

COMMONWEALTH OF PENNSYLVANIA



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August 16, 2011

Rosemary Chiavetta, Secretary
PA Public Utility Commission
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Harrisburg, PA 17120

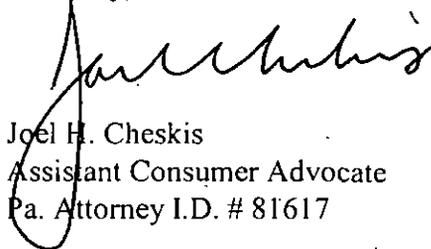
Re: AT&T Communications of Pennsylvania,
Inc. v. Verizon North Inc. and Verizon
Pennsylvania, Inc.,
Docket No. C-20027195

Dear Secretary Chiavetta:

Enclosed for filing please find an original and nine (9) copies of the Office of Consumer Advocate's Main Brief in the above-captioned proceeding. Please be advised that this Brief contains **Proprietary Information**. For your convenience I have enclosed a Proprietary and Non-Proprietary version.

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

Sincerely,


Joel H. Cheskis
Assistant Consumer Advocate
Pa. Attorney I.D. # 81617

Enclosures
cc: All parties of record
Hon. Cynthia Fordham, ALJ
135231

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

AT&T Communications of
Pennsylvania, Inc.

v.

Verizon North, Inc. and
Verizon Pennsylvania, Inc.

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Docket No. C-20027195

MAIN BRIEF
OF THE
OFFICE OF CONSUMER ADVOCATE

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Dated: August 16, 2011

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I. INTRODUCTION

This case involves the efforts by AT&T Communications of Pennsylvania, LLC (“AT&T”) and Sprint Communications Company L.P. (“Sprint”) to reduce, for a third time, the intrastate access rates of Verizon Pennsylvania, Inc. and Verizon North LLC (collectively “Verizon” or “the Companies”). The Pennsylvania Public Utility Commission (“Commission”) first reduced Verizon’s intrastate access rates as part of the “Global Order” in 1999,¹ and then again in an earlier phase of this proceeding in 2004.² In 2004, the Commission also remanded the case to the Office of Administrative Law Judge for further consideration of additional intrastate access charge reductions and other policy matters. On a separate track, the Commission examined the intrastate access charges of the rural incumbent local exchange carriers (“RLECs”).³

In this proceeding, AT&T argues that Verizon’s intrastate access rates should be lowered to their interstate levels, with any revenue reductions being offset by increases to Verizon’s basic local service rates. Verizon opposes any reductions in its intrastate access rates, unless such reductions are accompanied by certain conditions. The Office of Consumer Advocate (“OCA”) supports Verizon’s position that its current intrastate access rate levels should be maintained at

¹ Re Nextlink Pennsylvania, Inc., Docket No. P-00991648; P-00991649, 93 PaPUC 172 (September 30, 1999) (Global Order); 196 P.U.R. 4th 172, aff’d sub nom. Bell Atlantic-Pennsylvania, Inc. v. Pennsylvania Public Utility Commission, 763 A.2d 440 (Pa.Cmwlth. 2000), vacated in part, MCI WorldCom Inc. v. Pennsylvania Public Utility Commission, 577 Pa. 294, 844 A.2d 1239 (2004).

² AT&T Communications of Pennsylvania, Inc. v. Verizon North Inc. and Verizon Pennsylvania Inc., Docket No. C-20027195, Opinion and Order (entered July 28, 2004)(“ July 28, 2004 Order”).

³ Investigation Regarding Intrastate Access Charges and IntraLATA Toll Rates of Rural Carriers and the Pennsylvania Universal Service Fund, Docket No. I-00040105 and AT&T Communications of Pennsylvania, et al., v. Armstrong Telephone Company-Pennsylvania, et al., Docket No. C-2009-2098380, et al., Opinion and Order (entered July 18, 2011) (“Rural Access Order”).

this time. While the OCA differs as to the reasons for maintaining Verizon's intrastate access rates, the OCA submits that it would be inappropriate to further reduce Verizon's intrastate access rates at this time.

When determining the just and reasonable level of intrastate access charges, either Verizon's or the RLECs', the underlying issue that must be addressed is how will the cost of the joint and common plant of the public switched telephone network ("PSTN") be recovered. As the Commission noted in its recent Rural Access Order, quoting from the testimony of OCA witness Dr. Robert Loube:

The joint and common network plant is the plant outside that connects each customer to a 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 all of the services that other carriers 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 or local exchange or data transport service. None of those services, however, can be provided without it.⁴

The Commission also noted in the Rural Access Order that "this Commission has a long-established policy that permits the recovery of such costs from *all* users of such joint and common telecommunications plant and facilities, and not by end-users of regulated telecommunications services alone."⁵

Revenue to pay for the joint and common network is obtained from basic local exchange rates and intrastate access rates. Basic local exchange rates are those rates paid by retail

⁴ Rural Access Order at 11.

⁵ Id. at 12 (emphasis in original); *see also*, Id. at 104, 118, 120, 178.

customers, both residential and business, for the ability to make local telephone calls and to receive calls. Intrastate access rates are those rates paid by long distance companies, or interexchange carriers (“IXCs”), to both originate and terminate long distance calls on the local network in order to provide service to end users.

For a variety of reasons, various parties in this proceeding wish to change the relative burden associated with the recovery of the joint and common cost of the network. In particular, AT&T and Sprint wish to be relieved of their obligation to support the joint and common cost through access charges. If AT&T and Sprint are relieved of that obligation, however, then someone else must pay for the cost of the network. The cost could fall on the local telephone company, the basic local exchange customers of the local telephone company or a universal service fund.

Reducing the amount that long distance carriers pay to a local telephone company for access to the PSTN to provide its services to end users represents a substantial reduction in revenue for the local telephone company. This is particularly true for Verizon whose intrastate access rates are the subject of this proceeding. The OCA submits that any reduced revenue as a result of decreasing intrastate access rates that must be recovered by Verizon must be the responsibility of all users of the PSTN, and not just basic local exchange customers. The Commission has firmly established this principle in its recent Rural Access Order, *supra*. 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.

Moreover, state and federal laws seek to ensure the universal provision of basic local telecommunications services which is best accomplished by ensuring that all users of the PSTN

pay their fair share.⁶ 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. Increasing basic local exchange rates places the Commission's universal service goals at risk. Universal service is a vital element of telecommunications policy both at the state and federal levels. Although Verizon is not a recipient of funding from the Pennsylvania Universal Service Fund ("PA USF"), its basic local exchange customers must be protected from unjust and unreasonable increases in basic local rates.

In this proceeding, AT&T has proposed that Verizon's intrastate access rates be reduced to their interstate levels and that any lost revenue be recovered through corresponding increases to Verizon's basic local exchange rates. AT&T St. 1.0 at 5. Sprint, who, like AT&T, also pays Verizon's intrastate access rate, supports AT&T's position. Sprint St. 1 at 4. Verizon, the OCA and the Office of Small Business Advocate ("OSBA"), however, oppose any reduction in intrastate access rates.⁷

In this proceeding, the OCA has presented substantial record evidence demonstrating that basic local exchange customers already pay more to support the joint and common costs of the PSTN than access customers on both a relative and absolute basis. Adopting AT&T's position to reduce Verizon's intrastate access rates and increase basic local service rates would further tip the already lopsided scale and shift even more responsibility to pay for joint and common costs

⁶ 47 U.S.C. § 254; 66 Pa. C.S. § 3011(2).

⁷ As discussed below, Verizon argues, however, that if the Commission does reduce its intrastate access rates further, then the Commission should also reduce Verizon's "regulatory burdens." Verizon St. 1.0 at 34-51. The OCA does not support Verizon's proposed *quid pro quo* nor does the OCA support Verizon's reasoning.

onto basic local exchange customers. The Commission recently confirmed that *all* users of the PSTN should pay their fair share of the joint and common costs of the network. AT&T and Sprint, on the other hand, have not provided substantial record evidence that supports further reducing Verizon's intrastate access rates.

Since this proceeding was first established nine years ago, the fundamental issue in this matter has remained constant: how should the joint and common cost of the PSTN be recovered. There is no need for the Commission to lower intrastate access rates for the competitive interexchange carriers by raising the rates of the captive customers who will be harmed as a result of the required revenue neutral rate rebalancing that accompanies any further reductions in Verizon's intrastate access charges. This is particularly true, as the Commission found in the Rural Access Order as there is no guarantee that any benefit from such reduction would ever reach any of these customers.⁸

Verizon's intrastate access rates should not be further reduced at this time.

II. PROCEDURAL HISTORY

On March 21, 2002, AT&T filed a formal complaint against Verizon North seeking to have Verizon North's intrastate access charges reduced to Verizon Pennsylvania's levels pursuant to the Commission's Order approving the merger of then-Bell Atlantic and GTE.⁹ That

⁸ The Commission stated in the Rural Access Order: "At the same time we are not absolutely convinced that potential reductions in the intrastate carrier access charges of the RLECs will fully inure to the benefit of Pennsylvania end-users of long-distance services." Rural Access Order at 104.

⁹ Re Joint Application of Bell Atlantic Corporation and GTE Corporation for Approval of Agreement and Plan of Merger, Docket Nos. A-310200F0002, A-311350F0002, and A-310222F0002, (November 4, 1999) (Merger Order).

complaint was consolidated with a Joint Petition filed by Verizon on December 30, 2002 regarding the reduction of their access charges pursuant to the Commission's Merger Order, the 1999 "Global Order," *supra*, and the generic access charge investigation at Docket No. M-00021596.¹⁰ The ensuing proceeding culminated in a Commission Opinion and Order dated July 28, 2004 granting a Joint Petition for Resolution of Litigation filed by Verizon PA, Verizon North, the OCA and the OSBA.

The July 28, 2004 Order, among other things, permitted Verizon to reduce and restructure its access charges by allowing the Company to file a revenue-neutral, rate rebalancing filing in which the net revenue reductions from access charge increases and decreases were offset with revenue increases from monthly dial tone line rates for residential and business local exchange customers. However, the Commission stated that those policy issues and other access charge concerns that were raised by IXCs in their Exceptions, but which were not specifically resolved by a recommendation from the ALJ in her Recommended Decision, would be remanded to the ALJ for the further development of the record and the issuance of a further Recommended Decision.

Additionally, the Commission directed that the scope of the remanded proceeding be expanded to consider any activity before the Federal Communications Commission ("FCC") concerning intrastate access charge issues. The FCC has been examining intercarrier compensation issues, including intrastate access charges, since at least 2001.¹¹ The Commission

¹⁰ Access Charge Investigation per Global Order of September 30, 1999, Docket Nos. M-00021596, *et al.*

¹¹ *See e.g., 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). It should be noted that, on July 29, 2011, a group of ILECs, including Verizon and AT&T, filed a proposal to resolve the FCC's intercarrier compensation proceeding entitled "American's Broadband Connectivity Plan" seeking to address a number of issues pending before the FCC including intrastate access rates.

further directed that the impact that any FCC action may have on the Commission's jurisdictional responsibilities, as well as its relationship to the final Recommended Decision on access rates arising from the remand proceeding, be addressed to the extent that the FCC issues a decision prior to the issuance of the Recommended Decision on Remand in this proceeding.

On December 7, 2005, a Recommended Decision on Remand was issued. The Recommended Decision on Remand directed that Verizon PA and Verizon North eliminate their carrier charges between six months to one year after a final Commission Order in this matter. The reduced revenue was then to be made up by residential basic local service rate increases on a combined Verizon PA and Verizon North basis with the increase to the residential rate being \$1 or less. The remaining revenue was to be made up from business line rate increases on a combined Verizon PA and Verizon North basis.

By Order entered January 8, 2007, the Commission modified the ALJ's Recommended Decision on Remand by staying the proceeding pending the outcome of the FCC's intercarrier compensation proceeding, or for a period of 12 months. The stay of this proceeding was extended by the Commission in response to a motion filed by several parties. A second motion to extend the stay, however, was denied by Commission Order entered May 11, 2010. Instead, in its May 11, 2010 Order, the Commission directed that the investigation be assigned to the Office of Administrative Law Judge for the development of the appropriate evidentiary record and the issuance of a Recommended Decision.

The May 11, 2010 Order further provided all parties the opportunity to supplement the evidentiary record including any issues that were not adjudicated at the time of the Remand. The Commission specifically directed:

5. That the participating parties shall be afforded due process opportunities to supplement the evidentiary record including any issues that were not adjudicated at the time of the Remand before Administrative Law Judge Cynthia Williams Fordham at this docket.

6. That in addition to any supplemental issues raised per Ordering Paragraph No. 5, above, the participating parties shall address and provide record evidence on the legal, ratemaking and regulatory accounting linkages between: a) any Federal Communications Commission's ruling in its *Unified Intercarrier Compensation* proceeding; b) the intrastate access charge reform for ILECs in view of the new Chapter 30 law and its relevant provisions at 66 Pa. C.S. §§ 3015 and 3017; and, c) the potential effects on rates for Verizon's basic local exchange services.

In addition, the Commission noted that the FCC issued its National Broadband Plan ("NBP") on March 16, 2010 which includes a recommendation that intercarrier compensation be reformed over the next ten years. The Commission stated that the NBP is a "notable development" that "may have a profound effect on intrastate switched access charges."

In response to the May 11, 2010, Order, a prehearing conference was held on December 8, 2010 before ALJ Fordham. In attendance at the prehearing conference were Verizon, the OCA, OSBA, AT&T, Qwest Communications Corporation ("Qwest"), 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") and the Pennsylvania Telephone Association ("PTA"). During that Prehearing Conference, a procedural schedule was established for purposes of relitigating the remand. Pursuant to that procedural schedule, the OCA submitted the Direct, Rebuttal and Surrebuttal Testimonies of Dr. Robert Loube on March 29, 2011, May 10, 2011 and June 3, 2011, respectively.¹² Evidentiary hearings were held in this matter on June

¹² 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

14-15, 2011 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.

III. SUMMARY OF ARGUMENT

Verizon's intrastate access rates should not be further reduced at this time. The Commission should reject the arguments of AT&T and Sprint, the only parties in this proceeding who advocate for a reduction of Verizon's intrastate access rates. Neither AT&T nor Sprint have presented substantial evidence demonstrating that Verizon's intrastate access rates should be reduced. AT&T and Sprint's arguments in this proceeding are without merit and should be rejected.

Verizon's current composite intrastate access rate is 1.79¢ per minute and Verizon North's composite intrastate access rates is 1.57¢ per minute. OCA St. 1 at 4. As Dr. Loube testified: "these levels appropriately ensure that access service users of the public switched telephone network share in the costs to maintain and operate that network." *Id.* The reasonable and appropriate level of intrastate access charges in Pennsylvania should be set at a level that not only recovers the incremental cost of access, but also requires access customers, as well as all other customers that use the PSTN, to contribute towards the recovery of the joint and common costs of the network. Doing so would be consistent with the Commission's recent Rural Access

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.

Order and sound public policy. Verizon's current intrastate access rate levels achieve those goals and, therefore, Verizon's current intrastate access rates should not be further reduced in this proceeding.

Access customers, such as AT&T and Sprint, should not receive additional relief in the form of further access rate reductions. Any further reductions would considerably reduce access customers' contributions towards the recovery of joint and common costs of the PSTN and would not be reasonable at this time. The reduction in access rates would likely result in additional increases to basic local exchange rates given the requirement in Pennsylvania law that access reductions only be made on a revenue neutral basis.¹³ The transfer of additional joint and common costs to basic local exchange customers is not reasonable because those customers are currently responsible for the recovery of a substantial portion of the joint and common costs of Verizon's network.

Finally, this proceeding is not the appropriate forum to discuss Verizon's regulatory obligations. Regardless of whether the Commission determines to modify Verizon's intrastate access rates as part of this proceeding, which the OCA suggests it should not, the Commission should not modify Verizon's regulatory obligations as part of this proceeding.

IV. ARGUMENT

A. Introduction.

AT&T and Sprint argue in this proceeding that Verizon's intrastate access rate, a rate that they pay to Verizon when providing their toll service to consumers, should be reduced, and that

¹³ 66 Pa. C.S. § 3017(a). Section 3017(a) provides: “(a) **General Rule.** -- The commission may not require a local exchange telecommunications company to reduce access rates except on a revenue-neutral basis.”

such revenue reduction be offset with increases to Verizon's basic local exchange rates. This argument, if adopted, would result in an immediate reduction in costs for both AT&T and Sprint. Yet, neither company provides any substantial evidence to support such an inappropriate rate rebalancing. For example, both AT&T and Sprint argue that Verizon's intrastate access rates should be reduced because those rates subsidize basic local service and such a subsidy is improper. Neither company, however, has presented any evidence demonstrating that such a subsidy exists. In fact, OCA witness Dr. Loube presented analysis showing that no such subsidy exists but, rather, basic local exchange rates are already paying more than their fair share. Nor has either company properly supported any other argument they make that Verizon's intrastate access rates should be further reduced.

Verizon's primary position in this proceeding is that its intrastate access rates should not be reduced. The OCA agrees. Verizon further argues, however, that its intrastate access rates should not be reduced unless some "accompanying changes enable it to compete more effectively and ensur[e] robust revenue neutrality." Verizon St. 1.0 at 54. The accompanying changes proposed by Verizon include first addressing the RLEC intrastate access rates, relieving Verizon of "outdated regulatory burdens," ensuring revenue neutrality and requiring all of Verizon's competitors to reduce their intrastate access rates on the same date if Verizon is required to reduce its intrastate access rates. Id. at 54-57. In support of its position, Verizon argues that it is under intense competitive pressure and financial stress. Id. at 14-22. Verizon also argues that the Commission's regulation of basic local service contributes to substantial losses that dwarf the contributions from access rates. Id. at 22-34. Verizon filed a cost study as part of this proceeding to show that its revenues from providing basic residential and business services are exceeded by the expenses incurred to provide those services. Id. Verizon then

argues that it is unnecessarily burdened with legacy regulation and that eliminating such legacy regulation will benefit Pennsylvania consumers and the competitive market. Id. at 34-51.

The OCA supports Verizon's position that its intrastate access rates should not be further reduced at this time, but the OCA fundamentally disagrees with Verizon's other requests in the event the Commission adopts AT&T and Sprint's proposals. As discussed below, reducing Verizon's current intrastate access rates will further tip the scale of contribution to support the joint and common costs of the PSTN to Verizon's basic local exchange customers, exacerbating an imbalance that already exists. Verizon's intrastate access rates do not subsidize their basic local exchange rates because Verizon's basic local exchange rates are not lower than the incremental cost of service. Indeed, Verizon's basic local exchange customers already provide more support of the PSTN on both a relative and absolute basis than Verizon's intrastate access customers. The OCA submits that some of Verizon's underlying reasons for its position, as well as the conditions it proposes to accompany any reduction in its intrastate access rates, are without merit and should be rejected. In particular, the OCA strongly opposes Verizon's position that its regulatory obligations should be reduced if its intrastate access rates are further reduced.

B. Verizon's Current Intrastate Access Rate Levels Should Not Be Further Reduced At This Time.

1. Arguments By AT&T And Sprint In Favor Of Reducing Verizon's Intrastate Access Rates Are Without Merit And Should Be Rejected.

a. Introduction.

Both AT&T and Sprint advocate that Verizon's intrastate access rates be reduced to their interstate levels with any reduction in revenue recovered through increases to basic local exchange service rates. AT&T St. 1.0 at 5. Both AT&T and Sprint provide a number of reasons to support their position that Verizon's intrastate access rates should be reduced to their interstate

levels, with any reduced revenue being offset by increases in basic local exchange rates. Each of those reasons, however, are without merit and should be rejected. Verizon's intrastate access rates should not be further reduced at this time.

- b. Neither AT&T nor Sprint have provided any record evidence to demonstrate that Verizon's intrastate access rates subsidize their basic local exchange rates.

Throughout its Direct Testimony, AT&T argues that Verizon's intrastate access rates should be reduced, in part, because those rates subsidize basic local service and such subsidy is improper. AT&T St. 1.0 at 4, 9-11, 14, 16, 17, 19 and 21. Sprint's witness makes a similar allegation that intrastate access rates are inflated to subsidize the price of basic local service. Sprint St. 1 at 3. The OCA submits that Verizon's intrastate access rates are not excessive, do not subsidize basic local service and should not be further reduced at this time. The argument of AT&T and Sprint to the contrary should be rejected.

As Dr. Loubé testified, neither the AT&T panel witnesses Nurse and Oyefusi nor Sprint witness Appleby have supported with any evidence their argument that Verizon's intrastate state access rates are providing a subsidy to basic local service rates. OCA St. 1-R at 2, 12-13. As Dr. Loubé testified, for example, with regard to the AT&T testimony:

Even though their direct testimony uses the words "subsidy" or "subsidized" at least nine times, the panel witnesses never demonstrate or provide any evidence that could be used to determine whether a subsidy exists or whether that subsidy is provided by state access rates or whether that subsidy is received by basic local service. Instead, the panel witnesses continue to assert and claim that the subsidy exists without ever supporting that assertion with actual evidence.

Id. at 2 (citation omitted). Dr. Loubé added that determining whether a service is providing a subsidy requires an examination of whether the service rate is above the stand-alone cost of providing the service. Id. at 3. In this instance, for a subsidy to exist, the revenue from a service

must be greater than the total stand-alone cost of providing the service. Id. There is no record evidence in this proceeding to support such an argument.

In this case, none of the parties seeking a change in rates produced a stand-alone cost study for Verizon's intrastate access rates. As such, Dr. Loube noted that it is then necessary to perform an alternative analysis – which Dr. Loube did. Dr. Loube summed the incremental cost of access and the joint and common loop costs in order to determine if a subsidy exists. Id. Dr. Loube testified:

As I demonstrated in my Direct Testimony, the stand-alone cost includes not only the incremental cost of service but also the joint and common cost of providing the service. Because it is necessary to use the loop to provide access service, that is, it is not possible to complete the state access service without using the local loop, the loop is part of the joint and common cost of state access service. Therefore, to determine the stand-alone cost of access service, it is necessary to sum the incremental cost of access and the joint and common loop costs. State access rates do not provide a subsidy to basic local service because Verizon has shown that the total revenue from state access service is less than the joint and common loop costs without even considering incremental cost. Therefore, because state access revenue is less than the joint and common loop cost, and joint and common loop cost is less than the stand-alone cost of state access service, it must be true that state access revenue is less than the stand-alone cost of service. Thus, state access service cannot be providing a subsidy to basic local service or any other service.

Id. at 3-4; *citing*, OCA Exh. RL-2.

Dr. Loube also refuted the argument of AT&T and Sprint that intrastate access rates subsidize basic local service rates because intrastate access rates are higher than interstate access rates. Sprint argued, for example, that Verizon's intrastate access rates are unreasonably high because the state access rates are above the incremental cost of service, which Mr. Appleby asserts are close to zero. Sprint St. 1 at 20. Dr. Loube noted, however, that the interstate access rates were the result of a settlement and not a particular cost standard. OCA St. 1-R at 4, 14-

15.¹⁴ Dr. Loube added that the fact that intrastate access rates are higher than the interstate rates merely supports a claim that intrastate access rates provide a greater contribution to the support of the joint and common costs of the network than interstate access rates do. Id. at 5. Dr. Loube testified:

The difference between the rates only supports a claim that the per-minute revenue from the two services is different. The interstate rate was established as part of a settlement and was never compared to either an incremental cost or a stand-alone cost study. Thus, the fact that the state access rate is higher than the interstate rate means that the state rate is higher than a settlement rate, not that the state access rate is higher than a particular cost standard. In my direct testimony, based on my analysis of the reciprocal compensation rates, I suggest that it appears that the state access rate is greater than the incremental cost of that service. Therefore, the fact that the state access rate is greater than the interstate rate merely supports a claim that the state access service is providing a greater contribution to the support of the joint and common network cost than the support provided by the interstate access service.

Id. at 4-5. Dr. Loube noted too that Verizon's interstate access rates are supported by, and may be subsidized by, the federal universal service fund as well as by Verizon's special access services. Id. at 15. Dr. Loube reiterated, "if all rates are set equal to the incremental cost of service then it would be impossible for Verizon to recover all of its costs and there is no reason to assert that one service rate should equal its incremental cost of service when other services are paying substantially more than the incremental cost of service." Id.

The argument of AT&T and Sprint that Verizon's intrastate access rates subsidize basic local service rates is also undermined by the companies' recognition in their own testimony that

¹⁴ Citing, Access Charge Reform, Sixth Report and Order, CC Docket Nos. 96-262 and 94-1, Report and Order, CC Docket No. 99-249, Eleventh Report and Order, CC Docket No 96-45, 15 FCC Rcd 12962 (2000) (subsequent history omitted)("CALLS Order").

the network contains huge amounts of joint and common costs and that cost must be allocated to all services.

AT&T's panel witnesses argued, for example, that Verizon's cost model "improperly assumes that the network is used *exclusively* for basic service. A proper approach would recognize that the carrier will benefit from economies of scope when the network is designed to provide all services for which it is capable," citing advanced services as one such service.

AT&T St. 1.0 at 41 (emphasis in original). Dr. Loubé noted that AT&T's testimony:

is recognizing and acknowledging that the network contains huge amounts of joint and common costs and that that cost must be allocated to all services. This acknowledgement matches the basic position that I set forth in my testimony. AT&T also acknowledges that revenue rate-regulated services exceeds direct cost and therefore, there is no subsidy.

OCA St. 1-R at 5-6. AT&T further undermines its argument that a subsidy exists by also claiming that Verizon overstates its cost of providing local service. AT&T St. 1.0 at 19. As Dr. Loubé noted, "if the cost of local service is overstated then there is no basis for AT&T claiming that local service is receiving a subsidy or that local rates are artificially low." OCA St. 1-R at 6. Dr. Loubé testified that AT&T's testimony is an implicit recognition that this proceeding is about the allocation of joint and common cost. Id.

Similarly, Sprint witness Appleby testified that Verizon "now offers wireline long distance, numerous calling features, broadband and video services." Sprint St. 1 at 3-4. Dr. Loubé responded that this statement that Verizon offers a number of services using the same loop means that it is not possible to assign 100 percent of the loop cost to basic local service. OCA St. 1-R at 13. Dr. Loubé added:

If it is not possible to assign 100 percent of the loop cost to the basic local service then former claims about subsidies provided to basic local service must be reevaluated after the loop has been

allocated among all of the services that use the loop. However, Mr. Appleby has not performed that reevaluation. Indeed he states “that studying the cost of only rate regulated services is akin to studying the cost of hamburger sold as part of a happy meal.” Thus, he is claiming that it is not possible to separate the cost of one service from the cost of other services. If that is true, then it is not possible to determine a unique cost for basic local service. Without a unique cost for basic service, it is not possible to claim that the rate for basic service is below the cost of service. If he cannot show that the rate for basic service is below cost, then he cannot make any claims regarding whether basic local service is receiving a subsidy. Therefore, if his claim is true, then all claims regarding subsidies to basic local service are irrelevant to this proceeding.

Id. Sprint’s testimony is therefore contradictory and should be rejected.

The Commission should reject any arguments that Verizon’s intrastate access rates provide a subsidy to Verizon’s basic local exchange rates. There is no evidence of record that supports such an argument.

- c. Neither AT&T nor Sprint have provided any other valid reason why Verizon’s intrastate access rates must be further reduced at this time.

In addition to their repeated, and unfounded, arguments that Verizon’s intrastate access rates should be reduced because they subsidize Verizon’s basic local exchange rates, both AT&T and Sprint make several other arguments to support their claim that Verizon’s intrastate access rates should be reduced. None of the arguments presented by AT&T or Sprint have merit. All of them should be rejected and Verizon’s intrastate access rates should not be further reduced at this time.

- i. AT&T’s argument that Verizon’s intrastate access rates should be reduced because the current rates are economically irrational is without merit and should be rejected.

AT&T has argued that this case is about rebalancing rates so that services are priced in a “more economically rational way.” AT&T St. 1.0 at 25. Dr. Loubé responded that AT&T’s argument to rebalance rates simply seeks an immediate reduction in AT&T’s costs and a corresponding increase in AT&T’s profits. OCA St. 1-R at 7. This is true even if competition puts pressure on AT&T to reduce its prices. Id. Dr. Loubé also noted that AT&T’s argument is flawed because it applies an incorrect economic pricing rule that price equals marginal cost. Id. Dr. Loubé stated that rule does not apply to the telecommunications industry because the telecommunications industry is characterized by high network costs, non-separable cost functions and a large portion of common costs. Id. Dr. Loubé added that leading economists have noted that if a firm decided to price all goods at marginal costs it would be committing “voluntary suicide.” Id. at 8.¹⁵ AT&T’s argument that Verizon’s intrastate access rates should be reduced because the current rates are somehow economically irrational is without merit and should be rejected.

- ii. The cost of the public switched telephone network should be recovered from all users of the network, not just residential and business local exchange customers.

AT&T and Sprint both argue that Verizon should only recover its cost of the PSTN from retail (i.e, residential and business) customers. AT&T St. 1.0 at 16; Sprint St. 1 at 21. Dr. Loubé testified that this argument is without merit and should be rejected because other carriers are customers too and it is therefore reasonable to recover costs from them as well. OCA St. 1-R at

¹⁵ *Citing*, Hal Varian, *Differential Pricing and Efficiency*, *First Monday* (1996), available at <http://www.firmonday.dk/issues/issue2/different>; also quoted in the direct testimony of Dr. Jeffrey A. Eisenbach on behalf of Verizon Maryland in the Maryland Public Service Commission, Case No. 9133, filed July 8, 2008; and, William J. Baumol and Daniel G. Swanson *The New Economy and Ubiquitous Competitive Price Discrimination: Identifying Defensible Criteria of Market Power*. 70 *Antitrust Law Journal*, 2003, page 5.

9. Dr. Loubé's position is consistent with the Commission's recent finding in the Rural Access Order that all users of the PSTN should contribute to support the PSTN. Rural Access Order at

12. Dr. Loubé testified:

It is reasonable to recover costs from other carriers because the other carriers are customers. They are simply wholesale customers rather than retail customers. The wholesale customers use facilities and equipment just like retail customers, and thus, the wholesale customers should pay for the use of the facilities and equipment.

Id. Dr. Loubé noted that Verizon recovers costs from its special access customers who are also wholesale customers as well as when it sells unbundled network elements to competitors and high speed internet service to internet service providers. Id. These are all examples of Verizon recovering costs from wholesale customers, yet AT&T argues that it would somehow be more "rational" to recover costs only from retail customers.¹⁶

With regard to Sprint, the company again is contradicting itself. Dr. Loubé testified that Sprint has many wholesale customers for its services but is not claiming that Sprint should not charge those wholesale customers for the use of Sprint's network and facilities. Id. at 14. Yet, in this case, Sprint is arguing that wholesale customers should not pay for the PSTN.

The Commission should reject the argument of AT&T and Sprint that only residential and business retail customers should support the PSTN. All users of the PSTN should contribute support for the PSTN, as the Commission recently found again in the Rural Access Order.

¹⁶ Dr. Loubé quantified the impact AT&T's argument would have on Verizon if the Commission required Verizon to recover its cost only from retail customers. Dr. Loubé demonstrated that "nationwide, in 2008, ILECs generated \$32.1 billion in telecommunications services sales to other carriers, \$57.5 billion in telecommunications services to retail customers and \$25.5 billion in sales of non-telecommunications services for total revenues of \$115.3 billion." OCA St. 1-R at 9-10. Thus, wholesale sales represented approximately 28% of total revenue for ILECs, which would have a very negative effect on their profits if eliminated. Id. at 10.

- iii. The Commission should reject AT&T's arguments regarding text messaging, emailing and innovation as reasons for reducing Verizon's intrastate access rates.

AT&T provides significant argument that it is losing share of the long distance market because of emails and text messages that do not pay access charges. AT&T St. 1.0 at 5, 11-15; *see also*, Tr. at 410-414. AT&T makes this argument to suggest that Verizon's intrastate access rates should be reduced so that AT&T can better compete with these new communications technologies. The Commission should reject this argument as well.

As Dr. Loube testified, AT&T's argument fails to consider that text messages and emails use different functionality and therefore the comparison of rates for those services is not relevant to this proceeding. OCA St. 1-R at 11. Furthermore, AT&T was unable to quantify either in response to discovery or during cross-examination how much of its share of the intralata toll market AT&T was losing to these alternative forms of communication. Tr. 410-413. AT&T's argument is therefore speculative and unsubstantiated.

AT&T then argues that high access charges somehow act as a drag on innovation. AT&T St. 1.0 at 11. AT&T could not provide any specifics to substantiate this claim. As Dr. Loube testified:

However, when asked if AT&T had delayed or not introduced a new service or not made a new innovation due to Verizon's high access charges, AT&T could not identify any of its services that had been delayed or any new service that AT&T had not introduced due to Verizon's high access charges.

OCA St. 1-R at 12. Sprint made similar arguments but likewise could not identify any service or innovation that has been delayed or otherwise not introduced as a result of Verizon's current intrastate access levels. Id.

As such, the Commission should reject the argument from AT&T and Sprint that any lost market share as a result of text messaging and emailing supports reducing Verizon's intrastate access rates further. The Commission also should not adopt AT&T's argument that innovation is somehow prevented as a result of the Verizon's intrastate access rate levels.

- iv. All price increases, no matter what size, must be just and reasonable and based on substantial evidence.

AT&T and Sprint argue that the Commission should adopt their rate rebalancing plan because the impact on basic local exchange rates would be minimal. AT&T St. 1.0 at 21; Sprint St. 1 at 22. The OCA submits that just because the increase to basic local exchange service to offset any reductions to Verizon's intrastate access charges would only be *** **BEGIN PROPRIETARY** **END PROPRIETARY** *** per line per month on average under AT&T's proposal does not mean that the rate increase is just and reasonable or otherwise should be allowed, as AT&T and Sprint argue. The OCA submits that the matter is not as simple as AT&T and Sprint seem to argue. A mere mathematical exercise alone does not make a rate increase just and reasonable. Any rate changes, no matter what size, must be based on substantial record evidence and must be just and reasonable. Such evidence does not exist to support the rate rebalancing suggested by AT&T and Sprint in this proceeding. Therefore, Verizon's intrastate access rates should not be further reduced at this time.

- d. Conclusion.

The OCA submits that the arguments of AT&T and Sprint in favor of reducing Verizon's intrastate access rates at this time are without merit and should be rejected. Such arguments are not based on substantial record evidence and are unsound public policy. Neither AT&T nor Sprint have provided any reason why the Commission should further reduce Verizon's intrastate

access rates yet again. Verizon's intrastate access rates therefore should not be further reduced at this time.

2. Verizon's Current Intrastate Access Rates Should Be Maintained At Their Current Levels Because Of Sound Economic And Public Policy Reasons.

a. Introduction.

The OCA agrees with Verizon that the Commission should not further reduce Verizon's intrastate access rates at this time. Basic local exchange rates already contribute more support to the PSTN on both a relative and absolute basis than intrastate access rates, more than shouldering their fair share of costs. This has been demonstrated by Dr. Loubé based on his incremental cost of service analysis discussed below. Furthermore, there is no evidence that basic local exchange rates are subsidized by intrastate access rates. In fact, Dr. Loubé demonstrated that basic local exchange rates contribute more to support the PSTN than intrastate access rates on both a relative and absolute basis. Finally, Verizon's intrastate access rates are appropriate in that further reductions may jeopardize the Commission's state and federal obligations regarding universal service by increasing basic local exchange rates.

The appropriate level for intrastate access rates ensures the proper recovery of a portion of the joint and common costs of the telephone network and promotes universal service. Verizon's current intrastate access rates should be maintained at their current levels because they accomplish those objectives and therefore are based on sound economic and public policy reasons.

b. An incremental cost of service analysis supports maintaining Verizon's current intrastate access rates.

In order to establish a level for intrastate access rates that is just and reasonable based on sound economic and public policy reasons, the Commission should consider whether the rate

covers the incremental cost of service and contributes sufficiently to the joint and common costs. Dr. Loube testified that the incremental cost of service is the difference between the total cost of providing all of the services and the stand-alone cost of providing the services other than the service under investigation. OCA St. 1 at 5. This definition is the same definition as the one used by Verizon, with the exception that Verizon uses the term Total Service Long Run Incremental Cost (“TSLRIC”) rather than incremental cost. Id. The components of TSLRIC for basic local exchange service include the switching and interoffice facilities used to provide basic exchange local service, plus the customer operations and marketing cost associated with the basic exchange service. Id. at 6.

Importantly, Dr. Loube testified that the loop is not a part of the incremental cost of basic service. Id. This is because it is a shared cost of the many services that use the loop such as local service, interstate and intrastate access and toll service as well as the newer data services such as high speed internet service. Id. Dr. Loube noted: “even if local service were no longer provided, the carrier would still have to provide the loop in order to provide the other services.” Id.

The Commission has previously recognized that the cost of the loop is not incremental to basic exchange service because the loop is also required to provide multiple services. In the recent Rural Access Order, the Commission noted that:

joint and common facilities and plants enable not only the provision of various local and long-distance telecommunications services by a number of entities, but they also facilitate retail broadband services to the Internet and various data and communications services.¹⁷

¹⁷ Rural Access Order at 12. *See also*, Rural Access Order at 122, 143-44; *citing*, Motion of Vice Chairman James H. Cawley, Docket Nos. C-20077332 and C-20066987, August 7, 2008.

Similarly, the FCC has stated:

The cost of the local loops and their associated line cards in local switches, for example, are common with respect to interstate access service and local exchange service, because once these facilities are installed to provide one service, they are able to provide the other at no additional cost.

OCA St. 1 at 6.¹⁸ Thus, it is clear that both the Commission and the FCC hold that loop costs are common costs incurred to provide a number of services and are not a part of the incremental cost of basic local exchange service.

The OCA submits that the basic service contribution level demonstrates that basic service customers are already covering the incremental cost of basic local exchange service and providing substantial support for the recovery of the joint and common costs of the network. There is no basis to further increase this level of contribution to the joint and common costs by raising basic local exchange rates.

- c. Basic local exchange service contributes more to support the PSTN than intrastate access rates on both a relative and absolute basis.

Further evidence that it is sound economic and public policy to maintain Verizon's current intrastate access rates at their current levels is the fact that retail basic exchange customers are contributing a higher share of the burden of supporting the joint and common cost of the network than do access customers. To demonstrate these contribution levels, Dr. Loube showed that the contribution from retail basic exchange service customers is the difference between the revenue provided and the incremental cost of local service. *Id.* at 9. Dr. Loube

¹⁸ Citing, In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, First Report and Order, FCC 96-325 (rel. Aug. 8, 1996) at ¶ 678; *see also*, In the Matter of High Cost Universal Service Support, Further Notice of Proposed Rulemaking, WC Docket No. 05-337 (rel. Nov. 5, 2008), App. A at ¶ 247 (“a copper loop can be used to provide analog voice service as well as data service using DSL technology. The cost of the loop is therefore common to both voice and DSL services.”).

performed his analysis using revenue estimates from rate regulated services and competitive services for business and residential retail basic exchange service customers provided in Verizon's Direct Testimony at Appendix D. Id.

Using data from Verizon's Direct Testimony, Dr. Loube determined that the total revenue for rate regulated services only was *****BEGIN PROPRIETARY** **END PROPRIETARY *****

*****BEGIN PROPRIETARY** **END PROPRIETARY ***** is the incremental cost of local usage. Therefore, the difference between rate regulated revenue and the incremental cost of local service is *****BEGIN PROPRIETARY**

END PROPRIETARY ***. The revenue from rate regulated services is *****BEGIN PROPRIETARY** **END PROPRIETARY ***** the incremental cost of service. Id. From this determination, Dr. Loube estimated the amount that access customers contribute to the support of the joint and common costs of the network as *****BEGIN PROPRIETARY** **END PROPRIETARY***** or the difference between intrastate access revenue for 2010 of *****BEGIN PROPRIETARY**

END PROPRIETARY*** estimate of the incremental cost of access. That estimate is the product of the \$0.002439 reciprocal compensation rates and the intrastate minutes of use. Id. at 10. As such, in the case of access service, revenue is only *****BEGIN PROPRIETARY** **END PROPRIETARY***** the incremental cost of service. Id.

Therefore, Dr. Loube testified that basic exchange service customers contribute more to the support of the network than access customers in both an absolute and relative basis. In absolute terms, basic service customers contribute *****BEGIN PROPRIETARY** **END PROPRIETARY ***** while access customers contribute only *****BEGIN PROPRIETARY** **END PROPRIETARY ***** Id. at 11. On a relative basis, the

basic service customers' ratio is *****BEGIN PROPRIETARY** **END**

PROPRIETARY *** compared to access customers' ratio of *****BEGIN PROPRIETARY**

END PROPRIETARY *** Id. Dr. Loube concludes: "because the retail basic exchange customers are carrying such a high share of the burden of supporting the joint and common cost of the network at this time, it is inappropriate to shift more cost to retail basic exchange customers at this time." Id.

- d. Ensuring that all users of the PSTN pay to support the network will assist the Commission in meeting its state and federal universal service obligations.

Sound economic and public policy requires that Verizon's intrastate access rates enable interexchange carriers to support the Commission's efforts to meet its state and federal universal service obligations. The OCA submits that it would not be reasonable to increase the share of the joint and common network costs borne by basic service customers by further reducing Verizon's access charges as AT&T and Sprint recommend. Doing so will jeopardize the Commission's state and federal universal service obligations. Chapter 30 of the Public Utility Code, for example, provides that it is the policy of this Commonwealth to "maintain universal telecommunications services at affordable rates."¹⁹ Similarly, the federal Telecommunications Act of 1996 provides that "quality services should be available at just, reasonable and affordable rates."²⁰

¹⁹ 66 Pa. C.S. § 3011(2).

²⁰ 47 U.S.C. § 254(b)(1). *See also*, 47 U.S.C. § 151 ("**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...")(emphasis added).

In its recent Rural Access Order, the Commission recognized the importance of all users of the public switched telephone network contributing to the cost to support that network. The Commission noted at the outset of the Rural Access Order that “while labeled an access charge investigation, the primary issue to be addressed in these proceedings is how the cost of joint and common network plant will be recovered.”²¹ The Commission then, as noted above, proceeded to quote from OCA witness Dr. Loubé’s testimony in support of this fact.²² The Commission then noted:

[Non traffic sensitive] network costs are properly characterized as joint and common costs, and this Commission has a long-established policy that permits the recovery of such costs from *all* users of such joint and common telecommunications plant and facilities, and not by end-users of regulated telecommunications services alone. Joint and common facilities and plant enable not only the provision of various local and long-distance telecommunications services by a number of entities, but they also facilitate retail broadband access to the internet and various data and communications services.²³

Later, the Commission noted the ILECs’ obligations as the “carrier of last resort” in its service territory by stating that:

Although it is intuitive that RLEC intrastate carrier access charge revenues obviate the need for increased basic local exchange rates, thus assisting the maintenance of affordable universal service for the RLECs’ end-users, the issue of who pays and by how much for the RLECs’ joint and common [Non-traffic sensitive] network costs is one of preserving a sound balance among various objectives of regulatory policy. ...

²¹ Rural Access Order at 11.

²² Id.

²³ Id. at 12. In particular, in addition to lowering the RLECs’ intrastate access rates to their interstate levels, the Commission determined to maintain a \$2.50 carrier charge to ensure that all users of the PSTN contributed to the support of that network. Rural Access Order at 120.

At the same time we are not absolutely convinced that potential reductions in the intrastate carrier access charges of the RLECs will fully inure to the benefit of Pennsylvania end-user consumers of long-distance services.²⁴

The Commission reiterated its position that all users of the PSTN should contribute to the support of the network numerous times in the Rural Access Order.²⁵

Ensuring that all users of the PSTN pay to support the PSTN will assist the Commission in meeting its state and federal universal service obligations. As Dr. Loube testified:

it would be unreasonable to increase local rates for the purpose of lowering the contribution toward the recovery of joint and common costs received from access service. In addition to its obligation to promote the competitive provision of telecommunications services, the Commission also has state and federal obligations to ensure the universal provision of telecommunications services. And, because Pennsylvania requires any reductions in access rates to be revenue neutral, the Commission must recognize that the basic local service rate is the most likely source of revenue recovery for any reductions in intrastate access rates. Increases in local rates have direct impacts on universal service, yet Verizon discusses in its Direct Testimony little, if any, of universal service implications of access rate reductions.

²⁴ *Id.* at 104. *Citing*, 66 Pa. C.S. § 3018(b)(1) (“the commission may not fix or prescribe the rates, tolls, charges, rate structures, rate base, rate of return, operating margin or earnings for interexchange competitive services or otherwise regulate interexchange competitive services except as set forth in this chapter.”).

²⁵ *See*, Rural Access Order at 118 (“In reaching the disposition of the Exceptions in this area, we are guided by the long-established principle and regulatory policy of this Commission, which has been upheld upon appellate review, that the RLECs’ intrastate carrier switched access service NTS joint and common costs primarily associated with the RLECs’ local loop plant must be recovered from all users of the RLECs’ network.”), 120 (“First, the recovery of the NTS joint and common costs of the RLECs’ intrastate carrier access services will not be borne by end-user consumers alone. Instead, such recovery is shared by all those who use the RLECs’ network.”), 122, 144 (noting the requirement of Section 254(k) of the federal Telecommunications Act of 1996 that services included in the definition of universal service “bear no more than a reasonable share of the joint and common costs of facilities used to provide those services.”), 158 and 178.

OCA St. 1 at 13. Universal service obligations must be given due consideration when determining whether to reduce Verizon's intrastate access rates in this proceeding.

e. Conclusion.

The OCA submits that Verizon's current intrastate access rates should be maintained at their current levels because of sound economic and public policy reasons. The basic service contribution level demonstrates that basic service customers are already covering the incremental cost of basic local exchange service and providing substantial support for the recovery of the joint and common costs of the network. Verizon's current intrastate access rate levels should not be further reduced at this time because basic service customers already bear a greater portion of the costs to support the PSTN on both a relative and absolute basis. In contrast, Verizon's access charge customers currently contribute only marginally to the support of the PSTN. The Commission should not act to further tip the scale in favor of access customers and against basic local service customers thus compromising universal service. Ensuring that all users of the network pay to support that network will better enable the Commission to meet its state and federal universal service goals.

3. While The OCA Agrees With Verizon That Its Intrastate Access Rates Should Not Be Further Reduced At This Time, The Cost Model Verizon Submitted In This Proceeding Is Not Relevant As Filed.

In support of its Direct Testimony, Verizon submitted a cost model to support Verizon's contention in this proceeding that the company's cost of providing residential and business basic local exchange services exceeds revenues received from those services. Verizon St. 1.0 at 22. This cost model, however, did not examine the cost of providing intrastate access service in Pennsylvania. Verizon's cost model is therefore irrelevant to the issue of whether Verizon's

intrastate access rates should be reduced. However, with adjustments, Verizon's cost model can be used to demonstrate that its intrastate access rates should not be further reduced at this time.

Dr. Loubé is familiar with the Verizon cost model because he was an expert witness in two cases in other jurisdictions where the model was used – in Michigan and California. OCA St. 1 at 14-16.²⁶ Although Dr. Loubé testified in those other jurisdictions, and those other state commission's agreed, that the Verizon cost model was inconsistent with FCC and state commission standards for determining TELRIC costs, and that the model's output was too high because the assumptions were incorrect, Dr. Loubé accepted the outputs of the model in this proceeding because the model was not being used in this case to set rates. *Id.* at 14-15.²⁷ Dr. Loubé used the Verizon model outputs as inputs into his analysis of the relationship between revenue and forward-looking costs when providing his adjusted margin analysis. As Dr. Loubé's analysis demonstrated, basic local exchange service rates are covering the cost to serve and contributing more than their fair share to the recovery of the joint and common costs of the PSTN. *Id.* at 16.

²⁶ See, Declaration and Rebuttal Declaration on behalf of The Utility Reform Network in re: Investigation on the Commission's Own Motion into Open Access and Network Architecture Development of Dominant Carrier Networks, Verizon UNE Phase, Investigation 93-04-002, filed August 6, 2004 and November 9, 2004; and, Initial and reply testimony on behalf of TelNet Worldwide, Inc., ACD Telecom, Inc., TC3 Telecom, Inc., Michigan Access, Inc., JAS Networks, Inc., DayStarr, LLC, Clear Rate Communications, Inc., and Arialink Telecom. (the "CLECs"), In the matter on the Commission's own motion, to review the total element long run incremental costs and the total service long run incremental costs for Verizon North Inc. and Contel of the South, Inc. d/b/a Verizon North Systems, to provide telecommunications services, Michigan PSC Case No. U-15210, April 7 and June 26, 2008.

²⁷ In the matter, on the Commission's own motion, to review the total element long run incremental costs and the total service long run incremental costs for Verizon North Inc., and Contel of the South, Inc., d/b/a Verizon North Systems, to provide telecommunications services, Order, Michigan Public Service Commission Case No. U-15210, March 18, 2009; and, Investigation on the Commission's own motion into Open Access and Network Architecture Development of Dominant Carrier Networks, Investigation 93-04-002 (Verizon UNE Phase) Before the Public Utilities Commission of the State of California, Decision 06-03-025, March 15, 2006.

Verizon's cost model is flawed because it allocates 100% of loop costs to basic local exchange service. In response, Dr. Loube adjusted the outputs of the model so that only a portion of the dial tone part of the model-determined loop costs would be assigned to basic local exchange service instead of the 100% assignment in the Verizon model. Id. Dr. Loube then assigned the remaining portion of the dial tone part of the model-determined loop costs to non-basic service. Dr. Loube chose to allocate 50% of the common loop costs to basic local exchange service because "it is a substantial allocation that illustrates the proposition that basic local service is providing a significant contribution to the support of the common loop network." Id. Dr. Loube testified that he could have chosen other alternative cost assignments but those would have shifted an even higher proportion of the common network cost out of the basic exchange category. Id. at 17.

Using the 50% standard, Dr. Loube adjusted Verizon's model by reducing the dial tone line cost by 50% and entering the 50% reduction into the input tables that Verizon used to determine its margin analysis. Id. at 18. Dr. Loube also adjusted the Verizon model by including the federal universal service Interstate Access Support as revenue to basic local exchange service. Id. Dr. Loube testified:

The adjusted margin analysis shows that there is a positive contribution from basic local exchange service. On the basis of rate-regulated services, the margin is *** **BEGIN PROPRIETARY** **END PROPRIETARY*****. Including competitive services purchased by rate-regulated basic local exchange service customers, the margin increases to *** **BEGIN PROPRIETARY** **END PROPRIETARY*****.

Id. at 19; *citing*, OCA Exh. RL-2. Therefore, Dr. Loube concluded, "basic local exchange customers are making a reasonable contribution towards the support of the joint and common costs because those customers are paying for not only their incremental cost but they are also

paying for 50 percent of the joint and common costs.” Id. Basic local service rates recover both their incremental cost of basic service plus a portion of the joint and common costs.

Verizon, however, has criticized Dr. Loube’s adjustments. In response to the OCA testimony, Verizon argued that Dr. Loube made a series of arbitrary allocations with regard to joint and common costs that distorted Verizon’s financial condition. Verizon St. 1.1 at 28. Verizon’s arguments are without merit and should be rejected.

Dr. Loube testified that his allocation of 50% of the joint and common loop cost to the non-regulated sector is “economically arbitrary in the same way that every telephone cost study or financial report that allocates joint and common costs among service is arbitrary.” OCA St. 1-S at 2. That is, Dr. Loube’s allocation was arbitrary in the sense that it relied on a professional judgment or a policy maker’s concerns regarding just and reasonable allocations. Id. Dr. Loube testified that, “in these circumstances there is no precise mathematical formula that can define the exact allocation percentages.” Id. at 2-3. Dr. Loube added “every telephone cost study or financial report is based on arbitrated imprecise allocations of joint and common costs.” Id. at 3.

Verizon has recognized the arbitrary nature of assigning service-specific costs in comments to the FCC. Id.²⁸ In those Comments Verizon noted that “shared network costs cannot be ignored, but any assignment of those costs to any specific service is economically arbitrary.” Id. Dr. Loube testified that the use of the word “any” in this quote means that all networks costs should not be assigned to any service, including basic local exchange service; yet, Verizon’s direct testimony in this proceeding assigns 100% of network costs to basic local exchange service. Id. Dr. Loube added that “it is that assignment that drives its negative margin

²⁸ Citing, Comments of Verizon and Verizon Wireless, In the Matter of Special Access Rates for Price Cap Local Exchange Carriers, WC Docket No. 05-25, RM-10593, submitted January 19, 2010, page 45.

results and the low reported financial profits.” Id. The OCA submits that it is Verizon’s assignment that is arbitrary in that it ignores the fundamental principle that all customers and all services should share in paying the joint and common costs of the loop. As Dr. Loube testified:

Verizon arbitrarily assigns all of the shared network costs to basic local exchange service in its direct testimony. Only by making such an arbitrary assignment of shared network costs can Verizon assert that basic local exchange service provides a negative return. Thus, it appears that Verizon’s rebuttal testimony should be criticizing its own direct testimony rather than my direct testimony.

Id. Dr. Loube concluded his response by noting that most telephone cost studies are arbitrary in the sense that they “are based on professional judgments regarding allocations that are buried deep within the confines of the source code and equations of the model,” including Verizon’s VzCost model. Id.²⁹

Dr. Loube further supported the reasonableness of his 50%/50% allocation by looking at the change in the use of the loop plant over time. Id. at 5. Dr. Loube testified:

Formerly, the loop plant provided only voice services. These services included local service, intrastate toll service and interstate toll. Now the plant provides video and data services along with voice services. The allocation of additional loop plant to the non-regulated sector recognizes this transformation. It would be unreasonable and capricious to retain the old allocation given the change in usage of the loop. Therefore, I made a conservative arbitrated imprecise change to the allocation of the loop.

Id. Dr. Loube added that “all parties to this proceeding recognize the loop plant provides data and video services along with loop services.” Id., *quoting*, Verizon St. 1.0 at 45; Sprint St. 1 at 26; OSBA St. 1, *passim*; and AT&T St. 1.0 at 41.

²⁹ Dr. Loube also noted that the 75/25 cost allocation adopted by the FCC in 1982 that carriers were required to implement “is an arbitrated imprecise allocation and is thus an arbitrary allocation.” OCA St. 1-R at 5.

Dr. Loubé described his allocation as conservative because it is similar to or retains a higher proportion of loop cost assigned to basic service than other recent proposals by national rural associations, the state members of the separations joint board and by AT&T in recent comments to the FCC. Id. at 6-8 (citations omitted). For example, Dr. Loubé noted that if AT&T's proposal to the FCC to allocate 100% of the loop to the interstate jurisdiction were adopted, Verizon's interstate rate of return would *** **BEGIN PROPRIETARY**

END PROPRIETARY *** while its intrastate rate of return would *** **BEGIN PROPRIETARY**

END PROPRIETARY***. Id. at 8-9.

Verizon also criticized Dr. Loubé's analysis by claiming that he arbitrarily failed to remove the interstate Subscriber Line Charge ("SLC") revenue from his marginal calculation. Verizon argued that Dr. Loubé arbitrarily assigned 50 percent of loop costs to basic local exchange service rather than assigning 75 percent or 100 percent to basic local exchange service and that he arbitrarily shifted costs to special access services. Verizon St. 1.1 at 28. Dr. Loubé effectively refuted each of these criticisms of his analysis.

Dr. Loubé demonstrated that it is reasonable to assign SLC revenue to basic exchange service in the margin analysis calculation because the SLC is an interstate dial tone line charge and does not recover any usage costs associated with toll service. OCA St. 1-R at 9. Dr. Loubé also testified that assigning 50 percent of the loop costs to basic local exchange service is not arbitrary. Dr. Loubé noted that, in response to a Verizon data request, he performed a special study that assigned 75 percent and 100 percent of joint and common costs to basic local exchange service. Id. at 10. The result of those studies demonstrated "the unremarkable fact that as more costs are assigned to basic local exchange service, the contribution declines." Id.

Finally, Dr. Loube noted that he also did not arbitrarily assign the cost to special access, as Verizon asserted. Rather, he assigned the cost based on the recommendation of the state members of the Separations Federal-State Joint Board. Id. at 10-11.

As such, Verizon's cost model is irrelevant as filed. With appropriate adjustments, however, Verizon's cost model demonstrates that basic local exchange rates recover the incremental cost of basic local exchange service plus a portion of the joint and common costs of the PSTN.

C. The Commission Should Reject Verizon's Attempt To Link Its Intrastate Access Rate Levels To Its Contribution To The Pennsylvania Universal Service Fund.

Verizon argues in its Direct Testimony in this proceeding that it would be unreasonable for the Commission to reduce Verizon's intrastate access rates in this proceeding while requiring the company to contribute millions of dollars to the PA USF each year. Verizon St. 1.0 at 43-44. The RLEC access investigation includes an examination of the PA USF.³⁰ The OCA submits that the Commission should not link Verizon's intrastate access rate levels to Verizon's contribution to the PA USF.

Dr. Loube testified in this proceeding that:

the OCA is not advocating for an increase in universal service fund support to offset any reduction in Verizon's intrastate access rates because Verizon does not receive support from the PA USF. Thus it is necessary to maintain Verizon's current access rates in order to ensure that all users of the public switched network continue to contribute to the support of that network.

³⁰ Rural Access Order at 48-62, 162-180.

OCA St. 1 at 21.³¹ Likewise, neither should the Commission reduce Verizon's requirement to support the PA USF as part of this proceeding.

Verizon's current intrastate access rate level is not relevant to Verizon's contribution to the PA USF. Those contributions are actually being paid by Verizon customers in the form of foregone rate reductions. As Dr. Loubé testified:

The requirement to contribute to the PA USF allows the Commission to meet its state and federal universal service obligations. Moreover, the funds that Verizon pays into the PA USF are not funds that would support Verizon's rate of return or could be used to provide dividends to Verizon stockholders. Verizon's contribution to the PA USF is done primarily, if not exclusively, through its use of approximately \$17 million per year of foregone reduction in noncompetitive revenues Verizon would have provided as a result of its 2003 Price Change Opportunity ("PCO") filing made pursuant to its Commission-approved Chapter 30 plan. If Verizon is no longer required to pay into the PA USF, it must apply that \$17 million per year as a reduction to its noncompetitive revenues, which is primarily the basic local service rate.

Id. at 23-24.³² Dr. Loubé concluded that "nonetheless, I support Verizon's position to maintain its current access rates in order to prevent a revenue neutral increase in its local basic exchange rate because that position also allows the Commission to adopt a policy that furthers universal service." Id. at 24.

³¹ Dr. Loubé's first best solution to access reform in both proceedings is to equate all intercarrier compensation rates, both interstate and intrastate, access charge and reciprocal compensation, and so on, to the average of all of those existing rates. OCA St. 1 at 21. Dr. Loubé noted, however, that, because of the dual jurisdiction of the FCC and the Pennsylvania Commission, it is not possible for the Pennsylvania Commission to unilaterally establish the first best solution. Id.

³² On cross examination, Verizon witnesses recognized that the approximately \$17 million annual payment that Verizon makes to the PA USF from its 2003 PCO filing would be an issue that the Commission would have to address if Verizon were no longer required to contribute to the PA USF. Tr. at 249.

As such, the Commission should reject Verizon's attempt to link its intrastate access levels to its contribution to the PA USF.

D. Dr. Loubé's Testimony In This Proceeding Is Not Inconsistent With His Testimony In The RLEC Access Investigation.

AT&T has criticized Dr. Loubé for allegedly taking positions in this case that are contrary to his positions taken in the RLEC case. AT&T St. 2.0 at 12-15; Tr. 303-318. The OCA took the same essential position in the RLEC intrastate access investigation that it takes in this proceeding: all users of the public switched telephone network should contribute to the support of that network. AT&T's arguments are without merit and should be rejected.

Many correlations have been drawn in this proceeding to the Commission's investigation regarding the RLECs intrastate access rates. Just as the examination of Verizon's access rates began with the Commission's 1999 Global Order, so too did the RLEC access investigation also begin with the Global Order.³³ The RLECs intrastate access rates were reduced by the Global Order and subsequently reduced in 2003 when the Commission approved a settlement submitted by various parties, including Verizon.³⁴ As discussed above, by Order entered July 18, 2011, the Commission reduced the RLEC intrastate access rates for a third time as part of a bifurcated investigation that included issues pertaining to the PA USF and establishing a uniform benchmark rate for residential basic local exchange service.³⁵ Certainly, the Commission's

³³ See, fn. 1, *supra*.

³⁴ See, fn. 10, *supra*.

³⁵ Rural Access Order, at 191-195. Petitions for Reconsideration were subsequently filed in response to the Rural Access Order and remain pending before the Commission.

findings in the Rural Access Order that all users of the PSTN should pay to support that network is applicable to both proceedings.³⁶

As Dr. Loube testified:

In the RLEC proceeding, I proposed reducing the RLEC state access rates if and only if the Commission adopted a comprehensive reform plan. However, if the Commission did not adopt the comprehensive reform plan, I asserted that the existing RLEC access rates should be maintained because retaining existing RLEC access rates was a superior policy choice compared to accepting AT&T's proposed rate rebalancing plan. In this proceeding, my opinion is the same. Retaining the existing Verizon access rates is superior to accepting AT&T's proposed rate rebalancing plan.³⁷

OCA St. 1-S at 14. With respect to his proposal in the RLEC case, Dr. Loube added, "the key purpose of the plan was to ensure that all users of the public switched telecommunications network contribute to the support of the public switched telecommunications network" noting that "users of the network include retail customers such as individuals who purchase basic local exchange service and wholesale customers such as AT&T who purchase access service." Id.

Dr. Loube reiterated that retaining the current access rates in the Verizon case requires more users of the PSTN to provide a reasonable amount of support for the PSTN. Id. Dr. Loube testified that the AT&T proposal to lower Verizon's intrastate access rates and offset such revenue losses with increases to Verizon's basic local exchange rate would fundamentally

³⁶ The Commission determined to maintain a \$2.50 carrier charge for the RLECs to ensure that all users of the PSTN contribute support for that network. Rural Access Order at 120.

³⁷ In the RLEC access investigation, the OCA, through Dr. Loube, presented a comprehensive four-part proposal that included: 1) a reduction in the RLECs' intrastate access rates to interstate levels, 2) an increase in RLEC basic local exchange rates to a benchmark rate that is both affordable and comparable to Verizon's basic local exchange rate, 3) increased funding from the PA USF to ensure that the access reductions were revenue neutral and 4) an expansion of the base of contributors to the PA USF to ensure that all users of the public switched telephone network contribute to the support of that network. *See*, OCA St. 1-S at 14.

change the way the network is supported: “even though basic local exchange service customers are currently providing most of the support for the network, the AT&T proposal would dump even more of the network support responsibility on to the basic local exchange service customers.” Id. Dr. Loube added that the AT&T proposal is self-serving in that it reduces AT&T’s costs and increases the rates for basic local exchange service customers, calling such a proposal an “income redistribution,” not policy reform. Id.

Dr. Loube testified that he did not propose a comprehensive plan in this proceeding as he did in the RLEC proceeding because Verizon does not receive support from the PA USF and the Commission has refrained from including an expansion of the PA USF contribution base as an issue at this time. Id. at 16. If Verizon cannot receive PA USF support to offset any further reductions in its intrastate access rates, then the reduction in revenue loss would be recovered most likely from Verizon’s basic local exchange customers. Id. In contrast, expanding the base of contributors to the PA USF would further ensure that all users of the PSTN contribute to the support of that network. Id. Dr. Loube noted the FCC’s adoption of the Interstate Access Support (IAS) and Interstate Common Line Support (ICLS) mechanisms as ways to ensure an appropriate source of revenue to carriers when interstate access rates were reduced. Id. at 17.

During the evidentiary hearing, Dr. Loube explained some of the differences between the RLEC access investigation and this proceeding. Dr. Loube testified that the RLEC investigation and this case have “been separated by the Commission because the companies in [the two cases] have separate circumstances, and therefore I designed a solution to the circumstances of each company.” Tr. at 344. Dr. Loube noted that “there’s an internal universal service fund within Verizon where its urban and suburban customers pay enough money to cover its rural customers. So this is going on within Verizon itself because there’s no Pennsylvania Universal Service Fund

to support Verizon rural.” Tr. 345. Dr. Loubé added that “rural carriers don’t have that source of revenue.” Tr. 345.

Finally, Dr. Loubé was also criticized for taking allegedly varying positions in this proceeding from the RLEC proceeding regarding the potential for “regulatory arbitrage.” Regulatory arbitrage is the practice of taking advantage of a price differential that exists for virtually the same service in two or more markets. OCA St. 1 at 22. Yet, Dr. Loubé consistently has sought to minimize opportunities for regulatory arbitrage both in this proceeding and the RLEC access investigation. Dr. Loubé recognized that if his position is adopted – that the Commission not change Verizon’s intrastate access rates as part of this proceeding – the possibility of arbitrage technically remains possible. *Id.* Dr. Loubé noted, however, that:

In the RLEC case, however, the potential for arbitrage was greater because there was a much greater difference between the intrastate access rates and interstate access rates for many RLECs. There was, therefore, a greater incentive to game the intercarrier compensation system. The OCA agreed to reduce the RLECs intrastate access rates to their interstate levels in those proceedings, in conjunction with an expansion of the PA USF, to reduce or eliminate the potential for arbitrage that plagues the intercarrier compensation system. The difference between Verizon’s interstate access rates and their intrastate access rates, however, is much less.

Id. at 22-23. Any arguments that Dr. Loubé is taking contradictory positions in this proceeding from positions taken in the RLEC access investigation should be rejected.

E. Verizon’s Regulatory Obligations Should Not Be Modified As A Result Of This Proceeding, Regardless Of Whether The Commission Determines To Modify Verizon’s Intrastate Access Rates.

I. Verizon’s arguments that the Commission should reduce its regulatory obligations are irrelevant and should be rejected.

In its Direct Testimony, Verizon argues that “the Commission should not consider reducing Verizon’s switched access rates here, but rather should work to eliminate legacy

regulations on incumbents, starting with Verizon’s particular regulatory burdens.” Verizon St. 1.0 at 7; *see also, Id.* at 34-51.³⁸ Verizon raised this issue *sua sponte* and not in response to any specific request from the Commission. The OCA submits that, even if Verizon’s intrastate access rates are reduced as part of this proceeding, which the OCA opposes, the Commission should reject the conditions that Verizon proposes accompany any such reduction, namely a reduction in Verizon’s regulatory obligations.

As the incumbent local exchange carrier for decades, Verizon (or its corporate predecessors) has benefitted from monopoly regulation by being granted the opportunity to earn a regulated return in its exclusive service territory. As a result, Verizon experienced revenue gains without competitive pressures for much of its corporate existence. Verizon’s regulatory requirements are part of the regulatory *quid pro quo* for being the incumbent service provider. As an ILEC under the Pennsylvania Public Utility Code, Verizon has additional regulatory obligations that competitive carriers do not have. Yet, such differences remain reasonable. As Dr. Loube testified:

Verizon is the incumbent local telephone provider and has been for decades. As a result, for most of its corporate existence, Verizon operated as a monopoly and received an opportunity to earn regulated returns on its investments and faced no competition. Verizon also has network modernization commitments and other obligations under Chapter 30 of the Public Utility Code. As such, it is reasonable that Verizon have different regulatory obligations.

OCA St. 1 at 26. Dr. Loube added: “those regulations have not prevented Verizon from competing with other carriers, and they have provided positive benefits to Pennsylvania

³⁸ Verizon specifically identifies the following regulations in its testimony: 52 Pa Code §§ 53.37, 64.11, 64.31, 64.51, 64.61, 64.121, 64.191, 63.51, 64.131, 64.14-24, 63.137, 64.133, as well as changes to its reporting requirements listed in 66 Pa. C.S. § 3015(e). Similarly, Verizon notes its obligation to provide a Bona Fide Retail Request (BFRR) program under 66 Pa. C.S. § 3014 and its obligation to pay a regulatory assessment under 66 Pa C.S. §§ 510 and 511.

consumers.” Id. at 27. Dr. Loubé testified to the benefits that Pennsylvania consumers have realized as a result of regulation of Verizon, noting especially the percentage of availability of high speed data services at certain speeds in Pennsylvania compared to other states. Id. at 28.³⁹

Furthermore, no regulation prohibits Verizon from offering new services at wholly unregulated prices. Dr. Loubé noted that “for example, this Commission did not prevent or hinder Verizon’s offer of its FiOS service.” Id. at 27. Dr. Loubé also testified that “Verizon can change the price of its competitive services such as its Freedom packages without obtaining Commission authorization.” Id. In fact, Chapter 30 provides that “a local exchange telecommunications company may price competitive services at the company’s discretion.” 66 Pa. C.S. § 3015(e)(1). Only a small group of services offered by Verizon are considered “protected” by Chapter 30.⁴⁰ For the great majority of services, Verizon has significant or total pricing flexibility. Tr. at 189-190. Verizon has also earned significant revenues for noncompetitive services. Dr. Loubé noted that “from 2004 to the present, Verizon has increased its basic local exchange rates by more than 20 percent.” OCA St. 1 at 27.⁴¹ This percentage rate increase is greater than the 14 percent increase in consumer price index over the same period. Id. at 27-28 (citation omitted).

³⁹ Dr. Loubé noted that in the 14 states Verizon recently sold its incumbent properties to Frontier, only 62 percent of consumers could purchase high speed data service compared to *** **BEGIN PROPRIETARY** **END PROPRIETARY** *** of Pennsylvanians that can purchase such service. OCA St. 1 at 28 (citations omitted).

⁴⁰ Chapter 30 defines protected service as “(1) service provided to residential consumers or business consumers that is necessary to complete a local exchange call; (2) touch-tone service; (3) switched access service; (4) special access service; and (5) ordering, installation, restoration and disconnection of these services.” 66 Pa. C.S. § 3012.

⁴¹ *Comparing*, Verizon response to OCA interrogatory III-1 to OCA interrogatory III-9.

Yet, in contrast, Verizon was unable to quantify in response to discovery the cost of the supposed asymmetric regulations it seeks to have eliminated as part of any reductions in its intrastate access charges. Id. at 29. Verizon was specifically asked to identify the number of employee hours and the administrative costs associated with their compliance with each of the regulatory obligations they sought to eliminate. Verizon identified neither the number of employee hours nor administrative costs for any of the regulations in response to discovery.⁴² During cross examination, Verizon witnesses were again unable to specifically quantify costs associated with their compliance with the regulations they seek to eliminate. Tr. at 240-246.

Finally, Dr. Loubé noted in his testimony that Verizon actually can benefit in some respects from the asymmetric regulations. Dr. Loubé stated that consumers may favor Verizon services over the services of other companies because they know there are public agencies who will help them resolve any problems if they arise. OCA St. 1 at 29. Dr. Loubé further noted that the application of service quality standards may enhance Verizon's reputation as a carrier that provides reliable service and that Verizon benefits because consumers have a greater comfort level with and are therefore more likely to be chosen over a company with which a consumer has less experience. Id. Dr. Loubé therefore concluded that Verizon's arguments regarding the burdens it faces as a result of asymmetric regulation are not reasonable and should be rejected. Id. at 30.

The Commission should reject Verizon's arguments that its regulatory obligations should be reduced as part of this proceeding, regardless of whether the Commission also determines to reduce Verizon's intrastate access rates. Verizon's arguments have no relevance to this proceeding and should be rejected.

⁴² *Citing*, Verizon responses to OCA II-14, IV-9 and IV-10.

2. A Proper Review Of Verizon's Annual Financial Report Reveals The Company Is Not Experiencing The Financial Deterioration Verizon Claims With Respect To Its Regulated Services.

In its Direct Testimony, Verizon states that its “annual financial reports show significant financial deterioration” for the Company. Verizon St. 1.0 at 19. Verizon makes this argument to support both its positions that its intrastate access rates should not be reduced and that it should be freed from regulatory burdens. As discussed above, while the OCA supports Verizon’s position that its intrastate access rates should not be reduced, the OCA does not support Verizon’s position that it should be freed from its current regulatory obligations. Verizon’s claims of financial deterioration are misstated and should be rejected.

The OCA submits that some of the deficiencies in the financial report relied upon by Verizon include that Verizon has over-allocated certain costs to the state jurisdiction while allocating certain revenue to either the interstate jurisdiction or the non-regulated sector. Dr. Loube concluded that:

After a reasonable re-assignment of cost, the results of the adjusted financial report show that if Verizon is losing money, it is only in the non-regulated sector. In that sector, Verizon is free to compete and its losses, thus, must be due to its inability to secure a greater share of the demand for non-regulated services. While the adjusted state jurisdictional return on investment is low relative to past allowed rates of return, Verizon is no longer regulated on the basis of its rate of return and thus a relatively low but positive rate of return should not be an immediate concern for the Commission.

OCA St. 1 at 30-31.

Dr. Loube further addressed several deficiencies with the financial report presented by Verizon. Dr. Loube testified that “the costs allocated to the state jurisdiction are excessive because, in its Wireline Broadband Order, the FCC has allowed Verizon and other carriers to continue to count costs associated with internet transmission services as regulated costs even

though those services are offered as non-regulated services.” Id. at 31.⁴³ As such, Dr. Loube explained that part of the problem involves the FCC’s “separations” of interstate and intrastate costs. Id. at 31-33. Dr. Loube explained that proper assignment of cost to the non-regulated sector and removing cost associated with non-regulated services substantially reduces the non-regulated rate of return and increases the regulated rate of return. Id. at 33.

Dr. Loube testified that the Commission could require Verizon to do a proper separations allocation, or do one itself, but that such a cost study would be time consuming and burdensome. Id. at 34. Nonetheless, the lack of a proper study should not be used as the basis for Verizon making incorrect claims about financial losses on its state jurisdictional services. Id.

Dr. Loube testified, however, that the Commission should not investigate the impacts of separations rule changes at this time. Id. at 40. Rather, Dr. Loube recommended that the Commission should reject Verizon’s claim of financial deterioration based on the discussion of its annual financial report in its Direct Testimony filed in this proceeding because the claim is not based on valid cost allocation or jurisdictional separations analyses. Id.

Finally, Verizon’s own evidence contradicts the Company’s claim that any financial deterioration results from the regulated portion of its business. An examination of the Income Statements Verizon attached to its Direct Testimony in Exhibit C-1 for the years 2007-2009 and then in Rebuttal Testimony in Exhibit C-1 for 2010 reveals that the affiliated non-regulated companies have been operating with significant financial losses during all of that time. Verizon witness Price recognized during cross examination that those are the net revenues received by Verizon’s affiliate, Verizon Online. Tr. 229-230. Therefore, Verizon’s own evidence

⁴³ Citing, In the Matter of Appropriate Framework for Broadband Access to the Internet over Wireline Facilities, CC Docket No. 02-33, Report and Order and Notice of Proposed Rulemaking, FCC 05-150, released September 23, 2005 (Wireline Broadband Order), ¶ 129.

contradicts its prior testimony that “it makes no sense to presume that Verizon would offer [services] at such a huge loss, as Dr. Loubé’s analysis necessarily presumes.” Verizon St. 1.1 at 15.

As such, the Commission should reject Verizon’s arguments that its regulatory obligations should be reduced as part of this proceeding, regardless of whether the Commission also determines to reduce Verizon’s intrastate access rates. Verizon’s arguments regarding its annual financial reports are flawed and should be rejected.

V. CONCLUSION

WHEREFORE, the Pennsylvania Office of Consumer Advocate respectfully submits that the Commission should not modify Verizon’s intrastate access rates as part of this proceeding. The Commission should reject any arguments to the contrary. Regardless of whether the Commission determines to reduce Verizon’s intrastate access charges, the Commission should not reduce any of Verizon’s regulatory obligations as Verizon has advocated.

Respectfully submitted,



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148037

APPENDIX A

I. PROPOSED FINDINGS OF FACT

A. Introduction.

1. Verizon, the OCA and the Office of Small Business Advocate (“OSBA”) oppose any reduction in intrastate access rates.

2. Dr. Robert Loube is the Vice President of Rolka Loube Saltzer Associates. OCA St. 1 at 1; *see also*, OCA Exh. RL-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. Loube received his Ph.D in Economics from Michigan State University in 1983. *Id.*

3. Verizon’s current composite intrastate access rate is 1.79¢ per minute and Verizon North’s composite intrastate access rates is 1.57¢ per minute. OCA St. 1 at 4. As Dr. Loube testified: “these levels appropriately ensure that access service users of the public switched telephone network share in the costs to maintain and operate that network.” *Id.*

B. Verizon’s Current Intrastate Access Rate Levels Should Not Be Reduced At This Time.

4. Neither the AT&T panel witnesses Nurse and Oyefusi nor Sprint witness Appleby have supported with any evidence their argument that Verizon’s intrastate state access rates are providing a subsidy to basic local service rates. OCA St. 1-R at 2, 12-13.

5. Determining whether a service is providing a subsidy requires an examination of whether the service rate is above the stand-alone cost of providing the service. OCA St. 1-R at 3. For a subsidy to exist, the revenue from a service must be greater than the total stand-alone cost of providing the service. *Id.*

6. None of the parties seeking a change in rates produced a stand-alone cost study for Verizon’s intrastate access rates.

7. The stand-alone cost includes not only the incremental cost of service but also the joint and common cost of providing the service. OCA St. 1-R at 3. Because it is necessary to use the loop to provide access service, that is, it is not possible to complete the state access service without using the local loop, the loop is part of the joint and common cost of state access service. *Id.* Therefore, to determine the stand-alone cost of access service, it is necessary to sum the incremental cost of access and the joint and common loop costs. *Id.*

8. State access rates do not provide a subsidy to basic local service because Verizon has shown that the total revenue from state access service is less than the joint and common loop costs without even considering incremental cost. OCA St. 1-R at 3-4; *citing*, OCA Exh. RL-2.

Therefore, because state access revenue is less than the joint and common loop cost, and joint and common loop cost is less than the stand-alone cost of state access service, it must be true that state access revenue is less than the stand-alone cost of service. Id. at 4. Thus, state access service cannot be providing a subsidy to basic local service or any other service. Id.

9. Verizon's interstate access rates were the result of a settlement and not a particular cost standard. OCA St. 1-R at 4, 14-15. The fact that intrastate access rates are higher than the interstate rates merely supports a claim that intrastate access rates provide a greater contribution to the support of the joint and common costs of the network than interstate access rates do. Id. at 5.

10. The fact that the state access rate is higher than the interstate rate means that the state rate is higher than a settlement rate, not that the state access rate is higher than a particular cost standard and that the state access service is providing a greater contribution to the support of the joint and common network cost than the support provided by the interstate access service. OCA St. 1-R at 4-5.

11. Verizon's interstate access rates are supported by, and may be subsidized by, the federal universal service fund as well as by Verizon's special access services. OCA St. 1-R at 15.

12. AT&T's recognition that the network contains huge amounts of joint and common costs and that that cost must be allocated to all services acknowledges that revenue rate-regulated services exceeds direct cost and therefore, there is no subsidy. OCA St. 1-R at 5-6.

13. If the cost of local service is overstated, as AT&T recognizes, then there is no basis for AT&T claiming that local service is receiving a subsidy or that local rates are artificially low. OCA St. 1-R at 6.

14. AT&T's argument to rebalance rates simply seeks an immediate reduction in AT&T's costs and a corresponding increase in AT&T's profits. OCA St. 1-R at 7.

15. The economic pricing rule that price equals marginal cost does not apply to the telecommunications industry because the telecommunications industry is characterized by high network costs, non-separable cost functions and a large portion of common costs. OCA St. 1-R at 7.

16. Leading economists have noted that if a firm decided to price all goods at marginal costs it would be committing "voluntary suicide." OCA St. 1-R at 8.

17. Verizon should not recover its cost of the public switched telephone network ("PSTN") only from retail (i.e., residential and business) customers because other carriers are customers too and it is therefore reasonable to recover costs from them as well. OCA St. 1-R at 9.

18. Verizon recovers costs from its special access customers who are also wholesale customers as well as when it sells unbundled network elements to competitors and high speed internet service to internet service providers. OCA St 1-R at 12.

19. Nationwide, in 2008, incumbent local exchange carriers (“ILECs”) generated \$32.1 billion in telecommunications services sales to other carriers, \$57.5 billion in telecommunications services to retail customers and \$25.5 billion in sales of non-telecommunications services for total revenues of \$115.3 billion. OCA St. 1-R at 9-10. Thus, wholesale sales represented approximately 28% of total revenue for ILECs, which would have a very negative effect on their profits if eliminated. *Id.* at 10.

20. Text messages and emails use different functionality and therefore the comparison of rates for those services to intrastate access rates is not relevant to this proceeding. OCA St. 1-R at 11.

21. AT&T was unable to quantify either in response to discovery or during cross-examination how much of its share of the intralata toll market AT&T was losing to text messages and emails. Tr. 410-413.

22. When asked if AT&T had delayed or not introduced a new service or not made a new innovation due to Verizon’s high access charges, AT&T could not identify any of its services that had been delayed or any new service that AT&T had not introduced due to Verizon’s high access charges. OCA St. 1-R at 12.

23. When asked if Sprint had delayed or not introduced a new service or not made a new innovation due to Verizon’s access charges, Sprint could not identify any of its services that had been delayed or any new service that Sprint had not introduced due to Verizon’s high access charges. OCA St. 1-R at 12.

24. A mere mathematical exercise alone does not make a rate increase just and reasonable. Any rate changes, no matter what size, must be based on substantial record evidence and must be just and reasonable.

C. Verizon’s Current Intrastate Access Rates Should Be Maintained At Their Current Levels.

25. The incremental cost of service is the difference between the total cost of providing all of the services and the stand-alone cost of providing the services other than the service under investigation. OCA St. 1 at 5.

26. The loop is not a part of the incremental cost of basic service because it is a shared cost of the many services that use the loop such as local service, interstate and intrastate access and toll service as well as the newer data services such as high speed internet service. OCA St. 1 at 5. Even if local service were no longer provided, the carrier would still have to provide the loop in order to provide the other services. *Id.*

27. The contribution from retail basic exchange service customers is the difference between the revenue provided and the incremental cost of local service. OCA St. 1 at 9.

28. Verizon's total revenue for rate regulated services only was *****BEGIN PROPRIETARY** **END PROPRIETARY** *******, of which *****BEGIN PROPRIETARY** **END PROPRIETARY** ******* is the incremental cost of local usage. OCA St. 1 at 9. The revenue from rate regulated services is *****BEGIN PROPRIETARY** **END PROPRIETARY** ******* the incremental cost of service. Id.

29. The amount that access customers contribute to the support of the joint and common costs of the network is *****BEGIN PROPRIETARY** **END PROPRIETARY** ******* or the difference between intrastate access revenue for 2010 of *****BEGIN PROPRIETARY** **END PROPRIETARY** ******* estimate of the incremental cost of access. OCA St. 1 at 10. That estimate is the product of the \$0.002439 reciprocal compensation rates and the intrastate minutes of use. Id. In the case of access service, revenue is only *****BEGIN PROPRIETARY** **END PROPRIETARY** ******* the incremental cost of service. Id.

30. In absolute terms, basic service customers contribute *****BEGIN PROPRIETARY** **END PROPRIETARY** ******* while access customers contribute only *****BEGIN PROPRIETARY** **END PROPRIETARY** ******* OCA St. 1 at 11. On a relative basis, the basic service customers' ratio is *****BEGIN PROPRIETARY** **END PROPRIETARY** ******* compared to access customers' ratio of *****BEGIN PROPRIETARY** **END PROPRIETARY** ******* Id.

31. Because the retail basic exchange customers are carrying such a high share of the burden of supporting the joint and common cost of the network at this time, it is inappropriate to shift more cost to retail basic exchange customers at this time. OCA St. 1 at 11.

32. It would be unreasonable to increase local rates for the purpose of lowering the contribution toward the recovery of joint and common costs received from access service. OCA St. 1 at 13. Because Pennsylvania requires any reductions in access rates to be revenue neutral, the Commission must recognize that the basic local service rate is the most likely source of revenue recovery for any reductions in intrastate access rates. Id. Increases in local rates have direct impacts on universal service. Id.

D. The Verizon Cost Model.

33. Basic local exchange service rates are covering the cost to serve and contributing more than their fair share to the recovery of the joint and common costs of the PSTN. OCA St. 1 at 16.

34. By reducing the dial tone line cost by 50% and entering the 50% reduction into the input tables that Verizon used to determine its margin analysis, and including the federal universal service Interstate Access Support as revenue to basic local exchange service, the adjusted margin analysis shows that there is a positive contribution from basic local exchange

service. OCA St. 1 at 19; *citing*, OCA Exh. RL-2. . On the basis of rate-regulated services, the margin is *** **BEGIN PROPRIETARY** **END PROPRIETARY*****. Id. Including competitive services purchased by rate-regulated basic local exchange service customers, the margin increases to *** **BEGIN PROPRIETARY** **END PROPRIETARY*****. Id.

35. Basic local exchange customers are making a reasonable contribution towards the support of the joint and common costs because those customers are paying for not only their incremental cost but they are also paying for 50 percent of the joint and common costs. OCA St. 1 at 19.

36. Allocating of 50% of the joint and common loop cost to the non-regulated sector is economically arbitrary in the same way that every telephone cost study or financial report that allocates joint and common costs among service is arbitrary. OCA St. 1-S at 2. That is, such an allocation is arbitrary in the sense that it relied on a professional judgment or a policy maker's concerns regarding just and reasonable allocations. Id.

37. Verizon has recognized the arbitrary nature of assigning service-specific costs in comments to the FCC. OCA St. 1-S at 3.

38. Verizon arbitrarily assigns all of the shared network costs to basic local exchange service in its direct testimony. OCA St. 1-S at 3. Only by making such an arbitrary assignment of shared network costs can Verizon assert that basic local exchange service provides a negative return. Id.

39. Most telephone cost studies are arbitrary in that they are based on professional judgments regarding allocations that are buried deep within the confines of the source code and equations of the model, including Verizon's VzCost model. OCA St. 1-S at 3.

40. It would be unreasonable and capricious to retain the old allocation of loop plant given the change in usage of the loop. OCA St. 1-S at 5.

41. All parties to this proceeding recognize the loop plant provides data and video services along with loop services. OCA St. 1-S at 5.

42. If AT&T's proposal to the FCC to allocate 100% of the loop to the interstate jurisdiction were adopted, Verizon's interstate rate of return would *** **BEGIN PROPRIETARY** **END PROPRIETARY***** while its intrastate rate of return would *** **BEGIN PROPRIETARY** **END PROPRIETARY*****. OCA St. 1-S at 8-9.

43. It is reasonable to assign SLC revenue to basic exchange service in the margin analysis calculation because the SLC is an interstate dial tone line charge and does not recover any usage costs associated with toll service. OCA St. 1-R at 9.

E. The Pennsylvania Universal Service Fund.

44. It is necessary to maintain Verizon's current access rates in order to ensure that all users of the public switched network continue to contribute to the support of that network. OCA St. 1 at 21.

45. The first best solution to access reform is to equate all intercarrier compensation rates, both interstate and intrastate, access charge and reciprocal compensation, and so on, to the average of all of those existing rates. OCA St. 1 at 21. Because of the dual jurisdiction of the FCC and the Pennsylvania Commission, it is not possible for the Pennsylvania Commission to unilaterally establish the first best solution. Id.

46. The funds that Verizon pays into the PA USF are not funds that would support Verizon's rate of return or could be used to provide dividends to Verizon stockholders. OCA St. 1 at 23-24. Verizon's contribution to the PA USF is done primarily, if not exclusively, through its use of approximately \$17 million per year of foregone reduction in noncompetitive revenues Verizon would have provided as a result of its 2003 Price Change Opportunity ("PCO") filing made pursuant to its Commission-approved Chapter 30 plan. Id. If Verizon is no longer required to pay into the PA USF, it must apply that \$17 million per year as a reduction to its noncompetitive revenues, which is primarily the basic local service rate. Id.

47. Maintaining Verizon's current access rates will prevent a revenue neutral increase in its local basic exchange rate and allow the Commission to adopt a policy that furthers universal service. OCA St. 1 at 24.

F. The RLEC Access Investigation.

48. In the RLEC proceeding, Dr. Loube proposed reducing the RLEC state access rates if and only if the Commission adopted a comprehensive reform plan. OCA St. 1-S at 14. If the Commission did not adopt the comprehensive reform plan, the existing RLEC access rates should be maintained because retaining existing RLEC access rates was a superior policy choice compared to accepting AT&T's proposed rate rebalancing plan. Id.

49. In the RLEC access investigation, the OCA, through Dr. Loube, presented a comprehensive four-part proposal that included: 1) a reduction in the RLECs' intrastate access rates to interstate levels, 2) an increase in RLEC basic local exchange rates to a benchmark rate that is both affordable and comparable to Verizon's basic local exchange rate, 3) increased funding from the PA USF to ensure that the access reductions were revenue neutral and 4) an expansion of the base of contributors to the PA USF to ensure that all users of the public switched telephone network contribute to the support of that network. *See*, OCA St. 1-S at 14.

50. The AT&T proposal to lower Verizon's intrastate access rates and offset such revenue losses with increases to Verizon's basic local exchange rate would fundamentally change the way the network is supported. OCA St. 1-S at 14. Even though basic local exchange service customers are currently providing most of the support for the network, the AT&T

proposal would dump even more of the network support responsibility on to the basic local exchange service customers. Id.

51. If Verizon cannot receive PA USF support to offset any further reductions in its intrastate access rates, then the reduction in revenue loss would be recovered most likely from Verizon's basic local exchange customers. OCA St. 1-S at 14. In contrast, expanding the base of contributors to the PA USF would further ensure that all users of the PSTN contribute to the support of that network. Id.

52. The FCC adopted the Interstate Access Support (IAS) and Interstate Common Line Support (ICLS) mechanisms as ways to ensure an appropriate source of revenue to carriers when interstate access rates were reduced. OCA St. 1-S at 17.

53. There is an internal universal service fund within Verizon where its urban and suburban customers pay enough money to cover its rural customers. Tr. 345. This is going on within Verizon itself because there's no Pennsylvania Universal Service Fund to support Verizon rural. Id. Rural carriers do not have that source of revenue. Tr. 345.

54. Regulatory arbitrage is the practice of taking advantage of a price differential that exists for virtually the same service in two or more markets. OCA St. 1 at 22.

55. If the Commission does not change Verizon's intrastate access rates as part of this proceeding, the possibility of arbitrage technically remains possible. OCA St. 1 at 22. The potential for arbitrage is greater for rural carriers because there is a much greater difference between the intrastate access rates and interstate access rates for many RLECs. Id. The difference between Verizon's interstate access rates and their intrastate access rates, however, is much less. Id. at 23.

G. Regulatory Obligations.

56. Verizon is the incumbent local telephone provider and has been for decades. OCA St. 1 at 26. As a result, for most of its corporate existence, Verizon operated as a monopoly and received an opportunity to earn regulated returns on its investments and faced no competition. Id. Verizon also has network modernization commitments and other obligations under Chapter 30 of the Public Utility Code. Id.

57. Verizon's regulatory obligations have not prevented Verizon from competing with other carriers, and they have provided positive benefits to Pennsylvania consumers. OCA St. 1 at 27.

58. In the 14 states in which Verizon recently sold its incumbent properties to Frontier, only 62 percent of consumers could purchase high speed data service compared to *** **BEGIN PROPRIETARY** **END PROPRIETARY** *** of Pennsylvanians that can purchase such service. OCA St. 1 at 28 (citations omitted).

59. The Commission did not prevent or hinder Verizon's offer of its FiOS service. OCA St. 1 at 27.

60. Verizon can change the price of its competitive services such as its Freedom packages without obtaining Commission authorization. OCA St. 1 at 27.

61. For the majority of services, Verizon has significant or total pricing flexibility. Tr. at 189-190.

62. From 2004 to the present, Verizon has increased its basic local exchange rates by more than 20 percent. OCA St. 1 at 27. This percentage rate increase is greater than the 14 percent increase in consumer price index over the same period. Id. at 27-28.

63. Verizon was unable to quantify in response to discovery the cost of the supposed asymmetric regulations it seeks to have eliminated as part of any reductions in its intrastate access charges. OCA St. 1 at 29; *see also*, Tr. at 240-246.

64. Consumers may favor Verizon services over the services of other companies because they know there are public agencies who will help them resolve any problems if they arise. OCA St. 1 at 29. The application of service quality standards may enhance Verizon's reputation as a carrier that provides reliable service and that Verizon benefits because consumers have a greater comfort level with and are therefore more likely to be chosen over a company with which a consumer has less experience. Id.

H. Verizon's Annual Financial Reports.

65. After a reasonable re-assignment of cost, the results of the adjusted financial report Verizon submitted in this proceeding show that if Verizon is losing money, it is only in the non-regulated sector. OCA St. 1 at 30.

66. Proper assignment of cost to the non-regulated sector and removing cost associated with non-regulated services in Verizon's financial reports substantially reduces the non-regulated rate of return and increases the regulated rate of return. OCA St. 1 at 33.

67. The lack of a proper study should not be used as the basis for Verizon making incorrect claims about financial losses on its state jurisdictional services. OCA St. 1 at 33.

68. Verizon's 2007-2010 Income Statements reveal that the affiliated non-regulated companies have been operating with significant financial losses during all of that time. Tr. 229-230. Those are the net revenues received by Verizon's affiliate, Verizon Online. Id.

APPENDIX B

II. PROPOSED CONCLUSIONS OF LAW

1. The Pennsylvania Public Utility Commission first reduced Verizon's intrastate access rates as part of the "Global Order" in 1999. Re Nextlink Pennsylvania, Inc., Docket No. P-00991648; P-00991649, 93 PaPUC 172 (September 30, 1999) ("Global Order").

2. The Pennsylvania Public Utility Commission reduced Verizon's intrastate access rates a second time in an earlier phase of this proceeding in 2004. AT&T Communications of Pennsylvania, Inc. v. Verizon North Inc. and Verizon Pennsylvania Inc., Docket No. C-20027195, Opinion and Order (entered July 28, 2004).

3. The joint and common network plant is the plant outside that connects each customer to a central office. Investigation Regarding Intrastate Access Charges and IntraLATA Toll Rates of Rural Carriers and the Pennsylvania Universal Service Fund, Docket No. I-000401015, Order (entered July 18, 2011) ("Rural Access Order") at 11. The plant consists of cables and wires, poles, trenches and conduit, and electronic equipment that is situated in the field. Id. This plant is used to provide all of the services the customer wishes to consume and all of the services that other carriers wish to provide. Id. 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. Id. This plant is not directly assignable to any one service such as access or local exchange or data transport service. Id. None of those services, however, can be provided without it. Id.

4. This Commission has a long-established policy that permits the recovery of such costs from *all* users of such joint and common telecommunications plant and facilities, and not by end-users of regulated telecommunications services alone. Rural Access Order at 12, 104, 118, 120, 178.

5. State and federal laws seek to ensure the universal provision of basic local telecommunications services which is best accomplished by ensuring that all users of the PSTN pay their fair share. 47 U.S.C. § 254; 66 Pa. C.S. § 3011(2).

6. There is no guarantee that any benefit from a reduction in intrastate access rates would ever reach any basic local exchange customers. Rural Access Order at 104.

7. The FCC has been examining intercarrier compensation issues, including intrastate access charges, since at least 2001. *See e.g.*, 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. Section 3017(a) of the Public Utility Code provides: "**(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).

9. Verizon's interstate access rates were the result of a settlement and not a particular cost standard. Access Charge Reform, Sixth Report and Order, CC Docket Nos. 96-

262 and 94-1, Report and Order, CC Docket No. 99-249, Eleventh Report and Order, CC Docket No 96-45, 15 FCC Rcd 12962 (2000) (subsequent history omitted)(“CALLS Order”).

10. The cost of the loop is not incremental to basic exchange service because the loop is also required to provide multiple services. Motion of Vice Chairman James H. Cawley, Docket Nos. C-20077332 and C-20066987, August 7, 2008.

11. Joint and common facilities and plants enable not only the provision of various local and long-distance telecommunications services by a number of entities, but they also facilitate retail broadband services to the Internet and various data and communications services. Rural Access Order at 12. *See also*, Rural Access Order at 122, 143-44.

12. The cost of the local loops and their associated line cards in local switches are common with respect to interstate access service and local exchange service, because once these facilities are installed to provide one service, they are able to provide the other at no additional cost. In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, First Report and Order, FCC 96-325 (rel. Aug. 8, 1996) at ¶ 678; *see also*, In the Matter of High Cost Universal Service Support, Further Notice of Proposed Rulemaking, WC Docket No. 05-337 (rel. Nov. 5, 2008), App. A at ¶ 247 (“a copper loop can be used to provide analog voice service as well as data service using DSL technology. The cost of the loop is therefore common to both voice and DSL services.”).

13. Chapter 30 of the Public Utility Code provides that it is the policy of this Commonwealth to “maintain universal telecommunications services at affordable rates.” 66 Pa. C.S. § 3011(2).

14. The federal Telecommunications Act of 1996 provides that “quality services should be available at just, reasonable and affordable rates.” 47 U.S.C. § 254(b)(1).

15. The Federal Communications Commission was 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.

16. Non traffic sensitive network costs are properly characterized as joint and common costs, and this Commission has a long-established policy that permits the recovery of such costs from all users of such joint and common telecommunications plant and facilities, and not by end-users of regulated telecommunications services alone. Rural Access Order at 12. Joint and common facilities and plant enable not only the provision of various local and long-distance telecommunications services by a number of entities, but they also facilitate retail broadband access to the internet and various data and communications services. Id.

17. Although it is intuitive that RLEC intrastate carrier access charge revenues obviate the need for increased basic local exchange rates, thus assisting the maintenance of affordable universal service for the RLECs’ end-users, the issue of who pays and by how much

for the RLECs' joint and common non-traffic sensitive network costs is one of preserving a sound balance among various objectives of regulatory policy.

18. It is unclear whether potential reductions in the intrastate carrier access charges of the RLECs will fully inure to the benefit of Pennsylvania end-user consumers of long-distance services. Rural Access Order at 104.

19. The long-established principle and regulatory policy of this Commission, which has been upheld upon appellate review, is that the rural incumbent local exchange carriers' intrastate carrier switched access service non-traffic sensitive joint and common costs primarily associated with the RLECs' local loop plant must be recovered from all users of the RLECs' network. Rural Access Order at 118.

20. The recovery of the non-traffic sensitive joint and common costs of the rural incumbent local exchange carriers' intrastate carrier access services will not be borne by end-user consumers alone. Rural Access Order at 120. Instead, such recovery is shared by all those who use the RLECs' network. Id.

21. Section 254(k) of the federal Telecommunications Act of 1996 requires that services included in the definition of universal service "bear no more than a reasonable share of the joint and common costs of facilities used to provide those services." 47 U.S.C. § 254(k).

22. Chapter 30 provides that "a local exchange telecommunications company may price competitive services at the company's discretion." 66 Pa. C.S. § 3015(e)(1).

23. Chapter 30 defines protected service as "(1) service provided to residential consumers or business consumers that is necessary to complete a local exchange call; (2) touch-tone service; (3) switched access service; (4) special access service; and (5) ordering, installation, restoration and disconnection of these services." 66 Pa. C.S. § 3012.

24. In its Wireline Broadband Order, the FCC has allowed Verizon and other carriers to continue to count costs associated with internet transmission services as regulated costs even though those services are offered as non-regulated services. In the Matter of Appropriate Framework for Broadband Access to the Internet over Wireline Facilities, CC Docket No. 02-33, Report and Order and Notice of Proposed Rulemaking, FCC 05-150, released September 23, 2005 (Wireline Broadband Order), ¶ 129.

APPENDIX C

III. PROPOSED ORDERING PARAGRAPHS

1. The formal complaint filed by AT&T Communications of Pennsylvania, Inc. against Verizon North, Inc. and Verizon Pennsylvania, Inc. at docket number C-20027195 is hereby DISMISSED.

2. No further reductions to Verizon North, Inc. or Verizon Pennsylvania, Inc.'s intrastate access rates will be made at this time.

3. This matter shall be marked CLOSED.

148045

CERTIFICATE OF SERVICE

Re: AT&T Communications of Pennsylvania, Inc. v. Verizon North Inc. and Verizon Pennsylvania, Inc.,
Docket No. C-20027195

I hereby certify that I have this day served a true copy of the foregoing document, Office of Consumer Advocate's Main Brief, 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 16th day of August 2011.

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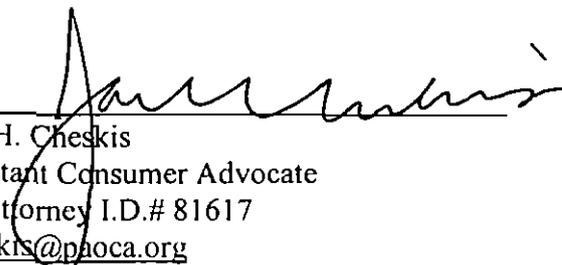
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