

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

IN THE MATTER OF REVISIONS)
AND/OR ADDITIONS TO THE)
COMMISSION’S SWITCHED ACCESS) Docket No. RM05-002
RULES CODIFIED IN ARSD 20:10:27)
THROUGH ARSD 20:10:29)
)

**VERIZON’S REPLY COMMENTS ON DRAFT RULES
REGARDING SWITCHED ACCESS RATES**

Verizon¹ hereby replies to the comments of other parties on the draft switched access rules that were distributed by the Commission Staff on June 1, 2010.

I. The Commission Should Pursue Comprehensive Access Charge Reform

AT&T joined Verizon and Midcontinent Communications (“Midcontinent”) in advocating “comprehensive,” “severe” and “meaningful reform” of the switched access regime in South Dakota. AT&T described a “broken system” and intrastate pricing rules that “are woefully out of date.”² According to AT&T, these failings have resulted in inflated intrastate switched access charges that harm consumers and competition, distort investment incentives, deter innovation, and are economically inefficient. Its comments thus echo the testimony of Verizon’s and Midcontinent’s witnesses earlier this year in Docket TC 10-014. Qwest also asserts that access charge reform must be stringent in order to eliminate distortions in South Dakota’s local exchange market and reduce incentives for local exchange carriers (“LECs”) to engage in improper arbitrage activities.

¹ The Verizon companies participating in this filing are MCI Communications Services, Inc. d/b/a Verizon Business Services and MCImetro Access Transmission Services LLC d/b/a Verizon Access Transmission Services (“Verizon”).

² Comments of AT&T at 3, 5, 12, 13.

In fact, the record indicates that the extraordinarily high switched access rates in South Dakota make it one of the most attractive states for traffic pumpers.³

The serious problems these parties identify apply across the board to all local exchange carriers in South Dakota. While the Staff's draft rules focus primarily on the access rates that competitive local exchange carriers ("CLECs") may charge, it would be a serious mistake if the Commission were to end its inquiry there. This proceeding was initiated four years ago to examine the switched access charge rules that govern *all* local exchange carriers in the state. It is not surprising that the incumbent local exchange carriers ("ILECs"), which are the major beneficiaries of an outdated regulatory regime that enables them to charge as much as 12.5 cents per minute – some of the highest access rates in the nation – favor preserving the status quo. They ask the Commission to retain rate-of-return regulation for ILECs and, by implication, the antiquated rules that support that system.⁴ But pricing rules adopted in a different era characterized by monopoly entities serving exclusive franchise service territories, and based on traditional cost-of-service principles, have clearly outlived their usefulness.

The pricing rules adopted in 1993 produce access rates today that are unreasonable on their face. The fact that the existing regulations do not achieve their fundamental purpose (establishing rates that are just, reasonable and serve the public interest) further underscores the importance of pursuing meaningful, substantive reform now. The ILECs' assertion that the type of regulation, *i.e.*, rate-of-return, "is critical" to the carriers' incentives and ability to provide quality service at affordable rates is

³ See Direct Testimony of William R. Easton on behalf of Qwest, Docket No. TC10-014 (April 1, 2010) at 11-13; Direct Testimony of Don Price on behalf of Verizon (same docket) (April 1, 2010) at 28-30.

⁴ Comments of the Local Exchange Carriers Association ("LECA") and the South Dakota Telecommunications Association ("SDTA") at 2.

misplaced in today's communications market.⁵ Both the method of regulation and the actual rules themselves must be examined to determine what is appropriate and needed in the current environment.⁶ As it fulfills its responsibility to ensure that the state's rules are in the public interest today, the Commission should also be guided by the Federal Communications Commission's ("FCC") strong commitment to reforming the intercarrier compensation system, its emphasis on reducing carriers' *intrastate* switched access rates, and its encouragement of state regulators to "rebalanc[e] local rates to offset the impact of lost access revenues."⁷

II. CLEC Intrastate Switched Access Rates

Midcontinent explains that the draft pricing rules contain unnecessary complications that "do not resolve the problem with switched access in South Dakota."⁸ Qwest also cautions that the rules designed for CLECs must be sufficiently stringent to prevent potential abuses, particularly various forms of arbitrage including traffic pumping.⁹ Verizon agrees with these commenters, and urges the Commission to adopt a

⁵ The draft rules make only one substantive revision to the rules affecting ILECs. Staff proposes to delete language in ARSD 10:10:27:07 that requires ILECs to update cost support "no less than once every three years." Midcontinent and Verizon oppose this proposal, as it would impermissibly allow ILECs to maintain their excessive intrastate access rates in place indefinitely. Midcontinent at 4; Verizon at 7 n. 7.

⁶ Midcontinent at 5 (current switched access rules "are in dire need of a complete revision to be consistent with the goals of the [Telecommunications Act of 1996] and associated South Dakota law.")

⁷ See Federal Communications Commission, "Connecting America: The National Broadband Plan", Recommendation 8.7 (March 16, 2010) at 148 (copy available on-line at <http://www.broadband.gov/download-plan/>).

⁸ Midcontinent at 1.

⁹ Verizon agrees with Qwest that the Commission should strengthen the rules to curb the potential for traffic pumping and to eliminate any potential loophole that would permit CLECs that do not provide service to actual end-user customers to charge rates above the price cap. The rules adopted by the Iowa Utilities Board (*see* Qwest at Attachment 1) prove a good model and starting point for this Commission's consideration.

simple, straightforward rule that implements pricing regulation for CLECs in an efficient and straightforward manner.

A. Draft Rule ARSD 20:10:27:02.01

The draft rules specify the actual rates (either 6.042 or 9 cents per minute) that CLECs could not exceed.¹⁰ The parties that addressed this issue all oppose this approach.¹¹ Midcontinent, Qwest and Verizon explained that because carriers' access rates may change over time, the rules would become outdated and outlive their intended purpose as ILECs change their access rates in the future. The Commission would have to undertake new rulemakings, and incur the time and costs associated with such proceedings, to recalibrate the mandatory rate ceiling and ensure rate parity between ILECs and CLECs each time ILECs modified their access rates.¹² This is inefficient, undesirable and unnecessary.

¹⁰ Draft Rule 20:10:27:02.01 reads as follows: “**Determination of intrastate switched access charges for competitive local exchange carriers -- General.** A competitive local exchange carrier shall charge intrastate switched access rates that do not exceed the rate of 6.042 cents per minute if 15 percent or more of the competitive local exchange carrier's total access lines in South Dakota are in communities of 10,000 inhabitants or more. The switched access rate shall be the same in each of the competitive local exchange carrier's service areas.

A competitive local exchange carrier shall charge intrastate switched access rates that do not exceed the rate of 9 cents per minute if 85 percent or more of the competitive local exchange carrier's total access lines in South Dakota are in communities with populations of less than 10,000 inhabitants. The switched access rate shall be the same in each of the competitive local exchange carrier's service areas.”

¹¹ Verizon and Midcontinent explained that the 9 cent rate in the second paragraph of draft rule ARSD 20:10:27:02.01 is an arbitrary amount that bears no rational relationship to existing ILEC or CLEC intrastate rates in South Dakota. Thus, apart from the fact that it would be unwise to specify an actual rate in the rule, there is no rational basis for selecting this particular amount. Verizon at 4; Midcontinent at 3.

¹² According to AT&T, the six cent and nine cent rate caps proposed in the draft rule “would maintain a very substantial implicit subsidy that is wholly inappropriate for switched access.” AT&T at 3. Thus, even if ILECs were to reduce their access rates, these subsidies in CLEC access rates would remain in place until the Commission completed new proceedings, lowered the rate caps, and ordered CLECs to adjust their rates accordingly. Delaying price reductions that are clearly warranted would be an unacceptable result.

Most parties agree that using a benchmark approach would be more administratively efficient than specifying an actual rate in the Commission's rules. There also was remarkable consensus on what the benchmark should be. Verizon and Midcontinent contend that the Commission should prohibit any CLEC from charging switched access rates higher than the intrastate access rates charged by the ILEC that provides service in the same area. AT&T also recommends that the Commission "follow[] the FCC's precedent on CLEC interstate switched access rates and require[e] all CLECs' intrastate switched access rates to be capped at the intrastate rates of the ILECs with which they compete."¹³ Qwest's position is similar, but it suggests that the benchmark should be the intrastate rate of the RBOC in South Dakota, which is Qwest. In contrast, no party expressly supported or attempted to justify a rule that specifies a particular rate. Accordingly, the Commission should reject that proposed approach and establish a benchmark instead. Verizon recommends that the Commission adopt the following rule:

20:10:27:02.01. Determination of intrastate switched access charges for competitive local exchange carriers -- General. A competitive local exchange carrier shall charge intrastate switched access rates that do not exceed the composite switched access rate charged by the incumbent local exchange carrier in whose service area the competitive local exchange carrier operates.

Establishing a straightforward benchmark – capping CLEC access rates at the ILEC's rate – also eliminates the need to include the various conditions set forth in draft rule ARSD 20:10:27:02.01, as well as the proposed exceptions to the rate cap in ARSD 20:10:27:02.02. As Verizon stated previously, Staff provided no explanation and there is no apparent rationale for authorizing different CLEC access rates based on whether 85

¹³ *Id.* at 13.

percent or more of a CLEC's access lines are in communities of less than 10,000 inhabitants, as contemplated by draft rule ARSD 20:10:27:02.01. In addition to the ambiguity (*i.e.*, how is a "community" defined?), the criteria appear to be entirely arbitrary. Moreover, they are unnecessary if the Commission follows a basic benchmark approach. This is because a CLEC would use as its benchmark the intrastate access rate of the ILEC that provides service in the same area. Accordingly, the Commission should decline to adopt superfluous language relating to percentages of access lines and population sizes that are included in draft rule ARSD 20:10:27:02.01.

Midcontinent was also critical of the Staff's proposal to distinguish between and among CLECs based on where they serve and how they operate, explaining that it "only continues the discrimination that has distorted the market."¹⁴ Midcontinent explained that there is a wide variety of CLECs and that carriers differ in many respects, including their service delivery methods (*e.g.*, facilities-based, resale, or UNE-P), technology and service offerings, organizational structure, service area, and size. Accordingly, Midcontinent argued persuasively that there is no rational basis for distinguishing between different types of CLECs for ratemaking purposes. Verizon agrees. Applying a "traditional" benchmark approach will avoid granting preferential treatment to certain carriers (and discriminating against others), and is thus more competitively neutral.

B. Draft Rule ARSD 20:10:27:02.02

ARSD 20:10:27:02.02 of the draft rules would provide for an exception to the requirement that CLEC access rates be capped at a certain level.¹⁵ The proposed

¹⁴ Midcontinent at 3.

¹⁵ Draft Rule ARSD 20:10:27:02.02 reads as follows: "**Exceptions for switched access rates of competitive local exchange carriers.** A competitive local exchange carrier may charge different rates than the rates established in § 20:10:27:02.01 if it meets one of the following exceptions:

exceptions provoked considerable comment. Northern Valley Communications, L.L.C. and Sancom, Inc. sought to expand the exception so that a CLEC could be exempt from the normal price cap requirement if it provides service using facilities owned by a corporate parent or subsidiary. Two other CLECs argued that, “regardless of how the CLEC provisions ... service,” a CLEC should be entitled to pursue an exemption from the price cap requirement; thus, these parties would grant an exemption to CLECs that lease, as well as own, facilities.¹⁶ However, none of these carriers provided any justification for allowing certain CLECs to obtain an exemption from the basic requirement that they not charge rates higher than those of the ILEC operating in the same service area.

Conversely, Verizon, Midcontinent and Qwest expressed concern with the draft rule that would carve out an exemption from the price cap requirement for certain types of CLECs. Verizon argued that no such exemption for any CLECs is justified. Having only entered the market relatively recently, CLECs have been able to design optimally efficient and cost-effective networks using the most up-to-date technology available. Therefore, it is not credible to suggest that CLECs have higher cost structures than ILECs with legacy network architectures, customer bases and “carrier of last resort”

(1) If a competitive local exchange carrier offers service with its own facilities throughout all the exchanges where it operates, the competitive local exchange carrier may charge intrastate switched access rates that do not exceed the rate established by § 20:10:27:12. A competitive local exchange carrier must offer local exchange service throughout all of the exchanges where it operates using its own facilities and may not rely on the facilities owned by an affiliate or subsidiary; or

(2) If a competitive local exchange carrier believes that a higher rate than the rate allowed under § 20:10:27:02.01 is justified under price regulation, the carrier may file a cost study in accordance with chapters 20:10:27 to 20:10:29 to determine its fully allocated cost of providing switched access services. In addition to considering the fully allocated cost of providing switched access services, the commission shall consider the other factors in SDCL 49-31-1.4 in its determination of the competitive local exchange carrier’s price for switched access services.”

¹⁶ Initial Comments of Midstate Telecom and RC Communications, Inc., d/b/a RC Services, at 4.

obligations.¹⁷ Nor is it credible to suggest that CLECs would be able to prove, because of their cost structures, that they should be entitled to charge rates that are higher than the already-excessive access rates that ILECs are currently charging in South Dakota. By seeking to expand the exemption beyond that contained in the draft rule, the CLECs' proposed modifications would further undermine the benefits of moving CLECs to pricing regulation in the first place.

Midcontinent also recommends that the Commission reject proposals to grant an exception to the price cap requirement based on the facilities used and where a CLEC operates. It argued that there is no lawful basis for treating carriers differently based on technology, extent of service, or corporate structure, and that basing rate regulation on any such "artificial distinction would ... result in undue discrimination and the inefficient operation of the market."¹⁸ Verizon agrees and reiterates its position that proposals to create an exemption from the price cap requirement are unsound and should be rejected.

Qwest addressed the proposed requirement that a CLEC seeking an exemption and authority to charge rates higher than the price cap must submit a cost study. Qwest raises a "fundamental question" of whether a rate-of-return model is appropriate for setting the access rates of CLECs, which generally set rates based on market conditions.¹⁹ This is similar to objections that Verizon raised earlier.²⁰ Indeed, having CLECs develop cost studies using the antiquated and discredited rules that ILECs have followed for nearly two decades is incompatible with the Commission's intention in moving CLECs to

¹⁷ Verizon at 5-6.

¹⁸ Midcontinent at 4.

¹⁹ Qwest at 3-4.

²⁰ Verizon pointed out that the second paragraph of draft rule ARSD 20:10:27:02.02 is confusing, and does not adequately describes the type of cost study that a CLEC would be required to file to justify rates above the approved price ceiling. Verizon's at 6.

pricing regulation.²¹ Because there is no legitimate basis for a CLEC to charge higher intrastate switched access rates than the ILEC that provides service in the same area, the Commission should reject all proposals to create an exception to the price cap requirement.

For the reasons stated above and its initial comments, Verizon recommends that the Commission establish a single rate benchmark; prohibit CLECs from charging more than the intrastate switched access rates of the ILEC operating in the same service area; decline to adopt other superfluous, confusing and unproductive proposed rule changes; and move swiftly to address meaningful and comprehensive access reform for incumbent local exchange carriers in South Dakota.

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Respectfully submitted,

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²¹ Qwest also points out that the proposed language contains a potential loophole that would allow CLECs that do not provide service to actual end-user customers to charge rates above the price cap. Qwest at 3-4.

and

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on June 28, 2010, I sent a true and exact copy of the within VERIZON'S REPLY COMMENTS ON DRAFT RULES REGARDING SWITCHED ACCESS RATES by e-mail to all parties identified on the Commission's Service List for this docket.

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