

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

**REBUTTAL TESTIMONY OF PAUL B. VASINGTON
ON BEHALF OF VERIZON**

REDACTED VERSION

June 5, 2009

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3 **I. INTRODUCTION**

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

5 A. My name is Paul B. Vasington. I am a Director - State Public Policy for Verizon.

6 My business address is 185 Franklin Street, Boston, Massachusetts 02110.

7 **Q. MR. VASINGTON, DID YOU SUBMIT DIRECT TESTIMONY IN THIS**
8 **PROCEEDING?**

9 A. Yes. I submitted direct testimony on February 18, 2009.

10 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

11 A. The purpose of my rebuttal testimony is to respond to the testimony filed by
12 Messrs. Dippon, Felz, and Roth, on behalf of Embarq on April 17, 2009.

13 **Q. PLEASE PROVIDE A SUMMARY OF YOUR REBUTTAL TESTIMONY**
14 **AS IT RELATES TO MESSRS. ROTH AND FELZ.**

15 A. Messrs. Roth and Feltz purport to demonstrate that Embarq needs and uses a large
16 subsidy from its intrastate switched access rates (more than **BEGIN HIGHLY**
17 **CONFIDENTIAL END HIGHLY CONFIDENTIAL** annually)¹ to maintain
18 “affordable” local retail service in its Washington exchanges. That translates into
19 a monthly subsidy of approximately **BEGIN HIGHLY CONFIDENTIAL**
20 **END HIGHLY CONFIDENTIAL** for each of Embarq’s access lines in

¹ Mr. Felz calculates that if Embarq were to mirror Verizon Northwest’s intrastate switched access rates, it would earn **BEGIN HIGHLY CONFIDENTIAL END HIGHLY CONFIDENTIAL** less annually. *See* Felz Responsive Testimony, Exhibit No. _____(JMF-4HC). If Embarq were to mirror its own interstate switched access rates, a proposal that AT&T supports, its revenue reduction would be greater. *Id.*

1 Washington.² According to Embarq, that subsidy (which is a tax on long distance
2 service paid by access purchasers, such as Verizon and its customers) is necessary
3 to ensure universal service. The majority of Embarq's residential customers pay a
4 local retail rate of \$8.90 per month, and residential customers in two Embarq
5 exchanges pay \$9.40 per month, rates far below what constitutes "affordable"
6 local retail service.

7 As I describe in Section II, the cost study on which Embarq's contribution
8 analysis is based suffers from a number of problems, so it cannot be concluded
9 that Embarq actually needs and uses the **BEGIN HIGHLY CONFIDENTIAL**
10 **END HIGHLY CONFIDENTIAL** annual contribution from intrastate switched
11 access in order to subsidize local service. Even if a properly performed cost study
12 would confirm Embarq's assertion that its switched access rates provide a
13 contribution to its local service, at best such a showing would mean Embarq has
14 good grounds to offset the reduction in its switched access rates with modest
15 increases in local retail rates – which would remain affordable (and would be well
16 below Verizon Northwest's local rates). Such a showing of a contribution flow
17 would *not* undercut Verizon's evidence that Embarq's ability to charge multiples
18 of what Verizon Northwest and Qwest charge for identical functions violates
19 Washington law by permitting Embarq to export a disproportionate amount
20 (millions of dollars annually) of its costs to its competitors.

² Embarq has a total of **BEGIN HIGHLY CONFIDENTIAL** **END HIGHLY CONFIDENTIAL** access lines. See Roth Responsive Testimony, Exhibit No. _____THC(HJR-2HC), at 2.

1 **Q. PLEASE PROVIDE A SUMMARY OF YOUR REBUTTAL TESTIMONY**
2 **AS IT RELATES TO MR. DIPPON’S TESTIMONY.**

3 A. Instead of engaging my direct testimony, Mr. Dippon constructs a series of
4 strawmen that seriously misrepresent and/or ignore what I wrote. For example,
5 Mr. Dippon recasts my argument about the competitive impact of Embarq’s
6 switched access as an antitrust-style vertical price squeeze (Dippon Responsive
7 Testimony, Exhibit No. _____(CMD-1THC), at 67), *completely ignoring* the
8 section where I describe the competitive impact of Embarq’s switched access
9 rates on the long distance market – including my analysis showing that Verizon
10 loses money *every time* it terminates an intrastate toll call in Embarq’s service
11 territory. *See* Vasington Direct Testimony, Exhibit No. _____(PBV-1T), at 17-19.
12 Mr. Dippon also ignores the evidence Commission Staff presented in 2005, which
13 reached the same conclusions about the excessive nature of Embarq’s switched
14 access rates,³ and he incorrectly asserts that my direct testimony did not address
15 the rebalancing issues (it did).

16 Moreover, Mr. Dippon’s analyses are inconsistent with Washington
17 precedent and the well established principles long recognized by regulators and
18 economists. For example, Mr. Dippon insists that reducing Embarq’s intrastate
19 switched access rates will not benefit consumers, and he appears to endorse his

³ Mr. Felz, in Exhibit No. _____(JMF-1THC), at 10, takes note of the Staff recommendation that Embarq reduce its intrastate access rates, but points out that Staff also endorsed “revenue neutrality.” As I have noted several times, Verizon is not opposed to a revenue neutral reduction in Embarq’s intrastate access rates, as long as Embarq demonstrates the need for the additional revenue and recovers it from the end users who cause the costs.

1 client's position that it is appropriate to allocate some portion of the local loop
2 costs to switched access costs. Those are positions that have been soundly
3 rejected by most economists who have examined the issue – including Mr.
4 Dippon's colleagues at NERA Economic Consulting.

5 Finally, Mr. Dippon asserts numerous half-truths about the nature of
6 Embarq's operations in Washington that simply do not pass muster. For example,
7 he repeatedly asserts that Embarq would be unable to collect more of its costs
8 from its own end users, but he provides no evidence or analysis to support that
9 assertion, and he ignores the fact (which I pointed out in my direct testimony) that
10 Embarq's local retail rates are low. In fact, Mr. Dippon barely even tries to
11 marshal factual support for his repeated assertion that reducing Embarq's
12 switched access rates would jeopardize universal service. That is presumably
13 because the facts do not support his position: even if Embarq were to increase its
14 local retail rates by fully **BEGIN HIGHLY CONFIDENTIAL END HIGHLY**
15 **CONFIDENTIAL** per month to offset the *entire* revenue reduction it would
16 incur if Embarq's switched access rates are reduced to Verizon Northwest's level,
17 Embarq's local retail rates would *still* be lower than those of Verizon Northwest.
18 So there is simply no reason to countenance Mr. Dippon's doomsday scenario
19 about the purported universal service implications of Verizon's proposed remedy.

20 Because so many defects call into question the seriousness and reliability
21 of Mr. Dippon's evidence and analyses, the Commission should reject his
22 testimony in its entirety. And the Commission should not permit Mr. Dippon to

1 rehabilitate his testimony at the surrebuttal stage by engaging (for the *first time*)
2 evidence and analyses that I (and Mr. Bax) presented on direct. Instead, the
3 Commission should require Embarq to reduce its intrastate switched access rates
4 to reasonable levels, and should place the onus on Embarq to seek a reasonable
5 amount of rate rebalancing – *if* (and to the extent) Embarq presents the
6 Commission with sufficient evidence showing that some rebalancing is
7 appropriate.

8 **II. EMBARQ'S CONTRIBUTION ANALYSIS IS FUNDAMENTALLY**
9 **FLAWED.**

10 **Q. MR. ROTH CLAIMS HIS COST STUDY SHOWS THAT EMBARQ'S**
11 **INTRASTATE SWITCHED ACCESS RATES ARE JUST AND**
12 **REASONABLE. SEE ROTH RESPONSIVE TESTIMONY, EXHIBIT**
13 **NO. _____THC(HJR-1T), AT 6. PLEASE RESPOND.**

14 A. As a starting point, while I am not an attorney and will let Verizon's attorneys
15 engage the legal standards, it is a *non sequitur* to assert that Embarq's switched
16 access rates comply with Washington law simply because they may provide a
17 contribution to local service. Even assuming *arguendo* that they do provide some
18 contribution (and, as I will discuss below, that is not a reasonable assumption
19 given the highly inflated nature of Embarq's cost study), Embarq nowhere cites
20 anything suggesting that the existence of a contribution flow somehow cures the
21 violations of statutes, rules and Commission precedents that Verizon has
22 demonstrated. The Commission confirmed this when it required Verizon

1 Northwest to reduce its intrastate switched access rates to levels that comply with
2 Washington law: the Commission recognized that Verizon Northwest had a right
3 to demonstrate the need for rebalancing, but de-linked the rebalancing issue from
4 the question of the legality of Verizon Northwest's switched access rates.⁴

5 Moreover, there are a number of problems with Embarq's cost analyses.
6 These problems call into question Embarq's claim that it needs and uses a
7 contribution flow from switched access to subsidize its local service.

8 **Q. WHAT IS THE PRINCIPAL CONCEPTUAL PROBLEM WITH THE**
9 **COST ANALYSES EMBARQ HAS PRESENTED?**

10 A. Embarq's proposed framework is wrong. Mr. Roth claims it is appropriate to
11 allocate fully **BEGIN HIGHLY CONFIDENTIAL END HIGHLY**
12 **CONFIDENTIAL** of the intrastate cost of the local loop to intrastate switched
13 access. Roth Responsive Testimony, Exhibit No. _____THC(HJR-1T), at 10. His
14 purported justification is: "The IXCs who purchase intrastate switched access
15 services from United use the local loop to deliver their services to their customers
16 and are purchasing access to the local customer using United's local loop. The
17 IXCs, as users of the local loop, should continue to pay an allocated portion for
18 usage of the local loop." *Id.* at 26. However, it is fundamentally out of step with
19 established economic principles of cost causation to allocate a portion of the local
20 loop to switched access costs.

21 **Q. DOES MR. DIPPON CONTRADICT MR. ROTH'S ANALYSIS?**

⁴ Eleventh Supplemental Order, Docket No. UT-020406, Order Sustaining Complaint, Directing Filing of Revised Access Charge Rates (issued Aug. 12, 2003) ("Eleventh Supplemental Order"), at 7.

1 A. Yes. The body of Mr. Dippon’s testimony is vague about whether he agrees with
2 his client’s position that local loop costs should be allocated to switched access
3 costs. He discusses the continuing need for “subsidies” in access rates and for
4 contribution to common cost recovery, but he does not specify whether he
5 believes that the loop is a direct cost of basic exchange service that requires a
6 subsidy from switched access, or whether he considers the loop to be a common
7 cost for which there should be an allocation to switched access service. However,
8 Mr. Dippon attaches as an exhibit to his testimony a “white paper” that he co-
9 authored that addresses the recovery of loop costs. In that paper, the authors refer
10 to “subscriber line costs” as “non-traffic sensitive” (“NTS”) costs of the network
11 and separately refer to joint and common costs of the network.⁵ They clearly
12 refer to the recovery of NTS costs, including loop costs, via access charges as
13 “subsidizing basic rates,”⁶ directly contradicting Mr. Roth, who characterizes
14 such recovery as an appropriate allocation of loop costs to access.

15 **Q. IS THIS CONTRADICTION IMPORTANT?**

16 A. Yes, because it highlights the difference between revenue support and cost
17 recovery. Mr. Dippon is describing – but not directly endorsing – the historical
18 practices of revenue recovery for loop support in access rates, and Mr. Roth is
19 trying to provide a justification for loop cost allocation to switched access service.
20 I agree that the historical practice of recovering loop costs in access rates is the

⁵ Exhibit No. _____(CMD-3) at 13.

⁶ *Id.*

1 result of a policy decision for revenue support and subsidy, as described by Mr.
2 Dippon, but it has no economic meaning in terms of efficient cost recovery. And
3 just because implicit subsidies were once used in setting access rates that is not a
4 justification for their continued use in today's competitive environment.

5 As I discussed in section IV-A below, it is not economically efficient to
6 recover NTS costs in switched access rates – and it is incorrect for Mr. Dippon to
7 assert that a more efficient rate structure will not have consumer benefits.

8 **Q. SHOULD LOCAL LOOP COSTS BE RECOVERED IN SWITCHED**
9 **ACCESS, AS MR. ROTH SAYS?**

10 A. No. Loop costs should not be recovered in switched access rates, and these costs
11 definitely should not be included in a study that purports to represent the cost of
12 switched access service.

13 The cost of the local loop is not a cost incurred in providing switched
14 access. The local loop is a non-traffic sensitive cost that is triggered only by a
15 customer's decision to purchase basic exchange service. In conducting a service-
16 specific cost study, the only service that should be assigned the cost of the local
17 loop is basic local service.

18 The cost of the loop is driven solely by the business or person purchasing
19 a dial tone line. The cost of the loop is fixed, regardless of the number of calls
20 made by that business or person. Allocating the cost of that loop based on
21 something other than the purchase of the dial tone line is arbitrary because it is
22 not directly related to the manner in which the costs are incurred.

1 Although the loop certainly is being used in connection with switched
2 access, that usage is not the driver for incurring the cost of the loop. The cost of that
3 loop is driven by the retail customer's purchase of dial tone line service. Loop cost
4 is a fixed cost that is not affected by switched access. In other words, if the
5 customer makes a lot of toll calls, a few tolls or no toll calls, the cost of providing
6 the loop to that customer will remain exactly the same. While it may have been
7 desirable in the past from a social policy basis to set switched access rates at a level
8 above cost in order to provide a contribution towards the recovery of loop costs, this
9 would purely be a pricing decision because there is absolutely no causative link
10 between the amount of investment a company makes in its loop plant and the
11 amount of switched access service it provides.

12 This economic principle was explained by the FCC in its *MTS and WATS*
13 *Market Structure* Order.

14 Thus, one should not ask whether costs are caused by carriers or users. One
15 should ask whether particular costs are caused by a particular user or class of
16 users. The cost of a common line is attributable to the user who has that line,
17 which is dedicated to his use and which remains available for his exclusive
18 use in sending or receiving any telecommunication that can be transmitted
19 through the local dial switch. For this reason the imposition of a flat charge
20 upon a subscriber who has a common line to recover some part of the fixed
21 costs associated with that common line burdens that customer with no costs
22 that the customer did not cause.

23 *See MTS and WATS Market Structure*, 97 F.C.C.2d 682, 688-689 (1983).

24 The same point also has been made by many economists. Here are just two
25 examples from economists who also have served as chairmen of state utility
26 commissions:

1 An obvious fact about telephone service is that to make or receive any calls
2 at all, you must first be connected to the network. There is a real cost to
3 establishing this connection even if you never make a call or receive one. By
4 virtue of merely standing ready to do either, the subscriber imposes an
5 identifiable cost on society. Cost-causative pricing principles, the principles
6 that apply in competitive markets, would require that each subscriber pay the
7 costs—that is, of being hooked up to the network—that he or she has
8 imposed on society.⁷
9

10 [T]o define “basic service” as not essentially equivalent to the loop is to
11 define *Hamlet* without the Prince of Denmark. The loop is not merely an
12 essential part of the basic telephone service that it is our national policy to
13 make universally affordable and subscribed to; it is at the heart of that
14 service—the lifeline connection between subscribers and the rest of the
15 society. ... It is the decision of consumers to *subscribe* to telephone service,
16 whether or not they use it to place calls, that is causally responsible for
17 imposing the cost of the loop on society.⁸

18 For all of these reasons, it is not appropriate to include the cost of the loop as
19 a cost of switched access.⁹

20 **Q. BOTH MR. ROTH AND MR. DIPPON STRESS THAT EMBARQ IS A**
21 **“RURAL” CARRIER AND ARGUE THAT ITS CUSTOMER DENSITIES**
22 **MILITATE AGAINST TREATING EMBARQ LIKE QWEST OR**

⁷ Gordon, Kenneth, and Duesterberg, Thomas J., “Competition and Deregulation in Telecommunications,” Hudson Institute Inc., 1997, at 29-30.

⁸ Kahn, Alfred E., “Letting Go: Deregulating the Process of Deregulation,” MSU Public Utilities Papers: 1998, at 74 (emphasis in original, and footnotes omitted).

⁹ In Exhibit No. _____THC(HJR-1T), at 10, Mr. Roth cites a 1996 Commission decision in support of his position that the local loop is a “shared cost” that should be allocated to switched access. Later in the order Mr. Roth cites, the Commission appears to acknowledge that cost causation principles are important in access rate design. Specifically, in requiring Qwest to eliminate its CCLC, the Commission stated that it favors a more “streamlined” rate structure under which “rate elements have a direct bearing on the service provided.” See Fifteenth Supplemental Order, Washington Utilities and Transportation Commission v. U.S. West Communications, Docket No. UT-950200, at 113. According to the Commission, “[t]o allow the CCLC to continue to exist is to imply, inaccurately, that local exchange services require a “subsidy” from toll.” *Id.* Moreover, in the more recent decision of *AT&T v. Verizon Northwest*, Docket No. UT-020406, the Commission appeared to embrace contemporary cost causation principles in requiring Verizon Northwest to eliminate its CCLC and reduce its Interim Terminating Access Charge. See Eleventh Supplemental Order.

1 **VERIZON NORTHWEST. SEE ROTH RESPONSIVE TESTIMONY,**
2 **EXHIBIT NO. _____THC(HJR-1T), AT 15-16; DIPPON RESPONSIVE**
3 **TESTIMONY, EXHIBIT NO. _____(CMD-1THC), AT 23-25. ARE THEY**
4 **CORRECT?**

5 A. No. Customer density may affect loop costs but, as discussed above, it is
6 inappropriate to include the cost of the loop as a cost of switched access.
7 Therefore, whether Embarq serves a territory with less customer density does not
8 affect its costs for providing switched access services.

9 There are several additional problems with Embarq's position on this
10 point. First, Embarq's appeal for the Commission to accept claims of high rural
11 LEC costs as a basis for higher access rates would seem useful only to the extent
12 that the Commission wishes to reward those companies that can demonstrate the
13 highest cost with the highest access rates. Such a regulatory design, however,
14 would create perverse incentives that reward firms for incurring higher costs.

15 Second, Embarq's suggestion that the Commission focus on higher rural
16 costs tends to ignore basic lessons from competitive markets, the standard to
17 which regulators often point. Specifically, in a competitive market with multiple
18 providers of a commodity product, prices should not vary significantly. That is,
19 in competitive markets, higher cost firms are not rewarded for their higher costs
20 with higher prices.

21 As I discussed in my initial testimony, the appropriate benchmark has
22 been determined by the Commission's recent establishment of Verizon

1 Northwest's intrastate access rates. That rate should serve as a proxy for the
2 "competitive" rate that Embarq, like other market participants, should be required
3 to accept. Accordingly, it is these rates, not Embarq's costs (and certainly not the
4 inflated costs it claims), that provide the relevant benchmark for pricing access.¹⁰

5 **Q. IN THE PAST, HAS THE COMMISSION CONSIDERED EMBARQ TO**
6 **BE A "RURAL" COMPANY?**

7 A. No. As I mentioned in my direct testimony, the Commission has never classified
8 Embarq as a "rural" company in Washington. For example, in its cost proceeding
9 aimed at estimating the universal service costs of Washington carriers, the
10 Commission considered Embarq, along with Qwest and Verizon Northwest, as
11 "Non-rural Companies," and separately analyzed the "rural companies."¹¹

12 **Q. WHAT ABOUT THE FCC? ARE EMBARQ'S OPERATIONS IN**
13 **WASHINGTON CONSIDERED "RURAL" UNDER THE FCC'S**
14 **FRAMEWORK?**

15 A. No. For example, the disbursements Embarq receives from the federal universal
16 service fund for its Washington operations are Interstate Access Support, which is
17 available for non-rural carriers. Embarq does not receive any of the types of
18 disbursement designated for rural carriers, such as High Cost Loop, Interstate
19 Common Line Support, Local Switching Support, Long Term Support, Safety Net

¹⁰ Importantly, as I pointed out in my direct testimony, Verizon Northwest's rate (and Qwest's) are multiples of Embarq's costs for providing switched access functions, so there is no danger of requiring Embarq to charge a below-cost rate. See Vasington Direct Testimony, Exhibit No. _____(PBV-1T), at 21.

¹¹ See Tenth Supplemental Order and Order Establishing Costs, *In the Matter of Determining Costs for Universal Service*, Docket No. UT-980311(a) (Nov. 20, 1998) ("Order Determining Costs"), ¶ 242-44.

1 Additive Support, or Safety Valve Support. Also, the FCC established Embarq's
2 interstate switched access rates in the same proceeding that established the rates
3 of Verizon, AT&T, and Qwest.¹² The FCC separately addressed the switched
4 access rates of the mid-sized companies.

5 In fact, precisely because of Embarq's non-rural status, CenturyTel
6 recently told the FCC that after its acquisition of Embarq is completed,
7 CenturyTel will not continue to claim the status of a primarily rural price cap
8 company. *See* Letter of Gregory J. Vogt to Marlene H. Dortch, CenturyTel, Inc.
9 Petition for Conversation to Price Cap Regulation and for Limited Waiver Relief,
10 WC Docket No. 08-191 (Fed. Comm. Comm'n filed March 19, 2009).

11 **Q. IS EMBARQ CONSISTENT WITH ITS ARGUMENTS ABOUT THE**
12 **PURPORTEDLY "RURAL" NATURE OF ITS OPERATIONS IN**
13 **WASHINGTON?**

14 A. No. Embarq wants to have it both ways. On the one hand, it argues that its
15 supposedly "rural" operations involve such high loop costs that Embarq is unable
16 to compete on the same playing field as Verizon Northwest and Qwest. However,
17 as I discussed in Section III-D below, Embarq *also* argues that the level of
18 competition it faces in most of its exchanges is so intense that Embarq would be
19 unable to collect more of its costs from its end users, as Qwest and Verizon
20 Northwest *have been doing for years*. It makes no sense for Embarq to claim both

¹² *Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Low-Volume Long Distance Users; Federal-State Joint Board On Universal Service*, Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45, 15 FCC Rcd 12962 (May 31, 2000) ("*CALLS Order*").

1 that it is more rural than Verizon Northwest and Qwest and that it is incapable of
2 charging its end users at least the same rate for local service that Verizon
3 Northwest and Qwest charge in their exchanges (where they obviously face at
4 least as much competition as Embarq).

5 **Q. YOU MENTIONED THAT THERE ARE A NUMBER OF PROBLEMS**
6 **WITH EMBARQ'S COST ANALYSES. PLEASE ELABORATE.**

7 A. First, Verizon was unable to run Embarq's cost model with varying input
8 assumptions. The cost model provided by Embarq has failed to run through to the
9 end to produce monthly costs. It shows a message similar to this: "2007
10 v2.0.1.3 switch.xls contains reference errors. Reference errors must be corrected
11 before process results are valid." Verizon did not have any additional time to
12 seek corrective action as to what was causing the model errors.

13 Second, Embarq used inflated input values in its cost model, including
14 depreciation rates and cost of capital. For example, Embarq is using 8.33%
15 depreciation rate for Central Office Switching and 25% depreciation rate for
16 Switching Software, which leads to a composite depreciation rate for switching of
17 12.22%, much higher than those that this Commission has approved in the past.

18 Finally, the Commission itself has undertaken analyses of Embarq's costs
19 that call into question the results of Embarq's cost study. In its Order
20 Determining Costs, the Commission estimated the loop costs of the three large
21 non-rural companies in Washington: Verizon Northwest, Qwest, and Embarq. In
22 Appendix A of that order, the Commission estimated Embarq's loop costs to be

1 \$44.17 per month. Mr. Roth's cost study estimates Embarq's loop costs to be
2 much higher – more than \$70.00 per month. Using the Commission's own
3 estimate as a "reality check" on Mr. Roth's cost study provides an additional
4 reason to doubt the validity of Mr. Roth's cost study.

5 **Q. WHY DO YOU SAY THAT EMBARQ'S DEPRECIATION RATES AND**
6 **COST OF CAPITAL ARE INFLATED?**

7 A. Embarq's depreciation rates are inflated because they appear to be higher than
8 those that this Commission has approved in the past.

9 In terms of the cost of capital, Embarq assumed a cost of debt of 12.40%
10 and a cost of equity of 10%. The rate of the debt is clearly too high. After the
11 financial crisis of last year and early this year, the debt markets are returning to
12 normal, and Embarq's credit profile can only improve due to its merger with
13 CenturyTel. But even using Embarq's current credit rating, it is likely to be able
14 to raise debt capital at a cost that is much less than 12.40%. In fact, a check on
15 current bond market data indicates rates for 10-year bonds from companies
16 comparable to Embarq in the range of 8%, which is much less than 12.40%. The
17 most fundamental flaw in Embarq's cost of capital is that Embarq assumed a cost
18 of debt that is higher than the assumed cost of equity. This is impossible because
19 debt investors have a preferential claim to the corporation's assets, so equity
20 investors will always demand a return on equity that is greater than the return on
21 debt.

1 All of these factors demonstrate that Embarq's cost analysis is not reliable
2 and does not demonstrate the reasonableness of its current switched access rates,
3 nor does it demonstrate the need for continued subsidies for basic exchange
4 service. As I will discuss later, Embarq should file a rate proceeding if it believes
5 it can demonstrate the need for rebalancing.

6 **III. MR. DIPPON FAILS TO ENGAGE VERIZON'S EVIDENCE ABOUT THE**
7 **UNREASONABLE AND ANTICOMPETITIVE NATURE OF EMBARQ'S**
8 **SWITCHED ACCESS RATES.**

9 **A. The Commission Should Not Consider Mr. Dippon's Irrelevant, "Straw**
10 **Man" Arguments.**

11 **Q. IN GENERAL, DOES MR. DIPPON ENGAGE THE FACTS AND**
12 **ARGUMENTS YOU PRESENTED IN YOUR DIRECT TESTIMONY?**

13 A. No. Presumably to make his testimony appear more forceful, Mr. Dippon
14 frequently simplifies, misrepresents, or ignores the contents of my direct
15 testimony. The result of Mr. Dippon's extensive use of fallacious "straw man"
16 arguments is that a large portion of what I said on direct remains unchallenged.

17 **Q. PLEASE GENERALLY RESPOND TO SECTION III OF MR. DIPPON'S**
18 **TESTIMONY.**

19 A. Mr. Dippon begins his overall critique of my (and Mr. Bax's) testimony by
20 asserting that both Mr. Bax and I "seem to arrive at their conclusions based solely
21 on their observations that United's intrastate switched access rates exceed
22 economic cost." See Dippon Responsive Testimony, Exhibit No. ____ (CMD-

1 1THC), at 10. Mr. Dippon does not cite anything to support that assertion, and
2 the assertion is wrong on many levels. First, nowhere in my direct testimony did I
3 state or imply that Embarq's switched access rates are excessive because they are
4 higher than Embarq's costs for switched access.¹³

5 More fundamentally, Mr. Dippon ignores the fact that I dedicated the
6 *majority* of my 32-page direct testimony (Exhibit No. ____ (PBV-1T)) to
7 explaining in detail why Embarq's switched access rates are unreasonable and
8 anticompetitive, based on the reasonableness standards and competitiveness
9 frameworks that the Commission has employed in the past. As I will discuss in
10 detail below, much of my direct testimony is either ignored or misrepresented by
11 Mr. Dippon.

12 **B. Embarq's Universal Service Arguments Are Unsupported and**
13 **Unsupportable.**

14 **Q. MR. DIPPON STATES THAT "MR. VASINGTON FINDS IT**
15 **UNNECESSARY TO PROVIDE UNITED WITH A PROVERBIAL TOOL**
16 **TO RECOVER ACCESS REVENUE." DIPPON RESPONSIVE**
17 **TESTIMONY, EXHIBIT NO. ____ (CMD-1THC), AT PAGE 58. DOES**
18 **THAT STATEMENT CORRECTLY CHARACTERIZE YOUR INITIAL**
19 **TESTIMONY?**

¹³ In fact, the *only* discussion of Embarq's costs in my direct testimony (Exhibit No. ____ (PBV-1T)) is on page 21. There I simply point out that the benchmark Verizon advocates is substantially above Embarq's costs – meaning that Embarq would continue to receive a reasonable contribution from switched access once rates are reduced to Verizon Northwest's level. Nowhere did I say or imply that Embarq's costs are relevant to determining an appropriate switched access for Embarq – other than acknowledging that Embarq should not be required to charge a below-cost rate.

1 A. No, it does not. I directly address this in Section V of my direct testimony. What
2 I said was that *if* Embarq can show that it needs a contribution from switched
3 access to subsidize local service, then the Commission “presumably will permit
4 Embarq to seek increases in other rates.” Vasington Direct Testimony, Exhibit
5 No. _____(PBV-1T), at 27-28.

6 In my section on universal service, I also noted that “[t]he possibility of
7 rebalancing would not raise any affordability concerns given that Embarq’s retail
8 rates are quite low – only \$8.90 or \$9.40 per month for residential customers.”
9 Vasington Direct Testimony, Exhibit No. _____(PBV-1T), at 28. The room for
10 rebalancing retail rates is a key point, and is wholly ignored by Mr. Dippon.

11 **Q. PLEASE ADDRESS MR. DIPPON’S ARGUMENT THAT “UNITED’S**
12 **EXISTING SWITCHED ACCESS RATE LEVELS MAINTAIN**
13 **UNIVERSAL SERVICE AT AFFORDABLE RATES IN RURAL, HIGH-**
14 **COST WASHINGTON.” SEE SECTION III-A, EXHBIT NO. _____(CMD-**
15 **1THC).**

16 A. I certainly agree that Embarq’s access rates (as well as those of every other ILEC)
17 were initially set over two decades ago to provide some contribution to cover the
18 costs of basic exchange service and joint and common costs. But that fact alone
19 does not lead to the conclusion that the same level of revenue contribution is still
20 necessary in 2009 to maintain universal service at affordable rates. There is
21 absolutely no evidence that a decrease in Embarq’s intrastate access rates will
22 undermine universal service or affordability. That stale argument has been raised

1 countless times in the past thirty years to justify higher access rates, yet there has
2 never been evidence that rebalancing local rates and access rates in any way has
3 harmed universal service. The fact is that Embarq can increase its basic exchange
4 rates more toward cost without any harm to universal service or affordability.

5 Mr. Dippon points to my testimony in New Jersey in support of his
6 contention that “switched access rates cannot be reduced in a vacuum,” and
7 suggests that my advocacy in that case is contrary to what Verizon advocates in
8 this case.¹⁴ That is wrong. Verizon’s position in New Jersey, where it is an
9 ILEC, is exactly the same as its position in Washington, where it is an ILEC,
10 CLEC and IXC. In both cases, Verizon supports more efficient recovery of costs,
11 with end users picking up a greater portion of the costs that they have caused, if
12 necessary. Verizon elsewhere has argued for full *revenue* recovery and has made
13 the point that if a regulator decides that it is not appropriate to recover NTS costs
14 in switched access rates, then it may be necessary for the regulator to provide for
15 other cost recovery mechanisms, such as an increase in basic exchange rates, upon
16 a showing that such revenue support is needed. That is entirely consistent with
17 Verizon’s advocacy in this case. Verizon does not claim that Embarq cannot
18 recover loop costs that it currently recovers from intrastate switched access rates;
19 it would simply be more appropriate and more economically efficient, and more
20 conducive to the development of efficient competition, if these costs were
21 recovered from end user customers.

¹⁴ Dippon Responsive Testimony, Exhibit No. _____(CMD-1THC), at 17.

1 C. **Embarq Has No Right to an “Assured Recovery Mechanism.”**

2 Q. **MR. DIPPON SAYS THAT “AN ASSURED RECOVERY MECHANISM IS**
3 **REQUIRED, RATHER THAN THE ILLUSION OF RECOVERY FROM**
4 **END USER RATE INCREASES.” DIPPON RESPONSIVE TESTIMONY,**
5 **EXHIBIT NO. _____(CMD-1THC), AT 18. IS THIS CORRECT?**

6 A. No. Mr. Dippon is wrong to argue that Embarq needs an “assured” recovery
7 mechanism for its costs. It only has a right to an *opportunity* to recover its
8 prudently incurred costs, not to an assurance. He admits that point on page 21 of
9 his testimony where he refers to a “fair opportunity to recover their prudently
10 incurred costs.” Exhibit No. _____(CMD-1THC). Conveniently, though, Embarq
11 attempts to insulate a significant portion of its costs from the growing competition
12 in the communications industry by recovering these costs from carrier customers
13 who have no choice but to use Embarq’s access services or via a direct universal
14 service tax. Such a result would be more favorable to Embarq than the alternative
15 of trying to recover direct costs caused by end users from those same end users,
16 but it would not fully promote efficient competition.

17 Contrary to Mr. Dippon’s caricature of Verizon’s position on access
18 charges (*see* Dippon Responsive Testimony, Exhibit No. _____(CMD-1THC), at
19 22, lines 15-17), Verizon does not disagree about the need for a “balanced
20 approach between intercarrier compensation and universal service.” *Id.* at 20.
21 However, there is no need for Embarq to enjoy the artificial competitive
22 advantage of being permitted to charge its own end users far less for local service

1 that what Verizon Northwest and Qwest charge their end users. Moreover, a
2 balanced position in 2009 is one in which carriers like Embarq are required to
3 charge reasonable access rates and recover more of their costs from their own end
4 users. Carriers in other states, including both Verizon and Embarq in New Jersey
5 most recently, were able to recover more of their costs from end users when
6 allowed by state commissions, and there is no reason to consider this to be an
7 “illusion.”

8 **Q. IS IT PROCOMPETITIVE FOR EMBARQ TO CHARGE LOCAL RATES**
9 **THAT ARE MUCH LOWER THAN BOTH EMBARQ’S OWN COSTS**
10 **FOR PROVIDING THE SERVICE AND WHAT OTHER ILECS**
11 **CHARGE?**

12 A. No. To the contrary, Embarq’s very low rates local rates – which are far below
13 what Verizon Northwest collects from its own end users – likely *impede* the
14 emergence of facilities-based competition in Embarq’s exchanges. Moreover as
15 discussed below, Embarq’s assertion that it cannot collect more of its costs from
16 its own end users is entirely unsupported – and it is undercut by the fact that both
17 Verizon Northwest and Qwest do collect a greater portion of their costs from their
18 own end users.

19 Even Embarq agrees that low local service rates impede the development
20 of competition. In a recent Ohio case, Embarq complained about a neighboring
21 ILEC (Doylestown) competing in its own ILEC service territory, arguing that:

1 It is simply unfair to allow Doylestown this unfair competitive advantage,
2 subsidized by its improperly high access rates ... Inflated access rates and
3 USAC payments are subsidizing Doylestown's local service rates. This
4 puts Embarq at an unfair competitive disadvantage in competing for
5 customers.¹⁵

6 Ironically, in *this proceeding*, Mr. Dippon describes low local service rates
7 as a competitive disadvantage *for Embarq*.¹⁶ If Embarq's low rates are a
8 competitive disadvantage for Embarq, then rebalancing would benefit both
9 Embarq and its competitors, for whom below-cost rates surely are a competitive
10 disadvantage. Therefore, more efficient pricing would promote efficient
11 competition by the incumbent (Embarq) and its current and potential competitors.

12 **D. Mr. Dippon Fails to Support His Assertion that Embarq Is Incapable of**
13 **Collecting More of its Costs from its Own End Users.**

14 **Q. MR. DIPPON CLAIMS THAT COMPETITION MAKES IT "DIFFICULT"**
15 **TO RAISE END USER RATES TO SUPPORT ACCESS RATE**
16 **REDUCTIONS. DIPPON RESPONSIVE TESTIMONY, EXHIBIT**
17 **NO. _____(CMD-1THC), AT 23. DO YOU AGREE?**

18 A. No. I do not agree that competition would prevent Embarq from increasing its
19 low local service rates. Indeed, Mr. Dippon points to absolutely no evidence to
20 support his contention. As I noted earlier, other carriers have been able to
21 rebalance and increase their basic exchange rates, and this has happened in

¹⁵ Memorandum Contra and Request for Hearing of United Telephone Company of Ohio d/b/a Embarq to Doylestown's Waiver Application, *In the Matter of the Application of Doylestown Telephone Company for a Waiver of Edge-Out Access Rate Reduction Requirements*, PUCO Case No. 08-0117-TP-WVR, at 3 (filed February 26, 2008).

¹⁶ Dippon Responsive Testimony, Exhibit No. _____(CMD-1THC), at 19, lines 10-16.

1 service territories that are likely facing far more competition than Embarq is
2 facing. For example, both Verizon and Embarq were able to increase their basic
3 exchange rates toward market levels last year in New Jersey, and Verizon has
4 been able to increase its basic exchange rates in Rhode Island, which is the most
5 competitive state in the country, at least in terms of CLEC market share. The
6 notion that Embarq could only support a rate increase for **BEGIN HIGHLY**
7 **CONFIDENTIAL END HIGHLY CONFIDENTIAL** residential customers in
8 Washington is absurd. Mr. Dippon *assumes* that Embarq cannot raise its basic
9 residential exchange rates at all in any area where a wireline cable competitor is
10 present, but there is no evidence to support such an extreme assumption.

11 In addition, the notion that some customers might defect to Embarq's
12 competitors actually *confirms* that universal service would not be jeopardized by
13 an increase in basic exchange rates. If it is true that some customers would switch
14 to Embarq's competitors, affordability and universal service concerns do not
15 apply. In fact, some switching to competitors is to be expected in a free market
16 when an incumbent's artificial competitive advantage (the ability to charge local
17 rates well below the market rate because of subsidies) is reduced.

18 Finally, there is an inherent inconsistency in Embarq's purported showings
19 that, on the one hand, Verizon Northwest and Qwest face more competition than
20 Embarq, while on the other, that Embarq is supposedly unable to increase its rates
21 up to the levels charged by those carriers in Washington. Embarq's basic
22 exchange rates are lower than the comparable rates of both Verizon Northwest

1 and Qwest, yet Embarq argues that Qwest and Verizon Northwest are operating in
2 more densely populated areas.¹⁷ According to Mr. Dippon, less competition
3 exists in rural areas than in more densely populated areas of Washington.¹⁸ Yet,
4 if Verizon Northwest and Qwest are facing more competition than Embarq, how
5 can it be that they are able to sustain higher local exchange prices than Embarq
6 claims it can sustain?

7 Obviously, as noted above, Embarq is better off if it is able to insulate and
8 protect a significant portion of its revenue from competition via recovery through
9 access charges, rather than through recovery of charges for services for which
10 customers are free to exercise choices. But that outcome is far worse for
11 Embarq's carrier customers and its retail customers.

12 **IV. MR. DIPPON DOES NOT UNDERCUT THE WELL-ESTABLISHED**
13 **FACT THAT REASONABLE ACCESS RATES BENEFIT COMPETITION**
14 **AND CONSUMERS.**

15 **A. Mr. Dippon Does Not Seriously Engage the Evidence Regarding the**
16 **Competitive Implications of Excessive Switched Access Rates.**

17 **Q. MR. DIPPON SAYS THAT THE SUBSIDIES CONTAINED IN**
18 **EMBARQ'S INTRASTATE SWITCHED ACCESS RATES DO NOT**
19 **PROVIDE ANY COMPETITIVE ADVANTAGE TO EMBARQ. DIPPON**

¹⁷ Roth Responsive Testimony, Exhibit No. _____THC(HJR-1T), at 15-19.

¹⁸ Dippon Responsive Testimony, Exhibit No. _____(CMD-1THC), at 80.

1 **RESPONSIVE TESTIMONY, EXHIBIT NO. _____(CMD-1THC), AT 36,**
2 **LINES 13-16. IS THIS CLAIM CORRECT?**

3 A. No, as the FCC, this Commission, and other regulators have found repeatedly. As
4 an initial matter, Mr. Dippon makes the nonsensical claim that IXCs “have many
5 options available to bypass [Embarq’s] carrier access services, at least at the
6 originating end of the call.” Dippon Responsive Testimony, Exhibit
7 No. _____(CMD-1THC), at 72. If this were true, then Verizon and AT&T would
8 not be before this Commission attempting to force Embarq to charge reasonable
9 access charges. Nor would access charges in 2009 continue to be the significant
10 source of subsidies that even Mr. Dippon claims they represent today. Indeed,
11 Mr. Dippon’s claims on the bypass options supposedly available to IXCs directly
12 conflict with the findings of the Commission and Staff, as I pointed out in my
13 direct testimony. See Vasington Direct Testimony, Exhibit No. _____(PBV-1T),
14 at 10.

15 The FCC has repeatedly concluded that economically efficient
16 competition and the consumer benefits it yields cannot be achieved as long as
17 carriers seek to recover a disproportionate share of their costs from other carriers
18 through access charges, rather than from their own end users.¹⁹ Mr. Dippon
19 completely ignores the prior findings of this Commission with respect to the

¹⁹ See generally *CALLS Order; Multi-Association (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, Second Report & Order and Further Notice of Proposed Rulemaking in CC Docket No. 00-256, Fifteenth Report & Order in CC Docket No. 96-45, and Report & Order in CC Docket Nos. 98-77 and 98-166, 16 FCC Rcd 19613 (2001) (“*MAG Order*”); *Reform of Access Charges Imposed by Competitive Local Exchange Carriers*, Seventh Report & Order and Further Notice of Proposed Rulemaking, 16 FCC Rcd 9923 (2001) (“*CLEC Rate Cap Order*”).

1 impact inflated access charges have on competition. The Commission has already
2 reached the appropriate conclusion on the questions that Mr. Dippon addresses in
3 his testimony, where he argues that inflated access charges have no deleterious
4 impact on competition. When it reduced Verizon Northwest's intrastate access
5 charges, the Commission observed that "competitive circumstances have changed
6 radically" since Verizon Northwest's rates had previously been established, and
7 stated that "we – and Verizon – must face the competitive realities of the 21st
8 century and bring access charges more in line with current conditions."²⁰ The
9 Commission found that:

10 The excess charges of Verizon allow it to export costs of the
11 Verizon local network to the customers of Qwest and/or the
12 interexchange companies that offer intrastate toll service.
13 Verizon's pricing structure results in some combination of
14 higher profits and lower rates for its local exchange services. It
15 also can distort competition in the long-distance market to the
16 disadvantage of any company that chooses to offer long-
17 distance service to Verizon's local exchange customers. This is
18 unjust, unfair, and unreasonable.²¹
19

20 Based on that analysis, the Commission concluded that "Verizon's access
21 charge rates give an undue and unreasonable preference or advantage to itself, and
22 that the charges at their present level subject the complainant to undue and
23 unreasonable prejudice or competitive disadvantage."²² There is no question in
24 this case that Embarq is exporting costs of its local network to the customers of
25 other carriers, and that Embarq's pricing structure results in some combination of

²⁰ Eleventh Supplemental Order, at ¶ 39.

²¹ *Id.* ¶ 48 (quoting testimony of Dr. Blackmon).

²² *Id.* ¶ 49.

1 higher profits and lower rates for its local exchange services. Therefore, the
2 Commission's prior findings apply to the current competitive advantage that
3 Embarq derives from its intrastate access charges.

4 **Q. PLEASE ADDRESS MR. DIPPON'S CRITICISM OF YOUR DIRECT**
5 **TESTIMONY AS IT RELATES TO YOUR ARGUMENT THAT**
6 **EMBARQ'S INTRASTATE ACCESS RATES ARE ANTICOMPETITIVE.**

7 A. Once again, Mr. Dippon fails to address the specific facts of my testimony,
8 instead rebutting manufactured straw man arguments and hypotheticals. In
9 fighting these imaginary battles, Mr. Dippon even goes so far as to cite only a few
10 lines from the introduction of my testimony, and then uses those citations to
11 suggest that my testimony was vague or incomplete. Dippon Responsive
12 Testimony, Exhibit No. _____(CMD-1THC), at 37. But he completely ignores the
13 body of my testimony, where I provided specific examples of the ways in which
14 Embarq's access charges provide it with a competitive advantage.

15 In order to change the subject from the relevant facts, Mr. Dippon attempts
16 to turn this case into a complex discussion of antitrust doctrines and analyses by
17 trying to fit my testimony into a framework of market definitions and a vertical
18 price squeeze analysis. See Dippon Responsive Testimony, Exhibit
19 No. _____(CMD-1THC), at 66-73. But that is not my testimony, and the
20 Commission need not undertake such analysis here. The simple facts are that
21 Embarq charges too much for its bottleneck switched access service and too little

1 for its competitive local exchange services. Mr. Dippon concedes the latter, but
2 contests or ignores the former.

3 **Q. WHAT DOES MR. DIPPON SAY ABOUT THE FACT THAT EMBARQ**
4 **CHARGES TOO LITTLE FOR ITS COMPETITIVE LOCAL EXCHANGE**
5 **SERVICES?**

6 A. He refers numerous times to the point that Embarq's switched access services
7 provide a subsidy for its residential basic exchange services. In particular, he
8 quotes Mr. Roth's estimate of the average monthly revenue shortfall for Embarq's
9 exchange service. Dippon Responsive Testimony, Exhibit No. _____(CMD-
10 1THC), at 19-20. Thus, Embarq directly concedes that its rates for basic
11 exchange services are below its costs. This state of affairs is not conducive to the
12 development of efficient competition, as has been noted by this Commission,
13 other regulators, and economists.

14 **Q. WHAT DOES MR. DIPPON SAY ABOUT YOUR ALLEGATIONS THAT**
15 **INFLATED SWITCHED ACCESS CHARGES PROVIDE A**
16 **COMPETITIVE ADVANTAGE TO EMBARQ?**

17 A. Rather than engage my specific examples and arguments, he tries to recast my
18 arguments in a different framework – most likely because the Commission's
19 precedent does not support his arguments when the facts I presented are taken into
20 account. He makes assumptions about my testimony and how it supposedly fits

1 into product market definitions and arguments about a “vertical price squeeze.”²³
2 However, the point I made in my testimony about the anticompetitive impact of
3 Embarq’s access rates was supported by a straight-forward comparison of
4 Embarq’s switched access rates to its own retail prices. I pointed out that for a
5 toll call that both originates and terminates in Embarq’s service territory, total
6 access charges (originating plus terminating) are more than **BEGIN HIGHLY**
7 **CONFIDENTIAL END HIGHLY CONFIDENTIAL** per minute. That is
8 *twice* as high as the average *retail price* Embarq charges its own long distance
9 customers when they make intrastate toll calls.

10 In fact, the combination of Embarq’s originating and terminating switched
11 access charges for intrastate calls is significantly greater than the price Embarq
12 offers its long distance customers for making *international* telephone calls.²⁴ Mr.
13 Dippon ignores this plain fact, and tries to rebut the argument indirectly by
14 claiming that Embarq would have no incentive to forego the opportunity cost of
15 higher access rates. Yet here the facts get in the way of theory. Mr. Dippon’s
16 attempts in this case to prove his theory in the face of inconsistent facts are akin to
17 trying to “prove” the folklore that says, according to the laws of aerodynamics,

²³ Mr. Dippon criticizes what he calls my “claim of a stand-alone market for intrastate toll,” and argues that competition takes place for all toll services and increasingly for the bundle. See Dippon Responsive Testimony, Exhibit No. _____(CMD-1THC), at 79. I do not disagree that competition takes place increasingly for a bundle of services, but this does not mean that the costs for intrastate toll service are irrelevant to the market. Embarq tariffs and sells intrastate toll service, as do Verizon and other carriers. Whether intrastate toll is sold or bought as part of a package or as a stand-alone service, the cost of the service relative to the prices charged is important to a determination that competition will be promoted by more efficient pricing for switched access.

²⁴ See www.embarq.com/Residential/Voice/LongDistancePlans (offering subscribers to its long distance plans rates to Canada of \$0.07 and rates to many European countries of \$0.12).

1 bumblebees cannot fly, while at the same time observing bumblebees flying
2 around the garden. Mr. Dippon nowhere rebuts, denies or even acknowledges my
3 straightforward comparison of access rates and retail rates. This comparison
4 confirms the Commission's prior findings that inflated access charges provide a
5 competitive advantage to the LEC that charges them.

6 **B. Mr. Dippon's Arguments About Consumer Benefits Are Backwards.**

7 **Q. WHAT DOES MR. DIPPON SAY ABOUT THE PROSPECT FOR**
8 **CONSUMER BENEFITS FROM REDUCED ACCESS CHARGES?**

9 A. Mr. Dippon claims that the net effect of cost savings for long distance customers
10 and the "costs or repercussions" that would result is "clearly negative." Dippon
11 Responsive Testimony, Exhibit No. _____(CMD-1THC), at 48, lines 8-11. He
12 also states that "[i]f pricing constraints and COLR obligations exist, then the
13 principles of universal service must at the very least be valued the same, from a
14 policy standpoint, as any alleged benefit from access reductions." (*Id.* at 19, lines
15 7-9). His position appears to be that the benefits of more efficient access and toll
16 pricing are outweighed by the "costs" to customers if the LEC rebalances and
17 thereby raises local exchange rates.

18 **Q. IS THIS ARGUMENT CORRECT?**

19 A. No, and it is contrary to the findings of this Commission, the FCC, other state
20 commissions, and economists, including Mr. Dippon's NERA colleagues. The
21 focus of Mr. Dippon's testimony is primarily backward-looking with the
22 implication that if rates were not set properly in the past, we should not take any

1 steps to reform them properly now. The reality is that while access charges have
2 not historically been cost-based, both federal and state-level regulators have taken
3 notable steps to move access charges toward more economically-based rates since
4 1997. As the FCC itself has recently pointed out, “These [reductions to interstate
5 access rates] for the rate-of-return carriers were designed to align the interstate
6 access rate structure more closely with the manner in which costs are incurred by
7 driving per-minute access charges towards lower, more cost-based levels.”²⁵

8 It is truly astounding for Mr. Dippon to argue that more efficient pricing
9 will not result in net consumer benefits. It is one thing to argue that legacy
10 subsidy policies need to be taken into account when reforming access charges (an
11 argument that I make myself, as Mr. Dippon points out), but it is entirely a
12 different matter to try to claim that there would be no consumer benefits from a
13 more efficient pricing structure. Economists have argued for the benefits of more
14 efficient telephone pricing since before the break-up of AT&T.

15 More than twenty years ago, Alfred Kahn (then a professor at Cornell and
16 a Special Consultant for NERA) and William Shew (a NERA Vice President)
17 wrote an article for the Yale Journal on Regulation, titled “Current Issues in
18 Telecommunications Regulation: Pricing.” In that article, Kahn and Shew
19 concluded that:

20 The central conception of economics ... is that moving in the direction of
21 efficient pricing is far from a zero-sum game ... prices below marginal
22 costs cause a loss in social welfare just as much as prices above marginal

²⁵ “Trends in Telephone Service,” Industry Analysis and technology Division, Wireline Competition Bureau, Federal Communications Commission, February 2007, at 1-2.

1 costs. These two inefficiencies do not offset one another; they are
2 additive.

3 ...
4 Whatever the historic justification for the system of pricing still in effect
5 today, it has long since disappeared. Its social cost today is to be reckoned
6 not merely in terms of a multi-billion dollar annual static welfare loss, but,
7 perhaps even more important, in the ways in which it has discouraged the
8 exploitation of one of our most dynamic, versatile technologies.²⁶

9 **Q. THAT CONCLUSION WAS REACHED MORE THAN TWENTY YEARS**
10 **AGO. ARE THERE MORE CURRENT ASSESSMENTS?**

11 A. Yes. In the ongoing New Jersey case (for which my testimony is cited by Mr.
12 Dippon), Dr. Debra Aron testifies for AT&T that:

13 Excessive access prices harm consumers, and highly disparate access
14 prices distort and harm competition – and thereby also harm consumers.
15 Further, they distort investment decisions and create incentives for
16 regulatory arbitrage that exploits access payers and wastes social
17 resources.²⁷

18
19 Professor Alfred Kahn has reached the same conclusion. In yet another
20 example of Mr. Dippon's repeated sleight of hand, he prominently cites Dr.
21 Kahn's summary (from his seminal textbook) of the various rationalizations
22 sometimes used to justify the implicit subsidy regime. *See* Dippon Responsive
23 Testimony, Exhibit No. _____(CMD-1THC), at 13-14. Remarkably, Mr. Dippon

²⁶ Alfred E. Kahn and William B. Shew, "Current Issues in Telecommunications Regulation: Pricing," Yale Journal on Regulation, Volume 4, Number 2, Spring 1987, at 208-09, and 255-56. Kahn and Shew also address (and demolish) Mr. Roth's theory that IXC's should pay for the loop because they "use" it: "Least defensible of all has been the effort of some economists, conceding the economic desirability of basing prices on 'cost' (though, for obvious reasons, rarely adding the adjective 'marginal'), to justify the allocation of a large portion of the putatively non-traffic-sensitive costs of subscriber plant to long-distance calling – whether on the basis of benefit, value, or usage." *Id.* at 207.

²⁷ *See* Reply Testimony of Dr. Debra J. Aron, *In the Matter of the Board's Investigation and Review of Local Exchange Carrier Intrastate Exchange Access Rates*, Docket No. TX08090830 (N.J. Bd. Pub. Util. filed Apr. 20, 2009), at 45.

1 fails to note that the quoted passage is from a *textbook* that simply paraphrases
2 arguments that Professor Kahn himself has rejected. Professor Kahn's own,
3 repeated position is on the subject is the following:

4 There is simply no longer any escaping the inevitability of reforming our
5 system for ensuring a continued close to universal subscription to
6 telephone service, as well as living up to the regulatory bargain with the
7 incumbent telephone companies. The present method, relying on markups
8 on toll, carrier access and a host of "intrastate" services alike, is both
9 grossly inefficient and unsustainable under our new national policies.²⁸

10
11 Even more important, the Commission itself has determined that access
12 reform will enhance efficiency. The Commission promulgated WAC 480-120-
13 540 in 1998 for the purpose of encouraging competition and increasing customer
14 choice throughout the state of Washington.²⁹ The Commission distinguished
15 between originating switched access charges and terminating switched access
16 charges. The Commission determined that implicit contributions should be
17 removed from terminating intrastate switched access charges in order to
18 encourage competition and enhance efficiency.

19 **Q. YOU CITE DR. KAHN AND DR. ARON. HAVE OTHER ECONOMISTS**
20 **RECOGNIZED THE INEFFICIENCIES BROUGHT ABOUT BY**
21 **EXCESSIVE ACCESS CHARGES?**

22 A. Yes. Numerous studies have described and quantified the economic inefficiencies
23 brought about by excessive access charges. The negative welfare effects of high

²⁸ Alfred E. Kahn, *Letting Go: Deregulating the Process of Deregulation* (1998), at 118.

²⁹See Order Adopting Rules Permanently, *In the Matter of Adopting WAC 480-120-540*, Docket No. UT-970325 (issued Sept. 23, 1998).

1 access charges have been estimated to range from \$1.1 billion to over \$10 billion
2 per year.³⁰

3 **Q. HAVE POLICYMAKERS ALSO RECOGNIZED THE ECONOMIC**
4 **INEFFICIENCY OF HIGH ACCESS CHARGES?**

5 A. Yes. In the wake of the Telecommunication Act's unequivocal call to embrace
6 competition, the FCC noted that the "patchwork quilt of implicit and explicit
7 subsidies generates inefficient and undesirable economic behavior."³¹ The FCC
8 subsequently moved to reduce switched access charges for major local exchange
9 companies. Subsequently, the FCC singled out rural carriers' high access
10 charges, noting that "higher rates and implicit subsidies may discourage efficient
11 local and long distance competition in rural areas and limit consumer choice."³²

12 It went on to say that:

13 By artificially inflating long distance per-minute rates, such rate structure
14 inefficiencies suppress demand for interstate long distance services, and
15 create implicit subsidies from high-volume to low-volume users of
16 interstate long distance service. Implicit subsidies have a disruptive effect
17 on competition in the market for local exchange and exchange access
18 services. In addition, by contributing to rate disparities between rate-of-
19 return and price cap carriers, rate structure inefficiencies may increase the
20 burden of compliance with toll rate averaging requirements and
21 discourage interexchange carriers from competing in rural and high-cost
22 areas, thus limiting consumer choice in those areas.³³
23

³⁰ See Stephen G. Parson "The Economic Necessity of an Increased Subscriber Line Charge (SLC) in Telecommunications," Administrative Law Review, Vol. 48, 1996, pp. 227-50.

³¹ *First Report and Order*, CC Docket No. 96-262 (released: May 16, 1997) ¶ 30.

³² MAG Order, ¶ 6.

³³ MAG Order, ¶ 18.

1 Given the problems associated with unreasonably high access charges,
2 federal and state regulators began serious efforts at both the interstate and
3 intrastate levels to reduce the subsidy elements that were embedded in the access
4 charges of large local exchange telephone companies. The result has been a
5 pronounced decline in typical access charge rates, with interstate switched access
6 charges of those carriers having fallen from more than 17 cents per minute in
7 1984 to 1.71 cents per minute in 2008.³⁴ Contrast this trend in rate reductions
8 with Embarq's claim that its "cost" for providing switched access in Washington
9 currently is **BEGIN HIGHLY CONFIDENTIAL END HIGHLY**
10 **CONFIDENTIAL** Dippon Responsive Testimony, Exhibit No. _____(CMD-
11 1THC), at 55, line 10. To put that claim in perspective, interstate access rates
12 crossed that threshold twenty years ago.

13 **Q. WHAT SPECIFIC DISTORTIONS TO ECONOMIC EFFICIENCY HAVE**
14 **BEEN IDENTIFIED WITH HIGH ACCESS CHARGES?**

15 A. Excessive access charges create economic distortions and inefficiencies by
16 suppressing demand for usage-based services (access and toll). Elevated access
17 charges drive up the price of long-distance services and, consequently, discourage
18 consumers from making such calls. An additional distortion occurs when
19 wireless-based long-distance calls are seen as a substitute for wireline based calls.
20 The result of excess access charges sends distorted price signals to consumers

³⁴ See "Trends in Telephone Service," Industry Analysis and Technology Division, Wireline Competition Bureau, Federal Communications Commission, August 2008, Table 1.2.

1 regarding the cost of providing wireline versus wireless-based long-distance
2 services.

3 Additionally, as I discuss above, to the extent that excessive access
4 charges provide a mechanism for subsidizing local exchange services, the result is
5 an artificial distortion which slows the emergence of local exchange competition.
6 Specifically, if the price of local exchange service is artificially depressed, then
7 potential entrants simply will not enter to compete for consumers' business.

8 **Q. MR. DIPPON ALSO TESTIFIES THAT REDUCING SWITCHED**
9 **ACCESS RATES WOULD NOT INCREASE COMPETITION FROM**
10 **WIRELESS OPERATORS. DIPPON RESPONSIVE TESTIMONY,**
11 **EXHIBIT NO. ____ (CMD-1THC), AT 50. IS HE CORRECT?**

12 A. He is asking the wrong question. It is not a question of whether reduced access
13 charges would "promote" competition from wireless operators (which is already
14 present), but whether it would be more neutral toward different technologies. The
15 answer is that reduced access charges would improve the situation because access
16 charges are applied to all wireline interexchange traffic, but only a portion (inter-
17 MTA) of wireless traffic. Reduced access charges would not make the situation
18 perfectly neutral, but it unquestionably moves in the right direction.

19 **Q. WHAT HAS MR. DIPPON HIMSELF SAID ABOUT THE EFFECT OF**
20 **ACCESS REDUCTIONS ON LONG DISTANCE PRICES?**

21 A. Mr. Dippon addressed that effect in testimony last year in a case before the
22 Virginia State Corporation Commission in which Embarq's switched access

1 charges were under review. While his written testimony was almost identical to
2 what he has submitted here in Washington, on the stand Mr. Dippon admitted that
3 if Embarq's switched access charges were reduced, the cost savings to long
4 distance carriers would likely be passed on to long distance customers. In
5 response to testimony by a Sprint witness suggesting that Embarq would not be
6 hurt by access reductions because its wholesale provider (Sprint) would reduce
7 what Embarq must pay for wholesale long distance services, Mr. Dippon testified:

8 The argument that [Sprint's witness] brings forth here is correct on its
9 own, but he sort of misses the other part of it.

10
11 It's correct – he's correct, there are, strictly seen, cost savings that Embarq
12 incurs by having to pay less to Sprint, but don't forget it also charges less
13 to Sprint. So it's a wash, entirely a wash.

14
15 To make matters worse, it is likely that Embarq will have to pass on the
16 cost savings to its consumers, so at the end it's still worse off than it was
17 before. So at a minimum it's a wash. There are no cost savings."³⁵

18
19 Thus, Mr. Dippon's testimony in Virginia not only flatly contradicts his
20 testimony here but also laments ("to make matters worse") the fact that cost
21 savings will be passed on to consumers. While *Embarq* may find it lamentable
22 that consumers will benefit from lower switched access charges, that is obviously
23 a good thing for consumers and public policy. Not surprisingly, the Hearing
24 Examiner in Virginia did not find Mr. Dippon's testimony credible. He
25 concluded that "if Mr. Dippon is correct and Embarq long-distance passes all

³⁵ Report of Alexander F. Skirpan, Jr., Senior Hearing Examiner, *Petition of Sprint Nextel for reductions in the intrastate carrier access rates of Central Telephone*, Case No. PUC-007-00108 (Va. State Corp. Comm'n issued Jan. 28, 2009), at 37.

1 access cost savings to its customers, then at the absolute worst, the level of
2 additional revenues required to replace lost intrastate access revenues, would
3 remain unchanged.” *Id.* The Hearing Examiner therefore recommended that the
4 Virginia Commission require Embarq to mirror its interstate switched access
5 rates, as Verizon Virginia is already required to do. *Id.*³⁶

6 **C. Contrary to Mr. Dippon’s Assertion, the Experiences of other States Are**
7 **Useful and Relevant.**

8 **Q. MR. DIPPON CLAIMS THAT YOU WANT “THIS COMMISSION**
9 **SIMPLY TO LOOK AT OTHER STATES’ DECISIONS,” AND THAT IT**
10 **IS NOT VALUABLE FOR THIS COMMISSION TO LOOK AT WHAT**
11 **OTHER STATES HAVE DONE. DIPPON RESPONSIVE TESTIMONY,**
12 **EXHIBIT NO. _____(CMD-1THC), AT 52. PLEASE RESPOND.**

13 A. As an initial matter, I can attest from personal experience that regulators often are
14 informed by what their peers are doing in other states, jurisdictions, and even
15 countries. It is a useful exercise to monitor what other government officials have
16 done on similar questions. Of course, what other regulators have done is not
17 dispositive for any particular case, and, contrary to Mr. Dippon’s allegation, I do
18 not “completely ignore” the differences between states in suggesting that this
19 Commission might be well-informed by looking at what other states have done.

³⁶ The Virginia Commission did not go quite as far as the Hearing Examiner recommended, but approved of his analysis and required Embarq to substantially restructure and reduce its intrastate switched access charges. *See Order on Intrastate Access Charges, Petition of Spint Nextel For Reductions in the Intrastate Carrier Access Rates of Central Telephone Company of Virginia and United Telephone-Southeast, Inc.*, Case No. PUC-2007-00108 (Va. State Corp. Comm’n issued May 29, 2009) (“Virginia Access Order”) (requiring Embarq to change its CCLC recovery mechanism so that it no longer guarantees the same fixed level of revenue and to reduce its CCLC by 50% over two years).

1 The purpose of my limited survey of other regulators' policies on access charges
2 is to confirm for the Commission that its prior decisions on access charges are
3 well within the mainstream of regulatory policy.

4 And on that note, the precedents of the one state commission that I spend
5 the most time summarizing in my testimony – this Commission – are completely
6 missing from the discussion in Mr. Dippon's testimony. This omission is not
7 surprising since Commission precedent on these questions is wholly inconsistent
8 with the arguments that Embarq has presented in this case.³⁷

9 Finally, I have to respond to Mr. Dippon's allegation that my reference to
10 Ohio policy is "incomplete at best." He criticizes me for pointing out that the
11 Ohio Commission has made the four largest LECs in the state charge intrastate
12 access rates that are no higher than interstate access rates without also mentioning
13 that the Ohio Commission authorized those carriers to charge an intrastate
14 subscriber line charge. There is nothing incomplete or inconsistent at all with
15 what the Ohio Commission has authorized and what Verizon advocates in this
16 case. If Embarq can prove the need for revenue recovery, Verizon is not at all
17 opposed to allowing Embarq to recover more of its costs from its end users when

³⁷ Mr. Dippon also ignores what the Commission Staff here in Washington previously said about Embarq's switched access rates. At pages 10-12 of my direct testimony (Exhibit No. _____(PBV-1T), I describe staff's recommendation in 2005 that Embarq's carrier common lines charges be eliminated, that its local switching rate be reduced to mirror Verizon Northwest's equivalent rate, and that Embarq's Interim USF Additive be reduced from \$0.064851 to \$0.022626. Mr. Dippon does not engage *any* of that testimony, and Mr. Felz's reference to it ignores the fact that Staff's position on revenue neutrality is consistent with Verizon's position in this case. See Felz Responsive Testimony, Exhibit No. _____(JMF-1THC), at 10.

1 its access charges are reduced to just and reasonable levels, just as the Ohio
2 Commission allowed.

3 **D. Mr. Dippon Presents a Serious of “False Choices” For the Commission To**
4 **Consider as Options.**

5 **Q. MR. DIPPON PRESENTS A SERIES OF CHOICES THAT HE SAYS**
6 **EMBARQ WOULD FACE IF THE COMMISSION ADOPTS VERIZON’S**
7 **OR AT&T’S PROPOSALS. DIPPON RESPONSIVE TESTIMONY,**
8 **EXHIBIT NO. _____(CMD-1THC), AT 57-58. IS THIS A COMPLETE SET**
9 **OF OPTIONS?**

10 A. No. Mr. Dippon claims that Embarq’s “options” include 1) raising rates only in
11 its more rural areas; 2) decreasing its network investment in more rural; or 3)
12 reducing its service quality in rural areas. I addressed earlier the problems with
13 Mr. Dippon’s unsupported assertion that Embarq cannot recover more of its basic
14 exchange service costs from its retail customers in all of its exchanges, and the
15 other two so-called “options” are included clearly as a scare tactic. Verizon is
16 confident that the Commission has had sufficient experience and knowledge of
17 access charges and how they have changed over the years here and nationally to
18 know that rural investment and service quality will not suffer as a result of a
19 policy decision requiring Embarq to charge more reasonable intrastate access
20 rates.

21 **Q. MR. DIPPON ASSERTS THAT GRANTING EMBARQ GREATER**
22 **PRICING FLEXIBILITY IS NOT AN OPTION THE COMMISSION CAN**

1 **CONSIDER. SEE DIPPON RESPONSIVE TESTIMONY, EXHIBIT**
2 **NO._____(CMD-1THC), AT 58-59. PLEASE RESPOND.**

3 A. Mr. Dippon incorrectly asserts that “Mr. Vasington finds it unnecessary to
4 provide United with a proverbial tool to recover the lost access revenues.”
5 Dippon Responsive Testimony, Exhibit No._____(CMD-1THC), at 58. As
6 discussed above, an entire section of my initial testimony (Section V) is devoted
7 to precisely that issue. I agree that the Commission should consider granting
8 Embarq greater retail pricing flexibility if (and to the extent) Embarq provides
9 evidence showing the need for a contribution to local service. The Commission
10 recently made clear that it is willing to consider providing Embarq more pricing
11 flexibility through an alternative form of regulation (“AFOR”) once it conducted
12 an “earnings review consistent with that required in a general rate case.” Order
13 05, Docket UT-082119, Final Order, Joint Application of Embarq Corporation
14 and CenturyTel (May 28, 2009) at 14-15 (“Embarq Merger Order”). Such a
15 review is necessary, the Commission noted, because Embarq’s earnings have not
16 been reviewed in Washington for more than twenty years. *Id.*

17 But Mr. Dippon’s Responsive Testimony, Exhibit No._____(CMD-
18 1THC), at pages 58-59 is fundamentally unwilling to subject Embarq to any
19 competitive pressure. For example, he warns that it “remains to be seen” whether
20 pricing flexibility translates into increased earnings for Embarq, and he argues
21 that it would be impossible for Embarq to both “price services at competitive
22 levels” and “price to recover regulatory costs.” That unwillingness to embrace a

1 world in which ILECs face competition, and are required a recover a reasonable
2 portion of their costs from its own customers, is out of step with contemporary
3 switched access policy. And it is undercut by the fact that other carriers in
4 Washington (Verizon Northwest and Qwest) do recover more of their costs from
5 their own end users.

6 **V. THE COMMISSION SHOULD REJECT MR. DIPPON'S SCARE**
7 **TACTICS.**

8 **Q. PLEASE RESPOND TO SECTION V OF MR. DIPPON'S RESPONSIVE**
9 **TESTIMONY.**

10 A. In Section V of his responsive testimony, Mr. Dippon mostly rehashes arguments
11 dealt with elsewhere, especially his vertical price squeeze analysis. I will not
12 further rebut his price squeeze analysis given that (as I discuss above in Section
13 IV) he fundamentally misconstrues my testimony. Mr. Dippon also attempts to
14 put an empirical gloss on the consumer harms that he claims would flow from
15 reducing Embarq's switched access rate, but that portion of his testimony is
16 flawed.

17 **Q. MR. DIPPON ASSERTS THAT THE INCREASE IN RETAIL RATES FOR**
18 **SOME END USERS WOULD BE HUGE IF EMBARQ IS REQUIRED TO**
19 **OFFSET ACCESS REDUCTION BY INCREASING LOCAL RETAIL**
20 **RATES. SEE DIPPON RESPONSIVE TESTIMONY, EXHIBIT**
21 **NO.____(CMD-1THC), AT 80. IS THAT BASED ON A SOUND**
22 **CALCULATION?**

1 A. No. On page 80 of his responsive testimony (Exhibit No. _____(CMD-1THC),
2 Mr. Dippon claims that some customers' rates would increase by **BEGIN**
3 **HIGHLY CONFIDENTIAL END HIGHLY CONFIDENTIAL** per month.
4 That calculation appears to be based on the notion that Embarq could only raise
5 end user rates in exchanges where Embarq faces no competition whatsoever. In
6 other words, he appears to be spreading Embarq's *entire* revenue reduction from
7 charging lower switched access rates over only **BEGIN HIGHLY**
8 **CONFIDENTIAL END HIGHLY CONFIDENTIAL** of Embarq's retail
9 customers – those customers that reside in exchanges where Embarq faces no
10 competition from a wireline cable competitor. But as I discussed above, there is
11 no reason to completely insulate Embarq from any competitive pressure, and no
12 reason to assume that Embarq is incapable of modestly increasing its retail rates
13 for customers that have competitive alternatives. As I noted above, the correct
14 figure for rebalancing purposes is much lower: if Embarq were to spread its
15 rebalancing across all of its **BEGIN HIGHLY CONFIDENTIAL END**
16 **HIGHLY CONFIDENTIAL** access lines, the increase per line would be
17 approximately **BEGIN HIGHLY CONFIDENTIAL END HIGHLY**
18 **CONFIDENTIAL** per month. In other words, Mr. Dippon's scare tactic about a
19 possible **BEGIN HIGHLY CONFIDENTIAL END HIGHLY**
20 **CONFIDENTIAL** local rate increase is completely unsupported.³⁸

³⁸ Last year, Mr. Dippon made identical arguments before the Virginia State Corporation Commission about purported local rate increases. The Commission rejected those arguments. *See* Virginia Access Order at 8-11.

1 **Q. MR. DIPPON ALSO MAKES MUCH OF EMBARQ’S STATUS IN**
2 **WASHINGTON AS A CARRIER OF LAST RESORT (“COLR”), AND**
3 **ARGUES THAT THIS STATUS IS A REASON FOR THE COMMISSION**
4 **TO KEEP INTRASTATE ACCESS RATES UNCHANGED. HOW DO**
5 **YOU RESPOND?**

6 A. Verizon agrees that Embarq’s status as a COLR is a factor that the Commission
7 should take into account in deciding this case, but not in the manner suggested by
8 Embarq. The imposition of COLR obligations on a LEC, however, does *not* mean
9 that the LEC should be protected against changes in its access rates; it means that
10 the Commission should strongly consider allowing Embarq to rebalance its rates
11 and/or to reduce or eliminate its COLR obligations as part of a decision to impose
12 more reasonable access charges. As mentioned above, in the Embarq Merger
13 Order, the Commission recently expressed a need to conduct a complete financial
14 analysis of Embarq’s earnings, which could provide the framework for such
15 rebalancing.

16 **Q. ALSO, AT PAGES 74-77 OF HIS RESPONSIVE TESTIMONY, EXHIBIT**
17 **NO._____(CMD-1THC), MR. DIPPON PRESENTS AN ECONOMETRIC**
18 **STUDY THAT HE SAYS PROVES SWITCHED ACCESS RATES DO NOT**
19 **IMPEDE COMPETITION IN WASHINGTON. DOES THIS STUDY**
20 **SUPPORT EMBARQ’S POSITION?**

21 A. No. Mr. Dippon again asks the wrong question and therefore arrives at a
22 conclusion that does not support his argument. Mr. Dippon shows that long

1 distance minutes of use do not vary significantly with Embarq's level of switched
2 access charges in Washington. That actually supports the point that I made in my
3 direct testimony on the inelasticity of demand for switched access services from
4 the perspective of carriers. As discussed in Section IV-A, Mr. Dippon is
5 fundamentally wrong to claim that IXC's have numerous options for "bypassing"
6 the switched access regime – and Mr. Dippon's econometric study actually
7 supports Verizon's position. IXC's cannot control whom its long distance
8 customer calls, and cannot price long distance based on different ILEC's switched
9 access charges, so of course the customer's long distance calling patterns will not
10 vary based on the price of a particular ILEC's switched access services.

11 As I discussed in detail in Section IV above, there is no longer any debate
12 among serious economists about the fact that reducing excessive switched access
13 charges increases economic efficiency and benefits consumers. Mr. Dippon's
14 econometric study does not demonstrate otherwise.

15 **VI. MR. DIPPON'S ARGUMENT FOR A PERMANENT USE FUND IS A RED**
16 **HERRING.**

17 **Q. MR. DIPPON ARGUES IN SECTION VI THAT THE COMMISSION**
18 **"MUST" ESTABLISH A PERMANENT USE FUND IF IT REDUCES**
19 **EMBARQ'S SWITCHED ACCESS CHARGES. IS THERE ANYTHING**
20 **ABOUT THIS PROCEEDING THAT POTENTIALLY RAISES THE**
21 **ISSUE OF THE NEED FOR SUCH A FUND?**

1 A. No. Reducing Embarq's intrastate switched access to Verizon Northwest's level
2 does not implicate the need for a new revenue source. As discussed in detail
3 above, remaining *fully revenue-neutral* by increasing its local rates to offset the
4 *entire* subsidy it claims to receive from switched access rates would not lead to
5 unaffordable local rates. In fact, even with full rebalancing (which Embarq has
6 not shown is needed), Embarq's local retail rates would *still* be lower than
7 Verizon Northwest's. Thus, the Commission should not countenance Mr.
8 Dippon's doomsday scenarios regarding the purported impact reducing Embarq's
9 switched access rates would have on universal service.

10 **VII. AT THIS LATE STAGE THE COMMISSION SHOULD PLACE THE**
11 **ONUS ON EMBARQ TO INITIATE A FORMAL RATE PROCEEDING IF**
12 **EMBARQ SEEKS TO DEMONSTRATE A NEED FOR REBALANCING.**

13 **Q. DURING THE PREHEARING CONFERENCE, EMBARQ REQUESTED**
14 **THAT IT BE GIVEN THE OPPORTUNITY TO SUBMIT SUR-**
15 **REBUTTAL TESTIMONY. SHOULD EMBARQ BE PERMITTED TO**
16 **USE THAT SUR-REBUTTAL TESTIMONY TO ENGAGE ISSUES THAT**
17 **EMBARQ IGNORED IN ITS RESPONSIVE TESTIMONY?**

18 A. No. During the prehearing conference on November 19, 2008, Embarq requested,
19 and received, an ample amount of time to develop a properly-done cost study.
20 Based on Embarq's representation that it would file a "comprehensive cost
21 study," Embarq was given five months (until April 17, 2009) to prepare its cost

1 case.³⁹ Yet, as I have demonstrated in this rebuttal testimony, Embarq has not
2 submitted a credible cost study. Moreover, Mr. Dippon, who had fully *two*
3 *months* to prepare his response to my direct testimony, chose not to engage most
4 of the evidence I presented showing that Embarq's switched access rates violate
5 Washington law. Having disregarded its opportunity to seriously prosecute its
6 defense, Embarq should not be permitted to shoehorn in large amounts of sur-
7 rebuttal testimony in an attempt to shore up its responsive testimony. Such a
8 tactic would be unfair and improper.

9 **Q. THEN HOW SHOULD THE COMMISSION PROCEED IN THIS CASE?**

10 A. The Commission should approach this proceeding the same way it approached the
11 complaint case that AT&T brought against Verizon Northwest in 2005: require
12 Embarq to immediately reduce its intrastate switched access rates to levels that
13 comply with Washington law, and separately permit Embarq to seek rebalancing
14 in another forum. While it was reasonable (although inconsistent with its own
15 precedent) for the Commission to give Embarq the opportunity in this docket to
16 present a cost defense, Embarq has not availed itself of that opportunity and
17 should not be permitted to do so at this late stage.⁴⁰

³⁹ See Second Prehearing Conference Order (Nov. 20, 2008), at 1.

⁴⁰ Verizon's position (including before this Commission, when Verizon Northwest's switched access charges were under review) is that the reasonableness inquiry regarding switched access rates should not be divorced from the question of revenue recovery. However, the Commission squarely rejected that argument when Verizon Northwest made it, instead requiring Verizon Northwest to seek rebalancing in a separate proceeding. Now that Embarq has presented a fundamentally flawed contribution defense in this docket, the Commission should apply its precedent and require Embarq to seek rebalancing in a separate rate proceeding – rather than let Embarq abuse its sur-rebuttal testimony by filing a massive amount of new testimony.

1 **Q. DOES EMBARQ ACKNOWLEDGE THAT A RATE PROCEEDING IS AN**
2 **APPROPRIATE FORUM FOR PROPERLY DETERMINING ANY**
3 **REBALANCING?**

4 A. Yes. Mr. Roth admits that his cost study “is not a substitute for a rate case.” Roth
5 Responsive Testimony, Exhibit No. _____THC(HJR-1T), at 7. Yet Embarq’s
6 primary defense nevertheless rests on its limited (and flawed) cost study. In a
7 sense, Embarq is trying to have it both ways. It does not want to undertake the
8 effort of a comprehensive rate case, yet it is raising defenses that arguably require
9 such an undertaking. Accordingly, Embarq should file a rate proceeding if it
10 believes it can demonstrate the need for rebalancing.

11 **Q. IS EMBARQ ALREADY REQUIRED TO INITIATE A RATE**
12 **PROCEEDING BEFORE THE COMMISSION?**

13 A. Yes. My understanding is that Embarq has already committed, as one of the
14 conditions for receiving approval for its merger with CenturyTel, to initiate an
15 Alternative Form of Regulation (“AFOR”) proceeding no later than five years
16 after the closing of its merger with CenturyTel. If Embarq believes it can marshal
17 factual support for its purported need for a new revenue source, it should initiate
18 such a proceeding immediately following the Commission’s order in this docket.
19 The Commission indicated in the Embarq Merger Order (*see* ¶ 49) that it may
20 well be prudent to consider Embarq’s costs and rates much sooner than five years
21 from now.

22 **Q. DOES THAT CONCLUDE YOUR TESTMONY?**

1 A. Yes.