

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

**IN THE MATTER OF THE INVESTIGATION OF)
PRICING REGULATION FOR SWITCHED)
ACCESS SERVICES PROVIDED BY)
COMPETITIVE LOCAL EXCHANGE CARRIERS)
)**

TC10-014

**DIRECT TESTIMONY
OF
TIMOTHY J GATES
ON BEHALF OF MIDCONTINENT COMMUNICATIONS**

April 1, 2010

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Exhibits

Exhibit TJG-1: *Curriculum Vitae* of Timothy J Gates

1 **I. INTRODUCTION**

2 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

3 A. My name is Timothy J Gates. My business address is QSI Consulting, 10451
4 Gooseberry Court, Trinity, Florida 34655.

5 **Q. WHAT IS QSI CONSULTING, INC. AND WHAT IS YOUR POSITION**
6 **WITH THE FIRM?**

7 A. QSI Consulting, Inc. ("QSI") is a consulting firm specializing in traditional and
8 non-traditional utility industries, econometric analysis and computer-aided
9 modeling. QSI provides consulting services for regulated utilities, competitive
10 providers, government agencies (including public utility commissions, attorneys
11 general and consumer councils) and industry organizations. I currently serve as
12 Senior Vice President.

13 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND**
14 **WORK EXPERIENCE.**

15 A. I received a Bachelor of Science degree from Oregon State University and a
16 Master of Management degree, with an emphasis in Finance and Quantitative
17 Methods, from Willamette University's Atkinson Graduate School of
18 Management. Since I received my Masters, I have taken additional graduate-level
19 courses in statistics and econometrics. I have also attended numerous courses and
20 seminars specific to the telecommunications industry, including both the NARUC
21 Annual and NARUC Advanced Regulatory Studies Programs.

1 Prior to joining QSI, I was a Senior Executive Staff Member at MCI WorldCom,
2 Inc. ("MWCOM"). I was employed by MCI and/or MWCOM for 15 years in
3 various public policy positions. While at MWCOM I managed various functions,
4 including tariffing, economic and financial analysis, competitive analysis, witness
5 training and MWCOM's use of external consultants. Prior to joining MWCOM, I
6 was employed as a Telephone Rate Analyst in the Engineering Division at the
7 Texas Public Utility Commission and earlier as an Economic Analyst at the
8 Oregon Public Utility Commission. Exhibit TJG-1 contains a complete summary
9 of my work experience and education.

10 **Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE SOUTH DAKOTA**
11 **PUBLIC UTILITIES COMMISSION ("COMMISSION")?**

12 A. Yes. I testified in the following Commission Dockets: TC03-057, F-3652-12 and
13 TC01-098. In addition, I have testified more than 200 times in 45 states and
14 Puerto Rico, and filed comments with the Federal Communications Commission
15 ("FCC") on various public policy issues including costing, pricing, local entry,
16 universal service, strategic planning, mergers and network issues. QSI was
17 retained by the Staff of the Commission to assist in two proceedings – TC01-098
18 (the Qwest Unbundled Network Element pricing case) and EL05-022 (the Big
19 Stone II proceeding.).

20 **Q. DO YOU HAVE EXPERIENCE WITH THE ISSUES IN THIS**
21 **PROCEEDING?**

1 A. Yes. I have participated in dozens of proceedings on access charge issues since
2 the divestiture of the Bell System in 1984 and since the 1996 amendments to the
3 Communications Act of 1934 (“Act”)¹ were enacted. I am knowledgeable about
4 the pricing and costing issues addressed in this testimony arising from the
5 obligations imposed by federal and state law. Further, I have been involved
6 directly and indirectly on access issues in South Dakota for several years.

7 **Q. ON WHOSE BEHALF ARE YOU FILING THIS DIRECT TESTIMONY?**

8 A. I am filing this testimony on behalf of Midcontinent Communications
9 (“Midcontinent”).

10 **II. PURPOSE OF THE TESTIMONY**

11 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

12 A. On January 27, 2010, the Commission issued an order opening this docket to
13 consider “...whether pricing regulation is appropriate for switched access services
14 provided by competitive local exchange companies.”² The Commission referred
15 the parties to SDCL 49-31-4.1 which permits the Commission to adopt pricing
16 regulation for noncompetitive services if such action has a positive impact on
17 universal service and is more reasonable and fair than rate of return regulation.
18 The purpose of this testimony is to provide Midcontinent’s position on whether

¹ Telecommunications Act of 1996, Pub. LA. No. 104-104, 110 Stat. 56 (1996) (“Telecom Act” or “Act”).

² See, **ORDER OPENING DOCKET; NOTICE OF INTERVENTION; AND NOTICE OF PROCEDURAL SCHEDULE**; Docket TC10-014; Dated January 27, 2010.

1 pricing regulation is appropriate for switched access services provided by
2 competitive local exchange companies (“CLECs”).

3 This testimony will show that Midcontinent’s proposed interim solution is
4 workable and in the public interest because it fixes the current disparity in CLEC
5 switched access rates and provides the Commission with additional time to fix the
6 real problem with switched access rates in South Dakota – the out-dated ILEC
7 switched access rules. Depending on how “price regulation” is defined,
8 Midcontinent’s proposal is consistent with SDCL 49-31-4.1 and 49-31-1.4.

9 The problems with CLEC switched access rates in South Dakota all emanate from
10 the existing switched access rules and the resulting ILEC switched access rates.
11 Once those rules are replaced with rules that are consistent with the competitive
12 mandate in the 1996 Act, and the rates and rate structures are rationalized, the
13 problems with switched access in South Dakota will be replaced by healthy
14 competition that will benefit the State and consumers.

15 **III. THE REAL PROBLEM WITH SWITCHED ACCESS REGULATION IN**
16 **SOUTH DAKOTA**
17

18 **Q. IS THERE A PROBLEM IN SOUTH DAKOTA WITH RESPECT TO**
19 **SWITCHED ACCESS CHARGES?**

20 A. Yes.

21 **Q. WHAT IS THE PROBLEM?**

1 A. The underlying problem is the Commission's out-of-date switched access rules.
2 The Commission's switched access rules are set forth in ARSD 20:10:27 through
3 20:10:29.³ I will provide a very brief overview of the problem.

4 Those rules were put into place in 1993 and are based on separations-based
5 accounting costs. Because the formula essentially divides embedded costs by
6 demand, rates over time have gone up as demand for switched access has gone
7 down. This is a counter-intuitive result given that telecommunications is a
8 decreasing cost industry.⁴

9 **Q. WHY HAS THE DEMAND FOR SWITCHED ACCESS SERVICES GONE**
10 **DOWN?**

11 A. The demand for switched access is directly related to toll or long distance calling
12 and the number of access lines. Because of expanded local calling areas, the
13 availability of wireless plans that include long-distance, and other alternatives, the
14 amount of switched access traffic has been trending downward for years. There
15 has been a negative trend in the number of wirelines in the United States since

³ Access Filing Rules (ARSD 20:10:27), Telecommunications Separations Procedures (ARSD 20:10:28), Telecommunications Switched Access Charges (ARSD 20:10:29).

⁴ Historical data tracked by the FCC shows that the consumer price index for telephone service has had a very low annual rate of change (only .1%) from 1998 to 2008, while the annual rate of change for the consumer price index for all items over the same period was 2.5%. See FCC Universal Service Monitoring Report, CC Docket No. 98-202, 2009 at Table 7.1. The relatively flat CPI for telephone service reflects, among other things, the huge advances in efficiencies for switching and transport technologies.

1 2000.⁵ Not surprisingly, the number of switched access minutes has also been
2 declining since about 2000.⁶

3 **Q. HAS TECHNOLOGY AND CANABALISM HAD A ROLE IN REDUCING**
4 **THE NUMBER OF LINES?**

5 A. Yes. In the past, when consumers wanted to have Internet access, they generally
6 had an additional line that they could dedicate for “dial-up” Internet access.⁷
7 Today, with the availability of broadband networks (DSL, cable modems, etc.)
8 those additional lines are no longer necessary. The FCC’s statistics confirm that
9 while primary lines are decreasing, the non-primary lines are decreasing at an
10 even faster rate as consumers purchase DSL or other broadband service that
11 allows them to have voice and data (Internet) over the same line.⁸ This decline in
12 additional lines and the fact that some consumers are abandoning their wireline
13 service and relying solely on their wireless service, just exacerbates the reduction
14 in lines and switched access minutes.⁹

15 **Q. YOU MENTIONED CANABALISM ABOVE. WHAT DID YOU MEAN**
16 **BY THAT?**

⁵ See, FCC “Trends in Telephone Service”, August 2008, at Table 7.1

⁶ *Id.* at Table 10.1 and Chart 10.1. These numbers are strictly interstate, but we would expect a similar trend for intrastate minutes. In fact, Table 10.2 shows that intraLATA toll calls carried by ILECs and IXC’s have declining as well.

⁷ I am not suggesting that consumers no longer use dial-up for their Internet access. Dial-up continues to be an important service especially in areas where broadband is not available or for consumers who cannot afford a broadband service.

⁸ *Id.* at Table 7.4.

⁹ *Id.* at Table 7.4. The data indicates that in 2006 19.3 percent of households had wireless only.

1 A. I was referring to the fact that ILECs sell DSL services which in many cases
2 result in the net loss of access lines. When the ILEC installs DSL, the customer
3 frequently disconnects the additional line because it is no longer necessary. I
4 consider that situation to be a form of cannibalism since the ILEC is actually
5 causing the loss of one of its services. Given the price of the DSL services,
6 however, there is generally not a negative impact on the bottom line.

7 **Q. SO, ALTHOUGH IT IS A BIT SIMPLISTIC, THE ILEC RATES ARE**
8 **GOING UP BECAUSE LINES AND SWITCHED ACCESS MINUTES ARE**
9 **GOING DOWN?**

10 A. Yes, although the algorithms are very complex, this is the biggest factor in the
11 rate increases. This is a problem with the rules that must be fixed to
12 accommodate the competition mandate of the Act. Today, even though the South
13 Dakota Local Exchange Carrier Association (“LECA”) rates are frozen, the rural
14 LECs (“RLECs”) in South Dakota are charging rates that are the highest or some
15 of the highest in the country. This fact shows that the existing switched access
16 rules are no longer appropriate given the national mandate for competition.

17 **Q. ARE YOU SUGGESTING THAT THE HIGH SWITCHED ACCESS**
18 **RATES ARE THE RESULT OF THE RLECS DOING SOMETHING**
19 **WRONG?**

20 A. No. I am not providing an opinion on the LECA cost support. Assuming,
21 however, that the LECA companies complied with the Commission’s rules, they

1 have not done anything wrong. The LECA companies put in their data and the
2 results are the results.

3 **Q. IS IT FAIR TO CONCLUDE THAT THE 1996 TELECOM ACT MADE**
4 **THE 1993 RULES OBSOLETE?**

5 A. Yes. With the Act, Congress recognized the need to rationalize pricing. The
6 three goals of the Act were to open the local markets to competition, reform
7 universal service and reform access charges. At paragraph 8 of the *Local*
8 *Competition Order* the FCC stated:

9 It is widely recognized that, because a competitive market drives
10 prices to cost, a system of charges which includes non-cost based
11 components is inherently unstable and unsustainable. It also well-
12 recognized that access charge reform is intensely interrelated with
13 the local competition rules of section 251 and the reform of
14 universal service.¹⁰

15
16 In its access charge reform proceeding, the FCC reiterated the benefits of moving
17 access charges to forward-looking costs:

18 Restructuring rates to reflect more accurately cost-causation will
19 promote competition, reduce per-minute charges, stimulate long-
20 distance usage, and improve overall efficiency of the rate
21 structure.¹¹

22
23 The FCC also encouraged the states to identify intrastate implicit subsidies:

24 Congress intended that states, acting pursuant to sections 254(f) of
25 the Communications Act, must in the first instance be responsible
26 for identifying intrastate implicit universal service support.

¹⁰ In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; **FIRST REPORT AND ORDER**; CC Docket No. 96-98; Released August 8, 1996. Hereinafter referred to as the FCC's "*Local Competition Order*."

¹¹ Before the Federal Communications Commission; In the Matter of Access Charge Reform; Price Cap Performance /Review for Local Exchange Carriers, Transport Rate Structure and Pricing, End User Common Line Charges; CC Docket Nos. 96-262, 94-1, 91-213, 95-72; **FIRST REPORT AND ORDER**; Released May 16, 1997; at ¶ 131.

1 Indeed, by our decisions in this Order and in our companion
2 *Universal Service Order*, we strongly encourage states to take such
3 steps.¹² (emphasis in original)
4

5 **Q. DID THE FCC REFORM INTERSTATE SWITCHED ACCESS**
6 **RATES?**

7 A. Yes. The FCC has made considerable progress in moving interstate access
8 charges towards cost. A few key examples include the FCC's CALLS¹³ and
9 MAG¹⁴ Orders issued in 2000 and 2001 respectively. Those orders reduced
10 interstate access rates significantly and rationalized the rate structures. The
11 introduction to the CALLS Order states:

12 By simultaneously removing implicit subsidies from the interstate
13 access charge system and replacing them with a new interstate
14 access universal service support mechanism that supplies portable
15 support to competitors, this Order allows us to provide more equal
16 footing for competitors in both the local and long-distance markets,
17 while still keeping rates in higher cost areas affordable and
18 reasonably comparable with those in lower cost areas.¹⁵
19

20 As discussed above, the FCC has recognized that the implicit subsidies in access
21 charges must be removed.

22 **Q. WHAT ARE THE INTERSTATE SWITCHED ACCESS RATES TODAY?**

¹² *Id.* at ¶ 11.

¹³ CALLS stands for the Coalition for Affordable Local and Long Distance Service.

¹⁴ The Multi-Association Group ("MAG") Plan was put into place for rate of return carriers at the federal level. The Order (FCC 01-304) was released on November 8, 2001.

¹⁵ Before the Federal Communications Commission; In the Matter of Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers, Low-Volume Long Distance Users; Federal-State Joint Board on Universal Service; CC Docket Nos. 96-262, 94-1, 99-249, 96-45; **SIXTH REPORT AND ORDER IN CC DOCKET NOS. 96-262 AND 94-1; REPORT AND ORDER IN CC DOCKET NO. 99-249; ELEVENTH REPORT AND ORDER IN CC DOCKET NO. 96-45**; Released May 31, 2000; hereinafter referred to as the "CALLS Order", at ¶ 3.

1 A. I will use Qwest as an example. Qwest's interstate switched access rates are
2 about .6 cents per minute, while its intrastate switched access rate is about 6 cents
3 per minute. Of course these amounts differ based on the amount of transport
4 involved in any particular call.

5 **Q. ABOVE YOU DISCUSS THE ORDERS THAT IMPACTED THE ILEC**
6 **INTERSTATE RATES. DID THE FCC ISSUE ANY ORDERS THAT**
7 **IMPACTED THE CLEC INTERSTATE SWITCHED ACCESS RATES?**

8 A. Yes. In 2001 the FCC issued an order that imposed transitional benchmarks for
9 CLEC interstate switched access charges. Those benchmarks were essentially the
10 rates charged by the ILEC where the CLEC is competing.¹⁶

11 **Q. HAS THE SOUTH DAKOTA COMMISSION REFORMED ITS**
12 **INTRASTATE SWITCHED ACCESS RULES TO BE CONSISTENT**
13 **WITH THE CONGRESSIONAL MANDATE DISCUSSED ABOVE?**

14 A. No. As a result, the switched access rates in South Dakota are conspicuously
15 high.

16 **Q. CAN YOU PROVIDE AN EXAMPLE?**

17 A. Yes. Some time ago, Midcontinent provided the following summary of intrastate
18 rates to the Staff.

¹⁶ *In The Matter of Access Charge Reform, Reform of Access Charges Imposed by Competitive Local Exchange Carriers, Seventh Report and Order and Further Notice of Proposed Rulemaking, CC Docket No. 96-262, rel. April 27, 2001; ("CLEC Access Reform Order").*

1

Composite Switched Access Rate for ICOs in Qwest's States and Associations Nationwide

Study includes all ICOs for which access rates were available.

"OTHER" indicates ICOs that do not participate in state associations.

State Association or Aggregate of Other LECs	Loops	Composite Rate Weighted by Loops*			
		Orig	Term	Total	Rank
SD Local Exchange Carrier Assoc.	109,325	\$0.13	\$0.13	\$0.25	1
SD OTHER	994	\$0.12	\$0.12	\$0.25	2
ID OTHER	26,313	\$0.12	\$0.12	\$0.23	3
MN OTHER	453,613	\$0.09	\$0.11	\$0.20	4
AZ OTHER	173,045	\$0.09	\$0.09	\$0.18	5
IA Network Services Assn.	155,543	\$0.09	\$0.09	\$0.18	6
ND OTHER	148,489	\$0.08	\$0.08	\$0.16	7
IL Small Company Exchange Carrier Assoc.	10,540	\$0.08	\$0.08	\$0.16	8
OR Exchange Carrier Association	70,547	\$0.07	\$0.09	\$0.16	9
VI Telecom Industry Assn.	77,089	\$0.06	\$0.09	\$0.15	10
ID Rural Exchange Carriers	37,626	\$0.07	\$0.07	\$0.14	11
WA Exchange Carrier Association	234,791	\$0.05	\$0.09	\$0.14	12
MT OTHER	71,919	\$0.06	\$0.07	\$0.13	13
OK Rural Telephone Cos.	246,006	\$0.06	\$0.04	\$0.11	14
WA OTHER	69,904	\$0.02	\$0.08	\$0.10	15
MI Exchange Carrier Association	164,348	\$0.05	\$0.05	\$0.10	16
OR OTHER	143,533	\$0.04	\$0.05	\$0.10	17
IA OTHER	290,360	\$0.05	\$0.05	\$0.09	18
NC Telephone Cos.	273,512	\$0.03	\$0.06	\$0.09	19
WI State Telephone Association	736,599	\$0.04	\$0.05	\$0.09	20
CO OTHER	88,645	\$0.04	\$0.05	\$0.09	21
WY OTHER	48,911	\$0.04	\$0.04	\$0.08	22
UT OTHER	45,453	\$0.04	\$0.04	\$0.08	23
TX Statewide Telephone Coop.	642,366	\$0.03	\$0.04	\$0.07	24
NM OTHER	103,354	\$0.02	\$0.02	\$0.05	25
NE OTHER	296,639	\$0.02	\$0.02	\$0.04	26
PA Telephone Assn.	68,263	\$0.02	\$0.02	\$0.04	27
TOTAL FOR SURVEYS ICOS	4,787,727	\$0.05	\$0.06	\$0.11	

* – Composite Rate assumes tandem routed transport and mileage 10 miles. ICO rates are aggregated through weighting by switched lines.

2

3

4

5

The rates above may have changed since this analysis was done last year, but the general point is unmistakable; RLEC rates in South Dakota, which are based on the Commission's switched access rules, are some of the highest in the country.

1 **Q. AS YOU NOTED ABOVE, QWEST'S RATES ARE NOT AS HIGH AS**
2 **THE RLEC RATES? WHY IS THAT?**

3 A. The LECA rate is a composite rate based on inputs from rural LECs. Qwest's
4 serving territory in South Dakota is less "rural" than the RLEC serving territories,
5 so one would expect Qwest's rates to be lower than those of the RLECs. I suspect
6 that if Qwest were to update its studies based on the rules, the rates would be
7 higher than the rates they have in place today.

8 **IV. THE COMMISSION'S FOCUS ON CLEC SWITCHED ACCESS RATES**
9

10 **Q. THE COMMISSION HAS SPECIFICALLY FOCUSED THIS CASE ON**
11 **CLEC RATES BUT YOU HAVE PROVIDED BACKGROUND ON THE**
12 **ILEC SWITCHED ACCESS RULES AND RATES. CAN YOU EXPLAIN**
13 **WHY?**

14 A. I have provided background on the switched access rules and resulting ILEC rates
15 because that is the real problem in South Dakota. Only the Commission can
16 explain why it has decided to focus on CLEC rates instead of the ILEC rates and
17 the rules used to develop those rates. Since the investigation was mentioned in
18 the Midcontinent Cost Case Order,¹⁷ I suspect the Commission was attempting to
19 resolve the long-standing complaint of Midcontinent over the handling of CLEC
20 switched access charges in South Dakota.

¹⁷ See, **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; Dated January 14, 2009, at 3.

1 **Q. ARE THERE RULES FOR CLEC SWITCHED ACCESS CHARGES?**

2 A. No. There are no switched access rules for CLECs because CLECs are not rate-
3 of-return regulated. CLECs have never been subject to the FCC's separations or
4 uniform system of accounts ("USOA") procedures. CLECs keep their books
5 based on Generally Accepted Accounting Practices ("GAAP"). CLECs have set
6 their rates to be competitive with those of the ILECs and the rates are generally at
7 or below the switched access rates of the ILEC.

8 **Q. ARE YOU SUGGESTING THAT CLEC RATES ARE HIGH BECAUSE**
9 **ILEC RATES ARE HIGH?**

10 A. Generally that is correct. Although given the density of CLEC customers and the
11 general costs of a CLEC as compared to an incumbent, you would expect the
12 CLEC rates to be higher, for instance, than those of Qwest.

13 **Q. DO YOU HAVE SUPPORT FOR THE STATEMENT REGARDING THE**
14 **COSTS THAT CLECS INCUR AS COMPARED TO THE COSTS OF THE**
15 **ILECS?**

16 A. Yes. It is obvious that CLECs would have a higher cost structure than urban
17 ILECs. Even the FCC recognized that fact in its *CLEC Access Reform Order*:

18 We acknowledge that CLEC access rates may, in fact, be higher
19 due to the CLECs' high start-up costs for building new networks,
20 their small geographical service areas, and the limited number of
21 subscribers over which CLECs can distribute costs.¹⁸
22

¹⁸ See, *CLEC Access Reform Order* at ¶ 18.

1 **Q. OTHER THAN THE RATE LEVELS FOR SWITCHED ACCESS IN**
2 **SOUTH DAKOTA, ARE THERE OTHER ISSUES HAMPERING THE**
3 **EFFICIENT OPERATION OF THE MARKET?**

4 A. Yes. A major problem in South Dakota is that CLECs have not been treated
5 consistently with respect to their switched access rates. In other words, CLECs
6 operating in the same service territory are allowed to charge different rates. This
7 treatment is discriminatory and harms to ability of CLECs to offer truly
8 competitive alternative services. I will discuss that later in this testimony.

9 **Q. IN THE ABSENCE OF CLEC RULES, CAN CLECS JUST USE THE ILEC**
10 **SWITCHED ACCESS RULES?**

11 A. It is possible, but difficult. But why would the Commission want CLECs to use
12 rules that are flawed, out of date and designed for ILECs? As I noted above,
13 CLECs have never been required to provide cost studies of any sort, but certainly
14 not separations based studies because they are not rate-of-return regulated. So
15 CLECs generally do not have the experience with cost studies in general, and
16 specifically they do not have the separations studies or USOA breakouts of the
17 relevant costs identified in the Commission's switched access rules.

18 **Q. HAVE CLECS ATTEMPTED TO USE THE ILEC SWITCHED ACCESS**
19 **RULES IN SOUTH DAKOTA TO COST-JUSTIFY RATES?**

20 A. Yes. Midcontinent has used the existing ILEC rules to develop cost studies for its
21 own switched access service. The process was difficult and costly. Ultimately,
22 despite Midcontinent's best efforts and that of its consultants, the Commission

1 denied not only Midcontinent's proposed cost-based rates but also its request for
2 an exemption from developing company specific cost-based switched access
3 rates.¹⁹

4 **Q. CAN YOU BRIEFLY EXPLAIN WHY MIDCONTINENT ATTEMPTED**
5 **TO USE THE ILEC SWITCHED ACCESS RULES TO JUSTIFY ITS**
6 **PROPOSED RATES?**

7 A. Yes. At that point in time, it had been more than two years since the Commission
8 initiated the RM05-002 rulemaking to address the switched access rules. As the
9 Commission will recall, that rulemaking was established based on concerns
10 voiced by the industry over the increasing LECA rates and the rules used to
11 justify those rates.²⁰ Although Midcontinent and others provided comments in
12 that proceeding, the Commission took no action. In its February 2006 Comments
13 in that rulemaking docket, Midcontinent explained how the Commission's
14 continued reliance on out-dated rules for determining intrastate switched access
15 rates has produced ILEC switched access rate levels that are far in excess of
16 economic cost, and thereby damaging to consumers and competition in both the
17 long distance and local markets.²¹ At the same time, over the expressed concerns
18 of Midcontinent, the Commission was approving rates for Midcontinent's

¹⁹ See, **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; Dated January 14, 2009.

²⁰ See, **ORDER OPENING DOCKET; RM05-002; In the Matter of Revisions and/or Additions to the Commission's Switched Access Rules Codified in ARSD 20:10:27 Through 20:10:29**; Dated December 14, 2005.

²¹ Docket RM05-002, Comments of Midcontinent Communications, Dated February 6, 2006, at page 9.

1 competitors that mirrored the RLEC rates and were much higher than the rates
2 that Midcontinent was charging. In essence, Midcontinent's competitors were
3 receiving more money for the same service that Midcontinent was providing. Not
4 only is that discriminatory treatment, but it created distortions in the market. In
5 an attempt to fix the problem Midcontinent filed for cost-based switched access
6 rates using the ILEC rules.²²

7 **Q. CAN YOU PROVIDE A BRIEF EXAMPLE OF THE DISPARATE**
8 **TREATMENT OF CLECS?**

9 A. Yes. When Midcontinent filed its petition for cost-based rates, Northern Valley
10 Communications ("NVC" a CLEC subsidiary of James Valley
11 Telecommunications of Groton) was charging the LECA rate, while Midcontinent
12 was charging the Qwest rate in Aberdeen. This means that NVC was charging a
13 rate about twice as high as the rate charged by Midcontinent. This is just one
14 example of the disparate treatment of CLECs in South Dakota.

15 **Q. DID THE MIDCONTINENT COST STUDIES SUPPORT RATES AT THE**
16 **LEVEL OF MIDCONTINENT'S CLEC COMPETITORS?**

17 A. No. The rates resulting from the cost studies were lower than the LECA rates that
18 its competitors were mirroring, but they were higher than the Qwest rates that
19 Midcontinent was mirroring.

²² See, Petition of Midcontinent Communications for Approval of Switched Access Rates, filed October 31, 2007; Docket No. TC07-117.

1 **Q. CAN YOU PROVIDE SOME EXAMPLES OF THE RATES THAT**
2 **MIDCONTINENT'S CLEC COMPETITORS ARE CHARGING?**

3 A. Yes. I believe that NVC, Midstate and RC Communications are charging 11.5
4 cents a minute. Dakota Communications, Mitchell Telecom and S S Telecom are
5 charging 12.25 cents per minute. Some CLECs are charging the LECA rates and
6 others are charging lower rates that were negotiated with the Staff. In any case,
7 there is no justification for treating CLECs providing switched access in the same
8 serving territory differently as the Commission has done. Instead, as proposed
9 below, all CLECs providing service in a particular serving territory should charge
10 the same rates for switched access.

11 **Q. WILL THE ADOPTION OF PRICING REGULATION FOR CLEC**
12 **SWITCHED ACCESS FIX THE PROBLEMS WITH ACCESS PRICING**
13 **IN SOUTH DAKOTA?**

14 A. The answer to that question depends entirely on how one defines price regulation.
15 In the next section of this testimony I explain why pricing regulation in and of
16 itself will not fix the underlying problem with switched access in South Dakota.

17 **V. WHETHER PRICING REGULATION IS APPROPRIATE FOR**
18 **SWITCHED ACCESS SERVICES PROVIDED BY CLECS**
19

20 **Q. IS SWITCHED ACCESS A REGULATED SERVICE IN SOUTH**
21 **DAKOTA?**

1 A. Yes. The Commission has classified CLEC switched access services as non-
2 competitive,²³ so that they remain regulated. But, as noted above, there is no
3 specific statutory framework for the regulation of CLEC services. Given that
4 void, the Commission has resorted to essentially bypassing the entire process by
5 routinely granting CLECs waivers from the ILEC rules on a case-by-case basis.²⁴

6 **Q. IS THE LACK OF RULES FOR CLECS UNUSUAL?**

7 A. No. Very few states have rules or regulations for CLECs because they are
8 competitive providers. But most states treat CLECs as CLECs and don't attempt
9 to create artificial distinctions that would allow different pricing by CLECs. Here
10 ins South Dakota, in the absence of rules and cost support, the Commission has
11 allowed the CLECs to mirror the ILEC rates in some cases and has negotiated
12 different rates in other situations.

13 **Q. YOU MENTIONED NEGOTIATED RATES. IS THERE SOME**
14 **PATTERN TO THE NEGOTIATED RATES?**

²³ See SDCL 49-31-1.1, which prescribes that all services other than those listed in 49-31-1.2 and 49-31-1.3 are classified as non-competitive (switched access not being so listed).

²⁴ See, e.g. TC05-186, *In the Matter of the Filing by Metropolitan Telecommunications of South Dakota, Inc. for Approval of its Intrastate Switched Access Tariff and for an Exemption from Developing Company Specific Cost-Based Switched Access Rates*, Order Approving Tariff and Granting Petition, December 28, 2005; TC05-224, *In the Matter of the Filing by Trinsic Communications, Inc. for Approval of its Intrastate Switched Access Tariff and for an Exemption from Developing Company Specific Cost-Based Switched Access Rates*, Order Approving Tariff and Granting Petition, February 10, 2006; and TC07-128, *In the Matter of the Filing by Sancom, Inc. d/b/a Mitchell Telecom for Approval of its Intrastate Switched Access Tariff and for an Extension of an Exemption from Developing Company Specific Cost-Based Switched Access Rates*, Order Granting Withdrawal of Intervention; Order Approving Settlement Stipulation, October 3, 2008.

1 A. Yes. As I mentioned above, the Staff did not negotiate rates based on some
2 specific metric. Instead, it seems that as long as the rate went down, then the
3 Staff was likely to approve a rate.

4 **Q. ISN'T A LOWER RATE A GOOD THING?**

5 A. There is no law or rule in South Dakota, or anywhere else for that matter, that
6 says that a lower rate is a "fair and reasonable rate" or a "just and reasonable
7 rate." In fact, given what we know about the network and cost characteristics of
8 CLECs, a lower rate might be a confiscatory rate. That was certainly the position
9 that Verizon and the CLECs took in New Jersey where the Board there set
10 switched access rates below the level considered to be compensatory. I discuss
11 the New Jersey proceeding and various parties' request for a stay later in this
12 testimony.

13 **Q. WHY HAS THE COMMISSION ALLOWED THE NEGOTIATION OF**
14 **CLEC RATES IN SOUTH DAKOTA?**

15 A. Today, there are more than sixty CLECs operating in South Dakota.²⁵ Even
16 assuming the Commission had switched access rules for CLECs, which it doesn't,
17 it would be difficult for the CLECs and for the Commission to create and review
18 the cost support. Instead, it appears that the Commission is relying on the waiver
19 process and mirroring. In the last few years, however, the Staff has attempted to

²⁵ The most recent CLEC listing on the Commission website (dated February 11, 2010) indicates that there are 66 CLECs, although a simple count of those listed therein (excluding those with cancelled certificates of operating authority) finds 74. See <http://puc.sd.gov/commission/telecom/clec.pdf> (downloaded February 25, 2010), at page 20.

1 negotiate rates with CLECs, which has resulted in the disparate treatment of
2 providers.

3 **Q. HAS THE COMMISSION'S RELIANCE ON THE WAIVER PROCESS**
4 **PRODUCED EQUITABLE OR FAIR AND REASONABLE RATES FOR**
5 **CLECS' SWITCHED ACCESS SERVICES?**

6 A. No, it has not. Instead, it has resulted in wide disparities among the switched
7 access rate levels of CLECs, even when they offer service in the same
8 exchange(s) and thus presumably under very similar cost conditions. The
9 Commission has required Midcontinent to limit its switched access rate level to
10 that tariffed by Qwest, i.e. about 6 cents per minute. Nevertheless, the
11 Commission has granted waivers permitting several CLEC affiliates of South
12 Dakota ILECs, including Midstate Telecom, Sancom (d/b/a Mitchell Telecom)
13 and NVC, to charge the "stipulated rate" of 11.5 cents per minute for switched
14 access in the same exchanges in which Midcontinent is attempting to compete.

15 **Q. IS THERE ANY EVIDENCE OF THE COSTS OF THE VARIOUS CLECS**
16 **IN PROVIDING SERVICE IN SOUTH DAKOTA THAT MIGHT JUSTIFY**
17 **DIFFERENT RATES IN THE SAME EXCHANGE?**

18 A. No. In fact, if we look at the Aberdeen area, it seems that if anything,
19 Midcontinent would have higher costs than NVC. NVC uses its parent
20 company's facilities and switch, while Midcontinent must transport its traffic
21 back to its switch. So one might assume that if anything Midcontinent would
22 have higher costs than NVC in Aberdeen; and yet NVC is charging rates almost
23 twice as high as Midcontinent's rates.

1 **Q. WILL PRICING REGULATION FIX THE DISPARATE TREATMENT**
2 **OF CLECS?**

3 A. Depending on how it is defined, it might be an improvement over the current
4 situation. Midcontinent proposes what could be considered “price regulation” in
5 an interim solution discussed below.

6 **Q. PLEASE EXPLAIN PRICING REGULATION AND WHY IT IS**
7 **INAPPROPRIATE FOR CLECS?**

8 A. The Commission specifically referred the parties to SDCL 49-31-4.1 to consider
9 whether pricing regulation is appropriate for switched access services provided by
10 CLECs.²⁶ SDCL 49-31-4.1 states, in pertinent part, that the Commission shall
11 hold hearings investigating methods of price regulation consistent with §49-31-
12 1.4. It states that pricing regulation may be used if such regulation has “a positive
13 impact on universal service and is more reasonable and fair than rate of return
14 regulation...”

15 **Q. ARE THESE CONCEPTS CONSISTENT WITH THE REGULATION OF**
16 **CLECS?**

17 A. No. First of all, the concept of universal service has never been associated with
18 CLECs. By definition there is always an alternative to the CLEC in the market
19 where the CLEC serves. Instead, universal service is associated with ILECs with
20 carrier of last resort responsibilities based on their historical monopoly heritage.
21 The statutes’ reference to a system that is more “reasonable and fair than rate of

²⁶ See, **ORDER OPENING DOCKET; NOTICE OF INTERVENTION; AND NOTICE OF PROCEDURAL SCHEDULE**; Docket TC10-014; Dated January 27, 2010.

1 return regulation” is also dependent upon traditional regulation of monopoly
2 providers and not competitive providers. As noted above, CLECs have never
3 been subject to rate of return regulation. The metrics cited in the statute are based
4 on revenue and capital requirements and a provider of last resort obligation
5 which, again, are unique to ILECs and not CLECs.

6 **Q. IS IT YOUR OPINION THAT 49-31-4.1 IS NOT RELEVANT TO CLECS?**

7 A. Yes. Although I am not a lawyer, the references to universal service and rate of
8 return regulation are clearly aimed at incumbents and not CLECs. This is not
9 surprising since the statute was written years before the consideration of local
10 competition.

11 **Q. THE STATUTE SAYS THAT THE METHODS OF PRICE REGULATION**
12 **CONSIDERED IN THE INVESTIGATION MUST BE CONSISTENT**
13 **WITH §49-31-1.4. WHAT DOES THAT SECTION REQUIRE?**

14 A. Section 49-31-1.4 is titled “Price Regulation.” That section reads as follows:

15 “Price regulaton” defined – Determination of fair and reasonable
16 price. For the purposes of this chapter, “price regulation” is the
17 procedure used by the commission to approve the charge for an
18 emerging or noncompetitive telecommunications service which is
19 not based on rate of return regulation. In determining whether the
20 price is fair and reasonable, the commission shall determine and
21 consider the price of alternative services, the overall market for the
22 service, affordability of the price for the service in the market it is
23 offered, and the impact of the price of the service on the
24 commitment to preserve affordable universal service. In
25 determining the price for an emerging competitive service, the
26 commission shall also consider the actual cost of providing the
27 service. In determining the price for a noncompetitive service, the
28 commission shall also consider the fully allocated cost of
29 providing the service.
30
31

1 **Q. WOULD IT BE REASONABLE FOR THE COMMISSION TO MAKE**
2 **THE DETERMINATIONS OUTLINED IN THE STATUTE FOR CLEC**
3 **SWITCHED ACCESS SERVICE?**

4 A. No. While the Commission might be able to determine the price of “alternative
5 services” and the “relevant market,” the other metrics are focused on regulated
6 monopoly providers. The concepts of “affordability” and “impact of the price of
7 the service on the commitment to preserve universal service” are clearly remnants
8 of Ramsey pricing²⁷ and revenue requirement determinations. Also, for
9 noncompetitive services like switched access, the statute requires the Commission
10 to consider the “fully allocated cost of providing the service.”

11 **Q. DOES THE REQUIREMENT FOR FULLY ALLOCATED COST**
12 **SUPPORT SEEM CONTRADICTORY?**

13 A. Yes. Although the section states that price regulation is not based on rate of
14 return regulation, it also requires a study of the fully allocated cost of the service.
15 The two concepts – rate of return regulation and fully allocated cost studies – are
16 almost inextricable. But despite the apparent contradiction, if the Commission
17 was to apply these metrics, and it appears they are not optional, then a fully
18 allocated cost study akin to the Commission’s existing but flawed switched access
19 rules would be required.

²⁷ Ramsey pricing is a reference to a form of price discrimination which is was referred to as the inverse-elasticity rule. We still have references to this type of rate making in texts such as Modern Industrial Organization (1999) by Carlton and Perloff at p.666; Industrial Market Structure and Economic Performance (1990) by Scherer/Ross at 496-500, etc. Of course such mechanisms were designed for monopoly environments and are not sustainable in the face of competition.

1 **Q. FROM A MORE GENERAL PERSPECTIVE, IF THE COMMISSION**
2 **COULD FIND THAT PRICING REGULATION “HAS A POSITIVE**
3 **IMPACT ON UNIVERSAL SERVICE AND IS MORE REASONABLE**
4 **AND FAIR THAN RATE OF RETURN REGULATION” SHOULD IT BE**
5 **ADOPTED?**

6 A. First, the Commission has never identified what it means when it refers to “price
7 regulation.” The statute refers to investigating “...*methods of price regulation*
8 consistent with § 49-31-1.4....”²⁸ The statute recognizes that there may be very
9 different approaches for price regulation, and the Commission has provided no
10 guidance on those “methods.” The concept was not defined in the Commission’s
11 order initiating this case and the statutes that are noted do not provide any
12 description of “price regulation” other than “determination of fair and reasonable
13 price.” The “fair and reasonable price” is a throw-back to rate of return regulation
14 which establishes a revenue requirement and sets rates that are by definition just
15 and reasonable or fair and reasonable because they recover the revenue
16 requirement while achieving public policy goals through regulation.²⁹ Despite the
17 ultimate definition, pricing regulation as defined in this statute is not a long-term
18 workable solution for CLEC switched access services.

19 **Q. IF THE COMMISSION DEFINED “PRICE REGULATION” FOR CLEC**
20 **SWITCHED ACCESS AS SETTING PRICE CAPS FOR SWITCHED**
21 **ACCESS, MIGHT THAT BE APPROPRIATE?**

²⁸ SDCL 49-31-4.1. (emphasis added)

²⁹ See, for instance, Principles of Public Utility Rates; by Bonbright, Daniels and Kamerschen; 1988; Chapters on “fair return” and “reasonable rate levels.”

1 A. It might be, depending on how the Commission designed the mechanism. It
2 sounds like price caps defined in that manner would at least fix the current
3 disparate treatment of CLEC rates. But CLECs must be allowed to prove up their
4 costs if they believe that the rate caps – presumably based on the ILEC rates – are
5 not sufficient to allow them to recover their costs.

6 **Q. CAN YOU PROVIDE AN EXAMPLE OF HOW RATES THAT DO NOT**
7 **RECOVER COSTS MIGHT HARM A COMPANY?**

8 A. Yes. Perhaps the most obvious example would be rates that are set below cost. If
9 rates are set below cost then the company will lose money on every minute they
10 originate or terminate.

11 **Q. DO REGULATED COMPANIES REQUIRE RATES THAT COVER**
12 **THEIR COSTS?**

13 A. Yes. In New Jersey the Board recently issued an order in the New Jersey
14 intrastate access case.³⁰ The order reduced Verizon's intrastate switched access
15 rates and the CLEC switched access rates significantly. Verizon sought a stay of
16 the Order arguing that the order violated constitutional and statutory requirements
17 that allow Verizon an opportunity to recover the costs it incurs to provide
18 services, along with a constitutionally adequate return of and on investments
19 needed to provide such services.³¹ Verizon argues for "just and reasonable" rates
20 which it defines as compensatory and not confiscatory.

³⁰ See, In the Matter of the Board's Investigation and Review of Local Exchange Carrier Intrastate Exchange Access Rates; BPU Docket No. TX08090830; dated February 1, 2010.

³¹ See, Emergent Application for a Stay of the Board's Access Charge Order; Docket No. TX08090830; dated February 3, 2010.

1 **Q. DID THE CLECS SEEK A STAY AS WELL BASED ON SIMILAR**
2 **ARGUMENTS?**

3 A. The “Joint CLECs” in that case appealed the Board’s order to the Superior Court
4 of New Jersey. In their brief, the Joint CLECs did make arguments that the
5 intrastate access rates were confiscatory, that they would be harmed by the rates
6 and that the Board did not engage in “reasoned decision-making.”³²

7 **Q. WHY DID YOU CITE TO THE NEW JERSEY CASE?**

8 A. There are several switched access cases pending around the country (Arizona,
9 Minnesota, Illinois, etc.) but I mentioned that case specifically to show that there
10 are states actively reviewing ILEC and CLEC switched access rates and that the
11 principles that the South Dakota Commission is grappling with are not new or
12 unique. But attempting to simply price regulate noncompetitive services without
13 regard to the cost of providing those services is not in the public interest. Further,
14 attempting to use rate of return concepts for regulating CLEC rates will be
15 difficult if not impossible and is not the best way to fix the switched access
16 problem in South Dakota. Below I propose an interim solution that eliminates the
17 current rate disparities and discriminatory treatment of CLECs while promoting
18 competition and allowing the Commission time to fix the real problem – the out
19 dated switched access rules.

20 **VI. MIDCONTINENT’S PROPOSED INTERIM SOLUTION**
21

³² See, Brief on Behalf of Appellants in Support of Motion for a Stay of an Order of the New Jersey Board of Public Utilities; In the Matter of the Board’s Investigation and Review of Local Exchange Carrier Intrastate Exchange Access Rates; filed in the Superior Court of New Jersey, Appellate Division, dated February 25, 1010.

1 **Q. WHAT IS MIDCONTINENT'S PROPOSED INTERIM SOLUTION TO**
2 **THIS PROBLEM?**

3 A. Midcontinent proposes that the Commission adopt switched access rate caps for
4 CLECs on an interim basis. The rate caps would apply in the following manner:

5 (1) All wireline CLECs operating in a given exchange would be allowed to
6 price their intrastate switched access service up to the ILEC switched
7 access rates in the exchange. Each CLEC could tariff any combination of
8 recurring rate elements that it chooses, as long as the total per-minute rate
9 is equal to or less than the ILEC's comparable total per-minute rate for
10 switched access.

11
12 (2) Similarly, each CLEC would have discretion in how it tariffs its
13 nonrecurring rate elements for required switched access functions (i.e.,
14 excluding optional features), provided that the total nonrecurring charges
15 for those functions is equal to or less than the ILEC's comparable total
16 nonrecurring charges for the same functions.

17
18 These rate caps should be maintained on an interim basis only, until the
19 Commission has had the opportunity to review and potentially modify the ILEC
20 switched access rates that serve as their basis, and that are a much higher priority
21 for the Commission to address.

22 **Q. WOULD ILEC SWITCHED ACCESS RATES BE REVIEWED ONCE**
23 **THE SWITCHED ACCESS RULES ARE UPDATED?**

1 A. Yes. Ideally, ILEC rate reviews would commence as soon as possible, following
2 the adoption of updated, economically-sound ratemaking rules for ILEC switched
3 access services. After the Commission has thoroughly addressed and resolved the
4 issues surrounding ILECs' switched access rate levels, then it should revisit
5 CLEC switched access rates and adopt a permanent ratemaking solution for them.

6
7 As a "safety valve" measure, if a CLEC believes its rates subject to the interim
8 rate caps are insufficient, then the CLEC could petition the Commission for
9 higher rates using the existing switched access rules or some other cost-based
10 method.

11 **Q. TO BE CLEAR, ARE YOU RECOMMENDING ANY CHANGES TO THE**
12 **SWITCHED ACCESS RULES OR RLEC RATES IN THIS**
13 **PROCEEDING?**

14 A. No. Based on the Commission's order, this is not the proceeding to address those
15 rates and the related issues. For instance, the Commission will hear arguments
16 about the need for the switched access revenues resulting from the current rates.
17 Given those arguments the Commission may consider investigating the need for
18 those revenues, and if a need exists, how to rebalance rates of offset the rate
19 reductions with other monies. This may lead to discussions of high cost funds or
20 state universal service funds and the appropriate use of those funds. But again,
21 those are not issues for this proceeding.

22 **Q. WHY IS THE ADOPTION OF INTERIM RATE CAPS THE RIGHT**
23 **SOLUTION AT THIS TIME?**

1 A. The Midcontinent proposal is the right solution at this time for a variety of
2 reasons. To summarize:

- 3 • **Rational Interim Solution** – It is reasonable to assume as a starting point that
4 all efficient providers would face essentially the same costs in providing
5 switched access services in a given exchange. As such, having the same rate
6 cap for all carriers in the same exchange would limit excessive rates. Further,
7 since the rate serving as the cap will be an ILEC rate set by the Commission,
8 there is at least some support for a “just and reasonable” rate (at least for the
9 ILEC). Moreover, the “safety valve” provision would allow individual
10 CLECs to demonstrate that their costs are higher, if in fact that is the case.
11
- 12 • **Fairness** – The Midcontinent solution is fair because it treats all LECs the
13 same in the same exchange. All LECs providing service in an exchange will
14 have their rates capped at the ILEC rates in that exchange – absent a showing
15 under the existing rules or some other cost-based approach.
16
- 17 • **Encourages Retail Competition** – Eliminating the current switched access
18 rate disparities among the CLECs would help to level the playing field for
19 retail competition. With CLEC wholesale access rates capped at a uniform
20 level, their revenues will depend more on their ability to compete in the
21 provision of retail local telephone service.
22
- 23 • **Benefits Consumers and Universal Service** – By encouraging retail
24 competition (see above), the Midcontinent Proposal will help to bring the
25 benefits of competition, i.e. better service and lower prices, to consumers. In
26 the long run, universal service goals are advanced by those improvements to
27 the retail telephone marketplace.
28
- 29 • **Efficient and Easy to Administer**– The Midcontinent Proposal is easy to
30 implement and avoids the creation and review of multiple CLEC cost studies,
31 thereby allowing the Commission to focus on the higher priority task of
32 revising its switched access rules.
33

34 **Q. WOULD MIDCONTINENT’S INTERIM PROPOSAL SATISFY THE**
35 **STATUTES THAT YOU DISCUSSED EARLIER?**

36 A. As I discussed at length, the statutes (49-31-4.1 and 49-31-1.4) are based on rate
37 of return regulation of the incumbent provider. Those standards are not
38 appropriate for CLECs. Nevertheless, as I discuss below, if you assume that the

1 proposal is an interim proposal, one could conclude that Midcontinent's proposed
2 interim solution is consistent with the statutory requirements. I discuss how those
3 findings might be made in the next section of this testimony.

4 **VII. MIDCONTINENT'S PROPOSAL COULD COMPLY WITH SOUTH**
5 **DAKOTA'S PRICE REGULATION STATUTES, SDCL 49-31-1.4 AND 49-**
6 **31-4.1**

7
8 **Q. WHAT STATUTORY CRITERIA MUST THE COMMISSION SATISFY**
9 **BEFORE ESTABLISHING PRICE REGULATION FOR CLEC**
10 **SWITCHED ACCESS SERVICES?**

11 A. As I discussed earlier in this testimony, the statutes that the Commission must
12 satisfy are set forth in SDCL 49-31-1.4 and 49-31-4.1. These two statutes are
13 sufficiently brief that I can recite them here in their entirety for reference:

14 49-31-1.4. "Price regulation" defined--Determination of fair and
15 reasonable price. For the purposes of this chapter, "price regulation" is the
16 procedure used by the commission to approve the charge for an emerging
17 or noncompetitive telecommunications service which is not based on rate
18 of return regulation. In determining whether the price is fair and
19 reasonable, the commission shall determine and consider the price of
20 alternative services, the overall market for the service, the affordability of
21 the price for the service in the market it is offered, and the impact of the
22 price of the service on the commitment to preserve affordable universal
23 service. In determining the price for an emerging competitive service, the
24 commission shall also consider the actual cost of providing the service. In
25 determining the price for a noncompetitive service, the commission shall
26 also consider the fully allocated cost of providing the service. (Source: SL
27 1988, ch 375, § 6; SL 1992, ch 328, § 1.)

28 49-31-4.1. Hearings on price regulation--Petition--Adoption of price
29 regulation for noncompetitive service. The commission shall, on its own
30 motion or upon petition, hold public hearings investigating methods of
31 price regulation consistent with § 49-31-1.4 and chapter 1-26. Within
32 thirty days of its receipt of a petition filed pursuant to this section, the
33 commission shall issue a procedural schedule setting forth dates by which

1 written direct testimony or data shall be filed and ordering the date for
2 commencement of a hearing. If the investigation indicates that pricing
3 regulation is appropriate for any noncompetitive service because such
4 regulation has a positive impact on universal service and is more
5 reasonable and fair than rate of return regulation, the commission may
6 adopt pricing regulation for any such noncompetitive service. (Source: SL
7 1988, ch 375, § 12; SL 1992, ch 328, § 8.)

8 **Q. DOES MIDCONTINENT'S PROPOSAL SATISFY THE CRITERIA FOR**
9 **PRICE REGULATION SET FORTH IN THESE STATUTES?**

10 A. Yes. However, because these statutes were enacted in 1988 and 1992 (as
11 indicated by their source attributions), they predate the introduction of
12 competitive entry. Consequently, some of the statutory criteria are less
13 meaningful when applied in the context of CLEC switched access services than
14 they might be if applied to retail ILEC services. This will become clear as I
15 review the statutory criteria in turn.

16 **Q. WOULD MIDCONTINENT'S PROPOSAL LEAD TO "FAIR AND**
17 **REASONABLE" PRICES PURSUANT TO SDCL 49-31-1.4?**

18 A. Yes. Midcontinent's proposal would lead to "fair and reasonable" prices for
19 CLEC switched access services, in that they would at least be the same for all
20 competitors in an exchange. Midcontinent's proposal would fix the current
21 disparity in CLEC rates and remove the market distortions that the disparity
22 causes. That being said, the additional requirements of SDCL 49-31-1.4 to
23 consider "the price of alternative services" and the "overall market" are
24 essentially moot because in the short run, no alternative services exist for the IXC
25 obliged to complete a call to/from the CLEC's end user customer, so that there is
26 no "overall market" (with multiple suppliers) to speak of. From a longer-term

1 view that considers all switched access offerings in the exchange as potential
2 “alternatives,” then the pricing discipline imposed by the uniform rate cap would
3 ensure that the CLEC rates are “fair and reasonable.”

4 Finally, the “safety valve” feature of the Midcontinent Proposal would provide
5 further assurance that the CLEC rates would be fair and reasonable. If any CLEC
6 believes that limitation to the ILEC rate is not fair and reasonable given its
7 particular circumstances, much as Verizon is currently arguing in New Jersey, it
8 can seek a higher rate by filing cost support. Any such cost support would give
9 the Commission the opportunity to “consider the fully allocated cost of providing
10 the service” pursuant to SDCL 49-31-1.4.

11 **Q. WOULD MIDCONTINENT’S PROPOSAL HAVE “A POSITIVE IMPACT**
12 **ON UNIVERSAL SERVICE” PURSUANT TO SDCL 49-31-4.1?**

13 A. Yes. As I observed earlier in my testimony, Midcontinent’s proposal would
14 encourage retail competition among the CLECs by eliminating existing switched
15 access rate disparities and creating a more level playing field for retail
16 competition. In the long run, universal service goals are advanced by the
17 improvements in the retail telephone marketplace that greater competition can
18 bring, i.e. better service and lower prices. In addition, Staff has previously stated
19 a concern that certain ILEC-affiliated CLECs may be undercutting ILEC retail
20 local rates and winning retail market share in part by charging excessive switched

1 access rates to recoup the difference.³³ By curbing this unfair practice and its
2 potential adverse impacts on ILEC revenue streams, the Midcontinent Proposal
3 would help to ensure that ILECs can continue to meet their universal service
4 obligations.

5 **Q. WOULD MIDCONTINENT'S PROPOSAL BE "MORE REASONABLE**
6 **AND FAIR THAN RATE OF RETURN REGULATION" PURSUANT TO**
7 **SDCL 49-31-4.1?**

8 A. Yes. However, this is another instance where the statute reflects its historical
9 context that predates CLEC competition, because the Commission has never
10 applied full-blown rate of return regulation (i.e., rate setting by means of a
11 comprehensive revenue requirement investigation) to the CLECs under its
12 authority. Indeed, it would be a practical impossibility for the Commission to
13 undertake comprehensive rate cases for the sixty-plus CLECs it oversees just
14 once, let alone on periodic basis to try to keep pace with changing market
15 conditions. As I observed earlier in my testimony, Midcontinent's Proposal
16 would be much more efficient and easy to administer, thus "more reasonable,"
17 and the combination of the uniform rate cap and safety-valve provisions of the
18 Proposal would ensure that it is sufficiently "fair" compared to rate of return
19 regulation.

20 **Q. DOES THIS COMPLETE YOUR DIRECT TESTIMONY AT THIS TIME?**

21 A. Yes.

³³ See Memorandum to the Commissioners (re: TC 05-060) from Keith Senger, PUC Commission Staff, January 27, 2006, at pages 2-3 and 5.