BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF SOUTH DAKOTA

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Proposed Rulemaking of the Public Utilities Commission of South Dakota on Telecommunications Switched Access Rules	)	
	)	Docket No. RM05-002
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Comments of AT&T Communications of the Midwest, Inc. in the Rulemaking of the Public Utilities Commission of South Dakota on Telecommunications Switched Access Rules

AT&T Communications of the Midwest, Inc. ("AT&T"), respectfully submits these comments before the Public Utilities Commission of the State of South Dakota ("SDPUC" or "Commission") on the proposed Telecommunications Switched Access Rules, 20 ARSD, Chapter 20:10:27 ("Rules"). AT&T applauds efforts to foster switched access reform in South Dakota, particularly in light of the outdated mechanisms currently in place, and in recognition of the national mission set forth in the Federal Communications Commission ("FCC")'s National Broadband Plan with its focus on universal service, intercarrier compensation, and the important role played by each in supporting in the ubiquitous deployment of advanced broadband technologies.

However, AT&T is concerned that the Rules offer only a cosmetic solution, when a major overhaul is required. The Rules fall short of balancing the long term interests of all market participants by supporting meaningful deployment of technological innovation and ridding the market of unsustainable, implicit subsidies which lead to skewed economic behavior.

Further, AT&T has consistently urged this Commission and others to mirror the policy reforms advocated by the FCC which would to bring parity to the switched access regime at both the interstate and the intrastate levels. An Incumbent Local Exchange Carrier ("ILEC")s intrastate switched access rates must be brought into parity with its interstate switched access rates, and Competitive Local Exchange Carrier ("CLEC") rates must be capped at the ILEC rates in the local market served. Only this mechanism will adequately level the playing field and eliminate the arbitrage potential which exists in CLEC rates today.

The real price for high intrastate access charges is ultimately borne by consumers. The skewed economics result in discrimination against certain market segments and slowed deployment of new technologies that should be used in providing the telecommunications services in certain markets. In his remarks to the National Association of Regulatory Utility Commissioners ("NARUC") convention in November, 2010, FCC Chairman Genachowski stated that:

> ...carriers are resisting converting to all-IP networks in order to hold on to intercarrier compensation revenues. Reform is necessary to spur innovation and investment in IP networks and foster an even playing field for competition. Several states have already taken steps to tackle these difficult problems by reducing intrastate access rates, rebalancing local residential rates, and creating their own universal service funds. At the FCC, we are learning from these states' experiences while looking for

ways to acknowledge their efforts and to encourage other states to follow their lead.[1]

I. Explanation of Switched Access Charges

Intrastate switched access services are wholesale services provided by local exchange carriers generally to wireline long-distance providers (*i.e.*, local long-distance providers and interexchange carriers ("IXCs")), for originating and terminating intrastate long-distance calls.

On the originating side, the IXC has no control over which ILEC or CLEC serve its customers; likewise, on the terminating side, the IXC has no control over which recipients its customers call, and no control over which ILEC or CLEC serve those recipients. Thus, the IXC must pay whatever switched access rates the ILEC or CLEC assess for those calls, because the ILEC or CLEC has a monopoly over access service. As the FCC stated, "when an end user decides to take service from a particular LEC, that LEC controls an essential component of the system that provides interexchange calls, and it becomes the bottleneck for IXCs wishing to complete calls to, or carry calls from, that end user."[2]

Given the market power that ILECs and CLECs yield over intrastate switched access services and the lack of conclusive action by the Commission on access reform to date, it is not surprising that the ILECs' and CLECs' intrastate switched access rates are much higher than their corresponding

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[1] Prepared Remarks of Chairman Julius Genachowski, Federal Communications Commission, "Our Innovation Infrastructure: Opportunities and Challenges," NARUC Annual Meeting, Atlanta, GA, November 15, 2010 ("*Genachowski NARUC Remarks*").

[2] *In re Access Charge Reform, Seventh Report and Order and Further Notice of Proposed Rulemaking*, 16 FCC Rcd. 9923, 9931 (2001).

interstate rates for the same access service. While the effort evidenced in the present proceeding is commendable for its attempt to effect much-needed reforms, the effort reflected in the Rules is incomplete. The ills wrought by the current access compensation scheme are likely to continue in the absence of the long term reforms suggested by AT&T.

a. The Problem: High Access Charges, Whether Charged by ILECS or CLECs, Harm Consumers And Competition.

Inflated intrastate switched access rates harm to both consumers and competition in South Dakota for several reasons. Switched access charges are a principal cost component of providing wireline long-distance service. Thus, the prices for in-state wireline long-distance calls are higher than they otherwise would be due to high access charges. And because long-distance rates are geographically averaged (so that long-distance providers spread high access costs over all South Dakota consumers who place long-distance calls) high intrastate access charges harm *all* South Dakota consumers.

Second, high access charges damage the state's economy in other ways. Wireline long-distance providers face a wide array of competing technologies including, but not limited to, email, texting, wireless phone service,[3] Voice over Internet Protocol ("VoIP") services, cable telephony, instant messaging, and social networking websites that do not have to bear the same subsidy-laden

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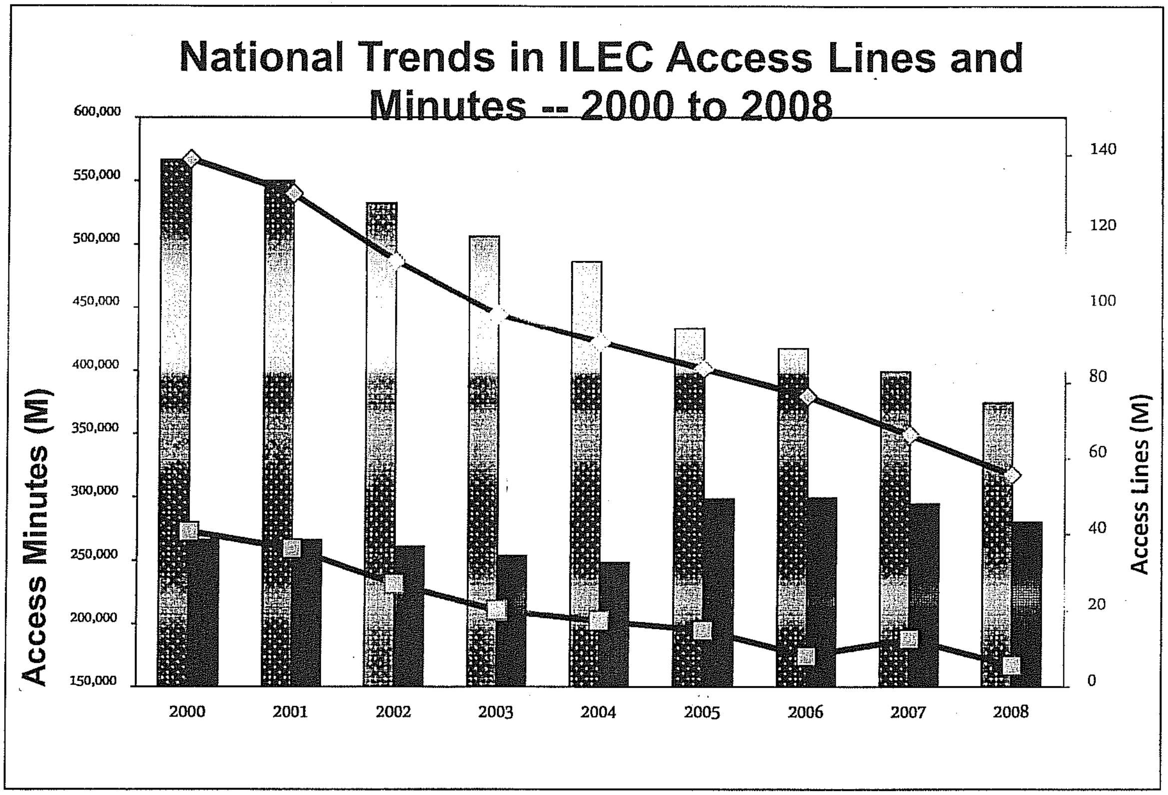
[3] Pursuant to FCC rules, wireless carriers pay access charges on calls between Major Trading Areas ("MTAs") but not on calls within an MTA. Given that virtually all of South Dakota falls within a single MTA, wireless carriers are practically exempt from South Dakota intrastate switched access charges. *See* http://wireless.fcc.gov/auctions/data/maps/mta.pdf.

access cost burden. Saddled with the cost of high access charges, wireline providers simply cannot compete fully and aggressively against competitors that are free from such burdens. Reducing competitive alternatives limits consumer choices, and results in skewed decision making by consumers, where fewer choices exist.

In recent years, AT&T's wireline long-distance business has lost millions of minutes of traffic to many of these competing technologies, not because of any real difference in quality, but in part because of the market distortion created by regulatory rules permitting those alternatives to avoid incurring access costs in the same way as wireline long-distance service. Accordingly, those alternatives can offer materially more attractive retail prices. Indeed, as shown in **Chart 1** below, nationally, from 2000 through 2008, the number of intrastate access minutes of use declined more than 39%, as consumers shifted their usage away from traditional long distance calling and to forms of communication not burdened with access subsidies.



Data in Millions	2000	2001	2002	2003	2004	2005	2006	2007	2008
Interstate mou	566,900	539,800	486,600	443,900	422,300	401,000	379,200	348,646	316,869
Intrastate mou	272,585	258,885	231,527	210,504	202,130	194,622	174,410	187,713	166,945
Residential Lines	139	133	127	119	112	94	89	83	75
Business Lines	39	39	37	34	33	49	50	48	43

Chart 1

b. The Path Toward Long-term Reform

If the artificial burden of high access charges were removed or at least lightened, wireline long-distance providers could compete more aggressively. In turn, other competing technologies will be forced to become more efficient, more innovative, and more attuned to consumer needs. The results will benefit both residential and business consumers of the South Dakota communications market.

There is no material technical difference in functionality between originating and/or terminating an interstate call versus originating and/or terminating an intrastate call, yet there is a vast difference in rates between the intrastate and interstate switched access rates. Charging radically different prices for materially the same functionality leads to arbitrage, substantial expense, waste, and inefficiency, resulting in decreased value for consumers.

Further, carriers that pay high intrastate access charges have an incentive to evade them if the interstate-intrastate differential is too great. For example, high switched access rates could encourage "buying" carriers to route traffic in such a way that makes it difficult or impossible to determine its jurisdiction. In addition, carriers may fail to provide the necessary information required to apply the proper charges, either access for long distance traffic or reciprocal compensation for the exchange of local traffic. This practice is known as "phantom traffic."

It is also widely acknowledged that high switched access rates also engender uneconomic traffic stimulation. Providers that receive high access charges have an incentive to generate increased traffic volumes. The recent, highly publicized "traffic pumping" schemes, which are designed to drive massive volumes of traffic to adult chat lines and similar services (*e.g.*, free conference call offers) via rural LECs and CLECs with high switched access rates, clearly highlight the potential for abuse.[4]

It is evident the status quo cannot be sustained. As indicated in Chart 1, access minutes of use are decreasing at an increasing rate as more and more consumers shift their usage away from traditional long distance services to alternatives not saddled with the same access subsidy obligations. As traditional landline minutes are transitioned to email, social networking, wireless and IP-based alternatives, access revenues (historically used as "implicit subsidies" for artificially low local service prices) diminish. With the erosion of these subsidies and ultimate loss of access revenues for ILECs comes a threat to universal service and rural investment, which puts rural connectivity at risk. As consumers shift their calling away from the traditional wireline telephone networks, the traditional telephone companies are strained to recover largely fixed costs from a shrinking customer base. Ironically, because high access charges drive customers and usage away from the wireline networks, they are drying up the stream of implicit subsidies that were intended for other wireline services like local exchange service in rural areas. As the FCC noted in its *FCC NBP*, "fewer terminating minutes ultimately mean a smaller revenue base for intercarrier compensation. ... Even rate-of-return carriers, who are permitted to increase per-

[4] *Connecting America: The National Broadband Plan*, FCC (Mar. 16, 2010), at 142 (citation omitted) ("*FCC NBP*").

minute rates so they have the opportunity to earn their authorized rate of return, acknowledge that the current system is 'not sustainable' and could lead to a 'death spiral' as higher rates to offset declining minutes exacerbate arbitrage and non-payment."[5]

2. ILEC Intrastate Switched Access Rate Reforms are required.

Intrastate switched access rates were first approved by the Commission several years ago and were established when wireline telephone service was essentially a closed monopoly. Generally, these charges were established containing an implicit subsidy so that local rates could be held artificially low. Consumers wanting to communicate over a long-distance network had little choice but to place a wireline long-distance call and pay long-distance rates that were established at rates levels that that were assumed in order to allow IXCs to recover the high intrastate access charges being assessed to them by ILECs. Now, the assumptions about long distance rate levels no longer hold, largely due to the rapid rise of intermodal competitive alternatives which are not saddled with the same cost structure.

Insofar as the Rules fail to address ILEC rates switched access rates, they are inadequate. The harms caused by implicit subsidization of the local rate structure through artificially inflated intrastate switched access rates is the province of ILEC market behavior as well as CLEC market behavior. ILEC reform is therefore equally urgent and equally necessary. There is no justification for differing treatment of interstate and intrastate calls, as the call

[5] *FCC NBP* at 142.

termination mechanism, the equipment, and operational costs to the ILEC are the same whether the call is intrastate or interstate. However, as has long been the case, ILECs are able to rely on archaic rules to treat such costs differently, and therefore create artificial subsidies of intrastate calling rates by imposing inflated costs on IXC termination charges.

AT&T thus advocates that ILEC intrastate switched access charges should also be brought under the reform of the Rules, and should be brought into parity with their own interstate rates. Again, there is no reason for the costs for an ILEC's intrastate switched access rates to be different than its own interstate switched access rates, unless the ILEC itself is engaging in irrational economic behavior simply because it can. As long as the Rules fail to require benchmarking between intrastate and interstate rates, the ILECs can, and will.

3. 20:10:27:02.01: Mandated Rates based on Carrier's Access Line Market Leave Room for Continued Abuse

Section 20:10:27:02.01 of the Rules provides that a CLEC shall charge intrastate switched access rates not in excess of 6.042 cents per minute if 15 percent or more of the CLEC's total access lines in South Dakota are in communities of 10,000 inhabitants or more, and shall charge intrastate switched access rates that do not exceed 9 cents per minute if 85 percent or more of the CLEC's total access lines in South Dakota are in communities with populations of less than 10,000 inhabitants.

Section 20:10:27:02:02 of the Rules provides an exception for determination for switched access rates of competitive local exchange carriers. If a CLEC believes that a higher rate is justified under price regulation, the carrier may file a cost study in accordance with Chapters 20:10:27-20:10:29 to determine its fully allocated cost. The Commission is required to consider the factors in SDCL 49-31-1.4 in considering approval of these prices.

Setting *specific* rates in the rules in the manner set forth in 20:10:27:02.01 is a mistake. There is no framework contained in the Rules themselves by which one can discern the basis or rationale for these prices, and no assurance has been provided that the Commission considered the requirements of SDCL 49-31-1.4 in establishing these prices. They appear somewhat arbitrary at best. Rather, AT&T believes the Rules here should be modeled after those adopted by the FCC and many other states, none of which have seen the need to specify an actual rate in their rules. The preferred approach is a *benchmark* standard which allows rates to be revised over time in reference to market driven rates. As determined by the FCC, cost-based rates should not even be required where meaningful market information--a more meaningful reference--is available.

> "The Commission explicitly declined to apply [a cost-based approach to competitive LEC access charges] and explained that it was applying market-based approach. Consistent with this finding, the Commission held that it will assess the reasonableness of competitive LEC access rates by evaluating market factors rather than a particular carrier's costs."[6]

An arbitrarily established rate is worse than no rate proxy at all. If any proxy is used rather than establishment of the fully allocated cost, proxy should reflect

[6] *In the Matter of Access Charge Reform; Reform of Access charges Imposed by Competitive Local Exchange Carriers,* Eighth Report and Order and Fifth Order on Reconsideration in CC Docket NO. 96-262; FCC 04-110 (released May 18th, 2004). ("2004 CLEC Access Order").

meaningful market information. Meaningful market information should be derived from the market itself, looking toward functional product substitution. That information exists, and is easily referenced and immediately obtainable with no need to engage in costly, lengthy and administratively taxing cost proceedings before this Commission. Interstate switched access rates are the available and relevant proxy here. Again, by requiring ILECs to keep intrastate switched access in parity with interstate switched access, and by requiring CLECs not to exceed the switched access rates of the ILEC in the market served, the market forces will dictate the price, because intrastate and interstate switched access can be viewed as functional substitutes for each other.

Further, the two-tiered rate structure in Section 20:10:27:02.01 creates implicit and artificial subsidies in CLEC's switched access charges, the burden of which is imposed on IXCs. CLEC switched access rates are a monopoly service that the user—here, the IXC—has no choice but to incur. The environment is ripe for arbitrage schemes which undeniably are present in the South Dakota market. CLECs, which have the ability to be selective as to which geographic areas they wish to enter and those customers whom they serve, should recover any access revenue reductions from retail pricing. Any other methodology only encourages economically irrational behavior, particularly when CLEC rates are not based on the ILEC rates for the corresponding intrastate switched access market.

4. Section 20:10:27:02:02 Conflicts with the Commission's Obligations under SDCL§49-31-1.4.

The general authority for the establishment of intrastate switched access charges based on the number of inhabitants in a community is found in SDCL§49-31-1.4. In order to meet the statutorily required "fair and reasonable price" the PUC is required to "determine and consider" five factors:

1. The price of alternative services;
2. The overall market for the service;
3. The affordability of the price for the service and the market it is offered;
4. The impact of the price of the service on the commitment to preserve affordable universal service; and
5. The fully allocated cost of providing the service.

SDCL§49-31-1.4 *Switched Access Rates for U. S. West*, 618 N.W.2d 847, 851 (SD 2000). This five-part test establishes the guidance for the rule making authority given the Commission by the legislature and outlines the standards to be followed in its execution. See, *Black Hills Novelty Company, Inc., v. South Dakota Commission on Gaming,* 520 N.W.2d 70, 73 (SD 1994)(*Internal citations omitted*). There must be a rational basis upon which the Commission differentiates between the pricing of services provided in different communities. The rule making authority of the Commission does not exist in a vacuum and clearly must comport with the statutory imposed duties and guidance given it by the legislature. The Commission must have a rational basis for the different rates proposed other than trying to split the difference in the rate between the Qwest ILEC rate and the Rural LECA rate of 12.5 cents.[7] With no additional rationale or reasonable basis the proposed rate cannot be seen to comply with the fair and reasonable price requirement of SDCL§49-31-1.4.

The proposed rules will allow CLECs to violate overtly the discrimination prohibition found in SDCL§49-31-11. The use of the 85% threshold in determination of whether or not a competitive local exchange carrier's total lines are in communities of 10,000 or more inhabitants leads to serious concerns for price manipulation and violations of SDCL§49-31-18, which requires compensation between carries to be reasonable and without discrimination. An IXC in the same market may pay a different rate for a carrier that falls outside the 15% threshold even though another competitive carrier in the same market may not. So with no knowledge or choice, yet again, an IXC may be paying disparate switched access rates in the same market depending on a standard with no fair or reasonable basis other than an attempt to strike a compromise between the 6 cent and 12.5 cent rate.

Clearly there also lies an equal protection claim for consumers and IXCs in a rule that creates an arbitrary classification, CLECs with a percentage of lines in communities of a certain size, and that rule does not provide for a rational relationship or basis between the legitimate legislative purpose for the rule and

[7] The very reason these proposed rules exist is the rule making docket created in 2005 which was spawned out of the settlement reached which created the higher switched access rate. In a settlement reached in 2006 between numerous parties the $0.125 rate was established to close 41 open dockets in front of the commission and move the rate issue to RM05-002.

the classification created. See, *Kraft v. Meade County ex rel Board of County Commissioners,* 726 N.W.2d 237, 241 (SD 2006).

5. Turning Toward the National Momentum as a Model

The Federal Communications Commission ("FCC") has ordered significant reductions in interstate switched access charges for incumbent local exchange carriers ("ILECs"), and it has "capped" the access rates for CLECs at the rates of the ILECs with which they compete. More than 20 states have followed the FCC's lead at the state level, by requiring from one to all local exchange carriers ("LECs") to reduce their intrastate switched access rates to "parity" with their corresponding interstate rates.[8]

In its recent National Broadband Plan, the FCC recommend a framework for long term intercarrier compensation reform that first looks to "staged reform [to] move carrier's intrastate terminating switched access rates to interstate terminating switched access rate levels..."[9]

The Rules would continue to support artificially low residential rates, through the implicit subsidies inherent in the current switched access rate structure. Looking toward the future, and this Commission's stated interest in supporting broadband deployment throughout South Dakota, the Rules should work in harmony with the *FCC NBP* recommendation for "comprehensive reform

[8] The following states have implemented parity between intrastate and interstate rates from one to all LECs, either through legislation, commission rule or commission order: Alabama, Georgia, Illinois, Indiana, Iowa, Kansas, Maine, Massachusetts, Michigan, Mississippi, Nebraska, Nevada, New Jersey, New Mexico, Ohio, Oklahoma, Oregon, Tennessee, Texas, West Virginia, and Wisconsin.

[9] *FCC NBP* at 148 (citation omitted).

... to shift from primarily supporting voice communications to supporting a broadband platform that enables many applications, including voice."[10]

Years ago, the FCC took significant steps to eliminate implicit subsidies from interstate access rates, by reducing ILEC rates and "capping" CLEC rates at the level of the corresponding ILEC rates.[11] Many states have followed the FCC's lead, by ordering some or all ILECs to reduce their intrastate rates to "parity" with the corresponding interstate rates and/or by adopting the FCC's interstate caps on CLEC rates.

II. Conclusion.

There is no dispute as to the need for comprehensive access reform in South Dakota. Such need is not confined just to CLECs as is presently outlined in the Rules, but to all LECs operating within South Dakota. Failure to address the interconnected prongs of the intrastate switched access puzzle will only continue the weaknesses of the current mode.

Comprehensive reform is needed now. Rather than preserve the malfunctioning status quo of implicit subsidies which has led to artificial market conditions, the Commission should adopt a policy framework that will promote robust and irreversible competition, while at the same time preserve universal service throughout the state.

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[10] FCC NBP at 141. *In the Matter of Access Charge Reform, Reform of Access Charges Imposed by Competitive Local Exchange Carriers,* CC Docket No. 96-262, Seventh Report and Order and Further Notice of Proposed Rulemaking, 16 FCC Rcd 9923, ¶ 3 (2001) ("*CLEC Access Reform Order*").

[11] *FCC NBP* at 148-149. The FCC also discusses a phase-in period and ultimately eliminating per-minute charges altogether, but that is not a part of AT&T's proposal in this docket.

Dated this 31st day of January, 2011.

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CERTIFICATE OF SERVICE

On the 31st day of January, 2011, the undersigned, attorney for AT&T Communications of the Midwest, Inc., hereby certifies that a true and correct copy of the foregoing Comments of AT&T Communications of the Midwest, Inc., was filed electronically and served upon the following via email:

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