

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Illinois Commerce Commission)	
On Its Own Motion)	
)	
v.)	
)	
McLeodUSA Telecommunications Services, Inc.)	Docket No. 09-0315
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.)	
)	

DIRECT TESTIMONY OF

DON PRICE

ON BEHALF OF VERIZON

PUBLIC VERSION

Verizon Exhibit 1.0

February 22, 2010

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

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

3 A. My name is Don Price. I am a Director - State Public Policy for Verizon. My
4 business address is 701 Brazos, Suite 600, Austin, Texas, 78701.

5 **Q. MR. PRICE, PLEASE DESCRIBE YOUR EDUCATIONAL AND**
6 **PROFESSIONAL BACKGROUND.**

7 A. I have more than 30 years experience in the communications industry, the vast
8 majority of which is in the public policy area. I worked for the former GTE
9 Southwest in the early 1980s. In 1983, I moved to the Texas Public Utilities
10 Commission. There, I acted as a Commission analyst and witness on rate-setting
11 and policy issues. In 1986, I became Manager of Rates and Tariffs, and was
12 responsible for Staff analyses of rate design and tariff policy issues in all
13 telecommunications proceedings before the Commission. I joined MCI in 1986,
14 where I spent 19 years focused on public policy issues in telecommunications,
15 including issues of intercarrier compensation and coordination of positions in
16 interconnection agreement negotiations. With the close of the Verizon/MCI
17 merger in January 2006, I assumed my current position as Director – State Public
18 Policy for Verizon.

19 During my career, I have testified before state regulators in at least 25
20 states on a wide range of issues in many types of proceedings and on a variety of
21 topics, including various intercarrier compensation issues, and technical and
22 policy issues arising in interconnection agreement arbitrations with local

1 exchange carriers. I earned both a Master’s and Bachelor’s degree in sociology
2 from the University of Texas at Arlington in 1978 and 1977, respectively.

3 **Q. HAVE YOU PREVIOUSLY TESTIFIED IN ILLINOIS?**

4 A. Yes. I testified on a number of issues in ICC Docket No. 04-0469 (Petition for
5 Arbitration of Interconnection Rates, Terms and Conditions and Related
6 Arrangements with Illinois Bell Telephone Company Pursuant to Section 252(b)
7 of the Telecommunications Act of 1996). I recently filed testimony in ICC
8 Docket No. 09-0313 (which is scheduled to go to hearing in March 2010) on
9 many of the same matters at issue in this proceeding.

10

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

12 A. On July 8, 2009, on its own motion, the Illinois Commerce Commission
13 (“Commission”) issued an Order opening an investigation into whether the
14 intrastate switched access rates of McLeodUSA Telecommunications Services,
15 Inc. d/b/a PAETEC Business Services (“McLeod”) are just and reasonable
16 (“Order”). McLeod is a competitive local exchange carrier (“CLEC”) operating
17 in Illinois. The Commission initiated its investigation as a result of a June 26,
18 2009 “Telecommunications Division Staff Report” (“Staff Report”)¹ indicating
19 that McLeod’s intrastate switched access rates may not be consistent with Section
20 9-250 of the Illinois Public Utilities Act (220 ILCS § 5/9-250), which requires
21 that the rates charged for all Illinois telecommunications services must be just and

¹ The Order made the Staff Report part of the record in this proceeding.

1 reasonable.² The Staff Report additionally noted that “[w]hile other Illinois
2 CLECs also may be charging arguably excessive intrastate access rates, *the*
3 *intrastate access rates charged by McLeodUSA are currently among the highest*
4 *in Illinois.*”³

5 The purpose of my testimony is to present the position of MCI
6 Communications Services, Inc. d/b/a Verizon Business Services, Verizon
7 Enterprise Solutions LLC and Verizon Long Distance LLC (collectively,
8 “Verizon”) on whether McLeod’s intrastate switched access rates are just and
9 reasonable, and if not, what actions the Commission should take. Dr. Jason
10 Zhang of Verizon is filing separate testimony criticizing McLeod’s Network
11 Usage Cost Assessment (“NUCA”) model.

12 **Q. WHAT IS VERIZON’S POSITION?**

13 A. McLeod’s current intrastate switched access rates are unjust and unreasonable.
14 As Staff noted in its calculation of McLeod’s intrastate access rates, those rates
15 are conservatively well over 4 cents a minute⁴ and greatly exceed those charged
16 by Illinois Bell Telephone Company (hereinafter, “AT&T Illinois”), the regional
17 Bell operating company (“RBOC”) in Illinois, as well as those of Verizon North
18 Inc., Verizon South Inc., and many of McLeod’s fellow Illinois CLECs—a
19 number of which charge less than a penny per minute for their intrastate switched
20 access services. Rates at the levels charged by McLeod are excessive and impede

² See Order at 1.

³ See Staff Report at 5 (emphasis added).

⁴ See “Staff of the Illinois Commerce Commission’s Report and Description of Access Rate Calculation,” filed September 1, 2009 in the instant docket (hereinafter “Staff Calculation”) at 2.

1 fair competition. As Dr. Zhang explains, McLeod’s NUCA model vastly
2 overstates McLeod’s costs of providing intrastate switched access service and
3 does not support McLeod’s excessive rates for the service. For these reasons, and
4 as discussed in detail below, Verizon recommends that the Commission cap all
5 Illinois CLECs’ intrastate switched access rates, including McLeod’s, at the level
6 of AT&T Illinois’ intrastate rates.

7 **Q. HAS COMMISSION STAFF INDICATED THAT IT MAY SHARE SOME**
8 **OF VERIZON’S CONCERNS REGARDING THE DISPARATE RANGE**
9 **OF INTRASTATE SWITCHED ACCESS RATES CHARGED BY**
10 **ILLINOIS CLECS?**

11 A. Yes. Staff has recognized that both the Federal Communications Commission
12 (“FCC”) and other state commissions have raised serious concern about such
13 access rate disparities elsewhere:

14 Over the past several years, questions regarding the propriety of
15 access rates charged by numerous competitive local exchange
16 carriers (“CLECs”) have been raised at both the federal and state
17 levels. The Federal Communications Commission (“FCC”) has
18 acted to constrain access rates charged by CLECs for interstate
19 access services. Several state regulatory agencies also have taken
20 actions to cap or otherwise constrain the level of intrastate access
21 rates applied by CLECs in their jurisdictions.⁵

22
23 And, of course, Staff recommended opening this investigation after comparing
24 McLeod’s intrastate access rates to those of other Illinois CLECs.

25 **Q. MCLEOD WITNESS MR. MICHAEL STARKEY OF QSI CONSULTING,**
26 **INC. IMPLIES THAT THE STAFF REPORT REFLECTS SKEPTICISM**
27 **REGARDING WHETHER MCLEOD’S INTRASTATE SWITCHED**

⁵ See Staff Report at 1-2; footnote omitted.

1 **ACCESS RATES ARE UNJUST AND UNREASONABLE.⁶ IS THIS A**
2 **FAIR CHARACTERIZATION OF THE STAFF REPORT?**

3 A. No. Mr. Starkey comments that the Staff Report does not “make any definite
4 conclusions,” but this does not indicate that Staff believes McLeod’s intrastate
5 switched access rates are just and reasonable. It indicates that when Staff
6 recommended that the Commission open this investigation, it did not purport to
7 decide the ultimate issues that the Commission will be responsible for deciding
8 after the development of a full record. That said, any objective reader of the Staff
9 Report would conclude that Staff is quite skeptical that McLeod’s current
10 intrastate access rates satisfy Section 9-250’s “just and reasonable” requirement.

11 **Q. THE STAFF REPORT MENTIONED THAT BOTH THE FCC AND**
12 **OTHER STATES HAVE TAKEN ACTION TO REDUCE CLEC ACCESS**
13 **RATES. COULD YOU ELABORATE?**

14 A. To address this issue at the federal level, the FCC established a benchmark policy
15 whereby CLECs’ per minute interstate access charges are capped at the interstate
16 access charge rates of the incumbent LEC (“ILEC”) in whose service territory the
17 CLEC competes.⁷ CLEC access charges that do not exceed the benchmark are
18 presumed to be just and reasonable.⁸ The FCC explained its benchmark policy as
19 follows:

⁶ See Direct Testimony of Michael Starkey on behalf of McLeodUSA Telecommunications Services, Inc. d/b/a PAETEC Business Services, filed October 8, 2009, at 7-8 (“McLeod Direct”).

⁷ 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; 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.

⁸ 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

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

15 * * *

16 [T]he benchmark we adopt will address persistent concern over the
17 reasonableness of CLEC access charges and will provide critical
18 stability for both the long distance and exchange access markets.⁹

19 The FCC's rule was prompted by "persistent" concerns that CLEC access rates
20 varied dramatically and were frequently well above the rates charged by ILECs
21 operating in the same area. The FCC's price cap was, therefore, intended to
22 prevent CLECs from imposing excessive access charges on toll carriers and their
23 customers.¹⁰

24 **Q. HAS ACCESS REFORM BEEN LIMITED TO CLECS' INTERSTATE**
25 **SWITCHED ACCESS RATES?**

26 A. Not at all. At least 20 states impose some form of constraint on CLEC rates, and
27 have found benchmarking approaches like the FCC's to be a simple and effective
28 means of reducing intrastate access rates to reasonable levels. Indeed, every state

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.

⁹ See *CLEC Rate Cap Order* at ¶¶ 41; 44.

¹⁰ *Id.* at ¶¶ 32-34.

1 commission that has formally considered capping CLEC rates has concluded that
2 such a benchmarking approach is good policy.¹¹ Since the issuance of the Staff

¹¹ 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 ILECs’ switched access rates at the level of the largest ILEC 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 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 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*

1 Report, the New Jersey Board of Public Utilities ordered CLECs to cap their
2 intrastate switched access rates at the level of the intrastate rates charged by the
3 competing ILEC in the area(s) they serve.¹² West Virginia also recently joined
4 the growing list of states that have imposed caps on CLECs' switched access
5 rates.¹³ And in December of last year, the Massachusetts Department of
6 Telecommunications and Cable ("DTC") affirmed its earlier decision capping
7 CLEC rates at Verizon Massachusetts' level¹⁴—a measure the DTC found
8 necessary "to correct the market failure regarding CLEC intrastate switched
9 access rates."¹⁵ The Massachusetts DTC found a rate cap based on Verizon's
10 intrastate switched access rates to be "an appropriate mechanism to ensure that
11 CLEC switched access rates are just and reasonable, in the absence of sufficient
12 competition, because ... Verizon's rates have been found to be just and
13 reasonable."¹⁶

14 **Q. WOULD YOU SUMMARIZE THE MASSACHUSETTS DTC'S**
15 **REASONING?**

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).

¹² 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 Board's ruling reducing Verizon NJ's access charges without giving it a simultaneous opportunity to recover its costs of rate-regulated services.

¹³ *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, Case No. 08-0656-T-PC (Nov. 23, 2009).

¹⁴ *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, D.T.C. 07-9 (December 7, 2009).

¹⁵ *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, D.T.C. 07-9 (June 22, 2009) ("*MA DTC Order*") at 23-24.

¹⁶ *Id.*

1 A. In its Final Order (affirmed on reconsideration), the Massachusetts DTC
2 recognized that IXCs cannot decline to terminate calls to CLECs whose access
3 charges they believe are too high.¹⁷ It thus found that while effective market-
4 based pricing would otherwise constrain access rates, “there is a market failure in
5 the CLEC switched access market.”¹⁸ It reached this conclusion after finding that
6 the “[e]vidence strongly shows that CLECs have market power in providing
7 intrastate switched access service.”¹⁹

8 The Massachusetts DTC found market failures in both the originating and
9 terminating CLEC switched access markets. It concluded that the market for
10 terminating switched access “is not sufficiently competitive because a carrier’s
11 customers do not have competitive alternatives for terminating their calls,”²⁰
12 leaving IXCs unable to constrain the level of terminating access charges and
13 giving CLECs market power that precludes a sufficiently competitive terminating
14 access market.²¹ This inability results from the fact that the cost causer (the party
15 receiving the call) “is insulated from changes in wholesale access prices because
16 they are not the customer of the IXC paying the terminating access charges,” and
17 thus “cannot be expected to react ‘in response to changes in [wholesale] price.’”²²

¹⁷ *Id.* at 5.

¹⁸ *Id.* at 6.

¹⁹ *Id.* at 9.

²⁰ 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.

²¹ *Id.* at 10.

²² *Id.* at 13.

1 The Massachusetts DTC concluded that “the originating switched access
2 market also is not sufficiently competitive.”²³ Although it noted that with
3 originating switched access, the calling party is the cost-causer and “could,
4 theoretically, react in response to high origination rates,” it held that because
5 IXCs cannot geographically deaverage their interstate toll rates, doing so for
6 intrastate toll calls “is not practicable” given the “unnecessarily burdensome and
7 confusing dual charge situation in which IXCs would be required to separately
8 track and bill an individual customer’s calls by LEC.”²⁴

9 Having found that CLECs possess market power in both the originating
10 and terminating switched access markets, the Massachusetts DTC concluded that
11 a rate cap based on the RBOC rate was the appropriate solution to ensuring just
12 and reasonable CLEC access rates.²⁵ Noting that “every state that has acted on
13 CLEC access rates has implemented a cap, with the majority of those states
14 setting a rate ceiling at the ILEC intrastate rate,”²⁶ it found that as a result of its
15 newly-ordered rate cap, “a market distortion will be removed, thus furthering
16 competition within the telecommunications industry,” which would, in turn,
17 “result in lower long distance rates for consumers in the Commonwealth.”²⁷

18 **Q. HAS THIS COMMISSION EVER TAKEN SIMILAR ACTIONS?**

19 A. Not on an industry-wide basis. However, this Commission has previously capped
20 individual CLECs’ access rates at AT&T Illinois’ levels in the context of

²³ *Id.* at 14.

²⁴ *Id.* at 15-16.

²⁵ *Id.* at 17; 22-24.

²⁶ *Id.* at 23-24.

²⁷ *Id.* at 1.

1 arbitrations conducted pursuant to the Telecommunications Act of 1996. And
2 more recently, by opening this and four other contemporaneous CLEC access
3 charge investigations,²⁸ the Commission has signaled a desire to begin addressing
4 CLEC access charge issues more broadly.

5 **Q. COULD YOU EXPAND ON WHAT THE COMMISSION HAS DONE TO**
6 **DATE WITH RESPECT TO CLECS' INTRASTATE ACCESS CHARGES?**

7 A. In at least two arbitrations, the Commission has ruled that a CLEC must mirror
8 AT&T Illinois' intrastate switched access rates. In an arbitration between TDS
9 Metrocom, Inc. ("TDS") and Ameritech Illinois (later known as SBC Illinois, and
10 now known as AT&T Illinois), the Commission considered TDS' contention that
11 TDS could require Ameritech to pay intrastate switched access rates that
12 exceeded those charged by Ameritech. Having reviewed the parties' arguments,
13 including TDS' contention that the FCC's *CLEC Rate Cap Order* was
14 erroneously decided and that capping TDS' intrastate access rates at Ameritech's
15 levels would require TDS to charge below-cost rates and impede competition, the
16 Commission ordered TDS to mirror Ameritech's terminating switched access
17 rates.²⁹ When AT&T Communications of Illinois, Inc., TCG Illinois and TCG
18 Chicago (the AT&T CLECs, prior to AT&T's merger with SBC Illinois)

²⁸ See ICC Dockets 09-0313 (Bullseye Telecom, Inc.); 09-0314 (Delta Communications, LLC d/b/a Clearwave Communications; 09-0316 (Nexus Communications, Inc. d/b/a TSI Telephone Company; and 09-0317 (Norlight, Inc. d/b/a Cinergy Communications, all initiated via orders dated July 8, 2009. Norlight/Cinergy and Nexus/TSI have already voluntarily agreed to rate reductions by which they will mirror the intrastate switched access rates of the ILEC in the territories in which they compete, resulting in dismissal of the Nexus/TSI proceeding on December 3, 2009 and the pending dismissal of the Norlight/Cinergy proceeding.

²⁹ See *TDS Metrocom, Inc., Petition for Arbitration of Interconnection Rates, Terms and Conditions and Related Arrangement with Illinois Bell Telephone Company d/b/a Ameritech Illinois Pursuant to Section 252(b) of the Telecommunications Act of 1996*, Arbitration Decision, ICC Docket No. 01-0338 (August 8, 2001) at 48-50.

1 subsequently made in their arbitration with SBC Illinois the same arguments that
2 TDS had previously made, the Commission concluded that it had previously ruled
3 in favor of SBC Illinois on “substantially the same issue” and that “AT&T has
4 given us no reason to change our decision.”³⁰ Thus, again in the context of an
5 arbitration proceeding, the Commission required a CLEC to cap its intrastate
6 switched access rates at the RBOC’s level to ensure that those rates met Section
7 9-250’s “just and reasonable” standard.

8 More recently, apparently as a result of access reform activities elsewhere,
9 Commission Staff began monitoring Illinois CLECs’ intrastate access rates
10 generally (outside of the arbitration context), and conducted informal workshops
11 to discuss issues regarding Illinois CLECs’ intrastate access rates.³¹ Staff
12 concluded that McLeod’s rates (as well as those of at least four other CLECs)
13 were in need of formal review and recommended that the Commission initiate this
14 investigation.³² Staff noted that the Commission has already acted to constrain
15 the intrastate switched access rates of the ILECs whose rates it has authority to
16 regulate. Staff further observed that although CLECs “file their rates as
17 competitive within the meaning of Section 13-502 of the [Illinois Public Utilities
18 Act], ... [a]rguably, however, CLEC access services are not provided under
19 effectively competitive market conditions.”³³

³⁰ See *AT&T Communications of Illinois, Inc. et al., Verified Petition for Arbitration of Interconnection Rates, Terms and Conditions and Related Arrangement with Illinois Bell Telephone Company (SBC Illinois) Pursuant to Section 252(b) of the Telecommunications Act of 1996, Arbitration Decision*, ICC Docket No. 03-0239 (August 26, 2003) at 150.

³¹ See Staff Report at 2.

³² See Staff Report at 2.

³³ *Id.* at 3.

1 Staff also recently recommended dismissal of the access charge
2 investigation against Norlight/Cinergy because the company had voluntarily filed
3 a revised intrastate switched access tariff whose “rates directly mirror, and are
4 identical to, the rates for identical services charged by AT&T.”³⁴ Staff noted that
5 “[t]he fact that these rates mirror AT&T’s rates is significant, because the
6 Commission has previously found AT&T’s rates for these services to be just and
7 reasonable in contested proceedings.”³⁵ As Staff Principal Policy Advisor Hoagg
8 stated:

9 It is my opinion that the Commission can safely conclude that the
10 intrastate access rates charged by Norlight as established in its
11 revised tariffs are just and reasonable within the meaning of
12 Section 9-250 of the Illinois Public Utilities Act, insofar as such
13 rates mirror those already found to be just and reasonable.³⁶
14

15 **Q. HAS STAFF NOTED ANY SIMILARITIES BETWEEN THE CLEC**
16 **INTERSTATE ACCESS RATES THAT THE FCC FOUND UNJUST AND**
17 **UNREASONABLE AND THE INTRASTATE ACCESS RATES BEING**
18 **CHARGED BY ILLINOIS CLECS?**

19 A. Yes. Staff observed that:

20 Conditions similar to those identified by the FCC appear to exist
21 with at least some CLEC Illinois intrastate access services.
22 Intrastate access rates charged by some Illinois CLECs are similar
23 to those found to be excessive by the FCC. Intrastate access rates
24 charged by some Illinois CLECs currently range as high as
25 approximately 7¢ per minute, on a composite or blended rate basis.
26 In comparison, the comparable rates charged by AT&T and
27 Verizon average approximately 0.5¢ per minute on a blended or
28 composite basis.³⁷
29

³⁴ See “Verified Statement of Jeffrey H. Hoagg,” filed September 29, 2009 in ICC Docket 09-0317 (“Hoagg Statement”) at 2.

³⁵ *Id.* at 2-3 (citations omitted).

³⁶ *Id.* at 3.

³⁷ See Staff Report at 4.

1 **Q. DOES VERIZON HAVE A RECOMMENDATION FOR HOW THE**
2 **COMMISSION SHOULD PROCEED HERE?**

3 A. Yes. In a competitive market, rate disparities among providers of the same
4 service such as those described by Staff would not exist—particularly where a
5 new entrant charges a rate much higher than the dominant provider in the market,
6 the RBOC. Regulatory intervention is therefore necessary to discipline CLECs’
7 access rates, as has been determined by the FCC and over a dozen state
8 Commissions, including this one. As I mentioned earlier, the Commission should
9 continue its efforts to ensure just and reasonable CLEC intrastate switched access
10 rates by requiring all CLECs, including McLeod, to cap their intrastate access
11 charges at the level of AT&T Illinois’ (the RBOC in Illinois) intrastate rates.³⁸
12 Verizon’s proposal, already adopted by this Commission in prior proceedings
13 involving individual CLECs, will promote just, reasonable and efficient intrastate
14 access rates for all local exchange carriers in Illinois by driving the most
15 excessive access rates (such as McLeod’s) toward more efficient levels.

16 **Q. WHY ARE AT&T ILLINOIS’ INTRASTATE SWITCHED ACCESS**
17 **RATES THE APPROPRIATE BENCHMARK FOR REDUCING**
18 **MCLEOD’S RATES TO JUST AND REASONABLE LEVELS?**

19 A. AT&T Illinois’ intrastate switched access rates are an appropriate benchmark for
20 this purpose because—as both the Commission and its Staff have recognized on a
21 number of occasions—they have been subject to the greatest regulatory scrutiny
22 and strictest discipline, and have previously been deemed just and reasonable in

³⁸ Verizon makes this recommendation even though this would require its own CLEC affiliate in Illinois to reduce its intrastate access rates (and the revenues derived from those rates)

1 contested proceedings.³⁹ Using AT&T Illinois’ rates as a benchmark, not just for
2 McLeod, but for all Illinois LECs generally, would reduce market distortions and
3 promote competitive equity by prompting local exchange carriers with the highest
4 access rates to recover more of their network costs from their own customers,
5 rather than from other carriers (and their customers) through access rates. While
6 this is Verizon’s recommended approach, as an alternative, the Commission could
7 order CLECs to cap their intrastate access rates at the level of the intrastate access
8 rates of the ILEC with which they compete (analogous to the interstate access rate
9 cap under which CLECs already operate).

10

11 **II. OVERVIEW OF SWITCHED ACCESS**

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

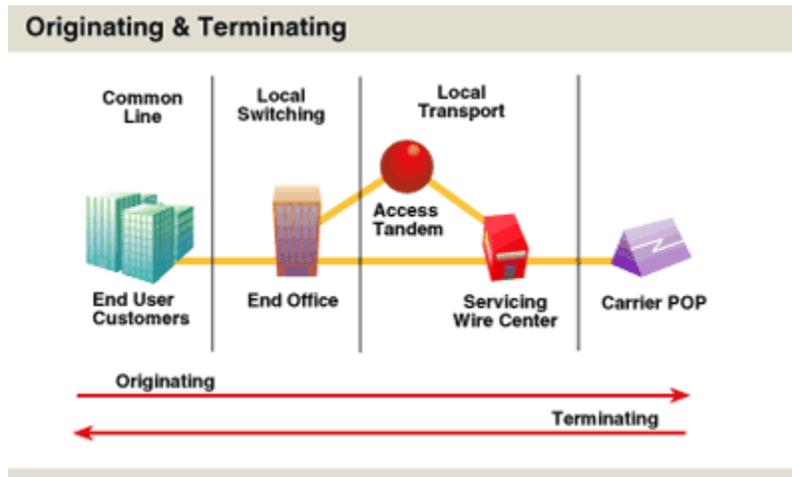
13 A. Switched access is a service provided by LECs to other carriers – usually
14 interexchange, or toll, carriers – for originating or terminating interexchange or
15 “toll” calls.⁴⁰ Access charges generally apply to calls that begin and end in
16 different local calling areas. Interstate access charges apply to calls that originate
17 and terminate in different states and are regulated by the FCC. Intrastate access

³⁹ See Order, *Illinois Commerce Commission on Its Own Motion v. Illinois Bell Telephone Company, et al., Investigation into Non-Cost Based Access Charge Rate Elements in the Intrastate Access Charges of Incumbent Local Exchange Carriers in Illinois; Illinois Commerce Commission on Its Own Motion, Investigation into Implicit Universal Service Subsidies in Intrastate Access Charges and to Investigate how these Subsidies Should Be Treated in the Future; Illinois Commerce Commission on Its Own Motion, Investigation into the Reasonableness of the LS2 Rate of Illinois Bell Telephone Company*; ICC Docket Nos. 97-0601; 97-0602; 97-0516 (Consol.); 2000 Ill. PUC LEXIS 1004 (March 29, 2000) (“*ICC Access Charge Order*”); see also Hoagg Statement at 2.

⁴⁰ 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 charges apply to calls that originate and terminate in different local calling areas
2 within the same state and are regulated by state commissions.

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



9
10 If the interexchange call originates in one state but terminates in another, switched
11 access charges are billed at the interstate rate in the carrier’s FCC tariff. If the
12 interexchange call originates and terminates within a state, then it is billed at the
13 intrastate access rate, which is under the state commission’s jurisdiction. The
14 switched access rates at issue in this proceeding are the rates that McLeod charges
15 IXCs and other carriers to originate or terminate interexchange calls that begin
16 and end in Illinois.

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

2 A. Historically, state and federal regulators jointly created a regulatory pricing
3 system in which business and toll rates (both in-state and interstate) were set
4 above the cost of providing these services to provide a contribution to basic
5 residential rates, thereby promoting federal and state universal service objectives.

6 AT&T traditionally had a monopoly on long distance communications,
7 and there was no “access” provided to other companies to the long distance
8 network. This industry structure started to change in the 1960s and 1970s with
9 the introduction of private line and then switched service competition in the long
10 distance market. With the advent of increasing interexchange competition and the
11 divestiture of the former Bell System in 1984, interstate and intrastate access
12 charges were established so that interexchange carriers could compensate LECs
13 for providing switched access service. Because of universal service concerns,
14 regulators sought to maintain in access charges the contribution flow from long
15 distance to local service that traditionally had been provided through retail long
16 distance charges. In other words, to maintain the rate structure that enabled basic
17 exchange service rates to remain low when toll revenue was available to offset the
18 costs of basic service, both interstate access rates and intrastate access rates were
19 purposefully set at artificially high levels to keep basic exchange service rates
20 low.

21 With the onset of local service competition in the 1990s, CLECs entered
22 markets without the legacy obligations of the incumbents, and also without

1 traditional regulation of their rates, whether retail rates charged to end users or
2 access rates charged to other carriers.

3 **Q. DOES THE COMMISSION CURRENTLY REGULATE INTRASTATE**
4 **ACCESS RATES?**

5 A. For some LECs, yes. As the Staff Report notes, the Commission has scrutinized
6 and reduced the intrastate switched access rates of AT&T Illinois, Verizon North
7 Inc. and Verizon South Inc. several times, recognizing that reducing high access
8 charges promotes competition and is in the public interest.⁴¹ The Commission
9 has not addressed CLECs' switched access rates comprehensively (although, as I
10 discussed earlier, it has addressed them on an individual basis in the arbitration
11 context). For example, the Commission does not currently impose regulations of
12 general application that discipline CLECs' intrastate switched access rates, even
13 though the same reasons that spurred the FCC to regulate CLECs' *interstate*
14 switched access rates (as discussed further below) hold true in the *intrastate*
15 context.

16 **Q. ARE THE RATES FOR CLECS' SWITCHED ACCESS SERVICES IN**
17 **ILLINOIS DISCIPLINED BY THE MARKET?**

18 A. As the Staff Report acknowledges, no.⁴² Given the nature of switched access
19 services, toll carriers that purchase switched access services are not able to switch
20 suppliers. Toll carriers have no choice but to use a CLEC's switched access
21 service when they handle interexchange calls originating from the CLEC's
22 customers and when they deliver interexchange calls for termination to the

⁴¹ See Staff Report at 2, citing *ICC Access Charge Order*.

⁴² See Staff Report at 3-4.

1 CLEC’s customers. A toll carrier cannot refuse to deliver a call to a CLEC’s end
2 user,⁴³ and thus cannot avoid that CLEC’s terminating access charges—it is at the
3 mercy of the carrier from which the called party obtains local exchange service.
4 The situation is similar in the originating access market, given that toll
5 deaveraging is prohibited at the interstate level and would thus be exceedingly
6 burdensome on the intrastate level.⁴⁴

7 **Q. DOES MCLEOD DISPUTE THAT THE MARKET FAILS TO**
8 **DISCIPLINE ITS SWITCHED ACCESS RATES?**

9 A. Yes, as I discuss below in responding to McLeod’s direct testimony. McLeod
10 ignores the plain reading of the FCC’s decision, which describes the lack of
11 market discipline over CLEC access rates as follows:

12 [O]nce an end user decides to take service from a particular LEC,
13 that LEC controls an essential component of the system that
14 provides interexchange calls, and it becomes the bottleneck for
15 IXCs wishing to complete calls to, or carry calls from, that end
16 user.⁴⁵
17

18 **Q. DOES STAFF APPEAR TO DISAGREE WITH MCLEOD ON THIS**
19 **POINT?**

20 A. Yes. The Staff Report stated:
21 Arguably, however, CLEC access services are not provided under
22 effectively competitive market conditions. An IXC does not have
23 any choice regarding which wireline LEC will terminate an
24 interexchange call to a specific end-user; every interexchange call

⁴³ 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), ¶ 6.

⁴⁴ See *MA DTC Order* at 14-17.

⁴⁵ See *CLEC Rate Cap Order* at ¶ 30.

1 must be terminated by the LEC to which the called party
2 subscribes, and no other. ... Conditions similar to those identified
3 by the FCC [which determined that ‘action is necessary to prevent
4 CLECs from exploiting the market power in the rates that they
5 tariff for switched access services] appear to exist with some
6 CLEC Illinois intrastate access services.⁴⁶
7

8 **Q. DOES PERMITTING CLECS SUCH AS MCLEOD TO COLLECT**
9 **INTRASTATE SWITCHED ACCESS CHARGES IN EXCESS OF AT&T**
10 **ILLINOIS’ DISTORT THE MARKET?**

11 **A.** Yes. Permitting CLECs such as McLeod to collect unreasonably high access
12 rates provides those companies with a competitive advantage because they are
13 able to recover disproportionately more of their costs from other carriers rather
14 than from their own end users. Purchasers of switched access services are thus
15 forced to help fund the retail service offerings of their direct competitors in the
16 same service areas. The FCC found that eliminating CLECs’ ability to engage in
17 such conduct and requiring them to recover their costs from their own end users
18 sends the appropriate pricing signals: “When a CLEC attempts to recover
19 additional amounts from its own end user, that customer receives correct price
20 signals and can decide whether he should find an alternative provider for access
21 (and likely local exchange) service. This approach brings market discipline and
22 accurate price signals to bear on the end user’s choice of access providers.”⁴⁷

23 In defending its current intrastate access rates, McLeod seeks to perpetuate
24 the subsidies it presently obtains from its competitors, in the form of unreasonably

⁴⁶ See Staff Report at 3-4 (underlining in original).

⁴⁷ See *CLEC Rate Cap Order* at ¶ 39.

1 high access rates. This pricing approach is contrary to federal policy, as discussed
2 below. It is also contrary to state policy, as explained in the Staff Report:

3 Staff believes intrastate access rates charged by some Illinois
4 CLECs exceed levels which could be considered just and
5 reasonable within the meaning of the PUA. If intrastate
6 terminating and originating access markets exhibit bottleneck
7 monopoly characteristics, competitive pressures may not ensure
8 just and reasonable access rates. Absent effective regulatory
9 oversight, CLECs arguably may shift costs to other carriers in a
10 manner inconsistent with cost-causation principles. Such cost-
11 shifting can distort the functioning of competition in interexchange
12 and other telecommunications markets, imposing costs which must
13 be passed on to IXC customers, distorting markets for
14 interexchange services.⁴⁸
15

16 **Q. IS THERE ANY REASONED BASIS TO ALLOW ILLINOIS CLECS TO**
17 **CHARGE INTRASTATE ACCESS RATES HIGHER THAN AT&T**
18 **ILLINOIS’?**

19 A. No. As I mentioned earlier, Verizon recommends capping CLECs’ intrastate
20 switched access rates—including McLeod’s—at AT&T Illinois’ levels (or, in the
21 alternative, at the competing ILEC’s level). There is no principled justification
22 for CLECs—including McLeod—to continue to charge intrastate switched access
23 rates higher than AT&T Illinois’. Newer market entrants such as McLeod have
24 no obligation to serve residential customers, let alone residential customers in
25 rural or other high-cost areas, and do not bear the historical legacy of having to
26 maintain low, regulated retail prices for residential consumers throughout their
27 service areas. CLECs also have the opportunity to use the most efficient mix of
28 technologies and network configurations possible, and should be able to operate at
29 least as efficiently as the incumbent LECs with their legacy networks.

⁴⁸ See Staff Report at 4; footnote omitted.

1 **Q. ARE ALL ILLINOIS CLECS, INCLUDING MCLEOD, ALREADY**
2 **REQUIRED TO COMPLY WITH THE FCC’S ACCESS RATE CAP?**

3 A. Yes. All Illinois CLECs already must comply with the FCC rule for *interstate*
4 switched access rates, and the rate cap mechanism that Verizon proposes for
5 CLECs’ *intrastate* rates in Illinois would be calculated in this same, familiar way.
6 As I discussed earlier, the FCC requires CLECs to benchmark their interstate
7 access rates to the competing ILEC’s interstate rates.

8

9 **III. THE COMMISSION SHOULD ESTABLISH AN INTRASTATE ACCESS**
10 **RATE BENCHMARK FOR ALL CLECS, INCLUDING MCLEOD**

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

13 A. Establishing a benchmark applicable to all CLECs would be a simple and
14 effective means to quickly move the most excessive CLEC switched access rates
15 in Illinois to more efficient levels, and to assure that no CLEC receives an
16 undeserved and unfair advantage in competing for retail customers. A benchmark
17 will promote equity and competitive parity and reduce market distortions by
18 prompting CLECs with the highest access rates to recover more of their network
19 costs from their own customers, rather than from other carriers and their
20 customers through access rates. Failure to establish such a benchmark would
21 allow CLECs to shift an excessive portion of their costs to switched access
22 purchasers (and their retail customers), thereby placing a disproportionate burden
23 on other carriers in the state—and ultimately, their customers—to subsidize those

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 Illinois.

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

6 A. No. Verizon requests that the Commission establish a benchmark that would
7 impose a ceiling on the intrastate access rates that CLECs may charge without
8 violating Section 9-250's "just and reasonable" standard, just as the FCC and
9 numerous other states (including this one) have done. CLECs with existing
10 intrastate access rates below the benchmark should not, of course, be permitted to
11 raise their rates. Such a result would have the aberrant effect of encouraging
12 some CLECs to *increase* the amount of costs shifted to other carriers, which
13 would obviously undermine the economic efficiency that establishing a cap is
14 intended to achieve.

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

16 A. As mentioned above, the intrastate switched access rates of the largest ILEC in
17 the state—in this case, AT&T Illinois—should serve as the benchmark given that
18 its intrastate access rates have historically been subject to the most regulatory
19 scrutiny and have previously been found "just and reasonable" in compliance with
20 Section 9-250. The Staff Calculation sets forth the various individual intrastate
21 switched access rate elements billed by AT&T Illinois.⁴⁹

⁴⁹ See Staff Calculation at 3 (reflecting originating and terminating end office switching, shared multiplexing, shared trunk port, tandem switching, transport facility charge per mile, and transport termination).

1 **Q. ARE THERE IMPLEMENTATION ISSUES THAT SHOULD BE**
2 **CONSIDERED BY THE COMMISSION IN SETTING THE**
3 **BENCHMARK?**

4 A. No. The benchmark rate is a concept with which CLECs are well acquainted,
5 given their familiarity with the FCC's interstate access rate benchmark. However,
6 this Commission should make clear in establishing the benchmark that a CLEC
7 can only charge for the functions that the CLEC actually performs in providing its
8 switched access service. Therefore, the rates charged will vary with the switched
9 access functions the CLEC performs and the miles of transport provided, as
10 applicable, because a CLEC should not be able to charge toll carriers for switched
11 access functions that it does not provide. For example, if a CLEC does not
12 perform tandem switching functions, it should not be allowed to include a charge
13 for a tandem switching service that it does not provide. This approach would
14 allow each CLEC to maintain its own intrastate switched access rate structure and
15 rate elements, while preventing them from receiving compensation for intrastate
16 switched access functions they do not perform.

17

18 **IV. MCLEOD'S DIRECT TESTIMONY**

19 **Q. ON OCTOBER 8, 2009, MCLEOD FILED THE DIRECT TESTIMONY OF**
20 **MICHAEL STARKEY OF QSI CONSULTING, INC. IN RESPONSE TO**
21 **THE STAFF REPORT AND ORDER. DOES ANYTHING IN MR.**
22 **STARKEY'S TESTIMONY CHANGE YOUR RECOMMENDATION FOR**
23 **CAPPING MCLEOD'S RATES AT THE SAME LEVEL AS AT&T**
24 **ILLINOIS?**

25 A. No. Mr. Starkey offers various policy arguments, along with the NUCA model –
26 and asserts that they confirm that McLeod's intrastate switched access rates are

1 just and reasonable.⁵⁰ However, I disagree with Mr. Starkey’s policy discussion,
2 and, as discussed below, disagree that McLeod’s costs are a relevant
3 consideration in determining what access rate level for McLeod would be just and
4 reasonable. Even if those costs were relevant, the NUCA model offered to
5 support McLeod’s rates is flawed and does not provide a reasonable basis for
6 allowing McLeod to establish rates in excess of the AT&T Illinois’. Dr. Zhang
7 will separately address some specific flaws in the NUCA cost model.

8 **A. Standard for Determining Whether McLeod’s Rates are “Just and**
9 **Reasonable”**

10 **Q. AS AN INITIAL MATTER, DOES MR. STARKEY DISPUTE STAFF’S**
11 **CALCULATION OF MCLEOD’S INTRASTATE SWITCHED ACCESS**
12 **RATES?**

13 A. No.⁵¹ Mr. Starkey simply seeks to “demonstrate that McLeodUSA’s intrastate
14 access rates are just and reasonable when analyzed in relation to McLeodUSA’s
15 cost of providing intrastate switched access services as well as switched access
16 rates of similarly-situated carriers (carriers whose access rates are not the subject
17 of an investigation).”⁵²

18 **Q. MR. STARKEY SUGGESTS THAT IN CONSIDERING WHETHER**
19 **MCLEOD’S INTRASTATE ACCESS RATES ARE JUST AND**
20 **REASONABLE, THE COMMISSION IS PROPOSING TO “PRICE**
21 **REGULATE CLECS”⁵³ – IS HIS COMMENT ACCURATE?**

22 A. No. Mr. Starkey apparently confuses the Commission’s effort to ensure that the
23 rates for all competitive and non-competitive services comply with Section 9-

⁵⁰ See McLeod Direct at 3-4.

⁵¹ Mr. Starkey confirms the accuracy of Staff’s numerical values, but notes that not all rate elements apply to all types of traffic. See McLeod Direct at 35-36.

⁵² *Id.* at 5.

⁵³ *Id.* at 9.

1 250's "just and reasonable" requirement with a Commission effort to price
2 regulate CLECs. The Commission has a statutory obligation to ensure that a
3 carrier's rates comply with Section 9-250. Requiring carriers to adhere to this
4 requirement is essential, but is different from price regulation, which generally
5 refers to regulating the retail rates charged by a provider that is subject to price
6 regulation. Establishing a price cap on CLEC switched access service, as Verizon
7 recommends, also does not constitute "price regulation," as a CLEC has the
8 flexibility to price its access service at any level so long as the rates do not exceed
9 the ceiling set by the Commission.

10 **Q. DO YOU AGREE WITH MR. STARKEY THAT NEITHER THE**
11 **ILLINOIS PUBLIC UTILITIES ACT NOR THE COMMISSION'S RULES**
12 **SET FORTH A SPECIFIC STANDARD FOR DETERMINING WHETHER**
13 **A CARRIER'S RATES ARE JUST AND REASONABLE?**⁵⁴

14 A. I agree that the Commission's determination of whether a particular rate is "just
15 and reasonable" is not constrained by any specific set of enumerated criteria.

16 **Q. WHAT CONSIDERATIONS DOES MR. STARKEY PROPOSE SHOULD**
17 **GUIDE THE COMMISSION?**

18 A. Mr. Starkey suggests that three considerations⁵⁵ should guide the Commission in
19 determining whether McLeod's intrastate switched access rates are just and
20 reasonable: (1) the relationship (if any) between McLeod's switched access rates
21 and the costs of providing McLeod's switched access service; (2) McLeod's rates

⁵⁴ *Id.* at 11.

⁵⁵ Mr. Starkey refers to these as his "primary" considerations, but when asked in discovery to identify other considerations, offered none. McLeod's Response to Data Request 1 of Verizon's Second Set of Data Requests (December 31, 2009), a true and correct copy of which is attached as part of **Attachment DP-1**.

1 in comparison to those of similarly-situated carriers; and (3) whether McLeod’s
2 intrastate switched access service is a “bottleneck” service.⁵⁶

3 **Q. DO YOU AGREE WITH THE CONSIDERATIONS PROPOSED BY MR.**
4 **STARKEY?**

5 A. In certain contexts, the cost of providing a service can factor into the analysis of
6 whether the rate for that service is just and reasonable. However, I do not believe
7 costs are pertinent here, or that examining McLeod’s alleged service-specific
8 costs of providing switched access service is a desirable, let alone preferable,
9 approach to evaluating McLeod’s rates.

10 As noted above, upon divestiture, ILECs’ intrastate access rates were
11 originally set above cost, in order to subsidize local service. When, years later,
12 the FCC reformed CLECs’ interstate access rates, it did so using a benchmarking
13 approach, concluding that ILECs’ rates represented a fair market rate for access
14 services. It did not evaluate individual CLECs’ costs. Indeed, the FCC deemed
15 alleged ILEC/CLEC cost differentials irrelevant, noting that “the CLECs retain
16 the option of recovering from their end users any additional costs they may
17 experience,”⁵⁷ and concluding that:

18 [Higher access rates] may allow some CLECs inappropriately to
19 shift onto the long distance market in general a substantial portion
20 of the CLECs’ start-up and network build-out costs [and such cost
21 shifting] is inconsistent with the competitive market.⁵⁸
22

23 **Q. COULD ANY COST SHOWING BY MCLEOD JUSTIFY ITS**
24 **INTRASTATE SWITCHED ACCESS RATES?**

⁵⁶ *Id.* at 12.

⁵⁷ See *CLEC Rate Cap Order* at ¶ 3.

⁵⁸ *Id.* at ¶ 27; 33.

1 A. Verizon disputes that any cost showing would be sufficient to demonstrate that
2 McLeod’s existing rates are “just and reasonable,” given that service-specific cost
3 studies typically were used in years past to set prices for certain services within
4 the larger context of rate-of-return regulation, to which incumbent LECs were
5 often subject. In contrast, the Commission does not have any experience in
6 reviewing the cost of any CLEC services. Where, as here, the Commission has no
7 knowledge of McLeod’s overall financial situation, the concept of a service-
8 specific cost study viewed in isolation has no relevance or meaning. Simply, this
9 Commission lacks any working familiarity with McLeod’s “costs,” as it has with
10 those of ILECs such as AT&T Illinois (gained from years of reviewing them in a
11 variety of contexts). This Commission has never routinely examined McLeod’s
12 costs, and thus has no way of comparing the purported costs of McLeod’s
13 intrastate access services with the costs of providing its other services. Nor has
14 the Commission reviewed the costs of McLeod’s fellow CLECs, leaving it unable
15 to assess McLeod’s alleged access costs in anything other than a vacuum (except
16 for McLeod’s claim that its costs greatly exceed those of the incumbent providers
17 of the same services).

18 Coupled with the fact that McLeod’s NUCA model suffers from a number
19 of flaws that are described by Dr. Zhang, which result in NUCA overstating
20 McLeod’s “costs” of providing intrastate switched access service, I disagree with
21 Mr. Starkey’s suggestion that the Commission should give any consideration to,
22 or place any weight on, McLeod’s “costs” in this proceeding. Moreover, even if
23 McLeod could successfully demonstrate that it has higher access costs (which it

1 has not done), that does not mean it should be rewarded by being allowed to
2 charge higher access rates. The Commission has no obligation to ensure
3 McLeod's profitability. Nor is there any reason whatsoever for it to permit
4 McLeod to charge rates above a benchmark level when the effect of doing so is to
5 shield McLeod's retail customers from appropriate price signals in a competitive
6 marketplace. The purpose of regulation is to mimic the effects of competition
7 when needed, and in competitive markets, higher cost firms typically are not
8 rewarded for inefficiency with higher prices. Indeed, it would be highly unusual
9 for a company to succeed in a competitive market if it charges *eight times* the
10 rates of its biggest competitors, as McLeod does.⁵⁹ In fact, McLeod's present
11 ability to charge intrastate access rates at these levels is, in itself, a strong
12 indication that McLeod wields market power in providing access services.

13 **Q. WHAT ABOUT MR. STARKEY'S SECOND AND THIRD CRITERIA?**

14 A. I agree that Mr. Starkey's second and third criteria are worthy of consideration by
15 the Commission, although McLeod has neither established that its rates are just
16 and reasonable in comparison to those of other similarly-situated carriers, nor
17 convincingly demonstrated that its intrastate switched access service is not the
18 sort of monopoly service that the FCC identified in deciding to cap CLECs'
19 interstate access rates. Mr. Starkey is asking the ICC to ignore the findings of the
20 FCC regarding the ability of CLECs to wield market power (as well as the similar
21 conclusions of numerous state commissions that have considered the matter).

⁵⁹ Compare Staff Calculation at 2 (citing McLeod's 4+ cents/minute rate) with Staff Report at 4 (noting AT&T Illinois/Verizon's comparable .5 cents/minute rate)

1 **Q. ARE THERE OTHER CRITERIA THE COMMISSION SHOULD**
2 **CONSIDER?**

3 A. Yes. In reviewing whether a rate is just and reasonable, the Commission should
4 consider the impact of the rate on the competitive market. And while the actions
5 taken by other state commissions are not legally binding on this Commission,
6 understanding what regulators in other states have done *vis a vis* CLEC intrastate
7 access reform can provide this Commission with beneficial information in making
8 a decision here. As noted above, every state commission that has formally
9 considered capping CLEC rates has concluded that such a benchmarking
10 approach is good policy. There are no unique conditions with respect to CLEC
11 switched access services in Illinois that would justify a different conclusion.

12 **B. McLeod Does Not “Necessarily” Incur Higher Switched Access Costs**
13 **Than Large ILECs**

14 **Q. MR. STARKEY ARGUES THAT MCLEOD’S INTRASTATE SWITCHED**
15 **ACCESS COSTS ARE “NECESSARILY” HIGHER THAN THOSE OF**
16 **LARGE ILECS.⁶⁰ DO YOU AGREE?**

17 A. No. I would first reiterate that for the reasons discussed above, McLeod’s
18 ostensible costs are not relevant to the issue before the Commission, and the
19 NUCA model overstates them in any event.

20 While McLeod correctly notes that its network structure differs from that
21 of large ILECs, its conclusion that this “necessarily” results in it having costs that
22 are higher than those of large ILECs is unconvincing.⁶¹ Comparisons between
23 CLEC and ILEC networks can be misleading. As newer market entrants, CLECs
24 are not constrained with the need to maintain a network that has been constructed

⁶⁰ *Id.* at 13.

⁶¹ *Id.* at 13-31.

1 incrementally over the course of a century or more, with the associated outdated
2 legacy technologies associated with such a network. CLECs instead have the
3 opportunity to construct and expand their networks using modern – and generally,
4 less expensive and more efficient – equipment. CLECs are also less apt to have
5 large unionized labor forces, and thus often have lower labor costs than ILECs.
6 Nor are CLECs saddled with legacy regulations that require them to offer a set of
7 essential services to all customers who request it. Because CLECs can decline to
8 serve a particular area, a particular type of customer, or to provide a particular
9 type of service, they can limit their network costs by focusing on, and investing
10 in, only the networks they choose to build. In other words, they are generally free
11 to make decisions based solely on their assessment of business and economic
12 factors, and the requirements of the customers they choose to serve, rather than on
13 regulatory constraints.

14 Mr. Starkey discusses customer density and market share as factors that
15 differentiate McLeod's network architecture from that of an ILEC. However,
16 McLeod admitted in discovery that it did not conduct any analysis of CLEC
17 customer density in Illinois.⁶² As a general matter, it may be correct that ILECs'
18 networks serve more dense concentrations of users, but that fact in isolation can
19 be highly misleading. A review of McLeod's website (www.paetec.com) makes
20 clear that its business model focuses on services to business customers in large

⁶² See McLeod's Response to Data Request 9 of Verizon's First Set of Data Requests (December 8, 2009), a true and correct copy of which is attached as part of **Attachment DP-1**.

1 metropolitan areas. For example, the “About Us” section of McLeod’s website
2 states:

3 **Who We Are**

4 Today, PAETEC delivers personalized communications solutions
5 and unmatched service to business-class customers in 84 of the
6 nation’s top 100 metropolitan areas.⁶³
7

8 Given its business model, it follows that McLeod’s network likely focuses
9 on areas with higher concentrations of business users, which are typically more
10 urban. Thus, there is no basis for concluding that McLeod’s network architecture
11 results in higher access costs simply because it may differ from an ILEC’s
12 network. In addition, regardless of a CLEC’s market share, the FCC concluded
13 that the fact that a CLEC starts with small market share is not a sufficient policy
14 reason to allow a CLEC to shift its “start up costs” to IXCs.⁶⁴ Rather, as noted
15 above, the FCC concluded that the superior policy result was to have the CLEC’s
16 retail end users receive “proper price signals.”⁶⁵

17 **C. McLeod’s Intrastate Switched Access Rates Are Not In Line With the**
18 **Rates of the Most Similarly-Situated Carriers – Other Illinois CLECs**

19 **Q. MR. STARKEY ARGUES THAT MCLEOD’S INTRASTATE SWITCHED**
20 **ACCESS RATES ARE IN LINE WITH THOSE OF “SIMILARLY-**
21 **SITUATED CARRIERS.”⁶⁶ DO YOU AGREE?**

22 **A.** Not at all. What is perhaps most incredible about Mr. Starkey’s position is the
23 assertion that the “similarly-situated carriers” McLeod refers to are the state’s
24 medium- and small-sized ILECs, and not other CLECs operating in Illinois. Mr.

⁶³ See **Attachment DP-2**, which is a printout of this portion of McLeod’s website.

⁶⁴ See *CLEC Rate Cap Order* at ¶ 33.

⁶⁵ *Id.* at ¶¶ 39, 43.

⁶⁶ See McLeod Direct at 31 (emphasis added).

1 Starkey admitted in discovery that he does *not* contend that McLeod’s network
2 more closely resembles those of small and/or medium-sized ILECs than it does
3 the networks of its fellow CLECs.⁶⁷ Thus, while McLeod’s network admittedly
4 more closely resembles that of other Illinois CLECs than those of small- to mid-
5 sized ILECs in Illinois, McLeod says absolutely nothing about the networks of its
6 fellow Illinois CLECs. McLeod has good reason to avoid comparisons to other
7 CLECs, given the Staff Report’s finding that McLeod’s intrastate access rates are
8 decidedly *not* in line with those of the other CLECs operating in Illinois, but
9 rather are “*currently among the highest in Illinois.*”⁶⁸

10 Given Mr. Starkey’s admission in discovery that McLeod’s network does
11 not resemble the networks of small and/or medium-sized ILECs as much as it
12 does those of other CLECs, there is no basis for comparing those ILECs’ access
13 rates with McLeod’s. The more likely reason for McLeod to offer such a
14 comparison is that those companies’ access rates are financially more attractive to
15 McLeod, because their access rates have not been constrained by the Commission
16 as have AT&T Illinois’ and Verizon’s. As previously discussed, regardless of a
17 particular CLEC’s cost structure, CLECs should recover more of their costs from
18 their own customers than from competitors. The preferable policy outcome
19 would be achieved by reducing CLECs’ rates to a benchmark level, which helps
20 ensure that customers of other carriers are not forced to pay excessive amounts to

⁶⁷ See McLeod’s Response to Data Request 8 of Verizon’s First Set of Data Requests (December 8, 2009), a true and correct copy of which is attached as part of **Attachment DP-1**.

⁶⁸ See Staff Report at 5 (emphasis added).

1 CLECs with high access rates, and that such CLECs cannot use revenues from
2 those rates to undercut their competitors’ retail rates.

3 Finally, Mr. Starkey offers no evidence to support his premise that
4 McLeod’s cost structure is similar to that of small- and mid-sized ILECs in
5 Illinois, such as evidence regarding the cost structures of the competitors whose
6 networks he claims are comparable to McLeod’s. And given that McLeod’s
7 website describes its business plan as focusing on business customers in large
8 urban areas, there is certainly no reason to presume that its network more closely
9 resembles those of small- to mid-sized ILECs operating in rural areas than those
10 of other Illinois CLECs focused on the business market, or the RBOC in Illinois,
11 AT&T.

12 **D. McLeod’s “Margins” Argument Does Not Demonstrate That Its**
13 **Intrastate Switched Access Rates Are “Just and Reasonable”**

14 **Q. MR. STARKEY CLAIMS THAT THE “JUST AND REASONABLE”**
15 **NATURE OF MCLEOD’S INTRASTATE ACCESS RATES IS**
16 **CONFIRMED BY THE FACT THAT THE “MARGINS” BY WHICH ITS**
17 **INTRASTATE SWITCHED ACCESS RATES EXCEED COST ARE LESS**
18 **THAN THE MARGINS BY WHICH AT&T’S SPECIAL ACCESS RATES**
19 **EXCEED ITS COMPARABLE UNE RATES, AND BECAUSE AT&T’S**
20 **AND VERIZON’S RETURNS ON SPECIAL ACCESS INVESTMENT ARE**
21 **HIGHER THAN MCLEOD’S ON INTRASTATE SWITCHED ACCESS**
22 **SERVICE.⁶⁹ HOW DO YOU RESPOND?**

23 **A.** First, for all the reasons discussed in the testimony of Verizon witness Dr. Zhang,
24 the alleged McLeod switched access costs presented by Mr. Starkey are not
25 credible. In the absence of credible cost data, there is no foundation on which a
26 McLeod “margin” on its switched access service can be calculated.

⁶⁹ See McLeod Direct at 55-59.

1 Second, the margins Mr. Starkey calculates for AT&T's and Verizon's
2 interstate special access services, as documented in his Attachment MS-6, are
3 based on a subset of values taken from ARMIS Report 43-04 for the companies.⁷⁰
4 However, that Attachment provides neither a description of the methodology
5 used, nor any rationale for the inclusion of certain values from the 43-04 Report
6 while excluding others in the calculation of purported interstate special access
7 "margins." The resulting "margin" figures are thus devoid of any factual or
8 explanatory foundation. With no credible figures making up either of the
9 components of Mr. Starkey's comparison, the Commission should not rely on the
10 comparison for any purpose.

11 Even if any part of his comparison were credible, which it is not, Mr.
12 Starkey fails to explain why the Commission should rely on his conclusions as a
13 basis for determining that McLeod's switched access rates are just and reasonable.
14 Comparing McLeod's alleged switched access "margins" with a different service,
15 with different characteristics, reveals nothing. When a carrier orders a special
16 access service, it is a conscious decision to fill a perceived need – for example, to
17 either augment its network or connect a customer's premises to its network. The
18 market characteristics of that service are in no way comparable to the
19 characteristics of switched access service, because the carrier paying for the
20 service has no choice but to handle the traffic delivered to it and to terminate the
21 call to the carrier chosen by the called end user, as I have discussed at length
22 above. Mr. Starkey provides no explanation whatsoever as to why there is any

⁷⁰ *Id.* at 60.

1 nexus between the two types of services, and the mere juxtaposition of differing
2 alleged “margins” of the two different services proves nothing. For these reasons,
3 the Commission should give no weight to Mr. Starkey’s argument.

4 **Q. IS THERE ANY EVIDENCE THAT MCLEOD’S MARGINS ON ITS**
5 **INTRASTATE SWITCHED ACCESS SERVICE ARE SO HIGH AS TO**
6 **RENDER ITS RATES UNJUST AND UNREASONABLE?**

7 A. Yes. It appears that McLeod is engaged in a traffic-pumping scheme with an
8 entity that runs a website called Talkee.com (www.talkee.com). In such schemes,
9 the local exchange provider – here, McLeod – pays a portion of its intrastate
10 switched access revenues to a third party that operates so-called “free” chat lines
11 that drive up the volume of intrastate calls that the CLEC terminates in order to
12 generate excessive access revenue. According to its website, Talkee.com operates
13 four such “free” chat lines in Illinois, including this Springfield, Illinois number:
14 217-241-2909.⁷¹

15 **Q. WHAT MAKES YOU BELIEVE THAT MCLEOD AND TALKEE.COM**
16 **HAVE ENGAGED IN A TRAFFIC-PUMPING SCHEME?**

17 A. On January 5, 2010, Sprint served its First Set of Data Requests to McLeod.
18 Those data requests identified the Talkee.com website, and its Springfield, Illinois
19 phone number 217-241-2909 (dubbed the “Chicago Raven” party line on the
20 Talkee.com website⁷²), and asked various questions about McLeod’s relationship

⁷¹ See **Attachment DP-3**, which is a printout of the home page of Talkee.com’s website.

⁷² *Id.*

1 with Talkee.com.⁷³ The nature of Sprint’s data requests indicated that Sprint
2 believed that Talkee.com was operating “free” chat lines in Illinois and that
3 McLeod was providing service for the “Chicago Raven” chat line (217-241-
4 2909).

5 The Talkee.com website fully substantiates Sprint’s belief that Talkee.com
6 is a “free” chat line provider:

7 Welcome

8

9 Talkee is a network of *free* telephone chat (party) lines in most
10 areas. ...

11

12 Remember we offer these lines free of any charges in most areas.
13 If you are dialing into a free chat line area, the only costs you will
14 ever see are whatever your own carrier charges for the normal calls
15 (if any).

16

17 Any Web site, portal, or company desiring their own line
18 accessible by the net and telephone are invited to email us.
19 Volume is everything. And anyone desiring their own conference
20 room with 30 people capacity and a personal phone number to it
21 can get it all for free at the MrConference Web site.⁷⁴

22

23 Separately, Verizon examined its own records for calls associated with
24 217-241-2909, the “Chicago Raven” number identified in the Sprint discovery
25 and listed on the Talkee.com website. Verizon discovered that, like Sprint, it was
26 experiencing a significant increase in traffic terminating to 217-241-2909 and
27 other Talkee.com Springfield numbers. Verizon pulled two traffic samples for
28 December 2009. *****BEGIN CONFIDENTIAL** [REDACTED]

29 [REDACTED]

⁷³ See Sprint’s First Set of Data Requests to McLeodUSA Telecommunications Services, Inc. d/b/a PAETEC Business Services, served January 5, 2010, a true and correct copy of which is attached as **Attachment DP-4**.

⁷⁴ See **Attachment DP-3** (Italics/underlining in original).

1 [REDACTED]
2 [REDACTED]
3 [REDACTED] **END**

4 **CONFIDENTIAL***** In addition, other numbers listed on Talkee.com’s website
5 belong to carriers associated with traffic pumping schemes.

6 Investigating further, Verizon discovered that when one calls 217-241-
7 2909 from a wireless phone, a lengthy recorded message indicates that the
8 number accepts calls only from landline numbers and provides further instructions
9 for how to attempt to complete the call. A transcript of the message is attached as
10 **Attachment DP-5**. Similarly, if one calls 217-241-2909 from outside Illinois, a
11 recording indicates that the number accepts only intrastate calls, and again offers
12 further instructions for how to attempt to complete the call.⁷⁵ Given that wireless
13 carriers pay access charges only when their customers’ calls originate and
14 terminate in different Major Trading Areas (“MTAs”), and that interstate access
15 rates are much lower than intrastate rates, this rejection of calls subject to lower-
16 than-intrastate access compensation was further indication of a traffic-pumping
17 scheme to exploit McLeod’s unreasonably high intrastate access rates.

18 **Q. DID MCLEOD PRODUCE INFORMATION THAT SUPPORTED**
19 **SPRINT’S APPARENT SUSPICIONS?**

20 A. Yes. *****BEGIN CONFIDENTIAL** [REDACTED]
21 [REDACTED]

⁷⁵ In-state callers that dial 217-241-2909 from a landline phone reach a nearly three-minute message giving “instructions” for participating in the chat room before being connected – all the while racking up per-minute-of-use intrastate access charges.

1 [REDACTED]
2 [REDACTED]
3 [REDACTED]
4 [REDACTED]
5 [REDACTED]
6 [REDACTED]
7 [REDACTED]
8 [REDACTED]
9 [REDACTED]
10 [REDACTED]
11 [REDACTED]
12 [REDACTED]
13 [REDACTED]
14 [REDACTED]
15 [REDACTED]
16 [REDACTED]

17 [REDACTED] **END CONFIDENTIAL*****

18 **Q. WHAT DOES THIS INFORMATION INDICATE?**

19 A. That McLeod is engaged in a traffic pumping scheme with Talkee.com, whereby
20 McLeod is benefitting from the intrastate access payments it receives on the

⁷⁶ See McLeod’s Confidential Response to Data Request 1 of Sprint’s First Set of Data Requests (February 5, 2010), a true and correct copy of which is attached as part of **Confidential Attachment DP-6**.

⁷⁷ *Id.*

⁷⁸ *Id.*

1 inflated call volumes being generated through Talkee.com’s “Chicago Raven”
2 chat line. As the Talkee.com website states, “[v]olume is everything.”⁷⁹

3 **Q. HOW DOES THIS SUPPORT YOUR CONTENTION THAT MCLEOD’S**
4 **MARGINS ON ITS INTRASTATE SWITCHED ACCESS SERVICE ARE**
5 **SO HIGH AS TO RENDER ITS RATES UNJUST AND**
6 **UNREASONABLE?**

7 A. Traffic pumping schemes are profitable for both the chat line operator and the
8 company providing phone service to the chat line operator. No profit-maximizing
9 entity would agree to “share” with a third party a significant portion of its
10 revenues unless its rates produce supra-competitive profits. These schemes can
11 benefit both parties even when the telephone service provider pays a majority of
12 its intrastate switched access revenue to the chat line operator. Given that
13 McLeod has agreed to *****BEGIN CONFIDENTIAL** [REDACTED]
14 [REDACTED]
15 [REDACTED] **END CONFIDENTIAL***** it follows that McLeod’s intrastate
16 access rates currently are set well above its costs, producing substantial margins
17 that make it financially beneficial to maintain this arrangement.

18 **E. Contrary to McLeod’s Allegations, Its Intrastate Switched Access**
19 **Service Is a Bottleneck Service and It Has Market Power in the**
20 **Intrastate Switched Access Marketplace**

21 **Q. MR. STARKEY ASSERTS THAT MCLEOD’S INTRASTATE SWITCHED**
22 **ACCESS SERVICE IS NOT A “BOTTLENECK” SERVICE AND THAT**
23 **MCLEOD DOES NOT HAVE MARKET POWER IN THE INTRASTATE**
24 **SWITCHED ACCESS MARKETPLACE.⁸⁰ IS HE CORRECT?**

⁷⁹ See Attachment DP-3.

⁸⁰ *Id.* at 62-66.

1 A. No, he is not. As I detailed earlier in my testimony, the FCC and a number of
2 state commissions have rejected precisely these sorts of claims. McLeod offers
3 no convincing reason to conclude that all of these agencies “got it wrong.”

4 **Q. HAS MCLEOD DEMONSTRATED THAT UNIQUE CONDITIONS IN**
5 **ILLINOIS MAKE CLECS’ INTRASTATE SWITCHED ACCESS RATES**
6 **SUBJECT TO RELATIVELY GREATER COMPETITIVE PRESSURE**
7 **THAN IN OTHER STATES?**

8 A. No, it has not. This is because McLeod cannot, and thus, Mr. Starkey did not
9 even try to do so. The same factors that prompted the FCC and numerous other
10 states to cap CLECs’ switched access rates apply to CLECs’ intrastate switched
11 access services in Illinois. Indeed, as the Staff Report notes, in the absence of
12 market discipline, Illinois CLECs’ intrastate switched access rates vary
13 significantly.⁸¹ Thus, while a number of Illinois CLECs charge less than a penny
14 per minute for intrastate access, others – like McLeod – choose to, and can,
15 maintain unreasonably high intrastate switched access rates here because (as
16 discussed above) the originating carrier cannot block calls to a CLEC with high
17 access rates, and the originating carrier does not have a choice of terminating
18 carriers, as addressed in the above discussion of the recent Massachusetts *DTC*
19 *Order* (and in numerous other state orders constraining CLEC access rates).

20 **Q. MR. STARKEY CLAIMS THAT CARRIERS COMPETING FOR END-**
21 **USER CUSTOMERS KEEPS CLECS FROM CHARGING EXCESSIVE**
22 **ACCESS RATES.⁸² IS HE CORRECT?**

⁸¹ See Staff Report at 4.

⁸² See McLeod Direct at 71-72.

1 A. No. The threat of *retail* competition will not force CLECs to lower their
2 *intrastate switched access rates*. The notion that competition for retail end users
3 will discipline CLECs' access rates over time ignores the marketplace reality that
4 carriers compete with each other for customers by offering the best *retail* price for
5 a service. End users care only about what they have to pay their chosen supplier,
6 not what that supplier may be charging others for switched access service. In
7 other words, carriers compete for end-user customers on the basis of *retail* rates,
8 not *switched access rates*. In fact, if a CLEC lowers its retail rates to compete in
9 the retail market, it has the incentive to maintain high switched access rates in
10 order to make up for retail revenues lost from aggressively lowering its retail rates
11 to win a customer.

12 **Q. DO YOU HAVE ANY REACTION TO MR. STARKEY'S RELIANCE ON**
13 **THE U.S. DEPARTMENT OF JUSTICE'S "HORIZONTAL MERGER**
14 **GUIDELINES" TO SUPPORT HIS CONTENTION THAT "PRICES**
15 **ABOVE COMPETITIVE LEVELS SIGNIFY MARKET POWER ONLY**
16 **WHEN THEY ARE SUSTAINABLE OVER A SIGNIFICANT TIME**
17 **PERIOD, FOR THE FORESEEABLE FUTURE?"⁸³**

18 A. Yes. These guidelines, which are used to evaluate the overall structure or
19 conditions of a market, measures and assessments of overall market
20 concentration, market share and market dominance, provide no useful guidance in
21 evaluating the need for constraints on CLECs' switched access prices. As
22 discussed above, given the inherent nature of CLEC switched access service, the
23 structure of the overall market, including definitions of the geographic market and
24 the product market, is irrelevant. While a CLEC may have a small retail market

⁸³ *Id.* at 65-66.

1 share relative to the totality of the retail market, the CLEC has a market share of
2 100% on all calls made to its customers, because by law, the originating carrier
3 has no other choice but to terminate the call through the called party's carrier.
4 Therefore, that CLEC, by virtue of the nature of access service, is a dominant
5 carrier in the provision of switched access service, regardless of its share of the
6 retail market.⁸⁴

7 **Q. MR. STARKEY ARGUES THAT THAT THE CLAIM THAT CLECS**
8 **HAVE CONTROL OVER SWITCHED ACCESS SERVICE BECAUSE**
9 **IXCS HAVE NO ALTERNATIVES WHEN A CALL NEEDS TO BE**
10 **ORIGINATED FROM OR TERMINATED TO A CLEC'S CUSTOMER IS**
11 **"ERRONEOUS" BECAUSE IT IS BASED ON AN "EXTREME SHORT-**
12 **RUN ANALYSIS."**⁸⁵ **IS THIS A LEGITIMATE CRITICISM?**

13 A. No. As an initial matter, Mr. Starkey does not make clear how long the
14 Commission should be willing to wait for the market to discipline CLECs'
15 intrastate switched access rates. In the nearly fifteen years since the
16 Telecommunications Act of 1996 opened the local exchange market to greater
17 competition, switched access rates have not been subject to competitive pressures
18 because regulation prevents carriers from refusing to deliver traffic to CLECs
19 with disproportionately high access rates.

20 Furthermore, Mr. Starkey's criticism is undermined by his own discussion.
21 He criticizes the so-called "extreme short-run analysis" by arguing that regulators
22 should not look at an originating carrier's options on a single call, because such
23 "extortionist" conduct would "quickly be penalized by the actions of competitors

⁸⁴ See *MA DTC Order* at 14-17.

⁸⁵ *Id.* at 71-72.

1 and consumers in the long run.”⁸⁶ However, as I have explained, end-users have
2 no idea what their local exchange providers charge for access, and are only
3 concerned about the *retail* rates they pay. A competitive market could only
4 discipline “extortionist” conduct in a scenario in which providers were not
5 *required by law* to originate and terminate calls to the CLEC engaging in
6 extortion, and could instead choose not to do business with it. That scenario does
7 not exist here.

8 Mr. Starkey’s recommendation – that the Commission ignore short term
9 market failure and instead focus on the long-term ability of carriers to enter the
10 market and compete for the customers of high-priced CLECs – is misguided.
11 Taken to its logical conclusion, under Mr. Starkey’s model, the only way for a
12 carrier to stop paying inflated switched access rates to a particular CLEC would
13 be to compete so aggressively against that CLEC in the retail market that the
14 CLEC loses all of its customers and is driven out of business. Mr. Starkey is
15 effectively arguing that a retail monopoly is the only way to eliminate high access
16 charges. Certainly a regulatory constraint on CLECs’ intrastate switched access
17 rates is a better and more effective solution.

18 **Q. DOES MCLEOD SEEK TO CREATE ECONOMIC DISINCENTIVES TO**
19 **ITS CUSTOMERS SWITCHING TO OTHER CARRIERS?**

20 A. Of course it does. This is by no means unusual in the industry, nor is it improper.
21 Customer retention is critical to any business’ long-term viability. However,
22 McLeod’s efforts to retain customers undermine Mr. Starkey’s argument about

⁸⁶ *Id.*

1 McLeod’s absence of market power in the intrastate switched access marketplace
2 on the grounds that competitors can simply win away McLeod’s customers if
3 competitors dislike McLeod’s intrastate access rates. In response to discovery,
4 McLeod indicated that 60% of its customers obtain service via written service
5 agreements, and that “McLeodUSA attempts to include provisions for a term
6 length and for ‘early termination’ payments in all new service contracts”⁸⁷
7 The standard McLeod early termination provision requires the customer to pay
8 McLeod “(i) all sums due and unpaid plus (ii) an amount equal to the Minimum
9 Monthly Fee times the number of months left in the Term.”⁸⁸ Such liability could
10 be very substantial.

11 Such contract language certainly creates economic disincentives both for
12 customers to switch to other carriers, and for other carriers to assume
13 responsibility for such fees on the customer’s behalf in order to win the customer
14 away. Thus, while McLeod argues that it possesses no market power in the
15 switched access market because other carriers can simply take its customers away,
16 like any competitor, McLeod strives to create financial incentives that encourage
17 its customers not to move to other carriers. Coupled with its ability to rely on
18 access revenues to make up for retail rate breaks offered to obtain (and retain)
19 customers, McLeod’s contention regarding the ease of defeating its market power
20 in the provision of switched access service is simply not credible.

⁸⁷ See McLeod’s Supplemental Response to Data Request 28 of Verizon’s First Set of Data Requests (January 5, 2010), a true and correct copy of which is attached as part of **Attachment DP-1**.

⁸⁸ See Attachment VZ-28(b) to McLeod’s Response to Data Request 28 of Verizon’s First Set of Data Requests (December 8, 2009), a true and correct copy of which is attached as part of **Attachment DP-1**, at ¶ 7(a).

1 **Q. ARE YOU AWARE OF ANY AGENCY OR REGULATOR THAT HAS**
2 **ACCEPTED MCLEOD’S ARGUMENTS THAT CLECS’ SWITCHED**
3 **ACCESS PRICES ARE DISCIPLINED BY THE MARKET?**

4 A. No, I am not. When asked this question in discovery, McLeod did not identify
5 one either.⁸⁹ McLeod did identify three proceedings in which it has raised these
6 arguments: Massachusetts D.T.C. 07-09; New Jersey BPU TX08090830 and
7 FCC CC Docket 01-92, WC Docket No. 04-36.⁹⁰

8 The Massachusetts Department of Telecommunications and Cable
9 unequivocally rejected this argument:

10 The Department is not persuaded by this argument because, even if
11 price signals were received by the called party, the market
12 structure would prevent any competitive pressure from forcing a
13 reduction in rates. As the LEC charging higher access charges
14 receives that additional revenue, it could use those funds to
15 subsidize its retail offerings, making it harder for Verizon, or any
16 other LEC, to win away customers.⁹¹

17
18 The New Jersey Board of Public Utilities similarly rejected McLeod’s logic:

19 [T]he Board HEREBY FINDS that switched access service is a
20 monopoly because there is no ability for an IXC or its customers to
21 avoid excessive access charges. The Board concurs with Sprint’s
22 argument, that LECs have a monopoly over access to their end
23 users, which has permitted a situation where CLECs have charged
24 access rates well above the rates that ILECs charge for similar
25 services. Verizon, in countering the Joint CLECs position that
26 switched access service is competitive, argues that regulation
27 prohibits an originating carrier from blocking calls to a CLEC with
28 a high access rate. Furthermore, switched access is a monopoly
29 because an originating carrier does not have a choice of
30 terminating carriers. Accordingly, the Board does not find
31 persuasive the Joint CLECs’ claim that they do not have a

⁸⁹ See McLeod’s Supplemental Responses to Data Requests 23-24 of Verizon’s First Set of Data Requests (January 5, 2010), true and correct copies of which are attached as part of **Attachment DP-1**.

⁹⁰ *Id.*

⁹¹ See *MA DTC Order* at 12.

1 monopoly on intrastate access services and that the Board should
2 permit the market to control Intrastate Access Rates.⁹²

3
4 And of course, as discussed at length above, in its *CLEC Rate Cap Order*, the
5 FCC has soundly rejected the contention that the CLEC switched access market is
6 competitive.

7 McLeod’s discovery responses failed to list a Texas proceeding that
8 investigated McLeod’s intrastate switched access rates. In that proceeding, a
9 Texas Public Utility Commission Staff member, Dr. Mark T. Bryant, filed
10 testimony prior to McLeod’s withdrawal of the tariff under investigation that
11 refuted the same argument that McLeod makes here. When asked if the ability to
12 win customers away from McLeod provided “sufficient market discipline to
13 prevent McLeod from charging excessive switched access rates,” Dr. Bryant
14 responded as follows:

15 No, it does not. Indeed, McLeod would not propose to set
16 switched access rates at the level it is proposing if it seriously
17 thought that such charges would create a danger for McLeod of
18 losing its end user customers. ... The fact is that, so long as the
19 end user is a customer of McLeod, all interexchange carriers must
20 pay switched access charges to McLeod at the rate set by McLeod
21 – they have no alternative.⁹³
22

23 **Q. DO YOU AGREE WITH MR. STARKEY’S POSITION THAT THE FCC’S**
24 **CLEC RATE CAP ORDER DOES NOT APPLY IN ILLINOIS TODAY?**⁹⁴

⁹² See *NJ BPU Order* at 27 (emphasis in original; record citations omitted).

⁹³ See Surrebuttal Testimony of Mark T. Bryant, Ph.D. of the Public Utility Commission of Texas, P.U.C.T. Docket No. 33545, *Application of McLeodUSA Telecommunications Services, Inc. for Approval of Intrastate Switched Access Rates Pursuant to PURA Section 52.155 and PUC Subst. R. 26.233* (October 5, 2007) at 3-4 (available on-line at http://interchange.puc.state.tx.us/WebApp/Interchange/application/dbapps/filings/pgSearch_Results.asp?TXT_CNTR_NO=33545&TXT_ITEM_NO=373).

⁹⁴ See McLeod Direct at 65-71.

1 A. No, I do not. As discussed herein, the same concerns raised by the FCC in its
2 *CLEC Rate Cap Order* exist in Illinois today with respect to Illinois CLECs'
3 intrastate switched access rates. McLeod claims that the FCC's findings were
4 "explicitly transitional" and are "not warranted in Illinois today" because of the
5 SBC/AT&T and Verizon/MCI mergers,⁹⁵ but the FCC's rules, codified at 47
6 C.F.R § 61.26, remain in full force and effect today, and McLeod admitted in
7 discovery that the FCC has not withdrawn, reversed, superseded, vacated or
8 otherwise invalidated the *CLEC Rate Cap Order*.⁹⁶ The fact that the FCC has not
9 done so, coupled with the fact that, as detailed above, so many states have found it
10 essential to constrain CLECs' intrastate switched access rates, demonstrates that
11 the conditions that caused the FCC to issue the *CLEC Rate Cap Order* have not
12 lessened due either to the passage of time or the two referenced mergers, and that
13 "regulatory arbitrage opportunities"⁹⁷ still exist today. Thus, while the *CLEC*
14 *Rate Cap Order* may have been deemed "transitional," Mr. Starkey has offered no
15 facts to demonstrate that the transition to a "competitive model"⁹⁸ for the
16 switched access market has occurred. Thus, regulatory intervention remains
17 necessary to discipline CLEC access rates at both the inter- and intrastate levels.

18 **Q. MR. STARKEY CLAIMS THAT LARGE ILECS AND THEIR LONG**
19 **DISTANCE AFFILIATES POSSESS "MONOPSONY" POWER IN**

⁹⁵ *Id.* at 67-68; 70-71.

⁹⁶ See McLeod's Response to Data Request 26 of Verizon's First Set of Data Requests (December 8, 2009), a true and correct copy of which is attached as part of **Attachment DP-1**. The request and response use the terminology "*CLEC Access Charge Order*" because that is the terminology used in the McLeod Direct.

⁹⁷ See *CLEC Rate Cap Order* at ¶ 3.

⁹⁸ *Id.* at ¶ 7.

1 **PURCHASING ACCESS SERVICES, AND CAN SUPPRESS**
2 **INTRASTATE ACCESS PRICING THAT WAY.⁹⁹ IS HE CORRECT?**

3 A. No. Mr. Starkey’s theory is erroneous because it once again ignores the market
4 structure for switched access. A monopsonist is a single buyer capable of using
5 market power to set the prices for the services it buys. However, no matter how
6 large the buyers of switched access services may be, they can have no market
7 power because, as discussed above, regulation forces them to use a particular
8 CLEC’s access services to terminate a call. In other words, originating carriers
9 have no leverage to set access prices because the existing regulatory paradigm
10 prevents an originating carrier from purchasing access services from anyone but
11 the particular CLEC providing local service to the called party. McLeod’s
12 contention that CLECs are merely access price-takers at the mercy of large
13 interexchange carriers is belied by the extent to which McLeod’s intrastate
14 switched access rates exceed those of AT&T and Verizon, the large ILECs in
15 Illinois – *eight times higher*, based on the information compiled by Staff – and by
16 the fact that AT&T’s and Verizon’s interexchange carriers have intervened in this
17 case to urge the Commission to limit McLeod’s intrastate access rates. If AT&T
18 Illinois’ and Verizon’s interexchange carrier affiliates were able to exercise
19 monopsony power to suppress McLeod’s intrastate switched access rates, this
20 docket would not exist.

⁹⁹ See McLeod Direct at 72-74.

1

2 **V. CONCLUSION**

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

4 **A. Yes.**