BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Petition of Sprint Communications Company L.P. for Arbitration of Interconnection Rates, Terms, Conditions and Related Arrangements with U S WEST Communications, Inc.	)))))	**Docket No. UT-003006**

Surrebuttal Testimony of Dr. William E. Taylor

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on behalf of

U S WEST Communications, Inc.

May 26, 2000

n/e/r/a
Consulting Economists

Q. PLEASE STATE YOUR NAME, AND HAVE YOU TESTIFIED PREVIOUSLY IN THIS PROCEEDING?

A. My name is William E. Taylor. I filed direct testimony (including a statement of my qualifications) and rebuttal testimony in this proceeding on behalf of U S WEST Communications, Inc. ("U S WEST") on April 26, 2000 and May 10, 2000, respectively.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I have been asked by U S WEST to respond to various assertions in the rebuttal testimony of Sprint witness David E. Stahly in this proceeding.

Q. MR. STAHLY ASSERTS [AT PAGE 7] THAT EVEN YOU AGREE THAT "CLECS SHOULD BE COMPENSATED FOR COSTS THAT U S WEST IMPOSES ON THE CLEC WHEN IT TERMINATES TRAFFIC TO SPRINT." HAS HE REPRESENTED YOUR POSITION CORRECTLY?

A. No. First, the delivery of Internet traffic to ISPs served by a CLEC (say, Sprint) is *not* "termination." The CLEC does not perform termination on an ISP-bound call, and the originating ILEC does not impose a termination cost on the ISP-serving CLEC. Instead, the ISP performs the functions of a carrier by receiving the Internet-bound traffic from the CLEC and routing it to various Internet destinations over the packet-switched network. Mr. Stahly, of course, sees the ISP as an end-user (akin to the passive recipient of a local voice call) and not, as I believe is correct, as a carrier that performs both economic and network functions, unlike a passive called party.

Second, while the ISP-serving CLEC incurs a cost for delivering an Internet-bound call, that cost is *not* caused or imposed by the ILEC whose subscriber originates that call. The cost causation principle correctly holds the end-user responsible (a fact that Mr. Stahly himself acknowledges, at page 10) for the cost of an Internet-bound call. That end-user is ultimately responsible for the costs of *all* types of calls (local calls placed as a customer of the ILEC, long distance calls placed as a customer of the IXC, and Internet calls placed as a customer of the ISP). However, the *agent* of cost recovery differs depending on the type of call made. The ILEC should be the agent for recovering—in local rates—the full cost of a local voice call. If that call crosses network boundaries and is terminated to a CLEC's end-user, then the CLEC becomes a collaborating carrier (by virtue of incurring a termination cost) and eligible for compensation by the ILEC. Similarly, the IXC should be the agent that recovers the full cost of a long distance call, defrays its own expenses, and compensates (through access charges) all LECs that collaborate to complete the call. Finally, the ISP should be the agent that fully recovers the cost of an Internet call, defrays its own expenses, and compensates (through access-like charges) all LECs that collaborate to handle the call within the circuit-switched network and backbone carriers that handle the same call within the packet-switched network.[1]

Q. IS IT TRUE, AS MR. STAHLY CLAIMS [AT 7-8], THAT U S WEST SEES RECIPROCAL COMPENSATION AS ESSENTIALLY AN ISSUE OF ONE-WAY

[1] Because of the current access charge exemption for ISPs, this cost-causative form of cost recovery is not possible. However, I had suggested in my direct testimony that the subsidy to the ISP represented by that exemption should be shouldered in some competitively neutral fashion by the ILEC and the CLEC (such as by sharing the PRI ISDN revenue earned from the ISP in the same proportion as their costs to handle the Internet call).

TRAFFIC AND PAYMENT, FROM U S WEST TO SPRINT?

A. No. The same cost causative form of cost recovery should apply for Internet traffic from Sprint's subscribers to ISPs served by U S WEST as for Internet traffic from U S WEST to ISPs served by Sprint. My point was only this: if the "termination" charge that the ISP-serving CLEC receives exceeds the actual cost to deliver an Internet call to the ISP, then that is likely to create or reinforce the perverse incentive to conduct price-cost arbitrage, such as by specializing in receiving, though not returning, ISP-bound traffic. This can happen, e.g., when the costs to deliver Internet traffic to ISPs are different on the two networks but each is obliged to compensate the other at the same rate. Such arbitrage can obviously distort meaningful local competition and bias CLEC incentives in the direction of specializing in serving ISPs (thus creating the one-way traffic problem).

Q. MR. STAHLY COMES TO THE CONCLUSION [AT PAGES 10-12] THAT U S WEST MUST RECOVER ITS RECIPROCAL COMPENSATION PAYMENTS TO SPRINT IN THE LOCAL RATES IT CHARGES ITS OWN SUBSCRIBERS. DO YOU AGREE?

A. No, raising local exchange rates is not the only answer. I explained in my previous testimonies that the method of cost recovery should depend on the cost-causer and his appropriate agent. Ideally, local rates should not be used to recover the cost of Internet calls, just as they are not used to recover U S WEST's costs originating and terminating long distance calls. Trying to use the same averaged local rate to recover the cost of both local voice and Internet calls is economically inefficient, setting up, in effect, a subsidy from non-Internet users to Internet users, which is poor public policy and contravenes the intent of the Telecommunications Act to remove implicit subsidies. Correcting this unintended subsidy with separate charges for local voice and Internet calls is also problematic when charges are flat-rated on a monthly basis, rather than assessed per call.

Of course, if U S WEST is required to make reciprocal compensation payments to CLECs without reimbursement from ISPs or their customers, U S WEST would have no alternative to raising local exchange rates. However, traditional rate structures may not be sustainable under the flood of ISP-bound traffic. Charging a flat rate for local usage cannot work when U S WEST must pay on a per-minute basis to terminate ISP-bound traffic.

Q. IS IT INEFFICIENT, AS MR. STAHLY CLAIMS [AT PAGE 14] FOR THE ISP TO BILL THE END-USER FOR INTERNET CALLS, AND DOES THE ISP PROVIDE A "FREE BILLING SERVICE" TO U S WEST?

A. Not at all. It is disingenuous to claim that the ISP cannot efficiently collect the cost of Internet calls from *its own customers*. Almost everyone is familiar with the general nature of ISP advertising and marketing and the almost ubiquitous monthly flat-rated $19.95 (unlimited use) Internet access service offered by ISPs. ISPs often arrange for automatic payment through their customers' credit cards, thereby reducing the transactions cost of billing and collection to almost nothing. In addition, such payments are cost-causative and necessarily economically efficient.

Q. MR. STAHLY PROVIDES AN EXAMPLE [AT PAGES 15-17] OF A COMPANY LAN THAT SENDS CALLS TO CROSS-STATE LOCATIONS AND ASKS

WHETHER U S WEST SHOULD TREAT THAT COMPANY AS AN IXC AND ASSESS ACCESS CHARGES? IS THAT A PROPER ANALOGY?

A. No, the analogy is forced and spurious. The company's LAN is not a carrier in the same sense that an ISP is. When the company connects its cross-state office locations using a wide area network ("WAN"), it typically uses dedicated access lines leased from a private line provider (who is authorized to run lines across state borders). The lease requires that company to pay a monthly flat fee, which is an alternative to, but not a bypass of, access charges.

Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?

A. Yes.