Suzan DeBusk Paiva
Assistant General Counsel
Pennsylvania

verizon

1717 Arch Street, 17W
Philadelphia, PA 19103

Tel: (215) 466-4755
Fax: (215) 563-2658
Suzan.D.Paiva@Verizon.com

September 18, 2009

VIA ELECTRONIC FILING
James J. McNulty, Secretary
Pennsylvania Public Utility Commission
400 North Street
Commonwealth Keystone Building, 2nd Floor
Harrisburg, PA 17120

RE: Investigation Regarding Intrastate Access Charges and IntraLATA Toll Rates of Rural Carriers, and the Pennsylvania Universal Service Fund
Docket No. I-00040105

Dear Mr. McNulty:

Enclosed please find the Verizon's Replies to Exceptions, being filed by Verizon Pennsylvania Inc., Verizon North Inc. and MCImetro Access Transmission Services, LLC d/b/a Verizon Access Transmission Services in the above-captioned matter.

If you have any questions, please feel free to contact me.

Very truly yours,

Suzan D. Paiva /SDB

Suzan D. Paiva

SDP/slb

VIA E-Mail and First Class U.S. Mail

cc: The Honorable Susan D. Colwell
Cheryl Walker Davis, Esquire, OSA
Attached Certificate of Service

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of Verizon's Replies to Exceptions, upon the participants listed below in accordance with the requirements of 52 Pa. Code Section 1.54 (related to service by a participant) and 1.55 (related to service upon attorneys).

Dated at Philadelphia, Pennsylvania, this 18th day of September, 2009.

VIA E-MAIL and FIRST CLASS U.S. MAIL

Norman J. Kennard, Esquire
Regina L. Matz, Esquire
Jennifer M. Sultzaberger
Thomas, Long, Niesen & Kennard
212 Locust Street, Suite 500
Harrisburg, PA 17108
Rural Telephone Company Coalition

Bradford M. Stern, Esquire
Rothfelder Stern, L.L.C.
625 Central Avenue
Westfield, NJ 07090
Omnipoint Communications Inc. d/b/a T-Mobile; Omnipoint Communications Inc. d/b/a T-Mobile and Voicestream Pittsburgh LP d/b/a T-Mobile Nextel Communications, Inc.

Christopher M. Arfaa, Esquire
Christopher M. Arfaa, P.C.
150 N. Radnor Chester Road, Suite F-200
Radnor, PA 19087-5245
Cingular Wireless LLC
Cellco Parthership d/b/a Verizon Wireless

Joel Cheskis, Esquire
Barrett Sheridan, Esquire
Christy Appleby, Esquire
Office of Consumer Advocate
555 Walnut Street, 5th Floor
Harrisburg, PA 17101-1923

Steven C. Gray, Esquire
Office of Small Business Advocate
300 North 2nd St, Suite 1102
Harrisburg, PA 17101

Zsuzanna Benedek, Esquire
Embarq Corporation
240 North Third Street, Suite 201
Harrisburg, PA 17101

Joseph R. Stewart, Esquire
Embarq Corporation
50 West Broad Street, Suite 3600
Columbus, OH 43215

Michelle Painter
Painter Law Firm, PLLC
13017 Dunhill Drive
Fairfax, VA 22030
AT&T Communications of PA, LLC, TCG Pittsburgh and TCG New Jersey

John C. Dodge, Esquire
Davis, Wright Tremaine, LLC
1919 Pennsylvania Avenue NW
Suite 200
Washington, DC 20006
Comcast Digital Phone and Comcast
Business Communications, LLC

Pamela C. Polacek, Esquire
Shelby A. Linton-Keddie, Esquire
McNees Wallace & Nurick LLC
P.O. Box 1166
100 Pine Street
Harrisburg, PA 17108-1166
Broadband Cable Association of PA

Renardo L. Hicks, Esquire
Stevens & Lee, P.C.
17 North Second Street
16th Floor
Harrisburg, PA 17101

Benjamin J. Aron
Sprint Nextel Corporation
Mailstop: VARESP0201-208
2001 Edmund Halley Drive
Reston, VA 20191

Suzan D. Paiva /SDB

Suzan D. Paiva
Pennsylvania Bar ID No. 53853
1717 Arch Street, 17 NW
Philadelphia, PA 19103
(215) 466-4755

Attorney for
Verizon Pennsylvania Inc.
Verizon North Inc.
MCImetro Access Transmission Services, LLC
d/b/a Verizon Access Transmission Services

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Investigation Regarding Intrastate Access Charges and IntraLATA Toll Rates of Rural Carriers, and the Pennsylvania Universal Service Fund	:	Docket No. I-00040105

VERIZON'S REPLIES TO EXCEPTIONS

Suzan D. Paiva (Atty No. 53853)
Verizon
1717 Arch Street, 17th Floor
Philadelphia, PA 19103
(215) 466-4755

Dated: September 18, 2009

Attorney for Verizon

TABLE OF CONTENTS

Pursuant to 52 Pa. Code § 5.535, Verizon[1] replies to the exceptions filed by the Pennsylvania Telephone Association ("PTA"), the United Telephone Company of Pennsylvania LLC d/b/a Embarq Pennsylvania ("Embarq") (together, the "RLECs") and the Office of Consumer Advocate ("OCA") to the Recommended Decision of Administrative Law Judge ("ALJ") Susan D. Colwell issued on July 23, 2009 ("RD").

INTRODUCTION

In 2004, this Commission opened this investigation to consider reducing the RLECs' reliance on subsidies provided by other telephone carriers from the dual mechanisms of inflated access charges and the state universal service fund ("USF"). The Commission set out to consider "whether there should be further intrastate access charge reductions" for the RLECs and whether the "interim funding mechanism" of the state USF should be altered or eliminated.[2] In the current phase of the investigation, the RLECs turn these clearly stated objectives on their head. Rather than determining how best to ***reduce*** the forced subsidy flow from other telephone carriers to the RLECs, as the Commission directed, the RLECs now demand an exponential ***increase*** in subsidies through the creation of a new USF.

This new proposed USF, which would be fundamentally different in size, scope, operation and purpose from the current temporary and interim USF, would force other carriers to fund the RLECs' annual inflation-based revenue increases under alternative regulation. This proposal runs directly contrary to the will of the Legislature, which presumed that RLECs would raise these revenues from their own operations through "rate changes." 66 Pa. C.S. §3015(b). In addition, as the record before the ALJ demonstrated, this proposal would harm consumers by at once unnecessarily siphoning off revenues from the contributing carriers that should be used for other, more appropriate purposes, while

---

1 Verizon Pennsylvania Inc. ("Verizon PA"), Verizon North Inc. ("Verizon North") and MCImetro Access Transmission Services LLC d/b/a Verizon Access Transmission Services (collectively "Verizon").

2 *Investigation Regarding Intrastate Access Charges and IntraLATA Toll Rates of Rural Carriers, and the Pennsylvania Universal Service Fund*, Docket No. I-00040105 (Opinion and Order entered Dec. 20, 2004) at 3.

also suppressing competition and innovation in the RLECs' territory. The ALJ correctly rejected this ploy and the Commission should adopt her recommendation.

The Exceptions filed by the RLECs and the OCA simply repeat the arguments they made before the ALJ, and are notable for their absolute failure to take on the legitimate criticisms of their self-serving USF proposal. It is evident that what the RLECs really seek is the revenue guarantee of rate-of-return regulation – at the expense of other carriers, including their own competitors – while at the same time reaping all the benefits of deregulation and flexibility provided by alternative regulation. But the RLECs cannot have it both ways. They have chosen to be governed by alternative regulation, under which regulators do not set rates based on the costs of service and their return is not guaranteed. The Commission should make clear that if the RLECs wish to exercise their annual revenue increase opportunities then they must operate under alternative regulation as the Legislature intended, raising new revenue through retail "rate changes" or banking those opportunities. If an RLEC asserts that it cannot stay in business under alternative regulation without additional external subsidies, then that RLEC should go back to rate-of-return regulation and submit itself to a comprehensive rate case, but it should not be entitled to increase its subsidies from other carriers based on the vague claims and generalities that have been presented here.

As part of their proposal to have other carriers finance the RLECs' annual alternative regulation revenue increases, these parties continue to insist that this Commission should use an $18 residential rate "cap" as the departure point for their new USF proposal (i.e., once the RLEC increases its residential rates to $18, it collects any additional revenue opportunities from the USF instead of through rates). But the RD rightly concluded that the record simply does not support maintaining for any purpose this outdated, six-year-old rate cap – which itself was the product of a settlement, not based on any evidentiary findings and intended for a completely different purpose when it was adopted in 2003. In fact, the RLECs' and OCA's own testimony shows that, even under the most conservative view, the evidence would not support a residential rate benchmark lower than $23, and it could easily support a higher level. But if the Commission establishes a residential benchmark rate, it should not be tied to allowing the RLECs to establish a new and expanded USF because there is no legal or evidentiary basis to require other carriers to finance the RLECs' annual revenue increase opportunities. The RLECs also fail to confront the consequences of their failure to present any record evidence to support a cap on their basic business rates, and the unrebutted evidence showing that their business rates are much lower than national averages – which of course means that even if residential rate increases were somehow limited, the RLECs should be raising their business rates rather than claiming an anti-competitive and anti-consumer flow of new subsidies from other carriers through the USF.

As to the current USF, the RD correctly evaluated the record evidence and recommended that the Commission convene a rulemaking to "reform[]" this fund "to provide monetary assistance only to those RLECs for service in high-cost service areas and for assistance to low-income customers." (RD at 66). It is telling that the OCA and RLECs would resist efforts to alter the fund to target it to the very constituency that these parties argue need USF support. The RD's recommendation to alter the current USF is amply supported by the record and should be adopted.

REPLIES TO EXCEPTIONS

Reply to PTA Exception #2; OCA Exceptions #1 and #2: The RD Correctly Held That There Is No Need For Retail Rate Caps In The Context Of The RLECs' Annual Chapter 30 Revenue Increases

A. Introduction

As the RD correctly held, the record shows that there is no need for any rate cap in the context of the RLECs' annual rate increases. (RD at 66). The PTA wrongly argues that the RD relied on nothing but "policy grounds" to recommend that any rate caps be "discontinued." (PTA Exceptions at 1). It is not at all surprising that the RLEC and OCA Exceptions largely ignore the detailed evidentiary record assembled before the ALJ relating to the rate cap issue, because the evidentiary record squarely refutes their argument to impose an $18 rate cap to limit the RLECs' annual residential rate increases and does not support any business rate cap. Any decision by this Commission to set a rate benchmark as a result of this investigation must be supported by substantial evidence (2 Pa. C.S. § 704), but the RLEC/OCA proposal is not supported by the record. As discussed in response to the RLECs' and OCA's other exceptions, whether or not there are rate caps, the USF should not be used to fund the RLECs' annual revenue increases. But in any event, the record supports the ALJ's conclusion that there should be no rate caps, or alternatively shows that any residential cap should be much higher than $18, and does not support any business cap.

B. The RD Correctly Held That Retail Rate Caps Are "Superfluous" In The Context Of Annual Revenue Increases Under Chapter 30

As the RD correctly recognized, "the evidence and the legal analysis indicates that following the implementation of the Chapter 30 alternative regulation plans of the RLECs, the rate caps are now superfluous." (RD at 75). One of the reasons that there is no need for rate caps to constrain the RLECs' exercise of their rate change opportunities is because Chapter 30 ***already*** contains its own safeguards to limit the pace and magnitude of annual inflation-based rate increases. (VZ Main Br. at 8-11).

Chapter 30's internal safeguards control the pace and magnitude of RLEC retail rate increases in three different ways. First, the authorized revenue increase each year is limited by a formula tied to the rate of inflation. Therefore, the total amount of new revenue each year is statutorily limited and the RLECs do not have discretion to increase revenue arbitrarily. Second, Chapter 30 relies on competitive pressures to control rates. Chapter 30 is designed to allow a carrier to exercise its own discretion to choose which of its noncompetitive service rates to increase – or to choose not to increase rates at all – based on its own assessment of the marketplace. The record evidence shows that competitive pressures are ***already*** constraining the RLECs' decisions whether or not to increase their retail rates, because the RLECs acknowledge that many of them have chosen to bank their revenue increase opportunities even though, if they had increased retail rates, the resulting residential rates would still be below the alleged $18 rate cap and thus would otherwise be allowed even under their rate cap theory.[3] Third, even if, notwithstanding these safeguards, a particular RLEC determines to raise its basic retail rates to a level that potentially raises a concern for the Commission, the Commission still retains authority to review rate levels on a case-by-case basis and may investigate whether the rate increase is just and reasonable to that carrier's end users under 66 Pa. C.S. § 1301.[4]

Notably, Act 183 does not itself impose a cap on RLEC rate increases, and it does not provide for other carriers to subsidize the RLECs' exercise of their annual revenue increases at all, but to the contrary presumes that this new revenue would be secured through "rate changes." 66 Pa. C.S. §3015(b). By seeking a rate cap, coupled with an absolute right to USF revenue once the cap is reached, the RLECs would fundamentally alter and undermine the scheme of alternative regulation established in Chapter 30, by protecting themselves from the competitive market that Chapter 30 intends to foster and encourage. The RLECs want to use the rate cap as a means to obtain a guaranteed, risk-free, competition-proof stream of subsidies from other companies, including from their own competitors, instead of having to make the decision of what retail rate increase the market will bear. The RLECs' testimony makes it clear that the RLECs seek to use this rate cap to obtain the benefits of operating under alternative regulation under a freely competitive market while eliminating all of the risks.[5] In fact, establishing a residential rate cap, at $18 or some other level, together with the prospect of USF subsidies for carriers that increase their residential rates to that level, may have the unintentional effect of encouraging RLECs to increase their retail rates when they might not otherwise

---

3 *See* VZ St. 1.0 (Price Direct) at 24; VZ St. 1.2 (Price Surrebuttal) at 17). Because of these safeguards, the record shows that there is no widespread risk of most RLECs approaching or exceeding the $18 level given present rate levels and the previous pattern of RLEC banking decisions. (VZ St. 1.0 (Price Direct) at 23-24; VZ St. 1.1 (Price Rebuttal) at 22-23). As Embarq's witness Mr. Gutshall conceded, "[e]conomic and affordability considerations will dictate the rate levels RLECs can sustain in their markets." (Embarq St. 1.0 (Gutshall Direct) at 6). If incentives were skewed by the promise of USF money, however, that situation could change.

4 *See* Verizon's response to PTA Exception #1 and Embarq Exception #2.

5 As Embarq's Mr. Gutshall stated, the RLECs wish to obtain revenue from their competitors and other carriers instead of from the RLECs' own customers because they want to increase revenue "without . . . losing access lines to competitors." (Embarq St. 1.1 (Gutshall Rebuttal) at 6). PTA's Mr. Laffey similarly argues that the Commission should use an $18 rate cap as a trigger for USF subsidies because "raising residential local rates above the current $18 cap" would accelerate line loss to competitors in "very competitive" markets. (PTA St. 1 (Laffey Direct) at 6).

have done so. This proposal is anti-consumer, anti-competitive and contrary to the very premise of alternative regulation.

C. If A Residential Rate Cap Is Established For Any Purpose, The Record Requires That It Be Higher Than $18

A second reason that rate caps are superfluous and unneeded in this context is because the record shows that $18 is not a reasonable cap and that there is no danger of RLEC rates becoming unaffordable in the near future if their alternative regulation revenue increase opportunities are permitted to take their natural course with small, inflation-based rate increases each year at the carrier's option, constrained by the inflation-based Chapter 30 formula and the discipline of the competitive market. Accordingly, the RD rightly concluded that rate caps were "superfluous" in this context. There is no need for a residential rate cap at any level, and certainly no justification to cap those rates at $18.

But if the Commission wishes to set a residential rate cap, then the RLECs and OCA concede that, even under their own theory, the rate cap does not necessarily have to be set at $18, and that the actual dollar value of the rate cap could be higher than $18 if the evidence supported it.[6] The RD correctly noted that "the original $16.00 and the subsequent raise to $18.00 numbers were not derivative of an economic analysis designed to create the perfect rate." (RD at 73). The Commission's April 24, 2008 order re-opening this phase of the investigation directed the parties to "address the appropriate benchmark for the rural ILEC residential rate for basic local exchange service," and thus for the first time to evaluate the evidence regarding an affordable RLEC residential rate. (4/24/08 Order at 24). While OCA and the RLECs ask the Commission to set an $18 cap on RLEC residential

---

[6] *See* Tr. at 104 (Dr. Loube testifies that the "benchmark rises" as Verizon's rates rise); Tr. at 483 (Mr. Laffey concedes that he is "not testifying that the rate cap could never be changed in the future" and that "it would be reasonable for that rate [cap] to be looked at periodically.") In Commonwealth Court briefing both the OCA and certain of the RLECs have conceded that this Commission has the authority to eliminate or increase any residential rate cap that might currently exist. (Verizon Main Br. at 11; see also OCA Exceptions at 21). Since these parties concede that the rate cap does not have to be set at $18 or at any particular level, OCA's argument that the rate cap was "codified" through 66 Pa. C.S. 3015(g) is academic, at best. The RD correctly held that this argument "is not realistic and certainly not supported by the wording of the section itself." (RD at 77).

rates as a result of this evidentiary proceeding, the record evidence simply does not support their argument.[7]

The RLECs and OCA continue to appeal to the general concept of "affordability" as the primary basis to support an $18 cap on RLEC residential rates. (OCA Exceptions at 6; PTA Exceptions at 2). OCA complains that the RD allegedly "did not consider the only record evidence regarding affordability – the testimony of OCA witness Roger Colton." (OCA Exceptions at 7). But as Verizon pointed out in its Main Brief – and OCA failed to acknowledge in its exceptions – Mr. Colton admitted under cross-examination that even under his absolute most conservative analysis the "affordability" level in Pennsylvania is $32 – and therefore does not even come close to supporting an $18 rate cap.[8] As Mr. Colton explained, when fees and taxes are included, the $18 rate cap is equivalent to about a $27 local telephone bill, which is ***a full $5 lower*** than his most conservative "affordability" level of $32, and Mr. Colton conceded that every single one of the RLECs "currently [has] basic service rates below the affordability [level]," with the highest RLEC rates still about $5 below and the lowest RLEC rates being a full $15 below the ***most conservative*** affordability level of $32.[9] Mr. Colton was therefore forced to concede on cross-examination that he was not testifying

---

7 The OCA contends that the $18 rate cap must continue in effect until there is a "rulemaking" to change it. (OCA Exceptions at 16). But the rate cap was not established through a rulemaking and so a rulemaking would not be required to revise or eliminate it. Notably, the Commission's USF regulations do not refer to an $18 or any other rate cap. In fact, Verizon believes the rate caps have already expired by their own terms, but even if they remain in effect, this proceeding has provided sufficient notice and opportunity to be heard and the caps may be eliminated or revised as a result.

8 Tr. at 132; OCA St. 2 (Colton Direct) at Schedule RDC-5; VZ St. 1.1 (Price Rebuttal) at 24; VZ Main Br. at 13. Mr. Colton was the only witness to provide evidence of "affordability" for basic residential rates in Pennsylvania, and so there is no evidence to support an affordability level lower than $32. Further, Verizon's Mr. Price demonstrated that with a few minor and well-supported corrections, Mr. Colton's analysis would actually yield a much higher affordability level in the range of $43. (Verizon Main Brief at 14).

9 Verizon Main Br. At 14; Tr. at 132, 134; *see also* OCA St. 2 at Schedule RDC-4 (showing that, with taxes and fees the RLEC basic residential rates range from a low of $16.72 per month to a high of $27.10 per month, all well below $32); VZ St. 1.1 (Price Rebuttal) at 24.

"that there should or should not be" a retail rate cap or "whether the $18 should be $18 or $16 or some other number," but rather his testimony was "limited to the affordability analysis." (Tr. at 138-139).[10]

PTA vaguely suggests that rate caps are needed to maintain telephone penetration at its currently high levels in Pennsylvania, which is just another spin of the "affordability" argument. (PTA Exceptions at 15). But nothing in the record shows or even suggests that increasing RLEC basic residential rates over $18 would reduce telephone penetration, and in fact FCC statistics show that on a statewide basis the annual average telephone penetration rates for Pennsylvania has increased from 95.6% in 2004 to 97.7% as of March 2008, a period when regulated basic exchange rates have also generally been increasing under Act 183's inflation-based formula. (VZ St. 1.1 (Price Rebuttal) at 28).

Obviously the evidence on "affordability" does not support the RLEC/OCA position to maintain an $18 rate cap, and instead it conclusively refutes their argument and shows that customers can reasonably afford to pay rates well above $18. OCA and the RLECs therefore add a second argument that, even if customers could afford to pay more, RLEC rates must be limited based on "comparability" to urban rates (primarily Verizon's rates). In other words, the only real basis for their argument in favor of an $18 residential rate cap is that the RLEC rates should be limited to keep them "comparable" with Verizon's basic regulated rates. This argument is faulty both as a matter of law and as a matter of fact.

As a matter of law, OCA and the RLECs are wrong in asserting that this Commission has any legal obligation or authority to limit the RLECs' rate increases to maintain "comparability" to "urban" rates or to Verizon's rates. The only legal basis the RLECs and OCA advance in support of their additional criterion of "comparability" is a provision of federal law set forth at 47 U.S.C. § 254(b)(3),

---

[10] Further, as Mr. Colton explained, regardless of where RLEC rates are set, those customers eligible for Lifeline service – the ones for whom the Commission would be expected to have the greatest "affordability" concern – will pay more than ***$10 less*** than the ordinary customer for basic residential service. For example, where the average RLEC customer would pay about $27 for basic local service under an $18 basic rate (when fees and taxes are included), a Lifeline customer would be entitled to various credits and would pay only $15.25 for the same service. (Tr. at 135). Accordingly, OCA's appeal to artificially depress rates for all customers in order to make rates "affordable" for those on fixed incomes does not survive scrutiny. (OCA Exceptions at 6).

which lists as one of the governing "principles" for the FCC and the Federal-State Joint Board on Universal Service that "[c]onsumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high cost areas, should have access to telecommunications . . . at rates that are reasonably comparable to rates charged for similar services in urban areas." 47 U.S.C. § 254(b)(3). (PTA Exceptions at 16; OCA Exceptions at 2). But nothing in the Public Utility Code authorizes this Commission to mandate that RLEC rates must be "reasonably comparable" to any other carrier's rates, and Section 254(b)(3) is not a mandate to ***state*** commissions regarding intrastate rates.[11] The RLECs and OCA point to no Pennsylvania authority mandating the application of a "reasonable comparability" standard to the RLECs' basic residential service rates.[12] In fact, the Commission's Law Bureau in the D&E Commonwealth Court appeal argued that "[t]his federal regulation pertains to federal universal service and is not a mandate to state Commissions. It has no bearing on rural ILECs' receipt of monies from the PaUSF, but may be relevant to non-rural ILECs' participation as recipient carriers regarding the federal USF." (VZ St. 1.1, Exhibit 1 (PUC Commonwealth Court Br.) at 38). Accordingly, the RLECs' and OCA's comparability analysis is irrelevant and this Commission should not attempt to make any comparison to Verizon's basic residential rates – which as Verizon explained in its Main Brief have themselves been kept artificially low by many years of regulatory limitations and do not provide a valid point of comparison. (*See* VZ Main Br. at 17).

[11] For example, the PTA relies on *Tex. Office of Pub. Util. Counsel v. FCC*, 183 F.3d 393 (5th Cir. 1999) (PTA Exceptions at 17), but that Court made clear that Section "254(b) identifies seven principles the FCC should consider in developing its policies; it hardly constitutes a series of specific statutory commands," and in fact is nothing more than "aspirational language." 183 F.3d at 421. PTA also relies on FCC orders, including *In re Federal-State Joint Bd. on Universal Serv.*, 18 FCC Rcd 22559 ¶ 21 (FCC 2003)). But the primary point being made in that order was that "the states retain jurisdiction over intrastate rates," not that federal law constrains the states' exercise of that sovereign authority. *Id.* In fact, although that order was partially vacated on appeal, the Tenth Circuit upheld as correct the FCC's conclusion that "the Act does not mandate state action" with regard to universal service. *Qwest Communs. Int'l, Inc. v. FCC*, 398 F.3d 1222, 1231 (10th Cir. 2005).

[12] PTA suggests that the Commonwealth Court addressed this issue in the appeal of the *Global Order*. (PTA Exceptions at 17). But the Commonwealth Court merely recognized that the Commission had argued on appeal that Section 254(f) generally authorizes state commissions to mandate a universal service fund – and did not address the issue of "comparability" of urban and rural rates. *Bell Atlantic-Pennsylvania v. PUC*, 763 A.2d 440, 497 (Pa. Commw. Ct. 2000).

But even if this Commission attempted to make a comparison to "urban" rates, as a matter of fact that analysis would not permit the Commission to keep the rate cap as low as $18. Even the limited number of states that voluntarily look to "reasonable comparability" with urban rates do not insist on strict equality and have set margins as high as 130% and 150% of urban rates as meeting this standard. (Verizon Main Brief at 17). Neither OCA nor the RLECs assert that these states are violating principles of "comparability" by using these ranges. Indeed, both PTA and OCA concede that some margin above urban rates is appropriate. Given the evidence that the affordability level is much higher than the regulated rates that Verizon is permitted to charge for basic residential service and given that Verizon's rates have been kept artificially low by many years of regulation, if the Commission looks at all to "comparability" it should use the highest margin cited by the OCA, 150%. (Verizon Main Br. at 17).

But as Verizon explained in its Main Brief, even using PTA's arbitrarily low 115% margin, the comparable rate is already more than $18 and would be expected to increase over time as Verizon exercises its own price change opportunities. (VZ Main Br. at 18). The current average basic residential rate in Verizon's urban Density Cells 1 and 2 is $16.21, and 115% of that rate is already more than $18. If one uses OCA's advocated 120% margin, the "comparable" rate is $19.45. If one uses the highest range of comparability cited by the OCA in other states of 150%, the comparable rate would be $24.32, which as discussed above, is within the range suggested by OCA's most conservative affordability analysis. (Verizon Main Br. at 18). Further, Verizon's own rate level can be expected to increase each year as Verizon exercises its own price change opportunities [13]

[13] PTA also purports to compare its proposed $18 rate cap to the national average urban rate as reported in FCC statistics. (PTA Exceptions at 18). PTA erroneously reports that the most recent average is $15.03, but the most recently reported monthly average in the record, from 2007, was $15.62. But as Mr. Price explained, the FCC itself has acknowledged that relying on a national average is not perfect and uses a very wide range of rates that can be considered "comparable" to urban rates nationwide, the upper end of that which is as high as $36.52. (VZ St. 1.1 (Price Rebuttal) Exhibit 3). Moreover, the FCC average is merely an average of existing rates whose levels may themselves have been kept artificially low by regulatory policies that pre-date today's competitive market, leaving PTA with the same circular argument that it makes when comparing to Verizon's rates – that the RLECs' Pennsylvania's rates should not be increased in the future because other carriers' rates have been kept artificially low in

Because the comparability to Verizon's "urban" rates analysis does not support an $18 rate cap, OCA attempts to suppress the Verizon rate to which it benchmarks "comparability" by using a statewide average to achieve a lower ultimate result. But OCA admits that the federal law on which it relies – which is the only source of support cited by any party for a "comparability" analysis – requires rates to be "reasonably comparable to ***urban*** rates for such services," not to statewide rates or rates in other rural areas. OCA does not explain how it could possibly rely on this statute and yet still look to statewide rather than urban rates. Even OCA's "Conclusion" to its Main Brief concedes that it is really only arguing that RLEC rates should be "reasonably comparable to those services provided in ***urban*** areas at rates that are reasonably comparable to rates charged for similar services in ***urban*** areas." (OCA Main Brief at 70) (emphasis added). Therefore, OCA effectively acknowledges that, just like its "affordability" analysis, its "comparability" analysis does not support an $18 residential rate cap.[14]

D. The Record Does Not Support Any Business Rate Cap

Even if the record supported imposing a rate cap that would restrict the RLECs from increasing basic ***residential*** rates to implement their annual price change opportunities – which it does not for the

---

the past. (VZ St. 1.1 (Price Rebuttal) at 36). Moreover, applying a reasonable margin over this average would lead to the same general conclusion as applying a reasonable margin over Verizon's Pennsylvania urban average.

14 OCA also complains that the RD failed to address its economic cost study. (OCA Exceptions at 9, n. 19). But OCA's cost study is not pertinent or helpful in answering the ultimate question of whether $18 is an appropriate level at which to cap RLEC rates. OCA attempted to calculate an "incremental cost" for providing basic local service that did not include the cost of the local loop, but only the other network costs associated with providing service – an exercise that itself was flawed by the use of faulty data because OCA used data derived from the FCC's Synthesis Model, which was not designed for the purpose for which OCA attempted to use it. OCA argues that an $18 "cap" on RLEC basic local service rates is reasonable because the "cap" is not below the purported "incremental" non-loop related cost of providing service. But it is not reasonable to argue that RLEC basic local service rates should be capped at a level that is at or near the "incremental" costs of service without regard to the loop costs – particularly when OCA itself asserts that the cost of the loop is 84% to 91% of a carrier's costs. OCA's witness agreed, conceding in his surrebuttal testimony that he is not asserting that basic residential service should be priced at "incremental cost," that he agrees that the price should be set above his asserted incremental cost to contribute to loop costs, and that the appropriate amount of contribution would be determined based on "the principles of comparability and affordability." (OCA St. 1-S (Loube Surrebuttal) at 8). In short, OCA conceded that its cost evidence was not relevant. The real question presented is what portion of the RLECs' loop costs should be recovered through these residential rates before the rates reach a level that is no longer just or reasonable, and whether it is necessary to impose a cap or benchmark in advance to control them from reaching that level. OCA's cost argument does not address that issue. (Verizon Reply Br. at 14-15).

reasons discussed above – the RLECs and OCA did not even attempt to submit record evidence to support a corresponding cap on basic ***business*** rates. This is a fatal flaw in their arguments for USF support above purported cap levels because even if a particular RLEC reached a point where it was restricted from increasing basic ***residential*** rates due to a rate cap, without a corresponding ***business*** rate cap, that RLEC could still increase its basic business rates to implement its revenue increase opportunity, and possibly raise other non-competitive service rates as well. PTA's Mr. Laffey conceded this fact at the hearing, noting that "if there was no business benchmark rate," then "the compan[ies] could raise . . . business rate[s] in [their] price change opportunit[ies]" and that "[i]f you then take away the business cap there's no ceiling involved there for the Fund to compensate." (Tr. at 499-500 (Laffey)).

These parties have never squarely addressed the testimony submitted by Verizon relating to the RLECs' business rates or explained why they failed to submit evidence on this issue. As Verizon explained in its Main Brief, the RLECs themselves conceded that the national average single line business rate was $36.59 in 2007 (a figure that itself is likely higher today),[15] which is ***$10 higher than*** Embarq's alleged business rate cap of $26.23 and ***$13 higher than*** D&E's alleged business rate cap $23.58, and considerably higher than the RLECs' current business rates. (VZ Main Br. at 20-21). The RLECs advanced no argument that would support requiring other carriers, including their direct competitors, to reimburse the RLECs to allow them to avoid increasing business rates that are presently far below the national average – an absurd and unsupportable proposition.

Given that the RLEC business rates are so far below those of other carriers, there is no need even to consider a "cap" on business rates. The record unquestionably lacks substantial evidence to support a requirement that other carriers fund RLEC revenue opportunities to avoid ***business*** rate increases.

[15] PTA St. 1R (Laffey Rebuttal) at 22.

E. Conclusion

The Commission should reject the entire USF and rate cap scheme advanced by the RLECs and the OCA. Rather, the Commission should allow the RLECs' alternative regulation revenue increases to take their natural course, constrained by the inflation-based formula and the disciplines of the competitive market. As the RD correctly found, rate caps in this context are "superfluous." If, however, the Commission wishes to establish any residential rate benchmark, the record evidence, even viewed in the light most favorable to the OCA and RLECs, does not support a benchmark level lower than $23.

Further, as discussed in Verizon's testimony and briefing, any residential benchmark should function as a safe harbor rather than an absolute cap. So long as an RLEC's rates remain below the safe harbor level, any increases are automatically deemed just and reasonable and do not require further scrutiny, but if the RLEC proposes to increase residential rates above the safe harbor level the Commission may conduct a more detailed analysis of whether the resulting rates will be just and reasonable considering the particular facts and circumstances relating to that RLEC and its customers. (Verizon Main Brief at 10-11). But the rate cap should not be tied to the RLECs' new USF scheme and ultimately any new revenue the RLEC receives must come from its own end users, not other carriers. The record does not support any business rate cap.

<u>Reply to PTA Exception #1; Embarq Exception #2</u>: The Commission Has Already Held That It Has Authority To Disallow An RLEC Rate Change That Is Unjust And Unreasonable

The RLECs persist in advancing an argument that the Commission has already rejected, contending that rates established to implement their annual revenue increases are "per se" just and reasonable and that the Commission lacks authority to perform a "just and reasonable" rate analysis of the RLECs' rates. (PTA Exceptions at 11; Embarq Exceptions at 4). But this Commission has already rejected the RLECs' argument, holding that "the Commission still has the statutory mandate, authority and responsibility under 66 Pa. C.S. § 3019(h) to adjudicate whether the proposed rate changes are just and reasonable and non-discriminatory respectively under sections 1301 and 1304 of the Public Utility Code, 66 Pa. C.S. § 1301 and 1304."[16] This very legal issue is presently before the Commonwealth Court in D&E's appeal of the Commission's orders disallowing its attempt to implement its 2006 price change opportunity by increasing its already excessive switched access rates, where D&E has advanced the same limited interpretation of "just and reasonable" that the RLECs advance here. This Commission, through its Law Bureau, rejected this argument as "incorrect," and asserted that "[t]he Legislature clearly preserved the Commission's authority to protect ratepayers of noncompetitive and protected services by disallowing any rate increase found to be unjust and unreasonable under 66 Pa. C.S. § 1301, even if that increase is proposed as part of an annual price change filing." (VZ St. 1.1, Exhibit 1 (PUC Commonwealth Court Br.) at 23).

But while this Commission continues to have the authority to ensure that end user rates are just and reasonable, its decisions in that regard must be based on substantial evidence. In light of the evidentiary record here, it would be arbitrary and capricious for the Commission to presume that any RLEC residential rate above $18 is by definition unjust and unreasonable. Even if it were appropriate to set a sweeping rate cap that establishes a uniform "just and reasonable" residential rate level for all RLEC residential rates – which should be rejected in favor of the safe harbor approach discussed above -- the record evidence does not support setting that level at $18.

<u>Reply to PTA Exceptions # 3 and #4; Embarq Exception #4; OCA Exception #3 and #4</u>: The RLECs Should Not Be Permitted To Use The USF To Obtain New Revenue Under Their Alternative Regulation Plans

A. Introduction

The OCA and the RLECs are asking for something very different from the USF that was adopted by the 1999 *Global Order* and maintained through the Commission's USF regulations. The current USF provides the RLECs with approximately $30 million in revenue each year, tied to specific

[16] *Commonwealth Telephone Company PSI/SPI Filing for Year 2005*, No. R-00050551 (Opinion and Order entered August 31, 2005) at 7.

access and toll reductions from the 1999/2000 timeframe. By contrast, under the plan proposed by the OCA and the RLECs, the USF would increase unpredictably and even exponentially every year, based on the RLECs' calculated revenue increase opportunities under their alternative regulation plans, and the USF would provide a ***new*** stream of subsidy revenues to the RLECs each year. The record does not support the RLEC/OCA proposal and the RD rightly rejected it.

B. The RLEC/OCA Proposal Would Vastly Expand The Size Of The Existing USF

The RLEC/OCA plan would set in motion a dangerous snowball effect through which the current $30 million USF could quickly expand to double or even triple its size, or more. (VZ St. 1.1 (Price Rebuttal) at 5-7). For example, ten years down the road a single RLEC generating a constant new $2 million revenue increase opportunity each year for which it claims against the USF would be receiving $20 million annually from the fund by year 10, turning the $30 million fund into a $50 million fund – without even accounting for the impact of other carriers' claims. There are over 30 RLECs, and if most or all of them began exercising the opportunity to fund their revenue increases through the USF as the RLECs and OCA propose, there is likely to be much more than $2 million in annual increases to the fund. Rather the size of the USF will increase exponentially. (*Id.*) Indeed, with the prospect of no-risk money available through this RLEC/OCA USF, the RLECs will have a powerful incentive to raise their rates to the cap levels in order to begin claiming this free money.

The potential magnitude of this snowball effect can be seen by reviewing Embarq's testimony on this issue. Embarq goes so far as to contend that not only should the RLECs be able to fund future revenue increase opportunities through the USF, but the RLECs should also be permitted to "recover" their "unexpired banked revenues" from the state USF. (Embarq St. 1.0 (Gutshall Direct) at 22; *see also* OCA St. 1 (Loube Direct) at 28-29). According to Mr. Gutshall, Embarq has nearly $9 million of unused revenue increase opportunities in its bank. (Embarq St. 1.0 (Gutshall Direct) at 18; Tr. at 257). If Embarq were to make a $9 million claim against the USF now, that claim alone would increase the size of the current fund by almost a third in the first year. If Embarq were to continue to generate new revenue opportunities each year at the same rate, its USF claim would double to $18 million, then triple to $27 million, and so on, soon dwarfing the present size of the fund in payments to Embarq alone, without considering other carriers' potential claims. (VZ St. 1.1 (Price Rebuttal) at 7).[17] This unchecked and perverse growth in the USF should not be allowed.

C. Using The USF To Fund The RLECs' Revenue Increases Would Harm Consumers And Competition

Consumers will lose all around under the new USF proposed by the RLECs and the OCA. Because companies like Verizon, Comcast, AT&T and the others that pay into the USF would be diverting more and more revenue each year to subsidize the RLECs (potentially an exponential increase, as discussed above), their customers would be denied the benefits of revenue that otherwise could have been used to improve the companies' products, services, or networks, or even to reduce rates. Those companies might even be required to increase some rates in order to carry on their everyday operations and meet their ever-increasing USF burden – particularly if the USF snowballs to tens or hundreds of millions of dollars. Because the USF contributions are calculated based on the carriers' intrastate revenue, moreover, telecommunications companies that might otherwise have chosen to invest in Pennsylvania could choose to take their business elsewhere, particularly as the USF burden becomes higher and higher as a percentage of revenue, leaving Pennsylvanians with fewer competitive options. (VZ St. 1.1 (Price Rebuttal) at 10-11).

Customers in the RLEC territory will also suffer. Although they will have access to $18 basic service rates, their opportunities for competitive alternatives will be diminished over time, because any carriers that wish to come in and compete with the RLEC will have to compete with heavily subsidized

[17] For example, Windstream has nearly $7.5 million in its "bank," (PTA St. 1.0 (Laffey Direct) Exhibit JJL-7), although it has not yet reached the $18 rate level. Mr. Laffey's Exhibit JJL-7 shows that the PTA RLECs have collectively banked at least $13.5 million, beyond Embarq's $9 million.

operations and either may choose not to compete at all or may not compete as effectively.[18] These RLEC customers might also be deprived of service, product and network innovation by the RLEC itself, because an RLEC that is guaranteed a constant, ever-increasing and risk-free stream of revenue from a source other than its customers, and also faces a diminished competitive threat, will naturally have less incentive or need to deploy innovative products and services to retain and attract customers. (VZ St. 1.1 (Price Rebuttal) at 10-11).

The Commission should not encourage the RLECs to rely on anticompetitive business plans that depend more on generating revenues from other carriers – and their customers – than from their own end users. As the FCC has observed, economically efficient competition and the consumer benefits it yields cannot be achieved as long as carriers seek to recover a disproportionate share of their costs from other carriers, rather than from their own end users.[19] Where the RLECs are able to obtain additional subsidies, competition is discouraged and competitors disadvantaged because the competitors must operate without those subsidies, and will be required – directly or indirectly – to fund those subsidies through their own USF assessments. This is of particular concern in the territories of those larger RLECs where there is decisive competitive presence.

D. Using The USF To Fund The RLECs' Revenue Increases Would Insulate The RLECs From The Disciplining Effect Of The Market, Contrary To The Premise Of Alternative Regulation

In establishing Chapter 30 as the alternative regulation mechanism, the Legislature did not include a provision requiring other carriers to fund the RLECs' annual revenue increases, and if the Commission were to do so here it would undermine the alternative regulatory scheme established by

---

[18] This anti-competitive effect is exactly the opposite of the goal the Commission wished to achieve when it set out to reform RLEC access rates and created the original USF. *See, e.g.*, 52 Pa. Code § 63.161(3) (purpose of the PUC's USF regulations is to "encourage[e] greater competition.")

[19] *See, e.g., Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Low-Volume Long Distance Users; Federal-State Joint Board On Universal Service*, Sixth Report and Order in CC Docket Nos. 96-262 and 94-1 (*CLEC Rate Cap Order)*; Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45, 15 FCC Rcd 12962 (May 31, 2000) ("*CALLS Order*").

the Legislature. The Legislature presumed that any revenue increases permitted under the inflation-based plan formula would be secured through "rate changes." 66 Pa. C.S. §3015(b). With their USF proposal, the RLECs and OCA would divorce the RLECs' annual exercise of their revenue increase opportunities from the disciplining effects of the market intended by the Legislature.

Specifically, when the RLECs must secure additional revenue through increasing end user rates, as they must now, the market disciplines their actions in at least two ways. First, the RLECs may choose not to increase their rates, even though they have the "right" under their plans to increase noncompetitive services revenue. As an example, some of the RLECs presently have banked revenue even though they could still increase their basic residential rates. (VZ St. 1.0 (Price Direct) at 24; VZ St. 1.1 (Price Rebuttal) at 8; Compare Price Direct Table 1 to Laffey Direct Exhibit JJL-7). The RLECs may view passing up on the rate increases as a better choice in the long run, increasing the chances of keeping those customers on their own networks where the RLEC has the opportunity also to sell them other services. Second, even if the RLECs do choose to increase basic service rates, there is no guarantee that they will secure the same revenue each year from the initial rate increase because Chapter 30 provides only a noncompetitive services revenue increase ***opportunity***, not a guarantee.[20] The RLEC/OCA proposal would have the effect of insulating the RLEC from the operations of the competitive market and diminishing the RLEC's incentives to take actions to keep its retail customers. (VZ St. 1.1 (Price Rebuttal) at 6). The PTA admits that it views the USF as an "important . . . company protection," (PTA Exceptions at 6), but the Commission should not be protecting the RLECs from competition at the expense of consumers. Instead, the RLECs' end users, who are the direct

[20] Taking the hypothetical RLEC example discussed above, if the carrier implemented basic service rate increases to secure $2 million in new revenue, and assuming that the hypothetical RLEC is experiencing line losses consistent with the overall trend described by Mr. Laffey (PTA St. 1 (Laffey Direct) at 7), then the number of lines paying the increased rates would decrease over time by approximately 5% each year. Looking ten years out at the impact of that initial year's increase, assuming 5% line loss each year, the original $2 million projected to be secured through those retail rate increases would be cut nearly in half. By contrast, with the RLEC/OCA USF proposal, this hypothetical RLEC would still be recovering $2 million per year ten years out because the RLECs are guaranteed a revenue stream that stays constant each year regardless of line loss – revenue supplied by unwilling payers that do not have a choice to terminate their service and stop paying.

beneficiaries of any investment and network deployment enabled by the increase, should provide the new revenue through rates. There is no reasonable basis to force other carriers, some of whom may also be attempting to compete with the RLECs in their own territory, to fund the RLECs' revenue increases. Doing so would be anti-competitive and harmful to consumers.

E. The Commission Cannot Rely On The RLECs' Vague And Unsubstantiated Claims As Record Support For USF Expansion

The RLECs have presented no evidence upon which the Commission could conclude that they are not already able to meet their operating obligations with existing revenues and federal and state USF subsidies. Again, the RLECs wish to have it both ways. They argue that the Commission should force other carriers to subsidize them through an expanded USF based on the general assertion that RLECs face hypothetically higher costs and/or carrier-of-last-resort obligations, but they do not want to open themselves up to an actual examination of their costs and finances. In fact, the witnesses conceded that they deliberately did ***not*** look at the RLECs' costs or profits and could not opine as to whether the new USF subsidies were actually needed by any particular company to meet its operating obligations. As Mr. Laffey – an outside consultant presented as the PTA's only witness – explained, he did not "study the revenues or the costs of any of the individual PTA companies" on whose behalf he testified and he "did not form any conclusion as to whether" any particular RLEC's "overall costs exceed their overall revenues for Pennsylvania regulated services." (Tr. at 477-478). Similarly, OCA's Dr. Loube conceded that he did not examine and does not know whether the RLECs could meet their operating obligations without this additional USF support. (Tr. at 105-06, 110-111). Further, the RLECs concede that many of them are "highly diversified and successful" companies that cannot be characterized as small. (PTA Exceptions at 4).

Instead of actual evidence, the RLECs rely on vague platitudes, such as claiming that they "remain shackled to carrier of last resort obligations and regulation." (PTA Exceptions at 2).[21] But the RLECs' USF proposal is unprecedented and potentially devastating to Pennsylvania telephone carriers and their customers. The RLECs' proposal should not be undertaken based on nothing more than these bare and unsubstantiated assertions. Simply because a company serves rural territories does not establish that it cannot serve its customers adequately without increased subsidies from other carriers. To date, the RLECs have provided service to their customers without the additional subsidies they now seek. They have presented no evidence demonstrating that they are in jeopardy of not being able to continue providing adequate service without a new infusion of cash from the USF. Indeed, Embarq represented to this Commission to secure approval of its spin-off from Sprint that it would "continue to have the financial capability to invest in its network, generate sufficient cash to pay all expenses and pay a dividend to its shareholders," even while banking nearly $9 million in upcoming revenue increase opportunities. (VZ Main Br. at 32). Further, where an RLEC actually faces higher costs under FCC criteria, the RLECs already receive federal USF support for serving high-cost areas, and they have presented no evidence demonstrating that this support — in conjunction with their other regulated revenue sources — is insufficient to allow them to serve their customers adequately.

The RLECs' attempt to contrast themselves with Verizon also does not remedy their lack of any real evidence about their own operations. The RLECs contend that the Commission should ignore their own scale, scope and finances, but with the same breath argue that because of ***Verizon's*** scale and scope it can easily afford its current payments to the USF. (PTA Exceptions at 9; Embarq Main Br. at 16). If the Commission were to adopt the RLECs' theory that the only relevant consideration is the "high cost" of rural territory and carrier-of-last-resort obligations, then the Verizon ILECs should be

[21] It goes without saying that the Verizon ILECs, which are currently the largest USF contributors, are similarly "shackled," and yet the PTA does not explain why Verizon should be diverting more and more revenue to support the RLECs' operations.

the largest ***recipients*** of state USF contributions, not the largest contributors because the Verizon ILECs serve more rural access lines in Pennsylvania than all of the RLECs put together and have the same carrier-of-last-resort obligations. (Verizon St. 1.2 at 9). But Verizon does not receive and is not asking for state USF subsidies, and most of the RLECs should not be receiving those subsidies either. Similarly, PTA complains that its companies do not "have the same level of business customers as Verizon" and no "urban customer base to average down the cost per customer." (PTA Exceptions at 6). But PTA supplies no evidence to support this claim. Simply assuming that Verizon is able to cover its overall cost of providing service does ***not*** establish that the RLECs are not ***also*** able to recover their overall costs. Under alternative regulation, an RLEC's rates are not set based on its costs and it is not required to disclose its overall profits, but the fact that each of the RLECs is able to operate and service its customers is reason enough to conclude that they are able to cover their operating costs, and they have not demonstrated otherwise. The RLECs' references to Verizon's size and scope are nothing but an irrelevant attempt to divert attention from their own failure to prove their case – a case that is about the RLECs, not about Verizon.

F. The RLECs Are Not Automatically Entitled To Use The USF To Fund Their Annual Chapter 30 Revenue Increases

Rather than attempting to defend on its merits their proposed huge expansion of the USF, the RLECs and OCA argue that the Commission is "obligated" to provide the USF funds they demand and thereby to force other carriers to subsidize the RLECs' annual revenue increases. (PTA Exceptions at 10; OCA Exceptions at 25-26). They contend that this result was pre-ordained by the Commission's adoption of RLEC-authored settlements and alternative regulation language that pre-dated Act 183 and the reference back to those orders in the RLECs' current alternative regulation plans. If the RLECs' argument were correct, then this Commission and the other carriers that participated in the various pre-Act 183 settlements bought the proverbial "pig in a poke." While they thought they were signing on for "interim" and "transitional" funding directly tied to the revenue neutral rate rebalancing expected under the old Chapter 30, the RLECs contend that what they really agreed to was to provide unlimited and ever-increasing new revenue to the RLECs every year in perpetuity. The Commission's Law Bureau attorneys rightly told the Commonwealth Court that this "argument . . . that the Commission has no choice but to reimburse the [RLECs] from the PaUSF is ***absurd***." (VZ St. 1.1 Exhibit 1 (PUC Commonwealth Court Brief) at 21) (emphasis added).

The RLECs attempt to rewrite history by arguing that "the concept of allowing the RLECs to derive rate increases from the Pa USF" originated with the *Global Order*. (PTA Exceptions at 7). But if one looks at the details of the *Global Order*, it is clear that the Commission only contemplated the USF being used to support a "rate rebalancing" of access and toll rates that is "revenue neutral," not overall revenue increases. (*Global Order* at 202). In fact, the USF settlement adopted by the *Global Order* made quite clear that "[a]ll revenues received from the Fund . . . ***shall*** be used to rebalance, on a revenue neutral basis, the rates/revenues derived from access and/or other services according to the rules set forth herein."[22] Because the USF was clearly intended for this limited purpose of supporting rate rebalancing, the Commission's USF regulations contain no reference to using the USF to fund general rate or revenue increases, under the LEC's alternative regulation plan or otherwise, and instead make clear that the "purpose of the Fund is to maintain the affordability of local service rates for end user customers while allowing rural telephone companies to reduce access charges and intraLATA toll rates, on a revenue-neutral basis, thereby encouraging greater competition." 52 Pa. Code § 63.161(3). The regulations do not contain ***any*** provision for a particular rate benchmark and do not provide for the USF to be used to fund RLEC annual revenue increases.

The RLECs next rely on a settlement between the Commission and the RLECs from 2000, relating to the RLECs' withdrawal of their appeal of the *Global Order*. (PTA Exceptions at 22-23). They suggest that this settlement somehow promised that in exchange for withdrawal of the appeal, the

[22] *Global Order* Appendix II, Small Company Universal Service Fund Settlement, Appendix A at II.B (attached as Verizon St. 1.0 (Price Rebuttal), Exhibit 2 (emphasis added)).

RLECs would be entitled to offsetting USF funds if they chose to increase rates over the applicable rate cap in a general revenue increase under the operation of their alternative regulations plans, in perpetuity. (PTA Exceptions at 22-23, citing Settlement attached as PTA Exhibit JJL-4). But as discussed above the USF plan adopted by the *Global Order* on an "interim" and "temporary" basis was expressly limited to the purpose of assisting to fund access or toll rate rebalancings, to reduce the magnitude of the end user rate increases required to keep the rebalancing revenue ***neutral.*** The language of this 2000 settlement cannot be read to expand and alter the *Global Order* to allow revenue ***positive*** draws on the USF, but rather must be read in the context of the Commission's reasonable understanding and expectations based on the law of alternative regulation as it existed at the time, under which large annual revenue increases outside of the access or toll rate rebalancing context were highly unlikely. Before 2004 the alternative regulation plans contained large inflation off-sets, which made it unlikely that the formula would result in the entitlement to increase overall revenue. When the new Chapter 30 was enacted in 2004, it eliminated the inflation off-set portion of the alternative regulation formula for RLECs, making it much more likely that large revenue increases would be permitted each year. It cannot be the case that by approving vague and general language referring to USF recovery from an "interim" fund nearly 10 years ago under a very different old Chapter 30 legal framework, that this Commission and other carriers are now bound to write the RLECs a blank check of unlimited USF funding for their hefty annual revenue increases under the new Chapter 30, forever. Neither the Commission nor the other carriers that consented to the creation of the USF in 1999 and to its continuation in 2003 could have consented to the interpretation of the USF that the RLECs advance now.[23]

[23] The fact that some of the RLECs' Chapter 30 plans refer to the *Global Order* rate cap and recovery of revenues from the USF also does not mean that the Commission is now bound to provide unlimited USF funding to the RLECs. These plans did not purport to establish rights beyond those that might have existed under the *Global Order* and July 2003 USF plans.

But even if the RLECs retain some hypothetical entitlement to USF funding when their basic residential and business rates reach certain "cap" levels – which they do not for the reasons discussed above – they have already conceded that this Commission is free to modify the cap level that triggers this entitlement. As discussed above, the record does not support a residential rate cap lower than $23 and supports no business rate caps. Accordingly, the Commission need not address the RLECs' theoretical "entitlement" to make USF claims if it finds that the RLECs are still able to implement their annual revenue increase opportunities by increasing residential and/or business rates based on eliminating or increasing any such caps.

Reply to PTA Exception # 4; Embarq Exceptions #1 and #3; OCA Exceptions #5 and #6: The Commission Must Radically Alter The USF

While the RLECs claim to advance "the interests of . . . local service customers," (PTA Exceptions at 4), they reject out of hand the RD recommendation that the Commission convene a rulemaking to "reform[]" the USF "to provide monetary assistance to only those RLECs for service in high-cost service areas and for assistance to low income customers." (RD at 66). The RD was correct in recommending a rulemaking to reform the USF and to clarify its terms.

Embarq contends that "there is no evidence that the PAUSF is broken," and so no need to try to fix it. But Embarq – like the PTA and OCA – ignores the record evidence showing that the USF is indeed "broken." The Commission clearly stated that it would consider evidence in this case that "funding for the PAUSF should decrease."[24] Verizon submitted uncontroverted evidence demonstrating why funding should be decreased because the RLECs are actually gaining a windfall from the current USF. If the RLECs had rebalanced their access and toll reductions with basic local service rate increases in 1999-2000, the $30 million in annual revenue from 1999-2000 would have decreased by approximately 20% to $24 million due to the line loss established by PTA's own

[24] *See* October 9, 2008 Order on Reconsideration ("we did not intend for there to be a preclusion of evidence that funding for the PAUSF should decrease.")

testimony. Similarly, if the RLECs had not rebalanced the revenue at all and left the toll and access rates the same, given industry trends the RLECs' access and toll minutes-of-use over this time have decreased, which would have reduced the resulting revenue. Extrapolating the annual average decline through the end of 2008, the decline would be 29.5%. (Verizon Main Brief at 34). Yet because they are receiving the replacement revenue from other carriers who cannot choose to stop paying, the RLECs are still receiving a constant $30 million a year nearly ten years later, when they would not be receiving that level of revenue in the absence of the USF.[25]

The record thus shows that if nothing else, the Commission would be well-justified in reducing each RLEC's USF draw by nearly 30% (or alternatively by that RLECs' individual percentage of line loss since 1999), even if it does nothing else. The Commission should also seriously examine why it is still necessary to require other carriers to provide millions of dollars in annual subsidies to the larger RLECs.

CONCLUSION

For the foregoing reasons, the Commission should deny the RLEC and OCA exceptions and should adopt the RD.

Suzan D. Paiva /SDB

Suzan D. Paiva (Atty No. 53853)
Verizon
1717 Arch Street, 17th Floor
Philadelphia, PA 19103
(215) 466-4755

Dated: September 18, 2009

Attorney for Verizon

[25] The RLECs contend that funding from the current USF could not be reduced or eliminated without violating the revenue neutrality provisions of 66 Pa. C.S. 3017(a). (PTA Exceptions at 29; Embarq Exceptions at 6). Not only does this argument ignore the above evidence, but also the 2000 access reductions occurred long before Section 3017(a) became law and therefore this provision does not apply.