BEFORE THE

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

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

DIRECT TESTIMONY OF

ORVILLE D. FULP

ON BEHALF OF
VERIZON NORTHWEST INC.

DECEMBER 3, 2002

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Orville D. Fulp. My business address is 600 Hidden Ridge Drive, Irving, Texas 75038.

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

A. I am employed by Verizon as Director-Regulatory and my responsibilities include national public policy and pricing matters. I am testifying on behalf of Verizon Northwest Inc. ("Verizon" or "Company").

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND WORK EXPERIENCE.

A. I have a Bachelor of Arts degree in Economics from the University of California, San Diego, and a Master of Science degree in Economics from the University of Wyoming. In 1981, I began working at the Illinois Commerce Commission in the Economics and Rates Department as Senior Economist, where I analyzed filings and testified in utility rate proceedings in the areas of pricing, cost of service, and demand analysis. In January of 1984 I transferred to the Policy Analysis and Research Division as Director of the Pricing Program. My responsibilities included developing policy concerning pricing in the telecommunications and energy fields. In 1985 I joined Contel as Manager-Revenue Requirements/Pricing for the company's eastern region, and was responsible for rate case activity, tariff maintenance, surveillance of regulatory activities, and pricing of local exchange, toll and access services in six states. In 1991, I became a Manager-Access Pricing for GTE Telephone Operations, and was responsible for the development of access pricing plans and rates for interstate and intrastate purposes in 40 states. Since that time I have held various positions in GTE and Verizon involving pricing and product management and operations. In December 2001, I assumed my current position.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. My testimony, together with the testimony of other Verizon witnesses, responds to the complaint filed by AT&T Communications of the Northwest Inc. (AT&T) against Verizon's intrastate access charges and to the pre-filed testimony of AT&T and Commission Staff.

Verizon's testimony addresses four fundamental points:

First and foremost, we explain that the Commission cannot reduce Verizon's access charges in this docket unless it allows Verizon to make revenue-neutral increases to other rates at the same time.

Second, we explain that Verizon's current access charges are not anti-competitive and do not result in a price-squeeze, and that Verizon's long-distance services satisfy the Commission's imputation test. Accordingly, we conclude that the Commission does not need to make any changes to Verizon's current access charges.

Third, we explain why Staff witness Dr. Blackmon is wrong in suggesting that Verizon's costs and charges should be the same as Qwest's. We also explain that Dr. Blackmon's claim that Verizon's access charges are "unjust and unreasonable" is simply wrong and, in fact, conflicts with Commission findings in other dockets.

Fourth, we explain that if the Commission chooses to reduce Verizon's access charges in response to AT&T's complaint, it must allow the Company to recover its lost revenues through increases in basic residential rates. Let me be clear: Verizon is not proposing access charge reductions or local rate increases at this time; rather, we explain that if the Commission decides to reduce access charges, then it must allow Verizon to increase residential rates. In addressing this point, we also explain why Dr. Blackmon's proposal to offset reductions with a per minute-of-use (MOU) adder to Verizon's customers' long-distance services is anti-competitive, violates fundamental principles of economics, and contradicts Dr. Blackmon's own policy positions in this case.

Q. HOW IS YOUR TESTIMONY ORGANIZED?

A. My testimony is divided into four parts:

Part I provides the background relevant to this case; for example, it explains how the Commission has regulated Verizon and how the Commission itself established and approved the very rates that AT&T and Staff now claim are unlawful, unjust and unreasonable. It also explains why, in light of the Commission's rate of return regulation, Verizon must be allowed to make revenue-neutral increases in other rates if access charges are reduced.

Part II summarizes Verizon's responses to every material point raised by AT&T and Staff in their direct testimonies, and identifies the specific Verizon witnesses that support each response. This part of my testimony is intended to provide a "roadmap" to the Commission that summarizes the issues presented.

In Part III, I address Staff's unsupported claim that Verizon and Qwest should have similar costs and rates.

Finally, Part IV presents Verizon's proposal to (a) restructure its access charges and (b) increase basic residential rates, should the Commission choose to reduce Verizon's access charges. I also propose a schedule for accomplishing these rate changes.

PART I – BACKGROUND

Q. PLEASE DESCRIBE HOW THE COMMISSION HAS REGULATED VERIZON.

A. The Commission has regulated Verizon under rate-of-return regulation to accomplish two things: (1) ensure customers receive quality service at a reasonable price, and (2) ensure Verizon has an opportunity to recover its costs and earn a reasonable return on its reasonable investment. The Commission's own web page, in the section entitled "What We Do," makes this very point:

> By law, the Commission must set rates that are fair, just, reasonable, and sufficient. This means that the Commission must balance the interest of customers, in receiving service at the lowest cost against that of investors, who have an opportunity to earn a rate of return on their reasonable investment used in providing service.

Verizon's Commissioned-authorized rate of return is 9.76%, and neither the complaint nor AT&T's and Staff's testimonies seek to change this.

Q. PLEASE SUMMARIZE THE MOST RECENT CASE IN WHICH THE COMMISSION FOUND VERIZON'S INTRASTATE ACCESS CHARGES TO BE JUST AND REASONABLE PURSUANT TO THIS STANDARD.

A. In late 1999, the Commission issued its order approving the Bell Atlantic-GTE merger (the "Merger Order").[1] That order resolved a number of matters, including Staff's investigation of Verizon's earnings and the Commission's access charge complaint against Verizon. In that order, the Commission approved a settlement that reduced Verizon's intrastate access charges and intrastate toll rates. The Commission found that the resulting access charges were "just, reasonable, and compensatory" (p. 24) and that "the agreed adjustments to [Verizon's] revenues produce fair, just, and compensatory rates and charges for terminating access and other services" (p. 25). Indeed, on page 27 of its Merger Order, the Commission made a specific finding of fact (Finding of Fact #6) that "the proposed adjustment to revenues produces charges for terminating access that are just, reasonable, compensatory, and neither unduly preferential nor discriminatory." And on the very next page, the Commission reached a specific conclusion of law (Conclusion of Law #5) that the resulting rates and charges "do not violate any provisions of law."

[1] Docket No. UT-981367 etc.

Pursuant to the Merger Order, Verizon made compliance rate change filings in 2000 and 2001, all of which were accepted by the Commission. Verizon's current rates are those that resulted from the Merger Order. These are the very rates that Staff and AT&T now claim are "unlawful," "unjust," and "unreasonable."

Q. STAFF AND AT&T, HOWEVER, POINT OUT THAT UNDER THE MERGER AGREEMENT ANY PARTY CAN CHALLENGE VERIZON'S RATES OR EARNINGS AFTER JULY 1, 2002, AND THEREFORE THEY ARE NOT PRECLUDED FROM MAKING THEIR CLAIMS. PLEASE COMMENT.

A. This argument is irrelevant, and here's why: Every claim made by AT&T and Staff in this docket – e.g., Verizon's current access charges are not just and reasonable and Verizon's toll rates are anti-competitive, result in a price-squeeze, fail imputation, etc. – could have been made (and applied with equal force) before the Commission issued its Merger Order. Indeed, at that time, Verizon's access charges were $7 million higher than they are today. Thus, if Verizon's current access charges are, as AT&T and Staff claim, unjust and unreasonable, then Verizon's access charges at the time of the Merger Order also had to have been unjust and unreasonable. But as I just explained, the Commission rejected this position and specifically found as a matter of fact, and held as a matter of law, that Verizon's access and toll charges are just, reasonable, and lawful.

Q. DID THE MERGER ORDER ADDRESS VERIZON'S EARNINGS?

A. Yes. Under the Merger Order, Staff and Public Counsel could not contest earnings until after July 1, 2002. Staff's testimony in this case does not address Verizon's earnings.

Q. HAS VERIZON PRESENTED EVIDENCE OF ITS CURRENT EARNINGS?

A. Yes. Verizon witness Nancy Heuring explains that Verizon's current rate-of-return (ROR) as of September 2002, calculated using Commission basis-prescribed inputs and adjustments is only 2.84%. She shows that if Verizon's revenues are decreased by $32 million with no offset, the resulting return drops to 0.73%. Her testimony also sets forth Verizon's intrastate return calculated to reflect actual market conditions including the ROR provided by Dr. Vander Weide in his testimony. This calculation produces a current intrastate return of negative 3.13%. Obviously, reducing Verizon's revenues by $32 million drops this return even more.

Q. IS VERIZON ASKING THE COMMISSION TO CHANGE ITS AUTHORIZED ROR IN THIS CASE?

A. No. Verizon is not asking the Commission to change its overall authorized ROR at this time.

Q. WHAT CONCLUSIONS DO YOU DRAW FROM YOUR ANALYSIS AND FROM MS. HEURING'S CALCULATIONS?

A. I draw two principal conclusions. First, Verizon's current access charges are just, reasonable, and compensatory and need not be changed. Second, if the Commission chooses to reduce Verizon's access charges, then it must permit Verizon to make simultaneous increases to local residential rates on a revenue-neutral basis. If it does not, it would violate its stated obligation of affording Verizon an opportunity to earn a reasonable rate of return on its investment. (Verizon witness Carl Danner explains this point in greater detail.)

Below, I present Verizon's proposal for revenue-neutral offsets should the Commission choose to reduce our access charges. But first I present Verizon's responses to the various points made by AT&T and Staff.

PART II – VERIZON'S RESPONSES TO AT&T AND STAFF

Q. PLEASE SUMMARIZE THE PRINCIPAL POINTS MADE BY AT&T AND STAFF IN THEIR TESTIMONIES, AND PLEASE IDENTIFY THE VERIZON WITNESSES THAT RESPOND TO EACH POINT.

A. AT&T has proffered the testimony of one witness, Dr. Lee L. Selwyn, who makes two principal points:

(1) AT&T claims that Verizon's current access charges are "anti-competitive" and create a price-squeeze (Selwyn, pp. 18-28). As I discussed earlier, the Commission's findings of fact and conclusions of law in the Merger Order contradict these points. In any event, Verizon witness Carl Danner explains that Verizon's charges are not anti-competitive and do not create a price squeeze, and in doing so he points out the fundamental flaws in Dr. Selwyn's analysis.

(2) AT&T claims that Verizon's intraLATA toll rates fail an imputation (i.e., price floor) test (Selwyn, pp. 28-50). Verizon witness Terry Dye presents an Imputation Study that proves Verizon's toll rates pass the Commission's imputation test. Mr. Dye also points out the errors in Dr. Selwyn's imputation analysis. Finally, Dr. Danner explains that he reviewed Verizon's study and concluded that it reflected the proper economic principles.

Staff makes four principal points:

(1) Staff witness Timothy Zawislak claims that Verizon's Interim Terminating Access Charge (ITAC) should be reduced by more than one-third (pp. 2-4). Mr. Dye explains that Mr. Zawislak's calculation includes a significant error, and that a corrected calculation shows that Verizon's ITAC should be increased.

(2) Staff witness Glenn Blackmon claims that Verizon's current access charges are not "fair, just, and reasonable" and should be reduced by $32 million (pp. 2, 7). Again, as I discussed earlier, Dr. Blackmon's opinion cannot be reconciled with the Commission's findings of fact and conclusions of law in the Merger Order. Dr. Danner also addresses this point.

(3) Dr. Blackmon claims that "there are no plausible reasons why Verizon's access charges should be significantly above those of Qwest" (p. 4), and suggests that Verizon and Qwest are "similar companies that could be expected to have similar costs" (p. 8). I address this point below, and Dr. Danner also addresses it in his testimony. We explain

how and why the Commission set Verizon's access charges above Qwest's, and we explain why a company that serves about 900,000 access lines in predominantly low-density rural and suburban areas will not have the same costs and rates as a company that serves almost 3.5 million lines in predominantly high-density urban areas.

(4) Finally, Dr. Blackmon proposes that if Verizon is allowed to offset any access reductions by increases to other rates, it should impose a per MOU "retail switched access charge" upon its local exchange customers whenever they make an intrastate long distance call (pp.8-9). Dr. Danner explains why this proposal is economically unsound, anti-competitive, and inconsistent with other portions of Dr. Blackmon's own testimony. In contrast, Dr. Danner explains why Verizon's offset proposal if the Commission chooses to reduce access – which is described later in my testimony – is the correct one. In addressing Verizon's offset proposal, Dr. Danner and I explain why Dr. Blackmon is simply wrong when he states that the cost of the local loop in not an incremental cost of basic service and why, in any event, Verizon's rate design proposal is the correct one.

Q. DR. SELWYN ALSO CLAIMS THAT CERTAIN VERIZON LONG DISTANCE (VLD) TOLL PLANS FAIL IMPUTATION. PLEASE RESPOND.

A. Here, too, Dr. Selwyn is wrong. First, though, VLD is a separate affiliate of Verizon, and AT&T has not brought a complaint against VLD. In fact, AT&T's complaint specifically states (p. 1) that it is brought only against Verizon. If AT&T wishes to pursue a claim against VLD, it should do so. Verizon will address this point further in its briefs. Moreover, as Verizon explained in earlier pleadings, VLD is not subject to any imputation test. Also Dr. Selwyn's analysis for VLD assumes, incorrectly, that VLD, even if it were subject to an imputation test, has the same price floor as Verizon. Again, though, VLD is not appearing in this case because it is not a party.

PART III – COMPARING QWEST AND VERIZON

Q. DR. BLACKMON STATES THAT "THERE ARE NO PLAUSIBLE REASONS WHY VERIZON'S ACCESS CHARGES SHOULD BE SIGNIFICANTLY ABOVE THOSE OF QWEST" (P. 4), AND SUGGESTS THAT VERIZON AND QWEST ARE "SIMILAR COMPANIES THAT COULD BE EXPECTED TO HAVE SIMILAR COSTS" (P. 8). IS HE CORRECT?

A. No, he is not correct. Dr. Blackmon appears to be saying that a company that serves about 900,000 access lines in predominantly low-density rural and suburban areas should have the same costs and rates as a company that serves almost 3.5 million lines in predominantly high-density urban areas, once you adjust for universal service support.

The obvious reason Verizon's and Qwest's access charges differ is because the Commission made them that way. It did so though company-specific proceedings in which the Commission as its web site says, "set rates that are fair, just, reasonable, and sufficient" in view of the companies' different revenue requirements and that balance the interest of customers against that of investors. However, even if it accurately compensates for high-cost areas, the Commission's ITAC mechanism only provides support related to 8 percent of the access lines that Verizon and Qwest serve in

Washington; the remaining 92 percent of lines are not supported, and Verizon's costs for its share of those lines are higher than Qwest's.[2] Thus, Dr. Blackmon's assertion is incorrect.

The Commission's company-specific approach to rate-setting is illustrated in previous cases. For example, in 1995, the Commission significantly reduced Qwest's (then U S WEST) access rates because it held Qwest was over-earning (Docket UT-950200), but in 1998 the Commission allowed Qwest to increase its residential rates by $2 per month because Qwest was under-earning (Docket UT-970766). Similarly, the Commission's 1999 Merger Order, which I mentioned above, approved rate adjustments to implement a $30 million reduction in Verizon's revenues. It reduced intrastate access charges and toll rates as well as business local service and other rates. It also effectively reduced residential local service rates by a significant amount by eliminating Extended Area Service (EAS) adders. The Commission found that the resulting rates - including access charges - were "just, reasonable, and compensatory" (p. 24) and that "the agreed adjustments to [Verizon's] revenues produce fair, just, and compensatory rates and charges for terminating access and other services" (p. 25). Verizon's current rates are those that resulted from the Merger Order.

In sum, this Commission, like other state commissions, has traditionally set rates on a company-specific basis to address company-specific concerns, and this approach – which

[2] Promoting competition and reforming Universal Service, a report to the Washington State Legislature, November 1998.

evidenced by the Commission's prior rulings – certainly provides a "plausible reason" for the differences in Verizon's and Qwest's rates.

Q. IS THERE ANY OTHER EVIDENCE THAT VERIZON AND QWEST HAVE DIFFERENT COSTS THAT WOULD LEAD TO DIFFERENT RATES AND DIFFERENT REVENUE REQUIREMENTS?

A. Yes. In fact, the Commission itself used a cost study to calculate the alleged forward-looking cost of providing service, and this study shows significant differences in cost between Verizon's service territory and Qwest's service territory.

Specifically, the Commission, in its universal service investigation (Docket UT-980311(a)), estimated the alleged forward-looking cost of providing basic service using HAI 5.0a and BCPM 3.1 cost models. Verizon does not agree with these models or their results, but the Commission relied on them, and their results show that Qwest and Verizon serve different types of areas with dramatically different costs. Table 1 also illustrates the differences between Qwest's and Verizon's access line density/square mile:

Table 1
Density Characteristics

Qwest (WA) and Verizon (Northwest)
Summary

Size of Switched Entry (Number of Switched Lines)	Number of Switches		Number of Switched Lines		Percent of Lines	
	Qwest	*Verizon*	*Qwest*	*Verizon*	*Qwest*	*Verizon*
Greater than 85K	3	0	275,463	-	8.1%	0.0%
60K-85K	6	4	424,532	301,829	12.4%	32.5%
30K-60K	8	6	355,062	214,902	10.4%	23.1%
25K-30K	34	2	1,926,453	53,788	56.4%	5.8%
20K-25K	4	4	87,835	92,565	2.6%	10.0%
15K-20K	7	4	126,659	70,742	3.7%	7.6%
10K-15K	6	5	74,351	67,800	2.2%	7.3%
5K-10K	10	13	67,767	83,068	2.0%	8.9%
3K-5K	11	5	41,074	20,739	1.2%	2.2%
2K-3K	8	1	21,545	2,626	0.6%	0.3%
1K-2K	8	7	11,473	10,371	0.3%	1.1%
Less than 1000	5	20	3,224	10,481	0.1%	1.1%
Total	**110**	**71**	**3,415,438**	**928,911**		
Average Switched Lines			**31,049**	**13,083**		

Data Source: FCC's HCPM/HAI Synthesis Model Version 2.6 Released January 10, 2000 (Qwest and Verizon Northwest –1998 Line Data)

Density Of Serving Areas

Density of Central Office Area (Switched Lines per Sq. Mile)	Number of Switches		Number of Switched Lines		Percent of Lines	
	Qwest	*Verizon*	*Qwest*	*Verizon*	*Qwest*	*Verizon*
Greater than 1000	34	10	2,106,564	499,932	61.7%	53.8%
800-1000	2	1	141,342	23,785	4.1%	2.6%
600-800	4	0	178,062	-	5.2%	0.0%
400-600	7	4	381,544	91,408	11.2%	9.8%
300-400	1	4	12,382	58,057	0.4%	6.3%
200-300	11	5	243,309	81,504	7.1%	8.8%
100-200	14	10	202,929	98,294	5.9%	10.6%
Less than 100	37	37	149,306	75,931	4.4%	8.2%
Total	**110**	**71**	**3,415,438**	**928,911**		
Average Switched Lines/Sq Mile			**387.65**	**205.66**		

Data Source: FCC's HCPM/HAI Synthesis Model Version 2.6 Released January 10, 2000 (Qwest and Verizon Northwest -1998 Line Data)

To summarize, Table 1 shows that 87.3% of Qwest's lines are served by switches that handle 25,000 or more lines; whereas only 61.4% of Verizon's lines are served by such switches. This Table also shows that the average density of switched lines per square mile in Qwest's territory is 88% higher than the average density in Verizon's territory.

Not surprisingly, these density characteristics significantly affect cost. For example, according to the Commission Verizon's costs range from $445.40 (Mansfield Exchange) to $18.36 (Mount Vernon Exchange); Qwest's cost range from $181.93 (Northport Exchange) to $15.74 (Seattle Exchange).[3]

Q. DR. BLACKMON, HOWEVER, CLAIMS THAT THESE COST DIFFERENCES THE MODEL PRODUCES ARE ALREADY CAPTURED IN EACH COMPANY'S ITAC, AND THEREFORE THE REMANING COSTS (AND THUS THE RATES) OF VERIZON AND QWEST SHOULD BE THE SAME. PLEASE COMMENT.

A. Dr. Blackmon is confusing hypothetical cost study results with a company's actual costs and revenue requirement. In other words, his claim is based on the assumption that a company's revenue requirement equals the sum of the costs produced by the FCC's cost model. He offers no proof, and I am unaware of any commission that has ever made such a finding. Also, his theory leads to the illogical conclusion that no state commission would ever have to conduct a company-specific rate proceeding – instead, a commission

[3] From UT-980311(a) 11th Supplemental order.

could simply use a one-size-fits-all cost model to establish any company's revenue requirement.

In addition, as stated earlier the Commission stated in its November 1998 report to the legislature on universal service, the support amounts now covered by Qwest's and Verizon's ITACs only cover eight percent of local service lines. Dr. Blackmon ignores the facts that, (1) at best, the ITAC only equalizes Qwest's and Verizon's costs for this eight percent of lines (i.e., for exchanges where the Commission-estimated basic service costs exceed the Commission's revenue benchmarks) and (2) that for the remaining ninety-two percent of lines, the costs in the Qwest exchanges are significantly lower than the costs in the Verizon exchanges. This can be seen by comparing the Commission's exchange level cost estimates in Docket UT-980311(a).

To summarize, Dr. Danner and I explain that Verizon and Qwest have different costs and prices because (1) the Commission accurately determined this through company-specific proceedings, and (2) different companies that serve different types of territories have different costs and therefore different prices.

<u>PART IV – VERIZON'S REVENUE-NEUTRAL OFFSET PROPOSAL</u>

Q. PLEASE SUMMARIZE VERIZON'S OFFSET PROPOSAL.

A. If the Commission chooses to reduce Verizon's access charges, then Verizon proposes to (1) restructure its access charges and (2) make revenue-neutral increases to basic residential rates. This proposal is based on access reductions of approximately $32 million as suggested by Commission Staff.

Q. PLEASE DESCRIBE THE ACCESS RESTRUCTURING PROPOSAL.

A. My Exhibit ODF-2C presents the detailed intrastate switched access service price-out. In summary, Verizon would propose to:

1) Eliminate the residual interconnection charge (RIC), which is an $8.9M decrease in access revenues;
2) Eliminate the carrier common line charge (CCL), which is a $19.5M decrease;
3) Reduce the originating end office switching (EOS) rate by $5.2M;
4) Recalculate transport and add new rate elements consistent with the interstate switched access rate structure, resulting in a $1.6M increase; and
5) Mimic the current interstate structure by discontinuing the unitary rate structure option for tandem-switched transport and by establishing the following new rate elements: shared trunk ports, shared multiplexing, and dedicated trunk ports at both end office and access tandem locations. The rates for these elements will equal the current interstate rates.

Q. WHY ELIMINATE THE CCL AND RIC RATE ELEMENTS?

A. In the interstate jurisdiction, the CCL revenue requirement has been shifted to other rate elements such as the interstate subscriber line charge (SLC) and the primary interexchange carrier charge (PICC). Likewise, the RIC revenue requirement has been eliminated on the interstate side and shifted to other rate elements. Given this, we propose similar changes to our intrastate charges.

Q. PLEASE DESCRIBE THE OTHER PROPOSED CHANGES TO VERIZON'S CURRENT INTRASTATE RATE STRUCTURE.

A. First, we propose to restructure our Tandem-Switched Transport rate elements. Currently, we charge both "per minute" and "per minute per airline mile" rates for transporting calls (1) from the end office to the tandem and (2) from the tandem to the carrier's serving wire center. Trunks between the end office and the tandem switch are shared among many carriers, and therefore our current rate structure is appropriate. However, the tandem switch routes each carrier's traffic onto a dedicated trunk that connects the tandem switch to the each carrier's serving wire center (or point of presence). Given this, Verizon proposes to restructure its charge so that customers purchase "Direct-Trunked Transport" between the tandem and their serving wire center. In other words, we convert the current per-minute charges to a flat rate.

Q. HAVE YOU ESTIMATED THE CHANGE IN UNITS DUE TO YOUR PROPOSED STRUCTURE?

A. Yes. Based on the demand for interstate services that are structured in the same manner as Verizon proposes to restructure on the intrastate side, we have estimated the reduction in demand for the "Tandem-Switched Transport – Facility" and the change in demand for "Direct-Trunked Transport" (Voiceband, DS1, and DS3) facility and terminations. (See Exhibit ODF-2C for details.)

Q. DO YOU PROPOSE ANY OTHER CHANGES?

A. Yes. As noted, we propose revised (or additional) intrastate rate elements to correspond with existing interstate elements. Here is a summary:

(1) For "shared multiplexing – access tandem," we propose to recover the costs of DS3/DS1 multiplexers on the end office side of the tandem via a per minute of use charge on each carrier purchasing common transport on the end office-to-tandem link. Because these multiplexers are shared among all users of common transport, traffic-sensitive per-minute charges are appropriate.

(2) We propose a flat-rated element, "dedicated trunk port – access tandem," for dedicated trunk ports used to terminate dedicated trunks on the serving wire center side of the tandem switch. Verizon incurs the costs of these ports on a non-traffic sensitive basis, but at present recovers these costs via per-minute charges for the tandem switch. Our new rate element would be assessed on a per channel basis at either the voice grade or DS1 level.

The rates for the two elements described above will equal the current interstate rate.

(3) We also propose a new flat-rate element, "dedicated trunk port – end office," that would be applied for the end office trunk port to carriers purchasing the Direct-Trunked Transport facility terminated by that port. The trunk card is a non-traffic sensitive cost dedicated to the exclusive use of a single carrier, and therefore it should be priced on a

flat rate basis. We propose, as in the federal jurisdiction, to assess it on a per channel basis at the voice grade or DS1 level.

(4) Similar to (3), we proposed a shared trunk port rate element, "shared trunk port – end office," that would be applied on a per-minute of use basis to the users of common transport for trunk cards at the end office.

The proposed rates for these last two rate elements are the same as Verizon's current interstate rates.

(5) Finally, Verizon proposes an additional $5.2M decrease to the originating end office switching rate to meet the total $32M access reduction proposed by Staff.

Q. HOW DOES VERIZON PROPOSE TO RECOVER THE REVENUES RESULTING FROM THE ACCESS REDUCTIONS?

A. Verizon's proposal is simple: if the Commission reduces Verizon's access charges, then it should increase Verizon's rates for residential service on a revenue-neutral basis. As discussed by Mr. Dye, if the Commission reduces access charges by $32 million as proposed by Staff, then Verizon's basic residential rates would increase by $4.56 per month (from about $13.00 to $17.56 per month).

Q. WHY DOES VERIZON PROPOSE TO INCREASE RESIDENTIAL RATES?

A. As Dr. Danner discusses further, a Commission policy decision to remove $32 million of cost recovery from access services means that the Company's only other service category (local services) must assume the costs, and sound economic and policy principles require that it be assumed by residential local services.

Dr. Blackmon's testimony and the Commission's order in a Qwest case (Docket UT-9700766) supports this approach. There, Dr. Blackmon recommended, and the Commission agreed, to increase rates for basic service instead of increasing access, toll or ancillary service rates:

> Staff agrees with the company that none of the increase should come from access charges, long distance rates, or features. . . . Access charges and, by extension, long distance rates are already too high. Something is wrong when a call from Seattle to East Coast is substantially cheaper than a call from one side of Puget Sound to the other. This problem arises because access charges are priced much higher, relative to cost, than local service. In the last rate case the Commission used 70% of the available decrease in revenue requirement to lower access charges and long distance rates. The Commission also indicated that even with those decreases, rates were too high and should be further decreased as the opportunity to do so arose. "Because access charges currently are above cost, the magnitude of reductions are primarily a function of the overall revenue requirement in this proceeding and the other rate design changes that must be made." (15th Supplemental Order, Docket No. UT-950200, page 111.) It would be a mistake to reverse that policy now by increasing access charges and long distance rates.[4]

[4] Verizon referred to the electronic version of Dr. Glenn Blackmon's testimony on or about pages 6 and 7 dated October 27, 1997 on the WUTC's website under Docket No. UT-970766. The electronic version did not include page numbers.

Dr. Blackmon's analysis in that case applies here, too. Strangely, though, Dr. Blackmon proposes to increase toll rates in this case. This proposal is inconsistent with his previous testimony. Dr. Danner addresses this point in greater detail.

Q. BUT DR. BLACKMON CLAIMS THAT VERIZON'S BASIC SERVICES ARE ALREADY "PRICED WELL ABOVE TOTAL SERVICE LONG-RUN INCREMENTAL COST, IN WHICH THE COST OF THE LOOP IS NOT AN INCREMENTAL COST OF EITHER LOCAL EXCHANGE SERVICE OR EXCHANGE ACCESS SERVICE" (P. 7). PLEASE RESPOND.

A. Dr. Danner explains why Dr. Blackmon is wrong; in doing so, he explains that basic economic principles require that the loop be treated as a direct cost of providing basic service, not as a common cost. He also explains whether the cost of the loop is considered a direct cost of providing basic service or a common cost that must be allocated to basic service, the end result is the same. The Commission must allow Verizon to increase its basic residential rates if it reduces Verizon's access charges.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.