BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

AT&T COMMUNICATIONS OF THE PACIFIC NORTHWEST, INC. Complainant, vs. VERIZON NORTHWEST, INC.	)	Docket No. UT-020406 VERIZON'S OPENING BRIEF

VERIZON'S OPENING BRIEF

I. Introduction

In this complaint case, AT&T seeks to reduce Verizon Northwest Inc.'s (Verizon) intrastate switched access charges by almost $40 million per year while ignoring the fact that these charges recover "[a] significant portion of the total cost of operating the local telephone network." (Docket No. UT-970325, *General Order No. R-450* at 4.) This transparent attempt to engage in single-issue ratemaking must be rejected.

As the Commission explained in its access charge rulemaking, incumbent local exchange carriers' (ILECs) access charges "account for almost 20% of total retail revenues in this state," and these charges are inextricably linked to an ILEC's overall profits, which must, by law, be fair, just, reasonable, and sufficient:

> [ILECs'] rates are regulated by the Commission and must be fair, just, reasonable, and sufficient. A decrease in access charges will result in either a decrease in their overall profits (which must remain "sufficient") or an offsetting increase in other rates, or some combination of the two.

(*Id.*)

In the Commission's rulemaking, AT&T ignored the link between access charges and "fair, just, reasonable, and sufficient" ILEC rates. It argued that access charges must be reduced to long run incremental cost (LRIC)-based rates "with little regard or concern for any revenue loss that local companies might incur." (*Id*. at 18) AT&T simply repeats this argument here. The Commission rejected AT&T's argument then, and it must do so now.

Indeed, this Commission "is charged by law with the setting of just, reasonable, and *sufficient* public utility rates," which means that the utility must be allowed to set rates that "will yield to the utility its aggregate allowed revenue requirement." *POWER v. WUTC*, 104 Wn.2d 798, 711 P.2d 319, 324-26 (1985). Here, the undisputed evidence shows that Verizon is not earning its authorized return, and therefore *any* reduction in revenues, let alone the nearly $40 million reduction proposed by AT&T, would result in unlawful, "insufficient" rates. In short, the Commission cannot unilaterally reduce Verizon's access charges in this docket.

Setting aside AT&T's disregard of Verizon's revenue requirement and Constitutional right to just compensation, AT&T makes two arguments why Verizon's access charges should be reduced: first, AT&T argues that intrastate access charges cannot, as a matter of federal and state law, exceed LRIC; second, it argues that Verizon's toll rates fail the Commission's imputation test and that the appropriate remedy is to reduce Verizon's access charges to LRIC.

AT&T is wrong on both counts. AT&T's claim that access charges cannot exceed LRIC under the federal Telecommunications Act of 1996 ("Act")[1] – a claim that AT&T has trotted out elsewhere, and a claim that has been uniformly rejected – ignores the fact that the Act itself expressly *preserves* the current intrastate access charge regime. Likewise, AT&T's state law argument ignores the fact that the Commission's existing access charge rule, WAC 480-120-540,

[1] Pub.L.No. 104-107, 110 Stat. 56 (1996).

which was recently upheld by the Washington Supreme Court, expressly permits access charges to be set above LRIC[2]. Indeed, the Commission's rule creates an interim terminating access charge adder ("the ITAC") that, by definition, is not part of the LRIC of access. AT&T's complaint, therefore, is nothing more than an impermissible collateral attack on the access charge rule. If AT&T thinks the rule should be changed, it should file a petition under WAC 480-09-220 ("Any interested person may petition the commission requesting the promulgation, amendment, or repeal of any rule").

Second, the evidence shows that Verizon's toll rates pass the imputation test. The Commission's imputation test is straightforward: a regulated carrier's toll price floor equals (1) the carrier's imputed cost of access, plus (2) the carrier's LRIC of billing and collection (B&C) and retail/marketing services. This is the very test that AT&T advocated in a prior Commission proceeding, and this is the very test reflected in the Commission's rules. AT&T, however, now wants to change the test so that instead of using Verizon's LRIC for B&C and retail/marketing, it uses the "stand-alone" costs of an unaffiliated inter-exchange carrier (IXC), which AT&T claims are significantly higher than Verizon's costs. AT&T's goal is obvious – it wants to set an artificially high price umbrella for Verizon and other local exchange carrier (LEC) toll providers so that AT&T has fewer competitors in the toll market. Verizon is unaware of any state that has adopted the type of test AT&T proposes, and this Commission should not do so.

AT&T's attempt to rewrite the Commission's imputation test proves that AT&T's imputation claim is simply a pretext to attack the access charge rule. AT&T admitted this at the hearing:

> Q. Dr. Selwyn, let's assume that all of Verizon's toll rates pass imputation, whatever the imputation floor is. You're not

[2] *Wash. Indep. Tel. Ass'n v. Wash. Util. & Transp. Comm'n,* 148 Wn.2d 887, 64 P.3d 606 (2003).

claiming that Verizon's access charges standing alone are unlawful or unjust or unreasonable, are you?

A. I think they are. . . .

Q. So under your testimony, even if no price squeeze exists because the toll rates pass imputation, you still disagree with the level of Verizon's access charges, correct?

A. Yes. (Tr. at 449-50)

Furthermore, assuming, for the sake of argument, that some of Verizon's toll plans do not pass the imputation test, then the proper (and only permissible) remedy is to increase toll rates, not decrease access charges. This is so for three independent reasons:

First, under state law, AT&T can complain only about Verizon's toll rates because AT&T competes only with Verizon's toll services; accordingly, any remedy must be limited to the rates that are the subject of the complaint, i.e., Verizon's toll rates.

Second, AT&T's proposal to reduce access charges rather than raise toll rates is an unlawful collateral attack on the Commission's imputation rule. The access charge rule and the imputation rule go hand-in-hand: the access charge rule allows local carriers to maintain access charges above LRIC, but the imputation rule requires local carriers to impute these charges in setting toll rates. AT&T does not agree with the Commission's imputation policy because AT&T prefers low access charges, but it cannot attack the imputation rule in a complaint case.

Third, as discussed above, Washington law prohibits the Commission from reducing Verizon's earnings in this docket.

For these reasons, and for the reasons set forth below, Verizon requests that the Commission re-affirm its previous findings that Verizon's current access charges are just, reasonable and sufficient, and hold that Verizon's current toll plans pass the imputation test.

Finally, in addition to the issues presented by AT&T's complaint, the Commission asked the parties to address the following questions: (1) what *should* Verizon's access charges be; and (2) how should an access charge reduction be implemented if a reduction is appropriate? As Verizon explained at the evidentiary hearing, Verizon believes its access charges should be restructured to be more economically efficient. Because of the Commission's access charge rule, Verizon's originating access charges are significantly higher than its terminating charges, and both sets of charges are subject to change whenever the Commission establishes new unbundled network element (UNE) rates. Verizon companies operate as ILECs in more than 30 states, and no other state regulates access charges in this manner. For this reason, Verizon does not oppose changes to its access charges as part of a revenue-neutral rate restructuring, and in Section II(F) proposes several ways this restructuring could be accomplished.

II. Discussion

A. What Should Verizon's Access Charges Be, and Why?

Verizon's access charges must remain as they are unless Verizon agrees to change them in the context of revenue-neutral rate rebalancing. Verizon's current charges are the result of longstanding Commission policy and the Commission's access charge rule, and therefore are just and reasonable. Indeed, AT&T's complaint against Verizon is a thinly veiled attempt to reverse almost twenty years of Commission policy.

The Commission established its access charge policy in Docket No. U-85-23, a generic investigation involving all of the state's LECs. There, the Commission set access charges at a level sufficient to avoid what it felt would have been excessive increases in local service rates. The Commission did this by (a) requiring access charges to cover the direct costs of providing access services and (b) generally requiring access charges to recover 25% of the LECs' actual

non-traffic sensitive ("NTS") costs - - mainly loop costs.[3] The Commission has never reopened this docket or otherwise modified its cost allocation and cost recovery policies in any subsequent generic proceeding.

When the Commission implemented its access charge rule in Docket No. UT-970325, it did not reduce the total costs assigned to switched access services under U-85-23; instead, it shifted these costs from terminating to originating access. Specifically, the rule (a) required terminating charges to be no higher than the LEC's current local interconnection rate (or if the LEC does not have such a rate, then the LEC's "total service long-run incremental cost"); (b) established a new interim terminating access charge (ITAC) to recover some of the costs of serving high cost areas, and (c) provided for revenue neutral increases to originating charges to offset the reductions in terminating access revenues. Verizon's access charges comply with this rule. Recently, at Staff's request, Verizon reduced its terminating access charges to reflect Verizon's new local interconnection rate and increased its originating charges on a revenue-neutral basis.[4]

In short, Verizon's current switched access rates comply with the Commission's orders and rules and cannot be changed in this complaint case. If AT&T thinks the cost allocation ordered in Docket U-85-23 needs to be changed, it should file a petition under RCW 80.04.210. If AT&T thinks the access charge rule should be changed, it should file a petition under WAC 480-09-220. And if AT&T thinks the access charge rule is unlawful, it may challenge the rule in

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[3] *See Seventeenth Supplemental Order* (Sept. 22, 1986); *Eighteenth Supplemental Order* (Dec. 30, 1986). The Commission ordered a 16.95% allocation for Pacific Northwest Bell (now Qwest), and a 25% allocation for all other LECs.

[4] Docket No. UT-030569. These new charges took effect May 24, 2003.

court under RCW 80.04.160 and Chapter 5 of RCW Title 34. What AT&T *cannot* do is attack the Commission's access charge rule and long-standing polices in this complaint case.

With this background, the following sections address AT&T's and Staff's specific proposals to reduce Verizon's access charges.

1. Verizon's Terminating Charges (including the ITAC)

Verizon's current terminating charge, expressed on a composite per minute-of-use (MOU) basis, is approximately ****** **(Confidential)**.[5] This charge reflects the Commission's access charge rule; specifically, it reflects (a) Verizon's LRIC-based rates for local interconnection plus (b) Verizon's current ITAC of ****** **(Confidential)**. Given that Verizon's terminating charges are already set at LRIC-based rates except for the ITAC, the only issues are whether the ITAC itself is unlawful, as AT&T alleges, or whether Verizon's ITAC should be reduced, as Staff alleges.

AT&T argues that Verizon's ITAC, as well as the ITAC of every other carrier in Washington, is unlawful and must be eliminated because the costs it recovers are not part of the LRIC of providing switched access service. AT&T makes this same argument for all other access charges. Given that AT&T's argument applies to all access charges, not just the ITAC, it is addressed in subsection II(A)(2), below.[6]

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[5] The individual charges that make up the composite charges are shown in Ex. T-105 at 7. The charges shown on this attachment were in effect until May 24, 2003. At Staff's request, these charges have been slightly modified effective May 24, 2003 to reflect the Commission's access charge rule. Specifically, Verizon's terminating end-office switching rate has been reduced from approximately $0.002 to $0.0014 to reflect the new local interconnection rate, and Verizon's originating charges have been increased on a revenue-neutral basis.

[6] As discussed below, however, AT&T has waived its claim that the ITAC must be eliminated. Nevertheless, this brief explains why AT&T's arguments regarding "above cost" access charges are wrong.

Turning to Staff's argument, Staff believes that Verizon's current ITAC should be updated to reflect (a) changes in access line counts, (b) changes in total minutes of use, and (c) an additional $21 million per year in "federal high cost support" that Verizon allegedly has been receiving since its current ITAC was established. According to Staff, this updated calculation produces a new ITAC of $0.0188679 per MOU, which equates to an $8.6 million reduction in Verizon's annual terminating access charge revenues. (Ex. T-100 at 2; Ex. 104C)

As a threshold matter, Staff's claim is procedurally improper because it goes beyond the scope of AT&T's complaint. Specifically, AT&T did not allege that Verizon's ITAC violates the Commission's access charge rule,[7] and Staff cannot amend AT&T's complaint by adding such a claim in its testimony. In any event, Staff is wrong on the facts. Properly updated, Verizon's ITAC should be *increased*, which, under the access charge rule, would require a corresponding decrease in originating charges.

Staff's most significant adjustment is the one that assumes Verizon receives an additional $21 million in federal high-cost support. According to Staff, Verizon will "double recover" this $21 million unless the Commission reduces Verizon's ITAC. Staff is wrong. The $21 million at issue is not additional federal high-cost support; rather, it is a portion of pre-existing interstate access revenue now called "interstate access support" (IAS), which was created in May 2000 under the FCC's *CALLS Order*.[8] There, the FCC restructured interstate access charges by (a) reducing the per MOU charges assessed upon IXCs and (b) offsetting these reductions with the IAS and other forms of support. Verizon did not receive any additional federal money.

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[7] *See, e.g.*, WAC 480-09-420(5)(b) (complaint must set forth ground of complaint and relief requested).

[8] *In the Matter of Access Charge Reform Price Cap Performance Review for Local Exchange Carriers Low-Volume Long Distance Users Federal-State Joint Board On Universal Service.* CC Docket Nos. 96-262; 94-1; 99-249; 96-45. Sixth Report and Order in CC Docket Nos. 96-262 and 94-1 Report and Order in CC Docket No. 99-249 Eleventh Report and Order in CC Docket No. 96-45. Released: May 31, 2000 ("*CALLS Order*").

At the hearing, Staff witness Tim Zawislak claimed that Verizon received additional federal support as a result of the *CALLS Order*, but later acknowledged that Verizon did *not* receive additional support:

> Q. [Y]ou say that since Verizon's current ITAC was established, Verizon has received additional federal USF support under the FCC's CALLS Order, [and] because of that additional explicit federal support, Verizon's ITAC should be reduced. Is that correct?
>
> A. That's correct . . . . (Tr. at 520, lines 15-21)
>
> * * *
>
> Q. Now, Mr. Zawislak, you're familiar generally with the FCC's CALLS order?
>
> A. Yes.
>
> Q. And is it fair to say, Mr. Zawislak, that in that order the FCC reduced the interstate access charges of carriers, thereby as the FCC put it removing implicit subsidies, and offset that with explicit federal support such as putting more money in a USF fund or allowing carriers to charge a higher subscriber line charge and other mechanisms. Is that a fair summary of the order?
>
> A. I think so. It was a revenue neutral approach.
>
> Q. Thank you. So given that, you're not claiming, are you, that Verizon Northwest received any additional incremental revenues from the FCC as a result of the CALLS order, correct?
>
> A. Correct. (Tr. at 521, line 16, through 522, line 7)

Even though Staff acknowledges that Verizon did not receive an additional $21 million from the FCC, it continues to believe that Verizon receives additional federal support that is not

reflected in Verizon's current ITAC. Staff is wrong – it confuses federal interstate access support, which was created under the *CALLS Order*, with federal high-cost support.[9]

Staff's confusion can be cleared up by explaining how the ITAC was calculated and by demonstrating that, as matter of simple arithmetic, Verizon's current ITAC already reflects the $21 million in IAS that Verizon receives.

A carrier's ITAC equals:

> (1) the monthly cost of providing basic service as calculated by the Commission's USF model; *minus*
>
> (2) the revenue benchmark of $31 for residential customers and $51 for business customers; *minus*
>
> (2) federal high-cost support, if any, for those exchanges where the monthly cost (1) is higher than the revenue benchmark (2).

Thus, for example, if the cost of providing basic residential service in a particular area is $80 per month then the ITAC would recover $49 per month ($80 *minus* $31) less any federal high-cost support. The total costs to be collected by the ITAC are then converted to a "per MOU" charge for each company.

As Verizon witness Terry Dye explained at the hearing, and as Staff witness Tim Zawislak acknowledged, the revenue benchmark includes revenues generated by all interstate services, including interstate access charges.[10] In fact, Mr. Zawislak provided an illustration of

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[9] The FCC explained this difference in its order: "In contrast to the Commission's existing high-cost support mechanism for rural and non-rural carriers, which provide support to enable states to ensure reasonable comparability of *intrastate* rates, the purpose of the new federal [IAS] is to provide explicit support to replace the implicit universal service support in interstate access charges." *CALLS Order* at para. 195; Ex. T-230-R at 7.

[10] The reason *interstate* revenues are included in a revenue benchmark used to calculate *intrastate* support (i.e., the ITAC) is because the cost of providing service, as calculated by the Commission's cost model, is "unseparated." Approximately 25% of a regulated carrier's loop costs are allocated to the interstate jurisdiction under the FCC's Separations Rules. Because the Commission's cost model does not separate these costs when calculating the cost of basic service, the revenue benchmark includes interstate revenues and interstate high-cost support. In this way, interstate loop *costs* (25% of which are allocated to the interstate jurisdiction) are accounted for by the interstate *revenues* included in the revenue benchmark.

how the revenue benchmark was calculated in Exhibit 120. Table One uses Staff's illustration to show the *pre*-CALLS calculation of the $31 residential benchmark *without* the IAS compared to the *post*-CALLS calculation *with* the IAS:

Table One
Revenue Benchmark

Pre-CALLS		**Post-CALLS**	
Local	$15.00	Local	$15.00
Features	$1.00	Features	$1.00
Toll/access	*$7.50*	Toll/access	*$5.50*
		Interstate access support	*$2.00*
SLC[11]	$6.50	SLC	$6.50
DSL/line sharing	$1.00	DSL/line sharing	$1.00
Total (benchmark)	**$31.00**	**Total (benchmark)**	**$31.00**

As shown in Mr. Zawislak's pre-CALLS illustration, the $31 revenue benchmark includes $7.50 of toll/access revenues, which includes all intrastate and *interstate* access charge revenues. As Mr. Zawislak admitted, the FCC's *CALLS Order* simply rebalanced interstate access charges on a revenue-neutral basis. Thus, using Mr. Zawislak's illustration, if the CALLS Order reduced interstate access charges by $2.00 and offset that reduction with $2.00 from the new IAS, the total $7.50 generated from toll and access services remain the same. In other words, there is no "new money"; the revenues provided by the federal IAS are already accounted for in the revenue benchmark and thus are already reflected in Verizon's current ITAC.

Once Staff's error is corrected, Verizon's ITAC must *increase*, not decrease. Verizon witness Terry Dye recalculated the ITAC using Mr. Zawislak's changes in access lines and usage and backing out the erroneous $21 million. This revised calculation yields an ITAC of $0.04742 per MOU. (Ex. T-230-R at 8; Ex. 232C) To be consistent with the Commission's access charge

[11] The pre-CALLS residential SLC was $3.50, not the $6.50 used in Mr. Zawislak's illustration, but this mistake does not affect the end result.

rule, this increase in the ITAC would be offset with a revenue-neutral decrease in Verizon's originating access charges.[12] As discussed below in Section II(B), increasing the ITAC and decreasing originating access will result in a lower price floor for Verizon's toll services. Consequently, Verizon's toll prices will pass the Commission's imputation test by an even greater margin than they do today.

2. Verizon's Originating Charges

Verizon's current originating access charge, expressed on a composite per MOU basis, is approximately ****** **(Confidential)**.[13] This charge was established under the Commission's access charge rule, WAC 480-120-540, the stated purpose of which was to "conform Washington's telecommunications access charge system with state and federal laws encouraging competition."[14]

Staff, however, proposes to reduce Verizon's access charges to the level of Qwest's charges, and AT&T proposes to reduce Verizon's charges to either (a) the LRIC-based rates for local interconnection,[15] or (b) Verizon's interstate access charge levels. The revenue effects of their proposals are shown in Table Two:

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[12] Verizon is not proposing to change its universal service costs and recover *additional* revenues through its access charges, as Mr. Zawislak suggests in his rebuttal testimony (Ex. T-105 at 16) where he criticizes the long run incremental cost studies sponsored by Verizon witness David Tucek. Verizon proffered these studies to show that the LRIC of basic service includes significant loop costs; these LRIC studies were *not* proffered to change Verizon's USF requirement. In fact, Mr. Tucek's studies understate the LRIC of basic service because they do not reflect common costs, nor do they reflect Verizon's actual costs as represented by Verizon's revenue requirement.

[13] The individual charges that make up the composite charge are shown on Ex. T-105 at 7. Verizon's originating charges are deaveraged; its per MOU rate for Zone 1 is lower than its per MOU rate for Zones 2 and 3. On average, Verizon's statewide composite originating charge is approximately ****** **(Confidential)** per MOU.

[14] Docket No. UT-970325, *General Order No. R-450* at 1.

[15] AT&T's proposed LRIC-based rate is ****** **(Confidential)** per MOU. (Ex. 6C at 1) In calculating this rate, however, AT&T used the wrong tandem switching rate. (Tr. at 463) AT&T also used a UNE-based rate for local switching instead of Verizon's proposed TSLRIC rate, which is about ****** **(Confidential)** per MOU for terminating access and ****** **(Confidential)** per MOU for originating access. When these changes are made, the LRIC-based rate for switching increase to about ************************************** **(Confidential)** for

Table Two
Access Charge Proposals – Revenue Effect

Type of Charge	Current Revenue (revenue loss)
Verizon's current charges	$61.8 million
Qwest's charges	($32.0 million)
LRIC-based charges	($38.4 million)
Verizon's interstate charge	($34.9 million)
Sources	Ex. 6C; Ex. T-130 at 7.

In short, Staff and AT&T propose to reduce Verizon's total access charge revenues between approximately $32 to $40 million per year.[16]

These proposals must be rejected for the following reasons:

First, as a threshold matter, AT&T's complaint must be dismissed because it seeks single-issue ratemaking. In 1997, the Commission dismissed a virtually identical complaint brought by MCI, stating, "the Commission generally will not engage in single-issue or 'piecemeal' ratemaking."[17] As the Commission explained,

> The ultimate determination to be made by the Commission in a rate proceeding is whether the proposed rates and charges are fair, just, reasonable, and sufficient. RCW 80.36.140. The Commission has consistently held that these questions are resolved by a comprehensive review of the company's rate base and

both ends.

[16] Staff's direct testimony is confusing – it recommends that Verizon's access charges be reduced by $32 million, which includes Staff's estimate of a $10 million reduction in the ITAC. But Staff goes on to state that "this value [the $32 million] assumes Verizon does not increase originating rates to offset the universal service rate realignment proposed by Staff; otherwise the target amount would be $42 million." (Ex. T-130 at 7) Verizon assumes Staff is proposing a *net* reductions of $32 million. AT&T's testimony also is confusing. In its complaint (para. 34), AT&T states that the ITAC is unlawful; however, in Dr. Sewlyn's rebuttal testimony, AT&T proposes to reduce Verizon's access charges by, at most, $38.4 million, which does not include *any* reductions in the ITAC. (Ex. T-4C-R at 14, Table 1) In fact, the exhibit to Dr. Selwyn's rebuttal testimony that calculates Verizon's revenue reductions leaves the current ITAC revenues unchanged. (Ex. 6C) Thus, AT&T has abandoned its claim to eliminate Verizon's ITAC. AT&T's abandonment of its claim confirms Verizon's position – even AT&T does not believe its own argument that "above cost" access charges are inherently unlawful.

[17] MCI Telecommunications Corp. v. GTE Northwest, Docket No. UT-970653, *Second Supplemental Order Dismissing Complaint* at 5-6 (Oct. 22, 1997).

> operating expenses, determining a proper rate of return, and allocating rate changes equitably among ratepayers. Changes to access rates could have a substantial effect on the company's overall results of operations and therefore should not be addressed in a single-issue rate proceeding.[18]

The MCI case is directly on point: here, as there, an IXC is asking the Commission to reduce Verizon's access rates; here, as there, the IXC's request constitutes single-issue ratemaking, and therefore the complaint should be dismissed.[19]

Verizon raised this issue in its first Motion to Dismiss (See Attachment A for copy of Verizon's motion), and although the Commission denied Verizon's motion in its *Second Supplemental Order*, it explained, in a one-paragraph decision, that "there are factual disputes relevant to the legal issues" and these disputes "can only be determined after a full record is developed."[20] The record has now been fully developed, and it shows that AT&T's complaint is, in fact, an improper attempt to engage in single-issue ratemaking.

Second, AT&T's complaint must be dismissed because it fails to state a claim under state law. Specifically, AT&T can complain only about Verizon's toll rates because AT&T competes only with Verizon's toll services; accordingly, any remedy must be limited to the rates that are the subject of the complaint, i.e., Verizon's toll rates, not Verizon's access charges. Verizon raised this issue, too, in its first Motion to Dismiss. Now that the record has been fully developed as the Commission desired in its *Second Supplemental Order*, Verizon renews its motion here and urges the Commission to grant it.

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[18] *Id*.

[19] For this same reason, the Commission has not allowed competitors to initiate a full rate proceeding by filing an access charge complaint, holding that such an outcome "is not intended by the complaint statute." Docket No. UT-970653, *Second Supplemental Order* at 6. The Commission must follow that same policy here. If AT&T, Staff, Public Counsel, or any other party believes that Verizon (or any other ILEC) is overearning, it should ask the Commission to initiate a formal or informal earnings review.

[20] *Id*. at 8, para. 11.

Third, AT&T's and Staff's proposals to reduce Verizon's access charges are an unlawful collateral attack upon the Commission's access charge rule. No party disputes the fact that Verizon's current access charges comply with the Commission's rule. This rule requires terminating access charges to be reduced to LRIC-based local interconnection rates (plus the ITAC), but allows these reductions to be offset by revenue-neutral increases in originating charges. As noted, the stated purpose of the rule was to "conform Washington's telecommunications access charge system with state and federal laws encouraging competition."[21] Staff and AT&T, however, argue that Verizon's access charges do *not* comply with state and federal laws encouraging competition. Clearly, their arguments are nothing more than an attack upon the Commission's rule. This issue is discussed in Section II(E), "What is the Impact of WAC 480-120-540 or Other Commission Orders?"

Fourth, AT&T's claim that Verizon's toll rates do not pass the Commission's imputation test and therefore Verizon's access charges must be reduced is an unlawful collateral attack on the Commission's imputation rule, WAC 480-80-204(6). The access charge rule and the imputation rule go hand-in-hand: the access charge rule allows local carriers to maintain access charges above LRIC, but the imputation rule requires local carriers to impute these charges in setting toll rates. AT&T does not agree with the Commission's imputation policy because AT&T prefers low access charges. But its remedy is to file a petition to change the Commission's rules, not to attack those rules in a complaint case. This issue is discussed in Section II (B), "Imputation Issues."

Fifth, even assuming AT&T's complaint and Staff's proposal are not unlawful collateral attacks on the access charge rule or imputation rule, Verizon's access charges cannot be reduced

[21] Docket No. UT-970325, *General Order No. R-450* at 1.

without simultaneous revenue-neutral increases in other Verizon rates. The Commission itself explained why this is so in its access charge rulemaking (Docket No. UT-970325). There, the Commission recognized that access charges are inextricably linked to a regulated carrier's overall profits, which must, by law, be fair, just, reasonable, and sufficient. This issue is discussed in Section II(D), "Verizon Earnings Issues," which also explains that (1) AT&T has the burden of proving that Verizon is "overearning" and AT&T has failed to meet its burden, but (2) even assuming Verizon has the burden of proof on the earnings issue, the evidence proves beyond any doubt that Verizon is *not* overearning.

In sum, Verizon's access charges cannot be reduced in this complaint proceeding unless Verizon agrees to the reductions. As Verizon explained at the hearing, Verizon does not object to restructuring its rates. As a result of the Commission's access charge rule, Verizon's originating access charges are higher than its terminating access charges, and both sets of charges are subject to change whenever the Commission establishes UNE rates. When the Commission was developing its access charge rule, Verizon (formerly GTE Northwest) explained that the revenue shift from terminating to originating access was not economically efficient, but the Commission rejected this argument. Verizon does not object to reducing its originating access charges; *provided, however*, that Verizon is permitted to increase other rates – notably, basic residential service rates – on a revenue-neutral basis.

The Commission made clear in its *Fifth Supplemental Order* that it would not entertain rate rebalancing proposals in this phase of the docket, and therefore Verizon has not presented one. Instead, Verizon proposes a *procedure* for restructuring its rates in Section II(F), "How Should an Access Charge Reduction Be Implemented, if the Commission Decides that Such a Reduction is Appropriate?"

B. Imputation Issues

Under the Commission's imputation test, Verizon's toll rates must be higher than Verizon's toll price floor, which equals (1) Verizon's imputed cost of access plus (2) Verizon's LRIC of providing toll service, i.e., its LRIC of billing and collection (B&C) and retailing/marketing. This test is set forth in WAC 480-80-204(6):

> The rates, charges, and prices of services classified as competitive under RCW 80.36.330 must cover the cost of providing the service. Costs must be determined using a long-run incremental cost analysis, including as part of the incremental cost, the price charged by the offering company to other telecommunications companies for any essential function used to provide the service, or any other commission-approved cost method.

The rates for each Verizon intraLATA toll plan, expressed on a per MOU basis, are set forth in Exhibits 110C and 231C, and are reproduced in Table Three:

Table Three
Total Price Per Plan (per minute)

Plan	Total Price (per minute)
Message Toll Service (all customers)	****** **(Confidential)**
Resale (all customers)	****** **(Confidential)**
Easy Savings Plan – Residence	****** **(Confidential)**
Sensible Minute Plan – Residence	****** **(Confidential)**
Value Cents Plan – Residence	****** **(Confidential)**
Easy Savings Plan – Business (monthly plan)	****** **(Confidential)**
Easy Savings Plan – Business (1-year term)	****** **(Confidential)**
Easy Savings Plan – Business (3-year term)	****** **(Confidential)**
Easy Savings Flat Plan – Business	****** **(Confidential)**
Value Cents – Business	****** **(Confidential)**
Weighted Average Price for All Plans	****** **(Confidential)**

As illustrated, Verizon's toll rates range from *********** **(Confidential)** per minute, with a weighted average of about ***** **(Confidential)**. As Verizon established in its testimony, the current price floor is ****** **(Confidential)** per minute; therefore, every Verizon toll plan

passes imputation. Staff reviewed Verizon's price floor and made only one adjustment – it applied a different conversion factor, which increased the floor to ****** **(Confidential)** per minute. As discussed below, Staff's adjustment is wrong, but even if it was not, only two of Verizon's toll plans fail imputation by a *********************** **(Confidential)** per minute. In contrast, AT&T's proposed price floor is $0.1444 per minute. The principal difference between Verizon's calculation and AT&T's calculation is that AT&T does not use Verizon's LRIC of B&C and retailing/marketing as required by the Commission's rule; instead, it relies on estimates of IXCs' stand-alone costs.

Table Four summarizes each party's price floor and compares them to the Commission-approved price floor from Docket No. UT-970767:

Table Four
Price Floor Comparison

Toll Floor Component	**Approved Floor**	**Verizon Proposal**	**Staff Adjustment**	**AT&T Proposal**
Cost of Access	****** **(Conf.)**	****** **(Conf.)**	****** **(Conf.)**	****** **(Conf.)**
B&C	****** **(Conf.)**	****** **(Conf.)**	****** **(Conf.)**	****** **(Conf.)**
Retailing / Marketing	****** **(Conf.)**	****** **(Conf.)**	****** **(Conf.)**	****** **(Conf.)**
Total	****** **(Conf.)**	****** **(Conf.)**	****** **(Conf.)**	****** **(Conf.)**
Sources (Exhibits)	T-106C at 9	231C	T-106C at 10	T-3-R at 26

As this table illustrates, Verizon's proposed toll floor is **************** **(Confidential)** than the floor the Commission approved in Docket No. UT-970767. This lower floor is due to the fact that Verizon's access charges have significantly decreased over time, and therefore the imputed cost of access has declined. This table also shows that Verizon has been very conservative in its current calculations of B&C and retailing/marketing costs. In fact,

Verizon's revised cost for B&C is almost double the cost approved by the Commission, and Verizon's revised cost for retailing/marketing is several hundred times higher than the Commission-approved cost.

Finally, this table illustrates that AT&T's proposal is, on its face, inconsistent with the Commission's imputation test. Indeed, if the Commission had agreed with AT&T's methodology, it would have rejected almost every Verizon toll plan it expressly approved in Docket No. UT-970767.

The reason AT&T's proposed floor is so high is simple: AT&T disagrees with the imputation rule's use of LRIC to establish a price floor. Although AT&T's pre-filed testimony attempts to sidestep this fact, AT&T's witness admitted it at the hearing:

> Q. Is it your position, Dr. Selwyn, that in establishing a price floor for Verizon Northwest toll service, the Commission should not use Verizon's long run incremental cost of marketing but should instead use an estimate of interexchange carriers' cost?
>
> A. Yes, for several reasons. . . . (Tr. at 455, line 23, through 456, line 3)

Dr. Selwyn then goes on to explain that AT&T dislikes the use of LRIC because it results in a lower price floor, and he applies this same reasoning in calculating B&C costs. (Tr. at 460, line 10)

AT&T's disregard of Verizon's LRIC conflicts not only with the Commission's rule, but also with AT&T's testimony in a prior proceeding. In the 1995 U S WEST rate case (Docket No. UT-950200), AT&T filed the testimony of Patricia A. Parker, a manager in AT&T's "Access Management" department. She testified U S WEST's individual price floors "must include the imputed price [of access] plus all remaining *TSLRIC inputs* such as advertising and

sales compensation."[22] Dr. Selwyn does not explain the reason for AT&T's reversal of its position. In any event, AT&T bears the burden of proving that Verizon's toll rates fail the Commission's imputation test, and AT&T has failed to meet its burden by ignoring the imputation rule.

Verizon is the *only* party that has presented a price floor calculation that complies with the Commission's rule. The floor Verizon proposes here is only slightly modified from the floor it provided Staff when Verizon filed its current toll rates. At that time, Staff reviewed Verizon's filing and was satisfied that Verizon's proposed (now current) toll rates passed the imputation test. Indeed, Staff has an independent obligation to ensure that any proposed Verizon toll rate passes the imputation test. The Commission established this obligation when it classified Verizon's intraLATA toll as competitive in Docket No. UT-970767:

> Any [future] rate changes must continue to meet the imputation analysis here adopted. Commission Staff must review price list changes to ensure that GTE's prices cover costs consistent with that imputation test.[23]

Staff fulfilled its obligation and, consequently, Verizon's current toll rates pass the imputation test. In fact, Staff has acknowledged that *every* toll plan Verizon has filed in the past (except for Toll-Pac, which was discontinued) has satisfied the Commission's imputation test. (Ex. 118) Of course, under AT&T's analysis, every toll plan Verizon filed in the past, and perhaps the toll plans of many other carriers, would have failed the imputation test.

Finally, Verizon's price floor of ****** **(Confidential)** is overstated because it is based on Verizon's current ITAC. If Verizon's ITAC is increased and Verizon's originating access charges are decreased on a revenue-neutral basis, then Verizon's price floor will *decrease*.

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[22] Direct Testimony of P.A. Parker at 3-4 (emphasis added).

[23] *First Supplemental Order* at 13.

(Verizon originates 100% of all its toll calls but terminates less than 100% of its calls. Thus, Verizon's weighted average imputed cost of access will always decrease when its originating charges are decreased.)

The following subsections address each component of the price floor calculation. They explain why Staff's adjustment to Verizon's access cost calculation is wrong, and they further explain why AT&T's price floor calculation is unlawful.

1. Access Cost (including the Conversion Factor)

a. *AT&T's calculations*

As shown in Table Three, AT&T's cost of access ****** **(Confidential)** is slightly higher than Verizon's ****** **(Confidential)**. AT&T's cost differs for two reasons. First, as Dr. Selwyn acknowledged, AT&T's calculation does not reflect the updated traffic distribution figures. (Tr. at 455, lines 1-13) Second, AT&T claims that Verizon should not have used a mix of tandem switched transport and direct trunked transport rate elements to calculate its cost of access because Verizon uses only tandem switched transport when handling its own intraLATA toll calls (Ex. T-3-R at 18) This position, however, conflicts with the position Dr. Selwyn took in his direct testimony. There, he stated that when IXCs provide toll service, they must pay Verizon for several interoffice transport and switching functions; but when Verizon provides toll service, the route may involve fewer transport and switching functions, resulting in lower costs. According to Dr. Selwyn, "[t]his is why Verizon Northwest is required to impute the access charge that its competitors pay rather than its own costs for the equivalent functionality in determining whether its retail price satisfies the imputation price floor" (Ex. T-1 at 18-19, n.27)

Verizon did precisely what Dr. Selwyn advocated in his direct testimony: it calculated the transport costs IXCs would incur with a mix of tandem switched and direct trunked transport. It is this very calculation Dr. Selwyn now attacks in his rebuttal testimony. The bottom line is that Dr. Selwyn's rebuttal testimony is nothing more than a self-serving reversal of the position he took in his direct testimony.

When AT&T's calculations are corrected for these two errors, its cost of access is equal to Verizon's calculation, ******** (Confidential)**. (Exs. 108C and 111C)

b. *Staff's calculation*

Staff proposes one adjustment to Verizon's cost of access: it adjusts Verizon's conversion factor, which converts access minutes to toll minutes. Staff's adjustment appears to be based on Staff's belief that Verizon's factor does not take into account "non-conversation" time associated with access minutes.

By way of background, in order to impute access charges to toll rates, one must convert an access minute-of-use (MOU) to a toll minute. An access MOU is not the same as a toll minute for two reasons: (1) IXCs pay access charges based on network usage, which include "non-conversation" time associated with unanswered attempts, whereas toll minutes are billed based on "conversation" minutes; and (2) IXCs do not pay for access once the call is disconnected, but toll customers continue to pay toll because toll charges are "rounded up" for business and residential customers. The first adjustment *increases* the number of access MOUs relative to toll minutes, and the second adjustment *decreases* the number of access MOUs relative to the number of toll minutes. A proper conversion factor must reflect both adjustments.

Staff claims that Verizon's conversion factor is wrong because it fails to properly account for "non-conversation" minutes that are included in access charges, and Staff proposes an

adjustment that raises Verizon's price floor by ****** **(Confidential)** per minute. (Ex. T-106C at 10) But Staff is mistaken – Verizon's conversion factor properly reflects non-conversation time. As discussed, the access-to-toll conversion factor must account for *two* differences between access MOUs and toll minute, not just one. The first is "non-conversation" usage, which is billed as switched access MOUs but not billed as toll; the second is the fact that toll minutes are "rounded up" and the end user is billed for time for which IXCs are *not* billed. Verizon's conversion factor reflects both differences, and therefore Staff's proposed adjustment is wrong. Once Staff's error is corrected, Staff's cost of access is equal to the cost Verizon calculated.

2. Billing and Collection Costs

Staff does not propose any adjustment to Verizon's B&C costs. AT&T, however, proposes to calculate B&C costs using IXC "stand alone" costs rather than Verizon's LRIC. AT&T's witness, Dr. Selwyn, argues that the use of incremental costs is inappropriate and that the "correct policy should be that 100% of the gains from joint production of a regulated and non-regulated service should inure to the regulated service" (Ex. T-3-R at 19-20).[24]

AT&T's proposal ignores the Commission's imputation rule, which requires the use of incremental costs. Staff witness Tim Zawislak explained this point in his rebuttal testimony at page 18:

> To the extent any input also has been classified as competitive (such as B&C) it may be imputed at total service long run incremental cost ("TSLRIC"). To the extent that any input has not been classified as competitive (such as tariffed carrier access charges) they must be imputed at tariffed rates. The Commission

[24] Dr. Selwyn himself contradicts this position. For example, on page 34 of Ex. T-1, he recognizes that the appropriate standard is the incremental cost standard: "The Commission has repeatedly stated that since B&C are competitive services, it is appropriate to impute the Long Run Incremental Cost (LRIC) rather than tariffed rates." He then proceeds to ignore this principle.

> has recently clarified this in its "Tariff, Price List, and Contract," rulemaking in Docket UT-991301, when it adopted WAC 480-80-204(6) . . . .

At the hearing, Mr. Zawislak re-affirmed this principle, stating that "based on current Commission precedent," Verizon's price floor should be calculated using Verizon's LRIC of billing and collection and retailing/marketing. (Tr. at 536, lines 18-25)

In short, Dr. Selwyn is attempting to re-write the Commission's price floor policy and imputation test as embodied in a rule. To do this, however, AT&T must petition for a rulemaking change under the appropriate Commission rule (WAC 480-09-220) and the Washington Administrative Procedure Act (RCW 34.05.330); it cannot change the rule in this proceeding.

Furthermore, Dr. Selwyn's claim that 100% of the "gains from joint production of a regulated and non-regulated service" should "inure to the regulated service" is wrong. Dr. Selwyn appears to believe that Verizon does not allocate sufficient B&C costs to its "unregulated" services, and therefore consumers are harmed. He is incorrect: Verizon allocates regulated and unregulated B&C costs in accord with the FCC's rules (Part 64). If Dr. Selwyn disagrees with these rules, he should talk to the FCC. Also, Dr. Selwyn appears to believe that Verizon's intraLATA toll services are "unregulated." Here, too, he is wrong: Verizon's local services *and* intraLATA toll services are, in fact, regulated; indeed, when the Washington Utilities and Transportation Commission (WUTC) examines Verizon's earnings, it includes the costs and revenues associated with intraLATA toll. Given this, his "cost-shifting" argument – Verizon is "harming consumers" by shifting most of its B&C costs to "regulated" services – is meritless.

Not only does Dr. Selwyn use the wrong methodology to calculate B&C costs, his calculation based on that methodology also is wrong. He calculated his $0.0155 per minute cost by dividing $1.15 by 74 minutes of use. The $1.15 is the monthly "per account" price Verizon New York charges its affiliate, Verizon Long Distance (VLD), for B&C activities. The 74 minutes is the average time residential customers spent making interLATA toll calls in 2000, as reflected in Table 15.2 of the FCC's *Trends in Telephone Service Report* dated May 2002.[25]

Both of these figures are incorrect. First, Verizon Northwest charges VLD $1.10 per account (excluding discounts), not $1.15. (Ex. 217) Second, Dr. Selwyn should have used the average minutes for *all* toll calls, not just inter-LATA calls, because Verizon's affiliates provide all types of toll calls. As shown in Table 15.2 of the FCC's *Trends Report*, the total toll minutes for an average residential customer in 2000 was 116, not 74. When Dr. Selwyn's errors are corrected, the B&C cost, using Dr. Selwyn's own methodology, is $0.00948 per MOU, significantly lower than his proposed cost of $0.0155. But even this corrected figure is overstated because it ignores any volume discounts VLD receives, which are set forth in the Verizon-VLD B&C contract, and because it excludes any analysis of *business* customers, which would be expected to have higher toll usage than residence customers.

Most importantly, however, Dr. Selwyn's calculation is not based on Verizon's long run incremental *cost*, which is what the Commission's imputation rule requires; instead, it is based on the *price* Verizon charges its affiliates. This price is regulated: under FCC rules, this price must be the *higher of* fair market value or book cost. Accordingly, this price is irrelevant to the calculation of a toll price floor.

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[25] http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/trend502.pdf

Finally, at the hearing, AT&T criticized Verizon's B&C cost because the cost study was prepared in 1998. Verizon witness David Tucek explained, however, that this was "the same study we used in a compliance filing in a UNE docket." (Tr. at 761, lines 12-13) Mr. Tucek also explained that Verizon's cost study was, in fact, an *incremental* cost study, i.e., it calculated the incremental costs Verizon incurs in providing toll service, not "stand alone" costs. (Tr. at 765) Futhermore, Mr. Tucek explained that Verizon "has been very conservative in [its] use of the billing and collection inputs in [its] imputation study," and that Verizon probably overstated its costs. (Tr. at 766) He explained that approximately 45% of B&C costs relates to data processing or other computer functions dealing with the collection and measurement of usage data, and "[c]ertainly since 1997 the cost of computing power has gone down." (Tr. at 773, lines 10-19) He concluded that if Verizon's B&C costs were updated, they would be lower, proving once again that Verizon's cost calculations are very conservative. (Tr. 773)

3. <u>Retailing/Marketing Costs</u>

Staff does not propose any adjustments to Verizon's retailing/marketing cost. AT&T, however, claims that Verizon's cost is understated because Verizon uses LRIC. In lieu of Verizon's LRIC, Dr. Selwyn proposes to use a cost of $0.03 per MOU, which he claims is supported by (a) a Verizon filing in an FCC proceeding, (b) a recent *New York Times* article, and (c) a stock analyst's report that suggests the total average annual acquisition cost of a long-distance customer is between $300 and $600 per year.

Dr. Selwyn is wrong on all counts. First, his retail/marketing cost calculations, like his B&C cost calculations, ignore Verizon's LRIC, and therefore must be rejected for the reasons discussed above.

Second, the Verizon filing in the FCC's *Special Access* proceeding[26] -- an affidavit filed by Drs. William E. Taylor and Alfred E. Kahn – does not support his use of a $0.03 retailing/marketing cost for Verizon in this proceeding. The Taylor-Kahn affidavit is quite clear: it presents an estimate of retailing and marketing costs for IXCs that provide intraLATA toll, interLATA toll and interstate toll services, and that estimate is based on nationwide-average data. Here, the relevant B&C costs are Verizon's incremental costs to provide intraLATA toll service in Washington. The Taylor-Kahn estimate is therefore irrelevant. Furthermore, the very page of the Taylor-Kahn affidavit that Dr. Selwyn believes supports his position makes clear that the authors' cost estimates "are obviously averages and *vary a great deal* across jurisdictions, times of day and technologies."[27]

Third, the *New York Times* article that Dr. Selwyn mentions also is irrelevant. That article sets forth an investment analyst's estimate of access and non-access costs based on information purportedly supplied by IXC "industry contacts." These cost estimates appear to be based on nationwide-average data of selected (although unidentified) IXCs that provide, among other things, interstate toll services. The analyst's specific cost estimates are as follows:

access charge (one-way)	$.0125
outside plant upgrade	$.0100
outside plant maintenance	$.0175
switch software upgrade	$.0100
billing & customer service	$.0050
Total cost/minute	**$.0550**

According to Dr. Selwyn, this estimate supports his use of $0.03 for Verizon's retail/marketing costs. But the only cost estimate that appears to be even remotely related to

[26] *In the Matter of AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, RM No. 10593. Declaration of Alfred E. Kahn and William E. Taylor On Behalf of BellSouth Corporation, Qwest Corporation, SBC Communications, Inc., and Verizon.

[27] *Id*. at 11, n. 22 (emphasis added).

retail/marketing costs is the $0.0050 estimate for "billing & customer service." This estimate is 1/6th of Dr. Selwyn's figure. And again, all of the analyst's estimates appear to reflect the nationwide-average costs of companies that provide much more than just intraLATA toll service, and therefore these estimates are irrelevant. The record does not reflect precisely what these estimates include because Dr. Selwyn did not bother to call the analyst or conduct any independent research to determine the nature of the estimates.[28]

Fourth, Dr. Selwyn's $300-$600 figure regarding customer acquisition costs is based solely on a stock analyst's report that spans all of three pages and that fails to explain where the figure comes from. In fact, the report itself has nothing to do with customer acquisition costs; rather, it focuses on customer churn. The $300-$600 figure is set forth in the opening paragraph of the report as a prelude to why customer churn is important. Here, too, Dr. Selwyn did not bother to contact the analyst to determine the source of her figures. AT&T's reliance on this type of "evidence" underscores the fact that it has failed to meet its burden of proof.

In sum, Dr. Selwyn's calculations are based on unproven, unsupported data that reflect the costs of companies that provide different services than Verizon. Tellingly, Dr. Selwyn had available to him a source that could provide actual, verifiable data of IXC retailing expenses: his client. But Dr. Selwyn did not bother to ask for such data:

> Q. Dr. Selwyn, [y]ou relied on an estimate of IXCs' marketing costs. Did you ask your client what its marketing costs were on a per minute of use basis?
>
> A. No, I did not.
>
> Q. Your client's a big interexchange carrier, right?

[28] *See* Exs. 71-74, where Dr. Selwyn admits he did not investigate this article or conduct his own analysis. Also, in Ex. 85, Dr. Selwyn admitted that he did not (and could not) identify that portion of the $0.03 marketing cost attributable only to the marketing of intraLATA toll service.

A. Correct. . . . (Tr. at 458-59)

In contrast to AT&T's estimates of other IXCs' costs,[29] Verizon's calculations are based on the costs associated with Verizon's actual and verifiable retailing/marketing activity in Washington for its intraLATA toll services. For example, Verizon's retailing/marketing costs are based on a company-specific Sales/Marketing/Advertising (SMA) cost study, which is included in binder 7 of 9 in the Company's cost study filing. The SMA costs are modeled as a percent of revenues for services in three broad market segments: consumer, business and carrier. Based on an analysis of individual budget centers, the SMA expenses were identified for (1) basic business and residential exchange service; (2) message toll service; (3) custom calling and CLASS services; and (4) intrastate switched and special access service. These costs are Washington specific; indeed, as Mr. Tucek testified, Verizon relied on the same cost study it used in its compliance filing in the most recent Washington UNE case. (Tr. 755)

4. Other Costs

There are no other LRICs to include in Verizon's price floor calculation.

5. Applicability to Verizon Affiliates

Verizon's affiliate, VLD,[30] is not subject to the Commission's imputation rule because it does not offer any "essential function used to provide [its] service" to any other company, which is the trigger for the imputation test under WAC 480-80-204(6). If AT&T thinks VLD is pricing its services too low in violation of some other law or rule, then it should have named VLD as a party to the complaint and alleged a proper claim. AT&T certainly knows how to do this: in

[29] Although AT&T claims that IXC costs should be used to set Verizon's price floor, it argued, paradoxically, that AT&T's marketing and billing costs are irrelevant. *See, e.g.,* Exs. 36, 37, 75, 76.

[30] Verizon has one other affiliate that is authorized to provide toll service in Washington: VSSI. Verizon has not provided any significant services to this affiliate in recent years, and therefore we do not address it separately. Our analysis of VLD, however, applies with equal force to all Verizon affiliates.

Texas, it filed an access charge complaint against SBC *and* SBC's long-distance affiliate (SBC-LD).[31]

But even assuming AT&T can attack VLD's rates in this docket, it has failed to prove that VLD's rates are unlawful. In fact, AT&T has offered *no* evidence of VLD's total costs of providing services to Washington consumers.

Finally, AT&T attempted to show at the hearing that Verizon and VLD engage in anticompetitive practices because Verizon and VLD jointly develop and market a "package" of local and long distance services.[32] AT&T ignores the fact that the federal Act expressly permits Verizon to jointly market services with its affiliates. In fact, Section 272 of the Act requires regional bell operating companies to establish separate affiliates for certain services, and the FCC audits these affiliate relationships. The bottom line is that AT&T disagrees with the Act. The arguments Dr. Selwyn makes here repeat the arguments that he made on behalf of AT&T in various Section 271 cases, and these arguments have uniformly been rejected by regulators.[33]

6. Whether There Is A Price Squeeze/Remedies

AT&T's complaint, direct testimony, and surrebuttal testimony all claim that Verizon's current toll rates put AT&T in a price squeeze. Indeed, its complaint is peppered with

[31] *Complaint of AT&T against Southwestern Bell and Southwestern Bell Long Distance Co*., Docket No. 23063 (Texas P.U.C. filed Sept. 22, 2000).

[32] *See, e.g*., Tr. at 857, where AT&T's counsel asked Verizon's witness if "it could be just coincidence" that Verizon and VLD filed tariffs that take effect at the same time and that cross-reference each other.

[33] For example, in the Verizon New Jersey 271 case (Docket No. TO01090541), Dr. Selwyn filed testimony virtually identical to his testimony in this case, arguing that Verizon NJ violates the law because it provides its long distance affiliate "between $600 million and $1.2 billion" per year in joint marketing benefits but collects only $16-$20 million. Declaration of Lee L. Selwyn at para. 63 (filed Oct. 22, 2001). He calculated his figure by relying on the same three-page "customer churn" report he uses in this docket. The New Jersey Board did not adopt his theories.

allegations on Verizon's alleged "price squeeze" and the resultant harm to AT&T,[34] and at the August 27, 2002 prehearing conference, AT&T's counsel represented to the ALJ that AT&T was "enduring a price squeeze" every day, and as a result was "making less money" and "serving fewer customers."[35]

AT&T, however, later recanted these claims, stating in a pleading filed with this Commission that "AT&T has made no claims that AT&T has suffered losses in providing toll service in Washington."[36] On this basis alone, AT&T's claims of a price squeeze should be rejected. Furthermore, AT&T has failed to list even one of its toll plans that is currently being "squeezed" by Verizon. In order for a price squeeze to exist, something has to be squeezed.

In addition, if Verizon has engaged in a systematic price squeeze as AT&T claims, then one would expect Verizon's market share for intraLATA toll service to have increased, not decreased, since the time Verizon's toll services were declared competitive. But the evidence in this case proves exactly the opposite – Verizon's market share has significantly *decreased*.

In 1997, when Verizon's toll services were classified as competitive, its intraLATA toll market share was ******** (Confidential)**.[37] The uncontested evidence in this proceeding shows that Verizon's intraLATA toll market share as of 2002 was only ******** (Confidential)**.[38] And even if one assumes, as AT&T suggests, that VLD and Verizon are the same company, their

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[34] *See, e.g.*, AT&T Complaint at paras. 2, 3, 17, 18, 20, 24, 25, 35; Selwyn Affidavit at paras. 4 (stating that price squeeze is a "fundamental concern" in this docket), 6, 14-19.

[35] Transcript, August 27, 2002, Vol. III, p. 80.

[36] AT&T's Petition for Review of Interlocutory Order Compelling Discovery at 5 (filed Feb. 7, 2003). *See also* Exs. 28, 46, 47 and 48, where AT&T states that its "potential profit margins" for toll service in Washington are irrelevant in this proceeding.

[37] Docket No. UT- 970767, *First Supplemental Order* at 2.

[38] This market share calculation is based on Exhibits 211 and 212C, which are Verizon's responses to AT&T Data Request Nos. 63(a), (b), and (c). The calculation is shown on Attachment B of this brief.

combined intraLATA toll market share is less than ****** **(Confidential)**. This significant reduction in market share during the time Verizon's toll service has been classified as competitive proves that Verizon is not engaging in a price squeeze and that Verizon's current access charges and toll rates are not anti-competitive.

Distilled to its essence, AT&T's price squeeze argument is a repackaged version of AT&T's argument that Verizon's toll rates fail the imputation test. As discussed above, all of Verizon's toll rates pass the imputation test, but even if they did not, the proper remedy is to increase these rates, not reduce Verizon's access charges.

Finally, even assuming the Commission could grant AT&T the remedy it seeks by altering the access charge rule or changing the imputation test, this "remedy" must be applied to *all* companies operating in Washington under RCW 80.04.110(1). In other words, the Commission cannot adopt one rule for Verizon and a different rule for all other companies.

C. Do Verizon's Access Charges Violate State or Federal Law As Alleged in AT&T's Complaint?

1. State Law

AT&T claims that Verizon's access charges violate state law because they exceed the LRIC of providing access service.[39] AT&T, however, has failed to refer to any state statute or rule that requires the Commission to set access charges equal to LRIC. Rather, AT&T merely repeats the same policy arguments that this Commission considered and rejected in prior dockets.

For example, when the Commission classified Verizon's (then GTE's) intraLATA toll services as competitive in Docket No. UT-970767, AT&T argued, as it does here, that "above-

[39] AT&T Complaint at 11-12, paras. 21-28. AT&T's Complaint sets forth two separate state law claims – it alleges that Verizon's charges are unlawful because (1) they are higher than LRIC-based rates and therefore give Verizon an "undue preference or advantage" in violation of RCW 80.36.186, and (2) they are higher than the LRIC-based rates Verizon is required to charge CLECs and wireless companies for interconnection and therefore are "discriminatory" in violation of RCW 80.36.180. Although separately plead, they are identical in substance.

cost" access charges, i.e., access charges that exceed LRIC-based rates, are discriminatory and anti-competitive: "GTE can use its monopoly provision of switched access to maintain an artificial, and potentially insurmountable, competitive advantage over other providers of intraLATA toll services."[40] The Commission rejected this claim, explaining that its imputation test addressed AT&T's concerns.

Undeterred, AT&T argued once again that "above-cost" access charges are unlawful in the Commission's access charge rulemaking (Docket No. UT-970325), and once again the Commission rejected AT&T's claim. It specifically rejected the IXCs' claim that access charges must be reduced to LRIC-based rates under state or federal law by reaffirming its long-standing policy that loop costs should be treated as "common" or "shared" costs that must be recovered, in part, from access charges.[41] In fact, the Commission expressly held that its rule "conforms Washington's telecommunications access charge system with state and federal laws encouraging competition."[42]

Finally, the Commission re-affirmed the principle that "above-cost" access charges do not violate any law when it approved the Bell Atlantic/GTE merger (*Merger Order*). There, the Commission approved a settlement that reduced Verizon's intrastate switched access charges by more than $7,000,000 per year.[43] The Commission found that the resulting access charges "are just, reasonable, and compensatory," and that "the agreed adjustments to [Verizon's] revenues

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[40] *First Supplemental Order* at 6.

[41] Docket No. UT-970325, *General Order R-450* at 15 ("The Commission again reaffirms its finding . . . that loop costs are shared and should be matched with all of the revenues derived from the use of the loop").

[42] *Id*. at 1.

[43] *Merger Order*, Appendix A.

produce fair, just, and compensatory rates and charges for terminating access and other services."[44]

The access charges that resulted from the *Merger Order* are the same charges AT&T now claims are unlawful under state law. The Commission, however, specifically held that these charges were lawful,[45] and therefore AT&T's claim is nothing more than an unlawful collateral attack on the *Merger Order*.[46]

In sum, AT&T's complaint in this docket re-hashes the arguments AT&T and others made in the access charge rulemaking. Simply repeating them in a complaint case does not make them any more valid.

2. Federal Law

AT&T argues that Verizon's intrastate access charges are not "just, reasonable, and nondiscriminatory" under the federal Act because they are not "cost-based."[47]

As a threshold matter, MCI made this same argument in the access charge rulemaking, and the Commission rejected it.[48] Here, too, AT&T is attempting to re-litigate the access charge rule in the context of a company-specific complaint case.

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[44] *Merger Order* at 24-25 (emphasis added).

[45] *Id*. at 27, Conclusions of Law 4-5.

[46] At the hearing, the Commission asked several questions about whether the *Merger Order* is binding. To be clear, Verizon does not take the position that the access charges and revenue requirement established by the *Merger Order* remain "fair, just, reasonable, and sufficient" forever and can never be changed or challenged; indeed, the Commission often changes access charges (and other rates) when evaluating a company's overall revenue requirement in a rate case. Rather, Verizon's point is that "above cost" access charges are not *per se* unlawful under state law as AT&T asserts, and the Commission has affirmed this point – directly and indirectly – in previous proceedings, including the merger proceeding.

[47] AT&T Complaint at 13-15, ¶¶ 32-35.

[48] *See, e.g*., Comments of MCI on Proposed Rule WAC 480-120-540, Docket No. UT-970325, at 5-6 (filed June 12, 1998).

Moreover, in this very proceeding, AT&T acknowledged that the Commission could, for public policy reasons, establish access charges that are higher than what AT&T claims is the "lawful" cost:

> [Dr. Selwyn]: I think access charges should ultimately be [equal to] inter-carrier compensation arrangements for local service. . . . Ideally I think you should try to do it now, but if you don't feel that for various public policy reasons it should be done now, certainly take a major step in that direction and reduce rates at least to match the interstate level. (Tr. at 496, lines 2-6, 18-22)

Setting aside AT&T's admission that the Commission need not reduce access to "cost," the FCC and federal courts have repeatedly rejected AT&T's legal argument. The FCC first addressed this issue in 1996 in its *Local Competition First Report & Order*,[49] where the FCC explained that access and local interconnection are legally distinct services:

> We recognize that transport and termination of traffic, whether it originates locally or from a distant exchange, involves the same network functions. Ultimately, we believe that the rates that local carriers impose for the transport and termination of local traffic and for the transport and termination of long distance traffic should converge. *We conclude, however, as a legal matter, that transport and termination of local traffic are different services than access service for long distance telecommunications.* Transport and termination of local traffic for purposes of reciprocal compensation are governed by sections 251(b)(5) and 252 (d)(2), while access charges for interstate long-distance traffic are governed by sections 201 and 202 of the Act. *The Act preserves the legal distinctions between charges for transport and termination of local traffic and interstate and intrastate charges for terminating long-distance traffic.*[50]

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[49] Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, CC Docket No. 96-98, First Report and Order, 11 FCC Rcd 15499 (1996) (*Local Competition First Report & Order*).

[50] *Id*. at ¶1033 (emphasis added).

This principle was affirmed by the United States Court of Appeals for the Eighth Circuit in *CompTel v. FCC*.[51] There, the IXCs argued that the federal Act requires all access charges to be reduced to the cost-based rates of local interconnection. The Eighth Circuit rejected this argument, holding that the federal Act "plainly preserves certain rate regimes already in place," including the access rate regime.[52] The IXCs also argued that treating access services and interconnection services differently has a "discriminatory impact" because it permits ILECs "to charge different rates for the same service based on whether the carrier who is seeking interconnection and other network services is a long-distance service provider or a local service provider."[53] The Eighth Circuit rejected this argument as well, holding that –

> the two kinds of carriers [IXCs and local providers] are not, in fact, seeking the same services. The IXC is seeking to use the incumbent LEC's network to route long-distance calls and the newcomer LEC seeks use of the incumbent LEC's network in order to offer a competing local service. Obviously the services sought, while they might be technologically identical (a question beyond our expertise), are distinct. And if the IXC wants access in order to offer local service (in other words, wants to become a LEC), then there is no rate differential. In these circumstances, we do not think [there is] a discriminatory impact.[54]

Finally, the FCC once again rejected the IXCs' arguments in its *CALLS Order,*[55] where the FCC reaffirmed that, as a matter of law, local interconnection services and access services are different:

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[51] 117 F.3d 1068 (8th Cir. 1997).

[52] *Id*. at 1072 (citing section 251(g) of the Act).

[53] *Id*. at 1073.

[54] *Id*.

[55] *See* ft 8.

> Some commenters have argued that the target [access] rates should be lower because, according to state approved interconnection rates, access costs are actually below one half of one cent per minute. The commenters contend that the Commission should reduce access rates to forward-looking costs, like the unbundled network element rates for local transport and termination. *The Commission has recognized that, as a legal matter, transport and termination of local traffic are different services than access service for long-distance telecommunications and therefore are regulated differently.*[56]

In sum, the FCC and the courts have repeatedly rejected AT&T's argument that the Act requires access charges to equal local interconnection rates.

AT&T ignores this precedent, and argues instead that the Fifth Circuit's *COMSAT* decision[57] requires the intrastate access charges of every carrier in every state to be reduced to LRIC. According to AT&T, this case stands for the proposition that all telecommunications services priced above LRIC contain "implicit subsidies" prohibited by Section 254 of the federal Act and create a "barrier to entry" in violation of Section 253.[58]

AT&T's reliance on *COMSAT* is misplaced. In that case, the Fifth Circuit addressed *interstate* access charges and the *FCC's* obligations under Section 254 of the Act; *COMSAT* has nothing to do with *intrastate* charges and state commissions' obligations. Section 254 requires the FCC to take action on universal service, not state commissions. Subsection 254(f) provides that state commissions *may* adopt regulations consistent with the FCC's rules, but state commissions are not required to do so.

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[56] *Id*. at ¶178 (emphasis added).

[57] 250 F.3d 931 (5th Cir. 2001).

[58] AT&T's Opposition to Verizon Motion to Dismiss at 9 (filed May 13, 2003).

The Federal-State Joint Board recognized this point in the FCC's *Universal Service* proceeding. There, the Joint Board explained that the Act does not require state commissions to make intrastate universal service support explicit:

> The same competitive forces that Congress anticipated would require making interstate universal service support explicit may militate for making intrastate universal service support explicit as well. *The Act, however, did not mandate such an outcome.* States should bear the responsibility for the design of intrastate funding mechanisms. The federal support mechanism should not be contingent upon, nor should it require, any particular action by the state.[59]

Furthermore, even assuming Section 254 requires state commissions to make implicit supports explicit, the commissions have considerable discretion as to when and how such a transition should occur. As discussed by the Fifth Circuit in *Alenco v. FCC*, "[t]he shift from monopoly to competition is indeed dramatic. Congress thus expressly contemplated that the [FCC] would adopt an *incremental* approach to retooling universal service for a world of competition."[60] Moreover, because the Act does not prescribe a time by which implicit supports must be made explicit, the courts will accord substantial deference to the agency regarding how and when this transition is made.[61] Since the Act does not prescribe *any* time by which state commissions must act, this Commission can continue to rely on access charges as a source of implicit subsidies.

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[59] *Second Recommended Decision*, CC Docket No. 96-45, at paras. 22, 25-26 (emphasis added).

[60] 201 F.3d at 616 (5th Cir. 2000) (emphasis added).

[61] *See Texas Office of Public Utility Counsel v. FCC ("TOPUC")*, 183 F.3d 393, 437 (5th Cir. 1999) ("Where the statutory language does not explicitly command otherwise, we defer to the agency's reasonable judgment about what will constitute 'sufficient' support during the transition period from one universal service system to another."); *see also MCI v. FCC*, 242 U.S. App. D.C. 287, 750 F.2d 135, 140 (D.C. Cir. 1984) (noting that "substantial deference by courts is accorded to an agency when the issue concerns interim relief").

Finally, if, as AT&T alleges, Section 254 requires state commissions to remove implicit supports from intrastate access charges, then it also requires state commissions to make these supports explicit so that "sufficient" support is maintained. In other words, state commissions violate Section 254 if they eliminate implicit supports without replacing them. And the Commission must do so for *every* carrier in Washington State, not just Verizon, because Section 254 applies to all carriers.[62]

D. Verizon Earnings Issues

1. Verizon's Earnings Are Relevant to This Proceeding

Verizon's access charges are inextricably linked to Verizon's overall earnings and revenue requirement. The Commission itself recognized this point in U-85-23 and reaffirmed it in its access charge rulemaking, observing that "[a] significant portion of the total cost of operating the local telephone network is recovered in access charges. Access charges paid by IXCs (and ultimately their customers) account for almost 20% of total retail revenues in this state, or about $18 per customer per month."[63] The Commission also explained how access charges relate directly to an ILEC's overall profits, which must, by law, be fair, just, reasonable, and sufficient:

> [Verizon's] rates are regulated by the Commission and must be fair, just, reasonable, and sufficient. A decrease in access charges will result in either a decrease in [its] overall profits (which must remain "sufficient") or an offsetting increase in other rates, or some combination of the two.[64]

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[62] *COMSAT* also is distinguishable because it does not address whether the loop is a common cost that could or should be allocated to access services. AT&T appears to be arguing that *COMSAT* trumps the Commission's long-standing policy of treating loop costs as a common.

[63] Docket No. UT-970325, *General Order* R-450 (Ex. 131) at 4. Here, the evidence shows that Verizon's intrastate access charges generate *more* than 20% of Verizon's total intrastate revenues. (Ex. 243 at 3)

[64] Docket No. UT-970325, *General Order R-450* at 4.

In that rulemaking, AT&T and MCI ignored the link between access charges and "fair, just, reasonable, and sufficient" ILEC rates and made the same arguments they make here: they argued that access charges must be reduced to LRIC-based rates "with little regard or concern for any revenue loss that local companies might incur."[65] The Commission rejected their arguments then, and it must, as a matter of law, reject them now.[66]

Furthermore, the direct link between access charges and a regulated company's earnings was reflected in the FCC's *CALLS Order,* and was addressed by various state commissions in the CALLS proceeding. As explained above, Verizon's interstate access charges are lower than its intrastate charges largely because of the *CALLS Order*, where the FCC reduced interstate access charges but offset these reductions with increases in other rates (e.g., the federal subscriber line charge) and other forms of support. This rebalancing of rates confirms the principle that access charges and a company's overall earnings go hand-in-hand.

The states also recognized this fact in the CALLS proceeding. There, the State Members of the Federal-State Joint Board on Universal Service filed comments explaining the possible impact of CALLS on state ratemaking. These comments noted that if the states mirrored CALLS, the end-user charge would increase to $26 and the universal service fund would increase to $2.6 billion:

> The Commission [i.e., the FCC] is urged to look beyond the specifics of the CALLS proposal and consider the long-term impacts of a decision to accept this proposal. The CALLS proposal deals with interstate rates alone that are roughly 25% of

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[65] *Id*. at 18.

[66] *See POWER v. WUTC*, 104 Wn.2d 798, 711 P.2d 319, 324-26 (1985) (the Commission "is charged by law with the setting of just, reasonable, and sufficient public utility rates," which means that the utility must be allowed to set rates that "will yield to the utility its aggregate allowed revenue requirement"). This obligation is based on the Fifth and Fourteenth Amendments. *See, e.g., Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1989).

> the total costs of providing domestic telecommunications services in the United States. The CALLS proposal includes a $6.50 SLC cap and a $650 million Universal Service Fund. If mirrored by the states to recover the remaining 75% of the intrastate investment, the SLC would be $26.00 and the Universal Service Fund would be $2.6 billion, all funded directly from customers.
>
> The Commission must recognize that CALLS would have a significant impact on intrastate access charge rates. Many states require that intrastate access fees mirror the interstate assessments. As a result, the ultimate increase in flat rate assessments on end users may be substantially higher than is currently estimated by the CALLS proponents. If the states do not mirror the interstate access charges proposed by the CALLS proposal, then the existing disparity between interstate and intrastate long distance services will be far worse than in the past. The State Members respectfully submit that if accepted by the Commission, the CALLS proposal places state regulators in a no-win position of having to either maintain state access charges that are much higher than interstate charges, or reducing intrastate access rates and raising other intrastate rates to compensate for the revenue reduction. . . . The CALLS proposal should therefore not be adopted without a comprehensive review including the effects on intrastate access rates and whether the interstate rates proposed will be reasonable.[67]

The FCC responded to the states' concerns by explaining that states are not required to mirror CALLS and that interstate access charge reform is "not contingent upon, nor should it require, and particular action by the states." *Second Recommended Decision*, CC Docket No. 96-45, at paras. 22, 25-26. But the State Members have it exactly right: states must either leave intrastate access charges at current levels or "rais[e] other intrastate rates to compensate for the [access] revenue reduction."[68]

As explained below, AT&T has failed to prove that Verizon is overearning; to the contrary, the evidence conclusively shows that Verizon is underearning.

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[67] *Supplemental Comments of the State Members* at 11-12 (filed April 3, 2000).

[68] Recent access charge legislation in Florida also reflects this principle. On May 23, 2003, Governor Jeb Bush signed legislation that allows incumbent LECs to apply to the Florida Public Service Commission to rebalance rates on a revenue neutral basis, moving intrastate access revenues to basic local rates over a period of 2 to 4 years.

2. AT&T Has the Burden of Proof on the Earnings Issue

As discussed in Verizon's first Motion to Dismiss, AT&T's complaint is an unlawful attempt to engage in single-issue ratemaking. But even if assuming the Commission could or should consider AT&T's complaint in this docket, AT&T, not Verizon, has the burden of proving that Verizon's earnings are excessive, because AT&T is the moving party.[69]

The Commission held in *MCI v. GTE Northwest* that an essential element of an access charge complaint is the regulated company's earnings: "[a] proposal to change a single rate raises two issues: (1) whether the proposed rates in a vacuum are okay; and (2) the relationship between the proposed rates and the other rates of the company,"[70] i.e., the sufficiency of the company's overall intrastate earnings. Here, AT&T proposes to change a "single rate," and therefore AT&T has the burden of proof on every issue presented by its proposal, including the issue of whether Verizon's other rates are legally "sufficient" if Verizon's access charges are reduced.

AT&T's own evidence shows that AT&T has failed to meet its burden. Indeed, AT&T did not even bother to address Verizon's earnings in its direct case. But even if *every* AT&T adjustment is accepted, Verizon's return increases to 9.09%, which is still below Verizon's authorized return of 9.76%. (T-4C-R at 38) Accordingly, AT&T has failed to meet its burden.

3. The Evidence is Overwhelming: Verizon is Not "Overearning"

Even assuming Verizon had the burden of proof on the earnings issue, the evidence proves beyond any doubt that Verizon is *not* overearning.

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[69] *GTE Northwest v. Whidbey Telephone Co.,* Docket No. UT-950277, Final Order at *14, 1996 Wash. UTC LEXIS 23 (Apr. 2, 1996).

[70] Docket No. UT-970653, Second Supplemental Order at 6.

Verizon's authorized return is 9.76%. Verizon's direct testimony shows that Verizon's current rate-of-return is only 2.84% as of September 2002.[71] After months of discovery, Staff and AT&T filed their rebuttal testimony addressing Verizon's earnings. Staff proposes several adjustments, the most significant of which reduces Verizon's revenue requirement by shifting intrastate costs to the interstate jurisdiction. As discussed below, such an adjustment is unlawful under Ninth Circuit precedent; but even with *all* of Staff's adjustments, Verizon's return is only 8.97%, well below Verizon's authorized return. The following sections address every Staff and AT&T adjustment and explain why they are wrong. But first, we briefly respond to Staff's claim that Verizon's earnings evidence is "insufficient."

Staff witness Betty Erdahl suggests in her rebuttal testimony that Verizon's earnings evidence is insufficient because "Verizon has not filed documentation required by WAC 480-09-330 to support a general rate case." (Ex. T-150 at 3) As a threshold matter, Ms. Erdahl fails to recognize that this is not a general rate case. As Dr. Blackmon acknowledged on the stand, Verizon is not seeking to increase its revenue requirement in this proceeding. (Tr. 551, lines 9-11) Setting aside this point, Ms. Erdahl failed to identify the rate case "documentation" that she alleges Verizon failed to provide. The fact of the matter is that Verizon filed *more* documentation than is required in a rate case. As Ms. Erdahl acknowledged at the hearing, Verizon provided Staff with financial data throughout 2002, and Verizon met with Staff on at least three separate occasions to discuss this data, including an "informal meeting on an earnings review" in August 2002. Staff continued to work on this informal earnings review in September, October, and November 2002. (Tr. 579-80) In the course of that review, Staff submitted

[71] Verizon provided the Commission with its most recent, final financial data for 2002. (Ex. 168, 169) Staff witness Erdahl agreed that it would be appropriate for the Commission to consider the most current data in order for it to make an informed analysis of Verizon's financial situation. (Tr. 585) Although her adjustments were based on Verizon's 2001 data, she would apply them to the 2002 data as well. (Tr. 582)

numerous data requests – both formal and informal – directly related to the company's earnings. (Tr. 580) In addition to this information, Verizon submits 17 financial reports to the Commission each year, and Ms. Erdahl testified that she reviewed some of these reports as well.

In sum, the financial data Verizon provided Staff and included in its testimony is more than sufficient. Indeed, Staff's own counsel explained this point when she responded to a question of Commissioner Hemstead during the March 7, 2003 hearing on the parties' proposed settlement. There, Public Counsel objected to the settlement on the grounds that Verizon should be required to file a general rate case. Commissioner Hemstad asked whether the Commission had before it all the evidence that would be presented in a rate case to determine the reasonableness of the settlement, and Staff counsel explained that not only is there "*sufficient* information before the Commission," but what is in the record "is *more information* than is required by the WAC in a rate case." (Tr. 236-37)[72]

4. Staff's Adjustments Are Wrong

a. *Overview*

Staff proposes five separate adjustments to Verizon's earnings, the most significant of which is Staff's "interstate" adjustment. The revenue effect of each adjustment – expressed as an increase in Verizon's rate of return – is shown on Table Five:

[72] The financial data presented in support of the settlement (Exs. T-242, 243, 244, 254) is the same data submitted into the record at the hearing, updated to reflect 2002 data. (Exs. T-242-R, 168, 169, 170)

Table Five
Staff's Earnings Adjustments

Verizon rate-of-return calculation (as of September 2002)	2.84%
Staff yellow page adjustment	****** **(Conf.)**
Staff line sharing adjustment	****** **(Conf.)**
Staff DA adjustment	****** **(Conf.)**
Staff expense adjustment	****** **(Conf.)**
Staff "interstate" adjustment	****** **(Conf.)**
Verizon's return with all Staff adjustments	8.97%
Verizon's return with Staff adjustments except interstate	6.07%

This table illustrates that Verizon's earnings are below its authorized level even if *every* Staff adjustment is accepted. But as discussed below, all Staff adjustments are unlawful.

b. *Staff's "interstate" adjustment*

Staff witness Erdahl proposes to adjust Verizon's earnings by re-allocating costs from the intrastate to interstate jurisdiction. She does this by calculating an "interstate revenue growth factor" based on the changes in Verizon's interstate revenues during the period 1998-2001. She then assumes that Verizon's interstate expense and investment for the period 1998-2001 increased in proportion to the interstate revenue growth factor. In other words, she *increased* Verizon's *inter*state expense and investment, and then *decreased* Verizon's *intra*state expense and investment by the same amount. In this way, she simply shifted costs from the intrastate jurisdiction to the interstate jurisdiction. In fact, her adjustment removes approximately ******** **(Confidential)** out of intrastate expenses and ******** **(Confidential)** out of intrastate rate base, which has the effect of ****************************** **(Confidential)**.

Ms. Erdahl's adjustment is unlawful because it ignores the FCC's separations freeze. In May 2002, the FCC adopted its *Separations Freeze Order*,[73] which imposes an interim freeze on its Part 36 cost allocation factors. In that docket, several states requested the FCC to adjust some separations factors "to compensate for the impact of the Internet on local calling patterns."[74] Also, the Federal-State Joint Board on Separations proposed a 5% adjustment factor to account for increased Internet usage.[75] The FCC, however, rejected both proposals and instead implemented the current freeze. The FCC explained that it had the legal authority to implement a freeze under *Smith v. Illinois Bell*.[76]

Here, Ms. Erdahl ignores the FCC's freeze. Indeed, she admits that Verizon properly followed the FCC separation rules in preparing and filing its financial data (Tr. 613, 616), but she thinks the FCC's jurisdictional allocation process is currently flawed and unfair and that it might be remedied in 2006. Thus, her adjustment (a) assumes there is a problem with the current FCC separation rules, (b) assumes this problem will be fixed the way she think it should by 2006, and (c) assumes, for ratemaking purposes, that this "fix" became effective three years before it happens (if ever). (Tr. 616)[77]

Not only is Ms. Erdahl's adjustment speculative, it is unlawful. The FCC's *Separations Freeze Order* is binding on the states, and Staff cannot ignore or modify it. The United States

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[73] In the Matter of Jurisdictional Separations, CC Docket No. 80-286, Report and Order (rel. May 22, 2001) (*Separations Freeze Order*).

[74] *Id*. at para. 9.

[75] *Id*. at paras. 39-42.

[76] 282 U.S. 133 (1930). The only state that argued the FCC did not have this authority was California.

[77] Ms. Erdahl has no idea if the FCC would allow Verizon to move her adjustment to its federal books. Nor did she bother to examine whether other companies were experiencing "similar interstate growth mismatch." Indeed Verizon presented evidence that established such an interstate "growth mismatch" is certainly not unique to Verizon. (Ex. 165).

Court of Appeals for the Ninth Circuit addressed this very point in *Hawaiian Telephone Co. v. Public Utilities Commission of Hawaii*,[78] where it struck down a state commission decision that did not follow an FCC separations order. In that case, the state consumer advocate argued that the FCC's separation procedures did not preempt state-developed procedures for intrastate ratemaking. The Court disagreed, holding that the FCC's order preempts the states under *Smith v. Illinois*. The Court struck down the state commission's "transparent and improper attempt to circumvent the FCC mandate."[79]

The Ninth Circuit's decision is directly on point. Here, as there, a party is attempting to circumvent an FCC separations order. It cannot do this. Accordingly, Staff's adjustment must be rejected.

For this same reason, AT&T's rebuttal testimony on Verizon's interstate operations must be ignored. For example, AT&T witness Selwyn argues that the Commission must consider Verizon's "combined regulated intrastate/interstate operations" in evaluating Verizon's earnings and any "confiscation" or "takings" claim.[80] This proposal, like Ms. Erdahl's, is unlawful because it ignores the FCC's separations rules and ignores the obvious fact that the Commission has jurisdiction only over a company's *intra*state operations.[81]

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[78] 827 F.2d 1264 (9th Cir. 1987).

[79] *Id*. at 1277.

[80] Ex. T-3-R at 42-43.

[81] This point is indisputable. Indeed, the State Members of the Federal-State Joint Board on Jurisdictional Separations have acknowledged this fundamental principle: "[T]he separations process provides the cost information that is the basis for determining the confiscation liability of each jurisdiction. Indeed, it may be said that the fundamental purpose of separations is to determine the potential confiscation liability of both the federal and state jurisdictions." In the Matter of Jurisdictional Separations Reform, CC Docket No. 80-286, State Members' Report at 3 (Dec. 21, 1998).

Finally, as demonstrated in the financials presented in Ms. Heuring's testimony, Verizon's return has declined in each period since 2000 for both its intrastate operations and total regulated operations. Moreover, Verizon is experiencing a continued decline in access lines and increases in pension cost. Simply stated, the Company does not have excess earnings.

c. *Staff's other adjustments*

In addition to her unlawful interstate adjustment, Staff witness Betty Erdahl proposes four other adjustments to Verizon's 2001 financial results. (Exs. T-150, 151-C). First, she imputes additional revenues attributable to an increase in a directory assistance rate that the company had neither proposed nor adopted. Specifically, she increased Verizon's directory assistance rate to $1.25 from the present rate of $.95 (Ex. 151C) on the theory that directory assistance was a competitive service and that $1.25 was consistent with rates offered by some other companies. In short, she added revenues from rates that did not exist. (Tr. 591-592)

Second, Ms. Erdahl raised November 2001 revenue levels and decreased October expenses because she felt they were not "normal." (Ex. T-150 at 8). In her prefiled testimony she attributed these variances to the reintegration of VADI, but on the stand conceded that she really did not know if VADI was the reason for the variances in the October and November 2001 numbers. (Tr. 599) Indeed, Ms. Heuring stated on cross-examination that VADI was reintegrated into Verizon Northwest in January of 2002, not 2001. Thus, Ms. Erdahl's speculation is based on an erroneous premise. (Tr 741)

Third, Ms. Erdahl imputes additional revenues in 2001 for line sharing, a new product first provided in January 2002. She conceded that this revenue is already included in Verizon's 2002 results of operation, and therefore this adjustment is unnecessary. (Tr. 595)

Fourth, Ms. Erdahl imputes directory publishing revenues from Verizon's affiliate to Verizon based entirely upon the Commission's adjustment in the 1995 US WEST rate case (Docket No. UT 950200). She did not explain why Verizon's directory publishing business should be treated like US WEST's. She acknowledged that, unlike US WEST (now Qwest), GTE Northwest (now Verizon) never had a directory operation itself - - let alone one that was in its rates base so as to become a "regulatory asset - - but instead has always contracted with a separate directory publishing company. Furthermore, Ms. Erdahl did no analysis of either the new or old directory publishing contracts between Verizon and Verizon Information Services. (Tr. 609-610) These contracts are on file with the Commission, and the current contract shows that the only revenues Verizon receives from the VIS are from the sale of subscriber listing information based upon charges that Verizon is required to charge other directory publishers. (Tr. 611) In short, Ms. Erdahl proposes to offset Verizon's regulated earnings with revenues from an unregulated Verizon affiliate. This proposal is unlawful.[82]

5. AT&T's Adjustments Are Wrong

Dr. Selwyn proposes four adjustments to Verizon's earnings. (Ex. T-4C-R at 38) First, he imputes directory advertising revenue, and second, he proposes to offset Verizon's intrastate earnings with Verizon's interstate earnings. These are the same adjustments Ms. Erdahl proposed, and must be rejected for the same reasons.

Third, he imputes what he claims is the "value of the joint marketing of local and long distance services" that "inures to the benefit of Verizon's non-regulated operations." (Ex. T-4C-R at 31-33)[83] Specifically, Dr. Selwyn contends that VLD avoids customer acquisition costs

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[82] *Brooks-Scanlon Co. v. Railroad Comm'n of Louisiana*, 251 U.S. 396 (1920) (regulator cannot offset losses in utility business with revenues from non-utility business).

[83] Although he makes this claim, Dr. Selwyn admitted that he has not undertaken a study to identify all these costs,

because when customers call Verizon (the ILEC) to order local service, Verizon's service representatives can take orders for VLD. He concludes that these avoided customer acquisition costs – which he estimates to be $300 per customer – should be imputed as revenue to the Verizon ILEC's regulated books, and he states that "none of [this value] has been accounted for by Verizon in its current earnings analysis." (Ex. T-3-R at 35)

Dr. Selwyn is wrong for several reasons. First, Verizon's regulated books do, in fact, reflect the revenues Verizon receives from its affiliates for joint marketing and other services. Under FCC rules, these services are priced at the higher of book cost or fair market value (47 C.F.R. § 32.27). For 2002, VLD paid Verizon several millions of dollars for joint marketing services, and all this revenue is reflected on Verizon's regulated books. Second, his $300 per customer estimate is pure speculation – indeed, it is based on the same three-page stock analyst report addressing customer churn he uses in his imputation analysis. In fact, his own client refused to validate this figure, and stated that AT&T's customer acquisition costs were irrelevant to this docket. (Ex. 75)

Finally, Dr. Selwyn proposes to reduce Verizon's rate base, and thereby increase Verizon's earnings, based on a 1994 continuing property record (CPR) audit conducted by FCC staff. This audit was never adopted by the FCC and has never been accepted by any state. Indeed, this audit did not include Washington State. (Tr. 464-65)[84]

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nor has he estimated the annual dollar amount. (*See, e.g.*, Exs. 51-53)

[84] Even if the CPR adjustment were appropriate, it would result in an equal decrease to Verizon's plant investment *and* the associated reserve in accordance with Part 32 accounting. Instead of preparing an adjustment consistent with Part 32 rules, Dr. Selwyn develops an adjustment that maintains the *same* relationship of accumulated reserve to total plant on a "before and after" adjusted basis. This ignores the Part 32 accounting rules, and in doing so improperly reduces the Company's rate base.

At the end of the day, Dr. Selwyn rejected his own testimony, stating that he "wasn't in any sense suggesting that based on [his] testimony the Commission make an affirmative finding of a precise result of the audit" (Tr. 490), but rather he was "simply raising [the audit] as one of the issues that would have to be examined before the Commission should just automatically provide a dollar for dollar offset to the reduction in access charges." (Tr. 490-91) In short, AT&T has failed completely to meet its burden of proof on the earnings issue.

E. What is the Impact of WAC 480-120-540 or Other Commission Orders?

1. The Commission's Access Charge Rule Controls This Docket

AT&T's and Staff's proposals to reduce Verizon's access charges constitute an unlawful collateral attack upon the Commission's cost allocation policies established in U-85-23 and reaffirmed in the access charge rule. Accordingly, their proposals must be rejected.

No party disputes the fact that Verizon's current access charges comply with the Commission's access charge rule. This rule requires terminating access charges to be reduced to LRIC-based local interconnection rates (plus the ITAC), but allows these reductions to be offset by revenue-neutral increases in originating charges. As noted, the stated purpose of the rule was to "conform Washington's telecommunications access charge system with state and federal laws encouraging competition."[85] Staff and AT&T, however, argue that Verizon's access charges do *not* comply with state and federal laws encouraging competition. Clearly, their arguments are nothing more than an attack upon the Commission's rule.

For example, Staff claims that "circumstances have changed" since the time the Commission established its rule. Specifically, Staff argues that when the Commission established its access charge rule and its resultant shift in revenues from terminating to

[85] Docket No. UT-970325, *General Order R-450* at 1.

originating charges, it "wanted to give competition a chance to reduce originating access charges," but Staff now believes that the Commission's assumption was wrong. (Ex. T-132, at 4-5) Thus, Staff proposes that the Commission reduce Verizon's originating charges to Qwest's levels.

AT&T also disagrees with the Commission's access charge rule – it believes the rule is unlawful because it results in access charges that are higher than LRIC-based rates and therefore permits "implicit subsides" to remain in access charges. Indeed, according to AT&T, the intrastate access charges of every carrier in Washington State (and most carriers throughout the country) are unlawful:

> Q. Is it your testimony, Dr. Selwyn, that the ITAC, which recovers universal service costs, is itself unlawful or discriminatory or unreasonable?
>
> A. I would have to answer yes to that. (Tr. at 451)

As Dr. Blackmon explained in the hearing, *every* carrier in Washington State has access charges that are above LRIC:

> Q. Dr. Blackmon, do you know of any other carriers in Washington whose access charges are above long run incremental cost?
>
> A. Any other than Verizon Northwest?
>
> Q. Correct.
>
> A. I do. In fact, I don't know of any carrier whose access charges are not above long run incremental cost. (Tr. at 550)

In a nutshell, Staff wants to reduce Verizon's originating access charges because it does not think the Commission's access charge rule works as intended, and AT&T wants to reduce Verizon's originating access charges and ITAC (and, necessarily, the access charges of every

other carrier in Washington) because it does not think the Commission's rule is lawful. Staff's and AT&T's arguments, however, are nothing more than an unlawful collateral attack on the Commission's rule. If Staff and AT&T believe the rule should be changed, they should file a petition under WAC 480-09-220.

Indeed, when Chairwoman Showalter asked Dr. Selwyn whether the Commission can reduce access charges as AT&T suggests and still comply with the rule, he responded, "I'm not sure" (Tr. at 477), and then proceeded to discuss "the problem" of how wireless carriers are not regulated by states as a result of the 1993 federal Omnibus Budget Reconciliation Act. (Tr. at 477-78). He concluded that the access charge rule is *not* competitively neutral (Tr. at 478, lines 13-14), and thus admitted that AT&T is attacking the rule directly.[86]

When Chairwoman Showalter asked Dr. Blackmon the same question, he stated that Verizon's originating access charges could be reduced and that the rule need not be changed (Tr. at 556), taking the remarkable position that a carrier's access charges can comply with the Commission's rule but still be unjust and unreasonable. (Tr. at 570) He based this theory on the belief that the rule "says absolutely nothing about whether the originating rate at any particular level is fair or unfair." (Tr. at 555) Verizon disagrees. The Commission specifically addressed originating access charge levels in its order adopting the rule, explaining that (a) the rule allows revenue-neutral increases to originating rates, (b) the ability of carriers to keep this revenue "will be a function of customer demand," and (c) that the rule is "consistent with the public interest

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[86] In fact, AT&T spent much of its time in the hearing explaining how wireless competition hurts AT&T, and for this reason access charges must be reduced to LRIC-based rates. (*See, e.g.*, Tr. at 451-52 and 477-84) This claim, however, is a direct attack on the rule and the Commission's order adopting the rule, because there the Commission explicitly rejected proposals to set access charges at the same rate for wireless interconnection.

(including economic theory, law, and public policy)."[87] There can be no doubt that the access charge rule did, in fact, address the appropriate level of originating access charges.

Ironically, Staff's position to correct in this complaint case what it perceives to be a problem with the Commission's access charge rule conflicts with the position this Commission took before the Washington Supreme Court in the access rule appeal. The Commission will recall that Verizon appealed the rule on the ground that the Commission cannot establish rates in a rulemaking. The intermediate appellate court agreed with Verizon and struck down the rule in February 2002. The Commission, however, appealed this decision to the Washington Supreme Court, arguing that access charge policy should be set in a rulemaking rather than developed "piecemeal" in individual complaint cases:

> A rulemaking proceeding is designed specifically to establish policy in a forum that allows more parties to participate than does a contested case proceeding.
>
> * * *
>
> By setting policy in the rulemaking setting, with broad notice and opportunity to participate, a greater number of people are allowed to provide their views on the appropriate standard to adopt.
>
> * * *
>
> The consequence of accepting Verizon's argument that access charge reform policy must be set by individual adjudications, or by a comprehensive adjudication involving all affected companies as parties, runs counter to these and other described benefits of rulemaking and would lead to an unwieldy procedure. Following Verizon's arguments, the Commission would presumably have to initiate a complaint against each company alleging that the company's rates were unreasonable.[88]
>
> * * *

[87] Docket No. UT-970325, *General Order R-450* at 6.

[88] Brief of WUTC at 23-24 (Court of Appeals, No. 25954-1-II, filed Nov. 30, 2000).

> The consequence of the decision of the Court of Appeals is that it could force the Commission to set policies . . . in piecemeal adjudications, rather than in rulemaking, thus leading to a greater chance of inconsistent results.[89]

The Washington Supreme Court agreed with the Commission's view that access charge policy should be set in a rulemaking rather than in company-specific proceedings, and reinstated the rule.[90] Staff's position in this case – to ignore the rule and establish access charge policy in company-specific complaint cases – cannot be squared with the Commission's position on appeal and the Court's decision.

AT&T's earlier pleadings also appear to recognize that the access charge rule controls. AT&T filed its complaint in April 2002, *after* the access charge rule had been struck down by the lower court. In opposing Verizon's first Motion to Dismiss, AT&T pointed out that the access charge rule had been struck down by the court, and therefore the only mechanism by which AT&T could challenge access rates was a company-specific complaint proceeding.[91] This argument is no longer valid.

For all these reasons, Verizon urges the Commission to reject Staff's and AT&T's proposals to reduce Verizon's access charges and to dismiss AT&T's complaint. On April 29, 2003, Verizon filed a Motion to Dismiss explaining that AT&T's complaint is an unlawful collateral attack on the Commission's rule. The Commission, in its *Tenth Supplemental Order*, stated it would address this motion after the evidentiary hearings. Verizon urges the

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[89] WUTC Petition for Review at 18 (Wa. Sup. Ct., No. 72-33-03, filed Mar. 1, 2002).

[90] *See* ft 2.

[91] AT&T Opposition to Verizon's Motion to Dismiss at 4-5 (May 13, 2002).

Commission to do so. Verizon will not repeat its arguments here, but for the Commission's convenience, a copy of Verizon's motion is included as Attachment C.

2. The Commission's Imputation Rule Controls This Docket

Although AT&T admitted at the hearing that it believes the Commission's access charge rule is unlawful, its legal strategy is to attack the rule *indirectly* by arguing that Verizon's toll rates do not pass the imputation test and that the proper remedy is to reduce Verizon's access charges. This argument, however, is nothing more than a collateral attack on the Commission's imputation rule. The access charge rule and the imputation rule go hand-in-hand: the access charge rule allows local carriers to maintain access charges above LRIC, but the imputation rule requires local carriers to impute these charges in setting toll rates. In this way, the imputation rule eliminates the theoretical competitive harms associated with high access charges. As this Commission noted in the access charge rulemaking, no imputation rule is needed if access were priced at LRIC.[92]

AT&T's proposed "remedy" of reducing access charges rather than increasing toll rates is just a back-handed way of attacking the imputation rule. AT&T does not agree with the Commission's imputation policy because AT&T prefers low access charges, and AT&T has argued this point in previous dockets. For example, in Verizon's (then GTE's) toll reclassification docket, AT&T argued that an imputation test was insufficient to ensure a competitive toll market and that access charges must be reduced to LRIC-based rates.[93] The Commission rejected this proposal. Undeterred, AT&T repeated its argument in the access

[92] Docket No. UT-970325, *General Order No. R-450* at 6.

[93] Docket No. UT-970767, *First Supplemental Order* at 7.

charge rulemaking, and once again the Commission rejected it, finding that its imputation rule was an appropriate safeguard.

But even though AT&T disagrees with the Commission's imputation rule, it admitted at the hearing that the Commission's imputation test works. Specifically, AT&T admitted that if Verizon's toll rates do not pass the imputation test, AT&T's alleged "price squeeze" could be remedied by increasing Verizon's toll rates instead of reducing access charges:

> Q. [T]he Commission could eliminate the price squeeze you claim exists by requiring Verizon to raise the retail price of its toll services, correct?
>
> A. Yes. (Tr. at 446, line 22, through 447, line 1)

In sum, AT&T is simply repackaging arguments to reduce access charges that the Commission has repeatedly rejected, and it cannot re-litigate these issues in a complaint case.[94] The only proper issue in this case is whether Verizon's toll rates pass the imputation test. If they do not, then Verizon must raise them.

Finally, the access charge rule and the imputation rule reflect the Commission's long-standing policy of requiring regulated carriers to recover significant portions of their costs through access charges. As discussed above, if the Commission changes this policy in this docket (assuming it has the power to do so), it cannot reduce access charges without simultaneous, revenue-neutral offsets to other rates.

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[94] Furthermore, AT&T's complaint must be dismissed because it fails to state a claim under state law. Specifically, AT&T can complain only about Verizon's toll rates because AT&T competes only with Verizon's toll services; accordingly, any remedy must be limited to the complained-about rates, i.e., Verizon's toll rates, not Verizon's access charges. Verizon raised this issue in its first Motion to Dismiss. Although the Commission denied this motion in its *Second Supplemental Order*, it suggested it would re-examine this issue once the record was fully developed. Verizon renews its motion here are urges the Commission to grant it.

F. How Should an Access Charge Reduction Be Implemented, if the Commission Decides that Such a Reduction is Appropriate?

For the reasons stated above, any access charge reduction must be offset by a simultaneous revenue-neutral increase in other rates. This can be accomplished in several ways:

First, the Commission can order the parties to try and reach a settlement that restructures rates on a revenue-neutral basis. If a settlement is reached, the Commission can review it to determine whether it is in the public interest. Verizon believes this is the quickest, most efficient way to reduce access and rebalance rates.

Second, if the Commission decides to change the cost allocations ordered in U-85-23 or the access structure created by its access charge rule it could re-open those proceedings, take comments from all interested parties, and then establish a procedure for revenue-neutral rate rebalancing.

Third, assuming the Commission has the power to change access charges in this complaint case, it could open a separate phase of this case to address the question it deferred in this phase, i.e., "If access charges are reduced, what rates should be increased?"

The Commission, however, cannot reduce Verizon's access charges and then require Verizon to file a rate case to recoup its revenues, for all the reasons discussed above. At the hearing, Commissioner Hemstad wondered why the company has not filed a rate case and expressed concern that the company has not had a rate case since the 1980s. (Tr. at 875-77) As Verizon witness Doug Fulp explained, Verizon could not file a rate case before July 1, 2002 under the *Merger Order*, and prior to that date AT&T filed its complaint. Moreover, filing a rate case is a major undertaking, and, as the Commission explained in *MCI v. GTE Northwest*, the complaint statute cannot be used to initiate a full rate case.[95]

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[95] Docket No. UT-970653, *Second Supplemental Order* (Oct. 22, 1996).

Furthermore, even though Verizon has not had a rate case in many years, it provides the Commission with comprehensive annual financial reports that allow the Commission to monitor Verizon's earnings.

In sum, the Commission has several options if it believes Verizon's access charges should be reduced. Each option, however, requires the Commission to consider Verizon's overall earnings and, at the very least, offset any access reductions with revenue-neutral increases in other rates.

III. Conclusion

AT&T's complaint must be dismissed. It ignores the essential and indisputable link between access charges and a company's revenue requirement. It ignores the Commission's 20-year old policy of requiring companies to recover loop costs from access charges. It ignores the Commission's access charge rule that codifies this policy. And, finally, it ignores the Commission's imputation test rule.

Not only does AT&T's complaint fail, the evidence AT&T proffered to support its complaint is insufficient and, in many instances, imaginary. For example, AT&T claims that it suffers a "price squeeze," but AT&T does not identify in its 100-plus pages of testimony *any* price that is being squeezed. Also, AT&T claims that Verizon's price floor should be based on an unaffiliated IXC's costs of billing and marketing, but AT&T, an "unaffiliated IXC" and thus the perfect candidate to supply these costs, refuses to provide any data, relying instead on "estimates" of IXC costs that its putative expert gleaned while browsing on the web.

In short, based on the law and the evidence, the Commission must either dismiss AT&T's complaint or deny AT&T's requested relief.

Respectfully submitted,

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