BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

In the Matter of	DOCKET NO. 990691-TP
Petition of ICG Telecom Group, Inc. for arbitration of unresolved issues in interconnection negotiations with BellSouth Telecommunications, Inc.	

VOLUME 2
Pages 117 through 218

PROCEEDINGS: HEARING

BEFORE: COMMISSIONER J. TERRY DEASON
COMMISSIONER SUSAN F. CLARK
COMMISSIONER E. LEON JACOBS

DATE: October 7, 1999

TIME: Commenced at 9:30 a.m.
Concluded at 6:30 p.m.

LOCATION: Betty Easley Conference Center
Room 148
4075 Esplanade Way
Tallahassee, Florida

REPORTED BY: JANE FAUROT, RPR
NOTARY PUBLIC IN AND FOR
THE STATE OF FLORIDA AT LARGE

APPEARANCES:

(As heretofore noted.)

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P R O C E E D I N G S

(Transcript continues in sequence from Volume 1.)

COMMISSIONER DEASON: Mr. McGlothlin, you may call your next witness.

MR. KRAMER: At this time, Commissioner, I would like to call Michael Starkey.

Thereupon,

MICHAEL STARKEY

was called as a witness on behalf of ICG Telecom Group, Inc., and having first been duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. KRAMER:

Q Mr. Starkey, would you state your name and your business address, please?

A My name is Michael Starkey, and my business address is 6401 Tracton Court in Austin, Texas, and the zip code is 78739.

Q And could you state your professional affiliation or position?

A I am employed by QSI Consulting, Incorporated, which is a consulting firm specializing in telecommunications.

Q And did you cause to be prepared or prepare yourself the direct testimony and exhibits of Michael

Starkey that have been submitted in this matter?

A Yes, I did.

Q And if I asked you each of the questions contained in the direct testimony and exhibits of Michael Starkey in this matter, would your answers to those questions be the same now?

A Yes, they would.

Q Do you have any corrections to the testimony?

A I don't have any corrections to my direct testimony.

MR. KRAMER: Commissioner, at this time I would move in the direct testimony of Michael Starkey.

COMMISSIONER DEASON: Without objection it will be will be so inserted.

DIRECT TESTIMONY AND EXHIBITS

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

DIRECT TESTIMONY AND EXHIBITS

OF MICHAEL STARKEY

ON BEHALF OF ICG TELECOM GROUP, INC.

DOCKET NO. 990691-TP

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

A. My name is Michael Starkey. My business address is Quantitative Solutions, Inc., 857 N. LaSalle Drive, Suite 3, Chicago, Illinois 60610.

Q. WHAT IS QUANTITATIVE SOLUTIONS, INC. AND WHAT IS YOUR POSITION WITH THE FIRM?

A. Quantitative Solutions, Inc. (QSI) is a consulting firm specializing in the areas of telecommunications policy, econometric analysis and computer aided modeling. I currently serve as the firm's President.

Q. PLEASE DESCRIBE YOUR EXPERIENCE WITH TELECOMMUNICATIONS POLICY ISSUES AND YOUR RELEVANT WORK HISTORY.

A. Prior to founding QSI I was a founding partner and Senior Vice President of Telecommunications Services at Competitive Strategies Group, Ltd. (CSG). Like QSI, CSG is a consulting firm providing consulting services to international telecommunications carriers, consumer advocates and policy makers. During my tenure at CSG I represented a number of clients in regulatory proceedings across the country, including numerous arbitrations held pursuant to Section 252 of the Federal Telecommunications Act of 1996 (TA96).

Prior to joining CSG I was most recently employed by the Maryland Public Service Commission as Director of the Commission's Telecommunications Division. In my role as the Commission's Telecommunications Director I was responsible for managing the Commission's Telecommunications Staff. My staff and I were responsible for providing the Commission with telecommunications policy, economic, and technical expertise. During my tenure with the Maryland Commission, I managed the Commission's transition to a competitive local telecommunications regulatory framework, headed the Commission's Industry Consortium on Local Number Portability and represented the Commission in an industry effort aimed at replenishing the supply of usable telephone numbers.

Prior to joining the Maryland Commission Staff I was employed by the Illinois Commerce Commission as Senior Telecommunications Policy Analyst within the Commission's Office of Policy and Planning (OPP). As a member of the Commission's OPP Staff I was a primary witness in the Commission's "Customers First" proceedings. In that capacity, I authored revisions to Commission Code Part 790 to incorporate "Line Side Interconnection" allowing, for the first time, interconnection to unbundled network elements. I also represented the Commission Staff at the Ameritech Regional Regulatory Conference (ARRC). I participated with the ARRC staff in preparing a report submitted to the FCC and the U.S. Department of Justice detailing Ameritech's proposal to participate in a trial waiver from the

Modified Final Judgement for purposes of offering in-region, inter-LATA services. Before joining the Illinois Commerce Commission Staff I began my career as an Economist with the Missouri Public Service Commission within the Commission's Utility Operations Division. My responsibilities included recommendations to the Commission with respect to the tariff filings submitted by Missouri's telecommunications companies and numerous other telecommunications issues. A more complete description of my relevant experience can be found in Exhibit No. _____ (MS-1).

Q. DO YOU HAVE DIRECT EXPERIENCE WITH THE ISSUES IN THIS CASE?

A. Yes, I do. Over the past three years I have participated in a number of proceedings dealing with the proper application of the Federal Communications Commission's (FCC's) local competition rules and the proper implementation of TA96. I have also been active in a number of cases involving the FCC's Total Element Long Run Incremental Cost ("TELRIC") methodology by which prices for unbundled network elements and reciprocal compensation rates must be set. I have participated in arbitrations and other proceedings across the country wherein the interconnection agreements and underlying incremental cost estimates of Ameritech, Bell Atlantic, Southwestern Bell Telephone, Sprint, U.S. West, GTE, NYNEX, Bell South and Cincinnati Bell Telephone have been at issue.

Q. HAVE YOU PROVIDED TESTIMONY BEFORE STATE UTILITY COMMISSIONS IN THE PAST?

A. Yes, I have. I have over the past seven (7) years provided testimony before the FCC and state utility commissions in the following states: Michigan, Illinois, Maryland, Wisconsin, Indiana, Ohio, New Jersey, Pennsylvania, Massachusetts, Wyoming, Hawaii, Georgia, Oklahoma, Kentucky, Mississippi and Missouri.

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

A. The purpose of my testimony in this proceeding is to establish the economic and public policy rationales supporting ICG Telecom Group, Inc.'s (ICG's) positions with respect to the following issues: (1) whether traffic originated on the network of one carrier and directed to an Internet Service Provider (ISP) served by another carrier's network should be subject to reciprocal compensation payments, (2) the appropriate reciprocal compensation rate to be paid to ICG by BellSouth Telecommunications, Inc. (BST), (3) the need not only for the inclusion of performance standards within the interconnection agreement, but also the inclusion of liquidated damages associated with failure to meet those specified performance levels and (4) the need for volume and term discounts when a company like ICG is willing to commit to a given volume of unbundled network elements purchased from BellSouth and/or a commitment to purchase those elements over a given period of time.

Q. PLEASE SUMMARIZE THE CONCLUSIONS OF YOUR TESTIMONY.

A. First, though a multitude of complex legal and technical arguments have been made both in support of, and in opposition to, requiring reciprocal compensation payments for traffic directed to ISPs, it is simply good public policy, as well as economically rational, to require payment for terminating this traffic. Second, ICG efficiently deploys its network in such a way that the appropriate rate for its termination of BST traffic is a rate, based upon the same rates charged by BST, that compensates it for tandem switching, transport and end office switching functions. Third, absent the inclusion of performance standards and liquidated damage provisions for non-performance within the interconnection agreement between ICG and BST, ICG will be at a distinct disadvantage in the marketplace *vis-à-vis* BST. Finally, both the Telecommunications Act of 1996 and the FCC's orders in C.C. Docket No. 96-98 support the need for volume and term discounts for purchases of unbundled network elements when necessary to reflect underlying economic costs and to maintain non-discriminatory treatment. As such, the Commission should find that volume and term discounts are required when a carrier is willing to commit itself to purchase a given volume of unbundled network elements or to purchase those elements for a particular period of time.

I. PAYMENTS FOR TERMINATING TRAFFIC TO ISPs

Q. ARE THE PARTIES IN DISAGREEMENT REGARDING SPECIFIC LANGUAGE WITH RESPECT TO PAYMENTS FOR TERMINATING TRAFFIC TO ISPS?

A. Yes, they are. While there are still interconnection agreement drafts circulating among the negotiating teams, it seems clear that BST intends to include the following, or similar, language in any interconnection agreement between the parties:

8. <u>Local Interconnection Compensation</u>

> 8.1 The Parties shall provide for the mutual and reciprocal recovery of the costs of transporting and terminating local calls on each other's network.
>
> 8.3 Interconnection with Enhanced Service Providers (ESPS) / Information Service Providers (ISPs). ESP/ISP traffic shall not be included in the local interconnection compensation arrangements of this Agreement. (Excerpts taken from Attachment 3, Page 11 of the 03/15/99 draft of BellSouth's proposed interconnection agreement.)

ICG does not agree that the proposed language included in Section 8.3 above should be included in the parties' interconnection agreement. Neither does it agree that calls terminated to ISP providers should be excluded from reciprocal compensation requirements. Instead, ICG requests that the Commission approve an interconnection agreement between ICG and BST that excludes the language in 8.3 entirely and includes language that highlights the fact that calls originated on one of the carriers' networks and directed to an ISP on the others' network is subject to payments for reciprocal compensation.

Q. CAN YOU PROVIDE SOME BACKGROUND AS TO WHY THIS ISSUE IS IMPORTANT TO BOTH ICG AND TO BST?

A. This issue is of the utmost importance to ICG because, as I am informed and explain in more detail below, ICG has been notably successful in attracting ISP providers and other customers requiring advanced technological services to its network. BST's attempt to exclude these types of local customers from reciprocal compensation obligations unfairly targets ICG's customer base and threatens to leave ICG in a position of terminating a large number of BST calls without any payment from BST. In essence, ICG is being asked to carry large volumes of BST traffic without an ability to charge BST for its carriage.

While I am not attempting to speak for BST as to why it finds this issue to be of such importance, I think it is safe to say that BST is oftentimes a "net payor" of reciprocal compensation. This is due primarily to the fact that ALECs have been far more successful in attracting ISP providers to their local service offerings than BellSouth has been in retaining them. Consider that although the vast majority of services and prices included in an interconnection agreement between BST and a ALEC govern the rates, terms and conditions by which the ALEC will pay BST for service, this is one area where BST may actually, in some circumstances, be required to pay the ALEC for services the ALEC provides to BST. It is likely for that reason that BST is acutely interested in the rates that will be paid for reciprocal compensation and the terms and conditions under which they will be assessed.

Q. HOW HAS THE FCC CHARACTERIZED CALLS TO ISPS?

A. On February 26, 1999 the FCC released its *Declaratory Ruling in CC Docket No. 96-98 and Notice of Proposed Rulemaking in CC Docket No. 96-98* (hereafter "ISP Order"). At paragraph 18 of its ISP Order, the FCC states the following:

> After reviewing the record, we conclude that, although some Internet traffic is intrastate, a substantial portion of Internet traffic involves accessing interstate or foreign websites.

Q. DOESN'T THIS FINDING BY THE FCC SUPPORT BST'S PROPOSED LANGUAGE EXCLUDING ISP TRAFFIC FROM RECIPROCAL COMPENSATION?

A. It does not. Included in the same ISP Order, at paragraph 20, the FCC includes the following language:

> Our determination that at least a substantial portion of dial-up ISP-bound traffic is interstate does not, however, alter the current ESP exemption. ESPs, including ISPs, continue to be entitled to purchase their PSTN links through intrastate (local) tariffs rather than through interstate access tariffs. <u>Nor, as we discuss below, is it dispositive of interconnection disputes currently before state commissions</u>. (emphasis added, footnotes removed)

The FCC also includes the following additional language at paragraph 25 meant to ensure that state commission's aren't misled into believing that the FCC has pre-empted their ability to require compensation for ISP traffic within an arbitration proceeding:

> <u>Even where parties to interconnection agreements do not voluntarily agree on an inter-carrier compensation mechanism for ISP-bound traffic, state commissions nonetheless may determine in their arbitration proceedings at this point that reciprocal compensation should be paid for this traffic</u>. The passage of the 1996 Act raised the novel issue of the applicability of its local competition provisions to the issue of inter-carrier compensation for ISP-bound traffic. Section 252 imposes upon state commissions the statutory duty to approve voluntarily-negotiated interconnection agreements and to arbitrate

interconnection disputes. As we observed in the Local Competition Order, state commission authority over interconnection agreements pursuant to section 252 "extends to both interstate and intrastate matters." Thus the mere fact that ISP-bound traffic is largely interstate does not necessarily remove it from the section 251/252 negotiation and arbitration process. However, any such arbitration must be consistent with governing federal law. While to date the Commission has not adopted a specific rule governing the matter, we do note that our policy of treating ISP-bound traffic as local for purposes of interstate access charges would, if applied in the separate context of reciprocal compensation, suggest that such compensation is due for that traffic. (emphasis added, footnotes removed)

Q. IF THE FCC HASN'T DECIDED THE ISSUE OF WHETHER ISP-BOUND TRAFFIC SHOULD BE SUBJECT TO RECIPROCAL COMPENSATION, AND IF IT IS THE STATE COMMISSIONS' RESPONSIBILITY TO DO SO, UPON WHAT BASIS SHOULD A STATE COMMISSION MAKE SUCH A FINDING?

A. First, the Commission should take special note of the following excerpt taken directly from paragraph 25 of the FCC's ISP Order:

While to date the Commission has not adopted a specific rule governing the matter, we do note that our policy of treating ISP-bound traffic as local for purposes of interstate access charges would, if applied in the separate context of reciprocal compensation, suggest that such compensation is due for that traffic.

From this excerpt it seems obvious that the FCC is encouraging state commissions to make findings consistent with its policy of treating ISP-bound traffic as local for purposes of applying interstate access charges. That is, the FCC is encouraging state commission's to require reciprocal compensation payments for ISP bound traffic.

Second, the Commission, as always, should rely upon sound public policy and economic reasoning to find that ISP-bound traffic should be subject to reciprocal compensation obligations. The Commission should keep in mind that its decisions in this regard will have substantial impact on the internet marketplace and the investment required to realize the potential of electronic communication and commerce as a whole.

Q. PLEASE EXPLAIN WHY SOUND PUBLIC POLICY AND ECONOMIC REASONING SUPPORT RECIPROCAL COMPENSATION PAYMENTS FOR ISP-BOUND TRAFFIC.

A. The list below provides an overview of the public policy and economic rationale that support requiring payments for ISP bound traffic *via* the application of transport and termination charges (*i.e.* reciprocal compensation):

(a) ISP providers are an important market segment for CLECs and eliminating a CLEC's ability to recover its costs associated with serving them is likely to distort one of the only local exchange market segments that appears to be well on its way toward effective competition. ISPs have been drawn to CLECs like ICG because these CLECs, unlike incumbent carriers

(ILECs) such as BST, have been willing to meet their unique service needs. Allowing ILECs to direct calls to the ISPs by using the CLEC network without compensating them for its use, penalizes the CLEC for attracting customers *via* innovative and customer service focused products.

(b) Despite complex legal arguments and historical definitions, the simple fact remains that calls directed to ISPs are functionally identical to local voice calls for which BST agrees to pay termination charges. Applying different termination rates or, even worse, compensating a carrier for one type of call and not for the other, will generate inaccurate economic signals in the marketplace, the result of which will drive firms away from serving ISPs. This result could have a dire impact on the growing electronic communication and commerce markets.

(c) Requiring carriers to pay reciprocal compensation rates for the termination of ISP bound traffic is economically efficient. Indeed, because termination rates must be based upon their underlying costs, BST should be economically indifferent as to whether it itself incurs the cost to terminate the call on its own network or whether it incurs that cost through a reciprocal compensation rate paid to ICG. The fact that BST is not economically indifferent stems from its incentive to impede ICG's entry into the marketplace instead of an incentive to be as efficient as possible in terminating its traffic.

(d) Because BST is required to pay, as well as receive, symmetrical compensation for local exchange traffic based upon its own reported costs, its payments to other carriers in this regard are an important check on BST's cost studies used to establish rates for the termination of traffic. Unless BST is required to pay the costs that it itself has established *via* its own cost studies, it has every incentive to over-estimate those costs for purposes of raising barriers to competitive entry. By removing large traffic volume categories such as ISP bound traffic from BST's obligation to pay terminating costs, the Commission would be removing an important disciplining factor associated with ensuring that BST's reported termination costs are reasonable.

Q. PLEASE EXPLAIN IN GREATER DETAIL YOUR CONTENTION THAT BECAUSE ISP PROVIDERS ARE AN IMPORTANT MARKET SEGMENT FOR ALECS, ELIMINATING AN ALEC'S ABILITY TO RECOVER ITS COSTS ASSOCIATED WITH SERVING THEM IS LIKELY TO DISTORT THE MARKET.

A. Transitionally competitive markets like the local exchange market have shown that new entrants are usually most successful in attracting customers that (1) are most disaffected by the services or quality offered by the incumbent, (2) have technological, capacity or other specific requirements that are not easily met by the incumbent's oftentimes inflexible service offerings and/or (3) don't have a long history of taking service from the incumbent. ISP providers fall directly into all three of these categories. Many of them have been unable to reach agreement with incumbent LECs in areas such as pricing for high capacity lines, provisioning intervals, collocation of their equipment in ILEC central offices or even, in some circumstances, the ability to purchase service in sufficient quantity to meet their own end-user customer demands. Likewise, most ISP organizations are fairly new and have begun their enterprise at a time when competitive alternatives for local exchange services are available. Hence, it is reasonable to expect that these types of businesses are less restricted by long term agreements, a long storied business relationship or other circumstances that often breed loyalty to the incumbent. The fact that these customers are far more likely to explore competitive opportunities than more traditional residential and/or business customers has made them an extremely important customer base for ALECs.

Likewise, ALECs, like ICG, because of their oftentimes unproven track record and non-existent customer base in new markets, have been forced to target customers that require services specifically tailored to their strengths (*i.e.* customer service, new technology deployment and substantial spare capacity). Given these characteristics, ISP providers and ALECs are often times "made for one another." ISP's have flocked to new entrant ALECs in increasing numbers. Likewise, ALECs have worked with ISPs to design new and innovative services and have provided ISPs the capacity they need to meet their customers' increasing demands.

Q. IS THE FACT THAT ALECS SERVE ISPS IN GREATER PROPORTION THAN A MATURE INCUMBENT LIKE BST THE RESULT OF A MARKET FAILURE?

A. Not at all. The relationships between ALECs and ISPs, as described above, are the direct result of how a competitive market is meant to work. Carriers who are unwilling to meet the demands of their customers-as ILECs have shown an unwillingness to work with ISPs-lose those customers to carriers who are more accommodating. Likewise, carriers who provide customer focused services and supply the capacity required to meet their customers' demands are rewarded. The fact that relatively new customers who require specific technological support have embraced new, competitive local carriers is one of the most promising outcomes of the local exchange market's transition to competition. Indeed, ISPs and other technologically reliant customer groups are, in many cases, providing the revenue and growth potential that will fund further ALEC expansion into other more traditional residential and business markets.

Q. IF THE COMPETITIVE MARKETPLACE FOR ISP CUSTOMERS APPEARS TO BE WORKING WELL, WHY IS ICG ASKING THE COMMISSION FOR ITS ASSISTANCE IN THIS ARBITRATION?

A. Within the interconnection agreement at issue in this proceeding, BST is refusing to pay for traffic that originates on its network and is directed to a local ISP customer served by ICG. Simply put, BST is asking that ICG avail its facilities for the use of BST's customers without compensation for its efforts. Traffic originated on the BST network and directed to ICG's local ISP customers is no different, either from a technical or cost basis, than other types of traffic for which BST has agreed to provide reciprocal compensation (*e.g.*, calls to ICG local business and residential customers). Given this, and the fact that ICG has agreed to pay BST for traffic originating on the ICG network and directed to a BST local ISP customer, ICG believes that the Commission should require BST to compensate it for such calls.

Q. EARLIER YOU MENTIONED THAT ALLOWING BST TO REMOVE ITS OBLIGATION TO COMPENSATE ICG FOR TRAFFIC DIRECTED TO ITS LOCAL ISP CUSTOMERS WOULD DISTORT ONE OF THE ONLY LOCAL EXCHANGE MARKET SEGMENTS THAT APPEARS TO BE WELL ON ITS WAY TOWARD EFFECTIVE COMPETITION. CAN YOU EXPLAIN THIS CONCEPT IN GREATER DETAIL?

A. As I described above, ALECs have been successful in attracting a number of ISP customers because they have offered those customers innovations and reasonably priced advanced services at a level of customer care that BST was unable or unwilling to provide. As such, BST has lost a number of these customers to ICG and other ALECs resulting in this particular market segment exhibiting some of the most competitive characteristics of any segment in the local market.

It is no coincidence that BST refuses to pay reciprocal compensation for calls directed to this particular customer group. If BST can successfully remove itself from an obligation to compensate ALECs for calls directed to their ISP customers, BST will have accomplished two goals very dangerous to the competitive marketplace.

First, BST will have been successful in branding ISP customers as "unattractive" customers from a local provider's standpoint because only ISP customers will generate costs for their local service provider without providing the reciprocal compensation revenues required to recover those costs. By branding ISP customers as unattractive customers, BST will have significantly diminished the hardearned victories made by its competitor ALECs. This result stems from the fact that a disproportionate percentage of BST's competitors' customer base (ISPs) will immediately turn from highly valued customers to customers that are likely to be unprofitable. This will have a significant impact on the viability of many competitive carriers and may, at least in the short term, significantly impact their ability to attract capital and other resources necessary to further penetrate the BST market.

Second, without the reciprocal compensation revenues necessary to recover costs caused by BST's customers directing traffic to the ICG network, ICG and other ALECs will have no choice but to raise rates charged specifically to ISP local customers to recover their costs (*e.g.*, a DS-1 service provided to a business customer could be provided at a lower rate than the same DS-1 provided to an ISP simply because the rate charged to the ISP must recover costs of terminating traffic that originate from the BST network). At a minimum, this will disrupt the ISP marketplace and is likely to send many ISPs back to BST where BST's more mature customer base can be used to offset the costs of terminating the ISPs traffic without raising ISP local rates.

Further, because their local exchange rates are increasing, ISPs who do not return to BST will have little choice but to raise the rates charged to their individual end users. This will in turn make *BellSouth.net*, BST's ISP retail service, more attractive to individual end users, further stifling competition. All of these circumstances would disrupt a competitive segment of the local exchange marketplace that seems to be operating more effectively than most other more traditional segments. The fact that each of these disruptions happens to benefit BST should not be lost on the Commission when it considers BST's rationale for refusing to pay reciprocal compensation for ISP bound traffic.

Q. PLEASE EXPLAIN IN GREATER DETAIL YOUR CONTENTION THAT CALLS DIRECTED TO ISPS ARE FUNCTIONALLY IDENTICAL TO LOCAL VOICE CALLS FOR WHICH BST HAS AGREED TO PAY TERMINATION CHARGES.

A. A ten minute call originated on the BST network and directed to the ICG network travels exactly the same path, requires the use of exactly the same facilities and generates exactly the same level of cost regardless of whether that call is dialed to an ICG local residential customer or to an ISP provider. The simplistic diagram, attached as Exhibit No. ___ (MS-2), details one scenario by which such a call might travel.

As you can see from the diagram, regardless of whether the originating customer dials either the ICG residential customer or the ICG ISP customer, the call travels from the originating customer's premises to the BST central office switch, which then routes the call to the BST/ICG interconnection point and ultimately to the ICG switch. From the ICG switch the call is then transported to either the residential customer or the ISP customer depending upon the number dialed by the BST caller. Both calls use the same path and exactly the same equipment to reach their destinations. To single out the ISP call and suggest that $0 compensation should be paid for purposes of carrying that particular call and some other, non-zero rate should be applied to all other calls ignores the simple economic reality that both calls generate costs that must be recovered by the reciprocal compensation rate paid for their carriage.

Q. WOULD THERE BE NEGATIVE ECONOMIC RESULTS FROM ALLOWING BST TO PAY $0 FOR CALLS DIRECTED TO ISPS WHILE PAYING A NON-ZERO RATE FOR ALL OTHER CALLS?

A. Of course. Given the option of receiving an amount greater than zero for carrying a non-ISP call and $0 for carrying an ISP call, any reasonable carrier would fill its switch with non-ISP calls to the extent possible. Likewise, any carrier that currently served a larger proportion of ISP customers would be a less profitable network than a network that served a smaller proportion of ISP customers. In effect, allowing BST to skirt its obligation to pay for the use of an interconnecting carrier's network for purposes of terminating its local customers' calls to ISP providers will skew the supply substitutability of ISP services versus other local services, thereby making other local exchange services more attractive production alternatives. This will in turn raise ISP prices in relation to other local exchange services thereby impairing an ISP's ability to receive services at rates comparable to other local end users. Not only is this in direct conflict with the FCC's decision to treat ISP traffic as local, so as to place ISPs on a level playing field with other local customers, it also is likely, all else being equal, to suppress ISP communication demand versus other types of non-ISP communication. This price discrimination effect will mean electronic communication and commerce demand will undoubtedly grow at a slower pace than if there were no discrimination. Any difference between the unrestricted growth of electronic communication and the suppressed growth caused by the uneconomic price discrimination described above would result in a net welfare loss due to the inefficient market consequences of BST's failure to pay reciprocal compensation rates.

Q. PLEASE EXPLAIN IN MORE DETAIL THROUGH EXHIBIT NO. ___ (MS-3) YOUR CONTENTION THAT BECAUSE TERMINATION RATES MUST BE BASED UPON THEIR UNDERLYING COSTS, BST SHOULD BE ECONOMICALLY INDIFFERENT AS TO WHETHER IT ITSELF INCURS THE COST TO TERMINATE THE CALL ON ITS OWN NETWORK OR WHETHER IT INCURS THAT COST THROUGH A RECIPROCAL COMPENSATION RATE PAID TO ICG.

A. Assume that a BST customer calls another BST customer within the same local calling area. The path the call travels will be very similar to the path detailed earlier in Diagram 1, except that both end offices will now be owned by BST as shown below:

In such a circumstance, BST incurs costs associated both with originating the call and terminating the call for which it is paid, by its originating customer, a local usage fee (either a flat fee per month or a per message or per minute charge). When compared to our original diagram, it is easy to see that the only difference between a call made between two BST local customers and the call made from a BST customer to an ICG customer is that ICG's central office serves the terminating switching function that was originally performed by the BST switch. In this way, BST avoids those terminating switching costs and ICG incurs them. Hence, if BST has accurately established its terminating reciprocal compensation rate based upon its own costs of terminating a call, it should be economically indifferent with respect to whether a call both originates or terminates on its own network or whether a call terminates on the ICG network. BST will either incur the terminating cost via its own switch or it will incur that cost via a cost based rate paid to ICG for performing the termination function. Either way, the extent to which a particular call is directed to a residential or business customer, or an ISP provider is irrelevant to the economics of the call.

Q. WHY IS THIS POINT IMPORTANT TO UNDERSTAND IN TERMS OF THE DISPUTE REGARDING PAYMENT FOR ISP BOUND TRAFFIC AT ISSUE IN THIS PROCEEDING?

A. This point is important for two reasons. First, assume that neither ICG nor any other ALEC existed and that BST provides local services to 100% of the customer base. Assume further that ISP traffic is occurring at today's levels and has experienced significant growth over the past few years with future growth expected to be even greater. In such a circumstance, BST would be responsible not only for originating every call but also for terminating every call, including calls made to ISP providers. BST would undoubtedly need to reinforce its network to accommodate the additional capacity requirements associated with this increase in traffic and would undoubtedly be asking state commissions and the FCC for rate increases intended to recover those additional investment costs. It seems highly unlikely under such a circumstance that BST would be arguing that terminating traffic to an ISP provider should be done for free, indeed, it would be the only carrier to suffer. However, that is exactly what BST is asking this state commission to do in this case. The arbitration issue before the Commission in this case differs from our hypothetical above in that instead of only BST investing in its network to meet the capacity requirements of the traffic volume increases that have occurred over the past few years, new entrants have also invested capital and have deployed their own switching capacity to accommodate this growth. Likewise, as BST would have undoubtedly argued in our hypothetical above that it should be compensated for its additional investment to meet this growth, those carriers should also be compensated for terminating that traffic such that their investments can be recovered.

The second reason is of paramount importance because it is at the heart of the dispute between the parties in this case. As I have shown above, BST should be indifferent as to whether it terminates the traffic or it avoids the costs of termination and pays someone else, namely a ALEC, to do so. Yet we know that BST is not indifferent because it has refused to agree to such a compensation framework. The question is: Why? The answer lies in one of two reasons. Either (1) BST's rate for call termination is not representative of its actual underlying costs and it realizes that paying an ALEC for terminating traffic actually makes it economically "worse off" than terminating the traffic itself, or (2) it has a competitive interest in not providing a cost recovery mechanism for its competitors regardless of the extent to which it is economically indifferent on any given call.

Q. DO YOU BELIEVE THAT EITHER OF YOUR CONTENTIONS ABOVE IS

LIKELY TO BE AT THE ROOT OF BST'S REFUSAL TO PAY COMPENSATION FOR CALLS DIRECTED TO ISP PROVIDERS SERVED BY AN ALEC?

A. Obviously, I can't speak to what motivates BST's position in this respect. However, I can speak to the economic incentives that are at work in the local exchange marketplace and how participants within that marketplace react to them. And, in this case, BST has an incentive (though an incentive steeped in self-interest) to refuse payment for traffic directed to an ISP served by an ALEC for both of the reasons described above.

As I mentioned earlier, with respect to 99% of the services included in the interconnection agreement between BST and ICG, ICG will be required to pay BST for services rendered. Hence, BST has every incentive to overestimate its underlying costs associated with the services it provides to ICG. By doing so, it not only increases its revenues from providing these services, it also raises the costs of its competitor thereby protecting its retail prices and slowing its competitor's entry into the marketplace. However, in the case of reciprocal compensation, it has come to BST's attention that it has become, in many cases, a net payor of termination charges because ALECs have been successful in attracting ISP providers and other technologically demanding customers. Hence, if indeed its rates for traffic transport and termination are overstated, it becomes the party most likely to be harmed. Given this scenario it has two basic options, either (1) reduce its charges to more appropriately cost based rates, or (2) remove from the equation the reason for its "net payor" status. It is apparent that BST has opted for the second option by refusing to pay reciprocal compensation for calls directed to ISP providers served by its ALEC competitors.

Likewise, even if BST's rates for transport and termination of traffic are in line with its actual costs, and it should be truly economically indifferent with respect to who terminates any given call, it still has an economic incentive to limit the amount of reciprocal compensation it pays to its competitors. By paying reciprocal compensation to its competitor, BST is in effect providing its competitor a revenue stream by which it can recover its investments and ultimately, extend its operation. Obviously, this is not in BST's self interest regardless of the extent to which those competitors reduce its own termination costs. Said another way, given the option of providing services more efficiently and at lower costs in a market full of competitors or providing higher cost services as a monopolist, it is easy to see which option most rational profiteers would chose.

Q. YOU MENTION ABOVE THAT ALECS LIKE ICG HAVE BEEN SUCCESSFUL IN ATTRACTING ISPS AND OTHER TECHNOLOGICALLY DEMANDING CUSTOMERS. WHAT DO YOU MEAN BY "OTHER TECHNOLOGICALLY DEMANDING CUSTOMERS?"

A. The New York Public Service Commission is currently in the midst of a proceeding to address the issue of whether ISP bound traffic should be subject to reciprocal compensation. One of the issues that has surfaced in that proceeding is that ALECs have been successful in attracting not only ISP providers, but more generally, customers that manage large call volumes (both inward and outward) and have unique or advanced technological needs. As I discussed earlier, that isn't surprising given that innovation, technological expertise and advanced service offerings are the strengths of many ALECs -ICG included. The fact that these types of customers have flocked to ALECs is simply the workings of a transitionally competitive marketplace matching supply and demand in the most efficient manner. However, the presence of these other large volume customers highlights the fact that ISPs are not alone in generating larger inbound than outbound traffic. A growing number of mail order companies, customer service centers and local chat lines are also relying upon the ALEC's ability to manage their complex telecommunications needs and provide the capacity they require at reasonable prices. A great number of these organizations also elicit disproportionate inbound calling volumes similar, if not more disproportionate, than ISP providers. Singling ISP providers out and holding that only the calls directed to them should be refused compensation would unfairly distinguish them not only from all other local exchange customers in general, but also from other local customers that have exactly the same calling characteristics. If we follow BST's logic is this regard far enough, we must eventually find payments for reciprocal compensation are available only for customers that have calling patterns wherein they receive no greater number of calls than they originate. This is obviously absurd.

Q. IF IT ISN'T FEASIBLE, OR ECONOMICALLY RATIONAL, TO ALLOW CARRIERS TO REFUSE PAYMENT FOR LOCAL CUSTOMERS THAT GENERATE LARGER INBOUND CALLING VOLUMES THAN OUTBOUND CALLING

VOLUMES, HOW CAN A CARRIER ENSURE THAT IT IS NOT A NET PAYOR OF RECIPROCAL COMPENSATION PAYMENTS?

A. First, as I've described above, except for competitive concerns regarding the provision of funds to a competitor for recovery of its costs, a carrier should be economically indifferent with respect to whether it terminates a call or another carrier terminates the call on its behalf. However, even if this were not true, every carrier has the opportunity to compete for the business of customers that generate more inbound than outbound calling. Hence, any carrier can actively target ISPs, mail order companies, customer care centers or even pizza delivery stores that generate significant inbound calling. This is no different than the long distance marketplace where charges are generally assessed on outbound calls. Long distance companies for years have targeted large outbound calling users such as research firms, direct marketers and large businesses. The appropriate way for BST to mitigate its "net payor" status for reciprocal compensation is not to simply refuse to pay for its customers' use of the ICG network, but instead to follow the demands of the competitive marketplace just as ICG and the long distance companies have (*i.e.*, to actively compete for customers that use its own network and require other carriers to use it as well).

Q. IN COMMENTS TO THE FCC, AND A NUMBER OF OTHER DOCUMENTS, ILECS HAVE ARGUED THAT IT IS UNFAIR TO FORCE THEM TO PAY ALECS FOR TERMINATING TRAFFIC TO ISPS WHEN THEY ARE UNABLE TO RECOVER THOSE RECIPROCAL COMPENSATION PAYMENTS EITHER

THROUGH ACCESS CHARGES ASSESSED ON THE ISP OR FOR USAGE CHARGES ASSESSED TO THEIR OWN LOCAL CUSTOMERS. DO YOU HAVE ANY COMMENTS REGARDING THIS ISSUE?

A. Yes, I do. First, I've already discussed the fact that calls to ISPs are really indistinguishable from calls to any other local customer. Hence, the fact that a call is directed to an ISP or to a local residential customer is really irrelevant to this argument. This argument does not support BST's position that it will pay termination charges for calls made to residential and business customers yet not for calls directed to an ISP provider.

Second, however, there seems to be some indication in this argument that ALECs are to blame for the increased costs the ILECs contend they are facing in meeting calling volume requirements associated with electronic communication and commerce. This simply isn't accurate. It is the public's seemingly unquenchable thirst for the internet and other electronic communications mediums that have caused the increased calling volumes which generate costs associated with carrying local traffic to the internet. And, it is important to note that companies like BST are on the front lines marketing these services to feed the public's demand. For example, BST aggressively markets its own internet product *BellSouth.net* by offering customers reduced rates when they purchase the company's internet services in combination with its local access line and vertical feature packages. Indeed, BellSouth.net provides an "unlimited usage" package to its customers at prices ($12.95 per month) far below its most notable competitor America Online (approximately $20.95).

To suggest that BST has no method by which to recover costs associated with increased internet traffic is also somewhat disingenuous. BST, more than any other ILEC in the nation, has been advantaged by the electronic communications revolution as it has significantly increased the demand for second access lines ordered and used by its local customers. According to a BST news release:

> Second lines increased 21 percent, and accounted for nearly half of all new residential hook-ups in 1995. With 1.3 million second lines, BellSouth has the most of any telephone company in the U.S. BellSouth markets additional lines to satisfy the growing customer demand for access to the internet, telecommuting and home offices, in-home fax machines, and children's phones. (*BellSouth Reports Record Quarter, Year*, taken from http://www.bellsouthcorp.com/proactive/documents/render/10191.html)

Likewise, it appears that since 1995, second access line growth has increased at an ever more impressive pace according to BST's 1998 10K Report to the Securities and Exchange Commission:

> Switched residence lines increased by 3.9% in the period ended December 31, 1998, compared to a growth rate of 4.6% in 1997. In addition to continued economic growth in the region, the growth rate reflects demand for additional lines related to home office purposes, access to on-line computer services and children's phones. The number of such additional lines increased by 375,000 (19.9%) to 2,259,000 and accounted for approximately 61% of the overall increase in switched residence lines since December 31, 1997.

(Taken from page 27 of the electronic version of BellSouth Corporation's 10K Report filed with the Securities and Exchange Commission for operations in 1998.)

The suggestion that BST should be allowed to reap large windfalls for second lines and enjoy profitability from its own retail internet service offering while at the same time refusing to pay for the use of ICG's network for carrying traffic originating by its growing customer base to ICG's ISP providers is without merit and should be rejected by the Commission.

II. BST SHOULD PAY ICG A RECIPROCAL COMPENSATION RATE BASED UPON THE RECOVERY OF TANDEM, TRANSPORT AND END OFFICE TERMINATION COSTS

Q. PLEASE DESCRIBE IN MORE DETAIL WHAT YOU MEAN WHEN YOU STATE THAT BST SHOULD COMPENSATE ICG FOR TERMINATING TRAFFIC BASED UPON THE RECOVERY OF TANDEM, TRANSPORT AND END OFFICE TERMINATION COSTS?

A. This issue is most effectively framed by the FCC in its Local Competition Order at paragraph 1090 (*First Report and Order*, CC Docket No. 96-98, Released August 8, 1996, ¶ 1090.):

1090. We find that the "additional costs" incurred by a LEC when transporting and terminating a call that originated on a competing carrier's network are likely to vary depending upon whether tandem switching is involved. We, therefore, conclude that states may establish transport and termination rates in the arbitration process that vary according to whether the traffic is routed through a tandem switch or directly to an end-office switch. In such event, states shall also consider whether new technologies (e.g. fiber ring or wireless networks) perform functions similar to those performed by an incumbent LEC's tandem switch and thus, whether some or all calls terminating on the new entrant's network should be priced the same as the sum of transport and termination via the incumbent LEC's tandem switch. Where the interconnecting carrier's switch serves a geographic area comparable to that served by the incumbent LEC's tandem switch, the appropriate proxy for the interconnecting carrier's additional costs is the LEC tandem interconnection rate.

Q. DOES ICG'S SWITCH SERVE A GEOGRAPHIC AREA COMPARABLE TO THAT SERVED BY THE INCUMBENT LEC'S (BST'S) TANDEM SWITCH?

A. Yes, it does. ICG, like many new entrant ALECs, generally deploys its individual switches to cover a large geographic area served by a common transport network. The advent of fiber optic technologies and multi-function switching platforms have, in many cases, allowed carriers like ICG to serve an entire statewide or LATA-wide customer base from a single switch platform. Likewise, the ability to aggregate unbundled loops from collocations within a number of ILEC central offices while transporting that traffic to a single location allows these carriers to originate, switch and terminate traffic between callers located many miles apart with a single switch. The diagram in Exhibit No. ___ (MS-4) provides a more detailed look at how the ICG switch platform and its multiple collocation arrangements allows it to maximize the geographic capabilities of its switching platform:

As Diagram 3 depicts, ICG uses its single switching platform not only to transfer calls between multiple ILEC central offices and the customers that are served by those central offices, but also to transfer calls between the ICG and ILEC network. In this way, the ICG switch provides services to customers in a geographic area at least as large as that serviced by the ILEC tandem.

Q. DOES THE ICG SWITCHING PLATFORM PERFORM THE SAME FUNCTIONS AS AN ILEC TANDEM SWITCH?

A. Yes, it does. Although the FCC order requires only that a ALEC's switch serve a geographic area comparable to that served by an ILEC tandem to qualify for tandem termination rates, in the case of ICG, its switch also performs many of the same functions that the ILEC tandem performs, further indicating that tandem termination rates are appropriately paid for its use. Tandem switches (what are commonly called Class 4 switches in the traditional AT&T hierarchy), generally aggregate toll traffic from a number of central office switches (Class 5 switches) for purposes of passing that traffic to the long distance network. The tandem switch is also a traditional focal point for other purposes as well, including the aggregation and processing of operator services traffic, routing traffic that is to be transferred between the trunk groups of two separate carriers and measuring and recording toll traffic detail for billing. While ILECs have traditionally employed two separate switches to accomplish these Class 4 and Class 5 functions, ICG's Lucent 5ESS platform performs all of these functions in addition to a number of others within the same switch.

Q. HOW CAN ICG PROVISION SO MANY OF THE SAME FUNCTIONS FROM A SINGLE SWITCH WHEN BST REQUIRES ADDITIONAL SWITCHES?

A. Simply put, the economics of network construction have changed since the time that the majority of the BST network was put in place, allowing new and very different network architectures. Because of their monopoly status and their ability to serve the entire local exchange customer base, ILECs have generally placed local end office switches in generous numbers in an attempt both to accommodate the number of individual access lines that require service within a finite geographic area as well as to minimize the length of the copper facilities needed to serve an individual customer. The dynamics of this network architecture have generally been governed by what is commonly referred to as the "switch/transport tradeoff." The switch/transport tradeoff is an economic give-and-take recognizing that ILECs, when building and maintaining their networks, generally have a choice between building very long copper loops from end users to a small number of centrally located end office switches or, deploying numerous switches across their service territory for purposes of limiting the amount of copper plant required to serve customers at their geographically dispersed locations. At the time the majority of the ILEC network was built, switches were very limited in the number of individual lines they could service and copper plant was the most expensive portion of the network to deploy. Therefore, ILECs chose to trade switching costs for copper plant costs by deploying greater numbers of switches and shorter copper loops. However, with the advent of relatively inexpensive fiber optic transport facilities and the enormous switching capacity available in today's switching platforms, the economics of the switch/transport tradeoff have changed. ALECs today are able to perform many of the same functions with a single switch that may be performed by at least two switches in the BST network.

Q. IF BST REQUIRES TWO SWITCHES TO TERMINATE A CALL WHEN ICG REQUIRES THE USE OF ONLY ONE, WHY SHOULD ICG BE PAID THE SAME TANDEM TERMINATION RATE AS THAT PAID TO BST?

A. ICG should receive the same tandem termination rate as that paid to BST because ICG's switch serves a comparable geographic area and performs the same functionality as the BST tandem switch and end office switch combined. Likewise, transport and termination rates paid to ICG recover costs in addition to those incurred by its switch. If we refer back to Diagram 3 above, the dotted circular line represents the fiber optic ring that ICG either owns or leases for purposes of transmitting traffic amongst its collocation locations and between itself and other carriers. For example, assume a BST customer served by ILEC Central Office C calls an ICG customer served *via* ICG's collocation at ILEC Central Office A. In this scenario BST will pass the call to ICG at the two carriers' point of interconnection. From that point, ICG's switching platform will direct the call to another piece of equipment located at ICG's collocation cage at ILEC central office A. This piece of equipment works as an extension of the ICG switch for purposes of terminating the call to the proper unbundled loop serving the called customer. Hence, in addition to switching costs associated with identifying the appropriate termination point for BST's call, ICG has also transported the call to the proper collocation point using its fiber optic transport network (many times miles away from the ICG switch) and identified the appropriate unbundled loop to which the call must be completed. This process is no different than the process BST would follow to terminate a similar call originated on the ICG network and terminated to its own Central Office A.

Q. WHAT RATE SHOULD BST PAY TO ICG FOR TERMINATION OF ITS TRAFFIC?

A. BST should pay to ICG a combined rate equal to the rate ICG pays to BST for terminating its traffic *via* the following individual rate elements: tandem switching, transport and end office switching.

Q. SHOULD THE COMMISSION RELY UPON BST'S COSTS FOR TANDEM SWITCHING, TRANSPORT AND END OFFICE SWITCHING TO SET THE RATE THAT ICG WILL CHARGE BST FOR TERMINATING ITS TRAFFIC?

A. Yes, it should. As the FCC points out at paragraphs 1085 thru 1089 in its Local Competition Order, BST should pay ICG rates for reciprocal compensation equal to its own reported costs for tandem switching, transport and end office switching. For example, the following excerpt is taken from paragraph 1085 of the Commission's Local Competition Order:

> Regardless of whether the incumbent LEC's transport and termination prices are set using a TELRIC-based economic cost study or a default proxy, we

> conclude that it is reasonable to adopt the incumbent LEC's transport and termination prices as a presumptive proxy for other telecommunications carriers' additional costs of transport and termination. Both the incumbent LEC and the interconnecting carriers usually will be providing service in the same geographic area, so the forward-looking economic costs should be similar in most cases.

Likewise, the Commission further addresses this issue at paragraph 1087, specifically addressing a concern I raised earlier in my testimony:

> We also find that symmetrical rates may reduce an incumbent LEC's ability to use its bargaining strength to negotiate excessively high termination charges that competitors would pay the incumbent LEC and excessively low termination rates that the incumbent would pay interconnecting carriers. As discussed by commenters in the *LEC-CMRS Interconnection* proceeding, LECs have used their unequal bargaining position to impose asymmetrical rates for CMRS providers and, in some instances, have charged CMRS providers origination as well as termination charges. On the other hand, symmetrical rates largely eliminate such advantages because they require incumbent LECs, as well as competing carrier's, to pay the same rate for reciprocal compensation.

III. PERFORMANCE STANDARDS AND ASSOCIATED DAMAGES

Q. WHAT IS ICG'S POSITION ON PERFORMANCE STANDARDS AND ASSOCIATED DAMAGES?

A. As explained in Ms. Notsund's testimony, these issues are important on an industry-wide basis and require separate in-depth consideration apart from any particular individual arbitration. Therefore, rather then deal with these important issues here, ICG believes the Commission should conduct a generic proceeding. The testimony that follows in this section will provide a brief overview of some of the issues the Commission should consider in a generic proceeding.

Q. WHAT IS THE ECONOMIC RATIONALE FOR THE ADOPTION OF PERFORMANCE STANDARDS AND DAMAGES ASSOCIATED WITH A FAILURE TO MEET THOSE STANDARDS?

A. A contract (including an interconnection agreement) is, in its essential form, a promise to perform in a way, or at a level, consistent with the parties' agreement. Indeed, a contract is little more than a detailed account specifying the manner by which one of the parties, or both of the parties, will perform, given a particular set of circumstances. Therefore, specific standards of performance should be included in an interconnection agreement.

Q. WHAT IS THE FUNCTION OF A DAMAGE PROVISION WITHIN A CONTRACT?

A. In the simplest terms, a damage provision's basic function is to be a deterrent from non-performance. Damage provisions are generally determined within a contract based primarily on two considerations:

1. the likelihood of non-performance and
2. the damages caused by non-performance.

Such a provision is critical to ensure performance in an interconnection agreement.

Q. HOW DO THESE CONCEPTS RELATE TO THE NEED FOR INDUSTRY-WIDE STANDARDS?

A. There is a need for an industry-wide set of performance measures for BellSouth as well as damages provisions in interconnection agreements to ensure the performance of the parties and to compensate one party or the other for some circumstance of non-performance. This is because the relationship between the parties yields both (1) a high likelihood of non-performance, and (2) a likelihood that damages resulting from non-performance will be substantial. The details of the performance measures and damages provisions should be considered in a generic proceeding.

IV. VOLUME AND TERM DISCOUNTS FOR UNBUNDLED NETWORK ELEMENTS

Q. PLEASE DESCRIBE ICG'S POSITION WITH RESPECT TO VOLUME AND TERM DISCOUNTS FOR UNBUNDLED NETWORK ELEMENTS.

A. A number of ICG's requests of BST in their negotiations for an interconnection agreement are aimed at arriving at a commercial relationship similar to that ICG enjoys with its other suppliers, customers and business partners. The contractual relationship between ICG that currently exists and that BST would prefer in the future, however, is without a number of common commercial arrangements that would undoubtedly exist if BST weren't participating in the agreement only as a result of its legal requirement to do so. One of those arrangements is a commitment to passing on cost savings associated with providing services in larger volume and commitments for longer term use of the BST network for carriers willing to commit themselves to volume and term purchases. ICG believes that BST's refusal to provide such discounts is a direct result of the fact that it is ICG's main competitor and that quite frankly, ICG has no alternative supplier for these services. Hence, BST doesn't have the same incentive that a normal commercial participant in a competitive transaction has to pass on some portion of its savings in this regard. For this reason, ICG requires the Commission to intervene and serve as a proxy for a competitive marketplace, thereby requiring BST to enter into what is an important, commonplace and sensible arrangement whereby cost savings associated with a carrier's willingness to commit to volume and term purchases from BST are shared, at least in some part, with the purchaser (e.g., ICG).

Q. WHAT IS BELLSOUTH'S POSITION IN THIS REGARD?

A. In other jurisdictions, BST has held that it should not be required to provide volume and term discounts for UNEs because neither the Act nor any FCC order or rule requires volume and term discount pricing for UNEs. Likewise, BellSouth has argued that both the nonrecurring and monthly UNE recurring rates that ICG will pay are cost based in accordance with the requirements of Section 252(d) and are derived using least cost, forward looking technology consistent with the FCC's rules."

Q. ARE THESE TWO POINTS ACCURATE?

A. Only partially. First, I would disagree that neither the Act nor any FCC order or rule requires volume and term discount pricing. Section 252(d)(1) of the TA96 provides two primary criteria by which prices for unbundled network elements "shall be" established; (1) rates must be based on the cost of providing the unbundled elements, and (2) rates must be nondiscriminatory:

(d) PRICING STANDARDS. -

(1) INTERCONNECTION AND NETWORK ELEMENT CHARGES.- Determinations by a State commission of the just and reasonable rate for the interconnection of facilities and equipment for purposes of subsection (c)(2) of section 251, and the just and reasonable rate for network elements for purposes of subsection (c)(3) of such section-

(A) shall be-

(i) based on the cost (determined without reference to a rate-of-return or other rate-based proceeding) of providing the interconnection or network element (whichever is applicable), and

(ii) nondiscriminatory, and

(B) may include a reasonable profit.

Likewise, the FCC in its Local Competition Order at paragraph 743 interprets this portion of the Act as follows:

743. We conclude, as a general rule, that incumbent LECs' rates for interconnection and unbundled elements must recover costs in a manner that reflects the way they are incurred. This will conform to the 1996 Act's requirement that rates be cost-based, ensure requesting carriers have the

right incentives to construct and use public network facilities efficiently, and prevent incumbent LECs from inefficiently raising costs in order to deter entry. We note that this conclusion should facilitate competition on a reasonable and efficient basis by all firms in the industry by establishing prices for interconnection and unbundled elements based on costs similar to those incurred by the incumbents, which may be expected to reduce the regulatory burdens and economic impact of our decision for many parties, including both small entities seeking to enter the local exchange markets and small incumbent LECs. [emphasis added]

The requirement that BST price its unbundled network elements based upon its costs, and the FCC interpretation that rates must recover costs in a manner that reflects the way they are incurred by BST, requires BST to reflect in its rates any reductions in cost that result from volume or term purchases. The most reasonable way to accomplish this requirement is to offer carriers volume and term discounts.

Likewise, the second criteria established by the Act requires that BST's rates for unbundled network elements be "nondiscriminatory." Again, the FCC interpreted the phrase "nondiscriminatory" as follows:

315. The duty to provide unbundled network elements on "terms, and conditions that are just, reasonable, and nondiscriminatory" means, at a minimum, that whatever those terms and conditions are, they must be offered equally to all requesting carriers, and where applicable, they must be equal to the terms and conditions under which the incumbent LEC provisions such

elements to itself. [footnote omitted, emphasis added]

Hence, if BST experiences any reductions in cost as a result of a carrier's purchase of unbundled elements in volume or as the result of the carrier's commitment to purchase those elements over a period of time, BST is required to reflect that cost reduction in a non-discriminatory fashion to the carrier purchasing those facilities. Otherwise, BST would incur a lower cost per unit of providing UNEs than was reflected in the price charged to its competitors. This would undoubtedly conflict with its obligation to provide cost-based, non-discriminatory rates.

Q. DOES THE FACT THAT BST'S PRICES FOR ACCESS TO UNBUNDLED NETWORK ELEMENTS ARE BASED UPON THE TOTAL ELEMENT LONG RUN INCREMENTAL COST ("TELRIC") STANDARD ADOPTED BY THE FCC LIMIT THE EXTENT TO WHICH COST SAVINGS WILL RESULT FROM LARGER VOLUME PURCHASES AND TERM COMMITMENTS?

A. Only slightly. The TELRIC methodology does require that prices for unbundled network elements reflect the economies of scale that are enjoyed by providing the "total element." To a certain extent, this reduces the likelihood that as BST sells greater volumes of specific unbundled network elements, its TELRIC costs go down as a result of the economies of scale it experiences. This results from the fact that these economies of scale have, to some extent, already been accounted for in the derivation of TELRIC costs.

However, there are a number of other areas where per-unit costs will undoubtedly fall with increases in volume purchases and commitments to longer purchase times and where the TELRIC methodology as applied does not account for such reductions. For example, one of the most important steps in developing a TELRIC study is the process of "unitizing" network investments into costs attributable to individual UNEs. For example, the investment associated with a given piece of equipment that can support 100 loops (assume $1,000) must be allocated among some portion of those 100 loops in order to develop a "per unit investment." The FCC addressed this process at paragraph 682 of its Local Competition Order as follows:

> Per unit costs shall be derived from total costs using reasonably accurate "fill factors" (estimates of the proportion of the facility that will be "filled" with network usage); that is, the per unit cost associated with a particular element must be derived by dividing the total cost associated with the element by a reasonable projection of the actual total usage of the element.

The FCC did not require that incumbent LEC's derive per unit investments based upon the capacity of the equipment they were deploying (i.e. to divide the $1,000 by its entire 100 loop capacity). Instead, the incumbent LEC's were allowed to use a projected level of actual usage to allocate those costs. Hence, instead of arriving at $10 of investment per unit in our example above ($1,000 / 100) it is likely that BST was allowed to attribute far more than $10 to each unit (likely in the neighborhood of $20 based upon a "fill factor" of 50% - i.e. $1,000 / 50).

This analysis is important for two reasons. First, it becomes obvious that as the volume of UNE purchases increases, the "actual fill" associated with the underlying BST equipment will rise, thereby altering the "actual" usage by which total investments are allocated. Returning to our example above, it is obvious that if ICG were willing to commit to 80 loops served by the particular piece of equipment described above and BST had developed its TELRIC costs based upon a 50% fill factor, BST's actual costs would fall on a per unit basis from $20 per loop ($1,000 / 50) to $12.50 per loop ($1,000 / 80). However, as BST's rates are set today (i.e. without any volume or term discount), ICG would not recognize any of this reduction in cost resulting from its volume purchase. Instead, whatever reduction in cost is achieved would simply be enjoyed by BST. This conflicts directly with the FCC's requirement that UNE rates recover costs in the manner in which they are incurred as well as the Act's specific requirement that BST's rates be non-discriminatory.

Q. ARE THERE OTHER WAYS IN WHICH VOLUME PURCHASES CAN/WILL AFFECT THE COSTS INCURRED BY BST IN THE PROVISION OF INTERCONNECTION AND UNES?

A. Yes there are. At paragraphs 694-698 of its Local Competition Order the FCC requires that ILECs be allowed to recover their "forward looking common costs attributable to operating the wholesale network." Common costs are by nature, not incremental to any given level of volume. That is, as the volume of goods sold increases or decreases, common costs are unlikely to change. For example, if BST were assumed to have $1,000,000 in common costs attributable to unbundled network elements and it sold 1,000,000 elements, its common costs per element sold would be $1.00 ($1,000,000 / 1,000,000). However, now assume that BST were to sell 1,500,000 unbundled network elements. By definition, BST's common costs would not rise they would remain at $1,000,000. Now instead of $1.00 reasonably attributable to each unbundled element, however, only $0.67 would be attributable to each element ($1,000,000 / 1,500,000). In this situation volume purchases reduce BST's costs of providing UNEs, however, without volume and term discounts included in its UNE rates, BST would be the only beneficiary of these decreasing costs. Again, this is inconsistent with the FCC's rules requiring that UNE rates recover costs in a manner in which they are incurred and that they be non-discriminatory.

Q. YOUR DISCUSSION ABOVE APPEARS TO FOCUS SOLELY ON THE NEED FOR DISCOUNTS RECOGNIZING COSTS SAVINGS RESULTING FROM GREATER VOLUME PURCHASES. WHY WOULD DISCOUNTS FOR TERM COMMITMENTS BE NECESSARY?

A. At paragraph 687 of the Local Competition order the FCC specifically addresses term discounts and suggests that this is one way that ILECs could mitigate the increased costs that result from normal business risk:

> As noted, we also agree that, as a matter of theory, an increase in risk due to entry into the market for local exchange service can increase a LEC's cost of capital. We believe that this increased risk can be partially mitigated, however, by offering term discounts, since long-term contracts can minimize the risk of stranded investment.

Q. DOES BST UTILIZE BOTH VOLUME AND TERM DISCOUNTS IN ITS

NORMAL COURSE OF BUSINESS WITH ITS RETAIL CUSTOMERS?

A. Yes. BST, along with the majority of other incumbent LEC's across the nation, uses both volume and term discount structures pervasively in pricing its retail services and has begun to employ these discounts with increasing frequency as local competitive alternatives increase. These discount structures are a good way for BST to "retain" its current customers, thereby stalling its customers' desire to pursue a competitor's service. This is perfectly logical on the part of BST and is a profit-maximizing strategy. Competitive markets require that BST pass along some level of savings it enjoys from large service volumes in an effort to retain the volume of services its customers represent and the associated economies of scale (cost savings) they provide. Absent BST's willingness to provide such discounts, it is likely that some number of its customers would pursue alternatives, thereby reducing BST's service volume and the economies of scale it enjoys. Instead of losing the entire cost savings associated with losing these customers, BST is willing to pass along a portion of those savings in an effort to retain at least some portion of the savings for itself.

However, when competitors partake in contributing to BST's service volume (and hence its economies of scale) by buying unbundled elements, BST has no such incentive to pass along some portion of the savings. It realizes that its competitors really have no alternative for the majority of the unbundled elements they purchase from BST and hence, BST can retain the entire cost savings for itself. Unfortunately, absent intervention by the Commission in requiring volume and term discounts for purchases of UNEs, BST prevails. It can retain the entire cost savings for itself. Even worse, by doing so it can improve its position with respect to its competitors in the marketplace at the same time. As competitors purchase more and more unbundled elements from BST, its volumes increase and its cost per unit of service fall. Hence, BST can provide its retail customers even greater discounts that position its services in an ill-gained, advantageous position in relation to competitors, who must buy unbundled elements, while receiving no such discount, to provide services in competition with BST. This is exactly the type of discriminatory behavior that both the Act and the FCC were attempting to foreclose by requiring that rates for UNE's be based upon the costs of their provision.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

MR. KRAMER: And is it appropriate at this time to also move in the exhibits?

COMMISSIONER DEASON: No, we will identify the exhibits and allow you to move them at the conclusion of cross examination and redirect.

MR. KRAMER: All right. Then I need to identify Exhibit MS-1, which I take to be Number 3, is that what we are on?

COMMISSIONER DEASON: There are exhibits attached, MS-1 through 4, is that correct?

MR. KRAMER: Yes.

COMMISSIONER DEASON: We will identify those as a composite exhibit and they will be identified as Exhibit Number 2.

MR. KRAMER: Thank you.

(Exhibit Number 2 marked for identification.)

BY MR. KRAMER:

Q Mr. Starkey, have you prepared a summary of your testimony?

A Yes, I have.

Q Could you please give that summary now?

A Yes.

Q Good morning. My name is Michael Starkey, and my direct testimony addresses three issues that must ultimately be answered by this Commission in the context of this arbitration. First and foremost, until the FCC adopts a rule with prospective application, should dial-up calls to Internet service providers be treated as if they were local calls for purposes of reciprocal compensation?

Second, for purposes of reciprocal compensation, including calls to ISP providers, should ICG be allowed to recover costs equal to the BellSouth tandem interconnection rate?

And, finally, should BellSouth be required to offer ICG volume and term discounts for unbundled network elements where ICG is willing to commit to volume and term purchases?

I will summarize my testimony by starting with the last of these questions first. Simply put, BellSouth experiences cost savings when it provides unbundled network elements in volume and when it receives a term commitment. My direct testimony explain how these savings are realized and why BellSouth's refusal to pass those savings on to ICG represents discriminatory pricing.

In a nutshell, when ICG commits to buying a large number of unbundled network elements, BellSouth is allowed to utilize its facilities more efficiency than when a carrier purchases an unbundled network element one at a time. Likewise, when a carrier commits to purchasing elements over a period of time, BellSouth can better gauge its network deployment and provision facilities more efficiently.

In both circumstances BellSouth is able to provide its network more efficiently, and its average cost per unbundled network element is reduced. While this is a desirable outcome, absent an agreement to pass at least some of those cost savings on to ICG via a volume and term discount applicable to its UNE rates, BellSouth alone reaps the rewards of the per unit cost savings generated by ICG's purchases. This isn't consistent with the act's requirement that BellSouth price its unbundled elements based upon the underlying costs incurred in their production.

The remainder of my testimony is directed at BellSouth's refusal to compensate ICG for carrying traffic bound for Internet service providers, or ISPs. I don't think it is any surprise to the panel or to this Commission that this is one of the most important issues to be decided in this arbitration, or that this decision in this respect will have an enormous impact on the progress of competition in Florida.

ICG's position is simple. ICG simply wants to be paid for carrying BellSouth's traffic regardless of the extent to which that traffic is ultimately passed to the residential, business, or ISP customer. BellSouth's position on this issue is that it shouldn't be required to pay ICG for carrying traffic to a particular subset of local customers, those being Internet service providers. In effect, BellSouth's position would allow its local exchange customers to generate large numbers of calls to the ICG network without BellSouth being required to pay ICG for carrying those calls. This simply isn't equitable, economically efficient, or in the public interest.

The issue of compensation for ISP-bound traffic is, in my mind, an issue with a simple economic answer. When BellSouth's local customers call an end user on the ICG network, ICG incurs costs associated with carrying that traffic. Those costs do not differ depending upon whether the end user being called is a residential customer, a business customer, or an ISP customer. The exact same call path is used, the exact same facilities are used, and the exact same costs result. As such, the same level of compensation should be paid.

In the face of these undisputed facts, BellSouth continues to suggest that carriers should be compensated for traffic to one set of customers, i.e., residential and business customers, and not to another, ISPs. This position should be rejected for a number of reasons. First, simple economics leads us to ask the question if the costs are exactly the same, why should the rates differ? They shouldn't.

Second, reasonable public policy rationale begs the question if there is neither a technical nor economic distinction between those two types of calls, why should they be treated differently in terms of compensation. And, again, they shouldn't.

And, third, the FCC in its declaratory ruling in this matter obviously encourages state commissions to require compensation for traffic bound ISPs. Throughout its order, the FCC suggests that it has and continues to treat ISP-bound traffic as local for purposes of compensation. Indeed, in Paragraphs 23 and 25 of its order it specifies that state commissions may either in an arbitration regarding a new agreement or in a proceeding addressing a previous agreement, find as the FCC has that traffic bound for ISPs is local traffic.

The FCC has clearly recognized that sound economics and public policy require BellSouth to pay ICG for carrying BellSouth's traffic. ICG urges this Commission to recognize those same benefits and to require BellSouth to pay ICG when its customers use the ICG network. BellSouth should be required to pay ICG, as ICG has agreed to pay BellSouth for all calls carried to its end user customers, even when those customers are Internet service providers.

The final issue addressed in my testimony speaks to the reciprocal compensation rate that BellSouth and ICG should pay one another for transport and termination of traffic. To appropriately address this issue, the Commission must answer only the following question. Does ICG's switch serve a geographic area comparable to that served by the BellSouth tandem switch? The FCC's rule established this criteria at Section 51.711. Rule 51.711 states as follows: Where the switch of a carrier other than an incumbent LEC serves a geographic area comparable to the area served by the incumbent LEC's tandem switch, the appropriate rate for the carrier other than an incumbent LEC is the incumbent LEC's tandem interconnection rate.

Over the term of the interconnection agreement between ICG and BellSouth, ICG's Florida switching platform will serve a geographic area at least as extensive as that area served by the BellSouth tandem. As such, ICG is entitled to charge BellSouth the same rate that BellSouth charges ICG. That is the BellSouth tandem interconnection rate.

In addition to meeting the FCC single requirement for receiving tandem interconnection rates, the Commission should also recognize that ICG's switch provides the same functionality as the BellSouth tandem. Though not necessarily required by the FCC for purposes of receiving a tandem interconnection rate, the fact that ICG's switch serves the same functionality as the BellSouth tandem further supports ICG's recovery of a tandem interconnection charge.

ICG's switches serve as ICG's toll center, it's operator position system, and it's interconnection point with other carriers. All of these are primary functions for which BellSouth also uses its tandem switch. Hence, not only will the BellSouth and ICG tandems serve comparable geographic areas, they will also serve the same functionality in each carrier's network. This comparable functionality provides another reason why the Commission should order that BellSouth and ICG compensate one another at the BellSouth tandem interconnection rate.

Based upon both of these facts, the Commission should find that the appropriate rate of compensation between the companies is a rate intended to recover tandem switching, transport, and end office switching costs. That concludes my summary, thank you.

MR. KRAMER: At this time the witness is available for cross.

COMMISSIONER DEASON: BellSouth.

CROSS EXAMINATION

BY MR. GOGGIN:

Q Mr. Starkey, my name is Michael Goggin. I represent BellSouth. Good morning.

A Good morning, Mr. Goggin.

Q I would like to first ask a brief question concerning your background. You have a Bachelor of Science degree in economics, correct?

A That is correct.

Q And you received that when?

A 1991.

Q Okay. Since that time you have worked for a number of state commissions, correct?

A I have worked for three.

Q And those were?

A I began my career in Missouri. I was there for approximately two years. I moved from Missouri to the Illinois Commission, and from the Illinois Commission I was the Director of Telecommunications at the Maryland Commission.

Q And you went from your position at the Maryland staff to your present position as a consultant?

A Not exactly. When I left the Maryland Commission, I began a company called Competitive Strategies Group, which was a different consulting firm. At the end of this last year, I sold my stake in Competitive Strategies Group and began the new firm for which I am currently employed, QSI Consulting.

Q In your summary you referred a couple of times to the declaratory ruling of the Federal Communications

Commission that was issued in February of this year. Do you have a copy of that?

A I do.

Q I would like you to look at Paragraph 5 of that order. And if you would, please, read for the Commission the first sentence of Paragraph 5 and the last sentence of Paragraph 5.

MR. KRAMER: Excuse me, we have copies of that order so you can follow along, or are they available to you?

COMMISSIONER DEASON: If you have it available and will distribute it, that will be fine.

THE WITNESS: Just to clarify, that was the first sentence and the last sentence of Paragraph 5?

MR. GOGGIN: That is correct.

A "Although the Commission has recognized that enhanced service providers, including ISPs, use interstate access services, since 1983 it has exempted ESPs from the payment of certain interstate access charges." That was the first sentence.

The last sentence of that paragraph says, "Thus, the Commission continues to discharge its interstate regulatory obligations by treating ISP-bound traffic as though it were local."

Q Do you disagree with either statement the FCC made that you read?

A I disagree slightly with the first sentence and it is not so much a disagreement as it is a clarification. The FCC in the first sentence, in my opinion, seems to be giving us a history of how it has treated ISPs in the past. And mentioning specifically that it has exempted those ISPs from a certain regime, the switched access regime that it implemented in 1983. Where I think clarification is in order is where the FCC at that point says that ISPs use interstate access services.

The reason I think that needs to be clarified is the fact that, in fact, in the real world they don't use interstate access services. When an ISP purchases services from a company like ICG, that ISP pursuant to the FCC's own direction, purchases services out of the local business tariff, not out of the interstate access tariff, and is treated by that carrier, like ICG, as an end user.

And later in the FCC's order, in three or four locations it specifies that that is the way that it is required to be. That ISPs are allowed to purchase services out of the local business tariff and to be treated as an end user. I think the clarification that is required is if they purchase services from the local business service, from the local business tariff, they use services from the local business tariff and they are an end user, it is difficult to rectify that with the FCC saying that they use interstate access services. I think the only rectification that can be made is the fact that the FCC in sentences like this is referring to its historical treatment of access services and ISPs and the exemption that is provided.

Q In brief, then, you would disagree with the FCC's statement that ISPs use interstate access service?

MR. KRAMER: Objection. The question has been answered. Asked and answered.

COMMISSIONER DEASON: There has been an objection.

MR. GOGGIN: I will withdraw the question.

BY MR. GOGGIN:

Q Would you take exception to the statement that the reason that ISPs purchase service out of local tariffs and are exempt from the exchange access regime is because the FCC in exercising its jurisdiction over them has chosen to exempt them from access regime and has chosen to treat them as though they were local in order to permit them to purchase service from local tariffs?

A I don't think I would take exception to that statement. I would simply -- and I didn't necessarily take exception to the original FCC's statement at sentence one of Paragraph 5. I simply thought some clarification was in order, and I think I provided the same clarification to the same statement that you just provided.

Q Turn, if you would, please, to Paragraph 12. If you would, please, read the first sentence of Paragraph 12?

A It reads, "Consistent with these precedents, we conclude as explained further below, that the communications at issue here do not terminate at the ISP's local service server as CLECs and ISPs contend, but continue to the ultimate destination or destinations specifically at an Internet web site that is often located in another state."

Q Do you disagree with this statement of the FCC?

A The reason I struggle is they are making a conclusion there. I don't disagree that that is what they concluded. So I would say, no, I don't.

Q So we read it the same way, you just -- what I'm asking is do you disagree with what they concluded?

A Again, I think I would provide the same answer. I don't necessarily disagree, but I think some clarification is in order. And I think it is the same clarification I provided earlier. I think what we are really talking about here is the FCC speaking to its history of how it has treated Internet service providers and enhanced service providers as a larger group with respect to how it has regulated them.

Q You don't view this as a factual conclusion that, in fact, these communication do not terminate at the ISP's server?

A I don't think I would call it a factual conclusion. I think the FCC is in this particular circumstance specifically addressing its Part 69 rules, which use the term terminate as a specific term of art. So I don't disagree that they are finding that they don't terminate under that definition.

Q I would like you to turn, please, to Paragraph 26 and bring your attention to Note 87. If you would please read the first sentence of the text of Footnote 87?

A It reads, "As noted, Section 251(b)(5) of the act and our rules promulgated pursuant to that provision concern intercarrier compensation for interconnected local telecommunications traffic. We conclude in this declaratory ruling, however, that ISP-bound traffic is not local interstate traffic." I'm sorry that was the first two sentences.

Q I'm sorry, could you read the second sentence, as well?

A I did. I did read the first two. Do you want me to read the third?

Q I'm sorry, would you read the third, as well.

A Okay. "Thus, the reciprocal compensation requirements of Section 251(b)(5) of the act, and Section 51, Subpart H, (reciprocal compensation for transport and termination of local telecommunications traffic), of the Commission's rules do not govern intercarrier compensation for this traffic."

Q Do you have any disagreement with what the FCC said in these three sentences?

A Again, I don't disagree with that they said, but a clarification, again, is in order. The FCC later in its order at Paragraph -- and it will take me a second to find it.

Q To save you the time, I believe it is the same paragraph in the text. Is this the part that you are looking for?

A Thank you, that is very kind of you. "Although reciprocal compensation --" and it is at Paragraph 26. It says, "Although reciprocal compensation is mandated under Section 251(b)(5) only for the transport and termination of local traffic, neither the statute nor our rules prohibit a state commission from concluding in an arbitration that reciprocal compensation is appropriate in certain instances not addressed by Section 251(b)(5), so long as there is no conflict with governing federal law."

And the FCC goes on, and I don't know exactly where that is, I could point to it later, that such a finding does not interfere with any of their rules, or the governing federal law.

Q At the same time that the FCC issued this declaratory ruling, it also issued an NPRM in which it stated its intent to adopt an intercarrier compensation mechanism for this traffic, isn't that right?

A That is correct.

Q To your knowledge, does ICG do business in Florida today?

A My understanding is that they are preparing to do so, but they have not at this point.

Q I believe there was testimony earlier today that they expect to begin business the first or second quarter of 2000, is that correct?

A That is my understanding.

Q So, if the FCC were, for example, to issue a ruling on the intercarrier compensation mechanism that it would apply, and this Commission were to do nothing about an interim mechanism, it's quite possible that ICG would not be harmed by that in any way, correct? Depending on the timing of the FCC's ruling.

A I think I would have two comments to that. The first comment would be that we are in the process of crafting an interconnection agreement that is going to last a period of time likely to be about three years. During that period there will need to be some indication in the interconnection agreement as to how traffic between the carriers, including traffic to ISPs, will be handled, such that even though they may not be in business today, the extent to which this Commission decides something in the arbitration will have an effect and an impact on their business for a dime to come when they are operating in Florida.

The second thing that I would say with respect to that, and you mentioned the NPRM earlier, in the NPRM I think the FCC provides as at least one option that the decision with respect to how compensation will be provided for traffic to ISPs may very well return to the states pursuant to the FCC's rule. In that respect it seems to me that there is a vast possibility and a very good possibility that the state commission is going to have to decide this issue one way or another based upon the merits of the case.

I think ICG's position is the merits of the case have been put forward in this case, and this is a good chance not only to decide an interim compensation mechanism, but could provide for a future finding for a prospective application, if necessary.

MR. KRAMER: Commissioner, I'm not going to object to that question, but I would hope that we could reserve questions for specific impacts on the company for the company representative rather than for the outside consultant. To the extent Mr. Goggin was asking a question about the theoretical impact or harm, I didn't object. Unfortunately, the answer wasn't answered that way, but I would hope we could reserve questions about specific impacts on the company for the company representative.

MR. GOGGIN: I would be happy to do that. I apologize.

BY MR. GOGGIN:

Q Your summary and in your testimony, Mr. Starkey, you have indicated that from the standpoint of ICG that there is no economic or functional difference between a call made -- a voice call made by a BellSouth customer to an ICG customer within the same exchange and a data call made by a BellSouth customer that passes through an ISP served by ICG in the same exchange. Is that a fair summary?

A I think that is a fair characterization, yes.

Q I would like to go through a couple of different call scenarios and to make a few assumptions to set these questions up. One, that ICG is operating in Florida, that they are doing very well. They have all sorts of customers; residential, business, ISPs, and that they are operating in BellSouth's territory so that the possibility of this situation arising can actually occur.

In the first instance I would like for you to consider a call made by a residential ICG customer to a residential ICG customer within the same exchange. Would the portion of the call handled by ICG on the receiving end be any different functionally or economically from a local call made by a BellSouth voice customer to an ICG voice customer within the same exchange?

A I'm trying to draw it out to make sure I give you the proper answer.

MR. KRAMER: Commissioner, I understand the witness has to answer the question, but do you mind trying to -- I'm not sure I got it, either, so that I understand what he is answering.

Q We are talking about leaving ISP out for a moment. In his testimony he has stated that a BST to BST call and a BST to ICG call are in some ways the same. What I'm asking him is the obverse of that. From ICG's perspective, would an ICG customer calling an ICG customer within the same exchange, how would that compare on the receiving or terminating side to a call from a BellSouth customer that is received by an ICG customer. So we're not considering BellSouth's costs at all, and we're not considering the costs of the originator of the traffic, just the receiving end.

A Well, then I guess I understood your original question to be would those differ technically in the way in which they are routed. My answer would be, no, I don't

believe that they substantially differ.
Q Okay. Assume a call from an ICG customer to another person in another state through an interexchange carrier served by ICG, so ICG is delivering the traffic to the interexchange carrier's point of presence. In that case is the carriage functionally different?
A Yes.
Q How so?
A For one thing, carriers purchase from ICG Feature Group D access, which is a trunk side connection to the ICG switch, provide certain functionality, certain signaling functionalities that are not provided on the line side of the switch. That call is transferred from the ICG switch to the interexchange carriers' point of presence using a completely different protocol than would be the call scenario we talked about earlier.
Q Leaving aside the question of compensation for the moment, does ICG incur costs in delivering that traffic to the interexchange carriers' point of presence?
A Yes, it does.
Q Now, take for a moment an ICG call to a BST customer. ICG local customer to BST local customer.
A Okay.
Q Does ICG incur costs in originating that traffic?
A Yes, it does.

Q And, finally, a BST customer calling -- making an Internet, dial-up Internet session where its ISP is an ICG customer within the same exchange. Does ICG incur costs in that situation?

A Yes, it does.

Q Okay. In the first instance, ICG to ICG, how does ICG recover the costs of terminating that call?

A ICG recovers the costs associated with terminating calls from one of two places; from its originating customer -- an originating customer, and I think Mr. Varner describes this in his testimony. Originating customers are customers whenever they purchase local exchange access. An access line, if you will. Purchase the ability to access the network and to make calls over the network. The calls that those customers make over the network, the costs associated with those calls are recovered in their price for network access line.

Q What about the receiving ICG customer, are they receiving a service from ICG when that call is delivered to them?

A I think you could say that they are receiving a service, yes.

Q Would part of what they pay to ICG be designed to cover the costs, ICG's cost of providing that service to them?

A No. And I think -- and, again, I would point to Mr. Varner's testimony where I think he supports the idea that they wouldn't. That originating calling is the responsibility and the costs associated with originating a call are the response of the cost causer, as they should be. The cost causer being the person who picks up the phone and instigates the cost, makes the call. The costs associated with that call, originating and terminating that call, are the responsibility of that cost causer, the originating customer.

Q In the example where an ICG customer makes a long distance call that is routed through an IXC point of presence served by ICG, you said that there were costs incurred in delivering that call from ICG's switch to the point of presence. How are those costs recovered?

A Those costs are recovered from the interexchange carrier.

Q Not the originating caller.

A If we wanted to be as detailed as possible, I think we could say that they are recovered by both. That the originating caller is compensating ICG for access to the network, but the usage associated with that originating caller's call is being recovered from the interexchange carrier.

Q Let me move on for just a moment from this example. In your testimony you made some arguments about why the Commission should adopt a reciprocal compensation regime for this traffic. One of the arguments, and I believe it is on Page 14 of your direct testimony, Lines 7 through 10. If I may paraphrase, you state that in many cases ISPs and other technologically reliant customer groups provide revenue and growth potential that will fund further ALEC expansion into more traditional business markets.

MR. KRAMER: Excuse me, I'm sorry, where are you?

MR. KITCHINGS: I'm sorry. Page 14 of Mr. Starkey's direct testimony, Lines 7 through 10.

MR. KRAMER: Thank you.

BY MR. KITCHINGS:

Q What is the source of that revenue or sources?

A Well, I think I would say first that that excerpt was taken really from an explanation -- from a question that deals with is the market working effectively when we realize that ICG serves a large number of technically and technology reliant customers.

Q Do you, I guess I wouldn't use the word disagree, but you would not disagree with your own statement that ISPs in many cases provide revenue that could lead to further ALEC expansion?

A No, absolutely not. I wouldn't disagree with that. Would not disagree with that. And more specifically in answering your question, the revenue associated with that growth comes from a number of different sources. It is intended to recover costs associated with serving those particular customers.

A portion of those costs, just like any other end user, is accessing the network, providing a facility to connect an ISP or any other customer with the ICG central office switch. The revenue associated with recovering that cost is the responsibility of the ISP, and ICG charges the ISP for those costs.

For calls made to the ISP, or really to any other customer, whether that be a business or residential customer, calls coming into those customers are the responsibility of the cost causer of those calls; the people who pick up the phone and make those calls. The revenue associated with that would come from those folks.

Q And for a customer like an ISP, or other -- as you pointed out in your testimony, others who have predominantly in-bound traffic, the bulk of the reciprocal compensation that you would have carriers pay would end up being paid to the party serving the in-bound traffic receiver or the parties that predominantly receive in-bound traffic, correct? That is a very difficult question to answer because it was very difficult to get out of my mouth.

What I'm asking is if a party is predominantly receiving traffic rather than generating traffic, then it is likely that the carrier serving that customer, with regard to that customer at least, is likely to be a net receiver of reciprocal compensation rather than a net payor, correct?

A You are asking whether I agree with that?

Q Yes.

A I do agree with that, but I just want to make clear the fact that whenever I say technologically reliant, I don't necessarily mean only customers with more in-bound calling than out-bound calling. I simply mean those customers that have technological needs beyond those of an average customer.

Speaking more particularly to your question, though, I think it is true that customers who receive more calls than they make receive compensation from customers who make those calls, whether those be ICG customers, or whether those be BellSouth customers, or any other LEC that is interconnected with ICG. And, again, I would suggest that is the economically rational way to do it. Customers who pick up the phone and make a call cost cause on the network, not only BellSouth's network, but ICG's network in some circumstances. Those customers are responsible for recovering those costs.

Q If the amount of reciprocal compensation, the rate of reciprocal compensation were just enough to allow

ICG to recover its costs for receiving this traffic, then ICG would be indifferent to whether its customer was a net receiver of reciprocal comp or a net payor of reciprocal comp, isn't that correct?

A Yes, it would be. Both ICG and BellSouth both would be indifferent in that respect. What ICG would not be indifferent to is carrying that traffic and receiving nothing for it, which is what is BellSouth's position is in this case.

Q So if the reciprocal compensation rate were set in a way to recover costs, recover ICG's costs, would ISPs necessarily generate funds required for expansion?

A Absolutely. ISPs, just like end users, are customers, and they are end users pursuant to the FCC's definition. The more customers ICG can get on its network, the more it can realize economies of scale and scope. The more it he can generate profits from its embedded capital base. ISPs would be and are no different than any other type of customer with respect to the fact that they are traffic on the ICG network and they are customers to be served. The more customers you have, the better off you are.

Q But if the reciprocal compensation rate is set at a level that is just enough to recover ICG's costs, then these revenues that are generated by ISP customers must be coming from someplace other than reciprocal compensation, correct?

A No. The revenues, the revenues recover costs but they are still revenues. I mean, just because they recover costs doesn't mean they are not revenues into the ICG -- I mean, they are paid just like any other type of revenue.

Q Wouldn't they have to be over and above costs in order to fund expansion?

A No, they wouldn't. One of the things that -- one of the things that a carrier tries to do is to generate traffic on its network, such that in the long-run it can generate economies of scale and scope. As long as it can recover the costs associated with the marginal costs of providing that service, it is better off.

COMMISSIONER DEASON: Did you interpret his question when he said costs to be costs other than marginal costs?

THE WITNESS: No, I interpreted it to mean marginal costs.

COMMISSIONER DEASON: Marginal costs?

THE WITNESS: Right.

COMMISSIONER DEASON: And so if the rate just covers marginal costs, that revenue is a source for expansion?

THE WITNESS: Let me clarify what I said. More appropriately, instead of marginal costs, I meant TSLRIC or total service long-run incremental cost. And, yes, I would agree that one of the things that -- TSLRIC costs obviously are a concept that is constructed over the long-run and has a long-run average cost curve. As if ICG were to gather more and more traffic on its network and were receiving just the TSLRIC associated with that cost over time its costs would fall because it is providing a larger volume of traffic. Just like BellSouth's costs fall when it provides larger volumes of traffic in other services. In that respect, those revenues would be fueling its growth associated with recovering the costs of its network.

BY MR. KITCHINGS:

Q Did ICG submit any cost studies in this proceeding to your knowledge?

A Not to my knowledge.

Q So we have no way of knowing whether reciprocal compensation or the rate of reciprocal compensation in this case has any relationship to ICG's costs, whether they are incremental costs or they are fully loaded costs, isn't that correct?

A I have an opinion on that matter and it is based on the fact that I have reviewed the costs of other companies like ICG that have -- that are in start-up mode that don't have the mature deployment of a network like BellSouth's. And in every circumstance to which I have seen, the costs associated with a new entrant are much higher than those associated with BellSouth. In this case, ICG is requesting that it be paid only the rate associated with BellSouth's costs as the FCC has decided that it should absent a showing of a cost study. In that respect it is my opinion that ICG is probably not recovering its costs at the BellSouth rate.

Q If we could go back for just one moment to one of the call examples.

A Okay.

Q A BST customer places an interexchange call through its interexchange carrier whose point of presence is served by ICG's local network. Under those circumstances, does ICG incur any costs in carrying the traffic originated by this BellSouth customer?

A Let me make sure I understand. A BellSouth customer calls an IXC whose point of presence is served by ICG?

Q Correct.

A And the question is does ICG incur costs associated with that scenario?

Q Yes.

A Yes, it does.

Q Under that scenario, BellSouth doesn't pay ICG for the cost of its carriage, does it?

A Actually, I'm not exactly sure. I'm not sure the extent to which ICG includes a transit charge in its tariff. That is the type of charge BellSouth would charge in exactly the opposite situation, and I'm just not familiar with whether ICG has a transit charge tariffed or not. Ms. Schonhaut may know.

Q The reason I asked is, if you could look at Page 18 of your testimony, lines -- your direct testimony, I'm sorry -- Lines 10 through 12.

A I'm sorry, which lines was that? I didn't catch the line number.

Q I'm sorry, it's the sentence that begins on Line 10 and ends on Line 14. If I may paraphrase what you have said here is that by not requiring reciprocal compensation in the case of ISP traffic, BST would be allowed to skirt its obligation to pay for the use of an interconnecting carriers' network. In the interexchange call example that we just described, isn't BellSouth in your view skirting its obligation to pay for the use of an inter connecting carriers' network?

A Well, again, I can't answer that question. I don't know the extent to which ICG charges BellSouth in that circumstance a transiting charge. In many cases local exchange companies do assess a transiting charge in such a circumstance to recover the costs that I suggested earlier were created.

Q It's safe to say, though, that BST in the interexchange example would not pay reciprocal compensation on that traffic?

A They probably wouldn't pay reciprocal compensation. They may pay a rate equal to reciprocal compensation. I just don't know what ICG has in its tariff or in the interconnection agreement agreed to with BellSouth, or not agreed to at this point.

Q I would like to go back for a minute to your discussion of costs. You stated that if there were no reciprocal compensation -- I'm sorry, I will refer you to Page 16 of your testimony, Lines 13 through 16. The sentence that begins on Line 13. And you said that one of the purportedly dire consequences of not permitting reciprocal compensation be paid on this is that ISPs may go back to BST where BST's more mature customer base can be used to offset the costs of terminating the ISP's traffic without raising ISP local rates. Doesn't this suggest that if the Commission's policy goal is to encourage ALECs to serve all segments of the telecommunication using public and not just ISPs or other net reciprocal comp revenue generators, that it should, in fact, not impose reciprocal compensation because it would create an incentive for ICG to develop a diverse customer base as BellSouth has?

A If that is what you drew from that sentence, I apologize, because that was not my intention, and nor is that my position. What this sentence says is absent the ability to recover their costs associated with serving ISPs, ICG doesn't have the same mature customer base to subsidize those carriers and keep them at the same rates. Hence, it has got to raise its rates. BellSouth, on the other hand, has a large customer base. The effect of having 100 ISPs on its network that aren't recovering their costs is not as financially damaging to BellSouth as it is to ICG. Hence, while ICG may need to race its rates to recover its costs because BellSouth is not paying reciprocal compensation, and assisting in the recovery of those costs as it should, they would have to raise its rates and the ISPs would likely return to BellSouth where such an action may not be necessary.

Q Is there any factual evidence in the record to suggest that the fees that ICG charges to its ISP customers would not alone be enough to cover its costs?

A I don't know if there is factual evidence, but certainly it has been my experience in discussing not only with ICG, but with other carriers that the high capacity digital service marketplace is a very competitive marketplace wherein margins are very thin. To suggest that there is a lot of margin in a marketplace where there are a lot of competitors or at least a number of competitors simply just doesn't make it any sense. I don't know that there is factual evidence to suggest that X is the amount of margin in ICG's service, but I would suggest the marketplace is such that it wouldn't support that.

Q Nevertheless, the assertion that you have made that ICG could not cover the cost of terminating this traffic without reciprocal compensation is not supported by facts in the record, isn't that correct?

A Well, I don't think I said it couldn't, I wasn't make that as a factual statement. I was suggesting that that would be the likelihood of the turn of the events, that absence an ability to recover its costs it would likely have to raise its rates.

Q I think I was asking you something a little bit different, which is is there evidence to suggest that they would not be able to recover its costs through what it charges to its subscribers for service?

A And I think I would give the same answer I gave awhile ago, which is I don't know of an analysis that provides numbers consistent with what ICG's margins are. It is my experience that the high capacity digital access line market is a very competitive market such that the margins that ICG could realistically provide are such that it is unlikely that they could recover on top of that BellSouth's costs associated with BellSouth's customers calling those carriers, or calling those particular customers.

MR. KITCHINGS: I have no further questions. Thank you, Mr. Starkey.

COMMISSIONER DEASON: Staff.

MR. FORDHAM: Thank you, Commissioner.

CROSS EXAMINATION

BY MR. FORDHAM:

Q Mr. Starkey, in ICG's proposed Florida network, how many switches is contemplated to be utilized in covering the same geographic area that is served by BellSouth's tandem switch?

A I think I would answer that question two ways; one, I think I would rely on an ICG representative to provide you the exact details of the network. My understanding is that currently in planning is one switch, though I don't know how many others are in planning, as well. Ms. Schonhaut may well be able to tell you that.

Q Do you know whether that will be a tandem switch?

A Yes, it will be a tandem switch.

Q On Pages 31 and 32 of your direct testimony you describe the economies of the switch transport trade-off and in this you refer to the advent of quote, relatively inexpensive fiberoptic transport facilities, and also the enormous switching capacity available in today's switching platforms that ICG will use in that proposed network enabling it to cover a wider area with only one switch. Now, based on those comments, do you believe it will be more expensive to terminate a call on ICG's network or on BellSouth's tandem switch arrangement?

A The issue of expense would go to the rate that ICG is able to charge, so that would to some extent be determinative of what is decided here. I think your question, however, gets to would it cost more from a network perspective to terminate a call on the ICG network than on the BellSouth network.

Q Correct. We are talking the cost of terminating.

A Right. I think the answer to that is it is likely to be more expensive to terminate a call on the ICG network, at least for a fairly long period of time. While fiber-optic technology and switching technology has certainly raised or certainly has enhanced the capability to enjoy lower average costs given particular usage levels compared to the past technology, we have to understand that there is a much more powerful offsetting factor, which is the fact that ICG will put that switch in the ground, spend anywhere from 3 to $5 million, and have no customers on it such that its average cost of terminating a minute of traffic is very large.

Q Okay. And in your direct testimony on Page 28, you discussed additional costs incurred by a LEC when transporting and terminating a call originated on a competing carriers' network by stating that these additional costs were likely to vary depending on whether tandem switching is involved. But you have stated at this point that --

MR. KRAMER: I'm sorry, could you just give us the page. I'm not finding it.

MR. FORDHAM: Page 28.

BY MR. FORDHAM:

Q So the question is what additional costs does ICG seek to recover through the reciprocal compensation at the tandem switch rate?

MR. KRAMER: I'm sorry, I'm not finding you. Could you give us a specific line? I'm not finding the testimony you are referring to in the paragraph, and neither is the witness.

MR. FORDHAM: Page 28 of the direct testimony.

THE WITNESS: Are you at Line 19, perhaps?

MR. FORDHAM: Yes.

MR. KRAMER: Oh, from the FCC quote. I see it right here. I'm sorry.

BY MR. FORDHAM:

Q And the question is, of course, what additional cost does ICG seek to recover through the reciprocal compensation at the tandem switch rate?

A The additional cost would be the same additional cost that BellSouth incurs in completing the same type of traffic, and that is the way ICG deploys its network is it provides a centrally based Class 4/Class 5 switch, which is a tandem and end office switch combined and provides the functionality of both.

However, to extend a footprint into the marketplace, it must rely upon a fiberoptic network. And in many instances collocated SONNET nodes within BellSouth's central offices. It is the costs associated with transporting calls between those nodes and its switch, and ultimately its customers and the places they want to go that generate those additional costs that the FCC is speaking of there.

And I would just -- the other thing I would say about that is that the FCC specifically recognized that that type of architecture -- and asked that state commissions look toward that type of architecture as the type of architecture that a new competitive local exchange carrier might implement and, hence, be subject to the tandem interconnection rate.

Q Changing channels here a little bit, let's look at Mr. Varner's testimony in his rebuttal testimony on Page 15. Mr. Varner states that none of the costs that a term commitment would reduce are included in TELRIC. And he concludes that the impact of any reduction even if it exists is irrelevant with respect to UNE prices. Can you provide some examples of costs included in TELRIC that would be reduced in a term commitment?

A Yes, I can. I think I mentioned this in my -- I don't remember whether it is in my direct or rebuttal, but I talk about to the extent to which the risk associated with constructing facilities on BellSouth's behalf would certainly be lower if they knew that ICG, for instance, was going to purchase X number of units of capacity for a number or a year or a period of time.

Based on that, they don't have to -- or BellSouth doesn't have to engineer its network attempting to forecast what that demand would be. It knows it already. The risk associated with its capital and placing its capital is much lower. In TELRIC cost studies one of the issues is what is the cost of capital associated with employing a network. Risk is a factor associated with the rate of the cost of capital that is included in the study. Less risk, the lower the rate of the cost of capital, the lower the unbundled network element rate.

Q Okay. Also on that same page in Mr. Varner's rebuttal testimony he states that discounts due to term commitments simply reduce the level of contribution and not the level of cost. UNE price do not include any contributions, and since there are no savings of TELRIC cost, there is no basis for offering term discounts. Can you provide any examples of contributions included in UNE prices?

A It's the same one. I think Mr. Varner is somewhat inaccurate when he says there is no contribution in UNE prices. UNE prices set at TELRIC rates include an economic return, which is a return on the capital employed to provision those unbundled network elements. And as I just discussed, whenever BellSouth knows the number of units it is going to sell on a given facility, its risk associated with employing that capital is decreased. Hence, its economic return is likewise decreased and the price for unbundled network elements decreases, as well.

Q Can you provide any examples using specific UNEs and associated costs that demonstrate the potential savings BellSouth would receive by providing volume and term discounts to ICG?

A Generally, yes. In reading through the Commission's orders with respect to their cost proceedings and the arbitrations, the original arbitrations, and I understand they are in the middle of another cost proceeding now, Ms. Caldwell is quoted in the Commission's order as suggesting that TELRIC is comprised of two different types of costs, volume sensitive and volume insensitive. Costs and Ms. Caldwell -- and I'm reading from Page 24 of Order Number PSC-96-1579-FOF-TP -- it is a faxed copy, I don't know if I got that right or not. Ms. Caldwell suggests that volume sensitive costs rise and fall with the level of volume that is purchased. Ms. Caldwell goes on to state that there are no volume insensitive costs in the costs associated with the loop. That leads me to leave that all costs associated with BellSouth's loop are volume sensitive costs, and that is exactly what we are saying, and ICG's position is in this case, which is the larger the volume to which ICG is willing to commit, so should follow that the costs are lowered, as well.

Q In the event that this Commission should mandate that BellSouth provide volume and term discounts for UNEs, has ICG determined what those discounts should be and how they should be applied?

A No, it hasn't. And our position is that what is really required here -- my understanding, and though I have not been involved in the negotiations, is that BellSouth simply has not been willing to negotiate any type of volume and term discounts as it is BellSouth's position that it is not required by the law to do so. ICG's position in this case is that what it needs from this Commission in terms of this arbitration is direction that volume and term discounts are required by the act and under the authority of this Commission to send the parties back to the table to discuss what volume and term discounts should be. ICG in this case has not presented a specific volume and term discount schedule.

Q Okay. And has ICG considered whether there will be any administrative cost in applying the discounts, and if so, who would be responsible for paying those costs?

A Well, administrative costs -- let me answer this, yes, that is something I think we thought about. Administrative costs are generally categorized, and it is my understanding from reading the Florida Commission's order that they are in Florida, as well, categorized either as shared and common costs. And that was another issue that I raised in my testimony was that shared and common costs must be calculated and unitized, I think, is the word I used in my testimony, over a given volume of unbundled network elements. As that volume increases, the per unit administrative costs associated with each unit falls, so as -- excuse me, volume of unbundled network element purchases increase pursuant to ICG's position, and if this Commission were to require volume and term discounts, the number of unbundled network elements purchased is likely to rise and the administrative costs associated with each unbundled network element is likely to fall. So I think I would just suggest that I don't think we are talking about an increase in the administrative expense per unit, I think we are talking about a decrease in the administrative expense per unit.

MR. FORDHAM: No further questions.

COMMISSIONER DEASON: Commissioners. Redirect.

MR. KRAMER: Thank you, Commissioner.

REDIRECT EXAMINATION

BY MR. KRAMER:

Q Let me start with the easy one. Mr. Starkey, going first to Footnote 87, which Mr. Goggin had you read, you read the first sentences of that footnote where the Commission, in essence, says that ISP traffic is not local and, therefore, Section 251(b)(5) does not apply. Do you recall that?

A Yes, I do.

Q Did the Commission go on and add anything in that sentence, in that footnote?

A Yes, it did.

Q Could you read the rest of the footnote?

A Yes. I think the only one I skipped was the last sentence that reads as follows: "As discussed supra, in the absence of a federal rule, state commissions have the authority under Section 252 of the act to determine intercarrier compensation for ISP-bound traffic."

Q And do you stand that to mean that this Commission then has authority to award reciprocal compensation or any other form of compensation for ISP traffic under -- do you agree that this sentence means the FCC says that this Commission has the authority to award reciprocal compensation or any other form of compensation for ISP traffic?

A Yes, I would agree with that. And Footnote 87 is taken from Paragraph 26, and at the end of Paragraph 26, the very last sentence, the FCC states that state commissions -- well, let me just read the whole sentence. It says, "By the same token, in the absence of governing federal law, state commissions also are free not to require the payment of reciprocal compensation," meaning that they must be free to require it or not require it. But it goes on to say if they don't require it, they must adopt another compensation mechanism. And I think that is an important point to make here.

What the FCC has said is states are free to adopt reciprocal compensation as the mechanism applicable to ISP-bound traffic. They are also free not to do that. But if they don't do that, they must adopt another mechanism.

I think what is important about that is two things. First, the FCC is encouraging states that reciprocal compensation is the proper mechanism, but they are saying if states choose not to do that, they must adopt another mechanism. One option that is not available, it seems to me, is to simply ignore the issue.

Q Now, I want to try to discuss several hypothetical calls that Mr. Goggin went through with you. I'm not sure I have them all, but let me start it off with a general question. In several instances, Mr. Goggin asked you about the technical characteristics of calls, and in several other instances he asked you about economic consequences of the calls. When you responded with respect to the technical aspects of the calls, were you assuming any particular ICG network configuration? If you can remember in the case of the particular hypotheticals.

A I can remember. I must have been assuming some type of configuration, but I don't think it was any particular type. I think it was simply the function where ICG would have a local network in place, including a central office switch.

Q Now, do you recall you had a discussion with Mr. Goggin about whether the costs of terminating calls are recovered from the subscriber, from the -- whether the cost of terminating a call to a subscriber is recovered by the serving LEC from that subscriber?

A Yes, I remember that conversation.

Q And do you remember that you referred to testimony of Mr. Varner, where Mr. Varner says that is not normally the way things are done in the common carrier industry, in the telecommunications industry?

A That is correct.

Q Would you have been referring to the said discussion contained on Page 20 of Mr. Varner's direct testimony at Line 15 through 18, or 15 through 16, excuse me?

A Yes, that is what I was referring to, where Mr. Varner says that end users do not pay for local calls terminated to them, so the CLEC cannot be expected to charge its end user. And some other discussion in there, but that is the most pointed.

Q Now, on several -- there were several questions regarding the -- that involved the issue of whether revenues were equal to costs. Do you recall that series of questions?

A Yes, I do.

Q When you said that revenue is equal to cost, does cost as you were using it there include the rate of return, a normal rate of return?

A Yes, it does. And that's why I clarified that I really was not speaking directly to a marginal cost concept, but more to a total service long-run incremental cost concept.

Q And that rate of return that you included in the cost would normally show up on the financial books, for example, when the company published its financials. That rate of return would normally show up as what we would call in the business world profit, is that correct, or earnings?

A Well, that is a complicated question, but, yes. It would show up as a difference between revenues and cost of goods sold.

Q And then presumably that difference between revenue and cost of goods sold would be available to be used as internal capital for expansion to provide service to additional groups of users, would it not?

A Yes. And it would also provide to the investment community an indication and an attraction of future capital.

Q And that would be true even though revenue would equal cost in the sense of the discussion that you and Mr. Goggin were having?

A That is correct.

Q Now, do you remember you and Mr. Goggin also discussed -- I think I have this right -- a BellSouth customer, a BST customer who makes a call to an IXC whose POP is served by ICG. Do you recall that?

A I do.

Q Can you describe for me what you had in mind for the routing of that call, how that call would traverse the network?

A Well, I have a picture drawn here that --

Q Well, if you could describe it for us, please.

A -- starts with a BellSouth customer making a call that is initially transferred to a BellSouth central office. The call from the BellSouth central office is routed over an interconnection trunk to the ICG central office. From the ICG central office to what is probably going to be referred to as entrance facility to an interexchange carriers' point of presence.

Q So in that instance there would be no direct connection between the BellSouth central office switch and the IXC POP?

A That is correct. That was my understanding of the hypothetical.

Q So, in essence, in that hypothetical situation, we would have a situation where ICG's switch and connection to the IXC was, in essence, functioning -- was, in essence, providing a sort of tandem function for the BellSouth switch, isn't that correct, in the sense that it was providing the connection usually provided by a tandem switch?

A It is providing exactly the tandem function. I mean, one of the primary tandem functions is interconnections between carriers.

Q And since we were talking about a long distance call, that would be conventional access, am I correct, about that?

A Yes, it would be.

Q And then would the IXC pay a fee to ICG, an access charge?

A Yes, they likely would.

Q Now, you refer to a transiting charge. When you referred to a transiting charge, did you mean an access charge?

A Yes, I think I did. A transiting charge is sort of its own special animal, which is a charge that is assessed generally, and generally it is assessed by the incumbent local exchange carriers when two carriers not affiliated with the incumbent transfer traffic between their two networks using a switch of the incumbent, and there is a particular charge associated with transiting the incumbent's network for purpose of interconnection.

Q Now, in that same hypothetical --

COMMISSIONER JACOBS: Excuse me, could I ask a quick question? It sounds like that is an optional charge. Why wouldn't it be charged? Why would a carrier choose to forego that?

THE WITNESS: I made it sound like an optional charge?

COMMISSIONER JACOBS: You said you wasn't sure whether ICG was charging that.

THE WITNESS: I don't know the extent to which the hypothetical that has been put forward actually exists. I don't know that ICG serves the function of connecting BellSouth and an interexchange carrier through its switch. If it does, I'm certain it might have such a charge, but I just don't know.

COMMISSIONER JACOBS: I see.

BY MR. KRAMER:

Q Mr. Starkey, do you know in fact whether ICG has a direct connection with any IXC?

A No, I don't know that.

Q Do you know whether ICG, in fact, switches all its interexchange traffic through the BellSouth tandem?

A That is possible.

Q You don't know?

A I don't know.

Q Just to go back to Mr. Goggin's hypothetical -- I will withdraw that. Never mind.

MR. KRAMER: I think that's all I have.

COMMISSIONER DEASON: I need to ask a follow-up question. Mr. Starkey, if you could look at Paragraph 26 of the FCC order once again, please?

THE WITNESS: Okay.

COMMISSIONER DEASON: I believe you, in response to one of the redirect questions, you referenced the very last sentence of that paragraph, and you made the interpretation then that state commissions are free to require -- I'm sorry, free to not require the payment of reciprocal compensation, but in that event that the Commission was under an obligation to adopt another compensation mechanism. Did I understand your interpretation correctly?

THE WITNESS: Yes, sir.

COMMISSIONER DEASON: So when the term and is used in that sentence, you interpret that that the Commission has to implement some type of mechanism, whether it is reciprocal compensation or another mechanism?

THE WITNESS: That is correct. And in my testimony I include an excerpt from the Maryland Commission's order in this respect. And that is the interpretation they took, which was they had -- apparently they thought they had three options. They could either accept reciprocal compensation -- or actually two options. Accept reciprocal compensation as the proper compensation mechanism, or choose not to accept reciprocal compensation and choose another mechanism based upon the fact that the Commission -- the FCC in this respect used the word and, and I think you pointed out the appropriate word. And I think I would agree with that interpretation.

COMMISSIONER DEASON: Have there been any other interpretations that interprets that language to mean that the Commission is free to not require reciprocal compensation period?

THE WITNESS: I don't know if that interpretation has been made from that particular part of the order. What I would say opposes that particular interpretation is in Paragraph 29, where the FCC says, "We acknowledge that no matter what the payment arrangement, LECs incur a cost when delivering traffic to an ISP that originates on another LEC's network."

I think there the FCC is saying that whatever mechanism you choose -- and, again, I think it is saying you must choose a mechanism -- whatever mechanism you choose should understand and should recognize the fact that costs are incurred by the person who ultimately carries the call originated on the other LEC's network.

COMMISSIONER DEASON: So that is not a reasonable interpretation, that the LEC can recover that cost from the charges associated with the customer who is receiving the call?

THE WITNESS: That is an interpretation that could be made, but I think pointing to both Mr. Varner's testimony and mine earlier, we have suggested that that is not the way rates are set up to recover those types of costs.

COMMISSIONER DEASON: So as a subscriber to local service from my telephone company, the fact that I pay them so much per month, that they -- when someone calls me, what I pay the company doesn't recover any of those costs?

THE WITNESS: That is generally correct, yes. It generally accounts for your outgoing calls.

COMMISSIONER DEASON: And if I make no calls myself, but I receive lots of incoming calls, where does my contribution go, then?

THE WITNESS: Let me make sure I understand your question. If you don't make outgoing calls and receive a lot incoming calls -- I think I understand your question. I think that is a statement of the fact that generally local rates are averaged such that on average the rates recover the costs associated with an average users' outgoing calls.

COMMISSIONER DEASON: The truth of the matter is that we don't have local service -- I mean, there is not measured local service, correct?

THE WITNESS: In Florida?

COMMISSIONER DEASON: That is correct.

THE WITNESS: That is my understanding.

COMMISSIONER DEASON: So it's really difficult to say whose revenues are recovering what costs, would you agree with that?

THE WITNESS: No, I don't think I would agree with that. I don't think it is difficult to say whose revenues are recovering what costs. I think the answer to that is the rates were set based upon recovering the originating caller's costs. I think the real question is are those rates sufficient, has the average number of outgoing calls increased such that those rates are no longer sufficient. That I don't have an answer for.

COMMISSIONER DEASON: No further redirect?

MR. KRAMER: No.

COMMISSIONER DEASON: Exhibits.

MR. KRAMER: We would move what has been marked -- the admission of what has been marked as Exhibits 2 through 6.

COMMISSIONER DEASON: I'm sorry, we just identified it as Exhibit 2 as a composite.

MR. KRAMER: You are just calling them all Exhibit 2?

COMMISSIONER DEASON: Yes, all Exhibit 2. Any objection? Hearing no objection, show then that Composite Exhibit 2 is admitted.

(Composite Exhibit Number 2 received into evidence.)

COMMISSIONER DEASON: Mr. Starkey, you are temporarily excused. I think you will be back on rebuttal. We will take a recess for lunch and reconvene in one hour.

(Lunch recess.)

(Transcript continues in sequence with Volume 3.)

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