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July 2, 2009

VIA FEDERAL EXPRESS
Jeff Derouen, Executive Director
Kentucky Public Service Commission
211 Sower Blvd
P.O. Box 615
Frankfort, KY 40602-0615

Re: ***In the Matter of: Brandenburg Telephone Company, et al. v. Windstream Kentucky East, Inc.,* Case No. 2007-0004**

Dear Mr. Derouen:

I have enclosed for filing in the above-styled case the original and eleven (11) copies of the Petition for Confidential Treatment of Certain Information in the Supplemental Prefiled Direct Testimony of Douglas D. Meredith.

Please return a file-stamped copy in the enclosed self-addressed stamped envelope.

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

Sincerely,

Stephen D. Thompson

SDT
Enclosures
cc: All parties of record *(w/encl.)*

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

Brandenburg Telephone Company; Duo County Telephone Cooperative Corporation, Inc.; Highland Telephone Cooperative, Inc.; Mountain Rural Telephone Cooperative Corporation, Inc.; North Central Telephone Cooperative Corporation; South Central Rural Telephone Cooperative Corporation, Inc. and West Kentucky Rural Telephone Cooperative Corporation, Inc.	)	
Complainants	)	
v.	)	**Case No. 2007-00004**
Windstream Kentucky East, Inc.	)	
Defendant	)	

PETITION FOR CONFIDENTIAL TREATMENT OF CERTAIN INFORMATION CONTAINED IN THE SUPPLEMENTAL PREFILED DIRECT TESTIMONY OF DOUGLAS DUNCAN MEREDITH

Brandenburg Telephone Company, Duo County Telephone Cooperative Corporation, Inc., Highland Telephone Cooperative, Inc., Mountain Rural Telephone Cooperative Corporation, Inc., North Central Telephone Cooperative Corporation, South Central Rural Telephone Cooperative Corporation, Inc., and West Kentucky Rural Telephone Cooperative Corporation, Inc. (collectively, the "RLECs"), by counsel, and pursuant to 807 KAR 5:001 §7 and KRS 61.878(1)(a) and 61.878(1)(k), move the Public Service Commission of the Commonwealth of Kentucky (the "Commission") to accord confidential treatment to certain highlighted information contained in the supplemental prefiled direct testimony of Douglas

Duncan Meredith ("Meredith")[1] regarding the cost study which Windstream Kentucky East, LLC ("Windstream") submitted to the Commission on March 20, 2009, and as to which Windstream has filed a Petition for Confidential Treatment ("Petition") currently pending before the Commission. In support of this Petition, the RLECs state as follows.

I. Applicable Law.

807 KAR 5:001 §7(2) sets forth a procedure by which certain information filed with the Commission may by treated as confidential. Specifically, the party seeking confidential treatment of certain information must "[set] forth specific grounds pursuant to KRS 61.870 et seq., the Kentucky Open Records Act, upon which the commission should classify that material as confidential." 807 KAR 5:001 §7(2)(a)(1).

The Kentucky Open Records Act, KRS 61.870 *et seq.*, exempts certain records from the requirement of public inspection. *See* KRS 61.878. In particular, KRS 61.878(c)(1) provides as follows:

> [r]ecords confidentially disclosed to an agency or required by an agency to be disclosed to it, generally recognized as confidential or proprietary, which if openly disclosed would present an unfair commercial advantage to competitors of the entity that disclosed the records.

Id.

II. Windstream's Petition for Confidential Treatment of Cost Study

As Windstream argues in its Petition, the information in the cost study was disclosed to the Commission in connection with data requests propounded by Commission staff and the RLECs. Thus, the cost study information was disclosed to the Commission and was required by the Commission to be disclosed to it.

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[1] This confidential treatment should include the <u>entire</u> supplemental exhibit entitled "Confidential Supplemental Exhibit DDM-01.pdf" which is attached to Meredith's supplemental prefiled testimony.

Moreover, Windstream asserts in its Petition that the cost study would be generally recognized as highly confidential, significant to its ability to provide competitive products, and could not be discovered through independent research. Windstream also asserts in its petition that a disclosure of the cost study would result in an unfair commercial advantage to its competitors resulting in a compromised competitive position for Windstream.

Therefore, the RLECs request the Commission, if the Commission finds that Windstream's Petition is meritorious and should be granted, to accord confidential treatment to the highlighted cost study references contained in the supplemental prefiled direct testimony of Meredith. Again, this highlighted testimony would be the same information that the Commission would treat as confidential if it grants Windstream's Petition for Confidential Treatment. In short, if the Commission grants Windstream's Petition, it should also grant this Petition.

Respectfully submitted,

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Certificate of Service

I hereby certify that a copy of the foregoing was served via United States First Class Mail, sufficient postage prepaid, on this 2nd day of July, 2009 upon:

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COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

Brandenburg Telephone Company; Duo County Telephone Cooperative Corporation, Inc.; Highland Telephone Cooperative, Inc.; Mountain Rural Telephone Cooperative Corporation, Inc.; North Central Telephone Cooperative Corporation; South Central Rural Telephone Cooperative Corporation, Inc. and West Kentucky Rural Telephone Cooperative Corporation, Inc.	)	
Complainants	)	
v.	)	**Case No. 2007-00004**
Windstream Kentucky East, Inc.	)	
Defendant	)	

CONFIDENTIAL

PREFILED SUPPLEMENTAL TESTIMONY OF DOUGLAS DUNCAN MEREDITH

ON BEHALF OF THE

<u>RURAL TELEPHONE COMPANY COMPLAINANTS</u>

July 3, 2009

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Q: ARE YOU THE SAME MR. MEREDITH THAT PREVIOUSLY PREPARED PREFILED DIRECT TESTIMONY IN THIS PROCEEDING?

A: Yes.

Q: PLEASE REMIND US ON WHOSE BEHALF YOU ARE TESTIFYING.

A: I am testifying on behalf of Brandenburg Telephone Company, Duo County Telephone Cooperative Corporation, Inc., Highland Telephone Cooperative, Inc., Mountain Rural Telephone Cooperative Corporation, Inc., North Central Telephone Cooperative Corporation, South Central Rural Telephone Cooperative Corporation, Inc. and West Kentucky Rural Telephone Cooperative Corporation, Inc. ("RLECs")

Q: WHAT IS THE PURPOSE OF YOUR SUPPLEMENTAL TESTIMONY?

A: My purpose in providing supplemental testimony to the Public Service Commission of the Commonwealth of Kentucky ("Commission") is to provide my assessment of the source data and the mechanics of the cost study filed by Windstream Kentucky East, Inc. ("Windstream") that I was able to review after the filing deadline for my prefiled direct testimony.

Q: PLEASE EXPLAIN WHAT EFFORTS YOU UNDERTOOK TO ANALYZE THE SOURCE DATA AND MECAHNICS OF THE WINDSTREAM COST MODEL.

A: First, I helped prepare a set of interrogatories and request for documents submitted to Windstream that would facilitate my examination of the cost

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study and its supporting workpapers. In several of its responses, Windstream objected to producing these supporting workpapers. Instead, it indicated these documents would be "available for review by the RLECs during normal business hours at Windstream's East corporate headquarters in Little Rock Arkansas and upon reasonable advance notice to Windstream East."[1]

I judged that the data Windstream had in Little Rock was necessary to determine the validity of the cost study source data and the computations used by Windstream. This judgment was based in part on the fact that the Excel workbook provided by Windstream in support of it tariff rates did not contain essential cost information and documentation necessary to judge whether the study was in fact a TELRIC study, nor whether the study was reasonable in the sense that it produced a reasonable rate for transit service. Windstream alleges its study complies with the FCC's regulations;[2] however, without a careful examination of the source documentation and the mechanics of the workpapers used to produce the tariff rates, it was not possible to make this determination.

RLEC Counsel made arrangements with Windstream to allow me to visit Little Rock and review the source data used in the study. I visited Windstream' East corporate headquarters in Little Rock on June 3, 2009. During my visit I was able to examine certain components of the source data used by Windstream. There were, however, other items that Windstream representatives could not produce. This failure at the time was due to the travel schedule of a key individual involved with the initial cost study and the

[1] *See e.g., Windstream Kentucky East, LCC's Responses to Supplemental RLEC Data Requests*, No. 21.

[2] *See Windstream Kentucky East, LCC's Responses to Supplemental RLEC Data Requests*, No. 2.

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subsequent cost study revision used to produce the rates Windstream proposed in its tariff.

Q: DID WINDSTREAM PRODUCE ADDITIONAL DATA AFTER YOUR VISIT?

A: Yes. We discussed having a conference call to review several outstanding items when the key individual returned from travel. Instead of having a conference call to discuss these items, Windstream produced a written response and provided some additional workpapers.

Q: PLEASE DESCRIBE THE STUDY USED BY WINDSTREAM TO PRODUCE ITS TARIFFED TRANSIT RATES.

A: The study used by Windstream to produce its tariffed transit rates was first developed in 2004 for other purposes. My understanding, obtained during my visit to Little Rock, is that Windstream prepared the study for a number of unbundled network element (UNE) rates. In 2006-2007, Windstream modified its 2004 study to produce the proposed transit rates.

Q: AFTER REVIEW OF THE SOURCE DOCUMENTATION AND THE MECHANICS OF THE STUDY PRODUCED BY WINDSTREAM, DO YOU HAVE ANY CONCERNS REGARDING WINDSTREAM'S STUDY?

A: Yes. My review of the supporting documents and the mechanics of the study workpapers leads me to the conclusion that the Windstream study does not comply with FCC regulations regarding TELRIC-based cost studies in two areas of concern. I understand that Windstream has asserted that its transit rates are not subject to TELRIC requirements. Nevertheless, in at least two other key areas the study is not reasonable regardless of the cost methodology used by Windstream. Those four major areas where I judge the study to be unreasonably deficient are: (1) tandem switch investment; (2) lack of operational efficiencies; (3) failure to update all costs; (4) inappropriate forecasting and assignment of termination costs.

Q: PLEASE DESCRIBE THE PROBLEMS YOU DISCOVERED WITH RESPECT TO WINDSTREAM'S SWITCH INVESTMENT.

A: I found several problems with how Windstream modeled its switch and calculated its switch investment used to develop transit rates. To put this item in perspective, [redacted]

My first problem with the Windstream model is that it uses outdated switch technology. The model uses a technology that is not "forward-looking least cost," which is required by FCC regulation.[4] The Windstream model uses Nortel DMS 100/200 switch technology that does not reflect the conversion to Softswitch technology for new projects. For many years now, Softswitch technology has been available and is widely deployed as an efficient least cost technology.[5] I judge this failure to use Softswitch technology to be rooted in Windstream's use of its 2004 base model. When it revised the model in 2006-2007, Windstream elected not to use a Softswitch that would have end office and tandem capability. This election becomes a major failure of the study because the study is not using least-cost forward-looking technology available in 2006 and certainly not using least-cost forward-

3 [redacted]

4 47 CFR § 51.505(b)(1).

5 In performing transport and termination cost studies for rural carriers, I require the use of Softswitch technology at the least cost most efficient switching technology available.

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looking technology in 2009. It is necessary to use Softswitch technology in order to satisfy FCC TELRIC regulation. The cost savings realized when installing a Softswitch platform that has the functional equivalence with the older [redacted] is significant: I understand that a soft-switch platform can be approximately one-half the cost of the older technology. Therefore, my first concern with Windstream's rate development is that its model over-prices the switch technology used in the model. This practice is contrary to FCC regulation directing the use of forward-looking least cost technology.

Second, Windstream revised its allocation of joint/shared and common switching costs in 2006-2007, thereby greatly increasing the assignment of those costs to tandem functionality. This revision is highly suspect because it has the effect of increasing transit service rates without reducing other TELRIC rates offered by Windstream that were not revised in the 2006-2007 study[6]— thus suggesting to me that the rates from the 2004 study and 2006-2007 study produce a double-recovery of allowable costs. Without examining the allocation of joint/shared and common costs across all services or network elements in a comprehensive study, it is impossible to confirm that Windstream's 2006-2007 modifications do not lead to a double-recovery of costs. Windstream's January 16, 2004 UNE cost study reported a total of [redacted] for tandem equipment investment. On January 19, 2007, however, Windstream changed the Joint Equipment allocation to [redacted] percent from [redacted] percent. This raised the tandem equipment to [redacted]—an increase of [redacted] percent resulting solely from this one allocation adjustment.

[6] On my visit to Little Rock, I understood from my conversation with Windstream representatives that the 2006-2007 revised study was streamlined to produce only the transit rate. No other UNE rates were updated.

The [redacted] percent allocation is based on dividing an embedded Cat 2 allocation of [redacted] percent by [redacted] percent. The [redacted] percent value is based on embedded historic accounting rules that have no foundation in forward-looking economic cost.[7] The [redacted] percent is Windstream's estimate of the percent of tandem equipment investment to total equipment investment. None of this is factor manipulation is even necessary; however, because Windstream has detailed investment data by switch location. This data can be used to determine the amount of joint and common costs that should be assigned to end-office switch functionality or to tandem switch functionality using a direct cost allocation method.[8]

The third problem I have with the Windstream study is with the incorrect joint assignments used by Windstream. Some of the joint assignments should actually be assigned to end-office switch usage and not assigned to tandem switching. Windstream assigned Line Module equipment, NDLC equipment, and TR08 equipment to be jointly allocated among end-office switch usage and tandem usage. The problem with this assignment is that the tandem functionality does not include line equipment, DLC equipment or TR08 interface equipment. All three of these assignments should be to EO Switch Usage. The approach suggested by Windstream is unfair, unreasonable, and simply wrong in that it assigns investment cost related to end-user connections to the tandem switching function. The tandem switch does not have end-user lines, DLC lines, or DLC TR-08 interface capability;

7 This proposed use of embedded cost is suspect. FCC regulations prohibit use of embedded cost in a TELRIC study. See 47 CFR § 51.505(d)(1). The embedded accounting cost information used here is highly dependent on the categorization of costs according to specific embedded cost standards. I do not recommend that this information be allowed in this study when other primary cost data is available.

8 The standard approach for joint cost allocation relies on assigning as much of the total investment directly to specific activities. The costs not assigned to specific activities are then spread across the specific activities based on the percentage of costs directly assigned. This method allocates joint or common costs based on the direct investment assignments.

accordingly the tandem functionality at issue in this matter should not bear those added costs.

Q: ARE YOU ABLE TO ADJUST THE WINDSTREAM STUDY TO CORRECT THE PROBLEMS YOU HAVE IDENTIFIED?

A: Not completely. To the extent possible, however, I will try to quantify the magnitude of the error these flaws impose upon Windstream's cost study. The three central problems with Windstream's flawed tandem switch investment methodology are: forward-looking switch investment, joint cost allocation, and joint cost assignment.

First, the failure to use a Softswitch platform is significant. Had Windstream modeled its costs on the use of a Softswitch—as is required to satisfy the FCC regulation requiring use of the least cost most efficient technology available—total switching costs associated with the transit rates would be reduced by approximately fifty percent. By itself, this failure is enough to warrant a determination that Windstream's transit rate is neither TELRIC compliant nor fair and reasonable.

The assignment and allocation of joint costs are both straightforward adjustments. In Confidential Supplemental Exhibit DDM-01, I show the Switching cost worksheet unadjusted and adjusted to reflect the correction to line module, DLC and TR08 assignments for the Ashland tandem office used by Windstream and the corrected joint cost allocation I discussed above. These adjustments do not reflect the Softswitch adjustment I also recommend be incorporated. Windstream suggests that the Ashland tandem investment is [redacted]

Step one corrects the assignment of line equipment, DLC equipment to tandem service. Performing only this assignment correction leads to an investment total of [redacted]; however, this should not be the final investment number because Windstream's allocation of joint costs is at best a hodgepodge allocation that is not rooted in the actual data from the study.[9]

Step two corrects the joint cost allocation percentage. Using the corrected direct assignments obtained in step one, I calculate that the joint cost allocator for tandem functionality should be 4.5 percent (this does not include power and common that is assigned independently in Windstream's worksheet). Replacing Windstream's embedded joint cost allocator of 47.9 percent with the 4.5 percent value—a value that is calculated using the same investment data used in the study—the total tandem investment for this office amounts to $206,215.[10]

This significant reduction in tandem investment is based on Windstream's supporting workpapers used to develop switching investment. The reduction of 87 percent of reported tandem investment shows that the module assigning tandem switching investment is significantly flawed because it does not reflect forward-looking least cost principles or standard modeling algorithms used to calculate appropriate joint cost allocations. Moreover, even without FCC regulations governing this process, the assignment of investment proposed by Windstream is unfair and unreasonable because line-side switching costs are not involved in the tandem function and therefore, should not be assigned to the tandem function.

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[9] Recall, Windstream uses a factor from an embedded cost accounting method and computes a joint allocation factor from this embedded historic cost method.

[10] Even if the joint cost allocator was returned to the 2004 value of [redacted] percent, total tandem investment would be [redacted].

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Q: IN THE COURSE OF YOUR EXAMINATION OF THE WINDSTREAM STUDY HAVE YOU FOUND A SECOND PROBLEM THAT YOU WOULD LIKE TO HIGHLIGHT?

A: Yes. The study uses embedded cost factors that have not been adjusted to account for operational efficiencies. Even though the model provides for these types of expense reductions, Windstream's inputs in this area are full of zeros—meaning Windstream does not recognize any operational efficiencies.

Q: IS IT USUAL OR CUSTOMARY TO RECOGNIZE OPERATIONAL EFFICIENCIES IN A FORWARD-LOOKING COST MODEL?

A: Absolutely. Because the investment in a forward-looking model is state of the art forward-looking equipment, it is widely recognized that there will be a reduction in operational costs associated with this new equipment. Since operational expenses are usually derived using a ratio of expenses to investment from historic and embedded equipment, the reduction of operational expenses is a reasonable approach to account for new equipment.

This reduction in operating expenses is material. For example, in the forward-looking studies I have performed in Michigan, that commission required its forward-looking economic cost studies to include a reduction of non-labor operational expenses of at least 15 percent. Windstream, conversely, proposes no operational efficiencies whatsoever. Windstream's failure to recognize these operational efficiencies unfairly, unreasonably, and artificially inflates its tandem rate.

Q: PLEASE DESCRIBE THE THIRD PROBLEM WITH WINDSTREAM'S COST STUDY THAT YOU WOULD LIKE TO BRING TO THE COMMISSION'S ATTENTION.

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A: The third problem deals with updating costs from the 2004 Windstream study to the 2006 Windstream study. During my visit to Little Rock, I was led to understand that the 2006 revised study did not update all costs and prices from the 2004 study. The cost book used for the revised 2006 study was developed in 2004. Certain other costs and/or prices were updated to 2006 levels. This inconsistency should not be permitted because it leaves the decision about whether to update a price to Windstream, who is free to pick and choose which costs – and, hence, service prices – get updated. All costs and prices affecting the newly tariffed rate(s) should be updated when performing a revision to a prior study. Windstream apparently did not take the effort required to update all prices/costs when revising its old study to develop the transit rate. This approach is unfair and unreasonable because it is not clear why certain costs were adjusted and other costs were not adjusted. Moreover, to selectively pick and choose which costs are adjusted is simply not reasonable in determining a transit rate.

Q: SO, ARE YOU SAYING THAT IT IS NOT POSSIBLE TO QUANTIFY THE IMPACT OF WINDSTREAM'S ERRORS BECAUSE YOU DO NOT HAVE UPDATED DATA FROM WINDSTREAM?

A: Yes. It was the responsibility of Windstream to ensure its 2006 study used up-to-date prices and costs. Because Windstream did not do so, however, I cannot completely quantify the effects of this error, except to say that it results in a rate that is – as a direct result of that failure – unfair and unreasonable.

Q: LASTLY, PLEASE DESCRIBE THE PROBLEMS YOU FOUND WITH THE TERMINATION COMPONENT OF THE STUDY.

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A: Windstream estimates that all interexchange fiber facilities will increase by approximately [redacted] percent over a five year period.[11] This factor is applied to currently-sized interexchange fiber facilities. This approach does not account for the possible switch to higher-capacity facilities based upon that forecast increase in demand. (As the size of the facility increases, the cost per minute decreases since more traffic can be transported over a larger facility—accounting for the distribution of fixed costs over more units transmitted.)[12] By fixing the demand by each type of equipment and not accounting for changes to optimally-sized facilities and pricing accordingly, Windstream's approach artificially and unreasonably inflates the termination rate.

Second, the model identifies the number of "IX fiber facilities" in the network. The term "facilities" is typically used to identify the equipment over which transmission occurs. Used in this manner, it would identity the number of "circuits" over which interexchange traffic is transmitted. However, there is no documentation in the model indicating the number of "IX terminations"—there are two terminations per circuit: one on each end of the facility.

If the model does not properly account for the number of "terminations" then the cost per minute for "transport termination" functionality derived from the model is inflated by a factor of two. Windstream's proposed transport termination cost is suspect because it is unclear whether it reflects only one termination per IX facility route when transmitting transit traffic from an RLEC.

[11] See Windstream Demand worksheet.

[12] The Windstream Material Factor worksheet IX port costs divided by DS-0 channel equivalency shows this relationship.

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Q: PLEASE SUMMARIZE YOUR CONCLUSIONS REGARDING THE WINDSTREAM STUDY.

First, I have discussed four significant errors that suggest that the Commission should reject Windstream's proposed transit rates because the cost study underlying those proposed rates is unreasonable

The switching investment problem and the efficiency factor problem further illustrate that the model is unreasonable and outside the customary bounds of a FCC TELRIC study. The switching assignment problem and the failure to update prices in a revised study are also errors that make the study unfair and unreasonable. The remaining questions showing Windstream's development of the termination rate, as well as Windstream's lack of documentation showing that termination numbers were correctly developed, further underscores the unreasonableness of Windstream's proposed transit rate(s). In total, the proposed rate is unfair and unreasonable, and it fails to conform to standard FCC TELRIC principles.

Q: DOES THIS CONCLUDE YOUR PREFILED SUPPLEMENTAL TESTIMONY?

A: Yes.

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was served by first class United States mail, postage prepaid on this 2nd day of July, 2009, on the following individual(s):

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Supplemental Exhibit DDM-01, Page 1

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