Exhibit No.______PBV-1T

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

VERIZON SELECT SERVICES, INC.; MCIMETRO ACCESS TRANSMISSION SERVICES, LLC; MCI COMMUNICATIONS SERVICES, INC.; TELECONNECT LONG DISTANCE SERVICES AND SYSTEMS CO. D/B/A TELECOM USA; AND TTI NATIONAL, INC., Complainants,	)	Docket No. UT-081393
v.	)	
UNITED TELEPHONE COMPANY OF THE NORTHWEST, Respondent.	)	

DIRECT TESTIMONY OF PAUL B. VASINGTON

ON BEHALF OF VERIZON

February 18, 2009

REDACTED VERSION

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME, TITLE, AND BUSINESS ADDRESS.

A. My name is Paul B. Vasington. I am a Director - State Public Policy for Verizon. My business address is 185 Franklin Street, Boston, Massachusetts 02110.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL AND PROFESSIONAL BACKGROUND.

A. I have a Bachelor of Arts in Political Science from Boston College and a Master's in Public Policy from Harvard University, Kennedy School of Government. I have been employed by Verizon since February 2005. From September 2003 to February 2005, I was a Vice President at Analysis Group, Inc. Prior to that, I was Chairman of the Massachusetts Department of Telecommunications and Cable ("MDTC") from May 2002 to August 2003, and was a Commissioner at the MDTC from March 1998 to May 2002. Before my term as a Commissioner, I was a Senior Analyst at National Economic Research Associates, Inc. from August 1996 to March 1998. Prior to that, I was in the Telecommunications Division of the MDTC (then called the Department of Public Utilities), first as a staff analyst from May 1991 to December 1992, then as division director from December 1992 to July 1996.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to present evidence in support of Verizon's complaint asking the Washington Utilities and Transportation Commission ("Commission") to reduce the intrastate switched access rates charged by United

Telephone Company of the Northwest ("Embarq") to levels that comply with Washington law. The complaint was filed on July 25, 2008 by Verizon Select Services, Inc.; MCImetro Access Transmission Services, LLC; MCI Communications Services, Inc.; Teleconnect Long Distance Services and Systems Co. d/b/a Telecom USA; and TTI National, Inc. (collectively, "Verizon"). These entities are competitive local exchange ("CLEC") and/or interexchange ("IXC") carriers.[1]

Q. WHAT IS VERIZON'S RELATIONSHIP WITH EMBARQ IN WASHINGTON?

A. Verizon is both a competitor and a customer of Embarq in Washington. Verizon is a customer of Embarq because Verizon has no choice but to pay Embarq's intrastate switched access rates every time one of Verizon's long distance customers makes a long distance call that originates or terminates in Embarq's service area.

At the same time, Verizon and Embarq are competitors. For many years Verizon and Embarq have competed in the provision of retail services within the state, and in recent years Embarq has emerged as a successful competitor in the market for providing long distance service to Washington residents. In 2007, **BEGIN CONFIDENTIAL END CONFIDENTIAL** of Embarq's residential end users purchased long distance service from Embarq's long distance affiliate.

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[1] Verizon also has an affiliate incumbent local exchange carrier ("ILEC") in Washington, Verizon Northwest Inc. ("Verizon Northwest").

Q. IS VERIZON COMPLAINING ABOUT EMBARQ'S SWITCHED ACCESS CHARGES AS A CUSTOMER OF EMBARQ OR AS A COMPETITOR TO EMBARQ?

A: Both. As a customer, it is unjust and unreasonable to pay an intrastate switched access rate that is many times higher than what Verizon and Qwest, whose rates have been subject to the most scrutiny and modification by the Commission, charge for the exact same service in Washington. Indeed, as discussed below, the rate Verizon must pay Embarq for providing intrastate switched access service in Washington is higher than the price many Washington residents pay for making retail long distance telephone calls.

But the anticompetitive impact of Embarq's excessive rates is also crucial to Verizon's claims. Embarq's excessive intrastate switched access rates give Embarq an artificial competitive advantage and create an undue prejudice to competitors such as Verizon. Embarq has shown that it is cognizant of the competitive threat presented by companies like Verizon: "[M]ajor providers are striving to provide integrated services in many of the markets we serve. This trend is also reflected in regulatory changes that have encouraged competition and the offering of integrated services. We expect competition to intensify as a result of the entrance of new competitors and the rapid development of new technologies, products and services."[2]

Q: PLEASE PROVIDE A BRIEF SUMMARY OF YOUR TESTIMONY.

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2 *See* Embarq 2008 Annual Report (Form 10-K) at 7 (filed February 13, 2009).

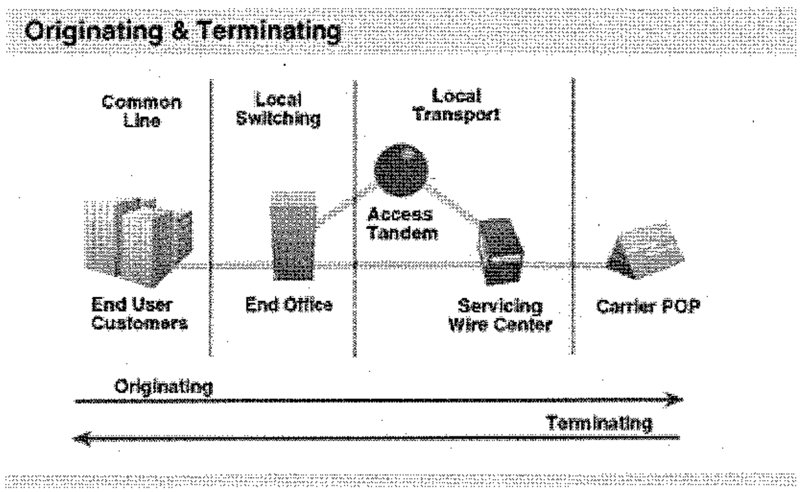
A: My testimony demonstrates that Embarq's intrastate switched access rates violate Washington law because they are unjust, unreasonable, and anticompetitive. They create an unreasonable prejudice to Embarq's competitors, including Verizon, and create economic distortions that reduce the efficiency of Washington's telecommunications industry. The fact that Embarq's intrastate switched access rates are multiples of what Verizon and Qwest charge for identical functions in Washington allows Embarq to export a disproportionate amount (millions of dollars annually) of its costs to it competitors. Commission precedent confirms that such excessive rates violate RCW 80.36.140 and RCW 80.36.186.

II. <u>BACKGROUND</u>

Q. WHAT IS SWITCHED ACCESS?

A. Switched access is a service provided by local exchange carriers to other carriers for originating or terminating *interexchange* or "toll" calls (whereas the origination and termination of local calls are billed at the reciprocal compensation rate, which is typically lower than access rates). Access charges generally apply to calls that begin and end in different local calling areas. Interstate access charges apply to calls that originate and terminate in different states, and intrastate access charges apply to calls that originate and terminate in different local calling areas within the same state. The FCC oversees interstate access rates, and the states oversee intrastate access rates.

The diagram below demonstrates how switched access works. The "Carrier POP" is the IXC's "point of presence" or "POP," and the diagram shows how an interexchange call is either delivered to or from the IXC's POP through connection with the local exchange carrier ("LEC"). Switched access charges compensate the LEC for the connection between the end user and the POP or other interconnection point.



If the interexchange call originates in one state but terminates in another, it is billed at the interstate rate in the carrier's FCC tariff. If the interexchange call originates and terminates within a state, then it is billed at the intrastate access rate, which is under the state commission's jurisdiction. The switched access rates at issue in this proceeding are the rates that Embarq charges IXCs and other carriers to originate or terminate interexchange calls that begin and end in Washington, to or from an Embarq customer.

Q. CAN THE IXC AVOID PAYING SWITCHED ACCESS TO EMBARQ?

A. No. The telecommunications industry today is highly competitive. New technologies and new services are delivering choice and innovation to customers. But switched access is a notable exception to this overall trend. Carriers have no choice but to use a local exchange carrier's switched access services when they handle interexchange calls originating from the local exchange carrier's customers and when they deliver interexchange calls for termination to the local exchange carrier's customers. A toll provider cannot refuse to deliver a call to a LEC's end user – and thus cannot avoid the LEC's terminating access charges. Verizon has no choice in the matter of which carrier can complete the call – it is wholly at the mercy of the carrier that the called party uses for her local exchange service.

In terms of originating switched access services, in theory these are less susceptible to unreasonable charges because the IXC has a relationship with both the end user customer, who has chosen the IXC, and with the originating LEC (*i.e.*, the IXC is on the LEC's list of presubscribed carriers). However, in reality, competitive pressures have not tended to significantly constrain originating switched access charges. For example, when reforming CLEC access charges, the FCC did not find that CLECs' originating and terminating access rates were significantly different, thereby indicating "that CLEC originating access service may also be subject to little competitive pressure."[3]

Q. WHAT HAS THE FCC DETERMINED REGARDING THE HARMS CAUSED BY EXCESSIVE ACCESS RATES?

A. The FCC has emphasized that irrational access rate structures "lead to inefficient and undesirable economic behavior," suppressing demand for the services of other carriers which must pay excessive access charges and reducing incentives for local entry by firms that might be able to provide service more efficiently than the LEC.[4] The FCC has repeatedly concluded that economically efficient competition and the consumer benefits it yields cannot be achieved as long as carriers seek to recover a disproportionate share of their costs from other carriers through access charges, rather than from their own end users.[5] As it has noted:

> These transfers, while reducing the pressures on the local companies to raise monthly rates, contributed to inefficiently high long distance rates. The high rates were responsible for suppressing demand for long distance calls and inducing large corporations to bypass the public switched network. Moreover, while such revenue sharing arrangements were sustainable in an

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3 *In the Matter of Access Charge Reform, Reform of Access Charges Imposed by Competitive Local Exchange Carriers*, Seventh Report and Order and Further Notice of Proposed Rulemaking, 16 FCC Rcd 9923 (issued April 27, 2001), ¶ 29.

4 *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 in CC Docket Nos. 96-262 and 94-1, Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45, 15 FCC Rcd 12962 (May 31, 2000) ("*CALLS Order*"), ¶¶ 129, 114.

5 *See generally CALLS Order*; *Multi-Association (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, Second Report & Order and Further Notice of Proposed Rulemaking in CC Docket No. 00-256, Fifteenth Report & Order in CC Docket No. 96-45, and Report & Order in CC Docket Nos. 98-77 and 98-166, 16 FCC Rcd 19613 (2001) ("*MAG Order*"); Reform of Access Charges Imposed by Competitive Local Exchange Carriers, Seventh Report & Order and Further Notice of Proposed Rulemaking, 16 FCC Rcd 9923 (2001) ("*CLEC Rate Cap Order*").

> industry where one firm monopolized both long distance and local service, they were not compatible with a competitive long distance industry.[6]

Also, the FCC has found that rationalizing switched access rates will enhance incentives for interexchange carriers to originate service in rural areas and will foster facilities-based competition for residential subscribers in those areas.[7]

Q: HAS THE COMMISSION ALSO RECOGNIZED THAT REASONABLE SWITCHED ACCESS RATES ARE BENEFICIAL TO COMPETITION AND TO CUSTOMERS?

A: Yes. The next section (Section III) of my testimony describes the actions where the Commission required Qwest and Verizon Northwest to reduce their access charges to levels it deemed just, reasonable, and pro-competitive. As discussed in that section, the Commission has repeatedly stressed that permitting telephone companies to charge unreasonable rates is unfair to competitors, bad for consumers, and bad economic policy.

Q: PLEASE DESCRIBE THE HISTORY AND THE PURPOSE OF WAC 480-120-540.

A: The Commission promulgated WAC 480-120-540 in 1998 for the purpose of encouraging competition and increasing customer choice throughout the state of

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6 Trends in Telephone Service, Industry Analysis and Technology Division Wireline Competition Bureau, Federal Communications Commission, February 2007.

7 *MAG Order* ¶ 11.

Washington.[8] The Commission distinguished between originating switched access charges and terminating switched access charges.

The Commission determined that implicit contributions should be removed from terminating intrastate switched access charges in order to encourage competition and enhance efficiency. Thus, WAC 480-120-540 requires LECs to reduce their terminating switched access rate elements to levels approaching their costs for providing the services. As an interim measure, the Commission permitted LECs to maintain their existing revenue stream by assessing an interim universal service charge on terminating traffic.[9] The Commission's intention was that LECs would adjust or eliminate their interim universal service charges over time.[10] With respect to originating intrastate switched access rates, the Commission did not require any adjustments. That is because the Commission, consistent with prevailing economic theory at the time, contemplated that competitive pressures would constrain originating switched access rates.[11]

Q: HAS THE COMMISSION RECOGNIZED THE NEED TO INTERVENE IN THE SWITCHED ACCESS MARKET TO ENSURE THAT LECS ARE CHARGING REASONABLE SWITCHED ACCESS RATES?

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8 *See* Order Adopting Rules Permanently, *In the Matter of Adopting WAC 480-120-540*, Docket No. UT-970325 (issued Sept. 23, 1998).

9 *Id.* at 7, 13-14, 25.

10 *Id.* at 25.

11 *Id.* at 12-13.

A: Yes. The Commission's actions on the access charges of Qwest and Verizon Northwest (which I discuss in detail in the next section) have recognized that Commission intervention is appropriate to ensure that both originating and terminating intrastate switched access rates in Washington are just, reasonable and pro-competitive. While in 1998 the Commission anticipated that competitive pressures may constrain originating switched access rates, its theoretical assumptions were not born out. Staff economist Glenn Blackmon accurately captured the subsequent economic learning. In 2002, he wrote:

> I believe that originating access charges have not proven to be as effective a catalyst to competition as we hoped in 1997. Competitors appear to charge the incumbents' prevailing access rates and do not compete based on the price of switched access services. Probably one reason for this lack of progress is that access charges are paid by carriers, rather than being assessed directly on retail customers. This experience suggests that achieving lower access charges, which has clearly been the Commission's objective all along, will require more overt pressure in the form of proceedings such as this one. In addition, we better understand the cross-subsidy problem that comes when toll prices must be uniform across the state and smaller carriers are permitted to charge high access charges. We now better understand that the "access charge problem" is not just high access charges but also markedly different access charges within the state.[12]

As described in the next section of my testimony, the Commission found Dr. Blackmon's testimony to be persuasive, and required Verizon Northwest to substantially reduce its intrastate switched access rates.

Q. HAS THE COMMISSION STAFF MADE RECOMMENDATIONS REGARDING EMBARQ'S ORIGINATING ACCESS CHARGES?

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12 Rebuttal Testimony of Glenn Blackmon, Ph.D, *AT&T Comm. v. Verizon Northwest*, Docket No. UT-020406 (filed Feb. 7, 2002) at 4-5.

A. Yes. In the 2005 docket examining the spin-off of Embarq from Sprint Nextel, Commission Staff witness Timothy Zawislak testified that the Commission should reduce Embarq's intrastate access rates similar to what the Commission had already done with Verizon Northwest. Mr. Zawislak noted that Embarq's:

> charges for originating access are significantly higher than the level that the Commission established as reasonable for Verizon. The Commission ordered Verizon to reduce its rates in Docket UT-020406 in order to correct what it found to be illegal and anti-competitive rate discrimination. At paragraph 48 of the Eleventh Supplemental Order in Docket UT-020406, the Commission adopted Dr. Blackmon's reasoning for lowering Verizon's intrastate originating access charges. The Commission should apply this same reasoning to United's access charges in this case and require United to lower its originating access rates to the same level required of Verizon.[13]

Based on that analysis, Mr. Zawislak recommended that Embarq's carrier common line charges of $.010 and $.005 be eliminated, and that its local switching rate be reduced from $0.0207400 to $0.015172. He stated that this recommendation on Embarq's originating access charges would "comply with the legal standard that the Commission applied to Verizon NW's originating switched access service in Docket UT-020406."[14]

Q: HAS THE COMMISSION STAFF ALSO EVALUATED EMBARQ'S TERMINATING ACCESS CHARGES?

A: Yes. Mr. Zawislak determined in that same testimony that Embarq's interim terminating access charge (which Embarq currently calls an "Interim USF Additive") of $0.064851 could not be justified based on universal service

13 Testimony of Timothy W. Zawislak, Docket No. 051291 (filed November 30, 2005) at 10-11.

14 *Id.* at 11.

considerations.[15] He recommended that the charge be reduced to $0.022626, explaining that such a level would "still support universal service without charging excessive intrastate access charges to its competitors."[16]

Q. DID THE COMMISSION CONSIDER MR. ZAWISLAK'S RECOMMENDATIONS?

A. No. The Administrative Law Judge decided that access charges would not be considered in the docket examining the spin-off transaction because there was not a "sufficient nexus" between access charge levels and the transaction.[17] Instead, the Administrative Law Judge noted that the matter of such charges would be better considered in a complaint process. The Commission is now presented with such a complaint, and the logic of Mr. Zawislak's analysis and recommendations remains sound.

III. THE COMMISSION'S ACTIONS REGARDING SWITCHED ACCESS CHARGES

Q: PLEASE DESCRIBE THE COMMISSION'S DECISION IN 1996 TO REDUCE QWEST'S INTRASTATE SWITCHED ACCESS RATE.

A: In April 1996, the Commission ordered substantial reductions to Qwest's switched access rates, finding that:

> The reduction in access rates can be expected to have substantial economic benefit for residential and business customers of this state. Toll calls are a substantial portion of the total telephone bill of many

15 *Id.* at 12-13.

16 *Id.* at 13-14.

17 Transcipt from Hearing on January 30, 2006, Docket No. 051291, at Tr: 0028:13-23.

> customers, and this reduction will make their overall telephone service more affordable."[18]

The Commission determined that it is important to abandon legacy rates if they no longer serve a legitimate purpose in a competitive telecommunications industry. For example, it eliminated Qwest's Carrier Common Line Charge ("CCLC") in favor of a more rational rate structure under which "rate elements have a direct bearing on the service provided."[19] According to the Commission, "[t]o allow the CCLC to continue to exist is to imply, inaccurately, that local exchange services require a 'subsidy' from toll."[20]

Q: WHAT IS THE CCLC?

A: When access charges were developed around the time of the AT&T Divestiture, the CCLC was created as a usage-based rate element to recover a portion of local loop costs, but this charge has been eliminated or significantly reduced for interstate access rates. As a result of Commission orders, Qwest and Verizon Northwest no longer have a CCLC rate element in their Washington intrastate access charges.

Q: IN 2003, AT&T FILED A COMPLAINT ALLEGING THAT VERIZON NORTHWEST'S ACCESS RATES VIOLATED WASHINGTON LAW. PLEASE DESCRIBE HOW THE COMMISSION EVALUATED THAT COMPLAINT.

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18 *See* Fifteenth Supplemental Order, *Wash. Util. & Trans. Comm'n v. U.S. West Comm.*, Docket No. UT-950200 (1996) ("Fifteenth Supplemental Order") at 112.

19 *Id.* at 113.

20 *Id.*

A: The Commission ordered Verizon Northwest to substantially reduce its intrastate switched access charges as a result of its investigation triggered by AT&T's complaint. The Commission observed that "competitive circumstances have changed radically" since Verizon Northwest's rates had previously been established, and stated that "we – and Verizon – must face the competitive realities of the 21st century and bring access charges more in line with current conditions."[21] The Commission found that:

> The excess 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 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 unjust, unfair, and unreasonable.[22]

Based on that analysis, the Commission concluded that "Verizon's access charge rates give an undue and unreasonable preference or advantage to itself, and that the charges at their present level subject the complainant to undue and unreasonable prejudice or competitive disadvantage."[23]

Q: HOW DID THE COMMISSION DETERMINE A REASONABLE SWITCHED ACCESS RATE FOR VERIZON NORTHWEST?

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[21] Eleventh Supplemental Order, Docket No. UT-020406, Order Sustaining Complaint, Directing Filing of Revised Access Charge Rates (issued Aug. 12, 2003) ("Eleventh Supplemental Order"), ¶ 39.

[22] *Id.* ¶ 48 (quoting testimony of Dr. Blackmon).

[23] *Id.* ¶ 49.

A: The Commission required Verizon Northwest to mirror Qwest's rates. It determined that "[r]educing access charges to the level of Qwest charges for comparable services will reduce the preference to Verizon and reduce the prejudice to interexchange carriers AT&T and WorldCom."[24] It also found that "[s]etting rates at Qwest's level is consistent with our authority in RCW 80.04.110 to set uniform rates to counter anticompetitive practices."[25] In other words, the Commission determined that applying a reasonable benchmark to a similarly situated competitor is an appropriate way to ensure compliance with Washington law.

Q: DOES A BENCHMARK APPROACH FOR EVALUATING AND SETTING INTRASTATE SWITCHED ACCESS CHARGES COMPORT WITH WHAT THE FCC HAS DONE?

A: Yes. For example, the FCC declined to conduct any cost proceedings before ordering the nation's largest ILECs (including Embarq and Verizon) to reduce their interstate switched access levels in the CALLS proceeding. It found that the public interest is better served by immediate access rate reductions to reasonable levels than trying to precisely determine costs.[26]

Q: AS A SUPPLIER OF LONG DISTANCE SERVICE, DOES EMBARQ BENEFIT FROM THE FACT THAT THE COMMISSION HAS

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24 *Id.* ¶ 162.

25 *Id.* ¶ 108.

26 *See CALLS Order*, ¶¶ 178, 84.

REDUCED THE INTRASTATE SWITCHED ACCESS RATES OF VERIZON NORTHWEST AND QWEST?

A: Yes. Embarq clearly benefits from the fact that Verizon Northwest and Qwest are required to charge more reasonable intrastate switched access rates in Washington. **BEGIN CONFIDENTIAL END CONFIDENTIAL** of Embarq's residential end users and **BEGIN CONFIDENTIAL END CONFIDENTIAL** of its business customers purchase long distance service from Embarq. Every time one of those long distance customers places a toll call to an end user in Qwest's or Verizon Northwest's service territory, Embarq pays significantly less than $0.02 per minute for the switched access termination functions Verizon Northwest or Qwest perform. If Verizon Northwest's or Qwest's terminating switched access rate were the same as Embarq's (**BEGIN CONFIDENTIAL END CONFIDENTIAL** per minute), Embarq's costs for terminating those telephone calls would be *millions* of dollars more annually. In fact, if Embarq were required to pay its own terminating switched access rate to Verizon Northwest and Qwest, Embarq would *lose money* whenever one of its long distance customers places a toll call to someone in Verizon Northwest's or Qwest's service territory.[27]

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[27] The average price per minute that Embarq's residential long distance customers paid for intrastate long distance calls in 2007 was **BEGIN CONFIDENTIAL END CONFIDENTIAL**, which is lower than Embarq's terminating switched access charge of **BEGIN CONFIDENTIAL END CONFIDENTIAL.** Embarq charges its business long distance customers an average of **BEGIN CONFIDENTIAL END CONFIDENTIAL** per minute for intrastate toll calls, which is slightly above Embarq's terminating switched access rate. But Embarq would still lose money on calls made by its business customers because it would also incur a charge for originating access – and Embarq's originating switched access rate is **BEGIN CONFIDENTIAL END CONFIDENTIAL** per minute. Also, this analysis does not take into

Unfortunately, while the Commission's actions to reduce Qwest's and Verizon Northwest's access rates helped Embarq become a vigorous and successful competitor in Washington's intrastate toll market, Embarq itself continues to charge unreasonable and anticompetitive rates.

IV. EMBARQ'S INTRASTATE SWITCHED ACCESS RATES

Q: PLEASE DESCRIBE THE HISTORY OF EMBARQ'S INTRASTATE SWITCHED ACCESS RATES IN WASHINGTON.

A: To my knowledge, the level of Embarq's intrastate switched access rates has not been reviewed in well over fifteen years. Embarq did restructure its access rates in 1998 to comply with WAC 480-120-540, but that restructuring was done on a revenue-neutral basis and did not include any analysis regarding the reasonableness of Embarq's rates. As indicated above in the references to Mr. Zawislak's testimony, the Commission Staff has for some time recognized that Embarq's access charges need to be examined and reduced, in order to comply with the legal standard set forth in the orders on the access charge complaints against Qwest and Verizon Northwest.

Q. WHAT EVIDENCE IS THERE THAT EMBARQ'S INTRASTATE ACCESS CHARGES ARE EXCESSIVE AND HARMFUL?

A. By any objective measure, Embarq's intrastate switched access rates are unreasonable. Because carriers have different rate structures, comparing their average access revenues per minute ("ARPM"), based on billings to Verizon, is a

account any costs other than access, such as retailing costs. Embarq's rates are discussed in more detail in the next section.

useful way to compare their access rates. The ARPM analysis takes into account all of the relevant access rate elements, so it provides a more "apples-to-apples" comparison than review of a single rate element. Embarq's ARPM in Washington is **BEGIN CONFIDENTIAL END CONFIDENTIAL** per minute, which is much higher than Verizon Northwest's ARPM of **BEGIN CONFIDENTIAL END CONFIDENTIAL.** It is also much higher than Qwest's ARPM, which is **BEGIN CONFIDENTIAL END CONFIDENTIAL.**[28]

The result is that Embarq collects *millions* of dollars more in intrastate switched access revenue than its competitors collect on similar volumes of traffic. Embarq's intrastate switched access revenues in 2007 were **BEGIN CONFIDENTIAL END CONFIDENTIAL**, and would have been roughly **BEGIN CONFIDENTIAL END CONFIDENTIAL** if Embarq were charging Verizon Northwest's intrastate switched access rate. That excessive recovery (over six million dollars annually more than the revenues that would be derived from Verizon Northwest's rate) is a direct transfer from carriers like Verizon to Embarq, and it gives Embarq a substantial artificial competitive advantage. Embarq's excessive switched access rates negatively affect competition in the long distance market. Every time a Verizon long distance customer in Washington places a telephone call to an end user in Embarq's service territory, Verizon must pay Embarq a terminating switched access charge of **BEGIN**

[28] All of the ARPMs provided here are based on Embarq's billings to Verizon for the year 2008.

CONFIDENTIAL END CONFIDENTIAL per minute.[29] That is greater than the *retail price* long distance carriers (including Embarq) charge for intrastate toll service in Washington.

And that is just Embarq's terminating switched access charges. IXCs must also pay originating switched access charges to Embarq, and Embarq's average price per minute for originating intrastate switched access is **BEGIN CONFIDENTIAL END CONFIDENTIAL.** For a toll call that both originates and terminates in Embarq's service territory, total access charges (originating plus terminating) are more than **BEGIN CONFIDENTIAL END CONFIDENTIAL** per minute. That is *twice* as high as the average *retail price* Embarq charges its own long distance customers when they make intrastate toll calls. In fact, the combination of Embarq's originating and terminating switched access charges for intrastate calls is significantly greater than the price Embarq offers its long distance customers for making *international* telephone calls.[30]

Such excessive intrastate switched access rates are patently unreasonable and anticompetitive.

Q: WHAT INTRASTATE SWITCHED ACCESS RATE IS REASONABLE FOR EMBARQ?

A: Verizon Northwest's intrastate switched access rates have received recent scrutiny and they have been determined to be just, reasonable, and pro-competitive under

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[29] This, and the originating rate discussed in the next paragraph, is Embarq's ARPM based on its 2008 billings to Verizon.

[30] *See* www.embarq.com/Residential/Voice/LongDistancePlans (offering subscribers to its long distance plans rates to Canada of $0.07 and rates to many European countries of $0.12).

Washington law. Verizon Northwest's intrastate switched access rates represent an appropriate benchmark for all large, sophisticated carriers in the state, including Embarq. Because Verizon's intrastate switched access charges have already been determined to be just and reasonable, mirroring them would remove Embarq's artificial competitive advantage. As discussed above, the FCC and state commissions, including this one, have relied on a benchmarking approach to determine appropriate levels for switched access rates.

Q: WHAT ABOUT QWEST'S INTRASTATE SWITCHED ACCESS RATE? IS THAT POTENTIALLY A REASONABLE BENCHMARK FOR EMBARQ?

A: Verizon Northwest's intrastate switched access rates have received more scrutiny, and more recent scrutiny, than have Qwest's. Although the Commission required Verizon Northwest to mirror Qwest's rate in 2003 in order to ensure that Verizon Northwest's rate was just and reasonable, Verizon Northwest's rates were subsequently investigated and reduced further.[31] The result is that Verizon Northwest's rate embodies contemporary reasonableness standards for Washington better than Qwest's, and therefore is the most appropriate benchmark.

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[31] Verizon Northwest eliminated its Interim Terminating Access Charge ("ITAC") pursuant to a settlement agreement entered into in 2005. Qwest, however, continues to charge an Interim Universal Service Support Fund Surcharge on terminating traffic of $0.015891, which causes Qwest's overall rate to be greater than Verizon Northwest's. Indeed, Verizon Northwest eliminated its ITAC despite the fact that its loop costs were estimated to be about $6.31 per month higher than Qwest's loop costs. *See* Tenth Supplemental Order, Order Establishing Costs, *In the Matter of Determining Costs for Universal Service*, Docket No. UT-9803119(a) (Nov. 20, 1998), App. A. I am not aware of any rationale why Qwest's intrastate switched access rates should be higher than Verizon Northwest's.

Q. HOW DO EMBARQ'S OWN SWITCHED ACCESS RATES FOR *INTERSTATE* TRAFFIC COMPARE TO ITS INTRASTATE ACCESS RATES IN WASHINGTON?

A. Embarq's rates for interstate switched access services are much lower than the benchmark Verizon advocates.[32] Embarq's overall interstate switched access rate is **BEGIN CONFIDENTIAL END CONFIDENTIAL** per minute, which is 48.9% lower than Verizon Northwest's overall intrastate switched access rate. That fact constitutes a useful "reality check" for the Commission: It makes clear that there is no danger that requiring Embarq to mirror Verizon's intrastate rate could result in a below-cost rate for Embarq. Embarq will clearly be able to continue to earn a contribution from its intrastate switched access rates in Washington – but it will be the same *reasonable* contribution that Verizon is authorized to earn.

Q. PLEASE DESCRIBE THE MAJOR ELEMENTS OF EMBARQ'S INTRASTATE SWITCHED ACCESS RATES AND DISCUSS HOW THE PROPOSED BENCHMARK WOULD WORK.

A: The largest element in Embarq's intrastate switched access tariff is its **Interim USF Additive** for terminating traffic, which is $0.064851.[33] Verizon Northwest eliminated its comparable charge pursuant to a 2005 settlement with Commission Staff and other parties. Qwest still has a similar (but much lower) charge of

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32 The switching and network functions required to terminate a call from another carrier's network to a local customer generally do not vary based on the type of traffic nor the type of carrier it is received from.

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

$0.015891.[34] As discussed above, the purpose of the Interim USF Additive was to ensure that carrier revenues were kept whole until the Commission turned to comprehensive switched access reform. Verizon Northwest's comparable charge was eliminated without waiting for such comprehensive reform, with the Staff taking the position that there was no universal service justification for the charge.[35] Embarq's Interim USF Additive should similarly be eliminated (or possibly, as an interim measure, reduced to the Qwest level of $0.015891) because Embarq – like Verizon Northwest – cannot claim a need for special protections and cannot seriously claim that the Commission would need to establish a universal service fund so that Embarq can recoup its lost revenue.[36] I discuss Embarq's universal service arguments in more detail in the next section.

Embarq has a **Carrier Common Line Charge ("CCLC")** of $0.01 per minute for originating traffic.[37] As noted earlier, neither Qwest nor Verizon Northwest assesses a CCLC because the Commission has found that such charges are inconsistent with its policy that "rate elements have a direct bearing on the

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[34] Qwest Access Tariff (WN U-44), § 6.8.2 (A)(1) ("Interim Universal Service Support Fund Surcharge").

[35] *See* Narrative Supporting Settlement Agreement, *Wash. Util. & Trans. Comm'n v. Verizon Northwest*, Docket No. UT-040520 (February 2005), at 11. The narrative stated that "Staff's proposed testimony shows that the charge is not justified based on universal service objectives, which is the only basis upon which a rate element of this type can be justified." *Id.*

[36] As discussed above, Commission Staff has confirmed that Embarq has no universal service justification for keeping this rate at $0.064851, and recommended reducing it to $0.022626. *See* Testimony of Timothy W. Zawislak, Docket No. 051291 (filed November 30, 2005) at 12-14. While Mr. Zawislak's recommended rate (or Qwest's rate) may be appropriate as an interim measure, there is no reason for Embarq to charge more than Verizon Northwest.

[37] *See* Embarq Access Tariff (WN U-9), § 3.8(A). All rates discussed herein are for premium traffic, which is traffic generated via traditional 1+ dialing. Premium traffic makes up the vast majority of interexchange voice traffic.

services provided." *See* Fifteenth Supplemental Order at 113. Embarq should similarly be required to eliminate its CCLC, as the Commission Staff recommended years ago.

Embarq's **local switching rate** for originating traffic is $0.020740.[38] Qwest's comparable rate is $0.014441,[39] and Verizon Northwest's is $0.0158172.[40] There is no justification for Embarq to receive a contribution from its switching charges that is greater than what Verizon and Qwest already receive, so its local switching rate should mirror Verizon's or Qwest's. Mr. Zawislak reached the same conclusion in 2005 when he recommended that Embarq's originating local switching rate be reduced to Verizon's level based on the reasonableness framework the Commission had previously adoped in *AT&T v. Verizon Northwest*."[41]

Embarq also charges a **common transport multiplexing** rate of $0.001055 per minute.[42] Verizon Northwest does not have a comparable rate element, and Qwest's comparable rate is $0.000198.[43] Embarq should be permitted to continue charging this rate element (as well as other minor rate elements in its access tariff) as long as it is providing the function.

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38 *Id.*, § 6.8.3.

39 Qwest Access Tariff (WN U-44), § 6.8.2 (A)(1).

40 Verizon Northwest Access Tariff (WN U-16), § 4.6.3.

41 *See* Testimony of Timothy W. Zawislak, Docket No. 051291 (filed November 30, 2005) at 10-11.

42 Embarq Access Tariff (WN U-9), § 6.8.2 (C)(3).

43 Qwest Access Tariff, §6.8.1.

The benchmark rate should be determined by calculating the composite of the Verizon Northwest intrastate switched access rate elements for the functions that Embarq actually performs in providing its switched access service.

Q. EMBARQ CLAIMED IN ITS MOTION TO DISMISS THAT IT SHOULD NOT BE PLACED IN THE SAME CATEGORY AS QWEST AND VERIZON. IS THAT TRUE?

A. No. As an initial matter, there is no basis for distinguishing among groups of carriers for purposes of following the legislative mandate to promote competition by removing excess levels of contribution or profit. In any event, Embarq is a sizeable, sophisticated, and well-financed competitor that cannot credibly claim any need for special protection. Neither the Commission nor the FCC considers Embarq to be a rural telephone company in Washington, and neither the Commission nor the FCC categorizes Embarq as a small telephone company.

Embarq is a large, sophisticated telephone company that can and does compete with Verizon and Qwest in Washington's telecommunications market, and it is growing larger with the pending merger with CenturyTel:

> Combined, CenturyTel and EMBARQ will have an operating presence in 33 states, approximately eight million access lines, two million broadband customers and approximately 400,000 video subscribers.
>
> ...
>
> This transaction is expected to deliver immediate value and provide significant growth potential via a combined company that is better positioned to compete and win in an increasingly competitive marketplace. Together, CenturyTel and EMBARQ are

> creating one of the leading communications companies in the United States.[44]

Embarq's parent, which was spun off from Sprint Nextel in 2006, owned 5.7 million access lines at the end of 2008 and is included in the S&P 500. *See* News Release, "Embarq Reports Fourth Quarter and Full-Year 2008 Results," dated February 12, 2009 (*available at* <http://investors.embarq.com/>). It trades on the New York Stock Exchange, reporting 2008 revenues of $6.12 billion and operating income of $1.63 billion. *Id.* Embarq highlighted its "...record cash flow before dividends. Although the company reported lower revenue, the decline was more than offset by expense improvements and capital efficiency." *Id.* Embarq's total revenue for 2008 declined 3.8% from 2007, but its 2008 operating income increased 8.6% from 2007. *Id.* On its Fourth Quarter 2008 earnings conference call (February 12, 2009), Embarq's Chief Financial Officer, Gene Betts, noted, "Whether you look at operating income, operating margin, or earnings per share, there has been marked improvement from prior years."[45]

Embarq states that "We provide a suite of integrated communications services including local and long distance voice, data, high-speed Internet, satellite video, professional services and communications equipment to consumer and business customers located primarily in our local service territories. We also provide wholesale local network access and other communications services primarily to wireline and wireless service providers. Through our Logistics

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44 http://www.centurytelembarqmerger.com/index.cfm (accessed February 13, 2009).

45 http://seekingalpha.com/article/120386-embarq-corporation-q4-2008-earnings-call-transcript?page=-1 (accessed February 13, 2009).

segment, we provide wholesale product distribution, logistics and configuration services." *See* Embarq 2008 Annual Report (Form 10-K) at Part I (filed February 13, 2009). According to a high-level Embarq executive, marketing that suite of products to its existing customers permits Embarq to achieve "increased average revenue per household (ARPH) and better profitability per household." *See* Movers & Shakers Interview with Harry Campbell, President Consumer Markets, Embarq (*available at* <www2.embarq.com/companyinfo> ("Frost & Sullivan" link)). Embarq states that "At the end of 2008 over 81% of our access lines were capable of providing high-speed Internet service to our customers."[46] Embarq concludes that "Despite the various challenges facing our business, our numerous strengths such as our established customer relationships, existing network architecture, extensive product and service expertise and wide array of bundled offerings, are helping us to mitigate access line losses."[47]

Thus, by its own account, Embarq is thriving, meeting competitive pressures and customer demand for a wide range of services, including long distance service. It is appropriate to apply to Embarq the same reasonableness standards that the Commission has established for Verizon Northwest.

V. EMBARQ'S PROVIDER OF LAST RESORT OBLIGATIONS AND ITS RIGHTS AS A RATE OF RETURN CARRIER

46 *See* Embarq 2008 Annual Report (Form 10-K) at 6 (filed February 13, 2009).

47 *Id.* at 8.

Q: EMBARQ'S MOTION TO DISMISS SOUGHT TO JUSTIFY ITS SWITCHED ACCESS RATES BY ARGUING THAT ITS EXCHANGES ARE LOWER-DENSITY THAN VERIZON'S AND QWEST'S, AND THAT ITS LOOP COSTS ARE HIGHER. PLEASE RESPOND.

A: It makes no sense for Embarq to isolate a single cost (loop costs) and to point to it as a justification for a higher intrastate switched access rate. First, Embarq receives over a million and a half dollars annually in federal universal service funding, which is specifically designed to compensate Embarq for its higher-cost exchanges. Any analysis of Embarq's universal service obligations must take into account the substantial federal support that is dedicated to ensuring universal service. Moreover, if Embarq wants to argue that a contribution from intrastate switched access subsidizes its costs for providing local service, it would need to demonstrate that its *overall* revenue from all regulated services does not cover its costs for all such services; focusing on just loop costs makes no sense.

Q: IF EMBARQ DEMONSTRATES THE NEED FOR A CONTRIBUTION FLOW FROM INTRASTATE SWITCHED ACCESS SERVICES TO LOCAL EXCHANGE SERVICE, HOW SHOULD THE COMMISSION PROCEED?

A: Of course, it should not be presupposed that such a contribution flow exists. However, to the extent Embarq can make such a factual showing, the Commission presumably will permit Embarq to seek increases in other rates. One possibility may be for Embarq to recover more of its costs from its own end users, as

Verizon and Qwest must already do. The possibility of rebalancing would not raise any affordability concerns given that Embarq's retail rates are quite low – only $8.90 or $9.40 per month for residential customers.[48]

VI. COMPLAINT PROCEEDINGS AGAINST EMBARQ IN OTHER STATES

Q: HAVE OTHER STATE COMMISSIONS ACTED TO ENSURE THAT EMBARQ'S INTRASTATE SWITCHED ACCESS RATES DO NOT GIVE EMBARQ AN UNDUE COMPETITIVE ADVANTAGE OVER ITS COMPETITORS?

A: Yes. Several state commissions have required Embarq to play by the same rules as the other large, sophisticated ILECs in the state. For example, the Ohio Commission determined that the state's four largest ILECS (Embarq, AT&T, Verizon, and Cincinnati Bell Telephone Company) should all be required to mirror their interstate rates – which resulted in each carrier charging a very similar intrastate rate.[49] The Ohio Commission determined that creating a level playing field would be "procompetitive" and would "place competitors in the long distance market on more equal footing."[50]

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48 *See* Schedule AE-1 of Embarq's local tariff (WN U-3), Original Sheet 6. Even including the EAS charges Embarq is authorized to assess on its retail customers, Embarq's retail rates in Washington are substantially lower than Verizon Northwest's.

49 *See* Opinion and Order, In the Matter of the Commission's Investigation Into the Modification of Intrastate Access Charges, Case No. 00-127-TP-COI (Ohio Pub. Util. Comm'n issued June 12, 2000). Embarq's interstate switched access rate is similar to the interstate switched access rates of other large ILECS in Ohio because Embarq's interstate switched access rate was established in the same FCC proceeding. *See* CALLS Order (establishing interstate switched access rates for the country's largest ILECs, including Embarq).

50 *Id.* at 13.

In some states, Embarq's ILECs – like Embarq in Washington – have managed for many years to avoid scrutiny of their intrastate switched access charges. But that is in the process of being remedied. For example, the Virginia Commission, having reduced Verizon's ILEC affiliate's access charges in 2004, is poised to issue a final order in a complaint proceeding regarding the switched access rates of Embarq.[51] In that proceeding, the Hearing Examiner has issued a report recommending that the Virginia Commission require Embarq to mirror its own interstate switched access rate.[52] Notably, Embarq made the same arguments in Virginia that it made in its motion to dismiss here – and the Hearing Examiner considered and rejected every one of them.[53]

Also, last year both the Minnesota Commission and the Kansas Commission decided to go forward with switched access complaints filed against

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[51] *Petition of Sprint Nextel for reductions in the intrastate carrier access rates of Central Telephone*, Case No. PUC-2007-00108 (Va. State Corp. Comm'n filed Nov. 7, 2007). That access charge proceeding has been fully briefed and is awaiting a final commission decision.

[52] See Report of Alexander F. Skirpan, Jr., Senior Hearing Examiner, *Petition of Sprint Nextel for reductions in the intrastate carrier access rates of Central Telephone*, Case No. PUC-2007-00108 (Va. State Corp. Comm'n issued Jan. 28, 2009).

[53] *Id.* at 25-26 (rejecting Embarq's argument that universal service would be jeopardized if its access rates are reduced), 26-27 (rejecting Embarq's argument that the Commission's precedent reducing Verizon's intrastate switched access rates is irrelevant to establishing a reasonable rate for Embarq); 27-28 (rejecting Embarq's argument that there was no evidence that reducing its intrastate switched access rates would increase efficiency and competition); 37-38 (rejecting Embarq's argument that it must be permitted to recoup its lost revenue through a state universal service fund), & 38 (rejecting Embarq's argument that the Commission should wait and see if the FCC takes action that would affect Embarq's intrastate switched access rates).

Embarq.[54] The Kansas Commission recently indicated that it will "comprehensively explore the access charge issue" and noted that "a 'level playing field,' and making implicit subsidies explicit, is of importance to the growth of competition."[55]

Q: WHAT DO THESE PROCEEDINGS SAY ABOUT EMBARQ'S ARGUMENT (*SEE* MOTION TO DISMISS AT 10-11) THAT ITS ACCESS RATES SHOULD ONLY BE REDUCED AS PART OF A COMPREHENSIVE REFORM PROCEEDING?

A: While every state is different, it is noteworthy that all of the cases above involve complaints or petitions filed against Embarq by other telephone companies seeking a level playing field. What each of these state commissions has recognized is that large carriers like Embarq distort the playing field more than the smaller "mom and pop" carriers that are often dealt with in comprehensive reform proceedings. Also, the Commission did not wait for comprehensive reform to lower the access charges of Qwest and Verizon Northwest, and there is no reason to exempt Embarq from a similar review and reform. Accordingly, it is both efficient and good public policy to promptly remedy – in a targeted manner – the major economic distortions created by larger carriers like Embarq. Complaint

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[54] *See* Order Serving Complaint, Requiring Answer, and Authorizing Comments, In the Matter of Verizon's Verified Complaint to Reduce the Intrastate Switched Access Charges of Embarq Minnesota, Inc., Docket No. P-3012 (Minn. Pub. Util. Comm'n issued March 10, 2008); Order Opening General Investigation and Denying Motion to Dismiss, *Petition of Sprint Communications Company et al. to conduct general investigation into the intrastate access charges of United Telephone Company of Kansas et al.*, Docket No. 08-GIMT-1023-GIT (Kan. Corp. Comm'n issued Oct. 10, 2008).

[55] *Id.* at 14, 18.

proceedings like this one are efficient vehicles for addressing the state's most pressing access problems, while the special considerations sometimes raised by small rural ILECs can be addressed at a later time.

VIII. CONCLUSION

Q. PLEASE SUMMARIZE YOUR TESTIMONY.

A. Reduction of Embarq's intrastate switched access rates is long overdue. The overall level of Embarq's intrastate switched access rates has not changed in over 15 years, despite substantial reductions in the intrastate switched access rates of its competitors and Embarq's own success in providing long distance service to its own end users. The law requires the Commission to promote competition by ensuring a level playing field and by removing excessive contribution from ILEC rate structures, as it has already done to Verizon Northwest, and, to a lesser extent, to Qwest. In this testimony, I have shown that Embarq's rates are, by any objective measure, unjust, unreasonable, and anticompetitive. The Commission cannot, consistent with its mandates to protect ratepayers (including carriers) from unreasonable rates and to protect competitors from undue prejudices, leave Embarq's access rates where they are now. It should order Embarq to mirror Verizon Northwest's intrastate access rates. This is a sensible, efficient, and conservative measure that would put the group of large Washington ILECs on more even footing and that would still yield intrastate access rates that are significantly higher than Embarq's own interstate access rates.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.