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.

FEB 0 9 2004

Estrice County on

January 16, 2004

Case No(s). 10-20

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REBUTTAL TESTIMONY OF

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

I. <u>INTRODUCTION AND PURPOSES OF TESTIMONY</u>

- 2 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.
- A. My name is Robert W. McCausland. My business address is 805 Central Expressway

 South, Suite 100, Allen, Texas 75013-2789.
- 5 Q. ARE YOU THE SAME MR. MCCAUSLAND THAT FILED DIRECT TESTIMONY IN THIS PROCEEDING?
- 7 A. Yes, I am.

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

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

II. GEOGRAPHIC MARKET

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

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

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

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

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

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

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

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

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

Q. DR. TARDIFF SUGGESTS THAT, AS AN ECONOMIST, HE "EXPECTS" CLECS TO ACT OR TO MAKE DECISIONS USING MSAS. DO YOU AGREE?²

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

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

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

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² Tardiff Direct at 11.

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Direct Testimony of Robert McCausland at 6-7 ("McCausland Direct").

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

4 Q. PLEASE IDENTIFY THE SECOND GENERALIZATION OF SBC 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.

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

McCausland Direct at 6-7.

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

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

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

18 Q. ARE THERE ANY OTHER GENERALIZATIONS THAT YOU WISH TO 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." I will refer to this claim as "SBC's cream-skimming allegation."

⁶ Tardiff Direct at 21.

Q. WHY DO YOU RAISE "SBC'S CREAM-SKIMMING ALLEGATION" HERE? PLEASE EXPLAIN IN DETAIL.

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A.

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

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

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

Finally, I will add that SBC witnesses raise this shallow and prejudicial creamskimming theme in seemingly every regulatory proceeding. Admittedly, I enjoy 2 discrediting it as often as they raise it. 3

BASED ON YOUR ANALYSIS, WHAT SHOULD THE COMMISSION DO? 4 Q.

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Clearly, the generalizations of SBC witnesses are inaccurate. Hence, I suggest that A. 5 the Commission take care to avoid using conclusions drawn from those highly-flawed 6 SBC generalizations, including SBC's conclusion involving the use of MSAs as 7 market areas. 8

III. THE CROSS-OVER THRESHOLD

Q. WHAT ISSUES WILL YOU ADDRESS IN THIS SECTION OF YOUR 10 **TESTIMONY?** 11

- A. I will provide and reference Sage-specific information as to the use of multiple lines 12 for voice telecommunications services, as well as recommend that the Commission 13 14 allow the grandfathering of Sage's existing customer base in order to avoid customer 15 impacts that may follow some of the Commission's decisions in this case.
- PLEASE EXPLAIN THE VALUE AND CONTEXT OF SAGE-SPECIFIC 16 Q. INFORMATION REGARDING CUSTOMERS' USE OF MULTIPLE VOICE 17 LINES. 18
- The Commission has, in the past, appropriately placed weight on actual customer-19 A. related data when making decisions that have had the potential to impact consumers. 20 This case clearly has the potential to impact consumers; therefore, I'm confident that 21 the Commission would want to do the same here. Hence, Sage will reveal its own 22 customer data -- data that will likely have value to the Commission for this purpose. 23

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

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

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

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

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

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

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

⁸ Id. at Table 6 (HC).

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

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

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

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

7 Q. HOW SHOULD THE COMMISSION USE THIS INFORMATION?

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

Q. DO YOU FEEL COMPELLED TO RESPOND TO ANY OTHER 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

9 Fleming Direct at 27-29.

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Q. PLEASE EXPLAIN YOUR DISAGREEMENT WITH THESE CHARACTERIZATIONS?

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

Q. WHY IS THIS FACT IMPORTANT?

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

Fleming Direct at 27-28.

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.

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

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

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

18 Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

19 A. Yes.

BEFORE THE PUBLIC SERVICE COMMISSION

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OF THE STATE OF MISSOURI

In the Matter of a Commission Inquiry into The Possibility of Impairment without Unbundled Local Circuit Switching When Serving the Mass Market) Case No. TO-2004-0207)		
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.			
ociter.	Robor W. M. Causland		
Subscribed and sworn to me this day of RILE VILLE VILL	f January, 2004. Light House Control of the Contro		