BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

NOTICE OF STAFF WORKSHOP

# COMPSOUTH'S[1] RESPONSES TO STAFF'S QUESTIONS

The answers below provide CompSouth's responses to Staff's Questions. CompSouth is also providing responses to other issues, raised in CompSouth's Proposed Supplemental Questions. Where appropriate, these CompSouth Responses to Staff's Questions occasionally refer to CompSouth's responses to CompSouth's Proposed Supplemental Questions.

1. **What are the key factors that CLECs consider when determining how to set their access charge rates?**

   **Response:**

   In setting intrastate switched access charge rates, CLECs consider the cost of service, the rates of other carriers providing switched access service and general market conditions. Until recently, CLECs did not generally prepare cost studies for internal management and price setting purposes; however, given regulatory conditions at the FCC and some recent developments at the state level, a small number of companies have supported tariff filings and otherwise justified switched access prices by means of expensive and time-consuming cost studies.

   The price- setting process for CLECs, as for all competitive firms, is a dynamic process and companies continuously probe and respond to market conditions to learn what level of prices are reasonably compensatory and sustainable in the face of consumer and competitor responses.

2. **Are the access rates being charged by Florida's CLECs cost-based?**

   **Response:**

   Currently, in Florida, the Commission rules do not require that CLECs file cost studies to support their intrastate switched access rates. Nonetheless, CLECs, like companies in competitive non-regulated markets, set rates at levels that are generally compensatory and consistent with market conditions.

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[1] Sprint, while an active member of CompSouth, is not sponsoring these comments.

The revenue contribution made by the intrastate switched access product set comprises an important and material portion of CLECs' overall cost recovery. To the extent CLECs are forced to cap their intrastate switched access rates at levels equal to the incumbent's intrastate switched access rates, those rates would be neither cost-based for the CLECs nor, in most cases, fully compensatory.

The relationship between CLEC exchange access rates, ILEC exchange access rates and costs are discussed in more detail in response to the CompSouth Proposed Supplemental Questions, #15 and #16.

**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?**

**Response:**

Generally, yes. Because CLECs operate in market segments created under the pro-competition and deregulation provisions of the Telecommunications Act of 1996 ("the Telecom Act"), regulators should *refrain* from price regulating CLEC services, including switched exchange access services because CLECs do not possess market power.

Of course, the question of whether price regulation of CLEC exchange access services is warranted hinges, in part, on the question of whether exchange access markets are distorted, thereby generating market power on the part of the CLECs, and if so, what the cause of those distortions might be. This issue underlies most of Staff's questions, and, is, therefore, worth addressing more explicitly.

Using a formal anti-trust analysis, incorporating standard notions of product and geographic market definitions, market shares, barriers-to-entry, supply responses and demand responses, it can be demonstrated that CLECs do *not* have market power in the provision of exchange access services. For a more formal analysis, please see the CLECs' response to Staff Question #5.

In the final analysis, advocates of the proposition that CLECs have market power in the provision of exchange access will be unable to answer the following question: *If CLECs are supposed to have market power – which, by definition, implies that they can raise*

*prices to earn supernormal profits*[2] *– what barriers-to-entry exist that permit them to luxuriate in those supernormal profits in the long term?*

Advocates of the proposition that CLECs have market power point to the *lack of alternatives* for IXCs confronted with an obligation to accommodate exchange access traffic. This was the belief of the FCC when it passed its *CLEC Access Reform Order* and lamented that certain *prerequisites* for well- functioning markets had not come to pass. Specifically, the FCC complained that its hopes that "IXCs would likely enter marketing alliances with LECs offering low-priced access service and would thereby be able to exert downward pressure on CLEC access rates" had not "come to pass."[3]

Far more powerful than marketing alliances – full-fledged mergers between IXCs and ILECs have since taken place – most likely well beyond anything the FCC could have conceived of in its *CLEC Access Reform Order*. Indeed, *the largest IXCs have merged with the largest ILECs* (AT&T/SBC and Verizon/MCI). As a result of those mega-mergers, and other developments, the barriers-to-entry that IXCs might once have faced have come down. The Commission should consider the various means of entry available to existing and potential CLEC competitors:

- Under the provisions of the Telcom Act, all properly certificated would-be competitors can avail themselves of the necessary loops, switching and transport facilities to compete for excessively profitable CLEC end users.
- IXCs (such as AT&T and Verizon) have *near ubiquitous facilities* and typically *own and operate* the last mile loop, switching and transport facilities necessary to provide exchange access to themselves, to others, and to end users. They have the technical, operational and customer relations (billing systems and information, etc.) capability to do so on a sufficiently short-term basis.

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[2] Market power is defined as the ability to raise prices and earn supernormal profits over a sustained period of time. Further, a demonstration of market power requires that barriers-to-entry exist that are so significant as to allow a company to maintain prices above costs for a sustained period of time (which permits it to earn supernormal profits) without inducing competitive entry.

[3] *In the Matter of Access Charge Reform, Reform of Access Charges Imposed by Competitive Local Exchange Carriers*, Seventh Report and Order and Further Notice of Proposed Rulemaking, CC Dkt No. 96-262, rel. April 27, 2001, (hereafter "*CLEC Access Reform Order*"), ¶32.

- IXCs (such as AT&T and Verizon) already have a relationship – as IXCs, as local providers, and often as wireless carriers – with the end user, thus facilitating customer acquisition efforts.

What's more, the FCC, in its TRRO, found nonimpairment for unbundled local switching, meaning that the FCC determined that switching facilities, the fundamental platform from which switched access services are provided, no longer constitute a bottleneck in the provisioning of telecommunications services to end users. The FCC in this analysis did not differentiate between certain services offered by the switch, but instead, found that competitive deployment of alternative switching facilities was sufficient to render all switch based-UNEs "unimpaired."

Given the local entry mechanisms established in the Telecom Act, the state of telecommunications markets and the mega-mergers of RBOCs and IXCs, *there are no barriers-to-entry* that would for a sustained period shield a CLEC from competitive alternatives if it were earning supernormal profits via its exchange access rates. If there are excess profits being earned by one company, surely others will enter to vie for those profits. The burden is on advocates of price regulation to explain why this is not so: that is, they need to explain by what magic CLECs are able to sustain excess profits without barriers-to-entry to protect them in the face multiple existing and would be competitors, including the mighty large ILECs. Without the ability to answer these questions satisfactorily, it becomes clear that advocates of regulatory intervention in this situation are merely seeking a short-cut to achieving rates they find more palatable, rather than deploying the facilities and competing vigorously to achieve them within the market structure envisioned by the Telecom Act.

Some advocates of benchmarking conclude that CLECs have market power on the superficial observation that -- *in the short run* -- an IXC literally has no option but to accept the CLEC's exchange access rates because it must terminate toll traffic to the CLEC. This type of argument is short-sighted and fallacious.

Most competitive companies could be – falsely – accused of enjoying market power based on analyses that ignore longer run demand and supply responses. For example, based on short-run considerations, one might conclude that airlines on cross-Atlantic flights have market power in food and beverage services or bathroom access on each flight, once the plane has left the ground and its passengers literally are "captive customers." Obviously, however, this conclusion is false, as in the long run customers would surely seek out competitive alternatives once submitted to such treatment.

Similarly, faulty conclusions about market power can be drawn with respect to auto parts that are exclusively available from the manufacturer. Once the car is purchased, a customer may have no short-run alternative to purchasing replacement parts from the manufacturer even if they are exorbitantly priced. Of course, in the longer run, consumers would shun the car manufacturer and purchase alternative brands. The same is true for exchange access services – a short- run abuse of market power is likely to generate devastating longer run demand and supply responses that could endanger the CLEC's entire business.

It should also be noted that the proposition that CLECs have market power is at odds with the fact that they typically have very small *individual* market shares. This is true for CLECs nationwide as well as for CLECs in Florida.

The table below shows the shrinking market shares of CLECs nationwide since the megamergers between the IXCs and ILECs.[4]

[4] FCC *Local Competition Report*, 2007. Table 1.

**End-User Switched Access Lines Reported**

| Date | ILEC Lines | CLEC Lines | Total | CLEC Share |
|---|---|---|---|---|
| Dec 1999 | 181,202,853 | 8,194,243 | 189,397,096 | 4.3 % |
| Jun 2000 | 179,648,725 | 11,557,381 | 191,206,106 | 6.0 |
| Dec 2000 | 177,561,022 | 14,871,409 | 192,432,431 | 7.7 |
| Jun 2001 | 174,752,275 | 17,274,727 | 192,027,002 | 9.0 |
| Dec 2001 | 171,917,359 | 19,653,441 | 191,570,800 | 10.3 |
| Jun 2002 | 167,330,006 | 21,644,928 | 188,974,934 | 11.5 |
| Dec 2002 | 164,386,452 | 24,863,691 | 189,250,143 | 13.1 |
| Jun 2003 | 158,274,538 | 26,985,345 | 185,259,883 | 14.6 |
| Dec 2003 | 153,157,843 | 29,775,438 | 182,933,281 | 16.3 |
| Jun 2004 | 147,993,218 | 32,033,915 | 180,027,133 | 17.8 |
| Dec 2004 | 144,809,899 | 32,880,812 | 177,690,711 | 18.5 |
| Jun 2005 | 143,757,708 | 33,975,336 | 177,733,044 | 19.1 |
| Dec 2005 | 143,773,101 | 31,387,839 | 175,160,940 | 17.9 |
| Jun 2006 | 142,293,047 | 29,896,109 | 172,189,156 | 17.4 |
| Dec 2006 | 138,833,928 | 28,625,971 | 167,459,899 | 17.1 |
| Jun 2007 | 134,458,920 | 28,711,461 | 163,170,381 | 17.6 |

Only LECs with at least 10,000 lines in a state were required to report through December 2004. Beginning with the June 2005 data all LECs are required to report. Some historical data have been revised.

While exact numbers for individual CLECs are not available, the individual market shares of a given CLEC (even the largest), of course, will generally be only a fraction of the overall market share of the CLECs. To place the market share information in context of a market power analysis, one should recognize that courts virtually never find market power when market shares for the company in question are less than 50 percent.[5] As an example, the FCC used approximately the same market share levels for assessing whether petitioners in forbearance petitions have market power.[6]

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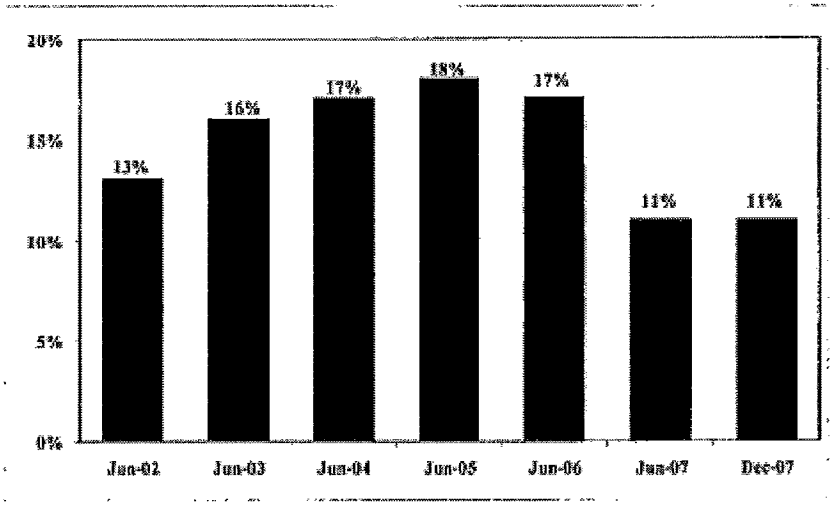
[5] A.B.A. Section of Antitrust Law, Antitrust Law Developments at 235-236 (4th ed.) (1997), cited in the FCC *Verizon Forbearance Order* at footnote 99.

[6] See, *Verizon Forbearance Petition.* For example, paragraph 28: "In particular, in the *AT&T Domestic Nondominance Order*, AT&T was declared nondominant in its provision of domestic interstate interexchange services when it had an approximate market share of '55.2 and 58.6 percent in terms of revenues and minutes

Florida-specific data illustrate the development of CLEC market share as a group within the Florida marketplace:[7]

**Figure 3-1. Florida CLEC Market Share**




*Source: Responses to 2002-2008 FPSC data requests.*

The above data further underscores that the competitive landscape has fundamentally changed since the FCC's *CLEC Access Reform Order*. CLECs no longer have access to the ILECs' unbundled local switching, since switching is no longer deemed to be a bottleneck. The megamergers between large RBOCs and large IXCs are also eroding the CLECs' abilities to compete. All these developments fly in the face of claims of CLEC market power.

Finally, it is supremely ironic that CLECs are being accused of having market power – i.e., *earning excess profits* – at the very point in time at which their numbers continue to dwindle and many struggle to remain EBITDA-positive.

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respectively.'" The exact market share data in the FCC's forbearance petitions are typically proprietary and redacted.

[7] *Report on the Status of Competition in the Telecommunications Industry*, December 31, 2007. Figure 3.1.

In conclusion, in the absence of a theoretically sound demonstration that CLECs have market power, regulators should, as they typically do, refrain from price-regulating CLEC services, including switched access services. Moreover, at a time when the FCC and the Congress are actively considering multiple intercarrier compensation issues, ranging from IP Enabled Services to Phantom Traffic to Special Access, state regulators should not engage in piecemeal reform initiatives for CLECs. The prudent path requires that the Commission take a more comprehensive view of intercarrier compensation so that any future policy changes will ultimately contribute to a more competitive retail market for Florida consumers.

**4. 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?**

**Response:**

No. This is largely a question that should be answered by parties advocating regulated rates for CLEC switched access rates (i.e., price-regulation advocates should be required to prove clear adverse impacts). Absent such a showing, and in the context of the market analysis above, it becomes clear that the advocates of this strategy are simply trying to use the regulatory process to achieve cost savings for their own long distance products. No evidence has been presented and we are aware of none demonstrating that consumers are harmed by allowing the market to set prices for CLEC services, including switched access services. First, as discussed in our response to Question 3, the CLECs' exchange access rates are disciplined by competitive markets, and, thus, consistent with economic theory,[8] the resulting rates are presumptively optimal from a societal perspective.

Further, exchange access rates are wholesale, inter-carrier rates paid by carriers to other carriers as compensation for originating or terminating exchange access traffic. The rates charged by carriers for exchange access are generally *not uniform* across any region of the country. In fact, exchange access rates vary from company to company, depending

[8] The notion that markets generally generate results superior to interventions by well-intended policy makers is well established in economic theory and goes back as far as Adam Smith's "The Invisible Hand" doctrine. See Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, 1776. (IV.ii.6-9, page 456 of the 1976 Glasgow Edition of Smith's works; vol. IV, ch. 2, p. 477 of 1976 U. of Chicago Edition).

on a large variety of factors. The fact that CLEC exchange rates are different from those of other, generally much larger, ILECs is not anomalous – rather, it is consistent with the general state-of-affairs in the industry. Indeed, forcing CLECs to set rates identical to those of other carriers – i.e., based on conditions that apply to other companies – is at odds with observed pricing practices in the industry and would cause a number of serious and deeply disabling distortions. Such distortions would ultimately harm Florida consumers and Florida's economy at large. Thus, there is no merit in forcing exchange access uniformity.

For a more detailed discussion of why ILEC rates are highly inappropriate as benchmarks for CLEC rates, please see CompSouth's Response to CompSouth's Proposed Supplemental Questions, #15 and #16, which explain why the ILECs' exchange access rates are typically established as part of negotiated deals that involve *quid pro quos* that do not relate to CLECs.

To see why it is inappropriate to pick the ILECs' exchange access rates – in isolation from other considerations -- as a benchmark for CLEC rates, Staff should consider the following analogy. When a new car buyer trades in a used car, the total value of the transaction involves the price paid for the new car *and* the price received for the trade-in car. For example, if the dealer accepted a lower price for the new car, it probably means that the buyer received less for a trade-in car. Advocates of benchmarking overlook the fact that requiring CLECs to adopt ILEC rates for exchange access is like demanding from a car dealer a low price for a new car without the *quid pro quo* of offering a trade-in car. ILECs received all sorts of "goodies" in return for exchange access reductions, such as increased USF subsidies, that do not benefit CLECs. In fact, some of the benefits the ILECs negotiated as a *quid pro quo* for exchange access reductions explicitly hurt the CLECs. The behind the scenes negotiations establishing the CALLS Order and the resulting rates are revealed in an illuminating dissent by FCC Commissioner Harold Furchtgott-Roth.[9]

Concessions regarding access rate levels were gained from the ILECs by the FCC's agreement to make decisions in the ILECs' favor regarding not only additional universal service funds, *but also two other actions completely independent from switched access services*: decisions regarding their obligations to provide Enhanced Extended Links ("EELs") to competing local service providers and an on-going audit initiative related to

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

continuing property records. As Commissioner Furchtgott-Roth put it: "[I]t was entirely improper for the Commission to have permitted the unrelated matters of depreciation and special access become part of the negotiations."[10]

State commissions and state legislatures have historically engaged in similar deals with ILECs. Those resulting exchange access rates, while they may make sense for the negotiating ILECs, are utterly irrelevant to CLECs. And moreover, as noted, given that the *quid pro quos* are not part of state benchmarking initiatives (i.e., they are not awarded to CLECs), it is like demanding low car prices without offering a trade-in car.

Driving the last nail into the coffin of the notion that the ILECs' exchange access rates have general merit, Commissioner Furchtgott-Roth concludes that interstate access charges (at that time) bore *little resemblance to the "costs of access actually incurred"* and observes that "the process by which the original CALLS proposal was modified [and ultimately approved] is fundamentally inconsistent with principles of neutrality and transparency that must govern agency decision making."[11]

Advocates of benchmarking have yet to explain the merit of ILEC rates that make them just and reasonable for any company other than the ILEC in question. The evidence for such a claim is just not there.

The extent to which ratepayers are in fact harmed by benchmarking policies is discussed in response to Question 11.

**5. Is the market for the access service structured in a way that allows competitive pressures to effectively constrain access prices? Why or why not?**

**Response:**

Yes.

Companies compete for *all* revenues associated with an end-user customer, which includes not just retail related revenues but also exchange access revenues associated

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

with long distance traffic. To the extent that a CLEC is perceived as earning supernormal profits,[12] it will induce competition for those profits and the CLEC will be disciplined by market forces. Indeed, even casual observation confirms that telecommunications markets simply do not tolerate CLECs that earn supernormal profits, whether those profits stem from retail services or exchange access services. Profit is profit, as far as the marketplace is concerned. And if there is profit to be made, competitors will line up for their share, until the profits have been dissipated through competitive strife. In other words, there are simply no *barriers-to-entry* to shield a CLEC if it attempts to extract supernormal profits. Absent identifiable barriers-to-entry, other market participants would step in to nibble away the CLEC's supernormal profits.

An extensive discussion of market power issues is also found in CompSouth's Responses to Staff's Question #3.

**6. Do market forces applicable to originating switched access differ from the market forces for terminating switched access? If so, how?**

**Response:**

There are differences in the relationships between customers and providers. However, the main issue remains that companies compete for all revenues associated with end users, which includes, in addition to retail-related revenues, revenues associated with both originating and terminating long distance traffic. As discussed in CompSouth's response to Question # 5, telecommunications markets simply will not tolerate CLECs earning supernormal profits – whether these profits are associated with originating or terminating long distance traffic.

To the extent that the Commission has more concerns about terminating exchange access rates, these concerns may be addressed by mandating those rates not exceed originating exchange access rates – though again, this type of intervention exceeds in scope the existence of any market power that would warrant price setting regulation. Nonetheless, given that the costs of terminating and originating exchange access traffic are roughly

[12] Again, market power is defined as the ability to earn supernormal profits over a sustained period of time. A demonstration of market power requires that barriers-to-entry exist that are so significant as to allow a company to maintain prices above costs for a sustained period of time (which permits it to earn supernormal profits) without inducing competitive entry.

comparable, equating originating and termination rates via regulation in the short-run could speed the long-term benefits that would otherwise likely result from market pressures. As such, while CompSouth would advocate that regulators defer from regulating CLEC switched access rates, a simple regulation that requires originating and terminating rates to be equalized is most likely acceptable to most CLECs and would not harm the market place.

**7. Under what conditions, if any, can a carrier decline to terminate its traffic to another carrier?**

**Response:**

There may be undesirable legal and regulatory consequences to permitting carriers to "block" traffic from one another based upon pricing concerns. Without question, there are socially undesirable consequences to placing customers in the middle of inter-carrier disputes.

Any debate about this issue should recognize that, to the extent market power exists in the market for toll and access services, it is the *monopsony* power of AT&T and Verizon that interferes with the proper functioning of access markets.

Economists define markets wherein single or dominant buyers can effectively set prices as "monopsonistic" or "oligopsonistic."[13] Similar to the more commonly understood circumstance of "monopoly" wherein a single *seller* can set prices and influence production levels because it controls all supply components, monopsonistic markets are dominated by enormous *buyers,* who so dominate the total demand characteristics of the market, that individual sellers have little choice but to accept prices and/or terms dictated by those buyers.

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[13] See *Oligopsony* (n), the market condition that exists when there are few buyers, as a result of which they can greatly influence price and other market factors. [www.dictionary.com], likewise; *Monopsony* (n) A market dominated by a single buyer. A monopsonist has the market power to set the price of whatever it is buying (from raw materials to labour). Under perfect competition, by contrast, no individual buyer is big enough to affect the market price of anything. [www.economist.com]

Taken as a group, Verizon Business (formerly MCI), Sprint, Qwest and AT&T can represent more than 80% to 90% of all switched access minutes sold by a CLEC. Said another way, 80% to 90% of all long distance calls CLEC customers receive are often carried to the CLECs' networks by those four carriers. This simple fact dominates the way in which rates for exchange access charges are effectively set in the marketplace. While the FCC's *CLEC Access Reform Order* suggests that CLECs may negotiate higher rates than the rates it benchmarked to incumbent levels, that notion is a fallacy. CLECs have little, if any, negotiating strength because they cannot realistically participate in the "self-help" necessary to disconnect these four carriers for non-payment, given that disconnection would keep 80% to 90% of all toll calls from reaching local exchange customers who rely upon them as their primary telecommunications providers. This places the CLEC in an untenable conflict between enforcing its own rates or betraying its own local customers. Further, by establishing a benchmark rate no greater than the rate charged by incumbents, the FCC effectively removed any incentive an IXC might otherwise have had to discuss rates that are higher and/or more compensatory – the IXC knows that even if a separate agreement cannot be reached, the most it will pay are the benchmarked rates.

The large IXCs expand this relative advantage they enjoy in inter-state ratemaking to intra-state ratemaking as well. There is little doubt that AT&T and Verizon Business (MCI) exert oligopsonistic influence in the market for intra-state exchange access. Consider the following scenario that has played out countless times going back 6 or more years. First, the large IXC simply stops paying a CLEC's intrastate tariffed rate and informs the CLEC that it believes the switched access rate is too high - even if the rates have been tariffed and approved by the relevant state utility commission. Given that one of these carriers may by itself represent 40% to 60% of the CLEC's total switched access revenue, unpaid invoices stack up quickly, resulting in a large unpaid balance and a significant drain on the CLEC's cash flow necessary for operations. Several months may pass as the CLEC weighs its options and undertakes the cost-benefit analysis related to multiple complaints, bristling all the while at its complete inability to exercise self-help in the form of disconnecting its delinquent switched access customer. Finally, with so much revenue at stake, the CLEC succumbs to the pressure and accepts pennies on the dollar for its prior receivable.

There are multiple market distortions created by this process, many of them resulting in less, as opposed to more, meaningful competition in the long distance market. Obviously, only the largest IXCs have the monopsonistic power necessary to force a CLEC into the position described above.

Likewise, the rates extracted by the larger IXCs are, in many circumstances, demonstrably below the costs incurred by the CLEC in providing the switched access services in question. As such, CLECs are required to subsidize exchange access rates with revenues generated either from their own local customers or from the smaller IXCs – ultimately harming the CLECs' relative strength in the marketplace against other local carriers, including those local carriers affiliated with the largest IXCs (each of which has a CLEC of its own).

Addressing the CLECs' difficulties in collecting exchange access revenues from large IXCs, the FCC found that the CLECs' exchange access rates may be tariffed as long as they are at or below the incumbent LECs' exchange access rates. To the extent, however, that CLECs require higher exchange access rates, the FCC found the following:

> Above the benchmark, CLEC access services will be mandatorily detariffed, so CLECs must negotiate higher rates with the IXCs.[14]

This policy fails to recognize the imbalances in the negotiating powers of the CLECs and their largest exchange access customers, such as AT&T and Verizon. As described above, the FCC's provision to permit CLECs to negotiate higher rates with IXCs is a token option. As a practical matter, the FCC has left the CLECs at the mercy of the monopsony powers of the large IXCs and they will rarely, if ever, be able to negotiate rates higher than the benchmarks (especially when IXCs are already refusing to pay if they believe the CLEC rate is too high).

It is interesting to compare the scenario above with a similar situation wherein the tables are turned. Consider a scenario wherein CLECs attempt to withhold payments for special access services procured from the large ILECs (the parent companies of the large IXCs), simply because they do not like the prices. Obviously, the ILECs would (and have) disconnected the special access circuits for non-payment. There is likely no discernable decrease in the quality of service experienced by the ILEC's own customers because of disconnection of the CLEC, yet disconnection for the CLEC can be devastating to the CLEC and its customers. Unfortunately, the same "self-help" option is not available to CLECs when the large IXCs (in most cases affiliated brethren of the same ILECs) fail to pay. CLECs cannot effectively thwart the largest IXCs' self-help efforts in this regard without disconnecting the long distance lifelines of their own local exchange consumers,

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14 *CLEC Access Reform Order* at 3.

thereby creating an enormous marketing opportunity for the very carriers exercising self-help (i.e., the IXCs and their affiliated local service providers).

The Commission should realize that the largest IXCs are actively exercising their monopsony power to avail themselves of subsidized switched access rates substantially lower in most cases than costs. It is inarguable that the largest IXCs' self-help efforts in this regard will have substantial disruptive consequences in both the long distance as well as the local marketplace (each of which benefits the largest IXCs and their local service affiliates).

In sum, it is important to note that a monopsony can be as detrimental to properly functioning markets as a monopoly. In view of this, if this matter goes forward, *the CLECs recommend, as part of this proceeding, that the Commission investigate the extent to which AT&T and Verizon are exerting undue market power in their relationships with smaller suppliers, such as the CLECs.*

**8. On what basis can it be determined if CLEC access rates are just and reasonable?**

**Response:**

As discussed in response to Question # 4, from an economic perspective, functional markets generate results that are generally superior to price- regulated markets. That is, to the extent that CLECs operate in market segments that are presumptively competitive under the pro-competition and deregulation provisions of the Telecom Act , CLEC exchange access rates -- *to the extent they are unregulated* – are just and reasonable.

However, if the Commission decides to review and/or regulate CLEC exchange access rates, the rates should be evaluated based on whether they are *reasonably compensatory for the costs incurred in the provision of services*. That is, the ultimate touchstone for just and reasonable rates is costs.

The Commission should recognize that for the better part of the twentieth century, much of public utility regulation, and certainly the regulation of telecommunications utilities, involved traditional rate-base/cost-of-service regulation. While allocations of costs across various customer classes and jurisdictions, such as intrastate and interstate, might have been impacted by universal service policies, the ultimate basis for rates and revenues was costs. As the United States Supreme Court noted:

> The enduring feature of ratesetting from *Smyth v. Ames* to the institution of price caps was the idea that calculating a rate base and then allowing a fair rate of return on it was a sensible way to identify a range of rates that would be just and reasonable to investors and ratepayers. [15]

Even as telecommunications regulation moved away from traditional rate-base regulation in the latter part of the twentieth century, the FCC and state commissions continued to emphasize costs as the relevant benchmark for just and reasonable rates. The notion that costs have been and remain the ultimate benchmark for just and reasonable rates is generally recognized and is evinced by such statements as:

> The Communications Act requires that rates be just and reasonable and not create unreasonable discrimination or undue preference. Section 201(b) and 202(a), 47 U.S.C. §§ 201(b), 202(a). [...] ***Costs are traditionally and naturally a benchmark for evaluating the reasonableness of rates.*** [16] (Emphasis added.)

The FCC has repeatedly referenced standard economic theory concerning the benefits of cost-based pricing policies. Going back almost two decades, a good example of how the FCC explained its cost-based pricing policies is the following:[17]

> *Costs* are traditionally and naturally a benchmark for evaluating the *reasonableness of rates*, because cost based rates both deliver price signals which contribute to efficient use of networks and generally distribute network costs to the customer who causes those costs. (Emphasis added.)

In its *Local Competition Order*, the FCC cited the signaling function of cost-based prices as the predominant reason for mandating the use of forward-looking incremental costs as the cost study method to be used in setting cost-based rates as required by section 252(d)(1) of the Act for unbundled network elements:[18]

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15 *See, Verizon v. FCC*, 535 U.S. at 487-88.

16 *Investigation of Special Access Tariffs of Local Exchange Carriers*, Memorandum Opinion and Order, 4 FCC Rcd 4797, 4799, at ¶ 32 (1988) ("*Special Access Tariff Order*").

17 *Special Access Tariff Order*, 4 FCC Rcd at 4799, ¶ 32.

18 *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket No. 96-98, First Report and Order, 11 FCC Rcd 15499 (1996) at ¶ 360 ("*Local Competition Order*"),

> We observed in the NPRM that ***economists generally agree*** that prices based on forward-looking long-run incremental costs (LRIC) give ***appropriate signals*** to producers and consumers and ensure ***efficient entry and utilization*** of the telecommunications infrastructure. (Emphasis added.)

Economic theory fully supports these regulatory practices. Economic texts on public utility regulation either explicitly or implicitly examine rate-setting practices against the backdrop of the *regulated firm's costs*. This is true whether the discussion concerns traditional rate- of- return regulation or other forms of regulation. When rates are set below costs, it may lead to under-recovery and cross-subsidies or constitute such anti-competitive practices as predation; when rates are set too high, it may lead to over-recovery of costs and represent an exercise of market power. Generally, economists advocate that rates be set at economic cost to provide the appropriate price signals and to prevent all sorts of other distortions. The rare exception to this rule concerns recognition that regulators have other legitimate public policy concerns, such as the pursuit of universal service.[19]

The relationship between prices and costs is also found in the *Horizontal Merger Guidelines* issued by the U.S. Department of Justice ("DOJ") and the Federal Trade Commission ("FTC").[20] In fact, this relationship lies at the heart of any analysis concerning the impact of mergers on the workings of markets and the ability of the merging firms to enhance their market power and impact prices. The following language from the *Horizontal Merger Guidelines* is instructive:

> The unifying theme of the Guidelines is that mergers should not be permitted to create or enhance market power or to facilitate its exercise.

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aff'd in part and vacated in part sub nom. *Comp. Tel. Assoc. v. FCC*, 117 F.3d 1068 (8th Cir. 1997) and *Iowa Utils. Bd. v. FCC*, 120 F.3d 753 (8th Cir. 1997), aff'd in part and remanded, *AT&T v. Iowa Utils. Bd.*, 525 U.S. 366 (1999); on remand *Iowa Utils. Bd. v. FCC*, 219 F.3d 744 (8th Cir. 2000), reversed in part sub nom. *Verizon Communications, Inc. v. FCC,* 535 U.S. 467 (2002).

[19] Prior to the Act, state commissions deliberately set some rates above cost in order to keep rates for basic local telephone service low, particularly in areas such as rural areas where costs are high. The Telecom Act eliminated such implicit subsidies and required that the FCC establish an explicit funding mechanism. Some states, such as Texas, have established an explicit funding mechanism to support universal service.

[20] United State Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines*, 1997.

> ***Market power to a seller is the ability profitably to maintain prices above competitive levels for a significant period of time.***[21] (Emphasis added.)

Again, while the DOJ and the FTC are not concerned with "just and reasonable" prices per se, the notion is that *costs are the touchstone for appropriate prices.*

The Florida Commission itself recognized that cost is the most natural touchstone for just and reasonable rates:

> Common sense as well as economic theory suggest that rates should be based on cost, thus sending proper pricing signals to the market. ***However, earlier public policy concerns resulted in a regulatory plan where switched access rates were not based on cost, rather certain services subsidized other services to satisfy public policy concerns. This intertwining of services through implicit subsidies makes it extremely difficult to untangle one service and move it to cost-based rates without an adverse impact on at least one of the interested parties.***[22]

All of this goes to show that in the event of market failure – and we do not think there is market failure – the ultimate touchstone for just and reasonable rates is costs. However, as the Staff indicated in their report, switched access rates have been intertwined with subsidies and it is difficult to move these rates to cost-based rates without looking at the bigger picture – that of inter-carrier compensation reform. The FCC has initiated a docket for this express purpose with a goal of resolving many outstanding intercarrier compensation issues by this fall.[23]

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21 *Id*, Section 0.1.

22 Florida Public Service Commission, *Switched Access Charges in Florida*, September 2001, page 13.

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

Further, it is important to note that for regulated companies, price regulation invariably focuses on *company-specific costs*. This is particularly true for exchange access rates, which are almost always established on the basis of company-specific considerations, as evinced not only by the history of exchange access rate making but also by the variations in exchange access rates. That is, consistent with standing rate making practices, just and reasonable exchange access rates for CLECs must consider company-specific costs.

CompSouth's response to CompSouth's Proposed Supplemental Questions, #16, discusses the differences between the ILECs and CLECs in terms of their network architectures, costs, customer densities, loop lengths, etc., and concludes that CLECs look more like medium- sized ILECs and rural ILECs than like RBOCs. This observation is consistent with the fact that CLEC exchange access rates are closer to the medium-sized ILECs' than to the large ILECs'.

**9. If it is determined that CLEC access charges are not just and reasonable, does the Commission have authority to act to remedy this situation?**

**Response:**

This issue suggests the flawed proposition that the Commission could make an across-the-board determination that all CLEC access charges, without regard to cost of service, are not just and reasonable. At this point in time, it is premature to posit that any CLEC's access charges are not just and reasonable.

**10. Should the Commission establish caps on the intrastate access rates that CLECs can charge? If so, how should caps be determined?**

**Response:**

No. See CompSouth's Response to Staff's Questions # 3, 5 and 8.

**11. What would be the impact on Florida CLECs if this Commission were to cap CLEC access rates at the rates of the incumbent LEC in the area in which they serve?**

**Response:**

CLECs will be unable to recoup legitimately incurred costs in the provision of exchange access services, which carries with it the attendant, well-known problems and distortions: disincentives to invest, unwarranted subsidies, over-use of the below cost product offering, etc.

As discussed in the CompSouth's Response to CompSouth's Proposed Supplemental Questions, #16, CLECs, for a large number of obvious reasons, such as lack of economies of scale and scope, higher input prices, lower customer densities, etc., incur demonstrably higher traffic sensitive costs in the provision of exchange access services. This is true even for optimally efficient CLECs. Therefore, to benchmark the CLECs' exchange access rates against the giant ILECs' is to set a standard no CLEC can meet, no matter how efficient.

The insidious aspect of such a policy is that it is often represented as a competitive market solution – i.e., the ILECs' rates are those that CLECs would have if markets were competitive. This is, of course, not true.

We have already discussed that the ILECs' rates – which are set by regulators and not by markets – are established as part of package deals, loaded up with *quid pro quos* that do not apply to CLECs. (See CompSouth Response to Question # 4.) Thus, imposing the large ILEC rates on CLECs, without awarding them comparable quid pro quos, is not just bad public policy, it is also violates common sense notions of fairness.

Further, there is simply nothing about the large ILECs' exchange access rates that have merit beyond the specific circumstances of the large ILECs in question. Indeed, if the large ILECs' rates are so meritorious, which of large ILECs' rates, one must wonder, are the meritorious ones? The mega-ILECs' exchange access rates differ greatly, not just between large ILECs, but for the same large ILEC across different states. The exchange access rates of the large ILECs, like exchange access rates of all ILECs, are all over the board – they are a hodgepodge.

The fact that exchange access rates are all over the board by no means signifies market failure. Indeed, the desire for uniformity, expressed by some regulators, is simply at odds with economics and the creativity and workings of free markets.

First, telecommunications is a multi-product industry in which carriers compete on an array of services. There is no reason to assume that carriers would charge the same prices as all other carriers for that array of services. This is true not just for telecommunications services but in many other industries in which companies deliver services and products in a multi-product production process. Banks and financial services companies have rates and charges that vary across the spectrum of their offerings. Even in the competitive supermarket industry, prices for identical products vary greatly from supermarket to supermarket; it's only by comparing bundles of products that one could determine which supermarket is overall the cheapest.

Next, companies do not always need to compete on price alone to justify their worth in the market place. For example, FedEx is generally more expensive than the U.S. Postal Service – yet no economist would argue that FedEx has not proven its worth in the marketplace or that somehow society does not benefit from the competition it has introduced. Many, if not most, industries see competition between companies that goes beyond price competition and even functionally equivalent products may be priced differently. For example, Toyota and Lexus (which is owned by Toyota) sometimes offer near identical cars for very different prices; consumer electronics are often manufactured by the same companies but offered at different prices, with the name brand extracting the higher price. The Banana Republic, Gap, and Old Navy may all carry garments made by the same factories, but they are price differentiated based in large part on brand name.

Further, it should be recognized that unrecovered costs that CLECs incur in the provision of exchange access services, because of the mandatory benchmarked rates, do not disappear. They are shifted either to the CLECs' end user customers (a much smaller base of customers than enjoyed by major ILECs) or come out of the shareholders' pockets. Either way, mandatory benchmarking policies result in below cost rates and thus in subsidies for IXCs and their customers. Most troublesome is perhaps a situation in which CLEC customers are harassed by IXC customers, *such as telemarketers,* who are the cost-causers of the exchange access costs. Adding insult to injury, under benchmarking policies contemplated in this question, CLEC customers would be required to *subsidize* telemarketers with below cost rates for the very calls they dread.

These types of cross-subsidization schemes, inherent in benchmarking policies, are exactly the type of regulatory distortion that the Telecom Act and regulators have been trying to remove from communications markets for years. Thus, both economic theory and empirical observations on the existing variations in exchange access rates for ILECs demonstrate that regulators should refrain from imposing uniform rates for uniformities'

sake. As FCC Commissioner Furchtgott-Roth noted in his Dissent to the *CLEC Access Reform Order*:

> Rather than remove the regulations that limit the clarity of price signals, the majority resorts to the opiate for regulators – price regulation.
>
> [...]
>
> If wisely interpreted, the Telecommunications Act of 1996 would serve as a basis for the proper government role in a free society. For more than five years, however, the Act has not been interpreted wisely. Indeed, it has served as a vehicle to support the ideas of those more comfortable with the opiate of regulation than with the nourishment of competition. Such regulation is no less harmful when, as here, it is masked in pro-competitive rhetoric.

CompSouth recommends that regulators tread very cautiously before imposing the heavy hand of regulation on a still developing, nascently competitive segment of the industry. The costs are real and the effects possibly irreversible. Far better and less intrusive policy alternatives exist, as discussed in our response to Question # 12.

**12. If the Commission opts to constrain allowable CLEC access rates through some means other than rate caps, what options are available?**

**Response:**

Until the Commission undertakes a comprehensive review of the entire intrastate access services market, including a review of all LEC access rates, and establishes a basis to exercise authority for action as to CLEC access rates (if the Commission has such authority), it is inappropriate to consider options just as to CLEC rates.

Other Options that could be implemented today:

The Commission could support IXCs in petitioning the FCC to remove its overly broad interpretation of Section 254(g) prohibitions on deaveraging, freeing them to establish market-based rates that meet their needs.

It would be more prudent for the FPSC to see how the FCC will address and resolve intercarrier compensation issues in a comprehensive matter.[24]

The FPSC should remain open to using the complaint process to examine allegations of particularly excessive rates.

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

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

NOTICE OF STAFF WORKSHOP

# COMPSOUTH'S[1] PROPOSED SUPPLEMENTAL QUESTIONS

**13. Do large IXCs have monopsony power in their purchase of switched access services from CLECs? If so, do those IXCs use that monopsony power to withhold payment and to engage in other unjust and unreasonable conduct to force CLECs to provide access service at rates other than tariffed rates?**

**Response:**

Yes. As discussed in more detail in response to Staff Question # 7, large IXCs have monopsony power that distorts the interaction between CLECs and IXCs. Often, large IXCs engage in "self-help" and simply refuse to pay the CLECs' tariffed rates. This practice is of questionable legality and highly damaging to CLECs. In fact, it is no less inappropriate than it would be for CLECs to withhold payments for services procured from the large ILECs (the parent companies of the large IXCs). Of course, CLECs would not be able to get away with such behavior; neither should the IXCs.

Further, the Commission should consider that the CLECs are – as a practical matter – obligated to accommodate the IXCs' exchange access traffic. In short, the IXCs are abusing their monopsony power to avail themselves of cheap access at the expense of competitors, the CLECs. This is not a sustainable situation as it undermines the CLECs' ability to remain economically viable.

**14. Should the Commission consider cost increases the ILECs impose on CLECs for access to network elements (as a result of the TRRO, supra-competitive SPA pricing, forbearance grants) and interconnection in this proceeding?**

**Response:**

Yes. Transport and loop facilities purchased by CLECs from the ILECs either in the form of UNEs or special access make up large portions of the network required to provide switched access services. The same is true for collocation and other elements.

Competitive carriers purchase much of the transport and loop capacity that constitute their local networks supporting switched access services directly from AT&T, Verizon and Embarq in the form of special access services. In some circumstances, these fees paid by the CLECs can constitute as much as 40% to 60% of their overall cost structure. Since the FCC

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[1] Sprint, while an active member of CompSouth, is not sponsoring these comments.

originally issued its *CLEC Access Reform Order* in 2001, prices paid by CLECs to purchase loops and transport capacity from the major incumbents have increased substantially, nearly doubling within some companies. These increases result largely from the fact that AT&T and Verizon have used increased pricing flexibility granted by the FCC to increase special access prices in critical markets while at the same time limiting access to less-costly UNE products per the FCC's finding of non-impairment in its *Triennial Review Remand Order*.

Special access services and switched access services work as effective substitutes in the overall market for telecommunications capacity. Where switched access prices are too high, carriers have the ability to connect directly to the customer via special access and bypass the switched provider. Yet, even as AT&T, Verizon and Embarq increase prices for dedicated capacity (critical inputs to CLEC switched access services), they are at the same time demanding that regulators force CLECs to reduce switched access rates they pay when they use CLEC facilities to originate or terminate toll traffic. With this in mind, it is not surprising that AT&T and Verizon attempt to convince regulators that the CLECs' costs should be ignored in establishing reasonable switched access rates – digging too deeply into CLEC costs is sure to highlight the inherent hypocrisy illustrated by increasing special access prices while demanding lower switched access prices.

15. **What factors do ILECs (large and small) consider in determining their access rates? (a) Are the access rates of ILECs cost-based? (b) Should the Commission order any change to the access rates of ILECs?**

**Response:**

Under rate-of-return regulation, access charges were set for ILECs based on overall revenue and cost targets that were determined as part of a complicated jurisdictional cost allocation process – an arcane methodology generally inconsistent with economic cost causation principles. More recently, ILECs' interstate and intrastate exchange access rates have typically been set in the context of negotiated deals that reconcile a large number of issues for ILECs, regulators, and other interested parties, generally providing some form of "revenue neutrality" to the ILEC – i.e., as access rates go down, other regulated rates are adjusted to make up some part, or all, the difference. To lift ILEC exchange access rates out of this larger context and apply them to CLECs – without any acknowledgement of the historical regulatory context – is without merit and inequitable.

The following statement by the FCC on the complex processes originally used in setting exchange access rates for ILECs underscores the fact that these rates were not set by market forces or economic cost causation that would make them good proxies for the economic costs of other carriers:

> The [FCC] uses a multi-step process to identify the cost of providing access service. First, the rules require an incumbent LEC to record all of its expenses, investments, and revenues in accordance with accounting rules set forth in our regulations. Second, the rules divide these costs between those associated with regulated telecommunications services and those associated with non-regulated activities. Third, the separations rules determine the *fraction* of the incumbent LEC's regulated expenses and investment that should be *allocated* to the interstate jurisdiction. After the total amount of interstate cost is identified, the access charge rules translate these interstate costs into charges for the specific interstate access services and rate elements. Part 69 specifies in detail the rate structure for recovering those costs. That is, the rules tell the incumbent LECs the precise manner in which they may assess charges on interexchange carriers and end users. [2]

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

a) the ILECs costs were determined only in some aggregated, top-down[3] sense and then allocated across various "buckets," such as regulated vs. non-regulated, state vs. interstate, etc., and

b) rates were set to recover some general revenue/cost target but were not based on per unit[4] costs that would result from TSLRIC, or other forms of more economically rational cost analysis.

As a result, there is no compelling indication that ILEC rates, either at the inter- or intra-state level, are "cost based" in relation to the economic costs of those firms, let alone other very different firms, such as CLECs.

CLECs were never part of this complicated rate-setting process because it has no relevance to the competitive marketplace in which CLECs operate. CLECs do not separate their costs

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

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

4 The term "per unit costs" refers to the costs calculated for one unit of a service, such as a minute of use. Costs calculated under either the FCC's TELRIC methodology, or the Commission's Subst R. § 26.215 (LRIC methodology), are calculated on a per unit cost basis.

into regulated and non-regulated activities and services; likewise, they do not engage in jurisdictional separations and allocations of costs between state and interstate jurisdictions. Further, while this top-down cost allocation process and similar state-initiated processes may have resulted in rates that permitted ILECs to achieve an *overall recovery* of revenue/cost targets, there is simply nothing in this process that ensures that the resulting rates for individual services, such as the various individual components of switched access services, are in any way relevant to how such rates would be set in more competitive markets.

More recently, the negotiated nature of interstate exchange access rates has become clear. On May 31, 2000, the FCC adopted an "integrated interstate access reform and universal service proposal" put forward by AT&T, Bell Atlantic, GTE, SBC and Sprint (referred to by the FCC as the Coalition for Affordable Local and Long Distance Service – CALLS).[5] The *CALLS Order* substantially altered interstate switched access rates, reducing the rates for SBC and BellSouth (both now AT&T), as well as Bell Atlantic and GTE (both now Verizon), dramatically from previous levels. The primary focus of the order was to reduce interstate access rates paid by CALLS' long distance members AT&T (before its merger with SBC Communications) and Sprint, while at the same time allowing CALLS' local exchange members (AT&T and Verizon) to recover lost monies through the interstate universal service support mechanism (*i.e.*, largely a revenue neutral undertaking for the ILECs).[6] Even a cursory reading of the order indicates that the CALLS proposal adopted by the FCC was a landmark event in the process of interstate access reform, and that the reduction in switched access rates offered by the local exchange carriers in return for numerous and important concessions elsewhere was an integral part of the overall "agreement" that was reached.

It is important to note that the exchange access rates produced by the *CALLS Order* were set primarily through non-public *negotiations* between the ILECs, the IXCs, and apparently the FCC itself. The behind the scenes negotiations establishing the *CALLS Order* and the resulting rates are revealed in an illuminating dissent by FCC Commissioner Harold Furchtgott-Roth.[7] In his dissent, Commissioner Furchtgott-Roth provides a rare look "behind the curtain" of the process leading up to the *CALLS Order* and offers some enlightening insights. He begins his dissent by agreeing that interstate access charges (at that time) bore *little resemblance to the "costs of access actually incurred."*[8] Further, he then goes on, in a strong statement, to discredit the process by which the lowered rates were reached as "dismaying." Indeed, he goes so far as to suggest that, in his opinion, "the process by which the original CALLS proposal was modified [and ultimately approved] is fundamentally

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5 *Sixth Report and Order* in CC Docket Nos. 96-262 and 94-1, *Report and Order* in CC Docket No. 99-249, *Eleventh Report and Order* in CC Docket No. 96-45, FCC 00-193, Adopted May 31, 2000 (hereafter "*CALLS Order*").

6 *CALLS Order*, ¶ 3.

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

8 *Id.*

inconsistent with principles of neutrality and transparency that must govern agency decision making."[9]

Specifically, Commissioner Furchtgott-Roth describes a process whereby the CALLS organization (primarily the remaining AT&T, Verizon and Sprint) negotiated with various consumer groups in an effort to craft a modified proposal regarding reduced switched access rates and increased universal service fund monies that would be adopted by the FCC. Commissioner Furchtgott-Roth is highly critical of this process for three primary reasons:

a) The Commission (acting chiefly through the Common Carrier Bureau) apparently "refereed" the negotiations between the parties, and participated in recommending various outcomes negotiated by the parties (*i.e.*, the Common Carrier Bureau apparently agreed to recommend to the Commission for approval, certain components of the parties' agreement(s)). Commissioner Furchtgott-Roth complained that the FCC, in playing the dual role of referee and decision maker, had acted in a highly improper manner.

b) Several key participants who were interested in the process were denied access to the negotiations which ultimately resulted in the settlement agreement adopted by the FCC, *i.e.*, the Ad Hoc Telecommunications Users Committee, Time Warner Telecom, and the Association for Local Telecommunications Services (basically competitive local exchange carriers),[10] and

c) Concessions regarding access rate levels were gained from the ILECs by the FCC's agreement to make decisions in the ILECs' favor regarding not only additional universal service funds, but also two other actions completely independent from switched access services (*i.e.*, decisions regarding their obligations to provide Enhanced Extended Links – "EELs" – to competing local service providers and an ongoing audit initiative related to continuing property records). As Commissioner Furchtgott-Roth put it: "[I]t was entirely improper for the Commission to have permitted the unrelated matters of depreciation and special access become part of the negotiations."[11]

In other words, the ILEC exchange access rates that resulted from the CALLS negotiations, and which serve as the baseline for non-ILEC interstate exchange access rates due to the FCC's benchmarking policy, were not adopted based upon some diligent review of economic variables or even an attempt to arrive at a more efficient or competitive switched access marketplace. Instead, they were established as a negotiated settlement meant to appease a discrete group of parties who had been allowed the benefit of participating, each with its own regulatory wish list, including many objectives having nothing to do with switched access. Importantly, CLECs, whose interstate exchange access rates are capped at the rate level

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9 *Id.*

10 In short, the ILECs' primary local exchange competitors were barred from the discussions, even though they would have had a direct interest in the resulting switched access rate levels.

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

produced by the CALLS process, were precluded from participating in the process, even though issues of supreme importance to them (e.g., EELs and their own switched access rates) were ultimately decided therein.

The advocates of benchmarking (or capping) non-ILEC exchange access rates often ignore the genesis of the ILECs' exchange access rates and *pretend that the ILEC rates somehow "make sense,"* or that they are the result of reasoned and rational policy-making on the part of the FCC (*i.e.*, they will serve as a reasonable benchmark that should be adopted for CLEC exchange access rates). Nothing could be further from the truth. As the Furchtgott-Roth Dissent makes clear, the interstate access rates set for carriers like SBC and Verizon were established through regulatory "horse trading" aimed at appeasing the few, but enormous, carriers fortunate enough to have been involved in the negotiations. For example, SBC and Verizon agreed to reduce exchange access rates at the interstate level because they were promised the revenues they were giving up would be made up with monies from the universal service fund. Further, they were promised that the FCC would end an ongoing audit that had, on a preliminary basis, shown an embarrassing shortfall in the plant accounts of the major ILECs related to continuing property records supporting their entire interstate ratebase. And finally, SBC and Verizon were promised that the FCC would raise the barriers for competitors making use of SBC and Verizon unbundled network element ("UNE") combinations – EELs – to compete for local exchange customers. In other words, SBC and Verizon received a good deal of consideration (*i.e.*, money) for their agreement to lower their interstate switched access rates – consideration that non-ILECs were not afforded, even though they were required by the FCC to mirror these same concessionary interstate access rates approximately one year later.

In any event, it should be clear that the ILECs' exchange access rates have no merit *outside the overall context of their own specific and individual regulatory regimes*. As such, those rates could not, other than through sheer happenstance, be just and reasonable for CLECs. The same is true for benchmarking generally, even at the intrastate level, wherein ILEC rates have likewise been set based upon arcane regulatory ratemaking principals and/or similar political bargaining.

**(a) Are the access rates of ILECs cost-based?**
While the ILECs' rates may (or may not) be generally compensatory within the specific context of the company for which those rates have been set (or negotiated in the case of large ILEC interstate rates), *they are not cost-based* in the sense that they recoup the costs – determined on a cost-causative basis – of specific facilities involved in the provision of exchange access services. More significantly, even if a particular ILEC's access rates are based on costs (which is rarely the case), such costs are not relevant to other providers. This means that the ILECs' exchange access rates in no way should be represented as some sort of

prevailing "market price," as suggested by the FCC in its *CLEC Access Reform Order.*[12] It is inarguable that in Florida, like elsewhere, ILEC access rates have been subject to multiple rounds of regulation and legislation with little influence from market dynamics that would prevail in a less regulated market.

**(b) Should the Commission order any change to the access rates of ILECs?**

As discussed in CompSouth's Response to CompSouth's Proposed Supplemental Question #1, the Commission should refrain from focusing exclusively on the exchange access rates of CLECs. Instead if the Commission decides to examine exchange access rates, it should examine the exchange access rates of all LECs (ILECs and CLECs alike) in Florida. Therefore, any policy changes should also involve the exchange access rates of the ILECs, including the rural ILECs.

16. **Is it appropriate to use large or small ILEC switched access rates as benchmarks for establishing maximum CLEC switched access rates? (a) If an ILEC's rates are used as benchmarks, what effect will such benchmarking have on CLECs? (b) If an ILEC's rates are used as benchmarks, what effect will such benchmarking have on the market generally?**

**Response:**

If the Commission decides that some form of benchmarking is appropriate – and CompSouth believes that it is not – then the rates of incumbent carriers with comparable scale and scope and other cost-causative characteristics (i.e., customer density) should be considered superior to rates of the largest ILECs. As discussed in more detail below, in terms of their costs and operations, CLECs have far more in common with small or medium size ILECs than with the huge vertically integrated large ILECs, with whom they have little in common.

There are obvious reasons why CLECs' costs are very different from the large ILECs', such as lack of economies of scale and scope, use of a different network architecture to cover larger distances from the central office to the end-user customer locations (including the use of more transport and collocation facilities), lower levels of facility utilization, demonstrably higher input costs, etc.

Further, the Commission should consider that while CLECs will often operate and compete with large ILECs like AT&T and Verizon in densely populated urban or suburban

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12 *In the Matter of Access Charge Reform, Reform of Access Charges Imposed by Competitive Local Exchange Carriers*, Seventh Report and Order and Further Notice of Proposed Rulemaking, CC Dkt No. 96-262, rel. April 27, 2001, (hereafter "*CLEC Access Reform Order*"), ¶4.

environments, these areas translate into a *sparsely populated customer base* for the CLECs, not unlike the customer base for medium- sized or rural ILECs.

Once CLECs enter a particular geographic market, they tend to serve customers over an area that is roughly comparable to the local calling areas of the ILEC. However, due to the limited scope of their facilities and their status as new entrants, among other factors, CLECs will only serve *a very small fraction* of the customers in these areas. Thus, if the CLECs' customer base is expressed on a customer-per-square mile basis, it is very sparse relative to that of the ILECs that serve the vast majority of customers. Said another way, it is in large part the density of the carrier's customer base in relation to the deployment of its facilities that drives per-unit costs, regardless of the customer density or the geography itself. Even though a CLEC may serve the entirety of downtown Miami, to the extent it is able to capture only 2%-3% (or much less) of the overall customer base, it may actually be serving fewer customers per square mile than are served by some of the smallest, most rural exchanges in the state.

The nature of CLECs as new market entrants intuitively suggests that their customer density is lower than the customer density of the incumbents; actual empirical evidence, however, is difficult to come by because of the proprietary nature of the CLEC line count data. For example, although the FCC reports statewide line counts for CLECs and ILECs in its *Local Competition Report*, these data provide information only on the combined line counts of CLECs at a state level and does not indicate customer density for an *individual* CLEC within its serving territory.[13] Much of this information is already in the possession of the Florida PSC.

QSI obtained permission from several of its CLEC clients to analyze their end user customer line count density data and report the results in aggregate (to preserve the anonymity of individual carriers). The basic design of the study was to construct a measure of customer density of an average individual CLEC within its serving territory (where the CLEC serving territory is defined as the ILEC's wire centers in which the CLEC is collocated) and compare it to the customer density of the respective ILEC. This study consisted of the following steps:

1. The starting point of this analysis was a data set in which individual CLEC's line counts were reported by ILEC's wire center in which the CLEC is collocated.

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[13] Nevertheless, because the combined CLEC line counts and shares reported in the FCC *Local Competition Report* are lower than the ILECs' line counts and shares (and there are a number of CLECs operating in each incumbent's territory), it is clear that the underlying CLEC-specific customer density is significantly less that the customer density of the incumbents in which territories CLECs operate. For example, in its most recent *Local Competition Report* (released in December 2007), the FCC reports that the CLEC share is on average 17% nationwide, and the highest CLEC share (46%) is observed in Rhode Island. However, Rhode Island's relatively high CLEC market share is based on 21 CLECs and one ILEC, meaning that each individual CLEC in Rhode Island is likely much smaller than the ILEC (The market shares in this example are from the FCC *Local Competition Report* , December 2007, Table 7, and the number of reporting carriers is from Table 13).

2. This information was combined with the ILEC switched line counts and the serving area (square miles) of the same wire centers.[14]
3. Customer density for CLECs and ILECs was calculated for each wire center in which the CLECs are collocated.
4. Wire center level information was aggregated to the state level and an average (composite) CLEC was compared to the corresponding ILEC.
5. State-level data were compared across states within each ILEC's territory[15] and the minimum, maximum and average customer densities were recorded.[16]

The results of this analysis are presented in the following two charts (based on a Voice Grade Equivalent or VGE basis):[17]

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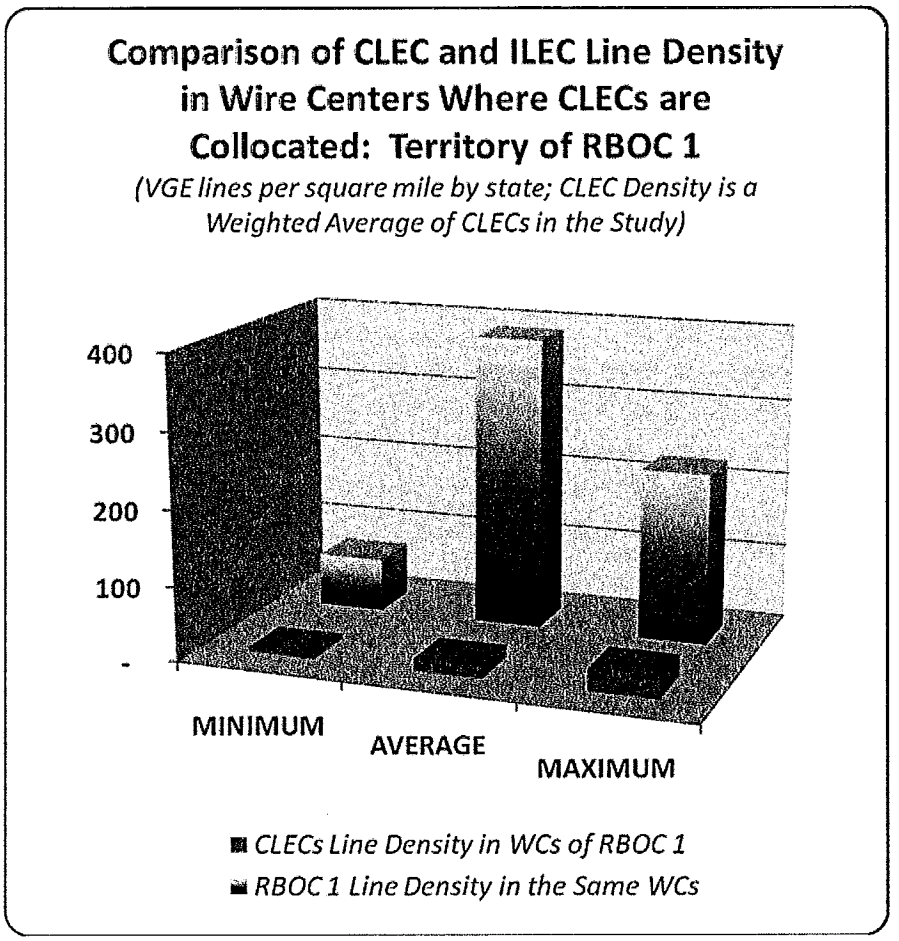
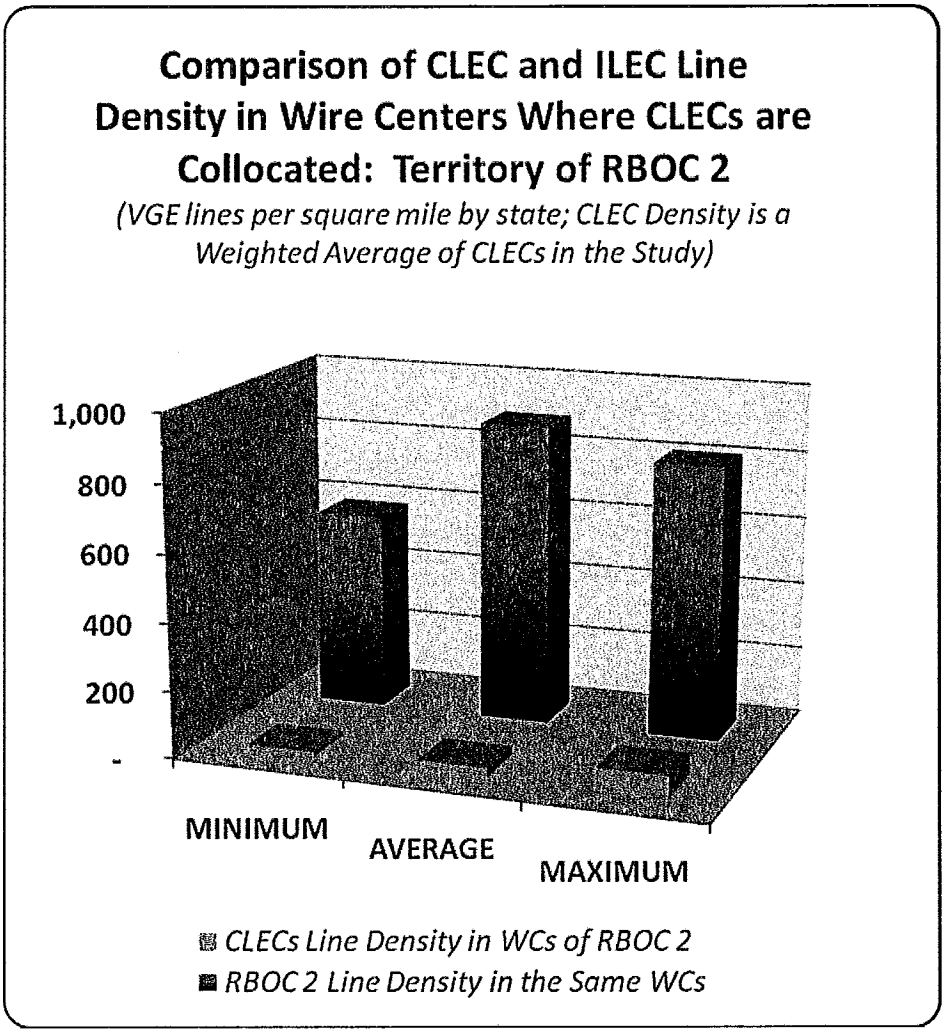
[14] The ILEC line counts are based on the following public data sources: Qwest's line counts are its 2007 business and residential line counts reported in its online Iconn database. The most recent public data source for wire center level line counts of other ILECs is the FCC Synthesis Model (the 2000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

[15] Because of the data limitations, this analysis was performed for the territory of two (out of three) RBOCs.

[16] While the "RBOC Average" corresponds to the RBOCs' average across all wire centers/states, the "RBOC Minimum" and "RBOC Maximum" are the measures of RBOC's density in wire centers where the Minimum and Maximum CLEC's densities are observed. In other words, while the RBOC may have the maximum customer density in state A, the CLEC may have the maximum customer density in state B. In this case, the chart depicts the RBOC and CLEC customer densities in state B.

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


Comparison of CLEC and ILEC Line Density in Wire Centers Where CLECs are Collocated: Territory of RBOC 1
(VGE lines per square mile by state; CLEC Density is a Weighted Average of CLECs in the Study)
400
300
200
100
-
MINIMUM
AVERAGE
MAXIMUM
CLECs Line Density in WCs of RBOC 1
RBOC 1 Line Density in the Same WCs




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

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

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

The table above shows that a CLEC's average customer line density (column (a)) is far lower than the incumbent's density. This is true not only if the comparison is performed in the wire centers where the CLECs operate (which may be relatively more urban/dense wire centers), but also if the CLEC's line density is compared to the ILEC's statewide line density (column (d)) so that the ILECs' rural areas are also taken into account.

To summarize the analysis of line densities, the CLECs' customer densities are significantly lower than the RBOCs' customer densities in markets where they compete. This suggests that, even though they may serve the same geographic market, assumptions that they face similar costs are substantially off-base. Indeed, all evidence suggests that CLECs are more appropriately compared with mid-size or rural ILECs than the RBOCs when it comes to important cost-causative measures, such as customer density. Although the data availability does not permit a full analysis of customer density for mid-size/rural ILECs, the following observations made by Windstream in the recent Texas USF case[18] illustrates the difference between an RBOC and a mid-size ILEC: According to this analysis, while AT&T has 94 access lines per square mile in Texas, Embarq has only 27 lines, and Windstream has only 7 lines per square mile. As the CLEC data above shows, in both circumstances, the average CLEC density per square mile is less than enjoyed by Embarq in Texas.

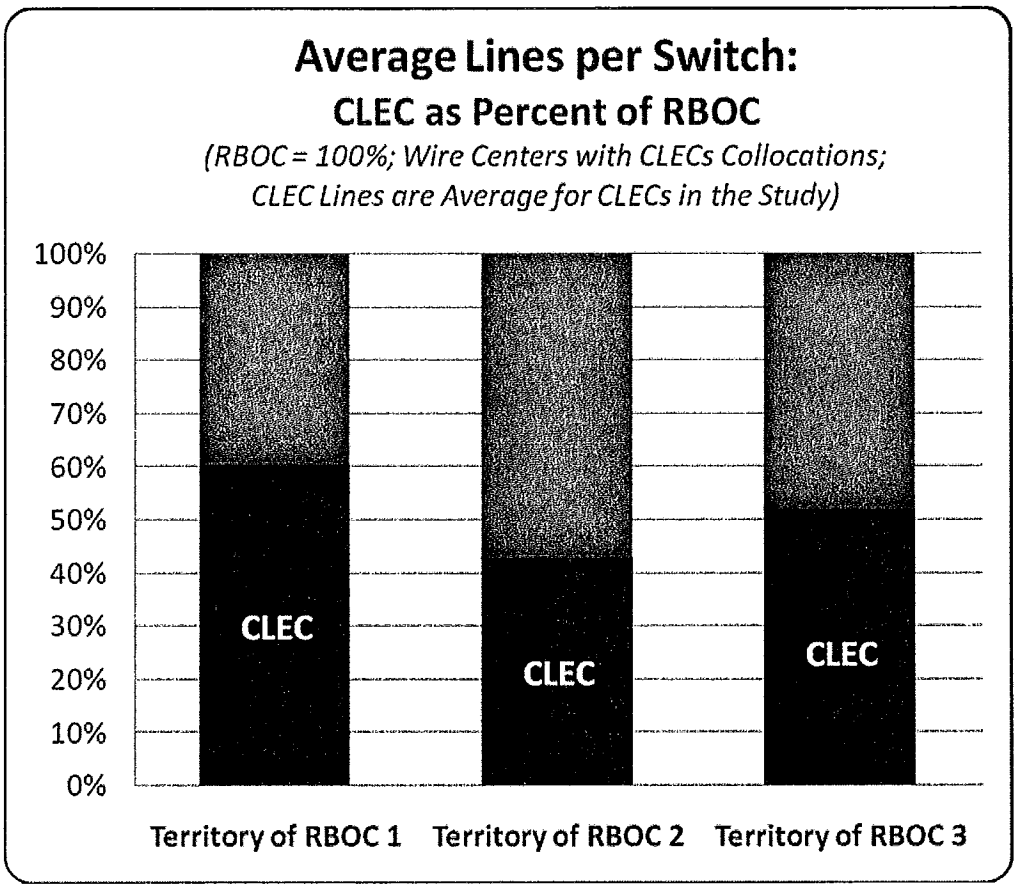
As regulators know from TELRIC and other cost proceedings, customer density is a major cost driver in cost studies. Higher customer density means that, among other efficiencies, fixed costs can be spread over larger units of production resulting in smaller costs per unit (the opposite is true as well – less density tends to generate higher per-unit costs). In fact, it is in recognition of this close relationship between customer density and ILEC costs that most regulatory commissions have established different rate zones for UNE rates in TELRIC proceedings, such as urban, suburban and rural rate zones – even when looking at the costs of a single carrier. Unfortunately, this intellectual equalization of geography with customer density (i.e., rural exchanges are less dense than urban exchanges) is a result of the fact that

[18] Texas PUC case No. 34723, Direct Testimony of William F. Kreutz (Windstream), November 30, 2007, p. 16.

the ILEC serves the vast majority of customers in each of those markets. Given that CLEC customer bases are more sparse (or less dense) relative toAT&T and Verizon, even in the same densely populated geographic regions in which CLECs compete with AT&T and Verizon, CLECs' costs tend to be higher on a per unit basis regardless of the shared geography. While this effect may have been intentionally moderated in the past by Congress allowing CLECs to use ILEC loop and transport facilities at prices approaching economic costs, with the FCC's TRRO decisions limiting cost-based access to these facilities and the FCC's lax regulatory oversight of special access prices, even these costs are increasing for CLECs - in some cases dramatically. Yet even as AT&T and Verizon increase prices for the input facilities CLECs use to provide switched access and other services, they are requesting across the country that regulators reduce the prices they themselves pay to CLECs when they rely upon these same facilities to obtain switched access services.

Another consequence of low customer density is that CLEC switches often support *fewer* lines than an ILEC switch despite the fact that a CLEC spends substantial monies on additional transport facilities intended to aggregate traffic over a much larger territory than that typically covered by an ILEC wire center. QSI made this observation while analyzing the above discussed proprietary line count data of its client CLECs. The following chart depicts this finding: [19]

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




The chart above expresses average CLEC lines per CLEC switch (blue bars) as a percent of the RBOC's lines per RBOC switch. As shown in this chart, an average CLEC has less lines per switch than the RBOC in whose territory the CLEC operates.

Again, all of these cost increases (relative to the ILECs' costs) are the result of the CLECs' sparser customer base.

In sum, the above discussion demonstrates that the CLECs' cost structure has far more in common with medium size and rural ILECs than with the large ILECs. *Therefore, to the extent that the Commission decides to adopt a benchmark policy, it should reject any recommendations that CLEC rates be benchmarked against the large ILECs' exchange access rates.*

**(a) If an ILEC's rates are used as benchmarks, what effect will such benchmarking have on CLECs?**

CLECs have demonstrably higher traffic-sensitive costs in the provision of exchange access services than large ILECs, due to such factors as lack of economies of scale and scope,

higher input prices, a network architecture that uses more transport and collocation arrangements, lower customer densities, etc. This means that if the Commission uses the large ILECs' exchange access rates as benchmarks, then CLECs will be unable to recoup all of their costs incurred in the provision of exchange access services. Further, given that CLECs are generally obligated to accommodate the IXCs' exchange access traffic, CLECs will be forced -- by government fiat – to subsidize the operations of the IXCs at below cost prices. There is simply not sound policy justification for such a reverse Robin Hood cross-subsidization scheme.

**(b) If an ILEC's rates are used as benchmarks, what effect will such benchmarking have on the market generally?**

The ILECs' exchange access rates are unlikely to be compensatory for the CLECs. This means that the CLECs will not be able to recoup their costs incurred in the provision of exchange access services. Given that CLECs have little or no ability to recoup those costs in other markets or from other customers, the unrecovered costs will be a constant drain on the CLECs' resources and seriously impair their ability to remain economically viable.

Further, the CLECs' exchange access rate reductions are unlikely to benefit Florida rate payers since it is doubtful that the large IXCs will flow them through to their long distance customers, and even if they do, the dollars transferred from CLECs to the IXCs are too small to meaningfully register with ratepayers in rate reductions. Also, as recent upward trends in toll rates suggest, it is far more likely that the IXCs will simply use the cost savings to increase returns to their shareholders. [20]

**17. If the Commission establishes a presumptive cap on CLEC access rates, do CLECs have the ability to recover access revenue reductions resulting from capped access rates through rate increases to end use customers? (a) Do CLECs have the same ability to pass through such rate increases as ILECs or RLECs? (b) If not, what impact should CLEC inability to pass through such rate increases have on the Commission action in this matter?**

**Response:**

CLECs have only a limited ability to recover access revenue reductions.

First, while some advocates of the benchmark policies have argued in other proceedings that CLECs should recoup costs associated with exchange access services from their own end

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[20] At a minimum, the burden must be on the parties advocating a cap on CLEC charges that the difference between CLEC access charges actually paid and CLEC access charges as capped would make a meaningful difference in IXC retail prices in the Florida market. As stated above, the CLECs doubt the IXCs will voluntarily pass through reduced access costs, and the Commission's statutory authority over IXCs and their retail rates is practically nonexistent.

users, this type of cross-subsidization is highly inappropriate. *The CLECs' end users are not the cost causers for costs incurred in the provision of exchange access calls; IXCs and their customers are.*[21] Therefore, the CLECs' end users should not be burdened with the cost recovery responsibility for exchange access costs. Instead, the cost causers are the IXC customers placing toll calls; as such, even if the same customer is both a CLEC customer and an IXC customer, it is the IXCs' customers that should shoulder the cost recovery responsibilities of using the network to make the toll call. An arbitrary mixing and matching of cost causation and cost recovery would only lead to inappropriate cross-subsidization schemes, such as the CLECs' end users subsidizing the IXCs' telemarketers.

Cross-subsidization irrespective of cost causation is fundamentally at odds with the price mechanism that guides free market economies or the mechanisms regulators should rely upon when they intervene in markets. A scheme under which the CLECs' end users are intended to pick up the tab for the IXCs' end users is also, aside from bad economic policy, inequitable from a common sense perspective – especially when the IXC and the CLEC compete against one another. In simple terms: *Why should the CLECs' end users have to pay for the costs of calls made by the IXCs' end users?* It is no less unjust and unwise than to devise a scheme under which United States citizens who fly domestically are required to pay a surcharge to subsidize foreigners on international flights to and from the United States. While undoubtedly airlines have more profitable routes and less profitable routes, a policy that imposes on a select group of airlines the aforementioned subsidization scheme would not only be absurd, it would also be very harmful to the long term prospects of those carriers.

The CLECs' ability to recoup unrecovered exchange access costs from other end-user services is limited. CLECs compete in local exchange markets and must meet or beat prevailing end user prices. This means that they cannot simply increase their rates to recover costs unrelated to the provision of local exchange services. That is, aside from the fact that such a cross-subsidy is unjustified, markets dynamics won't tolerate it.

**(a) Do CLECs have the same ability to pass-through such rate increases as ILECs or RLECs?**

No, for a number of real-world reasons, CLECs do not have the same ability as large ILECs to recoup under-recovered exchange access costs from end users.

First, a large portion, if not most, of the calls on the local network of AT&T are likely intra-switch and intra-network in nature. By that we mean that because AT&T provides service in the largest metropolitan areas and has such a large market share, most of the local calls that any AT&T customer places are going to a person or business who is likely also an AT&T

[21] This argument is certainly true for terminating exchange access traffic. Where it concerns *originating* access traffic, however, there is a complicating factor in that the IXC's end user and the CLEC's end user is likely the same customer. Thus, while the cross-subsidization may not be between different customers, it is cross-subsidization between the IXC's services and the CLEC's services.

customer. The same is true for Verizon. This means that much of the large ILECs' networks are largely designed to accommodate intra-office and interoffice *on-net* local calling.

By contrast, CLECs have very little on-net calling. Most of their traffic is *off-net*, and much of it is long distance. As a result, the CLECs' networks are designed to accommodate a much larger percentage of off-net, long distance calling. That is, the cost of originating and terminating off-net calls drives the CLECs' network costs to a larger degree than it drives the ILECs' network costs.

The fact that most of the CLECs' traffic is off-net increases the traffic sensitive portion – *the portion that is relevant for switched access rates* – of overall network costs. In other words, CLECs' costs are generally more usage sensitive than the ILECs'. Specifically, this means that a much larger portion of the CLECs' transport and switching facilities and costs are associated with and caused by switched access services (as those are a significant component of the off-net traffic).

The FCC's prior suggestion that CLECs should recover costs of providing exchange access services not recoverable through switched access rates from end-user customers ignores the fact that the CLECs do not have the same ability as the large ILECs to recoup network costs by raising the rates for services with flat-rated, non-usage sensitive rates (like monthly local telephone service), even putting aside the obvious competitive pressure on CLEC local rates. In essence, this approach asks CLECs to charge its competitors less, but gives them the Hobson's choice to increase end user customer rates to make up the difference – even though such increases only further expose the CLECs to the same competitors which now have lower costs. Perhaps this had some appeal when IXCs did not compete vigorously in the local market, but with the merger of the largest IXCs with the largest ILECs, this scheme is not only inequitable, it promises to lead to further concentration (and less competition) in both local and long distance markets.

The Commission should also note that all of the CLECs' retail customers have competitive alternatives for their phone service while a large portion of the ILECs' customer base still do not. This means that ILECs can easily maintain retail prices above competitive levels – to recoup any unrecovered switched access costs[22] – and CLECs cannot.

The table below summarizes the relationship between a carrier's relative size and its ability to shift traffic sensitive costs to its end users. As indicated below, the large ILECs have a *large* pool of end users and *few* traffic sensitive costs relative to their overall costs. This means that the large ILECs are able to shift – spread – those relatively few traffic sensitive costs onto a large number of end users without significantly impacting individual end users. By contrast, CLECs have relatively few customers onto whom they can shift the relatively higher traffic sensitive costs associated with access traffic. Thus, if CLECs are forced to

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[22] There is no demonstration, however, that ILECs are struggling to recover the costs of providing switched access services from IXCs.

provide exchange access services below cost, the CLECs' end users may be impacted quite significantly. In short, because CLECs and ILECs are so different in terms of their customer base, network architecture, and costs structures, using an ILEC exchange access rate as a proxy for a CLEC exchange access rate would be very damaging to competition in Florida.

| | Number of End-Users | Proportion of TS to Overall Costs | Ability to Shift TS Costs to End Users |
|---|---|---|---|
| **Large ILECs** | Many | Relatively Small | Great -- because there are many end users to absorb relatively few costs |
| **CLECs** | Fewer | Relatively Large | Little -- because there are relatively few end users to absorb large costs |

**(b) If not, what impact should CLEC inability to pass-through such rate increases have on the Commission action in this matter?**

The Commission should take great care to ensure that any exchange access policies are (1) mindful of the need for CLECs to have a reasonable opportunity to recoup their exchange access costs, and (2) avoid any implicit cross-subsidy schemes, such as those between users of exchange access services and users of local exchange services.

18. **Should the Commission review the entire Florida market for access services and the access rates of all carriers, not just CLEC access rates? (a) What harm will result if the Commission takes action only with respect to CLEC access rates? (b) What effect would Commission action only with respect to CLEC access rates have on the market for intrastate interexchange service?**

**Response:**

If the Commission determines that the market is currently structured such that it exerts insufficient discipline on access rates (a proposition with which CompSouth disagrees), it would need to determine that such insufficiencies are limited to the role of CLECs in the market if it chooses to focus solely on that subgroup of market participants. Unlike some other market participants, CLECs do not have market power for any services. Further, the

history of telecommunications regulation teaches that piecemeal regulations intended to solve larger, overarching problems rarely if ever lead to satisfactory solutions; rather they tend to create new problems and distortions in their wake. This is certainly true with respect to the larger issue of intercarrier compensation of which exchange access is a subset. Regulators should structure markets in a way that offers theoretically sound and internally consistent global solutions and not a seemingly endless stream of piecemeal, quick fixes that favor one participant over another.

Any evaluation of whether the CLECs' exchange access rates are appropriate should not be performed in isolation from the rest of the industry or in isolation from efforts being considered by the FCC in the larger scope of intercarrier compensation.

**(a) What harm will result if the Commission takes action only with respect to CLEC access rates?**

No evaluation of whether the CLECs' exchange access rates are appropriate should be performed in isolation from the rest of the industry or in isolation from efforts being considered by the FCC in the larger scope of intercarrier compensation. To focus just on the CLECs' exchange access rates would potentially cause harm to CLECs and competitive telephone service availability in Florida. First, an exclusive focus on the CLECs' exchange access rates would be discriminatory and disadvantage CLECs relative to the ILECs. This is particularly true if the Commission were to adopt exchange access policies that fail to consider the CLECs' need for adequate compensation. Further, as we have already discussed, CLECs incur more usage sensitive costs than ILECs and are more dependent on exchange access revenues. By precluding CLECs from recovering their costs, the Florida PSC would be reducing the ability of companies to offer competitive telephone service to end users in Florida.

**(b) What effect would Commission action only with respect to CLEC access rates have on the market for intrastate interexchange service?**

It is unlikely that Florida ratepayers will benefit from access charges reductions that may be forced upon CLECs. Indeed, it is far more likely that the IXCs/large ILECs will simply keep the relatively small savings to the benefit of their stockholders.

Both interstate and intrastate toll prices have demonstrated a well-established downward trend over the better part of the last three decades. However, there are indications that this downward trend is being reversed and that toll prices are increasing after many year-after-year decreases. The FCC's most recent Reference Book on rates for telecommunications services shows intrastate toll and interstate toll prices increasing in 2006 (the most recent year available in the 2007 publication) after almost a decade of year-after-year decreases.[23]

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[23] Nine years of decreases for interstate toll and eight years of decreases for intrastate toll. FCC 2007 Reference Book on Rates Table 3.1. Inflation Adjusted Interstate Toll Calls and Intrastate Toll Calls.

All in all, interstate and intrastate toll prices have increased in only five of the last 27 years, with 2006 being one of those years.[24] In addition, these increases in toll prices are occurring at the same time that the prices for local telephone service and wireless telephone services are decreasing.[25] Perhaps more importantly, these increases in toll prices roughly correspond to the time at which the mega-mergers of AT&T/SBC,[26] MCI/Verizon,[27] and Sprint/Nextel[28] occurred. While one year of price data may be insufficient to draw definitive conclusions about the extent to which the recent reversal in the established trend of decreasing toll prices is linked to increased consolidation in telecommunications markets, it should be sufficient reason to give regulators pause when IXCs/large ILECs approach them to seek rate caps on CLEC exchange access rates. At the very least, it should signal to regulators that any examination focusing on exchange access rates of CLECs is too narrow and that such an examination should be expanded to look at the prices of toll services which use exchange access as an input.

The Commission simply cannot assume, as the FCC did, that reductions in CLEC access charges will be passed through via lower long distance rates. Rather, it is quite possible that money taken from the CLECs – *by reducing their exchange access rates to below cost levels* – will go directly toward increasing the bottom line of the world's largest telecommunications providers.

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24 FCC 2007 Reference Book on Rates Table 3.1. Inflation Adjusted Interstate Toll Calls and Intrastate Toll Calls.

25 FCC 2007 Reference Book on Rates Table 3.1. Inflation Adjusted.

26 The SBC/AT&T merger was announced on or about January 30, 2005 and the FCC order approving the merger was released on November 17, 2005.

27 The Verizon/MCI merger was announced on or about February 14, 2005 and the FCC order approving the merger was released on November 17, 2005.

28 The Sprint/Nextel merger was announced on December 15, 2004 and the FCC order approving the merger as released on August 8, 2005.