Suzan DeBusk Paiva
Assistant General Counsel
Pennsylvania

1717 Arch Street, 17W
Philadelphia, PA 19103

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

September 17, 2010

VIA ELECTRONIC FILING
Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street, 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

and

AT&T Communications of Pennsylvania, LLC, TCG New Jersey, Inc. and TCG Pittsburgh, Inc. v. Armstrong Telephone Company-Pennsylvania, et al.
Docket No. C-2009-2098380, et al

Dear Secretary Chiavetta:

Enclosed please find the Verizon Companies' Replies to Exceptions to the Recommended Decision, filed on behalf of Verizon Pennsylvania Inc., Verizon North Retain Co., Bell Atlantic Communications, Inc. d/b/a Verizon Long Distance, MCImetro Access Transmission Services, LLC d/b/a Verizon Access Transmission Services, and MCI Communications Services, Inc., in the above captioned consolidated matter. Because the Replies to Exceptions include information that is Proprietary, an Expurgated copy for the public record is being submitted for e-Filing, and the Proprietary version is being provided via overnight delivery.

Please do not hesitate to contact me if you have any questions.

Very truly yours,

Suzan D. Paiva

SDP/slb
Enc.

Via E-Mail and First Class Mail

cc: Cheryl Walker Davis, Director, OSA
The Honorable Kandace F. Melillo
Certificate of Service

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the Verizon companies' 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 17th day of September, 2010.

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

Michael A. Gruin, Esquire
Stevens & Lee, P.C.
17 North Second Street
16th Floor
Harrisburg, PA 17101

Joel Cheskis, Esquire
Darryl Lawrence, 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

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

Barry A. Naum, Esquire
McNees Wallace & Nurick LLC
P.O. Box 1166
100 Pine Street
Harrisburg, PA 17108-1166
Broadband Cable Association of PA

John Povilaitis, Esquire
Matthew Totino, Esquire
Ryan, Russell, Ogden & Seltzer P.C.
800 North Third Street, Suite 101
Harrisburg, PA 17102-2025
Counsel for Qwest

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

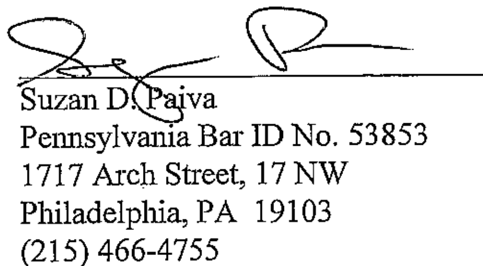
Garnet Hanley, Esquire
T-Mobile
401 9th Street, NW, Suite 550
Washington, DC 20004

Dr. Robert Loube
10601 Cavalier Drive
Silver Spring, MD 20901

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

Allison C. Kaster, Esquire
Adeolu Bakare, Esquire
Office of Trial Staff
PA Public Utility Commission
Commonwealth Keystone Bldg.
400 North Street
Harrisburg, PA 17120

Demetrios G. Metropoulos, Esquire
Mayer Brown LLP
71 S. Wacker Drive
Chicago, IL 60606



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

Attorney for Verizon

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

<table>
<tr><td>Investigation Regarding Intrastate Access
Charges and IntraLATA Toll Rates of
Rural Carriers and the Pennsylvania
Universal Service Fund</td><td>:
:
:
:</td><td>Docket No. I-00040105</td></tr>
<tr><td>AT&T Communications of
Pennsylvania, LLC
Complainant

v.

Armstrong Telephone Company -
Pennsylvania, et al.
Respondents</td><td>:
:
:
:
:
:
:
:
:</td><td>Docket No. C-2009-2098380, et al.</td></tr>
</table>

VERIZON'S REPLIES TO EXCEPTIONS

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

Counsel for Verizon

Dated: September 17, 2010

EXPURGATED VERSION

TABLE OF CONTENTS

INTRODUCTION 1

REPLIES TO EXCEPTIONS 4

I. Response to PTA Exception No. 1, CenturyLink Exceptions No. 1 and 2, and OSBA Exception No. 1: The RD Correctly Found That The RLECs' Intrastate Access Rates Are Too High And Should Be Reduced. 4

1. The RLECs Fail To Justify Their High Access Rates. 5

2. The Record Establishes That Reducing RLEC Dependence On Revenue From Other Carriers Will Benefit the Public. 9

II. Response to CenturyLink Exception No. 2, PTA Exception No. 2, Qwest Exception No. 2, and OSBA Exception No. 2: The RLECs Failed To Present Any Evidence To Support Their Criticism Of The RD's Recommended Access Rates. 12

III. Response to PTA Exception No. 3 and CenturyLink Exception No. 3: The RD's Recommendation To Rebalance Revenue To Rates For Other Noncompetitive Services Complies With Section 3017(a) And Is Reasonable Under The Record Presented. 15

1. The RLECs Did Not Demonstrate That They Will Fail To Recover Sufficient Revenue From Retail Rate Increases. 15

2. The Commission Can Take Steps To Provide A Robust And Meaningful Rebalancing Opportunity Without Continuing Anti-Consumer And Anti-Competitive Carrier Subsidies. 21

IV. Response to PTA Exception No. 3(4), OCA Exceptions No. 1, 2 and 4, OSBA Exception No. 3, Qwest Exception No. 1, Sprint Exception No. 2, and AT&T Exception No. 3: The Commission Should Accept The RD's Limited Use Of A $23 Residential Rate Level, But Should Not Declare Any Rate Caps. 23

1. There Is No Legal Or Factual Basis To Suppress RLEC Residential Rates To Keep Them "Comparable" To Verizon's Rates. 23

2. The RD Correctly Used $23 As A Benchmark To Trigger Closer Commission Scrutiny, But Not As A Rate Cap. 26

V. Response to AT&T Exception No. 1, OCA Exception No. 3, PTA Exception No. 4 and CenturyLink Exception No. 4: The RD Correctly Rejected Expanding The USF To Replace RLEC Access Revenue. 28

1. The RD Rightly Found That Expanding The USF Would Impose Significant Consumer Harm With No Countervailing Evidence Of Benefits. 29

a. Expanding The USF Will Impose Huge New Regulatory Burdens On Other Carriers, Which Are Not Tenable In Today's Competitive Market. 29

b. There Is No Record Evidence That Expanding The USF Would Benefit Customers. 34

2. USF Expansion To Replace RLEC Access Revenue Is Not Authorized By Current Law 36

3. AT&T's Temporary USF Proposal Suffers From The Same Problems And Should Be Rejected. 41

VI. Response to Sprint Exception No. 1, AT&T Exceptions No. 2 and 4, PTA Exception No. 5, and CenturyLink Exception No. 5: The RD's Phase-In Recommendation Is Generally Reasonable, Although Certain Details Should Be Improved. 45

CONCLUSION 47

INTRODUCTION

The Recommended Decision of Administrative Law Judge ("ALJ") Kandace F. Melillo, issued on August 3, 2010, ("RD") provides a thorough and well-supported plan to reduce Rural Incumbent Local Exchange Carrier ("RLEC") intrastate access rates through a phased-in rebalancing of revenue to retail rates for other noncompetitive services. Importantly, the proposed rebalancing would not increase the funding burden on other regulated carriers through the state Universal Service Fund ("USF"). The RD's recommendation balances the competing interests and policy arguments, is supported by the evidence and the law and should be adopted as the Commission's resolution of this case.[1]

The substantial record developed here demonstrates that the Commission can no longer continue to permit the RLECs to charge in some cases *more than ten cents a minute* for other carriers to originate or terminate calls on their networks. In some cases the RLECs charge more to the IXCs in the form of a carrier change than they do to their own retail end users. Such excessive intrastate access rates are far out of line with those charged by Verizon and most competitive carriers for the exact same service. The RLECs' disproportionate dependence on revenues from other carriers ultimately hurts consumers in all portions of the state. It is time to bring some much needed and long overdue rationality to the RLECs' access rates.

The RLECs' exceptions offer the Commission a false set of choices, both of which would continue the excessive subsidies from other carriers: either (i) require other

---

[1] Verizon filed exceptions on September 2, 2010 requesting certain clarifications to the RD, but not challenging the overall substance of the recommendation. (*See* Verizon Exceptions at 1, n. 1, defining Verizon parties).

carriers to continue to pay their high access rates, or (ii) require other carriers to replace the access revenue dollar-for-dollar through the state USF. Either of these "choices" would be bad for consumers and bad for competition. And, as the RD correctly recognized, those are not the only choices. Indeed, the only supportable path forward is the one envisioned by statute and recommended by the RD — a phased-in rate rebalancing. With 66 Pa. C.S. § 3017(a), the Legislature provided a statutory vehicle for this Commission to rebalance the RLECs' access revenue to retail rates in order to reduce access rates in a revenue neutral manner. The Commission should adopt the RD's recommendation to rely on this statutory provision to phase-in over time a rebalancing of the RLECs' revenues.

Faced with such a reasonable and statutorily envisioned outcome, the RLECs attempt to cling to the disproportionate stream of revenue flowing from other carriers through rhetoric, scare tactics and unsupported speculation. The RLECs claim that unless they collect excessive revenue from other carriers in one way (access rates) or another (the USF), they will face a parade of horribles — they will not be able to meet their purportedly high service costs; they will face the prospect of unfunded mandates and financial insolvency; and they will not recover a reasonable measure of their costs from carriers that originate and terminate calls on their network. Yet the RLECs failed to offer evidence to support these claims. They submitted no studies to prove the alleged high service costs; they submitted no evidence of their financial condition or alleged unfunded mandates; and they submitted no studies on the costs they incur to provide access or retail services. Similarly, without any supporting evidence, the RLECs ask the Commission to cap their residential and business retail rates at very low levels, effectively forbidding any

meaningful rate rebalancing. But, the uncontroverted record evidence on this point shows that many RLECs still charge very low residential rates of $13.50 and lower, while customers can afford to pay much higher rates, and that their business rates are far below the national average.

The record shows that either of the RLECs' false choices – continuing the RLECs' excessive access rates or expanding the "hidden tax" on other carriers that funds the USF – would harm consumers and competition while discouraging investment at a time when it is most crucial. The RLEC proposal to fund excessive subsidies through an expanded USF would simply change the vehicle under which RLECs recover too much revenue from other carriers. In fact, replacing the RLECs' access revenue with payments through an expanded USF would actually substantially *increase* the burden on Verizon's customers of funding the RLECs – the exact opposite of what this case set out to do. Indeed, the RLECs' demand for revenue neutrality applies only when it benefits them: they propose to take $100 million or even more each year from other carriers through an expanded USF without any means of revenue replacement for the carriers contributing the extra USF funding. The RLECs make that proposal notwithstanding that, for example, companies like the Verizon ILECs that contribute to the USF also provide local service and face even greater competitive pressures than the RLECs. The RD therefore rightly concluded that the USF should not be expanded because of "the compelling record evidence of its negative impact on Verizon ILEC customers, many of whom are also rural, and the lack of countervailing evidence that these PA USF payments are necessary to fulfill RLEC universal service/COLR commitments." (RD at 132). As ALJ Colwell recently explained, the USF "is not 'free money' to be plundered at will and

without concern for its origins or for whether it is the best use of the money."[2] In this RD, ALJ Melillo correctly recognized that it is unsupportable from both a policy and a legal basis to expand and make permanent the very same state USF that ALJ Colwell recently concluded was hopelessly flawed and in need of a complete overhaul.

There is only one rational and lawful solution supported by the record to the problem of excessive RLEC access rates: reduce their access rates and allow them the opportunity to rebalance that revenue to retail rates, over a reasonable phase-in time period. The RLECs failed to meet their burden of proving that the Commission should do anything other than what the Commonwealth Court recognized that Section 3017(c) calls for: decrease access rates by "making revenue neutral increases to other noncompetitive rates."[3]

REPLIES TO EXCEPTIONS

I. Response to PTA Exception No. 1, CenturyLink Exceptions No. 1 and 2, and OSBA Exception No. 1: The RD Correctly Found That The RLECs' Intrastate Access Rates Are Too High And Should Be Reduced.

The RD concludes correctly that the RLECs' intrastate access rates are too high, are harmful to consumers and competition and must be reduced. The majority of the parties agree with the recommendation to reduce RLEC access rates, including the OCA, which previously opposed access reductions. (OCA Exceptions at 3).

Not surprisingly, the RLECs disagree, and ask the Commission to do nothing and to leave their access rates at their current levels indefinitely. But their arguments do not

---

[2] *Investigation Regarding Intrastate Access Charges and IntraLATA Toll Rates of Rural Carriers and the Pennsylvania Universal Service Fund*, No. I-00040105, Recommended Decision Issued July 23, 2009 ("Colwell 7/23/09 RD") at 87.

[3] *Buffalo Valley Tel. Co. v. Pa. PUC*, 990 A.2d 67, 80 2009 Pa. Commw LEXIS 1728 (Pa. Commw. Ct. 2009) ("*Buffalo Valley*").

withstand scrutiny. The RLECs gloss over the unrebutted evidence of how high their intrastate switched access rates actually are: they average over 5 cents per minute and, incredibly, some are more than 10 cents a minute.[4] The record also shows that many of the RLECs charge huge carrier common line charges, or "CCLCs," to the IXCs, averaging almost $6 per line per month, with some over $15. As an illustration of the outrageousness of RLEC access charges, and as detailed below, in some cases the RLECs charge the IXCs more monthly per line for access services of originating and terminating a call than what they charge monthly to their own end user for stand-alone basic service over the same line. The unrebutted fact that the RLECs' intrastate switched access rates are so much higher than the rates charged for the same service by other carriers in the industry is itself sufficient evidence to suggest that the RLECs' rates are unjust and unreasonable.[5] The RLECs' challenges to the RD's recommendation provide no credible support to justify these excessive charges.

1. The RLECs Fail To Justify Their High Access Rates.

The RLECs first argue that they satisfied their "prima facie" case to prove that their rates should remain at current levels by showing that they charge the switched access rates stated in their filed tariffs and recognized by their alternative regulation plans. Indeed, PTA characterizes the charging of filed rates as "a complete defense" to any claim that the access rates are unjust or unreasonable. (PTA Exceptions at 9-11).

---

[4] *See* Verizon St. 1.1 (Price Rebuttal) at 10-11; Verizon St. 1.0 (Price Direct) at 19; PTA Exhibit GMZ-9, p. 2) (listing each PTA company's carrier charge). Interestingly, a few of the RLECs have nominal or zero-rated carrier charges, demonstrating that it is certainly possible for an RLEC to provide service in rural territory without charging a huge carrier charge to its carrier access customers. (Verizon St. 1.0 (Price Direct) at 14).

[5] *See Mobilfone of Northeastern Pennsylvania, Inc. v. PUC*, 78 Pa. Commw. 336, 467 A.2d 902 (1983) (affirming the Commission's consideration of the rates charged by other carriers for the same service as an indicium of reasonability).

The Commonwealth Court flatly rejected this argument when PTA raised it in the *Buffalo Valley* case, finding that charging switched access rates stated in tariffs and changed in compliance with the alternative regulation plan does not alone render them to be just and reasonable. Instead, the court found that this Commission is empowered independently to evaluate whether the rates are just and reasonable pursuant to the authority preserved to it under 66 Pa. C.S. § 1301.[6] Thus, the RLECs failed to satisfy their burden of proving "that the rate involved is just and reasonable" simply by showing they charged published rates.[7] As the RD explained, even rates that "at one time were reasonable may become unreasonable due to changed circumstances and are subject to re-evaluation and modification." (RD at 74).

The RLECs next contend that the RD improperly presumed that the only way they could satisfy their burden of proof was to submit cost studies. (PTA Exceptions at 18). But the RD simply observed that one way the RLECs could have attempted to prove that their access rates were just and reasonable was to "present cost data to establish that rates are not excessive in relation to costs," and that they did not do so. (RD at 75). The lack of such cost data was only one factor in the totality of the record that supported the RD's

---

[6] *Buffalo Valley*, 990 A.2d at 81 ("[B]oth Act 183 and the Amended Plans preserved the Commission's authority to oversee and regulate rates for noncompetitive services. The Commission would be remiss if it did not ensure these noncompetitive switched access rates were just and reasonable.") PTA's contention that the current Chapter 30 does not mandate access decreases (PTA Exceptions at 14) is irrelevant because the statute clearly permits access decreases on a revenue neutral basis and the record here supports the reasonability of a rate rebalancing.

[7] 66 Pa. C.S. § 315(a). OSBA disagrees with the RD's conclusion that the RLECs bore the burden of proof, arguing that the order initiating the investigation "speaks in generalities" and thus does not place the burden on any particular party. (OSBA Exceptions at 8). However, OSBA's argument is contrary to the plain language of 66 Pa. C.S. § 315(a), which states that "[i]n any proceeding upon the motion of the Commission involving any proposed or existing rate of any public utility . . . the burden of proof to show that the rate involved is just and reasonable shall be upon the public utility." In any event, the RD recognized that even if the RLECs had established a prima facie case, there was "more than co-equal evidence" sufficient to shift the burden back to the RLECs. (RD at 74).

overall conclusion that the RLECs' access rates are not just or reasonable and must be reduced.

According to CenturyLink, it did not submit cost studies because the pricing of switched access should be based on "policy objectives" rather than "cost studies and cost support." (CenturyLink Exceptions at 6). But even viewed as a matter of policy, the record contains more than ample evidence demonstrating the public harm caused by allowing the RLECs to continue to charge excessively high access rates. By contrast, the RLECs presented no real evidence to verify their vague claims in support of their exorbitant access rates. CenturyLink argues that "[e]xisting RLEC intrastate access rates are just and reasonable because those rates help provide critical revenue support for RLECs to comply with COLR/universal service policies and to undertake legislative requirements such as Act 183's broadband commitments," (CenturyLink Exceptions at 21), and that the "social benefits" of high access charges "more than outweigh the economic inefficiencies" of requiring other carriers to subsidize RLEC operations. (*Id.* at 25). CenturyLink, however, inexplicably faults the RD for expecting CenturyLink to "prove up via a cost study" that the revenues actually are providing "critical revenue support" to CenturyLink. (*Id* at 8). In any event, the RD did not hold that the RLECs should be prohibited from recovering this revenue; it simply found that the RLECs should recover more of their operating revenue from their own end users and less of it from other carriers. That makes sense because, as the RD concluded, the RLECs' excessive reliance on other carriers' revenue causes economic and consumer harm. The record clearly demonstrates that the superior policy objective is to reduce the RLECs'

access rates and allow them to recover more of the revenue from their own end-user customers.

The record evidence shows that RLECs collect an unreasonably high portion of their revenue from IXCs and that a meaningful rate rebalancing is long overdue. The record shows that certain RLECs actually collect more per-line from the IXCs than they collect from their own retail end users, who continue to pay extremely low monthly rates. For example, Ironton Telephone Company charges IXCs a $17.99 carrier charge per line, per month, while its own end-users pay only $13.50 for monthly stand alone basic residential service. (*See* Tr. at 582; *see also* AT&T Main Br. at 23). Similarly, Citizens of Kecksburg charges its own end users only $11 for monthly standalone basic residential services, yet charges IXCs $11.18 per line, per month, as a carrier charge. (AT&T Main Br. at 23; Tr. at 582). If there were some evidentiary basis for such a facially preposterous disparity, Ironton or Citizens could have come forward and presented it, but they did not.

In fact, the record shows that excessive RLEC access rates are not correlated with the RLEC areas expected to have highest costs, but rather the RLECs' access rates are "quite random in relationship to density." (Comcast Main Br. at 7). Indeed, carriers with higher density territories (and presumably lower costs) charge very high switched access rates relative to those charged by carriers with lower density territories (and presumably lower costs). Again using Ironton as an example, PTA's own evidence shows Ironton has an average density of 227.3 households per square mile, higher than Verizon density, and yet Ironton charges its $17.99 carrier charge and an average switched access rate per minute of **[BEGIN PROPRIETARY]** **[END PROPRIETARY]**, higher than

the average RLEC. Conversely, some of the Frontier companies serve areas with very low population densities, and yet have a $0 carrier charge and very low per-minute access rates. (PTA Exhibit GMZ 14). Without any evidence to show that these excessive access rates are necessary to recover a reasonable measure of costs, the Commission can only conclude that Ironton and Citizens, as well as the other RLECs that charge shockingly high access rates, are recovering an *unreasonably excessive* portion of their costs from other carriers, more of which should be recovered from their end users. That is exactly the result that will be achieved through the RD's plan for a reasonable rate rebalancing.

2. The Record Establishes That Reducing RLEC Dependence On Revenue From Other Carriers Will Benefit the Public.

The RLECs deny that reducing their access rates will benefit the public, faulting the supporting evidence as an "abstraction, not actual evidentiary proof." (PTA Exceptions at 22-24; *see also* CenturyLink Exceptions at 23). The RLECs argue that economic evidence of how markets behave is not a valid basis upon which this Commission could conclude that reducing RLEC access rates will provide a public benefit. This argument contradicts the Pennsylvania Supreme Court's decision affirming this Commission's approval of the Verizon/MCI merger, where the court observed that this Commission's "decision to accept" economic evidence of "a likelihood of longer-term benefits" is "grounded in the same philosophy as the General Assembly's decision to move from cost-based to price-cap regulation — both decisions appear to incorporate the underlying understanding that, in a competitive environment, market forces will constrain price and encourage valuable innovation," a policy that is "entirely rational."[8]

[8] *Popowsky v. Pa. PUC*, 594 Pa. 583, 615 (Pa. 2007).

The record shows that requiring other carriers to divert large sums of revenue away from their own operations to fund the RLECs' operations deprives those carriers of revenues that could be used to improve products, services, or networks, or even to reduce rates — to the ultimate detriment of their customers.[9] The FCC repeatedly has observed that economically efficient competition and the consumer benefits such competition yields cannot be fully achieved as long as carriers seek to recover a disproportionate share of their costs from other carriers, rather than from their own end users.[10] That is exactly what is happening with the excessive intrastate access charges of the RLECs; such irrational access rate structures lead to what the FCC has termed "inefficient and undesirable economic behavior,"[11] and, ultimately, to higher prices for consumers. (Verizon St. 1.0 (Price Direct) at 9-10).

All customers in RLEC territory will benefit as competition is enhanced by reducing undue subsidies to RLEC operations, as this Commission acknowledges.[12] This enhancement of the competitive market will provide more robust competitive choices for service and will put pressure on the RLECs themselves to improve their own service

---

9 The RLECs claim that no benefits are likely to be realized because the stand-alone long distance market is shrinking. But this argument is a red herring because the RLECs charge these rates not only to IXCs but also to every other local exchange carrier (ILEC or CLEC) that must terminate intraLATA toll traffic to RLEC customers. (PTA Exceptions at 24). For example, the Verizon ILECs, which provide wireline local service to many customers in Pennsylvania, themselves pay a substantial amount of money each year to the RLECs for switched access. (Verizon St. 1.1 (Price Rebuttal) at 19).

10 *See generally 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, Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45, 15 FCC Rcd 12962, 2000 FCC LEXIS 2801 (May 31, 2000) ("*CALLS Order*").

11 *CALLS Order*, at ¶ 129.

12 *Access Charge Investigation per Global Order of September 30, 1999*, Docket Nos. M-00021596, etc., (Opinion and Order entered July 15, 2003) ("*7/15/03 RLEC Access Order*") at 10 (recognizing that as RLEC access rates are reduced "competitors are better able to compete for local and long distance customers in an ILEC's service territory" and "CLECs are better able to compete with ILEC local service rates that have been kept artificially low as a result of the access charge subsidies.")

offerings, all of which will benefit customers. Likewise, customers of IXCs throughout the state will benefit as the costs of their serving carriers are reduced, another fact already acknowledged by the Commission.[13] Customers of other LECs, such as the Verizon ILECs, will benefit when their serving carriers no longer have to divert as much revenue to support the RLECs' operations. (Verizon St. 1.2 (Price Surrebuttal) at 13). And of course paying excessive rates for switched access is harmful to the carriers, such as Verizon, that are purchasing the switched access service from RLECs. As the Commonwealth Court recently recognized, Chapter 30 "expressly preserves the Commission's authority and responsibility to protect all ratepayers," and "[t]his protection extends to services provided to other telephone carriers, i.e., 'ratepayers,' for Petitioners' switched access service."[14]

The RD therefore correctly recommended that RLEC access rates should be reduced.

---

[13] *Investigation Regarding Intrastate Access Charges and IntraLATA Toll Rates of Rural Carriers and the Pennsylvania Universal Service Fund*, No. I-00040105 (Opinion and Order entered August 5, 2009) at 20 ("[i]t has been, and continues to be the intention of this Commission, since the *Global Order* of 1999, to gradually lower intrastate access charges so as to allow for greater competition in the intrastate and interexchange toll markets.")

[14] *Buffalo Valley*, 990 A.2d at 79. The RLECs' contention that access reductions will simply provide a "windfall" to other carriers that will not ultimately benefit customers, (PTA Exceptions at 22-23), fails to recognize that in the highly competitive market for communications services carriers must pass the benefits of cost savings along to their customers, or they will lose customers to those competitors who do. (Verizon Main Br. at 14-19). While "no one can predict exactly how a given provider will respond to a decision lowering its costs, because the provider could respond by product innovation, reduced retail prices, improved customer service, or some other creative response," it is certain that the benefits of the cost savings will be passed on. (Verizon St. 1. 3 (Price Rejoinder) at 2).

II. Response to CenturyLink Exception No. 2, PTA Exception No. 2, Qwest Exception No. 2, and OSBA Exception No. 2: The RLECs Failed To Present Any Evidence To Support Their Criticism Of The RD's Recommended Access Rates.

The RLECs argue in the alternative that, if the Commission agrees to reduce their intrastate switched access rates, the RD's recommended rate levels are too low and do not allow the RLECs to recover a sufficient portion of their alleged loop "costs" from IXCs. CenturyLink suggests that the Commission should be "moving toward' but not all the way down to "interstate switched access rates," but it does not state what it believes a reasonable access rate would be, nor does it provide any evidence to show that the RD's recommendation is unreasonable. (CenturyLink Exceptions at 9; *see also* PTA Exceptions at 61) ("a lesser access charge reduction should be considered"). The RLECs' arguments provide no basis to reject the RD's recommendation.

First, the RLECs' suggestion that they will not be able to recover their alleged "costs" if they must reduce access rates to interstate levels is a red herring because the proposal before the Commission is a rate *rebalancing,* not a revenue decrease. No one proposes that the RLECs be precluded from recovering the revenue at issue; they simply must recover more of that revenue from charges to their end users and less from charges to other carriers. Verizon has consistently argued that the RLECs' access rates should be reduced below their currently excessive levels so that the RLECs recover more of their operating costs – not *all* of their costs – from their own retail end users.

Second, if the RLECs sought to make an argument based on costs, this proceeding was their opportunity to create an evidentiary record by submitting cost studies to demonstrate exactly what costs each of them incurs and to request a specific level of intrastate switched access rates that, in their estimation, would provide them a vehicle to

recover a reasonable portion of their "costs" from IXCs and other carriers. They deliberately chose not to conduct any cost studies and to profess not to know their own costs.[15]

The RLECs should not now be permitted to take advantage of their self-created lack of cost evidence by arguing that cost studies are required before the Commission can reduce their access rates. They cannot expect the Commission to presume that the RD's recommended rate levels will not permit the RLECs to recover a reasonable measure of their "loop costs" in the absence of any evidence of those costs. Acceptance of the RLECs' litigation tactic would put them – instead of the Commission – in control of the outcome of this case.[16]

Third, the RLECs argue that the interstate rate structure presumes that they must recover some of the revenue removed from access rates from a USF and that they cannot be expected to collect all of the rebalanced revenue from their end users. (PTA Exceptions at 27; CenturyLink Exceptions at 10). But contrary to the RLECs' arguments, the FCC has recognized that its "long term goal was for incumbent LECs to recover substantially all of their non-traffic sensitive common line costs on a flat-rated basis from end users" through the subscriber line charge, or "SLC," and for that reason

---

[15] The PTA's witness testified at the hearing that he had not conducted any cost studies for any of the RLECs and could not say whether their local service rates already cover their costs, or even what their costs are. (Tr. at 583-84).

[16] The central premise of the PTA's argument is that without a carrier charge, the RLECs' access rates would not recover any contribution to the cost of the local loop, and would only recover the RLECs' "traffic sensitive" costs. PTA has not established this alleged fact with evidence, however. Notably, several RLECs have voluntarily chosen to zero-rate their carrier charges. But if the Commission is concerned about eliminating the CCLC altogether, it could accept Verizon's and Qwest's original argument to require all of the RLECs to match a uniform benchmark rate at the level of Verizon PA's switched access rates, which are 1.7 cents on a per-minute basis and include a 58 cent carrier charge. Verizon chose not to except to the RD's recommendation to match interstate rates, at least as an interim step in the right direction. But Verizon agrees with Qwest's Exception 2, arguing that a uniform benchmark rate at the level of Verizon's rates is the superior alternative.

the FCC has allowed the SLC to increase over the years to its present levels.[17] As the RD correctly recognized, the FCC reduced the RLECs' interstate access rates to their present level precisely because it found that the RLECs were recovering too large a portion of their loop costs from other carriers, and the FCC required them to recover more revenue from their own end users by creating and increasing the end-user SLC. (RD at 21). The RD correctly recommended that this Commission, too, should reduce the RLECs' dependence on revenue from other carriers and instead provide them with the opportunity to recover the same revenue from their retail end users.

In any event, the Commission must apply Pennsylvania law when rebalancing the RLECs' access rates. Chapter 30 contemplates that the Commission would reduce intrastate access charges by rebalancing revenue among noncompetitive services on a neutral basis so that rates for one service are reduced and rates for another service or services increased. It does not require or even contemplate that USF funds from other carriers would be used to rebalance the revenue. As the Commonwealth Court recently recognized, "[u]nder 66 Pa. C.S. § 3017 the Commission has specific authority to rebalance revenue among noncompetitive services by reducing access rates *and making revenue neutral increases to other noncompetitive rates.*"[18] Nothing in Pennsylvania law requires – or even permits (as discussed in more detail below) – that the Commission to replace some unspecified portion of the access revenues with new USF subsidies.

---

[17] *Multi-Association (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers, Second Report & Order and Further Notice of Proposed Rulemaking*, CC Docket No. 00-256, Fifteenth Report & Order in CC Docket No. 96-45, and Report & Order in CC Docket Nos. 98-77 and 98-166, 16 FCC Rcd 19613, 2001 FCC LEXIS 6052 (Rel. Nov. 8, 2001) ("MAG Order") ¶ 33.

[18] *Buffalo Valley*, 990 A.2d at 80 (emphasis added).

III. <u>Response to PTA Exception No. 3 and CenturyLink Exception No. 3</u>: The RD's Recommendation To Rebalance Revenue To Rates For Other Noncompetitive Services Complies With Section 3017(a) And Is Reasonable Under The Record Presented.

The RLECs contend that they cannot increase their retail rates to rebalance access revenue; thus they claim that the Commission must require other carriers to continue to provide excessive subsidies to RLEC operations, either by continuing their high access rates or requiring other carriers to replace the access revenue dollar-for-dollar through the state USF. With heavy rhetoric, the RLECs claim in these exceptions that the opportunity presented by the RD to rebalance the revenue to retail rates in a rebalancing phased in over time is tantamount to eliminating the access revenue altogether with no replacement. The PTA contends that the result of the RD's recommendation is that the RLECs would experience a revenue "loss" of $91.8 million, which they contend is an 80% reduction in operating income. (PTA Exceptions at 36). But of course this is not what the RD recommends. Under the RD's phased-in rate rebalancing, the RLECs are not to experience significant revenue "loss," but simply to shift the source of that revenue from rates charged to other carriers to rates charged to their own retail end users. The RLECs' claim that they cannot or should not be required to rebalance the revenue from access to retail rates does not survive scrutiny.

1. The RLECs Did Not Demonstrate That They Will Fail To Recover Sufficient Revenue From Retail Rate Increases.

The RLECs contend that rate rebalancing is not a "viable revenue-neutral opportunity" because a $23 residential rate is not "competitively sustainable." (CenturyLink Exceptions at 27; *see also* PTA Exceptions at 50). As discussed in more detail below, the RLECs did not demonstrate that it is impossible for them to recover a

reasonable level of revenue from retail rate increases, nor have they shown that a rate rebalancing would cause them to operate their regulated business at a loss. They also failed to offer a single proposal on rebalancing to maximize their chances of recovering the revenue from retail rates.[19] Instead, they take an "all or nothing" position and insist that rebalancing is impossible.

The RLECs' argument that retail increases are impossible is simply unreasonable, particularly where the record shows that many of them are charging fairly low retail residential rates and that all of them are charging business rates well below the national average.[20] Further, the RD even found that the RLECs deliberately presented the evidence to make the residential rate increases appear larger than necessary.[21] And the RLECs' anecdotal argument that competition prevents them from rebalancing their rates

---

19 It is certainly within this Commission's authority to take steps to make the rebalancing more robust and to increase the carrier's chances of realizing the revenue. While customer attrition is not unexpected in a competitive market, the Commission could account for that factor for example, by making an adjustment for prospective line loss in some fashion, such as a true-up based on updated line counts. *See, e.g., PUC v. Verizon Pennsylvania Inc.,* Docket No.s R-00051227 and R-00051228, 2007 Pa. PUC LEXIS 33 (Opinion and Order entered March 27, 2008) (adopting true-up mechanism for annual price change filing).

20 The record shows that many of the RLECs have not even increased their residential rates to the $16 level allowed by the *Global Order* more than ten years ago, and that only 4 of them have increased to the $18 level permitted in 2003. (*See* PTA Direct, Exhibit GMZ 13) (showing that 16 of the RLECs still have residential rates at or below $16 and the majority of them still have rates below $18). Put differently, if Buffalo Valley and D&E can charge almost $18 for basic residential service, then Ironton and Citizens of Kecksburg should be able to raise their rates to at least that level. And as the RD recognized, the single line business rates of CenturyLink and many of the RLECs is $10 below the national average business rate. (RD at 40-41).

21 As an initial matter, the record shows that many RLECs can rebalance their access rates to interstate levels without reaching the $23 rate level. Moreover, the RD correctly found that the RLECs had presented their case in a manner that maximizes the appearance of residential rate increases, to support their arguments that the resulting residential rates will be too high. As the RD found, "[t]he RLECs have made no effort to design a rebalancing that would minimize residential rate increases." (RD at 40, FOF 58). The RLECs should be required to make such an effort, as the ALJ correctly found that "[e]ach and every RLEC has room for access rebalancing if approached with an open mind to optimum rate design." (RD at 40, FOF 57). For example, the RD specifically found that the RLECs' "business rates are relatively low and could be increased" in greater proportion to residential rate increases if needed to keep residential rates lower, something that neither the RLECs' calculations nor AT&T's attempts to do. (RD at 40, FOF 59). As argued in Verizon's exceptions, the Commission should instruct the RLECs to design their rate rebalancings to minimize residential rate increases and take reasonable steps to avoid exceeding the $23 level. (Verizon Exceptions at 6; *see also* RD at 117).

is unsupported and facially unreasonable, particularly given the low retail rates charged by some of the RLECs. For example, PTA argues that Citizens Telephone Company of Kecksburg faces "stiff competition from the local cable company" and so cannot increase its extremely low $11 residential retail rates and is entitled to disproportionate subsidies from other carriers in order to keep its retail rates artificially low and prevent this cable company from making competitive inroads. (PTA Exceptions at 51). But a number of other RLECs charge rates $6 to $7 higher than Citizens of Kecksburg in the face of similar competition, and PTA presented no evidence that competitors were actually charging such low rates in Citizens' territory.

The RLECs effectively admit that they wish to use payment by other carriers of their high access rates to keep their retail rates artificially low (such as $11 per month) in order to prevent competition from gaining market share in their territories. But using excessive access rates as a means for the RLECs to fend off competitors is directly contrary to the pro-competitive goals of Chapter 30, including the obligation to "ensur[e] that rates, terms and conditions for protected services are reasonable and *do not impede the development of competition.*" 66 Pa. C.S. § 3011(5) (emphasis added) (switched access is a protected service). The Commission must price switched access rates reasonably by moving the RLECs to a more efficient rate structure that secures more revenue from their own end users. It is up to the RLECs to operate their business in a manner that effectively responds to threats from competition.[22]

[22] CenturyLink challenges the RD's rejection of its consumer survey by which it attempted to prove that if it increased residential rates above $18 it would lose market share to competitors. (CenturyLink Exceptions at 28-35). But the RD explained in detail why it found CenturyLink's survey to be "seriously flawed" and "results-oriented," and pointed out that the record showed that other RLECs had been able to increase retail rates without experiencing significant access line loss. (RD at 39).

The RLECs fault the RD for purportedly failing to understand their competition arguments, which seem to claim that RLECs must be protected from losing revenue in the competitive areas in order to have the money to provide "universal service" in the unspecified portions of RLEC territory that they claim constitute noncompetitive areas. (CenturyLink Exceptions at 39-40; *see also* PTA Exceptions at 47). But the RD correctly understood that the RLECs are attempting to have it both ways – they argue on the one hand that competition extends to every single exchange in their territories and threatens the viability of their business from all fronts, but on the other, they claim that some unspecified customers in undisclosed locations have no alternative to the RLECs for service and need their basic service rates to be maintained at artificially low levels. The record does not support either hand of this argument. The RLECs concede that customers throughout their territory – in every exchange – have access to service from competitors at attractive rates. As CenturyLink's witness explained its position at the hearing, "in every exchange, there's likely at least one customer who has a competitive option, but in all exchanges there are customers without competitive options," and one would have to go "street by street and house by house" to find, for example, cell phone "dead spots" to determine where competition is absent. (Tr. at 392).

But this transparently self-serving attempt to evoke "universal service" concerns for customers in such alleged "dead spots" does not survive scrutiny.[23] The RLECs

[23] PTA makes the wholly unsupported claim that the RLECs are the only service provider – in other words that there are no competitive options – for "perhaps, forty percent (40%)" of the RLECs' customers. (PTA Exceptions at 47). But the RLECs provided no evidence of what portion of their customers lack competitive options. Indeed, PTA's witness admitted at the hearing that PTA had not done any studies to quantify where competition exists in Pennsylvania. (Tr. at 675). With the RLECs conceding that competitive options are present in every single one of their exchanges, (Tr. at 392) this unsubstantiated guess that as many as 40% of customers lack competitive options is overstated and cannot be relied upon as evidence.

declined to undertake any granular studies of competition in their territories, (Tr. at 390), and the fact that they had to rely on unsupported conjecture about possible cell phone dead spots shows that competition is effectively ubiquitous. If the RLECs were truly concerned that a small subset of their customers required extra attention to universal service needs, they could have presented evidence to allow a targeted solution. But they chose not to present such evidence, apparently so that they could proffer arguments based on vague generalities for blanket operating subsidies from other carriers. Moreover, if evidence is presented bearing out such isolated concerns, they could be addressed with Lifeline service and/or through the rulemaking recommended by ALJ Colwell. As ALJ Colwell pointed out in response to the RLECs' vague appeals to universal service concerns in the first phase, eventually "the market is meant to rely on competition to keep rates affordable" rather than continuing to "provide subsidies to companies who do not have to prove need," which she observed "will not assist the market in reaching its goals and will, instead, provide barriers to entry for new carriers." (Colwell 7/23/09 RD at 87).

The RLECs' contention that they are entitled to charge higher access rates than other carriers is equally unsubstantiated. For example, PTA contends that the RLECs are entitled to have their operations subsidized by other carriers because they face higher costs to serve more rural areas with lower densities than the average density of Verizon territory. (PTA Exceptions at 38). But, as discussed above, the RLECs chose not to present any evidence of their costs, and so should not be heard now to make unsubstantiated claims of purportedly higher costs to resist the RD's reasonable rebalancing recommendation.

In any event, this argument falls apart under closer examination of the facts of record because the RLEC exceptions make a number of unsubstantiated or incorrect claims regarding their alleged costs of service. For example, PTA claims Verizon's density is 193.2 customers per square mile,[24] but according to PTA's own exhibit "GMZ 14," there are RLECs that have higher density than Verizon – and therefore under PTA's own theory have lower costs than Verizon – that are charging much higher access rates than Verizon, and even higher than some of the other RLECs. (Verizon Reply Br. at 9-10).

Similarly, PTA contends that its members must charge higher access rates or otherwise be subsidized by other carriers because they have no urban customer base with which to average down costs, in contrast to the Verizon ILECs. (PTA Exceptions at 41). PTA speculates the Verizon ILECs face lower average costs because their costs of serving urban customers are lower. This argument not only is factually unsupported,[25] but is nothing more than an irrelevant attempt to divert attention from their own failure to prove their case – a case that is about the RLECs, not about Verizon. The Commission cannot rely on unsubstantiated speculation to conclude that the RLECs' costs justify their current excessive access rates.

[24] PTA Main Br. at 54. Evidence provided by AT&T in the first phase showed Verizon's density to be 165 households per square mile. (Phase One, AT&T St 1.2 (Panel Surrebuttal) at 21).

[25] PTA relies on a 13-year-old case to contend that Verizon's urban customers subsidize the costs of serving its rural customers, by way of arguing that Verizon does not need to subsidize those costs with access rates to the same degree that the RLECs do. (PTA Exceptions at 41). But the Commission ruled in that case that the evidence of record was not sufficient for it to conclude that urban rates subsidize rural rates. *Pa PUC v. Bell Atlantic-Pennsylvania, Inc.*, Docket No. R-00963550 (Opinion and Order entered December 16, 1996) at 12. Moreover, not only have Verizon PA's rates changed since 1996 (with access rates decreasing and retail rates increasing) but its costs are likely to be different, too. In 1996 – before the advent of local competition and the extensive presence of intermodal (cable, VoIP and wireless) competitors, Verizon PA's predecessor, Bell Atlantic, served **[BEGIN PROPRIETARY]**

[END PROPRIETARY] and provided most or all of the telephone service in its territory. Much of that erosion is expected to have occurred in the urban areas, leaving fewer customers to share in the cost of serving the urban areas themselves, much less to provide "subsidies" to other service areas.

2. The Commission Can Take Steps To Provide A Robust And Meaningful Rebalancing Opportunity Without Continuing Anti-Consumer And Anti-Competitive Carrier Subsidies.

Verizon does not suggest that the Commission should be unresponsive to the RLECs' arguments that "[r]evenue neutrality must provide the PTA Companies with a realistic opportunity for recovery of revenues that are regulated by this Commission," and that "the Commission must design access reductions so that the RLECs have a real chance, in the marketplace, to actually recover the lost revenue." (PTA Exceptions at 55). But such a result is not achieved by maintaining the anti-competitive and anti-consumer *status quo* through which the RLECs claim an unreasonable portion of their operating revenues from other carriers. Instead, the Commission should focus on alleviating any regulatory burdens that are inappropriate in a competitive market and that may hamper the RLECs' ability to respond to competition. The Commission should look to effectuate the legislative policy of "recogniz[ing] that the regulatory obligations imposed upon the incumbent local exchange telecommunications companies should be reduced to levels more consistent with those imposed upon competing alternative service providers." 66 Pa. C.S. § 3011(13). CenturyLink is right when it argues that the proper response to the competitive market is to let the market work and to reduce or eliminate regulatory obligations on the RLECs. (CenturyLink Exceptions at 28). To the extent such a lightening of outdated regulatory burdens would allow the RLECs to operate more efficiently and reduce their own underlying costs and react appropriately to competitive losses, that result would be beneficial for the RLECs, for consumers and for the competitive market. In addition, if the RLECs are concerned about the effect of line

losses on their future revenue streams from the retail rate increases, the Commission could consider a true-up mechanism or entertain other proposals designed to maintain the RLECs' revenue recovery from their retail services.

Verizon also agrees that a company may not be forced by regulation to operate its business at a loss. But again the RLECs are trying to gain an advantage from their own deliberate choice not to present evidence of their costs and financial condition. They resort to unsupported hyperbole and scare tactics, threatening that rate rebalancing will be the "final denouement of the RLECs," (PTA Main Br. at 78), that it "will result in unfunded mandates and/or inadequately funded mandates for broadband obligations, will unravel COLR/universal service policy, and will leave Pennsylvania's most vulnerable constituents at risk," (CenturyLink Main Br. at 1) and that the RLECs "would be left with the choice of . . . financial insolvency" if their only alternative was to increase retail basic service rates. (OCA Main Br. at 18-19). But the RLECs failed to avail themselves of the opportunity to present actual evidence of their own financial condition or the profitability (or lack thereof) – although they certainly could have done so if they wished to show that the Commission's regulation places them under financial distress. And if they had presented such facts, the Commission would have had to take specific action to ensure that they are not required to operate at a loss. This, however, is a theoretical question in this case because no such evidence has been presented and the record here shows that the Commission can address the rebalancing of the RLECs' access rates within the parameters of Chapter 30, as the RD correctly concluded.

IV. <u>Response to PTA Exception No. 3(4), OCA Exceptions No. 1, 2 and 4, OSBA Exception No. 3, Qwest Exception No. 1, Sprint Exception No. 2, and AT&T Exception No. 3</u>: The Commission Should Accept The RD's Limited Use Of A $23 Residential Rate Level, But Should Not Declare Any Rate Caps.

Verizon argued in its exceptions that if the Commission adopts the RD's recommendation to use $23 as a benchmark residential rate level to control residential rate increases, it should not assume or conclude that $23 is in fact the limit of affordability because the record evidence clearly shows that the affordability level is higher. (Verizon Exceptions at 5-6). AT&T and Sprint agree. (AT&T Exceptions at 35-38; Sprint Exceptions at 5-6). The RD did not actually impose a "cap" of $23 on RLEC residential rates, but rather uses $23 as the point at which the Commission would have to undertake a more in-depth individual analysis of that RLEC before more rebalancing could occur. (RD at 116). The RD also makes very clear that it is "not treating the $23.00 rate as a benchmark for purposes of triggering USF support" and concludes that the USF should not be expanded to fund RLEC access reductions. (*Id.*).

PTA and OCA, however, argue that the Commission should actually cap RLEC residential rates, that the cap should be substantially lower than $23 and that the RLECs should be entitled to USF support to prevent them from increasing rates above the cap. The RD correctly rejected these arguments, which are not supported by the record.

1. There Is No Legal Or Factual Basis To Suppress RLEC Residential Rates To Keep Them "Comparable" To Verizon's Rates.

OCA and PTA fault the RD for relying only on the uncontroverted evidence that the "affordability" level for RLEC residential rates is no lower than $23. They contend that the RD should have capped RLEC residential rates at a level substantially lower than the lowest affordable level, to keep them "comparable" to Verizon's rates for stand-alone

residential service. (OCA Exceptions at 6-13; PTA Exceptions at 44). PTA argues that the "comparable" rate to Verizon's urban rates is $18.94, measured as 115% of Verizon's Density Cell 1 and 2 rates. (PTA Exceptions at 46). OCA contends that the "comparable" rate is $17.09, measured as 120% of Verizon's statewide average rate.[26] Neither the law nor the record supports their argument for a comparability limit. Moreover, even if comparability to Verizon's rates were a relevant concept, correcting for the factual flaws in their arguments shows that the RLECs could increase their rates as high as nearly $25 and still charge rates reasonably comparable to Verizon's urban rates.

There is no legal basis to impose a "comparability" restriction on the RLECs' rates – particularly where the purpose of the limit is to argue for an entitlement to USF subsidies funded by other carriers. These parties argued in the first phase of this case for a "comparability" component to the RLEC rate benchmark based on a federal statute listing governing "principles" for the FCC and the Federal-State Joint Board on Universal Service that rates in rural areas should be "reasonably comparable to rates charged for similar services in urban areas." 47 U.S.C. § 254(b)(3). ALJ Colwell rejected their comparability argument.[27] They rely on the same federal statute in their exceptions here. But the Public Utility Code does not mandate that RLEC rates must be "reasonably comparable" to any other carrier's rates, and the Commonwealth Court recently held – agreeing with the arguments of this Commission's Law Bureau – that Section 254(b)(3)

[26] That OCA's position is unreasonable is evidenced by the fact that nine of the RLECs already have rates above this level and the Commission already permitted the RLECs in 2003 to raise their rates to $18, with the OCA's agreement. (PTA Exhibit GMZ-13).

[27] *See* Colwell RD at 82, n. 18.

is not a mandate to ***state*** commissions constraining the level of intrastate retail rates.[28] OCA also purports to rely on provisions from Chapter 30, (OCA Exceptions at 9), but none of the cited provisions states or even implies that a carrier's rates must be kept "comparable" to the rates of some other carrier. As the RD correctly found, there is no legal basis to depress RLEC rates to keep them "comparable" to Verizon's. (RD at 115).[29]

But even if there were some legal basis that would permit this Commission to limit the RLECs' rates to a level "reasonably comparable" to some other carrier's rates – notwithstanding that the undisputed record shows that customers can afford to pay higher rates – OCA's and PTA's arguments are factually flawed. First, it is unreasonable to use Verizon's basic rates as the standard upon which to limit the RLECs from increasing their own residential rates. There has been no determination either that Verizon's current regulated basic residential local service rates define the level of "affordability" today, or that RLEC customers could not afford to pay rates higher than Verizon's residential rates.[30] Second, OCA deliberately depresses the results of its "comparability" calculation because it does not look to Verizon's "urban" rates – which is the only possible point of reference under 47 U.S.C. § 254(b)(3) (referring to rates that are "reasonably comparable to rates charged for similar services in *urban* areas.") (emphasis added). Rather, OCA

---

[28] *Buffalo Valley*, 990 A.2d at 85-86 (accepting this Commission's argument that Section 254(b) pertains to federal universal service and is not a mandate to state commissions).

[29] Not only is rate "comparability" under this federal statute a matter to be addressed by the FCC and not a mandate to state commissions, but the FCC has a process to provide additional *federal* USF support for states that come to the FCC and demonstrate that the rates of a particular carrier are not reasonably comparable to urban rates nationwide and that the state has taken all reasonably possible steps to achieve reasonable comparability through state action and existing federal support. *In re High-Cost Universal Serv. Support et al.*, WC Docket 05-337, 25 FCC Rcd 4072, 4117 (F.C.C. 2010) ¶ 88 (approving additional federal USF support for Wyoming).

[30] Verizon St. 1.1 (Price Rebuttal) at 35.

artificially depresses the Verizon rate by purporting to calculate a statewide average, which skews the result downward since Verizon's rural rates are lower. Verizon's "urban" rates are those in Density Cells 1 and 2 only, which are currently $16.32 and $16.62, respectively. (Verizon St. 1.1 (Price Rebuttal) at 37).

PTA's comparability calculations in the first phase, which its witness relies upon here, were also flawed. PTA used an average of Verizon's urban Density Cell 1 and 2 rates, but it used a very low 115% margin. (Phase One, PTA St. 1SR (Laffey Surrebuttal) at 4; Tr. at 484). The record in the first phase demonstrated that both PTA's 115% margin and OCA's 120% margin were purely arbitrary, and even OCA admits that other states that tie rates to other carrier rates in the state look to higher percentages, such as 130% in Wyoming and 150% in California. (Phase One, OCA St. 1 (Loube Direct) at 11-12; Phase One, Verizon St. 1.1 (Price Rebuttal) at 34-35). The FCC states that it has repeatedly rejected as too low the state of Vermont's argument for a 125% margin to define "reasonably comparable" rates, demonstrating that the FCC would view OCA's and PTA's even smaller margins to be unreasonable.[31] Using a 150% comparability range (as in California) and Verizon's highest urban rate would yield a "reasonably comparable" rate of $24.93 – a level that would be expected to increase as Verizon's rates increase.

2. The RD Correctly Used $23 As A Benchmark To Trigger Closer Commission Scrutiny, But Not As A Rate Cap.

OCA argues that if the Commission accepts the RD's reliance on a $23 affordability level, then it should "clarify" that the RLECs are forbidden from increasing

[31] *In re High-Cost Universal Serv. Support et al.*, WC Docket 05-337, 25 FCC Rcd 4072, 4120 (F.C.C. 2010) ¶ 92, n. 285. Verizon's witness explained in Phase One of this proceeding that the FCC defines reasonable comparable as being "within two standard deviations of the national average." (Phase I, Verizon St. 1.1 at 35).

their rates above that level – in other words, that $23 is an absolute rate cap. (OCA Exceptions at 14, 32). But as Verizon explained at length in its own exceptions, the record evidence does not actually show that the affordability level is $23. In fact, the most reasonable reading of the record evidence is that, based on OCA's own methodology, an affordable rural residential basic service rate would be substantially higher. (Verizon Exceptions at 7). There is no record support, therefore, for a $23 rate cap. Verizon does not oppose the RD's proposal to use OCA's most conservative affordability level of $23 as a point to trigger more in depth Commission scrutiny, but OCA's argument that RLEC rates should be capped at $23 is not supported by substantial evidence.[32]

As OSBA observes, rate caps erroneously presuppose that "[e]very rural residential customer is . . .. a low-income customer in need of rate assistance." (OSBA Exceptions at 18). The Commission can provide for low income customers through programs like Lifeline, and can also explore other methods to target assistance to customers who actually need it, as ALJ Colwell recommended. But these arguments do not justify blanket subsidies to the RLECs.[33] OSBA argues that the Commission instead should "eliminate[e] all caps on residential local exchange rates." (OSBA Exceptions at 18). While Verizon did not take exception to the RD's use of the $23 benchmark, with the limitations explained by the RD and the clarifications set forth in Verizon's exceptions, Verizon agrees with OSBA that a rate cap is unnecessary and inappropriate.

---

[32] OCA's contention that Act 183 effectively codified a cap on RLEC residential rates, (OCA Exceptions at 23), was rejected by the Commonwealth Court. *Buffalo Valley*, 990 A.2d at 46 (agreeing with Commission Law Bureau that the $18 rate cap was not a "rate change limitation" under 66 Pa. C.S. § 3015(g)).

[33] Customers eligible for Lifeline service already pay approximately $11 less than the ordinary customer for basic local service. (Phase One, Tr. at 135).

V. <u>Response to AT&T Exception No. 1, OCA Exception No. 3, PTA Exception No. 4 and CenturyLink Exception No. 4</u>: The RD Correctly Rejected Expanding The USF To Replace RLEC Access Revenue.

The RD correctly rejected proposals to replace reduced RLEC access revenue with funds from the USF. (RD at 131-32). In today's hyper-competitive communications market, companies like the Verizon ILECs, who are required to contribute a percentage of their intrastate revenue to the USF, cannot be required to send subsidies of tens of millions of dollars to RLECs. Such a huge "hidden tax" would seriously harm the consumers served by the contributing companies and would raise serious legal issues. And it would not solve the anti-competitive and anti-consumer problems the Commission set out to address because the RLECs would still depend on revenue from other carriers. As ALJ Colwell recently explained, the USF "is not 'free money' to be plundered at will and without concern for its origins or for whether it is the best use of the money." (Colwell 7/23/09 RD at 87). The RD correctly recognized that it is unsupportable from both a policy and a legal basis to expand and make permanent the very same state USF that ALJ Colwell recently concluded was hopelessly flawed and in need of a complete overhaul.

In an attempt to sidestep the serious defects in its USF proposal, OCA argues that the Commission should put off to another day the question of whether the USF would be increased to provide a dollar-for-dollar replacement of RLEC access revenue, and should simply conduct a small rebalancing while leaving open the possibility of future USF funding. (OCA Exceptions at 21). But it would be extremely unfair both to the carriers that contribute to the USF and to the RLECs themselves to leave them with such a huge uncertainty. The RLECs need to understand that they are required to obtain the revenue

at issue from their end users, so they can make their business plans accordingly. And companies like the Verizon ILECs cannot be expected to make their own regulatory or business decisions with the threat of a possible multi-million dollar unfunded regulatory mandate. Indeed, if anything, the current state USF should be reduced and ultimately abolished, not expanded in any way. The Commission must not leave the door open for the possibility of USF expansion, and should act now to accept the RD's primary recommendation and reject all proposals to expand the USF to fund RLEC access reductions.

1. The RD Rightly Found That Expanding The USF Would Impose Significant Consumer Harm With No Countervailing Evidence Of Benefits.

The RD rejected the proposal to rebalance RLEC access revenue to the USF because of "the compelling record evidence of its negative impact on Verizon ILEC customers," and the "lack of countervailing evidence that these PA USF payments are necessary to fulfill RLEC universal service/COLR commitments." (RD at 132). The Commission should accept this conclusion for the following reasons.

a. Expanding The USF Will Impose Huge New Regulatory Burdens On Other Carriers, Which Are Not Tenable In Today's Competitive Market.

The undisputed record evidence shows that replacing revenue from the RLECs' access rates with revenue from the USF would dramatically increase the funding burden on the Verizon ILECs. For example, OCA proposes to transfer $63 million in revenue funding from access rates to the USF. Today the Verizon ILECs would pay about $5.4 million of this amount through access rates, and other carriers, primarily IXCs, would pay

the remainder.[34] But if the $63 million were instead to be paid out by increasing the current USF, where the share to be paid by carriers is based on a percentage of their intrastate revenue rather than by the extent to which they use the RLECs' networks and access services, the Verizon ILECs' share of the burden would be an additional $32 million each year (on top of the $17.2 million that they already pay to the USF).[35] In other words, the Verizon ILECs and their customers would save $5.4 million in access payments due to the reduction of the RLECs' access rates, but the Verizon ILECs would gain $32 million in new USF costs, for a *net increase* in their funding burden to the RLECs of nearly $27 million.[36] There has been no evidence presented to the Commission that even attempts to justify such a massive transfer of wealth from Verizon to other carriers, and no demonstration that Verizon would still be able to cover its costs and serve its customers adequately following such a huge confiscation of its revenue.

Indeed, it is inconceivable that a $27 million per year additional revenue drain on the Verizon ILECs could be a pro-consumer outcome. While the RLECs lament their own line losses and pressures from competition in an attempt to argue that their own revenue cannot be reduced to any degree and that they must be subsidized by other carriers, their competitive pressures pale in comparison to the erosion in Verizon's business over the same time period. The Verizon ILECs operate in markets that are far

---

[34] If all of the Verizon companies are considered, the Verizon family of companies would pay $13.2 million of the $63 million in access charges (approximately 21%), while the remaining 79% is paid by other carriers. The Verizon ILECs alone pay about 8.6% of that total. (Verizon St. 1.2 (Price Surrebuttal) at 11-12).

[35] The share of all Verizon companies taken together would be $36 million. This calculation is based on the fact that the Verizon companies as a group currently pay about 57% of the assessments to the USF each year. The Verizon ILECs pay 51%. This calculation is based on the 2009 assessments. (Verizon St 1.2 (Price Surrebuttal) at 12).

[36] Even considering all of the Verizon companies together, shifting the revenue to the USF would result in a net increase in Verizon's burden of funding the RLECs of $23 million (the difference between $13.2 million in access charges and $36 million in new USF assessments). That calculation similarly assumes (conservatively and unrealistically) that the Verizon companies could retain all of their access savings.

more competitive than the RLECs' territory. From 1999 through 2009, the Verizon ILECs have experienced line loss of **[BEGIN PROPRIETARY] [END PROPRIETARY].** (Verizon St. 1.1 (Price Rebuttal) at 19). Because of such losses, Verizon's contributions to the current USF are now supported by only a fraction of the access lines that it served in 2000. For every Verizon access line in 2000, there was only **[BEGIN PROPRIETARY] [END PROPRIETARY]** access lines in 2009. On a per-access line basis, that means for every line paying $1 to fund the USF in 2000, that line in 2009 must pay **[BEGIN PROPRIETARY] [END PROPRIETARY]** to satisfy the same contribution burden. And, incredibly, the RLECs and OCA now propose to expand the USF burden.

The Verizon ILECs cannot be expected to absorb the costs of operating their regulated business in today's highly competitive market and at the same time be forced to turn the revenues that they earn over to the RLECs. Indeed, requiring such a forced revenue transfer, together with the other regulatory burdens imposed on the Verizon ILECs and the loss of revenues due to competition, would clearly constitute an unlawful confiscatory taking. *Brooks-Scanlon v. Railroad Comm'n of La.*, 251 U.S. 396, 399 (1920) (a carrier cannot be compelled to carry on its regulated business at a loss). It is black letter constitutional law that a regulator must evaluate – especially when imposing regulatory costs on entities experiencing financial distress – whether a regulated entity has an opportunity to recover its costs and earn a reasonable profit on its regulated operations. *F.P.C. v. Hope National Gas Co.*, 320 U.S. 591, 603 (1944) (the "end result"

of the regulator's decisions must be that the regulated entity can earn sufficient revenue to "assure confidence in the financial integrity of the enterprise").[37]

Depriving the Verizon ILECs of revenues needed to operate their own business is not only harmful to the companies but also to customers. The Verizon ILECs provide a broad array of services throughout their territories, including service to a larger number of rural access lines than all of the RLECs put together, and they continue to meet and/or exceed their own broadband availability obligations. All of these obligations come with costs, and the Verizon ILECs receive no state USF subsidies and charge much lower access rates than the RLECs. Further, many of their services are competitive and subject to pricing constraints by the market, and their rates for noncompetitive services are capped by the inflation-based Chapter 30 formula. If the Verizon ILECs are required to increase their already substantial transfer of revenue to the RLECs through the state USF, this new unfunded revenue drain would divert revenue from Verizon's operations that would otherwise be used to serve Verizon's customers and support its own business, such as by investing in the network, maintaining or improving products and services or through meeting competition on rates. It would be a disservice to the consumers in Verizon's territory to force Verizon to bear a larger burden of subsidizing the RLECs'

[37] The PTA's suggestion that the Verizon ILECs can well afford to send more revenue to the RLECs is, by PTA's own admission, based on the outdated and unsupported conception that Verizon is "the dominant carrier in Pennsylvania." (PTA Exceptions at 59). But the uncontested record evidence shows that the world had changed dramatically since the current USF was created in 1999, and Verizon in no way can be said to dominate the market. As of June of 2008, FCC data shoes that the Verizon ILECs serve just **[BEGIN PROPRIETARY]** **[END PROPRIETARY]** of the wireline access lines in Pennsylvania, when one considers RLEC, CLEC and cable lines – a percentage that is expected to be even smaller today as cable market share continues to grow. And of course looking at the relative percentage of wireline access lines does not even begin to account for wireless service, where the number of wireless lines far exceeds the number of wireline lines and the Verizon ILECs' share would be much smaller. (Verizon St. 1.1 (Price Rebuttal) at 21).

operations.[38] The purpose of this case is to decrease the burden Verizon and other carriers have borne over the years through a combination of USF contributions and excessive access rates, and to have the RLECs secure more of their revenue from their own end-users. But the USF proposal would actually *increase* rather than reduce the burden on Verizon and its customers. Although the RLECs insist on revenue neutrality for themselves – even demanding that the Commission guarantee their revenue stream against losses due to competition – the huge amount of revenue they propose to take from Verizon through an expanded USF is decidedly *not* revenue neutral.[39]

The other parties downplay the magnitude of the burden they are trying to impose on the other regulated telephone companies that currently must contribute to the USF, arguing that the Commission can lessen that burden by broadening the contributing base to the USF by requiring additional carriers such as wireless and voice over internet protocol ("VoIP") providers to contribute. (OCA Exceptions at 24). But the Commission has ruled that "[e]xamination of whether wireless carriers and VoIP service providers should be contributors to the PaUSF" is not a proper issue to be raised in this phase of the investigation. (12/10/09 Order at 24). Therefore, it certainly is not proper to presume that the funding base of the USF will be increased in making the decisions required in this phase of the proceeding. More importantly, steps must be taken to reduce

---

[38] In the face of this overwhelming evidence of the harm to the Verizon ILECs' and their customers, the best argument OCA can muster is that Verizon's customers "receive more value in their telephone service if they can call, and be called by, rural customers of RLECs." (OCA Exceptions at 29). But that is not a reason to force the Verizon ILECs to send tens of millions of dollars to the RLECs. In any event, if the RLECs rebalance the revenue to retail rates as the RD recommended, this calling capability would continue to exist.

[39] *See, e.g.,* 52 Pa. Code § 63.170 ("A telecommunications service provider may not implement a customer or end-user surcharge or any other direct or indirect charge to recover any contributions to the Fund."). PTA argues that the harm to Verizon's customers is not consequential because "only 20% of its customer base" is rural, as if the harm to the customers of over one million rural access lines, and the harm to suburban and urban customers, were inconsequential. (PTA Exceptions at 58; *see also* CenturyLink Exceptions at 58). The Commission is obviously bound to consider the interests of all consumers, not just RLEC consumers.

and ultimately eliminate the USF, not expand the services that contribute to it. Aside from the inevitable legal challenges that would result from any such attempts at expansion, as a policy matter, imposing such burdens on the more innovative services would greatly discourage investment in new technologies in Pennsylvania – the very opposite of the outcome Chapter 30 seeks to encourage. And instituting a proceeding to investigate expanding the contributing base of the USF before any RLEC access reductions would delay progress indefinitely while RLECs would continue both to charge their five-cent-a-minute and higher access rates and to collect a disproportionate amount of revenue from other carriers.

b. There Is No Record Evidence That Expanding The USF Would Benefit Customers.

The RD correctly found that the record lacks evidence "that these PA USF payments are necessary to fulfill RLEC universal service/COLR commitments." (RD at 132). In their exceptions, the RLECs again appeal to unspecified "universal service" obligations and rely on vague platitudes, such as that "[u]niversal service is vital to the common good of Pennsylvania." (PTA Exceptions at 56; *see also* CenturyLink Exceptions at 52). But there is no record evidence to show that universal service is in any jeopardy in RLEC territory or that forcing other carriers to send money to the RLECs is necessary to advance universal service. The RLECs themselves concede that customers in their territories enjoy access to affordable services from a number of different competitive options. As CenturyLink's Mr. Bonsick explained, "CenturyLink continues to see robust inter-modal competition for residential consumers, including wireless, voice and data services, cable voice and data services, and VoIP services (e.g., Vonage, Magic Jack). And on the business customer side, IP and data service providers are targeting all

classes of business customer." (CenturyLink St. 3.1 (Bonsick Surrebuttal) at 11). It is clear that an expansion of the fund is not needed to spur universal service, and in fact would have a negative effect. When consumers have access to quality services that are being provided by a number of competing carriers and technologies, at affordable rates (as the RLECs' testimony asserts is the case in Pennsylvania today), the goals of universal service are achieved through the workings of competitive markets, and artificial subsidies – particularly new ones based only on anecdotal evidence – are unnecessary.

When the Commission created the present USF over 10 years ago, it recognized that it was a temporary or interim measure that was only intended *"to facilitate the transition from a monopoly environment to a competitive environment."*[40] As ALJ Colwell pointed out, eventually "the market is meant to rely on competition to keep rates affordable" rather than continuing to "provide subsidies to companies who do not have to prove need," which she observed "will not assist the market in reaching its goals and will, instead, provide barriers to entry for new carriers." (Colwell 7/23/09 RD at 87). The record shows that the "competitive environment" the Commission foresaw back in 1999 has now arrived. There is no need to force other carriers to subsidize the RLECs' operations to ensure universal service.

Additionally, the anti-competitive and anti-consumer problem that is presented by allowing the RLECs to collect too much revenue from other carriers through their high switched access rates would not be remedied by allowing them to collect the same revenue from other carriers in a different way through the USF. More than tripling the size of the USF to provide further subsidies to the RLECs' operations would be

---

[40] *Global Order*, slip op. at 135 (emphasis added).

detrimental to both consumers and carriers, because it would encourage the RLECs to continue relying on artificial subsidies rather than becoming more efficient and/or innovative in their operations. This is the exact opposite of the incentive that alternative regulation is intended to provide. Expanding the USF in this manner would simply perpetuate the anticompetitive *status quo* under which one set of providers (the RLECs) recovers network costs from other providers. Such a result is incompatible with and harmful to the workings of a competitive market for communications services because it would recreate the exact same problem that is inherent in the RLECs' excessive access rates, albeit through a slightly different mechanism. In fact because the USF contributions are calculated based on the carriers' intrastate revenue, communications companies that might otherwise have chosen to invest in Pennsylvania could choose to take their business elsewhere, leaving Pennsylvanians in general with fewer competitive options at a time when attracting technological innovation is even more critical to Pennsylvania's future. (Verizon St. 1.1 (Price Rebuttal) at 48-49).

The only way actually to solve the anti-competitive and anti-consumer problem of excessive RLEC access rates is to have the RLECs reduce their dependence on revenue provided by other carriers and recover that revenue instead from their own end users.

2. USF Expansion To Replace RLEC Access Revenue Is Not Authorized By Current Law.

The current USF was created in a very different legal and factual environment more than ten years ago. The Commonwealth Court in 2000 affirmed the Commission's authority to establish the *Global Order* USF based in part on the former Chapter 30's retention of power to the Commission to "establish such additional requirements and regulations as it determines to be necessary to ensure the protection of consumers" and

the Commission's factual findings that the USF would advance policy goals of the previous Chapter 30.[41] Under the facts and the law today, however, neither the Commission nor the court could reach the same answer when faced with the question of expanding USF burdens to fund new access reductions.

The new Chapter 30 also preserves Commission authority "to ensure the protection of customers," although it requires any such requirements to be "consistent with this chapter." 66 Pa. C.S. § 3019(b)(3). Based on the unrebutted evidence discussed above of the serious harm to customers of the Verizon ILECs and lack of countervailing public benefits, the Commission could not reasonably conclude that creation of new USF obligations is necessary "to ensure the protection of consumers," because the record shows the exact opposite: it would harm consumers. The record also does not establish that this transfer of funds is necessary to advance universal service in the RLECs' territories. Nor could the Commission conclude that a forced transfer of millions of dollars of revenue from other regulated carriers to the RLECs comports with the new Chapter 30's policy objectives to promote competition and reduce regulatory burdens on regulated carriers. 66 Pa. C.S. § 3011(8), (9) and (13).

Another significant factor that the Commission would have to consider is that the new Chapter 30 contains a provision permitting the Commission to rebalance access revenues to rates for other noncompetitive services in a revenue neutral manner, (66 Pa. C.S. § 3017(a)), but it makes no reference at all to a state USF being used as a source for

[41] *Bell Atlantic-Pennsylvania, Inc. v. PUC*, 763 A.2d 440, 496, 2000 Pa Commw LEXIS 592 (Commw. Ct. 2000), *rev'd on other grounds, MCI WorldCom Inc. v. PUC*, 572 Pa. 294, 844 A.2d 1239 (2004). The Commonwealth Court also relied on the argument that Verizon's predecessor, Bell of Pennsylvania, was estopped from challenging the Commission's legal authority to establish the USF, having conceded that authority by agreeing to prior USF proposals under the governing statute at that time. *Id.* at 496. But that same reasoning cannot be used here because Verizon has consistently opposed expansion of the USF to fund future RLEC access reductions under the current Chapter 30.

that revenue.[42] Had the Legislature wished to authorize such a mechanism or to endorse the expansion of the current USF for future access reductions, it could have and would have said so.[43]

OCA argues that replacing access revenues with USF support "is consistent with the universal service process at the federal level." (OCA Exceptions at 23). But this Commission's actions are governed by Pennsylvania law and the evidentiary record assembled here. In any event, however, OCA does not provide a complete picture of federal law on this issue. The FCC and the federal courts have emphasized that the concept of universal service must take into account the burden on the customers funding the USF,[44] and the RD correctly held that expansion of the USF is not warranted in light of that burden. The FCC also recognizes that excessive USF support can actually detract from universal service.[45] Further, as discussed above, the FCC has made clear that its "long term goal" was for interstate access revenues to be charged to end users through the SLC.[46] Moreover, as OCA acknowledges, the largest recipient of federal Interstate Access Support (IAS) in Pennsylvania is Verizon PA, (OCA Exceptions at 23, n. 42),

---

[42] Because the revenue neutrality provision at Section 3017(a) does not even mention the USF as an option – and indeed there is no reference to the USF anywhere in Chapter 30 – the argument that use of the USF is essential to comply with Section 3017(a) is baseless. (CenturyLink Exceptions at 44). The RLECs may be dissatisfied with the way the statute is written, but the Commission cannot exceed the authority provided to it under the statute. *See, e.g., Feingold v. Bell of Pa.*, 477 Pa. 1, 383 A.2d 791 (1977).

[43] The RD was "not troubled by the lack of specific mention of universal service support funding in Act 183." (RD at 132). But the absence of a specific reference to a USF as a revenue source is certainly a relevant factor in determining whether funding these access reductions with new USF assessments is or is not consistent with the policy goals of Chapter 30.

[44] *In re High-Cost Universal Serv. Support et al.*, 25 FCC Rcd 4072, 4088 (F.C.C. 2010); *Rural Cellular Ass'n v. FCC*, 588 F.3d 1095, 1102 (D.C. Cir. 2009) (the concept of universal service "encompasses not just affordability for those benefited, but fairness for those burdened.")

[45] *In re High-Cost Universal Serv. Support et al.*, 25 FCC Rcd 4072, 4088 (F.C.C. 2010). *See also Qwest Commc'ns Int'l Inc. v. FCC*, 398 F.3d 1222, 1234 (10th Cir. 2005) (noting "excessive subsidization arguably may affect the affordability of telecommunications services, thus violating the principle in § 254(b)(1)").

[46] MAG Order ¶ 33.

which is a far cry from the proposal here whereby Verizon PA contributes millions of dollars to the USF each year and receives nothing.

The RD also found that the current USF regulations make no provision for increasing the fund size to account for future RLEC access reductions, and that "[n]o party, in my view, has sufficiently responded to Verizon's contentions" that a rulemaking would be required before the USF could be used here, either on a temporary or a permanent basis. (RD at 132). The regulations determine the size of the fund each year based on the "[p]rior year's size of fund minus the estimated surplus from the prior year or plus any shortfall from the prior year." 52 Pa. Code § 63.165(b). The only provision to increase the fund size is "due to growth in access lines of recipient carriers," (*Id.*), but the RLECs indicate that the recipient carrier lines are declining. Accordingly even if the contributing base and methodology remained the same, the size of the fund could not be increased without a rulemaking to alter the existing regulations, and therefore could not be accomplished through this proceeding. AT&T argues that because using the USF to reduce access rates is consistent with "the regulatory intent of the PaUSF," no rulemaking would be required to increase the size of the fund. (AT&T Exceptions at 29-30). Such an ambiguous assertion of "intent" does not provide authority that does not exist in the regulations to increase the size of the fund.

AT&T also relies on 52 Pa. Code § 63.164, which states that "[t]he Commission will issue an order within 90 days of receipt of the administrator's annual report, which establishes the size of the Fund, a budget, assessment rate for contributing telecommunications providers, and administrative guidelines for the upcoming calendar year," to argue that the Commission is free to increase the size of the fund in its order.

(AT&T Exceptions at 30). But clearly the regulations contemplate that the Commission will decide the size of the fund by applying the formula set forth in 52 Pa. Code § 63.165, not by arbitrarily increasing it without regard to the regulatory formula.

In short, just because the Commission accepted the creation of a USF to fund RLEC access reductions ten years ago does not mean that it is bound to do the same today; indeed, there would be serious legal problems if it attempted to do so. The *Global Order* USF was a temporary measure "*to facilitate the transition from a monopoly environment to a competitive environment*."[47] ALJ Colwell rightly concluded in phase one of this investigation that, "[l]ooking back over the Commission's Orders leading up to this Investigation, it is clear that there was no expectation by the Commission that the PA USF would be institutionalized in its present form." (Colwell 7/23/09 RD at 88). Contrary to PTA's arguments, Verizon did not agree to fund RLEC access decreases in perpetuity through an ever-expanding USF. (PTA Exceptions at 58). ALJ Colwell already rejected this argument, finding and that "[t]he parties to [the *Global Order*] litigation . . . were agreeable to settlement because they believed that the Commission would institute *and litigate* an investigation which would address and handle the PA USF and access charge issues in a timely manner." (Colwell 7/23/09 RD at 88). For this reason, when it reopened this proceeding the Commission cautioned "the Parties who rely on the PaUSF that access charge reform in Pennsylvania may or may not depend upon the continuation of the PaUSF" and "we are not constrained by the PaUSF for access charge reform." (12/10/09 Order at 23).[48]

---

[47] *Global Order*, slip op. at 135 (emphasis added).

[48] PTA claims that the RLECs are entitled to USF funding any time their access rates are reduced because USF funding was available in all prior access rebalancings. (PTA Exceptions at 56). But this claim is not factually correct. The current USF was sized specifically based on the RLEC access reductions

As the RD correctly observed, one of the benefits of a phased-in rebalancing of the RLECs' access revenue to retail rates is that it avoids a "legal stumbling block" that could delay and complicate the access reductions, although the ALJ noted that "the factual record alone provides sufficient support of" the phased-in approach. (RD at 132).[49] Accordingly, the Commission should conclude based on the record and the law that it will not attempt to use other carriers' revenues through the USF to fund the RLECs' access reductions, and should not consider expanding the USF as an option when designing the rate rebalancing here.

3. AT&T's Temporary USF Proposal Suffers From The Same Problems And Should Be Rejected.

AT&T's primary objection to the RD's phased-in rebalancing is that AT&T does not want to wait to start saving from access reductions. (AT&T Exceptions at 25). Accordingly, AT&T renews its argument for a transitional USF, contending it is the "most straightforward and reasonable mechanism for implementing" the RD's access reductions. (AT&T Exceptions at 16). In its haste to achieve access savings *now,* AT&T asks the Commission to sacrifice the best interests of the Verizon ILECs and their customers by having them disproportionately subsidize the transitional USF so that AT&T can realize immediate savings.

---

following the 1999 *Global Order*. When the RLECs reduced access rates through a settlement again in 2003, the size of the fund was not increased. Instead, the RLECs rebalanced the revenue through retail rate increases and shifted some of the USF receipts among the carriers with the overall size of the fund staying the same. Verizon has engaged in substantial access rate reductions since the *Global Order* and *none* of those reductions were off-set with USF funding. Instead, Verizon either rebalanced the revenue to retail rates directly through retail rate increases or indirectly through the use of negative price change opportunities under its alternative regulation plan, opportunities that might otherwise have been used to reduce regulated retail rates. (Verizon St. 1.1 (Price Rebuttal) at 45-46).

[49] PTA does not appear to disagree that a rulemaking would be necessary to expand the USF, but argues that the Commission should open and complete such a rulemaking before undertaking any reductions, which of course would potentially delay such reductions for years. (PTA Exceptions at 60)

AT&T characterizes its temporary USF proposal as a "reasonable compromise position," (AT&T Exceptions at 26), but it is no compromise. For the same reasons discussed above with regard to OCA's proposal, AT&T's proposal to "temporarily" increase the USF by $19.6 million would shift the funding burden away from the IXCs and to the Verizon ILECs and their customers. If the $19.6 million is transferred to a "temporary" USF under the same rules that apply to the current USF, the Verizon ILECs would pay $10 million of that $19.6 million, where they would only have paid $1.5 million if the revenue stayed in access rates – a net increase in the Verizon ILECs' funding burden to the RLECs of $8.5 million in the first year, with a continuation of that trend throughout the life of the interim USF. (Verizon St. 1.2 (Price Surrebuttal) at 12). Simply put, the AT&T transitional USF proposal would benefit AT&T at the expense of the Verizon ILECs and their customers, with no public benefit that would make such an approach superior to one that simply steps down the access rates over time.[50]

AT&T attempts to show that "Verizon will . . . be better off under AT&T's proposal," (AT&T Exceptions at 28 and Attachment B), but it is simply wrong. The Verizon ILECs – and more importantly the consumers in their territory – will be "better off" under the RD's recommendation of a gradual phase down of access decreases/retail rate increases than under AT&T's proposal. AT&T's Attachment B is deceptive in several respects. First, it does not depict the consequences of AT&T's proposal on the Verizon *ILECs*, where both Verizon and the ALJ expressed specific concern about the

[50] AT&T suggests that the Commission could alleviate the problem by "waiv[ing] the regulation that prohibits carriers from recovering PaUSF contributions as a line item surcharge." (AT&T Exceptions at 29). But this would not prevent the harm to Verizon's customers, and AT&T articulates no good reason why Verizon's customers should pay with an explicit bill line-item so that AT&T can realize higher immediate savings rather than waiting for the phase-in to be completed.

financial impact on the Verizon ILECs.[51] Second, AT&T does not show a comparison of the impact of *AT&T's proposal* on Verizon versus the impact of *the ALJ's recommendation* on Verizon. It only looks at AT&T's proposal versus doing nothing, but that is not the relevant question. AT&T does not – and cannot – deny that the Verizon and its customers will be worse off under AT&T's "temporary USF" proposal than under a phase-down scenario as contemplated by the RD, because the Verizon pays a disproportionately larger portion of any revenue that is replaced by the USF as compared to the portion it pays of revenue that continues to be charged through RLEC access rates. This disparity is true of the Verizon ILECs alone and of all the Verizon companies taken together. Finally, AT&T's chart only shows the impact for four years, but AT&T's proposal suggests that its "temporary" USF will continue for an indeterminate period of time. (*See* Verizon St. 1.2 (Price Surrebuttal) at 5).

There is no need to implicate the USF in a temporary manner to allow the RLECs to transition their retail rates up over time. If a transition period is needed (and the RD concluded that it was), then considerable litigation and debate can be avoided simply by reducing the RLECs' rates, phased-in over a few steps. As a practical matter, increasing the assessments to the state USF will bring in unnecessary administrative complexity to this case and the potential for continued litigation, appeals and delay, particularly if the

---

[51] AT&T attempts to depict a four-year snapshot of the cumulative impact of its proposal on all the Verizon entities taken together, but it deliberately does not show the impact on the Verizon ILECs taken alone. Certainly the Verizon IXCs will save from RLEC access reductions, as will AT&T and other IXCs. But that is not a reason for the Verizon ILECs to be forced to foot the bill so that the IXCs may enjoy those savings faster. And since under AT&T's own view the IXC savings will be passed on to their customers, the Verizon ILECs and their customers will remain out-of-pocket for amounts they are forced to contribute disproportionately to AT&T's transitional USF.

Commission attempts to expand the contributing base.[52] By far the simpler approach, if it is concluded that a transition period is needed, is to leave the revenue in access rates and take those rates down in defined steps over a period of time as the RD recommends.

As a substantive matter, moreover, there is no benefit to be gained by shifting this revenue to the USF to secure a larger immediate access reduction, as opposed to the more administratively simple stepping down of the RLECs' access rates over time, if a transition is found to be necessary. As discussed above, the RLECs should be reducing their dependence on revenue from other carriers, not simply shifting that burden from access rates to another carrier-funded source such as the state USF. Shifting the revenue to another carrier-funded source does nothing to ameliorate the adverse impact on customers both of the contributing carriers (because those carriers have less money to spend serving their own customers) and of the RLEC (because their customers still face diminished opportunities for competitive alternatives and the RLECs will continue to have diminished incentives to engage in service, product and network innovation). (Verizon St. 1.1 (Price Rebuttal) at 48-49).

Increasing the state USF – even on a purportedly "temporary" basis – is not good policy and is bad for consumers. Pennsylvania's telephone carriers already provide over $33 million each year in a direct revenue transfer to the RLECs through the current USF, which as discussed in Verizon's rebuttal testimony provides a substantial windfall to the RLECs: they have been guaranteed a constant amount of revenue since 2000 notwithstanding declines in access lines and access minutes. (Verizon Exceptions at 11; Verizon St 1.1 (Price Rebuttal) at 47). The Verizon family of companies and their

---

[52] AT&T tries to downplay the prospect of legal problems with its temporary USF proposal, (AT&T Exceptions at 29), but that proposal suffers from the same legal flaws discussed above.

customers alone provide nearly $20 million to the RLECs each year through their USF assessments, without even considering the additional revenue they are forced to contribute by paying the RLECs' excessive intrastate access rates. ALJ Colwell concluded that this current fund is a "hidden tax" that should be revisited and reconstituted. The Commission should not exacerbate this "hidden tax" by increasing the USF, even on a temporary basis.

In short, AT&T's proposal stands to benefit *AT&T* to the detriment of consumers and at the expense of an efficient and less controversial rebalancing process, and it would create more legal and policy problems than it would solve. As a practical matter, increasing the assessments to the state USF will bring in unnecessary administrative complexity to this case and the potential for continued litigation, appeals and delay, particularly if the Commission attempts to expand the contributing base. By far the simpler approach, if it is concluded that a transition period is needed, is to leave the revenue in access rates and take those rates down in defined steps over a period of time as the RD recommends.

VI. Response to Sprint Exception No. 1, AT&T Exceptions No. 2 and 4, PTA Exception No. 5, and CenturyLink Exception No. 5: The RD's Phase-In Recommendation Is Generally Reasonable, Although Certain Details Should Be Improved.

The RD concludes that "access reductions and associated revenue neutral rebalancing" should be "phased-in without additional PA USF funding." (RD at 131). Verizon supports the RD's recommendation, with a few reasonable modifications to improve the process, as discussed in Verizon's Exceptions. Perhaps not surprisingly, AT&T and Sprint argue that the phase-in is too long and leaves open opportunities for further delay, while the RLECs argue that the phase-in is too short.

AT&T argues that if the Commission adopts the RD's phased-in rebalancing and rejects AT&T's transitional USF proposal (which the Commission should do), the Commission should make certain process improvements to speed up the rebalancing and eliminate opportunities for needless delay. Verizon agrees with AT&T that there is little value in defining the first phase of the rebalancing as bringing residential rates up to $18, and that this artificial benchmark could be misused by having some carriers with rates already very close to $18 to undertake only very small changes in the first phase. (AT&T Exceptions at 31). It would be reasonable to alter the process so that all RLECs make a sizeable and approximately equal rebalancing in the first phase, and eliminate any reference to the $18 rate level. Verizon also agrees that the technical conferences should not be used "as an invitation to further delay and confusion." (AT&T Exceptions at 39). Verizon raised the same concern in its Exceptions. (Verizon Exceptions at 4).[53]

Verizon disagrees completely with the challenges raised by PTA and CenturyLink to the rebalancing. The ALJ gave due consideration to stepping up the rate increases over time to avoid consumer rate shock. PTA's descriptions of the three-to-four year phase-in as a "precipitious[]" access reduction that "force[s] rapid escalations in local rates"[54] are not credible. (PTA Exceptions at 61; *see also* CenturyLink Exceptions at 60). Likewise, the Commission should reject PTA's suggestion that the Commission send the parties

[53] Sprint does not oppose a phase-in of the rebalancing, but argues that it should be completed in a maximum of two years rather than the four years recommended by the RD, and "preferably" immediately. Sprint does not suggest any specific process changes. (Sprint Exceptions at 3).

[54] PTA asserts that "there should be no RLEC reductions using a statewide policy that does not also apply to Verizon." (PTA Exceptions at 62). But Verizon already charges much lower access rates than the RLECs, and does not present the same problem to the Commission that the RLECs present. In fact the PTA strenuously opposed arguments to reduce the RLECs' rates to Verizon's *current* levels, arguing that they are too low. Even after this rebalancing is complete, the RLECs' average per-minute intrastate switched access rate will be 1.9 cents, which is higher than Verizon's current 1.7 cent rate. (PTA Exceptions at 2). The Commission has an open investigation of Verizon's access rates and will address the matter in due course.

back to a "collaborative process" for the parties to "work out their differences." There is no need for such a process at this point; the record is complete, and the Commission should act on it by adopting the ALJ's well-reasoned recommendation.

CONCLUSION

For the foregoing reasons, the Commission should adopt the RD as its resolution of this proceeding, but also should consider the modifications and clarifications discussed in Verizon's Exceptions to improve the recommended rate rebalancing process.

Respectfully submitted,

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

Counsel for Verizon

Dated: September 17, 2010