

**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 )

TC 10-014

**INITIAL TESTIMONY  
OF VERIZON**

**DIRECT TESTIMONY OF**

**DON PRICE**

**ON BEHALF OF VERIZON**

**April 1, 2010**

1 **I. INTRODUCTION AND SUMMARY OF POSITION**

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

3 A. My name is Don Price, and my business address is 701 Brazos, Suite 600, Austin,  
4  
5 Texas, 78701.  
6  
7

8 **Q. BY WHOM ARE YOU EMPLOYED AND WHAT IS YOUR POSITION?**

9  
10 A. I am a Director - State Public Policy for Verizon. MCImetro Access  
11 Transmission Services LLC (“MCImetro”) and MCI Communication Services  
12 Inc. d/b/a Verizon Business Services (“Verizon Business Services”) are part of  
13 Verizon. I am testifying here on behalf of these two Verizon affiliates.

14 **Q. WHAT IS YOUR PROFESSIONAL EXPERIENCE AND EDUCATIONAL**  
15 **BACKGROUND?**

16 A. I have more than 30 years experience in the communications industry, the vast  
17 majority of which is in the public policy area. I worked for the former GTE  
18 Southwest in the early 1980s, and then moved to the Texas Public Utility  
19 Commission in 1983. There, I served as a Commission analyst and witness on  
20 rate-setting and policy issues. In 1986, I became Manager of Rates and Tariffs,  
21 and was responsible for Staff analyses of rate design and tariff policy issues in all  
22 telecommunications proceedings before the Commission. I was hired by MCI in  
23 1986, where I spent 19 years focused on public policy issues relating to  
24 competition in telecommunications, including issues of intercarrier compensation  
25 and coordination of positions in interconnection agreement negotiations.

1  
2 With the close of the Verizon/MCI merger in January 2006, I assumed the  
3 position of Director – State Regulatory Policy for Verizon Business. As a result  
4 of internal reorganization, I assumed my current position in January 2010.

5 Among other things, I work with various corporate departments, including those  
6 involved with product development and network engineering, to develop and  
7 coordinate policies permitting Verizon to offer products to meet the demands of  
8 corporate customers and government entities, as well as customer demand in  
9 wholesale markets.

10  
11 During my career, I have testified before state regulators in at least 27 states on a  
12 wide range of issues in many types of proceedings and on a variety of topics,  
13 including various intercarrier compensation issues, and technical and policy issues  
14 arising in interconnection agreement arbitrations with local exchange carriers. I  
15 earned Master’s and Bachelor’s degrees in sociology from the University of  
16 Texas at Arlington in 1978 and 1977, respectively.

17

18 **Q. PLEASE DESCRIBE THE PURPOSE OF YOUR TESTIMONY.**

19 A. On January 27, 2010, the Public Utilities Commission of South Dakota  
20 (“Commission”) issued an Order opening an investigation to consider whether  
21 price regulation is appropriate for intrastate switched access services provided by  
22 competitive local exchange companies (“CLECs”) (“*Order*”). According to the  
23 *Order*, a state statute, SDCL 49-31-4.1, provides that if the Commission  
24 determines that “pricing regulation is appropriate for any noncompetitive service

1 because such regulation has a positive impact on universal service and is more  
2 reasonable and fair than rate of return regulation,” then the Commission “may  
3 adopt pricing regulation for any such noncompetitive service.”

4  
5 The purpose of my testimony is to present Verizon’s position on the type of  
6 regulation that should govern the rates for intrastate switched access service  
7 charged by CLECs in South Dakota. I will explain that the answer to the  
8 Commission’s threshold question -- whether price regulation for these services is  
9 appropriate -- is “yes.” As to the method of price regulation that should be  
10 implemented, I recommend that the Commission impose a ceiling, or cap, on  
11 CLEC switched access prices and preclude CLECs from charging intrastate  
12 switched access rates that are higher than the access rates of Qwest Corporation  
13 (“Qwest”), the Regional Bell Operating Company (“RBOC”) and predominant  
14 incumbent local exchange carrier (“ILEC”) in South Dakota. Finally, to ensure  
15 that the Commission’s regulations are fair and competitively neutral, I also  
16 recommend that the Commission apply the same pricing regulations that it adopts  
17 for CLECs to all of the incumbent LECs in the state.

18 **Q. ARE CLECS’ SWITCHED ACCESS RATES REASONABLY PRICED?**

19 A. For the most part, no. While a few CLECs charge intrastate rates that are at or  
20 below the rates charged by Qwest, many do not. Some CLECs charge Verizon’s  
21 interexchange carrier (“IXC”), Verizon Business Services, as much as six to  
22 thirteen cents per minute for switched access. Rates at these levels are excessive -  
23 - among the very highest in the country - and impede fair competition. These

1 rates are also much more than these same companies charge for interstate  
2 switched access in South Dakota, even though they cover the same functions. On  
3 the interstate level, CLEC switched access rates may not exceed the rate of the  
4 ILEC against which a CLEC competes. As the Commission is aware from the  
5 record in a recent proceeding, Qwest's tariffed interstate switched access rate in  
6 South Dakota -- and thus the cap on competing CLECs' interstate access rates in  
7 South Dakota - is approximately \$0.0056 per minute,<sup>1</sup> which is a tiny fraction of  
8 what many CLECs currently charge for intrastate access. As I will explain,  
9 CLEC switched access rates are not subject to market discipline in South Dakota,  
10 and IXCs have no choice but to pay these excessive rates. Accordingly,  
11 regulatory intervention is needed to bring all carriers' prices down to more  
12 reasonable levels. Verizon thus recommends that the Commission cap all South  
13 Dakota CLECs' intrastate switched access rates at the level of Qwest's intrastate  
14 rates.

15 **Q. HAVE THE FCC AND OTHER STATES TAKEN ACTION TO REDUCE**  
16 **CLEC ACCESS RATES?**

17 A. Yes. Regulators across the country have imposed constraints on CLEC access  
18 prices. To address this issue at the federal level, the FCC established a  
19 benchmark policy whereby CLECs' per minute interstate access charges are  
20 capped at the level of the interstate access rates charged by the ILEC in whose

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<sup>1</sup> See TC 08-135 (*OrbitCom v. MCI, et al*), Hearing Exhibit 2, at Exhibits MP 2-03 and MP 2-04.0.

1 service territory the CLEC competes.<sup>2</sup> CLEC access charges that do not exceed  
2 the benchmark are presumed to be just and reasonable.<sup>3</sup> The FCC explained its  
3 benchmark policy as follows:

4 [A] benchmark provides a bright line rule that permits a simple  
5 determination of whether a CLEC's access rates are just and  
6 reasonable. Such a bright line approach is particularly desirable  
7 given the current legal and practical difficulties involved with  
8 comparing CLEC rates to any objective standard of  
9 "reasonableness." Historically, ILEC access charges have been the  
10 product of an extensive regulatory process by which an  
11 incumbent's costs are subject to detailed accounting requirements,  
12 divided into regulated and non-regulated portions, and separated  
13 between the interstate and intrastate jurisdictions. Once the  
14 regulated, interstate portion of an ILEC's costs is identified, our  
15 access charge rules specify in detail the rate structure under which  
16 an incumbent may recover those costs. This process has yielded  
17 presumptively just and reasonable access rates for ILECs.

18 \* \* \*

19 [T]he benchmark we adopt will address persistent concern over the  
20 reasonableness of CLEC access charges and will provide critical  
21 stability for both the long distance and exchange access markets.<sup>4</sup>

22 The FCC's rule was prompted by "persistent" concerns that CLEC access rates  
23 varied dramatically and were frequently well above the rates charged by ILECs  
24 operating in the same area. The FCC's price cap was, therefore, intended to  
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26  
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<sup>2</sup> See *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, 16 FCC Rcd 9923 (April 27, 2001) ("CLEC Rate Cap Order") at ¶¶ 40, 45; 47 C.F.R. § 61.26 (b). See also discussion of the terminating access monopoly, particularly as it relates to CLECs, in Nuechterlein, Jonathan E., and Weiser, Philip J., "Digital Crossroads," The MIT Press (2007) at 310-313.

<sup>3</sup> *Id.* 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.

<sup>4</sup> See *CLEC Rate Cap Order* at ¶¶ 41, 44.

1 prevent CLECs from imposing excessive access charges on toll carriers and their  
2 customers.<sup>5</sup>

3 **Q. WHAT REFORM EFFORTS HAVE OTHER STATE COMMISSIONS**  
4 **TAKEN TO ADDRESS CLECS' INTRASTATE SWITCHED ACCESS**  
5 **RATES?**

6 A. At least 20 states impose some form of constraint on CLEC access rates, and have  
7 found benchmarking approaches like the FCC's to be a simple and effective  
8 means of reducing intrastate access prices to reasonable levels.<sup>6</sup> Indeed, every

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<sup>5</sup> *Id.* at ¶¶ 22, 33-34, 39.

<sup>6</sup> *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); *TDS Metrocom, Inc., Petition for Arbitration*, Arbitration Decision, **Illinois** Comm. Comm'n Docket No. 01-0338, at 48-50 (Aug. 8, 2001) and *Arbitration Between AT&T Comm. of Illinois, Inc. and Ameritech, Arbitration Decision*, Illinois Comm. Comm'n Docket No. 03-0239, at 149-51 (Aug. 26, 2003) (a CLEC may not charge an ILEC more for terminating intrastate switched access than the ILEC charges the CLEC); 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); **New Jersey** Board of Public Utilities, Telecommunications Order, *In the Matter of the Board's Investigation and Review of the Local Exchange Carrier Intrastate Exchange Access Rates*, 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

1 state commission that has formally considered capping CLEC access prices has  
2 concluded that such a benchmarking approach is good policy. In recent months,  
3 the New Jersey Board of Public Utilities ordered CLECs to cap their intrastate  
4 switched access rates at the level of the intrastate rates charged by the competing  
5 ILEC in the area(s) they serve.<sup>7</sup> Last year, West Virginia<sup>8</sup> and Massachusetts  
6 joined the growing list of states that have imposed caps on CLECs' switched  
7 access rates at the level of the competing ILEC. The Massachusetts Department  
8 of Telecommunications and Cable ("DTC") concluded that capping the CLECs'  
9 switched access rates at Verizon's level was necessary "[t]o correct the market  
10 failure regarding CLEC intrastate switched access rates."<sup>9</sup> The DTC explained

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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 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).

<sup>7</sup> See *In the Matter of the Board's Investigation and Review of the Local Exchange Carrier Intrastate Exchange Access Rates*, Telecommunications Order, N.J. B.P.U. Docket No. TX08090830 (February 1, 2010) at 29-30 ("*NJ BPU Order*"). Verizon has requested a stay of the portion of the Board's ruling reducing Verizon NJ's access charges without giving the ILEC a simultaneous opportunity to recover its costs of rate-regulated services. Verizon did not challenge the Board's ruling capping CLECs' access rates, and Verizon's CLEC in New Jersey has filed tariffs implementing the rate reductions ordered by the Board.

<sup>8</sup> *Petition by Verizon West Virginia Inc. et al. Requesting that Commission Initiate a General Investigation of the Switched Access Charges of Competitive Local Exchange Carriers Operating in WV*, Commission Order, W.V. P.S.C. Case No. 08-0656-T-PC (Nov. 23, 2009).

<sup>9</sup> *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, Mass. D.T.C. 07-9 (June 22,



1 that the cap was “an appropriate mechanism to ensure that CLEC switched access  
2 rates are just and reasonable, in the absence of sufficient competition, because ...  
3 Verizon’s rates have been found to be just and reasonable.”<sup>10</sup>

4 **Q. WOULD YOU SUMMARIZE THE REASONING OF THE**  
5 **MASSACHUSETTS DTC?**

6 A. The Massachusetts DTC recognized that IXCs cannot decline to terminate calls to  
7 CLECs whose access charges they believe are too high.<sup>11</sup> It thus found that while  
8 effective market-based pricing would otherwise constrain access rates, “there is a  
9 market failure in the CLEC switched access market.”<sup>12</sup> The Commission reached  
10 this conclusion after finding that the “[e]vidence strongly shows that CLECs have  
11 market power in providing intrastate switched access service.”<sup>13</sup>

12 The Massachusetts DTC found market failures in both the originating and  
13 terminating CLEC switched access markets. It concluded that the market for  
14 terminating switched access “is not sufficiently competitive because a carrier’s  
15 customers do not have competitive alternatives for terminating their calls,”<sup>14</sup>  
16 leaving IXCs unable to constrain the level of terminating access charges and  
17 giving CLECs market power that precludes a sufficiently competitive terminating  
18

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2009) (“*MA DTC Order*”) at 23-24; reconsideration denied, *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*, Order on Motion for Reconsideration or Clarification, Mass. D.T.C. 07-9 (December 7, 2009).

<sup>10</sup> *MA DTC Order* at 23-24.

<sup>11</sup> *Id.* at 5.

<sup>12</sup> *Id.* at 6.

<sup>13</sup> *Id.* at 9.

<sup>14</sup> *Id.* at 10. As the Massachusetts DTC noted, “IXCs do not have the option of purchasing access from another vendor because customers can have only one LEC serving them.” *Id.* at 11.

1 access market.<sup>15</sup> This inability results from the fact that the cost causer (the party  
2 receiving the call) “is insulated from changes in wholesale access prices because  
3 they are not the customer of the IXC paying the terminating access charges,” and  
4 thus “cannot be expected to react ‘in response to changes in [wholesale] price.’”<sup>16</sup>

5  
6 The Massachusetts DTC concluded that “the originating switched access market  
7 also is not sufficiently competitive.”<sup>17</sup> Although it noted that with originating  
8 switched access, the calling party is the cost-causer and “could, theoretically,  
9 react in response to high origination prices,” it held that because IXCs cannot  
10 geographically deaverage their interstate toll rates, doing so for intrastate toll calls  
11 “is not practicable” given the “unnecessarily burdensome and confusing dual  
12 charge situation in which IXCs would be required to separately track and bill an  
13 individual customer’s calls by LEC.”<sup>18</sup>

14  
15 Having found that CLECs possess market power in both the originating and  
16 terminating switched access markets, the Massachusetts DTC concluded that a  
17 price cap based on the RBOC rate was the appropriate solution to ensuring just  
18 and reasonable CLEC access rates.<sup>19</sup> Noting that “every state that has acted on  
19 CLEC switched access rates has implemented a cap, with the majority of those

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<sup>15</sup> *Id.* at 10.

<sup>16</sup> *Id.* at 13.

<sup>17</sup> *Id.* at 14.

<sup>18</sup> *Id.* at 14-16.

<sup>19</sup> *Id.* at 17, 22-24.

1 states setting a rate ceiling at the ILEC intrastate rate,”<sup>20</sup> it found that as a result  
2 of its newly-ordered rate cap, “a market distortion will be removed, thus  
3 furthering competition within the telecommunications industry,” which would, in  
4 turn, “result in lower long distance rates for consumers in the Commonwealth.”<sup>21</sup>

5 **Q. HOW SHOULD THE COMMISSION PROCEED HERE?**

6 A. In a competitive market, rate disparities among providers of the same service  
7 would not exist -- particularly where a new entrant charges a rate much higher  
8 than the dominant provider in the market, the RBOC. Switched access service,  
9 however, is a “noncompetitive service,” as that term is used in the South Dakota  
10 statute. This is because, as I will explain later, switched access is a service “for  
11 which no competition exists” in South Dakota.<sup>22</sup> Regulatory intervention is  
12 therefore necessary to discipline CLECs’ access rates, as the FCC and the  
13 numerous state Commissions I have identified have found. In South Dakota,  
14 price regulation is an approved mechanism that the Commission may use to  
15 ensure that the price for a noncompetitive service is fair and reasonable. As I  
16 mentioned earlier, the Commission should exercise this authority by requiring all  
17 CLECs to cap their intrastate access charges at the level of Qwest’s (the RBOC in  
18 South Dakota) intrastate rates. Verizon’s proposal is a first step toward  
19 promoting fair and reasonable intrastate access rates in South Dakota by driving  
20 the most excessive CLEC access rates toward more efficient levels.

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<sup>20</sup> *Id.* at 24.

<sup>21</sup> *Id.* at 1.

<sup>22</sup> *See* SDCL 49-31-1.1.

1 **Q. WHY ARE QWEST’S INTRASTATE SWITCHED ACCESS RATES THE**  
2 **APPROPRIATE BENCHMARK FOR ENSURING THAT CLECS’ RATES**  
3 **ARE FAIR AND REASONABLE?**

4 A. As I noted, as the RBOC in South Dakota, Qwest is the dominant provider in the  
5 switched access market and it has received the most regulatory scrutiny. A  
6 primary benefit of price regulation is that it enables the Commission to determine  
7 fair and reasonable prices without resort to traditional “rate of return” concepts<sup>23</sup>  
8 that have never been used to review the reasonableness of CLEC access rates (or  
9 their retail rates, for that matter). Using Qwest’s rates as a benchmark for all  
10 CLECs in South Dakota would be a modest step toward reducing market  
11 distortions and promoting competitive equity by prompting at least some of the  
12 local exchange carriers with the highest access rates to recover more of their  
13 network costs from their own customers, rather than from other carriers (and their  
14 customers) through access rates. I characterize it as a modest step, because the  
15 benchmark I am recommending -- Qwest’s intrastate access rate in South Dakota -  
16 - is itself the highest RBOC intrastate access rate in the country.

17  
18 **II. OVERVIEW OF SWITCHED ACCESS**

19 **Q. WHAT IS SWITCHED ACCESS?**

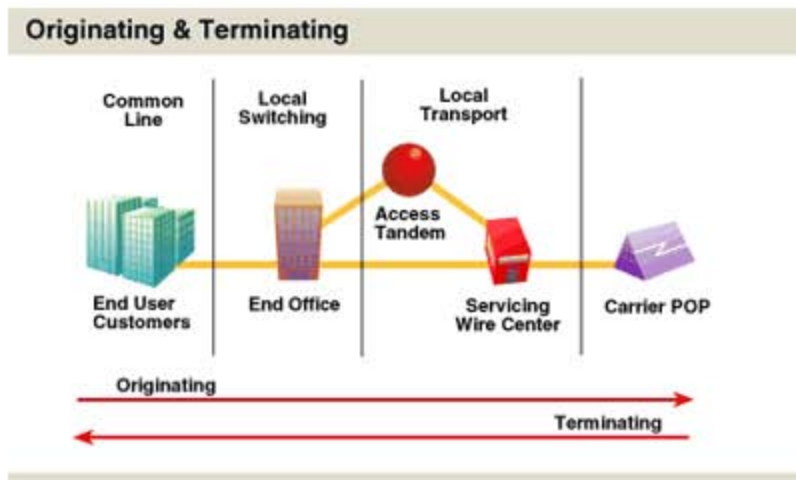
20 A. Switched access is a service provided by LECs to other carriers – usually  
21 interexchange, or toll, carriers – for originating or terminating interexchange or

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<sup>23</sup> See SDCL 49-31-1.4.

1 “toll” calls.<sup>24</sup> Access charges generally apply to calls that begin and end in  
2 different local calling areas. Interstate access charges apply to calls that originate  
3 and terminate in different states and are regulated by the FCC. Intrastate access  
4 charges apply to calls that originate and terminate in different local calling areas  
5 within the same state and are regulated by state commissions.

6  
7 The diagram below illustrates how switched access works. The “Carrier POP” is  
8 the interexchange carrier’s (“IXC’s”) “point of presence” or “POP.” The diagram  
9 shows how an interexchange call is delivered either to or from the IXC’s POP  
10 through connection with the LEC. Switched access charges compensate the LEC  
11 for the connection between the end user and the POP or other interconnection  
12 point.



13  
14 If the interexchange call originates in one state but terminates in another, switched  
15 access charges are billed at the interstate rate in the carrier’s FCC tariff. If the  
16 interexchange call originates and terminates within a state, then it is billed at the

<sup>24</sup> The origination and termination of local calls is governed by a different compensation regime, reciprocal compensation, the rates for which are typically lower than access rates.

1 intrastate access rate, which is under the state commission's jurisdiction. The  
2 switched access rates at issue in this proceeding are the rates that CLECs charge  
3 IXCs and other carriers to originate or terminate interexchange calls that begin  
4 and end in South Dakota.

5 **Q. HOW HAVE ACCESS CHARGES TRADITIONALLY BEEN SET?**

6 A. Historically, state and federal regulators jointly created a regulatory pricing  
7 system in which business and toll rates (both intrastate and interstate) were set  
8 above the cost of providing these services to provide a contribution to basic  
9 residential rates, thereby promoting federal and state universal service objectives.  
10  
11 AT&T traditionally had a monopoly on long distance communications, and there  
12 was no "access" provided to other companies to the long distance network. This  
13 industry structure started to change in the 1960s and 1970s with the introduction  
14 of private line and then switched service competition in the long distance market.  
15 With the advent of increasing interexchange competition and the divestiture of the  
16 former Bell System in 1984, interstate and intrastate access charges were  
17 established so that interexchange carriers could compensate LECs for providing  
18 switched access service. Because of universal service concerns, regulators sought  
19 to maintain in access charges the contribution flow from long distance to local  
20 service that traditionally had been provided through retail long distance charges.  
21 In other words, to maintain the rate structure that enabled basic exchange service  
22 rates to remain low when toll revenue was available to offset the costs of basic

1 service, both interstate access rates and intrastate access rates were purposefully  
2 set at artificially high levels to keep basic exchange service rates low.

3  
4 In South Dakota, the Commission adopted a set of switched access filing and  
5 pricing rules, but did so several years prior to the passage of the federal  
6 Telecommunications Act of 1996 and the opening of the local exchange market to  
7 competition. Given the stunning changes in telecommunications markets in the  
8 intervening 15 years, these rules have little relevance today and are in serious  
9 need of re-evaluation.

10  
11 In any event, with the onset of local service competition in the 1990s, CLECs  
12 entered markets without the legacy obligations of the incumbents, and also  
13 without traditional regulation of their rates, whether retail rates charged to end  
14 users or access rates charged to other carriers.

15 **Q. ARE THE RATES FOR CLECS' SWITCHED ACCESS SERVICES IN**  
16 **SOUTH DAKOTA DISCIPLINED BY THE MARKET?**

17 A. No. Given the nature of switched access services, toll carriers that purchase  
18 switched access services are not able to switch suppliers. Toll carriers have no  
19 choice but to use a CLEC's switched access service when they handle  
20 interexchange calls originating from the CLEC's customers and when they deliver  
21 interexchange calls for termination to the CLEC's customers. The FCC described  
22 the lack of market discipline over CLEC access rates as follows:

23 [O]nce an end user decides to take service from a particular LEC,  
24 that LEC controls an essential component of the system that  
25 provides interexchange calls, and it becomes the bottleneck for

1 IXC<sup>s</sup> wishing to complete calls to, or carry calls from, that end  
2 user.<sup>25</sup>

3  
4 As I reported earlier, the Massachusetts DTC concluded that “because a carrier’s  
5 customers do not have competitive alternatives for terminating their calls,” the  
6 market for terminating switched access “is not sufficiently competitive,” and  
7 IXCs are “unable to constrain the level of terminating access charges.” Last year,  
8 the Staff of the Illinois Commerce Commission reached similar conclusions in an  
9 investigation of CLEC access rates in that state:

10 Arguably, however, CLEC access services are not provided under  
11 effectively competitive market conditions. An IXC does not have  
12 any choice regarding which wireline LEC will terminate an  
13 interexchange call to a specific end-user; every interexchange call  
14 must be terminated by the LEC to which the called party  
15 subscribes, and no other. ... Conditions similar to those identified  
16 by the FCC [which determined that ‘action is necessary to prevent  
17 CLECs from exploiting the market power in the rates that they  
18 tariff for switched access services’] appear to exist with at least  
19 some CLEC Illinois intrastate access services.<sup>26</sup>

20  
21 A toll carrier cannot refuse to deliver a call to a CLEC’s end user,<sup>27</sup> and thus  
22 cannot avoid that CLEC’s terminating access charges -- it is at the mercy of the  
23 carrier from which the called party obtains local exchange service. The situation

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<sup>25</sup> See *CLEC Rate Cap Order* at ¶ 30.

<sup>26</sup> See, e.g. “Telecommunications Division Staff Report,” filed in *Illinois Commerce Commission v. McLeodUSA Telecommunications Services, Inc.* d/b/a PAETEC Business Services, Investigation into Whether Intrastate Access Charges of McLeodUSA Telecommunications Services, Inc. d/b/a PAETEC Business Services are Just and Reasonable, Docket No. 09-0315, June 26, 2009, at 3-4 (underlining in original). Illinois Staff included identical language in its reports in four parallel access charge investigations (ICC Dockets 09-0313, 09-0314, 09-0316 and 09-0317).

<sup>27</sup> As a general rule, common carriers are legally obligated to complete calls to any end users that their customers desire to call, including end users of CLECs with unreasonably high access rates. As the FCC has stated, “no carriers, including interexchange carriers, may block, choke, reduce or restrict traffic in any way.” *In the Matter of Establishing Just and Reasonable Rates for Local Exchange Carriers and Call Blocking by Carriers*, WC Docket No. 07-135, Declaratory Ruling and Order, DA 07-2863 (June 28, 2007), at ¶ 6.



1 is similar in the originating access market, given that toll deaveraging is  
2 prohibited at the interstate level and would thus be exceedingly burdensome on  
3 the intrastate level.<sup>28</sup> The New Jersey Board of Public Utilities recently relied on  
4 these same facts in rejecting arguments made by CLECs in an attempt to maintain  
5 their unreasonably high intrastate switched access rates: “[T]he Board does not  
6 find persuasive the Joint CLECs’ claim that they do not have a monopoly on  
7 intrastate access services and that the Board should permit the market to control  
8 Intrastate Access Rates.”<sup>29</sup>

9  
10 **Q. GIVEN THE LACK OF COMPETITION IN THE MARKET FOR**  
11 **SWITCHED ACCESS SERVICES, HOW SHOULD SWITCHED ACCESS**  
12 **BE CLASSIFIED FOR REGULATORY PURPOSES IN SOUTH**  
13 **DAKOTA?**

14  
15 A. The regulatory framework in South Dakota appears to recognize the market  
16 realities I just described. Because switched access is a “service for which no  
17 competition exists,” it should properly be considered a “noncompetitive service”  
18 under SDCL 49-31-1.1. That statute identifies several services that are deemed  
19 “noncompetitive,” including “[a]ll services not otherwise listed in §§ 49-31-1.2  
20 and 49-31-1.3.” Those two sections, in turn, list specific “emerging competitive”  
21 and “fully competitive” services, but switched access is not included in either list.  
22 Because switched access is not listed either in sections 49-31-1.2 or 49-31-1.3, it  
23 properly should be considered a “noncompetitive” service pursuant to SDCL 49-  
24 31-1.1. This is consistent with the fact that switched access does not exhibit the

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<sup>28</sup> See *MA DTC Order* at 14-17.

<sup>29</sup> See *NJ BPU Order* at 27 (emphasis in original; record citations omitted).

1 characteristics of an “emerging” or “fully” competitive service as described in  
2 SDCL 49-31-3.2. This is because, for reasons I have explained, there effectively  
3 are no “alternative providers” of switched access, and thus, IXC’s are not able to  
4 obtain switched access services from alternative providers at competitive rates,  
5 terms and conditions.

6  
7 **Q. DOES PERMITTING CLECS TO CHARGE INTRASTATE**  
8 **SWITCHED ACCESS RATES HIGHER THAN QWEST’S RATE**  
9 **DISTORT THE MARKET?**

10  
11 A. Yes. Permitting CLECs to collect unreasonably high access rates provides those  
12 companies with a competitive advantage because they are able to recover  
13 disproportionately more of their costs from other carriers rather than from their  
14 own end users. Purchasers of switched access services are thus forced to help  
15 fund the retail service offerings of their direct competitors in the same service  
16 areas. This cost-shifting distorts competition in interexchange and other  
17 communications markets by, for example, imposing costs that must be passed on  
18 to IXC customers. The FCC found that eliminating CLECs’ ability to engage in  
19 such conduct and requiring them to recover their costs from their own end users  
20 sends the appropriate pricing signals:

21 When a CLEC attempts to recover additional amounts from its  
22 own end user, that customer receives correct price signals and can  
23 decide whether he should find an alternative provider for access  
24 (and likely local exchange) service. This approach brings market  
25 discipline and accurate price signals to bear on the end user’s  
26 choice of access providers.<sup>30</sup>  
27

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<sup>30</sup> See *CLEC Rate Cap Order* at ¶ 39.

1 **Q. IS THERE ANY REASONED BASIS TO ALLOW CLECS IN SOUTH**  
2 **DAKOTA TO CHARGE INTRASTATE ACCESS RATES THAT ARE**  
3 **HIGHER THAN QWEST’S?**

4 A. No. As I mentioned earlier, Verizon recommends capping CLECs’ intrastate  
5 switched access rates at the level of Qwest’s intrastate rates. There is no  
6 principled justification for CLECs to continue to charge intrastate switched access  
7 rates higher than Qwest’s. Newer market entrants have no obligation to serve  
8 residential customers, let alone residential customers in rural or other high-cost  
9 areas, and do not bear the historical legacy of having to maintain low, regulated  
10 retail prices for residential consumers throughout their service areas. CLECs also  
11 have the opportunity to use the most efficient mix of technologies and network  
12 configurations possible, and should be able to operate at least as efficiently as the  
13 incumbent LECs with their legacy networks.

14 **Q. ARE CLECS IN SOUTH DAKOTA ALREADY REQUIRED TO COMPLY**  
15 **WITH THE FCC’S RATE CAP FOR ACCESS SERVICE?**

16 A. Yes. All CLECs already must comply with the FCC rule for *interstate* switched  
17 access rates, and the rate cap mechanism that Verizon proposes for CLECs’  
18 *intrastate* rates in South Dakota would be calculated in this same, familiar way.  
19 As I discussed earlier, the FCC requires CLECs to benchmark their interstate  
20 access rates to the competing ILEC’s interstate rates.

21

1 **III. THE COMMISSION SHOULD ESTABLISH AN INTRASTATE ACCESS**  
2 **RATE BENCHMARK FOR ALL CLECS**

3 **Q. WHY SHOULD THE COMMISSION ESTABLISH AN INTRASTATE**  
4 **ACCESS RATE BENCHMARK FOR CLECS?**

5 A. Under South Dakota law, the Commission may utilize price regulation to  
6 determine whether the price of a noncompetitive service (or, for that matter, an  
7 “emerging” telecommunications service) is fair and reasonable.<sup>31</sup> As explained in  
8 the statutes, price regulation “is not based on rate of return regulation” and may  
9 be used for any noncompetitive service if the procedure “is more reasonable and  
10 fair than rate of return regulation.”<sup>32</sup> Establishing a benchmark applicable to all  
11 CLECs would be a simple and effective means, consistent with these statutory  
12 provisions, to quickly move the most excessive CLEC switched access prices in  
13 South Dakota to more efficient levels, and to assure that no CLEC receives an  
14 undeserved and unfair advantage in competing for retail customers. A benchmark  
15 will promote equity and competitive parity and reduce market distortions by  
16 prompting CLECs with the highest access rates to recover more of their network  
17 costs from their own customers, rather than from other carriers and their  
18 customers through access rates. Failure to establish such a benchmark would  
19 allow CLECs to shift an excessive portion of their costs to switched access  
20 purchasers (and their retail customers), thereby placing a disproportionate burden  
21 on other carriers in the state -- and ultimately, their customers -- to subsidize those

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<sup>31</sup> See SDCL 49-31-1.4.

<sup>32</sup> See *id.* and SDCL 49-31-4.1.

1 CLECs' operations. A piecemeal approach should be rejected in favor of a rule  
2 that would have general applicability to all CLECs operating in South Dakota.

3 **Q. IS VERIZON ASKING THE COMMISSION TO SET SPECIFIC**  
4 **SWITCHED ACCESS RATES FOR INDIVIDUAL CLECS?**

5 A. No. Verizon requests that the Commission establish a benchmark that would  
6 impose a ceiling on the intrastate access rates that CLECs may charge without  
7 violating the "fair and reasonable rate" requirement of section 49-31-4, just as the  
8 FCC and numerous other states have done. CLECs with existing intrastate access  
9 rates below the benchmark should not, of course, be permitted to raise their rates.  
10 Such a result would have the aberrant effect of encouraging some CLECs to  
11 *increase* the amount of costs shifted to other carriers, which would obviously  
12 undermine the economic efficiency that establishing a cap is intended to promote.

13 **Q. WHAT RATE SHOULD SERVE AS THE BENCHMARK?**

14 A. As mentioned above, the intrastate switched access rates of the largest ILEC in  
15 the state -- in this case, Qwest -- should serve as the benchmark.

16 **Q. IS THE USE OF A BENCHMARK A REASONABLE MEANS FOR**  
17 **DETERMINING THAT ACCESS RATES ARE FAIR AND**  
18 **REASONABLE?**

19 A. Yes. SDCL 49-31-1.4 sets forth several factors the Commission should consider  
20 in determining whether the price for a noncompetitive service is fair and  
21 reasonable. These factors include "the price of alternative services, the overall  
22 market for the service, the affordability of the price for the service in the market it  
23 is offered, and the impact of the price of the service on the commitment to

1 preserve affordable universal service.” As I have explained, the market for  
2 switched access service in South Dakota is not competitive, is not capable of  
3 disciplining prices, and enables some CLECs to charge rates that are excessive.  
4 Because excessive rates distort the competitiveness of the market, “affordability”  
5 is not a meaningful concept in this context. Other carriers are not able to obtain  
6 “competitive” prices from “alternative service providers;” however, virtually all  
7 carriers obtain access services from the largest network operator in the state,  
8 Qwest. Its access rates constitute a *de facto* benchmark around which some – but  
9 clearly not all – CLECs have gravitated. Taken together, these factors all indicate  
10 that establishing a uniform benchmark price above which CLECs may not charge  
11 is a reasonable approach under the statute. The last factor referenced in the  
12 statute -- the impact of the price of the service on the commitment to preserve  
13 affordable universal service – is not relevant in this context because CLECs do  
14 not undertake any commitment to serve residential customers, which is the  
15 foundation of universal service policies.

16 **Q. ARE THERE OTHER CRITERIA THE COMMISSION SHOULD**  
17 **CONSIDER IN DETERMINING A “FAIR AND REASONABLE” RATE?**

18 A. Yes. In reviewing whether a rate is fair and reasonable, the Commission should  
19 consider the impact of the rate on the competitive market. And while the actions  
20 taken by other state commissions are not legally binding on this Commission,  
21 understanding what regulators in other states have done *vis a vis* CLEC intrastate  
22 access reform can provide this Commission with beneficial information in making  
23 a decision here. This type of guidance could be particularly valuable here because

1 the Commission has not revised its access pricing rules since before local service  
2 competition began to emerge. As noted above, every state commission that has  
3 formally considered capping CLEC rates has concluded that such a benchmarking  
4 approach is good policy. There are no unique conditions with respect to CLEC  
5 switched access services in South Dakota that would justify a different  
6 conclusion.

7 **Q. IS THE USE OF A RATE BENCHMARK SUPERIOR TO COST OF**  
8 **SERVICE REGULATION?**

9 A. Yes. According to the pertinent statutory provisions, price regulation “is not  
10 based on rate of return regulation” and may be appropriate if it “is more  
11 reasonable and fair than rate of return regulation.”<sup>33</sup> In certain contexts, the cost  
12 of providing a service can factor into the analysis of whether the rate for that  
13 service is just and reasonable. However, I do not believe costs are pertinent here,  
14 or that examining a CLEC’s service-specific costs of providing switched access  
15 service is a desirable, let alone preferable or efficient, approach to evaluating the  
16 prices the companies charge.

17  
18 As I noted earlier, upon divestiture, ILECs’ intrastate access rates were originally  
19 set above cost in order to subsidize local service. When, years later, the FCC  
20 reformed CLECs’ interstate access rates, it did so using a benchmarking  
21 approach, concluding that ILECs’ rates represented a fair market rate for access  
22 services. The FCC did not evaluate individual CLECs’ costs when it adopted this

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<sup>33</sup> See SDCL 49-31-1.4 and 49-31-4.1.

1 policy. Indeed, the FCC deemed alleged cost differentials between CLECs and  
2 ILECs irrelevant, noting that CLECs “retain the option of recovering from their  
3 end users any additional costs that they may experience.”<sup>34</sup> Absent a price cap,  
4 the FCC was concerned that higher access rates “may allow some CLECs  
5 inappropriately to shift onto the long distance market in general a substantial  
6 portion of the CLECs’ start-up and network build-out costs [and s]uch cost  
7 shifting is inconsistent with the competitive market.”<sup>35</sup>

8  
9 This Commission has no obligation to ensure the profitability of any CLEC. Nor  
10 is there any reason for the Commission to permit a CLEC to charge rates above a  
11 benchmark level when the effect of doing so is to shield that carrier’s retail  
12 customers from appropriate price signals in a competitive market. The purpose of  
13 regulation is to mimic the effects of competition when needed, and in competitive  
14 markets, higher cost firms typically are not rewarded for inefficiency with higher  
15 prices. Indeed, it would be highly unusual for a company to succeed in a  
16 competitive market if it charges considerably more than the rates of its largest  
17 competitors, as many CLECs do with respect to intrastate switched access. In  
18 fact, the current ability of some CLECs to charge intrastate access rates at much  
19 higher levels is, in itself, a strong indication that the CLECs wield market power  
20 in providing access services.

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<sup>34</sup> See *CLEC Rate Cap Order* at ¶¶ 4, 39.

<sup>35</sup> *Id.* at ¶ 33.



1 **Q. DOES THE COMMISSION HAVE EXPERIENCE EVALUATING CLEC**  
2 **COSTS?**

3  
4 A. I am not aware of a situation in which this Commission has set intrastate switched  
5 access rates for a CLEC with reference to any cost study. My understanding is  
6 that section 20:10:27.11 of the Commission's administrative rules permits the  
7 Commission to establish intrastate switched access rates without determining  
8 company-specific costs, and that the Commission has often allowed CLECs to file  
9 access tariffs without submitting cost data in support of their proposed rates. This  
10 is consistent with my general experience that state regulators typically do not  
11 examine the rates of any CLEC service, whether retail or wholesale, based on a  
12 review of an individual carrier's costs.

13  
14 Moreover, there is no apparent purpose to be served by undertaking a review of  
15 CLEC costs at this stage of the industry's development. CLECs generally do not  
16 keep their financial records according to the Uniform System of Accounts that  
17 historically has served as the foundation for regulatory decisions regarding  
18 incumbent LECs' costs. Thus, the Commission does not have sufficient  
19 information about the financial situation of individual CLECs or their "costs," has  
20 no way of comparing the purported costs of a CLEC's intrastate access services  
21 with the costs of providing its other services, and lacks a framework for relating  
22 CLEC costs into the rates for individual services. If the Commission were to  
23 begin analyzing the costs of individual CLECs in order to determine whether their  
24 switched access rates are fair and reasonable, this would impose an

1 unmanageable, costly and time-consuming burden on the Commission and  
2 carriers alike.

3  
4 As other regulatory agencies have found, establishing a clear benchmark for  
5 CLEC access rates is a simpler and more administratively efficient approach, and  
6 avoids the delay, controversy and confusion that would surely arise were the  
7 Commission to undertake a series of new cost cases. The FCC explained the  
8 rationale for its benchmark policy as follows:

9 We conclude that the benchmark we adopt will address persistent  
10 concern over the reasonableness of CLEC access charges and will  
11 provide critical stability for both the long distance and exchange  
12 access markets. In structuring the benchmark mechanism, we have  
13 taken into account a broad variety of competing factors, including:  
14 (1) the need to constrain access rates with an eye toward  
15 continuing the downward trend in long distance prices, (2) the  
16 importance of having new entrants' rates move toward and  
17 ultimately meet those of market incumbents, (3) the need to avoid  
18 too severe of a disruption in the CLEC sector of the industry, and  
19 (4) the extreme difficulty of establishing a "reasonable" CLEC  
20 access rate given the historical lack of regulation on the process of  
21 CLEC ratemaking. We conclude that our benchmark system, with  
22 its conclusive presumption of reasonableness, provides the best  
23 solution to the difficult problems associated with how CLECs set  
24 their access charges.<sup>36</sup>  
25

26 **Q. WOULD A BENCHMARK SET AT THE RBOC'S RATE PLACE CLECS**  
27 **AT AN UNFAIR DISADVANTAGE?**

28  
29 A. Not at all. As newer market entrants, CLECs are not constrained with the need to  
30 maintain a network that has been constructed incrementally over the course of the  
31 past century, with the associated outdated legacy technologies associated with  
32 such a network. CLECs instead have the opportunity to construct and expand

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<sup>36</sup> CLEC Price Cap Order at ¶¶ 41, 44.

1           their networks using modern – and generally, less expensive and more efficient –  
2           equipment. CLECs are also less apt to have sizeable unionized labor forces, and  
3           thus often have lower labor costs than ILECs. Nor are CLECs saddled with  
4           legacy regulations that require them to offer a set of essential services to all  
5           customers who request it. Because CLECs can decline to serve a particular area,  
6           a particular type of customer, or to provide a particular type of service, they can  
7           limit their network costs by focusing on, and investing in, only the networks they  
8           choose to build. In other words, they are generally free to make decisions based  
9           solely on their assessment of business and economic factors, and the requirements  
10          of the customers they choose to serve, rather than on regulatory constraints. For  
11          these reasons, plus the fact that CLECs currently charge much lower rates for  
12          interstate switched access, these carriers would not be disadvantaged or precluded  
13          from recovering their costs if they are prevented from charging a higher amount  
14          for intrastate switched access than Qwest does. Indeed, as I noted earlier, Qwest's  
15          intrastate switched access rates, at about a nickel a minute, are higher than any  
16          other RBOC's in the country, so benchmarking to those rates would plainly be no  
17          hardship for CLECs -- particularly in light of the fact that CLECs are already  
18          complying with a federal cap in South Dakota that is multiples lower than the cap  
19          on intrastate rates that Verizon is recommending here.

20  
21          Regardless of whether a CLEC may be small and has little market share, the FCC  
22          concluded that the lack of size is not a sufficient policy reason to allow a CLEC to

1 shift its “start up costs” to IXCs.<sup>37</sup> The FCC concluded instead that CLECs  
2 should recover more of their costs from their own customers than from  
3 competitors, because this policy would result in the CLEC’s retail end users  
4 receiving “accurate price signals.”<sup>38</sup> This preferable policy outcome would be  
5 achieved by reducing CLECs’ rates to a benchmark level. This would help ensure  
6 that customers of other carriers are not forced to pay excessive amounts to CLECs  
7 with high access rates, and that those CLECs cannot use revenues from those rates  
8 to undercut their competitors’ retail rates.

9 **Q. ARE THERE IMPLEMENTATION ISSUES THAT SHOULD BE**  
10 **CONSIDERED BY THE COMMISSION IN SETTING THE**  
11 **BENCHMARK?**

12 A. No. As I mentioned earlier, CLECs are already well acquainted with the concept  
13 of a benchmark rate, given their familiarity with the FCC’s interstate access rate  
14 benchmark. However, this Commission should make clear in establishing the  
15 benchmark that a CLEC can only charge for the functions that the CLEC actually  
16 performs in providing its switched access service. Therefore, the rates charged  
17 will vary with the switched access functions the CLEC performs and the miles of  
18 transport provided, as applicable, because a CLEC should not be able to charge  
19 toll carriers for switched access functions that it does not provide. For example, if  
20 a CLEC does not perform tandem switching functions, it should not be allowed to  
21 include a charge for a tandem switching service that it does not provide. The

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<sup>37</sup> See *CLEC Rate Cap Order* at ¶ 33.

<sup>38</sup> *Id.* at ¶¶ 39, 43.

1 Commission's rules appear already to embrace this principle,<sup>39</sup> but it should be  
2 reinforced as the Commission adopts price regulation for CLECs. This approach  
3 would allow each CLEC to maintain its own intrastate switched access rate  
4 structure and rate elements, while preventing them from receiving compensation  
5 for intrastate switched access functions they do not perform.

6 **Q. DO HIGH ACCESS RATES CREATE ADDITIONAL PROBLEMS**  
7 **THAT SHOULD BE OF CONCERN TO THE COMMISSION?**

8 A. Yes. High switched access rates create opportunities for arbitrage,<sup>40</sup> as well as  
9 incentives for local exchange carriers to engage in access stimulation or "traffic  
10 pumping" schemes. Under such arrangements, local exchange carriers enter into  
11 kickback arrangements with providers of "free" conference calling, international  
12 calling, chat line and other services to artificially inflate call volumes. These  
13 companies market their services to consumers who then dial interexchange  
14 numbers to reach the "free" service. When switched access rates are  
15 extraordinarily high, as they are in South Dakota, the huge spikes in traffic  
16 volumes generated by these scams produce a substantial increase in the LEC's  
17 switched access revenues. The windfall profits are then shared between the chat  
18 line operator and the LEC that provides phone service to the company offering the  
19 "free" chat line service.

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<sup>39</sup> 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).

<sup>40</sup> See *CLEC Rate Cap Order* at ¶ 34.

1           These schemes benefit both parties even when the telephone service provider pays  
2           a majority of its intrastate switched access revenue to the chat line operator. The  
3           LEC is willing to “share” a significant portion of its revenues with a third party  
4           only because the arrangement produces supra-competitive profits. The higher the  
5           access rates charged, the greater the incentive there is for unscrupulous firms to  
6           engage in such practices. Because interexchange carriers are obligated to deliver  
7           traffic to the numbers assigned by the traffic-pumping LEC, and then get billed  
8           enormous amounts for the inflated traffic volumes, these schemes harm IXCs and,  
9           ultimately, their customers.

10           The FCC and state regulators in Iowa have recently declared certain traffic-  
11           pumping schemes to be illegal.<sup>41</sup> However, just as in the arcade game “Whack-a-  
12           Mole,” unscrupulous chat line firms continue to seek out other local exchange  
13           companies -- especially those with high access rates – with which they may  
14           partner in similar arrangements. Because of the extraordinarily high access rates  
15           being charged by many LECs in South Dakota, a number of these firms have  
16           found a “home” for their traffic-pumping activities here. As the Commission is  
17           likely aware, several South Dakota LECs have engaged in “traffic pumping”  
18           schemes designed to take advantage of high access rates to generate revenues for  
19           these LECs and their free conference calling company co-conspirators. This is  
20           another reason why the need to police access charges is particularly acute in  
21

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<sup>41</sup> *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).

1 South Dakota. The best way to remove the incentive and opportunity to engage in  
2 these types of anti-consumer practices is to cap switched access rates at  
3 reasonable levels. In addition to removing the harm to competition, sending a  
4 strong message that South Dakota is not a safe haven for the traffic pumping  
5 industry will also protect South Dakota's business climate and reputation.

6 **IV. THE COMMISSION SHOULD ALSO REFORM THE ACCESS**  
7 **CHARGES OF INDEPENDENT LOCAL EXCHANGE CARRIERS**

8 **Q. SHOULD THE COMMISSION ALSO ADDRESS INTRASTATE**  
9 **SWITCHED ACCESS RATES CHARGED BY INDEPENDENT LECS?**

10  
11 A. Yes. All of the problems and concerns caused by high access charges apply to  
12 switched access services provided by *all* South Dakota local exchange carriers --  
13 both competitive LECs *and* independent LECs. If an independent LEC ("ILEC")  
14 charges excessive access rates -- and many plainly do -- it creates the same  
15 economic inefficiencies, market distortions and competitive harms that I have  
16 described with respect to CLEC access rates. Accordingly, Verizon recommends  
17 that the Commission adopt a common regulatory framework that applies to the  
18 intrastate switched access rates of both CLECs and ILECs. Requiring all local  
19 exchange carriers in South Dakota to cap their access rates at Qwest's rate level  
20 will also promote competitive neutrality.

21  
22 **Q. DO THE ACCESS RATES OF INDEPENDENT LECS WARRANT**  
23 **PARTICULAR ATTENTION?**

24  
25 A. Yes, in fact, the intrastate access rates of most ILECs in South Dakota dwarf the  
26 rates charged by Qwest and even those of some CLECs, and therefore pose a

1 more serious threat to a healthy competitive market. For the past three years, the  
2 ILECs that operate under the Local Exchange Carriers Association (“LECA”)  
3 tariff have been charging \$0.125 per minute for originating access and \$0.125 per  
4 minute for terminating access. These are easily among the very highest access  
5 charges in the country. They are also *more than double* Qwest’s comparable  
6 usage-based intrastate switched access rate, which is closer to \$0.05 per minute.  
7 If an interexchange call originates in one ILEC’s local service area and terminates  
8 in another ILEC’s local territory, the cost to the interexchange carrier for  
9 originating and terminating the call is 25 cents per minute.

10 Access charges of this magnitude harm consumers and competition. To recover  
11 these costs, an IXC must charge high toll rates, which dampens consumer demand  
12 for and usage of long distance services in rural areas. A further complicating  
13 factor is that IXCs are required to charge uniform prices on all routes where they  
14 offer interexchange services in South Dakota.<sup>42</sup> Thus, if an IXC wants to  
15 establish lower toll rates so that it may effectively compete in Qwest’s local  
16 service area, it is unable to recover the excessive access charges it is forced to pay  
17 when it originates or terminates interexchange calls to consumers served by  
18 independent LECs. One result of this disparity in access rates between Qwest and  
19 other ILEC service areas is that intrastate toll rates paid by consumers in Qwest’s  
20 territory are much higher than they otherwise would be. Alternatively, to avoid  
21

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<sup>42</sup> 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.”



1 paying high originating access rates, an IXC may choose not to serve customers in  
2 more expensive parts of the state, but this deprives consumers of a competitive  
3 choice and of service options that citizens in other states enjoy. Finally,  
4 extraordinarily high access rates create no incentives for IXCs to invest in their  
5 network infrastructure or to develop and promote innovative services in South  
6 Dakota. All of these problems exacerbate the problems with high access rates that  
7 I identified earlier.

8  
9 **Q. ARE THE ILECS' EXCESSIVE INTRASTATE SWITCHED ACCESS**  
10 **RATES JUSTIFIED?**

11  
12 A. No. The market for switched access is not sufficiently competitive, and market  
13 forces are not adequate to constrain the level of switched access rates that ILECs  
14 in South Dakota have been able to charge. The FCC has repeatedly observed that  
15 economically efficient competition and the consumer benefits it yields cannot be  
16 achieved as long as carriers seek to recover a disproportionate amount of their  
17 costs from other carriers, rather than from their own end users.<sup>43</sup> In South  
18 Dakota, it is apparent that many ILECs rely to a substantial extent on high access  
19 rates to fund their local service operations, rather than seek recovery of their costs  
20 from their own end users. This is evident from the fact that the residential local

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<sup>43</sup> See generally *Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Low-Volume Long Distance Users; Federal-State Joint Board On Universal Service*, 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, 15 FCC Rcd 12962 (May 31, 2000) (“*CALLS Order*”); *Multi-Association (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, Second Report & Order and Further Notice of Proposed Rulemaking in CC Docket No. 00-256, Fifteenth Report & Order in CC Docket No. 96-45, and Report & Order in CC Docket Nos. 98-77 and 98-166, 16 FCC Rcd 19613 (2001) (“*MAG Order*”); and *CLEC Rate Cap Order*, *supra*.

1 service rates charged by many ILECs are significantly below the national average,  
2 which was \$15.62 per month, as of 2007, according to the FCC.<sup>44</sup>

3  
4 According to this Commission's most recent annual Report on  
5 Telecommunications Companies' Operations, which contains information for the  
6 year 2008, a few ILECs and rural telephone cooperatives in South Dakota  
7 continue to charge rates as low as \$7.00 to \$8.00 per month for residential service.  
8 In about 40 other exchange areas in the state, local residential service rates range  
9 between \$9.00 and \$14.20 per month. As the FCC has pointed out, when LECs  
10 receive a disproportionate amount of their funding from other carriers instead of  
11 from their own end users, their customers do not receive accurate price signals,  
12 and this creates a distortion of the market. And, finally, artificially low retail rates  
13 inhibit potential competitive entry by other firms.

14  
15 **Q. ARE THERE OTHER REASONS WHY IT IS INAPPROPRIATE TO**  
16 **LOOK TO ACCESS CHARGES TO FINANCE THE ILECS'**  
17 **OPERATIONS?**

18  
19 A. Yes. It is not necessary for ILECs to depend so heavily on high access charges  
20 and the access revenues they receive from IXCs to subsidize their operations. In  
21 addition to the fact that ILECs should recover a larger portion of their costs from  
22 their own end users, it is important to point out that ILECs in South Dakota  
23 already have other significant sources of funding available to them. In particular,  
24 these carriers derive substantial amounts of money each year from federal "high

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<sup>44</sup> See "Reference Book of Rates, Price Indices, and Household Expenditures for Telephone Service," published by the FCC's Industry Analysis & Technology Division, Wireline Competition Bureau (2008). The basic rate was calculated before adding the FCC subscriber line charge, and any taxes and fees.

1 cost funding” programs. While the FCC’s high cost program is intended to reduce  
2 interstate access rates, certain elements of the federal program are also intended to  
3 provide a contribution to costs that are jurisdictionally *intrastate*. The FCC has  
4 explained, for example, that

5 “[I]ike ICLS [Interstate Common Line Support], the purpose of  
6 this mechanism [Interstate Access Support, or ‘IAS’] is to provide  
7 explicit support to ensure reasonably affordable interstate rates.  
8 This is in contrast to the Commission’s other high-cost support  
9 mechanisms, which provide support *to enable states to ensure*  
10 *reasonably affordable and comparable intrastate rates.*”<sup>45</sup>  
11

12 A review of the data contained in the Joint Board Monitoring Report shows that in  
13 each of the years 2006 through 2008, the amounts received by South Dakota  
14 ILECs from federal high cost programs included more than \$35 million intended  
15 to help ensure the affordability of local rates.<sup>46</sup> At the time the report was  
16 prepared, ILECs in South Dakota were projected to receive an additional \$35  
17 million in 2009 for the same purpose. On a cumulative basis, these carriers  
18 received nearly \$175 *million* dollars from federal high cost programs over the past  
19 five years for the purpose of supporting local intrastate service in South Dakota.

20 This stream of funding, coupled with the ability of ILECs to recover a larger  
21 proportion of their costs from their own end users, provide further reasons why  
22

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<sup>45</sup> “Universal Service Monitoring Report,” CC Docket No. 98-202 (2009), prepared by Federal and State Staff for the Federal-State Joint Board on Universal Service, in CC Docket No. 96-45 (“Joint Board Monitoring Report”) at 3-8 (emphasis added).

<sup>46</sup> Table 3.30 in the Joint Board Monitoring Report identifies “Total High-Cost Support Payments by Study Area.” To calculate the figures shown in the text, amounts paid to Qwest Corporation, wireless Eligible Telecommunications Carriers and CLECs in South Dakota were excluded from the total, and then the Interstate Common Line Support payments shown in Table 3.27 and the Interstate Access Support Payments shown in Table 3.28 were subtracted. All of these amounts and their sources are shown in Attachment 1 to my testimony.

1 the Commission should take action now and reduce the level of access charges  
2 that these companies now impose on interexchange carriers.

3  
4 **Q. WHAT ACTION DO YOU RECOMMEND THE COMMISSION TAKE**  
5 **WITH RESPECT TO ILEC SWITCHED ACCESS RATES?**

6  
7 A. More than four years ago, the Commission opened a docket, RM05-002, to  
8 consider revisions to its switched access pricing rules. The record of that  
9 proceeding contains ample evidence of the harms these excessive rates cause to  
10 competition and consumers in the state. The comments in that proceeding also  
11 showed that these ILECs' rates are considerably higher than the rates charged by  
12 ILECs in other states in the Qwest region, as well as in other rural states across  
13 the nation. That docket is still open and the record is closed. That rulemaking  
14 docket is an appropriate vehicle for the Commission to promptly take action based  
15 on the existing record to reduce ILEC rates to more reasonable levels. As I have  
16 indicated, and as Verizon has proposed in that proceeding, the Commission  
17 should adopt a requirement that all local exchange carriers cap their switched  
18 access rates at the level of Qwest's intrastate charges.

19  
20 **V. CONCLUSION**

21 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

22 A. Yes.