

**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.)	

**FINAL REPLY TESTIMONY OF PAUL B. VASINGTON
ON BEHALF OF VERIZON**

REDACTED VERSION

HIGHLY CONFIDENTIAL PER PROTECTIVE ORDER IN UTC DOCKET UT-081393

July 15, 2009

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1 **I. INTRODUCTION**

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

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

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

5 **Q. MR. VASINGTON, DID YOU SUBMIT DIRECT AND REBUTTAL**
6 **TESTIMONY IN THIS PROCEEDING?**

7 A. Yes. I submitted direct testimony on February 18, 2009 and rebuttal testimony on
8 June 5, 2009.

9 **Q. WHAT IS THE PURPOSE OF YOUR FINAL REPLY TESTIMONY?**

10 A. The purpose of my final reply testimony is to respond to the surrebuttal testimony
11 filed by Messrs. Dippon, Felz, and Roth, on behalf of Embarq on June 30, 2009.

12 **Q. PLEASE PROVIDE A SUMMARY OF YOUR TESTIMONY.**

13 A. Embarq has provided no legitimate defense for its excessive intrastate switched
14 access rates under the precedent set by the Commission, so I do not need to repeat
15 the arguments I made in direct and rebuttal testimony. However, there are three
16 arguments made by Embarq's witnesses in their surrebuttal testimonies that
17 warrant response:

18 1) Embarq's defense of its proposed allocation of loop costs to switched access is
19 based on a confusing and contradictory attempt by Embarq to square economic
20 principles with its desire to continue implicit subsidies of basic exchange service
21 with revenues from switched access;

1 2) Embarq did not demonstrate that it needs all of the revenues it currently
2 receives from switched access to meet social policy obligations. At this point,
3 Embarq should be required to file a rate case or alternative regulation plan if it
4 seeks to recover lost access revenue once its switched access rates are reduced to
5 a reasonable level; and

6 3) Embarq has completely abandoned its initial defense against Verizon's claim
7 of anticompetitive effects flowing from its excessive access rates. Mr. Dippon
8 now posits a defense that in effect concedes that Embarq has a competitive
9 advantage with respect to intrastate toll service, but he contends that this
10 advantage should not concern the Commission because it does not prevent
11 competitors from participating in the broader market that includes wireless and
12 interstate toll services. Mr. Dippon's argument entirely ignores the statutory basis
13 for Verizon's claim and Commission precedent, under which rates creating an
14 "undue or unreasonable preference" in the intrastate toll market are clearly
15 unlawful. Although Embarq's anticompetitive access pricing does not prevent
16 other interexchange carriers ("IXCs") from participating in the market (*i.e.*, it
17 does not constitute an entry barrier), it is nevertheless anticompetitive and
18 contrary to Washington law.

19 **II. EMBARQ'S ANALYSIS OF LOOP COST RECOVERY IS CONFUSING**
20 **AND CONTRADICTIONARY**

21 **Q. WHAT DID YOU SAY IN YOUR REBUTTAL TESTIMONY ABOUT**
22 **LOOP COST RECOVERY?**

1 A. I pointed out that Mr. Roth claims it is appropriate to allocate fully **BEGIN**
2 **HIGHLY CONFIDENTIAL** **END HIGHLY CONFIDENTIAL** of the
3 intrastate cost of the local loop to intrastate switched access. Roth Responsive
4 Testimony, Exhibit No. _____THC(HJR-1T)HC, at 10. His purported justification
5 is:

6
7 The IXCs who purchase intrastate switched access services from
8 United use the local loop to deliver their services to their
9 customers and are purchasing access to the local customer using
10 United's local loop. The IXCs, as users of the local loop, should
11 continue to pay an allocated portion for usage of the local loop.

12
13 *Id.* at 26. I also noted that Mr. Dippon contradicted Mr. Roth's analysis in his
14 "white paper," in which he and his co-authors refer to "subscriber line costs" as
15 "non-traffic sensitive" ("NTS") costs of the network and separately refer to joint
16 and common costs of the network.¹ They clearly refer to the recovery of NTS
17 costs, including loop costs, via access charges as "subsidizing basic rates,"²
18 directly contradicting Mr. Roth, who characterizes such recovery as an
19 appropriate allocation of loop costs to access.

20 **Q. HOW DID EMBARQ RESPOND?**

21 A. In trying to reconcile the contradiction I highlighted, Mr. Dippon and Mr. Roth
22 compounded it with even more contradictions. Mr. Dippon claims that there is no
23 contradiction between his testimony and Mr. Roth's and that I "evidently

¹ Dippon Responsive Testimony Exhibit No. _____(CMD-3) at 13.

² *Id.*

1 misunderstood the nature of Mr. Roth’s calculation.”³ Mr. Dippon also says that
2 “... loop cost ‘allocations’ are not part of the (incremental) cost of carrier
3 access.”⁴ Embarq’s latest attempt to “explain” the nature of Mr. Roth’s
4 calculation renders it more confusing than ever.

5 Mr. Roth claims that “[Embarq] has provided parties with a fully
6 documented [total-service, long-run, incremental cost (“TSLRIC”)] study in this
7 proceeding” for switched access service.⁵ Yet, he also says that “[Embarq]’s
8 position is the local loop is a direct cost of local service,” and then continues to
9 attempt to justify the allocation of loop costs to switched access.⁶ These
10 statements are not compatible.

11 **Q. WHY ARE THESE STATEMENTS INCOMPATIBLE?**

12 A. A TSLRIC study quantifies the incremental *cost* of providing the entire demanded
13 quantity of the product or service under examination. The study identifies what
14 forward-looking costs are incurred specifically because of the firm’s decision to
15 offer that particular product or service. Determining incremental costs is a first
16 step in making the policy decision as to whether the *price* for the service in
17 question is reasonable. Once the direct costs have been calculated using TSLRIC

³ Dippon Surrebuttal Testimony (CMD-6T) at 37.

⁴ Dippon Surrebuttal Testimony (CMD-6T) at 38.

⁵ Roth Surrebuttal Testimony THC(HJR-5T)HC at 6.

⁶ Roth Surrebuttal Testimony THC(HJR-5T)HC at 31.

1 methods, it may be necessary to add an allocation of shared and common costs to
2 the calculated TSLRIC.⁷

3 Therefore, in order for Embarq to include loop costs in its estimate of
4 costs for switched access, loop costs must be either a direct cost of switched
5 access (i.e., part of the TSLRIC for switched access) or a shared or common cost.
6 But Embarq says that the loop is neither a direct cost of switched access nor a
7 shared or common cost. So there is no principled basis for Embarq to allocate
8 loop costs to switched access.

9 Embarq states that the loop is not a shared cost, but is instead a “direct
10 cost of local service.” And, as noted, Mr. Dippon testifies that “... loop cost
11 ‘allocations’ are not part of the (incremental) cost of carrier access.”⁸
12 Notwithstanding its claim that loop costs are neither a direct cost of switched
13 access, nor a shared cost, Embarq allocates fully **BEGIN HIGHLY**
14 **CONFIDENTIAL** **END HIGHLY CONFIDENTIAL** of the intrastate cost
15 of the local loop to intrastate switched access, as part of its study of switched
16 access costs. And Mr. Roth continues to argue (in direct contradiction of Mr.
17 Dippon’s statement, above) that it is appropriate to allocate loop costs to switched
18 access on the basis that IXC’s “need” and “use” the local loop to offer their

⁷ Note that such an allocation is not appropriate in the determination of a price floor, which would only include direct costs. A price floor is designed to ensure that a competitive service is not being subsidized, and a subsidy is only defined in relation to direct costs, independent of shared and common cost recovery.

⁸ Dippon Surrebuttal Testimony (CMD-6T) at 38.

1 services.⁹ Embarq cannot square this circle. It is tying itself in knots because it is
2 confusing cost recovery with cost causation.

3 **Q. PLEASE EXPLAIN WHAT YOU MEAN.**

4 A. Mr. Dippon defends the recovery of loop costs in Embarq's cost study essentially
5 on the ground that such costs have been recovered in switched access historically.
6 This is tautological, *i.e.*, he is in effect saying that it is appropriate to recover loop
7 costs in switched access rates because loop costs are recovered in switched access
8 rates. Also, Mr. Dippon is confusing the concepts of cost recovery (*i.e.*, pricing)
9 with cost causation. Setting switched access rates above incremental costs in order
10 to provide a contribution towards the recovery of loop costs is a policy decision to
11 diverge from cost causation in ratemaking. Loop costs that receive a contribution
12 from access rates are not properly allocated to the cost of providing switched
13 access service in an incremental cost study, because there is no causative link
14 between providing a loop to a customer (and the corresponding amount of
15 investment a company makes in its loop plant), and the provision of switched
16 access service to other carriers. Embarq can argue (albeit incorrectly) that it is
17 appropriate policy to recover loop costs in switched access prices, but it cannot
18 argue that an appropriate TSLRIC study of switched access includes any of the
19 costs of the loop.

20 **Q. IS IT APPROPRIATE TO RECOVER LOOP COSTS IN SWITCHED**
21 **ACCESS?**

⁹ Roth Surrebuttal Testimony THC(HJR-5T)HC at 30-32.

1 A. No. Loop costs should not be recovered in switched access rates, and these costs
2 definitely should not be included in a study that purports to represent the cost of
3 switched access service. Since Embarq agrees that loop costs are a direct cost of
4 basic service, then loop costs should be recovered in rates for basic service upon a
5 demonstration of need. The Commission should consider granting Embarq
6 greater retail pricing flexibility if (and to the extent) Embarq provides evidence
7 showing the need for a contribution to local service.

8 **III. EMBARQ SHOULD INITIATE A FORMAL RATE PROCEEDING IF IT**
9 **SEEKS TO DEMONSTRATE A NEED FOR REBALANCING**

10 **Q. WHAT DID YOU SAY IN YOUR REBUTTAL TESTIMONY ABOUT**
11 **EMBARQ'S PURPORTED NEED FOR RATE-REBALANCING IF ITS**
12 **ACCESS RATES ARE REDUCED TO REASONABLE LEVELS?**

13 A. I testified that Embarq requested, and received, an ample amount of time to
14 develop a properly-done cost study in this case.¹⁰ Based on Embarq's
15 representation that it would file a "comprehensive cost study," Embarq was given
16 five months (until April 17, 2009) to prepare its cost case.¹¹ Yet, Embarq did not
17 submit a credible cost study showing the need for all of the revenues currently
18 derived from intrastate switched access rates. Based on Embarq's refusal to
19 submit comprehensive information about the need for full revenue recovery, I
20 recommended that if Embarq believes it can marshal factual support for its

¹⁰ See Vasington Rebuttal Testimony (PBV-2THC) at 47-48.

¹¹ See Second Prehearing Conference Order (Nov. 20, 2008), at 1.

1 purported need for a new revenue source, it should initiate an Alternative Form of
2 Regulation (“AFOR”) proceeding (which it must do anyway no later than five
3 years after the closing of its merger with CenturyTel) immediately following the
4 Commission’s order in this docket. The Commission indicated in the Embarq
5 Merger Order (*see* ¶ 49) that it may well be prudent to consider Embarq’s costs
6 and rates much sooner than five years from now.¹²

7 **Q. WHAT DID EMBARQ SAY IN ITS SUR-REBUTTAL TESTIMONY**
8 **ABOUT THE POSSIBILITY OF FILING A FORMAL RATE CASE OR**
9 **PURSUING AN ALTERNATIVE REGULATION PLAN?**

10 A. Mr. Felz testified that “such proceedings are complex and lengthy, with outcomes
11 that are uncertain. [Embarq] would suffer financial harm to the extent access
12 reductions were ordered to be implemented in advance of the company’s ability to
13 prosecute a local rate case or alternative regulation filing.”¹³

14 **Q. HOW DO YOU RESPOND?**

15 A. As an initial matter, I note that the situation Embarq describes is exactly the same
16 situation that Verizon Northwest was in in 2005, when the Commission ordered a
17 reduction to Verizon Northwest’s intrastate switched access rates, and Verizon
18 Northwest was forced to (and did) respond with a filing for a general rate case.
19 And of course the outcome of an Embarq rate case or AFOR docket is uncertain
20 because Embarq must first demonstrate that it requires the revenue. More

¹² Vasington Rebuttal Testimony (PBV-2THC) at 49-50.

¹³ Felz Surrebuttal Testimony THC(JMF-5THC) at 14-15.

1 important, Embarq already has committed to filing an AFOR within five years of
2 the closing of its merger with CenturyTel; there is no reason why Embarq cannot
3 make such a filing in a shorter period of time if it believes that it can show the
4 need for additional revenue. Finally, Embarq may not require a revenue-neutral
5 adjustment if access rates are lowered to reasonable levels, and Embarq had every
6 opportunity in this case to make a comprehensive showing that it requires all of
7 the revenue contribution that it currently receives in switched access rates. As I
8 noted in my rebuttal testimony, “In a sense, Embarq is trying to have it both ways.
9 It does not want to undertake the effort of a comprehensive rate case, yet it is
10 raising defenses that arguably require such an undertaking. Accordingly, Embarq
11 should file a rate proceeding if it believes it can demonstrate the need for
12 rebalancing.”

13 **IV. THE RECORD CLEARLY DEMONSTRATES THAT EMBARQ’S**
14 **EXCESSIVE INTRASTATE ACCESS RATES GIVE IT AN ARTIFICIAL**
15 **COMPETITIVE ADVANTAGE**

16 **Q. WHAT DOES THE RECORD IN THIS CASE DEMONSTRATE ABOUT**
17 **EMBARQ’S ACCESS RATES AND COMPETITION?**

18 A. The record clearly demonstrates that Embarq’s excessive intrastate access rates
19 are anticompetitive – a fact recognized by Staff in its testimony.¹⁴ In my direct
20 testimony, I described how for a toll call that both originates and terminates in

¹⁴ See Testimony of Glenn Blackmon (GB-1HCT), at 11: “United’s high access charges discourage competition for customers’ long-distance revenues.”

1 Embarq's service territory, total access charges (originating plus terminating) are
2 more than **BEGIN HIGHLY CONFIDENTIAL** **END HIGHLY**
3 **CONFIDENTIAL** per minute, which is *twice* as high as the average *retail price*
4 Embarq charges its own long distance customers when they make intrastate toll
5 calls.¹⁵ Mr. Dippon has never disputed the data that I presented or presented any
6 additional evidence. In his responsive testimony Mr. Dippon attempted to explain
7 how, in theory, Embarq would have no incentive to price its services in this
8 manner. Then, faced with the direct evidence that what he says would not occur
9 in theory is readily demonstrated in practice, Mr. Dippon now makes a new
10 argument: the effects of Embarq's access rates on the intrastate toll market are
11 supposedly irrelevant because the intrastate toll calling affected by Embarq's
12 intrastate switched access rate is only a subset of the relevant market, which
13 includes many other services such as interstate toll services and services provided
14 by wireless carriers. *See* Dippon Surrebuttal Testimony (CMD-6T) at 40-43.

15 **Q. IS HE CORRECT?**

16 A. He is correct that intrastate toll calls are a subset of the market, but that does not
17 undercut the fact that Embarq's excessive intrastate switched access rates provide
18 Embarq with an artificial competitive advantage. Embarq's competitive
19 advantage does not represent an entry barrier for Verizon to participate in the
20 market, but Verizon never asserted the existence of an entry barrier and such an
21 inquiry is irrelevant to whether Embarq's rates violate RCW 80.36.186. As the

¹⁵ Vasington Direct Testimony (PBV-1T) at 19.

1 Commission made clear when it determined that Verizon Northwest’s access rates
2 were anticompetitive, what matters when applying RCW 80.36.186 is whether the
3 rates create an “undue or unreasonable prejudice” with respect to *intrastate toll*
4 *services*.¹⁶ There is no basis for Mr. Dippon to assert that his proposed
5 framework – which would involve analyzing the effects on a market that is mostly
6 made up of services (*e.g.*, interstate and wireless) over which the Commission
7 does not have jurisdiction – is an appropriate framework for applying RCW
8 80.36.186.

9 Mr. Dippon again is trying to change the debate to an antitrust-type
10 analysis of whether or not Embarq is engaged in a price squeeze to drive
11 competitors out of the market, a contention that Verizon is not making, and that is
12 not necessary to prove Embarq’s access rates are unlawful. Verizon is simply
13 demonstrating that Embarq’s pricing provides Embarq with an artificial
14 competitive advantage, and Mr. Dippon does not dispute Verizon’s evidence (or
15 its conclusion).

¹⁶ For example, when determining that Verizon Northwest’s intrastate access rates violated RCW 80.36.186, the Commission endorsed Dr. Blackmon’s testimony that:

[T]he excess charges of Verizon allow it to export costs of the Verizon local network to the customers of Qwest and/or the interexchange companies that offer *intrastate toll service*. Verizon’s pricing structure results in some combination of higher profits and lower rates for its local exchange services. It also can distort competition in the long-distance market to the disadvantage of any company that chooses to offer long-distance service to Verizon’s local exchange customers. This is unjust, unfair, and unreasonable.

See Eleventh Supplemental Order, Docket UT-020406 at ¶ 48 (emphasis added).

1 **Q: YOU EXPLAINED IN YOUR REBUTTAL TESTIMONY THAT EVEN IF**
2 **EMBARQ COULD DEMONSTRATE THE NEED FOR A SUBSIDY**
3 **FLOW, SUCH A DEMONSTRATION WOULD NOT CURE THE FACT**
4 **THAT EMBARQ’S SWITCHED ACCESS RATES ARE UNREASONABLE**
5 **AND ANTICOMPETITIVE. SEE VASINGTON REBUTTAL**
6 **TESTIMONY (PBV-2THC) AT 5-6. DID ANY EMBARQ WITNESS**
7 **DISPUTE THAT POINT?**

8 A: No. In their more than 125 pages of far-ranging surrebuttal testimony, none of
9 Embarq’s witnesses engaged that point. None attempted to explain why the
10 existence of a subsidy flow (which in any event Embarq has not shown) would
11 cure the fact that Embarq’s excessive switched access rates are anticompetitive
12 under Washington law. As I noted in my rebuttal testimony, the Commission has
13 made clear that in a complaint proceeding like this one grounded in specific
14 alleged violations of Washington law, the first order of business is to make the
15 determination of whether the respondent’s rates are illegal. *See* Eleventh
16 Supplemental Order, Docket No. UT-020406, at 7. While Verizon agrees that,
17 absent the countervailing precedent that exists in Washington, it would be
18 appropriate to approve any necessary rebalancing simultaneously with the
19 switched access rate reduction *if* the respondent has demonstrated a need for
20 rebalancing (which Embarq has not), it is a *non sequitur* for Embarq to suggest
21 that the purported existence of a contribution is relevant to the analysis of whether
22 Embarq’s rates violate RCW 80.36.186 and RCW 80.36.140.

1 **Q DOES THAT CONCLUDE YOUR TESTIMONY?**

2 **A. Yes.**