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August 16, 2006

Via Hand Delivery
Hon. Beth O'Donnell
Executive Director
Public Service Commission
211 Sower Blvd.
P. O. Box 615
Frankfort, KY 40601

Re: ***In the Matter of: Petition of Duo County Telephone Cooperative Corporation, Inc. for Arbitration of Certain Terms and Conditions of Proposed Interconnection Agreement with Cellco Partnership d/b/a Verizon Wireless, GTE Wireless of the Midwest Incorporated d/b/a Verizon Wireless, and Kentucky RSA No. 1 Partnership d/b/a Verizon Wireless Pursuant to the Communications Act of 1934, as Amended by the Telecommunications Act of 1996, Case No. 2006-00217***

Dear Ms. O'Donnell:

I have enclosed for filing in the above-styled case the original and ten (10) copies of the testimony of Steven E. Watkins in compliance with the July 25th procedural order requiring RLEC's to file and serve TELRIC-based cost studies and written testimony in support of those cost studies today.

Thank you, and if you have any questions, please call me.

Very truly yours,

DINSMORE & SHOHL LLP

John E. Selent /by EJO

John E. Selent

JES/bmt

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cc: William McGruder (w/encl.)
Steven E. Watkins (w/encl.)
Edward T. Depp, Esq. (w/encl.)
Holly C. Wallace, Esq. (w/encl.)

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AUG 1 6 2006

PUBLIC SERVICE COMMISSION

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

Petition of Duo County Telephone Cooperative Corporation, Inc. for Arbitration of Certain Terms and Conditions of Proposed Interconnection Agreement with Cellco Partnership d/b/a Verizon Wireless, GTE Wireless of the Midwest Incorporated d/b/a, and Kentucky RSA No. 1 Partnership d/b/a Verizon Wireless, Pursuant to the Communications Act of 1934, as amended by the Telecommunications Act of 1996	)	Case No. 2006-00217

PREFILED DIRECT TESTIMONY OF STEVEN E. WATKINS ON BEHALF OF DUO COUNTY TELEPHONE COOPERATIVE <u>CORPORATION, INC.</u>

August 16, 2006

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PREFILED DIRECT TESTIMONY OF STEVEN E. WATKINS ON BEHALF OF DUO COUNTY TELEPHONE COOPERATIVE <u>CORPORATION, INC.</u>

Q: PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND TELEPHONE NUMBER.

A: My name is Steven E. Watkins. My business address is 2154 Wisconsin Avenue, N.W., Suite 290, Washington, D.C., 20007. My business phone number is (202) 333-5276.

Q: WHAT IS YOUR CURRENT POSITION?

A: I am a self-employed telecommunications management consultant.

Q: WHAT ARE YOUR DUTIES AND RESPONSIBILITIES IN YOUR TELECOMMUNICATIONS MANAGEMENT CONSULTANT POSITION?

A: I provide telecommunications management consulting services and regulatory assistance to smaller local exchange carriers ("LECs") and other smaller firms providing telecommunications and related services in rural and small town areas. My work involves assisting client LECs and related entities in their analysis of regulatory requirements and industry matters requiring specialty expertise; negotiating, arranging and administering connecting carrier arrangements; and assisting clients in complying with the rules and regulations arising from the passage of the Telecommunications Act of 1996 (the "Act"). Prior to the beginning of this year, I worked for client companies in association with the Kraskin, Moorman & Cosson, LLC law firm. Prior to my work association with the law firm, I was the senior policy analyst for the National Telephone Cooperative Association ("NTCA"), a trade association whose membership consists of approximately 500 small and rural telephone companies. While with NTCA, I was responsible for evaluating the then proposed Telecommunications Act, the implementation of the Act by the Federal Communications Commission ("FCC") and was largely involved in the association's efforts with respect to the advocacy of provisions addressing the issues specifically related to rural companies and their customers.

Q: HAVE YOU PREPARED AND ATTACHED FURTHER INFORMATION REGARDING YOUR BACKGROUND AND EXPERIENCE?

A: Yes, this information is included in Exhibit 1 following my testimony.

Q: ON WHOSE BEHALF ARE YOU SUBMITTING THIS PRELIMINARY TESTIMONY?

A: I am submitting this Preliminary Testimony to the Public Service Commission of the Commonwealth of Kentucky ("Commission") on behalf of five small and rural LECs, specifically Ballard Rural Telephone Cooperative Corporation, Inc. (Case No. 2006-00215); Brandenburg Telephone Company (Case No. 2006-00288); Duo County Telephone Cooperative Corporation, Inc. (Case No. 2006-00217); Logan Telephone Cooperative, Inc. (Case No. 2006-00218); and West Kentucky Rural Telephone Cooperative Corporation, Inc. (Case No. 2006-00220) (collectively referred to herein as the "RTCs").

Q: WHAT IS THE PURPOSE OF THIS PRELIMINARY TESTIMONY?

A: This testimony is in response to the Commission's Order dated July 25, 2006 ("July 25 Order"). The purpose of my testimony is to provide background information and a discussion of the rationale for the "transport and termination" rate that the RTCs proposed to the Commercial Mobile Radio Service ("CMRS") providers and submitted in their respective arbitration petitions.

Q: WHY IS YOUR TESTIMONY BEING DESIGNATED AS "PRELIMINARY TESTIMONY?"

A: I will be providing important information in this Preliminary Testimony for the Commission's consideration as the parties move forward to resolve interconnection agreements between the RTCs and the various CMRS providers. However, the basis for, and the determination of, an appropriate rate for "transport and termination" of traffic between the CMRS providers and the RTCs for traffic that is within the scope of the reciprocal compensation rules is an issue to be decided in the course of the arbitration proceeding. Moreover, I respectfully note that any decision about what the proper basis for such a rate should be for a <u>Rural Telephone Company</u>, as that term is defined in the Act, is a matter to be decided in the yet-to-be-conducted arbitration and any court review of that decision. Therefore, the initial Order and this preliminary testimony are premature, because a full record has not been established and a proper basis for such a conclusion has yet to be determined.

In the course of the arbitration proceeding, the Commission will have the opportunity and authority to consider an appropriate approach to determine a reasonable transport and termination rate, consistent with the public interest, and in keeping with the status of the

RTCs and their limited resources. As I will discuss below, there is an evolving policy convergence in the industry, as well as before the FCC, for transport and termination rates based on the same rate-setting process used to develop interstate access rates because those costing methods have been revised over the last decade to much lower levels than existed in 1996 and are now considered "cost-based." There is an equally evolving policy recognition that so-called "TELRIC" studies are problematic and should be abandoned. Accordingly, the Commission should adopt a rate-development approach in this proceeding that avoids unnecessary, complex, and burdensome TELRIC studies – an approach not required of Rural Telephone Companies such as the RTCs.

Q: WHY DID THE RTCS SET FORTH A TRANSPORT AND TERMINATION RATE OF $0.015 PER MINUTE OF USE IN THEIR ARBITRATION PETITIONS?

A: The RTCs set forth the 1.5 cent rate for several reasons.

1. The 1.5 cent rate is the rate that the RTCs currently apply to the CMRS providers that are the parties to these arbitrations. This current rate application is pursuant to the industry agreement between and among BellSouth, the CMRS providers party to the pending arbitration proceedings, and the RTCs. As such, the 1.5 cent rate proposal is simply a continuation of the existing rate.

2. The 1.5 cent rate proposal is consistent with at least some, and perhaps the majority, of existing interconnection agreements that the RTCs have in place with some of the CMRS providers. That is, it is my understanding that the 1.5 cent proposal is the same as, or lower rate than, the rate employed in existing CMRS interconnection agreements with the RTCs if those rates were applied reciprocally.

3. The 1.5 cent rate proposal is an efficient and reasonable approach which recognizes the facts that (a) the RTCs have not previously conducted such complex cost studies as those proposed by the CMRS providers (*i.e.*, "TELRIC") and (b) there is no requirement at this time for the RTCs to conduct such complex cost studies to support some other rate.

4. As I will further discuss below, the interstate access rates that the RTCs charge for the same transport and termination network functions have been "reformed" (*i.e.*, reduced) over the last several years, and the rate-setting methodology used for interstate access is, more than ever, justified as a basis for rate-setting and is just as reasonable as other, theoretical, economic approaches to rate setting. It is my understanding that the proposed composite 1.5 cent per minute of use rate for the functions of transport and termination is comparable to the combined RTCs' interstate access rates for these same functions, and less than the higher intrastate access rates for these functions. Accordingly, given a comparison to the cost-based interstate access rates for transport and termination, it is the position of the RTCs that the 1.5 cent proposal is a reasonable approach.

5. Assuming that the RTCs were to bear the burden and expense of conducting TELRIC studies, the resulting rates from such studies would likely be greater than both the 1.5 cent per minute proposal and the existing interstate access rates for these network functions. I will explain below why TELRIC based network costs and resulting rates would likely be higher. Therefore, the 1.5 cent proposal is reasonable given that unnecessarily burdensome TELRIC studies would likely yield an even higher rate.

6. A recent proposal that would address the local interconnection rates for transport and termination has recently been set before the FCC and the States. For Rural Telephone Companies, this proposal would apply a costing method identical to that used for the develop

of interstate access rates for transport and termination functions. (*See* FCC Press Release dated July 24, 2006 discussing the so-called "Missoula Plan" filed in the FCC's unified intercarrier compensation proceeding, CC Docket 01-92.) The RTCs' proposed 1.5 cent rate is reasonable when compared to the rate that would result from the pending proposal in that proceeding. I will further explain, below, the industry consensus proposal, proposed rate-setting methods, and relevance to this proceeding.

7. The 1.5 cent proposal is reasonable in lieu of conducting complex and expensive TELRIC studies for small Rural Telephone Companies (with a resulting higher rate) given that the FCC also doubts, as a fundamental matter, the efficacy of the TELRIC study approach. I respectfully submit, as the FCC's recent conclusions support and as I reference and explain below, that the facts already before the Commission demonstrate that the determination of a rate for transport and termination in this proceeding may be, and should be, resolved without conducting expensive and complex studies which, in the end, may not yield a conclusive answer.

8. As the RTCs have already set forth in the record supporting their arbitration petitions in these proceedings, the CMRS providers have been recalcitrant and have ignored the necessary and good-faith negotiations with the RTCs. Accordingly, there was no effective chance for the RTCs to resolve any of the issues with the CMRS providers. Therefore, the proposal to continue with the existing rate, given the other conclusions and facts set forth above, was expedient given the circumstances.

As a side note, the CMRS providers' recalcitrance over the last several months should not now be rewarded by the imposition of unnecessary and undue economic and administrative burdens on the RTCs. The CMRS providers' insistence on unnecessary cost studies, after they ignored the RTCs for months, should not be condoned. It is my view that the CMRS providers have used the issue of TELRIC studies simply to overburden the RTCs, by requiring the RTCs to redirect their resources, in order to gain advantage in the overall regulatory proceedings. Regardless of the CMRS providers' motives, the FCC's pricing rules and TELRIC methods that the CMRS providers would like to impose on the RTCs are not applicable to Rural Telephone Companies with the status of the RTCs. *See, e.g.*, Motion For Rehearing, filed by Ballard Rural Telephone Cooperative Corporation, Inc. with the Commission on August 3, 2006.

Q: HAS THE FCC EXPRESSED ANY CONCERNS OVER THE EFFICACY OF THE TELRIC METHODS FOR RATE DEVELOPMENT?

A: Yes. The FCC initiated a proceeding to review its own pricing rules given the industry interconnection experience since the enactment of the Act now over 10 years ago. (*See Notice of Proposed Rulemaking*, In the Matter of Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers, WC Docket No. 03-173, released September 15, 2003 ("*TELRIC NPRM*").) The FCC asked generally for comment on compensation and recognized that the current process creates significant burdens:

> We seek comment on what measures we might adopt to reduce the costs associated with establishing compensation arrangements. <u>We recognize that a formal negotiation and arbitration process could impose significant burdens on the parties</u>.

Id. at para. 140 (emphasis added).

Moreover, the futility and wastefulness of resources associated with the TELRIC methodology is not surprising to the FCC:

> State pricing proceedings under the TELRIC regime have been extremely complicated and often last for two or three years at a time. State commissions typically are presented with at least two conflicting cost models, and hundreds of inputs to those models, all supported by the testimony of expert witnesses.

Id. at para. 6 (citation omitted).

Furthermore, the FCC has questioned the wisdom of utilizing the TELRIC approach, not only with respect to intercarrier reciprocal compensation rates but also with respect to all competitive interconnection rates:

> We also note that, for any given carrier, there may be significant differences in rates from state to state, and even from proceeding to proceeding within a state. We are concerned that such variable results may not reflect genuine cost differences but instead may be the product of the complexity of the issues, the very general nature of our rules, and uncertainty about how to apply those rules. The resulting rates might not, therefore, achieve fully the Commission's goal of sending appropriate economic signals.

Id.

Finally, the FCC recognizes that the cost of conducting TELRIC studies impose significant burdens on the involved parties:

> These cases are extremely complex, as state commissions must make dozens of detailed decisions regarding the calculation of forward-looking cost of building a local telecommunications network. The drain on resources for the state commission and interested parties can be tremendous.

Id.

Q: WHAT RELEVANCE DO THE FCC'S CONCLUSIONS HAVE IN THIS PROCEEDING?

A: The FCC has recognized the potential waste of resources that results from contentious, inexact, and complex cost proceedings using TELRIC methods. In fact, the FCC may even address these drawbacks in its rulemaking proceeding before it would be possible for the parties to resolve TELRIC rates in this proceeding.

Based on my experience with the CMRS carriers in other states, even if the RTCs were to make good faith efforts to produce TELRIC studies, it will likely lead to protracted litigation with the CMRS providers. As the FCC admits, its rules are not explicit and clear; as such, TELRIC studies result in prolonged litigation about appropriate inputs and cost relationships. Similarly, the pursuit of TELRIC studies here would appear to be nothing more than a path to incessant and contentious proceedings that would be counterproductive given the facts and circumstances here. Such an approach would, furthermore, ignore the drawbacks that the FCC has already recognized. Instead, alternative approaches are available to the Commission that would recognize and avoid the problems and resource drain that the FCC has already observed.

Q: IF THE RTCS WERE TO CONDUCT TELRIC STUDIES, HOW WOULD THEY HAVE TO PROCEED?

A: They would have to seek outside assistance. The staffs of the RTCs do not possess expertise in the development of TELRIC studies or the methods. Moreover, the RTCs have no prior experience with the available consultants on these matters because there had never before been any reason to seek such assistance, and there has never been a requirement for these Rural Telephone Companies to conduct such studies. In light of events in this proceeding, the RTCs have made recent inquiries of the consultants to determine the scope, cost and potential scheduling of such studies.

It is the intent of Congress for Rural Telephone Companies and their rural subscribers to avoid undue economic burdens associated with the fulfillment of interconnection obligations. *See* 47 U.S.C. §§ 251(f)(1) and (2). Given the FCC's own conclusions, in its original interconnection decision in 1996 which concluded that Rural Telephone Companies that possess an exemption from the Section 251(c) interconnection requirements are not subject to the FCC's TELRIC pricing rules, and its conclusions in recent times about the problems associated with TELRIC studies and the significant burdens associated with the conduct of TELRIC studies, there is no policy objective to be served for such studies to be conducted here, particularly when there are more reasonable, less burdensome approaches available to the Commission.

Q: DO THE RTCS HAVE ANY ESTIMATE OF THE COST AND TIME IT WOULD TAKE TO COMPLETE TELRIC STUDIES?

A: Based upon my experience in other states, and responses to the RTCs' recent inquiries of the available consultants, a reasonable estimate of the direct costs for outside assistance would be $30,000 or greater (perhaps as much as $50,000) based on some variables, including the complexity of the network to be analyzed and the extent of existing cost information that may be useful. In addition to the outside expert costs, there will be extraordinary costs incurred by company personnel in the preparation of information and assistance to the consultants. This internal cost may very well add another $20,000 to $30,000 to the overall bill. And these costs would only cover the initial preparation and justification of such a study. Given the number of companies involved, and the requirement to develop some cost information for the first time for some of the RTCs, the initial studies would likely take a few months to complete. To the extent that TELRIC studies result in ongoing disagreement among the parties, the costs would likely be even higher.

As the FCC observes, there is no explicit or accepted TELRIC study method prescribed by general rules; and therefore, there are a range of possible approaches which will inevitably lead to disagreement among the parties to such proceedings as to what may be required. Furthermore, the time and cost of TELRIC studies in this set of proceedings is likely to be even greater because of the mere number of small company participants involved, their limited resources, and the availability of a finite set of outside experts that typically assist these companies.

Q: WHAT CONCLUSIONS DO YOU DRAW FROM THESE ESTIMATES?

A: The cost for an individual RTC to conduct, defend, debate, and litigate a TELRIC study could easily reach $100,000. To incur this amount of cost would be imprudent given: (a) the relatively small number of CMRS minutes to which the resulting rate would be applied; (b) the relatively little difference in the TELRIC rate result from the alternative rate already proposed by the RTCs; and (c) the likelihood that the TELRIC rate would be even greater than what the RTCs have proposed.

The Commission should consider a real world example using Duo County Telephone Cooperative Corporation, Inc. If one assumes a total cost of $100,000 to conduct a TELRIC study, and the fact that Duo County has approximately 5 million aggregate annual minutes of use with CMRS providers that would be affected by a decision in this proceeding, and if Duo County were to recover the costs of conducting a TELRIC study over the next two years during the course of a set of agreements with these CMRS providers, the cost recovery would equate to $0.01 per minute with these CMRS providers. This cost recovery rate, by itself, is almost as much as the underlying network costs to transport and terminate traffic with the CMRS providers, for which the RTCs have proposed a rate of only $0.015. When one looks at it this way, it seems absurd for the RTCs, the Commission, and the CMRS providers to waste their respective resources pursing an approach which will be counterproductive for both sides.

Q: WHY WOULD TELRIC BASED RATES LIKELY BE HIGHER THAN THE EQUIVALENT FUNCTION RATES DEVELOPED FOR INTERSTATE ACCESS SERVICE PURPOSES?

A: The National Exchange Carrier Association develops the costs, demand, and resulting rates for its participant LECs, including the RTCs, for local switching (which is the equivalent function to what is referred to as "termination" in the reciprocal compensation application) and transport functions. Interstate costs are developed on a relative interstate use basis compared to total usage of the particular network function/equipment under cost review.

However, the network costs that are considered for interstate access rate development for the switching component are not the total costs of the switching facilities because a portion of these costs is allocated to, and recovered from, Universal Service sources. In other words, the allocation of costs on a relative use basis and the resulting interstate rates for interstate switching are developed based on a less than total amount of actual network cost. The portion of switching costs allocated for Universal Service treatment is recovered via the Universal Service Fund distributions, not through interstate access rates.

However, a forward-looking, economic cost approach to rate-setting considers the full economic cost of representative networks used to transport and terminate traffic and, in so doing, considers the entire cost of such networks, without downward adjustment for Universal Service. For these reasons, TELRIC costing methods would likely yield a greater amount of cost for switching functions than does the equivalent process for interstate access.

Q: YOU MENTIONED THE RECENTLY FILED MISSOULA PLAN. HOW WOULD THAT PROPOSAL ADDRESS THE RATES FOR TRANSPORT AND TERMINATION OF TRAFFIC WITH CMRS PROVIDERS?

A: A diverse set of parties including BellSouth, AT&T, Cingular Wireless, as well as a large number of smaller LECs filed a proposal with the FCC for interconnection rules and pricing, now referred to as the Missoula Plan. This consensus and compromise effort was the product of the efforts of the NARUC Intercarrier Compensation Task Force conducted at the encouragement of the FCC. Under this compromise proposal, rural carriers such as the RTCs would be permitted to utilize their interstate access rates as the rates for transport and termination for purposes of reciprocal compensation for local interconnection. As has the FCC, the parties to the compromise proposal also recognized the drawbacks of TELRIC:

> To remove any potential statutory obstacles to voluntary State compliance with the rate provisions applicable to Track 3 carriers, the [FCC] can modify its rules implementing sections 251(b)(5) and 252(d)(2) to make clear that, in setting "cost"-based rates for a Track 3 carrier's transport and termination of traffic, a State opting into the Plan may choose to rely on the Track 3 carrier's interstate access rate. As the Supreme Court has observed, the term "cost," as it appears in section 252, "give[s] ratesetting commissions broad methodological leeway." *Verizon Communications Inc. v. FCC*, 535 U.S. 467, 500 (2002). Today's reformed interstate access rate-setting methodologies, while obviously different from TELRIC, are nonetheless "cost"-based. *See generally* Report and Order, Federal-State Joint Board on Universal Service, Multi-Association Group (MAG Plan for Regulation of Interstate Services of Non-Price Cap ILECs and IXCs, 16 FCC Rcd 11244 (2001).

See "Missoula Plan - Legal Justification," footnote 4. (The term Track 3 carrier refers to rural incumbent carriers such as the RTCs.)

Q: WHAT CONCLUSIONS SHOULD THE COMMISSION DRAW FROM THESE FACTS AND ANALYSIS?

A: In the course of the arbitration proceedings, the Commission should determine that more prudent options, other than TELRIC, are available to resolve a transport and termination rate for the RTCs. The use of the proposed 1.5 cents per minute or interstate access rates for the same network functions are both reasonable approaches to resolving this issue. For all of the reasons set forth in this preliminary testimony, the Commission should proceed in this manner because it will ensure that all of the parties, including the small RTCs, are not required to incur the undue economic burden of undertaking TELRIC studies.

Q. DOES THIS CONCLUDE YOUR PRELIMINARY TESTIMONY?

A: Yes.

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was served by Federal Express and electronic mail on this 16th day of August, 2006, to the following individual(s):

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