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September 17, 2010

VIA UPS OVERNIGHT

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

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

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

Dear Ms. Chiavetta:

Enclosed on behalf of AT&T Communications of Pennsylvania, LLC, TCG Pittsburgh, and TCG New Jersey, Inc., please find the original and nine copies of the Reply Exceptions of AT&T, including Appendices 1 through 4. Please note that the brief contains proprietary information and should be filed as confidential. I have also enclosed a public version of the brief, without appendices. Copies have been served in accordance with the attached Certificate of Service.

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

Very truly yours,

Demetrios G. Metropoulos

cc: Hon. Kandace F. Melillo
Cheryl Walker Davis
James H. Cawley, Chairman
Tyrone J. Christy, Vice Chairman
Wayne E. Gardner, Commissioner

Robert F. Powelson, Commissioner
John F. Coleman, Jr., Commissioner
Certificate of Service

Enclosures

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

REPLY EXCEPTIONS

of

AT&T

PUBLIC VERSION

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SEPTEMBER 17, 2010

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REPLY EXCEPTIONS OF
AT&T

I. INTRODUCTION

This case is about doing what's right for *all* Pennsylvania consumers, not just the ones served by the Rural Local Exchange Carriers ("RLECs"). The Commission first recognized over a decade ago that access reform was needed, and that reducing the implicit subsidies in access rates is best for competition and consumers throughout Pennsylvania. The Commission took two steps forward in implementing that reform – first in the 1999 *Global Order*, and again in 2003. Although promising further reform in 1999, 2003, 2004, 2007 and again in 2009, it has yet to occur.[1] The evidence in this case conclusively proves that given the dramatic changes to the market that have occurred since the Commission last reduced access rates, it is more critical than ever that the Commission fulfill its promise to give Pennsylvania consumers the benefits of further access reform.

The evidence presented in this case shows that, since the last access reforms in 2003, consumers across Pennsylvania have overpaid over $640 million in subsidies to the RLECs.[2] Few, if any, consumers in Pittsburgh or Philadelphia (or any other Pennsylvania community not

1 AT&T Statement 1.0 (Nurse/Oyefusi Direct) at pp. 21-24.

2 PTA calculates the difference between interstate and intrastate rates to be $91.7 million each year. Tr. at p. 588, which leads to $641.7 million when multiplied by 7 years. However, this number is conservative because it is based on 2008 line counts, which have been decreasing each year according to PTA and CenturyLink. Therefore, the total revenue difference between interstate and intrastate access rates would have been higher each prior year as access line counts were higher in those previous years.

served by the RLECs) even know they are overpaying for their wireline long distance service just so that the RLECs can be protected from adjusting to the realities of the new marketplace.

While the RLECs would have this Commission believe that customers have not, and will not, benefit from reducing access rates, nothing could be further from the truth. For starters, access reform will drive down long distance prices in Pennsylvania, just as it has in the past in Pennsylvania, and just as it has in every other state that has already implemented access reform.[3]

Access reform will also make the entire Pennsylvania communications market more competitive. Until now, the access subsidies that fall exclusively on AT&T and other traditional wireline long distance carriers have made it increasingly difficult for them to compete against e-mail, internet, social networking websites, cable telephony providers, other Voice over Internet Protocol ("VoIP") providers, wireless carriers, and other new and emerging technologies and applications not required to pay access subsidies in the same way. As access reform enables long distance carriers to enhance their service offerings, their competitors will be forced to respond, and consumers will reap the benefits.

Access reform will even benefit the RLECs that rail against it. With their access subsidies in hand, the RLECs have been insulated from having to innovate, to become more efficient, and to compete on price. That will change once access reforms are implemented and, like it or not, the RLECs will be forced to become more efficient, more customer-focused competitors. Moreover, bringing RLEC intrastate access rates to parity with their interstate rates will reduce their billing costs and help eliminate their litigation costs for disputes over "traffic pumping," "phantom traffic," and jurisdictional mis-reporting of access traffic.

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[3] The uncontested record evidence in the case is that AT&T's average long-distance prices fell by ***more*** than access rates declined in Pennsylvania. See Attachment H to AT&T Statement 1.0. This factual relationship was evidenced across Pennsylvania and 18 other states that have implemented access reform, and it was demonstrated over a sustained five-year period.

For more than a decade, the RLECs have been repeatedly forewarned that access reform was coming, yet they claim in this case that any reform implemented now would be rushed, premature and irresponsible. Of course, during that time the RLECs morphed into much different companies than the rustic "Mom and Pop" company imagery they hide behind. Most have expanded into broadband, video and other new revenue sources, yet they still want to cling to their access subsidies. The evidence shows that of the RLECs' approximately 1 million access lines, over 850,000 lines are now owned by three large, national carriers that continue to expand their reach – indeed, one is now acquiring a Regional Bell Operating Company.[4]

The ALJ agreed that it is time for the Commission to move forward and finally eliminate harmful anti-competitive subsidies that can no longer exist in today's hyper-competitive marketplace.[5] Although AT&T takes issue with the Recommended Decision's ("RD") ministerial and delayed path for implementing reform, the RD's determination that current access rates are unjust and unreasonable and that, accordingly, those rates must be reduced to interstate levels, is fully supported by the evidence of record, and should be sustained. And with the improvements to the ALJ's proposal outlined in AT&T's Exceptions, the Commission will be completing the work it started over a decade ago, when it found that developments in the markets and regulatory arena "***require[d] elimination of implicit subsidies***."[6] Completing this work will put Pennsylvania in step with the 25 states in this country that already have implemented access reform – and have seen no adverse effects on universal service, no adverse effects on companies' abilities to serve their customers, and no inordinate increases to retail rates.

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[4] See Appendix A to AT&T Exceptions for estimated 2009 line counts for all RLECs, including the 3 largest – CenturyLink, Windstream/D&E and the Frontier companies.

[5] In response to PTA's decision to attach its Proposed Findings of Fact and Conclusions of Law to its Exceptions, AT&T attaches its Proposed Findings of Fact and Conclusions of Law to these Reply Exceptions as Appendix 1 and Appendix 2, respectively.

[6] *Global Order* at p. 25.

AT&T has put forward a straightforward proposal for reducing access subsidies while giving the RLECs the opportunity to remain revenue neutral. Under AT&T's approach, RLECs first will look to their own subscribers for new revenues, as basic monthly local rates increase to $22/month *(i.e.,* the existing $18 rate cap brought forward for inflation), and then by $1 each year for four years. The evidence proved that $22/month falls well within affordability levels in Pennsylvania.[7] During that transition, if in any year a RLEC's reduced per-line access revenues exceed its increased local rate rebalancing opportunity, then it will be permitted to collect the additional per line amounts from the Pennsylvania Universal Service Fund ("PaUSF"), but this per-line amount will decrease each year as the benchmark rate increases. Assuming access reductions become effective January 1, 2011, the PaUSF will increase by $19.6 million in 2011, but then steadily decline by about half each year thereafter as the RLECs receive more revenues from their own customers until the PaUSF will be about the same size in 2015 as it was in 2010.

This proposal presents the proper balance of three key objectives: (i) reducing unjust, unreasonable and anti-competitive implicit subsidies in intrastate access rates immediately and establishing just and reasonable access rates; (ii) requiring RLECs to first look to their own customers to recover their own costs; and (iii) maintaining affordable retail rates by transitioning increases to those retail rates over a reasonable time frame. The Commission should adopt AT&T's proposal and deliver to Pennsylvania consumers the benefits the Commission identified and promised over a decade ago.

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[7] This rate is also close to the $23 rate cap in neighboring New York, where several of the RLECs also offer service. *See* Appendix 3 attached to AT&T's Reply Brief.

II. THE ALJ PROPERLY RULED THAT INTRASTATE ACCESS RATES MUST BE REDUCED TO PARITY WITH INTERSTATE RATES.

The RLECs claim that the ALJ erred by ordering intrastate access rates to be reduced to parity with interstate levels, and as a fallback they claim that, if access rates are to be reduced at all, the ALJ's four year access reform plan is too much too soon. In support of these claims, the RLECs engage in their usual scare tactics, arguing variously that if this Commission implements the access reform the RLECs have known has been coming for over a decade, the RLECs nevertheless will be unable to serve customers or meet undefined and unsupported Carrier of Last Resort ("COLR") obligations, and customers in RLEC territories will be left with unaffordable rates. The RLECs even go so far as to claim that no customers will benefit from access reform in any way. These claims were all made throughout this case, and after considering the substantial evidence contradicting those arguments, the ALJ properly rejected them. The Commission should do the same here.

Further, the ALJ properly held that the Commission should not wait for the FCC before acting in this case and implementing access reform. The RLECs continue to argue in their Exceptions that access reform in this case would be premature and rushed because the FCC is allegedly poised to act. The Commission has already heard and rejected these claims, the ALJ correctly rejected them again, and the Commission should reject them one final time.

A. Customers Throughout Pennsylvania Will Benefit From Access Reform.

Disregarding the substantial evidence of record that was evaluated and confirmed by the ALJ, the RLECs claim throughout their Exceptions that the ALJ erred by recognizing consumers have, and will, benefit from access reform. The PTA argues that the "purported public interest benefits of further access reform are overstated."[8] CenturyLink asserts that "the Commission and the public cannot have any confidence that the access reductions being sought will provide any

[8] PTA Exceptions at pp. 21-27.

real consumer benefits in rural Pennsylvania."[9] CenturyLink alleges that in order for any access reductions to occur, the Commission must first show "net benefits" to customers (although that is never actually defined).[10] PTA similarly argues that the IXCs must demonstrate exactly how every reduction in access rates will flow through to customers.[11] In addition, both parties allege that AT&T has not demonstrated that it has "flowed through" prior access reductions.[12] Both parties are plainly wrong.

The clear and undisputed evidence demonstrates that AT&T has in fact flowed through ***more than*** the prior access reductions to consumers, not only here in Pennsylvania, but in all states where reform has been implemented, and over a sustained five year period. As AT&T witnesses Nurse and Oyefusi testified:

> This repeated claim[that AT&T has not flowed through access reductions] is a blatant attempt to mislead the Commission – ***AT&T has provided concrete proof that its toll rates have come down faster than its access expenses.***[13] In 19 states where access rates have been reduced, AT&T's average toll rates have come down by more than its access reductions. That is hardly surprising, given the intense competition that has occurred in the long distance business since 1984, and given the universally accepted economic principle that *any* business – even an unregulated monopolist with zero competition – will reduce its retail price if costs go down, all else equal. What is surprising, however, is that, even with this long-term, broadly based evidence in hand, the RLECs are still arguing that access reform does not benefit consumers.[14]

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9 CenturyLink Exceptions at p. 23.

10 *Id.* at p. 1, pp. 22-23; pp. 52-56.

11 PTA Exceptions at pp. 21-27.

12 PTA Exceptions at pp. 22-23; CenturyLink Exceptions at p. 23, 54.

13 See Attachment H to our Direct Testimony and Attachment 8 to our Rebuttal Testimony, comparing AT&T's toll rates and access expenses in Pennsylvania and in 19 other states. (Footnote included in original).

14 AT&T Statement 1.4 (Nurse/Oyefusi Rejoinder) at p. 4. The RLECs also argue that AT&T did not prove that it flowed through the 2003 access reductions. However, this argument is a red herring. The Commission (and RLECs) have never previously accused AT&T of failing to flow through the 2003 reductions. The fact that AT&T filed a letter stating that it needed more information does not prove that reductions were not flowed through. To the contrary, AT&T presented uncontroverted evidence in this case that in fact the reductions were in fact flowed through in Pennsylvania, and have been flowed through in 18 other states.

Even when AT&T made a specific commitment to reduce its In State Connection Fee ("ISCF"), the RLECs were not satisfied. To the contrary, they criticized AT&T's commitment, claiming that this nearly $1 per month per line rate reduction will not be meaningful.[15] Interestingly, this position is in direct conflict with prior testimony by CenturyLink in a case in which that company was advocating for reduced access rates. There, CenturyLink's witness testified that numerous benefits accrued from reducing implicit subsidies in access rates, including the "elimination of the 'In state connection fee.' As a result, toll customers currently paying this fee to an IXC – regardless of their level of usage – will benefit as this charge is eliminated."[16]

Earlier this year, in ordering access reductions, the New Jersey Board of Public Utilities recognized the benefit of AT&T's commitment to reduce its ISCF, as well as AT&T's commitment to reduce the decrement on its calling cards.[17] AT&T has already lowered its New Jersey in-state connection fee for residential consumers by ***over*** 30%.[18] Likewise, AT&T lowered the in-state connection fee for small business by 30%. Contrary to the RLECs' claims that these reductions do not benefit customers, these are direct line-item charges on customers' bills that consumers in Pennsylvania will save if access reductions are implemented here.

It is a mistake, however, to focus only on specific, line item rate reductions as if that was the exclusive indication of benefits from access reductions. In reality, there are multiple benefits to reducing intrastate access rates. Outside of this proceeding, even the RLECs themselves have recognized these benefits. Buffalo Valley Telephone acknowledged to the Commission that "[c]ustomers in BVT's service territory will benefit if IXCs pass along their reduced expenses

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[15] CenturyLink Exceptions at p. 23; 55; PTA Exceptions at p. 24.

[16] Exhibit CTL-Panel 8 to CTL Statement No. 1.2; Direct Testimony of Brian K. Staihr, August 27, 2003, p. 14.

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

[18] AT&T Statement 1.2 at p. 50. See also Attachment 9 to AT&T Statement 1.2.

through lower long-distance service charges and more effective toll competition."[19] CenturyLink has testified that the benefits of reducing implicit subsidies "will come through increased choices brought about by competition, and enhanced service offering and innovation that are stimulated by competition."[20] CenturyLink also testified that "the removal of implicit subsidies is consistent with-and necessary for-the development of a healthy and sustainable competitive market for basic local telecom services..., a competitive market that will simultaneously 1) provide benefits and choices to the largest number of [state] residents possible, and 2) operate on a level playing field for all competitors."[21]

It does not take an exact prediction of every single future price reduction (something that is not even legal, if it is even possible, in a competitive environment) to realize that consumers will benefit from access reductions. Notwithstanding PTA's criticism of elementary economic theory,[22] it is a well established principle that decreasing a wholesale cost input will lead to a decrease in the retail price of that output or service.[23] Lower prices will, in turn, stimulate demand. Even a ***pure*** monopolist, including one that is ***completely*** unregulated, will reduce output price in response to a reduction in input costs, because that is the way to maximize profits. From a pragmatic perspective, there is nothing remarkable in the fact that wholesale cost reductions will result in lower retail prices. Clearly, lower retail prices benefit customers.

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19 *Buffalo Valley Telephone Company Revenue-Neutral Rate Rebalancing Filing for Year 2003*, Docket No. R-00038351, April 30, 2003 ("*Buffalo Valley* 2003 Filing"), p. 12. Conestoga made a virtually identical filing to reduce access rates and increase its local rates, and made the same statements about the importance of raising local rates to better reflect costs, and recover lost access revenues. *Conestoga Telephone & Telegraph Co. Revenue-Neutral Rate Rebalancing Filing,* Docket No. R-00027260, April 30, 2002 ("*Conestoga 2002 Filing*"). See AT&T Statement 1.2 at p. 49.

20 Exhibit CTL Panel 8 to CenturyLink Statement 1.2; Direct Testimony of Dr. Brian K. Staihr, August 27, 2003 at p. 15.

21 *Id.* at p. 3.

22 PTA Exceptions at p. 22.

23 The PTA did not present any testimony or evidence from any economist or expert witness that disputes this basic economic principle.

Having intrastate access rates mirror interstate rates would also benefit customers and the RLECs in several additional ways. First, as the ALJ found, unified rates can reduce RLEC billing costs.[24] Moreover, adopting symmetrical rates and rate structures will help to avoid or mitigate problems associated with "call pumping," "phantom traffic" and other arbitrage schemes that have arisen as a result of the wide disparity in interstate and intrastate access rates and between access rates and cost.[25] OCA witness Dr. Loube testified that the differential between interstate and intrastate access rates invites regulatory arbitrage in which carriers disguise intrastate traffic as interstate traffic for the purpose of avoiding the higher intrastate rates.[26] CenturyLink identified this arbitrage as "among the most serious problems affecting rural price cap carriers."[27] Indeed, CenturyLink argued to the FCC that differences between intrastate and interstate switched access rates are causing "artificial arbitrage" that is "harming competition and investment" in several ways, including "harming network investment and innovation."[28] The RLECs themselves noted the problem of tariff arbitrage in their testimony to the Commission in the *Global Order* proceedings.[29]

Eliminating the opportunity for arbitrage will also help eliminate the litigation that "phantom traffic" has spawned. In the recent past, several PTA companies have filed formal complaints against carriers in Pennsylvania over these exact issues, claiming that the carriers have disguised the traffic sent to the RLECs to avoid paying intercarrier compensation.[30] PTA

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24 R.D. Finding of Fact #33.

25 R.D. Finding of Fact #36.

26 OCA Statement 1.0 at p. 60.

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

28 *Id.* at 15-16.

29 *Re Next Link Pennsylvania, Inc.*, Docket No. P-00991648; P-00991649, 93 PA PUC 172 (Sept. 30, 1999) at pp. 51-52 ("*Global Order*").

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

claims in its Exceptions that the Commission should ignore the root cause for these disputes (the gross disparity between intrastate and interstate access rates), and instead just require parties to litigate the disputes through enforcement proceedings.[31] This is most definitely not beneficial to the Commission or to carriers, who must waste valuable time and resources litigating a dispute that should not have to occur at all, or to consumers. The basis for these disputes (and costs in bringing them) will be substantially reduced once intrastate and interstate switched access rates are set at the same levels and share the same rate structure.

In addition to phantom traffic arbitrage, the record also demonstrates that some PTA companies have engaged in the unscrupulous practice of call pumping, also known as traffic pumping.[32] Call pumping is the practice whereby local providers, spurred on by the ability to benefit from high access prices, develop programs that encourage the creation of chat rooms, pornography, adult services and other questionable services that can generate high volumes of access traffic. The carriers are able to then "kick back" a share of their access revenues with these providers (which just confirms that the access rates are excessive as the RLECs would not be able to share revenues if the service were not priced well above cost).[33] The entire point of traffic pumping schemes is to generate as many terminating minutes as possible to increase revenues from captive long-distance carriers rather than from a company's own retail customers. This can lead to absurd uses of the network – in one case, AT&T's traffic to one small PTA company grew to more than 600,000 minutes per month, the equivalent of about 14 subscriber lines being used 24 hours per day, 30 days per month.[34] By reducing state access rates to interstate levels, the

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31 PTA Exceptions at p. 26.

32 AT&T Statement 1.2 at pp. 52-58.

33 AT&T Statement 1.0 at p. 42. Contrary to what the PTA may claim, traffic pumping is not a legitimate practice where RLECs are simply serving whatever types of customers may come their way. It is an improper way of abusing the excessive subsidies in access rates by encouraging certain types of customers to "pump" as much access traffic as possible to the RLECs in order to increase revenues. Of course, this practice comes at the expense of IXCs and their customers.

34 AT&T Statement 1.2 at p. 55.

Commission will reduce the ability of a telephone company to share inflated subsidies with traffic-pumping entities, so the Commission will essentially cut such practices off at the source.

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

The RLECs themselves have previously recognized this reality. Buffalo Valley and Conestoga both have stated that "offering services that are priced without consideration of underlying costs creates advantages for competitors that are uneconomic in nature."[35] In requesting that it be permitted to reduce its intrastate access rates and increase its local rates, Buffalo Valley further recognized that "[i]f consumers are to have choices in telecommunications carriers, then all carriers must be able to price and compete according to their own efficiencies."[36]

In direct contrast to the positions it takes in its Exceptions, CenturyLink itself has specifically recognized that moving prices closer to costs benefits customers, even if that means increased retail rates:

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

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

> When alternative technologies are forced to compete with subsidized prices – as they are currently – technologies that have genuine efficiency advantages are kept out of the market. ***If prices move closer toward actually reflecting costs, all customers will be better served because firms will be able to compete for their business with prices that reflect legitimate differences in costs, not simply differences in cross-subsidization.*** It is true that many residential consumers currently enjoy paying below-cost rates for their telecom services. Most consumers would enjoy paying below-cost based rates for *any* good or service. But ***these artificially low prices are unsustainable in the face of competition, and they come at a cost: fewer options among services, less innovation, and…no competitive choices.***[37]
>
> ***By allowing local rates to approach costs for more and more customers, a true win-win situation is created in the competitive market.*** A larger number of basic local service customers become attractive to competitors (which means more customers will be offered choices). And competitive entry will occur when it is efficient and sustainable, not when it is inefficient.[38]
>
> To the extent that access charges (or a portion thereof) serve as an implicit subsidy for loop costs and basic service, it is desirable to reduce them and allow the rates charged for basic service to come closer to covering the costs of basic service. In the process, the rates that IXCs are charged for access to the LECs network come closer to cost, and long-distance charges to end users also come closer to cost. ***The goal, which is both economically efficient and social-welfare-enhancing, is to allow rates for all services to approach costs regardless of the direction the rate must move in order to get there.***[39]

Although CenturyLink would prefer to ignore this evidence – and its own prior admissions – it was clearly right to acknowledge the benefits of eliminating subsidies then, and most certainly has it wrong now. While varying competition has certainly emerged throughout the Commonwealth, that is no reason to abandon further reform. The Commission has always found that in order for full and fair competition to emerge and ***be sustainable***, the inefficient bloat in RLECs' intrastate access rates must be reduced. The evidence demonstrates that the goal here has to be to benefit consumers throughout the Commonwealth by permitting

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[37] Exhibit CTL Panel 8 to CenturyLink Statement 1.2; Direct Testimony of Dr. Brian K. Staihr, August 27, 2003, pp. 15-16 (emphasis added).

[38] *Id.* at p. 8.

[39] Exhibit CTL Panel-8 to CenturyLink Statement 1.2; Rebuttal Testimony of Dr. Brian K. Staihr in Kansas, July 13, 2001, p. 6.

competition to work without anti-competitive, unjust and unreasonable subsidies that are simply unsustainable in a competitive market. While AT&T is not proposing to remove all access subsidies at this time, moving state access rates closer to costs by reducing them to interstate levels will achieve important progress in the right direction.

Finally, PTA and CenturyLink argue throughout their Exceptions that intrastate access reductions will solely benefit IXCs. As discussed above, the facts show otherwise. In addition, PTA's claim that IXCs have already "benefitted" from over $500 million in prior access reductions misses several key points.[40] First, PTA ignores the fact that during that same period, carriers paid approximately $374 million in state universal service funds.[41] Second, the evidence put forward by PTA itself demonstrates how much work remains to be done even after the Commission's previous steps at access reform. Indeed, PTA's own data show that ***in the past eleven years, the high remaining gap between intrastate access rates and interstate rates has forced IXCs and their customers to overpay the RLECs by over $1 billion.***[42] In the past seven years alone, that amount has been nearly three quarters of a billion dollars. Thus, there is still a long way to go towards reform and this case presents the Commission with the opportunity to finalize reform and bring the benefits to the consumers throughout Pennsylvania.

B. The ALJ Properly Rejected The RLECs' Arguments That They Will Not Be Able To Meet Pennsylvania Carrier of Last Resort Obligations If Access Reform Is Implemented.

CenturyLink's main theme in its Exceptions is that access reform will leave it with what it calls "unfunded mandates," and that consequently it will be unable to serve its customers. PTA

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40 PTA Exceptions at p. 1.

41 The PaUSF is approximately $34 million/year x 11 years equals $374 million. As Verizon noted at page 47 of its Rebuttal Testimony (Verizon Statement 1.1), the RLECs are actually better off than if their access rates had not been reduced because the USF guaranteed them a fixed amount of revenue whereas the market forces would have led to reduced access revenues.

42 PTA claims that the revenue difference between intrastate and interstate rates is $91.7 million. Multiplying that by 11 years is $1.08 billion. Of course, that number is too low because it is based on 2008 data, and the revenue difference between intrastate and interstate rates was higher each prior year when access lines were greater.

makes the same claims. What both parties' assertions essentially boil down to is a claim that without guaranteed subsidy revenues obtained from other companies, either through implicit subsidies in access rates or large additional payments from a huge PaUSF, the Commission would be depriving the RLECs of all the revenues they need to meet their purported (but unidentified) Pennsylvania Carrier of Last Resort ("COLR") obligations.[43] As the ALJ found, that claim has no merit.

As an initial matter, the PTA and CenturyLink misrepresent the ALJ's decision on this issue. They both claim that the ALJ rejected their COLR arguments because they failed to present a formal cost study proving the exact amount of their COLR obligations.[44] That is not at all what the ALJ said. The ALJ quite clearly explained that the RLECs failed to provide "any cost information regarding these universal service/COLR responsibilities ***or other proof*** that universal service/COLR would be adversely impacted."[45] Similarly, in the Recommended Decision's Finding of Fact #8, the ALJ found that the RLECs "failed to provide any cost studies or ***other cost information*** attributable to these obligations." The RD recognized that "CenturyLink, in particular, asserted that access rates were just and reasonable *because* of this necessary [COLR] support."[46]

So the real problem – which the RLECs simply ignore – is not the absence of a formal cost study, but the RLECs' complete failure of proof to support the heart of their case. The ALJ properly held that if the RLECs were going to argue that current intrastate access rates must be maintained to support alleged COLR obligations, they should have presented at least *some* evidence to show what those alleged COLR obligations are, and how much they cost, in order to

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43 PTA Exceptions at pp. 20-21; CenturyLink Exceptions at pp. 35-38.

44 *Id.*

45 R.D. at p. 107 (emphasis added).

46 *Id.*

prove that the current access rates are necessary to support them.[47] The RLECs have not rectified that shortcoming now. The fact is that, although it is the crux of their case that access rates must be maintained at extremely high levels in order to support purported COLR obligations, the RLECs failed to identify with any specificity what their COLR obligations even are in Pennsylvania. Even more importantly, assuming such COLR obligations do in fact exist, the RLECs utterly failed to show that the current amount of subsidies in access rates are required to maintain and support those COLR obligations.[48] The ALJ properly found that these failures are fatal to their cases.

With respect to the first point, throughout this case and in their Exceptions, the RLECs have been unable to cite to any Pennsylvania statute, any Pennsylvania rule, any Pennsylvania Order or any Pennsylvania regulation that explicitly imposes COLR obligations on them and them alone. That is because none exist. Indeed, the Commission recently appeared to acknowledge that, unlike with electric and/or gas utilities, COLR mandates do ***not*** exist in the telecommunications arena.[49] To the extent there even are COLR obligations, they come from obligations as an Eligible Telecommunications Carrier ("ETC"), which are not peculiar to the ILECs. To the contrary, incumbent carriers, competitive carriers and even wireless carriers can ***voluntarily*** seek ETC status.[50]

CenturyLink argued in its Exceptions that COLR obligations can be inferred from sections of the Code such as 52 Pa.Code §63.58, which deals with installation of service intervals.[51] However, this claim fails because these sections apply equally to CLECs (whether an ETC or

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47 *Id.* at p. 76.

48 Likewise the RLECs failed to prove that such alleged COLR obligations are not already covered by the carriers' draws from the PaUSF and or the federal USF.

49 Rulemaking to Amend Chapter 63 Regulations so as to Streamline Procedures for Commission Review of Transfer of Control and Affiliate Filings for Telecommunications Carriers, Docket No. L-00070188, Final Rulemaking Order, April 29, 2010, pp. 9-10.

50 *Id.*

51 CenturyLink Exceptions at p. 36.

not), and are not unique to ILECs. CenturyLink also points to Section 1501 of the Pennsylvania Statutes, which requires utilities to provide "safe, adequate and reliable utility service."[52] Yet again, this requirement applies not just to RLECs, but to every certificated carrier (or public utility) within Pennsylvania. In fact, the Commission is permitted to regulate the "ordering, installation, restoration and disconnection of interexchange service to customers," so the requirements CenturyLink cites to are not even limited to local exchange carriers.[53]

Even assuming the RLECs bear some COLR obligations in Pennsylvania, the ALJ properly found that the RLECs could not adequately support their claims that high access rates are needed to meet them. The PTA and CenturyLink misrepresent this determination as requiring them to provide a detailed and specific cost study identifying the exact cost of each and every COLR obligation. Neither the ALJ nor any party asked for such a study. However, the PTA and CenturyLink could not even provide an ***estimate*** of the COLR burdens they allegedly suffer. When PTA was asked whether their COLR obligations are $10, $10 million, $30 million or $100 million, its witness (who has over twenty years of experience in regulatory and revenue requirements in the telecommunications industry) could not answer.[54] The point here is that the RLECs are saying that any reduction in access rates threatens their ability to meet their COLR obligations. The ALJ's finding, which was exactly right, is that if the RLECs are going to make such a claim, they must support it with some evidence.

According to evidence obtained at the hearing from the PTA, the current amount of subsidy in RLEC intrastate access rates, measured as the difference in intrastate and interstate rates, is $91.7 million.[55] The RLECs also receive approximately $34 million from the current

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52 *Id.*

53 66 Pa.C.S.A. §3018(b)(3).

54 Tr. at p. 588. *See also* PTA Statement No. 1 at pp. 1-2.

55 *Id.*

PaUSF.[56] The RLECs therefore are arguing that the Commission take it on faith that the RLECs need every penny of this $125.7 million in subsidization from other carriers in order to meet alleged COLR obligations they can neither identify nor quantify. However, the Commission cannot maintain the system of implicit subsidies – with all of its inefficiencies and consumer harms - based on such a "just trust us" claim. Given the fact that this Commission, and the Legislature, have taken great strides over the past several years to reduce regulatory burdens and to move towards a policy of regulatory parity so that RLECs are regulated more closely as their competitors are,[57] it is impossible to conceive that COLR obligations, if they even exist, are so substantial that they amount to over $100 million in required subsidies. And given the RLECs utter failure to present at least some evidence of such a need, the Commission must reject it.

But even more importantly, AT&T's proposal for reform in this proceeding does not deprive the RLECs of any legitimate revenues – as the ALJ properly held. First, under AT&T's proposal, in addition to the increase in revenue opportunities from their own customers that will come from retail rate flexibility, RLECs will be eligible to obtain on a transitional basis an additional $19.6 million from the USF, on top of nearly $34 million in existing support. That amounts to approximately $54 million in universal service funding in the first year. Second, AT&T's proposal does not reduce the RLECs' access rates all the way to cost, and therefore the rates will still contain some subsidy (as found by the ALJ, and as demonstrated by the fact that the RLECs' rates will in almost all cases be much higher than their cost-based reciprocal

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56 *Id.*

57 The Legislature specifically found that it is the policy of the Commonwealth to "[r]ecognize that the regulatory obligations imposed upon the incumbent local exchange telecommunications companies should be reduced to levels more consistent with those imposed upon competing alternative service providers." 66 Pa.C.S.A. §3011(13). AT&T is not aware of any case where the RLECs have accused the Commission of violating this policy, and the Commission has in fact taken great strides to ensure it is in compliance with this law. If the RLECs truly believe their regulatory burdens are so much greater than their competitors, they should bring an action before the Commission to address the issue while identifying specific regulatory burdens that should be reduced. Forcing other carriers to continue subsidizing the RLECs is not the proper way to deal with the RLECs' allegations that the Commission is not following a policy of regulatory parity.

compensation rates).[58] AT&T's proposal is the proper way to ensure that RLECs are able to meet any COLR obligations they may have – not by perpetuating implicit subsidies from consumers throughout the Commonwealth who have to pay higher long distance prices driven by the RLECs' excessively high access rates.

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

The RLECs once again argue that the Commission should not take charge of the reform of intrastate access rates, but should instead cede responsibility (and possibly jurisdiction) and defer action for some indeterminate period in the hope that the FCC will act on intercarrier compensation reform. The PTA in particular states that its primary position is that current access rates should be maintained "until the FCC gives a clearer indication of the direction it intends to pursue."[59] As it has before, the Commission should reject this invitation to interminable delay.

As an initial matter, PTA's position in its Exceptions is inconsistent with the position PTA's own witness espoused at the hearing. There, PTA witness Zingaretti testified that any Commission decision in this case should be "harmonized" with the FCC, but "that doesn't mean having to wait" for the FCC.[60] Clearly, adopting parity with interstate rates would "harmonize" the Commission with the FCC; the Commission would be mirroring on the intrastate side rates that the FCC has already adopted on the interstate side. By implementing parity now, the Commission certainly will not be out of tune with the FCC's as yet unsung reform plans.

Just as the Commission did not know six years ago when the FCC would act, or what the FCC would do when it did act, the Commission does not know today when the FCC may do

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58 The PTA falsely claimed in its Exceptions at pages 17-18 that the ALJ recommended cost-based access rates. She did not (and no party has even asked for cost-based access rates in this case) – she recommended that intrastate access rates be set at parity with interstate rates, recognizing that interstate rates are above cost.

59 PTA Exceptions at p. 1.

60 Tr. at p. 591.

something, much less what it will do. Given the fact that this Commission made the right decision to stop waiting on the FCC, and to move forward with this case, there is no valid reason to wait for the FCC now that the proceeding has been completed.

There have been numerous proposals on intercarrier compensation floated at the FCC over the past nine years, and another new rulemaking (that will be one of an incredible 60 rulemakings) may be issued by the FCC at the end of this year.[61] Given this history, no party can possibly anticipate when the FCC will issue any kind of decision on that rulemaking. One thing is clear, though. This Commission can most certainly take control over its own affairs and can increase the likelihood that, as more and more states implement intrastate access reform, the FCC must take into account that state action when adopting national intercarrier compensation policies. As it has done in the past on these issues, the Commission, by properly resolving this proceeding, will be asserting a leadership role in the shaping of national policy.

This Commission has already found that waiting for the FCC is not necessary.[62] The ALJ recognized that the Commission should not wait for the FCC.[63] It would make no sense to re-open this case, have a fully litigated and extensive record, have an ALJ recommendation to move forward with reform, and then yet again delay reform to wait for speculative FCC action. Chairman Cawley recently observed that "***we do not need and cannot afford to wait and speculate whether the FCC will reach some sort of coherent and sustainable solution to its IP-enabled services and intercarrier compensation reform proceedings, when this might happen, and what the FCC's conclusions might be.***"[64] And most recently, the Commission again noted that there has been no substantial action at the FCC, and it is unclear whether the FCC will act

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

62 August 5, 2009 Order at pp. 18-19.

63 R.D. Finding of Facts #41 & 42.

64 *Palmerton Telephone Company v. Global NAPS South, Inc., et. al.*, Docket No. C-2009-2093336, Motion of Chairman James H. Cawley, February 11, 2010, p. 15 (emphasis added).

anytime soon.[65] The same considerations warrant the immediate reform of the RLECs' rates in this proceeding.

III. AT&T'S PROPOSAL MAINTAINS THE PROPER BALANCE FOR ACHIEVING ACCESS REFORM.

While several parties criticize AT&T's reform plan for various reasons, AT&T's proposal is the only one presented in this case that brings intrastate rates to just and reasonable levels immediately while maintaining affordable retail rates and minimizing harmful and anti-competitive subsidies.

A. AT&T's Proposal Will Preserve Affordable Retail Rates

When focusing on universal service goals, the Pennsylvania Legislature and this Commission have always been properly concerned about ensuring that local rates are affordable for customers throughout the Commonwealth. AT&T's proposal is consistent with these objectives. Access reform under AT&T's proposal will keep local rates below affordable benchmark levels (assuming of course that the RLECs implement rate increases, which are entirely permissive, to offset access reductions), but without the massive, unsustainable subsidies that the RLECs and OCA seek and that the ALJ recognized are unnecessary.[66] Moreover, access reform will reduce artificial constraints on competition, thereby stimulating more competition, which, as the ALJ recognized, will ultimately lead to lower rates for all customers.

AT&T's proposed benchmark is initially set at $22 per month, which is simply the $18 local rate cap established in 2003, brought forward by inflation. Using even the most conservative estimate of affordability, this benchmark rate keeps all RLEC local rates below the

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

[66] PTA and CenturyLink both focus on the fact that prior access reductions have already led to increased retail rates. What they ignore, however, is the fact that the vast majority of customers are voluntarily choosing to spend much more than $18/month (or even $22/month) on their telephone service; that penetration rates have not declined; and therefore the past increases and proposed increases in this case have not harmed, and will not harm, customers.

affordability level. Under AT&T's proposal, thirteen PTA companies will still have rates below the $22/month benchmark after full rate rebalancing. After one year, the benchmark will rise to $23/month – again, below even the most conservative estimate of affordability. Another seven companies will be fully rebalanced after reaching the $23/month benchmark. Only six RLECs would even have to reach the $25/month benchmark in the fourth year in order to rebalance their local rates under AT&T's proposal.[67]

Thus, in the first two years of access reform under AT&T's proposal, the large majority of the RLECs will be fully rebalanced while keeping local rates under the OCA and ALJ's affordability level, thereby ensuring that universal service is not jeopardized. By the third and fourth year of AT&T's proposals, when local rates are permitted to increase to $24 and $25/month respectively, only a small handful of RLECs will still be drawing additional USF amounts, and so only a small handful would need to increase basic rates to those levels. However, as the evidence in this case shows, and as AT&T discussed in its Exceptions, even rates at $24 and $25/month will be well within the affordability range identified in the record.[68] As the evidence conclusively proves and AT&T discussed in its Exceptions, the affordability rate today in Pennsylvania, based on OCA's own study, extends from $23.43 to 34.34/month. AT&T's initial benchmark of $22/month is obviously well below this range, and even its ultimate benchmark of $25/month after four years is at the lower end of this range.[69]

Once the Commission determines that AT&T's proposal will not lead to unaffordable rates, as it must based on the evidence, then the other parties' claims that AT&T's proposal will harm universal service completely disintegrate. Promoting competition is the best way to

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67 See Appendix A to AT&T's Exceptions.

68 AT&T Exceptions at pp. 35-38.

69 For the reasons stated in AT&T's Exceptions regarding the fact that $23 should be considered a *minimum* affordability rate, the OCA's request to have $23 be set as a hard cap that cannot be exceeded should be rejected. In addition, OCA's arguments that the Commission is somehow precluded from eliminating or raising the cap (OCA Exceptions at pp. 33-34) were made, and rejected, in the case before ALJ Colwell. They should similarly be rejected here.

promote universal service, and AT&T's proposal does exactly that. Removing subsides from access rates – i.e., taking the Commission's thumb from the scales so that market forces, rather than regulatory action, decide which firms best meet consumer needs – is the best way to ensure Pennsylvania consumers receive the services they want at prices they are willing to pay.

B. AT&T's Proposal Is the Most Reasonable Compromise of All Competing Interests

PTA outlined numerous principles at the end of its Exceptions as to what it deems acceptable for access reform.[70] Interestingly, many of those principles are reflected in AT&T's proposal, although there are differences as to how the principles are implemented. For instance, PTA agrees in principle with the concept of setting a benchmark rate.[71] AT&T's proposal does just that. However, PTA proposes a benchmark rate of $18.94/month, which is based on a flawed standard of comparability, and which would create a USF far too large – as discussed further below. By contrast, AT&T's proposal establishes an initial benchmark of $22/month, which is reasonable and affordable for the reasons discussed in AT&T's Exceptions[72] and herein.

PTA also agrees that intrastate access rates should be reduced to interstate rates, although it would not have this reduction occur for as long as 10 more years.[73] Of course, that is another decade of further delay on top of the eleven years that already have elapsed since the Commission first said access reform should occur. Only PTA could conceive of a possible 21 year period for full reform as being "reasonable" or "rational." By contrast, AT&T's proposal requires intrastate access rates to be reduced to parity with interstate rates immediately. Of course, "immediately" in this case still means eleven years after the Commission first said reform was needed; nine years from the time the Commission expected that access reform would be complete; and six years since this case was initiated.

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70 PTA Exceptions at pp. 63-64.

71 *Id.*

72 AT&T Exceptions at pp. 35-38.

73 PTA Exceptions at pp. 63-64.

PTA further accepts that revenue neutral access reform can be implemented by first raising retail rates to a benchmark level, and then taking any remaining funds from the PaUSF.[74] That is exactly what AT&T's proposal does, although AT&T does not propose that the PaUSF be increased permanently. Rather, AT&T proposes that it be used solely as a temporary measure to permit reasonable retail rate increases to occur over a transitional period.

The PTA states that it supports expanding the contribution base of the PaUSF to include wireless and VoIP service providers.[75] The Commission specifically excluded that issue from this case, and there is absolutely no reason for the Commission to delay access reform until this complicated and highly controversial issue is decided.

Finally, the PTA recommends harmonizing any Pennsylvania reform with the "Federal outcome."[76] Yet again, the Commission should not delay reform in Pennsylvania solely to wait for the FCC, or attempt to guess what the FCC may do on intercarrier compensation reform. Waiting for the FCC is no more productive for Pennsylvania consumers than "waiting for Godot," and it should not be used to stave off much needed reform in Pennsylvania.

Some of the same parties who are so critical of the reforms proposed by AT&T in this case actually have seen fit to support them elsewhere. For instance, AT&T's proposal is actually consistent with OSBA's testimony in the Universal Service proceeding before ALJ Colwell. There, the OSBA recognized and correctly argued the basic economic theory that you cannot have some companies subsidizing others in a competitive environment:

> Q. **DR. LOUBE CLAIMS THAT YOU CAN HAVE COMPETITION WHILE SUBSIDIZING SOME COMPETITORS?**
>
> A. Dr. Loube has forgotten basic economic theory. Subsidizing the marginal costs of some players in a market will eventually drive out the non-subsidized carriers. In a competitive market, price equals marginal costs. Ultimately, if the government

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74 *Id.*
75 *Id.*
76 *Id.*

> chooses to subsidize one competitor's marginal cost over another, which is the case here, only the subsidized competitors will survive in the long run.[77]

In this case, the OSBA actually advanced the possibility of *increasing* RLEC access rates under a flawed theory that intrastate *rates* should be set to recover the same amount of *revenue* from interstate access charges, including the SLC.[78] Apparently, the OSBA has similarly forgotten basic economic theory, and its own argument. Adopting AT&T's proposal in this case ensures that the Commission is not maintaining high rates that are providing subsidies towards the costs of some players to the detriment of others.

AT&T's proposal is also consistent with CenturyLink's prior positions – again made outside the context of this case. In direct contrast to its position taken throughout this case and in its Exceptions, CenturyLink has said in the past that reducing access rates and increasing local rates is critical in order to have full competition, which does not harm consumers, but in fact benefits them greatly:

> [T]he removal of implicit subsidies is consistent with-and necessary for-the development of a healthy and sustainable competitive market for basic telecom services,....a competitive market that will simultaneously 1) provide benefits and choices to the largest number of [state] residents as possible, and 2) operate on a level playing field for all competitors.[79]
>
> Removing the implicit subsidies that currently exist in prices will help competition to develop in two ways: it will level the playing field between inter-modal competitors, and it will not force other technologies such as

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77 OSBA Statement No. 3 (Buckalew Surrebuttal), February 10, 2009, Docket No. I-00040105, p. 2.

78 OSBA Exceptions at p. 14. OSBA's theory that intrastate subsidies should be set to match interstate revenues (including ones from end user customers) would take access reform in exactly the wrong direction – instead of reducing subsidies and requiring the RLECs to begin relying more on their own customers, OSBA now proposes to *increase* implicit subsidies – all under the flawed premise that increased subsidies are required to contribute to the cost of the local loop. OSBA's position is also highly flawed given that the OSBA presents no evidence that intrastate access rates set at interstate rates are not already contributing to the cost of the loop.

79 Exhibit CTL Panel 8 to CenturyLink Statement 1.2; Direct Testimony of Dr. Brian K. Staihr, August 27, 2003, p. 3.

cable telephony to compete head-to-head against *subsidized* prices for basic local service.[80]

Finally, although Verizon criticized AT&T's temporary increase in the PaUSF, it overlooks the fact, discussed in AT&T's Exceptions and herein, that this increase is transitional, and not permanent.[81] Indeed, Verizon is better off under AT&T's proposal than if it continues paying the RLECs' existing high intrastate access rates.[82]

IV. THE OPPOSING PARTIES' PROPOSALS ON ACCESS REFORM EQUATE TO FURTHER UNWARRANTED DELAY.

Despite claiming that they do not oppose access reform, the other parties have put forward proposals for "reform" that in fact do nothing but delay it. OCA, while recognizing that bringing intrastate rates to parity is necessary, proposes essentially an indefinite delay to any reform. PTA suggests waiting for the FCC, or adopting "reasonable" reform that extends out another ten years beyond the eleven years customers have already been waiting in Pennsylvania. CenturyLink presents no proposal, but only advocates delay. None of these positions have any merit, and they should be rejected.

The OCA presents what it calls a comprehensive plan for access reform.[83] The OCA acknowledges that reducing access rates to interstate parity (including the elimination of the CCL) will achieve a more level and fair competitive playing field,[84] but then inexplicably recommends that RLECs recoup all of the access reductions from the PaUSF – which would triple to nearly $100 million[85] – rather than look to their own customers. In other words, OCA

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80 *Id.* at p. 9.
81 AT&T Exceptions at pp. 28-29.
82 *Id.*
83 OCA Exceptions at pp. 3-4.
84 OCA Statement 1, at p. 10; Transcript at p. 478 (Loube).
85 AT&T Statement 1.2 at p. 12.

would continue to force the rest of Pennsylvania to subsidize the RLECs, just in a different format.

Recognizing that such a huge increase in the PaUSF is simply not feasible, the OCA claims that part of its proposal is to expand the base of contributors to the PaUSF.[86] Of course, that issue is not a part of this case. Even if it were, it could take years, and possibly changes to legislation, to implement, given wireless carriers' vehement arguments that current law does not permit the Commission to require them to contribute to the USF. If the Commission (or a court) agrees with the wireless carriers, the OCA's proposal for access reform would be held hostage to litigation and to the legislative process and the amount of time (if ever) it would take to change the law.

PTA's primary recommendation in this case is to do nothing in order to wait for the FCC.[87] As discussed previously, there is absolutely no reason to wait for the FCC, as there is no indication that FCC action is imminent. PTA also recommends that rather than issue a decision based on the extensive record already developed in this case, the Commission should convene a collaborative to address these same issues.[88] This is simply another invitation to delay. This case has been pending before the Commission for nearly six years. At no time prior to the litigation stages of this case did PTA encourage the Commission to convene a collaborative. Instead, the PTA continuously opposed resuming this case at all. Now that this case has been fully litigated (and the parties remain highly divided), it is time for the Commission to issue a decision implementing access reform. It is not time for more process aimed at delaying the immediate reform the record demonstrates is necessary.

Alternatively, PTA recommends that if the Commission does act to reduce intrastate access rates, it should delay reform for up to 10 years before achieving parity with interstate

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86 OCA Exceptions at p. 4.
87 PTA Exceptions at p. 1.
88 *Id.* at p. 63.

rates.[89] Such delay is not warranted and is not supported by the record. Finally, PTA suggests that rather than adopt the ALJ's proposal for reform, the Commission could just order parity of traffic sensitive rates, leaving the CCL rates at their exorbitantly high levels.[90] While PTA claims that this will lead to a $10.4 million rate reduction for the IXCs, what PTA fails to mention is that the majority of RLECs would actually *increase* their intrastate access rates, while CenturyLink's intrastate rates would remain unchanged.[91] It should go without saying that adopting a final decision that actually leads to *increased* intrastate access rates is hardly a step towards the much needed "reform" the ALJ found is needed and this Commission has consistently said would be forthcoming.

CenturyLink characterized the ALJ's Recommended Decision to reduce intrastate access rates to parity with interstate rates within two-to-four years as "arbitrary and capricious,"[92] "reckless,"[93] "unreasonable,"[94] and "accelerated."[95] Despite claiming that it supports "rational" access reform, CenturyLink itself does not actually propose any process for achieving that goal. Instead, it merely argues that the Commission should not implement any reform at all. CenturyLink's obstructionism should be recognized for what it is.

V. THE ALJ PROPERLY RULED THAT ACCESS RATES SET AT INTERSTATE PARITY WILL MORE THAN COVER THE RLECS' RELEVANT INCREMENTAL COSTS OF PROVIDING ACCESS SERVICE.

Several parties argue that intrastate access rates cannot be reduced to interstate rates because IXCs would no longer be contributing to the cost of the local loop. These claims are

89 *Id.*
90 PTA Exceptions at p. 61.
91 See Appendix A to AT&T's Exceptions.
92 CenturyLink Exceptions at pp. 17, 62, 63.
93 *Id.* at p. 62.
94 *Id.* at p. 44, 59, 60, 62, 63.
95 *Id.* at p. 60.

misguided at best.[96] First, and most importantly, the market has already made this debate obsolete and academic, because the various services and technologies with which traditional long distance carriers compete (*e.g.*, e-mail, social networking websites, internet service providers, VoIP providers, wireless carriers) are largely immune from any loop cost subsidy obligations.[97] Whatever the Commission's views on loop cost allocation, it cannot impose loop costs on IXCs without putting them at a severe competitive disadvantage.

The OSBA and OCA acknowledge this unfairness, and the ideal outcome from the perspective of the OSBA and OCA would be to have other providers (such as wireless carriers) also pay access charges that contribute towards the cost of local loops.[98] The OSBA and OCA both admit, however, that the Commission has no authority to impose access charges on such carriers.[99] Thus, even though the OCA has always been (and still is) a supporter of the theory that IXCs should "contribute" to the cost of the local loop, the OCA recognized that changes in market conditions and fundamental fairness require that intrastate access charges paid by IXCs be reduced to the respective interstate rates, in order to achieve a more level and fair competitive playing field.[100] The Commission's objective should be to promote competition, not to use its regulatory authority to favor one set of competitors at the expense of another. Therefore, the parties' claims that the current excessive intrastate access rates must be maintained to ensure IXCs contribute to the cost of the loop should be rejected.

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96 The loop is a non-traffic sensitive cost that should be recovered from the price of basic local service. *Loop costs are incurred when a customer orders telephone service. Those costs do not change* regardless of whether the customer makes only local calls, only long distance calls, or never makes or receives any calls at all. Nor do those costs vary if the customer uses the loop for just a few minutes a day, or multiple hours a day. Loop costs are not a cost of providing switched access service. Exhibit CTL Panel-8, Rebuttal Testimony of Brian K. Staihr, July 13, 2001, Kansas, pp. 8-10.

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

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

99 OCA Statement 1, at p. 11; Transcript at p. 95 (Wilson).

100 OCA Statement 1, at p. 10; Transcript at p. 478 (Loube).

The OSBA's Exceptions are based almost entirely on the claim that intrastate access rates should not be reduced because the OSBA claims it would reverse the Commission's policy of having IXCs contribute to the cost of the loop.[101] OCA makes this same argument.[102] Even though PTA and CenturyLink did not spend much time addressing this issue throughout the case, they spent a considerable amount of time in their Exceptions now claiming that high access rates must be maintained in order to ensure IXCs contribute to the cost of the local loop.[103] Even assuming that this reworking of the now discredited theory of loop allocation had any validity in a competitive market – and it does not – these positions are undermined by the ALJ's correct finding that there is nothing in the record to show that IXCs will not be paying their "fair share" under AT&T's proposal to reduce intrastate access rates to interstate levels.[104] To the contrary, interstate access rates remain several times above relevant incremental costs,[105] and will therefore ensure that IXCs are contributing generously to the RLECs' joint and common costs. Contrary to what some parties assert, the IXCs will not be getting a "free ride" when access charges are reduced to interstate parity. Instead, the IXCs will be getting a fair chance to compete.

PTA and OSBA claim that the Carrier Common Line ("CCL") charge cannot be reduced because the CCL is a primary contributor to loop cost,[106] but the evidence demonstrates that CCL rates are not in any way associated with the cost of the loop.[107] To the contrary, the extreme variability in the RLECs' CCL rates only confirms that the CCL is nothing but a subsidy rate element. If the CCL was somehow associated with loop costs, one would expect that the most

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101 OSBA Exceptions at pp. 11-13.

102 OCA Exceptions at pp. 25-29.

103 CenturyLink Exceptions at pp. 15-16; PTA Exceptions at pp. 27-36.

104 R.D. at pp. 90-91.

105 See Exhibit F to AT&T Statement 1.0 (Nurse/Oyefusi Direct) showing reciprocal compensation rates in the range of $4/100^{th}$ of a penny to $2/10^{th}$ of a penny, compared to the RLECs' interstate access rates on the chart at pp. 35-36 of AT&T's Statement 1.0, showing rates generally in the range of 1-3 cents per minute.

106 PTA Exceptions at pp. 28-29; OSBA Exceptions at p. 13.

107 See Appendix 3 hereto, which demonstrates that CCL and local rates in Pennsylvania have nothing to do with cost.

rural carriers (which presumably have the highest loop costs and lowest density) would have the highest CCLs. But that is not the case. According to evidence introduced by the PTA, Ironton has a density of 227.3 lines per square mile, among the most dense of the RLECs, yet Ironton has the highest CCL of all companies at a whopping $17.99/line/month.[108] On the other hand, PTA's evidence shows that Buffalo Valley has a density of only 65.6 lines per square mile, yet Buffalo Valley's CCL (while still high) is one of the lowest among the RLECs at $4.20/line/month.[109] In addition, there are several RLECs that have no CCLs at all, yet those carriers provided no evidence that their loop costs are not being recovered. Thus, contrary to the RLECs' assertions, there is clearly no correlation between the CCL and any contribution to the cost of the loop.

CenturyLink takes the loop recovery theory to its absurd extreme when it claims that intrastate access rates set at interstate rates will mean that CenturyLink will be unable to recover its residential service costs.[110] The first problem with this argument is that it relies on an OCA cost model from the universal service fund proceeding before ALJ Colwell that was thoroughly discredited in that case -- even CenturyLink criticized the OCA cost model and CenturyLink's witness testified that there were problems with relying on the results of the cost model.[111] Second, CenturyLink does not explain why its access rates must recover its residential service costs rather than its costs of providing intrastate access service. Finally, CenturyLink ignores the fact that it recovers a substantial portion of its costs through federal universal service funding. In fact, after deducting what CenturyLink receives from the FUSF, its remaining average loop cost is only $19.78/month,[112] an amount below the $22/month local service rate AT&T is recommending in this case.

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

109 *Id.*

110 CenturyLink Exceptions at p. 15.

111 CenturyLink Statement 3.0 before ALJ Colwell, Docket No. I-00040105, p. 5.

112 See Attachment K to AT&T Statement 1.0.

This leads to an important point about the amount of subsidies the RLECs claim they need from other carriers and those carriers' customers. First, the RLECs are already receiving nearly $34 million from the current Pennsylvania USF. Second, all RLECs receive federal USF support (some, however, are not considered "high cost" enough to receive federal USF from the high cost loop fund),[113] in some instances enough to cover all but $11.67/month of the RLECs' loop costs,[114] and for even the largest RLECs enough cover all but $21/month of loop costs.[115] Even in the "worst case" scenario, the most any Pennsylvania LEC has remaining after its federal USF payment is a loop cost of $28.72/month.[116] The RLECs therefore do not need extremely high, subsidy-laden intrastate access rates to recover their loop costs.

Although CenturyLink now jumps on the "IXCs must contribute to the cost of the loop" bandwagon, CenturyLink has previously taken the exact opposite position. In fact, in the case before ALJ Colwell, CenturyLink stated that "the cost causation to [CenturyLink] for the loop is basic local exchange service."[117] Even more compelling, CenturyLink's Dr. Staihr (who was originally scheduled to be a witness in this case) has previously testified that an "allocation method where a customer pays for part of a loop every time he or she makes a toll call through access charges...is inefficient, uneconomical, and unfair..."[118] Dr. Staihr goes on to explain that the logic that IXCs must pay for the loop because long distance calls cannot be made without a loop is fundamentally flawed. He points out that it is impossible to watch cable television without

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

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

115 *Id.*

116 *Id.*

117 Embarq Statement 3.0 (Londerholm Rebuttal), Docket No. I-00040105 before ALJ Colwell, January 15, 2009, p. 7.

118 Exhibit CTL Panel-8 to CenturyLink Statement 1.2 (Lindsey/Harper Rejoinder), Rebuttal Testimony of Brian K. Staihr on behalf of Sprint, May 24, 1999, Kansas, p. 6.

a TV set, but nobody suggests that part of the TV should be included in the cable bill.[119] In 2001, Dr. Staihr again testified that, "With regard to the claim that the loop is a common cost, it is Sprint's position, ***a position supported by the majority of today's leading regulatory economists,*** that the cost of the loop is not a common or shared cost, but a direct cost of access to the public switched network."[120]

CenturyLink was right then. Access charges should not be used to subsidize loop costs, especially now that IXCs must compete against e-mail, internet access, cable telephone, VoIP providers, wireless carriers and other technologies and service providers that are not being saddled with a subsidy burden. The Commission's task is to ensure that competition is full and fair, not to tilt the playing field in favor of one set of competitors. Reducing access rates to interstate parity will accomplish that critically important policy objective, and still ensure that RLEC access rates cover cost and contribute to the RLECs' joint and common costs.

VI. THE ALJ PROPERLY REJECTED THE RLECS' CLAIMS THAT THE MARKET WILL NOT ALLOW THEM TO RAISE LOCAL RATES TO RECOVER ACCESS RATE REDUCTIONS.

A. The ALJ Properly Ruled that RLECs Must Be Given an *Opportunity* to Recoup Lost Access Revenues, But That Each RLEC's Response to Access Reform Is Left to the RLEC's Discretion; The Law Does Not Mandate That the Commission Guarantee Each RLEC Any Particular Amount of Revenue

Chapter 30 states: "The commission may not require a local exchange telecommunications company to reduce access rates except on a revenue-neutral basis."[121] This section of the law requires the Commission to give the RLECs the *opportunity* to make up any lost revenue from access reductions on a revenue neutral basis. As the ALJ properly found, this section of the law does *not* require the Commission to guarantee the RLECs' revenues.[122]

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119 *Id.* at p. 7.

120 Exhibit CTL Panel-8, Rebuttal Testimony of Brian K. Staihr, July 13, 2001, Kansas, p. 8.

121 66 Pa.C.S.A. §3017(a).

122 R.D. at p. 106.

CenturyLink and PTA take the flawed position that the "revenue neutral" provision in Chapter 30 requires the Commission to guarantee that any revenue reductions will be recovered.[123] In other words, they argue that simply allowing the RLECs the opportunity to increase local rates will not be sufficient to meet the revenue neutrality requirement of Chapter 30. They are wrong.

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

While the Commission should give the RLECs the *opportunity* to recoup reduced access revenues on a revenue neutral basis, that is entirely different than guaranteeing the RLECs will recover every single dollar. Such guarantees are simply impossible in today's competitive environment. After all, the RLECs' access revenues already have been decreasing for years (in part, because high access charges have created incentives for consumers to abandon wireline long-distance in favor of competing technologies), yet no one would seriously contend that the Commission had to reimburse the RLECs for those market losses.

In determining what Section 3017 means in operation, the Commission can look to "traditional regulation," such as rate of return regulation, or the way in which Chapter 30 operates with respect to the RLECs' broadband deployment and annual price change opportunities. As the ALJ found, "[t]raditional regulation afforded a public utility an

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123 PTA Exceptions at pp. 54-55; CenturyLink Exceptions at pp. 45-49.

opportunity to earn a reasonable rate of return as allowed by the Commission, but did not guarantee that the utility would in fact earn that rate of return."[124] In addition, the law permits the RLECs to raise rates each year by the rate of inflation, and this is the manner in which the Legislature gave the RLECs the opportunity to recover their costs of broadband deployment. However, whether the RLECs actually raise their rates is discretionary. If the RLECs choose not to raise their rates for whatever reason, the Commission is not obligated to help the RLECs obtain the forgone revenues from another source. That is a business decision left to the discretion of each RLEC based on its own analysis of how best to compete and serve its own customers. The law does not require the Commission to perpetually guarantee each RLEC some revenue number; rather, if a company comes to the Commission and requests increases that are consistent with the law, the Commission must permit those increases.

B. The ALJ Properly Rejected the CenturyLink "Survey."

CenturyLink claims that if access rates are reduced, 100% of revenue reductions must be recovered from the state USF because CenturyLink cannot profitably increase prices even a penny due to overwhelming competitive forces.[125] This conclusion is based entirely on a flawed, self-serving CenturyLink survey that purports to determine how customers will react to hypothetical price increases, and comes to the very unsurprising conclusion that customers told CenturyLink they do not want to spend more for their service.[126] The ALJ rejected this survey due to its numerous flaws, and the Commission should similarly reject it. CenturyLink's Exceptions offer no new arguments to reverse the ALJ's decision on this issue.

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124 R.D. at p. 106.

125 CenturyLink Exceptions at pp. 41-44.

126 The Commission should treat this survey just as ALJ Schnierle treated a Verizon survey years ago where Verizon asked business customers if they wanted Verizon to offer discounted pricing plans. ALJ Schnierle completely discredited the survey and said the only thing surprising about it was the fact that 2% of customers actually said they did not want a discounted price. *Re: Bell Atlantic-Pennsylvania, Inc.*, Docket No. P-00971307, Recommended Decision, July 24, 2008; 1998 WL 694516 (Pa.P.U.C.); p. 9.

The CenturyLink survey was not an independent market-based survey – it was conducted solely for purposes of supporting CenturyLink's attack on access reductions in this case.[127] In fact, in e-mails exchanged between the survey company and CenturyLink, the CenturyLink market research manager told CenturyLink's original witness, Dr. Brian Staihr, that he wanted to "make sure the output gets you want you want...."[128]

AT&T detailed the multiple problems with this survey and its methodology throughout this case – among them, asking customers if they would be willing to spend more money for telephone service in the middle of the Christmas buying season, and failing to take into account real world factors that would affect customers' decisions.[129] In addition, the survey is useless in determining all customers' behavior patterns as it was directed to just 810 – or less than 3 tenths of a percent -- of CenturyLink's approximately 300,000 customers. The ALJ recognized that the survey was "seriously flawed" for the reasons outlined by AT&T.[130]

As the ALJ properly found, the Commission simply cannot give any weight to this survey as a basis to reach the conclusion that retail rate increases must not be used for the revenue neutral recovery of access reductions.[131] Indeed, CenturyLink itself does not rely upon or even conduct such surveys to manage its real-world business.[132] For instance, CenturyLink did not conduct any similar customer surveys prior to implementing local rate increases in New Jersey, where CenturyLink also claimed it was facing competitive pressures.[133] In addition, CenturyLink did not present any evidence in the record that, as a result of the local rate increases in New Jersey, it experienced line losses its survey claimed it would see in a competitive

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127 Tr. at p. 311.
128 AT&T Cross Exam. Exh. 1.
129 AT&T Main Brief at pp. 56-58
130 R.D. Findings of Fact #48 and 49.
131 R.D. at p. 108.
132 R.D. Finding of Fact #51.
133 Tr. at p. 423.

market.[134] Obviously, if the empirical evidence supported CenturyLink's case, it would have introduced that evidence rather than relying on a flawed, hypothetical survey.[135]

In addition to the multiple problems with the survey identified in AT&T's testimony and its Main Brief,[136] CenturyLink itself previously acknowledged that a Commission cannot rely on elasticity studies to determine how customers react to price. Specifically, CenturyLink's own Dr. Staihr – who oversaw the Pennsylvania survey -- has previously testified that "***elasticity studies tend to overestimate the responsiveness of customers to price changes for basic telephone service....***"[137] CenturyLink further recognized that a Commission should not refuse to raise rates solely because customers may claim they do not want rate increases:

> The fact that a customer might be faced with a price adjustment that he or she finds disagreeable does not constitute 'rate shock.' Obviously all consumers would be happy to never see price increases on the goods and services they buy. But price adjustments occur throughout any market economy, and prices tend toward cost in a market economy, and ***the fact that many local service customers have been accustomed to reaping the benefits of cross-subsidization for years is no reason to attempt to maintain an inefficient, unsustainable pricing mechanism any longer than necessary***.[138]

Although the PTA did not conduct its own survey, it attempts to jump on the CenturyLink bandwagon and claims, without any actual evidence, that if PTA undertook the same survey, the results would be the same.[139] This claim is not only highly speculative, but also demonstrably

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134 Although it is true that the retail rates were lower in New Jersey, CenturyLink still claimed that the market in New Jersey is highly competitive, so its claims about being unable to raise rates in a competitive market should apply equally to New Jersey as in Pennsylvania.

135 In its Exceptions at page 34, CenturyLink claims for the first time that it relies on consumer focus groups and surveys to make pricing decisions. Of course, there is no cite to the record for this statement because there is no evidence in the record to support it. The statement should therefore be disregarded.

136 AT&T Main Brief at pp. 56-58.

137 Exhibit CTL Panel 8 to CenturyLink Statement 1.2 (Lindsey/Harper Rejoinder); May 1999 Kansas testimony at p. 19 (emphasis added).

138 Exhibit CTL Panel 8 to CenturyLink Statement 1.2 (Lindsey/Harper Rejoinder); Rebuttal Testimony of Brian K. Staihr, September 19, 2003, Florida, p. 5 (emphasis added).

139 PTA Exceptions at p. 57.

false, as real world evidence in the record shows. In fact, as the ALJ found, PTA's line losses over the years have absolutely nothing to do with changes in price.[140] For instance, in 2002, the PTA company Denver and Ephrata raised its price by over 35%, yet there was virtually no change in its line loss.[141] In other years, line losses remained steady regardless of the changes in price.[142] As yet another example, Citizens of Kecksburg has maintained an $11/month local rate for many years, but each year its number of lines have changed by large percentages, thereby showing that line losses (or gains) have little relation to price.[143]

This evidence further demonstrates the invalidity of that survey itself. The record amply supports the ALJ's ruling that the Commission should not rely on the CenturyLink survey, and the Commission should sustain that determination.

C. The ALJ Properly Rejected Comparability As The Sole Basis for Setting Local Rates; However, Even if Comparability Is Used, AT&T's Proposal Meets A Proper Comparability Standard.

The OCA and PTA criticize the ALJ for rejecting their comparability analyses, and therefore their proposed benchmark rates.[144] The OCA and PTA claim that even though retail rates up to $23/month would be affordable, such a benchmark should not be accepted because it will not meet a federal comparability standard. They therefore propose benchmarks that are based not on affordability, but based solely on comparability.

The OCA and PTA are contesting not only the ALJ here, but also ALJ Colwell and the Commission staff itself. The entire basis for the OCA's proposed benchmark is OCA's calculation that $17.09 is comparable to Verizon's statewide average rates.[145] Similarly, PTA

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140 R.D. Findings of Fact #52 and 53. *See also* Appendix 4 attached hereto; Tr. at pp. 604-605; and AT&T Cross Examination Exhibit 5.

141 *Id.*

142 Tr: at p. 605.

143 See Appendix 4 attached hereto; and Attachment 3 to AT&T Statement 1.2 (Nurse/Oyefusi Rebuttal) for Citizens-Kecksburg's number of lines each year.

144 OCA Exceptions at pp. 7-13; PTA Exceptions at pp. 44-46.

145 AT&T Statement 1.2 at p. 8.

testified that its $18.94 benchmark is based on the evidence it presented before ALJ Colwell regarding comparability.[146]

As ALJ Melillo found here,[147] adopting the OCA or PTA proposed benchmarks would be in direct conflict with ALJ Colwell's Recommended Decision to reject the imposition of comparability in Pennsylvania.[148] Not only did ALJ Colwell and ALJ Melillo reject the OCA's and PTA's arguments that the Commission must set rates based on a standard of comparability, but this Commission's own legal counsel has also rejected them:

> Similarly, the D&E Companies' contention that the Commission somehow violated 47 U.S.C. §254(b)(3) because it did not make a specific finding that Denver & Ephrata's retail rates are comparable to the rates charged for the same service in urban areas is baseless. This federal regulation pertains to federal universal service and is not a mandate to state Commissions. It has no bearing on rural ILECs' receipt of monies from the PaUSF, but may be relevant to non-rural ILECs' participation as recipient carriers regarding the federal USF.[149]

OCA and PTA add nothing new in this case.[150]

Even if the Commission were to reverse itself and two ALJs, and determine that comparability should be used in Pennsylvania, the manner in which OCA and PTA propose to calculate comparability is flawed. The OCA bases its analysis on Verizon's statewide average –

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146 Transcript at p. 585.

147 R.D. at p. 115.

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

149 *Buffalo Valley Telephone Company, et. al. v. Pennsylvania Public Utility Commission; No. 847 C.D. 2008; Popowsky v. Pennsylvania Public Utility Commission, No. 940 C.D. 2008;* Advance Form Brief of Respondent Pennsylvania Public Utility Commission at p. 38. The Commonwealth Court upheld the Commission's arguments on comparability in its decision issued on December 15, 2009. The Commission should reject the OCA's claims that the Commission's analysis somehow doesn't apply to this case. *OCA Exceptions at pp. 11-12.* In *Buffalo Valley,* the RLECs were similarly asking the Commission to increase the PaUSF in order to meet an alleged comparability requirement. The fact that the increases to the PaUSF are for different reasons is inapposite to the Commission's conclusion that the federal comparability standard is not a mandate to state Commissions.

150 For the first time in this case, OCA cites to Sections 3014(k) and 3015(a)(3) of Act 183 to claim that comparability is reflected in state law. *OCA Exceptions at pp. 9-10.* Neither of those sections come close to supporting a claim that state law prohibits the Commission from establishing rates that are undeniably within affordable levels, or requiring the Commission to adhere to a comparability standard when setting a benchmark for access reform.

presumably because that yields a lower figure more to the OCA's liking. But comparability is supposed to be a comparison between rural and urban rates. This statewide average, according to OCA, was $14.25.[151] As Verizon testified, its urban rates are those in Density Cells 1 and 2, which are $16.32 and $16.62, respectively.[152] Of greater significance, however, is that the OCA fails to acknowledge the "apples to oranges" nature of its analysis. Here, the Commission is crafting basic rates for use when RLEC access rates have been reduced and reformed; *i.e.,* basic rates that will be in effect when RLEC access rates will have been reduced to interstate parity. It is wholly inappropriate for the OCA to evaluate what appropriate rates should be based on an analysis of Verizon basic rates *that are still supported by implicit access subsidies*. As Verizon itself argued, Verizon's retail rates historically have been suppressed, and are artificially low.[153]

In addition, OCA does not justify its 120% factor and the PTA's 115% proposal is equally baseless. OCA's own witness, Dr. Loube, has advocated for higher comparability factors of 125% or 143%.[154] As OCA noted in its Exceptions, California has adopted a comparability factor of 150% of the urban rate.[155] Wyoming has adopted a factor of 130%.[156] Even if the Commission used a comparability analysis as the sole basis for setting a benchmark –

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151 OCA Statement 1.0, Appendix RL-2.

152 Verizon Statement 1.1 at p. 35.

153 Verizon Statement 1.1 at pp. 34-35. For instance, if Verizon's density zone 1 rate were increased by reducing implicit subsidies from intrastate access rates that are above Verizon's interstate rates (such as by removing the $.58 CCL), it would lead to a Verizon rate of $18.16/month. Even using Dr. Loube's 120% comparability factor, this brings the rate to $21.79. Using a 125% comparability factor brings the rate to $22.70/month. *See* AT&T Statement 1.2 at p. 9, fn. 14.

154 *In the Matter of High Cost Universal Service Support, Federal-State Joint Board on Universal Service,* WC Docket No. 05-337, CC Docket No. 96-45; Comments on Further Notice of Proposed Rulemaking by Maine Public Utilities Commission, Maine Office of Public Advocate, Montana Public Service Commission, Vermont Public Service Board, and West Virginia Consumer Advocate Division, January 28, 2010. *See also* Rebuttal Testimony of Don Price on behalf of Verizon in Docket No. I-00040105 (rate cap/USF case before ALJ Colwell) at p. 35.

155 OCA Exceptions at p. 10.

156 Verizon Statement 1.1 at p. 36.

and it should not – AT&T's proposed $22 benchmark falls squarely in the middle of the range of 120%-150% comparability factors using Verizon's *urban* rates.[157]

D. The PTA and CenturyLink Misrepresent Federal Access Reform

The PTA and CenturyLink claim that access reform that does not rely heavily on the expansion of the state USF is at odds with federal reform. They state that moving to interstate rates is not consistent with federal reform unless the Commission permanently expands the PaUSF to fund the intrastate access reductions, just as the FCC expanded federal universal support mechanisms to fund interstate access reductions.[158] These claims are misleading and wrong.

First, the FCC specifically recognized that it is best for carriers to first look to their own customers for cost recovery rather than rely on subsidies. Thus, the FCC increased the Subscriber Line Charge ("SLC") at the same time it reduced interstate access rates. Carriers were required to recoup their access reductions from their own customers, rather than through hidden subsidies. As the FCC said when adopting the *CALLS Order*, "Our actions today are in furtherance of our goal of having price cap LECs recover a large share of their NTS common line costs from end users who cause them instead of carriers..."[159] The FCC specifically agreed that loop costs should be recovered from the cost causers – namely the local service subscriber, rather than through other carriers.[160]

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[157] Using a 130% factor, but basing it on Verizon's Density Cell 1 and 2 rates leads to a comparability rate of $21.22-$21.61. Using the 150% factor, but again basing it on Verizon's Density Cell 1 and 2 rates leads to a comparability rate of $24.48-$24.93/month. Of course, if Verizon's rates increase, so too will this comparability rate.

[158] PTA Exceptions at pp. 33-34; CenturyLink Exceptions at pp. 9-10.

[159] *In Re: Coalition for Affordable Local and Long Distance Service (CALLS) Access Charge Reform, et. al., Sixth Report and Order in CC Docket Nos. 96-262 and 94-1; Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45, May 31, 2000 ("CALLS Order"),* at ¶77.

[160] *Id.* at ¶95.

Second, although the FCC did indeed establish federal universal support mechanisms, those programs are not the same as what the RLECs are requesting in this case. The *CALLS* proposal for implementing federal universal service funding was quite complicated, and most definitely was not solely a revenue guarantee program as the RLECs advocate here. To the contrary, the FCC wanted to ensure that reform was designed to provide the largest amount of support for the higher cost areas, based on looking at the costs of rural areas.[161] In contrast to the federal USF programs, the RLECs strenuously oppose having to present any cost data in Pennsylvania; and they do not advocate a universal service fund that leads to targeted support for high cost areas. Instead, the RLECs want a dollar-for-dollar matching of universal service funds that is based on historical pricing from a monopoly era, rather than based on providing support to high cost and low income customers that actually need it. In addition, the federal plan called for universal service funds to be portable, meaning that if a competitor serves a customer in a high cost area that is deemed eligible for support, a competitor can obtain federal USF support.[162] Obviously, that is not the case in Pennsylvania, where only the RLECs receive universal service funding.

For the very first time in this entire case, CenturyLink claims in its Exceptions that its interstate access rates may not recover the costs of intrastate rates in Pennsylvania because when the most recent interstate access rates were established by the FCC, CenturyLink was required to adopt an average traffic sensitive rate of $.0065 that is a national rate for all CenturyLink operating companies.[163] As a matter of fundamental due process and fairness, this claim must be ignored because it is not part of the record. CenturyLink did not bother to raise it throughout the past year while this case was being litigated. No party has had any opportunity to engage in discovery, present testimony or cross examine CenturyLink regarding the validity of its claim.

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161 *Id.* at ¶206.

162 *Id.* at ¶186.

163 CenturyLink Exceptions at pp. 12-13.

As the Commission well knows – and as CenturyLink should know – it is entirely inappropriate to raise new and unsubstantiated claims in Exceptions.

Second, the *CALLS Order* cited by CenturyLink makes it clear that CenturyLink voluntarily chose to use the national average traffic sensitive rate it now attacks. CenturyLink had a choice – it could either choose the average rate, or it could submit cost studies showing its actual rates.[164] CenturyLink chose the average rate. CenturyLink has never in any forum complained that this average rate does not recover its costs. Such a claim would be ludicrous anyway given that the rate is well above reciprocal compensation levels, which is an accurate reflection of costs for terminating a call (whether it be a local or long distance call).[165]

Finally, it is far too late for CenturyLink to be making this claim. CenturyLink knew since the beginning of this case that AT&T wants CenturyLink's intrastate access rates to be set at parity with CenturyLink's interstate rates. At no time did CenturyLink ever present any type of cost information to show that CenturyLink's interstate rates would not be high enough to cover CenturyLink's intrastate access costs, even though it had ample opportunity to do so. CenturyLink cannot now imply that its Pennsylvania costs will not be covered by its interstate rates that have been part of AT&T's advocacy since the beginning of the case. It had its chance to prove that point, yet sat on its hands.

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[164] The *CALLS Order*, at Paragraph 59 states "each price cap LEC will, at the holding-company level, choose between two options. The first alternative is to subscribe to the CALLS Proposal for its full five-year term. The second alternative is to submit a cost study based on forward looking economic costs..."

[165] The PTA claims that reciprocal compensation rates are not an appropriate proxy for determining intrastate access costs because they are set based on forward-looking cost models. PTA Exceptions at pp. 34-35. This argument should be disregarded. The RLECs' reciprocal compensation rates are tariffed rates or rates set by mutual agreement in an interconnection agreement. No RLEC has complained that it is unable to recover its costs and thereby requested that its reciprocal compensation rates be increased in Pennsylvania. In addition, no party is requesting that intrastate access rates be set at reciprocal compensation levels. Interstate rates are still well above the reciprocal compensation rates. If the RLECs thought that their intrastate access costs were much higher than their reciprocal compensation rates (despite the fact that the technical function of terminating a local and long distance call is materially the same), they could have presented some cost data to support that proposition, but they did not do so.

E. The ALJ Properly Rejected Qwest's Unsupported Proposal.

Qwest filed Exceptions based on the ALJ's rejection of Qwest's proposal to set a residential benchmark rate at 125% of the average Pennsylvania RLEC residence rate.[166] In the case, Qwest's entire support for this proposed benchmark amounted to a single sentence in which it claimed that this benchmark will "help limit the need for significant increases in the PaUSF, thereby striking an appropriate balance between local rate affordability and the need for PaUSF assistance."[167] In its Exceptions, and for the very first time, Qwest purports to describe what its proposal actually means. It is improper to wait until the Exceptions to identify the details of its proposal. There were many rounds of testimony in this case, and there is no legitimate reason Qwest had to wait until after its proposal was rejected to finally explain what its proposal actually is.

In any event, and as discussed above, Qwest's proposal is based on a comparability standard that has already been rejected in Pennsylvania. More importantly, Qwest's comparability analysis is highly flawed because rather than attempting to reach comparability between rural and urban rates, Qwest inexplicably uses the average rural companies' rates to calculate comparability. Qwest does not explain why using the average ***rural*** residence rate makes any sense at all when comparability is supposed to be based on a comparison to ***urban*** rates. The Qwest proposal is completely unsupported, it was properly rejected by the ALJ, and it should not be adopted by the Commission.

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166 Qwest Exceptions at pp. 3-5.

167 *Id.*

VII. THE ALJ IS CORRECT IN REQUIRING RLECS TO RECOVER REVENUES FROM THEIR OWN END-USER CUSTOMERS UP TO AN APPROPRIATE BENCHMARK RATE, RATHER THAN SHIFTING MOST OR ALL REVENUE RECOVERY TO THE PA USF.

As ALJ Melillo found, the solution to access reform cannot be to simply shift all (or even most) implicit subsidies from access charges to the Pennsylvania USF. This would just perpetuate the inefficient and anti-competitive cross-subsidization of the RLECs to the detriment of consumers throughout Pennsylvania. The OSBA got it exactly right when it argued against the expansion of the current USF in the case before ALJ Colwell:

> You can't have competition and at the same time provide general subsidies. That is simply a tax on one group of consumers to support another group of consumers without giving the first group any voice in how or why it is being taxed.[168]

More importantly, ALJ Colwell got it exactly right when she found:

> The PA USF is a fund which exists because the ratepayers of other telecommunications providers have paid the money, unwittingly, as a hidden tax. It is not "free money" to be plundered at will and without concern for its origins or for whether it is the best use of the money. All parties agree that the concept of universal service is a worthy one. This fund should be reconstructed to provide assistance to those customers who need it, and for those companies who can meet a stringent test for determining that they serve an area whose costs are so high that the company itself deserves extra help for that area alone.
>
> At some point, the market is meant to rely on competition to keep rates affordable. Institutionalizing the PA USF in its present form to provide subsidies to companies who do not have to prove need will not assist the market in reaching its goals and will, instead, provide barriers to entry for new carriers.[169]

The burden which some parties nevertheless would place on the majority of Pennsylvania consumers cannot be overstated. The OCA's proposal to *triple* the size of the PA USF to nearly $100 million, for example, would amount to a $90/line annual subsidy even for those customers

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168 OSBA Statement 1.1 (Buckalew Rebuttal), January 15, 2009, p. 14.

169 ALJ Recommended Decision, Docket No. I-00040109, July 22, 2009, pp. 87-88.

who have competitive options, and for those customers who are voluntarily purchasing bundles at prices much higher than AT&T's proposed benchmark of $22/month.[170]

The problem with the OCA's and the RLECs' arguments for permanently expanding the PaUSF to an unreasonably large size is that there is no credible evidence that such a large fund is necessary to actually ensure all customers pay affordable local rates. It is critical to remember that the purpose of a universal service fund is to ensure customers in high cost areas can have affordable telephone service. It is not the objective of a properly-structured USF to protect the RLECs and their revenue streams, or to insulate them from the effects of competition in the way that the RLECs and OCA propose.

CenturyLink itself testified that the primary purpose of universal service is to ensure service to "rural, high-cost consumers who generally do not have viable competitive alternatives available and who would otherwise not have any communications services available without implicit and/or explicit universal service support to provide communications services at affordable prices that are comparable to the rates of other consumers."[171] There is no record evidence as to how many of these customers even exist, if any. However, as the evidence showed, there *cannot be very many because competition exists throughout Pennsylvania.* Even if there are some limited number of customers who do not presently have competitive alternatives, and who cannot presently obtain voice-grade service at affordable rates without subsidies, those customers should be cared for through ***targeted*** subsidy mechanisms, not the sort of massive expansion to the USF that the RLECs and OCA advocate.

By any measure, the levels of subsidies the RLECs and OCA propose are extreme and go far beyond the amounts needed to assure telephone services for that exceedingly limited number

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170 AT&T Statement 1.4 (Nurse/Oyefusi Rejoinder) at p. 3.

171 CenturyLink Statement 1.1 (Lindsey/Harper Surrebuttal Testimony) at pp. 14-15.

of customers. As an example, the OCA proposes that CenturyLink receive nearly **BEGIN CONFIDENTIAL END CONFIDENTIAL** *in subsidies.*[172] As AT&T testified:

> If CenturyLink is given **BEGIN CONFIDENTIAL END CONFIDENTIAL** in subsidies, ***every single one of CenturyLink's lines would be subsidized by over*** **BEGIN CONFIDENTIAL END CONFIDENTIAL**. This includes business lines. This includes the majority of CenturyLink's customers who have elected to forego standalone local service in favor of a bundled offering. More importantly, this includes a subsidy for customers that have multiple competitive alternatives, and therefore under CenturyLink's own definition, do not ***need*** universal service protections or subsidies. Assume for the sake of argument that 50% of CenturyLink's customers have no competitive alternative – and by CenturyLink's own claims that is way too high – a **BEGIN CONFIDENTIAL END CONFIDENTIAL** subsidy to CenturyLink's "universal service customers" would equate to over **BEGIN CONFIDENTIAL END CONFIDENTIAL** Under a more realistic, but still conservative, assumption that 10% of CenturyLink's customers have no competitive alternative, the **BEGIN CONFIDENTIAL END CONFIDENTIAL** CenturyLink subsidy would equal *over* **BEGIN CONFIDENTIAL END CONFIDENTIAL** Even more troubling, this subsidy will continue permanently.[173] Thus, under CenturyLink's proposal, as more and more CenturyLink customers leave to go to a competitor (or at least have the option), the constant **BEGIN CONFIDENTIAL END CONFIDENTIAL** subsidy would continue on, supporting an ever-smaller number of customers.[174]

This evidence shows that the RLECs' and CenturyLink's approach is bad policy. In contrast, AT&T's proposal in this case provides a reasonable and balanced approach to universal service concerns. It reduces implicit subsidies, thereby eliminating market distortions and allowing full and fair competition to remain sustainable throughout the Commonwealth. AT&T's proposal also requires the RLECs to first turn to their own customers to recover any revenue reductions from access rate decreases. Again, this sends the proper pricing signal to the market and will even allow local competition to develop and thrive where it does not exist today

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172 AT&T Statement 1.4 (Nurse/Oyefusi Rejoinder) at p. 8.

173 The OCA claimed that under its proposal, the size of the USF would decrease each year, but that was based on speculation about whether Verizon will increase its retail rates each year, thereby increasing the "comparable" benchmark. OCA has no proposal of decreasing the size based on a reduction in customers that actually need support. (Footnote in original).

174 AT&T Statement 1.4 (Nurse/Oyefusi Rejoinder) at pp. 9-10.

because local rates are being artificially suppressed. Finally, AT&T's proposal permits the expansion of the state USF on a transitional basis in order to reform access rates immediately while phasing in local rate increases over a period of four years. This furthers the Commission's original intent regarding the purpose of a USF, as noted by ALJ Colwell:

> The PA USF anticipated in the *Global Order* was intended to be an interim measure for easing rural ILECs away from high access charges by compensating them for the difference which competition introduced into the market. That "interim measure" has continued for ten years, and that is considerably longer than the Order anticipated.[175]

VIII. THE ALJ DID NOT ERR IN HER APPLICATION OF THE BURDEN OF PROOF.

A. The RLECs Agree They Have the Burden of Proof

The ALJ properly held that the RLECs have the burden of proof in this case. The PTA and CenturyLink agree that they have the burden of proof. Despite this, the OSBA continues to advocate that the burden falls on AT&T.[176] The OSBA is wrong.

As the ALJ properly found, the issue of who has the burden of proof has already been decided by this Commission. Specifically, in the Verizon access case, a very similar procedural history was involved and the Commission held as follows:

> Notwithstanding that the instant docket bears a "C" designation, signaling a formal complaint by a participant, Verizon's rates, while existing rates, have not been endorsed by this Commission as the final stage in the access charge reform process that began years ago.[177]

OSBA claims that this case is different because the Commission did not appear to contemplate ordering specific RLECs to reduce their access charges by specific amounts.[178] This claim makes no sense whatsoever. Just as with the Verizon case, this case orginated from the *Global Order* and continues the Commission's policy established in that decision to implement

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175 ALJ Colwell Recommended Decision at Docket No. I-00040105, p. 88.
176 OSBA Exceptions at pp. 7-10.
177 Opinion and Order, Docket No. C-20027195, January 8, 2007, pp. 20-21.
178 OSBA Exceptions at p. 8.

further access reform. The exact details of what that reform would look like of course could not be determined until a record was developed. However, the fact that the Commission did not order specific reductions before this case started does not then shift the burden of proof away from the RLECs. Given that the RLECs themselves acknowledge they have the burden, the OSBA's claim that it does not fall on them should be rejected.

B. The ALJ Properly Held that the RLECs Did Not Meet Their Burden of Proof

While acknowledging that they have the burden of proof in this case, the PTA and CenturyLink argue that they have met their burdens merely by showing that their existing access rates were previously approved by the Commission.[179] The PTA further claims that the Commission's statements that further access reductions would be forthcoming "carried no substance."[180] For its part, CenturyLink essentially argues that once it proves its access rates were previously approved, the burden shifts to the parties proposing access reform.[181]

The RLECs' simplistic views should be rejected. First, as the ALJ properly held, the fact that the RLECs' access rates were permitted to go into effect in 2003 does not prove that they are just and reasonable today. To the contrary, as the ALJ found in her Conclusion of Law #1: "The Commission retains the authority to ensure that rates for noncompetitive, protected services, including intrastate switched access charges, remain just and reasonable. *Buffalo Valley Telephone Company et al. v. Pa. P.U.C.*, 990 A.2d 67 (2009); 66 Pa. C.S. §§ 1301, 3012, 3015(g)." As the ALJ further found, this Commission has already held that it can review access rates, and "[r]ates that were once 'just and reasonable' may be re-evaluated and modified based upon changed circumstances."[182] Thus, the RLECs are completely wrong that they can meet

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179 PTA Exceptions at pp. 10-11. CenturyLink Exceptions at pp. 4-5.
180 PTA Exceptions at p. 12.
181 CenturyLink Exceptions at p. 5.
182 R.D. Conclusion of Law #7.

their burden of proof simply by demonstrating that the Commission previously approved their current rates.

Further, the fact that no law *requires* specific access reductions is not determinative. The evidence in this case demonstrates that in order to promote just and reasonable rates that are in compliance with the policies of the Commonwealth and the Legislature, access rates must be reduced.[183] Contrary to PTA's claims, the Commission is not free to simply ignore these Legislative policies, but must ensure the rates utilities charge do not lead to anti-competitive and anti-consumer results in violation of the law.

Nor should the Commission give any weight to PTA's efforts to dismiss the Commission's prior commitments to further reduce access rates as "meaningless." The Commission recognized over a decade ago that implicit subsidies should be removed. While taking a first step towards that goal in 1999, the Commission acknowledged that further reform was required. The Commission took a second step towards reform in 2003. Yet again, the Commission promised to implement further reform. The Commission initiated this case in 2004 in order to finalize that reform. The record developed in this case conclusively proves that the Commission should not abandon its previously stated policies, but that the changes to the market make it even more critical that the Commission carry through with its promises and implement access reform in Pennsylvania.

IX. CONCLUSION

The Recommended Decision lays out the case for reform. By adopting the process improvements described in AT&T's Exceptions – and specifically by adopting AT&T's compromise proposal – the Commission can finally achieve meaningful reform. As AT&T described throughout the case and in its Exceptions, AT&T's proposal in this case presents a balanced compromise solution to access reform. It immediately reduces the intrastate access rates

[183] See AT&T Main Brief at p. 18 citing to 66 Pa.C.S.A. §3011.

of the RLECs to just and reasonable levels by reducing them to interstate parity, yet recognizes that retail rate increases may need to be implemented over a slower, transitional timeframe. The evidence demonstrates that adoption of this process for access reform will not lead to the dire consequences painted by the RLECs, but will instead greatly benefit customers throughout Pennsylvania by permitting full and fair competition to develop while still maintaining affordable local rates.

The Commission should reject the Exceptions of the PTA, CenturyLink, Qwest, OCA and OSBA and should instead grant AT&T's Exceptions, thereby adopting the Recommended Decision's finding that the RLECs' current intrastate access rates are unjust and unreasonable. However, instead of waiting up to four years to achieve just and reasonable access rates as the RD proposes, the Commission would bring the benefits of access reform immediately to Pennsylvania consumers consistent with AT&T's proposal.

Respectfully submitted,

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Date: September 17, 2010

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the foregoing Reply Exceptions of AT&T upon the participants listed below in accordance with the requirements of 52 Pa. Code Section 1.54 (related to service by a participant) and 1.55 (related to service upon attorneys).

Dated at Chicago, Illinois, this 17th day of September, 2010.

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