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Executive Secretary
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RE: MIDCONTINENT; LECA SWITCHED ACCESS DOCKETS AND RULEMAKING
DOCKET (RM05-002)
Our file: 4959

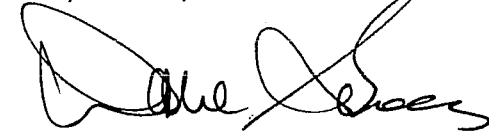
Dear Patty:

Enclosed are original and 10 copies of the Comments of
Midcontinent Communications. Please file the enclosures.

If you have any questions, please do not hesitate to contact me.
Thank you very much.

Yours truly,

MAY, ADAM, GERDES & THOMPSON LLP



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Enclosures

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RECEIVED

FEB 06 2006

**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF SOUTH DAKOTA**

**SOUTH DAKOTA PUBLIC
UTILITIES COMMISSION**

**IN THE MATTER OF REVISIONS AND/OR)
ADDITIONS TO THE COMMISSION'S)
SWITCHED ACCESS RULES CODIFIED,) DOCKET NO. RM05-002
IN ARSD 20:10:27 THROUGH 20:10:29)**

COMMENTS OF MIDCONTINENT COMMUNICATIONS

Midcontinent Communications ("Midcontinent") by its undersigned attorneys files these comments in response to the Public Utilities Commission of the State of South Dakota ("Commission") Order Opening Docket issued on December 14, 2005. Midcontinent is providing comments with regard to this rulemaking docket.

Background: Historically, charges for switched access services have been maintained at levels which exceed the actual cost of providing such services. Such practice constitutes an implicit tax upon carriers who have no choice but to pay these excessive rates. Moreover, this practice is entirely antithetical to the universally accepted theory that cost-based pricing maximizes societal benefits by ensuring optimal resource allocation and stimulating true competition. However, this practice has been tolerated in the telecommunications marketplace in order that certain other policy objectives may be obtained. Chief among these policy objectives is the notion that in order to maintain low rates and high penetration for local telecommunications services – particularly in rural areas – it is not only necessary, but desirable to allow local exchange carriers ("LECs") to charge prices for switched access services that are well in excess of the costs of those services. In so doing, LECs will have sufficient revenue streams to "offset" or, more accurately, subsidize local rates, thereby ensuring optimal

penetration in the telecommunications market. It had long been thought that such implicit subsidies were important to the preservation and advancement of universal service. An example of that theory is found in the following quote from a Washington order:

Historically, access charges have provided a substantial portion of local exchange company revenues and have assisted, along with averaging of rates across high-cost and low-cost locations, in keeping rates for local exchange service lower than might be otherwise necessary.¹

While this quote is from a Washington State proceeding, it is representative of the national approach and treatment of access charges prior to the Telecom Act of 1996. The FCC also recognized this phenomenon in its universal service proceeding:

States have maintained low residential basic service rates through, among other things, a combination of geographic rate averaging, high rates for business customers, high intrastate access rates, high rates for intrastate toll service and high rates for vertical features and services such as call waiting and call forwarding.²

Such an approach is no longer valid and is harmful to consumers.

Telecommunications Act of 1996: With the Telecommunications Act of 1996, Congress recognized the need to rationalize pricing. The three goals of the Act were to open the local markets to competition, reform universal service and reform access charges. At paragraph 8 of the *Local Competition Order* the FCC stated:

It is widely recognized that, because a competitive market drives prices to cost, a system of charges which includes non-cost based components is inherently unstable and unsustainable. It also well-recognized that access charge reform is

¹See ELEVENTH SUPPLEMENTAL ORDER; ORDER SUSTAINING COMPLAINT, DIRECTING FILING OF REVISED ACCESS CHARGE RATES; Docket No. UT-020406; Released August 12, 2003; at pages 11-12.

²Before the Federal Communications Commission; In the Matter of Federal State Joint Board on Universal Service; CC Docket No. 96-45; **REPORT AND ORDER**; dated May 8, 1997; at ¶ 14.

intensely interrelated with the local competition rules of section 251 and the reform of universal service.³

In its access charge reform proceeding, the FCC reiterated the benefits of moving access charges to cost:

Restructuring rates to reflect more accurately cost-causation will promote competition, reduce per-minute charges, stimulate long-distance usage, and improve overall efficiency of the rate structure.⁴

The FCC also encouraged the states to identify intrastate implicit subsidies:

Congress intended that states, acting pursuant to sections 254(f) of the Communications Act, must in the first instance be responsible for identifying intrastate implicit universal service support. Indeed, by our decisions in this Order and in our companion *Universal Service Order*, we strongly encourage states to take such steps.⁵ (emphasis in original)

The FCC has made considerable progress in moving interstate access charges towards cost. The CALLS⁶ and MAG⁷ Orders issued in 2000 and 2001 respectively have reduced interstate access rates significantly and rationalized the rate structures. The introduction to the CALLS Order states:

By simultaneously removing implicit subsidies from the interstate access charge system and replacing them with a new interstate access universal service support mechanism that supplies portable support to competitors, this Order allows us to provide more equal footing for competitors in both the local and long-distance

³In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; **FIRST REPORT AND ORDER**; CC Docket No. 96-98; Released August 8, 1996. Hereinafter referred to as the FCC's "*Local Competition Order*."

⁴Before the Federal Communications Commission; In the Matter of Access Charge Reform; Price Cap Performance /Review for Local Exchange Carriers, Transport Rate Structure and Pricing, End User Common Line Charges; CC Docket Nos. 96-262, 94-1, 91-213, 95-72; **FIRST REPORT AND ORDER**; Released May 16, 1997; at ¶ 131.

⁵*Id.* at ¶ 11.

⁶CALLS stands for the Coalition for Affordable Local and Long Distance Service.

⁷The Multi-Association Group (MAG) Plan was put into place for rate of return carriers at the federal level. The Order (FCC 01-304) was released on November 8, 2001.

markets, while still keeping rates in higher cost areas affordable and reasonably comparable with those in lower cost areas.⁸

As discussed above, the FCC has recognized that the implicit subsidies in access charges must be removed.

Excessive Access Rates Penalize IXCs: Switched access services are purchased from LECs by interexchange carriers (“IXCs”). IXCs must purchase such services from the LEC whenever an end-user places a long-distance call that traverses the LEC’s network in order that the call may be passed off to the IXC. The access rates apply for originating or terminating calls. When the price paid to the LEC by the IXC is higher than the cost incurred by the LEC for providing this service, the IXC is disadvantaged vis-à-vis other telecommunications providers who are not subject to such above cost pricing for key inputs (e.g., Internet protocol services such as VoIP, wireless offerings). Because the IXC has no alternative but to pay such charges (in order to provide service to its end-users) the IXC is captive to the LEC, who, with regard to its switched access services relationship with the IXC provides a service, over which it has complete monopoly control. Because other carriers are not faced with this monopoly relationship with the LEC (and the corresponding implicit tax upon vital inputs) the IXC is at an artificial competitive disadvantage to such carriers – a disadvantage that is, at least in large part, passed through to South Dakota consumers. A reduction of switched access service charges to TELRIC costs

⁸Before the Federal Communications Commission; In the Matter of Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers, Low-Volume Long Distance Users; Federal-State Joint Board on Universal Service; CC Docket Nos. 96-262, 94-1, 99-249, 96-45; **SIXTH REPORT AND ORDER IN CC DOCKET NOS. 96-262 AND 94-1; REPORT AND ORDER IN CC DOCKET NO. 99-249; ELEVENTH REPORT AND ORDER IN CC DOCKET NO. 96-45**; Released May 31, 2000; hereinafter referred to as the “CALLS Order”, at ¶ 3.

would eliminate this unfair and baseless disadvantage.⁹ More importantly, if switched access service charges are linked with their underlying costs there would be a direct benefit to South Dakota consumers.

Consumers Will Benefit from Reduced Access Charges: Artificially increasing the cost of long distance services through subsidy laden access charges keeps long distance rates artificially high for consumers. Consumers regularly complain about intrastate toll rates that are many times higher than interstate toll rates. The reason for the disparity, of course, is the difference in the level of access charges – a primary input for toll service. This artificial difference harms South Dakota consumers who are forced to pay higher rates.

Over the years, because the access charges were artificial, regulators have imposed imputation requirements on the incumbent providers who also provide toll services while imposing access charges on their dependent competitors. While the imputation requirement kept intrastate toll rates relatively comparable, it also kept intrastate toll rates higher than an efficiently operating market would allow. Imputation requirements and implicit subsidies harm consumers and the operation of an efficient market.

Excessive Access Rates Penalize CLECs: LECs benefit from pricing switched access service charges in excess of their underlying TELRIC costs in a number of ways. One of which is that by having the unique ability to impose this implicit tax upon some of its customers, LECs can effectively squeeze would-be local exchange competitors from the market. Because LECs use revenues from excessive switched access services rates to keep local rates artificially low, it

⁹TELRIC stands for Total Element Long Run Incremental Cost. The TELRIC principles are discussed in the FCC's *Local Competition Order* at paragraphs 672-703.

is unattractive for would-be competitors to seek to enter those markets. Indeed, because LECs are the sole beneficiary of the implicit subsidy, it may not even be profitable for alternative carriers (who do not benefit from such subsidies) to provide services in rural areas of South Dakota, since the associated unsubsidized costs would likely exceed “market” prices. In short, the excessive switched access service charges act to prohibit true competition in rural areas – areas that would likely see the most incremental benefit from such competition. This artificial economic roadblock denies South Dakota’s rural consumers of having a choice of providers, and other attendant benefits of competition such as technological advancements including access to high-speed internet services.

Excessive Access Rates Do Not Promote Subscribership: LECs often argue that absent the subsidy from excessive switched access service rates, subscribership, particularly in rural areas would suffer because local service rates – if not subsidized – would be higher. This argument, however, implicitly assumes that the only way to attain optimal subscribership is through the use of the implicit subsidies associated with excessive switched access charges. This assumption is patently false. In fact, by its nature, the implicit subsidy associated with excessive switched access rates equates to a shot gun approach to keeping rates low, which can result in the overall “support” for high cost consumers to be too high. In other words, without knowing where support is needed, and the amount of support required to maintain some level of penetration, it is likely that the implicit subsidy will be greater than necessary. Targeting support and support amounts so that subsidies go where they are needed the most would allow for a far more efficient means of maximizing penetration.

South Dakota's Switched Access Rules Should be Updated: For the last 13 years, South Dakota has relied upon its switched access rules. Those rules were put in place effective January 31, 1993. The rules can be found in Chapters 20:10:27, 20:10:28, and 20:10:29. These rules were put into place prior to the passage of the Telecommunications Act of 1996. As such, the rules didn't anticipate competition in the local market. Just as importantly, the rules could not have anticipated the explosive growth in wireless services or the introduction of Internet based services such as VoIP. Based on actions by the FCC in 2000 and 2001 to remove implicit subsidies and to rationalize the rate structure of interstate access charges, the rules are now incompatible with the federal access charge structure and levels. Finally, the upward trend in South Dakota's intrastate access charges is a testament to the need for review. Telecommunications is a decreasing cost industry.

South Dakota's Switched Access Model Overstates Access Costs: The South Dakota intrastate access cost model is contained in an Excel workbook comprised of 22 individual worksheets. This model applies Part 36 rules to jurisdictionally separate investments, expenses and taxes and then applies Part 69 rules to develop access charges. Investments and expenses associated with the provision of local service appear to be lumped together with the other historic costs in the study. The end result generates composite intrastate originating and terminating access charges for South Dakota independent exchange companies ("ICO") that are the highest of any in the entire Qwest region. Moreover, the rates generated are also the highest of every state telecommunications carrier association. The following table presents the results of research conducted for composite ICO intrastate originating and terminating switched access rates.

Composite Switched Access Rate for ICOs in Qwest's States and Associations in Other States

Study includes all ICOs for which access rates were available.

"OTHER" indicates ICOs that do not participate in state associations.

State Association or Aggregate of Other LECs	Loops	Composite Rate Weighted by Loops*			
		Orig	Term	Total	Rank
SD Local Exchange Carrier Assoc.	130,410	\$0.13	\$0.14	\$0.27	1
ID OTHER	27,579	\$0.11	\$0.11	\$0.22	2
NM OTHER	105,471	\$0.11	\$0.11	\$0.22	3
IA Network Services Assn.	184,765	\$0.10	\$0.10	\$0.20	4
MN OTHER	442,335	\$0.09	\$0.10	\$0.20	5
AZ OTHER	185,972	\$0.09	\$0.09	\$0.18	6
NC Telephone Cos.	318,251	\$0.07	\$0.11	\$0.18	7
VI Telecom Industry Assn.	78,717	\$0.06	\$0.09	\$0.15	8
ID Rural Exchange Carriers	39,299	\$0.07	\$0.07	\$0.14	9
WA Exchange Carrier Association	267,633	\$0.05	\$0.09	\$0.14	10
NY Access Settlement Pool	133,101	\$0.06	\$0.06	\$0.13	11
MT OTHER	70,501	\$0.06	\$0.06	\$0.13	12
OR Exchange Carrier Association	74,752	\$0.06	\$0.07	\$0.13	13
ND OTHER	17,838	\$0.06	\$0.06	\$0.11	14
WI State Telephone Association	788,587	\$0.05	\$0.06	\$0.11	15
OK Rural Telephone Cos.	238,526	\$0.06	\$0.04	\$0.11	16
WY OTHER	51,037	\$0.05	\$0.05	\$0.10	17
IL Small Company Exchange Carrier Assoc.	45,838	\$0.05	\$0.05	\$0.10	18
MI Exchange Carrier Association	187,760	\$0.05	\$0.05	\$0.10	19
UT OTHER	64,297	\$0.05	\$0.05	\$0.10	20
IA OTHER	329,652	\$0.04	\$0.05	\$0.09	21
CO OTHER	99,391	\$0.04	\$0.05	\$0.09	22
OR OTHER	157,474	\$0.04	\$0.04	\$0.08	23
WA OTHER	80,047	\$0.03	\$0.02	\$0.05	24
NE OTHER	342,132	\$0.02	\$0.02	\$0.04	25
PA Telephone Assn.	76,162	\$0.02	\$0.02	\$0.04	26
TOTAL FOR SURVEYED ICOS	4,537,527	\$0.06	\$0.07	\$0.13	

* - Composite rate assumes tandem routed transport and mileage 10 miles.

ICO rates are aggregated through weighting by switched lines.

The cost support for the South Dakota intrastate access cost model is historical in nature. As previously noted in these comments, such a costing methodology that foists a substantial share of costs to intrastate access while at the same time permitting local rates to remain artificially low,

is not sustainable in the new environment. The South Dakota cost model must be amended to take market participants and more current costing methodologies into account.

Summary: Implicit subsidies associated with excessive switched access rates are damaging to consumers and competition both in the long distance and local markets. By pricing this monopoly service in excess of TELRIC costs LECs disadvantage IXC carriers in the long-distance market vis-à-vis wireless and VoIP providers, since IXCs must pay these higher than TELRIC prices for key inputs whereas the other providers need not. Additionally such pricing and the associated revenues disadvantage and discourage potential competitors in the local exchange market, as these revenues provide LECs with the ability to squeeze such competitors from the market. These results, it has been argued, should be tolerated, since it is through this implicit subsidy that rural telephone rates and subscribership are kept at acceptable levels. However, this argument is flawed. A much more efficient method of dealing with these issues would be to target high cost customers and monitor the flow of subsidies so that subsidies flow to consumers who need them the most.

Each of these issues can be addressed by pricing switched access services at TELRIC levels, and making subsidies explicit and portable. In so doing, the Commission can mitigate the anti-competitive effects on both the long distance and local markets that are currently depriving South Dakota consumers of the benefits of competition in these markets. Simultaneously, this Commission action would allow for the achievement of any policy goals of high subscribership in the most efficient manner possible.

Respectfully submitted this 6th Day of February, 2006.

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CERTIFICATE OF SERVICE

David A. Gerdes of May, Adam, Gerdes & Thompson LLP hereby certifies that on the 6th day of February, 2006, he mailed by United States mail, first class postage thereon prepaid, a true and correct copy of the foregoing in the above-captioned action to the following at their last known addresses, to-wit:

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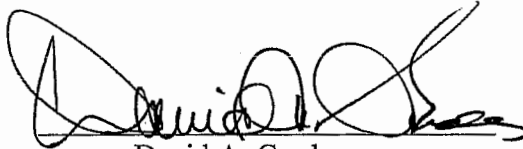
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