BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. UNDOCKETED

In the Matter of:

CLEC INTRASTATE ACCESS CHARGES WORKSHOP.
_______________________________/

PROCEEDINGS: STAFF WORKSHOP

DATE: Wednesday, July 16, 2008

TIME: Commenced at 9:30 a.m.

PLACE: Betty Easley Conference Center
Room 140
4075 Esplanade Way
Tallahassee, Florida

TRANSCRIBED FROM TAPE BY: JANE FAUROT, RPR
Official FPSC Reporter
(850) 413-6732

P R O C E E D I N G S

MR. TEITZMAN: All right. We're going to go ahead and get started. I'm going to start off with the notice.

Pursuant to notice issued June 17th, 2008, this time and place has been set for a workshop to discuss CLEC intrastate access charges. This meeting is being recorded and it will be transcribed at a later date, so I would ask that when speaking please remember to state your name and who you are representing for the benefit of the court reporter.

All right. We will go ahead and start with appearances, and we are going to go ahead and start with appearances on the phone. Feel free to --

MS. HALL: Lynn Hall with Smart City.

MR. TEITZMAN: I'm sorry, could you repeat that. I spoke over you.

MS. HALL: Lynn Hall with Smart City.

MR. TEITZMAN: Thank you.

MR. RIDLEY: Carolyn Ridley with TW Telecom.

MR. IVANUSKA: This is John Ivanuska with Excel Communications.

MS. HUTTENHOWER: Debbie Huttenhower with Smart City.

MS. SHULMAN: Christian Shulman, Excel Communications.

MS. TOWNSEND: Barbara Townsend (phonetic), Bright House Network Information Services.

MR. TWOMEY: This is Chris Twomey, counsel for AstroTel.

MR. TEITZMAN: Is there anyone else on the line who hasn't made an appearance? Did someone just join? Please state your name.

MS. WEST: Kathy West.

MR. TEITZMAN: I'm sorry, who are you representing?

MS. WEST: STS.

MR. TEITZMAN: All right. We will work our way around the room now. Once again, my name is Adam Teitzman. I am an attorney with the Commission.

MR. DOWDS: I'm Dave Dowds with the Commission staff.

MR. FEIL: I'm Matthew Feil with the Akerman Senterfitt law firm. I'm here representing NuVox Communications and Excel Communications.

MR. STRUMBERGER: Greg Strumberger with Level 3 Communications.

MS. KAUFMAN: Vicki Gordon Kaufman. I'm with the Anchor Smith Grimsley firm in Tallahassee, and I'm here on behalf of the Competitive Carriers of the South and DeltaCom.

MR. MASTANDO: My name is Tony Mastando, and I am an attorney with DeltaCom.

MS. BERLIN: Susan Berlin with NuVox.

MR. WATTS: Jerry Watts, DeltaCom.

MR. HATCH: Tracy Hatch, AT&T.

MR. FOLLENSBEE: Greg Follensbee actually representing AT&T Florida, AT&T Communications of the Southern States, Inc., AT&T Long Distance, and GECG.

MR. HATCH: South Florida.

MR. FOLLENSBEE: South Florida.

MR. PRICE: Don Price with Verizon. I'm not going to list the companies because I didn't commit it to memory, but Verizon Florida, Verizon Access, and anybody else whose name I might have forgotten.

MR. HIGGINS: Devlin Higgins, Commission staff.

MR. TEITZMAN: Anybody else in the room want to make an appearance?

MR. ADAMS: Yes. Gene Adams with the Pennington law firm representing TW Telecom.

MR. KNOOK: Dave Knook, Florida Cable.

MR. TEITZMAN: All right. Just one more piece of business. There is a sign-in sheet at the front of the room, so everybody who's in here please remember to sign in. With that being said, I'm going to turn it over to Dave Dowds.

MR. DOWDS: We are here to listen is the bottom line. We have been doing research, as many people know, for about a year to year and a half on CLEC intrastate access rate levels in Florida, and we were trying to decide what actions, if any, are warranted. And it was decided it would be good to have an industry workshop to elicit your opinions on whether there is a quote, problem, unquote. If so, what options are available to resolve it. What should we recommend, if anything, to the Commissioners. And we are here to listen.

I would note that there is a copy of the agenda at that end of the table, and essentially we anticipate that the bulk of the morning will be spent with CompSouth's presentation, and then we will probably -- depending on how long that runs, we will probably break early for lunch, come back after about an hour, and then spend the afternoon with a Q&A session on CompSouth's presentation and any other parties' views on the matter.

In particular with respect to the twelve questions that were identified in the original notice. I know some parties have filed responses to the questions in the docket file or the undocketed file. I'd like to hear from as many people as possible and as many different views as possible. That said, I'm basically done.

MS. KAUFMAN: You want CompSouth to start, I guess?

MR. DOWDS: Whenever you are ready.

MS. KAUFMAN: Okay. I just have a very brief introduction. As I said, I'm Vicki Kaufman, I'm here on behalf of CompSouth and DeltaCom.

Most of you know that CompSouth is a trade group. We have quite a few members, many of whom are either here in person or some of whom are on the phone. But companies like

Cbeyond, NuVox, DeltaCom, Time Warner, and others who do business here in Florida. We are very concerned with the issue that the staff has raised, and we have spent a lot of time thinking about your questions, and thinking about the issue in general, and we have actually engaged the firm of QSI to take a look at some of these issues and share their views with you.

We had intended that Mr. Mike Starkey, who is here, and Doctor Gus Ankum would talk to you, and review with you, and hopefully engage in discussion with you about our slide presentation. And, unfortunately, Doctor Ankum who was with us last night is ill, so he is in -- I mean, it's nothing serious, but he isn't able to here, so Mr. Starkey will give the presentation and hopefully engage in some Q&A with you. That's the end of my introduction, and I'm going to ask Mr. Starkey to come up and talk to you about the issues that you all have raised.

MR. STARKEY: Good morning. There's not a microphone over here. I am going to sort of need of manipulate the slide presentation. Is there a way to sort of accomplish that?

(Off the record discussion.)

MR. STARKEY: Good morning. My name is Mike Starkey. I'm the President of QSI Consulting. As Vicki mentioned, we've actually been -- we've been engaged by CompSouth to work on issues related to CLEC access charges. It's actually an issue that we have been working on for probably three to six months.

We are in the process of developing a white paper on the topic. We have been doing a lot of research. That white paper should be available within the next week or so we hope. It's in the final stages of sort of getting polished up, if you would. And so a lot of what I will be going through this morning in the presentation is the result of our analysis from the white paper.

Doctor Ankum, who is the primary author of the white paper, as Vicki said, was going to be the primary presenter this morning and I was just going to kind of add color commentary. So I'm now going to sort of take over the role of trying to go through the entire presentation, so bear with me to some extent.

I do hope that this will be more of a conversation than it will be sort of me presenting for three hours. That won't be good for any of us. I'm kind of hoping that if people have questions, they will raise them. I certainly would invite questions as we go through. If I say something you don't agree with, bring up the point and we should talk about it, because this is a debate that has been going on for awhile and there is a lot of material out there on this particular topic. So I very much would invite questions, or thoughts, comments, as we go through. Please feel free to interpret me. I'm not going to get upset about that.

We started our analysis, and I think sort of this issue started at the FCC in the 1999 to 2001 time frame. And as I know you are all aware, the FCC in '01 issued its Seventh Report and Order that capped interstate CLEC access rates and benchmarked them at the rates of the largest ILECs, or of the ILEC within which service territory you are currently serving.

That over time has filter down to the states to some extent. Other states, some states have taken up that same mantra and that same policy, and so we began our evaluation back at the FCC's record. What were they looking at when they made these original decisions. What was the state of the market at that time. How has it changed over time, and sort of what's the situation today compared to what it was then.

In reviewing the FCC's original order and doing some analysis around the record that it had before it when it was doing it, we have sort of reached five key conclusions from the white paper that will serve as sort of the outline of our presentation today. The FCC originally concluded that there was market power or a series of bottleneck monopolies is really the way they put it, in the provision of switched access. And primarily terminating switched access is where the FCC focused much of its effort.

We disagree with that. As we'll sort of describe as we go through here, the FCC in '01 when it described this market power and these series of bottleneck monopolies really did very little analysis, economic analysis of what market it was talking about, what barriers-to-entry erected this market power and allowed CLECs to wield it, and really lacked an analysis in general, even a technical analysis of what this series of monopoly bottlenecks was. It sort of took it for granted and then moved on from there to make some policy decisions.

Since that time, the FCC has taken the issue of market power a little bit more systematically and empirically in its forbearance petitions for one thing, so now we have a further record from the FCC post-2001 wherein it does a better job of employing sort of economic analysis related to market power and to barriers-to-entry that erected market power. So this morning I will be describing some of the -- I will be comparing and contrasting the FCC's original decision in that regard versus what it found later, and showing that if it had employed a more rigorous examination of what market power is and how market power is erected for carriers, then it probably would have reached a very different conclusion.

The other thing I would point out to begin with is that it had been awhile. When we started this research it had been awhile. We had been involved in those original proceedings at the FCC, but it had been awhile since I had been back and read that order. If you go back and read that order, one of the first things the FCC says is that when it benchmarked the CLEC rates at the ILEC levels it was doing it as an interim measure pending unified intercarrier compensation reform. And as we say in the white paper, seven years later we still don't have unified intercarrier compensation reform, but we are still stuck with this interim measure of capped CLEC access rates. Sort of bringing to mind the recent core decision where the FCC has sort of had an interim ISP policy in place for seven to eight years and the court has finally said enough is enough, you have got to put a real policy in place if you want to implement regulation.

The second conclusion that we have sort of reached in going through all of this information is that there has been substantial change in the market since '01. The FCC also premised its original finding on the fact that you really had segmented markets. You had basically IXCs, or long distance carriers on one side, and you had local carriers on the other. At that point there wasn't an enormous amount of vertical integration. It said -- the FCC suggested that it expected the market to drive vertical integration such that IXCs became or partnered with local carriers such that the issue of switched access became less and less of an important issue.

And, indeed, since '01 we are all aware that that has happened. Verizon has purchased MCI. SBC has purchased AT&T. We have amazing vertical integration throughout the marketplace. So what we are left with is an FCC order that was interim in the first place that relied upon primary market conditions at the time that have substantially changed.

Third, it's our opinion that there are existing regulations that likely cause any market distortion that may exist. And we don't necessarily believe that there are market distortions, but to the extent they do exist, it's likely other regulations that caused it. Primarily what comes to mind -- and I will get into this a little bit later. The other thing to be aware of about the FCC's order in 2001 was that it was not unanimous. Commissioner -- and I always get his name wrong, I should have got it right before I came, but I believe it is Furchtgott-Roth.

MS. KAUFMAN: Furchtgott-Roth.

MR. STARKEY: Okay. Thank you. Actually filed a pretty scathing dissent of the original 2001 order. And one of the things he said was there is a right way to solve -- if there is a problem, there is a right way to solve it and a wrong way to solve it, and the wrong way is price regulation. The right way is to remove the barriers that keep long distance carriers from pushing the cost that they bear in switched access onto their own customers so that customers can make reasonable price decisions, buy versus not buy.

What he was talking about really was the 254(g) prohibition in the Act against interstate deaveraged toll rates. The FCC has taken a fairly narrow reading of that particular prohibition and has suggested that IXCs must broadly average their rates across interstate for interstate traffic. Thereby sort of hiding, if you will, differences in costs associated with markets where it's more expensive versus less expensive to originate and terminate.

Commissioner Furchtgott-Roth suggested that that was really the problem, not these rates associated that they were paying, but if they could pass them through, then the market would work. When you called into one area you would know it was a little more expensive. You might choose a different carrier who charged less or more depending upon your particular needs. And we agree with that. We believe that to the extent distortions exist they exist because there is a regulatory prohibition in the chain of discipline, price discipline that keeps the prices from being where they ought to be so consumers can make reasonable decisions.

And, Commissioner -- I'm just going to call him FR. Commissioner FR said that other -- and the problem there is not the Act itself, because the Act itself gives some leeway to the FCC on how it can interpret that averaging requirement, but that the FCC's narrow interpretation of that particular requirement was the problem. And we agree.

So we sort of stepped through this piecemeal. We don't think there is a problem. We don't think there is a market distortion. But let's now assume that there is and we have to fix it, okay. If there is, then we sort of then have to look at our alternatives, and the alternative that the FCC chose and other state commission's consider is benchmarking the CLEC rates to the ILEC levels. And here we have RBOC, because really that is the primary marketplace within which CLECs operate. Most of them anyway.

And what we say here, and the conclusion of the white paper is that that is probably the most harmful of the particular and potential alternatives. Primarily because on the one hand you have AT&T and Verizon, two of the world's largest vertically and horizontally integrated firms with the largest economies of scale that under any sort of economic analysis should be able to charge rates that are lower than other folks in the marketplace. And you're taking much, much smaller carriers, regional carriers and local carriers in some circumstances, and you're holding them to that cost structure. You're saying your rates must be no higher than theirs.

There are a number of economic problems with that, including the fact that it's demonstrable that those rates are below the CLECs' cost of providing those services in some circumstances. And, you know, sort of the touchstone of regulation has always been if barriers-to-entry exist, if market power exists, then the regulator sets rates based on the cost of production. That's sort of the mantra that all of us that have been in regulation for the longest period of time have lived and died by. It is the way the FCC in most circumstances has lived and died with relation to its TELRIC rules that the Supreme Court ultimately confirmed. And with the way it originally did -- though it used embedded costs -- with Part 32 and 36.

So the FCC in 2001 made a dramatic departure in its Seventh Report and Order by suggesting that we are going to ignore costs of production and we are simply going to benchmark. Now, one of the things that sort of has come to light as we do -- at least in our own minds, as we have done our research is that there were very specific reasons why the FCC made that broad departure. It doesn't describe it in great detail. It doesn't describe it as being a dramatic departure, but it is. And the reason, from what we can tell, that it made that dramatic departure was largely administrative. In the '99 to 2000 time frame, the FCC had originally come to the conclusion that CLEC access rates operated in a competitive market, that there weren't market distortions, and that they should be allowed to price them as they saw fit.

They began to see a number of complaints primarily raised by AT&T at that point in time saying that these rates are just and reasonable under Section 201 of the Act. So they were being faced with a number of complaints and complaints that required a lot of analysis, economic analysis of, well, what are the costs of these, and are these cost-based, and they weren't well equipped to deal with it. They weren't well equipped to deal with -- and I know some of you share this view and some of you don't -- they are not well equipped to deal with sort of a hearing process where you have got a lot of data, economic data that you put in and describe what are the costs of service and those kind of things. They are just not well suited to deal with that and they talk a little bit about that in their order.

So what they did was they took an expedient route. They basically, in my opinion, said the easiest way to solve what we see as a problem now is to cap them and we have got to come up with a good cap. And the only rate that really existed out there at that time that they saw as a reasonable cap was the ILEC rate. So the result of that was there wasn't a lot of analysis that went into why that is the best cap. There wasn't lot of analysis or description of why they were making this vast departure from their previous regulatory construct of cost-based rates, and it was meant to be interim in nature.

Now, the problem with that is it has gained steam. It has gained a lot of momentum. Other states have started to pick it up, because, in my opinion, it is expedient. It's easy. But that shouldn't be the key regulatory driver in these kinds of circumstances is that it's easy. We should be striving for what is the right thing to do for the marketplace. And simply taking a rate that has nothing to do with the cost of the carriers who are producing the product you are talking about and saying you must abide by that rate. Easy, but not good in our opinion.

The fifth conclusion that we sort of reached at doing this -- and I guess I should have probably started by telling you a little bit about who QSI is and what we do. We are a consulting firm that works not only for carriers, but we work for state commissions, we work for state consumer advocates, we work for equipment manufacturers, we work for a good number of folks across the industry and have for 10 to 15 years. So we get a pretty good broad-scape view of what the marketplace looks like. At least we think we do. And as we began to review not only the FCC's order, but also the businesses of our various clients, it becomes clear to us that if market power exists in this marketplace, it's not market power on the part of the CLECs, but it is monopsony power on the part of the largest buyers.

Now, I'm going to kind of leave that. I know that probably requires some more explanation, but we have a few slides later that do that. So I'm going to kind of leave that for now because we need to define what monopsony is. And I know that is going to be painful for all of us, so I will leave that for a couple of slides later on.

I'm sorry you can't really read that very well, but this first slide -- I first want to sort of walk you through. The FCC in its original decision I said earlier sort of concluded blandly without a lot of analysis that switched access markets are defined by this series of bottlenecks that generates market power for the CLEC, but it didn't do a lot of analysis as I described about what it meant by market power or how its analysis -- how it came to that conclusion.

And so what we have done in the white paper extensively and here in about three or four slides is gone back through a more thorough analysis of how regulators, primarily the Department of Justice and the FTC, define market power, how they deal with it in marketplaces, and whether the FCC's original definition and ultimate conclusion stands up under that kind of scrutiny.

So I apologize in advance, but a brief definition of market power. And I would point your attention to a couple of words within that first definition there. The definition reads economists define market power as the ability of a firm or a group of firms within a market to profitably charge switched -- I'm sorry, prices above the competitive level for a sustained period of time. And then the last one says economists typically define market power by focusing on the ability to raise price relative to the competitive price level rather than the current price level.

There are a couple of key concepts there that sort of hint at where the FCC's lack of analysis lead it in the wrong direction. The first of those is that you have got to define a market. The very first step. If you read the Department of Justice's horizontal guidelines, or any other analysis, market handbooks, anything on how to define monopolization and market power, the first thing you have to do is you have to define a market, all right.

The FCC never did that within its analysis. It looked at a service, switched access service, and it said this switched access service has monopoly tenants. It has bottleneck power. Well, that's starting in the wrong place. The first thing you have to do is define the market, and there are multiple facets to the market. There is a geographic market and a product market, which I will talk about in a second. The FCC never took that analysis.

When you look later at its forbearance petitions and its decisions there, it took exactly that approach. It said, first, we must define the market and we must define the geographic and product market segments of the market we are talking about. The fact that it never did any of that analysis in its original 2001 order, I think, gives a very shaky footing for the seven to eight years it has been in place since then.

The other thing I would point your attention to is that there is a long-term concept involved here. It's a sustained period of time. This isn't a concept where you look at a day or a week. You look at the dynamics of the marketplace over time, and that's another thing the FCC did not do.

The final thing I would point your attention to here is it says that you compare the prices that you think may be generated by market power and you compare them to the competitive level, all right. What the FCC did in its order in 2001 was it said here are the ILEC switched access rates. Those must be the competitive level because they exist in the market. And, hence, when you compare the CLEC rates to them, they are much higher, there's a problem, let's fix it. All right.

To suggest that the ILEC switched access rates at that time or at this time are somehow generated by market dynamics, that they are the market level is wholely wrong. We all know that in the 2001 time frame when the FCC was considering this was almost immediately after the calls order. That's what set those rates. That was a negotiated settlement between AT&T, Verizon, Sprint, and one or two other folks that I can't remember their names right now, but I could pull that up for you.

So there were basically five or six folks in the room negotiating those rates and there was give and take. The order, the cause order is clear that what happened was the ILEC rates were up here, folks like AT&T and Sprint wanted them to come down, and so there were give and takes to get them down. There was additional universal service monies that were provided, there were concessions on the part of the FCC staff as to what it would do with other important policy decisions like yields, so there was give and take. So the result of those rates was anything but a market level. It was a negotiated regulatory settlement. And for the FCC to suggest there's a problem because there is a difference between those rates, you sort of inferred that that is a competitive level when, in fact, it is not at all a competitive level. So there are at least three primary errors in this analysis associated with market power and whether the CLECs have market power.

And I apologize you can't read that better, but on the left-hand side there I have sort of excerpted from the Seventh Report and Order the order that set the benchmark CLEC access rates, and on the right I have taken the FCC's analysis from the Qwest forbearance order where it sets out these various definitions of market and how you would apply the product market test.

As you can see, this is where I keep coming in with this series of bottleneck monopolies, this is largely, this paragraph on the left from the FCC's access order, this is largely its entire market analysis. We have gone through that order sort of front to back, and tried to find where they may have done a more systematic review, and they just didn't. This is pretty much the entirety of their analysis, and they have basically concluded that there is something unique about this particular product that because it works in a market consisting of a series of bottleneck monopolies, it never describes exactly what that means, and then suggested because that is indeed the case that IXCs have no choice with that particular end user.

You then compare that to what it did in the Omaha forbearance order where it first delineated a product market, it then delineated a geographic market, and it identified firms and potential suppliers in each market and determined whether there was market power resulting from that dynamic combination.

It's a completely different analysis. The one in the Omaha forbearance order is far more consistent with the way the Department of Justice would have done it, far more consistent with the FTC and the DOJ's guidelines. Horizontal merger guidelines.

What does all of that mean? What it means is this, and let me just give you an example. When you are on an airplane, and let's say you are flying transatlantic, you are flying New York no London, all right. And you have to go to the restroom. It's possible, and probably not far off from what we could tell the way airlines are going, that you may be charged a fee to use the restroom, all right. And let's say it is $5. Let's say it is $10. Let's say it is $20. Well, in that particular circumstance, if ever there was one, there is a series of bottleneck monopolies associated with you have got to use that restroom. But would we suggest that there is a market failure there? No. Because if they charge you $25, $30, next time you are not going to fly with those guys. You are going to fly with someone else.

So there is an ability, you have to sort of step back from the immediate buying decision there and look at the market to determine whether that is a barrier, whether there are barriers-to-entry that support that 10 to $15 price, or whether it is a circumstantial sort of price set within a market as opposed to across the whole market. Whether it could be competed away via other market decisions, i.e., the decision to purchase an airline ticket with that particular airline or with another, okay.

What the FCC did, in our opinion, was it looked at that bathroom price and said that is unreasonable. And we might agree. Twenty bucks to go to the bathroom is unreasonable. But the fact of the matter is the market is structured in such a way as to control that price. Next time you buy a ticket, you will buy a ticket on someone who doesn't charge you to go to the restroom, unless the ticket you buy is substantially lower. I mean, let's say you pay $500 to ride on an airline that didn't charge you to go to the bathroom and 150 to ride on one that did. You would probably pay that $15 to go to the bathroom as long as you didn't have to go to the bathroom 25 times during the flight, or you didn't have kids, like I do.

I mean, there are decisions that get made in that process within the larger market that are important associated with whether there is market power or whether there are barriers-to-entry. That's one thing the FCC didn't look at is the very thing that the DOJ's guidelines are intended to include, all right. So the first thing you have to do is define a relevant product and geographic market. Well, that's difficult. I can see why the FCC didn't go this way, if it intended to benchmark the CLEC rate, because it's difficult to define the product market as a single service. In fact, it's almost impossible.

You can't read the Department of Justice's guidelines in any way that says a given service rests in its own market. Because in the product market, you have to define what consumers buy in general. What their purchase decision revolves around, and in the telecommunications market it's a group of services. That's the product market. The product market is local service that includes access not only to local calling, but access to long distance calling, access to features, access to a number of other things. That's the product market that we are talking about here, not one particular service which is a subset of that market.

Also, the geographic market. I have heard people say that there is a geographic monopoly here because you've got one carrier -- I'm sorry, you've got one customer and there is only one channel in there, and so you have got this geographic monopoly over this client and you are exercising that market power. Well, that also falls flat when you look at the Department of Justice's guidelines, as well, because the geographic market has to be defined as a group of consumers facing similar market choices, all right. So it's do I have a choice for this bundle of services from AT&T; do I have it from this particular CLEC; do I have it from this particular cable company; can I use wireless as a substitute? That's the decision within the product market in most circumstances. Choosing a single service. And the only way the FCC could have come to its conclusion is choose a single service for a single consumer, and that simply doesn't work within the context of how you determine market power and/or a monopoly position.

The other thing it didn't do was assess it over the long-term. The notion here is that let's say -- and it also gets to this point they were saying with vertical integration some of this problem would go away, because let's say that CLEC A has really high access rates, all right, and they are generating a lot of revenue off of those access rates. The way the market works is that becomes a particularly attractive group of customers for another competitor, right, because they are generating all of this revenue. Why not go in there and either if you are an IXC reduce your costs dramatically by self-serving that customer, or if you are another CLEC go in there and serve that customer and get those revenues.

By charging rates that would otherwise be excessive compared to market levels, you are inviting additional competition. First, nobody wants to do that, but in the short run it might make sense. It doesn't make sense in the long-run, okay, and that's where the FCC again falls down on its analysis, because in the long-run, the market will begin to erode supernormal profits for that product set. Maybe not for one particular service, but when you look at the product as a whole, I see the product that generates sort of average revenue per customer, that is going to be confined and disciplined by the marketplace over the long-term.

The third thing you have to look at is the Department of Justice guidelines looks at concentration. The first step it does after it defines its market, its product market, and its geographic market is it looks at concentration in those markets to determine if there is even a sustainable chance that there could be market power. The Herfindahl-Hirschman Index, you know, we have all heard of those things where you look at concentration within a particular marketplace. Those are the kind of things they look at.

We've done some analysis. We've been unable to find any circumstance where concentration less than 50 to 60 percent in the marketplace ever rendered a positive decision of market power, okay. We all know, and I have some slides later on that CLECs, even as a group, let alone as a single CLEC, don't come anywhere near that kind of market concentration.

We look at Number 4, and I guess this is one of my own sort of personal stumping messages, I guess, for lack of a better word; because let's say, as I think we opened up this discussion, let's determine if there is a problem and if there is, let's figure out what to do with it. Well, let's assume that there is a problem and we figure out what to do with it. If there is market power, then there must be barriers-to-entry that generate that market power. That's the only way market power exists is from barriers-to-entry. Barriers that keep other competitive firms from entering the market and competing away supernormal profits.

So to the extent barriers-to-entry exist, it's at least our opinion, and it's sort of a long history of this is the way regulation works, in that regulators attempt to remove or lessen those barriers-to-entry. So to the extent there is a problem here and it is caused by barriers-to-entry, let's focus on what those barriers-to-entry are and see how we remove them. That's why from our opinion, if those barriers-to-entry are caused by, for example, an overly aggressive definition of Rule 254(g) that says you can't deaverage, then perhaps that is where we look. Allow them to deaverage. Allow those costs and rates to be exposed to the marketplace, consumers to bear those costs, and the market to work its magic the way it does to compete away any profits that might exist there.

It seems to us -- and that's why we also say that benchmarking is sort of the worst scenario, because it completely skips over the notion of looking for the barriers-to-entry. It simply says we have got a problem, let's fix it by benchmarking. Well, let's focus on the barriers-to-entry instead, so that the market can get rid of that rather than sort of -- and Commissioner Furchtgott-Roth at the FCC sort of -- I think I have a quote later on, suggests that we should remove those barriers-to-entry rather than sort of ending up at the opiate of regulators, which is price regulation, is the way he said it. So that in our mind is another thing the FCC never did, and we think that state commissions if they are looking at this issue should do is if you determine there is market power, we don't believe there is, then the next step is to define the barriers-to-entry that allow that market power to exist, and talk about ways to get rid of it rather than immediately jumping to let's regulate prices.

Yes, and the fifth one I talked about a little bit already, this notion that the ILEC rates at the time were at competitive levels. Those just doesn't make any sense. And I can see that I'm getting ahead of myself in my slides, because this slide really was meant to get us to the point that switched access services are really but a subset of the larger product market, and that CLECs possess no power, no market power in the relevant product market. I mean, if you define the relevant product market as the bundle of services for which AT&T, MCI, Verizon, and CLECs compete, which is the proper way to define a market, then that is a bundle of local services that CLECs certainly have no market power within that market.

This is where I was supposed to give you the airline example of the long-run versus the short-run. It is an important concept, though, so I can say it one more time a little bit, in that the sustainability of profits when looked at over time, as the sustainability of profits for the product market that is important. It is not looking at a snapshot in time as the FCC did and saying, well, those rates look comparatively higher, let's do something about it. And we hope you wouldn't follow the same path.

Here I just kind of want to equate, without market power there could be no monopoly. When the FCC describes this market as a series of bottleneck monopolies, in my mind it is trying to get away from the notion there has got to be market power. If you don't have market power, you don't have a monopoly. Probably said a better way is that monopolists are the only one who can exert market power in most circumstances. And if you don't have market power, you can't.

So when we look at it, as I said earlier, when we look at the product market as a whole and the geographic market as a whole, and you look at the concentration of CLECs in that market, and you look at the way they operate in the marketplace, I think it's very difficult to sustain an argument that they in some way have market power that allows them to generate these supernormal profits that would be the indicator of market power.

Here is some of that concentration information we were talking about earlier. On the left side you have the federal data, the time series from 1999 and 2007, and on the right you have the Florida data from the most recent Florida local competition report. I apologize you can't see the numbers as well as I had hoped, but, you can sort of see -- and both series of data sort of mirror one another with some little differences. But even at the peak, in June of '05 in Florida it looks like, CLECs as a group, and remember concentration is determined and calculated via the Department of Justice by individual suppliers. So they look at a market and say, okay, there are these three suppliers that generate or that -- well, that generate 80 percent of the product output, okay. Here we have an entire group, the CLECs, which we're studying in this workshop who at their peak achieved only an 18 percent market share during that period of time. Individually, we doubt any of them would probably be over 3 to 4 percent, even the very largest.

So when you look at concentration in this marketplace it is just not indicative of a market that generates market powers, at least for this particular subset. I mean, market power, as we all I think understand and may not agree, that there certainly is market power in this marketplace, but it exists with the monopolists that we currently regulate: BellSouth, AT&T, Verizon, Embarq, and the smaller guys in some circumstances. But to suggest in this marketplace that a group of carriers who have as a group less than 18 percent even at their peak, and today it looks like around 11 percent and declining, I mean, that is in another important concept here is that their market share is declining, yet we are still talking about whether they have market power. This is just not a market indicative of those particular customer group or carrier group having any market power.

The next set of slides sort of get to this notion that the FCC order is interim as a first matter, and was really just sort of a stopgap until we got unified intercarrier compensation. And the notion also that since that period of time there have been dramatic changes in the marketplace, including specific changes that the FCC foresaw as solving the problem it foresaw in switched access charges.

I have underlined there near the bottom and near the top where it says it foresaw that IXCs would enter marketing alliances with LECs, and that the IXCs themselves would choose to enter the local service market as a means of exerting downward pressure on terminating rates.

And, again, that is another thing the FCC focused on is terminating rates. The FCC's order is almost specifically written for terminating rates, not originating switched access rates. And I will talk a little bit about that in a little bit, but the notion here is that the FCC foresaw the market reacting if there were supernormal profits, the market reacting by vertical integration whether by teaming, or partnering, or merger and acquisition. And indeed that exact thing has happened. We now have SBC has bought AT&T, Verizon has bought MCI. Those are your two largest local carriers buying your two largest long distance carriers thereby sort of giving them the ability to self-provide for most people in the marketplace, and also the ability to compete down those profits by giving them a local presence to compete against areas where they believe there are supernormal profits generated perhaps, in part, by switched access rates.

So, again, it all comes down to if there aren't barriers-to-entry, they certainly have positioned themselves to compete away anywhere there are supernormal profits. To the extent we can't identify barriers-to-entry, then we must conclude that there is no market power. And this slide is basically what I just said.

I guess there are a couple of points to make on this slide also, and further. And it is back to this notion again that you can compete these things away. And we know that this happens in the marketplace. I mean, there are CLEC customers who I think are probably more attractive than other CLEC customers. And those are the customers for which everybody sort of competes. Those are the customers that generate better than average revenue relative to their costs, and switched access revenues goes into that entire basket that is evaluated in that particular perspective. So there certainly is a market stimulus that says if supernormal profits are being achieved, then that's where competition will go. And there aren't any barriers to an AT&T, or an MCI, or a Sprint, or a Qwest, or anyone else from competing for those customers for getting those customers on their network either to reduce their own cost of providing long distance service or to receive the profits that were previously generated for someone else. That is the notion of competition, and competition should be allowed to work.

Another just sort of point on the side here is that we now have this situation via these mergers where we have SBC in its territory and AT&T with its prior CLEC in other territories. Sometimes they overlap. Part of the white paper will be an extensive sort of database of every carrier's access rates in the country that we can find. And we paid a good bit of money for that data. It's an enormous database. What we have done is identified places where AT&T may operate in a given market, as SBC as the local carrier, and the AT&T CLEC operates in the same market. Rarely are the switched access rates for those two carriers the same. And in almost every circumstance the rates of the CLEC are substantially higher.

So what that tells us is that there is some need, or some ability, or some process by which CLECs set their rates a little differently than do the ILECs in that circumstance. And the CLECs' affiliated ILECs do the same thing, okay. So to suggest that there is market power for one group but not another just doesn't ring true to me from the notion that you see this sort of across the country and across markets and across profit centers.

And, again, the third point, the higher the charge assessed by CLECs the more vigorous the competition they invite. That's the whole notion of open markets in competition. And I guess here is where, from our perspective, that is what we have read through all of this material and analyzed it all, it seems to us that there is a burden on proponents of regulating CLEC switched access charges, and there is a further burden on proponents of benchmarking them to ILEC rates. And the first burden is identifying the barriers-to-entry that permit CLEC market power. I have never seen anybody do that. Perhaps I will today, but I have never seen anybody stand up and say here are the barriers-to-entry that allow these CLECs to expert market power to charge me rates that I can't compete with.

In my mind before -- and this gets to the point of first identify the problem, and if one exists, then fix it. That in my mind is the very first step in identifying whether there is a problem, is if there is a problem it must be caused by something. And in economics if there are market distortions the problems are caused by barriers-to-entry. And if we can't identify a barrier to entry to these markets that somehow supports supernormal profit or market power, then in my mind the analysis is done. You have identified the fact that there is no problem. There might be difficulties. The market is fraught with difficulties, and competitors overcome difficulties all the time to be successful, but the notion is there aren't barriers-to-entry.

And I guess the second question is if you are, if someone is able to stand up and define well barriers-to-entry, then the analysis should switch to how do we dismantle them, okay. The very last step in our minds should be -- I mean, it seems to me that the process is if you have identified a problem, how do you dismantle what causes the problem, barriers-to-entry. The very last step is say we can't. We can't make this market function better, so what we are going to do is regulate rates. That, in my mind, is the very last step on the ladder, because it is the most market impacting and has the most potential to provide disproportions is regulatory price setting.

Now, don't get me wrong, I spend most of my time on the other side of this fence saying ILECs have market power, ILEC prices need to be regulated, and from that perspective we can specifically identify the barriers-to-entry. But we are all the time required to do that. Here the same burden must be set on those who want to price regulate, which is identify those barriers-to-entry and then let's talk about how dismantling them works.

A little bit more about the fact that it's likely that existing market distortions are -- to the extent market distortions exists, they are caused by existing regulations. This, again, is a statement from Mr. Harold Furchtgott-Roth, and I guess the reason I focus on him so much is he was the only economist on the FCC at the time they initiated this order. So when you read his dissent -- and I would encourage you to do that, it's, in my mind, one of the most important documents in this entire debate -- when you read his dissent, he does a very nice job of describing the economics of why the FCC made a mistake.

And this, in my mind, though long and kind of tortuous, is a good example of what he says the market should be doing but for regulatory intervention. It talks about the notion that let's say you didn't have this requirement that you average long distance rates. What you would likely end up with, at least in his estimation, and I think mine, as well, is carriers, interexchange carriers, long distance carriers, and carriers that do multi-product delivery, what they would be doing is they would be offering different products to the marketplace. Some would be saying, you know what, I don't want to take any risk associated with that. I'm going to pass all of the costs and every variation in costs that comes to me onto the consumer and let them make the choice. So my rates are all over the board.

Some carriers are going to take a little more risk. They are going to say, you know what, a lot of people don't call into those small ICO territories, so I'm going to average my rates, assuming I get a 5 percent penetration into those markets, know where my other calls are, and give them a flat rate, because customers like flat rates. So I'm going to take a little more risk.

Some carriers might take a lot of risk, and say, you know what, I'm just going to charge a rate that is so high, because I've got other benefits in the marketplace from other services I have where I'm going to take all the risk. I don't care where they call, I'm going to make money on this particular rate. And the market for long distance rates would begin to accommodate any variations in that way.

He is saying what keeps that from happening, and the distortion he points to in the marketplace for allowing this to happen is the fact that the FCC has taken a very aggressive view on keeping average rates at the interstate level based on Rule 254(g) or that section of the Act. And I understand, I mean, don't get me wrong, I understand what Rule 254(g) is intending to do. It is a universal service requirement.

What it is saying is if customers really had to realize that it costs them 7 cents a minute, or 10 cents a minute to call into a small independent telephone exchange, then they are going to really be upset, and they are liable not to call there as often. And we think that is a problem for people who live in places where those rates exist. Well, okay. So you have got a specific policy decision why you are doing that, okay. You want there -- where there are cost differences, you don't necessarily want the end user to see those because you want them to make calling decisions on some other basis.

My question in that regard is, then, why require the CLECs to shoulder the burden of that universal service requirement, okay? Because what you are really saying is you have got to charge rates demonstrably below your cost in order so that IXCs don't have to deaverage their rates. Well, what you are really saying is you don't want them to deaverage because you want consumers to be able to make decisions without really realizing their costs, but you want the CLECs to bear the burden of that decision. And, in our mind, that just isn't good policy.

If you want consumers not to bear the burden, not to bear the burden of the costs they generate from the calls that they make, then universal service funds or explicit subsidies are the way to do it, and the FCC has said as much. It just seems to have departed from that notion in this order in 2001.

None of that seems to be within this debate. This debate all seems to be about capping CLEC access rates. And, in my mind, you just have sort of jumped over all the good solutions and ended up with the bad solutions, and everybody has kind of glommed onto it, and that, in my mind, is just problematic.

And I'm afraid, and I've spent so much time sort of talking about the FCC, I'm afraid the fact that regulators do that is because they see they did it at the FCC, it was expedient, it solved an immediate problem, but it caused a bunch of others. And we are really just trying to raise the notion that as they works itself down to the states it becomes more and more problematic.

And, once again, I have said most of what I need to say on these next slides, but this slide basically says markets work best when consumers are faced with prices reflecting the cost of the goods they consume. That there is a market distortion caused by overly averaging or requiring carriers to overly average now. As we have said before, there may be good public policy reasons for why you want to do that. You and I might disagree that those are good public policy options, but to the extent you have chosen a particular public policy option then you must support it or fund it in the right way. And funding it by requiring CLECs to charge rates demonstrably below their cost isn't the right way to do it.

And then as Mr. Roth said, again, the right way to solve this problem, if you think one exists, is to allow the toll rates that reflect the differences in origination and termination costs. I would point back that in doing the research, and specifically for this workshop, we went back and found some material that the staff had presented to the legislature in the '01 time frame, and much of this same analysis is in there. At that point in time it seemed that -- and the debate really there, I think, resolved around smaller ICOs more so than CLECs, but the notion was that there was disparity between the access rates that the small ICOs were charging and the large ICOs were charging, and the interexchange carriers were putting pressure to get those small ICO rates down.

And one way they did that was they instituted Florida-specific surcharges associated with calling. If you called into Florida or around Florida, then you had a bit of a surcharge that went on your bill because there were higher costs associated with that. I think politically -- from what I can tell, reading the undertone, politically that wasn't a great thing, but that's what the market will do, okay. The notion here is that -- and politically I guess it's not a good thing because you see it as rate increases. But then on the other side of that argument we hear people say, well, if CLECs can't recover their costs through their switched access rates, have them raise their local rates.

Well, the money has got to come from somewhere, and I guess what you are suggesting is what is suggested by that particular argument is that it should come from the local -- it should come from local customers on their local bill rather than a long distance bill. I would suggest to you it doesn't really matter. It's the same people who pay them. So from that particular notion, we know the market has the ability, in fact, the IXCs in the past have exercised that ability to reflect higher costs from switched access rates in their toll rates, and consumers can make reasonable decisions based on that.

That's how the market works. That's the way the market should be allowed to work, and it is a far better solution, I would suggest to you, than capping rates and then letting all the distortions that arise from that sort of flow out.

MR. DOWDS: I have one question.

MR. STARKEY: Sure.

MR. DOWDS: Do you think 254(g) allows deaveraged interstate rates?

MR. STARKEY: Interstate?

MR. DOWDS: Interstate.

MR. STARKEY: Yes, to some extent I think it does. I think there are limits. I think it does limit the deaveraging you can do, and the other thing I would point out it has no impact on intrastate rates as far as I read it. So, the extent to which --

MR. DOWDS: It wouldn't allow deintegration, though, right?

MR. STARKEY: I'm sorry.

MR. DOWDS: My understanding is 254(g) was intended to preserve two things that were pre-Act. One was rate integration, which means you can't charge more in Hawaii or Alaska than you can in the lower 49, and rate averaging. Did I misunderstand? I'm not sure I understand your position.

MR. STARKEY: That may be the intention, I'm not sure. I mean, the intention, I guess, is whatever the legislators want. But as I read the Act itself, as I read the rule itself, I don't get that rate integration notion from it. From the way I read it, and the attorneys may disagree, is that within a state, if you have a call from Miami to Orlando and then from Miami to Tallahassee, you can charge different rates associated with those two calls. I see nothing in the Act that would keep you from doing that.

MR. DOWDS: For intrastate?

MR. STARKEY: For intrastate rates, which is what we are talking about here. So I think that there is nothing -- I think the FCC, and Commissioner Roth thought so, too, that they narrowly defined it such that -- and let me say another thing here, too, a little bit of how the market really works there. Carriers do have deaveraged rates, okay. They do. If you go to AT&T or Verizon as a large user, you will likely get a two-tiered rate structure. You will likely get a rate structure for termination in Tier-1 markets and a rate structure for termination in Tier-2 markets. Tier-1 markets being largely the RBOCs, Tier-2 largely being smaller carriers, smaller ICOs.

So they are deaveraging within the context. So they must believe that they have some maneuverability within 254(g) to do that. And they are required to file certifications with the FCC that they are complying with 254(g), and they do. So there is an ability for them, and they do exercise their ability to deaverage in that respect. Certainly even at the interstate level. But, again, at the intrastate level, the rates we were talking about here, there is no prohibition by 254(g), as I read it, associated with them deaveraging in that regard.

UNIDENTIFIED SPEAKER: Can I ask a question? Is the deaveraging that you are talking about one that says that if a carrier is terminating a call into Orlando to an AT&T customer they can charge one rate, but if they are terminating a call to a customer of another CLEC that they charge a different rate because those rates are higher?

MR. STARKEY: I don't see any prohibition against that. The same would be the case in an ICO, in a smaller independent carrier, except that they are sort of geographically independent. That is the same notion that because you are calling this ICO and their access rates are higher you can charge more. It just so happens that they have a defined geographic area. The same is true of a CLEC, it's just that they sit perhaps in the same geographic area as an ILEC also does. So the notion is still where your talks are higher your rates are higher.

UNIDENTIFIED SPEAKER: So essentially customer-specific pricing, or called party-specific pricing really is where you are going.

MR. STARKEY: Well, again, I guess I'm sort of taking the same path that Commissioner Roth did. If you allow people to do that, they will choose how much of that they want to do based on their own tolerance for risk. It may be that you sit down and you say, you know what, only five percent of my calls go into this ICO, 10 percent goes here, 20 percent goes there.

I could do a flat rate that meets my needs, and I'm still allowed to make money.

I mean, I'm not suggesting that this has to result in customer-specific pricing. I'm saying let the market determine how carriers want to use those tools to best meet their needs.

Okay. Slide 17. I said earlier that market distortions largely exist from places other than this supposed market power on the part of CLECs. We've talked a little bit about how -- we talked a little bit how some of that comes from this deaveraging notion. Some of that also comes from the fact that for carriers -- let's take CLECs as an example. For CLECs it is not uncommon for 60 to 80 percent of their switched access volume, minutes and revenues, to come from the largest two to three IXCs, and a good portion of that to come from the largest IXC in that particular region.

So to the extent that there is market power being influenced, in our opinion it is an issue of monopsony power. Now, monopsony power. We are all pretty familiar with monopoly power. It is the notion of where there is a single producer, and because there is no other option from somebody to buy from, you have got that single producer and that single producer has some ability to set a price where it sees fits. And if you don't like it you either don't buy that product or you complain and pay that rate anyway.

Monopsony is the same notion only there is a single buyer. The primary -- the one that is thrown out most often is Wal-Mart as an example. Wal-Mart has become so large in the retail market space that there are some producers who Wal-Mart is their only client. There are a large number of producers who Wal-Mart is their only client.

So when Wal-Mart comes to the table and says, you know what, I'd like to pay two cents less for that particular widget than what you are currently selling me. The person on the other side of that table has very little leverage to say no. Potentially their choices are charge the two cents less or go out of business, because Wal-Mart will take its business elsewhere.

That same notion applies here. If you are a CLEC and AT&T comes to you and says your rate is too high, I'm not paying it. That could be 60 to 70 percent of your switched access revenue and that scares you to death. That gives you very little leverage on the other side of the table to talk about, yes, you are, or, yes, you should. And I think -- and I've got kind of a definition there that you can read if you choose to about what economists really called monopsony. But here we really have -- it gets any worse -- oligopsonistic marketplace where you have two or three large carriers that really sort of dominate the buying channel and can dictate prices.

So I sort of conclude there that the largest IXCs are price setters in this market and not price takers. And to give you a little bit more on that, Matt Feil was going to talk a little bit about his experience in that regard.

MR. FEIL: Plus this gives Mike an opportunity take a break and to get a drink of water. To illustrate the point on monopsony power, I had an experience while I was General Counsel of FDN Communications. This was several years ago. Beth Salak, I actually talked with her about it at the time. She is not in the room right now, so I don't know whether or not she would remember, but the gist of the situation was that AT&T was not paying FDN switched access rates and it was not a situation where AT&T was paying what they thought was reasonable and disputing the rest, AT&T was paying nothing.

In the way of putting it in the historical context, you know, this is at a time where CLECs are young. FDN was relatively young at the time. There's a lot of pressure on CLECs like FDN to attain the revenue growth and to get the customer growth that they needed in order to achieve sustainability. CLECs invested millions of dollars in the ground in their own facilities, and then there was a point in time where CLECs were dropping off like flies because of financial difficulties.

But AT&T took full advantage of those circumstances, I thought, because, again, they paid zero. And their argument at the time was that we didn't order -- we, AT&T, didn't order access charges -- or, excuse me, access services, therefore we don't have to pay anything.

So when you are a CLEC and you are faced with that situation where the accumulated nonpayment of the access charges is just growing and growing and growing, you are faced with a couple of different alternatives. One of them is complain to the FCC and/or PSC; another would be to take AT&T to court, file a collections action; another is to try to negotiate some sort of resolution with AT&T.

The first two alternatives, complaining to the FCC and/or PSC, and the alternative of taking AT&T to court aren't really viable for a small CLEC because you're talking about expending hundreds of thousands of dollars, and an extensive period of time, two or three years litigating against a behemoth of infinite resources who has nothing but incentive to drag the litigation out as long as they can. In the meantime they are still paying you nothing and you are accumulating bigger and bigger deficits as a result.

So you are put in the situation as a CLEC where you're incented to try to negotiate some sort of resolution with AT&T. That was the FDN experience at the time. I would surmise that it's probably typical of a lot of the CLECs in the space and we can talk about that a little bit more later on in the presentation.

MR. DOWDS: Matt, a quick question. This is Dave

Dowds with staff. Just to clarify your anecdote, they weren't paying you either interstate or intrastate for either originating or terminating, or paying you nothing?

MR. FEIL: There was a period of time where they were paying nothing. The origination would not have been significant anyway. It would not have been -- and, quite frankly, I can't recall if they were actually consciously withholding originating, because it wasn't significant dollars anyway. On the terminating side that was the key withholding, inter and intra, and there was a period where they were paying zero.

On the theory, again, that weren't -- AT&T wasn't disputing we don't like the way your bills are formatted, and you didn't bill us properly, the minutes are not accurate. It was AT&T did not order the services via ASR, or whatever vehicle they wanted to designate, we didn't order them, therefore, we're not paying them.

MR. STARKEY: And I guess the comparison that we make there is just sort of highlight the fact that that is a result of monopsony power, not just a normal commercial relationship, is that turn the tables on that. Suggest that -- I mean, consider that we spend a lot of money on -- ILECs -- special access rates, and we think we pay too much. I don't think that is any news to anybody. But consider the notion if we just stopped paying, and said come to the table and talk to us about lower rates. What would be the result? The result would be that they would disconnect us and we would be out of business.

If you turn the tables and see does that same relationship exists on the switched access side, you quickly see that it doesn't. Because let's say Matt, in that situation, had said, you know what, our rates are what our rates are. You either pay them or we disconnect you. Then Matt's customers, the customers which he has hard earned win, no longer get long distance calls from the primary provider in the nation, and Matt's business suffers.

It is that relationship that generates this monopsony power. And when you turn the situation around to look at our special access, you see that we certainly have none of that same kind of power. It's that kind of -- and that kind of monopsony power also distorts the marketplace to some extent.

MR. FOLLENSBEE: This is Greg Follensbee, AT&T. Just a comment or a question on that. If, on the other hand you are saying we should charge those end users higher rates, how is that the same result? The customer then makes the decision of I don't want to receive those calls because the rates are too high, or you say he's not going to receive the calls because I'm going to block them. I'm just trying to understand how there is a difference there between -- in both cases the signal to the customer is the rates are too high.

MR. STARKEY: Well, I guess in that particular circumstance, what I'm suggesting is that let's take the special access example. And we say, look, we are not going to pay because they are too high, right? And I guess what you are suggesting is we could pass those costs on to our particular customers and just -- then the rates wouldn't be too high. I guess the notion there, and the difference there is that we are competing in that particular circumstance. I mean, that's 60 to 80 percent of our entire cost structure in most circumstances, that amount of money. And we have no ability, because we are at such a competitive level in the marketplace, to pass those on.

I mean, there's no ability for us at this point in time -- and the staff recognized the same thing in a comment which I think I have later on here which is while the FCC said you should pass those on to end users, it ignores the fact that that's likely an impossibility. That the market is driven by such lower cost carriers than the CLECs in many circumstances that they don't set prices in the local exchange marketplace, okay.

So the notion here is that there is not only one or two competitors in the local marketplace in that respect. It also gets to another point we make in the paper, which is there is starting to accumulate convincing evidence that there is less competition in the long distance marketplace today than there was in 2001 when the FCC issued this order suggesting that if these reductions in switched access are made, there's no guarantee that they would make their way to the customer. To the extent that there is more concentration in the long distance marketplace they just make it to the bottom line of the long distance carriers.

MR. FOLLENSBEE: I'm not sure I agree with that, but thank you.

MR. STARKEY: You bet.

MR. HATCH: Even if you assume that's true, then doesn't that invite more IXCs back into the market, if you are talking about pure market forces.

MR. STARKEY: Well, I mean, I guess you're right -- what we are saying -- and I'm not suggesting that we regulate or that we set prices for the long distance marketplace. That is the difference. If indeed more profits flow to the long distance marketplace, great. Then let's invite more competitors. But here this suggestion on the other side is very different. You're saying the market doesn't work that way, we should benchmark rates, and that's what we are resisting.

MR. FOLLENSBEE: Let me ask a question on that, then. If this Commission doesn't have the ability to overturn those policies, then what recourse do they have?

MR. STARKEY: Overturn what policies?

MR. FOLLENSBEE: Of the FCC. In other words, if the

FCC dictates policies that this Commission can't overturn, then what ability do they have to change those to try to create what you say are putting in the wrong regulations to create a more competitive marketplace.

MR. STARKEY: I guess I would say two things. I take your word recourse in your first question and say recourse to what? I mean, I guess it comes down to the fact that we still don't think there is a problem, all right. So we are looking for solutions to something that isn't a problem.

But let's put that aside. Let's say that there is a problem. Again, those averaging rules don't apply to intrastate toll rates, so there is no inability, there is no restriction associated with deaveraging those. They don't need to do anything to allow that to happen.

MR. FOLLENSBEE: Assuming your legal interpretation is correct.

MR. STARKEY: Well, that is always a big assumption. You should not take me at my word on that, but these folks can probably give you a better sense of that, and you folks, as well. But, yes, taking my sense of that, yes.

MR. HATCH: Just to sort of follow up, and alluding back to a comment you made earlier. When some of the IXCs, and I come out of an IXC background, but when some of the IXCs attempted to account for the higher intrastate access and they placed surcharges on bills, we got politically bloodied.

You're absolutely right about that. The new view of that political landscape, then what are we left to do other than just leave as an IXC?

MR. STARKEY: Well, let me be as benign to that response as possible. What you are really saying is there a political problem over here, and we can fix it with a regulatory problem over here. And our problem is if you fix it with a regulatory problem, we don't have the political necessity to make the market right.

What the real answer should be is how do you set the market up correctly, all right? And if the market won't get set correctly because of political inability or unwillingness to do it, don't make the CLECs shoulder that unwillingness and inability.

MR. WATTS: Are you representing that your average -- that paying the current rates you are paying for access, your average revenue for LD, you know, you're got a margin problem?

MR. HATCH: I don't know the answer to that question, Jerry. I honestly don't. Thankfully, I'm not even privy to that.

MR. STARKEY: I guess the other thing I would say, under that analysis, the most politically strong player wins, which we probably know happens anyway. But that is not the way you should structure markets is, I guess, my point.

MR. WATTS: But, you know, the bottom line is we would say the solution isn't to set the cost of the minute for the CLEC at your cost for the minute if, in fact, your rate is your cost. No more than it is for any other carrier, including your rural carriers.

MR. HATCH: If you turn that around, are you suggesting that each CLEC should file cost-based access rates?

MR. STARKEY: No, that's not what we are suggesting. Because it gets to the fact of now we are trying to solve the problem that we don't think exists, right? I mean, again, I think there are three steps here, and maybe that is what I would like to leave you with most, and I should have a slide on it, but I don't, is the first step should be identify whether a problem exists or not, and by problem we mean is market power being exerted. To the extent you determine there is a problem, and that there is market power, barriers-to-entry must exist for market power to exist. Identify what those barriers-to-entry are, and your first potential solution should be to diminish them, to dismantle them.

And then if for some reason you suggest that they can't be dismantled, okay, then and only then are we talking about a situation where prices should be somehow regulatory. Intervention should happen from a regulatory perspective on prices. And then we talked a little bit about cost-based rates and that kind of thing.

Which is a good segue into our next session on why benchmarking, which is a way of taking that third step before we have even taken the first two, why that is so harmful. And it gets to the fact that the costs are different. I've got a lot of quotes here, and I'm sure you will probably see some of this stuff again when we file our written comments. I won't bore you with it. Suffice it to say that the FCC over time has recognized that there are substantial disparities in the cost structure of large ILECs and small CLECs. Those arise from a number of different things. They arise from the fact as simple as the buying power associated with being an enormous ILEC.

One of the things that QSI does, and probably the primary thing that QSI does is cost analysis. Not only for CLECs, but we get pulled into cases to review ILEC cost studies all over the country for every ILEC in the nation and lots of CLECs, as well. So we have a pretty good sense of what these various cost structures look like, and we have access to information, for example, proprietary information that obviously can't be shared, but that talks about things like buying power. If you are AT&T and you have a thousand switches across the country and you want to buy another switch, the cost that you pay for that switch is very different than CLEC B who has three switches and wants to buy its fourth switch.

When you go to Nortel, or Sonus, or anybody else and you say I want to buy a switch, the rate that they slide across the table to you is very, very different than the rate they slide across the table to AT&T. Now, am I saying that's wrong? No, there's nothing wrong with that. That is the way markets work. Volume, there's economies in volume, but you can't escape the notion that CLECs in some circumstances have higher costs.

Now, does technology allow them to bridge that gap in some circumstances? Absolutely, and that's the hope. That's the hope is that over time technology will overcome this problem of cost disparity, okay. But it hasn't happened yet. I can tell you as a demonstrable fact it has not happened yet. And the whole notion of the Act was to erect rules to give us time for technology to catch up, at least in my opinion that was the notion, give us time for technology to catch up with that gap such that we are all on a more, and I hate to say it, but a level playing field. But I'm talking about a technology playing field.

So to suggest that benchmarking CLEC rates at ILEC levels, and that that is somehow compensatory is a fallacy. I mean, I'm not saying that people don't do it. The FCC obviously did it. And, in fact, what they said in their order basically is they didn't care. They were ignoring cost as a factor.

Again, in a competitive market I would agree. In a competitive market, I would say if their costs are higher, then they bear the brunt of that for the marketplace. But here we are talking about a regulatory construct as we have that is progressing over time, and we are talking about regulators setting rates, not markets. Regulators setting rates at a certain level. And to suggest that regulators should be setting rates without attention to cost, in my mind, is very troublesome, very troublesome.

As I said earlier, part of your white paper is going to be the sort of the extensive database associated with ILEC/CLEC access rates, small ICOs. We tried to get every access rate we could find across the country, intrastate and interstate. This gets back to the notion that remember when we talked about defining market power, the notion was that you are able to sustain prices above the competitive level over time. And the FCC sort of jumps to this conclusion that the ILECs rates were this competitive level, okay. And I think when state commissions consider the notion of benchmarking, they also are implicitly suggesting that there is some value, some inherent worth economically of those particular ILEC rates. And what this diagram is meant to show you is that there is no rhyme or reason to it. I mean, they are no magical incubus. There is no rhyme or reason to these rates as you move across geographies.

This, for example, is a composite of Verizon's rates, both its ILEC and its CLEC across the states within which it operates. As you can see, Verizon in Florida has a rate of

.031. Verizon in Maryland has a rate of .004. That's a large disparity. MCI, the Verizon CLEC in Florida, has an even higher rate of .033. The same is true of the other ILECs and CLECs. And, in fact, we say here in many places across the country Verizon CLEC access rates are substantially higher than its ILEC rates even in the same territory, and the same is true of AT&T.

The next sort of scattergram is meant to give you the same information for Qwest and AT&T. These rates are just all over the board. And to suggest that they somehow equate to a market rate against which CLECs should be held or benchmarked within a given jurisdiction, at least in my mind, doesn't make any economic sense. Perhaps it makes political sense. Perhaps it makes expediency sense. It's easy, but if you're looking for a good sound economic solution, that is not the one.

I had one another point I was going to make, but I have lost it. Okay.

MR. FOLLENSBEE: While you are thinking about that, let me ask you a question. Given there is a wide variety across the states, what do you think is a competitive rate that ILECs could charge?

MR. STARKEY: I don't know. I don't know. There are distortions in the marketplace that I have described earlier. For example, the calls order in my mind. You know, some people think that I just really read too much of Commissioner

Furchtgott-Roth's stuff, but he had a dissent in the calls order, as well. Maybe I just like dissenters, I don't know. But he had a dissent in the calls order, as well, and basically his -- and I'm paraphrasing broadly, and I will admit that right up front. You should read the dissent to get what he actually said, but my paraphrase of what he said was this isn't the way rates should be set. He said you took a number of market participants, a small number, five or six, and you put them in a room. The FCC itself participated through its staff, right, and was able to give quid pro quo on certain proposals. For example, if you lower your rates, then we won't require you to do EELs. That was the one that Commissioner Furchgott-Roth really pointed out. So there was all of this giving and taking.

Other market participants were specifically excluded from the conversation. CLECs were not allowed. I think it was the Ad Hoc Group of Telecommunications Users wanted to participate. I think all of us wanted to participate and they said no, okay? So what comes out of that is access rates for the largest carriers go down, they get additional universal service support, they get better treatment with respect to EELs, which was important to them as a competitive proposal that they were -- you know, sort of protect their marketplace. This would make it more difficult for them to protect their marketplace, so getting some leeway there was very important to them. And, third, and completely off the topic, the FCC agreed to no longer push a continuing property records audit that it had been pushing wherein it found some very embarrassing discrepancies between what was on the books of the ILECs and what they actually found in their networks.

So all of this sort of mashed together and out of it came these rates, all right. Nine months later, the FCC says, you know what, those are competitive level rates and the CLECs should be held to them, too. I mean, just on its face, in my opinion, and perhaps I'm jaded on this, and I will admit that right up front, but that seems to be a poor regulatory process. That, in my mind, is not establishing competitive levels or understanding what those competitive levels are and setting rates accordingly. It's a political process, not a good sound economic or regulatory process.

MR. FOLLENSBEE: Would you agree that the more competitive the marketplace, the closer the rates should be towards their cost?

MR. TEITZMAN: Before you answer that, I just want to remind everybody to state your name.

MR. FOLLENSBEE: Oh, I'm sorry. Greg Follensbee.

MR. STARKEY: I would have you restate that, but I would sound much too like we are doing cross-examination.

MR. FOLLENSBEE: Well, I don't know if you are an economist or not by background, but it's just a general question. The higher a market is competitive, wouldn't the prices tend to be closer to the cost, i.e., the profits you could generate would not be as great in a less competitive marketplace.

MR. STARKEY: As a general proposition, absolutely.

MR. FOLLENSBEE: So if you look at the charts where more states are tending to be lower down the line than higher, in some cases could that mean that whether it is because of regulatory, or policy, or whatever, those rates are starting to get closer to cost, i.e., more toward a competitive marketplace would say they should be.

MR. STARKEY: We don't know.

UNIDENTIFIED SPEAKER: These rates?

MR. FOLLENSBEE: Yes.

MR. STARKEY: We don't know. I mean, in the white paper we also describe how rates are set at the intrastate level, and it is also a lot of times political horsetrading.

MR. FOLLENSBEE: Well, they are. But if they are continuing to lower toward cost, that to me would mean they are getting towards where a competitive marketplace may drive them to.

MR. STARKEY: You know what it means to me is something different. It means to me that the party with the most political power wants them to go down and is being effective in that regard.

MR. FOLLENSBEE: But could it also mean because competition isn't driving them down, that that is another reason why regulators could --

MR. STARKEY: It could be. I mean, I don't deny that. It could be that competition is driving them down in some markets and not in others.

MR. FOLLENSBEE: No, I mean a lack of competition, i.e., then regulators are saying I will get them closer to cost. I mean, access was set originally with a lot of implicit subsidy in it, no doubt about it, because of the fact that the incumbents could not change their prices so that all prices reflect what a market could bear. That still exists today.

MR. STARKEY: No question.

MR. FOLLENSBEE: It still exists today.

MR. STARKEY: No question.

MR. FOLLENSBEE: Less so than it did in the past.

MR. STARKEY: Right.

MR. FOLLENSBEE: I'm just trying to understand that you are saying there was a lot of give and take. A lot of things happened. But me the end result still is if the rates are getting closer to cost, then the regulators are trying to emulate what the competitive marketplace should be doing, but can't.

MR. STARKEY: I would stay perhaps, but I don't necessarily think so for the following reason. We have been involved in the last year in a lot of 271 price setting, in a lot of 271 cases where the notion is let's figure out what a just and reasonable price is, i.e., a price that might exist in the marketplace. And so we have had access to a lot of, okay, here is what the ILECs' rates look like on these particular services which are no longer -- impairment no longer exists, so there is some competitive pressure. At least as the FCC sees it, we might disagree. But there is some competitive pressure for these, and here are the rates.

We see margins above cost in the 1,000/2,000 range, so there is enormous margin in there. To the extent markets become more competitive, you would hope that that would start to go down over time. But in competitive markets -- we don't have a perfectly competitive market, so in competitive markets it's never going to reach its cost. There is always going to be some margin. And it is that level of acceptable margin that only the market can determine that sets the ultimate rate.

Well, there are a number of things we don't know about these particular rates. One, we don't know what the costs are in most circumstances. And, two, we don't know what the market would drive that margin to be for these particular services. So when someone tells me isn't it obvious that these rates that are going down are closer to cost, I would say I have no idea. And I don't think anybody else does, either. Because we don't know, in most circumstances, what the costs of these are, and in the second circumstances, we don't know what the competitive market would yield in terms of a representative mark-up on this particular service. And it varies by service across the market.

MR. WATTS: I'm Jerry Watts. I'll get in trouble for talking because I will get off script, but I may be the only person in the room that was around when access charges were created.

MR. FOLLENSBEE: No, not quite.

MR. WATTS: '82. But let's keep the story straight. The access charges, the intrastate access charges were created to keep the RBOCs whole on their revenues. That is where -- when they say they were obscenely high. This is not new to anybody in this room. And, you know, to get to these levels we are looking at, we are looking at a 20-plus year transition in access charges. How did they get transitioned based on some, you know, detailed cost analysis at various periods in times? Typically not. They got reduced because there was a general idea that you want to reduce them toward -- that was the terminology -- not to, but toward costs. How did you do that? You offloaded the revenue to somewhere else. Typically local service. Subscriber line charges, whatever.

So, I mean, one of the things that concerns me is just how we got here, where we are at this point in time with the CLEC industry, and if you want to have some reform in terms of pricing on this particular set of services, then what do you do? And I think we all feel very strongly that setting an arbitrary -- what we think is an arbitrary benchmark rate or safe harbor rate is inappropriate. Our costs don't reflect that.

And the other thing is setting a common rate for all CLECs is difficult because the nature of our networks are so different. You know, we have got special access companies. We have got companies that use special land UNEs. We have got companies who still have a big chunk of what used to be UNE-P that we are -- a for instance in terms of the costs that are imposed on us. The companies that still have a lot of UNE-P in their subscriber base, and you have to have some if you are a big company just because of the onesie-twosie situations you have with large customers.

You know, we were paying a buck and change for switching, and now we are paying ten times that in these commercial agreements. You look at any -- our cost as impacted by the TRRO relative to high cap loops and high cap transport. You know, when you moved, when you said there is a global finding of nonimpairment, you know, you moved from a UNE rate. And, by the way, the UNE rates were never -- the TELRIC rates were never found to be inappropriate. You know they were validated, if you want to talk about costs. But the reality of the world we operate in is you had to move a lot of your stuff from a TELRIC rate to a special access rate thousands of percent higher in costs.

So, you know, one of the things that -- a message we want to deliver today is, and we have talked some about this, is -- and Mike will talked more about it -- is, you know, if there is going to be reform in this area, it needs to be very deliberate. There needs to be a lot of analytics we think around how you go about that. And, you know, it needs to be coordinated with global intercarrier comp reform.

And I think the FCC is going to have to move ahead on that front soon. They are already in trouble on ISP, the core ISP order, and they have got a deadline from the court. So, anyway, I'm rambling, but how you got from where access charges were established to where they are today really is a story about moving the revenues somewhere else.

MR. FEIL: That has been a process that has occurred over --

MR. WATTS: And it took 20 years, or 20-plus years.

MR. NELSON: This is Doug Nelson with Sprint-Nextel. I can't help but ask the obvious question, Mr. Follensbee. Is it your contention that AT&T's intrastate switched access rates in Florida are set at cost?

MR. FOLLENSBEE: No, but my point is over time they are moving towards cost.

MR. NELSON: Are you willing to commit to lower

AT&T's rates in exchange for the relief you are requesting in this CLEC access proceeding? For all the same reasons that you have argued that the CLEC rates should be lower, why wouldn't that apply to your own pilot rates?

MR. FOLLENSBEE: I'm not sure I understand the question. Am I willing to lower my access rates to cost if all the CLECs will mirror that same rate?

MR. NELSON: If you will get whatever relief you are requesting, if that is what you are requesting.

MR. FOLLENSBEE: I might. That's the only thing I can say.

MR. NELSON: Can you restate that?

MR. FOLLENSBEE: I said I might.

MR. NELSON: You would go to interstate rates, or how would you benchmark your own rates?

MR. FOLLENSBEE: Well, we had a target to go to interstate waiting for intercarrier comp to occur at the FCC to see where that was going. To me that's still where we would like to get.

MR. NELSON: And you would consider that, or would you commit to that?

MR. FOLLENSBEE: Consider.

MR. NELSON: Okay. Thank you.

MR. STARKEY: Well, I think on that point -- and, Jerry, actually I'm glad you spoke up because your point is the right one. It is actually the right answer to the question you asked earlier. And I forgot your name, I'm sorry.

MR. HATCH: Tracy Hatch.

MR. STARKEY: Which was what is your recourse. I think it is the same recourse we all have, which is we all know that there are problems with intercarrier compensation. Some of them are problems just because we don't know what it means. I mean, we just have now the core order that was remanded to the FCC that says they have got to make a decision on the ISP traffic that we thought was settled and it's not.

VoIP, there are questions around VoIP. Intercarrier compensation is going to have to be remodeled. We all know that.

MR. HATCH: That's a gentle way to put it.

MR. STARKEY: Yes. We all know that. And the FCC knew that. In the '01 order they said this is the interim solution until we do intercarrier compensation reform. And I guess one of the things that we talk about here in the white paper is if that's all happening, why do we have individual sort of state proceedings going on? And Florida is not the only one, there are others, that are sort of taking one small piece of that and in my mind making it worse as opposed to waiting for the solution that will make it better.

MR. MASTANDO: And I would posit that that piece -- I'm sorry, this is Tony Mastando with DeltaCom -- that that piece is very small relative to the other pieces that are in play.

MR. STARKEY: Absolutely, no question. No question.

MR. TEITZMAN: Okay. Let's take a ten-minute break.

(Recess.)

MR. STARKEY: Do you want me to get started back up? Okay. The good news is I think we are going to break soon, and I'm going to try and just get through these last eight or nine slides as quick as I can, because I think we have made a lot of points.

But we were on the general topic of benchmarking is a bad idea, I guess, is kind of where you can paraphrase it. But it is harmful alternative, and a lot of that comes from the fact that we don't think it would be compensatory for the CLECs. And we think it puts you in a situation as a CLEC where you are still required to buy or maintain the capacity necessary to sort of -- and let's assume that the growth on a particular IXC is growing and you are seeing more and more traffic. It's real dollars associated with buying the trunks, putting the capacity in place to accommodate that traffic, and now you are set at rates by which you don't recover those costs. It's an untenable situation.

And the next few slides sort of get to the notion of, well, what you do mean it is not compensatory? What is your basis for suggesting that CLEC rates benchmarked at ILEC rates, specifically in most cases the AT&T and Verizon rates, why wouldn't those be compensatory?

We talked a little bit earlier about buying power is a simple example of why that probably isn't the case. But, frankly, that is not the biggest reason. The biggest reason is the simple economies of scale. Network industries, and telecommunications being no different as a network industry, are driven in most cases by economies of scale. The long-run average cost curve. The more units you produce, your average cost goes down. That is certainly true in telecommunications. And when you look at the scale differences between an ILEC like AT&T and Verizon in most states versus the operations of a CLEC, the economies of scale are substantially, remarkably, dramatically different.

In Texas, which many of you probably know, we are in the middle of a litigation associated with access rates for CLECs, and we have gotten access to information back and forth about what those economies of scale look like. Again, proprietary, but I can assure you that a chart like this is indicative. Though demonstrative and illustrative, it's indicative. We sit at a very different place on the long-run average cost curve than do ILECs. So it is not surprising at all that our average costs would be different.

Now, the hope, of course, is that as technology improves and we are able to substantially increase our penetration in the marketplace both with additional customers and with additional products, that we will achieve better parity along the long-run average cost curve. That is what is going to be required for this market to sustain over the long period of time. And we think that will happen, but it's not there now.

And as you can see from my box there, what I have basically done is I have taken a hypothetical long-run average cost curve with cost per unit on one side and volume along the bottom, such that as you produce more volume, obviously your cost per unit of output declines. I've put in the box to the left, higher on the cost curve, CLEC and mid-sized ILEC. It is important to note that if you are -- and just so we're clear, I'm at the third stage of what I think is a three-stage process, and we don't agree with the first two. And that is sort of what do you do if you have first identified there is a problem; second, identified that you can't change the barriers-to-entry to let the market fix it; and, third, if you have got to do something with the rates.

So at that point in the discussion, I would point out that the FCC prior to its 2001 order, which I have described earlier was sort of a departure from many of things it did, was also a departure from how it had previously looked at this benchmarking process. It had previously said that there are probably good proxies if they needed to be used in the independent company framework for CLECs, because they are similar in size in some cases, similar in buying power, probably exist somewhere along the same place in the long-run average cost curve. And that's what I have sort of shown here.

Our experience is that that is true. That if you look at the cost structure of CLECs, even the largest ones, their cost structure is far more indicative, or far more comparable to that of a mid-sized ICO than it is of a very large ILEC, like AT&T and Verizon.

On the left side there I have a quote from the Commission staff's switched access charges in Florida review -- I don't know exactly what to call it, but it was a document they produced apparently for the Legislature. And I couldn't agree more wholeheartedly with what they said. They said common sense as well as economic theory suggests that rates should be based on cost, thus sending proper price signals to the market.

If we are talking about benchmarking CLEC rates at AT&T and Verizon rates, it's unlikely in most circumstances that as it does at the FCC -- I mean, I would extend to you that the rates that CLECs charge at the interstate level are not cost-based. They are below cost in most circumstances. And those dollars have to be recovered somewhere, too, which is a different debate. But if we are talking about cost-based rates, then setting benchmarking rates at the ILEC levels, the big ILEC levels is not the right number.

I would also, I guess, take this opportunity to sort of point out that, you know, we have done this for awhile and we used to work for AT&T and MCI before they were purchased by SBC and Verizon respectively. And one of our issues was access rates. We spent time in proceedings on behalf of the interexchange carriers arguing that the large ILEC access rates were too high. But we had specific standards associated with that. One, it was always in our testimony necessary to describe why they had market power. What these barriers-to-entry were, and we defined them specifically, and said here is why the large ILECs have market power, and here is why as a regulator you should intervene and set those prices.

And we have said, here is why you can't dismantle them, or they are not dismantling fast enough, or the Act is meant to dismantle them, but it is not effective for setting these particular prices. We had to sort of describe to regulators that three-step process.

And, thirdly, our bottom-line contention was always that costs should serve as the basis for those bottom-line rates. Even if we wanted them lower for our own business interest, the notion always was that at most they have to be above cost. I am concerned that when I see advocacy from those same two companies that now sometimes that notion has been tossed out. That last notion that cost matters has been tossed out, and the notion is that costs don't matter. That is concerning, and in my mind it is not economically sound and the Commission shouldn't do it. Staff shouldn't, hopefully, agree with that notion, and it shouldn't be implemented as a matter of regulatory policy.

So if costs do matter and we can demonstrate that CLEC costs are higher than ILEC costs, that benchmarking ILEC rates necessarily has to fail.

MR. DOWDS: Any ILEC rates or just the RBOCs?

MR. STARKEY: Well, I think the RBOCs are the two that we see most often bandied about as being the primary candidates for benchmarking. Certainly those, I think, are demonstrably below cost. As I said earlier, the cost structure of CLECs and mid-tier ILECs are similar. They would be better.

MR. DOWDS: By mid-tier you mean Embarq, CenturyTel, those kind?

MR. STARKEY: Yes. In Texas we used WindStream as an example.

MR. DOWDS: Not Embarq Florida, though?

MR. STARKEY: Right.

MR. DOWDS: Or in Nevada?

MR. STARKEY: Right. I mean, they are closer. I mean, the bottom line is we don't know exactly because we don't have their cost studies in front of us, but all indications are that we look far more like them. We have seen them in the past.

So, yes, I mean, if you get to that three-stage process where benchmarking is the only thing you have got to do, I guess what I'm suggesting to you is using the RBOCs is a bad thing. Using the mid-sized CLECs is bad, but not as bad.

MS. KAUFMAN: RLECs.

MR. STARKEY: RLECs, yes. The rural guys. The independents.

MR. PRICE: Don Price, Verizon. Just to make sure, I wasn't clear on exactly what you said. You said something about those rates, meaning the ones that are held up as the appropriate benchmark are below cost. You didn't mean that relative to the carriers themselves, you meant that relative to using them as a benchmark for CLECs.

MR. STARKEY: Correct.

MR. PRICE: They would be below -- in your opinion, below the CLECs' costs.

MR. STARKEY: Correct. I don't know their relationship to the ILECs' costs. And the next few slides sort of get to that notion. Because the FCC -- and what troubles us about the FCC is it said -- it threw a token to the notion that there are differences in cost in different geographies. So, if you are a CLEC that operates in a small ILEC territory, you get to charge the small ILEC rate.

What it was doing there really was making a proxy and saying we understand there are differences in costs in some circumstances and we want to pay attention to that notion a little bit, but what we're saying is we are defining it to a geography. We are saying that if you serve in this particular geography, because it is served by a small LEC, a small independent LEC, then you can charge a different rate than if you serve in downtown Miami, for example.

But the FCC's proxy is not a good one because it's not whether you are serving in one part of the state or another that defines your costs, it's your density. The most determinant cost in a cost study in most circumstances, and in this circumstance specifically, is density of your network deployment relative to your customer base, all right. It is the economy of scale notion. The more you are able to sell units on a fixed network obviously the more your fixed costs are going to be spread over lower average cost.

So the point that is being made in this particular slide is if you look at a CLEC serving downtown Miami, and you take all of their collocations where they have got facilities extended out to, they then grab customers, aggregate them onto a central switch, and you define that as their service territory. And you take their number of customers defined by the square miles of their service territory, in many circumstances it is fewer customers per mile than the smallest of the ILECs in the state. So when you look at cost proxies, saying just because you serve in Miami you should have the same cost as Verizon or BellSouth doesn't hold. It is fallacious (phonetic). It is just not true. And that is the thing that the FCC in sort of making its proxy associated with sort of geography misses and misses poorly.

To sort of back that up we have done some analysis, and this will be available in the white paper. What we did is we had access to some of our client's information, detailed network information, customer information, and cost information, and we are able to pull similar statistics from public information related to the ILECs. So what these two charts are meant to do is show the average customers per square mile for a CLEC compared to the average customers per square mile from an ILEC in the same territory, okay.

I don't want to tell you exactly where this is because I don't want to give away whose information this is. But take the first chart as an example, and the way -- we had our Ph.D. statistician do this, so she likes this minimum average and maximum thing. But what it is meant to do is you take a CO on the minimum side, the one where there was minimum density, and you compare the CLEC density to the ILEC density. And then you take the CO that had the maximum density and you compare those two. And then the average in my mind is the most meaningful, because it is sort of a network-wide comparison.

So the CLEC is in blue and the RBOC is in red. And you see that even in densely populated, when we are talking about a CLEC who has focused its network. UNE-P is gone, so these guys are focusing their networks on only the collos that make sense, only the collos that are profitable. They are retracting. Funds are hard to get, so this is an efficient CLEC, and still the best they can achieve is that relative comparison in density to the ILEC. And then when you tell that CLEC that they should be held to the same cost standard or the same rate associated with particular services in that regard, you can see why it's offensive because they just don't have those economies of scale.

The second sort of chart is the same analysis for a different region. This region on the left, by the way, I can say that's the BellSouth region, and the region on the right is the Qwest region. Other than that, I can't be more specific. But it's the same analysis and holds true across geographies. So there are cost differences. Dramatic. And that sort of gives you the sense of how dramatic.

These are the numbers associated with that. This one is kind of cumbersome to describe, but it's the same notion, RBOC One and RBOC Two, it just gives the lines per square mile as opposed to the graph. So you see that the RBOC density either per square mile in -- the RBOC density is 389 customers per square mile and the CLEC density is 16 customers per square mile versus 893 per squire mile for the RBOC in RBOC Two and 25 for the CLEC.

MR. DOWDS: (Inaudible.)

MR. STARKEY: For the study area, yes. And the study area -- we define the study area basically by the data we had. We had our CLEC clients data associated with its entire network of collos where it could reach into customers. So it's not going to be like a study area defined by the ILEC, it is not going to be like ten exchanges that they define as the study area, it's going to be where our client was in those particular areas.

So it is probably still ten exchanges, they are just scattered around. But it's likely, given the way CLECs operate, it's likely to be the ten most densest exchanges in that particular geography. Densest using the RBOC information. The same is true --

MR. FOLLENSBEE: Was there a comparable analysis that also brought in average minutes per lines to see what that produced?

MR. STARKEY: The next one does something like that, because that is also -- because there are a number of different ways to generate scale, which is a good point. Lines within a given network, and then also if you have some very active lines, then you can at least generate -- you don't generate scale on your loop and transport network that way, necessarily, but you certainly do in your switched network because you have got more minutes on your switch.

So what we did is we took the switches for those same carriers in those same areas, the data source here -- and in the white paper it is all defined and rolled out, but the data source here, we had to use publicly available dialed equipment minutes for the ILECs. We didn't have criteria information there. We did have the actual proprietary information for the CLECs. But the notion is always that CLECs put switches in very differently. They put switches in sort of regionally, extend transport and sort of the long loop method out to collos, aggregate them on, get them on the switches. And the notion has always sort of -- the public opinion, I guess, has always sort of been that by doing that they are able to achieve the same economies on a given switch as an ILEC. An ILEC has more switches, a CLEC has fewer switches.

And to some extent you can see that CLECs are able to catch up with some of the disparity. The difference isn't as dramatic on the switch side, but it is still pretty dramatic. At best they have about a 60 percent utilization when compared to the ILEC on those switches, even when they have deployed them regionally, and that doesn't account for the fact that they spent a whole lot of money on those loops and transport to get that same sort of efficiency.

MR. DOWDS: Just to clarify. This is Dave Dowds, you said 60 percent. Is that 60 percent utilization on the soft switch or 60 percent of the ILEC's utilization?

MR. STARKEY: It is the second. If you assume that -- let's assume that, on average, the ILEC has an 80 percent fill on its switch, then the CLEC bill is 60 percent of that.

MR. DOWDS: Okay. To make sure I understood.

MR. STARKEY: So as you can see here -- and your point is a good one that that does differ. The difference, the substantial difference is different -- incremental difference -- when you look at the loop network versus the switching network. We are able to gain in some of those efficiencies on the switching side, but not nearly to the extent to be comparable.

And then you get into the other factors of we pay sometimes twice as much for our switches as they do and that kind of thing. Okay. Actually that's my last slide before we go to the questions.

MR. DOWDS: Let's go ahead and break until 1:00 o'clock. We have some rabbits to chase. When we come back, CompSouth, why don't you resume with your response and questions and then I would encourage all other parties to weigh in on their views at that time.

Also, there's copies of the sign-up sheet here, those who desire --

UNIDENTIFIED SPEAKER: You said 1:00 o'clock?

MR. DOWDS: One o'clock. All right. We will break until 1:00 o'clock.

(Lunch recess.)

MR. DOWDS: Do you want to start?

MS. KAUFMAN: I think so.

MR. DOWDS: We are going to go issue-by-issue on the twelve questions.

(Inaudible discussion.)

MR. STARKEY: I will try to keep it short. I know we probably look a little bit more time on that original presentation than we intended, so I will try to make our initial responses pretty quick.

The first question is what are the key factors that CLECs consider when determining how to set their access charges. I think the primary point is they set them very much like other carriers do in other parts of the market. They look around and see what their competitors are charging. They understand where their rates fit in respect to that. They analyze the extent to which, sort of, what is achievable with those rates, what is collectible with those rates, and then they throw them out in the marketplace. From time to time they change.

In terms of our last point, CLECs don't typically undertake what we in regulatory sort of think as the TSLRIC studies to determine the cost-based rate nature. They sort of set them more as a market dynamic.

MR. DOWDS: Anyone else that would like to respond to the question.

MR. PRICE: This is Don Price for Verizon. I think I generally agree with the points Mr. Starkey made. I think possibly one other factor that at least some CLECs take into account in setting the rates is the fact that once those rates are set, that basically IXCs for the most part have no choice but to pay those rates for the traffic they terminate to the CLEC.

UNIDENTIFIED SPEAKER: And is that Verizon as the ILEC or the CLEC speaking?

MR. PRICE: Well, I'm here on behalf of all the Verizon companies, but I was talking about our view as to factors that CLECs take into account.

UNIDENTIFIED SPEAKER: All right. Because Verizon is a CLEC as well.

MR. PRICE: That is exactly right.

MS. BERLIN: So does Verizon ever have the ability to -- ever pay less than the tariffed price to any CLEC, as far as you know?

MR. PRICE: I'm not aware of any circumstances where Verizon does pay less than the tariffed rates, although the question sort of raises an interesting point, because at some juncture, and I don't think we're anywhere near that point in terms of history, timing, dynamic in the marketplace, a lot of the factors that you talked about this morning, it may well be that the industry could move to a place where negotiated rates would be the norm.

MS. BERLIN: Does Verizon negotiate rates today?

MR. DOWDS: Excuse me. This is Dave Dowds. Did you identify yourself?

MS. BERLIN: I'm so sorry. Susan Berlin with NuVox. Does Verizon have any such agreements in place today? Does Verizon always invariably pay the tariffed rate, or does it sometimes insist on negotiated agreements?

MR. PRICE: My understanding today is that the only states that we have any negotiated agreements in are states that expressly permit those in their statute. For the most part, I would say the answer is no.

MR. FOLLENSBEE: This is Greg Follensbee from AT&T. I mean, I would agree with Mr. Starkey's comments that that is generally how a CLEC would set its rates. Usually the first one in the market is kind of what the rates have been set, and then a lot of times other CLECs will come in and look at those rates and either mirror them, they may make changes. I have noticed in a lot of cases that CLECs when they introduce a rate in one market, they may use that same rate throughout the whole state, so they basically have one statewide rate that they are charging. It normally implies a freeze (phonetic) of billing in a lot of cases.

MR. FEIL: This is Matt Feil with Akerman Senterfitt. So is it the case that the AT&T CLEC has a statewide tariff rate rather than differentiating by other geographic factors, if you know?

MR. FOLLENSBEE: It does in Florida. I can't speak to other states, but for Florida, the rate we charge is -- with some assumptions of are you going through a tandem or using dedicated transport kind of things, that the rates are the same for at least the three largest ILECs. So from what I can tell, the rates are the same throughout the whole state.

MR. FEIL: And for clarification, what Mike said, how CLEC rates are set, the same is true for the AT&T CLEC?

MR. FOLLENSBEE: Yes, because at the time the AT&T CLEC set the rates it was by itself a CLEC. It wasn't, at that time, owned by an ILEC. Now, I can tell you as a result of that, we actually have rates under the ILEC rates in this state which may be an anomaly that probably doesn't exist for any other CLEC.

MR. FEIL: You mean under the ILEC --

MR. FOLLENSBEE: Our rates in Verizon territory are lower than what they charge in the marketplace, because we have used the statewide rate. I don't think any other CLEC can make that representation.

MR. FEIL: Well, I don't know about that, but

Embarq's rates are probably the highest of the three.

MR. FOLLENSBEE: No, actually Verizon's are the highest.

(Simultaneous conversation.)

MR. FEIL: -- since the step down.

MR. FOLLENSBEE: Yes.

MR. FEIL: There may be some that are lower than Verizon.

MR. DOWDS: Anyone else care to respond? Hearing none.

MR. STARKEY: Question 2. Are the access rates being charged by Florida's CLECs cost-based? I guess I would start on this one by -- being a witness, we always have to ask a question when you're asked a question, and my question here would be what do you mean by cost-based. If we are saying was a cost study done, was a determinable margin determined and then a rate was set? Most likely not. If we're saying are they above cost from the perspective of, you know, you can't charge below cost under most statutes, most likely. But the bottom line is that CLECs generally don't do cost studies associated with their rates, switched access rates or really any rates, because they use the process I described earlier. They sort of gauge the marketplace to understand what they are going to be able to recover and they assess their rates accordingly. So I would say no, if your definition of cost-based is if there is this sort of regimented cost study notion, and I would say most likely if the question is are they above cost at their current levels, or at least exceeding their incremental cost. The other question then becomes what do you mean by cost, but that is a really long road.

Prices set by CLECs -- well, we have already talked about that second bullet point. I think the third bullet point you sort of have to recognize which is, you know, CLECs have capital employed. They are attempting to attract capital, they are attempting to generate profits for their shareholders, and so they sort of take their overall revenue stream related to their overall cost structure and try to generate a profit. Most of them don't achieve that in most circumstances. But all the rates are sort of set around that common objective and it's a factor that goes in.

So to the extent -- and I think the point there is to the extent that if benchmarking came into play, for example, and a chunk of revenue went away, it would have to be recovered somewhere else or they would go out of business kind of notion. That's, I think, back to the notion of when ILECs faced this in the past there was almost always an offsetting corresponding revenue recovery mechanism. I don't think we are suggesting that here, we are simply saying that, again, there is not a problem to fix.

And we have obviously made the last point over and over again. Our costs are different, so their rates would not be compensatory.

MR. DOWDS: Comments?

MR. PRICE: Mike, if I could, Don Price with Verizon. Just a question about your general observation about CLECs rates being set, and I'm not going to paraphrase, but I think what I heard you say is that your sense is that the CLEC rates as they are today are not below cost.

MR. STARKEY: I don't know that to be the case, and I think what I said was most likely, and I think that is probably true. I think most likely they are not below cost today. Now, that is not a rate-by-rate analysis, that is just as a general matter I would expect that they are not.

MR. PRICE: And just to follow up, when you say as a general matter, you are talking about all the rates that they charge, both on the wholesale and the retail side collectively, or are you specifically talking about access?

MR. STARKEY: I was talking about access in that respect.

MR. PRICE: Okay.

MS. SIMMONS: Sally Simmons. I have a question for kind of the CLEC community. I'm wondering when you go about your rate setting, do you tend to look at the retail rates first and kind of then back in the access rates, or if you could comment on that, I would appreciate it.

MR. STARKEY: Maybe I will start with that and then you guys can add what you think. Because one of the things that we have done in the past is help CLECs set rates. Sort of do market research and analysis to understand where rates should be set and then go in and help and sort of rationalize from our perspective some of their rate setting.

And like I say, no, it is not a catch-all. I mean, not our perspective, it never has. If the notion is that you sort of set all of your rates and then what's left goes into switched access, no, that is not the way it works. Normally, the way it works, as I described earlier, sort of for the services that you offer, you analyze the market and understand where the other rates in the market are and sort of set your rates accordingly based on your internal risk/reward situation of what you think you can collect versus what you charge and how you think the market -- whether you will be attracting that competition if you set your rates too high. Will you make yourself a target for additional competition, those kinds of issues. But, no, not a catch-all.

MS. CASWELL: Kim Caswell with Verizon. If CLECs don't know what the costs of providing access are, then how can you allege that the benchmark rates would not be compensatory?

MR. STARKEY: Let me break that in two pieces.

MS. CASWELL: Yes.

MR. STARKEY: When we talk about costs, I think we have to be aware of the fact that regulators look at costs differently than business operators often look at costs. Costs when you are typically running a business, and I'm telling most of you things you already know, but costs when you typically run a business aren't incremental in nature. They are capital in nature. I've got to expend so much capital, I have to incur so much expense to produce my products, all right. It's not normally on a product-by-product basis until you get into more sophisticated firms.

When we talk as regulators about -- or as the regulatory community, I guess, about costs, we generally mean either a fully distributed cost or an economic cost, TSLRIC cost. TSLRIC from many perspectives means nothing to a business operator. So whenever we are talking about them being TSLRIC-based, we are really talking about economic efficiency. From a regulatory perspective, we want rates that sort of tend toward their economic costs.

So while it may mean something to us, it probably doesn't really mean anything to the people who run the business. Where I'm sort of going with that is this notion that when you benchmark, we do -- at QSI, we do do TSLRIC cost studies, both for CLECs, we have seen them for ILECs, we sort of understand where those levels are. I think it is demonstrable that if someone says you must charge, let's say the interstate, at the interstate level where in most cases we are forced to charge about double aught four, double aught five. I can demonstrate, and we have in places that that double aught four and double aught five does not recover the incremental cost, the economic cost of the CLEC who's providing those services. And I would say the same thing here. When you start to -- and it depends on the rate you are benchmarking to versus the CLEC in question, but as a general notion, I don't believe the ILECs rates would be compensatory to the CLEC.

MS. CASWELL: But just so I understand your notion of cost from a business perspective, you look at your costs on a total company basis of providing your complete (inaudible) services, whatever they may be, and then you just somehow allocate cost recovery to the particular parts of that business?

MR. STARKEY: Let me give you an example. We went into a company a couple of years ago and they wanted us to build a TSLRIC cost study associated with their switched-based services, all right. And the way we normally do that is we go in, we gather an enormous amount of information, expense information, investment information, network topology information to try to understand how their business works.

When we had finally compiled that and understood that for each minute of use their incremental capacity cost associated with additional trunking, additional switching, additional expense associated with manpower to run the business, was more than the rates they were currently charging. They didn't know that, because they were looking at the business (inaudible) for each new trunk it cost me X, for each new switch module it cost me Y. But they had never broken that down on a per minute of use basis to understand for each unit I sell, my incremental cost is X, Y, or Z. They hadn't done that analysis because they were running the business, as most people would, based on the notion of when I have to expend capital, I want to make sure as a general sense I'm recovering that capital, and their analysis just wasn't as specific to that per minute of use.

MR. DOWDS: Further comments on that? Questions?

MR. STARKEY: Number 3, should Florida's CLECs be allowed to set their intrastate access charge rates at any level they choose? Should their cost to provide access service be considered? We sort of start by saying the Commission should refrain from price regulating CLEC exchange access rates, and we think that is true, but it doesn't really answer the question.

I think the answer to the question is both yes and no. From a regulatory perspective, I think they should be allowed to charge the rates that they choose through this process that they use today to set them. Does that mean they can choose any rate they want? No, it doesn't. I think it means that they have to consider these various forces that impact them, i.e., are they going to be attracting additional attention to their particular customer base? Are they going to become a more likely competitive target? Are they going to stand out from rates that exist across the industry? Those kind of things.

There certainly are disciplines that exist on them today. I think I will say one other thing here that -- let's take the interstate jurisdiction, because we know what has happened over the last few years when they benchmarked it. If the FCC had not benchmarked rates at the interstate level -- in a lot of cases, by the way, interstate traffic is larger than intrastate traffic. If they hadn't benchmarked those, I think we would see a very different market today. I think the market would have responded enforcing discipline here and there with respect to how these prices are set. But because there was regulatory intervention with benchmarking them to the ILEC rates, that market development never happened, okay.

So from this perspective at the intrastate level we don't want to see the same thing happen. If the market were reacting, and I think now because the interstate market was so big and it was sort of taken care of from the large IXC perspective associated with the interstate rates, they didn't really manipulate the market and discipline it the way they otherwise would have. I think we still see some of that at the ILEC on the intrastate side. But if the market is left to figure some of this stuff out, it will figure it out. And CLECs are disciplined in that respect in many ways, so they don't have this ability to just set whatever rate they want to.

And, again, at the last there we make the point, and I think it is kind of the point I am making now, which is that if there was an ability to pass costs through to the end user through deaveraged toll rates, as an example, a broader interpretation of 254(g) at the interstate side and none at the intrastate side, then certainly I think more discipline would be brought to bear.

MR. DOWDS: Dave Dowds, again. Do you think that deaveraged intrastate toll rates would be sellable in the market? Would consumers rebel from that?

MR. STARKEY: Let me answer the first question first. Yes, I think it would be sellable on the market as long as the -- because you don't have to deaverage them. I mean, you can still average them, it is just that likely the price of an average flat rate is going to be higher than the price of a deaveraged, because it is going to have to take into account all of this insurance we talked about earlier. Like I need to ensure that if they call into here that is it here; if they call into this particular region, it is higher cost, and I need to account for that.

I think you would have -- what you would end up with is what you end up with in most markets. If you want flat rate, if you want the security as a consumer of knowing no matter who I call it is going to cost me the same thing, your rate is going to be a little higher. If you are willing to take a little risk and determine it on a call-by-call basis, the rates are probably going to be a little lower and then your calling pattern is going to discern which one is cheaper for you, more economical over the long-run.

So I don't think the market would reject it. I don't think the market has rejected it. Look at the long distance market at the interstate level. It is not all flat rate. My mother, for example, makes very few phone calls. It makes no sense for her to be on a flat rate plan. She loses money that way. So she still pays a rate per toll call. Those options exist in the marketplace for a reason because consumers have different calling patterns and different demands, and in my mind that is the way it is supposed to happen.

MR. FOLLENSBEE: This is Greg Follensbee with AT&T. I don't think I would -- I don't agree with him for this reason. I don't think there is any practical way an IXC could tell to a customer if you call this customer the cost is going to be this, if you call that customer the cost is going to be that, not only because of the ability to do that in realtime, but because customers can switch providers and, therefore, you are constantly saying, well, yes, your cost last week was this, but today it is that.

On the terminating side there is no practical way to tell an originating customer I'm going to charge you a different rate depending on who you call. You couldn't quote them a rate on that, you couldn't estimate a rate on that, you only know it is going happen after they have dialed the digits to call some customer.

So, I mean, on the originating side there might be a way to discipline by deaveraging, but there is no way on the terminating side to do that.

MS. BERLIN: I don't -- I'm sorry.

MR. FOLLENSBEE: Go ahead, Susan.

MR. DOWDS: Identify yourself, please.

MS. BERLIN: Susan Berlin with NuVox. I worked for MCI customer service in 1989, and I remember I would rate calls for people because there was much more deaveraging back then. People would say, well, if I called so-and-so, how much is that going to be per minute, and I could look it up. If I called so-and-so, how much is that going to be a minute, because there was such a variability. I mean, things have gotten much more normalized due to the Telecom Act, I guess, and other forces and the people's desire for simplicity. But certainly if the capability was there then it is certainly there now.

In calling different countries you can see the rates are vastly different depending on the terminating rate. You know, if you want to call Bangladesh it is going to be a lot per minute; but if you call, you know, Canada, it is not.

MR. FOLLENSBEE: Susan, this is Greg. I don't disagree if I did it company-wide to a country, sure, because it is the same rate going anywhere in that country. But I have a hard time believing Verizon had the ability to say you are going to call this customer in Jacksonville at this price and you are going to call that customer in Jacksonville for that price. I don't believe they ever had that capability to say because of who was serving that customer I can tell you what it is going to cost me so I can charge you in the same city.

Now, the question is can you say if you call Jacksonville I'm going to blend all the rates of the CLECs together, and so if you call a CLEC customer assist rate, again the issue you are going to have is can you do it that way when the next day the customer switches to something else and it isn't that. I'm just saying on the terminating side there is no way an IXC can really discipline the marketplace because they have no control on the terminating side as to who the originating customer is calling.

The FCC won't allow us to block the traffic, and I guarantee this Commission won't allow us to block the traffic, so I'm having a hard time understanding how to discipline the market on the terminating side.

MR. STARKEY: And I guess I would respond to that in this way, the extent to which IXCs can perfectly identify and pass through the cost to an individual caller as potentially they move from one provider to another is really a technology question for which I don't know the answer. We know that each consumer's telephone number is identifiable by carrier who serves them through number portability and other means, the LERG and others. So, I mean, there is a mechanical method by which to identify a telephone number and identify who serves that customer. Whether that can be perfectly integrated into a billing system is beyond my expertise. I don't know.

But the bottom line is that even if not perfect, there certainly are ways and ways that have been implemented in the past associated with showing the customer -- and, by the way, I'm not asking the IXCs to discipline the marketplace. The only people that can discipline the marketplace are the customers, the people who ultimately pay the bills. So what we need to do is give them the information necessary. And to the extent it is not perfect, then, well, it is like every other market we work in, right? Nowhere do we have perfect information. What we have is attempts to identify information to give the proper price signals.

Here we are talking about perhaps it is that -- perhaps there is a three-tiered rate structure as we talked about earlier. We know when we work with clients who buy large volumes of long distance, we know they pay at least two different rates. We know they pay a rate for the RBOC territories and we know they pay a rate for the small ICO territories, the Tier-2. Perhaps there is a third. A CLEC tier, or something like that. I don't know. I am not a marketing expert, but I know that there are those people out there and they are already coping with this problem and will cope with it further if regulatory intervention doesn't sort of quote, unquote, solve the problem where we don't even think there is a problem.

MR. PRICE: This is Don Price with Verizon. I will venture a somewhat informed opinion on the question of the LERG and the ability to identify, because, yes, carriers do rely on -- and LERG, by the way, is an acronym, Local Exchange Routing Guide, and carriers do rely on that for determining how to get a call to the point where it can be completed. What carriers don't rely on as part of that process is any intelligence as to the rates that those carriers charge, and trying to integrate that into what today is an instantaneous set of computerized decisions would be, in my view, extremely burdensome and unnecessary. I mean, it's a solution in search of a problem, I think.

MR. STARKEY: Well, I couldn't agree more. We don't think there is a problem, either. I guess what I would say, though, with respect to the complexity is, yes, it might be complex, I don't know, but if you look at -- there are people who exist in the industry -- sorry, I couldn't help you.

UNIDENTIFIED SPEAKER: Cheap shot.

MR. STARKEY: It's the witness coming out, you know, you have always got to push back.

If you look at the industry there are people out there who perform least-cost routing in the long distance industry, and what they do basically is force smaller carriers to buy in bulk. If somebody is cheaper by the day, by the hour, by the territory you terminate it to, they have these enormous rate tables and they know exactly if you make a call during this particular minute of the day to this particular region who's the cheapest, okay. And that's their business. And people buy traffic from them, or buy capacity from them so that they will always get the cheapest minute wherever it goes.

If that exists in the marketplace, then certainly the ability of a carrier to do the same thing on its billing side could exist in the marketplace. Is it easy? Probably not, but markets aren't easy. The notion is is it possible and could it be used to discipline the marketplace and we think it could.

MR. HATCH: Are you contemplating building a billing table for an end-use customer that has an entire laundry list of all the CLECs with all their relevant access rates within the state and within the country?

MR. STARKEY: No, because -- well, I don't contemplate anything, really, other than the market doing what it does, which is find the best solution for the customers that they have. And today we don't do that, nor do we have to do that, because as, I think, Commissioner Roth said, the notion here is that IXCs -- and, by the way, the CLECs are also IXCs in some circumstances, so what we are talking about here is long distance providers who have a certain set of costs out here that vary based upon different variables.

It is completely common for them to take on the role of simplifying that for their own customers, right? So they do, okay, 10 percent of my traffic goes here, 5 percent of my traffic goes there, and they determine a flat rate that helps them be compensatory across that traffic. And as the traffic flow changes, then perhaps their rate changes.

This notion that it has to be a perfect scenario is, in my mind, sort of a fallacy. It doesn't have to be perfect. It's never perfect in the marketplace. But the concept of forcing customers to pay for the cost they generate is the fundamental nature of the market, and that is what we all do as enterprises in the market. To say it's hard doesn't get us out of the need to do it.

MR. DOWDS: Anyone else? Anyone?

MR. NELSON: Comments for Mike or just comments generally?

MR. DOWDS: All of the above.

MR. NELSON: I just have one or two briefly. This is Doug Nelson on behalf of Sprint-Nextel. Sprint-Nextel just wants to point out what we consider to be the elephant in the room today, Florida's inordinately high ILEC intrastate switched access rates. The Florida ILEC rates are among the highest in the nation indisputably, and they include large monopoly era subsidies that are both anticompetitive -- that are anticompetitive and that in maintaining those rates the ILECs are engaging in activities that are unfair and harmful to competition pursuant to Section 364, Florida Statutes.

What's happening here today, I think, is the largest IXCs in the state, who are also the largest ILECs in the state, are asking the Commission to lower CLEC switched access rates in order to increase their margins. And they are also asking the Commission to ignore and allow them to continue to maintain their own ILEC switched rates and retain the subsidies that I just discussed.

And, incidentally, they are simultaneously seeking deregulation in various places on the basis of the presence of competition. In Sprint-Nextel's opinion there is no place in a competitive market for one competitor to be subsidized by another. And all competitors in a competitive market, including ILECs, should recover the full costs of providing the services directly from their end users across their full spectrum of services.

Now, what we are asking the Commission to do is expand this proceeding to include ILEC access rates. And one way to get toward costs in a fairly simplistic fashion is to order parity with ILEC interstate rates, and that's what we suggest the Commission does.

Just very briefly, and then I will get to the questions. Just to put on the record the magnitude of what we are talking about here, the lowest of the large ILEC rates in Florida is about a penny and a half as a composite rate. The other major ILECs are considerably higher, two and a half cents, 3.3 cents, 5.9 cents. AT&T's rates in Florida are the highest in any of its legacy BellSouth territory. And what we should do, I think, today is when we listen to the answers to these questions asked about CLEC access rates, and particularly looking at what AT&T filed before this workshop, is ask the question why the arguments AT&T makes do not also apply to ILEC rates.

In answer to Question 4, it's true also that ILEC access rates are an irrational outcome in a competitive market. And to use AT&T's words, they continue to put IXCs and other LECs, and I would argue wireless providers who are not affiliated with ILECs, at a competitive disadvantage because, of course, the ILECs have bottleneck control over access to each of their end users, as well.

In answer to Question 5, just reviewing AT&T's response, the market for ILEC access is not competitive, either, and that has been discussed some this morning. IXCs and wireless providers can't reject high ILEC rates for the same reason AT&T gives that they cannot reject CLEC rates. And ILECs' competitors have the same problem passing through ILEC rates in a transparent fashion that AT&T points out. In fact, IXCs in this state are prohibited from assessing access recovery fees.

Going on to Question 9, the Commission has the same broad statutory authority to prevent ILEC activities that are unfair and harmful to competition pursuant to Section 364.01, Paragraph 4. And to the extent the Commission determines that excessive levels of ILEC rates to be unfair and harmful to competition, the Commission may assert authority over ILEC switched access rates.

And, finally, in response to Question 11, lowering ILEC rates would also have minimal impact on the ILECs who are able to fully recover the costs of providing the services from the full spectrum of services they provide to consumers. The ILECs are offering you services, and their average revenue per unit, or RPU, is growing dramatically. Verizon in its first quarter earnings report reported a 9.6 percent increase in RPU, and broadband and video revenue was up 56 percent. In its first quarter earning report, AT&T reported average revenue per primary line being up 5.6 percent, quote, unquote, continuing trends in recent quarters.

It is clear that the subsidies that the ILECs are expecting the Commission to retain in perpetuity are not warranted in a competitive market and certainly are not necessary to subsidize the services in today's market. So, again, our position is that you can't ignore the elephant in the room. If you are going to address this, the first step is to look at ILEC access rates, look at what some of the other states in the south, perhaps, and in other states have done, and a good way to get toward cost and to rationalize the market is to require them to set them in parity with interstate rights.

MR. DOWDS: Dave Dowds. It sounds to me as though you are advocating for elimination of intercarrier compensation, or at least zeroing out access charges and recovering the revenue requirements from other -- the full panoply of services or however you phrased it. Am I hearing that correctly?

MR. NELSON: Well, what I'm advocating is we are advocating the elimination of subsidies. You know, I mean, in the competitive market a carrier has got to recover its costs in providing service from its own customers. You can't expect its competitors to come in and pay them a subsidy that's left over from the days when we had regulated monopolies, when there was a basis for supporting the local market -- (Inaudible).

MR. DOWDS: So you are essentially saying that there are certain ILEC services that are unmentioned at the present time that are priced below cost, and they are thus being subsidized by above cost access rates. I'm just trying to understand what you are saying.

MR. NELSON: I'm saying they didn't recover the full cost of providing the services from their end user customers. Their RPU is going up and so --

MR. DOWDS: They are not providing access to their end user customers, they are providing it to IXCs, aren't they?

MR. NELSON: Well, access is a subsidy traditionally to support upkeep of the network that provide services to end users, and therein lies the problems. They can collect all of those fees from their end users essentially.

MR. DOWDS: And they shouldn't.

MR. NELSON: And they shouldn't receive a subsidy.

MR. DOWDS: So you are advocating bill and keep?

MR. NELSON: I don't know if I would say that. I'm advocating elimination of the subsidies. I mean, bill and keep is a great ultimate goal, I think, absolutely.

MR. DOWDS: So you're not going to bill and keep yet, but you are advocating pricing at TSLRIC or something like that for access rates? I'm just trying to pin you down. What do you want?

MR. NELSON: Yes, well, pin me down. What I'm advocating is what I said, which is in order to go toward costs, which is where, you know, people have discussed earlier today where rates should go and where AT&T said it would consider heading towards, that the first step to doing that -- and when you asked about bill and keep and you asked about, you know, if we performed intercarrier compensation, people pointed out and it is very true that there is a proceeding going at the FCC. There's a lot of work to be done. What I say is take the first step. Get to the rational level that approaches cost and address the element of the ILEC rates.

MR. DOWDS: Which we have tried to do at this Commission for many years. (Inaudible.)

MR. NELSON: But I would maintain that you have the jurisdiction to do that.

MR. DOWDS: That I would defer to the lawyers.

MR. HATCH: Coward.

MR. DOWDS: I'm not playing lawyer today.

MR. HATCH: Today.

MS. SIMMONS: I've got to ask a follow-up question. Sally Simmons.

Doug, I'm just curious, how do you envision this happening, what you are suggesting from the standpoint of the Florida Statutes? I'm a little confused, because the rebalancing stature, 364.164, was repealed. How do you -- and you are saying you believe the Commission would have authority. Can you explain some of your rationale, how you think the Commission would have authority?

MR. NELSON: Well, for the same reason AT&T has proposed jurisdiction over, you know, CLEC access rates. Network access services are capped for three years pursuant to legislation last year. It doesn't mean you cannot lower it, particularly in the context of your charge to exercise exclusive jurisdiction under 364.014(c), (g), and (i), I think. You should ensure that monopoly services provided by telecommunications companies are subject to an effective price rate and service regulation and ensure providers of telecom services are treated fairly by preventing anticompetitive behavior and eliminating unnecessary regulatory constraint, and continue this historical, what is a surrogate for competition for monopoly services provided by the local exchange companies.

MS. SIMMONS: I guess a follow-up question. You don't see the price regulation statute, 364.051, causing any concern? Is it your concept that you are advocating elimination of the subsidies in the access charges, but not allowing -- I'm trying to figure out how the ILECs would be able to offset that in any fashion. They are pretty limited in terms of -- well, they're at least somewhat limited in terms of what they can do with their retail rates.

Do you believe that's a nonissue, the fact that they might have some constraint in terms of what they can do with their retail rates, particularly their basic rates?

MR. NELSON: Like I said, the ability to recover over the full spectrum of services they offer. They offer television service now. They offer Internet service. They offer any number of services, regulated and nonregulated. And as a policy matter, they don't need that subsidy anymore.

MS. SIMMONS: You are just saying that they can make it up elsewhere, even if it is not in the regulated arena?

MR. NELSON: Yes, absolutely. And, you know, I think you have to look at -- I mean, that .051 that you are citing, which I guess exempts them from .05 rate setting authority is essentially saying (inaudible) rate of return LECs anymore and they shouldn't be regulated as such. They have a price cap on them. But you still have an obligation to prevent monopoly anticompetitive behaviors under a separate portion of the Act, essentially.

MS. SIMMONS: Well, in your mind, it isn't really material that the ILECs would be limited in terms of what they could do to increase basic rates because they --

MR. NELSON: Well, they are free to describe how they think they are limited, but I don't see that as an impediment at all.

MS. SIMMONS: I mean, they can only increase their basic rates once in a 12-month period as the GDP (inaudible) one percent.

MR. NELSON: Right.

MS. SIMMONS: Okay. And you don't think the

Commission should be concerned about that? Okay.

MR. FOLLENSBEE: This is Greg Follensbee with AT&T. I mean, I am kind of in the horns of a dilemma. I actually agree with what Doug is saying is what the outcome should be. I don't agree with some of his rationale as to why it should occur. If this Commission would find that it could investigate ILEC rates, we would wholeheartedly support what he's saying to do that, as well.

I will take exception with the idea that he thinks we should have new services that have never subsidized the service all of a sudden absorb that. We firmly believe that any services that are being subsidized ought to be what you ought to be able to freely market and price that. But Ms. Simmons has correctly pointed out that we are price constrained today, which does limit our ability to put the costs where the costs probably are being incurred to be able to shift the access somewhere else.

So, I mean, we endorse what you're saying. We think if this Commission finds it can investigate the ILEC rates and thinks that there is some ability for them to allow us to recover those costs through the rates we charge that the statute gives us other things, we will whole-heartedly endorse the investigation. Unfortunately, I think you are going to find the price caps that exist are a regulatory constraint. If you want to endorse legislation to change that, I think we would wholeheartedly support it. I question would the CLECs -- I would hope they would endorse it, as well, if they are saying that is a regulatory barrier to allowing the competitive marketplace to work better.

MR. NELSON: Well, I just think in a competitive marketplace you have to -- I mean, you are admitting that what you consider the present statutory constraints to be are not rationale in today's world. You are saying we would love to do it. We would love to give up this money, but, darn it, we are just not allowed to. Sorry, we have to collect it.

I would say a few things there. One, nothing prohibits you voluntarily from doing that. Essentially putting your money where your mouth is with respect to reductions in access rates. And, secondly, I would say, you know, although there appears to be a conventional interpretation of the statute out there that has gotten a lot of -- you know, has been interpreted in that fashion for many years, there are other ways to look at things, and I think you have to look at the statute as being flexible to accommodate these circumstances.

MR. DOWDS: Others?

MR. STARKEY: Okay. We're on 4? Right.

Are Florida consumers harmed by CLECs charging access rates that are in excess of those charged by the ILEC in the area in which they compete? Are there other adverse effects?

I think, first, I would say I don't think they are harmed, but even if they were harmed it wouldn't be because the rates are different. That wouldn't be the result of the harm, even if there were harm.

As we showed earlier, there is really no rationale, at least economic rationale to the existing ILECs rates that makes them a better benchmark than any other. So, I mean, to the extent the question is would they be harmed because we don't charge the same rates they do, no, not at all. And I think that's what my slide says. I hope so.

And I guess here we sort of saw this as a threshold issue for those who are advocating benchmarking. It's sort of that three-step process. Let's first see if there is a problem. If there is a problem, what is the impact? If you can show us an impact on end user customers that would be solved by benchmarking, then perhaps we would have a more straight on debate, but we don't think there is one. We don't think anyone has shown one. It's difficult to prove a negative.

MR. DOWDS: Others?

MR. PRICE: Yes, Don Price from Verizon. I respectfully disagree with Mr. Starkey on this. Notwithstanding the presentation that we heard this morning, it is a fact that from the IXC perspective, once the caller hands that call off to us, there is no ability to avoid the rates that are charged at the terminating end by a CLEC that charges rates in excess of the ILEC. I mean, it's that simple. And because of that, the effect we think is they have the effect of transferring costs from the CLEC's customers to other carriers' customers. And I can't see that as anything other than harmful in the marketplace.

As a result, some rates are probably higher than they otherwise would be, so if there was a benchmark and they would result in rates being lower than they perhaps are today. The difference, I think, between the situation with respect to CLECs and what Doug was talking about a few minutes ago with respect to ILECs is that the Commission has exercised review of ILEC rates in the past. That's not the case with the CLECs.

And have we talked little bit about whether rates are compensatory for CLECs. I mean, I don't know, I think Mr. Starkey agrees he doesn't know, the Commission certainly doesn't know. But what we do know is that if those rates are excessive and they cause other carriers' customers to pick up a share of the CLECs' revenues, an excessive share of the CLECs' revenues, I can't see that as anything other than harmful to the consumer.

MR. FOLLENSBEE: AT&T would agree with the comments from Verizon.

MR. FEIL: Matt Feil with Akerman Senterfitt. I was going to ask a question.

Do you agree Mr. Starkey's suggestion earlier that the extent that the benchmark CLEC rates, if are not compensatory, that you are, in effect, replacing one harm with another harm, i.e., the harm you refer to with IXCs being unable to avoid CLEC access rates, one perceived harm for another harm where CLECs are not being compensated.

MR. PRICE: Don Price for Verizon. No, I don't agree with Mr. Starkey's conclusion on that. I mean, I heard this morning the assertion a couple of times that that would create harm, but I don't know that anything has ever been identified in terms of what that harm would be. There is sort of this vague reference to the fact that the rates would not be compensatory, but we don't know that. And you have this other problem, and I think Doug's comments a minute ago pointed to this, ultimately I think where we would all like to go is the situation where as a network provider that interconnects with another network provider, or any number of other network providers, we all have our networks, we all have to pay for those networks, we all have to operate those networks, so in the long-run I think the idea would be for the most part for us to all recover those costs from our own users and not rely on intercompany transfers for a big source of revenue.

MR. STARKEY: Do you mind if I insert something there, because that is an important point. I hope I wasn't interrupting you. Were you done?

MR. PRICE: I think I was through.

MR. STARKEY: Okay. This notion of sort of let's not let one carrier impose costs on another carrier, you know, let the customers all pay in the end. It has always been my question why we single switched access out in that scenario and leave special access in a completely different scenario, because switched access is nothing more than a substitute for special access.

Switched access says I don't have the volume to this one particular place to justify putting in a circuit, so I'm going to use somebody else's network to get there. That is interconnection and access to that customer. The same scenario exists when we buy special access from the ILECs to get to a particular place where we want to get our network. So this notion that because it's switched it should be free, but if it is special you have to pay us, that's the part of that argument I never have understood.

Why is bill and keep okay for per minute charges, but not okay when we want to interconnect to their network using their special access circuits? That's the part that has always thrown me off, I don't understand it, but would love to be able to eliminate it.

MR. PRICE: Don Price on behalf of Verizon. I think at least to some extent we're talking about apples and oranges here, because my current comments have been in the context of

CLEC rates. And as a CLEC, MCImetro certainly does not -- well, we provide wholesale circuits. They are technically the same as special access, but they are not -- I don't think they are not in the, quote, special access that your comments were directed to.

MR. STARKEY: Probably not tariffed similarly, right. I was really looking more at sort of the Verizon and AT&T incumbent carrier from which we buy most of our special access circuits. The point was really broader. It is, look, networks interconnect in a number of different ways. They don't just interconnect via this circuit to do recip comp and this circuit to do switched access. We interconnect with them to get special access to get to parts of their network and parts of the geography we don't have access to. To the extent you were saying one of those should be bill and keep and the other one should have these rates associated with it that have no regulatory scrutiny, or very little, or diminishing regulatory scrutiny under the opinions of the incumbents, the large incumbents, I still am lost on that. I still don't understand why one is the right economic solution and the other one is not.

MR. FOLLENSBEE: This is Greg Follensbee with AT&T, I'm going to speak to Mike's, and then also to Matt's. Let me go to Matt's first. Matt, AT&T would not have a problem having a position of set a benchmark, but if a CLEC believes its costs are higher than that, it is free to then demonstrate that and charge higher rates. I don't think we would ever take the position that you should be forced to charge under cost rates. So we would have no problem with that kind of a situation occurring. Then it becomes a business decision for that CLEC to charge the benchmark (inaudible) rate goes in, and that's fine with us.

To Mr. Starkey's comments, if the companies bought a lot of intrastate switched access I might be concerned. They don't buy enough of it. We are here to talk about intrastate rates, so I don't know why special access is even brought up. They don't buy enough of it to even worry about what they are.

And if he's trying to mix jurisdictions, I think that is kind of inappropriate because this Commission can only look at what it regulates, which is intrastate rates.

MR. STARKEY: Let me respond to one thing and it won't be that last point, because I see what he is saying. I disagree, but I see what he is saying. It's this notion that AT&T would never stay below cost. I'm glad to hear that, because in other jurisdictions we have heard different.

In Texas, the notion was even if they are below cost, that's fine, because the policy here is let's get these things as low as possible. If the position has changed now to where cost does matter, and that was the question I was going to have for Don, as well, from my perspective it helps to parse the issue.

Are we saying that let's say we had a perfect -- we had a cost study that was done perfectly for a CLEC, okay, and the cost came in at some number that was higher than the ILECs, okay. Should we still benchmark to the ILEC? That was the question I would have for both of you.

MR. FOLLENSBEE: This is Greg Follensbee. Not for that CLEC.

MS. CASWELL: This is Kim Caswell. This is the same position Verizon has. It's a rebuttable presumption. That is what we are proposing at least, and that's what I think in a dozen or more states who have enacted these kind of caps, I think that's how it works, as well as with the FCC.

This benchmarking is not a new or extraordinary concept. For instance, in the recip comp context, I believe that CLECs are required to charge symmetrical rates unless (inaudible). So it's just the same kind of concept, and (inaudible).

MR. STARKEY: Well, I guess what I'm responding to is testimony I have seen elsewhere which says costs doesn't matter. Even if -- even if the cost is higher, you should still benchmark to the ILEC rate. If I'm hearing something different, then that is --

MR. FOLLENSBEE: That's sometimes the problem, having a company not having the same person speak all the time. But I would represent for Florida our position would be if you could justify higher rates based on your costs, I would be hard pressed to say that you shouldn't be able to charge those.

MR. WATTS: This is Jerry Watts, DeltaCom. I guess a question for Greg and for Verizon, too. In general, would you say that in general, given the economies of scale and just general knowledge about ILEC networks and CLEC networks at this point in the CLEC development of networks, that you would expect the costs to be higher for a CLEC, marginally higher than an ILEC? Or are you saying that you have some -- you talk about a rebuttable presumption. I still believe that the idea that you are going to set the safe harbor or the benchmark at the ILEC rate, it can't be defended. I mean, maybe there is a -- if you were going to set a benchmark, which we are opposed to, maybe there is some analytics that can be applied to the CLEC industry that would get you to an appropriate benchmark. I'm not conceding that point, but I am just saying. But to use the ILEC as the benchmark and then say it's a rebuttable presumption, and then put any CLEC who's not charging in the posture of spending -- or how much money has to be spent to do cost studies, and defend the cost study, and everything that goes with that seems to me to be applying a tremendous amount of cost to a relatively small part of the competitive landscape for the purpose of, you know, some kind of equity objective for the ILECs. I just think it is bad policy.

MR. STARKEY: I mean, don't get me wrong, I am probably the one person in the room who would really benefit from you saying (inaudible). So keep that in mind whenever I say it's the wrong way to go. And it is exactly what Jerry just said, which is why would you put a rebuttable presumption on the one rate you know which is not right? We know the ILEC rates -- well, we can demonstrate and we have a little bit here, sort of anecdotal information, but we can demonstrate that the ILEC rate is not the right rate. If costs matter, the ILEC rate is not the right rate. Why would you put a rebuttable presumption at that rate and then force us to disprove it? That's the part I don't understand.

MS. CASWELL: And it's not the right rate because it's too far above cost, is that what you are --

MR. STARKEY: No, it's not compensatory.

MS. CASWELL: It's not compensatory for you. That's you. I understand that argument, but --

(Simultaneous conversation.)

MS. CASWELL: -- the theme of your presentation is that costs matter and rates should be cost-based, but you are not willing to produce any data that sets the rates.

MR. STARKEY: No, we are. We are, and we have. And I guess it's a two-step, I think the presentation has two pieces, which is, one, there is not a problem. It is that three step again. Identify the problem; if there is one, determine what is causing that problem, what are the barriers-to-entry; and then, third, if you find that you can't dismantle those, then cap the rate. We are now at what happens if you can't dismantle them. We haven't gotten over those two first hurdles in my mind at all. But that being said, let's say we have theoretically. We have said, basically, that the right rate is the rate that the market will set. But if the market isn't working, we have gotten past these two steps, then costs do matter. Regulatory costs matter in that circumstance.

And we have -- in Texas we've rolled out a model, TSLRIC model. We have rolled it out. We have said here are the costs. They are demonstrably higher than the ILEC costs, and AT&T in that scenario said it doesn't matter. Even if you find that this cost study is right, it doesn't matter, because the policy is that the fee should be as low as possible.

And so, I mean, there is a difference now, and I think that is great. I can't remember her name now. Anyway, I'm glad to here that's changing, that's good. But the rebuttable presumption bothers me almost as much, which is, at least from my perspective, intuition should tell you that our costs are not like the ILECs' costs, and the data we presented here I hope is compelling in that regard, because they are not the same. And to presume that they are and then make us rebut it just doesn't make any sense to me.

MR. HATCH: Here's a question. This may be a stupid question, but then that has never stopped me before.

MR. FOLLENSBEE: He's my back-up.

MR. HATCH: This is Tracy Hatch for AT&T, and I'm Greg Follensbee's bag handler.

UNIDENTIFIED SPEAKER: You're here to ask the stupid questions.

MR. HATCH: If you believe Doug that all the ILEC access rates are way the hell in excess of cost, and assuming AT&T Florida, which is probably the lowest in the state for the ILECs, and it's way in excess of cost, then how does that say that the CLEC rates that are so much higher, it's not compensatory for them.

MR. STARKEY: I don't know that I do agree with Doug. We know how ILEC rates are set. They have been set primarily, at least in many places, and from what I can tell from the history here, as well, through a political process more so than a process by which we understand costs and rates and margins and that kind of thing. So I don't know, I'm not necessarily agreeing with Doug.

UNIDENTIFIED SPEAKER: We have AT&T on the record from this morning saying that they were above cost, so --

MR. STARKEY: Well, AT&T and I have disagreed many times over what cost means, too. So, I mean, there is information that is necessary. I think that's Jerry's point about the analytics, which is the worst thing to do is make a decision without the necessary information to educate you as to what the right decision is. And I think what you are pointing out is that there is information to be had that would educate this decision. I can't disagree with that.

MR. PRICE: This is Don Price with Verizon. There is an argument in support of the proposition that the costs don't matter. And that argument applies to CLECs, but not to ILECs. And that argument is no one has ever taken a look at any of the CLEC costs. They don't know the proportion of revenues that are generated by local voice services, by data services, by Internet access services, by whatever, and yet here we are focusing on this little narrow -- maybe not little, but anyway this particular subset of services and saying this part has to be compensatory, and we have got to really zoom down and focus on the costs of that service. And that to me is where it is a really valid policy question. Because if you are not going to look at the whole, how do you know whether there is a need for any compensation at all in order for the firm to be fully compensated.

MR. STARKEY: I absolutely agree with that, Don. Absolutely agree with that. And our problem is narrowing in on one service and saying that particular rate is excessive without looking at generally as to what is in the marketplace and how was it excessive. I mean, you guys know we don't make big profits. I mean, does anybody disagree with that? Has anybody seen the balance sheets of these public companies? They don't make big profits. I mean, this isn't like this money goes in and then goes to the bottom line somewhere.

I mean, I also agree that the problem here is this sort of narrow focus on here is a rate, it's excessive, and then kind of ignoring all of the other context around it, including the market in which it operates. I totally agree with that. And so I totally agree that looking at one particular cost isn't the right way to do it, because we haven't overcome those first two obstacles, identifying the extent to which there is a problem, and identifying the barriers-to-entry that it created.

MR. WATTS: This is Jerry Watts from DeltaCom. On the issue of identifying the problem, I mean, in terms of the magnitude of the problem relative to the industry in general, have you guys got any numbers as to what percent of your costs are reflected in the totality of CLEC access charges, switched access?

MR. FOLLENSBEE: This is Greg Follensbee. I don't have it with me today. I mean, sure it can be gathered, but I don't have a sense.

MR. WATTS: Okay. The other thing is --

MR. FOLLENSBEE: I mean, we are focusing on charges that we are incurring from CLECs, and you have got both the group that is doing CLEC end user or selling to an affiliate that is doing CLEC voice. So it's not isolated to just your traditional CLECs. And I know that it is a growing -- probably the other body is a growing amount as compared to the traditional CLECs that started out 12 years ago.

MR. WATTS: This is Jerry with DeltaCom. I guess the point I would encourage and hope that would be a factor in this in terms of the public policy determinations is what is the impact on the CLECs, the remaining CLECs operating in Florida relative to an arbitrary benchmark being established, and what is the impact on the large ILECs in Florida in that regard, and what's the ultimate impact on the consumer?

I mean, I would offer up the consumer is going to see no benefit as a practical matter from a benchmark being established for CLECs. Is the consumer, particularly small business consumers in Florida, realizing a benefit from the CLECs who are around this table operating in Florida? And getting back to what Mike said about, you know, the financial circumstances for most CLECs, you know, we are generally small, you know, early in our business developmental cycle, companies who are striving to make profits. You know, we are not well-established older companies who are trying to increase our profits with some kind of scheme on access charges. So, again, and we have urged this several times, to the extent the Commission is going to take action, I hope that it will be a very broad view and will take into consideration all the consequences that might flow from this, both intended and unintended.

MR. DOWDS: Jerry, Dave Dowds. Is it your view that were we to establish a rate cap that the resulting access reductions that would inure to IXCs would get lost in the rounding of the toll rates, is that what you are essentially saying?

MR. WATTS: I'm saying as a practical matter the way services are priced today, and this is -- I'm not an economist, and I'm not a marketing expert.

UNIDENTIFIED SPEAKER: Or a lawyer or anything else.

MR. WATTS: Or a lawyer or anything else.

UNIDENTIFIED SPEAKER: What are you?

MR. WATTS: I'm a guy that has been around for about 35 years. If you look at the bundles that are being offered, and the prices for them, and the nature of the market today, I mean, we don't see a lot of pure IXCs returning around the landscape these days, or at least I'm not aware of them. It is hard for me to believe that there will be a significant impact on pricing, or quality of service, or anything else for the consumers of AT&T relative to this action.

If you look at the magnitude of the impact, financial impact, obviously it is going to be a much greater impact on the CLEC industry than it will be on AT&T. That's is my point.

MR. DOWDS: I have one question. Dave Dowds, again, for Mike. The Texas TSLRIC study done for CLECs, is that a public record?

MR. STARKEY: No, unfortunately not. Some of the testimony is.

MR. DOWDS: Could you provide us the document?

MR. STARKEY: Yes. I can do that today. I will look on my computer.

MR. DOWDS: So we can see what mischief is afoot in Texas.

MR. STARKEY: Sure. Are we ready for Question 5?

MR. DOWDS: Sure.

MR. STARKEY: Is the market for the access service structured in a way that allows competitive pressures to effectively constrain access prices, why or why not? Our response is yes, it is. There are no barriers-to-entry. To the extent distortions arise, they are likely the result of regulations that have already been passed primarily related to averaging that is meant to be a universal service sort of objective. I think we have kind of hit that from all angles.

MR. DOWDS: Dave Dowds, again. Assume I told you that the range of variability in CLEC access rates in Florida is a possible range of, oh, about 800 percent. Does that reflect that the market is properly regulating the matter?

MR. STARKEY: I guess I'm not -- I just don't find meaningful variations in rates, because markets all over the world have dramatic variation in the rates that ultimately result from it. If you are suggesting that this is a commodity and, hence, that variability is odd or strange, then that might be a different matter, and I might agree or disagree as to whether it is a commodity or not. But I don't think the extent to which there is variability in the rates that exist has anything to do, in my mind, with the discipline of the marketplace.

MR. DOWDS: (Inaudible) I really don't know. Arguably, toll pretty much is these days, especially where it is interchangably -- in fact, I don't have an IXC anymore. I got mad at them. So any interstate calling I make is on a cell phone.

MR. STARKEY: You are exactly right. Sorry.

MR. DOWDS: So the question is if the toll is, is the underlying access a commodity. Better minds than mine can answer that.

MR. STARKEY: My own personal opinion is that toll is not a commodity. Toll is just no longer a stand-alone service. Toll now is a, perhaps, commodity portion of a larger bundle of services. I'm the same way, I couldn't probably tell you who my long distance provider is frankly, because I buy the service based on getting a whole bunch of service that I get.

Does that mean that the prices for that bundle have to be the same? No, and they are definitely not. They vary dramatically, depending on what I want to buy and what I don't. I just don't see variability in a marketplace that has competitive discipline in it as problems.

MR. MASTANDO: This is Tony Mastando at DeltaCom. I want to draw a quick analogy to another space where we can see kind of a large difference. If you were to purchase a copper loop as a UNE, you will pay one price. If you purchase essentially that same copper loop as a special access service, you will see a variability of 1600 percent or so in the difference of prices. Does that mean that the market is not competitive?

MR. DOWDS: It's a regulatory aberration.

MR. STARKEY: I hate to answer Tony's question, but I think it does mean the market is not competitive in that circumstance. I mean, in that circumstance --

MR. WATTS: I'm sorry, this is Jerry with DeltaCom. Jerry Watts with DeltaCom. It, in fact, means the market is not competitive, and it's a regulatory aberration, as well. But the reason that means the market is not competitive is we have had some global findings of nonimpairment by the FCC. None of us can change that. The fact of the matter is, and we are very aggressive on this front in our network organization, if you could go buy it somewhere at a price that was between that and the TELRIC price, which was never invalidated, which you were paying for it when it was a UNE, you would be buying it somewhere else.

The fact of the matter is if you are a CLEC with any scope you are in a lot of places where there's nowhere else to buy it. You buy it from the incumbent, and that's the rate you are going to pay. Which brings to mind if you look at the total global cost and margins for interconnection between these companies, that's an interesting analysis, too. I don't have the wherewithal to do it, but if you look at what I pay these guys to interconnect with them on all services, and you look at what they pay us switched access and whatever other services, you know, they are extracting huge margins in some of these services which you don't have any control over and, of course, we don't, either.

MR. STARKEY: I would really like to draw a picture, but I don't know if that -- to make the point, again, and maybe I don't need to make it again, which is, you know, assume you have a central office, and here you have a customer. And AT&T, or the long distance carrier wants to get to that customer, so they use our network to do it. Well, they use us on a switched access basis to get it. Now, let's assume that is a different scenario. Instead of us being here now, we have AT&T here now. And we want to buy a special access circuit to that particular customer because we have enough volume there. It's exactly the same functionality that is being provided but for dedicated versus switched, and here we are hearing these rates on the switch made to need to come down because they are excessive because the market doesn't work. But if we were to go and buy the special access piece, we are hearing the prices there are fine at these 1600 percent level increases.

There is no difference in my mind. Why focus on one and not the other? It is a matter of accessing a customer.

MR. DOWDS: I'm scratching my head. Are you saying that if we did something that effectively foreclosed CLEC intrastate switched access rates you want us to lower your special access rates, as well?

MR. STARKEY: I think I'm not saying that. I think what I'm saying is there is not a problem to either.

(Simultaneous conversation.)

MR. DOWDS: -- you are doing a bait and switch. I mean, you changed the example in midstream.

MR. STARKEY: No. I mean, I wouldn't mind that, yes. I guess what I'm saying is you don't -- in this circumstance you're looking at one rate, a CLEC access rate, and you are saying there is variability here, and this rate that people don't like, and so we need to put some regulatory scrutiny on it. And I guess what I'm saying here is that rate, that service is nothing but a substitute for another service which we have been trying to shine regulatory scrutiny on because there are barriers-to-entry there. We can show and define what those regulatory barriers-to-entry are.

That analysis has been skipped here in my mind. And I'm not suggesting you guys have done anything yet. I'm just saying that when we start talking about how to cap the rates, we have gotten past the most important part of the discussion already and just jumped over it, which is what are the barriers-to-entry, is there a need to do it.

MR. PRICE: This is Don Price for Verizon. The references to special access are a little troubling, because I don't think they really bear directly on what we're talking about here. Because I do see a significant distinction between special access and switched access as special access is typically used by an IXC, and I think really that is the only context in which it has meaning here.

As an IXC, if we realize that we are incurring an awful lot of switched access cost in order to get to a particular customer, we make the business decision to substitute special access. And that's something that's easily done based on the relationship between the IXC and the end use customer.

That relationship doesn't exist for terminating traffic that our customers get to our network because it doesn't matter -- we have no ability to influence how that customer gets its traffic terminated. And so, I mean -- well, because, you know, if John Smith picks up the phone and calls XYZ Communications, and XYZ Communications happens to be the customer of a particular CLEC, it is XYZ Communications and the CLEC that made that determination as to how to connect. The IXC doesn't have any ability to influence them because they are not our customer. John Smith is our customer. He is the one that's sending you the call.

MR. FEIL: I think special access has a huge bearing on competition, and I think the ILEC rates really stifle the wireless and CLEC. Special access is not just to the customer premises for a retail customer. We are talking about the glue that cobbles networks together, and I don't think you can dismiss it as being irrelevant.

MR. STARKEY: I agree with that, but I also want to respond to Don's analysis. I'm afraid we are slipping back into the short-run analysis again, which is we have got one customer, we have got one service, and we have troubles sort of disciplining that one thing. Let's take as an example. Let's say it is Mike Starkey, and Mike Starkey gets a lot of calls, and Mike Starkey is served by a carrier who has high access charges.

Why isn't it that my telephone number doesn't show up somewhere and say, man, we're spending a lot of money getting telephone calls into Mike Starkey's house. Let's get that guy on our network. Let's send somebody out there and market to that guy. It is our loop in most circumstances anyway, if you are AT&T or Verizon in these territories, let's get somebody out there. If we can't beat these guys out of Mike Starkey's house and compete with him, then, you know, we deserve to pay the higher price.

I mean, that's the whole notion here is that if you, as a CLEC, are generating these high fees from these customers and you can compete them away, then the market is doing its job. And there is no barrier to them competing them away.

MR. PRICE: This is Don. If I could, I mean, short-run, long-run, I'm not going to argue that point, but the fact of the matter is that the CLEC goes and negotiates the service agreement with the customer. And that may be a one-year agreement, I don't know, but it is probably some kind of contract. And to assume that somehow or the other there is intelligence in the industry that allows, you know, carriers to have this perfect knowledge of every user and how much that user, you know, imposes costs on the network, I think is pretty silly because it just doesn't exist. Now, in a perfect world it might, but we are talking about the real world.

MR. STARKEY: I agree. And if we regulated every circumstance where people don't have perfect information, we would need a very large commission. I mean, the notion here is that it is doable, it is possible, and it is done. I mean, I can tell you in talking to people who have long distance companies, that when they see a number or a region pop up in red flag, as we are spending a lot of money in that region, they start looking at alternatives. They start looking at can we get some connectivity into that marketplace; can we knock out the tandem rate and go to the central office rate instead? That's what the access management group at these companies do, and it's the right thing to do, because you are trying to minimize your costs over time.

I guess I just keep hearing the notion that it's not easy. That it's hard. And I don't disagree with that, it is hard. But that's the way markets work, is you allow them to sort of solve those problems for you. That is why you have dynamic efficiencies you don't get with regulation.

MR. PRICE: Don Price on behalf of Verizon. To be clear, what I have been trying to say is not that it's hard, I have been trying to say, in so many words, these are the problems that I keep hearing you say you don't recognize.

MR. STARKEY: No, I don't disagree that there are problems. I don't disagree that it's not a perfectly competitive marketplace. We don't have one of those -- we certainly don't have one in telecom. What I guess I'm saying is that you've got -- if you've got two choices as a regulator, and that is you can cap the rates, that's a substantial regulatory move, okay. That's sort of the nuclear bomb of regulation is to set prices.

You have got to have good rationale for doing that. I mean, as you are determining whether you implement that tool or not, you've got to note -- you've got to do this analysis of what are the barriers-to-entry. Could the market take care of this itself if we dismantled some of those barriers-to-entry. And what I just keep hearing people say is sort of jumping over that, what are the barriers entry, and just sort of saying they can't be dismantled, and we haven't even identified what they are.

MR. FOLLENSBEE: To get back to Question 5 directly, and we have all been talking about it, but at AT&T -- this is Greg Follensbee with AT&T. In our view, no, I mean, there's a lot of indicators that the market is not working right. I did allude to this earlier. The other issue that we have got is for some of the changes that need to be made, this Commission can't make them. So the question is if they can't make the right changes, is the more appropriate thing to allow the rates to continue to be high, or for this Commission to do what they can do within its purview. And we think the Commission should take a look to see are there things they could do.

MR. DOWDS: You mentioned there are things that needed to be done that we can't do. Could you expand a little bit on that?

MR. FOLLENSBEE: You can't change the federal law on deaveraging, you can't change the federal law on equal access, because another way we could discipline the market is we basically tell a CLEC you cannot sign up another one of our customers for long distance.

MR. DOWDS: Dave Dowds, again. Is the problem you perceive -- and it goes to Don, as well -- primarily for terminating access or originating or both?

MR. FOLLENSBEE: Terminating is the one you really can't avoid. Originating there are -- the question is if you can deaverage there are things you could do on the originating side to incent customers not to buy from a particular provider at all. Terminating, as Mr. Price has said, there is no way we can avoid it to a mass market. To a particular end user, Mr. Starkey is right, we could try to sell to that customer, and if we are successful we avoid some costs. If we aren't, we aren't. But to a mass market kind of view, no, you cannot avoid us incurring costs, and there is no way that we see we can put the costs back on the cost-causer in that view.

UNIDENTIFIED SPEAKER: (Inaudible.)

MR. FOLLENSBEE: You clearly can't for enterprise customers, which is how the whole market evolved years ago from going from a public switch to more of a dedicated.

UNIDENTIFIED SPEAKER: (Inaudible.)

MR. FOLLENSBEE: That's exactly right.

MR. STARKEY: Which is a good point. I mean, if you look at the CLECs that are in the room, most of them don't serve mass market. Most of them serve enterprise customers. That is not to say that there aren't CLECs who do. I mean, there certainly are. But if we are defining the problem and then trying to figure out what to do about it, you know, do you have the right people in the room?

MR. FEIL: This is Matt Feil. Could I ask a clarifying question, because earlier you mentioned that if the Commission had authority, or if the Commission wanted to look at ILEC access rates, the Commission could do that. Were you saying that it's AT&T's position that in Florida the Commission would have the authority to review ILEC access rates? I was a little unclear on that.

(Inaudible. Simultaneous conversation.)

MR. HATCH: There is case law in Florida to suggest that they don't have the authority on ILEC access rates. There is not synonomous case law in the CLEC context, and there are some differences in how the original case came down. In fact, it was a case against -- MCI filed a complaint against GTE years ago. And so it appears as though there at least is a colorable claim to jurisdiction for CLEC access charges, because the impediment in the Commission's order doesn't address and never applied to CLECs, it applies only to ILECs.

I mean, there's a good reason why that should be, even and beside that, because ILECs aren't like CLECs. We are price constrained. We have regulatory issues that CLECs do not. They can freely come and go, we don't have that kind of flexibility.

MR. FEIL: Since that case you have mentioned that statute has changed three, four, five, six times.

MR. HATCH: The rationale of the statute and what the Commission's rationale in relying on that statute was, I don't think has changed. What it said was that that is the statute, 364.163 that applies and controls ILEC access charges. Those ILEC access charge are capped, blah, blah, blah, blah, blah, when you go read the order and pull all the rationale out, but that has never applied to CLECs. So it at least certainly opens the door to examine whether the Commission can pursue CLEC access charges.

MS. RIDLEY: This is Carolyn Ridley with TW Telecom. If the CLECs can freely come and go, then we wouldn't be having this workshop. I'm just begging the question on that one, because I thought you raised a good point about CLEC rates, period, overall, but if we truly are free to come and go, then we wouldn't need this.

MR. HATCH: I'm not sure that I understand. But if it an issue, then I will say CLECs have to stay all they want to.

MR. NELSON: Tracy, this is Doug Nelson. You just mentioned that 163 caps network access service rates.

MR. HATCH: Yes.

MR. NELSON: That's not the same to me as saying you can't reduce them. The cap is on the upper end. And with all of this other jurisdictional responsibility the Commission has, we have had competition, control monopoly behavior, 163 doesn't really seem to be an issue. Or it certainly seems like something that should be sort of an example for addressing ILEC access rates.

MR. HATCH: I guess my only response to that, Doug, is that anybody in the room is free to reduce their access charges any time they want to. But when you are dealing with the reality of the marketplace that we have, two things happen. One, in our case as an ILEC where do we go to replace those revenues? Second, the next question is why would you voluntarily blow a hole in your foot when none of your other competitors are likely to follow suit?

MR. NELSON: Well, I'm saying why wouldn't the Commission order you to do it?

MR. HATCH: That's a whole different question. But your point was that we could voluntarily reduce access charges, and that is not a rational thing to do in this marketplace.

MR. DOWDS: Tracy, Dave Dowds.

Could you provide staff a cite to the order you are referring to?

MR. HATCH: I could.

MR. DOWDS: Thank you. (Inaudible.)

MR. HATCH: I think it was '97 or '98.

UNIDENTIFIED SPEAKER: Yes, I remember it was.

MR. STARKEY: Can I ask an admittedly unfair question?

MR. HATCH: No. That was Tracy Hatch.

MR. FOLLENSBEE: My answer is, no, you can ask it.

MR. STARKEY: And I hate to ask it, because I don't know the answer. Does the AT&T IXC and the Verizon IXC pay their respective CLEC access charges, tariffed access charges when they terminate long distance calls to them?

MR. HATCH: Yes.

MR. STARKEY: At Verizon they do, as well?

MR. PRICE: Yes.

MR. HATCH: The mergers never affected the access bills. They come in, we pay them.

MR. STARKEY: And that's true in Florida. We don't know about everywhere. That's even more unfair.

MR. FOLLENSBEE: No, it's true everywhere.

MR. NELSON: This is Doug Nelson. I mean, the corporate books are done in New York City for Verizon, and they are done, as I understand it, for Dallas for AT&T.

MR. FOLLENSBEE: Not quite yet. We haven't completed that move yet, Doug. No, it's in San Antonio.

MR. NELSON: San Antonio, okay. Wherever they are done, though, the corporate books, and you have a revenue coming in from your own IXC, or your wireless entity, and you have costs going out, basically. So is it the costs and revenues?

MR. STARKEY: No, I totally understand that. I was really just trying to -- I didn't know whether they did or not, or whether they did an intercompany transfer or something. I didn't know.

MR. HATCH: No, it is an actual bill and checks are cut.

MR. FOLLENSBEE: This is Greg Follensbee. Particularly since we file tariffs, we could not discriminate in how we then charge rates under those tariffs to basically give free service to ourselves.

MR. MASTANDO: This is Tony Mastando. Did you guys make that arrangement via a tariff or is it a written agreement?

MR. FOLLENSBEE: No, it's a tariff. We charge pursuant to our tariffs to anybody that buys that service. So when AT&T Long Distance is calling from AT&T Florida to AT&T Communications Southern States, Inc., AT&T Florida charges on the originating side, AT&T CLEC charges on the terminating side to AT&T Long Distance pursuant to the tariff.

MR. STARKEY: Maybe while they're talking about that, it's time to go to 6.

MS. WATTS: I was going to ask a follow-up question. This is Jerry Watts at DeltaCom. You guys may or may not know.

Relative to the merger integration activity you guys are engaged in, do you guys have any information relative to traffic was formerly AT&T -- or not AT&T, BellSouth LD traffic, is that being moved to the legacy AT&T LD network, or do you guys know, so that minutes that were formerly AT&T -- I mean, BellSouth LD minutes from a capped billing standpoint would now be AT&T LD minutes, or do you have any sense of that?

MR. FOLLENSBEE: You're asking us or asking the staff, I'm sorry?

MR. WATTS: I'm asking you.

MR. FOLLENSBEE: This is Greg Follensbee with AT&T. As a general proposition, I believe that for large customers we would normally use AT&T Long Distance. The IXC is what we are selling. For mass market we are actually using DSLD as the preferred provider, not moving DSLD long distance to replace it with AT&T legacy.

MR. WATTS: Okay, thanks.

MR. STARKEY: Are we ready for 6?

MR. PRICE: Before we do, Don Price, Verizon. I just wanted to say that similar to AT&T's comments, we also don't believe that the market is structured in such a way so that competition disciplines (inaudible).

MR. STARKEY: Six. Do market forces applicable to originating switched access differ from the market forces for terminating switched access? Looking at Gus' notes here, and this is where I wish I had him, because I think we say -- I think -- the notion here is yes, they probably do somewhat, and Gus has notes here written that it's a difference between the supply-side and demand-side characteristics of the market, which I don't know what he means by that. But what I guess I would say is that they probably do a little bit, probably just because they do today. They wouldn't necessarily have to in the long-run, but they do today primarily because there is a little bit more control that the IXC has on the originating customer that they don't on the terminating customer.

That is not to say they couldn't get that same level of control in the terminating side by doing some of these things we talked about. But probably as the market rests today, there is somewhat of a difference. And I think we have said here that as the very last thing an expectation on the part of regulators that terminating exchange access rates do not exceed originating exchange access rates would not be unreasonable. We have thrown out in other places that if, indeed, there are different market characteristics, the much preferred solution to benchmarking is simply to say terminating must equal originating, and let the characteristics of originating to the extent they are more competitive dictate the rate.

Now, again, a three-step process. We don't think we have established that there is a problem or that we have identified the barriers-to-entry that would make it so, so we are back to that level again of if you have done all of that and identified that there is a problem, then the far better solution than benchmarking is to tie those two together.

MR. DOWDS: You're saying that a CLEC should charge the same rate for originating and terminating?

MR. STARKEY: Yes.

MR. DOWDS: What if I tell you they primarily do?

MR. STARKEY: Good. Then we have even less of a problem. I mean, the notion here I thought for this question was that there are differences in the characteristics of the market associated with originating and terminating, and I think we would agree to some extent there are in some circumstances in today's market. And that if one is more -- has fewer barriers, and we don't know that there are barriers, but if it has fewer barriers, then if you match the two of them, they are both disciplined by those fewer barriers. I'm sorry, it was more of a theoretical issue point.

MR. FOLLENSBEE: This is Greg Follensbee with AT&T. I'm not sure I followed all of what he said, but I think when I get to the conclusion, I think we would say, no, that originating and terminating really isn't much of a difference, and that's probably why you are seeing now that to the extent regulators have set prices in the past or they have been approved in the past that you are seeing an equalization between originating and terminating. The only difference that might take place in cost is the set-up time to do originating versus terminating, which is not a major cost, but there is actually a differential in cost between the two. But the rates are pretty much the same.

MR. PRICE: Verizon has nothing to add beyond what Mr. Follensbee said.

MS. SIMMONS: I would like to ask a question. It is kind of following up on that last point on the slide, because that had occurred to me about, well, perhaps, you know, it can kind of constrain a little bit what goes on with terminating by tying that to the originating rate.

MR. STARKEY: Right.

MS. SIMMONS: I had an additional thought that might possibly go with that, or maybe it wouldn't. And I was wondering if there would be any impediment to this. I'm just interested in your collective reactions here, and that is I was wondering about having an approach whereby an IXC, say, on the originating end, let's say in addition to that provision, let's say we had that provision, but in an addition let's say the IXC -- and I don't know if there are legal barriers to this, but let's say the IXC would have the option in the situation where a CLEC's originating access rate is greater than the prevailing ILEC rate, that the IXC would have an option to indicate to the CLEC that I don't want to be on the list of available carriers for your end users. If there wasn't any legal impediment to that, presumably what I was thinking is the IXC would only resort to declining the traffic if it was just unprofitable to take it. But if it was an instance of, well, maybe it is not as profitable as you would like, but still profitable, I was thinking an IXC would still take the traffic. Anyway that's just an idea. I wanted to see what the reactions would be to that. And I was also interested in if anyone thought that there were legal impediments to an IXC saying, I don't want to be on the list of pickable carriers for a particular CLEC. And I'm just interested in any reactions to that.

MR. FOLLENSBEE: This is Greg Follensbee with AT&T. I would raise the same question. I have been preliminarily told there is a legal constraint, but I can't tell you exactly what it is. So your answer -- my answer would be, if there was not a legal impediment, I would think we would already be doing it. So that must mean to me there probably is, because I can't believe if we weren't incurring higher costs to originate traffic that we wouldn't just stop doing it as a way to try to discipline the marketplace.

But we'll be glad to confirm that it is the legal impediment that has caused us not to do it. Because otherwise, if it is a legal impediment, then what you are surmising is right, it must not be as big a cost issue that we are accepting what is going on in the marketplace in that way. And I don't believe that's occurring.

MS. SIMMONS: Yes. I was trying to differentiate. Obviously blocking is a no-no, but, you know, declining traffic, I was thinking that might be a different situation. Also I know the CLECs are concerned about benchmarking to an ILEC rate, but this would be sort of a different kind of benchmark. It would be such that the CLEC could charge more if they were so inclined. But, I mean, then the ILEC would have the option of either accepting or declining the presubscribed traffic. I don't know what you would do about the dial-around traffic.

MR. FOLLENSBEE: Yes, but dial-around is not -- there is not that many people using dial-around any more anyway.

Sally, I don't know. I mean, being that AT&T was the legacy provider at divestiture, I don't know if there is some requirement there that is different than the other IXCs. I mean, I know for instance, all IXCs didn't immediately have to serve in ICO territories. They chose when they wanted to enter that marketplace. We couldn't exit, so we will just have to research to see if there is some condition on AT&T that is preventing us. Which is what has been represented to me.

MR. HATCH: If you go back to the original AT&T certification order that goes way back to divestiture, there was a requirement in that order that made AT&T the carrier of last resort for toll within Florida. As far as I know, that order has never gone away. But how much validity that would still hold is the crux of the question that needs to be answered.

MS. BERLIN: This is Susan Berlin. I know BellSouth Long Distance solicits agreements with CLECs in order to sign that CLEC's customers up for BSLD service, and many CLECs have refused to enter into those agreements. So presumably there is very little, if any, BSLD traffic originating on CLEC networks.

MR. PRICE: This is Don Price with Verizon. I was going to say I think what I just heard you say, Susan, only sort of from the opposite perspective, which is from the IXC perspective it's not clear to me that we get a lot of originating traffic from the CLECs, because the arrangements that they have are with their own affiliate LD companies, and so that originating traffic is going to them, and it really reflects on the terminating issue that we have talked about before where the problem occurs, because there is no way to get around those rates in the terminating.

MS. SIMMONS: So you think the IXCs are much more concerned about terminating rates?

MR. PRICE: Yes, because I think -- like I said, I think it is sort of the opposite of what Ms. Berlin just said, which is that we don't see nearly as much originating traffic from the CLECs as we do terminating traffic to them.

MR. MASTANDO: This is Tony Mastando with DeltaCom.

I think that that is true, but for perhaps (inaudible) 800 traffic, toll free traffic. We might see a little bit more, you know, from a BellSouth customer or a Verizon customer calling into an 800 or we have our vice-versa.

MR. STARKEY: Doesn't that in and of itself tell us something, that if you are a CLEC and you have access rates that are so high that they earn you supernormal profits, wouldn't the quickest way to shoot yourself in the foot be to serve long distance to one of your own customers? Why wouldn't you open it up to equal access and let every other IXC serve your originating customer so you can reap the supernormal profits of the switched access rates?

I mean, the fact of the matter is these guys go out there and sell long distance on the originating end, and do away with those switched access rates because the profitability on toll is obviously better. But that being said, back to your original question. I think it does turn -- I see what you are trying to do, you put leverage on them to make an economic decision about the entirety of what they do, originating and terminating, that leverage sort of turns on the profitability of the originating side. And if they don't have a lot of originating, then it's pretty easy to say take me off, I don't want to pay terminating, either.

I like the notion. I think it's a perfect game theory. I just don't know if there is enough leverage generated on that originating side to make it work. It's probably an empirical question, I don't know the answer to that.

MS. SIMMONS: It was just a thought. I wanted to throw it out there.

MR. STARKEY: I think it is an intriguing thought, and I have written it down so I'll run it by the smart folks at the firm and see what they think.

MS. SIMMONS: The whole idea was to the extent there is more -- well, of course, your last point on the slide, I think, goes to the point that there might be a little more leverage on the originating end, so maybe you can discipline the terminating rate through the originating rate, and then I was just trying to take it a step further. If the IXC had an option to accept or refuse the presubscribed traffic under the scenario where the CLEC rate, originating rate exceeds the prevailing ILEC rate. It is kind of like --

MR. STARKEY: They have to make a decision about the whole package.

MS. SIMMONS: It's kind of like a different kind of benchmark. A different kind of benchmark. It's a benchmark that would trigger the IXC's option.

MR. STARKEY: Agreed. No, I like the notion. I'm going to run it back by the folks who helped with the white paper inside the firm and see what they think. It's intriguing. I like the notion. It's probably an issue of how much originating there is whether it turns to be to work or not, but we will see. Let's think about it.

MS. SIMMONS: Okay.

MR. DOWDS: Moving along.

MR. STARKEY: Okay. Seven. Under what conditions, if any, can a carrier decline to terminate its traffic to another carrier.

I think here you kind of have to parse the question. You sort of have to talk about -- well, let me just go through my response. You sort of have to talk about are you talking about disconnecting when you say decline to terminate, or are you talking about just not paying when you do terminate. We think that there are -- and we talked earlier about this monopsony power. From the CLECs' perspective, if you were to disconnect AT&T because they didn't pay you or didn't pay you the tariffed rates, then it's your customers who really suffer. I mean, you have to go to the marketplace and say, look, I can give you phone service, but you can't receive calls from AT&T. And it's not a selling proposition in the marketplace to do that. They know that they are cutting their own throat by taking that sort of self-help.

So, no, I don't think realistically they can decline to terminate the traffic. And that's sort of the second point we made there also, which is any part of this debate has to recognize that CLECs just don't have that ability. That's why I sort of -- we are sort of left with -- because this monopsony power exists, this notion that we don't have equal leverage at the table to say, look, either pay us our rates or we'll cut you off. That it's important that if regulators step in, that the rates that ultimately result are compensatory, because we don't have the market power necessary. We have no market power. We don't have the leverage negotiation ability to say this rate needs to be compensatory.

And, again, we make that comment at the end there, again, about special access to sort of show that there is monopsony power in one and there is not in the other. If we refuse to pay their special access charge, they would just cut us off and we would suffer, so --

MR. FOLLENSBEE: Greg Follensbee with AT&T. I think that's a little bit simpler answer. The FCC has stated in an order, no carriers, including IXCs can block, choke, reduce, restrict traffic in any way. So the FCC says you can't do it as a way to try to control the marketplace.

MR. STARKEY: Let's take that one step further, though. Let's take the scenario where you are a large IXC and you are terminating traffic, and you don't like the rate you pay, whether it's tariffed or not. And you simply say I'm not going to pay. You refuse to pay until you charge me a lower rate or a rate I'm comfortable with. That's not disconnection.

That doesn't fall under at least -- again, you're not playing lawyer poorly -- that I don't believe that falls under the FCC's prohibition on disconnection. But it happens in the marketplace, and it's a vehicle in this market that sort of impacts how prices are set and how revenues flow between the two companies.

So you may not be able to disconnect, but you can refuse to pay. And if you are a carrier, a large IXC, who constitutes an enormous revenue stream, and I should also say not only a revenue stream, but an enormous cost burden on the CLEC because of the capacity necessary to support your traffic, then not paying is a whole lot worse than disconnecting.

MR. HATCH: It seems to me that's what Matt was talking about earlier.

MR. STARKEY: It was, I believe. That's why I was looking at him to see if he was going to chime in again.

MR. FEIL: Well, the only other thing I was going --

MR. HATCH: I'm sorry, that was Tracy Hatch.

MR. FEIL: This is Matt Feil. AT&T's right on the issues in Issue 5. AT&T says the fact that under current access structure IXCs cannot decline high rates tariffed by CLECs is evidence of some market failures that would allow competitive pressures to constrain CLEC rates.

In my experience, in FDN's experience that's not the case. The IXCs, and AT&T in particular, do decline to pay tariffed rates. It's not as though they have accepted the tariff rate and paid it, rather they just said we didn't order the service, so we are not paying you anything, tariffed or otherwise.

MR. HATCH: But this is not where it stopped.

MR. FEIL: Where your comment stopped, you mean?

MR. HATCH: Well, that's not the end of the entire saga, as I understand it. Ultimately they paid you something.

MR. FEIL: The tariffed rate?

MR. HATCH: I honestly don't have any idea. You would have to tell me.

MR. FEIL: Well, whenever you enter into discussions there are confidentiality --

MR. HATCH: I understand that.

MR. FEIL: -- problems associated with the settlement, and if AT&T is going to say whatever confidentiality pertains to that is waived for purposes of letting the Commission staff know, then we'll discuss that. But the fact of the matter is in the FDN case they didn't pay, refused to pay, tariffed or otherwise, it didn't matter. And I surmise and suspect that the same is true, the same sort of shakedown for other CLECs.

MS. BERLIN: This is Susan Berlin for NuVox. And, you know, it's a very sensitive subject, and it's difficult to talk about, but just recently I found an order from the

Kentucky Commission, and it is from 2003, actually, but it sort of states -- it was a Brandenburg Telecom filing a complaint against AT&T. And Brandenburg, I think, is an affiliate of an ICO, is a CLEC affiliate of an ICO in Kentucky. It complained that AT&T was not paying its access bills at all to Brandenburg.

AT&T claimed -- you know, it is a very short order, and the paragraph I'm going to cite is very brief. It says AT&T claims it never ordered switched access service from Brandenburg. AT&T admits it provides long distance service to customers in Kentucky, including some end user customers who receive local exchange telephone service from Brandenburg. AT&T admits that it has not paid Brandenburg for intrastate switched access services. AT&T has informed Brandenburg that it will only pay for access services that it orders through a ICA (phonetic) for access service. AT&T claims that this document will contain additional terms and conditions not found in Brandenburg's tariff.

So in this particular instance, which is public record, Brandenburg had a tariff and it was billing AT&T, and AT&T was refusing to pay in the absence of a special agreement. And it's my understanding that jibes with the experience of many, maybe most CLECs across the states.

MR. HATCH: In the context of what we are talking about in terms of disciplining CLEC access charges, did it cause either of you, or Brandenburg, or FDN to reduce its access charges?

MR. FEIL: I thought I already talked about the confidentiality.

(Simultaneous conversation.)

MR. HATCH: Your switched access rate that you claim we should have paid, did you change that and reduce it because of AT&T's actions?

MR. FOLLENSBEE: To all other carriers?

UNIDENTIFIED SPEAKER: You mean to carriers other than AT&T?

MR. HATCH: Right.

MR. FEIL: The tariffed rate changed over time, but can I say it was a result of the dispute with AT&T, I don't know that I can say that. But over time FDN's rates, I believe, if memory serves, changed.

MR. HATCH: Did they go down or up?

MR. FEIL: I believe they went down over time.

MR. FOLLENSBEE: This is Greg Follensbee.

MR. TWOMEY: I would like to address this, if I could. My name is Chris Twomey, I'm counsel for AstroTel, a small CLEC in Sarasota. And I have some general comments to make after we get through all of these questions regarding QSI's (inaudible).

But specifically regarding AT&T's arguments that they do pay the switched access tariff, AstroTel is not constrained by the nondisclosure agreements that many other CLECs are. And I would just like to say real quickly what their experience is. I'm looking right now, in fact, at the standard form letter that AT&T sends CLECs who bill AT&T a rates that they don't agree with. And AstroTel's rates are the mirrored rates, these are the rates that the ILECs charge. They are filed at the Commission (inaudible) and they change over time as the mirrored rates from the ILECs change, as well.

And the letter is really very clear. It makes no bones about it. It says either you are a contracted company or you are a non-contracted company. And AstroTel takes the position that it's contracted because it has tariffs that reflect the rates of the incumbent. But that's not the stance that AT&T takes. Instead, they consider AstroTel to be a non-contracted company, and there are a bunch of different checkmarks. It says, well, your billed rates are incorrect for the following reason. The interstate rates they don't like saying they are not (inaudible) by the FCC although they are the rates that AstroTel charges. You know, the rates that are filed every July.

And then for intrastate, it specifically says AT&T Corp has not reached agreement with your company regarding intrastate rates (inaudible). Please contact us at your earliest convenience. Now, in my mind that is a direct refusal to pay intrastate tariffed switched access rates. I think the staff should be aware that these letters exist.

(Simultaneous conversation).

MR. FOLLENSBEE: This is Greg Follensbee with AT&T. I guess then I am encouraged by the fact that we are trying to discipline the marketplace. The question is is the discipline working.

MR. TWOMEY: I can say that with respect to AstroTel, it has not changed its rates. AstroTel says that the rates that are tariffed by incumbents in their territory are, in effect, benchmark rates, although they are not specifically benchmarked, but they are the rates that AstroTel is supposed to charge, is going to charge them, and it is going to expect AT&T to pay. AT&T hasn't paid yet, but AstroTel sure is not going to change its rates to reflect what AT&T feels like it should pay. That's why there needs to be regulatory intervention in this market, because that's a failure.

MR. FEIL: This is Matt. I think the other point of this statement Chris illustrates is that what is portrayed in your response on Issue 5 isn't entirely the case, where you say IXCs cannot decline high rates tariffed by CLECs, because you have.

MR. FOLLENSBEE: And, Matt, I appreciate it. Again, I didn't know this was going on, and I will find out more about it, because this was clearly the policy of the company. We wouldn't have put it in there if it wasn't. So now I've got to go back and say, all right, guys, why is practice not policy. And I'll be glad to share whatever information I can find out on this.

MR. TWOMEY: Again, this is Chris Twomey. Just to be clear, I wasn't suggesting that you had any knowledge one way or either about that. I just wanted to make clear that this is going on, and I hope you can follow up.

MR. FOLLENSBEE: I will. But, I guess to go to the higher point, if that's a way to try to discipline the marketplace, what I'm trying to understand is I'm hearing, well, no, that is a bad way to do it.

UNIDENTIFIED SPEAKER: (Inaudible) -- Sprint-Nextel the same to you, the same kind of form to discipline the marketplace with respect to your rates wouldn't have any different impact than you are telling them that it would have on their rates?

MR. FOLLENSBEE: I don't know. Honestly, I don't know.

(Simultaneous conversation.)

MR. FOLLENSBEE: Set it and see what happens. I have no idea.

UNIDENTIFIED SPEAKER: I'll have it on your desk tomorrow morning.

MR. STARKEY: And that is one of the reasons I asked earlier whether AT&T Long Distance pays AT&T the CLEC and Verizon pays the CLEC the tariffed rates, and they apparently do. It is problematic if they pay their affiliate the tariffed rates, but don't pay others the tariffed rates. I guess the whole point of this is not to sort of make for an embarrassing situation, it's really meant to sort of highlight the notion that it is a complex issue. That the marketplace isn't as simple as might be portrayed by the FCC when it says, look, it is a bottleneck facility. It doesn't work. You have got to set these rates. That the analysis, this three-step analysis we keep talking about is credible because you have to understand all the various complexities associated with it.

MR. PRICE: Don Price for Verizon. With respect to the question, if we are talking about the physical act of terminating traffic that comes to the IXC's network, it is true, as Mr. Follensbee said, that the traffic has to be terminated. All the rest of this stuff is interesting, but I'm not sure it gets directly to the question.

MR. HATCH: This is Tracy Hatch with AT&T. For the CLEC community, at least it appears that AT&T is declining to pay what otherwise are tariffed switched access charges. Is it the CLEC community's position that that is okay or not okay? I'm getting the impression that's not okay, so we are sort of back to where we started in the first instance.

MR. STARKEY: But I guess what we are saying is it a clear exercise of monopsony power. Because as I think Doug was saying, if Sprint came to AT&T, AT&T probably doesn't get enough from Sprint to say, you know, okay, fine, we'll sue you. Or, fine, we will go and exercise our tariffed rate. It really is that exercise of monopsony power that is the problem here. And if we are going to examine market distortions in this analysis, then that is a distortion we should look at. That was really the point I wanted to make with it.

MR. HATCH: And I guess my only point is that if we can't decline, which it appears the CLECs say we can't, then the enforcement issues in terms of disciplining the market seem to go away.

MR. STARKEY: Well, they are back to what we talked about earlier, competing them away, which we may agree or disagree. It's fundamental. Are we on 8? We are at 8, right?

MR. DOWDS: Eight.

MR. STARKEY: On what basis can it be determined if CLEC access rates are just and reasonable? Here we sort of suggest that just and reasonable, you know, again, is a definitional issue. What do you mean by just and reasonable? Do you mean the legal standard or do as mean as the market would produce it? We think the market produces just and reasonable rates as they are today. And if the question is how do we determine that, or how do we prove that, then, again, I think is that three-step process. And I know you are all getting really tired of me saying that, but it's the same way we do anytime we decide whether to regulate or not. We determine whether there is a market distortion; if there is, we identify the barriers-to-entry that allow that market distortion to exist; and then we talk about dismantling it.

So that is the process that at least in my opinion should happen, if we really want to examine the issue of are they just and reasonable. And we believe that they are.

Again, our next couple we'll come back to. When you are at that third stage, let's say you have gone through that process and determined there is a problem, but you just can't, there is no physical, or economic, or technological way to overcome those market barriers, then what do you do in terms of regulation? Then we suggest that costs do matter. That benchmarking to the ILEC rate is, we believe, demonstrably below our cost in some circumstances, and that this reasonable presumption that we should benchmark there and then prove otherwise puts an inequitable burden on us to do so, because we know from many perspectives that the costs are very different.

MR. PRICE: This is Don Price for Verizon. I mean, Verizon believes that the benchmarking process set by the FCC is a good approach. And we heard this morning that, you know, that was an order that was ill conceived, et cetera, but the order stands.

We also heard this morning that somehow or the other that the benchmark approach that was adopted by the FCC there was something that was a departure from the FCC's previous reliance on costs, and I disagree with that for the simple reason, A, that for the ILECs the FCC had already departed from a strict cost basis for rate setting. They had already removed price caps. And as the order itself says, the question was -- and I think, Mike, you used the term expedient. I don't think that's necessarily the word the FCC used, but it did say, you know, look, we face a problem here, and the problem is how do you come up with something that is a reasonable proxy when we have no information whatsoever about CLEC rates, and we have never looked at them, we have no data, we have no history, we have nothing. And what they concluded was, look, we have looked at ILEC rates. Those have survived scrutiny, and they do make a reasonable benchmark.

And so I think for the reasons that I disagreed with what he said this morning about that order, I think that in itself is good cause to look at what the FCC did as a reasonable basis for benchmarking. And, by the way, the dissent was just a dissent, so --

MR. STARKEY: Scathing, I think.

MR. PRICE: Scathing, but just a dissent.

MR. FOLLENSBEE: I'm sorry, this is Greg Follensbee, AT&T, (inaudible).

MR. PRICE: Whatever they were.

MR. FOLLENSBEE: No, I was listening to them. I agree with what you said.

MR. STARKEY: I think the only thing that I would add to that, and I have been in these proceedings where you were looking at the access rates of an old -- or you're in a TELRIC proceeding and you are looking at the TELRIC rates of an old GTE territory, or of an Embarq territory, or a territory like that. And you say, look, let's use the RBOC UNE loop rate and let's benchmark it. Let's say that in Columbia, Missouri, which is an old GTE exchange, used to be, let's use the rate for St. Louis. Let's use the unbundled loop rate for St. Louis, which is an SBC exchange, and let's make it as proxy.

The ILECs fly off the handle. I mean, this has got to be based on our costs. These are our costs that matter. These proxies doesn't give us a right, an ability to compensate us for our costs. And I guess what we are saying here is what is good for goose is good for gander. That the notion here is that costs do matter, and that there is not enough information at a minimum. We think there may be enough information to suggest that their rates aren't compensatory for us, but let's put that aside and say we don't know. So at least there has got to be some analysis, in our opinion, that says the rates we are setting for you, whether benchmark or not, are compensatory.

MR. MASTANDO: This is Tony Mastando with DeltaCom.

That decision with the FCC was intended to be an interim decision until they revisited it through intercarrier compensation. Also, I can understand whether it's expedience or administratability, the FCC didn't want to get in the cost case for 50 states and 700 competitive local exchange carriers. That is a daunting task for any regulatory body. And so we are a little bit closer to the ground here in Florida. So the FCC operated under, you know, a different regimen, nationwide regimen than we are operating here in one state.

MR. PRICE: This is Don Price for Verizon. The hat that I wear, one of the hats that I'm wearing here at the table today is that of MCImetro Access Transmission Services, d/b/a Verizon Access, which is a CLEC. And in every state where the regulator has followed the FCC approach and established a benchmark, we have quickly complied with that, and have never gone to the effort of trying to determine whether that particular rate for a subset of our services was compensatory.

Because, frankly, like I said earlier, at some point we hope that along with, I think, most everybody at the table here, we hope that we can get to a point where all the distortions in the switched access rates that have built up over the years are ultimately gone, you know, go by the wayside. And, to my knowledge, no one has ever -- no CLEC has ever tried to challenge the benchmark at the FCC and tried to demonstrate something above that for purposes of its interstate access rates, to my knowledge.

MR. STARKEY: They have. Digiwave (phonetic), I think is the name of the company, and they just recently did it, too, about a year and a half ago, and the order just recently came out. They were a small CLEC that operated in ICO territories somewhere in the midwest. And they filed a cost study and the FCC didn't even look at it. The FCC sent the order back and said costs don't matter.

And, again, I'm grossly paraphrasing. But they basically said costs doesn't matter. No, thank you. So, I mean, I think that horse is out of the barn at the FCC, that the FCC doesn't care about costs. They really just want to benchmark it and leave it alone.

MR. FOLLENSBEE: Do you mind if we take a short break?

MR. DOWDS: Sure. Take ten.

(Recess.)

MR. DOWDS: What we are going to go is skip the next three and go to 12, and basically wrap up, because 12 is the one (inaudible).

(Simultaneous conversation. Inaudible.)

MR. DOWDS: Let's have folks address Question 12.

MS. KAUFMAN: Could I just say one thing before that, Dave?

MR. DOWDS: Yes.

MS. KAUFMAN: We brought a lot of people here, and put a lot of effort into our presentation. I hope that shows. We would just like an opportunity to kind of maybe hit the highlights briefly and not skip over some of the questions. Would that be all right? I thought you were saying you want to jump to --

MR. DOWDS: Well, just 9, 10, and 11 we basically addressed quite a bit in response to questions.

MS. KAUFMAN: Well, I guess that may be true, and if Mike thinks so, but if he can --

MR. DOWDS: If you disagree, we will quickly go through them.

MR. STARKEY: I think we have. There may be a couple of extra points I might take a couple of minutes to make.

MS. KAUFMAN: Mike talks really fast.

MR. STARKEY: I mean, 9 is really a legal question in my mind that I'm not equipped to answer anyway. I mean, the attorneys have written something here. We could probably skip to 12. I think the more important issue may be just allowing us to hit two or three of the points in our proposed questions, but I can do that very quickly.

So, 12, if the Commission opts to maintain allowable CLEC access rates through some means other than rate caps, what options are available? Here, again, I think we make -- we put forward the notion that why are we just looking at CLEC access rates? If this is problematic, I think as Doug pointed to earlier, why not look at all ILEC rates? And then, more importantly, and to our position is the FCC is supposed to fix intercarrier compensation. The FCC's benchmarking for interstate CLEC access rates was interim with the notion being that they are going to fix intercarrier compensation in total. We would say let them fix it. Our understanding is it is supposed to be coming in, and I know you are all going to laugh when I say this, but it is supposed to be coming in in the next 60 to 90 days, something on this notion.

UNIDENTIFIED SPEAKER: I've heard this before somewhere.

MR. STARKEY: Yes, I've heard that before, too. But the bottom line is that doing it piecemeal is problematic, as I think we have seen as other regulations are implemented. Especially when you are looking just at CLEC, one competitor as opposed to the market for this particular -- the product market in question. So that's sort of our first response.

The second response is we think that the tools exist to make the market more responsive if it's not responsive enough. And that is as -- at least in my opinion, and hopefully my attorneys will back this up later, but on the intrastate side deaveraging rates is not prohibited. And on the interstate side, that a broader reading of 254(g) by the FCC that could be encouraged by the Florida Commission, or the

Florida staff, certainly would also help to strengthen the market to the extent it needs it.

And then, again, the FCC, or the Florida Commission should participate fully in the FCC's endeavor to address all the intercarrier compensation issues in a comprehensive manner, which, again, we think is the right way to sort of deal with this issue.

MR. DOWDS: Other comments? Let me modify this question just a little bit. It says other than rate caps. Are there any alternative forms of rate caps that might be more palatable than pegging them to the RBOC rates? I think the answer is no, but --

MR. STARKEY: Well, no, I think the answer is yes. I mean, given the Hobson's choice of you must take the ILEC rates or are there other alternatives you would prefer, given that Hobson's choice, yes, there are others. And I think I mentioned them earlier, proxies relative to ICOs which are more aligned in terms of scale and cost to the mid-sized ILECs. And perhaps even if the notion is that there is a broad disparity across the marketplace in terms of rates for access, determining sort of a benchmark based on an average, I don't know. I mean, we really haven't talked about those kind of things because we don't think there is a problem. We just know that the ILEC rate is the right one, so --

MR. DOWDS: RBOC rate.

MR. STARKEY: Right. The large ILEC rate.

(Simultaneous conversation.)

MR. STARKEY: We struggled with that, too.

MR. DOWDS: Don.

MR. PRICE: Yes. Don Price for Verizon. As you might suspect, you know, we think there is some limited variation. One possibility is just setting a rate, having the Commission set a rate and say this is it. Connecticut did that (inaudible). The problem with that rate or with that approach is (inaudible) and, you know, raises the prospect that if the Commission at some point in the future decides that that rate is not right, then we have got to go through something else in order to reset what the standard is.

Long-term arguably where we would be is at a place where we could all negotiate rates that are just contract type arrangements so that everyone could negotiate something, which because of the structure of the market I think we are a ways away from that. So options are rather limited today.

MR. FOLLENSBEE: This is Greg Follensbee with AT&T. We don't really at this stage see any viable options to use other than that. As I said, I mean, somehow there is a misconception and maybe because of what we said in Texas, which I need Heidi (phonetic) to read, but as I said, we are not opposed to having the cap be the default and letting the company come in and justify higher rates.

A group of customers, you know, CLECs could come in. I mean, there is a lot of ways we could look at doing this. I think we are all trying to get to the end result, which is to create a more competitive marketplace in this arena. But given that we don't agree that we have the ability to deaverage rates in this state, and --

MR. DOWDS: Legally or --

MR. FOLLENSBEE: I think legally, but (inaudible).

MR. HATCH: My understanding is there is a legal reason out there, as well, but it's a practical reason, as well, when you start creating, literally, customer-specific rates, or ILEC-specific rates, or CLEC-specific rates. Because if you don't do that, then you have some level of averaging, and when you do that, then higher than average access rates are going to take advantage of deaveraging.

MR. DOWDS: Anyone else? Doug.

MR. STARKEY: I think I can make our other points in two minutes.

MR. DOWDS: Okay.

MR. FOLLENSBEE: Let me further say something. I mean, if, in fact, the FCC is going to do something in 60 or 90 days, I mean, we sure wouldn't be opposed to waiting to see what they are going to do, but not have this -- it's going to be the status quo forever. I don't think 60 or 90 days in the grand scheme of things is going to really -- that we need to move immediately, in other words, to do something on this. In fact, we are going to get some direction from the FCC. I'm not sure I agree we will, but --

(Simultaneous conversation.)

MR. FOLLENSBEE: It would be nice.

MR. STARKEY: I don't think I can posit it's something that is going to happen. Okay. I was just going to flip to -- we threw out some additional questions in our presentation we thought would be interesting to answer. I am going to flip to Slide 41 now and make just a couple of points, and I think we will largely be done.

And here it is an issue we have raised before, but I wanted to just kind of put a point on it, which is you can kind of see -- I can kind of see where the CLECs are coming from when they look at their business, and they say what I pay in special access, access to build my network in many circumstances, the same network that I use to provide AT&T and Verizon long distance services has gone up dramatically over the last three to five years. Not only in the prices I pay, but the fact that I'm no longer able to get UNEs for some of it, but now I must pay special access.

As my cost structure is increasing because of these two carriers charging me more for building the very network they use for switched access, it's also being advocated that I should charge them less to use it. That's part of the problem here. And it gets to the fact that -- and when we do these cost studies it is not uncommon to see that within a CLEC, depending on how they build their network, it's not uncommon to see 40 to 60 percent of their total cost structure associated with transport and the other factors that contribute to switched access being based on special access rates they pay to the ILECs, primarily AT&T and Verizon.

So as those costs increase, and then we are being forced on this side to decrease the switched access rate for the very same facilities. I mean, these are the facilities that support our switched access services, that's problematic. That is a price squeeze in some ways. I mean, that is the business problem that exists in this particular scenario.

I think the other thing I would say -- the same is true of collocation, as well, because that is obviously an important component here, as well. And I think -- was there one other point I wanted to make? I think there was just one other point I wanted to make, which gets back to -- well, I think I'll stop there, unless somebody else wants to make a point about something else.

I guess the last one I would make is this notion that it is a complex analysis. That you have to take that three steps. If you don't take the three steps you are really shorting the process. We shouldn't just start at, okay, how do we fix this problem. We should start at, okay, let's define what this problem is. And, again, what are the barriers that generate this market power we keep talking about before we start talking about how to solve a problem. I think that is my last comment.

MR. DOWDS: Well, I have one question for you, because I didn't hear you answer the question, or actually it wasn't posed to you directly. Doug alleges that under state law we have authority under .04, I think is what you cited, to somehow or another direct ILECs to reduce their switched access charges. Do you agree or disagree, or is the jury out?

MR. HATCH: I think the jury is out. I think it's a harder hill to climb than it is -- than looking with respect to CLEC access charges, because the prior case law regarding ILEC access charges was directly on point. And I'll get you that cite.

MR. DOWDS: That's my last question.

Any further comments or further written responses to our questions that any party would like to file with us, we would appreciate if you would file them by August 1st, and file them in Docket Number 080000, which is the undocketed docket.

MS. CASWELL: (Inaudible).

MR. DOWDS: I hadn't really thought about it. Does anybody have any preference?

MS. CASWELL: (Inaudible.)

UNIDENTIFIED SPEAKER: It wouldn't hurt. You said reply comments?

MR. DOWDS: Yes. Kim wants to do reply comments. If so, what about two weeks later? These are voluntary, you don't have to do them.

UNIDENTIFIED SPEAKER: We thought that that August 1st deadline might be a little bit quick, and we're wondering whether it could be extended by maybe a week or so.

MR. DOWDS: Okay. August 8th and August 22nd, then.

MR. HATCH: August 8th, a fortuitous date.

* * * * * * *

STATE OF FLORIDA)

: CERTIFICATE OF REPORTER

COUNTY OF LEON)

I, JANE FAUROT, RPR, Chief, Office of Hearing Reporter Services, FPSC Division of Commission Clerk and Administrative Services, do hereby certify that the foregoing proceedings, Pages 1 through 176 transcribed from digital recording.

I FURTHER CERTIFY that I am not a relative, employee, attorney or counsel of any of the parties, nor am I a relative or employee of any of the parties' attorneys or counsel connected with the action, nor am I financially interested in the action.

DATED this 4th day of August, 2008.

Jane Faurot

JANE FAUROT, RPR
Chief, Office of Hearing Reporter Services
Office of Commission Clerk
(850) 413-6732