BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

AT&T COMMUNICATIONS OF THE PACIFIC NORTHWEST, INC., Complainant, v. VERIZON NORTHWEST, INC., Respondent.	DOCKET NO. UT-020406

BRIEF OF COMMISSION STAFF

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I. INTRODUCTION

1 On April 3, 2002, AT&T Communications of the Pacific Northwest, Inc. (AT&T) filed a complaint against Verizon Northwest Inc. (Verizon) with the Washington Utilities and Transportation Commission (Commission). In short, AT&T alleged that Verizon's intrastate access charges are excessive and discriminatory and should be reduced. Compl., ¶ 35.

2 This Commission has acknowledged that access charges "pose a problem and should be reformed." Exhibit 131.[1] One of the reasons the Commission enacted WAC 480-120-540 was to promote fair competition in the market for intrastate long-distance service. *Id.* at 6.

3 As argued below, Verizon's access charges are excessive to the degree that they cannot be considered fair, just, and reasonable. Verizon's access charges are anticompetitive because they give Verizon a competitive advantage over other long-distance service providers, who must pay those high charges to Verizon.

II. DISCUSSION

A. <u>What Should Verizon's Access Charges Be, and Why?</u>

1. Verizon's Access Charges are Unfair, Unreasonable, and Discriminatory in Violation of RCW 80.36.080, 80.36.180, and 80.36.186

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[1] *In the Matter of Adopting WAC 480-120-540 Relating to Intrastate Carrier Access Charge Reform*, WUTC Docket No. UT-970325, Order Adopting Rules Permanently, at 3 (Sept. 23, 1998), *aff'd Washington Indep. Tel. Ass'n. v. Washington Utils. & Transp. Comm'n*, 148 Wn.2d 887, 64 P.3d 606 (2003).

4 The rates and charges of telecommunications companies must be "fair, just, reasonable and sufficient." RCW 80.36.080. Rates that are not fair, just, and reasonable fail this statutory requirement and consequently are unlawful. As argued below, Verizon's access charges are excessive to the degree that they are neither fair nor reasonable.

5 In addition, a telecommunications company's rates for noncompetitive services cannot be priced in such a way as to discriminate against other carriers. *See* RCW 80.36.180; .186. Verizon's current access charges are so high that they discriminate against other providers of intrastate long-distance service, such as AT&T.

6 Verizon's access charges fail the statutory requirements that rates be reasonable and nondiscriminatory. Therefore, the Commission should order Verizon to reduce its switched access charges by $32 million a year.[2]

a. <u>Verizon's Access Charges Are Excessive in Violation of RCW 80.36.080</u>

7 In its testimony, the Commission Staff offered several criteria against which the Commission could measure the reasonableness of Verizon's access charges. First, while cost alone will not determine the reasonableness and legality of Verizon's access charges, the Commission could look to Verizon's cost of providing access service as an

[2] This represents the approximate amount of revenue reduction resulting from the rate changes recommended by Staff. The actual revenue effect would depend on the volume of access traffic and therefore would vary from one time period to another. Commission Staff recommends that the Commission order the specific rates discussed below, rather than adopt an overall revenue amount.

indication of their reasonableness. *See* Exhibit T-130 at 3.[3] Indeed, Verizon's access charges exceed Verizon's cost of providing the service. Exhibit 223C (relevant portion attached for convenience as Confidential Appendix 1). The Commission should consider the cost of access service to the extent that this assists the Commission in determining the degree to which Verizon's access charges are excessive and unreasonable. *See* Exhibit T-130, at 7.

8 Second, Verizon's intrastate access charges exceed the rates the company charges for the same service when it connects interstate calls. Verizon charges long-distance companies more to access its network to complete intrastate toll calls than it does when the calls are interstate toll calls. Exhibit T-130, at 3; 6. This indicates that Verizon's intrastate access charges are too high because intrastate calls use the same network functionalities as interstate calls. Verizon's intrastate access charges are contrary to the public interest because they discriminate against customers making intrastate long-distance calls versus those customers who make interstate long-distance calls. *Id.* at 6-7.

9 Finally, Verizon's intrastate access charges greatly exceed Qwest's intrastate access charges. *Id.* at 3. In 1996, the Commission reduced Qwest's originating access charges to 1.5 cents a minute as a result of that company's last general rate case. *Id.* (citing WUTC Docket No. UT-950200). While the difference between Verizon's and

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[3] Unlike AT&T, the Commission Staff does not advocate that access charges be priced at long-run incremental cost. It is Staff's position that telecommunications companies, like Verizon, should be able to cover all of their costs of providing a particular service, not just their long-run incremental costs. Some costs, like the cost of the local loop, are shared costs and are not included in the long-run incremental cost of a particular service. Tr. 553-54.

Qwest's access charges may have appeared reasonable at one time, since the Commission has identified and made explicit the portion of each company's access charges that can be attributed to high-cost locations, there is no longer any reason why Verizon's access charges should be nearly four times greater than Qwest's. *Id.* at 4.

10 The comparison against Qwest's intrastate access charges best demonstrates the anticompetitive effect of Verizon's access charges. The unwarranted difference between Verizon's and Qwest's access charges results in an unfair advantage to Verizon and negatively affects competition. As Staff witness Glenn Blackmon, Ph.D., testified:

> [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.

Exhibit T-130, at 4 ll. 13-20.

11 Verizon disputed Commission Staff's argument that the Commission should gauge the reasonableness of Verizon's access charges by comparing them with Qwest's access charges. Verizon argues the comparison is not accurate because Qwest serves more access lines, which are predominately in high-density areas, and because the Commission had approved different rates for the two companies. Exhibit T-200R, at 11. Verizon also argues that the comparison remains flawed even after adjusting for universal service support. *Id.* at 11-12.

12 Verizon's arguments against using Qwest's access charges as a comparison of its access charges miss the point of Staff's testimony. Staff did not testify that Verizon's access charges should be the same as Qwest's. Staff recognized that Verizon has higher costs, but once universal service support and Verizon's higher retail rates are considered, there remains no rationale for the vast difference between the two companies' access charges. *See* Exhibit T-132, at 5-7.

b. Verizon's Access Charges are Anticompetitive in Violation of RCW 80.36.180 and 80.36.186

13 Verizon's high access charges negatively impact competition for intrastate long-distance service. Dr. Blackmon offered a succinct explanation why Verizon's comparatively high access charges are discriminatory:

> Many companies compete for the long-distance business of Qwest's local exchange customers. Some of these companies—most notably Qwest itself—may not offer long-distance service to Verizon's local exchange customers. Other competitors, such as AT&T or [MCI], may offer service to both Qwest's customers and Verizon's customers. Verizon's high access charges put the latter group of companies at a disadvantage relative to the former group of companies. In the extreme case, with enough price competition from Qwest, companies like AT&T and [MCI] would be forced to absorb the excess access charges of Verizon, or they would have to exit either the Qwest market or the Verizon market.

Exhibit T-130, at 5-6. AT&T's witness Dr. Lee Selwyn made a similar observation regarding the anticompetitive effect of Verizon's access charges. *See* Exhibit T-1, at 18-19 (explaining how Verizon can reap additional profits equal to the difference between the retail rate and cost for switched access functionality).

14 Verizon's argument that its access charges are just, reasonable, and nondiscriminatory can be restated as: "The Commission found the company's access charges just and reasonable in the past, so the charges must be deemed just and reasonable forever." *See, e.g.*, Exhibit T-200R, at 5 l. 4 to 6, l. 19; 8 ll. 17-18; 9 ll. 15-17; 12 ll. 9-18; Exhibit T-260R, at 10 ll. 16-20. This argument is without merit. That the Commission has approved rates in the past, does not mean that the Commission cannot change those rates in a subsequent proceeding. In fact, the statutes governing telecommunications regulation anticipate that the Commission will change rates from time to time. *See* RCW 80.04.110 (the Commission may order rate changes upon its own motion or upon complaint by a competing company); 80.36.140 (the Commission may change rates upon its own motion or upon complaint).

15 Verizon's argument that past rates will continue to be reasonable in perpetuity is further contradicted by the fact that the Commission approved Verizon's current access charges as a result of a multi-party settlement of the Bell Atlantic/GTE merger proceeding in 1999. In the merger proceeding, the Commission did not scrutinize Verizon's rates, instead it approved a settlement that disposed of many issues, including access charges. *See* Exhibit T-132, at 2-5. Therefore, Verizon's argument that the Commission had (and lost) its chance to evaluate the company's access charges is without merit.

2. The Commission Should Order Verizon to Reduce Its Terminating Access Rates

16 Terminating access charges are the rates incumbent local exchange carriers (ILECs), such as Verizon, charge long-distance companies to terminate traffic to the ILEC's end-use customers. There are two primary components to Verizon's terminating access service: end-office switching and the interim terminating access charge (ITAC). Currently, Verizon charges $0.0337945 per minute for terminating access. Staff recommends that the Commission set Verizon's terminating access charges at $0.0202830 per minute. *See* Appendix 2 (spreadsheet listing Verizon's current access charges, Staff's proposed access charges, and the percentage change between the two).

17 The Commission Staff's proposed terminating access rate is reasonable and consistent with WAC 480-120-540. That rule, which has been affirmed by the Washington Supreme Court, requires that "the rates charged by a local exchange company for terminating access shall not exceed the lowest rate charged by the local exchange company for the comparable local interconnection service (in each exchange), such as end office switching or tandem switching." WAC 480-120-540(1).

a. <u>End-Office Switching</u>

18 Verizon's current end-office switching rate is $0.0014151 per minute, which is consistent with WAC 480-120-540. This rate element should remain at its current level.

b. Interim Terminating Access Charge (ITAC)

19 The terminating access rate element on which Staff and Verizon significantly disagree is the ITAC. Today, Verizon's ITAC is $0.0323794 per minute. Exhibit T-100, at 2. The Commission Staff recommends that the Commission reduce Verizon's ITAC to $0.0188679. *Id.* As argued below, the Staff's recommendation results in terminating access charges that are fair, just, reasonable, and sufficient.

20 The ITAC is an explicit universal service rate element applied to terminating access service, through which companies can recover universal service costs. WAC 480-120-540(3). In determining the proper level for Verizon's ITAC, the Staff calculated the total amount of support Verizon needs by multiplying the number of access lines for each class of service by the difference between the costs per exchange[4] and the revenue benchmarks of $31.00 for residential service and $51.00 for business service. Exhibit T-100, at 3. The total amount of support Verizon requires is set forth in Exhibit 102C, and is reflected on an unseparated exchange level basis and on a total unseparated Washington basis. Staff then subtracted the amount of federal interstate access support Verizon will receive from the total amount of support that Verizon requires. Exhibit T-100, at 4. By removing the federal support that Verizon will receive, Staff was able to project the correct amount of support Verizon should be entitled to recover through the ITAC. *Id.*

[4] The Commission determined the costs per exchange in the *In the Matter of Determining Costs for Universal* Service, Docket No. UT-090311(a), Eleventh Supplemental Order, Appendix B (Feb. 11, 1999).

21 Contrary to Verizon's argument, the Commission Staff properly removed the additional $21.5 million in interstate support that Verizon received in calculating the correct level of Verizon's ITAC. *See* Exhibit T-230R, at 7-8. According to Verizon, if Staff witness Timothy Zawislak had used what Verizon believes is the correct amount of interstate support, Verizon's ITAC would increase from current levels. The Commission should reject Verizon's argument.

22 The Commission Staff properly determined Verizon's ITAC by comparing the <u>cost</u> of basic service (including both interstate and intrastate access to interexchange carriers) with the revenue benchmarks of $31 for residential and $51 for business service. The revenue benchmarks are not unique to Verizon, rather they are the same for all companies providing local exchange service in Washington. The benchmarks are not measures of a telecommunications company's costs of providing service, nor do they reflect the actual amount of revenue the company will receive. Rather, they are a statement of the total amount of revenue a company should earn per line, per month, on an average basis, below which no universal service should be provided. The benchmarks include revenue from many different elements, including access charges, subscriber line charges, revenue earned from providing DSL, and custom calling features. A company's cost of providing service is measured against the benchmarks, and if the costs exceed the benchmarks, the company is entitled to universal service support in an amount that will allow it to cover its total costs. A company's total

universal service support is made up of a federal component, the federal interstate access support, (IAS), and a state component, the ITAC. *See* Tr. 795-803.

23 In 1998, the Commission had determined universal service costs for all companies on a jurisdictionally unseparated basis, which includes both interstate and intrastate costs. The benchmarks, which were set in 1998, also were determined on an unseparated basis. The total amount of universal service support a company needs is determined by subtracting the benchmarks from the costs (where the costs are greater than the benchmarks for each exchange). *See* Exhibit 102-C. Until the CALLS order was implemented, the amount of federal support was not known (or was implicit). With the release of the CALLS order, which made federal interstate access support explicit, the Commission now can determine the exact amount of federal interstate access support each company will receive from the Universal Service Administrative Company (USAC). *See* Tr. 795-803.

24 Because both the universal service costs and benchmarks are calculated on an unseparated basis, the Commission should exclude the amount of federal support a company needs when determining the proper level of the company's state support, or ITAC. Otherwise, the company will recover that amount for a second time in the ITAC. In determining Verizon's ITAC in this proceeding, Mr. Zawislak properly excluded the $21 million in federal interstate access support Verizon will receive.

25 Although Verizon criticized Staff's reliance on the revenue benchmarks of $31 for residential and $51 for business service, *see* Exhibit T-230R, at 7-8, the company did not propose revenue benchmarks of its own. Nor did Verizon perform the calculations necessary to do so. *See* Tr. at 783-74. The revenue levels used by Staff are the proper benchmarks because they compare the target level of jurisdictionally unseparated revenue for each class of customers with the unseparated cost estimates. *See* Exhibit 102-C; Exhibit 120. The purpose of benchmarks is to distinguish the level at which the cost of service in an exchange is "high" versus "low" throughout the state. The most important aspect of the benchmarks is that they are used consistently throughout the state. *Id.* at 800 ll. 6-18; 803 ll. 8-15.

26 Verizon argues that the benchmarks are not accurate because the amount of access charge revenues included in the combination of revenues has changed over time. *See* Exhibit T-230R, at 7-8. Staff agrees that access charges have changed over time, as have other revenue components. For example, the revenue per line now includes revenue from DSL line sharing, as well as revenue from the increase in the subscriber line charge. Tr. 798-800. Verizon witness Terry Dye testified during cross-examination that the revenue benchmarks account for changes in revenue. Tr. 784 l. 25 to 785 l. 6 ("So the subscriber line charges that were established under the CALLS program and the reduced carrier common line charges together more or less maintained the revenue

benchmarks. So the calculation maintaining the same $31 and $51 certainly accounted for any shifts in the revenues associated with the CALLS order.").

27 The Staff properly offset the amount of intrastate support Verizon needs by the interstate support it will receive, therefore Staff did not double count access revenue. The evidence in this case unequivocally demonstrates that Verizon will receive $21.5 million in interstate access support. Exhibit T-105 at 14; Exhibit 103, Exhibit 114; Exhibit 115. Verizon should not be allowed to double collect this amount through the ITAC.

3. The Commission Should Order Verizon to Reduce Its Originating Access Rates

28 Originating access charges are those rates ILECs, such as Verizon, charge long-distance companies to originate traffic from their end-use customers. Currently, Verizon charges 5.7 cents per minute for originating access service. Exhibit T-130, at 4. The Commission Staff recommends the Commission reduce Verizon's originating access charges to $0.0158172 by eliminating Verizon's carrier common line charge (CCLC) and its transport interconnection charge (TIC), which is also known in the industry as the residual interconnection charge (RIC). The Commission Staff's recommended originating access charges are set forth in Appendix 2 to this brief.

29 As argued above, Verizon's originating access charges are excessive. Once Verizon's need for universal service support is taken into consideration, there is no reason why Verizon's originating access charges should be nearly four times greater than Qwest's originating access charges. To achieve originating rates that are

comparable to Qwest's, the Commission should maintain Verizon's end-office switching element at $0.0158172, and reduce Verizon's CCLC and RIC to zero.

30 In Docket No. UT-950200, the Commission eliminated Qwest's CCLC upon concluding that the continuation of the rate element implied that local exchange service required a subsidy from toll service. *Washington Utils. & Transp. Comm'n v. US West Communications, Inc.*, Docket No. UT-950200, Fifteenth Supplemental Order, at 113 (April 11, 1996). The Commission held that "[e]liminating the CCLC takes an important step away from the historical method of assigning costs, and the result will be a more streamlined rate structure where rate elements have a direct bearing on the service provided." *Id.* The same reasoning applies to the elimination of Verizon's CCLC.

31 The Commission should eliminate Verizon's RIC for the same reasons that it should eliminate the CCLC. Qwest does not charge a RIC, and Verizon's use of a RIC simply contributes to the excessive levels of overall access charges. There is no more reason to retain the RIC than there is to continue the CCLC. *Id.* at 114.

32 Therefore, the Commission should eliminate Verizon's CCLC and RIC. Only after the Commission eliminates these two rate elements will Verizon's current end-office switching rate of $0.0158172 result in a fair, just, reasonable, and sufficient originating access charge.

B. Imputation Issues

33 Staff believes that issues of imputation are of secondary importance in this proceeding because even if Verizon's toll rates were found to pass an imputation test using current access rates, those access rates would still be excessive and anti-competitive. Nevertheless, the issue of whether Verizon's toll rates pass the Commission's imputation test is important.

34 The Commission requires that the retail prices for an ILEC's competitive services pass imputation. Dr. Selwyn explained why imputation is important:

> The purpose of an imputation test is to assure that such price [retail price for an ILEC's competitive service] fully covers all charges that the ILEC would apply to a competitor for any essential services that are required by the competitor in order to offer a competing retail service. Thus, even though Verizon Northwest does not "pay itself" any access charge, the imputation test is applied to assure that the price that a competitor would pay *to Verizon* for switched access and other essential functions, together with any *non-access costs* that Verizon Northwest incurs in providing retail toll service, is not in excess of the retail price that Verizon Northwest charges its end-user customers for the retail toll service.

Exhibit T-1, at 28-29. To put it more succinctly, the Commission must determine the price floor above which Verizon must price its toll services so that Verizon does not negatively impact the market for intrastate long-distance service.

35 Verizon's intrastate toll service is competitive and therefore subject to imputation. In determining whether Verizon's toll service passes imputation, the Commission Staff recommends that the Commission first reduce Verizon's intrastate access charges to the levels Staff proposes in this docket. Exhibit T-100, at 6-7. Once the

Commission reduces Verizon's access charges to the levels recommended by Staff, Verizon's intrastate toll rates should pass imputation. *Id.* at 8. However, if the Commission does not decrease Verizon's access charges, particularly its originating access charges, Verizon's current intrastate toll service may not pass imputation. *Id.* at 8.

36 Verizon's price floor for toll service consists of several inputs: access costs, billing and collection costs, retail/marketing costs, and other costs. In determining Verizon's price floor, Staff believes that the Commission should use Staff's proposed access charges as well as Staff's recommended conversion factors.

37 Once Verizon's access charges are reduced to the levels Staff has proposed in this docket, the Commission should order Verizon to update Exhibit 111C to reflect these new rates. The Commission also should order Verizon to apply conversion factors of 1.0012171 on originating access and 1.1213631 on terminating access. These conversion factors should be applied so that Verizon's price floor reflects what Verizon's competitors must pay Verizon for non-conversation time. Exhibit T-106C, at 8.

38 Telephone calls using Verizon's toll service also are terminated by other local exchange or wireless companies. In determining the proper price floor for Verizon's toll service when the toll calls are terminated by other carriers, the Commission Staff recommends that the Commission apply the conversion factor of 1.1213631.

39 The Commission Staff recommends these conversion factors because Verizon failed to properly account for non-conversation time in determining the company's imputation price floor. Exhibit T-106C, at 8. The Commission should not allow Verizon to use any conversion factor of less than 1.0000000 unless and until the company can adequately support such use. *Id.*; *see also* Exhibit 108 C, at 3 (prior Commission-approved conversion factors for GTE Northwest Incorporated).

40 When considering Verizon's imputation price floor, the Commission should give particular attention to the potential for anticompetitive behavior between affiliated companies. *See* Tr. 482-83. Dr. Selwyn explained that a long-distance company affiliated with Verizon Northwest could price its toll service below Verizon's price floor and absorb the difference, and it wouldn't matter which company earned the profit, Verizon or the affiliate. This practice would put a non-affiliated competitor in a price squeeze situation. *Id.* at 483. Staff witness Dr. Blackmon reiterated the importance of scrutinizing transactions between affiliated companies. Tr. 561-63.

41 As the Commission Staff has testified, access charges have the greatest impact on imputation and must be set at proper levels in order for Verizon's current toll services to pass the imputation test. Because access costs are the largest component of the price floor, it is critical that the Commission reduce Verizon's access charges as Commission Staff has recommended in order to avoid a price squeeze.

C. <u>Verizon's Earnings Issues</u>

42 Verizon raised the issue of its earnings in this docket by arguing that any decrease in access charges must be accompanied by a corresponding increase in retail rates. The Commission's orders striking testimony in this matter have removed most issues relating to earnings. Verizon's remaining earnings issue is how a reduction in access charges as proposed by Staff and AT&T would affect Verizon's authorized rate of return of 9.76%.

43 AT&T and Staff bear the burden of proving that Verizon's access charges are not fair, just, and reasonable. Verizon has the burden of proving how a reduction in access charges would affect its earnings. Verizon raised this issue in defense of the complaint, so it carries the burden of proof.

44 Verizon's evidence regarding the sufficiency of its earnings is set forth in the testimony of Nancy Heuring. In short, Verizon's earnings evidence does not support its argument that "the Commission cannot reduce Verizon's revenues by any amount . . ." Exhibit T-242R, at 3.

45 As a preliminary matter, Verizon claims it will earn a rate of return of 2.84% and will experience a revenue deficiency of $105 million for 2002. *Id*. at 4; 7. If this were true—which Staff disputes—the more pressing question is why hasn't Verizon filed a general rate case. *See* Exhibit T-150, at 3 ll. 5-8; Tr. 828, ll. 13-20. Verizon does not appear concerned about this perceived revenue deficiency because the company may

not file a rate case even if the Commission reduces its access charges as a result of this proceeding. Tr. 829 ll. 12-22. The Commission should consider the company's position when it deliberates as to the credibility of Verizon's earnings argument.

46 Verizon's earnings analysis is deficient in many respects. In her rebuttal testimony, Staff witness Betty Erdahl conducted a high-level review of Verizon's earnings analysis, which revealed several marked flaws in Verizon's analysis. Ms. Erdahl's made some basic "Ratemaking 101" adjustments to Verizon's analysis, which are enumerated below and concluded that Verizon currently is earning 11.57%, well above its authorized rate of return of 9.76%. Exhibit T-150, at 11-12. The Commission should disregard Verizon's earnings analysis.

1. Verizon's Earnings Analysis Should Be Adjusted to Reflect Increased Revenue for Directory Assistance

47 Directory assistance is a competitively classified service, which allows for pricing flexibility. Verizon's current retail rate for directory assistance is below the going rate for directory assistance charged by other carriers. Had Verizon properly made this adjustment, the company's revenue received would have increased on a pro forma basis. *Id.* at 4.

2. Verizon's Earnings Analysis Should Be Adjusted to Normalize the Test Year

48 The Staff made and adjustment to decrease expenses booked in October and increase intrastate access revenue in November of 2001 to adjust for defects that may

exist in actual recorded results, but can distort test period earnings. In reviewing the monthly report for the year ended December 31, 2002, the accrual going forward for intrastate access charges remains at the $10 million range rather the $3 million in November 2001. Exhibit 156, at 3 ("Adjustment to Oct/Nov rev. and Exp to Normalize for the test year ended December 31, 2001"). The same is true of Plant Specific Expenses: the norm is approximately $10 million a month, and not the $17 million the company booked in October 2001. *Id.* These adjustments reflect an increase in revenue for Verizon.

3. Verizon's Analysis Should Be Adjusted to Impute Line Sharing and DSL Revenue

49 In the Generic Cost Case, Docket No. UT-003013, Part A, the Commission ordered Verizon to share its lines. *In the Matter of the Continued Costing and Pricing of Unbundled Network Elements, Transport, and Termination*, Docket No. UT-003013, Thirteenth Supplemental Order, Part A Order Determining Prices for Line Sharing, Operations Support Systems, and Collocation, ¶¶ 70; 391 (Jan. 31, 2001). In its earnings analysis submitted in this proceeding, Verizon failed impute the required $4.00 per line for line sharing. Exhibit T-150, at 7; Exhibit 153C; Tr. 594-95. Properly imputing the $4.00 for line sharing would increase Verizon's revenues for ratemaking purposes.

4. Verizon's Earnings Analysis Improperly Allocates Investment and Expenses to the Intrastate Jurisdiction, While Allocating More Revenue to the Interstate Jurisdiction ("Interstate Growth Mismatch")

50 In its review of Verizon's earnings analysis, Staff properly made and adjustment to reflect the "interstate growth mismatch." In its annual reports to the Federal Communications Commission, Verizon reported that from 1998 to 2001 its intrastate revenues had decreased, while the investment and expenses the company allocated to the intrastate jurisdiction increased. However, for the same period of time, Verizon's interstate expenses and investment increased, but at a much smaller rate than the growth in interstate revenues. This shows that while Verizon allocates more expenses and investment to intrastate, the company channels the revenues to interstate. From this result, it appears that Verizon's jurisdictional allocation process is flawed. For example, Verizon does not measure dial-up minutes of use, but more and more minutes of use are related to Internet usage, which for revenue purposes are allocated to the interstate jurisdiction. However, Verizon allocates the expenses and investment to the intrastate jurisdiction. Exhibit T-150, at 5-6. As Ms. Erdahl testified, "It is unfair to saddle intrastate ratepayers with the expenses and investment while the interstate jurisdiction enjoys the effects of increased returns." *Id.* at 6 ll. 16-18.

5. Verizon's Earnings Analysis Should Be Adjusted to Reflect Directory Revenues

51 In its earnings analysis, Verizon failed to impute directory revenue. Commission Staff made this adjustment in its review. *Id.* at 5; Exhibit 152C, at 2. Verizon chose not to impute directory revenue, even though the Commission had done so in Verizon's last general rate case. Exhibit T-242R, at 6.

6. Verizon's Earnings Analysis Incorrectly Accounts for Merger Transition Costs

52 Verizon includes in its analysis the total costs of the Bell Atlantic/GTE merger amortized over time, in the going forward cost of service. *Id*. at 5. The Commission should disregard this allocation because the costs were taken into consideration in the merger settlement, which resulted in Verizon's agreement not to increase rates for two years following approval. Exhibit T-150, at 9.

D. <u>What is the Impact of WAC 480-120-540 or Other Commission Orders?</u>

53 WAC 480-120-540 requires local exchange companies, like Verizon, to charge rates for terminating access that do not exceed the lowest rate the company charges for the comparable local interconnection service. WAC 480-120-540(1). The cost of terminating access shall be based on the total service long-run incremental cost (TSLRIC) of the service, plus a reasonable contribution to joint and common costs. *Id.* § 2. Companies are not allowed to include loop costs when determining the cost of terminating access service. Verizon's access tariffs must comply with the requirements of this rule. Once the Commission orders Verizon to reduce its originating access charge as set forth above, Verizon may increase its originating access charge pursuant to WAC 480-120-540(6). Verizon also may recover authorized universal service costs

through an ITAC. As argued above, the Commission should order Verizon to reduce its current ITAC.

54 In its motion to dismiss, Verizon argued that if its access charge structure complies with WAC 480-120-540, the resulting access charges must be lawful. This argument misses the point of the rule. WAC 480-120-540 sets forth a methodology for structuring access charges, it does not condone excessive access charges.

E. The Commission Should Order Verizon to Reduce Its Access Charges Immediately

55 As argued above, Verizon's access charges are not fair, just, and reasonable. They are excessive and discriminatory. Therefore, the Commission should order Verizon to reduce immediately its access charges to the levels recommended by Staff.

56 Verizon's alleged earnings deficiency is no reason to delay the necessary reduction in access charges. The Commission Staff has demonstrated that Verizon's evidence on earnings is deficient and incomplete. A high-level review identified $24.5 million in revenue reductions. Exhibit T-150, at 12. The Commission should not permit Verizon to perpetuate further the harm to the public interest that results from its access charges.

57 If Verizon believes it can justify increases to other rates as a result of a reduction to access charges, Verizon may avail itself of a number of options. First, Verizon may file for a general rate increase, which the Commission might approve, or suspend and

set for hearing. *See* RCW 80.04.130. In such a case, Verizon would have the burden of proving that its proposed rates are just and reasonable. *Id.*

58 Second, Verizon may file for an interim rate increase, pending the outcome of a formal rate case. The Commission has entertained such petitions in prior cases. *See, e.g., Washington Utils. & Transp. Comm'n v. Puget Sound Energy, Inc.*, Docket No. UT-011570.

59 Third, Verizon may request expedited rate relief outside of the context of a general rate case. Recently, the Commission has granted[5] and denied[6] requests for expedited rate relief in other cases. The standard for expedited rate relief is set forth in the Commission's prior orders and Verizon would be required to demonstrate a need for expedited rate relief.

60 The Commission's duty is to ensure that Verizon's rates are fair, just, reasonable, and nondiscriminatory. If the Commission finds that they are not, the Commission must order reductions immediately in order for Verizon's rates to be lawful. An excessive rate cannot be justified by some deficiency elsewhere in Verizon's rate structure, and this is even more true since Verizon has made no effort to increase those other rates during the extended period in which this case has been pending. Once the

[5] *In the Matter of Avista Corporation, d/b/a Avista Utilities Request Regarding the Recovery of Power Costs Through the Deferral Mechanism*, Docket No. UE-010393, Sixth Supplemental Order Rejecting Tariff Filing; Granting Temporary Rate Relief, Subject to Refund; and Authorizing and Requiring Compliance Filing (Sept. 24, 2001).

[6] *Washington Utils. & Transp. Comm'n v. Puget Sound Energy, Inc.*, Docket No. UE-011163, Sixth Supplemental Order, Order Granting Motions; Dismissing Dockets (Oct. 4, 2001).

Commission has addressed the access charges question, the burden should be on Verizon to manage its options and make whatever business decisions it believes are necessary in response to the Commission's decision.

III. CONCLUSION

61 As argued above, Verizon's current access charges are excessive and discriminatory. The Commission should order Verizon to reduce immediately its originating and terminating access charges to the levels recommended by Staff.

Dated: June 9, 2003.

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