

CONFIDENTIAL TESTIMONY

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF SOUTH DAKOTA

IN THE MATTER OF THE PETITION
OF SANTEL COMMUNICATIONS
COOPERATIVE, FOR ARBITRATION
PURSUANT TO THE
TELECOMMUNICATIONS ACT OF
1996 TO RESOLVE ISSUES RELATING
TO AN INTERCONNECTION
AGREEMENT WITH ALLTEL
COMMUNICATIONS, INC.

Docket No.

TC07-115

**DIRECT TESTIMONY OF TIM EKLUND
ON BEHALF OF SANTEL COMMUNICATIONS COOPERATIVE**

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I. Introduction

A. Witness Background

Q. Please state your name, employer, and business address.

A. My name is Tim Eklund. I am employed with Consortia Consulting
("Consortia"). My business address is 9300 Underwood Avenue, Suite 310,
Embassy Tower, Omaha, Nebraska, 68114.

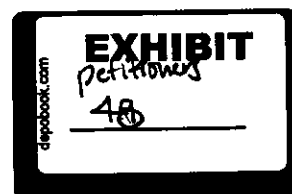
Q. On whose behalf are you testifying?

A. I am testifying on behalf of Santel Communications Cooperative, ("Santel").
Santel provides local telephone exchange service and exchange access services
predominantly in the more rural parts of South Dakota.

Q. What is your current position?

A. I am the Director of Settlements and Financial Analysis at Consortia.

Q. What are your duties and responsibilities at Consortia?



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A. I am responsible for consulting with clients regarding regulatory, financial and interconnection issues. I am also responsible for the development of economic models to facilitate competitive studies and exchange/business valuations. In addition, I manage Consortia’s cost separations team which prepares interstate and state jurisdictional cost studies.

Q. What was your professional experience prior to your current position?

A. I have worked in the telecommunications industry for 25 years. Prior to my position with Consortia, I worked for Alltel (formerly known as Aliant Communications and Lincoln Telephone prior to merging with Alltel) in various accounting and finance capacities for both wireline and wireless properties.

Q. What is your educational background?

A. I have a Bachelor’s Degree with an emphasis in accounting from Nebraska Wesleyan University.

B. Issues Addressed in Testimony

Q. Please describe the issues raised in this proceeding for which you will be providing testimony.

A. The areas for which I will be providing testimony fall under the first issue identified in the Petitions for Arbitration (the “Petition”) identified as “Is the reciprocal compensation rate for IntraMTA Traffic proposed by each South Dakota Rural Telephone Company appropriate pursuant to the pricing standards of 47 U.S.C. §252(d)(2)?” I will also testify that in addition to complying with 47 U.S.C. §252(d)(2), Santel’s reciprocal compensation rates comply with 47 C.F.R. § 51.505 and 47 C.F.R § 51.511 which are the Federal Communications

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1 Commission's ("FCC") attendant rules to 47 U.S.C. §252(d)(2), specifying the
2 basis on which incumbent local exchange carriers ("ILECs"), such as Santel, shall
3 establish rates for transport and termination of telecommunications traffic. In
4 addition, I will provide testimony regarding Issue 1 in Alltel's Response to the
5 Petition for Arbitration.

6 **II. The Reciprocal Compensation Rate for IntraMTA Traffic Proposed by**
7 **Santel is Appropriate Pursuant to the Pricing Standards of 47 U.S.C.**
8 **§252(d)(2).**
9

10 **Q. Are the proposed transport and termination rates for Santel that are**
11 **described in your testimony compliant with the requirements of 47 U.S.C. §**
12 **252(d)(2)?**
13

14 A. Yes. The transport and termination rates established for Santel that I am
15 presenting are based on forward-looking economic costs and are consistent with
16 applicable federal laws and FCC regulations.

17 **Q. Santel is proposing a rate for transport and termination. What are the**
18 **FCC's definitions of the terms "Transport", "Termination" and "Reciprocal**
19 **Compensation"?**
20

21 A. The FCC's definition of the terms "Transport" and "Termination" are found in 47
22 C.F.R. § 51.701. Such terms are defined as follows:

23 Transport. For the purposes of this subpart, transport is the transmission
24 and any necessary tandem switching of telecommunications traffic subject
25 to section 251(b)(5) of the Act from the interconnection point between the
26 two carriers to the terminating carrier's end office switch that directly
27 serves the called party, or equivalent facility provided by a carrier other
28 than an incumbent LEC.
29

30 Termination. For purposes of this subpart, termination is the switching of
31 telecommunications traffic at the terminating carrier's end office switch,
32 or equivalent facility, and delivery of such traffic to the called party's
33 premises.
34

35 Reciprocal compensation. For purposes of this subpart, a reciprocal
36 compensation arrangement between two carriers is one in which each of

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1 the two carriers receives compensation from the other for the transport and
2 termination on each carrier's network.
3

4 **Q. Please identify the section of the FCC's rules that establishes how an ILEC's**
5 **rates for transport and termination are to be determined?**
6

7 A. 47 C.F.R. § 51.705(a)(1) establishes that such rates are to be determined based on
8 the forward-looking economic costs of such offerings, using a cost study pursuant
9 to 47 C.F.R. §51.505 and §51.511.

10 **Q Has Santel established a rate for transport and termination consistent with**
11 **47 C.F.R. §51.705(a)(1)?**
12

13 A. Yes. Santel determined its rates for transport and termination on the basis of 47
14 C.F.R. §51.705(a)(1) in accordance with a forward-looking economic cost study
15 prepared pursuant to 47 C.F.R. §51.505 and §51.511. I will discuss in detail later
16 in my testimony the results of this cost study.

17 **Q. The pricing standards for transport and termination are set forth in Section**
18 **252(d)(2) of the Act. Please explain when Section 252(d)(2) is applied and**
19 **what sections of the FCC's rules implemented Section 252(d)(2) of the Act?**
20

21 A. Section 252 of the Act is entitled "Procedures for Negotiations, Arbitration, and
22 Approval of Agreements." Section 252 of the Act established the procedure for
23 agreements arrived at through voluntary negotiations, as well as the procedures
24 for agreements arrived at through arbitration. Section 252(c) establishes the
25 standards for arbitration, and Section 252(d) includes the pricing standards that a
26 state commission must consider in determining whether the charges for transport
27 and termination are just and reasonable. 47 C.F.R. §§ 51.505 and 51.511 are the
28 FCC's rules that implement the pricing standards set forth in the Act for transport
29 and termination.

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1 **Q. When an incumbent uses a forward-looking economic cost study to**
2 **determine its rates for transport and termination, which FCC rules are**
3 **required to be followed?**
4

5 A. Rules 47 C.F.R. §§ 51.505 and 51.511 are referenced in 47 C.F.R. § 51.705,
6 entitled “Incumbent LECs’ rates for transport and termination.” According to
7 51.705(a)(1), an ILEC’s forward-looking economic cost for transport and
8 termination shall be developed using a cost study pursuant to §§ 51.505 and
9 51.511.

10 § 51.505 describes the standard to be used to develop forward-looking economic
11 cost. The text of § 51.505 is shown below.

12 **§ 51.505 Forward-looking economic cost (“FLEC”).**
13

14 (a) *In general.* The forward-looking economic cost of an element equals the
15 sum of:
16

- 17 (1) the total element long-run incremental cost of an element, as
18 described in paragraph (b); and
19 (2) a reasonable allocation of forward-looking common costs, as
20 described in paragraph (c).
21

22 (b) *Total element long-run incremental cost.* The total element long-run
23 incremental cost of an element is the forward-looking cost over the long
24 run of the total quantity of the facilities and functions that are directly
25 attributable to, or reasonably identifiable as incremental to, such element,
26 calculated taking as a given the incumbent LEC’s provision of other
27 elements.
28

- 29 (1) Efficient network configuration. The total element long-run
30 incremental cost of an element should be measured based on the
31 use of the most efficient telecommunications technology currently
32 available and the lowest cost network configuration, given the
33 existing location of the incumbent LEC’s wire centers.
34 (2) Forward-looking cost of capital. The forward-looking cost of
35 capital shall be used in calculating the total element long-run
36 incremental cost of an element.
37 (3) Depreciation rates. The depreciation rates used in calculating
38 forward-looking economic costs of elements shall be economic
39 depreciation rates.

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(c) Reasonable allocation of forward-looking common cost.

- (1) Forward-looking common costs. Forward-looking common costs are economic costs efficiently incurred in providing a group of elements or services (which may include all elements or services provided by the incumbent LEC) that cannot be attributed directly to individual elements or services.
- (2) Reasonable allocation.
 - (i) The sum of a reasonable allocation of forward-looking common costs and the total element long-run incremental cost of an element shall not exceed the stand-alone costs associated with the element. In this context, stand-alone costs are the total forward-looking costs, including corporate costs that would be incurred to produce a given element if that element were provided by an efficient firm that produced nothing but the given element.
 - (ii) The sum of the allocation of forward-looking common costs for all elements and services shall equal the total forward-looking common costs, exclusive of retail costs, attributable to operating the incumbent LEC's total network, so as to provide all the elements and services offered.

(d) Factors that may not be considered. The following factors shall not be considered in a calculation of the forward-looking economic cost of an element:

- (1) Embedded costs. Embedded costs are the costs that the incumbent LEC incurred in the past and that are recorded in the incumbent LEC's books of accounts.
- (2) Retail costs. Retail costs include the costs of marketing, billing, collection, and other costs associated with offering retail telecommunications services to subscribers who are not telecommunications carriers, described in § 51.609 of this part.
- (3) Opportunity costs. Opportunity costs include the revenues that the incumbent LEC would have received for the sale of telecommunications services, in the absence of competition from telecommunications carriers that purchase elements.
- (4) Revenues to subsidize other services. Revenues to subsidize other services include revenues associated with elements or telecommunications service offerings other than the element for which the rate is being established.

Q. Describe the FLEC standard set forth in § 51.505(a).

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1 A. The forward-looking economic cost (“FLEC”) is equal to the total element long-
2 run incremental cost plus a reasonable allocation of forward-looking common
3 cost.

4 **Q. Describe the TELRIC standard in § 51.505(b).**

5
6 A. According to § 51.505(b), there are three properties of total element long-run
7 incremental cost (“TELRIC”). These three properties are an efficient network
8 configuration (given the existing location of the ILEC’s wire centers), forward-
9 looking cost of capital, and economic depreciation rates.

10 **Q. Describe the efficient network configuration standard in § 51.505(b)(1).**

11
12 A. The efficient network configuration standard has two components. First, it
13 requires that the network configuration be based on the most efficient technology
14 currently available. Second, it requires that the lowest cost network configuration
15 be used given the existing location of the ILEC’s wire centers.

16 The FLEC study filed on behalf of Santel is based on current switch technology at
17 its existing wire centers. In developing transport and termination costs for
18 reciprocal compensation purposes, existing wire centers reduce the complexity of
19 network design. The costs associated with interoffice transport were based on
20 current technology used by Santel.

21 **Q. Describe the forward-looking cost of capital standard in § 51.505(b)(2).**

22
23 A. The FCC has defined the forward-looking cost of capital as the cost of obtaining
24 debt and equity financing. The FCC determined to utilize the authorized federal
25 11.25 percent rate of return to determine forward-looking costs. According to the

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1 FCC, states may adjust the cost of capital if a party demonstrates to a state
2 commission that either a higher or lower cost of capital is warranted.¹

3 **Q. Describe the economic depreciation rates standard found in § 51.505(b)(3).**

4

5 A. This standard is the forward-looking economic life or the expected life of a new
6 investment placed today. The depreciation rates for Santel's asset classes were
7 adjusted as necessary to comply with this standard.

8 **Q. You have described the necessary standards employed in the development of**
9 **TELRIC, one component of FLEC. Please describe the standards required**
10 **when developing the second component of FLEC, which is the reasonable**
11 **allocation of forward-looking common costs.**

12

13 A. The FCC rules outline the reasonable allocation of forward-looking common costs
14 in § 51.505(c). This allocation would include both shared and common costs
15 which the FCC combines together as common costs. Shared costs are those costs
16 that are shared by a subset of network elements or services. Common costs are
17 shared by all elements or services of the ILEC. Common costs cannot be
18 attributed directly to individual elements or services. Consistent with the FCC
19 rules, common costs such as corporate costs may be included, whereas retail costs
20 are excluded.

21 The FLEC study prepared for Santel developed common costs based on
22 relationships determined from the current account balances from the accounting
23 books of Santel. The ratios developed were then applied to the forward-looking
24 costs for transport and termination.

¹ *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket No. 96-98 and *Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, CC Docket No. 95-185, First Report and Order, FCC 96-325 (rel. Aug. 8, 1996) ("*Local Competition Order*") at para. 702.

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1 **Q What are the types of costs that are to be excluded in the development of**
2 **FLEC?**

3
4 A. The FLEC standard excludes specific costs that are not to be considered as
5 outlined in § 51.505(d). Such costs include:

- 6 (1) Embedded or past costs incurred by the company;
7 (2) Retail costs including marketing and billing of retail services;
8 (3) Opportunity cost such as revenues that a company may have
9 received absent competition; and
10 (4) Revenues to subsidize other services.

11 The FLEC study submitted on behalf of Santel does not include any of these items
12 and the study fully complies with this standard.

13 **Q. Once the forward-looking economic cost has been developed, which FCC**
14 **rule defines how forward-looking economic cost per unit is to be developed?**

15
16 A. Rules 47 C.F.R. §§ 51.505 and 51.511 are referenced in 47 C.F.R. § 51.705.
17 After the forward-looking economic cost has been developed in accordance with
18 § 51.505, the per unit costs are to be developed in accordance with § 51.511. §
19 51.511 reads as follows:

20 (a) The forward-looking economic cost per unit of an element equals
21 the forward-looking economic cost of the element, as defined in §
22 51.505 of this part, divided by a reasonable projection of the sum
23 of the total number of units of the element that the incumbent LEC
24 is likely to provide to requesting telecommunications carriers and
25 the total number of units of the element that the incumbent LEC is
26 likely to use in offering its own services, during a reasonable
27 measuring period.

28
29 (b) (1) With respect to elements that an incumbent LEC offers on a
30 flat-rate basis, the number of units is defined as the discrete
31 number of elements (e.g., local loops or local switch ports)
32 that the incumbent LEC uses or provides.
33

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1 (2) With respect to elements that an incumbent LEC offers on a
2 usage-sensitive basis, the number of units is defined as the
3 unit of measurement of the usage (e.g., minutes of use or
4 call-related database queries) of the element.
5

6 The units used to develop transport and termination rates were a projection of the
7 total switch minutes for termination and the total transmission minutes for
8 transport.

9 **Q. On the basis of the definition of “transport” and “termination” in**
10 **§ 51.701, were other sections of the FCC rules referred to in determining the**
11 **manner in which the per-unit cost should be calculated?**
12

13 A. Yes. § 51.509 identifies the rate standards for specific elements. Based on the
14 definitions of transport and termination in § 51.701, the per unit cost for local
15 switching can be developed as set forth in § 51.509(b), and the per unit cost of
16 shared transmission facilities can be developed as set forth in § 51.509(d). Such
17 sub-sections of § 51.509 read as follows:

18 (b) Local Switching. Local switching costs shall be recovered through
19 a combination of a flat-rated charge for line ports and one or more
20 flat rated or per-minute usage charges for the switching matrix and
21 line ports.
22

23 (d) Shared transmission facilities between tandem switches and end
24 offices. The cost of shared transmission facilities between tandem
25 switches and end offices may be recovered through usage-sensitive
26 charges, or in a another manner consistent with the manner that the
27 incumbent LEC incurs those costs.
28

29 The transport and termination rates presented in the FLEC study performed for
30 Santel are usage sensitive charges consistent with § 51.509(b) and § 51.509(d).

31 **Q. Explain how the model you used is consistent with the FCC FLEC standards.**
32

33 A. The model presented here on behalf of Santel meets the requirements outlined in
34 § 51.505 and § 51.511 of the FCC rules as follows:

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1 1) **Total element long run incremental costs.**

2 Transport and termination costs include the costs of traffic sensitive
3 switching and interoffice transport facilities. The model uses estimates of
4 switching and transport facilities based on forward-looking network
5 design. These costs are forward-looking and meet the standard for long
6 run incremental costs.

7 2) **Efficient Network Configuration.**

8 Vantage Point Solutions (“Vantage Point”), a telecommunications
9 engineering and consulting company, provided switching estimates, based
10 on recent switch acquisitions. The switch estimates were derived using
11 the location of existing wire centers, current subscribers, and engineering
12 trunking guidelines. The switching cost estimate was designed to be the
13 most efficient configuration given existing wire centers. Those costs were
14 adjusted in the model to remove the non-traffic sensitive cost component.

15 Transport facility electronic costs included the use of OC192 equipment.
16 Prices were obtained from transport estimates based on recent equipment
17 acquisitions. The number of OC192 terminals required was based on the
18 forward-looking network design.

19 Fiber cable cost per mile associated with interoffice transport was
20 provided by Vantage Point. Total costs were developed using the forward-
21 looking network design. This design includes miles of plant required for
22 EAS, Toll, and CMRS traffic. The miles included for Toll and CMRS

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1 traffic reflect the most efficient routing as determined by the forward-
2 looking network design.

3 **3) Forward looking capital costs.**

4 The FLEC model uses the FCC's authorized rate-of-return of 11.25
5 percent as the forward looking capital cost.

6 **4) Depreciation Rates.**

7 The FLEC studies used depreciation rates that were based upon the
8 economic life of each asset class.

9 **5) Reasonable allocation of forward-looking common costs.**

10 As explained previously, the approach taken to include common costs
11 (both shared and common) is based on ratios determined from the current
12 account balances of Santel. Ratios of various shared and common capital
13 and expense amounts to total direct capital costs were calculated. These
14 ratios were then applied to the forward-looking direct capital costs to
15 derive a forward-looking common cost amount. This is the most widely
16 used methodology in the industry and I believe it provides a reasonable
17 allocation of forward-looking common costs as outlined in § 51.505(c) of
18 the FCC rules.

19 **6) Forward-looking economic cost per unit. (§ 51.511)**

20 The forward-looking economic cost per unit of an element equals the total
21 cost of the element divided by a reasonable projection of the total demand
22 for that element. The FLEC model utilized the most currently available

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1 demand levels to produce transport and termination costs on a per unit
2 basis.

3 **Q. Based upon the study that was prepared, what are the rates that you propose**
4 **for transport and termination for each of the South Dakota Rural Telephone**
5 **Companies?**

6
7 A. The FLEC studies result in the following transport and termination rates per
8 minute of use for Santel:

9	Switching Termination	\$0.0071
10	Transport	<u>\$0.0279</u>
11	Total	\$0.0350

12

13 **Q. Please explain how these rates were developed?**

14

15 A. **Switching Termination**

16 1. The total forward-looking switch investment was obtained from Vantage
17 Point. The switch investment for Santel was established by Vantage Point
18 and was compared to a recent switch invoices purchased by rural LECs of
19 various sizes to verify its reasonableness. The switch investment amount
20 for Santel was based on the location of existing wire centers, current
21 subscribers, and engineering trunking guidelines.

22 2. The total forward-looking switching costs also include:

- 23 • Power, land and building investment amounts which are based on
24 account relationships in Santel's current financial statements.
- 25 • Common investment amounts which include motor vehicles, work
26 equipment, furniture, office equipment and general purpose
27 computers. Using Santel's current financial statements, a ratio of
28 common investment to direct investment was calculated. This

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1 ratio was then applied to the projected direct investment amounts
2 to calculate the common investment amounts.

3 • Annual charges were calculated as an annuity based on the
4 prescribed life of each asset account, a rate of return of 11.25
5 percent, and income tax rates. Since Santel is a cooperative, the
6 study uses a federal tax rate of 0 percent.

7 3. Adjustments eliminating switching termination investment:

8 • 27 percent of the total forward-looking switch investment was
9 excluded for the non-traffic sensitive line portion.

10 • 5 percent of the switch matrix and processor was excluded for their
11 use in the provision of vertical services.

12 4. The summation of items 1 and 2 less 3 results in the annual net FLEC
13 investment switching or termination cost for Santel.

14 5. In calculating expenses, the direct expenses are first calculated. The direct
15 expenses include the labor costs associated with maintenance and repair of
16 plant and equipment. These amounts were calculated by applying a ratio,
17 based on account relationships in Santel's current financial statements, to
18 the total forward-looking switch investment amounts.

19 6. The common expenses were then calculated. The common expenses
20 include support expenses, marketing expenses split between wholesale and
21 retail, customer services expenses split between wholesale and retail and
22 corporate expense. Common expenses were calculated by applying the
23 relationship of common expenses to direct expenses, based on account

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1 relationships in Santel's current financial statements to the total forward-
2 looking switch investment amounts.

3 **Transport**

4 1. The total forward-looking transport investment was based on a forward-
5 looking network design.

6 2. The total forward-looking transport investment also includes:

7 • Power, land and building investment which are based on account
8 relationships in Santel's current financial statements for
9 transmission only.

10 • Common investment amounts, which include motor vehicles, work
11 equipment, furniture, office equipment and general purpose
12 computers. Using Santel's current financial statements, a ratio of
13 common investment to direct investment was calculated. This
14 ratio was then applied to the projected direct investment amounts
15 to calculate the common investment amounts.

16 • Annual charges were calculated as an annuity based on the
17 prescribed life of each asset account, a rate of return of 11.25
18 percent and income tax rates. Since Santel is a cooperative, the
19 study uses a federal tax rate of 0 percent.

20 3. The following adjustments to transport investment were made:

21 • A portion of total forward-looking transport investment was
22 eliminated for facilities not used in inter-office transport.

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1 • Special transport for inter-office electronics and inter-office plant
2 was eliminated.

3 4. The summation of items 1 and 2 less 3 results in the annual net FLEC
4 investment transport cost.

5 5. In calculating expenses, the direct expenses are first calculated. The direct
6 expenses include the labor costs associated with maintenance and repair of
7 plant and equipment. These costs were calculated by applying a ratio,
8 based on account relationships in Santel's current financial statements, to
9 the total forward-looking transport amounts.

10 6. The common expenses were then calculated. The common expenses
11 include support expenses, marketing expenses split between wholesale and
12 retail, customer services expenses split between wholesale and retail and
13 corporate expense. These expenses were calculated by applying the
14 relationship of common expenses to direct expenses, based on account
15 relationships in Santel's current financial statements to the total forward-
16 looking transport amounts.

17 **Demand**

18 1. The total demand or minutes of use (MOUs), obtained from the most
19 recent traffic studies performed for Santel, were used to determine the
20 switching termination rate.

21 2. Local and dial-up internet MOUs were eliminated from total demand in
22 determining the transport rate.

23 3. The result of item 1 less item 2 is the net FLEC demand.

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1 **Q. Do you believe that you have developed FLEC rates for Santel that comply**
2 **with the FCC Rules?**

3
4 **A. Yes, I believe the cost study described in my testimony meets all of the FCC**
5 **requirements for a FLEC study of transport and termination costs. I recommend**
6 **that the rate levels provided in my testimony that are based on this FLEC study be**
7 **approved.**

8 **Q. In its Response to the Petition for Arbitration of Santel, Alltel refers to cost**
9 **information presented in an arbitration involving Santel in 2003. Was there**
10 **an arbitration hearing between Santel and other rural telephone companies**
11 **in South Dakota and Alltel (then WWC) in 2003?**

12
13 **A. No, there was not.**

14
15 **Q. Since there was not an arbitration hearing between Santel and Alltel in 2003,**
16 **was Alltel's estimate of Santel's transport and termination cost reviewed by**
17 **the South Dakota Public Utilities Commission ("SDPUC")?**

18
19 **A. No, it was not.**

20
21 **Q. Given that Alltel's estimate of Santel's transport and termination cost was**
22 **not reviewed by the SDPUC in 2003, is such information relevant to**
23 **determining whether Santel's proposed transport and termination rates are**
24 **appropriate pursuant to the pricing standards of 47 U.S.C. §252(d)(2)?**

25
26 **A. No, it is not.**

27
28 **Q. Does this conclude your direct testimony?**

29
30 **A. Yes it does.**