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PUBLIC SERVICE
COMMISSION

Jeffrey DeRouen
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
P.O. Box 615
Frankfort, KY 40601

RE: Case No. 2009-00127--dPi Teleconnect, L.L.C. v. BellSouth Telecommunications, Inc. dba AT&T Kentucky Dispute Over Interpretation of the Parties' Interconnection Agreement Regarding BellSouth's Failure to Extend Cash Back Promotions to dPi

Dear Mr. DeRouen:

On September 26, 2011 BellSouth Telecommunications ("AT&T") filed a recent order from the North Carolina Utilities Commission with a letter claiming the order will inform issues to be argued before the Commission on October 25. That non-final order should not guide the Commission's determinations here, for several reasons. Moreover, if the Commission is to consider decisions from other commissions, it will want to consider any states that have not adopted AT&T's position. For example, the Louisiana Commission recently rejected a proposed decision adopting AT&T's position, and remanded the case to the administrative law judge. It is expected the administrative law judge will decide which of the alternate proposals to adopt (reseller's method, or Staff's true percentage less than method) in the upcoming weeks.

Nevertheless, should this Commission look for guidance from other state commissions on this issue, North Carolina is not the best place to look: the North Carolina order is irretrievably flawed by its violation of federal law and the parties' agreement, and should be overturned on appeal if the North Carolina Commission does not correct its order on reconsideration. Furthermore, the North Carolina order bases its decision not the undisputed *actual* facts, but on *hypothetical* facts which make the North Carolina order unsustainable as precedent and subject to reversal either on reconsideration or on appeal.

The FCC made clear that when calculating wholesale rates, the wholesale rate would be set "below retail rate levels."¹ The North Carolina Commission's order strays from federal law because it does not require AT&T to sell its services subject to promotions at a wholesale rate below the retail rate.² The North Carolina Commission's order also allows AT&T to use

¹ See *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, First Report and Order, CC Docket No. 96-98, FCC 96-325, 11 FCC Rcd 15499, ¶ 910 (rel. Aug. 8, 1996) ("*Local Competition Order*") (emphasis added).

² See, e.g., 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.]

promotions to avoid its wholesale obligation in violation of paragraphs 948 and 950 of the *Local Competition Order*.

Furthermore, the North Carolina Commission's order disregards the parties' interconnection agreement which make clear that AT&T must make its promotions available to resellers on terms that are no less favorable than those received by AT&T's retail customers. In fact, the ICA at issue before the North Carolina Commission (which applies in Kentucky too) shows that AT&T must make promotions lasting 90 days or less available for resale at the promotional rate, but must make promotions lasting longer than 90 days available *at the promotional rate further discounted by the avoided cost*. Thus, for the long term promotions at issue in this case, the resale rate must be *below* the promotional rate.

The North Carolina Commission attempted to justify its position by reasoning that over time, the cumulative amount paid by a reseller will drop below the cumulative amount paid by the retail customer. This contravenes the undisputed fact that the promotions are paid in a single lump sum, not over time, and that the customer need not maintain service for longer than 30 days to be entitled to the cash back promotion. It also contravenes paragraph 950 of the *Local Competition Order*, which holds that "*To preclude the potential for abuse of promotional discounts, any benefit of the promotion must be realized within the time period of the promotion. . . .*"

Despite the fact that federal law clearly expects that wholesale prices will be set *below* retail rates, and expects that this obligation will be honored even when promotions are in play, the North Carolina Commission adopts AT&T's approach which results in the wholesale rate being *ABOVE* the retail rate. The FCC spent considerable effort explaining the importance of competition by resale in its *Local Competition Order*, and laying out how wholesale rates should be calculated. The FCC made clear that when using percentages to calculate wholesale rates, the wholesale rate would be set by a "percent *below* retail rate levels."³ The FCC also repeatedly expressed its concern that promotions would be used by ILECs to avoid their resale obligations – namely, the obligation to wholesale their services at a rate "below retail rate levels." In fact, in the space of four paragraphs on promotions, the FCC articulates this concern *no less than five times*:

- "We are concerned that conditions that attach to promotions and discounts could be used to avoid the resale obligation to the detriment of competition"⁴;
- "we are concerned that excluding promotions [from the wholesale obligation] may

³ *Local Competition Order* para. 910, (emphasis added).

⁴ *Id.* at para. 952.

unreasonably hamper the efforts of new competitors that seek to enter local markets through resale.”⁵;

- “*To preclude the potential for abuse of promotional discounts*, any benefit of the promotion must be realized within the time period of the promotion. . . .”⁶;
- “In addition, an incumbent LEC *may not use promotional offerings to evade the wholesale obligation*, for example by consecutively offering a series of 90 day promotions.”⁷;
- Consequently, the FCC found that:

...no basis exists for creating a general exemption from the wholesale requirement for all promotional or discount service offerings made by incumbent LECs. **A contrary result would permit incumbent LECs to avoid the statutory resale obligation by shifting their customers to nonstandard offerings, thereby eviscerating the resale provisions of the 1996 Act.**⁸

The FCC’s concern that ILECs would attempt to use promotions to avoid the wholesale obligation to resell services at a rate below “*below* retail rate levels” has been borne out again and again. For example, for years AT&T sought to avoid extending gift card and cash back promotions altogether, but was made to do so against its will. See e.g., *BellSouth Telecommunications, Inc. v. Sanford*, 494 F.3d 439, 442 (4th Cir. 2007); *In the Matter of dPi Teleconnect, LLC, v. BellSouth Telecommunications, Inc.*; Docket No. P-55, Sub 1744, before the North Carolina Utilities Commission. As another example, in the second half of 2009, AT&T attempted to implement a scheme in which it proposed to credit resellers eligible for cash back promotions not the fixed \$50 cash back that the eligible retail customer received, but an amount drastically reduced by bizarre “retention” and “redemption” “factors.” The net effect had AT&T providing its retail customers a cash back credit in the amount of \$50, but extending resellers a promotion credit of only \$5.54 in Texas; in Georgia, \$3.73; in Tennessee, \$3.65; in Alabama, \$4.20; in Kentucky, \$5.92; in Louisiana, \$3.74; in South Carolina, \$4.66, and so on across all the states. This Retail Promotion Methodology Adjustment model (as it was called by AT&T) was announced in various AT&T Accessible Letters and was to go into effect in September 2009, but was enjoined by the U.S. District Court for the Northern District of Texas. See *Budget Prepay, Inc. et al., v. AT&T Inc., f/k/a SBC Communications, Inc. et al., Cause No. No. 3:09-CV-1494-P in the U.S. District Court, Northern District of Texas, Dallas Division.*

⁵ *Id.* at para. 950

⁶ *Id.* at para. 950 (emphasis added)

⁷ *Id.* (emphasis added).

⁸ *Local Competition Order* ¶ 948.

Although the Fifth Circuit eventually vacated the injunction, *see See Budget Prepay, Inc. v. AT&T Corp.*, 605 F.3d 273, 281 (5th Cir. 2010), it did so solely as a matter of primary jurisdiction, and without review of the facts about AT&T's conduct the district judge had found so compelling.

Because AT&T's method for calculating the wholesale promotional price results in a wholesale price above, rather than below, the retail customer's price, it is less favorable. As a consequence, AT&T's method violates not just federal law, but also the parties' ICA, and must be repaired or replaced.

The North Carolina Commission suggests that *BellSouth Telecommunications, Inc. v. Sanford*⁹ approves AT&T's proposed method of reducing the value of the cash back promotion by the Commission's wholesale discount percentage. This is pointedly incorrect.

In fact, the principle that wholesale rates should always be *below* retail rates is key to the Fourth Circuit Court of Appeals' decision in *Sanford*, the leading appellate case on promotions. In *Sanford*, the Fourth Circuit held that promotional offers extending for more than 90 days created a "promotional retail rate" to which the avoided cost (wholesale discount) must be applied.¹⁰ The Fourth Circuit held that for long-term promotional offerings (such as the ones at bar), the avoided cost or wholesale discount must be subtracted from the *effective* retail rate that results from applying the value of the promotional offering to the retail rate of the underlying service.¹¹

The key lesson from *Sanford* is that wholesale must be less than retail. However, in cases like those at bar, where the promotion amount exceeds the retail price of the service (*e.g.*, a \$25 service combined with a \$50 cash back promotion), AT&T's methodology creates a higher price to resellers (through a smaller bill credit) than the price paid by AT&T's retail customers, which is *exactly* the outcome that *Sanford* found unreasonable.¹² In effect, the AT&T formula turns *Sanford* on its head, by trying to use the court's reasoning to achieve the very result – a wholesale rate above retail – that offended the *Sanford* court and caused it to reject AT&T's policy of refusing to provide the value of cash back promotions to resellers altogether.

⁹ *BellSouth Telecommunications, Inc. v. Sanford*, 494 F.3d 439 (4th Cir. 2007).

¹⁰ This "promotional retail rate" is referred to herein as the "effective retail rate."

¹¹ *Sanford* at 442.

¹² As explained by the *Sanford* court, "Because its position would not account for the promotional rebate check, BellSouth's position would obviously impede competition. The competitive LEC would have to pay BellSouth a wholesale rate of \$96 for the telephone service for which BellSouth's retail customers would pay only \$20." *BellSouth Telecommunications, Inc. v. Sanford*, 494 F.3d 439, 451 (4th Cir. 2007). Although AT&T's method as applied in the case at bar results in a slight less stark example of the wholesale rate being higher than the retail rate, it violates the same core principal from *Sanford* that the wholesale rate *must be* less than the retail rate or competition would be harmed.

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The North Carolina Commission erred by disregarding the facts. Notwithstanding the clear directive of the law and contract, AT&T admittedly does not charge resellers a price *below* the retail promotional price; it charges resellers **MORE** than the retail promotional price.

AT&T's method for calculating cash back promotion credits approved by the North Carolina Commission conflicts with federal and state law and regulations because it violates the key principle that wholesale should be less than retail.

Please acknowledge receipt of this filing by placing your file-stamp on the extra copy and returning to me via the enclosed self addressed postage paid envelope. Thank you.

Very truly yours,

A handwritten signature in black ink, appearing to read 'C. Malish', written in a cursive style.

Christopher Malish

DFB: jms

cc: Service List