

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

AT&T COMMUNICATIONS OF)
THE PACIFIC NORTHWEST, INC.)
)
Complainant,)
)
v.)
)
VERIZON NORTHWEST INC.,)
)
Respondent.)
_____)

Docket No. UT-020406

**OPENING POST-HEARING BRIEF OF
AT&T COMMUNICATIONS OF THE PACIFIC NORTHWEST, INC.**

June 9, 2003

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I. INTRODUCTION

1. A minute is a minute is a minute. AT&T Communications of the Pacific Northwest, Inc. (“AT&T”) has been advocating for years that carriers should compensate each other for the exchange of *all* telecommunications traffic at the same level, and events have demonstrated the desirability of that position. Commercial mobile radio service (“CMRS”) providers (wireless carriers) have emerged as one of the most formidable intraLATA toll competitors because they pay the same compensation to terminating carriers for *all* traffic within a major trading area (“MTA”) – a larger geographic area than a LATA.¹ Voice over Internet Protocol (“VoIP”) and virtual foreign exchange (“VFX”) services have developed and are growing in popularity for the same reason. Technology and the telecommunications market are attempting to push toll prices to the long run costs of the facilities used to provide that service.

2. Incumbent local exchange carrier (“ILEC”) switched access charges represent a major roadblock to those efforts. The access charges imposed by Verizon Northwest, Inc. (“Verizon”) are particularly egregious, many times higher than the underlying costs to provide the service. Even Verizon feels the market pressure to reduce its access charges and recognizes the need to respond. Unfortunately, Verizon has not responded by seeking to rebalance its intrastate rates but by offering intraLATA toll, both directly and indirectly through its affiliate Verizon Long Distance (“VLD”), at levels well below its imputed costs – and in some cases, even its own calculation of switched access costs. When Verizon violates the law, rather than adjusts its access rates, to compete in the intraLATA toll marketplace, Commission action is overdue.

¹ See Tr. at 554 (Staff Blackmon); Ex. T1 (AT&T Selwyn Direct) at 12-17.

3. AT&T filed its Complaint over fourteen months ago seeking just such Commission action. Verizon has staunchly opposed any change to the status quo, and has engaged in trench warfare litigation in an effort to delay Commission resolution of the issues in AT&T's Complaint for as long as possible. Even when most of the parties had reached a partial settlement, Verizon's recalcitrance resurfaced and undermined the agreement, resulting in still further delay. The Commission, to its credit, has attempted to minimize Verizon's procedural tactics, and now the substantive issues in AT&T's Complaint are squarely presented for determination.

4. AT&T strongly urges the Commission to grant the relief AT&T has requested in its Complaint and to require Verizon to reduce its switched access charges to forward-looking cost-based levels. Only such action will eliminate the gamesmanship in the market that has developed as competitors – and Verizon itself – attempt to work around the artificial costs imposed by the monopoly access provider. More importantly, removal of these costs will allow the intraLATA toll market to act as it should, further reducing prices and stimulating demand for the public switched network to the ultimate benefit of all Washington consumers.

II. DISCUSSION

A. WHAT SHOULD VERIZON'S ACCESS CHARGES BE, AND WHY?

5. Verizon's switched access charges should be set at forward-looking cost-based levels. Switched access services provide call transmission from one end user to another. The service is comprised of switching (generally both tandem and end office switching) and interoffice transport. The Commission has established the forward looking costs of these elements for Verizon in Docket Nos. UT-960369, *et al.* and UT-003013, both as unbundled network elements and as components of reciprocal compensation for the transport and termination of local exchange traffic. Verizon's switched access services provide exactly the

same functionality as transport and termination of local exchange traffic and therefore should be priced at the same levels.² Such pricing is consistent with principles of economics, competitive neutrality, and nondiscrimination, as well as applicable law, as discussed throughout this Brief.

6. Verizon disagrees and proposes to retain its current access charges, which include not only the forward-looking facilities costs but subsidies for universal service support and a large contribution to Verizon's intrastate earnings. Funding universal service support through switched access charges violates federal law,³ and Verizon has produced no evidence that would justify burdening intraLATA toll carriers and their customers with disproportionate contributions to Verizon's profits. To the contrary, Verizon acknowledges the desirability of reducing its switched access charges.⁴ Verizon, however, claims the need to increase other rates to offset any access charge reduction, and Verizon is in no hurry to do so.⁵ Rate rebalancing is not at issue in this proceeding, but the level of Verizon's access charges is. The Commission, therefore, should order Verizon to reduce its access charges and permit Verizon to initiate its own proceeding if Verizon believes it must adjust its other intrastate rates.

7. Commission Staff ("Staff") agrees that Verizon's switched access charges should be substantially reduced, but Staff does not propose that those charges be set at forward-looking cost. Rather, Staff proposes that Verizon be entitled to charge no more than Qwest Corporation ("Qwest") charges for intrastate switched access:

I think the reason we disagree [with AT&T] is that Staff recognizes that like other businesses, telephone companies need to

² Ex. T1 (AT&T Selwyn Direct) at 10-17.

³ See *infra* Section C.

⁴ Tr. at 704 (Verizon Danner); see Tr. at 870 (Verizon Fulp) ("do we think reductions in access rates are the wrong thing to do, and the answer to that is no, from an economic efficiency standpoint and from a competition standpoint").

⁵ Tr. at 872-78 (Verizon Fulp).

be able to cover all of their costs, not just their incremental costs. We believe it's appropriate that some of the costs that are very real but not included in the incremental cost, most notably the cost of the loop, be recovered under all services, including access services.⁶

8. AT&T agrees with Staff that telephone companies need to be able to recover all of their costs, but disagrees that Verizon should be permitted to recover costs *from competitors* through switched access rates other than the costs that Verizon incurs to provide switched access service. Indeed, the pricing requirements in the Telecommunications Act of 1996 ("Act") are based on the concept that ILECs must provide monopoly facilities and services to competitors at forward-looking cost.⁷ Ensuring that all companies have access to such facilities and services at the same cost promotes the development of competition based on each company's efficiency, rather than on the ILECs' inherent advantage of having built their networks over generations with captive ratepayer support. That concept is equally applicable to switched access charges. To the extent that Verizon incurs costs other than the forward-looking costs of switched access, Verizon should recover those costs from the rates it charges its end users, not from the switched access rates imposed on its competitors.

1. Terminating Rates (including ITAC)

9. Verizon's terminating access charges should be equal to the sum of the forward-looking costs of tandem switching, transport, and end office switching, *i.e.*, the same rates that CMRS providers and CLECs pay Verizon for providing the same functionality for terminating intraMTA and local traffic. These charges should not include any costs for subsidizing universal

⁶ Tr. at 553-54 (Staff Blackmon).

⁷ See, e.g., 47 U.S.C. § 252(d).

service support or for contribution to Verizon's intrastate revenue requirement other than the "reasonable profit" permitted in the calculation of the switching and transport elements.

2. Originating Rates

10. Verizon's originating access rates should be equal to Verizon's terminating access rates – a combination of the forward-looking costs of tandem switching, transport, and end office switching. Again, no costs for subsidizing universal service support or excessive contribution to Verizon's earnings should be included. Indeed, principles of competitive neutrality would dictate that Verizon not be permitted to charge *any* originating access rate, just as Verizon does not impose originating access charges on CMRS providers for intraMTA calls made by Verizon local subscribers. For purposes of this proceeding, however, AT&T proposes that Verizon be permitted to charge the same rate for both originating and terminating switched access.

B. IMPUTATION ISSUES

11. Imputation is one legal basis on which the Commission should determine that Verizon's current switched access charges are unlawful and unreasonable. Washington law prohibits a telecommunications company from pricing its competitively classified services below cost or cross-subsidizing those services with revenues from noncompetitive services.⁸ In addition, the Commission has required ILECs to provide retail services that are subject to competition at prices that exceed the rates the ILEC charges to competitors for bottleneck monopoly facilities plus the forward-looking costs of other facilities and services used to provide

⁸ RCW 80.36.330(3) & (6).

the retail service. Specifically, ILECs must impute their switched access charges and the costs of other network and retailing functions into their retail toll rates.⁹

12. The Commission expressly imposed this requirement on Verizon's intraLATA toll services in its order classifying those services as competitive.¹⁰ The Commission, however, did not specify how access and other costs were to be calculated but deferred to Staff's analysis of a Verizon filing in a separate docket, pending a more global consideration of switched access services.¹¹ No such global consideration has occurred, and the parties in this proceeding now dispute how those calculations should be conducted. Verizon proposes that the Commission use Verizon's version of "incremental" costs, *i.e.*, costs that Verizon incurs above and beyond the costs that Verizon incurs to provide monopoly local exchange service. Such a proposal would effectively permit Verizon to leverage its monopoly power in the local exchange market into the intraLATA toll market and is inconsistent with statutory requirements, as well as the best interests of Washington consumers.

13. The Commission, therefore, should reject Verizon's proposal in favor of the cost estimates proposed by AT&T. Those estimates reflect the proper weighted average of the access charges that Verizon pays to other service providers (and should be deemed to pay to itself) and the forward-looking costs that Verizon incurs to provide toll service without reliance on services, facilities, and expenses funded by captive ratepayers. Only under AT&T's approach can

⁹ See, e.g., *MCI, et al. v. U S WEST, et al.*, Docket No. UT-970658, Final Order Granting Petition (March 1999); *WUTC v. U S WEST*, Docket No. UT-950200, Fifteenth Supp. Order at 96-97 (March 1996).

¹⁰ *In re Investigation on the Commission's Own Motion Whether the IntraLATA Toll Services of GTE Northwest Incorporated Should Be Classified as a Competitive Telecommunications Service*, Docket No. UT-970767, First Supp. Order Granting Competitive Service Classification With Conditions at 12-13 (Sept. 29, 1997).

¹¹ *Id.*

imputation serve its intended purpose to ensure that Verizon cannot use its local service monopoly power to undermine effective competition in the intraLATA toll market.

1. Access Costs (including the Conversion Factor)

14. Switched access charges – both Verizon’s and the charges imposed by other local exchange carriers – comprise the largest portion of a price floor for toll services. Based primarily on data provided by Verizon, Dr. Selwyn calculated that “[t]he combined weighted average access charge that a toll carrier would face for a call placed from a subscriber in Verizon Northwest’s service territory to another resident of Washington is \$0.0989.”¹²

15. Verizon apparently uses a different figure in its imputation calculation. No Verizon witness, however, identified the specific amount of access charges that Verizon includes in its imputation analysis, much less attempted to justify or even explain how Verizon developed that amount. Mr. Dye provides only the confidential sum of all costs that Verizon believes should comprise the price floor for its intraLATA services.¹³ But for the inclusion of Verizon’s calculations in an exhibit to Staff’s rebuttal testimony,¹⁴ the record would be devoid of any evidence on Verizon’s proposal. As Mr. Zawislak observes, however, Verizon’s calculations are severely flawed and understate the access costs that Verizon incurs or should be deemed to incur.¹⁵ The testimony of Mr. Zawislak and Dr. Selwyn on the calculation of access costs was un rebutted and essentially unchallenged.¹⁶

¹² Ex. T1 (Selwyn Direct) at 34; *see id.* at Attachment 3 (providing details of calculation).

¹³ Ex. 231C (Verizon imputation analysis) at col. (k).

¹⁴ Ex. 111C (Attachment 26b to Verizon Response to Staff DR No. 26).

¹⁵ Exs. T105 & 106C (Staff Zawislak Rebuttal) at 6-11.

¹⁶ The only direct challenge to Dr. Selwyn’s calculations came on cross-examination, but Verizon only pointed out that Dr. Selwyn had not changed his figures in light of the modifications that Verizon made to its response to Staff Data Request No. 26. Tr. at 455 (AT&T Selwyn). As Dr. Selwyn explained, however, those modifications included changes to the

16. The \$0.0989 per minute that Dr. Selwyn developed properly and conservatively captures the access costs that Verizon incurs or should be deemed to incur in its provision of intraLATA toll services. Particularly in the absence of any evidence supporting Verizon's calculations, the Commission should adopt this amount for use in its imputation analysis. Alternatively, the Commission should adopt the access costs proposed by Staff.

2. Billing and Collection Costs

17. No party disputes that Verizon incurs billing and collection costs in its provision of intraLATA toll services and that those costs should be included in the price floor. The parties, however, propose widely disparate estimates of the appropriate costs to be included. Dr. Selwyn used the publicly available prices that Verizon charges its affiliate, VLD, to estimate that Verizon's billing and collection costs are \$0.0155 per minute.¹⁷ That estimate is very conservative, in light of the \$0.0346 billing and collection cost that the Commission previously established for independent ILECs, including Verizon,¹⁸ and compared to a stock market analyst's estimate of AT&T's billing and collection costs of \$0.0353 per minute of use.¹⁹

18. Verizon, on the other hand, proposes a much smaller, proprietary amount that allegedly represents Verizon's incremental costs for billing and collection for intraLATA toll service.²⁰ Verizon's proposal is fatally flawed in at least two fundamental respects.

methodology that Verizon previously used, at least some of which was inappropriate. *Id.* at 506-09. Because Verizon never provided any testimony in support of its calculations, much less explaining the modifications to Staff Data Request No. 26, Dr. Selwyn had no opportunity to address the issue in his rebuttal testimony. *See* Ex. T1 at 34, n.48 (incorrectly anticipating that Verizon would address its methodological changes in its testimony and promising a response).

¹⁷ Exs. T1 & T2 (AT&T Selwyn Direct) at 35-37.

¹⁸ *Id.* at 37.

¹⁹ Ex. 265 (Credit Suisse First Boston Report) at 3 & 5; Tr. at 683-84 & 705 (Verizon Danner).

²⁰ As discussed above in connection with Verizon's calculation of access charges for imputation, Verizon has not identified the specific amount it proposes for billing and collection but simply

19. The first fatal flaw is Verizon's cost study itself. The study uses data from 1997 and relies on "interviews with key personnel to determine relevant costing information."²¹ Mr. Tucek, Verizon's sponsoring witness, moreover, was not involved in these "interviews" or in preparing this cost study.²² Mr. Tucek's testimony thus is triple hearsay – a Verizon employee told the information to an interviewer, who told that information to the cost study developer, who told it to Mr. Tucek – and the cost study's reliance on the opinions of unidentified personnel means that neither the Commission nor any party can determine the source, much less the reliability, of the information contained in that study. The Commission has previously determined that such cost studies are unreliable and unacceptable.²³

20. The second fatal flaw with Verizon's billing and collection cost estimate is that Verizon proposes to account only for those costs that Verizon incurs above and beyond the costs that Verizon incurs for billing and collection for local exchange service. Such an approach improperly enables Verizon to use its local service billing and collection infrastructure – the systems and personnel used to prepare and mail bills and to process payments – to provide competitive toll service without any compensation to the local ratepayers who fund that infrastructure.²⁴ As Dr. Selwyn explains, such an approach is comparable to a company

includes that amount in its proprietary price floor. *See* Ex. 231-C (Verizon Dye chart) at col. (k). Staff's testimony, however, includes what appears to be the billing and collection cost amount that Verizon includes in its proposed price floor, and Mr. Tucek confirmed that Mr. Dye used an output from Verizon's ICM to estimate incremental billing and collection costs. Tr. at 760-61 (Verizon Tucek).

²¹ Ex. 228C (Billing and Collection excerpts from ICM); Tr. at 761-62 (Verizon Tucek).

²² Tr. at 762 (Verizon Tucek).

²³ *E.g.*, Docket No. UT-003013, 41st Supp. Order at 82, para. 319 & 45th Supp. Order at 57, para. 216.

²⁴ Ex. T-3C (AT&T Selwyn Rebuttal) at 20; Ex. 56 (AT&T Response to Verizon DR No. 45); Tr. at 470-77 (AT&T Selwyn).

employee using the office, computer, and other resources provided by his or her employer to operate a separate business after hours. The entity supplying the resources – here, the local service customers funding the billing and collection infrastructure – should receive the full benefit of the use of those resources. For purposes of calculating imputation, therefore, Verizon’s costs to provide toll service should include the full billing and collection costs that Verizon would incur to provide that service on a stand alone basis.

21. Verizon attempts to justify its approach as being consistent with RCW 80.36.330 and the Commission’s order classifying Verizon’s toll services as competitive. The statute that Verizon cites, however, does not specify any particular costing methodology, but provides only, “The commission shall determine proper cost standards to implement this section.”²⁵ The fact that the Commission and Staff may have accepted Verizon’s approach in the past, moreover, does not require that the Commission continue to do so, particularly when no party opposed that approach or explained its short-comings until AT&T filed this Complaint. Indeed, Verizon’s proposed cost standard cannot be considered “proper” when it results in rates for Verizon’s noncompetitive services effectively cross-subsidizing Verizon’s competitive service offering.

22. The \$0.0155 per minute that Dr. Selwyn developed properly and conservatively captures the costs that Verizon incurs to provide billing and collection for its intraLATA toll services. Particularly in the absence of reliable cost data from Verizon, the Commission should adopt this amount for use in its imputation analysis.

3. Retailing/Marketing Costs

23. The parties have a similar dispute with respect to the amount of retailing and marketing costs that should be included in the price floor for Verizon’s intraLATA toll services.

²⁵ RCW 80.36.330(3).

Dr. Selwyn estimates that Verizon incurs retailing and marketing costs of approximately \$0.03 per minute, based on the calculations of long distance carriers' retailing and marketing costs provided by Dr. William Taylor, a frequent Verizon witness, in an affidavit he submitted in support of Qwest's bid to obtain authority to provide interLATA services.²⁶ This estimate is consistent with evidence presented by Verizon that a stock market analyst has estimated that AT&T incurs \$0.0257 per minute in customer acquisition costs (i.e., advertising and promotion expenses, which do not include customer care costs).²⁷

24. Verizon, as with billing and collection, proposes a much smaller, proprietary number that allegedly represents Verizon's incremental costs for retailing and marketing activities associated with intraLATA toll service.²⁸ Verizon's proposed retailing and marketing cost estimates are even more flawed than its billing and collection cost estimates.

25. Verizon's retailing and marketing cost study, like its billing and collection cost study, (1) uses 1997 data, (2) relies on "interviews and surveys with appropriate client personnel" to provide cost estimates, none of whom are identified, and (3) was prepared by unidentified personnel, not the sponsoring witness.²⁹ The retailing and marketing cost study, moreover, is based on an August 1997 *budget*, not the *actual* costs that Verizon incurred.³⁰ This

²⁶ Ex. T1 (AT&T Selwyn Direct) at 37-38.

²⁷ Ex. 265 (Credit Suisse First Boston Report) at 3 & 8; Tr. at 679-83 (Verizon Danner).

²⁸ As discussed above in connection with Verizon's calculation of access charges and billing and collection costs for imputation, Verizon has not identified the specific amount it proposes for retailing and marketing but simply includes that amount in its proprietary price floor. See Ex. 231-C (Verizon Dye chart) at col. (k). Staff's testimony, however, includes what appears to be the retailing and marketing cost amount that Verizon includes in its proposed price floor, and Mr. Tucek confirmed that Mr. Dye used an output from Verizon's ICM to estimate incremental retailing and marketing costs. Tr. at 754 (Verizon Tucek).

²⁹ Ex. 227 (Nonconfidential excerpts of Verizon retailing and marketing cost study); Tr. at 754-57 (Verizon Tucek).

³⁰ Ex. 227 at 16035; Tr. at 755 (Verizon Tucek).

study also excludes costs that Verizon currently incurs in reselling intraLATA toll because Verizon did not resell toll service in 1997.³¹ Verizon's proposal thus does not even satisfy Verizon's own criteria of being based on Verizon's costs.

26. Verizon's cost study methodology is also flawed. Verizon developed its proposed retailing and marketing cost estimate as a factor, calculated by dividing budgeted expenses by its revenues for toll services. Verizon provided no support for the proposition that retailing and marketing expenses are directly proportional to toll revenues. At least with respect to advertising and other marketing expenses, one would expect that a company's expenses would increase if, like Verizon, it was losing market share.³² Indeed, the numbers support that expectation, rather than Verizon's assumption. Verizon's proposed retailing and marketing cost estimate developed in 1998 is over 400 times higher than the comparable cost estimate that Verizon provided when it first obtained competitive classification in 1997.³³ Verizon's toll revenues, meanwhile, declined over 55% during the same period, from approximately \$82 million in 1996 to approximately \$36 million in 1998.³⁴ The record thus fails to support Verizon's assumption that retailing and marketing expenses comprise a constant percentage of toll revenues.

³¹ Ex. 227a-C (Confidential excerpts of Verizon retailing and marketing cost study) at 16208; Tr. at 759-60 (Verizon Tucek). Although Mr. Tucek did not know whether Verizon resells toll service, the record evidence demonstrates that Verizon provides intraLATA toll to resellers, including its affiliate VLD. *E.g.*, Ex. 219C (Verizon confidential response to AT&T DR No. 71).

³² *See* Ex. 209 (Verizon Response to AT&T DR No. 52), attachment 52 (Verizon revenue figures, showing decline in "Long Dist Netwk Revenues" from 1995 to 2000). Such an increase would be expected both because the company would spend more to increase its market share and because there would be fewer minutes of toll use over which to spread those marketing costs.

³³ *Compare* Ex. 108C (Verizon original imputation study for intraLATA toll) *with* Ex. 113C (Verizon current imputation study for intraLATA toll).

³⁴ Ex. 209, attachment 52.

27. Finally, Verizon's cost study fails to account for the benefit that Verizon derives from serving – and thus having established relationships with – captive local exchange customers. As Dr. Selwyn explained,

Verizon already has preexisting relationships with its customers, so that Verizon's incremental cost of marketing to legacy customers is necessarily substantially less than the costs that other carriers would incur in marketing their services, so Verizon starts out with a very substantial advantage with respect to those legacy customers.

....

So it's reasonable to ascribe a marketing cost for purposes of determining a price floor that reflects realistic marketing costs that a downstream competitor would have to incur and that the only reason Verizon itself is not necessarily incurring those costs, and it's not even clear that they're not, is simply because they are gaining advantage of legacy relationships.³⁵

Indeed, Verizon recognizes this benefit and its inherent advantage, providing intraLATA toll services only to customers who are also Verizon local service customers.³⁶ Again, failure to include in Verizon's toll price floor the value of Verizon's relationship with its captive local customers would result in monopoly ratepayers effectively cross-subsidizing Verizon's more competitive intraLATA toll services.

28. The \$0.03 per minute that Dr. Selwyn proposes properly and conservatively captures the costs that Verizon incurs to provide retailing and marketing for its intraLATA toll services. Particularly in the absence of reliable cost data from Verizon, the Commission should adopt this amount for use in its imputation analysis

³⁵ Tr. at 457-58 (AT&T Selwyn).

³⁶ Ex. 206 (Verizon Response to AT&T DR No. 19). Mr. Fulp had no knowledge of whether Verizon markets its intraLATA toll services to customers located outside of Verizon's local service territory. Tr. at (Verizon Fulp). The record evidence that Verizon does not provide toll services to customers who are not Verizon local subscribers – even on a resold basis to VLD –

4. Other Costs

29. Each party's imputation analysis includes cost estimates for access, billing and collection, and retailing and marketing, but no party includes the costs that Verizon incurs to transport its intraLATA toll traffic from its access tandem to another local exchange carrier's access tandem or switch (or to another Verizon tandem). Although transport costs generally are low, Verizon incurs intertandem transport costs in its provision of intraLATA toll service and these costs should be included in the imputation analysis.³⁷

30. No party developed intertandem transport costs, but the record includes costs for interoffice transport. Verizon's access cost calculations contained in an exhibit to Staff's testimony include Direct Trunked Transport cost estimates.³⁸ These costs appear to be specific to transport costs between a Verizon tandem and end office, but they should be comparable to (if not lower than) transport costs between a Verizon tandem and another LEC's (or other Verizon) access tandem or switch. Using these costs as a surrogate for intertandem transport costs would be very conservative in light of a stock market analyst's estimate of \$0.0275 per minute for toll providers' outside plant costs.³⁹

31. Accordingly, the Commission should require that intertandem transport costs be included in Verizon's intraLATA toll service price floor and should estimate those costs as being equal to the Direct Trunk Transport costs that Verizon has calculated.

strongly suggests, if it does not demonstrate, that Verizon does not market its toll services outside of its local service territory.

³⁷ See Tr. at 671-75 (Verizon Danner).

³⁸ Ex. 111C at page 3 of 4, lines 12-18.

³⁹ Ex. 266; See Tr. at 679 (Verizon Danner).

5. Applicability to Verizon Affiliates

32. Not only does Verizon price its intraLATA toll services below an appropriately calculated price floor, Verizon uses its affiliate, VLD, to provide Verizon's intraLATA toll services below even Verizon's proposed price floor. VLD has minimal, if any, involvement in the intraLATA toll service provided to end user customers under its name. Rather, Verizon is the *de facto* service provider, and Verizon's parent company is offsetting VLD's paper losses with revenues from Verizon. Under these circumstances, the Commission should find that VLD and any other Verizon affiliate that provides intraLATA toll service in Washington is not distinguishable from Verizon and should be treated the same for imputation purposes.

33. VLD provides intraLATA toll service within Verizon's local service territory by reselling Verizon's intraLATA toll service.⁴⁰ In addition to the toll service itself, VLD uses Verizon to provide billing and collection, sales and marketing, and other functions associated with the provision of intraLATA toll services to end user customers.⁴¹ Not surprisingly, VLD provides intraLATA toll services almost exclusively to Verizon local service subscribers.⁴² VLD even offers discounts in some of its toll plans to customers who obtain their local service from Verizon, even though Verizon does not provide VLD with a corresponding discount.⁴³ VLD also offers to provide at least one toll plan *only* to Verizon local service subscribers.⁴⁴ For all practical purposes, Verizon provides the intraLATA toll service under VLD's price list, and VLD provides only its own slightly different name.

⁴⁰ *E.g.*, Exs. 203 & 219C (Verizon Responses to AT&T DR Nos. 14 & 71).

⁴¹ *E.g.*, Exs. 217C & 218C (Verizon Responses to AT&T DR Nos. 34 & 70).

⁴² Exs. 204C & 207C (Verizon Responses to AT&T DR Nos. 17 & 20).

⁴³ VLD Price List at 51.1 & 51.3; Ex. 219C (Verizon Response to AT&T DR No. 71; Tr. at 844-45 & 848-49 (Verizon Fulp)).

⁴⁴ Ex. 400 (VLD price list filing); Tr. at 855-56 (Verizon Fulp).

34. Verizon uses this interaffiliate relationship to price intraLATA toll services below Verizon's price floor. Confidential Appendix A to this Post-Hearing Brief ("Confidential Appendix A") includes an imputation analysis for three of the toll plans provided by Verizon under the VLD price list. This analysis demonstrates that intraLATA toll services under the VLD price list are priced below not only VLD's costs but below Verizon's price floor and even below Verizon's calculations of its access costs. Not surprisingly, the VLD price list offerings are even more popular than the Verizon price list offerings among Verizon local service subscribers.⁴⁵ The Commission, however, should not permit Verizon to provide intraLATA toll services at rates below cost through an affiliate any more than Verizon may provide below-cost toll services under its own price list.

35. Verizon, like the Wizard of Oz, urges the Commission to "pay no attention to that man behind the curtain." Verizon repeatedly asserts that VLD is a separate company over which Verizon has no control, but VLD's actions speak louder than Verizon's words. A company would not sell a separate company's services substantially below the price it pays for those services. Indeed, VLD could resell intraLATA toll services from unaffiliated companies at a loss if that were its business strategy, but VLD does not do so, serving only a small handful of customers outside of Verizon's local service territory.⁴⁶ A company also would not require its customers to take service from a separate company – either as a condition of service or by offering a discount – when that separate company provides no compensation or other benefit to the first company in exchange. Again, VLD's price list imposes such a requirement and offers such discounts only for customers who obtain local service from Verizon. Siamese twins are no more connected than Verizon and VLD.

⁴⁵ Ex. 204C (Verizon Response to AT&T DR 17).

36. Verizon even refuses to recognize that VLD is pricing its intraLATA toll services far below the prices that Verizon charges VLD to provide those services. Mr. Fulp suggested that VLD may be making up the difference through its interstate and international toll services, although Mr. Fulp presented no evidence to support such a suggestion.⁴⁷ Nor is Mr. Fulp's suggestion plausible in light of the record evidence. At least one stock market analyst questions whether interstate long distance provided by Verizon and other Bell companies is even profitable, much less generating sufficient excess revenue to compensate for the substantial losses VLD is incurring by reselling Verizon intraLATA toll.⁴⁸ Indeed, even if VLD incurred *no* costs to resell *interLATA* service, VLD would not be profitable charging its price list rates in light of the payments it makes to Verizon (and other costs VLD incurs) for *intraLATA* toll.⁴⁹ If VLD's strategy were to use intraLATA toll as a "loss leader," moreover, it could do so throughout the state, yet VLD provides intraLATA toll service to only a few customers who are not Verizon local service customers.⁵⁰

37. Verizon, not VLD, provides the intraLATA toll services under VLD's price list, and Verizon, not VLD, receives the benefits of so providing those services. Accordingly, the Verizon intraLATA toll services offered under VLD's price list should be subject to the same price floor and imputation analysis applicable to the intraLATA toll services offered under Verizon's price list.

⁴⁶ Ex. 207C (Verizon Response to AT&T DR 20).

⁴⁷ Tr. at 839-44 (Verizon Fulp).

⁴⁸ Ex. 266 (Friedman Billings Ramsey Technology Industry Update).

⁴⁹ See Confidential Appendix A.

⁵⁰ Ex. 207C (Verizon Response to AT&T DR 20).

6. Whether there is a price squeeze/remedies

38. Verizon's intraLATA toll rates in its and VLD's price list create a price squeeze, requiring unaffiliated toll providers to price their intraLATA toll offerings below cost in order to compete. A conservative estimate of Verizon's price floor is \$0.1444 per minute, and Verizon's rates for all of the intraLATA toll offerings in Verizon's price list are substantially below that floor.⁵¹ VLD's price floor is even higher, yet most of the intraLATA toll rates in VLD's price list are lower than the rates in Verizon's price list.⁵² Such circumstances represent a definitive example of a price squeeze.⁵³

39. Two potential remedies exist for eliminating this price squeeze: (1) lower Verizon's access charges, or (2) raise the intraLATA toll rates in Verizon's and VLD's price lists. Far and away the best remedy is to lower Verizon's access charges. Reducing access charges to cost-based levels will result in more effective competition because Verizon and competing toll providers will incur the same out-of-pocket costs for the essential switched access functions and thus can compete on the basis of their own costs, not artificial costs imposed by the monopoly access provider.⁵⁴ More importantly, "the competitive nature of the toll market will force carriers to flow through the access cost reductions in their retail prices," thus "stimulating additional use of the public switched network and resulting in lower prices for all Washington residential and business consumers."⁵⁵

⁵¹ *E.g.*, Exs. T1 & T2C (AT&T Selwyn Direct) at 28-44.

⁵² *Id.* & Confidential Appendix A.

⁵³ *Id.* at 44-49.

⁵⁴ Ex. T1 (AT&T Selwyn Direct) at 49.

⁵⁵ *Id.* at 50-52; Tr. at 511-12 (AT&T Selwyn).

40. Increasing toll rates, on the other hand, would be both anticompetitive and bad for consumers. The effect of such an increase “would be to provide Verizon with an even higher margin on its intrastate toll services, potentially fueling cross-subsidization of other competitive services and in so doing shifting the price squeeze problem from toll to those services.”⁵⁶ A toll rate increase would also discourage consumers from using intraLATA toll services, not only “suppressing consumer demand for the services of the incumbent, but . . . also suppressing consumer demand for services of the competitors and basically denying the competitors the opportunity to compete on price where the vast majority of their cost is being dictated by the incumbent with respect to the central access services.”⁵⁷

41. The Commission, therefore, should eliminate the price squeeze by requiring Verizon to reduce its switched access rates to cost-based levels.

C. DO VERIZON’S ACCESS CHARGES VIOLATE STATE OR FEDERAL LAW AS ALLEGED IN AT&T’S COMPLAINT?

42. Verizon’s intraLATA toll rates not only fail to satisfy imputation because of Verizon’s excessive switched access charges, but those charges are directly inconsistent with both Washington and federal law. Specifically, Verizon’s access charges violate state prohibitions on anticompetitive practices and rate discrimination and federal restrictions on how universal service support may be collected.

⁵⁶ Ex. T1 (AT&T Selwyn Direct) at 50-51.

⁵⁷ Tr. at 512 (AT&T Selwyn). As a practical matter, moreover, the Commission cannot increase all toll rates that would need to be increased in this proceeding. VLD is not a party, and thus the Commission order in this docket could not require VLD to increase its intraLATA toll prices, leaving Verizon able to continue to exert a price squeeze by providing below-cost service through its affiliate.

43. Washington law precludes Verizon from subjecting AT&T or any other telecommunications company to any undue or unreasonable prejudice or competitive disadvantage with respect to the pricing of, or access to, noncompetitive services:

Notwithstanding any other provision of this chapter, no telecommunications company providing noncompetitive services shall, as to the pricing of or access to noncompetitive services, make or grant any undue or unreasonable preference or advantage to itself or to any other person providing telecommunications service, nor subject any telecommunications company to any undue or unreasonable prejudice or competitive disadvantage. The commission shall have primary jurisdiction to determine whether any rate, regulation, or practice of a telecommunications company violates this section.⁵⁸

44. Verizon's switched access services are noncompetitive services, and Verizon has subjected AT&T and other unaffiliated providers of intraLATA toll service to undue or unreasonable prejudice or competitive disadvantage on two grounds. First, as discussed above, Verizon prices its intraLATA toll services below the level of the access charges it imposes on competitors plus a reasonable estimate of other forward-looking costs. Verizon, therefore, provides itself with an unreasonable competitive advantage by charging its toll competitors more for switched access services than Verizon effectively pays itself for those same services.⁵⁹

45. Second, Verizon imposes an unreasonable competitive disadvantage on unaffiliated wireline toll competitors by charging them a significantly higher rate for access than Verizon charges its wireless affiliate and other CMRS providers for the same service. CMRS providers pay Verizon a cost-based rate of \$0.0016 per minute for terminating all traffic within a major trading area ("MTA") – a geographic area that is larger than a LATA – and *receive*

⁵⁸ RCW 80.36.186.

⁵⁹ Verizon's failure to price its intraLATA toll services above a reasonable price floor not only violates RCW 80.36.186 but also RCW 80.36.330, prohibiting Verizon from cross subsidizing its competitive services with revenues from noncompetitive services.

compensation from Verizon for intraMTA calls that Verizon originates.⁶⁰ AT&T and other wireline toll providers pay Verizon \$0.0324 per minute for terminating traffic within the same geographic area and pay (not receive) an even higher rate for calls originated from Verizon subscribers.⁶¹ Verizon's switched access charges thus subject AT&T and other wireline toll providers to an undue and unreasonable competitive disadvantage in violation of RCW 80.36.186.

46. Washington statutes also prohibit rate discrimination:

No telecommunications company shall, directly or indirectly, or by any special rate, rebate, drawback or other device or method, unduly or unreasonably charge, demand, collect or receive from any person or corporation a greater or less compensation for any service rendered or to be rendered with respect to communication by telecommunications or in connection therewith, except as authorized in this title or Title 81 RCW than it charges, demands, collects or receives from any other person or corporation for doing a like and contemporaneous service with respect to communication by telecommunications under the same or substantially the same circumstances and conditions.⁶²

47. Verizon provides the equivalent of switched access services to CMRS providers at a fraction of the price that Verizon charges AT&T and other wireline toll providers for calls that originate from and terminate to exactly the same end points.⁶³ Competing local service providers pay the same cost-based rates as CMRS providers for calls within a local calling area that use exactly the same tandem and end office switching and transport that Verizon provides to

⁶⁰ Ex. T1 (AT&T Selwyn Direct) at 11-17; *see* Ex. 216 (Verizon Response to AT&T DR 18); Tr. at 451-53 (AT&T Selwyn).

⁶¹ *Id.*

⁶² RCW 80.36.

⁶³ Ex. T1 (AT&T Selwyn Direct) at 11-17; *see* Ex. 216 (Verizon Response to AT&T DR 18); Tr. at 451-53 (AT&T Selwyn).

wireline toll providers.⁶⁴ Traffic bound for Internet Service Providers is compensated at an even lower rate.⁶⁵ Verizon, therefore, unlawfully charges landline toll providers a vastly higher rate for the same traffic termination and origination services that Verizon provides to CMRS and other local service providers.

48. In addition to state law, Verizon's switched access charges violate federal law. The Act permits states to promulgate regulations governing universal service support that are "not inconsistent" with FCC rules and requires that "[e]very telecommunications carrier that provides intrastate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, in a manner determined by the State to the preservation and advancement of universal service in that State."⁶⁶ Congress Act imposed on the FCC, in turn, the requirement that universal service support "be explicit."⁶⁷ Verizon's switched access rates, as discussed above, include an amount intended to support universal service and thus violate federal law.

49. The first problem with the universal service element of Verizon's switched access charges is that it represents an implicit, rather than explicit, subsidy. The Fifth Circuit Court of Appeals in reviewing the FCC's rules promulgated pursuant to the Act, held that the FCC cannot permit or require ILECs to recover universal service contributions from their interstate access charges because such a contribution mechanism represents an implicit subsidy prohibited by the

⁶⁴ Ex. T1 (AT&T Selwyn Direct) at 10-12; Ex. 216 (Verizon Response to AT&T DR 18).

⁶⁵ See *In re Intercarrier Compensation for ISP-Bound Traffic*, CC Docket 01-131, Order on Remand and Report and Order (effective June 14, 2001) (FCC ISP Order).

⁶⁶ 47 U.S.C. § 254(f).

⁶⁷ *Id.* § 254(e).

Act.⁶⁸ The court explained that “the implicit/explicit distinction turns on the difference between direct subsidies from support funds and recovery through access charges and rate structures.”⁶⁹ If FCC rules cannot permit or require ILECs to recover universal service support subsidies through switched access charges, state regulations that are not inconsistent with the FCC rules also cannot do so. Verizon’s interim universal service terminating access charge (“ITAC”) rate element, therefore, is inconsistent with federal law.

50. In addition, Verizon’s ITAC rate element fails to satisfy the statutory requirement that universal service support be collected from “[e]very telecommunications carrier that provides intrastate telecommunications services . . . on an equitable and nondiscriminatory basis.” Every telecommunications carrier that provides intrastate telecommunications services does not pay Verizon’s ITAC rate. CMRS providers do not pay that rate, nor do ILECs or CLECs pay it if they do not provide intraLATA toll service. Only intraLATA toll carriers pay Verizon’s ITAC. Verizon’s ITAC also is not equitable or nondiscriminatory. Even when ILECs and CLECs pay Verizon’s ITAC, they pay only for those minutes of use associated with intraLATA toll traffic, not other types of traffic that makes the same use of Verizon’s network. AT&T and other wireline toll providers, however, pay Verizon’s ITAC on every minute of use they make of Verizon’s network.

51. Accordingly, Verizon’s switched access charges subject AT&T and other unaffiliated wireline toll providers to undue and unreasonable competitive disadvantage and rate

⁶⁸ *COMSAT Corp. v. FCC*, 250 F.3d 931, 938-940 (5th Cir. 2001); *Texas Office of Public Util. Counsel v. FCC*, 183 F.3d 393, 425 (5th Cir. 1999).

⁶⁹ *Alenco Comm., Inc. v. FCC*, 201 F.3d 608, 623 (5th Cir. 2000). Thus, the fact that Verizon has established a specific interim universal service rate element does not make the inclusion of the universal service subsidy “explicit” within the meaning of the statute. Indeed, Verizon has taken the position that “explicit” in this context means explicit to end users, not to other carriers. *Texas Office of Public Util. Counsel v. FCC*, 183 F.3d at 425.

discrimination in violation of state law. Verizon's switched access charges, to the extent that they include universal service support contributions, also violate federal law by imposing implicit subsidies and by applying to less than all telecommunications carriers that provide intrastate telecommunications services on an inequitable and discriminatory basis.

D. VERIZON EARNINGS ISSUES

52. Verizon's earnings are irrelevant to the issues raised in AT&T's Complaint. AT&T has alleged and proven that Verizon's access charges are unlawful, unfair, unjust, and unreasonable. The level of Verizon's earnings does not change that outcome. Under earning, even if Verizon had proven it is under earning (which it has not), does not justify unlawful access charges any more than poverty excuses any other illegal activity.

53. To the extent that the Commission considers Verizon's earnings, Verizon has not even approached providing sufficient record evidence to prove that it could not generate its authorized rate of return if the Commission reduced Verizon's access charges to cost-based levels.⁷⁰ Both AT&T and Commission Staff evaluated the limited information that Verizon provided and proposed just a few adjustments that collectively would raise Verizon's reported earnings well above its authorized rate of return.⁷¹ Verizon's conduct, moreover, demonstrates that even Verizon does not believe that it is under earning. As Commissioner Hemstad observed, filing a rate case would be a "no brainer" if Verizon actually were faced with an annual revenue shortfall of between \$105 million and \$145 million, as Verizon claims.⁷² Verizon's

⁷⁰ Verizon's earnings level is not an element of any claim raised by AT&T or made by Commission Staff. Verizon raised that issue as an affirmative defense to AT&T's Complaint and accordingly, bears the burden to prove that defense.

⁷¹ Exs. T150-154C (Staff Erdahl Rebuttal and Exhibits); Exs. T3R & T4C-R (AT&T Selwyn Rebuttal) at 28-39; Exs.7C-10 (AT&T Selwyn Rebuttal Exhibits).

⁷² Tr. at 875-76.

representation that such a filing is only a “strong possibility” effectively refutes Verizon’s assertions that it is under earning.⁷³

54. The Commission should disregard Verizon’s under earning claims as irrelevant, unsupported by the record evidence, and inconsistent with Verizon’s actions.

E. WHAT IS THE IMPACT OF WAC 480-120-540 OR OTHER COMMISSION ORDERS?

55. Verizon erroneously contends that WAC 480-120-540 and the Commission order approving the settlement in the merger between Bell Atlantic and GTE somehow preclude the relief that AT&T seeks in its Complaint.⁷⁴ Neither the Commission rule nor its prior order has any impact on AT&T’s entitlement to relief.

56. Verizon claims that once the Commission approves an access charge tariff filing as complying with WAC 480-120-540, those charges are invulnerable to attack. The rule makes no such provision. Rather, the rule requires terminating access charges to be set at cost. The rule also permits carriers entitled to receive universal service support to include a specific rate element in its terminating access charge to recover that support. Finally, a carrier may establish originating access charges that are just and reasonable. The rule, as Dr. Blackmon testified, merely establishes general standards for determining the proper level of access charges and neither expressly nor impliedly states that it represents the sole legal requirements for access charges.⁷⁵ As discussed above, multiple statutes and Commission rules impose requirements on

⁷³ *See id.* at 876 (Verizon Fulp).

⁷⁴ Verizon raised these claims most recently in the latest of its series of motions, filed one week before the evidentiary hearings began. The Commission deferred ruling on that motion, and the discussion in this Brief is intended to address this issue generally, as well as specifically in response to the deferred motion.

⁷⁵ Tr. at 555 (Staff Blackmon).

rates, and the Commission can and should consider all of those requirements – not just WAC 480-120-540 – when evaluating Verizon’s access charges.

57. Verizon’s contention that the Commission’s merger order is determinative is similarly flawed. Verizon’s argument appears to be that once the Commission finds Verizon’s rates to be fair, just, reasonable, and sufficient, those rates remain fair, just, reasonable, and sufficient and can never be challenged. Verizon’s own witnesses disagree. Dr. Danner agreed that Verizon’s rates would need to be changed if they violate a statute or other law.⁷⁶ Dr. Danner also testified that Verizon’s current rates are fair, just, reasonable, and *sufficient*, even though Verizon allegedly is under earning, because the Commission previously approved them,⁷⁷ but Mr. Fulp took the opposite view, testifying that Verizon’s current rates are *insufficient* because they do not allow Verizon to earn its authorized rate of return.⁷⁸ Verizon apparently wants to have its cake and eat it too – precluding any change to its rates except those requested by Verizon. Neither the law nor the record evidence supports such a position.

F. HOW SHOULD AN ACCESS CHARGE REDUCTION BE IMPLEMENTED, IF THE COMMISSION DECIDES THAT SUCH A REDUCTION IS APPROPRIATE?

58. The Commission should require Verizon to reduce its access charges to forward-looking cost within 10 days after the effective date of the Commission order. AT&T and Commission Staff have produced more than ample evidence to demonstrate that Verizon’s access charges violate applicable law and are not fair, just, and reasonable. IntraLATA toll providers and their customers, therefore, are entitled to an immediate reduction in those unlawful charges.

⁷⁶ Tr. at 693-97 (Verizon Danner).

⁷⁷ *Id.* at 717-19.

⁷⁸ Tr. at 826 (Verizon Fulp).

59. Verizon has taken the position that any reduction in its access charges must await additional proceedings to allow Verizon to demonstrate its alleged need to offset that reduction with an increase in other rates. The Commission should reject that position. AT&T filed its Complaint on April 3, 2002. During the more than 14 months that have passed since that date, AT&T and other intraLATA toll providers have overpaid Verizon for switched access by \$46 million. These carriers – and more importantly their intraLATA toll customers – should not be required to pay these excessive rates for another day, much less another year or more.

60. Verizon has also failed to demonstrate that any delay is necessary. At any time after July 1, 2002, Verizon could have filed a rate case to rebalance its rates. Such a filing would have permitted Verizon to address both the allegations in AT&T's Complaint and the \$105 million that Verizon claims to be under earning annually. Had Verizon made such a filing proposing revised rates effective on or shortly after July 1, 2002, the Commission order resolving these issues would have been due over one month ago.⁷⁹ Verizon made no such filing, demonstrating that Verizon obviously prefers further delay to a prompt resolution of the issues. Nor can Verizon credibly claim that immediately granting AT&T its requested relief would unreasonably deprive Verizon of needed revenues in light of the fact that Verizon devoted its resources to defending a \$40 million complaint case while allegedly continuing to suffer losses of \$105 million.⁸⁰ Indeed, Verizon would not even commit to filing a rate case after the Commission issues its order in this proceeding, stating only that such a filing is a "possibility."⁸¹

⁷⁹ See RCW 80.04.130(1).

⁸⁰ See Tr. at 827-29 (Verizon Fulp).

⁸¹ *Id.* at 829. Even when pressed by the Commissioners, Mr. Fulp was willing to represent only that a rate case filing is a "strong possibility." *Id.* at 875-76. Verizon also was willing to agree to a further overall revenue reduction of \$7 million to settle this case, Ex. 300, further undermining Verizon's claim that revenue increases are a prerequisite to requiring Verizon to reduce its access rates.

If a \$40 million reduction to Verizon's access charges makes a rate case filing only a "possibility," Verizon has provided the Commission with no basis for further delaying that reduction.

61. If the Commission nevertheless is concerned about the impact of a reduction in access charges on Verizon's intrastate revenues, the Commission should adopt Staff's proposal for a retail access charge.⁸² Staff's proposal would provide Verizon with the opportunity to generate the same amount of revenue it currently generates through its intrastate access charges, but that revenue would be collected directly from Verizon's local exchange customers who make intraLATA toll calls, rather than from "customers of other companies through the mechanism of statewide long-distance averaging."⁸³ Such access charge pricing thus would be far more competitively neutral and provide Verizon with fewer opportunities to discriminate against competing unaffiliated toll providers.

62. Verizon has provided no basis on which the Commission should delay granting AT&T's requested relief, and the Commission should refuse to do so. Verizon can file a rate case when and if Verizon believes that it needs to increase its revenues or rebalance its rates. In the meantime, Washington intraLATA toll consumers should not continue to be required to pay rates that incorporate Verizon's unlawful, unfair, unjust, and unreasonable access charges.

⁸² Ex. T130 (Staff Blackmon Direct) at 8-9.

⁸³ *Id.* at 9.

III. CONCLUSION

63. Verizon's switched access rates are unlawful, unfair, unjust, and unreasonable.

Accordingly, the Commission should grant the relief requested in AT&T's Complaint and should require Verizon immediately to reduce those rates to forward-looking cost based levels.

RESPECTFULLY SUBMITTED this 9th day of June, 2003.

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