Exhibit No. ___ THC (JMF-1THC)
Docket No. UT-081393
Witness: John M. Felz

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, d/b/a EMBARQ Respondent	DOCKET NO. UT-081393

RESPONSIVE TESTIMONY OF
JOHN M. FELZ

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

Q. Please state your name, business address, employer and position.

A. My name is John M. Felz. My business address is 5454 West 110th Street, Overland Park, Kansas 66211. I am Director – State Regulatory for Embarq.

Q. Please describe your educational background, work experience, and present responsibilities.

A. I received my Bachelor's degree in Accounting from Rockhurst University in Kansas City, Missouri in 1979. In 1989, I earned a Master's Degree in Business Administration with an emphasis in Finance from Rockhurst University. I began my career with Embarq as an internal auditor in 1979 and assumed increasing levels of responsibility in that department, including positions as Senior Auditor, Audit Manager and Assistant Director. From 1986 to 1988, I was Revenue Accounting Manager for Embarq’s Midwest Group of local telephone companies with responsibility for billing approximately 500,000 customers in six states. In 1988, I was named to the position of Financial Budget Manager and had responsibility for preparing and managing the budget for Embarq's Midwest Group of local telephone companies. From 1991 to 1996, in the position of Revenue Planning Manager, I was responsible for regulatory and tariff issues for Embarq's local telephone operations in Kansas. From 1996 to 1998, I held the position of Senior Manager - Wholesale Markets with responsibility for negotiating and implementing interconnection agreements with competitive local exchange carriers and wireless providers. I was named to my current position as Director - State Regulatory in January 1998 and have responsibility for development and implementation of regulatory policies for Embarq's operations in a number of states, including Washington.

Q. On whose behalf are you testifying?

A. I am testifying on behalf of United Telephone Company of the Northwest d/b/a Embarq (United).

Q. What is the purpose of your responsive testimony?

A. The purpose of my responsive testimony is to address certain issues raised in the direct testimonies filed by Lawrence J. Bax on behalf of AT&T Communications of the Pacific Northwest, Inc., TCG Oregon, Inc. and TCG Seattle, Inc (AT&T) and Paul B. Vasington on behalf of 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). Specifically, I will address how United's switched access rates are just and reasonable and have been established in compliance with Commission rules and orders as they apply to United. Further, I address how the intrastate switched access reductions proposed by AT&T and Verizon would impact United. Finally, I explain that attempts to apply prior precedent from Verizon Northwest or Qwest intrastate access reductions to United are not appropriate.

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

A. Yes. While Mr. Vasington claims that United's intrastate switched access rates are "unjust, unreasonable, and anticompetitive"[1] and Mr. Bax refers to them as "excessive,

[1] Vasington Direct, page 4.

unjust, unfair, and unreasonable,"[2] their conclusions are principally based on attempts to take prior Commission action related to Verizon Northwest and Qwest access rates and apply those same actions to United. But such comparisons ignore the realities that United's switched access rates reflect application of the Commission's historical policies of promoting universal service at affordable rates through subsidies established in intrastate switched access rates. Consistent with those policies, United's intrastate switched access rates are set at levels that are just and reasonable because they provide an important source of support for United to meet its carrier of last resort obligation and to provide universal service in rural Washington at affordable rates.

Q. What obligations are imposed on United as a Carrier of Last Resort ("COLR") in its service territory?

A. United's COLR obligation in part arises from statute RCW 80.36.090 as follows:

> Every telecommunications company operating in this state shall provide and maintain suitable and adequate building and facilities therein, or connected therewith, for the accommodation, comfort and convenience of its patrons and employees. Every telecommunications company shall, upon reasonable notice, furnish to all persons and corporations who may apply therefore and be reasonably entitled thereto suitable and proper facilities and connections for telephonic communication and furnish telephone service as demanded.

The Commission also has adopted specific service quality rules. Included are rules governing standards for installation and activation of service – 480-120-105; extension of service – 480-120-071; response time for calls to business office or repair center – 480-120-133; network performance, maintenance standard and service quality performance

[2] Bax Direct, page 3.

standards – 480-120-401 through 440. United's general exchange tariffs further delineate the areas in which United must provide telephone service.

Q. Can you address the import to an ILEC, such as United, of these requirements?

A Yes, I can. The obligation includes extending service to new customers, but that's not the only aspect of the obligation. United is required to construct <u>and</u> maintain, consistent with Commission standards, a network and to provide service <u>throughout</u> United's service area. United is obligated to maintain and enhance this network, provide dependable service, at affordable rates, even in areas that are high-cost to serve. United is also required to provide service to all customers, residential and business customers alike, within its defined service territory. This is the essence of the COLR obligation that Mr. Vasington and Mr. Bax fail to recognize. Particularly for an ILEC serving rural, high-cost areas of a state, the failure to recognize these obligations demonstrates the error in the end-result oriented approach taken by Mr. Vasington and Mr. Bax.

Q. Has the Commission recognized the need to provide support for carriers with COLR obligations to ensure the provision of universal service at affordable rates?

A. Yes. The Commission has long recognized the need to support the provision of universal service and has established policies and mechanisms to provide such support. Beginning as early as 1985 in response to the requirements of the Regulatory Flexibility Act enacted by the Washington legislature, the Washington Commission has implemented policies and programs to support the provision of universal service. As outlined in the Commission's January 1998 report on universal service, the program relied most heavily on price averaging, contributions from access charges and a small company universal service fund based on access charges.[3] In 1998, the Commission initiated a rulemaking to restructure intrastate access charges and establish an interim universal service funding mechanism (Docket UT-970325). In addition, the Commission opened Docket UT-980311(a) to carry out three directives of the Washington Legislature regarding universal service as follows: 1) to prepare a program for implementing a universal service fund; 2) to estimate the cost of the proposed universal service program; and 3) to present a report to the Legislature.

Q. What was the resolution of the Commission's 1998 dockets mentioned above?

A. As described more fully below, in Docket UT-970325, the Commission adopted a new rule which restructured intrastate access rates and established a universal service fund access rate element. In the universal service proceeding (UT-980311), the Commission completed the directives of the Legislature, including the development of universal service support levels which were utilized in establishing the universal service fund access rate element. The Commission prepared and delivered a report to the Legislature in November 1998 outlining its recommendations for establishing a state universal service fund. However, the Legislature did not approve the universal service program recommended by the Commission. Therefore, intrastate access charges, including the universal service fund access rate element described further below, have remained as a vital mechanism for supporting the provision of universal service at affordable rates for companies like United that serve predominantly rural, high-cost areas in Washington.

[3] See Preserving and Advancing Universal Service in a Competitive Environment, WUTC, January 1998.

Q. Please explain how the Commission's actions to establish the terminating access charges rule (WAC 480-120-540) in Docket UT-970325 provide continued support for universal service.

A. The Commission adopted the "Terminating Access Charges Rule" (WAC 480-120-540) in Docket UT-970325 resulting in a restructure of ILEC terminating intrastate access rates and maintenance of the status quo for universal service support. The rule required ILECs to establish terminating access charges in parity with local interconnection services. In addition, the rule provided for explicit recovery of universal service costs to be determined in the Commission's universal service proceeding in Docket UT-980311(a). I have included the relevant portions of the rule as Exhibit No. ___(JMF-2) for reference.

Q. Did United modify its intrastate access charges to comply with the Terminating Access Rule adopted by the Commission in 1998?

A. Yes. Consistent with the provisions of the terminating access charge rule, United implemented the following changes, completed on a revenue neutral basis, to its intrastate access tariff in December 1998:

- Eliminated its originating and terminating information surcharge rate elements.
- Eliminated its terminating carrier common line rate.
- Reduced its terminating local switching rate to a level equal to its comparable rate for local interconnection service.

- Restructured its local transport rates (originating and terminating) and implemented rate elements for tandem switched transport (fixed and facility); tandem switching; common transport multiplexing; and common transport trunk port. And,
- Established a universal service fund rate element.

Q. Please explain the derivation of United's universal service rate.

A. United's intrastate access charge reductions to comply with the provisions of the terminating access charges rule totaled approximately $6.573 million. As provided for by the new rule, United established a universal service fund additive of $.064851 to provide revenues of $6.573 million to offset the access charge reductions. Consistent with the Commission's direction, United calculated its universal cost support requirement in docket UT-980311(a) as $8.873 million.[4] To determine United's required intrastate universal support, an intrastate factor of 74% was applied to the $8.873 million, resulting in an intrastate universal service support amount of $6.566 million. This analysis confirmed that United's universal service fund additive was established to recover the appropriate level of intrastate universal service support.

Q. AT&T and Verizon have both recommended elimination of United's interim terminating access charge[5]. Is that approach consistent with how the charge was treated for Qwest and Verizon Northwest?

[4] See Exhibit No.___(JMF-3).
[5] Vasington Direct, page 22, line 8 and Bax Direct, page. 9, line 11.

A. No. Qwest established its interim universal service fund rate additive in 1998 and to the best of my knowledge, that rate remains in place today. For Verizon Northwest, in Docket UT-020406, the Commission lowered Verizon Northwest's interim terminating access charge (ITAC) rate element by 25% to $.0242846 effective October 2003. Verizon Northwest's ITAC rate remained at that level until 2005, when as part of a settlement agreement in a Verizon Northwest filed rate case in Docket UT-040520, Verizon Northwest agreed to a phase-out of the ITAC in two steps, the last of which was completed in July 2007. Furthermore, the settlement agreement of this rate case filed by Verizon Northwest also included offsetting increases in local service rates.

Q. Verizon's witness Mr. Vasington states that United receives over a million and a half dollars annually in federal universal service funding, which is specifically designed to compensate United for its higher cost exchanges[6]. Should interstate federal support be a consideration in evaluating United's need for intrastate universal service support?

A. No. United's federal universal service fund support was designed to replace local service subsidies that were once implicit in interstate switched access rates. In addition to universal service fund support, the FCC created other replacement mechanisms such as subscriber line charges. Both federal and state universal service support are necessary to keep basic local service rates affordable in high cost areas of Washington. In addition, in the proceeding establishing United's universal service fund additive, United performed the necessary calculations to remove the interstate portion of the identified universal

[6] Vasington Direct, page 27, lines 8-11.

service support need. As a result, United's current Washington universal service support relates only to its intrastate support and no consideration of federal universal service support is appropriate.

Q. Verizon's witness Mr. Vasington refers to Commission Staff recommendations at Docket UT-051291 regarding United's access charges.[7] Does his testimony address the entire story?

A. No. While the Commission Staff did recommend certain reductions to United's intrastate access rates in that proceeding, Staff also recommended revenue neutrality which included increases in United's residential and business rates.[8] Furthermore, Staff's recommendation also reflected a continued need for a universal service fund rate element along with the recommended local rate increases.

Q. Does United still have a need for intrastate universal service support?

A. Yes. As demonstrated in the testimony of United witness Mr. Roth, United's costs to meet its COLR obligation to provide basic local exchange service to all customers in its Washington service territory are greater than the average revenues it receives from its customers. Mr. Roth identifies United's universal service support requirement to be even greater than the $6.5 million level identified when United's current universal service fund rate element was calculated.

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[7] Vasington Direct, pages 11 and 12.

[8] The other portion of Staff's recommended revenue neutral rebalancing involved recognition of a portion of the gain on the sale of Sprint's directory publishing business.

Q. Before assessing the impact of the access reductions proposed by Verizon and AT&T in this case, can you provide a summary of United's current intrastate switched access rates?

A. United's current intrastate access rates are the result of the company's compliance with Commission rules and orders. The table below summarizes the current rate structure.

Rate Element	Originating	Terminating
Carrier Common Line	$.010000	$.000000
Local Switching	$.020740	$.004663
Local Transport		
Tandem Switching	$.001995	$.001995
Common Transport Multiplexing	$.001055	$.001055
Common Trunk Port	$.000408	$.000408
Tandem Switched Transport – Fixed	$.000180	$.000180
Tandem Switched Transport - Facility	$.000065	$.000065
Interim Universal Service Fund Additive	Not applicable	$.064851
Line Extension Rate Additive	Not applicable	$.007200
WECA Universal Service Fund Rate	$.001520	$.001520

Q. Have you analyzed the revenue impacts of the proposed access reductions recommended by Verizon and AT&T on United's revenues?

A. Yes. Exhibit No. ___(JMF-4HC) provides an estimate of the impact on United's intrastate access revenues if the access rate reductions proposed by AT&T or Verizon were adopted. AT&T's proposal is for United to reduce its intrastate access rates to the same level as interstate[9] which would result in an estimated annual revenue reduction of **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]**. Verizon proposes reductions to United's access rates to the levels

[9] Bax Direct, page 9.

of Verizon Northwest (estimated impact of **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]**, or alternatively of Qwest[10] (estimated impact of **[BEGIN HIGHLY CONFIDENTIAL]** [redacted]) **[END HIGHLY CONFIDENTIAL]**.

Q. Are these proposed revenue reductions material to United's financial status in Washington?

A. Absolutely. To put the impacts in perspective, United's intrastate regulated revenues for 2008 were approximately $30.9 million and intrastate operating income was approximately $3.4 million.[11] The proposals would represent a significant revenue reduction to United's intrastate regulated revenues and would effectively eliminate United's Washington intrastate operating income.

Q. What are the implications of reducing intrastate access support?

A. United's costs do not go away with intrastate switched access reductions. Rather, reducing intrastate access rates would only remove the subsidies that today provide universal service at affordable rates and permit United to meet its COLR obligation. If a permanent USF is not implemented in Washington, intrastate switched access reductions present a risk to United and its customers and jeopardize the maintenance of universal

[10] Vasington Direct, pages 22-24.
[11] United Telephone Company of the Northwest 2008 Annual Report (filed May 1, 2009).

service at affordable rates in high-cost, rural areas of Washington. These issues are further addressed by United witness Mr. Dippon in his testimony.

Q. Are Verizon Northwest's or Qwest's intrastate access rates appropriate benchmarks for United as advocated by Verizon?[12]

A. No. For Verizon to argue that intrastate access rates for United should be set based on benchmarks of Verizon Northwest or Qwest ignores the reality of the significant differences in United's service territory versus the service territories of those companies and ignores the underlying economics of providing service in those territories. Verizon Northwest and Qwest face different economic and competitive conditions as they serve different (and generally less rural) geographic areas, have different cost structures and different economies of scale. Measures of service area scale and density for the Washington operations of these companies bear out that United is nothing like Verizon Northwest or Qwest. United serves only 2.3% of the access lines in the state, while Verizon Northwest and Qwest combined serve almost 76% of the state's access lines. As measured by access lines served, Verizon Northwest is almost 9 times larger than United in Washington and Qwest is nearly 24 times larger. United's service territory in Washington is characterized principally by rural high-cost areas made up of smaller communities with low population and large geographic areas. In contrast, Verizon Northwest and Qwest serve significantly larger cities and suburban areas, including Bellevue, Olympia, Vancouver, Spokane, Seattle and Tacoma for Qwest and Everett, Kennewick, Redmond and Bothell for Verizon Northwest. Indeed, the most populous

[12] Vasington Direct, page 20.

communities that United serves are still small by comparison, including cities like Poulsbo, agricultural communities in the Yakima Valley, and communities in the Columbia River Gorge, like Stevenson, Bingen, White Salmon, and Lyle. As discussed more fully in the testimony of United witness Mr. Roth, measures of population and geographic area served are important factors influencing costs, and there are stark differences between United on the one hand and Verizon Northwest or Qwest on other hand with regard to these key variables. These two factors alone – economies of scale and customer density – provide both Verizon Northwest and Qwest with a significantly lower cost structure than United and render any suggestion that United's access rates should be set at the same levels as Verizon Northwest or Qwest completely flawed and inappropriate.

Q. But Mr. Vasington claims that United is a well-financed competitor that does not need special protection.[13] How do you respond?

A. Mr. Vasington points to selected financial information from Embarq Corporation's annual financial reports and other information to attempt to paint a picture that Embarq would not be harmed if United's access rates were reduced. Embarq Corporation's financial results are not at issue in this proceeding – this proceeding is about United's demonstrated need to continue recovery of its costs to fulfill its COLR obligation and provide universal service at affordable rates in Washington. Furthermore, Verizon's corporate entity, (Verizon Communications, Inc.) size and financial situation are multiples of those of United's parent, Embarq Corporation. For instance, Verizon

[13] Vasington Direct, page 24, line 13.

Communications has approximately 36 million wireline and 70 million wireless service customers compared to Embarq's 5.7 million customers; Verizon Communications reported 2008 revenues of $97 billion and operating income of $16.8 billion compared to Embarq's $6.12 billion of revenue and operating income of $1.63 billion.[14] Clearly if the debate were to be focused to a consideration of impacts of this case at the corporate level, which it should not, any benefits that Verizon Communications would derive from access reductions imposed on United would have much less impact for Verizon Communications than the corresponding access reduction would have for Embarq Corporation.

Q. Are there other factors that distinguish this proceeding from the access reductions previously ordered for Verizon Northwest?

A. Yes. The telecommunications marketplace has changed dramatically in the years since the access rates of Verizon Northwest (Docket UT-020406 in 2003) were adjusted. In that case, the Commission ordered Verizon Northwest to reduce access charges specifically in an effort to assist interexchange carriers in the provision of long distance services.[15] At the time of that proceeding there were interexchange carriers. Specifically, there *were* stand-alone interexchange carriers that were unaffiliated with incumbent local exchange carriers ("ILEC"), and these interexchange carriers were attempting to compete, head-to-head, with Verizon Northwest for the provision of long distance service. Today the market in Washington could not be more different. As

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[14] Information from Verizon Communications, Inc. 2008 Annual Report (Form 10-K).
[15] See paragraph 181 of Eleventh Supplemental Order in Docket No. UT-020406.

discussed in the testimony of United witness Mr. Dippon, increasingly the competition that takes place is for bundles of service that include all-distance calling, and it is overwhelmingly inter-modal competition. As a stand-alone service, long distance is virtually extinct. In this proceeding, Verizon and AT&T advocate a solution to a problem that no longer exists.

Q. In summary, is it appropriate for the Commission to consider changes to United's access rate in the same light as it did for Verizon Northwest or Qwest?

A. No. This case is really one of first impression in that it is the first to deal with intrastate switched access rates for a telecommunication carrier having carrier of last resort obligations *and* provisioning local service in predominantly high-cost, rural areas of Washington. As described more fully in the testimony of United witness Mr. Roth, there are fundamental differences between the service territories of Verizon Northwest and Qwest and those of United, differences which result in significantly different economics of providing service, and more importantly, differences in need for subsidies from access rates to support local service. For these reasons, it would be incorrect and flawed to apply intrastate access rate changes required of Verizon Northwest or Qwest to United.

Q. What is United asking the Commission to do in this proceeding?

A. United asks the Commission to maintain the company's current level of intrastate access charge rates and structure, including the universal service fund rate element. United has a long history of providing a reliable telephone network in Washington and providing high quality service at affordable rates. As other United witnesses explain, the company's ability to fulfill its carrier of last resort obligations, especially in rural, high-cost areas, is dependent on support for basic local service currently contained in intrastate switched access rates, especially the universal service fund rate. To the extent the Commission desires to move away from the current universal service support mechanism provided through access charges, it should only do so after ensuring a permanent universal service fund is established to provide the necessary support for United to fulfill the important policy objectives of universal service at affordable rates and enable United to meet its COLR obligation.

Q. Does this conclude your responsive testimony?

A. Yes.