Exhibit T-___ (GB-T-1)
Docket No. UT-020406
Witness: Glenn Blackmon, Ph.D.

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

AT&T COMMUNICATIONS OF THE PACIFIC NORTHWEST, INC.,	)	
Complainant,	)	
v.	)	**DOCKET NO. UT-020406**
VERIZON NORTHWEST, INC.	)	
Respondent.	)	

DIRECT TESTIMONY OF

Glenn Blackmon, Ph.D.

STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

September 30, 2002

Q. Please state your name and business address.

A. My name is Glenn Blackmon, Ph.D., and my business address is 1300 South Evergreen Park Drive Southwest, P.O. Box 47250, Olympia, Washington 98504. My business e-mail address is blackmon@wutc.wa.gov

Q. By whom are you employed and in what capacity?

A. I am employed by the Washington Utilities and Transportation Commission (Commission) as Assistant Director for Telecommunications.

Q. What are your education and experience qualifications?

A. I hold Ph.D. and master's degrees in public policy from Harvard University and a bachelor's degree in economics from Louisiana State University. I have been employed at the Commission since August 1995 and assumed my current position in April 1996. I previously served as the Commission's economics advisor in the interconnection case, UT-941464, and the U S WEST general rate case, UT-950200. Prior to working at the Commission, I was a consultant in private practice, where my clients included both regulated companies and consumer advocates, and an analyst for the Washington State Senate Energy and Utilities Committee. I have presented testimony as an expert witness before this Commission, as well as the Illinois and Idaho commissions.

In my current position, I have testified before the Commission in various proceedings, including U S WEST's most recent general rate case (Docket UT-970766), the GTE/Bell Atlantic merger case (Docket UT-981367), the Qwest/U S WEST merger case (Docket UT-991358), the generic cost and price cases (Dockets UT-960369 and UT-003013), and the Qwest competitive classification of business services case (Docket UT-000883). In addition, Mr. Zawislak and I were the authors of a white paper that was the basis for the Commission's 1997-98 access charge reform proceeding, Docket UT-970325. The proceeding culminated in the adoption of WAC 480-120-540 and implementation of the required access charge structure by each local exchange company.

I am the author of a book, *Incentive Regulation and the Regulation of Incentives* (Boston: Kluwer Academic Publishers, 1994). I have authored co-authored articles on utility regulation and economic theory published in *American Economic Review*, *Journal of Regulatory Economics*, *Yale Journal on Regulation*, *Journal of Risk and Uncertainty*, and *Public Utilities Fortnightly*.

Q. What is the scope of your testimony at this time?

A. My testimony explains why Staff believes Verizon's access charges are above what the Commission should consider to be fair, just, and reasonable. It offers a target level of reductions. It also explains why the Commission should order Verizon to use an access charge rate design in which, with the exception of any explicit rate element for the recovery of authorized universal service costs, the overall charge for terminating access does not exceed what Verizon charges its local exchange competitors for termination of local exchange traffic.

OVERALL LEVEL OF VERIZON'S ACCESS CHARGES

Q. Does Staff recommend that the Commission order a reduction in Verizon's switched access charges?

A. Yes. Staff has concluded that Verizon's access charges are above the level that can be considered to be fair, just, and reasonable. Verizon's access charges are excessive, and the Commission should order a reduction.

Q. Please explain the basis for this recommendation.

A. Verizon's access charges are high based on virtually any reasonable comparison. They are high relative to the actual cost of providing the service. This will not be news to the Commission, as it has long been known that access charges are at multiples of the long-run incremental cost of the service. More significantly, they are higher than the rates Verizon itself is charging for the same service when used to connect interstate calls, and they are higher than the rates that Qwest, the state's largest local exchange company, charges for intrastate access service.

Q. Which of these comparisons is most important?

A. The single most important comparison is between Verizon's intrastate access charges and Qwest's intrastate access charges. The Commission examined Qwest's access charges in the 1995-96 general rate case, Docket UT-950200, and concluded that Qwest's rates were too high. The Commission ordered a 45% reduction in Qwest's access charges. Since then, the Commission has identified and made explicit the portion of each company's access charges that can be attributed to its service to customers in high-cost locations.

Once this effect has been removed, there is no plausible reason why Verizon's access charges should be significantly above those of Qwest. Yet in fact, Verizon's are much higher than Qwest's. Verizon charges 5.7 cents per minute for originating access service, while Qwest 1.5 cents for the same service. Even this comparison understates the potential disparity in access rates, because it does not reflect the effect of the universal service rate realignment that Staff is recommending. As Mr. Zawislak explains, Verizon's interim universal service charge should be reduced. Verizon could elect to offset this reduction on terminating access with an equal increase on originating access. If Verizon does so, its originating access charge would increase to 6.9 cents per minute, more than four times the 1.5-cent rate charged by Qwest.

Q. Why does it matter than Verizon's access charges are higher than Qwest's?

A. It matters because the excess access charges of Verizon allow it to export costs of the Verizon local network to the customers of Qwest and/or the interexchange companies that offer intrastate toll service. Verizon's pricing structure results in some combination of higher statewide toll rates and lower interexchange company profits. It allows Verizon to enjoy some combination of higher profits and lower rates for its local exchange services. It also can distort competition in the long-distance market to the disadvantage of any company that chooses to offer long-distance service to Verizon's local exchange customers. This is unfair, unjust, and unreasonable.

Q. Please explain how Verizon can export its costs through high access charges.

A. Access charges are paid, in the first instance, by interexchange companies that provide long-distance services and, ultimately, by the customers who pay for those long-distance services. It is obvious that high access charges lead to high long-distance rates, but what is less obvious is that this effect goes beyond the long-distance rates of Verizon's own customers. Verizon's high access charges affect the long-distance rates of all Washington customers, particularly those of Qwest. The reason for this effect is the practice of statewide averaging of long-distance rates. While intrastate long-distance prices can vary from one long-distance company to another, each company charges the same price in all areas of the state. This means that Verizon's high access charges cannot lift only the long-distance prices paid by Verizon's local exchange customers; they must lift the long-distance prices of all customers in the state.

Q. Please explain how Verizon's high access charges can adversely affect competition in the long-distance market.

A. Many companies compete for the long-distance business of Qwest's local exchange customers. Some of these companies – most notably Qwest itself – may not offer long-distance service to Verizon's local exchange customers. Other competitors, such as AT&T or WorldCom, may offer service to both Qwest's customers and Verizon's customers. Verizon's high access charges put the latter group of companies at a disadvantage relative to the former group of companies. In the extreme case, with enough price competition from Qwest, companies like AT&T and WorldCom would be forced to absorb the excess access charges of Verizon, or they would have to exit either the Qwest market or the Verizon market.

Q. Why don't the interexchange carriers maintain their competitive parity in the Qwest market by charging lower prices there and higher prices in the Verizon market?

A. This would be a reasonable response to a distinct difference in costs, not unlike the utilities' practice of charging higher rates in cities with high local utility taxes. However, federal statute and rule requires statewide averaging of intrastate long-distance rates, so it is not an option for relief. See 47 C.F.R. 64.1801. Interexchange carriers cannot pass Verizon's high access charges through to their Verizon customers; they must either absorb those excess costs or raise their rates statewide.

Q. How should the Commission weigh the relationship of Verizon's access charges to its corresponding charges for interstate service and to the long-run incremental cost of access services?

A. These are both relevant points of comparison that each suggest Verizon's intrastate access charges are too high. It raises issues of undue discrimination whenever a regulated company is charging different prices for the same service, and that is what Verizon is doing with access services. Verizon charges substantially more for access to the local network if the destination of the call is within the state of Washington than if the destination is outside the state, and yet the two calls make the same use of Verizon's local network. This is unfair to customers making intrastate calls and contributes to illogical rate structures in which calls to nearby cities are more expensive than calls to some foreign countries.

I believe the comparison of Verizon's access prices to total service long-run incremental cost is worth noting but is ultimately of less significance in determining whether the charges are excessive. It is well established that access charges are high relative to incremental cost. In an ideal world, charges would not exceed incremental cost for any service. In reality there are only differences of degree in the markup of price over cost, and most if not all of Verizon's services are priced above incremental cost. Verizon's local exchange service is also priced well above total service long-run incremental cost, in which the cost of the loop is not an incremental cost of either local exchange service or exchange access service. To the extent the markup of access service is greater than the markup of local service, this would suggest that access charges should be reduced relative to local rates.

Q. What is Staff's recommendation as the target level of reductions for Verizon's access charges?

A. Staff recommends that the Commission establish a target reduction level of $32 million per year, at which level Verizon's intrastate access charges would be approximately the same as Qwest's intrastate access charges. (This value assumes that Verizon does not increase originating access rates to offset the universal service rate realignment proposed by Staff; otherwise the target amount would be $42 million.) I understand that an even greater reduction would be required to reduce Verizon's intrastate access charges to the level that Verizon charges for comparable interstate service or to total service long-run incremental cost.

INCREASES IN OTHER RATES TO OFFSET THE ACCESS CHARGE REDUCTION

Q. Should the Commission allow Verizon to increase local rates or other rates to offset the revenue loss from Staff's recommended reduction in access charges?

A. Not necessarily. Staff believes that the Commission can determine that Verizon's access charges are not fair, just, and reasonable for the reasons I have already discussed and, having reached that conclusion, can make a separate decision about whether any offsetting rate increases are appropriate. The Commission should consider any evidence that Verizon may offer about its overall earnings level, but it also should ask why Verizon today is charging both higher access rates and higher local rates than Qwest. The answer should not be Verizon's universal service obligations, because Staff is not including the universal service rate elements of either Verizon or Qwest in calculating the target reduction. Otherwise the comparison is between two similar companies that could be expected to have similar costs.

Q. If the Commission does decide that some portion of the access charge reduction should be offset by other rate increases, what would Staff recommend?

A. In that hypothetical scenario, Staff believes that any offset to the access charge reduction should be collected directly from Verizon's local exchange customers as a retail switched access charge. In other words, the full target reduction would be made in the charges paid by interexchange carriers, but Verizon would be allowed to impose a per-minute access charge on its own retail local exchange customers. This charge would be assessed on all intrastate long-distance calls made by Verizon customers, whether they use Verizon or another company as their long-distance carrier. This approach would leave that portion of existing access charge revenues on access services, but it would ameliorate the inequities and harmful competitive effects that I discussed earlier. Verizon would still be collecting this money for access services, but it would not export the costs to customers of other companies through the mechanism of statewide long-distance rate averaging.

TERMINATING ACCESS RATE DESIGN

Q. Should the Commission impose a specific rate design requirement on Verizon's terminating access service?

A. Yes. Staff recommends that the Commission order Verizon to charge no more for terminating access service than what Verizon charges for local interconnection. The only exception should be to permit Verizon also to collect an interim universal service rate on its terminating access service. This is the same rate design requirement that the Commission imposed by rule on all local exchange companies in WAC 480-120-540. That rule was overturned on appeal based on procedural issues, but the court did not criticize the substantive provision limiting terminating access rates. Staff recommends that the Commission impose these requirements on Verizon for the same reasons that it adopted WAC 480-120-540 in 1998. These reasons are set out in the adoption order, which is attached as Exhibit GB-2.

Q. Why does Staff recommend that the terminating access rate be set no higher than the local interconnection rate?

A. For the same reasons that led the Commission to adopt WAC 480-120-540. Briefly, these two services – terminating access and local interconnection – are ones that Verizon provides to other telecommunications companies when their customers make calls to Verizon's customers. Whether the access charge or the interconnection charge applies depends on whether the call is classified as a long-distance call or a local call. It is inappropriate for the terminating carrier to make that distinction by charging differently for termination based on where the call originated. To do so hinders competition based on the scope of the local calling area. A competitor who wanted to offer customers a broader local calling area would be forced to pay Verizon a higher rate for calls that Verizon deems to be long-distance, even though the originating carrier is treating the call as a local call. It can be appropriate in circumstances where customers have a choice of originating companies for those companies to differentiate prices based on where the call terminates – i.e., to define "local" and "long-distance" calling areas and have different prices for each type of call. It is not, however, in the public interest for the terminating company to impose this distinction on customers who have not selected it.

Q. What is the reason for the exception allowing universal service costs to be collected on terminating access service?

A. This exception was a part of the rule adopted by the Commission in 1998 as an interim measure. At the time stakeholders generally expected Washington to establish a universal service program consistent with federal law. The Commission had conducted a formal proceeding to determine the universal service requirements of the incumbent local exchange companies. Inclusion of universal service costs on terminating access service caused those costs to be shared broadly across the state, ultimately being recovered in the long-distance charges of all customers. In contrast to Verizon's high originating access charges, the inclusion of universal services costs on terminating access exports costs for a purpose that is consistent with public policy to preserve and advance universal service.

Q. Is this the same method of funding universal service that the Federal Communications Commission (FCC) uses under 47 U.S.C. 254?

A. No. The interim universal service charge is not at all like the FCC's universal service program. Indeed, the only reason for the existence of the interim charge is that Washington does not have a universal service program. The FCC currently collects from each telecommunications company a contribution based on the company's interstate and international revenues, though it is considering a change to a per-connection assessment basis. The money is disbursed to those local exchange companies that provide service in high-cost locations. By contrast, the interim universal service charge is simply an element of Verizon's rate structure that recovers a portion of Verizon's own costs of serving its own customers.

CONCLUSION

Q. Does this conclude your testimony at this time?

A. Yes, it does. Thank you.