

STATE OF ILLINOIS  
ILLINOIS COMMERCE COMMISSION

GENESEO TELEPHONE COMPANY,	)	
CAMBRIDGE TELEPHONE COMPANY and	)	
HENRY COUNTY TELEPHONE COMPANY	)	
	)	Docket 11-0210
Petition for Universal Service.	)	
	)	
	)	
ILLINOIS INDEPENDENT TELEPHONE	)	
ASSOCIATION	)	
	)	Docket 11-0211
Petition to update the Section 13-301(1)(d) Illinois	)	
Universal Service Fund and to implement	)	
Intrastate Switched Access Charge reform as	)	
described herein and for other relief.	)	
	)	Consolidated

**DIRECT TESTIMONY**

**OF**

**LAWRENCE J. BAX**

**ON BEHALF OF  
AT&T ILLINOIS**

MAY 9, 2011

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**I. INTRODUCTION & SUMMARY**

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

A. My name is Lawrence (Larry) J. Bax. My business address is 125 Corporate Office Drive, Room 157-B, Earth City, Missouri, 63045.

**Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

A. I am employed by AT&T Services, Inc. in the Access Management organization with responsibility for the review of public policy and state activity, especially as it relates to local exchange access, intercarrier compensation and universal service.

**Q. ON WHOSE BEHALF ARE YOU PRESENTING THIS TESTIMONY?**

A. I am testifying on behalf of Illinois Bell Telephone Company (“AT&T Illinois”), which is an incumbent local exchange company (“ILEC”) providing local exchange telecommunications services in Illinois. AT&T Illinois is also authorized to provide interexchange telecommunications services in Illinois and, as such, uses the intrastate switched access services provided by both ILECs and competitive local exchange carriers (“CLECs”) in Illinois.

**Q. PLEASE BRIEFLY DESCRIBE YOUR EDUCATIONAL AND PROFESSIONAL EXPERIENCE.**

A. I possess a Master of Arts-Telecom Management from Webster University in St. Louis, Missouri and a Bachelor of Arts-Government from Southern Illinois University in Edwardsville, Illinois. I have formal training in telecommunications

24 economics, law and regulation from Telcordia Technologies (i.e., formerly Bell  
25 Communications Research, Inc. or Bellcore) and INDETEC International, among  
26 others. Since joining the company in 1980, I have served in various regulatory  
27 positions, with responsibilities including witnessing, testimony development and  
28 support, policy development and advocacy, cost and rate development, and tariff  
29 management.

30

31 **Q. HAVE YOU PREVIOUSLY APPEARED AS A WITNESS IN A**  
32 **REGULATORY PROCEEDING?**

33 A. Yes. I have testified in the following states: Illinois, Iowa, Kansas, Nebraska,  
34 Washington, and Wyoming. My participation in those proceedings included filing  
35 written testimony and/or delivering oral testimony.

36

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

38 A. This proceeding addresses principal understandings and agreements between the  
39 Illinois Independent Telephone Association (“IITA”) and AT&T Illinois concerning  
40 proposed modifications to the Illinois Universal Service Fund (“IUSF”) and the  
41 methodology to be used by small ILECs serving 35,000 or fewer access lines in  
42 setting their intrastate switched access charge rates. The Stipulation and Agreement  
43 entered into by the IITA and AT&T Illinois (“Stipulation”) was attached to the  
44 Petition submitted by the IITA to initiate Docket No. 11-0211, and amended on May  
45 5, 2011.

46

47 IITA and AT&T Illinois agree in the Stipulation that the Commission should require  
48 the small ILECs intrastate switched access to be capped at rates no higher than their  
49 respective interstate switched access rates. Under the terms of the Stipulation, the  
50 small ILECs would be eligible to receive an amount from a new access restructuring  
51 element of the IUSF.

52  
53 Specifically, my testimony will support those portions of the Stipulation which  
54 establish mirroring<sup>1</sup> requirements with respect to intrastate switched access charges  
55 on those ILECs serving 35,000 or fewer access lines.

56

57 **Q. HOW IS YOUR TESTIMONY ORGANIZED?**

58 A. First, I would note that my testimony will address the public policy reasons that  
59 support the concept of mirroring. Under the Illinois statute, ILECs serving fewer  
60 than 35,000 or fewer access lines are not required to mirror. That is why an important  
61 part of the Stipulation is that these small ILECs are agreeing to mirror. My testimony  
62 which largely addresses the policy reasons for mirroring in general is organized as  
63 follows:

64 **Section II:** Basic concepts underlying switched access service,  
65 including the characteristics of switched markets that permit LECs  
66 to exercise market power over the rates for those services;

67

68 **Section III:** Mirroring discussion, including public policy  
69 considerations;

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71 **Section IV:** Adverse consequences to the marketplace resulting  
72 from jurisdictionally disparate switched access rates;

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<sup>1</sup> Mirroring is sometimes referred to as parity and the terms are interchangeable. In other words and in this matter particularly, the mirroring is effected between the interstate switched access tariff and the intrastate switched access tariff.

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**Section V:** Regulatory activity with respect to LEC switched access service rates; and,

**Section VI:** Summary and conclusion.

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## **II. SWITCHED ACCESS OVERVIEW**

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### **Q. PLEASE BRIEFLY DESCRIBE SWITCHED ACCESS SERVICES.**

81

A. Switched access service is provided by local exchange carriers (“LECs”) to interexchange carriers<sup>2</sup> (“IXCs”) for the purpose of originating and terminating toll calls. Basically, when an end-user picks up the telephone to place a typical wireline long-distance call, the call is routed from the calling end-user’s telephone to a switch in that end-user’s LEC central office. The switch recognizes that the call is a long-distance call and routes the call over transport facilities to switching equipment operated by the IXC the calling party has selected to carry their long-distance traffic. The IXC carries the call to its switch nearest the called end-user, at which point the IXC delivers the call to transport facilities used to deliver the call to the LEC central office serving the called end-user, which in turn causes the called end-user’s telephone to ring. Access service offers the temporary use of LEC facilities to transport and switch the toll call between the toll carrier and its customer.

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94

Access charges represent the compensation the IXC pays to the LECs on both the originating and terminating end of the call to switch the call onto (or off of) the transport facilities and deliver the call to (or from) the IXC switch. If the long-

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<sup>2</sup> When I use the term “LECs” in my testimony, I am not only referring to incumbent local exchange carriers. I am also including CLECs unless otherwise indicated since the same policy rationale for adopting a mirroring policy applies to both. Interexchange carriers are sometimes referred to as toll providers or long-distance carriers.

97 distance call is between different states, interstate access charges apply. If the call is  
98 between two points within the same state, intrastate access charges apply.<sup>3</sup>

99

100 **Q. HOW CAN A LEC SUSTAIN EXCESSIVE RATES WHEN IT SELLS**  
101 **SERVICES TO A LARGE IXC?**

102 A. The size of the LEC or the IXC is not the controlling factor. Rather, it is the  
103 prevailing structure described above which gives the LEC power to control access  
104 rates, absent regulatory oversight.

105

106 An IXC has no choice but to use the calling and/or called party's respective LEC for  
107 the completion of the long-distance call the IXC is carrying for its own customer. By  
108 definition, there is no other provider that can originate or terminate a call other than  
109 the LEC which serves the calling/called party. Thus, the calling/called party's LEC  
110 has – regardless of its size – the incentive and the ability (absent appropriate  
111 regulatory constraints) to set the highest tariffed switched access service rate it can.  
112 Once the LEC access rate is filed and effective, absent a negotiated agreement, the  
113 IXC is compelled to pay the tariffed rate.

114

115 In short, market forces are impeded from disciplining the LEC access rates. In this  
116 environment, regulatory action is appropriate to establish a cap on LEC tariffed  
117 switched access rates.

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<sup>3</sup> It is critical to note that the functions a LEC provides for intrastate and interstate switched access are materially identical in that the LEC employs the same facilities.

119 **Q. IS THERE ANY JUSTIFICATION FOR INTRASTATE SWITCHED ACCESS**  
120 **RATES TO BE HIGHER THAN INTERSTATE RATES?**

121 A. No. Intrastate switched access and interstate switched access perform the same  
122 functions utilizing the same facilities. As such, the costs underlying each service  
123 must be same.

124  
125 The FCC adopted a series of orders affecting access reform in the interstate  
126 jurisdiction. By way of its CALLS, MAG and CLEC Access orders,<sup>4</sup> the FCC has  
127 already implemented reforms that have reduced<sup>5</sup> implicit subsidies from interstate  
128 access rates. Presumably, existing interstate switched access rates are sufficient to  
129 recover the associated costs. This is illustrated by the fact that no LEC has asked the  
130 FCC or the courts to review their interstate rates or argue that those rates do not  
131 recover its cost of interstate switched access service, to the best of my knowledge.

132  
133 As such, the Commission can safely conclude that requiring LECs' intrastate  
134 switched access rates to be at parity with the interstate level will also be sufficient to  
135 recover the LECs' intrastate switched access costs. Generally, any intrastate switched

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<sup>4</sup> *In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Low-Volume Long Distance Users*, Federal-State Joint Board on Universal Service, Sixth Report and Order, etc., FCC 00-193, CC Docket Nos. 96-262, 94-1,99-249,96-45 (ReI. May 31, 2000) ("CALLS Order"). *In the Matter of Multi-Assoc. Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers Subject to Rate-of-Return Regulation, Prescribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, Second Report and Order and Further NPRM, FCC 01-304, CC Docket Nos. 00-256, 96-45, 98-77, 98-166 (ReI. Nov 8, 2001) ("MAG Order"). *In the Matter of Access Charge Reform; Reform of Access charges Imposed by Competitive Local Exchange Carriers*, Eighth Report and Order and Fifth Order on Reconsideration, FCC 04-110, CC Docket No. 96-262 (ReI. May 18, 2004)("2004 CLEC Access Order"); *In the Matter of Access Charge Reform; Reform of Access Charges Imposed by Competitive Local Exchange Carriers*, Seventh Report and Order and Further NPRM, FCC 01-146, CC Docket No. 96-262 (ReI. Apr.27, 2001) ("2001 CLEC Access Order").

<sup>5</sup> Notably, the FCC recognized that the interstate switched access rates continued to include some level of implicit support, albeit greatly reduced from previous levels.

136 access service rate above the interstate level increases the implicit subsidies, and must  
137 be reduced.

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### **III. MIRRORING DISCUSSION**

140 **Q. MR. BAX, YOU PREVIOUSLY STATED THAT THE PURPOSE OF YOUR**  
141 **TESTIMONY IS TO EXPLAIN THE MIRRORING REQUIREMENTS**  
142 **INCORPORATED IN THE STIPULATION BETWEEN AT&T ILLINOIS**  
143 **AND THE IITA. CAN YOU BRIEFLY EXPLAIN THE TERM**  
144 **“MIRRORING?”**

145 A. Mirroring, as referenced in the Stipulation between the IITA and AT&T Illinois,<sup>6</sup>  
146 refers to the implementation of an intrastate switched access service tariff which is  
147 identical (i.e., in the rates, terms and conditions) to the then effective interstate  
148 switched access service tariff.

149

150 **Q. WHAT ARE THE PUBLIC POLICY IMPLICATIONS OF MIRRORING?**

151 A. As will be discussed in my testimony, excessive (i.e., those burdened with implicit  
152 subsidies) or disparate (i.e., those which differ between jurisdictions, for example  
153 between interstate and intrastate) switched access service rates are a detriment to the  
154 marketplace and harm consumers. While I am not saying that this has taken place in  
155 Illinois, in a situation where the switched access service rates in one jurisdiction (i.e.,  
156 in this case, the intrastate rates) are higher than the rates in a corresponding  
157 jurisdiction (i.e., in this case, the interstate rates), market participants have an  
158 incentive to engage in regulatory arbitrage in order to take advantage of that

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<sup>6</sup> The mirroring requirement is contained in item number 8 within the Agreement.

159 disparity.<sup>7</sup> As such, any disparities in the rates between the two jurisdictions will  
160 exacerbate the jeopardies associated with excessive switched access service rates.  
161 Given that no material functional difference exists between intrastate switched access  
162 service and interstate switched access service, these pitfalls can be minimized, if not  
163 avoided all-together, through a mirroring requirement. Therefore, the benefit is  
164 compounded: The jeopardies associated with excessive switched access rates are  
165 eliminated, as well as the jeopardies and gaming associated with any disparity  
166 between the corresponding jurisdictions.

167

168 **Q. IS MIRRORING OF SWITCHED ACCESS RATES (I.E., BETWEEN THE**  
169 **STATE AND FEDERAL JURISDICTIONS) A NOVEL OR UNTESTED**  
170 **CONCEPT?**

171 A. No. In fact, many states have already implemented mirroring requirements whereby  
172 the intrastate switched access rates must be in parity with the corresponding interstate  
173 rates. A list of those states is included in Bax Direct – Schedule LJB-A.

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176 **Q. PURSUANT TO THE AGREEMENT, THE IITA MEMBERS WOULD BE**  
177 **PERMITTED TO RECOUP THE LOSS IN REVENUES FROM THE**  
178 **REDUCTION OF THEIR INTRASTATE ACCESSS CHARGE RATES TO**

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<sup>7</sup> For example, purchasers of the switched access services (e.g., toll providers) may seek to characterize traffic toward that jurisdiction which results in lesser charges. Similarly, sellers of the switched access services may seek to inappropriately stimulate traffic demand toward that jurisdiction with the higher rates. And, consumers will likely seek to utilize services and/or technology which are burdened with the lowest switched access costs (i.e., presumably resulting in lower rates to the consumer). These jeopardies may exist wherever there is disparity between rates for “like” services, including wherever excessive implicit subsidies create such disparity.

179 **THEIR INTERSTATE LEVELS THROUGH AN ACCESS CHARGE**  
180 **RESTRUCTURING ELEMENT OF THE USF. ARE THERE POLICY**  
181 **CONSIDERATIONS THAT SUPPORT THIS ASPECT OF THE**  
182 **AGREEMENT?**

183 A. Yes. Section 13-301(1)(d) of the Illinois Public Utilities Act (“PUA”) provides that in  
184 creating a fund pursuant to 13-301(1)(d), the Commission shall under (2)(b)  
185 “[i]dentify all implicit subsidies contained in rates or charges of incumbent local  
186 exchange carriers, including all subsidies in interexchange access charges, and  
187 determine how such subsidies can be made explicit by the creation of the fund.”  
188 Although I am not an attorney, it seems self-evident that this provision reflects a  
189 policy of removing any implicit subsidies for service in rural high cost areas from  
190 rates and charges, such as switched access charges, and making such subsidies  
191 explicit through the USF fund. The proposal being considered in this case is fully  
192 consistent with this policy because it would remove implicit subsidies from the access  
193 charges that are borne by one class of carriers (interexchange carriers), and their  
194 customers, and allow the IITA companies to receive explicit support for the costs  
195 being subsidized through an increase in the USF fund.

196  
197 This is consistent with the approach taken in the interstate jurisdiction where  
198 reductions in implicit subsidies in interstate switched access were replaced with end-  
199 users charges (e.g., common carrier line charges) and with the Interstate Common  
200 Line Support and Local Switching Support elements of the Federal Universal Service  
201 Fund.

202

203 Similarly, as shown in Bax Direct – Schedule LJB-A, many states have utilized  
204 explicit support mechanisms to replace the implicit support flows from switched  
205 access revenues.

206

207 Moreover, by reducing the level of implicit subsidies embedded in intrastate switched  
208 access charges and creating explicit sources for those subsidies, the Commission can  
209 be assured that the market will operate more effectively and efficiently (i.e., by  
210 eliminating the opportunities for the jeopardies described herein) and that targeted  
211 market providers (e.g., interexchange carriers) and their customers will not be  
212 inequitably burdened with supporting those subsidies.

213

214 **Q. HAS THE ILLINOIS LEGISLATURE ADOPTED ANY MIRRORING**  
215 **REQUIREMENTS?**

216 A. Yes. In June 2010, the Governor signed SB107, which provides, in relevant part, that  
217 any telecommunications carrier electing market regulation (“Electing Provider”) must  
218 reduce its intrastate switched access rates to levels that mirror the rates and rate  
219 structure of its interstate switched access rates by June 30, 2013.<sup>8</sup> Electing Providers  
220 are required to continue to mirror their interstate switched access rates and rate  
221 structure thereafter.<sup>9</sup> Even if a telecommunications carrier does not choose to become  
222 an Electing Provider, the same legislation required those non-Electing Providers,  
223 including both ILECs serving more than 35,000 access lines and CLECs, to mirror

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<sup>8</sup> 220 ILCS 5/13-506(g)(1).

<sup>9</sup> 220 ILCS 5/13-506(g)(1).

224 their interstate access rates by July 1, 2012.<sup>10</sup> Thus, the legislature has recognized  
225 that mirroring is good policy and has passed legislation to implement it in Illinois.  
226 The legislature did not apply this law to ILECs serving 35,000 or fewer access lines.  
227 That is why the Stipulation in which the small ILECs agree to mirror their interstate  
228 rates is significant.

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#### **IV. MARKETPLACE HARM**

231 **Q. HOW DO JURISDICTIONALLY DISPARATE SWITCHED ACCESS RATES**  
232 **AFFECT THE MARKETPLACE?**

233 A. Market participants have been proven to game the marketplace, especially any  
234 disparity between intrastate and interstate switched access rates. Furthermore,  
235 excessive costs resulting in increases to IXCs' toll rates will drive toll consumers to  
236 providers which are not burdened with those excessive costs.

237

238 Jurisdictional disparity in switched access rates engenders arbitrage. Providers that  
239 receive high access charges have an incentive to generate increased traffic volumes.  
240 The recent, highly publicized "traffic pumping" schemes, which are designed to drive  
241 massive volumes of traffic to adult chat lines and similar services (*e.g.*, free  
242 conference call offers) via rural LECs and CLECs with high switched access rates,  
243 serve to highlight the potential for abuse.<sup>11</sup>

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<sup>10</sup> 220 ILCS 5/13-900.2

<sup>11</sup> *In the Matter of Establishing Just and Reasonable Rates for Local Exchange Carriers, Notice of Proposed Rulemaking*, Notice of Proposed Rulemaking, FCC 07-176, WC Docket No. 07-135 (Rel. Oct. 2, 2007).

245 As the market proves time and again, any effort to impose excessive implicit  
246 subsidies on one class of customers (i.e., in this case, those using intrastate toll  
247 services) simply leads those customers to find ways to avoid paying the implicit  
248 subsidies and shift their demand to alternative choices. As the customers continue to  
249 shift long-distance minutes to the competitive alternatives, the amount of a LEC's  
250 subsidy revenue will be lost, ultimately culminating at a point where the proverbial  
251 "last minute of traditional long-distance" cannot bear that burden.

252

253 Also, in a market where consumers now have many alternatives to wireline long-  
254 distance services, any increase in the price of long-distance will result in customers  
255 shifting usage to services and technologies that are not subject to the high access  
256 costs. Thus, the IXCs are at a competitive disadvantage against communications  
257 service providers using alternative technologies. IXCs are unable to effectively  
258 compete – not because of their own merits – but because unjust and unreasonable  
259 access charges ultimately distort prices in the marketplace.

260

261 Ironically, when consumers leave wireline long-distance carriers, they often decide to  
262 leave wireline telephone service altogether. Nationally, FCC statistics shows that  
263 incumbent local exchange carriers have lost 40% of their lines since 2000.<sup>12</sup>  
264 According to a study by the National Center for Disease Control, "One of every four  
265 American homes (26.6%) had only wireless telephones (also known as cellular  
266 telephones, cell phones, or mobile phones) during the last half of 2010—an increase  
267 of 2.1 percentage points since the second half of 2010. In addition, one of every six

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<sup>12</sup> *See*, Bax Direct – Schedule LJB-B.

268 American homes (15.9%) had a landline yet received all or almost all calls on  
269 wireless telephones.”<sup>13</sup>

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271 As illustrated in Bax Direct – Schedule LJB-B, while the number of housing units has  
272 increased over the past decade, ILECs have lost more than 40 percent of their lines.

273 Every customer that abandons an incumbent raises the average cost per line of  
274 serving those customers that remain. As incumbents lose more and more customers,

275 they are also losing any associated implicit subsidies (e.g., including those embedded  
276 in switched access charges). Compounding this problem, incumbents also confront a

277 dramatic decline in access minutes even for those lines that they manage to retain.

278 Bax Direct – Schedule LJB-B shows that interstate switched access minutes have  
279 declined almost 47% over the past decade. Similar declines in intrastate switched

280 access minutes can also be expected.<sup>14</sup> These declines in local exchange and

281 switched access revenues are exacerbated by arbitrage schemes (i.e., as described  
282 herein) that exploit well-known flaws in the intercarrier compensation system.

283

284 **Q. ARE THERE NETWORK INVESTMENT JEOPARDIES ASSOCIATED**  
285 **WITH NON-UNIFORM COMPENSATION RATES?**

286 A. Yes. A major policy objective in the Federal and state jurisdictions is the goal to

287 encourage network investment. An analysis by the Phoenix Center for Advanced

288 Legal & Economic Public Policy Studies finds that a lower, more uniform

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<sup>13</sup> Stephen J. Blumberg, Ph.D., and Julian V. Luke, Division of Health Interview Statistics, National Center for Health Statistics. Released December 21, 2010.

<http://www.cdc.gov/nchs/data/nhis/earlyrelease/wireless201012.htm>

<sup>14</sup> As detailed in Bax Direct – Schedule LJB-C, the distribution of toll calls and minutes between the interstate and intrastate jurisdictions has been relatively constant.

289 compensation rate can promote network investment, “especially in rural and less  
290 densely populated areas where current call termination rates are very high, by  
291 reducing arbitrage opportunities that distort investment decisions.”<sup>15</sup>

292

293 Furthermore, as affected intrastate toll consumers continue to migrate to alternative  
294 technologies and providers (e.g., VoIP, wireless, etc.), thereby disconnecting their  
295 traditional telecommunications services, the support burden is greater on a smaller  
296 customer base. The result is that an outdated network receives continued support  
297 while investment in advanced networks and services is put at risk. Customers realize  
298 a greater burden with less opportunity for alternative and/or advanced choices.

299

300 **Q. DO HIGHER SWITCHED ACCESS RATES NECESSARILY RESULT IN**  
301 **CORRESPONDING HIGHER REVENUES (I.E., SUPPORT)?**

302 A. No. In an ex parte filed with the FCC in its proceeding looking at intercarrier  
303 compensation, Jerry Ellig, Senior Research Fellow, George Mason University-  
304 Mercatus Center, Regulatory Studies Program, states, “Demand for long-distance  
305 communication is significantly more elastic than the demand for local wireline  
306 service; increases in price cause consumers to buy many fewer minutes, which leads  
307 them to forego significant benefits. The elasticity of demand for wireline long-  
308 distance service is approximately 0.7; that is, a 1 percent increase in the price of long

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<sup>15</sup> *Do High Call Termination Rates Deter Broadband Deployment?*, Phoenix Center Policy Bulletin No. 22, Phoenix Center For Advanced Legal & Economic Public Policy Studies, October 2008, at p. 1. A copy of the paper can be found at <http://www.phoenix-center.org/PolicyBulletin/PCPB22Final.pdf>.

309 distance leads to a 0.7 percent decrease in minutes used.”<sup>16</sup> Therefore, it is  
310 economically inefficient to rely on inflated long-distance rates (i.e., by way of  
311 implicit subsidies in the switched access rates) as a means to support local wireline  
312 service. The support should be explicit and directly attributed to local wireline  
313 service.

314

315 **V. REGULATORY ACTIVITY WITH RESPECT TO SWITCHED ACCESS**

316 **SERVICE RATES**

317 **Q. THE FCC IS CURRENTLY CONSIDERING COMPREHENSIVE**  
318 **INTERCARRIER COMPENSATION REFORM. WHY SHOULD THE**  
319 **COMMISSION ACT IN ADVANCE OF AN OUTCOME FROM THE FCC?**

320 A. The FCC has tried for years to address comprehensive reform, but due to the  
321 complexities of the issues, comprehensive reform has been elusive. Many states have  
322 argued to keep their jurisdiction over intrastate rates and should accordingly take the  
323 lead in intrastate access reform efforts.<sup>17</sup> In fact, as illustrated in Bax Direct –

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<sup>16</sup> From an *ex parte* prepared by Jerry Ellig, senior research fellow, George Mason University-Mercatus Center, Regulatory Studies Program: Public Interest Ex Parte Comment On Intercarrier Compensation And Universal Service: Developing a Unified Intercarrier Compensation Regime, CC Docket No. 01-92; Biennial Review of Telecommunications Regulations, WC Docket No. 08-183; High-Cost Universal Service Support, WC Docket No. 05-337; Federal-State Joint Board on Universal Service, CC Docket No. 96-45; Intercarrier Compensation for ISP-Bound Traffic, WC Docket No. 99-68; Establishing Just and Reasonable Rates for Local Exchange Carriers, WC Docket No. 07-135, September 22, 2008, pg. 3. Mr. Ellig states, “A range of estimates exists, but -0.7 is the consensus view.” Mr. Ellig cites to Jerry Hausman & Howard Shelanski, *Economic Welfare And Telecommunications Regulation: The E-Rate Policy For Universal-Service Subsidies*, 16 Yale J. ON Reg. 19, 36–37 (1999); See Also Michael H. Riordan, *Universal Residential Telephone Service*, in “1 Handbook Of Telecommunications Economics” 423, 431 (Martin E. Cave Et Al., Eds.) (2002). A copy of the document can be found at: [http://fjallfoss.fcc.gov/prod/ecfs/retrieve.cgi?native\\_or\\_pdf=pdf&id\\_document=6520170017](http://fjallfoss.fcc.gov/prod/ecfs/retrieve.cgi?native_or_pdf=pdf&id_document=6520170017).

<sup>17</sup> See, generally, Initial Comments of the National Association Of Regulatory Utility Commissioners, High-Cost Universal Service Support, WC Docket No. 05-337; Federal-State Joint Board on Universal Service, CC Docket No. 96-45; Lifeline and Link Up, WC Docket No. 03-109; Universal Service Contribution Methodology, WC Docket No. 06-122; Numbering Resource Optimization, CC Docket No. 99-200; Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98; Developing a Unified Intercarrier Compensation Regime, CC Docket No. 01-92;

324 Schedule LJB-D, many states have already taken or are in the process of taking  
325 interim action in advance of a FCC comprehensive reform decision. Time is running  
326 out to transition the outdated and unsustainable implicit subsidy structure to one that  
327 ensures that all competitors are operating on a level playing field.

328

329 **Q. HAS THE FCC PROVIDED ANY FURTHER DIRECTION TO THE STATES**  
330 **RECENTLY?**

331 A. Yes. Recently, in its National Broadband Plan, the FCC has reiterated its intention to  
332 further reduce access rates and ultimately eliminate them entirely.<sup>18</sup> In that Plan, the  
333 FCC expressed particular concern about the detrimental effects of the current access  
334 regime on the incentives to invest in broadband facilities. As the FCC observed,  
335 “Because providers’ [access] rates are above cost, the current system creates  
336 disincentives to migrate to all IP-based networks...[which] hinders the transformation  
337 of America’s networks to broadband.”<sup>19</sup> Obviously, states with any opportunity to  
338 review switched access rates should take guidance from this clear policy statement by  
339 the FCC.

340

341 More recently, in its Notice of Proposed Rulemaking and Further Notice of Proposed  
342 Rulemaking (“NPRM & FNPRM”) in its proceeding addressing intercarrier

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Intercarrier Compensation for ISP-Bound Traffic, CC Docket No. 99-68; IP Enabled Services, WC Docket No. 04-36; November 26, 2008.

<sup>18</sup> “Connecting America: The National Broadband Plan,” Federal Communications Commission, March 16, 2010, (hereafter *National Broadband Plan*), p. 148.

<sup>19</sup> *National Broadband Plan*, p. 142.

343 compensation reform,<sup>20</sup> the FCC described the jeopardies associated with excessive  
344 switched access rates and the appropriate revenue balancing strategies:

- 345 • Eliminate wasteful billing disputes by closing loopholes and tightening  
346 rules to prevent “phantom traffic,” which is traffic that has been  
347 disguised so it can’t be identified for billing purposes.
- 348 • Amend rules to reduce “traffic pumping,” a practice that drains  
349 revenues from the system by exploiting existing rules to earn more  
350 intercarrier compensation. Reclaimed revenues could be invested in  
351 networks or used to reduce prices for consumers.
- 352 • Gradually reduce per-minute Intercarrier Compensation charges. These  
353 charges create incentives for carriers to maintain legacy networks that  
354 maximize intercarrier revenues rather than investing in advanced,  
355 efficient IP-based infrastructure.
- 356 • Develop a system to offset reductions in intercarrier rates, including,  
357 where necessary, support from the Connect America Fund.<sup>21</sup>  
358

359 In summary, the FCC seeks

360 to take action in the near term to reduce inefficiency and waste in the  
361 intercarrier compensation system while providing a framework for  
362 long-term reform. This long-term reform would gradually phase out  
363 the current per-minute ICC system and implement a recovery  
364 mechanism (based on costs and/or revenues), which could enable some  
365 carriers to receive additional explicit support from the CAF.<sup>22</sup>  
366

367 While it cannot be determined *if* or *when* the FCC might take final and definitive  
368 action, it is incumbent on states to take whatever action necessary and available to  
369 better position themselves for eventual action in the Federal jurisdiction. Regardless  
370 of action/inaction at the Federal level, state action is necessary and warranted to  
371 “reduce wasteful arbitrage . . . [costing] hundreds of millions of dollars each year.”<sup>23</sup>

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<sup>20</sup> *See, Connect America Fund*, WC Docket No. 10-90; *A National Broadband Plan for Our Future*, GN Docket No. 09-51; *Establishing Just and Reasonable Rates for Local Exchange Carriers*, WC Docket No. 07-135; *High-Cost Universal Service Support*, WC Docket No. 05-337; *Developing an Unified Intercarrier Compensation Regime*, CC Docket No. 01-92; *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45; and, *Lifeline and Link-Up*, WC Docket No. 03-109. (“FCC ICC Reform Proceeding”)

<sup>21</sup> *FCC ICC Reform Proceeding*, News, February 8, 2011.

<sup>22</sup> *NPRM & FNPRM* at paragraph 34.

<sup>23</sup> *NPRM & FNPRM* at paragraph 35.

372

373

**VI. SUMMARY AND CONCLUSION**

374 **Q. PLEASE SUMMARIZE YOUR TESTIMONY.**

375 A. The very nature of the switched access marketplace (i.e., without regard to relative  
376 size of the provider) necessitates taking steps to ensure that the appropriate public  
377 policy goals are achieved and that the marketplace jeopardies described herein do not  
378 materialize. Implicit subsidies (i.e., resulting in excessive rates) and/or disparate rates  
379 between jurisdictions provide an opportunity for such jeopardies to materialize. For  
380 these reasons, mirroring is an excellent safeguard against those jeopardies. Since the  
381 FCC has established interstate switched access rates which minimize the level of  
382 implicit subsidies, the interstate switched access rates are a sound target for intrastate  
383 switched access rates.

384

385 The Stipulation provides mirroring requirements with respect to intrastate switched  
386 access charges for those ILECs serving 35,000 or fewer access lines. Furthermore,  
387 the Stipulation allows those ILECs to offset those revenues from a new access  
388 restructuring element of the IUSF.

389

390 The balances achieved in the Stipulation will help to ensure that the appropriate  
391 public policy goals are preserved and that opportunities for the marketplace  
392 jeopardies described herein are mitigated.

393

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

395 A. Yes.