COMMONWEALTH OF PENNSYLVANIA
PENNSYLVANIA PUBLIC UTILITY COMMISSION
P.O. BOX 3265, HARRISBURG, PA 17105-3265

IN REPLY PLEASE
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July 11, 2007

I-00040105
P-00981428F1000
R-00061375
P-00981429F1000
R-00061376
P-00981430F1000
R-00061377

DOCUMENT
FOLDER

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Investigation Regarding Intrastate Access Charges and IntraLATA Toll Rates of Rural Carriers and The Pennsylvania Universal Service Fund
(I-00040105)
2006 Annual Price Stability Index/Service Price Index Filing of Buffalo Valley Telephone Company
(P-000981428F1000/R-00061375)
2006 Annual Price Stability Index/Service Price Index Filing of Conestoga Telephone & Telegraph Company
(P-00981429F1000/R-0061376)
2006 Annual Price Stability Index/Service Price Index Filing of Denver & Ephrata Telephone & Telegraph Company
(P-00981430F1000/R-00061377)

To Whom It May Concern:

This is to advise you that the Commission in Public Meeting on July 11, 2007 has adopted an Opinion and Order in the above entitled proceeding.

An Opinion and Order has been enclosed for your records.

Very truly yours,

James J. McNulty
Secretary

encls
cert. mail
JF
See attached list for additional parties of record.

PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17105-3265

Public Meeting held July 11, 2007

Commissioners Present:

Wendell F. Holland, Chairman
James H. Cawley, Vice Chairman, Dissenting Statement attached
Terrance J. Fitzpatrick
Tyrone J. Christy, Dissenting
Kim Pizzingrilli

Investigation Regarding Intrastate Access Charges And IntraLATA Toll Rates of Rural Carriers and The Pennsylvania Universal Service Fund	I-00040105
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OPINION AND ORDER

BY THE COMMISSION:

Before the Commission for consideration are the Exceptions, filed on March 14, 2007, by the Verizon Companies[1] (Verizon) to the Recommended Decision (R.D.) of Administrative Law Judge (ALJ) Susan D. Colwell, issued February 22, 2007. Replies to Exceptions were filed by Denver and Ephrata Telephone and Telegraph Company (D&E), Conestoga Telephone and Telegraph Company (Conestoga) and Buffalo Valley Telephone Company (Buffalo Valley) (collectively The D&E Companies), the Office of Small Business Advocate (OSBA), and the Office of Consumer Advocate (OCA) on March 26, 2007.

This matter is the result of a proceeding conducted pursuant to our Order entered November 15, 2006 (November 15th Order) and the provisions of 66 Pa. C.S. § 703(g), to reconsider our Orders entered June 23, 2006 (June 23rd Orders).[2]

In our June 23rd Orders, we allowed the D&E Companies to raise intrastate access charges consistent with the proposals included in their 2006 annual PSI/SPI filings. The proceedings initiated by our November 15th Order were to determine, whether based on the record, any rescission or amendment would be warranted by the evidence, consistent with our access charge reform and universal service policies, and lawful under the D&E Companies' Chapter 30 plans. (November 15th Order, slip op. at 15).

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[1] The Verizon Companies include Verizon Pennsylvania Inc., Verizon North Inc., Verizon Select Services Inc., Bell Atlantic Communications, Inc. d/b/a Verizon Long Distance, Verizon Global Networks, Inc., MCImetro Access Transmission Services LLC d/b/a Verizon Access Transmission Services, and MCI Communications Services, Inc. d/b/a Verizon Business Services.

[2] The Docket Numbers for each of the D&E Companies' June 23rd Orders are as follows: Buffalo Valley – P-00981430F1000 and R-00061375; Conestoga P-00981429F1000 and R-00061376; and D&E – P-00981430F1000 and R-00061377.

In the Recommended Decision, presiding ALJ Colwell recommended that no rescission or amendment of the June 23rd Orders are warranted by the evidence. *See* Recommended Ordering Paragraph No. 1. On consideration of the Recommended Decision, the record, and the Exceptions and Replies, we shall grant the Exceptions of Verizon consistent with our discussion in this Opinion and Order. Accordingly, we shall reject the recommendation of the presiding ALJ and, hereby, rescind and amend our June 23rd Orders. As such, the proposed increases to access charge rates is expressly rejected consistent with this Opinion and Order and the D&E Companies shall be permitted to recover their allowable 2006 revenue in any manner consistent with this determination and their Chapter 30 plans.

History of the Proceeding

On April 28, 2006, the D&E Companies filed their 2006 Annual PSI/SPI Chapter 30 filings. The filings were made under the provisions of Act 183 of 2004, P.L. 1398 (66 Pa. C.S. §§ 3011-3019), which repealed the prior Chapter 30 law, and pursuant to The D&E Companies' Alternative Regulation and Network Modernization Plan (NMP).

The D&E Companies' Annual PSI/SPI filings determine the allowable changes in rates for noncompetitive services based upon the annual change in the Gross Domestic Product Price Index (GDP-PI). Based on the change in GDP-PI for the years 2004 and 2005, the filings of The D&E Companies produced an overall 3.70% allowable increase for noncompetitive revenues. See R.D. Finding of Fact Nos. 7-9, *infra*.

In the 2006 Annual PSI/SPI filings, the D&E Companies generally proposed increasing non-basic local service rates and intrastate access charges.[3]

However, in each company filing, the overwhelming majority of the rate increases were allocated to access services. The percentage rate increases for each of the companies and allocated to access services were as follows: Conestoga – 99%, Denver & Ephrata – 96% and Buffalo Valley – 77%.

By identical Orders entered June 23, 2006, (June 23rd Orders), this Commission found that the D&E Companies' 2006 PSI/PSM filings were in partial compliance with their Amended Chapter 30 Plans. The Commission had two specific concerns with regard to the D&E Companies' filing. Those concerns were the proper calculation of allowable revenue increases and the proposed increases allocated to intrastate access service rates. The proposed increase in access rates appeared to be contrary to the Commission's intrastate access charge reform policy.

Based on the foregoing, in our June 23rd Orders we directed the D&E Companies to correct their calculations. We further gave the companies the option to "bank" the allowable increases or to allocate such increases to basic local exchange services rather than to access rates. We also gave the companies a third option, to put the access services rate increases into effect, but subject to any final determinations on access charge reform, including the pending intrastate access reform proceeding at Docket No. I-0004015.

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[3] Buffalo Valley was the only D&E Company that proposed small increase in local services rates.

The D&E Companies chose the third option, to increase access rates with the 2006 Annual PSI/SPI filing and not to reallocate the allowable rate increases to local service rates or bank the allowable increase for future use. On June 28, 2006, The D&E Companies revised their PSI/SPI calculations as directed by the Commission to arrive at the correct allowable revenue increases and filed revised tariff rates to reflect those calculations. The compliance tariffs were permitted to become effective on July 1, 2006. Accordingly, the D&E Companies' access service rate increases were placed in effect subject to a final determination that would result from this Commission's access charge reform proceedings which, at the time of the Order, expressly included the proceedings at Docket No. I-00040105, or changes mandated by related federal proceedings.

Shortly after the D&E Companies' 2006 PSI/SPI filing rates went into effect, on or about August 30, 2006, the Rural Telephone Company Coalition (RTCC),[4] OCA, the Commission's Office of Trial Staff (OTS), and The United Telephone Company of Pennsylvania d/b/a Embarq Pennsylvania (Embarq Pennsylvania), filed a Joint Motion in which they requested the Commission further stay the pending intrastate

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[4] The RTCC consists of the following rural incumbent local exchange carriers: Windstream Pennsylvania, Inc. f/k/a ALLTEL Pennsylvania, Inc., Armstrong Telephone Company – PA, Armstrong Telephone Company-North, Bentleyville Communications Corporation, d/b/a The Bentleyville Telephone Company, Buffalo Valley Telephone Company, Citizens Telephone Company of Kecksburg, Commonwealth Telephone Company, Conestoga Telephone and Telegraph Company, Denver and Ephrata Telephone and Telegraph Company d/b/a D&E Telephone Company, Deposit Telephone Company, Frontier Communications of Breezewood, Inc., Frontier Communications of Canton, Inc., Frontier Communications of Lakewood, In., Frontier Communications of Oswayo River, Inc., Frontier Communications of Pennsylvania, Inc., The Hancock Telephone Company, Hickory Telephone Company, Ironton Telephone Company, Mahanoy & Mahantango Telephone Company, Marianna & Scenery Hill Telephone Company, The North-Eastern Pennsylvania Telephone Company, North Penn Telephone Company, North Pittsburgh Telephone Company, Palmerton Telephone Company, Pennsylvania Telephone Company, Pymatuning Independent Telephone Company, South Canaan Telephone Company, Sugar Valley Telephone Company, Venus Telephone Corporation, West Side Telephone Company and Yukon-Waltz Telephone Company.

access charge reform proceeding for another year or until the Federal Communications Commission (FCC) rules on its *Unified Intercarrier Compensation* proceeding. By Order entered November 15, 2006, we granted the Joint Motion. Thus, the intrastate access charge reform proceeding was stayed for another year, until November 15, 2007, or until the FCC rules on its *Unified Intercarrier Compensation* proceeding, which ever comes first.

Simultaneously with our granting of the Joint Motion, we directed the Office of Administrative Law Judge (OALJ) to hold expedited hearings for the limited purpose of reconsidering the June 23rd Orders directed to the D&E Companies. Reconsideration was with regard to that portion of the Order that allowed the D&E Companies to raise intrastate access charges. As noted, the proceedings on reconsideration were to determine whether any rescission or amendment of the June 23rd Orders is warranted by the evidence, taking into consideration the Commission's access charge reform and universal service policies, and whether the intrastate access charges are lawful under the companies' Chapter 30 Plans.[5]

Our Order also directed that the D&E Companies' revenues collected from increases in access charges be subject to refund depending upon the outcome of further hearings. We therefore directed that a Recommended Decision be issued on or before February 28, 2007. (November 15th Order, Ordering Paragraph No. 6).

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[5] On July 10, 2006, the D&E Companies also sought reconsideration of the Commission's June 23rd Order insofar as it directed the adjustment to the PSI/SPI and the criticisms regarding increases in intrastate access charges. The Commission by Orders entered on December 8, 2006 (December 8, 2006 Orders), denied both requests on the merits.

In our November 15th Order, we stated that:

> It is important to note that since the *Global Order* of September 30, 1999, this Commission has been lowering intrastate access charges in an effort to transition from a monopolistic to a competitive environment in rural areas within the Commonwealth. Generally, since *Global,* we have only discussed the reduction of access charges. The fact that we never expressly stated that increases to access charges were precluded until the next investigation was held, does not mean the Commission intended to carve out an exception to our general public policy rule of lowering intrastate access charges and allow for intermittent increases to intrastate access charges with rural ILEC PSI filings. Such a policy would cause problems in the administration of the Pennsylvania Universal Service Fund which depends upon annual recalculations regarding what is owed recipient carriers versus what contributors owe on an annual basis. To allow carriers to increase their intrastate access charges mid-year would cause problems in calculating support owed the recipient carriers, and calculating mid-year reductions in the overall size of the fund.

Order at Docket No. I-00040105, slip op. at 14.

Based on the foregoing, our November 15th Order directed investigation into the following issues:

> 1. Whether the increases in access service charges as a vehicle to recover the Company's allowable PSI revenues are consistent with law and policy;
>
> 2. Whether the increases as proposed violate the Chapter 30 provision that the Commission promote and encourage the provisions of competitive services by a variety of service providers on equal terms and throughout the geographic areas of the Commonwealth without jeopardizing reasonableness of rates or the provision of universal telecommunications service at affordable rates; and,

3. Whether the switched access services charges increases contradict Pennsylvania's attempt to reduce local carriers' dependence on access revenues and preserving the affordability of local rates.

In the Recommended Decision issued February 22, 2007, ALJ Colwell recommended that no rescission or amendment of the June 23rd Orders is warranted by the evidence. (R.D. at 34). Exceptions and Replies were filed as noted.

Discussion

A. Brief History of Access Charges[6]

Access charge refers to the compensation paid to local exchange carriers (LECs) for the use of their network by interexchange carriers (IXCs) and other telecommunications service providers. *See Global Order*[7] citing *Competitive Tele. Ass'n v. FCC*, 87 F.3d 522 (D.C. Cir. 1996). "Access rates are designed to recover a portion of the loop and switching costs of the local telephone company." (R.D. at 11; OSBA Stmt. 1 at 6). As noted in our *Global Order*:

> Access charges were established during a monopoly regime of telecommunications regulation at the local exchange level. Access charges provide a significant source of ILEC earnings and contain implicit and explicit subsidies for local rates. This combination of earnings and subsidy was approved

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[6] We adapt this discussion from the Recommended Decision. As noted by the presiding ALJ, a more thorough history of access charges appears in the July 15, 2003 Order in *Access Charge Investigation per Global Order of September 30, 1999*, M-00021596 (reproduced as Appendix B in the *Compendium of Common Orders* accompanying the D&E Main Brief). (R.D. at 12).

[7] *Re Nextlink Pennsylvania, Inc.*, Docket No. P-00991648; P-00991649, 93 PaPUC 172 (September 30, 1999)(*Global Order*); 196 P.U.R. 4th 172, *aff'd sub* nom. *Bell Atlantic-Pennsylvania, Inc. v. Pennsylvania Public Utility Commission,* 763 A.2d 440 (Pa.Cmwlth. 2000), *alloc. granted.*

> pursuant to a public policy of encouraging universally available and relatively affordable telecommunications services while providing earnings sufficient to attract stable investment in a national communications infrastructure. Consequently, public policy over time has resulted in a situation wherein higher cost areas, such as rural areas, with lower density cell rates and longer loop distances, obtain rate support from lower cost areas, such as urban areas with higher density cell rates and shorter loop distances. Access charges provide a source of earnings while keeping basic local service rates lower than might otherwise be the case in high cost areas.

(*Global Order*, 196 PUR 4th at ___).

Access charges are of two distinct types, special access and switched access. "Access charge reform" generally refers to the need to move these charges closer to cost. This policy is in recognition that access charges have, over time, and under a prior monopoly telecommunications regime, included implicit as well as explicit subsidies. Such implicit subsidies contained in access charges were permitted under the regulatory policy of, *inter alia*, providing for basic universal service at affordable rates. This Commission, as well as the FCC, acknowledged that a policy of implicit subsidies must be changed in light of competition in the local exchange telecommunications industry.

Access charge reform has been concerned primarily with switched access, as special access service has been deemed competitive for some time. *See Global Order*. Switched access charges are the rates charged by the D&E Companies to IXCs and other entities in providing switched access facilities in originating and terminating long distance calls to and on behalf of the companies' customers. Access services are "protected services" pursuant to the definition of "Switched Access Service" under Section 3012 of Act 183, 66 Pa. C.S. § 3012.

Switched access rate elements are designed to recover both "non-traffic sensitive" (NTS) and "traffic-sensitive" (TS) costs. The traditional major Switched Access Rate Elements include: (1) Carrier Common Line; (2) Local Switching; (3) Line Termination; (4) Intercept; and (5) Local Transport. The Carrier Common Line Charge (CCLC) is the only switched access rate element designed to recover NTS costs. Historically, the CCLC is the largest contributor to local service rates not directly related to costs. *See Global Order*. Thus, the Carrier Charge (CC) is the only switched access rate designed to recover non-traffic-sensitive costs. (R.D. at 11; D&E Main Brief at 2).

In our *Global Order*, the Commission, acting in tandem and compliance with FCC orders, reduced access charges of all local incumbent exchange carriers (ILECs) operating in Pennsylvania. Access charge reform, and the initial access charge reductions from the *Global Order*, proceeded on three tracks: (1) reforms addressed to Verizon (formerly Bell Atlantic-Pennsylvania, Inc. and GTE North Inc.); (b) reforms addressed to The United Telephone Company of Pennsylvania (now known as Embarq Pennsylvania); and (c) reforms concerning "Other" ILECs, which include the rural incumbent carriers (rural ILECs) of which the D&E Companies are a part.

Additionally, in our *Global Order* we established a Pennsylvania Universal Service Fund (PaUSF). The Pa USF was integrally related to achieving access charge reform. It was a fund to enable the rural LECs and Embarq to reduce access charges and intraLATA toll rates, while at the same time, ensuring that residential basic local service rates for these LECs would not exceed the designated price cap of (at that time) $16.00 per month. The *Global Order* also called for an investigation to be initiated in January 2001 to further refine a solution to the question of how the CC pool can be reduced and to consider the appropriateness of a toll line charge to recover any resulting reductions.

On July 15, 2003 at Docket Nos. M-00021596, P-00991648, P-00991649, M-00031694, M-00031694C0001, and P-00930715, this Commission entered an order

(July 15, 2003 Order) granting a Joint Procedural Stipulation filed by the RTCC, Sprint/United (Embarq), OTS, OCA, OSBA, AT&T Communications of Pennsylvania, Inc., Verizon and MCI WorldCom Network Services, Inc. The July 15, 2003 Order, *inter alia*, further reduced intrastate access charges for the rural telephone companies. This same Order also increased the cap on basic local service rates from $16.00 to $18.00 per month. The Joint Procedural Stipulation proposed generic modifications for access charges as:

> the next transitional step in access charge reform in Pennsylvania in an attempt to avoid a rate shock to Pennsylvania local telephone consumers. The Joint Proposal advocates a continuation of the current PaUSF under the existing regulations codified at 52 Pa.Code §§ 63.161-63.171, until a future rulemaking determines otherwise. The Joint Proposal requests further access charge reductions in a revenue-neutral method that are recovered not through an increase in the size of the PaUSF, but rather through gradual increases to local residential and business rates.
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> * * *
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> We commend the parties' united efforts in agreeing to one proposed access charge reduction plan at this time. The RTCC and Sprint/United [Embarq] have offered cost data to support their petition. The Commission has reviewed the cost data from the rural ILECs and Sprint/United [Embarq] and we are satisfied that the Joint Proposal, if implemented, will be revenue-neutral. At this juncture, the Commission is persuaded that the proposed access charge reductions are in the public's interest and in accordance with the Commission's objective to reduce implicit subsidy charges such as access charges that impede competition in the telecommunications market. As implicit charges become explicit charges, competitors are better able to compete for local and long distance customers in an ILEC's service territory because IXCs are not hindered by paying ILECs excessive access charges in providing competitive toll services and CLECs are better able to compete with ILEC local service rates that have been kept artificially low as a result of the access charge

> subsidies. Thus, although our approval of the Joint Proposal will allow the rural ILECs and Sprint/United to raise their local residential monthly service rates up to a cap of $18.00 per month, ($2.00 more than the current $16.00 cap), this increase is incremental so as to avoid customer rate shock, and, at the same time, encourages the IXCs, CLECs and wireless telecommunications carriers to compete on a more level playing field with the ILECs.

(Slip op. at 9-10).

The July 15, 2003 Order did not change the size of the PaUSF. Also, no regulations were promulgated to alter the regulations[8] governing the PaUSF or to terminate the fund. The Pa USF continues until a further rulemaking is completed.

On December 20, 2004, the Commission entered an Order (December 20, 2004 Order) instituting an investigation into whether there should be further intrastate access charge reductions and intraLATA toll rate reductions in the service territories of rural ILECs. This investigation was instituted as a result of the July 15, 2003 Order. The July 15, 2003 Order also provided that a rulemaking proceeding would be initiated no later than December 31, 2004, to address possible modifications to the PaUSF regulations and the simultaneous institution of a proceeding to address all resulting rate issues should disbursements from the PaUSF be reduced.

The December 20, 2004 Order directed the OALJ to conduct the appropriate proceedings including, but not limited to, a fully developed analysis and recommendation on the following questions:

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[8] The regulations governing the PaUSF are found at 52 Pa. Code §§ 63.161 – 63.171. There is no sunset provision.

(a) Whether intrastate access charges and intraLATA toll rates should be further reduced or rate structures modified in the rural ILECs' territories.

(b) What rates are influenced by contributors to and/or disbursements from the PaUSF?

(c) Should disbursements from the PaUSF be reduced and/or eliminated as a matter of policy and/or law?

(d) Assuming the PaUSF expires on or about December 31, 2006, what action should the Commission take to advance the policies of this Commonwealth?

(e) If the PaUSF continues beyond December 31, 2006, should wireless carriers be included in the definition of contributors to the Fund? If included, how will the Commission know which wireless carriers to assess? Will the Commission need to require wireless carriers to register with the Commission? What would a wireless carrier's contribution be based upon? Do wireless companies split their revenue bases by intrastate, and if not, will this be a problem?

(f) What regulatory changes are necessary to 52 Pa. Code §§63.161 – 63.171 given the complex issues involved as well as recent legislative developments?

Following the institution of the investigation directed by our December 20, 2004 Order, the FCC, on March 3, 2005, entered its order instituting an intercarrier compensation proceeding. *See* CC Docket No. 01-92 (FNPRM). The FCC is examining the intercarrier compensation system including interstate and intrastate access, reciprocal compensation and universal service.

By Order entered August 30, 2005, this Commission stayed the rural access charge investigation for a period not to exceed twelve months, unless extended by Commission Order, or until the FCC issues a ruling in its *Unified Intercarrier Compensation* proceeding. We further directed parties to submit status reports pertaining to related matters in the instant investigation and in the FCC's *Unified Intercarrier*

Compensation proceeding and to advise of the need for any coordination of these matters that may arise after the instant investigation is reinstated. We also stated that we shall entertain future requests for further stays of this investigation for good cause shown and for the purpose of coordinating this Commission's action with the FCC's ruling in its *Unified Intercarrier Compensation* proceeding. We noted that the FCC proceeding continues to have significant potential to directly impact, if not render moot, the issues in the instant proceeding.

Upon receipt of any forthcoming status reports, Commission Staff was directed to prepare a recommendation regarding the reinstitution of the investigation which was stayed, and the taking of any other appropriate action.

On or about August 30, 2006, status reports were submitted to the Commission by the RTCC, OTS, OCA, Embarq[9], Verizon, Sprint/Nextel Corp.,[10] the Wireless Carriers, and Qwest Communications. Additionally, the RTCC, OTS, OCA and Embarq filed a Joint Motion for further stay of investigation to which the other parties which filed status reports in objection. By Order entered November 15, 2006, at Docket No. I-00040105, the Commission subsequently granted the above Joint Motion and the rural access charge investigation was further stayed pending the outcome of the FCC's Unified Intercarrier Compensation proceeding at CC Docket No. 01-92 or for one year from the date of entry of the Order, whichever is earlier.

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9 The RTCC, OTS, OCA and Embarq filed a joint status report.

10 Sprint Nextel Corp. filed on behalf of Sprint Communications Company L.P., its interexchange and competitive local exchange carrier entity and its wireless entities operating in the state, Sprint Spectrum, L.P. d/b/a Sprint PCS and Nextel Communications, Inc., and NPCR, Inc. d/b/a Nextel Partners.

B. Brief Procedural History

A brief procedural history of the instant proceeding, excerpted from the Recommended Decision, is printed below:

> On April 28, 2006, Denver & Ephrata Telephone & Telegraph Company, Conestoga Telephone & Telegraph Company, and Buffalo Valley Telephone Company (collectively "Companies") filed their annual PSI/SPI Chapter 30 filings which determine the allowable change in rates for noncompetitive services based upon the annual change in the Gross Domestic Product Price Index. The Commission issued orders which permitted each proposed rate change to become effective after adjustment of the PSI/SPI procedure using actual year-end revenues from 2005. The Companies sought reconsideration of the Commission's Order insofar as it directed the adjustment to the PSI/SPI procedure, requesting reconsideration of the change directed in the revenue entitlement formula and addressing the criticisms regarding increases in intrastate access charges.
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> The Commission adopted an order at the public meeting of November 9, 2006, entered November 15, 2006 which directed the Office of Administrative Law Judge to conduct expedited hearings reconsidering the Commission orders of June 23, 2006 which had allowed the three telephone companies to raise intrastate access charges. The order directed that a recommended decision be issued on or before February 28, 2006, and a prehearing conference was scheduled and held on November 28, 2006.
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> * * *
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> At the prehearing conference, the Companies were represented by Michael L. Swindler, Esq., and Charles E. Thomas III, Esq.; the Office of Consumer Advocate (OCA) was represented by Joel Cheskis, Esq.; the Office of Small Business Advocate (OSBA) was represented by Steven C. Gray, Esq.; the Office of Trial Staff (OTS) was represented by

Johnnie E. Simms, Esq.; and the Verizon companies (Verizon) were represented by Suzan D. Paiva, Esq.

The Verizon Petition to Intervene was opposed by the Companies and argued at the prehearing conference by Verizon and the Companies. Verizon's intervention was granted by Order issued December 19, 2006.

* * *

A Scheduling Order was issued on November 28, 2006 . . .

On December 7, 2006, the Commission entered Orders which denied the D&E companies' Petitions for Reconsideration on the merits and affirmed that the three cases which are the subject of this Recommended Decision are not affected by those Orders.

The evidentiary hearing was held as scheduled on January 17, 2007, and resulted in a transcript of 171 pages. D&E presented Leonard J. Beurer, who sponsored D&E Statements, both proprietary and nonproprietary forms: 1, with exhibits 1 through 6; 1-R, with exhibits 1-R through 5-R; 1-SR, with exhibit 1-SR. Verizon presented Don Price, who sponsored, in both proprietary and nonproprietary forms, Statements: 1, with exhibits 1 through 10; 1.1, with exhibits 1 through 7; and 1.2. The OSBA presented Allen G. Buckalew, who sponsored Statement 1. OCA submitted its Statement 1-R, the rebuttal testimony of Dr. Robert Loube. Various cross-examination exhibits were also entered into the record.

Main and Reply Briefs were filed by D&E, Verizon, OCA and OSBA. In addition, D&E compiled a volume of relevant Commission Orders for ease of reference for Commission Staff in reviewing this Decision, Compendium of Common Orders. The fact that this was done within the extremely short period of time allotted for briefing makes what would otherwise be a simple task appear Herculean and worthy of commendation.

The matter is now ready for decision.

(R.D. at 1-4; notes omitted)

C. ALJ Recommendation

ALJ Colwell made 42 Findings of Facts and arrived at 11 Conclusions of Law. We shall specifically reject Finding of Fact No. 23,[11] consistent with our discussion in this Opinion and Order. The Findings of Fact are, however, incorporated herein by reference and are adopted without comment unless they are either expressly or by necessary implication rejected or modified by this Opinion and Order. Said Conclusions of Law are adopted, as modified by the discussion contained in this Opinion and Order. Conclusion of Law No. 11[12] is, expressly, rejected consistent with our discussion.

As noted, the presiding ALJ concluded that the June 23rd Orders should not be rescinded. Her pertinent reasoning in this regard is set forth below:

> While the Commission's stated policies in the pre-Amended Chapter 30 era indicated that the Commission's preference was to reduce access charges, three events preclude me from concluding that the stated policy is both still effective and strong enough to support a finding of unjust or unreasonable rate structure: (1) the new Chapter 30 changed the way that telephone companies are regulated; (2) the Commission began an investigation into access charges to scrutinize this very issue, which indicates that it was not comfortable with the way in which access charges were being figured; and (3) the Commission had sufficient information to make this finding in this matter when the Companies filed this rate case and the Commission declined to do so.

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[11] Finding of Fact No. 23 states: "None of the D&E carriers' post-Global rate filings had an impact on the PAUSF support levels because the access rates and revenue reductions associated with them were offset by local service rate increases, *i.e.*, the filings were revenue neutral thereby requiring no additional funding from the PaUSF. D&E Stmt. 1, p. 48."

[12] Conclusion of Law No. 11 states: "No Commission Orders expressly prohibit rural carriers from increasing access rates within the boundaries of the carriers' Amended Chapter 30 Plans as long as the resulting rates are just and reasonable."

> In the absence of a Commission determination regarding the proper method of figuring switched access rates, the Companies are in violation of no Commission regulation or Order. Neither did the Commission Orders implementing the stay of the [rural companies' access charge] investigation provide for a freeze on access rates pending the outcome of the proceeding. Without a finding of a violation of any Commission orders or regulations, there is no legal reason to disallow the rates as submitted.

(R.D. at 30-31; note omitted)[13]

D. Exceptions and Replies

Verizon filed six Exceptions to the Recommended Decision. We address each Exception in conjunction with the modified subject headings below.[14]

1. Effectiveness of Access Charge Reform After Act 183

In its Exception No. 1, Verizon objects to the ALJ's conclusion that the Commission's policy, pre-Act 183, to reduce ILEC access charges is no longer effective. (VZ Exc. at 6-14.). Verizon cites as evidence the several Commission Orders, beginning with the *Global Order*, and pronouncements regarding the policy to reduce access rates. These determinations are cited for the proposition that the 2006 filing of the D&E Companies is contrary to those declared policy objectives. Verizon finds it of extreme

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[13] In light of our finding that the proposed rate structure of the D&E Companies should be rejected, we make no finding regarding the contested or uncontested nature of Verizon's participation in this matter. *See* R.D., n. 11.

[14] Any issue or Exception that we do not specifically address has been duly considered and will be denied without further discussion. The Commission is not required to consider, expressly or at length, each contention or argument raised by the parties. *Consolidated Rail Corporation v. Pa. PUC*, 625 A.2d 741 (Pa. Commw. Ct. 1993); *see also, generally, Univ. of Pa. v. Pa. PUC*, 485 A.2d 1217 (Pa. Commw. Ct. 1984).

significance that the D&E Companies' access rates were acknowledged as above cost in a September 2001 rate rebalancing filing. *See* VZ Exc. at 8-9 citing Docket No. R-00016682 (November 30, 2001).

Verizon further elaborates on the July 15, 2003 Joint Proposal. Verizon draws a nexus between this Commission's deferring the opportunity to review detailed cost studies in support of the proposal and further deferring a comprehensive substantive evaluation of the small carriers' access rates based on the consideration that the Joint Proposal would not permit access rate increases as part of the companies' annual PSI filings unless the small carriers could prove that a particular access rate element does not recover its costs based upon the development of a cost study. (VZ Exc. at 11). Thus, Verizon finds it important to note that while adopting the Joint Proposal, the Commission held that it would not, at that time, require the small carriers to incur the expense of producing detailed cost studies because the compromise merely seeks to extend and continue additional access reform as initially begun in the *Global Order*. *Id.*

Verizon finally details the procedural dockets which immediately preceded the instant proceeding on reconsideration. (VZ Exc. at 12-14). It observes that, on August 30, 2005, at the request of the small carriers (including the D&E Companies), the Commission stayed its access charge investigation for a period of 12 months to await developments at the FCC regarding intercarrier compensation. It was during this period of the stay that the D&E Companies proposed to raise access rates in their 2006 Annual PSI/SPI filings. (VZ Exc. at 12). Verizon cites this Commission's December 8, 2006 Orders on Reconsideration at Docket Nos. R-00061375, R-00061376 and R-00061377, which reiterated a strong policy in favor of further access reductions as evidence that the Commission's policy to achieve access charge reform has not been changed by the enactment of Act 183. (VZ Exc. at 13).

The D&E Companies respond to Verizon's Exception No. 1 by taking the position that ALJ Colwell recognized the Commission's policy of reducing access charges. However, they reiterate their strongly-held view that the question raised is one of utility managerial discretion and absent a showing of an abuse of managerial discretion, and in the absence of an express determination by the Commission prohibiting its proposal to increase access rates, the Commission may not interfere with such managerial discretion. (R.Exc. at 7-9).

The D&E Companies also rely on the evidentiary presentation made in this case. Based on the evidence, the D&E Companies argue for affirmance of the June 23rd Orders. They rely on evidence to the effect that their access customers achieved a cumulative savings in excess of $30 million due to the D&E Companies' implementation of access charge reform directives since the *Global Order* and that access charges for the D&E Companies are below 19 of the 22 other rural telephone holding companies. (R.Exc. at 9 citing D&E Stmt. 1.1 at 23-24 and D&E Exh. 1).

In its Reply, OCA states that the fundamental issue is that the D&E Companies have not violated any Commission regulation or order by increasing their intrastate access rates. OCA states that the Commission's policies do not have the force and effect of law, but are only an indication of what action the Commission may take in response to a certain situation. *See* OCA Exc. at 4, 8, citing *Pa. Human Relations Comm'n v. Norristown Area School Dist.*, 473 Pa. 334, 374 A.2d 671 (1977) and *Pacific Gas & Electric Co. v. FPC*, 506 F.2d 33 (D.C. Cir. 1974).

In response to Verizon's Exception No. 1, OSBA states that it is reasonable for the ALJ to question whether the Commission's access charge policy was still effective. OSBA believes that the Commission was uncertain in the original June 23rd Orders addressing the D&E Companies' PSI/SPI filings. Thus, OSBA submits that the

Commission gave the D&E Companies three options regarding how to collect the increased noncompetitive service revenue calculated in their 2006 PSI/SPI filings.

OSBA believes that the policy of access charge reform faces a difficult hurdle in light of the enactment of Act 183. It respectfully submits that the Commission's access charge policy has been overtaken by events in the telecommunications industry. (R.Exc. at 10). These events include a change in the economic environment. The OSBA asserts that the old rationale for access reductions (i.e., that toll services were paying more than their fair share of the cost of the local network and access charges were seen as a hindrance to the development of competitive toll services and local exchange service) is no longer true. OSBA argues that toll carriers have been merged into local exchange companies, *e.g.* Verizon has acquired MCI and SBC has acquired AT&T. *Id.* Also, OSBA cites the testimony of its witness Buckalew, OSBA Stmt. 1, to note that the biggest threat to traditional wireline telephone companies is that competitors such as wireless carriers and VOIP over broadband are now providing service over two entirely different networks. Thus, the competitive environment that the Commission sought to stimulate with its access charge reform policies has "manifested" itself in the form of a dynamic, "intermodal" marketplace. (OSBA R.Exc. at 10-11).

OSBA also makes a statutory construction argument. OSBA argues that in Act 183, the legislature's stated goal of accelerating broadband deployment should take precedence over reducing intrastate access rates in the rural ILEC territories so as to gradually mirror interstate access charges and to bring about greater competition in those areas. (OSBA R.Exc. at 8, 12-13).

OSBA notes that Section 3017 of Act 183, 66 C.S. § 3017, prohibits the Commission from requiring a local exchange telecommunications carrier to reduce access charges except on a revenue neutral basis. (R.Exc. at 6). It argues that nowhere in the Act are access rate *increases* prohibited. *Id.* OSBA further asserts that under the D&E

Companies' Amended NMPs, only noncompetitive service revenue is to be included in the revenue total used in their PSI/SPI calculations. By definition, access charges are a noncompetitive service. (R.Exc. at 7 referring to Section 3012). Based on the foregoing, OSBA believes that the ILECs are only permitted to collect additional noncompetitive service revenue from noncompetitive services. And, unfortunately, the list of noncompetitive services that can be the source of this additional revenue includes local exchange rates and access charges.[15]

Disposition

We shall, consistent with the discussion in this Order, grant the Exceptions of Verizon. We are mindful of the necessity for this Commission, as a creature of statute, to give effect to the intent of the General Assembly in the enactment of Act 183. We do not, however, conclude that policy goals of access charge reform have been nullified as a result of Act 183. While Act 183 made changes to Chapter 30 and the regulation of LECs thereunder, the act retained several of the Commission's duties and also gave some additional powers and duties. *See* 66 Pa. C.S. § 3019(h).

Contrary to the interpretation of Section 3017 argued by OSBA, the absence of an express reference to access charge *increases* in Act 183 is more consistent with the view that the General Assembly was aware of, and approved, the Commission's direction in achieving access charge reform. That reform, while not prohibiting increases, *per se*, unequivocally encompassed removing implicit subsidies in these charges and moving them closer to cost.

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[15] OSBA also takes the position that the only way for toll to contribute to the development of broadband in Pennsylvania is through access rates. To the extent access is excluded, toll users get a "free ride," according to OSBA. (OSBA Stmt. No. 1, at 17-18).

Additionally, we note that the position of OSBA relative to the changing market realities in the telecommunications industry is well-taken. We do not, however, reach the conclusion that such market realities created by, *inter alia*, intermodal competition and the necessity for ILECs to increase revenues to meet an accelerated broadband deployment commitment to insinuate a movement toward the return to implicit subsidies in access rates. While the D&E Companies, OSBA, and OCA seem certain that the record does not establish the existence of such subsidies, we are not confident in the record in this matter. Based on the foregoing, we are reluctant to abandon a generic, industry-wide approach to achieve access charge reform for the accommodation of the D&E Companies based on the record in this proceeding. The record is not convincing for this step. And, the request for and grant of a stay in the generic proceedings gives us cause to decline the D&E Companies' proposal for equitable reasons.

With regard to OCA's position that general policies alone are not sufficient to determine rate levels in a company-specific proceeding, we again note that the record does not unequivocally establish the lack of subsidy. While OCA emphasizes the testimony of its witness Dr. Loube regarding subsidies, it states "it is not possible to assert the existence of a subsidy in this proceeding because no party to this case filed an incremental cost study." (OCA R.Exc. at 6, 7, citing OCA Stmt. 1-R at 10-11).

2. Should the June 23rd Orders Be Rescinded Absent An Express Prohibition in the Form of a Rate Freeze Against Access Rate Increases?

As noted, the presiding ALJ concluded that the Commission Orders that implemented a stay of the access charge investigation proceedings did not provide for a "freeze" on access rate increases during the pendency of the proceeding. As such, the ALJ reasoned that without a finding of a violation of any Commission order or regulation, there is no legal reason to disallow the rates as submitted. The ALJ also concluded that, in the absence of a Commission determination regarding the proper method of figuring

switched access rates, the Companies are not in violation of any Commission regulation or Order. *See* R.D. at 31.

In its Exception No. 2, Verizon excepts to the ALJ's recommendation and conclusion that only an express prohibition in a Commission Order or Regulation, and not the Commission's policy to reduce access charges, can support a finding of unjust or unreasonable rate structure pursuant to 66 Pa. C.S. § 1301. Verizon also is of the opinion that that the ALJ's argument, that the Commission had sufficient information to disallow access rate increases when the D&E Companies filed their annual PSI/SPI case, is moot because the Commission directed the ALJ to conduct these further hearings.

In response, the D&E Companies state that based on the totality of the evidence, the ALJ concluded that any Commission policy of reducing access rates of carriers was not strong enough to outweigh the Commission's approval of the D&E Companies' Chapter 30 Plans as well as the requirements of Act 183. The D&E Companies also claim that their Chapter 30 Plans expressly provide them the discretion to increase access charges within the boundaries of their plans as long as the resulting rates are just and reasonable. Thus, they believe that the Recommended Decision is balanced in approach and represents a well-reasoned result after weighing the evidence presented.

In its response, OCA emphasizes that the telephone companies should have the opportunity to propose access rate increases as just and reasonable under the facts for each company.

OSBA responded with a statutory interpretation of the goals of Act 183. Based on this position, OSBA states that the D&E Companies' decision to raise access charges did not violate Act 183.

Disposition

We note that an essential legal consideration raised in this proceeding involves the position of the D&E Companies, to some degree endorsed by OCA, that the question involved in its proposed rate increase for access rates purely turns on an analysis of utility managerial discretion. The D&E Companies correctly note that the issue is one of the appropriateness of rate design. *See* R. Exc. at 7. However, the D&E Companies also take the position that it is purely within the confines of their managerial prerogative and consistency with their Chapter 30 Plans that we must review and, therefore, accede to their proposed allocation of rate increases to access charges at this time. We disagree.

At page 7 of its Replies, the D&E Companies cite to *Pa. PUC v. Phila. Elect. Co.*, 522 Pa. 338, 561 A.2d 1224 (1989), for the proposition that in determining whether a rate is just and reasonable, the Commission must not interfere with managerial decisions of the utility, absent an abuse of discretion. The *Pa. PUC v. Phila. Elect. Co.* case involved this Commission's disallowance of claimed reimbursement for energy costs due to outages at Salem 1 and Peach Bottom nuclear plants. This Commission was upheld in substantial part for our disallowance of various costs claimed by the utility based on that utility's failure to observe a proper standard of care with regard to the maintenance and operations of those plants.

In the present case, we conclude that the goals of intrastate access charge reform counsel against approval of the D&E Companies' tariffs. This conclusion is reinforced by the record on reconsideration. *See Popowsky v. Pa. PUC*, 550 Pa. 449, 706 A.2d 1197 (1997). The position of the D&E Companies, while simultaneously acknowledging the need for continued progression toward access charge reform, is that it has made significant strides in this area. Thus, the D&E Companies strongly assert that they have been frontrunners in carrying out access charge reform in Pennsylvania. (R.Exc. at 9). Based on these considerations, the D&E Companies would distinguish

their circumstances from other LECs and depart from the industry-wide approach toward access charge reform. The D&E Companies assert that the allocation of the permitted revenue increases to access charges is necessary so as to avoid further increases in their basic local service rates. *See* Replies. It further supports this position by noting that its basic local service rates are among the highest in the state. *See* D&E Stmt. 1, at 43-55.

While the D&E Companies, as have several ILECs, made significant strides toward the industry-wide goals of access reform, we cannot conclude that the objectives which began even prior to our *Global Order* have been sufficiently realized so as to erode the generic approach at this juncture. Thus, while it may be necessary to revisit the status of access charge reform in the current environment, they very proceedings which would permit this to be accomplished have been voluntarily held in abeyance by the industry stakeholders. Thus, we are constrained to disallow the proposed allocation of the D&E Companies' revenue increase to intrastate access charges in advance of the pending access charge reform proceedings.

We expressly conclude that the question raised by the D&E Companies need not hinge on a mere conclusion as to whether or not the utility is in violation of an express Commission Order. We have afforded the D&E Companies substantial procedural opportunity to demonstrate, on the record, whether the deviation from our generic approach was appropriate. We conclude that the D&E Companies have failed to do so. The determination of just and reasonable rates, as the approval of a proposed rate structure, may involve a range of possibilities which, in and of themselves, are not unreasonable. However, we must exercise informed judgment in reaching a determination:

> The Commission is not required to accept, without question, all outputs of this complex cost study without the application of its informed judgment and administrative expertise. As

explained by Commonwealth Court in discussing rate structure:

> Rate structure, which is an essential, integral component of rate-making, is not merely a mathematical exercise applying theoretical principles. Rate structure must be based on the hard economic facts of life and a complete and thorough knowledge and understanding of all the facts and circumstances which affect rates and services; and the rates must be designed to furnish the most efficient and satisfactory service at the lowest reasonable price for the greatest number of customers, *i.e.*, the public generally.

Phila. Suburban Transportation Co. v. Pa. PUC, 281 A.2d 179 (Pa. Cmwlth. 1971).

> Likewise, we do not view the establishment of a rate structure for UNE rates as a mere mathematical exercise in which the Commission is bound to accept whatever rates are produced by the cost study computer program. Also, we note that TELRIC is not a specific formula, but rather, a collection of methodological principles. *See Sprint Communications Co. v. FCC*, 274 F.3d 549 (D.C. Cir. 2001).

(*Generic Investigation Re Verizon Pennsylvania Inc.'s Unbundled Network Element Rates*, Docket No. R-00016683 (December 11, 2003), slip op. at 44).

Based on the above, we shall grant Verizon's second Exception.

3. Has An Improper Subsidy Has Been Shown?

ALJ Colwell concluded that no evidence was presented to either support a finding that a subsidy does or does not exist. (R.D. at 17). The ALJ also concluded that there is no actual cost study to support a finding that the distribution of rates is either reasonable or not reasonable. *Id.*

In its Exception No. 3, Verizon points out that Section 315(a) of the Code, 66 Pa. C.S. § 315(a), requires that in any proceeding instituted upon a motion of the Commission involving any proposed or existing rate of any public utility, the burden of proof to show that the rate involved is just and reasonable falls upon the public utility. (Exc. at 18).

Verizon alleges that the D&E Companies' 2006 filings are in apparent disregard to the July 15, 2003 Order in which the Commission granted the rural companies joint access proposal for access charge reductions. As noted, under that proposal, the signatories proposed that access rates not be changed unless it could be proven that each access rate element recovers its cost based upon the development of a cost study. Verizon also references the arguments concerning the cost support based on the National Exchange Carrier Association (NECA). It characterizes the D&E Companies' argument that the disbursements received from the NECA average schedule process are somehow reflective of the costs for intrastate access rates as an attempt to confuse this issue. Verizon states that NECA information is irrelevant to the issue in this proceeding since the NECA process does not purport to be a measure of the D&E Companies' costs, but rather is a simulation intended to allocate disbursements. (Exc. at 19, Verizon St. 1.1 (Price Rebuttal at 28)).

Verizon also faults the ALJ for failing to consider a prior Commission Order[16] that found D&E's access rates to be above cost. Verizon depicts the filing at Docket No. R-00016682 as the beginning of the process toward eliminating the subsidization of local exchange service rates by inflated access rates. Verizon states that D&E indicated to the Commission at the time of that filing that it was intended as a reduction of subsidies from access charges and an attempt to bring intrastate access rates

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[16] *See PUC v. Denver and Ephrata Telephone and Telegraph Co.*, Docket No. R-00016682 (Opinion and Order entered November 30, 2001) at 3 (Attachment 1 to VZ Main Brief).

closer to the cost of providing the service. The filing was also made to prepare D&E to meet the challenges of competitive entry of other telecommunications providers into its service territory. (VZ Exc. at 9).

In response, the D&E Companies submit that they are average schedule companies and that FCC cost allocation rules are the only cost allocation rules known to exist for access services. The D&E Companies further add that use of NECA information as cost support is, in fact, justified by FCC rules and that the Commission has allowed the use of interstate rates for intrastate access. (R. Exc. at 13)

Disposition

Both the D&E Companies and OCA advance the position that the record adequately shows that their intrastate access rates are cost justified. This position is based on the testimony of the D&E Companies witness Beurer and is supported by OCA witness Loube. The cost justification are "proxy" costs which are based on a sample of the costs for "average schedule" carriers that file cost studies with NECA. These studies are based on equations which relate the cost of a particular function to a group of attributes. Attributes include, *inter alia*, measures of lines, number of exchanges, and interstate access minutes. An average schedule carriers' attributes are placed into an equation to determine that carrier's proxy cost. *See* OCA Stmt. 1-R at 11.

This Commission has not had occasion to extensively address to what extent the NECA proxy cost model may be used by small carriers to demonstrate actual cost support for access rates.[17] We shall, therefore, reject, without prejudice, reliance on this data in this proceeding. The record is not sufficiently developed for us to render a

[17] We question whether the support of the cost proxy that NECA uses for distribution purposes are suitable for development of rates.

determination pertaining to the appropriateness of this approach in reaching a company-specific determination.

4. Are The D&E Companies' Access Rate Increases are Just and Reasonable?

The ALJ concluded that this issue is reduced to the level of whether the D&E Companies have sustained their burden of proving that their rates are just and reasonable, and not in violation of a Commission regulation or order. (R.D. at 29). ALJ Colwell was persuaded by the D&E Companies' argument that banking did not provide the additional revenue that the companies need and if they were not permitted to increase access rates, they would be forced to increase basic local service rates to a level in excess of the PaUSF $18.00 rate cap currently in place. (R.D. at 18, 19; D&E Stmt.1 at 53, 54)

In its Exceptions, Verizon requests that if this Commission decides to adopt the ALJ's recommendation to allow access charges to increase while the access charge reform investigations are pending, the Commission should lift the stay and immediately proceed with the rural carrier access investigation on an expedited schedule. (Exc. at 23). Verizon also is of the opinion that if the D&E Companies' "stubborn intransigence" is rewarded so that they will be permitted to increase access rates, then other local carriers will be emboldened to attempt the same. Verizon cautions that, in this case, the impact on Verizon and other carriers that pay access rates could be compounded. (Exc. at 24).

Verizon also points out that while the D&E Companies claim they need additional revenue to fund their broadband deployment,[18] they have not demonstrated the justness or reasonableness of imposing the costs of their broadband deployment on the customers of other carriers rather than obtaining the additional revenue from their own retail

[18] *See* D&E St. 1 (Beurer Direct) at 41; OSBA St. 1 (Buckalew Rebuttal) at 12.

end users. Verizon contends that raising access rates is not the only available source for the D&E Companies to raise new revenue and notes that the D&E Companies' Chapter 30 plans also allow them to raise any noncompetitive rates to implement PSI revenue increases, including the rates they charge to their own customers. (Exc. at 31)

Verizon further explains that before the access charge increases were implemented, the D&E Companies represented to the Securities Exchange Commission (SEC) that they are currently capable of providing broadband services to 98% of their customers and are well positioned to meet the required 100% threshold by December 31, 2008.[19] Verizon asserts that the D&E Companies have already substantially completed their broadband commitments and, therefore, have no need for additional subsidies from other carriers.

Verizon also finds fault with the ALJ's endorsement of the position that the D&E Companies comprehensively considered with great analysis the intense intermodal competition faced by them and the detrimental line loss that would result from local rate increases. (R.D. at 30). Verizon points out that the D&E Companies presented no specific evidence in support of their assertions that they could not raise basic local service rates further or that rates would not be affordable if they were increased. Verizon adds that if the ALJ had examined the record evidence with the slightest skepticism she would have concluded that the D&E Companies had alternatives to increasing access rates. (Exc. at 31)

Verizon points out that its witness Mr. Price demonstrated in the following chart that Buffalo Valley and Conestoga would both be able to allocate all of the required increase to basic rates and still be well below the $18.00 PaUSF benchmark:[20]

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[19] *Id.* at 15-16.

[20] VZ St. 1.1 (Price Rebuttal) at 17; *see also* D&E Responses to Verizon I-21, I-22 and I-23, calculating the companies' average weighted residential rates (attached as Exhibit 4 to VZ St. 1.1).

	Current Average Residential Rate	Increase	New Average Residential Rate
Buffalo Valley	$14.50	$0.96	$15.46
Conestoga	$14.28	$1.28	$15.56
D&E	$17.51	$1.35	$18.86

Accordingly, Verizon finds no justification for Buffalo Valley and Conestoga to claim that they are not able to apply their PSI increases to end-user rates, as their average residential rates would still remain well below the affordability level. With regard to D&E, Verizon asserts that even though D&E's residential rates would exceed the $18 affordability benchmark by $0.86 if it allocated the increases evenly among all basic residential service rates, D&E has not demonstrated that it could not allocate more of the increase to services other than residential exchange or to the lower priced end of its range of residential services to fall below the $18.00 level. Moreover, D&E did not explore whether the Commission would consider raising the $18.00 affordability level to reflect increases in the cost of living and in household income, and that the affordability level was set by agreement of the parties in July 2003. (Exc. at 32)

In response to Verizon's claims above, the D&E Companies argue that except for this one instance, it has continued to make strides in achieving access reform when compared to other carries. (R.Exc. at 15). The D&E Companies claimed that its Chapter 30 Plans give them fairly wide discretion in designing rate increases and that they are free to reconfigure the increases in a different way among their various other noncompetitive services to reduce the amount of any rate increases for residential services. (R.Exc. at 21). The D&E Companies further assert that that its local end users have already experienced rate increases from over 60% to 100% since the Global Order was entered. *Id.*

Disposition

Consistent with our discussion, above, we find that "just and reasonable" under the Public Utility Code, contemplates a range of possible outcomes for the allocation of revenue increases. We shall, consistent with the discussion in this Opinion and Order, reject the proposed increases in access rates, at this time. As such, we shall grant Verizon's Exceptions to the extent they are consistent with this disposition.

5. Can the D&E Companies Recover Revenue from Other Noncompetitive Services?

The ALJ summarized D&E's position in that it evaluated the alternatives to raising access charges and concluded that its previous access charge reform efforts have made the rates of the D&E Companies' residential end users to be among the highest in the state. (RD at 30). The ALJ also accepted the D&E Companies' position that they have comprehensively considered with great analysis the intense intermodal competition and that their management ascertained that the allocation of further increases to local rates is not a viable option. (R.D. at 30).

Verizon Excepts to the ALJ's failure to address Verizon's alternative argument that D&E's access revenue should be rebalanced to other noncompetitive rates under 66 Pa. C.S. § 3017(a). Verizon argues that because this case involves access charge increases, Chapter 30 provides another independent basis for the Commission to revoke these rate increases. More specifically, Verizon notes that the new Chapter 30 enacted in 2004, or Act 183, supports the Commission's policy goals that local exchange carriers reduce dependence on access revenue from other carriers and rebalance those revenues to retail services so that the carriers' end users will provide more of the companies' revenues. Verizon states that access rates are different from other noncompetitive rates in this respect, because Act 183 provided this Commission with

specific authority to rebalance revenue by reducing access rates and making revenue neutral increases to rates for other noncompetitive services. *See* 66 Pa. C.S. § 3017(a) ("The Commission may not require a local exchange telecommunications company to reduce access rates except on a revenue-neutral basis."). (Exc. at 34).

Verizon stated that this statutory provision provides the Commission with authority to further its access reform policies by reducing the D&E Companies' access rates to pre-July 1, 2006 levels (*i.e.*, to maintain the *status quo*), without a finding that the increases were "unjust and unreasonable," so long as the reduction is done on a revenue-neutral basis. Verizon submits that it was a legal error of the ALJ to omit a legal analysis of 66 Pa. C.S. § 3017(a), as to whether the Commission could rely on this statute to rescind the access increases. *Id.*

The D&E Companies disagree with Verizon's claim that the ALJ failed to address Section 3017(a). Specifically, they argue that the instant proceeding is a Chapter 30 proceeding that did not arise out of a Commission Section 3017 (a) order that mandated decrease to access charges. Further, the D&E Companies claim that Section 3017(a) was placed in Act 183 as a measure to protect the local exchange carrier and to assure that reductions to access charges can only be made on a revenue-neutral basis. (R.Exc. at 22).

OSBA replies that the Commission's general public policy rule of lowering access charges appears to conflict with the legislature's decision to accelerate the deployment of broadband throughout the Commonwealth without unreasonably increasing local exchange rates. (R.Exc. at 13).

Disposition

We agree with Verizon 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.[21] Consistent with our earlier discussion, we reject the ALJ recommendation that our policies prior to Act 183 have changed the policy regarding access charge reform. As such, Verizon's Exceptions on this matter are granted to the extent they are consistent with this disposition.

6. Should the D&E Companies' Draw From the PaUSF be Reduced If They Are Permitted to Maintain Their Access Charge Increases?

Although the ALJ included in her Recommended Decision, a discussion on Verizon's position that the D&E companies draw from the PaUSF should be reduced if they are permitted the increase in access charges, she did not address the merits of Verizon's argument. The ALJ only noted that D&E was a net payer into the fund (Finding of Fact No. 15 at 6) but made no mention as to the status of Buffalo Valley and Conestoga, who are net recipients of PaUSF funding. The ALJ also found that none of the D&E Companies' post-*Global Order* rate filings had an impact on the PaUSF support levels because the access rates and revenue reductions associated with them were offset by local service rate increases, *i.e.*, the filings were revenue neutral thereby requiring no additional funding from the PaUSF.[22] (Finding of Fact No. 23 at 8).

As noted, Verizon excepts to the fact that the ALJ failed to address whether the D&E Companies draw from the PaUSF should be reduced if their proposed access charge increases are permitted after this investigation is completed. Verizon submits that the Commission created the PaUSF in the *Global Order* to provide subsidies to enable the small carriers to reduce their access rates if those decreases could not be supported by

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[21] We take official notice that the D&E Companies, in their 2007 Annual PSI/SPI filings, which we are approving today at separate dockets (Buffalo Valley – R-00072193; Conestoga – R-00072194; and D&E – R-00072195), propose local rate increases for residential and business customers and banking for the remaining allowable revenue increases for 2007.

[22] D&E Stmt. 1, at 48.

corresponding increases in end user rates at that time. (Exc. at 35). Through the PaUSF, Verizon maintains that the D&E Companies' pre-*Global Order* switched access rate reductions are partly funded on a continuing basis by other carriers, including Verizon.[23]

Verizon states that while the ALJ found that D&E is a net payer into the fund today, (R.D. at 6), she failed to acknowledge that the other two D&E ILECs receive substantial annual subsidies from the PaUSF.[24] Verizon suggests that the Commission eliminate that portion of the support Buffalo Valley and Conestoga receive from the PaUSF if the access charge increases remain. Verizon also notes that that D&E also receives some money from the PaUSF, but that its payments into the fund are reduced by the amount it draws. As such, Verizon also suggests that the amount D&E's draws from the fund be reduced accordingly.

The D&E Companies argue that to now reduce PaUSF draws would violate the Section 3017(a) revenue neutrality requirement since it would result in carriers facing a severe revenue shortfall. They further argue that it would also be violation of Chapter 30 and their Amended Chapter 30 Plans since their 2006 PSI/SPI filings would no longer produce the additional annual revenue entitlements under their price-cap formula. Accordingly, D&E carriers request that the Verizon's Exception be rejected. (R.Exc. at 24).

OCA submits that the increase in the D&E Companies local rates would exceed the $18.00 benchmark and put additional strain on the PaUSF. OCA is also concerned that even with the PaUSF many Pennsylvanians will have difficulty maintaining basic local services. (OCA R.Exc. at 19-20).

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[23] Because Verizon PA and Verizon North were not permitted to draw from the USF, no such explicit intercarrier subsidy flow was used to replace the Verizon ILECs' previous access reductions. VZ St. 1.0 (Price Direct) at 16, n. 14.

[24] VZ St. 1.0 (Price Direct) at 12.

Disposition

In light of the fact that we will reverse the ALJ's recommendation that would have allowed the access charge increases to stand, this Exception by Verizon is moot. We may, however, consider its merits in the future at such time as may be necessary. The extensive discussion concerning the PaUSF highlights the need for this Commission not to abandon a generic approach to access charge reform at this time. The impact on access rate increases and the PaUSF are considerations which must be addressed in conjunction.

Conclusion

Upon review and consideration of the Recommended Decision, record evidence, Exceptions and Replies, we conclude that the Exceptions of Verizon Companies shall be granted consistent with the discussion in this Opinion and Order. The ALJ's Recommended Decision is reversed consistent with this Opinion and Order; **THEREFORE,**

IT IS ORDERED:

1. That the Exceptions of Verizon Companies are granted, to the extent consistent with the discussion in this Opinion and Order.

2. That the February 22, 2007 Recommended Decision of Administrative Law Judge Susan D. Colwell is reversed, consistent with the discussion in this Opinion and Order.

3. That, pursuant to 66 Pa. C.S. § 703(g), we rescind and amend our June 23, 2006 Orders, consistent with the discussion in this Opinion and Order.

4. That the D&E Companies shall file tariffs or tariff supplements designed to recover their allowable 2006 Annual PSI/SPI revenue in any manner consistent with their Chapter 30 plans. The proposed increases to access charge rates is expressly rejected. Said tariffs or tariff supplements shall be made within thirty (30) days of the entry date of this Opinion and Order and shall provide refunds for access rates from November 15, 2006 forward.

5. That this matter shall be marked closed upon entry of the final Order resulting from the limited and expedited rural access charge proceeding initiated by Commission Order entered November 15, 2006, at Docket No. I-00040105, et al.

BY THE COMMISSION

James J. McNulty
Secretary

(SEAL)

ORDER ADOPTED: July 11, 2007

ORDER ENTERED: JUL 11 2007

PENNSYLVANIA PUBLIC UTILITY COMMISSION
HARRISBURG, PENNSYLVANIA 17105

Investigation Regarding Intrastate Access Charges And IntraLATA Toll Rates of Rural Carriers and The Pennsylvania Universal Service Fund	PUBLIC MEETING: July 11, 2007 JUN-2007-OSA-0081* Docket No. I-00040105
2006 Annual Price Stability Index / Service Price Index Filing of Buffalo Valley Telephone Company	Docket Nos. P-00981428F100 R-00061375
2006 Annual Price Stability Index / Service Price Index Filing of Conestoga Telephone & Telegraph Company	Docket Nos. P-00981429F1000 R-00061376
2006 Annual Price Stability Index / Service Price Index Filing of Denver & Ephrata Telephone & Telegraph Company	Docket Nos. P-00981430F1000 R-00061377

DISSENTING STATEMENT OF VICE CHAIRMAN JAMES H. CAWLEY

Before us for disposition is the Staff recommendation on the Exceptions to the Recommended Decision (R.D.) of Administrative Law Judge (ALJ) Susan D. Colwell that was issued on February 22, 2007, and the Replies to Exceptions that were filed in this proceeding. For the reasons outlined below, I believe that the Commission should sustain the result of ALJ Colwell's R.D. and, thus, affirm the conclusion that was reached through the eventual implementation of the Commission's original June 23, 2006 Order in this matter. The majority's decision to reverse the conclusion of its original June 23, 2006 Order in this matter, and not to uphold the result of ALJ Colwell's R.D., is fraught with a great deal of regulatory policy pitfalls, it directly subverts the interests of end-user consumers of basic local exchange telephone services, and undermines past Commission decisions that were designed to preserve and enhance the concept of universal telephone service within this Commonwealth consistent with Pennsylvania and federal law.

A. Prior Commission Actions

The Commission in a series of Orders has recognized that the issues of reforming the intrastate carrier access charges of Pennsylvania's major non-rural and rural incumbent local exchange carriers (ILECs) are interlinked with corresponding developments in the

federal arena that are pending before the Federal Communications Commission (FCC), the Pennsylvania Universal Service Fund (Pa. USF), the implementation of the ILEC Chapter 30 annual revenue and rate increases, and the effects on the rates for basic local exchange telephone services. *See generally Investigation Regarding Intrastate Access Charges And IntraLATA Toll Rates of Rural Carriers and The Pennsylvania Universal Service Fund et al.*, Docket No. I-00040105 *et al.*, Order entered November 15, 2006; Order entered August 30, 2005; *AT&T Communications of Pennsylvania, LLC v. Verizon North Inc. and Verizon Pennsylvania Inc.*, Docket No. C-20027195, Opinion and Order entered January 8, 2007, Opinion and Order (Petition for Reconsideration) entered April 24, 2007. The Commission has consciously stayed generic type of proceedings that involve intrastate carrier access reform in view of pending developments before the FCC, including a decision on the Missoula Plan proposal at the FCC's *Intercarrier Compensation* proceeding. *In re Developing a Unified Intercarrier Compensation Regime – Missoula Intercarrier Compensation Reform Plan,* FCC Docket No. CC 01-92, DA 06-1510.

The Denver and Ephrata Telephone and Telegraph Company (D&E), Buffalo Valley Telephone Company (Buffalo Valley), and the Conestoga Telephone and Telegraph Company (Conestoga – collectively also referenced as the "Companies") application of their 2006 Chapter 30 annual price stability index and service price index (PSI/SPI) revenue and rate increases to their respective intrastate carrier access services was not consistent with the Commission's long-standing policy of intrastate carrier access charge reform. In my June 22, 2006 Concurring and Dissenting Statement, I indicated that when "considering the most optimal among the 'second best' choices, the Commission should be guided by principles that first safeguard the interests of the Companies' end-user customers that have a lesser number of competitive choices and traditionally exhibit a lesser price elasticity of demand."[1]

Although the Companies' actions in raising their respective intrastate carrier access charges through their Chapter 30 annual 2006 PSI/SPI submissions were contrary to the Commission's trend in access charge reforms, it appears that the rest of the Chapter 30 rural ILECs have heeded this Commission's concerns. So far we have not seen any other filings that may undermine the Commission's past access charge reform efforts. It is my hope that the members of Pennsylvania's ILEC industry will not disturb this status quo until the Commission deals with these issues in an integrated, generic, and comprehensive fashion. In the same vein, the Companies' Chapter 30 annual 2007 PSI/SPI revenue and

[1] Statement of Vice Chairman James H. Cawley Concurring in Part and Dissenting in Part, Docket No. R-00061377 *et al.*, June 22, 2006 Public Meeting.

rate increase submissions have not impacted their respective intrastate carrier access services.[2]

B. Disturbing the Status Quo

The Commission's reversal of the results of its June 23, 2006 Order and of ALJ Colwell's R.D. substantially ignores the need for a comprehensive examination of the issues relating to intrastate carrier access charge reform, the FCC's *Intercarrier Compensation* proceeding, the Pa. USF, the federal USF, and past Commission decisions that relate to the maintenance and enhancement of universal telephone service in Pennsylvania. Rather than maintaining the status quo and proceeding with a comprehensive and integrated examination of these issues in the stayed Commission investigation of the rural ILEC intrastate carrier access charges, the majority's decision in this proceeding reflects an ill-advised choice to approach these issues in a piecemeal and uncoordinated fashion. The majority's focus in this proceeding is solely and inappropriately placed only on the single issue of intrastate carrier access charge reform, while ignoring the linkages and undesirable effects on end-user customers of basic local exchange telephone services and, potentially, the levels of universal service telephone penetration within this Commonwealth.

The majority's action in the present proceeding overturns the Commission's generic and long-established safeguard of the average rate of $18.00 per month for residential end-user consumers of basic local telephone exchange service. It is well documented in the record of this proceeding that the reversal of the Commission's June 23, 2006 Order and ALJ Colwell's R.D. result in piercing the $18.00 residential basic local service rate cap for the end-user consumers of D&E. Because Section 3017(a) of Chapter 30, 66 Pa. C.S. § 3017(a), mandates that ILEC intrastate carrier access charges may be changed only on a "revenue neutral" basis, the majority's action alone will increase the average residential basic local exchange service rate for D&E's customers to $18.86 per month. However, because this Commission has already approved D&E's 2007 PSI/SPI filing, the same

[2] *2007 Annual Price Stability Index / Service Price Index Filing of Buffalo Valley Telephone Company*, Docket Nos. R-00072193, P-00981428F1000, Order entered June 21, 2007 (Buffalo Valley 2007 PSI/SPI Order); *2007 Annual Price Stability Index / Service Price Index Filing of Conestoga Telephone and Telegraph Company*, Docket Nos. R-00072194, P-00981429F1000, Order entered June 21, 2007 (Conestoga 2007 PSI/SPI Order); *2007 Annual Price Stability Index / Service Price Index Filing of Denver and Ephrata Telephone and Telegraph Company*, Docket Nos. R-00072195, P-00981430F1000, Order entered June 21, 2007 (D&E 2007 PSI/SPI Order).

average residential rate is likely to increase to a the level of at least $19.31 per month.[3] This essentially translates to a case-specific piercing of the long-standing and generic $18.00 residential cap by $1.31 or by 7.28%.[4] One then is left to wonder what the value is for instituting and maintaining a basic telephone service residential rate cap for ILECs such as D&E, if this cap can be pierced on a case-by-case basis without any meaningful and integrated discussion on-the-record of the relevant regulatory policy implications and consequences.

The residential rate cap for rural ILECs such as D&E was not established by happenstance. It was the product of due deliberation and reasoned decision in the Commission's landmark *Global Order. Joint Petition of Nextlink Pennsylvania, Inc., et al.*, Docket Nos. P-00991648 & P-00991649, Order entered September 30, 1999, at 201, 196 PUR4th 172 at 260-261, *affirmed, Bell Atlantic-Pennsylvania v. Pa. Public Util. Comm'n*, 763 A.2d 440 (Pa. Cmwlth. 2000), *vacated in part, MCI WorldCom v. Pa. Public Util. Comm'n*, 844 A.2d 1239 (Pa. 2004). A plain reading of the *Global Order* indicates that the establishment of the residential rate cap - $16.00 per month at that time – was done *in conjunction with* the intrastate carrier access charge reforms *and* the institution of the Pa. USF mechanism. The Commission's July 15, 2003 Order affirmed the continuation of the residential rate cap for ILECs such as D&E albeit at the new level of $18.00 per month. The instant case-specific breach of the $18.00 residential cap creates a host of procedural due process and substantive regulatory policy problems.

The establishment and retention of the residential rate cap has been the result of comprehensive adjudications that included the participation of numerous interested parties. The Rural Telephone Company Coalition, The United Telephone Company of Pennsylvania (currently d/b/a Embarq PA), and AT&T Communications of Pennsylvania were some of the additional participants in the proceeding that led to the outcome of the July 15, 2003 Order. The record of the instant proceedings plainly indicates that not all of these parties have been afforded the opportunity to participate and present their respective viewpoints in a decision that disturbs one of the cornerstones of this Commission's long-standing regulatory policy. It is inadvisable from a due process and substantive perspective to change fundamental tenets of regulatory policy in non-generic adjudication proceedings.

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[3] The D&E 2007 PSI/SPI filing increased the average residential One-Party basic local exchange service rate from $15.69 per month to $16.14 per month, or by $0.45 per month. D&E 2007 PSI/SPI Order at 3.

[4] *See generally Access Charge Investigation per Global Order of September 30, 1999 et al.*, Docket Nos. M-00021596, P-00991648, P-00991649 *et al.*, Order entered July 15, 2003, at 10, and Attachment A at 18 (July 15, 2003 Order).

The decision of the majority fails to address the linkage between the residential rate cap for ILECs such as D&E and the orderly function of the Pa. USF. The case-specific piercing of the residential $18.00 per month cap will undermine the orderly function of the Pa. USF and will create perverse regulatory incentives for the rural ILECs operating in Pennsylvania. These perverse incentives also hold the potential of undermining the development of telecommunications competition in areas served by the rural ILECs. Both the *Global Order* and the July 15, 2003 Order linked the residential rate cap with the function of the Pa. USF. The July 15, 2003 Order specifically stated the following:

> *Any approved future increases in rates above the $18.00 rate cap for any ILEC shall also be recoverable from the USF under the exact same terms and conditions as approved in the Global Order.* For example, if ILEC A's R-1 rates are currently $17.25, then their customer is billed $17.25 but receives a credit of $1.25 from USF, receiving a net bill of $16.00. ILEC A could, as of December 31, 2004, implement the provisions of Paragraph 3 hereof, increase its rates, if justified, by $2.00 to $19.25, charge its customers $19.25, reflect a credit of $1.25 to its customers, receive $1.25 from the USF, and then send a net bill to its customers of $18.00. If ILEC A justified an R-1 rate of $20.25, then it would be entitled to $2.25 from the USF and will send a net bill to its customers of $18.00.

July 15, 2003 Order, Attachment A, Paragraph No. 4, at 18 (emphasis added).

Since D&E's average basic local exchange R-1 rates will be pushed to a level of approximately $1.31 above the $18.00 cap through the majority's decision in the instant proceeding, D&E will be entitled to recover this $1.31 per month amount from the Pa. USF for all of its R-1 residential access lines. The Companies made the conscious choice of increasing their respective residential basic local exchange rates through their 2007 PSI/SPI submissions by 2.20%-2.81% (Conestoga) to 3.79% (Buffalo Valley), while increasing the residential rates for certain vertical services by as much as 25%-28.21%, and certain residential non-recurring charges by as much as 33.33%. In this manner, D&E was able to maintain an average R-1 rate consistent with the $18.00 cap. Now, the majority's decision renders the $18.00 rate cap totally meaningless not only for D&E and its two other ILEC affiliates, but it also renders it meaningless for other Pennsylvania Chapter 30 ILECs for which the residential rate cap is applicable. D&E has already testified that, if its residential rates were to exceed the $18.00 rate cap, it would seek the appropriate amount of support distributions from the Pa. USF.[5] This result not only will create problems for the

[5] R.D. at 19, citing D&E St. 1.0, at 54. *See also* OCA R.Exc. at 19-20.

routine function of the Pa. USF, but it will also create perverse regulatory incentives for the Chapter 30 ILECs that operate under the $18.00 residential rate cap.

Since the Chapter 30 ILECs that are under the $18.00 residential rate cap will no longer have any incentive to proceed with a more rational allocation of their annual Chapter 30 revenue and rate increases, they will not hesitate to pierce the cap and receive the incremental amount over the $18.00 level as support distributions from the Pa. USF. In sharp contrast so far, certain rural ILECs have been reluctant to implement the full amounts of their annual Chapter 30 revenue increases in actual rates, preferring instead to bank some of these amounts. Now, the Pa. USF will need to be increased and the associated contribution assessments and support distributions managed. Naturally, the contributing telecommunications carriers to the Pa. USF – including both competitive entities and ILECs – must shoulder an increasing contribution assessment burden. Certain regulated telecommunications carriers may be more able than others to pay their Pa. USF contribution assessments.[6] However, carriers that are generating their revenues on a more competitive basis may not be in the same position. Furthermore, such competitive carriers are not entitled to any support distributions from the Pa. USF in accordance with our regulations. This may have counterproductive results with respect to the market entry of competitive carriers in the service areas of Chapter 30 ILECs which are net recipients of Pa. USF support distribution funds. It should be clear that these issues must be addressed in a comprehensive and integrated fashion and not on a case-by-case basis.

C. Intrastate Carrier Access Charges and Subsidies for Local Exchange Services

OCA witness Dr. Robert Loube conclusively demonstrated that in the absence of certain incremental cost studies – which were not filed in the instant proceeding by any of the parties – it "is not possible to determine if local service is receiving a subsidy from other services whenever it is not possible to state that the price is below the incremental cost of service." OCA St. 1-R at 11. Based on Dr. Loube's extensive and uncontroverted testimony and definitions of what constitutes a "subsidy," ALJ Colwell concluded the following:

> The policy for reducing access charges is based on the assumption that those charges subsidize other rates, and as succinctly stated by OCA, *no such evidence exists here, either to support a finding that a subsidy does or does not*

[6] The Verizon Pennsylvania Inc. Pa. USF annual contribution assessment obligation is largely funded through its 2003 price change opportunity "negative" revenues. *Verizon Pennsylvania Inc. 2005 Price Change Opportunity Filing, Verizon North Inc. 2005 Price Change Opportunity Filing*, Docket Nos. P-00930715 & P-00001854, Order entered October 11, 2005, *Statement of Vice Chairman James H. Cawley Concurring in Part and Dissenting in Part.*

> *exist:* OCA Stmt. 1-R pp. 4-6. There is *no actual cost study to support a finding* that the distribution of rates is reasonable; there is no support to find that the distribution is not reasonable.

R.D. at 17 (emphasis added).

OCA witness Dr. Loube also pointed out in his testimony that the Companies' residential basic local exchange service rates are higher than Verizon's corresponding rates for its density cells 3 and 4, where the Verizon density cells 3 and 4 service areas are adjacent to the service areas of the Companies. OCA St. 1-R at 18. This clearly creates the inference that the Commission has enacted intrastate access charge and local exchange service rate reforms for the rural ILECs which have generated the desired outcome of bringing such rates closer to some measure of cost while maintaining basic residential rate affordability through the continuous application of the $18.00 cap. Dr. Loube further testified that the Companies' intrastate carrier access rate increase in their 2006 PSI/SPI filings was "consistent with Commission policy because the increase equalizes the carriers' [Companies'] intrastate rates with their interstate rates." OCA St. 1-R at 11.

In view of the fact that the majority's decision pierces the $18.00 residential rate cap, and the manner in which the Chapter 30 ILEC annual price stability mechanism revenue and rate increases operate, perhaps it is time to question whether the basic local exchange service rates and revenues of a Chapter 30 ILEC provide implicit support for the ILEC's intrastate carrier access services rather than the other way around. It is well established that the Chapter 30 ILEC access service revenue component essentially "feeds" a substantial part of the annual price stability mechanism revenue increase which in turn is allocated to the residential and business basic local exchange service rates of the ILEC. At the same time, the intrastate carrier access service rates of the ILEC remain essentially unchanged (the Companies' 2006 PSI/SPI filings being the only exception). These annual Chapter 30 ILEC revenue increases – that are primarily shouldered by local service rate-payers – finance the deployment of telecommunications facilities including those that are designed to meet the ILEC's Chapter 30 broadband network deployment commitments. However, I am certain that a number of these facilities, e.g., fiber optic transmission and/or distribution facilities, have multiple "shared" or "joint" uses.[7] For example, such facilities are used *both* for the provision of basic local exchange services *and* the provision of

[7] OCA's witness Dr. Loube pointed out that the loop "is a shared cost of the many services that use the loop" including the provision of "interstate and intrastate access and toll service, and the newer data services such as DSL service." OCA St. 1-R at 7. Dr. Loube also testified on this Commission's regulatory treatment of the shared and joint loop costs. OCA St. 1-R at 8-9, and nn. 12-15.

intrastate carrier access services. Since the ILEC's intrastate carrier access services do not absorb any of the annual Chapter 30 price stability mechanism revenue and rate increases – and appropriate and relevant cost studies are completely absent for a Chapter 30 ILEC – the question arises whether, perhaps, it is the legacy copper-based basic local services that provide an implicit revenue support to the ILEC's intrastate carrier access services. This question is particularly difficult for D&E, Conestoga and Buffalo Valley because they all are "average schedule" rural Chapter 30 ILECs.[8]

D. Residential Rate Affordability and Benefits of Access Reform

I have repeatedly stated that the "sky is not the limit" when it comes to the annual Chapter 30 ILEC revenue and rate increases that are implemented through the ILECs' respective price stability mechanisms. The Chapter 30 rural ILEC end-user residential consumers of basic local exchange services may have a lesser number of competitive choices, and a lesser degree of price elasticity of demand, but their ability to absorb repetitive annual revenue and rate increases for legacy copper-based services is not infinite. They will and they do seek either inter-modal telecommunications services alternatives, e.g., wireless services, or, in the worst case scenario, their landline service simply becomes unaffordable. The testimony of OCA witness Dr. Loube plainly indicated that the telephone penetration rate in Pennsylvania has declined from a high level of 98.0% in 2002 to 94.8% in March 2006. OCA R.Exc. at 16, citing OCA St. 1-R 27-28. Dr. Loube also stated that "one factor that may be contributing to the decrease is the fact that the rate for local service has been increasing." *Id.*, citing OCA St. 1-R at 28. It is commonly known that these Federal Communications Commission (FCC) statistics on telephone penetration capture the availability of both wireless and "other" telephone services for households. The OCA points out that these declining telephone penetration rates in Pennsylvania are an indication that "even with the Pa. USF, many Pennsylvanians are having difficulty maintaining basic local service." *Id.* at 20.

Will end-user consumers realize the benefit of reversing the Companies' one-time increase of their intrastate carrier access rates? This is highly unlikely to happen. First, the long-distance interexchange carriers (IXCs) that pay the Companies' intrastate carrier access charges have nationwide pricing of their toll services and such pricing will remain unaffected by the reversal of the Companies' isolated access rate increases. As OCA witness Dr. Loube pointed out, the Companies account for a very small portion of interstate

[8] OCA St. 1-R at 15.

and intrastate long-distance traffic volumes. OCA St. 1-R at 23-24. Furthermore, Dr. Loube testified that nationwide long-distance carriers such as AT&T can and do charge differential toll rates to end-user consumers of rural ILECs such as the Companies with the aim of recovering their access expense. *Id.* at 24, and Exh. RL-2. Because IXC intrastate toll services have been classified as "competitive" under Section 3018 of Chapter 30, 66 Pa. C.S. § 3018, the Commission is legally forestalled from policing the beneficial pass through of ILEC intrastate access charge reductions to end-user consumers in the form of reduced intrastate IXC toll rates. In short, we are not going to realize the benefits of the Commission's actions that took place in the context of the *Global* Order. The Verizon Companies will realize a benefit from the reversal of the intrastate access rate increase decided by the majority. I sincerely doubt that Verizon's own end-user consumers will realize any concrete and corresponding pass through benefits as a result of the majority's reversal of the Companies' one-time intrastate carrier access rate increase.

E. Conclusion

I believe that the end result of ALJ Colwell's R.D. is consistent with prior Commission actions that have generally maintained the status quo in the area of intrastate carrier access charge reform and the Pa. USF. In addition, it is obvious from the available analysis and testimony that the reversal of the Companies' 2006 PSI/SPI intrastate access rate increases will lead to piercing the average $18 residential basic local exchange service rate benchmark for one of the Companies. This Commission has established this benchmark rate as a signpost for the maintenance and advancement of the universal telephone service concept. Whether or not intrastate carrier access reform under the auspices of Chapter 30 should undermine the $18 benchmark average residential rate for ILECs such as the Companies, with attendant consequences for the Pa. USF, cannot and should not be examined on an isolated case-by-case basis since the retention of this benchmark has implications for universal telephone service within Pennsylvania. I believe that sustaining the result of ALJ Colwell's R.D. is the more prudent course of action, and for these reasons I respectfully dissent.

DATED: July 11, 2007

James H. Cawley
Vice Chairman