

Suzan DeBusk Paiva  
Assistant General Counsel  
Law Department



Verizon Pennsylvania Inc.  
1717 Arch Street, 10W  
Philadelphia, PA 19103

Tel: (215) 466-4755  
Fax: (215) 563-2658  
Suzan.D.Paiva@Verizon.com

**ORIGINAL**

August 17, 2005

Via UPS Overnight Delivery  
James J. McNulty, Secretary  
Pennsylvania Public Utility Commission  
Commonwealth Keystone Building  
400 North Street, 2<sup>nd</sup> Floor  
Harrisburg, PA 17120

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**AUG 17 2005**

**PA PUBLIC UTILITY COMMISSION  
SECRETARY'S BUREAU**

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

Dear Secretary McNulty:

Enclosed please find the original and nine copies of the Main Brief on Remand of Verizon Pennsylvania Inc. and Verizon North Inc. in reference to the above captioned matter. In addition, an electronic copy of the Brief, in Word, is being provided. Please note that the Brief contains proprietary information, and that an Expurgated copy of the Brief also is enclosed.

Please do not hesitate to contact me if you have any questions.

Very truly yours,

Suzan DeBusk Paiva

SDP/slb  
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Via E-Mail and UPS Overnight Delivery  
cc: Honorable Cynthia W. Fordham  
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BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

AT&T COMMUNICATIONS OF  
PENNSYLVANIA, LLC,

v.

VERIZON NORTH INC.

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Docket No. C-20027195

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MAIN BRIEF ON REMAND OF VERIZON PENNSYLVANIA INC.  
AND VERIZON NORTH INC.

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EXPURGATED VERSION  
**ORIGINAL**

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AUG 19 2005

William B. Petersen  
Suzan DeBusk Paiva  
1717 Arch Street, 10W  
Philadelphia, PA 19103  
Phone (215) 466-4755  
Fax (215) 563-2658  
[william.b.petersen@verizon.com](mailto:william.b.petersen@verizon.com)  
[Suzan.d.paiwa@verizon.com](mailto:Suzan.d.paiwa@verizon.com)

Counsel for Verizon  
Pennsylvania Inc. and  
Verizon North Inc.

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SECRETARY'S BUREAU

Date: August 17, 2005

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## I. INTRODUCTION

In this access remand proceeding no party has presented any compelling reason to rush to implement additional access rate reductions (and potential end-user rate increases) for Verizon Pennsylvania Inc. and Verizon North Inc. (“Verizon”) without waiting for the Federal Communications Commission (“FCC”) to complete its pending intercarrier compensation proceeding.<sup>1</sup>

That FCC case – which has been fully briefed and is awaiting FCC action – proposes to reform comprehensively *all* intercarrier compensation, including the very same intrastate access rates that are at issue in this remand proceeding. The FCC is considering whether to preempt this Commission’s jurisdiction over intrastate access charges entirely. At the very least, the FCC’s decision will provide guidance to the states as to whether and how they should alter intrastate access rates. In fact, interexchange carriers (“IXCs”) Qwest, AT&T and MCI – the same parties that are asking this Commission to forge ahead with access rate reductions and retail rate increases now, and to ignore the FCC proceeding – are at the same time urging the FCC to preempt this Commission’s jurisdiction over intrastate access charges.

If there was any doubt that the best course for Pennsylvania customers is to defer any substantive consideration of further intrastate access rebalancing for the Verizon companies until the FCC completes its open proceeding addressing the same subject, that doubt was laid to rest last week with the Commission’s unanimous adoption of Vice

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<sup>1</sup> *In the Matter of Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92 (FNPRM Rel. March 3, 2005).

Chairman Cawley’s Motion in the rural carriers’ access proceeding.<sup>2</sup> The Commission determined, over the IXCs’ strenuous objections, to stay that investigation – in which the Commission was considering further access rate rebalancing for all Pennsylvania incumbent local exchange carriers (“ILECs”) other than the Verizon companies. The Commission issued a stay to last for a period not to exceed twelve months, or until the FCC issues its ruling in the intercarrier compensation proceeding. The Commission also stated that it would entertain further requests for a stay beyond the twelve months “for the purpose of coordinating this Commission’s actions with the FCC’s ruling in its *Unified Intercarrier Compensation* proceeding.” (*Id.* ¶ 5). The Commission noted that if the investigation resumed after the FCC’s ruling, the parties would be given further due process opportunities to supplement the evidentiary record. (*Id.* ¶ 8).

There is no reason why the result should be different in this access proceeding. In this case not only Verizon, but all three of the public parties – the Office of Trial Staff (“OTS”), Office of Consumer Advocate (“OCA”) and Office of Small Business Advocate (“OSBA”) – have advised the Commission to await the outcome of this FCC proceeding and not to make any specific recommendations regarding access rate rebalancing for the Verizon companies at this time.

Not only has the Commission now issued clear direction that its intrastate access rulings must wait for and be “coordinated” with the FCC proceeding, but the record developed in this remand also demonstrates *no* offsetting benefit to end user customers in Pennsylvania from precipitously rushing to implement access reductions and end-user rate

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<sup>2</sup> *Investigation Regarding Intrastate Access Charges and IntraLATA Toll Rates of Rural Carriers, and the Pennsylvania Universal Service Fund*, No. I-00040105 (Motion of Vice-Chairman Cawley adopted 5-0 on August 11, 2005) (Attached hereto as “Exhibit A”).

increases now and without waiting for the FCC to rule, as the IXCs demand. While it may advance the IXCs' own corporate financial interests to vigorously litigate to reduce their own access costs, these companies do not represent the best interests of Pennsylvania consumers, and it is this public interest that the Commission must consider in deciding what to do at this stage of the proceeding. Having already benefited from *approximately \$140 million* in direct cost savings from Verizon through intrastate access reductions in Pennsylvania since the *Global Order*,<sup>3</sup> these IXCs have not demonstrated how customers in Pennsylvania have benefited, or that there is any urgency or great consumer benefit to be gained from further rate rebalancing at this time.

In favor of immediate rate rebalancing, Qwest, AT&T and MCI raise their same time-worn arguments: they vaguely claim that reducing their own intrastate access costs will somehow result in lower toll rates for end-users or enhance competition in the toll market – a market that the Commission has already recognized is highly competitive. But there is no concrete evidence on the record in this proceeding to show that toll rates in Pennsylvania have decreased as a result of the last rebalancing, or will decrease if access rates are lowered again. Also, no party has produced any evidence to contradict what this Commission itself found years ago – that “IXCs are setting their rates on a national level using flat rates that have *no relationship with the access rates of any specific ILEC*,” so

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<sup>3</sup> See VZ St. 1.1 Remand (Kane/Dean Rebuttal) at 12. First, in compliance with the *Global Order* Verizon PA made approximately \$89 million in annual access revenue reductions without raising end-user rates, keeping those reductions revenue-neutral through the application of Verizon PA's Price Cap Mechanism. Of course, had Verizon not decreased intrastate access rates it could have used those PCOs to reduce other noncompetitive rates. As a second step, Verizon reduced access rates by another \$50 million as a result of the OCA/OSBA/Verizon settlement approved in Phase I, keeping the reductions revenue neutral through a combination of PCO offsets and end-user rate increases. *Id.*

that access reductions are not necessary to spur toll competition.<sup>4</sup> Given the IXCs' recognized national pricing strategies, any isolated decrease in Pennsylvania intrastate access rates at this time would be, at best, spread over the entire country *with minimal to no impact on Pennsylvania end users.*<sup>5</sup> Under Pennsylvania statute, however, Verizon's lost revenue from such access reductions must be off-set directly by *immediate and certain increases to retail end-user rates* in Pennsylvania. See 66 Pa. C.S. § 3017. In short, the prospects for toll rate decreases or other benefits are remote, at best, while the off-setting retail rate increases are a certainty.

Given the Commission's stated desire to coordinate its own access decisions with the outcome of the FCC proceeding, and the fact that the IXCs have not demonstrated any public benefit from rushing to judgment here, the Commission should not calculate or require any specific access reductions or end-user rate increases at this time. Thus, there is no reason to reach the specific arguments about the proposed amounts of such access reductions and rate increases. If the Commission does reach the merits of these arguments, however, then it must do so with a full understanding of the misstatements and flaws in the other parties' calculations and arguments.

Advancing their own agendas, the IXCs misconstrue the applicable law. They wrongly suggest that the Commission somehow preordained that further access reductions *must* occur now, and that access rates must be set at or close to cost. A plain reading of the Commission's Phase I orders shows that it directed the ALJ to consider and make a recommendation on "the merits of *each* of the Parties' positions," (7/28/04 Order at 19, 25)

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<sup>4</sup> *Implementation of the Telecommunications Act of 1996: Imputation Requirements for the Delivery of IntraLATA Services by Local Exchange Carriers*, No. M-00960799 (Opinion and Order entered January 29, 2002) at 14 (emphasis added).

<sup>5</sup> VZ St. 1.1 Remand (Kane/Dean Rebuttal) at 4.

(emphasis added), and that it also directed the ALJ to consider the impact of the FCC proceeding. (01/18/05 Order at 14). The “position” that the ALJ should find has the most merit in light of present circumstances is that Verizon’s access rates – which have already been subject to substantial reductions since the *Global Order* and which are considerably lower than those of most other Pennsylvania ILECs – should continue to be priced as they are, for the present time. The record shows that Verizon incurs substantial costs, not only to serve each retail end user and access customer, but also to fulfill its obligations to provide basic residential exchange service at rates that are below-cost and to deploy facilities ubiquitously in order to serve as carrier of last resort. Those expenses must be recovered in rates, and no party has demonstrated an immediate need to restructure how they are presently being recovered. Contrary to the IXCs’ persistent refrain that “subsidies” must immediately be eliminated and access should be priced at “cost,” the Commonwealth Court had ruled that it is well within this Commission’s discretion to determine that carrier access charges, like rates for all other services, should continue to be priced *above* cost to help defray the costs of providing affordable and universal service.<sup>6</sup>

The IXCs and other parties also misstate the facts to advance their own positions on access pricing. For example, they understate Verizon’s cost of providing access to IXCs, misrepresent the effects of the Phase I rate rebalancing and attempt to spread any rate increases over lines that could not possibly absorb them, in violation of the statutory mandate for true revenue neutrality. The Commission should reject all of these arguments.

Accordingly, the ALJ should recommend that no further access rebalancing for the Verizon companies is warranted at this time.

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<sup>6</sup> See, e.g., *Bell Atlantic-Pennsylvania, Inc. v. Pennsylvania Public Utility Commission*, 763 A.2d 440, 480 (Pa. Commw. 2000).

## II. FACTUAL BACKGROUND

### A. Access Pricing Background

This proceeding relates to the switched access rates that IXCs pay to local exchange carriers Verizon PA and Verizon North for originating and terminating intrastate long distance traffic on the facilities of these Verizon companies. After the break-up of AT&T, access charges developed as a means for the IXCs to pay for the use of local facilities through “originating access” payments to the local telephone company serving the customer placing the long distance call and “terminating access” payments to the local telephone company serving the customer receiving the call (which may or may not be the same local telephone company). The IXCs pay “interstate” access rates where the calls in question cross state lines. Those rates are exclusively within the jurisdiction of the Federal Communications Commission (“FCC”) and are not at issue here. The IXCs pay “intrastate” access rates where the calls remain within the state, but are not local calls but rather intrastate toll calls. Intrastate access rates are governed by this Commission and are the rates that are the subject of this proceeding.<sup>7</sup>

Historically in Pennsylvania and throughout the nation, the pricing of access has not been tied to the cost of providing this service. As this Commission recognized in the *Global Order*:

[a]ccess charges provide a significant source of ILEC earnings and contain implicit and explicit subsidies for local rates. This combination of earnings and subsidy was approved pursuant to a public policy of encouraging universally available and relatively affordable telecommunications services . . . . Access charges provide a source of earnings while keeping basic local service rates lower than might otherwise be the case in high cost areas.<sup>8</sup>

<sup>7</sup> VZ Phase I St. 1.0 (Berry/Wirl Direct) at 4-5.

<sup>8</sup> *Joint Petition of Nextlink Pennsylvania, Inc.*, No. P-00991648-1649 (Opinion and Order entered September 30, 1999) (“*Global Order*”) at 11.

The Commission further noted that the “combined subsidies” from access rates and other services “is what have helped keep basic local exchange service rates in Pennsylvania at an affordable level over the years.”<sup>9</sup>

In 1997, this Commission instituted a generic investigation to examine the costs and pricing structure of intrastate access charges. This generic access investigation became part of the Global proceeding, and the Commission resolved the issues in its September 1999 *Global Order*. There, the Commission relied upon Judge Schnierle’s Recommended Decision and stated that its goal with regard to access pricing was to “take the necessary steps to strive to replace the system of implicit subsidies with ‘explicit and sufficient’ support mechanisms to attain the goal of universal service in a competitive environment.”<sup>10</sup> The *Global Order* also stated the Commission’s intent to open a further investigation of statewide access charges, and required Verizon PA to reduce its intrastate access charges by \$89 million annually – which Verizon PA subsequently did.<sup>11</sup>

Before the Commonwealth Court, AT&T faulted the Commission’s *Global Order* for failing to reduce access rates to “cost.”<sup>12</sup> The Court held that the Commission was *not* required to reduce access rates to “cost,” but rather, it is within this Commission’s sound discretion to determine where to draw the line at which access rates subsidize other costs. The Court cautioned the Commission to consider *all relevant interests* in drawing that line:

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<sup>9</sup> *Global Order* at 13, n. 9; *see also Global Order* at 15, n. 10 (“residual pricing is a tariff pricing mechanism used by utility regulators in the monopoly environment in which access and toll rates, as well as vertical local services, are priced at rates well above their costs, but at prices that the market will bear, in order to keep basic local exchange telephone service rates affordable.”)

<sup>10</sup> *Global Order* at 26-27.

<sup>11</sup> VZ Phase I St. 1.0 (Berry/Wirl Direct) at 6.

<sup>12</sup> *Bell Atlantic-Pennsylvania, Inc. v. Pennsylvania Public Utility Commission*, 763 A.2d 440, 480 (Pa. Commw. 2000).

One of the lessons of this proceeding is that the cost of excessively priced elements must be reduced to a point nearer to actual incremental cost, but not so greatly as to eliminate the support such revenue provides to other areas of the system that need that support.<sup>13</sup>

As the Commonwealth Court noted, “[t]he record here confirms the soundness of the PUC’s view, based on evidence from consumer witnesses, that users of all services, including access, should share in the payment of total network costs, with the cost of the local loop included as an element of that total network.”<sup>14</sup> The Court noted that the PUC would continue to evaluate access pricing in future proceedings.

### **B. History Of This Proceeding**

On December 30, 2002 Verizon filed the petition that opened this access pricing proceeding, in order to fulfill its commitment under the Commission’s November 4, 1999 Order approving the Bell Atlantic/GTE merger to propose statewide access rates for Verizon PA and Verizon North. Earlier, on March 20, 2002, AT&T had filed a formal Complaint against Verizon North, demanding that Verizon North’s access charges be reduced to a level “no higher” than Verizon PA’s due to the fact that they were now owned by the same company. These proceedings were consolidated at the above-captioned docket.

Based on the record developed in Phase I of this proceeding, by Order entered July 28, 2004 this Commission approved a rate rebalancing for the Verizon companies that resulted in annual cost savings to the IXCs through substantial access rate reductions of approximately \$50 million. Those reductions were offset with retail rate increases to Verizon basic exchange customers. The rebalancing resulted in uniform access rates and rate structure for the two Verizon companies and reduced the IXC-portion of Verizon

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<sup>13</sup> *Id.*

<sup>14</sup> *Id.*

North's Carrier Charge from \$7.40 per line per month to equal Verizon PA's Carrier Charge of \$0.58.<sup>15</sup>

As a result of the rebalancing, the revenue that IXCs pay to Verizon through access rates decreased significantly by approximately \$50 million.<sup>16</sup> Although the access revenue reduction resulted from the reduction of Verizon North's access rates (primarily its Carrier Charge), the Commission minimized the impact of the revenue neutral offset to retail end users by spreading the recovery over the end-user lines of both Verizon companies. The increase to non-package residential and business monthly dial tone line rates was \$0.80. Both the access decreases and the retail rate increases took effect in February of 2005.<sup>17</sup>

Even before the rebalancing, Verizon PA's access rates were among the lowest in the state. After the substantial reduction to Verizon North's rates, the current intrastate access rates for both Verizon North and Verizon PA are among the very lowest ILEC access rates in the state. The majority of other Pennsylvania ILECs have Carrier Charges many multiples of Verizon's \$0.58 carrier charge. For example, there are several ILECs with Carrier Charge rates over \$10.00.<sup>18</sup> The larger Pennsylvania ILECs still have significantly higher Carrier Charges than Verizon PA and Verizon North. According to their tariffs, Sprint's Carrier Charge is \$7.19, Alltel's is \$4.88 and Commonwealth's is \$7.00.<sup>19</sup>

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<sup>15</sup> VZ St. 1.0 Remand (Kane Direct) at 9 and Exhibit Kane-1.

<sup>16</sup> These figures are based on an updated estimate using actual volumes through August 2004. See VZ St. 1.0 Remand (Kane Direct) at 9, n. 2.

<sup>17</sup> VZ St. 1.0 Remand (Kane Direct) at 10.

<sup>18</sup> For example, based on their publicly available Pennsylvania Telephone Association (PTA) access tariff, Palmerton has a Carrier Charge of \$11.28, South Canaan has a Carrier Charge of \$11.35, Citizens of Kecksburg has a Carrier Charge of \$11.18, Yukon Waltz has a Carrier Charge of \$11.45, Armstrong PA has a Carrier Charge of \$15.11 and Ironton has a Carrier Charge of \$17.99. *Id.* at 10, n. 3.

<sup>19</sup> *Id.* at 10-11.

The July 28, 2004 Order also remanded to the OALJ “for the further development of the record and the issuance of a recommended decision concerning those policy issues and other access charge concerns that were raised by the IXCs in their Exceptions but which were not specifically resolved by a recommendation in this instant proceeding.” (07/28/04 Order at 16-17). Those issues “include, but are not limited to, AT&T’s two-step access charge reduction proposal, the removal of all implicit subsidies from access charges, the reduction and possible elimination of the Carrier Charge.” (7/28/04 Order at 17). In other words, the Commission directed the ALJ to make a recommendation on the question of whether there should be further access rebalancing at this time, but did not pre-judge the answer to that question.

In a January 18, 2005 Order, the Commission denied the IXCs’ request that the Commission itself decide the need for further access rate rebalancing without a remand to the OALJ for further development of the record, and also denied the IXCs’ request to direct the OALJ to “expedite” the remand. In the January 18 Order, the Commission recognized the potential impact on this remand proceeding of new developments in the federal arena, and expanded the scope of the remand, noting that “[w]e are especially concerned about any impact that the proposed ICF [Intercarrier Compensation Forum] proposal, if it is ultimately approved by the FCC, may have jurisdictionally on access charge regulation in Pennsylvania, our ability to further reduce or restructure intrastate access charges, and whether any FCC action may lead to a double recovery by the LECs in Pennsylvania in light of the remanded proceeding, and if the FCC permits intrastate access charges to be offset by increases to the federal SLC.” The Commission therefore expanded the scope of this Phase II remand proceeding to “address[] the impact the FCC action may have on our

jurisdictional responsibilities, as well as its relationship to the final recommended decision on access rates arising from this remand proceeding.” (1/18/05 Order at 14).

### C. The FCC Intercarrier Compensation Proceeding

As the Commission has already recognized, the FCC has embarked upon its own investigation of intercarrier compensation that may impact intrastate access charges and constrain the Commission’s actions on this remand. This FCC proceeding has progressed since the Commission issued its January 18 Order. Specifically, on March 3, 2005 the FCC issued its Further Notice of Proposed Rulemaking (“FNPRM”) in its investigation of intercarrier compensation that was referred to in this Commission’s Order.<sup>20</sup> Comments were filed on May 23, 2005 and Reply Comments were filed on July 20, 2005. While the FCC has not set a deadline for its own action, statements by individual Commissioners have urged that the FCC reach a resolution by the end of this year.<sup>21</sup>

The FNPRM seeks comments from the industry on a number of issues that could impact the very same intrastate access charges that are the subject of this proceeding and could alter or eliminate this Commission’s jurisdiction over these issues. For example, the FCC seeks comments on its own legal authority to reform intrastate compensation mechanisms that have traditionally been handled by state commissions. (¶35, 80, 82). The FCC notes that some of “the industry proposals call for a cooperative process between the Commission and states,” which if implemented would have to be accounted for in the result

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<sup>20</sup> *In the Matter of Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92 (Rel. March 3, 2005).

<sup>21</sup> For example, when the FCC announced its FNPRM, FCC Commissioner Copps issued a statement that “[i]ntercarrier compensation is a must-do item for this Commission this year. It should be our number one telecommunications priority.” *See also Speech of Commissioner Copps to Federal Communications Bar Association*, TR Daily, March 28, 2005. VZ St. 1.0 Remand (Kane Direct) at 11, n.5.

of this proceeding. (¶ 81). It specifically asks the parties to comment on whether the FCC has authority to replace intrastate access regulation with some alternative mechanism. (¶79). The FCC also asks the parties to address the question of how it might offset any revenues lost from reductions to intrastate access rates, including the possibility of subscriber charges and universal service funding, (¶114), and whether the FCC should create a federal mechanism to offset any lost intrastate revenues, or whether the states should be responsible for establishing *alternative cost recovery mechanisms* for LECs within the intrastate jurisdiction. (¶115).

Approximately 100 parties filed comments on May 23, 2005. Verizon in its comments endorsed the use of commercial agreements between interconnecting carriers as the preferred long-term solution to the complex issues associated with the current intercarrier compensation mechanisms. However, if the FCC were to require an interim plan to transition from access *tariffs* to commercial agreements, Verizon provided certain critical principles/criteria that any transitional intercarrier compensation default rules must satisfy to be acceptable. Verizon did not support adoption of any of the plans included in the FCC's FNPRM since none of the plans satisfied all of the principles/criteria specified in its Comments.<sup>22</sup>

AT&T, MCI and Qwest – the large IXC's that have demanded further access rebalancing through this remand – all filed comments before the FCC on May 23, 2005. AT&T and MCI are members of the Intercarrier Compensation Forum (“ICF”). The ICF comments are attached as Exhibit Kane-3 to Verizon St. 1.0 Remand. Qwest filed its own comments, which are attached as Exhibit Kane-4 to Verizon St.1.0 Remand.

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<sup>22</sup> See VZ St. 1.0 Remand (Kane Direct) Exhibit 2.

### III. ARGUMENT

#### A. The Commission Should Refrain From Further Action On Access Rates Until Completion Of The FCC's Intercarrier Compensation Proceeding, As It Has Done With The Other ILECs' Access Proceeding

The IXCs demand that the Commission rush to consider additional Verizon access rate rebalancing in isolation, ignoring the pendency of the FCC's intercarrier compensation proceeding, in which the FCC may assume jurisdiction over the very same intrastate access rates that are the subject of this proceeding, or at the very least will provide some guidance as to how the states should reform their access rates to comport with the FCC's overall policy toward intercarrier compensation.<sup>23</sup> The suggestion that the Commission should simply implement more access reductions and end user rate increases immediately, without recognizing the impact of this simultaneous FCC proceeding is plainly contrary to the Commission's own holdings and is not in the public interest.

First, in its January 18, 2005 Order in this proceeding, the Commission expanded the scope of this Phase II remand to "address[] the impact the FCC action may have on our jurisdictional responsibilities, as well as its relationship to the final recommended decision on access rates arising from this remand proceeding." (1/18/05 Order at 14). The recommended decision on remand thus must address the impact of the FCC proceeding on this matter, including whether it is in the public interest to await a ruling from the FCC.

Second, in the motion unanimously adopted last week in the other Pennsylvania ILECs' access case, the Commission stayed that proceeding for at least 12 months "for the purpose of coordinating this Commission's actions with the FCC's ruling in its *Unified Intercarrier Compensation* proceeding."<sup>24</sup> The Commission stayed that proceeding over the

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<sup>23</sup> Verizon St. 1.0 Remand (Kane Direct) at 12.

<sup>24</sup> *Investigation Regarding Intrastate Access Charges and IntraLATA Toll Rates of Rural*

IXCs' vehement objections, making essentially the same arguments about the rural carriers' access charges that they make here about Verizon's access charges. In a joint filing, Qwest, AT&T and MCI opposed the stay of the other access proceeding, arguing that "it may take years for the FCC to finalize its actions. There is no reason for this Commission to delay taking action in Pennsylvania on these critical issues at this time."<sup>25</sup> They argued that "the Commission knew about the existence of the FCC intercarrier compensation rulemaking when it opened this proceeding, and that "the Commission should move swiftly to take the next step on access charge reform."<sup>26</sup> The Commission rejected all of these arguments and determined nonetheless to stay the access case for the other ILECs. The Commission did so even though, as the record in this proceeding demonstrates, the other Pennsylvania ILECs' access charges are in large part much higher – in many instances substantially higher – than Verizon's.<sup>27</sup>

The public parties – the OCA and the OSBA – agree that the Commission should also defer any further Verizon access rate rebalancing to await the FCC's order.<sup>28</sup>

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*Carriers, and the Pennsylvania Universal Service Fund*, No. I-00040105 (Motion of Vice-Chairman Cawley adopted 5-0 on August 11, 2005) ¶ 5 (Attached hereto as "Exhibit A").

<sup>25</sup> *Investigation Regarding Intrastate Access Charges and IntraLATA Toll Rates of Rural Carriers and the Pennsylvania Universal Service Fund*, No. I-00040105, Answer of Qwest, etc., to Motion to Defer, filed June 3, 2005 at 7.

<sup>26</sup> *Id.* at 4, 5.

<sup>27</sup> See, e.g., VZ St. 1.0 Remand (Kane Direct) at 10-11.

<sup>28</sup> See OCA St. 1R (Loubé Dir.) at 29 ("I recommend that the Commission forbear any action in the current proceeding until the FCC has issued its order in the intercarrier compensation docket."); OSBA St. 1 Remand (Buckalew Dir.) at 5 ("Changes to intrastate access charges at this time are not justified, either based on costs . . . or given the fact that the FCC may soon change the entire structure for access charges.")

The IXCs' contention that this Commission should rush ahead and ignore the fact that these same intrastate access rates are also being considered is directly contrary to what the IXCs have been arguing to the FCC. While these carriers are demanding immediate action by this Commission with regard to intrastate access rates and have resisted every effort to establish a schedule that would allow the Commission to await the outcome of the FCC proceeding, they are simultaneously arguing to the FCC that the FCC should assume jurisdiction over intrastate access rates and preempt this Commission. AT&T and MCI argue that the FCC should "preempt intrastate access regimes *in toto*," and that "every intrastate intercarrier compensation mechanism across the country must be made identical, not just to each other, but to the federal system as well." (Verizon St. 1.0 Remand, Exhibit 3, ICF Comments at 76). Similarly Qwest argues that "[t]he FCC has plenary jurisdiction over" state access charges and, if necessary, the FCC also "has the authority to preempt state access charges." (Verizon St.1.0 Remand, Exhibit 4, Qwest Comments at 5). Qwest argues that all access payments should "be subject to federal jurisdiction," which "includes replacement of intrastate access tariffs . . . with the charging structure described herein." (Id.). If the FCC accepts these arguments, all of the Commission and party efforts expended in this case could be wasted because the Commission will lose its authority over intrastate access rates.

While the IXCs are insisting that this Commission take action immediately and that the matter is so urgent that the Commission cannot even wait for the outcome of the FCC proceeding, which could be concluded this year, they are not demanding the same rushed process from the FCC. Rather, the AT&T/MCI plan allows a phase-down with three years to achieve a single termination rate for all traffic, and then a transition period where this uniform rate is gradually reduced to "shift[] cost recovery to end users" culminating in a bill

and keep regime as of July 1, 2011. (Verizon St. 1.0 Remand, Exhibit 3, ICF Comments at 6 and Appendix C at 6). Qwest also allows for a transition period of three years. (Verizon St. 1.0 Remand, Exhibit 4, Qwest Comments at 7). Since they are willing to have the FCC assume jurisdiction over intrastate access rates and take from three to six years to reduce them, then their claims that it is urgent for this Commission to act immediately without awaiting the outcome of the FCC case lack credibility. Moreover, while the IXCs are urging this Commission to get ahead of the FCC on this issue, they are also urging the FCC to take “rapid and decisive action,” (Verizon St. 1.0 Remand, Exhibit 4, Qwest Comments at 1), which only increases the likelihood that the efforts before this Commission will be wasted.

In support of their argument that the Commission should rush ahead and reduce Verizon’s intrastate rates without waiting for the FCC, the IXCs contend that the level of Verizon’s intrastate rates is impeding their ability to compete for toll customers against carriers providing bundled plans, including wireless carriers (which as discussed in other sections, below, is not supported). Even if these claims had some merit, however – which they do not – as Verizon explained in its comments to the FCC, only a comprehensive solution by that agency that covers both interstate and intrastate rates nationally will remedy the concerns over the disparity in intercarrier compensation rates for different types of traffic subject to different jurisdictions.<sup>29</sup> A limited reduction to intrastate rates in Pennsylvania isolated from the FCC’s comprehensive solution will not<sup>30</sup> Accordingly, this Commission should await FCC action or guidance.

The IXCs also express impatience with the speed of the FCC proceeding, contending that it will take too long for the FCC to sort out these complex policy issues and

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<sup>29</sup> See VZ St. 1.0 Remand (Kane Direct) Exhibit 2 (Verizon Comments).

<sup>30</sup> VZ St. 1.1 Remand (Kane/Dean Rebuttal) at 11.

therefore the Commission should not wait for the FCC.<sup>31</sup> The Commission rejected this argument in deciding to stay the rural ILECs' access case, as discussed above. This speculation that the FCC will not act quickly is not based on any facts. As discussed in Mr. Kane's direct testimony, statements by individual FCC Commissioners have indicated that the agency is taking this matter seriously and have urged that the FCC reach a resolution by the end of this year.<sup>32</sup> In any event, the Commission should wait for the FCC to act even if it requires some time for the FCC to complete a thorough review of this complex issue of intercarrier compensation.

Accordingly, the Commission should act consistently with its decision last week in the other ILECs' access case and refrain from making any substantive decision regarding further access rate rebalancing for at least 12 months, to allow the FCC time to act in its parallel proceeding.

**B. The IXCs Have Demonstrated No Public Benefit From Rushing To Rebalance Verizon's Access Rates Now.**

The IXCs' testimony is long on rhetorical claims of amorphous "benefits" from immediate access reductions, but notably short on any details establishing precisely how immediate access rate reductions will actually benefit Pennsylvania end users, or demonstrating any specific harm that would result from leaving rates at current levels until the FCC completes its intercarrier compensation proceeding. Their arguments in favor of access reductions presume that it is obvious that there will be benefits to consumers from rebalancing rates immediately, but when one looks for the details of these benefits to the

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<sup>31</sup> See, e.g. Qwest Remand St. 1.0 (McIntyre Direct) at 4; AT&T St.1.1-R (Rebuttal) at 13.

<sup>32</sup> VZ St. 1.0 Remand (Kane Direct) at 11.

public, nothing is there. And in fact, history demonstrates that it is the IXCs, and not ordinary Pennsylvanians, that have benefited from past access reductions.

As the presiding officer ruled in denying Qwest's motion to strike OCA, OTS and Verizon testimony demonstrating that the IXCs have proven no consumer benefit from access reductions, "[a]lthough the Commission does not have the authority to set long distance rates, the Commission can consider the effect of the reduced access charges on the residential consumer."<sup>33</sup> The Commission should consider the IXCs' failure to prove such benefits as a factor supporting a decision to wait for the FCC to complete its proceeding before issuing any substantive decision here.

The public parties – the OCA, OSBA and OTS – have effectively demonstrated that the IXCs have shown no such benefit, either from the Phase 1 access reduction of approximately \$50 million that was implemented in February of 2005, or from the proposed further reductions.<sup>34</sup> Indeed, it is logical to expect that the rapid technological changes and industry consolidation that are occurring now are much more likely to impact the prices and products available to end users than would a reduction in intrastate access charges in one state.<sup>35</sup> Indeed, AT&T's affidavit from its merger proceeding with SBC – produced in discovery – explaining its decision to abandon the consumer mass market, demonstrates that forces much larger than intrastate access rates are transforming the communications marketplace at this time.<sup>36</sup> Notably, in all of its explanations of the forces that eroded its

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<sup>33</sup> Order 5 on Remand, at 8.

<sup>34</sup> See, e.g., OTS St. 1-SD (Kubas Dir.); OTS St. 1-Supp.-R (Kubas Rebuttal); OTS St. 1-Supp.-SR (OTS Surrebuttal); OCA St. 1R (Loube Dir.) at 24-28.

<sup>35</sup> VZ St. 1.1 Rebuttal (Kane/Dean Rebuttal) at 6.

<sup>36</sup> *Id.*, Kane/Dean Exhibit 1 (AT&T Response to OCA Set I, No. 1).

consumer business and caused AT&T to refocus its business strategies, not once was the level of Pennsylvania's intrastate access rates mentioned as a factor. (Id.)

There is no evidence on the record in this proceeding that toll rates in Pennsylvania have decreased as a result of the last rebalancing, and no party has produced any evidence to contradict what this Commission itself found years ago – that “IXCs are setting their rates on a national level using flat rates that have no relationship with the access rates of any specific ILEC,” so that access reductions are not necessary to spur toll competition.<sup>37</sup> With national pricing strategies, any isolated decrease in Pennsylvania intrastate rates would, at best, be spread over the entire country with minimal to no impact on Pennsylvania end users.<sup>38</sup> Indeed, MCI admits that prices for all inclusive packages allowing for unlimited long distance and local calling “vary slightly from state to state,”<sup>39</sup> effectively conceding that IXCs price their all inclusive packages as uniformly as possible, spreading their costs of doing business nationally, rather than within each particular state. Qwest similarly admitted in Phase I that “fierce competition” among the approximately 500 certificated IXCs in Pennsylvania is bringing the IXCs “average rate per minute down in Pennsylvania year after year.”<sup>40</sup> The IXCs have not demonstrated that further access reductions are necessary to spur competition, or that consumers would benefit from further access reductions.

The IXCs' attempt to prove a benefit from rushing to further reduce access rates is notably lacking in concrete details. AT&T, for example, contends that any “delay” in

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<sup>37</sup> *Implementation of the Telecommunications Act of 1996: Imputation Requirements for the Delivery of IntraLATA Services by Local Exchange Carriers*, No. M-00960799 (Opinion and Order entered January 29, 2002) at 14.

<sup>38</sup> VZ St. 1.1 Remand (Kane/Dean Rebuttal) at 4.

<sup>39</sup> MCI St. 1.0 Remand (Rebuttal) at 9.

<sup>40</sup> Qwest Phase I Main Brief at 23. Qwest makes this point to argue that the Commission should trust the market to flow through any savings from access reductions.

reducing access charges “will only make a bad situation worse,”<sup>41</sup> but AT&T has not established as a matter of fact that current access rates are causing any “bad situation” for consumers or that immediate reductions are necessary to prevent it from getting “worse.” AT&T has failed to indicate how, when, or even if it would reduce any of its intrastate toll rates if access rates were further reduced in Pennsylvania. Indeed, if AT&T’s actions with regard to the last Verizon access rate rebalancing are any indication, its customers do not stand to gain any savings.

In fact, history suggests the opposite result. Immediately before the last access reduction took effect, AT&T *raised* its rates,<sup>42</sup> and also continued (and still continues) to charge its \$1.95 In-State Connection Fee that was purportedly based on the higher access rates.<sup>43</sup> Unable to show that it lowered its rates directly to reflect the access reductions,

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<sup>41</sup> AT&T St. 1.1-R (Rebuttal) at 12.

<sup>42</sup> In its affidavit submitted in connection with the AT&T/SBC merger, AT&T stated that since the Commission’s Phase I order directing an approximately \$50 million reduction in Verizon’s access rates, AT&T has actually raised retail rates for its all-distance bundles in Pennsylvania from \$2 to \$5 (See VZ St. 1.1 Remand (Kane/Dean Rebuttal) Exhibit 1 (AT&T Response to OCA Set I, No. 1, attached Affidavit of John C. Polumbo ¶¶ 33-34).

<sup>43</sup> In Phase I, it was revealed that AT&T passes through to its end users its own supposed “cost” of paying intrastate access charges to Verizon and the other ILECs in the form of an “In-State Connection Fee” of \$1.95 per month, and AT&T’s witnesses did not commit to lowering the \$1.95 charge when Verizon lowered its access charges (See Verizon Phase I Main Brief at 43). In response to Verizon’s February 2005 reduction of approximately \$50 million in annual access charges, AT&T did not lower its in-state connection fee. AT&T reported in response to Verizon’s discovery requests in Phase II that the \$1.95 In-State Connection Fee continues to appear in its tariff at PA PUC No. 22, Section 1, First Revised Sheet 58, and that AT&T is currently assessing this fee in Pennsylvania. (See VZ. St. 1.1 Remand, Kane/Dean Exhibit 2). AT&T provided discovery responses showing the monthly revenue, in millions of dollars, from the In-State Connection Fee for each month from March of 2003 (when it was instituted) through May of 2005. (See *id.*) For example, in 2004 AT&T’s revenue per month from the In-State Connection Fee ranged from a low of **[BEGIN AT&T PROPRIETARY]** **[END AT&T PROPRIETARY]** Its annual revenue from the In-State Connection Fee in 2004 was

AT&T vaguely contends that customers have benefited because they are able to change to lower cost alternative calling plans,<sup>44</sup> but AT&T has not demonstrated any link between the level of access rates and the availability of these plans.<sup>45</sup> Regardless of whether Verizon's intrastate access rates are altered at this time, lower cost alternative calling plans have been and continue to be available to end users without any further reduction to access rates. AT&T has not demonstrated that any new, lower cost plans were introduced as a result of the last rebalancing.<sup>46</sup>

MCI contends that competition in the long distance market "will force each carrier to reduce its rates to reflect any cost reductions,"<sup>47</sup> but MCI has not demonstrated that IntraLATA toll rates were actually reduced as a result of the rebalancing that took effect in February of 2005.<sup>48</sup> Similarly, Qwest contends that "delay" in reducing intrastate access rates "will only deny the benefits to consumers offered by access reform,"<sup>49</sup> but Qwest has not established that there will be any "benefits to consumers" in the form of lower prices or enhanced services from the access reductions it demands.

The IXCs' failure to provide anywhere in their testimony an express promise that they will pass on to consumers the cost reductions they seek demonstrates that there is actually no *public* benefit associated with their unnecessary request.

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[BEGIN AT&T PROPRIETARY]

[END AT&T PROPRIETARY].

<sup>44</sup> AT&T St. 1.1-R (Rebuttal) at 7.

<sup>45</sup> VZ St. 1.2 Remand (Kane/Dean Surrebuttal) at 7.

<sup>46</sup> *Id.*

<sup>47</sup> MCI St. 1.1 Remand (Rebuttal) at 10.

<sup>48</sup> VZ St. 1.2 Remand (Kane/Dean Surrebuttal) at 8.

<sup>49</sup> Qwest Remand St. 1.1 (Rebuttal) at 1.

Forced to admit that the IXCs have not actually demonstrated any tie between toll rate reductions and past access reductions, Qwest claims that it is too soon to evaluate whether end-user toll prices have decreased as a result of the last rebalancing, and that “market forces must have time to work.”<sup>50</sup> Rather than supporting Qwest’s demand to rush to further rebalance rates now, that admission actually makes a case for this Commission to wait until it is able to evaluate the impact of the last rate rebalancing, which took effect in February of 2005, before deciding to rebalance rates again.<sup>51</sup> Certainly where there is the prospect of a comprehensive FCC order on this issue, possibly by the end of this year but *certainly in the near future, the Commission should wait and see if these market forces will work to the public benefit before undertaking another rebalancing.*

In the face of this evidence that the consumer benefits from immediate intrastate access reductions are remote, if not nonexistent, the Commission must balance the fact that end-user retail rate increases to off-set any such reductions are a certainty. After the passage of Act 183 last year, this Commission is statutorily required to permit revenue neutral recovery of any revenue lost by access reductions.<sup>52</sup> Accordingly, the IXCs have not proven that the immediate access reductions they seek are in the public interest.

### **C. The IXCs’ Arguments Are Wrong On The Law And On The Facts**

If the Commission reaches the merits of the IXCs’ arguments, it should still conclude that no further access reductions are warranted at this time.

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<sup>50</sup> *Id.* at 15.

<sup>51</sup> VZ St.1.2 (Kane/Dean Surrebuttal) at 8.

<sup>52</sup> 66 Pa. C.S. § 3017 (“The commission may not require a local exchange telecommunications company to reduce access rates except on a revenue-neutral basis.”)

**1. The Purpose Of This Remand Is To Evaluate The Merits Of All Arguments In Favor And Against Further Access Rebalancing**

In its testimony AT&T misconstrues the purpose of this remand proceeding, contending that this Commission issued a “mandatory directive” to reduce intrastate access rates and suggesting that the purpose of this remand is simply to calculate the amount of the preordained access reductions.<sup>53</sup> To the contrary, the Commission did not prejudge the outcome of the disputed issues and directed the ALJ to consider “the merits of each of the Parties’ positions” and make a recommendation. (07/28/04 Order at 19).

The Commission remanded this matter for the presiding officer to make a recommendation on the issues that she did not address in her first Recommended Decision, but it did not prejudge what the resolution of those competing arguments would be.

According to the Commission:

Although the ALJ explained in detail each of the various Parties’ positions, she opted to refrain from offering specific recommendations to numerous outstanding issues raised by the Parties in favor of recommending approval of the Verizon/OCA Joint Proposal. In light of the significant resources that have already been expended by the IXCs and the other Parties in this proceeding, we are of the opinion that it is not prudent to mark this proceeding closed without the benefit of a recommended decision on these outstanding issues. (07/28/04 Order at 16)

On the issue of “implicit subsidies that may exist in access charge rates” the Commission recognized that Verizon argued “while the Commission has stated the goal of *reducing* implicit subsidies in access rates, the Commission has stopped short of declaring that access should be priced at ‘cost’ and that IXCs should be absolved of any contribution to local service. Verizon asserts that the Commonwealth Court approved the Commission’s

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<sup>53</sup> AT&T St. 1.1R (Rebuttal) at 4-5.

decision in the *Global Order* to continue to price access above its cost as a sound exercise of the Commission's specialized expertise in this area." (*Id.* at 18). The Commission did not prejudge either that implicit subsidies still existed or that they needed to be completely eliminated at this time, but rather held that "[w]e shall, therefore, direct that the ALJ consider *the merits of each of the Parties' positions* on this matter and make a recommendation based on the record evidence in the next phase of the investigation." (*Id.* at 19) (emphasis added).

The scope of this remand also must be viewed in light of the Commission's later January 18, 2005 Order, in which it "direct[ed] the ALJ to expand the scope of this proceeding for the purpose of addressing the impact the FCC action may have on our jurisdictional responsibilities, as well as its relationship to the final recommended decision on access rates arising from this remand proceeding." (1/18/05 Order at 14). Clearly an alternative that is available to the ALJ is to resolve the "merits" of the parties' disputes over the remanded issues by deciding that Verizon's carrier access charges should remain at current levels until the FCC acts in its intercarrier compensation proceeding.

## **2. Access Rates Should Continue To Contribute To The Costs Of The Company**

### **a. There Is No Legal Or Factual Requirement That Access Rates Be Reduced To Or Near "Cost"**

The IXC parties to this case, AT&T, MCI and Qwest, uniformly demand extreme, rock-bottom access rates for the Verizon companies. All three IXCs propose the complete elimination of Verizon's carrier charge, as well as extreme reductions of the traffic sensitive rates, all calculated to move access rates "closer" to cost.<sup>54</sup> It is perhaps understandable that

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<sup>54</sup> Qwest argues that traffic sensitive rates should be reduced to mirror interstate levels (to which AT&T states it "would not object"), while AT&T and MCI argue for reductions

these parties all want the lowest access rates they might obtain – even lower than the substantial reductions they already received as a result of the Phase I rebalancing – since any additional access reductions by Verizon represent direct revenue increases into the pockets of the IXCs. However, the Commission should keep in mind that Verizon’s rates are already among the very lowest in the state.<sup>55</sup> The IXCs demonstrate that they will never be satisfied, and the Commission need not cater to their extreme demands.

The IXCs’ demands that the Commission reduce intrastate access rates to cost (or some proxy of cost) are flawed on many levels and should be rejected. While the Commission has stated the goal of *reducing* implicit subsidies in access rates (a goal that the Phase I rebalancing already accomplished), the Commission has stopped short of declaring that access should be priced at “cost” and that IXCs should therefore be absolved of any contribution to local service. It need not reach that issue here.

As a legal matter, this Commission is well within its discretion to continue to price access rates above cost. As the Commonwealth Court recognized in reviewing this Commission’s access pricing decision from the *Global Order*, the Commission is not required to reduce access rates to “cost” (as the IXCs contend here).<sup>56</sup> Rather, it is within this Commission’s sound discretion to determine where to draw the line between reducing access rates, yet still requiring those rates to contribute to the overall costs of the business. The Court cautioned the Commission to consider all relevant interests in drawing that line:

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in traffic sensitive rates to TELRIC levels (the methodology used under federal law for calculating rates for unbundled network elements based on hypothetical costs). AT&T St. 1-R (Direct) at 20; MCI St.1.0 Remand (Direct) at 20; Qwest Remand St. 1 (Direct) at 2.

<sup>55</sup> See VZ St. 1.1 Remand (Kane/Dean Rebuttal) at 10-22 (comparing Verizon’s carrier charge of \$0.58 to other ILEC carrier charges ranging as high as \$17.99).

<sup>56</sup> *Bell Atlantic-Pennsylvania, Inc. v. Pennsylvania Public Utility Commission*, 763 A.2d 440, 480 (Pa. Commw. 2000).

One of the lessons of this proceeding is that the cost of excessively priced elements must be reduced to a point nearer to actual incremental cost, but not so greatly as to eliminate the support such revenue provides to other areas of the system that need that support.<sup>57</sup>

The Commonwealth Court opinion is instructive because it rejects the false premise of all of the IXC arguments here – the erroneous contention that the Commission is somehow bound to arrive at “cost based” access rates. The Court emphasized that it would be reasonable for the Commission ultimately to conclude that access rates should never be reduced to “cost,” and that the Commission’s goal is to determine, in the exercise of its sound discretion, where to draw the line so that access is providing neither too little nor too much support to network costs.<sup>58</sup>

As a factual matter, there is good reason to continue to price access rates at their present levels, at least until the FCC completes its intercarrier compensation proceeding. Today’s carrier access rates include contribution—that is, exceed incremental and shared fixed cost— to provide a means for recovery of fixed common costs and recovery of costs associated with the public utility franchise obligations of local exchange carriers such as Verizon. These obligations include providing basic residential exchange service at rates that are frequently below the cost to serve certain areas and deploying facilities ubiquitously in order to serve as carriers of last resort. Those obligations impose unique costs on Verizon and other ILECs. Carrier access charges, like rates for all other services, should continue to help defray these costs to the extent possible in an increasingly competitive market.<sup>59</sup> As Dr. Taylor testified in Phase I, from an economic perspective switched access charges still can

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<sup>57</sup> *Id.*

<sup>58</sup> *Id.*

<sup>59</sup> VZ Phase I St. 1.0 (Berry/Wirl Direct) at 29.

and should provide some support to the shared fixed and common costs of the network by being priced above incremental cost.<sup>60</sup>

The IXCs' arguments in support of pricing at "cost" do not survive scrutiny. Practically since the inception of access charges – when Verizon PA's composite rate was 7 cents a minute as compared to today's [BEGIN VERIZON PROPRIETARY] [END VERIZON PROPRIETARY] – the IXCs have been arguing that ILECs have a competitive advantage in the toll market and the IXCs will go out of business unless this Commission prices intrastate access at "cost." The Commission has never accepted their arguments and should not do so now. Contrary to AT&T's and MCI's oft-repeated rhetoric, history and this Commission's own prior holdings demonstrate that it is not necessary for intrastate access rates to be set at "cost" in order for IXCs to be able to compete in the in-state long distance market on a fair basis. Irrespective of the fact that switched access services are priced above costs, the Commission concluded that the market for intraLATA toll services is competitive.<sup>61</sup> Indeed, AT&T's own witness admitted that "the interexchange market is a very, very competitive market."<sup>62</sup>

Second, this Commission has consistently rejected the IXC's "price squeeze" argument, in which they claim that access rates must be reduced to cost or Verizon (or another ILEC) will gain a competitive advantage by pricing its toll calls below the price its competitors must pay for access. The Commission was unconvinced by that argument in the Verizon merger case (where it rejected the IXCs' demand for an immediate reduction of access rates to cost as a merger condition), and found that the terms of the Merger and

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<sup>60</sup> VZ Phase I St. 3.0 (Taylor Surrebuttal) at 30.

<sup>61</sup> See *Global Order* at 231.

<sup>62</sup> Phase I Tr. 270.

Global orders regarding access charges and imputation were sufficient to allow the merger to proceed as in the public interest. More recently, the Commission explicitly rejected the price squeeze argument in holding that the non-Verizon ILECs would not even be subject to a requirement to “impute” their access charges in their toll rates:

We agree with the PTA that there is no evidence that [IXCs] are unable to compete today with the ILECs in the IntraLATA toll market. Further, we take administrative notice of the fact that the toll market is subject to increasingly intense price competition as many IXCs are setting their rates on a national level using flat rates that have no relationship with the access rates of any specific ILEC. Finally, we know of no evidence to refute AT&T's own witness that predatory pricing is extremely unlikely to occur; and, even if predatory pricing does occur, the federal antitrust laws are already available to address this type of conduct. Frankly, we are wary of taking any regulatory action that may discourage the aggressive pricing of toll services by any and all competitors, including ILECs, in that market...<sup>63</sup>

As Dr. Taylor explained, the supposed incentive to price toll rates below access makes no sense, because the ILEC would actually be losing money by taking a retail customer from an IXC and serving it at long distance rates below access charges. The ILEC is better off having an IXC pay it 5 cents a minute than having the end user pay it 4 cents a minute. The price squeeze would only be ultimately profitable if the ILEC could drive all of its competitors from the market— and keep them out -- and then raise its rates sufficiently to recover the lost revenue. That scenario is highly unlikely in the toll market given the great number of large, global companies with deep pockets who have sunk investments in switches and fiber transport to provide this service.<sup>64</sup> Moreover, if the switched access charges became intolerable (unlikely since they have been decreasing steadily over the

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<sup>63</sup> See, *Implementation of the Telecommunications Act of 1996: Imputation Requirements for the Delivery of IntraLATA Services by Local Exchange Carriers*, No. M-00960799 (Opinion and Order entered January 29, 2002) at 14.

<sup>64</sup> Verizon Phase I St. 3.0 (Taylor Surrebuttal) at 36.

years), those companies have alternatives, such as dedicated access and leasing UNEs to avoid paying access charges.<sup>65</sup>

Even if the “price squeeze” were theoretically possible, moreover, this Commission has already protected the IXCs from it by imposing an imputation requirement upon Verizon PA, which means that Verizon PA cannot price its toll service below the price that it charges competitors for access because it must affirmatively demonstrate that total toll revenues exceed total imputed switched access and carrier charges on an aggregated toll services level.<sup>66</sup> This imputation rule effectively places Verizon PA in the same position as the IXCs insofar as the pricing of toll services is concerned. Instead of basing its toll price entirely on the incremental cost of the service, Verizon must use its competitors’ incremental cost for the access portion of the service: *i.e.*, the tariff price of switched access that IXCs pay to Verizon. Under the Pennsylvania imputation rule, Verizon is neither advantaged nor disadvantaged in the toll market because it supplies access to competitors at a price above incremental cost.<sup>67</sup> Other protections also exist, such as the separate affiliate safeguards in Section 272 of the Telecommunications Act, which require Verizon’s long distance affiliate to purchase carrier access from the same tariff under the same terms and conditions as other long distance carriers.<sup>68</sup> The FCC has therefore consistently reiterated its belief that regulatory and non-regulatory safeguards are sufficient to rule out a price squeeze<sup>69</sup>

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<sup>65</sup> *Id.*

<sup>66</sup> *See Global Order* at 232-233.

<sup>67</sup> Verizon Phase I St. 3.0 (Taylor Surrebuttal) at 35.

<sup>68</sup> *Id.*

<sup>69</sup> *Id.* at 42. *See also*, Memorandum Opinion and Order, *In re Applications of Ameritech Corp. and SBC Communications Inc.*, CC Docket No. 98-141, FCC 99-279 (released October 8, 1999) (“SBC-Ameritech”), ¶ 234.

The implicit premise of the IXCs' argument that access should be priced at "cost" is that end-users will benefit from the extreme reductions in access rates they demand here. As discussed above, the IXCs have not proven that fact, however. To the contrary, this Commission's own holdings and the IXCs' admissions on the record demonstrate that toll services to end users are priced based on what the market will bear – not based on the magnitude of any particular ILEC's intrastate access charges.<sup>70</sup> One example of that fact is AT&T's history of passing through to its end users its own supposed "cost" of paying intrastate access charges to Verizon and the other ILECs in the form of an "In-State Connection Fee" of \$1.95 per month "to help recover" rates "AT&T is charged by your local telephone company in Pennsylvania to carry your AT&T in-state long distance and local toll calls over its lines."<sup>71</sup> AT&T's witnesses admitted in Phase I that AT&T charges the same fee state-wide, so that notwithstanding Verizon's comparatively low access rates, end users in Verizon territory are paying a higher In-State Connection Fee to compensate AT&T for the substantially higher access rates it pays to the rural ILECs.<sup>72</sup> Even after Verizon reduced its own access rates substantially after Phase I, this fee was not reduced. AT&T has obviously concluded that the toll market in Verizon's territory will bear paying

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<sup>70</sup> This Commission has already determined that "IXCs are setting their rates on a national level using flat rates that have no relationship with the access rates of any specific ILEC." *Implementation of the Telecommunications Act of 1996: Imputation Requirements for the Delivery of IntraLATA Services by Local Exchange Carriers*, No. M-00960799; *Rulemaking Re Generic Competitive Safeguards Under 66 Pa. C.S. §§3005(b) and 3005(g)(2)*, No. L-00990141 (Opinion and Order entered January 29, 2002) at 14.

<sup>71</sup> VZ Phase I Cr. Ex. 1. See also VZ Phase I Cr. Ex. 2 (AT&T intrastate tariff imposing In-State Connection Fee); VZ Phase I Cr. Ex. (material from AT&T's website demonstrating that its fee varies among states and that Pennsylvania's fee is among the highest).

<sup>72</sup> Phase I Tr. 274; 322; 326-27.

rates reflective of higher access rates than Verizon actually charges, casting doubts on all of AT&T's complaints about its inability to compete under Verizon's current rates. Moreover, AT&T's witnesses have essentially stated the intention to price toll (including its connection fee) based on what the market will bear, and refused to commit to lowering the \$1.95 charge even after Verizon lowered its access charges as a result of Phase I and even after many of the rural ILECs implemented reduced access rates as a result of the RTCC settlement.<sup>73</sup> Therefore, AT&T's own admissions show that there is no urgency to lowering Verizon's access rates at this time.

**b. The IXCs Do Not Price Their Own Intrastate Access Rates Under The Standard They Seek To Impose On Verizon**

While the IXCs demand that Verizon be required to reduce its intrastate access rates either to mirror interstate rates or UNE rates, the record shows that none of the IXC parties to this case price their *own* intrastate access rates under the extremely low standard they seek to impose upon Verizon. As OCA's witness pointed out, CLECs have generally priced their own access rates (charged to Verizon, for example, where a Verizon customer calls a CLEC customer) at approximately the level of the regulated access rate of the incumbent, not to mirror UNE rates or at "cost".<sup>74</sup>

Similarly, in Phase I, Qwest's witness admitted that even though Qwest has come to Pennsylvania to demand that Verizon lower its intrastate access rates to the same level as its

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<sup>73</sup> Phase I Tr. 271-272 (Stating that AT&T will change its fee only if it needs to do so to remain competitive in the market, and in responding to the question "it's possible then that even if Verizon reduces its access charges, AT&T will not reduce its in-state connection fee; correct," AT&T's witness states "[a]nything is possible in a competitive market"). See also Tr. 325 (similar response regarding Sprint/RTCC Settlement).

<sup>74</sup> OCA St. 1R-S (Loube Surrebuttal) at 5.

interstate rates, Qwest, which itself operates as an ILEC in many states, has not rebalanced its own intrastate access rates to the same level as interstate rates in all of those states.<sup>75</sup> In response to discovery requests in Phase II, Qwest has acknowledged that in 12 of the 14 states in which Qwest does business as an ILEC it still has not reduced its intrastate access rates to parity with its interstate access rates, as it demands this Commission require of Verizon here.<sup>76</sup>

**c. “Cost” Is Of Limited Relevance To This Proceeding, But The IXCs Underestimate The Cost Of Providing Access In Order To Justify Their Demands For Rock Bottom Rates**

Although as discussed above Verizon does not agree that it is appropriate to reduce access rates to “cost,” the IXC’s notion of what constitutes the “cost” of access is flawed and deliberately understates Verizon’s costs in order to obtain rock-bottom rates and to exaggerate their claims that current access rates are too high.

It is important to clarify the role of access cost studies in this case. It is neither relevant nor necessary to this proceeding to precisely examine the cost of providing access, because both the FCC and this Commission have consistently rejected the notion that pricing of carrier access should be based exclusively upon cost.<sup>77</sup> The incremental cost of providing access is relevant to define the price floor – the level below which the price should not be allowed to fall. While Verizon’s studies demonstrate that its carrier access

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<sup>75</sup> See, e.g., Phase I Tr. 382.

<sup>76</sup> See VZ St. 1.1 Remand (Kane/Dean Rebuttal) at 9 and Kane/Dean Exhibit 3.

<sup>77</sup> See, e.g., *Access Charge Reform*, CC Docket No. 96-262, First Report and Order, 12 FCC Rcd 15982 (rel. May 16, 1997), 199 (disagreeing with parties that argued that access rates should be based on long run incremental costs, and relying instead on market-based approach to drive rates); *Access Charge Reform*, CC Docket No. 96-262, Sixth Report and Order, 15 FCC Rcd 12962 (rel. May 31, 2000 (“CALLS Order”), 60 (extending market-based approach for five years).

rates are above this price floor – though not to the degree the IXCs claim – as discussed above it is appropriate for carrier access charges, like rates for all other services, to continue to help defray the ILEC’s unique costs of providing universal service, to the extent possible in an increasingly competitive market.<sup>78</sup>

Although the cost studies are of limited relevance, the IXC’s criticism of Verizon’s cost studies is unfounded. The IXCs contend that Verizon should have used UNE rates or inputs used for calculating UNE rates under the federal “TELRIC” methodology as applied in the Commission’s current UNE pricing proceeding for Verizon PA. UNEs are the individual pieces of an incumbent local exchange carrier’s network that competing local exchange carriers may lease to provide competing local telephone service under the provisions of the federal Telecommunications Act. Binding Federal Communications Commission (“FCC”) regulations establish a methodology, known as “total-element-long-run-incremental-cost” or “TELRIC,” to calculate UNE costs.<sup>79</sup> TELRIC costs are not appropriately used to price access.

First, the federal Telecommunications Act of 1996, as interpreted by the FCC, mandates that local interconnection rates be set at TELRIC costs, but there is no such mandate in the Telecom Act for switched access rates. In fact, the FCC has flatly rejected IXC demands to price interstate access at TELRIC costs. In its *Access Charge Reform* proceeding, the FCC reaffirmed this conclusion, holding that “[w]hile unbundled network elements may be used to provide interstate access services, their availability at TELRIC-based prices does not compel adoption of similar rates for access services.”<sup>80</sup> In its *CALLS*

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<sup>78</sup> VZ Phase St. 1.0 (Berry/Wirl Direct) at 29.

<sup>79</sup> 47 C.F.R. § 51.501, et seq. See also *AT&T Corp. v. Iowa Utilities Bd.*, 525 U.S. 366 (1999); *Verizon Communications, Inc. v. FCC*, 535 U.S. 467 (2002).

<sup>80</sup> *Access Charge Reform*, CC Docket No. 96-262, First Report and Order, 12 FCC Rcd

Order the FCC again affirmed this approach, and on at least three occasions federal appellate courts have rejected IXC arguments that access should be priced at TELRIC.<sup>81</sup>

Second, from a cost perspective TELRIC costs do not represent Verizon's actual expected cost of providing service. As the D.C. Circuit has observed, it appears to be "common ground" that TELRIC prices "fall well below the costs that ILECs had actually historically incurred in constructing the elements."<sup>82</sup> TELRIC costs are the costs of a hypothetical network using "the most efficient telecommunications technology currently available and the lowest cost network configuration, given the existing location of the incumbent LEC's wire centers."<sup>83</sup> As Mr. Sanford and Ms. Dean explained, TELRIC, particularly as it has been interpreted and applied by this Commission, is based on a standard that would understate the forward looking costs of access service because in applying the "hypothetical" TELRIC standard this Commission has been extremely optimistic (unrealistically optimistic in many instances) regarding the cost-saving efficiencies that the hypothetical network might gain in providing UNE elements, with the result of severely reducing the rates competitors must pay to use Verizon's network.<sup>84</sup> Of

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15982 (rel. May 16, 1997) ¶ 199.

<sup>81</sup> *Access Charge Reform*, CC Docket No. 96-262, Sixth Report and Order, 15 FCC Rcd 12962 (rel. May 31, 2000) ("CALLS Order") ¶ 60; *Texas Office of Public Utility Counsel v. FCC*, 265 F.3d 313, 324-26 (5<sup>th</sup> Cir. 2001), *cert. denied*, 535 U.S. 986 (2002); *Southwest Bell Telephone v. FCC*, 153 F.3d 523, 546-49 (8<sup>th</sup> Cir. 1998); *Competitive Telecom. Ass'n v. FCC*, 117 F.3d 1069 (8<sup>th</sup> Cir. 1997).

<sup>82</sup> *United States Telecom Assoc. v. FCC*, 359 F.3d 554, 562 (D.C. Cir. 2004).

<sup>83</sup> 47 C.F.R. § 51.501(b)(1), (d)(1).

<sup>84</sup> VZ Phase I St. 2.1 (Dean/Sanford Surrebuttal) at 5 ("Those same unrealistic assumptions about hypothetical costs are entirely inappropriate to be applied when it comes to evaluating Verizon's own forward looking costs of providing access and dial tone line service. Instead, the forward looking assumptions used in Verizon's access and dial tone line studies are correctly based on how Verizon will engineer, install and maintain its network in the future and the resultant cost of providing these services. Verizon's forward looking assumptions are based on its real life experience in

particular relevance to the access study, the Commission's switching rates are based on assumptions regarding switch discounts for a hypothetical provider that Verizon indisputably will not obtain itself, with the result of drastically reducing the UNE switching costs, which the other parties improperly compare to Verizon's access costs in this case.<sup>85</sup>

Third, from an economic perspective it does not make sense to apply TELRIC pricing to access. As Dr. Taylor explained, in pricing services — as opposed to network elements — the incremental cost of those services is a price floor only; prices need to reflect market conditions and to recover the shared and common costs of the firm so that overall the firm can remain viable. Services are not priced at “cost” in competitive markets; indeed, firms could not remain viable if they were required to price all their services at cost.<sup>86</sup> As the FCC recognized when it rejected the proposition that interstate carrier access charges be set at TELRIC, “competition will do a better job of determining the true economic cost of providing such services.”<sup>87</sup>

### **3. The Phase I Rebalancing Was Revenue Neutral And Complied With This Commission's Phase I Orders**

AT&T attempts to distract the Commission from the fact that the IXCs have demonstrated no benefit to immediately reducing Verizon's access rates, and no legal or factual mandate to price access at or near cost, by criticizing Verizon's implementation of the Phase I rate rebalancing. AT&T manufactures this argument by claiming that Verizon has actually lost less access revenue than projected at the time of the compliance filing, if

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providing a real telecommunications network -- not a make believe network.”)

<sup>85</sup> *Id.* at 6.

<sup>86</sup> VZ Phase I St. 3.0 (Taylor Surrebuttal) at 3.

<sup>87</sup> *See, Before the Federal Communications Commissions, In the Matter of Access Charge Reform* (CC Docket No. 96-262), First Report and Order, Release No. FCC 97-158, May 7, 1997, at ¶265.

calculated based on current access volumes. Of course, AT&T ignores the fact that Verizon's volume of end-user lines has also shrunk, so Verizon is not recovering as much revenue as anticipated at the time of the compliance filing, if the revenue from the end-user rate increases were calculated using more current volumes.

The volumes that were used to calculate the Phase I rebalancing accurately reflected access and end user line volumes at the time they were filed, and the rebalancing based on those calculations was approved by this Commission. There always remains a possibility that volumes will increase or decrease in the future.<sup>88</sup> A revenue-neutral rate rebalancing is necessarily a snap-shot in time, where new rates are calculated based on volume information available at the time the details of the rebalancing are filed with the Commission, to recover the estimated revenue reduction from other rate increases based on the volume information at that time. It is not practical or reasonable to suggest that the Commission revisit the amount of revenue reduced or gained again under subsequent volumes. Both access minute volumes and the number of retail end-user lines are subject to change, so that it is highly unlikely that a precise match-up will be calculated if the Commission uses post-filing volumes.<sup>89</sup>

In any event, if the Commission were to consider AT&T's argument that its access minutes of use are shrinking, then it should also realize that Verizon's retail access lines are shrinking and that there is no guarantee – or even any likelihood – that Verizon will actually recover from the end user rate increase the actual amount of revenue reduction projected

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<sup>88</sup> Had access volumes increased, causing Verizon to lose more than the anticipated amount of revenue, AT&T surely would not be offering to undo part of the access rate reduction.

<sup>89</sup> See VZ St. 1.1 Remand (Kane/Dean Rebuttal) at 27.

from the access rate reductions as of the date upon which the compliance filing calculations were based.

AT&T admitted in its surrebuttal testimony that its witnesses were mistaken in contending that Verizon's retail rate increase was calculated to recover \$55 million annually.<sup>90</sup> Rather, the updated data upon which the compliance filing was based indicated that Verizon would lose [BEGIN VERIZON PROPRIETARY] [END VERIZON PROPRIETARY] in annual revenue from the ordered access rate reductions, rather than the [BEGIN VERIZON PROPRIETARY] [END VERIZON PROPRIETARY] estimated earlier in the case. Additionally, because \$19.8 million of the access revenue reduction was off-set by Verizon's Price Change Opportunities ("PCOs"), as discussed in more detail below, the rate increases to end-users was to recover an annual total of [BEGIN VERIZON PROPRIETARY] [END VERIZON PROPRIETARY] based on retail line counts as of August of 2004 (the same time period as the access volumes).<sup>91</sup>

Verizon calculated that each residential and business line subject to the revenue neutral offset would receive an \$0.80 increase. This was the amount of increase necessary to recover in a revenue neutral manner a projected total annual amount of [BEGIN VERIZON PROPRIETARY] [END VERIZON PROPRIETARY] This estimate was based on Verizon's end-user line counts as of August of 2004. However, Verizon's retail line counts have been experiencing a trend of decreasing over time. Based on actual volumes through May of 2005, Verizon's line counts have already decreased substantially below those used to estimate the rate increase necessary to achieve revenue

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<sup>90</sup> AT&T St. 1.2R (Surrebuttal) at 9.

<sup>91</sup> VZ St. 1.2 Remand (Kane/Dean Surrebuttal) at 21-22.

neutrality. Accordingly, based on those May 2005 volumes, Verizon would recover only [BEGIN VERIZON PROPRIETARY] [END VERIZON PROPRIETARY] annually from the \$0.80 increase per line. Because it is expected that Verizon's retail end-user lines will continue to decrease, it is unlikely that Verizon will recover even as much as an annualized [BEGIN VERIZON PROPRIETARY] [END VERIZON PROPRIETARY] in 2005 or subsequent years.<sup>92</sup>

#### **4. The Other Parties Understate The Magnitude Of Potential End User Rate Increases Under The IXCs' Proposed Rebalancing**

The other parties also attempt to convince the Commission that the rate increase to end-users can be minimized by spreading the lost revenue over a larger amount of lines. This argument is faulty for two reasons.

First, because of the lack of public benefits from immediate access reductions discussed above and the pendency of the FCC proceeding, *any* rate increase to end-users would cause the harm to outweigh the benefits at this time.

Second, a rate rebalancing will not comply with 66 Pa. C.S. § 3017, directing that “[t]he commission may not require a local exchange telecommunications company to reduce access rates except on a revenue-neutral basis,” if it places *any* portion of the off-set upon lines that clearly will not produce the revenue to Verizon needed to make the rebalancing truly revenue-neutral.

Dr. Pelcovits for MCI, for example, attempts to reduce the amount of the required retail rate increase by spreading the access revenue reduction from matching interstate rates across [BEGIN VERIZON PROPRIETARY] [END VERIZON

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<sup>92</sup> *Id.* at 22-23.

**PROPRIETARY]**.<sup>93</sup> OCA’s Dr. Loube contends that any rebalancing should go over all of Verizon’s lines, including those purchasing bundled services.<sup>94</sup>

It is not appropriate to propose to increase the rates of all of these lines because not all lines can receive a rate increase and actually produce the revenue necessary to achieve the statutorily-required revenue-neutrality. Lines that are subject to contractual agreements cannot raise their rates, and lines subject to competitive pressures are not subject to rate regulation and cannot be expected to accept an increase without being lost to a competitor. Accordingly, allocating revenue to such lines would not achieve revenue neutrality and would violate 66 Pa. C.S. § 3017.

In an even more extreme and unsupportable position, OSBA’s Mr. Buckalew contends that if the Commission chooses to rebalance access rates (which the OSBA, like Verizon, opposes) then it should reduce the impact on retail end users by spreading the revenue recovery over approximately 14 million “lines,” which he characterizes as Verizon’s “equivalent” lines.<sup>95</sup> This suggestion makes no sense, and is transparently calculated to minimize the appearance of the rate reduction, but would not possibly result in true revenue neutrality because “equivalent” lines are not actually individual customer lines, and do not represent individual customers to whom a modest rate increase might be assessed. “Equivalent” lines are a measure of the data transmission capacity of Verizon’s high-speed lines based on standard digital transmission rates in the North American Digital Hierarchy.<sup>96</sup> Saying that Verizon has approximately 14 million equivalent lines

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<sup>93</sup> MCI St. 1.0 Remand (Dir.) at 17.

<sup>94</sup> OCA St. 1R (Loube Direct) at 38.

<sup>95</sup> OSBA St. 2 Remand (Buckalew Rebuttal) at 2.

<sup>96</sup> VZ St. 1.2 Remand (Kane/Dean Surrebuttal) at 12. This is expressed as “DS0 equivalents.” A DS0 is an ordinary voice-grade line, which has a line rate speed of 64

does not mean that Verizon actually serves that number of retail switched lines.<sup>97</sup> Verizon has only [BEGIN VERIZON PROPRIETARY] [END VERIZON PROPRIETARY] retail switched lines in Pennsylvania. Even those lines are not all suitable for a revenue-neutral rebalancing, as discussed above. In short, “equivalent” lines are not real voice lines and cannot reasonably be treated as such in any rate rebalancing proposal. To Verizon’s knowledge, this Commission has never used equivalent lines to calculate any revenue neutral rate rebalancing, nor should it in this case.

Rather, the Commission should wait for the FCC to act, but if the Commission over Verizon’s objections were to consider rebalancing any access revenue, then the increase should be spread over approximately [BEGIN VERIZON PROPRIETARY] [END VERIZON PROPRIETARY] lines (the same category of lines used for the Phase I rebalancing). While the other parties now imply that Verizon’s selection of lines for the revenue neutral increase in Phase I was somehow inappropriate, not only did the OSBA and OCA agree to the lines that received the increase, but the Commission approved the settlement.

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Kbps. One voice grade line is counted as one DS0 equivalent. A DS0 equivalent is also a measure of the speed or capacity of a high-capacity line, based on how many multiples of the capacity of an ordinary voice-grade DS0 line can be carried over that high-speed connection. These high-speed lines, such as DS1, DS3, OC3 and the like are generally used by larger business customers to transmit data or a combination of voice and data. A DS1 line has a capacity equal to 24 equivalent DS0 channels. A DS3 has a capacity equal to 672 equivalent DS0 channels. An OC3 line has a capacity equal to 2016 equivalent DS0 channels. An OC12 line has a capacity equal to 8064 equivalent DS0 channels, and so on. *Id.*

<sup>97</sup> This number counts as 8,064 lines, for example, one high-capacity OC12 data line that is not even used to provide voice service and for which no one pays access charges. Assuming for the sake of argument that the monthly increase were \$1, OSBA would assess approximately \$8,000 per month upon the customer of that one data line. VZ St. 1.2 (Kane/Dean Surrebuttal) at 13.

#### IV. CONCLUSION

For the foregoing reasons, the Commission should not require any further access rebalancing now, pending the outcome of the FCC's intercarrier compensation proceeding.



William B. Petersen  
Suzan DeBusk Paiva  
1717 Arch Street, 10W  
Philadelphia, PA 19103  
Phone (215) 466-4755  
Fax (215) 563-2658  
[william.b.petersen@verizon.com](mailto:william.b.petersen@verizon.com)  
[Suzan.d.paiva@verizon.com](mailto:Suzan.d.paiva@verizon.com)

Counsel for Verizon  
Pennsylvania Inc. and  
Verizon North Inc.

Date: August 17, 2005

# **EXHIBIT A**

PENNSYLVANIA PUBLIC UTILITY COMMISSION  
HARRISBURG, PENNSYLVANIA 17105

Investigation Regarding Intrastate  
Access Charges and IntraLATA Toll  
Rates of Rural Carriers, and the  
Pennsylvania Universal Service Fund

PUBLIC MEETING: August 11, 2005  
AUG-2005-OSA-0243\*  
I-00040105

MOTION OF VICE CHAIRMAN JAMES H. CAWLEY

Before us for disposition is the Petition for Interlocutory Review (Petition) of a Material Question filed by the Office of Consumer Advocate (OCA), the Commission's Office of Trial Staff (OTS), and the Rural Telephone Company Coalition (RTCC) (collectively referred as Joint Petitioners). The Joint Petition arises from a ruling of Administrative Law Judge (ALJ) Susan D. Colwell, who presides over the evidentiary stage of this proceeding, to deny Joint Petitioners' *Motion to Defer*. ALJ Colwell denied Joint Petitioners' *Motion to Defer* that had requested a stay of this proceeding in view of the Federal Communications Commission's (FCC's) ongoing activities in its *Unified Intercarrier Compensation* proceeding.<sup>1</sup> The Petition raises two separate questions:

- (1) Did the presiding officer erroneously issue an Order on a Motion filed with the Commission?
- (2) Did the presiding officer erroneously conclude not to stay the instant investigation pending action by the FCC on the same matters at issue in this Commission investigation?

I believe that the Staff analysis and recommendation disposing of the first question is correct. The Commission's rules permit a presiding ALJ to rule on Motions that are properly made in the evidentiary phase of a Commission adjudicative investigation. See 52 Pa. Code § 5.103(d). Therefore, I believe that ALJ Colwell had the requisite authority to make a ruling on Joint Petitioners' *Motion to Defer*.

The second question presents this Commission with more complex issues that hold the potential of serious implications for both telecommunications carriers operating in Pennsylvania and their respective end-user consumers. These implications arise not only from the yet unknown outcome of the FCC's *Unified Intercarrier Compensation* proceeding, but are also based on the interaction between the *Unified Intercarrier Compensation* proceeding potential outcomes and this Commission's implementation of Act 183 of 2004, or the new Chapter 30 law. P.L. 1398, 66 Pa. C.S. § 3011 *et seq.*

This Commission's implementation of the new Chapter 30 law includes statutorily mandated annual revenue and rate increases for those rural incumbent local exchange carriers

<sup>1</sup> *In re Developing a Unified Intercarrier Compensation Regime*, (FCC Rel.: March 3, 2005), CC Docket No. 01-92, *Further Notice of Proposed Rulemaking*, FCC 05-33 (*Unified Intercarrier Compensation*).

(ILECs) that have Commission-approved amended network modernization plans (NMPs).<sup>2</sup> The Commission has already approved four (4) such revenue and rate increases for rural ILECs with approved amended NMPs that operate under price stability mechanisms and price change opportunity (PSM/PCO) formulas.<sup>3</sup> The new Chapter 30 law also directs that the Commission “may not require a local exchange telecommunications company [ILEC] to reduce access rates except on a revenue-neutral basis.” 66 Pa. C.S. § 3017(a). In other words, without prejudging the outcome of this Investigation, potential intrastate carrier access charge reductions that may be achieved in the context of this proceeding for the rural ILECs may have to be absorbed totally or in part by the rural ILECs’ basic local exchange service ratepayers on a “revenue-neutral basis.”

However, the intrastate access charge reform for the rural ILECs is not independent from the potential outcomes of the FCC’s *Unified Intercarrier Compensation* proceeding. A number of the rural ILECs operating in Pennsylvania are “average schedule companies,” i.e., their operational revenues, expenses, and assets are not subject to jurisdictional intrastate – interstate allocations. Thus, the overall annual revenue level of these ILECs depends on the receipt of federal Universal Service Fund (USF) support distributions. Similarly, these ILECs are also recipients of support contributions from the Pennsylvania USF (Pa. USF).<sup>4</sup> Furthermore, certain outcomes of the FCC’s *Unified Intercarrier Compensation* proceeding can *directly* affect the *intrastate* carrier access charges of the rural ILECs.<sup>5</sup>

It is intuitively understood that the level of the rural ILEC intrastate carrier access charges affects the services that are offered in the Commonwealth by interexchange carriers (IXCs) as well as by other categories of telecommunications carriers. However, it should also be noted that under the new Chapter 30 law IXC services have been classified as “competitive” and the Commission cannot “fix or prescribe” the rates and charges for IXC services. 66 Pa. C.S. § 3018 (a)&(b).

The OCA’s Brief in Support of the Joint Petition (OCA Brief) clearly and persuasively demonstrates the risks to the end-user ratepayers of the rural ILECs if this Investigation was allowed to proceed while the FCC’s *Unified Intercarrier Compensation* proceeding was still pending. For example, the OCA Brief points out that, depending on the outcome of the FCC’s *Unified Intercarrier Compensation* proceeding, if this Commission proceeds with intrastate access charge reform, potentially increased federal USF funding may not apply to rural ILEC intrastate access charge reductions that will be put in place *prior* to the conclusion of the FCC’s proceeding.<sup>6</sup> Similarly, the OCA Brief persuasively argues that, under certain outcomes in the same FCC proceeding, the rural ILECs’ ratepayers may bear the same burden twice from the

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<sup>2</sup> 66 Pa. C.S. § 3015(a)&(b).

<sup>3</sup> See generally *ALLTEL Pennsylvania, Inc.*, Docket No. R-00050574, Secretarial Letter issued July 29, 2005; *Buffalo Valley Telephone Company*, Docket No. R-00050520, Secretarial Letter issued July 29, 2005; *Conestoga Telephone and Telegraph Company*, Docket No. R-00050521, Secretarial Letter issued July 29, 2005; *Denver and Ephrata Telephone and Telegraph Company*, Docket No. R-00050522, Secretarial Letter issued July 29, 2005. These revenue and rate increases are based on the statutory level of the inflation offset in the PSM/PCO formulas that has been set at 0% or 0.5% depending on the ILEC’s rural or non-rural status and its selected amended NMP option. 66 Pa. C.S. § 3015(a).

<sup>4</sup> See generally *Rulemaking Re Establishing Universal Service Fund Regulations at 52 Pa. Code* §§63.161-63.172, Docket No. L-00000148, Revised Final Rulemaking Order entered March 23, 2001, 31 Pa.B. 3402 (June 30, 2001).

<sup>5</sup> See generally *Unified Intercarrier Compensation*, ¶¶ 114-115, at 51-52.

<sup>6</sup> OCA Brief at 8-9.

same reduction in intrastate access charges if such reductions are not simultaneously coordinated between this Commission and the FCC.<sup>7</sup> In short, the interests of the rural ILEC ratepayers will be seriously prejudiced if this Investigation is not coordinated with the ongoing FCC *Unified Intercarrier Compensation* proceeding. Such prejudice meets the applicable legal standards of granting the stay of the Investigation in accordance with the request of Joint Petitioners and, in my opinion, outweighs the potential benefits that could be achieved through a more immediate implementation of intrastate carrier access charge reform for the rural ILECs through this Investigation.

However, granting of this stay must balance the interests of the participating parties in this Investigation and of the end-user consumers of telecommunications services within Pennsylvania. For these reasons, I cannot agree with the original request of Joint Petitioners in their *Motion to Defer* that this matter should be deferred "pending the outcome of the FCC intercarrier compensation proceeding at Docket No. 01-92, but not to exceed a period of twenty-four months or until the FCC acts on its Intercarrier Compensation proceeding, whichever is earlier." Joint Petition, Attachment 2 (*Motion to Defer*), ¶ 14, at 12. I believe that this Investigation should originally be stayed for a period not to exceed twelve (12) months or until the FCC issues its ruling in its *Unified Intercarrier Compensation* proceeding, whichever occurs earlier.

I believe that, upon the termination of the 12-month stay period or upon the issuance of an FCC ruling in its *Unified Intercarrier Compensation* proceeding, the parties to this Investigation should submit the appropriate status reports to the Commission. The Commission Staff will monitor developments in the FCC's *Unified Intercarrier Compensation* proceeding, and, upon the receipt of the status reports from the parties, will formally and timely advise the Commission on the resumption of this Investigation. The Commission will then address this Staff recommendation at a future Public Meeting and take appropriate action in reinstating this Investigation.

Furthermore, the resumption of this Investigation should include and provide record evidence addressing the legal, ratemaking, and regulatory accounting linkages between: (1) the FCC's ruling in its *Unified Intercarrier Compensation* proceeding; (2) the intrastate access charge reform for rural ILECs in view of the new Chapter 30 law and its relevant provisions at 66 Pa. C.S. §§ 3015 and 3017; (3) the Pa. USF; and (4) the potential rate effects on the basic local exchange services of the rural ILECs.

Therefore, I move:

1. That the material question regarding the authority of Presiding ALJ Colwell to rule on Joint Petitioners' *Motion to Defer* be answered in the negative consistent with the Staff recommendation.

2. That the material question regarding the request of Joint Petitioners for a stay of this proceeding be answered in the affirmative and granted in part and denied in part.

3. That a stay of this Investigation be granted for a period not to exceed twelve (12) months or until the FCC issues its ruling in its *Unified Intercarrier Compensation* proceeding, whichever occurs earlier.

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<sup>7</sup> OCA Brief, at 9-10.

4. That the Commission Staff monitor the FCC's *Unified Intercarrier Compensation* proceeding.

5. That the Commission shall entertain future requests for further stays of this Investigation for good cause shown and for the purpose of coordinating this Commission's actions with the FCC's ruling in its *Unified Intercarrier Compensation* proceeding.

6. That upon the expiration of the 12-month stay period or the issuance of an FCC ruling in the *Unified Intercarrier Compensation* proceeding, whichever occurs earlier, the parties to this proceeding shall submit status reports to the Commission.

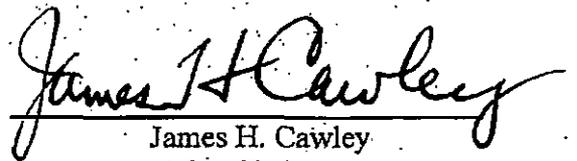
7. That, upon the receipt of these status reports, the Office of Special Assistants and the Law Bureau shall prepare a Staff recommendation for the Commission's timely consideration at a Public Meeting on reinstating this Investigation and taking any other appropriate action.

8. That upon the resumption of this Investigation, the participating parties shall be afforded the due process opportunity to appropriately supplement the evidentiary record.

9. That, upon the resumption of this Investigation, the participating parties should address and provide record evidence on the legal, ratemaking and regulatory accounting linkages between: (a) the FCC's ruling in its *Unified Intercarrier Compensation* proceeding; (b) the intra-state access charge reform for rural ILECs in view of the new Chapter 30 law and its relevant provisions at 66 Pa. C.S. §§ 3015 and 3017; (c) the Pa. USF; and (d) the potential effects on rates for the basic local exchange services of the rural ILECs.

10. That the Office of Special Assistants prepare the appropriate Order.

August 11, 2005



James H. Cawley  
Vice Chairman

ORIGINAL



August 17, 2005

*Via Overnight Delivery*

James J. McNulty, Secretary  
Pennsylvania Public Utility Commission  
Commonwealth Keystone Building, 2<sup>nd</sup> Floor  
400 North Street  
Harrisburg, PA 17120

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

Dear Mr. McNulty:

Please find enclosed an original and nine (9) copies of the Main Brief on Remand of MCImetro Access Transmission Services LLC in the above-referenced case.

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

Very truly yours,

A handwritten signature in cursive script that reads "Michelle Painter".  
Michelle Painter

cc: The Honorable Cynthia Williams Fordham  
Certificate of Service

Enclosure

DOCUMENT  
FOLDER

RECEIVED

AUG 18 2005

PA PUBLIC UTILITY COMMISSION  
SECRETARY'S BUREAU

**SERVICE LIST**

I hereby certify that I have this day caused a true copy of MCI's Main Brief to be served upon the parties of record in Docket No C-20027195 in accordance with the requirements of 52 Pa. Code Sections 1.52 and 1.54 in the manner and upon the parties listed below.

Dated in Ashburn, VA on August 17, 2005

**VIA E-MAIL AND OVERNIGHT DELIVERY**

Patricia Armstrong  
Thomas, Thomas, Armstrong & Niesen  
212 Locust Street, Suite 500  
Harrisburg, PA 17108  
Phone – 717-255-7627

Bill Petersen  
Verizon  
1717 Arch Street, 32N  
Philadelphia, PA 19103  
Phone – 215-963-6065

Robert Eckenrod  
Pennsylvania Public Utility Commission  
Office of Trial Staff – 2<sup>nd</sup> Floor  
Commonwealth Keystone Building  
400 North Street  
Harrisburg, PA 17120  
Phone – 717-787-1976

Steven Gray  
Office of Small Business Advocate  
Suite 1102, Commerce Building  
300 North Second Street  
Harrisburg, PA 17101  
Phone – 717-783-2525

Sue Benedek  
United Telephone  
240 North Third Street, Suite 201  
Harrisburg, PA 17101  
Phone – 717-236-1385

Robert C. Barber  
AT&T  
3033 Chain Bridge Road  
Oakton, VA 22185  
Phone – 703-691-6061

Phil McClelland  
Office of Consumer Advocate  
555 Walnut Street, 5<sup>th</sup> Floor  
Harrisburg, PA 17101  
Phone – 717-783-5048

John F. Povilaitis  
Ryan, Russell, Ogden & Seltzer  
800 North Third Street, Suite 101  
Harrisburg, PA 17102  
Phone – 717-236-7714

Kirstin L. Smith, Esquire  
Qwest Communications Corporation  
1801 California Street - Suite 4900  
Denver, Colorado 80202  
Phone - 303.672.2820

Alan Kohler  
Wolf Block Schorr & Solis-Cohen  
213 Market St, 9<sup>th</sup> Floor  
Harrisburg, PA 17101  
Phone – 717-237-7172

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**AUG 18 2005**

**PA PUBLIC UTILITY COMMISSION  
SECRETARY'S BUREAU**

  
Michelle Painter

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

MAIN BRIEF

on Remand of

MCI METRO ACCESS TRANSMISSION SERVICES LLC

DOCUMENT  
FOLDER

**DOCKETED**  
AUG 19 2005

August 17, 2005

**RECEIVED**

AUG 18 2005

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	:	
v.	:	C-20027195
	:	
Verizon North, Inc.	:	

**MAIN BRIEF ON REMAND OF  
MCImetro ACCESS TRANSMISSION SERVICES LLC**

**I. BACKGROUND**

This is the second phase of a case to address the access rates of Verizon Pennsylvania, Inc. and Verizon North, Inc. (collectively "Verizon"). The first phase was concluded by a Commission Order entered on July 28, 2004 ("Phase I Order"). In that first phase, the Commission adopted a settlement between Verizon and several other parties that was supposed to lead to access reductions of approximately \$55.6 million, but that led to actual reductions of less than \$49 million. These reductions came primarily from decreases in the access rates of Verizon North. In the Phase I Order, the Commission remanded this case back to the Office of Administrative Law Judge, stating as follows:

[R]ather than marking the instant proceeding closed, as recommended by the ALJ and suggested by Verizon, we shall remand this case back to the ALJ for the further development of the record and the issuance of a recommended decision concerning those policy issues and other access charge concerns that were raised by the IXCs in their Exceptions but which were not specifically resolved by a recommendation in this instant proceeding. These issues include, but are not limited to, AT&T's

two-step access charge reduction proposal, the removal of all implicit subsidies from access charges, the reduction and possible elimination of the Carrier Charge, as well as the outstanding issues delineated in the Exceptions that follow..."

Phase I Order, pp. 16-17.

The ALJ issued a Prehearing Order on February 14, 2005. A Prehearing Conference was held on February 17, 2005. A supplemental Prehearing Conference was held on April 4, 2005. At that time, a schedule was established. Direct Testimony was filed by MCI and other parties on June 8, 2005. Rebuttal Testimony was filed by MCI and other parties on June 29, 2005. Surrebuttal Testimony was filed by MCI and other parties on July 11, 2005. Hearings were scheduled for July 19-20, 2005. However, the parties agreed to waive the need for hearings. Instead, a telephonic hearing was held on July 19, 2005, at which time testimony was admitted into the record. This Main Brief is being filed in accordance with the schedule established in this matter.

## II. INTRODUCTION AND STATEMENT OF THE CASE

Intrastate access rates imposed by Verizon remain significantly in excess of cost, however calculated. These above cost rates are distorting the competitive marketplace and must be lowered to cost-based levels. The only significant debate in this proceeding focuses on two issues: whether reductions in addition to those ordered in Phase I should be ordered now and how to implement any rate reduction in a revenue neutral manner as mandated by the legislature.

The communications industry is undergoing revolutionary change. The telecommunications landscape that existed in 1984 when the current rules for interstate and intrastate access rates were implemented following the break up of the Bell System

bears little resemblance to today's landscape. Markets have evolved in ways not even anticipated in 1996 when Congress enacted the Telecommunications Act. The market for voice communications has seen massive change, with the emergence of local/long distance bundled service, substitution of wireless service for landline local and long distance calling and the use of e-mail and instant messaging as substitutes for voice communications over traditional landline networks.

With all this change, it is critical that regulation keep pace with the changes in the market landscape. The remnants of the old traditional regulatory regime must be eliminated so that the market, not regulation, chooses who succeeds and who fails. Regulatory policies should no longer protect one class of carrier at the expense of other classes of providers. No carrier should be burdened by outmoded regulatory policies; likewise, no carrier or class of carriers should be protected, and even subsidized, by archaic regulatory policies. The current intrastate access charge regime seriously tilts the competitive playing field and is in need of fundamental overhaul in order to make regulatory policies consistent with the market realities of today.

This Commission has already recognized the need to reduce access rates to cost-based levels. As the Commission noted on the second page of its Phase I Order, "[t]he *Global Order* further directed that a subsequent access charge proceeding be commenced in January 2001 for the purpose of determining additional access charge reductions, and possible elimination of the Carrier Charge pool, with a deadline to complete the case and effect additional access charge reductions by December 31, 2001."<sup>1</sup> The *Global Order*

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<sup>1</sup> See *Re Nextlink Pennsylvania, Inc.*, Docket No. P-00991648; P-00991649, 93 PaPUC 172 (September 30, 1999) (*Global Order*); 196 P.U.R. 4<sup>th</sup> 172, *aff'd sub nom. Bell Atlantic-Pennsylvania, Inc. v. Pennsylvania Public Utility Commission*, 763 A.2d 440 (Pa.Cmwlth. 2000), *vacated for lack of jurisdiction, MCI WorldCom, Inc. v. Pa.PUC* 844 A2d 1239 (Pa. 2004).

was entered in September of 1999. In that Order, the Commission specifically stated, "We believe that the sooner that we resolve the reduction and possible elimination of the carrier pool, the better it would be for the competitive environment in Pennsylvania." Global Order, p. 59. This Commission has thus recognized for nearly six years that access reductions should be reduced, and that the Carrier Charge should possibly be eliminated to promote competition. In remanding this case back to the ALJ for further hearings, the Commission further stated that, "consistent with the Telecommunications Act of 1996, as well as our *Global Order*<sup>2</sup>, it has been this Commission's policy to work toward the elimination of implicit subsidies that may exist in access charge rates." Phase I Order, p. 19. The Commission also found that "based on our previous goal in the *Global Order* that we may eventually dissolve the Carrier Charge, we believe it is in the best interest of the public for the ALJ to address and recommend a plan that addresses further reductions or even a complete elimination or phase-out of the Carrier Charge in the next phase of the investigation." *Id.* at p. 20.

In its Further Notice of Proposed Rulemaking in the *Unified Intercarrier Compensation* proceeding, the FCC acknowledged that the current system of access charges and intercarrier compensation is broken and in need of change:

The record in this proceeding shows that the three basic principles underlying our existing intercarrier compensation regimes must be re-examined in light of significant market developments since the adoption of the access charge and reciprocal compensation rules. First, our existing compensation regimes are based on jurisdictional and regulatory distinctions that are not tied to economic or technical differences between services. As the Commission observed in the *Intercarrier Compensation NPRM*, regulatory arbitrage arises from different rates that different types of providers must pay for essentially the same functions. Our current classifications require carriers to treat identical uses of the network differently, even though such disparate treatment usually has no economic

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<sup>2</sup> See, *Global Order*, p. 26.

or technical basis. These artificial distinctions distort the telecommunications markets at the expense of healthy competition. Moreover, the availability of bundled service offerings and novel services blur the traditional industry and regulatory distinctions that serve as the foundation of the current rules.<sup>3</sup>

Since FCC action to fix the current flawed system is neither certain nor imminent, the Commission should not wait to implement further changes to Verizon's intrastate access rates in Pennsylvania. Verizon's rates should be reduced immediately to cost, or at a minimum, they should be reduced to the level of Verizon's interstate access rates as a transitional step to a final reduction to cost. Even though the law now requires any access reductions to be revenue neutral, these access reductions can be implemented without substantial increases to end user rates.

### **III. EXCESSIVE INTRASTATE ACCESS RATES CONTINUE TO HARM THE COMPETITIVE MARKET**

As MCI witness Dr. Pelcovits explained in his testimony, the pricing of access services at cost will remove distortions in the marketplace and will allow consumers to realize both static and dynamic efficiency gains. First, pricing access at cost will send the right signals to consumers. If rates are not cost-based, consumers will consume too little of the service and will substitute other services that are not as desirable. Pelcovits Direct, p. 8. In addition, maintaining above-cost access rates will cause long distance rates to be set artificially high, resulting in usage levels that are below optimal levels, thereby discouraging technological change that might have resulted were long distance rates correctly aligned with costs. Pelcovits Direct, p. 8.

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<sup>3</sup> Further Notice of Proposed Rulemaking, *In the Matter of Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, rel. March 3, 2005, ¶15 (footnotes omitted).

Above-cost access rates distort the functioning of the competitive marketplace by conferring unfair cost advantages on the incumbent LECs and wireless carriers. The market is moving toward flat-rate, bundled services, with consumers paying a flat monthly fee for unlimited local and long distance service. If intrastate access rates are allowed to remain at their current levels, companies that seek to compete with the ILECs are placed at an unfair cost advantage. These competitors must pay high originating and terminating access fees to Verizon, while Verizon incurs only the economic costs of providing access functions to itself. The competitors must still try to price their services to end users at rates that will be competitive with Verizon's rates. The difference between the high access rates paid by competitors and the economic cost of access "paid" by Verizon is an unfair cost advantage for Verizon that competitors cannot overcome. Pelcovits Direct, p. 9.

The current access regime also creates an unfair cost advantage for wireless carriers. This class of competitors pays only local transport and termination charges for calls within Major Trading Areas. In contrast, wireline IXCs must pay the much higher intrastate access rates for these same calls.

The local transport and termination rates paid by wireless carriers are substantially lower than the intrastate access charges paid by IXCs for intrastate traffic. For example, local switching costs 0.6212 cents per minute for intrastate access, but only 0.1175 cents per minute under the local transport and termination rates. Transport rates show a similar gap; a typical minute of common transport costs 0.1628 cents as intrastate access, but only 0.0426 cents as local transport.<sup>4</sup> Pelcovits Direct, p. 9.

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<sup>4</sup> Transport costs assume a tandem switch and transport termination charge, plus ten miles of per mile tandem transport.

As illustrated in Dr. Pelcovits' direct testimony, most of *Pennsylvania is located* in the Philadelphia or Pittsburgh MTAs. Pelcovits Direct, p. 10; *see also* Exhibit 1 to Pelcovits Direct. Wireless calls within these large areas can be terminated at a much lower cost than wireline long distance calls. The Commission should remove this unfair cost advantage by reducing intrastate access rates to cost-based levels.

#### **IV. VERIZON'S INTRASTATE ACCESS RATES REMAIN WELL ABOVE COST**

In Phase I of this proceeding, the Commission restructured intrastate access rates so that the rate structure mirrored Verizon's interstate access rates. The Commission also adopted a settlement that was supposed to lead to reduced access rates in the amount of \$55.6 million. The evidence in this case shows that the reductions were actually closer to \$49 million. Virtually all of the reduced access rates came from decreases to Verizon North's carrier charge and a slight decrease to local switching. However, Verizon Pennsylvania's rates remained virtually unchanged, and in fact, some rates increased. Despite the overall reductions in Phase I, the intrastate access rates of these two ILECs remain well in excess of costs, creating inefficiencies and anti-competitive distortions in the market. As shown in Dr. Pelcovits' direct testimony, intrastate access rates remain well above interstate rates:

**Verizon's Intrastate vs. Interstate Switched Access Rates**

<b>Rate Element</b>	<b>Intrastate rates<sup>5</sup> Cents per minute</b>	<b>Interstate rates<sup>6</sup> Cents per minute</b>	<b>Intrastate as Percent of Interstate</b>
Local Switching	0.6212	0.2431	255.5%
Tandem transport termination	0.0195	0.0000	∞
Tandem transport facility (per Mile)	0.0045	0.0030	150.0%
Tandem-switching	0.0983	0.1000	98.3%
Carrier Charge	\$0.58	0	∞

Pelcovits Direct, p. 11. The Commission's Phase I decision affected only two of these rates, reducing the local switching rate from \$0.9336 to \$0.6212, and the carrier charge to \$0.58.

Even if the Commission were to set intrastate access rates at the interstate level, the intrastate rates would still be well in excess of cost. Verizon's UNE rates in Pennsylvania represent the Commission's best estimate of the forward looking economic cost of providing switching and transport. These rates are below Verizon's interstate rates. The following table from Dr. Pelcovits' direct testimony compares Verizon's intrastate access, interstate access and UNE rates:

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<sup>5</sup> Tariff PA PUC No. 302, §§ 6.9.2.(B); 6.9.3.(A); 6.9.7. The carrier charge is per line per month.

<sup>6</sup> Tariff FCC No. 1, §§ 6.9.1.B; 6.9.2.A.

**Verizon's Intrastate Switched Access vs. UNE Rates**

<b>Rate Element</b>	<b>Intrastate rates Cents per minute</b>	<b>Interstate rates<sup>7</sup> Cents per minute</b>	<b>UNE rates<sup>8</sup> Cents per minute</b>
Local Switching	0.6212	0.2431	0.1274
Tandem transport termination	0.0195	0.0000	0.0206
Tandem transport facility (per Mile)	0.0045	0.0030	0.0010
Tandem-switching	0.0983	0.1000	0.0120
Carrier Charge	0.58	0	0

Pelcovits Direct, p. 13.

Verizon's intrastate access rates are also, for the most part, in excess of the costs of access services estimated by Verizon. See Pelcovits Direct, p.14. Thus, by any measure of cost, Verizon's current intrastate access rates are well above the cost of providing the service.

Finally, there is simply no cost basis whatsoever for imposing the carrier charge on interexchange carriers. Dr. Pelcovits explained the point in his direct testimony:

The carrier charge is intended to recover a portion of the non-traffic sensitive part of the network, e.g. the local loop, from long distance carriers and their customers. By its very nature, however, the ILEC's non-traffic sensitive costs are not affected by the level of long distance usage, and therefore they should not be recovered on a usage sensitive basis.

Pelcovits Direct, pp. 14-15.

<sup>7</sup> Tariff FCC No. 1, §§ 6.9.1.B; 6.9.2.A.

<sup>8</sup> Tariff PA PUC No. 216, §§ 3.C.2.b; 3.C.2.d; 3.C.3.b. The local switching rate is the average of the originating rate of 0.1373 cents and the terminating rate of 0.1175 cents. Even with the FCC's recent decision to allow the switching rate to be raised by \$1 per month as a transition mechanism to phasing out the local switching UNE, the local switching UNE rate would increase by only about 0.04 cents. This increase can be computed by dividing the \$1 increase by 2,465, which is the number of dial equipment minutes (176.2 billion, as reported in the 2004 ARMIS 43-04, row 1216, column b) per switched access line (5,957,098, as reported in ARMIS 43-08, row 490 column "f") for Verizon Pennsylvania and Verizon North. However, the FCC's \$1 increase has nothing to do with a cost-based analysis and therefore should not be used for purposes of setting cost-based access rates in this case.

The Office of Small Business Advocate and the Pennsylvania Office of Consumer Advocate contend that interexchange carriers should continue to pay this charge as a means of compensating Verizon for the IXCs' use of the local loop. Buckalew Direct, p. 7; Loube Direct, p. 12. As Dr. Pelcovits explained in his rebuttal testimony, the per line carrier charge does not collect non-traffic sensitive costs in the most efficient manner. When the IXCs pay this charge, cost recovery is simply shifted from Verizon to the IXCs, who then have to try to recover the charge in their rates, which is not always possible in a competitive market. The most efficient and sustainable manner for recovering these costs is for Verizon to charge its end users directly on a flat-rate basis. Pelcovits Rebuttal, p. 2.

The carrier charge is a non-cost-based rate and should be abolished in setting access rates at a cost-based level. The Commission has recognized since 1999 that the Carrier Charge should be eliminated, and it is well past the time for the Commission to *finalize the elimination of this unjustified and discriminatory rate element.*

## **V. THE COMMISSION SHOULD NOT DELAY FURTHER ACCESS REDUCTIONS**

The Commission should act now to further reduce access rates, and to bring them to cost-based levels. As noted previously, the Commission recognized as far back as 1999 in the *Global Order* that access charges should be further reduced, and that implicit subsidies should be eliminated. In initiating this second phase, the Commission stated:

Nevertheless, we also agree, to some extent, with those IXCs who argue that the ALJ's Recommended Decision did not go far enough because it failed to establish "next steps" to further reduce access rates in the near future. We note that the ALJ's recommendation mainly focused on the issue of attaining access

rate parity as required by the *Merger Order*, but failed to address some of the more significant policy issues raised by the Parties. In particular, a major aspect of the *Global Order* involving the possible elimination of the Carrier Charge and removal of all implicit subsidies from access charges were not resolved in this proceeding by the ALJ.<sup>9</sup>

Phase I Order, pp. 15-16.

The Commission further recognized that access reductions to cost-based levels are well overdue.

Furthermore, we note that this proceeding, in part, had its genesis in the *Global Order*, which ordered that an investigation be commenced on January 2, 2001, with an original deadline to complete the case, and reduce rates, by December 31, 2001.<sup>10</sup>

Phase I order, p. 16.

The Commission also should not wait for the FCC before implementing further access reductions consistent with this Commission's prior stated policy. While the FCC is considering access charge reform in the *Unified Intercarrier Compensation* rulemaking, there is no guarantee as to when this proceeding will be completed. Given the complex nature of the issues before the FCC in its proceeding and the multitude of conflicting industry interests, quick resolution is unlikely. Even if final action is forthcoming reasonably soon (which does not appear to be the case), it is impossible to predict as to whether the FCC will take any action that would affect the ability of the state commissions to set intrastate access rates.

The Commission should also not wait until the FCC addresses interstate access rates in light of the expiration of the CALLS Plan. The CALLS Plan will remain in effect

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<sup>9</sup> See *Global Order* at 59-60.

<sup>10</sup> *Global Order* at 60.

until the FCC changes it. As a result, FCC action to further revise switched access price cap regulation cannot reasonably be expected in the near term. Delaying action until the FCC acts on a post-CALLS Plan or until the FCC completes its rulemaking on a unified intercarrier compensation regime will simply result in postponing the benefits of lower access rates to Pennsylvania consumers and will unfairly perpetuate the unfair competitive advantages held by the incumbent LECs and wireless carriers in the provision of intrastate toll service.

## **VI. REVENUE NEUTRALITY CAN BE IMPLEMENTED WITH MINIMAL IMPACT ON END USERS**

Last year, the Pennsylvania legislature amended the Public Utilities Code to require that any reductions in switched access rates ordered by the Commission must be implemented on a revenue neutral basis.<sup>11</sup> As Dr. Pelcovits testified, reducing access rates to cost will have only a minimal impact on end user rates:

If intrastate access charges were cut to the level of interstate access charges, and the entire reduction were recovered in a per-line charge assessed on all business and residential lines, the resulting charge would be at most \$0.95 per line per month. Furthermore, cutting the five rates listed in Table 2 to UNE levels would add only about \$0.13 per line per month for a total of \$1.08 per line per month.

Pelcovits Direct, p. 17 (footnote omitted). According to the FCC's reports on local service rates, monthly local rates in Pennsylvania range from a low of \$20.73 in New Castle to a high of \$23.45 in Philadelphia and Pittsburgh. Pelcovits Direct, p. 18. A rate increase of this small size -- \$1.08 per month -- would still leave Pennsylvania consumers with local rates below the level of rates in neighboring states:

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<sup>11</sup> See Public Utilities Code (66 PA.C.S.) – Omnibus Amendments Act of 2004, P.L. 1398, No. 183, § 3017(a).

Pennsylvania has the lowest monthly local charge among all its neighboring states, except for New Jersey. Rates in Pennsylvania are below those reported for Virginia (\$30.59 to \$31.43), Maryland (\$27.94), and New York (\$20.44 to \$34.47). Only New Jersey, with a rate of \$17.09, has a lower monthly rate. However, New Jersey has relatively small local calling areas, which keeps its basic local rate low.

Pelcovits Direct, p. 18.

From an economic perspective, the best policy choice for the Commission in complying with the legislative mandate is to recover the revenues "lost" from access rate reductions by increasing the rates for services that are priced below cost or that are priced closer to cost than access service is. As shown earlier, access rates are currently set well in excess of costs. In addition, the rate-to-cost ratio for switched access service is much higher than for most other services, including local dial tone rates and local usage rates.

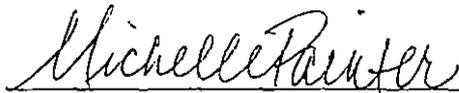
Pelcovits Direct, pp. 18-19.

## **VII. CONCLUSION**

The Commission should ensure that its regulatory policies are consistent with the current state of competition in the telecommunications industry. The system of intrastate access charges permits certain competitors to enjoy a significant unfair cost advantage relative to other competitors. Regulation should not favor some competitors over others. To remedy these problems, the Commission must act and act now to lower intrastate access rates to cost, or, as an interim step, to the level of interstate rates. In initiating the second phase of this matter, the Commission already recognized the need to eliminate all subsidies in access charges, and particularly, to eliminate the Carrier Charge. Market forces will cause access savings to be returned to consumers, negating any perceived

negative effects of a slight increase in local rates that would be necessary to comply with the legislature's mandate that these rate changes be revenue neutral.

Respectfully submitted,



Michelle Painter  
MCI, Inc.  
22001 Loudoun County Parkway  
Ashburn, VA 20147  
Telephone: (703) 886-5973  
Facsimile: (703) 886-0633  
E-mail: [Michelle.Painter@mci.com](mailto:Michelle.Painter@mci.com)

Richard C. Fipphen  
MCI, Inc.  
200 Park Avenue, 6<sup>th</sup> Floor  
New York, NY 10166  
Telephone: (212) 519-4624  
Facsimile: (212) 519-4811  
E-mail: [Richard.Fipphen@mci.com](mailto:Richard.Fipphen@mci.com)

Dated: August 17, 2005

**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

In Re The Joint Application of :  
Bell Atlantic Corporation and GTE :  
Corporation for Approval of Agreement :  
And Plan of Merger : Docket No. C-20027195  
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AT&T Communications of Pennsylvania, Inc. :  
v. Verizon North, Inc. :

**MAIN BRIEF ON REMAND  
OF QWEST COMMUNICATIONS CORPORATION**

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John F. Povilaitis  
Matthew A. Totino  
RYAN, RUSSELL, OGDEN & SELTZER LLP  
800 North Third Street, Suite 101  
Harrisburg, PA 17102-2025  
Phone: (717) 236-7714  
Fax: (717) 236-7816  
Email: [JPovilaitis@RyanRussell.com](mailto:JPovilaitis@RyanRussell.com)

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PA PUBLIC UTILITY COMMISSION  
SECRETARY'S BUREAU

Kristin L. Smith  
Senior Attorney  
Qwest Communications  
1801 California Street, 10th Floor  
Denver, CO 80202  
Phone: (303) 383-6614  
Fax: (303) 298-8197  
Email: [kristin.smith@qwest.com](mailto:kristin.smith@qwest.com)

Counsel for Qwest Communications Corporation

Dated: August 17, 2005

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<i>AT&amp;T Communications of Pennsylvania, Inc. v. Verizon North, Inc.</i> , C-20027195 (Order Entered January 18, 2005) at 15 ( <i>emphasis added</i> ) (“ <i>January 18, 2005 Order</i> ” ).....	3

### Miscellaneous Cases

<i>See In the Matter of Deployment of Wireline Services Offering Advanced Telecommunications Capability</i> , 15 FCC Rcd. 385, 390 (1999); <i>In the Matters of Deployment of Wireline services Offering Advanced Telecommunications Capability and Implementation of the Local Competition Provisions of the Telecommunications Act of 1996</i> , 14 FCC Rcd. 20912, 20953 (1999).....	14
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## I. STATEMENT OF THE CASE

The Pennsylvania Public Utility Commission (“Commission”) concluded the initial phase of this proceeding by issuing *July 28, 2004 Order*, approving the Joint Petition of Verizon Pennsylvania Inc. and Verizon North Inc. (collectively “Verizon”) and Office of Consumer Advocate (“OCA”), as supplemented by the February 26, 2004 Joint Petition for Resolution.<sup>1</sup> The Joint Petition for Resolution reconciled the rate structure parity between Verizon Pennsylvania and Verizon North, pursuant to the *Bell Atlantic-GTE Merger Order*.<sup>2</sup> However, the Commission reversed the recommendation of the Administrative Law Judge (“ALJ”) to close the case by directing the issues of access charge reform raised by AT&T Communications of Pennsylvania, LLC. (“AT&T”), MCI WorldCom Communications, Inc. (“MCI”) and Qwest Communications Corporation (“Qwest”) (collectively “IXCs”), but not ruled on, be remanded for a recommended decision.

In its *July 28, 2004 Order* remanding the issue of access charge reform, the Commission specified that:

[W]e also agree, to some extent, with those IXCs who argue the ALJ’s Recommended Decision did not go far enough because it failed to establish ‘next steps’ to further reduce access rates in the near future. We note that the ALJ’s recommendation mainly focused on the issue of attaining access rate parity as required by the *Merger Order*, but failed to address some of the more significant policy issues raised by the parties. In particular, a major aspect of the *Global Order* involving the possible elimination of the Carrier Charge and removal of all implicit subsidies from access charges were not resolved in this proceeding by the ALJ.”<sup>3</sup>

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<sup>1</sup> The Joint Resolution was also supported by Office of Small Business Association (“OSBA”).

<sup>2</sup> *AT&T Communications of Pennsylvania, Inc. v. Verizon North, Inc.*, C-20027195 (Order Entered July 28, 2004) at 36 (“*July 28, 2004 Order*”). The access charge reductions were made on a revenue-neutral basis with the understanding that no more than \$40 million would be shifted residential local service rate increases, and increases to business lines would be no more than \$1.00 per line.

<sup>3</sup> *July 28, 2004 Order* at 15-16.

Indeed, the Commission described the issues remaining to be resolved as including “AT&T’s two-step access charge reduction proposal, the removal of all implicit subsidies from access charges, the reduction and possible elimination of the Carrier Charge, as well as the outstanding issues delineated in the Exceptions that follow.” The “Exceptions-that-follow” included Qwest’s recommendation that rates be set at interstate access charge levels, as set forth in Verizon’s approved tariffs at the Federal Communications Corporation (“FCC”).<sup>4</sup> The Commission noted that the parties had expended “significant resources” in the initial phase of this docket on issues that did not receive the “benefit of a recommended decision.”<sup>5</sup>

Verizon petitioned the Commission for reconsideration of the *July 28, 2004 Order*. Verizon sought reconsideration of the Commission’s decision to remand on three grounds. First, Verizon saw no need to further develop the record since Verizon believed that the issues to be addressed in the remand were already addressed by the Parties in the testimony and briefs filed in the underlying proceeding. Second, Verizon felt that the ALJ did address the policy issues, either explicitly or implicitly, when she recommended adoption of the Verizon /OCA Joint Proposal and thus, no further consideration of these issues was warranted. Third, Verizon opined that the consideration of the policy issues was beyond the scope of this Docket.

In an *November 23, 2004 Order*, the Commission denied the reconsideration, confirming its decision to remand the proceeding for issuance of a recommended decision on policy issues including: “(1) a recommendation of the ‘next steps’ for access reform”; “(2) a

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<sup>4</sup> *July 28, 2004 Order* at 17.

<sup>5</sup> *See supra* at 16.

recommendation on whether access charges should be reduced ‘to cost’; and “(3) a recommendation on the elimination of the carrier charge.”<sup>6</sup>

As of November of 2004, Verizon had failed to implement the access rate restructure from the *July 28, 2004 Order*. Concerned with this lack of compliance, AT&T, MCI and Qwest also filed a Joint Petition for Clarification on November 17, 2004 requesting: (1) that the Commission to set February 1, 2005 as the compliance filing deadline; (2) that the compliance rates be made retroactive to February 1, 2005, if necessary; and (3) that the remand be completed on an expedited basis with further reduction of access rates based on the record.

The Commission granted the Joint Petition for Clarification in part and denied it in part. The Commission established February 1, 2005 as the compliance filing date and directed the remand be conducted “*in an expedited manner*” to the extent the Office of ALJ was able to do so.<sup>7</sup> More importantly, the Commission recognized “now that the PCO has been filed and Verizon has committed to making its compliance filing to become effective February 1, 2005, the Parties will have a better understanding of the actual level of Verizon’s remaining access charges so that they could proceed in a manner that best addresses whether the newly restructured access charges *should be reduced to cost or eliminated*.”<sup>8</sup> Per OCA’s suggestion, the Commission agreed to expand the remand phase of this proceeding to consider the FCC activity “*to the extent that the FCC issues a decision prior to the issuance of the Recommended Decision on Remand in this proceeding*.”<sup>9</sup>

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<sup>6</sup> *AT&T Communications of Pennsylvania, Inc. v. Verizon North, Inc.*, C-20027195 (Order Entered November 23, 2004) at 3, citing *Id.* at 16, 18 and 20 (“*November 23, 2004 Order*”).

<sup>7</sup> *AT&T Communications of Pennsylvania, Inc. v. Verizon North, Inc.*, C-20027195 (Order Entered January 18, 2005) at 15 (*emphasis added*) (“*January 18, 2005 Order*”).

<sup>8</sup> *January 18, 2005 Order* at 12-13 (*emphasis added*).

<sup>9</sup> *January 18, 2005 Order* at 15 (*emphasis added*).

In this remand phase, the ALJ has conducted several prehearing conferences, contemplating various delay tactics offered. Despite arguments from Verizon, OCA, OSBA and OTS to set a schedule that would postpone completion of the remand until the FCC completes its intercarrier compensation proceeding, the ALJ set a schedule calling for submission of supplemental direct, rebuttal and surrebuttal testimony, and hearings on July 19, and 20, 2005. These hearings were convened as scheduled but were curtailed in length, due to a stipulation that admitted testimony and waived cross-examination by all parties. In response to the Direct Testimony of OCA, OTS and Verizon, Qwest filed a Motion to Strike on the grounds that certain recommendations proposed were unlawful, because. Qwest reasoned that any discussion and consideration of long distance rates and “flow-through” is beyond the scope of the remand, and that the Commission does not have authority to require “flow-through” under Chapter 30 of the Public Utility Code. The ALJ denied this Motion by Order of July 22, 2005, noting that parties may address the potential consumer impact of finally effectuating access charge reform in Pennsylvania, though requiring a mandatory flow through was not at issue in this remand.

## II. SUMMARY OF ARGUMENT

Verizon's intrastate switched access charges should be reduced to the interstate levels in a revenue-neutral and a competitively-neutral manner. The Commission has a choice in this proceeding of either buttressing the archaic policies argued by OCA, OSBA, OTS and Verizon that originally supported establishment of a Verizon carrier charge and minutes-of-use charge in the 1999 *Global Order* in order to reduce the price of local exchange service, or eliminating inconsistency between jurisdictions and reducing opportunities for arbitrage. The regulatory structure currently in place artificially distorts the competitive process by permitting shifts of costs to IXCs through intercarrier charges.

Access charge reform in Pennsylvania has been delayed long enough. Six years ago, the Commission reiterated its commitment "to reduce implicit subsidy charges such as access charges that impede competition in the telecommunications market."<sup>10</sup> The Commission went on to explain that "[a]s implicit charges become explicit charges, competitors are better able to compete for local and long distance customers in an ILEC's service territory because IXCs are not hindered by paying ILECs excessive access charges in providing competitive toll services and CLECs are better able to compete with ILEC local service rates that have been kept artificially low as a result of the access charge subsidies."<sup>11</sup> Removing the implicit subsidies in Verizon's access charges requires reducing intrastate access rates to interstate rates on a revenue-neutral and competitively-neutral basis, as well as eliminating the Carrier Charge ("CC"). However, this reduction envisioned by the Commission has yet to be fully realized by Pennsylvania consumers.

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<sup>10</sup> *Global Order* at 10.

<sup>11</sup> *Id.*

First, there was a delay for the Commission to approve the merger between Bell Atlantic and GTE (now Verizon).<sup>12</sup> Next came the granting of Verizon's Section 271 relief, allowing Verizon to re-enter the long distance marketplace.<sup>13</sup> In the meantime, Pennsylvania consumers have yet to benefit from achieving access charge reform in Pennsylvania, while the competitive carriers striving to serve them face increasing impediments on their ability to compete effectively, as industry changes and new technologies become available which allow certain industry participants either to avoid or arbitrage access charges.<sup>14</sup>

It is clear from the record that removing the implicit subsidies in Verizon's intrastate access charges will benefit Pennsylvania consumers. Reforming access charges by removing implicit subsidies on a revenue-neutral and competitively neutral basis serves several policy goals, including (a) eliminating an opportunity for rate arbitrage; (b) instituting a level playing field for IXCs to compete with non-traditional technologies, such as wireless, cable and VoIP services, which are not subject to access charges; and (c) allowing IXCs with averaged toll rate plans to recover their costs. Such reformation provides consumers the ability to make informed decisions about their telephony service, while offering carriers and industry investors a stable regulatory environment, rather than transitory, niche business opportunities, upon which to make sound economic decisions about how the industry should evolve. In light of the pending

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<sup>12</sup> *Id.* In fact, the *Merger Order* recognizes that "in the *Global Order*, we have provided for an investigation to achieve *permanent solutions* to access charge reform on or about January 2, 2001."

<sup>13</sup> *In Re The Joint Application of Bell Atlantic Corporation and GTE Corporation for Approval of Agreement And Plan of Merger, AT&T Communications of Pennsylvania, Inc. v. Verizon North, Inc.*, Docket No. C-20027195, Order (May 1, 2003)("Order Initiating Proceeding") at 3. The Commission in this proceeding recognized that "[t]he mandated access charge investigation was delayed because of Verizon's Section 271 hearings in January and February of 2001."

<sup>14</sup> Qwest St. 1.0, p. 3, lines 13-16.

mega-merger between Verizon and MCI, fostering competition in the local and long distance markets also brings unequivocal advantages to Pennsylvania consumers.<sup>15</sup>

Moreover, the approach proposed by Qwest is consistent with the trends to replace implicit subsidies as indicated at the FCC,<sup>16</sup> which will further benefit Pennsylvania consumers when the FCC decides to take final action on all intercarrier compensation issues. Continuing to postpone the inevitable access charge restructuring in Pennsylvania will only expose consumers to a more significant rate shock, as other jurisdictions evolve compensation mechanisms to reflect the marketplace in 2005, as opposed to 1999. By moving ahead quickly with further access charge reform, the Commission can minimize any impact that local rate rebalancing could arguably have on Pennsylvania consumers.

However, the record remains void of any evidence that any *actual* harm might befall any Pennsylvania consumer from the proposed access charge reform, though the existence of some undefined, unidentified harm was touted repeatedly by several parties.<sup>17</sup> Instead of proving the “harm” some parties contend exists, these parties point to Qwest, and other IXCs, to either prove that no “harm” will occur, or disprove that the alleged, though unsubstantiated “harm” does exist. The IXCs have proven on the record that access charge reform is long overdue in Pennsylvania, while the other parties have failed to provide any evidence that such reform is not warranted. Most importantly, the historic policies of providing contribution through high switched access rates to offset low basic exchange rates are no longer valid in Pennsylvania, given the opportunity to reduce Verizon’s access charges in a revenue-neutral and competitively-neutral manner.

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<sup>15</sup> Qwest St. No. 1.0, p. 7; Qwest Remand St. No. 1, p.p. 6-7.

<sup>16</sup> Qwest St. No. 1.0, p. 12.

<sup>17</sup> Qwest St. No. 3.0, p. 6, lines 7-8.

### III. ARGUMENT

#### **A. THE COMMISSION SHOULD REDUCE VERIZON'S INTRASTATE SWITCHED ACCESS CHARGES TO THE INTERSTATE LEVEL IN A REVENUE-NEUTRAL AND COMPETITIVELY-NEUTRAL MANNER.**

The Commission should adhere to the underlying purpose of this proceeding to reform the switched access charges in Pennsylvania in a meaningful, pro-competitive manner. In evaluating the record in this proceeding, the Commission should consider how resolution of the issues will further the goals of creating and enforcing policies to achieve an overall market-oriented intercarrier compensation regime.

As the record demonstrates, reducing intrastate switched access charges to interstate levels in a revenue-neutral and competitively-neutral manner will ensure that access charge restructuring does not penalize any particular class of consumers or carriers.<sup>18</sup> Although Qwest's position is supported by other carriers specifically, AT&T and MCI who originally sought reductions of Verizon's access charges to "cost", but are consistent with Qwest in that they support an immediate reduction of those charges to parity with Verizon's interstate rates].<sup>19</sup> AT&T explains that "the Commission should instead require the [Verizon ILEC] companies to reduce their traffic sensitive intrastate access rates to the level of Verizon's interstate access rates."<sup>20</sup> MCI states that the Commission should "at a minimum, reduce access rates to their interstate levels, with a specific time frame for finally reducing access rates to cost-based levels."<sup>21</sup> In fact, revenue neutrality and competitive neutrality ensure that local exchange carriers, incumbent and competitive carriers alike, are not penalized for the progressive

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<sup>18</sup> Qwest St. No. 1.0, p. 7; AT&T St. No. 1.0, pp. 8, 26; MCI St. No. 1.0, p. 33.

<sup>19</sup> AT&T St. 1-R, p. 7; MCI St. 1.0 Remand, p. 7, lines 14 – 17.

<sup>20</sup> AT&T St. No. 1.0, p. 8.

restructuring of rates that are in the long term best interests of competition and consumers in Pennsylvania.<sup>22</sup>

Moving to parity with interstate rates should include adopting Verizon's interstate traffic-sensitive rates, and eliminating the CC charge. Quoting the FCC, Mr. McIntyre explained:

the [FCC's ] longstanding policy is to require, to the extent possible, rate structures to reflect the manner in which carriers incur costs. Inefficient rate structures lead to inefficient and undesirable economic behavior, and create an implicit subsidy between high-volume users and low-volume users. For example, a rate structure that recovers non-traffic sensitive costs through traffic sensitive access rates increases the per-minute rates paid by IXCs and long-distance companies, thereby artificially suppressing demand for interstate long-distance services, and requiring high-volume customers to pay charges in excess of the cost of serving them. Meanwhile, low-volume customers pay rates that are less than the cost of the dedicated equipment.<sup>23</sup>

This subsidization also occurs at the state level. Providing intrastate long distance service over the local loop requires no additional functionality and generates no additional cost to the local carrier.<sup>24</sup> In fact, Verizon agrees with the basic premise that costs for interstate and intrastate switched access are the same.<sup>25</sup>

Consequently, as Mr. McIntyre also explained, since the intrastate access charges of Verizon are higher than its interstate access charges, subsidies do indeed exist in the intrastate rates, regardless of what they are called.<sup>26</sup> In fact, despite its adamant opposition to the existence

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<sup>21</sup> MCI St. 1.0 Remand, p. 7, lines 14 – 17.

<sup>22</sup> Qwest St. No. 1.0, p. 7.

<sup>23</sup> Qwest St. No. 2.0, pp. 8 and 9, lines 19-22, lines 1-7.

<sup>24</sup> Qwest St. No. 1.0, p. 17; Verizon St. No. 3.0, pp. 3-11; MCI St. No. 1.0, pp. 38-39. In fact, access services for intrastate telecommunications are identical with access services provided for interstate telecommunications, though no CC is required for interstate. Tr. at 278-279, 423.

<sup>25</sup> Qwest Ex. 3, Verizon Response to Set II, Interrogatory No. 3 of Qwest (“There are no functional, technical or operational differences in proving these rate elements [access service] for interstate versus intrastate traffic.

<sup>26</sup> Qwest St. No. 2.0, p. 9, lines 11-13.

of subsidies in Verizon's intrastate switched access rates, OCA recognizes that there is "support" for local rates contained in access charges that would not exist, but for the public policy that keeps local rates artificially low.<sup>27</sup> The issue of whether or not there is a "subsidy" or "support" for local rates in access charges is mere semantics.

As the record demonstrates, the traffic-sensitive access rates were designed to recover *more than* Verizon's costs for carrying the IXCs' intrastate toll traffic with a reasonable return.<sup>28</sup> Accordingly, there is no question that the CC, which IXCs pay to Verizon for intrastate long distance services, "is the clearly identifiable subsidy",<sup>29</sup> While there is no question that the loop carries all of these "other services",<sup>30</sup> no entity using the local loop other than the IXCs pay a CC charge, including providers of interstate long distance, wireless, DSL or IP-based telephony services.<sup>31</sup> It is not competitively-neutral to depend solely on intrastate toll services to fund the entire universal service needs of basic customers in the Verizon territory. The CC imposed upon providers of intrastate long distance services, therefore, is an implicit subsidy of the local service, which must be made an explicit charge.<sup>32</sup>

Mr. McIntyre further explained that the historic policies of implicit subsidies underlying current access rates are no longer valid, and are unsustainable. Indeed, Qwest explained that:

Prior to the divestiture of the Bell System, and the proliferation of competition in the long distance market, long distance rates were kept high in support of low local service rates for public policy reasons. The concept of universal service

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<sup>27</sup> Qwest St. No. 2.0, pp. 9 and 10, lines 15-19, lines 1-14.

<sup>28</sup> AT&T St. No. 1, p.p. 27-28; MCI St. No. 1, p. 40.

<sup>29</sup> See also AT&T St. 1-R, p. 18, lines 4 – 7; Qwest St. No. 1.0, p. 8; AT&T St. No. 1.0, pp. 26-28; MCI St. No. 1.0, p. 37; MCI St. No. 2.0, p. 10; Tr. 314-315.

<sup>30</sup> OCA St. No. 1.0, p. 48; OSBA St. No. 1.0, p. 9; OTS St. No. 1.0, p. 6.

<sup>31</sup> AT&T St. No. 1.0, pp. 12, 18-19; Tr. 234, 278-279, 406, 423.

<sup>32</sup> See *Global Order* at 10; see also AT&T St. No. 1.0, pp. 8-9; Tr. 263-280; 408.

drove this implicit subsidy in toll rates. Toll service was still considered somewhat of a luxury. It made sense, from a policy perspective, to keep these rates artificially high to promote the concept of universal local service. . . . [W]hile the original intent of high switched access rates might have been to support the [non-traffic-sensitive] costs of local service, there is no identifiable trail for this hidden support.<sup>33</sup>

Regardless of whether it is called “support” or “subsidization”, Mr. McIntyre went on to explain that:

Whether you call this support a subsidy or not, if such a rate structure is left in place, the support will disappear over time. In fact, even if you consider such support to be ‘appropriate’, it will still disappear. New technologies such as wireless, or Voice-Over-Internet Protocol (“VoIP”) do not pay the carrier charges supported by the OCA. In a competitive environment, the carriers, who must recover this cost from their customers, will be at a competitive disadvantage to those providers not faced with this cost. The result of this is that carriers who must pay this charge will lose business to those who don’t. As a result this support mechanism, whether it is called a ‘subsidy’ or not, is doomed. This support will disappear and will need to be replaced by some other mechanism.”<sup>34</sup>

Contribution through high switched access rates to offset low basic exchange rates no longer fulfills any public policy objectives.

Alternatively, reducing intrastate switched access rates to interstate rates and removing the CC, while shifting support for other services to end-users, will create an economically sound and competitively-neutral rate structure, which will encourage vigorous competition in the market for telecommunications services to the benefit of all Pennsylvania consumers. Moreover, Qwest’s recommendation to set current intrastate access charges at interstate levels has been estimated by Verizon to require an increase of only **Begin Proprietary** \*\*\* **End Proprietary** based on 3.239,000 lines, still leaving Pennsylvania’s local rates below the

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<sup>33</sup> *Id.*, p. 9.

<sup>34</sup> Qwest St. No. 2.0, pp. 11 and 12, lines 17-22, lines 1-4.

levels of neighboring states.<sup>35</sup> Based on these concepts, Qwest encourages the Commission to establish switched access rate reductions in Pennsylvania, which can be accomplished in a revenue-neutral and competitively-neutral manner.

**1. Access Charge Reform Achieves Certain Public Policy Goals Through Establishing Competitively-Neutral Pricing Platforms.**

When participants in a marketplace are required to bear different costs for the same function as other market participants, the market—including the participants, the investors and the consumers—will adapt accordingly. “Lowering access rates to interstate levels on a revenue-neutral and competitively-neutral basis will not only reduce industry problems concerning arbitrage and accurate billing, it will encourage competitive investment, reduce confusion among customers, and create long-term benefits for all consumers.”<sup>36</sup> Bringing intrastate access rates in line with interstate rates on a revenue-neutral and competitively-neutral basis will continue to encourage competition by putting all market participants on a level playing field.

**a. Aligning intrastate access rates with interstate rates will reduce rate arbitrage.**

“The existing disparities between the interstate and intrastate access charge structures invite [sic] rate arbitrage.”<sup>37</sup> Participants in a competitive market often modify their businesses to find lower-priced alternatives to lower their operational costs. Such alternatives created by

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<sup>35</sup> MCI St. 1.0 Remand, pp. 17-18. MCI currently estimates the increase at **Begin Proprietary \*\*\* End Proprietary**, which includes more lines in the per line base than Verizon.

<sup>36</sup> Qwest St. No. 1.0, p. 5.

<sup>37</sup> Qwest St. No. 1.0, p. 14. In fact, Qwest also explains in footnote 4. that “[i]n an *ex parte* filed with the FCC in support of its recent petition to withdraw its FCC tariff on physical collocation, Verizon stated that one of the reasons supporting the move was the elimination of tariff shopping and the “dual [federal and state] regulatory scheme.” Therefore, in other contexts, Verizon has supported the elimination of rate arbitrage opportunities that exist between the intrastate and the interstate jurisdictions.

differences in interstate and intrastate access charges provide the ability and the incentive to IXC carriers to disguise the origin of the calls to change the jurisdiction of calls from intrastate to interstate when the interstate access services costs significantly less.<sup>38</sup>

Specifically, the ILEC often cannot determine whether a call is local, intrastate or interstate—for instance, “when a customer uses a dedicated link to an IXC for both local and long-distance calls.”<sup>39</sup> These customers and other carriers have “the incentive and ability to disguise toll calls as local calls.”<sup>40</sup> Thus, “the other carrier benefits from the favorable terms of local interconnection—including being paid for terminating calls, while avoiding carrier access.”<sup>41</sup>

However, a high degree of regulatory intervention is far from ideal to address these understandable types of market behavior. Qwest submits that “[a] much better solution is to rationalize the rate structure in order to fix the problem.”<sup>42</sup> The Commission has identified this opportunity for arbitrage as a reason for reducing intrastate switched access rates to the interstate rates. In fact, the Commission recognized that mirroring intrastate access rates to interstate rates is “a step towards making the charges closer to cost and closer to the interstate access charges will help to avoid arbitrage and will help competition enter the ILECs territories.”<sup>43</sup> “With a rational rate structure where intrastate rates are at parity with interstate

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<sup>38</sup> Qwest St. No. 1.0, p. 14; MCI St. No. 1.0, pp. 17-18; Verizon St. No. 3.0, p. 3.

<sup>39</sup> Qwest St. No. 1.0, p. 14.

<sup>40</sup> *Id.*

<sup>41</sup> *Id.*

<sup>42</sup> *Id.*

<sup>43</sup> *RTCC Settlement Order* at 11.

rates, payments of CLECs and IXCs would depend on the activities that the ILEC performs on their behalf—not on what is reported on the honor system in the different jurisdictions.”<sup>44</sup>

Once these rate arbitrage opportunities are eliminated, businesses and investors alike can make economic decisions based upon a stable regulatory environment rather than transitory, niche business opportunities.<sup>45</sup> Qwest explained that:

In the current environment, some investments are based on niche services that may only be short-term arbitrage opportunities. Other investments may only be viable if regulatory rules stay the same, while still others may rely on regulatory rules changing in the future. This environment puts all investing on shaky ground. As a consequence, consumers pay the price in the form of limited competition that is not equally available to all customers. Indeed, robust competition requires that archaic regulatory rate platforms be changed to competitively-neutral structures that can be sustained over the long term.<sup>46</sup>

There can be no doubt that markets with clear competitively-neutral regulatory schemes generate efficient investing in capital expenditures that benefit not only the carriers, but the consumers.<sup>47</sup>

**b. Eliminating the hidden support in intrastate toll rates will remove the discriminatory impact on IXCs.**

Artificially high access charges artificially discriminate between traditional wireline technologies, and newer wireless, cable and IP-based technologies, in violation of the fundamental principles of the 1996 Act—the market, not the regulator, should ultimately determine the optimal telecommunications technology to be deployed.<sup>48</sup> As Mr. McIntyre explained, “[c]arriers pass uneconomic costs on to their customers in a variety of ways, most of

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<sup>44</sup> Qwest St. No. 1.0, p. 14.

<sup>45</sup> *Id.*, pp. 12, 29.

<sup>46</sup> *Id.*, p. 7.

<sup>47</sup> *Id.*, p. 17.

<sup>48</sup> See *In the Matter of Deployment of Wireline Services Offering Advanced Telecommunications Capability*, 15 FCC Rcd. 385, 390 (1999); *In the Matters of Deployment of Wireline services Offering Advanced Telecommunications Capability and Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, 14 FCC Rcd. 20912, 20953 (1999); *In the Matter of Federal-State Joint Board on Universal Service*, 12 FCC Rcd. 8776, 8801-03 (1997).

which will be hidden from the consumer."<sup>49</sup> Alternatively, providers not subject to uneconomic costs can provide services at lower prices, making their offerings more attractive to consumers.<sup>50</sup>

This phenomenon may explain the movement of consumers to wireless and IP-based telephony services where no access charges are paid.<sup>51</sup> For instance, there are more than half as many consumers using wireless service than are using wireline service in Pennsylvania. According to a recent FCC Report, while 8.3 million customers use wireline telephony in Pennsylvania, the number of wireless customers has increased to 6.4 million in Pennsylvania.<sup>52</sup>

Such movement evidences the discriminatory impact of the current access charge regime in Pennsylvania on services utilizing the traditional wireline network.<sup>53</sup> Mr. McIntyre went on to note that:

the industry is changing at a rapid rate, and antiquated systems of compensation restrict the ability of some carriers to compete effectively. As the industry changes and new technologies become available which allow certain industry participants either to avoid or arbitrage access charges, the ability of IXCs to compete effectively becomes increasingly hampered and negatively impacts Pennsylvania consumers.<sup>54</sup>

MCI further explains that:

To the extent that long distance rates are artificially high, usage will be depressed below optimal levels and technological change will be skewed. Specifically, technologies that rely upon use of long distance will be discouraged, and new services and innovations, which otherwise might have appeared, may fail to materialize.<sup>55</sup>

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<sup>49</sup> Qwest St. No. 1.0, p. 15.

<sup>50</sup> Qwest St. No. 1.0, p. 15; AT&T St. No. 1.0, pp. 11-12, 14-17; MCI St. No. 1.0, p. 17; Tr. 278.

<sup>51</sup> AT&T St. No. 1.0, pp. 11-12, 14-17; MCI St. No. 1.0, p. 17; Tr. 278-279.

<sup>52</sup> *Trends in Telephone Service*, Federal Communications Commission, Wireline Competition Bureau, Industry Analysis and Technology Division (June 30, 2005) at 8-5, 11-4.

<sup>53</sup> See also AT&T St. No. 1.0, pp. 14-17; MCI St. No. 1.0, p. 18.

<sup>54</sup> Qwest St. 1.0, p. 3, lines 13-16.

<sup>55</sup> MCI St. No. 1, p. 3, lines 3-7.

Simply put, “[b]ecause these uneconomic costs are hidden from the consumer, the consumer has a difficult time making sound economic choices”<sup>56</sup> among providers of telecommunications services, such as local and long distance carriers. What is perhaps most telling is that “[t]here appears to be no explanation in the record as to why this discriminate scheme should continue to favor VoIP, wireless or cable telephony over traditional long-distance, and in turn eliminate true competition for Pennsylvania consumers.”<sup>57</sup>

The ramifications of this artificial preference for certain technologies over traditional wireline technologies are critical. MCI also notes that “the social costs of these effects are difficult to measure, but are certainly an important consideration for the Commission.”<sup>58</sup> For instance, movement of consumers from the legacy wireline network to wireless and IP-based telephony services also jeopardizes certain regulatory mechanisms, such as universal service fund contributions, which have been put in place to protect the ability of all consumers to utilize the wireline network.

On the other hand, “[r]educing intrastate switched access rates, on a revenue-neutral basis, to the level of their interstate counterparts will eliminate these uneconomic costs from the carrier’s calculation of the price for its services.”<sup>59</sup> “This, in turn, will afford consumers rates that more accurately reflect costs in their decision-making process for choosing a local and/or long distance provider.”<sup>60</sup> Indeed, revenue-neutral and competitively-neutral reductions in access charges “will allow for robust competition without pricing anomalies that confuse

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<sup>56</sup> Qwest St. No. 1.0, p. 15.

<sup>57</sup> Qwest St. No. 3.0, p. 5, lines 9-14.

<sup>58</sup> MCI St. No. 1, p. 3, lines 7-9.

<sup>59</sup> Qwest St. No. 1.0, p. 15.

<sup>60</sup> Qwest St. No. 1.0, p. 15; *see also* AT&T St. No. 1.0, p. 18.

customers.”<sup>61</sup> The FCC has recognized this need to rebalance the compensation for carriage of traffic in a manner that “establishes a straightforward, economically rational pricing structure which enables consumers to make a choice among competing providers through head-to-head comparisons and better promotes competition by sending potential entrants economically correct entry incentives”.<sup>62</sup> Accordingly, the Commission should restructure access charges in Pennsylvania in a competitively-neutral manner that does not favor non-wireline services over wireline services, but instead, provides consumers the ability to make informed decisions about their telephony service.

**c. Economic penalties will be removed for carriers that rate average their toll plans.**

Intrastate switched access rates differ from interstate rates in the current switched access rate regime. Qwest explains that:

Switched access rates differ from state to state and from LEC to LEC and from CLEC to CLEC. IXC's price their services in the aggregate. Where one state, LEC or CLEC has higher than average switched access rates, the IXC must decide whether to create a specific rate plan for the area or accept lower contribution when pricing its services for that area.

Maintaining several area-specific rate plans imposes greater costs on IXC's than managing a single rate plan or a few rate plans. Alternatively, an IXC that decides to maintain a single rate plan incurs costs in the form of lower contribution that the carrier must recover in some other way. In either case, the carrier may choose to withhold some services in an area or create higher priced plans in order to compensate for the disparity in intrastate switched access rates. Ultimately, the customer pays the price for this inefficiency.<sup>63</sup>

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<sup>61</sup> Qwest St. No. 1.0, p. 11; *see also* AT&T St. No. 1.0, p. 18.

<sup>62</sup> *CALLs Order*, ¶ 78.

<sup>63</sup> Qwest St. No. 1.0, p. 15; *see also* Tr. 270-271, 326-328.

Thus, adopting intrastate access rates at parity with interstate rates would benefit Pennsylvania consumers, along with Pennsylvania carriers, by removing the incentive to withhold services and increase the price of long distance in Pennsylvania.

**2. The Record is Devoid of Evidence that the Proposed Access Charge Reform Will Harm Pennsylvania Consumers.**

Verizon, OCA and OTS argue that the Commission should not order the access charge reform the IXCs propose, because of an unsubstantiated “harm” incurred by consumers associated with such reformation. Instead of offering some proof of the “harm” they contend exists, the parties seek to confuse the issue by pointing out that Qwest and other IXCs have not proven that Pennsylvania consumers will not be harmed by access charge reform, or that the alleged “harm” does not exist. Simply put, Verizon, OCA and OTS improperly attempt to shift the burden to the IXCs to prove the negative of what they have failed to prove, while shifting focus from the fact that everything on the record supports the proposed access charge reform.

In contrast to the competitive benefits that IXCs have identified in this proceeding that there will ultimately benefit consumers, there appears to be no evidence in the record showing any *actual* harm that would befall customers from access charge reform. As is evidenced from the Verizon and OCA responses to Qwest data requests, neither party had any data that would allow them to document one single negative impact on Pennsylvania customers from the proposed access charge reform in this remand.<sup>64</sup> Neither OCA nor Verizon had forecasted that low income customers might be required to move to lifeline support in the event local rates were increased.<sup>65</sup> There was no response as to how many consumers have a wireless

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<sup>64</sup> Qwest Exh. 3 Remand Surrebuttal.

<sup>65</sup> Qwest Exh. 3 Remand Surrebuttal, Verizon Response to Set II, Interrogatory No. 4 of Qwest (“Verizon cannot produce the forecast requested . . .”); OCA Response to Set I, Interrogatory No. 5 of Qwest.

phone in addition to their existing local phone service. It is also clear from OCA's responses to Qwest's data requests that no analysis has occurred on how what Pennsylvania consumers pay for other types of utility service, like cable television and electricity, compares to what those consumers currently pay for Verizon local phone services.<sup>66</sup> None of this evidence, which Qwest believes might be most indicative, if some harm were to exist, was produced in this record. Thus, the overall impact of a **Begin Proprietary \*\*\* End Proprietary** per month increase in rates has not been assessed by any party and has not determined to be harmful to consumers.<sup>67</sup>

With this in mind, it is important to note that Verizon gains a competitive advantage by keeping switched access rates high, which will become exacerbated with the proposed merger between Verizon and MCI. With the merger, MCI will gain a competitive advantage in Verizon territory over carriers like Qwest. Higher switched access rate would be inconsequential to Verizon and MCI because the transaction would be internal and occur only on paper.<sup>68</sup>

Simply put, there is no concrete evidence exists that Pennsylvania's penetration rate of customer lines will be materially impacted by the revenue neutral access charge reform Qwest supports in this remand proceeding, and any "harm" to local customers stemming from the proposed access charge reform is mere speculative harm.<sup>68</sup> Instead of providing evidence to support their speculation of harm, OCA, OTS and even Verizon have disparaged Qwest's position in support of parity with interstate rates claiming this recommendation provides insufficient benefits to Pennsylvania because immediate toll service rate reductions are not guaranteed by the IXCs.

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<sup>66</sup> Qwest Exh. 3 Remand Surrebuttal, OCA Response to Set I, Interrogatory No. 4 of Qwest.

<sup>67</sup> Qwest St. No. 3.0, pp. 5 and 6, line 22, lines 1-8.

<sup>68</sup> Qwest St. No. 3.0, p. 6, lines 7-8.

According to Verizon, IXC's have not pledged to pass through further access reductions to end-users, nor have they demonstrated or indicated that their access savings would result in lower toll rates or in any other benefit in toll options to end-users.<sup>69</sup> In response, Qwest notes that Verizon in its own testimony admits that "it is not seeking a flow-through of cost savings condition."<sup>70</sup> Moreover, Qwest notes that the issue of "flow-through" is beyond the scope of this remand proceeding.<sup>71</sup>

First, OTS points to the absence of an IXC intrastate rate reduction in response to the access charge reductions that took effect in February 2005 as evidence Qwest has falsely promised benefits will accrue to Pennsylvanians as a result of access charge reductions.<sup>72</sup> In response, Qwest points out that these much delayed access charge reductions were not even apparent until the March 2005 billing.<sup>73</sup>

Next, OTS's simplistic expectation that access rate reductions will translate directly into dollar-for-dollar toll rate reductions confirms OTS's lack of familiarity with how carriers market. Since there are many toll rate plans offered by different carriers the average composite rate will be affected by how many customers purchase each plan and what their calling habits are.<sup>74</sup> For example, if a carrier aggressively markets one plan that has greater benefits and lower rates for customers, the average rate will go down. This will happen if in response to competition reduce costs allow carriers to promote such low cost plans.<sup>75</sup> Overall

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<sup>69</sup> Verizon St. No. 1 Remand, p. 18, lines 6-8.

<sup>70</sup> Verizon St. No. 1 Remand, p. 18, lines 8-9.

<sup>71</sup> Qwest St. No. 2, p. 14, lines 6-7.

<sup>72</sup> OTS St. No. 1 – SD, p.p. 15-16, Lines 16-22, 1-2.

<sup>73</sup> Qwest St. No. 2 Remand, p. 15, lines 9-11.

<sup>74</sup> Qwest St. No. 2.0, p. 16, lines 1-3.

<sup>75</sup> Qwest St. No. 2.0, p. 16, lines 3-7.

reductions in customer rates are likely to come in the form of combinations of different rate plans that are not identifiable on a one-to-one basis.<sup>76</sup>

Finally, OTS clearly does not recognize that the competitive pressures on the toll market are intense. This is not just competition among various IXCs but the aggressive competition placed on IXCs by wireless and VoIP providers that are not subject to access charges, by explained by Mr. McIntyre.<sup>77</sup> Many customers view the toll service that comes with basic wireless service as “free” long-distance service. This competitive pressure forces traditional long-distance carriers to offer services including package services that are attractive to customers in price and quality. Again, in contrast to OTS’s one dimensional take on the access charge reduction issue, Mr. McIntyre pointed out that in addition to access charges there are administration, marketing, sales support and network costs that are greater, in total, to IXCs than the cost of access. Increases in these types of costs, such as labor cost increases, have a significant impact on overall rates.<sup>78</sup> Therefore, access charge reductions could benefit consumers by, for example, stalling a late increase by an IXC that otherwise might have occurred.<sup>79</sup>

In addition, OCA asserts that a beneficial impact on the local market is irrelevant because of examples as AT&T’s and MCI’s withdrawal from the local market. However, as Mr. McIntyre also pointed out, the relevant point is that lines serves by competitive local exchange

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<sup>76</sup> Qwest St. No. 2.0, p. 16, lines 14-16.

<sup>77</sup> Qwest St. No. 2.0, p. 16, lines 20-23.

<sup>78</sup> Qwest St. No. 2.0 p. 18, lines 4-8.

<sup>79</sup> Qwest St. No. 2.0, p. 18, lines 4-8.

carriers has been on a steady increase and in 2004 represented 20% of the lines in Pennsylvania.<sup>80</sup>

The bottom line for each of these accusations is that market will need time to work. As Mr. McIntyre explained, this market is complex with new technologies constantly developing and expanding. As he indicated, “this complexity makes direct dollar-for-dollar consumer benefits difficult to demonstrate in detail. In addition, toll reductions at the interstate level have demonstrated how access rates flow downward after reductions over the last several years. Time will also prove that similar actions in the state arena will also effectuate more competition and lower pricing, without Commission interventions.”<sup>81</sup>

**B. Reducing Intrastate Switched Access Rates on a Revenue-Neutral Basis Will Be Consistent with FCC Policy.**

If the Commission closes the jurisdictional gap between interstate switched access rates and switched access rates in Pennsylvania, the Commission will have taken an important step toward a more sensible, pro-competitive intercarrier compensation scheme. Not doing so will only widen the gap between the policies pursued by the state jurisdiction and the FCC as it moves further toward its broader intercarrier compensation goals.

In the record, AT&T explains that the 1996 Telecommunications Act established a nationwide goal to “replac[e] those implicit support mechanisms with explicit, targeted, and competitively neutral universal service support mechanisms.”<sup>82</sup> At the federal level, the FCC continues to consider rationalizing intercarrier compensation. Accordingly, the FCC has directly

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<sup>80</sup> Qwest St. No. 2.0., p. 13, lines 5-9.

<sup>81</sup> Qwest St. No. 2.0., p. 15, lines 17-22.

<sup>82</sup> AT&T St. No. 1.1, p. 9; *see also* Tr. 307.

addressed removing any implicit support for local service out of access rates at the interstate level.

State commissions should stay consistent with FCC policies and direction and reduce intrastate switched access rates in the same manner as the FCC. At the pre-remand hearing, an AT&T witness, Mr. Nurse, acknowledged that:

The sea change . . . was the passage of the Telecommunications Act, which fundamentally changed the landscape, that fundamentally changed the national policy of protected monopoly LECs having implicit subsidies and achieving universal service through intra-company subsidies and from access subsidies to local, expressly changed and explicitly required support to be implicit. Judge Schnierle recognized that: Society made a change in the passage of the Telecommunications Act and moved to a competitive local market and that there were certain changes that would be necessary in access and local pricing to do that.<sup>83</sup>

If intrastate switched access rates are reduced, the opportunity for regulatory driven arbitrage will be diminished, the competitive landscape will be enhanced, and consumer confusion will be reduced.

The FCC restructured interstate switched access as part of its *CALLS* and *MAG Orders*. In the *CALLS Order*, the FCC instituted an access restructure for price cap ILECs that included a reduction of interstate switched access rates and an increase in the End User Common Line (“EUCL”) charge to certain maximums. The result of these FCC actions is to shift recovery of some end user revenues from usage sensitive access charges to flat rated monthly end user line charges, consistent with principles of cost causation. A similar restructure has been adopted for non-price cap ILECs through the *MAG Order*. Restructuring intrastate switched access rates by requiring Verizon to reduce its rates on a revenue-neutral basis is consistent with the FCC’s most recent restructuring actions.<sup>84</sup> If this revenue-neutral restructure of intrastate switched access

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<sup>83</sup> Tr. 309.

<sup>84</sup> Qwest St. No. 1.0, p. 12.

charges is adopted, a significant step toward more rational economic pricing for intercarrier compensation will be accomplished.

Most importantly, in the Pennsylvania Commissions *RTCC Settlement Order* of July 15, 2003, approving the Joint Procedural Stipulation of June 5, 2003 filed by the Rural Telephone Company Coalition and other supporting parties, the Commission clearly signaled its preference for proposals, which moved access charges closer to cost and closer to interstate rates.

We further look to the Federal Communications Commission's ("FCC") recent decisions in the *CALLS* and *MAG* orders for precedence in ordering implicit charges to become explicit, through either an increase in basic local telephone service rates, or through service line charges on customer bills. This enables other carriers to compete due to reduced subsidies. **While the Joint Proposal does not require a rural ILEC or Sprint/United to mirror interstate access charges, the fact that this is a step toward making the charges closer to cost and closer to the interstate access charges will help to avoid arbitrage and will help competition enter the ILECs territories.**<sup>85</sup>

This excerpt from the Commission's *RTCC Settlement Order* virtually expresses chagrin that the parties did not fully embrace interstate rates in their settlement. This recent expression of the Commission's policy views on access charges fully supports Qwest's position that the Commission should mirror interstate access charges and thus help avoid arbitrage and promote competition in ILEC territories.

It is clear that the Commission should expressly adopt the policy position that intrastate access rates must be at parity with interstate access rates.<sup>86</sup> Indeed, the Commission has acknowledged that the *CALLS Order* demonstrates an appropriate preference for a coordinated approach to access charges at the state and federal levels.<sup>87</sup> Qwest describes that the FCC has indicated its intentions to continue with the philosophy of moving "the support for local

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<sup>85</sup> *RTCC Settlement Order* at 11 (**emphasis added**).

<sup>86</sup> See also Qwest St. No. 1.0, p. 7, 12; AT&T St. No. 1.0, pp. 8, 26; MCI St. No. 1.0, p. 33.

<sup>87</sup> *Order Initiating Proceeding* at 3; *RTCC Settlement Order* at 6-9.

services back to the end user in a way that is consistent with cost causation . . . in its current and future proceedings as the competitive nature of telecommunications continues to evolve.”<sup>88</sup>

Qwest also explains that “[i]nterstate switched access will continue to decline as the FCC moves closer to a bill and keep regime for all intercarrier compensation.”<sup>89</sup> Adopting sound policy that intrastate access rates in Pennsylvania will mirror interstate access charges will guarantee the continued evolution of the Pennsylvania market.

OCA has heavily emphasized why in its view the existence of the FCC’s Intercarrier Compensation FNPRM calls for shelving access charge reform in Pennsylvania. To the contrary, the FCC’s Intercarrier Compensation Docket is actually a justification for the Commission to move ahead quickly with further access charge reform. Mr. McIntyre explained that, in reality, the savvy regulatory reaction to the FCC’s docket is for Pennsylvania to move swiftly. As he explained:

If the FCC should make a dramatic move to restructure intercarrier compensation, it could require significant rate impacts on local rates. To the degree that the states are as close as possible to the FCC levels, the impact at the state level will be minimized. This impact on local customers’ rates makes it important for Pennsylvania to close the gap between state and interstate rates as much as possible before the FCC acts on this issue.<sup>90</sup>

Thus, by moving ahead quickly with further access charge reform, the Commission can control the uncertainty of the outcome of the Intercarrier Compensation Docket by taking the initiative and minimizing the impact that local rate rebalancing will have on Pennsylvania consumers. As

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<sup>88</sup> Qwest St. No. 1.0, p. 17.

<sup>89</sup> *Id.*, p. 12.

<sup>90</sup> Qwest Remand St. No. 1.0, p. 7, lines 3-8.

Mr. McIntyre stated, “by acting ahead of the FCC, control over consumer impact can be managed to a large degree by this Commission.”<sup>91</sup>

Moreover, the scope of the intercarrier compensation docket and its complexity make it impractical to hold further access charge reform in Pennsylvania in abeyance until this complex proceeding is fully completed. The intercarrier compensation docket includes six original proposed plans, three position papers and a staff white paper. There had been over one hundred comments filed and there is no clear consensus on an appropriate outcome for this docket. Moreover, there are many issues besides intrastate access charges in play within this docket, such as reciprocal compensation, wireless compensation, interstate access, and VNXX traffic compensation.<sup>92</sup> Given the complexity of this docket, the FCC is likely to craft its own reform plan, mixing proposed plan components and new components so that the kind of conclusions OCA is drawing about the plans that are presented are clearly premature and thus, should not serve as a basis to delay further reform.<sup>93</sup>

OCA has outlined several so-called “double recovery” scenarios, as alleged justification for the Commission suspending the process of access reform in Pennsylvania. First, it is unrealistic to assume that the FCC will ignore existing levels of compensation and fail to factor in changes to access rates that are in progress in various states.<sup>94</sup> In fact, the FCC is likely to start with whatever rates are in place at the time it completes its docket.<sup>95</sup> The FCC would

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<sup>91</sup> Qwest Remand St. No. 1.0, p. 7, lines 17, 18.

<sup>92</sup> Qwest Remand St. No. 1.0, p. 5, lines 10-17.

<sup>93</sup> Qwest St. No. 2.0, p. 3, lines 6-9.

<sup>94</sup> Qwest St. No. 2.0, p. 3, lines 12-15.

<sup>95</sup> Qwest St. No. 2.0, lines 15-17. At the public meeting of August 11, 2005, the Commission adopted a motion staying its investigation of rural telephone company access rates, citing the FCC docket. However, an order delineating the Commission’s full view has not yet been issued. That proceeding is certainly distinguishable from this case, given the vastly different procedural posture of this proceeding and other factors.

have to completely ignore existing levels of compensation in order to set the stage for the kind of inappropriate double recovery of carrier costs the OCA envisions. This is an unlikely scenario.

Moreover, to the extent this double recovery scenario has a probability of occurring; Pennsylvania consumers are not realistic candidates for being the victims of a double recovery. As Mr. McIntyre explained, the Alliance for Rationale Inter-carrier Compensation (“ARIC”) Plan calls for a federal local rate benchmark which must be exceeded to entitle a state to federal universal service support. However, Pennsylvania is generally not considered to be a high cost state, so even after increasing local rates to offset a revenue-neutral access charge decrease, Pennsylvania rates are not likely to exceed the federal benchmark.

Furthermore, if Pennsylvania does not engage in the kind of rate rebalancing urged by Qwest, it is *less* likely that Pennsylvania rates would reach the benchmark level for universal service support.<sup>96</sup> Therefore, increasing local rates increases the chances of obtaining federal universal service funds.<sup>97</sup>

While OCA’s scenarios are extremely unlikely, the FCC will likely reduce interstate access rates, further widening the gap with Pennsylvania’s intrastate rates unless access charge reform occurs soon. Mr. McIntyre summarized this issue concisely in his testimony:

The OCA would hold off reform in Pennsylvania pending some action at the FCC based on much exaggerated claims for what the FCC what do. Most importantly, the FCC completing its review, deciding on a plan, and starting the industry on a transition to implementing its plan will not happen overnight. If the Commission acts timely, access charge reform will have been in effect in Pennsylvania for many months, if not years, before the implementation of the ultimate FCC plan occurs. Given this timeline, there is no justification for the Commission to continue waiting to remove the implicit subsidy inherent in high intrastate access charges. *Now is the time to reform Pennsylvania intrastate*

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<sup>96</sup> Qwest St. No. 2.0, p. 4, lines 3-14.

<sup>97</sup> Qwest St. No. 3.0, p. 2.

switched access charges and remove the implicit subsidy inherent in the existing rates.<sup>98</sup>

Thus, the FCC's Intercarrier Compensation Docket remains an unresolved matter that is far from completion, and as such, should not act to suspend further access charge reform in Pennsylvania.

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<sup>98</sup> Qwest St. No. 2.0, pp. 4 and 5, lines 18-24, lines 1-3.

**V. CONCLUSION**

Accordingly, Qwest urges the Commission to take the following steps to ensure that the telecommunications marketplace can continue to thrive in the manner in which the Commission has endeavored to create, by:

- a. Adopting a clear policy position that the ILECs' intrastate access rates must be at parity with interstate access rates;
- b. Reducing Verizon's intrastate switched access charges to the interstate level in a revenue-neutral and a competitively-neutral manner; and
- c. Establishing a clear timetable under which Verizon must comply with the access charge reductions, given the experience from the initial phase of this docket.

Respectfully submitted,

  
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John E. Povilaitis  
Matthew A. Totino  
RYAN, RUSSELL, OGDEN & SELTZER LLP  
800 North Third Street, Suite 101  
Harrisburg, PA 17102-2025  
Phone: (717) 236-7714  
Fax: (717) 236-7816  
Email: [JPovilaitis@RyanRussell.com](mailto:JPovilaitis@RyanRussell.com)

Kristin L. Smith  
Senior Attorney  
Qwest Communications  
1801 California Street, 10<sup>th</sup> Floor  
Denver, CO 80202  
Phone: (303) 383-6614  
Fax: (303) 298-8197  
Email: [kristin.smith@qwest.com](mailto:kristin.smith@qwest.com)

Counsel for Qwest Communications Corporation

Dated: August 17, 2005

213 Market Street, 9th Floor, P.O. Box 865, Harrisburg, PA 17108-0865  
Tel: (717) 237-7160 ■ Fax: (717) 237-7161 ■ www.WolfBlock.com

# ORIGINAL

Alan C. Kohler  
Direct Dial: (717) 237-7172  
Direct Fax: (717) 237-2752  
E-mail: akohler@wolfblock.com

August 17, 2005

**VIA HAND DELIVERY**

James J. McNulty, Secretary  
Pennsylvania Public Utility Commission  
Commonwealth Keystone Building  
400 North Street, 2nd Floor  
Harrisburg, PA 17120

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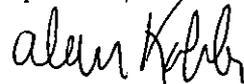
Re: AT&T Communications of Pennsylvania LLC v. Verizon North, Inc.  
and Verizon Pennsylvania Inc.  
Docket No. C-20027195

Dear Secretary McNulty:

Enclosed for filing please find the original and nine (9) copies of AT&T Communications of Pennsylvania L.L.C.'s Main Brief, both a proprietary and public version, in the above-captioned matter. A copy of the proprietary version is being served on all parties of record and a copy of the public version will be served upon request.

If you have any questions, please contact the undersigned.

Respectfully submitted,



Alan C. Kohler

For WOLF, BLOCK, SCHORR and SOLIS-COHEN LLP

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Enclosures

cc: Attached Certificate of Service (w/enc)  
Administrative Law Judge Cynthia W. Fordham (w/ enc Via Email and Overnight Mail)

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BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

AT&T Communications of Pennsylvania,  
Inc.

v.

Verizon North, Inc.  
Verizon Pennsylvania, Inc.

: Docket No. C-20027195  
: Remand Phase

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AT&T COMMUNICATIONS OF PENNSYLVANIA, LLC'S  
MAIN BRIEF

(PUBLIC VERSION)

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AUG 18 2005

Daniel Clearfield  
Alan Kohler  
Wolf, Block, Schorr & Solis-Cohen LLP  
213 Market Street, 9th Floor  
Harrisburg, PA 17108-0865  
(717) 237-7160

Counsel for AT&T Communications of  
Pennsylvania, LLC

Of Counsel:  
Mark A. Keffer  
Robert C. Barber  
AT&T Communications of Pennsylvania LLC  
1120 20th St., NW Suite 1000  
Washington, DC 20036

Date: August 17, 2005

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## I. INTRODUCTION

The access reform initiated six years ago by the Commission's *Global Order* remains uncompleted. During that time, new forms of communication not saddled with excessive access costs – most notably wireless and e-mail – have entered the market and are taking traffic away from long distance carriers. Today AT&T and other IXC's are being driven from the market, not because they provide poor service or are inefficient, but because they cannot compete when forced to pay excessive access rates that other providers do not pay.

This problem is causing a severe drain on Pennsylvania's economy. Consumers are paying more than they should for long distance services. The high cost of long distance constrains businesses' ability to invest in Pennsylvania and, in some cases, may be causing firms to locate elsewhere.

The Commission's Phase I access reductions were not nearly enough. Indeed, as discussed herein, because the relatively fixed-cost Carrier Charge is being recovered over an ever-shrinking number of access minutes, Verizon's effective per-minute access rate has actually *gone up*, not down, and is now higher than it was before the Phase I reductions.

The time has come for the Commission to complete the work it began in 1999. Verizon's access rates should be reduced to cost immediately. This includes eliminating the Carrier Charge, an access rate element that is nothing but pure subsidy. It also includes reducing switching and other rates to match the Verizon UNE rates recently affirmed by the United States District Court for the Eastern District of Pennsylvania as being cost-based.

While this overdue access reform is critical to fair competition, resulting access reductions will, by legal definition, be revenue neutral to Verizon, and harmless to consumers who are not captive customers of any carrier or service and have the opportunity to and routinely

do choose the carrier, services and pricing which is optimal for their individual services. Indeed, this is the essence of a competitive marketplace,

## II. STATEMENT OF THE CASE

The Commission's landmark September 30, 1999 *Global Order*<sup>1</sup> began much-needed reform of incumbent local exchange carrier ("ILEC") access charges, finding that "ILEC access charges are substantially above cost" and that access rates had to be reduced and restructured "in order to maintain fair toll competition..."<sup>2</sup> As to Verizon Pennsylvania, Inc. ("Verizon PA") and Verizon North, Inc. (jointly "Verizon"),<sup>3</sup> the *Global Order* reduced and restructured the intrastate access charges of both companies, but only minimally and only as a first step. Per the *Global Order*, the Commission would initiate a generic access investigation in 2001, to be completed by January 31, 2001, that would further reduce access charges "to further refine a solution to the question of how the Carrier Charge ("CC") pool can be reduced."<sup>4</sup>

The Commission did not initiate the generic access investigation directed in the *Global Order* until January of 2002. Shortly thereafter, AT&T Communications of Pennsylvania, Inc. ("AT&T") filed a formal complaint at this docket requesting that the Commission reduce Verizon North's access rates to Verizon PA levels (now that the two companies had merged) to achieve intrastate access charge price parity. On December 24, 2002, the Commission bifurcated

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<sup>1</sup> *Joint Petition of Nextlink Pennsylvania, Inc. et al*, P-00991648, P-00991649 (September 30, 1999).

<sup>2</sup> *Global Order* at 18.

<sup>3</sup> Of course, at the time of the *Global Order*, the two ILECs were Bell Atlantic Pennsylvania, Inc. and GTE North, Inc.

<sup>4</sup> *Global Order* at 60.

its generic access investigation and consolidated all matters pertaining to Verizon's access charge reform with AT&T's formal complaint at this docket. Subsequently, issues pertaining to Verizon's 2003 Price Change Opportunity ("PCO") were also consolidated into this docket.

In May of 2003, the consolidated docket was assigned to Administrative Law Judge ("ALJ") Cynthia Williams Fordham. AT&T, Verizon, the office of Consumer Advocate ("OCA"), the Office of Trial Staff ("OTS"), the Office of Small Business Advocate ("OSBA"), Qwest Communications Corporation ("Qwest"), and MCI Metro Access Transmission, LLC ("MCI") participated actively in the proceedings.

On July 28, 2004, the Commission entered an Opinion and Order adopting a proposed resolution between Verizon, OCA and OSBA which was designed to achieve access charge rate parity between Verizon PA and Verizon North ("*Phase 1 Order*"). However, the Commission did not terminate the investigation as requested by those parties. Instead, it granted the request of AT&T and other participating interexchange carriers ("IXC's") to remand the case back to the ALJ for additional Verizon access charge reform, noting that the Verizon/OCA/OSBA agreement failed to address "the possible elimination of the Carrier Charge and removal of all implicit subsidies from access charges" as was envisioned by the *Global Order*.<sup>5</sup>

The Commission identified three outstanding issues for the ALJ to address:

- 1) The need to complete AT&T's two-step access charge reduction;
- 2) The need to remove all implicit subsidies from Verizon's access charges; and
- 3) The need to eliminate the Carrier Charge.<sup>6</sup>

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<sup>5</sup> *Phase 1 Order* at 15-16. ("Nevertheless, we also agree, to some extent, with those IXCs who argue that the ALJ's Recommended Decision did not go far enough because it failed to establish 'next steps' to further reduce access rates in the near future.")

<sup>6</sup> *Phase 1 Order* at 17.

The Commission rejected Verizon's request for reconsideration and the remand phase of this proceeding began. On February 17, 2005, and April 4, 2005, pre-hearing conferences were held before ALJ Fordham with the same active parties as in the original phase of the case. Direct testimony, rebuttal testimony and surrebuttal testimony were served by the parties on June 8, 2005, June 29, 2005, and July 11, 2005, respectively. While hearings were scheduled for July 19 and 20, 2005, the parties agreed to waive cross-examination and to stipulate the testimonies into the record.<sup>7</sup>

### III. SUMMARY OF ARGUMENT

Six years ago, the Commission's *Global Order* initiated intrastate access reform for Verizon. There, the Commission explicitly recognized that intrastate access reform would not be complete until the Commission eliminated all subsidies from Pennsylvania's access charge rate structures.

Unfortunately, access reform has been slow in coming. Despite the *Global Order's* promise to address the Carrier Charge by the end of 2001, it was not until May of 2003 that proceedings were actively commenced (through conduct of a pre-hearing conference before ALJ Fordham) to address Verizon access reform issues through the original phase of this proceeding.

And even then, the long overdue Verizon access reform proceedings were all too limited in their focus. Despite AT&T's request that the initial phase eliminate all above-cost subsidies embedded in Verizon's intrastate access rates, the original phase only addressed access rate parity issues between Verizon PA and Verizon North – a requirement which had been imposed

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<sup>7</sup> On July 11, 2005, Verizon filed a motion requesting the Commission to strike certain portions of AT&T's testimony as improper legal argument. As part of the stipulation between the parties, AT&T agreed to cite the contested portion of its testimony as legal argument in its brief and Verizon withdrew its motion. *See Order #5 on Remand* issued by ALJ Fordham on July 22, 2005.

on Verizon as a condition of the Bell Atlantic/GTE merger.<sup>8</sup> The initial phase did virtually nothing to address necessary reform of Verizon PA's access rates as envisioned in the *Global Order*.

The slow pace at which the Commission has addressed access charge issues has hurt Pennsylvania's consumers, Pennsylvania's economy, and Pennsylvania's long distance carriers. High access charges have kept intrastate long distance rates too high, and, as a result, over the years Pennsylvania consumers have spent millions too much for their in-state long distance calling. Those same excessive access rates have saddled Pennsylvania businesses with high long distance costs that have constrained economic development. In recent years, wireless carriers (including of course Verizon's wireless affiliate), which do not pay long distance access charges to complete long distance calls within very large Major Trading Areas ("MTAs") and so can offer their customers "free" long distance, have been able to steal market share from Pennsylvania long distance carriers crippled by high access costs.<sup>9</sup> Indeed, the IXCs' inability to compete against wireless and e-mail, neither burdened by excessive access charges, is a major reason why the two largest IXCs are being acquired by other carriers.

Pennsylvania access reform cannot wait any longer. The Commission found in the *Global Order* that the sooner access reform can be completed, "the better it would be for the competitive environment in Pennsylvania."<sup>10</sup> The record here confirms the truth of that statement. Indeed, it shows that the access problem is actually getting much worse. As IXCs

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<sup>8</sup> See, *Joint Application of Bell Atlantic Corporation and GTE Corporation for Approval of Agreement of a Plan of Merger*, A-310222 F0002 et. al., 1999 Pa Lexis 86 (November 4, 1999).

<sup>9</sup> See MCI St. 1.0 Remand, Exh.1 for a map of the MTAs in Pennsylvania.

<sup>10</sup> *Global Order* at 60.

lose their long distance traffic to wireless carriers and to e-mail, they use fewer Verizon access minutes. Verizon's Carrier Charge, however, is a relatively fixed amount per month. When that fixed amount is spread across a shrinking number of access minutes, the effective per minute access rate is actually *increasing*. As discussed below, AT&T's effective per minute access rate from Verizon is actually 16% above the access charge rate levels mandated by the Commission in its *Phase 1 Order*.

Moreover, the record shows that access reform will not cause Verizon financial harm. Here, the record shows the revenue impact of the access reduction ordered in the original phase is significantly less than that projected by Verizon -- the result being an overrecovery of revenue from the associated local rate increases (taking into account offsets to Verizon PCO adjustments) in violation of revenue neutrality requirements.

There is no debate that Verizon's current access rates remain far above cost. The record reveals that the effective per minute access rate billed by Verizon to AT&T after the Phase 1 rate reduction remains more than **[BEGIN PROPRIETARY]** **[END PROPRIETARY]** the cost-based rate as determined by the Commission for the same functionality in pricing Verizon's wholesale local service (including both overhead and a reasonable profit). The market is changing quickly and the need for access reform far more urgent than at the time of issuance of the *Global Order*. AT&T and other IXC's simply cannot compete against wireless carriers, E-mail, Voice Over Internet Protocol ("VOIP") and Virtual Foreign Exchange ("VFX") competition, not because the IXC's offer poor service or are less efficient, but because none of these other competitors are burdened with subsidy laden access rates. So long as the Commission allows access rates to remain too high, it is needlessly distorting the market and

handicapping market participants in favor of Verizon and these other, largely unregulated, competitors and against Pennsylvania IXCs. That is not what the *Global Order* intended.

#### IV. ARGUMENT

##### A. THE COMMISSION'S ORDER IN THE ORIGINAL PHASE OF THIS PROCEEDING HAS NOT BEEN PROPERLY IMPLEMENTED.

###### 1. Verizon's Effective Access Rates Remain Well Above Commission Ordered Rate Levels.

In the discussion and Ordering Paragraphs in the *Phase 1 Order*, the Commission was very specific as to the access rate levels it was directing to be implemented. Ordering Paragraph 2(b) directed that, “[t]he effective Carrier Charge rate per minute will be changed to establish parity between Verizon Pennsylvania, Inc. and Verizon North, Inc. and will decrease from [BEGIN PROPRIETARY] [END PROPRIETARY] to [BEGIN PROPRIETARY] [END PROPRIETARY] for Verizon Pennsylvania, Inc. and decrease from [BEGIN PROPRIETARY] [END PROPRIETARY] to [BEGIN PROPRIETARY] [END PROPRIETARY] for Verizon North, Inc.” Furthermore, Ordering Paragraph 3c. of the *Phase 1 Order* provides as follows:

c. A weighted average of the combined Traffic Sensitive Access Charge and the Carrier Charge on a per minute of use basis for Verizon Pennsylvania, Inc. and Verizon North, Inc. will be reduced from [BEGIN PROPRIETARY] [END PROPRIETARY] per minute to [BEGIN PROPRIETARY] [END PROPRIETARY] and will result in an access charge revenue reduction of [BEGIN PROPRIETARY] [END PROPRIETARY]

*Phase 1 Order* at 36.

While the Commission's directives are clear, the Remand record reveals that the Verizon access rates which have been implemented as a result of the *Phase 1 Order* do not comply with

these directives. As to the Carrier Charge, Verizon's access bills to AT&T since the Phase 1 rates become effective yield an average per minute rate of [BEGIN PROPRIETARY] [END PROPRIETARY] or approximately [BEGIN PROPRIETARY] [END PROPRIETARY] per minute of use approved in Phase 1.<sup>11</sup> As to the weighted average access rate per minute, the record reveals that Verizon's access bills to AT&T since implementation of the Phase 1 reductions yield an effective rate of **BEGIN PROPRIETARY** **END PROPRIETARY** per end which is 16% higher than the **BEGIN PROPRIETARY** **END PROPRIETARY** per end per minute rate ordered by the Commission.<sup>12</sup>

It is particularly noteworthy that because of declining minutes, the per minute Carrier Charge and weighted average access rates currently being paid by AT&T post-Phase 1 reductions are actually **above** the rates reported by the Commission and Verizon as in effect prior to the Phase 1 reductions.<sup>13</sup> Certainly, this was not the result the Commission intended.

This compliance issue emphasizes two important points. First, the Commission should enforce its *Phase 1 Order* and require Verizon to conduct a periodic analysis of all access customers and, as necessary, reduce the access rates to the levels ordered by the Commission.

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<sup>11</sup> As explained below, the required revenue reduction of [BEGIN PROPRIETARY] [END PROPRIETARY] was reduced to [BEGIN PROPRIETARY] [END PROPRIETARY] to reflect updated and declining access volumes as of August, 2004 data through review of Verizon's compliance filing to the *Phase 1 Order*. AT&T St.1.2-R at 9.

<sup>12</sup> AT&T St.1.2-R at 13-14; OAO Remand Exhibit 6. While the data only reflects the effective Carrier Charge and weighted average access rates being paid by AT&T -- while the Commission's directive pertained to all access customers -- it is reasonable to expect that an analysis of the effective access rates being paid by all access customers would yield similar results. AT&T St. 1.2-R at 14.

<sup>13</sup> *Phase 1 Order* at 36-37, *Ordering Paragraph 3*, Verizon St. 1.1, Exhibit DMB1.

Second, because access minutes continue to decline dramatically, as long as the flat rate (and subsidy laden) Carrier Charge remains in place, effective per minute access costs will go up, not down, and the Commission's intended reductions in access rates in Phase 1 will never materialize.<sup>14</sup>

2. Verizon's Phase 1 Rate Rebalancing Combined with its PCO Adjustment Yields an Improper Overrecovery of Revenue.

Section 3017(a) of the Public Utility Code, 66 Pa. C.5. § 3017(a) provides that "[t]he Commission may not require a local exchange telecommunication company to reduce access rates except on a revenue neutral basis." This newly enacted statutory provision requires the Commission to assure that any rate rebalancing (or PCO adjustment) permitted to recover the revenue associated with access reductions is revenue neutral to the ILEC -- with no overrecovery or underrecovery. Furthermore, Ordering Paragraph 3e. of the Commission's *Phase 1 Order* request that "[a]ll rates changes will be made on a revenue neutral basis."<sup>15</sup>

Verizon's response to the *Phase 1 Order* was to implement revenue increases of [BEGIN PROPRIETARY] [END PROPRIETARY]<sup>16</sup> However, Verizon now estimates in this case that, as a result of a decline in access minutes of use, its access revenues declined by only [BEGIN PROPRIETARY] [END PROPRIETARY] as a result of the Phase

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<sup>14</sup> AT&T St. 1.2-R at 13.

<sup>15</sup> *Phase 1 Order* at 36.

<sup>16</sup> Verizon recovered [BEGIN PROPRIETARY] [END PROPRIETARY] from an \$.80 increase to certain of its retail residential and business lines and \$19.8 million as AN offset to PCO adjustments it would have otherwise made.

1 reductions.<sup>17</sup> Accordingly, by Verizon's own estimates, its rate rebalancing plan has enabled it to overrecover \$4.8 million per year.

Furthermore, because the record overwhelmingly demonstrates that Verizon's access minutes of use will continue to experience significant declines on an annual basis, it is virtually certain that the actual revenue impact of Verizon's access reduction will be significantly less than its current [BEGIN PROPRIETARY] [END PROPRIETARY] estimate, which was based on actual access minutes of use from February 4, 2004 through January 31, 2005.<sup>18</sup> Based on current trends, it is a certainty that Verizon's access minutes for any future period will be substantially reduced from that estimate with an associated downward effect on Phase 1 access reduction revenue impact.

While Verizon is likely to claim that its lower access minutes will be offset by a reduction in the number of retail end user lines subject to its \$.80 per line rate increase, the facts suggest otherwise. With AT&T and MCI no longer pursuing mass market customers and the elimination of UNE-P as a wholesale service arrangement,<sup>19</sup> as well as the pending Verizon/MCI merger (which will convert MCI wholesale lines to *de facto* Verizon retail lines and MCI access minutes will become *de facto* Verizon long distance minutes), it appears certain that, if anything, Verizon's \$4.8 million overrecovery is understated.<sup>20</sup>

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<sup>17</sup> AT&T St. 1.2-R at 9-10.

<sup>18</sup> AT&T St. 1.2-R at 9, fn. 4.

<sup>19</sup> Indeed, Verizon has publicly touted its success in "winning back" these wholesale lines to its retail operations. See, Verizon 10-Q, March 31, 2005, p. 21, at [http://investor.verizon.com/sec/sec\\_frame.aspx?fid=3660793](http://investor.verizon.com/sec/sec_frame.aspx?fid=3660793).

<sup>20</sup> AT&T St. 1.-2-R at 10.

In any case, the Commission need not guess to assure revenue neutrality as required by Section 3017(a) of the Code and its *Phase I Order*. Instead, the Commission should require that the actual effect of the Phase 1 access reduction be trued up on an annual basis to include the most recent available data on access volumes and end user line volumes.<sup>21</sup> Any overrecovery should result in additional access reductions, or as an offset to local end user rate rebalancing associated with additional and future access charge reductions.<sup>22</sup>

Furthermore, as to future rate rebalancing (associated with both Phase 1 access reductions and future additional access reductions), the Commission should use a forecast of access minutes, taking into account projected volume reductions, rather than using historic and unrealistically high access minute volumes. Forecasts based on a three year period would provide for reasonably realistic projections.<sup>23</sup> Such a process will help avoid the overrecovery which is virtually assured if rate rebalancing is based on historic access volumes as is the case with Verizon's \$.80 per line Phase 1 increase.

**B. THE COMMISSION SHOULD IMMEDIATELY REDUCE VERIZON'S ACCESS RATES TO COST BASED LEVELS.**

The Commission concisely explained the competitive benefits of eliminating implicit subsidies from exchange access rates.

“As implicit charges become explicit charges, competitors are better able to compete for local and long distance customers in an ILEC's service territory because IXC's are not hindered by paying ILECs excessive access charges in providing competitive toll services and CLEC's are better able

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<sup>21</sup> AT&T St. 1.-2-R at 12.

<sup>22</sup> AT&T St. 1.-2-R at 11.

<sup>23</sup> AT&T St. 1.-2-R at 12.

to compete with ILEC local service rates that have been kept artificially low as a result of the access charge subsidies.

*Access Charge Investigation per Global Order of September 30, 1999, M-20021596 et. al. (July 15, 2003) at 10.*

Both the original record and the Remand Record are replete with evidence of the anti-competitive effects of excessive, above-cost access charges. First, the emergence of wireless providers, including Verizon's own wireless affiliate, as well as internet services like "instant messaging" have created new competitors and new alternatives for traditional toll service. Unlike AT&T and other IXCs, wireless carriers and email providers do not have to pay subsidy laden access charges to terminate their customers' calls. Wireless carriers pay extremely low, cost-based reciprocal compensation rates rather than subsidy-laden access charges to terminate calls within a given MTA – an area usually much larger than a LATA.<sup>24</sup>

The ability of wireless carriers to terminate calls anywhere within these very large areas at virtually no cost is what gives the wireless providers the ability to advertise "free long distance" and that "any call is like a local call." So long as wireless carriers can terminate calls essentially for free at properly priced call termination rates while AT&T and other IXCs have to pay Verizon's subsidy laden access rates, then AT&T and the IXCs are being put at a severe, *regulatory-created* disadvantage. In essence, the IXCs are being squeezed out of the market because of improper access pricing based on antiquated and outmoded regulatory policies which

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<sup>24</sup> AT&T St. 1.0 at 11-16, AT&T St. 1-R at 15. For example, in Pennsylvania, the Philadelphia MTA stretches from Delaware to State College – spanning across several LATAs.

provide wireless carriers a substantial cost advantage over IXCs providing wireline toll services.<sup>25</sup>

VOIP<sup>26</sup> and VFX<sup>27</sup> services are also growing in popularity because the providers of these services are also not forced to pay subsidy-laden access charges to terminate toll calls and, accordingly, can price their services at much lower retail rates.<sup>28</sup> Here again, high access rates tilt the competitive playing field in their favor.

High access rates also give Verizon an unfair competitive advantage for its long distance services. Since 2001, IXCs have been forced to compete against Verizon and its long distance affiliate in the provision of toll service in Pennsylvania. Since Verizon only has to pay access rates to itself – in effect, shifting money from its long distance pocket to its local service pocket – from a practical perspective it avoids access charges for all calls that originate and/or terminate with its local exchange customers. This enables Verizon to offer retail landline toll plans at retail rates below what other IXCs pay for Verizon wholesale access service alone.<sup>29</sup>

By keeping access rates high, the Commission is hamstringing AT&T's ability to compete, while providing artificial advantage to other competitors. The proof is in the numbers.

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<sup>25</sup> AT&T St. 1.0 at 11-18; AT&T St. 1-R at 15-16.

<sup>26</sup> Voice Over Internet Protocol (“VOIP”) services convert digital voice calls into data packets and piggyback such “calls” over a broadband Internet connection—whether a Cable Modem or Telco DSL, bypassing access rates. Vonage and AT&T Call Vantage are well known VOIP service offerings.

<sup>27</sup> Virtual Foreign Exchange (“VFX”) is a CLEC variant of the traditional incumbent's foreign exchange service which provides a different local calling area to a customer than he would otherwise have, as a vehicle to reduce inbound or outbound toll charges.

<sup>28</sup> AT&T St. 1-R at 16.

<sup>29</sup> AT&T St. 1.0 at 11-18; AT&T St. 1-R at 16.

AT&T's intrastate access minutes from Verizon decreased from almost **BEGIN**

**PROPRIETARY**

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minutes in 2004.<sup>30</sup> All indications are that this trend will continue until the access problem is fixed once and for all.

As the Commission is well aware, there is only one fix to this problem. That fix is to remove all implicit subsidies from Verizon's access rates immediately and reduce those rates to levels which reflect Verizon's economic cost of providing exchange access service. Once implicit subsidies are removed, a fair competitive market with no regulatory handicapping can sort out the rest. There are simply no other effective alternatives and it is these facts which so strongly support and compel immediate relief at this docket.

**C. THE COMMISSION SHOULD ELIMINATE THE CARRIER CHARGE AND REDUCE TRAFFIC SENSITIVE ACCESS RATES TO THE COMMISSION'S LOCAL WHOLESALE RATES FOR THE SAME FUNCTIONALITY.**

The Commission's *Phase 1 Order* directed the ALJ to "further develop the record and provide recommendations to the Commission to establish the 'next steps' to further reduce access charges in the near future."<sup>31</sup> More specifically, the Commission directed that this remand phase of the proceeding examine the following issues: 1) the importance of completing AT&T's Two Step Access Charge Proposal; 2) the best manner to eliminate the Carrier Charge;

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<sup>30</sup> AT&T St. 1-R at 10; AT&T St. 1.2.-R at 14-15.

<sup>31</sup> *Phase 1 Order* at 15-16.

3) the best manner to remove of all other implicit subsidies from access charges; and 4) any other outstanding issues<sup>32</sup> Each issue will be addressed specifically below.

1. AT&T's Two Step Access Charge Proposal.

In the original phase of this proceeding, AT&T argued that the Phase 1 access reductions were a valuable effort as a “first step” in achieving Verizon access reform– but, only a first step. In order to complete the job, the Commission must implement a second step through this remand phase of the proceeding. For as the Remand Record conclusively demonstrates, even after the reductions directed by the Commission in the *Phase 1 Order*, substantial work is required to completely eliminate the implicit subsidies that remains in Verizon’s intrastate access rates.

2. Elimination of the Carrier Charge

The Carrier Charge is a component of Verizon’s access rates which was originally established in the *Global Order*. Up until the *Global Order*, Verizon assessed IXCs a per-minute subsidy rate element called the Carrier Common Line Charge, or CCLC. The *Global Order* eliminated the CCLC and replaced it on a revenue neutral basis with a “Carrier Charge” assessed on a per line per month basis.<sup>33</sup>

At the time the *Global Order* was issued in 1999, the conversion from a per minute CCLC to a flat rate Carrier Charge made complete sense, since at the time Verizon’s access minutes of use were increasing at a rapid pace. The idea behind the conversion was to limit the increasing subsidy revenue associated with the CCLC which was caused by rapid minutes growth, by linking the subsidy payment to the number of access lines Verizon has in service.

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<sup>32</sup> *Phase 1 Order* at 17.

<sup>33</sup> AT&T St. 1.-R at 17.

Under a Carrier Charge structure, if access minutes of use continued to grow faster than access lines, as they had in the past, the per minute subsidy cost would decline over time. However, if the opposite occurred, the subsidy would increase over time.<sup>34</sup>

Of course, as explained above, since the time that the *Global Order* was issued, wireless carriers, email and other forms of communications that can avoid high access charges are taking long distance market share, meaning that access minutes of use are now declining at a rapid pace. This has the distorted effect of actually driving up the IXCs' effective access rate per minute.<sup>35</sup> The best way to rectify this problem is to eliminate the Carrier Charge in its entirety.

As recognized in the *Phase 1 Order*, the *Global Order* directed that the Carrier Charge be reduced by no later than December 31, 2001.<sup>36</sup> That never happened. Furthermore, Verizon's Carrier Charge on a per line basis was not reduced at all in the first phase of this proceeding and was maintained at \$.58 per line per month. Accordingly, because of declining minutes of use, the Carrier Charge collected by Verizon on a per-minute continues to increase as is demonstrated in the chart below.<sup>37</sup>

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<sup>34</sup> AT&T St. 1-R at 18.

<sup>35</sup> AT&T St. 1-R at 18-19.

<sup>36</sup> *Phase 1 Order* at 16. The *Global Order* also expressly recognized that the sooner the Carrier Charge was eliminated, "the better it would be for the competitive environment in Pennsylvania." *Global Order* at 60.

<sup>37</sup> All of the figures are as set forth in the Commission's *Phase 1 Order* which it appears were based on 2003 minutes of use volumes. AT&T's current effective rates are based on an average of the Carrier Charge billed by Verizon to AT&T in February, March and April of 2005 –the only bills received prior to the close of the record which reflected the Phase 1 access rate reduction. See OAO Revised Exhibit 6; AT&T St. 1.7-R at 12-13.

	Prior to Phase 1 (All Access Customers)  V2-PA/V2-North	As Required by Phase 1 Order	As Currently Paid by AT&T
Per Line CC	\$0.58/\$8.64	\$0.58	\$0.58
CC Payment Per Minute	[BEGIN PROPRIETARY]		
Per Minute Rate for Each Access Minute <sup>38</sup>			[END PROPRIETARY]

As the chart demonstrates, because of the impact of declines in access minutes of use, AT&T's effective per minute payment to Verizon for the Carrier Charge subsidy element is actually [BEGIN PROPRIETARY] [END PROPRIETARY] higher than the per minute rate ordered by the Commission. Moreover, it is [BEGIN PROPRIETARY] [END PROPRIETARY] higher than the effective per minute rates for the Carrier Charge (as recognized by the Commission) paid by all Verizon PA access customers prior to the Phase 1 reduction.<sup>39</sup> Furthermore, as a result of the upward impact of the Carrier Charge on Verizon's per minute access charges, the total effective per minute rate for each access minute currently

<sup>38</sup> The per minute access rate for each access minute includes the per minute rate associated with the Carrier Charge, as well as Verizon's traffic sensitive rates for transport and switching of toll traffic.

<sup>39</sup> *Phase 1 Order* at 35-36, Ordering Paragraph 3(b).

paid by AT&T to Verizon after the Phase 1 reduction is actually 16% high than the effective per minute charge mandated by the Commission and over 10% higher than the Verizon PA effective per minute charge for each access minute (as recognized by the Commission based on Verizon's own data) prior to the Phase 1 reduction.<sup>40</sup>

Certainly the perverse effect of Verizon's Carrier Charge, which actually has increased Verizon's access rate billed per minute to AT&T in spite of and undermining the Phase 1 reductions, was never intended by the Commission. This analysis is critical because it underscores the necessity of eliminating the Carrier Charge immediately. Increasing access rates will increase the already unfair and unsustainable competitive advantage handed to wireless carriers, e-mail providers, VOIP providers, VFX providers, and Verizon itself in Pennsylvania's intrastate toll market.

In its *Global Order*, the Commission directed that the Carrier Charge be reduced or eliminated by the end of 2001 in express recognition of the fact that there could not be fair competition until the Carrier Charge was eliminated. Three and one-half years later, not only has Verizon PA's Carrier Charge not been substantially reduced, but the same Carrier Charge is causing the intrastate access rates of the combined Verizon companies to *actually increase* rather than decrease. This scenario cannot be permitted to continue. The Commission should act with urgency to eliminate Verizon's Carrier Charge once and for all.

### 3. Elimination of All Implicit Subsidies

While, as explained above, the Carrier Charge is pure subsidy and must be eliminated in its entirety, the Remand Record also reveals that Verizon's other access charge elements

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<sup>40</sup> *Phase 1 Order* at 36, Ordering Paragraph 3(c); OAO Record Exhibit 6; AT&T St. 1.2-R at 13-14.

(referred to as Traffic Sensitive Elements) are priced well above cost-based levels (including a reasonable profit). Until all of these implicit subsidies are eliminated (or made explicit), fair intrastate toll competition will not be possible.

Indeed, starting with the *Global Order*, the Commission itself has consistently recognized the need to remove implicit subsidies from access charges over the years. As cited earlier in this brief (p. 12), the Commission demonstrated a clear understanding of the implicit subsidy problem in a sister access case involving non-Verizon companies and recognized that fair competition was not possible until implicit subsidies were removed or eliminated.

Furthermore, in the *Phase 1 Order*, the Commission stated, “we note that, consistent with the Telecommunications Act of 1996, as well as our *Global Order*, it has been the Commission’s policy to work toward the elimination of implicit subsidies that may exist in access rates.”<sup>41</sup> The Commission also noted that the access reform it intended in its 1999 *Global Order* for Verizon has taken much longer than originally intended.<sup>42</sup>

In AT&T’s testimony in the Remand Phase, AT&T witness Dr. Oyefusi conducted an analysis which identified the implicit subsidies remaining in Verizon’s access rates after the Phase 1 reductions.<sup>43</sup> The analysis compares Verizon’s current Traffic Sensitive access rates for switching and transport with the Unbundled Network Element (“UNE”) rates for Verizon recently established by the Commission for the same switching and transport functionality.

The results of the analysis demonstrate that, even setting aside the Carrier Charge, Verizon’s remaining access rates remain well above cost-based levels. While the current (post

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<sup>41</sup> *Phase 1 Order* at 19.

<sup>42</sup> *Phase 1 Order* at 16-17.

<sup>43</sup> OAO Remand Exhibit 1.

Phase 1) access rate for Traffic Sensitive Elements is \$0.0123 per access minute of use, the underlying costs (including overhead and a reasonable profit) recently established by the Commission is \$0.0019254.<sup>44</sup> Amazingly, the analysis reveals that Verizon's Traffic Sensitive access rates are priced over six times higher than UNE prices for the exact same network functionality.<sup>45</sup>

The analysis conducted by Dr. Oyefusi comparing access rates to UNE rates is a proper comparison which should be adopted by the Commission. This is because exchange access and comparable UNEs are the same functionality and have the same underlying costs.<sup>46</sup> While several of the participants' witnesses are very critical of the Total Element Long Run Incremental Cost ("TELRIC") rate methodology for establishing local switching, transport and reciprocal compensation rates, the fact remains that the Commission's establishment of UNE rates for materially the same network functionality as is utilized for exchange access is the only example of Commission establishment of a cost-based rate for the access services being provided by Verizon to IXCs.<sup>47</sup> In fact, these UNE rates are the exact rates which were recently affirmed

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<sup>44</sup> Verizon's current UNE rates became effective on October 1, 2004 and were established by the Commission in *Generic Investigation Re: Verizon Pennsylvania's Unbundled Network Element Rates*, R-00016683 (July 16, 2004). The Commission established UNE rates for Verizon as listed in Appendix A to that Order.

<sup>45</sup> AT&T St. 1-R at 12, OAO Record Exhibit 1. Verizon's local switching rate elements are some 388% above the UNE rate for the same functionality and its fixed transport access rate is priced 111% above the UNE rate for the same functionality

<sup>46</sup> AT&T St. 1-R at 11.

<sup>47</sup> AT&T St. 1.2-R at 5-6.

by the United States District Court for the Eastern District of Pennsylvania as complying with a cost-based standard.<sup>48</sup>

Verizon will undoubtedly argue that there are differences in the switching functionality utilized for toll traffic (access) as compared to local traffic (UNEs). However, these claims are not supportable. Review of Verizon's UNE cost studies reveals that all of the switch functions and characteristics utilized to provide exchange access service are included in the Verizon cost study which formed the basis for UNE pricing. Indeed, the Phase 1 record provides clear and convincing evidence that there are no technical differences between the switches Verizon uses to route local and access calls -- a fact that Verizon has concurred in on a past occasion.<sup>49</sup> At the end of the day, criticism of the Commission's UNE rate analysis is nothing more than an appeal to use Verizon's result oriented embedded cost study which, as the record demonstrates, is replete with flaws and has been rejected by the Commission in the past.<sup>50</sup>

#### 4. Other Outstanding Issues

Removing all implicit subsidies from Verizon's intrastate exchange access rates and reducing those rates to UNE rate levels for the same network functionality is the best way to promote competition in Pennsylvania's long distance market and to ensure that market forces, rather than regulatory handicapping, determines which service providers provide the mix of prices and services that Pennsylvania consumers want. Put simply, reducing access to cost will

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<sup>48</sup> *Verizon Pennsylvania, Inc. v. Pennsylvania Public Utility Commission et. al.*, Civil Action No. 04-3866 (August 3, 2005).

<sup>49</sup> AT&T St. No. 2.0 at 8.

<sup>50</sup> AT&T St. 1.2-R at 7; AT&T St. 2.0 at 4-7.

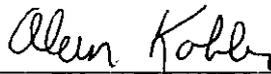
level the Pennsylvania long distance playing field. Anything less confers an unwarranted competitive advantage on the services that do not incur access expenses.

If, however, the Commission for some reason is unwilling to reduce access to cost, then at an absolute minimum it should reduce Verizon's intrastate access rates to Verizon's interstate levels. Even after the Phase 1 reductions, Verizon's intrastate access rates remain approximately three times higher than Verizon's interstate counterpart. Reducing rates to match interstate levels would still leave competitive disparities in place, but at least would represent a step in the right direction.

## V. CONCLUSION

While the Commission took a meaningful step forward in the first phase of this proceeding, it must now complete the job in this phase by eliminating the Carrier Charge completely and removing all implicit subsidies from Verizon intrastate access rates. As the Commission itself has recognized, this relief is long overdue. Given the current competitive environment, the outdated and antiquated access regime in Pennsylvania simply cannot be sustained any longer.

Respectfully submitted,



Daniel Clearfield  
Alan Kohler  
Wolf, Block, Schorr & Solis-Cohen LLP  
213 Market Street, 9th Floor  
Harrisburg, PA 17101  
(717) 237-7160

Counsel for AT&T Communications  
of Pennsylvania

Of Counsel:

Mark A. Keffer  
Robert C. Barber  
AT&T Communications of Pennsylvania LLC  
1120 20th St., NW Suite 1000  
Washington, DC 20036

Dated: August 17, 2005

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

**CERTIFICATE OF SERVICE**

I hereby certify that I have this day served a copy of the foregoing documents in accordance with the requirements of 52 Pa. Code § 1.54 et seq. (relating to service by a participant).

**VIA FEDERAL EXPRESS AND ELECTRONIC MAIL**

Susan Debusk Paiva, Esquire  
William B. Petersen, Esquire  
Verizon Pennsylvania Inc.  
1717 Arch Street 32 NW  
Philadelphia, PA 19103  
Bus. (215) 963-6068  
Fax (215) 563-2658  
[suzan.d.paiva@verizon.com](mailto:suzan.d.paiva@verizon.com)  
[william.b.petersen@verizon.com](mailto:william.b.petersen@verizon.com)

Mark Keffer, Esquire  
Robert C. Barber, Esquire  
AT&T Communications of PA Inc.  
1120 20th St., NW Suite 1000  
Washington DC 20036  
Bus. (202) 457-3839 (MK),  
Bus. (202) 457-2160 (RB)  
Fax (281) 664-9658  
[mkeffer@att.com](mailto:mkeffer@att.com)  
[rcbarber@att.com](mailto:rcbarber@att.com)

Michelle Painter, Esquire  
MCI Worldcom Inc.  
22001 Loudon County Parkway  
Ashburn, VA 20147  
Bus. (703) 886-5973  
Fax (703) 886-0633  
[michelle.painter@mci.com](mailto:michelle.painter@mci.com)

Kristin Smith, Esquire  
Qwest Communications Corporation  
1801 California Street, Suite 4900  
Denver CO 80202  
Bus. (303) 672-2820  
Fax (303) 296-7069  
[kristin.smith@qwest.com](mailto:kristin.smith@qwest.com)

**VIA ELECTRONIC MAIL &  
FEDERAL EXPRESS**

Robert V. Eckenrod  
PA Public Utility Commission  
Office of Trial Staff  
400 North Street  
Commonwealth Keystone Building  
Harrisburg, PA 17120  
Bus. (717) 787-1976  
Fax (717) 772-2677  
[roeckenrod@state.pa.us](mailto:roeckenrod@state.pa.us)

Philip R. McClelland, Esquire  
Barrett C. Sheridan, Esquire  
Joel H. Cheskis, Esquire  
Shaun A. Sparks, Esquire  
Office of Consumer Advocate  
555 Walnut Street 5<sup>th</sup> Floor  
Forum Place  
Harrisburg, PA 17101-1923  
Bus. (717) 783-5048  
Fax (717) 783-7152  
[pmcclelland@paoca.org](mailto:pmcclelland@paoca.org)  
[bsheridan@paoca.org](mailto:bsheridan@paoca.org)  
[jcheskis@paoca.org](mailto:jcheskis@paoca.org)

Patricia Armstrong, Esquire  
Regina L. Matz, Esquire  
Thomas T. Niesen, Esquire  
Thomas Thomas Armstrong & Niesen  
212 Locust Street  
Suite 500  
Harrisburg, PA 17108  
Bus. (717) 255-7627  
Fax (717) 236-8278  
[parmstrong@ttanlaw.com](mailto:parmstrong@ttanlaw.com)  
[rmatz@ttanlaw.com](mailto:rmatz@ttanlaw.com)  
[tniesen@ttanlaw.com](mailto:tniesen@ttanlaw.com)

Date: August 17, 2005

Zsuzsanna E. Benedek, Esquire  
United Telephone  
240 North Third Street  
Suite 201  
Harrisburg, PA 17101  
Bus. (717) 245-6346  
(717) 245-6213  
[sue.e.benedek@mail.sprint.com](mailto:sue.e.benedek@mail.sprint.com)

Steven C. Gray, Esquire  
Office of Small Business Advocate  
Suite 1102, Commerce Building  
300 North Second Street  
Harrisburg, PA 17101  
Bus. (717) 783-2525  
Fax (717) 783-2831  
[sgray@state.pa.us](mailto:sgray@state.pa.us)

John F. Povilaitis, Esquire  
Matthew A. Totino, Esquire  
Ryan, Russell, Ogden &  
Seltzer LLP  
800 North Third Street, Suite 101  
Harrisburg, PA 17102-2025  
Phone: (717) 236-7714  
Fax: (717) 236-7816  
[JPovilaitis@RyanRussell.com](mailto:JPovilaitis@RyanRussell.com)  
[mtotino@ryanrussel.com](mailto:mtotino@ryanrussel.com)



---

Alan C. Kohler, Esquire



OFFICE OF CONSUMER ADVOCATE  
555 Walnut Street, 5th Floor, Forum Place  
Harrisburg, Pennsylvania 17101-1923  
(717) 783-5048  
800-684-6560 (in PA only)

ORIGINAL

IRWIN A. POPOWSKY  
Consumer Advocate

FAX (717) 783-7152  
consumer@paoca.org

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August 17, 2005

James J. McNulty, Secretary  
PA Public Utility Commission  
Commonwealth Keystone Bldg.  
400 North Street  
Harrisburg, PA 17120

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

Dear Secretary McNulty:

Enclosed please find for filing an original and nine (9) copies of the Office of Consumer Advocate's Main Brief on Remand in the above-captioned proceeding.

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

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Sincerely,

Joel H. Cheskis  
Assistant Consumer Advocate

Enclosures

cc: All parties of record  
Hon. Cynthia Fordham, ALJ  
\*68614

**ORIGINAL**

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

AT&T Communications of Pennsylvania :  
Inc. :

v. :

Verizon North Inc. :

Docket No. C-20027195

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MAIN BRIEF ON REMAND OF THE  
OFFICE OF CONSUMER ADVOCATE

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Philip F. McClelland  
Senior Assistant Consumer Advocate  
Joel H. Cheskis  
Shaun A. Sparks  
Assistant Consumer Advocates

**DOCUMENT  
FOLDER**

For:  
Irwin A. Popowsky  
Consumer Advocate

RECEIVED  
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IA PUC  
SECRETARY'S BUREAU

Office of Attorney General  
Office of Consumer Advocate  
555 Walnut Street 5th Floor, Forum Place  
Harrisburg, PA 17101-1923  
(717) 783-5048

**DOCKETED**  
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DATED: August 17, 2005  
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## I. INTRODUCTION

On December 30, 2002, Verizon Pennsylvania Inc. (“Verizon PA”) and Verizon North, Inc. (“Verizon North”)(collectively referred to as “Verizon”) filed a Joint Petition regarding the reduction of their access charges pursuant to the Bell Atlantic-GTE Merger Order,<sup>1</sup> the Global Order of 1999,<sup>2</sup> and the generic access charge investigation at M-00021596. The Joint Petition was consolidated with a formal complaint filed by AT&T Communications of Pennsylvania, Inc. (“AT&T”) on March 21, 2002 and docketed at C-20027195 against Verizon-North wherein AT&T sought to have Verizon-North’s access charges reduced to Verizon-PA’s levels. Several parties, including the Office of Consumer Advocate (“OCA”), objected to certain elements of the Joint Petition. As such, the Joint Petition was assigned to the Office of Administrative Law Judge for hearing and disposition.

The ensuing proceeding culminated in a Commission Opinion and Order dated July 28, 2004 in this proceeding granting a Joint Petition for Resolution of Litigation filed by Verizon, the OCA and the Office of Small Business Advocate (“OSBA”). The July 28<sup>th</sup> Order, among other issues, permitted Verizon to reduce and restructure its access charges by allowing Verizon to file a revenue neutral, rate rebalancing filing in which the net revenue reductions from access charge increases and decreases are offset with revenue increases in monthly dial tone line rates for residential and business local exchange customers. As part of the July 28<sup>th</sup> Order, the Commission requested the development of, and a recommendation on, issues that were not

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<sup>1</sup> 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”).

<sup>2</sup> Re Nextlink Pennsylvania, Inc., 93 PaPUC 172, 196 P.U.R.4<sup>th</sup> 172 (1999) (“Global Order”); *clarified*, 93 PaPUC 477 (1999), *aff’d sub nom. Bell Atlantic-Pennsylvania, Inc. v. Pennsylvania Public Utility Commission*, 763 A.2d 440 (Pa.Cmwlth. 2000); *vacated in part, sub nom. MCI WorldCom Inc. v. Pennsylvania Public Utility Commission*, 844 A.2d 1239 (Pa. 2004) (state court lacked jurisdiction to review unbundled network element decision).

included in the initial Recommended Decision issued by ALJ Fordham. In particular, the Commission delineated a series of issues that are to be addressed in this remand and specifically noted that the remanded proceeding was not limited to addressing only those issues. July 28<sup>th</sup> Order at 17. Additionally, the Commission directed that “the ALJ consider the merits of each of the parties’ positions on this matter and make a recommendation based on the record evidence in the next phase of the investigation.” Id. at 19.

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 raised in the FCC’s intercarrier compensation proceeding.<sup>3</sup> The Commission further directed that the parties should consider 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 this remand.

As a result, a Prehearing Conference on Remand was held before presiding officer Administrative Law Judge Cynthia Williams Fordham on February 17, 2005. At that time, the parties requested an additional amount of time in which to conduct settlement discussions regarding the remanded issues. A Further Prehearing Conference on Remand was held on April 4, 2005. At that time, a schedule was established for the litigation of the remanded issues. Pursuant to that schedule, the OCA submitted Direct Testimony (“OCA St. 1R”) on June 8, 2005, Rebuttal Testimony (“OCA St. 1R-R”) on June 29, 2005 and Surrebuttal Testimony (“OCA St. 1R-SR”) on July 11, 2005 from its witness Dr. Robert Loube. Several other parties also submitted multiple pieces of pre-filed testimony. By agreement of the parties, evidentiary

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<sup>3</sup> In the Matter of Developing a Unified Intercarrier Compensation Regime, CC Docket No. 01-92, Further Notice of Proposed Rulemaking (May 23, 2005) (“ICC FNPRM”).

hearings scheduled for July 19 and 20, 2005 were waived following the admission of prefiled testimony and exhibits via stipulation.

The OCA files this Main Brief to further articulate its positions in this matter.

## **II SUMMARY**

The OCA submits that the Commission should not further reduce intrastate access rates at this time, but should instead defer any action until the FCC has completed its review of the same issues in its intercarrier compensation (“ICC”) proceeding. As discussed throughout this Main Brief, deferring action by this Commission would avoid several problems, including potential double recovery of any access reductions by the FCC and the PUC and the concomitant overcharging of basic local service customers. Delaying any action on the remanded issues in this proceeding may also reduce the burden on basic service customers.

It seems likely that the FCC will structure ICC reform by narrowing the rate differences among the various types of compensation paid between carriers. Such ICC rate reductions will likely be funded, in whole or in part, through some form of federal rate increases. This may involve increases in the federal Subscriber Line Charge (“SLC”) or the creation of new forms of a federal Universal Service Fund (“USF”). A delay in the PUC’s potential reduction in intrastate access rates will more likely allow Pennsylvania carriers to share in the universal service funding that may be made available as a result of the FCC proceeding. Delay will also avoid the potential for Pennsylvania consumers to overpay for intrastate access reductions resulting from overlapping efforts of the PUC and FCC to reduce the same intrastate access rates.

Moreover, the Commission should recognize that reducing the intrastate access charge at this time will not have a significant beneficial impact on competition in the long distance market. Intrastate access reductions will likely produce little or no benefit for Pennsylvania long distance

customers. This is because the major long distance companies, that are parties to this proceeding, have recently announced plans to irreversibly exit that market or increase rates in these markets.

Additionally, the Commission should refrain from increasing local rates at this time, as further local rate increases would have a negative impact on universal service. Any reduction in access revenue may be matched by a revenue neutral increase in other revenues, pursuant to applicable law. This may further reduce the number of Pennsylvania consumers that can afford telephone service.

Economic analysis shows that Verizon's current access rates do not subsidize other rates. The Commission should recognize that there is no implicit subsidy flowing from access rates, because access rates are already below the stand-alone cost of service and no Verizon residential customer basic local service rates are below the incremental cost of service. Whatever subsidy may exist more likely comes from residential customers in density cells one and two, because the rates for unlimited local services in those cells are above a reasonable estimate of the stand-alone cost of service. The Commission should also recognize that the carrier charge is an efficient mechanism for recovering a reasonable share of loop costs from the interexchange carriers. The OCA submits that the Commission should reaffirm its conclusion that the local loop is a facility shared by many users and services. Its cost should be recovered from the many users and services of that facility, including access charges.

Finally, if the Commission concludes that further intrastate access rate reductions are necessarily required at this time, the Commission should consider applying the plan proposed at the FCC by the National Association of State Utility Consumer Advocates ("NASUCA") to Pennsylvania access rates. If the PUC decides to implement any access rate reductions and

related local rate increases, the PUC should calculate the required local rate increases based upon all lines served.

### III. ARGUMENT

A. The PUC Should Not Reduce Intrastate Access Rates At This Time But Should Wait For The FCC To Determine What Access Reductions Are Appropriate.

1. This FCC Currently Is Conducting A Proceeding On The Same Matters At Issue In This Proceeding And May Preempt State Action.

On March 3, 2005, the FCC released its ICC FNPRM in which it solicited comments on a variety of issues. Through the ICC FNPRM, the FCC desires to alter the intercarrier compensation regime because it believes that a regime different than that which currently exists would work better with the diverse services that use the same networks.<sup>4</sup> Presently, many different ICC rates apply to the many forms of traffic exchange that take place between carriers. Much of this proliferation of ICC rates has resulted from rates created by the FCC. Intrastate access rates are one example of the many types of ICC rates applied to the intercarrier traffic exchanged between carriers. The FCC asserts that the current regime creates opportunities for regulatory arbitrage because charges for similar interconnection services differ depending on the connecting carrier type, *e.g.* wireless or wireline, the type of call, *e.g.* local or toll, or the jurisdiction, *e.g.* intrastate or interstate.<sup>5</sup> At the same time, existing telecommunications retail service offerings blur these distinctions by becoming mixed bundles of state and interstate local and long distance service. The FCC is attempting to establish a more unified intercarrier compensation regime in an effort to reduce the impact of different ICC rates on services offered to consumers.

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<sup>4</sup> ICC FNPRM at ¶¶ 15-17.

<sup>5</sup> Id. at ¶ 3.

In the ICC FNPRM, the FCC requested comments on a number of plans that were filed by major advocacy groups in response to the first notice in that proceeding. Some of these plans were submitted by groups that include parties to this proceeding. For example, AT&T and MCI are members of the Intercarrier Compensation Forum (“ICF”) that submitted a plan, and the OCA is a member of NASUCA, which has also submitted a plan.

Significantly, many of the proposals submitted to the FCC will likely have a substantial impact on intrastate access reform, the very issue that is at the heart of the instant proceeding. In many of the proposals, interstate and intrastate access charges, as well as interstate and intrastate universal service funds, will be affected. Whether the FCC preempts the PUC from further action in this area, offers incentives to reach targeted intrastate access rates, or simply encourages states to comply with new FCC guidelines, the FCC’s action in this area will prove critical in establishing a national mechanism for bringing intercarrier compensation rates closer together.

One of the most important issues specifically posed by the FCC in the ICC FNPRM is the FCC’s authority to preempt a state’s regulation of intrastate access and local interconnection rates and the establishment of alternative cost recovery mechanisms within the intrastate jurisdiction. The FCC requested comments concerning the legal basis for it to exercise jurisdiction over intrastate access mechanisms in order to adopt a uniform intercarrier compensation rate structure that will reduce arbitrage, protect universal service and reduce regulation.<sup>6</sup> As such, the FCC’s legal authority to order a decrease in state access rates is being debated in that proceeding. As part of that debate, AT&T, MCI and Qwest (collectively referred

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<sup>6</sup> ICC FNPRM at ¶¶ 78-82.

to as “the IXCs”) each advocate before the FCC that the FCC should assume jurisdiction over intrastate access rates and reduce such rates.

On October 5, 2004, the ICF, which includes AT&T and MCI, filed its plan for ICC reform.<sup>7</sup> The ICF plan alleges, *inter alia*, that national intrastate access charges for large ILECs average 2.5¢ per minute and proposes a plan over a number of years for reducing all ICC rates.<sup>8</sup> In response to the ICC FNPRM, AT&T and MCI, through their participation in the ICF, filed comments advocating in favor of their plan that they alleged “crucially, tackles both interstate and intrastate compensation rules”<sup>9</sup> and argued that the intrastate rates have the greatest disparity in the current system.<sup>10</sup> The ICF Comments state “[A] uniform regime must apply the same rate consistently across all carriers, technologies, and services [and] unify interstate and intrastate compensation systems.”<sup>11</sup> The ICF then argues that “section 251(b)(5) clearly provides the [FCC] with authority to preempt intrastate access regimes *in toto* in order to replace them with a uniform intercarrier compensation system...”<sup>12</sup>

Likewise, Qwest has also advocated in Comments in the FCC’s ICC FNPRM proceeding that “the FCC has the authority to adopt a bill and keep plan for *all* intercarrier traffic,” including

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<sup>7</sup> Ex Parte Filing of ICF at [http://gullfoss2.fcc.gov/prod/ecfs/retrieve.cgi?native\\_or\\_pdf=pdf&id\\_document=6516492297](http://gullfoss2.fcc.gov/prod/ecfs/retrieve.cgi?native_or_pdf=pdf&id_document=6516492297) (ICF Plan).

<sup>8</sup> ICF Plan, App. C at 2. AT&T’s latest calculation also seems to indicate that the current Verizon average access rate is [BEGIN PROPRIETARY] [END PROPRIETARY]. AT&T 1.2-R at 13. Depending upon the accuracy of these two calculation, it would appear that Verizon has already achieved access rates [BEGIN PROPRIETARY] [END PROPRIETARY] the national average.

<sup>9</sup> In the Matter of Developing a Unified Intercarrier Compensation Regime, CC Docket No. 01-92, Comments of the Intercarrier Compensation Forum at 6 (May 23, 2005) (emphasis added).

<sup>10</sup> Id. at 8.

<sup>11</sup> Id. at 12 (emphasis added).

<sup>12</sup> Id. at 76.

intrastate traffic, and “in fact, without such an opportunity, the entire plan would be unlawful.”<sup>13</sup> Qwest further argued to the FCC that “in order for the Qwest plan, or any other plan that relies on bill and keep, to be workable, it *must apply to intrastate traffic* as well as interstate traffic” and that “state rules must conform to the bill and keep scheme in the same time frame as traffic in the interstate jurisdiction.”<sup>14</sup> Similar to AT&T and MCI in the ICF Comments, Qwest also notes that, “if necessary, the FCC has the authority to preempt state access charges in order to implement a rational intercarrier compensation regime.”<sup>15</sup> Qwest argues that “exercise of federal preemptive jurisdiction is not necessary because Section 251(b)(5) of the Act is a direct jurisdictional grant that does not need further analysis or preemptive action.” *Id.*

NASUCA, however, has argued that the FCC has no such preemptive authority. NASUCA argues that the FCC should encourage, but cannot compel, states to order access charges consistent with an FCC determined rate. Similarly, the OCA disagrees that the FCC has jurisdiction over intrastate access rates. While AT&T, MCI and Qwest have each aggressively argued for the PUC to reduce access charges in Pennsylvania, they also simultaneously argue that the FCC should assume jurisdiction over Pennsylvania access rates and reduce access charges in Pennsylvania. As further explained below, the IXCs have asserted that a double recovery would not occur from local service customers if both the PUC and FCC attempted to reduce the same access rates simultaneously. But none of the IXC proposals to the FCC explain how such double recovery can be avoided. This Commission should not put itself in the position where two jurisdictions attempt to set the same rate at the same time. There is significant

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<sup>13</sup> In the Matter of Developing a Unified Intercarrier Compensation Regime, CC Docket No. 01-92, Comments of Qwest Communications International Inc. on Further Notice of Proposed Rulemaking at 16 (May 23, 2005).

<sup>14</sup> *Id.* at 15 (emphasis added).

<sup>15</sup> *Id.* at 5-6.

overlap between the issues to be addressed in this investigation and the issues to be addressed in the ICC FNPRM.

In summary, it is difficult, if not impossible, for the PUC in the instant proceeding to be consistent with all of the potential outcomes from the FCC's ICC FNPRM. Too many regulatory cooks are bound to ruin the intrastate access stew. The Commission should defer any action in this proceeding so that the PUC has the benefit of the FCC intrastate access requirements or recommendations. It may be that, once the FCC acts, the PUC will decide that no further action is required, or it may simply conform to the FCC recommendations. Regardless, it is likely that the ICC FNPRM will affect the standards for intrastate ICC reform – in Pennsylvania as well as in all other state jurisdiction. For the reasons discussed more specifically below, it would not be sound public policy for this Commission to act on the remanded issues while the ICC FNPRM is still proceeding.

2. It Would Not Be Sound Public Policy And Would Prejudice Consumers For The Commission To Act On The Remanded Issues In This Proceeding In Advance Of The FCC Proceeding Because Doing So Could Lead To Higher Rates For Pennsylvania Consumers Purchasing Protected Noncompetitive Local Services.

As recommended above, the PUC should not reduce intrastate access rates at this time but should wait for the FCC to act to determine whether any intrastate access reductions are appropriate. A revenue neutral increase of Pennsylvania rates through the instant proceeding will likely lead to higher rates for customers purchasing noncompetitive local services than if this proceeding were postponed until after the FCC has issued an order in the ICC FNPRM. If the PUC acts now, this will likely prejudice consumers. The same state access rate reductions at issue in this proceeding may be recovered through an increase in the federal SLC or the federal USF under proposals now pending in the ICC FNPRM. The OCA is concerned that, if any PUC

access decrease is not properly timed, both FCC and PUC proposed offsetting rate increases may each pay for the same Pennsylvania intrastate access reductions. The OCA submits that the FCC is also aware of the large impact that reducing intrastate access charges will have nationwide. Accordingly, many parties appearing before the FCC have proposed various mechanisms by which federal funds will be developed in order to fund such required intrastate access reductions.

Timing of intrastate Pennsylvania access reform will become important under a federal mechanism. These expanded federal funds will generally fund intrastate access reductions that result from an ICC FNPRM order and will not apply to intrastate access reductions that were ordered *prior* to such an Order. The Commission should delay the current proceeding to avoid double recovery and an unnecessary overcharging of customers.

The OCA notes that the Commission recently recognized the significance of this issue in the companion access proceeding currently pending before the Commission that involves access charges of the rural incumbent local exchange carriers. The Commission agreed with the OCA specifically that reducing rural intrastate access charges prior to the FCC action on the ICC FNPRM could lead to higher rates for Pennsylvania consumers. *See, Investigation Regarding Intrastate Access Charges and IntraLATA Toll Rates of Rural Carriers, and the Pennsylvania Universal Service Fund*, Docket No. I-00040105, Motion of Vice Chairman James H. Cawley (Aug. 11, 2005) at 2-3 (“the OCA Brief persuasively argues that, under certain outcomes in the same FCC proceeding, the rural ILECs’ ratepayers may bear the same burden twice from the same reduction in intrastate access charges if such reductions are not simultaneously coordinated between this Commission and the FCC”). Attached as Appendix A. The same issues arise in the current proceeding.

In his direct testimony, OCA witness Loube explained the possibility of double-recovery of the same intrastate access rate reductions. OCA St. 1R at 33-34. For example, Dr. Loube testified that the ICF plan,<sup>16</sup> the plan currently supported by most industry participants, including AT&T and MCI, allows carriers to recover access reductions generally through revenue neutral mechanisms. Id. at 33. The plan allows carriers to increase the SLC in order at least to recover the difference between the base year access revenues and the projected revenues determined by the FCC through the adoption of the access rate reduction. Id. at 33-34. If this Commission were also to order an access charge reduction in this proceeding, any such reduction may result in revenue neutral rate rebalancing applied to local rates. Id. at 34. Thus, both the FCC and this Commission could allow the carrier to recover the **same** access reduction through an increase in the SLC or the local rate if these actions are not carefully coordinated. Id. In both cases, the result is an increase in the monthly bill for consumers – and quite possibly to recover more than the intrastate access reduction.

Dr. Loube also calculated the potential problems that may occur if the FCC and PUC access reform efforts are not carefully coordinated. More specifically, Dr. Loube assumed, hypothetically, that the difference between interstate and intrastate Verizon access revenue is \$100 million and that there are 6 million customers.<sup>17</sup> Id. If access rates are reduced by \$100 million this would increase the SLC by \$1.39 per line per month or increase the local exchange rate by \$1.39 per month (\$100 million divided by 6 million customers divided by 12 months) counting all local lines. Id. If the FCC and this Commission calculated the reduction in intrastate access rates based upon the same or similar base year access revenues, they would then

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<sup>16</sup> The ICF Plan.

<sup>17</sup> OCA will discuss below the actual local rate increases required to accomplish various types of access rate reductions.

each raise the SLC and local rate by \$1.39 per month in order to reduce the same dollars of intrastate access revenue. Id. The two different regulatory bodies would not be coordinating their simultaneous implementation of intrastate access reductions and Pennsylvania consumers would be required to bear the burden twice for the same reduction.

Regrettably, this double recovery would also occur if the FCC were to adopt many of the other plans currently before it in the ICC FNPRM that reduce intrastate access rates. Dr. Loube testified that a double-recovery would also occur under the plan proposed by Alliance for Rational Inter-carrier Compensation (“ARIC”). Id. at 41. Dr. Loube testified that, similar to the ICF plan, the ARIC plan, along with a separate Pennsylvania rebalancing, could allow the carrier to recover the same access revenue loss through a SLC increase and through a local rate increase. Id. The double recovery would occur if the PUC and the FCC use the same base year to determine the respective rate increase that they approve. Id. Dr. Loube testified that a double recovery could be prevented if the PUC waited for the FCC to act. Id.

Qwest witness McIntyre, however, argued “there is no indication that revenue-neutral reform at both the state and federal level will lead to any windfall or double recovery for the ILECs.” Qwest St. 2 at 3. In response, Dr. Loube testified that double recovery is indeed a likely outcome unless there is very close co-ordination of the two proceedings. OCA St. 1R-SR at 2. Dr. Loube noted that the access charge reduction can easily be recovered twice, once through a SLC increase, as possible through the ICC plans, and a second time through an increase in the basic local service rate, as possible through this PUC proceeding. Id. at 3. No other party advocating intrastate ICC reform has explained how any of their plans that propose increasing FCC controlled charges are designed to avoid such double recovery of intrastate access reductions that would also take place.

Unless the Commission waits until the FCC has acted, a double recovery cannot be prevented. If the Commission follows the FCC, then it could tailor its intrastate access charge revisions based on the reductions and recovery mechanisms already ordered or recommended by the FCC. The Commission would then know to what extent the FCC has required or encouraged intrastate access rates to be reduced and how much of the reduction in intrastate access rates will be assumed by a federal rate mechanism. The OCA emphasizes that the FCC may entirely preempt this Commission's authority over Pennsylvania access charges. If the FCC does not preempt this Commission, and the FCC federal mechanism recovers the entire revenue difference, then there is no reason for this Commission to act at all. If the federal mechanism recovers only part of the difference, then the Commission will be in a better position to determine what, if any, further action it need take. At the very least, however, the Commission could ensure that Pennsylvania consumers will not be double-charged for the same access rate reductions. The OCA submits that making sure that Pennsylvania consumers are not overcharged for intrastate access reform should be a Pennsylvania PUC responsibility. The uncertainty contained in the FCC proceeding requires that this Commission not act now but wait until it is more clear how much intrastate access charge reform may still be needed, if any, after the FCC rules concerning the ICC FNPRM.

As such, it would not be sound public policy and would prejudice consumers if the Commission were to act on the remanded issues in this proceeding in advance of the FCC's ICC FNPRM. Doing so could lead to higher rates for Pennsylvania consumers that purchase protected noncompetitive local services.

3. It Would Not Be Sound Public Policy For The Commission To Act On The Remanded Issues In This Proceeding In Advance Of The FCC Proceeding Because Doing So May Foreclose An Opportunity To Receive Federal Universal Service Funds.

Pennsylvania may not be able to receive additional federal universal service funds if this Commission acts on the remanded issues prior to the FCC issuing an Order on the ICC FNPRM. OCA witness Loubé testified that some plans currently pending before the FCC, such as the ICF, allow carriers to recover the total allowed revenue per-line by either increasing their SLC or from a new universal service plan. OCA St. 1R at 38. Under these proposals, “**the carriers must first increase their SLCs to the allowed amounts prior to obtaining supplemental funding from the federal USF.**” Id. (emphasis added). As a result, the total allowed revenue that can be obtained from the federal USF depends on the level of state access rates in existence immediately prior to the start of the FCC plan. Id. at 38-39. The higher the state access rates going into the ICC FNPRM Order the more likely that a state will qualify for additional USF funds flowing from the FCC Order. Conversely, if the PUC takes another step to reduce Pennsylvania access rates, such funding will be less likely to become available. Id.

As a result, Pennsylvania consumers would be better off if this Commission delays its actions and allows the FCC to take the first step in rebalancing rates because the double recovery of any access revenue reduction will be avoided and there is the possibility that Pennsylvania will receive universal service support to offset the access revenue reduction. Id. Clearly, Pennsylvania consumers would be prejudiced if they were precluded from receiving the full benefit of additional federal universal service funding to which they contribute simply because this Commission’s actions preceded the determination of the ICC FNPRM and precluded taking full advantage of available universal service funding.

4. *This Commission Should Wait To Act On The Remanded Issues In This Proceeding Because Waiting Will Diminish The Amount Of Revenue Required To Offset Access Reductions.*

If this Commission postpones reducing access charges pending FCC action, the amount of revenue required to offset any access rate reduction will also be diminished. Because total access revenues are declining, the amount of revenues that must be recovered to fund a particular access rate reduction will also decline.

However, Qwest witness McIntyre has argued that “the larger the gap between the current intrastate rates, and any future compensation mechanism ultimately ordered by the FCC, the larger the impact will be on Pennsylvania customers.” Qwest St. 1.0 at 6-7. Mr. McIntyre argued that “by acting ahead of the FCC, control over consumer impacts can be managed to a large degree by this Commission.” *Id.* at 7.

Qwest’s argument simply fails to recognize that access revenues are diminishing even as the rates remain the same. OCA witness Loube testified that waiting for the FCC to complete its proceeding will most likely decrease the burden on Pennsylvania access reform on local basic customer rates. OCA St. 1R-R at 4. Dr. Loube explained that this is largely due to the fact that access minutes are decreasing. *Id.* As support for this position, Dr. Loube referenced a statement by AT&T witness Oyefusi where AT&T explains that long distance carriers have been losing access minutes. OCA St. 1R-R at 3 *citing* AT&T St. 1-R at 9. AT&T explains that the result is that Verizon has been carrying fewer access minutes than it did before. *Id.* More specifically, Dr. Oyefusi noted that, for AT&T, “access minutes billed by Verizon decreased from almost **[BEGIN PROPRIETARY]**

**[END PROPRIETARY]**

in 2004.” Id. Dr. Oyefusi stated that “all indications are that AT&T’s access minutes will continue to experience significant reductions in 2005 and in future years.” Id.

Dr. Loubé testified that, as a result, the trend in access minutes indicates that any revenue neutral basic rate increase in the future will be less than a revenue neutral basic service rate increase today. OCA St. 1R-R at 4. Dr. Loubé explained:

as access minutes decline, the monthly per line difference between access minutes at a higher rate and a lower rate will actually decline. Local rate rebalancing on a revenue neutral basis will actually have less of an impact if made at a later date. The same rate decrease with fewer minutes generates a smaller amount of revenue that must be offset by a revenue neutral increase. Therefore, basic service customer rates are reduced by postponing Pennsylvania action until the FCC has completed its proceeding.

Id. The revenue neutral increase to local rates required to offset a particular access rate reduction will be higher if the PUC acts today rather than waiting for the completion of the FCC proceeding. Thus, the degree of local rate rebalancing required to accomplish any particular rate reduction will be reduced as further access reductions are deferred. As such, the OCA submits that this Commission should not act on the remanded issues until the FCC has resolved the ICC FNPRM.

##### 5. Conclusion.

This Commission should not reduce intrastate access rates at this time but should wait for the FCC to act to determine whether any intrastate access reductions are appropriate. The FCC is currently conducting a proceeding on the same matters at issue in this investigation and may preempt state action. It would not be sound public policy and would prejudice Pennsylvania local service consumers for the Commission to act on the remanded issues in this proceeding in advance of the FCC ruling in the FCC ICC NPRM. Doing so could lead to higher rates for Pennsylvania consumers purchasing protected noncompetitive local services than if the PUC

waited for the FCC to act. Similarly, the Commission may also foreclose an opportunity for Pennsylvania to receive federal universal service funds if it acts in this proceeding prior to the conclusion of the FCC proceeding. Finally, waiting to act on the remanded issues in this proceeding will diminish the amount of revenue required to offset access rate reductions.

B. Further Access Reductions At This Time Will Not Bring Benefits To The Customers In The Toll Market.

1. Introduction

One of the problems with further access rate reductions is that such Pennsylvania access reductions do not appear to offer any real consumer benefits. In the past, PUC access reductions were supported by the idea that lowering the rates that IXCs pay for access would “flow through” to benefit Pennsylvania consumers. Under this model, IXC toll rates would decline even as local rates increased to pay for such access reductions.

However, the landscape of long distance competition has now changed dramatically. AT&T and MCI, the largest long distance competitors to Verizon, have practically exited the mass market. AT&T and MCI no longer market local services as well. MCI proposes that it should now become part of Verizon, its largest long distance competitor, while AT&T seeks to merge with SBC, another giant RBOC.

As explained below, any potential consumer benefits that may have existed from access reductions no longer apply. In fact, the evidence demonstrates that long distance rates in the mass market have increased – not decreased – even as access reductions continue. In many respects, such rate increases have been achieved through new and increased surcharges. Such lack of consumer benefit should caution the PUC against further revenue neutral access rate reductions at this time.

2. Access Reductions Have Not Promoted Long Distance Rate Reductions.

In its July 28<sup>th</sup> Order, the Commission specifically directed the ALJ to consider the merits of the parties' positions with regard to whether Pennsylvania's intrastate access rates should mirror the FCC interstate access rates. July 28<sup>th</sup> Order at 25. Qwest had previously argued in Phase I of this proceeding that the Commission will take an important step toward a more pro-competitive intercarrier compensation scheme if the Commission closes the jurisdictional gap between interstate switched access rates and switched access rates in Pennsylvania. Id. at 24. AT&T agreed with Qwest that Verizon's intrastate rates should be reduced to interstate access rate levels within the next several years. Id. The OCA recognizes the importance of evaluating the impact of any reductions in access rates on competition and the price of long distance services, but disagrees with the IXCs that lowering access rates will likely increase competition for local and long distance services.

As OCA witness Loube testified, the two most significant recent events in the interexchange markets are the announcements by AT&T and MCI that they are pulling out of the interexchange mass market. OCA St. 1R at 21-28. Dr. Loube noted that, in mid-2004, AT&T decided to cease actively competing for new mass-market customers and decided to increase its rates in an effort to allow customer churn to erode its customer base. Id. at 21-22.<sup>18</sup>

Significantly, as explained in AT&T's discovery answers, AT&T believes that its "actions are so extensive that AT&T's decision is now irreversible as a practical matter." Id. at 22. Likewise, MCI is in the same position having also made an allegedly irreversible decision to leave the mass-market and increase its rates for long distance residential customers. Id.<sup>19</sup>

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<sup>18</sup> *Citing*, AT&T Response to OCA Set I, Int. 1, Attached Affidavit of John C. Polumbo at ¶2.

<sup>19</sup> *Citing*, Verizon Communications Inc. and MCI Inc. public interest statement, WC 05-75, In the Matter of Verizon Communications, Inc. and MCI Inc. Applications for Approval of Transfer of Control at 4.

Dr. Loube testified that AT&T and MCI have been the first and second leading interexchange carriers in the United States markets, respectively, and have had particularly high market shares in the Mid-Atlantic region, which includes Pennsylvania. Id. Yet, while AT&T and MCI provided several reasons that prompted their decision to leave the mass-market, neither carrier mentioned high state access charges as a fundamental concern. Id. at 23. In fact, Dr. Loube noted that the IXCs' difficulties in the long distance market are linked to losing the opportunity to provide bundled "all-you-can-eat" local and long distance service at a single rate to customers when the FCC changed the rules regarding the availability of the unbundled network element platform ("UNE-P"). OCA St. 1R-R at 9-13. Dr. Loube testified that once UNE-P was no longer available, AT&T and MCI announced their withdrawal from the consumer long distance markets. Id. at 9.

Overall, Dr. Loube testified that the exit of AT&T and MCI from the Pennsylvania mass market reduces any potential value of decreasing state access charges. OCA St. 1R at 24. Dr. Loube added that "now that the major carriers that pay those access charges are leaving the consumer market, much of the reason for reducing the access charges also is removed." Id. As a result, the Commission must be aware that the reduction of state access charges in Pennsylvania will likely not have a significant impact on long distance prices or competition.

Furthermore, Dr. Loube noted that the IXCs have recently been increasing their rates for long distance service for mass-market customers through monthly recurring charges. Id. at 24-25. While AT&T's average consumer rate per minute has decreased over the past several years, Dr. Loube noted that these averages do not include flat rate charges that AT&T has added to its per-minute rates. Id. at 25. These flat rate charges include a "regulatory assessment fee," an "in-state connection fee," and other monthly recurring charges that turn the reported decreasing trend

in average revenue per-minute into an increasing trend in monthly bills. Id. Dr. Loube added that MCI and Qwest have similar monthly fees. Id. Furthermore, MCI has not been willing to provide any information in response to discovery that would allow for a determination of whether its toll rates decreased in response to past decreases in access charges. Id. at 25-26. In fact, MCI increased its toll rates by \$1.90 per month in March 2005, just one month after Pennsylvania access rates decreased. Id. at 26.

Dr. Loube testified that when the additional fees are included in AT&T's revenue, the average revenue per minute increases and the IXC's margin to provide access service also increases. OCA St. 1R-R at 12. As such, the IXCs' rates and margins have, in fact, increased over the past several years when these fixed rates are considered.

Finally, Dr. Loube noted that reducing Pennsylvania's intrastate access rates will not benefit customers because IXCs have developed service plans based on nationwide costs and marketing considerations. OCA St. 1R at 26-27. Dr. Loube opines that the actions of one state commission cannot have a significant effect on the price an interexchange carrier charges because the access level in one state are not of any great significance. Id. at 27. Actions as requested by AT&T, MCI and Qwest in this proceeding will have little or no impact on the rates those IXCs charge to Pennsylvania consumers for services. Id. Dr. Loube added that IXC rates tend to follow one another so that "if AT&T and MCI increase or do not reduce rates, Qwest will probably also increase rates" so that there is "no reason to believe that Pennsylvania consumers will benefit from access reductions." OCA St. 1R-R at 5. The IXC arguments to the contrary should be rejected. While actions taken by the FCC may have a significant impact on the overall telecommunications market, Pennsylvania access revisions will not have a material effect.

As such, the Commission should withhold implementing any further access reductions at this time. As illustrated above, access reductions have not brought benefits to the customers in the toll market. The IXC's arguments that access charge reductions are necessary to increase competition in the local and long distance markets are without merit and should be rejected. There is no competitive benefit demonstrated for consumers when long distance rates have been increasing. The OCA has shown that long distance rates and associated margins have actually increased as a result of new charges created by IXCs. Therefore, the OCA submits that the Commission should not reduce access rates at this time.

C. The Commission Should Not Reduce Access Rates And Increase Basic Local Service Rates Because Increasing Rates Continue To Be A Concern For Universal Service.

The OCA submits that the Commission should consider the effects that further increases in local rates may have on telephone subscribership should it determine to offset any reductions in access charges with increases in the basic local service rates. As OCA witness Loube testified, telephone subscribership is measured by the telephone penetration rate, the ratio of the number of households with at least one telephone, including cellular phones and Voice over Internet Protocol ("VoIP") connections, to the number of total households. OCA St. 1R at 27. Dr. Loube noted that telephone penetration in Pennsylvania has been dropping. *Id.* at 28. In 2002, the annual penetration rate achieved was 98 percent. That number dropped to 95.6 percent in 2004 and dropped to 94.3 percent as of March, 2005. *Id.*<sup>20</sup> Dr. Loube also provided data showing that the current levels are also low in comparison to the long-term experience in Pennsylvania. Dr. Loube testified that, for the period 1990 to 2001, the penetration rate varied from a low of 96.6 percent to a high of 97.3 percent such that the current monthly value is 2.3

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<sup>20</sup> *Citing*, Alexander Belifante, "Telephone Subscribership in the United States (Date through March 2005)," FCC Industry Analysis and Technology Division, May 2005, Table 3.

percentage points below the lowest annual number recorded over a historically long period. Id. Dr. Loubé added that the extremely low March 2005 value does not reflect the full impact of the February 2005 Verizon local rate increase so that any additional increase in local rates could decrease the penetration rate further. Id.

Dr. Loubé reiterated the significant effect on universal service of any increase in basic local service rates to offset intrastate access charge reductions in response to testimony by MCI witness Pelcovits. Dr. Pelcovits had argued that it was not important to safeguard a particular rate from increases because “a telephone subscriber uses his line for many different purposes, such as local calling, long distance, call waiting and voice mail. It is arbitrary whether to categorize any one of these uses as a separate service or not.” MCI St. 1.1 (Remand) at 4. Dr. Loubé testified that it is common practice to categorize telecommunication use into different services for many purposes. OCA St. 1R-SR at 12. Dr. Loubé explained his concern that basic local service is a particularly important category, often termed “universal service.” Dr. Loubé testified:

In this proceeding two of these services, access service and local exchange service, are very important. **Local exchange service is important because it is the service that is the likely candidate for any revenue neutral offsetting increases that the PUC would be required to adopt if it chooses to decrease the access rates. However, state and federal regulatory principles also caution against increases in local service in order to safeguard universal service.** Therefore, categorizing use into these services is not arbitrary; and it is essential that the PUC have a reasonable estimate of the stand-alone and incremental cost of local exchange and access service.

Id. at 13 (emphasis added).

Finally, as illustrated above, the IXCs have not passed through to customers past access charge reductions. Thus, further access reductions and local rate rebalancing are likely to lead to a general increase in the consumers’ overall telecommunications bills. This supports the OCA

position that universal service may be jeopardized if the Commission acts now to implement any access charge reductions that would be offset by an increase in the basic local service rate.

The OCA submits that the Commission should not reduce access rates and increase basic local service rates because increasing rates continue to be a concern for universal service. The OCA has shown that telephone penetration rates in Pennsylvania are lower than at any point in the last 15 years. Penetration rates in Pennsylvania may get worse if the Commission adopts the positions advocated by the IXCs in this proceeding, particularly as the IXCs have been resistant to flow through any access reductions to customers.

D. The Commission Must Reaffirm Its Long-Standing Position That All Users Of The Local Loop Have An Obligation To Pay For Non-Traffic Sensitive Costs.

1. PUC And Other Regulatory Precedent Supports Requiring IXCs To Share In The Non-Traffic Sensitive Costs Of The Local Loop.

Pennsylvania law is clear regarding the type of cost allocation issues raised in this proceeding. The Commission has recognized on more than one occasion the principle that shared usage should lead to shared cost allocations.

As Dr. Loube noted in his testimony, in Verizon's (then Bell Atlantic's) 1996 rate rebalancing case in Pennsylvania, the Commission determined that 100 percent of the loop costs should not be assigned directly to basic service. OCA St. 1R at 12-13. In particular, the Commission found:

[W]e generally agree with the analysis of the ALJ, as amplified by the OCA, and the OTS with regard to the rejection of Bell's studies based on the allocation of 100% of dial tone line costs to the dial tone line component of local exchange service. That dial tone line is a specific service, with specific demand, begs the question of whether the 100% allocation of these costs to one class of service is acceptable. It is without question that the dial tone serves as the platform from which a host of telecommunications services are, in fact, provided.

Consequently, while there may be some merit in Bell's distinction that the debate over the proper allocation to other services is to be viewed as a debate over the proper recovery of these costs, the allocation of 100% to one component renders the Rate Rebalancing proposal of Bell inherently flawed. Thus, while we do not, as of yet, endorse any competing percentage allocation of local loop costs, we find that 100% allocation to one component is not reasonable and does not result in a revenue neutral impact.

Pa. P.U.C., et al v. Bell Atlantic – Pennsylvania, Inc., Opinion and Order, Docket No. R-00963550 et.al. at 23-24 (December 16, 1996).

Similarly, in the Commission's Order of August 31, 1995 in the Universal Service Investigation, the Commission explained:

. . . a portion of all joint shared and common costs, including overhead costs, should be reasonably assigned to basic universal service.

We agree with the PTA and the OCA that local loop costs are joint or shared costs since the local loop is jointly utilized to provide a wide array of telecommunications services, among which are basic universal services. Our view is unaffected by whether one views basic universal service as a single service or a group of services. Regardless, we believe an appropriate portion of local loop costs should be assigned to basic universal service, consistent with the treatment of other joint, shared or common costs.

Universal Service Investigation, Docket No. I-00940035, Opinion and Order at 12 (August 31, 1995).<sup>21</sup> Thus, the Commission has clearly ruled on multiple occasions that the joint and common costs of the local loop facilities must be considered as a shared cost of all services that use the local loop, including access services.

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<sup>21</sup> See also, Formal Investigation to Examine and Establish Updated Universal Service Principles and Policies for Telecommunications Services in the Commonwealth, Docket No. I-00940035, Order at 82-83 (January 28, 1997) ("We reaffirm our findings in our September 5, 1995 Order at Docket No. L-00950105 that the local loop is a "joint cost", not a direct cost of providing only those services included in the definition of B[asic] U[niversal] S[ervice]. It is used for a variety of services other than BUS and must be allocated among the services which utilize it.").

The FCC,<sup>22</sup> the United States Supreme Court<sup>23</sup> and other state commissions<sup>24</sup> have also concluded that the local loop facilities are costs properly allocated across all the services that use the local loop. More specifically, the FCC has further determined that loops are required for the provision of access to long distance service. As Dr. Loubé noted in his testimony, the FCC has previously stated:

By contrast, the costs of other facilities used for both interstate and intrastate traffic do not vary with the amount of traffic carried over the facilities, i.e. the costs are non-traffic sensitive. These costs pose particular difficult problems for the separations process: the cost of such facilities cannot be allocated on the basis of cost-causation principles because **all of the facilities would be required even if they were used only to provide local service or only to provide interstate access service.** (emphasis added) A significant illustration of this problem is allocating the cost of the local loop, which is needed both to provide local telephone service as well as to originate and terminate long-distance calls.

Id. at 1R-SR at 6.<sup>25</sup>

Most important, however, is the Commonwealth Court decision in the Global Appeal Order that is contrary to the LXC's position in this case. In that decision, the Commonwealth Court upheld the PUC conclusion that access rates do not need to be reduced to incremental cost. In the Global Appeal Order, AT&T argued that the PUC's decision to set access rates above incremental costs was illegal. In rejecting AT&T's appeal, the Commonwealth Court noted the

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<sup>22</sup> See e.g., In the Matter of: Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98 at paras. 676, 678 (August 8, 1996); In the Matter of NYNEX Telephone Companies Petition for Waiver, 10 FCC Rcd. 7445 at ¶ 39 (May 4, 1995); and In the Matter of Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, CC-Docket No. 01-338 (rel. August 21, 2003). See also, 47 C.F.R. § 36.154.

<sup>23</sup> Smith v. Illinois Bell Telephone, 282 U.S. 133, 51 S.Ct. 65, 75 L.Ed. 255 (1930) (the loop cost must be recovered from both the intrastate and interstate jurisdictions).

<sup>24</sup> See e.g., Washington Utilities and Transportation Commission v. US West Communications, Inc., Docket No. UT-950200, 169 PUR4th 417, 476-77 April 11, 1996; 4 CCR 723-30, Rule 4(2)(a)(iii)(Colorado); and Re: Southwestern Bell Telephone Company, Case Nos. TR-83-253 and TR-83-288, 26 MO.P.S.C. (N.S.) 344, 381 (1983).

<sup>25</sup> Citing, In the Matter of Access Charge Reform, Sixth Report and Order, CC Docket No. 96-262, FCC 00-193, released May 31, 2000, ¶11.

testimony of the OCA witness regarding AT&T's request to reduce access rates to incremental cost. The Commonwealth Court wrote:

[t]he Office of Consumer Advocate responds to AT&T by submitting that there is no legal authority requiring the PUC to reduce access rates to the incremental cost of access service. OCA witnesses testified that such a reduction could require customers other than the long distance carriers to pay all of the joint and common costs of the network and therefore should be rejected. The logic of that analysis commends it.<sup>26</sup>

The decision of the Commonwealth Court on this point in the Global Appeal Order is illuminating. The Commonwealth Court decided:

One of the lessons of this proceeding is that the cost of excessively priced elements must be reduced to a point nearer to actual incremental cost, but not so greatly as to eliminate the support such revenue provides to other areas of the system that need that support. The record here confirms the soundness of the PUC's view, based on evidence from consumer witnesses, that **users of all services, including access, should share in the payment of total network costs, with the cost of the local loop included as an element of that total network.**<sup>27</sup>

Thus, it is clear that the Commonwealth Court has ruled that all users of the network should pay a portion of network costs, including the local loop. It is entirely appropriate and necessary that access services should contribute to the cost of the loop. Loop facility costs must be allocated to all services, including access service, that employ the local loop facility. That is the law as explained by the Commonwealth Court.

As such, it is clear that this Commission and the courts have correctly viewed the local loop facilities costs as a shared cost among all the services that use the local loop. The Commission should reaffirm its long-standing position that all users of the local loop have an obligation to pay for non-traffic sensitive costs. Thus, it continues to be appropriate for the IXCs

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<sup>26</sup> Bell Atlantic-Pennsylvania, Inc. v. Pennsylvania Public Utility Commission, 763 A.2d 440, 480 (Pa. Cmwlth 2000) ("Global Appeal Order"), *vacated in part, sub nom. MCI Worldcom Inc. v. Pa. Public Utility Commission*, 844 A.2d 1239 (Pa. 2004) (State court lacked jurisdiction to review unbundled network elements decision)(emphasis added).

<sup>27</sup> Global Appeal Order at 480.

that use the local loop to originate and terminate long distance service to pay for a portion of such loop costs.

2. While Access Rates May Be Above The Incremental Cost Of Access Service, This Relationship Does Not Prove That Access Rates Are Subsidizing Local Service.

a. Introduction

In its July 28<sup>th</sup> Order, the Commission noted that it has been its policy “to work toward an elimination of implicit subsidies that may exist in access charge rates.” July 28<sup>th</sup> Order at 19. As a result, the IXCs have argued in this proceeding that access rates contain implicit subsidies and therefore must be reduced.

OCA submits that there are many important issues in this proceeding concerning the effect of ICC reform, failure to flow through access reductions, and a declining rate of local subscribership that would caution against further access reductions at this time. Nonetheless, the PUC has also addressed issues concerning the often debated economic issues of subsidy in this proceeding. OCA submits that the record in this proceeding does not demonstrate the existence of subsidy in this case.

On the contrary, it is clear through the testimony of OCA witness Loube that residential customers are not receiving a subsidy and that interexchange carriers are not paying a subsidy. As shown below, the IXCs “subsidy” arguments are without merit and do not support decreasing access charges and increasing local rates in order to eliminate an implicit subsidy.

b. The OCA Cost Analysis Shows That No Subsidy Exists.

Dr. Loube presented extensive testimony demonstrating that there is no subsidy provided by Verizon’s intrastate access rates. OCA St. 1R at 5-17. In particular, Dr. Loube testified that a generally accepted definition of subsidy is “that a service is subsidized if its price is less than the

incremental cost and the service pays a subsidy if its price is above the stand-alone cost of service.” Id. at 6.<sup>28</sup> Dr. Loubé testified that an implicit subsidy is a subsidy that is embedded in rates charged, but not disclosed as such, where the rates for one group of services are set higher than the complete or stand alone cost of providing that service. This would mean that the revenue generated by the rate above the stand alone cost of service is used to maintain rates below the incremental cost for the second group of services. Id. at 7.

Accordingly, a service receives a subsidy if the rate is set below the incremental cost of service. Dr. Loubé testified that, for Verizon’s services, the Company should use the incremental cost determined by the Total Service Long Run Incremental Cost (“TSLRIC”), which is the common convention used in many telephone proceedings. Id. at 7-8. Using TSLRIC, the “total” in the TSLRIC definition defines the size of the increment to be investigated as the existing total demand for the service and the “long run” requires that the cost estimate include the cost of the facilities and equipment that may be fixed in the short run. Id. at 8. Dr. Loubé further testified that the components of TSLRIC for basic local exchange service should “include the switching and interoffice facilities used to provide basic exchange local service plus the customer operations and marketing cost associated with basic exchange local service.” Id.

Significantly, Dr. Loubé testified that the local loop is not considered part of the incremental cost of basic service because it is considered a shared cost of the many services that use the loop. Id. As explained above, Dr. Loubé added that the local loop:

... is used to provide not only local service but also to provide interstate and intrastate access and toll service, and the newer data services such as DSL service. It is part of the stand-alone cost of all other services. Even if local service were no longer provided, the carrier would still have to provide the loop

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<sup>28</sup> *Citing*, Faulhaber, G.R., Cross-subsidization: pricing in the public enterprise. *American Economic Review* 65, 966-977.

in order to provide the other services. Thus, the local loop and port are not incremental to the provision of local service.

Id. Dr. Loube testified that the incremental network cost of providing local service is estimated by using a cost model and allocating the shared costs among the services that use these shared facilities. Id. at 9.

As such, Dr. Loube was able to identify that the incremental network cost of Verizon basic service is [BEGIN PROPRIETARY] [END PROPRIETARY] based on the current rates for unbundled network elements (“UNEs”) for switching, transport and tandem services and Verizon’s usage patterns. Id.; *citing*, OCA Exh. RL-2. To establish his TSLRIC estimate for Verizon basic local service, Dr. Loube added the incremental network cost to the incremental *retail* cost of basic local service, *i.e.* the sum of the marketing and other customer operations expenses, and the forward-looking customer operations cost associated with basic residential service. Id. at 10. The FCC has previously determined in its universal service proceeding that the estimated marketing costs, based on a detailed examination of a submitted cost study and the ARMIS data for non-rural carriers, was \$0.09 per line. Id.<sup>29</sup> In the same universal service proceeding, the FCC also determined that the estimated forward-looking customer operations costs was \$1.24. Id. at 10-11.<sup>30</sup> As a result, Dr. Loube’s analysis reveals that the TSLRIC estimate for Verizon basic residential service is the sum of \$0.09, \$1.24 and [BEGIN PROPRIETARY] [END PROPRIETARY].

Id. at 11.

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<sup>29</sup> See, In the Matter of Federal-State Joint Board on Universal Service, Tenth Report and Order, CC Docket No. 96-45, (rel. Nov. 2, 1999) at ¶¶ 403-407. ARMIS is the FCC’s Automated Reporting Management Information System.

<sup>30</sup> Id. at ¶¶ 382-402; *see also*, OCA Exh. RL-3.

Finally, Dr. Loube noted that the Verizon PA average monthly residential revenue per-line for flat rate local service is **[BEGIN PROPRIETARY]**

**[END PROPRIETARY]** and a \$6.50 SLC. Id.

Therefore, Dr. Loube concluded that, on average, residential basic service revenue is far greater than the incremental cost of service. Id. Dr. Loube emphasized that the charges for every residential customer are greater than the incremental cost of service because the sum of the dial tone line charge and the SLC line charge in every density cell is greater than the incremental cost of such service. Id. These rates are higher than the incremental costs no matter what additional charges are paid for the usage package the customer chooses. Id. at 12. Dr. Loube concluded that “every residential customer pays Verizon more than the incremental cost of service, implying that there are no residential customers anywhere in the Verizon service territories that are receiving a subsidy.” Id.

Verizon has argued in this proceeding that the OCA has “overstate[d] the cost of access by allocating a significant amount of the subscriber loop and port ‘costs’ to intrastate switched access service.” Verizon St. 1.1 (Remand) at 15. More specifically, Verizon argues that Dr. Loube has improperly based his TSLRIC cost study on UNE rates and therefore completely omits from the cost of providing basic service the cost of providing the loop itself. Id. at 19. Verizon also argued that the “subscriber loop and port costs are not incremental costs related to the provision of intrastate switched access services.” Id. at 18.

*The OCA submits that this argument is without merit and should be rejected. As OCA witness Loube testified, Verizon’s argument confuses the terms “stand-alone” and “incremental.”*

OCA St. 1R-SR at 10. Dr. Loubé's analysis does not include any loop cost in the incremental cost of switched access services, but he does include the loop cost in the stand-alone cost of access service. Id. As noted above, this position is supported by FCC and PUC precedent. Dr. Loubé, therefore, has not overstated the cost of the stand-alone access service, as the stand-alone estimate includes the cost of the loop and the port and is part of the test of whether access services are providing a subsidy to other services. Id. The stand-alone cost of access, or any other telephone service, would include the loop cost. Dr. Loubé added: "To show that switched access service is providing a subsidy, it is necessary to show that the price of switched access service is above the stand-alone cost. Because the price of switched access is below the stand-alone cost of service, switched service is not providing a subsidy to other services." Id.

Dr. Loubé further testified that Verizon's estimates for its cost of local service is very high. Id. at 10-11. Dr. Loubé noted that Verizon witnesses Dean and Kane testified that the cost of local service is **[BEGIN PROPRIETARY]** **[END PROPRIETARY]** for Verizon PA and Verizon North respectively. Id. at 10.<sup>31</sup> Dr. Loubé noted that these values are extremely high compared to other estimates of the forward-looking cost of service and Verizon's own embedded cost of service. Id. Dr. Loubé cites as an example the FCC's estimate of the Pennsylvania forward-looking cost of \$20.24. Id.<sup>32</sup> Dr. Loubé testified that Verizon's estimates for Pennsylvania are greater than two standard deviations higher than even the FCC's highest state forward-looking cost estimate in the entire nation -- \$36.43 for Mississippi. Id. at 10-11.

Finally, Dr. Loubé also testified that, with regard to Verizon's embedded cost of service, *i.e.* Verizon's cost of service from its own books of account, Verizon PA has an embedded loop

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<sup>31</sup> *Citing*, Verizon St. 1.1 (Remand) at 20.

<sup>32</sup> *Citing*, Universal Service Administrative Company, High Cost Model Support Projected By State, Third Quarter 2005, Appendix HC 16.

cost of \$18.80 and that Verizon North has an embedded loop cost of \$24.61. Id. at 11. Dr. Loube noted that the embedded cost estimates follow the same pattern as the FCC's forward-looking cost estimates in relation to other jurisdictions and that only the Verizon estimates by its witnesses Dean and Kane appear to be out of place and extraordinarily high. As such, Verizon's cost estimates for local service and its subsidy calculations are unrealistically high.

c. The Commission Should Also Consider That The Modern Network Is Increasingly One Of Large Fixed Costs That Should Not Be Entirely Paid For By Local Service.

The Commission should determine that, while access rates may be above the incremental cost of access service, this relationship certainly does not prove that access rates are subsidizing local service. It is not appropriate for local service to pay the entire fixed costs of connecting customers to the network. This fact becomes even more obvious when considering that the modern telecommunications network does much more than simple local voice communications.

As Dr. Loube testified, Verizon is currently deploying a new fiber to the premises network that has the capability to provide high-speed data and video services. OCA St. 1R at 13. Verizon offers video services in some places where it has installed this network and is actively seeking the authority to provide cable television services wherever the network is constructed. Id. Dr. Loube noted that there are now eight wire centers in Pennsylvania where customers can purchase from Verizon services provided over a fiber to the premise network. This level of delivering telephone service will likely be more common in the future. Id. Dr. Loube added that, under federal law, the Commission has the responsibility to "ensure 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." Id.<sup>33</sup> Dr. Loube noted that:

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<sup>33</sup> *Citing*, 47 U.S.C. § 254(k).

offering video services over a shared 'loop' plant emphasizes the problem that one service, local telephone service, is not being subsidized simply because it does not pay for the entire cost of the fiber 'loop' plant that will offer many services – including video entertainment.

Id. The OCA submits that where Verizon has built its fiber to the home network, it will be increasingly difficult to determine the cost of voice service on such a system, given all the services that are provided over that system.

As such, the idea that telephone networks are built merely to provide local services and that local service should pay for all of the fixed costs of such a network is an antiquated argument that ignores how Verizon is currently building networks to offer voice, data and video through fiber to the home.

d. The Current Levels of Intrastate Access Rates Do Not Force Interexchange Carriers To Subsidize Other Customers.

OCA witness Loube has also analyzed whether intrastate access rates force interexchange carriers to subsidize other customers. OCA St. 1R at 14-16. Dr. Loube first noted that, based on responses to OCA discovery, it can be determined that the average access revenue per-line is only [BEGIN PROPRIETARY] [END PROPRIETARY]. Id. at 14; *see also*, OCA Exh. RL-4. Dr. Loube then determined that the stand-alone cost of access service – the cost of providing access service if no other services are being produced, which would include the full cost of the shared inputs required to provide the service and the direct costs associated with the production of the service – ranges from [BEGIN PROPRIETARY] [END PROPRIETARY]. Id. at 15. This estimate uses [BEGIN PROPRIETARY] [END PROPRIETARY] as a per line estimate of the access service TSLRIC. Id. Dr. Loube then concluded that, given that the average access revenue per-line is [BEGIN PROPRIETARY] [END PROPRIETARY] and that this is far less than the minimum reasonable estimate of

the stand-alone cost of access service in every density cell in Verizon's service territory. Id. Access service is not subsidizing any residential local service or any other service. Id.

However, Dr. Loubé testified that it is quite possible that rates for basic local service in density cells one and two are close to or above the stand-alone cost of such service. Id. Dr. Loubé noted that the minimum reasonable estimate of the stand-alone cost of basic local service – the sum of the loop and port TELRIC, the retail costs for all switching services and the TSLRIC for the basic service – is more than the basic local rate charged. Id. at 15-16. More specifically, Dr. Loubé noted that the Verizon PA rate for residential service, using the unlimited local calling option and including the SLC, is \$20.28 and \$20.58 in density cells one and two respectively. Id. at 16; *see also*, OCA Exh. RL-5. Therefore, residential customers in density cells one and two are paying a subsidy either to other services or to the stockholders and that such subsidy would increase if the state access rates are decreased and residential rates are increased. Id.

Qwest witness McIntyre argues that, even when access services are priced below a stand alone cost, a subsidy may still exist. Qwest St. 2 at 7-10. In response, Dr. Loubé noted that economists and regulators have agreed that, only when a service is charged more than the stand-alone cost of service may a subsidy exist. OCA St. 1R-SR at 4.<sup>34</sup>

e. Conclusion.

While access rates may be above the incremental cost of access service, this relationship does not prove that access rates are subsidizing local service. As such, the Commission must reaffirm its long-standing position that all users of the local loop have an obligation to pay for

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<sup>34</sup> *Citing, Bridger M. Mitchell and Ingo Vogelsand, Telecommunications Pricing Theory and Practice, Cambridge University Press at 119.*

non-traffic sensitive costs and access rates that are above incremental costs do not indicate that such rates are paying a subsidy.

3. The Carrier Charge Need Not Be Eliminated Or Reduced Because It Is An Efficient Cost Recovery Mechanism.

AT&T and MCI have argued that the carrier charge has no cost basis and is an inefficient way to recover loop costs. AT&T Exc. at 6-7; MCI Exc. at 5. Essentially, the IXCs argue for an elimination of the carrier charge in Pennsylvania when they argue that interstate access rates should match intrastate rates because there is currently no interstate carrier charge. AT&T Exc. at 3; Qwest Exc. at 8.

In response, however, the OCA submits that the carrier charge need not be eliminated because it is reasonable to recover a portion of the shared cost of the network from all of the users of the network so that every user of the network makes a contribution to the shared cost. As OCA witness Loube testified, the carrier charge achieves just that result. OCA St. 1R at 18. Dr. Loube further testified that the carrier charge is not a subsidy because it is a “payment towards partial recovery of the shared costs of the loop” and “cannot be a subsidy to the local residential customers because the rates for local residential service are above the incremental cost of service.” Id.

Dr. Loube further testified that the most common efficiency claim associated with loop charges is that the loop charges should be flat-rated rather than recovered through a per minute rate because loop costs do not vary with usage. Id. Dr. Loube pointed to a decision of the FCC to support this position. Id. at 18-19.<sup>35</sup>

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<sup>35</sup> Citing, In the Matter of Access Charge Reform, First Report and Order, CC Docket No. 96-292 (rel. May 16, 1997) at ¶ 6.

Dr. Loube further noted that interexchange carriers have imposed flat-rated charges that will collect more than the carrier charges in some cases. Id. at 19. For example, AT&T charges its customers a \$1.95 in-state connection fee and MCI also has a \$1.95 in-state access recovery fee to recover Pennsylvania access charges. Id. Dr. Loube noted the inefficiencies of such non-traffic sensitive charges because they are greater than Verizon's \$0.58 carrier charge and therefore recover more than the Verizon carrier charge. Id. Dr. Loube testified that collecting traffic-sensitive costs through a non-traffic sensitive rate element distorts price signals and that the situation is of particular concern because the IXC's charges are increasing even as flat rate access charges are declining. Id.

As such, the OCA submits that the carrier charge need not be eliminated or reduced, despite the IXCs arguments to the contrary, because it is an efficient cost recovery mechanism. It is reasonable to collect this revenue from IXCs because IXCs are users of the network and should pay to support that network.

4. The IXCs Should Have Some Responsibility To Pay For A Portion Of The Non-Traffic Sensitive Costs Of The Local Loop.

The IXCs have generally argued that state access rates should be reduced to the interstate level, and also recommended that generally all such rates should be reduced to the incremental cost of access. The OCA submits that this argument is without merit and should be rejected. Rather, as indicated above, the Commission must reaffirm its long-standing position that all users of the local loop have an obligation to pay for non-traffic sensitive costs.

Qwest witness McIntyre argued that state rates should match interstate rates "on a rate by rate and element by element" basis. Qwest St. 1 at 2. MCI witness Pelcovits argued that price should be reduced to cost because prices set at that level would lead to both static and dynamic efficiency gains. MCI St. 1.0 (Remand) at 7-8. Finally, AT&T witness Oyefusi has argued that,

in addition to the access reductions previously ordered, the PUC should now eliminate the carrier charge and other implicit subsidies embedded in Verizon's access rates and "reduce the remaining access rates to cost based levels (or at least to levels no higher than Verizon's interstates rates)." AT&T St. 1-R at 7 (emphasis added). Dr. Oyefusi and Dr. Pelcovits have also defined "cost" as the additional or incremental cost of using the incumbent carrier's network to complete their long distance calls. These costs include only the cost of using the incumbent carrier's local switch, tandem switch and interoffice transport facilities. AT&T St. 1-R at Exh. 1; *see* MCI St. 1.0 at 14.

In response, OCA witness Loubé testified that the IXC witnesses do not include the cost of the loop as part of the incremental cost of using the network but insist that any loop recovery through the payment of access charges is a subsidy. OCA St. 1R-R at 7. Dr. Loubé added that, if pricing goals were to reduce all rates to incremental cost, then this same logic would reduce local rates to incremental cost as well in order to achieve the same static and dynamic efficiency gains as proposed by MCI's Dr. Pelcovits. *Id.* Dr. Loubé concluded that setting the price of every service at the incremental cost of service would then lead to bankruptcy for any carrier. *Id.*<sup>36</sup>

Dr. Loubé added that it would not be reasonable to set the price for each service at the incremental cost of that service because doing so would not provide the revenue needed to recover the cost of the loop network. *Id.* at 8. Dr. Loubé noted that the loop network is an input to all services, including local usage and access usage, which it supports. *Id.*; *see also*, OCA St. 1R-SR at 8. Dr. Loubé testified that: "it is not possible to complete either a local call or a long distance call without using the loop network. Therefore, the prices for local usage and access

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<sup>36</sup> *Citing*, William J. Baumol, *The Free Market Innovation Machine: Analyzing the Growth of Miracle Capitalism*, Princeton University Press, 2002, page 166.

must be set above the incremental cost of service in order to allow the incumbent to recover the cost of the loop.” OCA St. 1R-SR at 8.

Finally, Mr. McIntyre argued that he had found a problem with Dr. Loube’s stand-alone cost standard because Mr. McIntyre considered an example where one product is priced above its stand-alone cost, and nine other products are priced above their incremental costs. Qwest St. 2.0 at 8. Dr. Loube testified that Mr. McIntyre’s argument did not show an inconsistency in Dr. Loube’s position, but rather described a situation where the total revenue from a group of services was greater than the total economic cost of service for all the products taken together. OCA St. 1R-SR at 7. While this situation may exist, it would not demonstrate the existence of a subsidy to a particular service. Instead, it would simply show that the provider is receiving more than its total economic cost of service.

Dr. Loube also noted that there are many markets where there are two prices for the same service. Id. at 8. Dr. Loube gave, as an example, that the price of an airplane seat on the same plane traveling between two cities can be different for almost all of the passengers on the plane and that movie theaters charge different prices for parents and children watching the same film. Id. Dr. Loube testified that different prices are a function of the seller’s marketing strategy and do not prove that a subsidy exists. Id. Therefore, it is not reasonable to set the price of access equal to its incremental cost in this proceeding.

##### 5. Conclusion.

The Commission must reaffirm its long-standing position that all users of the local loop have an obligation to pay for a share of the non-traffic sensitive costs. As discussed above, long-standing precedent of this and other commissions supports requiring IXCs to share in the non-traffic sensitive costs of the local loop. While access rates may be above the incremental cost of

access service, the OCA analysis in this proceeding shows that this relationship does not prove that access rates are subsidizing local service. Furthermore, the carrier charge need not be eliminated or reduced because it is an efficient cost recovery mechanism. In contrast, the IXCs have generally not shown why they should not pay for the non-traffic sensitive costs of the local loop. Finally, the fact that FCC access rates are lower than state access rates does not prove a subsidy exists.

E. If The Commission Determines To Take Action Now On Further Access Charge Reductions, The OCA Submits That It Should Implement The Proposal Advocated At The FCC By NASUCA.

If the Commission is determined to decrease intrastate access rates at this time, it should apply the five-year plan proposed by NASUCA at the FCC to the Verizon access rates in Pennsylvania.<sup>37</sup> OCA emphasizes its position that the PUC should take no action concerning access reductions until the FCC has ruled on the ICC FNPRM. Only if the PUC believes it is compelled to take action at this time should the PUC apply the NASUCA plan to Pennsylvania rates. As discussed further below, the NASUCA plan in Pennsylvania would produce no access reductions in the first year of the plan because of Verizon's already low access rates. Further, if access minutes continue to decline the total revenue that must be recovered through a revenue neutral offset mechanism at a later time will be less than that if recovery was implemented at this time.

OCA witness Loube discussed some of the details of the NASUCA plan. Dr. Loube testified that the NASUCA plan calls for a five-year transition to target rates for both interstate and intrastate access rates. OCA St. 1R at 42. Most of the rate reductions triggered by the

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<sup>37</sup> In the Matter of Developing a Unified Intercarrier Compensation Regime, CC Docket No. 01-92, National Association of State Utility Consumer Advocate, Initial Comments (May 23, 2005).

NASUCA plan will be associated with a price cap carrier's intrastate rates and rural carrier ICC rates. Id.

The NASUCA plan filed at the FCC recommends, but does not mandate, reductions in state access rates. Id. Dr. Loube testified that the NASUCA plan sets intrastate target rates that the states are not required to match. However, if they choose to adopt such rates, states would be able to share in a new federal universal service fund, called a "state inducement fund." Id. The NASUCA plan also requires the carriers to periodically recalculate the amount of revenue required to meet certain access targets as access revenues decline. Id.

More specifically, the NASUCA plan establishes final target access rates for non-rural carriers' (such as Verizon) intrastate access rates of \$0.0055 per minute. This is the same as the interstate rate as established for price cap carriers in the CALLS proceeding. This intrastate access rate target will be reached over a five year period. Id. at 43. Dr. Loube testified that there would be no change in the access rates in Pennsylvania in the first year under the NASUCA plan because both the Verizon North and Verizon PA intrastate rates are below the NASUCA first year target. Id. The Verizon PA rate would decrease by a small amount in the second year of the plan and continue to decrease for each succeeding year. The Verizon North rate would decrease by a small amount in the third year and continue to decrease in the final two years of the plan. Id.

Dr. Loube testified that, if the Commission now determines to implement any access rate reductions, the Commission should adopt the NASUCA plan because the benefits of the Commission adopting the NASUCA plan are related to NASUCA's five-year transition path. Id. at 44. That is, by taking five years to reach targeted rate levels the annual revenue neutral increases in local rates will be smaller and therefore would have a lesser impact on universal

service in Pennsylvania. Id. The amount of local rate increases necessary to reach the intrastate access target would be recalculated each year. Dr. Loube added that a five-year NASUCA plan could reduce the total amount of access revenue that would be recovered through a revenue neutral increase in local rates due to the long-run downward trend in access minutes. Id. As a result, in each of the five years of the plan, the total amount of revenue subject to a revenue neutral offset in local rates would be less than if the entire amount were replaced in the first year of the plan due to the reduction in access minutes occurring in each year. Id.

The OCA specifically notes that the NASUCA plan does not reduce intrastate access charges to zero. Instead, the NASUCA plan recognizes that all users of the local loop have an obligation to pay for non-traffic sensitive costs, consistent with the positions discussed above. While such contribution would be reduced, it would not be eliminated. Rather, the NASUCA proposal is based on the importance of achieving an overall reduction in national interconnection rates.

Verizon witnesses Kane and Dean argued that the Commission cannot adopt the NASUCA plan because the Commission is statutorily required to permit revenue neutral recovery of any revenue lost by access reductions. Verizon St. 1.1 (Remand) at 37.<sup>38</sup> OCA recognizes that Section 3017 of the Public Utility Code requires the Commission to allow compensation to Verizon for access reductions. The NASUCA plan, permits, but does not mandate, revenue neutral recovery of access reductions under state rules. OCA St. 1R-SR at 11. Dr. Loube added that the NASUCA plan requires carriers to first request state commissions to provide the revenue offset before requesting federal funding. Id. Dr. Loube testified that, in fact, the NASUCA plan is consistent with Section 3017. Id. at 12.

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<sup>38</sup> *Citing*, 66 Pa.C.S. § 3017.

F. Any Local Rate Increases That Are Required Should Be Calculated On The Basis of All Verizon Lines.

Finally, the OCA submits that, if the Commission determines to take action now on further access charge reductions, it should order recovery over a broad base of access lines. Dr. Loube notes that Verizon has estimated, in response to discovery, that the access revenue reduction associated with present intrastate and interstate rate parity to be [BEGIN PROPRIETARY] [END PROPRIETARY] and the number of Verizon lines subject to rebalancing as [BEGIN PROPRIETARY] [END PROPRIETARY]. OCA St. 1R at 36.<sup>39</sup> This would result in a monthly per-line increase of [BEGIN PROPRIETARY] [END PROPRIETARY]. *Id.*

However, dividing the revenue reduction by Verizon total line counts generates a lower rate increase. In response to OCA discovery in this proceeding, Verizon estimated that it had [BEGIN PROPRIETARY] [END PROPRIETARY] total retail lines and [BEGIN PROPRIETARY] [END PROPRIETARY] resold lines. *Id.*<sup>40</sup> In the 2004 ARMIS 43-01 report, Verizon indicated it had 5,136,047 billable access lines. In the 2004 ARMIS 43-08 report, Verizon reports that it had 5,957,098 switched access lines. Dr. Loube testified that, using these alternative lines counts, the monthly per-line increase would be much lower at [BEGIN PROPRIETARY] [END PROPRIETARY] based on the retail line, ARMIS 43-01 and ARMIS 43-08 line counts respectively. *Id.* at 36-37. Accordingly, customers of protected services could pay as much as [BEGIN PROPRIETARY] [END PROPRIETARY] more each month if Verizon's method of calculating the method of recovery is used.

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<sup>39</sup> *Citing*, Verizon response to Qwest Set I, Interrogatory No. 4.

<sup>40</sup> *Citing*, Verizon Response to OCA Set I, Interrogatories Nos. 1 and 2.

The OCA submits that, if the Commission decides to implement further intrastate access reductions and use rate rebalancing to do so, then using a more complete line count would be more appropriate. As Dr. Loube testified: “While it is not appropriate for the PUC to order such rebalancing at this time, if the PUC mandated rebalancing, then the revenue neutral rate increase should be determined by counting all lines. This would mean calculating local rate increases for protected noncompetitive lines based upon a calculation that included bundled competitive services.” OCA St. 1R at 38. Dr. Loube added that “basic noncompetitive customers should only be required to pay the portion of any access reduction that is attributable to their lines.” Id.

As such, if the Commission determines to take action now on further access charge reductions, the OCA submits that the Commission should implement the proposal advocated at the FCC by NASUCA and should also order recovery over a broader base of access lines.

#### IV. CONCLUSION

WHEREFORE, the Pennsylvania Office of Consumer Advocate respectfully submits that the Commission should not reduce intrastate access rates at this time but should instead delay any action on the remanded issues until after the Federal Communications Commission has completed its review of the same issues. The Commission should reaffirm its position that all users of the local loop have an obligation to pay for the non-traffic sensitive costs. The Commission must likewise recognize that revenue neutral reductions in access rates have not brought benefits to customers in the toll market but have only jeopardized this Commission's universal service policies. Finally, if the Commission determines to act on the remanded issues in this proceeding, it should adopt the proposal advocated at the FCC by the National Association of State Utility Consumer Advocates and should calculate any increase on the basis of all access lines.

Respectfully submitted,



Philip F. McClelland  
Senior Assistant Consumer Advocate  
Joel H. Cheskis  
Assistant Consumer Advocate

For: Irwin A. Popowsky  
Consumer Advocate

Office of Consumer Advocate  
555 Walnut Street  
Forum Place, 5<sup>th</sup> Floor  
Harrisburg, Pennsylvania 17101-1923  
(717) 783-5048

Dated: August 17, 2005  
85072

APPENDIX A

PENNSYLVANIA PUBLIC UTILITY COMMISSION  
HARRISBURG, PENNSYLVANIA 17105

Investigation Regarding Intrastate  
Access Charges and IntraLATA Toll  
Rates of Rural Carriers, and the  
Pennsylvania Universal Service Fund

PUBLIC MEETING: August 11, 2005  
AUG-2005-OSA-0243\*  
I-00040105

MOTION OF VICE CHAIRMAN JAMES H. CAWLEY

Before us for disposition is the Petition for Interlocutory Review (Petition) of a Material Question filed by the Office of Consumer Advocate (OCA), the Commission's Office of Trial Staff (OTS), and the Rural Telephone Company Coalition (RTCC) (collectively referred as Joint Petitioners). The Joint Petition arises from a ruling of Administrative Law Judge (ALJ) Susan D. Colwell, who presides over the evidentiary stage of this proceeding, to deny Joint Petitioners' *Motion to Defer*. ALJ Colwell denied Joint Petitioners' *Motion to Defer* that had requested a stay of this proceeding in view of the Federal Communications Commission's (FCC's) ongoing activities in its *Unified Intercarrier Compensation* proceeding.<sup>1</sup> The Petition raises two separate questions:

- (1) Did the presiding officer erroneously issue an Order on a Motion filed with the Commission?
- (2) Did the presiding officer erroneously conclude not to stay the instant investigation pending action by the FCC on the same matters at issue in this Commission investigation?

I believe that the Staff analysis and recommendation disposing of the first question is correct. The Commission's rules permit a presiding ALJ to rule on Motions that are properly made in the evidentiary phase of a Commission adjudicative investigation. *See* 52 Pa. Code § 5.103(d). Therefore, I believe that ALJ Colwell had the requisite authority to make a ruling on Joint Petitioners' *Motion to Defer*.

The second question presents this Commission with more complex issues that hold the potential of serious implications for both telecommunications carriers operating in Pennsylvania and their respective end-user consumers. These implications arise not only from the yet unknown outcome of the FCC's *Unified Intercarrier Compensation* proceeding, but are also based on the interaction between the *Unified Intercarrier Compensation* proceeding potential outcomes and this Commission's implementation of Act 183 of 2004, or the new Chapter 30 law. P.L. 1398, 66 Pa. C.S. § 3011 *et seq.*

This Commission's implementation of the new Chapter 30 law includes statutorily mandated annual revenue and rate increases for those rural incumbent local exchange carriers

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<sup>1</sup> *In re Developing a Unified Intercarrier Compensation Regime*, (FCC Rel.: March 3, 2005), CC Docket No. 01-92, *Further Notice of Proposed Rulemaking*, FCC 05-33 (*Unified Intercarrier Compensation*).

(ILECs) that have Commission-approved amended network modernization plans (NMPs).<sup>2</sup> The Commission has already approved four (4) such revenue and rate increases for rural ILECs with approved amended NMPs that operate under price stability mechanisms and price change opportunity (PSM/PCO) formulas.<sup>3</sup> The new Chapter 30 law also directs that the Commission “may not require a local exchange telecommunications company [ILEC] to reduce access rates except on a revenue-neutral basis.” 66 Pa. C.S. § 3017(a). In other words, without prejudging the outcome of this Investigation, potential intrastate carrier access charge reductions that may be achieved in the context of this proceeding for the rural ILECs may have to be absorbed totally or in part by the rural ILECs’ basic local exchange service ratepayers on a “revenue-neutral basis.”

However, the intrastate access charge reform for the rural ILECs is not independent from the potential outcomes of the FCC’s *Unified Intercarrier Compensation* proceeding. A number of the rural ILECs operating in Pennsylvania are “average schedule companies,” i.e., their operational revenues, expenses, and assets are not subject to jurisdictional intrastate – interstate allocations. Thus, the overall annual revenue level of these ILECs depends on the receipt of federal Universal Service Fund (USF) support distributions. Similarly, these ILECs are also recipients of support contributions from the Pennsylvania USF (Pa. USF).<sup>4</sup> Furthermore, certain outcomes of the FCC’s *Unified Intercarrier Compensation* proceeding can *directly* affect the *intrastate* carrier access charges of the rural ILECs.<sup>5</sup>

It is intuitively understood that the level of the rural ILEC intrastate carrier access charges affects the services that are offered in the Commonwealth by interexchange carriers (IXCs) as well as by other categories of telecommunications carriers. However, it should also be noted that under the new Chapter 30 law IXC services have been classified as “competitive” and the Commission cannot “fix or prescribe” the rates and charges for IXC services. 66 Pa. C.S. § 3018 (a)&(b).

The OCA’s Brief in Support of the Joint Petition (OCA Brief) clearly and persuasively demonstrates the risks to the end-user ratepayers of the rural ILECs if this Investigation was allowed to proceed while the FCC’s *Unified Intercarrier Compensation* proceeding was still pending. For example, the OCA Brief points out that, depending on the outcome of the FCC’s *Unified Intercarrier Compensation* proceeding, if this Commission proceeds with intrastate access charge reform, potentially increased federal USF funding may not apply to rural ILEC intrastate access charge reductions that will be put in place *prior* to the conclusion of the FCC’s proceeding.<sup>6</sup> Similarly, the OCA Brief persuasively argues that, under certain outcomes in the same FCC proceeding, the rural ILECs’ ratepayers may bear the same burden twice from the

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<sup>2</sup> 66 Pa. C.S. § 3015(a)&(b).

<sup>3</sup> See generally *ALLTEL Pennsylvania, Inc.*, Docket No. R-00050574, Secretarial Letter issued July 29, 2005; *Buffalo Valley Telephone Company*, Docket No. R-00050520, Secretarial Letter issued July 29, 2005; *Conestoga Telephone and Telegraph Company*, Docket No. R-00050521, Secretarial Letter issued July 29, 2005; *Denver and Ephrata Telephone and Telegraph Company*, Docket No. R-00050522, Secretarial Letter issued July 29, 2005. These revenue and rate increases are based on the statutory level of the inflation offset in the PSM/PCO formulas that has been set at 0% or 0.5% depending on the ILEC’s rural or non-rural status and its selected amended NMP option. 66 Pa. C.S. § 3015(a).

<sup>4</sup> See generally *Rulemaking Re Establishing Universal Service Fund Regulations at 52 Pa. Code §§63.161-63.172*, Docket No. L-00000148, Revised Final Rulemaking Order entered March 23, 2001, 31 Pa.B. 3402 (June 30, 2001).

<sup>5</sup> See generally *Unified Intercarrier Compensation*, ¶¶ 114-115, at 51-52.

<sup>6</sup> OCA Brief at 8-9.

same reduction in intrastate access charges if such reductions are not simultaneously coordinated between this Commission and the FCC.<sup>7</sup> In short, the interests of the rural ILEC ratepayers will be seriously prejudiced if this Investigation is not coordinated with the ongoing FCC *Unified Intercarrier Compensation* proceeding. Such prejudice meets the applicable legal standards of granting the stay of the Investigation in accordance with the request of Joint Petitioners and, in my opinion, outweighs the potential benefits that could be achieved through a more immediate implementation of intrastate carrier access charge reform for the rural ILECs through this Investigation.

However, granting of this stay must balance the interests of the participating parties in this Investigation and of the end-user consumers of telecommunications services within Pennsylvania. For these reasons, I cannot agree with the original request of Joint Petitioners in their *Motion to Defer* that this matter should be deferred “pending the outcome of the FCC intercarrier compensation proceeding at Docket No. 01-92, but not to exceed a period of twenty-four months or until the FCC acts on its Intercarrier Compensation proceeding, whichever is earlier.” Joint Petition, Attachment 2 (*Motion to Defer*), ¶ 14, at 12. I believe that this Investigation should originally be stayed for a period not to exceed twelve (12) months or until the FCC issues its ruling in its *Unified Intercarrier Compensation* proceeding, whichever occurs earlier.

I believe that, upon the termination of the 12-month stay period or upon the issuance of an FCC ruling in its *Unified Intercarrier Compensation* proceeding, the parties to this Investigation should submit the appropriate status reports to the Commission. The Commission Staff will monitor developments in the FCC’s *Unified Intercarrier Compensation* proceeding, and, upon the receipt of the status reports from the parties, will formally and timely advise the Commission on the resumption of this Investigation. The Commission will then address this Staff recommendation at a future Public Meeting and take appropriate action in reinstating this Investigation.

Furthermore, the resumption of this Investigation should include and provide record evidence addressing the legal, ratemaking, and regulatory accounting linkages between: (1) the FCC’s ruling in its *Unified Intercarrier Compensation* proceeding; (2) the intrastate access charge reform for rural ILECs in view of the new Chapter 30 law and its relevant provisions at 66 Pa. C.S. §§ 3015 and 3017; (3) the Pa. USF; and (4) the potential rate effects on the basic local exchange services of the rural ILECs.

Therefore, I move:

1. That the material question regarding the authority of Presiding ALJ Colwell to rule on Joint Petitioners’ *Motion to Defer* be answered in the negative consistent with the Staff recommendation.
2. That the material question regarding the request of Joint Petitioners for a stay of this proceeding be answered in the affirmative and granted in part and denied in part.
3. That a stay of this Investigation be granted for a period not to exceed twelve (12) months or until the FCC issues its ruling in its *Unified Intercarrier Compensation* proceeding, whichever occurs earlier.

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<sup>7</sup> OCA Brief, at 9-10.

4. That the Commission Staff monitor the FCC's *Unified Intercarrier Compensation* proceeding.

5. That the Commission shall entertain future requests for further stays of this Investigation for good cause shown and for the purpose of coordinating this Commission's actions with the FCC's ruling in its *Unified Intercarrier Compensation* proceeding.

6. That upon the expiration of the 12-month stay period or the issuance of an FCC ruling in the *Unified Intercarrier Compensation* proceeding, whichever occurs earlier, the parties to this proceeding shall submit status reports to the Commission.

7. That, upon the receipt of these status reports, the Office of Special Assistants and the Law Bureau shall prepare a Staff recommendation for the Commission's timely consideration at a Public Meeting on reinstating this Investigation and taking any other appropriate action.

8. That upon the resumption of this Investigation, the participating parties shall be afforded the due process opportunity to appropriately supplement the evidentiary record.

9. That, upon the resumption of this Investigation, the participating parties should address and provide record evidence on the legal, ratemaking and regulatory accounting linkages between: (a) the FCC's ruling in its *Unified Intercarrier Compensation* proceeding; (b) the intra-state access charge reform for rural ILECs in view of the new Chapter 30 law and its relevant provisions at 66 Pa. C.S. §§ 3015 and 3017; (c) the Pa. USF; and (d) the potential effects on rates for the basic local exchange services of the rural ILECs.

10. That the Office of Special Assistants prepare the appropriate Order.

August 11, 2005

James H. Cawley  
Vice Chairman

CERTIFICATE OF SERVICE

Re: AT&T Communications of Pennsylvania, Inc. v. Verizon North 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 on Remand, 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 17th day of August, 2005.

SERVICE BY E-MAIL & INTER-OFFICE MAIL

Robert Eckenrod, Esq.\*  
Office of Trial Staff  
Pa. Public Utility Commission  
Commonwealth Keystone Bldg.  
400 North Street  
Harrisburg, PA 17120

SERVICE BY E-MAIL & FIRST CLASS MAIL, POSTAGE PREPAID

William B. Petersen\*  
Suzan Debusk Paiva\*  
Verizon Inc.  
1717 Arch Street 32NW  
Philadelphia, PA 19103

Steve Gray, Esq.\*  
Office of Small Business Advocate  
Suite 1102 Commerce Building  
300 North Second Street  
Harrisburg, PA 17101

Robert C. Barber\*  
AT&T Communications  
1120 20<sup>th</sup> St., NW  
Suite 1000  
Washington, DC 20036

Michelle Painter, Esq.\*  
MCI Telecommunications Corp.  
22001 Loudoun County Parkway  
Ashburn, VA 20147

Patricia Armstrong, Esq.\*  
Thomas, Thomas, Armstrong  
& Niesen  
212 Locust Street, Suite 500  
Harrisburg, Pa 17108

Alan Kohler\*  
Daniel Clearfield\*  
Wolf, Block, Schorr & Solis-Cohen  
Locust Court, Suite 300  
212 Locust Street  
Harrisburg, PA 17101

Kristin L. Smith, Esq.\*  
Qwest Communications Corp.  
1801 California Street, Suite 4900  
Denver, CO 80202

John F. Povilaitis\*  
Ryan, Russell, Ogden & Seltzer LLP  
800 North Third Street  
Suite 101  
Harrisburg, PA 17102-2025



---

Philip F. McClelland  
Senior Assistant Consumer Advocate  
Barrett C. Sheridan  
Joel H. Cheskis  
Shaun A. Sparks  
Assistant Consumer Advocates

Counsel for  
Office of Consumer Advocate  
555 Walnut Street 5th Floor, Forum Place  
Harrisburg, PA 17101-1923  
(717) 783-5048  
0068610

**\*indicates receiving proprietary  
information if applicable**

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SERVICE BY E-MAIL & INTER-OFFICE MAIL

Robert Eckenrod, Esq.\*  
Office of Trial Staff  
Pa. Public Utility Commission  
Commonwealth Keystone Bldg.  
400 North Street  
Harrisburg, PA 17120

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William B. Petersen\*  
Suzan Debusk Paiva\*  
Verizon Inc.  
1717 Arch Street 32NW  
Philadelphia, PA 19103

Steve Gray, Esq.\*  
Office of Small Business Advocate  
Suite 1102 Commerce Building  
300 North Second Street  
Harrisburg, PA 17101

Robert C. Barber\*  
AT&T Communications  
1120 20<sup>th</sup> St., NW  
Suite 1000  
Washington, DC 20036

Michelle Painter, Esq.\*  
MCI Telecommunications Corp.  
22001 Loudoun County Parkway  
Ashburn, VA 20147

Patricia Armstrong, Esq.\*  
Thomas, Thomas, Armstrong  
& Niesen  
212 Locust Street, Suite 500  
Harrisburg, Pa 17108

Alan Kohler\*  
Daniel Clearfield\*  
Wolf, Block, Schorr & Solis-Cohen  
Locust Court, Suite 300  
212 Locust Street  
Harrisburg, PA 17101

Kristin L. Smith, Esq.\*  
Qwest Communications Corp.  
1801 California Street, Suite 4900  
Denver, CO 80202

John F. Povilaitis\*  
Ryan, Russell, Ogden & Seltzer LLP  
800 North Third Street  
Suite 101  
Harrisburg, PA 17102-2025



---

Philip F. McClelland  
Senior Assistant Consumer Advocate  
Barrett C. Sheridan  
Joel H. Cheskis  
Shaun A. Sparks  
Assistant Consumer Advocates

Counsel for  
Office of Consumer Advocate  
555 Walnut Street 5th Floor, Forum Place  
Harrisburg, PA 17101-1923  
(717) 783-5048  
0068610

**\*indicates receiving proprietary  
information if applicable**

COMMONWEALTH OF PENNSYLVANIA



OFFICE OF CONSUMER ADVOCATE

555 Walnut Street, 5th Floor, Forum Place  
Harrisburg, Pennsylvania 17101-1923  
(717) 783-5048  
800-684-6560 (in PA only)

IRWINA. POPOWSKY  
Consumer Advocate

FAX (717) 783-7152  
consumer@paoca.org

August 31, 2005

ORIGINAL

DOCUMENT  
FOLDER

James J. McNulty, Secretary  
PA Public Utility Commission  
Commonwealth Keystone Bldg.  
400 North Street  
Harrisburg, PA 17120

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

Dear Secretary McNulty:

Enclosed please find for filing an original and nine (9) copies of the Office of Consumer Advocate's Reply Brief on Remand in the above-captioned proceeding.

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

Sincerely,

Joel H. Cheskis  
Assistant Consumer Advocate

Enclosures

cc: All parties of record  
Hon. Cynthia Fordham, ALJ  
\*68614

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BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

ORIGINAL

AT&T Communications of Pennsylvania Inc. :

v. :

Verizon North Inc. :

Docket No. C-20027195

REPLY BRIEF ON REMAND OF THE  
OFFICE OF CONSUMER ADVOCATE

DOCUMENT  
FOLDER

Philip F. McClelland  
Senior Assistant Consumer Advocate  
Joel H. Cheskis  
Shaun A. Sparks  
Assistant Consumer Advocates

For:  
Irwin A. Popowsky  
Consumer Advocate

Office of Attorney General  
Office of Consumer Advocate  
555 Walnut Street 5th Floor, Forum Place  
Harrisburg, PA 17101-1923  
(717) 783-5048

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## I. INTRODUCTION

On August 17, 2005, the Office of Consumer Advocate (“OCA”), along with the other active parties in this proceeding, filed its Main Brief setting forth its position on the issues raised in the remanded proceeding. The other active parties in this proceeding include Verizon Pennsylvania, Inc. and Verizon North (collectively referred to as “Verizon”), AT&T Communications of Pennsylvania, Inc. (“AT&T”), MCImetro Access Transmission Services, LLC (“MCI”), Qwest Communications Corporation (“Qwest”), the Office of Small Business Advocate (“OSBA”) and the Public Utility Commission’s (“Commission”) Office of Trial Staff (“OTS”). *The OCA submits that its Main Brief provides the Commission and Your Honor with a comprehensive discussion of the issues in this proceeding. The OCA’s Main Brief fully addresses and responds to many of the contentions raised by the parties in their Main Brief.*

The OCA respectfully submits that the Commission should not reduce intrastate access rates at this time but should instead delay any action on the remanded issues until after the Federal Communications Commission (“FCC”) has completed its review of the same issues. The Commission should reaffirm its position that all users of the local loop have an obligation to pay for the non-traffic sensitive costs. The Commission must likewise recognize that revenue neutral reductions in access rates have not brought benefits to customers in the toll market, but have only jeopardized this Commission’s universal service policies. Finally, if the Commission determines to act on the remanded issues in this proceeding, it should adopt the proposal advocated at the FCC by the National Association of State Utility Consumer Advocates (“NASCUA”) and should calculate any revenue neutral rate increase on the basis of the largest reasonable number of access lines so as to minimize the actual rate increase for any single customer.

The OCA now files this Reply Brief in response to some of the assertions made by the various parties in their Main Briefs. The OCA specifically submits that certain other parties in this proceeding have taken positions that fail to reflect recent experience and current industry changes. The OCA further submits that the Commission should reject the arguments that access charges can be reduced with “minimal impact” on consumers. The OCA notes that its objections to discovery have been misused and that a party has made contradictory arguments regarding delaying any action by this Commission on the remanded issues.

## II. REPLY ARUGMENT

### A. The OCA’s Positions In This Proceeding Are Forward-Looking And Reflect The Changing Telecommunications Industry, Whereas Other Parties Have Taken Positions In This Proceeding That Fail To Reflect Recent Experience.

In their Main Briefs, AT&T, MCI and Qwest (collectively referred to as “the IXCs”) each argue that the OCA, as well as other parties, have made arguments in this proceeding that are archaic and do not reflect the current state of the telecommunications industry in Pennsylvania. For example, MCI has argued that “remnants of the old traditional regulatory regime must be eliminated so that the market, not regulation, chooses who succeeds and who fails.” MCI M.B. at 3. AT&T also argued about “long overdue Verizon access reform proceedings” and “the slow pace at which the Commission has addressed access charge issues.” AT&T M.B. at 4-5. In its Main Brief, Qwest has argued that the OCA, OSBA, OTS and Verizon have made arguments that support “archaic policies.” Qwest M.B. at 5.

The OCA submits that it is the IXCs who each are relying on outdated policies to support their positions that intrastate access charges must be reduced at the expense of increased basic rates. Each of the IXCs reference the Commission’s 1999 Global Order<sup>1</sup> as support for the

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<sup>1</sup> Re Nextlink Pennsylvania, Inc., 93 PaPUC 172, 196 P.U.R.4<sup>th</sup> 172 (1999) (“Global Order”); *clarified*, 93 PaPUC 477 (1999), *aff’d sub nom. Bell Atlantic-Pennsylvania, Inc. v. Pennsylvania Public Utility*

proposition that the Commission must now reduce intrastate access charges further in this remanded proceeding. While the OCA recognizes that the Global Order was a monumental step by the Commission in an attempt to create the competitive provision of local telecommunications services in Pennsylvania, the OCA submits that much has changed in the telecommunications industry in the six years since the Global Order was entered. Much of that change could not have been anticipated by the Commission.

Most significantly, important circumstances that have arisen since the 1999 Global Order include efforts to accomplish substantial industry consolidation (*e.g.*, the potential acquisition of MCI by Verizon and AT&T by SBC Communications, Inc.)<sup>2</sup> and the comprehensive review of all interstate and intrastate access charges by the FCC, as discussed in the OCA Main Brief. OCA M.B. at 5-17. Both of these circumstances have a significant impact on this proceeding. For instance, AT&T and MCI both argued in the Global proceeding for intrastate access charge reductions, but may now soon be subsumed by other companies. One of these acquiring companies, Verizon, opposes intrastate access charge reductions in this proceeding. Additionally, there have been significant technological changes including the growth of wireless phones as well as the introduction and refinement of Voice-over-Internet Protocol (“VoIP”). These factors could not have been considered by the Commission in the 1999 Global proceeding but now impact whether intrastate access charges should be further reduced at this time.

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Commission, 763 A.2d 440 (Pa.Cmwlth. 2000); *vacated in part, sub nom. MCI WorldCom Inc. v. Pennsylvania Public Utility Commission*, 844 A.2d 1239 (Pa. 2004) (state court lacked jurisdiction to review unbundled network element decision).

<sup>2</sup> See, Joint Application of Verizon Communications, Inc. and MCI, Inc. MCI Metro Access Transmission Services LLC, MCI WorldCom Communications, Inc., MCI WorldCom Network Services, Inc. TTI National, Inc., Teleconnect Long Distance Services and System Co. d/b/a/ Telecom USA for approval of Agreement and Plan of Merger, Docket Nos. A-310580F0009, *et al.*; *see also*; Joint Application of SBC Communications, Inc. and AT&T Corp. together with its Certificated Pennsylvania Subsidiaries for Approval of Merger, Docket Nos. A-311163F0006, *et al.*

This Commission must be mindful of these changes when considering the IXCs' arguments that intrastate access charges must be reduced even further because the Commission directed as such in the Global Order. The OCA will not reiterate its positions regarding the impact of the FCC proceeding on this proceeding, but incorporates by reference its discussion in its Main Brief herein. OCA M.B. at 5-17. However, the OCA notes that two major proponents of such access reductions in the Global proceeding, AT&T and MCI, have claimed in their respective merger proceedings before this Commission that they are no longer the telecommunications giants they once were. Id. at 18-19. AT&T and MCI have both presented evidence in those proceedings that detail how they each are no longer actively marketing to mass market customers. Id. at 18.

Qwest has argued in its Main Brief that the OCA's positions in this proceeding are archaic. More specifically, Qwest argued that "new technologies such as wireless, or VoIP, do not pay the carrier charges supported by the OCA." Qwest M.B. at 11. Qwest further argued that certain regulatory mechanisms such as universal service funds contributions may also be jeopardized. Id. at 16. The OCA recognizes the impact of new technologies on universal service and notes that it has supported advocacy before the FCC that such contributions from the types of services referenced by Qwest are a matter vital to a functioning universal service fund.<sup>3</sup> The OCA notes that this proceeding is not the appropriate place to determine whether and to what extent these new services should contribute to universal service funding.

However, the OCA has articulated in its Main Brief that raising basic rates, as the IXCs argue for in this proceeding, will jeopardize universal service in light of the impact increasing

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<sup>3</sup> See, e.g., In the Matters of IP-Enabled Services and E911 Requirements for IP-Enabled Service Providers, WC Docket Nos. 04-36 and 05-196, Comments of the National Association of State Utility Consumer Advocates (May 28, 2004) at 67-70 ("VoIP providers should pay into the Universal Service Fund and should be allowed to obtain eligible telecommunications carrier status if they meet mandated federal requirements"). The OCA is a member of NASUCA.

rates will have on already declining subscribership rates. OCA M.B. at 21-23. The OCA has also advocated that this Commission should consider that the modern network is increasingly one of large fixed costs that should not be entirely paid for by local service. Id. at 32-33. Moreover, the OCA emphasizes that the competitive benefits anticipated by reducing access charges have become irrelevant to the current market. The Commission must candidly review the current state of the industry and recognize that Pennsylvania access reductions will offer little hope of reviving competition.

As such, the OCA submits that its positions in this proceeding are forward-looking and reflect the changing telecommunications industry. However, other parties have taken positions that are outdated. The IXCs cannot argue that the OCA's positions are "archaic" when they are wedded to a future vision that has become outdated.

B. Arguments That Access Charges Can Be Reduced With Minimal Impact On End Users Are Without Merit And Should Be Rejected.

The IXCs in this proceeding have argued that the intrastate access rates should be reduced because any offsetting increase to basic local service rates will have minimal impact on consumers. For example, MCI has argued that "these access reductions can be implemented without substantial increases to end user rates." MCI M.B. at 5, 12-13. Qwest has argued that "by moving ahead quickly with further access charge reform, the Commission can minimize any impact that local rate rebalancing could arguably have on Pennsylvania consumers." Qwest M.B. at 7. Qwest further argued that "the record is devoid of evidence that the proposed access charge reform will harm Pennsylvania consumers." Id. at 18-22. The OCA submits that these arguments are without merit and should be rejected because, in fact, any further increase in the basic local service rate will have a significant impact on consumers.

In its Main Brief, MCI argued that, given that the monthly local rates in Pennsylvania range from \$20.73 to \$23.45, and the necessary rate increase of \$1.08 to reduce intrastate access rates to what MCI considers to be “cost”, Pennsylvania consumers would still be left with local rates below that of neighboring states. *Id.* at 12-13 (citations omitted). The OCA submits that MCI’s arguments are flawed for several reasons.

Most significantly, even assuming that MCI is correct in its range of local monthly rates in Pennsylvania, an increase of \$1.08 represents a percentage increase ranging from 4.6% to 5.2%. If a similar rate increase was requested by a telephone company under the traditional rate base rate of return regulation, this range is more than sufficient to trigger the necessity to file a formal general rate increase filing under statutory law and the rigorous Commission review that accompanies such a proceeding. 66 Pa. C.S. § 1308(d).<sup>4</sup> Clearly, then, such an increase would not be minimal according to the Commission.

MCI’s argument is also flawed because the comparison to other states’ basic monthly rate is not relevant to this proceeding. There are many reasons why the rates for a similar service may vary among states. For example, MCI does not attempt to compare the local calling areas or the costs involved in local services in various other states. This Commission should not be led to believe that merely because some neighboring states may have basic monthly rates higher than Pennsylvania that it is acceptable to increase Pennsylvania’s rates, or that the impact of any such increase would be minimal.

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<sup>4</sup> Section 1308(d) provides, in pertinent part, that a “general rate increase means a tariff filing which affects more than 5% of the customers and amounts to in excess of 3% of the total gross annual intrastate operating revenues of the public utility.”

Qwest has argued that “increasing local rates increases the chances of obtaining federal universal service funds.” Qwest M.B. at 27.<sup>5</sup> The OCA submits that Qwest’s reliance on Verizon’s increased receipts from the federal universal service fund to offset reductions in intrastate access charges is highly speculative. Qwest does not explain how this is likely or how local rate rebalancing in this case would lead to an increased draw on such federal funds.

AT&T argued in its Main Brief that intrastate access charges must be reduced because “excessive access rates” are “causing a severe drain on Pennsylvania’s economy.” AT&T M.B. at 1. AT&T also argued that access charge reform is “harmless to consumers who are not captive customers of any carrier or service and have the opportunity to and routinely do choose the carriers, services and pricing which is optimal for their individual services.” Id. at 1-2.

AT&T’s argument is flawed because it requires a competitive environment for the provision of local telecommunications services such that a consumer could easily move from Verizon to a competitive local exchange carrier to enjoy lower prices. Regrettably, this does not exist to the level where all Verizon customers can “routinely” switch providers of local telecommunications services and save money as a result.

While this case is not a referendum on local telephone competition in Pennsylvania, it is clear that consumers can not merely “choose carriers” as easily as AT&T argued. There may be some areas of Pennsylvania where consumers can shop amongst legitimate providers of local telecommunications services. However, AT&T’s argument neglects the significant portions of Pennsylvania where there are no competitive alternatives for local telephone service, and where

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<sup>5</sup> The OCA will respond in more detail below to Qwest’s particular arguments pertaining to the OCA’s objections to Qwest’s interrogatories that Qwest uses to discuss the minimal impact any local rate increase may have. *See*, Section II.D, *infra*. As discussed there, Qwest mischaracterizes the OCA objections to support its position that access charge reform will not harm consumers. For the reasons discussed below, Qwest’s arguments are without merit and should be rejected.

wireless, VoIP and cable telephony are not widely available. These services are not available in all areas of Pennsylvania, particularly in rural areas.

The OCA submits that this Commission must consider, first and foremost, in this proceeding, the impact on consumers that any action may have. While the OCA recognizes the benefit to consumers that may arise as a result of the competitive provision of intrastate telecommunications services, it is not the presence of competitors *per se* that creates a benefit for consumers. That is, if rates had to increase 10%, for example, so that competitors could enter the market and provide consumers with a 5% rate reduction, clearly that would not be a benefit to consumers. The OCA welcomes competition but only to the extent that it provides actual benefits to consumers, not an increase in rates.

It is ironic that AT&T champions local competition as a cure for rate rebalancing while it has ceased actively competing for new mass-market customers in the local exchange market to such an extent that its decision is “now irreversible as a practical matter.” OCA M.B. at 18. The OCA is skeptical that high access charges drain the Pennsylvania economy while higher local rates for an essential local service would not. The OCA has shown that, as a result of new and increasing fees included as part of access service, the average revenue per minute increases and the IXC’s margin to provide access service also increases. *Id.* at 20. As such, AT&T’s argument that the current intrastate access rates represent a drain on the Pennsylvania economy is without merit.

Finally, the OCA reiterates that the Commission should not reduce access rates and increase basic service rates because increasing rates continue to be a concern for universal service. *Id.* at 21-23. The OCA has shown that the telephone penetration rate in Pennsylvania has been dropping, even without consideration of the local rate increases that recently went into

effect with the intrastate access reductions ordered in Phase I of this proceeding. Id. at 21-22.

Any further increase in basic local service rates could have a significant impact on universal service in Pennsylvania. Id. at 22.

As such, the OCA submits that arguments that access charges can be reduced on a revenue-neutral basis with minimal impact on end users are without merit and should be rejected. The OCA has shown above that the potential increase to the basic local service rate, according to MCI's calculations, could be higher than 5% of the existing monthly rate. The OCA submits that such a rate increase is far from minimal.

C. Any Local Rate Increases That Are Required Should Be Calculated On The Basis Of The Largest Reasonable Number Of Lines So As To Minimize The Actual Rate Increase For Any Single Customer.

In its Main Brief, Verizon stated that the Commission should refrain from further action on access reform for a variety of reasons. Verizon M.B., *passim*. The OCA agrees with Verizon on this general position. However, Verizon also argued that, if the Commission were to order any rate rebalancing in this case, any offsetting increases should not be rebalanced over all of Verizon's lines, particularly lines purchased with bundled services. Id. at 39. Verizon specifically argued that "it is not appropriate to propose to increase the rates of all of these lines because not all lines can receive a rate increase and actually produce the revenue necessary to achieve the statutorily-required revenue-neutrality." Id. Verizon adds that lines that are subject to contractual agreements cannot be raised, and lines subject to competitive pressures are not subject to rate regulation and cannot be expected to accept an increase without being lost to a competitor. Id.

The OCA disagrees with Verizon's position on this particular matter. The OCA has shown in its Main Brief that, to the extent this Commission determines to lower intrastate access

rates, and offset that reduction by increasing the basic local service rate, which the OCA opposes, then any local rate increases should be calculated on the basis of a greater number of Verizon lines than what Verizon has proposed in this proceeding by considering FCC ARMIS data. OCA M.B. at 42-43. The OCA has shown in its Main Brief the wide range of rate increases that could occur depending on which line count would be used in offsetting any revenue reductions. Id. at 42. As Dr. Loube testified:

While it is not appropriate for the PUC to order such rebalancing at this time, if the PUC mandated rebalancing, then the revenue neutral rate increase should be determined by counting all lines. This would mean calculating local rate increases for protected noncompetitive lines based upon a calculation that included bundled competitive services.

OCA St. 1R at 38. Dr. Loube added that “basic noncompetitive customers should only be required to pay the portion of any access reduction that is attributable to their lines.” Id. In particular, Dr. Loube noted that data provided to the FCC by Verizon includes larger access line counts. Id. at 36-37. Dr. Loube proposes that those figures should be used so as to minimize the actual rate increase for any single customer, should the Commission determine to raise local rates in this case. Dr. Loube concluded that “as IXCs pay access charges for originating and terminating calls to noncompetitive and competitive lines alike, recovering any lost access revenue only from noncompetitive lines may be equivalent to subsidizing some of those lines.” Id. at 38.

The OCA notes that the OSBA has taken a stronger stance on this issue of what access line count to use in determining any local rate increases. The OSBA has argued for the inclusion of a greater number of lines in the calculation than the OCA proposed if local rates are increased. OSBA M.B. at 10-11. Specifically, the OSBA argued that Verizon must spread the recovery of any lost access revenue over all the retail switched lines in the Commonwealth, including

Verizon's contract customers. Id. (citations omitted). The OCA submits that its position to use ARMIS data is reasonable and should be adopted.

As such, the OCA submits that the Commission should not further reduce intrastate access charges on a revenue neutral basis at this time. However, if the Commission determined to take such a step at this time, any local rate increases that are required should be calculated on the basis of the largest reasonable number of lines so as to minimize the actual rate increase for any single customer.

D. Qwest Has Inaccurately Represented The OCA's Objections To Qwest Interrogatories As Responses.

In its Main Brief, Qwest argued that "in contrast to the competitive benefits that IXCs have identified in this proceeding that will ultimately benefit consumers, there appears to be no evidence in the record showing any *actual* harm that would befall customers from access charge reform." Qwest M.B. at 18 (emphasis supplied). To support this argument, Qwest argued that "as is evidenced from the Verizon and OCA responses to Qwest data requests, neither party had any data that would allow them to document a single negative impact on Pennsylvania consumers from the proposed access charge reform in this remand." Id. Qwest added that "it is also clear from OCA's responses to Qwest's data requests that no analysis has occurred on how what Pennsylvania consumers pay for other types of utility service, like cable television and electricity, compared to what those consumers currently pay for Verizon local phone services." Id. at 19.

The OCA submits that there are several errors in Qwest's argument. To begin, the OCA has shown that the IXCs' rates and margins have, in fact, increased over the past several years as a result of additional fixed charges IXCs have added to their bills. OCA M.B. at 20. Clearly such additional charges on consumers' bills can be considered "harm." Furthermore, the OCA

submits that this proceeding should not be judged based on how much “harm” consumers will realize, as Qwest argued in its Main Brief. Rather, as discussed above, this proceeding must also be considered in light of whether consumers will realize any benefit. The OCA has shown that consumers have not realized any benefit as a result of recent intrastate access reductions and the OCA doubts that such benefit will occur in the future. Id. at 17-21.

Furthermore, the OCA submits that Qwest’s arguments concerning the OCA’s discovery responses to Qwest are without merit and should be rejected because Qwest is misusing what, in fact, were objections of the OCA to Qwest interrogatories, not actual responses to those interrogatories. Qwest served only one set of interrogatories on the OCA in this proceeding. Some of those interrogatories asked the OCA to identify how many wireless, VoIP and cable telephony customers are in the Verizon service area, how much they pay for that service and how many of those customers also have traditional wireline service. Qwest Exh. 3 (Remand). Other interrogatories asked for the average monthly charges Pennsylvania consumers in the Verizon service area pay for electricity, water/sewage, cable/satellite and other services as well as how many customers utilize Lifeline or other telephone assistance programs also use a wireless phone, cable television or paging service. Id. In response, the OCA objected to each of the questions on the basis that they were burdensome. Id. Particularly, the OCA objected that there was no data available to answer these questions specifically related to the “Verizon service area.” Qwest did not move to compel any answers but merely made the interrogatories and OCA objections a part of this record in their surrebuttal testimony.

A clear reading of the OCA’s objections shows that Qwest has mischaracterized the OCA objections to their interrogatory as “responses” from which any conclusion could be drawn. Public data concerning the number of consumers in Pennsylvania that subscribe to wireless,

VoIP or cable telephony is not segregated according to Pennsylvania local telephone company areas, as Qwest sought. As such, how much Verizon customers pay for wireless, VoIP and cable telephony service and how many such customers also subscribe to wireline service is not available to the OCA. Requiring the OCA to provide such data would be unduly burdensome and would therefore violate the Commission's rules of discovery. 52 Pa Code §§ 5.361(a)(2) & (4). Similarly, the average monthly charges Pennsylvania consumers pay for various utilities and other services, and the number of customers who use these other services while also utilizing a telephone assistance program, is not segregated according to local telephone company and would likewise violate the Commission's rules of discovery.

The Qwest interrogatories to the OCA are dated May 25, 2005, approximately two weeks prior to the submission of Direct Testimony in this proceeding and nearly two months before the record in this proceeding closed. Had Qwest wanted to explore the issue of what evidence showed that the proposed access charge reform would harm Pennsylvania consumers, they had ample time to pursue that issue. However, Qwest took no other action that would have placed any evidence into the record to support their argument. Had they done so, the OCA would have had an opportunity to explore Qwest's argument and respond. Now, however, the OCA is prejudiced by Qwest's use of the OCA objections. Such misuse is inappropriate and should be rejected.

As such, the OCA submits that Qwest has misused OCA's objections to interrogatories as responses upon which certain conclusions could be drawn. Qwest is drawing an unrealistic inference from the OCA's objections that should not be used as evidence to support the position that it is acceptable to reduce Verizon's intrastate access charges in a revenue-neutral manner at this time.

E. AT&T Has Provided Reasons In Its Main Brief For Delaying Any Further Access Reductions At This Time.

The IXCs have generally argued in this proceeding that the Commission should not wait for FCC action on its intercarrier compensation proceeding before acting on the remanded issues. Qwest has argued, for example, that “by moving ahead quickly with further access charge reform, the Commission can control the uncertainty of the outcome of the Intercarrier Compensation Docket by taking the initiative and minimizing the impact that local rate rebalancing will have on Pennsylvania consumers.” Qwest M.B. at 25. Similarly, MCI has argued that this proceeding should not be delayed because “it is critical to keep pace with the changes in the market landscape.” MCI M.B. at 3, 9-11. AT&T has argued that “the Commission should immediately reduce Verizon’s access rates to cost based levels.” AT&T M.B. at 11-14. These arguments are contrary to the position taken by every other party in this proceeding.

The OCA has articulated in detail why this Commission should not reduce intrastate access rates at this time but wait for the FCC to determine what access reductions are appropriate. OCA M.B. at 5-17. The OCA will not reiterate those positions herein but notes that AT&T has also raised issues that support delaying any action in this proceeding until the FCC proceeding has ended. For example, AT&T argued in its Main Brief that Verizon’s access minutes of use has declined over the past several years and that “based on current trends, it is a certainty that Verizon’s access minutes for any future periods will be substantially reduced from that estimate with an associated downward effect on Phase 1 access reduction revenue impact.” AT&T M.B. at 9-10.

AT&T also argued that “the Commission should use a forecast of access minutes, taking into account projected volume reductions, rather than using historic and unrealistically high

access minute volumes.” AT&T M.B. at 11, 14, 16-17. The OCA submits that, in lieu of attempting to forecast access minutes, the Commission should delay any intrastate access reductions because waiting to do so will also diminish the amount of revenue required to offset access reductions. OCA M.B. at 15-16.

As such, this Commission should not reduce intrastate access rates at this time. Despite its general positions to the contrary, a closer review of the Main Brief submitted by AT&T shows that AT&T has provided reasons that support delaying any further access reductions by this Commission at this time.

F. . The Arguments That Access Charges Are Subsidizing Local Service Are Without Merit And Should Be Rejected.

Each of the IXCs have argued in this proceeding that intrastate access charges subsidize local service rates. For example, Qwest argued that “there is no question that the [carrier charge], which IXCs pay to Verizon for intrastate long distance services, ‘is the clearly identifiable subsidy’.” Qwest M.B. at 10. Likewise, AT&T has argued that “substantial work is required to completely eliminate the implicit subsidies that remains in Verizon’s intrastate access rates.” AT&T M.B. at 15. MCI has made similar arguments. MCI M.B. at 3, 10-11.

The OCA has shown in its Main Brief why access rates are not subsidizing local service. OCA M.B. at 27-35. This is true even though access rates may be above incremental costs of access service. Id. The OCA has also shown that it has been the Commission’s policy for many years that all users of the local loop have an obligation to pay for non-traffic sensitive costs. Id. at 23-27. The OCA Main Brief details how this position is consistent with legal precedent from other state commissions, the FCC, the Commonwealth Court and the United States Supreme Court that support requiring IXCs to share in the non-traffic sensitive costs of the local loop. Id.

(citations omitted). The OCA will not reiterate those positions now but incorporates them herein in response to the IXCs arguments that intrastate access charges subsidize local service rates.

However, the OCA adds that a Wisconsin appeals court has also recently held that access rates do not subsidize local service rates.<sup>6</sup> In AT&T Wisconsin, AT&T Wisconsin appealed a decision of the Wisconsin Public Service Commission that set permanent rates that included local-line access charges. AT&T Wisconsin's first appeal of the decision was denied by the circuit court and AT&T Wisconsin appealed again. In affirming the second appeal, the Court of Appeals of Wisconsin held that AT&T had not shown "any reason to suppose that AT&T, as one of Central Wisconsin's and Telephone USA's customers, should not, like any other customer, bear part of the local loop costs." AT&T Wisconsin at 6.

The Wisconsin Court added "we cannot discern from AT&T's arguments any reason why the commission cannot require AT&T to pay a local-line access charge without running afoul of a rule against implicit subsidies." Id. The Court concluded "in short, AT&T has not demonstrated that the access rates approved by the commission provide a subsidy to other customers of Central Wisconsin and Telephone USA." Id. at 7. The Court of Appeals of Wisconsin, therefore, dismissed AT&T Wisconsin's second appeal of the issue.

As such, the OCA submits that other state commissions and appellate courts continue to support the position that access charges do not subsidize local service rates. While IXCs pay very little to support loop costs, some payment is appropriate. This Commission must reaffirm its long-standing position that all users of the local loop have an obligation to pay for non-traffic sensitive costs. Such a requirement is not "an implicit subsidy" but simple fairness in requiring all customers that use a facility to share in its costs. While access rates may be above the

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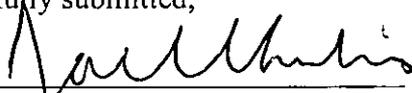
<sup>6</sup> See, AT&T Communications of Wisconsin, L.P. v. Public Service Comm'n of Wisconsin, 2005 WI App 176, 2005 Wisc. App. Lexis 586 (2005) ("AT&T Wisconsin").

incremental costs of access service, this relationship does not prove that access rates are subsidizing local service.

### III. CONCLUSION

WHEREFORE, the Pennsylvania Office of Consumer Advocate respectfully submits that the Commission should not reduce intrastate access rates at this time but should instead delay any action on the remanded issues until after the Federal Communications Commission has completed its review of the same issues. The Commission should reaffirm its position that all users of the local loop have an obligation to pay for such non-traffic sensitive costs. The Commission must likewise recognize that revenue neutral reductions in access rates have not brought benefits to customers in the toll market, but may jeopardize this Commission's universal service policies. Finally, if the Commission determines to act on the remanded issues in this proceeding, it should adopt the proposal advocated at the FCC by the National Association of State Utility Consumer Advocates and should calculate any increase on the basis of all access lines so as to minimize the actual rate increase for any single customer.

Respectfully submitted,

  
Philip F. McClelland  
Senior Assistant Consumer Advocate  
Joel H. Cheskis  
Assistant Consumer Advocate

For: Irwin A. Popowsky  
Consumer Advocate

Office of Consumer Advocate  
555 Walnut Street  
Forum Place, 5<sup>th</sup> Floor  
Harrisburg, Pennsylvania 17101-1923  
(717) 783-5048

Dated: August 31, 2005  
85611

CERTIFICATE OF SERVICE

Re: AT&T Communications of Pennsylvania, Inc. v. Verizon North 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 Reply Brief on Remand, 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 31st day of August, 2005.

SERVICE BY E-MAIL & INTER-OFFICE MAIL

Robert Eckenrod, Esq.\*  
Office of Trial Staff  
Pa. Public Utility Commission  
Commonwealth Keystone Bldg.  
400 North Street  
Harrisburg, PA 17120

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SERVICE BY E-MAIL & FIRST CLASS MAIL, POSTAGE PREPAID

William B. Petersen\*  
Suzan Debusk Paiva\*  
Verizon Inc.  
1717 Arch Street 32NW  
Philadelphia, PA 19103

Steve Gray, Esq.\*  
Office of Small Business Advocate  
Suite 1102 Commerce Building  
300 North Second Street  
Harrisburg, PA 17101

Robert C. Barber\*  
AT&T Communications  
1120 20<sup>th</sup> St., NW  
Suite 1000  
Washington, DC 20036

Michelle Painter, Esq.\*  
MCI Telecommunications Corp.  
22001 Loudoun County Parkway  
Ashburn, VA 20147

Patricia Armstrong, Esq.\*  
Thomas, Thomas, Armstrong  
& Niesen  
212 Locust Street, Suite 500  
Harrisburg, Pa 17108

Alan Kohler\*  
Daniel Clearfield\*  
Wolf, Block, Schorr & Solis-Cohen  
Locust Court, Suite 300  
212 Locust Street  
Harrisburg, PA 17101

Kristin L. Smith, Esq.\*  
Qwest Communications Corp.  
1801 California Street, Suite 4900  
Denver, CO 80202

John F. Povilaitis\*  
Ryan, Russell, Ogden & Seltzer LLP  
800 North Third Street  
Suite 101  
Harrisburg, PA 17102-2025



---

Philip F. McClelland  
Senior Assistant Consumer Advocate  
Barrett C. Sheridan  
Joel H. Cheskis  
Shaun A. Sparks  
Assistant Consumer Advocates

Counsel for  
Office of Consumer Advocate  
555 Walnut Street 5th Floor, Forum Place  
Harrisburg, PA 17101-1923  
(717) 783-5048  
0068610

**\*indicates receiving proprietary  
information if applicable**

**ORIGINAL**



August 31, 2005

*Via Overnight Delivery*

James J. McNulty, Secretary  
Pennsylvania Public Utility Commission  
Commonwealth Keystone Building, 2<sup>nd</sup> Floor  
400 North Street  
Harrisburg, PA 17120

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PA PUBLIC UTILITY COMMISSION  
SECRETARY'S BUREAU

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

Dear Mr. McNulty:

Please find enclosed an original and nine (9) copies of the Main Brief on Remand of MCImetro Access Transmission Services LLC in the above-referenced case.

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

Very truly yours,

A handwritten signature in black ink that reads "Michelle Painter". The signature is written in a cursive, flowing style.

Michelle Painter

cc: The Honorable Cynthia Williams Fordham  
Certificate of Service

Enclosure

**DOCUMENT  
FOLDER**

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

ORIGINAL

AT&T Communications of Pennsylvania, :  
v. :  
Verizon North, Inc. :

Docket No. C-20027195

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REPLY BRIEF

*on Remand of*

MCIMETRO ACCESS TRANSMISSION SERVICES LLC

DOCKETED  
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August 31, 2005

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**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

AT&T Communications  
of Pennsylvania, Inc.

v.

Verizon North, Inc.

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Docket Number

C-20027195

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**REPLY BRIEF ON REMAND OF  
MCI metro ACCESS TRANSMISSION SERVICES LLC**

PUBLIC UTILITY COMMISSION  
SECRETARY'S BUREAU

**I. INTRODUCTION**

Verizon Pennsylvania Inc. and Verizon North Inc. (collectively "Verizon") and the public parties urge the Pennsylvania Public Utility Commission ("Commission") to postpone consideration of additional access rate reductions, arguing that delay is warranted for a number of reasons, principally, the possibility of action by the Federal Communications Commission ("FCC") on intercarrier compensation issues in its Unified Compensation proceeding. These asserted justifications for delay by this Commission are unwarranted, given the highly speculative arguments about the timing and content of any potential FCC action.

Verizon and other parties argue that no compelling argument exists for additional rate reductions at this time, but these parties do not challenge the fundamental point raised in MCI's direct case (and the direct cases of AT&T and Qwest) that Interexchange Carriers ("IXCs") face a significant competitive disadvantage in the market on account of the disparate call termination rates paid by different classes of carriers. The current

system of keeping access costs above-cost creates a situation where the Commission is creating an unlevel playing field and favoring some types of carriers over others. This regulatory favoritism should be put to a halt, especially in light of the dramatic changes to the competitive environment where intermodal providers are not placed at the same disadvantage of having to pay the above-cost access rates.

MCI disagrees that Pennsylvania consumers will not benefit from additional access rate reductions, as argued by those parties opposing any further access reform. Finally, there is no record evidence to support the concern that rate rebalancing needed to offset these reductions will negatively affect universal service in Pennsylvania.

## **II. DELAYING FURTHER ACTION ON INTRASTATE ACCESS REFORM CANNOT BE JUSTIFIED**

Verizon, the Office of the Consumer Advocate (“OCA”) and the Office of the Small Business Advocate (“OSBA”) urge this Commission to delay consideration of additional intrastate access rate reductions until the FCC concludes its *Unified Intercarrier Compensation* proceeding. Verizon argues that only a national comprehensive solution that covers both interstate and intrastate rates will remedy the flaws in the intercarrier compensation regimes currently in place. Verizon Brief, p. 16. The OCA argues that delay is necessary for a number of reasons, including the need to coordinate this Commission’s decisions with the FCC’s requirements on intercarrier compensation reform. OCA argues that “[t]oo many regulatory cooks are bound to ruin the intrastate access stew.” OCA Brief, pp. 5-9.

There is simply no valid basis for postponing a decision on additional access rate reductions. First, the Commission expanded the scope of this remand proceeding to

consider decisions by the FCC that occur *prior to* the issuance of the recommended decision, not possible actions that the FCC might take at some unknown point in the future. January 18, 2005 Order, p. 15.

Verizon justifies its request for delay by arguing that the IXC parties have offered *no compelling reason for additional rate reductions*, Verizon Brief, p.1. Yet none of the parties to this proceeding, including Verizon, disputes in their briefs the inherently unfair and anticompetitive effects of having different schemes for intercarrier compensation for the same type of traffic. Ending years of unfair competitive advantages is certainly a compelling policy goal, one which none of the parties to this case have questioned. Delay only perpetuates an un-level playing field.

Although MCI is hopeful that the FCC will act promptly on intercarrier compensation issues, the timing and content of any FCC actions are pure speculation on the part of those parties urging delay. The issues being addressed in the FCC proceeding are complex, go well beyond access issues only, and may necessitate significantly more work than expected, such that hitting a publicly announced goal of action by year end 2005 may be unattainable. The FCC might adopt one of the proposed reform plans, like the ICF Plan supported by MCI, or it might craft one of its own. The FCC also might conclude that it lacks the authority to preempt the states on intrastate access rates. There is simply no possible way to guess, at this stage, what path the FCC will take in its final decision, whenever that decision is entered. In short, delay is certain to perpetuate the current un-level playing field in Pennsylvania, especially when FCC action in the short term to address these concerns remains highly speculative. The Pennsylvania

Commission should finalize the access reform it recognized needed to be finalized nearly six years ago.

The OCA argues that delay is necessary because of the risk of “double recovery” of access rate reductions if both the FCC and the Commission lower intrastate access rates. OCA states that

The same state access rate reductions at issue in this proceeding may be recovered through an increase in the federal SLC or the federal USF under proposals now pending in the ICC FNPRM. The OPA is concerned that, if any PUC access decrease is not properly timed, both FCC and PUC proposed offsetting rate increases may each pay for the same Pennsylvania intrastate access reductions.

OCA Brief, pp. 9-10. This concern is simply unfounded. Pennsylvania law compels the Commission to permit revenue neutral rate increases to offset access rate reductions ordered by the Commission. 66 Pa. C.S.A. §3017 (a). If Verizon or another ILEC lowers its intrastate access rates on account of new FCC rules, then the Commission would clearly have the discretion under state law to deny any retail rate increase proposed by Verizon or the ILEC to recoup lost access revenues because the source of the rate change was not a decision of the Commission, especially if the FCC had permitted an increase in the federal subscriber line charge to offset the lost access revenues in the state jurisdiction. The concern about “double recovery” is highly speculative and would suggest a level of constraint on the Commission’s ability to interpret state law that does not exist. If a decision by this Commission to further lower intrastate access rates is followed by a decision from the FCC that affects what the Commission has done in this docket, this Commission clearly would retain the authority to regulate intrastate retail rates to make whatever adjustments would be required to harmonize the local and access rates adopted by the Commission with the results of the FCC’s rulemaking. There is no

dispute that the access reform issues are complex, but that does not support an argument that the state commission should sit on the sidelines until the FCC acts.

### **III. CLAIMS THAT ACCESS RATE REDUCTIONS HAVE NOT BENEFITTED PENNSYLVANIA CONSUMERS IGNORE THE REALITIES OF TODAY'S TELECOMMUNICATIONS MARKET**

Verizon, OCA and OSBA argue that additional access rate reductions are not warranted because the IXC parties have not shown that toll rates were lowered in Pennsylvania as a result of the prior rate rebalancing or that additional rate reductions would be passed on to consumers. Verizon Brief, pp. 17-21; OCA Brief, pp. 17-20; OSBA Brief, p. 6 This argument entirely ignores the reality of today's market. First, as AT&T stated in its Main Brief, access rates may actually be increasing as a result of the dramatically lower toll minutes. AT&T Brief, pp. 7-8. Second, this argument assumes that when access rates are reduced, all other costs of the IXCs have remained constant, and therefore the IXCs must demonstrate an exact reduction in rates to match the access reductions. The state of the long distance market does not support the assumption that IXC costs are reduced overall by a reduction in access rates. To the contrary, costs of standalone long distance continue to increase. Therefore, benefits to consumers may actually be in the lack of increases to long distance rates, or in the offering of different types of long distance calling plans. It is nothing short of misleading to claim that consumers in the long distance market have received no benefits from IXCs' rate reductions or consumer pricing plans over the years. The fact that customers can now obtain unlimited long distance along with unlimited local service and a host of features for a reasonable flat rate should not be overlooked as a substantial customer benefit flowed through by the long distance companies who are also local service providers.

The rebuttal testimony of MCI witness Dr. Pelcovits further explained why the allegations regarding lack of customer benefits miss the mark:

This claim ignores the current state of the long distance market, and incorrectly assumes that the only way consumers benefit from access reductions is from an immediate reduction in the rates on all existing tariffs. The way in which cost reductions are passed on to consumers is far more complex than the other parties would have the Commission believe. Competitive markets do not operate in a rigid and predictable manner and it is very difficult to discern what actions happen as a result of particular changes in the circumstances faced by competitive firms. To say that IXCs have not passed any benefits from access reductions to consumers ignores the dramatic changes in the long distance industry.... The primary change has been the increasing prevalence of unlimited all distance packages. These services make no distinction between local, intrastate toll, and interstate toll and allow customers to make unlimited local and long distance calling at a flat monthly rate. These packages would not have been possible if interstate and intrastate access charges had not been reduced over the last several years. The prices for these packages typically vary slightly from state to state, reflecting both the different mix of per line and per minute charges that must be reflected in the monthly price and the average number of minutes of each type expected within the state.

Although it may be difficult to track the relationship between specific access reductions and changes in the price or availability of these bundled flat-rate service plans, this does not mean that intrastate access charges are irrelevant for the pricing of these packages. As access rates are reduced towards economic costs, the price of these packages can be reduced as well. What is certain is that if access charges remain above cost, the price for these packages will remain higher than they otherwise would be.

Pelcovits Rebuttal, pp. 8-9.

**IV. THERE IS NO EVIDENCE THAT A SLIGHT RATE INCREASE ASSOCIATED WITH RATE REBALANCING WILL ADVERSELY AFFECT UNIVERSAL SERVICE IN PENNSYLVANIA**

The OCA has raised the concern that additional local rate increases will threaten universal service in Pennsylvania. The only piece of evidence that the OCA offers in support of that speculative argument is the May 2005 report of the FCC on telephone penetration rates. OCA Brief, p. 21 (citing "Telephone Subscribership in the United

States,” FCC Industry Analysis and Technology Division, May 2005, Table 3). The cited data purport to show that telephone penetration in Pennsylvania has declined from 98 per cent in 2002 to 94.3 per cent in March 2005, leading the OCA to state that penetration rates in Pennsylvania are the lowest they have been in 15 years, and could get worse if additional access rate reductions are ordered. OCA Brief, p. 23.

Noticeably absent from the OCA’s presentation on the telephone penetration rates in the state is any attempt to explain the changes in telephone penetration or to establish a causal link between the decline in the telephone penetration rate in Pennsylvania to the level of local rates or to any local rate increases ordered by the Commission. Indeed, the level of Verizon’s local telephone rates is but one of several economic factors affecting a household’s ability to have telephone service. As Qwest points out in its brief, the record also lacks any evidence on how the price of local telephone service from Verizon in Pennsylvania compares with the rates paid by consumers for other utility services, like electricity, cable television, and wireless services. Qwest Brief, p. 19. MCI witness Dr. Pelcovits has estimated that the local rate increase necessary to bring intrastate levels down to cost is not significant relative to the total cost of local service in Pennsylvania. Pelcovits Direct, pp. 17-18.

**V. THE OCA AND OSBA ARE STUCK IN THE PAST WHEN THEY ARGUE THAT IXCS SHOULD BEAR THE BURDEN OF SHARING THE COSTS OF THE LOCAL LOOP**

The OCA’s brief argues that the Commission has ruled that “the joint and common costs of the local loop facilities must be considered as a shared cost of all services that use the local loop, including access services.” OCA Brief, p. 24. In support

of this claim, the OCA cites to two Commission Orders – one from 1995 and one from 1996. OCA Brief, pp. 23-24. Further, OCA defends the Carrier Charge, arguing that “it is reasonable to recover a portion of the shared cost of the network from *all of the users of the network* so that every user of the network makes a contribution to the shared cost.” OCA Brief, p. 35 (*emphasis added*). OSBA similarly argues that the Carrier Charge should not be eliminated because “there is a continued need for toll carriers to contribute to the cost of the loop...” OSBA Brief, p. 7. These arguments again ignore the fundamental changes in the telecommunications market that have occurred since the Commission last decided this issue, and should be rejected. Indeed, even Verizon agrees that the IXCs should not share in the cost of the local loop.

The OCA and OSBA's argument is extremely inconsistent in its application. They justify their argument that IXCs should pay for a portion of the loop solely because long distance calls must traverse over the local loop. The OCA states that “the local loop facilities are costs properly allocated across all the services that use the local loop.” OCA Brief, p. 25. However, the OCA and OSBA cannot deny that other types of carriers (such as wireless, VoIP and cable) must rely on the use of the local loop in order to complete their calls. Yet, OCA and OSBA never once advocate for the Commission to truly assess the cost of the loop over *all services* that use the local loop. Instead, the OCA and OSBA want to continue the discriminatory and antiquated practice of assessing IXCs to use the loops, even while providers using new technology are not saddled with this same burden. Again, maintaining the Carrier Charge creates the situation where regulation favors some types of carriers over others. The Commission's prior determinations on this issue were made at a time when the competitive landscape was vastly different. This type of

discriminatory treatment and assessment of non-cost based charges on only one type of carrier cannot continue in this changed telecommunications market.

The Commission recognized both in the Global Order and in its Order initiating this case that the Carrier Charge should be eliminated. The parties' arguments opposing the elimination of the Carrier Charge are not supportable, and must be rejected.

## VI. CONCLUSION

The Commission should ensure that its regulatory policies are consistent with the current state of competition in the telecommunications industry. The system of intrastate access charges currently in effect in Pennsylvania permits certain competitors to enjoy a significant unfair cost advantage relative to other competitors. The Commission must act now to lower intrastate access rates to cost, or, as an interim step, to the level of interstate rates. Market forces will cause access savings to be returned to consumers, negating any perceived negative effects of a slight increase in local rates that would be necessary to comply with the legislature's mandate that these rate changes be revenue neutral.

Respectfully submitted,



Michelle Painter  
MCI, Inc.  
22001 Loudoun County Parkway  
Ashburn, VA 20147  
Telephone: (703) 886-5973  
Facsimile: (703) 886-0633  
E-mail: [Michelle.Painter@mci.com](mailto:Michelle.Painter@mci.com)

Richard C. Fipphen  
MCI, Inc.  
200 Park Avenue, 6<sup>th</sup> Floor  
New York, NY 10166  
Telephone: (212) 519-4624  
Facsimile: (212) 519-4811  
E-mail: [Richard.Fipphen@mci.com](mailto:Richard.Fipphen@mci.com)

Dated: August 31, 2005

SERVICE LIST

I hereby certify that I have this day caused a true copy of MCI's Reply Brief to be served upon the parties of record in Docket No C-20027195 in accordance with the requirements of 52 Pa. Code Sections 1.52 and 1.54 in the manner and upon the parties listed below.

Dated in Harrisburg, PA on August 31, 2005

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PA PUBLIC UTILITY COMMISSION  
SECRETARY'S BUREAU

Patricia Armstrong  
Thomas, Thomas, Armstrong & Niesen  
212 Locust Street, Suite 500  
Harrisburg, PA 17108  
Phone - 717-255-7627

Bill Petersen  
Verizon  
1717 Arch Street  
Philadelphia, PA 19103  
Phone - 215-466-6070

Robert Eckenrod  
Pennsylvania Public Utility Commission  
Office of Trial Staff - 2<sup>nd</sup> Floor  
Commonwealth Keystone Building  
400 North Street  
Harrisburg, PA 17120  
Phone - 717-787-1976

Steven Gray  
Office of Small Business Advocate  
Suite 1102, Commerce Building  
300 North Second Street  
Harrisburg, PA 17101  
Phone - 717-783-2525

Sue Benedek  
United Telephone  
240 North Third Street, Suite 201  
Harrisburg, PA 17101  
Phone - 717-236-1385

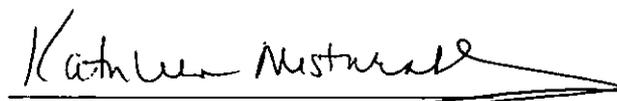
Robert C. Barber  
AT&T  
3033 Chain Bridge Road  
Oakton, VA 22185  
Phone - 703-691-6061

Phil McClelland  
Office of Consumer Advocate  
555 Walnut Street, 5<sup>th</sup> Floor  
Harrisburg, PA 17101  
Phone - 717-783-5048

John F. Povilaitis  
Ryan, Russell, Ogden & Seltzer  
800 North Third Street, Suite 101  
Harrisburg, PA 17102  
Phone - 717-236-7714

Kirstin L. Smith, Esquire  
Qwest Communications Corporation  
1801 California Street - Suite 4900  
Denver, Colorado 80202  
Phone - 303.672.2820

Alan Kohler  
Wolf Block Schorr & Solis-Cohen  
213 Market St, 9<sup>th</sup> Floor  
Harrisburg, PA 17101  
Phone - 717-237-7172

  
Kathleen Misturak-Gingrich

Verizon Pennsylvania Inc.  
Verizon Delaware Inc.  
1717 Arch Street, Floor 10  
Philadelphia, PA 19103  
Tel: 215 466-6070  
Fax: 215 563-2658  
william.b.petersen@verizon.com

William B. Petersen  
Vice President and General Counsel



ORIGINAL

August 31, 2005

Via UPS Overnight Delivery  
James J. McNulty, Secretary  
Pennsylvania Public Utility Commission  
Commonwealth Keystone Building  
400 North Street, 2<sup>nd</sup> Floor  
Harrisburg, PA 17120

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PA PUBLIC UTILITY COMMISSION  
SECRETARY'S BUREAU

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

DOCUMENT  
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Dear Secretary McNulty:

Enclosed please find the original and nine copies of the Reply Brief on Remand of Verizon Pennsylvania Inc. and Verizon North Inc. in reference to the above captioned matter. In addition, an electronic copy of the Reply Brief, in Word, is being provided. Please note that the Reply Brief contains proprietary information, and that an Expurgated copy of the Brief also is enclosed.

Please do not hesitate to contact me if you have any questions.

Very truly yours,

A handwritten signature in black ink, appearing to read "WBP".

William B. Petersen

WBP/slb  
Enc.

Via E-Mail and UPS Overnight Delivery  
cc: Honorable Cynthia W. Fordham  
Attached Certificate of Service

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BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

AT&T COMMUNICATIONS OF  
PENNSYLVANIA, LLC,

v.

VERIZON NORTH INC.

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Docket No. C-20027195

**ORIGINAL**

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REPLY BRIEF ON REMAND OF VERIZON PENNSYLVANIA INC.  
AND VERIZON NORTH INC.

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SECRETARY'S BUREAU

DOCKETED  
SEP 02 2005

William B. Petersen  
Suzan DeBusk Paiva  
1717 Arch Street, 10W  
Philadelphia, PA 19103  
Phone (215) 466-4755  
Fax (215) 563-2658  
[william.b.petersen@verizon.com](mailto:william.b.petersen@verizon.com)  
[Suzan.d.paiva@verizon.com](mailto:Suzan.d.paiva@verizon.com)

Counsel for Verizon  
Pennsylvania Inc. and  
Verizon North Inc.

Date: August 31, 2005

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## I. INTRODUCTION

Nothing in the other parties' Main Briefs demonstrates that the Commission should rush to implement a further Verizon rebalancing by reducing intrastate access rates and increasing retail end-user rates at this time. Particularly now, when the FCC has an open and fully briefed proceeding in which it will either preempt this Commission's jurisdiction over the very intrastate access charges that are the subject of this proceeding or, at the very least, provide guidance as to whether and how this Commission should alter intrastate access rates, the Commission should demand very good reasons and specific and concrete proof of public benefits before it acts ahead of the FCC on this issue. No such proof has been provided.

The IXC parties – Qwest, AT&T and MCI – stretch mightily to articulate some public benefits that might result from an immediate Pennsylvania intrastate access rate rebalancing, but fail to do so. They appeal primarily to vague concepts such as correcting market “distortions” and eliminating “arbitrage” incentives, but these are the very same arguments that the IXCs have made to the FCC in urging that agency to assume jurisdiction over all intercarrier compensation and to preempt this Commission. Plainly, isolated decreases to Pennsylvania intrastate access rates -- one small subset of the universe of intercarrier compensation that is before the FCC in its comprehensive proceeding-- will not provide the market-correcting benefits the IXCs tout. Only comprehensive reform of *all* types of intercarrier compensation – the very reform the FCC is presently considering – can achieve these ends.<sup>1</sup> As AT&T and MCI have told the FCC in its pending proceeding, “[a] uniform regime must apply the same rate consistently across all carriers, technologies and services, unify interstate and intrastate compensation systems.”<sup>1</sup> It is not that the IXCs

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<sup>1</sup> Verizon St.1.0 Remand, Exhibit 3, ICF FCC Comments at 12.

arguments will not be addressed, but they should be addressed in the proper forum by the FCC.

The IXCs no longer even purport to guarantee that Pennsylvania end-users will experience toll rate decreases as a benefit of intrastate access reductions. Indeed, Qwest, despite virtually promising such decreases in Phase I,<sup>2</sup> now calls the expectation of toll rate reductions “simplistic.” (Qwest Brief at 20). The record shows that the IXCs price their products nationally and any isolated decrease in Pennsylvania intrastate access rates at this time would be, at best, spread over the entire country *with minimal to no impact on Pennsylvania end users.*<sup>3</sup>

On the other side of the scale to these amorphous and unsupported claims of “benefits” from immediate access reductions, the Commission must weigh the fact that under 66 Pa. C. S. § 3017 end users will certainly experience retail rate increases if any rebalancing is ordered. Additionally, the potential for confusion and complication if this Commission acts inconsistently with the FCC’s ultimate policy in this area will impose additional costs.

Having already benefited from *approximately \$140 million* in annual direct cost savings from Verizon through intrastate access reductions in Pennsylvania since the *Global Order*,<sup>4</sup> the IXCs have not demonstrated how customers in Pennsylvania have benefited, or that there is any reason why Verizon’s access and retail rates cannot stay at present levels until the FCC completes its intercarrier compensation proceeding.

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<sup>2</sup> See Qwest Phase I Reply Brief at 10 (“reductions in intrastate access charges should result in a decrease in the rates end-users pay for toll services. The interexchange market, however, is sufficiently competitive to ensure flow-through without the need for carriers to document flow-through to state commissions.”)

<sup>3</sup> VZ St. 1.1 Remand (Kane/Dean Rebuttal) at 4.

<sup>4</sup> See VZ St. 1.1 Remand (Kane/Dean Rebuttal) at 12.

The weak arguments that the IXCs muster to urge the Commission to get ahead of the FCC on access rates were specifically rejected by a unanimous Commission decision on August 11, 2005, when the Commission stayed the rural ILECs' access case in order to "coordinate" its own access decisions with that of the FCC.<sup>5</sup> Verizon's intrastate access rates are among the very lowest in the state – substantially lower than those of most of the ILECs subject to the proceeding that was stayed, and also below the national average. The Commission should likewise leave Verizon's access and retail end user rates at their present levels for now, and wait to coordinate any further action with regard to Verizon's intrastate access rates with the outcome of the FCC proceeding.

## II. ARGUMENT

### A. **The Commission Should Refrain From Additional Verizon Access Rate Rebalancing Until The FCC Completes Its Intercarrier Compensation Proceeding**

The OCA, OSBA and OTS agree with Verizon that the Commission should refrain from requiring any additional access rate rebalancing for the Verizon companies at this time, and should wait for the FCC to complete its own pending intercarrier compensation proceeding, where it will comprehensively address many types of intercarrier compensation, including the intrastate access rates at issue in this case<sup>6</sup> (OSBA Main Brief at 3, 8-9; OTS Main Brief at 5; OCA Main Brief at 5). Leaving Verizon's intrastate access and retail rates at their current levels for the present, at least until the FCC completes its own more

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<sup>5</sup> *Investigation Regarding Intrastate Access Charges and IntraLATA Toll Rates of Rural Carriers, and the Pennsylvania Universal Service Fund*, No. I-00040105 (Motion of Vice-Chairman Cawley adopted 5-0 on August 11, 2005) (Attached as "Exhibit A" to Verizon's Main Brief).

<sup>6</sup> *In the Matter of Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92 (FNPRM Rel. March 3, 2005).

comprehensive review of intercarrier compensation issues, is in the public interest and is consistent with this Commission's recent decision to defer access rebalancing for all other Pennsylvania ILECs pending the FCC's completion of its pending proceeding.<sup>7</sup> The IXCs have shown no immediate public benefit to be gained from rushing to rebalance Verizon's access rates now, and certainly have not shown benefits sufficient to justify the confusion and complication that may result if this Commission acts inconsistently with the FCC's policy in this area, or the statutorily mandated end-user rate increases required to make the rebalancing revenue neutral.

The IXCs do not articulate any reasoned basis for this Commission to rush ahead without waiting for the FCC to complete its case. AT&T's Main Brief does not even address the argument that the Commission should await the FCC proceeding, but simply argues that it would benefit AT&T and other IXCs to reduce their intrastate access costs (See AT&T Brief at 12-14). MCI weakly argues that the Commission should forge ahead despite the FCC's concurrent review of the same issues because there is "no guarantee" when the FCC will complete its proceeding. (MCI Brief at 11). Qwest similarly argues that the Commission should not expect prompt FCC action because the FCC proceeding is

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<sup>7</sup> *Investigation Regarding Intrastate Access Charges and IntraLATA Toll Rates of Rural Carriers, and the Pennsylvania Universal Service Fund*, No. I-00040105 (Motion of Vice-Chairman Cawley adopted 5-0 on August 11, 2005) (Attached to Verizon's Main Brief as "Exhibit A"). It is telling that both Qwest and AT&T rely on Commission orders relating to the intrastate access charges of the rural ILECs in support of their arguments that the Commission's policy is to immediately reduce access rates. AT&T contends that in the rural carriers' case the Commission has "demonstrated a clear understanding of the implicit subsidy problem" and "recognized that fair competition was not possible until implicit subsidies were removed or eliminated." (AT&T Brief at 19; see also Qwest Brief at 24). Since the Commission found it to be in the public interest to stay access rebalancing for the very same rural carriers for whom it made these supposed statements of policy – when the record shows that many of the rural ILECs' intrastate access rates are many multiples *higher* than Verizon's rates – its handling of the rural carriers' case only supports waiting for the FCC in this case, too.

“complex” and the FCC’s final decision unknown. (Qwest Brief at 26). Qwest also argues that the Commission should disregard the FCC’s judgment on access reform, and “move ahead quickly” to wrest control of this issue from the FCC. (Qwest Brief at 25). The full Commission rejected these precise arguments in deciding to stay the rural ILECs’ access case – over the IXCs’ vociferous objections – in order to “coordinate” the Commission’s actions with the FCC’s. These same recycled arguments are no more convincing here.

Because the IXCs have demonstrated no immediate benefit from access reductions – as discussed in detail in the next section – they have demonstrated no urgency for the Commission to act now, when the FCC is considering precisely the same intrastate access rates in connection with its larger and more comprehensive review of intercarrier compensation generally. Indeed, as OCA points out, Verizon’s present intrastate access rates are well below the national average. (OCA Brief at 7 and note 8). They are certainly well-below those of most of the rural ILECS – whose proceeding the Commission just decided to stay. (Verizon Main Brief at 9). Moreover, the IXCs have already benefited from *approximately \$140 million* in annual direct cost savings from Verizon through intrastate access reductions in Pennsylvania since the *Global Order*.<sup>8</sup> As OCA aptly observes, “[t]he Commission should not put itself in the position where two jurisdictions attempt to set the same rate at the same time.” (OCA Brief at 8).<sup>9</sup>

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<sup>8</sup> See VZ St. 1.1 Remand (Kane/Dean Rebuttal) at 12.

<sup>9</sup> The OCA suggests as a fallback position, if the Commission determines not to wait for the FCC, that the Commission should adopt the plan that the OCA supports before the FCC – the NASCUA plan. (OCA Brief at 40). OCA admits that under this plan there would be “no change” in Verizon’s intrastate access rates for a few years (because those rates are already relatively low compared to the national average). (Id.). This argument simply demonstrates that the best course is to wait for the FCC, rather than to risk adopting a plan different from that ultimately adopted by the FCC.

**B. Isolated Rebalancing Of Intrastate Access Rates By This Commission Without Waiting For The FCC's Larger Reform Will Not Provide The Benefits The IXCs Tout**

The primary question presented in this Phase II proceeding is whether any party has demonstrated significant benefits to the immediate access reductions that the IXCs seek, benefits substantial enough to outweigh the statutorily mandated end-user rate increases that such a rebalancing would require and benefits immediate enough to justify a decision not to wait for the FCC's guidance on this issue. Plainly, none of the IXCs have demonstrated such benefits. Indeed, the general beneficial effects they tout – such as more efficient markets and reduced arbitrage incentives – are only likely to occur if *all* types of intercarrier compensation are reformed uniformly, which can *only* be done by the FCC because this Commission alone lacks jurisdiction to address all of the relevant types of compensation. Moreover, the arguments that the IXCs make to this Commission are the same arguments they are simultaneously making to the FCC, where they are asking that agency to assume jurisdiction over the intrastate access rates at issue here and preempt this Commission. While the IXCs have every incentive to seek to lower their own costs by continuing to demand access rate reductions, the record shows that isolated reductions to intrastate access rates in one state are not sufficient to significantly impact nationally priced long distance rates and are not comprehensive enough to correct any market distortions relating to intercarrier compensation.

Attempting to muster a showing of “benefits” in support of their demand that Verizon's intrastate access charges be substantially reduced, the IXCs largely focus on benefits they argue will result to the toll “market” and thus to themselves and other long distance carriers. Even here, the IXCs have not demonstrated that such benefits would

actually occur with an isolated rate reduction by this Commission alone, and their arguments actually counsel in favor of waiting for the FCC. Qwest contends that an intrastate access reduction would eliminate “inconsistency between jurisdictions” and reduce “opportunities for arbitrage,” (Qwest Brief at 5), arguing that the difference between interstate and intrastate rates creates an incentive for what Qwest euphemistically calls “arbitrage”— where IXCs “disguise” calls as interstate or local to evade the tariffed access rates that they should be paying for this traffic. (Qwest Brief at 13). These are precisely the same problems that Qwest has asked the FCC to address, contending in its Comments before that agency that “the entire system is fatally flawed,” and that “the need for rapid and decisive action by the [FCC] to rationalize the system of intercarrier compensation is one of the most pressing issues currently before the FCC.”<sup>10</sup> As Qwest’s FCC comments implicitly recognize, only a comprehensive decision addressing all types of intercarrier compensation will truly address the concerns raised by the IXCs – and only the FCC can make such a decision.

MCI similarly contends that reducing intrastate access rates would remove “distortions” in the marketplace that cause long distance rates to be set “artificially high.” (MCI Brief at 5). AT&T argues that under the current pricing structure traditional IXCs cannot compete with wireless carriers, e-mail, voice over IP and virtual FX. (AT&T Brief at 6, 12-13). MCI similarly refers to “cost advantages” for wireless carriers. (MCI Brief at 6-7).<sup>11</sup> The ICF – of which AT&T and MCI are members – argued to the FCC in its

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<sup>10</sup> Verizon St.1.0 Remand, Exhibit 4, Qwest FCC Comments at 1.

<sup>11</sup> AT&T contends that the “proof” of the advantages of these other methods of communications over AT&T’s traditional long distance business is “in the numbers,” pointing to AT&T’s declining access minutes. (AT&T Brief at 14). However, AT&T admitted in response to discovery that it has halted all marketing efforts to its traditional long distance (including toll) customers, stopped attempting to compete on price and selectively raised prices. According to AT&T itself, “[t]he inevitable effect of these actions is that AT&T’s mass market customer base will dwindle away over time

Comments in support of comprehensive intercarrier compensation reform by that agency, that “[a] uniform regime must apply the same rate consistently across all carriers, technologies and services, unify interstate and intrastate compensation systems, and rationalize network interconnection rules, ending ‘artificial regulatory distinctions.’”<sup>12</sup> Again, only the FCC can implement a “uniform” regime of the type AT&T and MCI have argued to the FCC is necessary to correct the problems they perceive. Moreover, since the IXCs have not demonstrated that isolated rate reductions by this Commission would impact the larger market problems they perceive, they certainly have not shown that any such “benefits” would flow down to the end-user customer.

The IXCs also have demonstrated no consumer benefits in the form of rate reductions flowing from the immediate access reductions they demand. While in the past the IXCs have specifically touted potential toll rate reductions as the primary consumer benefit that would flow from access reductions,<sup>13</sup> Qwest now accuses OTS of making a “simplistic” argument in expecting access reductions to translate dollar for dollar in toll reductions. (Qwest Brief at 20). The IXCs apparently no longer promise toll rate reductions. While Qwest asserts that there will be “consumer benefits” from isolated intrastate access reductions here, it names no concrete benefits and makes only the vague claim that access

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through churn,” and “AT&T is simply no longer attempting to win new customers.” (See VZ St. 1.1 Remand, Exhibit 1, AT&T Response to OCA Set I, No. 1 and attached affidavit of John C. Polumbo, ¶ 9 and 17). Obviously, it is AT&T’s own business decision to abandon the traditional long distance market that has caused its decline in minutes, and it therefore cannot follow that all IXCs would be experiencing the same level of decline as AT&T. See VZ St. 1.1 Remand at 29.

<sup>12</sup> Verizon St.1.0 Remand, Exhibit 3, ICF FCC Comments at 12.

<sup>13</sup> See Verizon Main Brief at 21.

reductions would “provide[] consumers the ability to make informed decisions.”<sup>14</sup> (Qwest Brief at 6).

The record shows, however, as this Commission has already recognized, that “IXCs are setting their rates on a national level using flat rates that have *no relationship with the access rates of any specific ILEC.*”<sup>15</sup> Given the IXCs’ recognized national pricing strategies, any isolated decrease in Pennsylvania intrastate access rates at this time would be, at best, spread over the entire country *with minimal to no impact on Pennsylvania end users.*<sup>16</sup> Qwest admits that “IXCs price their services in the aggregate.” (Qwest Brief at 17). OCA points to the testimony of its expert, Dr. Loube, demonstrating that “reducing Pennsylvania’s intrastate access rates will not benefit customers because IXCs have developed service plans based on nationwide costs and marketing considerations,” so that the actions of one state reducing rates “cannot have a significant effect on the price” of toll service. (OCA Brief at 20).<sup>17</sup> (See also Verizon Main Brief at 19).

Having demonstrated no substantial benefits to the public interest from the immediate access rebalancing it demands, Qwest attempts to turn the tables and place the burden on Verizon and the public advocates to demonstrate “harm” from the rate

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<sup>14</sup> AT&T abandons any attempt to demonstrate “consumer” benefits at all, arguing instead that the Commission should lower intrastate access rates to confer benefits on traditional long distance carriers.

<sup>15</sup> *Implementation of the Telecommunications Act of 1996: Imputation Requirements for the Delivery of IntraLATA Services by Local Exchange Carriers*, No. M-00960799 (Opinion and Order entered January 29, 2002) at 14 (emphasis added).

<sup>16</sup> VZ St. 1.1 Remand (Kane/Dean Rebuttal) at 4.

<sup>17</sup> OSBA contends that the Verizon/MCI merger and the merger of AT&T with SBC will reduce competition in the toll market and lessen the likelihood of toll rate decreases, (OSBA Brief at 6; see also OCA Brief at 18), but the Commission has already recognized that the toll market is highly competitive. Moreover, the record shows that national pricing strategies are the primary factor preventing toll rate decreases.

rebalancing. Qwest contends that the record is “void of any evidence” of actual harm. (Qwest Brief at 7). Under 66 Pa. C.S. § 3017, “[t]he commission may not require a local exchange telecommunications company to reduce access rates except on a revenue-neutral basis.” While a retail rate increase might be well-justified in this instance if accompanied by sufficient public benefits, in the absence of such benefits the prospect of such an increase alone may be considered a negative impact on the public interest. As the presiding officer ruled in denying Qwest’s motion to strike OCA, OTS and Verizon testimony demonstrating that the IXCs have proven no consumer benefit from access reductions, “the Commission can consider the effect of the reduced access charges on the residential consumer.”<sup>18</sup> Moreover, while the Public Utility Code mandates revenue neutrality for any access rate decreases, as the OTS aptly points out, “no section of the [Public Utility] Code also requires that the Commission reduce access charges any further.” (OTS Brief at 8). Finally, Qwest does not address the potential for confusion and harm to the public interest if the Commission acts now, inconsistently with the FCC’s ultimately direction on this issue. Indeed, OCA has discussed at length potential problems based on the FCC’s later adoption of various of the plans before it, (OCA Brief at 9-16) and this potential for adverse impact on Pennsylvania ratepayers was a primary concern of the Commission when it stayed the rural carriers’ access proceeding.<sup>19</sup>

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<sup>18</sup> Order 5 on Remand, at 8.

<sup>19</sup> *Investigation Regarding Intrastate Access Charges and IntraLATA Toll Rates of Rural Carriers, and the Pennsylvania Universal Service Fund*, No. I-00040105 (Motion of Vice-Chairman Cawley adopted 5-0 on August 11, 2005) (Attached as “Exhibit A” to Verizon’s Main Brief) at 2 (noting that the OCA “clearly and persuasively demonstrates the risks to end users” if the rural ILECs’ access case were allowed to proceed while the FCC case is still open).

AT&T similarly ignores the prospective rate increase to consumers, and contends that revenue-neutral access decreases “will not cause Verizon financial harm.” (AT&T Brief at 6). This argument does not support the immediate rebalancing AT&T seeks. First, while the Commission must consider the impact on Verizon, its inquiry does not stop there and it also must consider the impact on the public interest, even if it determines there would be no “financial” harm to Verizon. Second, because some of the parties are arguing that the access revenue reduced should be spread over too large a category of lines, including those that would not actually provide the revenue needed to achieve revenue neutrality, it is not a true statement that the access decreases sought will not cause Verizon financial harm. Third, to the extent the Commission makes a premature decision that then complicates Verizon’s compliance with the FCC’s ultimate order from its intercarrier compensation proceeding or leads to some of the risks OCA details, then Verizon and its customers could suffer additional harm of a financial or non-financial nature.

Finally, Qwest contends that LXC’s are being treated unfairly, and that the Commission should as a policy matter reduce intrastate access rates because it is not “competitively neutral” to depend only on intrastate toll service to fund universal service. (Qwest Brief at 10). What Qwest fails to acknowledge, however, is that even interstate services still contribute to universal service, but this contribution has been made explicit through interstate subscriber line charges (“SLCs”). (See Verizon Phase I Main Brief at 8) (noting that the FCC has reduced interstate access charges and replaced that revenue with federal SLCs that are charged directly to the end-user customers). Thus, it is not “only” intrastate access service that is contributing to universal service. Qwest similarly contends that the policy of contribution through high switched access rates to offset low basic exchange rates no longer fulfills any public policy objective. (Qwest Brief at 11). However,

Qwest's argument lacks credibility because the record shows that Qwest still maintains high intrastate access rates in the majority of its ILEC states. (See Verizon Main Brief at 32). While Qwest argues that refraining from lowering intrastate access rates in Pennsylvania now will "widen the gap" between PUC and FCC policies, (Qwest Brief at 22), Qwest is content to wait for the FCC and keep that "gap" in the vast majority of states where it operates as an ILEC and so there is no reason for Qwest to resist waiting for the FCC in Pennsylvania as well.

**C. If The Commission Rebalances Rates Now, Which It Should Not Do, It Must Make The Rebalancing Revenue-Neutral**

**1. It Would Violate 66 Pa. Code § 3017 To Place Increases On Services That Are Not Likely To Provide The Required Revenue And For Which The Commission Cannot Set Rates**

If this Commission were to require a rebalancing now, without waiting for the FCC – which it should not do – then it should place the revenue neutral end-user retail rate increases on tariffed basic residential and business local service rates. This would result in the increase being placed on the same category of residential and business lines used for the Phase I rebalancing. At the time Verizon submitted its testimony in this Phase II proceeding, it estimated that approximately **[BEGIN VERIZON PROPRIETARY]**

**[END VERIZON PROPRIETARY]** lines purchased those basic tariffed residential and business services that would be subject to the rate increases.

While it agrees with Verizon that the Commission should take no action at this time, the OSBA argues that if the Commission nonetheless determines to require Verizon to rebalance rates, it should "spread" any retail rate increases on both contract and non contract lines. (OSBA Brief at 3). The OCA similarly argues that any rate increase should be spread

over all Verizon lines, including lines purchasing bundled or competitive services. (OCA Brief at 42-43).

These arguments miss the point. The Commission determines which *rates* to increase. It may only increase those over which it has jurisdiction, the basic *non-competitive* residential and business services. Chapter 30 provides that Verizon may price *competitive* services “at the company’s discretion,” and so the Commission may not mandate the level of those rates. 66 Pa. C.S. § 3016(e)(1). Moreover, the Commission places the increase on particular rates, not particular lines; any individual customer is always free to switch to bundled or packaged service plans or even to another carrier if it does not wish to pay the rate.

Not only is the Commission statutorily prohibited from raising competitive rates, but the Commission also cannot place portions of the revenue-neutral offset on services that the evidence demonstrates will not actually produce the required revenue. The statutory mandate given this Commission when calculating a rate rebalancing is that it *must* achieve revenue neutrality. 66 Pa. C.S. § 3017 (“The commission *may not* require a local exchange telecommunications company to reduce access rates *except* on a revenue-neutral basis.”) In other words, the Commission *must* design the rebalancing so that Verizon will actually recover the lost access revenue through increases in some other rates. The undisputed record here demonstrates that “not all lines can receive a rate increase. Lines that are subject to contractual agreements cannot raise their rates, and lines subject to competitive pressures are not subject to rate regulation and cannot be expected to accept an increase without being

lost to a competitor.<sup>20</sup> Accordingly, a paper exercise of allocating revenue to such lines would not actually achieve revenue neutrality and would violate 66 Pa. C.S. § 3017.

Not only did OCA and OSBA agree to the category of rates which were subject to the increase in Phase I, but the increase was approved by the Commission and is consistent with the way revenue neutral rate increases have been designed in other Chapter 30 rate rebalancings.<sup>21</sup> There is no basis to depart from this method of rate increases for Phase II.

## **2. Placing The Increases On “Protected” Services Does Not Result In “Cross-Subsidization”**

The OSBA contends that placing the offsetting increases on only “non-contract lines” would violate Chapter 30’s prohibition at 66 Pa. C. S. § 3016(f)(1) that revenues earned or expenses incurred in conjunction with “protected services” may not be used to “subsidize” competitive services. (OSBA Brief at 10-11).<sup>22</sup> “Protected services” are basic dial tone line, touch tone and switched and special access services provided to residential and business customers. 66 Pa. C.S. § 3012.

OSBA’s argument incorrectly presumes that after a rate increase to basic service rates, “protected services” would somehow be priced above cost, and therefore would be able to provide a subsidy to competitive services. The record demonstrates that this premise is incorrect. Verizon’s cost studies show that the actual cost of providing basic residential service is [BEGIN VERIZON PROPRIETARY]

[END VERIZON PROPRIETARY]. The record in Phase I showed that Verizon’s weighted average rate for residence basic local service was \$12.55 for Verizon

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<sup>20</sup> VZ St. 1.1 Remand at 34.

<sup>21</sup> VZ St. 1.1 Remand at 35.

<sup>22</sup> The OSBA’s quote of the statute refers to “noncompetitive” services and is not accurate.

North and \$13.31. Even with the addition of the \$0.80 increase from Phase I, these rates are still well below cost. Similarly, the statewide average cost of providing basic business dial tone line and port service was [BEGIN VERIZON PROPRIETARY] [END VERIZON PROPRIETARY], plus additional costs for usage.<sup>23</sup> OSBA has not demonstrated that protected services would be priced above costs, even with a rate rebalancing.

**3. There Is No Basis For AT&T's Suggestion That The Commission Should Calculate The Revenue-Neutral Offset Based On A "Forecast" Of Lines, And "True-Up" Annually**

AT&T contends that the Commission should use a "forecast" of access minutes—rather than current actual volumes—to calculate the amount of the off-set needed to achieve revenue neutrality. (AT&T Brief at 11). Of course, AT&T believes that a forecast would show decreasing access revenue under the same access rates, and thus call for a lower revenue-neutral offset.

AT&T's suggestion is inconsistent with the manner in which the Commission has traditionally calculated rate rebalancings. A revenue-neutral rate rebalancing is necessarily a snap-shot in time, where new rates are calculated based on volume information available at the time the details of the rebalancing are filed with the Commission, to recover the estimated revenue reduction from other rates based on the volume information at that time.<sup>24</sup>

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<sup>23</sup> VZ Phase I St. 2.0, Exhibit 2.

<sup>24</sup> AT&T contends that the "facts" suggest that Verizon will not continue to lose retail access lines when AT&T and MCI are no longer pursuing mass market customers. (AT&T Brief at 10). There are no record facts to support AT&T's conjecture. AT&T itself did not provide residential competitive service, and there are many other active CLECs serving Pennsylvania. The FCC's publicly available Local Competition Report as of December 31, 2004 shows CLECs serving 21.9% of lines in Pennsylvania. Moreover, as AT&T's own arguments demonstrate, Verizon's retail line losses are attributable to larger factors, such as the use of e-mail, wireless phones, lack of need for second lines, and similar intermodal competition which will continue to exist

In any event, if the Commission were to consider AT&T's argument that it should base the rebalancing calculations on a "forecast" of access revenue, then it must calculate the rebalancing on an "apples to apples" basis by also forecasting Verizon's retail access lines that will be subject to the rate increase. The record shows that the number of Verizon's retail access lines is also shrinking, so that a larger increase per line would be necessary if the rebalancing were based on a forecast of lines available to recoup the revenue.<sup>25</sup> Utilizing current volumes there is no guarantee – or even any likelihood – that Verizon will actually recover from the end user rate increase the actual amount of revenue reduction projected from the access rate reductions as of the date upon which the compliance filing calculations were based.

While the Commission could calculate a rebalancing based on a forecast of access and retail volumes, such a calculation would require new evidence because no party has provided such a forecast. If the Commission were to solicit such new evidence, it might as well wait for the FCC proceeding to be completed.

AT&T also contends that the Commission should "true-up" the amount of the access reductions annually to require additional access rate reductions in order to maintain the same amount of revenue loss projected based on the volumes at the time of implementation. (AT&T Brief at 11). It is not practical or reasonable to suggest that the Commission revisit the amount of revenue reduced or gained under subsequent volumes. Both access minute volumes and the number of retail end-user lines are subject to change, so that it is highly unlikely that a precise match-up will be calculated if the Commission uses post-filing

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notwithstanding these mergers.

<sup>25</sup> Verizon St. 1.1 Remand at 22-23.

volumes.<sup>26</sup> Again, if the Commission were to adopt AT&T's suggestion it would also have to "true-up" the volume of retail access lines and impose additional end user rate increases if the volumes do not recover projected revenue.

**D. Verizon Is In Compliance With Phase I Order**

AT&T contends that Verizon is not in compliance with the Phase I rate rebalancing order in the magnitude of access rate reductions. (AT&T Brief at 7-8). Verizon rebutted this argument in detail in its Main Brief. (See Verizon Main Brief at 35-38).

AT&T contends that it is actually paying more on average "per minute" than estimated during Phase I, because its total minutes of use have decreased.<sup>27</sup> The Commission in Phase I recognized that the joint petition for approval of settlement provided that "Verizon will make a compliance filing after Commission approval of this proposal that contains a final calculation of the amount of the rate changes, based on updated volumes." (07/28/04 Order at 30). Indeed, it ordered Verizon to file its compliance tariff "effecting the rates resulting from a final calculation based on updated usage volumes." (07/28/04 Order, ordering paragraph 5).

Moreover, AT&T's calculation of its effective per-minute rate is admittedly based on AT&T's own bills. AT&T admitted in response to discovery that it has halted all marketing efforts to its traditional long distance (including toll) customers, stopped attempting to compete on price and selectively raised prices. According to AT&T itself,

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<sup>26</sup> Verizon St. 1.1 Remand at 27.

<sup>27</sup> Indeed, it is apparent from the chart appearing on page 17 of AT&T's Brief that AT&T admits it is *still* paying a per line carrier charge *rate* of \$0.58. It contends that its "effective" rate – dividing all of its carrier charge costs by its total number of access minutes – has increased, but this is because AT&T's own access minutes have decreased, which is a matter not within Verizon's control and not necessarily representative of all other IXCs.

“[t]he inevitable effect of these actions is that AT&T’s mass market customer base will dwindle away over time through churn,” and “A&T is simply no longer attempting to win new customers.” Obviously, it is AT&T’s own business decision to abandon the traditional long distance market that has caused its decline in minutes, and it therefore cannot follow that all IXCs would be experiencing the same level of decline as AT&T.<sup>28</sup> The record also shows that the only long distance consumer service AT&T is actively marketing in Pennsylvania is a “voice over IP” service where AT&T refuses to pay intrastate access charges, so transfer of customers to this product would also make AT&T’s access minutes appear to be declining.<sup>29</sup>

AT&T also contends that the use of a carrier charge (which is a flat rate per month, per line (the calculation uses VZ’s retail lines)) is unfair to AT&T because its per line costs of paying the carrier charge are being spread across a shrinking number of access minutes, causing “effective” per minute access rates to rise. (AT&T Brief at 6, 9). AT&T itself admits that it was the IXCs – not Verizon – that argued for the Commission to alter what Verizon had until the *Global Order* charged as a “per minute” carrier common line charge, to make it a “per line” carrier charge. (AT&T Brief at 15). AT&T contends that this “made complete sense” at the time (*id.*) - in other words, it operated to AT&T’s financial advantage when AT&T’s access minutes were increasing faster than the number of lines. Now that AT&T’s own access minutes are apparently shrinking faster than the number of lines, it is not to AT&T’s financial advantage to have a per-line charge, but this is the risk AT&T took when advocating for such a pricing structure at the time of the *Global Order*.

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<sup>28</sup> See VZ St. 1.1 Remand, Kane/Dean Exhibit 1 (AT&T Response to OCA Set I, No. 1 and attached affidavit of John C. Polumbo, ¶¶ 9 and 17).

<sup>29</sup> *Id.* at 30.

In sum, AT&T's quibbles with Verizon's compliance with the Phase I order are nothing but baseless attempts to secure further access reductions without the statutorily required revenue neutral offsets, and should be rejected.

**E. The Parties' Arguments Regarding Verizon's Cost Of Service Are Wrong, And Calculated Only To Advance Their Own Agendas**

**1. The IXCs Argue For Below-Cost Access Rates**

As Verizon explained in detail in Phase I, the "cost" of access is of limited relevance only to define the "price floor," and even in an increasingly competitive market it is reasonable to expect carrier access charges to continue to defray at least some portion of the ILEC's unique costs of providing ubiquitous availability and universal service. (VZ Phase I Main Brief at 45-48). The IXCs continue to argue that the Commission should view the "cost" of providing access to be lower than depicted in Verizon's access cost study, and AT&T and MCI argue that the Commission should use unbundled network element ("UNE") rates to estimate these costs. AT&T argues that Verizon is "over-recovering" for the service of providing access to IXCs because its rates are not priced under TELRIC. (AT&T Brief at 6). MCI argues that UNE rates are the "best evidence" of cost.

Verizon has already explained that the specialized "TELRIC" pricing methodology that the IXCs try to use here does not apply to access charges, and that the FCC has consistently rejected their attempts to price access on that basis. (VZ Phase I Main Brief at 47-48; Verizon Phase II Main Brief at 32-35).

AT&T's contention that "exchange access and comparable UNEs are the same functionality and have the same underlying costs" misses the point. (AT&T Brief at 20). As Verizon has explained, TELRIC is a specialized methodology that calculates rates based on "hypothetical" costs for the specific purpose of encouraging competitors to use UNEs,

and as the D.C. Circuit Court of Appeals has recognized, TELRIC costs do not reflect Verizon's actual historic costs of providing service.<sup>30</sup> Even the FCC has recognized that "critics argue that the TELRIC methodology is flawed due to an alleged emphasis on unrealistic efficiency assumptions," which "result in rates that are so far below an incumbent LEC's 'actual' costs that neither incumbent LECs nor competitive LECs have an incentive to invest in new facilities," and has set out to revise the TELRIC rules.<sup>31</sup>

Accordingly, there is no basis to assume that the "cost floor" of providing access is the TELRIC rate for comparable services, or to price access at hypothetical TELRIC rates.

## **2. OCA Underestimates The True Cost Of Providing Basic Local Service**

OCA contends that Verizon's cost study demonstrating that the cost of providing local residential service is **[BEGIN VERIZON PROPRIETARY]** **[END VERIZON PROPRIETARY]** for Verizon PA and Verizon North respectively is "extremely high," and suggests that Verizon's costs are actually lower. (OCA Brief at 31-32). OCA attempts to understate the cost of providing local service to argue that local service rates are not as far below-cost as they appear to be. As Verizon explained in Phase I, however, the sources that OCA relies upon to estimate costs of providing basic service are not appropriately used for this purpose. For example, the federal universal service figures OCA cites are for another purpose entirely, and are based on outdated and understated historical labor cost estimates and exclude certain retail costs, such as marketing and customer support. (Verizon Phase I Main Brief at 51). The only party that has provided a

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<sup>30</sup> *United States Telecom Assoc. v. FCC*, 359 F.3d 554, 562 (D.C. Cir. 2004).

<sup>31</sup> *In the Matter of Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers*, WC Docket No. 03-173, 18 FCC Rcd 18945; 2003 FCC LEXIS 5027 (Rel. September 15, 2003) ("TELRIC NPRM") ¶ 5.

cost study of the cost of providing basic local service is Verizon, and Verizon's cost study is the best evidence of such costs.

### III. CONCLUSION

For the foregoing reasons, the Commission should not require any further access rebalancing now, pending the outcome of the FCC's intercarrier compensation proceeding.

  
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William B. Petersen  
Suzan DeBusk Paiva  
1717 Arch Street, 10W  
Philadelphia, PA 19103  
Phone (215) 466-4755  
Fax (215) 563-2658  
[william.b.petersen@verizon.com](mailto:william.b.petersen@verizon.com)  
[Suzan.d.paiva@verizon.com](mailto:Suzan.d.paiva@verizon.com)

Counsel for Verizon  
Pennsylvania Inc. and  
Verizon North Inc.

Date: August 31, 2005