Exhibit No. ___ (LJB-3T)

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

VERIZON SELECT SERVICES, INC.; MCI METRO ACCESS TRANSMISSION SERVICES, LLC; MCI COMMUNICATIONS SERVICES, INC.; TELECONNECT LONG DISTANCES SERVICES AND SYSTEMS CO. d/b/a TELECOM USA; AND TTI NATIONAL, INC. Complainants v. UNITED TELEPHONE COMPANY OF THE NORTHWEST, d/b/a Embarq Respondent.	Docket No. UT-081393

REBUTTAL TESTIMONY OF

LAWRENCE J. BAX

ON BEHALF OF
AT&T COMMUNICATIONS OF THE PACIFIC NORTHWEST, INC., TCG OREGON, INC., AND TCG SEATTLE, INC.

REDACTED PER PROTECTIVE ORDER
IN WUTC DOCKET UT-081393

June 5, 2009

I. INTRODUCTION & SUMMARY

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Lawrence (Larry) J. Bax and my business address is 125 Corporate Office Drive, Room 153, Earth City, Missouri, 63045.

Q. ARE YOU THE SAME LAWRENCE J. BAX WHO FILED DIRECT TESTIMONY IN THIS CASE ON FEBRUARY 18, 2009?

A. Yes, I am.

Q. HAVE YOU CHANGED ANY OF THE POSITIONS EXPRESSED IN YOUR DIRECT TESTIMONY?

A. No. I affirm by reference all of the positions in my direct testimony of February 18, 2009.

Q. HAVE YOU REVIEWED THE DIRECT AND RESPONSIVE TESTIMONY FILED BY OTHER PARTIES IN THIS PROCEEDING?

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. In my rebuttal testimony I will address primarily the arguments raised by Christian M. Dippon[1] and John M. Felz[2] on behalf of United Telephone Company of the

[1] Responsive Testimony of Christian M. Dippon on Behalf of United Telephone Company of the Northwest d/b/a/ Embarq, April 17, 2009.

[2] Responsive Testimony of John M. Felz on Behalf of United Telephone Company of the Northwest d/b/a/ Embarq, April 17, 2009.

Northwest, d/b/a Embarq ("Embarq") in their respective responsive testimony. Furthermore, I will address some of the arguments raised by Henry J. Roth[3] on behalf of Embarq.

II. REDUCTIONS TO EMBARQ'S INTRASTATE SWITCHED ACCESS RATES ARE WARRANTED AND NECESSARY

Q. HAVE ANY DEFENSIBLE ARGUMENTS BEEN OFFERED DEMONSTRATING THAT EMBARQ'S INTRASTATE SWITCHED ACCESS RATES SHOULD NOT BE REDUCED?

A. No. The Embarq witnesses have not provided any evidence to show: that the intrastate switched access rates charged by Embarq are not excessive, unjust, unfair and unreasonable; that these excessive rates are not harming Washington wireline toll consumers; or, that these excessive rates do not place interexchange carriers ("IXCs") at a competitive disadvantage.

In fact, we need only look to Embarq witness Dippon for guidance as to why Embarq's intrastate switched access rates ***should*** be reduced. Two years ago, Mr. Dippon presented the following thoughts:

> Traditional regulation's formula to ensure [universal service goals] has been to subsidize network access services (i.e., price them below incremental cost) by obliging carriers to mark up their usage services above incremental cost. This formula is, on its face, an outright and policy-sanctioned violation of the allocative efficiency rule, but is usually justified by the argument that the costs of that violation are compensated by the internalization of the network and call externalities generated by expanding network subscribership. Unfortunately, cross-subsidies of this form generate significant deadweight losses, are wasteful, and cannot be sustained under

[3] Responsive Testimony of Henry J. Roth on Behalf of United Telephone Company of the Northwest d/b/a/ Embarq, April 17, 2009.

> competition and convergence. Also, it is unclear from an empirical standpoint, just how much economic benefit flows from the capture of the supposed network externalities (especially in developed countries where network subscribership rates are already high) and whether that benefit overcomes the inefficiencies and other costs associated with any subsidy-based program in increasingly competitive markets.[4]

Believing that the United States and the State of Washington are both well-developed areas where network subscribership is high and that competition and convergence are present in the Washington telecommunications marketplace (i.e., as will be demonstrated herein), it seems indefensible that the implicit subsidies inherent in Embarq's intrastate switched access service rates can be sustained.

Certainly, it cannot be and notably was not argued by Embarq's witnesses that reducing Embarq's intrastate switched access rates would be inconsistent with prior Commission precedent. Instead, Embarq attempts to differentiate itself from Qwest and Verizon, but as shown in my rebuttal testimony it has been unsuccessful in doing so.

Q. THROUGHOUT HIS RESPONSIVE TESTIMONY EMBARQ WITNESS FELZ PORTRAYS EMBARQ AS A HIGH COST RURAL CARRIER THAT IS SIGNIFICANTLY DIFFERENT FROM QWEST AND VERIZON NORTHWEST. DO YOU AGREE WITH MR. FELZ'S PORTRAYAL?

A. No. Qwest and Verizon each have the same Carrier of Last Resort ("COLR") obligations and Quality of Service standards as Embarq. All three of these companies have eligible telecommunications carrier ("ETC") status in the State of Washington.

[4] *Communications Regulation and Policy under Convergence: Advancing the State of the Debate*; Aniruddha Banerjee and Christian M. Dippon, International Telecommunications Society, 16th Biennial Conference, Beijing, China, June 12-16, 2006 at pp. 13-14.

As indicated in the direct testimony of AT&T witness Mullin, Embarq recently and successfully petitioned the Commission for minimal regulation pursuant to RCW 80.36.332,[5] just as Verizon did in the same timeframe.[6] Similarly, the Commission recently adopted a four-year alternative form of regulation plan for Qwest.[7]

And, while each of these of these carriers receives Federal USF Interstate Access Support, none of these companies receive other Federal high cost support.[8] Although Mr. Felz repeatedly mentions that Embarq serves high cost areas, according to NECA 2008 Universal Service Fund Data Submission to the FCC,[9] Embarq's (i.e., United Telephone Company of the Northwest-WA) cost per loop is the lowest of any rural incumbent local exchange carrier in the state, significantly less than the weighted average of the other rural carriers, lower than the weighted average for the Verizon study areas and only slightly higher than the state weighted average.[10]

Contrary to the characterization suggested by Mr. Felz, Embarq is more similar to both Verizon and Qwest than it is to other rural carriers in the state.

Q. MR. BAX, TURNING TO THE INITIAL PETITION FILED BY VERIZON IN THIS PROCEEDING, IS IT APPROPRIATE FOR THE COMMISSION TO

[5] *In the Matter of the Petition of United Telephone Company of the Northwest, d/b/a Embarq for Minimal Regulation of Bundled Telecommunications Services*, Docket UT-071575, (September 18, 2007), Order 01.
[6] *In the Matter of the Petition of Verizon Northwest, Inc. for Minimal Regulation of Bundled Telecommunications Services*, Docket UT-071574, (September 18, 2007), Order 01.
[7] *In the Matter of the Petition of Qwest Corporation for an Alternative Form of Regulation Pursuant to RCW 80.36.135*, Docket UT-061625.
[8] As determined by reviewing the Universal Service Administrative Company Disbursement Data for these carriers at: http://www.universalservice.org/hc/tools/disbursements/default.aspx.
[9] *See*, BAX – Rebuttal Appendix 3. BAX – Rebuttal Appendix 3 includes pages 43 and 44 (i.e., State of Washington data) of Appendix E (i.e., rural and non-rural study area loops, loop cost and projected 2009 expense adjustments by study area code) from the NECA 2008 Universal Service Fund Data Submission to the FCC.
[10] *See*, BAX – Rebuttal Appendix 4 for the calculations that support this analysis. The data included in this appendix is derived form BAX – Rebuttal Appendix 3.

REQUIRE EMBARQ TO REDUCE ITS INTRASTATE SWITCHED ACCESS RATES TO EITHER VERIZON'S OR QWEST'S INTRASTATE SWITCHED ACCESS RATES?

A. I agree with Verizon's request to the Commission "to reduce Embarq's intrastate switched access charges in light of the dramatic changes in the telecommunications market."[11] However, Verizon suggests that "Verizon NW's intrastate switched access rates represent a reasonable benchmark"[12] or, alternatively, that "Qwest's intrastate switched access rates may represent a reasonable interim step."[13]

As discussed in my direct testimony and herein, Embarq's own interstate switched access rates are the most appropriate proxy as those rates can be demonstrated to be more than sufficient for the recovery of Embarq's switched access services costs[14] and are most indicative of the markets and customers that Embarq serves. Therefore, AT&T continues to ask the Commission to require that Embarq's intrastate switched access service rates mirror its own interstate switched access service levels and

[11] Verizon Select Services, Inc.; MCI Metro Access Transmission Services, LLC; MCI Communications Services, Inc.; Teleconnect Long Distances Services And Systems Co. d/b/a Telecom USA; And TTI National, Inc. (Complainants) v. United Telephone Company Of The Northwest, d/b/a Embarq (Respondent), Docket No. UT-081393, ("Verizon Complaint") at para. 8.

[12] Verizon Select Services, Inc.; MCI Metro Access Transmission Services, LLC; MCI Communications Services, Inc.; Teleconnect Long Distances Services And Systems Co. d/b/a Telecom USA; And TTI National, Inc. (Complainants) v. United Telephone Company Of The Northwest, d/b/a Embarq (Respondent), Docket No. UT-081393, ("Verizon Complaint") at para. 10.

[13] Verizon Select Services, Inc.; MCI Metro Access Transmission Services, LLC; MCI Communications Services, Inc.; Teleconnect Long Distances Services And Systems Co. d/b/a Telecom USA; And TTI National, Inc. (Complainants) v. United Telephone Company Of The Northwest, d/b/a Embarq (Respondent), Docket No. UT-081393, ("Verizon Complaint") at para. 11.

[14] Although my rebuttal testimony and the Rebuttal Testimony of Kent Currie on behalf of AT&T Communications of the Pacific Northwest, Inc., TCG Oregon, Inc., and TCG Seattle, Inc., WUTC Docket UT-081393, June 5, 2009, will demonstrate that Embarq's true costs for switched access service are below their current interstate rates, AT&T preserves its arguments that a cost proceeding is not warranted, that Embarq's interstate rates are sufficient, and that no challenge or demonstration has successfully shown that Embarq's interstate rates are not adequate and compensatory and, therefore, interstate rates can be used as a reasonable proxy.

structure.[15] In implementing AT&T's proposal, the Commission may find it necessary and appropriate to adopt a transitional reduction plan.[16]

Q. THE EMBARQ WITNESSES ASSERT THAT EMBARQ'S INTRASTATE SWITCHED ACCESS RATES ARE NOT EXCESSIVE. DO YOU AGREE?

A. No. Regardless of statements by various Embarq witnesses,[17] the fact remains Embarq's intrastate rates are significantly higher than the interstate level and Embarq's underlying costs to provide switched access services.[18] Embarq's witness Dippon even admits that Embarq's intrastate switched access rates contain significant subsidies,[19] but attempts to argue that these are necessary.[20]

AT&T is not suggesting that the Commission or the parties to this proceeding should engage in a time-consuming and laborious cost proceeding to determine switched access costs. Instead, a reasonable and rational proxy exists which cannot be ignored. As proposed in my direct testimony and herein, Embarq's own interstate switched access rates provide the most appropriate target. As determined in the FCC's CALLS proceeding,[21] the interstate switched access rates result in rates that

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[15] As offered in my direct testimony, AT&T is amenable to a transitioned solution. (*See,* Direct Testimony of Lawrence J. Bax at p. 25, ll. 29 – 30.)
[16] *See,* Direct Testimony of Lawrence J. Bax at p. 16 and at p. 25.
[17] Responsive Testimony of John M. Felz at p. 4, ll. 6 – 7. Responsive Testimony of Henry J. Roth at p. 7, ll. 1 – 5. Responsive Testimony of Christian M. Dippon at p. 10, ll. 9 – 10.
[18] In fact, Embarq witness Dippon readily admits that Embarq's intrastate switched access rates "are set above forward-looking incremental cost" and do "include a subsidy element." *See,* Responsive Testimony of Christian M. Dippon at p. 10, ll. 8 – 15.
[19] Responsive Testimony of Christian M. Dippon at p. 10, ll. 8-9.
[20] Responsive Testimony of Christian M. Dippon at p. 10, l. 9 – p. 11, l. 2.
[21] A more comprehensive discussion of the FCC's proceedings is included in my direct testimony. And, in fact, the Responsive Testimony of Christian M. Dippon provides a succinct summary at p. 12, l. 13 – p. 13, l. 7.

more than compensate Embarq for the costs of providing switched access service and that continue to include some level of implicit support.[22]

As demonstrated in my direct testimony, regulators consistently have determined that no functional or provisioning difference exists between interstate switched access service and intrastate switched access service[23] and no Embarq witness has shown otherwise. Obviously, since no material difference exists, and it is unreasonable to allow the disparity between Embarq's interstate and intrastate rates to continue.

Notably, Embarq witness Roth attempts to argue that the interstate switched access rates will not recover the cost of switched access services,[24] but Mr. Roth readily admits previously that ***his*** cost of intrastate switched access services includes local loop-related costs even though the Commission has previously determined that switched access rates should not include the recovery of local loop costs.[25] Therefore, Mr. Roth's costs will be unreliable in determining if the current interstate rates are compensatory.[26]

III. IMPLICIT SUBSIDIES ARE NOT IN THE PUBLIC INTEREST AND ARE ANTI-COMPETITIVE

Q. EMBARQ WITNESS DIPPON QUOTES NOTED ECONOMIST DR. ALFRED E. KAHN AS A MEANS TO SUPPORT HIS CONTENTION THAT THE

[22] Embarq witness Roth concurs that "interstate rates are not cost based." (*See*, Responsive Testimony of Henry J. Roth at p. 21, ll. 1 – 2.)
[23] Direct Testimony of Lawrence J. Bax at p. 15.
[24] Responsive Testimony of Henry J. Roth at p. 22, ll. 5 – 6.
[25] Responsive Testimony of Henry J. Roth at p. 10, l. 6.
[26]This Commission has determined in the past that the switched access charge structure is not an appropriate mechanism for the recovery of local loop costs. As cited in my direct testimony, the Commission eliminated Qwest's CCL Charge in order to drive toward an access structure in which rate elements have a direct bearing on the service provided. (*See*, Docket No. UT-950200 (1996), Fifteenth Supplemental Order at para. 113.)

COMMISSION'S PUBLIC POLICY GOALS CANNOT BE MET WITHOUT THE IMPLICIT SUBSIDIES FLOWS FROM ACCESS CHARGES. DO YOU BELIEVE THAT DR. KAHN SUPPORTS SUCH CROSS-SUBSIDIES?

A. Not from my reading and understanding of Dr. Kahn's views on the subject. First, it is important to note that although Mr. Dippon's cite[27] points to a 1988 reprint, the comments were originally published in 1970-71.[28] Therefore, Mr. Dippon is highlighting a statement that is now almost forty (40) years old. In light of the vast evolution of the telecommunications marketplace during that time, Dr. Kahn would likely want to revisit the point ***if*** indeed his conclusions were as Mr. Dippon characterizes. However, by way of the referenced passage, Dr. Kahn merely illustrates that public policy goals are typically utilized to justify the use of cross-subsidies. Nowhere in the passage does Dr. Kahn express broad agreement with or support of such social or political schemes. Fortunately, we can look to more recent statements by Dr. Kahn to determine his stance with regard to the cross-subsidies associated specifically with switched access services and long-distance rates.

In a 2004 publication, Dr. Kahn specifically addressed the long-distance cross-subsidy issue:

> Meanwhile, both state and federal regulators sought to preserve the multibillion dollar per year cross-subsidy between long-distance and basic local service, requiring the local companies to charge the long-distance carriers outrageously inflated prices for access to their local networks.[29]

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[27] Responsive Testimony of Christian M. Dippon at p. 13, l. 16 – p. 14, l. 12.

[28] *The Economics of Regulation: Principles and Institutions, Vol. 1: Economic Principles, Vol. 2: Institutional Issues,* Alfred E. Kahn, John Wiley & Sons, New York, 1970-71, reprinted by The MIT Press, Cambridge, Massachusetts, 1988.

[29] *Lessons from Deregulation: Telecommunications and Airlines After the Crunch*, Alfred E. Kahn, AEI-Brookings Joint Center for Regulatory Studies, the American Enterprise Institute for Public Policy Research (Washington D.C.) and the Brookings Institution (Washington D. C.), (2004) at p. 25.

And, in the subtending footnote:

> There have been some heroic exceptions at the state levels – cases in which commissions have recognized the awesome waste in overcharging for long-distance services. Two heroes at the federal level were FCC chairman Mark Fowler and the chief of his Common Carrier Division, Albert Halprin. They recognized in the very early 1980s that the inflated access charges not only were grossly inefficient, but were no longer sustainable in the face of growing competition among access providers. In a courageous move, they induced the FCC to substitute flat subscriber line charges for usage-sensitive access fees. Although Congress forced them to retract part of those flat charges, their initiative constituted a very important step in the direction of greater efficiency . . . The FCC later adopted a considerably less courageous (and less efficient) method for financing otherwise laudable further reductions in access charges – a move proclaimed by the chairman as responsible for "the single best day for consumers in the agency's history."[30]

Obviously, Dr. Kahn does not support the use of implicit, non-competitively neutral cross-subsidies. In fact, he describes the cross-subsides as "outrageously" inflating switched access rates.

Q. EMBARQ WITNESS DIPPON STATES THAT EMBARQ'S INTRASTATE SWITCHED ACCESS DOES NOT GIVE IT A COMPETITIVE ADVANTAGE OVER IXCS. DO YOU AGREE WITH HIS STATEMENT?

A. Embarq witness Dippon seeks to define a competitive link between Embarq's local exchange markets and the IXC's toll markets[31] in order to dissuade the "anti-competitive" arguments proffered in my direct testimony, I believe he is inappropriately misinterpreting my testimony and/or attempting to cloud the

[30] *Lessons from Deregulation: Telecommunications and Airlines After the Crunch*, Alfred E. Kahn, AEI-Brookings Joint Center for Regulatory Studies, the American Enterprise Institute for Public Policy Research (Washington D.C.) and the Brookings Institution (Washington D. C.), (2004) at fn. 60.

[31] Responsive Testimony of Christian M. Dippon at p. 36, ll. 5 – 20, at p. 44, ll. 1 – 7 and, at p. 45, ll. 11 – 14..

argument. Under the current cross-subsidy regime in the State of Washington, revenues resulting from Kahn-described *outrageously inflated*, non-competitive switched access service rates are being used to support the understated rates for competitive local exchange services.

Therefore, there are *two markets* in which anti-competitive behaviors are being exercised. First, with respect to the toll marketplace, wireline IXCs are bound, if not unilaterally forced, to pay the intrastate switched access rates with the attendant subsidies assessed by Embarq; alternate technologies are not bound to those charges and the attendant subsidies incorporated within Embarq's intrastate switched access rates. The result is that the wireline IXC toll providers bear the full and sole responsibility for the subsidies, leaving the IXCs at an arbitrary competitive disadvantage. Second, Embarq is able to price its local exchange service below its actual costs giving it a competitive advantage over alternate technologies and potential competitors.

The Commission must remain mindful of the fact while the local access marketplace is extremely competitive and, as such, is sufficient to self-regulate the behaviors of providers; the switched access marketplace continues to be characteristic of a monopoly marketplace. The market structure for switched access is characterized by the following conditions:

1. An IXC has no competitive alternative for access to a particular end user;
2. An IXC pays the local provider originating and terminating access charges, but recovers those costs through ***competitive, averaged*** retail long distance rates; and,

3. An IXC cannot refuse to originate or terminate calls and is, therefore, effectively "held hostage" when a local provider is able to demand payment for excessive access charges that the IXC would otherwise have declined to pay.

Taken together, this market structure provides fertile ground for the creation of a subsidy that flows from consumers in the overall toll market to individual local providers. Furthermore, switched access rates are tariffed and the IXC is obligated to pay the tariffed rate. Clearly, these conditions do not constitute a market characterized by voluntary transactions for the IXC. Rather, local providers may realize an enormous incentive to raise access charges and to establish a subsidy flow to its own consumers by essentially taxing the toll consumers of its competitors.

IV. EMBARQ'S INTRASTATE SWITCHED ACCESS SERVICE COSTS

Q. AT EXHIBIT HJR-4HC, MR. HENRY J. ROTH INDICATES THAT EMBARQ'S WEIGHTED AVERAGE INCREMENTAL COST OF SWITCHED ACCESS IS GREATER THAN THE CURRENT INTERSTATE RATE. DO YOU AGREE WITH MR. ROTH?

A. No. AT&T witness Dr. Kent Currie has reviewed the Embarq Cost model that Mr. Roth sponsors as support for his testimony. Based on only limited analysis[32] and review, Dr. Currie has identified several significant deficiencies resulting in the

[32] Since AT&T's position in this case is that a cost proceeding is not warranted as a reasonably proxy (i.e., interstate switched access rates) exists, Dr. Currie sought only to identify whether or not, with limited analysis and adjustment, Embarq's costs could be demonstrated to be below interstate switched access rates levels. It is my understanding that for these reasons, Dr. Currie did not conduct a more in-depth analysis.

conclusion that Mr. Roth's claims are seriously flawed.[33] I have relied on Dr. Currie's corrections to Embarq's modeling to restate the weighted average incremental cost calculation presented by Mr. Roth. The results are reflected in Bax – Rebuttal Appendix 1HC which demonstrates with only limited adjustments to Embarq's study that Embarq's intrastate switched access incremental costs are **[BEGIN EMBARQ HIGHLY CONFIDENTIAL]** XXXXXX **[END EMBARQ HIGHLY CONFIDENTIAL]** Embarq's interstate average per minute rate.

In his rebuttal testimony, Dr. Currie outlines in detail the adjustments which he believes are appropriate. As I understand Dr Currie's analysis, the limited adjustments include removal of line allocation, switch processor, switch software, other volume-insensitive costs and common costs; correcting cost of capital, switch equipment costs, copper cable prices and fill factors; and adjustments to maintenance factors. These limited adjustments alone produce a result **[BEGIN EMBARQ HIGHLY CONFIDENTIAL]** XXXXXXXXXXX **[END EMBARQ HIGHLY CONFIDENTIAL]** than Embarq's current intrastate rates in the State of Washington. Additionally, Dr. Currie identifies another adjustment (i.e., synergies related to Embarq's merger and acquisition activities), though not precisely quantified, which would nonetheless result in the decrease of forward-looking switched access costs. Furthermore, Dr. Currie states that additional adjustments within the model and the results could likely be uncovered with more in-depth analysis.

[33] *See*, generally, Rebuttal Testimony of Kent Currie on behalf of AT&T Communications of the Pacific Northwest, Inc., TCG Oregon, Inc., and TCG Seattle, Inc., WUTC Docket UT-081393, June 5, 2009.

The bottom line is that Embarq's true TSLRIC for switched access is certain to be **[BEGIN EMBARQ HIGHLY CONFIDENTIAL]** XXXXX **[END EMBARQ HIGHLY CONFIDENTIAL]** the adjusted cost shown in Bax – Rebuttal Appendix 1HC and, as such, **[BEGIN EMBARQ HIGHLY CONFIDENTIAL]** XXXXX **[END EMBARQ HIGHLY CONFIDENTIAL]** Embarq's interstate switched access rates.

Q. WOULD THE FACT THAT SOME ISSUES WERE LEFT UNCORRECTED MEAN THAT YOUR ANALYSIS ABOVE IS NOT USEFUL TO DETERMINE WHETHER EMBARQ'S INTRASTATE RATES SHOULD BE REDUCED TO INTERSTATE LEVELS?

A. Certainly not. AT&T's position in this proceeding is that Embarq's switched access rates should be reduced to parity with its interstate rates, not to cost. Once AT&T confirmed that Embarq's costs, *with only limited analysis and adjustment*, are **[BEGIN EMBARQ HIGHLY CONFIDENTIAL]** XXXXX **[END EMBARQ HIGHLY CONFIDENTIAL]** its interstate rates, there was no reason for AT&T to continue with a detailed review of Embarq's cost study materials.

V. REBALANCING EMBARQ'S INTRASTATE SWITCHED ACCESS REVENUE REDUCTIONS

Q. SOME EMBARQ WITNESSES IN THIS PROCEEDING EXPRESS CONCERN WITH THE AFFORDABILITY OF LOCAL EXCHANGE SERVICES IF EMBARQ INCREASES THOSE RATES AS A MEANS TO

OFFSET INTRASTATE SWITCHED ACCESS REVENUE REDUCTIONS. CAN YOU ADDRESS THE ISSUE OF AFFORDABILITY?

A. Contrary to the discussions by Embarq witness Dippon where he describes a number of scenarios in which the intrastate switched access revenue reductions are assigned to only a subset of Embarq's end-user customers,[34] AT&T has proposed a solution which requires that ***all*** revenue producing access lines should be used to calculate the per line impact.[35] By using analysis based on subsets of Embarq's customers, Embarq is able to portray an exaggerated per line impact. In fact, Embarq witness Dippon seems to ask the Commission to shift the entire burden of the access revenue reduction to only Embarq's customers in areas that Embarq describes as ***noncompetitive***, thus preserving Embarq's arbitrary advantage in competitive markets.[36] By using the count proposed by AT&T, the Commission can ensure that all of Embarq's customers share equitably in recovery of the access reduction.

In reviewing the tariffed residential basic local exchange rates in Washington for both Embarq and Verizon, a comparison of the simple average of the respective rates for each entity yields that Embarq's average tariffed residential basic local exchange rate is below that for Verizon.[37] As such, it appears that there is some opportunity to increase Embarq's end-user retail rates as a means to offset any revenue reduction resulting from intrastate switched access reform.

There is no need for intense regulatory concern with regard to local exchange service rates when competition exists. In a competitive marketplace, market forces

[34] Responsive Testimony of Christian M. Dippon at p. 57, l. 16 – p. 58, l 10 and at p. 80, l. 1 – p. 81, l. 16.
[35] Direct Testimony of Lawrence J. Bax at p. 24, ll. 5 – 11.
[36] Responsive Testimony of Christian M. Dippon at p. 81, ll. 9 – 10.
[37] Embarq: WN U-3; United Telephone Company of the Northwest d/b/a Embarq, Exchange Service Rates, Schedule AE-1. Verizon: WN U-17; Verizon Northwest, Inc., General and Local Exchange Tariff.

will ensure that rates are kept just and reasonable. The market provides effective rate controls such that regulatory intervention is not necessary. If a provider sets rates too high, then customers can and will move to a competitive alternative.

By its own admission, Embarq faces competition in the State of Washington. Embarq witness Dippon offers the following:

> ILECs are facing strong and growing competition from intermodal competitors, such as wireless, cable, and VoIP in many parts of the country. This competition is particularly strong in nonrural areas and has led to significant line losses by the ILECs. The State of Washington is no exception in this trend. The Washington ILECs have seen a decrease in their access lines, carrier access MOUs, and long distance traffic, particularly in nonrural areas.[38]

Competition in the telecommunications industry is intense and increasing. Competition exists in the form of many telecommunications service providers, including cable operators, wireless carriers, VoIP providers, long distance providers. As shown in Table 1, competition from CLECs and wireless increased dramatically between December, 2000 and December, 2007.

[38] Responsive Testimony of Christian M. Dippon at Exhibit 3, *Access Charges, Universal Service, and Competition*; Christian M. Dippon, William E. Taylor, and Harold Ware; April 17, 2009 at p. 14.

Table 1

LOCAL TELEPHONE COMPETITION ANALYSIS – WASHINGTON			
	Status a/o December 31, 2000[39]	**Status a/o December 31, 2007**[40]	**Percent Growth**
CLEC Share of End-User Lines	8%	14%	75%
Number of Reporting CLECs	10	41	310%
% of Zip Codes w/CLECS - WA	71%	78%	10%
% of Zip Codes w/CLECS - US	56%	81%	45%
% of Zip Codes w/4+ CLECS - WA	30%	52%	73%
Mobile Wireless Subscribers	2,286,082	5,291,131	131%

Furthermore, FCC data shows while wireless expenditures as a percentage of total telephone service expenditures was only 1% in 1998, as of 2007 wireless expenditures now account for 51% of total telephone services expenditures.[41] During the period from 1999 through 2006, while the number of ILECs remained virtually unchanged (i.e., decreasing approximately 1%), the number of ILEC competitors (excluding wireless providers) increased 315%.[42] Similarly, during that same period, ILEC gross revenues decreased 11% while the gross revenues of ILEC competitors

[39] The 2000 data is extracted from the following source: Industry Analysis; Common Carrier Bureau (FCC). Local Telephone Competition: Status as of December 31, 2000 (May 2001): Table 6, Table 7, Table 9, and Table 12.

[40] The 2007 data is extracted from the following source: Industry Analysis and Technology Division; Wireline Competition Bureau (FCC). Local Telephone Competition: Status as of December 31, 2007 (September 2008): Table 7, Table 13, Table 14, and Table 17.

[41] Industry Analysis and Technology Division: Wireline Competition Bureau (FCC), Trends in Telephone Service, August 2008, Table 3.3 at p. 3-5.

[42] Industry Analysis and Technology Division: Wireline Competition Bureau (FCC), Trends in Telephone Service, August 2008, Table 15.3 at p. 15-5.

(excluding wireless providers) increased by 199%.[43] With respect to the State of Washington, during the period from 2000 through 2005, ILEC revenues declined 14%, while CLEC revenues increased 56% and wireless revenues increased 59%.[44]

Even absent competition, it is not a foregone conclusion that the detriments associated with cross-subsidies are overridden by the benefits of those subsidies.

> If, as some studies indicate, the price elasticity of demand for network access is "very low" (and certainly in the inelastic range), then lowering the price of that access through a subsidy is unlikely to stimulate even a proportional increase in subscribership. In that event, the benefit from internalizing the supposed network externality may not be substantial enough to overcome the costs imposed by subsidy-related distortions.[45]

Q. WHAT CONCLUSIONS CAN BE DRAWN FROM THIS DATA?

A. The data demonstrates that permitting rebalancing by way of local retail rates does not necessarily mean that rates will automatically or immediately increase. The actual increase that would be sustained is limited because consumers can choose an alternative provider if they perceive that the price offered by their current provider is unaffordable. Moreover, a large number of customers who currently purchase bundled telecommunication service packages likely will not be affected by any increase in the basic service rate because bundled packages are already subject to greater competition.

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[43] Industry Analysis and Technology Division: Wireline Competition Bureau (FCC), Trends in Telephone Service, August 2008, Table 15.4 at p. 15-6.

[44] Estimated 2000 data is from Industry Analysis and Technology Division: Wireline Competition Bureau (FCC), Trends in Telephone Service, May 2002, Table 16.7, p. 16-9. Estimated 2005 data is from Industry Analysis and Technology Division: Wireline Competition Bureau (FCC), Trends in Telephone Service, August 2008, Table 15.4, p. 15-6. Notably, during the same period, access revenues fell 2% and toll revenues declined 41%.

[45] *Communications Regulation and Policy under Convergence: Advancing the State of the Debate*; Aniruddha Banerjee and Christian M. Dippon, International Telecommunications Society, 16th Biennial Conference, Beijing, China, June 12-16, 2006 at fn. 34.

Nearly 5 years ago, then FCC Chairman Kevin Martin noted in a speech to NARUC that [then] 51 million customers subscribed to bundled offerings. Specifically, Chairman Martin stated:

> Telecommunications companies are packaging local and long distance services, just like the [Telecommunications Act of 1996] envisioned, and consumers are buying these bundles. MCl's Neighborhood plan and Verizon's One Rate plan have been a phenomenal success, with 51 million customers now subscribing to bundled offerings. The RBOCs now offer LD/Local bundles in all of their states to almost 85% of all American households.[46]

In February 2008, Consumer Reports noted consumers are "bombarded with pitches to receive [their] cable TV, Internet, and phone service from one provider."[47] The Commission can take great comfort in observing that consumers are already voting with their dollars purchasing by way of competitive alternatives and/or bundled services which, obviously, many consumers see as a better value. As concluded by NERA Vice President Dr. Harold Ware:

> Packaged services provided by cable companies, wireless companies, and CLECs regulate prices for ILEC customers, including basic service customers, in four ways. First, they compete directly for customers purchasing ILEC packages. Second, packages are available at rates close to those paid by synthetic-package customers; thus, current synthetic package customers could easily become packaged service customers. Third, competitive packages compete for those basic service customers "at the margin," i.e., those who may now buy only basic service but that would switch to a competitive package of some type if the ILEC were to raise basic rates above competitive levels. Fourth, competitive packages provide indirect protection for customers who only purchase basic service because an increase in the basic rate would also affect customers who purchase synthetic bundles—of basic service, toll, and optional services—and the prospect of losing these more

[46] http://www.fcc.gov/commissioners/previous/martin/NARUC3-8-04.
[47] http://www.consumerreports.org/cro/electronics-computers/tvs-services/bundled-services-2-08/overview/bundled-services-ov.htm .

lucrative customers to competitors deters ILECs from raising basic rates.[48]

Q. IS THERE ANY JUSTIFICATION TO MAINTAIN THE EXISTING INTRASTATE SWITCHED ACCESS SERVICE RATE LEVELS AND STRUCTURE?

A. In fact, the arguments offered by Embarq are contrary to sound public policy. Embarq witness Dippon attempts to argue in support of maintaining the existing implicit, non-competitively neutral cross-subsides stating that "[i]n light of these competitive forces, the ILECs' ability to recover any decrease in carrier switched access revenue by increasing retail prices is constrained by market forces, as well as by price regulation."[49]

In its purest form, this argument asks the Commission to utilize implicit subsides from non-competitive services (i.e., switched access services) to support below costs rates in competitive markets (i.e., local exchange services). With respect to non-competitive markets and services (i.e., where the availability of competitive alternatives is minimal or nonexistent), it is imperative that the responsible regulatory authority exercise the most intense oversight and control to ensure that abuses such as price gouging are not occurring. Similarly, in competitive marketplaces, each provider or supplier should be left to their own devices to compete on a *level playing field*. As such, no provider or supplier should be advantaged by being permitted to price the competitive offering below cost *while* receiving cross-subsidy support from non-competitive sources.

[48] *Can Competition Regulate Rates for Basic Services?*, Harold Ware, January 4, 2008, at pp. 1 – 2.
[49] Responsive Testimony of Christian M. Dippon at Exhibit 3, *Access Charges, Universal Service, and Competition*; Christian M. Dippon, William E. Taylor, and Harold Ware; April 17, 2009 at p. 14.

Interestingly, in other venues, Embarq witness Dippon has made this very argument:

> Better still, in an era of convergence, the appropriate policy would be to secure universal service (or access) indirectly by encouraging progressively lower-cost access technologies to emerge—thus steadily diminishing the size of the requisite support fund—even if pioneering technologies (and those that deploy them) earn rents and enjoy first-move advantages for some time. From a dynamic perspective, it would be more efficient in a converged environment to let the market (and competition) evolve the appropriate access solutions, rather than to rely on politically attractive but ultimately inefficient cross-subsidies borne by incumbent carriers or on external support funded by only a hapless subset of service providers.[50]

Furthermore, it is disingenuous, at best, to claim that customers will be harmed by any opportunity to rebalance intrastate switched access revenue reductions through increases in local retail rates. First, the claim presumes that providers will seek to rebalance the whole of the reduction by way of local retail rates. Secondly, a large portion of customers potentially will not be affected, especially given the presence of competitive alternatives and/or the availability of bundled telecommunications services.

[50] *Communications Regulation and Policy under Convergence: Advancing the State of the Debate*; Aniruddha Banerjee and Christian M. Dippon, International Telecommunications Society, 16th Biennial Conference, Beijing, China, June 12-16, 2006 at p. 15.

VI. IMPACTS ON THE MARKETPLACE

Q. EMBARQ WITNESS DIPPON STATES THAT AT&T'S TOLL VOLUME DECREASES ARE UNRELATED TO EMBARQ'S INTRASTATE SWITCHED ACCESS RATES. DO YOU AGREE?

A. Mr. Dippon attempts to demonstrate that the AT&T toll volume decreases are unrelated to Embarq's intrastate switched access rates;[51] however, he does so using the similar data as I used to make the argument that IXCs cannot compete with alternate technologies that are not saddled with high intrastate access costs. He artfully paints a picture using data and graphs portraying the significant downward trend in wireline toll usage.[52] And, at the same time, he highlights the significant advancements made by competitive providers and by competitive alternatives.[53]

And, Mr. Dippon argues that "[w]ireline carriers of all types are losing business to competitors primarily due to ***price*** . . . and nonprice . . . attributes."[54] If the IXCs prices for wireline long-distance services were not priced to recover inflated intrastate access service rates, then the IXCs would be left to compete on terms more conducive to an efficiently and effectively competitive marketplace rather than a marketplace whose winners were determined by regulatory fiat.

The continued use of implicit support mechanisms which competitively disadvantage the IXCs results in regulatory arbitrage and, in the net, decreases in the demand for AT&T's toll services. AT&T is concerned with the inappropriate market opportunities and practices resulting from misguided or archaic regulatory policy.

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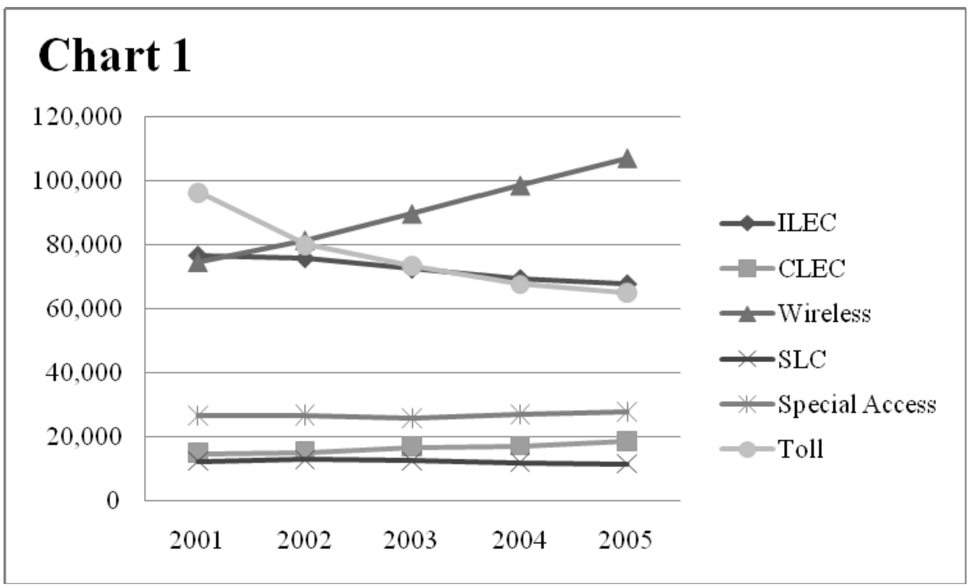
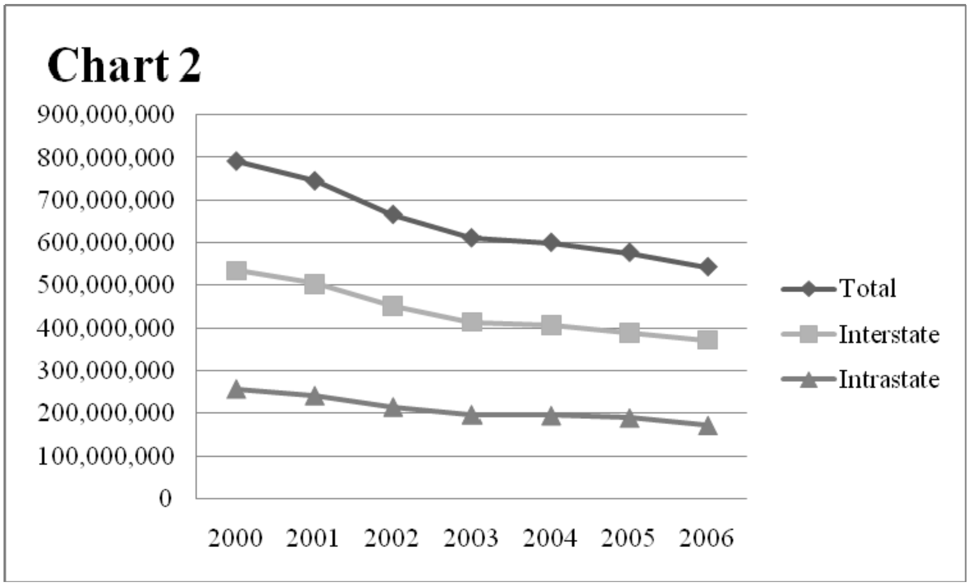
[51] Responsive Testimony of Christian M. Dippon at p. 39, l. 8 – p. 43, l. 21.
[52] *See*, *especially*, Responsive Testimony of Christian M. Dippon at Figure 8.
[53] Responsive Testimony of Christian M. Dippon at p. 42, ll. 2 – 4.
[54] Responsive Testimony of Christian M. Dippon at p. 42, ll. 5 – 8. (emphasis added)

As cited in my direct testimony, AT&T has experienced toll market share losses completely unrelated to its inherent ability to offer quality services. It is the undue burden created by the implicit subsidies within the intrastate switched access rates of certain providers, such as Embarq, that incent inappropriate market opportunities and practices that underlie AT&T's toll market share losses. Demand for toll minutes of use has migrated to competitors and to technological alternatives, including wireless, VoIP, internet-based messaging and networking applications, which are not burdened with these implicit subsidies. As shown in Chart 1, while ILEC, CLEC, SLC, and Special Access revenues have remained relatively constant, the revenues for Wireless have risen commensurate with the decline in toll revenues.[55]



[55] The data is extracted from the following sources: Industry Analysis and Technology Division Wireline Competition Bureau. Trends in Telephone Service: May 2002, Table 15.7, p. 15-9; May 2004, Table 15.7, p. 15-9; April 2005, Table 15.7, p. 15-9; February 2007, Table 15.7, p. 15-9; and, August 2008, Table 15.7, p. 15-9. Revenues are shown as dollars in millions.

Furthermore, as shown in Chart 2, toll MOUs have been in decline for a number of years.[56]



In fact, as shown in BAX – Rebuttal Appendix 2HC, Embarq has experienced **[BEGIN EMBARQ HIGHLY CONFIDENTIAL]** XXXXXXXX **[END EMBARQ HIGHLY CONFIDENTIAL]** in its intrastate access minutes of use demand (i.e., on both a total volume and a per line basis[57]) in the State of Washington.

In addition to demonstrating the impacts resulting from the availability of competitive alternatives[58] which are not burdened with the implicit support inherent in intrastate switched access rates, these trends predict the declining base from which that implicit support is derived.

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[56] Data is extracted from the FCC's Trends in Telephone Service, Industry Analysis and Technology Division, Wireline Competition Bureau, August 2008, Table 10.2.

[57] A *per line* analysis is meaningless since the true impact to Embarq's support base is measured by the total intrastate switched access MOUs. Similarly, the true impact to wireline IXCs, including AT&T, would be demonstrated by declines in total intrastate long-distance MOUs and not a *per line* analysis.

[58] In fact, Embarq witness Dippon points to AT&T's continued recognition of the continuing growth of competition in the marketplace in citing AT&T's reference to this fact on its most recent 10-K form. *See*, Responsive Testimony of Christian M. Dippon at p. 15, ll. 14 – 20.

Q. CAN YOU BE MORE SPECIFIC WITH RESPECT TO THE JEOPARDIES ASSOCIATED WITH MISGUIDED OR ARCHAIC REGULATORY POLICY?

A. As discussed above, there are several competitive alternatives to traditional switched long distance services, primarily alternatives like wireless, VoIP and internet applications. Whenever an ILEC's end user chooses to use an alternative technology instead of a long distance call, the competitive provider does not face the same implicit subsidy burden, and the ILEC's subsidy revenue stream (in the form of access charges) may be reduced. The implicit subsidies in switched access rates—and the economic reactions that they trigger—are harming Washington consumers and the Washington telecommunications market.

Four significant jeopardies are noteworthy. First, the sustainability of implicit subsidies is further threatened in cases where carriers dispute whether reciprocal compensation, interstate access or intrastate access charges should apply to a particular call. For example, with respect to VoIP traffic, certain VoIP providers have asserted that VoIP services are exempt from access charges,[59] and through self-help measures attempt to have their calls treated as local calls. Wireless carriers and rural

[59] There are ongoing proceedings before the FCC regarding the compensation mechanism that should apply to VoIP traffic. Some carriers assert that such traffic is subject only to reciprocal compensation charges while others assert that it is subject also to switched access charges. As a result of this disagreement, compensation for VoIP traffic is in dispute, which further threatens the sustainability of implicit subsidies contained in access charges. *See*, High-Cost Universal Service Support, WC Docket No. 05-337 Federal-State Joint Board on Universal Service, CC Docket No. 96-45; Lifeline and Link Up, WC Docket No. 03-109; Universal Service Contribution Methodology, WC Docket No. 06-122; Numbering Resource Optimization, CC Docket No. 99-200; Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98; Developing a Unified Intercarrier Compensation Regime, CC Docket No. 01-92; Intercarrier Compensation for ISP Bound Traffic, CC Docket No. 99-68; IP Enabled Services, WC Docket No. 04-36.

carriers dispute whether certain traffic is subject to access charges or reciprocal compensation.[60]

Second, the disparate regulatory treatment of calls for intercarrier compensation purposes has also strained the reliability of implicit subsidies. For example, with respect to wireless, under federal rules all wireless calls that originate and terminate within a single MTA are subject to reciprocal compensation for intercarrier compensation purposes.

Third, carriers that pay intrastate access charges have an incentive to evade them if the interstate-intrastate differential is too great. For example, high switched access rates could encourage "buying" carriers to route traffic in such a way that makes it difficult or impossible to determine its jurisdiction, (i.e., phantom traffic).

Fourth, high switched access rates also engender arbitrage. Providers that receive high access charges have an incentive to generate increased traffic volumes. The recent, highly publicized "traffic pumping" schemes, which are designed to drive massive volumes of traffic to adult chat lines and similar services (e.g., free conference call offers) via rural LECs and CLECs with high switched access rates, serve to highlight the potential for abuse.[61]

As the market proves time and again, any effort to impose implicit subsidies on one class of consumers simply leads those consumers to find ways to avoid paying the subsidies and shift their demand to alternative choices, "end users can resort to

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[60] *Alma Communications Co. v. Missouri Public Service Commission*, 490 F.3d 619 (8th Cir. 2007).

[61] *In the Matter of Establishing Just and Reasonable Rates for Local Exchange Carriers, Notice of Proposed Rulemaking*, Notice of Proposed Rulemaking, FCC 07-176, WC Docket No. 07-135 (Rel. Oct. 2, 2007).

alternative [providers].”[62] As the customers continue to shift long distance minutes to the competitive alternatives, the ILEC’s subsidy revenue will be lost.

The Commission needs to follow its past precedent and reduce the implicit subsidies in Embarq’s intrastate switched access rates.

Q. OUTSIDE OF THIS PROCEEDING, DO EMBARQ WITNESSES BELIEVE THERE ARE JEOPARDIES AND ARBITRAGE OPPORTUNITIES ASSOCIATED WITH IMPLICIT SUBSIDIES?

A. Yes. Mr. Dippon has spoken to the jeopardies and arbitrage opportunities which exist under a regulatory scheme with implicit subsidies. He states that, “restraint or caution can protect policymakers from unwittingly creating opportunities for regulatory arbitrage that further feed on the distortions that give rise to responsive but faulty policies in the first place.”[63] In the subtending footnote he continues:

> One of the most troublesome instances of this has arisen with respect to the design and implementation of inter-carrier compensation. Under traditional regulation, one carrier compensates another carrier whenever the latter transports or terminates traffic originated by the former (or, more precisely, the former’s end user). In the U.S. and elsewhere, the precise form and magnitude of the compensation has depended more on artificial jurisdictional or geographic characterizations of the traffic in question (e.g., local, long distance, Internet-directed, etc.) rather than on functions performed or actual cost characteristics. Predictably, this has induced interconnecting carriers to either attempt to re-characterize the traffic or otherwise game the compensation process so as to be

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[62] *Communications Regulation and Policy under Convergence: Advancing the State of the Debate*; Aniruddha Banerjee and Christian M. Dippon, International Telecommunications Society, 16th Biennial Conference, Beijing, China, June 12-16, 2006 at p. 12.

[63] *Communications Regulation and Policy under Convergence: Advancing the State of the Debate*; Aniruddha Banerjee and Christian M. Dippon, International Telecommunications Society, 16th Biennial Conference, Beijing, China, June 12-16, 2006 at p. 13.

> able to maximize inter-carrier receipts or minimize inter-carrier payments, as the case may be.[64]

VII. CONSUMER AND PUBLIC BENEFIT INTERESTS

Q. SOME EMBARQ WITNESSES CLAIM THAT CONSUMERS WOULD NOT BENEFIT FROM A DECREASE IN EMBARQ'S INTRASTATE SWITCHED ACCESS RATES. DO YOU AGREE?

A. Embarq witness Dippon questions whether any reductions to Embarq's intrastate switched access rates would impact AT&T rates[65] and expresses concern that access reductions will flow-through.[66]

First and foremost, the Commission needs to recognize that AT&T's rates are reflective of intrastate switched access rates throughout the state and not just those assessed by Embarq. Therefore, one could not expect that as Embarq's intrastate switched access rates are reduced, there would be a commensurate *dollar-for-dollar* reduction in AT&T's toll rates.[67]

AT&T witness Kent Currie provides further evidence that toll rates do decline in response to reductions in switched access service rates and that a reduction in switched access service rates result in further economic benefit.

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[64] *Communications Regulation and Policy under Convergence: Advancing the State of the Debate*; Aniruddha Banerjee and Christian M. Dippon, International Telecommunications Society, 16th Biennial Conference, Beijing, China, June 12-16, 2006 at fn. 29.

[65] Responsive Testimony of Christian M. Dippon at p. 46, ll. 1 – 17.

[66] Responsive Testimony of Christian M. Dippon at p. 47, ll. 1 – 14, at p. 48, ll. 7-18.

[67] Mr. Dippon seems to expect such a flow-through as evidenced by his statements at p. 46, ll. 12 – 17 in his Responsive Testimony. Although, at p. 47, l. 5, Mr. Dippon recognizes that "AT&T sets its prices on a regional basis."

Q. ARE THERE OTHER WAYS IN WHICH THE PUBLIC INTEREST IS SERVED GENERALLY (I.E., OTHER THAN PRICE) BY REDUCING INTRASTATE SWITCHED ACCESS RATES?

A. Yes. There are numerous public benefits other than price. Over the longer term, consumers will benefit from intrastate access reform in a number of important ways. Intrastate access reform will help to ensure that consumers in rural and high-cost areas continue to have uninterrupted access to high quality telecommunications services. As discussed herein, many if not most of the ways consumers communicate today do not involve access charges which ultimately support affordable universal service in states where high access charges continue to exist. Because the many alternatives to wireline long-distance service available today are tremendously desirable (they are convenient, feature rich, and have never been more affordable), their continued growth seems assured.

Consequently, switched access demand – and hence, the implicit subsidies contained in high intrastate switched access charges - will inexorably decline to a level close to zero. In states that continue to have high intrastate switched access charges, the implicit subsidies in access charges have been relied on for achieving the policy goal of affordable and universal telecommunications service. As this base erodes, states may no longer be able to achieve their universal service goals, particularly in rural and high-cost areas. Absent effective intrastate access charge reforms, service to consumers in rural and high-cost areas is jeopardized.

Q. MR. BAX, HAS ANY PARTY TO THIS PROCEEDING OFFERED A WORKABLE SOLUTION FOR THE COMMISSION TO ADOPT?

A. Yes. As described herein and in my direction testimony, AT&T has offered a workable and appropriate solution for the Commission. AT&T does not agree as Mr. Dippon suggests that the Commission has only three choices as it considers the facts in this proceeding. In summary, Mr. Dippon states that those choices are: "(1) leave the current rates as they are, (2) open a full rate rebalancing case that would provide United with more pricing flexibility and that would establish an explicit universal service fund, or (3) remove all regulatory constraints currently imposed on United."[68]

The first choice is untenable, even by the philosophy of Embarq witness Dippon as shown by his own contemplation of the matter in other statements and presentations, as detailed herein, and is not consistent with Commission precedent.

AT&T also disagrees with Mr. Dippon's second choice on the list. AT&T believes that the Commission should require Embarq to reduce its current intrastate switched access rates to its interstate level and structure including elimination of the Carrier Common Line Charge and the Interim USF Additive. In return, Embarq should be permitted the opportunity to offset any reductions in revenues by way of increases to its rates for local end-user retail services. To the extent proven necessary, the Commission may want to consider a transition period.

Similarly, the third choice, to the extent that it applies to intrastate switched access, is unacceptable as one could reasonably expect that Embarq will continue to take inappropriate advantage of the monopoly nature of the switched access relationship by shifting an even greater burden to the wireline IXCs in order to further

[68] Responsive Testimony of Christian M. Dippon at p. 61, ll. 2 – 5.

address the competition it faces and potentially could face for its local exchange services.

Contrary to the allegations by Mr. Dippon, the AT&T recommendation offered in my direct testimony and herein does not necessarily place the full burden on Embarq and/or its "rural Washington and low-income households."[69] And, in spite of the dire prediction by Embarq witness Felz, the proposal by AT&T will not "effectively eliminate [Embarq's] Washington intrastate operating income."[70] AT&T's recommendation simply directs the cost toward the cost causer (i.e., the end-user retail customers of Embarq) without regard to geography and/or income. Under the existing structure, the burden is shifted to only customers of the wireline IXCs within in the State of Washington, who may or may not be customers of Embarq.[71]

Embarq witness Dippon suggests that permitting Embarq the *opportunity* to offset the revenue reductions resulting from intrastate switched access service rate decreases is not a feasible solution because "[t]he competitive nature of United's service territory in Washington would likely restrict United's ability to profitably raise prices."[72]

As offered in my direct testimony, the Commission has previously determined that "[a] regulated utility company is not entitled as a matter of law to 'rate rebalancing,' in which substantial reductions in some rates must be offset by a

[69] Responsive Testimony of Christian M. Dippon at p. 61, ll. 11 – 12, at p. 62, ll. 11 – 12 and at p. 64, ll. 3 – 16.
[70] Responsive Testimony of John M. Felz at p. 12, ll. 10 – 12.
[71] And, as portrayed in my direct testimony, the burden is borne by citizens who are likely not Embarq's customers since a disproportionate share of the cross-subsidy is included in the rates for terminating intrastate switched access service.
[72] Responsive Testimony of Christian M. Dippon at p. 59, ll. 7 – 18.

revenue-neutral increase in other rates, but is entitled to seek an increase in its rates and charges when it believes it is entitled to rate relief."[73]

As such, the Commission is not necessarily bound to automatically rebalance Embarq's rates in this proceeding. AT&T is offering that Embarq should be permitted the opportunity to offset any reductions to its intrastate switched access service revenues by way of its end-user retail services. This is the same solution that was made available to Verizon and to Qwest in their respective switched access service rate proceedings, as described in my direct testimony.

Q. IS THE PROVERBIAL *CATCH 22* PORTRAYED IN THE RESPONSIVE TESTIMONY OF MR. DIPPON AT FIGURE 9 ON PAGE 63 ACCURATE WITH RESPECT TO THE SOLUTION OFFERED BY AT&T?

A. I believe that Mr. Dippon's "stop light" as portrayed in his Figure 9[74] misstates and obfuscates benefits that will be realized under the solution offered by AT&T. Mr. Dippon attempts to paint a bleak and grossly inaccurate picture of the consequences that will result from the recommendation offered by AT&T. AT&T suggests that Embarq be permitted the opportunity to fully recover any revenue reduction resulting from decreases in its intrastate switched access service rates through appropriate increases to its end-user retail rates. Embarq instead continues to threaten degradation in the quality of service or in the levels of innovation[75] which customers experience. Furthermore, AT&T's proposal precludes Embarq from shifting price increases solely to customers in areas with less competition.

[73] Docket No. UT-020406 (2003), Eleventh Supplemental Order at para. 175.
[74] Responsive Testimony of Christian M. Dippon at Figure 9, p. 63.
[75] Responsive Testimony of Christian M. Dippon at p. 62, l. 5.

Therefore, Embarq's rural customers are not being asked to "subsidize themselves."[76] Rather, ***all*** of Embarq's customers are being required to contribute equitably to the costs of their services.

VIII. SUMMARY AND CONCLUSION

Q. MR. BAX, CAN YOU SUMMARIZE YOUR REBUTTAL TESTIMONY?

A. Embarq witness Dippon concisely describes what AT&T believes is so critical in any analysis of this matter by offering that "[t]he 'fatal attraction' of inefficient cross-subsidies cannot be overstated" and "that it makes little sense from efficiency (static or dynamic) and sustainability standpoints to perpetuate the use of cross-subsidies to support universal service (however defined) in an era of convergence."[77]

No evidence has been offered that demonstrates convincingly and defensibly that "the policy objectives of providing ubiquitous and affordable telephone service,"[78] much less Washington consumers and the Washington telecommunications marketplace, will be best served by preserving the existing rates and structure or that Embarq's "intrastate switched access rates in the State of Washington are just, fair and reasonable."[79]

Q. MR. BAX, DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes.

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[76] Responsive Testimony of Christian M. Dippon at Figure 9, p. 63.

[77] *Communications Regulation and Policy under Convergence: Advancing the State of the Debate*; Aniruddha Banerjee and Christian M. Dippon, International Telecommunications Society, 16th Biennial Conference, Beijing, China, June 12-16, 2006 at fn. 36.

[78] Responsive Testimony of Christian M. Dippon at p. 7, l. 14.

[79] Responsive Testimony of Christian M. Dippon at p. 5, ll. 16 – 17.