COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the matter of:

AN INVESTIGATION INTO THE	)	
INTRASTATE SWITCHED ACCESS	)	ADMINISTRATIVE CASE
RATES OF ALL KENTUCKY	)	NO. 2010-00398
INCUMBENT AND COMPETITIVE	)	
LOCAL EXCHANGE CARRIERS	)	
	)	

PREFILED DIRECT TESTIMONY OF

DON PRICE

ON BEHALF OF VERIZON

(CONFIDENTIAL INFORMATION DENOTED BY **___)**

July 8, 2011

I. INTRODUCTION AND BACKGROUND.

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Don Price, and my business address is 701 Brazos, Suite 600, Austin, Texas, 78701.

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

A. I am a Director – State Public Policy for Verizon. Intervenors MCImetro Transmission Access Transmission Services LLC d/b/a Verizon Access Transmission Services, MCI Communications Services, Inc. d/b/a Verizon Business Services, Bell Atlantic Communications, Inc. d/b/a Verizon Long Distance, NYNEX Long Distance Company d/b/a Verizon Enterprise Solutions, TTI National, Inc., Teleconnect Long Distance Service & Systems d/b/a Telecom*USA and Verizon Select Services, Inc. are part of Verizon. I am testifying here on behalf of those Verizon affiliates. Unless otherwise noted, I will refer to them all collectively as "Verizon."

Q. WHAT IS YOUR PROFESSIONAL EXPERIENCE AND EDUCATIONAL BACKGROUND?

A. I have more than 30 years experience in the communications industry, the vast majority of which is in the public policy area.

After earning Master's and Bachelor's degrees in sociology from the University of Texas at Arlington in 1978 and 1977, respectively, I began working for the former GTE Southwest in the early 1980s, and then moved to the Texas Public Utility Commission in 1983. There, I served as a Commission analyst and witness on rate-setting and policy issues. In 1986, I became Manager of Rates and Tariffs for the Commission Staff, and was responsible for Staff analyses of rate design and tariff policy issues in all telecommunications proceedings before the Commission. I was hired by MCI in 1986, where I spent 19 years focused on public policy issues relating to competition in telecommunications, including issues of intercarrier compensation and coordination of positions in interconnection agreement negotiations.

With the close of the Verizon/MCI merger in January 2006, I assumed the position of Director – State Regulatory Policy for Verizon Business. As a result of internal reorganization, I assumed my current position in January 2010. Among other things, I work with various corporate departments, including those involved with product development and network engineering, to develop and coordinate policies permitting Verizon to offer products to meet the demands of various customers, including government entities, as well as customer demand in wholesale markets.

During my career, I have testified before this Commission and state regulators in at least 26 other states on a wide range of issues in many types of proceedings, including various intercarrier compensation and switched access issues.

Q. WHAT DO YOU UNDERSTAND THE COMMISSION'S TASK TO BE IN THIS PROCEEDING?

A. The Commission initiated this proceeding for the stated purpose of examining the intrastate switched access rates of Kentucky incumbent and competitive local exchange carriers ("ILECs" and "CLECs," respectively).[1] The Commission observed that "[i]nter-carrier complaints related to the billing of access charges have increased on the Commission's docket in recent years" and, "in consideration of the facts established in those cases and others, the Commission finds that it has a duty to investigate and address the basis and structure for intrastate access rates and how they are affecting Kentucky's telephone market."[2] The Commission has indicated that it is concerned, in particular, with whether the switched access rates of Kentucky carriers include above-cost implicit subsidies and, if so, whether those subsidies are anti-competitive.[3] As a bottom line, the Commission must determine whether current Kentucky intrastate switched access rates are "fair, just and reasonable," as required by Kentucky law,[4] and – if not – how to ensure that such rates are fair, just and reasonable on a going-forward basis.

Q. PLEASE DESCRIBE THE PURPOSE OF YOUR TESTIMONY.

A. The purpose of my testimony is to present evidence that current intrastate

[1] *See* Order (Nov. 5, 2010) ("*Nov. 5 Order*") at 1.

[2] *Id*. at 2.

[3] *Id*. at 1.

[4] KRS § 278.030(1).

switched access rates in Kentucky are ***not*** "fair, just and reasonable," and that the Commission should take certain steps to ensure that intrastate switched access rates comply with this Kentucky statutory requirement.[5]

Negotiated intercarrier compensation agreements are the best long-term solution to ensuring the efficiency of telecommunications markets in the face of substantial technological change and, where possible, such market-based approaches should be used to establish intrastate switched access rates. However, as I will explain, switched access rates are not subject to market discipline in Kentucky today, so regulatory intervention is warranted unless and until carriers can negotiate their own compensation arrangements. Many local exchange carriers ("LECs") currently charge excessive intrastate switched access rates that long distance carriers (sometimes referred to as interexchange carriers or "IXCs") like Verizon have no choice but to pay. These excessive rates impair competition and, ultimately, harm consumers.

Kentucky intrastate switched access rates are so high, in part, because some ILECs continue to recover substantial – and, in many cases, outrageous – amounts for their so-called Non-Traffic Sensitive Revenue Requirement ("NTSRR") through the Carrier Common Line Charge ("CCLC") element of their intrastate switched access rates. These non-cost-based charges – *as high as ten dollars or*

[5] *Id*.

more per line per month – are pure subsidies that are not linked to any function performed by local exchange carriers. These charges cannot be justified and have no place in today's competitive telecommunications market. Verizon is not aware of any other state where non-cost-based elements this excessive have persisted for this long. In fact, this Commission long ago made the policy decision to eliminate the NTSRR as competition developed, but it has not yet done so with respect to most of the carriers that collect this subsidy. Accordingly, the Commission should immediately eliminate any remaining NTSRR charges (which can be accomplished in most cases simply by eliminating the CCLC element) in Kentucky intrastate switched access rates.

In addition, the Commission should address intrastate switched access rates more broadly by adopting a benchmark approach to ensure that all Kentucky carriers otherwise maintain their intrastate switched access rates at just and reasonable levels. As I discuss below, the most appropriate benchmark is the switched access rate of BellSouth Telecommunications, Inc. d/b/a AT&T Kentucky ("AT&T"), the largest incumbent local exchange carrier ("ILEC") in the Commonwealth. This benchmark would produce rates about the same as those many Kentucky carriers already charge for the same services on an interstate basis.

Comprehensive access reform and a more rational access regime will lead to increased efficiency, innovation, and consumer benefits. The Commission nevertheless has raised the concern that implementing switched access rate reductions potentially will affect the revenue structure for a number of Kentucky carriers.[6] However, both Kentucky ILECs and CLECs have the regulatory flexibility to make up any "lost" access revenues in a variety of ways, including through retail rate rebalancing. Indeed, for nonbasic service, rate rebalancing can be accomplished without any action by the Commission. Accordingly, there is no need to establish any sort of replacement fund that would guarantee Kentucky carriers a certain level of revenue. And, in any event, simply shifting the revenue burden from one carrier-funded source (access rates) to another (a state fund) would not solve the underlying problem nor represent meaningful reform.

Q. HAS VERIZON PARTICIPATED IN OTHER KENTUCKY COMMISSION PROCEEDINGS RELATED TO SWITCHED ACCESS CHARGES?

A. Yes, the MCI entities owned by Verizon have provided service in Kentucky for nearly 30 years and have participated in numerous proceedings related to access charges, market entry, and local and long-distance competition. Today, Verizon's interexchange network extends to points throughout the state. Verizon purchases switched access services from numerous carriers and has an obvious interest in making sure that it has a fair opportunity to compete with carriers from which it purchases access services. Verizon has many years of experience as a customer for access services both in Kentucky and in other states and has a broad historical

[6] *See, e.g.*, *Nov. 5 Order* at 4.

perspective on access pricing policy.

II. <u>OVERVIEW OF SWITCHED ACCESS SERVICE AND THE ASSOCIATED POLICY ISSUES</u>.

Q. WHAT IS SWITCHED ACCESS SERVICE?

A. Switched access is a service provided by local exchange carriers ("LECs") to other carriers – usually long distance carriers or IXCs – for originating or terminating interexchange or "toll" calls. The rates at issue in this proceeding are the intrastate switched access rates that Kentucky LECs charge IXCs and other carriers to originate or terminate calls that both begin and end in Kentucky.

For example, when a caller in Frankfort places a long distance call to Lexington, the local exchange carrier serving the caller will provide "originating" switched access service by transporting that call from the caller to a long distance carrier (like Verizon), which then transports the call across its own network to a location nearer the call recipient. The long distance carrier frequently then must hand the call off to another LEC, which then provides "terminating" switched access service by delivering the call from the long distance provider's network to the recipient of the call. LECs typically assess the long distance carrier originating and terminating switched access charges, respectively, for providing those services.

Those switched access charges can have several component elements – including, for example, charges for transport, local switching, or other specific aspects of the switched access services being provided. However, in some instances – as is the case with some Kentucky ILECs' rates here – a LEC may include certain rate elements within its access charges that are not intended to recover the costs of providing switched access services at all, but instead are rooted in social policy goals from the monopoly era, and reflect a subsidy for the LEC's other operations being paid by long distance carriers.

Q. PLEASE EXPLAIN WHY SUCH SUBSIDIES EXIST.

A. In the early 20th century, state and federal regulators jointly created a regulatory pricing system in which business and toll rates (both intrastate and interstate) were set above the cost of providing these services in order to provide a contribution to basic residential rates, thereby promoting federal and state universal service objectives. In those days, subsidizing local service was a way to help wireline telephony gain wide acceptance.

Then, AT&T (the long distance arm of the Bell System) had a monopoly on long distance communications, and there was no "access" provided to other companies to the long distance network. Instead, non-traffic sensitive costs for local networks were recovered through separations and settlements processes among AT&T, its subsidiary operating companies, and various independent companies. Those settlements were provided under negotiated "division of revenue" contracts. This industry structure started to change in the 1960s and 1970s when MCI introduced private line and then switched service competition in the long distance market.

With the advent of increasing interexchange competition and the divestiture of the former Bell System in 1984, interstate and intrastate access charges were established so that IXCs could compensate LECs for providing access to their local networks. The initial federal and state "access tariffs" supplanted the "division of revenue." The Commission acknowledged this in 1984 when it first approved intrastate access tariffs.[7] MCI began providing intrastate long distance service in Kentucky at about that time, as soon as the Commission endorsed competitive entry. Because of universal service concerns, regulators – including the Commission – sought to maintain in access charges the contribution flow from long distance to local service that traditionally had been provided through retail long distance charges. In other words, to maintain the rate structure that enabled basic exchange service rates to remain low when toll revenue was available to offset the costs of basic service, both interstate access rates and intrastate access rates were purposefully set at artificially high levels to keep basic exchange service rates low. On the intrastate level in Kentucky, those subsidies were kept in place by the Commission when it made its initial decision in 1984 to maintain

[7] *Investigation of Toll and Access Charge Pricing and Toll Settlement Agreements*, Order, Case No. 8838, at 5, 14 (November 20, 1984) (describing the division of revenue arrangements as prohibited under the Modified Final Judgment).

"existing toll support for the NTS costs of the local network" – although no specific NTS costs were determined or proven – while shifting from "settlements" to an access charge environment.[8]

But those policy choices, in Kentucky and elsewhere, were made at a very different time and with a very different competitive landscape than exists today. For example, in 1984 the Commission applied full rate of return regulation to Kentucky ILECs, which required the Commission to determine "revenue requirements" for local providers' operations in the Commonwealth. In approving the initial access charge structure for Kentucky the Commission said it would "maintain revenue stability" among the LECs but described that decision as "an imperfect short term solution to a long term problem."[9]

Q. DO THOSE "SHORT TERM" POLICY CHOICES REMAIN APPROPRIATE TODAY?

A. No. A dramatically different telecommunications environment exists today, requiring a different regulatory approach.

The federal Telecommunications Act of 1996 opened local exchange markets to competition, and the myriad technological advances in recent years have led to consumers today being able to obtain service from a wide variety of providers – including not just traditional wireline ILECs, but wireline CLECs, wireless

[8] *Id*. at 28.

[9] *Id*. at 47.

carriers, cable companies, and Voice over Internet Protocol ("VoIP") providers.[10] All of these different kinds of providers offer services in Kentucky today, such that Kentucky consumers can choose from a host of different retail providers. Given these choices, Kentucky consumers no longer are forced to rely on wireline ILEC service to be assured affordable basic universal service. As this Commission has recognized, "[t]he legacy narrowband [wireline] world is quickly being superseded by a very intermodal, competitive, and increasingly Internet-oriented telecommunications environment."[11]

For example, the non-ILEC share of Kentucky access lines has nearly doubled in the last five years, with consumers increasingly choosing wireless services for their voice communications.[12] Indeed, as of June 2010, there were nearly three times as many mobile wireless subscribers in Kentucky (3.65 million) as there were ILEC access lines (1.3 million).[13]

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[10] *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, FCC 01-146, CC Docket No. 96-262, 16 FCC Rcd 9923 (April 27, 2001) ("*CLEC Rate Cap Order*") at ¶ 21.

[11] *Nov. 5 Order* at 3.

[12] *See* Local Telephone Competition: Status as of June 30, 2010, Industry Analysis and Technology Division, Wireline Competition Bureau (March 2011).

[13] *Id*.

This is consistent with data from across the country. The FCC estimated that, by the end of 2008, 90 percent of Americans already had a mobile wireless device.[14] Since then, the percentage has increased, with many Americans choosing to forego any wireline telephone communication and utilize only wireless devices for voice services. The Centers for Disease Control estimated that, by June 2010, "[m]ore than one out of every four American homes (26.6%) had only wireless telephones" and, "[i]n addition, nearly one of every six American homes (15.9%) received all or almost all calls on wireless telephones despite having a landline."[15]

Similar trends are visible in broadband and VoIP services, both in Kentucky and nationwide. According to data compiled by the National Telecommunications and Information Administration ("NTIA") in collaboration with the FCC, by June 30, 2010, nearly 86 percent of Kentuckians had access to one or more wireline broadband providers[16] – many of which also provide voice services. Similarly, 86.4% of Kentucky consumers in that time frame had access to wireless broadband services.[17]

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[14] *In the Matter of Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993, Annual Report and Analysis of Competitive Market Conditions with Respect to Mobile Wireless, Including Commercial Mobile Services*, Fourteenth Report, FCC 10-81, W.T. Docket No. 09-66 (2010).

[15] Blumberg S.J., Luke J.V., "Wireless Substitution: Early Release of Estimates from the National Health Interview Survey, January-June 2010" (National Center for Health Statistics, December 21, 2010). Available from: http://www.cdc.gov/nchs/nhis.htm.

[16] *See* http://www.broadbandmap.gov/summarize/state/kentucky.

[17] *Id*.

This data confirms that Kentuckians have a number of alternatives among retail providers. Accordingly, there no longer is the same need to subsidize traditional incumbent wireline providers. To the contrary, continuing excessive, indiscriminate subsidies actually is now counterproductive, as it inhibits competition and, ultimately, harms consumers.

In view of the profound shift from wireline to other communications options, the Commission should be increasingly concerned with Kentucky wireline LECs continuing to receive excessive historical subsidies paid by other providers that, in many cases, are competitors of the LECs. There cannot be a level playing field when certain competitors receive excessive subsidies that others do not, and in some cases receive them from the very companies with which they compete. Among other problems, when local rates are kept artificially low through subsidy payments not available to new entrants, entry is discouraged.

In short, excessive implicit subsidies in intrastate switched access rates are vestiges of an outdated regulatory approach, designed solely to promote wireline universal service objectives in monopoly local telephone markets.[18] As the Commission noted with respect to Kentucky access rates, in particular, "[t]he

[18] *See Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Low-Volume Long Distance Users; Federal-State Joint Board on Universal Service*, Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45, 15 FCC Rcd 12962 (May 31, 2000) ("*CALLS Order*") at ¶ 23.

existing cost-recovery mechanism was developed for a communications world where single narrowband wireline connections were the dominant form of telecommunications and competition was very limited."[19] But, as the Commission acknowledged, "[t]hat is no longer the case."[20]

Q. ARE THERE OTHER CHANGES THAT SHOULD INFORM THE COMMISSION'S JUDGMENT ABOUT ACCESS CHARGE POLICY?

A. Given the stunning changes in telecommunications market in the 15 years since the Act, regulators have re-evaluated outdated rules and, as I discuss below, have taken steps to eliminate excessive subsidies and reduce LEC switched access rates. This Commission is among those that have taken steps to remove excessive subsidies from access charges, but has not yet done so for all Kentucky carriers or in the sort of comprehensive manner now under consideration in this docket.

But it is not just changes in the marketplace itself that should inform the Commission's consideration of access reform. Kentucky law has changed, too. The 2006 amendments to KRS Chapter 278 allow total pricing flexibility for a broad category of retail "nonbasic service," in recognition of the fact that prices for the most competitive retail telecommunications services need no regulation at all. In that case, the competitive market itself provides pricing discipline. A retail end user customer dissatisfied with one carrier's price can choose another service, if not another carrier altogether.

[19] *Nov. 5 Order* at 3.

[20] *Id*.

Q. ARE THE RATES FOR SWITCHED ACCESS SERVICES DISCIPLINED BY THE MARKET IN THE SAME WAY?

A. No. In contrast to the highly competitive market for the retail services that telecommunications carriers provide to end-user customers, the market for the wholesale switched access services that Kentucky LECs provide to other carriers is not competitive. Long distance carriers and other providers subject to access charges cannot choose whom their customers call and, under existing legal and regulatory requirements, generally must carry and complete any call a customer places.[21] Accordingly, as the Commission recognized in its *Nov. 5 Order* initiating this proceeding, "an IXC has no control over which incumbent LEC ('ILEC') or competitive LEC ('CLEC') serves that IXC's customer, and IXCs are obligated to pay whatever switched access rates ILECs and CLECs choose to assess for those calls."[22] Both the Commission and the FCC long have recognized that this arrangement creates the risk that, absent regulatory intervention, some LECs will charge unreasonably high switched access rates.[23]

Q. DO UNREASONABLY HIGH SWITCHED ACCESS CHARGES HAVE ANY ADVERSE PUBLIC POLICY CONSEQUENCES?

A. Yes. This Commission has identified a need for access reform and has found that

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[21] The situation is similar in the originating access market, particularly given that toll deaveraging is prohibited at the interstate level and thus would not be feasible on the intrastate level.

[22] *Nov. 5 Order* at 2-3.

[23] *See, e.g.*, *CLEC Rate Cap Order*, 16 FCC Rcd. 9923, at 9936 ("We … acknowledge that the market for access services does not appear to be structured in a manner that allows competition to discipline rates."); *Inquiry into IntraLATA Toll Competition*, Order, Adm. Case No. 323, Phase 1 at 45 (May 6, 1991).

removing excessive subsidies from switched access rates and pricing access services more closely to their costs is in the public interest.[24] In approving access reductions for certain carriers over the past decade, the Commission has specifically cited such public interest benefits.[25] Indeed, with respect to the NTSRR element, in particular, the Commission has recognized the public policy harms of continuing to include it in switched access rates. As the Commission made clear more than a decade ago: "The NTSRR is a non-cost based access charge that is used to support local access rates. The Commission has, through other proceedings, used excess revenues . . . to reduce NTSRR and ***has an established policy of working to eliminate the NTSRR.***"[26] In this case, then, Verizon is not asking the Commission to set new policy, but to implement a long-overdue application of that policy to all Kentucky carriers.

The Commission's policy choice to reduce excessive subsidies in access rates is consistent with findings of the FCC, which repeatedly has observed that economically efficient competition and the consumer benefits it yields cannot be fully achieved as long as local exchange carriers seek to recover a

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[24] *Inquiry into Universal Service and Funding Issues*, Adm. Case No. 360, Order (June 18, 1997); *see also Certification of the Carriers Receiving Federal Universal Service High-Cost Support*, Adm. Case No. 381 (March 24, 2000) ("*2000 Certification Order*").

[25] *Review of BellSouth Telecomm., Inc.'s Price Regulation Plan*, Order, Case No. 99-434 ("*BellSouth Price Plan Review*"), at 9-10 (Aug. 3, 2000); *see also Tariff Filing of BellSouth Telecommunications, Inc. to Mirror Interstate Rates*, Order, Case No. 98-065 ("*BellSouth Mirroring Order*"), at 4-5 (March 31, 1999); *Cincinnati Bell Telephone*, Case No. 98-292, Order at 13-14 (Jan. 25, 1999).

[26] *2000 Certification Order* at 2 (emphasis added).

disproportionate share of their costs from other carriers (*i.e.*, long distance providers), rather than from their own end users.[27] Such irrational access rate structures lead to what the FCC has termed "inefficient and undesirable economic behavior"[28] and, ultimately, to higher prices for consumers. By raising the price of a necessary input to other carriers (*i.e.*, access services), in turn, the cost – and, therefore, the price – of those carriers' services are elevated. As the FCC has observed, this also suppresses demand for the services of those carriers that must pay the excessive access charges and reduces incentives for local entry by firms that might be able to provide service more efficiently than the LEC.[29] Particularly with regard to relatively small, rural LECs, the FCC has found that rationalizing their switched access rates will enhance incentives for long distance carriers to originate service in rural areas and will foster facilities-based competition for residential subscribers in those areas.[30]

Accordingly, the FCC has taken steps to reduce LECs' interstate switched access charges, noting that continuing to allow local exchange carriers to shift their costs onto the long distance market through unduly high access rates would be

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[27] *See generally CLEC Rate Cap Order*, *supra; CALLS Order*, *supra*; *Multi-Association (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, Second Report & Order and Further Notice of Proposed Rulemaking, CC Docket No. 00-256, Fifteenth Report & Order in CC Docket No. 96-45, and Report & Order in CC Docket Nos. 98-77 and 98-166, 16 FCC Rcd 19613 (Rel. Nov. 8, 2001) ("*MAG Order*").

[28] *CALLS Order* at ¶ 129.

[29] *Id*. at ¶ 114.

[30] *MAG Order* at ¶ 11.

"inconsistent with the competitive market that we seek to encourage for access service."[31] The FCC recognized, over a decade ago, the urgency of removing excessive implicit subsidies from access charges: "Because of the growing importance of the telecommunications industry to the economy as a whole, this inefficient system of access charges retards job creation and economic growth in the nation."[32] Of course, as the communications industry has become even more critical to the economy in intervening years, the objective of more efficient pricing has become a greater imperative. That is why, in connection with the pending National Broadband Plan docket, the FCC has encouraged states to continue to move forward with intrastate access charge reform.[33]

III. <u>ACCESS CHARGE REFORM SINCE THE 1996 ACT</u>.

Q. IN LIGHT OF THE POLICY CONCERNS YOU IDENTIFIED, WHAT STEPS HAS THE FCC TAKEN TO REDUCE SWITCHED ACCESS RATES?

A. "With the passage of the 1996 Act" and the opening of retail markets to competition, "the [FCC] determined that it was necessary to make substantial revisions to access charges,"[34] because continuing to allow LECs to shift their costs onto other providers through unduly high access rates would be

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[31] *CLEC Rate Cap Order* at ¶ 33.

[32] *Access Charge Reform,* First Report and Order, 12 FCC Rcd 15982, ¶ 30 (1997) ("*Access Charge Reform Order*"), *aff'd sub. nom.*, *Southwestern Bell v. FCC*, 153 F.3d 523 (8th Cir. 1998).

[33] *See* Connecting America: The National Broadband Plan ("NBP"), Recommendation 8.7 at 148 (rel. March 16, 2010) (available at http://www.broadband.gov/download-plan/).

[34] *CALLS Order* at ¶ 18.

"inconsistent with the competitive market that we seek to encourage for access service."[35] Accordingly, the FCC begin revising the interstate access charge regime to "foster and accelerate the introduction of competition into all telecommunications markets."[36]

In its 1997 *Access Charge Reform Order*, the FCC, among other things, began the process of phasing out the non-traffic-sensitive CCLC as part of its "long range goal… to have incumbent LECs recover a large share of the NTS common line costs from end users instead of carriers."[37] The FCC continued the access reform process in its 2000 *CALLS Order*, which reduced the interstate access rates of local exchange carriers operating under price caps and finished the process of eliminating the interstate CCLC for those carriers. The FCC reiterated that, "[b]y making the end-user rate for long distance calls more expensive, the CCL charge artificially suppresses demand for interstate long distance services."[38]

Then, on November 8, 2001, the FCC issued the "*MAG Order*," which substantially reduced the interstate access rates of federal rate-of-return carriers. Among other things, the *MAG Order* eliminated the CCLC from these carriers' interstate switched access tariffs, noting that doing so would reduce switched

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[35] *CLEC Rate Cap Order* at ¶ 33.

[36] *Access Charge Reform Order* at ¶ 1.

[37] *Id*. at ¶ 68.

[38] *CALLS Order* at ¶ 18.

access rates, reduce the cost of long distance service, and encourage a more efficient level of consumption.[39]

The FCC also established a benchmark policy whereby CLECs' per minute interstate access charges are capped at the level of the interstate access rates charged by the ILEC in whose service territory the CLEC competes.[40] CLEC access charges that do not exceed the benchmark are presumed to be just and reasonable.[41] As the FCC explained, "a benchmark provides a bright line rule that permits a simple determination of whether a [carrier's] access rates are just and reasonable."[42]

Q. HAS THIS COMMISSION ALSO EMBRACED A BENCHMARKING APPROACH?

A. Yes. The Kentucky Commission has used benchmarking before. In fact, the original Kentucky access tariffs were permitted to mirror the then-current traffic sensitive elements of interstate access tariffs.[43] The Commission also relied on benchmarking to federal rates in another context when, in March 2006, it decided to allow Kentucky ILECs to revise their intrastate primary interexchange carrier ("PIC") change charges to mirror federally tariffed rates that fall within the "safe

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39 *MAG Order* at ¶ 63.

40 *See CLEC Rate Cap Order* at ¶¶ 40, 45; 47 C.F.R. § 61.26 (b).

41 *CLEC Rate Cap Order* at ¶ 40.

42 *Id.* at ¶ 41.

43 *Investigation of Toll and Access Charge Pricing and Toll Settlement Agreements*, Order, Case No. 8838, at 40-41 (Nov. 20, 1984).

harbor" rates adopted by the FCC in CC Docket No. 02-53. The Commission said that "in light of the FCC actions and adoption of new safe harbor rates, it is appropriate for the Commission to adjust its cap to mirror the FCC's interstate rates."[44]

Q. HAVE OTHER STATES TAKEN ACTION TO ADDRESS LECS' INTRASTATE SWITCHED ACCESS RATES?

A. Yes. Over the past 15 years or so, Commissions (and legislatures) around the country have reduced switched access charges. This trend has accelerated in recent years, and removal of non-cost-based elements has been a prominent feature of many decisions.

For example, at the end of 2007, the California Public Utilities Commission extended to small and mid-sized ILECs the requirement, set earlier for large carriers, of eliminating "non-cost-based elements" from intrastate switched access rates.[45] The California Commission considered this action necessary to promote "[f]air competition in the long distance market."[46]

Similarly, the Virginia State Corporation Commission in 2009 cut one carrier's CCLC in half, recognizing that it was a "pure subsidy rate element," and, as such,

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[44] *Petition of Duo County Telephone Coop. Corp.*, Order, Case No. 2006-00076 (March 20, 2006).

[45] *Order Instituting Rulemaking to Review Policies Concerning Intrastate Carrier Access Charges*, Rulemaking 03-08-018, D. 17-12-20, Final Opinion Modifying Intrastate Access Charges (C.P.U.C. Dec. 6, 2007).

[46] *Id*. at 13.

impeded "the development of the market for telephone services."[47] Much like the situation here, a CCLC revenue recovery amount fixed years earlier had come to produce unsustainably high per-minute access charges as access minutes had declined over that period. Last year, the Virginia Legislature finished the job the Commission had started, adopting legislation requiring complete elimination of carriers' CCLCs.[48]

The New Jersey Board of Public Utilities, likewise, recently ordered all carriers to remove the "subsidy elements," including the CCLC, from their rates as a first step in the transition to the interstate rate benchmark the Board had set.[49]

Q. ARE THERE OTHER EXAMPLES OF STATE ACTIONS REDUCING LEC SWITCHED ACCESS RATES?

A. Yes – there are many more such examples around the country. In most instances, states have followed a benchmarking approach as the simplest and most effective means of reducing LECs' intrastate access prices to reasonable levels. And a number of states have relied on benchmarking to the dominant carrier – as

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[47] *Petition of Sprint Nextel for Reductions in the Intrastate Carrier Access Rates of Central Tel. Co. of Va. and United Tel.-Southeast, Inc*., Case No. PUC-2007-00108, at 5-6 (May 29, 2009).

[48] Va. Acts of Assembly, 2010 Session, Chapter 748, H 387 (signed into law on April 13, 2010).

[49] *In the Matter of the Board's Investigation and Review of Local Exchange Carrier Intrastate Exchange Access Rates*, Telecommunications Order, TX-08090830, at 29 (Feb. 1, 2010), appeal docketed, No. A-2767-09T2 (N.J. Super. Ct. App. Div. Mar. 2, 2010).

Verizon proposes here – as a simple and effective means of reducing LECs' intrastate access prices.[50]

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[50] *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 Conn. PUC Lexis 15, at *45 (2004) (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); 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); *Iowa Telecommunications Assoc.*, Final Order, Iowa Utilities Board Docket Nos. TF-07-125 and TF-07-139 (May 30, 2008) (requiring rural ILECs concurring in association tariff for intrastate switched access rates to mirror NECA interstate switching rates); **Louisiana** PSC General Order No. U-17949-TT, App.B, Section 301 (k)(4) (May 3, 1996) (CLECs must charge switched access rates that do not exceed the competing ILEC's rates); Code of **Maryland** Regulations § 20.45.09.03(b) (capping all LECs' switched access rates at the level of the largest LEC in Maryland); *Petition of Verizon New England Inc. et al. for Investigation Under Chapter 159, Section 14, of the Intrastate Access Rates of Competitive Local Exchange Carriers*, Final Order, **Massachusetts** D.T.C. 07-9 (June 22, 2009) (capping CLEC switched access rates at level of Verizon ILEC); *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 reasonably 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 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); 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 (CLEC may not charge a higher rate for intrastate switched access than the ILEC in the area served or the statewide average composite rates published by the Texas P.U.C. and updated at least every two years); *Amendment of Rules Governing the Certification and Regulation of CLECs*, Final Order, **Virginia** State Corp. Comm. Case No. PUC-2007-00033 (Sept. 28, 2007) (a CLEC's switched access rate cannot exceed the higher of its interstate rate or the rate of the competing ILEC); **Washington** Admin. Code § 480-120-540 (requires CLECs' and ILECs' terminating access rates to be no higher than their local interconnection rate, or depending on their regulatory status, incremental cost); *Petition by Verizon West Virginia Inc. Requesting that Commission Initiate a General Investigation of the Intrastate Switched Access Charges of Competitive Local Exchange Carriers Operating in WV*,

IV. <u>KENTUCKY INTRASTATE SWITCHED ACCESS RATES ARE UNREASONABLY HIGH AND IN NEED OF REFORM</u>.

Q. HOW LONG HAVE THE CURRENT KENTUCKY INTRASTATE SWITCHED ACCESS RATES BEEN IN PLACE?

A. The answer to that question varies from carrier to carrier. But, in general, access services tariffs were introduced in Kentucky in 1984 as part of a Commission plan to introduce interLATA competition. Later, in Administrative Case No. 323, which added intraLATA competition, the Commission approved revised access services tariffs for all Kentucky local exchange carriers. Those tariffs mirrored then-current interstate access rates.[51] However, the structure of the rates changed – and the NTSRR recovery was added – as the result of a 1990 agreement (the "Joint Motion") between various local and interexchange carriers that was later accepted by the Commission in May 1991.[52]

Since then, and particularly in the last decade or so, switched access rates around the country generally have declined – sometimes dramatically – as carriers have reduced their rates, both on an interstate and intrastate basis. The same is true to an extent in Kentucky, where (1) all LECs have reduced their interstate switched access rates and (2) some LECs have reduced – or been ordered to reduce – their intrastate rates. For example, in 2000, AT&T reduced its intrastate switched

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West Virginia Public Serv. Comm'n Order, Case No. 08-0656-T-PC (Nov. 23, 2009) (capping CLEC switched access rates at the competing ILEC's level).

[51] *See Investigation into the Elimination of Switched Access Service Discounts*, Adm. Case No. 336, Order at 13, (Sept. 2, 1992).

[52] *Inquiry into IntraLATA Toll Competition*, Adm. Case No. 323 (May 6, 1991).

access rates by having those rates mirror its generally lower interstate switched access rates.[53] Cincinnati Bell likewise reduced its intrastate switched access rates around the same time.[54]

However, many Kentucky carriers – including more than a dozen ILECs – have kept the same intrastate switched access rates in place for years or, in some cases, even decades. For instance, as the Commission knows from the record in the complaint case Verizon filed challenging Windstream's intrastate switched access rates that has been incorporated into this proceeding,[55] Windstream West still uses the same intrastate switched access rates today that were established 20 years ago, when the Commission adopted the Joint Motion. The rates for Windstream East also were derived from that 1990 agreement, albeit modified somewhat by a 2000 tariff filing by Windstream's predecessor-in-interest that reduced – but did not eliminate – the NTSRR revenues generated by the CCLC. The Commission has left other ILEC access rates untouched. For example, when North Central Telephone filed its 2007 rate case and Verizon intervened, citing North Central's

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[53] *See BellSouth Price Plan Review* at 9; *BellSouth Mirroring Order*, *supra*.

[54] *See Cincinnati Bell Telephone*, Case No. 98-292, Order at 13-14 (Jan. 25, 1999).

[55] *See In the Matter of: MCI Communications Services, Inc., et al. v. Windstream Kentucky West, Inc., et al.*, Case No. 2007-00503, Order (Nov. 5, 2010) at 3.

extremely high NTSRR, the Commission deferred any decision on access rates.[56] These rates are long overdue for reform.

Q. AT THE TIME THEY WERE ESTABLISHED, WERE KENTUCKY INTRASTATE SWITCHED ACCESS RATES BASED ON THE COSTS OF PROVIDING INTRASTATE SWITCHED ACCESS SERVICE?

A. No. When they initially were established, Kentucky intrastate switched access rates were not tied to any carrier's costs of providing intrastate switched access services. That certainly is true of the rates established by the 1990 Joint Motion, which contained several elements that were not associated with any specifically identified costs, including the CCLC through which some ILECs continue to collect the preponderance of their NTSRR from other carriers.

The NTSRR, in particular, was introduced in the Joint Motion and approved as a *transitional* recovery mechanism for unspecified non-traffic sensitive (and potentially other) costs to help ease the transition to statewide long distance competition.[57] However, in later discussing alternatives for cost recovery, the Commission made clear that NTS charges eventually should be decreased or eliminated to promote competition. *See Adm. Case No. 323, Phase I*, Order, at 18 (Dec. 29, 1994). That time has long since come, as interexchange competition is now fully implemented in Kentucky, local competition is fully authorized, and the

[56] *In the Matter of Application of North Central Telephone Cooperative Corporation to Adjust Rates and Charges for Basic Local Exchange Service*, Case No. 2007-00161, Order (April 24, 2008) at 6.

[57] *See generally Inquiry into IntraLATA Toll Competition*, Adm. Case No. 323, Order (May 6, 1991).

"toll services" referred to in Adm. Case No. 323 are all nonbasic services that are no longer subject to any form of price regulation. Whatever justification existed for the NTSRR introduced by the Joint Motion has long since ceased to exist.

Q. SINCE APPROVING THE JOINT MOTION, HAS THE COMMISSION EXPRESSED ANY VIEWS REGARDING THE NTSRR AND/OR THE APPROPRIATE RATE LEVELS FOR INTRASTATE SWITCHED ACCESS CHARGES IN KENTUCKY?

A. Yes. The Commission began to recognize the need to rationalize Kentucky access rates well over a decade ago. In 1995, it approved a Price Regulation Plan for AT&T that required its intrastate switched access rates to mirror analogous interstate rate elements.[58] As FCC and Commission thinking about access charges evolved, AT&T restructured its rates to move them "more closely to their costs and to continue the process of removing cross-subsidies,"[59] including eliminating the NTSRR element in 2000 to move its aggregate intrastate switched access rate to the FCC's "CALLS" interstate rate.[60] Indeed, the Commission emphasized that "[e]limination of NTS is a priority and will be considered along with the elimination of other implicit subsidies."[61]

[58] *BellSouth Telecomm, Inc.'s Application to Restructure Rates*, Case No. 97-074, Order, at 1 (Oct. 24, 1997), citing Case No. 94-121, *Application of BellSouth Telecomm, Inc. d/b/a South Central Bell Tel. Co. to Modify Its Method of Regulation*.

[59] *BellSouth Price Plan Review* at 9.

[60] *See BellSouth Mirroring Order, supra*.

[61] *Inquiry into Universal Service and Funding Issues*, Adm. Case No. 360, Order, at 35 (May 22, 1998).

But because the Commission had not revisited the issue of intrastate switched access charge reform in the interim, the Commission acknowledged that "[t]he need for a comprehensive review of intra-state access charges has been a looming specter over this Commission for a significant period of time"[62] and initiated this docket "to investigate and address the basis and structure for intrastate access rates and how they are affecting Kentucky's telephone market."[63]

Q. CAN YOU GENERALLY DESCRIBE THE LEVELS OF INTRASTATE SWITCHED ACCESS RATES CHARGED IN KENTUCKY TODAY?

A. Yes. As noted above, far too many Kentucky carriers have escaped scrutiny of their rates such that, in far too many cases, Kentucky intrastate switched access rates today continue to remain as high as they were years ago. As a result, the intrastate switched access rates charged by many Kentucky carriers are excessively high, such that they do not meet the statutory "fair, just and reasonable" requirement. And making matters worse, some carriers collecting the NTSRR are apparently think they should get this subsidy even for access lines lost to competition. For example, in 2007 Windstream proposed access tariff revisions stating that its "revenue requirement" for NTS costs "shall not decrease" even if the number of access lines decreased. Windstream withdrew its proposal only after Verizon sought suspension and investigation of the tariff, but claimed

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[62] *In the Matter of: MCI Communications Services, Inc., et al. v. Windstream Kentucky West, Inc., et al.*, Case No. 2007-00503, Order (Mar. 11, 2009) at 5.

[63] *Nov. 5 Order* at 2.

the revisions were mere clarification and not a material change.[64] Obviously, if a fixed revenue requirement is applied to a decreasing number of access lines, per minute access charges will continue to increase.

Given the lack of market discipline, it is hardly surprising that intrastate switched access rates vary widely from carrier to carrier. For example, as of December 2010, Highland Telephone reportedly assessed average intrastate switched access charges of **[redacted]** cents per minute.[65] Ballard Rural Telephone's average intrastate switched access charges for 2010 were approximately **[redacted]** cents per minute.[66] Logan Telephone charged, on average, over **[redacted]** cents a minute for intrastate switched access services for much of 2010.[67] But Duo County and South Central both had average intrastate switched access rates for December 2010 over **[redacted]** cents per minute.[68] Other Kentucky ILECs fall within this range.

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[64] *See* TFS2007-00793 (letter from Daniel Logsdon dated December 14, 2007)

[65] *See* Responses of Highland Telephone Cooperative, Inc. to Data Requests of TWTC, Level 3 and Paetec, Response to No. 2.

[66] *See* Responses of Ballard Rural Telephone Cooperative Corporation, Inc. to Data Requests of TWTC, Level 3 and Paetec, Response to No. 2.

[67] *See* Responses of Logan Telephone Cooperative, Inc. to Data Requests of TWTC, Level 3 and Paetec, Response to No. 2.

[68] *See* Responses of Duo County Telephone Cooperative Corporation, Inc. to Data Requests of TWTC, Level 3 and Paetec, Response to No. 2; Responses of South Central Rural Telephone Cooperative Corporation, Inc. to Data Requests of TWTC, Level 3 and Paetec, Response to No. 2.

Q. HOW DO THE INTRASTATE SWITCHED ACCESS RATES OF OTHER KENTUCKY CARRIERS COMPARE TO AT&T'S CHARGES FOR THE SAME SERVICE?

A. Because carriers have different rate structures, to compare their switched access rates, it often is necessary to review the aggregate charges that result from applying the various switched access rate elements in the carriers' respective tariffs. Using data provided in discovery, it appears that every Kentucky LEC charges more – and, in some cases, many multiples more – than AT&T for the same intrastate switched access services. The difference between AT&T's rate and the rates charged by other Kentucky carriers is particularly acute on the terminating access side – owing in large part to certain ILECs' bloated NTSRR charges.

In its discovery responses, AT&T reported that its average intrastate switched access rates over the last five years were less than **[redacted]** per minute.[69] But, as of late 2010 (the latest time period for which most other carriers provided discovery responses reporting their own average intrastate switched access rates), Verizon's internal billing records reflect an even lower AT&T intrastate switched access rate of **[redacted]** per minute.[70] But, regardless of which AT&T rate is used for comparison, every other Kentucky carrier charges more.

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[69] *See* Responses of AT&T Kentucky to Data Requests of TWTC, Level 3 and Paetec, Response to No. 2 (indicating that AT&T's average intrastate switched access rates for the last five years ranged from **[redacted]** to **[redacted]**).

[70] This rate reflects the average per minute intrastate usage charges billed by AT&T to Verizon in Kentucky for August through October 2010.

For example, Highland Telephone's reported average per-minute intrastate switched access rate in December 2010 (**[redacted]**)[71] was **[redacted]**% higher than the average rate AT&T billed Verizon in late 2010. Foothills' average intrastate switched access rate for the same time (**[redacted]**)[72] was **[redacted]**% higher than that AT&T rate. And, in December 2010, Duo County,[73] North Central[74] and South Central[75] all had average intrastate switched access rates of more than **[redacted]**% higher than this AT&T rate – making them some of the highest rates in the country.

Even larger carriers like Windstream and Cincinnati Bell charge significantly more than AT&T for the same intrastate access services. Indeed, the record from the complaint case Verizon brought against Windstream reveals that Windstream was charging anywhere from over **[redacted]**% to nearly **[redacted]**% more than AT&T for the very same service.[76]

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[71] *See* Responses of Highland Telephone Cooperative, Inc. to Data Requests of TWTC, Level 3 and Paetec, Response to No. 2.

[72] *See* Responses of Foothills Rural Telephone Cooperative Corporation, Inc. to Data Requests of TWTC, Level 3 and Paetec, Response to No. 2.

[73] *See* Responses of Duo County Telephone Cooperative Corporation, Inc. to Data Requests of TWTC, Level 3 and Paetec, Response to No. 2.

[74] *See* Responses of North Central Rural Telephone Cooperative, Inc. to Data Requests of TWTC, Level 3 and Paetec, Response to No. 2.

[75] *See* Responses of South Central Rural Telephone Cooperative Corporation, Inc. to Data Requests of TWTC, Level 3 and Paetec, Response to No. 2.

[76] *See In the Matter of: MCI Communications Services, Inc., et al. v. Windstream Kentucky West, Inc., et al.*, Case No. 2007-00503, Direct Testimony of Don Price (July 14, 2010), Table 1.

Q. ARE THERE PARTICULAR RATE ELEMENTS THAT ARE DRIVING THIS DIFFERENCE IN THE AGGREGATE SWITCHED ACCESS RATES OF AT&T AND OTHER CARRIERS?

A. In some cases, yes. Given the massive difference between the aggregate intrastate switched access rates of AT&T and other Kentucky carriers, it is not surprising that there is also a substantial difference between a number of the specific switched access rate elements charged by those other carriers and those charged by AT&T.

For instance, AT&T has no CCLC.[77] Other carriers – including comparable larger ILECs like Windstream and Cincinnati Bell still do. And while AT&T eliminated the NTSRR rate element from its Kentucky access tariff almost ten years ago,[78] consistent with the Commission's determination that the NTSRR should eventually be phased out for all carriers,[79] Windstream, Cincinnati Bell, and other carriers have not taken the same step. To the contrary, at least 16 Kentucky ILECs continue to include the NTSRR in their intrastate switched access rates.

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[77] *See* BellSouth PSC Tariff E2, § E3.9, Sixth Revised page 10, effective 2/16/1997.

[78] AT&T eliminated its own NTSRR through tariff revisions made on September 5, 2000.

[79] *See, e.g., Inquiry into Universal Service and Funding Issues*, Adm. Case No. 360, Order, at 35 (May 22, 1998) ("Elimination of NTS is a priority and will be considered along with the elimination of other implicit subsidies.")

Windstream West still has a $2.51 per access-line, per-month NTSRR which it recovers through its CCLC,[80] and the Windstream East companies have analogous rates of $2.1075 per access line, per month.[81] These charges alone account for an outsize portion of the Windstream companies' access rates: Windstream East's CCLC charges make up **[redacted]** of its total, per-minute intrastate switched access rate, and these charges make up almost **[redacted]** of Windstream West's total intrastate switched access rate.

Similarly, despite reducing its intrastate switched access rates in 1999, Cincinnati Bell continues to include a substantial NTSRR charge within its originating and terminating CCLCs. Indeed, owing in large part to this NTSRR recovery, Cincinnati Bell continues to include an effective intrastate CCLC rate of **[redacted]** cents a minute as part of its intrastate switched access rates.[82] (Cincinnati Bell does not include any CCLC in its own interstate switched access rates.) Cincinnati Bell has collected so much in NTSRR recovery over the last three years that its NTSRR recovery has made up almost **[redacted]** – at

[80] Windstream Kentucky West Tariff PSC No. 5, Original Page 17-2.

[81] Windstream Kentucky East Tariff PSC No. 8, Original Page 4; Windstream Kentucky East Tariff PSC No. 9, Original Page 12. Windstream converts the tariffed, per-access-line NTSRR to a per-minute charge for billing purposes.

[82] *See* Responses of Cincinnati Bell Telephone Company LLC to Data Requests of TWTC, Level 3 and Paetec (Confidential Version), Response No. 14.

least **[redacted]** – of its total Kentucky intrastate switched access revenues for each of 2008, 2009 and 2010.[83]

In the same vein, pursuant to their concurrence with the tariff of Duo County Telephone Cooperative Corp., Inc., thirteen of the rural local exchange carriers ("RLECs") all continue to maintain significant NTSRR charges.[84] Several RLECs receive ***more than ten dollars per access line per month***. Brandenburg Telephone Company receives $9.67 per line per month, ***an amount nearly double the $5.60 per month it charges for local residential service***.[85] Indeed, virtually **[redacted]** of Brandenburg's 2010 total intrastate switched access revenues (over **[redacted]**%) were derived from NTSRR charges.[86] These facts are nothing short of shocking.

The NTSRR, again contained in both originating and terminating CCLCs, has caused the rates of some Kentucky ILECs to balloon to astronomical levels. For

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[83] *See* Responses of Cincinnati Bell Telephone Company LLC to Verizon's First Set of Data Requests (Confidential Version), Response No. 6.

[84] *See* Duo County Telephone Cooperative Corp., Inc. PSC KY NO. 2A, Original Page 17-2. The RLECs concurring in the Duo County tariff are: Ballard Rural Telephone Coop. Corp., Inc., Brandenburg Telephone Company, Inc., Gearheart Communications, Inc. d/b/a Coalfields Telephone Company, Inc., Foothills Rural Tel. Coop. Corp., Inc., Highland Telephone Cooperative, Inc., Logan Telephone Cooperative, Inc., Mountain Rural Telephone Coop. Corp., North Central Telephone Coop., Inc., Peoples Rural Tel. Coop. Corp., Inc., South Central Rural Tel. Coop. Corp., Inc., Thacker-Grigsby Telephone Company, and West Kentucky Rural Tel. Coop. Corp., Inc.

[85] Brandenburg Telephone Company Tariff P.S.C. KY. NO. 2, Part III, Tenth Revision Sheet 5.

[86] *See* Responses of Brandenburg Telephone Company to Verizon's First Set of Data Requests (Confidential Version), Response No. 6.

example, Leslie County Telephone Company's CCL charges alone are over **[redacted]** cents per minute,[87] while Salem Telephone Company's CCLC is nearly **[redacted]** cents a minute, and Lewisport Telephone Company's CCLC is over **[redacted]** cents a minute. This one element of these companies' intrastate switched access rates is by itself several times larger than AT&T's entire aggregate intrastate switched access rate.

In addition, some carriers continue to include other non-cost-based charges in their intrastate switched access rates that AT&T has long since dropped. For example, Windstream West has a $0.013179 per-minute "residual interconnection charge" or "RIC."[88] Other ILECs also continue to assess this non-cost-based charge.[89] Duo County Telephone Cooperative includes a RIC of **[redacted]** cents per minute in its intrastate switched access rates.[90]

The RIC originally was created as part of a restructuring of tandem-switched transport access rate elements in federal access tariffs, and Windstream West apparently mirrored the RIC in its state tariffs. The term "residual" denotes that the amount of the charge was determined as a make-whole or revenue neutral

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[87] *See* Responses and Objections of Leslie County Telephone Company, Lewisport Telephone Company and Salem Telephone Company to CLECs' First Set of Data Requests (Confidential Version), Attachments TDS/CLEC Set I-14.1, 14.2 and 14.3.

[88] Windstream Kentucky West Tariff PSC No. 5, Original Page 17-4.

[89] *See* Responses of Ballard Rural Telephone Cooperative Corporation, Inc. to Data Requests of TWTC, Level 3 and Paetec, Response to No. 4.

[90] *See* Responses of Duo County Telephone Cooperative Corporation, Inc. to Data Requests of TWTC, Level 3 and Paetec, Response to No. 14 and attachments.

component of the expressly "interim" rate structure for tandem-switched transport.[91] However, the "interim" charge was not intended to continue indefinitely and, as noted, the FCC and a number of states have phased out such non-cost based elements. But Windstream West did not follow suit in its Kentucky intrastate tariffs, even though Windstream East does not include such a charge. And other carriers – including those concurring in the Duo Country tariff – continue to receive this subsidy today.

But, on top of continuing to include rate elements that access providers like AT&T no longer charge, many Kentucky carriers also charge more than AT&T for some of the very same rate elements – including, for example, for local end office switching.

By any objective measure, whether viewed on the basis of these individual rate elements or in the aggregate, Kentucky intrastate switched access rates generally are substantially higher than those charged by AT&T.

Q. ARE THESE DIFFERENCES IN RATES CONSISTENT WITH WHAT YOU WOULD EXPECT TO SEE IN A COMPETITIVE MARKET?

A. No. In a competitive market, rate disparities among providers of the same service would not exist – particularly where many carriers charge a rate much higher than the dominant provider (*i.e.*, the AT&T RBOC). In other words, where the

[91] *See Access Charge Reform Order* at ¶¶ 158-162 .

dominant firm (like AT&T) has established a rate for switched access services, you would not expect every other provider to charge higher prices for the same switched access services. If the switched access market truly were competitive in Kentucky, no purchaser of switched access services would use other carriers' switched access services if they were priced higher than those of the RBOC (or any other alternative provider that offered cheaper switched access services in the same territory). Those purchasers simply would use the cheaper switched access services. This is yet another indication that the market does not discipline the prices for switched access services in Kentucky and that carriers generally are charging rates that are higher than they would be in a competitive market.

Q. IS THERE ANY DISPUTE THAT KENTUCKY INTRASTATE SWITCHED ACCESS RATES CONTAIN SUBSIDIES?

A. This point does not seem to be in dispute, as even carriers that would be subject to the proposed access charge reductions have admitted that their intrastate switched access rates contain subsidies. In the complaint proceeding Verizon brought challenging Windstream's intrastate switched access rates, Windstream candidly "agree[d] … that switched access rates in general have included implicit subsidies."[92] The same undoubtedly is true for other carriers, as I discussed above. Indeed, Windstream easily could have been speaking for other Kentucky

[92] *In the Matter of: MCI Communications Services, Inc., et al. v. Windstream Kentucky West, Inc., et al.*, Case No. 2007-00503, Windstream's Responses and Objections to Verizon's First Requests for Information, Response to No. 29(a)-(b).

carriers when, in that case, it objected to the removal of "implicit subsidies" from its intrastate switched access rates because that would reduce its revenues.[93]

V. THE COMMISSION SHOULD REFORM THE KENTUCKY INTRASTATE ACCESS SYSTEM BY ELIMINATING THE NTSRR AND BENCHMARKING ALL CARRIERS' INTRASTATE SWITCHED ACCESS RATES TO AT&T'S INTRASTATE RATE.

Q. WHAT SHOULD THE COMMISSION DO WITH RESPECT TO INTRASTATE SWITCHED ACCESS RATES IN THIS PROCEEDING?

A. In order to eliminate the excessive subsidies in Kentucky access rates and move toward a more rational rate structure, the Commission should (1) eliminate all NTSRR elements from Kentucky intrastate switched access rates and (2) otherwise cap all Kentucky carriers' intrastate switched access rates at the level charged by the AT&T RBOC.

Q. PLEASE SUMMARIZE WHY THE COMMISSION SHOULD ELIMINATE THE NTSRR.

A. As shown above, the continuing inclusion of non-cost-based charges – and, particularly, the NTSRR – has been a driving factor keeping many ILECs' intrastate switched access rates above any fair, just and reasonable threshold. A regime that allows some carriers to collect so much – in some cases, the majority – of their access revenue in the form of pure subsidies from competitors cannot remain in place any longer. Indeed, the Commission long ago made the policy decision to eliminate the NTSRR as competition developed, recognizing that – whatever good the NTSRR originally may have done – the public policy harms of

[93] *Id.*

continuing to subsidize certain wireline carriers through this switched access rate element had come to outweigh the benefits. As the Commission stated more than ten years ago: "The NTSRR is a non-cost based access charge that is used to support local access rates. The Commission has, through other proceedings, used excess revenues . . . to reduce NTSRR and ***has an established policy of working to eliminate the NTSRR.***"[94] That Commission policy is entirely consistent with action taken by the FCC, which has phased out the non-traffic-sensitive CCLC as part of its "long range goal… to have incumbent LECs recover a large share of the NTS common line costs from end users instead of carriers."[95] For its part, the Commission has emphasized that the "[e]limination of NTS is a priority and will be considered along with the elimination of other implicit subsidies."[96]

Consistent with the Commission's policy, certain Kentucky LECs – including AT&T – already have eliminated any NTSRR (and/or the CCLC element through which Kentucky carriers have collected the NTSRR) from their intrastate switched access rates. But in the decade since the Commission established its policy, the Commission has not required all Kentucky LECs to do so. Indeed, although the stand-alone Kentucky long distance market is much smaller today than it was when the NTSRR for many carriers was established, at least some

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94 *2000 Certification Order* at 2 (emphasis added).

95 *See generally Access Charge Reform Order,* at ¶ 68.

96 *Inquiry into Universal Service and Funding Issues*, Adm. Case No. 360, Order, at 35 (May 22, 1998).

Kentucky carriers continue to collect the same amount of NTSRR revenue as they did years – or even decades – ago. As a result, in an era in which the Commission has called for the elimination of the NTSRR, NTSRR revenues for those carriers actually have been ***increasing*** as a percentage of total interLATA toll revenues.[97] This sort of dramatic increase is directly at odds with the Commission's policy pronouncements regarding the need to reduce and eliminate NTSRR charges over time to promote competition.

As a result, through the NTSRR, certain ILECs have been able to maintain the level of toll revenues they had years ago, before toll competition was introduced, and have done so on the backs of their competitors and their customers. The NTSRR has become a windfall that insulates these carriers from the market risks that its competitors – including those that pay the NTSRR – must face. Elimination of this and other anachronistic and anticompetitive subsidies (like the RIC) is long overdue. And the fact that AT&T has continued to compete effectively without an NTSRR subsidy for a decade confirms that other Kentucky ILECs can, too.

[97] For example, my testimony in the Verizon complaint proceeding against Windstream established that the NTSRR recovery for Windstream (and its predecessors) ***more than doubled*** as a percentage of Kentucky interLATA toll revenues from 1990 through 2010. *See In the Matter of: MCI Communications Services, Inc., et al. v. Windstream Kentucky West, Inc., et al.*, Case No. 2007-00503, Direct Testimony of Don Price (July 14, 2010) at 30-32.

To level the playing field and promote competition, the Commission should finish what it started and eliminate any continuing NTSRR recovery for all Kentucky LECs, thereby reducing if not eliminating the terminating Carrier Common Line Charge.[98]

Q. WHY IS BENCHMARKING AN APPROPRIATE APPROACH TO OTHERWISE ADDRESS INTRASTATE SWITCHED ACCESS RATES?

A. Establishing a benchmark would be a simple, administratively workable and effective means, consistent with FCC and Commission policy, to quickly move excessive switched access prices to more efficient levels, and to assure that Kentucky LECs do not receive an undeserved and unfair advantage in competing for retail customers.

As the FCC explained when adopting a benchmark approach to interstate CLEC switched access charges:

> [A] benchmark provides a bright line rule that permits a simple determination of whether a [carrier's] access rates are just and reasonable. Such a bright line approach is particularly desirable given the current legal and practical difficulties involved with comparing … rates to any objective standard of "reasonableness."
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> * * *
>
> [T]he benchmark we adopt will address persistent concern

[98] Indeed, the FCC already has eliminated (or significantly reduced) CCLCs in their entirety on an interstate basis and, for the same policy reasons, they no longer have a place in Kentucky either. *See generally Access Charge Reform*, *supra*; *MAG Order* at ¶ 63 (noting that eliminating the CCLC from interstate switched access tariffs for federal rate-of-return carriers would reduce switched access rates, reduce the cost of long distance service, and encourage a more efficient level of consumption).

> over the reasonableness of [carrier] access charges and will provide critical stability for both the long distance and exchange access markets.[99]

As discussed above, the FCC and numerous other states have moved away from anachronistic cost-based approaches and toward the use of benchmarking as a means to set access rates. This Commission likewise has utilized benchmarking in the past – including for access rates. In fact, the original Kentucky access tariffs were permitted to mirror the then-current traffic sensitive elements of interstate access tariffs.[100]

Verizon's recommendation that the Commission take another step toward rationalizing access charges through benchmarking to the RBOC rate therefore does not ask the Commission to set new policy. Rather, it simply asks the Commission to apply its existing policy to additional Kentucky LECs – including large carriers like Windstream and other Kentucky ILECs that have avoided scrutiny of their intrastate switched access rates for years and now charge rates that are, in some cases, several hundred percent higher than those charged by other Kentucky carriers, including AT&T.

Q. IS BENCHMARKING PREFERABLE TO A COST-BASED APPROACH FOR ESTABLISHING INTRASTATE SWITCHED ACCESS RATES?

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[99] *CLEC Rate Cap Order* at ¶¶ 41, 44.

[100] *Investigation of Toll and Access Charge Pricing and Toll Settlement Agreements*, Order, Case No. 8838, at 40-41 (Nov. 20, 1984).

A. Yes – which is why the FCC and numerous other states increasingly have moved away from trying to set rates through protracted, complicated cost proceedings and instead have adopted benchmarking as a means to set access rates.

By eliminating any NTSRR recovery and adopting AT&T's intrastate switched access rates as a benchmark for all Kentucky LECs, the Commission can quickly, effectively and lawfully move intrastate access rates toward cost. In these circumstances, moving to a completely cost-based system for access rates is not necessary, nor advisable.

Benchmark rates are not necessarily set at cost. Indeed, the benchmark rates proposed in this docket by both Verizon and AT&T are likely set above cost. But, those proposed benchmark rates still are set at levels much closer to cost than the rates currently charged by many Kentucky LECs, such that there can be no question that moving Kentucky LECs' intrastate rates toward AT&T's rates would drive other carriers' intrastate rates down closer to cost.

Moreover, using a benchmark rate is much more straightforward and easy to administer than conducting a full-blown rate case or adopting some other cost-based alternative. If each carrier were required to support its intrastate switched access rates by demonstrating its own, individual costs either through the use of cost studies or some other method, that demonstration would impose potentially significant costs on each carrier, lead to a flood of time-consuming proceedings before the Commission, and serve no real purpose beyond what already can be served by using a benchmark.

Q. WHY ARE AT&T'S INTRASTATE SWITCHED ACCESS RATES THE APPROPRIATE BENCHMARK FOR ENSURING THAT ALL OTHER KENTUCKY INTRASTATE SWITCHED ACCESS RATES ARE FAIR, JUST AND REASONABLE?

A. The AT&T rates reflect an appropriate benchmark for several reasons.

First, AT&T already has eliminated the NTSRR and the corresponding CCLC rate element from its intrastate switched access rates,[101] thereby rendering those rates compliant with the Commission's determination that the NTSRR should be phased out for all carriers.[102]

Second, AT&T operates as the RBOC – and, therefore, the dominant provider – in Kentucky. As the dominant provider, AT&T's rates for intrastate switched access service better approximate the rates that would prevail if the market for that service were competitive.

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[101] *See* BellSouth PSC Tariff E2, § E3.9, Sixth Revised page 10, effective 2/16/1997 (eliminating CCLC). AT&T eliminated its own NTSRR through tariff revisions made on September 5, 2000.

[102] *See, e.g., Inquiry into Universal Service and Funding Issues*, Adm. Case No. 360, Order, at 35 (May 22, 1998) ("Elimination of NTS is a priority and will be considered along with the elimination of other implicit subsidies.")

Similarly, as the RBOC, AT&T has received the most regulatory scrutiny, both in general and with respect to its intrastate switched access rates, in particular. Accordingly, the AT&T intrastate switched access rates not only act as a proxy for what the prevailing market rate would be, but already have been approved by the Commission as just and reasonable.

Finally, the AT&T intrastate rate represents a reasonable rate for other Kentucky LECs because, in some cases, those LECs already charge interstate switched access rates that are comparable to – or even lower than – the AT&T intrastate switched access rate.

Q. DO THE AT&T INTRASTATE SWITCHED ACCESS RATES PROVIDE A BETTER BENCHMARK THAN WHAT AT&T HAS PROPOSED?

A. Yes. For all the reasons stated above, benchmarking to AT&T's intrastate switched access rates is preferable to AT&T's own two-fold proposal, which is to benchmark Kentucky ILEC intrastate rates to interstate levels and to benchmark Kentucky CLEC intrastate rates to the intrastate rates of the ILECs with which they compete.[103] There is no reason to treat ILECs and CLECs differently, and having different rates for different carriers creates the potential for arbitrage and inefficiency.

[103] Comments of AT&T (Dec. 17, 2010) ("AT&T Comments") at 8.

However, if the Commission is reluctant to accept Verizon's proposal, AT&T's benchmarking proposal is still preferable to a purely cost-based approach. Regardless of which benchmark is used, capping rates at benchmark levels is a simple, easily-implemented and effective means of rationalizing intrastate switched access rates in Kentucky, at least until market-based mechanisms (like negotiated agreements) are able to produce more efficient pricing.

Q. DOES PERMITTING OTHER CARRIERS TO CHARGE INTRASTATE SWITCHED ACCESS RATES HIGHER THAN AT&T'S RATE DISTORT THE MARKET?

A. Yes. Permitting other Kentucky carriers to collect unreasonably high access rates provides them with a competitive advantage because they are able to recover disproportionately more of their costs from other carriers, rather than from their own end user customers. Purchasers of switched access services (like Verizon) thus are forced to help fund the retail service offerings of companies that are, in some cases, their direct competitors in the same service areas. This cost-shifting distorts competition in interexchange and other communications markets by, for example, imposing costs that must be passed on to IXC customers.

The FCC has expressly held that eliminating LECs' ability to engage in such conduct and requiring them to recover their costs from their own end users sends the appropriate pricing signals: "When a [local exchange carrier] attempts to recover additional amounts from its own end user, that customer receives correct price signals and can decide whether he should find an alternative provider for access (and likely local exchange) service. This approach brings market discipline and accurate price signals to bear on the end user's choice of access providers."[104]

Q. IS THERE ANY REASONED BASIS TO ALLOW OTHER CARRIERS TO CHARGE INTRASTATE ACCESS RATES THAT ARE HIGHER THAN AT&T'S?

A. No. As noted above, AT&T's rates best approximate what the prevailing market rate for intrastate switched access services would be if that market were competitive, and those rates already have been approved by the Commission as just and reasonable. There is no principled justification why other carriers – and particularly similarly situated ILECs like Windstream and Cincinnati Bell – should be permitted to continue to charge so much more than the AT&T rates the Commission already has determined to be just and reasonable for providing the same intrastate switched access service.

Indeed, even Windstream has emphasized that – like other large federal price-cap carriers, including Verizon and the RBOCs – it is in a position to compete effectively without access charge subsidies. In petitioning the FCC for (and obtaining) authority to convert its remaining rate-of-return local exchange properties to federal price cap regulation, Windstream indicated that its "focus over the long term is on running its operations efficiently in order to compete effectively rather than on maximizing … regulated access revenues over the short

[104] *See CLEC Rate Cap Order* at ¶ 39.

term."[105] Windstream boasted that it already had "eliminated its CCL charges" in the interstate jurisdiction[106] and emphasized the consumer benefits of reducing implicit subsidies and lowering interstate access rates.[107] It explained that the relief it requested would "merely put Windstream in a similar regulatory position to other comparable price cap carriers and would be consistent with the Commission's longstanding policy and practice of promoting efficient forms of regulation."[108]

Verizon is asking for the same thing here – that is, to treat Windstream and other carriers in a similar regulatory position and expand the benefits Windstream touted at the federal level to consumers of services in the intrastate jurisdiction.

VI. THE COMMISSION SHOULD ALLOW KENTUCKY CARRIERS TO REPLACE REVENUE LOSSES ASSOCIATED WITH INTRASTATE SWITCHED ACCESS RATE REDUCTIONS THROUGH RETAIL REBALANCING, RATHER THAN ESTABLISH A STATE REPLACEMENT FUND.

Q. IN INITIATING THIS DOCKET, THE COMMISSION RAISED A QUESTION REGARDING HOW INTRASTATE SWITCHED ACCESS RATE REDUCTIONS POTENTIALLY COULD AFFECT REVENUES FOR KENTUCKY CARRIERS.[109] HOW SHOULD THE COMMISSION ADDRESS THAT ISSUE?

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[105] Windstream Petition for Conversion to Price Cap Regulation and for Limited Waiver Relief, WC Docket No. 07-171, at 2 (Aug. 6, 2007).

[106] *Id*. at 25.

[107] *Id*. at 8-9, 11, 17, 20, 24, 35.

[108] *Id*. at 2.

[109] *See, e.g., Nov. 5 Order* at 4.

A. Kentucky LECs should look to recoup any revenue losses associated with intrastate switched access reform from their own customers through retail rate rebalancing.

Q. HAS AT&T PROPOSED A DIFFERENT APPROACH?

A. Yes. AT&T proposes that, if the Commission reduces the implicit subsidies contained in current Kentucky intrastate switched access rates by capping those rates at a benchmark level, it should allow at least certain Kentucky local exchange carriers (namely, ILECs) to make up the difference through explicit subsidies paid from a state universal service fund.[110] But, in today's marketplace, there is no need or public policy justification for guaranteeing that any Kentucky LECs continue to receive a level of revenue that reflects historic, excessive subsidies. To the contrary, simply shifting the subsidy and revenue burden from one carrier-funded source (access rates) to another (a state USF) solves nothing. To achieve meaningful access reform, the Commission should look to other methods, rather than establish any form of fund that requires competitive providers (and their customers) to subsidize the ILECs with which those providers must compete. The obvious alternative is for the Commission to allow affected LECs to rebalance their retail rates, which even AT&T acknowledges should be the first – and, in some cases, only – revenue recovery mechanism.[111]

Q. WHY DO YOU SAY THERE IS NO NEED FOR SUCH A FUND?

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[110] AT&T Comments at 8-9.

[111] *See id.*

A. The purpose of any appropriate universal service fund is to ensure that consumers in every area have access to basic telecommunications services at affordable rates. A proper fund achieves this goal by subsidizing providers that offer services in higher cost areas that otherwise would not be served, thereby defraying that cost and incentivizing providers to serve areas they otherwise would not. But a fund can only be justified in those locations or instances where the alternative is that, without such a fund, basic affordable service (and not just wireline service) will not be available.

Verizon agrees that ensuring the universal availability of some form of basic telephone service at an affordable price is important. However, there is no need to create a government fund to meet these objectives in Kentucky when the market already has met them. AT&T's proposed fund is intended solely to preserve historic profits and revenues and is not intended to fulfill any universal service objectives.

AT&T's plan would provide funding to ILECs without any demonstration that the funding is necessary to achieve or would even be used to support any universal service objective. In other words, to accept AT&T's plan, the Commission simply would have to ***assume***, among other things, that: (1) wireline ILECs will only provide universal service if they are guaranteed to continue to receive today's revenue levels through a state universal service fund; (2) only wireline

ILECs can ensure universal service; and (3) affordable equivalent service is unavailable from alternate providers.

But there has been no showing here that the first assumption is true. That is hardly surprising because, to the extent that requiring Kentucky ILECs to benchmark their intrastate switched access rates to AT&T's rate would result in lost revenues, that does not necessarily mean that those carriers would be unable to recover their costs or would cease providing service without those revenues. Due to the excessive implicit subsidies baked into those access rates, other regulated revenue streams available to the ILECs, cost-cutting measures and other actions these carriers can undertake, it cannot be assumed that those carriers will fail to cover their costs even after the rates are reduced or continue providing the same level of service they do today.

Moreover, the second two assumptions are demonstrably false. As discussed above, in addition to ILECs, there are a host of other providers that already stand ready to provide service throughout the Commonwealth at rates consumers already have demonstrated are affordable and that they are willing to pay. Given the presence of alternate providers in the market, there is no need, as AT&T proposes, to subsidize Kentucky ILECs. Since the goals of universal service already have been achieved through competition, any government subsidies at this point are unnecessary.

Q. AS A MATTER OF PUBLIC POLICY, IS RETAIL RATE REBALANCING PREFERABLE TO ESTABLISHING A NEW FUND?

A. Yes – very much so.

Due to excessive implicit subsidies contained in current intrastate access rates, Kentucky local exchange carriers may still be able to cover their costs even after those rates are reduced. But, if a given LEC wishes to attempt to recoup the revenue reduction associated with access rate reductions, as a matter of public policy and sound economic principles, it should look to its own retail customers, cost-cutting or other measures, rather than to other carriers and their customers.

The FCC specifically has recognized that recovery from a carrier's own end users is a proper, economically efficient way to proceed.[112] Even Kentucky carriers that would be affected by access charge reductions – including specifically Windstream – have acknowledged that recovery from its customers is the best approach.[113] In fact, even AT&T acknowledges that CLECs do not need any "help" from the Commission and that even ILECs first should look to recover lost access revenues by rebalancing their basic local exchange rates before seeking any recovery from a state fund.[114]

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[112] *See*, *e.g*., *Access Charge Reform Order* at ¶ 68.

[113] *See* Windstream's Comments in WC Docket No. 08-152 (Aug. 21, 2008) ("Windstream supports the premise that carriers should first recover a reasonable amount of the costs to provide service from their customers before seeking universal service funding.").

[114] AT&T Comments at 8-9.

As detailed above, one of the fundamental problems associated with excessive switched access rates and revenue replacement funds is that they allow LECs to rely on recovering their costs from other carriers, rather than competing in the open market for revenues from their end-user customers. As the FCC has held:

> Such cost shifting is inconsistent with the competitive market that we seek to encourage for access service. Rather, it may promote economically inefficient entry into the local markets and may distort the long distance market. While we seek to promote competition among local-service providers, we also seek to eliminate from our rules opportunities for arbitrage and incentives for inefficient market entry.[115]

Indeed, the FCC repeatedly has observed that economically efficient competition and the consumer benefits it yields cannot be fully achieved as long as local exchange carriers seek to recover a disproportionate share of their costs from other carriers (*i.e.*, access payors), rather than from their own end users.[116] However, that is precisely what AT&T's proposed fund would allow. By replacing lost access revenue, a state USF merely would take the implicit subsidy reflected in excessive access charges and make it explicit through state USF payments. In other words, competing carriers and their customers *still* would be subsidizing the ILECs under AT&T's plan, but the subsidy vehicle would be shifted from access charges to direct contributions to a fund. In either case, the

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[115] *CLEC Rate Cap Order* at ¶ 33

[116] *See generally id.*; *CALLS Order, supra*; *MAG Order, supra*.

same fundamental problem remains. As such, the proposed fund would leave the competitive playing field just as uneven as it is now.

The more economically efficient approach – and the approach that will best serve the access reform goals articulated by both the FCC and this Commission – is to allow Kentucky LECs to rebalance their retail rates when excessive artificial subsidies are removed. Verizon would also support further relaxing or eliminating legacy regulatory requirements that might slow the LECs' ability to rebalance rates quickly, reduce their costs, or otherwise make up for reduced access revenues.

This is precisely how the National Broadband Plan proposes that state commissions handle access charge reductions on a going-forward basis. The NBP proposes certain intercarrier compensation reforms, including reducing carriers' intrastate switched access rates through benchmarking. But, with respect to providing carriers the opportunity to recoup any unrecovered legitimate costs, the NBP explicitly provides that "[t]he FCC should also encourage states to complete rate rebalancing of local rates to offset the impact of lost access revenues."[117]

Q. IS RETAIL RATE REBALANCING FEASIBLE IN KENTUCKY?

A. Yes. This approach is feasible as both a regulatory and practical matter.

[117] NBP at 148 (Recommendation 8.7).

AT&T suggests that only CLECs – not ILECs – have the flexibility under Kentucky law to rebalance their retail rates to offset intrastate switched access charge rate reductions. But, while I am not a lawyer, my understanding is that Kentucky law actually allows both classes of local exchange carriers the flexibility they need to rebalance the retail rates they charge their own end users for local exchange services.

My understanding is that virtually all CLEC retail services are nonbasic under the 2006 statutory revisions, giving competitive carriers the ability to price their services to meet market demands.[118] And ILECs have the same flexibility for their own nonbasic services provided to residential and business customers. For basic local exchange services, every Kentucky ILEC has the option to seek rate adjustments using the methods provided by statute.[119] Only three Kentucky ILECs adopted the price regulation plans provided by KRS 278.543, such that their basic local exchange rates currently are limited by statute. But those five-year statutory caps expire this month. In other words, today's regulatory paradigm for competitive services is not remotely comparable to what existed when the NTSRR scheme was put in place. Thanks to significant statutory changes, flexibility abounds, and there are no regulatory constraints on carriers' ability to price their competitive services.

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[118] KRS 278.544(4).

[119] KRS 278.180.

Despite this flexibility, many Kentucky local exchange carriers have taken advantage of the excessive implicit subsidies in their access rates and artificially suppressed their rates for basic local exchange services. But, as a practical matter, because those local exchange service rates currently are so low, they afford those LECs significant room to recoup any unrecovered costs following the necessary rate reductions.[120]

Q. PLEASE EXPLAIN HOW CURRENT LOCAL EXCHANGE RATES AFFORD KENTUCKY LECS ROOM TO RECOUP WHAT IS LOST TO INTRASTATE ACCESS RATE REDUCTIONS.

A. While Kentucky LECs should have the discretion to determine which of their retail rates to adjust to ensure recovery of any legitimate costs from their own end users following the necessary access rate reductions, Verizon notes that many Kentucky carriers' tariffed rates for basic residential services are relatively low and should afford them room to recoup any unrecovered costs.

[120] In addition to the fact that Kentucky local exchange carriers can and should recover a larger portion of their costs from their own end users, many of those carriers already have other significant sources of funding available to them. In particular, many Kentucky LECs derive substantial amounts of money each year from federal "high cost funding" programs. While the FCC's high cost program is intended to reduce interstate access rates, certain elements of the federal program are also intended to provide a contribution to costs that are jurisdictionally *intrastate*. *See* "Universal Service Monitoring Report," CC Docket No. 98-202 (2009), prepared by Federal and State Staff for the Federal-State Joint Board on Universal Service, in CC Docket No. 96-45 ("Joint Board Monitoring Report") at 3-8 ("Like ICLS [Interstate Common Line Support], the purpose of this mechanism [Interstate Access Support, or 'IAS'] is to provide explicit support to ensure reasonably affordable interstate rates. This is in contrast to the Commission's other high-cost support mechanisms, which provide support *to enable states to ensure reasonably affordable and comparable intrastate rates*.") (emphasis added).

For example, as discussed above, Brandenburg Telephone charges only $5.60 per month for local residential service – significantly less than the $9.67 it receives per line per month in NTSRR recovery. Thacker-Grigsby Telephone, which built an advanced fiber to the home network to provide triple-play services to residential customers, charges only $5.74 per month for local residential service, while collecting $10.64 per line per month in NTSRR recovery. Gearheart Communications, Inc. (dba Coalfields Telephone Company) charges only $10.58 per month for local residential service but collects $10.38 for its NSTRR. Duo County Telephone, another provider of fiber-based triple play services, gets $8.52 per month in NTSRR but charges only $12.37 for local residential service.

Kentucky carriers therefore have room to increase their retail rates to make up for revenue reductions associated with the proposed access rate reductions. But not only ***can*** Kentucky local exchange carriers recoup such revenue losses from their own end-user customers, they ***should*** do so rather than seek recovery through a carrier-funded source that would undermine fair and efficient competition.

Q. WOULD A FUND LIKE THAT PROPOSED BY AT&T AFFECT PROVIDERS OF NEWER TECHNOLOGY LIKE WIRELESS?

A. Yes. The Proposed state USF would unfairly burden the newer technologies that are increasingly preferred by consumers and that drive innovation and investment in Kentucky.

The Commission should reject any fund and it certainly should reject establishing a fund on the terms proposed by AT&T. Under AT&T's proposal, wireless carriers would be treated the same as regulated ILECs, CLECs and toll providers, and would be required to subsidize ILECs directly through payments to the state USF. However, wireless carriers utilize little to no intrastate access service and, unlike LECs, they do not collect tariffed access charges. The intrastate traffic that they exchange with ILECs is predominantly intra-Metropolitan Trading Area ("MTA") traffic and, thus, is not subject to access rates. Clearly, it would be improper and unfair to impose a state USF contribution requirement on wireless carriers when wireless carriers do not participate in the access charge system the way ILECs do. This is particularly true because, while the Commission expressly sought intervention in this case from IXCs and CLECs, it did not seek participation from wireless CMRS carriers, whose rates it does not regulate. And in light of KRS 278.54611, the 2005 statute that deregulated wireless services, my understanding is that any proposal to tax wireless carriers to "make whole" the ILECs potentially would face immediate legal problems.

But, even if there were no jurisdictional or other legal barriers to the Commission exercising authority to assess wireless providers in this manner, the Commission would have to reject such action as a matter of public policy. Public policy dictates that the Commission should not require providers of new, innovative services — including wireless services — to finance the business models of other telephone companies. That is particularly the case where there has been no demonstration that basic service would otherwise be unaffordable, that alternatives to traditional wireline service do not exist, or that wireline carriers could not provide the service without the support of such a fund. The Commission should not burden new services and technologies (and the customers that use them) based on legacy regulatory concepts and obligations that have outlived their usefulness. Indeed, these service and technology innovations are spurring competition in the telecommunications marketplace. Burdening such services and customers with unnecessary new state USF fees will tend to drive investment dollars away from Kentucky at a time when Kentucky's economy can least afford such a loss. If the Commission forces wireless carriers to contribute to any fund that might be established, the result will simply be higher rates, a chilling effect on innovation, reduced investment, and fewer competitive options and benefits for Kentucky consumers.

VII. CONCLUSION.

Q. IN LIGHT OF YOUR TESTIMONY, WHAT SHOULD THE COMMISSION DO IN THIS CASE?

A. The Commission should: (1) immediately remove any remaining NTSRR elements (and corresponding CCL charges) and other non-cost based rate elements (like the RIC) from Kentucky intrastate switched access rates; (2) otherwise benchmark all Kentucky intrastate switched access rates to a level not exceeding those charged by the AT&T for the same service; and (3) allow

Kentucky LECs to recoup revenues associated with intrastate switched access rate reductions through retail rate rebalancing, rather than establish any state USF or replacement fund.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.