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May 13, 2010

VIA UPS OVERNIGHT

Ms. Rosemary Chiavetta
Secretary
Pennsylvania Public Utility Commission
2nd Floor West
Commonwealth Keystone Building
Harrisburg, PA 17105-3265

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

AT&T Communications of Pennsylvania, LLC, et. al. v. Armstrong Telephone Company-Pennsylvania, et.al., Docket Nos. C-2009-2098380, C-2009-2099805, C-2009-2098735

Dear Ms. Chiavetta:

Enclosed on behalf of AT&T Communications of Pennsylvania, LLC, TCG Pittsburgh, and TCG New Jersey, Inc., please find the original and nine copies of the Opening Brief of AT&T, including Appendices A-C. Please note that Appendix C contains proprietary information, and that the brief should be filed as confidential. I have also enclosed a public version of the brief that excludes Appendix C. Copies have been served in accordance with the attached Certificate of Service.

Please contact me if you have any questions or concerns with this matter.

Very truly yours,

Demetrios G. Metropoulos

cc: Hon. Kandace F. Melillo
Certificate of Service

Enclosures

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of AT&T's Opening Brief 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 Chicago, Illinois, this 13th day of May, 2010.

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Investigation Regarding Intrastate Access Charges and IntraLATA Toll Rates of Rural Carriers and the Pennsylvania Universal Service Fund	:	Docket No. I-00040105
AT&T Communications of Pennsylvania, LLC, *et al.*, *Complainant*	:	
v.	:	Docket Nos. C-2009-2098380, *et al.*
Armstrong Telephone Company - Pennsylvania, *et al.*, Respondents	:	

MAIN BRIEF

of

AT&T

PUBLIC VERSION

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MAY 13, 2010

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BEFORE THE
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v.	:	Docket Nos. C-2009-2098380, *et al.*
Armstrong Telephone Company - Pennsylvania, *et al.*, Respondents	:	

MAIN BRIEF
OF AT&T

Pursuant to 52 Pa. Code §5.501 and the Orders issued by Administrative Law Judge Melillo in this matter, AT&T Communications of Pennsylvania, LLC, TCG Pittsburgh, and TCG New Jersey, Inc. (collectively "AT&T") hereby submit their Main Brief using the format of the joint outline agreed upon by the parties.[1]

[1] AT&T attaches three Appendices to this Main Brief. Appendix A is AT&T's Proposed Findings of Fact. Appendix B is AT&T's Proposed Conclusions of Law. Appendix C is Attachment 5 to AT&T Statement 1.2 (Nurse/Oyefusi Rebuttal Testimony). Appendix C is Proprietary. Other than Appendix C, this Main Brief and Appendices A and B contain only public information.

I. STATEMENT OF QUESTIONS AND SUMMARY OF POSITIONS

A. STATEMENT OF QUESTIONS

The Commission made it clear over ten years ago that access reform, and the substantial access reductions that are inherent in that reform, were essential for the development of a fully competitive telecommunications market throughout the Commonwealth – not just for consumers in our large metropolitan areas, but for the millions of customers in Pennsylvania's rural areas. Thus, the Commission made it equally clear that access reform not only was a necessity for Pennsylvania's largest carrier, but it was just as critical for the Rural Local Exchange Carriers ("RLECs"). The evidence developed in this case conclusively proves that it is time for the Commission to act now to achieve that promise by decisively and immediately reducing the RLECs' above-cost access rates.

The RLECs cannot seriously claim to be surprised by this prospect. They have been on notice for over a decade that this day was coming. Yet, rather than use that time to prepare to compete on even terms, the RLECs have stubbornly resisted reform, maintaining their unsustainable dependence on excessive subsidies from their competitors. And they have displayed that same intransigence throughout this proceeding, insisting in their testimony that reform – even after years of delay – still would be premature.

The Commission should not be deterred by these tactics. By relying on the record in this proceeding and directing immediate reform, the Commission will achieve several important objectives. It will have furthered the implementation of its own, and the Legislature's, pro-competitive policies and goals. It will have kept pace with the changing competitive market. It will have recognized once and for all that regulatory policies of the past, built in an age of monopoly, cannot be sustained in today's vastly changed market. It will have helped level the

competitive playing field by ensuring that one type of competitor is not handcuffed by being forced to pay high subsidies that other types of competitors do not have to pay. Finally, it will have ensured that customers benefit from regulation that makes sense, and that sends the proper pricing signals to the market so that competition can thrive.

The questions presented in this case are as follows:

> (1) Should the RLECs' intrastate access rates be reduced? If so, when and to what levels?
>
> (2) If the RLECs' intrastate access rates are reduced, how should any revenue reductions be recovered?

AT&T's answer to question (1) is that the RLECs' high intrastate access rates must be reduced ***immediately*** to parity with their interstate levels and rate structure. There is no need for a "transition" period in reducing access rates — we have already had a decade of transition. The Commission has already phased in access reductions beginning in 1999, and again in 2003. This is the years-delayed third phase, and thus should result in immediate access reform, implemented promptly after a final Order is issued. Given the drastic changes to the market in the past seven years alone since the Commission last reduced the RLECs' access rates, it is critical that intrastate access rates be immediately reduced to interstate levels.[2]

As for question (2), any access reductions should be recovered first through reasonable increases in local rates, and then from ***transitional*** Universal Service Fund ("USF") support, over a four-year transition period. [3]

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[2] For the few companies whose intrastate access rates are currently below their interstate access rates, their intrastate access rates should be permitted to increase to, and thereby also match, their interstate levels. Thus, AT&T's proposal ensures parity for all RLECs.

[3] Thus, to the extent there is any transition period in reforms that the Commission directs as a result of this proceeding, it should be on the revenue neutral recovery side to minimize the impact on consumers. AT&T also proposes that the access differential between intrastate and interstate be converted to a per-line basis.

The first step of the revenue recovery is to establish the reasonable benchmark of $22/month, which is simply the Commission's 2003 policy judgment of a reasonable rate brought forward to current dollars. This benchmark means that RLECs would first look to their own customers to recover or offset any intrastate access reductions.[4] The second step is to use the state USF as a ***transitional*** tool to temporarily recover access reductions if increasing local rates to the benchmark does not sufficiently cover the access revenue loss for some RLECs.[5] For each of the next three years, the benchmark would increase by $1/month until it reaches $25/month; thus each year carriers that apply for transitional USF funding will receive more per-line from local service, and be supported by a correspondingly lower per-line draw from the USF. After the fourth year, virtually all of the companies will be recovering any access reductions from their own customers rather than through the customers of other companies.[6] Thereafter, if there were still any remaining need to regulate basic local service rates at all, the benchmark could be raised annually by the rate of inflation until such time as revenue recovery has been completed.[7]

The parties opposing access reductions make the same claims they have been making for years – that customers will not see benefits, that universal service will be "destroyed," and therefore that high access rates must be maintained. These arguments are completely contradicted by the evidence in this case, as well as the empirical experience of nearly half the

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[4] There are some RLECs that would never need to reach the $22/month basic local service rate as part of access rate rebalancing because their local rates would only need to be increased slightly as a result of the access reductions advocated by AT&T. *See* Attachment 5 to AT&T Statement 1.2, which has been attached to this Main Brief as Appendix C for convenience and ease of reference because it provides the details on the exact USF and local rate revenue increases, for each carrier, for each step under AT&T's proposal.

[5] Many RLECs will be fully rebalanced and will not need to draw transitional state USF funding with the $22 benchmark. See Appendix C hereto.

[6] There would be five smaller RLECs still drawing from the USF in Year 5, and CenturyLink would be drawing 19 cents per line. *See* Attachment 5 to AT&T Statement 1.2.

[7] After one such increase in the fifth step, CenturyLink would drop out of the transitional USF as fully rebalanced.

states in the country, which have reformed intrastate access in some form or another without the dire consequences alleged by the RLECs.[8] The Commission and the Legislature have long since rejected these claims that access reform is bad public policy, and the overwhelming evidence shows that the Commission should reject such claims here as well. To the contrary, the reform sought by the Commission, and supported by this record, will in fact engender precisely the competitive market, and consumer benefit, that is at the heart of the Commission's and the Legislature's policies.

B. SUMMARY OF ARGUMENT

1. The Time Is Now For Access Reform.

High subsidies embedded in access charges may have made sense when they were first established, when the local market was served solely by monopoly carriers. They do not make sense today. When intrastate access charges were first established in 1984, they were set far in excess of cost to generate a subsidy to help keep monopoly local exchange service "affordable." Economic efficiency was sacrificed in order to ensure universal service. However, that system was only sustainable at a time when local markets were closed monopolies, and where traditional wireline long-distance calls were consumers' only real option for long-distance voice communications. In that closed system, it was mechanically possible to overprice access, and thus retail long distance rates, in order to under-price the basic local telephone service offered by one monopoly provider in each market, thereby implicitly promoting "universal service." Now-retired Administrative Law Judge Michael Schnierle accurately described the way in which access charges worked:

> Despite the existence of distortions and inefficiencies, this system of cross-subsidies has been justified on policy grounds, principally as a means to serve

[8] AT&T Statement 1.4 at pp. 12-13; AT&T Statement 1.0 at pp. 53-54; AT&T Statement 1.2 at pp. 30-32.

> universal service goals. By providing ILECs with a stream of subsidized revenues from certain customers, the system has allowed regulators to demand below-cost rates for other customers, such as basic telephone service for those customers in high-cost areas. For all intents and purposes, the system serves as a hidden tax collected by the telephone companies. Low cost telephone customers are required to pay more than they would have to pay in a competitive market, to allow the telephone companies to charge less to customers whose cost of service would otherwise be higher.[9]

Given the dramatic changes in the telecommunications marketplace, this inefficient system of cross-subsidization does not work today. In fact, this system did not work ten years ago when the market first started to evolve – competition was allowed in local markets; local companies were eventually permitted to provide long distance services; and most importantly, alternative technologies began emerging (and exploding) onto the market. All of these changes rendered a system of keeping local rates artificially low while keeping access rates extraordinarily high unsustainable, especially when only some types of companies were required to pay the high access rates.

ALJ Schnierle again accurately described the problem of high access rates in a competitive market, and properly recognized how the Commission must act:

- "***The existing system (of implicit subsidies and support flows) is sustainable only in a monopoly environment where ILECs are guaranteed an opportunity to earn returns from certain services and customers that are sufficient to support the high cost of providing other services to other customers.*** The new competitive environment envisioned by the Telecommunications Act of 1996 threatens to undermine this structure over the long run. The 1996 Act removed barriers to entry in the local market, generating competitive pressures that make it difficult for ILECs to maintain access charges above economic cost." ALJ Schnierle 1998 RD at p. 6 (emphasis added).

- ***"[T]his scheme [of pricing access well above cost to keep basic service rates as low as possible] is no longer practical because the rates of various services bear***

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[9] *In Re: Intrastate Access Charge Reform*, Docket No. I-00960066, Recommended Decision, June 30, 1998 at p. 6 (hereinafter "ALJ Schnierle 1998 RD").

no relationship to their costs, and competitors are encouraged to enter the market for those services that are priced well in excess of costs, while ignoring those markets and services where prices at or below costs." ALJ Schnierle 1998 RD at p. 24 (emphasis added).

- "***[A]ccess charges must be closer in magnitude to access costs for there to be true competition in the toll market.*** While some of these problems might be ameliorated by a universal service program, reliance only on such a fund cannot be justified for reasons of fairness to the customers who will be forced to contribute to the USF." ALJ Schnierle 1998 RD at p. 24 (emphasis added).

- "In short, politically unpopular though it may be, ***rate rebalancing is required, along with access charge reductions, if there is to be competition for all customers in all locations***, and if urban customers are not to be saddled with excessive universal service fund costs. I am aware of no other way to solve this problem, and the parties here have presented no other proposal that is likely to solve the problem. Moreover, ***the very point of introducing competition to the local exchange market is to bring about lower prices through the operation of the market. An unwillingness to rebalance rates suggests an unwillingness to trust the market to bring about lower prices.*** If that is the case, I suggest that society rethink the notion of attempting to have competition in the local exchange market." ALJ Schnierle 1998 RD at p. 28 (emphasis added).

As part of the *Global Order*,[10] the Commission incorporated these findings, stating that ALJ Schnierle's June 30, 1998 Recommended Decision had reached "various conclusions regarding the necessity of access reform in a competitive environment and we incorporate those conclusions in that regard in this Order by reference."[11]

ALJ Schnierle and this Commission were right nearly twelve years ago, and these conclusions are even more accurate today. It is time for the Commission to move forward and complete access reform for the RLECs. Step 1 in access reform came in 1999. At that time, the Commission recognized that further reform was necessary, and even anticipated *completing* the reform by the end of 2001. Obviously, that did not happen. Step 2 in access reform came in

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[10] *Re Nextlink Pennsylvania, Inc.*, Docket No. P-00991648; P-00991649, 93 PaPUC 172 (September 30, 1999)("*Global Order*").

[11] *Id.* at p. 27.

2003, when the Commission agreed to adopt a settlement that reduced some access rates, but again stated that further access reform was needed. The order that results from this proceeding should be the third (and final) step in the Commission's continued policy and promise to reduce access rates. There is absolutely no need to delay access reform any further, or to phase in access reductions. Access reductions have already been "phased in" over the past decade -- in fact, the RLECs have reaped massive windfalls for years given the protracted delay in fulfilling the *Global Order*'s assurance that comprehensive reforms would be completed by the end of 2001. The time is here to complete the reductions and bring intrastate rates to parity with interstate levels.

There are multiple reasons for reducing access rates. First and foremost, access reform is in the best interests of Pennsylvania consumers. Reducing access rates places competitors on a level playing field and stops handicapping one type of competitor – particularly the wireline interexchange carriers -- relative to others. Increasing the level of competition in Pennsylvania will ensure that all firms have even stronger incentives to innovate, improve their efficiency, and give consumers the services they demand at prices they are willing to pay. Indeed, the overwhelming weight of evidence shows that reduced access rates result in lower long-distance prices for consumers. Equally important, rate rebalancing aligns rates closer to costs, thereby providing the proper economic pricing signals to the market. Consumers and competition both lose when allegedly "competitive" markets are in fact afflicted by artificial pricing signals that are distorted by regulation. Access reform eliminates cross-subsidies among carriers, especially implicit subsidies, in a competitive market. It also aligns the rates for services that are materially the same (such as intrastate and interstate access), thus helping eliminate incentives for harmful arbitrage schemes. The record shows these arbitrage schemes are occurring in

Pennsylvania – the RLECs have filed complaints against other carriers for attempting to avoid payment of intrastate access charges; and there is uncontroverted evidence in the record that RLECs have engaged in "traffic pumping" where access traffic is artificially stimulated to take advantage of high, above-cost access rates.[12]

None of these reasons are new to the Commission – the Commission recognized the need to reduce access rates for all of these same reasons in 1999, again in 2003, and yet again in 2007 when it stated "Act 183 and Section 3017(a) support this Commission's policy goals that local exchange carriers reduce dependence on access revenue from other carriers and rebalance those revenues."[13] In fact, even the RLECs themselves have recognized these factors. In 2002, Buffalo Valley told the Commission: "[T]he continued existence of access charge rates that are above cost constitute a barrier to effective competition for toll services."[14]

The Commission nevertheless has delayed implementing the final phase of access reform – not because it thought such reform was unnecessary, but because the Commission thought the FCC was going to act on intercarrier compensation reform.[15] The FCC has not acted, and there is no indication that the FCC is going to act anytime soon. The perennial prospect that perhaps the FCC might consider action on intercarrier compensation reform at some point in the future has never been a good reason to delay reform in Pennsylvania, and it has not gained any strength in its retelling in this case. Given the record evidence of the benefits to be derived in Pennsylvania

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12 AT&T Statement 1.0 at p. 43.

13 Opinion and Order in Dockets I-00040105, P-00981428F1000, R-00061375, P-00981429F1000, R-00061376, P-00981430F1000 and R-00061377 (July 11, 2007) at pp. 34, 35.

14 *Buffalo Valley Telephone Company Revenue-Neutral Rate Rebalancing Filing for Year 2003*, Docket No. R-00038351, April 30, 2003 ("*Buffalo Valley* 2003 Filing"), p. i; *Buffalo Valley Telephone Company Revenue-Neutral Rate Rebalancing Filing for Year 2002*, Docket No. R-00027256, April 30, 2002 ("*Buffalo Valley 2002 Filing*"), p. i; *Conestoga Telephone and Telegraph Company Revenue-Neutral Rate Rebalancing Filing*, Docket No. R-00027260, April 30, 2002 ("*Conestoga 2002 Filing*"), pp. ii, 12.

15 *See e.g.* Order, Docket No. I-00040105, November 15, 2006, pp. 10-12.

from access reductions now, the Commission should not wait on the possibility of some future FCC action, but should immediately implement much needed reform.

2. Intrastate Access Rates Should Be Immediately Reduced To Interstate Levels.

Once the Commission makes a determination that it is time to move forward with access reform, the next question is what that reform should look like. The evidence shows that the Commission should ***immediately*** reduce the RLECs' intrastate access rates to interstate rate levels and structures. There is no reason to implement further access reductions on a phased-in basis. First, access reductions have already been phased in over the past decade. The Commission has been saying for over ten years now that it would complete access reform. The Commission has already implemented two steps in that reform, the second of which occurred nearly seven years ago. Adding yet additional phases to this much needed reform only serves the purpose of delaying further reform for no valid reason.

Second, the evidence demonstrates that access reform must occur *now* given the changes to the market, the benefits to reducing access rates to interstate levels, and the harms caused by high access rates. Delaying the reduction of intrastate access rates will only delay the benefits to Pennsylvania customers. If there is any need to "phase in" reform, it is with regard to local service rate increases, not access rate decreases. AT&T has made such a phase-in proposal (discussed further below), and a four year transition period is more than adequate to protect consumers and ensure RLECs are given the opportunity to fully recover any access reductions.

Bringing intrastate access rates to interstate levels has many benefits. First, it makes sense because there is no material difference in originating or terminating an intrastate long distance call versus an interstate long distance call. There is simply no rational basis for having

higher rates for customers who make a call from Philadelphia to Pittsburgh than from Philadelphia to San Francisco. Second, having unified rates has the potential to reduce RLEC billing costs, if for no other reason than they will only have one set of rates to bill instead of two. It is also easy to implement because the RLECs only have to mirror rates they already have in effect. CenturyLink itself has recognized that having the same rates for interstate and intrastate access will "reduce administrative costs" and "create[ ] a more stable and predictable system of levying access charges."[16] Third, bringing intrastate rates to parity with interstate levels reduces the incentive for harmful and costly arbitrage schemes. Even CenturyLink has recognized the fact that having different intrastate and interstate rates creates serious problems with arbitrage opportunities, especially in rural areas:

> "arbitrage is fueled in particular by wide disparities between interstate and intrastate terminating switched access rates. Those rate disparities are common and they are the widest in rural areas where lower population densities result in increased per-customer costs. Further, due to high costs in rural areas, limited population size, and increasing competition (which targets lower-cost service areas), regulators cannot expect local subscribers of rural carriers to bear the costs of regulatory arbitrage."[17]

3. Revenue Reductions Should Be Recovered From RLEC Customers First Up To A Reasonable Benchmark, and Then From a Transitional USF.

Chapter 30 requires the Commission to give RLECs the opportunity to recover any access reductions on a revenue neutral basis. AT&T's proposal does that. AT&T originally proposed that any access reductions should be recovered only through increases to local rates. That is because in today's competitive environment, requiring some carriers to subsidize others

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[16] *In the Matter of Petition for Waiver of Embarq Local Operating Companies of Sections 61.3 and 61.44-61.48 of the Commission's Rules, and any Associated Rules Necessary to Permit it to Unify Switched Access Charges Between Interstate and Intrastate Jurisdictions*, WC Docket No. 08-160, Petition for Waiver of Embarq, p. iv, August 1, 2008, p. 28.

[17] *Id.*

is simply not sustainable. The OSBA has previously recognized this fact when it testified in the USF/rate cap case that competition cannot thrive while subsidizing some competitors. Specifically, the OSBA testified that it is basic economic theory that "[s]ubsidizing the marginal costs of some players in a market will eventually drive out the non-subsidized carriers. In a competitive market, price equals marginal costs. Ultimately, if the government chooses to subsidize one competitor's marginal cost over another...only the subsidized competitors will survive in the long run."[18] OSBA further testified that "Generalized support programs in today's competitive market should end. You can't have competition and at the same time provide general subsidies. That is simply a tax on one group of consumers to support another group of consumers without giving the first group any voice in how or why it is being taxed."[19] The RLECs themselves have previously told this Commission that "rate subsidization is not sustainable in a competitive telecommunications market."[20]

Permitting RLECs to increase local rates will promote proper pricing signals in the market, and will thereby create a more conducive environment to the development of competition. It will require the RLECs to look to their own customers to recover their costs. In a competitive environment, rates must be allowed to move closer to costs, and AT&T's proposal does just that. Even the RLECs have recognized that "offering services that are priced without consideration of underlying costs creates advantages for competitors that are uneconomic in

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[18] OSBA Statement No. 3 (Buckalew Surrebuttal), p. 3 before ALJ Colwell at Docket No. I-00040105.

[19] OSBA Statement No. 2 (Buckalew Rebuttal), p. 14 before ALJ Colwell at Docket No. I-00040105. Although Dr. Buckalew was referring to subsidies in an explicit Universal Service Fund, the same principles would most certainly apply to implicit subsidies found in intrastate access rates.

[20] BVT 2003 Filing, p. 11.

nature. In an equitable competitive marketplace, all carriers must be able to price and compete according to their own efficiencies."[21]

Although AT&T originally proposed that all access reductions should be recovered through increases to local rates, AT&T subsequently modified that position and has provided the Commission with a reasonable and equitable way to ensure revenue recovery in a manner that gives consumers a smooth transition. Specifically, as detailed in the Rebuttal Testimony of AT&T witnesses Nurse and Oyefusi (AT&T Statement 1.2), AT&T proposes that, for purposes of recovering access revenue losses, the Commission establish a retail rate benchmark for basic local service of $22/month. This benchmark makes perfect sense because it takes the current $18/month rate cap that was established in 2003 and raises it by the level of inflation since then.[22] In addition, the $22/month rate remains well within the range of affordable rates.[23] After setting an initial benchmark of $22/month, the Commission would then increase the monthly benchmark rate by $1 per month each year for the subsequent three years. Thereafter, if necessary, the benchmark would increase by the GDP-PI rate of inflation.

If a particular carrier cannot recover the full amount of its access revenue decreases that result from this proceeding by increasing its local rates to the benchmark level, then that carrier would be permitted to recover any remaining revenue deficits from the state USF. Each year, as the benchmark increases, each carrier's draw from the USF would concurrently decrease, thereby leading to the economically correct result that carriers eventually reduce and eliminate their dependence on subsidies, and rely on their own customers for their revenues.

AT&T's modified proposal presents a reasonable compromise position that should be adopted. First, AT&T's proposal immediately reduces RLEC intrastate access rates to parity

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21 *Id.* at pp. 15, 16.

22 AT&T Statement 1.2 at pp. 4-6.

23 *Id.* at pp. 9-11.

with their interstate levels –which is critical for all of the reasons stated herein. Second, AT&T proposes that revenue recovery for access reductions be phased in over a four year transition period. While local rates may increase, those rates will remain well within affordable levels and the increases are based solely on the very logical process of raising the current $18 rate cap to match the rate of inflation. Even though RLECs will still be subsidized by other carriers, those subsidies are explicit rather than implicit, and those subsidies will be transitioned down over several years. Once intrastate rates achieve parity with interstate rates, even at that level access rates will still provide a significant contribution towards joint and common costs. AT&T's proposal is comprehensive, and presents a viable and rational ***solution*** to this Commission's long standing policy to complete access reform.

II. FACTUAL AND LEGAL BACKGROUND

This case has its roots in the 1999 *Global Order.* In that Order, the Commission first began the process of reducing intrastate access rates. The Commission recognized that implicit subsidies should be removed from intrastate access rates and intended to complete access reform by 2001. That did not happen. In fact, no new action was taken to reduce access rates for the RLECs after the *Global Order* until July 2003, when the Commission adopted a settlement proposal involving the RLECs' intrastate access rates and rate rebalancing. The rate rebalancing included some access reductions and some local rate increases, but access rates were, for the most part, still left at extremely high levels that included large implicit subsidies. As a result, the Commission specifically said it would continue to pursue access reform:

> [W]e do not intend to declare the access rates established by this Order as the final word on access reform. Rather, this is the next

> step in implementing continued access reform in Pennsylvania in an efficient and productive manner.[24]

In December 2004, the Commission opened this specific case to further address access reform. The Commission subsequently delayed this case on three different occasions in order to await what the RLECs repeatedly (and erroneously) said was imminent action by the FCC.[25] As we all know, such FCC action has never occurred.

AT&T filed individual Complaints against each RLEC's access rates in March 2009 alleging, *inter alia*, that the RLECs' intrastate access rates are unjust and unreasonable and must be reduced to interstate levels. The Commission denied the RLECs' attempts to dismiss AT&T's Complaints. Instead, through its August 5, 2009 Order, the Commission lifted the stay on the generic investigation of the RLECs' intrastate access rates and consolidated the investigation with AT&T's Complaints. As a result of disagreement among the parties as to the scope of the case, the Commission issued an Order on December 10, 2009 clarifying the scope of this proceeding. In particular, the Commission made clear that issues adjudicated before ALJ Colwell in Docdet No. I-00040105, the proceeding addressing rate caps and the Universal Service Fund ("USF"), were not to be re-litigated here. In addition, the Commission held that the issue of whether wireless and VoIP carriers should contribute to the Pennsylvania USF – an issue that would require a rulemaking -- was not to be addressed in this proceeding.

There were multiple rounds of testimony filed throughout this case, beginning with AT&T, Sprint and Verizon filing testimony on July 2, 2009, remarkably only *eight days* after a telephonic pre-hearing conference. The RLECs and public parties were then given over *six months*, or until January 20, 2010, to file their direct testimony. Three more rounds of

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[24] Access Charge Investigation per Global Order of September 30, 1999, et. al., Docket Nos. M-00021596, et. al., Order of July 15, 2003 at p. 12.

[25] See Orders entered on August 30, 2005, November 15, 2006 and April 24, 2008.

testimony were filed by the parties – on March 10, 2010, April 1, 2010 and April 8, 2010. Hearings were held on April 14-16, 2010. This case is now ready for a recommended decision, and AT&T files this Main Brief in accordance with the ALJ's procedural schedule.

III. BURDEN OF PROOF

The issue of who has the burden of proof has already been decided by this Commission – that burden plainly lies with the RLECs. A very similar procedural history occurred in the Verizon intrastate access case at Docket No. C-20027195. In that case, AT&T filed a formal complaint against Verizon's access rates. Despite requests to dismiss AT&T's complaint, the Commission permitted the complaint to move forward, and consolidated it with a generic investigation into Verizon's access rates – just as the Commission did here.[26] When determining who had the burden of proof in that case, Verizon argued that AT&T, as the complainant, must share the burden of proving that access rates should be modified. The Commission rejected that argument. Specifically, the Commission held as follows:

> Notwithstanding that the instant docket bears a "C" designation, signaling a formal complaint by a participant, Verizon's rates, while existing rates, have not been endorsed by this Commission as the final stage in the access charge reform process that began years ago.[27]

Just as the Verizon access investigation had its origins in the 1999 *Global Order,* so does this generic investigation. In this case, the Commission specifically stated in 2003 that the existing rates were not the final stage in access reform. That was the reason the Commission started the I-docket to further investigate the RLEC access rates. As the Commission stated in December 2004 when it initiated the instant investigation case:

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[26] Order, AT&T Communications of Pennsylvania, Inc. v Verizon North, Inc., Docket No. C-20027195, December 24, 2002.

[27] Opinion and Order, Docket No. C-20027195, January 8, 2007, pp. 20-21.

> As stated in our prior Order of July 15, 2003, at M-00021596, *In re: Access Charge Investigation per Global Order of September 30, 1999,* at 12, at that time we did not declare the access rates established by that Order as the final word on access reform. Rather, we characterized the Order as the next step in implementing continued access reform in Pennsylvania in an efficient and productive manner.[28]

Therefore, there is absolutely no basis for reaching a different conclusion regarding burden of proof in this case than was reached in the Verizon case. The RLECs have the burden of proving that their access rates should remain at their current levels.

IV. SHOULD RLECS' INTRASTATE SWITCHED ACCESS RATES BE REDUCED?

The answer to this question is a resounding "yes." RLEC intrastate access rates should be reduced immediately to interstate rate levels and structures. The Commission, the IXCs, the RLECs, and the Office of Consumer Advocate have all acknowledged that, as a result of technological change and the resulting advances in competition, the RLECs' intrastate access rates cannot be sustained. Even if the RLECs' intrastate access rates could have been considered just and reasonable in 2003 when they were last set – and they were not -- the market has changed so substantially since then that the access rates cannot be considered just and reasonable today. Unjust access rates impair both *local* and long-distance competition.

Even in 1999, the Commission recognized that new competition in the local and long distance markets meant that access rates must be reduced and that implicit subsidies must be eliminated. While the Commission has taken steps to reduce access rates since then, it has done so gradually and slowly. The first reductions occurred in 1999 and then additional reductions

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[28] Order, Docket No. I-00040105, December 20, 2004, p. 4.

occurred in 2003. The Commission, however, always intended to continue its policy of reducing access rates and eliminating implicit subsidies. The vast changes to the market over the past several years make that policy even more critical today, and given the passage of time, there is no reason to yet again phase in the reductions AT&T proposes here.

A. CHANGES TO THE MARKET REQUIRE THE COMMISSION TO IMMEDIATELY REDUCE INTRASTATE ACCESS RATES TO CREATE A LEVEL PLAYING FIELD AMONG ALL TYPES OF COMPETITORS.

The Legislature has established that it is the policy of the Commonwealth to:

- Ensure that customers pay only reasonable charges for protected services which shall be available on a nondiscriminatory basis,
- Ensure that rates for protected services do not subsidize the competitive ventures of telecommunications carriers,
- Provide diversity in the supply of existing and future telecommunications services and products in telecommunications markets throughout this Commonwealth by ensuring that rates, terms and conditions for protected services are reasonable and do not impede the development of competition...;
- Promote and encourage the provision of competitive services by a variety of service providers on equal terms throughout all geographic areas of this Commonwealth without jeopardizing the provision of universal telecommunications service at affordable rates," and
- Encourage the competitive supply of any service in any region where there is market demand.[29]

In order to meet these policy requirements, the Commission must rebalance the RLECs' intrastate access and basic service rates. Leaving rates at current levels does not permit compliance with the statutory policies of the Commonwealth, especially given the dramatic changes to the market.

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[29] 66 Pa.C.S.A. §3011.

Since the RLECs' access rates were last addressed by the Commission in 2003, market conditions have changed dramatically. As just one example, wireless service has exploded. From December 2003 through December 2007, wireless penetration rates jumped by nearly 60%.[30] There are now substantially more wireless phones than wireline phones in Pennsylvania. In addition, newer technologies and methods of communicating have emerged and taken off. These include e-mail, social networking, as well as free computer-to-computer services such as Skype, or a computer to PSTN service like Vonage, to make voice calls and avoid traditional subsidy-laden long distance access charges. Just as an example of the tremendous growth of these competitive alternatives to traditional long distance, at the end of 1st Quarter 2009, Skype reported over 443 million users worldwide; adding 37.9 million new users in the 1st Quarter 2009 alone.[31]

The PTA companies have acknowledged that competition in their territories has greatly intensified. CenturyLink described its territory as hyper-competitive.[32] In its June 30, 2008 10-Q quarterly report, Frontier Communications Corporation ("Frontier") stated:

> Competition in the telecommunications industry is intense and increasing. We experience competition from many telecommunications service providers, including cable operators, wireless carriers, voice over internet protocol (VOIP) providers, long distance providers, competitive local exchange carriers, internet providers and other wireline carriers. We believe that as of June 30, 2008, approximately 58% of the households in our territories are able to be served VOIP service by cable operators.[33]

Frontier stated that competition "will continue to intensify" throughout 2008 and in 2009. Frontier acknowledged that "[t]he communications industry is undergoing significant changes. The market is extremely competitive, resulting in lower prices."

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30 AT&T Statement 1.0 at p. 26.
31 *Id.* at p. 28.
32 CenturyLink Statement 3.0 at p. 8.
33 AT&T Statement 1.0 at p. 29.

North Pittsburgh Systems, Inc. ("North Pitt"), in its third quarter 2007 10-Q quarterly report, also recognized the intense competition that exists throughout its territory:

> The national wireless companies have built robust networks that cover the majority of our LEC territory. In addition, the two cable companies that overlay the majority of our territory each launched, in 2006, aggressive triple play packages of voice, video and broadband service. In general, these cable companies have very modernized networks, a high percentage of homes passed and a high penetration rate for their video services.[34]

Subsidies are incompatible with a competitive market. With competition now widespread in all segments of the communications marketplace, providers should be recovering the costs of their retail services from their own retail customers, rather than relying on hidden subsidy payments from other carriers.

More importantly, none of the growing competitive alternatives are saddled with access charges in the same way as traditional wireline long distance, placing a disproportionate –and patently unfair – subsidy burden on the IXCs. For example, wireless carriers generally only pay the very low reciprocal compensation rates, which are often as low as $.07 cents per minute.[35] In contrast, the intrastate access charges that IXCs must pay in Pennsylvania are in some cases over 14,000% more than the rates wireless carriers must pay for originating or terminating a long distance call.[36]

Charging some types of carriers over 14,000% more than other types of carriers can hardly be considered reasonable or non-discriminatory. AT&T and other IXCs cannot

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34 *Id.*

35 AT&T Statement 1.0 at p. 40. Wireless carriers terminate traffic within the very large Metropolitan Trading Areas at either reciprocal compensation or local termination rates, including for traffic that would be subject to access rates for wireline carriers. AT&T is not complaining about these wireless termination rates in this case. However, since the FCC controls these rates, the available remedy for this Commission is to reduce the differential by lowering the intrastate access rate.

36 *Id.* at p. 48. In addition, there are instances where an RLEC's intrastate rates are as much as 800% higher than the RLEC's corresponding interstate rate. This huge disparity, especially when there is no logical basis for the distinction in charges, is patently unreasonable.

reasonably be expected to compete against e-mail, social networking web sites, wireless carriers and VoIP providers when IXCs must pay subsidy-laden switched access charges, and its competitors do not, at least not in the same way as IXCs. Access costs are not costs that the IXCs can avoid, no matter how efficient the IXCs may be compared to their competitors.

Pennsylvania consumers are the ones who suffer as a result of these subsidies. When RLECs are being subsidized, they have reduced incentives to become more efficient, to innovate, or to reduce prices. Likewise, when IXCs are forced to pay subsidies, long distance prices are higher than they otherwise would be, and consumers who want to use wireline long distance instead are driven to alternatives. That fact is not in dispute. AT&T presented uncontroverted evidence that its wireline traffic is significantly eroding,[37] and much of this can certainly be attributed to the fact that IXCs face artificially higher costs than their competitors. Interestingly, by pushing away customers from traditional wireline service, high access charges are actually eroding the very subsidies they are intended to generate. The RLECs themselves recognize this fact. As one RLEC told the Commission, "the continued existence of subsidies in access charges renders [the RLEC] susceptible to 'toll bypass'... In this case, [the RLEC] would lose all revenue from access services related to the service provided to those customers."[38] That is bad news for IXCs, bad news for the RLECs who are seeing their access minutes and revenues decline, and, most importantly, bad news for those Pennsylvania consumers who may prefer wireline long distance but are being driven to other alternatives because the Commission has not yet eliminated implicit access subsidies.

Even the RLECs themselves have acknowledged that intrastate access rates must be reduced. Specifically, Buffalo Valley and Conestoga previously argued that "rate subsidization

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37 *Id.* at p. 31.

38 *Buffalo Valley 2003 Filing* at p. 17.

is not sustainable in a competitive environment."[39] They also stated, in direct contrast to the testimony they filed in this case, that "***implicit subsidies in access charges must be removed*** and access services must be based primarily on the cost to provide the service."[40] CenturyLink filed a petition with the FCC in which CenturyLink acknowledged that "reduced intrastate switched access charges would benefit carriers, and ultimately their end-user customers, by promoting greater competition for intrastate toll calling."[41] These statements simply reinforce the substantial record supporting the need for immediate reform.

B. THE RLECS' INTRASTATE ACCESS RATES ARE EXCESSIVE AND MUST BE REDUCED TO MORE REASONABLE LEVELS.

The RLECs' effective intrastate per minute switched access rates are anywhere from about 1 cent to as high as 11 cents.[42] For an intrastate toll call that both originates and terminates with an RLEC, AT&T must pay that RLEC as much as 2 to 22 cents per minute for switched access.[43] Think about that for a moment. In today's competitive market for long distance service where consumer rates are around a nickel a minute, or less, how can a long distance company possibly compete effectively if its own costs are anywhere from 2 to an astounding 22 cents per minute per call?

The short answer is that it can't. AT&T presented evidence that its toll rates are in fact below the access rates of many RLECs, meaning that AT&T's rates cannot be recovering its cost of providing service in those RLEC territories.[44] Even if all of AT&T's other costs were zero, on

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39 *Buffalo Valley 2003 Filing*, at p. 11.

40 *Id.* (emphasis added).

41 FCC WC Docket No. 08-160, Petition of Waiver of Embarq, at p. 27.

42 AT&T Statement 1.0 at p. 34.

43 The average RLEC wholesale access rate in Pennsylvania is approximately 5 cents per minute, which is less than AT&T average in-state toll revenue. *See* Attachment H to AT&T Statement 1.0.

44 Exhibit H to AT&T Statement 1.0.

average, AT&T would lose money on RLEC-to-RLEC calls in Pennsylvania. As AT&T witness E. Christopher Nurse testified, new entrants into the long distance market would likely avoid entering and providing originating long distance service in the RLEC territory because they would lose money on RLEC-to-RLEC calls.[45] The RLECs' access rates thus act to inhibit competition and hinder competitive entry into markets, to the detriment of customers and the development of fully competitive markets.

Case in point is the Carrier Common Line ("CCL") charge, the single largest rate element in the RLECs' intrastate access rates. This charge does not exist on the interstate side. The Commission and the RLECs themselves have previously acknowledged that there is no cost basis for the CCL – the rate level of the CCL is not based on any type of costing methodology, but is based solely on what the Commission has allowed RLECs to charge over the years. Even cursory glance at the RLECs' CCL rates demonstrates just how excessive they are. For instance, there are some companies that charge IXCs a higher per month per line CCL than they charge their own customers for local service. As an example, Citizens of Kecksburg charges an $11/month basic local rate, but charges a CCL of $11.18/month.[46] Ironton Telephone charges its own customers a basic local rate of $13.50/month, yet it charges IXCs $17.99/month for the CCL. Clearly, a pricing scheme that permits carriers to charge other carriers, including carriers with whom they compete, more than they charge their own end user customers makes absolutely no sense and must be modified.

No party presented a cost model in this case as to what the cost of intrastate access actually is. However, as the PTA itself has acknowledged, there is no need for a cost model in

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45 Transcript at p. 151.

46 See Exhibits GMZ-7 and GMZ-9 attached to PTA Statement 1.0.

order to resolve the issues in this case.[47] There is also no need for a cost model in order to recognize that the RLECs' intrastate access rates are well above cost-based levels. First, this Commission has always acknowledged that intrastate access rates are set above cost, and that they include an implicit subsidy. The prior two access reductions implemented by the Commission do not alter this fact. Notably, none of the RLECs disputed this fact in this case.

More importantly, there are two other rates that conclusively prove the RLECs' intrastate access rates are excessive and well above cost-based levels. It is undisputed that for virtually all RLECs, their interstate access rates are substantially lower than their intrastate rates.[48] In fact, evidence in the case shows that there are instances in which RLECs' intrastate access rates are as much as 800 percent higher than their corresponding interstate rate.[49]

As this Commission has acknowledged, and the RLECs have not disputed, there is no material technical difference in terminating an interstate long distance call versus terminating an intrastate long distance call.[50] Therefore, there is no technical reason for the rate differential. There is not a single RLEC that has ever complained to the FCC or any other governmental entity that their interstate access rates are below their costs.[51] To the contrary, the interstate rates remain well above cost. Second, the function of terminating a long distance call is not materially different than the function of terminating a local call.[52] This Commission has previously established cost-based rates for terminating local calls, or reciprocal compensation rates. Those

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47 PTA Statement No. 1SR, pp. 3-4, 9; wherein PTA's witness Zingaretti stated, "[t]here is no role for local or access service cost studies given the absence of cost studies in this Commission's access reform efforts over the past decade."

48 In the extremely limited case of an RLEC that has intrastate access rates below their interstate rates, AT&T proposes to allow the RLEC to raise its intrastate rates to parity with their interstate rate levels and structure. *See* Transcript at p. 192.

49 AT&T Statement 1.0 at p. 48.

50 *Global Order* at p. 49.

51 AT&T Statement 1.0 at p. 37.

52 *Id.*

generally are in the range of around $.07 cents to $.28 cents per minute.[53] Thus, if the RLECs were to reduce their intrastate access rates to interstate levels, as AT&T proposes, the intrastate access rates would remain well above the reciprocal compensation rates, and therefore well above cost. Again, the RLECs did not present any evidence that they have ever complained about their reciprocal compensation rates, or ever alleged that such rates do not cover their costs. Therefore, the Commission already has a proxy for cost-based rates and does not need a cost study to determine the cost of intrastate access.

By comparing the RLECs' intrastate access rates to either interstate rates, or the reciprocal compensation rates, it is clear that the intrastate rates are excessive and must be reduced to more reasonable levels. In this case AT&T advocates that they be reduced to interstate levels immediately.

C. CUSTOMERS WILL BENEFIT FROM REDUCED ACCESS RATES.

There are multiple benefits to reducing intrastate access rates. Outside of this proceeding, even the RLECs themselves have recognized these benefits. Buffalo Valley Telephone acknowledged to the Commission that "[c]ustomers in BVT's service territory will benefit if IXCs pass along their reduced expenses through lower long-distance service charges and more effective toll competition."[54]

Simple economics support this conclusion. First, decreases in the incremental costs of producing a service lead to a decrease in retail prices for that service, and the lower prices will, in turn, stimulate demand. Even a ***pure*** monopolist, including one which is ***completely***

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53 *Id.* at p. 38-39.

54 *Buffalo Valley 2003 Filing*, p. 12. Conestoga made a virtually identical filing to reduce access rates and increase its local rates, and made the same statements about the importance of raising local rates to better reflect costs, and recover lost access revenues. *Conestoga 2002 Filing*. See AT&T Statement 1.2 at p. 49.

unregulated, will reduce price in response to a reduction in input costs, because it is profit maximizing to do so. Second, from a pragmatic perspective, there is nothing remarkable in the fact that wholesale cost reductions will result in lower retail prices. Clearly, lower retail prices benefit customers.

AT&T presented uncontroverted evidence that it has in fact reduced retail rates even ***more*** than access rates have been reduced. This evidence demonstrated that in nineteen states where access rates had been reduced, AT&T's long distance revenue per minute has in fact decreased ***more*** than the amount of the access decrease.[55] This includes Pennsylvania, where AT&T has reduced its rates more than the access reductions it has realized.[56]

Earlier this year, the New Jersey Board of Public Utilities relied on those same benefits in directing substantial reductions in ordered intrastate access rates, holding that:

> [T]he Board HEREBY FINDS that a reduction of Intrastate Access Rates will benefit customers because there is a relationship between reduced access charges and toll reductions. The record also shows that not only will market discipline drive IXC rates lower, but AT&T has committed to eliminate an in-state connectivity fee and reduce the decrement rate on prepaid calling cards.[57]

Although it would be premature for AT&T or any other IXC to commit to specific price reductions, AT&T has made the same commitment here in Pennsylvania that it made (and has now implemented) in New Jersey. Specifically, AT&T will reduce its Instate Connection Fee (ISCF) and the prepaid calling card charges once access reductions occur. In response to the New Jersey Board's decision to lower intrastate access rates, AT&T has already lowered its New Jersey in-state connection fee for residential consumers by ***over*** 30%.[58] Likewise, AT&T

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55 Attachment 8 to AT&T Statement 1.2.

56 *Id. See also* Attachment H to AT&T Statement 1.0.

57 *In the Matter of the Board's Investigation and Review of Local Exchange Carrier Intrastate Exchange Access Rates*, NJ BPU Docket No. TX08090830, Order, February 1, 2010, p. 27.

58 AT&T Statement 1.2 at p. 50. See also Attachment 9 to AT&T Statement 1.2.

lowered the in-state connection fee for small business by 30%. These are direct line-item charges on customers' bills that were reduced as a result of access reductions in New Jersey, and that consumers in Pennsylvania will experience if access reductions are properly implemented here.

Having intrastate access rates mirror interstate rates would also benefit customers and the RLECs in several additional ways. First, having unified rates has the potential to reduce RLEC billing costs, if for no other reason than they will only have one set of rates to administer instead of two. Moreover, adopting symmetrical rates and rate structures will help to avoid or mitigate problems associated with "call pumping," "phantom traffic" and other arbitrage schemes that have arisen as a result of the wide disparity in interstate and intrastate access rates and between access rates and cost.

"Phantom traffic" is the term used to describe schemes to disguise the jurisdictional nature of calls in an attempt to treat intrastate calls as interstate. These schemes may involve inefficient routing of calls, attempts to mislabel the originating points of calls, and attempts to deliver traffic without sufficient information for the LEC to determine the jurisdictional nature of the call. OCA witness Dr. Loube testified that the differential between interstate and intrastate access rates invites regulatory arbitrage in which carriers disguise intrastate traffic as interstate traffic for the purpose of avoiding the higher intrastate rates.[59] CenturyLink identified this arbitrage as "among the most serious problems affecting rural price cap carriers."[60] Indeed, CenturyLink argued to the FCC that differences between intrastate and interstate switched access rates are causing "artificial arbitrage" that is "harming competition and investment" in several

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59 OCA Statement 1.0 at p. 60.

60 FCC WC Docket No. 08-160, Petition of Waiver of Embarq, at p. 20.

ways, including "harming network investment and innovation."[61] The RLECs themselves noted the problem of tariff arbitrage in their testimony to the Commission in the Global Order proceedings.[62]

Eliminating the opportunity for arbitrage will also help eliminate the litigation disputes that "phantom traffic" have engendered. In the recent past, several PTA companies have filed formal complaints against carriers in Pennsylvania over these exact issues, claiming that the carriers have refused to pay intercarrier compensation to the RLECs, and have disguised the traffic sent.[63] The basis for these disputes (and costs in bringing them) will be substantially reduced once intrastate and interstate switched access rates are set at the same levels and share the same rate structure.

In addition to phantom traffic arbitrage, the record also demonstrates that some PTA companies have engaged in the unscrupulous practice of call pumping, also known as traffic pumping. Call pumping is the practice whereby local providers, spurred on by the ability to benefit from high access prices, develop programs that encourage the creation of chat rooms, pornography, adult services and other questionable services that can generate high volumes of access traffic. The carriers are able to then "kick back" a share of their access revenues with these providers, which proves indisputably that the access rates are excessive.[64] The entire point of traffic pumping is to generate as many terminating minutes as possible to increase revenues from captive long-distance carriers rather than from a company's own retail customers. This can

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61 *Id.* at 15-16.

62 *Global Order* at pp. 51-52.

63 *See e.g. Laurel Highland Telephone Company v. Choice One Communications of Pennsylvania, Inc. d/b/a/ One Communications, and Other Affiliates*, Docket No. C-2009-2108366; *Buffalo Valley Telephone Company v. CommPartners, LLC and Other Affiliates*, Docket No. C-2009-2105918: *Palmerton Telephone Company v. Global NAPs South, Inc., Global NAPS Pennsylvania, Inc., Global NAPs, Inc., and Other Affiliates*, PA PUC Docket No. C-2009-2093336.

64 AT&T Statement 1.0 at p. 42.

lead to absurd uses of the network – for instance, AT&T saw a trend where some numbers provided by a PTA company received more than 600,000 minutes per month, the equivalent of about 14 subscriber lines being used 24 hours per day, 30 days per month.[65]

Such call pumping has occurred, and is still occurring, in Pennsylvania. Throughout the last quarter of 2009 and the first quarter of 2010, AT&T presented evidence that three companies engaged in traffic pumping schemes. Fortunately, Windstream (the new owner of two of the traffic pumping companies) agrees that traffic pumping is an insidious practice that must not be tolerated, and has put a stop to any traffic pumping by its affiliates. However, in less than a year, the amount of access charges billed to AT&T alone by those companies was over $400,000 and Windstream has not reimbursed AT&T for the excessive access charges. In addition, North Pittsburgh continues to engage in traffic pumping schemes, thereby taking advantage of high access rates and overcharging IXCs. As AT&T testified, with just the traffic pumping activity of these three companies, the annual cost to AT&T alone could run as high as $2 million in Pennsylvania, and the cost to the industry could be even higher, at $10 million.[66] If other Pennsylvania RLECs see traffic pumping as "easy money," the problem will spread.

Traffic pumping is bad for all customers throughout Pennsylvania. Long distance carriers must recover their access costs from their paying customers. The access costs IXCs incur to terminate "free" porn and chat lines end up being paid by all of the IXCs customers. Thus, in a very real way, all Pennsylvania consumers are being saddled with the costs of traffic pumping.

The only reason carriers engage in traffic pumping is to drive up access revenues. In addition, the only reason a RLEC can share its revenues is if the rates are substantially above

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65 AT&T Statement 1.2 at p. 55.

66 AT&T Statement 1.2 at pp. 57-58.

costs. Thus, by reducing access rates, the Commission reduces the incentives RLECs have to engage in these types of unscrupulous practices.

The RLECs' high access charges are not just damaging the intrastate long distance market, they are damaging the local exchange market as well. To the extent access charges are being used to subsidize local exchange services, it means that RLEC local exchange prices are being artificially maintained below market-based levels and that RLECs are insulated from having to improve the efficiency of their operations. Both outcomes are bad for Pennsylvania consumers. If RLEC local exchange prices are allowed instead to gravitate towards market-based levels, new entrants will have greater incentives to enter and expand. The resulting competitive pressures and even the prospect of such pressure will give all carriers, both the RLECs and the new entrants alike, incentives to improve their efficiency, introduce new service, enhance customer care, and otherwise compete for the attention of potential customers. When competition occurs on a level playing field, Pennsylvania consumers are the clear winners.

The RLECs have previously recognized this reality. Buffalo Valley and Conestoga both have stated that "offering services that are priced without consideration of underlying costs creates advantages for competitors that are uneconomic in nature."[67] In requesting that it be permitted to reduce its intrastate access rates and increase its local rates, Buffalo Valley further recognized that "[i]f consumers are to have choices in telecommunications carriers, then all carriers must be able to price and compete according to their own efficiencies."[68]

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67 *Buffalo Valley 2002 and 2003 Filings*, p. 18 and 15 respectively; *Conestoga 2002 Filing* at p. 19.

68 *Buffalo Valley 2003 Filing* at p. 18; *See also Buffalo Valley 2002 Filing* at pp. 15-16 and *Conestoga 2002 Filing* at p. 19.

Consumer choice and competitive markets – these are the very same benefits the Commission can expect from implementing immediate and comprehensive reform for all of the RLECs in this proceeding.

D. THE RLECS' REASONS FOR DELAYING FURTHER ACCESS REFORM SHOULD BE REJECTED.

The PTA and CenturyLink's position on access reform boils down to these points: In their view, RLECs cannot survive or meet un-defined or un-quantified Carrier of Last Resort ("COLR") obligations without being subsidized by their competitors; they are entitled to guaranteed revenues; and customers will not benefit from access reductions. These arguments are misguided and wrong. While the RLECs argue that the time is not ripe for access reductions, these companies have been on notice for over *ten years* that the Commission intended to complete access reform and eliminate implicit subsidies in intrastate access rates. In addition, the majority of these companies are not the small mom-and-pop companies that they may have been a decade ago, and they do not need protection from competition. The five companies that generate the most access volumes are all multi-state, multi-million dollar entities that are not even based out of Pennsylvania anymore, and the biggest of them (CenturyLink) has announced it is acquiring an RBOC (Qwest).[69] These companies are certainly capable of competing on their own without being heavily subsidized by their competitors and long distance companies.

1. The Commission Should Reject The RLECs' Arguments That They Will Not Be Able To Meet Carrier of Last Resort Obligations If Access Reform Is Implemented.

The RLECs claim that they will not be able to meet Carrier of Last Resort ("COLR") obligations, or may not be able to invest in their networks, if the Commission reforms intrastate

[69] AT&T Statement 1.0 at pp. 61-65. *See also* Attachment J to AT&T Statement 1.0 for a detailed description of these large RLECs.

access rates in Pennsylvania. What these claims really mean is that, after over ten years of being on notice that the Commission had every intention of eliminating harmful subsidies from access rates, the RLECs have either not positioned themselves to adapt to this reality, or they are using this argument as a red herring to "scare" this Commission into not adopting much-needed reform. Either way, the arguments must be rejected.

The RLECs spend a great deal of time discussing their Carrier of Last Resort ("COLR") obligations as the primary justification for urging this Commission to reject AT&T's proposal regarding access reform. The RLECs claim that they are the carriers that have faithfully served rural Pennsylvania; competitors are not willing to serve all rural customers; and therefore RLECs are entitled to keep every dollar of subsidies they are currently receiving. This amounts to approximately $124.7 million in subsidies, including funds from the state USF, according to the PTA.[70] While AT&T does not dispute that there are instances where COLR obligations most certainly exist, the problem with the RLECs' arguments is that they seek to justify the continued monopoly practice of subsidization to the tune of $124.7 million without any identification of the exact obligations they are talking about, much less whether those obligations amount to a need for $124.7 million. Despite having multiple rounds of testimony to do so, they have pointed to no Commission order, no regulation and no statute in Pennsylvania that identifies Pennsylvania COLR obligations that are unique to the RLECs alone.[71] If they cannot even identify the obligations, the Commission must not accept this argument as a basis for handing the RLECs $124.7 million in continued subsidies at the expense of competition and customers throughout Pennsylvania.

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70 Transcript at p. 588.

71 Transcript at pp. 171-177.

It is also important to remember several critical points about the amount of subsidies the RLECs claim they need from other carriers and those carriers' customers. First, the RLECs are already receiving approximately $34 million from the current Pennsylvania USF. There is no evidence that such funding is not sufficient to cover the RLECs' purported COLR obligations, to the extent they exist in Pennsylvania. Second, all of the RLECs receive federal USF support (even though some RLECs are not considered "high cost" enough to receive federal USF from the high cost loop fund).[72] The FUSF covers a substantial portion of the RLECs' loop costs, in some instances all but $11.67/month.[73] Thanks to the FUSF, the largest RLECs, in particular, have remaining intrastate loop costs that are less than $21/month.[74] The highest *remaining* intrastate loop cost a Pennsylvania LEC has after application of the FUSF is $28.72/month.[75] Given that the loop encompasses the vast majority of the cost of providing local service, it is simply inconceivable that the RLECs cannot recover their remaining costs from their own customers. More importantly, it is nonsensical to assume that the RLECs need to maintain the extremely high, subsidy-laden current intrastate access rates in order to serve their customers and meet whatever COLR obligations may exist.

Finally, and perhaps most importantly, under AT&T's proposals, the RLECs are not being denied any revenues, COLR-related or otherwise. AT&T's proposal in this case gives the RLECs the opportunity to remain revenue neutral, but does it in a way that requires the RLECs to obtain revenues first from their own customers, and then on a transitional basis, through explicit payments from a state USF. That is the proper way to ensure that RLECs are able to

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72 There are several different types of federal universal service funding, including high cost loop funding. Although all RLECs do not receive funds from every single type of FUSF, they all are recipients of federal universal service funds. See AT&T Statement 1.2 at p. 28.

73 *See* AT&T Exhibit K to Direct Testimony of Nurse/Oyefusi, AT&T Statement 1.1.

74 *Id.*

75 *Id.*

meet any COLR obligations they may have – not to perpetuate implicit subsidies from excessively high access rates.

2. The Commission Should Not Delay Access Reform In Pennsylvania By Waiting For The FCC.

The RLECs have argued that the Commission should yet again delay much-needed intrastate access reform, and instead wait on the FCC. This argument is the regulatory equivalent of Waiting for Godot, and it must be rejected. Having previously delayed this case for over four years *while waiting on the FCC, the Commission has now repeatedly recognized* that it must be responsible for its own reform, and must move forward with intrastate access reform. Specifically, when the Commission decided to lift the stay on this generic investigation, it stated that waiting for the FCC was no longer necessary.[76] Chairman Cawley recently observed that "we do not need and cannot afford to wait and speculate whether the FCC will reach some sort of coherent and sustainable solution to its IP-enabled services and intercarrier compensation reform proceedings, when this might happen, and what the FCC's conclusions might be."[77] And most recently, the Commission lifted the stay on the Verizon access case, again noting that there has been no substantial action at the FCC, and it is unclear whether the FCC will act anytime soon."[78]

In pre-filed testimony, the RLECs argued that the Commission should stop any Pennsylvania reform due to the fact that a FCC task force recently released a National Broadband Report ("NBR"). But at the hearing, the PTA's witness (Mr. Zingaretti) modified the

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[76] August 5, 2009 Order at pp. 18-19.

[77] *Palmerton Telephone Company v. Global NAPS South, Inc., et. al.*, Docket No. C-2009-2093336, Motion of Chairman James H. Cawley, February 11, 2010, p. 15.

[78] Opinion and Order, *AT&T Communications of Pennsylvania, Inc. v. Verizon North Inc. and Verizon Pennsylvania Inc.*, Docket No. C-20027195; May 11, 2010, pp. 17-18.

PTA position, stating that the PTA's true goal was that the Commission "harmonize[]" its own actions with the FCC's policies, and that the PTA position is not that a decision in this case should be delayed.[79] Mr. Zingaretti's modification reflects the reality that waiting for FCC action would be absurd. The NBR will lead to over 60 rulemakings – comprehensive intercarrier compensation reform being only *one* of the 60 rulemakings.[80] At this stage no one, not even the FCC itself, can predict when, or even if, the FCC will garner the necessary three votes needed to push through the intercarrier compensation reform envisioned in the NBR. The new rulemaking to address intercarrier compensation reform isn't even scheduled to be *opened* until the fourth quarter of 2010.[81] The FCC's first rulemaking on intercarrier compensation reform was issued in 2001, and a final decision has yet to be issued, so there is absolutely no basis to believe any FCC action is "imminent."

Even more importantly, the NBR expressly *supports* state regulators undertaking intrastate access reform. The NBR specifically recommends that the "FCC should also ***encourage states to complete rebalancing of local rates to offset the impact of lost access revenues. Doing so would encourage carriers and states to "rebalance" rates to move away from artificially low $8–$12 residential rates that represent old implicit subsidies to levels that are more consistent with costs.***"[82]

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79 Transcript at p. 591 ("My position is that they need to be harmonized. And that doesn't mean having to wait ....").

80 AT&T Cross Examination Exhibit No. 4. *See also* Transcript at pp. 590-591.

81 *Id.*

82 Connecting America: The National Broadband Plan, p. 148 (emphasis added).

E. THE OFFICE OF TRIAL STAFF'S REASONS FOR DELAYING ACCESS REFORM ARE NOT VALID.

It appears that the Office of Trial Staff's ("OTS") entire basis for opposing intrastate access reform is premised on an allegation that AT&T did not meet its burden of proof in this case, and did not provide cost studies showing that the RLECs' current intrastate access rates contain a subsidy. This is not a valid basis for delaying much-needed access reform.

First, as discussed above, the Commission has already found that in a combined complaint/generic investigation such as this one, it is the RLECs that have the burden of proof, not AT&T. Regardless, it is unclear why the OTS never bothered to ask the RLECs for their own cost studies -- if the RLECs believed that their intrastate access rates are truly at or below cost, they are clearly in the best position to provide such cost data. OSBA's witness Dr. Wilson recognized that the RLECs are the best source of information about their own costs of providing access service.[83] Yet, no RLEC presented a cost study or any other estimate of its costs of intrastate switched access.[84] To the contrary, the PTA and CenturyLink agreed that no cost studies were necessary.[85]

Second, a cost study is not required to reach the conclusion that the RLECs' intrastate access rates are well above cost, and contain implicit subsidies. The five largest RLECs in Pennsylvania – CenturyLink, Commonwealth, Windstream, North Pittsburgh and Denver & Ephrata – all have intrastate access rates approximately 4 cents per minute or more per end, which is three to four times what they charge for the same functionality on an interstate call.[86] As

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83 Transcript at p. 91.

84 Transcript at pp. 91-92 (Wilson); pp. 530-31 (Kubas); pp. 334 (Harper). CenturyLink did provide cost studies in recent cases in Virginia and New Jersey. However, after those cost studies were universally rejected, it appears CenturyLink chose not to introduce cost studies in this case. *See* AT&T Statement 1.4 at p. 18.

85 Transcript at p. 334 (Harper); PTA Statement 1SR, at p. 14.

86 AT&T Statement 1.0, at pp. 15, 35-36 & Ex. C thereto.

stated previously, there is no material cost difference between terminating an intrastate long distance call and an interstate long distance call.

In addition to the evidence provided through a comparison to interstate access service, it is also instructive to compare intrastate switched access rates to the RLECs' cost-based "reciprocal compensation" rates for terminating local calls. The function and cost of terminating a call is materially the same whether the call is a long distance call (coming from an IXC) or a local call (coming from a CLEC).[87] The FCC has set local call termination rates at 0.07 cents (a rate that may also apply to ISP and intraMTA wireless call termination), specifically finding that those rates are "sufficient to provide a reasonable transition from dependence on intercarrier payments *while ensuring cost recovery*" (emphasis added).[88] Likewise, the Commission has approved, or parties have voluntarily agreed to, cost-based reciprocal compensation rates" - applicable for the exchange of calls within the designated local calling areas of the RLECs - that range between 0.07 cents and 0.28 cents.[89]

The intrastate switched access rates for all of the RLECs are well above these levels. The fact that intrastate access rates are well above the corresponding reciprocal compensation rates shows that intrastate access rates remain well above the RLECs' costs.[90]

Thus, the OTS is wrong that the evidence does not support a finding that RLEC intrastate access rates are well above cost, and therefore contain an implicit subsidy. In light of the Commission's prior findings in the 1999 *Global Order*, the fact that terminating a long distance

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87 AT&T Statement 1.0, at p. 37.

88 *See In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Intercarrier Compensation for ISP Traffic*, CC Docket No. 96-98, and No. 99-68, at 6 (April 27, 2001) (remanded on other grounds, *WorldCom, Inc. v. FCC*, 288 F.3d 429 (D.C. Cir. 2002), cert. den., *Core Communications, Inc. v. FCC*, 538 U.S. 1012 (2003), subsequent mandamus, *In Re: Core Communications, Inc.*, 531 F.3d 849 (2008); order on remand, *In the Matter of High Cost Universal Support, et al*, WC Docket No. 05-337 (released Nov. 5, 2008).

89 AT&T Statement 1.0, at pp. 38-39 & Ex. F thereto.

90 AT&T Statement 1.0, at p. 13.

call is materially identical to terminating a local call, and the absence of any contrary cost evidence presented by the RLECs (who would have both the incentive and the ability to present evidence of their own costs if such evidence supported high access charges), further or more detailed "cost studies" are unnecessary to conclude that the RLECs' access charges contain implicit subsidies that must be removed.

F. THE OSBA'S REASONS FOR NOT REDUCING INTRASTATE ACCESS RATES ARE FLAWED AND MUST BE REJECTED.

The OSBA's entire testimony focused on the claim that there is no subsidy in access rates because intrastate access charges paid by IXCs, and in particular, the Carrier Common Line ("CCL") charge, contribute to the cost of the local loop.[91] The OCA made the same claim.[92] The proposition that there is no subsidy in access rates is contrary to every other party's testimony (except OTS, who claims they don't know if there is a subsidy or not), and is contrary to the Commission's own prior findings.[93] As just discussed, the evidence conclusively proves that intrastrate access rates are well above cost and therefore continue to contain implicit subsidies.

Critically, although the OSBA claims that intrastate access rates should contribute to the cost of the local loop, no party provided any data to show *how much* of the current high access rates are currently contributing to the loop, and therefore there is no basis to conclude that access rates cannot be reduced (and still contribute to the loop).[94]

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91 OSBA Statement 1, at pp. 5-7.

92 OCA Statement 1, at pp. 69-75.

93 *Global Order* at footnote 8. The Commission stated, "In reality, local exchange rates throughout the United States have been subsidized by access charges which are well in excess of their costs."

94 AT&T Statement 1.2, at p. 46.

The evidence in fact demonstrates that the CCL rates are not in any way associated with the cost of the loop. To the contrary, the extreme variability in the RLECs' CCL rates confirms that the CCL is nothing but a subsidy rate element. If the CCL was somehow associated with loop costs, one would expect that the most rural carriers (who presumably would have the highest loop costs) would have the highest CCLs. But that is not the case. According to the PTA, Ironton has a density of 227.3 lines per square mile, among the most dense of the RLECs, yet Ironton has the highest CCL of all companies at a whopping $17.99/line/month.[95] On the other hand, PTA shows that Buffalo Valley has a density of only 65.6 lines per square mile, yet Buffalo Valley's CCL (while still high) is one of the lower ones among the RLECs at $4.20/line/month.[96] Thus, contrary to the OSBA's assertion, there is clearly no correlation between the CCL and any contribution to the cost of the loop.

Even more importantly, the market has already trumped this endless (and pointless) economic debate because the various services and technologies with which traditional long distance carriers compete (*e.g.*, e-mail, social networking websites, internet service providers, VoIP providers, wireless carriers) are largely immune from any loop cost subsidy obligations.[97] Whatever the Commission's views on loop cost allocation, it cannot impose loop costs on IXCs without putting them at a severe competitive disadvantage. The OSBA appears to acknowledge this unfairness, and the ideal outcome from the perspective of the OSBA and OCA would be to have other providers (such as wireless carriers) also pay access charges that contribute towards the cost of local loops.[98] The OSBA and OCA both admit, however, that the Commission has

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95 See PTA Exhibit GMZ-6 for current CCL rates of all companies and PTA Exhibit GMZ-14 for PTA's density analysis for each PTA company.

96 *Id.*

97 AT&T Statement 1.3, at p. 7; AT&T Statement 1.4, at p. 28.

98 OCA Statement 1, at p. 11; Transcript at p. 94 (Wilson).

no authority to impose access charges on such carriers.[99] Thus, even though the OCA has always been (and still is) a supporter of the theory that IXCs should contribute to the cost of the local loop, the OCA recognized that changes in market conditions and fundamental fairness require that intrastate access charges paid by IXCs be reduced to the respective interstate rates, in order to achieve a more level and fair competitive playing field.[100] The Commission's objective should be to promote competition, not to favor one set of competitors at the expense of another, and therefore the OSBA's reasoning for maintaining the current excessive intrastate access rates should be rejected.

One last point on this issue: even if the Commission did want to ensure that intrastate access rates contribute to the cost of the loop (which is wrong as an economic policy), as discussed above, the RLECs' interstate access rates are still above the incremental cost of access. Thus, even with the access rate reductions proposed by AT&T, the RLECs' access rates will still include a contribution to the cost of local loops.[101]

V. IF THE RLECS' INTRASTATE SWITCHED ACCESS RATES SHOULD BE REDUCED, TO WHAT LEVEL SHOULD THEY BE REDUCED AND WHEN?

A. RATE LEVELS

The Commission should ***immediately*** reduce the RLECs' intrastate access rates to mirror each RLECs' corresponding interstate access rates in rate level and structure. AT&T presented evidence as to exactly what that would mean in this case in Attachment 1 to its Rebuttal Testimony (AT&T Statement 1.2). Reducing intrastate access rates to interstate levels is not a difficult process, and would provide multiple benefits to the industry and customers.

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99 OCA Statement 1, at p. 11; Transcript at p. 95 (Wilson).
100 OCA Statement 1, at p. 10; Transcript at p. 478 (Loube).
101 AT&T Statement 1.3, at pp. 6, 8.

The RLECs themselves previously recognized that intrastate access rates should be at parity with interstate rates. In the *Global Order,* the Commission summarized the RLECs' testimony advocating for such parity:

> On the interstate side, the FCC has undertaken significant steps to reform access charges. . . .
>
> It is critical, from the perspective of Pennsylvania's rural ILECs, that the Commission mirror these access reforms at the state level. Since there is no functional difference between access provided on an interstate or an intrastate basis, any pricing differential that may exist will give an incentive to IXCs, upon whom ILECs rely to identify the volume of terminating interstate and intrastate traffic, to report lesser usage in the higher cost venue. In sum, '***in order to avoid tariff arbitrage, it is extremely important that intrastate access charges mirror their federal counterpart.***'[102]

Unifying rates has the potential to reduce RLEC billing costs by reducing the set of access rates they must bill from two down to one. CenturyLink has indicated in comments to the FCC that having the same rates for inter- and intrastate access will "reduce administrative costs" and "create[ ] a more stable and predictable system of levying access charges." It also acknowledged in its FCC comments that having the same rates for interstate and intrastate access will reduce CenturyLink's access billing costs and will reduce its costs of litigating access disputes. Moreover, adopting symmetrical rates and rate structures will help to avoid problems associated with the arbitrage schemes discussed in Section IV(C) above that have arisen as a result of the wide disparity in interstate and intrastate access rates and between access rates and cost. CenturyLink noted that maintaining different inter- and intrastate switched access rates creates incentives for carriers to misreport traffic, but that with parity, it "would no longer be at the mercy of [wholesale] customer estimate of PIU factors . . . " and that

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[102] *Global Order* at pp. 51-52. (citing the rural ILECs' witness Mr. Laffey's testimony; emphasis added).

"customers would have significantly less motive to misreport traffic or PIC factors in the first place."[103]

The only other proposal on access rate levels was put forward by Verizon and Qwest. They both propose that the Commission reduce intrastate access rates to Verizon's intrastate rate levels. This position should not be adopted for multiple reasons. First, the Verizon/Qwest proposal does not fix the disparity between interstate and intrastate access rates. Second, Verizon's intrastate rates are higher than most carriers' interstate rates, so making those carriers match Verizon on the intrastate side means that most carriers will continue to charge higher rates for intrastate traffic than for interstate traffic.[104] That disparity will continue to create arbitrage opportunities, including incentives for carriers to disguise intrastate traffic as interstate and engage in other schemes to artificially increase their intrastate access revenues.[105] Third, the Verizon/Qwest proposal results in higher administrative costs and inefficiency.[106] For instance, the Verizon/Qwest proposal would require carriers to implement new procedures so they can charge rates that only Verizon charges today.[107]

Fourth, although the PTA did not put forth a specific proposal in its testimony as to the levels to which intrastate access rates should be reduced, PTA's witness testified at the hearing that the FCC stated its intention to mirror intrastate access rates to interstate levels, and that is consistent with the PTA proposal.[108] The OCA also proposed that interstate parity was the proper approach. Verizon/Qwest's proposal is thus plainly out of step with those approaches. Finally, as discussed above, CenturyLink has consistently stated that achieving parity is critical

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103 *See* AT&T Statement 1.2 at pp. 25-26, citing to FCC WC Docket No. 08-160, Petition of Waiver of Embarq.

104 AT&T Statement 1.3, at p. 15.

105 *Id.*

106 *Id.* at pp. 15-16.

107 *Id.*

108 Transcript at p. 591-592 (Zingaretti).

to eliminate inefficiencies and arbitrage opportunities. Accordingly, the Commission should conclude that intrastate switched access rates should be reduced to parity with the corresponding interstate rates, rather than parity with Verizon's intrastate rates.

B. TIMING

Intrastate access rates should be reduced to interstate levels ***immediately***. There is no legitimate reason to further delay the reduction of access rates. To the contrary, such reform is long overdue. As stated previously, the Commission first recognized the need for access reform in the 1999 *Global Order*. There the Commission found "that current ILEC access charges are priced substantially above cost," and recognized that such rates must be reduced in order "to maintain fair toll competition in Pennsylvania."[109] At that time, the Commission took an initial step towards such reform. Also at that time, the Commission expressed its intention to complete access reform in the near term. In fact, the Commission cautioned the RLECs that the reductions were only a first step towards eliminating the implicit and anti-competitive subsidies that remained embedded in the rates.[110] In order to "complete intrastate access charge reform and to presumably eliminate all subsidies in the access charge rate structure," the Commission intended to initiate and conclude a further access investigation by December 31, 2001.[111]

Although the Commission did not conclude a further access investigation by the end of 2001, the Commission took another step in reforming the RLECs' access rates in 2003 when it approved a settlement that resulted in further access reductions and increased the rate cap to

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109 *Global Order* at p. 18.
110 *Global Order*, p. 26.
111 *Global Order*, pp. 58-59.

$18.[112] At that time, the Commission yet again warned the RLECs that it did not consider access reform to be complete, and further reform would be forthcoming. The Commission then initiated this case's generic investigation in December 2004, saying:

> As stated in our prior Order of July 15, 2003, at M-00021596, In re: Access Charge Investigation per Global Order of September 30, 1999, at 12, at that time we did not declare the access rates established by that Order as the final word on access reform. Rather, we characterized the Order as the next step in implementing continued access reform in Pennsylvania in an efficient and productive manner. In the Commission's judgment it is now an appropriate time to consider further access charge reform.[113]

The Commission just recently recognized that "an entire decade has passed since the Commission began reforming access charges in the *Global Order* and many of the same areas of concern may still persist. This Commission cannot forgo such an opportunity to effectuate industry-wide access reform any longer."[114]

This history is important because it demonstrates that the RLECs have been on notice for over ten years now that the Commission intended to reduce intrastate access rates. It is also important because it can hardly be said that reducing intrastate to interstate levels in this case is a sudden, flash cut of access reform. To the contrary, the Commission started reform over a decade ago, and has already phased in reductions. There is simply no reason to further delay reform, especially given the incredible inequity to IXCs by saddling them with high charges other carriers do not have to pay.

Although AT&T proposes that intrastate access rates be reduced immediately to interstate levels, AT&T's proposal does include a transitional period for phasing in the

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[112] *Access Charge Investigation per Global Order of September 30, 1999, et. al.*, Docket Nos. M-00021596, et. al., Order of July 15, 2003 at p. 12.

[113] *Investigation Regarding Intrastate Access Charges of Rural Carriers, and the Pennsylvania Universal Service Fund*, Docket No. I-00040105, December 20, 2004 Order at p. 4.

[114] Opinion and Order, *AT&T Communications of Pennsylvania, Inc. v. Verizon North Inc. and Verizon Pennsylvania Inc.*, Docket No. C-20027195; May 11, 2010, p. 19.

opportunity for revenue neutral recovery of access revenue reductions. Specifically, although the RLECs will have to turn to their own local customers to recover some of the revenue reductions, that is only up to a benchmark of $22/month, after which the RLECs will be permitted to recover revenue decreases attributable to the Commission-directed access reduction from the state USF.[115] AT&T's proposal decreases the state USF each year, but it is unlikely the transitional USF will get to zero in the near future. On the first year, the increase to the USF will be $19.6 million and 16 RLECs will obtain increased revenues from the USF. In the second year, the transitional funding from the USF will be reduced to approximately $9.8 million with 11 RLECs continuing to receive funds from the USF. In the third year, the transitional funding will be reduced to approximately $4.2 million, and 8 RLECs will continue to draw transitional funds from the USF. In the fourth year, the USF will be reduced to less than $1 million with only 6 RLECs continuing to obtain additional funds from the USF.[116] Each year thereafter, the USF will continue to decrease. Thus, AT&T's proposal contains a multi-year phase in approach before RLECs are required to eliminate their dependence on subsidies and instead rely on their own customers.

In short, over time the RLECs will be expected to recover more of their costs from their own customers, as the subsidies they have been collecting from consumers across the rest of Pennsylvania are reduced. That is fundamentally fair by any measure.

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[115] There are some RLECs that will not even need to reach the $22 benchmark in order to achieve rate rebalancing. *See* Attachment 5 to AT&T Statement 1.2.

[116] See Attachment 5 to AT&T Statement 1.2, which is also attached to this Brief as Appendix C for purposes of convenience and ease of reference.

VI. IF THE RLECS' INTRASTATE SWITCHED ACCESS RATES SHOULD BE REDUCED, HOW SHOULD ANY REVENUE REDUCTIONS BE RECOVERED IN COMPLIANCE WITH 66 Pa.C.S.A. 3017?

A. MEANING OF THE REVENUE NEUTRALITY REQUIREMENT UNDER SECTION 3017

Chapter 30 states: "The commission may not require a local exchange telecommunications company to reduce access rates except on a revenue-neutral basis."[117] This section of the law requires the Commission to give the RLECs the *opportunity* to make up any lost revenue from access reductions on a revenue neutral basis. This section of the law does *not* require the Commission to guarantee the RLECs' revenues.

CenturyLink and PTA take the flawed position that "revenue neutral" rate reductions mean the Commission must guarantee any revenues lost will be recovered. In other words, they argue that simply allowing the RLECs to increase local rates will not be sufficient to meet the revenue neutrality requirement of Chapter 30. They are wrong.

The RLECs are no longer monopolies operating under rate-of-return regulation. Instead, they voluntarily chose to operate pursuant to price cap plans in which they are not guaranteed any particular or fixed level of revenues. In fact, the entire point of price cap regulation is to permit the RLECs to thrive if they operate efficiently. If a company is guaranteed a certain level of revenues, regardless of whether it is more efficient than its competitors, that company has less incentive to be efficient and to invest in cost-saving and innovative technologies. That is sending exactly the wrong signals and distorting the market.

While the Commission should and must give the RLECs the *opportunity* to recoup lost access revenues on a revenue neutral basis, that is entirely different than guaranteeing the RLECs will recover every single dollar. Such guarantees are simply impossible in today's

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[117] 66 Pa.C.S.A. §3017(a).

competitive environment. After all, the RLECs' access revenues have been decreasing for years (in part, because high access charges have been forcing consumers away from wireline long-distance in favor of competing technologies) yet no one would seriously contend that the Commission had to reimburse the RLECs for those market losses.

In determining what Section 3017 means in operation, the Commission can look to the way in which Chapter 30 operates with respect to the RLECs' broadband deployment and annual price change opportunities. The law permits the RLECs to raise rates each year by the rate of inflation, and this is the manner in which the Legislature gave the RLECs the opportunity to recover their costs of broadband deployment. However, whether the RLECs actually raise their rates is discretionary. If the RLECs choose not to raise their rates for whatever reason, the Commission is not obligated to help the RLECs obtain the forgone revenues from another source.[118] That is a business decision left to the discretion of each RLEC based on its own analysis of how best to compete and serve its own customers. The law does not require the Commission to perpetually guarantee each RLEC some revenue number; rather, if a company comes to the Commission and requests increases that are consistent with the law and the requirements of Chapter 30 for annual inflation increases, the Commission must permit those increases.

B. RATE INCREASES

AT&T's original proposal in this case was that the RLECs should recover their entire access revenue reductions from their own retail customers. This is a superior approach from an economic perspective – in a competitive environment, companies present their costs to their

[118] In fact, many RLECs have voluntarily chosen not to implement their permitted rate increases under Chapter 30, instead allowing such increases to be "banked." The Commission has not permitted the RLECs to make up these banked revenues from other sources. The amount that each company has "banked" was part of the record before ALJ Colwell at Docket No. I-00040105. *See* Exhibit JJL-7 to PTA Statement 1.0 (Direct) in the case before ALJ Colwell for banked revenue amounts.

customers in the form of the price they wish to charge, and the customers can either accept or reject those offers based on the available options. If rejected, that company must come up with a better offer, either (i) by becoming more efficient and reducing its costs to improve the attractiveness of its offer so that it can survive at a lower competitive price, or (ii) by improving its services so that customers will accept a higher price. The telecommunications marketplace has become more competitive and the RLECs must transition to an environment where they recover their costs from their own customers (who order the RLECs' services and benefit from them) rather than shifting costs onto the backs of other telecommunications carriers and their customers through artificial, obsolete regulatory regimes like access charges.

By keeping local rates artificially low, implicit (or even explicit) subsidies stifle competition to the detriment of customers. By readjusting the market to create better pricing signals, carriers are encouraged to operate more efficiently in order to reduce their costs because they can no longer rely on subsidies to survive, and so other newer competitors will be encouraged to enter the RLECs' territories and offer more services and options to the RLECs' customers. Even CenturyLink's own Dr. Staihr, recognized this fact when he testified in another access proceeding:

> In situations where retail rates have been suppressed to remain at artificially low levels for years it is more difficult for competitors to successfully enter a market and compete against those unnaturally low retail rates. And when this happens, customers are ***hurt***, not helped, by these artificially low rates because customers are denied choices of other providers who may indeed have a legitimate cost advantage or efficiency advantage but cannot act on it due to these unreasonably low retail rates. The solution would be, in areas where rates have been artificially suppressed for years, allow the market to set those rates. [119]

[119] *I/M/O* the *BPU's Investigation Regarding the Classification of Incumbent Local Exchange Carrier (ILEC) Services as Competitive*, NJ BPU Docket No. TX07110873, Rebuttal Testimony of Brian K. Staihr, January 29, 2008, p. 40.

1. The Commission Should Establish A Basic Local Rate Benchmark Of $22/month; And Raise The Benchmark By $1/month Each Year.

Even though recovering access reductions entirely from local rates is the best solution, AT&T presented a compromise proposal in order that phases the revenue recovery portion of the access reform so as to mitigate the impact on retail customers. Therefore, AT&T has proposed that a benchmark retail rate be established as a "second best" means to help carriers wean themselves from unsustainable subsidies while insulating consumers from sudden large increases. This benchmark will allow companies whose access reductions are too large to recover at once from their retail rate restructuring to draw from a transition fund until they can gradually increase retail rates in subsequent steps.

The benchmark is established to determine the rate at which carriers can begin recovering lost access revenues from the state USF. Once carriers recover their forgone access revenues from their own retail rates up to the benchmark level, any remaining access revenue losses (attributable to the access rate change) would be recovered from the transitional state USF.[120]

AT&T proposes to set the initial benchmark at $22 per month and then increase the monthly benchmark rate by $1 each year for the subsequent three years. Thereafter, if a benchmark is even necessary, it should increase by the GDP-PI rate of inflation.

The Commission found that $18 was a reasonable rate in 2003. By establishing a current benchmark of $22, AT&T simply adjusted the $18 rate forward to develop a benchmark for 2010 and later years. The objective of the benchmark is to determine the highest residential benchmark rate level the Commission would be willing for RLECs to implement. The starting

[120] It is not AT&T's position that any carrier ***must*** raise its rates – that is a choice for each of the carriers to make.

point for that analysis has to be the previous rate cap the Commission approved, not the RLECs' actual 2003 rates. All RLECs could have increased their rates to $18/month and, had the Commission established an inflation adjustment in 2003, today's "reasonable" rate would be about $22. That is the basis for AT&T's proposed benchmark rate. AT&T's inflation analysis is reasonable, and it should be adopted.

Using inflation as a basis to increase rates is not new to this Commission. In fact, when the Legislature passed Act 183, it did exactly that. Specifically, if RLECs agreed to accelerated broadband deployment plans (and all of them did), the Legislature eliminated the productivity factor from the rate-setting calculation, thereby allowing RLECs to raise their local rates each year by the level of inflation. AT&T is simply proposing that the same methodology be used for purposes of determining a benchmark rate.

2. AT&T's Proposed Benchmarks Are Reasonable And Affordable.

The evidence presented in this case conclusively proves that the $22 benchmark is affordable. The only evidence on the record regarding affordability comes from AT&T and the OCA. Specifically, the OCA presented evidence in the rate cap case before ALJ Colwell that the affordable bill for customers is between $32.00 and $42.91/month, inclusive of fees and surcharges.[121] The PTA has testified that surcharges and fees add up to about $8.57.[122] Thus, after deducting fees and surcharges, the OCA affordability analysis yields results for basic rates

[121] Transcript from Rate Cap case of Docket No. I-00040105 at pp. 131-132. *See also* Schedule RDC-5 attached to OCA Statement 2.0 (Colton) from Rate Cap case at Docket No. I-00040105. The $32 is calculated using 0.75%, but if you take 1% of the $51,500 income for 2008, it leads to a rate of $42.91/month. Using 1% of customers' income as a basis for the amount they are willing and able to spend on telecommunications service is most certainly reasonable. Verizon convincingly testified that the OCA's affordability is conservative, at best. *See* Verizon Main Brief in rate cap case before ALJ Colwell at Docket No. I-00040105, May 11, 2009.

[122] Direct Testimony of Joseph Laffey on behalf of PTA, Docket No. I-00040105, December 10, 2008, p. 5.

in the range of $23.43-$34.34 per month, well above the $22 benchmark rate level AT&T is proposing in this case.

Moreover, AT&T presented evidence that a large percentage of consumers already spend well in excess of $22 per month for telephone service, yet another sign that the $22 rate is affordable. The industry is moving towards bundles. The RLECs are no different – they are targeting their marketing towards bundles and the number of standalone lines are steadily decreasing.[123] In the rate cap/USF case before ALJ Colwell, CenturyLink's data demonstrate that its customers on average are paying much higher rates than the $18 per month rate cap, which provides powerful evidence as to what customers are freely willing to pay, and can actually afford. Specifically, CenturyLink's customers of "local services only (including features)" pay an average of $30.19 per month.[124] But a majority of its customers pay even more than that. The majority of CenturyLink's customers now are on bundles, spending an average of $57.63 per month as of December 2008.[125]

CenturyLink's customers are not alone. End users across the country pay $50.00 or more on bundled packages and other services from newer technologies such as wireless and broadband where prices are free of subsidies.[126] In addition, a recent article in the New York Times reported that, according to US Census data, the average American spent about $64 per month on telephone services, and this number is expected to increase to $83 per month.[127] All of this demonstrates that a $22/month benchmark is eminently reasonable and affordable.

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123 See Attachment 3 to AT&T Statement 1.2. *See also* AT&T Statement 1.2 at pp. 9-10; footnote 17 with cites to various financial reports from RLECs and articles regarding the industry's move towards bundling.

124 *Id.*

125 *Id.*

126 AT&T Statement 1.2 at p. 10, fn. 19.

127 See AT&T Statement 1.2 at p. 11, citing to: Article, *Dollars Flow Out as Data Flows In* , New York Times, February 8, 2010. http://www.nytimes.com/2010/02/09/technology/09spend.html.

AT&T proposes that the benchmark be permitted to raise by $1/month for each year for the three years following the initial establishment of the benchmark. This proposal makes sense on many levels. One of the primary benefits to AT&T's proposal is that setting the increase at a uniform $1 per month simplifies the process and ensures that after the initial catch-up adjustment to $22, all residential customers are subject to the same potential level of annual price increases. While it certainly would be possible for the Commission to precisely identify the impact of inflation each year, the $1 is a reasonable proxy and will yield judicial economy in its administration and provide stability, certainty and transparency during the reform transition, sparing the Commission and the parties from unnecessary and time-consuming proceedings devoted solely to determining an inflation factor.

Moreover, the $1 increase will be uniform for all customers going forward. That is a distinct advantage over dozens of carrier-specific factors based on widely varying legacy rates, which would perpetuate different levels of increase for different customers depending on the starting point. At bottom, access reform is a competition policy and it inescapably involves policy choices such as the timing and degree of adjustments from the old to the new, meaning the customer who enjoyed the inordinate benefit of an $11 per month local rate should converge with the customers paying a higher proportion of their costs for a longer time—this is a fair policy, and the uniform benchmark and uniform annual increases are reasonable, equitable and efficient.

AT&T's modified proposal permits full access reform, albeit with a transition over several years. By establishing a benchmark, AT&T's proposal would allow RLECs to increase their draw from the state USF support, but support would decrease each year thereafter as the RLECs transition to recover more of their revenues from their own end-user retail customers.

In other words, AT&T's proposal avoids having other carriers and their customers subsidize the RLECs in perpetuity. Over time, as RLECs are required to seek to recover a greater portion of their revenues from their own end-user customers, the RLECs' customers will be receiving appropriate price signals and the RLECs will have increased incentives to innovate and become more efficient. Other carriers in the market likewise will respond more efficiently once the price signals are less distorted. That outcome benefits Pennsylvania consumers of *both* local and long-distance and is an appropriate goal for this proceeding.

3. The OCA's Proposed Benchmark of $17.09 Is Unreasonable And Must Be Rejected.

While AT&T was encouraged to see the OCA move towards supporting intrastate access reform, the OCA's proposed benchmark of $17.09/month is unrealistically low and at odds with prior Commission decisions. If the Commission found that $18 was a reasonable rate seven years ago, then $17.09 is obviously less than the maximum reasonable rate today.[128] Even the PTA and CenturyLink ultimately supported benchmarks higher than the OCA proposed rate of $17.09. Although the PTA did not make a proposal in its testimony as to a proper benchmark level, the PTA eventually testified that it supported a benchmark of $18.94/month.[129] In addition, CenturyLink's witness testified that a benchmark above $18/month could be appropriate.[130]

The problem with the OCA's proposal (and even the PTA and CenturyLink positions) is that it places an unreasonable burden on the state USF, thereby continuing a practice of substantial subsidies rather than having RLEC customers pay their own way. That proposal is

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128 Indeed, the Commission recognized the need to investigate whether the $18 rate cap was even reasonable anymore when it initiated the rate cap case before ALJ Colwell. The evidence in that case, and ALJ Colwell's Recommended Decision, demonstrate that an $18 rate cap is in fact no longer reasonable.

129 Transcript at p. 585.

130 *Id.* at pp. 425-426.

at sharp odds with a competitive market. As the OSBA has previously testified, "You can't have competition and at the same time provide general subsidies."[131] Indeed, the RLECs themselves have conceded they should "increase local service rates for residential and business customers to continue the process of eliminating subsidies that are provided by access charges."[132]

The burden the OCA's proposal would place on the majority of Pennsylvania consumers is extraordinary. The OCA's proposal would increase the size of the USF by approximately $63 million, thereby *tripling* the size of the PA USF to nearly $100 million.[133] This would amount to a $90/line annual subsidy even for those customers that have competitive options, and for those customers who are voluntarily purchasing bundles at prices much higher than AT&T's proposed benchmark of $22/month.[134] ALJ Colwell has already found that perpetuating the existing $34 million USF would be bad policy, finding that:

> The PA USF is a fund which exists because the ratepayers of other telecommunications providers have paid the money, unwittingly, as a hidden tax. It 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.
>
> At some point, the market is meant to rely on competition to keep rates affordable. Institutionalizing the PA USF in its present form to provide subsidies to companies who do not have to prove need will not assist the market in reaching its goals and will, instead, provide barriers to entry for new carriers.[135]

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131 Direct Testimony of Allen G. Buckalew, Docket No. I-00040105, December 10, 2008, p. 12.

132 *Buffalo Valley 2003 Filing* p. 13. Conestoga made a virtually identical filing to reduce access rates and increase its local rates, and made the same statements about the importance of raising local rates to better reflect costs, and recover lost access revenues. *Conestoga 2002 Filing*.

133 AT&T Statement 1.2 at p. 12.

134 AT&T Statement 1.4 at p. 3.

135 Recommended Decision of ALJ Susan Colwell, Docket No. I-00040105, July 22, 2009, pp. 87-88.

Adopting a proposal that leads to a significant increase in the size of the USF would fly in the face of ALJ Colwell's well-reasoned Recommended Decision in the USF phase of this proceeding.

The OCA (and PTA) proposed benchmarks are also directly at odds with ALJ Colwell's Recommended Decision because they rely on comparability – a standard she expressly rejected.[136] Specifically, the entire basis for the OCA proposed benchmark is OCA's calculation that $17.09 is comparable to Verizon's statewide average rates.[137] Similarly, PTA testified that its $18.94 benchmark is based on the evidence it presented before ALJ Colwell regarding comparability.[138]

Adopting the OCA or PTA proposed benchmarks would be in direct conflict with ALJ Colwell's Recommended Decision that comparability is *not* a proper standard for setting a rate cap. Not only did ALJ Colwell reject the OCA's and PTA's arguments that the Commission must set rates based on a standard of comparability, but this Commission's own legal counsel has also rejected them:

> "Similarly, the D&E Companies' contention that the Commission somehow violated 47 U.S.C. §254(b)(3) because it did not make a specific finding that Denver & Ephrata's retail rates are comparable to the rates charged for the same service in urban areas is baseless. This federal regulation pertains to federal universal service and is not a mandate to state Commissions. It has no bearing on rural ILECs' receipt of monies from the PaUSF, but may be relevant to non-rural ILECs' participation as recipient carriers regarding the federal USF."[139]

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136 "AT&T argues convincingly that the OCA and PTA offer a flawed standard for comparability." *ALJ Colwell Recommended Decision* at p. 82, fn. 18.

137 AT&T Statement 1.2 at p. 8.

138 Transcript at p. 585.

139 *Buffalo Valley Telephone Company, et. al. v. Pennsylvania Public Utility Commission; No. 847 C.D. 2008; Popowsky v. Pennsylvania Public Utility Commission, No. 940 C.D. 2008;* Advance Form Brief of Respondent Pennsylvania Public Utility Commission at p. 38. The Commonwealth Court upheld the Commission's arguments on comparability in its decision issued on December 15, 2009.

The same OCA (and PTA) arguments on comparability fare no better in this case. Once again, the OCA fails to acknowledge the variability in Verizon's rates between urban and rural areas. The OCA bases its analysis on a statewide average – presumably because that yields a lower figure more to the OCA's liking – but could just as easily built its analysis on Verizon's urban rates. Of greater significance, however, is that the OCA fails to acknowledge the "apples to oranges" nature of its analysis. Here, the Commission is crafting basic rates for use when RLEC access rates have been reduced and reformed; *i.e.,* basic rates that will be in effect when RLEC access rates will have been reduced to interstate parity. It is wholly inappropriate for the OCA to evaluate what appropriate rates should be based on an analysis of Verizon basic rates *that are still supported by implicit access subsidies.* As Verizon itself argued in the USF case, Verizon's retail rates historically have been suppressed, and are artificially low.[140]

Because the OCA's proposed benchmark of $17.09/month would place an unreasonable burden on the Pennsylvania USF, and because it (along with the $18.94/month benchmark proposed by PTA) is based on a flawed and already rejected standard of comparability, the benchmarks of OCA and PTA cannot be adopted in this case.

4. CenturyLink's Flawed Customer Survey Should Be Given No Weight.

In an effort to oppose access reform and argue that local rates cannot be used to recover any access revenue reductions, CenturyLink submitted a survey that purported to investigate possible consumer reactions to hypothetical price increases.[141] The Commission should find that CenturyLink's survey is unpersuasive and entitled to no weight. First, CenturyLink itself

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[140] For instance, if Verizon's density zone one rate were increased by reducing implicit subsidies from intrastate access rates that are above Verizon's interstate rates (such as by removing the $.58 CCL), it would lead to a Verizon rate of $18.16/month. Even using Dr. Loube's 120% comparability factor, this brings the rate to $21.79. Using a 125% comparability factor brings the rate to $22.70/month. *See* AT&T Statement 1.2 at p. 9, fn. 14.

[141] CenturyLink Statement 2.0, at pp. 5-8.

does not give such surveys any weight in conducting its own business. CenturyLink was not able to cite any instance where it used a similar survey in any state where CenturyLink has increased its retail rates.[142]

Second, the exact magnitude and timing of each consumer's reaction, whether drastic or gradual, instantaneous or over a longer period, depends on many real-world factors that are not easy to predict through a survey. CenturyLink's own Dr. Staihr, who oversaw the survey, testified in another case that price is not the only factor in determining how consumers will act.[143]

CenturyLink's survey made no attempt to account for those real-world factors that would affect customers' reactions to the questions asked. For example, CenturyLink's survey asked a few people about price increases for local service in the abstract, without advising those people that they might also see price decreases for wireline long distance.[144] CenturyLink's survey, which asked customers whether they would be willing to spend more money, was conducted from December 21-23 – two to four days before Christmas. Yet, CenturyLink's survey results did not attempt to take into account whether customers' reactions may vary due to this timing of the survey.[145]

Rather than rely on a hypothetical survey that was created and conducted solely for litigation purposes, CenturyLink should have provided evidence about its real-world experience of consumer responses to actual price increases, but it did not do so.[146] CenturyLink has

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142 AT&T Statement 1.2, at pp. 39-40.

143 AT&T Statement 1.2, at pp. 41-43 (citing *I/M/O the BPU's Investigation Regarding the Classification of Incumbent Local Exchange Carrier (ILEC) Services as Competitive*, NJ Board of Public Utilities ("BPU") Docket No. TX07110873, Rebuttal Testimony of Brian K. Staihr, January 29, 2008).

144 AT&T Statement 1.2, at p. 42.

145 Transcript at p. 314 (Harper).

146 AT&T Statement 1.2, at p. 40.

increased rates both in Pennsylvania and in other states throughout the country, so there was no need to conduct a survey to see how customers might react to hypothetical price increases.[147]

When looking at real world examples rather than hypothetical questions, the evidence does not support CenturyLink's conclusion from its survey – that customers will leave CenturyLink due to price increases to basic local service.[148] To the contrary, the evidence shows that CenturyLink's customers are in fact moving ***away*** from lower priced services, and moving ***towards*** higher priced bundled services.[149] In addition, the evidence shows that the number of customers who left CenturyLink at a time of price increases was no different than those who left during years with no price increases.[150] As another example, in New Jersey, after seeking and obtaining wide discretion to increase local prices, CenturyLink aggressively exercised that discretion and increased local residential rates twice by $3.00 and $2.50 over 13 months, and the evidence did not show that customers migrated away from CenturyLink due to those price increases.[151] To the contrary, although CenturyLink believed that the market in New Jersey was competitive, CenturyLink was able to increase rates by $3.00, and it then increased rates a second time[152] – thereby completely undermining CenturyLink's claim that any increase in prices in a competitive market will lead to mass defection of customers. The evidence regarding the PTA companies' data related to customer reactions to price increases also does not support the conclusion that customers are leaving or will leave an RLEC due to increases in local rates.[153]

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147 *Id.*
148 *Id.* at pp. 40-41.
149 *Id.* at pp. 44-45.
150 *Id.* at p. 41.
151 *Id.*
152 Transcript at pp. 423-424.
153 Transcript at pp. 600-605 & AT&T Cross Ex. 5.

The Commission should reject the RLECs' arguments that access revenue decreases cannot be recovered through local rate increases, particularly with the Pennsylvania USF used as an additional transitional recovery mechanism as proposed by AT&T, and should find that the evidence compels reductions in the RLECs' intrastate switched access rates.

C. PENNSYLVANIA USF

AT&T initially did not propose using the state USF at all to recover any access reductions realized in this case. However, in order to reach a reasonable compromise, AT&T's modified and current proposal does permit the RLECs the opportunity to obtain funds from the USF to recover access revenue reductions resulting from Commission action in this proceeding. However, this draw would be temporary and transitional and would decrease each year.

If the Commission establishes a benchmark of $22/month per AT&T's proposal, AT&T calculated that the current USF would initially increase by nearly $20 million.[154] After intrastate access rates are reduced to parity with interstate, and local rates are increased to recover the access reductions, there will be 17 RLECs at the $22/month benchmark level and 14 RLECs with rates that will remain below $22/month. As the benchmark increases each year, the amount of money drawn from the USF decreases each year and the number of companies receiving additional funds from the USF will decrease. If a company can recover its full access reductions by rebalancing it retail rates up to or below the benchmark, then that company would not receive any additional funding from the state USF. AT&T provided a detailed description as to the exact effect its proposal would have on RLEC local rates and the USF in Attachment 5 to AT&T Statement 1.2 and that document is attached to this Brief for ease of reference. What

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[154] AT&T Statement 1.2 at p. 14.

it shows is that after a four year transition period, the increase to the USF will be less than $1 million, and only six RLECs would continue to draw these additional funds from the USF.

AT&T's proposal to use the USF as a ***transitional*** tool reasonably balances various Pennsylvania interests. Increasing the benchmark level to $22/month initially, and then by $1/month every year, will enable the USF to begin achieving its intended purpose – to ensure that low income and high cost customers can afford local service. However, it will also reduce the USF each year. This is entirely consistent with this Commission's prior policies. The Commission never intended for the USF to be used as a permanent subsidy mechanism. To the contrary, the Commission specifically planned to *eliminate* the PaUSF by the end of 2003.[155] As the Commission noted in 2004, "The Fund was conceived to be an ***interim*** funding mechanism operating during the period of access charge reform. According to the Commission's Order establishing the Fund, it was originally scheduled to expire on December 31, 2003."[156] The Commission has further stated that, "At some point, the system of the PaUSF whereby other operating companies in the Commonwealth support the incumbent rural ILECs during what is ***supposed to be a transitory time*** between local telephone monopolies into competitive markets must be reexamined."[157]

Access rate reform should not be used as a windfall to the RLECs or to lock in their current levels of access revenues, which are otherwise continuing to decline as competition intensifies. Access revenues are declining each year as IXCs lose traffic to competitors not saddled with the access subsidy obligation.[158] The RLECs are not currently protected against access revenue decreases each year – and those revenues will continue to decline if the

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155 *Global Order* at p. 153.

156 *Investigation Regarding Intrastate Access Charges and IntraLATA Toll Rates of Rural Carriers, and the Pennsylvania Universal Service Fund*, Docket No. I-00040105, December 20, 2004, p. 3.

157 April 24, 2008 Order at p. 19 (emphasis added).

158 See Attachment 4 to AT&T Statement 1.2.

Commission takes no action. Each year the access revenues decrease, but the RLECs do not and cannot request the Commission to reimburse them for those losses. This case should not be about putting the RLECs in a ***better*** position than they would otherwise be, or about protecting them from losses they would have otherwise incurred. Thus, it would simply be a windfall to guarantee the RLECs a fixed stream of revenues in perpetuity by setting a fixed USF that stays at a permanent level year after year.

The Commission should not endorse such a windfall, and therefore should adopt AT&T's compromise proposal to phase in the revenue recovery portion of access reductions through a transitional USF that decreases each year.

VII. GENERAL LEGAL ISSUES

A. RETROACTIVITY OF ANY ACCESS RATE REDUCTIONS

At this time, AT&T is not advocating that any access rate reductions ordered in this case be retroactive. AT&T's proposal is that the RLECs' intrastate access rates be reduced to interstate levels immediately on a going-forward basis.

B. COMPLIANCE

Compliance with any Order by this Commission should not be a difficult process, especially if AT&T's proposal is adopted. With respect to requiring the RLECs to modify their intrastate access rates, that simply involves filing updated tariffs. This would be especially straightforward if the Commission orders an immediate reduction to interstate rates – the Commission could either permit the RLECs to reference their interstate tariffs, or cut and paste their interstate tariffs and file them as their intrastate ones. Because the RLECs' billing systems

are already set up to charge interstate rates, there is no reason it should take a substantial amount of time to change any systems to begin billing the new access rates.

Once a final Commission decision is issued, the RLECs will need to provide updated intrastate access information (such as minutes of use and access lines) for the most recent time period available in order to calculate the exact dollar impact of reducing access rates. Parties should be given an opportunity to review the RLECs' updated data and ask questions if necessary. Once the exact revenue impact is finalized, if the Commission adopts AT&T's proposal, then the Commission would permit RLECs to increase basic local rates up to $22/month. However, such increases do not have to actually be filed or in place before determining the amount that will need to come from the Universal Service Fund. The Commission would assume that the RLECs raised their rates to $22and calculate the revenue impact from that increase; any shortfall would come from the USF.

There is no need for a rulemaking to increase the size of the USF when the increase is as a result of access reductions. The USF was specifically intended to be used for access reductions, and therefore no regulations need to be altered to implement AT&T's proposal. Clearly, the USF Administrator and the Commission must calculate the impact on carrier assessments and must collect such assessments in accordance with the normal practice and procedures for administering the USF.

Again, this does not need to be a lengthy process and AT&T submits that compliance and implementation issues should not be used as a basis to delay any reform actually being realized. This Commission has a large and talented staff, and has dealt with many implementation issues associated with large regulatory tasks. This case is no different, and

AT&T is confident that the RLECs, the parties, and the Commission can implement any access reform within a reasonable time period after it is ordered.

VIII. CONCLUSION

The RLECs have known for over ten years that this day was coming. The RLECs have admitted that access reform is critical in order to foster a competitive environment in both the local and long distance markets. While it is certainly understandable that the RLECs do not want to see the gravy train of access revenues come to an end, the practice of one type of carrier (IXCs) being forced to subsidize the RLECs must cease and access charges must be reformed.

Access reform is in the best interests of Pennsylvania consumers. By making the market more competitive, the Commission will be giving all carriers stronger incentives to become more efficient, to innovate, and to deliver to consumers the services they demand at prices they are willing to pay.

As it has pledged to do for a decade, the Commission must reduce the RLECs' intrastate access rates. In the past seven years since the Commission last modified the RLECs' intrastate access rates, the Pennsylvania telecommunications market has changed dramatically. IXCs now compete against Internet providers, wireless carriers, VoIP providers, social networking websites and other forms of communication that, in many instances, were barely off the drawing board when the Commission last addressed RLEC access rates in 2003. It should go without saying that competition can never be fair if one competitor is forced to incur subsidy obligations its competitors do not face. Reducing RLEC access rates will help eliminate the competitive disparity and further the Legislature's goals to make the Pennsylvania telecommunications market as competitive as it can be, so that consumers can reap the benefits.

The evidence overwhelmingly supports an immediate reduction of intrastate access rates to interstate levels. On the revenue recovery side, AT&T's proposal to phase in rate rebalancing by establishing a benchmark of $22/month and then increasing it each year by $1/month is the most reasonable and fair approach to accomplishing the Commission's goals of comprehensive and fair access reform. This approach will allow the RLECs the opportunity to offset some of the access revenue reductions that result from the Commission's reforms in this proceeding from the state USF, but will gradually phase down that support such that the RLECs become dependent on their own customers, and must compete just as all other carriers in Pennsylvania compete – without being subsidized and protected from competitive pressure.

AT&T respectfully requests that the Commission adopt its proposal and finalize access reform for the RLECs by no later than the end of this year. Customers have waited long enough for this reform. The time to act is now.

Respectfully submitted,

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A

AT&T'S PROPOSED FINDINGS OF FACT

I. Switched Access Charges.

A. Historical Background

1. Switched access charges are the fees that a Local Exchange Carrier ("LEC") assesses upon long distance carriers when the LEC originates or terminates long distance calls made or received by the LEC's local service subscribers. AT&T Statement 1.0, at 14.

2. Switched access charges were created over two decades ago as a legacy of the cross-subsidy arrangements that existed when (i) the former Bell System held a *de facto* monopoly over interexchange services, (ii) there was no local service competition, and (iii) wireline services were the only communications services available. AT&T Statement 1.0, at 15.

3. In that environment, it was possible to shift a portion of the costs of local telephone facilities onto those who made toll calls. Since customers wanting to make toll calls had no other options, in the short-run, they could not avoid or by-pass the subsidies built into long distance rates. AT&T Statement 1.0, at 15-16.

4. With the breakup of the Bell System in 1984, the subsidy flow was re-cast as switched access charges. AT&T Statement 1.0, at 16.

B. The 1999 Global Order

5. In the 1999 *Global Order* (at 18),[1] the Commission found "that current ILEC access charges are priced substantially above cost," and recognized that such rates must be reduced in order "to maintain fair toll competition in Pennsylvania."

6. The Commission recognized that "the FCC has undertaken significant steps to reform access charges" on the interstate side, and noted that Pennsylvania's rural ILECs deemed

[1] *Re Nextlink Pennsylvania, Inc.*, Docket No. P-00991648; P-00991649, 93 PaPUC 172 (September 30, 1999)("*Global Order*").

it "critical that the Commission mirror those access reforms at the state level." *Global Order*, at 51-52.

7. In this regard, the Commission found that "there is no functional difference between access provided on an interstate or an intrastate basis," so that "any pricing differential that may exist will give an incentive to IXCs, upon whom ILECs rely to identify the volume of terminating interstate and intrastate traffic, to report lesser usage in the higher cost venue." *Global Order*, at 51-52.

8. "In sum," the Commission found, "in order to avoid tariff arbitrage, it is extremely important that intrastate access charges mirror their federal counterpart." *Global Order*, at 51-52 (citing the rural ILECs' witness Mr. Laffey's testimony; emphasis added).

9. As part of the *Global Order*, the Commission also noted with approval that ALJ Michael Schnierle's June 30, 1998, Recommended Decision had reached "various conclusions regarding the necessity of access reform in a competitive environment and we incorporate those conclusions in that regard in this Order by reference." *Global Order*, at 27.

10. Judge Schnierle's findings incorporated into the *Global Order* include a finding that "a rate structure that requires the use of per-minute access charges where flat-rated fees would be more appropriate increases the per-minute rates paid by IXCs and long-distance consumers, thus artificially suppressing demand for long distance service." ALJ Schnierle 1998 Recommended Decision at 5.

11. Judge Schnierle also found that per-minute access charges also affect competition.

> For example, where rates are significantly above cost, consumers may choose to bypass the ILEC's switched access network, even if the ILEC is the most efficient provider. Conversely, where rates are subsidized (as in the case of consumers in high-cost areas), rates will be set too low and an otherwise efficient provider would have no incentive to enter the market. In either case, the total cost

of telecommunications services will not be as low as it would otherwise be in a competitive market. Finally, as the Commission recognized in its *US Order of January 28, 1997*, access charges must be closer in magnitude to access costs for there to be true competition in the toll market.

ALJ Schnierle 1998 Recommended Decision at 5.

12. In addition, Judge Schnierle found:

The existing system (of implicit subsidies and support flows) is sustainable only in a monopoly environment where ILECs are guaranteed an opportunity to earn returns from certain services and customers that are sufficient to support the high cost of providing other services to other customers. The new competitive environment envisioned by the Telecommunications Act of 1996 threatens to undermine this structure over the long run. The 1996 Act removed barriers to entry in the local market, generating competitive pressures that make it difficult for ILECs to maintain access charges above economic cost.

ALJ Schnierle 1998 Recommended Decision at 6.

13. Judge Schnierle also recognized that:

In short, politically unpopular though it may be, rate rebalancing is required, along with access charge reductions, if there is to be competition for all customers in all locations, and if urban customers are not to be saddled with excessive universal service fund costs. I am aware of no other way to solve this problem, and the parties here have presented no other proposal that is likely to solve the problem. Moreover, the very point of introducing competition to the local exchange market is to bring about lower prices through the operation of the market. An unwillingness to rebalance rates suggests an unwillingness to trust the market to bring about lower prices. If that is the case, I suggest that society rethink the notion of attempting to have competition in the local exchange market."

ALJ Schnierle 1998 Recommended Decision at 28.

14. Based in part on Judge Schnierle's recommended findings, the Commission reduced the access rates of all RLECs in the 1999 *Global Order*, and cautioned the RLECs that

the reductions were only a first step towards eliminating the implicit and anti-competitive subsidies that remained embedded in the rates. *Global Order*, at 26.

15. In order to "complete intrastate access charge reform and to presumably eliminate all subsidies in the access charge rate structure," the Commission intended to initiate and conclude a further access investigation by December 31, 2001. *Global Order*, at 58-59.

C. Subsequent Commission Orders

16. In July 2003, the Commission approved a settlement whereby the RLECs agreed to implement some intrastate access rate reductions, but the reductions did not bring intrastate access rates to parity with interstate rates. The Commission assured that further reductions would be forthcoming:

> [W]e do not intend to declare the access rates established by this Order as the final word on access reform. Rather, this is the next step in implementing continued access reform in Pennsylvania in an efficient and productive manner.[2]

17. In December 2004, the Commission initiated a case to review the RLEC intrastate access rates, again stressing the need for further access reform:

> As stated in our prior Order of July 15, 2003, at M-00021596, In re: Access Charge Investigation per Global Order of September 30, 1999, at 12, at that time we did not declare the access rates established by that Order as the final word on access reform. Rather, we characterized the Order as the next step in implementing continued access reform in Pennsylvania in an efficient and productive manner. In the Commission's judgment it is now an appropriate time to consider further access charge reform.[3]

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[2] *Access Charge Investigation per Global Order of September 30, 1999, et al.*, Docket Nos. M-00021596, *et al.*, Order of July 15, 2003 at 12.

[3] *Investigation Regarding Intrastate Access Charges of Rural Carriers, and the Pennsylvania Universal Service Fund*, Docket No. I-00040105, December 20, 2004 Order at 4.

18. More recently, in July 2007, the Commission agreed that "Act 183 and Section 3017(a) support this Commission's policy goals that local exchange carriers reduce dependence on access revenue from other carriers and rebalance those revenues."[4]

19. In April 2008, this Commission acknowledged that keeping intrastate access rates above interstate levels presents opportunities for gaming and arbitrage, and that existing access rates are anti-competitive, observing that it "continues to be the intention of this Commission . . . to gradually lower intrastate access charges so as to allow for greater competition in the intrastate and interexchange toll markets." April 24, 2008 Order in Docket I-00040105 at 20, 26.

D. The Continued Growth Of Competition Since The *Global Order*.

20. Since 1999, when the *Global Order* adopted Judge Schnierle's finding that "[t]he new competitive environment envisioned by the Telecommunications Act of 1996 threatens to undermine" the monopoly-era structure of high access charges, the availability of competitive alternatives has continued to increase dramatically. AT&T Statement 1.0, at 25; CenturyLink Statement 1.0, at 31-32.

21. With regard to wireless service, as of December 2007, Pennsylvania had over 9.6 million wireless subscribers (up 60% since just 2003), which means that at the end of 2007 some 77% of Pennsylvania residents had a wireless phone. AT&T Statement 1.0, at 26 (citing (citing September 2008 FCC report on status of local competition as of December 31, 2007); see also CenturyLink Statement 1.0, at 27-28 (stating that Pennsylvania wireless subscribers increased from 3 million to nearly 10 million between 1999 and 2008).

22. Those wireless carriers serve virtually all of Pennsylvania, including the RLEC territories. According to a 2008 Legislative Budget and Finance Committee Report,

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[4] Opinion and Order in Dockets I-00040105, P-00981428F1000, R-00061375, P-00981429F1000, R-00061376, P-00981430F1000 and R-00061377 (July 11, 2007) at 34, 35.

"Pennsylvania has cell phone coverage throughout most of the state, and most of the population can choose from four or more cell phone providers." Cell Phone Service in Pennsylvania, Legislative Budget and Finance Committee, November 2008, at S-1 ("LBFC Cell Phone Report").

23. The LBFC Cell Phone Report concluded that "there is at least some coverage in every county, and there are areas in each county where there is a choice of four or more carriers." *Id.*

24. The RLECs agree that wireless carriers abound in their service territories. CenturyLink, for example, testified that it is facing "strong and aggressive competitive challenges by competitors such as wireless and cable companies." Embarq Statement 1.0 (Gutshall Direct) in Docket No. I-00040105, filed December 10, 2008 at 22.

25. CenturyLink further testified that "[w]ireless service is available for the overwhelming majority of [CenturyLink's] customers." Embarq Statement 2.1 (Lindsey Surrebuttal) in Docket No. I-00040105, filed Feb. 10, 2009 at 6.

26. In this phase of the proceeding, CenturyLink has continued to acknowledge that it faces "robust inter-modal competition for residential consumers, including wireless, voice and data services." CenturyLink Statement 3.1, at 11.

27. As for text messaging, usage has exploded since the Commission last reviewed RLEC access rates. The FCC reports that as of December 2007, customers sent 48.1 billion text messages a month compared to 2.8 billion in December 2003. AT&T Statement 1.0, at 27 (citing September 2008 FCC report on status of local competition as of December 31, 2007).

28. Likewise, technologies such as DSL, broadband cable, and VoIP have also exploded in demand and are challenging interexchange carriers in the marketplace. The FCC

reported that as of year-end 2007, there were 5.15 million high speed lines in service in Pennsylvania. AT&T Statement 1.0, at 27-28 (citing FCC report on High-Speed Lines for Internet Access).

29. The same report shows that every zip code in Pennsylvania has at least one high speed provider, and most have four or more. For example, according to one industry source, approximately 78% of households passed in Pennsylvania have VoIP service available via broadband cable. AT&T Statement 1.0, at 28 (citing report).

30. Any customer with a high speed connection can use that connection for Internet access, e-mail, social networking, as well as for free computer-to-computer service such as Skype, or a computer-to-PSTN service like Vonage, to make voice calls and avoid traditional subsidy-laden long distance prices. As of the end of 1st Quarter 2009, Skype reported over 443 million users worldwide; adding 37.9 million new users in the 1st Quarter 2009 alone. AT&T Statement 1.0, at 28 (citing Skype report).

31. Pennsylvania consumers today have a broad range of options for their in-state long distance communications, including wireless carriers, e-mail, social networking websites, and VoIP providers – none of which pay intrastate access charges in the same manner as wireline IXCs. AT&T Statement 1.0, at 25, 28.

32. The RLECs' current per-minute intrastate access rates generally range from about 1 cent to as high as 11 cents, ***per end*** of the call, so an RLEC-to-RLEC in-state long-distance call can impose access charges of 2 to 22 cents a minute. Because IXCs maintain statewide averaged rates, the access costs often can exceed what the IXC charges its end-user customers. AT&T Statement 1.0, at 15, 34, 41.

33. When one segment of the market is singled out and forced to incur subsidy obligations that its competitors do not face, the results are predictable. Pennsylvania consumers are leaving traditional wireline long distance at an accelerating rate, in part because they perceive it to be overpriced relative to other options not burdened with the access subsidy obligations. AT&T Statement 1.0, at 25.

34. CenturyLink's panel testified that "wireless substitution is the biggest driver" of the decline in switched access revenues "as customers continue to increasingly take advantage of unlimited long distance calling that is provided routinely by wireless providers." CenturyLink Statement 1.0, at 35-36.

E. Implicit Subsidies Remain Embedded In Intrastate Switched Access Charges

35. In the 1999 *Global Order* (at 18), the Commission found "that current ILEC access charges are priced substantially above cost."

36. When the Commission approved reductions in ILEC access rates in the 1999 *Global Order*, and again in 2003, it made clear that such reductions were not the final word on access reform, but were simply steps in an orderly process of reducing intrastate access rates towards cost.

37. The evidence presented in this case confirms that the Commission's previous finding that ILEC access charges are substantially above cost remains true.

38. The Commission finds it instructive to compare switched access charges for intrastate calls to the parallel access charges assessed on interstate (state-to-state) long distance calls. AT&T Statement 1.0, at 35-36.

39. There is no dispute, and the Commission finds (as it did in the *Global Order*), that the access functionality and cost of providing access service for intrastate calls is identical in all material respects to the functionality and cost of providing access service for interstate calls.

AT&T Statement 1.0, at 36; see also CenturyLink Statement 1.0, at 34 ("The functionalities used for interstate and intrastate switched access are essentially the same.").

40. However, the RLECs' intrastate access charges generally are far higher than their corresponding interstate rates. AT&T Statement 1.0, at 35-36.

41. The five largest RLECs in Pennsylvania – CenturyLink, Commonwealth, Windstream, North Pittsburgh, and Denver & Ephrata – all have intrastate access rates approximately 4 cents per minute or more per end, which is three to four times what they charge for the same functionality on an interstate call. AT&T Statement 1.0, at 15, 35-36 & Ex. C thereto.

42. In addition to the evidence provided through a comparison to interstate access service, it is also instructive to compare intrastate switched access rates to the RLECs' cost-based "reciprocal compensation" rates for terminating local calls. AT&T Statement 1.0, at 37-39.

43. The function and cost of terminating a call is materially the same whether the call is a long distance call (coming from an IXC) or a local call (coming from a CLEC). AT&T Statement 1.0, at 37.

44. The FCC has set local call termination rates at 0.07 cents (a rate that may also apply to ISP and intraMTA wireless call termination), specifically finding that those rates are "sufficient to provide a reasonable transition from dependence on intercarrier payments *while ensuring cost recovery*" (emphasis added).[5]

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[5] *See In re Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Intercarrier Compensation for ISP Traffic*, CC Docket No. 96-98, and No. 99-68, at 6 (April 27, 2001) (remanded on other grounds, *WorldCom, Inc. v. FCC*, 288 F.3d 429 (D.C. Cir. 2002), cert. denied, *Core Communications, Inc. v. FCC*, 538 U.S. 1012 (2003), subsequent mandamus, *In Re: Core Communications, Inc.*, 531 F.3d 849 (2008); order on remand, *In re High Cost Universal Support, et al*, WC Docket No. 05-337 (released Nov. 5, 2008).

45. The Commission has approved, or parties have voluntarily agreed to, cost-based "reciprocal compensation rates" - applicable for the exchange of calls within the designated local calling areas of the RLECs - that range between 0.07 cents and 0.28 cents. AT&T Statement 1.0, at 38-39 & Ex. F thereto.

46. The intrastate switched access rates for all of the RLECs are well above the reciprocal compensation levels. AT&T Statement 1.0, at 13.

47. The fact that intrastate access rates are well above the corresponding reciprocal compensation rates shows that intrastate access rates remain well above the RLECs' costs.

48. As OSBA's witness Dr. Wilson recognized, the RLECs are the best source of information about their own costs of providing access service. Hearing Tr. at 91.

49. No RLEC presented a cost study or any other estimate of its costs of intrastate switched access. Hearing Tr. at 91-92 (Wilson); Hearing Tr. at 530-31 (Kubas); Hearing Tr. at 334 (Harper). PTA and CenturyLink agreed that no cost studies were necessary. Hearing Tr. at 334 (Harper); PTA Statement 1SR, at 14.

50. In light of the Commission's prior findings in the 1999 *Global Order*, the fact that terminating a long distance call is materially identical to terminating a local call, and the absence of any contrary cost evidence presented by the RLECs (who would have both the incentive and the ability to present evidence of their own costs if such evidence supported high access charges) the Commission finds that further or more detailed "cost studies" are unnecessary to conclude that the RLECs' access charges are above-cost. AT&T Statement 1.4, at 4-5, 26-27.

51. By reducing intrastate access rates to parity with the corresponding interstate rates, the Commission is maintaining the RLECs' intrastate access rates above cost-based levels. AT&T Statement 1.0, at 5-6, 38-39; AT&T Statement 1.4, at 27-28.

II. Should RLECs' Intrastate Switched Access Rates Be Reduced?

A. The Monopoly-Era Regime Of High Access Rates Is Both Harmful And Unsustainable.

52. **Impact on Competition.** In the *Global Order*, the Commission adopted Judge Schnierle's findings, including his finding that "[t]he existing system (of implicit subsidies and support flows) is sustainable only in a monopoly environment," and that "[t]he new competitive environment envisioned by the Telecommunications Act of 1996 threatens to undermine this structure over the long run." ALJ Schnierle 1998 Recommended Decision at 6 (emphasis added).

53. That finding applies with even more force today, as the types and amount of competition have continued to increase dramatically. AT&T Statement 1.0, at 11.

54. Regulation, unfortunately, has not kept pace with advances in technology and competition, and as competition has grown, the high intrastate access rates have become a more unreasonable burden to consumers, to the carriers forced to pay them, and, more generally, to the development of fair and effective competition. AT&T Statement 1.0, at 11-12.

55. As things now stand, intrastate access charges as high as 11 cents per minute -- for only one end of an in-state call – are being imposed almost exclusively on long distance interexchange carriers. AT&T Statement 1.0, at 11-12.

56. Meanwhile, the new entrants against whom IXCs compete for long distance communications – internet service providers, VoIP providers, text messaging providers, e-mail providers, wireless carriers, social networking websites – are generally able to complete their calls for as little as 7/100ths of a cent per minute (.07 cents or $0.0007), or in the case of e-mail traffic, essentially for free. AT&T Statement 1.0, at 12.

57. Wireless carriers, for example, pay access charges only on long distance calls that are routed outside the "Major Trading Area" ("MTA") where the call originated. All wireless calls *within* a MTA are treated as "local." AT&T Statement 1.0, at 39; CenturyLink Statement 1.0, at 35-36.

58. As a practical matter, that means most wireless calls are not subject to access charges because MTAs are very large. The MTA for Philadelphia covers the eastern half of Pennsylvania, Delaware, and the southern half of New Jersey. The Pittsburgh MTA covers the western half of Pennsylvania, the northern half of West Virginia, and portions of Ohio. AT&T Statement 1.0 at 39-40 & Ex. G thereto (providing FCC map).

59. IntraMTA calls are treated as local calls and subject only to reciprocal compensation termination charges that are much lower than the intrastate switched access charges borne by the IXCs. AT&T Statement 1.0, at 40; Hearing Tr. at 92-93 (Wilson).

60. VoIP-originated calls are not subject to originating access charges and, in many instances, are terminated at reciprocal compensation rates instead of the much higher switched access rate. AT&T Statement 1.0, at 40.

61. Text messaging, instant messaging and email providers *pay no terminating charges at all* – not even the much lower rates that wireless and VoIP providers pay. AT&T Statement 1.0, at 40.

62. As the Commission and Judge Schnierle foresaw, this patchwork of rates for the same call completion functionality is anti-competitive and unsustainable. AT&T and other wireline long distance carriers cannot be expected to compete on a level-playing field if they must pay high intrastate access charges while their competitors do not. AT&T Statement 1.0, at 40; AT&T Statement 1.2, at 13-14; AT&T Statement 1.3, at 1-2, 7.

63. As OCA's Dr. Loube recognized, it is inequitable to impose a disproportionate subsidy burden on one industry segment. OCA Statement 1 at 12; Hearing Tr. at 478.

64. Consumers benefit from a free choice among competitors that compete aggressively on a more level playing field, based on real differences in quality and cost. Conversely, consumers are harmed when their choice is distorted by artificial differences in price driven by high access costs. AT&T Statement 1.0, at 52.

65. **Impact on Long Distance Rates.** Access charges are a direct and unavoidable cost to IXCs. Therefore, high access charges affect long-distance rates for consumers across Pennsylvania, not just those served by the RLECs. AT&T Statement 1.0, at 17.

66. By law, IXCs must maintain statewide averaged long distance rates, so excessive RLEC access charges are driving up the price of a call from Pittsburgh to Philadelphia just as much as a call from Gettysburg to Zion. AT&T Statement 1.0, at 17.

67. Competitive alternatives and high intrastate access charges are eroding wireline long distance traffic, and thus the implicit subsidies in access charges. AT&T Statement 1.0, at 28.

68. The RLECs previously recognized this reality of high access rates eroding implicit subsidies when they observed that "the continued existence of subsidies in access charges renders [a RLEC] susceptible to a 'toll bypass' by a designated access provider or a facilities-based CLEC." *Buffalo Valley 2003 Filing*, at 17.[6] *See also Buffalo Valley 2002 Filing* at 19[7]; *Conestoga 2002 Filing* at 19.[8]

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[6] *Buffalo Valley Telephone Company Revenue-Neutral Rate Rebalancing Filing for Year 2003*, Docket No. R-00038351, April 30, 2003 ("*Buffalo Valley 2003 Filing*").

[7] *Buffalo Valley Telephone Company Revenue-Neutral Rate Rebalancing Filing for Year 2002*, Docket No. R-00027256, April 30, 2002 ("*Buffalo Valley 2002 Filing*").

[8] *Conestoga Telephone and Telegraph Company Revenue-Neutral Rate Rebalancing Filing*, Docket No. R-00027260, April 30, 2002 ("*Conestoga 2002 Filing*").

69. The RLECs have recognized that the high access charges lead to higher toll rates, thus pushing customers towards alternative services, such as wireless, which "places a large portion of [the RLEC's] access revenues at risk." *Buffalo Valley 2003 Filing* at 17.

70. Today, the "bypass" the RLECs were concerned about in 2002 has expanded, exponentially, to include Internet services, wireless carriers, e-mail, social networking websites, VoIP providers, and other technologies that do not incur the same access subsidies still being imposed on IXCs. AT&T Statement 1.0, at 25-33.

71. High access rates are a contributing factor in consumers' decisions to move to different technologies, and are also a factor in consumers' decisions to discontinue traditional wireline service altogether when consumers seek bundled packages from alternative technologies. AT&T Statement 1.0, at 26-27.

72. As consumers continue to move away from higher priced long distance services saddled by high intrastate access rates, the RLECs are going to be forced to recover their costs from a continually shrinking customer base. Ironically, then, high access charges are drying up the stream of subsidies they were supposed to provide. AT&T Statement 1.0, at 44.

73. The RLECs' concerns are not merely theoretical. In the "rate cap/ USF" phase of this proceeding, the RLECs testified that they have lost 20% of their access lines since 1999, and that in the last two years, the line losses have averaged 5.3% per year. PTA Statement 1.0 (Laffey Direct), filed in Docket No. I-00040105, December 10, 2008, at 7.

74. More recently, PTA's witness testified in this phase of the proceeding that overall, its members had lost 17% of their access lines from 2005 through 2008; as an example, Citizens of Kecksburg was experiencing "stiff competition." PTA Statement 1 at 19-20.

75. CenturyLink's panel testified that it had lost 28% of its access lines since 2000. CenturyLink Statement 1.0 at 28.

76. CenturyLink's Mr. Bonsick also testified that CenturyLink is experiencing continued "access line erosion" of 7-8% each year. CenturyLink Statement 3.1 at 11.

77. AT&T, as but one long distance competitor, suffered a massive drop in the access minutes it obtained from RLECs between 2004 and 2008. AT&T Statement 1.0, at 31.

78. At least in part, consumers are deciding to forgo wireline service in favor of wireless service because they perceive traditional wireline long distance calls to be expensive, but wireless long distance calls to be "free." AT&T Statement 1.0, at 45.

79. That perception results from the fact that IXCs must pay access rates of several cents per minute on each end of the call, while, under the FCC's directives, wireless carriers terminate most intrastate calls for 7/100ths of a cent per minute. AT&T Statement 1.0, at 45.

80. The RLECs have acknowledged that "rate subsidization is not sustainable in a competitive environment." *Buffalo Valley 2003 Filing* at 11. They have advocated that "***implicit subsidies in access charges must be removed*** and access services must be based primarily on the cost to provide the service." *Id.* (emphasis added).

81. In 2002 and 2003, Buffalo Valley conceded that:

> Charging high access rates in order to subsidize below cost local service rates places Buffalo Valley at a severe disadvantage in the competitive marketplace. [T]he continued existence of access charge rates that are above cost constitute a barrier to effective competition for toll services.[9]

82. In a filing with the FCC, CenturyLink (then Embarq) acknowledged the need for intrastate access reform:

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[9] *Buffalo Valley 2003 Filing*, at i; *Buffalo Valley 2002 Filing*, at i; *Conestoga 2002 Filing*, at ii, 12.

> Nearly everyone in the industry agrees that intercarrier compensation and universal service need comprehensive reform. The Commission has long recognized that today's intercarrier compensation rules treat "identical uses of the network differently, even though such disparate treatment usually has no economic or technical basis." That breeds "opportunities for regulatory arbitrage" and distorts "incentives for inefficient investment and deployment."
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> *2008 CenturyLink FCC Petition*, at 1 (footnotes omitted).[10]

B. Reductions In Access Rates Will Benefit Consumers And Competition.

83. While the present system of high access charges is both harmful and unsustainable, reductions in access charges will benefit Pennsylvania consumers. AT&T Statement 1.0, at 42-45.

84. **The Benefits Of Reduced Long-Distance Rates.** First, just as high access costs result in higher long-distance rates, reductions in access costs will lead to lower long-distance rates. AT&T Statement 1.0, at 42.

85. As a matter of economic principle, decreases in the incremental costs of producing a service lead to a decrease in retail prices for that service, and the lower prices will, in turn, stimulate demand. AT&T Statement 1.0, at 42.

86. Even a pure monopolist, including one which is completely unregulated, will reduce price in response to a reduction in input costs, because that is the response that maximizes profit. AT&T Statement 1.0, at 42; AT&T Statement 1.2, at 48; AT&T Statement 1.4, at 4.

87. The market for long distance communication is highly competitive, and the competitive pressures in today's market reinforce the normal incentive for IXCs to reduce prices

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[10] *In re Petition for Waiver of Embarq Local Operating Companies of Sections 61.3 and61.44-61.48 of the Commission's Rules, and any Associated Rules Necessary to Permit it to Unify Switched Access Charges Between Interstate and Intrastate Jurisdictions*, WC Docket No. 08-160, Petition for Waiver of Embarq (filed Aug. 1, 2008) ("*2008 CenturyLink FCC Petition*").

in response to a reduction in access costs. AT&T Statement 1.0, at 42; AT&T Statement 1.2, at 48; Hearing Tr. at 186.

88. From a pragmatic perspective, there is nothing remarkable in the fact that wholesale cost reductions will result in lower retail prices. AT&T Statement 1.0, at 42.

89. AT&T presented compelling evidence that, in 19 states that have reduced intrastate switched access rates to "parity" with the corresponding interstate rates, its own long-distance prices have dropped even more than its access costs. AT&T Statement 1.2, at 47 & Attachment 8 thereto; AT&T Statement 1.4, at 4, 24-25; Hearing Tr. at 186.

90. The evidence in Pennsylvania is even more compelling. Since 2004, AT&T's average in-state long distance rate in Pennsylvania has in fact been below the average intrastate access rate of RLECs (see Attachment H to AT&T Statement 1.0), and AT&T has reduced its toll rates as much as or even more than the access reductions it has realized. AT&T Statement 1.0, at 59; AT&T Statement 1.4, at 21-22.

91. AT&T has made the same commitment here in Pennsylvania that it made (and implemented) in New Jersey to reduce its Instate Connection Fee and certain prepaid calling card charges once access reductions occur. AT&T Statement 1.0, at 59; AT&T Statement 1.2, at 50.

92. In response to the New Jersey Board of Public Utilities' decision to lower intrastate access rates, AT&T has already lowered its New Jersey in-state connection fee for residential consumers by over 30%. Likewise, AT&T lowered the in-state connection fee for small businesses by 30%. AT&T Statement 1.2 at 50 & Attachment 9 thereto.

93. Based on the uncontroverted evidence that toll rates are in fact reduced by at least as much as access reductions, in this highly competitive marketplace, Pennsylvania consumers will see savings when access reductions are implemented.

94. **The Benefits Of Fair Competition.** In addition to the benefits from reduced long-distance prices, rebalancing access rates and local rates creates the proper pricing signals in the market and allows for more competition to thrive. AT&T Statement 1.2, at 50.

95. By keeping local rates artificially low, implicit (or even explicit) subsidies stifle competition to the detriment of customers. AT&T Statement 1.2, at 50.

96. By readjusting the market to create better pricing signals, carriers are encouraged to operate more efficiently in order to reduce their costs because they can no longer rely on subsidies to survive, and so other newer competitors will be encouraged to enter the RLECs' territories and offer more services and options to the RLECs' customers. AT&T Statement 1.2, at 50-51.

97. CenturyLink's own Dr. Staihr recognized this fact when he testified:

> In situations where retail rates have been suppressed to remain at artificially low levels for years it is more difficult for competitors to successfully enter a market and compete against those unnaturally low retail rates. And when this happens, customers are ***hurt***, not helped, by these artificially low rates because customers are denied choices of other providers who may indeed have a legitimate cost advantage or efficiency advantage but cannot act on it due to these unreasonably low retail rates. The solution would be, in areas where rates have been artificially suppressed for years, allow the market to set those rates. [11]

98. **The Benefits of Reduced Arbitrage.** Reductions in intrastate switched access rates will reduce the incentives for arbitrage that the present regime encourages. AT&T Statement 1.0, at 42-44; AT&T Statement 1.2, at 52-58.

99. Some local providers, spurred on by the ability to benefit from high access rates, have developed programs that encouraged the creation of "call pumping" schemes where

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[11] AT&T Statement 1.2, at 52 (citing *I/M/O* the *BPU's Investigation Regarding the Classification of Incumbent Local Exchange Carrier (ILEC) Services as Competitive*, NJ BPU Docket No. TX07110873, Rebuttal Testimony of Brian K. Staihr, January 29, 2008, at 40).

services are provided to chat rooms, adult services, and other questionable services that intentionally generate high volumes of access traffic in order to drive up revenues from high access rates. AT&T Statement 1.0, at 42-44; AT&T Statement 1.2, at 52-58.

100. As the Iowa Public Utilities Board recognized in putting a stop to "traffic pumping" schemes in that state, "it is the level of intrastate access rates, in part," that makes such arrangements both "possible and profitable."[12]

101. While the chat lines and other services used in traffic pumping arrangements appear "free" to the end user that calls them, they impose costs on all Pennsylvania consumers, even those who do not use those chat lines or other services. When customers call these "free" numbers, the customers' long distance carriers are billed access charges to terminate the calls. These charges can run in the millions of dollars on an annualized basis. In turn, the access costs that IXCs incur to terminate "free" porn and chat lines end up being paid by all of the IXCs' customers. AT&T Statement 1.2, at 53-54, 57-58.

C. The RLECs' Arguments Against Access Reform

102. Both the RLECs themselves, and the Commission, recognized years ago that using high intrastate access rates to subsidize local rates, thereby keeping local rates artificially low, cannot be sustained in a competitive environment. ALJ Schnierle 1998 Recommended Decision at 6.; *Global Order*, at 27 (adopting ALJ Schnierle's conclusions); *Buffalo Valley 2003 Filing*, at 11.

103. One of the RLECs that is a party to this case previously argued that "rate subsidization is not sustainable in a competitive environment." *Buffalo Valley 2003 Filing*, at

[12] *Qwest Communications Corp. v. Superior Telephone Co-operative*, No. FCU-07-2, Final Order at 57 (Iowa Utils. Bd. Sept. 21, 2009).

11. It also stated that "implicit subsidies in access charges must be removed and access services must be based primarily on the cost to provide the service." *Id.*

104. CenturyLink filed a petition with the FCC in which CenturyLink (then Embarq) argued that its intrastate access rates should be reduced, and that intrastate and interstate switched access rates should be the same. *2008 CenturyLink FCC Petition*, at 20.

105. CenturyLink's FCC comments acknowledge that "reduced intrastate switched access charges would benefit carriers, and ultimately their end-user customers, by promoting greater competition for intrastate toll calling." *2008 CenturyLink FCC Petition*, at 20.

106. Nevertheless, the RLECs now claim that access reform would be harmful to Pennsylvania. CenturyLink Statement 1.0, at 17-18; PTA Statement 1, at 17-20.

107. The RLECs first claim that they will not be able to invest or maintain the network if they lose access revenues. CenturyLink Statement 1.0, at 6, 20; PTA Statement 1, at 18.

108. The Commission rejects the RLECs' claims that they will not be able to invest or maintain their networks if they lose access revenues. Essentially, the RLECs are contending that, in a highly competitive environment, they cannot survive if they are not subsidized by other carriers and that argument is not sustainable. AT&T Statement 1.2, at 27.

109. Arguments that a carrier must be subsidized to receive a fixed level of revenue in order to survive are remnants of a monopoly era that is long gone. AT&T Statement 1.2, at 27-28.

110. The five companies that generate the most access volumes are all multi-state, billion dollar entities. These companies are certainly capable of competing on their own without being heavily subsidized by their competitors and long distance companies. AT&T Statement 1.2, at 25.

111. The RLECs claim that they are competitively disadvantaged because they have "carrier of last resort obligations" that competitors do not share. PTA Statement 1, at 29; CenturyLink Statement 1.0, at 22-23.

112. The Commission finds this argument to be a red herring. For one thing, despite having multiple rounds of testimony to do so, the RLECs do not point to any Pennsylvania law, Commission rule, or Commission order that imposes any such obligations exclusively on them (and not on other carriers), nor are they able to identify areas where they have service obligations not borne by others. AT&T Statement 1.4, at 20-21; Hearing Tr. at 171-176 (Nurse/Oyefusi).

113. Likewise, the RLECs do not provide any estimate of the costs attributable to such obligations. AT&T Statement 1.4, at 21; PTA Statement 1, at 29; Hearing Tr. at 332 (Lindsey); Hearing Tr. at 595-96 (Zingaretti).

114. Absent some showing of specific obligations and specific costs, the Commission has no basis for concluding that the massive subsidies in existing access rates are necessary or reasonable in order to support carrier of last resort obligations.

115. The Commission's order in this case gives the RLECs the opportunity to recover any reductions in intrastate access revenues ordered herein. The RLECs may obtain revenues first from their own customers, and then on a transitional basis through explicit payments from the state USF. AT&T Statement 1.2, at 29.

116. The Commission finds that reasonable rebalancing of local service rates, coupled with transitional support from the universal service fund, is the proper way to ensure that the RLECs are able to meet any COLR obligations they may have – not to perpetuate implicit subsidies from excessively high access rates. AT&T Statement 1.2, at 29.

117. The RLECs claim that access reform will destroy universal service. This assertion is not supported by any evidence. AT&T Statement 1.2, at 30; AT&T Statement 1.4, at 11.

118. Many states have already implemented access reform, yet the RLECs produce no evidence that access reform led to the catastrophic results they allege here in any state. AT&T Statement 1.2, at 30; AT&T Statement 1.4, at 12 & n.13.

119. The evidence shows that the RLECs are vigorously promoting more expensive bundled services to their customers, and more and more customers are voluntarily moving towards those more expensive bundles. AT&T Statement 1.2, at 31. In fact, only 20% of CenturyLink's customers are even purchasing standalone basic local service. Hearing Tr. at 322-323 (Harper).

120. Having a system where all of the RLECs' retail rates are artificially suppressed through implicit subsidies does not promote universal service, but merely ensures the RLECs are protected from competition. This is not a proper policy goal. AT&T Statement 1.2, at 31; AT&T Statement 1.4, at 13-14.

121. In an effort to oppose access reform and rebalancing of local rates, CenturyLink submitted a survey that purported to investigate possible consumer reactions to hypothetical price increases. CenturyLink Statement 2.0, at 5-8.

122. The Commission finds that CenturyLink's survey is unpersuasive and entitled to no weight. CenturyLink itself does not give such surveys any weight in conducting its own business. CenturyLink was not able to cite any instance where it used a similar survey in any state where CenturyLink has increased its retail rates. AT&T Statement 1.2, at 39-40.

123. The exact magnitude and timing of each consumer's reaction, whether drastic or gradual, instantaneous or over a longer period, depends on many real-world factors that are not easy to predict through a survey. CenturyLink's own Dr. Staihr, who oversaw the survey, testified in another case that price is not the only factor in determining how consumers will act.[13]

124. CenturyLink's survey made no attempt to account for other real-world factors that would affect customers' responses to the survey questions. For example, CenturyLink's survey asked a few people about price increases for local service in the abstract, without advising those people that they might also see price decreases for wireline long distance. AT&T Statement 1.2, at 42.

125. CenturyLink's survey asking customers whether they would be willing to spend more money was conducted from December 21-23 – two to four days before Christmas. CenturyLink's survey results did not attempt to take into account whether customers' reactions may vary due to the timing of the survey. Hearing Tr. at 314 (Harper).

126. CenturyLink's survey did not advise respondents that they might buy local service as part of a package or bundle of services, nor did it advise them of the various packages and bundles available. AT&T Statement 1.2, at 42.

127. CenturyLink did not advise the survey respondents that competitors might also raise their prices. AT&T Statement 1.2, at 42-43.

128. Rather than rely on a hypothetical survey that was created and conducted solely for litigation purposes, CenturyLink should have provided evidence about its real-world experience of consumer responses to actual price increases. AT&T Statement 1.2, at 40.

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[13] AT&T Statement 1.2, at 41-43 (citing *I/M/O the BPU's Investigation Regarding the Classification of Incumbent Local Exchange Carrier (ILEC) Services as Competitive*, NJ Board of Public Utilities ("BPU") Docket No. TX07110873, Rebuttal Testimony of Brian K. Staihr, January 29, 2008).

129. CenturyLink has increased rates both in Pennsylvania and in other states throughout the country, so there was no need to conduct a survey to see how customers might react to hypothetical price increases. AT&T Statement 1.2, at 40.

130. The evidence does not support CenturyLink's conclusion from its survey – that customers will leave CenturyLink due to price increases. AT&T Statement 1.2, at 40-41.

131. To the contrary, the evidence shows that CenturyLink's customers are in fact moving ***away*** from lower priced services, and moving ***towards*** higher priced bundled services. AT&T Statement 1.2, at 44-45; Hearing Tr. at 322-323 (Harper).

132. The evidence shows that the number of customers who left CenturyLink at a time of price increases was no different than those who left during years with no price increases. AT&T Statement 1.2, at 41.

133. In addition, in New Jersey, after seeking and obtaining wide discretion to increase local prices, CenturyLink aggressively exercised that discretion and increased local residential rates twice by $3.00 and $2.50 over 13 months, and the evidence did not show that customers migrated away from CenturyLink due to those price increases. AT&T Statement 1.2, at 41. Just as in Pennsylvania, CenturyLink believes that the New Jersey market is competitive. Hearing Tr. at 42 (Bonsick).

134. The evidence regarding the PTA companies' data related to customer reactions to price increases also does not support the conclusion that customers are leaving or will leave an RLEC due to increases in local rates. Hearing Tr. at 600-605 & AT&T Cross Ex. 5.

135. The Commission also finds it telling that, in the recent proceedings regarding the merger between CenturyLink and Embarq, CenturyLink refused to commit that it would keep local service rates at $18 per month if the Commission lifted the current caps on those rates. In

fact, CenturyLink called such $18 rate cap unreasonable. Hearing Tr. at 330 (Lindsey) & AT&T Cross Ex: 3.

136. At the hearing in this case, CenturyLink's witness openly acknowledged that it was *not* wedded to the $18 cap as a benchmark for local rates, and suggested that it might support a higher level benchmark. Hearing Tr. at 426 (Bonsick).

137. The Commission rejects the RLECs' arguments that access revenue decreases cannot be recovered through local rate increases, particularly with the Pennsylvania USF used as an additional transitional recovery mechanism, and finds that the evidence compels reductions in the RLECs' intrastate switched access rates.

D. Whether IXCs Should "Contribute" To The Cost Of Local Loops.

138. The OCA and OSBA argue that the access charges paid by IXCs should include a contribution towards the cost of local loops. OSBA Statement 1, at 5-7; OCA Statement 1, at 69-75.

139. This issue has already been resolved by the market. Today, long-distance providers are competing against e-mail, social networking websites, Internet services providers, text messaging, and wireless carriers, all of which are largely immune from subsidy-laden access charges. AT&T Statement 1.3, at 7; AT&T Statement 1.4, at 28.

140. Attempting to force long-distance providers to make large "contributions" towards the cost of local loops, when their competitors do not, is both discriminatory and anti-competitive. AT&T Statement 1.3, at 7; AT&T Statement 1.4, at 28.

141. The OSBA appears to acknowledge this unfairness, and the ideal outcome from the perspective of the OSBA and OCA would be to have other providers (such as wireless

carriers) also pay access charges that contribute towards the cost of local loops. OCA Statement 1, at 11; Hearing Tr. at 94 (Wilson).

142. The OSBA and OCA both admit, however, that the Commission has no authority to impose access charges on such carriers. OCA Statement 1, at 11; Hearing Tr. at 95 (Wilson).

143. Thus, the OCA advocates that access charges paid by IXCs be reduced to the respective interstate rates, in order to achieve a more level and fair competitive playing field. OCA Statement 1, at 10; Hearing Tr. at 478 (Loube).

144. The Commission agrees, and notes that it simply following the path it already chose in the 1999 *Global Order*, in approving access charge reductions in 2003, and in opening this proceeding.

145. Further, the Commission notes that no party provided any data to show how much of the current high access rates are actually contributing to the loop. AT&T Statement 1.2, at 46.

146. The Commission declines to assume that the current access rate levels must be maintained for eternity without any showing of how much of each company's access rates are contributing or should be contributing to the loop. AT&T Statement 1.2, at 46.

147. The Commission finds that bringing intrastate access rates to parity with interstate rate levels and structures does not reduce intrastate access rates all the way down to the direct incremental cost of access service. AT&T Statement 1.3, at 7; AT&T Statement 1.4, at 28.

148. Because interstate access rates are above the incremental cost of access, even with reducing intrastate access rates to parity with interstate rates, the RLECs' intrastate access rates will still include a contribution to the cost of local loops. AT&T Statement 1.3, at 6, 8.

III. If The RLECs' Intrastate Switched Access Rates Should Be Reduced, To What Level Should They Be Reduced And When?

A. Rate Levels

149. **Reducing Intrastate Rates To "Parity" With Interstate Rates.** In the *Global Order*, the Commission found that "there is no functional difference between access provided on an interstate or an intrastate basis," so that "any pricing differential that may exist will give an incentive to IXCs, upon whom ILECs rely to identify the volume of terminating interstate and intrastate traffic, to report lesser usage in the higher cost venue." *Global Order* at 51-52.

150. Thus, the Commission found, 'in order to avoid tariff arbitrage, it is extremely important that intrastate access charges mirror their federal counterpart." *Global Order* at 51-52 (citing the rural ILECs' witness Mr. Laffey's testimony; emphasis added).

151. As in the *Global Order*, the Commission agrees with the OCA, AT&T and Sprint that the RLECs' intrastate switched access rates must be reduced to parity, in rate structure and level, to the RLECs' corresponding interstate rates.

152. The bulk of the access reductions will involve the immediate elimination of the Carrier Common Line ("CCL") charge, which does not exist on the interstate side and which has no cost basis. AT&T Statement 1.2, at 20.

153. Reducing intrastate access rates to "parity" with the corresponding interstate rates has several benefits over and above the benefits already described above that will flow from access reductions in general. AT&T Statement 1.0, at 42-46.

154. Implementing "parity" will be administratively simple. The RLECs can implement "parity" by simply revising their intrastate access tariffs to state that they mirror the corresponding interstate access tariffs, which are (and always have been) publicly available. AT&T Statement 1.2, at 20.

155. Alternatively, carriers can simply take the rates and items from their publicly filed, interstate access tariffs and "cut and paste" them into their intrastate access tariffs. AT&T Statement 1.2, at 20.

156. Given that the RLECs have already been charging interstate rates on interstate calls, they already have systems and processes in place to charge the same rates on intrastate calls. AT&T Statement 1.3, at 15-16.

157. Unified rates have the potential to reduce RLEC billing costs, if for no other reason than they will only have one set of rates to administer instead of two. AT&T Statement 1.0, at 42.

158. Just as the Commission recognized in the *Global Order*, adopting symmetrical rates and rate structures will help to avoid problems associated with "call pumping," "phantom traffic" and similar arbitrage schemes. AT&T Statement 1.0, at 42-43; AT&T Statement 1.2, at 52-58; AT&T Statement 1.3, at 20.

159. Disputes over "call pumping" and "phantom traffic" have resulted in a great deal of confusion and litigation. In fact, in recent past, several PTA companies have filed formal complaints against carriers in Pennsylvania over these exact issues, claiming that the carriers have refused to pay intercarrier compensation to the RLECs, and have disguised the traffic sent. AT&T Statement 1.0, at 43 (citing complaints by Laurel Highland, Buffalo Valley, and Palmerton, Docket Nos. C-2009-2108366, C-2009-2105918 and C-2009-2093336).

160. Such disputes will be reduced once intrastate and interstate switched access rates are set at the same levels and share the same rate structure. AT&T Statement 1.0, at 43.

161. In 2008, CenturyLink (then Embarq) told the FCC that:

> arbitrage is fueled in particular by wide disparities between interstate and intrastate terminating switched access rates. Those

> rate disparities are common and they are the widest in rural areas where lower population densities result in increased per-customer costs. Further, due to high costs in rural areas, limited population size, and increasing competition (which targets lower-cost service areas), regulators cannot expect local subscribers of rural carriers to bear the costs of regulatory arbitrage.
>
> *2008 CenturyLink FCC Petition*, at iv.

162. CenturyLink acknowledged that having the same rates for inter- and intrastate access will "reduce administrative costs" and "create[ ] a more stable and predictable system of levying access charges." *2008 CenturyLink FCC Petition,* at 28.

163. CenturyLink's comments acknowledge that maintaining markedly different inter- and intrastate switched access rates creates incentives for carriers to misreport traffic, but that with inter- and intrastate rates as the same level "Embarq would no longer be at the mercy of [wholesale] customer estimate of PIU factors . . . " and that "customers would have significantly less motive to misreport traffic or PIC factors in the first place." *2008 CenturyLink FCC Petition*, at 28.

164. CenturyLink also acknowledged in its FCC comments that having the same rates for inter- and intrastate access will reduce CenturyLink's access billing costs and will reduce its costs of litigating access disputes. *2008 CenturyLink FCC Petition*, at 28.

165. Although the PTA did not put forth a specific proposal in its pre-filed testimony as to the levels to which intrastate access rates should be reduced, PTA's witness testified at the hearing that the FCC stated its intention to mirror intrastate access rates to interstate leavels, and that is consistent with the PTA proposal. Hearing Tr. at 591-592 (Zingaretti).

166. **The Verizon/Qwest Proposal**. Verizon and Qwest propose that the RLECs reduce their intrastate switched access rates to match the intrastate rates currently charged by Verizon.

167. The Commission finds Verizon's intrastate access rate to be an inappropriate target for other carriers. AT&T Statement 1.3, at 15-17.

168. The Verizon/Qwest proposal does not fix the disparity between interstate and intrastate access rates. Verizon's intrastate rates are higher than most carriers' interstate rates, so making those carriers match Verizon on the intrastate side means that most carriers will continue to charge higher rates for intrastate traffic than for interstate traffic. AT&T Statement 1.3, at 15.

169. That disparity will continue to create arbitrage opportunities, including incentives for carriers to disguise intrastate traffic as interstate and engage in other schemes to artificially increase their intrastate access revenues. AT&T Statement 1.3, at 15.

170. The Verizon/Qwest proposal results in higher administrative costs and inefficiency. AT&T Statement 1.3, at 15-16.

171. The Verizon/Qwest proposal would require carriers to implement new procedures (so they can charge rates that only Verizon charges today). AT&T Statement 1.3, at 15-16.

172. In addition, carriers would still be charging different rates for interstate and intrastate traffic, so the present inefficiencies of keeping two sets of rates in place will be perpetuated. AT&T Statement 1.3, at 15-16.

173. The Commission further notes that the PTA itself advocates that intrastate switched access rates be reduced to parity with interstate rates, on the grounds that this approach best harmonizes with the FCC's intent at the federal level. Hearing Tr. at 591-592 (Zingaretti).

174. Accordingly, the Commission concludes that intrastate switched access rates should be reduced to parity with the corresponding interstate rates, rather than parity with Verizon's intrastate rates.

B. Timing of Reductions

175. The Commission has pledged a comprehensive solution to high intrastate access charges for over a decade. AT&T Statement 1.4, at 1.

176. The landmark 1999 *Global Order* reduced access rates, but recognized that it was not the "last word" on access reductions, and promised full access reform by the end of 2001. *Global Order*, at 58-59.

177. The Commission approved additional access rate reductions in July 2003, and reaffirmed that it would move forward on comprehensive access reform. *Access Charge Investigation per Global Order of September 30, 1999, et al.*, Docket Nos. M-00021596, et al., Order of July 15, 2003 at 12.

178. The Commission first opened this investigation in 2004, but delayed the investigation and consideration for several years. AT&T Statement 1.4, at 1.

179. While the RLECs argue that the time is not ripe for access reductions, these companies have been on notice for over ten years that the Commission intended to complete access reform and eliminate implicit subsidies in intrastate access rates. AT&T Statement 1.2, at 24.

180. The Commission finds that meaningful access reform is overdue, that Pennsylvania consumers have waited long enough to receive the benefits of such reform, and that further delay in implementing access charge reductions would be untenable.

181. The Commission further notes that the access rate reductions ordered herein would not fully eliminate implicit subsidies, but would only reduce such subsidies by mirroring reforms that the FCC adopted (and that the RLECs have been working with) nearly a decade ago for interstate calls.

182. In that respect, this order represents another reasonable, measured step in the process of intrastate access reform, not a "flash cut."

183. The Commission further finds that the RLECs have already had ample notice of the Commission's goal that intrastate access rates be reduced, and that the 1999 and 2003 access charge reductions provide a sufficient and orderly transition for access rates, particularly in light of the opportunities this Order provides for RLECs to recover the reductions in access revenues that will result from the rate reductions ordered herein.

184. The Commission accordingly rejects the RLECs' arguments that the benefits of reform should be further delayed by implementing the access reductions herein over an additional multi-year transition period.

185. While the Commission rejects the use of a transition period for reducing the RLECs' access rates, the Commission establishes a reasonable transition period for revenue neutral rate recovery and rebalancing the basic local service rates paid by retail consumers.

186. **FCC Proceedings.** The Commission opened this proceeding in 2004, but delayed moving forward based on erroneous RLEC arguments that the FCC would soon implement comprehensive reform of all intercarrier charges.

187. After four years of delay, the Commission rejected the RLECs' continued arguments that the Commission wait for the FCC to act, and reopened this proceeding.

188. In its pre-filed testimony, the PTA and CenturyLink nonetheless advocated that the Commission continue to wait for FCC action, notwithstanding the considerable time and effort expended by the parties to develop the evidentiary record. PTA Statement 1, at 49; CenturyLink Statement 1.0, at 48.

189. At the hearing, however, the PTA's witness Mr. Zingaretti modified the PTA position, stating that the PTA's true goal was that the Commission "harmonize[]" its own actions with the FCC's policies, and that the PTA position is not that a decision in this case should be delayed. Hearing Tr. at 591 ("My position is that they need to be harmonized. And that doesn't mean having to wait ....").

190. Mr. Zingaretti further acknowledged that reducing intrastate access rates to "parity" with the corresponding interstate rates would satisfy the PTA's goal of "harmony" with the FCC. The Commission agrees. Hearing Tr. at 592 (Zingaretti).

191. In this regard, the Commission notes that the FCC recently delivered to Congress a *National Broadband Plan*[14] authored by an FCC task force which recognized that (i) intrastate and interstate switched access rates "were set above cost" to "provide[] an implicit subsidy to keep residential rates low" and (ii) that intrastate and even *inter*state access rates – which are well below the RLECs' *intra*state rates in Pennsylvania – are *still* above cost. *National Broadband Plan*, at 142.

192. Moreover, the Broadband Plan recognized that "[t]he current ICC [InterCarrier Compensation] system is not sustainable" and "creates opportunities for access stimulation." Broadband Plan at 142.

193. Page 148 of the Broadband Plan encourages states to engage in intercarrier compensation reform that is consistent with the reforms adopted in this order to reduce intrastate access rates and rebalance local rates:

> The FCC should also encourage states to complete rebalancing of local rates to offset the impact of lost access revenues. Even with SLC increases and rate rebalancing, some carriers may also need support from the reformed Universal Service Fund to ensure adequate cost recovery. When calculating support levels under the

[14] Connecting America: The National Broadband Plan, available at http://www.broadband.gov/plan/8-availability.

> new CAF, the FCC could impute residential local rates that meet an established benchmark. Doing so would encourage carriers and states to "rebalance" rates to move away from artificially low $8–$12 residential rates that represent old implicit subsidies to levels that are more consistent with costs.

194. Waiting for the FCC to implement these reforms in Pennsylvania would be untenable. It would not make any sense to spend the time and resources on developing a full record on the need for access reform in Pennsylvania just to then stall a decision to wait for FCC action that is uncertain, at best. AT&T Statement 1.2, at 59.

195. There is no indication that the FCC is going to act any time soon. Indeed, the FCC is instituting some 60 rulemakings to address the numerous recommendations of the Broadband Plan, and the rulemaking on intercarrier compensation is not scheduled to even begin until the fourth quarter of 2010. Hearing Tr. at 590-91 (Zingaretti); AT&T Cross Ex. 4.

196. Moreover, given the ever-growing list of states implementing intrastate access reform and given the Broadband Plan's encouragement of such state action, there is no reason to believe that the FCC would act in a way that harms those states. To the contrary, the *National Broadband Plan* (143 n.65, 148) recommended taking into account state actions. AT&T Statement 1.4, at 5-6, 30-31.

197. Chairman Cawley, in a recent Motion in a case involving a RLEC attempting to obtain access payments due from another carrier, observed that "we do not need and cannot afford to wait and speculate whether the FCC will reach some sort of coherent and sustainable solution to its IP-enabled services and intercarrier compensation reform proceedings, when this might happen, and what the FCC's conclusions might be." *Palmerton Telephone Co. v. Global NAPS South, Inc.*, Docket No. C-2009-2093336, Motion of Chairman James H. Cawley, Feb. 11, 2010, at 15; AT&T Statement 1.2, at 59-60.

198. Most recently, the Commission lifted the stay on the Verizon intrastate access case, again noting that there has been no substantial action at the FCC, and it is unclear whether the FCC will act anytime soon."[15]

199. Other states have moved forward with reform of intrastate switched access rates and rejected arguments that such reforms be delayed based on the possibility of FCC action at some indefinite future date. As a recent example, New Jersey, like Pennsylvania, is a net payor into the federal USF, and, therefore, faces the same "risk" as Pennsylvania in moving forward with access reform ahead of FCC action. AT&T Statement 1.2, at 60.

200. The New Jersey Board, however, rejected arguments that it wait for FCC action (arguments advanced by some of the same LECs appearing in this case) and moved ahead with intrastate access reform:

> The Board also HEREBY FINDS that the Board need not to wait for federal action from the FCC or from Congress on Intrastate Access Rate issues. As the Board stated in its December 2008 Order, the Board regulates Intrastate Access Rates and it is within the Board's authority to review the complete record in this proceeding and render its decision.[16]

201. Based on the need for intrastate switched access reductions, the recommendations in the *National Broadband Plan*, and the actions of other states, the Commission finds that there is no need to delay reform for intrastate switched access rates.

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[15] Opinion and Order, *AT&T Communications of Pennsylvania, Inc. v. Verizon North Inc. and Verizon Pennsylvania Inc.*, Docket No. C-20027195; May 11, 2010, at 17-18.

[16] *I/M/O the Board's Investigation and Review of Local Exchange Carrier Intrastate Exchange Access Rates*, NJ BPU Docket No. TX08090830, Order, February 1, 2010, at 27.

IV. IF THE RLECS' INTRASTATE SWITCHED ACCESS RATES SHOULD BE REDUCED, HOW SHOULD ANY REVENUE REDUCTIONS BE RECOVERED IN COMPLIANCE WITH 66 Pa.C.S.A. 3017?

A. Retail Rate Increases

202. For purposes of this case, a "benchmark" is a rate that would be established for determining the rate at which RLECs would be assumed to raise their basic local service rate for purposes of recovering any access revenue reductions, after which any remaining access revenue reductions would be recovered on a transitional basis through the Pennsylvania Universal Service Fund ("PaUSF"). See AT&T Statement 1.2, at 4.

203. **Initial Benchmark.** The Commission finds that an initial benchmark of $22 per month best satisfies the Commission's goals of (i) maintaining reasonable and affordable rates for local service and (ii) allowing RLECs the opportunity to recover access revenue reductions, while keeping the PaUSF at a reasonable level. AT&T Statement 1.2, at 5-14.

204. Seven years ago, the Commission set the residential local exchange services rate cap at $18 per month, finding it a just and reasonable rate. AT&T Statement 1.2, at 5.

205. Adjusting that rate for the inflation that has occurred since then would result in a rate of $21.97 per month, or, rounded to the nearest whole dollar, $22 per month. AT&T Statement 1.2, at 5.

206. The OSBA agrees that the $18 cap should be updated for inflation, if not eliminated entirely. Its proposed benchmark of $21 is based on an inflation adjustment through 2009, while AT&T's $22 benchmark adopted herein is based on an inflation adjustment through 2010, which is when this case will be decided. AT&T Statement 1.3, at 8 & n.8.

207. The $22 benchmark is well within the range of affordable rates. AT&T Statement 1.2, at 9-12.

208. The OCA presented evidence in the rate cap case before ALJ Colwell that the affordable bill for customers is between $32.00 and $42.91/month, inclusive of fees and surcharges.[17]

209. The PTA testified in the rate cap/USF phase of this proceeding that surcharges and fees add up to about $8.57. Direct Testimony of Joseph Laffey on behalf of PTA, Docket No. I-00040105, December 10, 2008, at 5.

210. Thus, after deducting fees and surcharges, the OCA affordability analysis yields results for basic rates in the range of $23.43-$34.34 per month, well above the $22 benchmark. AT&T Statement 1.2, at 9.

211. No party presented any evidence disputing that a rate of $23.43 per month is an affordable rate. To the contrary, the evidence demonstrates that such a rate is conservative, and may be well below the affordability level. AT&T Statement 1.2, at 9-12.

212. On cross-examination, the OCA's Dr. Loube admitted that an affordable basic local service rate would be within the $22-$23 per month range. Hearing Tr. at 508 (Loube).

213. Moreover, there is substantial evidence that a large percentage of consumers already spend well in excess of $22 per month for telephone service. AT&T Statement 1.2; at 9-11.

214. The industry is moving towards bundles, and the RLECs themselves are targeting their marketing towards bundles, so the number of standalone lines is steadily decreasing. AT&T Statement 1.2, at 10 & Attachment 3 thereto. Only 20% of CenturyLink's customers even purchase its standalone basic local service. Hearing Tr. at 322-323 (Harper).

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[17] Transcript from Rate Cap case of Docket No. I-00040105 at 131-132. *See also* Schedule RDC-5 attached to OCA Statement 2.0 (Colton) from Rate Cap case at Docket No. I-00040105.

215. In the rate cap/USF phase of this proceeding, CenturyLink's data demonstrated that its customers on average are paying much higher rates than the $22 per month benchmark. The majority of CenturyLink's customers now are on bundles, spending an average of $57.63 per month as of December 2008. AT&T Statement 1.2, at 10.

216. End users across the country pay $50.00 or more on bundled packages and other services from newer technologies such as wireless and broadband where prices are free of subsidies. AT&T Statement 1.2, at 10.

217. A recent article in the New York Times reported that, according to US Census data, the average American spent about $771 annually in 2004 on services like cable television, Internet connectivity and video games, a figure that translates to more than $64 per month. AT&T Statement 1.2, at 10-11.

218. **OCA's Proposed Benchmark.** The Commission finds the OCA's proposed benchmark of $17.09 to be unreasonable.

219. Given the Commission's finding that $18 was a reasonable rate seven years ago, the OCA's proposed $17.09 prospective benchmark is unrealistically low. AT&T Statement 1.2, at 6.

220. The $17.09 benchmark will place too much of a burden on the state USF. That benchmark would cause the USF to triple in size – expanding from approximately $33 million to over $97 million. Hearing Tr. at 484-85 (Loube); OCA Statement 1, at 16, 17; AT&T Statement 1.2, at 12-13.

221. The record fully developed in the rate cap/USF phase of this proceeding before ALJ Colwell demonstrated that such a large USF is not prudent or necessary to protect customers. As ALJ Colwell found:

> The PA USF is a fund which exists because the ratepayers of other telecommunications providers have paid the money, unwittingly, as a hidden tax. It 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. All parties agree that the concept of universal service is a worthy one. This fund should be reconstructed to provide assistance to those customers who need it, and for those companies who can meet a stringent test for determining that they serve an area whose costs are so high that the company itself deserves extra help for that area alone.
>
> At some point, the market is meant to rely on competition to keep rates affordable. Institutionalizing the PA USF in its present form to provide subsidies to companies who do not have to prove need will not assist the market in reaching its goals and will, instead, provide barriers to entry for new carriers.
>
> Recommended Decision of ALJ Susan Colwell, Docket No. I-00040105, July 22, 2009, 87-88.

222. The OSBA testified in the rate cap/ USF phase of the proceeding that "You can't have competition and at the same time provide general subsidies." Direct Testimony of Allen G. Buckalew, Docket No. I-00040105, Dec. 10, 2008, at 12.

223. A $22 per month benchmark would temporarily increase the state USF by $19.6 million in the first year, far less than the approximately $64 million increase that would be required with a $17.09 benchmark. Hearing Tr. at 489 (Loube); AT&T Statement 1.2, at 14.

224. The OCA's proposed benchmark is based entirely on its argument that all RLEC local rates should be "comparable" to Verizon's statewide average rates. OCA Statement 1 at 13-15; see also Hearing Tr. at 480-81 (discussing "comparability standard").

225. Although the PTA did not present any pre-filed testimony on an appropriate benchmark level, for the first time at the hearing, the PTA witness stated that PTA would support a benchmark rate of $18.94 per month. Hearing Tr. at 585 (Zingaretti).

226. The PTA's benchmark proposal of $18.94 per month is based entirely on the PTA's comparability analysis presented in the proceeding before ALJ Colwell. Hearing Tr. at 585 (Zingaretti).

227. Judge Colwell explicitly rejected the OCA and PTA proposed rate cap/benchmarks, finding them to be based on a "flawed standard of comparability." ALJ Colwell Recommended Decision at 82, n.18.

228. The Commission's own legal counsel has rejected the "comparability" arguments, explaining that the federal standard of comparability "pertains to federal universal service and is not a mandate to state Commissions" and "has no bearing on rural ILECs' receipt of monies from the PaUSF."[18]

229. Adopting the OCA or PTA proposed benchmarks would be in direct conflict with ALJ Colwell's Recommended Decision in the rate cap/USF phase of this docket.

230. The Commission is crafting basic rates for use when RLEC access rates have been reduced and reformed. The OCA and PTA "comparability standard" is based on a comparison to Verizon's rates. It is wholly inappropriate to establish a benchmark based on Verizon basic rates that are still supported by implicit access subsidies. AT&T Statement 1.2, at 8.

231. **Increases In Benchmark Over Time.** The Commission adopts AT&T's proposal that the $22 monthly rate benchmark be increased by $1 each year in the first three years following this Order. AT&T Statement 1.2, at 4, 14-16.

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[18] *Buffalo Valley Telephone Company, et al. v. Pennsylvania Public Utility Commission; No. 847 C.D. 2008; Popowsky v. Pennsylvania Public Utility Commission, No. 940 C.D. 2008;* Advance Form Brief of Respondent Pennsylvania Public Utility Commission at 38. The Commonwealth Court upheld the Commission's arguments on comparability in its decision issued on December 15, 2009.

232. Allowing the benchmark to increase by $1 each year will allow rates to keep pace with inflation. AT&T Statement 1.2, at 14.

233. A uniform $1 per month increase also simplifies the process and ensures that after the initial catch-up adjustment to $22, all residential customers are subject to the same potential level of annual price increases. AT&T Statement 1.2, at 14.

234. While it certainly would be possible for the Commission to precisely identify the impact of inflation each year, the $1 per month increase is a reasonable proxy and will yield judicial economy in its administration and provide stability, certainty and transparency during the reform transition, sparing the Commission and the parties from unnecessary, time-consuming, and uncertain proceedings devoted solely to determining a precise inflation factor. AT&T Statement 1.2, at 14-15.

235. By increasing the benchmark, the demands on the PaUSF would decrease each year as the RLECs transition to recover more of their revenues from their own end-user retail customers. AT&T Statement 1.2, at 15.

236. Under the OCA's proposal, the benchmark depends entirely on the average statewide rate charged by Verizon. OCA Statement 1, at 13-15.

237. As a result, the OCA proposal would result in USF payments of $97 million to the RLECs each year, and those payments would continue indefinitely so long as Verizon's basic local service rates remain the same. Hearing Tr. at 491 (Loube).

238. In addition, OCA's Dr. Loube acknowledged on cross-examination that USF payments to the RLECs would remain at over $97 million per year so long as Verizon's basic local service rates remain the same, even if all or a large majority of RLEC customers transition to unregulated "bundles" or leave the RLEC for a competitor. Hearing Tr. at 487-88.

239. The Commission finds it inappropriate to subsidize RLEC lines where the customer is already paying the price that the market will bear for a "bundle" of services, or where the customer has left the RLEC for a competing provider (making it clear that that the customer has an alternative to the RLEC). AT&T Statement 1.4, at 9-10.

240. The OCA's benchmark is contingent upon a modification of the USF rules (and possibly the law) to expand the pool of contributing providers (for example, to require wireless carriers to contribute a percentage of intrastate revenues) which would substantially delay the day that Pennsylvania consumers realize the benefits of already-overdue access reform. OCA Statement 1 at 16-17; Hearing Tr. at 494-95 (Loube).

241. Absent an expansion of USF contributors, the percentage of revenues that service providers have to contribute to the USF would nearly triple. Hearing Tr. at 493-94 (Loube).

242. As the present proceeding demonstrates (taking a year before a recommended decision is issued and longer for a final Commission decision), and as the USF/rate cap case before ALJ Colwell demonstrates (where the Commission opened the case April 24, 2008; a recommended decision was issued July 22, 2009; and a final decision has yet to be issued), and as the OCA's Dr. Loube acknowledged at the hearing, the proceedings to modify the USF rules could take a year or more. Hearing Tr. at 495.

243. In addition, after the rulemaking is over, affected carriers are likely to appeal, further delaying the implementation of access reform. Hearing Tr. at 518 (Loube).

B. Pennsylvania USF

244. The OCA proposes that the majority of access reductions be recovered through USF support, an approach that would nearly triple the USF, from its present size of $33 million

to $97.3 million. Hearing Tr. at 484-85 (Loube); OCA Statement 1, at 16, 17; AT&T Statement 1.2, at 12-13.

245. The Commission finds AT&T's approach to reflect a reasonable balance between the competing concerns expressed by Verizon and the OCA: (i) that the USF not be unnecessarily or permanently expanded, while (ii) that Pennsylvania consumers not see unreasonably large or sudden increases in local service rates.

246. Under AT&T's approach, RLECs would be permitted (but not required) to raise local service rates up to an initial $22 benchmark, resulting in a temporary increase in the USF by $19.1 million (as compared to the over $60 million increase that would result from the OCA's proposal). AT&T Statement 1.2, at 4, 12-14.

247. For the following three years, the monthly benchmark would increase by $1 each year, resulting in a monthly benchmark rate of $25, while reducing USF support to only $1 million per year. AT&T Statement 1.2, at 4, 14-15; Attachment 5 to AT&T Statement 1.2.

248. As a result, other carriers and their customers would not have to subsidize the RLECs in perpetuity. AT&T Statement 1.2, at 14.

249. Over time, as RLECs are required to seek to recover a greater portion of their revenues from their own end-user customers, the RLECs' customers will be receiving appropriate price signals and the RLECs will have increased incentives to innovate and become more efficient. AT&T Statement 1.2, at 14.

250. In the *Global Order,* the Commission anticipated the USF should be reduced and/or eliminated as markets became more competitive. It is therefore an appropriate result to transition down any revenue recovery from the USF.

251. It is also appropriate to gradually reduce the transitional universal service funding because RLECs should not lock in their current levels of access revenues when all of the evidence demonstrates those revenues are already decreasing each year in response to issues unrelated to their rates, *e.g.,* competition. AT&T Statement 1.2, at 16 & Attachment 4 thereto.

252. Access revenues are declining each year as IXCs lose traffic to competitors not saddled with the access subsidy obligation. AT&T Statement 1.2, at 16 & Attachment 4 thereto (providing discovery responses from PTA and CenturyLink).

253. Access rate reform should not be used as a windfall to the RLECs or to lock in their current levels of access revenues which are otherwise continuing to decline as competition intensifies. AT&T Statement 1.2, at 16.

254. The RLECs are not currently protected against access revenue decreases each year, and those revenues will continue to decline if the Commission takes no action. AT&T Statement 1.2, at 16.

255. The Commission finds that the USF should not put the RLECs in a *better* position than they would otherwise be, or protect them from losses they would incur through the normal operation of the competitive market. AT&T Statement 1.2, at 16.

256. For all these reasons, AT&T's proposed approach to USF support best serves the Commission's goals.

AT&T'S PROPOSED CONCLUSIONS OF LAW

I. Background.

1. The RLECs are all "incumbent local exchange telecommunications companies" as defined by 66 Pa. C.S. §§ 3012 and 3017.

2. The Commission has jurisdiction over all of the RLECs, and the Commission has authority to reduce each RLEC's intrastate access rates to levels that comply with Pennsylvania law and Commission precedent. Intrastate access charges are non-competitive services and are therefore within the Commission's jurisdiction.

3. When the Commission finds that a public utility's rates are unjust, unreasonable, or discriminatory, it must determine just, reasonable, and non-discriminatory rates. *See* 66 Pa.C.S.A. §1309(a).

4. The Commission is obligated by law to resolve complaints that a telephone company's rates are unjust and unreasonable. *See* 66 Pa.C.S.A. §1309(b).

II. Should RLECs' Intrastate Switched Access Rates Be Reduced?

5. The RLECs' intrastate access rates are unjust and unreasonable in violation of 66 Pa § 1301, which requires that rates be just and reasonable.

6. The existing intrastate switched access charges are neither just nor reasonable, as they (i) fall disproportionately on one type of long-distance communications (wireline long distance service), (ii) substantially exceed interstate charges for the same service, thereby creating arbitrage opportunities, disputes, and inefficiencies, and (iii) can no longer be sustained in today's competitive environment.

7. The RLECs' intrastate access rates violate 66 Pa.C.S.A. §3011(3), which states that it is the policy of the Commonwealth to "[e]nsure that customers pay only reasonable charges for protected services which shall be available on a nondiscriminatory basis."

8. The existing intrastate switched access charges are neither reasonable nor "nondiscriminatory." IXCs must pay large switched access charges, while their competitors (*e.g.*, wireless service, e-mail, social networking websites) do not, at least not in the same way or to the same extent as IXCs.

9. *Intra*state rates that are several times higher than the corresponding interstate rates, when there is no logical basis for the distinction in charges, are not "reasonable."

10. The RLECs' intrastate access rates violate 66 Pa.C.S.A §3011(4), which states that it is the policy of the Commonwealth to "[e]nsure that rates for protected services do not subsidize the competitive ventures of telecommunications carriers."

11. The RLECs have acknowledged they face substantial competition in their respective service territories. As local exchange service has become increasingly competitive, access charges are subsidizing RLEC "competitive ventures."

12. The RLECs' intrastate access rates violate 66 Pa.C.S.A §3011(5), which states that it is the policy of the Commonwealth to "[p]rovide diversity in the supply of existing and future telecommunications services and products in telecommunications markets throughout this Commonwealth by ensuring that rates, terms and conditions for protected services are reasonable and do not impede the development of competition."

13. IXCs must pay large intrastate switched access charges to complete intrastate long distance calls in the RLECs' territories, while other technologies do not incur access costs in the same way. Given the substantial losses in wireline minutes over the past several years, it is clear

that the RLECs' existing intrastate switched access rates impede the development of competition by IXCs and reduce the diversity of supply.

14. The existing, vastly different access schemes for different types of competitors, which severely handicap one type of competitor (wireline long distance), do not "provide diversity in the supply of existing and future telecommunications services and products" but discourage the supply of one type of competitive service.

15. Because RLECs are using access subsidies to maintain local exchange rates at artificially low, subsidized rates, they are discouraging entry from other potential competitors and impeding the development of competition in local exchange service.

16. The RLECs' intrastate access rates violate 66 Pa.C.S.A. §3011(8), which states that it is the policy of the Commonwealth to "[p]romote and encourage the provision of competitive services by a variety of service providers on equal terms throughout all geographic areas of this Commonwealth without jeopardizing the provision of universal telecommunications service at affordable rates."

17. The existing intrastate access rates do not promote or encourage the provision of competitive long-distance service on equal terms, because IXCs must pay large intrastate switched access charges to complete intrastate long distance calls, while other technologies do not incur access costs in the same way.

18. The existing intrastate access rates are used to maintain the RLECs' local exchange rates at artificially low, subsidized rates, and do not promote or encourage the provision of competitive local exchange service by a variety of service providers on equal terms.

19. The RLECs' intrastate access rates violate 66 Pa.C.S.A. §3011(9), which states that it is the policy of the Commonwealth to "[e]ncourage the competitive supply of any service in any region where there is market demand."

20. The existing intrastate access rates do not encourage the competitive supply of long-distance service, because IXCs must pay large intrastate switched access charges to complete intrastate long distance calls, while other technologies do not incur access costs in the same way.

21. The existing intrastate access rates are used to maintain local exchange rates at artificially low, subsidized rates, thereby discouraging competitive supply of local exchange service.

III. IF THE RLECS' INTRASTATE SWITCHED ACCESS RATES SHOULD BE REDUCED, HOW SHOULD ANY REVENUE REDUCTIONS BE RECOVERED IN COMPLIANCE WITH 66 Pa.C.S.A. 3017?

22. Chapter 30's section 3017 states: "The commission may not require a local exchange telecommunications company to reduce access rates except on a revenue-neutral basis." 66 Pa.C.S.A. § 3017(a).

23. By permitting RLECs to (i) raise local service rates up to a reasonable benchmark, and (ii) obtain transitional support from the Pennsylvania universal service fund for any access revenue reductions that would not be recovered by implementation of the benchmark rates, the Commission has given the RLECs sufficient opportunity to recover any access revenue reductions and thereby satisfied the requirements of section 3017(a).

24. Section 3017 does not require the Commission to guarantee the RLECs that they will always receive the same dollar amount of revenues they are making today. Such a guarantee would be contrary to the RLECs' price-cap regulation.

25. Section 3017 does not require the Commission to protect the RLECs from losses that they would incur through the normal operation of the competitive market, or to lock in the RLECs' current levels of access revenues, which are otherwise continuing to decline as competition intensifies.

C

PROPRIETARY ATTACHMENT 3

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MATERIAL FOLLOWS:

NO SCANNED IMAGE AVAILABLE

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