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.,	)	Docket No. UT-081393
Complainants,	)	
v.	)	
UNITED TELEPHONE COMPANY OF THE NORTHWEST,	)	
Respondent.	)	

RESPONSIVE TESTIMONY OF

CHRISTIAN M. DIPPON

ON BEHALF OF

UNITED TELEPHONE COMPANY OF THE NORTHWEST

d/b/a

EMBARQ

April 17, 2009

Public Version

Highly Confidential per Protective Order in UTC Docket UT-081393

Contents

I. QUALIFICATIONS AND SUMMARY

Q. Please state your name, occupation, and business address.

A. My name is Christian Michael Dippon. I am a Vice President at the San Francisco office of NERA Economic Consulting (NERA) where I am an economist in the Communications practice. NERA provides expert economic and financial analysis for firms and government bodies on a wide variety of issues. My business address is 1 Front Street, Suite 2600, San Francisco, CA 94111.

Q. Please describe your educational background and professional experience.

A. I received a B.A. in Business Administration from California State University in 1993 and an M.A. in Economics from the University of California at Santa Barbara in 1995. I have specialized in telecommunications economics for close to 13 years, especially in wireline, wireless, cable, and emerging technologies. I serve on the Board of Directors of both the International Telecommunications Society (ITS) and the International Intellectual Property Institute (IIPI). I have authored and edited several books as well as book chapters in anthologies and have published numerous articles on telecommunications competition and strategies. I also frequently lecture in these areas at industry conferences, continuing education programs for lawyers, and at universities. My work has been cited by national and international newspapers and magazines, including the *Financial Times*, *Business Week*, *Forbes*, the *Chicago Tribune*, and the *Sydney Morning Herald*.

My experience in telecommunications includes assessing the competitive impact of mergers and acquisitions, the need (or lack thereof) of state and federal regulatory reform, the industry impact of competition policy, the review of alleged anticompetitive conduct, and the analysis of consumer class action litigation. I have also assessed the level of competition in the telecommunications sector of several countries and consulted on cases involving industry standards.

I have served as a consultant to clients in the United States, Canada, Japan, the United Kingdom, China, Brazil, Singapore, Hong Kong, Spain, Israel, the Dominican Republic, Korea, Indonesia, and Australia. Exhibit No. ___ (CMD-2) of this testimony contains my curriculum vitae, which includes a list of my testimonies in other cases.

Q. Have you testified previously on telecommunications matters before regulatory commissions or courts?

A. Yes. I have testified on telecommunication matters before the Federal Communications Commission (FCC), the Federal Trade Commission (FTC), state regulatory commissions in Michigan, Minnesota, Missouri, Massachusetts, California, New Jersey, Virginia, Oregon, and Washington. I have also testified on telecommunications matters before an antitrust authority and in state and federal courts. Moreover, I have coauthored expert reports regarding cost models and methodologies in interconnection arbitrations in approximately a dozen states.

Q. ***In which matter did you testify before the Washington Utilities and Transportation Commission?***

A. I provided written and oral testimonies in the Matter of Review of: Unbundled Loop and Switching Rates; the Deaveraged Zone Rate Structure; and Unbundled Network Elements, Transport, and Termination, Docket No. UT-023003, on behalf of Verizon Northwest Inc.

Q. ***On whose behalf are you testifying?***

A. I am testifying on behalf of United Telephone Company of the Northwest (United).

Q. ***Please summarize your testimony.***

A. I am providing responsive testimony to AT&T Communications of the Pacific Northwest, Inc.; TCG Oregon, Inc.; and TCG Seattle, Inc (AT&T) and to 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. (Verizon).Counter to allegations of Verizon and AT&T, United's intrastate switched access rates in the State of Washington are just, fair, and reasonable. They are part of a complex system of subsidies intended to maintain the affordability of residential local exchange service in predominantly high-cost, rural areas of the State of Washington. The witnesses are not questioning the desirability of these social and political objectives. Instead, they argue that intrastate toll services should contribute less, or nothing, to these objectives. Not surprisingly, the witnesses' testimonies do not address how Washington consumers would benefit from any proposed access rate reduction. The witnesses also do not take into consideration any economic repercussions that would result if their proposals were to be accepted; thus, they ignore the most likely outcome where subscribers from high-cost areas and low-income communities would have to carry the financial burden created by the access rate reduction. In essence, the Complainants' proposals call for a rate restructuring that would be in direct conflict with the social objectives of the universal service program in Washington. I recommend that the Commission reject the proposals sponsored by Verizon and AT&T and leave United's intrastate switched access rates unchanged unless it undertakes a complete overhaul of the intrastate intercarrier compensation system. Specifically, should the Commission find it beneficial to reduce intrastate switched access rates, it should only do so, if it replaces the implicit subsidies that are lost by the reduction with an explicit recovery mechanism, such as a permanent state universal service fund. Washington consumers could suffer serious economic consequences if United's rates were simply reduced without implementing an alternative recovery mechanism.

II. PURPOSE OF THIS RESPONSIVE TESTIMONY

Q. What is the purpose of your responsive testimony?

A. I have been asked by United Telephone Company of the Northwest d/b/a Embarq (hereafter United when referring to local operations and Embarq when referring to services outside the LATA) to respond to the direct testimonies filed by Paul B. Vasington, and Lawrence J. Bax. Mr. Vasington represents 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. (hereafter Verizon).[1] Mr. Bax represents AT&T Communications of the Pacific Northwest, Inc.[2] I respond to these witnesses' claims that United's switched access rates are excessively high and in violation of the law in the State of Washington. In addition, United has asked me to provide a history of the switched access charge regime in the United States and to explain how intrastate switched access rates relate to the policy objectives of providing ubiquitous and affordable telephone service throughout the country.

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[1] 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 v. United Telephone Company of The Northwest*, Respondent, Docket No. UT-081393, "Direct Testimony of Paul B. Vasington on Behalf of Verizon," February 18, 2009 (Vasington Direct).

[2] 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 v. United Telephone Company of The Northwest*, Respondent, Docket No. UT-081393, "Direct Testimony of Lawrence J. Bax, on behalf of AT&T Communications of the Pacific Northwest, Inc., TCG Oregon, Inc. and TCG Seattle, Inc., February 18, 2009 (Bax Direct).

Q. ***How is your responsive testimony structured?***

A. My testimony consists of this responsive testimony as well as the attached white paper, Exhibit No. ___ (CMD-3). The responsive testimony addresses Washington-specific issues, such as how a reduction in intrastate switched access rates could affect competition in the State of Washington. The white paper, authored by my colleagues Dr. William Taylor, Dr. Harold Ware, and myself, provides an overview of the history of the access charge regime in the U.S. and explains why regulated access rates are part of a holistic rate structure aimed at providing available and affordable basic local telephone service to all U.S. citizens.

My responsive testimony focuses on the claims and recommendations made by Mr. Vasington and Mr. Bax (collectively the witnesses). In Section III, I demonstrate that United's intrastate switched access rates are just, fair, and reasonable and not excessive or unreasonable as claimed by the witnesses. They are part of a complex system of subsidies designed to keep local rates affordable, particularly in high-cost rural areas where competition is often limited. Unlike the witnesses, both the FCC and state policies have recognized this crucial consideration. (See Exhibit No. ___ (CMD-3).) I also show why an assured recovery mechanism is necessary for United to recover the loss of switched access revenue that today enables United to be a carrier of last resort (COLR) and to provide universal service at affordable rates. Moreover, competition is quite strong in United's more densely populated areas (i.e., the nonrural areas using the FCC's definition of rural and nonrural), which would make it extremely difficult to raise end user rates. In Section IV, I explain why the alleged anticompetitive effects of United's current intrastate switched access rates raised by the witnesses defy basic economic principles. I demonstrate that United's rates are fair, just, and reasonable (under the applicable economic and regulatory principles) and thus do not violate Washington state law (as Mr. Bax describes the law). I also show that neither consumers nor competition would benefit from a rate reduction. In addition, comparisons to proceedings in other states are irrelevant, incomplete, and misleading. Rather, each state must look at the state-specific issues facing the ILECs as a whole and United specifically. In Section V, I explain the competitive conditions faced by United in Washington. I present the first part of the necessary cost-benefit analysis that one must conduct when evaluating the proposed intrastate switched access rate reductions. Specifically, I demonstrate that the two proposals to reduce United's switched access rates would not benefit consumers or competition. I also present the cost side of the cost-benefit analysis, which clearly demonstrates that Washington consumers could suffer serious economic consequences if the Commission were to grant a switched access rate reduction. Section VI discusses why the subsidies contained in intrastate switched access rates cannot simply be reduced in a vacuum. United is mostly a rural carrier and unless the Commission implements an alternative recovery mechanism, such as a permanent state universal service fund, the proposed reductions would lead to a significant price increase in rural and low-income communities. Section VII concludes my responsive testimony.

III. UNITED'S INTRASTATE SWITCHED ACCESS RATES ARE JUST, FAIR, AND REASONABLE

Q. ***Are United's intrastate switched access rates just, fair, and reasonable?***

A. Yes. Despite Mr. Vasington's reference to United's intrastate switched access rates as "unjust, unreasonable, and anticompetitive"[3] and Mr. Bax's similar characterization of them as "excessive, unjust, unfair, and unreasonable,"[4] both of these witnesses seem to arrive at their conclusions based solely on their observations that United's intrastate switched access rates exceed economic cost. I do agree that the switched access rates include a subsidy element. However, this does not mean that the subsidy is free money and the subsidized rates are excessive, unjust, unfair, or unreasonable. Instead, as implied in the definition of the word subsidy, it is funding that provides a contribution to the costs of promoting universal service—that is, it serves as a *recovery mechanism* for the costs incumbent local exchange carriers incur in order to achieve a set of social goals. Specifically, United's intrastate switched access rates (and likely its toll as well as other rates) are set above forward-looking incremental cost to allow the carrier to recover the costs associated with building and maintaining a ubiquitous network throughout its serving area so that it can keep basic residential local exchange service prices at affordable levels. This is done in order to expand demand for service in high-cost (rural) areas and for low-income (lifeline service) consumers. As such, the revenues from these

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[3] Vasington Direct, p. 4.
[4] Bax Direct, p. 3.

subsidies are part of a holistic approach designed to promote economic efficiency and competition and to further public policy objectives.

A. United's Existing Switched Access Rate Levels Maintain Universal Service at Affordable Rates in Rural, High-Cost Washington

Q. Is there a link between access charges and universal service?

A. Definitely. As explained in more detail in Exhibit No. ___ (CMD-3), toll rates and access charges have been set pursuant to regulatory policies that have kept ILEC basic residential local rates below competitive levels to promote ubiquitous service and more generally to ensure "affordable" local service. The economic justification for such pricing is to stimulate demand by low-income customers and those living in high-cost areas. Historically, basic local telephone rates have also reflected regulatory and consumer pressures that have resulted in a complex set of internal subsidies—from toll to local service, from business to residential service, and from urban to rural areas.

Prior to the breakup of the former Bell System in the early 1980s, AT&T's toll services subsidized the local Bell Operating Companies basic local rates, thus allowing them to be set below cost. Growing competition for toll services, which began in the 1970s with the entrance of competing long distance carriers into the market and the breakup of the Bell System (starting in 1982 with the AT&T Consent Decree), necessitated the replacement of these internal subsidies with carrier access charges.[5] As competition intensified and

[5] "The term 'AT&T Consent Decree' means the order entered August 24, 1982, in the antitrust action *United States v. Western Electric*, Civil Action No. 82-0192, in the United States District Court for the District of Columbia,

carrier access charge revenues became threatened (i.e., as large customers and carriers developed ways to bypass the local access network and its associated charges), the FCC working with the Federal-State Joint Board developed subscriber line charges (SLCs) and a universal service fund. This restructuring and transition was also influenced by the passage of the Telecommunications Act of 1996 (the 1996 Act), which required the FCC to replace implicit subsidies with explicit universal service funding. Nevertheless, in phasing in universal service reform, the FCC recognized that "drastically cutting access charges to bring them to cost-based levels could prove disruptive to business operations."[6] Thus, the FCC "declined to implement any dramatic changes to its access charge regime, ruling that 'the existing system of largely implicit subsidies,' would have to 'continue to serve its purpose.'"[7]

The process, which started with the divestiture of AT&T, took decades to unfold and indeed remains contentious even today. The history of the process leads to two major findings. First, interstate carrier access charges were not simply lowered; the rates were rebalanced and restructured. That is, the FCC increased the interstate portion of basic monthly rates through SLCs to offset reductions in carrier access charges. In addition, universal service funding was introduced and expanded over time to give the ILECs the ability to replace the contribution to network costs that would have come from carrier

and includes any judgment or order with respect to such action entered on or after August 24, 1982." 47 U.S.C. § 153.

[6] P.W. Huber, Michael K. Kellogg, and John Thorne, *Federal Telecommunications Law, Second Edition*, Aspen Law and Business, Gaithersburg, New York, 1999, p. 584, citing *Access Charge Reform Order*, 12 F.C.C. Rec. at 16,002, ¶ 46, (Huber, Kellogg, and Thorne).

[7] Huber, Kellogg, and Thorne, p. 584, citing *Universal Service Order*, 12 F.C.C. Rec. at 8786–8787, ¶ 17.

access charges. This point cannot be emphasized enough. The FCC (and many states) did not remove the implicit subsidies contained in interstate switched access rates without first establishing a mechanism (in the case of interstate it was establishing a universal service fund and increasing the cap on the SLC) to ensure the recovery of the lost revenues. Second, it is clear that state and federal regulators and legislators recognized that carrier access charges were created specifically to cover network costs in order to subsidize basic local rates and promote universal service.

Q. Could these public policy goals be met without access charges?

A. No. The reason for this is straightforward. ILECs, like United, confront at least four interrelated problems. First, building and operating a telecommunications network engenders substantial common costs; therefore, to recover their total costs, ILECs must price some services above their incremental costs. Second, they are subject to pricing constraints designed to promote universal service by keeping basic local rates affordable. As summarized by Professor Kahn below, the objective of these pricing constraints is to meet social and political objectives.

> Social or political objectives are especially obvious in the practice of internal subsidization—where some services or markets pay less than their marginal costs, thus clearly imposing a burden on other users. The practice is often rationalized on distributional grounds, the desire being to make the service more widely available to people who could not otherwise afford it. Internal subsidization of service to rural areas may be justified also on the ground that by helping to keep the population dispersed, it contributes to reduced social and psychological tensions. There is also a possible economic justification—in the event that the particular use subsidized confers economic benefits on others besides the individual purchaser. Making telephone service and

> electricity available on the farm benefits city dwellers as well because it holds down urban congestion. Since a good deal of governmental economic activity and collective consumption involves precisely the provision of services that are believed to confer large external benefits—outstanding examples are public education and public health—it is not surprising that the social or political objectives that are brought to bear on public utility rates often involve, explicitly or implicitly, a purely economic judgment that the private market provides insufficient consumption because the external benefits are large.[8]

Third, the ILECs are required to build and maintain their networks for customers throughout their service territory, including high-cost customers and those in low-density rural areas—even to customers who no longer rely on wireline phone service.[9] Fourth, they confront growing competition from competitors who are free to focus on the more lucrative customers and areas. Accordingly, setting policies to recover common costs and meet COLR and other regulatory obligations has become a challenging task for ILECs and their regulators.

Q. ***Do any of the witnesses question the validity of the public policy objectives to which you refer?***

A. No. Mr. Vasington and Mr. Bax do not appear to advocate the elimination of these public policy objectives. They also do not seem to question the fact that these policy objectives come at a cost to the incumbent carriers that are required to build and maintain a ubiquitous network throughout their serving territories in Washington and then are

[8] Alfred E. Kahn, *The Economics of Regulation, Principles and Institutions,* Cambridge, Massachusetts: MIT Press, 1988, p. 190.

[9] This is not to say that cost recovery concepts such as construction charges and contribution in aid to construction are not accepted mechanisms for sharing cost recovery risks with end-user customers and developers in high-cost areas.

required to price their services below economically efficient levels to keep rates affordable. The Complainants' proposals address one, and only one, aspect of this larger regulatory framework: the financial contributions to meeting these public policies, which are collected through implicit subsidies from intrastate toll customers. While Mr. Vasington recommends that this Commission reduce United's intrastate switched access rates to mirror Verizon Northwest's (hereafter Verizon NW) intrastate switched access rates, Mr. Bax wants United's switched access rates reduced to United's interstate levels.

Q. Do any of the witnesses question the fact that meeting these public policy objectives generates costs to incumbent carriers?

A. No. None of the witnesses seems to question this fact. Moreover, AT&T's parent company's 2008 Form 10-K seems to further support it:

> Competition continues to increase for telecommunications and information services. Technological advances have expanded the type and uses of services and products available. In addition, lack of a reduced level of regulation of comparable alternatives (e.g., cable, wireless and VoIP providers) has lowered costs for these alternative communications providers. As a result, we face heightened competition as well as some new opportunities in significant portions of our business.[10]

[10] AT&T Inc., 10-K, February 25, 2009, p. 18.

Q. ***Do the subsidies built into United's switched access rates create an unreasonable prejudice to United's competitors?***

A. No. Mr. Vasington claims that United's switched access rates "allow[s] Embarq to export a disproportionate amount (millions of dollars annually) of its costs to it[s] competitors."[11] This is incorrect. As summarized above, carrier access prices are part of a holistic approach, designed to balance a host of different policy objectives. The subsidies contained in United's intrastate switched access rates are not "free money," let alone a wealth transfer from United's competitors to United. Rather, they provide United with a just and reasonable return on its investments and the ability to cover the costs of meeting its universal service obligations. Furthermore, the subsidies do not come solely from Verizon and AT&T. Instead, they come from services provided by United as well as its competitors; thus, they encompass more than intrastate switched access rates. To be precise, the landline telephone pricing structure includes many prices set above incremental costs in order to recover common network costs, subsidize basic residential services, subsidize lifeline services, and meet COLR obligations. Carrier access charges are only a small part of the story and thus cannot be analyzed in a vacuum.

[11] Vasington Direct, p. 4.

Q. ***Does Mr. Vasington seem to agree with your conclusion that intrastate switched access rates cannot be reduced in a vacuum?***

A. Yes. In a similar proceeding currently taking place in the State of New Jersey, Mr. Vasington seems to agree with my statements above. In particular, he testified that:

> The Board cannot reduce Verizon NJ's intrastate access rates in a vacuum (whether in a later stage of this proceeding or otherwise). While Verizon NJ continues to invest hundreds of millions of dollars to fundamentally remake the communications infrastructure in one of the most competitive states in the nation, and is simultaneously providing basic residential exchange service at among the lowest rates in the nation, it would make no sense to reduce Verizon NJ's intrastate access revenues without permitting offsetting revenue increases. Moreover, Verizon NJ is the carrier of last resort ("COLR") in its service territory, which comprises 95% of the state, and must be afforded the opportunity to earn sufficient revenues from its rate-regulated services to maintain that network.[12]

Mr. Vasington's quote is interesting for several reasons. First, Mr. Vasington confirms that intrastate switched access rates cannot be analyzed in a vacuum. However, this is contrary to what Mr. Vasington advocates in this proceeding. In this proceeding, Mr. Vasington is only concerned that United's intrastate switched access rates be reduced. He hardly addresses other factors and only vaguely describes how United could "be afforded the opportunity to earn sufficient revenues from its rate-regulated services" should his recommendation be accepted. Second, he seems to agree that ILEC should be allowed to earn "sufficient revenues," rather than being forced to incur a loss in certain areas. Third,

[12] State of New Jersey Board of Public Utilities, In the Matter of The Board's Investigation and Review of Local Exchange Carrier Intrastate Exchange Access Rates, BPU Docket No. TX08090830, Joint Initial Testimony of Paul B. Vasington and Patrick A. Garzillo On Behalf of Verizon, February 13, 2009, p. 21 (Vasington & Garzillo Initial).

he seems to agree that this revenue must come from "rate-regulated" services, rather than forcing ILECs to subsidize the losses from rate-regulated services with revenue from nonregulated services.

B. An Assured Recovery Mechanism Is Required, Rather than the Illusion of Recovery from End User Rate Increases

Q. ***Historically, how did regulators and operators handle below cost residential rates?***

A. A key part of the historic balance that regulators and the industry reached was to set toll rates and carrier access charges above their incremental costs to recover some of the nontraffic sensitive (NTS) costs of the network (i.e., basic access costs) and possibly to recover some of the common costs of the network (e.g., shared switching costs). Once toll competition was permitted, regulators set access charges to contribute towards recovering NTS costs (i.e., subsidizing basic local rates) and possibly to help recover common costs. Thus, both the ILECs' own toll services and the toll services of other carriers accessing ILEC networks contribute to recovering NTS and common network costs.

Q. ***Given the rapidly changing competitive environment, are implicit subsidies now obsolete?***

A. No. Mr. Bax claims, "implicit subsidies are no longer sustainable."[13] What Mr. Bax suggests is that implicit subsidies in intrastate access rates need to be removed because

[13] Bax Direct, p. 16.

competition in his view requires the removal of those subsidies. This is incorrect. As long as regulation imposes pricing constraints and COLR obligations on ILECs, a balanced approach is absolutely vital. If pricing constraints and COLR obligations exist, then the principles of universal service must at the very least be valued the same, from a policy standpoint, as any alleged benefit from access reductions. The rationale for this is straightforward. Carriers that have COLR obligations incur higher costs than carriers that do not because they must provide and maintain a ubiquitous network.[14] This puts COLR carriers at a competitive disadvantage. Additionally, these same carriers are also subject to pricing constraints that prevent them from both charging market-based prices and pricing to recover their costs, again putting them at a competitive disadvantage. The effects of these regulatory responsibilities are higher costs and lower prices than nonregulated entities. In fact, as shown by United witness Mr. Henry J. Roth, in United's case the regulatory burden actually leads to an average monthly revenue shortfall of

[14] This is true in particular for United because it is a rural ILEC with the most ubiquitous network in its service territories. Therefore, it has substantial COLR obligations.

[BEGIN HIGHLY CONFIDENTIAL] [redacted] **[END HIGHLY CONFIDENTIAL]** per line.[15] Not surprisingly, the largest shortfall is with residential lines where United loses an average of **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]** per line *per month*.[16] Thus, in order for United to remain a strong competitive force in Washington, it is crucial that a balanced approach remain in place, particularly given the rapidly changing competitive environment.

Q. Is your finding consistent with the findings of the FCC?

A. Yes. The FCC recently recognized the need for retaining a balanced approach between intercarrier compensation and universal service funding:

> Preservation of universal service is another priority under the Act and we recognize that fulfillment of this mandate must be a consideration in the development of any intercarrier compensation regime … and we are particularly sensitive to the interests of rural and high-cost communities.… Because of the high costs associated with serving rural areas, we must be certain that any reform of compensation mechanisms does not jeopardize the ability of rural consumers to receive service at reasonable rates.[17]

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[15] See 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 v. United Telephone Company of The Northwest*, Respondent, Docket No. UT-081393, "Responsive Testimony of Henry J. Roth on Behalf of United Telephone Company of the Northwest, d/b/a Embarq," April 17, 2009, Exhibit No. ___HC(HJR-2HC), p. 3 (Roth Responsive).

[16] See Roth Responsive, Exhibit No. ___HC(HJR-2HC), p. 3.

[17] See FCC, In the Matter of Developing a Unified Intercarrier Compensation Regime, *Further Notice of Proposed Rulemaking,* CC Docket No. 01-92, FCC 05-33, rel. Mar. 3, 2005, ¶ 32 (FNPRM Unified Carrier Comp).

Q. ***If the witnesses are not questioning the validity or the cost causation of meeting these public policy goals, why do they question the level of United's intrastate switched access rates?***

A. The level of access charges, both inter- and intrastate, has been a contentious issue for a very long time—since the divestiture of AT&T (see Exhibit No. ___ (CMD-3)). After the divestiture of AT&T, the local telephone companies inherited a historical and continuing obligation to extend service ubiquitously and a continuing entitlement to a reasonable opportunity to recover their costs, both past (to the extent they have been capitalized) and current, of fulfilling that obligation. They also inherited a rate structure that reflected the residual pricing of basic residential telephone service with rates in large areas of the country clearly below incremental cost and in most areas below economically efficient levels. Rates for other services, for example, toll, vertical services, and switched access services to long-distance carriers, were set above both incremental costs and efficient levels.

The question of whether the still-regulated ILECs should be entitled to the continuing recovery of those historically incurred costs remains intensely contested. It seems incontestable, however, that under the historical—and still continuing in most jurisdictions—regulatory system, they have been entitled to a fair opportunity to recover their prudently incurred costs.

The FCC explicitly set interstate charges at levels—concededly far above incremental cost—in order to perpetuate after the dissolution of AT&T the flow of cross-subsidy to the intrastate jurisdiction and, specifically, to holding down the basic local service rates that AT&T had previously earned directly and transferred from toll to basic service. Thus, the most dramatic reduction in those charges enacted by the FCC came when it simultaneously imposed a flat line charge directly on subscribers' bills, thereby substantially (but concededly far from completely) diminished the underpricing of that basic service, on the one side, and, correspondingly, the size of the subsidy required from access charges. The rationale of the access charge, imposed at the time of the breakup was to honor both of the commitments already described—recovery of costs incurred both historically and on a continuing basis in fulfillment of the obligation to serve and, specifically, to serve residential customers at inefficiently low, flat monthly charges.

The Complainants through their respective affiliates/parents were part of both the access charge and the universal service proceedings and are well aware of the history behind not only access charges but also universal service. The arguments they present here are the same arguments they have presented to regulatory agencies for many years in one form or another. It is an attempt to obtain a rate reduction, which in turn they hope to turn into a competitive advantage to the detriment of consumers in high-cost areas and low-income communities.

C. Strong Competition in More Populated Areas and Emerging Competition in Rural Areas Make It Difficult to Raise End User Rates to Support Access Rate Reductions and Provide an Assured Means for Universal Service at Affordable Rates

Q. How do the areas served by Qwest and Verizon NW differ from those served by United?

A. Both Verizon and AT&T have relied upon decisions made for Verizon NW and Qwest to justify the relief requested in this case. The remedy sought is simply inapposite to this case. As I explain, the large majority of United's wire centers are rural—with population densities below 100 people per square mile—and the majority of its access lines are in such areas.[18] I stress that even the wire centers that the FCC would classify as nonrural (Grandview, Poulsbo, and Wapato) are very sparsely populated and simply do not compare to rural areas such as the metropolitan area of Seattle. In contrast, Qwest and Verizon NW are more concentrated in urban and suburban areas of the State of Washington. The average population density of wire centers served by United is 27.96 people per square mile, only about 11 percent as large as that of Qwest and 18 percent as large as Verizon NW's. Finally, while about 73 percent of the lines served by United are residential lines, Qwest's and Verizon NW's residential lines make up about 66 and 69 percent, respectively, of total lines. Table 1 summarizes the differences between the local exchange service areas.

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[18] This is based on the FCC's definition of rural, which is not to say that it cannot be changed by the states based on circumstances.

[BEGIN HIGHLY CONFIDENTIAL]

Table 1
Comparison of the Local Exchange Carriers' Service Areas

[redacted]

[END HIGHLY CONFIDENTIAL]

Q. What are the implications of these differences for United's costs and COLR obligations?

A. Firms operating in rural areas with low population densities like United tend to incur greater average costs to serve basic service customers. Furthermore, basic rates in such areas are lower because of the legacy of value of service pricing. Additionally, areas that are more rural tend to have a lower ratio of business to residential lines. Finally, the economics for providing advanced services, such as broadband and video, are less favorable in low population density areas. These factors imply that United has higher costs, lower average revenue per line, and a greater percentage of its lines subject to COLR obligations, relative to operators serving more populated areas such as Qwest and Verizon NW. Thus, policies approved for the two larger, less rural ILECs cannot simply

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be ported to United. Rather, the Commission must apply different carrier access charge policies to United than it does to Qwest and Verizon NW.

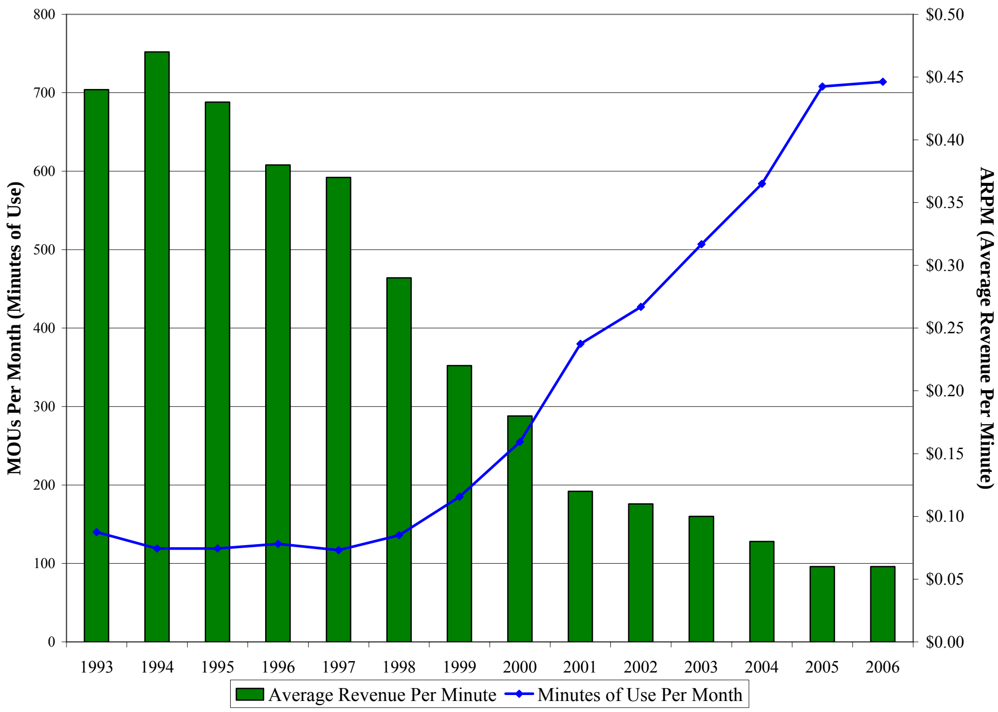
Q. ***Who competes with incumbent local exchange carriers in Washington?***

A. The ILECs face competition from various sources. First, CLECs compete with them. Second, as described above, ILECs also face competition from intermodal competitors, that is, competitors other than local exchange carriers. Intermodal competitors are chiefly wireless operators, broadband cable companies, and VoIP providers.

Q. ***Before addressing Washington, please provide an overview of the trends in wireless service that have made it more competitive with wireline service in the United States.***

A. FCC data on national wireless trends show a dramatic increase in wireless usage associated with an equally dramatic decrease in the average price per minute of wireless usage. Specifically, as illustrated in Figure 1, from 1993 through 2006, wireless mobile usage (minutes-of-use per subscriber per month) grew by 400 percent to over 700 minutes per mobile subscriber per month, and the average charge per wireless voice minute fell by 86 percent to only six cents per minute.

Figure 1
Trends in U.S. Wireless Usage and Voice Charges Per Minute
1993–2006[19]

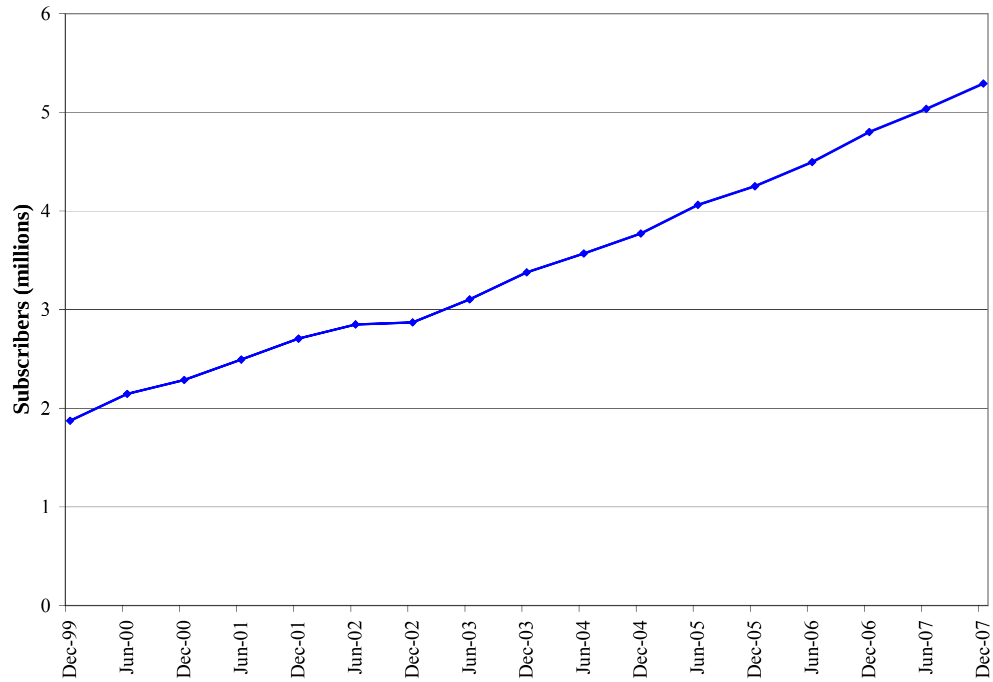


1 **Q.** ***Has wireless demand in Washington grown throughout the state?***

2 **A.** Yes. Reflecting the above national trends, wireless penetration and wireless subscriber
3 counts in Washington are increasing in all areas for which the FCC has tabulated data.
4 These trends are illustrated in Figures 2 and 3.

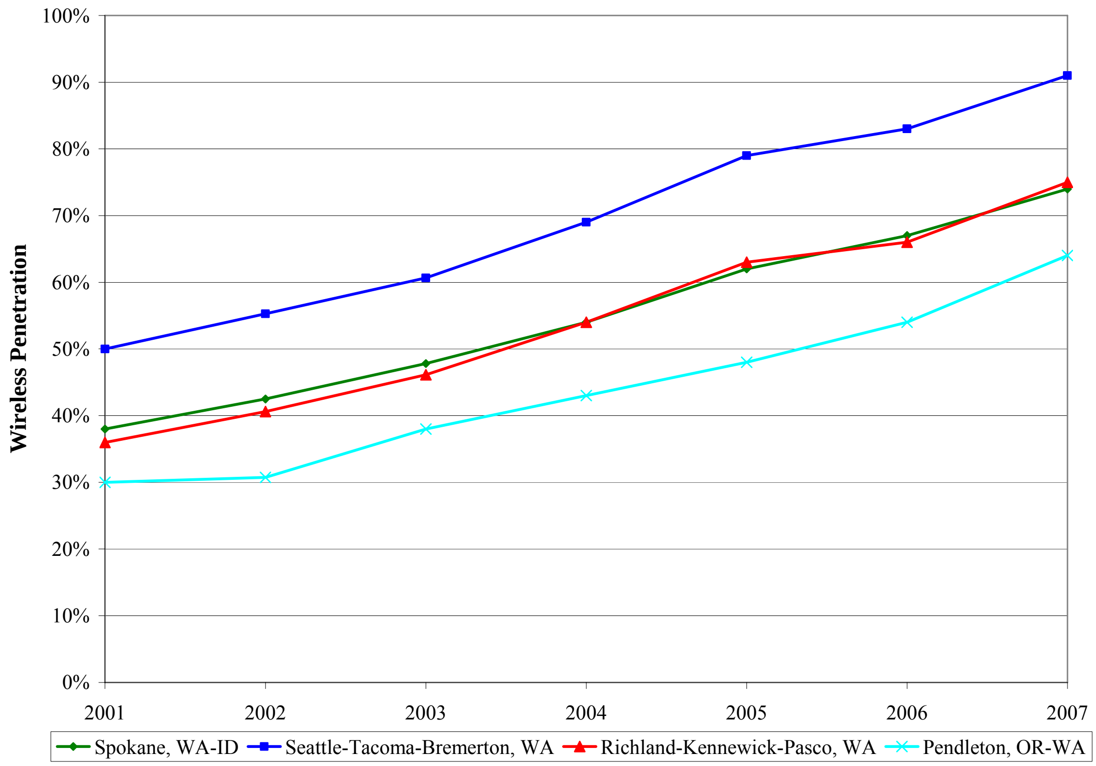
[19] See Implementation of Section 6002(b) of the Omnibus Reconciliation Act of 1993, Annual Report and Analysis of Competitive Market Conditions with Respect to Commercial Mobile Services, *Twelfth Report*, WT Docket No. 07-71, FCC 08-28, rel. Feb. 4, 2008, Table 14 (Twelfth CMRS Report).

Figure 2
Washington Wireless Subscriber Demand
1999–2007[20]



[20] Source: FCC, Industry Analysis and Technology Division, Wireline Competition Bureau, *Local Telephone Competition: Status as of December 31, 2007*, September 2008 and *Status as of June 30, 2007,* , Table 14, http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-285509A1.pdf. Note: Starting with the June 2005 data, wireless carriers were required to use the area codes of telephone numbers provided to subscribers to determine subscriber counts by state instead of using billing addresses for this purpose as they had done through December 2004. This change may explain why the reported number of subscribers declined in 2005. Also beginning in 2005, the FCC required all facilities-based wireless carriers to report, rather than only those with more than 10,000 lines in the state.

Figure 3
Wireless Penetration Has Grown in All Market Areas with Washington Customers 2001–2007[21]

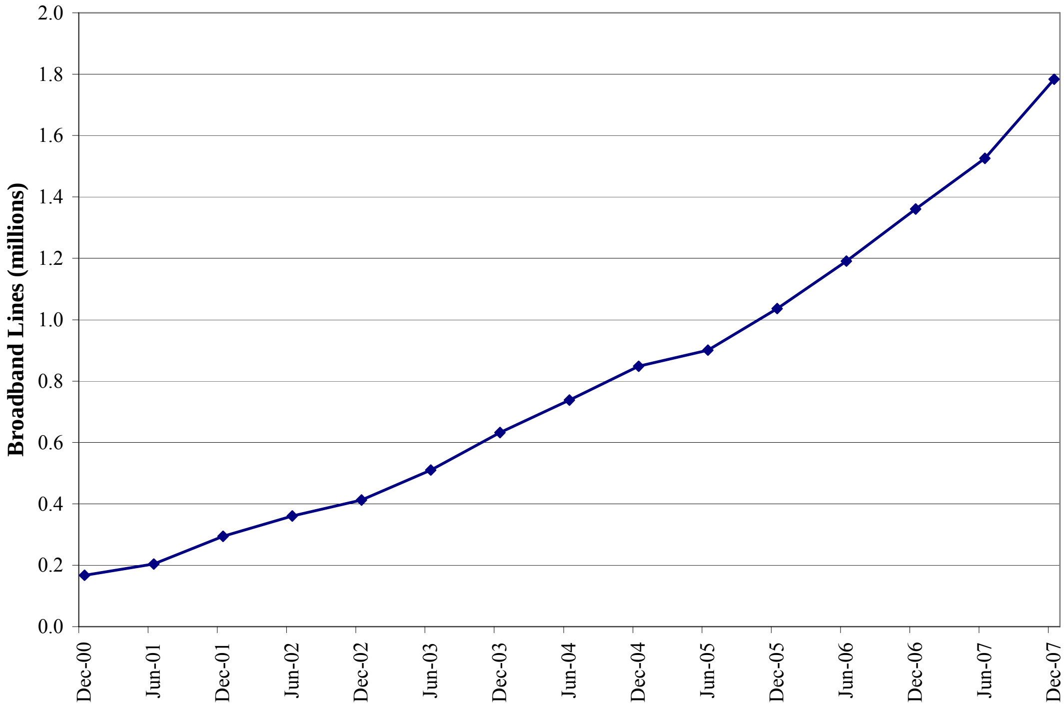


Q. ***Have residential broadband subscriptions been growing in Washington?***

A. Yes. The number of residential broadband subscribers in Washington has also increased dramatically, as illustrated in Figure 4. Indeed, in only two years from December 2005 to December 2007, the number of residential and small business high-speed lines grew by 72 percent to 1.78 million lines.

[21] Source: FCC, Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993, Annual Report and Analysis of Competitive Market Conditions with Respect to Commercial Mobile Radio Services, Seventh through Eleventh CMRS Reports (2002–2006), Table 3 and Twelfth through Thirteenth CMRS Reports (2008-2009), Table A-3, http://wireless.fcc.gov/index.htm?job=cmrs_reports.

Figure 4
Washington Broadband Subscriber Demand
2000–2007[22]



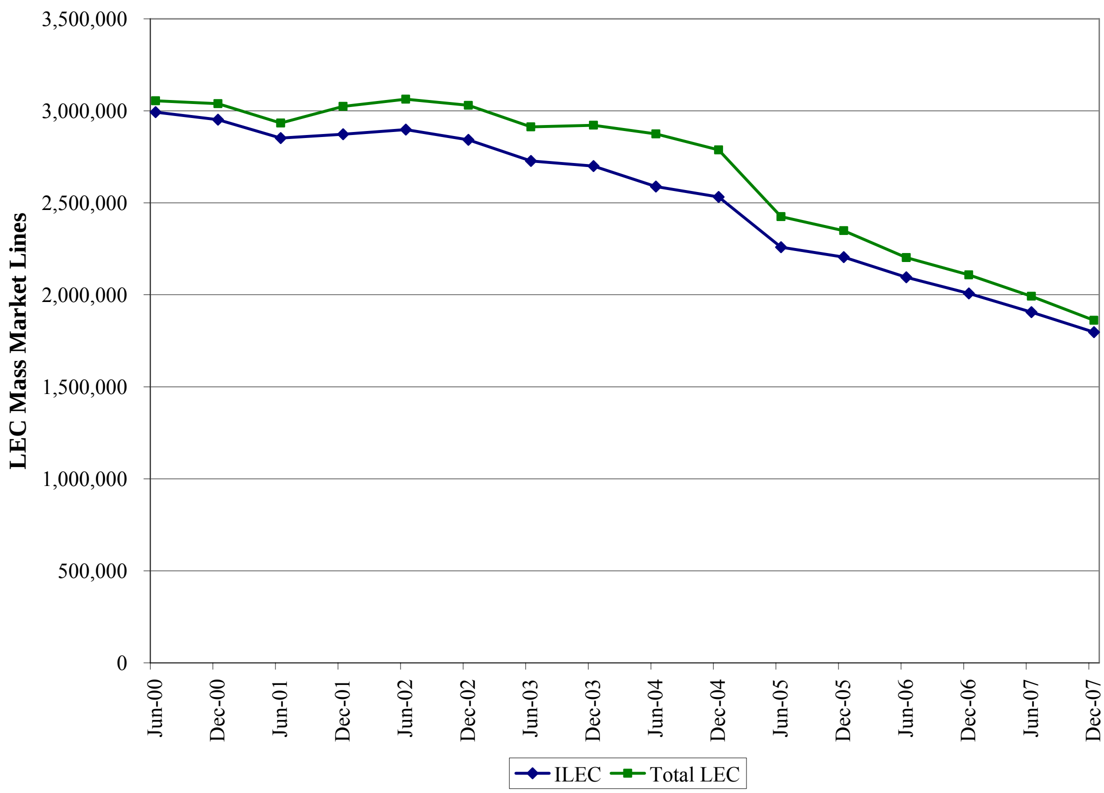
Q. ***How does the increase in demand for intermodal competitors relate to wireline line counts in Washington?***

A. As shown in Figure 5, the total local exchange carrier (ILEC plus CLEC) mass-market (residential and small business) switched-voice lines have been declining since June 2002 as demand for intermodal competitors in Washington has been rising. This indicates that consumers in Washington are substituting wireless, cable, and VoIP for traditional local wireline service. The actual decline due to intermodal competition is probably larger than

[22] Source: FCC, Industry Analysis and Technology Division, Wireline Competition Bureau, High-Speed Services for Internet Access, *2000–2007*, http://www.fcc.gov/wcb/iatd/comp.html.

shown in Figure 5 because the FCC data include cable CLECs, which have likely been growing over this time period.

Figure 5
LEC Washington Mass Market Lines
2000–2007[23]



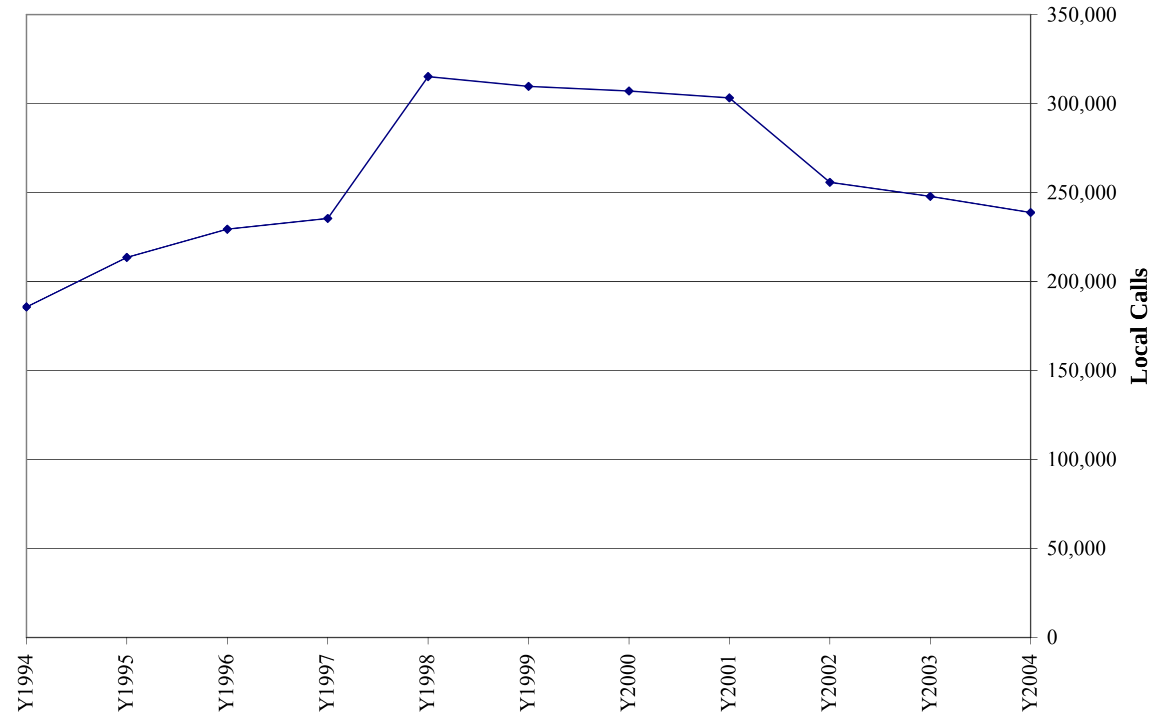
Q. ***How does the increase in demand for intermodal competitors relate to wireline local usage in Washington?***

A. As illustrated in Figure 6, United's ARMIS data show that the company has lost substantial local usage since 1998—the year in which FCC national data show that

[23] Source: FCC, Industry Analysis and Technology Division, Wireline Competition Bureau, *Local Telephone Competition*, 2000-2007. Note: Data for 2000–2004 include small businesses; data for 2005–2007 include residential lines only.

wireless usage began to burgeon. Again, this suggests that subscribers are substituting wireless, cable, and VoIP for traditional local wireline service.

Figure 6
United Washington Wireline Usage Demand
1994–2004[24]



Note: Sprint/United Telephone of the Northwest fell below the revenue threshold as of 12/31/2004. Therefore, they have discontinued filing the ARMIS Summary (43-01) and ARMIS Operating (43-08) Reports with the Commission.

Q. ***What do you conclude based on published FCC data regarding the level of competition ILECs face in Washington?***

A. The data show that Washington ILECs face substantial competition for mass-market customers.[25] Thus, the internal subsidies do not benefit local exchange companies to the

[24] FCC, ARMIS 4308 Report, Table IV, Row 570, available at http://fjallfoss.fcc.gov/eafs7/adhoc/table_year_tab.cfm?reportType=4308.

detriment of long distance carriers. Rather, more broad-based competitive forces are at work—forces that draw customers away from all forms of traditional fixed voice services.

Q. ***Then why are IXCs faced with decreasing levels of demand?***

A. The arguments of Mr. Bax and Mr. Vasington ignore the fact that the losses faced by IXCs stem not from internal subsidies present in wireline rates, but from regulatory asymmetries that affect ILECs at least as much as IXCs. Because, within the bundle of local and long distance services, subsidies from toll to local services mostly cancel each other out—that is, the overall bundle is no more expensive on average because of internal wireline subsidies.[26] However, because United's customers face similar prices if they buy a synthetic bundle of ILEC and IXC services or if they buy toll and local service from a single carrier, United is not advantaged (compared to the IXCs) by the current rate structure.

Q. ***What level of intermodal competition does United face in its service territory in Washington?***

A. The level of intermodal competition faced by United varies from region to region. Again,

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[25] A mass market covers substantial numbers of the population and may consist of a whole population or just a segment of that population.
[26] High use toll customers may be more affected by higher toll prices than those who use make fewer toll calls.

using the FCC's definitions, about **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]**

The wire centers in United's more populated areas serve 33 percent of its access line count, 37 percent of the population living in its serving territory, and **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]**. In these wire centers, United faces strong and growing competition. Specifically:

- **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]**
- 100 percent of households are covered by at least one wireless service provider.
- **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]**

Highly Confidential per Protective Order in UTC Docket UT-081393

Q. ***What is the status of competition in United's rural areas?***

A. Competition is somewhat limited relative to more populated areas. Yet, emerging competition is still present in United's rural wire centers,[27] which average **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]** per square mile. For example, United has lost **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]** of the residential lines it served almost eight years ago. In short, United faces strong competition in its more populated serving areas and relatively less intense competition in its rural areas.

Q. ***Is it possible that the drop in access lines is the result of a decrease in population rather than an increase in competition?***

A. No. The population in United's serving area in Washington actually increased between 2000 and 2008. Specifically, the number of households in United's more densely populated wire centers experienced an increase of **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]**, and the households in its rural areas increased by **[BEGIN**

Highly Confidential per Protective Order in UTC Docket UT-081393

[27] The following wire centers in Washington are rural, according to the FCC's definition of rural and nonrural: Bickleton, Brinnon, Chimacum, Columbia, Dallesport, Gardiner, Glenwood, Goldendale, Granger, Harrah, Klickitat, Lyle, Mabton, Mattawa, Paterson, Prosser, Quilcene, Roosevelt, Stevenson, Sunnyside, Toppenish, Trout Lake, White Salmon, White Swan, Whitstran, Willard, Wishram, Zillah

HIGHLY CONFIDENTIAL] [redacted] **[END HIGHLY CONFIDENTIAL]** The decrease in demand also is shown by the trend in the number of lines per household between 2000 and 2008.[28] In United's more populated areas, the lines per household decreased **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]**

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[28] Lines per household = total (residential and business) lines divided by the number of households. This measure is used to show that, when adjusted for growth in the areas served by Embarq, demand has actually fallen more rapidly than implied by the unadjusted raw counts of lines.

IV. THE PROPOSALS TO REDUCE ACCESS RATES ARE FLAWED AND WITHOUT MERIT

A. United's Current Rates Are Not Anticompetitive and Are Not in Violation of Washington State Law

Q. ***Do United's current intrastate switched access rates give it an anticompetitive advantage over the IXCs?***

A. No. As discussed above and in Exhibit No. ___ (CMD-3), United's own retail rates—like its intrastate switched access rates—are set *above* forward-looking incremental cost to allow the recovery of shared fixed and common costs of the firm as well as to cover the costs of residential basic exchange services intentionally priced below market-based levels to achieve social goals. This fact, however, does not imply that the current switched access prices harm competition between the IXCs and United as Mr. Vasington and Mr. Bax argue. Rather, the subsidies contained in the intrastate switched access rates were designed as part of a competitively neutral approach to fund universal service and thus do not provide any competitive advantage to United or other ILECs who provide the subsidized services. Specifically, carrier access charges in conjunction with charges for other services such as United's own intraLATA toll services are intended to allow United and other incumbent local exchange carriers to offer what are deemed "affordable" local rates and to serve all customers living in Washington, regardless of the cost to serve them.

Q. ***Mr. Vasington claims that United's intrastate switched access rates are anticompetitive. Is Mr. Vasington's argument complete?***

A. No. According to Mr. Vasington, "the anticompetitive impact of Embarq's excessive rates is … crucial to Verizon's claim."[29] Mr. Vasington makes numerous references to this alleged anticompetitive impact. He argues that: (1) United's intrastate switched access rates contain a subsidy element; (2) United thus receives a "contribution" from Verizon's long distance services; and (3) this gives United a competitive advantage over Verizon "in the provision of retail services within the state…."[30]

Q. ***What is wrong with Mr. Vasington's arguments?***

A. There are two basic problems. First, he ignores the competitive handicaps under which United must operate—for example, its own contributions to subsidize basic services and meet COLR obligations. Second, Mr. Vasington's claim is incomplete, as he never identifies the retail services within the state in which United supposedly has a competitive advantage. It is unclear whether he claims that United has an advantage over Verizon in the supply of long distance services, in the supply of basic local exchange services, or any other service or service basket.

[29] Vasington Direct, p. 3.
[30] Vasington Direct, p. 2.

Q. ***Did you try to obtain further clarifications from Mr. Vasington through discovery?***

A. Yes. Mr. Vasington was asked in discovery to list all Verizon retail services that he believes compete with United's services. He was unable to produce such a list and simply stated, "Verizon can potentially compete with all of Embarq's services."[31] While this may or may not be accurate, it does not answer the question, and it does not clarify which services Mr. Vasington claims are competitively affected by United's switched access rates.

Q. ***Based on the remainder of his direct testimony, could it be that Mr. Vasington refers to the supply of long distance services?***

A. That is possible. Mr. Vasington's testimony is all about toll carriers and they are "wholly at the mercy of the carrier that the called party uses for the local exchange service."[32] Therefore, it is reasonable to conclude that Mr. Vasington's claim of anticompetitive effects refers to the supply of long distance service.

Q. ***Does Mr. Vasington describe the form of competitive advantage that United allegedly enjoys?***

A. No. Again, Mr. Vasington does not explain his conclusions as he fails to identify the competitive advantage to which he refers. Generally, a competitive advantage is a situation in which a company is able to earn above normal returns. There are many types

[31] Verizon Response to Embarq's First Data Request, EQ-VZ DR-8 (see Exhibit No. ___ (CMD-4).
[32] Vasington Direct, p. 6.

of competitive advantages. For instance, a company can have a cost advantage over its competitors. In this instance, the company with the competitive advantage would be able to offer the identical product as its competitors at a lower price. Another form of competitive advantage comes from service or product differentiation. In this case, the firm with the competitive advantage can offer a superior product at the same price that its competitors charge for a less valuable product or service. Other types of competitive advantages are first-mover advantages, incumbency advantages, and network effects.

Q. ***Are United's switched access rates the reason AT&T's toll volumes decreased in Washington?***

A. No. Mr. Bax claims that **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** [redacted] **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** He uses these and other statistics to demonstrate that IXCs cannot compete when "burdened with a huge cost their competitors (using alternative technologies including the Internet and wireless) do not pay."[33] He further argues, "implicit subsidies are a 'ball and chain' that thwarts the ability of AT&T and other IXCs to compete on their own merits in the market place."[34] While I generally agree that regulation financially burdens regulated

Highly Confidential per Protective Order in UTC Docket UT-081393

[33] Bax Direct, p. 5.
[34] Bax Direct, p. 6.

operators, Mr. Bax's statements do not demonstrate that United's switched access rates are responsible for AT&T's decline in intrastate toll volume and revenues. Indeed, he ignores that many other factors account for AT&T's losses. Among the factors that Mr. Bax ignores are the following:

(1) The FCC's approval of Qwest's application to provide in-region interLATA toll service in Washington beginning in 2003.[35] Thus, starting in 2003 AT&T faced a potent new wireline competitor for long distance traffic in the state.

(2) AT&T's share of wireline toll was declining during the period at issue. FCC data show that nationally AT&T's share of residential wireline long distance subscribers fell from 31.7 percent in 2003 to 18 percent in 2005. Its share of residential interLATA minutes carried by wireline carriers fell by about 58 percent (from 26 percent to 10.8 percent) over the same period, during which the regional Bell operating companies (RBOCs) expanded their share of long distance.[36] Figure 7 summarizes data on AT&T and RBOC shares of residential InterLATA traffic volumes from 2003 to 2005. Since AT&T was losing market share rapidly during the period from 2003 forward, changes in its own volumes are unreliable measures of the impact of carrier access charges on the IXCs' ability to compete.

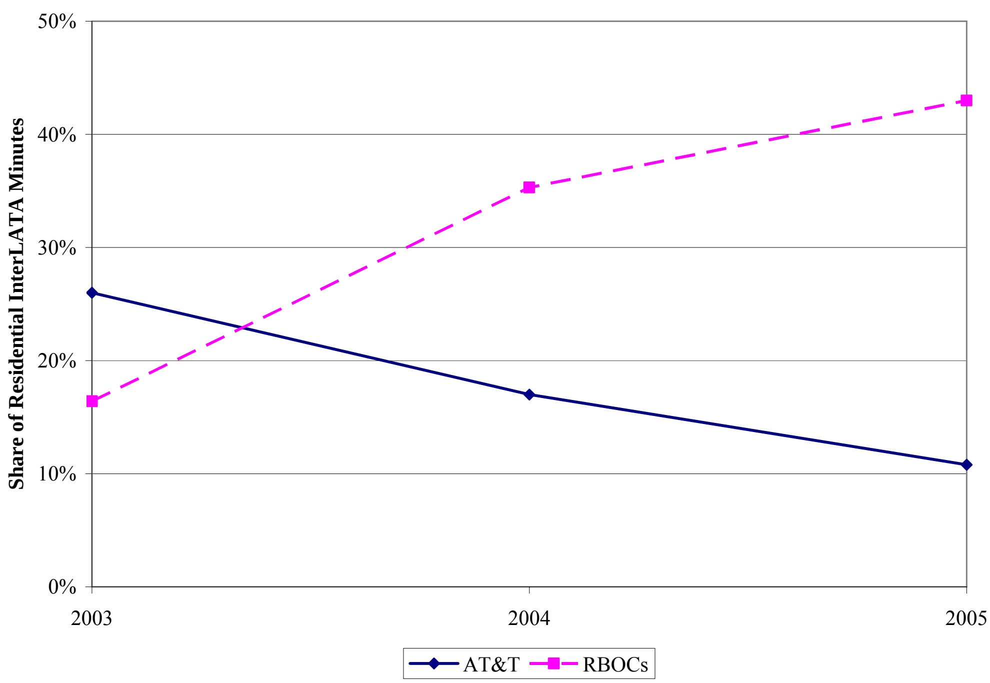
[35] See FCC, *Trends in Telephone Service, August 2008*, Table 9.7, Regional Bell Operating Companies' Applications To Provide In-Region InterLATA Service (Section 271 Applications), which shows that Qwest received approval to provide in-region interLATA toll service in Washington on December 23, 2002.

[36] Ibid, Table 9.5, Residential Household Market Shares: 1995–2007. I do not carry the analysis through the next two years because the AT&T data reflect its acquisition by SBC. Since these are national data, it is necessary to include all of the RBOCs because their impact on the residential market was generally confined to their own regions.

(3) All forms of wireline calling, including local and interstate as well as intrastate toll calls, have been declining since 2003.[37] More specifically, as shown in Figure 8 from 2003 to 2006:

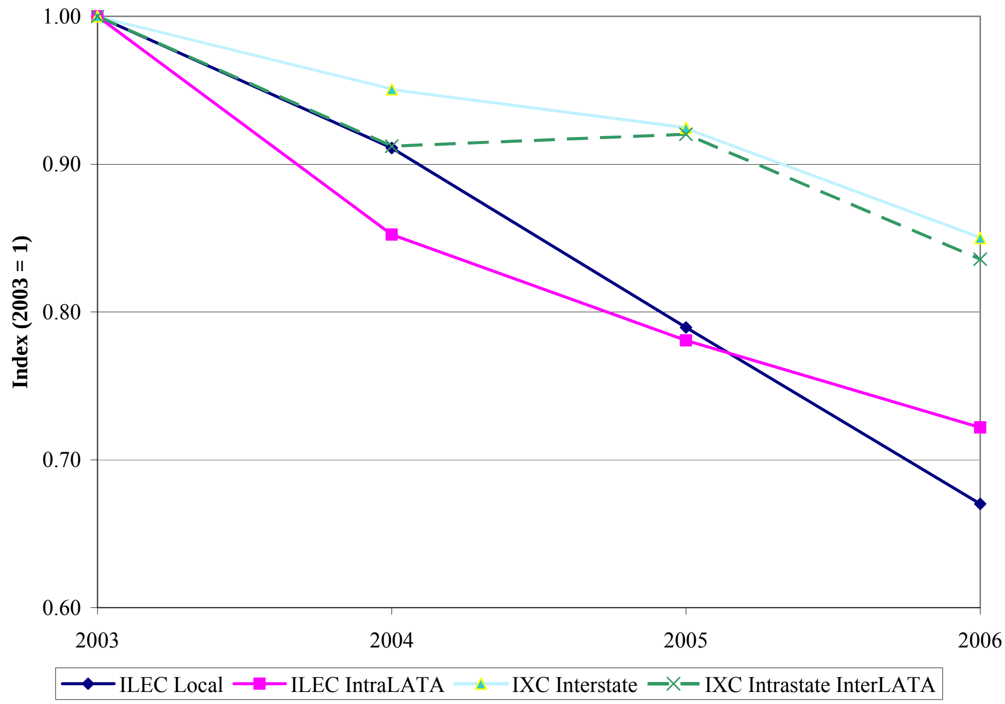
- The number of IXC interLATA interstate and intrastate toll calls declined by about the same percentage during the period—by about 15 and 16 percent, respectively.
- Both ILEC and IXC calls declined from 2003 to 2006.
- Indeed, ILECs saw a more rapid loss of calling volumes than did the IXCs.

Figure 7
AT&T Lost Market Share as RBOC Toll Shares Increased



[37] Ibid., Table 10.2, Telephone Calls and Billed Access Minutes of Large ILECs Reporting to the Commission.

Figure 8
Indices of Number of Wireline (ILEC and IXC) Calls 2003 to 2006



1 The overall decline in wireline traffic is attributable to factors other than switched access charges. As I quoted previously from AT&T's Form 10-K, competition from cable, wireless, and VoIP providers has eroded AT&T's overall wireline business, not just its long distance operations. These same forms of intermodal competition have affected United as well. Wireline carriers of all types are losing business to competitors primarily due to price (e.g., unlimited, "free" off-peak toll calling included in wireless plans) and nonprice (e.g., mobility and the rapidly growing capabilities of wireless services) attributes that affect United as well as the IXCs. Telecommunications competition is strong and thriving. A natural by-product of competition is that IXCs, as well as ILECs, are losing market share to intermodal competitors, such as wireless, cable, and VoIP. Subscribers are switching their mode of communications not because of a subsidy that

the IXCs feel compelled to recover in their long distance rates, but for other reasons—notably, competition for the overall bundle of telecommunications services. As summarized by AT&T:

> We continue to lose access lines due to competitors (e.g., wireless, cable and VoIP providers) who can provide comparable services at lower prices because they are not subject to traditional telephone industry regulation (or the extent of regulation is in dispute) and consequently have lower cost structures. In response to these competitive pressures, for several years we have utilized a bundling strategy that rewards customers who consolidate their services (e.g., local and long-distance telephone, DSL, wireless and video service through our AT&T U-verse service and our relationships with satellite television providers. We will continue to develop innovative products that capitalize on our expanding fiber network.[38]

Mr. Bax does not offer any valid evidence linking the trend away from wireline long distance to wireless, email, and so on to the level of intrastate switched access rates. Moreover, all parties seem to agree that intermodal competition in the U.S. is strong and thriving. This type of competition developed for many reasons ranging from technological changes that have stimulated demand for new communications services to the asymmetric regulation under which wireline carriers operate. The subsidies in wireline service prices that perpetuate low prices for basic services thus adversely affect all types of wireline carriers, including ILECs, like United.

[38] AT&T Inc., 10-K, February 25, 2009, p. 19.

Q. ***If United's access rates are not providing the company with a competitive advantage, are they violating Washington state law?***

A. Not being a lawyer, I can only provide a layman's response to this question. According to Mr. Bax, the State of Washington's law requires rates to be "fair, just and reasonable."[39] Based on my analysis in this testimony and the testimonies presented by Mr. Henry J. Roth and Mr. John M. Felz, I do find United's rates to be fair, just, and reasonable; therefore, by Mr. Bax's standard they are *not in violation of Washington state law*.

B. Reducing United's Intrastate Switched Access Rates Will Not Benefit Consumers or Competition

Q. ***Does Mr. Vasington show how Washington consumers would benefit from Verizon's proposed access rate reduction?***

A. No. Short of a few general statements to the effect that United's alleged excessively high intrastate switched access rates "create economic distortions that reduce the efficiency of Washington's telecommunications industry," Mr. Vasington does not address how his proposal would benefit consumers or competition in Washington.[40]

[39] Bax Direct, p. 16.
[40] Vasington Direct, p. 4.

Q. ***Does Mr. Bax show how Washington consumers would benefit from Verizon's proposed access rate reduction?***

A. No. Similar to Mr. Vasington, Mr. Bax relies on a few high-level, incomplete and unsupported (and incorrect) claims, such as "implicit subsidies are a 'ball and chain' that thwarts the ability of AT&T and other IXCs to compete on their own merits in the marketplace."[41] His recommendation is entirely divorced from these claims because he does not establish how reducing United's intrastate switched access rates to interstate levels are supposed to remove this "ball and chain" or how it is supposed to improve AT&T's ability to compete or how consumers would actually, and directly, benefit.

Q. ***Will reducing intrastate switched access rates increase competition in Washington?***

A. No. There are at least two reasons for this. First, as I have shown above, competition in Washington is strong and thriving—particularly in urban and suburban areas. If, in fact, United's access rates were a true "ball and chain" to competition, then there would be no competition, or competition would be severely limited. Second, marketplace evidence suggests that there is no correlation between intrastate switched access rates and long distance pricing. That is, counter to the claims made by Mr. Vasington and Mr. Bax, statistical evidence does not support the claim that lower access rates leads to increased competition.

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[41] Bax Direct, p. 6.

Q. ***Please explain how you arrived at the finding that reducing United's intrastate switched access rates would not benefit long distance customers in Washington.***

A. AT&T charges its Washington long distance customers state-specific fees aimed at recovering at least a portion of the intrastate switched access fees paid by the carriers. In Washington, AT&T describes its residential "in-state connectivity fee" as follows:

> AT&T is charged by your local telephone company in Washington to carry your AT&T in-state long distance and local toll calls over its lines. In order to help recover these costs, AT&T includes in your monthly bill a $1.40 In-State Connection Fee. The fee applies to Customers subscribed to AT&T for residential long distance or local toll service. The fee does not apply to customers of AT&T Local Service, where applicable.[42]

If United's access rates were reduced to United's interstate access rate levels, as AT&T has recommended, United's intrastate switched access rate would be reduced by about 91 percent. Assuming that AT&T passes through the entire cost savings to its customers, this could mean a corresponding reduction in AT&T's in-state connectivity fee from its current level to approximately $0.13—a cost savings of $1.27 per month for customers living in United's operating area in Washington.

[42] AT&T, Washington, In-State Connectivity Fee, http://www.consumer.att.com/instate-connectionfee/wa_home.html.

Q. ***By how much would the per-minute price for AT&T's long distance calling prices decline?***

A. I cannot accurately predict to what extent AT&T would pass through the access charge reduction, if at all, and whether this reduction would have an impact on AT&T's overall pricing strategy. Given that AT&T sets its prices on a regional basis, it is unlikely that it would have any impact. However, I can provide an order of magnitude forecast of how per-minute prices for AT&T's long distance calling might decline if United's intrastate switched access rates were lowered to interstate levels. I have estimated that an AT&T customer subscribing to AT&T's "One Rate 10 cent Nationwide Plan" with 100 minutes of toll calls per month would see his calling prices decline by *little over one cent* per minute. This assumes that AT&T fully passes through any reduction to consumers, something to which it has not committed, and something it has failed to do in the past in similar situations when access charges were reduced. The calculations for this analysis are shown in Exhibit No. ___ (CMD-4).

Q. ***Does Verizon have a similar in-state recovery fee in Washington?***

A. Yes. Verizon has a similar fee, labeled "instate access recovery fee," which Verizon uses to charge Washington residential customers $1.25 per month per line.[43]

[43] Verizon Response to Embarq's First Data Request, EQ-VZ DR-31.

Q. Have you done a similar analysis for Verizon?

A. Yes. As shown in Exhibit No. ___(CMD-4), I estimate that reducing United's intrastate switched access rates to its interstate levels could reduce Verizon's average residential in-state toll rates in Washington by *just over one cent per minute.* Again, this assumes that Verizon would fully pass through the switched carrier access rate reduction—an assumption that is ultraconservative.

Q. Would this decline in prices benefit Washington consumers?

A. No. Again, one could argue that any cost savings for long distance customers is a benefit, regardless of how small. However, when compared to the costs or repercussions that follow a reduction in intrastate switched access rates, the net effect remains clearly negative.

Q. Would a decline in prices increase competition for long distance services in Washington?

A. The reduction is unlikely to have any material impact on competition between IXCs and other modes of carrying long distance services. Reducing the average per-minute charge for AT&T's or Verizon's residential in-state toll rates by one cent per minute would have little effect on competition with wireless and VoIP carriers offering plans with free long distance calling.

Q. ***Would reducing intrastate switched access rates increase competition from local exchange carriers?***

A. The reduction is unlikely to have any impact on competition from local wireline carriers competing with United. There could be a slight impact in that lowering switched access rates could allow companies such as AT&T, that offer bundled local and toll services, to reduce the monthly bundled charge and increase competition at the margin between the CLECs and intermodal competitors. Unfortunately, LECs offering such bundles *over their own networks* would then have to make up for lost access revenues by increasing their local rates, so the results would be offsetting at best. To the extent that such LECs were the only ones with COLR and other universal service obligations, they would be adversely affected for the reasons explained above.

Moreover**,** reducing switched access rates would likely have no impact on competition for local usage from competing local providers because interconnection rates within a LATA for local calls are based on reciprocal compensation. Essentially, reciprocal compensation is a settlement mechanism for telephone traffic transferred between two local networks. Reciprocal compensation rates can be determined by tariff through a state regulatory body's organized plan or other methods such as agreements between the parties involved. Such agreements (for example, an interconnection agreement) state the billing rates and the application of these rates.

Q. ***Would reducing intrastate switched access rates increase competition from wireless operators?***

A. This is highly unlikely for several reasons. First, wireless carriers often can avoid intrastate switched access on calls that would be toll calls on a wireline network because the FCC has found that wireless carriers are subject to the reciprocal compensation rules for calls within major trading areas (MTAs).[44] Because of the large size of these areas (shown for the State of Washington in Figure 5 of Exhibit No. ___ (CMD 3) wireless carriers generally pay for call termination and under their reciprocal compensation agreements, they do not pay intrastate switched access rates. Second, wireless carriers typically set their pricing plans based on the competitive condition in a region, not state-specific intrastate switched access rates. Moreover, wireless carriers are largely unregulated, which they can use to their competitive advantage over their regulated wireline competitors.

[44] "In the *Local Competition First Report and Order*, the Commission stated that traffic to or from a CMRS network that originates and terminates within the same Major Trading Area (MTA) is subject to reciprocal compensation obligations under section 251(b)(5), rather than interstate or intrastate access charges." FCC, In the Matter of Developing a Unified Intercarrier Compensation Regime, *Further Notice of Proposed Rulemaking*, CC Docket No. 01-92, FCC 05-33, ¶ 134 (FNPRM Unified Carrier Comp.). See also note 36 where the Commission notes, "In the Local Competition First Report and Order, the Commission also concluded that 'the new transport and termination rules should be applied to LECs and CMRS providers.'" FCC, Local Competition First Report and Order, 11 FCC Rcd at 16016-17,¶ 1043," and ¶ 134, where the Commission states, "… section 51.701(b)(2) of the Commission's rules defines telecommunications traffic exchanged between a LEC and a CMRS provider that is subject to reciprocal compensation as traffic 'that, at the beginning of the call, originates and terminates within the same Major Trading Area.'"

Q. ***Does the empirical evidence suggest that reducing intrastate switched access rates is associated with lower prices for AT&T's bundled local, toll, and long distance offering?***

A. No. Although the State of Washington requires statewide averaged toll rates, one might think that the rates would vary on a state-by-state basis depending on varying switched access rates. However, as I illustrate in Table 2, AT&T's intrastate long distance and local toll rates are not only identical in areas served by United, Verizon NW, and Qwest in Washington, but also identical to AT&T's comparable toll plans in areas served by United in Oregon, Verizon in Texas, and Qwest in South Dakota. These data suggest that AT&T sets its prices with a national focus, and intrastate switched access rates have little, if any, effect on its domestic long distance retail pricing.

Table 2
AT&T Wireline Long Distance Calling Prices
by Zip and Serving ILEC in Oregon and Idaho
Using the "AT&T One Rate 10 Cent Nationwide" Plan

					Price Per Minute		
ILEC	**State**	**Locality[1]**	**Access Charge[2]**	**Monthly Fee**	**Interstate LD**	**Intrastate LD**	**Local Toll**
United	Oregon	Bay City	$0.68	$2.99	$0.10	$0.10	$0.10
Verizon	Texas	Argyle	$0.70	$2.99	$0.10	$0.10	$0.10
Qwest	South Dakota	Pierre	$1.00	$2.99	$0.10	$0.10	$0.10

Notes and Sources:
[1] http://www.localcallingguide.com/lca_listexch.php
[2] http://www.consumer.att.com/instate-connectionfee/index.html

Q. ***What do you conclude from these analyses?***

A. Clearly, intrastate switched access rates in Washington have no direct impact on retail long distance prices. Therefore, lowering them likely would not benefit consumers in Washington.

C. Comparing this Proceeding to Other States Is Inaccurate and Meaningless

Q. ***Is it valuable for this Commission to look at other states when addressing this matter?***

A. No. Mr. Vasington wants this Commission simply to look at other states' decisions and preliminary decisions when addressing Verizon's complaint.[45] By doing so, Mr. Vasington completely ignores that the costs, service territories, population densities, as well as many other characteristics differ significantly among the states. All he has done is compared inapplicable results. What might have made sense in one state might not make sense in another state as the facts, the policies, and the state requirements may differ. Rather than "rubberstamping" the results from other proceedings, I recommend that this Commission carefully analyze the effect the proposed rate reductions would have on Washington consumers living in United's service territory. As I have shown above, a state-specific analysis is particularly important in Washington because United's costs, service territory, population densities, as well as many other characteristics differ significantly from Verizon NW and Qwest. Further, the goals of the Commission in Washington may not be the same as the goals and/or the requirements of other state

[45] See Vasington Direct, pp. 28–31.

regulatory agencies. Each Commission has to assess what is necessary and/or required for its particular state. So, rather than arbitrarily adopting another state's policy *results*, this Commission must analyze and determine the best policy for Washington regarding the costs and benefits of United's existing intrastate switched access levels and the effect of any access rate reduction, as proposed by Verizon and AT&T, given that United is an ILEC serving high-cost, rural areas in Washington. Finally, Mr. Vasington's analysis is incomplete at best. For example, he cites to Ohio, claiming that "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."[46] What Mr. Vasington ignores is that the same commission allowed Embarq's and Verizon Ohio's ILECs to establish intrastate access fees that they charge to end users, similar (albeit not identical) to the federal SLC charge described in Exhibit No. ___ (CMD-3). The objective of the intrastate access fees is to help offset the reductions in intrastate access revenues.

Mr. Vasington also refers to proceedings in Kansas, Minnesota, and Virginia. However, Mr. Vasington does not mention states whose decisions do not support his recommendation. For instance, in Maine, the legislature ordered the commission to ensure intrastate mirroring of interstate switched access rates: "By May 31, 2005, the commission shall insure that intrastate access rates are equal to interstate access established by the Federal Communications Commission as of January 1, 2003."[47]

[46] Vasington Direct, p. 28.
[47] See MN Rev. Stat. Ann. 35-A 4 7 IO I -B(2).

Specifically, the Maine public utilities commission implemented the statutory directive by adopting a rule requiring each local exchange carrier to implement access mirroring by June 1, 2003, and to refresh the mirrored rates on June 1 every two years thereafter. However, unlike Verizon's proposal in this matter, the regulators created a state USF effective in April 2003 with the stated purpose of:

> [P]rovid[ing] support from the Fund to local exchange carriers (LECs) that provide local exchange service in areas served by rural incumbent local exchange carriers and that are unable otherwise to meet their allowed intrastate revenue requirement from retail local exchange, other telephone services, *and access revenues*.[48] (emphasis added)

Thus, while I believe that only a state-specific review provides meaningful answers, should this Commission rely on the actions of regulators in other states, it should look at all states, not just a few select states that support Mr. Vasington's position.

[48] See MN Rev. Stat. Ann. 35-A 4 7 IO I -B(2).

D. The Point that Intrastate and Interstate Access Perform the "Same Functions" Is Incorrect and Fails to Support a Major Change in Pricing and Universal Service Objectives

Q. ***If the Commission chooses to reduce intrastate switched access rates to interstate levels, how much would United's revenue decline?***

A. As detailed in Mr. Felz's testimony, United's 2008 annual demand was **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]**[49] As detailed in Mr. Roth's testimony, Mr. Roth explains that United's intrastate switched access rate, based on *today's* costs, should be **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]** Assuming constant demand, this results in annual access costs for the company of **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]** United's annual access revenues are **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]**, well below their costs. In contrast, should the Commission decide to reduce United's intrastate switched access rate to its 2008 interstate switched access rate of $0.00593 per minute, United's

A.

Highly Confidential per Protective Order in UTC Docket UT-081393

[49] See 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 v. United Telephone Company of The Northwest*, Respondent, Docket No. UT-081393, "Response Testimony of John M. Felz on Behalf of United Telephone Company of the Northwest," April 17, 2009, Exhibit No. ___ HC(JMF-4HC) (Felz Responsive).

annual access revenue would be **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]**—a reduction of over $5.6 million per year.

Q. How does this switched access revenue loss compare to United's total revenue?

A. United's intrastate regulated annual revenue is approximately $30.9 million. Hence, when benchmarked against the current composite intrastate switched access costs detailed in Mr. Roth's testimony, a reduction of intrastate switched access rates to interstate levels would equate to a shortfall of 18 percent.

Q. If the Commission chooses to reduce United's intrastate switched access rates to Verizon NW's intrastate levels, how much would United's revenue decline?

A. United's revenue would decline to **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]**—a reduction of over $5 million per year.

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Q. ***Could United simply ignore this revenue loss?***

A. No. United could not continue to provide the same high quality service to all of the people in its operating area that it does today if it were to incur the drastic losses contained in either AT&T's or Verizon's proposal. In addition, its fiduciary duty to its stockholders would not allow United to do so.

Q. ***Can the proposed intrastate switched access rate reductions be analyzed without United's economic costs?***

A. No. Intrastate switched access rates are part of a rate structure designed to counterbalance the financial impact of COLR and universal service obligations. Therefore, it is imperative that the Commission analyzes United's TSLRICs and contrasts them to the revenue that United is allowed to collect from its subscribers under the prevailing regulatory framework. Based on this fact alone, Mr. Vasington's proposal to lower United's access rates to mirror Verizon NW's rates makes little sense. Verizon NW's serving areas and its cost structure are entirely different from United. Therefore, there is no reason why United's rates should be set at the same level as Verizon NW's rates.

Q. ***How could United recover its loss of switched access revenue?***

A. If the Commission adopts either Verizon's or AT&T's proposal, United has a limited set of options available to recover its loss in intrastate switched access revenue. First, it could attempt to recover the lost revenue from its customers in its nonrural, densely populated areas. However, market forces likely would prevent, or at least limit, such recovery as United faces relatively strong competition in its rural population clusters. Second, it could attempt to recover the lost revenue from its customers in its more rural areas. However, such a move, particularly at the levels that would be required to address the intrastate access reductions advanced in this case, would jeopardize the fundamental objectives of the universal service program because it would raise basic local rates in rural Washington, affecting the availability and affordability of local telephone service. Third, it could attempt to recover the lost revenue from single-line businesses. However, as explained, most of these businesses are in more populated areas that are subject to competitive forces. Fourth, it could decrease its network investment. This would be possible only in rural areas because in areas where the population is higher it would not be an economically sound decision because of the greater competition that exists in these areas. Finally, United could attempt to reduce the quality of service it provides to its customers. However, any reduction in service quality would also have to be in areas where competition is not strong—rural areas. Therefore, it appears that, absent any regulatory recovery method (such as a state universal service fund), United would need to recover any revenue loss from customers living in wire centers with limited competition—the rural wire centers.

Q. Could pricing flexibility be used as a tool to recover the lost access revenue?

A. No. Although Mr. Vasington finds it unnecessary to provide United with a proverbial tool to recover the lost access revenue, Mr. Bax does find that in order for United to recover any lost access revenue "Embarq should be permitted the opportunity to offset any reductions in revenues by way of increases to its rates for end-user retail services.…" However, as Mr. Bax points out, pricing flexibility merely provides an opportunity for United to adjust its prices to more competitive levels. Similarly, AT&T witness Ms. Mullin suggests that United could utilize pricing flexibility to increase prices for its bundled services to offset revenue reductions.[50] Both of these claims are incorrect. Whether the granted flexibility translates into increased earnings remains to be seen. The competitive nature of United's service territory in Washington would likely restrict United's ability to profitably raise prices. More importantly, pricing flexibility does not provide United with a recovery tool for the cost burden imposed by its universal service obligations as United cannot both price its services at competitive levels *and* price to recover its regulatory costs. This is a problem unique to United and other ILECs serving high-cost, low-density areas of Washington. Conversely, Verizon NW and Qwest, as ILECs, have greater customer densities, lower costs, and more urban service territories and, therefore, with such key distinguishing facts likely can both price services at competitive levels and price to recover regulatory costs. Pricing flexibility cannot replace subsidies that today provide tangible benefits to United's Washington consumers in the form of universal service at just and reasonable rates. Hence, the second part of Mr. Bax's recommendation is more meaningful where he recommends that United be allowed

[50] See 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 v. United Telephone Company of The Northwest*, Respondent, Docket No. UT-081393, "Direct Testimony of Sharon L. Mullins on behalf of AT&T Communications of the Pacific Northwest, Inc., February 18, 2009, p. 6.

to recover the lost access revenues "with explicit and competitively neutral access replacement support."[51]

Q. Which strategy has most potential?

A. No one thing will make up for the loss of any switched access revenue. It is important to recognize that, given the complex structure of access charges in Washington and elsewhere, intrastate switched access rates cannot simply be reduced without considering the potentially serious implications on universal service, or consumer welfare. It requires several things to happen. First, a state-specific universal service fund is needed to help make the existing implicit subsidies explicit. Second, sufficient pricing flexibility to raise rates where competition permits is needed. Third, the ability to rebalance rates to correct for inefficiencies in the existing system is needed. If faced with a rate reduction absent these three items, United will have some very troubling decisions to make with potentially serious consequences. United would be forced to recover any lost switched access revenue from wherever it could. It could increase prices on its retail services, but these services are generally sold in more competitive areas; therefore, United would stand to lose those customers if its prices were raised above competitive levels. It could raise end user charges, but only where there was sufficient room to move prices to cover costs and still have reasonable rates. This would certainly exclude those customers in high-cost areas because any attempt to price basic local service at cost-based rates in these areas would make the price too high to be affordable. Finally, United could cut back on its

[51] Bax Direct, p. 25.

investments and its service quality, which would be detrimental to consumers. The Commission has three basic choices: (1) leave the current rates as they are, (2) open a full rate rebalancing case that would provide United with more pricing flexibility and that would establish an explicit universal service fund, or (3) remove all regulatory constraints currently imposed on United. Whichever option this Commission elects, it is imperative that it not reduce intrastate switched access rates, but carefully consider which of the options described above would be best for the residents of Washington.

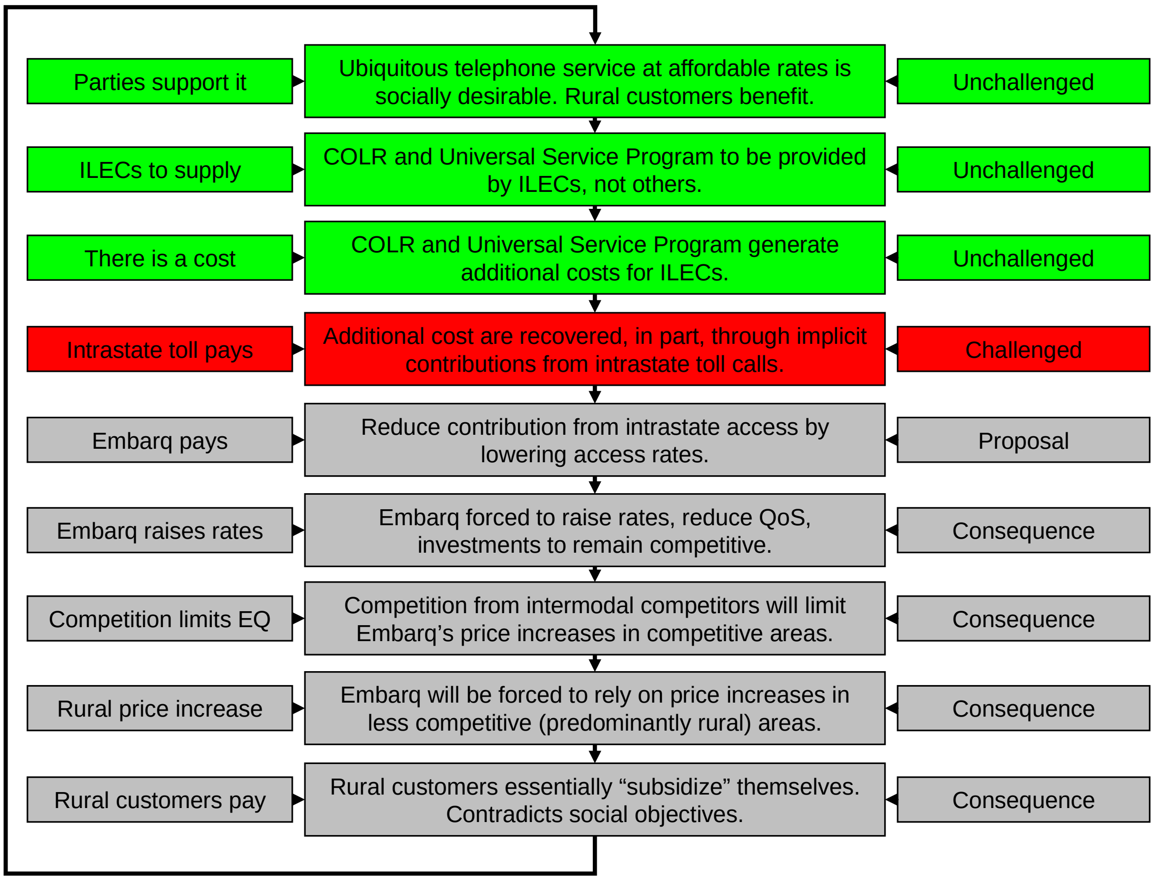
Q. ***Based on these considerations, what would be the economic consequences of adopting either of these proposals?***

A. The witnesses argue for the elimination of the requirement that the IXCs collect the necessary subsidy, or contribution, from long distance customers and want the full burden to fall on United—they want United to absorb these costs. Mr. Vasington states, "there is no danger to requiring Embarq to mirror Verizon's intrastate rate could result in a below-cost rate for Embarq. Embarq will clearly be able to continue earn a contribution from its intrastate switched access rates in Washington.…"[52] This policy focuses only on the direct costs of switched access service; it ignores that the current prices were determined to be needed to help offset other costs associated with furthering public policy goals. What Mr. Vasington fails to establish is whether United can afford to absorb the proposed access rate reduction. Even if it were true (which it is not) that United could lower its intrastate switched access rates and still make a positive return in the provision

[52] Vasington Direct, p. 21.

of local exchange service, it would be economically irrational. United would not be able to continue servicing customers with below competitive rates or investing in its network to low-income customers or those living in high-cost areas. Hence, short of regulatory relief, United would be forced to pass the access revenue reduction on to its customers in the form of higher prices, lower quality of service, lower levels of innovation, or a combination of these actions. However, given the competitive forces present in at least some of the areas served by United, it is unlikely that United would be able to sustain such price increases. Consequently, United would have to limit its price increases and other recovery measures to the very rural areas and low-income customers that gave cause to the universal service program. In short, Mr. Vasington's and Mr. Bax's proposals recommend that rural Washington and low-income households subsidize themselves. This, of course, directly contradicts the social objectives underlying universal service discussed above. I summarize this crucial point in Figure 9.

Figure 9
Complainants' Recommendations Contradict Public Policy Objectives



Q. ***Does Mr. Vasington offer any testimony as to how his proposal prevents the outcome you explain above?***

A. No. Mr. Vasington's testimony fails to address how this Commission can continue to ensure that rates remain affordable, particularly in high-cost, rural Washington. In fact, Mr. Vasington does not explore at all how Washington consumers would be impacted by the proposed access rate reduction. Moreover, Mr. Vasington remains largely silent on how long distance customers would benefit if his proposal were to be granted. Rather, he presents a very broad, generic argument that United's access rates "reduce the efficiency of Washington's telecommunications industry" and are "unjust, unreasonable, and anticompetitive."[53]

Q. ***Does Mr. Bax offer any testimony as to how his proposal prevents the outcome you explain above?***

A. No. Although Mr. Bax finds it "extremely important" to note that he is addressing the implicit subsidies imposed on intrastate interexchange services "that are causing Washington consumers to pay more than they should for their intrastate long distance calls," he too fails to elaborate on how the Commission could avoid having low-income customers or those living in rural Washington "subsidize themselves."[54] Mr. Bax also does not explain how his proposal would benefit Washington consumers who allegedly pay inflated prices.

Mr. Bax, however, does acknowledge that "Embarq should be permitted the opportunity to offset any reductions by way of increases to its rates for end-user retail services.…"[55] Therefore, if anything, Mr. Bax confirms my finding that a reduction in United's switched access rates would directly undermine the public policy objective of keeping local exchange rates affordable.

[53] Vasington Direct, p. 4.
[54] Bax Direct, p. 4.
[55] Bax Direct, p. 25.

V. WASHINGTON CONSUMERS COULD SUFFER SERIOUS ECONOMIC CONSEQUENCES IF INTRASTATE SWITCHED ACCESS RATES ARE REDUCED

Q. ***How is it that incumbent local exchange carriers subject to COLR obligations incur higher costs than carriers that are not mandated to provide a ubiquitous network and affordable service?***

A. The COLR obligation has several practical consequences for an incumbent local exchange carrier like United. First, as originally intended, it requires the company to serve the entirety of it service area in Washington, including high-cost, low-density areas. Second, United is required to maintain its network even to customers who no longer wish to subscribe to wireline service, but instead opt for competing services, such as wireless, cable telephony, or VoIP. United does not receive any revenues from these customers, and the company does not expect to receive any revenues from these customers in the near future. In stark contrast, nonregulated competitive entities, such as wireless and cable providers, are free to select the regions, neighborhoods, and even households they seek to serve. This allows them to minimize serving neighborhoods and density zones where they cannot make a positive return. This is consistent with profit-maximizing behavior. Similarly, but-for the regulatory burden, United would pursue a strategy of profit maximization and cost minimization, which could mean not serving a particular neighborhood or density zone. The fact that it cannot pursue such a strategy means that it cannot maximize profits and minimize costs as freely as its competitors can.

Q. ***Would United still be financially affected by its regulatory obligations even if did make a profit per residential line?***

A. Yes. Mr. Bax states that United must prove that "it cannot recover all of its costs and at the same time maintain fair and reasonable basic service rates in its rural area[s]" in order to qualify for "an explicit and competitively neutral cost recovery mechanism."[56] This is incorrect as a matter of economics because United would still be financially affected by the regulatory burden *even if it could recover all of its costs.* The reasons for this are at least twofold. First, but-for the regulatory burden (the pricing constraints and COLR obligation) under which United must operate, its profits would be higher. Stated differently, if the regulatory burden causes United to earn below normal returns, the firm is still financially affected by the regulatory burden. Second, even if United made a profit per line, it might still be losing money in higher-cost areas because of regulatory constraints on its price structure.

Q. ***Could United use its allegedly high access rates as a cost advantage by decreasing the price of its retail services below competitive levels?***

A. No. Such a strategy is often referred to as a vertical price squeeze. In a price squeeze, a carrier with market power for an essential product input uses this power to increase the input (wholesale) prices of its competitors, in order to drive its competitors from the downstream (retail) market. United, however, has no incentive to do so for at least two

[56] Bax Direct, p. 16.

reasons. First, such a strategy would overlook the very real opportunity cost that United incurs when it carries toll traffic and foregoes access revenues. Second, United would not be able to recover the foregone carrier access revenues in the long run.

Q. ***Why do you believe that Mr. Vasington is implying that United is employing a vertical price squeeze?***

A. The term "vertical" refers to a production process with at least two stages—one of which can be considered an upstream (wholesale) production stage that serves as an input into other downstream retail markets where the carrier also competes. Specific to this case, a price squeeze could occur if an operator were to set intrastate switched access rates high enough or its retail rates low enough so that equally efficient competitors could not match the retail price in the long run (due to relatively high input prices). Although not directly calling it a price squeeze, Mr. Vasington's allegations that United's intrastate switched access rates are anticompetitive and that carriers are "wholly at the mercy of the carrier that the called party uses for her local exchange services" seem to indicate that he believes United could use its intrastate switched access rates to engage in a price squeeze.[57] This conclusion is further supported by Mr. Vasington's responses to United's data requests. Specifically, in response to the question of whether intrastate switched access rates charged by ILECs should not contain a subsidy element, Mr. Vasington responds:

[57] Vasington Direct, p. 4, 6.

> … some level of subsidy may be appropriate in the context of a state commission's other regulatory goals, but an excessive rate either provides more subsidies than are necessary or provides monopoly profit.[58]

Q. ***Please explain the opportunity cost that prevents United from engaging in a price squeeze.***

A. Mr. Vasington's apparent claim of a price squeeze, however, has no basis in economics as it overlooks the opportunity cost United incurs when it supplies long distance service to a customer rather than carrier access service to an IXC. Specifically, if United were to win a long distance customer from a long distance competitor, it would no longer receive carrier access revenues from that customer. If United's long distance service cannot earn enough revenue to cover both its own costs and the opportunity cost of foregone access revenues, then taking the minutes away from the competitors would be unprofitable for the corporation as a whole. Hence, pricing access above cost does not grant United the freedom to price below competitive levels. Contrary to Mr. Vasington's argument, it follows that it is not necessary to reduce access charges to "mirror Verizon Northwest's intrastate switched access rates" to prevent United from putting its competitors in an anticompetitive price squeeze.[59] Similarly, it is also not necessary to reduce access charges to interstate levels, as argued by AT&T.[60]

[58] Verizon Response to Embarq's First Data Request, EQ-VZ DR-9.a.
[59] Vasington Direct, p. 31.
[60] Bax Direct, p. 25.

Q. Please illustrate your point with an example.

A. Consider two options by which an intrastate toll call is carried. In option 1, Verizon, AT&T, or another IXC carries the call. In option 2, United carries the call. For the sake of argument, assume that Mr. Bax's calculation is correct and that United earns approximately 6 cents per minute in access revenue.[61] Under option 1, a call would generate 6 cents per minute for Embarq. Under option 2, Embarq would forsake the 6 cents per minute that it would otherwise have earned. Further, assume that Embarq's costs to supply carrier access is 0.5 cent per minute and its incremental cost to carry a toll call is 1 cent per minute.[62] In deciding on whether to engage in a price squeeze, Embarq, as a profit-maximizing firm, would evaluate its costs and profits without (Option 1) and with (Option 2) a price squeeze and select the scenario that promises higher profits. This trade-off analysis is shown in Tables 2 and 3.

Table 3 shows that Embarq's toll price level without a price squeeze would be at least 7 cents per minute, and, at this level, Embarq would be no worse off carrying the call itself. If it could profitably charge a retail price above 7 cents per minute, it would be better off carrying the call itself. Table 4 shows Embarq's change in profit if it were to use its allegedly high access rates as a cost advantage by decreasing the price of its retail services below competitive levels, as Mr. Vasington seems to imply. Specifically, it shows that if Embarq were to decrease its retail rate below competitive levels to 4 cents

[61] See Bax Direct, p. 9.
[62] These costs are for illustration only.

per minute, it would still earn a profit of 2.5 cents per minute. However, the company would forego a profit of 5.5 cents per minute that it would earn if Verizon, AT&T, or other IXCs carried the call. Taking this opportunity cost into account means that Embarq would lose 3 cents in profit for every minute of toll traffic it carried compared to what it would make if Verizon, AT&T, or another IXC carried the call. This would be economically irrational and thus an unlikely event. In fact, any pricing below the breakeven point of 7 cents (which is where Embarq would be no worse off carrying the call itself than having an IXC carry the call) would be economically irrational.

Table 3
Embarq Per Minute Profits
No Price Squeeze

	Option 1 (IXC carries)	Option 2 (Embarq carries)	Change in Embarq Profit
Retail revenue	n/a	$ 0.070	
Access revenue	$ 0.060	$ -	
Access costs	$ 0.005	$ 0.005	
Retail costs	$ -	$ 0.010	
Net revenue	$ 0.055	$ 0.055	$ -

Table 4
Embarq Per Minute Profits
With Price Squeeze

	Option 1 (IXC carries)	Option 2 (Embarq carries)	Change in Embarq Profit
Retail revenue	n/a	$ 0.040	
Access revenue	$ 0.060	$ -	
Access costs	$ 0.005	$ 0.005	
Retail costs	$ -	$ 0.010	
Net revenue	$ 0.055	$ 0.025	$ (0.030)

Q. ***Please explain why United would not be able to recover the foregone access revenues in the long run.***

A. The witnesses might argue that even though United would be worse off in the short run, the company could recover this shortfall (3 cents per minute in the example above) in the long run. This, however, is equally incorrect because United could not recover the foregone carrier access revenues in the long run. In order for a price squeeze to be considered a real threat to competition, economists and the courts have long recognized that a firm must have the ability to recover its losses from below-cost pricing by subsequent increases to supracompetitive levels.[63] In United's case, such recovery is highly unlikely because it would have to keep out competing long distance and wireless carriers long enough to recoup its losses by raising its toll rates. This means that United would have to drive out and keep out large, diversified, global companies such as AT&T and Verizon that have sunk facilities throughout the entire country—a virtually inconceivable task for United to accomplish. Moreover, intermodal competition from both cable and wireless is present in the company's less rural areas where nearly

[63] For example, in its opinion in *Covad v. BellSouth,* the Eleventh Circuit Court remanded back to the district court the issue of whether Covad's price squeeze claim—that BellSouth was charging too much for access to key local telephone exchange elements (e.g., the copper loops that connect customers' homes to the telephone network) while pricing its downstream DSL services too low—was a violation of the antitrust laws. Just as in the case of a predatory pricing claim, it instructed the district court to determine (1) whether BellSouth's prices for its DSL downstream service were lower than its costs (which would include the cost of the upstream service provided to both itself and rivals) and (2) if so, was there a dangerous probability that Bell South would recoup its investment in below-cost prices. See *Covad Communications Co. v. BellSouth Corp.,* 374 F.3d 1044.

[BEGIN HIGHLY CONFIDENTIAL] [redacted] **[END HIGHLY CONFIDENTIAL]** are located (and often one competitor in more rural areas). As the FCC recognized in its order that established pricing flexibility rules for interstate services:

> Once multiple rivals have entered the market and cannot be driven out, rules to prevent exclusionary pricing behavior are no longer necessary.... In telecommunications, where variable costs are a small fraction of total costs, the presence of facilities-based competition with significant sunk investment makes exclusionary pricing behavior highly unlikely to succeed.[64]

Q. Are there any others reasons why United could not engage in a price squeeze?

Yes. For a price squeeze to exist, United must control an upstream essential facility. This, however, is not the case as IXCs (and other operators) have many options available to bypass United's carrier access services, at least at the originating end of the call. For instance, IXCs can, and do, use their own local facilities, purchase wholesale special access, use VoIP, or use unbundled network elements (UNEs) to avoid paying for access charges. Additionally, there also is an imputation safeguard in place in the State of Washington, which means that United cannot price its toll service below the price that it charges competitors for access.[65]

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[64] Before the Federal Communications Commission, In the Matter of Access Charge Reform, *Fifth Report and Order and Further Notice of Proposed Rulemaking*, 14 FCC Rcd 14221 (1999) ¶ 80.
[65] In the Matter of the Petition of United Telephone Company of the Northwest d/b/a Sprint, for Competitive Classification of its IntraLATA Toll Services, *Order Granting Petition*, Docket No. UT-971689, January 28, 1998.

Q. ***If United did not engage in a vertical price squeeze, could it use the revenue from the allegedly high access rates as extra profits?***

A. No. As explained, the subsidy element contained in United's intrastate switched access rates does not translate to extra profits. Rather, as we discuss in Exhibit No. ___ (CMD-3), current carrier access charges were designed to be part of an overall rate structure intended to promote universal service objectives by allowing basic rates to be set below cost in certain areas and for certain customers. The witnesses offer no evidence that the subsidy contained in United's switched intrastate access rates permits United to earn excessive profits. In stark contrast, United offers a cost study and the testimony of Mr. Henry J. Roth, which clearly show that the current local retail access prices do not exceed the cost of providing telephone service to rural areas and low-income customers.

Furthermore, access revenue is only one of several revenue streams used to cover the overall costs of United and other incumbent carriers. These revenue sources cover, among other things, common and shared network costs, COLR obligations, and universal service obligations. Finally, competition further constrains United from earning excessive profits.

Q. ***Did you conduct other studies to determine whether there is a correlation between intrastate switched access rates and long distance usage?***

A. Yes. I developed an econometric model to test whether the empirical evidence supports Mr. Bax's claim that "the implicit subsidies are a 'ball and chain' that thwarts the ability of AT&T and other IXCs to compete on their own merits in the marketplace."[66] To do so, I tested whether higher switched access rates were associated with lower levels of toll usage as measured by the levels of switched access minutes.

More specifically, I first built a database consisting of the following variables:

- Intrastate switched access minutes sold by Embarq
- Interstate switched access minutes sold by Embarq
- Intrastate switched access rates
- Number of households
- Population
- Area (square miles)
- Average income
- Number of households with cable telephone available
- Number of CLEC switches
- Availability of wireless carriers
- Business lines
- Residential lines

[66] Bax Direct, p. 6.

- Trunk lines

Each observation in this database represents one of the 21 operating companies in Embarq's nationwide serving area.

I then statistically evaluated (i.e., regressed) the number of switched access minutes sold by Embarq in each of its areas on Embarq's intrastate switched access rates, various demographic variables, and measures of competition. Essentially, I tested whether intrastate switched access MOUs sold by Embarq depend on, or are a function of, Embarq's intrastate switched access rates. Mathematically, this model can be represented as follows:

EQ intrastate switched access minutes sold = constant + α (intrastate switched access rates) + β (number of hh) + γ (number of businesses) + δ (pop density) + ε (average income) + ζ (number of hh with cable telephone available) + η (CLEC switches) + θ (wireless availability) + error term

The objective of this model is to empirically analyze AT&T's claim that Embarq's allegedly high intrastate switched access minutes cause long distance carriers to lose minutes of use. Although such a claim is highly questionable (as discussed above), if AT&T's claim were correct, then the coefficient for the intrastate switched access rate variable in the fitted model would be significant and negative. In other words, if Mr. Bax's claim (that high intrastate switched access charges constrain IXC intrastate toll demand) were correct, we would expect to see higher switched access rates associated with lower intrastate switched access usage.

Q. ***What was the result of this regression analysis?***

A. Contrary to AT&T's claim, the analysis reveals that the number of switched access minutes sold by Embarq to long distance carriers *does not* depend on the level of intrastate switched access rates. In statistical terms, the equation above, and a number of variations of this equation, revealed no statistically significant relationship between intrastate switched access MOUs and the level of United's intrastate switched access rates. This finding directly refutes Mr. Bax's claim. That is, consumers are shifting away from wireline long distance *not* to avoid United's intrastate switched access rates, but for other reasons.

Q. ***Was AT&T alone in its loss of toll revenues?***

A. No. Mr. Bax claims that as a result of the alleged excessive intrastate switched access rates, **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** [redacted] **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** This statement is not only

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unsupported, but also incorrect. First, as shown above, United, in its more densely populated areas experienced similar reductions in demand, *even with* the alleged high access rate revenues. Second, AT&T and other IXCs are not losing business to competitors because of access rates, but due to price (free minutes by wireless carriers) and nonprice (e.g., mobility) attributes. The reality is that telecommunications competition is strong and thriving. A natural by-product of competition is that IXCs, as well as ILECs, are losing market share to intermodal competitors, such as wireless, cable, and VoIP. Subscribers are switching their mode of communications not because of a subsidy that the IXCs feel compelled to recover in their long distance rates, but for other reasons. Not surprisingly, Mr. Bax is unable to offer any evidence linking the trend away from wireline long distance to wireless, email, and so on to the level of intrastate switched access rates.

Q. Is Mr. Vasington correct in claiming that United benefits from Verizon NW's and Qwest's lower switched access rates?

A. Mr. Vasington argues, "Embarq clearly benefits from the fact that Verizon Northwest and Qwest are required to charge more reasonable intrastate switched access rates in Washington."[67] He further claims that the benefits have "helped Embarq become a vigorous and successful competitor in Washington's intrastate toll market…."[68] Mr. Vasington is wrong for several reasons. First, intrastate toll is not an economic market.

[67] Vasington Direct, pp. 15–17.
[68] Vasington Direct, p. 17

The narrow analysis of Washington intrastate toll alone ignores the fact that IXCs compete with each other and with other providers for *all* intrastate and interstate toll services and increasingly for the entire telecommunications bundle—local, toll, Internet, and possibly wireless. It also contradicts Verizon's statements in the company's Form 10-K:

> The wireline telecommunications industry is highly competitive. We expect competition to intensify further with traditional, non-traditional and emerging players seeking increased market share. Current and potential competitors include cable companies, wireless service providers, other domestic and foreign telecommunications providers, satellite television companies, ISPs and other companies that offer network services and managed enterprise solutions. Many of these companies have a strong market presence, brand recognition, and existing customer relationships, all of which contribute to intensifying competition and which may affect our future revenue growth.
>
> We believe that cable operators represent the most significant threat to our wireline business. Cable operators have increased the size and digital capacity of their networks so that they can offer digital products and services. We continue to market competitive bundled offerings that include high-speed Internet access, digital television and voice services. Several major cable operators also offer bundles with wireless services through strategic relationships.
>
> Wireless substitution is an ongoing competitive trend which we expect to continue as wireless companies position their service as a landline alternative. We also face increasing competition from companies that provide Voice over Internet Protocol (VoIP) services. These services use the Internet or private broadband networks to transmit voice communications. VoIP services are available from a wide range of companies including cable companies, and national and regional providers. Internet portal providers are also entering our competitive space.[69]

[69] Verizon Communications Inc., 10-K, February 24, 2009, p. 10.

Not only does this statement directly contradict Mr. Vasington's claim of a stand-alone market for intrastate toll, it also illustrates that the market is much broader and that telecommunications carriers, including Verizon, increasingly compete to provide bundles, rather than stand-alone services. Interestingly, there is no mention in the entire 10-K report that high intrastate switched access rates have forestalled competition or unreasonably advantaged others.

Second, Mr. Vasington's claim that United benefits from the lower switched access rates charged by Verizon NW and Qwest is economically incorrect. Verizon NW's and Qwest's lower switched access rates simply mean that the per-minute access revenue for these companies is lower than United's. This, however, has nothing to do with Verizon NW's and Qwest's ability to compete for toll customers. If anything, it makes Verizon NW and Qwest stronger competitors because their opportunity costs are lower than United's. That is, relative to United, it is more profitable for Verizon NW and Qwest to provide toll services than access services. Similarly, relative to Verizon NW and Qwest, it is more profitable for United to offer switched access services than toll services.

Q. ***From what percentage of its lines would United need to recover the proposed switched access revenue reduction?***

A. Approximately **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]** of United's switched access lines are in wire centers in which United is the only facilities-based wireline telephone provider.[70] Of these **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]**

Q. ***What would be the impact of the access revenue loss for subscribers living in areas where there is limited competition?***

A. If this Commission were to grant Verizon's proposal, then United would stand to lose **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]**

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[70] I based the analysis on whether or not a cable MSO provides voice service in a given wire center. This is extremely conservative because it ignores the presence of cable broadband service in many more exchanges and of wireless mobile offerings. Cable broadband provides the platform for standalone VoIP, and once the cable company has upgraded its network to provide high-speed Internet service, it can typically add its own voice service in a relatively short time and at low incremental costs.

If United were to spread its revenue loss over the residential lines *and* single-line businesses in the same wire centers **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]**

The potential price increases would be even higher if this Commission were to grant AT&T's proposal and decide to decrease intrastate switched access rates to the same level as United's interstate rates. Specifically, United would stand to lose **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]** Spreading this loss over residential customers living in noncompetitive wire centers would increase United's rates by **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]** Finally, if United were to spread the revenue loss over residential *and* single-line businesses, then the increase would be **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]** In all of these scenarios, the effect of reducing intrastate switched access rates would be a significant impact on the very customers for whom subsidies and the universal service program were designed.

Q. ***Would United be able to implement such price increases in rural areas?***

A. Probably not. Political realities would most likely prevent it. Moreover, the potential for competition in these areas with this higher rate would limit United's ability to obtain this increase—as the potential for profit increases, the potential for competition increases.

Q. ***What could United do if it were not able to sufficiently increase prices in rural areas?***

A. Absent additional universal service funding or a permanent universal service mechanism to replace the lost revenues, United would face investor pressure to reduce service quality and scope by cutting back on maintenance expenses and by reducing network investment in Washington.

Q. ***Why would reducing intrastate switched access rates jeopardize the regulatory policy structure in place in United's service areas?***

A. As I explained above, if either Verizon's or AT&T's proposal were to be adopted, United's rural customers would face a significant increase in their basic service rates, a reduction in service quality, a reduction in network investment, or all of the above. This jeopardizes the basic objectives of the universal service program that we describe in Exhibit No. ___ (CMD-3)—providing widely available and affordable basic local service.

Q. ***What can this Commission do to avoid such a situation?***

A. It is important to recognize that, given the complex rate structure of which access charges are a part in Washington and elsewhere, intrastate switched access rates cannot simply be reduced without considering the potentially serious implications on universal service or consumer welfare. The Commission has three basic choices: (1) leave the current rates as they are, (2) open a full rate rebalancing case that would provide United with more pricing flexibility and that would establish an explicit universal service fund, or (3) remove all regulatory constraints currently imposed on United. Whichever option this Commission elects, it is imperative that it not reduce intrastate switched access rates in a vacuum, but carefully consider which of the options described above would be best for the residents of the State of Washington.

Q. ***Why is it important that the Commission fully understand the economic repercussions of Verizon's and AT&T's proposals?***

A. First, from an analytical perspective, the Commission can only make an informed decision about the proposals by carefully weighing the cost and benefits of each of them. Second, any potential benefits of a reduction in intrastate switched access rates must be measured in the market for the final good. If the reduction has no effect in the downstream market, then it is of no benefit to consumers. Neither Mr. Vasington nor Mr. Bax analyzes the benefits and costs of their proposals. Rather, they claim that since a rate reduction is good for Verizon and AT&T, it should also be somehow good for consumers.

VI. ANY REDUCTION TO UNITED'S INTRASTATE SWITCHED ACCESS RATES REQUIRES A PERMANENT STATE USF BEFORE ANY REDUCTIONS ARE UNDERTAKEN

Q. What are the economic implications of the competition United faces in more populated areas?

A. In areas where United faces retail competition from other service providers, market forces discipline the company's prices. Consequently, it likely cannot profitably increase retail prices (i.e., to recover lost intrastate switched access revenue) as higher prices would likely be more than offset by a drop in subscribers (hence subscriber revenue). Practically, this means that United would be forced to attempt to recover its lost switched access revenue from areas where it can profitably increase prices due to limited or no competition—residential and possibly single-line businesses located in Washington's most rural areas. In fact, the loss of access lines in more populated areas makes the need for switched access revenue much greater. The two proposals being proffered, however, would have the opposite effect.

Q. ***What are the economic implications of the relatively limited competition United faces in rural areas?***

A. Competition in more rural areas is limited as potential entrants find it difficult to develop a viable business case for these high-cost areas. This is the very reason COLR obligations and the associated universal service programs have been put into place. As we discuss in Exhibit No. ___ (CMD-3), the goal of this regulatory framework is to ensure the availability of affordable phone service in all geographic areas, regardless of the business case. If this Commission were to grant either of the two proposals, United would have to find a way to recover the lost switched access revenue. Given the limited presence of disciplining market forces (particularly in the most rural areas), it would need to recover the lost revenue by increasing prices or reducing service quality. Alternatively, this Commission would have to implement a new regulatory recovery option, such as a state universal service fund. (These options are discussed above.)

Q. ***Are the public policy objectives that were in place when access charges were established still as important today?***

A. Absolutely. In fact, as mentioned before, Mr. Vasington and Mr. Bax do not appear to advocate the elimination of these public policy objectives. Moreover, they appear to recognize that these policy objectives come at a cost to the incumbent carriers who must build and maintain a ubiquitous network throughout their serving territories and then have to price their services below incremental cost and/or economically efficient levels to keep rates affordable. As I have shown, United faces significant competition in its more densely populated areas, thereby making it difficult, if not impossible, to raise end user rates to support the proposed access rate reductions. Reductions to United's intrastate switched access rates require a permanent state universal service fund that offsets these reductions. Furthermore, some of the witnesses claim that Embarq's current access rates are anticompetitive. This also is wrong as a matter of economics. United's intrastate switched access rates are just, fair, and reasonable and serve the purpose for which they were designed. Washington consumers could suffer serious economic consequences if United's rates were reduced without implementing an alternative recovery mechanism, such as a state-specific universal service fund.

VII. CONCLUSION

Q. Do you recommend this Commission reduce United's intrastate switched access rates?

A. No, I do not. There is no clear evidence of the need for such a reduction. Furthermore, the proposals before the Commission ignore that the current intrastate switched access charge regime is the result of a larger approach that promotes universal service goals in Washington's high-cost rural areas. Granting the rate reduction requests of Verizon and AT&T in this Docket would jeopardize this holistic approach and could have negative repercussions for customers in rural Washington.

Q. ***What would the Commission need do to do if it chooses to reduce United's intrastate switched access rates?***

A. The Commission should first investigate whether there is even a need to reduce United's intrastate switched access rates. If it then decides to lower these rates, it must do so in the context of additional regulatory reform as discussed above.

Q. ***Please summarize your testimony.***

A. United's current intrastate switched access rates in Washington are fair, just, and reasonable. They are part of a holistic approach aimed at keeping rates affordable and basic telephone service ubiquitous. They are also not anticompetitive as they are designed to recover costs associated with this regulatory burden. Even if they were not, adopting the Complainants' proposals would not lead to net benefits for customers in United's service areas.

United faces strong competition in its more populated areas and limited (but growing) competition in rural areas. A reduction in switched access rates would yield little benefit to consumers in Washington, if any. On the other hand, a reduction could inflict serious economic harm, particularly to rural customers, the very customers for which the holistic approach was developed.

I recommend that the Commission reject both Verizon's and AT&T's access rate reduction proposals. The Complainants have not demonstrated the justness and reasonableness of their proposals. The costs to consumers and to rural Washington far outweigh the allegations of benefits that the Complainants have suggested. Notwithstanding, if the Commission should determine that United's intrastate switched access rates should be reduced, then the Commission must *first* establish an explicit recovery mechanism, such as a state universal service fund, to replace the implicit subsidy that would be lost. Consistent with the FCC's approach, the Commission should consider a phase in of any reductions in intrastate switch access rates in order to avoid rate shock.

Q. ***Does this conclude your direct testimony?***

A. Yes, it does.