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January 16, 2004

Missouri Public Service Commission
Attn: Secretary of the Commission
200 Madison Street, Suite 100
P.O. Box 360
Jefferson City, Missouri 65102-0360

Re: Case No. TO-2004-0207
Mass Market Impairment Inquiry

Dear Mr. Roberts:

Please find enclosed for filing on behalf of Sage Telecom, Inc. in the above-referenced case: 1) an original and eight (8) copies of the Rebuttal Testimony of Robert W. McCausland; an original and eight (8) copies of the Highly Confidential Rebuttal Testimony of Michael Starkey; and 3) one original non-proprietary version of the Rebuttal Testimony of Michael Starkey.

A copy of this filing has been sent this date via electronic mail to counsel for all parties of record.

Sincerely,


Brent Stewart

CBS/bt

Enclosure

cc: Counsel for all parties of record

FILED³

JAN 16 2004

**Missouri Public
Service Commission**

Exhibit No.:
Issues: Geographic Market and Cross-over
Witness: Robert W. McCausland
Type of Exhibit: Rebuttal Testimony
Case No.: TO-2004-0207
Date Testimony Prepared: January 16, 2004

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. TO-2004-0207

PHASE I

REBUTTAL TESTIMONY

OF ROBERT W. McCAUSLAND

ON BEHALF OF

SAGE TELECOM, INC.

FILED³

JAN 16 2004

**Missouri Public
Service Commission**

January 16, 2004

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ROBERT W. McCAUSLAND
CASE NO. TO-2004-0207

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PHASE I REBUTTAL TESTIMONY

OF

ROBERT W. McCAUSLAND

CASE NO. TO-2004-0207

1 **I. INTRODUCTION AND PURPOSES OF TESTIMONY**

2 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

3 A. My name is Robert W. McCausland. My business address is 805 Central Expressway
4 South, Suite 100, Allen, Texas 75013-2789.

5 **Q. ARE YOU THE SAME MR. McCAUSLAND THAT FILED DIRECT**
6 **TESTIMONY IN THIS PROCEEDING?**

7 A. Yes, I am.

8 **Q. WHAT ARE THE PURPOSES OF YOUR REBUTTAL TESTIMONY?**

9 A. I will respond to certain statements made in the direct testimonies of SBC Missouri
10 ("SBC") witnesses Gary Fleming and Timothy Tardiff as being inaccurate as they relate
11 to Sage Telecom, Inc. ("Sage"), and thereby demonstrate that none of the cited statements
12 should be considered credible or given weight in this proceeding. Specifically, I will
13 refute generalizations made by both witnesses regarding Sage's decisions for market
14 entry into specific areas in Missouri and Sage's alleged use of "mass market advertising"
15 – both conclusions which are used by the SBC witnesses as bases for SBC's proposed use
16 of the Metropolitan Statistical Area ("MSA") as the relevant geographic market. I will
17 also address Sage's need to have the cross-over calculations to be reasonable and based
18 on actual study, along with the need for the Missouri Public Service Commission

1 ("Commission") to grandfather Sage's existing customer base from any decisions reached
2 in this proceeding that could cause disruption.

3 **II. GEOGRAPHIC MARKET**

4 **Q. WHAT ARE THE ISSUES TO WHICH YOU WILL RESPOND IN THIS**
5 **SECTION OF YOUR TESTIMONY?**

6 A. I will respond directly to several generalizations made by SBC witnesses Fleming and
7 Tardiff relating to CLEC market entry strategies and customer target-marketing
8 strategies of CLECs, neither of which is an accurate depiction of Sage's business
9 approach. I will highlight that each of the SBC generalizations deserves this
10 Commission in its efforts to secure the right decisions for Missouri consumers and
11 will demonstrate the need to reject both.

12 **Q. PLEASE IDENTIFY STATEMENTS INVOLVING THE FIRST OF THE SBC**
13 **GENERALIZATIONS THAT YOU DISPUTE.**

14 A. SBC witnesses Fleming and Tardiff generalize that competitive local exchange
15 companies ("CLECs") have entered into Missouri on a regional or MSA basis.¹ Both
16 witnesses make assertions about how CLECs, in general, have entered into the
17 markets in Missouri based on location of CLEC switches (although there is no
18 indication that those switches are used to provide mass market services) and
19 collocation arrangements (which again, are not tied to any evidence that would
20 associate them with mass market services). Both of these incumbent local exchange
21 company ("ILEC") witnesses assume that CLECs enter into markets on an "MSA" or
22 a "regional" level, and use that assumption to support their recommendation of the
23 use of MSAs as the appropriate geographic markets.

1 **Q. PLEASE EXPLAIN YOUR DISAGREEMENT WITH THESE**
2 **GENERALIZATIONS.**

3 A. I'm confident that both SBC witnesses would recognize the fundamental flaw in their
4 assumptions if either had ever worked for a Missouri CLEC. I do work for a Missouri
5 CLEC, Sage Telecom, Inc. And I have worked for other Missouri CLECs in the past.
6 Therefore, I have personal knowledge that these SBC generalizations are incorrect.
7 As I indicated in my Direct Testimony, Sage does not market based on MSAs. In this
8 regard, my experience at Sage is consistent with my working experience at both of the
9 other Missouri CLECs by whom I have been employed in the past. Hence, I can
10 definitively state that SBC's witnesses are simply wrong and the conclusions that they
11 draw from their flawed assumptions about appropriate geographic areas are therefore
12 faulty.

13 **Q. WITH REGARD TO SAGE, HAVE SBC'S MSA-RELATED**
14 **GENERALIZATIONS EVER BEEN CONSISTENT WITH THE CLEC'S**
15 **APPROACHES?**

16 A. No. Sage is a case study of how a UNE-P provider can successfully create a customer
17 base comprised of residential and small business customers and provide competitive
18 choices to those customers in suburban and urban areas in Missouri. Sage's growth in
19 Missouri has resulted to a large extent from its efficient practices. Contrary to the
20 conclusions drawn by SBC witnesses Fleming and Tardiff and reflected in their
21 testimony, Sage has never used MSA or region as a determining factor in entering a
22 market.

¹ Direct Testimony of Gary D. Fleming at 9-10 ("Fleming Direct"); Direct Testimony of Timothy J. Tardiff at 11-12, 16-17, 19.

1 **Q. DOES SAGE MARKET ITS SERVICES TO CUSTOMERS IN MISSOURI**
2 **USING AN MSA?**

3 A. No. As I stated in my Direct Testimony, Sage does not market or consider servicing
4 its customers in Missouri (or in any of the other nine states that Sage provides
5 competitive choices) using MSA as a basis or factor in its decisions.

6 **Q. DR. TARDIFF SUGGESTS THAT, AS AN ECONOMIST, HE “EXPECTS”**
7 **CLECS TO ACT OR TO MAKE DECISIONS USING MSAS. DO YOU**
8 **AGREE?²**

9 A. I do not agree that SBC witness Tardiff's expectations regarding CLEC behavior are
10 realistic or accurate. He may expect CLECs to do certain things, but, as demonstrated
11 here, his expectations are not always based on complete or accurate information or on
12 realistic beliefs. Sometimes there is a vast gap between theory and reality. Here, the
13 Grand Canyon just got moved to Missouri. Dr. Tardiff assumes that a CLEC is
14 “expected” to try to serve “at least an MSA” because of the “high degree of social and
15 economic integration present in such areas”, which apparently, according to Dr.
16 Tardiff, “implies that firms would generally market services throughout this
17 geographic area.”³ But, the reality for Sage, which is a viable and healthy CLEC, is
18 that Sage does not make its decisions on where to enter or use its marketing on an
19 MSA or regional basis.

20 **Q. ON WHAT BASIS DOES SAGE DETERMINE TARGET AREAS OR**
21 **CONSUMER SOLICITATION AREAS?**

22 A. As I indicated in my Direct Testimony, Sage's target marketing process starts with
23 specific NPA/NXX code areas⁴, proceeds through screening, mailing and other steps,

² Tardiff Direct at 11.

³ *Id.*

⁴ Direct Testimony of Robert McCausland at 6-7 (“McCausland Direct”).

1 none of which has anything to do with or is tied to the use of an MSA. I will not
2 duplicate my previous testimony here, but I want to highlight for the Commission that
3 my Direct Testimony directly refutes SBC's MSA generalization.

4 **Q. PLEASE IDENTIFY THE SECOND GENERALIZATION OF SBC**
5 **WITNESSES IN WHICH YOU DISAGREE.**

6 A. I disagree with SBC witnesses' assumption that all CLECs use "mass market"
7 advertising in regional areas.

8 **Q. PLEASE EXPLAIN WHY YOU DISAGREE WITH SBC WITNESSES OVER**
9 **THIS SECOND GENERALIZATION ON WHICH THEY BASE THEIR**
10 **CONCLUSION.**

11 A. As I indicated in my Direct Testimony, Sage does not use "mass market" or mass
12 media advertising (*e.g.*, newspapers, radio, television). Yet, both Mr. Fleming and
13 Dr. Tardiff convey an assumption that all CLECs do, and thus conclude that the MSA
14 is an appropriate geographic market. Again, however, SBC's statements are not
15 supported by credible empirical evidence and contradict real world experience. I
16 explained in my Direct Testimony that, after identifying specific NPA-NXXs and
17 potential customer addresses within those NPA-NXXs and after certain screening
18 functions are performed, Sage sends mailouts targeted to essentially all potential
19 customers within those areas.⁵ I also indicated in my Direct Testimony that Sage uses
20 word-of-mouth "advertising" as well because satisfied customers can provide an
21 effective means of finding new customers. Hence, the notion that CLECs that serve
22 mass market customers use mass market advertising and that the use of an MSA is

⁵ McCausland Direct at 6-7.

1 therefore appropriate for a relevant geographic market is as faulty as SBC's market
2 entry theory that I addressed above.

3 **Q. IS SAGE UNIQUE OR AN UNUSUAL EXCEPTION TO THESE SBC**
4 **GENERALIZATIONS?**

5 A. Based on my own experience of having worked for multiple Missouri CLECs, Sage is
6 not a unique exception to SBC's generalizations. SBC witness statements and
7 implications that CLECs utilize regional or MSA-wide entry strategies and mass
8 media marketing are terribly flawed and inaccurate. Even if SBC's witnesses were
9 able to produce empirical data that show some credible examples in support of their
10 theories (something that SBC has not produced), I would be able to demonstrate the
11 data's irrelevance through the very examples and personal experience that I cite here.
12 From my perspective, the bottom line is that Sage is not the exception to SBC's
13 "generalization", but rather is the reality of how CLECs make decisions in today's
14 telecommunications market environment. We have to make decisions based on where
15 we can economically and efficiently provide competitive alternatives and be
16 successful at it. Those decisions are based on economics and on where likely
17 customers reside, not on arbitrary lines used by the federal government.

18 **Q. ARE THERE ANY OTHER GENERALIZATIONS THAT YOU WISH TO**
19 **ADDRESS? IF SO, PLEASE SPECIFY.**

20 A. Yes. Mr. Tardiff states that "because CLECs are free to target their customers, they
21 can choose to serve only the most lucrative customers and/or locations, at least
22 initially."⁶ I will refer to this claim as "SBC's cream-skimming allegation."

⁶ Tardiff Direct at 21.

1 Q. WHY DO YOU RAISE “SBC’S CREAM-SKIMMING ALLEGATION” HERE?
2 PLEASE EXPLAIN IN DETAIL.

3 A. I raise SBC’s cream-skimming allegation here because, like the previously-addressed
4 SBC generalizations, it is an inaccurate premise on which SBC bases its conclusion
5 involving the use of MSAs as geographic market areas. *First*, Sage does not target
6 “lucrative” customers (*e.g.*, large business customers or small business customers
7 with multiple lines). Rather, Sage targets residential customers and very small
8 business customers and does not exclude classes of customers based on revenue
9 potential. Sage has never targeted nor provided service to large business customers.

10 *Second*, as I explained in my Direct Testimony and again above, Sage
11 identifies target market areas through the use of an approach initially involving
12 NPA/NXXs. That approach does not involve any sort of “cream-skimmer” algorithm
13 and does not result in Sage targeting only customers that offer a certain revenue
14 threshold. And that approach helps ensure that Sage serves residential and very small
15 business customers, the very base that Sage sets out to serve.

16 *Third*, a review of Sage’s tariffs reveals that, like those available to residential
17 customers, offerings from which business customers may select are standardized.
18 Sage does not provide for individual customer contracts, the kind of which SBC
19 offers to the “lucrative” types of customers that it serves. The bottom line here, as
20 above, is that the generalization of SBC’s witnesses is factually lacking and
21 incessantly inaccurate and therefore cannot be used as the basis for a Commission
22 decision as important as that involving geographic markets.

1 Regarding the context of the Sage customer data, Sage continues to believe that all of
2 its customers, both the residential and the very small business, are appropriately
3 categorized as mass market customers because all are served through the use of
4 DS0/voice grade level facilities. Sage witness Michael Starkey and I have addressed
5 Sage's belief in our testimony in this proceeding; therefore, I will not reiterate the
6 details here. However, the Direct Testimony of both SBC witnesses Fleming and
7 Tardiff cause me to feel that additional emphasis by Sage on this issue is needed in
8 order to ensure a full understanding by the parties and to ensure an appropriate level
9 of consideration by the Commission.

10 **Q. WHAT ARE THE SAGE-SPECIFIC DATA THAT WILL LIKELY ASSIST**
11 **THE COMMISSION IN MAKING ITS DECISION ON THE APPROPRIATE**
12 **CROSS-OVER?**

13 A. I refer the Commission to the Sage-specific data contained in the Rebuttal Testimony
14 of Michael Starkey, filed on behalf of Sage.⁷ Basically, those data confirm that Sage
15 has mass market customers that rely on the use of multiple lines ranging from two to
16 eleven.⁸ Mr. Starkey does an admirable job of laying out the data and thereby has
17 enabled me to succinctly emphasize to the Commission that the cross-over point will
18 result in customer impacts.

19 **Q. IN WHAT WAYS WILL CUSTOMERS BE IMPACTED BY THE CROSS-**
20 **OVER RELATED DECISION?**

21 A. If, for example, the Commission's cross-over determination were to become
22 intertwined with the definitions of "mass market customer" and "enterprise market
23 customer," Sage's ability to provide service to mass market customers would be

⁷ Rebuttal Testimony of Michael Starkey at 53-59 (HC).

1 affected. In that case, for any cross-over point that the Commission may determine,
2 there will be certain existing customers who are satisfied with Sage's services, but for
3 which Sage will have to determine whether it can continue to provide comparable
4 services or whether it will lose those customers solely because those customers rely
5 on more than a certain number of lines at the same location. In other words, any cross
6 over decision that affects the mass market customer definition will impact consumers.
7 And when the detrimental impact to the CLEC and ultimately to overall competition
8 is considered, more "downstream" impacts will become evident.

9 **Q. PLEASE EXPLAIN WHAT YOU MEAN BY "DOWNSTREAM" IMPACTS AND**
10 **PROVIDE AN EXAMPLE.**

11 A. I am using the term "downstream" to refer to impacts that occur not necessarily
12 immediately following such a cross-over decision, but rather over time. And I have not
13 limited the use of the term to either consumers or CLECs since consumers and CLECs
14 are in key ways interdependent. For example, if such a cross-over decision were to result
15 in the simultaneous dislocation of more than just a few impacted consumers and
16 significantly restrict the UNE-P CLEC's ability to re-achieve sufficient scale, then that
17 CLEC would eventually be forced from that market, thereby impacting the consumers
18 that it had been able to retain during the period immediately following the cross-over
19 decision.

20 **Q. IN SUCH AN EXAMPLE, IS THAT THE LIMIT OF THE DOWNSTREAM**
21 **IMPACT? IF NOT, PLEASE EXPLAIN.**

22 A. No. The downstream impact is clearly multi-faceted. For instance, such a cross-over
23 decision would restrict a UNE-P CLEC's ability to serve customers having more than a

⁸ *Id.* at Table 6 (HC).

1 certain number of lines, but would do nothing to restrict the ILEC's ability to serve such
2 customers. In fact, the ILEC would be able to provide service to such customers using
3 any number of DS0/voice grade level lines when the CLEC could not. This is certainly
4 not the kind of "level playing field" envisioned by either this Commission or by Congress
5 when it passed the Telecommunications Act of 1996. A cross-over restriction would
6 detrimentally affect the economics of CLEC provisioning while simultaneously
7 improving the economics of ILEC provisioning for the same set of customers. That
8 means that the playing field has been further slanted in favor of the ILEC, resulting in
9 greater financial pressure on the CLEC and ultimately less competition, then resulting in
10 less pricing pressure on the ILEC and ultimately higher prices for consumers. The
11 implications of a cross-over restriction are clearly complex, but the ultimate impact is
12 simple: customer disruption, less competition, higher prices and less innovation.

13 **Q. WHAT DIFFERENCE DOES THIS DETRIMENTAL IMPACT MAKE IN THIS**
14 **PROCEEDING AND HOW MAY THE IMPACT BE MINIMIZED?**

15 A. Given the somewhat arbitrary nature of a cross-over point, the opportunity for the
16 Commission to minimize the impact to consumers exists. In light of this opportunity
17 to minimize consumer impact, the Commission should make consumer impact
18 analyses central to this proceeding and integral to its decisions in this case. Sage's
19 customers, like those of other CLECs, made the determination of the number of lines
20 based on the number necessary to fulfill their needs – in other words, customer line
21 counts are driven by customer needs and are not often discretionary. Rarely did those
22 customers determine what facilities were used to provide their service. Hence,
23 customers don't have the flexibility to arbitrarily forgo lines in order to be served by
24 competitors, typically did not control the selection of the facilities used to serve their

1 premises, and are truly at the mercy of this Commission's decisions here. Sage is
2 committed to assist the Commission in minimizing the impact to customers. As
3 stated above, all of Sage's customers are served through the use of DS0/voice grade
4 level facilities. None is served via DS1 or above facilities. Therefore, the customer
5 impact could be minimized by a Commission determination that any customer served
6 through the use of DS0/voice grade level facilities is a mass market customer.

7 **Q. HOW SHOULD THE COMMISSION USE THIS INFORMATION?**

8 A. As is obvious above, I believe that the Commission should adopt my recommendation
9 to simply define all lines served by a DS0/voice grade level facility as mass market
10 customer lines. However, if the Commission were to decide on the use of a cross-
11 over approach, I request that the Commission grandfather Sage's existing customers
12 in order to avoid undue customer disruption.

13 **Q. DO YOU FEEL COMPELLED TO RESPOND TO ANY OTHER**
14 **STATEMENTS OF SBC'S WITNESSES? IF SO, PLEASE SPECIFY.**

15 A. Yes. SBC witness Fleming identifies small business customer characteristics and
16 expectations that are inconsistent with those of Sage's customers. Mr. Fleming's
17 specific characterizations include: (a) the small business customer expects to be able
18 to obtain combined voice and data services, and (b) small business customers have
19 "multiple lines".⁹

20

⁹ Fleming Direct at 27-29.

1 **Q. PLEASE EXPLAIN YOUR DISAGREEMENT WITH THESE**
2 **CHARACTERIZATIONS?**

3 A. Sage's small business customers do not conform to Mr. Fleming's assumptions. Most
4 significantly, Sage's small business customers do not obtain combined voice and data
5 services -- Sage cannot and therefore does not offer such.¹⁰ Obviously, these
6 customers would not remain with Sage if their needs were not fulfilled. It is therefore
7 clear that such assumptions of Mr. Fleming are flawed, if not downright wrong. Note,
8 however, that many potential customers do not subscribe to Sage service because
9 Sage cannot provide combined voice and data to them. Nonetheless, as is evident
10 here, not every small business customer expects or requires such which is contrary to
11 Mr. Fleming's assertions.

12 **Q. WHY IS THIS FACT IMPORTANT?**

13 A. Based on his assumption that small business customers expect to receive combined
14 voice and data, Mr. Fleming concludes that the CLEC has an "increased revenue
15 opportunity" to make more money off of the customer through the sale of data
16 services.¹¹ Apparently, Mr. Fleming believes that the CLEC could use this supposed
17 "increased revenue opportunity" to offset the additional cost of providing service over
18 DS1 or non-UNE facilities. But the bottom line here is that a central point in Mr.
19 Fleming's argument -- that small business customers inherently offer an additional
20 revenue opportunity to CLECs through combined voice and data needs -- is incorrect.
21 There is nothing better to retort a claim such as Mr. Fleming's than actual customer

¹⁰ As a UNE-P provider, SBC is not willing to allow Sage to reasonably offer data services of a data service provider in combination with the Sage UNE-P voice services. Nor is SBC willing to provide its DSL service over lines used for Sage UNE-P-based voice service.

¹¹ Fleming Direct at 27-28.

1 experience as reflected by CLEC data. Unfortunately for SBC, Mr. Fleming has no
2 such experience or data. And this discussion further highlights the appropriateness of
3 classifying as mass market services all voice-only small business lines provided
4 through the use of DS0/voice grade level facilities.

5 **Q. HOW SHOULD THE COMMISSION USE THIS INFORMATION IN ITS**
6 **DETERMINATION OF THE APPROPRIATE CROSS-OVER?**

7 A. First, and most importantly, the Commission has access to the kind of information
8 that it needs in order to analyze and fully understand the impact that its potential
9 decisions will have on consumers and to avoid making those decisions that will have
10 a detrimental impact. Sage can help, and has attempted to do so here. With that all in
11 mind, there is clearly value in Sage's recommendation that the Commission define the
12 mass market as being the base of customers served through the use of DS0/voice
13 grade level facilities irrespective of inherently arbitrary cross-over points. But if the
14 Commission feels that cross-over points must be used, it should take care to analyze
15 the impact to consumers that cross-over points at various levels would have, and
16 should, for the sake of consumers, grandfather any existing customer that would
17 otherwise be impacted by its decision.

18 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

19 A. Yes.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of a Commission Inquiry into)
The Possibility of Impairment without) Case No. TO-2004-0207
Unbundled Local Circuit Switching When)
Serving the Mass Market)

AFFIDAVIT OF ROBERT W. McCAUSLAND

STATE OF TEXAS)
)
COUNTY OF COLLIN)

Robert W. McCausland, being of lawful age, on his oath states: that he has participated in the preparation of the foregoing Rebuttal Testimony in question and answer form, consisting of 14 pages to be presented in the above case; that he provided the answers in the foregoing Rebuttal Testimony; that he has knowledge of the matters set forth in the answers; and that such matters are true and correct to the best of his knowledge and belief.


Robert W. McCausland

Subscribed and sworn to me this 13th day of January, 2004.



