16. At paragraph 19, Dr. Taylor states that "from an economic perspective, then the party that causes the cost associated with Internet-bound traffic is the originating LEC's subscriber." I agree. Where Dr. Taylor and I disagree is when he begins to argue that the identity of the called party determines the flow of causation; he argues that the originating LEC subscriber that causes the cost is doing so while acting "in the capacity of an ISP customer." What Dr. Taylor does not explain in his declaration is why the same subscriber, when calling to order a pizza, is not likewise acting "in the capacity of a pizza parlor customer." Without such an explanation, Dr. Taylor goes on to exempt all members of his classification of purported cost-causing called parties (those with which the subscriber has a commercial relationship) *except* ISPs.

17. In summary, what Dr. Taylor has actually done is to:

(1) Acknowledge the correct cost causation: "the party that causes the cost associated with Internet-bound traffic is the originating LEC subscriber," then

(2) Attempt to create an exception to that rule – when the called party offers services for sale telephonically, and therefore is engaged in a commercial relationship with the LEC telephone subscriber, the subscriber causes the cost in the capacity of a customer of the called party rather than a customer of the LEC (presumably justifying the elimination of reciprocal compensation for that call), but then

(3) Inexplicably exempts all called parties with such a commercial relationship with the subscriber -- except ISPs – from the exception, even when they are factually indistinguishable from ISPs.

18. At the end of the process, nothing in Dr. Taylor's argument changes the flow of causation outlined in paragraphs 7 and 8 of my declaration. ISPs really are like pizza parlors in this

regard, and the subscribers to a LEC's local exchange service that elect to make calls to either pizza parlors or ISPs cause the originating LEC to incur costs associated with completing the call. Reciprocal compensation, if applied without regard to the identity of the called party, maintains this logical flow of cost causation and provides the correct economic incentives.

Response to Claim No. 2: The costs incurred by CLECs to terminate calls made to ISPs are less than the cost that would be incurred to terminate a comparable call to a non-ISP end users.

19. At paragraphs 24-35 of his declaration, Dr. Taylor recites several standard ILEC claims suggesting that a meaningful method exists for distinguishing calls made to ISPs from other calls terminated by CLECs. The assertion is that calls to ISPs, because of these technical distinctions, cost CLECs less to terminate than calls to other called parties, and by logical extension, that CLECs over-recover their costs when receiving existing reciprocal compensation rates (which were based on the purportedly higher cost of terminating non-ISP calls).

20. The first distinguishing characteristic of ISP-bound traffic claimed by Dr. Taylor is the largely non-controversial one of call duration. Dr. Taylor does not claim that call duration is itself a cost driver, but merely that the rate structure that exists in some interconnection agreements fails to accurately reflect estimated differences in call duration. Dr. Taylor is

correct that call duration only takes on the appearance of a cost driver when a rate structure is established that causes the terminating call setup cost to be recovered over an assumed number of minutes: "set-up costs are spread over more minutes in a longer duration call, so the per-minute cost of a long duration (28 minute) Internet-bound call is smaller than for a short duration (3 minute) local exchange call." While I disagree with Dr. Taylor that the average duration of calls to ISPs has been accurately measured to date, I agree that it is the averaging of the terminating setup costs over an assumed number of minutes that creates the observed problem regarding cost recovery.

21. The issue, therefore, is not one of ILEC or CLEC costs, but one of rate structure. If the call setup cost is recovered through a separate per-call rate rather than being included in the per-MOU rate based on an assumed number of minutes, call duration becomes irrelevant.[2] The average duration of ISP-bound calls (or calls to any identified called party, for that matter) could be 3, 30, or 300 minutes, and the result would be the same: the originating carrier would not overpay, and the terminating carrier would not over-recover its costs. In no way does a difference in call duration support a recommendation to discontinue reciprocal compensation for calls delivered to ISPs.

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[2] Such a rate structure was ordered by the Public Utility Commission of Texas in Docket No. 21982, and is utilized in interconnection agreements between Pacific Bell and CLECs approved by the California Public Utilities Commission.

22. The second distinguishing characteristic of ISP-bound traffic claimed by Dr. Taylor relates to factual assertions regarding line concentration ratios and the nature of traffic-sensitive versus non traffic-sensitive switching functions. Dr. Taylor first makes the conceptual argument that "only those costs that are traffic sensitive – i.e., vary with additional usage – should be recovered in [reciprocal compensation] rates." I agree with this observation.

23. Dr. Taylor then goes on to argue that because CLECs sometimes utilize ISDN Primary Rate Interface ("PRI") facilities to provide ISPs with network access, the CLEC does not incur traffic-sensitive switching costs when terminating calls to the CLEC. Specifically, Dr. Taylor states at paragraph 30 that: "Line CCS costs for Internet-bound traffic, however, are not traffic-sensitive. CLECs that focus on Internet traffic rely on ISDN PRI to serve ISPs and build switches at a concentration ratio of one to one. For those carriers, line CCS costs are fixed with respect to usage. Each line serving an ISP has associated with it dedicated capacity through the switch and increased usage from other lines does not impact the use of the line serving the ISP." Dr. Taylor concludes that for this reason, line CCS costs "are not incremental costs of delivering the ISP calls."

24. Dr. Taylor is simply wrong about this for several reasons. First, the "dedicated capacity through the switch" referred to by Dr. Taylor involves the traffic sensitive elements of the switch (e.g. internal transport links, time slot management equipment, routing/rating functions, and the central processor). As a result, the costs created are properly characterized as traffic sensitive. Second, the path in question through these elements of

the switch creates costs that are incremental, because the capacity used is displaced and unavailable for other call paths, causing these elements of the switch to be measurably closer to exhaust (or the level of utilization at which they will be reinforced). This measurable difference in how close the traffic-sensitive portions of the switch are to exhaust before and after the establishment of the call path in question is what creates the conceptually meaningful cost; a cost that is clearly incremental to the delivery of the ISP call.

25. It is also noteworthy that Telcordia's Switching Cost Information System ("SCIS") calculates the switching resources needed to deliver traffic via ISDN PRI facilities and reports traffic-sensitive costs for this traffic that are higher than the costs reported for calls delivered via voice grade loops.

26. Dr. Taylor also argues that the use of ISDN PRI permits CLECs to design and build switches with "a concentration ratio of one to one." While he is correct that ISDN PRI service is designed with a concentration ratio of 1:1, he is incorrect that such a design reduces or eliminates the costs of call termination incurred by a CLEC. A circuit design with a 1:1 ratio assures that a call path through the switch will always be available. This call path is through the same traffic-sensitive elements of the switch as the call path for other calls, however. Calls delivered via an ISDN PRI contribute to the exhaust of finite traffic-sensitive switching resources, and, by doing so, create incremental costs. The only technical distinction is that the circuit engineered with a 1:1 ratio receives a higher priority

for switch resources than a circuit with a higher ratio. As a result, it may be meaningful to describe the ISDN PRI circuit as more costly than other switched circuits, but there is no factual basis for an argument that the use of ISDN PRI circuits reduces or eliminates traffic-sensitive switching costs.

27. The third distinguishing characteristic of ISP-bound traffic claimed by Dr. Taylor is what he refers to as call direction. Dr. Taylor states at paragraph 31 that "sometimes the TELRICs for originating and terminating local exchange traffic are averaged together to determine a single reciprocal compensation rate, and such a rate would not be appropriate for Internet-bound traffic unless the costs of originating features were removed." As with call duration, this "distinction" is not a characteristic inherent in calls to ISPs but is simply a rate structure issue. If a reciprocal compensation rate is in place that accurately measures the ILEC's cost of terminating switching, "call direction" is simply not relevant.

28. The fourth distinguishing characteristic of ISP-bound traffic claimed by Dr. Taylor is that of load distribution. Dr. Taylor states at paragraph 33 that "it is likely that the load distribution of Internet-bound traffic – number and duration of calls in the busy hour as a percent of total traffic – is different than for other types of calls...Whereas the business day is approximately confined to an 8 hour period with little evening or weekend activity, consumers frequently use the Internet during the evening and weekends." This observation leads Dr. Taylor to the conclusion that "on average Internet-bound traffic

requires less investment and costs per minute to provide capacity to meet peak demand than does ordinary voice traffic."

29. The problem with Dr. Taylor's flow of logic is his implicit assumption that the consumer use of the Internet during the evening and weekends creates an "ISP busy hour" that is different than the switch busy hour. Depending on the mix of business and residence subscribers making calls to a given ISP, the busy hour for these calls could be the same as, or significantly different from, the typical business busy hour. Depending on the mix of customers served by the CLEC, its switch could experience a busy hour at any time of the day. There is simply no basis to speculate that the busy hour for calls to ISPs will be different that the CLEC switch busy hour. Of course, if the ILECs are correct in their assertions that the majority of the traffic on the CLEC switch is bound for ISPs, then it is a near certainty that the ISP-bound calls will occur mostly in the switch busy hour.

30. Dr. Taylor describes in paragraph 34 certain changes that Verizon has made to its switching cost study in order to estimate the cost of terminating an "Internet-bound call." Neither of the two changes that he describes are appropriate. First, he indicates longer holding times were assumed. As described in paragraphs 20-21 of my declaration, call duration is not a cost driver, but simply takes on that appearance when setup costs are averaged over an assumed duration. As a result, this a rate structure, not a cost, issue. The substitution by Verizon of a different assumed average holding time does not solve the problem (at best, it changes the magnitude in an unpredictable direction). Rather than

assume a different holding time, it would be appropriate for Verizon to calculate call setup and per-MOU costs separately, rendering any estimate of call duration unnecessary. Unfortunately, Dr. Taylor's Table 1 indicates that this was not done.

31. Dr. Taylor also indicates that the study was altered in order to substitute an assumption of a 1:1 concentration ratio for the 6:1 ratio that Verizon typically assumes for a POTS line. As described in paragraphs 22-26, however, the traffic-sensitive elements of switching are not displaced in a different way depending on the line concentration ratio; if done correctly, this change should have no impact on the costs that determine the appropriate rate for reciprocal compensation.

32. Dr. Taylor also states that Verizon's costs for tandem switching and tandem trunks were removed from its study, and offers the justification that CLECs typically do not have separate tandem and end office switches. Such an adjustment, if implemented, would penalize CLECs for network efficiency and require them to deploy a network that is as inefficient as the ILEC's in order to receive symmetrical rates for reciprocal compensation. Dr. Taylor also offers the justification that CLECs, through the switches they deploy, do not provide "tandem functions." This is, of course, not the case: CLECs typically offer, through their switches, the opportunity for the ILEC to have calls terminated (to the destination of the ILEC customer's choosing) anywhere within a geographic area comparable to – and often larger than – the geographic area served by the ILEC tandem.

This is the most meaningful definition of tandem functionality, and the only one that is not constrained by historic ILEC decisions regarding network deployment.

Response to Claim No. 3: The application of reciprocal compensation to calls made to ISPs creates, through various methods, harm to economic efficiency.

33. Dr. Taylor argues in paragraphs 37-43 that the application of reciprocal compensation to calls made to ISPs creates "inefficient subsidization." In support of this claim, he states that "the principle of cost causation requires that the ISP customer pay at least the cost his call imposes on the circuit-switched network. Suppose intercarrier compensation for Internet-bound traffic is treated as in the ILEC-CLEC interconnection regime [e.g. reciprocal compensation applies to the calls]. This regime assumes at the outset that the customer initiating the call has paid the originating ILEC for the end-to-end carriage of the call, typically, the per call equivalent of the local call charge. Out of what it receives, the ILEC then pays reciprocal compensation to the CLEC that carries the Internet call to the ISP. This compensation is a per-minute call 'termination' charge which, ideally, should reflect the incremental cost that the ILEC avoids by not having to deliver the call itself."

34. Dr. Taylor then goes on to state that there are two consequences of such a scenario that are created, he suggests, by the application of reciprocal compensation to calls made to ISPs (what he refers to as the application of the ILEC-CLEC interconnection regime): Internet users would be subsidized by non-Internet users, and the ILEC would be faced

with pressure to increase the rates for its retail services, including residential local exchange service. My disagreement with Dr. Taylor is not with his observation that increased Internet usage (and the resulting increase in calls to ISPs) has caused increased network usage costs for both ILECs and CLECs, but with any suggestion that such a problem is created by – or even increased in magnitude by – the application of the reciprocal compensation mechanism to these calls.

35. Dr. Taylor has cast the "problem" to be "solved" by the Commission as one of increased usage costs that cannot be recovered through the existing rates paid by most local exchange end users (many of whom subscribe to flat rate service). The problem here lies less with the basic observations than with the logical leaps taken to reach the conclusions. There is no real debate that network usage has increased, and that at least some portion of this increase can be attributed to increased dialup access to ISPs by local exchange customers. There is also no debate that network usage costs are experienced by both ILECs and CLECs on a per call and per MOU (i.e. usage sensitive) basis, and that many local exchange customers (especially residential customers) subscribe to a flat-rated service . There is absolutely no foundation, however, for a conclusion that the mismatch between costs and rates has been created by the involvement of CLECs or has increased in magnitude because of the involvement of CLECs. There is also no basis whatsoever for the assertion that the application of Dr. Taylor's "LEC-LEC-IXC paradigm" -- effectively bill and keep -- to ISP-bound traffic will provide a solution to this problem.

36. If CLECs did not exist, all ISP-bound traffic would originate and terminate on the networks of the ILECs. As a consequence, the ILECs would incur the cost of both originating and terminating these calls on their networks. The total cost experienced by the ILECs would increase if network usage by its end user customers increased as a result of their calls to ISPs, and for the customers of flat rated local exchange service a mismatch would occur between the way the ILEC's incurred costs and the way they were compensated by customers. In other words, both the "subsidy" of Internet users by non-Internet users and the alleged pressure on ILEC retail rates would exist exactly to the degree that it does today.

37. When CLECs do exist and are involved, some portion of the total ISP-bound traffic originates on the ILEC networks but terminates on the networks of the CLECs. The ILECs incur the cost of originating these calls on their networks, avoid the cost of terminating the calls, and incur a reciprocal compensation obligation. If the reciprocal compensation rates are properly established at a level equal to the ILEC's forward-looking economic costs of call termination, there is no net cost impact when call termination costs are avoided and replaced by reciprocal compensation rates. As a result, the impact on the ILECs of increasing usage by end users calling ISPs is completely unaffected by the fact that some traffic is being handed off to CLECs for delivery to ISPs (or any other called party).

38. The fact that Internet usage has increased, leading to increased usage on the ILEC (and CLEC) networks, is completely unrelated to the existence of CLECs and reciprocal compensation. As a result, there is no basis whatsoever to "solve" the ILEC's purported "problem" by eliminating reciprocal compensation for calls to ISPs, thereby requiring CLECs to incur a portion of the ILEC's costs of serving its end user customers.

39. Equally importantly, Dr. Taylor's proposed solution would not effectively address the problem he identifies. If CLECs are no longer compensated for delivering the calls originated by ILEC customers to called parties that happen to be ISPs, they will have no incentive to serve these customers. The migration of ISPs to the ILEC networks means that while the growth of ISP-bound traffic continues, the traffic will be originated and terminated on the ILEC networks, and the ILECs will incur the costs of both ends of the call. They will be trading cost-based reciprocal compensation for the network costs that these rates are meant to duplicate, and the net effect will be zero. The "problem" associated with the increased usage costs and any mismatch of usage sensitive costs and flat local exchange rates will remain at exactly the same magnitude that would exist if CLECs were delivering the calls to ISPs and the ILECs were paying reciprocal compensation. The existence of CLECs and/or reciprocal compensation is not what creates any cost recovery problem, and the elimination of CLECs from the call flow (a likely consequence of the elimination of reciprocal compensation for ISP-bound calls) will not change the ultimate financial consequences for the ILECs.

40. Dr. Taylor argues at paragraph 44 that if reciprocal compensation is applied to ISP-bound calls, LECs, and especially CLECs would have a diminished incentive to compete to serve residential end users. In reality, the desirability of serving residential customers is not impacted either way by the application of reciprocal compensation rates that reflect the ILEC's forward-looking incremental cost of call termination. The act of trading call termination costs for cost-based reciprocal compensation rates does nothing to change the financial appeal of any group of subscribers. If, as Dr. Taylor suggests, "end users that generate Internet-bound traffic would not pay the full incremental cost of carrying it, LECs would have the incentive to avoid competing for such customers," the incentive is not impacted by the application of reciprocal compensation. In Dr. Taylor's scenario, the LEC serving the below-cost subscriber would not be able to recover its network usage costs even if all calls made by the subscriber were intra-network. If that LEC avoids the cost of call termination and instead is assessed a cost-based reciprocal compensation rate, its ability to recover its costs will not have changed in any way.

41. Dr. Taylor argues at paragraph 48 that "the market for Internet access services should be permitted to evolve freely as consumer preferences and network costs evolve. The choice of technology mix (or mix of technologies) that emerges over time ought not to be affected by regulatory decisions regarding intercarrier compensation." I agree. Dr. Taylor's concern is that the presence of reciprocal compensation rates in excess of the

costs incurred by a CLEC will limit the availability of new forms of dedicated access such as DSL.

42. Dr. Taylor's concern is misplaced. There is no evidence that the availability of DSL and comparable services has been limited by CLECs, or that CLECs have the power in the marketplace to impose such a limitation. Consumer awareness of such services means that no one provider, or group of providers, can restrict customer access; consumers will simply choose to become a subscriber of a carrier that does offer the service. ILECs will continue to have the incentive to move subscribers off the public switched network and onto non-switched services for access to ISPs, and ISPs, including those served by CLECs, will have to respond to their customer's desires for these services. CLECs will have no leverage whatsoever to delay the availability of these services, even if they were to have an incentive to do so.

43. At paragraphs 49-55, Dr. Taylor describes his concerns regarding the potential for arbitrage. He correctly notes that "arbitrage is a frequent response to a market distortion." He is incorrect, however, that any incentives or potential for arbitrage is inherent in the application of reciprocal compensation to calls to ISPs (what he refers to as "the ILEC-CLEC local interconnection regime"). The potential that Dr. Taylor describes exists only if reciprocal compensation rates have inappropriately been established at levels that exceed the ILEC's cost of call termination.

44. Dr. Taylor acknowledges at paragraph 51 that "if the intercarrier compensation rate exceeds the LEC's incremental cost of transmitting Internet-bound traffic, CLECs would have an incentive to create sham traffic solely for the purpose of collecting windfall intercarrier compensation." In support of this assertion, he refers to what is notably the ILECs' only example of such alleged activity: US LEC's interconnection with BellSouth in North Carolina. The key fact that Dr. Taylor neglects to bring to the Commission's attention is that BellSouth had previously explicitly rejected bill and keep, rejected a cost-based rate for reciprocal compensation, and insisted on (and subsequently received from the North Carolina Utilities Commission) reciprocal compensation rates equal to its rates for intrastate access. This charge was eight times the level of BellSouth's reported TELRIC. If Dr. Taylor is arguing that when an ILEC insists on the implementation of a rate that is eight times its cost, competitors will be highly motivated to find ways to change the balance of traffic in their favor, then I agree. The North Carolina circumstances that he describes were not created by the application of reciprocal compensation to ISP-bound traffic, but rather by BellSouth's initial insistence on an excessive rate. Dr. Taylor is correct that such a distortion between costs and rates will create the incentive for arbitrage, but is incorrect that the example that he cites supports the elimination of cost-based reciprocal compensation for ISP-bound traffic. Cost-based rates effectively eliminate that incentive, however.

Response to SBC Arguments

45. At pages 32 through 37 of its Comments, SBC makes several factual claims in support of its assertion that CLECs can terminate traffic to ISPs at lower cost than traffic to other end users can be terminated. This "lower cost" assertion is then used as a part of a broader argument that all of the costs that a CLEC incurs to deliver calls to an ISP should, as a matter of economics and policy, be recovered from the ISP. This broader argument relies completely on a transfer of the role of cost causer from the telephone service subscriber that originates the call to the called party (in this case an ISP).

46. In order to address this issue, it is necessary to divide the costs that a CLEC incurs into two categories: (1) those that it incurs to provide service to the ISP as its end user customer, and (2) those that it incurs to meet its responsibilities set forth in an interconnection agreement to accept and deliver traffic originated by the end user subscriber of another LEC. Only this second category of cost is intended to be recovered through reciprocal compensation.

47. SBC asserts at page 32 that "because ISPs receive so much more traffic than the typical end user, and because all of that traffic (unlike local traffic) is one-way traffic, CLECs can and do serve their ISP customers far more efficiently and at far less unit cost." The salient

question then becomes: To the extent any such cost savings are demonstrated to exist, do they relate solely to the cost that the CLEC incurs to serve the ISP as its end user customer (e.g. to provide it with network access, originating usage, advanced features, and service guarantees), or do they relate to the cost that the CLEC incurs to accept and terminate traffic originated by an ILEC customer?

48. SBC relies on a series of factual claims in order to provide the necessary foundation for their assertion that CLECs experience lower costs and should be compensated at a lower rate. First, SBC claims (pp. 32-33) that the fact that CLECs permit ISPs to collocate equipment at their central offices allows the CLECs to avoid "'huge' transmission *costs that are normally associated with the termination of local traffic*" (emphasis added). This is factually incorrect. The costs that are associated with call termination include switching costs and any transport needed to reach that switch; the facility used to connect the called party to the CLEC – whether it be a high volume facility, a POTS copper pair, or a short jumper has absolutely no impact on the costs of switching and interoffice transport. The savings being addressed by the CLECs cited by SBC make it possible for them to provide service to the ISP – as the CLEC's end user customer – but in no way impacts the cost that the CLEC incurs to provide the service of call termination to the ILEC.

49. Second, SBC claims that CLECs experience lower switching costs when delivering calls to ISPs, because ISPs are sometimes served via "trunk to trunk" connections. SBC offers no

factual underpinning for the asserted cost savings, other than the rather glib assumption that the Commission is already aware of this "fact." In reality, as explained in paragraph 26 of my declaration, the ISDN PRI "trunks" that sometimes connect the CLEC and ISP impose a higher traffic-sensitive cost on the CLEC than a simple POTS "trunk to line" connection.

50. SBC then quietly makes the unsupported leap that since the CLECs are providing service to ISPs utilizing facilities that take on a "trunk to trunk" appearance, a meaningful cost proxy is the ILEC cost of tandem switching. Not surprisingly, the reported TELRIC for tandem switching is significantly lower (less than half) of the reported TELRIC for end office switching. The similarity between the "trunk to PRI" switching functionality sometimes used when a call is delivered to an ISP and the "trunk to trunk" switching functionality provided by an ILEC tandem bears only superficial similarity; in reality, TWTC, and most other CLECs, are deploying fully functional end office switches. These CLECs could not, and do not, provide service to their customers by deploying the functional equivalent of an ILEC tandem switch. SBC does not (as the other ILECs generally have not) asserted that the ILECs are actually deploying switching with the ability to only provide capabilities comparable to an ILEC tandem; they merely note the superficial similarity of the self-described "trunk to trunk" arrangements and hope that the Commission will conclude that a demonstration has been made regarding the existence of

comparable costs. The similarity is only superficial, however, and CLECs such a TWTC deploy – and incur the cost of – fully functional end office switches. As a result, the ILEC tandem switching cost is not a meaningful proxy of the costs that CLECs incur to terminated calls, whether or not the called party is an ISP.

51. SBC next argues (p. 34) that the originating capabilities of the switch are not needed to terminate calls to ISPs. While this is strictly true, it is misleading: the originating functions of the switch are not needed to terminate calls to any end user, whether or not that end user is an ISP. That a distinction between call origination costs and call termination costs exists is undisputed, but such a distinction in no way implies a distinction between the costs of call termination for ISP versus non-ISP end users. In fact, no such distinction exists.

52. SBC argues (pp. 34-35) that a cost distinction exists because some CLECs may not utilize a switch to terminate such traffic, but instead may utilize any of a number of newly available pieces of equipment designed with some variation of "termination only" capability. The SBC argument fails both conceptually and factually. As a factual matter, CLECs such as TWTC are deploying fully functional end office switches in their network in order to meet the call origination and termination needs of its customers. It would not be appropriate to penalize CLECs who deploy these switches by disallowing the recovery of the costs incurred when the CLEC utilizes its switch to terminate a call originated by an

ILEC customer. Conceptually, although the ILECs present no information that shows that this equipment has actually been deployed or that it operates as they have described, the various equipment described by SBC may represent a lower cost solution for an ILEC or CLEC to handle the termination of certain traffic (related or unrelated to ISPs). The Commission should not discourage ILECs or CLECs from deploying the most efficient network arrangement possible by implementing a mechanism that would penalize such efficiency.

53. SBC attempts (p. 35) to support its argument that the costs incurred by CLECs to terminate traffic is lower than the cost incurred by SBC to terminate all traffic by referring to a cost study presented by SBC in Texas. In footnote 69, SBC acknowledges that "the Public Utility Commission of Texas held in its Arbitration Award that this was not a TELRIC study and could not be used to justify differentiating ISP-bound traffic and voice traffic for costing purposes." SBC then goes on to attempt to provide spin to what it refers to as a "somewhat obtuse statement" by the Texas Commission. Far from being obtuse, the stated conclusion of the Texas Commission was clear: the SBC study is not TELRIC, and it does not support a cost distinction between ISP-bound traffic and voice traffic. In fact the results of the SBC study are what SBC claims the costs of a hypothetical CLEC to be, if – but only if -- that CLEC (1) deploys switches that provide the capability to deliver calls to an area comparable only to the area served by a SBC end

office switch, (2) has deployed in Texas a mixture of switch types identical to the mixture in SBC's existing network (including AXE-10s and DMS 10s), (3) serves *only* ISP customers, (4) provides only call terminating (rather than originating) capability, (5) experiences usage volumes equal to SBC's discredited estimate of the volume of ISP-bound traffic delivered by CLECs, (6) experiences call characteristics for those ISP-bound calls equal to SBC's discredited estimate of the current call characteristics of its own ISP customers, and (7) experiences all other costs and expenses at the same level as SBC. Not surprisingly, the Texas Commission found the results of such a study to be inconsistent with TELRIC principles and of no value in showing a distinction in the cost incurred by CLECs to terminate traffic to ISP versus the cost incurred to terminate traffic to other end users. Far from being obtuse, the Texas Commission clearly and completely rejected SBC's flawed study.

54. SBC then goes on to present the broader argument that even if the costs incurred by a CLEC are higher than those shown in the flawed SBC cost study, that the CLEC could nevertheless recover both the costs incurred in providing service to an ISP, and all of the costs incurred to provide the service to SBC of completing calls from SBC customers to that ISP, in the rates charged to the ISP. In other words, SBC is proposing that the cost basis for reciprocal compensation be abandoned in favor of a needs-based test: a CLEC must show that it needs the money in order to be compensated for the call termination

services that it supplies directly to the ILEC and indirectly the ILEC's customers. SBC does so even though there is no precedent in this industry of which I am aware that requires a carrier otherwise fail to recover its costs from end users before receiving payment for a service rendered to another carrier, yet this appears to be exactly what SBC is proposing.

55. In the Texas proceeding cited by SBC, SBC presented the testimony of Edward Wynn and Dr. Robert Harris. Both Mr. Wynn and Dr. Harris presented various arguments in support of SBC's needs-based proposal.

56. Specifically, Mr. Wynn argued at pp. 9-10 of his direct testimony in that proceeding that "[c]ost recovery principles would require that such a determination be made first and that any additional compensation be strictly limited to no more than any demonstrable shortfall, in order to avoid systematic over-recovery of costs." Two elements of Mr. Wynn's assertion need to be addressed.

57. First, he does not identify or explain the "cost recovery principles" to which he is referring . I have spent the past twelve years reviewing cost studies – and the corresponding rate proposals – prepared by each of the Tier 1 ILECs, including SBC companies (well over 350 studies in all). I have never heard an ILEC argue that the recovery of the calculated costs should be contingent on its failure to receive sufficient revenues from other related

(or unrelated) sources. In contrast, the ILECs have consistently argued that the reported costs should be recoverable without regard to other sources of revenue.

58. Second, Mr. Wynn does not explain what he means by the phrase "systematic over-recovery of costs." In the context in which it is presented (as a part of SBC's proposal to limit payment of reciprocal compensation), such an "over-recovery of costs" would occur any time a carrier receives total revenues in excess of total costs.

59. Mr. Wynn goes on (pp. 23-24 of his direct testimony) to explain how his theory would work in practice. CLECs would apparently be required to demonstrate to the Commission that the revenues received from a given ISP are insufficient to permit the recovery of the CLEC's cost of serving that ISP. Mr. Wynn does not explain which costs are to be included in this analysis, however. Clearly, the costs associated with providing network access (local loop or other facilities) should be recovered from the ISP, as they would be for any other end user customer.[3] The costs at issue in the Texas proceeding or the immediate proceeding, however, are not those associated with network access, but instead are directly related to the delivery of a call originated by the end user customer of one LEC to a called party served by a second LEC, including those times that the called party is an ISP. Mr. Wynn was apparently confused about what the CLECs were arguing in

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[3] Of course, in high cost areas it may be appropriate for the network access costs to be recovered through a combination of charges to the end user customer and disbursements from a universal service fund.

that proceeding. TWTC was not (and the other CLECs were not), as they are not in the immediate proceeding, arguing that the costs of providing network access to an ISP should be recovered through reciprocal compensation charges. It is up to each CLEC to recover (or to fail to recover, if it chooses to do so) those network access costs through its rates to the ISP. Instead, the CLECs were seeking in Texas – and are seeking in this proceeding -- reciprocal compensation for its intended purpose: to permit the recovery of the costs incurred when delivering a call when the calling party is the customer of another LEC.

60. One means of testing the reasonableness of a proposal is to consider whether the general principles used to support the proposal in a specific context would also support the application of the proposal in other contexts. In other words, while a given proposal may be specific to a given set of circumstances (in this case and in Texas SBC applies a needs test only to CLECs serving ISPs), the principles underlying and supporting the proposal should hold and continue to make sense in a broader application.

61. The broad application of the SBC theory in the telecommunications industry would result in a number of interesting changes to rates and rate structures, depending on how it intends the proposal to be applied. In Texas, SBC witness Wynn referred to "revenues from the ISPs" in his testimony, but was unclear whether he would require CLECs to make a needs test demonstration for each individual ISP or for their ISP customers collectively. SBC is similarly vague in its Comments.

62. If the test is to be applied at the level of the individual customer, it is my understanding that the general principle supporting the SBC proposal to be the following: carriers should not be compensated for accepting traffic from another carrier and delivering traffic to a called party served by their network unless they have first demonstrated that the revenues that they receive from the called party are insufficient to recover the costs of serving them. In the immediate context, the application of this principle would eliminate reciprocal compensation payments to CLECs for delivering calls to ISPs unless they have demonstrated that their costs of serving the ISP will not be recovered from the revenues that are received (or could be received pursuant to the terms of the access charge exemption) from the ISP.

63. Of course, the delivery of traffic to ISPs by CLECs is not the only possible application of this principle. SBC delivers significant volumes of traffic to called parties delivered to it by other carriers, namely IXCs. If the principle underlying the SBC theory is applied in this context, SBC will only be entitled to receive terminating access charges if it has first met their burden of proving that the revenues that it receives from the called party are less than its costs of providing service. For the majority of business customers and for many residential customers (especially those which live in relatively dense areas, purchase vertical features, or make intraLATA toll calls), SBC will be unable to make such a demonstration of "need." *As a result, a broader application of the SBC theory will inevitably result in the elimination of most terminating access charges currently paid by*