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REPLY TO
ATTENTION OF

Regulatory Law Office
U 4124

December 16, 2004

VIA ELECTRONIC FILING (12/17/04) & OVERNIGHT MAIL

Commission Secretary
Washington Utilities & Transportation Commission
P.O. Box 47250
1300 S. Evergreen Park Drive, S.W.
Olympia, WA 98504-7250

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Subject: **DoD/FEA's Rate Design Testimony (General Rate Case)**

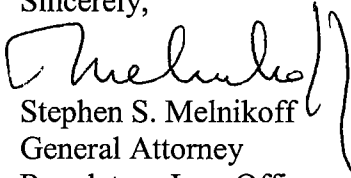
In Re: **Docket No. UT-040788** – Washington Utilities and Transportation Commission,
Complainant, v. Verizon Northwest Inc., Respondent.

To The Honorable Commission Secretary:

Pursuant to the Notice (December 9, 2004) of the presiding Administrative Law Judge in the above-referenced proceeding, enclosed for filing are the original and fifteen (15) copies of the Rate Design Testimony (General Rate Case) of Robert W. Spangler (including the exhibits thereto) on behalf of the United States Department of Defense and All Other Federal Executive Agencies (collectively referred to herein as "DoD/FEA"). **Certain of the enclosed exhibits contain information asserted by Verizon to be CONFIDENTIAL in nature and are provided pursuant to the Protective Order in this docket.** Public versions of the confidential exhibits are also enclosed.

In accordance with the Commission's Rules, a Certificate of Service is appended. Copies of this filing are being sent to all parties of record in accord with the Certificate of Service. Inquiries to this office regarding this proceeding should be directed to the undersigned at (703) 696-1643.

Thank you for your cooperation and assistance in this matter.

Sincerely,

Stephen S. Melnikoff
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Enclosures: Fifteen (15) Copies

CF: See Certificate of Service (12/17/04 electronic service & 12/16/04 overnight mail)
Honorable C. Robert Wallis (Email on 12/17/04)

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION
COMMISSION

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

Complainant,

v.

VERIZON NORTHWEST INC.,

Respondent.

Docket No. UT-040788

THE UNITED STATES DEPARTMENT
OF DEFENSE AND ALL OTHER
FEDERAL EXECUTIVE AGENCIES

CERTIFICATE OF SERVICE

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CERTIFICATE OF SERVICE

I certify that I have caused a copy of the foregoing document, together with this Certificate of Service, in Docket No. UT-040788 to be sent this day by electronic service (email) and postage prepaid, properly addressed, overnight U.S. Mail (or private courier) to the counsel and parties named below, as indicated:

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Dated this 16th day of December 2004,
at Arlington County, Virginia.



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(12/3/04)

EXHIBIT NO. ____ (RWS-1T)
Docket No. UT-040788
DoD/FEA

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION
COMMISSION

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

Complainant

v.

VERIZON NORTHWEST, INC.,

Respondent

Docket No. UT-040788

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STATE OF WASH.
UTIL. AND TRANSP.
COMMISSION

TESTIMONY OF

ROBERT W. SPANGLER

On behalf of

THE UNITED STATES DEPARTMENT OF DEFENSE

And

ALL OTHER FEDERAL EXECUTIVE AGENCIES

December 15, 2004

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I. INTRODUCTION AND QUALIFICATIONS

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

A. My name is Robert W. Spangler. I am a Senior Consultant at Snavelly King Majoros O'Connor & Lee, Inc. ("Snavelly King"), an economic and management consulting firm. My business address is 1220 L Street, NW, Suite 410, Washington, DC 20005.

Q. WHAT IS YOUR EDUCATIONAL BACKGROUND?

A. I received a B.A. degree, with a major in economics, from The Pennsylvania State University in 1963. I received an LL.B. degree from Duke University in 1966.

Q. PLEASE DESCRIBE SNAVELY KING.

A. Snavelly King, formerly Snavelly, King & Associates, Inc., was founded in 1970 to conduct research on a consulting basis into the rates, revenues, costs and economic performance of regulated firms and industries. The firm has a professional staff of 14 economists, accountants, engineers and analysts. Most of its work involves the development, preparation and presentation of expert witness testimony before Federal and state regulatory agencies. Over the course of its 34-year history, members of the firm have participated in over 500 proceedings before almost all of the state commissions and all Federal commissions that regulate utilities or transportation industries.

Q. PLEASE DESCRIBE THE TYPE OF WORK YOU HAVE PERFORMED WHILE AT SNAVELY KING.

A. Since joining Snavelly King in 2002, I have assisted clients in proceedings before

1 state regulatory commissions related to a variety of matters involving
2 telecommunications regulation, including the classification of local telephone
3 services as competitive, and state proceedings responding to the Federal
4 Communications Commission's ("FCC") Triennial Review Order. I also advise
5 clients as to regulatory issues under consideration by the FCC.

6 **Q. WHAT WAS YOUR EMPLOYMENT PRIOR TO JOINING SNAVELY**
7 **KING?**

8 A. I have been involved with the regulation of telecommunications carriers
9 (including rate of return, cost allocation and rate development issues) since 1970,
10 when I joined the federal General Services Administration as an attorney in the
11 Office of General Counsel specializing in utility regulation before federal and
12 state commissions. In 1975 I joined the FCC's Common Carrier Bureau, and I
13 served in various management capacities in that Bureau until my retirement in
14 1998. A full description of my positions and responsibilities at the FCC is
15 contained in Exhibit No. ____ (RWS-2). My primary duties initially included the
16 conduct of on-the-record rate proceedings examining the rates, practices and cost
17 allocation methods of interstate carriers such as AT&T and Western Union.
18 Subsequently, I held management responsibilities for areas such as implementing
19 procedures for allocating costs between regulated and non-regulated activities,
20 and implementing the FCC's Computer II and affiliate transaction rules. I also
21 supervised the resolution of formal and informal complaints asserting that
22 interstate carriers' rates and practices violated the federal Communications Act.
23 As Deputy Chief for policy in the Enforcement Division, I also supervised FCC

1 rulemaking proceedings implementing various provisions of the
2 Telecommunications Act of 1996, and FCC efforts to deal with consumer-related
3 issues such as the unauthorized conversion of long distance service.

4 Following my retirement from the FCC, I became a consultant in the area of
5 telecommunications regulation. In 1999 I associated with Wallman Strategic
6 Consulting, LLC as a Senior Advisor. That firm (and its successor) assisted a
7 wide variety of clients before the FCC, state and federal courts and state
8 regulatory agencies in matters involving telecommunications regulation and
9 policy, and tariff interpretation. Clients to whom I directly provided assistance
10 included a provider of cable telephony, two large interexchange carriers, a mid-
11 sized interexchange carrier, a competitive local exchange carrier, a wireless
12 company, and a telecommunications association.

13 **Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE A STATE OR**
14 **FEDERAL REGULATORY COMMISSION?**

15 A. No.

16 **Q. FOR WHOM ARE YOU APPEARING IN THIS PROCEEDING?**

17 A. I am appearing on behalf of the United States Department of Defense and all other
18 Federal Executive Agencies ("DoD/FEA").

19 **Q. WHAT IS DoD/FEA'S INTEREST IN THIS PROCEEDING?**

20 A. DoD/FEA is one of the largest users of telecommunications services in
21 Washington, and accordingly it has an interest in assuring that the rates that it
22 pays are just, reasonable and non-discriminatory. DoD/FEA obtains a variety of
23 services from Verizon for federal offices, activities and installations located in

1 both urban and rural locations in Washington. These telecommunications
2 services range from small office services to large PBX systems. DoD/FEA also
3 obtains services through competitive bidding procedures whenever possible.
4 Thus, DoD/FEA supports regulatory decisions that encourage carriers to provide
5 telecommunications services at market-driven competitive rates.

6 **Q. WAS THIS TESTIMONY PREPARED BY YOU OR UNDER YOUR**
7 **DIRECT SUPERVISION?**

8 A. Yes, it was.

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

10 A. In this testimony, I address rate design issues pertinent to the request of Verizon
11 Northwest, Inc. ("Verizon") for an increase in its rates for local exchange services,
12 as set forth in the direct testimony of Verizon witness Orville D. Fulp.

13 **Q. WHAT DO YOU CONCLUDE?**

14 A. I conclude that, although Verizon's basic approach to establishing local exchange
15 rates moves some rates more closely to the costs that Verizon has identified, the
16 company has failed to reduce sufficiently the differential between rates for
17 business and residential exchange services such as Premium One Party Flat
18 services. Moreover, Verizon improperly proposes to continue to charge a
19 differential of \$5.00 monthly for Premium PBX trunks and Premium Key System
20 trunks compared to Premium One Party Flat business lines, although its cost
21 analysis fails to support that differential.

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II. BACKGROUND

Q. HAVE RATES FOR BUSINESS EXCHANGE SERVICES TRADITIONALLY BEEN SET HIGHER THAN THOSE FOR CORRESPONDING RESIDENTIAL SERVICES?

A. Yes. The history of telecommunications regulation during the 20th century reflects a tendency of regulatory agencies to maintain business rates that exceeded corresponding residential rates by a large factor, especially when cost differences were taken into account. There were several reasons for this ratemaking approach. One reason was a desire to make telephone subscribership as widespread as possible. Including more subscribers on the nationwide network increased the value of the network to all subscribers. One way to accomplish this goal was to ensure that residential rates were set low enough to encourage subscribership throughout the nation, including areas where costs were higher and cost-based residential rates may have discouraged subscribership. Also, regulatory agencies maintained business rates higher than residential rates in part because business service generated business revenues, and the cost of the service could be deducted as a business expense. Thus, service was seen to have "more value" to business subscribers, which should be reflected in the higher business rates. Also, it was thought that higher business rates were warranted because businesses used the network to make more calls than did residential subscribers, and those calls usually were made at the peak periods.

1 **Q. DID REGULATORY AGENCIES HAVE METHODS OTHER THAN**
2 **MAINTAINING HIGHER BUSINESS RATES TO ENSURE THAT**
3 **RESIDENTIAL RATES WERE KEPT LOW?**

4 A. Yes. In addition to setting higher business rates, there were several methods of
5 maintaining residential exchange rates at a level that did not necessarily
6 compensate the company for the costs of incurring residential service. One
7 method was to set toll rates at levels that would provide revenue support for
8 exchange rates in addition to covering the cost of toll service. Another method
9 was to create separations procedures that shifted plant and expenses to interstate
10 operations, thereby lessening the need for higher rates for intrastate services.
11 Finally, a regulatory agency often set exchange rates in urban areas at a level that
12 exceeded corresponding costs, so that exchange rates in rural or higher-cost areas
13 could be maintained at a lower level.

14 **Q. ARE THE ABOVE FACTORS THAT MAY HAVE LED TO BELOW-**
15 **COST RESIDENTIAL RATES IN THE PAST APPROPRIATE TODAY?**

16 A. No. The primary reasons why the old ratemaking approach is no longer
17 appropriate or necessary flow from changes in the telecommunications industry,
18 especially those mandated by the Telecommunications Act of 1996. That Act,
19 among other things, removed legal and regulatory barriers to competitive
20 provision of local exchange service. Competitors accordingly have entered the
21 market for the provision of local service, although with varying degrees of

1 coverage.¹ The 1996 Act also created other methods of providing support for
2 certain residential exchange services, such as contributions to support universal
3 service (which I discuss below).

4 **Q. HOW DOES THE COMPETITIVE PROVISION OF LOCAL SERVICE**
5 **AFFECT THE ABILITY OF INCUMBENT CARRIERS AND**
6 **REGULATORY COMMISSIONS TO SET LOCAL RATES?**

7 A. Competitors (except perhaps cable telephony providers) have focused
8 considerable efforts to provide local service to business customers. When a
9 carrier or a regulatory commission establishes a rate for business service that
10 exceeds its costs, that action encourages competitors to market their offerings to
11 the business customers of the regulated incumbent carrier, especially those
12 customers who can be expected to purchase larger, more complex systems.
13 When the incumbent loses a business customer to a competitor, part or all of the
14 revenue stream that provided support for local rates is lost, depending on the
15 manner in which the competitive carrier provides the service. Thus, the presence
16 of competitors requires regulatory commissions and incumbent carriers to pay
17 greater attention to, and reduce the differences between, residential and business

¹ A major focus of competitors has been larger business customers. The FCC semi-annually collects and publishes data as to local service competition. The most recent report shows that competitive local exchange carriers (CLECs) provide 63 percent of their nationwide end-user switched access lines to residential and small business customers, whereas the incumbent carriers provide 78 percent of their end-user lines to those customers. In Washington, however, CLECs provide only 51 percent of their end-user lines to residential and small business customers. Local Telephone Competition: Status as of December 31, 2003, Federal Communications Commission, June 18, 2004, Table 11. "Residential and Small Business Customers" are those with fewer than four voice-grade equivalent lines used for local service. *Id.*, p. 1.

1 rates for the same type of service. In other words, the emergence of competition
2 requires that rates be more closely related to the incumbent's costs of providing
3 service to avoid the loss of lines for reasons not related to the quality (or other non
4 price-related factors) of the service provided.

5 **Q. IF THE INCUMBENT'S ABOVE-COST BUSINESS EXCHANGE RATES**
6 **MAKE BUSINESS CUSTOMERS MORE ATTRACTIVE TO**
7 **COMPETITORS WHO MAY CHARGE LESS, WHY SHOULD A**
8 **BUSINESS CUSTOMER SUCH AS DoD/FEA BE CONCERNED WITH**
9 **THE INCUMBENT'S RATES?**

10 A. There are two reasons why competitive alternatives to the incumbent's high-
11 priced services may not benefit business customers. First, it may be that the
12 competitors do not target smaller businesses, or they may choose not to provide
13 service to a particular geographic area. Under those circumstances, the incumbent
14 can charge the above-cost rate without fear of a competitive response; however,
15 that could not be sustained long-term in a fully-competitive market. Moreover, if
16 the incumbent carrier prices business service substantially above costs, a
17 competitor whose costs of providing the service also are lower does not have an
18 incentive to price its offerings at a cost-based rate. Rather, the incumbent's
19 excessive rate has created an "umbrella" under which the competitor also can
20 charge a high rate -- albeit a rate lower than that of the incumbent. Under those
21 circumstances, the customer fails to enjoy the cost-based, lower-priced service
22 that it would obtain in a fully-competitive market.

1 **Q. DID OTHER PROVISIONS OF THE 1996 ACT HAVE AN IMPACT ON A**
2 **COMMISSION'S NEED TO MAINTAIN LOW RESIDENTIAL**
3 **EXCHANGE RATES BY IMPOSING ABOVE-COST BUSINESS RATES?**

4 A. Yes. The 1996 Act required all interstate telecommunications carriers, and other
5 providers of interstate telecommunications as determined by the FCC, to
6 contribute on a nondiscriminatory basis to the mechanisms that the FCC
7 established to preserve and advance universal telecommunications service. States
8 were authorized to create or maintain state-specific support programs to advance
9 universal service.² The creation of the universal service funds (or comparable
10 mechanisms) and the explicit support thus provided to eligible carriers by nearly
11 all telecommunications carriers to provide service in high-cost and other areas
12 have reduced the need for states to maintain lower residential rates through the
13 artificial mechanism of setting local business exchange rates well above cost.

14 **Q. IS IT STILL POSSIBLE FOR LONG DISTANCE SERVICES TO BE**
15 **PRICED AT A LEVEL THAT PROVIDES SUPPORT FOR LOCAL**
16 **SERVICES?**

17 A. No. The ability of a carrier to support residential local service costs with
18 revenues from long distance services is much more limited than it was previously.
19 Competition, technological changes, wireless services and prepaid calling card
20 services have forced toll rates downward, with a correspondingly smaller
21 potential for incumbents to provide revenue support for local service. Changes in

² It is my understanding that Washington does not have an explicit state Universal Service Fund; rather, interexchange carriers provide intrastate universal service contributions through an interim terminating access charge. Other support sources include the Washington Telephone Assistance Program.

1 access charge pricing, imposition of the FCC-mandated Subscriber Line Charge,
2 and reductions in access charges, such as that imposed by the Commission in
3 Docket No. UT-020406,³ have also reduced the incumbents' ability to support
4 residential service through rates for toll services.

5 **Q. PLEASE SUMMARIZE THE CHANGES IN THE ABILITY AND NEED**
6 **FOR INCUMBENT CARRIERS TO CHARGE NON COST-BASED**
7 **RATES FOR BUSINESS EXCHANGE SERVICE.**

8 A. In a market in which competitors offer service, the mandated pricing of business
9 services above cost will create an imperfect competitive arena. Competitors will
10 focus on business customers, but not necessarily charge cost-based rates as long
11 as they can undercut the incumbent's prices. The below-cost residential rates
12 make these services less attractive to potential competitors, and the incumbent
13 loses the implicit support provided by business customers who have moved to
14 competitors, creating pressure to obtain revenues from other areas, including
15 residential rates. Thus, both business and residential customers are disadvantaged
16 by misguided pricing policies. A significant amount of support for residential
17 services, previously generated by above-cost business rates, now can -- and
18 should -- be obtained through other sources that have been made available to local
19 carriers.

³ AT&T Communications of the Pacific Northwest, Inc. v. Verizon Northwest, Inc., Docket No. UT-020406, *Eleventh Supplemental Order* (August 12, 2003).

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III. VERIZON'S RATE PROPOSAL

Q. HOW DOES VERIZON PROPOSE TO RECOVER THE BULK OF THE PURPORTED REVENUE DEFICIENCY FROM LOCAL EXCHANGE SERVICE CUSTOMERS?

A. Verizon proposes to add a fixed amount of \$9.80 per month to all local service line and trunk charges, both business and residential, to recover the alleged revenue deficiency.⁴

Q. DO YOU AGREE WITH THAT APPROACH?

A. No. Verizon apparently did not attempt to set rates that were designed to correspond to individual service costs, which is especially troublesome given the passage of time since Verizon's last general rate case. Verizon's approach is better than applying a simple uniform percentage increase on all lines, but only because Verizon's approach appropriately decreases the current differences between the rates for residential and business service. The current rate structure, for example, requires business subscribers to pay \$29.70 for a premium one party flat line. A residential user pays only \$13.00. That is a difference of 128 percent. Adding the \$9.80 proposed increase to each of the existing line rates reduces the difference to 73 percent, which is still substantial and inappropriate.

⁴ My testimony deals only with rate design, not the need (if any) for increased intrastate revenues. The principles that I discuss herein are appropriate for implementing any change in Verizon's revenue requirement, increased or decreased.

1 **Q. IF VERIZON IS PROPOSING TO REDUCE THE RATE DIFFERENCE**
2 **THAT BUSINESS USERS MUST PAY COMPARED TO RESIDENTIAL**
3 **USERS, WHY ARE YOU OPPOSED TO THAT STEP?**

4 A. Verizon's position has been that there are minimal, if any, differences between the
5 company's provision of a business exchange line and a residential exchange line.
6 Verizon witness Steven M. Banta, Verizon Group President -- Northwest and
7 Southwest Regions, for example, stated in the interim proceeding that the services
8 are essentially the same.⁵ Maintaining a rate differential of the magnitude that
9 Verizon proposes is inconsistent with Verizon's claim of service similarity.

10 **Q. DOES VERIZON CLAIM THAT THE COST OF PROVIDING A**
11 **BUSINESS LINE EXCEEDS THE COST OF PROVIDING A**
12 **RESIDENTIAL LINE?**

13 A. No. Rather, Verizon's cost study results show the opposite: the direct and shared
14 costs associated with residential exchange service are greater than those costs
15 associated with the corresponding business service. This consideration cannot be
16 reconciled with Verizon's proposal to set business exchange rates 73 percent
17 above corresponding residential rates. Moreover, the costs for certain business
18 services as identified by Verizon are substantially less than Verizon's proposed
19 rates for those services.⁶

⁵ Tr. 261.

⁶ Compare Exhibit No. ____ (KCC-2C) and Exhibit No. ____ (ODF-2).

1 **Q. DOES VERIZON'S DIRECT TESTIMONY IN THIS PROCEEDING**
2 **ACKNOWLEDGE THE NEED TO TAKE COMPETITION INTO**
3 **CONSIDERATION IN SETTING LOCAL RATES?**

4 A. Yes. Verizon witness Orville D. Fulp, for example, states that if the proposed
5 rates are approved, Verizon will have to "closely monitor demand for these
6 [above-cost] services, as well as competitive actions of other carriers."⁷ In the
7 interim phase of this proceeding, Verizon witness Banta acknowledged that
8 increasing rates for competitive services to the extent that those customers
9 migrate to competitors would result in Verizon losing the "entire revenue stream"
10 and exacerbate the company's financial situation.⁸ Maintaining high, above-cost
11 business rates is inconsistent with Verizon's position as to the effect of
12 competition. Its approach to setting rates is neither an effective response to the
13 presence of competitors nor fair for business customers, for the reasons that I have
14 described above. If the company is concerned about a competitive response to its
15 increase in business rates, it should take action now in a general rate case to align
16 rates and costs, rather than wait until a future period, seek selected rate changes
17 and then attempt to recover the lost revenues from other services.

18 **Q. DID YOU INQUIRE INTO WHETHER VERIZON IS IN FACT SUBJECT**
19 **TO COMPETITION IN ITS WASHINGTON SERVICE AREA?**

20 A. Yes. DoD/FEA requested data from Verizon because the company did not
21 furnish any support for its general claims (also asserted by Verizon witness James

⁷ Exhibit No. ____ (ODF-1T), p. 4).

⁸ Tr. 325.

1 H. Vander Weide) that Verizon faces competition for the provision of local
2 service. I have attached as Exhibit No. ____ (RWS-3C) Verizon's response to a
3 DoD/FEA request for more specific information as to the existence of
4 competitors' exchange service in the Verizon wire centers. That exhibit confirms
5 that competitors who rely on Verizon for part or all of their local service offerings
6 are operating in many wire centers in Verizon's service area, and, significantly,
7 are providing local service to business customers in the Seattle Metropolitan
8 Statistical Area (MSA). I note that in Docket No. UT-030614, the Commission
9 found that Qwest faced effective competition throughout its service area for its
10 business exchange services, and accordingly reclassified them as competitive.⁹
11 Given that Qwest's service area in the Seattle MSA is not far from Verizon
12 service areas such as Bothell and Redmond, it would be surprising if the
13 competitive carriers operating in the Qwest service area did not also target
14 Verizon's business customers nearby. The data in Exhibit No. ____ (RWS-3C)
15 include lines provided only by competitors who are Verizon's wholesale
16 customers. In addition to these competitive access lines, other companies may
17 provide exchange service using only their own facilities or Voice Over Internet
18 Protocol. However, I caution that currently there is uncertainty as to the nature
19 and extent of local competition using wholesale facilities, and accordingly
20 Verizon's data must be viewed in the particular context of this case. For this
21 reason I testify here only that competition for Verizon's business exchange

⁹ In the Matter of the Petition of Qwest Corporation For Competitive Classification of Basic Business Exchange Telecommunications Services, Docket No. UT-030614, *Order No. 17* (December 22, 2003).

1 services appears to be emerging, and these business services doubtless will remain
2 or have the potential to be the target of competitors in the future local
3 telecommunications market.

4 **Q. IN THE US WEST GENERAL RATE PROCEEDING (DOCKET NO. UT-**
5 **950200), THE COMMISSION PRESCRIBED BUSINESS RATES FOR US**
6 **WEST THAT SUBSTANTIALLY EXCEEDED CORRESPONDING**
7 **RESIDENTIAL RATES. DID VERIZON ADDRESS THE FACTORS**
8 **THAT LED THE COMMISSION TO ADOPT THE US WEST RATE**
9 **STRUCTURE IN 1996?**

10 A. Not significantly, other than the brief and unsupported references to competitive
11 alternatives that I mentioned above. There are, however, several differences
12 between the information available to the Commission more than eight years ago
13 in Docket No. UT-950200 and the information available to the Commission in the
14 subject proceeding. First, the Commission in the *US West Order* declined to
15 consider the existence of competition as a factor in setting business exchange
16 rates. The Commission found that "effective or price-constraining competition
17 does not exist," and that to the extent that US West predicated its proposals on
18 competitive threats, "those proposals should be rejected."¹⁰ The degree of local
19 competition now facing Verizon, however, is quite different from that facing US
20 West (or Verizon) in 1996.¹¹

¹⁰ Washington Utilities and Transportation Commission v. US West Communications, Inc., Docket No. UT-950200, *Fifteenth Supplemental Order*, p. 106 (hereafter cited as *US West Order*).

¹¹ The FCC's semi-annual Local Competition Reports, summarizing comprehensive filings by local exchange carriers as to lines provided to end-user customers, indicate that the number of competitive lines

1 **Q. WHAT OTHER FACTORS CONCERNING BUSINESS AND**
2 **RESIDENTIAL SERVICE ARE APPLICABLE TO DESIGNING**
3 **EXCHANGE RATES FOR THOSE SERVICES?**

4 A. One consideration is network usage. In the *US West Order*, the Commission
5 justified the price differential in part because of "calling patterns and volumes."¹²
6 Verizon responded to a data request as to calling volumes, which I have attached
7 as Exhibit No. ____ (RWS-4C). I believe, based on the calling data summarized
8 in Verizon's study, that the Commission should not consider this factor as a basis
9 for establishing business exchange rates that are higher than residential rates.

10 **Q. THE COMMISSION ALSO STATED IN THE *US WEST ORDER* THAT**
11 **THE DIFFERENTIAL BETWEEN BUSINESS AND RESIDENTIAL**
12 **RATES WAS JUSTIFIED IN PART BECAUSE BUSINESS USERS**
13 **RECEIVED FASTER REPAIR SERVICE. IS THIS THE CASE FOR**
14 **VERIZON?**

15 A. It appears that Verizon has adopted an informal policy of attempting to provide
16 repair service to business customers "as quickly as possible."¹³ Verizon's tariff
17 does not accord business customers faster repair service, however, and business
18 customers therefore are not assured that they will receive preferential treatment as
19 to residential customers when a repair is requested. Given the absence of any
20 tariff provision that ensures that business customers (including Verizon's many

in Washington increased from 138,449 lines (provided by nine reporting CLECs) as of December 31, 1999 (the first such report) to 433,977 lines (provided by 14 reporting CLECs) as of December 31, 2003.

¹² *US West Order*, p. 111.

¹³ Verizon response to DoD/FEA Data Request No. II-16. Verizon attached to that response data from its ARMIS reports showing that business outages are generally shorter than residential outages.

1 small business customers) are entitled to preferential treatment in this regard, and
2 in light of the absence of data showing that Verizon incurs proportionately higher
3 repair costs for business users, the Commission should accord this factor little or
4 no weight in designing exchange rates for business users compared with
5 residential users.

6 **Q. DURING CROSS-EXAMINATION IN THE INTERIM PHASE OF THIS**
7 **PROCEEDING, VERIZON WITNESS BANTA STATED THAT**
8 **VERIZON'S COST OF PROVIDING A BUSINESS LOOP IS LOWER**
9 **THAN THAT FOR A RESIDENTIAL LOOP BECAUSE THE AVERAGE**
10 **BUSINESS LOOP LENGTH IS LESS.¹⁴ DID YOU CONFIRM THAT THIS**
11 **IS THE CASE?**

12 A. Yes. I reviewed documentation in Verizon's cost study as to average loop lengths
13 for the Verizon wire centers. I found that for only a very few Verizon wire
14 centers are average residential loops shorter than average business loops. In some
15 cases average residential loops are double the length of average business loops.
16 The information that Verizon provided in its cost study on loop lengths is attached
17 as Exhibit No. ____ (RWS-5C). The longer average loop lengths necessary to
18 serve residential customers require Verizon to incur greater investment costs per
19 residence loop than the corresponding investment for a business loop. The higher
20 investment cost required for residential lines in turn creates higher recurring
21 expenses such as depreciation, and a greater amount associated with required

¹⁴ Tr. 302.

1 return. The Commission should consider this difference in setting exchange rates
2 as an offset to any concerns that business usage causes network investment to be
3 higher because of business-day usage characteristics.

4 **Q. ARE THERE COSTS THAT ARE ATTRIBUTABLE TO BUSINESS**
5 **EXCHANGE CUSTOMERS THAT ARE NOT APPLICABLE TO**
6 **RESIDENTIAL CUSTOMERS?**

7 A. Yes, but those costs appear to be minimal. A Verizon business exchange
8 customer receives a free listing in the yellow pages directory. That causes
9 Verizon to incur some small costs to provide the listing information to its
10 directory publisher.

11 **Q. DO YOU BELIEVE THAT THIS FEATURE SUPPORTS BUSINESS**
12 **EXCHANGE RATES THAT ARE HIGHER THAN CORRESPONDING**
13 **RESIDENTIAL RATES?**

14 A. No. Verizon is not required by the Commission or its contract with the directory
15 publisher to provide the free listing, and Verizon has not presented any evidence
16 as to its cost of providing the complimentary listing other than citing the FCC-
17 mandated charge to directory publishers. Given that the FCC's rules establish a
18 "presumptively reasonable" rate of \$0.04 per new listing and \$0.06 per updated
19 listing,¹⁵ the cost to Verizon of providing this feature to business subscribers is
20 minimal (and in fact is recoverable from the directory publishers). Thus, there is

¹⁵ 47 FCR § 64.2325(a).

1 no need to recover that very small cost through monthly charges on every
2 business exchange line.

3 **Q. CAN A HIGHER BUSINESS RATE BE JUSTIFIED BECAUSE BUSINESS**
4 **SUBSCRIBERS, UNLIKE RESIDENTIAL SUBSCRIBERS, CAN DEDUCT**
5 **THE COST IN DETERMINING TAXABLE INCOME?**

6 A. No. Although Verizon did not cite this factor in support of its proposed premium
7 for business service, some regulatory agencies have considered tax-deductibility
8 as a justification for an above-cost business rate. I do not believe that this is
9 proper, and note that this non cost-based pricing approach for the same product
10 seems to be limited to exchange (but not toll) telecommunications services.
11 Moreover, commercial retail transactions do not generally entail a higher price for
12 business customers because the business cost is deductible. This justification is
13 basically a throwback to the pre-1996 approach of seeking non cost-based
14 revenue sources to support residential rates.

15

16 **IV. ALTERNATE RATE PROPOSALS**

17

18 **Q. YOU HAVE CRITICIZED VERIZON'S RATE DESIGN. DO YOU HAVE**
19 **AN ALTERNATIVE?**

20 A. Yes. Establishing rates is not an exact science but an informed judgment, as
21 Verizon witness Fulp testifies.¹⁶ There is no formula for tying business rates to

¹⁶ Ex. No. ____ (ODF-1T), p. 5.

1 residential rates. I believe, however, that an appropriate differential is much less
2 than the 73 percent proposed by Verizon for these services. In the *US West*
3 *Order*, the Commission noted "gradualism" and universal service concerns as
4 relevant considerations in this regard, and stated that it would look at market
5 conditions in future proceedings.¹⁷ In view of the changed market conditions that
6 I have noted, but recognizing that implementing new cost-based business and
7 residential rate relationships should not be made too quickly, I suggest that,
8 should the Commission prefer to take the approach adopted in the *US West Order*,
9 the differential between the Business Premium One Party Flat and the Residential
10 Premium One Party Flat rates be set at no more than 50 percent. For example, if
11 the Commission sets the monthly residential Premium One Party Flat rate at
12 \$16.00, the corresponding business rate would be \$24.00.

13 **Q. WOULD A DIFFERENTIAL OF THIS SIZE RECOGNIZE CONCERNS**
14 **AS TO CONTRIBUTIONS TO SUPPORT UNIVERSAL SERVICE?**

15 Yes. So long as the business rate covered the direct and shared costs associated
16 with that service, revenues from business customers would contribute to common
17 costs and provide support to residential services. The lower residential service
18 rates would be justified in part by the revenues provided by other support
19 mechanisms to the extent deemed necessary. Moreover, that differential would
20 recognize any higher cost attributable to business exchange service resulting from
21 design of the traffic-sensitive portions of the network to meet busy hour demand
22 created by business customers, although such a cost differential doubtless would

¹⁷ *US West Order*, p. 111.

1 not exist when differences resulting from shorter average business loop lengths
2 are taken into account as an offset to the smaller traffic-sensitive costs, if any,
3 associated with network usage.

4 **Q. THE COMMISSION'S STAFF HAS CONCLUDED THAT VERIZON'S**
5 **CURRENT RATES PRODUCE REVENUES THAT EXCEED ITS**
6 **REVENUE REQUIREMENT. WHAT ACTION COULD THE**
7 **COMMISSION TAKE TO IMPLEMENT A RATE DECREASE?**

8 A. In the *US West Order*, the Commission faced such a situation. The Commission
9 concluded that it should not reduce the residential class average flat rate, but that
10 business exchange service rates should be reduced by an amount that represented
11 about 44 percent of the overall revenue decrease, with message toll and switched
12 access services also receiving substantial portions of the decrease.¹⁸ Should the
13 Commission find that Verizon is in fact overearning and that its rates accordingly
14 must be reduced, the Commission should, in order to achieve appropriate
15 realignment of business and residential rates, focus the reduction on business
16 exchange service rates rather than proportionately reducing all exchange rates.

17 **Q. DO YOU HAVE ANY FURTHER COMMENTS ON VERIZON'S**
18 **PROPOSAL?**

19 A. Yes. Verizon has proposed to increase PBX trunk rates by the same amount as
20 other rates -- \$9.80 per month. Currently, rates for Premium PBX trunks are
21 \$5.00 greater than rates for Premium One Party Flat lines. Verizon's proposed

¹⁸ *Id.*, p. 146.

1 PBX trunk rates are well above direct and shared costs, according to its cost
2 study. In the *US West Order*, the Commission found that the costs and usage of
3 business lines and PBX trunks are "similar, though not identical" and that "there is
4 no justification for pricing PBX trunks differently from a business line."¹⁹
5 Verizon's witnesses did not address PBX and business line cost differences in
6 their direct testimony. Although the VzCost analysis does purport to show a cost
7 difference for a Premium PBX trunk compared to a Business Premium One Party
8 Flat line, apparently due to differences in the volume of calls and the cost of
9 termination,²⁰ the \$5.00 differential appears to be unwarranted. Accordingly, I
10 recommend that the \$5.00 difference be decreased to no more than \$3.00 (to
11 account approximately for cost differences that Verizon claims) or, as in the *US*
12 *West Order*, eliminated.

13 **Q. HAS VERIZON ATTEMPTED TO DEVELOP A COST-BASED**
14 **PREMIUM TRUNK - KEY SYSTEM RATE?**

15 A. No. Verizon proposes to maintain a rate difference of \$5.00 between this popular
16 business offering and the Business Premium One Party Flat service. The cost
17 analysis that Verizon has provided, however, purports to show that those service
18 costs are nearly identical.²¹ Because Verizon's witnesses did not provide any
19 explanation for inconsistent rate treatment and Verizon's own data fail to show a

¹⁹ *Id.*, p. 117.

²⁰ Verizon Response to DoD/FEA DR II-19.

²¹ Exhibit ____ (KCC-2C), p. 2.

1 significant cost differential, the Premium Key System Trunk rate should be
2 decreased to recognize the similarity of the costs.

3 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

4 A. Yes.

5

6

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

Complainant

v.

VERIZON NORTHWEST, INC.,

Respondent

Docket No. UT-040788

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**EXHIBIT TO THE
TESTIMONY OF
ROBERT W. SPANGLER
On behalf of
THE UNITED STATES DEPARTMENT OF DEFENSE
And
ALL OTHER FEDERAL EXECUTIVE AGENCIES**

(Verizon Response to DoD/FEA Data Request I-2)

PUBLIC VERSION

DATA REQUEST NO. I-2:

Please list all Verizon wire centers in Washington and identify the county in which each wire center is located. For each wire center, using the definition of "residential and small business users" that is used by the Federal Communications Commission in its reporting requirements for Form 477, provide the following information as of June 30, 2003 and June 30, 2004:

- The number of Verizon switched access lines serving residential and small business end users;
- The number of Verizon switched access lines serving customers other than residential and small business end users;
- The number of CLEC resold switched access lines serving residential and small business end users;
- The number of CLEC resold switched access lines serving customers other than residential and small business end users;
- The number of UNE-P switched access lines provided to CLECs for serving residential and small business end users;
- The number of UNE-P switched access lines provided to CLECs for serving customers other than residential and small business end users;
- The number of unbundled UNE loops provided to CLECs for serving residential and small business end users; and
- The number of unbundled UNE loops provided to CLECs for serving customers other than residential and small business users.

RESPONSE: *(Filed November 12, 2004)*

Verizon objects to this data request and cannot fully respond because it would require Verizon NW to disclose carrier proprietary information. Pursuant to 47 U.S.C. Sec. 222 (b) Verizon NW is prohibited from such disclosure.

Prepared By: Frank Flanagan
Date: November 12, 2004
Witness: TBD

SUPPLEMENTAL RESPONSE:

See Confidential Attachment I-2a for the number of switched access lines by wire center at June 2003 and June 2004. The lines are categorized by Business, Public, and Residential and further differentiated as Retail, Resale, and UNE-P within each category. Business customers are not differentiated between "small business" and "other". County information was not available for this response.

See Confidential Attachment I-2b for the number of business and residential UNE loops by wire center at June 2003 and June 2004. Business customers are not differentiated between “small business” and “other”. County information was not available for this response.

Prepared By: Adolf Andrzejewski

Date: November 16, 2004

Witness: TBD

EXHIBIT NO. ____ (RWS-3)
Docket No. UT-040788
DoD/FEA

**CONFIDENTIAL PER PROTECTIVE ORDER IN
WUTC DOCKET NO. UT-040788**

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

Complainant

v.

VERIZON NORTHWEST, INC.,

Respondent

Docket No. UT-040788

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**EXHIBIT TO THE
TESTIMONY OF
ROBERT W. SPANGLER**

On behalf of

THE UNITED STATES DEPARTMENT OF DEFENSE

And

ALL OTHER FEDERAL EXECUTIVE AGENCIES

(Verizon Response to DoD/FEA Data Request I-11)

PUBLIC VERSION

DATA REQUEST NO. I-11:

For the most recent period for which data are available, please identify the average daily (or monthly) number of local calls originating from Verizon's premium one party flat business lines in Washington and the corresponding number of calls originating from its premium one party flat residential lines in Washington. Provide documentation and workpapers.

Response:

Please see Confidential Attachment I-11.

Prepared By: Tom Pani

Date: October 25, 2004

Witness: Doug Fulp

EXHIBIT NO. ____ (RWS-4)
Docket No. UT-040788
DoD/FEA

**CONFIDENTIAL PER PROTECTIVE ORDER IN
WUTC DOCKET NO. UT-040788**

ROBERT W. SPANGLER

Experience

**Snavely King Majoros O'Connor
& Lee, Inc.
Washington, DC**

Senior Consultant (2002-Present)

Mr. Spangler performs analyses of complex regulatory issues relating to telecommunications that are used in the preparation of draft comments and expert witness testimony before federal and state regulatory agencies.

**Telecommunications Consultant
(1998-2002)**

Mr. Spangler provided consulting services regarding the regulation of telecommunications services at both the federal and state levels, and served as Senior Advisor at Wallman Strategic Consulting, LLC in Washington, DC.

Federal Communications Commission

***Deputy Chief, Enforcement Division, Common Carrier Bureau
(1991-1998)***

Mr. Spangler supervised the preparation of Commission orders in formal complaint and rulemaking proceedings (including implementation of the Telecommunications Act of 1996), supervised enforcement proceedings, coordinated projects with other divisions, and reviewed proposed legislation. He also spoke before numerous groups and before Congress on the Commission's enforcement activities. He served as Acting Division Chief for eight months during 1997-1998.

***Chief, Legal Branch, Accounting and Audits Division, Common Carrier Bureau
(1985-1991)***

Mr. Spangler supervised the preparation of Commission orders dealing with implementation of the Commission's Computer II regulatory program, audits of carriers, depreciation issues, jurisdictional separations and federal preemption.

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COMMISSION

ROBERT W. SPANGLER

Deputy Chief, Hearing Division, Common Carrier Bureau (1975-1985)

As the deputy chief of an interdisciplinary staff of trial attorneys, engineers and economists, Mr. Spangler represented the Bureau or Trial Staff in hearings before the Commission's Administrative Law Judges. He presented the staff's direct case, including the testimony of staff and outside expert witnesses, cross-examined other witnesses, prepared pleadings and briefs and presented oral argument. He also supervised other attorneys and handled many of the administrative functions of the division.

Attorney, Complaints and Compliance Division, Broadcast Bureau (1974-1975)

Mr. Spangler supervised the investigatory work of junior attorneys and investigators, and reviewed and approved investigation reports and Commission agenda items resulting from investigations of broadcast stations.

General Services Administration (1970-1974)

As General Attorney in the Office of General Counsel, Mr. Spangler represented the federal government as a consumer of utility (primarily communications) services in administrative hearings before state and federal regulatory commissions. He prepared pleadings, prepared and presented direct cases, examined witnesses, prepared briefs and presented oral argument.

Attorney, Renewal and Transfer Division, Broadcast Bureau (1968-1970)

Mr. Spangler prepared Bureau and Commission orders and decisions involving the renewal of broadcast stations' licenses. He also worked in this division during the summer of 1966.

United States Army (1966-1968)

Mr. Spangler was a military intelligence officer with assignments at the Army Intelligence Command, Fort Holabird, Maryland and with the 11th Armored Cavalry Regiment, Vietnam. Honorably discharged as a captain.

ROBERT W. SPANGLER

Education

Duke University,
LL.B., 1966

The Pennsylvania State University,
B.A. in Economics, 1963

Davidson College,
1959-1961

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

Complainant

v.

VERIZON NORTHWEST, INC.,

Respondent

Docket No. UT-040788

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**EXHIBIT TO THE
REBUTTAL TESTIMONY OF
ROBERT W. SPANGLER**

On behalf of

THE UNITED STATES DEPARTMENT OF DEFENSE

And

ALL OTHER FEDERAL EXECUTIVE AGENCIES

(Excerpt from Verizon Cost Study -- Average Loop Length)
[Ex. ___(KCC-4C)]

PUBLIC VERSION

EXHIBIT NO. _____(RWS-5)
Docket No. UT-040788
DoD/FEA

**CONFIDENTIAL PER PROTECTIVE ORDER IN
WUTC DOCKET NO. UT-040788**