

COMMONWEALTH OF PENNSYLVANIA



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May 13, 2010

Rosemary Chiavetta
Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120

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

AT&T Communications of Pennsylvania,
LLC, *et al.* v. Armstrong Telephone
Company - Pennsylvania, *et al.*
Docket No. C-2009-2098380 *et al.*

Dear Secretary Chiavetta:

Enclosed for filing is the Main Brief of the Office of Consumer Advocate, in the
above-referenced proceeding.

Copies have been served upon all parties of record as shown on the enclosed
Certificate of Service.

Sincerely,

A handwritten signature in black ink, appearing to read "Joel H. Cheskis".

Joel H. Cheskis
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Enclosures

cc: All parties of record
Hon. Kandace F. Melillo, ALJ

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

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

MAIN BRIEF OF THE
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I. STATEMENT OF QUESTIONS AND SUMMARY OF POSITIONS

A. Introduction.

The underlying issue that must be addressed in this proceeding is how will the cost of the joint and common plant of the public switched telephone network (“PSTN”) of Pennsylvania’s rural telephone companies be recovered. The joint and common network plant is the plant outside customers’ homes that connects each customer to a telephone company’s central office. The plant consists of cables and wires, poles, trenches and conduit, and electronic equipment that is situated in the field. This plant is used to provide all of the services the customer wishes to consume and allows telephone companies to provide all of the services that they wish to provide. This plant allows the customer to make a local telephone call and it also allows a long distance carrier or a wireless carrier to complete a call. This plant is not directly assignable to any one service, such as access, local exchange or data transport service. None of those services, however, can be provided without this plant.

Revenue to pay for the joint and common network is obtained from local and access rates. Local rates are those rates paid by retail customers, both residential and business, for the ability to make local telephone calls and to receive calls. Access rates are those rates paid by long distance, or toll, companies to both originate and terminate long distance calls on the local network in order to provide service to end users.

In order to reduce access rates for the purpose of spurring competition in the long distance industry, while still preserving universal service, the Pennsylvania Public Utility Commission (“Commission”) established the Pennsylvania Universal Service Fund (“PA USF”). The PA USF helps to maintain the affordability of local telephone service rates for end-user customers while allowing rural telephone companies to reduce access charges, on a revenue

neutral basis.¹ For a variety of reasons, various parties wish to change the relative burden associated with the recovery of the common cost of the network. In particular, the long distance carriers wish to be relieved of their obligation to support the joint and common cost through access charges. If the long distance carriers are relieved of that obligation, then someone else must pay for the cost of the network. The cost could fall on the local telephone company, the affiliates of the local telephone company, the basic local exchange customers of the local telephone company or a universal service fund.

As discussed further below, reducing the amount that long distance carriers pay to local telephone companies for access to the PSTN represents a substantial reduction in revenue for the local telephone companies. This is particularly true for the Pennsylvania rural telephone companies that are the subject of this proceeding. While the Office of Consumer Advocate (“OCA”) agrees that differences in access rates should be reduced to prevent regulatory arbitrage, any lost revenue as a result of reducing access rates must be the responsibility of all users of the PSTN, and not just basic local exchange customers. Basic local exchange customers should not bear the entire burden to pay for the network that is used to provide a variety of services, particularly given the numerous changes to the network and the telecommunications industry over the past decade, as well as state and federal laws that seek to ensure the universal provision of basic local telecommunications services. Telephone service is unique among public utility services because of its two-way nature; the more individuals and the more areas of Pennsylvania and the United States that are connected to the PSTN, the more benefit that accrues to all users.

In this proceeding, the OCA has presented a comprehensive proposal that establishes a just and reasonable mechanism to recover joint and common costs of the network. The proposal

¹ 52 Pa. Code § 63.161(3).

recommends the elimination of the non-traffic sensitive carrier common line charge (“CCLC”), which is a type of access charge, and also recommends that the basic local service rates of some of the rural incumbent local exchange carriers (“RLECs”) be increased to levels that remain reasonable and affordable. These recommendations, however, are contingent upon the Commission expanding the PA USF and increasing the support from the PA USF for the RLECs. The increase in PA USF support to the RLECs allows all users of the joint and common plant to make a reasonable contribution to the support of the PSTN.

The four integrated steps of the OCA’s comprehensive plan presented in this proceeding are as follow:

1. RLEC intrastate access rates should be set equal to their respective interstate rates, including the elimination of the carrier common line charge;
2. RLEC residential basic local exchange rates that are below 120 percent of the Verizon Pennsylvania weighted average residential basic local exchange service rate should be increased to that level, subject to an affordability constraint, while RLEC rates that are above 120 percent of the Verizon weighted average rate remain at their current levels;
3. Any remaining revenue required to offset the revenue decrease associated with access rate reductions should be recovered from the Pennsylvania Universal Service Fund; and
4. The revenue base of the Pennsylvania Universal Service Fund should be enlarged to include any service provider that uses the public switched telecommunications network at any point in providing their service.

All four of these components must be adopted in their entirety in order to meet the goals of the OCA’s plan.

The OCA’s comprehensive proposal seeks to achieve a balance of the varying interests in this proceeding. Long distance companies, or interexchange carriers (“IXCs”), benefit by the

reduction in access rates, but are still required to contribute for their use of the PSTN. Basic local exchange customers will see an increase in their basic local exchange rates but are protected from unreasonable rate increases by a comparability and affordability benchmark. The RLECs will see a reduction in access revenues, and may realize a loss of customers due to increases in certain rates, but will continue to receive support from the PA USF for the PSTN. Overall, the OCA's comprehensive proposal will promote competition and universal telecommunications service alike.

After extensive litigation and development of an evidentiary record in this and related proceedings, several parties have agreed to varying portions of the OCA's comprehensive proposal. That is, under certain circumstances, most parties agree with the ultimate goal of reducing the RLECs' intrastate access rates to their interstate rates. Most parties agree that a reasonable benchmark of basic local service rates, adjusted over time, is appropriate. Most parties also agree that the PA USF should remain a viable source of revenue for the RLECs as they continue to carry the obligation of universal service. At the same time, some parties supported portions of the OCA's proposal but failed to recognize the interrelated nature of all aspects of that proposal.

The OCA's comprehensive proposal, when viewed in its entirety, presents the most reasonable accommodation of a variety of conflicting goals, objectives and interests of both state and federal law, as well as parties to this proceeding, and should be adopted by the Commission.

B. Summary of Position and Rebuttal.

The OCA submits that all users of the PSTN must pay a reasonable share of the cost to maintain that network. Nevertheless, the OCA submits that the RLECs' intrastate access rates should be reduced to their interstate levels and the CCLC be eliminated to remove any disparities

or competitive advantages created as a result of differences between federal and state intercarrier compensation rules. At the same time, however, the OCA submits that, in conjunction with promoting the competitive provision of telecommunications services, the Commission must maintain universal telecommunications service at just, reasonable and affordable rates. As a result, the OCA has proposed a comprehensive plan that reduces the RLEC intrastate access rates to interstate rates and eliminates the CCLC but also establishes a benchmark rate for residential basic local exchange service that is equal to 120% of the Verizon Pennsylvania weighted average basic local exchange rate and bounded by an affordability constraint. Any additional revenue required to offset the reduction in the RLECs intrastate access rates will come from the PA USF.

In response to the positions raised by other parties in this proceeding, the OCA submits that those parties that seek intrastate access reductions while either 1) requiring basic local exchange customers alone to compensate the RLECs for such revenue reductions or 2) allow the RLECs to not be reasonably compensated for such revenue reductions, are jeopardizing the nearly century old public policies of universal telephone service. These universal service policies are equally as vital as the competitive provision of telecommunications services. Arguments that would jeopardize these policies must be rejected.

C. Statement of Questions.

1. Whether the intrastate access rates of Pennsylvania's rural local exchange carriers should be reduced to their interstate levels, including the elimination of the state carrier common line charge?

Suggested Answer: Yes

2. Whether the revenue lost as a result of such a reduction should be recovered first by increases in the basic local exchange service rates up to 120% of the Verizon weighted average, subject to an affordability constraint, and then from the Pennsylvania Universal Service Fund?

Suggested Answer: Yes

3. Whether the Pennsylvania Universal Service Fund should be expanded to require all carriers that provide service using the public switched telephone network to contribute to the Fund?

Suggested Answer: Yes

II. FACTUAL AND LEGAL BACKGROUND

State and federal telecommunications law recognize the importance of both promoting the competitive provision of telecommunications services and maintaining and enhancing the universal provision of basic local exchange telecommunications service. Neither state nor federal law prioritizes one goal over the other. Both of these goals must be addressed by the Commission in this proceeding.

Universal telephone service principles have been at the foundation of our Nation's telecommunications policy since the passage of the Federal Communications Act of 1934. Section 151, for example, provides in pertinent part:

Purposes of Act; Federal Communications Commission created. For the purpose of regulating interstate and foreign commerce in communication by wire and radio *so as to make available, so far as possible, to all the people of the United States*, a rapid, efficient, nationwide, and world-wide wire and radio communication service with adequate facilities at reasonable charges...²

Since that time, it has been the policy of the United States to ensure that as many Americans as possible have access to affordable telephone service.

Federal law has been especially concerned about the high cost to provide telephone service to rural areas due to the geographic character of these areas. In 1996, Congress enacted the Federal Telecommunications Act of 1996 ("TA-96") to, in part, provide greater statutory guidance on universal service funding for "high cost" customers in rural areas as well as for low-income customers.³ Subsequently, federal law established a Universal Service Fund through

² 47 U.S.C. § 151 (emphasis added).

³ 47 U.S.C. § 254(b)(3).

which “high cost” rural and insular regions of the Nation can receive support for their basic service from other interstate customers.⁴

In addition, federal law requires that consumers in rural and high cost areas have access to telecommunications services that “are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas.”⁵ According to the Federal Communications Commission (“FCC”), “the primary federal role in ensuring the statutory goal of reasonably comparable rural and urban rates for non-rural carrier customers is to enable reasonable comparability among states.”⁶ States, on the other hand, “have primary responsibility for ensuring reasonably comparable rural and urban rates” within the state.⁷ Congress has further articulated as a universal service principle that “quality services should be available at just, reasonable and affordable rates.”⁸

Similarly, at the state level, in Pennsylvania, universal service principles have long been at the heart of our regulatory framework. Even while promoting the competitive provision of

⁴ In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45, 12 FCC Rcd. 8776, 1997 WL 236383 (rel. May 8, 1997) (“1997 FCC Order”).

⁵ 47 U.S.C. § 254(b)(3).

⁶ In the Matter of the Federal-State Joint Board on Universal Service, CC Docket No. 96-45, 18 FCC Rcd. 22559, Order on Remand, ¶ 18 (rel. Oct. 27, 2003).

⁷ Id., ¶ 21. Several states have established a comparability standard for determining rural rates or implementing a state universal service fund. *See e.g.*, Maine Public Utility Commission, Chapter 288; Public Utilities Commission of the State of California, Resolution T-17122, January 10, 2008; 2007 Annual Telecommunications Report, Wyoming Public Service Commission.

⁸ 47 U.S.C. § 254(b)(1). The FCC stated in its implementation of Section 254(b)(1) of TA-96 that the concept of affordability has two components: (1) an absolute component and (2) a relative component. 1997 FCC Order at ¶ 110. In the 1997 FCC Order, the FCC referenced the use of a percentage of income standard in assessing the relative component of affordability of telephone service. Id. Examining the “relative component” of affordability, however, the FCC said, “takes into account whether consumers are spending a *disproportionate amount of their income* on telephone service.” Id. (emphasis added). The FCC noted that “subscriber levels do not reveal whether consumers are spending a *disproportionate amount of income* on telecommunications services.” Id. (emphasis added).

local telephone service, the Pennsylvania General Assembly made clear in its landmark revisions to Pennsylvania telecommunication law that competition was not to be promoted at the expense of universal service. In the original Chapter 30 legislation (Act 67 of 1993), since replaced by the new Chapter 30 (Act 183 of 2004), the very first line of that Act declared that:

§ 3001. Declaration of Policy.

The General Assembly finds and declares that it is the policy of this Commonwealth to:

- (1) Maintain universal telecommunications service at affordable rates⁹

When Chapter 30 was re-enacted in 2004, the universal service provision contained in the original Section 3001(1) was recodified in Section 3011(2). Section 3011(2) provides:

§ 3011. Declaration of Policy.

The General Assembly finds and declares that it is the policy of this Commonwealth to:

- (2) Maintain universal telecommunications service at affordable rates¹⁰

The re-enacted Chapter 30 of the Public Utility Code also requires telephone companies to: “(3) Ensure that customers pay only reasonable charges for protected services which shall be available on a nondiscriminatory basis.”¹¹ As a result, the concepts of comparability and affordability are fundamental guidelines that must be recognized when setting basic local exchange service rates in order to maintain universal telephone service at just and reasonable rates.

⁹ 66 Pa. C.S. § 3001(1).

¹⁰ 66 Pa. C.S. § 3011(2).

¹¹ 66 Pa. C.S. §§ 3011(3). “Protected service” includes, among other things, “service provided to residential or business consumers that is necessary to complete a local exchange call.” 66 Pa. C.S. § 3012.

The Pennsylvania Public Utility Commission has recognized the need to take steps to ensure universal service – particularly in rural areas – as competitive pressures in other areas could compromise revenue support in high cost areas that had been available under the prior regulatory system. As a result, the Commission established the PA USF that was designed to keep rural rates affordable and comparable to urban rates as reductions in access charges were implemented. The PA USF was established in 1999 in the Global Order.¹² The Commonwealth Court explicitly affirmed the creation of the PA USF when affirming the Global Order in its entirety.¹³

Finally, it should be noted that when Chapter 30 of the Public Utility Code was reenacted in 2004, the specific directive contained in the original Chapter 30 to *reduce* certain intrastate access rates was not included in Act 183.¹⁴ Rather, the General Assembly directed only that any reductions in intrastate access rates ordered by the Commission must be revenue neutral.¹⁵ As such, any revenue loss created by reducing intrastate access rates must be made up by an increase from another source. Most commonly, the other source that is increased to maintain revenue neutrality is the basic local service rate. The Commission cannot, however, simply increase basic local service rates for rural customers to extreme levels without considering the impact such actions have on the Commission’s obligation to maintain universal telephone service at affordable rates.

¹² In re: Nextlink PA, 93 Pa PUC 172 (Sept. 30, 1999) (Global Order), *aff’d*, Bell Atlantic-Pennsylvania, Inc. v. Pa.P.U.C., 763 A.2d 440 (Pa. Cmwlth 2000) (Global Order Appeal), *vacated in part sub nom*, MCI WorldCom, Inc. v. Pa.P.U.C., 844 A.2d 1239 (Pa. 2004).

¹³ Global Order Appeal, 763 A.2d at 492-93 (“the concern has always been to provide public service in telecommunications with affordability and reasonable uniformity in services and costs”).

¹⁴ Compare, 66 Pa. C.S. § 3007 (repealed) with 66 Pa. C.S. § 3017.

¹⁵ 66 Pa. C.S. § 3017(a).

It is against this legal and factual backdrop that this proceeding was originally instituted by an Order entered on December 20, 2004 by the Commission at Docket No. I-00040105. In that investigation, the Commission was seeking to determine whether there should be further intrastate access charge reductions and intraLATA toll rate reductions in the service territories of RLECs. The Commission sought an investigation into all rate issues and rate changes that should or would result in the event that disbursements from the PA USF are changed. In that Order, the Commission recognized its responsibility for assuring the maintenance of universal telecommunications services at affordable rates in Pennsylvania as well as the evolving nature of this responsibility. The Commission noted that the PA USF helps to maintain the affordability of local service provided by a majority of the telephone companies in the Commonwealth. The OCA filed a Notice of Intervention in that proceeding on February 2, 2005.

Since the December 20, 2004 Order, the investigation has been stayed by subsequent orders of the Commission in deference to the FCC which has an open proceeding that may affect the same issues and rates.¹⁶ By Order entered April 24, 2008, however, the Commission reopened the matter for the express and limited purpose of addressing selected issues pertaining to, among other things, rural rate affordability and the PA USF. The proceeding regarding rural rate affordability and the PA USF was adjudicated before Administrative Law Judge (“ALJ”) Susan D. Colwell and is currently pending before the Commission. The Commission granted a request to further stay the other portions of the investigation, such as what, if any, specific reductions in intrastate access rates should be ordered, as part of its April 24, 2008 Order.

On March 19, 2009, AT&T Communications of Pennsylvania, LLC (“AT&T”) and its affiliates filed complaints against each of the Pennsylvania RLECs for a total of ninety-six (96)

¹⁶ In the Matter of Developing a Unified Intercarrier Compensation Regime, CC Docket No. 01-92, FCC 05-33, Further Notice of Proposed Rulemaking (rel. March 3, 2005) (“FCC ICC NPRM”).

complaints. Those 96 complaints requested that the RLECs' intrastate access charges be reduced and were consolidated by presiding officer ALJ Kandace F. Melillo into one proceeding at Docket No. C-2009-2098380, *et al.* The OCA filed a Notice of Intervention in that proceeding on April 24, 2009. By Commission Order entered July 29, 2009, the Commission then consolidated those 96 AT&T complaints with the stayed portion of the rural access investigation and, in a separate Order entered August 5, 2009, restarted the investigation by denying a pending request for a further stay.

The Commission established an Initial Prehearing Conference regarding the consolidated investigation and complaint cases for August 19, 2009. In attendance at the Prehearing Conference were OCA, AT&T, the Office of Small Business Advocate ("OSBA"), Verizon Pennsylvania, Inc., Bell Atlantic Communications, Inc. d/b/a Verizon Long Distance, MCImetro Access Transmission Services, LLC d/b/a Verizon Access Transmission Services, and MCI Communications Services, Inc. (collectively "Verizon"), Comcast Phone of Pennsylvania, LLC d/b/a Comcast Digital Phone and Comcast Business Communications LLC d/b/a Comcast Long Distance ("Comcast"), Qwest Communications Company ("Qwest"), Cellco Partnership d/b/a Verizon Wireless ("VZ Wireless"), The United Telephone Company of Pennsylvania LLC d/b/a Embarq Pennsylvania ("CenturyLink"), Sprint Communications Company, L.P., Sprint Spectrum, L.P., Nextel Communications of the Mid-Atlantic, Inc., and NPCR, Inc. (collectively "Sprint"), the Pennsylvania Telephone Association ("PTA"), Omnipoint Communications Inc. d/b/a T-Mobile, Omnipoint Communications Enterprises LLC d/b/a T-Mobile and VoiceStream Pittsburgh LP d/b/a T-Mobile ("T-Mobile") and the Commission's Office of Trial Staff ("OTS").

During the Prehearing Conference, a procedural schedule was established. Pursuant to that procedural schedule, the OCA submitted the Direct and Surrebuttal Testimonies of Dr.

Robert Loube on January 20, 2010 and April 1, 2010, respectively.¹⁷ Evidentiary hearings were held in this matter on April 14-16, 2010 for purposes of admitting pre-filed testimony into the record and cross-examining witnesses.

The OCA now files this Main Brief setting forth its positions on the issues raised in this case pursuant to the procedural schedule governing this matter.

¹⁷ Dr. Robert Loube is the Vice President of Rolka Loube Saltzer Associates. His consulting practice centers on providing expert advice to state agencies involved in telecommunications regulation. Prior to joining Rolka Loube Saltzer Associates, Dr. Loube worked at the Federal Communications Commission, the Public Service Commission for the District of Columbia and the Indiana Utility Regulatory Commission on issues associated with incremental cost, rate design, competition, universal service and separations. OCA St. 1 at 1. Dr. Loube received his Ph.D in Economics from Michigan State University in 1983. *See*, OCA Exh. RL-1.

III. BURDEN OF PROOF

This proceeding presents a consolidation of both a group of formal complaints, filed by AT&T, and a Commission investigation. With regard to the formal complaints filed by AT&T, Section 332(a) of the Public Utility Code provides that the party seeking affirmative relief from the Commission has the burden of proof.¹⁸ In its Formal Complaints, AT&T alleges that the RLECs intrastate switched access rates are maintained at such a level that these rates are unjust and unreasonable, and are anti-competitive. AT&T alleges that the switched access rates thus violate Section 1301,¹⁹ 3011(3),²⁰ 3011(5)²¹ and 3011(9)²² of the Public Utility Code. As the complainant in this matter, AT&T is the party seeking affirmative relief from the Commission and, thus, bears the burden of proof on all facts relative to its Complaints.

In Se-Ling Hosiery, Inc. v. Margulies,²³ the Pennsylvania Supreme Court held that the term “burden of proof” means a duty to establish a fact by a preponderance of the evidence. The term “preponderance of the evidence” means that one party has presented evidence that is more convincing than the evidence presented by the other party. The Commission has held that a

¹⁸ 66 Pa. C.S. § 332(a).

¹⁹ Section 1301 of the Public Utility Code provides, in pertinent part, that “every rate made, demanded, or received by any public utility, or by any two or more public utilities jointly, shall be just and reasonable, and in conformity with regulations or orders of the commission.” 66 Pa. C.S. § 1301.

²⁰ Section 3011(3) of the Public Utility Code provides that “the General Assembly finds and declares that it is the policy of this Commonwealth to: ... (3) ensure that customers pay only reasonable charges for protected services which shall be available only on a non-discriminatory basis.” 66 Pa. C.S. § 3011(3).

²¹ Section 3011(5) of the Public Utility Code provides that “the General Assembly finds and declares that it is the policy of this Commonwealth to: ... (5) provide diversity in the supply of existing and future telecommunications services and products in telecommunications markets throughout this Commonwealth by ensuring that rates, terms and conditions for protected services are reasonable and do not impede the development of competition.” 66 Pa. C.S. § 3011(5).

²² Section 3011(9) of the Public Utility Code provides that “the General Assembly finds and declares that it is the policy of this Commonwealth to: ... encourage the competitive supply of any service in any region where there is market demand.” 66 Pa. C.S. § 3011(9).

²³ Se-Ling Hosiery, Inc. v. Margulies, 364 Pa. 45, 70 A.2d 854 (1950).

complainant, to establish a sufficient case against a utility and satisfy the burden of proof, must show that the utility should be held responsible or accountable for the problem described in the complaint.²⁴ The Pennsylvania Supreme Court also has clearly stated that the party with the burden of proof has a significant task before its position can be adopted by the Commission. Even where a party has established a prima facie case, the litigant still must establish that "the elements of that cause of action are proven with substantial evidence which enables the party asserting the cause of action to prevail, precluding all reasonable inferences to the contrary."²⁵

In addition to determining whether the complainants have satisfied the burden of proof, the Commission must exercise care to ensure that its decision is supported by substantial evidence in the record.²⁶ The term "substantial evidence" has been defined by the Pennsylvania Supreme Court, Superior Court and Commonwealth Court as such relevant evidence that a reasonable mind might accept as adequate to support a conclusion. More is required than a mere trace of evidence or a suspicion of the existence of a fact sought to be established.²⁷

At the same time, however, this proceeding involves the Commission's investigation into whether there should be further intrastate access charge reductions, and multiple related issues. No individual party is assigned the initial burden of proof in this investigation. Nevertheless, the OCA submits that, through the expert testimony of its witness, Dr. Robert Loube, the OCA has presented a comprehensive proposal that is designed to resolve the issues raised by the Commission in its investigation. The proposal is a four-part proposal and each part should be

²⁴ Feinstein v. Philadelphia Suburban Water Co., 50 Pa PUC 300 (1976).

²⁵ Burleson v. Pa. Pub. Util. Comm'n, 501 Pa. 433, 461 A.2d 1234 (1983).

²⁶ 2 Pa. C.S. § 704.

²⁷ Norfolk & Western Ry. Co. v. Pa. P.U.C., 489 Pa. 109, 413 A.2d 1037 (1980); Erie Resistor Corp. v. Unemployment Comp. Bd. of Review, 194 Pa. Super. Ct. 278, 166 A.2d 96 (1961); and Murphy v. Comm. Dept. of Public Welfare, White Haven Center, 85 Pa. Commw. 23, 480 A.2d 382 (1984).

adopted by the Commission. As such, the OCA submits that the OCA's comprehensive proposal is supported by the evidence in this proceeding and should be adopted in its entirety.

IV. SHOULD THE RLECS' INTRASTATE SWITCHED ACCESS RATES BE REDUCED?²⁸

A. RLEC Intrastate Access Rates Should Be Reduced To Their Interstate Levels But Only If The Commission Adopts The OCA Comprehensive Plan In Its Entirety.

The OCA submits that the RLECs' intrastate switched access rates should be reduced, but only if the entire OCA comprehensive proposal presented in this proceeding is adopted by the Commission. As discussed in the Direct Testimony of OCA witness Dr. Loube, the OCA has presented in this proceeding a comprehensive plan designed to revise the RLECs' intrastate access rates and to maintain universal service in Pennsylvania. OCA St. No. 1 at 9-18. The OCA plan has four interlocking features that all must be adopted for any change in intrastate access levels to be found just and reasonable. Those components are:

1. RLEC intrastate access rates should be set equal to their respective interstate rate, including the elimination of the carrier common line charge;
2. RLEC residential basic local exchange rates that are below 120 percent of the Verizon Pennsylvania weighted average residential basic local exchange service rate should be increased to that level, subject to an affordability constraint, while RLEC rates that are above 120 percent of the Verizon weighted average rate remain at their current levels;
3. Any remaining revenue required to offset the revenue decrease associated with access rate reductions should be recovered from the Pennsylvania Universal Service Fund; and
4. The revenue base of the Pennsylvania Universal Service Fund should be enlarged to include any service provider that uses the public switched telecommunications network at any point in providing their service.

²⁸ The outline of this brief was established by agreement of the parties pursuant to the direction of the Presiding Officer. All such headings and subheadings are bolded. As with all agreements among multiple parties, compromises were made in the development of the outline. The OCA comprehensive proposal presented in testimony is relevant to multiple sections of the outline. Therefore, some duplication may occur.

Id. at 10. As Dr. Loubé testified, the OCA plan resolves the AT&T complaints with regard to the fact that intrastate access rates are higher than interstate rates, while simultaneously ensuring that the residential basic exchange rate remains affordable and universal service is promoted. Id. at 11. The OCA plan will also resolve the issues the Commission sought to have addressed in this investigation established by Order entered December 20, 2004.

Regarding Step 1 of the OCA plan, recommending elimination of the state carrier common line charge (“CCLC”) is a new position for the OCA. The CCLC is a non-traffic sensitive rate used to recover the joint and common costs of the network from carriers that use it. As Dr. Loubé explained, the CCLC has been a reasonable way to recover the joint and common costs of the network from carriers that use the network and is not a subsidy. Id. The Commission is preempted, however, by the FCC from applying the CCLC to intra-MTA²⁹ wireless minutes. In addition, the FCC had eliminated the CCLC associated with interstate toll minutes. As a result of these FCC decisions, opportunities for regulatory arbitrage exist. The OCA therefore now recommends that the charge be eliminated to create a more level playing field among carriers that interconnect with the RLECs. Id.

Dr. Loubé cautioned, however, that eliminating the CCLC is one part of an integrated OCA plan and that if the Commission does not adopt the entire package, then the result of eliminating the state CCLC would be extremely harmful to RLECs and their basic exchange customers because of the lost revenue from service providers that use the local loop. Id. at 12. Dr. Loubé added that, if the CCLC were eliminated without adopting the other portions of the OCA comprehensive plan: “The RLECs would be left with the choice of either financial

²⁹ An “MTA” is a Major Trading Area and represents the areas within which a wireless carrier charges reciprocal compensation for terminating calls. OCA St. 1 at n.2.

insolvency or of establishing rates that are so high that they are not just, not reasonable and not affordable. That choice cannot be considered to be in the public interest.” Id.

Under Step 2 of the OCA plan, and as discussed in Section V.A., *infra*, the RLEC residential basic exchange rate would be benchmarked to 120 percent of the Verizon Pennsylvania weighted average residential rate. Id. at 13.³⁰ Currently, the Verizon weighted average rate is \$14.25. Id. at 14; *see also*, OCA Exh. RL-2. Therefore, a just and reasonable comparability benchmark, using the 120% target, would be \$14.25 x 1.2, or \$17.09. Id. Under the OCA’s plan, current RLEC rates that are below 120% would be raised to that rate. Id. at 13. The benchmark rate would also be constrained by an affordability analysis that limits the entire customer basic local telephone bill to no more than 0.75% (three-quarters of one percent) of the Pennsylvania median rural household income.³¹ The OCA benchmark retains the policy of fairness and comparability that the OCA recommended in the portion of the investigation conducted by ALJ Colwell that is pending before the Commission. Id. If the Commission adopts the OCA plan, the immediate impact would be to require RLECs’ residential basic local exchange rates to be no lower than 120% of the Verizon rate, or \$17.09 based on current Verizon rates. Id. at 14-15.

While twenty-two RLECs would be required to increase their basic local exchange rate to match the benchmark under the OCA plan, those increases range from 10 cents to \$3.60 per month, with the exception of Citizens of Kecksburg which would receive an increase of \$6.09.

³⁰ The term Verizon Pennsylvania refers to only the former Bell Atlantic territory and does not include the former GTE territory. OCA St. 1 at n.11.

³¹ The 0.75% affordability constraint was established by OCA witness Roger Colton in the portion of this investigation conducted by ALJ Colwell. *See, Investigation Regarding Intrastate Access Charges and IntraLATA Toll Rates of Rural Carriers and The Pennsylvania Universal Service Fund*, Docket No. I-00040105, Direct Testimony of Roger D. Colton, dated December 10, 2008.

Id. at 15; *see also*, OCA Exh. RL-3.³² The OCA's proposed benchmark will increase every year in which Verizon increases its basic service rates, so long as the overall customer bill for basic local service remained less than 0.75% of the Pennsylvania median rural household income. Therefore, if 120% of the Verizon weighted average basic local exchange rate increases to \$17.50 next year, the RLEC support would be determined using the \$17.50 benchmark. Id. As a result, the amount of support required from the PA USF decreases each year under the OCA proposal. OCA St. 1-S at 15. In addition, the OCA comprehensive plan calculates support as if the RLEC business rates are increased by the same amounts as the residential rate. OCA St. 1 at 15.

Under Step 3 of the OCA plan, and as set forth in Section VI.B, *infra*, any additional revenue required to offset the revenue decrease associated with access rate reductions that is not made up by increasing the RLECs' basic local exchange service rate to 120% of the Verizon weighted average rate would be recovered from the PA USF. In order to reduce the RLECs' intrastate access rates to interstate levels and eliminate the state CCLC, the pay-out of the PA USF would increase in total by approximately \$64.3 million. Id. at 16; *see also*, OCA Exh. RL-4.³³

Finally, under Step 4 of the OCA plan, to minimize the impact of the OCA recommendation on the size of the PA USF contribution factor, the OCA is also recommending

³² Given the size of the increase to customers of Citizens of Kecksburg, the OCA submits that a phase-in of the increase would be appropriate. OCA St. 1 at n.6.

³³ Reducing the RLEC's intrastate access rates to their interstate rates and eliminating the state CCLC, as discussed above, would increase the PA USF payout to a total of \$79 million. OCA St. 1 at 16. This figure, however, is offset, in part, by increases in the intrastate switching and transport rate for those 21 carriers whose intrastate rates are less than their interstate rates. Id. There would also be an offset related to increased revenues for those RLECs with residential rates that are now less than the OCA benchmark. Id. Therefore, the total net increase to the PA USF under the OCA comprehensive plan is \$64.3 million.

that the Commission enlarge the PA USF revenue base to include any service provider that uses the PSTN at any point in providing their service. Id. As Dr. Loubé testified,

the OCA realizes that a finding regarding the recommendation to enlarge the PA USF contribution base may not be within the purview of the assigned issues in this portion of the proceeding. However, the OCA's recommended comprehensive plan is contingent on the Commission addressing this issue in another proceeding of its choice and finding in that proceeding that it is necessary to increase the size of the contribution base.

Id. at 16-17. Dr. Loubé estimated that the PA USF revenue base would increase by \$4.4 billion by adding wireless revenue. Id. at 17 (citations omitted). Dr. Loubé then calculated that increasing the fund payout \$64.3 million from the current \$33 million, for a total PA USF of approximately \$97.3 million, while increasing the fund revenue base from the current \$2.9 billion to approximately \$7.3 billion by including wireless revenue, would increase the contribution factor by only 0.00166%. Id. This example does not address the impact of adding other services that use the PSTN to the contribution base, such as Voice over Internet Protocol ("VoIP") providers. Clearly, adding more service providers as contributors to the revenue base will further reduce the impact of the OCA proposal on any one service provider. Id. at 17-18. Dr. Loubé concluded by noting that 14 of 21 states that currently have state universal service funds require wireless carriers to contribute to those funds. Id. at 18.³⁴

As such, the OCA submits that the Commission should reduce the RLEC's intrastate access rates to the interstate levels, but only as part of adopting the OCA comprehensive proposal in its entirety as its resolution of this proceeding. If the Commission does not adopt the

³⁴ See, e.g., Alaska (3 AAC 53.340), Arizona (A.A.C R14-2-R 1204 B.2), Connecticut (CT G.S. § 16-247e), Idaho, Kansas (K.S.A. 66-2008(a)) and Nebraska. See also, Bluhm, Peter, *et al.*, "State High Cost Funds: Purposes, Design and Evaluation." National Regulatory Research Institute, 2010 at n. 171, available at (http://www.nrri.org/pubs/telecommunications/NRRI_state_high_cost_funds_jan10-04.pdf).

OCA comprehensive proposal in its entirety, then the RLECs intrastate access rates should not be reduced.

B. The OCA Comprehensive Proposal Represents A Reasonable Revenue Replacement For Any RLEC Intrastate Access Rate Reductions.

When addressing the issue of whether RLEC intrastate access rates should be reduced, it is important to note that the principal cause of the difference in intrastate and interstate access rates is, as Dr. Loube testified, that the FCC reduced the federal CCLC while this Commission has retained the state CCLC per-line charges on carriers. OCA St. 1 at 49. At the same time, however, the FCC's elimination of the federal CCLC has not gone without offsetting revenue replacement mechanisms to support the cost of the PSTN.

For example, the FCC has established two universal service mechanisms to help replace the revenue associated with elimination of the federal CCLC. *Id.* at 49-50; *see also*, OCA Exh. RL-9. First, the Interstate Access Support ("IAS") mechanism for price cap carriers is a fund that is disaggregated by carriers' unbundled network element ("UNE") zones and customer type. *Id.* at 51. Dr. Loube demonstrated that 8 of 10 Pennsylvania price cap carriers receive IAS support for a total of \$20.2 million, including \$8.6 million to Verizon Pennsylvania, the largest recipient. *Id.*; *see also*, OCA Exh. RL-10. Second, the Interstate Common Line Support ("ICLS") mechanism for rate of return carriers provides each carrier with the difference between the carrier's interstate common line revenue and interstate common line revenue requirement and guarantees a specified return on the common line portion of the carrier's interstate revenue requirement. *Id.* at 51-52. All 26 of Pennsylvania's interstate rate-of-return carriers receive ICLS support for a total annual amount of \$30.1 million. *Id.* at 52. On a per-line basis, the range of support varies from \$1.04 to \$37.38 per month. *Id.*; *see also*, OCA Exh. RL-11.

Dr. Loube noted that the total common line support the RLECs receive from the ICLS and the IAS in Pennsylvania is \$35.5 million. Id. Given the \$97.3 million initial size of the PA USF under the OCA's comprehensive proposal in this proceeding, and that, pursuant to FCC rules, common line investments and costs are separated between the intrastate and interstate jurisdictions on the basis of a 25/75 gross allocator, the expansion of the PA USF proposed by the OCA in this proceeding is reasonable. Id. at 52-53.³⁵ Dr. Loube stated: "in comparison to the interstate universal service fund support of common line costs, the [OCA's] proposed increase in the Pennsylvania fund is reasonable." Id. at 53.

As such, the Commission should reduce the RLECs' intrastate access rates, but only by adopting the OCA comprehensive proposal in its entirety. The OCA comprehensive proposal represents a reasonable revenue replacement for any RLEC intrastate access rate reductions the Commission may order as a result of this proceeding.

C. The Commission Must Consider Changes In The Telecommunications Industry And Telecommunications Law During The Past Decade When Determining Whether The RLECs' Intrastate Access Rates Should Be Reduced.

When determining whether the RLEC's intrastate access rates should be reduced to their interstate levels, the Commission should consider changes in the telecommunications industry and telecommunications laws that have occurred during the past decade. In particular, while the OCA comprehensive plan includes the elimination of the state CCLC, and requires intrastate traffic sensitive access rates to equal interstate traffic sensitive access rates, it should be recognized that Pennsylvania state law does not require such changes. The original Chapter 30,

³⁵ *Citing*, 47 C.F.R. § 36.154(c). The \$35.3M/\$97.3M ratio nearly equals the 25/75 gross allocator.

passed in 1993, contained a specific provision that reduced intrastate access charges.³⁶ Act 183 of 2004, however, enacted after the original Chapter 30 sunset, states:

(a) General Rule.—The commission may not require a local exchange telecommunications company to reduce access rates except on a revenue-neutral basis.³⁷

As such, current Pennsylvania law requires only that the Commission provide for revenue neutrality to offset any revenue reductions associated with prescribed access rate reductions. There is no requirement in current Pennsylvania law that RLEC intrastate access rates be set at a certain level.

Despite the lack of a legal mandate, the OCA agrees that it may be appropriate to consider reductions in intrastate access rates because there have been changes to the long distance market that could result in unfair advantages to certain carriers and provide opportunities for “regulatory arbitrage” under the current system. *See*, OCA St. 1 at 60. Regulatory arbitrage is the process that allows carriers to earn a profit or avoid a cost due to the fact that rates for similar services are different. *Id.* Carriers can “disguise” traffic as a particular type in order to pay a lower rate. *Id.*

Dr. Loube identified four significant changes in the long distance market that should be considered in determining the appropriate policy response to the issues raised in this proceeding.

Dr. Loube testified:

First, the major long distance carriers have exited from the mass market interexchange markets and have been purchased by leading local exchange carriers. Second, the local exchange carriers have obtained substantial positions in the long distance markets by selling bundles that combine local and long distance service. Third, wireless carriers appear to be capturing a larger share of the total long distance market. Fourth, the FCC has eliminated the

³⁶ 66 Pa. C.S. § 3007 (repealed).

³⁷ 66 Pa. C.S. § 3017(a).

carrier common line charge for rate-of-return carriers and has virtually eliminated the carrier common line charge for price-cap carriers.

Id. at 61.

Dr. Loubé more specifically discussed these changes. He testified that, as late as 2002, the former AT&T, before being acquired by SBC Communications, Inc., had 32.9% of the national long distance market and the former MCI, before being acquired by Verizon, had 21.1%. Id. at 62 (citations omitted). Beginning around 2000, the local exchange companies started expanding their share of the long distance market by offering bundles of local and long distance services. Id. at 63. The national residential long distance market share of Verizon, for example, increased from 4.6% in 2000 to 27.3% in 2007. Id. Dr. Loubé noted with regard to the impact of the wireless industry on long distance markets that wireless interexchange usage also has substantially increased. Id. at 64. He noted that this can be measured by the decrease in local exchange carrier access minutes and increase of wireless minutes of use. Id.

By eliminating the intrastate carrier common line charge, as the OCA's comprehensive plan does, these major changes in the long distance markets are addressed and the competitive playing field is leveled. OCA St. 1 at 64. Moreover, incentives to engage in arbitrage activities are reduced because, as Dr. Loubé testified, "it reduces the differences between rates paid for similar services." Id. at 65.

As Dr. Loubé testified, the OCA has agreed to support the reduction of the RLECs intrastate access rates to their interstate levels as part of the OCA's comprehensive plan because the FCC rules allow wireless carriers to pay extremely low reciprocal compensation rates for intra-MTA termination and, thus, provide unfair discrimination in favor of the wireless carriers.

OCA St. 1 at 48. But the OCA only agrees to such a reduction if the entire OCA comprehensive proposal is adopted.

As such, RLEC intrastate access rates should be reduced to their interstate levels but only if the Commission adopts the OCA comprehensive plan in its entirety. Arguments to the contrary should be rejected.

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

A. Rate Levels – The RLECs Intrastate Access Rates Should Be Reduced To Their Interstate Levels, But Only If The Commission Adopts The Entire OCA Comprehensive Plan.

1. If The Commission Decides To Reduce The RLECs' Intrastate Access Rates, The Appropriate Level Is The RLECs' Respective Interstate Access Rates.

The OCA comprehensive proposal provides that the RLECs' intrastate access rates should be reduced to their interstate access rate levels. Witnesses for other IXC's support the reduction of the RLEC's intrastate access rates equal only to their own interstate rates, and not lower. In addition to AT&T, who advocates such a position in both its original complaints and in its modified proposal presented in rebuttal, Sprint witness James A. Appleby also testified that the RLECs should "be required to set their intrastate switched access rates and structure for each individual access element equal to the equivalent interstate switched access rate and structure." Sprint St. 1.0 at 4.

Lowering the RLECs' intrastate access rates to their interstate levels will greatly reduce opportunities for regulatory arbitrage and maintain some financial support of the PSTN from the IXCs while supporting both competition and universal telecommunications service principles.

2. Reducing The RLECs' Intrastate Access Rates Below The Respective Interstate Levels Is Inappropriate, Burdensome And Should Be Rejected.

Some parties to this proceeding have argued that the RLEC intrastate access rates should be lowered to the Verizon intrastate access rates, or lower, levels. These arguments are without merit and should be rejected.

a. Verizon.

Through its witness Don Price, Verizon proposed that the RLECs adopt the Verizon intrastate rates as a benchmark and require RLECs above that benchmark to reduce their rates to that level. Verizon St. 1.0 at 17. The OCA submits that Verizon's arguments are without merit and should be rejected. OCA witness Dr. Loubé testified, "the Commission should not adopt the Verizon plan because the Verizon plan would establish unreasonably low intrastate access rates for the RLECs." OCA St. 1 at 33. Dr. Loubé added that such a proposal is unreasonable, in part, "because the accompanying revenue neutral rate increases would harm universal service." Id. Dr. Loubé further noted that Verizon argued against benchmarking RLEC basic local service rates to Verizon's basic local service rates in the portion of the investigation conducted by ALJ Colwell but now recommends benchmarking the RLECs' intrastate access rates to Verizon's intrastate access rates in this proceeding. Id. Dr. Loubé identified several reasons why the RLECs' intrastate access rates should not mirror Verizon's intrastate access rates.

First, the fact that intrastate access rates are higher in rural areas than in urban areas is reasonable given that telephone costs are usually influenced by economies of scope and scale and it is reasonable to expect that the cost to serve Philadelphia, for example, is lower than the cost to serve for any of the RLECs. Id. at 34. Second, Dr. Loubé noted that the additional RLEC revenue loss associated with reductions in RLEC intrastate access rates to Verizon's rates generates an additional \$13.1 million in revenue loss for the RLECs. Id. at 34-35; *see also*, OCA Exh. RL-7. The RLECs' revenue loss if Verizon's plan were adopted would create a total revenue loss of \$91.3 million when also eliminating the CCLC. Id. at 35. Third, the benchmarking examples in Virginia, Massachusetts and the FCC that Mr. Price cited to support his recommendation that RLEC access rates should be benchmarked to Verizon's intrastate access

rates are without merit and should be rejected. None of the examples Mr. Price cited require an ILEC operating in its service territory to match the access charges of another ILEC. Id. at 37.

In response to the concerns raised by the OCA, Mr. Price maintained his recommendation that the RLECs' intrastate access rates should be reduced to Verizon's intrastate access rates, noting that the average RLEC rate is approximately 5 cents per minute, and some as high as 10 cents per minute, while the Verizon access rate is 1.7 cents per minute. Verizon St. 1.1 at 3. Mr. Price's argument, however, ignores the fact that the RLEC traffic sensitive costs may be higher than Verizon's traffic sensitive costs. As Dr. Loubé testified:

The RLEC traffic sensitive costs are approximately equal to their interstate traffic sensitive rates. The Verizon traffic sensitive rate is less than the RLEC interstate traffic rate for 29 of 30 PTA RLECs. Thus, if the RLECs were to adopt the Verizon traffic sensitive rate, 29 of the 30 PTA RLECs would be required to sell traffic sensitive access services at below cost.

OCA St. 1-S at 3-4. Dr. Loubé also noted that Verizon's comparisons are skewed by the inclusion of the CCLC on a per minute basis and that "any comparisons between Verizon and RLEC rates should compare the traffic sensitive rates separate from the combination of traffic sensitive and common line rates." Id. Dr. Loubé continued to maintain that it would be reasonable to set the RLEC intrastate traffic sensitive access rates equal to their interstate traffic sensitive access rates.

b. Qwest.

Qwest witness Easton also recommended that the RLEC intrastate access rate should match the Verizon intrastate access rate. Qwest St. 1-R at 3. The basis of his argument is that the differential between the rates is an incentive for carriers to engage in traffic pumping. The OCA submits in response, however, that, as Dr. Loubé noted, if the Commission adopts the OCA's comprehensive plan, the RLECs' weighted average rate will be about 5 cents, with most

RLEC interstate access rates being between 1 and 3 cents. As such, the incentive to engage in traffic pumping will be vastly reduced. OCA St. 1-S at 16-17. Dr. Loubé added that adopting Qwest's proposal would cause unnecessary harm because it would reduce rates to below cost levels. Id. at 17. Dr. Loubé noted that doing so is inefficient and would require excessive increases in basic local service or excessive increases in PA USF support payments, or both. Id.

c. Comcast.

Comcast argued initially for a significant reduction in the RLECs' intrastate access rates. Comcast witness Dr. Pelcovitz advocated that it is proper to set access rates equal to "long run incremental cost, which is likely to be much lower than Total Element Long Range Incremental Cost (TELRIC), and be very close to zero." Comcast St. 1.0 at 10. In response to Dr. Pelcovitz's argument, Dr. Loubé testified that it is not appropriate to set access rates equal to the incremental cost of service because doing so is not practical given that the cost of the telephone network contains many joint and common costs. OCA St. 1 at 42. Dr. Loubé cited to leading economists who have demonstrated, among other things, that if a firm decided to price all goods at marginal cost, it would be committing "voluntary suicide." Id. at 42-43. Dr. Loubé further testified:

Dr. Pelcovitz makes an apples-to-oranges comparison throughout his testimony. He compares intrastate rates that provide for the recovery of common line and traffic sensitive costs to interstate rates that provide for recovery of only traffic sensitive costs. If he had compared intrastate traffic sensitive costs to interstate traffic sensitive costs, he would have found that, in many instances, the intrastate rates are below the interstate rates. For example, the composite average RLEC intrastate traffic sensitive rate is 0.2925 while the composite interstate rate is 0.3011.

Id. at 43; *see also*, OCA Exh. RL-8. Ultimately, however, Dr. Pelcovitz concluded that it is reasonable to adopt AT&T's proposal to reduce the RLECs intrastate access rates to their interstate rates as the OCA advocates. Comcast St. 1.0 at 11.

Therefore, the Commission should reject any argument that advocates for the RLEC intrastate access rates being equal to the Verizon intrastate access rates, or lower.

3. Conclusion.

The OCA submits that the RLECs intrastate access rates should be reduced to their interstate levels, but only if the Commission adopts the entire OCA comprehensive plan. Any reductions in the RLEC intrastate access rates below the level of their interstate access rates is inappropriate and burdensome and should be rejected.

B. Timing – Any Reductions In The RLECs' Intrastate Access Rates Must Be Done With Contemporaneous Increases In Universal Service Funding To Cover The Revenue Reductions.

The OCA generally takes no position regarding when the reduction of the RLEC intrastate access rates should take place, as long as there are contemporaneous increases in universal service funding to cover the revenue reductions. The OCA notes, however, that it is still unclear what the impact of any action on intercarrier compensation issues by the FCC may have on Pennsylvania's intrastate access rates. In its open intercarrier compensation proceeding, the FCC has indicated that it has jurisdiction over intrastate access rates and may make changes to those rates as part of its proceeding.³⁸ As Dr. Loubé testified, the Pennsylvania Commission should strive to avoid a situation where Pennsylvania consumers are paying twice for the same

³⁸ *See, FCC ICC NPRM, supra*, at ¶¶ 78-82. *See also, Investigation Regarding Intrastate Access Charges and IntraLATA Toll Rates of Rural Carriers, and the Pennsylvania Universal Service Fund*, Docket No. 1-00040105, Motion of Vice Chairman James H. Cawley (Aug. 11, 2005) at 2-3 (“the OCA brief persuasively argues that, under certain outcomes in the same FCC proceeding, the rural ILECs’ ratepayers may bear the same burden twice from the same reduction in intrastate access charges if such reductions are not simultaneously coordinated between this Commission and the FCC”).

access reductions since the FCC has indicated that it may change intrastate access rates as part of its proceeding. OCA St. 1 at 59.

The OCA recognizes that the FCC proceeding has been pending for many years and that the current inequities in the intercarrier compensation system in Pennsylvania can be resolved by adopting the entire OCA comprehensive proposal now. Nonetheless, the OCA wishes to address two specific issues raised by other parties regarding the timing of the OCA comprehensive proposal.

First, AT&T's panel witnesses suggested that the OCA comprehensive proposal seeks an immediate reduction in the RLEC intrastate access rates. AT&T St. 1.2 at 4. The AT&T witness testimony failed to recognize, however, that the OCA proposal is a comprehensive plan and that the intrastate access rate reduction was "contingent on the Commission adopting the other parts of the OCA plan that include the expansion of the PA USF contribution and an increase of support from the PA USF for the RLECs." OCA St. 1 at 4-5. The Commission may need to conduct an additional proceeding to accomplish that. If the Commission does not adopt all aspects of the OCA's comprehensive proposal, then the Commission should *not* reduce the RLECs' intrastate access rates. OCA St. 1-S at 25. Doing so would substantially harm universal service either through significant increases in basic local service rates or through the financial weakening of the RLECs. As such, the OCA does not seek an "immediate" reduction in RLEC intrastate access rates; rather such reduction should only occur when the Commission is in a position to implement all the components of the OCA comprehensive proposal.

Second, the Commission should also not adopt the AT&T panel witnesses' recommendation that the increase in the PA USF support should only be for a short transitional period. AT&T St. 1.2 at 4. As Dr. Loube testified, if the Commission orders a long term

reduction in access rates, it must be accompanied by additional PA USF support on a long-term basis as well. OCA St. 1-S at 25. Dr. Loube added that “if the Commission reduces access rates, it must be prepared to expand PA USF support” so that local rates are not the only source of revenue replacement. Id. at 25-26. Any reduction in the RLEC’s intrastate access rates must be for the same period of time in which the RLECs receive the additional support from the PA USF, as discussed in the OCA’s comprehensive proposal.

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

A. Meaning of Revenue Neutrality Requirement Under Section 3017.

1. Introduction.

Pursuant to the OCA comprehensive plan, the OCA submits that the revenue neutrality requirement under Section 3017(a) of the Public Utility Code should be satisfied first by raising the RLECs' basis local service rates to 120% of the Verizon weighted average rate, and then allowing the RLECs to recover from the PA USF any further revenues needed to offset reductions of the intrastate access rates to their interstate levels. Several parties have raised various arguments in this proceeding providing alternative issues that affect the meaning of the revenue neutrality requirement in Section 3017(a). Such issues pertain to inappropriately imposing rate base/rate of return principles to maintain revenue neutrality, limiting the time frame during which revenue neutrality applies and considering affiliated revenues to maintain revenue neutrality. As discussed further below, such arguments are without merit and should be rejected. The Commission, instead, should adopt the OCA's comprehensive proposal in its entirety.

2. The Commission Should Reject Any Attempts To Impose Rate Base/Rate Of Return Principles When Maintaining Revenue Neutrality Under Section 3017(a).

In its testimony, Sprint argued that the RLEC's have attempted to turn this proceeding into a rate case but failed to produce financial information to prove their case. Sprint St. 1.2 at 12. Dr. Loube noted that it is Sprint, not the RLECs, that have attempted to turn this case into a rate-of-return regulation rate case. OCA St. 1-S at 20. Dr. Loube noted that Sprint witness Appleby attempts to determine state jurisdictional revenue requirement by applying Part 64 rules

to separate the RLECs non-regulatory costs from its regulatory costs. Id. Dr. Loube added that Mr. Appleby would consider all vertical service, and other revenue and make PA USF support contingent upon a showing that the TELRIC cost of service is above an inflation adjusted benchmark. Id. Each of these adjustments may be relevant in a rate-of-return proceeding but are not relevant under Chapter 30. Id.

Sprint's argument that the RLECs have attempted to turn this proceeding into a rate case but failed to produce financial information to prove their case is without merit and should be rejected. Rate base/rate of return issues are not relevant to Section 3017(a) of the Public Utility Code.

3. The Commission Should Reject Any Argument That Limits The Duration Of The Revenue Neutrality Requirement Under Section 3017(a).

In its testimony, Verizon has argued that the revenue neutrality requirement of Section 3017(a) should only be applied for a limited time. More specifically, Verizon witness Price argued that the OCA's comprehensive proposal should be rejected because it will create a permanent, guaranteed revenue offset for the RLECs. Verizon St. 1.1 at 2, 44. Verizon's argument will upset the revenue neutrality requirement in Section 3017 and should be rejected.

OCA witness Dr. Loube demonstrated that Verizon's argument is not correct. Under the OCA proposal, support from the PA USF will decrease whenever the benchmark, as determined by Verizon's average rate, increases. OCA St. 1-S at 14-15. Dr. Loube explained:

For example, if the carrier serves 10,000 lines and the benchmark increases to \$17.50, then the PA USF support would decrease by \$49,200 (41 cents times 10,000 lines times 12 months) in the second year, and with every further increase in the benchmark, the fund size would also decrease. Based on the 2,044,768 lines served by RLECs in 2008, the decrease for the entire fund would be approximately \$10 million in the second year (41 cents times 2,044,768 times 12 months).

Id. at 15. As such, assuming a modest increase in the Verizon local exchange rate, under the OCA comprehensive proposal, the PA USF would decrease by approximately \$10 million in the second year alone, while still maintaining the revenue neutrality requirement under Section 3017. Given that Verizon has utilized all or virtually all of its allowed revenue increases pursuant to its Chapter 30 plan each year since its inflation offset was reduced in 2004, Tr. 186-187, it is highly likely that the PA USF would continue to decrease under the OCA comprehensive proposal. The PA USF will not be the guaranteed source of revenue Verizon avers.

4. The Commission Should Reject Any Argument That Revenues From RLEC Affiliates Should Be Considered When Maintaining The Revenue Neutrality Requirement Under Section 3017(a).

Several parties have suggested that the revenue neutrality requirement under Section 3017(a) should be maintained by using revenue from the RLEC affiliates. Such arguments are without merit, risk jeopardizing universal service principles and should be rejected.

Sprint witness Appleby, for example, argued that the RLECs obtain enough revenue from their non-regulated services to offset the revenue loss associated with the access rate reductions. Sprint St. 1.2 at 46. Similarly, Dr. Pelcovitz opined that, in order to maintain revenue neutrality, the RLEC retail rates should be allowed to increase to recover any revenue loss associated with the access rate decrease and that some of that funding can come from non-regulated services. Comcast St. 1.0 at 14. In response, however, Dr. Loubé cautioned against adopting any recommendation that non-regulated revenues be used to offset the reduction in access charges. Tr. 485-486. Dr. Loubé cautioned against relying on the profits of the affiliates to support an underlying network because “if you rely on the profits of the affiliates, then you might also have to cover their losses when there are losses.” Tr. 485. Dr. Loubé’s position is consistent with

recent actions of other state commissions that have rejected contentions that the economic burden of competitive entry should be assessed on an entire group of affiliated companies.³⁹

The AT&T panel witnesses also argued that the parent affiliates of some of the RLECs should be considered as part of this proceeding. AT&T argued, for example, that some of the RLECs are “large, national sophisticated Fortune 1000 telecommunications providers” as reasons why its position should be adopted in this proceeding. Considering such affiliated relationships, however, may also upset the revenue neutrality requirement contained in Section 3017. Dr. Loube noted why AT&T’s argument should be rejected, including the fact that even the largest RLECs are small in comparison to AT&T. Dr. Loube testified:

For example, in 2008, AT&T’s combined revenue was \$124 billion. It served 55.6 million access lines and was the nation’s largest wireless carrier. The mid-sized carriers in comparison are almost entirely wire line carriers. Windstream served approximately 3 million lines, Frontier 2.2 million lines and the combination of CenturyTel and Embarq served 7.6 million lines nationwide. Windstream’s operating revenue was \$3.1 billion. Frontier’s operating revenue was \$2.2 billion. Thus, compared to AT&T, these carriers are small.

OCA St. 1 at 30. Dr. Loube also noted the rural nature of these carriers in comparison to the nature of AT&T’s territory. Dr. Loube testified that, nationwide, CenturyTel operates four non-rural study areas, Frontier one non-rural study area and Windstream two non-rural study areas, whereas AT&T serves 22 non-rural study areas. *Id.* at 30-31.

Dr. Loube concluded his comparison by quoting AT&T’s own recent comments to the FCC regarding the difficulties of serving rural areas:

The exclusive franchise portion of that regulatory compact has long since vanished, but ILECs in many cases remain obliged to

³⁹ See, Re Sprint Communications Company, L.P., Case No. P-294, sub. 30, North Carolina Public Utilities Commission at 15 (Order entered Aug. 29, 2008) and Midcontinent Communications/Missouri Valley Communications, Inc. Rural Exemption Investigation, Case No. PU-08-61, Findings of Fact, Conclusions of Law and Order, North Dakota Public Service Commission, Oct. 8, 2008, at ¶ 31.

provide basic voice service throughout their service areas including in rural and high-cost areas, often at rates significantly below costs. Because these state requirements are not generally imposed on cable companies or competitive providers of voice and data service, they permit competitive providers to focus on the customers who are easiest to serve, while leaving the ILECs bound by COLR rules to serve the highest-cost and most difficult-to-serve customers. Under these circumstances, ILECs may have little incentive to upgrade their networks or invest in broadband in high-cost areas.

Id. at 31.⁴⁰ Thus, even AT&T recognizes that the RLECs operate under a disadvantage compared to their competitors and that building a broadband infrastructure is expensive. Id. at 32. These factors must be considered when determining the meaning of the Section 3017 revenue neutrality requirement.

The Commission should reject any argument that distorts the revenue neutrality protections in Section 3017. Any attempts to impose rate base/rate of return principles, limit the time frame under which revenue neutrality applies, or assert that the revenue neutrality principle includes a consideration of affiliated revenues, must be rejected.

B. Rate Increases – If The Commission Reduces The RLEC Intrastate Access Rate To Their Interstate Access Rates, Revenue Required To Maintain Neutrality, As Required By Section 3017, Should First Come By Raising The Basic Local Service Rates To 120% Of The Verizon Weighted Average Rate As Set Forth In The OCA’s Comprehensive Proposal.

1. It Is Reasonable To Recover From Basic Local Exchange Customers Some Of The Revenue Needed To Offset Any Reductions In The RLECs Intrastate Access Rates.

As discussed above, under Step 2 of the OCA comprehensive proposal, the RLEC residential basic exchange rate is benchmarked to 120 percent of the Verizon Pennsylvania weighted average residential rate. OCA St. 1 at 13. Currently, the Verizon weighted average

⁴⁰ *Quoting, In the Matter of a National Broadband Plan for Our Future*, GN Docket No. 09-51, Comments of AT&T, Inc. on the transition from the legacy circuit-switched network to broadband. December 21, 2009 (Attached to OCA St. 1 as Appendix A).

rate is \$14.25. Id. at 14; *see also*, OCA Exh. RL-2. Therefore, if the Commission decides to reduce the RLEC intrastate access rates to their interstate levels, any recovery to maintain revenue neutrality should first come from raising the RLEC basic local exchange rates to a just and reasonable comparability and affordability benchmark, using the 120% target of \$17.09. Id.⁴¹ Other parties have also proposed benchmarks for basic local service rates, although the specific benchmark rate level varies. Under Qwest's proposal, for example, a benchmark rate of 125% of RLEC statewide average rates would be established. Qwest St. 1 at 9.⁴²

Under the OCA's plan, current RLEC rates that are below 120% of the Verizon weighted average rate would be raised to that rate. OCA St. 1 at 13. This benchmark retains the policy of fairness and comparability that the OCA recommended in the portion of the investigation conducted by ALJ Colwell that is pending before the Commission. Id. If the Commission adopts the OCA plan, the immediate impact would be to require RLECs' residential basic local exchange rates to be no lower than 120% of the Verizon rate. Id. at 14-15. Rates would be allowed to increase with increases in the Verizon rate, subject to the affordability constraint. Id. at 15.

While twenty-two RLECs would be required to increase their basic local exchange rate to match the benchmark in order to receive PA USF funding under the OCA plan, those increases range from 10 cents to \$3.60, with the exception of Citizens of Kecksburg which would receive an increase of \$6.09. Id.; *see also*, OCA Exh. RL-3.⁴³ The OCA's proposed benchmark would

⁴¹ As previously discussed, the benchmark rate is also be subject to an affordability constraint. *See*, fn. 31, *supra*.

⁴² The Qwest benchmark should be rejected because it is a moving target tied to a state-wide average and is not tied specifically to the Verizon weighted average rate. As Dr. Loube explained, "every time a current rate is equated to the state-wide average rate that average changes and therefore the standard would then cause the other carriers to change their rates." OCA St. 1 at 46. Such a moving target is unworkable.

⁴³ As indicated previously, given the size of the increase to customers of Citizens of Kecksburg, the OCA submits that a phase-in of the increase would be appropriate. OCA St. 1 at n.6.

increase every year in which Verizon changes its basic service rates. Therefore, if the Verizon weighted average basic local exchange rate increases to \$17.50 next year, the RLEC support would be determined using the \$17.50 benchmark. Id. As a result, the amount of support required from the PA USF would also decrease each year. OCA St. 1-S at 15. In addition, the OCA plan calculates support as if the RLEC business rates are increased by the same amount as the residential rate. OCA St. 1 at 15. Under the OCA's comprehensive plan, the rate changes are reasonable in light of the goal of maintaining and enhancing universal service. Dr. Loube stated: "The OCA plan does not allow any rate to be lower than \$17.09. It would require 20 companies to increase rates to that level. The weighted average residential rate increase is \$1.13 per month, which is a 7.7% rate increase." Id. at 55; *see also*, OCA Table 1.⁴⁴

Finally, Dr. Loube testified regarding the impact of any rate increase on those customers who receive the Lifeline discount. Tier 1 of the federal Lifeline program compensates carriers for the federal Subscriber Line Charge ("SLC") (\$6.50) while Tier 2 provides a carrier with \$1.75 for each Lifeline customer if the carrier reduces the customer's bill by \$1.75. Id. at 56. Because these are fixed dollar discounts, any increase to basic local exchange service would increase the overall rate paid by Lifeline customers as well. The rate paid by Lifeline customers would increase by the same amount as the basic local service rate increase. Id. at 57.

The OCA submits that it is reasonable to recover from basic local exchange customers some – but not all – of the revenue needed to offset any reductions in the RLECs intrastate access rates.

⁴⁴ Under AT&T's original proposal in this case, the weighted average rate increase would be \$6.87, which is a 42.9% rate increase. OCA St. 1 at 65 and OCA Exh. RL-12.

2. The Verizon Basic Local Exchange Rate Is A Reasonable Benchmark For The RLEC Basic Local Exchange Service Rates.

In response to the OCA comprehensive proposal, Verizon witness Price argued that the OCA's comprehensive proposal should be rejected because the Verizon basic local exchange rate is not a reasonable benchmark since it has been artificially constrained by regulation. Verizon St. 1.1 at 34-35. Mr. Price bases this assertion on the fact that for some years Verizon was not allowed to increase its basic local exchange service rates and in other years Verizon actually had to lower those rates, and only since 2004 has Verizon been able to increase those rates with inflation. Id. at 35. Mr. Price's arguments are without merit and should be rejected.

Dr. Loube demonstrated that "if anything Verizon [basic local exchange service] rates are too high and its urban rates are especially too high." OCA St. 1-S at 9. First, Dr. Loube demonstrated that, under price cap regulation, if the carrier's change in cost is below the long term trend, then the carrier is rewarded with additional profits equal to the difference in the change in price and its change in cost. Id. Nothing in price cap regulation requires that the allowed rate increase be equal to the general level of inflation. Id. at 10. Furthermore, Dr. Loube recognized that the "inflation offset" created as part of Verizon's original price cap regulation plan, 2.93%, was not unreasonably high. Id. at 11. The FCC first adopted an offset of 3% for interstate rates, which was then increased to 4% and then later increased again to 6.5%. Id. Certainly, under Verizon's current price cap regulation plan, the 0.5% inflation offset cannot be considered unreasonably high.⁴⁵

Second, Dr. Loube also demonstrated that Verizon's residential rates, in fact, may be *too high* because neither Verizon nor the Commission has addressed the issue of separating the cost of non-regulated services such as video services from the cost of telephone services. OCA St. 1-

⁴⁵ 66 Pa. C.S. § 3015(a)(1)(ii).

S at 11. Under recent FCC Orders, Verizon is no longer required to separate its telephone company investments and expenses between regulated and non-regulated services at the very time when Verizon is investing heavily in providing additional non-regulated services, such as video services, using its FiOS network. Id. at 12. Dr. Loubé testified that, as a result, it is impossible to claim that the inflation offset that is embodied in the Chapter 30 law is too high or too low because no one has conducted a productivity study of the combined network that provides voice, data and video services. Id.

Dr. Loubé also testified that Verizon's rates are not unduly constrained but rather, "on the contrary, regulation has consistently established high urban residential rates." Id. Dr. Loubé testified that the Verizon urban residential rates are high because those rates are established using value of service pricing which occurs when customers are charged on the basis of the size of their local calling areas. Id. at 12-13. Thus, under this principle, Verizon charges higher rates to its urban density cell 1 and 2 customers than it does to its rural density cell 3 and 4 customers because customers in density cell 1 and 2 can call more people in their local calling area than density cell 3 and 4 customers can call in their local calling area. Id. at 13. Dr. Loubé also demonstrated that Verizon's urban rates are high because they are higher than the unbundled network element ("UNE") prices in urban zones for those services. Id. at 13-14; *see also*, Table 1-S. Verizon's UNE rates include the cost of the network required to provide all services and, as such, UNE rates approach the stand alone cost of service. Id. at 13. It is reasonable, therefore, for Dr. Loubé to use all of Verizon's state-wide rates, and not just Verizon's urban rates, in setting the benchmark in the OCA's comprehensive proposal in this proceeding. Id. at 14.

The OCA submits that it is reasonable to recover some – but not all – of the revenue needed to offset any reductions in the RLECs’ intrastate access rates from basic local exchange customers.

3. The Commission Should Reject AT&T’s Overall Proposals In This Proceeding To The Extent They Impose An Unreasonable Burden On RLEC Basic Local Exchange Customers.

In response to the OCA comprehensive proposal, various parties to this proceeding have supported various parts of the proposal and rejected other parts. Some IXCs, for example, clearly support the portion of the OCA comprehensive proposal that reduces the RLECs’ intrastate access rates to their interstate level.

In fact, after reviewing the OCA comprehensive proposal, AT&T recognized the reasonable and moderate approach the OCA presented. AT&T St. 1.2 at 1-4. As such, in its Rebuttal Testimony, AT&T presented a proposal modified from what it originally provided in its Direct Testimony. AT&T’s modified proposal moves towards a more reasonable position regarding the issues in this proceeding, including recognizing the need to establish a benchmark for the residential basic local exchange rate and to expand PA USF support. Nonetheless, AT&T’s modified proposal presents arguments that contradict the OCA comprehensive proposal and should be rejected.

In both its original and modified proposals, AT&T proposed that all or a large portion of the revenue needed to maintain neutrality under Section 3017 should be recovered from the RLECs’ basic local exchange customers. AT&T initially proposed that the RLECs be allowed to increase their basic local exchange service rates by \$5.31 per month in order to maintain revenue neutrality under Section 3017. AT&T St. 1.0 at 6. The AT&T panel witnesses claimed that such an increase is affordable because it would increase local rates by approximately the rate of

inflation and because the final rate would be below the affordability standard supported by the OCA in the portion of the investigation conducted by ALJ Colwell. In response, Dr. Loube demonstrated why such claims were incorrect and should be rejected.

Dr. Loube demonstrated, for example, that the AT&T panel witnesses are incorrect regarding the OCA's affordability standard because that standard is based on a \$32 per month *total* local phone bill and the AT&T witnesses compared the OCA's total bill affordability standard to only the basic local exchange rate. OCA St. 1 at 19. Dr. Loube testified:

However, a rate is not the same as the bill. The bill includes the basic local exchange rate plus the subscriber line charge plus the E-911 charge plus the Federal Universal Service Fund charge plus the PA relay charge plus Touch-tone charges plus other charges. OCA witness Roger D. Colton clearly specifies the relationship between the bill and the rate in his Schedule RDC-4 submitted in the proceeding before ALJ Colwell.

Id. at 19-20; *see also*, OCA Exh. RL-6. As a result, AT&T is not comparing apples to apples when arguing that the basic local service rate can increase to \$32 and still be affordable under the OCA's analysis. There are more charges than the basic local service rate that a customer is required to pay in order to receive basic local telephone service.

Dr. Loube further demonstrated that it is not correct to assert that AT&T's initially proposed residential rate increase of \$5.31 is reasonable because the rate increase matches the general rate of inflation. First, the AT&T witnesses did not compare the percentage of change in rates required to offset the access reduction to the percentage change in the residential rate if the residential rate tracked inflation. Id. at 20. Second, the panel witnesses began their analysis with the average rate for RLECs that exists today instead of starting with the average RLEC rate that existed in 2003, the last time the Commission increased the residential rate cap. Id. at 20-21. The AT&T witnesses argued that if the existing \$18.00 residential cap had tracked the rate of

inflation from 2003 to 2009, then the rate cap would be \$21.97. AT&T St. 1.2 at 5. That would be a 22% increase $((\$21.97 - \$18.00) / \$18.00)$. As noted by Dr. Loube, however, current average RLEC residential rate is \$16.16. OCA St. 1-S at 28. Increasing that rate by \$5.31, as AT&T recommends, would equal an increase of 33% $(\$5.31 / \$16.16)$. As a result, AT&T's position, in fact, advocates for increases that are 1.5 times greater than the rate of inflation $(33\% / 22\%)$. OCA St. 1 at 21.

Tracking inflation is not the definitive criteria for rate determinations because it is only one part of a combination of factors that must be used to determine whether a rate is affordable, and affordability is only part of the criteria that should be used to determine whether a rate is just and reasonable. Id. at 22. In making this determination, Dr. Loube relied on the OCA affordability analysis presented by Roger Colton in the portion of the investigation conducted by ALJ Colwell. Dr. Loube noted that affordability depends on the relationship between the overall bill and median family income, i.e., the ability to pay. Id. Dr. Loube testified, "if the median family income is not increasing as fast as inflation, then a rate that is increasing as fast as inflation could become unaffordable in a very short period of time." Id. Moreover, Dr. Loube noted that applying the 2.5 percent average annual inflation rate for the period 2003 to 2009 to the RLEC current average rate of approximately \$16.16 provides a benchmark of \$19.45, not \$22.00 as AT&T proposes. Id. at 28.

Dr. Loube also pointed out that AT&T has consistently argued for an increase in the federal Subscriber Line Charge ("SLC") from \$6.50 to \$10.00 in the FCC's intercarrier compensation proceeding while also arguing that the local residential rate should be increased in order to offset its proposed access rate reductions in this proceeding. Id. at 23. If both the Commission and the FCC were to agree with AT&T and increase the basic local telephone bill

by \$5.31 and the SLC by \$3.50, respectively, the combination could make local telephone service for many rural customers unaffordable.

In its Rebuttal Testimony, AT&T slightly modified its benchmark proposal. The AT&T panel witnesses testified that the benchmark rate should be set at \$22 and then increased by \$1 each year for three consecutive years. AT&T St. 1.2 at 2. Despite this change, differences between the AT&T modified proposal and the OCA comprehensive plan remain. Dr. Loube demonstrated why such a high benchmark is not appropriate and should be rejected. Dr. Loube testified that AT&T's benchmark is still inappropriate, in part, because it starts from the wrong point, the current \$18 rate cap, and not the Verizon weighted average rate. Dr. Loube testified:

The rate cap and the benchmark measure two different concepts. The rate cap is the maximum rate that any RLEC could charge. Its purpose is to prevent rate increases above a reasonable level. Under the OCA's proposal, the benchmark is the floor rate that a RLEC must adopt in order to receive PA USF support. If an RLEC does not increase its rates to the benchmark then the RLEC forfeits the revenue equal to the difference between its rates and the benchmark times its lines. Thus, the benchmark drives rate increases and differs from the rate cap that prevents rate increases.

OCA St. 1-S at 26-27. AT&T's support of the modified benchmark still suffers the same flaw by depending on the rate of inflation as support.

Moreover, after raising the benchmark to \$22, the AT&T panel witnesses proposed to increase the benchmark by \$1 per year. This proposal should also be rejected. The \$1 increase on a \$22 rate, for example, represents a 4.5% increase ($\$1.00/\22.00), which is substantially higher than the average rate of inflation of 2.5%. *Id.* at 28. AT&T's panel witnesses' assertion that "allowing the benchmark to increase by \$1 each year generally will allow rates to return to 'real' rates" simply means that retail customers would be required to bear the full burden of

paying for the entire cost of supporting the joint and common costs of the network. Id. at 29; *quoting*, AT&T St. 1.2 at 14.

Both AT&T's original and modified proposals in this proceeding should be rejected. Both AT&T proposals place too much burden on the RLECs' basic local service customers to support the joint and common costs of the PSTN.

4. The Commission Should Reject Any Arguments That Require All Of The Revenue Offset To Be Recovered Solely From Basic Local Exchange Customers.

Verizon witness Price testified that all of the access revenue reductions required to maintain revenue neutrality under Section 3017 should be collected from retail end-user customers. Verizon St. 1.1 at 4, 42. Verizon's position contains a fundamental flaw. Dr. Loube explained:

My concern is that Mr. Price's insistence on recovering access revenue reductions from retail end-user customers is based on the false premise that carriers should obtain all of their revenue from their retail customers. Wholesale customers are also customers of the company. When Verizon provides long distance services to customers of the RLECs, every call that is transported over Verizon's long distance network terminates or originates on RLEC loop facilities. Thus, wholesale customers, such as Verizon's long distance network, consume the services provided by the facilities and equipment of every carrier, and wholesale customers should not be provided with a free-ride on those facilities and equipment.

OCA St. 1-S at 5.

Mr. Price also argued that basic local service rates should be raised because the difference between the intrastate and interstate access rates "distorts economic incentives and leads to economic inefficiencies." Verizon St. 1.2 at 15-16. Dr. Loube demonstrated that the only reason for reducing the intrastate access rate to eliminate those distortions is because "the Commission is pre-empted by the Federal Communications Commission from establishing the

best solution of one rate for all intercarrier compensation, with that rate being the ratio of all intercarrier compensation revenue divided by all intercarrier compensation minutes.” OCA St. 1-S at 5-6.

Sprint witness Mr. Appleby also argued that “the entire cost of the local loop is created and should be paid by an RLEC’s local customer.” Sprint St. 1.2 at 6. In response to Mr. Appleby’s argument, Dr. Loube testified:

The local loop provides multiple services such as access to long-distance carriers, Internet data services and in some instances video services. Thus, the entire loop expense is not incurred solely to provide local service. It has been incurred to provide the multitude of services that it provides and cost recovery is the responsibility of all of those services.

OCA St. 1-S at 21. This principle has been recognized as far back as the United States Supreme Court decision Smith v. Illinois Bell Telephone Co.,⁴⁶ and affirmed by the FCC and this Commission numerous times.⁴⁷ In fact, Mr. Appleby’s own testimony in this proceeding affirms this principle as well. Mr. Appleby stated: “the singularly narrow-band, voice-only network that was tasked with the delivery of only voice service is being modified into a broadband network capable of delivering voice, broadband, and so many more services to the citizens of Pennsylvania.” Sprint St. 1.2 at 40. Sprint’s argument that the loop is provisioned for and should be recovered only from local service is wrong and antiquated.

Mr. Appleby also provided several examples in response to the assertion that the IXCs are attempting to receive a “free ride” on the RLEC facilities by reducing or eliminating intrastate access charges. Id. at 5-11. Dr. Loube demonstrated why these examples are not correct. In particular, Dr. Loube testified:

⁴⁶ Smith v. Illinois Bell Telephone Co., 282 U.S. 133 (1930).

⁴⁷ See e.g., Verizon Pennsylvania, Inc. et al. v. CTSI, LLC, et al., Motion of Vice Chairman James H. Cawley, Docket Nos. C-20077332 and C-20066987, August 7, 2008 at 3.

As Mr. Appleby acknowledges, both the calling party and called party benefit from the existence of the public switched network. That is, the value of a telephone network for any consumer increases as more consumers are added to the network. This situation is known as a positive externality. The existence of a positive externality is the foundation of the economic argument for universal service funds. Therefore, Mr. Appleby's examples support the expansion of the PA USF and the expansion of the contribution base to all users of the public switched telecommunications network.

OCA St. 1-S at 22-23. Universal service benefits everyone because the more people that can access the PSTN, the more benefit the PSTN is to all users. Furthermore, while Dr. Loubé agrees that the local loop facilities have traditionally been considered non-traffic sensitive, in areas served by Remote Terminals, such as rural areas, the entire loop is no longer non-traffic sensitive because the remote terminal concentrates traffic and, therefore, a portion of the loop becomes traffic sensitive. Id. at 23.

The Commission should reject any argument that places the entire burden to support the joint and common costs of the PSTN on basic local exchange customers only.

5. Conclusion.

The OCA submits that, if the Commission decides to reduce the RLEC intrastate access rates to their interstate access rate levels, the revenue required to maintain neutrality should first come by raising the basic local service rates to 120% of the Verizon weighted average rate in conjunction with the OCA's comprehensive proposal. Any further revenue required to maintain neutrality should come from the PA USF. The Commission should reject any argument that supports placing an unfair burden to pay for the entire PSTN on basic local exchange customers.

C. **Pennsylvania USF – If The Commission Decides To Reduce The RLECs’ Intrastate Access Rates To Their Interstate Levels, Revenue Required To Maintain Neutrality Should First Be Recovered By Raising The Basic Local Service Rates To 120% Of The Verizon Weighted Average, With Any Remaining Additional Revenue Needed To Maintain Revenue Neutrality Obtained From The Pennsylvania Universal Service Fund, In Conjunction With The OCA’s Comprehensive Proposal.**

If the Commission decides to reduce the RLECs’ intrastate access rates to their interstate levels, pursuant to Step 3 of the OCA plan, any additional revenue required to offset the revenue decrease associated with access rate reductions that is not made up by increasing the RLECs’ basic local exchange service rate to 120% of the Verizon weighted average rate should be recovered from the PA USF. Other parties have made similar recommendations. For example, even though Qwest recommends in this proceeding that RLEC access rates mirror the Verizon Pennsylvania rates, Qwest, similar to the OCA, recommends that the RLECs be allowed to obtain revenue neutral revenue increases by increasing basic local service rates up to a benchmark rate and recover the remainder from the PA USF. Qwest St. 1 at 8.

As discussed above, to reduce the RLEC intrastate access rates to their interstate levels, including eliminating the state CCLC, the total size of the PA USF to maintain revenue neutrality pursuant to Section 3017 increases to \$97.3 million, up from the current size of approximately \$33 million. OCA St. 1 at 17. Raising RLEC basic local exchange rates to 120% of the Verizon weighted average rate will not recover all of this revenue, although it will recover increasingly more revenue as Verizon’s weighted average rate increases. OCA St. 1-S at 15. Therefore, the reliance on the PA USF under the OCA comprehensive proposal will decrease over time.⁴⁸

⁴⁸ As the OCA explained above, as Verizon’s average weighted residential rate increases, the OCA benchmark proposal increases. Therefore, for example, if a carrier serves 10,000 lines and the benchmark increases to \$17.50, then the PA USF support would decrease by \$49,200 (41 cents times 10,000 lines times 12 months) in the second year, and with every further increase in the benchmark, the fund size would also decrease. Based on the 2,044,768 lines served by RLECs in 2008, the decrease for the entire fund would be approximately \$10 million in the second year (41 cents times 2,044,768 times 12 months).

Nevertheless, under Step 4 of the OCA plan, in order to minimize the impact of the OCA recommendation on the size of the PA USF contribution factor, the OCA is also recommending that the Commission enlarge the PA USF revenue base to include any service provider that uses the PSTN in providing their service. OCA St. 1 at 17. As Dr. Loubé testified:

the OCA realizes that a finding regarding the recommendation to enlarge the PA USF contribution base may not be within the purview of the assigned issues in this portion of the proceeding. However, the OCA's recommended comprehensive plan is contingent on the Commission addressing this issue in another proceeding of its choice and finding in that proceeding that it is necessary to increase the size of the contribution base.

Id. at 16-17.

Dr. Loubé estimated that the PA USF revenue base would increase by \$4.4 billion, for example, by including intrastate wireless revenue. Id. at 17 (citations omitted). Dr. Loubé then calculated that increasing the fund payout from the current \$33 million to approximately \$97.3 million pursuant to the OCA proposal in this proceeding, while increasing the fund revenue base from the current \$2.9 billion to approximately \$7.3 billion by including wireless revenue, would increase the contribution factor by only 0.00166%. Id. This example does not address the impact of adding other services that use the PSTN, such as Voice over Internet Protocol ("VoIP") providers, to the contribution base. Doing so would further reduce the impact of the OCA proposal on any one service provider. Id. at 17-18. Dr. Loubé concluded by noting that 14 of 21 states that currently have state universal service funds require wireless carriers to contribute to those funds. Id. at 18; *see*, fn. 34, *supra*.

Qwest witness Easton expressed concern with regard to whether the OCA comprehensive plan would interfere with the federal universal service fund. Qwest St. 1-R at 6-7. As Dr. Loubé testified, however, the OCA comprehensive plan will not interfere with or burden the federal

universal service fund because the OCA comprehensive plan will retain the current practice that the contribution factor will be assessed against intrastate retail telecommunications revenue. OCA St. 1-S at 19.

Dr. Loube testified that it is appropriate to continue to support the access reforms already implemented. As Dr. Loube stated, “all users of that network have a responsibility to support the network. ... Nothing has happened that has changed the need for all users to support the network and, therefore, it is entirely appropriate to continue the current support program.” OCA St. 1 at 58. Similarly, Dr. Loube noted that it is not appropriate to implement an additional toll line charge for local exchange customers because such a charge is the same as an increase in the basic local rate, since all customers are required to pay the charge in order to obtain basic local telephone service. Id. Likewise, the Commission should not eliminate the current PA USF credits and allow carriers to increase basic local exchange service rates. As Dr. Loube testified, doing so would create a return to the world prior to the Global Order, *supra*, and is not appropriate. Id. at 59. If the Commission decides to reduce intrastate access charges again, it is appropriate to implement additional contributions to the PA USF to offset access rate reductions in a revenue neutral fashion so long as the basic local exchange rate for the RLECs is 120% of the Verizon PA weighted average residential basic local exchange service rate. Id. at 53.

As such, if the Commission decides to reduce the RLEC intrastate access rate to their interstate access rates, revenue required to maintain neutrality should first come by raising the basic local service rates to 120% of the Verizon weighted average rate, subject to an affordability constraint, in conjunction with the OCA’s comprehensive proposal. Any additional revenue required beyond that point should come from the PA USF, which should be expanded to include in the base of contributors any service provider that uses the PSTN to provide service.

VII. GENERAL LEGAL ISSUES

A. Retroactivity Of Any Access Rate Reductions.

In its Formal Complaints filed on March 19, 2009, AT&T raised several legal provisions that it averred were violated as a result of the RLECs' current intrastate access rates. Because AT&T sought a reduction in those rates, AT&T also averred that Section 1309(b) of the Public Utility Code was implicated. Section 1309 provides, in pertinent part, that:

(b) Deadline for decision. Before the expiration of a nine-month period beginning on the date of the commission's motion or the filing of a complaint pursuant to subsection (a), a majority of the members of the commission serving in accordance with law, acting unanimously, shall make a final decision and order, setting forth its reasons therefore. The subsection shall apply only when the requested reduction in rates affects more than 5% of the customers and amounts to in excess of 3% of the total gross annual intrastate operating revenues of the public utility, provided that, if the public utility furnishes two or more types of service, the foregoing percentages shall be determined only on the basis of the customers receiving, and the revenues derived from, the type of service to which the requested reduction pertains.⁴⁹

At that time, the AT&T complaints had not been consolidated with the portion of the access investigation at Docket No. I-00040105 and the parties to the complaint proceeding disagreed with the applicability of Section 1309(b) to AT&T's formal complaints as it affected the establishment of a procedural schedule to resolve the AT&T complaints.

ALJ Melillo determined that Section 1309(b) was applicable to this proceeding. In response to that determination, on June 26, 2009, the PTA and CenturyLink⁵⁰ filed a Petition Requesting Interlocutory Review and Answer to Material Questions. Among other questions, the PTA and CenturyLink asked the Commission:

⁴⁹ 66 Pa.C.S. § 1309(b).

⁵⁰ At the time, CenturyLink was Embarq.

3. Does the provision of Section 1309(b), 66 Pa.C.S. §1309(b), mandating a decision within nine months of filing of the complaint or retroactive relief under certain circumstances, apply to AT&T's complaints against Petitioners' intrastate access rates?

By Order entered July 29, 2009, the Commission determined that, because it was consolidating the complaints with the reopened portion of the investigation, Section 1309(b) did not apply. July 2009 Order at n.8. In response to that decision, however, Sprint filed an appeal with the Pennsylvania Commonwealth Court. In a subsequent Order addressing the scope of the issues in this consolidated proceeding, the Commission specifically allowed for parties to present argument regarding the applicability of Section 1309(b) to this consolidated proceeding.⁵¹

The OCA submits that there should be no retroactive application of any reduction the Commission may order to the RLEC's intrastate access rates in this proceeding. Section 1309(b) provides that the nine month limitation applies only when the requested reduction in rates affects more than 5% of the customers and amounts to in excess of 3% of the total gross annual intrastate operating revenues of the public utility. These threshold figures are applied only to the "type of service" for which the rate reduction is requested. Because the RLECs offer only telecommunications services and because the rate reduction sought by AT&T does not affect more than 5% of the RLECs' telecommunications customers, Section 1309(b) does not apply to this proceeding.

The 5% threshold is not reached in this matter because the number of customers who pay intrastate access charges is less than 5% of the RLECs' overall telephone customers. AT&T, however, has argued that these thresholds are applied to the *individual services* provided by a

⁵¹ The Commonwealth Court remanded the appeal filed by Sprint was back to the Commission for further proceedings upon consideration of an unopposed application for remand filed by the Commission with the Court. *See, Sprint Communications Company, L.P., et al. v. Pa. P.U.C.*, Docket No. 1657 CD 2009, Order (entered November 5, 2009).

telephone company (i.e., basic local service, switched access service, special access service, etc.) and not to the RLECs *overall provision of telephone service* as the “type of service.” AT&T’s argument is without merit and should be rejected. The “type of service” discussed in Section 1309(b) refers to the overall type of service provided by the utility – telephone, electric, gas, water or sewer – not the individual telecommunications services within that broader type of service. Under AT&T’s theory, each “service” – basic local service, switched access service, special access service, etc. – would trigger Section 1309(b) if the rate for that service was reduced. The OCA submits that a proper reading is that, since less than 5% of the RLECs’ total telephone service customers would receive a reduction in intrastate access rates if AT&T prevails on the merits of its complaints, Section 1309(b) does not apply. The phrase “type of service” is relevant when a utility provides more than one type of service. For example, some utilities provide both electric and natural gas service, while other utilities provide both water and waste water services.

To hold otherwise, as AT&T argues, would lead to an unreasonable result. That is, any time a single rate is changed (in this case, the intrastate access rate), 100% of those customers who are charged that rate will be affected. That is the case here. But this is only a very small percentage of the RLECs’ overall telephone service customers. Pennsylvania rules of statutory construction provide that “the General Assembly does not intend a result that is absurd,

impossible of execution or unreasonable.”⁵² The phrase “type of service” in Section 1309(b) should not be applied in such a manner as to produce an unreasonable result.⁵³

As such, the OCA submits that Section 1309(b) is not applicable to this proceeding.

B. Compliance.

The OCA has no affirmative position on this issue but reserves the right to respond to any arguments made by other parties. The OCA will actively review any compliance filings made as a result of the Commission’s Order in this proceeding to ensure that the Commission’s directives are properly adhered to.

⁵² 1 Pa. C.S. § 1922(1).

⁵³ The phrase “type of service” is used elsewhere in Section 529 in Section 529(c)(2), (h) and (i), 66 Pa. C.S. §§ 529(c)(2), (h), (i), as well as in other sections of the Public Utility Code such as Section 1311(c) (relating to valuation of and return on the property of a public utility) and Section 1526(4) (relating to notice of service termination provided to customers. 66 Pa. C.S. §§ 1311(c), 1526(4). Each of these instances also supports defining the phrase “type of service” to mean the broader service, such as telephone, electric, gas, water or sewer, not the individual service provided by a utility to any particular group of customers.

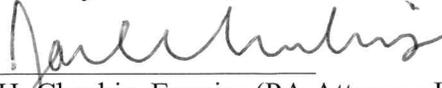
VIII. CONCLUSION

WHEREFORE, the Pennsylvania Office of Consumer Advocate respectfully requests the Pennsylvania Public Utility Commission adopt the following four steps as a resolution of this proceeding:

1. RLEC intrastate access rates should be set equal to their respective interstate rates, including the elimination of the carrier common line charge;
2. RLEC residential basic local exchange rates that are below 120 percent of the Verizon Pennsylvania weighted average residential basic local exchange service rate should be increased to that level, subject to an affordability constraint, while RLEC rates that are above 120 percent of the Verizon weighted average rate remain at their current levels;
3. Any remaining revenue required to offset the revenue decrease associated with access rate reductions should be recovered from the Pennsylvania Universal Service Fund; and
4. The revenue base of the Pennsylvania Universal Service Fund should be enlarged to include any service provider that uses the public switched telecommunications network at any point in providing their service.

The OCA respectfully submits that all of these four components should be adopted in their entirety.

Respectfully submitted,



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Dated: May 13, 2010

125963

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

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

APPENDICES TO THE
MAIN BRIEF OF THE
OFFICE OF CONSUMER ADVOCATE

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APPENDIX A
PROPOSED FINDINGS OF FACT

A. The OCA Comprehensive Proposal.

1. The carrier common line charge (“CCLC”) recovers the joint and common costs of the network from carriers that use the network and is not a subsidy. OCA St. 1 at 11.

2. If the CCLC were eliminated without adopting the other portions of the OCA comprehensive plan, the RLECs would be left with the choice of either financial insolvency or of establishing rates that are so high that they are not just, not reasonable and not affordable. OCA St. 1 at 12.

3. Currently, the Verizon Pennsylvania weighted average rate is \$14.25. OCA St. 1 at 14; *see also*, OCA Exh. RL-2.

4. While twenty-two RLECs would be required to increase their basic local exchange rate to match the benchmark in order to receive PA USF funding under the OCA plan, those increases range from 10 cents to \$3.60, with the exception of Citizens of Kecksburg which would receive an increase of \$6.09. OCA St. 1 at 15; *see also*, OCA Exh. RL-3.

5. The OCA’s proposed benchmark would increase every year in which Verizon changes its basic service rates, so long as the overall customer bill remained less than 0.75% of the Pennsylvania median rural household income. OCA St. 1 at 15. Therefore, if 120% of the Verizon weighted average basic local exchange rate increases to \$17.50 next year, the RLEC support would be determined using the \$17.50 benchmark. Id.

6. The amount of support required from the PA USF decreases each year under the OCA comprehensive proposal. OCA St. 1-S at 15.

7. In order to reduce the RLECs’ intrastate access rates to interstate levels, the payout of the PA USF would increase by approximately \$64.3 million. OCA St. 1 at 16; *see also*, OCA Exh. RL-4.

8. The PA USF revenue base would increase by \$4.4 billion by adding wireless revenue. OCA St. 1 at 17 (citations omitted). Increasing the fund payout from the current \$33 million to approximately \$97.3 million pursuant to the OCA proposal in this proceeding, while increasing the fund revenue base to include wireless revenue, would increase the contribution factor by only 0.00166%. Id.

9. Dr. Robert Loube is the Vice President of Rolka Loube Saltzer Associates. OCA St. 1 at 1. His consulting practice centers on providing expert advice to state agencies involved in telecommunications regulation. Id. Prior to joining Rolka Loube Saltzer Associates, Dr. Loube worked at the Federal Communications Commission, the Public Service Commission for the District of Columbia and the Indiana Utility Regulatory Commission on issues associated

with incremental cost, rate design, competition, universal service and separations. Id. Dr. Loubé received his Ph.D in Economics from Michigan State University in 1983. *See*, OCA Exh. RL-1.

B. Federal Universal Service Support.

10. The principle cause of the difference in intrastate and interstate access rates is that the FCC reduced the federal CCLC while this Commission has retained the state CCLC per-line charges on carriers. OCA St. 1 at 49.

11. The FCC's Interstate Access Support ("IAS") mechanism for price cap carriers is a fund that is disaggregated by carriers' unbundled network element ("UNE") zones and customer type. OCA St. 1 at 49-51; *see also*, OCA Exh. RL-9. Eight of 10 Pennsylvania price cap carriers receive IAS support for a total of \$20.2 million, including \$8.6 million to Verizon Pennsylvania, the largest recipient. Id.; *see also*, OCA Exh. RL-10.

12. The FCC's Interstate Common Line Support ("ICLS") mechanism for rate of return carriers provides each carrier with the difference between the carrier's interstate common line revenue and interstate common line revenue requirement and guarantees an 11.25 percent return on the common line portion of the carrier's interstate revenue requirement. OCA St. 1 at 51-52. All 26 of Pennsylvania's interstate rate-of-return carriers receive ICLS support for a total of \$30.1 million annual. Id. at 52. On a per-line basis, the range of support varies from \$1.04 to \$37.38 per month. Id.; *see also*, OCA Exh. RL-11.

13. The total common line support the RLECs receive from the ICLS and the IAS in Pennsylvania is \$35.5 million. OCA St. 1 at 52.

14. The ratio of proposed state to current federal universal service fund support (\$35.5 million to \$97.3 million) roughly equals the federal separations allocation factor (25/75) under the OCA's proposal. OCA St. 1 at 53.

C. Changes to the Telecommunications Industry.

15. There have been changes to the long distance market that could result in unfair advantages to certain carriers and provide opportunities for "regulatory arbitrage" under the current intercarrier compensation system. *See*, OCA St. 1 at 60. Regulatory arbitrage is the process that allows carriers to earn a profit or avoid a cost due to the fact that rates for similar services are different. Id.

16. The major long distance carriers have exited from the mass market interexchange markets and have been purchased by leading local exchange carriers. OCA St. 1 at 61. The local exchange carriers have obtained substantial positions in the long distance markets by selling bundles that combine local and long distance service. Id. Wireless carriers appear to be capturing a larger share of the total long distance market. Id. The FCC has eliminated the carrier common line charge for rate-of-return carriers and has virtually eliminated the carrier common line charge for price-cap carriers. Id.

17. As late as 2002, the former AT&T, before being acquired by SBC Communications, Inc., had 32.9% of the national long distance market and the former MCI, before being acquired by Verizon, had 21.1%. OCA St. 1 at 62 (citations omitted). The national residential market share of Verizon increased from 4.6% in 2000 to 27.3% in 2007. Id.

18. Eliminating a charge on long distance carriers that wireless carriers are not charged will increase competition in the long distance industry. OCA St. 1 at 65.

19. Long-distance rates are not typically set on a state by state basis, meaning that there are no retail long distance rates that are unique to Pennsylvania. Qwest St. 1-R at 3-4.

20. Because long-distance rates are set nationally, reducing the RLECs intrastate access rates in this proceeding will have very little impact on those long distance rates. OCA St. 1-S at 17.

21. The IXCs would not commit to flow through to consumers any reductions that may be ordered by the Commission as part of this proceeding. Tr. 243-244, 272-274.

D. Level of any rate reduction.

22. The RLEC intrastate access rates should not be reduced to Verizon's intrastate access rate levels because doing so would establish unreasonably low intrastate access rates for the RLECs and the accompanying revenue neutral rate increases would harm universal service. OCA St. 1 at 33.

23. The fact that intrastate access rates are higher in rural areas than in urban areas is expected given that telephone costs are usually influenced by economies of scope and scale and it is reasonable to expect that the cost to serve Philadelphia, for example, is lower than the cost to serve any of the RLECs. OCA St. 1 at 34.

24. The additional RLEC revenue loss associated with reductions in RLEC intrastate access rates to Verizon's rates generates an additional \$13.1 million in revenue loss for the RLECs. OCA St. 1 at 34-35; *see also*, OCA Exh. RL-7.

25. The RLEC traffic sensitive costs are approximately equal to their interstate traffic sensitive rates. OCA St. 1-S at 3-4. The Verizon traffic sensitive rate is less than the RLEC interstate traffic rate for 29 of 30 PTA RLECs. Thus, if the RLECs were to adopt the Verizon traffic sensitive rate, 29 of the 30 PTA RLECs would be required to sell traffic sensitive access services at below cost.

26. If the Commission adopts the OCA's comprehensive plan, the RLEC's weighted average rate will be about 5 cents, with most RLEC interstate access rates being between 1 and 3 cents. OCA St. 1-S at 16. As a result, the incentive to engage in traffic pumping will be vastly reduced. Id. at 16-17.

27. Sprint witness James A. Appleby testified that the RLECs should “be required to set their intrastate switched access rates and structure for each individual access element equal to the equivalent interstate switched access rate and structure.” Sprint St. 1.0 at 4.

28. Comcast witness Dr. Pelcovitz concludes that it is reasonable to adopt AT&T’s proposal to reduce the RLECs intrastate access rates to their interstate rates. Comcast St. 1.0 at 11.

29. It is not appropriate to set access rates equal to the incremental cost of service because doing so is not practical given that the cost of the telephone network contains many joint and common costs. OCA St. 1 at 42. Leading economists have indicated, among other things, that if a firm decided to price all goods at marginal cost, it would be committing “voluntary suicide.” Id. at 42-43.

E. Timing of any rate reduction.

30. A situation where Pennsylvania consumers are paying twice for the same access reductions should be avoided since the FCC has indicated that it may change intrastate access rates as part of a currently pending proceeding. OCA St. 1 at 59.

31. If the Commission orders a long term reduction in access rates, additional PA USF support on a long-term basis is needed as well. OCA St. 1-S at 25.

F. The meaning of revenue neutrality under Section 3017(a).

32. Under the OCA proposal, support from the PA USF would decrease whenever the benchmark, as determined by Verizon’s average rate, increases. OCA St. 1-S at 14-15. For example, if the carrier serves 10,000 lines and the benchmark increases to \$17.50, then the PA USF support would decrease by \$49,200 (41 cents times 10,000 lines times 12 months) in the second year, and with every further increase in the benchmark, the fund size would also increase. Based on the 2,044,768 lines served by RLECs in 2008, the decrease for the entire fund would be approximately \$10 million in the second year (41 cents times 2,044,768 times 12 months). Id. at 15.

33. Verizon has utilized all or virtually all of its allowed revenue increases pursuant to its Chapter 30 plan each year since its inflation offset was reduced in 2004. Tr. 186-187.

34. In 2008, AT&T’s combined revenue was \$124 billion. OCA St. 1 at 30. It served 55.6 million access lines and was the nation’s largest wireless carrier. Id. The mid-sized carriers in comparison are almost entirely wire line carriers. Id. Windstream served approximately 3 million lines, Frontier 2.2 million lines and the combination of CenturyTel and Embarq served 7.6 million lines nationwide. Id. Windstream’s operating revenue was \$3.1 billion. Frontier’s operating revenue was \$2.2 billion. Id.

35. CenturyTel operates four non-rural study areas, Frontier one non-rural study area and Windstream two non-rural study areas, whereas AT&T serves 22 non-rural study areas. OCA St. 1 at 30-31.

36. RLECs operate under a disadvantage compared to their competitors because building a broadband infrastructure is expensive. OCA St. 1 at 32.

G. Rate Increases.

37. Under the OCA comprehensive proposal offered in this proceeding, the immediate impact would be to require RLECs' residential basic local exchange rates to be no lower than 120% of the Verizon weighted average residential rate. OCA St. 1 at 14-15. Rates would be allowed to increase with increases in the Verizon rate, subject to the affordability constraint. Id. at 15.

38. Under the OCA's plan, the weighted average residential rate increase for RLEC basic local exchange customers is \$1.13 per month, which is a 7.7% rate increase. OCA St. 1 at 55; *see also*, OCA Table 1. In AT&T's original proposal prior to it presenting its modified position in rebuttal, the weighted average rate increase for RLEC basic local exchange customers would be \$6.87, which is a 42.9% rate increase. Id. at 65 and OCA Exh. RL-12.

39. Any increase to basic local exchange service would not prevent the rate paid by Lifeline customers from increasing. OCA St. 1 at 57. Rather, the rate paid by Lifeline customers would increase by the same amount as the basic local service rate increase. Id.

40. Nothing in price cap regulation requires that the allowed rate increase be equal to the general level of inflation. OCA St. 1-S at 10.

41. Verizon's residential rates may be too high because neither Verizon nor the Commission has addressed the issue of separating the cost of non-regulated services such as video services from the cost of telephone services. OCA St. 1-S at 11. It is impossible to claim that the inflation offset that is embodied in the Chapter 30 law is too high or too low because no one has conducted a productivity study of the combined network. Id. at 12.

42. Verizon urban residential rates are high because those rates are established using value of service pricing which occurs when customers are charged on the basis of the size of their local calling areas. OCA St. 1-S at 12-13. Verizon charges higher rates to its urban density cell 1 and 2 customers than it does to their rural density cell 3 and 4 customers because customers in density cell 1 and 2 can call more people in their local calling area than density cell 3 and 4 customers can call in their local calling area. Id. at 13.

43. A rate is not the same as the bill. OCA St. 1 at 19. The bill includes the basic local exchange rate plus the subscriber line charge plus the E-911 charge plus the Federal Universal Service Fund charge plus the PA relay charge plus Touch-tone charges plus other charges. Id.

44. The current average RLEC residential rate is \$16.16. OCA St. 1-S at 28.

45. Tracking inflation is not the definitive criteria for rate determinations because it is only one part of a combination of factors that must be used to determine whether a rate is affordable, and affordability is only part of the criteria that should be used to determine whether a rate is just and reasonable. OCA St. 1 at 22.

46. Affordability depends on the relationship between the bill and median family income, i.e., the ability to pay. OCA St. 1 at 22. If the median family income is not increasing as fast as inflation, then a rate that is increasing as fast as inflation could become unaffordable in a very short period of time. Id.

47. AT&T has consistently argued for an increase in the federal Subscriber Line Charge from \$6.50 to \$10.00 in the FCC's intercarrier compensation proceeding. OCA St. 1 at 23.

48. Wholesale customers are customers of the company. OCA St. 1-S at 5.

49. When Verizon provides long distance services to customers of the RLECs, every call that is transported over Verizon's long distance network terminates or originates on RLEC loop facilities. OCA St. 1-S at 5. Thus, wholesale customers, such as Verizon's long distance network, consume the services provided by the facilities and equipment of every carrier, and wholesale customers should not be provided with a free-ride on those facilities and equipment. Id.

50. The local loop provides multiple services such as access to long-distance carriers, Internet data services and in some instances video services. OCA St. 1-S at 21. The entire loop expense is not incurred solely to provide local service. Id. It has been incurred to provide the multitude of services that it provides and cost recovery is the responsibility of all of those services.

51. The singularly narrow-band, voice-only network that was tasked with the delivery of only voice service is being modified into a broadband network capable of delivering voice, broadband, and so many more services to the citizens of Pennsylvania. Sprint St. 1.2 at 40.

H. Universal Service.

52. Both the calling party and called party benefit from the existence of the public switched network. OCA St. 1-S at 22-23. That is, the value of a telephone network for any consumer increases as more consumers are added to the network. Id.

53. Universal service benefits everyone because the more people that can access the public switched telephone network, the more benefit the public switched telephone network is to all users.

54. To reduce the RLEC intrastate access rates to their interstate levels, including eliminating the state CCLC, the total size of the PA USF to maintain revenue neutrality pursuant to Section 3017 is \$97.3 million. OCA St. 1 at 17. Raising RLEC basic local exchange rates to 120% of the Verizon weighted average rate will not recover all of this revenue, although it will recover increasingly more revenue as Verizon's weighted average rate increases. OCA St. 1-S at 15.

55. The OCA comprehensive plan will not interfere with or burden the federal universal service fund because the OCA comprehensive plan will retain the current practice that the contribution factor will be assessed against intrastate retail telecommunications revenue. OCA St. 1-S at 19.

APPENDIX B
PROPOSED CONCLUSIONS OF LAW

A. Federal Law.

1. Section 151 of the federal Telecommunications Act of 1996 provides in pertinent part:

Purposes of Act; Federal Communications Commission created. For the purpose of regulating interstate and foreign commerce in communication by wire and radio *so as to make available, so far as possible, to all the people of the United States,* a rapid, efficient, nationwide, and world-wide wire and radio communication service with adequate facilities at reasonable charges... .

47 U.S.C. § 151 (emphasis added).

2. Federal law established a Universal Service Fund through which “high cost” rural and insular regions of the Nation can receive support for their basic service from other interstate customers. In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45, 12 FCC Rcd. 8776, 1997 WL 236383 (rel. May 8, 1997).

3. Federal law requires that consumers in rural and high cost areas have access to telecommunications services that “are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas.” 47 U.S.C. § 254(b)(3).

4. The primary federal role in ensuring the statutory goal of reasonably comparable rural and urban rates for non-rural carrier customers is to enable reasonable comparability among states. In the Matter of the Federal-State Joint Board on Universal Service, CC Docket No. 96-45, 18 FCC Rcd. 22559, Order on Remand, ¶ 18 (rel. Oct. 27, 2003). States, on the other hand, “have primary responsibility for ensuring reasonably comparable rural and urban rates” within the state. Id., ¶ 21.

5. Congress has further articulated as a universal service principle that “quality services should be available at just, reasonable and affordable rates.” 47 U.S.C. § 254(b)(1).

6. The FCC stated in its implementation of Section 254(b)(1) of TA-96 that the concept of affordability has two components: (1) an absolute component and (2) a relative component. In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45, 12 FCC Rcd. 8776, 1997 WL 236383 (rel. May 8, 1997) at ¶ 110. The FCC referenced the use of a percentage of income standard in assessing the relative component of affordability of telephone service. Id. Examining the “relative component” of affordability, however, the FCC said, “takes into account whether consumers are spending a *disproportionate amount of their income* on telephone service.” Id. (emphasis added). The FCC noted that “subscriber levels

do not reveal whether consumers are spending a *disproportionate amount of income* on telecommunications services.” Id. (emphasis added).

7. In its open intercarrier compensation proceeding, the FCC has indicated that they have jurisdiction over intrastate access rates and may make changes to those rates as part of their proceeding. In the Matter of Developing a Unified Intercarrier Compensation Regime, CC Docket No. 01-92, FCC 05-33, Further Notice of Proposed Rulemaking (rel. March 3, 2005).

8. Twenty-five percent of the cost of the local loop should be assigned to the interstate jurisdiction. Smith v. Illinois Bell Telephone Co., 282 U.S. 133 (1930).

B. Pennsylvania Law.

9. Section 1301 of the Public Utility Code provides, in pertinent part, that “every rate made, demanded, or received by any public utility, or by any two or more public utilities jointly, shall be just and reasonable, and in conformity with regulations or orders of the commission.” 66 Pa. C.S. § 1301.

10. Section 3011(2) of the Pennsylvania Public Utility Code provides: “**§ 3011. Declaration of Policy.** The General Assembly finds and declares that it is the policy of this Commonwealth to: ... (2) Maintain universal telecommunications service at affordable rates”. 66 Pa. C.S. § 3011(2).

11. Section 3011(3) of the Public Utility Code provides that “the General Assembly finds and declares that it is the policy of this Commonwealth to: ... (3) ensure that customers pay only reasonable charges for protected services which shall be available only on a non-discriminatory basis.” 66 Pa. C.S. § 3011(3).

12. Section 3011(5) of the Public Utility Code provides that “the General Assembly finds and declares that it is the policy of this Commonwealth to: ... (5) provide diversity in the supply of existing and future telecommunications services and products in telecommunications markets throughout this Commonwealth by ensuring that rates, terms and conditions for protected services are reasonable and do not impede the development of competition.” 66 Pa. C.S. § 3011(5).

13. Section 3011(9) of the Public Utility Code provides that “the General Assembly finds and declares that it is the policy of this Commonwealth to: ... encourage the competitive supply of any service in any region where there is market demand.” 66 Pa. C.S. § 3011(9).

14. “Protected service” includes, among other things, “service provided to residential or business consumers that is necessary to complete a local exchange call.” 66 Pa. C.S. § 3012.

15. When Chapter 30 of the Public Utility Code was reenacted in 2004, the specific directive contained in the original Chapter 30 to reduce intrastate access rates was not included in Act 183. *Compare*, 66 Pa. C.S. § 3007 (repealed) with 66 Pa. C.S. § 3017. Rather, the

General Assembly directed only that reductions in intrastate access rates ordered by the Commission be revenue neutral. 66 Pa. C.S. § 3017(a).

16. Section 3017(a) of the Pennsylvania Public Utility Commission states: “(a) **General Rule.**—The commission may not require a local exchange telecommunications company to reduce access rates except on a revenue-neutral basis.” 66 Pa. C.S. § 3017(a).

17. The Pennsylvania Universal Service Fund was established in 1999 in In re: Nextlink PA, 93 Pa PUC 172 (Sept. 30, 1999) (Global Order), *aff’d*, Bell Atlantic-Pennsylvania, Inc. v. Pa.P.U.C., 763 A.2d 440 (Pa. Cmwlth 2000) (Global Order Appeal), *vacated in part sub nom*, MCI WorldCom, Inc. v. Pa.P.U.C., 844 A.2d 1239 (Pa. 2004).

18. The Commonwealth Court explicitly affirmed the creation of the Pa USF when affirming the Global Order in its entirety. Global Order Appeal, 763 A.2d at 492-93 (“the concern has always been to provide public service in telecommunications with affordability and reasonable uniformity in services and costs”).

C. Other States’ Laws.

19. Several states have established a comparability standard for determining rural rates or implementing a state universal service fund. *See e.g.*, Maine Public Utility Commission, Chapter 288; Public Utilities Commission of the State of California, Resolution T-17122, January 10, 2008; 2007 Annual Telecommunications Report, Wyoming Public Service Commission.

D. Burden of Proof.

20. Section 332(a) of the Public Utility Code provides that the party seeking affirmative relief from the Commission has the burden of proof. 66 Pa.C.S. §332(a).

21. In Se-Ling Hosiery, Inc. v. Margulies, 364 Pa. 45, 70 A.2d 854 (1950), the Pennsylvania Supreme Court held that the term “burden of proof” means a duty to establish a fact by a preponderance of the evidence.

22. The term “preponderance of the evidence” means that one party has presented evidence which is more convincing than the evidence presented by the other party. Feinstein v. Philadelphia Suburban Water Co., 50 PaPUC 300 (1976). The Commission has held that a complainant, to establish a sufficient case against a utility and satisfy the burden of proof, must show that the utility should be held responsible or accountable for the problem described in the complaint. Id.

23. The Pennsylvania Supreme Court has clearly stated that the party with the burden of proof has a formidable task before its position can be adopted by the Commission. Burleson v. Pa. Pub. Util. Comm'n, 501 Pa. 433, 461 A.2d 1234 (1983). Even where a party has established a prima facie case, the litigant still must establish that "the elements of that cause of action are proven with substantial evidence which enables the party asserting the cause of action to prevail, precluding all reasonable inferences to the contrary." Id.

24. In addition to determining whether the complainants have satisfied the burden of proof, care must be exercised to ensure that the decision of the Commission is supported by substantial evidence in the record. 2 Pa.C.S. §704.

25. The term "substantial evidence" has been defined by the Pennsylvania Supreme Court, Superior Court and Commonwealth Court as such relevant evidence that a reasonable mind might accept as adequate to support a conclusion. More is required than a mere trace of evidence or a suspicion of the existence of a fact sought to be established. Norfolk & Western Ry. Co. v. Pa. P.U.C., 489 Pa. 109, 413 A.2d 1037 (1980); Erie Resistor Corp. v. Unemployment Comp. Bd. of Review, 194 Pa. Super. Ct. 278, 166 A.2d 96 (1961); and Murphy v. Comm. Dept. of Public Welfare, White Haven Center, 85 Pa. Commw. 23, 480 A.2d 382 (1984).

E. The meaning of section 3017(a).

26. Rate base rate of return issues are not relevant to Section 3017(a) of the Public Utility Code.

27. Other state commissions have rejected contentions that the economic burden of competitive entry should be assessed on an entire group of affiliated companies. *See, Re Sprint Communications Company, L.P.*, Case No. P-294, sub. 30, North Carolina Public Utilities Commission, Order entered Aug. 29, 2008; Midcontinent Communications/Missouri Valley Communications, Inc. Rural Exemption Investigation, Case No. PU-08-61, Findings of Fact, Conclusions of Law and Order, North Dakota Public Service Commission, Oct. 8, 2008.

F. Section 1309(b).

28. Section 1309 provides, in pertinent part, that:

(b) Deadline for decision. Before the expiration of a nine-month period beginning on the date of the commission's motion or the filing of a complaint pursuant to subsection (a), a majority of the members of the commission serving in accordance with law, acting unanimously, shall make a final decision and order, setting forth its reasons therefore. The subsection shall apply only when the requested reduction in rates affects more than 5% of the customers and amounts to in excess of 3% of the total gross annual intrastate operating revenues of the public utility, provided that, if the public utility furnishes two or more types of service, the foregoing percentages shall be determined only on the basis of the customers

receiving, and the revenues derived from, the type of service to which the requested reduction pertains.

66 Pa.C.S. § 1309(b).

29. The phrase “type of service” is used in Section 529 in Section 529(c)(2), (h) and (i), 66 Pa. C.S. §§ 529(c)(2), (h), (i), as well as in other sections of the Public Utility Code such as Section 1311(c) (relating to valuation of and return on the property of a public utility) and Section 1526(4) (relating to notice of service termination provided to customers. 66 Pa. C.S. §§ 1311(c), 1526(4).

30. Pennsylvania rules of statutory construction provide that “the General Assembly does not intend a result that is absurd, impossible of execution or unreasonable.” 1 Pa C.S. § 1922(1).

APPENDIX C
PROPOSED ORDERING PARAGRAPHS

THEREFORE, it is recommended:

1. That the OCA comprehensive proposal, as discussed herein, is adopted in its entirety.
2. That the Commission institute a further proceeding for the purpose of expanding the base of contributors to the Pennsylvania Universal Service Fund to include all service providers that use the Public Switched Telephone Network in Pennsylvania to provide service.
3. That, upon completion of such a further proceeding ordered in paragraph 2, the Pennsylvania Rural Local Exchange Carriers set their intrastate access rates equal to their respective interstate rate, including the elimination of the carrier common line charge.
4. That, upon completion of such rate changes ordered in paragraph 3, the Pennsylvania Rural Local Exchange Carriers increase their basic local exchange rates that are below 120 percent of the Verizon Pennsylvania weighted average residential basic local exchange service rate to that level, so long as no local telephone bill is greater than 0.75% of the Pennsylvania median rural household income, with increases to Citizens of Kecksburg rates phased-in over two years, while RLEC rates that are above 120 percent of the Verizon weighted average rate remain at their current levels.
5. That, upon completion of such rate changes ordered in paragraphs 3 and 4, any remaining revenue required to offset the revenue decrease associated with access rate reductions should be recovered from the Pennsylvania Universal Service Fund in order to maintain revenue neutrality required by 66 PA CS § 3017.
6. That the Formal Complaints filed by AT&T Communications of Pennsylvania, LLC., et al. at Docket Nos. C-2009-2098380, et al., be marked CLOSED.

CERTIFICATE OF SERVICE

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 No. C-2009-2098380, *et al.*

I hereby certify that I have this day served a true copy of the foregoing document, the Main Brief of the Office of Consumer Advocate, upon parties of record in this proceeding in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant), in the manner and upon the persons listed below:

Dated this 13th day of May 2010.

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