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August 13, 2010

RECEIVED

AUG 13 2010

PUBLIC SERVICE
COMMISSION

VIA COURIER

Mr. Jeff Derouen
Executive Director
Public Service Commission
211 Sower Boulevard
P.O. Box 615
Frankfort, KY 40602

Re: MCI Communications, Services, Inc., Bell Atlantic Communications, Inc.,
NYNEX Long Distance Company, TTI National, Inc., Teleconnect Long
Distance Services & Systems Company and Verizon Select Services, Inc.,
Complainants v. Windstream Kentucky West, Inc., Windstream Kentucky
East, Inc.-Lexington, and Windstream Kentucky East, Inc.-London,
Defendants
PSC 2007-00503

Dear Mr. Derouen:

Enclosed for filing in the above-captioned case are the original and ten (10)
copies of an Errata Sheet to the Direct Testimony of Dr. Debra J. Aron filed on July 14,
2010, on behalf of BellSouth Telecommunications, Inc., d/b/a AT&T Kentucky and AT&T
Communications of the South Central States, LLC.

Should you have any questions, please let me know.

Sincerely,


Mary K. Keyer

Enclosures

cc: Parties of Record

840478

DR. DEBRA J. ARON

On Behalf of

**BellSouth Telecommunications, Inc., d/b/a AT&T Kentucky
and AT&T Communications of the South Central States, LLC**

**BEFORE THE KENTUCKY PUBLIC SERVICE COMMISSION
Docket No. 2007-00503**

August 13, 2010

ERRATA

Direct Testimony (p.24, fn 24)

²⁴ *FCC CALLS Order*, ¶¶ 30, 32, 56, 162. AT&T Kentucky is subject to the 0.55¢ rate in Kentucky, and Windstream is subject to the 0.55¢ and 0.65¢ rates. See, *FCC CALLS Order*, ¶ 144, 162.; Windstream's May 1, 2007 Annual Access Charge Support Filing, Description and Justification, p. 5; and Windstream's June 16, 2010 Annual Access Charge Support Filing, Transmittal No. 38, Description and Justification, p. 10 and Exhibit 3A.

Direct Testimony (p.25)

5 by the *CALLS Order* to reduce its interstate rates to 0.55¢ per minute. Windstream East,
as a
6 ~~non-rural price cap large ILEC in Kentucky~~ under the *CALLS Order*, was also required to
reduce its
7 interstate rates in Kentucky to 0.55-0.65¢ per minute. Windstream West, as a non-rural
price cap LEC, was required to reduce its interstate rates to 0.65¢.²⁹

²⁹ ~~*FCC CALLS Order*, ¶ 28162; and Order, *In the Matter of Windstream Petition for Conversion to Price Cap Regulation and for Limited Waiver Relief*, before the federal Communications Commission, FCC 08-81 (released March 18, 2008), ¶¶ 2-4, 15-16. Windstream's May 1, 2007 Annual Access Charge Support Filing, Description and Justification, p. 5; and Windstream's June 16, 2010 Annual Access Charge Support Filing, Transmittal No. 38, Description and Justification, p. 10 and Exhibit 3A.~~

CERTIFICATE OF SERVICE – PSC 2007-00503

I hereby certify that a copy of the foregoing was served on the following individuals by mailing a copy thereof, this 13th day of August 2010.

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Complainants v. Windstream Kentucky West, Inc., Windstream Kentucky
East, Inc.-Lexington, and Windstream Kentucky East, Inc.-London,
Defendants
PSC 2007-00503

Dear Mr. Derouen:

Enclosed for filing in the above-captioned case are the original and ten (10)
copies of Rebuttal Testimony of Dr. Debra J. Aron and Dr. Ola A. Oyefusi on behalf of
BellSouth Telecommunications, Inc., d/b/a AT&T Kentucky and AT&T Communications
of the South Central States, LLC.

Should you have any questions, please let me know.

Sincerely,

Mary K. Keyer

Enclosures

cc: Parties of Record

839233

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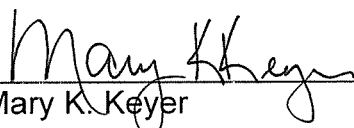
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Mary K. Keyer

COMMONWEALTH OF KENTUCKY

KENTUCKY PUBLIC SERVICE COMMISSION

COUNTY OF Cook

STATE OF Illinois

BEFORE ME, the undersigned authority, duly commissioned and qualified in and for the State and County aforesaid, personally came and appeared Debra Aron, who being by me first duly sworn deposed and said that she is appearing as a witness on behalf of BellSouth Telecommunications, Inc. d/b/a AT&T Kentucky and AT&T Communications of the South Central States, LLC before the Kentucky Public Service Commission in Docket Number 2007-00503, *In the Matter of: MCI Communications Services, Inc., Bell Atlantic Communications, Inc., NYNEX Long Distance Company, TTI National, Inc., Teleconnect Long Distance Services & Systems Company, and Verizon Select Services, Inc., Complainants v. Windstream Kentucky West, Inc., Windstream Kentucky East, Inc.—Lexington and Windstream Kentucky East, Inc.—London, Defendants*, and if present before the Commission and duly sworn, her statements would be set forth in the annexed rebuttal testimony consisting of 29 pages and 0 exhibits.

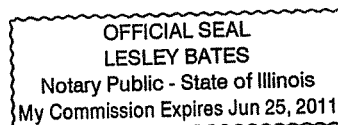


Debra Aron

SWORN TO AND SUBSCRIBED BEFORE ME
THIS 10th DAY OF AUGUST, 2010



Notary Public



My Commission Expires: June 25, 2011

REBUTTAL TESTIMONY OF DR. DEBRA J. ARON

On Behalf of

**BellSouth Telecommunications, Inc., d/b/a AT&T Kentucky
and AT&T Communications of the South Central States, LLC**

BEFORE THE KENTUCKY PUBLIC SERVICE COMMISSION

Docket No. 2007-00503

August 13, 2010

Table of Contents

I. Introduction and Summary of Conclusions1

II. Windstream’s Intrastate Switched Access Rates are Not Just and Reasonable, Contrary to Mr. Caballero’s Incorrect Economic Arguments.....7

III. AT&T’s Access Reform Plan Does not Suffer from the Weaknesses in Verizon’s and Sprint’s Proposals Identified by Mr. Caballero23

IV. Concluding Comments.....29

1 **I. Introduction and Summary of Conclusions**

2 **Q: WHAT IS YOUR NAME?**

3 A: Debra J. Aron.

4 **Q: ARE YOU THE SAME DEBRA J. ARON WHO PROVIDED DIRECT**
5 **TESTIMONY IN THIS PROCEEDING?**

6 A: Yes, I am.¹

7 **Q: WHAT DO YOU ADDRESS IN THIS REBUTTAL TESTIMONY?**

8 A: My comments are directed primarily to the assertions and opinions expressed by
9 Windstream East and Windstream West (hereafter “Windstream companies” or
10 “Windstream”) witness, Mr. Cesar Caballero.² I also comment on the proposals of
11 Verizon³ and Sprint⁴ in the context of Mr. Caballero’s testimony regarding those
12 proposals.

13 Mr. Caballero’s conclusions are based primarily on legal argument. He claims that the
14 Commission does not have the authority to reform Windstream’s intrastate access rates
15 because under Windstream’s price cap plan the rates are deemed just and reasonable as a
16 matter of law.⁵ I understand that the Commission has already rejected this argument⁶

¹ Direct Testimony of Dr. Debra J. Aron filed July 14, 2010, (hereafter *Aron Direct*).

² Direct Testimony of Cesar Caballero filed July 14, 2010, (hereafter *Caballero Direct*).

³ Prefiled Direct Testimony of Don Price filed on July 14, 2010, (hereafter *Price Direct*).

⁴ Direct Testimony of James A. Appleby filed on July 14, 2010, (hereafter *Appleby Direct*).

⁵ *Caballero Direct*, p. 5.

⁶ Order, *In the Matter of MCI Communications Services, Inc., Bell Atlantic Communications, Inc., NYNEX Long Distance Company, TTI National, Inc., Teleconnect Long Distance Services & Systems Company and Verizon Select Services, Inc., v. Windstream Kentucky West, Inc., Windstream Kentucky East, Inc. – Lexington and*

1 and, not being a lawyer, I have no comment on it. Mr. Caballero also offers some non-
2 legal, conceptual arguments attempting to refute Verizon's conclusions that
3 Windstream's intrastate switched access rates are not in the public interest. My
4 testimony describes why, on the basis of standard economic principles as well as analysis
5 of industry data, Mr. Caballero's conceptual arguments and conclusions are incorrect, and
6 why Windstream's intrastate switched access rates are excessive and should be reduced.
7 I also explain the differences between AT&T's proposal and those of Verizon and Sprint,
8 and why the objections levied by Mr. Caballero at Verizon's proposal do not apply to
9 AT&T's proposed holistic access reform plan.

10 **Q: DO YOU HAVE ANY GENERAL OBSERVATIONS ABOUT THE TESTIMONY**
11 **PROVIDED IN THIS PROCEEDING THUS FAR?**

12 A: Yes, I do. All witnesses appear to agree that Windstream's intrastate switched access
13 rates contain subsidy elements not associated with the cost of providing switched access
14 service.⁷ In my Direct Testimony, I explained why subsidy-laden intrastate access rates
15 harm consumers by increasing intrastate long distance prices to levels that artificially and
16 inefficiently discourage wireline long distance usage in favor of other communications
17 technologies, and inefficiently distort investment in broadband and long distance
18 infrastructure in Kentucky.⁸ In addition, I provided extensive empirical analysis of actual
19 data across 50 states and several years of the relationship between intrastate switched

Windstream Kentucky, East Inc. – London, before the Public Service Commission, Commonwealth of
Kentucky, Case No. 2007-00503, January 17, 2008.

⁷ *Caballero Direct*, p. 30 (discussing the implicit subsidies within the CCL and NTSRR charges); *Price Direct*, p.
13 (describing the lack of cost basis for the NTSRR); *Appleby Direct*, p. 2 (opining that access rates have
embedded subsidies).

⁸ *Aron Direct*, Section VI.

1 access rates and intrastate long distance prices. I showed that access charges are directly
2 correlated with long distance prices to consumers: higher intrastate switched access rates
3 translate into higher intrastate long distance prices, while lower intrastate access rates
4 translate into lower intrastate long-distance prices. I documented the rate disparity
5 between wireless call termination rates within a Major Trading Area (“MTA”) and
6 wireline long distance termination (i.e., access) rates for the same functionality and noted
7 that this rate disparity would translate into a cost and price differential that provided an
8 artificial competitive advantage to wireless service over wireline long distance service in
9 Kentucky.⁹ I provided references to empirical research in the professional economics
10 literature that documents the effect of above-cost access charges on substitution by
11 consumers between wireline long distance and competing technologies that are driven by
12 nothing other than a pricing inefficiency.¹⁰ In sharp contrast to the economic evidence
13 supporting my testimony, Windstream’s Mr. Caballero makes conclusory statements with
14 no *evidence* that would challenge my conclusions.

15 In fact, while Windstream’s witness offers some erroneous and, as I will explain, easily
16 refuted arguments to supplement his legal conclusion that Windstream’s current rates are
17 “just and reasonable,” I believe it is a fair reading of Mr. Caballero’s testimony that
18 Windstream’s real objection is that Verizon’s proposal fails to provide for a source of
19 revenues to offset the revenues that would be forgone due to access reform. Windstream
20 is correct that sound access reform policy should be holistic. That is, the reform plan

⁹ *Aron Direct*, pp. 52-53.

¹⁰ *Aron Direct*, p. 54.

1 should provide an opportunity for appropriate revenue replacement in light of the
2 historical regulatory tradeoff that led to the currently-excessive access rates, as I
3 explained in my Direct Testimony.¹¹ AT&T's witness Dr. Ola Oyefusi provides in his
4 Direct Testimony a roadmap for a comprehensive reform that, in fact, would provide
5 Windstream (and other local carriers) the opportunity to replace the revenues lost as a
6 result of ordered reductions in intrastate switched access rates.¹² Holistic reform should
7 also encompass the other local exchange carriers ("LECs") in Kentucky and, therefore,
8 this proceeding should establish a framework for statewide reform to follow.

9 In addition, I observe as a general matter that Windstream offers several criticisms of
10 Verizon's proposal to reduce Windstream's intrastate switched access rates to the level of
11 AT&T Kentucky's intrastate access rates. These arguments do not apply to AT&T's
12 proposal, which is to reduce Windstream's intrastate access rates to *Windstream's own*
13 *interstate access rates*.

14 Finally, I note that Windstream devotes over a page of testimony to describing the costs
15 that it incurs to engage in this regulatory proceeding.¹³ While I do not minimize the
16 burden that regulatory proceedings place on all regulated carriers, I would note that
17 Windstream itself calculates that the amount of access revenues at issue in this
18 proceeding to be on the order of \$27 million¹⁴ (or \$26 million by Dr. Oyefusi's estimate

¹¹ *Aron Direct*, pp. 66-67.

¹² See Direct Testimony of Dr. Ola A. Oyefusi filed July 14, 2010, (hereafter *Oyefusi Direct*), Section IV.

¹³ *Caballero Direct*, pp. 6-7.

¹⁴ *Caballero Direct*, p. 40 (Mr. Caballero's computation is based on Verizon's plan).

1 of the revenues at issue under AT&T's proposal¹⁵), which are dollars that are today
2 largely coming out of the pockets of wireline long distance customers in Kentucky. The
3 focus of this proceeding should be on the public interest, not the Parties' interests. The
4 resource costs claimed by Windstream in its testimony pale in comparison to the amount
5 of money at stake to residents in this state. Certainly the inefficient subsidies of tens of
6 millions of dollars that are being paid by a subset of the state's residents, so burdened
7 only because of their choice of long distance technology, should be a cause of regulatory
8 attention and correction.

9 **Q: DR. ARON, PLEASE SUMMARIZE THE CONCLUSIONS OF YOUR**
10 **REBUTTAL TESTIMONY.**

11 **A:** From an economic standpoint, contrary to the assertions of Mr. Caballero, Windstream's
12 current intrastate switched access rates are not just and reasonable. Mr. Caballero's
13 argument that the competitiveness of the long distance industry itself is an indication of
14 the justness and reasonableness of access rates is incorrect: one cannot determine the
15 justness and reasonableness of access rates by observing current levels of wireline long
16 distance competition. In fact, competitive market forces do not affect intrastate switched
17 access prices. This is precisely why regulation of these prices is necessary and in the
18 public interest. The implicit subsidies in Windstream's intrastate access rates harm
19 consumers directly (through higher intrastate wireline long distance rates) and indirectly
20 (by their distorting effect on wireline and broadband investment incentives). Reducing
21 those access rates is in the public interest. This would include moving to zero the Non-
22 Traffic Sensitive Revenue Requirement ("NTSRR"), because costs of the loop are not

¹⁵ *Oyefusi Direct*, Exhibit OAO-7.

1 caused by access service and are not properly recovered from access rates. Subsidies that
2 are currently embedded in Windstream’s intrastate switched access rates should be
3 recovered from Windstream’s end users and, the Commission deems it unacceptable to
4 increase Windstream’s retail rates sufficiently to recover access revenues that would be
5 foregone when intrastate switched access rates are reduced to interstate levels,
6 supplemented by revenues in the form of an explicit subsidy from a state Universal
7 Service fund.

8 Mr. Caballero lodges a number of criticisms against the access reform plans proposed by
9 Verizon and Sprint. AT&T’s plan differs from Verizon and Sprint’s proposals in ways
10 that precisely eliminate Mr. Caballero’s criticisms of these plans.

11 Verizon proposes to limit Windstream’s intrastate switched access rates to the intrastate
12 rates of AT&T Kentucky. In contrast, AT&T (and Sprint¹⁶) propose to require
13 Windstream (and all LECs) to limit intrastate switched access rates to their own interstate
14 levels—rates that were determined after a lengthy, industry-wide proceeding, and which
15 the LECs are already charging for the same service in the interstate jurisdiction—not to
16 the access rates of AT&T Kentucky or any other LEC. In addition, AT&T’s plan
17 considers access reform holistically, and therefore incorporates a specific proposal to
18 provide Windstream the opportunity to recover forgone access revenues. Unlike the
19 proposals of Verizon and Sprint, AT&T’s proposal recognizes the regulatory context of
20 Universal Service in which the current access rates were set, by providing for the

¹⁶ *Appleby Direct*, p. 12.

1 possibility of draws from a state Universal Service fund if the Commission deems
2 recovery entirely from retail rate increases to be unacceptable in the near term.

3 **Q: WHAT IS THE ORGANIZATION OF YOUR REBUTTAL TESTIMONY?**

4 A: In Section II, I respond to Mr. Caballero’s conceptual (as opposed to legal) arguments in
5 support of his claim that Windstream’s intrastate switched access rates are just and
6 reasonable, explaining why his arguments have no economic merit. In Section III, I
7 compare and contrast the proposals put forward by AT&T, Verizon, and Sprint with
8 regard to Windstream’s intrastate switched access rates. I show why AT&T’s plan
9 provides a reasoned and reasonable path to comprehensive access reform that should be
10 adopted in this proceeding and extended to other Kentucky LECs in a subsequent
11 proceeding. Section IV contains my concluding comments.

12 **II. Windstream’s Intrastate Switched Access Rates are Not Just and Reasonable,**
13 **Contrary to Mr. Caballero’s Incorrect Economic Arguments**

14 **Q: MR. CABALLERO ASSERTS THAT BECAUSE WINDSTREAM EAST AND**
15 **WINDSTREAM WEST HAVE ELECTED TO OPERATE UNDER THE**
16 **ALTERNATIVE REGULATION PROVISIONS OF THE KENTUCKY**
17 **STATUTE, THEIR RATES ARE BY LAW “JUST AND REASONABLE.”¹⁷**
18 **PLEASE COMMENT.**

19 A: I cannot comment on what the statute permits and does not permit the Commission to do
20 in this proceeding, but as a matter of economics and public policy, Windstream’s
21 intrastate access rates are not just and reasonable. This is because by reducing
22 Windstream’s intrastate switched access rates to their interstate levels, the Commission

¹⁷ *Caballero Direct*, p. 5.

1 could improve economic efficiency, make business and residential customers of intrastate
2 long distance services in Kentucky better off, reduce economic distortions to competition
3 between technology platforms, reduce distortions to investment decisions in traditional
4 and broadband infrastructure, reduce wasteful arbitrage, and reduce the inequities
5 inherent in a system in which some customers are required to subsidize others merely on
6 the basis of the technology they use for long distance service, or on the basis of where
7 they live. Moreover, under AT&T's proposal, the Commission could accomplish all of
8 this while providing for appropriate opportunities for revenue recovery for Windstream.
9 Under these circumstances, the current rates cannot be deemed just and reasonable from
10 an economic or public policy standpoint.

11 **Q: IS IT NECESSARY FOR THE COMMISSION TO ANALYZE WINDSTREAM'S**
12 **PROFITABILITY IN THIS PROCEEDING?**¹⁸

13 A: No. What is of central relevance in this proceeding is not Windstream's level of profits
14 or overall revenues, but who is paying for them. Today, Windstream is earning
15 significant revenues from excessive, subsidy-laden access rates that are being paid for not
16 by Windstream's own customers, but largely—for no sound economic or policy reason
17 but just as an artifact of regulatory history—by wireline long distance providers and their
18 customers. There is no justification for Windstream to continue to receive large subsidy
19 revenues from certain Kentucky residents and businesses just because they happen to be
20 wireline long distance customers.

21 As I explained in my Direct Testimony (and as Sprint and Verizon agree), the most
22 economically efficient rate structure is one in which the LEC recovers its costs of

¹⁸ It appears that Sprint makes this suggestion. See, *Appleby Direct*, p. 26.

1 providing local exchange service from its own local exchange customers, via retail
2 prices.¹⁹ This is why Verizon,²⁰ Sprint,²¹ and AT&T advocate that as a first principle, the
3 most efficient way to recoup forgone access revenue is by increasing retail prices. If the
4 Commission believes, however, that immediately increasing retail local exchange prices
5 to levels that would fully rebalance the forgone access revenues would be unacceptable, it
6 would be sound public policy to allow Windstream to increase rates to a benchmark level
7 that the Commission deems reasonable and rely on a Kentucky Universal Service fund to
8 provide support for the remaining reduction in access revenues. The reason is that the
9 subsidy burden, to the extent that one will remain, should not fall disproportionately and
10 predominantly on customers of wireline long distance service, as excessive switched
11 access charges do; rather, it should be spread as broadly as possible and borne by all
12 telecommunications customers in the state, as it would if funded by a Kentucky Universal
13 Service fund. Wireline long distance service has long ago ceased to be the only
14 significant technology for providing telecommunications over long distances. Spreading
15 the remaining burden (i.e., that which remains after the Commission has permitted
16 Windstream to increase its retail prices as much as the Commission deems acceptable) to
17 all telecommunications customers in the state will help correct the competitive distortion
18 of imposing the subsidy largely on the customers of wireline long distance customers,
19 increasing the ability of different telecommunications technologies to compete on their
20 merits, to the benefit of consumers.

¹⁹ *Aron Direct*, p. 67.

²⁰ *Price Direct*, p. 43.

²¹ *Appleby Direct*, p. 18.

1 Hence, in this proceeding the Commission should focus on correcting harmful
2 inefficiencies in the rate *design*, by reducing the implicit subsidies embedded in intrastate
3 switched access rates and converting them either to efficient cost recovery via retail
4 prices, or to explicit subsidies. In this way, the Commission can be assured of increasing
5 overall customer welfare in Kentucky, decreasing incentives for wasteful arbitrage, and
6 reducing distortions in the incentives to invest in telecommunications and broadband
7 infrastructure, as I explained in my Direct Testimony,²² without necessitating any
8 contentious inquiry of profitability in this proceeding.

9 **Q: OTHER THAN HIS LEGAL ASSERTIONS, MR. CABALLERO'S CENTRAL**
10 **ARGUMENT AGAINST REDUCING WINDSTREAM'S INTRASTATE**
11 **SWITCHED ACCESS RATES APPEARS TO BE THE FOLLOWING CLAIM:**
12 **"IF THE LONG DISTANCE MARKET IS ALREADY COMPETITIVE AS**
13 **VERIZON AGREES THAT IT IS, THEN THERE SHOULD BE NO DOUBT**
14 **THAT THE EXISTING SWITCHED ACCESS RATES PAID BY THE LONG**
15 **DISTANCE CARRIERS TO COMPETE IN THAT MARKET ARE JUST AND**
16 **REASONABLE."**²³ **IS THIS A SOUND ECONOMIC ARGUMENT?**

17 A: No, it is an economic *non sequitor*. One cannot draw any conclusion about the merits of
18 access prices by observing the competitiveness of the wireline long distance industry.
19 More generally, one cannot draw any conclusions about whether the prices of any inputs
20 into production of a product *X* are reasonable by observing whether the market for the
21 product *X* is competitive. The "competitiveness" of an industry refers to the industry
22 structure and the opportunities for earning above-normal profits in that industry. A
23 competitive industry is generally one in which the vigor of rivalry among the firms in the
24 market and/or the existence of potential competitors tend to erode profits of the market

²² *Aron Direct*, Section VI.

²³ *Caballero Direct*, p. 9.

1 participants in a relatively short period of time. The long distance marketplace consists
2 of numerous providers, using a variety of technologies, including some that are relatively
3 new entrants (such as VoIP). There are alternative technologies (such as IM, email, and
4 social networking) that also may discipline prices for long distance services. All of this
5 underlies the fact that it is generally understood that wireline long distance service is
6 provided in highly competitive markets.

7 None of these criteria that describe a competitive market relates to whether the costs that
8 some (or all) providers of long distance services incur to provide the service are just and
9 reasonable, efficient, or cost-based. The access rates that long distance providers pay are
10 not determined in the long distance market, but rather are determined by the market for
11 that input or, in this case, by regulators. Prices for access service constitute an input cost
12 to long distance providers. The fact that some providers pay excessive prices for that
13 input puts those providers at a competitive disadvantage *vis à vis* their rivals in the long
14 distance market, but does not imply that the long distance market is not competitive.
15 Conversely, the fact that the long distance market is competitive provides no information
16 as to whether the price of access is just and reasonable.

17 As an analogy, consider the competition between trucking companies in the provision of
18 freight transport services. That industry may be extremely competitive even if all of the
19 truckers must pay an excessive toll to cross the only bridge that spans a river. The
20 excessive bridge toll would cause the price of freight services to be higher than it
21 otherwise would be, harming customers of the trucking service. But the existence of the
22 excessive toll bears no relation to whether the trucking companies vigorously compete
23 with each other. If they do, economic principles tell us that the price of freight services

1 will be driven down to the point where the trucking companies' economic profits are
2 eroded toward zero, taking into account the costs they incur to pay the bridge tolls. That
3 means that the price will fully reflect and recover from customers the bridge toll and all
4 other costs of operation, including a normal return to the owners, but would provide little
5 or no additional profit. This is the result of the competitive process. The excessive
6 bridge toll does not make the freight market less competitive; rather, the fact that the
7 freight market is competitive only ensures that consumers of freight services bear the full
8 brunt of the excessive bridge toll.

9 Now suppose that the trucking companies compete with railroads, who (let us assume)
10 pay no bridge toll to cross the river. The trucking companies will suffer a competitive
11 disadvantage *vis à vis* railroads owing to the excessive bridge fee and trucking will
12 thereby be artificially discouraged relative to rail. But this does not imply that the freight
13 transport marketplace is not competitive, or even that the trucking companies will not
14 survive along with rail in that competition. What is clear is that trucking will not perform
15 as well in the market in competition with railroads as it would if trucking companies were
16 permitted to compete entirely on their relative merits. Even if freight customers
17 recognized *bona fide* differences between trucking and trains that favored train hauling
18 services in many circumstances, the additional burden of the toll on the truckers would
19 create a discriminatory cost and pricing inefficiency that would encourage those using
20 hauling services to favor trains over trucks even more than they otherwise would if prices
21 were not artificially increased for trucking. Hence, again, the competitiveness of the
22 market only ensures that consumers of trucking services bear the full brunt of the
23 excessive bridge tolls, and the excessive toll rate further harms customers by

1 discouraging them from opting for trucking services in circumstances when, at more
2 efficient prices, it would be their first choice.

3 The current access regime similarly causes competitive distortions and consumer harms
4 because it discriminates among technologies. The above-cost access rates apply
5 differentially across technologies, as I described in my Direct Testimony, placing
6 wireline long distance providers at a competitive disadvantage in the (competitive)
7 marketplace.²⁴ The fact that they operate in a competitive market in no way exonerates
8 the access rates that wireline long distance companies pay; it only ensures that consumers
9 of wireline long distance service bear the full burden of the excessive access prices
10 through higher retail prices.

11 **Q: MR. CABALLERO FURTHER ARGUES THAT “THE WINDSTREAM RATES**
12 **SIMPLY CANNOT BE UNJUST AND UNREASONABLE IF THE LONG**
13 **DISTANCE CARRIERS PAYING THOSE RATES, INCLUDING VERIZON,**
14 **SPRINT, AND AT&T, ARE SUCCESSFULLY COMPETING IN THE**
15 **MARKETPLACE.”²⁵ IS THIS CORRECT?**

16 **A:** No. Not only is this reasoning incorrect as a matter of economic principle, as I just
17 explained, but it demonstrates a remarkable misunderstanding of the state of the long
18 distance marketplace and what has transpired in it over the last decade. Rather than
19 “successfully competing in the marketplace,” the wireline long distance industry has been
20 crushed by competition from wireless, VoIP, and other communications technologies.

21 According to the FCC, interstate switched access minutes, a measure of wireline long
22 distance calling, increased steadily by about 6.8 billion minutes per year every year from

²⁴ *Aron Direct*, Section VI.C.

²⁵ *Caballero Direct*, p. 9.

1 about 38 billion minutes in 1984 to over 140 billion minutes by January 2000. But, after
2 January 2000, access minutes *decreased* by 6.7 billion per year each year until by year-
3 end 2008 (latest available data), local wireline carriers were terminating fewer than 90
4 billion access minutes—39 percent lower than the January 2000 level.²⁶ These industry-
5 changing declines are not the result of overall declines in demand for communications
6 services—on the contrary, they have occurred during a period of enormous growth in
7 communications connectivity, including extraordinary growth in wireless and VoIP
8 services.²⁷

9 The decline of wireline long distance service during the past decade has been enough to
10 cause a structural shift in the stand-alone wireline long distance industry, creating the
11 imperative for providers to offer bundled local and long distance services for many
12 customers, and resulting in the acquisition of the largest (AT&T) and second-largest
13 (MCI/WorldCom) long distance providers of those services by local exchange companies
14 at small fractions of their prior market values. Mr. Caballero’s assertion that wireline
15 long distance service is competing successfully in the market, and his argument that such
16 competition is evidence that access rates are just and reasonable, are truly out of touch
17 with the realities of the marketplace changes in the last decade.

²⁶ See, “Local Telephone Competition: Status as of December 31, 2008,” Federal Communications Commission, Industry Analysis and Technology Division, Wireline Competition Bureau, June 2010, (hereafter *Locom 2008*), Table 10.1.

²⁷ See, for example, “Annualized Wireless Industry Survey Results - December 1985 To December 2009,” in CTIA’s Semi-Annual Wireless Industry Survey, 2010; and “High-Speed Services for Internet Access: Status as of December 31, 2008,” Federal Communications Commission, Industry Analysis and Technology Division, Wireline Competition Bureau, February 2010, Table 14 (regarding wireless subscription growth); and *Locom 2008*, Table 8 (regarding VoIP subscription).

1 **Q: IS THE DECLINE OF THE WIRELINE LONG DISTANCE INDUSTRY**
2 **ATTRIBUTABLE SOLELY TO THE ACCESS RATE REGIME?**

3 A: No. The decline in demand for wireline long distance service in favor of wireless, VoIP,
4 and other technologies is not attributable solely to access rate distortions. However, the
5 access rate pricing distortions contributed to the decline, and harmed consumers, as I
6 elaborated in my Direct Testimony,²⁸ by artificially elevating the price of wireline long
7 distance service above what it would be if access rates did not contain those subsidies,
8 and thereby exacerbating any downward trend that would have occurred had wireline
9 long distance been competing with other technologies solely on its own merits.

10 **Q: MR. CABALLERO CLAIMS THAT THE WINDSTREAM COMPANIES HAVE**
11 **LOWER SWITCHED ACCESS RATES THAN ALL OTHER RURAL LECs IN**
12 **KENTUCKY.²⁹ IF TRUE, IS THIS EVIDENCE THAT WINDSTREAM'S**
13 **ACCESS RATES ARE NOT EXCESSIVE?**

14 A: No, it is not. It is evidence that the Commission should follow up this proceeding with a
15 generic proceeding to reform the intrastate switched access rates of all LECs in Kentucky
16 so that all LECs are required to limit their intrastate access rates to their own interstate
17 levels. It does not diminish the fact, which I demonstrated in my Direct Testimony, that
18 Windstream's intrastate switched access rates are blatantly excessive.³⁰ As I showed in
19 my Direct Testimony, Windstream's intrastate access rates are far in excess of its own
20 interstate access rates, which are the rates it charges for the same service in the interstate
21 jurisdiction.³¹ In fact, Windstream's intrastate access rates are so far in excess of its

²⁸ *Aron Direct*, Section VI.

²⁹ *Caballero Direct*, p. 13.

³⁰ *Aron Direct*, Section V.

³¹ *Aron Direct*, pp. 28-30.

1 interstate rates that reforming Windstream's intrastate rates alone would be expected to
2 return tens of millions of dollars to Kentucky consumers of long distance services.³² In
3 addition, it does not diminish the fact that, as I also documented in my Direct Testimony,
4 a substantial portion of AT&T Communications' access expenses in Kentucky are
5 accounted for by Windstream's access rates.³³

6 **Q: MR. CABALLERO SPECULATES THAT VERIZON "MAY BE"**
7 **TERMINATING MORE ACCESS MINUTES TO CARRIERS THAT CHARGE**
8 **HIGHER SWITCHED ACCESS RATES THAN WINDSTREAM'S RATES THAN**
9 **IT IS TERMINATING TO WINDSTREAM.³⁴ DOES THIS FACT, IF TRUE,**
10 **IMPLY THAT WINDSTREAM'S RATES ARE NOT EXCESSIVE, AS MR.**
11 **CABALLERO CLAIMS?**

12 A: No, it does not. Mr. Caballero offers no explanation or theory as to why this fact, if it is
13 true, would relate in any way to whether Windstream's access rates are excessive.
14 Verizon, like all long distance providers, has no choice over the LEC to which it will
15 terminate any given call. If Verizon's long distance customer calls a local exchange
16 customer of Windstream, Verizon must terminate that call to Windstream, regardless of
17 what access charges Windstream assesses. If Verizon's long distance customer calls a
18 customer of Coalfields Telephone Company in Grethel, Verizon must terminate that call
19 to Coalfields, regardless of the access rates that Coalfields charges. Moreover, because

³² *Oyefusi Direct*, Exhibit OAO-7 (estimating \$26 million in forgone access revenues if AT&T's plan is adopted); *Caballero Direct*, p. 40 (estimating \$27 million in forgone access revenues if Verizon's plan is adopted). These are both static analyses that do not account for the declining trend in access minutes, the elasticity of demand for long distance services, or other factors. But they do provide an estimate of the order of magnitude of the benefits that would be expected to flow through to customers of all wireline intrastate long distance providers in Kentucky.

³³ More specific, confidential information about the portion of AT&T Communications' access expenses in Kentucky that are accounted for by Windstream's access rates is provided in the confidential version of my Direct Testimony at footnote 55.

³⁴ *Caballero Direct*, pp. 10-11.

1 of retail rate averaging rules imposed by the FCC,³⁵ Verizon's customers would not pay
2 any different price for their intrastate long distance call whether they call a Coalfields
3 customer or a Windstream customer. Hence, the Verizon customer has no incentive to
4 avoid making calls to friends and associates who happen to be customers of LECs that
5 charge high access rates. Therefore, if Verizon is terminating more calls to other LECs
6 with even higher switched access rates than it is terminating to Windstream, that is only
7 because its customers are calling customers of those other LECs more frequently.
8 Verizon has no control over this, and its customers have no incentive to change it. The
9 pattern of calling across LECs is not caused by differences in the access rates they charge
10 and therefore can imply nothing about whether the access rates of any LECs are just and
11 reasonable.

12 **Q: IS THERE ANY USEFUL INFORMATION THAT THE COMMISSION CAN**
13 **GLEAN FROM MR. CABALLERO'S DISCUSSION OF VERIZON'S**
14 **INTRASTATE TERMINATING MINUTES?**

15 **A:** Yes. Mr. Caballero's discussion provides additional confirmation that the excessive
16 access charge problem is not localized solely to Windstream, but instead affects many
17 local carriers in the state, and that the problem is material insofar as a long distance
18 provider such as Verizon purchases substantial, excessively priced volumes of intrastate
19 access minutes from assorted local carriers in the state. If anything, this points to the
20 regulatory imperative to follow this proceeding with a more generalized intrastate access

³⁵ Report and Order, *Policy and Rules Concerning the Interstate, Interexchange Marketplace and Implementation of Section 254(g) of the Communications Act of 1934, as amended*, before the Federal Communications Commission, CC Docket No. 96-61, FCC 96-331, (released August 7, 1996), ¶¶ 7, 9, and 42.

1 reform proceeding to address the intrastate switched access rates of other LECs in
2 Kentucky.

3 **Q: MR. CABALLERO OFFERS SEVERAL ARGUMENTS IN REPLY TO**
4 **VERIZON'S PROPOSAL TO ELIMINATE WINDSTREAM'S NTSRR.³⁶ DO**
5 **YOU AGREE WITH VERIZON THAT WINDSTREAM'S NTSRR SHOULD BE**
6 **REDUCED TO ZERO, AS MR. PRICE PROPOSES?³⁷**

7 A: Yes, I do. Windstream admits that those rates recover loop costs only.³⁸ Loop costs are
8 not caused by access service and therefore should not be recovered in the price of access
9 services.

10 **Q: MR. CABALLERO ARGUES THAT LOOP "FUNCTIONS" SHOULD BE**
11 **INCLUDED IN SWITCHED ACCESS RATES BECAUSE THEY ARE "USED TO**
12 **PROVIDE SWITCHED ACCESS SERVICE."³⁹ IS THIS A VALID ARGUMENT?**

13 A: No. Loop costs should not be recovered as part of access rates. When a long distance
14 provider purchases switched access service, the functionality provided is call origination
15 or termination, which involves only the switch and transport network facilities. The
16 economic costs of providing those functions do not include costs of the loop. The costs
17 of the loop are independent of the usage on the loop, and, most important, are *dedicated*
18 *to a particular customer*. Therefore, the economically efficient way to recover the costs
19 of the loop is in the form of a *flat rate*, paid by the customer *to whom the loop is*
20 *dedicated*. The fact that the consumer uses the loop when making long distance calls
21 does not alter this result and provides no justification for a subsidy imposed on long
22 distance providers to support the loop.

³⁶ *Caballero Direct*, Section III.C.

³⁷ *Price Direct*, p. 46.

³⁸ *Caballero Direct*, p. 19.

³⁹ *Caballero Direct*, p. 19.

1 Mr. Caballero's argument that loop costs should be recovered from long distance
2 customers because loops are "used to provide" switched access service is essentially the
3 same as arguing that, because long distance customers require the use of a handset
4 (paraphrasing Mr. Caballero's logic) in order to place or receive a long distance call, long
5 distance companies should subsidize the customer's handset. Following this flawed
6 logic, handset manufacturers might argue that long distance companies require the use of
7 the handset to provide their service, so long distance companies should be required to pay
8 a fee to the handset manufacturer for every minute of long distance usage to help recover
9 the costs of the handset. Their argument would be that if long distance companies (and,
10 for the same reasons, local exchange companies) are not required to pay a fee to handset
11 manufacturers for every minute of a long distance or, respectively, local call made using
12 that handset, the service providers are getting a free ride—after all, the call cannot be
13 made without the use of the handset and the cost of the handset is a "shared" cost
14 between local and long distance service.

15 The fallacy in this argument is the same one as the fallacy in Mr. Caballero's assertions
16 regarding the loop: the cost of *furnishing* a handset, like the cost of furnishing a loop, is
17 independent of the *usage* of the handset, and the handset is *dedicated* to a particular
18 household. The efficient recovery of the cost of the handset is that the customer pays a
19 flat (not usage-sensitive) price for it to the company that built the handset, and uses it for
20 as much or as little service as she likes—however much she may use local or long
21 distance service. There would be no justification for requiring long distance providers to
22 pay a per minute fee to Panasonic or Motorola for the recovery of handset costs based on

1 how much their customers use the handset for long distance service. The same principles
2 hold for recovery of the costs of furnishing the loop.

3 **Q: DO ECONOMISTS AGREE WITH YOU THAT LOOP COSTS ARE NOT**
4 **ATTRIBUTABLE TO SWITCHED ACCESS SERVICE?**

5 A: Yes. The debate over this issue was effectively put to bed well over a decade ago by
6 renowned regulatory economist Alfred Kahn and co-author William Shew:

7 Using the price of telephone calls to recover access costs that do not in
8 fact vary as more or fewer calls are made... induces wasteful choices by
9 customers. It encourages them to order underpriced access lines that they
10 value less than the incremental costs to society of providing the lines, and
11 it discourages them from making overpriced calls whose value to them
12 would have exceeded the incremental cost to society. The same result
13 would follow if an electric utility were to supply its customers with all the
14 appliances they wanted at no charge and recovered the costs in the price of
15 electricity -- wasteful overpurchasing of appliances and underconsumption
16 of electricity.⁴⁰

17 **Q: DOES THE FCC AGREE WITH YOU THAT LOOP COSTS ARE NOT**
18 **ATTRIBUTABLE TO SWITCHED ACCESS SERVICE?**

19 A: Yes, the FCC long ago rejected the argument posited by Mr. Caballero. As early as 1982,
20 the FCC established the goal of recovering non-traffic-sensitive loop costs through flat
21 rates to end-users:

22 A subscriber who obtains a line to a local dial switch or a manual
23 switchboard necessarily obtains access to interstate as well as local
24 services. The cost of that access has traditionally been described as non-
25 traffic sensitive because such costs do not vary with usage. A subscriber

⁴⁰ Alfred E. Kahn and William B. Shew, "Current Issues in Telecommunications Regulation: Pricing," *Yale Journal on Regulation* 4 (Spring 1987), p. 202. (Footnotes omitted.) See also, David L. Kaserman and John W. Mayo, "Cross-Subsidies in Telecommunications: Roadblocks on the Road to More Intelligent Telephone Pricing," *Yale Journal on Regulation* 11 (Winter 1994), p. 125; ("Efficient (and intelligent) telephone pricing therefore requires a two part tariff. A fixed monthly charge, independent of usage, should recover the fixed costs of providing customer access to the network. A usage based charge for both local and long distance services equal to the marginal costs of the respective services would recover usage sensitive costs.")

1 who does not use the subscriber line to place or receive calls imposes the
2 same NTS costs as a subscriber who does use the line. A subscriber who
3 does not make local calls would normally pay a flat fee for the exchange
4 portion of such costs. Imposing a flat charge for the interstate portion of
5 those costs is equally reasonable. Any other procedure violates the
6 general principle that costs should be recovered from the cost-causative
7 ratepayer whenever it is possible to do so.⁴¹

8 **Q: WHAT ARGUMENTS DOES WINDSTREAM OFFER FOR WHY THE NTSRR**
9 **SHOULD NOT BE ELIMINATED?**

10 A: Windstream’s witness Mr. Caballero offers three arguments, none of which has merit.

11 First, Mr. Caballero argues that Verizon is wrong in its claim that the NTSRR was
12 intended to recover for functions associated with implementing equal access. Mr.
13 Caballero claims that the NTSRR was really intended to recover loop costs.⁴² Whether
14 Windstream or Verizon is correct on this point is irrelevant, however, because in either
15 case the charge was admittedly not intended to cover ongoing costs that are caused now
16 by the provision of access. Hence, the NTSRR should be eliminated from the access
17 regime and the revenues recovered from end users or via an explicit subsidy mechanism,
18 as AT&T proposes.

19 Second, Mr. Caballero argues that Windstream’s assessment of the NTSRR is “in line”
20 with all other rural local exchange carriers (“RLECs”) in Kentucky.⁴³ If this is true,
21 however, it merely reinforces the need for the Commission to engage in state-wide access
22 reform with deliberate speed, as AT&T has suggested in its petition filed separately from

⁴¹ Third Report and Order, *In the Matter of MTS and WATS Market-Structure*, Before the Federal Communications Commission, CC Docket No. 78-72, Phase I, FCC 82-579, (released February 28, 1983), ¶ 121.

⁴² *Caballero Direct*, p. 19.

⁴³ *Caballero Direct*, p. 20.

1 this proceeding.⁴⁴ The fact that consumers are being harmed by excessive access rates of
2 all RLECs hardly justifies perpetuating those rates by any one carrier.

3 Third, Mr. Caballero observes that Verizon has failed to acknowledge that when the FCC
4 eliminated the carrier common line (“CCL”) charge, an analogous rate in the federal
5 jurisdiction, it permitted revenue replacement for those implicit subsidies through explicit
6 mechanisms.⁴⁵ Mr. Caballero is correct that the FCC provided for revenue replacement,
7 as I explained in my Direct Testimony,⁴⁶ but that is not a reason to keep the NTSRR.
8 Rather, it is a reason to adopt a holistic reform plan such as that proposed by AT&T, in
9 which the revenues forgone from elimination of the NTSRR (and reduction of other
10 intrastate access rate elements) are compensated for by increased retail rates and, if
11 necessary, draws from a state Universal Service fund. AT&T’s plan is analogous to the
12 FCC’s plan in these very respects.

⁴⁴ See AT&T's Petition and Complaint Seeking Reduction of Intrastate Switched Access Rates, *In the Matter of AT&T Communications of the South Central States, TCG Ohio, and BellSouth Telecommunications, Inc., d/b/a ATT&T Kentucky v. Kentucky Rural Incumbent Local Exchange Carriers, Kentucky Competitive Local Exchange Carriers, Windstream West, LLC, Windstream EAST, LLC, and Cincinnati Bell*, before the Public Service Commission, Commonwealth of Kentucky, Case No. 2010-00162, April 21, 2010.

⁴⁵ *Caballero Direct*, p. 20.

⁴⁶ *Aron Direct*, p. 23.

1 **III. AT&T's Access Reform Plan Does not Suffer from the Weaknesses in Verizon's and**
2 **Sprint's Proposals Identified by Mr. Caballero**

3 **Q: DR. ARON, MR. CABALLERO LEVELS A NUMBER OF CRITICISMS OF**
4 **VERIZON'S ACCESS REFORM PROPOSAL. WHAT ARE THE KEY**
5 **DIFFERENCES BETWEEN AT&T'S PROPOSAL AND VERIZON'S**
6 **PROPOSAL?**

7 A: There are two major differences. The first is that AT&T (as well as Sprint⁴⁷) propose to
8 have Windstream's intrastate switched access rate mirror *Windstream's* own *interstate*
9 switched access rate. In contrast, Verizon would have Windstream mirror *AT&T*
10 *Kentucky's* intrastate switched access rate. The second difference is that AT&T provides
11 a holistic or comprehensive access reform plan that would give the Windstream
12 companies an opportunity to replace the revenues lost as a result of the access rate
13 decrease with appropriate local service rate increases up to a benchmark level,
14 supplemented if necessary with funding from a state Universal Service fund. In contrast,
15 neither Verizon nor Sprint provide any plan for the replacement of forgone access
16 revenues that would permit draws from a Universal Service fund, nor recognize the
17 implications of the fact that the subsidies embedded in access rates were part of a
18 historical *quid pro quo* between regulators and regulated companies under which
19 excessive access rates were intended to compensate for retail rates constrained below
20 cost-recovering levels, as I explained in my Direct Testimony.⁴⁸ Consistent with this
21 recognition of the overarching regulatory framework in which access rates were
22 established, AT&T's access reform plan is one of rate rebalancing and includes

⁴⁷ *Appleby Direct*, p. 17.

⁴⁸ *Aron Direct*, pp. 18-20.

1 appropriate revenue recovery mechanisms including the possibility of draws from a state
2 Universal Service fund.

3 **Q: MR. CABALLERO CLAIMS THAT WINDSTREAM WILL EXPERIENCE DIRE**
4 **CONSEQUENCES IF SWITCHED ACCESS CHARGES ARE REDUCED. WILL**
5 **AT&T'S PLAN CAUSE THESE PROBLEMS FOR WINDSTREAM?**

6 A: No, as I have discussed and as Dr. Oyefusi elaborates in his Direct and Rebuttal
7 Testimonies, AT&T's proposal provides the opportunity for Windstream to replace the
8 revenues that it would lose as a result of access reform. It provides that opportunity
9 through a combination of the opportunity to increase local rates up to a reasonable
10 benchmark (to be set by the Commission), with supplementary revenues, as necessary,
11 from a state Universal Service fund.

12 **Q: YOU NOTED THAT AT&T PROPOSES THAT WINDSTREAM'S INTRASTATE**
13 **SWITCHED ACCESS RATES BE SET AT THE LEVEL OF WINDSTREAM'S**
14 **INTERSTATE SWITCHED ACCESS RATES, WHILE VERIZON PROPOSES**
15 **THAT WINDSTREAM'S INTRASTATE SWITCHED ACCESS RATES BE SET**
16 **AT AT&T KENTUCKY'S INTRASTATE RATES. WHICH PLAN IS**
17 **SUPERIOR?**

18 A: In my view, AT&T's plan is superior. AT&T's plan is based on sound reasoning, and
19 avoids the criticisms leveled by Mr. Caballero at Verizon's plan. Mr. Caballero raises
20 three criticisms of Verizon's proposal to reduce Windstream's intrastate switched access
21 rates to AT&T Kentucky's intrastate rates, all of which are addressed by AT&T's plan.

22 First, he challenges Verizon's assertion that AT&T Kentucky's intrastate switched access
23 rates have undergone the most regulatory scrutiny,⁴⁹ on the grounds that Windstream
24 East's predecessor made reductions to intrastate switched access rates between 2000 and

⁴⁹ *Caballero Direct*, p. 12.

1 2001. In fact, it is fair to say that the access rates that have undergone the most
2 regulatory scrutiny are the LECs' interstate access rates, and Windstream's interstate
3 rates are, as I documented in my Direct Testimony, significantly lower than the intrastate
4 rates it currently charges.⁵⁰

5 In fact, the ILECs' interstate rates were determined in the *CALLS* proceeding on the basis
6 of an extensive, multi-year, multi-party proceeding in which comments were provided by
7 ILECs, CLECs, state commissions, congressmen, consumer advocate groups, industry
8 trade groups, attorneys general, and others that culminated in the FCC's adoption of the
9 rates that are in effect today. In full recognition of the regulatory history and public
10 policy role that carrier switched access rates have historically played, the FCC found the
11 rates it adopted to be beneficial to consumers, pro-competitive, and economically
12 efficient.⁵¹

13 **Q: WHAT IS MR. CABALLERO'S SECOND CRITICISM OF VERIZON'S**
14 **PROPOSAL?**

15 A: Second, Mr. Caballero observes that LECs do not all pay the same rates in the interstate
16 jurisdiction.⁵² This is correct. As I explained in my Direct Testimony, the interstate
17 access rates in effect today are those established in 2000 in the *FCC CALLS Order*, in
18 which the FCC established three separate interstate access rates for price capped
19 companies, adopting a proposal set forth by a consortium of local and long distance

⁵⁰ *Aron Direct*, p. 30.

⁵¹ 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, *In the Matter of Access Charge Reform and Price Cap Performance Review for Local Exchange Carriers et al.*, before the Federal Communications Commission, CC Docket No. 96-262 et al., FCC 00-193, (released May 31, 2000), (hereafter *FCC CALLS Order*), ¶ 29.

⁵² *Caballero Direct*, p. 14.

1 providers.⁵³ The FCC ordered large ILECs, other price cap LECs, and rural price cap
2 ILECs to reduce their average traffic-sensitive rates to 0.55¢, 0.65¢, and 0.95¢ per
3 minute, respectively, and established a new explicit Universal Service fund to help local
4 exchange carriers offset the reduction in interstate switched access revenues received.⁵⁴
5 AT&T Kentucky and Windstream East, as large ILECs, were required to reduce their
6 traffic-sensitive rates to .55¢, and Windstream West was required to reduce its traffic-
7 sensitive rates to .65¢.⁵⁵

8 These different rates presumably reflect the assessment by the FCC and the industry
9 consortium that proposed the *CALLS* plan of the different costs and circumstances
10 associated with these three different categories of LECs. Hence, in contrast to Verizon's
11 proposal, AT&T's access reform plan requiring Windstream to mirror its own interstate
12 access rates fully incorporates the analysis conducted by the industry consortium and the
13 FCC that led to rates that distinguish between LECs such as AT&T Kentucky and
14 Windstream West (which was assigned a higher rate than AT&T Kentucky in the
15 interstate jurisdiction).

⁵³ *FCC CALLS Order*, ¶¶ 30. By "price cap ILECs," I mean ILECs that are subject to price cap regulation by the FCC.

⁵⁴ *FCC CALLS Order*, ¶¶ 30, 32, 56, 162. Qwest and Verizon are subject to the 0.55¢ rate in Arizona. See, *FCC CALLS Order*, ¶ 162; Federal Communications Commission, "Carrier Filing History," http://www.fcc.gov/wcb/armis/carrier_filing_history, (accessed July 8, 2010); and Federal Communications Commission, "Verizon GTE Corporation (GTTC)," http://www.fcc.gov/wcb/armis/carrier_filing_history/COSA_History/gtcc.htm, (accessed July 8 2010).

⁵⁵ *Aron Direct*, p. 25.

1 Q: WHAT IS MR. CABALLERO'S THIRD CRITICISM OF VERIZON'S
2 PROPOSAL?

3 A: Third, Mr. Caballero asserts that the FCC has never required any ILEC to mirror the
4 switched access rates of another ILEC.⁵⁶ Whether or not this is true, AT&T's plan does
5 not require any ILEC to mirror the switched access rates of any other ILEC; rather,
6 AT&T's plan requires only that Windstream charge the same rates in the intrastate
7 jurisdiction *that it already charges* for its interstate access service.

8 Q: MR. CABALLERO CLAIMS THAT THE FCC NEVER LOOKED AT COST.⁵⁷ IS
9 THIS TRUE?

10 A: No. As I explained in my Direct Testimony,⁵⁸ the FCC specifically found in its *CALLS*
11 *Order* that the rates it established in the *FCC CALLS Order* proceeding are well above
12 cost. Moreover, as I noted, in the *FCC CALLS Order* the FCC specifically established an
13 option for all carriers to supply a cost study instead of adopting the established rate, if the
14 carrier believed the established rate to be below its cost. Windstream did not opt to
15 submit a study, and, as I also observed in my Direct Testimony, Windstream admitted in
16 discovery that it has not sought review of its interstate switched access rates on the
17 ground that such rates are below cost.⁵⁹

⁵⁶ *Caballero Direct*, p. 14.

⁵⁷ *Caballero Direct*, pp. 31-32.

⁵⁸ *Aron Direct*, pp. 26-27.

⁵⁹ See Windstream's Responses to AT&T's First Set of Data Requests, No. 10.

1 **Q: DO WINDSTREAM'S INTRASTATE SWITCHED ACCESS RATES HAVE TO**
2 **BE LOWERED TO A LEVEL EQUAL TO WINDSTREAM'S COSTS OF**
3 **PROVIDING ACCESS SERVICE FOR THE PROPOSED REFORM TO**
4 **INCREASE CONSUMER WELFARE AND EFFICIENT INVESTMENT?**

5 A: No. Reducing Windstream's intrastate switched access rates to the level of Windstream's
6 interstate access rates would move them closer to, though undoubtedly not all the way to,
7 costs.⁶⁰ Hence, they would be more economically efficient although, because the
8 intrastate access rates would still be above costs, not fully efficient.

9 **Q: MR. CABALLERO CLAIMS THAT EVEN IF A COST STUDY WERE TO**
10 **SHOW WINDSTREAM'S INTRASTATE SWITCHED ACCESS RATES IN**
11 **EXCESS OF COST, THIS WOULD NOT MEAN THAT ITS INTRASTATE**
12 **SWITCHED ACCESS RATES ARE NOT JUST AND REASONABLE, BECAUSE**
13 **WINDSTREAM'S PRICE CAP PLAN "BREAKS THE LINK" BETWEEN**
14 **COSTS AND PRICES.⁶¹ PLEASE COMMENT.**

15 A: The evidence shows that Windstream's access rates are excessive and that a downward
16 adjustment would increase social well-being. As long as there is accommodation for
17 recovery of forgone access revenues, requiring reductions of access rates is consistent
18 with the principles of price cap regulation, the preservation of the incentives for cost
19 minimization inherent in the price cap mechanism, the obligations of regulators to price
20 capped companies, and the intended efficiency gains associated with price cap regulation,
21 while also correcting prices for a monopoly service that are harmful to consumers and
22 that the market will not correct on its own.

⁶⁰ I explained in my Direct Testimony the evidence that interstate switched access service prices are actually a multiple of nearly 8 times the level of rates that the FCC determined would cover the relevant costs. *Aron Direct*, p. 33 (explaining that reciprocal compensation rates, which the FCC concluded are sufficient to recover costs, are far lower than interstate access rates) and p. 53 (explaining that local call termination and switched access are the same functionality).

⁶¹ *Caballero Direct*, p. 16.

1 **IV. Concluding Comments**

2 **Q: DR. ARON, DO YOU HAVE ANY CONCLUDING COMMENTS?**

3 A: Yes, I do. All Parties concur that Windstream's intrastate switched access rates contain
4 an implicit subsidy. The rates and rate structure of Windstream's intrastate switched
5 access service are relics of a bygone era in telecommunications. Today, these rates cause
6 material harm to consumers and distort competition, to the detriment of efficient
7 investment. The economically sound remedy is to reduce the intrastate switched access
8 rates of Kentucky LECs, starting with Windstream, to the rates they are already charging
9 for the same services in the interstate jurisdiction. The plan should provide the
10 opportunity to recover forgone access revenues from end-user customers in the form of
11 higher retail prices, supplemented, to the extent that the Commission deems it
12 unacceptable to increase retail prices to fully recover forgone access revenues, by draws
13 from a Universal Service fund. The AT&T plan outlines a way to reform intrastate
14 switched access rates in Kentucky that accomplishes the goals of improving economic
15 efficiency and increasing consumer well-being, while avoiding the criticisms lodged by
16 Mr. Caballero against the plans offered by Verizon and Sprint.

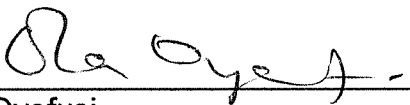
17 **Q: DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

18 A: Yes, it does.

COMMONWEALTH OF KENTUCKY
KENTUCKY PUBLIC SERVICE COMMISSION

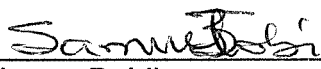
COUNTY OF PRINCE GEORGES
STATE OF MARYLAND

BEFORE ME, the undersigned authority, duly commissioned and qualified in and for the State and County aforesaid, personally came and appeared Ola Oyefusi, who being by me first duly sworn deposed and said that he is *appearing as a witness on behalf of BellSouth Telecommunications, Inc. d/b/a AT&T Kentucky and AT&T Communications of the South Central States, LLC before the Kentucky Public Service Commission in Docket Number 2007-00503, In the Matter of: MCI Communications Services, Inc., Bell Atlantic Communications, Inc., NYNEX Long Distance Company, TTI National, Inc., Teleconnect Long Distance Services & Systems Company, and Verizon Select Services, Inc., Complainants v. Windstream Kentucky West, Inc., Windstream Kentucky East, Inc.—Lexington and Windstream Kentucky East, Inc.—London, Defendants*, and if present before the Commission and duly sworn, his statements would be set forth in the annexed rebuttal testimony consisting of 24 pages and 0 exhibits.



Ola Oyefusi

SWORN TO AND SUBSCRIBED BEFORE ME
THIS 10th DAY OF AUGUST, 2010



Notary Public

My Commission Expires: 9-5-2012

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**REBUTTAL TESTIMONY OF
DR. OLA A. OYEFUSI**

On Behalf of

**BellSouth Telecommunications, Inc., d/b/a AT&T Kentucky
and AT&T Communications of the South Central States, LLC**

BEFORE THE KENTUCKY PUBLIC SERVICE COMMISSION

Case No. 2007-00503

August 13, 2010

1 **I. INTRODUCTION AND SUMMARY**

2
3 **Q. PLEASE STATE YOUR NAME.**

4 A. My name is Dr. Ola Oyefusi.

5 **Q. ARE YOU THE SAME DR. OYEFUSI WHO SUBMITTED DIRECT TESTIMONY**
6 **ON JULY 14, 2010?**

7 A. Yes.

8 **Q. PLEASE SUMMARIZE YOUR REBUTTAL TESTIMONY.**

9 A. In my Direct Testimony, I showed that Windstream's excessive intrastate
10 switched access rates hurt Kentucky consumers, distort the competitive playing
11 field, encourage harmful arbitrage, and lead to wasteful and unnecessary costs
12 of administration. Verizon and Sprint agree, and Windstream does not really
13 dispute the point.

14 Much of the discussion, then, is about the proper solution. AT&T
15 proposes that the Commission immediately reduce Windstream's intrastate
16 switched access rates to "parity" with its corresponding interstate rate levels and
17 structures.¹ (AT&T has also asked the Commission to adopt the same parity
18 model for other incumbent local exchange carriers in a separate proceeding,
19 Case No. 2010-00162.) The Commission has already adopted the "parity"
20 approach for AT&T Kentucky. Over 20 states have taken a similar approach, as I
21 documented in my Direct Testimony. Sprint also supports this model.

¹ If adopted, this parity solution will require Windstream to maintain for its intrastate switched access service the same interstate switched access rate elements and charge the same rates level as in its interstate tariff filed with the FCC.

1 Even Windstream does not oppose this model. In fact, Windstream's
2 witness states that the Commission should act consistently with the FCC. That is
3 exactly what AT&T proposes: by implementing "parity" between intrastate and
4 interstate switched access rates, the Commission would, by definition, track
5 reforms the FCC has already adopted at the federal level (and by ordering
6 Windstream to maintain parity going forward, the Commission can also track any
7 further reforms the FCC adopts in the future). Moreover, Windstream praises the
8 FCC's approach of "rebalancing" access rate reductions through increases in the
9 charges paid by end users and through universal service support. That, too, is
10 exactly what AT&T proposes.

11 That is why the Commission needs to adopt AT&T's proposal. The
12 remainder of Windstream's testimony consists of irrelevant sidetracks that the
13 Commission should ignore.

14 **First**, much of Windstream's testimony is a critique of Verizon's proposed
15 solution: that Windstream mirror *AT&T Kentucky's* rates for intrastate switched
16 access. The Commission can easily avoid that debate by adopting AT&T's
17 proposal.

18 **Second**, Windstream claims that its rates compare favorably to the rates
19 of rural ILECs in Kentucky ("RLECs"). That comparison is entirely meaningless.
20 The fact that some RLECs currently charge the same, or higher, rates than
21 Windstream does not make Windstream's rates just and reasonable. All
22 Windstream has shown is that the rates of the other rural ILECs are also too
23 high. AT&T has already filed a petition with this Commission (Case No. 2010-

1 00162) challenging the rates of other rural ILECs (as well as competitive LECs),
2 and the Commission should grant that petition. For the present proceeding, the
3 only meaningful comparison is between Windstream's intrastate switched access
4 rates and its own interstate rates for the same switched access service.

5 Switched access service involves materially the same function, and the same
6 costs, for in-state calls and interstate calls. Windstream cannot justify charging
7 higher rates for its intrastate switched access service than its interstate switched
8 access service.

9 **Third**, Windstream erroneously claims that its non-traffic-sensitive carrier
10 common line charge is a valid component of Windstream's switched access rates
11 because it is meant to recover the costs of local loops, which Windstream claims
12 are used to provide intrastate switched access service. Windstream's argument
13 flies in the face of elementary cost causation principles, which require costs to be
14 recovered in the manner they are incurred. The costs of a local loop are incurred
15 when a local service consumer requests a connection to its end user location,
16 and those costs do not change by one cent when the consumer uses that
17 connection to make or receive a long-distance call. More fundamentally,
18 Windstream's argument is irrelevant: whether or not long-distance providers
19 should pay something towards the cost of local loops, it is fundamentally unfair
20 for wireline long-distance carriers to pay much more than competing long-
21 distance technologies (like wireless, e-mail, and texting) do.

22 **Fourth**, Windstream claims non-basic rates that are deemed competitive
23 cannot be increased sufficiently to recover the reduction in access revenues.

1 The AT&T plan proposes that carriers must be provided pricing flexibility
2 opportunities, not a mandate to raise retail rates or a revenue guarantee that will
3 insulate Windstream from the effects of competition or provide it with an unfair
4 competitive advantage.

5 **Fifth**, Windstream's witness Mr. Caballero contends that procedurally
6 Windstream West and Windstream East are exempt (pursuant to KRS 278.541)
7 from this complaint proceeding because their intrastate switched access rates
8 are deemed by Kentucky law to be just and reasonable. The Commission has
9 already rejected Windstream's theory and the Franklin Circuit Court upheld the
10 Commission's order on this issue.

11 **Finally**, Windstream raises other assertions that are irrelevant and
12 incorrect. I refute those below.

13 **II. RESPONSE TO THE DIRECT TESTIMONY OF MR. CESAR**
14 **CABALLERO ON BEHALF OF WINDSTREAM KENTUCKY EAST, LLC**
15 **AND WINDSTREAM KENTUCKY WEST, LLC**

16 **A. WINDSTREAM SUPPORTS THE BASIC PRINCIPLES OF**
17 **AT&T'S PLAN.**

18
19
20 **Q. IS THERE ANY REAL DISPUTE THAT HIGH SWITCHED ACCESS CHARGES**
21 **ARE HARMFUL TO CONSUMERS?**

22
23 A. No. AT&T, Verizon, and Sprint have each submitted extensive direct testimony
24 (including mine and Dr. Aron's) showing the many ways in which high switched
25 access charges hurt Kentucky consumers. Windstream makes theoretical (and
26 erroneous) arguments about loop costs and "just and reasonable" rates (which I
27 refute below) but does not offer any substantive analysis or supportable
28 arguments.

1 That is because no one could seriously defend the intrastate switched
2 access regime that applies to Windstream (and for that matter all other local
3 exchange carriers in Kentucky, with the exception of AT&T Kentucky, which
4 implemented interstate mirroring over a decade ago). Windstream's switched
5 access rates for in-state calls are inflated by implicit subsidies, making them
6 much higher than the rates Windstream charges for the same access service on
7 interstate calls. High access charges drive up the cost of providing wireline long-
8 distance service, and thus drive up the retail price, as Dr. Aron documented in
9 her Direct Testimony on the basis of extensive analysis of data on actual rates
10 across the country. Moreover, because wireline long-distance carriers average
11 their retail prices on a statewide basis, Windstream's high access charges force
12 consumers all across Kentucky (including customers in AT&T Kentucky's local
13 exchange territory) to pay higher prices than they should for wireline long-
14 distance service, just to subsidize artificially low prices for local service in the
15 small territories served by Windstream and other rural LECs.

16 In addition, high access charges prevent Kentucky consumers from
17 receiving the benefits of full and fair competition. Wireline long-distance
18 providers like AT&T have to bear the burden of high switched access charges,
19 but the many competing technologies (such as e-mail, social networking
20 websites, and wireless phones) do not have to bear anywhere near the same
21 access burden. High access charges are an artificial disadvantage for wireline
22 long-distance providers, and prevent those providers from competing as
23 effectively as they could on the things that should matter (like price and quality).

1 Conversely, competing technologies get an artificial advantage, so they are
2 unfairly positioned to offer lower prices and improved quality. Kentucky
3 consumers lose again.

4 Finally, the fact that intrastate switched access rates are much higher than
5 interstate rates for the same access service creates harmful arbitrage
6 opportunities (and incentives for unsavory schemes like call pumping). That fact
7 also leads to the purely wasteful administrative expenses of maintaining two sets
8 of prices for essentially the same service.

9 **Q. PLEASE SUMMARIZE AT&T’S PROPOSED SOLUTION.**

10
11 A. AT&T offers a comprehensive plan for access reform, which consists of three
12 components:

13 (1) require Windstream and all other ILECs in Kentucky to reduce their switched
14 access rates for in-state calls to “parity” with their corresponding rates on
15 interstate calls, as AT&T Kentucky has already done a decade ago;

16 (2) allow Windstream and other incumbent LECs to recover the resulting
17 reductions in access revenue through (a) the flexibility to increase local rates up
18 to a reasonable benchmark and (b) in limited circumstances, support from a
19 Kentucky universal service fund (“KUSF”); and

20 (3) require competitive LECs to cap their switched access rates for in-state calls
21 at the levels of the ILECs with which they compete (just as the FCC already
22 requires when competitive LECs originate or terminate interstate calls), while
23 granting them unlimited retail rate flexibility to recover the resulting reduction in
24 revenue.

1 This approach will allow the Commission to achieve meaningful reductions
2 in access charges, and bring significant relief to Kentucky consumers. And it is
3 simple: rather than reinventing the wheel, the Commission can track reforms that
4 it has already approved for the Commonwealth's largest ILEC (AT&T Kentucky),
5 and that the FCC has already implemented for interstate calls.

6 In this proceeding, of course, the Commission is considering
7 Windstream's access rates. But it is worth noting that AT&T's plan is a holistic
8 one that the Commission can and should use as a model for comprehensive
9 reform for all local exchange carriers. The Commission can implement AT&T's
10 plan for Windstream in this proceeding, and it can approve the same plan for
11 other local exchange carriers in the separate proceeding that AT&T filed and that
12 is pending before the Commission.

13 **Q. HOW DOES WINDSTREAM RESPOND?**

14
15 A. Windstream never addresses the AT&T plan by name. But Mr. Caballero
16 appears to endorse the AT&T plan, because he praises the FCC's access
17 reforms as "meaningful," "comprehensive", and "rational."² Specifically, he states
18 that the current differential between interstate and intrastate switched access
19 rates is the result of "careful and rational access reforms [sic] efforts undertaken
20 by the FCC."³ Further, he specifically endorses the FCC's approach of allowing
21 carriers to rebalance the reductions in revenue by partial increases to the
22 subscriber line charge (SLC) paid by end users and the remainder through

² See Direct Testimony of Cesar Caballero filed July 14, 2010 ("*Caballero Direct*") at 29.

³ See *id.*

1 explicit revenue replacement mechanisms.⁴ Mr. Caballero expressly proposes
2 that if the Commission decides to reform Windstream's intrastate access rates, it
3 should follow an approach similar to the one the FCC has implemented.

4 **Q. IS AT&T'S PROPOSAL IN THIS PROCEEDING CONSISTENT WITH THE FCC**
5 **REFORMS THAT WINDSTREAM PRAISES?**

6
7 A. Yes, AT&T's proposal is fully consistent with the FCC's reforms. First, by
8 proposing parity between interstate and intrastate switched access rates, AT&T
9 is proposing that Windstream implement the exact same access reductions that
10 the FCC has already adopted (and any additional reductions the FCC adopts in
11 the future). Second, AT&T recommends that the Commission allow Windstream
12 the opportunity to recover the reduction in access revenue by (i) increasing its
13 retail rates for local service up to a reasonable "benchmark", and (ii) to the extent
14 the "benchmark" rate is not sufficient for Windstream to recover all of its access
15 reductions for all qualified switched access lines, the Commission could allow
16 Windstream to receive support from a KUSF. As for Windstream's emphasis on
17 the fact that the FCC implemented increases in the end user SLC over three
18 years to minimize impacts to consumers, AT&T proposes a similar "glide path" to
19 increase the end user local retail rate, *i.e.*, proposed in the AT&T Plan's
20 transitional cap provision described in my Direct Testimony.⁵

21 It is curious that Windstream criticizes Verizon's proposal for its
22 dissimilarities to FCC's access reform efforts in this regard, but it fails to mention
23 that the AT&T Plan offers the same approach as the FCC reforms that

⁴ See *Caballero Direct* at 29-34. The SLC is an interstate end user charge which is analogous to the local retail rates for in-state basic local exchange service.

⁵ See Direct Testimony of Dr. Ola Oyefusi filed July 14, 2010 ("*Oyefusi Direct*") at 44, *citing* AT&T Plan at ¶ 3.

1 Windstream endorses. Presumably, because Windstream wants to delay or
2 derail reform procedurally (arguments that I refute below), it does not want to
3 come right out and say that it agrees with AT&T's approach. Nonetheless,
4 Windstream cannot legitimately have any objections to the access reform that
5 AT&T proposes, given that the AT&T Plan tracks the same federal reforms that
6 Windstream has endorsed. The Commission should adopt the same reform in
7 this proceeding.

8 **Q. WINDSTREAM CLAIMS THAT THE FCC WILL SOON IMPLEMENT**
9 **ADDITIONAL REFORMS FOR THE ENTIRE INTERCARRIER**
10 **COMPENSATION SYSTEM AND URGES THE COMMISSION TO DO**
11 **NOTHING UNTIL THE FCC ACTS.⁶ DO YOU AGREE?**

12
13 A. No. Over a decade has passed since this Commission recognized the need for
14 access reform. It is disingenuous for Windstream to suggest that the
15 Commission wait any longer on the theory that the FCC might someday
16 implement reforms for in-state rates that fall within this Commission's jurisdiction.
17 The FCC has been pondering comprehensive reform of the intercarrier
18 compensation system for a decade, with no concrete results and no commitment
19 that it will act any time soon. Although the recent National Broadband Plan
20 ("NBP") *recommends* that the FCC reduce intrastate switched access rates, the
21 FCC has not even opened a proceeding to consider those recommendations. In
22 fact, the FCC does not plan to even issue a notice of *proposed* rulemaking until
23 the fourth quarter of 2010 and the NBP itself contemplates that the FCC may
24 take two years to develop an order.

⁶ See *Caballero Direct* at 42.

1 In the meantime, the FCC has not made any attempt to dissuade states
2 from acting simultaneously towards the same goal. The recent NBP – which
3 Windstream cites as a reason the Commission should wait – endorses the type
4 of straightforward reforms that AT&T proposes here and encourages states to
5 complete rebalancing of retail local rates to offset the reductions in revenue due
6 to access reform. Specifically, the NBP states:⁷

7 The FCC should also **encourage states to complete rebalancing of**
8 **local rates to offset the impact of lost access revenues.** Even with
9 SLC increases and rate rebalancing, some carriers may also need
10 support from the reformed Universal Service Fund to ensure adequate
11 cost recovery. When calculating support levels under the new CAF, the
12 FCC could impute residential local rates that meet an established
13 benchmark. Doing so would **encourage carriers and states to**
14 **“rebalance” rates to move away from artificially low \$8–\$12**
15 **residential rates that represent old implicit subsidies** to levels that
16 are more consistent with costs.
17

18 **Q. IS THERE ANY REASON FOR THIS COMMISSION TO BE CONCERNED**
19 **THAT THE AT&T PLAN COULD PROVE INCONSISTENT WITH WHATEVER**
20 **DECISIONS THE FCC REACHES IN ITS NBP RULEMAKINGS?**
21

22 A. No reason at all. All AT&T is asking the Commission to do is to track reforms
23 that the FCC has *already* implemented at the federal level, and that the
24 Commission ordered long ago on the intrastate side for AT&T Kentucky.

25 **B. BY ADOPTING THE AT&T PLAN, THE COMMISSION CAN**
26 **IGNORE WINDSTREAM’S CRITICISMS OF THE VERIZON**
27 **PROPOSAL.**
28

29 **Q. WHAT ARE WINDSTREAM’S OBJECTIONS TO VERIZON’S PROPOSAL IN**
30 **THIS PROCEEDING?**
31

32 A. Windstream criticizes Verizon mainly for suggesting that Windstream’s rates
33 should be set at, or mirror, another carrier’s rates (*i.e.*, AT&T Kentucky’s rate

⁷ See *Connecting America: The National Broadband Plan*, FCC (Mar. 16, 2010), Recommendation 8.7 at 148 (citation omitted), (emphases added). The full text of the NBP can be found at www.broadband.gov.

1 level), and references the fact that other incumbent local exchange carriers in the
2 Commonwealth have access rates that are higher than Windstream's access
3 charges.⁸ Windstream also criticizes Verizon for not recommending any revenue
4 replacement mechanism (in contrast to the FCC's approach which provided for
5 revenue recovery) to offset the revenue reductions that Windstream will
6 experience when its access rates are reduced.⁹

7 **Q. DOES THE COMMISSION HAVE TO ADDRESS WINDSTREAM'S CRITICISM**
8 **OF VERIZON'S PROPOSAL?**

9
10 A. No. The Commission does not need to delve into this issue in order to determine
11 the merits of Windstream's criticism of Verizon's proposal as long as the
12 Commission adopts the AT&T plan, which has all of the same characteristics as
13 the FCC's approach for interstate access reform. That is, the AT&T plan has the
14 same features that Windstream has endorsed as "meaningful", "comprehensive",
15 and "rational".¹⁰

16 Unlike the Verizon proposal that Windstream criticizes, the AT&T plan
17 does not suggest that Windstream mirror other carriers' rates. Rather, AT&T
18 proposes that Windstream mirror the same rates that Windstream itself currently
19 assesses for interstate switched access service. Windstream's interstate access
20 service consists of the same functions and costs as its intrastate switched access
21 service, a point Windstream does not dispute. Also, the AT&T plan provides
22 adequate access replacement mechanisms by which Windstream would have an
23 opportunity to recover its access revenue reductions. Windstream cannot

⁸ See *Caballero Direct* at 8-9.

⁹ See *Caballero Direct* at 34-35.

¹⁰ See *Caballero Direct* at 34-35.

1 provide any valid reasons it believes it is just and reasonable for the Commission
2 to allow Windstream to maintain intrastate switched access rates that are higher
3 than its interstate rates when the functions of interstate and intrastate switched
4 access (and the costs of providing them) are materially the same in all respects.

5
6 **C. WINDSTREAM CANNOT JUSTIFY ITS OWN HIGH RATES BY**
7 **REFERRING TO THE EQUALLY EXCESSIVE RATES OF OTHER**
8 **LOCAL EXCHANGE CARRIERS**
9

10 **Q. WINDSTREAM CLAIMS ITS HIGH ACCESS RATES ARE JUSTIFIED**
11 **BECAUSE OTHER KENTUCKY LECs HAVE EQUALLY HIGH RATES. IS**
12 **THAT COMPARISON VALID?**
13

14 A. Not at all. As I explain above, and as AT&T explains in its petition in Case No.
15 2010-00162 asking the Commission to direct all LECs to reduce their access
16 rates to interstate parity, there is no valid reason for LECs to maintain different
17 rates for interstate and intrastate switched access services. The current
18 differentials between interstate and intrastate rates are based on artificial, legacy
19 regulations, not economic or cost reasons.

20 This is analogous, for example, to a Frankfort gas station charging
21 different prices at the pump based on whether the motorist arrived from out-of-
22 state Indianapolis or from in-state Louisville. No such gasoline pricing practices
23 exist today because there is no legacy regulation that requires it. In fact, if a gas
24 station attempted to establish any such discriminatory pricing practice, the out-of-
25 state motorists would simply seek out alternatives.
26

1 Q. **WHAT IS THE CORRECT COMPARISON WITH RESPECT TO**
2 **WINDSTREAM'S INTRASTATE ACCESS CHARGES?**

3
4 A. The correct and relevant comparison is between Windstream's interstate and
5 intrastate switched access charges. As I discussed in my Direct Testimony, and
6 reiterate herein, an ILEC's interstate and intrastate access services involve the
7 same functions using the same network facilities, so the costs are materially the
8 same in all relevant respects. In fact, Windstream does not dispute that its costs
9 of interstate and intrastate switched access services are the same.¹¹

10 Q. **SHOULD THE COMMISSION DEFER ITS DECISION IN THIS PROCEEDING**
11 **BECAUSE OTHER ILECS AND THE CLECS CHARGE HIGH ACCESS**
12 **RATES?**

13
14 A. No. The access charge rate levels of other carriers are irrelevant to the
15 determination of whether Windstream's access charges are just and
16 reasonable.¹² As I explain above, the only valid comparison for Windstream's
17 intrastate switched access charges is to its corresponding interstate levels and
18 structure. Similarly, other ILECs' intrastate access rates should be compared
19 only to the ILECs' interstate rates, while the CLECs' intrastate access charges
20 are compared to the rates charged by the ILECs in whose service territories the
21 CLECs operate. Such comparisons are supported by economic principles and
22 have been adopted by many states and the FCC (*i.e.*, the same FCC approach
23 that Windstream endorses).

¹¹ In discovery, AT&T asked Windstream to identify any instances where it has claimed its interstate rates are below incremental cost, and Windstream responded there was none. See Windstream Response to AT&T First Data Request No. 10e.

¹² Using other ILECs' rates as determinant of just and reasonable is only meaningful and supported by economic principles when investigating the switched access rates of the CLECs, but such comparison is limited to the rates charged by the ILECs with which the CLECs compete.

1 Q. YOU CLAIM OTHER CARRIERS' SWITCHED ACCESS RATES ARE ALSO
2 UNJUST AND UNREASONABLE, BUT THOSE CARRIERS ARE NOT
3 PARTIES TO THIS PROCEEDING. WHAT SHOULD THE COMMISSION DO
4 IN THIS PROCEEDING?
5

6 A. AT&T has filed a petition in a separate docket (Case No. 2010-00162) asking the
7 Commission to reduce the other carriers' intrastate switched access rates to
8 parity with their own interstate switched access rates. The Commission can
9 apply the AT&T Plan to Windstream in this proceeding, and then apply the Plan
10 to the other carriers in a case specifically aimed at those carriers.

11
12 D. WINDSTREAM'S THEORY ABOUT LOOP COSTS IS
13 IRRELEVANT AND WRONG.
14

15 Q. DO YOU AGREE WITH WINDSTREAM'S ARGUMENT THAT THE NON-
16 TRAFFIC SENSITIVE REVENUE REQUIREMENT ("NTSRR") CURRENTLY
17 ASSESSED AS A "CARRIER COMMON LINE CHARGE" RECOVERS ANY
18 COST FOR FUNCTIONS ASSOCIATED WITH SWITCHED ACCESS
19 SERVICE?¹³
20

21 A. Not at all, but the Commission does not even need to decide the issue. In the
22 first place, Windstream is trying to trigger a debate that the real world has long
23 since made academic. Whether or not providers of long-distance service should,
24 purely as a matter of theory as Windstream erroneously claims,¹⁴ pay some
25 portion of loop costs through the carrier common line charge, it is undisputed that
26 *most* providers (such as email, wireless, and social networking site providers) do
27 not pay that charge, at least nowhere near the extent that wireline long-distance
28 carriers have to pay. So the real-world question is whether wireline long-distance
29 carriers should have to make a large payment towards loop costs while

¹³ See *Caballero Direct* at 19-20.

¹⁴ Windstream's theory is incorrect. Economists have completely resolved this issue for over a decade by concluding that loop costs are not attributable to switched access.

1 competing providers do not. That result distorts competition, which ultimately
2 hurts Kentucky consumers, and no one makes any attempt to defend today's
3 unfair regime.

4 Second, the discussion of loop costs is nothing but a red herring. AT&T
5 does not propose that Windstream's access charges be reduced all the way
6 down to the incremental cost of providing access service, nor does AT&T
7 propose that all of the current payments towards loop costs be eliminated.
8 Rather, AT&T proposes that Windstream reduce its in-state access rates to parity
9 with its corresponding interstate rates, which are well above the cost of providing
10 switched access service and thus still provide ample contribution towards loop
11 costs – a point that Windstream does not dispute. Moreover, AT&T proposes
12 that Windstream and other incumbents be given the opportunity to recover
13 access reductions through rebalancing of local rates (up to a reasonable
14 benchmark) plus universal service support (where necessary).

15 **Q. IF THE COMMISSION DOES CONSIDER THE QUESTION OF LOOP COSTS,**
16 **IS WINDSTREAM'S ARGUMENT CORRECT?**

17
18 A. No. Windstream's attempt to maintain the carrier common line charge ("CCL") by
19 claiming it is linked to the cost of providing switched access service is completely
20 flawed both as a matter of economics and as a matter of network operations. The
21 "carrier common line charge" is a legacy intrastate access rate element that has
22 absolutely no relationship to the cost of providing switched access service and
23 has been eliminated in the interstate jurisdiction. It is nothing but a pure subsidy
24 rate element that has no place in a competitive market.

1 As the New Jersey Board of Public Utilities (“BPU”) concluded, loop cost
2 “... should not be included” in the determination of access costs.¹⁵ That is
3 because the cost of the loop is caused by the local service user. The loop is
4 dedicated to the local service customer (*i.e.*, the end user), and it is the same
5 whether the end user makes a million long distance calls or none. Hence, pricing
6 regulation that recovers loop costs from flat-rated retail prices, rather than from
7 usage sensitive switched access charges, will encourage efficient decision
8 making by the end-user consumer. The retail prices should be paid by the end-
9 user consumer who makes the purchasing decision to obtain a loop. And it
10 should be imposed by the local exchange company that incurs the costs of
11 installing the loop. Taken together, these cost causation principles instruct that
12 loop costs be recovered through charges assessed on end-user customers.

13 Thus, for the same reasons that implicit subsidies should be reduced (as I
14 explained in my Direct Testimony) there is no justification for continuing to
15 assess the CCL charge implicitly as a part of the intrastate switched access rate
16 structure.¹⁶ AT&T, Verizon and Sprint, all agree that the cost of the local loop
17 should be borne by the customers who directly cause the loop to be deployed –
18 *i.e.*, the local exchange customer.

¹⁵ See *In the Matter of the Board's Investigation and Review of Local Exchange Carrier Intrastate Exchange Access Rates*, New Jersey Board of Public Utilities, Docket No. TX08090830, Final Order at 27 (February 1, 2010).

¹⁶ The FCC has reached the same conclusion in its series of access reforms in the past 13 years. See, e.g., FCC's CC Docket No. 96-262, 94-1, 91-213, 95-72, *In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, End User Common Line Charges* (First Report and Order released May 16, 1997), ¶¶ 36-37.

1 Q. WINDSTREAM STATES THAT IF THE NTSRR IS ELIMINATED IT SHOULD
2 BE “MADE EXPLICIT” IN A “MEANINGFUL AND RATIONAL MANNER.”¹⁷ DO
3 YOU AGREE?
4

5 A. Yes. As I explained above, the FCC in reforming interstate switched access
6 rates undertook a very similar restructuring to what AT&T has proposed in its
7 Plan. Windstream endorses the FCC’s actions, so it cannot have any legitimate
8 objection to the Commission’s adoption of the AT&T Plan – as is clear from the
9 fact that it has not taken issue with any feature of the AT&T Plan in its Direct
10 Testimony.

11 AT&T’s proposal is consistent with the Commission’s own prior adoption
12 of a requirement that AT&T Kentucky reduce its intrastate switched access rates
13 to parity with its interstate rates as a condition of AT&T Kentucky’s plan for
14 alternative regulation.¹⁸ As a result, AT&T Kentucky no longer assesses the
15 NTSRR or CCL since that rate element had been eliminated from its interstate
16 tariff.

17 **E. THE AT&T PLAN PROVIDES LECS WITH AN OPPORTUNITY**
18 **TO REPLACE ACCESS REDUCTIONS WITH HIGHER RETAIL**
19 **PRICES, BUT THAT IS NOT A MANDATE THAT LECS**
20 **INCREASE RETAIL PRICES, NOR CAN IT BE A GUARANTEE**
21 **THAT LECS WILL ACHIEVE ANY PARTICULAR LEVEL OF**
22 **RETAIL REVENUES IN KENTUCKY’S COMPETITIVE MARKET.**
23
24

¹⁷ See *Caballero Direct* at 21.

¹⁸ *BellSouth Telecomm., Inc.’s Application to Restructure Rates*, Case No. 97-074, Order at 1 (Oct. 24, 1997), citing *Application of BellSouth Telecomm., Inc. d/b/a South Central Bell Tel. Co. to Modify Its Method of Regulation*, Case No. 94-121. *Tariff Filing of BellSouth Telecommunications, Inc. to Mirror Interstate Rates*, Case No. 98-065, Order (Mar. 31, 1999).

1 Q. **WINDSTREAM CLAIMS THAT BECAUSE ITS NON-BASIC RETAIL**
2 **SERVICES FACE COMPETITION, WINDSTREAM CANNOT RAISE PRICES**
3 **FOR THOSE SERVICES TO OFFSET ACCESS REVENUE REDUCTIONS.¹⁹**
4 **WHAT IS WRONG WITH WINDSTREAM'S CLAIM?**
5

6 A. There are two primary problems with Windstream's claim. First, it is ignoring the
7 fact that, today, Windstream collects its high switched access charges on long
8 distance calls originated from and/or terminated to *all* of its access lines, both
9 basic and non-basic alike. Those high access rates were established well before
10 any of Windstream's lines were re-categorized as "non-basic," and so it is fair to
11 say that Windstream's access rates are (and have been) subsidizing *all* of
12 Windstream's access lines, basic and non-basic alike.

13 This means, simply, that in setting its prices for its non-basic services,
14 Windstream has been able to factor in the access subsidy it has been receiving
15 from access services rendered over those lines. To the extent those access
16 subsidies are being reduced, it is fair to expect Windstream to recoup at least the
17 same portion of those subsidies from its non-basic services as it does from its
18 basic services. This will put Windstream on the same footing as its competitors,
19 none of which receive the same access subsidies for the services they offer to
20 Kentucky consumers.

21 That underscores the second problem with Windstream's claim – that
22 Windstream wants access reform to serve as a "revenue guarantee" ensuring
23 that it will recoup 100% of the access revenues it foregoes. But that is not the
24 way competitive markets operate. Whether Windstream elects to increase the
25 prices for its non-basic services is a matter entirely within Windstream's control

¹⁹ See *Caballero Direct* at 30.

1 and discretion. It may elect to raise prices. It may elect to trim costs and
2 become more efficient. It may elect to change the structure of its service
3 offerings. In making these elections, Windstream will face the same choices as
4 other competitive service providers, none of which receives any “revenue
5 guarantees.” Thus, while it is important that the Commission provide
6 Windstream with an opportunity to recoup access revenue reductions, it would be
7 inappropriate to give Windstream a “revenue guarantee” not available to other
8 carriers in the market.

9 **Q. HOW WOULD WINDSTREAM’S NON-BASIC LINES BE TREATED UNDER**
10 **THE KUSF OUTLINED IN AT&T’S PLAN PROPOSED IN CASE NO. 2010-**
11 **00162?**

12 A. Under the AT&T Plan proposed in Case No. 2010-00162, the amount of KUSF
13 support to which Windstream would be entitled is determined by imputing any
14 retail rate increase required to get to the Commission-approved benchmark to all
15 basic and non-basic lines as if the increases actually occurred. For example, if
16 Windstream’s basic service rates were \$2.00 below the Commission’s
17 benchmark rate, Windstream’s allowable draw from the KUSF would be reduced
18 by \$2.00 for each basic *and non-basic* line, regardless of whether Windstream
19 increased its prices or not. Windstream would have an additional revenue
20 opportunity, not a revenue guarantee.

21 **F. THE COMMISSION HAS ALREADY REJECTED**
22 **WINDSTREAM’S PROCEDURAL ARGUMENT**
23
24

1 Q. WINDSTREAM ARGUES THAT, PROCEDURALLY, THIS PROCEEDING IS
2 NOT APPROPRIATE FOR COMPANIES LIKE WINDSTREAM EAST AND
3 WINDSTREAM WEST THAT HAVE ELECTED TO OPERATE UNDER
4 ALTERNATIVE REGULATION PROVISIONS OF KRS 278.541.²⁰ HOW DO
5 YOU RESPOND?
6

7 A. This is a legal matter that AT&T's lawyers will address in AT&T's brief. As I
8 understand it, however, Windstream believes it is exempt (pursuant to KRS
9 278.541) from this complaint proceeding because its intrastate switched access
10 rates are deemed by Kentucky law to be just and reasonable, and therefore do
11 not need to be reviewed any further. The Commission rejected Windstream's
12 argument in an order in this case dated March 11, 2009, and the Franklin Circuit
13 Court upheld the Commission's order on appeal.²¹ While Windstream has
14 appealed the court's order to the Kentucky Court of Appeals, Windstream's
15 motions to further stay this proceeding have been denied.²²

16 G. WINDSTREAM'S OTHER ARGUMENTS ARE
17 INACCURATE AND IRRELEVANT.
18

19 Q. WHAT OTHER ARGUMENTS DID WINDSTREAM MAKE?

20 A. The remainder of Windstream's testimony consists of discussions that are either
21 erroneous or irrelevant and are apparently designed to distract the Commission
22 from implementing access reform. First, Windstream suggests that
23 interexchange carriers ("IXCs") are competing successfully in the long distance

²⁰ See *Caballero Direct* at 3.

²¹ See *Windstream Kentucky West, et al. v. Kentucky Public Service Commission*, Franklin Circuit Court, Civil Action No. 09-CI-00552, Opinion and Order dated Oct. 19, 2009. Windstream's appeal of that order is pending before the Kentucky Court of Appeals.

²² See *id.*, Order dated Dec. 1, 2009 (denying Windstream's motion to reinstate injunctive relief); Commission Order dated Jan. 25, 2010, in this case (lifting stay entered June 12, 2009); *Windstream Kentucky East, LLC, et al. v. Kentucky Public Service Commission, et al.*, Kentucky Court of Appeals, No. 2009-CA-001973-MR, Order dated June 7, 2010 (denying Windstream's motion for injunctive relief to stay Commission proceedings in Case No. 2007-00503).

1 market even with the existing switched access rates.²³ This statement is
2 incorrect, as Dr. Aron discusses in more detail in her Rebuttal Testimony, and it
3 is not supported by recent trends where the traditional wireline long distance
4 providers have lost minutes to their competitors that do not have to pay
5 Windstream's unreasonably high access rates for all of their long distance calls.²⁴
6 Even Windstream acknowledges the same point that wireline long distance
7 (switched access) minutes have declined dramatically.²⁵

8
9 **III. CONCLUSION AND RECOMMENDATION**

10 **Q. IS THERE ANY REASON TO DELAY OR DEFER THE REFORM OF**
11 **WINDSTREAM'S INTRATSTATE SWITCHED ACCESS RATES?**

12
13 A. None whatsoever. As I show in my Direct Testimony, and reiterate in this
14 Rebuttal Testimony, there are many reasons why the Commission should adopt
15 AT&T's plan for substantial access reform for Windstream in this proceeding, and
16 then adopt AT&T's plan to address reform of switched access charges of other
17 Kentucky ILECs and the CLECs in Case No. 2010-00162 (AT&T Petition filed on
18 April 21, 2010):

- 19 1. High intrastate access rates, which drive high long-distance prices, as Dr.
20 Aron documented empirically in her Direct Testimony, are harming
21 consumers and competition;
22
23 2. The straightforward approach AT&T proposes in the AT&T Plan is
24 workable, tracks reforms already adopted by the FCC and many states,
25 and is consistent with the anticipated further FCC's actions as
26 recommended by the NBP;
27

²³ See *Caballero Direct* at 23.

²⁴ See *Oyefusi Direct* at 19-20.

²⁵ See *Caballero Direct* at 23.

- 1 3. Modest retail pricing flexibility and limited KUSF support will easily offset
2 the decrease in revenues Windstream will see from reducing intrastate
3 access rates to interstate levels; and
4
5 4. The Commission already implemented the same reform for AT&T
6 Kentucky over a decade ago. Comprehensive access reform has been
7 delayed for Windstream and other ILECs and the CLECs for many years
8 while these LECs have continued to collect excessive charges that can no
9 longer be sustained in the new competitive environments.

10
11 The Commission should allow no further delay. Rather, it should move ahead
12 promptly and order, in this proceeding, an immediate reduction of Windstream's
13 intrastate switched access rates to interstate levels, subject to the rebalancing
14 opportunities that I discussed in my Direct Testimony. The Commission should
15 then do the same in subsequent proceedings for other ILECs and the CLECs so
16 that Kentucky can join many other states that have given the same benefits to
17 their consumers.

18 **Q. WHAT HARM WOULD FURTHER DELAY CAUSE FOR KENTUCKY**
19 **CONSUMERS?**

20
21 A. In my Direct Testimony, I explained the serious problems and consumer harm
22 produced by the current high level of intrastate switched access charges in
23 Kentucky. Dr. Aron also discussed in detail the consumer benefits in the form of
24 lower long distance prices that will be forthcoming as a result of decreasing
25 intrastate switched access rates. Kentucky consumers should not have to wait
26 any longer before they see those benefits, and the Commission should not allow
27 the current rate structure to continue distorting competition for long distance
28 service and harming consumers when they have to pay higher retail long
29 distance prices than they would if access rates were lower.

1 Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

2 A. Yes, it does.

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