BEFORE THE STATE OF SOUTH DAKOTA
PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE PETITION OF MIDCONTINENT COMMUNICATIONS FOR APPROVAL OF ITS INTRASTATE SWITCHED ACCESS TARIFF AND FOR AN EXEMPTION FROM DEVELOPING COMPANY-SPECIFIC COST-BASED SWITCHED ACCESS RATES	) Docket No. TC07-117

DIRECT TESTIMONY OF

WARREN R. FISCHER

On Behalf Of

MIDCONTINENT COMMUNICATIONS

July 15, 2008

TABLE OF CONTENTS

EXHIBITS

I. INTRODUCTION

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

A. My name is Warren R. Fischer. My business address is 2500 Cherry Creek Drive South, Suite 319, Denver, Colorado 80209.

Q. BY WHOM ARE YOU EMPLOYED AND WHAT IS YOUR POSITION?

A. I currently serve as Chief Financial Officer for QSI Consulting, Inc. ("QSI").

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.

A. I have a Bachelor of Science degree in Business Administration with a concentration in Accounting from the University of Colorado in Boulder, Colorado. I am licensed as a Certified Public Accountant in the States of Colorado and California.

Q. WHAT IS YOUR EMPLOYMENT BACKGROUND?

A. After graduating from the University of Colorado, I worked for several years as an accountant with Deloitte & Touche conducting financial audits. Thereafter, I worked for two major corporations as a financial analyst. I joined AT&T Wireless Services in 1995 as a financial analyst where I managed the preparation of annual revenue forecasts for the company's cellular division. In 1996, I transferred to AT&T Corp. where I became a financial manager and a subject matter expert on pricing and costing issues involving local exchange and exchange access services. In 2000, I joined QSI as a Senior Consultant. In 2007, I became QSI's Chief Financial Officer.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS OR OTHER PUBLIC UTILITY COMMISSIONS?

A. While I have not testified before the South Dakota Public Utilities Commission ("Commission"), I have testified at the FCC and before 14 other state commissions on rate of return issues as well as pro-competitive regulatory reform issues concerning universal service, inter-carrier compensation, and appropriate cost-based rates under the FCC's Total Element Long-Run Incremental Cost ("TELRIC") methodology. A more detailed description of the cases wherein I have provided testimony is included in my curriculum vitae as Exhibit WRF-1.

Q. ON WHOSE BEHALF ARE YOU FILING THIS TESTIMONY?

A. This testimony was prepared on behalf of the Midcontinent Communications ("Midcontinent").

II. PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I generally describe the regulatory landscape that Midcontinent is faced with in conjunction with other similarly-situated CLECs in South Dakota. I then describe the efforts undertaken by QSI and Midcontinent to develop South Dakota-specific cost-based access rates according to South Dakota's Telecommunications Switched Access Filing Rules (ARSD 20:10:27), Telecommunications Separations Procedures (ARSD 20:10:28), and rules governing Telecommunications Switched Access Charges (ARSD 20:10:29). I will highlight the effort made to map Midcontinent's GAAP[1]-based general ledger accounts to the FCC's Uniform System of Accounts

[1] This acronym abbreviates Generally Accepted Accounting Principles.

(U.S.O.A.) prescribed in 47 C.F.R. Part 32 of its rules and to develop jurisdictionally separated costs under 47 C.F.R. Part 36. Even though a CLEC such as Midcontinent is under no obligation to maintain its books of accounts according to these rules in the normal course of business, I will describe how this mapping process assisted QSI in developing costs for Midcontinent that allow it to comply with the South Dakota-specific rules identified above. I also describe how the cost study I am sponsoring with this testimony was discussed with the Commission's Telecommunications Staff during informal meetings over the past year, and that changes were made in key input assumptions to address Staff's concerns. Finally, I discuss whether the cost study in its current form can produce a definitive company-specific intrastate access rate for Midcontinent in South Dakota.

III. ACCESS RATES CHARGED BY OTHER CLECS

Q. IS THERE AN ISSUE OF FUNDAMENTAL EQUITY AMONG COMPETITIVE CARRIERS WHO CHARGED SWITCHED ACCESS RATES WITHIN SOUTH DAKOTA?

A. Yes. While the Commission continues to consider how and when to revise its switched access rules, a number of CLECs have filed petitions for revisions to their intrastate switched access rates in the last few years. Some CLECs have also filed petitions for exemption from developing company-specific cost-based switched access rates pursuant to ARSD 20:10:27:11. One example is the filing of Northern

Valley Communications, LLC ("NVC") in Docket Number TC05-197. That filing sought an extension of the exemption originally granted on December 2, 2002.

Q. WHAT WAS THE RESULT OF THIS PETITION?

A. The Commission granted NVC's petition for exemption from filing a cost study and allowed it to mirror the statewide average schedule "LECA Plus" intrastate switched access rate even though Staff originally opined that NVC adopt the Qwest rates for intrastate access.[2] The initial rate was set at $0.1250 per minute and the current rate is $0.1150 per minute. Although Staff stated its belief that "...NVC cannot prove it lacks the managerial or technical staff" required to conduct a study, it nevertheless recommended that "the Commission grant NVC's petition from filing a cost study." Further, Staff stated in support of the settlement stipulation that ARSD 20:10:27:12 was not intended for CLECs, but that NVC's request was in accordance with a "black and white interpretation of ARSD 20:10:27:12."[3] Other CLECs have had similar treatment (e.g. Midstate Telecom, Inc. and RC Communications, Inc.).

Q. HOW DOES THE AFOREMENTIONED PRECEDENT AFFECT MIDCONTINENT?

A. Fairness requires that similarly-situated CLECs be allowed to charge the same switched access rates in South Dakota. After all, the rates approved for rural LEC-owned CLECs are based on the ILEC's costs – not the affiliated CLEC's costs.

---

[2] See Memorandum to the Commissioners from Keith Senger, dated February 4, 2006 at 3. ("*Initial Senger Memo*")

[3] See Commission Staff Memorandum in Support of Settlement Stipulation, from Keith Senger, dated May 19, 2006, at 2.

IV. SCOPE OF QSI'S ENGAGEMENT

Q. WHAT WAS THE INITIAL SCOPE OF QSI'S ENGAGEMENT WITH MIDCONTINENT?

A. As noted in Midcontinent's response to Staff RFI 1-2, QSI was asked to construct a company-specific cost study for Midcontinent's South Dakota intrastate switched access service utilizing forward-looking economic cost principles for potential use in the access charge reform rulemaking (RM05-002).[4] QSI utilized its Network Usage Cost Assessment ("NUCA") model which is based upon the Total Service Long-Run Incremental Cost ("TSLRIC") methodology and populated with substantial information regarding Midcontinent's network topology and financial data. This methodology was used to demonstrate the feasibility of using forward-looking costs to set switched access rates in South Dakota as an alternative to the embedded cost framework that South Dakota incumbent local exchange carriers ("ILECs") use today. As a result of the Commission opening a generic rulemaking in December 2005 on the topic of intrastate switched access charges, Midcontinent believed that the Commission might consider adopting a forward-looking economic cost standard for all carriers going-forward. If that turned out to be the result of the rulemaking, Midcontinent envisioned that it could use a finalized version of the NUCA model to support a filing for company-specific access rates. Midcontinent also filed comments in that rulemaking that supported the adoption of a forward-looking cost

[4] The Commission initiated its proceeding "In the Matter of Revisions and/or Additions to the Commission's Switched Access Rules Codified in ARSD 20:10:27 Through 20:10:29"; Order Opening Docket; RM05-002; dated December 14, 2005.

standard, and documented the deficiencies in the existing South Dakota intrastate switched access cost model (the Local Exchange Carrier Association ("LECA") model), which relies on embedded costs. [5]

Q. DID THE SCOPE OF QSI'S ENGAGEMENT CHANGE?

A. Yes. Although Midcontinent continues to believe that rates based upon forward-looking economic costs best mimic the dynamic efficiencies of a competitive market, such efficiencies are achieved only if all market participants are held to the same standard. It seems clear that many of South Dakota's carriers (both incumbent and competitive) will, for the foreseeable future, be allowed to assess rates that are not based upon forward-looking economic cost support. As such, in December 2006 Midcontinent asked QSI to develop an estimate of Midcontinent's company-specific switched access costs using its historical book costs similar in method to that employed by many of the ILECs in South Dakota (specifically the LECA members).

Q. PLEASE DESCRIBE HOW QSI DEVELOPED BOOKED COSTS FOR MIDCONTINENT CONSISTENT WITH THE METHOD USED BY LECA AND OTHER CARRIERS IN SOUTH DAKOTA.

A. To conform to South Dakota rules governing switched access rates today, we began our analysis with the Microsoft Excel-based template that calculates switched access rates for the LECA companies using the FCC's jurisdictional accounting rules under 47 C.F.R. Parts 32, 36, 64 and 69. This was a difficult, time consuming and expensive process, requiring substantial effort not only from QSI, but from Midcontinent's internal financial and accounting resources as well. Much of the

[5] Midcontinent Communications filed Comments in Docket No. RM05-002 on February 6, 2006.

effort focused on mapping Midcontinent's GAAP-based accounting system to the U.S.O.A. Chart of Accounts as required under ARSD 20:10:27:04. As a CLEC, Midcontinent has no business-related reason or regulatory requirement to maintain its books of accounts according to the FCC's rules nor has it ever produced a cost study to support its switched access rates. Both endeavors require a significant amount of time to learn the regulatory paradigm that ILECs have operated under for decades and to compile the accounting data necessary to satisfy the FCC rules.

V. LECA MODEL-BASED COST STUDY DEVELOPMENT

Q. WHAT WAS THE GENERAL PROCESS UNDERTAKEN BY QSI TO DEVELOP EMBEDDED COST-BASED RATES FOR MIDCONTINENT'S INTRASTATE SWITCHED ACCESS SERVICE?

A. As a first step we reviewed the South Dakota rules governing intrastate switched access rates in ARSD 20:10:27 through 20:10:29 and obtained the Microsoft Excel template used by the LECA companies to calculate their costs of providing intrastate switched access service. We then obtained Midcontinent's most current full year of financial results for the fiscal year ending ("FYE") August 31, 2006 and mapped its total company plant investment, revenue and operating expenses to the U.S.O.A. Chart of Accounts, one account at a time. Since Midcontinent does not maintain its books of accounts on a state-by-state basis or by study area as ILECs are required to do, we then segregated total company investment, revenue and expenses into South Dakota-specific amounts. Since Midcontinent's operations consist of cable television and data services in addition to its telecommunications service, we also had to apportion its investment, revenue and expenses between regulated telecommunications services and other non-regulated services.

Q. PLEASE DESCRIBE THE CONTENTS OF THE COST STUDY THAT YOU DEVELOPED.

A. Confidential Exhibit WRF-2 contains the LECA-based model used by QSI to develop Midcontinent's estimated costs of providing switched access service in South Dakota. This model was given to Staff in response to RFI 1-3 in February 2008. The model contains all of the individual worksheets labeled as "A" through "U" which takes a company's accounting data and then applies a series of allocations and calculations to derive the intrastate revenue requirement related to switched access service. Additionally, all of the raw accounting data and analyses required to conform Midcontinent's investment, revenue and expenses to the format required by the LECA model are contained in a series of 15 sheets in the model following Sheet U.

Q. WHAT ARE THE NAMES OF THESE SUPPORTING SHEETS AND WHAT DO THEY DO?

A. The individual Sheets containing Midcontinent financial data and assumptions are as follows:

	Sheet Name	Description and Purpose of Data
1.	*Balance Sheet*	Contains Midcontinent's South Dakota-specific plant investment and accumulated depreciation for regulated telecommunications service mapped to the U.S.O.A. Chart of Accounts.

	Sheet Name	Description and Purpose of Data
2.	*Income Statement*	Contains Midcontinent's South Dakota-specific revenue and expenses for regulated telecommunications service mapped to the U.S.O.A. Chart of Accounts.
3.	*Trial Balance FY 2006*	Contains Midcontinent's financial data according to its general ledger accounts for the FYE ending August 31, 2006. Allocations to South Dakota and then regulated telecommunications service are also calculated here.
4.	*Chart of Accounts – Revenue*	Details Midcontinent's revenue accounts by service assigned to its general ledger accounts. Also contains index of cost centers by market used to segment revenue to specific markets.
5.	*Chart of Account – Expense*	Details Midcontinent's operating expense by department assigned to its general ledger accounts. Also contains index of cost centers by market used to segment expenses to specific markets.
6.	*Regulated Telecom Factor*	Contains the factor apportioning certain South Dakota-specific asset and expenses to regulated telecommunications services.
7.	*SD Fixed Assets Summary*	Summarizes Midcontinent's South Dakota-specific plant investment and accumulated depreciation by its general ledger account.
8.	*Inv $ Related to Telephone Serv*	Summary of inventory amounts specific to telecommunications service and amounts allocated to telecommunications service.
9.	*Specific Inv Identification*	Identification of amounts specific to telecommunications services.
10.	*Traffic By Jurisdiction*	Listing of Midcontinent's South Dakota 2006 minutes of use by service.
11.	*Access Lines By Town 06*	Midcontinent's access lines by town and by type of provisioning for 2006.
12.	*End User Billing*	Midcontinent's Universal Service Worksheet data for its Form 499-A filed with USAC to determine the Current Billings factor required by the LECA model on Sheet G.
13.	*Wholesale Bad Debt*	Contains data on wholesale bad debt and its split by jurisdiction/rate element (used in LECA model Sheets V, P and J).
14.	*FGD Access Expense*	Provides a split of Feature Group D expense (Access Expense Account U.S.O.A. 6540) by Jurisdiction and Access Rate Element.

	Sheet Name	Description and Purpose of Data
15.	*Cable & Wire – Circuit Alloc.*	Summary of analysis used to determine the portion of cable & wire and circuit equipment investment attributable to common line versus long-haul usage. The result is used in Sheet L to allocate intraLATA exchange trunk investment to the Common Line category.

Q. WHICH SHEET SHOULD THE COMMISSION REVIEW TO BEST UNDERSTAND THE "MAPPING" PROCESS YOU'VE DISCUSSED ABOVE?

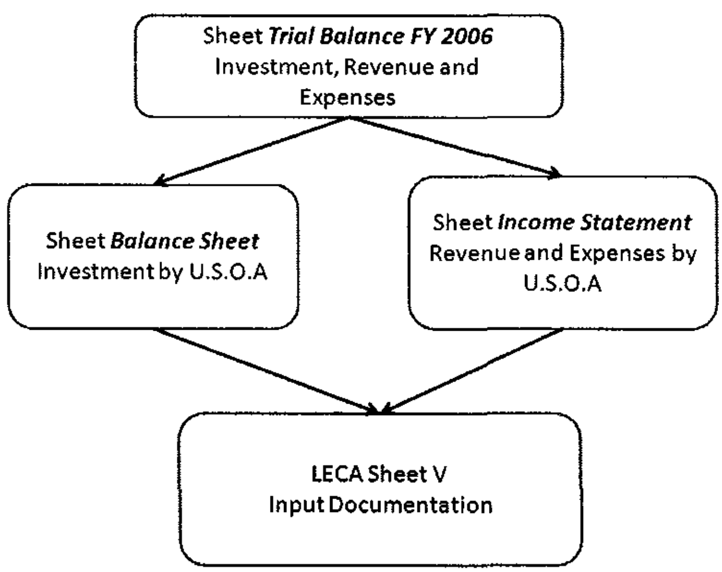
A. Sheet *Trial Balance FY 2006* identifies the specific steps taken to map Midcontinent's financial data to the U.S.O.A. Chart of Accounts and allocates total company investment, revenue and expenses to South Dakota-specific regulated telecommunications service.

Q. WERE FACTORS USED TO ALLOCATE INVESTMENT AND EXPENSES TO SOUTH DAKOTA-SPECIFIC REGULATED TELECOMMUNICATIONS SERVICE?

A. Yes. Allocation factors were developed through numerous discussions with Midcontinent Finance personnel and analyses prepared jointly by QSI and Midcontinent. Because Midcontinent's investment and expenses support all of its services, we worked closely with Midcontinent's engineering, finance and accounting experts to develop allocation factors that would parse out the investment and expense attributable to South Dakota regulated telecommunications service. For accounts where an allocation factor unique to the activity represented by that account was not determinable, a broad-gauged factor of 33% was used to apportion investment and expense among Midcontinent's three classes of service (cable television, data, and telecommunications) equally. Midcontinent's revenue did not require allocation since it is recorded by individual service and market in distinct general ledger accounts. Therefore, non-regulated and non-South Dakota revenue was easily identified and excluded.

Q. HOW ARE THE DATA FROM MIDCONTINENT'S FYE 2006 TRIAL BALANCE INCORPORATED INTO THE LECA MODEL CALCULATIONS?

A. The general flow of Midcontinent's financial data into the LECA model algorithms is illustrated as follows using the sheet names listed above.



Once the financial data is entered into Sheet V, it flows to the rest of the LECA model sheets by the inherent formulas embedded within the model.

Q. WHAT ARE PHYSICAL ALLOCATION FACTORS AND HOW WERE THEY DEVELOPED?

A. Sheet G of the LECA model contains allocation factor input fields by categories of plant equipment type and usage that are designed to segment costs according to Part 36 rules that govern the separation of costs between interstate and intrastate jurisdictions and then by service categories within the intrastate jurisdiction. Virtually all ILECs have developed special studies to develop these factors using accounting and usage data that has been tracked at a granular level of detail according to specific types of equipment used within the telecommunications network. Because Midcontinent has never had to develop these factors in the normal course of business, estimates were developed for certain essential physical allocation factors based on Midcontinent's actual usage and billing data. The factors that result from this process represent reasonable estimates of how Midcontinent would, were it an ILEC, likewise allocate costs consistent with the FCC's methodology.

Q. WHAT RATE OF RETURN WAS USED BY MIDCONTINENT FOR THE LECA MODEL?

A. Midcontinent does not have a readily available cost of capital analysis to support a rate of return that is specific to its operations. Midcontinent's Chief Financial Officer conveyed to QSI that the industry average cost of capital is approximately 12-13%. Normally, a Capital Asset Pricing Model and/or a Discounted Cash Flow analysis performed by a cost of capital expert is used to develop a company-specific weighted average cost of capital. Because of the time and expense involved in preparing such an analysis, Midcontinent chose to use a conservative rate of return of 10% based upon an average of the LECA member rates of return. It is my opinion that this is a very conservative approach designed to eliminate debate over one of the significant inputs into the cost model.

Q. WHAT PURPOSE DO ACCESS MINUTES OF USE SERVE IN THE LECA COST MODEL AND HOW WERE MIDCONTINENT'S ACCESS MINUTES OF USE DETERMINED?

A. Access minutes of use serve as the divisor in the switched access rate per minute calculation within the LECA model. The intrastate revenue requirement attributable to switched access service is summarized on Sheet A within the LECA model. The revenue requirement is then divided by minutes of use associated with intrastate switched access services to determine the rate per minute of use for that access element. Because Midcontinent provisioned service over a combination of resale, UNE-P and facilities-based platforms during 2006, we were required to identify and separate only that Midcontinent intrastate switched access usage supported by its facilities-based services within South Dakota for use in the model. This analysis was performed on sheet *Traffic By Jurisdiction*. Usage for the 12-month period January – December 2006 was used as the most recent data at the time the cost study was developed.[6]

[6] The LECA-based cost model used by Midcontinent contains Midcontinent's 2006 facilities-based South Dakota access minutes of use only as the divisor to the intrastate revenue requirement. The 2006 access minutes of use provided by Midcontinent in its response to Staff RFI 1-9 are significantly higher than the access minutes of use in the cost model because they include the total intrastate usage in Midcontinent's annual report to the South Dakota PUC. The annual report requires inclusion of all intrastate CABS minutes of use which contain several million minutes of usage from the Qwest QPP resale platform.

VI. EVOLUTION OF THE COST STUDY DEVELOPMENT

Q. WHAT WAS THE TIMELINE OF THE DEVELOPMENT OF THE BETA VERSION OF THE MODEL?

A. A beta version of the model was initially developed during the first four months of 2007 with a presentation of preliminary results to Staff as the primary milestone. Midcontinent and QSI personnel met with Staff in April 2007 to walk Staff through the various inputs and assumptions made to map Midcontinent's financial data to the structure required within the LECA cost model.

Q. WHAT WAS THE RESULT PRODUCED BY THE BETA VERSION OF THE LECA COST MODEL?

A. The result of the beta model version of the cost model was a switched access rate of $0.1954 per access minute of use. This was a full $0.0800 above the current $0.1150 per minute rate developed using the statewide average schedule formula prescribed in ARSD 20:10:27:12 and is commonly referred to as the "LECA Plus" rate. The difference between the cost study rate calculated for Midcontinent and the LECA Plus rate was primarily attributable to two issues. First, Midcontinent estimated that 70% of its plant investment was necessary for the provision of regulated telecommunications service. Second, access minutes of use for the months comprising Midcontinent's fiscal year (September 2005 – August 2006) were used to be consistent with the time period of its financial data.

Q. DID STAFF RAISE ANY CONCERNS WITH THE INPUTS AND ASSUMPTIONS WITHIN THE BETA VERSION OF MIDCONTINENT'S MODEL?

A. Yes. The one issue raised by Staff during the April 2007 meeting was the percentage of cable and wire plant investment attributable to regulated telecommunications service. Cable and wire investment is the primary cost driver of the Common Line access rate element. Staff believed that a larger proportion of Midcontinent's cable and wire investment should be attributed to Midcontinent's cable television and data services than was attributed via the beta version of the model.

Q. WHAT CHANGES WERE MADE TO THE COST MODEL BEFORE ITS FILING IN THIS PROCEEDING?

A. First, further discussions were held with Midcontinent Finance personnel to refine the plant investment allocation factor resulting in a 33% factor that splits plant investment equally among Midcontinent's three primary services (voice, video, and data). This significantly lowered Midcontinent's Common Line costs. Second, 2006 minutes of use for the calendar period of January – December were used in place of the fiscal year time period used originally due to distortions caused by the ramp-up of Midcontinent's telecommunications service during the 4th Quarter of 2005. This increased the divisor by approximately 4 million minutes of use which further decreased the access rate per minute. Other refinements were made to develop Midcontinent-specific allocation factors as opposed to previous values which had relied upon averages developed from LECA company filings.

Q. WHAT WAS THE NET RESULT OF THESE CHANGES TO THE LECA MODEL USED BY MIDCONTINENT?

A. A revised rate of $0.0985 was produced which is approximately half of the original rate produced by the beta version of the cost model.

Q. IS THIS RATE CONSERVATIVE?

A. Yes. Since the LECA model uses uniform algorithms to calculate switched access costs for all companies who utilize the template, the only area of variability among the companies is the data and assumptions used as inputs. Midcontinent developed conservative estimates of financial data trends and cost allocations to eliminate as many potential contentious issues from its data and assumptions as possible. In other words, Midcontinent insisted that in every circumstance wherein judgment or expert decision-making was required to conform its data in to the LECA model, the most conservative approach be used (i.e., an approach that would result in lower, as opposed to higher, costs). For example, known and measurable increases in plant capital expenditures that occurred outside of the test year were excluded. This could have significantly, and legitimately, increased Midcontinent's revenue requirement within the LECA-based model. Additionally, Midcontinent's decision to use the average rate of return for the LECA companies rather than a Midcontinent-specific rate of return is another example of the conservative approach taken by Midcontinent in this case.

VII. COMPLETENESS OF COST STUDY

Q. GIVEN THE EVOLUTION OF THE COST STUDY DEVELOPMENT YOU DESCRIBE ABOVE, SHOULD THE COST STUDY BE A DEFINITIVE REPRESENTATION OF MIDCONTINENT'S COST OF PROVIDING SWITCHED ACCESS SERVICE IN SOUTH DAKOTA?

A. No. Given the overly conservative nature of QSI's and Midcontinent's efforts in replicating the LECA-based model using Midcontinent's data, the results are more appropriately viewed as a "price-floor" below which rates should not be considered. Good faith efforts were made by Midcontinent to allocate total company costs to the South Dakota intrastate jurisdiction. These estimates were based on judgment rather than detailed studies that an ILEC routinely relies upon. Conservative assumptions were employed in the determination of regulated telecommunications plant and Midcontinent's rate of return. The resulting cost estimate utilizing these key input assumptions is meant to show the proximity of Midcontinent's costs to the LECA Plus rate currently in effect in South Dakota and to support Midcontinent's petition for permission to charge the LECA Plus rate. However, were Midcontinent to spend the time and resources necessary to replicate not only the method, but the data-development processes of LECA-members, I am convinced the results of the model would be notably higher than the results represented by the version included with this testimony.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes, it does.