OSBA STATEMENT NO. 1

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

Direct Testimony of

JOHN W. WILSON

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

On Behalf of the

Pennsylvania Office of Small Business Advocate

Date Served: January 20, 2010

Date Submitted for the Record: ____________________

QUALIFICATIONS AND INTRODUCTION

Q. PLEASE STATE YOUR NAME, OCCUPATION, AND ADDRESS.

A. My name is John W. Wilson. I am President of J.W. Wilson & Associates, Inc. Our offices are at 1601 North Kent Street, Suite 1104, Arlington, Virginia, 22209.

Q. PLEASE OUTLINE YOUR EDUCATIONAL BACKGROUND.

A. I hold a B.S. degree with senior honors and a Masters Degree in Economics from the University of Wisconsin. I have also received a Ph.D. in Economics from Cornell University. My major fields of study were industrial organization and public regulation of business, and my doctoral dissertation was a study of utility pricing and regulation.

Q. HOW HAVE YOU BEEN EMPLOYED SINCE THAT TIME?

A. After completing my graduate education, I was an assistant professor of economics at the United States Military Academy, West Point, New York. In that capacity, I taught courses in both economics and government. While at West Point, I also served as an economic consultant to the Antitrust Division of the United States Department of Justice.

After leaving West Point, I was employed by the Federal Power Commission, first as a staff economist and then as Chief of FPC's Division of Economic Studies. In that capacity, I was involved in regulatory matters involving most phases of FPC regulation of electric utilities and the natural gas industry. Since 1973 I have been employed as an economic consultant by various clients, including federal, state, provincial and local governments, private enterprise and nonprofit organizations. This work has pertained to a wide range of issues concerning public utility regulation, insurance rate regulation, antitrust matters and economic and financial analysis. In 1975 I formed J. W. Wilson & Associates, Inc., a Washington, D.C. corporation.

Q. WOULD YOU PLEASE DESCRIBE SOME OF YOUR ADDITIONAL PROFESSIONAL ACTIVITIES?

A. I have authored a variety of articles and monographs, including a number of studies dealing with utility regulation and economic policy. I have consulted on regulatory, financial and competitive market matters with the Federal Communications Commission, the National Academy of Sciences, the Ford Foundation, the National Regulatory Research Institute, the Electric Power Research Institute, The North American Telecommunications Association, the U.S. Department of Justice Antitrust Division, the Federal Trade Commission Bureau of Competition, the Commerce Department, the Department of the Interior, the Department of Energy, the Small Business Administration, the Department of Defense, the Tennessee Valley Authority, the Federal Energy

Administration, and numerous state and provincial agencies and legislative bodies in the United States and Canada.

Previously, I was a member of the Economics Committee of the U.S. Water Resources Council, the FPC Coordinating Representative for the Task Force on Future Financial Requirements for the National Power Survey, the Advisory Committee to the National Association of Insurance Commissioners (NAIC) Task Force on Profitability and Investment Income, and the NAIC's Advisory Committee on Nuclear Risks.

In addition, I have testified as an expert witness in court proceedings dealing with competition in telecommunications and other regulated and unregulated industries. I have also testified in telecommunications regulatory proceedings before more than thirty state regulatory commissions and on other regulatory matters before more than fifty Federal and State regulatory bodies throughout the United States and Canada. I have also appeared on numerous occasions as an expert witness at the invitation of U.S. Senate and Congressional Committees dealing with competitive market and regulatory legislation. In addition, I have been retained as an expert on regulatory matters by more than twenty-five State and Federal regulatory agencies. I have also participated as a speaker, panelist, or moderator in many professional conferences and programs dealing with business regulation, financial issues, economic policy and antitrust matters. I am a member of the

American Economic Association and an associate member of the American Bar Association and the ABA's Antitrust, Insurance and Regulatory Law Sections.

Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS PROCEEDING?

A. I am presenting this testimony on behalf of the Office of Small Business Advocate ("OSBA") for the Commonwealth of Pennsylvania.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I have been asked by OSBA to address issues as stated in ALJ Melillo's Order Addressing Scope of Consolidated Proceedings dated September 15, 2009 as confirmed by the Commission's Opinion and Order in this Docket dated November 19, 2009 and to respond to arguments made on these issues in the testimony filed on November 30, 2009 by Parties aligned with AT&T.

Q. THE FIRST ISSUE STATED IN ALJ MELILLO'S ORDER IS "WHETHER INTRASTATE ACCESS CHARGES... SHOULD BE FURTHER REDUCED OR RATE STRUCTURES MODIFIED IN THE RURAL ILEC'S TERRITORIES." RELATED SPECIFIED ISSUES ARE WHETHER RURAL ILEC INTRASTATE ACCESS RATES ARE JUST AND REASONABLE AND NON-DISCRIMINATORY AND WHETHER FURTHER INTRASTATE ACCESS CHARGE REFORM IS NEEDED IN VIEW OF NEW CHAPTER 30 LAW PROVISIONS AND THE

ELIMINATION IN ACT 183 OF MANDATORY ACCESS REDUCTIONS. WHAT IS YOUR RESPONSE TO THESE ISSUES?

A. The cost of access includes the cost of switching a toll call in the local telephone companies' networks, the cost of transporting the call, and the cost of using the local loop facilities that were designed for toll services. Access rates are the charges made by ILECs to toll carriers for the use of the local exchange company's network. Toll carriers consider these access charges as a cost in determining the toll rates that they charge to consumers for toll services. Access rates have historically recovered a portion of the loop and switching costs of the local telephone company, which is the facilities-based provider of access to consumers' telephones. The loop is the wire pair that runs from a local exchange carrier's central office near the customer to the customer's location. In the case of small business and residential customers, the wire pair runs from the central office to a network interface device on the customer's premises. The network interface device connects to the customer's inside wiring and telephones.

Q. ARE THE COSTS OF THESE LOCAL ACCESS FACILITIES SUBSTANTIAL?

A. Yes. Local exchange carriers have spent billions of dollars to develop access systems that are cost-effective and efficient in delivering all forms of telephone traffic: local exchange service; intrastate, interstate, and international toll; cellular;

and Voice over Internet Protocol ("VOIP"). These local exchange network facilities allow the interconnection of all traffic because they were designed for all traffic, not simply local telephone calls. In addition, with very little added investment in these network facilities, local telephone companies have been able to provide broadband access through Digital Subscriber Line ("DSL") using the very same facilities.

Q. ARE THE LOCAL ACCESS FACILITIES OF TELEPHONE COMPANIES CUSTOMER SPECIFIC?

A. No. Because basic loop systems are generally designed and installed on a mass basis rather than on a customer-specific basis, loop costs have been influenced by various service needs and new usage considerations as they have developed. With changes in customer usage, many new combinations of loop design and administration have been introduced and adopted for standardized loops. Standard loops must be capable of meeting various signaling and transmission quality requirements for a wide variety of services.

Q. DOES THIS MEAN THAT TOLL SERVICE CUSTOMERS SHOULD PAY FOR A PORTION OF LOCAL EXCHANGE ACCESS COSTS?

A. Yes. Local exchange access facilities are designed to enable customers to make and receive toll calls as well as local calls. Toll carriers need these local exchange facilities in order to complete toll calls. Therefore, toll carriers should contribute their fair share toward the cost of local exchange loops and switches. Any additional reduction in rural ILEC access charges would essentially push all, or virtually all, of the cost of these facilities onto local exchange ratepayers. This would be unfair to residential local exchange ratepayers and especially burdensome to business local exchange customers since business customers already pay more than the cost of providing them with local exchange service.

Customer access lines or "loops" are the major investment cost for every local exchange telephone company, and the major cost for access. Over the past twenty years, telephone regulators have reduced access rates charged to toll carriers and shifted revenue recovery to local service in an attempt to spur toll competition. Access charges to toll carriers have therefore gone down.

Q. SHOULD ACCESS RATES CHARGED TO TOLL CARRIERS BE FURTHER REDUCED IN RURAL ILEC TERRITORIES?

A. No. There is no valid justification for further reductions in access rates. While the parties aligned with AT&T continually assert that access rates exceed access costs (e.g., see November 30, 2009 testimony of AT&T witnesses Nurse and Oyefusi at 3 and Comcast witness Pelcovits at 10), there is no credible evidence to support that assertion. This Commission's previous findings are informative in addressing this question. Specifically, the Commission stated as follows:

> We reaffirm our findings in our September 5, 1995 Order at Docket No. L-00950105 that the local loop is a 'joint cost',

not a direct cost of providing only those services included in the definition of BUS [Basic Universal Service]. It is used for a variety of services other than BUS and must be allocated among the services which utilize it. For universal service funding purposes, not allocating a portion of the local loop to all the services which utilize it fails to give recognition to the fact that the loop is used to provide many services in addition to BUS.

This finding is consistent with our earlier rulings including <u>Pennsylvania Public Utility Commission v. Breezewood Telephone Company</u>, 74 Pa P.U.C. 431 (1991) wherein we stated:

> ...[W]e consider the costs associated with the loop from the central office to the customers premises a non-traffic sensitive joint cost.

* * *

We reject the ILECs' arguments that the local loop is not a joint cost because other services which use the loop do not result in any additional cost. We do not find the arguments of Bell's expert witness Dr. Kahn persuasive on this point. In particular, we do not accept the basis of Dr. Kahn's argument that because the loop is needed for local service and the incremental cost of the loop does not increase to provide other services, that its full cost must be attributed to local services. This same argument could be made with respect to toll service. Since the loop is necessary to provide toll service, it could at the same time be argued that the full cost should be allocated to toll, and in so doing the incremental cost to provide local service would be zero. Moreover, since the installation of an additional subscriber loop increases the capacity available for placing and receiving all three types of calls, the telephone company cannot increase the capacity for local calls without concurrently increasing the capacity for toll calls.

Universal Service Investigation, at 82-83.

The Commission has thus found that the loop is part of the integrated telephone network and was built to serve both local and toll usage. In fact, today's loops are of such good quality that they are being put to all kinds of uses, e.g., DSL.

Q. COMCAST WITNESS PELCOVITS ARGUES THAT THE RIGHT COST MEASURE FOR INTRASTATE TOLL ACCESS SHOULD BE THE LONG RUN INCREMENTAL COST OF USAGE, WHICH HE CLAIMS IS LIKELY TO BE VERY CLOSE TO ZERO (November 30, 2009 testimony at 10). IS HE CORRECT?

A. No. These assertions by Dr. Pelcovits are entirely unencumbered by fact. The undeniable facts in this case are that local access exchange facilities are, as described above, very costly and that they are required and designed for toll service as well as for local service. While the very short run incremental cost of adding a small volume of intrastate toll traffic to an existing local network designed with excess capacity to accommodate growth may be near zero, one could say exactly the same for the incremental cost of local service. Where there are joint and common facilities costs for related uses that share those facilities, it is a sham to single out one of those uses as the cost-causer or as the zero cost incremental user. That is simply a self-serving contrivance in the pursuit of a free ride. In this case, while the parties aligned with AT&T assert repeatedly that access charges are "inflated" and above cost, they have presented no cost evidence to support their exaggerated claims.

Q. HAS THE ECONOMIC RATIONALE FOR REDUCING ACCESS CHARGES CHANGED?

A. Yes. In addition to recognizing the fact that the loop is a shared cost with toll, the economic environment has changed. The historic economic rationale for access reductions was that toll services were paying more than their fair share of the cost of the local network. This was claimed to hinder the development of competitive toll services and local exchange services, but this is no longer true. The competitive market, at least for toll, has sorted itself out as the major toll carriers have been merged into local exchange companies (e.g., Verizon acquired MCI and SBC acquired AT&T and then retained the AT&T corporate name). Today, there is little facilities-based competition for loops and most toll and local competition rides over the local exchange companies' loop facilities.

Q. IS IT REASONABLE TO CONTEND THAT THE FAILURE TO FURTHER REDUCE ACCESS CHARGES FOR INTRASTATE TOLL CARRIERS WILL IMPAIR COMPETITION?

A. No. As stated above, toll competition is established. As stated by Sprint witness Appleby, "The toll market was deemed competitive long ago and it remains competitive today. Consumers have many choices for their toll calling needs …" (November 30, 2009 testimony at 4)

Q. DO LOCAL EXCHANGE CARRIERS FACE COMPETITION TODAY?

A. Yes. The two biggest competitive threats to local telephone companies in the current environment are over different networks: wireless carriers over their own networks, and VOIP over broadband networks. In the FCC's February 5, 2006, Remand Order of the Triennial Review Order (commonly called the "TRRO"), the FCC made it clear that markets were open and moving toward competition: "we recognized the marketplace realities of robust broadband competition and increasing competition from intermodal sources, and thus eliminated most unbundling requirements for broadband architectures serving the mass market" (Page 2 of the TRRO).[1] Local telephone companies now need the ability to set their rates with these new "marketplace realities" in mind. Also, forcing local exchange consumers to pay for broadband development subsidizes new VOIP competition. In any case, the economics that were once used to shift the recovery of local access costs away from toll usage and onto local consumers has changed. Moreover, local exchange consumers are already being charged most of the costs of the local network.

Q. WHAT HAS BEEN THE MOTIVATION TO REDUCE ACCESS CHARGES?

[1] See the *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers; Implementation of the Local Competition Provisions of the Telecommunications Act of 1996; Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Docket Nos. 01-338, 96-98, 98-147, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, 18 FCC Rcd 16978, 17145, para. 278 (2003) (*Triennial Review Order*), *corrected by* Errata, 18 FCC Rcd 19020 (2003) (*Triennial Review Order Errata*), *vacated and remanded in part, affirmed in part, United States Telecom Ass'n v. FCC*, 359 F.3d 554 (D.C. Cir. 2004) (*USTA II*) *cert. denied*, 125 S.Ct. 313, 316, 345 (2004).

A. Over recent years, proposals to shift access costs from toll services to local services have found favor with those telephone companies eager to recover more of their costs from captive local customers. The historic motivation for favoring such cost recovery shifts has been to reduce charges for competitive services, and to instead recover them from monopoly services. More recently, the motivation to make such shifts has increased, as large local service providers have merged with toll carriers and are now in the toll business themselves.

Q. IS IT REASONABLE, IN YOUR OPINION, TO MAINTAIN ACCESS CHARGES SO THAT TOLL CARRIERS AND THEIR CUSTOMERS PAY A PORTION OF THE LOCAL NETWORK LOOP COSTS THROUGH ACCESS RATES?

A. Yes. Toll carriers should be required to support local access facilities costs. Toll carriers need and use these facilities; without them, there is no connection to local customers. Local access facilities were designed to provide quality toll service. One of the reasons we have a telecommunications system that connects to virtually everyone and everywhere in this country is due to the sharing of the local access facilities costs by all services that use the local loop.

Further reducing access charges that permit toll carriers to use local facilities that are required to provide toll service (and that are designed to provide that toll service) would cause local exchange ratepayers to pay more of the local facilities' costs. Business customers, in particular, are already paying more than enough to cover the cost of their usage of the loops required for local exchange and toll calls. Those business customers have had their local exchange rates increased beyond cost to subsidize toll use of the local loops. Also, there are contract and bundled rates customers that have not had their rates changed to reflect any of the price increase for local exchange service due to the lowering of access charges. This is an inequitable result; revenue neutral should not mean that only those customers that don't have an agreement or contract must pick up the burden of shifting access costs to local exchange rates.

Q. WOULD CROSS-SUBSIDIZATION BE INHERENT IN CONTINUING TO LOWER ACCESS RATES FOR TOLL COMPANIES?

A. Yes. First, existing access charges for many toll carriers are already very low, and contribute relatively little to pay for the use of the local access facilities that are required to provide toll services. This causes other services and ratepayers to pay a larger share of loop costs.

Second, lower access charges for large toll providers like Verizon would provide a subsidy from the local exchange customers of rural ILECs to Verizon's customers. Qwest witness Easton argues that Verizon's intrastate switched access rates are the appropriate access rate level for all rural ILECs in Pennsylvania. (November 30, 2009 testimony at 6) But that argument ignores the fact that Verizon's access rates reflect relatively lower costs due to Verizon's size and the more urban distribution of its customers. In contrast, rural ILECs typically have higher local network costs because they have fewer customers per square mile when compared to Verizon's more urban areas. In that case, reducing access rates for rural ILECs to the level of Verizon's intrastate switched access rates would allow Verizon's toll customers to access these rural local networks without paying the appropriate cost-based rates for the facilities they are using. Verizon's toll customers would therefore not pay their fair share of the support for the rural networks that they access. Instead, rural system local exchange customers would be forced to pay higher rates for local service so that Verizon's toll customers could have lower charges for accessing rural networks. In addition, toll carriers, like Verizon, would likely profit by passing through less than the full amount of access charge reductions to their toll customers.

Q. IF THE COMMISSION DETERMINES THAT RURAL CARRIER ACCESS CHARGES SHOULD BE FURTHER REDUCED, SHOULD THE REDUCTION BE DONE ON AN ACROSS THE BOARD BASIS?

A. No. Rural carriers are a very diverse group of companies. Each has a different operating environment and their costs can be quite different. In addition, some companies have low access charges and some have high access charges due to different operating costs. There is no reason to assume that a "one-size-fits-all" reduction in access charges should be ordered by the Commission. If the

Commission determines that additional access charge reductions are required, each company should be reviewed on its own to determine its rates and access costs.

A central, inescapable conclusion in this debate is that local access facilities are used by both toll and local services. Federal law requires the interstate jurisdiction to assume some recovery of access costs that are attributable to both interstate and intrastate usage. The FCC has ordered a 25% assignment of total loop costs to interstate toll use. That leaves 75% to be recovered from the intrastate jurisdiction, and the Commission has jurisdiction to allocate that 75% in any way that it decides is reasonable. Based on the principle of equal availability of local access facilities for toll and local service, and the fact that 25% of the total is attributed to interstate usage, it would be entirely reasonable to allocate another 25% to intrastate access. That would leave 50% of these joint and common costs to be covered by charges for local exchange services.

Q. WOULD IT BE MORE APPROPRIATE FOR THE CUSTOMERS OF RURAL ILECs TO PAY THE FULL COST OF THEIR OWN SERVICE LOOPS AND LOCAL NETWORKS AND FOR THE CUSTOMERS OF LARGE URBAN ILECs LIKE VERIZON TO PAY FOR THEIR OWN LOOPS AND NETWORKS RATHER THAN ATTEMPTING TO SHARE THESE LOCAL ACCESS COSTS BETWEEN LOCAL SERVICE AND TOLL USERS?

A. No. The rationale for charging local exchange customers for loop costs, rather than including these costs in toll carriers' costs, centers on the argument that loop costs are non-traffic sensitive or customer-specific. The classification between non-traffic sensitive and traffic sensitive costs is arbitrary. Most access costs are sensitive to types and amounts of service in the long run. The investment costs associated with loop plant are central office circuit costs and the loop itself. The expenses associated with loops include maintenance and testing of loops and other directly related costs. The argument that these costs are non-traffic sensitive ignores the fact that the loop is part of the integrated telephone network and was built to serve both local and toll usage.

Q. WHY IS THAT SO?

A. It is a mistake to think of local loops as customer-specific facilities. Telephone subscriber access lines are part of the integrated telecommunications network. They are not customer-specific facilities like electric service drops or gas line laterals. No gas or electric service subscriber demands or benefits directly from another subscriber's service connection. Consequently, regulatory commissions have frequently approved utility rate structures that recover gas and electric service connection costs through customer charges rather than demand or energy charges.

Telephone subscriber loops are quite different. No one would want telephone service unless others had loops. In placing a telephone call, one demands the use of the called party's loop. In order to obtain toll service subscribers, long-distance carriers must be able to obtain access to the local loops that their subscribers wish to call. In short, the subscriber access loop is an integral part of the telephone service network. Recovering loop costs as if loops were merely the telephone industry's equivalent of customer-specific electric or gas service connections is not reasonable.

Q. ALJ MELILLO's ORDER ALSO SPECIFIES A NUMBER OF ISSUES PERTAINING TO THE PENNSYLVANIA UNIVERSAL SERVICE FUND ("PAUSF"), INCLUDING THE IMPACT ON RATES OF PAUSF CONTRIBUTIONS AND DISBURSEMENTS AND THE APPROPRIATENESS OF CONTINUED PAUSF SUPPORT OF ACCESS CHARGE REDUCTIONS AND/OR OF ELIMINATING THE CURRENT PAUSF AND INCREASING ACCESS CHARGES. WHAT IS YOUR RESPONSE TO THESE ISSUES?

A. The PAUSF, as implemented today, should be reconsidered and possibly eliminated. To continue to require all ratepayers to fund the PAUSF without examination of each beneficiary's needs and costs is inefficient and counterproductive. The PUC has little knowledge of which ILECs today need a subsidy. In addition, the PAUSF could be having the unintended consequence of keeping lower cost competitors out of subsidized markets, including rural areas, rather than promoting competition. There is no reason to provide a general subsidy to all rural ILECs. Each ILEC's costs and particular operating conditions should be examined to justify a PAUSF subsidy in today's market. Relatedly, rate caps, which create a "need" for PAUSF subsidies when ILEC local exchange rates increase, should be reevaluated and reconsidered at the same time, as these are inseparable issues.

Q. SHOULD RURAL ILECS' NETWORK MODERNIZATION PLAN EXPENDITURES BE RECOVERED BY PAUSF ASSESSMENTS TO LONG DISTANCE COMPANIES OR OTHER LECS?

A. No. There is no reason for other broadband competitors to fund the competitive broadband business expansion of any ILEC. That is, however, exactly what broadly structured local exchange service rate caps and PAUSF-related funding actually do. Such broadly structured PAUSF funding allows rural ILECs to collect PAUSF funds to support the very same loop facilities that are being upgraded for broadband service.

This is especially objectionable in that the largest beneficiaries of the PAUSF subsidies are not small rural ILECs, but large holding companies, that earn substantial revenues and profits from non-regulated services. Because we as a society have embraced the competitive model for telecommunications, the broadbased ILEC-level subsidy system is no longer useful or acceptable. The market should be allowed to work without any general ILEC-level subsidies. Current PAUSF funding practices and related rate caps, especially in rural markets, should be reevaluated and reformed because they subsidize all rural consumers, whether there is a need or not. That is, they treat all rural consumers as low-income consumers. There is no basis for that assumption. The target for subsidies should be refined to focus on low-income consumers.

Q. OTHER THAN THE PAUSF, IS THERE ANY OTHER SOLUTION FOR JUSTIFIED LOW-INCOME SUBSIDIES?

A. Yes. That concern is already being treated through a customer-specific Federal USF Lifeline program that provides highly discounted local exchange rates for the benefit of low-income consumers in Pennsylvania.

Q. PLEASE DESCRIBE THE FEDERAL USF LIFELINE PROGRAM.

A. Federal rules (47 CFR Part 54 Subpart E, starting at Section 54.400) provide low-income consumers with direct support. A major difference between the Federal and Pennsylvania USF ("PAUSF") support is that Federal USF support is applied in a uniform fashion to all carriers in the market, not just to the ILECs as the current Pennsylvania system does. The Federal USF provides direct support to low-income consumers. Under this existing Federal Lifeline program, which is used in Pennsylvania, consumers have choices in how they get and use local service support. In addition, Federal Lifeline support does not have to be tied to the low-income consumer's existing ILEC. Federal USF Lifeline support is portable, including cellular and other wireless service, a feature which is important to many consumers. If there is need for additional specific and targeted low-income support from the PAUSF, it has not been demonstrated.

Q. WOULD A SUBSIDY STANDARD THAT PROVIDES FOR RURAL RATES AT THE LEVEL OF URBAN RATES BE REASONABLE?

A. No. Simply equating rural rates with non-rural rates is not sufficient justification for continuing existing rate caps and PAUSF funding. While it is, of course, appropriate for all consumers to be treated equitably and to have access to reasonably comparable services at just and reasonable rates that are not unduly discriminatory, costs must be considered in determining what is reasonable. Wealthy people who choose to live in rural areas should not be entitled to PAUSF subsidies and rate caps funded by less affluent urban residents.

Q. IS IT BECOMING MORE GENERALLY RECOGNIZED THAT RATEPAYER SUBSIDIES SUCH AS THOSE PROVIDED BY THE PAUSF SHOULD BE MORE JUSTIFIABLY TARGETED?

A. Yes. There should be a demonstrated and specific cost-based need for any type of universal service subsidy, and the costs should be consumer or ILEC-specific. The January 29, 2008 FCC notice stated that "we tentatively conclude that we should require competitive ETCs [eligible telecommunications carriers] that seek high-cost support to file cost data demonstrating <u>their costs</u> of providing service in high-cost areas." (FCC, Notice of Prepared Rulemaking, WC Docket No. 05-337, cc Docket No. 96-45, January 29, 2008, ¶ 12 (emphasis added)). The FCC will require any company that wants a universal service subsidy to justify it with that company's specific costs of providing local exchange service. The PUC should apply the same rules to the PAUSF, or alternatively eliminate the PAUSF. In addition, the rural companies have several years of increases in rates due to Chapter 30, and these increases may have diminished any further or continuing need for a subsidy. The only way to determine whether there remains any need for a subsidy is to examine each company's cost to provide service.

Q. ARE YOU SAYING THAT IF THE PAUSF IS CONTINUED, THE COMMISSION SHOULD DETERMINE EACH ILEC'S COSTS TO PROVIDE LOCAL EXCHANGE SERVICE?

A. Yes. Establishing a cap on rates and providing a corresponding subsidy from PAUSF when local exchange rates would otherwise exceed a specific level cannot be justified from an economic or social standpoint unless there is a "need" for the PAUSF subsidy. To answer the "need" question, the Commission must determine what is the "affordable" rate and what are each ILEC's costs? Determining an "affordable" rate is not an exercise in economic principles; it is a public policy decision. After making this determination, each ILEC that wants to draw funds from the PAUSF should be required to demonstrate that its costs are substantially higher than the "affordable" rate. If an ILEC's costs are not substantially higher than the "affordable" rate, then the ILEC should not be permitted to draw from the PAUSF.

Q. IS THERE DISAGREEMENT AMONG THE PARTIES TO THIS CASE ON THE MATTER OF PAUSF FUNDED SUBSIDIES?

A. Yes. While a number of the parties, even AT&T aligned parties, appear to agree with me that a needs test should govern PAUSF distributions (e.g., see November 30, 2009 testimony of Comcast witness Pelcovits at 20), there are some that apparently advocate granting PAUSF funding as an automatic offset entitlement (in the absence of offsetting local service rate increases) whenever rural ILEC intrastate access rates are reduced. (See November 30, 2009 testimony of Qwest witness Easton at 7-8). In my opinion, the Commission's obligation to enforce just and reasonable rate standards counsels against approving any such automatic entitlement to PAUSF funding.

Q. DOES THE COMMISSION HAVE THE AUTHORITY UNDER CHAPTER 30 AND OTHER RELEVANT PROVISIONS OF THE PUBLIC UTILITY CODE TO PERFORM A JUST AND REASONABLE ("J&R") RATE ANALYSIS OF THE RURAL ILECS' RESIDENTIAL AND BUSINESS

RATES FOR BASIC LOCAL EXCHANGE SERVICES WHEN SUCH RATES REQUIRE PAUSF SUPPORT?

A. Yes. I am informed by counsel that the Commission has the authority (under Chapter 30 and other relevant provisions of the Public Utility Code) to perform a J&R rate analysis of any ILEC's residential and business rates for basic local exchange services. The OSBA believes that not only does the Commission have the authority to perform such J&R rate analyses, but that the Commission must use that authority to analyze the costs and revenues of any ILEC that takes money from the PAUSF.

Q. HOW WOULD A "NEEDS TEST" IMPACT THE ANNUAL FEDERAL USF SUPPORT THAT THE PENNSYLVANIA RURAL ILECS RECEIVE?

A. Assuming the PAUSF subsidy to companies continues, the annual Federal USF support payments that Pennsylvania rural ILECs receive would not change. However, that support should be considered as an offset to PAUSF subsidy requirements in relation to each ILEC's costs.

Q. HOW WOULD THE "NEEDS TEST" IMPACT WHETHER THE PAUSF LEVEL OF SUPPORT DISTRIBUTIONS TO THE RECIPIENT RURAL ILECS SHOULD BE ADJUSTED IN RELATION TO REVENUE INCREASES IN LOCAL EXCHANGE RATES THAT MAY BE

IMPLEMENTED THROUGH CHAPTER 30 MODIFIED ALTERNATIVE REGULATION PLANS AND PRICE STABILITY MECHANISMS?

A. If such targeted PAUSF subsidies are implemented, adjustments will need to be made as revenues and costs change. In addition, what is an "affordable" rate is likely to change. Rural ILEC's costs and revenue (including Federal USF revenue) will need to be examined before each annual PSM increase.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes; it does.

OSBA STATEMENT NO. 2

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Rebuttal Testimony of

JOHN W. WILSON

On Behalf of the

Pennsylvania Office of Small Business Advocate

Date Served: March 10, 2010

Date Submitted for the Record: ____________________

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Harrisburg JS

Q. PLEASE STATE YOUR NAME, OCCUPATION, AND ADDRESS.

A. My name is John W. Wilson. I am President of J.W. Wilson & Associates, Inc. Our offices are at 1601 North Kent Street, Suite 1104, Arlington, Virginia, 22209.

Q. ARE YOU THE SAME JOHN WILSON WHO FILED DIRECT TESTIMONY IN THESE CONSOLIDATED PROCEEDINGS ON JANUARY 20, 2010?

A. Yes, I am.

Q. WERE YOUR QUALIFICATIONS, EXPERIENCE AND EDUCATION SUMMARIZED IN YOUR JANUARY 20, 2010 DIRECT TESTIMONY?

A. Yes, they were.

Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS PROCEEDING?

A. I am presenting this rebuttal testimony on behalf of the Office of Small Business Advocate ("OSBA") for the Commonwealth of Pennsylvania.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of my rebuttal testimony is to respond to proposals made by other parties in direct testimony filed in these Consolidated Proceedings on January 20, 2010.

Q. WHAT ARE THE SPECIFIC PROPOSALS BY OTHER PARTIES TO WHICH YOU ARE RESPONDING?

A. I am responding to proposals for further reductions in the intrastate access rates of Pennsylvania rural local exchange carriers ("RLECs"), a proposal for the complete elimination of the carrier common line charge, and proposals for increases in access cost subsidies through expanded contributions to the Pennsylvania Universal Service Fund ("PAUSF"). In particular, OCA witness Loube proposes the elimination of the carrier access line charge and substantial increases in PAUSF contributions to subsidize the associated local exchange carrier revenue loss. Also, while not supporting the inter-exchange carriers' specific access line reduction proposals in this case, the PTA companies and CenturyLink argue for increased PAUSF funding of telephone access costs in the event of any further reductions in carrier access line charges.

Q. ARE FURTHER REDUCTIONS IN THE ACCESS RATES OF THE PENNSYLVANIA RLECS WARRANTED AT THIS TIME?

A. No. There is no valid justification for further reductions in these access rates and none has been presented by parties to this proceeding. There is no evidence that RLEC access rates exceed their respective access costs.

The Commission has previously and correctly found that carrier common lines have joint costs that must be allocated among the services that use these lines. The fact that many services are typically provided in combinations, using the same facilities, does not mean that definable shares of the joint and common costs of these facilities cannot be causally attributable to each. There should be no question that the intrastate portion of local access costs is substantially attributable to the design and use of local access facilities for the benefit of toll carrier traffic.

Q. WHAT CONCLUSION DO YOU DRAW FROM THE FACT THAT LOCAL ACCESS COSTS ARE IN SOME MEASURE ATTRIBUTABLE TO THE DESIGN AND USE OF LOCAL ACCESS FACILITIES FOR THE BENEFIT OF TOLL CARRIER TRAFFIC?

A. I conclude that toll carriers should be required to support a reasonable share of the local access facilities' costs that are essential for their businesses. Further reducing access charges (that permit toll carriers to use local facilities that are designed and required to provide toll service), or eliminating them altogether as is proposed by the OCA, would cause local exchange ratepayers to pay more of these local facilities' costs, either through higher local exchange rates or through higher charges to support PAUSF subsidies. Such a result would particularly harm the RLECs' business customers, who are already paying local exchange rates that are more than enough to cover a fair portion of the cost of their usage of the loops required for local exchange service.

Q. WOULD THE PROPOSED ELIMINATION OF THE CARRIER COMMON LINE CHARGE BE A REASONABLE RATE POLICY FOR THE COMMISSION TO ADOPT?

A. No. Elimination of the carrier common line charge and the replacement of the associated lost revenues by a large increase (i.e., nearly triple) in PAUSF funding are a central feature of the access rate proposal presented by OCA witness Loube. Loube direct testimony at 6 and 10. Although OCA has argued in favor of the intrastate carrier common line access charge in the past, Dr. Loube now recommends its elimination "because the Commission has been preempted by the FCC from applying the carrier common line charge to intra-MTA wireless minutes." Loube direct testimony at 11.

Q. IS THE ISSUE OF WIRELESS CARRIER CONTRIBUTIONS TO THE SUPPORT OF COMMON ACCESS LINE COSTS AN IMPORTANT REGULATORY ISSUE?

A. While applying access charges to wireless carriers may be an important equitable issue, I understand that the Commission has exempted this issue from the present proceeding. Moreover, eliminating access charges entirely and replacing them with an expanded PAUSF subsidy, all because of frustration about the inability to charge wireless service providers for their use of local access facilities, would be a classic exercise of throwing the baby out with the bath water.

Q. IS THE ELIMINATION OF CARRIER ACCESS LINE CHARGES A NEW REGULATORY POLICY ISSUE?

A. No. Carrier access line charges have been an issue in telecommunications regulation for more than two decades.

Commenting on this, OTS witness Kubas presents the following explanation in his direct testimony at 13-14 with which I agree:

> "The FCC determined years ago that the portion of the local loop allocated to interstate traffic should be paid for by end-users through a Federal Subscriber Line Charge (FSLC) rather than from companies such as IXCs that use the loop to originate and terminate calls. Since a portion of interstate access costs are recovered from end-users through the FSLC, the RLEC interstate access rates do not recover their full cost from IXCs that use the local loop to provide interstate toll service....
>
> ...I believe that the FCC improperly shifted the cost of the local loop to end users because this cost used to be recovered from the companies that profit from providing services to customers over the local loop. The RLEC FSLC is not a small charge, currently approximately \$6.00-\$7.00 per month per line for residential customers. Whether imbedded in basic local exchange rates or through an Intrastate Subscriber Line Charge (ISLC), the Commission should not improperly shift the recovery of the instate portion of local loop costs to end-users and let the IXCs also become intrastate freeloaders."

Q. SINCE CARRIER COMMON LINES ARE FIXED FACILITIES WITH FIXED COSTS, WOULD IT BE A VIOLATION OF ECONOMIC PRINCIPLES TO RECOVER THESE COSTS FROM USERS, INCLUDING

TOLL CARRIERS, THROUGH THE APPLICATON OF USAGE SENSITIVE RATES?

A. No. The notion that fixed capital costs may be partially (or even largely) usage sensitive and properly collected through usage charges is not new to public utility regulation. For example, state regulatory commissions have long recognized that it is appropriate to collect a substantial portion of the fixed capital costs of nuclear, hydro, or coal-fired electric generating capacity through usage charges (e.g., kilowatt-hour charges). Thus, under commonly used methods of pricing to recover electric generating plant costs, utility regulators have recognized that a substantial portion of fixed plant costs are properly classified and collected as usage-sensitive costs.

Similar cost causation principles apply to investments in fixed telephone utility plant. To argue that once a loop is installed, its costs are sunk, and therefore marginal cost rules dictate that the price for access use should be zero, is similar to arguing that once a nuclear power plant is built, its costs are sunk and nuclear power should be sold at a near zero price, i.e., a price equal to only the variable cost of running the plant.

Just as regulators have found that a large portion of the fixed capital cost of electric plant is properly recovered through usage-sensitive rates, the same should also be true of subscriber loops. No doubt, erroneous conclusions in this regard by telephone companies and the FCC are more likely to be avoided by state regulators because of their greater familiarity with the more advanced cost classification and pricing principles that have been applied in other types of utility regulation for many years.

Q IS THERE ADDITIONAL EVIDENCE THAT ACCESS COSTS ARE A USAGE-RELATED COMPONENT OF INTEGRATED TELEPHONE COMMUICATIONS SYSTEM COSTS?

A. Yes. The fact that access costs are usage-related and a component of integrated system costs is further evidenced by the fact that there are discretionary trade-offs between loop and switching costs in designing an integrated telecommunications system. It is hardly reasonable to conclude that the same economic cost of performing a given function is not usage-related if it is embodied in loop plant but that it is usage-related if it is embodied in switching plant.

Q. DID DR. LOUBE ESTIMATE HOW MUCH PAUSF FUNDING WOULD INCREASE IF HIS PROPOSAL TO ELIMINATE COMMON CARRIER LINE CHARGES WERE ADOPTED BY THE COMMISSION?

A. Yes. According to Dr. Loube, annual PAUSF payments would increase from $33 million to $97.3 million under his proposal.

Q. WOULD THIS INCREASE BE REASONABLE?

A. No. The proposal to eliminate common carrier line charges and shift this cost burden to PAUSF financing would effectively convert an interim funding mechanism into a very large, long-term access cost subsidy.

Q. PLEASE EXPLAIN.

A. The Commission's September 30, 1999 *Global Order* established the PAUSF to enable RLECs to reduce access charges without the need to make up for the revenue loss that would be incurred by raising local service rates beyond a designated threshold. All Pennsylvania telecommunications providers, except wireless carriers, were required to contribute to the PAUSF based on their jurisdictional revenues, and RLECs were allocated PAUSF funding to offset revenue deficits resulting from access charge reductions. Pursuant to the *Global Order*, the PAUSF was intended to be an interim funding mechanism during a period of access charge reform that was scheduled to expire on December 31, 2003. Subsequently, the Commission's 2003 Joint Stipulation Order extended PAUSF expiration to allow additional time for the Commission to consider related rate issues and modifications to PAUSF funding.

Q. CAN IT BE ARGUED THAT DR. LOUBE's PROPOSAL TO TRIPLE PAUSF FUNDING IS CONSISTENT WITH THE COMMISSION's

***GLOBAL ORDER* IN THAT THE INCREASED FUNDING WOULD BE TIED TO A REDUCTION IN RLEC ACCESS CHARGES?**

A. Yes, but only to the limited extent that this increased PAUSF funding would relate to the proposed elimination of carrier access charge revenues Contrary to what I understand to be the intent of the *Global Order*, such funding would convert the PAUSF from its intended role as an interim funding solution into a much larger, complete, and apparently permanent subsidy of intrastate carrier access costs in much the same way the Federal subscriber line charge subsidizes interstate toll carrier access costs.

Q. WHAT APPEARS TO BE THE UNDERLYING MOTIVATION FOR DR. LOUBE'S PROPOSAL?

A. At the present time, wireless carriers do not pay common access line costs and also do not contribute to the PAUSF, which subsidizes RLECs when carrier access line payments fall short of full cost recovery. Apparently, Dr. Loube finds his proposal to be an acceptable, though roundabout, alternative way to make wireless carriers compensate for common line access costs.

Presumably, Dr. Loube would favor the institution of common access line charges for wireless carriers, since they require and use the RLECs' facilities just like all other types of network users. However, because he sees such direct charges to wireless carriers as being foreclosed, his recommendation here is to accomplish the same end result indirectly, by eliminating direct common access line charges for all users and transferring the full cost burden of these common network access facilities to the PAUSF subsidy. At the same time, to accomplish his desired end, his proposal is to add wireless carriers as contributing supporters of the PAUSF. Loube direct testimony at 11-12.

Q. IS THIS PROPOSED PAUSF SUBSIDY OF CARRIER ACCESS COSTS A WARRANTED ECONOMIC POLICY?

A. No. At best, it is a clever end-run to get around what is perceived to be a ban on any straightforward requirement for wireless carriers to contribute their share of support for the telephone network's common access line costs.

Q. DO YOU BELIEVE THAT DR. LOUBE WOULD AGREE WITH YOUR CHARACTERIZATION OF HIS PROPOSAL AS CONSTITUTING A PLAN TO SUBSIDIZE COMMON ACCESS LINE COST RECOVERY?

A. Only in part. I believe that we would agree that his plan would, as a general matter, subsidize the access network and the recovery of common access line costs. On the other hand, as I understand his argument, I believe he would contend that this does not result in the subsidization of any customer group or service by any other group or service. In contrast, I believe that it does result in the unwarranted subsidization of toll service providers.

Q. PLEASE EXPLAIN.

A. Dr. Loube essentially defines away the issue of cross subsidy. That is, on one hand, he says that if the access rates charged for a service are above the incremental cost of access, then the service is not being subsidized. Loube direct testimony at 69. He then goes on to argue that the incremental cost of access is zero (or very near zero) for each service because access facilities would have to be there for other services anyway. Loube direct testimony at 70. Thus, any price at or above zero means that no service is being subsidized.

On the other hand, Dr. Loube also says that because each service would, alone, require network access, any price paid by a service that is below the full stand-alone cost of network access means that the price paid is not providing a subsidy. Loube direct at 70.

Therefore, very simply, and by definition, any price at or above zero and below the full stand-alone cost of network access means no subsidy. Problem solved.

Q. DOES THIS REALLY SOLVE THE PROBLEM OF DETERMINING WHO SHOULD PAY FOR NETWORK ACCESS COSTS?

A. No. It is simply a clever, but I believe mistaken, way of defining away the problem of cross subsidy. In my view, this "solution" does not provide any useful regulatory ratemaking guidance. Instead, it reflects a very extreme short-run perception of marginal costs that does not comport with how network costs have been (and are) incurred. As discussed above, facility costs (such as generating plants and access networks) that are fixed in the short-run are nevertheless incurred in the long-run as a consequence of network usage. Rates for network access that are intended to be equitable and economically efficient in the long-run should reflect network usage.

Q. IS THERE ANY ALTERNATIVE TO INCREASED PAUSF FUNDING IF CARRIER ACCESS LINE CHARGES ARE REDUCED?

A. Carrier access line charges should not be further reduced. Nevertheless, if, despite the lack of any cost justification, carrier access line charges were to be further reduced, the PAUSF subsidy would come into play only if the access charge reductions were not offset by corresponding increases in local exchange rates. While Dr. Loube's proposal does call for certain increases in local exchange rates for RLEC customers, these are limited by ceilings comprised of (a) an amount equal to 120% of Verizon's weighted average residential rate in Pennsylvania ($17.09/mo) or (b) an $18/mo affordability rate cap. The end result of this proposal, even after factoring in the local service charge increases, is an increase in PAUSF funding from $33 million to $97 million per year. Loube direct testimony at 17.

Q. DOES THIS PROPOSED INCREASE IN THE PAUSF SUBSIDY RAISE ADDITIONAL ECONOMIC QUESTIONS?

A. Yes. Independent of the issue of reducing carrier access charges without supporting cost justification, the offsetting PAUSF subsidy raises two important economic questions: (1) is it reasonable to assume that all RLECs require the same PAUSF funding, and (2) is it reasonable to assume that all residential ratepayers require the same rate cap at a fixed level of $18/mo?

Q. WHAT ARE THE ANSWERS TO THESE QUESTIONS?

A. The answers to these questions are that (1) there is no evidence that all RLECs require the same level of PAUSF funding, and (2) not all residential ratepayers are in economic need of service cost subsidies funded by other ratepayers – and certainly not at the current cap level of $18/mo.

Q. PLEASE EXPLAIN WHY, AS AN ECONOMIC MATTER, NOT ALL RESIDENTIAL RATEPAYERS ARE IN NEED OF SERVICE COST SUBSIDIES, FUNDED BY OTHER RATEPAYERS, AT THE CURRENT CAP LEVEL.

A. When the first cap was placed into effect in September 1999 (as an offset to reductions in local network access charges for intrastate toll carriers), the cap was $16 for residential local exchange service and there was a corresponding rate cap for business local exchange service. In July 2003, the residential cap was increased to $18 (again, to offset below-cost local network access charges for intrastate toll carriers), and the corresponding business rate cap was increased on a dollar-for-dollar basis. The residential caps were instituted to sustain the affordability of basic local exchange telephone service for all citizens, especially those at the lower end of the income spectrum for whom affordability was a real economic issue. Such subsidies for lower income consumers were viewed as justified, not only on social welfare grounds, but also because the existence of universal service and the ability to readily access a broader service subscriber base provided a more valuable network for all network users.

Q. IS THE $18 CAP ON MONTHLY LOCAL RESIDENTIAL SERVICE RATES STILL APPROPRIATE?

A. No. Given the level of inflation since 1999 when a $16 cap was first instituted, it is quite clear that the $18 cap on monthly local residential service rates today (if retained at all on a general basis) should be increased, at least for consumers who do not require low-income public assistance support.

The new Chapter 30 rules base annual rate adjustments on the overall health of the U.S. economy. From September 1999 through January 2010, the Consumer Price Index ("CPI") increased by 29%. Using this change in the CPI would suggest an increase in the rate cap of $18 to at least $20.65 per month for residential local exchange service customers who do not pass a needs test justifying a greater level of subsidized public support. In other words, if a cap that is generally applicable to all residential service subscribers is retained at all, it should now be adjusted to about $21 per month, with a lower cap being applicable only to low-income customers who qualify for greater public support pursuant to a needs test.

Q. SHOULD THE CORRESPONDING BUSINESS RATE CAP BE INCREASED AS WELL?

A. Using the same rationale I recommend for the residential cap, it could be argued that the corresponding cap on business local exchange rates should also be increased by applying the 29% rate of inflation to each RLEC's business rate cap in effect when the $16 residential cap was established. However, as my colleague Allen Buckalew testified in the parallel proceeding before ALJ Colwell, "It is not so clear that the cap on business single line rates (established in the Sprint/RTCC Settlement) should be increased. Generally, when I have examined business local exchange rates, I have always found them to be higher than cost of service, even with full assignment of loop costs to the local exchange category. Although this can also be true for residential local exchange rates in many cases, business rates usually exceed cost by a much larger percentage than do residential rates. For this reason, caps on rates for business local exchange service should remain unchanged." Direct Testimony of Allen G. Buckalew, OSBA Statement No. 1, Docket No. I-00040105 (Served December 10, 2008), at 8.

Q. IS IT IMPORTANT TO RAISE THE CAP PERIODICALLY?

A. Yes. If it is determined that a general cap for all RLEC residential customers should be retained, it is important to raise the cap periodically with the inflation rate index that is used to raise RLEC rates. A policy of capping certain rates while the revenue requirement is increased based on inflation cannot be sustained in the long run. The underlying premise of Chapter 30 regulation is the assumption that an ILEC's costs increase with inflation. Leaving aside whether that assumption is true, if some non-competitive services and their associated rates are exempt from these annual inflation increases, other non-competitive service rates must be increased by more than the rate of inflation in order to give the ILEC an opportunity to earn the revenues authorized by that ILEC's Price Stability Mechanism (PSM). If continued, this cycle will proceed until the only customers that remain on regulated rates are those that have no competitive choice.

Q. HOW SHOULD THE NEED FOR RLEC FUNDING SUBSIDIES FROM THE PAUSF BE DETERMINED FOR SPECIFIC LOCAL EXCHANGE SERVICE PROVIDERS?

A. There should be a demonstrated and specific cost-based service provider revenue deficiency to justify a universal service subsidy for any local exchange service provider requesting PAUSF support. Just as there should be a needs test to justify PAUSF support below the adjusted cap for low-income consumers, there should be clear cost of service evidence demonstrating that local exchange service rates and carrier access charges do not provide adequate compensation for the local access costs of any local exchange service provider seeking a PAUSF subsidy. Such "needs" and "cost of service" tests should be specific to each consumer or RLEC requiring a PAUSF subsidy.

Q. WHY ARE NEEDS TESTS AND COST OF SERVICE TESTS IMPORTANT IN THIS REGARD?

A. These tests are important because there is no justifiable economic reason to provide a general PAUSF subsidy to all RLECs and because not all residential customers require low-income support. To continue to require ILECs to fund the PAUSF without the examination of each beneficiary's needs and costs is economically inefficient and unwarranted. In fact, without supporting cost of service evidence, there is little knowledge of which RLECs today need a subsidy. There are wide economic differences between these companies and the markets that they serve. Each potential recipient's costs and particular operating conditions should be examined to justify a continued PAUSF subsidy.

Moreover, indiscriminate PAUSF funding could be having the unintended consequence of keeping lower cost competitors out of subsidized rural markets rather than promoting competition.

Q. HAS THE FCC REQUIRED CARRIERS SEEKING COST SUPPORT SUBSIDIES AT THE FEDERAL LEVEL TO COST-JUSTIFY THEIR NEEDS FOR SUCH SUPPORT?

A. Yes. On January 29, 2008, the FCC stated that "we tentatively conclude that we should require competitive ETCs [eligible telecommunications carriers] that seek high-cost support to file cost data demonstrating <u>their costs</u> of providing service in high-cost areas." (FCC, Notice of Proposed Rulemaking, WC Docket No. 05-337, cc Docket No. 96-45, January 29, 2008, ¶ 12 (emphasis added)). Pursuant to this Notice, which is still pending as of this date, the FCC will require any company that wants a universal service subsidy to justify it with that company's specific costs of providing local exchange service. The PUC should apply the same rules to PAUSF funding, pending the ultimate elimination of the PAUSF.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY AT THIS TIME?

A. Yes, it does.

OSBA STATEMENT NO. 3

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

Surrebuttal Testimony of

JOHN W. WILSON

On Behalf of the

Pennsylvania Office of Small Business Advocate

Date Served: April 1, 2010

Date Submitted for the Record: ____________________

Q. PLEASE STATE YOUR NAME, OCCUPATION, AND ADDRESS.

A. My name is John W. Wilson. I am President of J.W. Wilson & Associates, Inc. Our offices are at 1601 North Kent Street, Suite 1104, Arlington, Virginia, 22209.

Q. ARE YOU THE SAME JOHN WILSON WHO FILED DIRECT TESTIMONY ON JANUARY 20, 2010 AND REBUTTAL TESTIMONY ON MARCH 10, 2010 IN THESE CONSOLIDATED PROCEEDINGS?

A. Yes, I am.

Q. WERE YOUR QUALIFICATIONS, EXPERIENCE AND EDUCATION SUMMARIZED IN YOUR JANUARY 20, 2010 DIRECT TESTIMONY?

A. Yes, they were.

Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS PROCEEDING?

A. I am presenting this surrebuttal testimony on behalf of the Office of Small Business Advocate ("OSBA") for the Commonwealth of Pennsylvania.

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

A. The purpose of my surrebuttal testimony is to respond to certain contentions made by the Verizon and Comcast witnesses in their March 10, 2010 Rebuttal Testimony.

Q. VERIZON WITNESS PRICE STATES IN HIS MARCH 10, 2010 REBUTTAL TESTIMONY THAT THERE IS NO RECORD SUPPORT FOR THE PROPOSITION THAT THE RLECs SHOULD NOT BE ABLE TO INCREASE THEIR BUSINESS RATES BY A LARGER AMOUNT THAN THEY INCREASE THEIR RESIDENTIAL RATES TO OFFSET CARRIER ACCESS RATE REDUCTIONS. DO YOU AGREE?

A. No. In contrast to Mr. Price's testimony that "the record simply does not contain the evidence to support imposing a business rate cap at all," I testified in my rebuttal testimony that when the first residential local exchange service rate cap of $16.00 per month was placed into effect in September 1999, there was a corresponding rate cap for business local exchange service. Further, in July 2003, when the residential rate cap was increased to $18.00 per month to offset below cost local network access charges for intrastate toll carriers, the corresponding business cap was increased on a dollar-for-dollar basis. I am also informed by counsel that the business cap corresponding to the residential cap remains a legal requirement at this time.

Q. SHOULD THESE RESIDENTIAL AND BUSINESS LOCAL EXCHANGE SERVICE RATE CAPS BE RETAINED AT THEIR CURRENT LEVELS?

A. No. OSBA does not advocate the retention of these caps. However, it would be entirely unjustified, unreasonable and inconsistent with the history of these caps to now attempt to offset RLEC revenue deficiencies stemming from reduced toll carrier intrastate access charges, as suggested by Verizon, by raising only business local exchange service rates while retaining the residential cap at its current level.

Q. ARE THERE REASONABLE ALTERNATIVES TO RAISING RESIDENTIAL AND BUSINESS LOCAL EXCHANGE SERVICE RATE CAPS?

A. Yes. These caps should be removed entirely, except for a social welfare/universal service subsidy that may be justified for those low income consumers where affordability is a real economic issue. However, if a comprehensive residential local exchange service rate cap is retained, a general subsidy structure that imposes increased revenue balancing burdens in a disproportionate and uncapped manner on business customers, while retaining the current affordability cap for all residential customers, would be unduly discriminatory and economically unwarranted. Therefore, if a comprehensive residential cap is to be retained, retention of a business cap is an essential element of just and reasonable rates.

Q. COMCAST WITNESS PELCOVITS STATES, IN HIS REBUTTAL TESTIMONY, THAT YOUR POSITION ON INTERCARRIER COMPENSATION IS "ANACHRONISTIC" AND "ILLOGICAL." HOW DO YOU RESPOND?

A. In my rebuttal testimony I said:

> While the very short run incremental cost of adding a small volume of intrastate toll traffic on an existing local network designed with excess capacity to accommodate growth may be near zero, one could say exactly the same for the incremental cost of local service. Where there are joint and common facilities costs for related uses that share these facilities, it is a sham to single out one of those uses as the cost-causer or as the zero cost incremental user. That is simply a self-serving contrivance in the pursuit of a free ride.

Apparently Dr. Pelcovits takes issue with my testimony that toll carriers and their customers share responsibility for network local access costs and should not be excluded from responsibility for the recovery of a reasonable portion of those costs. In support of his view that toll carrier charges for local access should "exclude any portion of common costs, including the cost of the loop," Dr. Pelcovits cites an FCC rulemaking that he says makes "nearly identical points as I [Dr. Pelcovits] have about the pricing of intercarrier charges in relationship to costs." (Pelcovits Rebuttal at 19).

Dr. Pelcovits' view parallels the "incremental cost" theory offered by OCA witness Loube, that I have already addressed in my March Rebuttal Testimony. That theory essentially holds that since the local access network is needed for other services in any event, the incremental cost of toll access is zero or near zero. Since I have already addressed this argument, I would only note here that each and every service could make the same claim, and that practical solutions to revenue adequacy issues require a fair cost distribution rather than theories designed to produce zero charges.

I would also acknowledge that I do disagree with the FCC's access cost allocation philosophy which attributes these costs at the interstate level to subscriber line charges. I am advised by counsel that, as a legal matter, this Commission is not bound by these FCC views, and that it has the discretion to allocate intrastate local exchange access costs in Pennsylvania on a reasonable basis to the various services that demand and require local access facilities and that share responsibility for these costs.

Q. HOW DO YOU RESPOND TO DR. PELCOVITS' TESTIMONY THAT YOUR VIEWS ON COST ALLOCATION AMONG THE USERS OF LOCAL ACCESS FACILITIES AND YOUR RELATED ADVOCACY OF "SOME PLATONIC IDEAL OF FAIRNESS" ARE "FUTILE," "ANACHRONISTIC" AND CRUSHED BY COMPETITION IN TODAY'S WORLD ?

A. I disagree with Dr. Pelcovits' view that the regulatory goal of a fair allocation of local exchange access costs is obsolete, out of date or unattainable in today's world. Contrary to Dr. Pelcovits' assertion, there is no competitive market force that prevents the Commission from attributing a fair share of local exchange access costs to toll carriers. And, while doing so will impose a fair cost burden on toll carrier competitors who require and use local network access facilities (just like they are compelled by resource supply markets to pay for the unregulated cost components of providing toll service), it will not impede competition that is beneficial to consumers.

More fundamentally, and especially in today's world, "fairness" remains a cornerstone of just and reasonable rate regulation. To sacrifice it so cavalierly in the interest of a free ride for toll carriers, would greatly diminish the very reason for, and justification of, regulating rates and cost recovery. The Commission's role regarding the regulation of local exchange access costs should not be reduced to one of instituting and administering a massive PAUSF cost subsidy program that fundamentally separates local access cost recovery from cost responsibility.

Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?

A. Yes, it does.