BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF FLORIDA

In re: Amended Complaint of Qwest Communications Company, LLC against MCImetro Access Transmission Services (d/b/a Verizon Access Transmission Services); tw telecom of florida, l.p.; Granite Telecommunications, LLC; Broadwing Communications, LLC; Budget Prepay, Inc.; Bullseye Telecom, Inc.; DeltaCom, Inc.; Ernest Communications, Inc.; Flatel, Inc.; Navigator Telecommunications, LLC; PaeTec Communications, Inc.; Saturn Telecommunications Services, Inc. d/b/a EarthLink Business; US LEC of Florida, LLC; Windstream Nuvox, Inc.; and John Does 1 through 50, for unlawful discrimination.	DOCKET NO. 090538-TP **REDACTED** REDACTED

REBUTTAL TESTIMONY OF DENNIS L. WEISMAN

ON BEHALF OF

QWEST COMMUNICATIONS COMPANY, LLC

Filed: August 9, 2012

COM 5
AFD
APA
ECO
ENG
GCE 7
IDM
TEL 2
CLK 1-CT Rep

TABLE OF CONTENTS

I. IDENTIFICATION OF WITNESS

Q. PLEASE STATE YOUR NAME, CURRENT POSITION AND BUSINESS ADDRESS.

A. My name is Dennis L. Weisman. I am employed by Kansas State University as a Professor of Economics. My business address is Department of Economics, Waters Hall, Kansas State University, Manhattan, Kansas 66506-4001.

Q. ARE YOU THE SAME DENNIS L. WEISMAN THAT FILED DIRECT TESTIMONY IN THIS CASE?

A. Yes.

II. PURPOSE AND SUMMARY OF MAIN POINTS

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of my rebuttal testimony is to respond to the direct testimony of Mr. Wood and Mr. Reynolds (hereafter, "opposing witnesses"). In crafting these responses, I rely upon sound economic and public policy principles that are firmly grounded in the economics and regulation literature.

Q. PLEASE SUMMARIZE THE MAIN POINTS DEVELOPED IN YOUR REBUTTAL TESTIMONY.

A. The main points developed in my rebuttal testimony are as follows.

- There is an important distinction between rate differences and rate discrimination. The latter is defined as rate differences that cannot be explained by cost differences.

- Preventing unreasonable rate discrimination is not synonymous with rate regulation. The Commission should intervene in wholesale telecommunications markets to prevent unreasonable rate discrimination when the failure to do so could result in market distortions and anticompetitive outcomes.

- Two interexchange carriers (IXCs) that are "different" in certain respects are presumptively similarly situated if there is no difference in the cost of supplying switched access to them.

- Distinctions between IXCs, including revenue commitments and reciprocal serving arrangements, that do not result in differences in the cost of supplying switched access are "distinctions without a difference."

- Switched access is a bottleneck input because the IXCs cannot generally choose the CLEC from which they must purchase switched access.[1] The implication is that the IXC is captive to the CLEC that has been chosen by the end-user customer and is therefore not able to avoid unreasonable rate discrimination.

- Simply forcing the favored IXCs to disgorge their undercharges or discounts for switched access would not be an adequate remedy. The Commission should craft a remedy that restores competitive parity, both prospectively and retrospectively.

III. POINT-BY-POINT REBUTTAL OF OPPOSING WITNESSES

A. Mr. Wood

Q. DOES MR. WOOD CLAIM THAT QCC SEEKS TO HAVE THE COMMISSION REGULATE CLEC-PROVIDED SWITCHED ACCESS?

A. Yes. Mr. Wood states that "As I understand the Complaint, Qwest is effectively asking the Commission to treat CLEC-provided switched access as a regulated service and to determine a rate (or set of rates) for switched access that should have been charged to Qwest …"[2]

[1] As I previously observed, "While I acknowledge that there are differences between originating and terminating switched access, concerns related to the switched access bottleneck are present in both cases because it is the end user (and not the IXC) that ultimately decides on the LEC that supplies switched access to the IXC." Weisman Direct Testimony, p. 14.

[2] Wood Direct Testimony, pp. 3-4.

Q. HAS MR. WOOD ACCURATELY CHARACTERIZED QCC'S POSITION THAT THE COMMISSION SHOULD REGULATE CLEC-PROVIDED SWITCHED ACCESS?

A. No. QCC fully recognizes that the rates for CLEC-provided switched access have not been set by this Commission. There is an important distinction, however, between setting and approving these rates, which the Commission does not do, and preventing unreasonable rate discrimination and anticompetitive conduct, which I understand the Commission is empowered and mandated to do. For example, the issue is not whether the price list rate that QCC is charged for switched access is 1 cent or 6 cents per minute. Rather, the issue is QCC being charged a rate of 6 cents per minute when other similarly-situated IXCs are being charged a rate of 1 cent per minute. Hence, the concern is unreasonable rate discrimination rather than rate regulation *per se*.

Q. DOES MR. WOOD CLAIM THAT QCC'S POSITION IS THAT RATE DIFFERENCES ARE SYNONYMOUS WITH RATE DISCRIMINATION?

A. Yes. To be precise, Mr. Wood states that "Qwest appears to argue for 'per se' discrimination – an idea that a rate is discriminatory simply because it is different."[3]

Q. HAS MR. WOOD ACCURATELY CHARACTERIZED QWEST'S POSITION?

A. No. As I stated in my direct testimony, there is an important distinction between rate differences and rate discrimination.[4] Rate differences that merely reflect cost differences do not constitute rate discrimination. Rate discrimination refers to price differences that cannot be explained by cost differences. In terms of this proceeding, the CLECs claim that QCC is not similarly situated to the IXCs that received more favorable rate treatment. The issue, however, is not whether QCC is different from the

[3] Id., p. 22.
[4] Weisman Direct Testimony, Section III.

IXCs that received more favorable rate treatment, but rather whether the differences between the IXCs (as no two firms will ever be precisely identical in every sense), such as they are, lead to differences in costs for the CLECs that fully explain the differences in rates. In the absence of such a credible demonstration of cost differences, these rate differences presumptively amount to unreasonable rate discrimination.

Q. DOES MR WOOD CONTEND THAT COST DIFFERENCES FOR SWITCHED ACCESS FULLY EXPLAIN THE RATE DIFFERENCES FOR SWITCHED ACCESS?

A. No. Mr. Wood claims that "Qwest ignores the fact that this industry is filled with rates that would meet its definition of discriminatory."[5] He cites two specific examples in support of his argument. His first example is differential pricing for residence and business local exchange services. Mr. Wood's second example is the initial pricing structure for ILEC switched access services that provided for different switched access rates for dominant and non-dominant IXCs.

Q. DO YOU BELIEVE THESE TWO EXAMPLES ARE APT IN ATTEMPTING TO JUSTIFY DISCRIMINATORY PRICING OF SWITCHED ACCESS?

A. No. The first and most important observation to make is that in putting forth these examples Mr. Wood is effectively confirming that the differential rate structure for CLEC-provided switched access constitutes rate discrimination rather than mere rate differences that are explained by cost differences.

Mr. Wood's first example, that of different rates for business and residential customers, is inapt on two grounds. First, it is an example of *retail* price discrimination rather

[5] Wood Direct Testimony, pp. 22-23.

than *wholesale* or *input* price discrimination.[6] Second, the "value-of-service" pricing structure that explains this price discrimination arose in the pre-competitive era and hence was the product of regulatory fiat.[7] These types of discriminatory pricing structures are unlikely to be sustainable under increasingly competitive market conditions.

Mr. Wood's second example, that of charging different switched access rates for dominant and non-dominant IXCs, is also inapt on two grounds. First, when competition was first introduced in the long-distance marketplace, it was technically infeasible for the local exchange carriers to provide non-dominant IXCs with the same quality of switched access as that provided the dominant IXC, AT&T.[8] Hence, the rate differential was designed, in part, to compensate the non-dominant IXCs for this inferior quality of switched access. Second, the FCC was concerned that the continuation of this discriminatory rate structure for switched access would lead to economic distortions and anticompetitive outcomes.[9] The following passage from an article authored by FCC officials is instructive in understanding the specific nature of the problem.

[6] As I previously observed, "Price discrimination for intermediate goods (inputs) is likely to be particularly pernicious in this regard due to the risk of efficiency distortions in the downstream market." Weisman Direct Testimony, p. 10.

[7] Peter Temin, THE FALL OF THE BELL SYSTEM. New York: Cambridge University Press, 1987, pp. 33-34. See also Alfred E. Kahn and William B. Shew, "Current Issues in Telecommunications Regulation: Pricing," *Yale Journal on Regulation*, Vol. 4, 1997, pp. 194-199.

[8] The Bell System was designed and engineered as an integrated network serving one long-distance provider, AT&T Long Lines. Hence, when competition first surfaced in the long-distance market, a patchwork of network connections was required to provide other common carriers with access to end-user customers. Indeed, as the FCC observed, "Because in the short run the superior quality access received by AT & T could be provided to only one carrier, we imposed a charge upon AT & T and its interexchange partners that would reflect an estimate of premium value, called the premium access charge." Federal Communications Commission, FCC 86-504, In the Matter of Exchange Network Facilities for Interstate Access, CC Docket No. 78-371, *Memorandum Opinion and Order*, Released November 14, 1986, ¶ 26. See also Gerald W. Brock, TELECOMMUNICATIONS POLICY FOR THE INFORMATION AGE, Harvard University Press: Cambridge MA, 1994, pp. 139-141.

[9] Federal Communications Commission, FCC 86-504, In the Matter of Exchange Network Facilities for Interstate Access, CC Docket No. 78-371, *Memorandum Opinion and Order*, Released November 14, 1986, ¶¶ 57-62.

> It can be argued, for instance, that some of the Commission's regulatory actions in the interexchange market that were designed to promote competition during transition, such as highly discounted access pricing for OCCs [Other Common Carriers] and restrictions on competitive pricing responses by AT&T, in fact have encouraged entry by uneconomic providers and uneconomic construction of excess capacity. If this is true, the gradualist approach to deregulation of interexchange markets will have resulted in substantial, unnecessary costs for society that never would have been incurred in a truly competitive marketplace. Moreover, this approach will have directly increased consumer costs by requiring regulated firms to charge higher prices to protect competitors during the transition.[10]

The bottom line is that the rate discrimination that Mr. Wood dismisses as standard industry practice represents the very type of unreasonable rate discrimination that this Commission's policies should seek to prevent.

Q. DOES MR. WOOD CONTEND THAT THE 1996 TELECOMMUNICATIONS ACT EXPLICITLY PROVIDES FOR THE TYPE OF RATE DISCRIMINATION AT ISSUE IN THIS PROCEEDING?

A. Yes. In support of his contention, Mr. Wood states that "The 1996 Federal Telecommunications Act explicitly created different and discriminatory pricing for the exchange of local versus interexchange traffic among carriers, even when the services were technically equivalent."[11]

[10] Mark S. Fowler, Albert Halprin, and James D. Schlichting. "'Back To The Future': A Model For Telecommunications," *Federal Communications Law Journal*, Vol. 38(2), 1986, pp. 193-194. [At the time this article was written, the authors were, respectively Chairman, Chief, Common Carrier Bureau, and Special Counsel, Common Carrier Bureau, Federal Communications Commission.]

[11] Wood Direct Testimony, p. 23.

Q. DOES MR. WOOD'S INVOCATION OF THE 1996 TELECOMMUNICATIONS ACT RATIONALIZE THE RATE DISCRIMINATION AT ISSUE IN THIS PROCEEDING?

A. No. Mr. Wood cites an example in which different types of telecommunications traffic are subject to different rate treatment when the costs of providing the various services in question are presumptively the same. However, this proceeding is concerned with different IXCs being subject to disparate rate treatment when the costs of providing switched access are presumptively the same. Hence, in Mr. Wood's example there is discrimination across different traffic types, but not across different carriers. In contrast, the issue in this proceeding involves discrimination across carriers that provide the same type of traffic, presumptively unreasonable discrimination, and therefore gives rise to market distortions and anticompetitive outcomes. Hence, once again Mr. Wood's example is inapt for the purposes of the Commission's evaluation of the issues in this proceeding.

Q. DOES MR. WOOD ATTEMPT TO EXPLAIN THE RATE DIFFERENCES BETWEEN QCC AND THE FAVORED CARRIERS?

A. Yes. Mr. Wood's argument is essentially that QCC is not similarly situated to the IXCs that were charged lower rates for switched access.[12] He further points out that "§ 364.10(1) prohibits only '*undue* or *unreasonable* preference' and *undue* or *unreasonable* prejudice.'"[13] He therefore implies that the rate discrimination at issue in this proceeding does not constitute *unreasonable* or *undue* rate discrimination.

Q. DO YOU CONCUR WITH MR WOOD'S REASONING?

A. No. I am not an attorney, so I will defer to counsel to brief the legal interpretation of this particular passage from the statute and limit my discussion and analysis to the

[12] Id., pp. 23-26.
[13] Id., p. 25.

relevant economic issues. It is my understanding that the Commission has a duty to intervene in Florida's telecommunication markets when the failure to do so can lead to market distortions and anticompetitive outcomes. Mr. Wood's counsel to the Commission is two-fold. First, he opines that rate discrimination is standard practice in the telecommunications industry and hence there is no sound rationale for the Commission to intervene in the switched access market. Second, because Mr. Wood believes QCC is not like the other IXCs that received favorable rate treatment, any such rate discrimination fails to constitute undue preference or prejudice.

Q. HOW DO YOU RESPOND TO MR WOOD'S FIRST ARGUMENT THAT RATE DISCRIMINATION IS STANDARD PRACTICE IN THE TELECOMMUNICATIONS INDUSTRY?

A. Mr. Wood appears to ignore the critical distinction between retail rate discrimination and wholesale (input) rate discrimination, particularly as it relates to a bottleneck service such as switched access. Furthermore, the fact that rate discrimination is common in the telecommunications industry does not imply that such practices do not give rise to market distortions and anticompetitive outcomes under certain conditions. As I explained at length in my direct testimony, switched access is one of those exceptions that requires regulatory intervention to prevent unreasonable rate discrimination.[14] Contrary to Mr. Wood's suggestions, the conduct of other providers in other contexts does not immunize Mr. Wood's clients from their duty to avoid undue rate discrimination. Neither does it offset or mitigate the anticompetitive effects on QCC of the CLECs' discriminatory switched access pricing.

[14] Weisman Direct Testimony, § IV.

Q. CAN YOU ELABORATE AS TO WHY PRICE DISCRIMINATION CAN BE PROBLEMATIC UNDER CERTAIN CONDITIONS?

A. Yes. It is important to differentiate clearly between price discrimination in input (generally wholesale) markets and price discrimination in output (generally retail) markets. With respect to retail markets, the economics literature recognizes that price discrimination can be welfare-enhancing when it leads to an increase in total output in the market relative to a uniform price.[15] There is a general consensus that price discrimination is increasingly common in retail markets, that competition may actually force firms to adopt discriminatory pricing schemes, and that it is presumptively welfare-enhancing.[16] This proceeding, however, involves rate discrimination in *input markets*, as switched access is a wholesale service provided by one carrier to another carrier.

Q. DO THE SAME ARGUMENTS THAT ARE GENERALLY SUPPORTIVE OF PRICE DISCRIMINATION IN RETAIL MARKETS CARRY OVER TO THE CASE OF INPUT MARKETS?

A. No. The general policy advisability of allowing price discrimination in retail markets does not carry over to wholesale or input markets. The welfare implications of input price discrimination are mixed, but the prevailing view in the literature is that it can often be welfare diminishing.[17] The problem arises from the fact that the input supplier has an incentive to charge the relatively efficient provider a higher price for the input and the relatively inefficient provider a lower price for the input, all things being equal. The net effect of this price discrimination is to decrease the output of the efficient

---

[15] See, for example, Jean Tirole, INDUSTRIAL ORGANIZATION, Cambridge MA: The MIT Press, 1988, pp. 137-140.
[16] ANTITRUST MODERNIZATION COMMISSION, REPORT AND RECOMMENDATIONS, Washington D.C. 2007, Section 3.
[17] See, for example, Michael Katz, "The Welfare Effects of Third-Degree Price Discrimination in Intermediate Good Markets," *The American Economic Review*, Vol. 77(1), March 1987, pp. 154-167; and Patrick Degraba, Input Market Price Discrimination and the Choice of Technology," *The American Economic Review*, Vol. 80(5), December 1990, pp. 1246-1253.

provider, increase the output of the inefficient provider and thereby raise the total resource costs borne by society in producing any given level of output. These are basically the same type of market distortions that I discussed in my direct testimony.[18]

Q. DOES THIS OBSERVATION HAVE ANY IMPLICATIONS FOR THE COMMISSION'S POLICY ON INPUT PRICE DISCRIMINATION AS COMPARED TO RETAIL PRICE DISCRIMINATION?

A. Yes. What this suggests is that, in contrast to retail price discrimination, there can be no reasonable presumption that input price discrimination is welfare-enhancing. This is important for regulatory policy because it suggests that in retail telecommunications markets the presumption should be in favor of permitting price discrimination, but any such presumption should be reversed in the case of input markets.[19] That is to say, input price discrimination (particularly for a service such as switched access) should be deemed presumptively welfare-diminishing absent credible evidence to the contrary. From an economic perspective, regulators and policymakers designing competition policy should strive to prohibit particular business practices when they are welfare-diminishing and should permit business practices when they are welfare-enhancing. The objective would be to set the policy guideline so as to minimize the expected social cost of error. Hence, if input price discrimination is more often welfare-diminishing than welfare-enhancing, it is advisable to establish a default policy that prohibits input price discrimination absent credible information to suggest that departures from this policy are warranted.

---

[18] Weisman Direct Testimony, pp. 8-13.

[19] For a discussion of these types of trade-offs in the telecommunications industry, see Dennis L. Weisman, "A 'Principled' Approach to the Design of Telecommunications Policy." *Journal of Competiton Law & Economics*, Vol. 6(4), December 2010, pp. 927-956.

Q. DOES MR. WOOD ASSERT THAT SWITCHED ACCESS IS NOT A MONOPOLY BOTTLENECK?

A. Mr. Wood does not directly assert that switched access is not a monopoly bottleneck, but he does intimate it. He states in a footnote that "IXCs are not required to use the network facilities of unaffiliated LECs to complete calls, and often do not do so."[20] I have addressed the matter of switched access being a monopoly bottleneck and therefore not a competitive service in my direct testimony.[21] I will not repeat all of those arguments here, but I would make two observations.

First, despite the fact that telecommunications markets are becoming increasingly competitive, a fact recognized by the recently passed Florida legislation, this does not mean that all sectors of the industry are experiencing the same level of competitive intensity. It is paradoxical perhaps, but the problem of the switched access monopoly bottleneck is not one that is remedied by competition, it is in fact one that is created by competition. To wit, in the pre-competitive era of the former Bell System, there was essentially a single vertically-integrated provider of local and local-distance telecommunications and, of course, there is no economic incentive for a firm to leverage its market power against itself.

Second, that the local exchange market is competitive means that *end-user customers* can choose from a number of different providers for their local exchange telephone service. Once the end-user customer enters into an agreement with a particular CLEC, that CLEC enjoys a monopoly bottleneck that can be leveraged to charge differential switched access rates to IXCs. The CLECs are effectively gatekeepers that control the rights of passage and the fees for doing so. Furthermore, because the choice of CLEC

[20] Wood Direct Testimony, p. 8, note 3.
[21] See, in particular, Weisman Direct Testimony, pp. 5-9, 12-14. In addition, unless a special access arrangement is being used to reach the end-user, an option that is cost-effective only when volume is sufficient to justify the expenditures on such facilities, switched access charges are being paid, either by the IXC, or in situations where the IXC hands the call off to an underlying carrier for termination, by the underlying third-party carrier.

is made by the *end-user customer*, whereas switched access charges are paid by the IXC, there is no market mechanism that corrects this condition; it is inherent in the way the market for long distance calls works. The following passage in instructive on this point.

> Because the terminating carrier controls the only line and local switch connecting the called party to the network, that carrier has strong incentives to extract as high a payment as possible from the calling party's carrier. Competition at the retail level has not diminished the terminating access monopoly of the carrier selected by the called party. As a result ... regulators must ensure that terminating rates are cost-based, and the need for regulation continues indefinitely.[22]

Hence, once the IXC opts to provide long-distance service, it has no choice but to originate/terminate the long-distance call over the CLEC facilities chosen by the end-user customer.[23] Commission oversight is required under these conditions to serve as a surrogate for competition and thereby prevent market distortions and anticompetitive outcomes.[24]

---

[22] Glen O. Robinson and Thomas B. Nachbar, COMMUNICATIONS REGULATION, St. Paul MN: Thompson-West, 2008, pp. 527-28.

[23] As the FCC has recognized, this problem is further exacerbated by rate averaging requirements.

> Second, the Commission has interpreted Section 254(g) to require IXCs geographically to average their rates and thereby to spread the cost of both originating and terminating access over all of their end users. Consequently, IXCs have little or no ability to create incentives for their customers to choose CLECs with low access charges. Since the IXCs are effectively unable either to pass through access charges to their end users or to create other incentives for end users to choose LECs with low access rates, the party causing the costs – the end user that chooses the high-priced LEC – has no incentive to minimize costs. (footnote omitted)

Seventh Report and Order and Further Notice of Proposed Rulemaking, *Access Charge Reform, Reform of Access Charges Imposed by Competitive Local Exchange Carriers*, CC Docket No. 96-262, FCC 01-146 (rel. April 27, 2001) at ¶ 31.

[24] Weisman Direct Testimony, p. 3 and notes 2 and 3.

Q. HOW DO YOU RESPOND TO MR WOOD'S SECOND ARGUMENT THAT QCC IS NOT SIMILAR TO THE OTHER IXCS THAT WERE THE BENEFICIARIES OF FAVORABLE RATE TREATMENT?

A. Mr. Wood reflexively invokes the "not similarly-situated" criterion to justify discounts to the favored IXCs that were not offered to QCC. The fact that there may be differences between the favored IXCs and QCC is a necessary, but not a sufficient, condition for rationalizing the differences in rate treatment. What is more, the Commission should be aware that distinctions without a difference do not establish that QCC and the preferred IXCs were not and are not similarly situated in the context of the CLECs' provision of intrastate switched access in Florida.

Q. DID CLECS ALSO RAISE IRRELEVANT DISTINCTIONS IN THE PARALLEL COLORADO PROCEEDING?

A. Yes. In the Colorado proceeding, the CLECs raised a laundry list of alleged differences between the favored IXCs and QCC in an attempt to establish that QCC was not similarly situated, and thus was not subjected to unlawful conduct. And yet, the differences between the IXCs raised by the CLECs were not sufficient to establish that the IXCs are not similarly situated. Indeed, as the Administrative Law Judge (ALJ) in the Colorado proceeding observed.

> Without regard to implementation, the thrust of MCImetro's second theory is that QCC was not similarly situated to AT&T because QCC could not undertake the reciprocal arrangement. ... the attempt to distinguish customers by a combination of access with other tariff and off-tariff provisions was previously rejected. The substance of access agreements must prevail over form and access services cannot be obscured or obviated by inclusion with other terms. Creativity of those

> contracting for access . . . cannot change the access service provided nor the unlawful pricing thereof.[25]
>
> Illustratively, the agreement between AT&T and MCI applies switched access service regardless of delivery method. However, if the parties had negotiated a commercial agreement to limit charges to a unique negotiated methodology using traditional means plus delivery of a peppercorn, or perhaps a unique billing requirement (e.g., use of controlled proprietary applications), they would forever prohibit any competitor from being similarly situated . . .[26]

The key policy message to take away from the Colorado ALJ's decision, of course, is that CLECs cannot simply point to any differences that may exist between IXCs as a credible rationale to establish that the IXCs are not similarly situated. Indeed, as the Colorado Commission observed, if this were not the case "the regulated entities would be able to obscure their discriminatory conduct simply by executing off-tariff agreements covering multiple services."[27]

Q. RECOGNIZING THAT NOT EVERY DIFFERENCE BETWEEN CLECS CONSTITUTES A SOUND BASIS TO FIND THAT THEY ARE NOT SIMILARLY SITUATED, DO YOU HAVE A VIEW AS TO WHAT CRITERIA WOULD CONSTITUTE A SOUND RATIONALE THAT JUSTIFIES PRICE DIFFERENCES IN THIS CONTEXT?

A. Yes. I believe that any differential rate treatment for switched access should be firmly grounded in (and fully explained by) the differential costs for the CLECs' serving one IXC *vis-à-vis* another IXC. Absent such a credible demonstration of cost differences,

[25] *QCC v. MCImetro, et al*, Docket No. 08F-259T, Decision No. C11-1216 (mailed June 21, 2012), Recommended Decision of Administrative Law Judge G. Harris Adams on Remand ("Colorado Remand Order"), ¶ 27.
[26] Id., ¶ 28.
[27] *QCC v. MCImetro, et al*, Docket No. 08F-259T, Decision No. C11-1216 (mailed Nov. 15, 2011) at ¶ 76.

the default policy should be that each IXC pays the same uniform rate for switched access, all things being equal. To do otherwise would likely lead to market distortions and anticompetitive outcomes.

Q. HOW DO YOU RESPOND TO MR. WOOD'S CLAIM THAT "QWEST HAD YET TO PROVIDE ANY EVIDENCE THAT IT WAS SIMILARLY SITUATED TO ANY IXC WHOSE CONTRACT TERMS QWEST SEEKS TO CONFER UPON ITSELF"?[28]

A. Mr. Wood's contention is that the burden for establishing that QCC and the favored IXCs are similarly situated is wholly borne by the customers of the CLECs rather than the CLECs themselves. In light of the above discussion, this implies that QCC bears the burden for establishing that the CLECs' cost to provide switched access to the favored IXCs is lower than the cost to provide switched access to QCC. The question as to which party bears the burden of proof calls for a legal determination and hence lies outside my particular area of expertise. I hasten to point out, however, that it is the CLECs (and not QCC) that control cost information related to *their* provision of switched access services to particular IXCs.[29]

Hence, it would be illogical to assign responsibility for establishing the existence of cost differentials on the IXC customers consuming the service rather than on the CLECs producing the service. It is illogical because the burden would be assigned to the party that is arguably the least well-positioned to credibly inform the record. It would be akin to requiring an automobile customer to prove that it costs Ford Motor Company less to produce an automobile for her than it does for someone else. It is

[28] Wood Direct Testimony, pp. 25-26.

[29] QCC inquired of each respondent CLEC in discovery whether it performed cost or demand studies in connection with establishing the intrastate switched access rates set forth in the agreement(s). To my knowledge, not a single CLEC responded that it had performed such a study. *See* the CLECs' response to QCC Interrogatory Nos. 2(l) and 2(m). *See, e.g.* Direct Testimony of William R. Easton, Exhibits 6B (Broadwing), 34A (PAETEC) and 40 (US LEC).

quite obvious that Ford Motor Company is better positioned than the customer to establish the existence of any cost differences or lack thereof.

In the parallel Colorado proceeding, the Commission recognized this tension and resolved it by first evaluating whether QCC had established a *prima facie* case. The Commission then evaluated whether the CLECs effectively rebutted QCC's *prima facie* showing.[30]

Q. DOES MR. WOOD TAKE ISSUE WITH THE REMEDY THAT QCC PROPOSES FOR THE SWITCHED ACCESS OVERCHARGES?

A. Yes. QCC's proposed remedy is that it be charged the same rate for switched access as the favored IXCs and that it receive a refund equal to the amount of the overcharges, plus interest. Mr. Wood states that "If public policy is best served by having all IXCs, regardless of circumstances, pay the published rate (something Qwest has yet to demonstrate), then the only remedy is to adjust the charges to the other IXCs who paid a lower rate."[31] In other words, the remedy would be to force the favored IXCs to disgorge an amount equal to the switched access undercharges or discounts that they received over the many years that the secret switched access agreements were in effect. Notably, Mr. Wood's contention that refunds to QCC would only exaggerate discrimination because they would leave other IXCs continuing to pay the publicly stated rates was rejected outright by the Colorado Commission.

> In response, QCC argues that, if the Commission were to accept the argument that an award of reparations would result in further discrimination, it would then accept and endorse the current level of unlawful discrimination. QCC contends this claim, when taken to its

[30] Colorado Remand Order, ¶ 39 ("Qwest made a *prima facie* case that the Respondents' cost to provide service was the same as to all comers requiring access services and no Respondent demonstrated reasonable justification related to the variation in pricing.").

[31] Wood Direct Testimony, p. 30.

> logical conclusion, means that a customer aggrieved by rate discrimination is never entitled to be made whole through an award of reparations, so long as there are any other similarly situated parties.[32] We agree with QCC on this issue and deny the exceptions filed by XO, Granite, and BullsEye on this ground. We agree that the above argument presented by the respondent CLECs, when taken to its logical conclusion, would frustrate the ability of any complainant to enforce the non-discrimination and reparations statutes in Title 40, as long as any other similarly situated parties chose not to prosecute a complaint.[33]

Q. ARE THERE OTHER CONCERNS WITH MR. WOOD'S PROPOSAL TO FORCE THE FAVORED IXCS TO DISGORGE THE DISCOUNTS THAT THEY RECEIVED?

A. Yes.[34] Should the Commission find that the CLECs engaged in unreasonable rate discrimination, Mr. Wood's proposal would have the effect of penalizing the favored IXCs but not penalizing (and possibly even rewarding) the offending CLECs that violated statutory obligations.[35] What is particularly "novel" about Mr. Wood's proposal is that it seemingly punishes all of the parties except the offending parties. This, of course, is problematic if one of the Commission's objectives in crafting an appropriate remedy is to provide sufficient disincentives for the CLECs to engage in unreasonable rate discrimination.

---

[32] *QCC v. MCImetro, et al,* Docket No. 08F-259T, Decision No. C11-1216 (mailed Nov. 15, 2011) at ¶ 84.
[33] Id., ¶ 85.
[34] Please note that my testimony only addresses the substantive concerns plaguing disgorgement as a remedy. Not being an attorney, I will not address any procedural shortcomings arising from the fact that the CLECs urging disgorgement did not act to include the favored IXCs as parties to this case. I assume that counsel will address this on brief.
[35] To the extent that the favored IXCs reduce long-distance rates to reflect the switched access discounts, the CLECs would, in turn, realize higher demand for switched access services. Hence, the CLECs benefit from the higher demand for switched access resulting from the switched access discounts while having those discounts returned to them as part of Mr. Wood's proposal.

Q. WHAT OBJECTIVES SHOULD GUIDE THE COMMISSION'S DELIBERATIONS IN CRAFTING A SUITABLE REMEDY?

A. First, in the absence of credible cost studies that demonstrate that the rate differentials are fully explained by the cost differentials, each IXC should by default pay the same uniform rate for switched access. This implies that there should be pricing parity for switched access. Pricing parity, of course, can be achieved either by decreasing the rate for QCC or increasing the rate for the favored IXCs.

Second, increasing the rate for the favored IXCs achieves parity on a prospective basis, but it does not retroactively address the competitive impact of the unlawful practice on QCC. To wit, the favored IXCs were conferred an artificial competitive advantage by the CLECs that lowered their cost structure in the provision of long-distance telecommunications *vis-à-vis* QCC. Hence, it is not sufficient in terms of a remedy to simply (i) require the favored IXCs to disgorge the amount of the undercharges or discounts; and (ii) correct the switched access rate disparity going forward. This is necessarily the case because the expected competitive impact on QCC in the retail long distance market would already have occurred and it is not possible to "un-ring the bell" so to speak.

The above discussion necessarily implies that any remedy should satisfy three conditions: (1) Ensure parity pricing on a prospective basis to prevent market distortions and anticompetitive outcomes; (2) retrospectively mitigate to the greatest extent possible the impact on the party subject to rate discrimination; and (3) provide sufficient disincentives for the CLECs to selectively employ rate discrimination as a form of *self-help* in their business dealings with the IXCs – a tactic that is privately beneficial for the CLECs and yet socially harmful in terms of competitive distortions in Florida's telecommunications markets. While the CLECs may claim that providing a discount to AT&T and Sprint was not beneficial to them, it must have been beneficial to them relative to charging all IXCs the same rate because they would not have rationally engaged in such conduct otherwise.[36] This conduct on the part of the CLECs ensured collectibles from the preferred IXCs and, by keeping the discounts secret, enabled them to continue to impose higher rates on other IXCs, including QCC.

Finally, by proposing that the CLECs recover large payments from the favored IXCs, Mr. Wood has, in effect, devised a "remedy" that would potentially *reward* the party that violated Florida law. Paradoxically, this is not a remedy for the victim of discriminatory pricing, but rather a potential *windfall* for the party that perpetrated the discriminatory pricing scheme.

Q. DO YOU BELIEVE REFUNDS (REPARATIONS) ARE AN APPROPRIATE REMEDY IN THIS CASE?

A. Yes. Refunds would provide as much retrospective parity as is possible to assure in this context. No remedy is perfect, but requiring the CLECs to make QCC whole for what QCC overpaid over many years is the most sensible remedy. The Colorado ALJ reached exactly this conclusion. In the recent Remand Order, the ALJ concisely explained the rationale for refunds. The ALJ held, "[r]eparations are not an attempt to calculate contract damages. Rather, reparations approximate a remedy of past unjust discrimination and, consistent with prior Commission policy, avoids a windfall to the utility from discriminatory conduct violating its own tariff obligations."[37]

Q. DO YOU HAVE A VIEW AS TO HOW PRICING PARITY SHOULD BE ACHIEVED ON A PROSPECTIVE BASIS?

A. Yes. As discussed above, pricing parity can be achieved either by decreasing the rate for QCC or increasing the rate for the favored IXCs. Achieving parity by decreasing

[36] The rationality axiom postulates that economic agents behave in their own self-interest.
[37] Colorado Remand Order, ¶ 37.

the rate to QCC *vis-à-vis* increasing the rate to the favored IXCs would increase economic efficiency because the rates for switched access would be more closely aligned with the underlying marginal cost of switched access, all other factors being equal. This, in turn, would be expected to lead to rate reductions across-the-board for switched, long-distances service in Florida and thereby increase consumer welfare.

B. Mr. Reynolds

Q. DOES MR. REYNOLDS CONTEND THAT QCC IS NOT SIMILARLY-SITUATED TO AT&T AND THEREFORE IS NOT ENTITLED TO THE SAME DISCOUNTS FOR SWITCHED ACCESS?[38]

A. Yes. In similar fashion to Mr. Wood, Mr. Reynolds invokes the not similarly-situated criterion to justify granting AT&T discounts that were not offered to other IXCs. And yet, it is not sufficient merely to assert that QCC and the other IXCs are not similarly situated to AT&T without credibly demonstrating that the characteristics that differentiate AT&T from the other IXCs explain the difference in rate treatment. What this means is that the similarly-situated criterion must be grounded in economic reality. Mr. Reynolds provides the Commission with a litany of reasons why QCC is somehow different than AT&T. I am not questioning whether AT&T is different from QCC or any other IXC because that is not the substantive issue. I am questioning whether the differences that Mr. Reynolds identifies provide a credible, economic basis for the differences in rate treatment.

Q. DOES MR. REYNOLDS IDENTIFY SPECIFIC CRITERIA FOR CHARGING QCC A HIGHER RATE FOR SWITCHED ACCESS THAN AT&T?

A. Yes. In essence, Mr. Reynolds' defense of MCI's rate discrimination is two-fold. First, QCC is not a vertically-integrated provider so it cannot "reciprocate" in

[38] Reynolds Direct Testimony, p. 21.

providing discounted switched access to MCI. Second, QCC does not generate the same traffic volumes as AT&T. Both of these arguments are fine and good as far as they go; the problem is that they don't go very far.

Q. WHY SHOULD THE COMMISSION BE CONCERNED ABOUT MR. REYNOLDS'S FIRST CLAIM THAT QCC CANNOT "RECIPROCATE" IN THE SAME MANNER AS AT&T?

A. Mr. Reynolds states that "QCC would not have been able to provide MCI's IXCs with the same benefits" as AT&T because it does not provide switched access.[39] The benefits that Mr. Reynolds is alluding to, of course, are the discounted rates for switched access that were a component of the arrangement between AT&T and MCI. And yet, absent credible cost information to establish that these rate differences reflect the underlying cost differences, this agreement amounts to discrimination against QCC simply because it is not a vertically-integrated provider of local and long-distance telecommunications. As I demonstrated in my direct testimony, the concern with this sort of discrimination is that it can result in market distortions (and inefficient foreclosure) by precluding the least-cost provider from serving as the least-price provider.[40] In other words, MCI and AT&T may prevail in the long-distance market, not because they are necessarily the most efficient providers, but because they control the pricing of a bottleneck, monopoly input in the form of switched access.

Q. CAN YOU ELABORATE ON YOUR CONCERNS THAT THESE ALLEGEDLY RECIPROCAL AGREEMENTS ARE DISTORTIONARY AND POSSIBLY ANTICOMPETITIVE?

A. Yes. To illustrate with a stylized example, suppose that there are three transport companies, AT&T, MCI and QCC, that operate on a toll road from Tampa to Miami.

[39] Reynolds Direct Testimony, p. 24.
[40] Weisman Direct Testimony, pp. 9-12.

AT&T owns the toll booth in Tampa and MCI owns the toll booth in Miami. Each transport company must pass through these toll booths in order to enter and exit the toll road. The public toll rate is \$4.00, but AT&T and MCI enter into a reciprocal agreement granting each other discounted tolls of only \$1.00. Hence, QCC pays a toll premium of $\$3 = \$4 - \$1$ on each end of the toll road. The competitive problem arises from the fact that even if QCC is the most efficient transport company, it can be inefficiently foreclosed from the market if its efficiency advantage on the Tampa-Miami (Miami-Tampa) route is less than $\$6 = 2 \times \$3$, the total toll premium it pays relative to its rivals AT&T and MCI.

Q. HAVE OTHER REGULATORY COMMISSIONS FOUND THAT RECIPROCAL AGREEMENTS OF THIS TYPE ARE ANTICOMPETITIVE?

A. Yes. As discussed in my direct testimony, the Minnesota Public Utilities Commission investigated the companion AT&T (as CLEC) – MCI (as IXC) off-tariff agreement.[41] The Minnesota Commission found that "This conduct distorts the market, harms competition, and ultimately harms consumers."[42]

Further, the Colorado ALJ recently rejected MCI's reciprocity defense, noting that it did not justify MCI's violation of Colorado law.

> MCI heavily relies upon the reciprocal scope and terms of the negotiated 2004 Contracts and the fact that QCC could not undertake those reciprocal obligations because QCC did not (and was not legally able to) provide switched access in Colorado. However, the fact that QCC could not enter into an identical agreement does not determine unlawful discrimination of services provided within the scope of

---

[41] Id., pp. 21-22.

[42] In the Matter of the Complaint of the Minnesota Department of Commerce for Commission Action Against AT&T Regarding Negotiated Contracts for Switched Access Services, DOCKET NO. P-442, 5798, 5340, 5826, 5025, 5643, 443, 5323, 5668, 4661/C-04-235, Minnesota Public Utilities Commission, *2007 Minn. PUC LEXIS 146* October 26, 2007, Issued, p. 10.

agreement, particularly in light of other applicable statutory requirements.[43]

For MCI to condition pricing or availability of intrastate access service upon reciprocation of service alone would directly contravene the limitations of § 40-15-105(1), C.R.S. An IXC requiring intrastate access service to terminate a call is totally independent of the reciprocal provision of access service. Such an IXC requiring access need not have any ability to provide access services. For MCI to lower the rate for access service only for those able to provide reciprocal service directly contravenes Colorado law.[44]

MCI unlawfully discriminated in failing to show that QCC was a relevant dissimilar customer class purchasing identical access service. MCI failed to overcome QCC's *prima facie* showing of unjust discrimination and no lawful price differentiation has been shown.[45]

Q. DO YOU HAVE ANY OTHER CONCERNS WITH MCI'S RECIPROCITY THEORY?

A. Yes. Even if reciprocity was a reasonable justification for input rate discrimination, my understanding is that it did not meaningfully exist in the MCI-AT&T arrangement.[46] Accordingly, there is even less justification for Mr. Reynolds' reciprocity defense.

[43] Colorado Remand Order, ¶ 18.
[44] Colorado Remand Order, ¶ 33.
[45] Colorado Remand Order, ¶ 34.
[46] See Direct Testimony of William Easton, pp. 31-33, Direct Testimony of Derek Canfield, pp. 36-38 and Exhibit DAC-17.

Q. SHOULD THE COMMISSION BE CONCERNED ABOUT MR. REYNOLDS'S SECOND CLAIM THAT QCC DOES NOT GENERATE THE SAME TRAFFIC VOLUMES AS AT&T?

A. Yes. First, [redacted] As such, this *post hoc* rationalization is not credible.[47] Further, there is no evidence to indicate that the cost to MCI in provisioning switched access to AT&T is lower than the cost to MCI in provisioning switched access to QCC due to differences in traffic volumes. Hence, granting AT&T but not QCC switched access discounts on the basis of traffic volumes amounts to discrimination against QCC simply because it is a smaller provider than AT&T. The economic concern is the same as that discussed above, that these practices can serve to preclude the least-cost provider from serving as the least-price provider and lead to inefficient foreclosure. In the absence of a cost justification, this disparate rate treatment is unjustified from an economic perspective.

Q. WHAT CONCLUSIONS DO YOU DRAW ABOUT MR. REYNOLDS' CLAIMS THAT QCC IS NOT SIMILARLY SITUATED TO AT&T?

A. Mr. Reynolds' claims fall victim to the same fallacy as that of Mr. Wood in that he identifies meaningless distinctions to support his contention that QCC is not similarly situated to the favored IXCs. For all of the reasons that I have identified above and in my direct testimony, it is critical that any claims on the part of the CLECs that QCC is not similarly situated to AT&T be grounded in economic reality – that any difference in rates for switched access be explained by differences in costs for switched access.

---

[47] *QCC v. MCImetro, et al*, Docket No. 08F-259T, Decision No. C11-1216 (mailed Nov. 15, 2011) at ¶ 75. ("Further, we find most persuasive QCC's argument that none of the unfiled off-tariff agreements ties the discount to the IXC to the purchase of specific volumes of switched access service. To the contrary, all of the unfiled agreements at issue in the instant proceeding grant the discount in unlimited fashion, regardless of how much switched access a favored IXC purchases. This alone is fatal to the claim that differences in size or traffic volumes justify price differentiation in this case.")

REDACTED

Absent such a credible demonstration of cost differences, I believe the Commission's policy should be that each IXC pays the same uniform rate for switched access.

Q. DOES MR. REYNOLDS DEFEND MCI'S PRACTICE OF CHARGING QCC A HIGHER RATE THAN THE FAVORED IXCS?

A. Yes. Mr. Reynolds states that "MCImetro charged QCC the switched access rates in its intrastate price list on file with this Commission."[48] The intimation is that there can be no claim of rate discrimination when QCC is charged access rates that are in compliance with the price list on file with the Commission. This is incorrect as a matter of economics. What matters in a competitive marketplace is relative positioning. It is not possible to confer an advantage on one IXC without simultaneously conferring a disadvantage on another IXC, particularly in the case of a monopoly bottleneck input like switched access. The relevant issue is the absence of pricing parity for switched access between QCC and AT&T. It is immaterial that QCC was charged the rate on file with the Commission when other IXCs were charged a lower rate. What Mr. Reynolds fails to recognize is that it is the practice of selectively departing from the public price list when there is no cost justification for doing so that constitutes rate discrimination. In point of fact, had the CLECs departed from the public price list uniformly for all IXCs (absent any difference in costs) there would be no rate discrimination issue.

Q. DOES MR. REYNOLDS BELIEVE THAT ANY REMEDIES ARE APPROPRIATE IN THIS CASE?

A. No. Mr. Reynolds supports his claim by arguing that "MCImetro complied with its Florida price list at all times by charging QCC the switched access rates contained

[48] Reynolds Direct Testimony, p. 27.

therein."[49] He further states that "MCImetro did not unreasonably discriminate against QCC with respect to the rates it charged QCC for switched access in Florida . . .[50]

Q. DO YOU CONCUR WITH MR. REYNOLDS CLAIM THAT NO REMEDIES ARE CALLED FOR IN THIS CASE?

A. No. The basis for Mr. Reynolds' claim is that there was no rate discrimination because MCImetro charged QCC the switched access rate contained in its Florida price list. The concept of rate discrimination does not turn on rate levels, however, but on rate differences that cannot be explained by cost differences. According to Mr. Reynolds' logic, MCI could charge AT&T ½ cent per minute for switched access, charge QCC $10 per minute for switched access and yet still claim that it was not engaged in unreasonable discrimination as long as the $10 per minute rate is contained in the Florida price list. This is a fallacious argument and should be accorded no weight by the Commission.

IV. CONCLUSION

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes.

[49] Reynolds Direct Testimony, p. 43.
[50] Id.