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

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

**VERIZON'S COMMENTS ON PROPOSED RULES REGARDING SWITCHED ACCESS RATES**

Verizon[1] hereby submits its comments on the Commission's proposed rules regarding rates for switched access service that were set forth in a Notice of Public Hearing to Adopt Rules, on November 24, 2010.

Verizon will address its concerns and objections to the proposed rules below, as well as respond to Commissioner Nelson's request made during the hearing on January 20, 2011, that the parties provide sufficient information to ensure a complete record, put the proposals in proper context and explain their position. Accordingly, Verizon will first review the issues, describe the problems that result from excessive access charges, and explain why the proposed rules will only be of marginal, if any, benefit. This is so because intrastate switched access rates in South Dakota are among the highest in the nation, yet the proposed rules would do nothing to address the significant problems that those excessive rates have caused.

## I. Introduction: Switched Access Charges

Switched access is a service provided by local exchange carriers ("LECs") to other carriers – usually interexchange, or toll, carriers – for originating or terminating

[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").

traditional, wireline interexchange or "toll" calls. Access charges generally apply to such calls that begin and end in different local calling areas. If the interexchange call originates in one state but terminates in another, switched access charges are billed at the interstate rate in the carrier's tariff filed with the Federal Communications Commission ("FCC"). If the interexchange call originates and terminates within a state, then it is billed at the intrastate access rate, which is under the state commission's jurisdiction. The switched access rates at issue in this proceeding are the rates that local exchange carriers charge interexchange (or long-distance) carriers ("IXCs") and other carriers to originate or terminate interexchange calls that begin and end in South Dakota.

Access charges were established in 1984 in connection with the divestiture of the Bell System and to facilitate increased competition in the long distance market. Before then, AT&T had a monopoly on long distance communications, and there was no "access" provided to other companies to the long distance network. Once interexchange competition began to take hold, interstate and intrastate access charges were established so that IXCs could compensate LECs for use of the LECs' local networks to originate and terminate long distance calls.

Throughout much of the $20^{th}$ Century, state and federal regulators created a regulatory pricing system in which business and toll rates (both intrastate and interstate) were set above the cost of providing these services to provide a contribution to basic residential rates, thereby promoting federal and state universal service objectives. As long distance competition developed, beginning in the 1970's and 1980's, long distance prices dropped, and thereby put pressure on a system that had relied on above-cost pricing of toll services. Because of universal service concerns, regulators sought to maintain in the new access charge regime the contribution flow from long distance to local service that previously had been provided through retail long distance charges. In other words, to maintain the rate structure that enabled basic exchange service rates to remain low when toll revenue was available to offset the costs of basic service, both interstate and intrastate access rates were purposefully set at artificially high levels to keep basic exchange service rates low.

The onset of local service competition in the 1990s prompted further shifts in regulatory policy. High access charges provided a mechanism for subsidizing local exchange service, but this distortion artificially slowed the emergence of local exchange competition. Beginning in 2000, the FCC issued a series of decisions in which it found that unreasonably high access charges impair competition for local and long distance services and negate the consumer benefits that competition is intended to bring.[2] Excessive access charges enabled LECs to recover a disproportionate share of their costs from other carriers, rather than from their end users, and this led to inefficient and irrational price structures. The FCC concluded that moving to a more economically efficient pricing structure would benefit consumers, promote competition and efficiency and provide economically correct entry incentives. To accomplish these goals, the FCC began reducing the implicit subsidies in access charges by lowering interstate switched access rates, and moving towards a system in which explicit universal service support

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[2] *Access Charge Reform*, CC Docket No. 96-261, Sixth Report and Order, 15 FCC Rcd 12962 (2000) ("*CALLS Order*"); *In the Matter of Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256, Second Report and Order, 16 FCC Rcd 19613 (2001) ("*MAG Order*"); *In the Matter of Access Charge Reform, Reform of Access Charges Imposed by Competitive Local Exchange Carriers*, Seventh Report & Order and Further Notice of Proposed Rulemaking, 16 FCC Rcd 9923 (2001) ("*CLEC Rate Cap Order*"); *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, 19 FCC Rcd. 9108 (2004).

was provided in the form of direct monetary payments to carriers, including increased end user charges through the federal Subscriber Line Charge.

In the *CALLS* and *MAG* decisions cited above, the FCC first required incumbent LECs ("ILECs") to substantially reduce their interstate access charges. After investigating the access rates of competitive local exchange carriers ("CLECs"), the FCC established a benchmark policy whereby CLECs' per minute interstate access charges are capped at the level of the interstate access rates charged by the ILEC in whose service territory the CLEC competes. CLEC access charges that do not exceed the benchmark are presumed to be just and reasonable.[3]

Since then, many states have followed the FCC's lead and instituted similar policies intended to lower excessive intrastate access rates charged by ILECs and CLECs. Generally speaking, in those states that have implemented access charge reform, carriers either have reduced their intrastate access rates to the level of their interstate rates, or they have been required to set their intrastate rates no higher than the rates charged by the largest ILEC in the state (which is typically the Regional Bell Operating Company).

## II. The Access Charge Regime in South Dakota.

In South Dakota, the Commission adopted a set of switched access filing and pricing rules[4] in 1993, several years before passage of the federal Telecommunications Act of 1996, which ushered in a new era of competition and technological innovation. The rules were written during and for a different era characterized by monopoly entities serving exclusive franchise service territories, when regulation was based on traditional

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[3] *CLEC Rate Cap Order* at ¶ 40. The FCC allows CLECs to charge rates higher than those of the ILEC only through negotiated arrangements – not through a tariff. The FCC reasoned that if a CLEC provides a superior quality of access service, or if it has a particularly desirable subscriber base, an interexchange carrier may be willing to contract to pay access rates above the benchmark. *Id.* at ¶ 43.

[4] ARSD 20:10:27 through 20:10:29.

cost-of-service principles. Since 1993, telecommunications markets have experienced real transformative changes. Competition is now thriving with numerous CLECs and in various intermodal forms, including wireless, Voice over Internet Protocol (VoIP) and cable. Incumbents that once provided only voice services now provide a variety of other services, such as broadband, alarm and video.

These dramatic changes have led the FCC and other state regulators to move away from traditional cost-of-service regulatory tools and accounting rules. They have relied instead on more efficient, streamlined and alternative methods of regulation. For example, the FCC has made much use of benchmarks rather than prescriptive rules for determining just and reasonable rates for ILECs and CLECs alike. Given the stunning changes in telecommunications markets in the intervening 18 years, the rules in South Dakota have little relevance today. They are outdated, unduly complicated and unnecessary in today's market.[5] Accordingly, the rules need to be changed to conform to changes in national access charge policy and the marketplace.

More than five years ago, the Commission opened a docket, RM05-002, to consider revisions to its switched access pricing rules. The comments of Midcontinent Communications (filed January 28, 2011) detail the lengthy and tortured history of that and related dockets, so there is no need to restate that chronology here. What is notable about that history is the lack of any meaningful progress at tackling the serious issues that have been raised. Several parties have cooperated to develop a substantial factual record that should provide the basis for meaningful reforms but, after five years, the Commission is only poised to take a minor, insignificant step that will not achieve any

[5] South Dakota's access charge rules rely on federal separation rules, but those have been frozen for many years, based on the FCC's determination that the former rules "are out of step with today's rapidly-evolving telecommunications marketplace." FCC 01-062, released May 22, 2001.

real reform. While the Commission initially set out to undertake a comprehensive examination of the switched access charge rules that govern *all* local exchange carriers in the state, mid-way through the process it abandoned any consideration of ILEC access rates,[6] and now is only proposing to impose modest limits on the rates that CLECs may charge. As a result, the proposed rules under consideration will do nothing to address the significant problems that have resulted from the unreasonably high access rates that have been allowed to persist in South Dakota.

## III. Excessive Access Rates Harm Competition and Consumers.

The current ratemaking methodology in ARSD 20:10:27 through 20:10:29 results in ILEC intrastate switched access rates that are excessive by any measure. Independent LECs in South Dakota charge rates higher than those of their counterparts in any other state in the 14-state Qwest region. The rates charged by members of the Local Exchange Carriers Association ("LECA") have increased by up to 60% over the past decade. For the past several years, these ILECs have been charging $0.125 per minute for originating access and $0.125 per minute for terminating access.[7] As a result, if an interexchange call originates in one ILEC's local service area and terminates in another ILEC's local territory, the cost to the interexchange carrier for originating and terminating the call is 25 cents per minute. The LECA rate is *more than double* Qwest's comparable usage-

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[6] In an unrelated proceeding that involved the petition of a single carrier, and without providing notice to the parties in this docket, the Commission declared that "Docket RM05-002 shall be redirected from a general switched access rulemaking docket to a rulemaking docket focused more specifically on a CLEC switched access rate-setting policy." *In the Matter of the Petition of Midcontinent Communications for Approval of Switched Access Rates*, Order Denying Requests for Exemption and Waiver, Requiring the Filing of a Rate Tariff and Redirecting Docket RM05-002 to Focus on CLEC Switched Access Rate Issues, Docket TC07-117, issued January 14, 2009. That ruling was procedurally improper and violated the parties' legitimate rights in having the docket proceed and having all of the relevant issues fully addressed.

[7] Facts about high ILEC access rates have been in the record before the Commission since at least 2007. *See, e.g.*, Verizon's Proposed Revisions to the Commission's Switched Access Rules, Docket No. RM05-002, filed September 20, 2007, at 3. That pleading is incorporated herein by reference as if fully set forth.

based switched access rate of approximately $0.056 per minute.[8] And even Qwest's rate here is *three to four times higher* than the rate it charges for intrastate switched access in several other states. Given these facts, there is no dispute that switched access rates in South Dakota are among the highest in the nation.

A few CLECs charge intrastate access rates that are at or below the rates charged by Qwest, but many do not. Some CLECs charge Verizon as much as six to thirteen cents per minute for switched access.[9] Rates at these levels are excessive -- among the very highest in the country - and impede fair competition. These rates are also much more than these same CLECs charge for interstate switched access in South Dakota (which are capped by the FCC), even though the charges cover the same functions.

Unfortunately, the market for switched access in South Dakota is not sufficiently competitive, and market forces are not adequate to constrain the level of switched access rates that LECs in South Dakota have been able to charge.[10] Because of the nature of switched access services, toll carriers that purchase switched access services are not able to switch suppliers. Long distance carriers have no choice but to use a LEC's switched access service when they handle interexchange calls originating from the LEC's customers and when they deliver interexchange calls for termination to the LEC's customers. As a result, the Massachusetts Department of Telecommunications and Cable concluded that "because a carrier's customers do not have competitive alternatives for terminating their calls," the market for terminating switched access "is not sufficiently

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[8] *See* OrbitCom v. MCI, TC 08-135, Hearing Exhibit 2, at Exhibits MP 2-03 and MP 2-04.0.

[9] *See* Direct Testimony of Don Price on Behalf of Verizon, Docket TC 10-014, April 1, 2010 ("*Price Testimony*") at 3. Mr. Price's testimony is incorporated in these comments by reference as if fully set forth.

[10] *Id.* at 14-16.

competitive," and IXCs are "unable to constrain the level of terminating access charges."[11]

The record in this and related proceedings contain ample evidence of the harms these excessive rates cause to competition and consumers. To recover high access costs, an IXC must charge high toll rates, which dampens consumer demand for and usage of long distance services in rural areas. A further complicating factor is that IXCs are required to charge uniform prices on all routes where they offer interexchange services in South Dakota.[12] Thus, if an IXC wants to establish lower toll rates so that it may effectively compete in Qwest's local service area, it is unable to recover the excessive access charges it is forced to pay when it originates or terminates interexchange calls to consumers served by independent LECs. One result of this disparity in access rates between Qwest and other ILEC service areas is that intrastate toll rates paid by consumers in Qwest's territory are much higher than they otherwise would be. Alternatively, to avoid paying high originating access rates, an IXC may choose not to serve customers in more expensive parts of the state, but this deprives consumers of a competitive choice and of service options that citizens in other states enjoy. Extraordinarily high access rates create no incentives for IXCs to invest in their network infrastructure or to develop and promote innovative services in South Dakota.

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[11] *Petition of Verizon New England Inc. et al. for Investigation Under Chapter 159, Section 14, of the Intrastate Access Rates of Competitive Local Exchange Carriers*, Final Order, Massachusetts D.T.C. 07-9 (June 22, 2009) at 10-11. The FCC has made similar findings. *See CLEC Rate Cap Order* at ¶ 30

[12] SDCL 49-31-4.2 ("Uniform prices for intrastate interexchange telecommunications services--Volume discounts—Taxes") provides in part that "[a] telecommunications company providing intrastate interexchange telecommunications services shall charge uniform prices on all routes where it offers the services."

Permitting LECs to collect unreasonably high access rates provides those companies with a competitive advantage because they are able to recover disproportionately more of their costs from other carriers rather than from their own end users. The FCC has found that this situation undermines economically efficient competition and the consumer benefits that competition is intended to bring.[13] This is because purchasers of switched access services are forced to help fund the retail service offerings of their direct competitors in the same service areas. This cost-shifting also distorts competition in interexchange and other communications markets by imposing costs that must be passed on to IXC customers. Conversely, the FCC found that eliminating LECs' ability to engage in such conduct and requiring them to recover their costs from their own end users sends the appropriate pricing signals:

> When a LEC attempts to recover additional amounts from its own end user, that customer receives correct price signals and can decide whether he should find an alternative provider for access (and likely local exchange) service. This approach brings market discipline and accurate price signals to bear on the end user's choice of access providers.[14]

In South Dakota, it is apparent that many ILECs rely to a substantial extent on high access rates to fund their local service operations, rather than seek recovery of their costs from their own end users. This is evident from the fact that the residential local service rates charged by many ILECs are significantly below the national average, which was $15.62 per month, as of 2007, according to the FCC. Indeed, the record indicates that some ILECs and rural telephone cooperatives in South Dakota charge rates as low as $7.00 to $8.00 per month for residential service.[15] In about 40 other exchange areas in

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[13] *See generally CALLS Order, MAG Order*, and *CLEC Rate Cap Order, supra.*

[14] *CLEC Rate Cap Order* at ¶ 39.

[15] Price Testimony at 32-33.

the state, local residential service rates range between $9.00 and $14.20 per month. As the FCC has pointed out, when LECs receive a disproportionate amount of their funding from other carriers instead of from their own end users, their customers do not receive accurate price signals, and this creates a distortion of the market. At the same time, artificially low retail rates inhibit potential competitive entry by other firms.[16]

Finally, high switched access rates create opportunities for arbitrage,[17] as well as incentives for local exchange carriers to engage in access stimulation or "traffic pumping" schemes. Under such arrangements, local exchange carriers enter into kickback arrangements with providers of "free" conference calling, international calling, chat line and other services to artificially inflate call volumes. These companies market their services to consumers who then dial interexchange numbers to reach the "free" service. When switched access rates are extraordinarily high, as they are in South Dakota, the huge spikes in traffic volumes generated by these scams produce a substantial increase in the LEC's switched access revenues. The windfall profits are then shared between the chat line operator and the LEC that provides phone service to the company offering the "free" chat line service.

These schemes benefit both parties even when the telephone service provider pays a majority of its intrastate switched access revenue to the chat line operator. The LEC is willing to "share" a significant portion of its revenues with a third party only because the

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[16] Mr. Price also explained that because ILECs have other significant sources of funding available to them, it is not necessary for the carriers to depend so heavily on high access charges and the access revenues they receive from IXCs to subsidize their operations. He testified that in each of the years 2006 through 2008, South Dakota ILECs received more than $35 million from federal high cost programs to help ensure the affordability of local rates, and they were expected to receive the same amount in 2009. On a cumulative basis, these ILECs received nearly $175 *million* dollars from federal high cost programs over five years to support local intrastate service in South Dakota. *Id.* at 33-35.

[17] *See CLEC Rate Cap Order* at ¶ 34.

arrangement produces supra-competitive profits. The higher the access rates charged, the greater the incentive there is for unscrupulous firms to engage in such practices. Because interexchange carriers are obligated to deliver traffic to the numbers assigned by the traffic-pumping LEC, and then get billed enormous amounts for the inflated traffic volumes, these schemes harm IXCs and, ultimately, their customers.

The FCC and state regulators in Iowa have declared certain traffic-pumping schemes to be illegal.[18] However, just as in the arcade game "Whack-a-Mole," unscrupulous chat line firms continue to seek out other local exchange companies -- especially those with high access rates – with which they may partner in similar arrangements. Because of the extraordinarily high access rates being charged by many LECs in South Dakota, a number of these firms have found a "home" for their traffic-pumping activities here. The problem has become so acute, and the regulatory response so lax, that the state legislature is now addressing the issue. In particular, eight state Senators and 11 Representatives recently introduced legislation, Senate Bill 87, whose purpose is to prohibit traffic-pumping practices in South Dakota.

While legislation is a strong step in the right direction, the best way to remove the incentive and opportunity to engage in these types of anti-consumer practices is to reduce switched access rates to reasonable levels. In addition to removing the harm to competition, sending a strong message that South Dakota is not a safe haven for the traffic pumping industry will also protect South Dakota's business climate and reputation.

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[18] *In the Matter of Qwest Communications Corporation v. Farmers and Merchants Mutual Telephone Company*, FCC File No. EB-07-MD-001, Second Order on Reconsideration (Nov. 25, 2009); *In Re: Qwest Communications Corp. v. Superior Telephone Cooperative, et al.*, Iowa Utilities Board Docket No. FCU-07-2 (Sept. 21, 2009).

## IV. The Proposed Rules Do Not Address the Fundamental Problems with Excessive Access Charges in South Dakota

The record developed over the past few years provides compelling reasons why comprehensive and meaningful reform of the access charge regime in South Dakota is necessary and long overdue. Regrettably, the proposed rules ignore the most serious problems that have been identified and contemplate making only token changes. The serious problems associated with excessive access rates apply across the board to all local exchange carriers in South Dakota. However, the proposed rules focus solely on the rates that *CLECs* may charge, even though the ILECs, not the CLECs, are by far the major cause of market distortions caused by excessive access rates in South Dakota. Avoiding excessive ILEC access rates is to ignore "the elephant in the room."

The importance of moving forward on access charge reform is even more pressing given the FCC's issuance of its *National Broadband Plan.* That blueprint for action identifies reform of the intercarrier compensation system – including reducing carriers' intrastate switched access rates – as a critical, but as-yet unmet, goal.[19] The *NBP* recommends adoption of a framework for long-term intercarrier compensation reform that will *eliminate* per-minute access charges in ten years.[20] The first phase of this process, to be accomplished in two to four years, is to "move carriers' intrastate terminating switched access rates to interstate terminating switched access rate levels in equal increments."[21] Of particular relevance here, the *NBP* also "encourag[es] states to

[19] *See* Federal Communications Commission, "Connecting America: The National Broadband Plan" ("NBP"), (March 16, 2010) at 148 (copy available on-line at http://www.broadband.gov/download-plan/).

[20] *See NBP* at 148 (Recommendation 8.7).

[21] *Id.*

complete rebalancing of local rates to offset the impact of lost access revenues."[22]

Verizon supported the Commission's ruling in Docket TC10-014 (issued May 4, 2010) that pricing regulation is appropriate for switched access services provided by CLECs. In that case, several parties expressed substantial support for imposing a cap on CLECs' intrastate switched access rates. The proposals most commonly discussed in the parties' testimony were to establish a specific benchmark and prohibit any CLEC from charging more than the access rates charged by the incumbent local exchange carrier, either Qwest or another ILEC, against which the CLEC competes.[23] Rather than codify this general policy, the Commission's proposed rules would implement pricing regulation by setting forth actual rates in the Commission's rules. Specifically, the Commission proposes to establish a new rule, ARSD 20:10:27:02:01, as follows:

> **20:10:27:02.01. Determination of intrastate switched access charges for competitive local exchange carriers.** 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.

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[22] *Id.*

[23] Verizon has proposed specific language to implement a price cap for CLEC access rates. *See* Verizon's Comments on Draft Rules Regarding Switched Access Rates, Docket No. RM05-002, filed June 15, 2010, at 3-4. Its recommendation is restated below. Those comments, along with Verizon's Reply Comments on the Draft Rules, filed June 28, 2010, are incorporated herein by reference as if fully set forth.

Because the Commission's one-page Notice of Public Hearing did not contain any commentary explaining the rationale for the proposed rule and the language and concepts contained therein, it is difficult to comprehend the basis for the particular proposal. Basic principles of administrative law, however, require an agency to set forth the factual basis and rationale for the rules it promulgates. The Commission must provide a satisfactory explanation for its action, the decision must be based on a fair evaluation of the relevant evidence and the parties' positions, and the rules must be supported by evidence in the record. Even in the absence of any such explanation to date, it is clear that the proposed rule is flawed in material respects. Accordingly, Verizon opposes it as presented.

First, the proposed rule specifies the actual rates (either 6.042 or 9 cents per minute) that CLECs could not exceed. These rates are exorbitant from any perspective (*e.g.*, nationally or compared to RBOC rates generally), and thus cannot rationally be adopted as a measure of "just and reasonable" rates. Indeed, no other commission has ever proposed to "cap" access rates at such shockingly high levels. Setting a rate cap at these levels (6 and 9 cents per minute) would afford interexchange carriers virtually no relief. Accordingly, adopting no rule at all would be preferable to enshrining these unreasonable and exorbitant rates in the Commission's rules.

Because rates may change over time, it would be a serious mistake to lock in stone specific rates in the Commission's administrative rules, even if they were reasonable when the rule was adopted – which the proposed cap surely is not. Such a rule could quickly become outmoded. If, for example, the objective of the 6.042 cent rate is to ensure some degree of competitive equity with Qwest (which the proposed rule does not accomplish), that principle would be violated as soon as Qwest lowers its access rates in South Dakota. To achieve competitive balance, the Commission would have to conduct a new rulemaking each time an ILEC modifies its access rates, to recalibrate the mandatory rate ceiling and issue new rules before any CLEC would be required to lower its rates so that it did not exceed the ILEC's new rate. As the five year history of this proceeding suggests, that could likely be a lengthy process. This approach clearly would be administratively inefficient and extremely wasteful of the Commission's and industry's resources.

This unorthodox manner of capping CLEC rates would also be unprecedented. While many state commissions and legislatures have imposed constraints on CLEC access rates, in no instance have they specified an actual rate in the rules, let alone rates that are far higher than most in the U.S. Establishing a general standard (*e.g.*, prohibiting a CLEC from charging access rates higher than those of the ILEC against which the CLEC competes) allows for continuing compliance with the regulation even as ILECs revise their rates over time. CLECs only have to modify their rates to be in conformance with the general requirement that their rates not exceed those of the ILEC. Establishing a clear benchmark is thus simpler and more administratively efficient, and is the approach taken by the FCC and many other states. But again, while the approach of benchmarking to the competing ILEC is administratively the right one, the fundamental problem of excessive ILEC rates in South Dakota must be addressed at the same time to result in any meaningful relief.

To avoid the administrative problem, Verizon recommends that the Commission adopt the following language instead:

**20:10:27:02.01. Determination of intrastate switched access charges for competitive local exchange carriers.** 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. The switched access rate shall be the same in each of the competitive local exchange carrier's service areas.

A second problem with the Commission's proposed rule is that there is no factual basis for the two rates specified. The "9 cents per minute" rate in particular bears no rational relationship to existing ILEC or CLEC intrastate rates in South Dakota – or to any rate that is reasonable from any perspective. It is at least 50% higher than Qwest's rate and *lower* than the rate charged by most other LECs in the state. Absent any cogent explanation, the proposed 9 cent rate appears to be purely arbitrary and is, in any event, ridiculously high. In contrast, using the benchmarking approach recommended by Verizon will avoid the problem of using an arbitrary standard.[24]

The third major problem is that the Commission has provided no explanation and there is no apparent rationale for authorizing a CLEC to charge different access rates based on the percentage of access lines that they have in communities with less than 10,000 inhabitants. The proposed rule distinguishes between "communities" with more or less than "10,000 inhabitants," but does not define what a "community" is. Is a "community" a city, a county, an exchange, a provider's service area, or some other geographic area? Absent any definition, the rule is vague and subject to many interpretations. In addition, the Commission has not explained the basis for the proposed dividing line (*i.e.*, a

[24] When commenting on the Staff's earlier draft rule (which has not been changed), AT&T also observed that the two proposed rate caps (six and nine cents) "would maintain a very substantial implicit subsidy that is wholly inappropriate for switched access."

CLEC may charge the higher rate if "85 percent or more" of its access lines are in communities with fewer than 10,000 inhabitants) or explain why CLECs in certain areas should be able to charge nearly 50% more than CLECs that operate in other "communities."

In fact, there is no rational basis for creating an artificial distinction between CLECs depending on where they operate. As newer market entrants, CLECs have the opportunity to construct and expand their networks using modern, efficient and generally less expensive equipment. Because they can decline to serve a particular area, a particular type of customer, or to provide a particular type of service, they can limit their network costs by focusing on, and investing in, only the networks they choose to build. In other words, they are generally free to make decisions based solely on their assessment of business and economic factors, and the requirements of the customers they choose to serve. Moreover, they are not saddled with legacy regulations and constraints imposed on other carriers. Accordingly, there is no justification for carving out two classes of CLECs for ratemaking purposes.

In sum, aside from proposing to set an astonishingly high benchmark, the proposed rule is vague and ambiguous. It includes criteria (the percentage of access lines and number of inhabitants) for which there is no support in the record, and are therefore purely arbitrary. In addition, those standards are unnecessary if the Commission establishes a straightforward benchmark – and requires a CLEC to use as a ceiling the intrastate access rate of the ILEC that provides service in the same area. Accordingly, the Commission should eliminate superfluous language relating to percentages of access lines and population sizes in the final rule. For the same reasons, the second paragraph of the proposed rule is unnecessary and should be deleted. If a CLEC operates in smaller communities that are served by a rural ILEC, the CLEC would be able to charge up to the rural ILEC's access rate under the single paragraph of ARSD 20:10:27:02.01 proposed by Verizon. Because the second paragraph does not add anything of substance, it can simply be deleted, and thereby avoid needless confusion.

All CLECs are already complying with a federal rate cap under which they currently charge much lower rates for interstate switched access. Accordingly, they would not be disadvantaged or precluded from recovering their costs if they are prevented from charging a higher amount for intrastate switched access than the ILEC against which they compete, which in most cases will be Qwest.

## V. What Should the Commission Do?

Verizon recommends that the Commission adopt the revised rule set forth above and cap all CLECs' intrastate switched access rates at the level of the ILEC in whose service area the CLEC operates. There is no principled justification for CLECs to continue to charge intrastate switched access rates higher than the incumbent carriers against which they compete. Establishing a reasonable benchmark applicable to all CLECs would be a simple and effective means of quickly moving their rates to levels that are more efficient, fair and reasonable. Such a benchmark will promote equity and competitive parity and reduce market distortions by prompting CLECs with the highest access rates to recover more of their network costs from their own customers, rather than from other carriers and those carriers' customers through access rates. Failure to establish such a benchmark would allow CLECs to continue to shift an excessive portion of their costs to switched access purchasers (and their retail customers), and thereby place a disproportionate burden on other carriers in the state -- and ultimately, their customers -- to subsidize those CLECs' operations.

More than half of the states impose some form of constraint on CLEC access rates; most have found benchmarking approaches like the FCC's to be a simple and effective means of reducing intrastate access prices to reasonable levels.[25] Indeed, every

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[25] *See, e.g.*, *Order Instituting Rulemaking to Review Policies Concerning Intrastate Carrier Access Charges*, **California** D. 07-12-020 in Rulemaking 03-08-018, Final Opinion Modifying Intrastate Access Charges ( Dec. 6, 2007) (capping CLEC rates at no higher than Verizon's or SBC's rate, plus 10%); *DPUC Investigation of Intrastate Carrier Access Charges*, Decision, **Connecticut** D.P.U. Docket No. 02-05-17 (2004), 2004 Conn. PUC Lexis 15, at *45 (capping CLEC rates at SBC's then-current rate); **Delaware** Code, Title 26, § 707(e) (capping all service providers' switched access rates at the level of the largest ILEC in the state); **Indiana** Code § 8-1-2.6-1.5 (a carrier's switched access rates are just and reasonable if they mirror its interstate switched access rates); 199 **Iowa** Admin. Code 22.14(2)(d)(1)(2) (prohibiting CLECs from charging a carrier common line charge if it would render the CLEC's rate higher than the competing ILEC's rate); **Louisiana** PSC General Order No. U-17949-TT, App.B, Section 301 (k)(4) (May 3, 1996) (CLECs must charge non-discriminatory switched access rates that do not exceed the competing ILEC's rates); Code of **Maryland** Regulations § 20.45.09.03(b) (capping all LECs' switched access rates at the level of the largest LEC in Maryland); *Petition of Verizon New England Inc. et al. for Investigation Under Chapter 159, Section 14, of the Intrastate Access Rates of Competitive Local Exchange Carriers*, Final Order, **Massachusetts** D.T.C. 07-9 (June 22, 2009) (capping CLEC switched access rates at Verizon's level); *Access Rates to Be Charged by Competitive Local Exchange Telecommunications Companies in the State of Missouri*, Report and Order, **Missouri** P.S.C. Case No. TO-99-596, 2000 Mo. PSC Lexis 996, at *28-31 (June 1, 2001) (capping CLEC access rates at the competing ILEC's level); *In the Matter of the Commission, on Its Own Motion, Seeking to Conduct an Investigation into Intrastate Access Charge Reform and Intrastate Universal Service Fund*, **Nebraska** Pub. Serv. Comm'n Application No. C-1628/NUSF, Progression Order #15, at ¶ 9 (Feb. 21, 2001) ("absent a demonstration of costs, a CLEC's access charges, in aggregate, must be reasonable comparable to the ILEC with whom they compete"); **New Hampshire** PUC § 431.07 (CLECs cannot charge higher rates for access than the ILEC does); *In the Matter of the Board's Investigation and Review of the Local Exchange Carrier Intrastate Exchange Access Rates*, Telecommunications Order, **New Jersey** Board of Public Utilities Docket No. TX08090830 (February 1, 2010) at 29-30 (ordering ILECs to mirror their own interstate access rates and CLECs to mirror the competing ILEC's intrastate access rates); **New York** P.U.C. Case 94-C-0095, Order, at 16-17 (Sept. 27, 1995), N.Y. P.U.C. Opinion 96-13, at 26-27 ( May 22, 1996), and N.Y. P.S.C. Opinion 98-10, 1998 N.Y. PUC Lexis 325, at 26-27 (June 2, 1998) (benchmarking CLEC access charges to the level of the largest carrier in the LATA); *Establishment of Carrier-to-Carrier Rules*, Entry on Rehearing, **Ohio** P.U.C. Case No. 06-1344-TP-ORD, at 16-18 (Oct. 17, 2007) (capping CLECs' switched access rates at the level of the competing ILEC); *Investigation into the Modification of Intrastate Switched Access Charges*, Opinion and Order, Case No. 00-127-TP-COI (requiring four ILECs' intrastate switched access rates to mirror their interstate access rates); 66 **Pennsylvania** Consolidated Statutes § 3017 (c) (prohibiting CLEC access rates higher than those charged by the incumbent in the same service territory, absent cost justification); **Texas** P.U.C. Subst. Rule § 26.223 (a CLEC may not charge a higher rate for intrastate switched access than the ILEC in the area served or the statewide average composite rates published by the Texas P.U.C. and updated at least every two years); *Amendment of Rules Governing the Certification and Regulation of CLECs*, Final Order, **Virginia** State Corp. Comm. Case No. PUC-2007-00033 (Sept. 28, 2007) (a CLEC's switched access rate cannot exceed the higher of its interstate rate or the rate of the competing ILEC); **Washington** Admin. Code § 480-120-540 (requires CLECs' and ILECs' terminating access rates to be no higher than their local interconnection rate, or depending on their regulatory status, incremental cost); *Petition by Verizon West Virginia Inc. Requesting that Commission Initiate a General*

state commission that has formally considered capping CLEC access prices has concluded that such a benchmarking approach is good policy. There are no unique conditions with respect to CLEC switched access services in South Dakota that would justify a different conclusion.

CLECs are already well acquainted with the concept of a benchmark rate, given that they must currently comply with the FCC's rule for *inter*state switched access rates. The rate cap mechanism that Verizon proposes for CLECs' *intra*state rates in South Dakota would be calculated in this same, familiar way.

The Commission should make clear in establishing the benchmark Verizon recommends that a CLEC can only charge for the functions that the CLEC actually performs in providing switched access service. For example, if a CLEC does not perform tandem switching functions, it should not be allowed to include a charge for a tandem switching service that it does not provide. The Commission's rules appear already to embrace this principle,[26] but it should be reinforced as the Commission implements price regulation for CLECs. This approach would allow each CLEC to maintain its own intrastate switched access rate structure and rate elements, while preventing it from receiving compensation for intrastate switched access functions it does not perform.

Finally, as explained above, all of the problems and concerns caused by high access charges apply to switched access services provided by *all* LECs in South Dakota, including independent LECs. If an ILEC charges excessive access rates -- and many

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*Investigation of the Intrastate Switched Access Charges of Competitive Local Exchange Carriers Operating in WV*, **West Virginia** Public Service Commission Order, Case No. 08-0656-T-PC (Nov. 23, 2009) (capping CLEC switched access rates at the competing ILEC's level).

[26] For example, Section 20:10:29:16.03 of the Commission's Administrative Rules provides that a "tandem-switched transport transmission charge" may be "assessed on all interexchange carriers and other persons *that use* the [local exchange] carrier's tandem-switched transport facilities." (Emphasis added).

plainly do -- it creates the same economic inefficiencies, market distortions and competitive harms that are experienced with CLEC access rates. Accordingly, Verizon recommends that the Commission promptly initiate a further rulemaking to complete the task of implementing comprehensive and meaningful access charge reform for all LECs in the state.

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 fair, just and reasonable) underscores the importance of pursuing meaningful, substantive reform now. The existing rules are cumbersome and antiquated, and should be replaced with the same kind of simple benchmark already used at the federal level.

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Respectfully submitted,

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