

Exhibit No. ____ HCT (JL-1HCT)
Docket UT-081393
Witness: Jing Liu
REDACTED VERSION

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 Co. of the Northwest,

Respondent.

DOCKET UT-081393

TESTIMONY

OF

JING LIU

**STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION**

June 5, 2009

HIGHLY CONFIDENTIAL PER PROTECTIVE ORDER

TABLE OF CONTENTS

I.	INTRODUCTION AND SCOPE OF TESTIMONY	1
II.	INTERIM TERMINATING ACCESS CHARGE (ITAC)	2
III.	UNITED’S CLASSIFICATION AS A HIGH COST COMPANY	8
IV.	CONCLUSION.....	10

LIST OF EXHIBITS

Exhibit No. ____ (JL-2): Washington State Incumbent Local Exchange Carriers'
Average Cost per Loop

1 **I. INTRODUCTION AND SCOPE OF TESTIMONY**

2

3 **Q. Please state your name and business address.**

4 A. My name is Jing Liu. My business address is 1300 South Evergreen Park Drive

5 Southwest, P. O. Box 47250, Olympia, Washington, 98504. My business e-mail address

6 is jliu@utc.wa.gov.

7

8 **Q. By whom are you employed and in what capacity?**

9 A. I am employed by the Washington Utilities and Transportation Commission

10 (Commission) as a regulatory analyst in the telecommunications section.

11

12 **Q. What are your education and experience qualifications?**

13 A. I have a masters' degree in organizational communication and a masters' degree in

14 telecommunications policy from Ohio University. I also completed four years of doctoral

15 study in public policy from Ohio State University. I worked as a graduate research

16 associate at the National Regulatory Research Institute (NRRI) from 2005 to 2007.

17 During that period, I authored and co-authored five papers published by the NRRI,

18 primarily on universal service and inter-carrier compensation issues.

19

20 **Q. What is the scope of your testimony at this time?**

21 A. My testimony provides a universal service perspective of United Telephone Company of

22 the Northwest, Inc.'s (United's) access charge issue. I will discuss: (1) some of the

23 disadvantages of above-cost intrastate access charges as a universal service mechanism;

1 and (2) United's classification as a high cost company. These two points support Staff's
2 recommendation to lower United's originating access charge rate element and phase out
3 its Interim Universal Service Fund Additive (IUSAF a/k/a Interim Terminating Access
4 Charge or "ITAC").

6 II. INTERIM TERMINATING ACCESS CHARGE (ITAC)

8 **Q. What is ITAC?**

9 A. Intrastate access charges have three main components: originating access rate,
10 terminating access rate and ITAC. ITAC is an explicit rate element assessed on
11 terminating access minutes. The purpose is to compensate carriers' universal service
12 costs that cannot be otherwise recovered.¹

14 **Q. Why should United's ITAC be adjusted?**

15 A. ITAC inflates the overall intrastate terminating access charge that long distance service
16 providers pay to local exchange carriers (LECs). Above-cost intrastate access charges
17 are not an effective or sustainable universal service mechanism, as I will explain below.
18 In addition, United's ITAC was established in 1998² and was intended to be an interim
19 mechanism. It is now time to re-evaluate the actual ITAC revenue requirement given the
20 circumstances today.

¹ See the Commission's universal service proceedings in Dockets UT-970325 and UT-980311.

² Docket UT-981494.

1 **Q. As a general matter, what are the regulatory tools states can use to maintain**
2 **universal service in rural areas?**

3 A. Typically, states have three main approaches to subsidize basic telephone services in
4 rural high cost areas. First, an urban-to-rural subsidy can be achieved through
5 companies' internal geographical price averaging. Second, many states have explicit
6 state high cost fund programs similar to the federal high cost fund. In such cases, an
7 explicit universal service surcharge is assessed based on established contribution rules;
8 the fund is then distributed based on established eligibility criteria. Third, some states set
9 carriers' intrastate access charges above cost as an implicit universal service mechanism.
10 These three approaches are not mutually exclusive. State utilities commissions can adopt
11 one or a combination of these approaches.

13 **Q. How does Washington's universal service approach compare to other states?**

14 A. Washington's universal service approach is in-between the second and third approach.
15 Washington does not have a high cost fund, but instead allows rural carriers to use above-
16 cost access charges to subsidize high cost areas. However, this commission has required
17 the above-cost component of a company's access charges to be identified as "an
18 additional, explicit universal service rate element applied to terminating access service."
19 WAC 480-120-540(1) (b). Based on the NRRI 2006 Survey,³ 22 states have a state high
20 cost fund mechanism. This count includes Washington because of the rule requiring an
21 explicit universal service rate element. The other 29 (of 51 total) jurisdictions do not

³ Liu, Jing and Rosenberg, Edwin A., 2006. *State Universal Service Funding Mechanisms: Results of the NRRI's 2005-2006 Survey* (NRRI State USF Survey Report). Columbus, Ohio: The National Regulatory Research Institute, 06-09.

1 have an explicit state high cost subsidy and may or may not allow above-cost intrastate
2 access charges as a matter of rate design.

3
4 **Q. What are the disadvantages of using above-cost intrastate access charges as a state**
5 **universal service mechanism?**

6 A. Compared to an explicit state high cost fund, subsidy through high intrastate access
7 charges has three main disadvantages: (1) it is not competitively and technologically
8 neutral; (2) it is not sustainable over time; and (3) it lacks specificity and accountability.

9
10 **Q. Explain in more detail the negative competitive impact of above-cost intrastate**
11 **access charges.**

12 A. They are not competitively and technologically neutral in either their contribution or
13 distribution aspects. This point is best made by comparing above-cost access charges to
14 an explicit state high cost fund. First, under an explicit state high cost fund, all
15 companies providing intrastate telecommunications services contribute to the fund,
16 including ILECs, competitive local exchange carriers (CLECs), interexchange carriers
17 (IXCs) and in many states, commercial mobile radio service (CMRS) providers. In some
18 states, facility-based Voice over Internet Protocol (VoIP) providers, paging providers,
19 operator service providers and special access service providers are also required to
20 contribute to the state high cost fund.⁴ In comparison, with a high intrastate access
21 charge mechanism, only IXCs and CMRS providers pay to the subsidy. CMRS providers

⁴ For details, please see *NRRI State USF Survey Report*, Table 7.

1 make much smaller contributions, due to the exemption of intra-MTA traffic from
2 switched access charges.⁵

3 Second, a state high cost fund has explicit criteria for fund distribution, either
4 based on companies' costs or classifications. The fund is available to any company that
5 meets the eligibility criteria. In many states that have a high cost program, wireless
6 carriers or CLECs are also eligible for the fund.⁶ With the above-cost intrastate access
7 mechanism, however, only LECs can collect the subsidy. The majority of the benefits go
8 to ILECs as they have a large share in the local access market in Washington (86% of the
9 end-user switched access lines as of 2007⁷). The subsidy is not portable to CMRS
10 providers or facility-based VoIP providers.

11 Because of such contribution and distribution mechanisms, above-cost intrastate
12 access charges enable ILECs to shift part of their cost to long distance service providers
13 and ultimately their customers. Dr. Blackmon explains this in detail in his testimony.
14 United's witness, Mr. Christian M. Dippon, argues that a reduction of United's access
15 charges would have a very small impact on AT&T and Verizon's long distance prices
16 (Exhibit No. ____ HCT (CMD-1HCT), pages 47-48, and Exhibit No. ____ (CMD-4)).
17 However, this cannot serve as a rationale for maintaining United's current intrastate
18 access charges. The fact that United's customers enjoy concentrated benefits and that
19 Verizon and AT&T's customers share more dispersed burdens does not mean that there is
20 no competitive harm. United's ITAC rate must be set based on actual revenue
21 requirement and not on competitors' ability to absorb the costs.

⁵ Federal Communications Commission, 1996, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, First Report and Order, 11 F.C.C. Rcd 16014.

⁶ For details, please see *NRRI State USF Survey Report*, Table 11.

⁷ Federal Communications Commission, 2008, *Local Telephone Competition: Status as of December 31, 2007*, released September 2008.

1 **Q. Why aren't above-cost intrastate access charges a sustainable universal service**
2 **mechanism?**

3 A. Over the past decade, the wireline industry has experienced a steady decline of toll
4 minutes. As more customers switched to wireless and VoIP technologies, the revenue
5 base on which intrastate access charge could be assessed shrank. The high intrastate toll
6 rates also suppress consumer demand, contributing to a faster decline in intrastate toll
7 revenue. In addition, the system creates incentives for some carriers to disguise their toll
8 traffic as local traffic, or not to identify the origin of the traffic at all, which also leads to
9 ILECs' loss in intrastate access revenue. Over the period from 2004 to 2008, United
10 experienced a [REDACTED] in the number of terminating switched access
11 minutes.⁸ This loss exceeds the company's loss of access lines, which was [REDACTED]
12 during the same period.⁹ United might respond to this shortfall of the subsidy revenue by
13 proposing to adjust per-minute access rates upward, but this would only exacerbate the
14 problem.

15
16 **Q. Explain why above-cost intrastate access charges lack specificity and accountability**
17 **as a universal service mechanism.**

18 A. Traditionally, ILECs treat the access charges they collect as a regular revenue stream.
19 ILECs are not accountable to show specific expenses for the subsidy they receive. More
20 than 10 years have passed since United's access rates were established and more than 20

⁸ Calculated based on Discovery Responses of United to Verizon, Attachment VZ 8 (HC).

⁹ Calculated based on Discovery Responses of United to Verizon, Attachment VZ 12 (HC).

1 years have passed since United's revenue requirement was examined in a rate filing.
2 There could be a discrepancy between the cost of providing service and the subsidy
3 collected based on the old rates. United's retail rate structure is also outdated, with no
4 updates to ensure that customers in high cost locations are paying enough of their own
5 costs through an affordable and reasonably comparable rate.
6

7 **Q. What is Staff's position with regard to United's ITAC based on the above**
8 **discussion?**

9 A. In 1998, the Commission presented the legislature with a proposal for an explicit state
10 high cost fund that would be "specific, sufficient, competitively neutral, and
11 technologically neutral," as directed by RCW 80.36.600(1). However, the Commission's
12 proposal did not get legislative approval. In the absence of a state USF, the Commission
13 continues to use the ITAC as a lesser alternative to meet the goal of universal service in
14 Washington. For this reason, it is especially important to set the ITAC at the right level
15 to achieve its intended purpose while minimizing negative consequences. As Dr.
16 Blackmon, Mr. Zawislak, and Mr. Applegate explain in their testimonies, United's cost
17 analysis and claims of high cost status do not justify its ITAC rate. Continuing United's
18 current access rates will magnify the negative impacts of above-cost intrastate access
19 rates discussed above.
20
21
22

1 **Q. Is the ITAC the only mechanism available for United to recover its universal service**
2 **costs?**

3 A. No. Carriers that serve a mix of urban and rural customers, like United, can implement a
4 local rate structure across their service area to make sure local rate payers pay their fair
5 share of universal service costs. As Mr. Zawislak illustrates in his testimony, United is
6 capable of increasing local rates in some areas to offset its universal service revenue
7 requirement.

8
9 **III. UNITED'S CLASSIFICATION AS A HIGH COST COMPANY**

10
11 **Q. In their testimony on behalf of United, both Mr. Dippon and Mr. Felz argued that**
12 **United's network incurs much higher costs than Verizon and Qwest (Exhibit No.**
13 **___ HCT (JMF-1THC), pages 13-14, and Exhibit No. ___ HCT (CMB-1THC), pages**
14 **23-24). Do you agree that United is a "high cost" company that requires a universal**
15 **service subsidy?**

16 A. I do not disagree that United serves some high cost locations and that it incurs costs
17 associated with its universal service obligations. However, the Company is not
18 automatically entitled to a subsidy without demonstrating the need for it. United is the
19 fourth largest ILEC in Washington based on the number of access lines. Although it is
20 "high cost" relative to Verizon and Qwest, it is "low cost" relative to other rural ILECs.
21 In fact, under the federal universal service support mechanisms, United does not reach
22 the high cost benchmark set by the Federal Communications Commission (FCC) and
23 does not qualify for High Cost Loop Support.

1 **Q. What is the eligibility benchmark for federal High Cost Loop Support and how does**
2 **United measure up?**

3 A. A rural ILEC is eligible for High Cost Loop Support if the average unseparated cost per
4 loop in a study area exceeds 115 percent of the national average. For 2008, United's
5 average loop cost in Washington was \$357.65, which is 93 percent of the national
6 average cost per loop of \$382.97.¹⁰ Even at the state level, United's average loop cost
7 would not qualify under a 115 percent benchmark: It is 113 percent of the Washington
8 State weighted average cost per loop. Exhibit No. ____ (JL-2) Washington State ILECs'
9 Average Loop Cost.

10
11 **Q. Does United receive any support from the federal high cost universal service**
12 **program?**

13 A. Yes. United, like Verizon and Qwest, receives Interstate Access Support (IAS).
14 Historically, ILECs charged above-cost interstate access rates as an implicit universal
15 service subsidy. After the FCC's interstate access reform in 2000, part of this implicit
16 subsidy was converted to IAS, an explicit support mechanism; and part of it was
17 collected through increases to end user bills via subscriber line charge. In 2008, United
18 received about \$1.6 million IAS for its Washington service area, representing \$20 per
19 loop. However, IAS is not based on any specific cost threshold. 47 C.F.R. § 54.800, et
20 seq.

21
22

¹⁰ NECA Study Results, 2007 Report, submitted 9/30/08, Available at <http://www.fcc.gov/wcb/iatd/neca.html>

1 **Q. Why is United's federal universal service subsidy relevant in this case?**

2 A. United seeks to justify its intrastate access rates, which it acknowledges to be above cost,
3 based on its claims that it is a high cost company. The information about the federal high
4 cost loop support mechanism shows that United's Washington State service area does not
5 have sufficiently high costs to qualify for federal high cost loop support. This
6 determination is based on companies' actual investments, rather than model results such
7 as those put forward by United in this case. Given that the FCC, which has primary
8 responsibility under federal law for universal service policy, does not consider United's
9 Washington State service area to be a high cost area, it is hard to see why this
10 commission should authorize the company to continue a universal service charge on
11 terminating access service. United should not automatically qualify for state high cost
12 subsidy without a comprehensive revenue review.

13
14 **IV. CONCLUSION**

15
16 **Q. Please summarize your testimony.**

17 A. My testimony first explains some of the drawbacks of above-cost intrastate access
18 charges, including an ITAC, as a universal service mechanism. I then explain that United
19 does not receive high cost support under the federal universal service mechanism. These
20 considerations, together with Dr. Blackmon's testimony about the harm that excessive
21 access charges can cause to competition in the market for long distance services, and Dr.
22 Blackmon, Mr. Zawislak, and Mr. Applegate's testimony regarding United's failure to

1 demonstrate a universal service revenue requirement, all support Staff's conclusion that
2 United's ITAC rate should be phased out.

3

4 **Q. Does this conclude your testimony at this time?**

5 A. Yes, it does. Thank you.

6