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July 14, 2010

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PUBLIC SERVICE COMMISSION

VIA HAND DELIVERY
Jeff DeRouen
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, KY 40601

RE: MCI Communications, Inc. et al v. Windstream Kentucky East, LLC et al
Case No. 2007-00503

Dear Mr. DeRouen:

Enclosed please find an original and ten copies of Verizon's prefiled direct testimony of Don Price. The testimony includes several references to information taken directly from or derived from information previously granted confidential protection by the Commission, including data Windstream provided to Verizon under a protective agreement. Accordingly, a CONFIDENTIAL copy of the testimony is included in the enclosed envelope and will be provided to Windstream pursuant to the protective agreement. Ten redacted copies of the testimony are also being filed.

Please indicate receipt of this filing by placing your file stamp on the extra copy and returning to me via the enclosed, self-addressed stamped envelope.

Very truly yours,

STOLL KEENON OGDEN PLLC

Douglas F. Brent

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cc: Service List

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COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the matter of:

MCI Communications Services, Inc., Bell Atlantic Communications, Inc., NYNEX Long Distance Company, TTI National, Inc., Teleconnect Long Distance Services & Systems and Verizon Select Services, Inc., Complainants, vs. Windstream Kentucky West, Inc., Windstream Kentucky East, Inc. – Lexington, and Windstream Kentucky East, Inc. – London, Defendants.	)	Case No. 2007-00503

PREFILED DIRECT TESTIMONY OF

DON PRICE

ON BEHALF OF VERIZON

* * * * REDACTED VERSION * * * *

July 14, 2010

I. <u>INTRODUCTION AND BACKGROUND</u>.

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. Complainants 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 Services & Systems Company 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 state regulators in at least 27 states on a wide range of issues in many types of proceedings, including various intercarrier compensation issues.

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

A. The Commission must determine whether the intrastate switched access rates that Defendants Windstream Kentucky East, Inc. and Windstream Kentucky West, Inc. (collectively, "Windstream") charge to Verizon and other carriers are "fair, just and reasonable," as required by Kentucky law. KRS § 278.030(1).

Q. PLEASE DESCRIBE THE PURPOSE OF YOUR TESTIMONY.

A. The purpose of my testimony is to present evidence that Windstream's current intrastate switched access rates are ***not*** "fair, just and reasonable" and to otherwise support Verizon's Petition to Reduce Windstream's Switched Access Charges ("Petition"). As I will explain, Windstream's switched access rates are not subject to market discipline in Kentucky, and long distance carriers (otherwise known as interexchange carriers or "IXCs") like Verizon have no choice but to pay these excessive rates. Those rates are so high, in part, because – unlike some other Kentucky carriers – Windstream continues to recover substantial amounts for its so-called Non-Traffic Sensitive Revenue Requirement ("NTSRR") through the Carrier Common Line Charge ("CCLC") element of its intrastate switched access rates. While the Commission long ago made the policy decision to eliminate the NTSRR as competition developed, it has not yet done so with respect to Windstream. Owing to this and other charges, Windstream's intrastate switched access rates remain well above any just and reasonable level and impede fair competition. Ideally, Verizon and Windstream would be able to negotiate more reasonable intercarrier compensation rates, but Windstream was not willing to do so. Accordingly, regulatory intervention is needed to bring

Windstream's rates down to more reasonable levels.

Verizon thus recommends that the Commission (1) eliminate the NTSRR recovery (which virtually can be accomplished just by eliminating the CCLC element) from Windstream's intrastate switched access rates[1] and (2) adopt a benchmark approach to ensure that Windstream's intrastate switched access rates otherwise are set at just and reasonable levels. 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 Windstream already charges for its own interstate switched access services.

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

A. Yes, through the former MCI entities, Verizon has provided service in Kentucky for nearly 30 years and has 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 access service from numerous carriers, including Windstream, 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

[1] Based on Windstream's discovery responses, it appears that Windstream recovers almost all (approximately 96%) of its NTSRR through the CCLC. (The CCLC does not appear to provide recovery for anything other than the NTSRR; in other words, 100% of Windstream's CCL charge goes to the NTSRR.)

customer for access services both in Kentucky and in other states and has a broad historical perspective on access pricing policy.

Q. WHAT IS VERIZON'S GENERAL CONCERN WITH WINDSTREAM'S PRICING FOR INTRASTATE SWITCHED ACCESS SERVICES?

A. As noted in the Petition, while interstate switched access rates in general have fallen dramatically since the 1990s and some Kentucky local exchange carriers have mirrored those reductions in their intrastate switched access rates, Windstream has not followed suit. Other Kentucky ILECs, including AT&T, do not include recovery for NTSRR in their intrastate switched access rates. But Windstream continues to charge Verizon and other long distance carriers the same intrastate switched access rates that have been in place in some cases since at least the 1990s – including a CCLC charge for recovery of its NTSRR.[2]

Meanwhile, Windstream itself has entered the long distance market and is competing against the very same carriers on which it assesses switched access charges. Verizon should not be competitively disadvantaged by having to pay excessive access rates to its competitors – particularly because Windstream's own long-distance operation has benefited from the access reductions of other carriers. And while Windstream is a sophisticated, well-financed company, Windstream has not taken any steps to bring its intrastate switched access rates in line with

[2] Because of the way the CCL charge is calculated and billed, Windstream's per-minute rate actually has been increasing over time (and can be expected to continue to do so) as the fixed amount is spread over fewer access minutes, and in 2008 was ***50% higher*** than it was in 2006. (Windstream has not provided data for 2009 that would allow for a more current calculation.)

what other large ILECs charge for intrastate services. For example, as a result of the NTSRR recovery and other rate elements, Windstream's intrastate switched access rates (based on the data Windstream itself has provided in discovery) range from ***over* [redacted]*% to nearly* [redacted]*% higher*** than the AT&T rates.

Q. PLEASE EXPLAIN VERIZON'S PROPOSAL TO BENCHMARK WINDSTREAM'S RATES TO THE AT&T LEVEL.

A. Verizon asks the Commission to cap Windstream's intrastate switched access rates at the level charged by AT&T. As discussed below, Windstream and AT&T are the two largest ILECs in Kentucky, offering a similar suite of products and services. But AT&T eliminated the NTSRR from its intrastate switched access rates more than ten years ago, making its intrastate switched access rates substantially lower than Windstream's. As the Regional Bell Operating Company ("RBOC") and largest provider of switched access service in Kentucky, AT&T's rates have been subject to the greatest regulatory scrutiny and, as discussed below, best reflect the rates that would have prevailed in a competitive switched access market. Indeed, in some cases, Windstream itself already charges substantially ***less*** than the AT&T rates for ***inter***state switched access services. AT&T's rates therefore reflect an appropriate benchmark for what just and reasonable Windstream intrastate rates would be.

II. <u>OVERVIEW OF SWITCHED ACCESS SERVICE.</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. We refer to the rates for these services as "access charges." Access charges generally apply to calls that begin and end in different local calling areas. The rates at issue in this proceeding are the intrastate switched access rates that Windstream charges IXCs and other carriers to originate or terminate calls that begin and end in Kentucky.

To further illustrate the concept, 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, like Windstream, 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 Windstream's 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 are instead rooted in social policy goals, thereby amounting to a subsidy for the LEC's other operations being paid by long distance carriers.

Q. PLEASE EXPLAIN WHY SUCH SUBSIDIES EXIST.

A. Subsidies in intrastate switched access rates are vestiges of a prior regulatory approach that is incompatible with a competitive marketplace, and that largely has been abandoned by regulators and policymakers in recent years. 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.[3] 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

[3] *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).

maintain "existing toll support for the NTS costs of the local network" while shifting from "settlements" to an access charge environment.[4]

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."[5]

Q. DO THOSE POLICY CHOICES REMAIN APPROPRIATE TODAY AS THEY ARE REFLECTED IN WINDSTREAM'S RATES?

A. No. In the wake of the federal Telecommunications Act of 1996 and the opening of the local exchange market to competition, as well as technological advances, a dramatically different telecommunications environment exists today. In addition to the traditional incumbent wireline providers, consumers today are able to obtain service from a host of wireline CLECs, wireless carriers, and cable and Voice over Internet Protocol ("VoIP") providers. In most cases, consumers have a number of alternatives among retail providers and many no longer want or need wireline service. Accordingly, there no longer is the same need to subsidize

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[4] *Id.* at 28.

[5] *Id.* at 47.

traditional incumbent wireline providers on an across-the-board basis. Indeed, continuing excessive, indiscriminate subsidies harms consumers.

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 14 years since the Act, regulators have re-evaluated outdated rules and, as I discuss below, consistently have taken steps to eliminate excessive subsidies and reduce LEC switched access rates. The Kentucky Commission is among those that have taken steps to remove excessive subsidies from access charges, though not yet from Windstream.

But it is not just changes in the marketplace itself that should inform the Commission's consideration of Verizon's Petition. 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.

Q. ARE THE RATES FOR WINDSTREAM'S SWITCHED ACCESS SERVICES DISCIPLINED BY THE MARKET?

A. No. In contrast to the competitive retail services I describe above, the Commission has recognized that long distance or toll carriers that purchase switched access services are not able to switch suppliers, resulting in what this Commission has described as a "monopoly service" in Kentucky.[6]

A long distance carrier cannot choose whom its customers call or what LEC serves the calling or called party. Instead, the long distance company generally must carry and complete any call a customer places and must pay whatever switched access fees the LEC assesses for terminating that call. 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.

This lack of market discipline presents the risk that some LECs, absent regulatory intervention, will charge unreasonably high switched access rates, and that is the case with Windstream today.

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 removing excessive subsidies from switched access rates and pricing access services more closely to their costs is in the public interest.[7] In approving access

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[6] *Inquiry into IntraLATA Toll Competition*, Order, Adm. Case No. 323, Phase 1 at 45 (May 6, 1991) ("LECs must continue to be subject to full rate of return regulation due to their provisioning of [switched] access, a monopoly service.")

[7] *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*").

reductions for other carriers over the past decade, the Commission has specifically cited such public interest benefits.[8] 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 said 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.***"[9] 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 Windstream.

The Commission's policy choice to reduce excessive subsidies in access rates is consistent with findings of the Federal Communications Commission ("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 disproportionate share of their costs from other carriers (*i.e.*, long distance providers), rather than from their own end users.[10] Such

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[8] *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).

[9] *2000 Certification Order* at 2 (emphasis added).

[10] *See generally 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*"); *Access Charge Reform; Price Cap Performance Review for Local Exchange*

irrational access rate structures lead to what the FCC has termed "inefficient and undesirable economic behavior"[11] 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.[12]

Even 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. *MAG Order* at ¶ 11. (Of course, as discussed below, Windstream is a much larger and more sophisticated company and has much greater financial clout than most rural LECs.)

Accordingly, the FCC has taken steps to reduce LECs' interstate switched access

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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*"); *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*").

[11] *CALLS Order* at ¶ 129.

[12] *Id.* at ¶ 114.

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 "inconsistent with the competitive market that we seek to encourage for access service." *See, e.g., CLEC Rate Cap Order* at ¶ 33. 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."[13] Of course, as the telecommunications industry has become even more critical to the economy in intervening years, the objective of more efficient pricing has become a greater imperative.

Q. IN LIGHT OF THESE POLICY CONCERNS, WHAT STEPS HAS THE FCC TAKEN TO REDUCE LEC ACCESS RATES?

A. Soon after the Act was passed, the FCC begin revising the interstate access charge regime to "foster and accelerate the introduction of competition into all telecommunications markets." [14] 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."[15]

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[13] *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).

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

[15] *Id.* at ¶ 68.

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."[16]

Then, on November 8, 2001, the FCC issued the "*MAG Order*," referenced above, 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 access rates, reduce the cost of long distance service, and encourage a more efficient level of consumption.[17]

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.[18] CLEC access charges that do not exceed the benchmark are presumed to be just and reasonable.[19] As the FCC explained, "a benchmark provides a bright line rule that

[16] *CALLS Order* at ¶ 18,

[17] *MAG Order* at ¶ 63.

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

[19] *CLEC Rate Cap Order* at ¶ 40.

permits a simple determination of whether a [carrier's] access rates are just and reasonable."[20]

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.[21] 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 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."[22]

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 undertaken sustained efforts to reduce switched access charges, usually starting with the RBOCs, then turning to the next-tier carriers. This trend

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[20] *Id.* at ¶ 41.

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

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

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.[23] The California Commission considered this action necessary to promote "[f]air competition in the long distance market."[24]

Embarq – which, like Windstream, has grown into a leading ILEC through acquisitions in recent years – has been the focus of a number of recent state Commission complaint proceedings. In March, in a Sprint complaint case against Embarq, the Kansas Public Service Commission ordered Embarq to reduce its intrastate switched access rates to parity with its interstate rates, in accordance with state legislative policy.[25] In Washington last year, Embarq reduced its access rates by means of a settlement of a complaint brought by Verizon.[26] Also last

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[23] *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).

[24] *Id.* at 13.

[25] *Petition of Sprint to Conduct General Investigation into the Intrastate Access Charges of Embarq*, Order, Docket No. 08-GIMT-1023-GIT (March 10, 2010). See also Kansas Code, Ch. 66 § 66-2005(c) (requiring LECs, subject to commission approval, to reduce intrastate access rates to interstate levels).

[26] *Verizon Select Services Inc., etc. v. Embarq*, Final Order Approving and Adopting Settlement Agreement; Authorizing and Requiring Compliance Filing, Order 05, Docket No. UT-081393 (Va. S.C.C. Nov. 13, 2009).

year, acting on a Sprint complaint, the Virginia State Corporation Commission cut Embarq's CCLC in half, recognizing that it was a "pure subsidy rate element," and, as such, impeded "the development of the market for telephone services."[27] 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. This year, the Virginia Legislature finished the job the Commission had started, adopting legislation requiring complete elimination of CCLCs for Embarq and other carriers.[28]

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 set earlier this year.[29] And, in a May 2008 decision, the Iowa Utilities Board reduced the switched access rates of small, mostly rural carriers to better reflect the carriers' interstate rate structure, including elimination of the non-cost-based transport interconnection charge ("TIC"). In this regard, the Board found that "it is just and reasonable to eliminate a rate that has no corresponding service."[30]

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[27] *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).

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

[29] *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).

[30] *In re: Iowa Telecomm. Ass'n*, Docket Nos.TF-07-125 & TF-07-139, Final Order, at 8 (I.U.B. May 30, 2008).

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. The benchmark for CLEC rates has usually (but not always) been the competing ILEC's rate, analogous to the FCC's approach for interstate access rates.[31] For

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[31] *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); **Illinois** PA-96-0927 (signed into law on June 15, 2010) (requiring CLECs to transition their intrastate switched access rates to interstate parity by July 2010); 199 **Iowa** Admin. Code 22.14(2)(d)(1)(2) (prohibiting CLECs from charging a carrier common line charge if it would render the CLEC's rate higher than the competing ILEC's rate); **Louisiana** PSC General Order No. U-17949-TT, App.B, Section 301 (k)(4) (May 3, 1996) (CLECs must charge switched access rates that do not exceed the competing ILEC's rates); *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); *Access Rates to Be Charged by Competitive Local Exchange Telecommunications Companies in the State of Missouri*, Report and Order, **Missouri** P.S.C. Case No. TO-99-596, 2000 Mo. PSC Lexis 996, at *28-31 (June 1, 2001) (capping CLEC access rates at the competing ILEC's level); *In the Matter of the Commission, on Its Own Motion, Seeking to Conduct an Investigation into Intrastate Access Charge Reform and Intrastate Universal Service Fund*, **Nebraska** Pub. Serv. Comm'n Application No. C-1628/NUSF, Progression Order #15, at ¶ 9 (Feb. 21, 2001) ("absent a demonstration of costs, a CLEC's access charges, in aggregate, must be 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 Jersey** Board of Public Utilities, Telecommunications Order, *In the Matter of the Board's Investigation and Review of the Local Exchange Carrier Intrastate Exchange Access Rates*, Docket No. TX08090830 (Feb. 1, 2010) at 29-30 (ordering CLECs to mirror the competing ILEC's intrastate access rates); **New York** P.U.C. Case 94-C-0095, Order, at 16-17 (Sept. 27, 1995), N.Y. P.U.C. Opinion 96-13, at 26-27 (May 22, 1996), and N.Y. P.S.C. Opinion 98-10, 1998 N.Y. PUC Lexis 325, at 26-27 (June 2, 1998) (benchmarking CLEC access charges to the level of the largest carrier in the LATA); *Establishment of Carrier-to-Carrier Rules*, Entry on Rehearing, **Ohio** P.U.C. Case No. 06-1344-TP-ORD, at 16-18 (Oct. 17, 2007) (capping CLECs' switched access rates at the level of the competing ILEC); 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

ILECs, regulators and legislators have often applied a benchmark at the ILEC's own interstate rate.[32] Some jurisdictions have taken the very same kind of

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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*, **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).

[32] *See, e.g.*, **Georgia** HB 168 (signed into law on June 4, 2010) (requiring all LECs to transition their intrastate switched access rates to parity with their interstate rates); **Illinois** PA-96-0927 (signed into law on June 15, 2010) (requiring all LECs to transition their intrastate switched access rates to interstate parity); **Indiana** Code § 8-1-2.6-1.5 (providing that a LEC's intrastate switched access rates will be considered just and reasonable if they mirror its interstate rates); *In re: 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); **Maine** Revised Statutes Title 35-A, Ch. 71 § 7101-B and Maine Admin. Code 65-407, Ch. 280 § 8.B (capping all LEC rates at interstate levels); *Investigation by D.T.E. on Its Own Motion into the Appropriate Regulatory Plan to Succeed Price Cap Regulation for Verizon Massachusetts' Intrastate Retail Telecommunications Services in the Commonwealth of Massachusetts*, **Massachusetts** DTE Docket No. 01-31 (May 8, 2002) (requiring intrastate switched access rates for Verizon ILEC to mirror its interstate rates); MCL § 484.2310 (capping all **Michigan** LEC intrastate rates at interstate levels); **Missouri** HB 1750 (signed into law on June 24, 2010) (requiring large ILECs, (AT&T, Windstream, CenturyLink), for a three-year period, to reduce their intrastate switched access rates by 6% of the difference between intrastate and interstate rates each year; *In the Matter of the Board's Investigation and Review of the Local Exchange Carrier Intrastate Exchange Access Rates*, Telecommunications Order, **New Jersey** B.P.U. Docket No. TX08090930 (Feb. 1, 2010) (ordering all ILECs to eliminate CCLC and benchmark intrastate switched access rates to interstate levels); **New Mexico** Stats. §§ 63-9H-1, et seq., and New Mexico Admin. Code § 17.11.10.8 (requiring all LECs to reduce intrastate rates to interstate levels); *Investigation into the Modification of Intrastate Switched Access Charges*, Opinion and Order, **Ohio** P.U.C. Case No. 00-127-TP-COI (requiring the four largest ILECs' intrastate switched access rates to mirror their interstate access rates); **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).

approach Verizon recommends here and required ILECs to cap their intrastate switched access rates at the level charged by the largest ILEC in the state.[33]

III. WINDSTREAM'S INTRASTATE SWITCHED ACCESS RATES.

Q. WHAT ARE WINDSTREAM'S CURRENT INTRASTATE SWITCHED ACCESS CHARGES?

A. In response to discovery from Verizon, Windstream provided a rate element-by-rate element listing of its own intrastate switched access rates, which it contrasted with those charged by AT&T, the RBOC. The information is in Windstream's response to Verizon data request No. 32. I discuss some of those specific rate elements (and how they compare to similar AT&T rate elements) in detail below. However, the following chart provides a summary of Windstream's intrastate switched access rates on a composite basis, using the confidential data provided by Windstream.

[33] *See*, *e.g.*, *DPUC Investigation of Intrastate Carrier Access Charges*, Decision, **Connecticut** D.P.U. Docket No. 02-05-17, 2004 Conn. PUC LEXIS 15 (2004) (ordering all ILECs to benchmark their rates to the SBC/AT&T rate cap); **Delaware** Code, Title 26, § 707(e) (capping all service providers' switched access rates at the level of the largest ILEC in the state); Code of **Maryland** Regulations § 20.45.09.03(b) (capping all LECs' switched access rates at the level of the largest LEC in the state).

Table 1: Comparison of the Windstream Companies' and AT&T Kentucky's Intrastate Switched Access Rates (Assuming 10 miles of Switched Transport)

	Windstream West	Windstream East - Lexington	Windstream East - London	AT&T	Source
Composite rate per access minute (excludes CCL for Windstream companies)	$ 0.0579180	$ 0.0163199	$ 0.0144395	$0.0049490	Windstream response to Verizon's DR 32
Estimated Windstream CCL per minute (AT&T actual)	[redacted]	[redacted]	[redacted]	$ -	Calculation based on Windstream's Confidential responses to Verizon's DR 6
Total	[redacted]	[redacted]	[redacted]	[redacted]	calculation
Percent of AT&T rate	[redacted]%	[redacted]%	[redacted]%		calculation

Q. HOW DO WINDSTREAM'S INTRASTATE SWITCHED ACCESS CHARGES COMPARE TO AT&T'S CHARGES FOR THE SAME SERVICE?

A. As the above table indicates, Windstream's intrastate switched access rates are significantly higher – particularly on the terminating side – owing in large part to Windstream's bloated NTSRR charge.

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. The above table shows Windstream's composite rates using data provided by Windstream (assuming 10 miles of transport). Verizon also calculates its cost of purchasing access services from a particular carrier (like Windstream) using the aggregate charges – or average access revenues per minute ("ARPM") – based on billings to Verizon. This calculation produces results very similar to the Windstream data summarized in the chart, above, and shows that the Windstream companies' switched access ARPMs (including the NTSRR-related carrier common line charges calculated on a per-minute basis) range from ***over 700% to 2000% higher*** than the ARPM for AT&T.[34] (Again, Windstream's own data shows its composite intrastate switched access charges are [redacted]% to nearly [redacted]% higher than AT&T's.)

Given the massive difference that both Verizon and Windstream have found between the aggregate Windstream intrastate switched access rates and AT&T's aggregate rates, it is not surprising that, as alluded to above, there is also a substantial difference between a number of the specific switched access rate elements in Windstream's intrastate tariffs and those charged by AT&T in Kentucky. For instance, unlike Windstream, AT&T has no CCLC.[35] And AT&T eliminated the NTSRR rate element from its Kentucky access tariff almost ten years ago,[36] consistent with the Commission's determination that the NTSRR

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[34] Confidential Exhibit 1 to the Petition contained a table that includes the ARPMs for BellSouth/AT&T and each of the Windstream entities.

[35] *See* BellSouth PSC Tariff E2, § E3.9, Sixth Revised page 10, effective 2/16/1997. As discussed in fn. 1, *supra,* the CCLC is the mechanism by which Windstream collects the vast majority of its NTSRR charges from other carriers.

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

should eventually be phased out for all carriers.[37] Windstream has not taken similar steps.

Windstream West still has a $2.51 per access-line, per-month NTSRR which it recovers through its CCLC,[38] and the Windstream East companies have analogous rates of $2.1075 per access line, per month.[39] These charges alone account for a substantial portion of the Windstream companies' access rates: Windstream East's CCLC charges make up ***over half*** of its total, per-minute switched access rate, and these charges make up almost ***three-quarters*** of Windstream West's total rate.

In addition, Windstream West has a $0.013179 per-minute "residual interconnection charge" or "RIC."[40] 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 component of the expressly "interim" rate structure for

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[37] *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.")

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

[39] 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.

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

tandem-switched transport.[41] However, the "interim" charge was not intended to continue indefinitely and, as noted, the FCC has phased out such non-cost based elements at the federal level. But Windstream West did not follow suit in its state tariffs. Other carriers – including AT&T – no longer include a "RIC" in their intrastate switched access charges. Indeed, not even Windstream East includes such a charge.

AT&T also does not assess any switched access information surcharges, which are charges originally intended to be assessed for connecting to information centers. AT&T eliminated those charges in 2000. But Windstream West continues to assess a $0.000267 per-minute switched access information charge today (a rate ***420 times higher than*** its own interstate information surcharge rate of $0.000063 per 100 minutes), and the Windstream East companies assess a $0.0000895 per-minute switched access information charge[42] (whereas the information surcharge has been eliminated in their interstate tariffs).

In addition to continuing to include rate elements that access providers like AT&T no longer charge, Windstream also charges more than AT&T for some of the very same rate elements. For example, AT&T's per-minute rate for tandem switched

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

[42] Windstream Kentucky West Tariff PSC No. 5, Original Page 17-7; Windstream Kentucky East Tariff PSC No. 8, Original Page 144; Windstream Kentucky East Tariff PSC No. 9, Original Page 106.

transport termination is $0.000176.[43] The Windstream companies' charges for the same type of termination range from $0.00032 to $0.001444, or up to ***eight times higher*** than AT&T's rate for the same service.

Similarly, AT&T's per-minute rate for local end office switching is $0.002158.[44] But the Windstream companies' per-minute charge for the same rate element ranges from $0.01379 to $0.0412,[45] or up to ***19 times higher*** than AT&T's rate.

By any objective measure, whether viewed on the basis of these individual rate elements or in the aggregate, Windstream's intrastate switched access rates are substantially and unreasonably higher than those charged by AT&T.

Q. IS THIS DIFFERENCE 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 one carrier (*i.e.*, Windstream) charges a rate much higher than the dominant provider (*i.e.*, the AT&T RBOC). In other words, where the dominant firm (like AT&T) has established a rate for switched access services, you would not expect another provider (like Windstream) to charge a

[43] BellSouth Telecommunications Kentucky PSC Tariff 2E, Twenty First Revised Page 57.1, Section E6.8.1.C.2(a).

[44] BellSouth Telecommunications Kentucky PSC Tariff 2E, Twentieth Revised Page 59, Section E6.8.3.A.1(b).

[45] Windstream Kentucky West, Inc. Tariff PSC No. 5, Original Page 17-7; Windstream Kentucky East, Inc.-Lexington Tariff PSC No. 8, Original Page 141; Windstream Kentucky East, Inc.-London Tariff No. 9, Original Page 106.

higher price for the same switched access services being provided at a lower rate by the dominant firm. If the switched access market truly were competitive, no purchaser of switched access services would use Windstream's 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 Windstream's switched access services in Kentucky and that Windstream is charging rates that are higher than they would be in a competitive market.

Q. HOW WERE WINDSTREAM'S INTRASTATE SWITCHED ACCESS RATES SET?

A. As I discussed above, 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.[46] 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 (including the predecessors-in-interest of both Verizon (GTE South, Inc. and Contel of Kentucky, Inc.) and Windstream (ALLTEL

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

Kentucky, Inc.)) that was later accepted by the Commission in May 1991.[47] Those are the same rates that Windstream West continues to use today, almost 20 years later.

The rates for Windstream East were derived from that 1990 agreement, 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.

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

A. No. When they were established, Windstream's intrastate switched access rates contained several elements that were not associated with any specifically identified costs, including the CCLC. (As noted above, the CCLC is the mechanism by which Windstream collects the preponderance of its NTSRR charges from other carriers.)

The NTSRR, in particular, was introduced in the Joint Motion and approved as a *transitional* recovery mechanism for non-traffic sensitive (and potentially other) costs to help ease the transition to intraLATA competition.[48] However, in later discussing alternatives for cost recovery, the Commission made clear that NTS recovery eventually should be decreased or eliminated to promote competition.

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

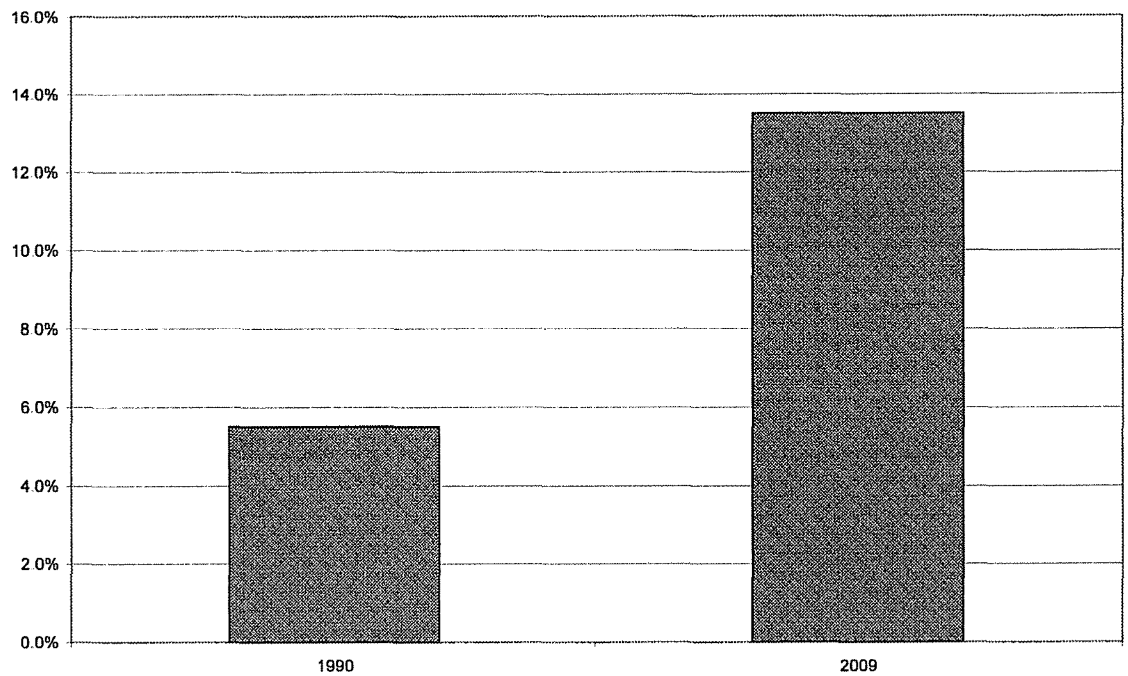
[48] *See generally Inquiry into IntraLATA Toll Competition*, Adm. Case No. 323, Order (May 6, 1991).

See Adm. Case No. 323, Phase I, Order, at 18 (Dec. 29, 1994). That time has long since come, as intraLATA competition is now fully implemented in Kentucky, local competition is fully authorized, and the "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. IS THERE ANY ADDITIONAL REASON WHY YOU SAY THERE IS NO LONGER ANY JUSTIFICATION FOR WINDSTREAM'S NTSRR?

A. Yes. The Kentucky long distance market was much larger when Windstream's NTSRR was established than it is today. Based on FCC reports, I estimate that the total InterLATA toll service revenues for Kentucky in 1990 were around $270 million. The NTSRR recovery for Windstream's predecessors would have represented about 5.5% of Kentucky interLATA toll revenues at that time. Since then, however, total interLATA toll revenues have sharply declined to the point where, today, total Kentucky interLATA toll revenues are only about $120 million. But, despite this overall drop, Windstream continues to recover the same amount of NTSRR revenue from IXCs (through the CCLC charge) that was being recovered almost two decades ago. Thus, Windstream's NTSRR charges now represent 13.5% of all Kentucky interLATA toll revenues, well over double the original amount. This dramatic increase is shown in the following graph:

Windstream's NTSRR as a Percent of Total Kentucky Retail InterLATA Toll Revenues



In other words, while any original need for NTSRR subsidies and the total amount of interLATA revenues have decreased over time, Windstream's NTSRR charges actually have substantially ***increased*** on a relative basis. Indeed, as noted above, on a per-minute basis, Windstream's CCLC has increased as much as 50% over a two year period.[49]

Windstream's NTSRR is also a major factor in the ever-growing proportion of Windstream's revenues that it generates from access services. Based on Windstream's discovery responses, access services made up over half (nearly [redacted]) of Windstream's Kentucky intrastate revenues in 2009, up from less than

[49] *See* fn. 2, *supra*.

[redacted]% in 2005. This is directly contrary to the Commission's policy pronouncements regarding the need to reduce and eliminate NTSRR charges over time to promote competition.

Through the NTSRR, Windstream has been able to maintain the level of toll revenues it had 20 years ago, before toll competition was introduced, and has done so on the backs of its competitors and their customers. The NTSRR has become a windfall that insulates Windstream from the market risks that its competitors – including those that pay the NTSRR to Windstream – must face. Elimination of this anachronistic and anticompetitive subsidy is long overdue. And the fact that AT&T has continued to compete effectively without an NTSRR subsidy for a decade confirms that Windstream can, too.

Q. HAS WINDSTREAM INDICATED WHETHER ITS CURRENT INTRASTATE SWITCHED ACCESS RATES REFLECT A SUBSIDY TO WINDSTREAM?

A. Yes – it has. Windstream claims it does not have the information and/or has not undertaken the calculations necessary to "unequivocally state that … its intrastate switched access rates exceed its costs." Windstream's Responses and Objections to Verizon's First Requests for Information, Response to No. 29(a)-(b). (Windstream has not said whether it will file a cost study in this case or not, despite Verizon's inquiry in discovery. *Id.*, Response to No. 25.) But Windstream nevertheless "agrees … that switched access rates in general have included implicit subsidies." *Id.*, Response to No. 29(a)-(b). And Windstream admits that its intrastate switched access charges are used to recover costs for other services it provides, separate and apart from intrastate switched access service, including for basic local service. *Id.*, Response to No. 9(a)-(b) (Windstream conceding that "its intrastate switched access charges in part may be considered to recover some costs related to maintaining affordable rates for basic local service"). Windstream therefore objects to the removal of "implicit subsidies" from its intrastate switched access rates in this case because that would reduce Windstream's revenues. *Id.*, Response to No. 29(a)-(b).

Q. HAVE OTHER CARRIERS REDUCED THEIR SWITCHED ACCESS RATES SINCE THE TIME THAT WINDSTREAM'S RATES WERE ESTABLISHED?

A. Yes. Switched access rates generally have declined – sometimes dramatically – over the past decade or so, as carriers around the country have reduced their rates, both on an interstate and intrastate basis. The same is true in Kentucky, where all LECs have reduced their interstate switched access rates and other large ILECs – including specifically AT&T – have reduced their intrastate rates.[50]

Q. HAS THE COMMISSION EXPRESSED ANY VIEWS REGARDING THE APPROPRIATE RATE LEVELS FOR INTRASTATE SWITCHED ACCESS CHARGES SINCE THE TIME WINDSTREAM'S RATES WERE ESTABLISHED?

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

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

for AT&T that required its intrastate switched access rates to mirror analogous interstate rate elements.[51] 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,"[52] including eliminating the NTSRR element in 2000 to move its aggregate intrastate switched access rate to the FCC's "CALLS" interstate rate.[53] Indeed, the Commission emphasized that eliminating the non-cost based NTSRR charge and other such subsidies would be a priority in Kentucky. *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.")

But because the Commission has not revisited the issue of intrastate switched access charge reform in the interim, the Commission acknowledged in this docket 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." *Order* (Mar. 11, 2009) at 5. The Commission recognized "the need to address intercarrier compensation," in general. *Id.* at 6. *See also id.* at 8 ("The

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[51] *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.*

[52] *Review of BellSouth Telecomm, Inc.'s Price Regulation Plan*, Order, Case No. 99-434, at 9 (Aug. 3, 2000) ("*BellSouth Price Plan Review*"); *see also Tariff Filing of BellSouth Telecommunications, Inc. to Mirror Interstate Rates*, Order, Case No. 98-065 (Mar. 31, 1999) ("*BellSouth Mirroring Order*").

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

Commission affirmatively states that an investigation into the issue of intercarrier compensation reform is necessary."). And it has recognized the need to address Windstream's switched access rates, in particular. *Id.* ("[t]he Commission finds that an investigation into Windstream's switched access rates is necessary").

As the Commission observed, "Verizon has raised sustainable questions regarding the reasonableness of the compensation which Windstream currently receives for its access service." *Id.* Specifically, the Commission noted that "Verizon has raised a compelling argument that Windstream's current non-traffic sensitive revenue requirement rates have not been modified by Windstream to actively reflect its most recent revenue results and, therefore, are not specifically cost-based and are adversely affecting the provision of access services by carriers within the Windstream territories." *Id.* at 8-9. The Commission echoed that conclusion in its recent order denying Windstream's motion to compel various discovery requests. *See Order* (May 14, 2010) at 4 (citing March 11 Order).

Q. HAS WINDSTREAM ITSELF EXPRESSED ANY VIEWS REGARDING THE APPROPRIATE RATE LEVELS FOR SWITCHED ACCESS CHARGES AND/OR RATE ELEMENTS LIKE THE CCLC?

A. Yes. As Windstream has emerged as a sizeable, sophisticated and well-financed competitor,[54] it 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)

[54] *See*, *e.g.*, Petition at ¶ 17.

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 term."[55] Windstream boasted that it already had "eliminated its CCL charges" in the interstate jurisdiction[56] and emphasized the consumer benefits of reducing implicit subsidies and lowering interstate access rates.[57] 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."[58] Verizon is asking for the same thing here—that is, to treat Windstream like the comparable RBOC in the Commonwealth and expand the benefits Windstream touted at the federal level to consumers of services in the intrastate jurisdiction.

Q. WHAT SHOULD THE COMMISSION DO WITH RESPECT TO WINDSTREAM'S INTRASTATE SWITCHED ACCESS RATES IN THIS CASE?

A. In order to eliminate subsidies and move toward a more rational rate structure, the Commission should (1) eliminate any NTSRR recovery element and the RIC from

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

[56] *Id.* at 25.

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

[58] *Id.* at 2.

Windstream's intrastate switched access rate and (2) otherwise cap Windstream's intrastate switched access rates at the level charged by the AT&T RBOC.

Verizon and Windstream agree that negotiated intercarrier compensation agreements are the best long-term solution to ensuring the efficiency of telecommunications markets in the face of substantial technological change. *See* Petition at ¶ 20; Answer ¶¶ 38, 43. Negotiated intercarrier compensation agreements can adapt more easily to changing technologies, encouraging their introduction without the need to modify the regulatory regime, and can better address intercarrier compensation in a comprehensive way that effectively addresses concerns about arbitrage among rates in different jurisdictions and for different types of traffic.

Until the industry can fully transition to a regime of commercially negotiated agreements, however, the Commission needs to assure that access rates are set and maintained at a level that will promote competition and economic efficiency. Eliminating the NTSRR is a first step, consistent with the Commission's long-standing recognition of the need to remove that excessive subsidy from intrastate rates. And Verizon's benchmarking will go a long way toward otherwise driving Windstream's intrastate access rates toward fair, reasonable and economically efficient levels.

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 Windstream does not receive an undeserved and unfair advantage in competing for retail customers. A benchmark will promote equity and competitive parity and reduce market distortions by prompting Windstream, as a larger carrier with some of the highest access rates, to recover more of its network costs from its own customers, rather than from other carriers and their customers through access rates. Failure to reduce Windstream's rates to a just and reasonable level would continue placing a disproportionate burden on other carriers in the state – and ultimately, their customers – to subsidize Windstream's operations.

Q. WHY ARE AT&T'S INTRASTATE SWITCHED ACCESS RATES THE APPROPRIATE BENCHMARK FOR ENSURING THAT WINDSTREAM'S INTRASTATE RATES ARE FAIR AND REASONABLE?

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

First, Windstream's operations in Kentucky are much more comparable to AT&T's than they are to any other carrier's. AT&T and Windstream are the two largest ILECs in Kentucky. AT&T serves the largest city in the Commonwealth; Windstream serves the second largest. As of its 2008 publicly available data with the Commission, Windstream served approximately 400,000 access lines in 48 counties. Both Windstream and AT&T have entered the long distance market and introduced broadband services. Both offer bundles, including high definition video service. And both are part of large, successful national telecommunications companies that provide a host of services in multiple states (Windstream alone operates in 23 different states) and generate substantial revenue. Indeed, the Windstream parent company (Windstream Corporation) reported nearly $2.9 billion in annual service revenues in 2009, according to its 10-K filing with the Securities and Exchange Commission. And the Windstream website indicates that, company-wide, Windstream has about $4 billion in total annual revenues. In short, AT&T's Kentucky intrastate switched access rates provide an appropriate benchmark for Windstream because the two companies are similarly situated. Indeed, as noted, Windstream compared itself to the RBOCs in seeking similar price-cap treatment at the FCC.

Moreover, as noted above, 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 best approximate the rates that would prevail if the market for that service were competitive, particularly because they reflect the federal CALLS rates, which were based on negotiations among carriers. Moreover, 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 reflect the best estimate of 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 (which is substantially the same as its interstate rate) represents a reasonable rate for Windstream because, in some cases, Windstream's interstate switched access rate is already comparable to AT&T's interstate switched access rate. In other words, benchmarking Windstream's intrastate switched access rate to AT&T's intrastate rate, as Verizon has recommended, would take Windstream closer to its own interstate rates. Indeed, the largest of the Windstream entities (Windstream East – Lexington) actually charges a composite interstate rate that is less than the AT&T composite rate.[59] While the other Windstream entities (Windstream East – London and Windstream West) charge a higher rate for interstate switched access services, those are much smaller companies serving many fewer customers and, in any event, their interstate switched access rates are much closer to the AT&T rate than any of Windstream's current intrastate rates.[60]

The fact that Windstream's rates for the same switched access services in the interstate jurisdiction are, in most cases, lower than the AT&T benchmark Verizon recommends here underscores the reasonableness of Verizon's recommendation.

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[59] AT&T's composite rates for intra- and interstate switched access service largely mirror one another. The data provided by Windstream indicates that AT&T's composite intrastate rate is slightly higher ($0.0049490) than its interstate rate ($0.0049240).

[60] Based on the data provided by Windstream in discovery, it appears that Windstream East – London's composite intrastate switched access rates are approximately 110% higher than AT&T's composite intestate rates and Windstream West's composite interstate access rates are approximately 268% higher than AT&T's.

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

A. Yes. Permitting Windstream to collect unreasonably high access rates provides it with a competitive advantage because it is able to recover disproportionately more of its costs from other carriers, rather than from its own end user customers. Purchasers of switched access services (like Verizon) thus are forced to help fund the retail service offerings of a company that is, in some cases, their direct competitor 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."[61]

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

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

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 a similarly situated ILEC like Windstream 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.

Q. IS VERIZON ADVOCATING DENYING WINDSTREAM THE ABILITY TO RECOVER ITS COSTS?

A. No. As Windstream concedes, its current intrastate switched access rates contain subsidies allowing Windstream to recover amounts above and beyond its cost of providing intrastate switched access service.[62] But if Windstream proves that the costs of the services for which the Commission still regulates its prices exceed the revenues for those services, then Windstream should be permitted to recover the shortfall through increases in the prices for those regulated services. Indeed, the FCC specifically has recognized that the proper, economically efficient way to proceed is through recovery of costs primarily from a carrier's own end users. *See*, *e.g.*, *Access Charge Reform Order* at ¶ 68.

Q. DOES WINDSTREAM HAVE THE ABILITY TO RECOVER ITS COSTS FROM ITS OWN END USERS THROUGH OTHER RATES?

A. Yes. Windstream has virtually complete retail pricing flexibility under KRS

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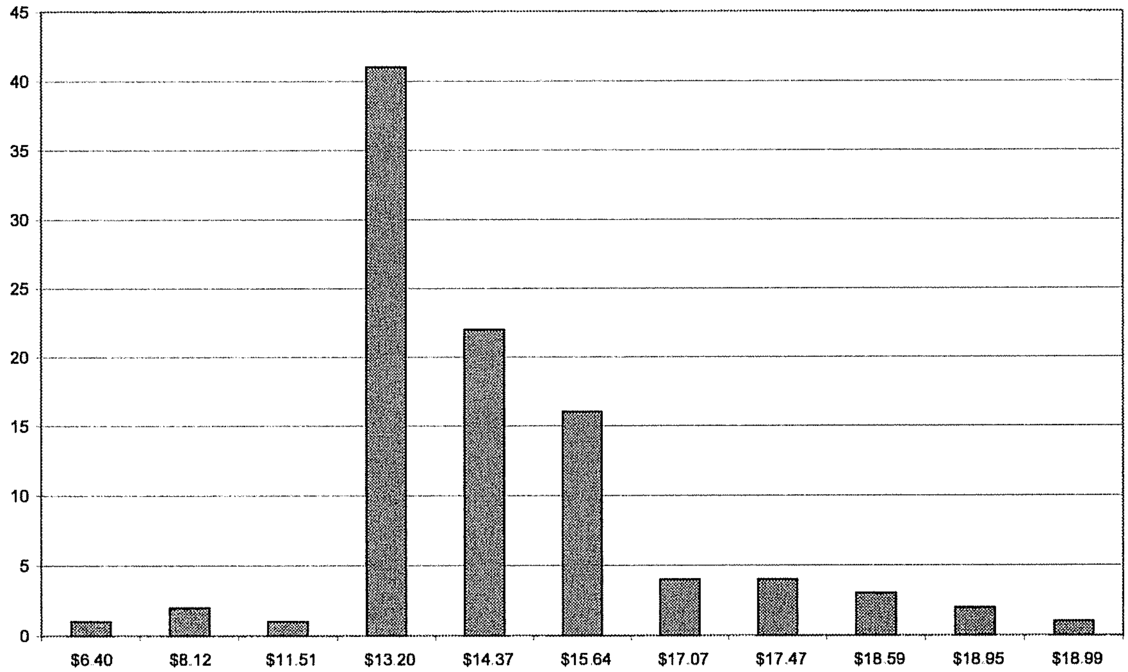
[62] Windstream's Responses and Objections to Verizon's First Requests for Information, Responses to Nos. 9(a)-(b) and 29(a)-(b).

278.544(3). Like Verizon, Windstream can set its all of its retail rates for nonbasic service as it wishes. While some of Windstream's rates are capped as a result of a statutory election it made in 2006, the cap on basic service expires next year – allowing Windstream even greater flexibility.

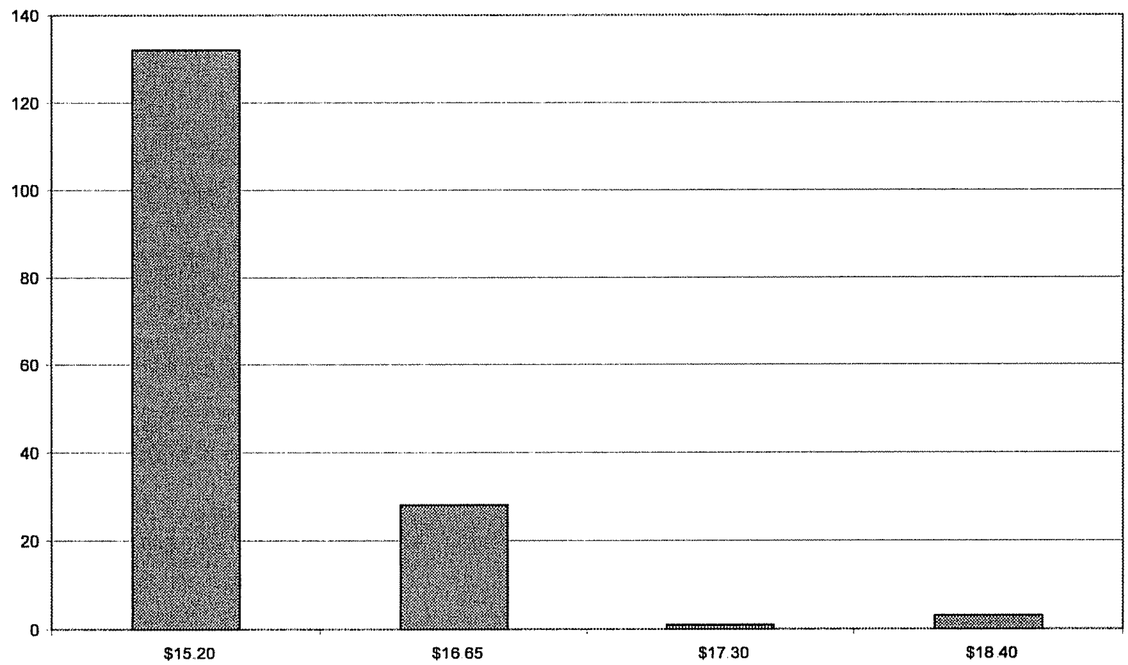
While Windstream should have the discretion to determine which of its retail rates to adjust to ensure recovery of any legitimate costs from its own end users, Verizon notes that Windstream's rates for basic residential services are relatively low and should afford Windstream room to recoup any unrecovered costs. Overall, Windstream's basic residential rates range from a low of $6.40 per month to a high of $18.99 per month. As can be seen in the graph below – the rates in the vast majority of Windstream's exchanges range from $13.20 per month to $15.64 per month. By way of comparison, AT&T's rates for basic residential service are somewhat higher, as depicted below.[63]

[63] Of course, it is possible that other carriers' basic local rates are being subsidized by access charges, as well. So, the fact that some carriers' rates may be lower than Windstream's is not evidence that Windstream lacks rate flexibility or, more importantly, that Windstream's intrastate switched access rates are just and reasonable.

Windstream KY - Monthly Residential Local Service Rates by Number of Exchanges



BellSouth KY - Monthly Residential Local Service Rates by Number of Exchanges



Q. ARE THERE OTHER REASONS WHY IT IS INAPPROPRIATE TO LOOK TO ACCESS CHARGES TO FINANCE WINDSTREAM'S OPERATIONS?

A. Yes. In addition to the fact that Windstream can and should recover a larger portion of its costs from its own end users, Windstream already has other significant sources of funding available to it. In particular, Windstream derives 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*.[64]

A review of the data contained in the Joint Board Monitoring Report shows that Windstream receives millions of dollars a year in federal subsidies. This stream of funding, coupled with Windstream's ability to recover a larger proportion of its costs from its own end users, provide further reasons why the Commission should take action now and reduce the level of access charges that Windstream imposes on interexchange carriers.

V. CONCLUSION

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

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[64] "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).

A. The Commission should order Windstream to (1) remove the NTSRR recovery from its intrastate switched access rates and (2) otherwise reduce its intrastate switched access rates to a level not exceeding those charged by the AT&T for the same service.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.