Bob Sahr, Chair
Dustin Johnson, Vice-Chair
Gary Hanson, Commissioner

SOUTH DAKOTA PUBLIC UTILITIES COMMISSION

500 East Capitol Avenue
Pierre, South Dakota 57501-5070
www.puc.sd.gov

Capitol Office
(605) 773-3201
(605) 773-3809 fax

Transportation/Warehouse
(605) 773-5280
(605) 773-3225 fax

Consumer Hotline
1-800-332-1782

MEMORANDUM TO THE COMMISSIONERS

RECEIVED
JAN 27 2006
SOUTH DAKOTA PUBLIC UTILITIES COMMISSION

TO: Commissioners Sahr, Johnson and Hanson

FROM: Keith Senger, PUC Commission staff

DATE: January 27, 2006

RE: TC05-060

On April 27, 2005, Midstate Telecom, Inc. (MTI) filed an ARSD 20:10:27:11 petition requesting the Commission grant an exemption from filing company specific cost based switched access rates and approve MTI's intrastate switched access rate. This memo will briefly explain MTI's petition, explain staff's position and provide staff's recommendations.

MTI is a certified LEC providing competitive local exchange telecommunication services in the Chamberlain exchange (a Qwest Corporation exchange). MTI is NOT the incumbent LEC with carrier of last resort obligation. MTI is a for-profit Competitive LEC who has entered into the service area of Qwest, the incumbent LEC. MTI is currently serving the least cost, highest profit generating customers while leaving the high cost customers for the ILEC servicing that area. MTI has indicated that it "will begin to offer service to all of rural Chamberlain in November of 2005, which will increase costs." However, no details or updates have been provided to staff.

According to staff's understanding, MTI is currently providing competitive local exchange services utilizing upgrades made to a legacy coax cable TV system. MTI is not reselling any Qwest facilities. Thus, MTI is providing the opportunity to receive services only to those end-user customers who have cable TV facilities extended to their homes or businesses. This currently only includes locations within city limits, and excludes all of the ILEC's high cost rural end-user customers.

Staff has issued four data requests to MTI. The Company has been less than timely with responses to those data requests. In fact, even after several oral and written follow-up communications from staff, the fourth data request issued on November 16, 2005 remains unanswered to date. Staff could have either filed a motion to compel or schedule the docket for decision before the Commission. Although staff believes that the unanswered discovery would have provided this Commission with more information to help make an informed decision, staff has chosen to move forward and schedule this docket for decision at the January 31, 2006 Commission meeting.

Essentially, MTI is requesting two separate actions of this Commission. First, MTI is requesting the Commission approve a request for an exemption from filing company specific cost based switched access rates. Second, MTI is requesting approval of the intrastate access rate of

$0.1325 per minute. Although these two issues may be interrelated, this memo will address each separately.

Exemption from filing company specific cost based switched access rates.

MTI filed a petition requesting an exemption from filing company specific cost based access rates in accordance with ARSD 20:10:27:11. That rule requires the requesting LEC to prove 1) that the company lacks the financial, technical, or managerial resources to conduct a study, or 2) that the additional cost of filing a study would outweigh any benefits. Since MTI shares the same managerial and technical staff as its ILEC parent company who files cost studies, it cannot prove it lacks the managerial or technical staff. However, MTI indicates it is not financially capable because it did not "cash flow." MTI's 2004 income statement shows a net loss of about $63,000 in the calendar year ending 2004.[1] MTI further states that the costs associated with a cost study would cause "further company losses and it would be detrimental to the customers of MTI if a local rate increase were to occur." Nevertheless, in 2004, MTI increased its intrastate switched access rate it charges to the IXCs by 44%.

MTI has provided information that shows in 2004, MTI, 1) collected over a half million dollars in revenues,[2] 2) provided POTS to 67% of the customers in which its facilities pass, and 3) captured about 41% of the total landline customers in the Chamberlain exchange. This is remarkable considering MTI's facilities are only able to serve about 62% of the total landline customers in the Chamberlain exchange.[3] The fact is MTI is a major competitor in the Chamberlain exchange. Staff is not totally convinced that MTI has met the burden of proof required to receive the ARSD 20:10:27:11 exemption.

The FCC has made it clear they will not subject CLECs to the same regulatory requirement as the ILECs. The FCC does not wish to require CLECs to file cost studies supporting access rates.[4] As will be discussed later, the FCC has also ruled that the costs of the CLEC are irrelevant when tariffing an access rate. Staff agrees with the FCC position and supports granting MTI's request for an exemption from filing cost based rates on those grounds. **Staff recommends the Commission grant MTI's petition from filing a cost study.**

Intrastate Switched Access Rate

MTI is requesting an intrastate switched access rate of $0.1325. MTI argues that this rate was developed in accordance with ARSD 20:10:27:12 which allows companies receiving a 20:10:27:11 exemption to use the statewide average "LECA Plus" interstate access rate.[5]

ARSD 20:10:27:12 allows an ILEC receiving a 20:10:27:11 exemption to use the average schedule rate. However, staff believes that ARSD 20:10:27:12 was only intended to be used for INCUMBENT LECs. The intent was to allow small, extremely high cost, rural South Dakota Incumbent LECs a waiver from filing an expensive cost study. In return that small, high cost ILEC must use the LECA Plus rate, which in theory, should be a lower rate than had they filed a

---

[1] The net loss of $63,000 does not include the internet, DSL or cable TV revenues provided over those same facilities. Those revenues are reported in the not-for- profit parent entity.

[2] Excluding internet, DSL or cable TV revenues reported in the not-for- profit parent entity.

[3] Estimate based on information provided to the Commission by Qwest regarding 2004 customer data.

[4] FCC 01-146 – Seventh Report and Order and Further Notice of Proposed Rulemaking.

[5] The "LECA Plus" rate is a term used by staff to identify the average rate of all cost companies with under 100,000 access lines using the formula identified in ARSD 20:10:27:12. It is derived by averaging all the "LECA" cost companies "Plus" two non LECA member cost companies.

company specific cost based rate. If ARSD 20:10:27:12 is extended to CLECs, it is possible for a CLEC providing service to low cost customers and whose company specific cost based rate would be less than that of the LECA PLUS rate, to simply apply for the 20:10:27:11 exemption and receive access revenue in excess of costs.

Additionally, ARSD 20:10:27:12 became effective January 31, 1993. That is more than three years prior to the implementation of the Telecommunications Act of 1996 which allowed CLEC activity. When enacted, ARSD 20:10:27:12 did not envision the emergence of CLECs. Furthermore, ARSD 20:10:27:12 indicates that the rate is "based on the cost of all the telecommunications companies with less than 100,000 access lines. The statewide average LECA Plus rate that MTI is requesting includes the rural ILECs with less than 100,000 access lines but excludes the CLECs in South Dakota serving fewer than 100,000 access lines. Thus, MTI's interpretation of the LECA Plus rate shows the intent of this rule was for incumbent LECs only.

If not the statewide average rate, then what rate should the CLEC be allowed to charge?. The FCC has already answered that question. FCC 01-146 Seventh Report and Order and Further Notice of Proposed Rulemaking in general forbids a CLEC from tariffing an access rate that is in excess of the ILEC rate whose service territory they are competing in. Although the FCC's rules regarding interstate access are not binding on this Commission regarding intrastate access, they can be used as a guide. Staff concurs with the FCC and believes that MTI should adopt the ILEC rate for intrastate access. MTI is competing against the ILEC Qwest for end-user customers in the Chamberlain exchange. MTI's basic local service rate for the Chamberlain exchange is currently less than the Qwest basic local service rate. MTI is undercutting the Qwest price to gain end-user customers, a natural and expected result of competition. These end-users are the customers who have a competitive choice of providers (either the ILEC or the CLEC). However, by gaining an end-user customer, MTI also captures the IXC picked by the end-user (for originating access) and the IXC of any end-user that calls MTI's end-users (for terminating access) as captive customers. Unlike the end-user, the IXCs have no choice. The IXC is a captive customer of the CLEC's monopoly access rate. For every local service end-user customer that MTI "wins" from the Qwest, the end-users see a decrease in the basic local service rate, but the IXCs see an approximate two fold increase in intrastate access rates. Staff believes this is inappropriate.

Many CLECs argued that its costs to provide service are higher than ILEC's costs. That fact remains unproven by MTI. MTI's facility deployment thus far is based on a cable TV legacy system and only provides service to the lowest cost customers in the Chamberlain exchange, those end-users located in the town. Qwest is left to provide service the high cost, long loop rural customers. Furthermore, if MTI's costs are higher than Qwest, then how can MTI provide basis local service to end-users at rates that are less than Qwest's basis service rates.

MTI has provided staff with some preliminary cost data that does indicate a rate close to the requested rate. This information remains suspect in staff's opinion. However, even if staff conceded that MTI's costs are higher than that of Qwest, staff believes that is not justification to charge an intrastate access rate that is approximately twice that of Qwest to the monopoly customer, the IXC, while also undercutting Qwest for the end-user customer, who has a competitive choice.

The FCC has also weighed in on the issues of high CLEC costs and the CLEC's monopoly power. In its order, the FCC concluded that the IXCs are subject to the monopoly power of the CLEC and found it necessary "to constrain the extent to which the CLECs can exercise their

monopoly power and recover an excessive share of their costs from the IXC.[6] To do this, the FCC limited the CLEC's access rate to that of the ILEC. The FCC further concluded that the high startup costs of a CLEC may be reasonable but that is not justification for tariffing an access tariff rate in excess of the ILEC. The FCC refused to let the CLECs subsidize their local service offering through access rates. In support the FCC stated that under normal market conditions, market entry is gained by offering service at a price lower than that of the competitors, exactly what MTI is doing for end-user customers. By limiting the CLEC access rate to that of the ILEC, the FCC is mimicking normal market entry for access rates and limiting the monopoly power the CLEC wields over the IXC.

In response to this FCC action, CLECs argued that they provide a service that is superior to that of the ILECs. The FCC acknowledges that CLECs may be offering state of the art facilities capable not only of POTS but also of providing broadband services to the end-user customers. However, the FCC concluded that this is not justification for tariffing an access rate greater than that of the ILEC. First, the IXC does not receive any benefit from these state of the art facilities capable of providing broadband services. Even if the IXC did receive some benefit for originating or terminating traffic over the CLEC facilities versus the ILEC facilities, the CLEC is free to negotiate a separate rate with the IXC; however, it may not tariff a rate greater than the ILEC rate. Second, the FCC found that it was very important to send the appropriate price signals to the end-user. If the CLEC service truly is a superior service, any increased costs associated with those facilities should be appropriately priced to the end-user who is receiving the benefits, not the IXC. This ensures market discipline and sends proper price signals which allows the end-user to decide if the superior service is worth the increased price.

Rural Exemption

The FCC in its order also created a "Rural Exemption" which allows certain "rural" CLECs to tariff the NECA rate instead of the ILEC rate for interstate access in some rural service territories. The FCC allows a "CLEC competing with a non-rural ILEC where no portion of the CLEC's service area falls within (1) any incorporated place of 50,000 inhabitants or more, based on the most recently available population statistic of the Census Bureau or (2) an urbanized area, as defined by the Census Bureau"[7] to charge the NECA rates.[8] MTI qualifies for this Rural Exemption for the interstate jurisdiction. However, staff does not believe this should automatically allow MTI to charge the LECA Plus rate for intrastate access.

The FCC selected the 50,000 inhabitants and the urbanized area criteria based on the geography, population, density, etc. of the nation. The FCC rejected several other broader criteria proposals (such as all customers living outside of zone 1 of the nation's top 50 MSAs or 100,000 access lines) because the FCC found these proposals would have been too encompassing and too broad. The FCC's intent was to limit this exemption to the most rural areas of the nation. When viewing the intrastate jurisdiction, staff believes that the FCC's national view is too encompassing and too broad for South Dakota's intrastate jurisdiction. The 50,000 inhabitants criteria excludes only Sioux Falls and Rapid City or 24% of the state population for receiving the Rural Exemption. Thus, the entire remaining area within the state (76% of the state population) would qualify for the exemption. Using this criteria, a CLEC providing service in Aberdeen, South Dakota's third largest city, would be eligible for the exemption. On a relative scale, Aberdeen to South Dakota is like Chicago to the United States. The FCC did not intend for Chicago to qualify for the rural exemption. The FCC did not include

[6] FCC 01-146 – Seventh Report and Order and Further Notice of Proposed Rulemaking, paragraph 39.
[7] Ibid. Paragraph 76.
[8] Ibid. Paragraphs 80 and 81.

76% of the US population eligible for the CLEC rural exemption. It is irrational to use those criteria on an intrastate jurisdiction.

The FCC created the rural exemption based on the fact that multi-state ILEC's access rates are an average rate for the entire service territory. For Qwest, the interstate access rate is an average of dense, high populated service areas like Minneapolis, Denver and Seattle, but also includes areas like rural Timber Lake and Morristown. Given the vast differences in these areas, the FCC was convinced that it was unfair to force a CLEC serving extremely rural areas to be forced to accept the averaged rate that included areas like Denver, so the FCC created the Rural Exemption. However, for the intrastate jurisdiction, the demographics are different. Qwest's intrastate rate is an average of its South Dakota service territory, but the difference between Morristown and Sioux Falls is not nearly the same as the difference between Morristown and Denver. This further indicates that the 50,000 inhabitants criteria do not fit the South Dakota intrastate demographics.

Additionally, a CLEC does not have the carrier of last resort obligation. Therefore, a CLEC could move into an exchange area, cherry pick the low cost high revenue producing customers, and essentially could provide service for less than the ILEC costs. Allowing a CLEC, whose costs may be less than the ILEC, to charge a rate that is approximately twice that of the ILEC is absurd and could "...create perverse incentives for uneconomic competitive entry by CLECs into rural areas...".[9] Staff questions if MTI's entry into the Chamberlain exchange may be just such a case, especially since MTI indicated that they are relying on the high access rate to make its business plan work.

Staff believes that just because the FCC has granted an exemption for the CLEC to use the NECA rate for the interstate jurisdiction is by no means justification to use the LECA Plus rate for the intrastate jurisdiction for over 76% for the state's population.

It also needs to be noted that the costs to a LEC to originate or terminate an interstate call over specific local exchange facilities is no different than originating or terminating an intrastate call over the same facilities. The pricing of each may be different due to jurisdiction differences[10], but the cost is the same. This holds true for MTI. The cost to originate or terminate a call over its Chamberlain local exchange facilities (the only facilities of MTI) is the same whether the call is an interstate or an intrastate jurisdictional call. However, in the case of MTI which is a single state and single exchange CLEC, the pricing difference would only be affected by the jurisdictional rule differences and not the facilities difference since MTI has facilities in only one exchange.

Based on the information that staff has received, in 2004 MTI has collected $86,822.47 in interstate related access fees. Staff can find no other revenue that MTI received related to interstate access jurisdiction. MTI originated and terminated 2,083,032 interstate minutes for that same period. By dividing the interstate revenues by the interstate MOU, staff calculated the 2004 interstate access revenue per MOU to be approximately $0.0417 per minute. The cost for MTI to originate or terminate an interstate call is the same as an intrastate call yet MTI is requesting approval of an intrastate rate of $0.1325 per minute – over three times the rate that

---

[9] Ibid. Paragraph 70

[10] Multi-state ILEC's interstate rate will include an allocated portion of the facility costs and expenses for the entire service territory divided by the total interstate MOU. The intrastate rate will include an allocated portion of facility costs and expenses for only the state jurisdiction, divided by the intrastate MOU. That and the different rules between the different jurisdictions create a price difference between interstate and intrastate jurisdictional origination and/or termination pricing; but the cost to the LEC is the same for the specific facilities.

the FCC has deemed appropriate for the interstate jurisdiction. It is somewhat voracious that MTI would be charging the NECA rate for interstate, but request the LECA Plus rate for the intrastate, especially since the cost for each is the same.

It is also important to note that other active CLECs in the state, including those providing service in towns with less than 50,000 inhabitants have, at their own request, tariffed the Qwest rate and not the LECA Plus rate.

Given the actions of the FCC and the facts discussed above, **staff would recommend that the Commission deny the intrastate access rate MTI has requested and order MTI to mirror and tariff the Qwest current rate.** This rate would essentially generate 50% more revenue per intrastate MOU than MTI is generating per interstate MOU.

In the alternative, if the Commission should choose to approve the intrastate switched access rate that MTI is requesting, staff believes it is necessary that the rate be subject to refund with interest and the 20:10:27:11 exemption be limited to three years as has been done in the past. MTI's proposed rate is based on the 2004 LECA Plus rate which uses the 2004 LECA rate. The 2004 LECA rate is an interim rate subject to refund with interest because it includes 2004 unapproved cost studies. Therefore, the rate that MTI is requesting is an interim rate not yet approved by the Commission.

Other Issues

MTI's current intrastate tariff was approved on May 16, 2002, for a period of 3 years. That tariff expired on May 16, 2005. MTI has continued to bill IXC's intrastate access without an approved tariff. The Commission has three options; 1) order MTI to refund with interest all intrastate access revenues collected since May 16, 2005; 2) order MTI to refund with interest the difference between the rate they have been charging since May 16, 2005, and the rate approved in this filing; or 3) allow MTI to keep all untariffed revenues it has collected.

Staff has considered several facts. First, MTI has known for 3 years that this tariff was set to expire, yet MTI did not make a timely tariff filing. Second, MTI has been less than responsive in providing staff with the information necessary to complete this filing. Staff's second data request remained unanswered for 133 days. Staff's fourth data request was issued November 16, 2005, with a requested response due date of December 7, 2005. That fourth request remains unanswered as of the date of this memo. Staff has provided both verbal and written reminders to MTI's attorney, yet staff has not received a response. Given these facts, **staff recommends that the Commission order MTI to refund with interest the difference between the rate MTI has billed since May 16, 2005, and the rate that the Commission approves in this docket**.

During the course of this docket, staff has determined that MTI's local exchange tariff on file with the Commission is not current and does not appropriately represent MTI's local exchange offering. Staff has requested that MTI update this tariff, but MTI has failed to do so. **Staff would recommend that the Commission order MTI to update its Local Exchange Tariff within two weeks of the date of the order in this docket.**

Staff has also found what it believes is an error in MTI's annual report filed with the Commission. Staff is unable to reach complete certainty that the report is in error because of the unanswered discovery posed to MTI. **Staff would recommend that the Commission order MTI to file a revised annual report** if the Commission finds it necessary.