion is that neither retail nor wholesale customers are charged the line connection charge, which is appropriate.

C. WORD-OF-MOUTH PROMOTION

AT&T witness Taylor testified that the Word-of-Mouth referral program should be regarded as an AT&T marketing expense. Customers are acting in the capacity of a part-time sales force for AT&T and compensated for successful referrals by receiving a cash reward. (Tr. p. 50) Dr. Taylor also stated that the benefit the recipient receives has no relationship to the services purchased by the recipient from AT&T, and that to receive the Word-of-Mouth payment, the recipient must perform a service of value to AT&T by convincing someone to become a new AT&T customer.

Respondents' witness Klein testified that the Word-of-Mouth referral program is a rebate offered as a term and condition of service and FCC rules require that rebates must be available for resale. (Tr. pp. 287-88) Dr. Klein offered a formula used to calculate the effective rate to the customer based on the rebate, and concluded that if the referral program was not available for resale, AT&T would be evading its wholesale rate obligation.

The Commission agrees with AT&T that the Word-of-Mouth referral program is not subject to the resale obligations of the Act. As explained by witness Taylor, the referral program differs from offerings that are subject to resale obligations in several critical aspects. First, there is no correlation between the referral program and services purchased from AT&T by the recipient; those services may remain unchanged regardless of the number of successful referrals. Instead, the benefit received is directly tied to telecommunications services purchased by other end users, creating a situation where the recipient of the referral program is essentially performing a marketing or sales service on behalf of AT&T. (Tr. p. 51).

The parties agree that marketing and sales costs are specifically included in the calculation of avoided costs as required by FCC rules (§ 51.609). Under cross-examination, Dr. Klein agreed that sales costs associated with several potential individual promotional efforts would not be required to be made available for resale. (Tr. pp. 315-16). The Commission believes that the Word-of-Mouth referral program is analogous to the sales efforts described in the cross-examination of Dr. Klein and is essentially a marketing program for AT&T's services. The Commission is aware of nothing in the *Local Competition Order* requiring a program that markets retail services to be made available for resale by a competitor.

The Commission, therefore, finds and concludes that the Word-of-Mouth referral program is not required to be made available for resale. Since the Commission has determined that the Word-of-Mouth referral program is not subject to the resale obligation, the question of how credits to Resellers should be calculated is moot.

IT IS, THEREFORE, ORDERED as follows:

1. That the credits to Resellers for the Cashback and Line Connection Charge Waiver promotions should be calculated by applying the Commission-approved 21.5% resale discount to the retail price of the underlying service; and.

2. That the Word-of-Mouth referral program does not have to be made available for resale.

ISSUED BY ORDER OF THE COMMISSION.

This the 22nd day of September, 2011.

NORTH CAROLINA UTILITIES COMMISSION

Gail L. Mount

Gail L. Mount, Deputy Clerk

Commissioner Lucy T. Allen did not participate in this decision.

lh092211.01

CHAIRMAN EDWARD S. FINLEY, JR., CONCURRING IN RESULT: I concur with the conclusion of the majority that the calculations of any payments due the resellers from AT&T for cash back promotions should result in payments produced by AT&T's formula but for reasons different than those relied upon by the majority in its discussion and conclusions set forth in subsection A. For reasons that do not appear on the record, AT&T has agreed voluntarily to resell the subscription incentives at issue in this docket and has stipulated that it would do so in this case. In my view AT&T has no obligation to resell the promotions under TA-96 or the FCC's Local Competition Order because the subscription incentives are items of economic value, not rate discounts. Moreover, the subscription incentives are one-time promotion payments and the duration of the promotion is for less than 90 days.

All of the difficulties, the differences of opinion and the myriad formulae and calculations with which the Commission has been presented arise because in the one month the subscription incentive payments are made to AT&T's retail customers, the resale price to resellers exceeds the retail price. Under ¶¶ 949 and 950 of the Local Competition Order and 47 C.F.R. § 51.613(a), ILECs are not required to resell short term promotions or promotions that will be in effect for no more than 90 days. Failure to acknowledge that these one-time subscription incentives fall clearly within the short term promotion category has resulted in endless arguments in which the parties struggle mightily to force a square peg into a round hole. These arguments miss the dispositive point.

In North Carolina the Commission's jurisdiction to require ILECs to resell these subscription incentive promotions arises because they are "items of value" affecting the underlying services the subscriber receives and are therefore "de facto" offerings in contrast to "de jure" or "per se" offerings addressed by Congress and the FCC. Because they are only "de facto" offerings they pose less potential anticompetitive harm to resellers. Such was the Commission's holding upheld by the Fourth Circuit in Sanford. Being only "de facto" offerings the subscription incentives need not be assessed by the FCC's requirements on resale at all. If they are to be so assessed, they need not be resold to resellers due to their one-time duration.

While painting itself into a corner by asserting "AT&T North Carolina is not arguing that the 'short term promotion exception' relieves it of its resale obligation with regard to the cash back promotions at issue in this proceeding" AT&T proceeds to substantiate its arguments on the very principles underlying this exception.

> As the discussion of Attachment D above demonstrates, the Resellers' "wholesale is higher than retail" argument is the result of myopically focusing on a single month or two in isolation and ignoring the reality of what happens thereafter.

Brief p. 20.

> Indeed, no aspect of a cash back promotion makes economic sense in such a short term, because it would be irrational for AT&T North Carolina to offer $50 cash back to woo customers who will stay with the Company for only a month or two. Likewise the provisions of the 1996 Act are not intended to enable new entrants to win customers in a single month: that is not competition – it is churn. A proper understanding of the economics of a cash back promotion necessarily looks at a longer term.

Brief p. 21.

> And the Resellers cannot honestly claim that what they perceive as a "wholesale is higher than retail" situation persists for an unreasonable period of time – in the example addressed in Attachment D of this Brief, for example, the situation is forever reversed when the service is kept for more than a single month.

Brief p. 22.

> Looking at one-month in isolation for the on-going service charges ignores the economic realities of the tenure of the end user customer and does nothing more than encourage Resellers to churn those end users off after one month.

Brief p. 24.

> In its Local Competition Order, the FCC excluded short-term promotions from the Federal Act's resale obligations and thus sanctioned retail prices that temporarily are higher than wholesale prices, recognizing that
>
>> Promotions that are limited in length may serve procompetitive ends through enhancing marketing and sales based competition and we do not wish to unnecessarily restrict such offerings. We believe that, if promotions are of limited duration, their procompetitive effects will outweigh any potential anticompetitive effects. We therefore conclude that short-term promotional prices do not constitute retail rates for the underlying services and are thus not subject to the wholesale rate obligation.

Brief pp. 24-25.

Resellers likewise advance arguments anchored on the principle that the promotion aspect of the subscription incentive lasts for a duration of only one month.

> Regarding the cash back promotions, the question before the Commission is how to determine the amount Resellers are entitled when reselling services subject to cash back promotions <u>for that single month when the promotion is processed</u>. No other months are in dispute.
>
> . . .
>
> However, for this single month in dispute, AT&T continues to resist the requirements that it resell its services to CLECs at the effective retail rate less its costs avoided.

Brief p. 1. (emphasis in original).

> It is unclear why this was a concern, since AT&T does not reduce its monthly rate. A cash back promotion is a price gimmick – a one-time deal designed to win business from competitors – that does not change the standard monthly rate and does not indicate a change in avoided costs.

Brief p. 22.

Both parties are absolutely correct. The subscription incentives are short term promotions that, were the FCC rules to apply, would be exempted from any resale requirement. As the ILEC has no obligation to resell the promotion in the first place, the Commission should not force the ILEC to pay Resellers more than the ILEC is willing voluntarily to pay. Endless arguments as to how the payment should be calculated through reference to FCC principles that apply to long term, de jure promotions, not short term and not de facto ones, simply are not useful.

\s\ Edward S. Finley, Jr.
Chairman Edward S. Finley, Jr.

STATE OF SOUTH CAROLINA)
) CERTIFICATE OF SERVICE
COUNTY OF RICHLAND)

The undersigned, Nyla M. Laney, hereby certifies that she is employed by the Legal Department for BellSouth Telecommunications, Inc. d/b/a AT&T South Carolina ("AT&T") and that she has caused AT&T South Carolina's Letter dated September 22, 2011 in Docket Nos. 2010-14-C, 2010-15-C, 2010-16-C, 2010-17-C, 2010-18-C and 2010-19-C to be served upon the following on September 22, 2011:

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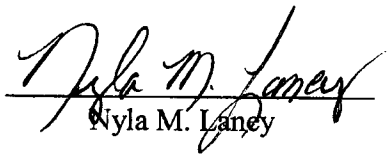

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