COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF TELECOMMUNICATIONS AND CABLE

Petition of Verizon New England Inc., MCImetro Access Transmission Services of Massachusetts, Inc., d/b/a Verizon Access Transmission Services, MCI Communications Services, Inc., d/b/a Verizon Business Services, Bell Atlantic Communications, Inc., d/b/a Verizon Long Distance, and Verizon Select Services, Inc. for Investigation into the Intrastate Access Rates of Competitive Local Exchange Carriers	**))))))))))**	**D.T.C. 07-9**

PRE-FILED TESTIMONY OF

MICHAEL STARKEY

ON BEHALF OF

One Communications, PAETEC Communications, Inc., RNK Communications, and XO Communications Services, Inc.

PUBLIC VERSION

Confidential Information Redacted

August 20, 2008

TABLE OF CONTENTS

Exhibits

I. INTRODUCTION AND PURPOSE OF TESTIMONY

Q1. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS FOR THE RECORD.

A1. My name is Michael Starkey. My business address is QSI Consulting, Inc., 243 Dardenne Farms Drive, Cottleville, Missouri 63304.

Q2. WHAT IS QSI CONSULTING, INC. AND WHAT IS YOUR POSITION WITH THE FIRM?

A2. QSI Consulting, Inc. ("QSI") is a consulting firm specializing in regulated industries, econometric analysis and computer-aided modeling. I currently serve as the firm's President.

Q3. PLEASE PROVIDE A SYNOPSIS OF YOUR EDUCATIONAL BACKGROUND AND RELEVANT WORK EXPERIENCE.

A3. Included with this testimony as Exhibit MS-1 is a thorough description of my educational background and relevant work experience. In brief, I have been a consultant to telecommunications providers, equipment manufacturers, government agencies and other private parties since 1996. Previous to my consulting experience I served as the Director of Telecommunications for the Maryland Public Service Commission ("PSC") and prior to that, as the Office of Policy and Planning's Senior Policy Analyst for the Illinois Commerce Commission. I began my career as a Senior Economist at the Missouri PSC.

Throughout my career I have spent a great deal of time studying telecommunications networks, including substantial time and effort aimed at developing rational, efficient means by which competing communications carriers can interconnect their respective facilities. I have likewise analyzed the underlying economic characteristics of communications networks and have on numerous occasions provided expert testimony regarding the costs of providing various services, including switched access (also known as exchange access) services.

Q4. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS OR OTHER PUBLIC UTILITY COMMISSIONS?

A4. Yes. Prior to the reorganization of the Department, I testified before the Massachusetts Department of Public Utilities in D.P.U. 96-73/74, D.P.U. 96-75, D.P.U. 96-80/81, D.P.U. 96-83, D.P.U. 96-94 and have also provided testimony before other state public utility commissions on numerous occasions in approximately 40 other states (see Exhibit MS-1).

Q5. ON WHOSE BEHALF WAS THIS TESTIMONY PREPARED?

A5. This testimony was prepared on behalf of One Communications,[1] PAETEC Communications, Inc., RNK Communications, and XO Communications Services, Inc. ("Joint CLECs").

[1] Choice One Communications of Massachusetts Inc., Conversent Communications of Massachusetts Inc., CTC Communications Corp. and Lightship Telecom LLC all do business as and are referred to herein as "One Communications."

Q6. YOU MENTION ABOVE THAT YOU HAVE PROVIDED EXPERT TESTIMONY ON THE COSTS OF PROVIDING SWITCHED ACCESS SERVICES. PLEASE ELABORATE.

A6. I am currently sponsoring testimony in Docket No. 33545 before the Public Utility Commission of Texas where I am the chief architect of a switched access cost study prepared by QSI for McLeodUSA Telecommunications Services, Inc.[2] I am likewise participating in Case No. 08-C-0166 before the New York Public Service Commission wherein Verizon has filed a complaint against PAETEC Communications, Inc. and its subsidiary US LEC Corp. I also recently participated on behalf of multiple competitive local exchange carriers ("CLECs") in workshops conducted by the Illinois Commerce Commission and Florida Public Service Commission to examine CLEC intrastate switched access charges and, among other things, whether a rate cap for CLEC access rates is warranted in those states.

Q7. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A7. My testimony responds to the Pre-Filed Testimony of Paul B. Vasington on behalf of Verizon in this proceeding, filed July 7, 2008.[3] Mr. Vasington's

---

[2] The acquisition of McLeodUSA by PAETEC Communications was completed on February 8, 2008. McLeodUSA and PAETEC Communications continue as separate companies under PAETEC Holding Corp.

[3] Pre-Filed Testimony of Paul B. Vasington on Behalf of Verizon, *Petition of Verizon New England Inc., MCImetro Access Transmission Services of Massachusetts, Inc., d/b/a Verizon Access Transmission Services, MCI Communications Services, Inc., d/b/a Verizon Business Services, Bell Atlantic Communications, Inc., d/b/a Verizon Long Distance, and Verizon Select Services, Inc. for Investigation into*

testimony is filed in support of Verizon's complaint regarding the level of CLEC intrastate switched access charges in Massachusetts[4] and Verizon's proposed requirement that CLEC intrastate switched access charges be capped at levels equivalent to rates charged by incumbent local exchange carriers ("ILECs").[5] Further, it is to add reliable and relevant information to the record for consideration by the Department as it proceeds forward with this case and help the Department make a well-reasoned decision that sets good policy, and is supported factually and legally.

Q8. DO YOU HAVE ANY GENERAL OBSERVATIONS REGARDING VERIZON'S COMPLAINT AND MR. VASINGTON'S TESTIMONY?

A8. Yes. Verizon has initiated a complaint regarding the level of CLEC intrastate switched access charges and has asked the Department to undertake what I consider to be relatively drastic, market-intervening behavior in the form of price-setting for competitive, non-dominant carriers. Yet, Verizon's testimony provides very little analysis or data in support of its claims (let alone in support of its proposed solution) other than showing that CLEC intrastate switched access charges, in general, exceed Verizon's intrastate switched access charges.

---

the Intrastate Access Rates of Competitive Local Exchange Carriers, D.T.C. 07-9, filed July 7, 2008 ("Vasington Testimony").

[4] *See,* Petition for Investigation under Chapter 159, Section 14 of the Intrastate Access Rates of Competitive Local Exchange Carriers, filed by Verizon on October 11, 2007. Verizon's request for the Department to initiate an investigation on its own motion was denied, so the proceeding is being handled as a Verizon complaint, with Verizon possessing the burden of proof.

[5] Vasington Testimony, p. 1, lines 19-22.

Q9. DOES VERIZON'S EFFORT FALL SHORT OF SUBSTANTIATING ITS PROPOSAL THAT CLEC ACCESS RATES SHOULD BE CAPPED?

A9. Yes. The Department has repeatedly endorsed "competitive markets over regulation as the best way to achieve economic efficiency, technological innovations, and a greater sensitivity to customer demands."[6] Likewise, I have been informed that CLECs, by definition in Massachusetts, provide only competitive services and are presumed to lack market power.[7] As such, it seems obvious that Verizon bears the burden to substantiate its claim that regulatory price-intervention is necessary for what are otherwise considered to be competitive services. Yet, Mr. Vasington provides almost no information about either: (i) how CLEC switched access rates are unreasonable in terms of traditional Department analysis or (ii) the market characteristics that would bestow upon CLECs the market power necessary to extract supernormal profits within prices they charge for switched access services (i.e., whether barriers to entry exist that would keep Verizon or any other competitor from using the marketplace to defeat efforts on the part of CLECs to maintain supernormal

---

[6] *See, e.g., Investigation by the Department of Telecommunications and Energy on its own Motion into the Appropriate Regulatory Plan to succeed Price Cap Regulation for Verizon New England, Inc. d/b/a Verizon Massachusetts' intrastate retail telecommunications services in the Commonwealth of Massachusetts*, D.T.E. 01-31 (Phase I), 2002 Mass. PUC LEXIS 10, *3, May 8, 2002 ("The Massachusetts Department of Telecommunications and Energy ("Department") again has endorsed competitive markets over regulation as the best way to achieve economic efficiency, technological innovations, and a greater sensitivity to customer demands.")

[7] D.T.E. 01-31 (Phase I), 2002 Mass. PUC LEXIS 10, *4, May 8, 2002 ("In 1985, the Department classified both AT&T and New England Telephone (now Verizon) as dominant carriers with market power, subject to traditional ratemaking standards for ensuring that prices are just and reasonable. All other carriers have been classified as non-dominant, a classification that means that market forces are sufficient to ensure that their rates are just and reasonable.")

profits). In short, Mr. Vasington appears to simply assume that CLEC switched access rates are unreasonable and that the market is "broken," and spends most of his time trying to explain how to "fix" it. The Commission, however, should not take his assumption for granted.

Q10. IF THE DEPARTMENT REFUSES TO ASSUME THAT THE MARKET IS "BROKEN," HOW WOULD IT GO ABOUT EVALUATING VERIZON'S CLAIM?

A10. The following step-by-step process sets forth the minimum considerations that should guide any analysis of whether CLEC access charges should be capped (or benchmarked to the ILEC rate).

Step 1: **Determine if there is a problem**.
This step involves determining whether CLECs have market power. Market power cannot exist without barriers to entry, so barriers to entry must be identified prior to a finding that there is a market power problem.

Step 2: **Dismantle Barriers**.
If barriers to entry are identified under Step 1, then Step 2 involves determining how those barriers to entry can be dismantled. Removing barriers to entry so that markets can work effectively should be the primary objective of regulators, with price regulation serving as a last resort.

Step 3: **Examine Regulatory Alternatives**.
If barriers to entry cannot be dismantled, there should be a good explanation as to why those barriers cannot be removed and other regulatory alternatives should be examined – only one of which is price regulation.

Step 4: **Determine the Type of Price Regulation**.
If price regulation is determined to be the best of potential regulatory alternatives, a sound foundation should be established as to why "benchmarking" is the best solution,

rather than more traditional regulatory approaches; e.g., limiting the "margin" rates may include in excess of underlying costs.

Step 5: **Determine the Proper Benchmark**.
If benchmarking is determined to be the best regulatory alternative, a sound foundation should be established as to what the proper benchmark is. As it relates to Verizon's complaint, a foundation should be established as to why Verizon, one of the world's largest and most vertically-integrated[8] companies, as opposed to another carrier or carriers, is the proper benchmark for much smaller, competitive carriers.

A primary problem with Verizon's case is that it skips these steps by presuming that market power exists (without identifying any barriers to entry) and jumps straight to prescribing Verizon's rates as a benchmark (without examining any other options or explaining why Verizon's rate is the proper benchmark).

Q11. IS THE MARKET "BROKEN" IN THE WAY MR. VASINGTON ASSUMES?

A11. No. In the following testimony I will demonstrate that CLECs do not have market power because there are no barriers to entry that preclude other carriers, including Verizon, from competing against them in the switched access market. Further, I will show that Mr. Vasington's assumption that CLEC access rates must be unreasonable simply because they exceed the prices charged by Verizon is fallacious. Rather than the result of a "broken" market, I will demonstrate that

---

[8] Vertical integration can be defined as the conjunction of two or more successive stages of production within a single firm. *See,* Shepherd, William G., *The Economics of Industrial Organization*, 3rd ed. (Prentice-Hall, 1990), at pages 363-364. Verizon has previously acknowledged that it is a vertically-integrated firm in both input and downstream markets. *See, In the Matter of Verizon Communications Inc. and MCI, Inc. Applications for Approval of Transfer of Control*, WC Docket No. 05-75, Memorandum Opinion and Order, Rel. November 17, 2005 ("FCC Verizon/MCI Merger Order"), ¶ 55.

where CLEC access rates are higher than Verizon's, the primary cause is likely to be that CLEC costs of production exceed those of Verizon due to substantially smaller economies and other factors. As a result, benchmarking CLEC switched access rates to Verizon's rates is likely to result in CLEC charges that fail to cover their underlying costs, a situation certain to create unwanted and unnecessary market distortions.

Q12. MR. VASINGTON ARGUES THAT THE FEDERAL COMMUNICATIONS COMMISSION ("FCC") HAS ALREADY DETERMINED THAT THERE ARE PROBLEMS WITH THE MARKET FOR CLEC SWITCHED ACCESS SERVICES AND HAS REQUIRED BENCHMARKING. IS HE RIGHT?

A12. As I will explain in more detail below, the FCC decided upon an ***interim*** solution of benchmarking CLEC access rates to ILEC rates in 2001 pending (a) changes in the market that would support a more competitive environment and (b) its completion of more comprehensive restructuring of inter-carrier compensation. As I describe below, the changes in the underlying market discussed by the FCC have come to pass. This fact alone shows that the FCC action in 2001 is no longer appropriate and not something that the Department should follow. Further, it is worth noting that the FCC, after more than seven years of delay, has stated that it is committed to comprehensively restructuring inter-carrier compensation, including switched access charges for all carriers in the near term. As such, Verizon's complaint is, at the very least, poorly timed.

Q13. WHAT IS THE BASIS FOR YOUR STATEMENT THAT THE FCC IS FINALLY COMMITTED TO COMPREHENSIVELY RESTRUCTURING INTERCARRIER COMPENSATION?

A13. On July 8, 2008, the United States Court of Appeals for the District of Columbia Circuit granted Core Communications Inc.'s writ of mandamus and directed the FCC to explain the legal basis for its ISP[9]-bound compensation rules within six months. The court ruled that the FCC's ISP-bound compensation rules would be vacated if no such explanation is provided by the FCC within the specified timeframe.[10] Counsel for the FCC indicated in oral arguments in that case that FCC Chairman Martin "intends to achieve broad-based comprehensive intercarrier compensation reform within six months"[11] – or by November of this year. With the FCC set to act on intercarrier compensation (including access charges) very soon, by the time a decision is rendered in this case,[12] it is likely that the FCC will have already taken action to restructure the intercarrier compensation regime Mr. Vasington relies upon as a model.

---

[9] "ISP" is an acronym for Internet Service Provider.
[10] *In Re: Core Communications, Inc.*, D.C. Cir. Civ. No. 07-1446, Decided July 8, 2008.
[11] *In Re: Core Communications, Inc.*, D.C. Cir. Civ. No. 07-1446, Transcript of May 5, 2008 Oral Argument, at 22 (Palmore comments).
[12] Reply Briefs in this case are due on October 24, 2008 (*see*, Procedural Notice, July 1, 2008), which means that the Department will not render a decision in this case until some time in or after November.

II. CLECS DO NOT POSSESS MARKET POWER IN THE PROVISIONING OF INTRASTATE SWITCHED ACCESS SERVICES

A. A Formal Market Power Analysis Shows That CLECs Do Not Possess Market Power

Q14. CAN YOU PROVIDE A BRIEF SYNOPSIS OF HOW REGULATORS DETERMINE WHETHER MARKET POWER EXISTS IN MARKETS?

A14. Yes. There are essentially four components of a market power determination:

1. definition of market power;
2. definition of the product and geographic market dimensions;
3. market share analysis; and
4. final assessment of all demand and supply responses in reaction to an attempted exercise of market power (*i.e.*, whether an exercise of market power will succeed or be defeated).

Q15. REGARDING THE FIRST COMPONENT – HOW IS MARKET POWER DEFINED?

A15. Market power is defined in the *Horizontal Merger Guidelines* (which is used by the U.S. Department of Justice ("DOJ") and Federal Trade Commission ("FTC") in analyzing prospective mergers) as follows:

> Market power to a seller is the ability profitably to maintain prices above competitive levels for a significant period of time.[13]

[13] *Horizontal Merger Guidelines* at Section 0.1 (emphasis added). U.S. DOJ and FTC Horizontal Merger Guidelines available at: http://www.usdoj.gov/atr/public/guidelines/horiz_book/toc.html

Implied in this definition is the notion that competitive prices are compensatory only in the sense that they provide for a natural rate of return (*i.e.*, zero economic profits), and any returns above the competitive levels would be competed away as long as the market is competitive. Conversely, if the market is not competitive, then a seller's attempt at extracting excessive or "positive economic" profits will succeed. If those positive economic profits are sustained for a significant period of time, then the seller is deemed to possess market power.

Q16. HAS THE FCC USED A SIMILAR DEFINITION OF MARKET POWER?

A16. Yes. Drawing on this theoretical framework, the FCC has used a definition of market power essentially the same as that used by the DOJ and FTC:[14]

> Market power is defined as "the ability to raise prices by restricting output," or "to raise and maintain price above the competitive level without driving away so many customers as to make the increase unprofitable."

Q17. HOW ARE THE GEOGRAPHIC AND PRODUCT MARKETS DEFINED IN A MARKET POWER ANALYSIS (SECOND COMPONENT)?

A17. The ultimate purpose of defining the market is to ensure that the market power analysis reflects all the relevant demand responses and supply responses that may cause a firm to fail in its attempt to exercise market power. In doing so, a market should not be defined too narrowly because it may exclude possible competitors (and products) and lead to an erroneous conclusion that a firm has market power.

[14] *In the Matter of Petition of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Omaha Metropolitan Statistical Area*, WC Docket No. 04-223, Memorandum Opinion and Order, Rel. December 2, 2005 ("Qwest Omaha Forbearance Order") at note 54.

A market should also not be defined too broadly because it may suggest the presence of alternatives that are not truly available, and lead to an erroneous conclusion that a firm does not have market power. To define the proper scope of the market, the *Horizontal Merger Guidelines* approach the market definition process as follows:

> A market is defined as a product or group of products and a geographic area in which it is produced or sold such that a hypothetical profit-maximizing firm, ***not subject to price regulation***, that was the only present and future producer or seller of those products in that area likely would impose at least a "small but significant and nontransitory" increase in price, assuming the terms of sale of all other products are held constant. (Emphasis added.)
>
> […]
>
> A relevant market is a group of products and a geographic area that is no bigger than necessary to satisfy this test. The "small but significant and non-transitory" increase in price is employed solely as a methodological tool for the analysis of mergers: it is not a tolerance level for price increases.

Using this approach, two dimensions of the market need to be defined: the product market and the geographic market.

Q18. PLEASE ADDRESS THE PRODUCT MARKET.

A18. The Horizontal Merger Guidelines discusses the product market as follows:

> Absent price discrimination, the Agency will delineate the product market to be a product or group of products such that a hypothetical profit-maximizing firm that was the only present and future seller of those products ("monopolist") likely would impose at least a "small but significant and nontransitory" increase in price. That is, assuming that buyers likely would respond to an increase in price for a tentatively identified product group only by shifting to other products, what would happen? If the alternatives were, in the aggregate, sufficiently attractive at their existing terms

> of sale, an attempt to raise prices would result in a reduction of sales large enough that the price increase would not prove profitable, and the tentatively identified product group would prove to be too narrow.
>
> Specifically, the Agency will begin with each product (narrowly defined) produced or sold by each merging firm and ask what would happen if a hypothetical monopolist of that product imposed at least a "small but significant and nontransitory" increase in price, but the terms of sale of all other products remained constant. If, in response to the price increase, the reduction in sales of the product would be large enough that a hypothetical monopolist would not find it profitable to impose such an increase in price, then the Agency will add to the product group the product that is the next-best substitute for the merging firm's product.[15]

Q19. PLEASE EXPLAIN HOW THE GEOGRAPHIC MARKET IS DEFINED?

A19. As with the product dimension of the market, the geographic dimension of a market in a market power analysis is defined by postulating a large, single provider and then asking the question: what should the geographic size of the market be so that the firm would be able to sustain a small but significant and non-transitory price increase? The notion is that if the geographic market is defined too small, then consumers would be able to go "next door" to purchase the product at a lower price, which means that "next door" should have been included in the geographic scope of the market. On the other hand, to avoid the selection of an overly expansive geographic market, the *Horizontal Merger Guidelines* applies the principle of the "smallest market":

> The "smallest market" principle will be applied as it is in product market definition. The price for which an increase will be postulated, what constitutes a "small but significant and

[15] *Horizontal Merger Guidelines,* Section 1.11.

> nontransitory" increase in price, and the substitution decisions of consumers all will be determined in the same way in which they are determined in product market definition.[16]

Within the context of the issue under consideration – whether or not CLECs have market power in the provision of switched access services – the geographic dimensions may be usefully defined as the entirety of the service area in which local exchange carriers compete. That is, the geographic market is the entire service area in which ILECs and CLECs compete for end user customers.[17]

Q20. PLEASE ADDRESS THE THIRD COMPONENT OF THE MARKET POWER ANALYSIS – MARKET SHARES.

A20. The *Horizontal Merger Guidelines* considers two sets of alternative providers who can apply competitive pressures to defeat an attempted price increase: currently existing providers and potential entrants. An evaluation of the impact of alternative providers typically involves some assessment of relative market shares. Given that the issue under investigation concerns whether or not CLECs have market power in the provision of switched access services, the relevant

[16] *Horizontal Merger Guidelines*, at Sec. 1.2.1

[17] This geographic market definition follows the FCC's geographic market definition for switched access services in the *Qwest Omaha Forbearance Order*: "Qwest also states that its service territory in the Omaha MSA includes 24 wire centers in the Omaha MSA, and that it therefore seeks relief throughout the territory served by those wire centers. In its Petition, Qwest filed retail market data regarding the entire MSA, without disaggregating the state of competition by county, zip code, wire center or other more narrow geographic market… For the purposes of analyzing dominant carrier regulation of Qwest in this proceeding, *we define the relevant geographic market here to be Qwest's service area in the Omaha MSA.* Qwest has proposed its *service territory* as the market and submitted its case consistent with that definition, *so we begin our analysis with that region as the relevant geographic market* unless the record indicates compelling reasons to narrow it." *Qwest Omaha Forbearance Order*, ¶¶ 23-24. (emphasis added).

question is: what are the market shares of CLECs, individually, relative to the total size of the market?

Q21. WHAT ARE THE MARKET SHARES OF CLECS?

A21. As indicated in the FCC's Local Competition Report, collectively, CLECs still constitute but a small percentage of local exchange markets across the country.[18] The most recent FCC data shows that CLECs serve only about 17.6% of the local market[19] in the U.S. (down from a high of 19.1% as of June 2005). In Massachusetts, CLEC market share is slightly higher at 23% (down from 25% in 2005 and 24% in 2006).[20] While exact numbers for individual CLECs are not available, the individual CLEC market shares, of course, will generally be only a fraction of the overall market share of the CLECs. For example, the 17.6% CLEC market share nationally is split between 398 reporting CLECs, and the 23% CLEC market share in Massachusetts is split between 39 reporting CLECs.[21]

Q22. ARE THESE CLEC MARKET SHARES INDICATIVE OF THE POTENTIAL FOR MARKET POWER?

A22. No. Neither collective CLEC market shares, nor individual CLEC market shares rise to the levels indicative of market power. To place the market share information in context of a market power analysis, one should recognize that

---

[18] FCC *Local Competition Report*, 2007. Table 1.
[19] Measured as a percentage of total access lines – one measure of market share. It must be noted, however, that CLECs typically serve small to mid-sized business customers that generally have multiple lines, and not residential customers, who generally have only one line. Thus a CLEC's percentage of lines served will typically be higher than its percentage of customers served.
[20] FCC *Local Competition Report*, 2007. Table 8.
[21] FCC *Local Competition Report*, 2007. Table 13.

courts virtually never find market power when market shares are less than 50%.[22] The FCC used approximately the same market share levels for assessing whether petitioners in forbearance petitions have market power.[23] Obviously, CLEC market shares – to be assessed on an individual basis – are not even close to 50%.[24]

Q23. PLEASE EXPLAIN THE FOURTH COMPONENT OF A MARKET POWER ANALYSIS – SUPPLY AND DEMAND RESPONSES.

A23. I will discuss supply responses first and demand responses below. Supply responses are generally determined by the extent to which there are *barriers to entry* that keep existing and potential providers at bay. These are discussed in Section 3.0 of the Horizontal Merger Guidelines. The Horizontal Merger Guidelines state that

> A merger is not likely to create or enhance market power or to facilitate its exercise, if entry into the market is so easy that market participants, after the merger, either collectively or unilaterally could not profitably maintain a price increase above premerger levels. Such entry likely will deter an anticompetitive merger in its incipiency, or deter or counteract the competitive effects of concern.

---

[22] A.B.A. Section of Antitrust Law, Antitrust Law Developments at 235-236 (4th ed.) (1997), cited in the FCC *Verizon Forbearance Order* at footnote 99.
[23] A.B.A. Section of Antitrust Law, Antitrust Law Developments at 235-236 (4th ed.) (1997), cited in the FCC *Verizon Forbearance Order* at footnote 99.
[24] Because intrastate access charges are charges for IXC access to customers or lines to originate or terminate an intrastate toll call, and access lines indicate numbers of potential lines served (to which, or from which toll calls could be made), this market analysis is appropriate in establishing switched access charge market share.

Though the Horizontal Merger Guidelines apply primarily to analyzing mergers, the point is the same here: if entry is easy, supply responses will thwart attempts to raise prices above competitive levels. The ease of entry of alternative suppliers is dictated by whether there are barriers present in the market, and absent barriers, there is nothing to keep existing and potential providers from coming in to compete away the profits obtained by a firm charging prices above the competitive levels (i.e., lack of barriers equates to ease of entry).

Q24. ARE THERE BARRIERS IN THE SWITCHED ACCESS MARKET THAT WOULD ALLOW CLECS TO PROFITABLY MAINTAIN PRICES FOR SWITCHED ACCESS ABOVE COMPETITIVE LEVELS FOR A SIGNIFICANT PERIOD OF TIME?

A24. None that can be erected by CLECs. Due to the local entry strategies made available in the Telecom Act and the vertical integration brought about by the mergers of Regional Bell Operating Companies ("RBOCs") and large interexchange carriers ("IXCs"), it cannot be convincingly argued that the vertically-integrated RBOCs/IXCs (e.g., Verizon) face barriers-to-entry that would allow a CLEC to earn supernormal switched access profits without a competitive response. The vertically-integrated RBOCs/IXCs like Verizon own and operate the last mile loop facilities, including those that are used by the CLECs to serve most of their local exchange customers (not to mention the ubiquitous switching and transport facilities owned by the RBOC/IXCs). Accordingly, there is no barrier that would prohibit Verizon, AT&T, Sprint or other IXCs from entering the switched access market and competing away any alleged supernormal profits.

Q25. CAN YOU PROVIDE AN EXAMPLE THAT PUTS THE COMPETITIVE PRESSURES FACED BY CLECS FROM VERTICALLY-INTEGRATED RBOCS/IXCS IN PERSPECTIVE?

A25. Yes. By way of example, if a CLEC is serving end user customers in Boston via Verizon Massachusetts' UNE loops and that CLEC's end users are presubscribed to Verizon Long Distance as their long distance carrier, Verizon will be billed by the CLEC for originating or terminating access when those customers place or receive long distance calls through Verizon Long Distance. If Verizon Long Distance believes that the CLEC's switched access rates are too high, its affiliate Verizon Massachusetts (the ILEC and owner of the loop over which the CLEC's end users are served) could attempt to win those customers away from the CLEC so that its long distance affiliate can avoid paying the CLEC's access charges. Given that Verizon owns the switched access connection (i.e., the local loop) and can compete with CLECs on price, products, and quality of service if it chooses to, Verizon certainly has the means to attract CLEC customers.

Q26. PLEASE DESCRIBE RELEVANT DEMAND CHARACTERISTICS OF THE MARKET.

A26. The demand characteristics of the access market are distorted by public policy goals (as laudable as they may be) of regulators. The FCC has previously interpreted section 254(g) of the Act as requiring IXCs to spread the cost of switched access among all of their end users.[25] This means that under the FCC's current policies, IXCs are not allowed, in billing their end users, to pass through the actual cost of switched access, and as a result, their end users do not receive accurate price signals. Many states likewise require geographic long distance price averaging.[26] Because of these prohibitions on de-averaging, IXCs do not signal to their end user customers when calls are expensive to terminate and when they are less expensive to terminate, which distorts the demand responses of end users. By de-averaging, for example, IXCs could differentiate long distance prices to reflect the relative cost of switched access, and as a result, end users would be more apt to respond to the cost of switched access based on the associated price of long distance services. While these prohibitions on de-averaging may serve public policy objectives of universal service, they also, as most price regulations do, stymie proper price signals and create distortions. Capping CLEC access rates in the face (or due to) de-averaging prohibitions unfairly singles out CLECs to foot the bill for the pursuit of universal service by not allowing them to recover their legitimately-incurred costs. By imposing what are likely below-cost switched access rates on CLECs, benchmarks force CLECs

---

[25] *See* Order ¶ 11 & n.15; *Policy and Rules Concerning the Interstate, Interexchange Marketplace, Implementation of § Section 254(g) of the Communications Act of 1934, as amended*, Report and Order, 11 FCC Rcd 9564, ¶ 9 (1996).

[26] AT&T has indicated that "IXCs are required by federal law to geographically average interstate rates and for all practical purposes are forced to do the same with intrastate rates." Comments of AT&T in Support of Verizon's Petition for Investigation of CLEC Access Rates and Motion to Consolidate with AT&T's Requested Investigation of Level 3's Proposed Terminating Access Rate Increases. November 7, 2007, p. 2.

and their end users to subsidize the IXCs and their customers. It should be noted that this subsidization – in the name of universal service – runs contrary to the express objectives of the Telecom Act, which mandate that universal service policies be pursued through explicit, not implicit, subsidies (i.e., implicit subsidies were supposed to be phased out – not phased in).

Q27. ARE THERE OTHER OPTIONS THAT COULD BE PURSUED BY IXCS LIKE VERIZON TO MODIFY DEMAND RESPONSES IN RELATION TO SWITCHED ACCESS COSTS?

A27. Yes. Under the current switched access structure, CLECs assume the capacity risks of having sufficient stand-by capacity necessary to accommodate all levels of IXC traffic volumes. In other words, while Verizon IXC may buy 2 minutes of access from a CLEC in one month, nothing prohibits Verizon IXC from sending 1,000,000 minutes of traffic the next month with all minutes charged exactly the same rate. Of course, the CLEC must stand ready to support as much traffic as it may be sent or its customers do not receive their calls (a situation that is not sustainable for competitive carriers like CLECs). The costs of that stand-by capacity are real costs of supporting a telecommunications network and are legitimately recoverable in switched access rates. Further, due to the smaller size and other characteristics of the CLECs' operations (discussed below), CLECs generally have lower levels of utilization for this stand-by capacity than the RBOCs. This means that per minute-of-use switched access rates for CLECs may very well be substantially, but reasonably, higher than IXCs would prefer. One potential solution (or demand response) would be for IXCs to share the capacity risks by purchasing blocks of switched access minutes (i.e., capacity) at lower per-minute rates (but at designated increments by which CLECs can ensure necessary capacity) or even dedicated, fixed-rate switched access lines. After all, IXCs are far better informed about expected toll traffic volumes coming from their customers and are well positioned to make arrangements for optimally-sized and relatively more efficient dedicated facilities, which would normally be priced on a flat-rated basis. These types of arrangements could save money and would only require additional negotiations between IXCs and CLECs.

Q28. WHAT IS YOUR ASSESSMENT ON WHETHER CLECS POSSESS MARKET POWER FOR INTRASTATE SWITCHED ACCESS SERVICES?

A28. CLECs do not possess market power for intrastate switched access services. Any attempt by a CLEC to earn supernormal profits on switched access services would be defeated by supply responses. There are no barriers that keep existing or potential suppliers at bay – particularly the vertically-integrated RBOCs/IXCs that own the switched access connection and oftentimes provide the CLEC end users with transportation or other elements of the toll service. Further, companies compete for all revenues (and profits) associated with an end user, and if certain end users become more profitable or less profitable to serve due to higher switched access rates, then the market will respond by increased or decreased competition for those customers. In other words, should a CLEC set and collect exorbitant switched access rates, then the overall revenues[27] associated with the CLEC's customers would be high, and the customer would be especially attractive to would-be competitors from a customer acquisition perspective.[28] In this way, retail competition disciplines upstream, wholesale markets for switched access services. And given that Verizon, in the post-merger era, is a fully vertically-integrated company, combining IXC and LEC operations, and has near ubiquitous facilities and operations in its territory, it is now uniquely positioned to compete for all CLEC customers.

Q29. WOULD A CLEC BE SUCCESSFUL IN MAINTAINING ACCESS RATES AT LEVELS HIGHER THAN COMPETITIVE LEVELS FOR A NON-TRANSITORY PERIOD?

A29. No. In order to build and preserve its customer base, a CLEC will be forced to (1) attract customers for which it has a competitive advantage and (2) set prices at levels sufficiently low so as not to dissipate its competitive advantage. Setting intrastate switched access rates at exorbitant levels would forfeit any competitive advantages and be a self-defeating strategy as it would draw existing and would-be competitors into the segment of the market targeted by the CLEC, thus undermining the prospects of its long term success. To reiterate, *competition in retail markets disciplines market behavior in upstream wholesale markets for*

[27] A finding of market power requires that those revenues are also associated with supernormal profits.
[28] In this way, when a vertical-integrated competitor like Verizon pays a "high" CLEC access rate on the wholesale side, it could also acquire this customer as a retail customer, and thereby eliminate and save the cost of paying the CLEC's access rates, in addition to gaining its own access rates, and making retail profits from whatever retail services the customer would purchase.

switched access services. Taking all relevant supply and demand responses into consideration, the conclusion is that CLECs lack the ability to set prices higher than competitive levels for a non-transitory period: thus, they lack market power.

Q30. HOW THEN DO CLECS MAINTAIN PRICES FOR SWITCHED ACCESS SERVICES NOTABLY ABOVE LEVELS CHARGED BY VERIZON?

A30. As I will describe in more detail later in this testimony, there is no evidence that Verizon's switched access charges equate to any type of "competitive level" or "market clearing" price to which CLEC access charges should be compared in evaluating market power.

Q31. HAS THE DEPARTMENT CONDUCTED MARKET POWER ANALYSES IN THE PAST AND HAS MR. VASINGTON ACKNOWLEDGED THE DEPARTMENT'S RELIANCE ON A FORMAL MARKET POWER ANALYSIS WHEN ADDRESSING MARKET POWER ISSUES?

A31. Yes, which makes Mr. Vasington's lack of analysis in this regard particularly disturbing. In response to data request AG-VZ-1-17, Verizon indicates that:

> The Department's long-standing framework on assessing competition is an assessment of supply elasticity, demand elasticity, and market share, with a primary emphasis on supply elasticity. It is unknown to what extent a requirement for CLECs to charge just and reasonable rates for intrastate access would have any impact on any of the three factors in a competition assessment.

The fact that Mr. Vasington knows that the Department has a "long-standing" practice of conducting a formal market power analysis when evaluating competition-impacting regulations that may, or may not, be proper in a given circumstance indicates that Verizon affirmatively chose not to conduct the very analysis (as it relates to CLEC intrastate switched access rates) on which the Department has traditionally relied.

B. There Is No Basis For Verizon's Presumption That CLECs Possess Market Power For Intrastate Switched Access Services in Massachusetts

Q32. VERIZON CLAIMS THAT CLECS POSSESS MARKET POWER FOR ACCESS SERVICES.[29] WHAT ARE THE PROBLEMS WITH VERIZON'S CLAIM IN THIS REGARD?

A32. The only information that Verizon provides in support of its claim of CLEC market power is that CLEC rates are higher than Verizon rates – information that, in isolation, says nothing about market power. Verizon does not attempt to conduct a formal market power analysis, nor does Verizon attempt to explore alternative reasons why CLEC and Verizon access rates may differ. Contrary to Verizon's claim, that CLEC rates are higher is not an indication of market power, but more likely a product of the cost differences between CLECs and Verizon as well as the manner in which Verizon's intrastate switched access rates have been established. When these factors are taken into account (both of which are discussed in Section III below), it is evident that Verizon's claims regarding unreasonable CLEC access rates fall far short of the mark.

[29] Vasington Testimony, p. 7.

Q33. MR. VASINGTON STATES THAT CLECS POSSESS MARKET POWER BECAUSE "A TOLL PROVIDER CANNOT REFUSE TO DELIVER A CALL TO A CLEC'S END USER – AND THUS CANNOT AVOID THAT CLEC'S TERMINATING ACCESS CHARGES."[30] HOW DO YOU RESPOND?

A33. Mr. Vasington makes a mistake that is all too prevalent in the debate on CLEC access charges: he focuses only on the short run.

Q34. PLEASE EXPLAIN.

A34. Mr. Vasington's argument is as follows: when an end-user makes or receives a long distance call, the IXC is obligated to originate or terminate the call at whatever price the CLEC may charge for that call because there are no alternatives or substitutes available to the IXC related to that particular call. Therefore, according to Mr. Vasington, the CLEC has market power. This reasoning, although intuitively appealing, is incorrect. Using this type of a short run analysis, many companies may appear to have monopoly power. For example, in the short run, it may appear that airlines on cross-Atlantic flights have market power in the provision of restroom access. Anyone that has been on a long flight knows that airlines could extract substantial fees for access to the restroom if they were not otherwise constrained. In a slightly longer-run analysis, however, it is clear that they have little or no market power and are, in fact, operating in a highly competitive environment. For example, if an airline

[30] Vasington Testimony, p. 8.

attempted to charge a regular competitive price for airline tickets and then an exorbitant amount for bathroom access on its flights, customers would likely decide not to fly on that airline more than once, and other airlines would surely swoop in to serve those passengers. The truth is that a determination of market power, by definition, must be premised on a *time horizon* that is *sufficiently long to permit for demand and supply responses to discipline market participants.* Recall the definition of market power above: "Market power to a seller is the ability profitably to maintain prices above competitive levels ***for a significant period of time***."[31] By focusing only on a particular call, Mr. Vasington makes the same mistake that would be made in suggesting airlines possess market power in providing bathroom services: he ignores a key element of the definition of market power – to be able to maintain prices above competitive levels *for a significant period of time.*

Q35. WHEN THIS FLAW IS CORRECTED, DOES IT STILL APPEAR THAT CLECS HAVE MARKET POWER?

A35. No. When a longer run analysis is considered, it is clear that alternative suppliers can win customers away from CLECs charging excessive intrastate access rates. Therefore, the time horizon needs only to be sufficiently long for the competitive process of customer acquisition – or rather, the threat of customer acquisition – to play out. CLECs operate in an environment in which they compete for all the

[31] *Horizontal Merger Guidelines* at Section 0.1 (emphasis added). U.S. DOJ and FTC Horizontal Merger Guidelines available at: http://www.usdoj.gov/atr/public/guidelines/horiz_book/toc.html. [emphasis added]

revenues associated with the end-user, which includes not only the revenues from the local exchange and long distance services offered to the end-user, but also the revenues of switched access services offered to IXCs. That is, when Mr. Vasington's short-run error is corrected, retail competition disciplines the upstream wholesale markets.

C. Verizon has failed to show that CLEC switched access rates in Massachusetts are unreasonable

Q36. HAS VERIZON DEMONSTRATED THAT CLEC SWITCHED ACCESS CHARGES IN MASSACHUSETTS ARE UNREASONABLE?

A36. No. Verizon through the testimony of Mr. Vasington has simply highlighted differences in the rates CLECs charge for access relative to rates Verizon charges for access and thereafter assumed that those differences are caused by market power exercised by the CLECs. As explained above, Verizon fails to demonstrate that market power exists for CLECs and ignores the numerous reasons (as described herein) costs of providing switched access services for CLECs are likely higher than Verizon's. Also problematic is the fact that Verizon's analysis specifically ignores other causes for the rate differences it highlights.

Q37. PLEASE ELABORATE.

A37. Verizon's intrastate switched access rates were reduced by the Department in the 2002-2003 timeframe to Verizon's interstate access rate level. In so doing, the Department authorized Verizon to reduce its access rates in a revenue neutral manner such that the reduction in access revenue were met with a commensurate increase in revenues for Verizon's most inelastic basic residential local exchange services. Therefore, a comparison between Verizon's current intrastate access rates (which were previously reduced in a revenue neutral manner) and CLECs' current intrastate access rates is not a valid comparison.[32] When Verizon's revenue neutral reduction is taken into account, CLEC intrastate access rates in Massachusetts compare favorably to Verizon's.

Q38. CAN YOU DEMONSTRATE THAT CLEC INTRASTATE ACCESS RATES IN MASSACHUSETTS COMPARE FAVORABLY TO VERIZON'S?

A38. Yes. Verizon has stated that just prior to Verizon's revenue neutral access rate reduction, Verizon's traffic-sensitive intrastate switched access rate in Massachusetts was about $0.039 (or 3.9 cents) per minute.[33] I also calculated Verizon's pre-01-31 composite terminating intrastate switched access rate to be $0.03835.[34] By comparison, the current average CLEC intrastate terminating

[32] Verizon quantified this revenue impact at $51.9 million, which due to the revenue neutral access reduction, it was able to recover through increases to basic local exchange service rates.

[33] *See*, Pre-Filed Testimony of Paula Brown on behalf of Verizon Massachusetts in D.T.E. 01-31 (filed April 12, 2001) ("**Q.** What is the rate reduction associated with the change to the interstate rate levels and rate structure? **A.** The movement of state switched access to the interstate rates and rate structure reduces the overall intrastate switched access rate per minute of use ("MOU") in Massachusetts, from approximately $0.039 per MOU to $0.0125 per MOU on an end-to-end basis. The proposed rate levels and structure for switched access services are detailed in the Attachment II to my testimony. Included in that attachment is a detailed description of the rate structure changes, a comparison of the present and proposed average rate per minute, and diagrams that compare the current and proposed rate structures.")

[34] The Verizon pre-01-31 rate I calculated assumes terminating peak rates with 10 miles of local transport. This is a summation of the usage-sensitive access rates for: carrier common line ($0.028243), local switching ($0.003086), tandem switching ($0.000258), local transport fixed ($0.003472), local transport mileage ($0.000099 x 10) and interconnection charge ($0.002301). The source for Verizon's pre-01-31

switched access rate in Massachusetts is about $0.0365 per minute – around 5 to 7% *less than* Verizon's pre-01-31 rates.[35]

Q39. WHEN VERIZON'S REVENUE NEUTRAL ACCESS RATE REDUCTION IS TAKEN INTO ACCOUNT, DO THE CLEC COMPOSITE RATES CALCULATED BY MR. VASINGTON INDICATE THAT CLEC ACCESS RATES ARE IN A ZONE OF REASONABLENESS?

A39. Yes. Mr. Vasington calculates what he refers to as the Average Revenue Per Minute ("ARPM") for CLECs, which is according to Mr. Vasington, a composite rate of all usage-sensitive switched access rate elements for the CLEC. While I do not vouch for Mr. Vasington's ARPM calculations, the CLEC ARPMs he calculates compare favorably to Verizon's pre-01-31 rate of $0.039.[36] Mr.

---

access rates is Verizon's workpapers from D.T.E. 01-31. Attachment II, Workpaper 2, available on the Department's website.

[35] Like the Verizon pre-01-31 rate, this assumes terminating peak minutes with 10 miles of transport and is a summation of the usage sensitive access rates. The average CLEC rate is based on the rates of 20 CLECs in Massachusetts. The CLEC rates were compiled from the following sources: (a) the Center for Communications Management Information's ("CCMI's") Telview Intrastate Access Database (all Massachusetts CLECs in this database are included in the average, (b) CLEC access tariffs (for CLECs not in CCMI's database, but whose tariffs were available), and (c) Verizon workpapers in response to data requests in this proceeding (for CLECs not included in (a) or (b). Note: rates for Lightship not included because it is my understanding that Lightship no longer provides access service in Massachusetts. Also, the rates for Granite Telecom from Verizon's response to discovery is not included in the average because Verizon indicates that the rates Verizon reports for Granite are based on Verizon's billings and not Granite's tariffs. The bottom line is that all CLECs providing access in Massachusetts and whose access rates I was able to obtain and verify are included in the CLEC average.

[36] To the extent that Verizon takes issue with comparing the $0.039 Verizon rate to the ARPMs Verizon calculates for CLECs, the Department should be aware that Verizon was asked in discovery to provide Verizon's ARPM and terminating access rate assuming that the revenue that was previously shifted to basic residential services through the revenue neutral reduction was recovered through Verizon's switched access rates (i.e., Verizon's pre-01-31 ARPM and terminating access rate) and Verizon objected to providing the requested information. Verizon Response to data request RNK-VZ-1-15(b) and (c). If Verizon would have provided the requested information perhaps a more accurate comparison could have been made to the current CLECs' ARPMs that Verizon calculates, but the larger point that the numbers are designed to support holds true: when the access rate comparisons account for the revenue neutral reduction that Verizon received, CLEC access rates compare favorably to Verizon's and are not on their face unreasonable.

Vasington calculates XO's current ARPM to be [*****BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL***]**[37] - ***which is lower than Verizon's rate prior to Verizon's revenue neutral access rate reduction.*** Similarly, Verizon calculates the ARPM for Choice One to be **[*** BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL***]** Verizon's pre-01-31 rate.[38] Verizon also calculates the ARPM of another CLEC (RNK Telecom) as [*****BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL***]**, which is right at (or just slightly above) the level of Verizon's pre-01-31 rate. Indeed, the highest CLEC ARPM that Verizon calculated **[***BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL***]** is about **[***BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL***]** higher than Verizon's pre-01-31 rate (in contrast to the exponential differences cited by Mr. Vasington[39]). These comparisons show that CLEC rates compare favorably to the rates Verizon had in place before it was allowed to shift some portion of its switched access cost recovery from switched access rates onto highly inelastic residential rates (an option CLECs simply do not have).

Q40. HAS VERIZON ADMITTED THAT IT WOULD STILL HAVE THE HIGHER SWITCHED ACCESS RATES IN MASSACHUSETTS TODAY

---

[37] Vasington Testimony (Proprietary), p. 15.
[38] Verizon response to data request XO-VZ-1-5 proprietary attachment A, Tab *VZ CLEC Summary by ARPM* column D, row 36.
[39] See, Vasington Testimony, p. 14, lines 12-16.

IF NOT FOR THE REVENUE NEUTRAL REDUCTION THAT WAS IMPLEMENTED IN DTE 01-31?

A40. Yes. In response to data request RNK-VZ-1-19, Verizon admitted that if it was still allowed to charge its old access rates then it would not have filed this complaint.

> If Verizon's intrastate switched access rates remained above its interstate rates, then there would be no reason today to require CLECs to price below Verizon's rates. But, since Verizon was required to reduce its rates to its interstate levels, CLECs should be required to match Verizon's rate levels, unless they can demonstrate a cost justification for higher rates.

This admission not only underscores the inappropriateness of Verizon comparing CLECs' access rates to Verizon's *post*-01-31 rates, but it also shows that Verizon's proposal is grounded more in its desire to be a price-setter for switched access services than any desire to arrive at a more economically-rational outcome. And despite Mr. Vasington's attempt to tie its proposal in this case to Verizon's revenue-neutral access reduction, Verizon waited several years after Verizon's rate reduction in Massachusetts to claim that CLEC access rates should be reduced because of Verizon's rate reduction.[40]

[40] During this time, Verizon merged with MCI, which provided the new vertically-integrated RBOC/IXC carrier an incentive to seek access charge reductions for the carriers to whom its IXC arm pays access and with whom the RBOC arm competes for local customers. As a profit-maximizing firm, Verizon likely performed its own cost-benefit analysis, and determined that the access revenues it was generating through Verizon's CLEC's intrastate access rates (i.e., about 4 cents per minute for terminating access) was less than what Verizon-MA was paying to CLECs at their various intrastate access rates above Verizon-MA's interstate access rate. Indeed, this cost benefit analysis is precisely what is shown in Verizon's proprietary responses to discovery. *See*, Verizon's proprietary attachments to XO-VZ-1-5.

Q41. HAS VERIZON PREVIOUSLY RECOGNIZED THAT REDUCING ACCESS RATES WILL NOT, *A PRIORI*, ENHANCE ECONOMIC EFFICIENCY, AND THAT A SERIOUS MARKET ANALYSIS MUST BE DONE TO REACH THAT CONCLUSION?

A41. Yes. Verizon testified in D.T.E. 01-31 as follows:

> **Q.** The Company's proposal includes a provision for the restructure and reduction of intrastate switched access charges. From an economic perspective, are such price reductions required?
>
> **A.** Not necessarily. Since intrastate switched access prices exceed the economic costs of the service, it is likely that economic efficiency would be enhanced by the proposed rate reductions. However, multiproduct firms in industries characterized by high proportions of shared fixed and common costs must price some services above forward-looking economic cost in order to recover the total cost of the firm, so that **we cannot conclude *a priori* that reduced switched access prices would *necessarily* increase economic efficiency**. **In addition, there is nothing anticompetitive in recovering shared fixed and common costs from carrier access charges rather than from retail service prices.** Imputation rules, as well as the pursuit of self-interest, ensure that the Company prices toll service so that competitors who must purchase its carrier access service are not placed at a competitive disadvantage. **The vigorous competition in Massachusetts' toll markets provides empirical evidence that pricing carrier access above incremental cost does not inefficiently or unfairly constrain competition for retail toll services.**[41]

Verizon's position in this case is directly contrary to the position it expressed above. Verizon, in this case, concludes *a priori* that reducing CLEC switched access charges would increase economic efficiency as well as concludes that it is

[41] Testimony of William E. Taylor, prepared on behalf of Verizon New England Inc. d/b/a Verizon Massachusetts, before the Massachusetts Department of Telecommunications and Energy, p. 14, April 12, 2001. (emphasis added)

anti-competitive to allow CLECs to recover more access costs from carriers instead of end users than does Verizon. Further, Verizon claims in this case that allowing CLECs to price access above cost (without any showing that CLEC rates are indeed above costs) holds IXCs hostage to the CLECs' access rates. Mr. Vasington never explains what has changed since Verizon's previous testimony on access charges that would result in this 180 degree turn in Verizon's position.

Q42. IS THERE OTHER INFORMATION DEMONSTRATING THAT CLEC RATES GENERALLY FALL INTO A ZONE OF REASONABLENESS?

A42. Yes. QSI recently conducted a survey of switched access rates charged by carriers across the United States,[42] and the results of this survey show that CLEC switched access rates are generally comparable to rates of other carriers.

Q43. PLEASE DESCRIBE QSI'S SURVEY OF SWITCHED ACCESS RATES.

A43. QSI pulled switched access rates of various companies[43] and calculated the composite per minute access rates – the aggregated rates that permit "apples to apples" comparisons between carriers.[44] The composite rates of individual carriers in each jurisdiction were grouped by the type of carrier to produce an

[42] This rate survey was conducted in May 2008.

[43] The starting point of QSI's survey was the CCMI Telview access rate database, which QSI supplemented with access rate information for companies that do not appear in the Telview database – information that QSI derived directly from CLEC and ILEC access tariffs. QSI included in this survey tariff information on all CLECs that it was able to locate, which was more than 400 CLECs.

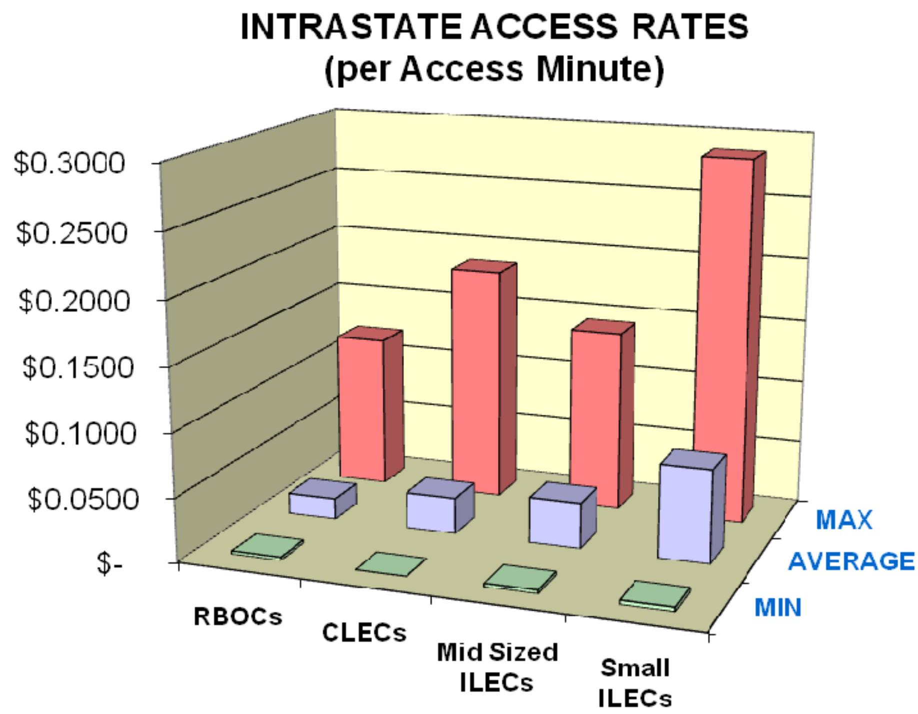
[44] The composite rates presented below are rates per access minute of use (one side of a long-distance call). They were calculated based on a scenario that a call is routed via tandem transport with transport mileage of 10 miles. Because smaller companies often do not own a tandem, the tandem switching rates are not included in the calculation of the composite rates in order to make an apples-to-apples comparison. In cases where rates were zoned or differentiated according to direction or time of day, a straight average of the differentiated values was used.

average switched access rate by type of carrier.[45] The types of carriers included RBOCs, mid-sized ILECs,[46] CLECs and Small ILECs, with NECA carriers reported as a separate group in the interstate jurisdiction. The survey included rates of approximately 1,200 tariff entities (carrier-state combinations), including all RBOCs, all mid-sized ILECs, NECA, over 400 CLECs, and over 400 small ILECs (other than the NECA tariff).

Q44. WHAT ARE THE RESULTS OF QSI'S ACCESS RATE SURVEY?

A44. The charts below summarize the results of the access rate survey. The first chart compares intrastate switched access charges by type of carrier and the second chart depicts a comparison of the average intrastate and interstate access rates by carrier type.

[45] Because the purpose of the study was to measure variation in rates, the aggregation was done as a simple average between tariff entities (rather than a weighted average).
[46] These are typically the non-RBOC ILECs that are price-cap regulated in the interstate jurisdiction.

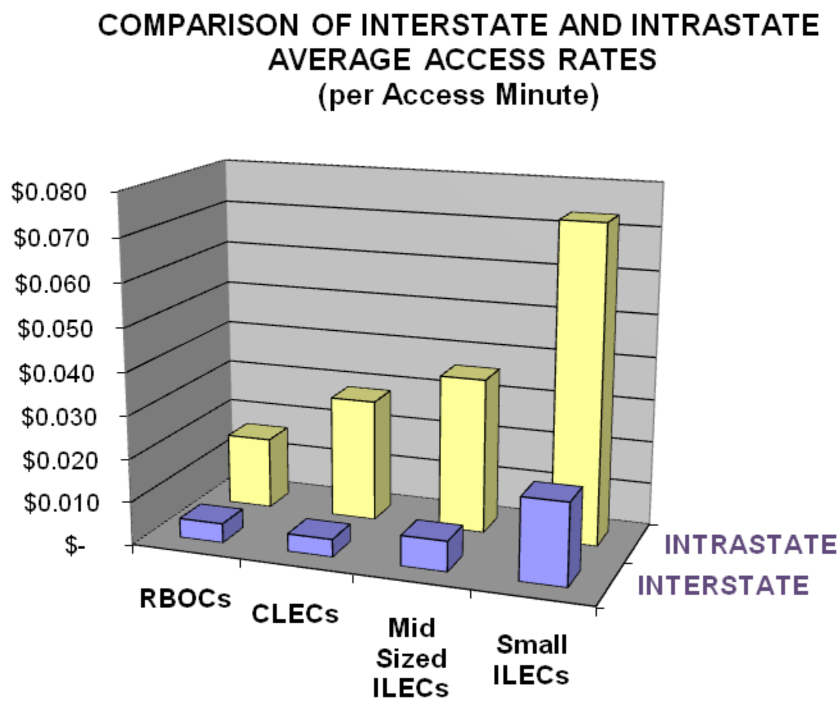


	RBOCs	CLECs	Mid Sized ILECs	Small ILECs
MIN	$0.0025	$0.0002	$0.0027	$0.0033
AVERAGE	$0.017	$0.029	$0.036	$0.073
MAX	$0.121	$0.186	$0.144	$0.288

As shown in the above chart, CLEC intrastate switched access rates are, on average, higher than the RBOCs' rates, *but lower than the rates of mid-sized and small ILECs.* A comparison of the minimum and maximum rates shows that a CLEC has the lowest minimum rate and a higher maximum rate (when compared to RBOCs and mid-sized ILECs), which could indicate the presence of outlier carriers. Small ILECs have significantly higher switched access rates than the other types of carriers in all three comparison categories (*i.e.*, minimum, maximum and average). *It is important to note that these results are consistent* *with cost and network architecture considerations.* Because CLECs look more like small and mid-sized ILECs in terms of customer density and cost structure than they look like RBOCs, it is logical that CLEC switched access rates would, on average, fall somewhere between the RBOCs' rates and the small and mid-sized ILECs – the very point demonstrated by the above chart. Further, despite the average switched access rate for small, rural ILECs being two and a half times that of the average CLEC switched access rate, regulators tend to exclude small, rural ILECs from benchmarks for switched access rates. Given that CLECs have similar cost characteristics to these smaller ILECs, yet have switched access rates that are, on average, far below the smaller ILECs' rates, it is fundamentally unreasonable for CLECs to be singled out for switched access rate caps.

The chart below compares the average intrastate and interstate access rates by carrier type:[47]

[47] The intrastate rates appear in the above chart. For small ILECs, the NECA rate is picked for the interstate jurisdiction because of the large number of carriers in the NECA pool.



	RBOCs	CLECs	Mid Sized ILECs	Small ILECs
INTERSTATE	$0.004	$0.004	$0.007	$0.019
INTRASTATE	$0.017	$0.029	$0.036	$0.073

As this chart shows, for both interstate and intrastate switched access charges, the CLEC rate levels generally fall between the RBOCs and the medium size and small ILECs (though in the interstate jurisdiction, the CLEC rates are the same as the RBOCs because of the FCC's interstate benchmark requirement).[48]

Q45. WHAT DO THESE DATA DEMONSTRATE?

[48] The above chart also shows that for all four carrier types – RBOCs, CLECs, mid-sized ILECs and small ILECs – intrastate rates are generally significantly higher than the interstate rates. This observation stands in stark contrast to Verizon's proposal in this case to benchmark CLEC ***intra***state access rates at Verizon's ***inter***state level.

A45. The data demonstrates that the reasons provided by RBOCs such as Verizon for attempting to require benchmarks for CLEC switched access rates – that CLEC switched access rates are unreasonably high – is based on a false premise. In other words, CLEC switched access charges are generally reasonable in relation to rates charged by other types of carriers even when they may exceed the rates of large, vertically-integrated carriers like Verizon.

Q46. VERIZON LISTS LOCAL SWITCHING ACCESS RATES OF SELECTED CLECS AND CLAIMS THAT BECAUSE THEY ARE HIGHER THAN VERIZON'S, THIS IS EVIDENCE OF CLECS ABUSING MARKET POWER.[49] PLEASE RESPOND.

A46. At the surface, when Verizon's switched access rate is compared to the selected CLEC switched access rates listed at page 13 of Mr. Vasington's testimony,[50] they are higher. However, when one considers the manner in which Verizon's access rates were established, such that a reduction in access rates was accompanied by a revenue neutral increase in retail revenue, it is evident that Mr. Vasington's comparison of Verizon's rate to the CLECs' rate is the classic "apples and oranges" comparison.

---

[49] Vasington Testimony, pp. 12-13.

[50] Though Mr. Vasington discusses CLEC rates in terms of magnitudes greater than Verizon's, he does not also list Verizon's current rate. Vasington Testimony, pp. 12-13. For the record, my research indicates that Verizon's intrastate local switching access rate is $0.002124/MOU. New England Telephone and Telegraph Company, Tariff DTE MA No. 15, Section 30, page 11 (30.6.9).

Q47. SHOULD VERIZON'S ARPM COMPARISON[51] BE RELIED UPON IN FINDING THAT CLECS ARE ABUSING MARKET POWER?

A47. No. According to Mr. Vasington, Verizon's ARPM comparison compares access rates of Verizon to CLECs taking "into account all of the usage-based access rate elements that the carrier charges its access customers."[52] Again, Verizon's usage based access rates that make up its ARPM[53] are lower than CLEC rates in large part because they were lowered in a *quid pro quo* wherein Verizon's usage sensitive rates were offset by increases in demand-inelastic local residential rates. As such, comparing Verizon's ARPM (which were lowered in a revenue neutral manner) to CLECs' ARPM (which were not) is not a valid comparison. Moreover, as shown above, a comparison of CLECs' average composite rate to Verizon's pre-01-31 composite rate shows that CLEC rates compare favorably – with CLECs' rates being very close to or *lower* than Verizon's pre-01-31 rate.

Q48. MR. VASINGTON ARGUES THAT THE DIFFERENCE BETWEEN CLEC ACCESS RATES AND VERIZON'S ACCESS RATES RESULT FROM A LACK OF "REASONABLE CHECKS" ON CLEC RATES. DO YOU AGREE?

---

[51] Vasington Testimony, pp. 14-15.
[52] Vasington Testimony, p. 14.
[53] Verizon states in response to data request D.T.C.-VZ-1-5 (filed July 25, 2008, Respondent: Paul B. Vasington) that Verizon calculated its ARPM as end-to-end (i.e., both originating and terminating) and by dividing usage-sensitive switched access revenues by switched access local switching minutes of use.

A48. No. Mr. Vasington claims that "there have been no reasonable checks [on CLEC access rates] as there have been with traditionally regulated carriers[,]"[54] but he ignores the clear differences between dominant and non-dominant carriers. According to Mr. Vasington, for CLEC rates to be subject to "reasonable checks," they would have to be subject to the same pricing regulation applied to dominant carriers in Massachusetts (of which Verizon is the only one).[55] However, that flies in the face of the regulatory construct of dominant and non-dominant carriers in Massachusetts: non-dominant carriers are not subject to the same pricing regulations as dominant carriers because they are presumed to be competitive carriers who lack market power and whose rates are constrained by competitive forces. In other words, competitive forces are the "reasonable checks" on CLEC access rates. Mr. Vasington acknowledges this very point at page 5 of his testimony ("[non-dominant carriers] are presumed to lack market power, so their rates are generally deemed to be just and reasonable due to the disciplining effect of competitive forces.")

Q49. IS THERE A BIT OF IRONY IN VERIZON'S CLAIM OF CLECS ABUSING MARKET POWER?

A49. Yes. At page 2 (footnote 1) of Mr. Vasington's testimony, he states that the access rates of Verizon's affiliated CLEC exceed that of Verizon-Massachusetts (the ILEC). Ironically, following Verizon's logic, this is an admission by Verizon

[54] Vasington Testimony, p. 17.
[55] Vasington Testimony, p. 5.

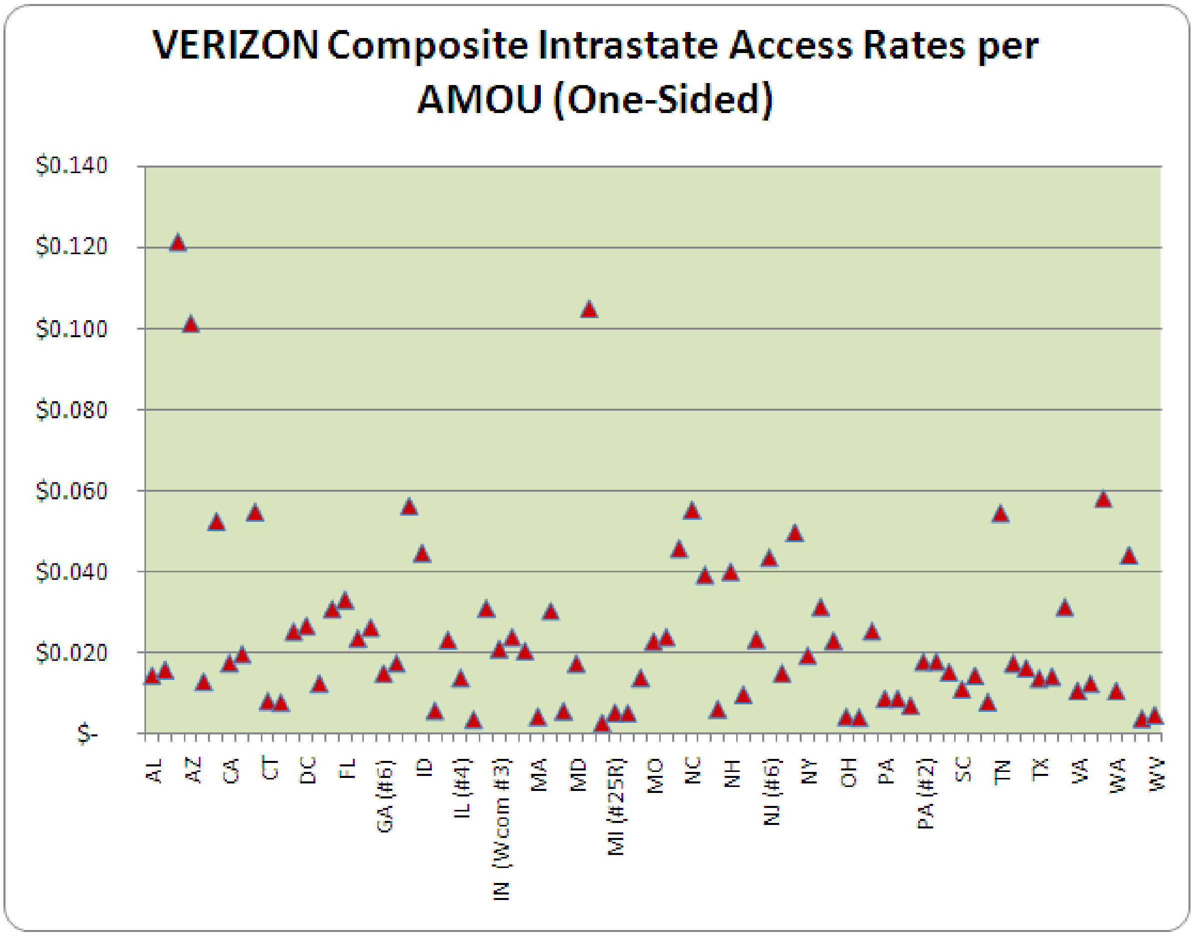
that its CLEC affiliate is abusing market power. Rather than capping Verizon's competitors' rates, perhaps the Department should instead investigate the justness and reasonableness of Verizon's CLEC's access rates in light of Verizon's admission in this case.

Though I have not independently reviewed Verizon's CLECs cost of switched access, given that it is affiliated with one of the largest RBOCs in the nation – not to mention one of the nation's largest IXCs – and benefits from the vertically-integrated company's economies of scale, it is likely that Verizon's CLEC's cost of switched access could be lower (perhaps significantly lower) than other CLECs who have no RBOC affiliation.

Q50. IS IT REASONABLE TO ASSUME, AS VERIZON DOES, THAT VERIZON MASSACHUSETTS' ACCESS RATES REPRESENT A "COMPETITIVE" LEVEL AROUND WHICH ALL CARRIERS' ACCESS RATES SHOULD GRAVITATE?

A50. No. An examination of Verizon's intrastate switched access rates shows that there is an enormous degree of variation from company to company and state to state. This degree of variation is at odds with any notion that Verizon's switched access rates are reasonable surrogates or proxies for a competitive market rate. There is no uniformity – in fact, there is a hodge-podge, reflecting the non-cost-based considerations involved in setting Verizon's switched access rates. QSI recently conducted a survey in which it collected switched access rates of Verizon and its affiliate CLECs[56] and calculated the composite per minute access rates – the aggregated rates that permit comparisons between carriers.[57] The chart and table below summarizes the results of the access rate survey for Verizon. It depicts the intrastate and interstate access charges and their variations, underscoring the fact that there is no single "uniform" or "competitive" level of access charges established by Verizon's access rates. Instead, it seems clear that Verizon's access rates are set across its territory in much the same fashion that they were set in Massachusetts; i.e., in response to specific regulatory initiatives of Verizon and the corresponding regulatory agencies that govern it.

[56] The starting point of QSI's survey is CCMI's Telview intrastate access database.
[57] The composite rates presented below are rates per access minute of use (one side of a long-distance call). They were calculated based on a scenario that a call is routed via tandem transport with transport mileage of 10 miles. Because this survey was part of the broader study of access rates across company types (RBOCs, mid-sized ILECs, small ILECs and CLECs) and because smaller companies often do not own a tandem, the tandem switching rates are not included in the calculation of the composite rates in order to make an apples-to-apples comparison. In cases where rates were zoned or differentiated according to direction or time of day, a straight average of the differentiated values was used.



Clearly, the "competitive rate level" for switched access services sought by Verizon does not exist with respect to its switched access rates. Therefore, to require CLECs to benchmark their rates against this hodge-podge of Verizon rates would not bring the industry any closer to "competitive" switched access rates; rather it would simply require CLECs to mirror the same hodgepodge that exists today without any discernable benefit.

Q51. VERIZON CLAIMS THAT ALLOWING CLECS TO CHARGE ACCESS RATES HIGHER THAN VERIZON MASSACHUSETTS' RATES CREATES DISTORTIONS. DO YOU AGREE?

A51. No. Verizon claims that CLECs charging higher access rates than Verizon provides a competitive advantage to CLECs by allowing them to "recover disproportionately more of their costs from other carriers rather than from their own end users."[58] This claim is misguided and unsupported. As discussed in detail below, CLECs likely have higher per-unit costs of providing access and should be allowed to recover those costs from the cost causer – the IXC whose customer originates or terminates toll traffic on the CLEC network. Further, because CLECs generally have proportionately higher traffic sensitive costs than do RBOCs like Verizon and the provisioning of switched access services is traffic-sensitive cost-intensive, that CLECs may recover more of their costs from IXCs is not indicative of a market failure as Verizon claims.

<u>III. VERIZON'S ACCESS CHARGES ARE NOT A REASONABLE PROXY FOR CLEC ACCESS CHARGES</u>

Q52. VERIZON REQUESTS THAT THE DEPARTMENT CAP CLEC INTRASTATE ACCESS CHARGES AT THE LEVEL OF THE ILEC IN WHOSE TERRITORY THE CLEC IS PROVIDING SERVICE.[59] ARE

[58] Vasington Testimony, p. 17.
[59] Vasington Testimony, pp. 20-21.

VERIZON'S ACCESS RATES A REASONABLE PROXY FOR CLEC ACCESS RATES?

A52. No. There are a number of reasons why Verizon's intrastate switched access rates do not serve as a reasonable proxy for CLEC intrastate switched access rates. First as alluded to above, Verizon's Massachusetts access rates result from a quid pro quo that allowed Verizon to recover the shortfall from reduced per-minute rates from its residential retail rates. Second, it can be demonstrated that CLECs likely have higher per-unit access costs than do large, vertically-integrated RBOCs like Verizon. As a result, capping CLEC access rates at levels charged by Verizon will likely result in CLECs offering switched access services at prices below their costs of production. Third, Verizon's intrastate access rates are not cost-based, as Verizon admits. Hence, tying CLEC rates to Verizon rates, without any acknowledgement of CLEC costs, does nothing to "rationalize" switched access rates in the marketplace – it simply results in a windfall for the IXCs who end up paying less to CLECs to receive the same services.

Q53. BEFORE YOU ADDRESS THE VARIOUS REASONS WHY THE ACCESS RATES OF RBOCS ARE NOT A REASONABLE PROXY FOR CLEC RATES, DO YOU HAVE ANY COMMENTS ABOUT THE SPECIFIC BENCHMARK LEVEL PROPOSED BY VERIZON?

A53. Yes. The benchmark that Verizon is apparently attempting to establish for CLECs is *not* Verizon's tariffed intrastate switched access rate elements, but rather an Average Revenue Per Minute number that Verizon calculated for itself.

The Average Revenue Per Minute Verizon calculates is even lower on a per minute of use basis than a composite of Verizon's tariffed usage-sensitive intrastate switched access rate elements.[60] Hence, Verizon is apparently attempting to set the benchmark for CLECs below Verizon's tariffed intrastate switched access rates. Further, Verizon provided nothing in its testimony in this case to justify or explain the Verizon ARPM it is apparently proposing as a CLEC benchmark. The many other problems with Verizon's proposed benchmark aside, given Verizon's utter failure to address the specific benchmark level it is proposing for CLECs (which is lower than Verizon's tariffed rates), it should not be adopted under any circumstances in this docket.

A. Verizon's Intrastate Access Rate Reduction Was Revenue-Neutral to Verizon, A Luxury Not Available to CLECs If Verizon's Complaint Is Granted

Q54. PLEASE EXPLAIN THE REVENUE NEUTRAL REDUCTION THAT PRODUCED THE CURRENT VERIZON ACCESS RATE LEVEL.

A54. In D.T.E. 01-31 (Phase 1), the Department stated: "the Department is persuaded that [Verizon's] switched access rates should be reduced to interstate levels…with the revenue shortfall recovered from fixed charges for residential dial tone lines, and instructs Verizon to include such provisions within its proposal submitted in

[60] Compare the Confidential Verizon ARPM at page 14 of Mr. Vasington's Testimony to the approximately $0.005547 per minute calculated by summing Verizon-MA's current usage sensitive intrastate switched access rate elements (assuming 1 mile of transport mileage).

Phase II of this proceeding."[61] Pursuant to the Phase I Order, Verizon included provisions related to this revenue neutral access charge reduction in its re-pricing proposal in Phase II of D.T.E. 01-31. Verizon's proposal involved increasing the monthly residential dial tone rate by $1.98 due to the reduction of intrastate switched access rates to Verizon's interstate level.[62] Notably, Verizon acknowledged in Phase II that residential dial tone was the "most inelastic service of its offerings." In other words, these services are those that the end users are most willing to pay higher charges for (i.e., seen as essential by the end users) and for which there is little competition. The Attorney General of Massachusetts opposed Verizon's proposal stating that since it was based on estimated – as opposed to actual – losses from access reductions which would result in a windfall for Verizon if its losses were less than estimated, and that an earnings review should be conducted to ensure this does not happen. The Department ultimately rejected the concerns of the Attorney General and approved Verizon's revenue-neutral access charge reduction, finding: "it is appropriate and fair that movement on one side of the ledger be matched with symmetrical movement on the other side. For example, it would not be fair to increase residential retail rates

[61] *Investigation by the Department of Telecommunications and Energy on its own Motion into the Appropriate Regulatory Plan to succeed Price Cap Regulation for Verizon New England, Inc. d/b/a Verizon Massachusetts' intrastate retail telecommunications services in the Commonwealth of Massachusetts*, D.T.E. 01-31 (Phase I), 2002 Mass. PUC LEXIS 10 *168, May 8, 2002. Note that CLECs would experience a "revenue shortfall" if Verizon's proposal was adopted, but unlike Verizon, CLECs would not be able to counter this revenue shortfall by raising rates of inelastic basic residential local exchange services.

[62] *Investigation by the Department of Telecommunications and Energy on its own Motion into the Appropriate Regulatory Plan to succeed Price Cap Regulation for Verizon New England, Inc. d/b/a Verizon Massachusetts' intrastate retail telecommunications services in the Commonwealth of Massachusetts*, D.T.E. 01-31 (Phase II), April 11, 2003, p. 88.

by an amount that produces more revenue than Verizon is losing from reductions towards efficient rates in other areas, and vice versa."[63]

Q55. WHAT DOES YOUR SUMMARY OF THE D.T.E. 01-31 PHASE I AND PHASE II ORDERS DEMONSTRATE?

A55. The clear intention was that Verizon not lose any revenue from reducing its intrastate switched access rates to interstate levels as it was allowed to offset access revenue decreases with increases in revenues from noncompetitive residential services (i.e., the most inelastic services Verizon provided). That is why Mr. Vasington's testimony is misleading when he states that, "Verizon Massachusetts has substantially lowered its intrastate access rates and has experienced a significant reduction in access revenues…" While it may be technically true that Verizon did shift revenues from its access services to its residential fixed service fees, leaving the impression that Verizon lost money in the process or that it saw a net revenue reduction from lowering its access fees is misleading.[64]

Q56. MR. VASINGTON ADDRESSES THE REVENUE NEUTRALITY GRANTED FOR VERIZON IN MASSACHUSETTS AND CLAIMS THAT

---

[63] D.T.E. 01-31 (Phase II) Order, p. 94.

[64] Ironically, Verizon did exactly what it is *claiming* CLECs are doing here – recovering revenues where it has market power.

CLECS COULD DO THE SAME THING BECAUSE THEY HAVE PRICING FLEXIBILITY.[65] DO YOU AGREE?

A56. No. Mr. Vasington's claim is an oversimplification at best and in fact is blatantly misleading. For starters, Verizon was particularly careful in its rate-rebalancing effort to ensure that any revenue increase came from its basic residential local exchange service revenues – the most price inelastic of Verizon's services. In other words, Verizon focused its rate increase on customers with the fewest alternative options, thereby ensuring that demand elasticity (i.e., customers choosing other alternatives rather than pay the increased rates) would be minimized and Verizon would recover the full breadth of any revenue shortfall. Verizon has a large base of residential customers with highly inelastic demand as a result of its incumbency and the difficulty most competitors experience in competing for residential customers. As such, CLECs don't have the luxury that Verizon had to offset intrastate switched access charge reductions by revenue increases from a captive group of customers; and even if the Department wanted to authorize a revenue-neutral CLEC rate reduction, the Department could not ensure that CLECs would remain whole due to the competitive environment in which CLECs operate. For example, instead of having a base of residential customers that are highly price inelastic, most CLECs in Massachusetts serve predominantly medium and large business customers that are not so tolerant to price changes.

[65] Vasington Testimony, p. 24.

In sum, Mr. Vasington's point that CLECs are non-dominant carriers with pricing flexibility is completely beside the point: CLECs may have the <u>authority</u> to adjust their retail rates in hopes of shifting cost recovery from the IXCs who buy their access services to their retail customers, but they do not have the <u>ability</u> to do so.

Q57. ARE YOU SURPRISED THAT CLECS DID NOT REDUCE INTRASTATE SWITCHED ACCESS RATES AFTER THE DEPARTMENT IMPLEMENTED VERIZON'S REVENUE NEUTRAL ACCESS RATE REDUCTION?

A57. No. Mr. Vasington states at page 10 of his testimony, "most of these carriers have made no corresponding efforts to reduce their intrastate switched access rates, despite the significant intrastate access reductions that Verizon Massachusetts has implemented." First, there was no requirement for CLECs to reduce access rates as implied by Mr. Vasington. Second, because CLECs were not guaranteed revenue neutrality for access rate reductions, as Verizon was, the same reduction in access rates would have much different impacts on CLECs than the non-impact on Verizon.

B. CLECs' Per-Unit Costs Of Providing Access Are Likely Higher Than Verizon's

Q58. WHAT IS THE BASIS FOR YOUR CONTENTION THAT THE CLECS' PER-UNIT INTRASTATE ACCESS COSTS ARE LIKELY HIGHER THAN VERIZON'S?

A58. As I described in my introduction, I have spent several years reviewing cost information for ILECs, CLECs, wireless carriers and a host of other telecommunications entities. That experience has time and again highlighted a simple fact: telecommunications, like most network industries, is a scale business wherein size matters, and the largest carriers (like Verizon) have notable cost advantages over smaller competitors *ceteris paribus*. Those cost advantages most readily materialize in relation to switched access services in the following ways:

1. CLECs do not have the same economies of scale as Verizon, i.e., they lack the sheer size necessary to produce average, per-unit costs as low as those enjoyed by Verizon.
2. CLECs have different network architectures than Verizon with proportionately more traffic-sensitive costs.
3. CLECs tend to have lower facility utilization than Verizon, even though they have fewer facilities.
4. CLECs have a sparser customer base than Verizon thereby limiting the “density” they enjoy.
5. CLECs have higher input prices than Verizon.

A major problem with Verizon’s proposal is that it wrongly assumes that Verizon is a good “comparable” for CLECs when in reality, it is not. Indeed, Verizon’s proposal would almost certainly not allow most CLECs to recover their expected higher costs. Yet, when establishing regulated rates (a step Verizon is advocating for CLECs in this proceeding), allowing the regulated company (or companies) to recover its production costs is a cornerstone of public utility regulation. This is not only a fundamental tenet of fairness, but is also economically rational (not to mention would likely be unreasonably confiscatory). I am also informed that it would likely be contrary to Massachusetts statute which requires rates to be sufficient "to yield reasonable compensation for the service rendered."[66]

1. CLECs do not have the same economies of scale as Verizon

Q59. PLEASE EXPLAIN THE DIFFERENCES IN ECONOMIES OF SCALE BETWEEN CLECS AND VERIZON?

A59. The relationship between scale economies and costs and the related differences between ILECs and CLECs is well-recognized by the FCC:

> Fixed costs are the largest portion of the cost of a switch. The average cost of providing service to customers decreases as the number of customers served increases. As a general rule, we find that scale economies are more pronounced when switches operate at full utilization. Because incumbent LEC switches serve the majority of customers for local exchange service, they are likely to be able to take advantage of substantially greater economies of scale than the competitor would using its own switches.[67]

Another instance in which the FCC recognized the greater economies of scale for ILECs versus CLECs is the following:

---

[66] Chapter 159, Section 14.

[67] *In the Matter of Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-98, Third Report and Order and Fourth Further Notice of Proposed Rulemaking, FCC 99-238, Rel. November 5, 1999, ¶ 258 ("UNE Remand Order").

> The Commission has recognized that smaller telephone companies have higher local switching costs than larger incumbent local exchange carriers (ILECs) because the smaller companies cannot take advantage of certain *economies of scale*.[68] (Emphasis added.)

The FCC recognized these differences further as follows:

> We find that incumbent LECs retain material scale advantages with regard to provisioning and operating local circuit switches. Requesting carriers therefore will encounter generally greater direct costs per subscriber when provisioning their own switches, particularly in the early stages of entry when requesting carriers [CLECs] may not have the large number of customers that is necessary to increase their switch utilization rates significantly. *When we examine the market as a whole, we find that requesting carriers incur higher costs due to their inability to realize economies of scale using circuit switching equipment.*[69]

The higher switching costs incurred by CLECs have also been recognized in the universal service support context by the Universal Service Administration Company ("USAC"). In specifying conditions for high cost support for competitive companies, the USAC notes:[70]

> Local Switching Support (LSS) is available to ***competitive carriers*** providing service in the areas of ***rural incumbent carriers*** serving 50,000 lines or fewer (mostly rate-of-return and some price-cap carriers) and designated as eligible telecommunications carriers (ETCs) by their state commissions or the Federal Communications Commission (FCC).
>
> […]
>
> Local Switching Support is designed to help carriers recoup some of the high fixed switching costs of providing service to fewer customers. LSS helps keep customer rates comparable to more densely populated urban areas.

---

[68] *National Exchange Carrier Assn., Inc. proposed Modifications to the 1998-99 Interstate Average Schedule Formulas*, Order, 13 FCC Rcd 24225, at n. 6.
[69] FCC *UNE Remand Order*, ¶ 260. (emphasis added)
[70] See, USAC website for competitive carriers: http://www.usac.org/hc/competitive-carriers/step01/local-switching-support.aspx

Q60. HAVE YOU INDEPENDENTLY STUDIED THE DIFFERENCES IN ECONOMIES OF SCALE BETWEEN CLECS AND ILECS AS THEY RELATE TO SWITCHED ACCESS COSTS?

A60. Yes, and my independent analysis verifies the above statements of the FCC and USAC. QSI has examined cost studies for the RBOCs in many states and has prepared cost studies for a number of CLECs. While we are generally unable to publicly divulge details of those studies due to confidentiality agreements, we have filed public testimony demonstrating the substantial differences between large ILECs and CLECs. For example, in a Texas proceeding, I testified as follows:

> It shows that AT&T Texas sells nearly 13 times more switched access minutes in a year than does McLeodUSA [in Texas]. In other words, in terms of the economies of scale between the two carriers related to this product alone, AT&T Texas dwarfs McLeodUSA. […] It seems clear that if we were to include in the comparison above, the local calls switched by AT&T Texas, compared to the total minutes switched by McLeodUSA, the disparity would be even larger. The shear overall economies of scale (and scope – i.e. when services other than switched access are considered) make the two companies very poor "comparables" when evaluating their relative costs of producing switch-based services.[71]

Clearly, smaller carriers, such as CLECs, lack the economies of scale of RBOCs and, therefore, have generally higher per unit switching costs – a primary building block of switched access services.

---

[71] *Application of McLeodUSA Telecommunications Services, Inc., for Approval of Intrastate Switched Access Rates Pursuant to PURA Section 52.155 and PUC Subst. R. 26.223,* SOAH Docket. 473-07-1365, and PUC Docket No. 33545, Rebuttal Testimony of Michael Starkey, page 14.

2. CLECs have different network architectures than Verizon with proportionately more traffic-sensitive costs.

Q61. PLEASE EXPLAIN THE DIFFERENCES IN NETWORKS THAT ARE LIKELY TO LEAD TO HIGHER PER-UNIT ACCESS COSTS FOR CLECS.

A61. CLECs typically enter the market with a distributed network architecture that is significantly different from the legacy network of Verizon. Under this distributed architecture, CLECs tend to substitute longer transport routes for switching nodes and outside plant facilities, while at the same time providing origination/termination services throughout large geographic areas roughly comparable in size to areas served, for example, by ILEC tandem switches (which aggregate traffic from the ILEC's end office switches).

Q62. CAN YOU ILLUSTRATE THE DIFFERENCES IN CLEC AND ILEC NETWORKS?

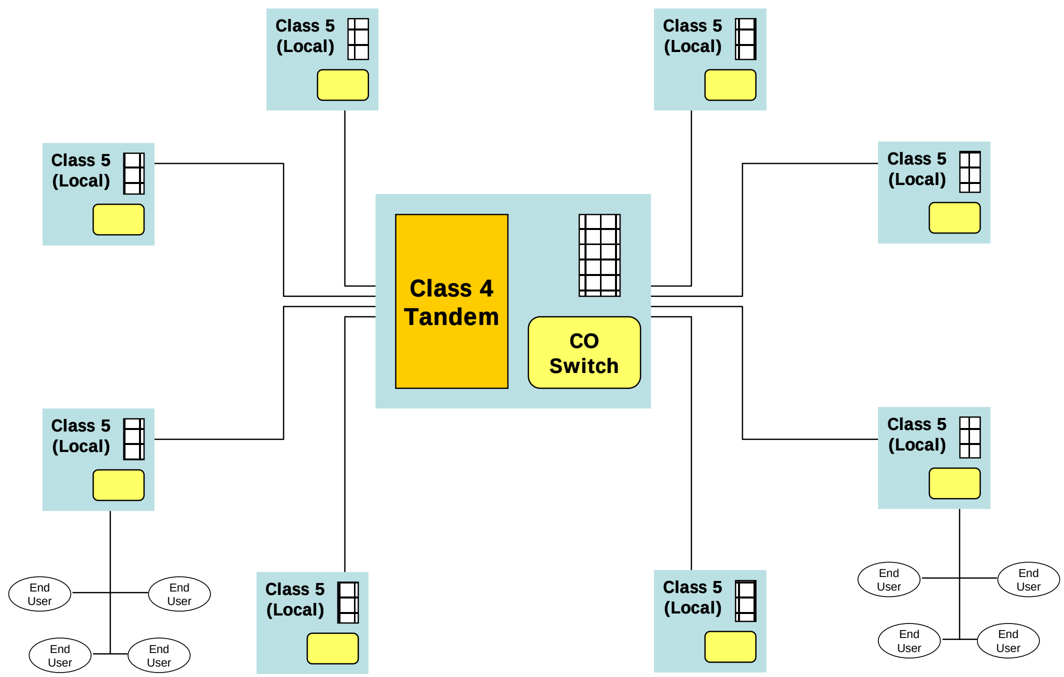
A62. Yes. The diagrams below provide a simplified illustration of the two disparate network architectures. The first is the traditional ILEC architecture that uses a hierarchical Class 5 (end office)[72] and Class 4 (tandem)[73] office-structure to serve relatively densely populated, defined geographic areas.

---

[72] Class 5 (end office) switches typically aggregate the traffic of end user customers over end user loops, which terminate at the switch. They also provide the vertical features, such as call waiting, etc.

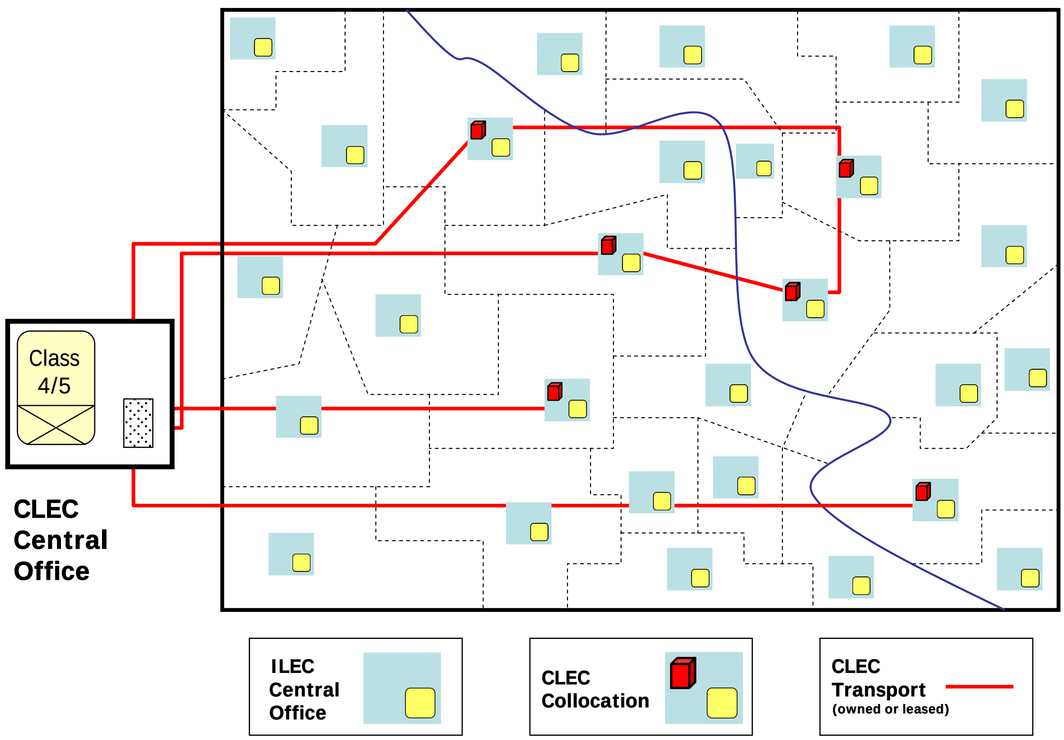
[73] Class 4 (tandem) switches are typically used to aggregate the traffic from end office switches and provide a point in the ILEC network at which IXCs can connect for terminating and originating long distance calls.

ILEC Switch Hierarchy



The second diagram represents a typical CLEC architecture that uses one switch to serve a comparable geographic area. The CLEC uses one switch for the same area as the ILEC because unlike the ILEC who serves the majority of the customers in the serving area, the CLEC can expect to serve only a fraction of all the customers in the area.

Distributed CLEC Network Design



CLECs generally deploy switches that provide a *combined* Class 5 (end office) and Class 4 (tandem) functionality (rather than switches that provide those functionalities on a stand-alone basis) and provide call origination and termination functionalities across large geographic areas by means of a distributed architecture. By extending their switching and transport networks into collocated arrangements in multiple ILEC central offices, CLECs often are able to serve a customer base that is spread out across an entire state or LATA using a single, integrated end office and tandem switching platform.

Q63. ARE THERE ADVANTAGES TO THE CLECS' DIFFERENT, DISTRIBUTED NETWORKS?

A63. Yes. The advantage of this architecture is that it minimizes the amount of switching and central office investment required to serve a more *dispersed customer base*, both by minimizing the number of Class 5 local switches required as well as reducing the need for a stand-alone tandem switch.

Q64. ARE THERE OFFSETS TO THIS ADVANTAGE?

A64. Yes, and this offset is especially evident in the provisioning switched access services. The tradeoff is that this network architecture requires substantial additional investment in transport and collocation arrangements necessary to aggregate traffic for delivery back to the centrally located switch. Because transport and aggregation equipment must be sized in relation to the amount of traffic they support, most of the costs of these additional network components relied upon by the CLEC are *traffic sensitive* in nature, thereby generating *traffic sensitive costs*. Recall that switched access rates are, in general, intended to help the underlying carrier recover the traffic sensitive costs it incurs in accommodating the long distance traffic of other carriers. Because CLEC networks tend to deploy more traffic sensitive investment when compared to ILEC networks (which rely more heavily on ubiquitous loop facilities to aggregate traffic to multiple, local switches), it follows that CLECs have more traffic sensitive costs to recover via their switched access rates.

Q65. CAN'T CLECS USE MORE EFFICIENT TECHNOLOGIES AND NETWORK CONFIGURATIONS THAN VERIZON'S LEGACY NETWORKS TO OPERATE AT LEAST AS EFFICIENTLY AS VERIZON?[74]

A65. As mentioned above, CLECs can, and do, use efficient technologies and network configurations and do operate efficiently, but even efficient CLECs using state of the art technology are likely to incur higher costs due, in part, to the lower utilization rates that CLECs experience for their facilities, a sparser customer base served, and higher traffic sensitive costs.

3. CLECs have lower facility utilization than Verizon

Q66. PLEASE EXPLAIN WHY CLECS HAVE LOWER FACILITY UTILIZATION THAN VERIZON.

A66. CLECs typically purchase large switches capable of serving as many as one hundred thousand customers. Likewise, the transport facilities constructed to transport traffic to end-users and other carriers are often capable of carrying huge volumes of traffic. Unlike ILECs like Verizon who have built their customer base in protected markets for more than one hundred years, CLECs must deploy some number of these facilities before they even begin to attract customers. This means that, over much of their economic life, the utilization of CLEC facilities is likely to be substantially below full capacity unless they begin by buying lower

[74] Vasington Testimony, p. 17.

capacity, higher cost facilities and building larger, more efficient facilities as they grow. Either way, CLECs are faced with either lower utilization or higher per unit costs as they grow their networks and attract customers. In contrast, when an ILEC installs a new digital switch or replaces a transport route with more efficient technology, it normally does so to replace existing facilities that are already highly utilized. For example, old analog switches, such as the 1AESS, served tens of thousands of customers that may very well be comparable to the number of customers that a fully loaded digital switch could serve (though the analog switch cannot provide the same functionalities). This means that from the moment the ILEC installs a digital switch to replace the older, analog switch, its new switch will be highly utilized. Compare that scenario with a CLEC switch-installation where it must build its customer base "from the ground up," likely starting at zero.

4. CLECs have a sparser customer base than Verizon

Q67. PLEASE EXPLAIN WHY CLECS HAVE A SPARSER CUSTOMER BASE THAN VERIZON.

A67. By and large, CLECs operate and compete with RBOCs, such as Verizon, in urban or suburban environments that are densely populated. However, while a high population density in these areas translates into a *dense customer base* for the RBOCs, the CLEC customer base is typically far more dispersed because CLECs are new entrants that serve a small fraction of the customers in these areas, and serve primarily small-to-medium sized business customers. Thus, if a CLEC's customer base is expressed on a customer-per-square mile basis, it is very sparse relative to that of the RBOC that serves the vast majority of customers in the same area.

Q68. IS THERE EMPIRICAL EVIDENCE AVAILABLE TO SUPPORT YOUR POINT?

A68. Yes. While the nature of CLECs as new entrants to the market intuitively suggests that their customer density is lower than the customer density of the incumbents, actual empirical evidence is difficult to obtain because of the proprietary nature of the CLEC line count data. Although the FCC reports statewide line counts for CLECs and ILECs in its *Local Competition Report*, these data provide information only on the combined line counts of CLECs at a state level and does not indicate customer density for an *individual* CLEC within its serving territory.[75] More specifically, I'm not aware of available data that would allow a Massachusetts-specific analysis in this regard. That being said, QSI did recently obtain permission from several of its CLEC clients to analyze their proprietary, end user customer line count density data for a recent QSI study on CLEC switched access charges/costs and report the results in aggregate (to

[75] Because the combined CLEC line counts and shares reported in the FCC *Local Competition Report* are lower than the ILECs' line counts and shares (and there are a number of CLECs operating in each incumbent's territory), it is clear that the underlying CLEC-specific customer density is significantly less that the customer density of the incumbents in which territories CLECs operate. For example, as discussed above, in its most recent Local Competition Report (released in December 2007) the FCC reports that the CLEC share is 23% in Massachusetts which is split between 39 CLECs, meaning that each individual CLEC market share in Massachusetts is much smaller than the ILEC's (not to mention that the collective CLEC market share of 23% is much lower than Verizon's).

preserve the anonymity of individual carriers). This data unquestionably demonstrates the point that CLECs serve a sparser customer base relative to the RBOCs.

Q69. PLEASE EXPLAIN HOW QSI COMPILED THIS DATA ON CUSTOMER DENSITY.

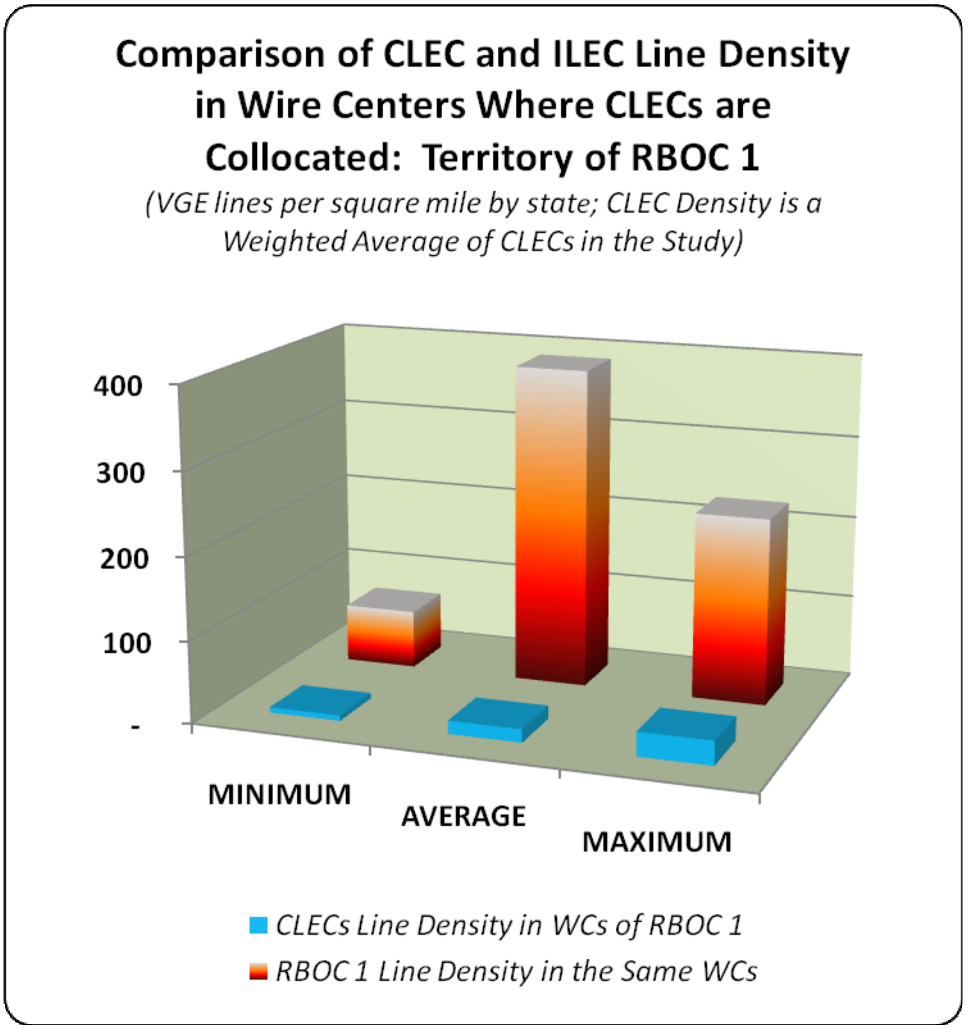
A69. The basic design of the study was to construct a measure of customer density for an average, individual CLEC within its serving territory (where the CLEC serving territory is defined as the ILEC's wire centers in which the CLEC is collocated) and compare it to the customer density of the respective ILEC. This study consisted of the following steps:

1. The starting point of this analysis was a data set in which individual CLEC line counts were reported by ILEC wire center in which the CLEC is collocated.
2. This information was combined with the ILEC switched line counts and the serving area (square miles) of the same wire centers.[76]
3. Customer density for both CLECs and ILECs were calculated for each wire center in which the CLECs are collocated.
4. Wire center level information was aggregated to the state level and an average (composite) CLEC was compared to the corresponding ILEC.
5. State-level data were compared across states within each ILEC's territory[77] and the minimum, maximum and average customer densities were recorded.[78]

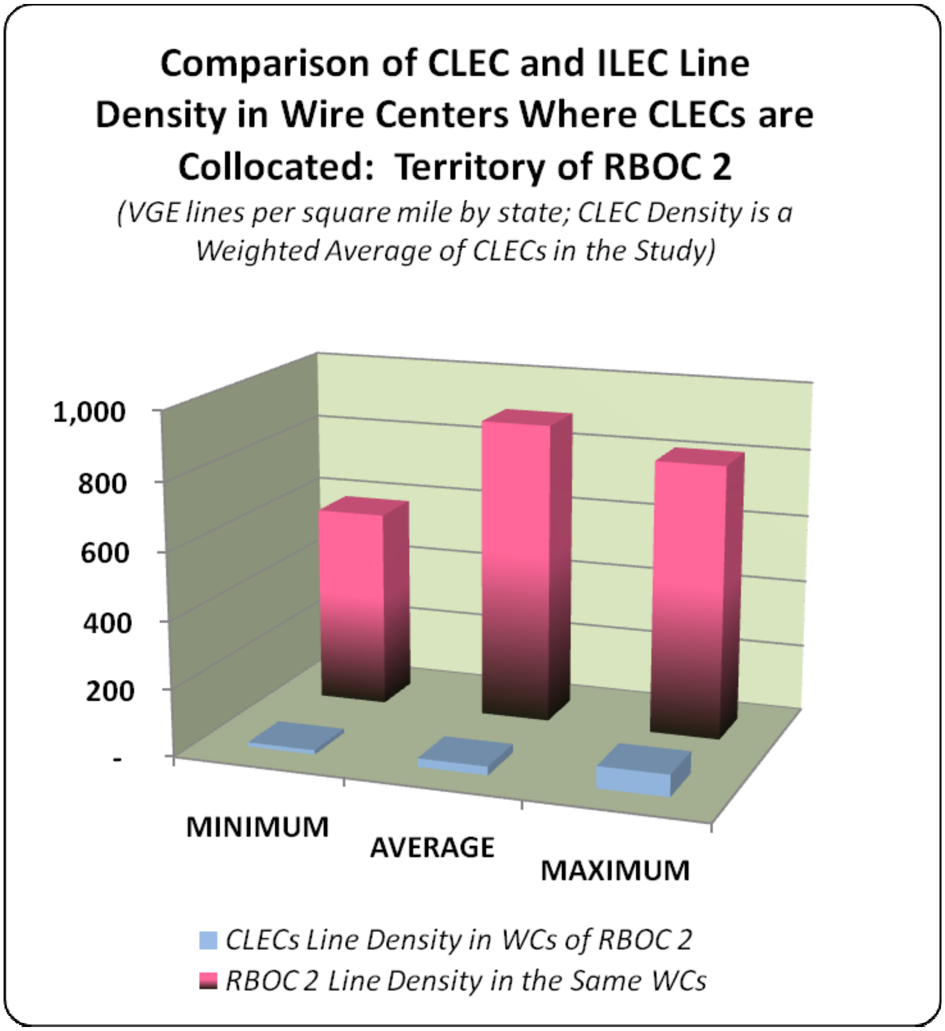
[76] The ILEC line counts are based on the following public data sources: Qwest's line counts are its 2007 business and residential line counts reported in its online Iconn database. The most recent public data source for wire center level line counts of other ILECs is the FCC Synthesis Model (the 2000 model results available at the FCC web site). While it is likely that the ILEC line counts (and hence, customer density) decreased compared to 2000, the difference between the CLEC and ILEC customer density (when based on the ILECs' 2000 line counts) is too significant (as shown on charts below) to be overcome if the more recent ILEC line count is used. Further, the ILEC customer density calculated using the 2000 switched line data does not capture the full extent of today's customer base of the ILECs because it excludes the ILECs' special access, Internet (DSL) lines, long-distance customers and video customers.

Q70. WHAT ARE THE RESULTS OF THIS ANALYSIS?

A70. The results of this analysis are presented in the following two charts (based on a Voice Grade Equivalent or VGE basis):[79]



[77] Because of the data limitations, this analysis was performed for the territory of two (out of three) RBOCs.
[78] While the "RBOC Average" corresponds to the RBOCs' average across all wire centers/states, the "RBOC Minimum" and "RBOC Maximum" are the measures of RBOC density in wire centers where the Minimum and Maximum CLEC densities are observed. In other words, while the RBOC may have the maximum customer density in state A, the CLEC may have the maximum customer density in state B. In this case the chart depicts the RBOC and CLEC customer densities in state B.
[79] As explained above, in order to preserve the data confidentiality, the operating territories are identified simply as "RBOC 1" and "RBOC 2."



These two charts demonstrate that in both territories (the territories of RBOC 1 and RBOC 2), an individual CLEC's customer density per wire center is significantly lower than the customer density of the corresponding RBOC. This observation is true on average and at the extremes. Numerically, the gap between the average customer densities depicted in the above charts (the relative heights of the "Average" bars) is striking: an individual CLEC's customer density is 24 times lower than the RBOC's density in the territory of RBOC 1, and 35 times lower than the RBOC's density in the territory of RBOC 2. The following table lists these results (column (c)), along with an additional data point, which is RBOC's statewide customer density (column (d)):

Average Line Densities: CLECs versus RBOCs *(VGE lines per sq. mile)*

Territory	Wire Centers with CLECs' Collocations			RBOC Statewide (Same States)
	Average Line Density per CLEC	RBOC Line Density	Ratio: RBOC Density Over CLEC Density	RBOC Line Density
Column	(a)	(b)	(c)	(d)
RBOC 1	16	389	***24***	50
RBOC 2	25	893	***35***	158

This table shows that a CLEC's average customer line density (column (a)) is significantly lower than the RBOC's density when the comparison is performed in the wire centers where the CLECs operate (which may be relatively more urban/dense wire centers) as well as when the CLEC's line density is compared to the RBOC's statewide line density (column (d)) which accounts for the RBOC's more sparsely populated areas.

Q71. DOES OTHER DATA EXIST THAT SUPPORTS THIS SAME POINT?

A71. Yes. Another data source that supports QSI's findings is a recent study of CLEC line counts in the Minneapolis-St. Paul Metropolitan Statistical Area ("MSA") conducted by the Minnesota Department of Commerce and filed in Ex Parte Comments of the Minnesota Public Utilities Commission in FCC Docket WC No.

07-97.[80] This study represents a fairly comprehensive survey of CLEC line counts in the Minneapolis-St. Paul MSA as it contains aggregate line counts of ten major CLECs in the state.[81] QSI combined the line counts reported in this study with Qwest's publicly available switched residential and business line counts to derive average line densities for CLECs and Qwest in the Minneapolis-St. Paul MSA's wire centers. The resulting line densities[82] are contained in the table below:

Average Line Densities in Minneapolis/St. Paul MSA: CLECs versus Qwest

(Lines per Sq. Mile)

Wire Centers in Minneapolis/St. Paul MSA			All MN Qwest Wire Centers
Average Line Density per CLEC		Qwest Line Density (Switched Lines)	Qwest Line Density (Switched Lines)
Mass Market	Mass Market and Enterprise Market		
3	**16**	**429**	**73**

This table shows the gap between the average line density of the ten CLECs in the Minneapolis-St. Paul MSA and Qwest. Again, the magnitude of the difference between CLECs and the RBOC is striking, even when enterprise CLEC counts are included. (Compare the CLEC density of 16 lines per square mile with Qwest's density of 429 lines per square mile in the same wire centers). What's

[80] Ex Parte Comments of the Minnesota Public Utilities Commission dated February 8, 2008 in FCC docket WC No. 07-97 *In the Matter of Petition of Qwest Corporation Pursuant to 47 U.S.C. para. 160(c) in the Minneapolis/St. Paul Metropolitan Statistical Area* (Qwest's Forbearance Petition).

[81] The ten CLECs include AT&T/TCG, Covad, Eschelon, Integra, MCImetro, McLeodUSA, Onvoy, Popp, TDS Metrocom and XO.

[82] Note that this measure of CLEC line density is different from the measure used in QSI's analysis of CLEC proprietary data because the Minnesota Public Utilities Commission Ex Parte contained only CLEC-total line counts for each wire center, while each individual CLEC may not be present in each wire center.

more, the CLEC line density is several times lower than Qwest's statewide line density despite the fact that the latter measure includes more rural/sparsely populated areas of Minnesota.

Q72. HOW DOES "LINE DENSITY" IMPACT A CLEC'S COST OF SERVICE?

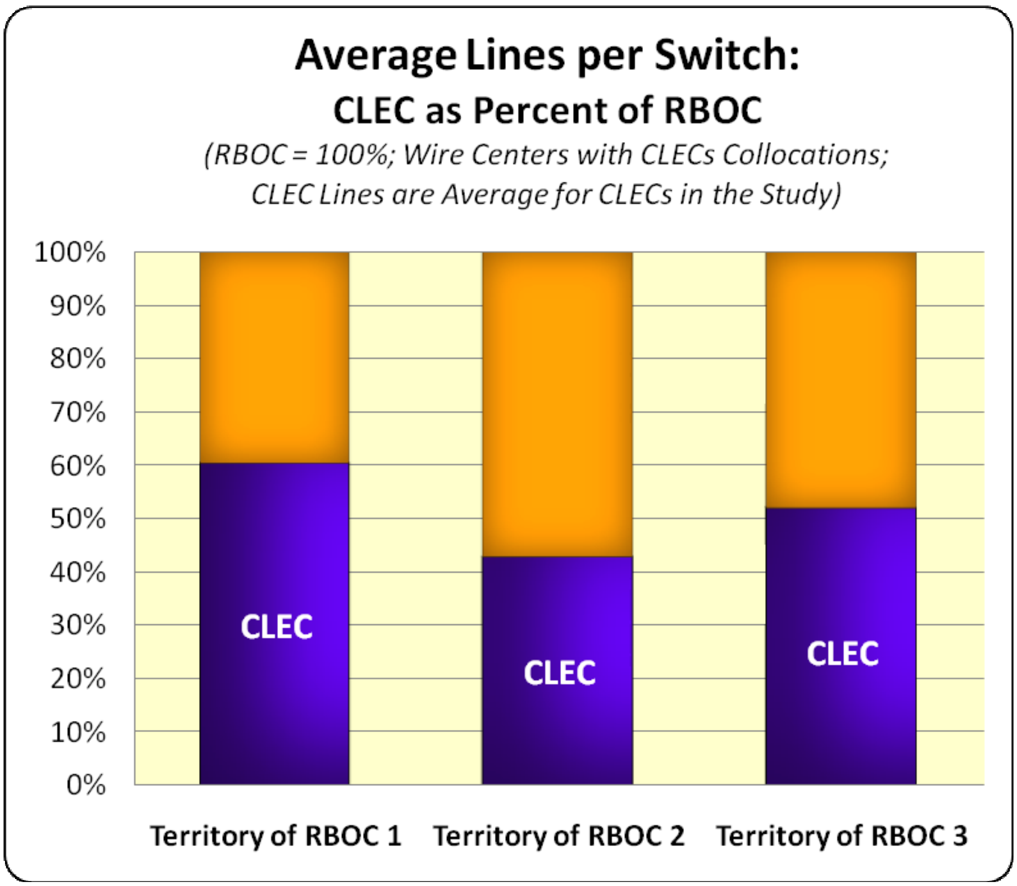
A72. Consider the following example. CLECs typically employ within their collocation arrangements equipment meant to aggregate multiple voice-grade lines onto larger, more efficient transport circuits back to centrally-located switch sites. While the central office in which the CLEC is collocated might serve forty thousand (40,000) ILEC lines, it is quite possible that the CLEC has won away (or anticipates winning) only one thousand (1,000) or less of those lines. Hence, when the CLEC deploys its equipment in the collocation arrangement, it purchases and installs equipment capable of supporting 1,000 lines (or slightly more if it believes it can be more successful in the future in that location). Equipment purchased to support 1,000 access lines is substantially more expensive, on a per-line basis, than is equipment capable of servicing 40,000. Hence, even though the CLEC and the ILEC are serving customers in exactly the same geographic area, the customer density enjoyed by the two firms is very different – and the costs of serving those disparate customer groups differ dramatically as well. Of course, the CLEC could purchase and install equipment capable of supporting 40,000 lines and enjoy the smaller, per unit costs. However, it still only serves 1,000 lines and obviously loses any gains in lower per unit costs by paying for substantial spare capacity for which it has no income producing services. Either way, its lack of customer density increases its costs relative to the larger ILEC customer base – even in the same geographic area.

Q73. WHAT IS THE RELATIONSHIP BETWEEN CUSTOMER DENSITIES AND ACCESS COSTS?

A73. As regulators know from Total Element Long Run Incremental Cost ("TELRIC") pricing cases and other cost proceedings, customer density is a major cost driver in cost studies. The higher the customer density, the lower certain per-unit costs are – and vice versa. In fact, it is in recognition of this close relationship between customer density and costs that most regulatory commissions, including the Department, have established different rate zones for ILEC UNE rates in TELRIC proceedings, such as urban, suburban and rural rate zones – with lower rates in the urban zone relative to the suburban and rural zones, lower rates in the suburban zone relative to the rural zone, and so on. It is important to note that while differences in ILEC loop and even switching density can be reflected by costs defined by given geography, the geography is actually a proxy for the "customers per square mile" characteristics they are intended to represent. It is not the geography or the incumbent carrier within that geography that most dramatically impacts a CLECs costs, it is the density of customers the CLEC has been able to win in that geography that is most determinative.

Q74. IS THERE ANOTHER CONSEQUENCE ON CLECS OF A SPARSER CUSTOMER BASE RELATIVE TO THE RBOCS?

A74. Yes. Another consequence of low customer density is that CLEC switches often support *fewer* lines than RBOC switches despite the fact that a CLEC's switch aggregates traffic over a large territory. QSI made this observation while analyzing the above discussed proprietary line count data of its client CLECs. The following chart depicts this finding:[83]



This chart depicts average CLEC lines per CLEC switch (blue bars) as a percent of RBOC lines per RBOC switch, and shows that an average CLEC has less lines

[83] As explained above, in order to preserve the data confidentiality, the operating territories are identified simply as "RBOC 1," "RBOC 2" and "RBOC 3."

per switch than an RBOC in which territory the CLEC operates. This is another factor that drives up switched access costs for CLECs relative to RBOCs.

Q75. HOW IS IT THAT CLECS CAN DEPLOY SWITCHES ON A REGIONAL BASIS, COVER BROAD GEOGRAPHIC AREAS, AND STILL END UP WITH LOWER UTILIZATION THAN ILEC SWITCHES THAT ARE MORE LOCAL IN NATURE AND SERVE MUCH SMALLER GEOGRAPHIC AREAS?

A75. Again, the issue is customer density. Consider the following hypothetical. Assume that a given CLEC switch in Boston supports 50 different collocation arrangements spread throuhout the Northeast. Each collocation arrangement supports approximately 1,000 voice grade-equivalent lines the CLEC has been successful in attracting to its network. By deploying a regional switch site, the CLEC has been able to accommodate 50,000 access lines on a single switch, wherein more local deployment would have resulted in far fewer lines per switch. As such, the CLEC has deployed a highly efficient network relative to the options it had available to it in order to serve a geographically dispersed, and relatively sparse, customer base. Yet, when we consider that Verizon likely has switches in Boston that serve 50,000 or more access lines over a geographic area of just a few square miles, the opportunities for substantially increased efficiency on the part of Verizon become more clear.

5. CLECs have higher input prices than Verizon

Q76. WHY DO CLECS TYPICALLY HAVE HIGHER INPUT COSTS THAN RBOCS LIKE VERIZON?

A76. Large buyers typically are able to extract better input prices from suppliers than small buyers. Verizon, as one of the nation's largest, vertically-integrated telecommunications firms, is also one of the nations' largest purchasers of telecommunications equipment. This gives Verizon significant bargaining power with suppliers and it is able to negotiate dramatic discounts by shifting the bulk of their purchases to the supplier that is willing to offer the best deal. Regulators are well aware of those discounts and have examined them in various proceedings in which RBOC costs are at issue.[84] By contrast, the CLECs are much smaller and purchase fewer facilities and equipment than does Verizon. As a result, CLECs do not have the bargaining power of Verizon to induce suppliers to offer substantial discounts or to bid against one another. It is not uncommon for CLECs to pay double the price paid by a large RBOC for exactly the same piece of equipment. Given that one of the most important determinants of costs of a service is the prices of the inputs used to provide that service, there is a strong

---

[84] *See, e.g.*, California Public Utilities Commission *Rulemaking on the Commission's Own Motion to Govern Open Access to Bottleneck Services and Establish a Framework for Network Architecture Development of Dominant Carrier Networks, Investigation on the Commission's Own Motion into Open Access and Network Architecture Development of Dominant Carrier Networks*, Decision 06-03-025, Rulemaking 93-04-003; Investigation 93-04-002 (Verizon UNE Phase), Dated March 15, 2006. *See also,* Illinois Commerce Commission Docket No. 02-0864 Order *Illinois Bell Telephone Company Filing to Increase Unbundled Loop and Nonrecurring Charges*, Dated June 9, 2004; and Georgia Public Service Commission Docket No. 14631-U *In RE: Review of Cost Studies, Methodologies, Pricing Policies, and Cost Based Rates for Interconnection and Unbundling of BellSouth Telecommunications, Inc.'s Services,* March 18, 2003.

likelihood that CLECs will have higher costs associated with switched access services than RBOCs. As input prices increase, so does the cost of service. In fact, the relationship between the level of input prices and the costs that are to be calculated is almost linear in the sense that if input prices double, then one should expect the costs to double.

Q77. CAN YOU PROVIDE AN EXAMPLE TO ILLUSTRATE THIS POINT?

A77. Yes. The table below illustrates this relationship for a hypothetical facility, following a traditional layout for a cost study. As can be seen from the table, when hypothetical input prices are $100, the monthly cost is calculated to be $3.33; when input prices double (*i.e.*, increase to $200), the monthly cost doubles as well.

EF&I Facilities[85]	**Fill Factor**	**ACF**[86]	**Monthly Costs**
(a)	(b)	(c)	((a)/(b)x(c))/12
$100	80%	0.32	$3.33
$200	80%	0.32	$6.67

In sum, even if a CLEC had a customer base identical to the RBOCs' in terms of customer densities (though not size), a network architecture identical to the RBOCs (though smaller), and ran its operations with the same level of efficiency, the CLEC's costs associated with providing switched access services would likely

[85] The term "EF&I" refers to the engineered, furnished and installed investment in facilities.
[86] The term "ACF" means annual cost factor, a factor used to convert the EF&I investment into an annual recurring cost stream. When these annual costs are divided by 12, they become monthly recurring costs.

still be higher than the RBOCs' because it pays *higher prices* for its network facilities than do the RBOCs.

Q78. HAVE CLEC INPUT PRICES BEEN INCREASING IN RECENT YEARS?

A78. Yes. The prices of major inputs used by CLECs in the provisioning of switched access – inputs that CLECs purchase from RBOCs like Verizon – have been increasing. Competitive carriers purchase much of the transport and loop capacity that constitute their local networks supporting switched access services directly from Verizon and other RBOCs in the form of special access services or UNEs. In many circumstances, these fees paid by the CLECs can constitute as much as 40% to 60% of their overall cost structure. Since the FCC originally issued its *CLEC Access Reform Order* in 2001, prices paid by CLECs to purchase loops and transport services from the large incumbents have increased substantially, more than doubling within some companies. These increases result largely from the fact that the RBOCs, including Verizon, have used increased pricing flexibility granted by the FCC to increase special access prices in critical markets while at the same time limiting access to UNE products in certain areas per the *Triennial Review Remand Order*.

Q79. DOES THIS PUT CLECS IN A "SQUEEZE" SITUATION?

A79. Yes. Even as the RBOCs increase prices for dedicated capacity, they are at the same time demanding that regulators force CLECs to reduce switched access rates their affiliated IXCs pay when they use those facilities to originate or terminate toll traffic. In other words, the vertically-integrated RBOCs/IXCs are squeezing the CLECs' margins by increasing their cost of inputs for services while at the same time attempting to reduce the revenues that can be generated from those services.

Q80. PLEASE SUMMARIZE THE FACTORS THAT CAN LEAD TO DEMONSTRABLY HIGHER CLEC COSTS OF SWITCHED ACCESS RELATIVE TO VERIZON.

A80. My testimony above explains that the following factors, at a minimum, can lead to demonstrably higher CLEC access costs:

1. CLECs do not have the same economies of scale as Verizon.
2. CLECs have different network architectures than Verizon with proportionately more traffic-sensitive costs.
3. CLECs have lower facility utilization than Verizon.
4. CLECs have a sparser customer base than Verizon.
5. CLECs have higher input prices than Verizon.

It is for these reasons that Mr. Vasington is wrong when he states that, "There is no principled justification for CLECs to continue to charge intrastate rates that are so much higher than ILEC rates."[87] Higher costs is an obvious justification for higher rates, and I have provided five factors that are likely to lead to higher per-unit access costs for CLECs relative to Verizon.

[87] Vasington Testimony, p 17.

C. Verizon's Intrastate Switched Access Rates Are Not Cost-Based Even For Verizon

Q81. WHY ARE VERIZON'S INTRASTATE SWITCHED ACCESS RATES NOT COST BASED?

A81. When Verizon's intrastate switched access rates were lowered in a revenue neutral manner in D.T.E. 01-31, the lower rate was not established based on Verizon's intrastate costs; rather, it was based on Verizon's interstate rate.[88] Mr. Vasington concedes this point.[89] Therefore, to have a complete understanding of the intrastate access rate benchmark that Verizon is proposing for CLECs in Massachusetts, one must look to how Verizon's interstate access rates are established.

Q82. HOW WERE VERIZON'S INTERSTATE ACCESS RATES TRADITIONALLY ESTABLISHED?

A82. The following statement by the FCC on the complex processes for setting switched access rates for ILECs underscores why these rates are not appropriate for CLECs:

---

[88] Verizon-MA's intrastate rates were reduced to its interstate rates in D.T.E. 01-31.

[89] Verizon Response to data request AG-VZ-1-34, dated July 25, 2008, Respondent: Paul B. Vasington ["The Department in D.T.E. 01-31 directed Verizon to reduce its Massachusetts intrastate access rates to interstate levels, not based on any cost study. No Massachusetts intrastate cost study for switched access service has been done since that time."] *See also,* Mr. Vasington's response to data request RNK-VZ-2-16, dated July 28, 2008, Respondent: Paul B. Vasington (in relevant part) ["Historically, Verizon's switched access rates were set in a manner that took into account other Department policy goals, such as universal service, and allowed for contribution to recovery of other costs….Since that time, Verizon does not know the exact relationship between its approved switched access rates and its actual costs for providing switched access."] This last quote exposes the double-standard in Verizon's proposal: Verizon does not know how its own switched access rates relate to their underlying costs (and has not intention to find out). Yet, at the same time, Verizon wants to cap CLEC access rates at Verizon's rate levels because Verizon believes the rates are too high and force CLECs to cost justify their switched access rates.

> First, the rules require an incumbent LEC to record all of its expenses, investments, and revenues in accordance with accounting rules set forth in our regulations. Second, the rules divide these costs between those associated with regulated telecommunications services and those associated with non-regulated activities. Third, the separations rules determine the ***fraction*** of the incumbent LEC's regulated expenses and investment that should be ***allocated*** to the interstate jurisdiction. After the total amount of interstate cost is identified, the access charge rules translate these interstate costs into charges for the specific interstate access services and rate elements. Part 69 specifies in detail the rate structure for recovering those costs. That is, the rules tell the incumbent LECs the precise manner in which they may assess charges on interexchange carriers and end users.[90]

The above FCC description of how access charges have historically been set for Verizon demonstrates two things:

i. ILEC costs were determined only in some general, top-down[91] sense and then allocated across various "buckets," such as regulated vs. non-regulated, state vs. interstate, etc., and

ii. rates were set to recover some general revenue/cost target but were not based on the per unit costs, such as determined under, for example, TELRIC, or other forms of forward-looking cost studies.

Q83. IS THIS PROCESS APPLICABLE TO CLECS?

A83. No. CLECs have never been a part of this complicated process because it has no relevance to the competitive marketplace in which CLECs operate. CLECs do

---

[90] *In the Matter of Access Charge Reform*,, First Report and Order, 12 FCC Rcd 15982, 15991-92, at ¶ 22 (1997) ("*Access Charge Reform Order (1997)*"), *aff'd Southwestern Bell Tel. Co. v. FCC,* 153 F.3d 523 (8th Cir. 1998). (emphasis added).

[91] The term "top down" refers to a costing methodology that starts with costs recorded on the company's books and allocates them – top down – over the company's services. By contrast, a bottom up approach starts with a company's telecommunications technologies and network, identifies which technologies and portions of the network are used for certain services, and then proceeds to calculate – bottom up – what the costs are associated with these technologies and portions of the network to arrive at the cost of providing the services. As is generally recognized, the two methodologies may not result in the same service costs or in the same overall costs.

not separate their costs into regulated and non-regulated activities and services; likewise, they do not engage in Part 69 jurisdictional separations and allocations of costs between state and interstate jurisdictions. Further, while this top-down cost allocation process may result in rates that permit ILECs to achieve an *overall recovery* of revenue/cost targets, there is simply nothing in this process that ensures that the resulting rates for individual services, such as the various individual components of the switched access services, are in any way cost-based for the ILECs, let alone that they are compensatory or otherwise relevant to the CLECs' costs and operations.

Q84. ARE THERE OTHER REASONS WHY VERIZON'S INTERSTATE ACCESS RATES WOULD BE A COMPLETELY ARBITRARY BENCHMARK FOR CLEC INTRASTATE SWITCHED ACCESS RATES?

A84. Yes. On May 31, 2000, the FCC adopted an "integrated interstate access reform and universal service proposal" put forward by Bell Atlantic, GTE, AT&T, SBC and Sprint (referred to by the FCC as the Coalition for Affordable Local and Long Distance Service – CALLS).[92] The *CALLS Order* substantially altered interstate switched access rates, reducing the rates for Bell Atlantic and GTE (both now Verizon) and SBC and BellSouth (both now AT&T) from previous levels. The primary focus of the order was to reduce interstate access rates paid by CALLS' long distance members AT&T (before its merger with SBC Communications) and

[92] *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, FCC 00-193, Adopted May 31, 2000 (hereafter "*CALLS Order*").

Sprint, while at the same time allowing CALLS' local exchange members (Verizon and AT&T) to recover those same monies through the interstate universal service support mechanisms (*i.e.*, a revenue neutral undertaking for the ILECs).[93]

It is important to note that the interstate access rates produced by the *CALLS Order* were set primarily through a *negotiated* agreement reached by the ILECs and IXCs. The "behind the scenes" negotiations establishing the *CALLS Order* and the resulting rates are discussed in a dissent by then-FCC Commissioner Harold Furchtgott-Roth,[94] which begins by agreeing that interstate access charges (at that time) bore *little resemblance to the* "*costs of access actually incurred*" and goes on to describe a process whereby the CALLS organization (primarily the remaining Verizon, AT&T and Sprint) negotiated with various consumer groups in an effort to craft a modified proposal regarding reduced interstate switched access rates and increased universal service fund monies that would be adopted by the FCC. Two notable aspects of this process are noted:

i. Several key participants who were interested in the process were denied access to the negotiations which ultimately resulted in the settlement agreement adopted by the FCC, *i.e.*, the Ad Hoc Telecommunications Users Committee, Time Warner Telecom, and the Association for Local Telecommunications Services (representing, primarily, the interests of competitive local exchange carriers),[95] and

[93] *CALLS Order*, ¶ 3.

[94] *Statement of Commissioner Harold Furchtgott-Roth, Concurring in Part and Dissenting in Part,* appended to the CALLS Order, May 21, 2000.

[95] In essence, it appears that the ILECs' primary local exchange competitors were barred from the discussions, even though they would have had a direct interest in the resultant switched access rate levels.

ii. Perhaps most importantly, concessions regarding access rate levels were gained from the ILECs by the FCC's agreement to make decisions in the ILECs' favor regarding not only additional universal service funds, but also two other actions completely independent from switched access services: (1) decisions regarding their obligations to provide Enhanced Extended Links – "EELs" – to competing local service providers and (2) an ongoing audit initiative related to continuing property records.

Q85. HOW IS THIS RELEVANT TO VERIZON'S COMPLAINT?

A85. Verizon's interstate switched access rates resulting from the CALLS negotiations, which would serve as the benchmark for CLEC intrastate switched access rates in Massachusetts under Verizon's proposal, were not adopted based upon a diligent review of economic variables or even an attempt to arrive at a more efficient or competitive switched access marketplace. Instead, they were established as a negotiated settlement meant to appease multiple participating parties who had been allowed the benefit of participating, each with its own regulatory "wish list" including many objectives having nothing to do with switched access. Importantly, CLECs, whose interstate switched access rates are capped at the rate level produced by the CALLS process and whose intrastate access rates in Massachusetts would be capped at that rate level under Verizon's proposal, were specifically precluded from participating in the process. What's more, much like Verizon proposes here, via the CALLS agreement, Verizon and other ILECs were allowed to offset switched access revenue reductions, an option CLECs have little hope of implementing successfully.

This is especially true because approximately one year later, the FCC required that these same competitors charge interstate switched access rates no higher than the incumbent LECs – rates which resulted from the CALLS discussions.

Verizon bypasses this important issue and simply assumes that its interstate access rates somehow "make sense," or that they are the result of reasoned and rational policy-making. Nothing could be further from the truth. The interstate switched access rates set for Verizon were established through regulatory "horse-trading" aimed at appeasing the carriers fortunate enough to have been involved in the negotiations. This included promises to Verizon that the revenues they were giving up would be made up with monies from the universal service fund,[96] promises that the FCC would end an ongoing audit that had (on a preliminary basis) shown an embarrassing shortfall in the plant accounts of the major ILECs related to continuing property records supporting their interstate rate-base, and promises that the FCC would raise the barriers for competitors making use of Verizon UNE combinations to compete for local exchange customers.

This underscores the fundamental unfairness of Verizon's requested relief in its complaint. Not only was Verizon kept whole through a revenue neutral ***intra***state access rate reduction when its intrastate rates were reduced in Massachusetts to its interstate rates, but Verizon was also kept whole through a revenue neutral ***inter***state access rate reduction when its interstate rates were reduced through the CALLS Order (in addition to raising the barriers to entry for Verizon's competitors). By contrast, CLECs were afforded no revenue neutrality by the FCC when their ***inter***state rates were capped at the ILEC level in 2001, and

[96] Similar, in effect, to Verizon's revenue-neutral intrastate access charge reduction in DTE 01-31.

CLECs are not afforded revenue neutrality under Verizon's proposal to cap CLEC ***intra***state rates at the Verizon rate. This would be a double-whammy for CLECs.

IV. BENCHMARKING REQUIREMENTS IN OTHER JURISDICTIONS SHOULD NOT GUIDE THE DEPARTMENT'S DECISION IN THIS PROCEEDING

Q86. VERIZON REFERENCES THE FCC'S BENCHMARK THAT IT INSTITUTED FOR CLEC INTERSTATE ACCESS RATES AS SUPPORT FOR THE DEPARTMENT INSTITUTING A SIMILAR CAP FOR INTRASTATE RATES.[97] DO YOU AGREE THAT THE FCC'S BENCHMARKING REQUIREMENT PROVIDES SUPPORT FOR A STATE CAP?

A86. No. There are at least two reasons why the FCC's benchmark for interstate switched access rates implemented in 2001 does not support a similar benchmark for intrastate rates today: (i) the FCC did not intend for its interstate benchmark to be permanent, and (ii) the FCC's interstate benchmark is no longer relevant in the current state of the telecommunications industry.

Q87. PLEASE ELABORATE ON YOUR POINT THAT THE FCC DID NOT INTEND FOR THE INTERSTATE BENCHMARK TO BE PERMANENT.

A87. The FCC explicitly noted that its benchmarking policies were intended as *transitional*, awaiting the FCC's more permanent resolution of inter-carrier compensation issues:

[97] Vasington Testimony, pp. 8-10.

> We stress, however, that the mechanism set out below is a *transitional* one; it is not designed as a permanent solution to the issues surrounding CLEC access charges. Rather, we view the mechanism we adopt today as a means of moving the marketplace for access services closer to a competitive model. Because our tariff benchmark is tied to the incumbent LEC rate, we will re-examine these rates at the close of the period specified in the *CALLS Order*. Through a separate notice of proposed rulemaking that we issue today, we also evaluate the access charge scheme as part of a broader review of inter-carrier compensation.[98]

As recently indicated, the FCC is likely to comprehensively address inter-carrier compensation issues by November of this year.[99] Therefore, irrespective of a host of other problems concerning Verizon's proposed intrastate benchmark, it is particularly ill timed. To the extent the FCC may reconsider other compensation issues, there is a strong logic in awaiting the outcome.

Q88. WHY IS THE FCC'S INTERSTATE BENCHMARK NO LONGER RELEVANT IN TODAY'S TELECOMMUNICATIONS MARKETPLACE?

A88. In its *Access Reform Order*, the FCC recognized the presumptively competitive nature of CLEC switched access services:

> [A]s CLECs attempted to expand their market presence, the rates of incumbent LECs or other potential competitors should constrain

---

[98] *CLEC Access Charge Reform Order,* ¶ 7. (Emphasis added.)

[99] On July 8, 2008, the United States Court of Appeals for the District of Columbia Circuit granted Core Communications Inc.'s writ of mandamus and directed the FCC to explain the legal basis for its ISP-bound compensation rules within six months. The court ruled that the FCC's ISP-bound compensation rules would be vacated if no such explanation is provided by the FCC within the specified timeframe. *In Re: Core Communications, Inc.* No. 07-1446, Decided July 8, 2008. Counsel for the FCC indicated in oral arguments in that case that FCC Chairman Martin "intends to achieve broad-based comprehensive intercarrier compensation reform within six months." *In Re: Core Communications, Inc.*, D.C. Cir. Civ. No. 07-1446, Transcript of May 5, 2008 Oral Argument, at 22 (Palmore comments).

> the CLECs' terminating access rates. The Commission found that access customers likely would take competitive steps to avoid paying unreasonable terminating access charges. Thus, it explained that a call recipient might switch to another local carrier in response to incentives offered by an IXC.[100]

When the FCC revisited the issue in its *CLEC Access Reform Order* to address what IXCs viewed as "the CLECs' abuse of [the FCC's] tariff rules to impose excessive access charges"[101] it came to an *opposite* conclusion. The FCC noted:

> ***We decline to conclude, in this order, that CLEC access rates, across the board, are unreasonable.*** Nevertheless, there is ample evidence that the combination of the market's failure to constrain CLEC access rates, our geographic rate averaging rules for IXCs, the absence of effective limits on CLEC rates and the tariff system create an arbitrage opportunity for CLECs to charge unreasonable access rates. Thus, we conclude that some action is necessary to prevent CLECs from exploiting the market power in the rates that they tariff for switched access services.[102]

Perhaps the most important conclusion in the FCC's order as it related to CLEC interstate access rates is shown in the bold, italicized language above – the FCC did ***not*** conclude that CLEC interstate access rates were unreasonable across the board. By contrast, in this case Verizon is seeking a conclusion by the Department that CLECs' intrastate access rates are "across the board" unreasonable without any examination of the relationship between CLEC costs and rates or any examination of potential CLEC market power. That being said, while the FCC went on to conclude that CLECs may be able to exploit market

[100] *CLEC Access Reform Order*, ¶ 14.
[101] *Id.*, ¶ 1.
[102] *Id.*, ¶ 34. (emphasis added)

power, it is important to note that the FCC explicitly identified *two developments* that would make switched access markets competitive:

> The Commission previously projected that, at least in the case of originating access service, IXCs would likely enter marketing alliances with LECs offering low-priced access service and would thereby be able to exert downward pressure on CLEC access rates. The Commission even raised the prospect that IXCs would themselves choose to enter the local service market as a means of exerting downward pressure on terminating rates. [103]

That is, switched access markets would discipline CLEC switched access rates if the following occurred:

1. Alliances between IXCs and ILECs.
2. IXC entry into local exchange markets.

In 2001, the FCC lamented that neither of these developments had come to pass and, accordingly, the FCC concluded that CLECs must have market power in the provision of switched access services:

> However, neither of these eventualities has come to pass, at least not to an extent that has resulted in effective downward competitive pressure on CLEC access rates. We now acknowledge that the market for access services does not appear to be structured in a manner that allows competition to discipline rates.[104]

Of course, what the FCC was hoping for in 2001 – (i) alliances between IXCs and ILECs and (ii) IXC entry into local markets – now *has* come to pass. All RBOCs have obtained Section 271 approval to provide interLATA long distance services, and perhaps more importantly, there have been a number of mergers between

[103] *CLEC Access Reform Order,* ¶32.
[104] *Id*, ¶32. (Emphasis added.)

IXCs and RBOCs – most notably the *megamergers* between Verizon and MCI and between AT&T and SBC – which has further transformed the RBOCs into vertically integrated firms that offer local and long distance services (not to mention wireless and other services). The watershed changes brought about by the megamergers and section 271 approvals alter any conclusions regarding the CLECs' ability – or lack of ability – to exercise market power due to any alleged barriers faced by IXCs. Indeed, given that the same companies – i.e., Verizon, AT&T, and Qwest – who own the switched access connections (i.e., local loops) are also the country's largest IXCs, it must now be concluded that the IXCs face no barriers in the switched access market. Ultimately, the rational that the FCC relied upon for finding CLEC market power and requiring interstate switched access rate benchmarks is no longer valid.

Q89. IS THERE ANOTHER REASON WHY THE DEPARTMENT SHOULD NOT ADOPT A CLEC INTRASTATE ACCESS RATE BENCHMARK PATTERNED AFTER THE FCC'S INTERSTATE ACCESS RATE BENCHMARK?

A89. Yes. The FCC did not perform a formal analysis of CLEC market power when adopting its interstate benchmark in 2001 – likely because the FCC intended for this to be only a transitional (not permanent) action. The lack of a market power analysis in the FCC's *CLEC Access Reform Order* stands in stark contrast to the more systematic and formal market power analyses set out in the Horizontal

Merger Guidelines used by the DOJ and FTC and previously conducted by both the FCC and the Department for permanent decisions.

Q90. VERIZON REFERS TO A NUMBER OF STATES THAT HAVE ADOPTED INTRASTATE ACCESS BENCHMARKS FOR CLECS (OR SIMILAR LIMITS) LIKE THE FCC'S BENCHMARK FOR INTERSTATE RATES.[105] SHOULD THE ACTIONS IN OTHER STATES PERSUADE THE DEPARTMENT TO FOLLOW SUIT IN THIS INSTANCE ANY MORE THAN THE FCC'S INTERSTATE BENCHMARK?

A90. No. The two preconditions to a competitive access market that the FCC discussed in the *CLEC Access Charge Reform Order* have now come to pass. Mr. Vasington has simply listed states that have adopted some sort of CLEC access charge cap without any details (e.g., the differences in statutory requirements in those states, or the market power analyses (or lack thereof) conducted in those states). It is likely that some of these states have relied, at least in part, on following the FCC's lead on benchmarking, which as explained above, is an outdated approach and not based on a formal market power analysis.

In addition, in all but one of the states Verizon's lists, the intrastate bench-marking cap used is not the ILEC's interstate rate, as it would be in Massachusetts. And as explained above, using Verizon's interstate rates as a proxy for CLECs' intrastate rates in Massachusetts is particularly problematic.

[105] Vasington Testimony, pp. 10-12.

Q91. DO ANY OF THE STATES TO WHICH MR. VASINGTON REFERS STRIKE YOU AS BEING POTENTIALLY MISLEADING?

A91. Yes. Let me start by saying that I have not independently researched all of the other states Mr. Vasington claims have adopted CLEC intrastate access reform comparable to what Verizon proposes for Massachusetts because frankly those decisions are irrelevant. However, Mr. Vasington's claims regarding Illinois having "rules benchmarking CLEC rates to ILEC rates"[106] jumped out at me.

Q92. WHY DID THE ILLINOIS EXAMPLE "JUMP OUT" AT YOU?

A92. Because I recently personally participated in a workshop[107] conducted by the Staff of the Illinois Commerce Commission to examine the very issues of whether CLEC access charge reform was needed in Illinois and, more specifically, whether benchmarking to the ILEC rate was appropriate. The fact is that after careful consideration, the Staff decided in May 2008 ***not*** to recommend that the Illinois Commission undertake a rulemaking or generic proceeding for establishing general constraints upon CLEC prices for intrastate access. There is no such benchmark rule in Illinois and the Illinois Commission Staff recently made an affirmative decision not to pursue one.

[106] Mr. Vasington states that Illinois is a state that has "rules benchmarking CLEC rates to ILEC rates." Vasington Testimony, p. 11.
[107] The Illinois Staff's workshop on CLEC access rates in which I participated was held in January 2008.

V. VERIZON'S BROAD BRUSH APPROACH TO CAPPING CLEC ACCESS RATES IS INAPPROPRIATE

Q93. IF THE DEPARTMENT IS CONCERNED ABOUT THE LEVEL OF CLEC ACCESS RATES IN MASSACHUSETTS, IS VERIZON'S APPROACH TO CAPPING ALL CLEC ACCESS RATES IN ONE FELL SWOOP APPROPRIATE?

A93. No. The Department should not simply assume, as Verizon does, that all CLEC access rates are unreasonable simply because they are higher than Verizon's rates. There may be very good reasons for this – reasons that were not explored by Verizon. As a result, Verizon's requested CLEC access rate cap should be rejected outright. To the extent, however, that the Department is concerned about the rates of particular CLECs, it should address those CLECs' rates on a case-by-case basis. This would allow the Department to thoroughly examine the rates of any such carriers and the reasons why these carriers' rates may be higher. In addition, as stated earlier, the FCC will likely be restructuring intercarrier compensation in the near future that might provide the Department with a framework within which to work on this matter.

Q94. WHAT IF, DESPITE THE EVIDENCE YOU HAVE PROVIDED ABOVE SHOWING WHY VERIZON'S REQUEST IS BAD PUBLIC POLICY, THE DEPARTMENT IS STILL CONCERNED ABOUT THE GENERAL LEVEL OF CLEC ACCESS RATES IN MASSACHUSETTS?

A94. At the very least, a more thorough analysis of individual CLEC costs would be needed first to ensure that CLECs recover their access costs from the cost causers. And contrary to Verizon's proposal, this detailed analysis should be done *before* CLEC intrastate access rates are capped across the board. After all, the rates of non-dominant carriers like CLECs are presumed to be just and reasonable, and nothing Verizon has provided in this case rises to the level of reversing that presumption.

Q95. MR. VASINGTON SAYS THAT "IT WOULD BE REASONABLE FOR THE DEPARTMENT TO ALLOW A CLEC THE OPTION OF DEMONSTRATING THAT RATES HIGHER THAN VERIZON'S ARE REASONABLE, BASED ON A FULL DEMONSTRATION BY THE CLEC THAT ITS OWN COST OF PROVIDING SWITCHED ACCESS REQUIRES A HIGHER RATE."[108] WHAT IS YOUR RESPONSE?

A95. Mr. Vasington has it backwards. CLEC rates are presumed to be just and reasonable, and it is Verizon's burden in this complaint proceeding to demonstrate they are not in order for its requested relief to be granted. Mr. Vasington's assertion goes against how services are regulated in Massachusetts and the economic theory underlying competitive services (i.e., competitive forces constrain prices so that cost of service studies are not necessary).

[108] Vasington Testimony, p. 21.

Further, coming from a consulting firm that has developed them, I can tell you first-hand that developing CLEC access cost studies are not a cheap or easy undertaking. Verizon's proposal to impose a rebuttal presumption on the CLECs to substantiate higher rates than Verizon's imposes a requirement on every CLEC to conduct an access cost study or be forced to live with Verizon's rates. This is further support for addressing any individual CLEC's rates that concern the Department on a case-by-case basis.

That being said, if the Department does cap CLEC access rates, it should indeed allow CLECs the option to justify their costs.

Q96. DOES MR. VASINGTON'S TESTIMONY ON ALLOWING CLECS TO JUSTIFY HIGHER COSTS CREATE AN INTERNAL CONFLICT IN HIS TESTIMONY?

A96. Yes. At page 17 of his testimony, Mr. Vasington states that "there is no principled justification for CLECs to continue to charge intrastate access rates that are so much higher than ILEC rates." However, four pages later, Mr. Vasington concedes that one justification for CLECs to charge higher intrastate access rates than the ILEC is if the CLEC demonstrates that its costs are higher than the ILECs. Either there is a justification for CLECs to assess higher access charges than an ILEC or there is not – and Mr. Vasington's concession that there is a justification for higher CLEC rates is damaging to Verizon's complaint.

Q97. PLEASE ELABORATE ON HOW MR. VASINGTON'S CONCESSION IS DAMAGING TO VERIZON'S COMPLAINT.

A97. Verizon's complaint is premised on the notion that the fact that CLEC intrastate switched access rates are higher than Verizon's means that CLECs have market power and their access rates are unreasonably high. However, Mr. Vasington's acknowledgement that CLECs can have higher access costs than Verizon without his analyzing *any* CLEC's costs means that the premise for Verizon's complaint is lacking – Verizon has made no attempt to analyze whether CLECs have higher access rates because of higher access costs. Verizon has the burden of proof to substantiate its complaint, and Mr. Vasington's acknowledgment shows that Verizon, by failing to examine reasons why CLEC costs may be higher, has failed to meet its burden.

Q98. DO YOU FIND ANYTHING CURIOUS ABOUT MR. VASINGTON'S TESTIMONY ON ALLOWING CLECS TO JUSTIFY HIGHER COSTS?

A98. Yes. Though Mr. Vasington states that CLECs should be allowed to justify higher rates than Verizon's, Verizon's proposed "new rule or policy" mentions nothing about CLECs justifying higher rates – a point acknowledged by Mr. Vasington.[109] Seemingly, if Verizon truly believed that CLECs should be allowed to justify higher rates, then it would have included such a provision in its proposed rule – it did not.

---

[109] Vasington Testimony, p. 21. ["Although not specifically referenced in the text proposed by Verizon, as with any general rule or policy, the Commission has the authority to grant exceptions for good cause shown on a case-by-case basis."]

VI. VERIZON MISCONSTRUES COMMENTS MADE AT THE PUBLIC HEARING IN THIS CASE

Q99. MR. VASINGTON DISCUSSES COMMENTS MADE BY CLEC REPRESENTATIVES AT THE FEBRUARY 12, 2008, PUBLIC HEARING IN THIS CASE.[110] WOULD YOU LIKE TO RESPOND?

A99. Yes. Though the transcript from the public hearing speaks for itself, my reading of the transcript leads me to the conclusion that Mr. Vasington has seriously misconstrued these comments. Take for example, Mr. Vasington's claim that "CLECs seemed to concede that they are earning revenues well above costs from intrastate access charges, but argued that this is somehow in the 'public interest' to promote CLEC competition."[111] Mr. Vasington's support for this assertion is a statement by a One Communications attorney (and similar statements by other CLEC reps) that "access charges represent a significant revenue stream for CLECs in Massachusetts." The fact that access charges represent a significant revenue stream for CLECs says nothing about the relationship between these revenues and the costs CLECs incur to generate access revenues – and certainly nothing in these comments can reasonably be interpreted as a concession that CLECs "are earning revenues well above costs." Further what Mr. Vasington fails to mention is that the attorney explained that access charges represent a significant revenue stream for CLECs because "unlike Verizon, CLECs offer

---

[110] Vasington Testimony, pp. 22-25.
[111] Vasington Testimony, p. 22.

relatively few services over their common plant."[112] In the proper context, it is clear that this statement had nothing to do with CLECs admitting to earning access revenues well in excess of costs.

Another example of Mr. Vasington misconstruing comments made at the public hearing is the following statement: "That certain CLECs are charging unreasonably high access charges to other carriers as part of the CLECs' business plan is not a legitimate justification for keeping those rates in place."[113] Contrary to Mr. Vasington's testimony, no CLEC representative stated at the public hearing that CLECs were charging unreasonably high access rates as part of their business plans, nor did any CLEC representative say that CLEC rates should remain in place because of the CLECs' business plans. This is evident from reading the page of the transcript to which Mr. Vasington cites in support of his testimony,[114] which shows that the CLEC representative was discussing the impact on small and medium sized businesses from granting Verizon's requested relief.

Q100. DO YOU BELIEVE THAT STATEMENTS BY CLEC REPS AT THE PUBLIC HEARING INDICATING THE IMPORTANCE OF THIS CASE

---

[112] Transcript, February 12, 2008, p. 4. The relevant quote is as follows: "Your Honor, unlike Verizon, CLECs offer relatively few services over their common plant. Thus, access charges represent a significant revenue stream for CLECs in Massachusetts, and the Department should examine CLEC access rates with that reality foremost in mind."

[113] Vasington Testimony, p. 23.

[114] See, Transcript, p. 7 ["We serve primarily business customers, and that's an important distinction to some extent between many of the CLECs in this room and Verizon, in that the access rates that the CLECs have, which they have reasonably relied upon, are rates that business plans have been formed around, that products have been priced taking into account the rates, and reasonably so; and, given the business environment, that most CLECs find a principal amount or a significant amount of their revenue to come from any rush to judgment or hasty decision to decrease access rates could have a significant impact on the business community of Massachusetts, especially the small and medium-sized businesses."]

TO THE FUTURE OF LOCAL COMPETITION IS HYPERBOLE, AS MR. VASINGTON CLAIMS?[115]

A100. No. If Verizon's relief is requested, CLECs could be forced to provide access services below costs, in which case CLECs must either eat the loss or attempt to recover those costs previously recovered through access charges another way (e.g., from its retail customers). Because CLECs, unlike Verizon, do not have a near local monopoly, they do not have a base of customers from whom they can recover these costs. An inability to recover costs for switched access would put CLECs in Massachusetts at a severe competitive disadvantage vis-à-vis Verizon who has been allowed to recover all reductions in both its inter and intrastate rates through other protected revenue streams.

VII. CONCLUSION AND RECOMMENDATIONS

Q101. PLEASE SUMMARIZE YOUR CONCLUSIONS AND RECOMMENDATIONS.

A101. I recommend that Verizon's complaint be denied in its entirety. Verizon has provided no relevant information showing that CLECs' intrastate switched access rates are unjust or unreasonable or that CLECs possess market power in the provisioning of switched access services. Verizon's entire case is based on the premise that because CLECs' rates are higher than Verizon's, they are therefore unjust and unreasonable. However, I have shown that there are other, rational and

[115] Vasington Testimony, p. 23.

reasonable reasons why CLEC rates are, in some cases, higher than Verizon's. In other words, Verizon has failed to justify its complaint that CLEC intrastate switched access rates should be capped at the Verizon level. As I mentioned above, the necessary analysis requires that Verizon demonstrate, at a minimum, that: (1) CLECs have market power (i.e., barriers exist that keep other competitors or potential competitors from the marketplace), (2) those barriers cannot be dismantled, (3) regulatory alternatives other than price regulation have been examined and found unacceptable, (4) benchmarking is the best regulatory option rather than some more traditional cost-plus alternative, and (5) that Verizon's access rate is the best of the available benchmarks. Verizon has demonstrated none of these things: Verizon simply *presumes* that CLECs have market power (without any market power analysis) and then jumps straight to prescribing Verizon's access rates as the benchmark – thereby skipping all five intervening steps necessary to discern the best regulatory response. By contrast, I have shown under Step 1 that CLECs do not have market power for intrastate access services and that no barriers exist in the switched access market that would allow CLECs to exploit market power. As a result, the remainder of steps #2-#5 are irrelevant. Nonetheless, I have also shown that establishing a benchmark is not the best regulatory option because it would negatively impact the competitive market and further strengthen Verizon's competitive position beyond the obvious advantages it already enjoys as a former monopolist and fully-integrated RBOC/IXC (Step 4). Finally, I have shown that even if a benchmark were appropriate, Verizon's rate is certainly not the best benchmark available for CLEC access rates (Step 5). Based on this, Verizon's proposed policy/rule regarding capping CLEC access rates at Verizon's level should be rejected.

Q102. DOES THIS CONCLUDE YOUR TESTIMONY?

A102. Yes.