

**BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

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| <div>VERIZON SELECT SERVICES, INC.; MCI METRO ACCESS TRANSMISSION SERVICES, LLC; MCI COMMUNICATIONS SERVICES, INC.; TELECONNECT LONG DISTANCES SERVICES AND SYSTEMS CO. d/b/a TELECOM USA; AND TTI NATIONAL, INC.</div> <div>Complainants</div> <div>v.</div> <div>UNITED TELEPHONE COMPANY OF THE NORTHWEST, d/b/a Embarq</div> <div>Respondent.</div> | <div>Docket No. UT-081393</div> |
|---|---------------------------------|

**DIRECT TESTIMONY OF
LAWRENCE J. BAX**

**ON BEHALF OF
AT&T COMMUNICATIONS OF THE PACIFIC NORTHWEST, INC.,
TCG OREGON, INC., AND TCG SEATTLE, INC.**

**REDACTED PER PROTECTIVE ORDER
IN WUTC DOCKET UT-081393**

February 18, 2009

1 **I. INTRODUCTION & SUMMARY**

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

3 A. My name is Lawrence (Larry) J. Bax and my business address is 125 Corporate
4 Office Drive, Room 153, Earth City, Missouri, 63045.

5
6 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

7 A. I am employed by AT&T Operations, Inc. in the Access Management organization
8 with responsibility for the review of public policy and state activity, especially as it
9 relates to local exchange access, intercarrier compensation and universal service.

10
11 **Q. PLEASE BRIEFLY DESCRIBE YOUR EDUCATIONAL AND**
12 **PROFESSIONAL EXPERIENCE.**

13 A. I possess a Master of Arts-Telecom Management from Webster University in St.
14 Louis, Missouri and a Bachelor of Arts-Government from Southern Illinois
15 University in Edwardsville, Illinois. I have formal training in telecommunications
16 economics, law and regulation from Telcordia Technologies (i.e., formerly Bell
17 Communications Research, Inc. or Bellcore) and INDETEC International, among
18 others. Since joining the company in 1980, I have served in various regulatory
19 positions, with responsibilities including witnessing, testimony development and
20 support, policy development and advocacy, cost and rate development, and tariff
21 management.

1 **Q. HAVE YOU PREVIOUSLY APPEARED AS A WITNESS IN A**
2 **REGULATORY PROCEEDING?**

3 A. Yes. I have testified in Wyoming, Iowa and Nebraska. My participation in those
4 proceedings included filing written testimony and delivering oral testimony.

5
6 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

7 A. My testimony demonstrates that United Telephone Company of the Northwest, d/b/a
8 Embarq's ("Embarq") intrastate switched access charges are excessive, unjust, unfair
9 and unreasonable in violation of Washington law. These excessive rates come at the
10 expense of Washington wireline toll consumers, interexchange carriers ("IXCs"),
11 including AT&T, and their shareholders. Further, the excessive intrastate switched
12 access charges assessed by Embarq put the IXCs at a competitive disadvantage.

13

14 **II. OVERVIEW OF SWITCHED ACCESS SERVICES**

15 **Q. PLEASE BRIEFLY DESCRIBE SWITCHED ACCESS SERVICES.**

16 A. Switched access service is provided by local exchange carriers ("LECs") to IXCs for
17 the purpose of originating and terminating toll calls. Access service offers nothing
18 more than the temporary use of LEC facilities to transport and switch the toll call
19 between the toll carrier and its customer. The LEC bills the IXC for the access
20 service that adds to the IXC's overall cost of providing those toll services. In some
21 jurisdictions, implicit subsidies were included in the rate structure for switched access
22 service, in addition to the cost of the service itself. Historically, these subsidies were
23 intended to ensure the deployment and maintenance of basic local telephone service

1 in high cost and rural areas, among other things. It is critical to note that the
2 functions a LEC provides for intrastate and interstate switched access are materially
3 identical in that the LEC employs the same facilities.

4
5 **Q. DO EMBARQ'S INTRASTATE SWITCHED ACCESS RATES INCLUDE AN**
6 **IMPLICIT SUBSIDY?**

7 A. Yes. Embarq's intrastate switched access rates include such implicit subsidies (i.e.,
8 "hidden charges").¹ For purposes of this proceeding, it is extremely important to note
9 that I am addressing the implicit subsidies imposed only on intrastate interexchange
10 services that are causing Washington consumers to pay more than they should for
11 their intrastate long distance calls.

12
13 **Q. ARE EXCESSIVELY HIGH SWITCHED ACCESS RATES HARMFUL?**

14 A. Yes. In addition to other problems, high access charges prevent interexchange
15 carriers from being able to fairly compete in the marketplace with other
16 communications providers (e.g., including, but not limited to, VoIP providers,
17 wireless carriers, etc.) because those providers are not saddled with the subsidies
18 implicit in access charges. The result is that IXC's lose business to those providers.

19 This Commission is to be commended for what it has done to date in reducing
20 intrastate access charges for some carriers within the State. But, more needs to be
21 done, starting with a reduction of Embarq's artificially high intrastate switched access
22 charges. Embarq can and should eliminate most of the implicit subsidies that remain

¹ Although some of the universal service support elements are identified as such by way of the providers' tariffs, for reasons detailed herein they cannot be characterized as either explicit or competitively neutral.

1 embedded in access rates simply by reducing its intrastate access rates to the same
2 level as its interstate access rates. Such a reduction would mitigate the undue and
3 unreasonable prejudice and lessen the competitive disadvantage that IXC's currently
4 face.

5
6 **Q. GENERALLY SPEAKING, HOW HAVE THESE EXCESSIVE INTRASTATE**
7 **SWITCHED ACCESS RATES AFFECTED AT&T?**

8 A. [BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]From 2003 to
9 2007, AT&T's Washington intrastate toll volumes declined XX%; its intrastate toll
10 revenues decreased XX%; and, its average price, expressed per access minute,
11 dropped XX%.[END AT&T HIGHLY CONFIDENTIAL INFORMATION]
12 Other IXC's are facing similar declines. This is not because AT&T and other IXC's
13 provide poor service. Rather, IXC's cannot compete when burdened with a huge cost
14 their competitors (using alternative technologies including the Internet and wireless)
15 do not pay.

16 While hidden charges were sustainable in a monopoly marketplace, the influx of
17 competitors and the evolution of alternative technologies render such a model
18 ineffective, inefficient and inappropriate.

19 With respect to interstate switched access rates, the FCC has done much work to
20 bring those rates closer to cost (i.e., minimizing the implicit subsidies and the
21 associated jeopardies) and to implement explicit, more competitively neutral
22 universal service support mechanisms.²

² The actions taken by the FCC are detailed herein.

1 Unfortunately, the intrastate switched access rate structure in Washington still
2 includes many of the old opportunities for abuse and places AT&T and other IXC's at
3 a distinct competitive disadvantage in the toll marketplace. The significant implicit
4 subsidies which continue to be inherent in the rates for intrastate switched access
5 services arbitrarily disadvantage AT&T in effectively vying for toll customer
6 demand. The hidden charges are neither explicit (i.e., sufficiently transparent to deter
7 abuse) nor assessed in a competitively neutral manner. Because these hidden charges
8 are incorporated into the intrastate switched access rates, yet are designed to support
9 basic local exchange services, they are not related to any particular functionality
10 performed by the local exchange provider on behalf of the IXC or its customers.
11 Furthermore, these hidden charges are assessed to only one segment of the industry
12 (i.e., IXC's, their shareholders and their customers) and are not generally applied to all
13 competitors.

14 As such, the implicit subsidies are a "ball and chain" that thwarts the ability of
15 AT&T and other IXC's to compete on their own merits in the marketplace.
16 Commission action is necessary to take a step toward leveling the playing field by
17 ensuring that a subset of competitors does not continue to be unfairly burdened with
18 these hidden charges.

20 **III. EMBARQ'S INTRASTATE SWITCHED ACCESS RATES**

21 **Q. YOU HAVE DEFINED THE GENERAL PROBLEM WITH INTRASTATE**
22 **SWITCHED ACCESS SERVICE, LET'S TURN TO EMBARQ**

1 **SPECIFICALLY. HAVE YOU READ VERIZON’S COMPLAINT WITH**
2 **REGARD TO EMBARQ’S RATES?**

3 A. Yes, I have. The Verizon complaint articulates the problems I have identified, above,
4 in that it recognizes the need for the Commission to further its “policy favoring
5 switched access rates that are just, reasonable, and pro-competitive”³ in the context of
6 Embarq’s rates. The complaint also notes, and AT&T agrees, that Embarq’s rates
7 allow it to recover a disproportionate amount of its costs from its competitors, which
8 place its competitors at a disadvantage.

9
10 **Q. WHAT ARE AT&T’S CONCERNS RELATED TO EMBARQ’S**
11 **INTRASTATE SWITCHED ACCESS RATES?**

12 A. Embarq’s intrastate switched access rates greatly exceed the intrastate switched
13 access rates charged by Verizon NW and Qwest, as well as Embarq’s own interstate
14 switched access services rates. As will be discussed herein, Embarq’s interstate
15 switched access rates fully recover the cost to provide switched access service. In
16 fact unlike interstate rates, Embarq’s intrastate rates still assess the carrier common
17 line (“CCL”) charge. And, within its CCL charge structure, Embarq imposes a
18 significant “Interim USF Additive” and a “Line Extension Rate Additive”⁴ on its
19 terminating intrastate switched access per minute of use. Imposing charges intended
20 to maintain universal service in Washington on one, and only one,

³ Verizon Select Services, Inc.; MCI Metro Access Transmission Services, LLC; MCI Communications Services, Inc.; Teleconnect Long Distances Services And Systems Co. d/b/a Telecom USA; And TTI National, Inc. (Complainants) v. United Telephone Company Of The Northwest, d/b/a Embarq (Respondent), Docket No. UT-081393, (“Verizon Complaint”) at para. 8.

⁴ See, Embarq Access Tariff (WN U-9), §3.8(C).

telecommunications industry segment – IXCs – can hardly be called competitively neutral.

Q. PLEASE EXPLAIN THE CCL CHARGE IN GREATER DETAIL.

A. The local loop or “common line” connects the customer’s home or business to the LEC’s end office. The cost of the loop does not vary by usage.⁵ LECs incur local loop costs for each subscriber by virtue of that subscriber’s interconnection into the local network.⁶ The per-minute CCL charge was created as a mechanism to aid in recovery of some loop costs, but that fact alone “does not forever transform loop costs into an IXC cost. These costs are, in fact, LEC costs, regardless whether they are recovered directly from end users or recovered indirectly through IXC payments that are passed onto end users.”⁷ As the Commission has for other carriers, it should eliminate Embarq’s CCL charge.⁸ Notably, the FCC has long since eliminated the CCL charge as outdated and anticompetitive.

⁵ *In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Low-Volume Long Distance Users, Federal-State Joint Board on Universal Service*, Sixth Report and Order, etc., FCC 00-193, CC Docket Nos. 96-262, 94-1, 99-249, 96-45 (rel. May 31, 2000) at para. 120 (“CALLs Order”).

⁶ *NARUC v. FCC*, 737 F.2d 1095, 1114 (D.C. Cir. 1984).

⁷ CALLs Order at para. 120.

⁸ Embarq’s CCL charge is discussed in more detail herein.

Q. WHAT IS THE DIFFERENCE BETWEEN EMBARQ'S INTERSTATE AND INTRASTATE SWITCHED ACCESS RATES?

A. [BEGIN EMBARQ HIGHLY CONFIDENTIAL DATA]As shown in Table 1, Embarq's intrastate average minute of use rate is almost XXXXX (XX) times its interstate average minute of use rate.

Table 1

| EMBARQ AVERAGE MINUTE OF USE RATE⁹ | |
|--|------------|
| Interstate | \$XXXXXXXX |
| Intrastate | \$XXXXXXXX |

[END EMBARQ HIGHLY CONFIDENTIAL DATA]

Because the interstate rate covers Embarq's costs and then some, the Commission should require Embarq to reduce its intrastate switched access rates to its interstate levels and rate structure. In evaluating Embarq's intrastate switched access rates, the Commission should also eliminate Embarq's intrastate CCL charge, including the Interim USF Additive and the Line Extension Rate Additive.¹⁰

Q. WHAT IF EMBARQ CLAIMS, AS CARRIERS IN THE PAST HAVE, THAT IT CANNOT REDUCE ITS INTRASTATE SWITCHED ACCESS RATES TO INTERSTATE LEVELS WITHOUT INCREASING ITS OWN RETAIL CUSTOMER'S RATES?

A. The universal service goal behind the implicit subsidies (and the Federal fund) is to ensure rural and high cost retail customers enjoy roughly equivalent rates to those paid by similar retail customers in the urban areas. So the first step the Commission should consider when reducing Embarq's intrastate switched access rates is whether

⁹ The data utilized is extracted from BAX – Appendix 1.

¹⁰ The Interim USF Additive and the Line Extension Rate Additive are described in more detail herein.

1 Embarq customers are paying similar rates for basic local exchange service. If the
2 rates they are paying are lower than those in urban areas, then the Commission should
3 allow Embarq to raise its retail rates to match the urban rates. If the rates are higher,
4 then perhaps the Commission should consider making any support Embarq receives
5 explicit and competitively neutral.

6

7 **Q. THE FCC HAS AN INTERCARRIER COMPENSATION REFORM DOCKET**
8 **PENDING. WHY SHOULD THE WASHINGTON COMMISSION ACT IN**
9 **ADVANCE OF THE FCC IN THIS DOCKET?**

10 A. As an initial matter, the Commission must enforce the laws of the State of
11 Washington and it has appropriately exercised this responsibility in the past with
12 respect to reducing the intrastate switched access charge of local exchange carriers
13 such as Qwest and Verizon.

14 Further, the FCC has tried unsuccessfully for years to address comprehensive
15 reform, but due to the complexities of the issues, comprehensive reform has been
16 elusive. The FCC is now in transition: Over the next several months, new FCC
17 Commissioners will be named and new priorities established. It is unclear at this
18 stage how, when, or even whether, the FCC will address access reform. Awaiting
19 action at the Federal level is therefore neither a realistic nor a responsible strategy.
20 There is clearly work that states (including Washington) can, and *should* be doing to
21 further the goal of long-overdue reform.

22 Furthermore, many states have argued before the FCC to keep their jurisdiction
23 over intrastate rates. Accordingly, states should move forward to address intrastate

1 access reform expeditiously.¹¹ In fact, in comments filed with the FCC, this
2 Commission argued that “Despite the Commission's efforts to effectively ‘federalize’
3 all aspects of intercarrier compensation, the fact remains that state commissions are
4 closest to consumers and the specific aspects of the provision of telecommunications
5 services in their markets.”¹² The Washington Commission, therefore, must move
6 expeditiously in reducing Embarq’s intrastate switched access rates.

7
8 **Q. HAS THE COMMISSION TAKEN SIMILAR ACTION WITH OTHER**
9 **PROVIDERS WITHIN THE STATE?**

10 A. Yes. Pursuant to Washington statute,¹³ the Commission has required other local
11 exchange carriers (including Qwest and Verizon NW) to make significant reductions
12 in their intrastate switched access services in order to yield “substantial economic
13 benefit for residential and business customer of this state”¹⁴ recognizing that the
14 Commission and service providers “must face the competitive realities of the 21st

¹¹ See, generally, Initial Comments of the National Association Of Regulatory Utility Commissioners, High-Cost Universal Service Support, WC Docket No. 05-337’ Federal-State Joint Board on Universal Service, CC Docket No. 96-45; Lifeline and Link Up, WC Docket No. 03-109; Universal Service Contribution Methodology, WC Docket No. 06-122; Numbering Resource Optimization, CC Docket No. 99-200; Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98; Developing a Unified Intercarrier Compensation Regime, CC Docket No. 01-92; Intercarrier Compensation for ISP-Bound Traffic, CC Docket No. 99-68; IP Enabled Services, WC Docket No. 04-36; November 26, 2008.

¹² Comments of the Washington Utilities and Transportation Commission, High-Cost Universal Service Support, WC Docket No. 05-337’ Federal-State Joint Board on Universal Service, CC Docket No. 96-45; Lifeline and Link Up, WC Docket No. 03-109; Universal Service Contribution Methodology, WC Docket No. 06-122; Numbering Resource Optimization, CC Docket No. 99-200; Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98; Developing a Unified Intercarrier Compensation Regime, CC Docket No. 01-92; Intercarrier Compensation for ISP-Bound Traffic, CC Docket No. 99-68; IP Enabled Services, WC Docket No. 04-36; November 26, 2008; at p. 4.

¹³ RCW. 80.36.140 and RCW 80.36.186.

¹⁴ Docket No. UT-950200 (1996), Fifteenth Supplemental Order at para. 112 (“Fifteenth Supplemental Order”).

1 century and bring access charges more in line with current conditions.”¹⁵
2 Unfortunately, as shown in Table 1, Embarq’s intrastate switched access services
3 rates continue to be well above its own interstate switched access services rates.

4 With respect to the CCL Charge, neither Verizon NW nor Qwest assess a similar
5 charge.¹⁶ In fact, as Verizon points out, the Commission eliminated Qwest's CCL
6 Charge in order to drive toward an access structure in which “rate elements have a
7 direct bearing on the service provided” ¹⁷ in its reform proceeding. **[BEGIN**
8 **EMBARQ HIGHLY CONFIDENTIAL DATA]**Unfortunately, as shown in Table
9 2, Embarq’s CCL Charge is quite significant with respect to its intrastate switched
10 access service rates, accounting for almost XX% on average.

¹⁵ Docket No. UT-020406 (2003), Eleventh Supplemental Order at para. 39. (“Eleventh Supplemental Order”) *See also*, Docket No. UT-040788, Order No. 15 *and* Docket No. UT-040520, Narrative Supporting Settlement Agreement.

¹⁶ Verizon Complaint at para. 22. It should be noted that original participants in the Washington Carriers Access Plan (“WCAP”) assess a universal service fund element on intrastate switched access MOUs. *Year 2000 Washington Carrier Access Plan* (“WCAP”); Ninth Supplemental Order Approving Washington Carrier Access Plan; Docket No. UT-971140; June 28, 2000. The current (i.e., frozen) rate for this element is \$0.00152 as provided in Paragraph 9 of the WCAP. The element is not at issue in this proceeding and AT&T takes no position with regard to the charge at this time. Qwest assesses an Interim Universal Service Support Surcharge of \$0.015891. The element is not at issue in this proceeding and AT&T takes no position with regard to the charge at this time. Embarq assesses an “Interim USF Additive” on intrastate switched access terminating MOUs. The rate for that element is \$0.064851. And, Embarq assesses a “Line Extension Rate Additive” on intrastate switched access terminating MOUs. The current rate for that element is \$0.004207, but under Advice No. WA 09-01A Embarq proposes to increase that rate by \$0.002993 to \$0.0072 effective March 13, 2009.

¹⁷ Fifteenth Supplemental Order at para. 113.

Table 2

| EMBARQ AVERAGE MINUTE OF USE RATE¹⁸ | | | | |
|---|-------------------|--|---|---|
| Interstate | Intrastate | CCL Charge Portion of Intrastate Rate | Intrastate Rate Minus the CCL Charge | CCL Charge as a % of Intrastate Rate |
| XXXXXXXX | XXXXXXXX | XXXXXXXX | XXXXXXXX | XX% |

[END EMBARQ HIGHLY CONFIDENTIAL DATA]

It should be noted that the level of Embarq's CCL Charge is driven primarily by the Interim USF Additive and the Line Extension Rate Additive which together add \$0.06906 to terminating MOUs.¹⁹**[BEGIN EMBARQ HIGHLY CONFIDENTIAL DATA]** This is reflected in the fact that Embarq's 2008 terminating CCL average MOU unit price was over XXXXX (XX) times its originating CCL average MOU unit price.²⁰**[END EMBARQ HIGHLY CONFIDENTIAL DATA]**

More precisely, and certainly more germane to the broader issues in this proceeding, the Commission has previously concluded that "[t]o allow the CCLC to continue to exist is to imply, inaccurately, that local exchange services require a 'subsidy' from toll."²¹ Ultimately, the Commission's stated objective of a level playing field²² cannot be realized if Embarq's rates are not reduced in a manner commensurate with that taken for other providers in the State.

¹⁸ The data utilized is extracted from BAX - Appendix 1.

¹⁹ With the proposed increase to the Line Extension Rate Additive, the impact will be \$0.07205. The Interim USF Additive accounts for 92% of the total CCL Charge currently charged to terminating MOUs and 88% of the total proposed CCL Charge for terminating MOUs. When combined with the Line Extension Rate Additive, the additives' portion is 98%, current and proposed.

²⁰ The data utilized is extracted from BAX - Appendix 1.

²¹ Fifteenth Supplemental Order at para. 112.

²² Eleventh Supplemental Order at para. 161.

1 **Q. HAVE EMBARQ'S INTRASTATE ACCESS RATES BEEN SUBJECT TO**
2 **COMMISSION SCRUTINY IN THE RECENT PAST?**

3 A. No. As such, Embarq's rates bear little relevance to the current state of the
4 marketplace. In fact, even though the Commission has conducted repeated reviews of
5 the intrastate access rates for Verizon NW and Qwest, no similar reviews of Embarq's
6 intrastate access rates have been undertaken.²³

7 A glaring result of this lack of scrutiny is the extremely high "Interim USF
8 Additive"²⁴ which Embarq continues to assess on terminating traffic. As I testify
9 herein, imposing a charge that is apparently intended to maintain affordable universal
10 service in Washington on one, and only one, telecommunications industry segment –
11 IXC's – can hardly be called competitively neutral. Moreover, the Embarq *Interim*
12 (emphasis added) USF Additive has been in place at the current level since at least
13 2000. The current amount of the Interim USF Additive is \$0.064851.²⁵ Verizon NW
14 does not assess a similar charge.²⁶ Although it appears that Qwest does assess a
15 similar charge, it is much less at only \$0.015891.²⁷ Notably, no similar charges exist
16 in the interstate access rate structure. In fact, both the CCL Charge and implicit USF
17 subsidies have been eliminated from the interstate access rate structure.

18 Therefore, AT&T requests that the Commission require Embarq to immediately
19 reduce its intrastate switched access rates to interstate levels and rate structure,

²³ Verizon Complaint at para. 15-20.

²⁴ In pertinent part, WCAP, *Part VI: Individual Company Rate Additives*, paragraph 22 provides that "When filing for a company specific rate additive . . . the LEC shall file such supporting work papers as is requested by the WUTC for determining an initial WCAP Revenue Objective for a new participating carrier."

²⁵ Embarq Access Tariff (WN U-9), §3.8(C).

²⁶ Verizon Complaint at para. 22(c).

²⁷ Qwest Access Tariff (WN – U44), §6.8.2(A)(1). This element appears to be commensurate with the Pend Oreille Telephone Company surcharge described in paragraph 6(e) of the WCAP. The surcharge is not at issue in this proceeding and AT&T takes no position with regard to the charge at this time.

1 including the elimination of the discriminatory and competitively harmful CCL
2 Charges and, as necessary, to permit Embarq the opportunity to recover associated
3 revenue reductions from their end users.
4

5 **Q. IS THERE ANY COST JUSTIFICATION FOR EMBARQ'S INTRASTATE**
6 **SWITCHED ACCESS RATES TO BE SO MUCH HIGHER THAN ITS**
7 **INTERSTATE RATES?**

8 A. No. As previously noted, LECs perform the same functions utilizing the same
9 facilities when providing intrastate and interstate switched access services.
10 Therefore, the costs underlying each service must be the same. The FCC has already
11 adopted a series of orders in the interstate jurisdiction. By way of its CALLS, MAG
12 and CLEC Access orders,²⁸ the FCC has already implemented reforms that have
13 reduced²⁹ implicit subsidies from interstate access rates. Presumably, Embarq's
14 interstate switched access rates are sufficient to recover the associated costs, as
15 Embarq has not asked the FCC or the courts to review those rates or argued that those
16 rates do not recover its cost of interstate switched access service.

²⁸ *In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Low-Volume Long Distance Users*, Federal-State Joint Board on Universal Service, Sixth Report and Order, etc., FCC 00-193, CC Docket Nos. 96-262, 94-1,99-249,96-45 (ReI. May 31, 2000) ("CALLS Order").

In the Matter of Multi-Assoc. Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers Subject to Rate-of-Return Regulation, Prescribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers, Second Report and Order and Further NPRM, FCC 01-304, CC Docket Nos. 00-256, 96-45, 98-77, 98-166 (ReI. Nov 8, 2001) ("MAG Order").

In the Matter of Access Charge Reform; Reform of Access charges Imposed by Competitive Local Exchange Carriers, Eighth Report and Order and Fifth Order on Reconsideration, FCC 04-110, CC Docket No. 96-262 (ReI. May 18, 2004)("2004 CLEC Access Order");

In the Matter of Access Charge Reform; Reform of Access Charges Imposed by Competitive Local Exchange Carriers, Seventh Report and Order and Further NPRM, FCC 01-146, CC Docket No. 96-262 (ReI. Apr.27, 2001) ("2001 CLEC Access Order").

²⁹ Notably, the FCC recognized that the interstate switched access rates continued to include some level of implicit support, albeit greatly reduced from previous levels.

1 Consequently, the Commission can safely conclude that reducing Embark's
2 intrastate switched access rates to the interstate level will also be sufficient to recover
3 Embark's intrastate switched access cost. Any intrastate switched access service rate
4 above the interstate level increases the implicit subsidies (and the potential for abuse)
5 and must be reduced. However, as discussed herein, should Embark prove that it
6 cannot recover all of its cost and at the same time maintain fair and reasonable basic
7 service rates in its rural area, the Commission may find it necessary and appropriate
8 to adopt a transitional reduction plan combined with an explicit and competitively
9 neutral cost recovery mechanism.

11 **IV. IMPLICIT SUBSIDIES ARE CONTRARY TO THE PUBLIC INTEREST**

12 **Q. WHY SHOULD THE COMMISSION BE CONCERNED WITH THE** 13 **IMPLICIT SUBSIDIES IN EMBARQ'S INTRASTATE SWITCHED ACCESS** 14 **RATES?**

15 A. According to statute, the Commission must fix rates that are unjust and unreasonable.
16 But, the Commission should also take action now for the same reasons it chose to
17 take action in reforming other providers' intrastate switched access rates, namely, to
18 eliminate subsidies that distort competition, create a competitive disadvantage, and
19 unfairly burden one class of customers. When the provision of telecommunications
20 was essentially limited to a wireline monopoly, regulators could direct that access
21 charges be set well above cost in order to subsidize basic local exchange service, but
22 with the emergence of competition from so many new technologies and new carriers,
23 those implicit subsidies are no longer sustainable.

1 In the past, local service providers have recovered their universal service support
2 obligations through higher access charges that only wireline IXC's were required to
3 pay. Although, AT&T strongly supports the principles and objectives of universal
4 service, AT&T believes that all telecommunications carriers – not just IXC's – must
5 contribute to the preservation and advancement of universal service on an *equitable*
6 and *non-discriminatory* basis.³⁰ The high subsidies embedded in Embarq's access
7 charges, which ultimately recovers their universal service obligations, are imposed
8 solely on IXC's and, more importantly, on their customers. The IXC's' competitors are
9 unencumbered by these implicit subsidies. It is thus no great surprise that consumers
10 are shifting usage away from wireline long distance because these subsidies simply
11 render wireline long distance service less competitive and more expensive for
12 providers to offer and for consumers to purchase. That trend is increasing over time.

13 It is therefore even more important to take a step toward leveling the playing field
14 so that wireline long distance services can compete fairly with those alternative
15 technologies. Consumers should choose between competitors based on their *merits* –
16 That is, they should be empowered to make choices because of the real cost, features,
17 and quality of service, not because one service is saddled with implicit subsidies
18 designed to support other services, while other competing services are not. Unless
19 the hidden charges are eliminated, those implicit subsidies, rather than consumers,
20 will be deciding market winners and losers.

³⁰ See 47 U.S.C. § 254.

1 **Q. HOW DO HIGH ACCESS CHARGES HARM CONSUMERS?**

2 A. The hidden charges embedded in access charges, and, therefore, in the prices
3 consumers pay for wireline long-distance service, are forcing long-distance providers
4 like AT&T to maintain higher-than-necessary retail rates for consumers. To the
5 extent those consumers do not or cannot shift usage to alternative services (as
6 described above) they pay more for long-distance service than they should, and, it
7 stands to reason, they respond to the hidden charge by suppressing wireline long
8 distance usage. IXCs are unable to effectively compete – not because of their own
9 merits – but because access charges distort prices in the marketplace.

10 The problem is not limited solely to long distance carriers. The economic
11 distortion of implicit subsidies may well be driving consumers to alternative providers
12 and technologies. Thus, the hidden charges also are creating incentives for customers
13 to leave traditional wireline services—in whole or in part—in favor of other
14 competitors and technologies.

15 Ironically, when consumers leave wireline long-distance carriers, they often
16 decide to leave wireline telephone service altogether. **[BEGIN EMBARQ HIGHLY**
17 **CONFIDENTIAL INFORMATION]** During the period between 2004 and 2008,
18 Embarq has lost approximately XX% in revenue producing access lines.³¹ During
19 that period, Embarq's local access line revenues also fell about XX%.³²**[END**
20 **EMBARQ HIGHLY CONFIDENTIAL INFORMATION]** Nationally, more than

³¹ See, Embarq's response to AT&T 1-1, as Attachment VZ-12, as updated.

³² See, Embarq's response to AT&T 1-2.

one out of every eight American homes (13.1%) received all or almost all calls on wireless telephones despite having a landline telephone in the home.³³

Q. DO YOU AGREE THAT THE CURRENT ACCESS RATE REGIME, AND ITS CONTINUING DEPENDENCE ON IMPLICIT SUBSIDIES, JEOPARDIZE NETWORK INVESTMENT?

A. Certainly. A major policy objective in the Federal and state jurisdictions is the goal to encourage investment that will expand the availability of broadband, digital networks. Policy makers have recognized that advanced broadband services can act as a catalyst for further economic growth and development, and have thus articulated the desire to bring advanced broadband services to every corner and by-way of the State.³⁴ The current access charge regime, which continues to rely on implicit subsidies as a support mechanism for local service, is contrary to that policy objective. An analysis by the Phoenix Center For Advanced Legal & Economic Public Policy Studies concludes,

. . . compared to the current Byzantine intercarrier compensation system, a lower, more uniform compensation rate can promote and spur broadband deployment, especially in rural and less densely populated areas where current call termination rates are very high, by reducing arbitrage opportunities that distort investment decisions. As such, comprehensive intercarrier compensation reform would appear to make a significant contribution towards the development of a true national broadband strategy.³⁵

³³ Stephen J. Blumberg, Ph.D., and Julian V. Luke, Division of Health Interview Statistics, National Center for Health Statistics <http://www.cdc.gov/nchs/data/nhis/earlyrelease/wireless200805.htm>

³⁴ See, generally, my discussion of the *Broadband Study Report Prepared for the Washington Utilities and Transportation Commission* by CBG Communications, Inc., herein.

³⁵ *Do High Call Termination Rates Deter Broadband Deployment?*, Phoenix Center Policy Bulletin No. 22, Phoenix Center For Advanced Legal & Economic Public Policy Studies, October 2008, at p. 1. A copy of the paper can be found at <http://www.phoenix-center.org/PolicyBulletin/PCPB22Final.pdf>.

1 Access reform is an important component of this framework. Why do access
2 charges matter to broadband deployment? First, the POTS infrastructure that access
3 revenues support today – the local loop and transport - are fundamentally the same
4 infrastructure needed to provide broadband and access to the Internet – but under a
5 new and very different business model. Because of the many communications
6 alternatives now available that are not subject to the same access charge obligations
7 as IXCs, access revenues are declining and may well go to \$0 as these alternatives
8 increasingly take hold in the market.

9 Consequently, policy makers must initiate a rational transition to explicit, stable,
10 and sustainable alternative revenue sources, rather than continue to rely on access
11 revenue streams which, over time, may totally evaporate. Without such explicit
12 support mechanisms, network providers will not be able to invest in advanced
13 technology, and ultimately, rural areas may be denied the benefits of a broadband
14 infrastructure.³⁶

15 Second, because broadband-enabled VoIP services deprive rural providers of high
16 access charges, the legacy access regime discourages the marketing of, if not
17 investment in, advanced broadband or broadband-enabled services like VoIP. These
18 providers thus have no incentive to abandon the POTS model, which in turn
19 discourages them from making those advanced services available to their customers.³⁷

³⁶ For example, in a *Broadband Study Report Prepared for the Washington Utilities and Transportation Commission* by CBG Communications, Inc., ((June 27, 2008), a review of broadband availability in the State of Washington yields the following, “Although Washington is making efforts to bring broadband to more rural areas, as Jerry Cornfield, a writer for the Daily Herald observed, ‘there are still large chunks of the state and of the population without DSL, cable, fiber optic, wireless or satellite service because it’s either not available or not affordable.’” At Section H, p. 173. A copy of the study can be found at: <http://www.wutc.wa.gov/webimage.nsf/0/0C107F2AECEC013A8825733800684FCF>.

³⁷ *Id.* For example, “Generally, several key inhibitors to broadband adoption and use (i.e., uncertainty as to the benefits of broadband, lack of reliable broadband service and cost of service) are interwoven and

1 It is thus critical that policy makers find a means to transition from the
2 increasingly anachronistic POTS/long distance/access charge business model to the
3 business model of the 21st century which is based on the provision of broadband
4 capacity, together with competitive prices for voice services and other applications on
5 top of the broadband pipe.

6 In order to encourage broadband availability and deployment, more rational retail
7 service pricing coupled, to the extent necessary, with explicit and competitively
8 neutral access replacement support, is long overdue.

9

10 **Q. DO HIGHER SWITCHED ACCESS RATES NECESSARILY RESULT IN**
11 **CORRESPONDINGLY HIGHER REVENUES AND LOCAL SERVICE**
12 **SUBSIDIES?**

13 A. No. In an ex parte recently filed with the FCC in its intercarrier compensation
14 proceeding, Jerry Ellig, Senior Research Fellow, George Mason University-Mercatus
15 Center, Regulatory Studies Program, states,

16 Demand for long-distance communication is significantly more
17 elastic than the demand for local wireline service; increases in price
18 cause consumers to buy many fewer minutes, which leads them to
19 forego significant benefits. The elasticity of demand for wireline
20 long-distance service is approximately 0.7; that is, a 1 percent

coalesce around the price/value relationship concerning service access. For instance, residents in rural areas may be able to receive satellite broadband, but the cost can be significantly higher than dial-up service, likely the only alternative to satellite broadband service in their area. Nevertheless, consumers may choose to adopt such offerings, but they tend to experience more significant service problems such as latency, service outages and the service-barring effects of certain 'fair use' policies that may be applied. Some rural consumers choose to 'un-adopt' and go back to dial-up because the value of satellite service has diminished relative to the cost. Some remain on satellite broadband service, albeit frustrated and greatly dissatisfied with the quality of service. When other service options are available, evidence suggests that many will migrate to those options. Similarly, evidence suggests, when there are multiple options, that the price and types of services are broad-based enough that value is established for users at very high levels.'" The preceding was relevant to all states and not particular to the State of Washington. At *Conclusions and Recommendations*, p. 193.

1 increase in the price of long distance leads to a 0.7 percent decrease
2 in minutes used.³⁸
3

4 Therefore, it is economically inefficient to rely on inflated long-distance rates
5 (i.e., by way of implicit subsidies in the switched access rates) as a means to support
6 local wireline service. This conclusion is consistent with trends in the toll
7 marketplace where IXC's (including AT&T as shown in Part I of my testimony) have
8 experienced significant declines in toll volumes and revenues. If support is needed, it
9 should be explicit, predictable and directly attributed to local wireline service.
10

11 **Q. HAS EMBARQ ESPOUSED VIEWS SIMILAR TO THOSE YOU HAVE**
12 **EXPRESSED WITH RESPECT TO ACCESS REFORM?**

13 A. Yes, although outside of this proceeding and this jurisdiction. Embarq recently filed
14 a petition with FCC in which Embarq argued that its intrastate switched access rates
15 should be reduced and that intrastate and interstate switched access rates should be
16 the same.³⁹ Embarq argued to the FCC that differences between intrastate and
17 interstate switched access rates are causing "artificial arbitrage" that is "harming
18 competition and investment" in several ways, including "harming network investment

³⁸ From an *ex parte* prepared by Jerry Ellig, senior research fellow, George Mason University-Mercatus Center, Regulatory Studies Program: Public Interest Ex Parte Comment On Intercarrier Compensation And Universal Service: Developing a Unified Intercarrier Compensation Regime, CC Docket No. 01-92; Biennial Review of Telecommunications Regulations, WC Docket No. 08-183; High-Cost Universal Service Support, WC Docket No. 05-337; Federal-State Joint Board on Universal Service, CC Docket No. 96-45; Intercarrier Compensation for ISP-Bound Traffic, WC Docket No. 99-68; Establishing Just and Reasonable Rates for Local Exchange Carriers, WC Docket No. 07-135, September 22, 2008, pg. 3. Mr. Ellig states, "A range of estimates exists, but -0.7 is the consensus view." Mr. Ellig cites to Jerry Hausman & Howard Shelanski, *Economic Welfare And Telecommunications Regulation: The E-Rate Policy For Universal-Service Subsidies*, 16 Yale J. ON Reg. 19, 36-37 (1999); See Also Michael H. Riordan, *Universal Residential Telephone Service*, in "1 Handbook Of Telecommunications Economics" 423, 431 (Martin E. Cave Et Al., Eds.) (2002). A copy of the document can be found at: http://fjallfoss.fcc.gov/prod/ecfs/retrieve.cgi?native_or_pdf=pdf&id_document=6520170017.

³⁹ FCC WC Docket No. 08-160, Petition of Waiver of Embarq, at p. 20 and Exhibit B (August 1, 2008).

1 and innovation.”⁴⁰ Embarq's FCC comments acknowledge that "reduced intrastate
2 switched access charges would benefit carriers, and ultimately their end-user
3 customers, by promoting greater competition for intrastate toll calling."⁴¹
4

5 **Q. IS THERE ANY NEED TO PERFORM A COST STUDY TO DETERMINE**
6 **THE AMOUNT OF IMPLICIT SUBSIDIES TO BE ELIMINATED FROM**
7 **EMBARQ’S ACCESS CHARGES?**

8 A. No. AT&T’s recommendation is that Embarq’s intrastate access rates be reduced to
9 match its interstate rates. Neither Embarq, nor any other party to this proceeding for
10 that matter, has asserted that Embarq’s interstate rates are below its cost. Likewise,
11 Embarq has not credibly argued that interstate access is functionally different from
12 intrastate access. Thus, the Commission can adopt a meaningful access charge reform
13 for Embarq without the need for a wasteful, time-consuming and contentious cost
14 study.

15 This is consistent with the Commission’s action in other proceedings. Over the
16 past few years, the Commission has reduced access rates for Verizon NW and Qwest
17 without soliciting or relying on access cost studies. Therefore, in the current
18 proceeding, it is not necessary to incur the time and expense of trying to eliminate
19 implicit subsidies *completely* or set access rates *exactly*. Instead, the Commission can
20 make real, meaningful progress quickly and painlessly by reducing intrastate rates to
21 interstate levels, which are apparently quite sufficient to recover costs.
22

⁴⁰ *Id.* at pp. 15-16.

⁴¹ *Id.* at p. 27.

1 **V. REVENUE NEUTRAL REBALANCING**

2 **Q. HOW MUCH WILL EMBARQ'S ACCESS REVENUES DECLINE WHEN**
3 **ITS INTRASTATE ACCESS RATES ARE REDUCED TO INTERSTATE**
4 **LEVELS?**

5 A. Based on the analysis in BAX – Appendix 1, reducing Embarq's intrastate access
6 rates to interstate levels will reduce Embarq's annual access revenues by about
7 **[BEGIN EMBARQ HIGHLY CONFIDENTIAL INFORMATION]**\$XXXXXXX
8 based on 2008 data. If the intrastate access reduction were shifted to Embarq's
9 revenue producing access lines as of 2008, the per line, per month shift would be
10 approximately \$XXXXX.**[END EMBARQ HIGHLY CONFIDENTIAL**
11 **INFORMATION].**

12
13 **Q. SHOULD EMBARQ BE PERMITTED THE OPPORTUNITY TO OFFSET**
14 **ACCESS REDUCTIONS WITH INCREASES IN OTHER RETAIL RATES?**

15 A. In its Eleventh Supplemental Order in Docket No. UT-020406, the Commission
16 determined the following:

17 The Commission is not barred from proceeding to hear a complaint
18 alleging violations of RCW 80.04.110, 80.36.180, 80.36.186, federal
19 law, and Commission rules and orders against a regulated utility
20 when, if sustained, the result could lower revenues to the point that a
21 general increase in the respondent's rates might be required to allow
22 the company the opportunity to earn a fair return. (at paragraph 173)

23
24 The doctrine disfavoring single-issue ratemaking does not prevent
25 the Commission from hearing a complaint against the tariff of a
26 regulated company. (at paragraph 174)

27
28 A regulated utility company is not entitled as a matter of law to "rate
29 rebalancing," in which substantial reductions in some rates must be
30 offset by a revenue-neutral increase in other rates, but is entitled to

1 seek an increase in its rates and charges when it believes it is entitled
2 to rate relief. RCW 80.04.130, RCW 80.36.140. (at paragraph 175)

3
4 A complaint by a competitive company against another company
5 under RCW 80.04.110 is not limited to an examination of the level
6 of a rate complained of, but may consider whether the rates, charges,
7 rules, regulations or practices of such other or others with or in
8 respect to which the complainant is in competition, are
9 unreasonable, unremunerative, discriminatory, illegal, unfair or
10 intending or tending to oppress the complainant, to stifle
11 competition, or to create or encourage the creation of monopoly . . .
12 and require correction. RCW 80.04.110. (at paragraph 178)

13
14 Therefore, the Commission is not compelled to automatically rebalance Embarq's
15 rates in this proceeding. However, Embarq should be permitted the opportunity to
16 offset any reductions to its intrastate switched access service revenues by way of its
17 end-user retail services, as was the opportunity availed to other providers, and to the
18 extent necessary, with explicit and competitively neutral access replacement support.

19 20 **VI. CONCLUSION**

21 **Q. DO YOU HAVE ANY RECOMMENDATIONS FOR THE COMMISSION TO** 22 **CONSIDER?**

23 A. Yes. I recommend that the Commission take immediate steps to reduce Embarq's
24 intrastate switched access services rates to interstate levels and rate structure,
25 including elimination of the Carrier Common Line Charge and the Interim USF
26 Additive. In return, Embarq should be permitted the opportunity to offset any
27 reductions in revenues by way of increases to its rates for end-user retail services, and
28 to the extent necessary, with explicit and competitively neutral access replacement
29 support. To the extent proven necessary, the Commission may want to consider a
30 transition period

1

2 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

3 A. Yes.

BAX - Appendix 1
REDACTED
PER PROTECTIVE ORDER
IN
WUTC DOCKET UT-081393

WASHINGTON - EMBARQ ACCESS REVENUE CALCULATIONS

| A | B | C | D | E | F | G | H | I | J | K |
|--|-----------------------------------|-----------------------------------|---------------------------------------|---------------------------------------|-----------------------------|-----------------------------|------------------|---|---|-----------------------------|
| 2008 Revenue Producing Access Lines ¹ | 2008 Interstate MOUs ² | 2008 Intrastate MOUs ³ | 2008 Interstate Revenues ⁴ | 2008 Intrastate Revenues ⁵ | Interstate Unit Price (D/B) | Intrastate Unit Price (E/C) | Difference (G-F) | Intrastate Access Revenue Reduction (H*C) | Access Shift per Line ⁶ ((I/A)/12) | Ratio: Intra to Inter (G/F) |
| XXXXXXX | XXXXXXX | XXXXXXX | XXXXXXX | XXXXXXX | #VALUE! | #VALUE! | #VALUE! | #VALUE! | #VALUE! | #VALUE! |

| L | M | N | O | P | Q | R |
|--|--|---------------------------------------|--|--|---------------------------------------|---|
| 2008 Terminating CCL MOUs ⁷ | 2008 Terminating CCL Revenues ⁸ | 2008 Terminating CCL Unit Price (M/L) | 2008 Originating CCL MOUs ⁷ | 2008 Originating CCL Revenues ⁸ | 2008 Originating CCL Unit Price (P/O) | Ratio: CCL Terminating to CCL Originating (N/Q) |
| XXXXXXX | XXXXXXX | #VALUE! | XXXXXXX | XXXXXXX | #VALUE! | #VALUE! |

| S | T | U | V | W | X |
|---------------------|--------------------------------|---------------------------|-----------------------------|------------------|---------------------------|
| 2008 CCL MOUs (L+O) | 2008 CCL Charge Revenues (M+P) | Intrastate Unit Price (G) | CCL Charge Unit Price (T/S) | Difference (U-V) | Ratio: CCL to Intra (V/U) |
| #VALUE! | #VALUE! | #VALUE! | #VALUE! | #VALUE! | #VALUE! |

Notes:

¹Embarq's Response to AT&T 1-1 as Attachment VZ-12, as updated: 2008 Revenue Producing Access Lines.

²Embarq's Response to AT&T 1-13 as Attachment VZ-9, as updated: Interstate MOU data for LS1 Premium and LS2 Premium, originating and terminating

³Embarq's Response to AT&T 1-12 as Attachment VZ-8, as updated: Intrastate MOU data for LS1 Premium and LS2 Premium, originating and terminating

⁴Embarq's Response to AT&T 1-13 as Attachment VZ-9, as updated: Total interstate switched access revenue data, originating and terminating.

⁵Embarq's Response to AT&T 1-12 as Attachment VZ-8, as updated: Total intrastate switched access revenue data, originating and terminating.

⁶Expressed as a per month figure.

⁷Embarq's Response to AT&T 1-12 as Attachment VZ-8, as updated: MOU data for Carrier Common Line Premium, originating and terminating

⁸Embarq's Response to AT&T 1-12 as Attachment VZ-8, as updated: Revenue data for Carrier Common Line Premium, originating and terminating

Special Note: On February 6, 2009, Embarq filed Advice No. WA 09-01A requesting an increase to its Line Extension Rate Additive. The increase (i.e., \$0.00299) raises the Line Extension Rate Additive from \$0.004207 to \$0.007200 effective March 13, 2009. The data in this analysis relies on 2008 data and, as such, does not include the impact from the proposed increase. Therefore, 2009 data for intrastate revenues, intrastate unit price, intrastate access revenue reduction, access shift per line, the interstate/intrastate ratio, CCL Charge unit price, terminating CCL revenues, terminating CCL unit price and the ratios could be expected to rise commensurate with the proposed increase, all else being equal.