

COMMONWEALTH OF PENNSYLVANIA



OFFICE OF CONSUMER ADVOCATE

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ORIGINAL

February 18, 2003

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

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Re: In re the Joint Application of Bell Atlantic Corporation and GTE Corporation for Approval of Agreement and Plan of Merger Docket Nos. A-310200F0002; A-311350F0002; A-310222F0002 and A-310291F0003
Access Charge Investigation per Global Order of September 30, 1999,
Docket Nos. P-00991648, P-00991649, M-00021596 and
AT&T Communications of Pennsylvania, Inc. v. Verizon North Inc.,
Docket No. C-20027195

Dear Secretary McNulty:

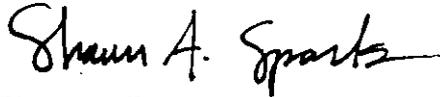
Enclosed please find for filing an original and fifteen (15) copies of the Office of Consumer Advocate's Comments in the above-captioned proceeding.

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

Sincerely,



Shaun A. Sparks
Assistant Consumer Advocate

Enclosures

cc: All parties of record

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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 Nos. A-310200F0002, : A-311350F0002, A-310222F0002, : A-310291F0003 :
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AT&T Communications of Pennsylvania, Inc. v. Verizon North Inc.	: : : Docket No. C-20027195 :

COMMENTS OF THE OFFICE OF CONSUMER ADVOCATE

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MAR 06 2003

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Dated: February 18, 2003

I. INTRODUCTION

The Office of Consumer Advocate ("OCA") submits these Comments in response to the above-referenced Petition. The OCA requests that the Commission deny that Petition for all the following reasons.

II. SUMMARY

With the advent of telephone competition after the passage of the Telecommunications Act of 1996, Pennsylvania's two largest local service providers, Bell Atlantic-Pennsylvania, Inc. (now Verizon Pennsylvania, Inc.) and GTE North, Inc. (now Verizon North, Inc.), opted to merge rather than engage in head-to-head competition. As part of the regulatory review of that merger, and as a condition of the approval of that merger, the two companies agreed to initiate a proceeding to develop access charge parity based on consolidated cost studies within thirty months of the merger closing.¹ The merger was approved by the Pennsylvania Public Utility Commission ("PUC") on November 4, 1999.²

On December 30, 2002, Verizon Pennsylvania Inc., and Verizon North Inc. ("VPA" and "VN," respectively; jointly "Verizon"), filed a Petition ("Petition") wherein those two companies submitted a unilateral Petition that this Commission should approve access rate reductions and local service increases regarding VPA and VN. In that Petition, VPA and VN offer several scenarios through which VN, and to a lesser extent VPA, will reduce the access fees it charges to toll providers that use the Verizon network to either initiate or terminate calls on the VN network. The Petition then seeks to recover all access reductions on a dollar-for-dollar basis

1. Joint Application of Bell Atlantic Corporation and GTE Corporation for Approval of Agreement and Plan of Merger, Docket Nos. A-310200F002 et al, Opinion and Order at 36 (November 4, 1999) ("Merger Order").

2. Id.

via increases in the local monthly service rates of VN and VPA. This necessarily causes the VPA local service customers to pay for most of the VN access rate reductions.

As an initial matter, the OCA objects to any characterization of the Petition as a settlement agreement. This Petition is in fact the opposite; it is a unilateral Petition on the part of Verizon Pennsylvania, Inc. and Verizon North, Inc. – two parts of the same corporation. The Petition is deficient in a great many ways and should be rejected outright by this Commission.

Regardless of the theoretical effects this change may have on toll services, the immediate and tangible effect of this revenue neutral rate rebalancing simply is that the monthly local service costs charged to VPA and VN customers will increase. While the Petition is not clear as to the *exact* amount of the rates it proposes under its various scenarios, the local rate increases will be substantial.³ The Office of Consumer Advocate opposes this Petition because of its unjustified, unsupported local rate increases, and requests that the Commission deny this Petition. These rate increases would not comply with the statutory provisions at 66 Pa. C.S. § 1325, and, to the extent they are proposed to begin in 2003, would violate applicable rate freezes.

The OCA recognizes that VN and VPA are required to seek access rate parity pursuant to their merger order. The OCA also does not object to access rate reductions as a means of achieving that parity. The OCA strongly objects, however to Verizon's proposal to increase basic local service rates for both VN and VPA customers in order to offset those access reductions on a dollar-for-dollar basis.

In support of its position, the OCA submits the following bases on which the Commission should deny the Petition of VPA and VN.

3. Verizon has attached to its Petition the proprietary Attachments B and C. These Attachments disclose the full effect of the rate increases under certain scenarios, but are not publicly available. It is important to recognize that under one scenario greater access reductions are proposed that would require decreases in the access rates of both VPA and VN.

III. COMMENTS

A. Verizon Cannot Be Compared To The Companies Of The RTCC For The Purpose Of Justifying Verizon's Proposed Access Reforms.

Here, Gulliver masquerades as a Lilliputian. Verizon alleges that it merely seeks the same access reform as the Rural Telephone Company Coalition ("RTCC"). For the purposes of local access reform, a global mega-corporation like Verizon cannot justifiably compare itself to entities that serve only 1,000 or 2,000 customers. This access reform Petition suggests that Verizon is just like "every other ILEC in Pennsylvania." This statement is certainly incorrect.

As a provider of local telephone service, Verizon is a gargantuan enterprise, and it is not normally hesitant to tout its global scale. On its website, Verizon states that it:

*is one of the world's leading providers of communications services. Verizon companies are the largest providers of wireline and wireless communications in the United States, with 135.0 million access line equivalents and 31.5 million Verizon Wireless customers. Verizon is also the largest directory publisher in the world. With more than \$67 billion in annual revenues and more than 236,000 employees, Verizon's global presence extends to more than 35 countries in the Americas, Europe, Asia and the Pacific.*⁴

In addition, Verizon's website announces that it is the third-largest provider of long distance services in the United States.⁵ The Commission should therefore take a dim view of Verizon's self-serving comparison to the RTCC companies for the purposes of access reform.

Verizon cannot seriously contend that the Commission should view it in the same light as the Pymatuning Independent Telephone Company or the Yukon Waltz Telephone Company for the purposes of access reform. Simply put, the member companies of the RTCC

4. News release, Verizon, Verizon now third largest long-distance company, available at <http://newscenter.verizon.com/proactive/newsroom/release.vtml?id=78494> (January 7, 2003).

5. Id.

lack the options and resources of Verizon when faced with the question of access reform. VPA and VN, on the other hand, serve the largest number of customers and urban areas in the Commonwealth by a substantial margin. The Commission should simply identify Verizon's comparison as having no basis in reality.

In regard to Pennsylvania's telephone consumers, what is good for the RTCC is not necessarily good for Verizon. The RTCC seeks to reduce its access charges, and it is in possession of far fewer options to do so than Verizon. Verizon's Pennsylvania customers number in the millions. That huge customer base reduces Verizon's average costs and provides a multitude of options regarding access reform.

While Verizon couches its request in terms of equal treatment, Verizon knows that large telecommunications providers, such as itself, are regulated under a very different regulatory scheme compared to small providers. For example, section 251(f) of the Telecommunications Act of 1996 creates additional requirements before small rural companies must face certain forms of competition. In addition, Pennsylvania's Chapter 30 makes numerous distinctions between those companies that are smaller than 50,000 and larger than 250,000 access lines.⁶ Therefore, in practical and in legal terms, Verizon and the RTCC companies are simply not alike; the Commission must not treat Verizon as if it were just another ILEC. The Verizon companies are unique within Pennsylvania and the Nation. "Verizon companies are the largest providers of wireline and wireless communications in the United States." The Commission should recognize that Verizon is unique; it is unlike any other ILEC. The Commission should afford the Verizon companies the treatment deserving of the largest provider of telecommunications services in Pennsylvania and the Nation. The Verizon Petition must

6. See, e.g., 66 Pa. C.S. § 3006.

stand or fall on its own merits, not on the basis of a comparison to the Petition filed by Companies that are a minuscule fraction of Verizon's size.

B. VPA And VN Are Prohibited From Increasing Local Service Rates Through December 2003.

The Petition states that Verizon seeks to achieve access reform through an increase to the local service rates of VPA and VN customers. It is not clear from the Petition the point in time at which those local rate increases would begin. The Commission cannot allow those increases to take effect within 2003 because that would violate the VPA and VN merger commitments. In the Merger Order, the Commission determined that VPA's rates for protected services cannot increase until December 31, 2003.⁷ Therefore, VPA cannot raise its rates for protected services for any reason until after that time. In addition, the Commission specifically stated that "[t]here shall be no increases to BA-PA's protected services for the purpose of offsetting or recovering the reduction of switched access or toll rates charged by BA-PA, prior to December 31, 2003."⁸ Therefore, VPA is precluded from raising rates for the purpose of access reform before that time. In addition, if VPA cannot raise its rates for its own purposes, it cannot raise the rates on its protected services for the benefit of a different company, i.e. VN.

To the extent that the Petition is a request to recover access reductions directly from their customers within the calendar year of 2003, the Commission should also deny that request because granting it would allow VPA to violate its merger commitments as well. In

7. Joint Application of Bell Atlantic Corporation and GTE Corporation for Approval of Agreement and Plan of Merger, Docket Nos. A-310200F0002 et al., Opinion and Order at 18, 33 (November 4, 1999) ("Merger Order").

8. In re: Nextlink Pennsylvania, Inc., 196 PUR 4th 172, 258 (Pa.P.U.C. Sep. 30, 1999), affirmed Bell-Atlantic Pennsylvania, Inc. v. Pennsylvania Public Utility Comm'n., 763 A.2d 440 (Pa. Cmwlth.Ct. 2000), reargument denied (Jan. 5, 2001), appeal on other grounds pending 1 EAP 2002 (Pa.Supreme Ct.) ("Global Order").

addition to any requirements that were established as part of the Global Order, the Merger Order directs that the rates of VPA be capped through December 31, 2003.⁹ In addition, the Commission specifically referenced the Global Order rate cap in the Merger Order.¹⁰

Under the Merger Order and the Global Order, VPA and VN are free to make access reductions as they see fit. Under the Merger Order and the Global Order, however, VPA is prohibited from increasing the local rates of their customers until after December 31, 2003. Until that date, therefore, that company cannot recoup access reductions as a charge against their local service customers. For that reason alone, the Commission should deny the Petition.

If VN were to increase its basic residential local exchange service rates it would also be in violation of its commitments in the Memorandum of Understanding ("MOU") concerning the VPA and VN merger. The MOU provides that 1) VN's current basic local service charges are capped until December 31, 2003, 2) VN will reduce its rates for basic local service within comparable density cells by \$5 million, and 3) those reductions required in (2) must remain in effect until December 31, 2003.¹¹ Therefore, VN is not only prohibited from increasing its rates until December 31, 2003, it, in fact, was required to reduce those rates and keep the reduction in place until December 31, 2003.¹² In accordance with the MOU

9. Joint Application of Bell Atlantic Corporation and GTE Corporation for Approval of Agreement and Plan of Merger, Docket Nos. A-310200F0002 et al.; Opinion and Order at 18-19, 33 (November 4, 1999) ("Merger Order") at 18-19, 33.

10. Merger Order at 32.

11. Memorandum of Understanding among Bell Atlantic-Pennsylvania, Inc., GTE North, Inc., and the Attorney General of Pennsylvania, ¶ 1, July 29, 1999.

12. See infra note 14. VN did meet the requirements of (2) in July of 2002.

commitment, VN is not permitted to increase its local rates. The OCA submits that the Commission should not allow it to do so through this Petition.

At the time that VN reduced its basic local service within comparable density cells by \$5 million, it produced a press release touting that reduction as a benefit of the merger.¹³ There, Verizon stated that “[t]his rate reduction and streamlining is the latest in a series of benefits Verizon customers have enjoyed since the merger’s completion two years ago. Verizon also has...[c]apped residential rates for basic local service through 2003.”¹⁴ It is plain from the language of that press release that the rate reduction and freeze was one of the most significant benefits that the MOU and the Merger Order sought to bring Pennsylvania consumers: lower prices for local telephone service. That is attached as press release Appendix A. To the extent that the current Verizon Petition seeks to raise rates prior to January 1, 2004, it cannot be permitted.

C. VPA And VN Have Not Supported The Local Rate Increases And They Have Failed To File Cost Studies In Conformity With Section 1325 Of Public Utility Code.

The Commission must deny the Petition because VN and VPA have not complied with section 1325 of the Public Utility Code. They have not filed the necessary cost studies in this proceeding.¹⁵ The Commission must therefore deny the Petition of VPA and VN because it fails on its face to comply with Section 1325.

13. Press release, Verizon, Verizon Reduces Rate by \$5 Million for Former GTE Customers in Pennsylvania, July 23, 2002, available at <http://newscenter.verizon.com/proactive/newsroom/release.vtml?id=77391> (February 10, 2003).

14. Id.

15. The cost studies that VPA and VN have filed deal only with access service, and do not encompass the scope of the cost studies required under Section 1325.

Section 1325 of the Public Utility Code limits increases in local exchange service rates, and requires utilities to file certain cost studies where local rate increases are sought.¹⁶

Section 1325 provides:

(a) General rule.--In any rate proceeding pursuant to section 1308 (relating to voluntary changes in rates), no public utility shall be granted a percentage increase in local exchange service unless that percentage increase is just and reasonable. In no event shall the public utility be granted an increase in local exchange rates which is greater than the overall average percentage increase in total intrastate revenues authorized by the commission unless the utility proves by record evidence that a greater percentage increase for local exchange service is justified based upon the cost of providing that service.

(b) Generic studies permitted.--The commission, after notice and hearing, may promulgate regulations setting forth appropriate methods of calculating the stand-alone costs of telecommunication services.

(c) Definitions.--As used in this section the following words and phrases shall have the meanings given to them in this subsection:

"Cost of providing local exchange service." The direct cost of providing the service plus a share of the costs of the dial tone line, allocated in proportion to the stand-alone cost of each class of service which utilizes the dial tone line.

"Local exchange service." The intrastate charge for access to the telephone network plus the charge for making calls which originate and terminate within the same calling area.¹⁷

The Commission has determined that Section 1325 applies to revenue neutral rate rebalancing.¹⁸ In fact, the Commission rejected Verizon's prior attempt to engage in revenue neutral access reform in 1996 based on Verizon's non-compliance with Section 1325. The Recommended Decision and Opinion and Order rejecting that rate increase request are attached

16. Pennsylvania Public Utility Commission et al v. Bell Atlantic – Pennsylvania, Inc., Docket No. R-00963550, Opinion and Order at 23-24 (December 16, 1996).

17. 66 Pa.C.S. § 1325 (emphasis added).

18. Pennsylvania Public Utility Commission v. Bell Atlantic-Pennsylvania, Inc., Docket Nos. R-00963556 et al., Opinion and Order at 24 (December 16, 1996).

to these comments as Appendix B. The Commission should reject the Petition under the precedent of that 1996 case.

In that case Bell sought to “restructure and rebalance its Residential , Local and Toll Service rates, Business Local and Toll Service rates and Switched Access rates on an allegedly revenue neutral basis.”¹⁹ The ALJ decided, and the Commission affirmed, that “[s]ection 1325 does apply to Bell’s rate rebalancing filing. As set forth in Section 1325(a), this statute applies to ‘any rate proceeding pursuant to section 1308 (relating to voluntary changes in rates).’ 66 Pa. C.S. §1325(a) (Emphasis added.) The statute is clearly applicable in this case.”²⁰

While the Petition affects rates differently than the 1996 rate rebalancing, it is an identical proceeding in terms of the applicable requirements. Section 1325 requires Verizon to submit certain cost studies in support of its request to increase local service rates. The Commission should reject the Petition because Verizon has not provided those studies.

In addition, information concerning the cost studies filed by Verizon in response to discovery in this proceeding indicate that the current studies suffer the same flaw as those filed in Verizon’s rejected 1996 filing: current cost studies would improperly allocate local loop costs.

In the January 1996 proceeding, in order to prove that its local exchange rate increases were justified based upon costs associated with providing local exchange service, Bell filed certain types of cost studies. Then, as now, Bell asserted that 100% of the local loop costs

19. Pennsylvania Public Utility Commission v. Bell Atlantic-Pennsylvania, Inc., Docket Nos. R-00963556 et al., Opinion and Order at 2 (December 16, 1996).

20. Id. at 14.

should be assigned to the dial tone component of local exchange service.²¹ The result of that allocation was that Bell caused the costs of local service to appear to be well above the rates that Bell charged for that component of local service. The Commission properly determined that that allocation was absolutely incorrect.²²

Instead, the Commission determined that the correct approach was to allocate the cost of the local loop across all services that used that loop; that is, to treat the loop as a joint and common cost of service.²³ The Commission determined that “the costs associated with dial tone line should be viewed as joint or common costs of those services, and should be allocated across those services instead of being assigned totally to local exchange service, as Bell asserted.”²⁴ The Commission also found that Section 1325 directs that the costs of the dial tone line are “shared costs, and requires that only a portion of these costs be allocated to local exchange service.”²⁵ The Commission added that “[t]he only reasonable and proper conclusion in light of the language of section 1325(c) is that dial tone line must be treated as a component of multiple services whose costs must be allocated among these services and not as a separate service.”²⁶ The Commission added that “because Bell has steadfastly maintained that dial tone line is a separate service, the Company cannot justify its proposed rate increase in view of the statutory

21 Pennsylvania Public Utility Commission v. Bell Atlantic-Pennsylvania, Inc., Docket Nos. R-00963556 et al., Recommended Decision at 11-12 (October 8, 1996), affirmed, (December 16, 1996).

22. Id. at 11.

23. Id.

24. Id. at 12.

25. Id. at 13.

26. Id. At 15.

definition. In other words, Bell's position is inconsistent with the language of section 1325(c)."²⁷

The Commonwealth Court has also affirmed the Commission's Global Order decision where it continued to require access services to pay some portion of local loop costs.²⁸

As Commonwealth Court stated:

The record here confirms the soundness of the PUC's view, 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 a total network.²⁹

That fatal flaw, the misallocation of local loop costs, is common to both the current Verizon Petition and the 1996 rate rebalancing filing. In the 1996 filing, the Commission wrote "[t]hus, while we do not, as 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."³⁰

The Commission must deny the Petition because Verizon openly admits that the Petition asks that the Commission endorse the same misallocation of local loop costs that it rejected in 1996 and in other proceedings. The allocation of loop costs across all services that use the local loop is a central feature of the cost studies that Verizon must file under Section

27. Id.

28. Bell-Atlantic Pennsylvania, Inc. v. Pennsylvania Public Utility Comm'n., 763 A.2d 440, 480 (Pa. Cmwlth.Ct. 2000), *reargument denied* (Jan. 5, 2001), *appeal on other grounds pending* 1 EAP 2002 (Pa. Sup. Ct.).

29. Id. (footnotes omitted).

30. Pennsylvania Public Utility Commission v. Bell Atlantic-Pennsylvania, Inc., Docket Nos. R-00963556 et al., Opinion and Order at 23-24 (December 16, 1996).

1325, as is clear from the discussion of that section above. The Interrogatories of the Office of Trial Staff in the present docket asked Verizon questions as to whether some portion of the cost of the local loop should be recovered through access charges.³¹ In other words, that interrogatory asked Verizon if it was seeking to recover any of the cost of the residential and business customer local loop from access charges, a service that utilizes the local loop. Verizon responded that Verizon "...does not believe that any portion of the cost of the "local loop" should be recovered through access charges. Dial tone line rates should be set to at least cover 100% of the cost of the local loop."³² It is also clear from Verizon's cost study manual that it considers loop costs as a part of access costs where only loops are used exclusively for access traffic.³³

Given the Commission's conclusion relative to that issue in the 1996 case, that allocating 100% of the local loop costs to local service is not the type of cost allocation that Section 1325 permits, the local rate increases that Verizon proposes in the Petition cannot be approved. In the context of increases in local rates, therefore, as long as Verizon chooses to allocate 100% of the costs of the local loop to local service its cost studies cannot be used to comply with Section 1325. Thus, the Commission must reject the proposed rate increase because Verizon has failed to base its rate increase upon a cost study that conforms to Section 1325.

Indeed, it is beyond dispute that the local loop is used to provide many services. Accordingly, loop costs should be recovered from many services. In addition to the prior orders

31. Response of Verizon Pennsylvania Inc. to Set I Interrogatory No. 13 of Office of Trial Staff, Docket No. M0021596 (January 9, 2003).

32. Id.

33. Verizon Cost Methodology and Costing Process Manual for Access Services at 45.

of this Commission, many regulatory commissions consider the loop as a shared, common, or joint cost of many services. The OCA submits that recovery of this common cost must be shared across all services. Verizon, however, incorrectly bases its cost analysis in this case on the assumption that the loop cost must be entirely recovered from only the dial tone line rate component of local exchange service. Verizon has not shown any Pennsylvania regulation, statute, or case that would support such a theory. Verizon's underlying assumption that basic dial tone rates are subsidized is based on this misallocation of costs, and it infects its entire analysis. That misallocation renders its Petition such that the Commission cannot approve it under Pennsylvania law.

This principle that dial tone line costs should be recovered from the many services that use it was the basis upon which the United States Supreme Court required a portion of the dial tone line cost to be recovered from interstate service. In Smith v. Illinois Bell Telephone,³⁴ the Court considered an appeal by the City of Chicago which opposed the assignment of 100% of loop costs to intrastate service. The Court considered how the loop cost must be recovered from both the intrastate and interstate jurisdictions and ruled as follows:

In the method used by the Illinois Company in separating its interstate and intrastate business, for the purpose of the computations which were submitted to the court, what is called exchange property, that is, the property used at the subscriber's station and from that station to the toll switchboard, or to the toll trunk lines, was attributed entirely to the intrastate service.

While the difficulty in making an exact apportionment of the property is apparent, and extreme nicety is not required, only reasonable measures being essential [citations omitted] it is quite another matter to ignore altogether the actual uses to which the property is put. It is obvious that, unless an apportionment is made, the intrastate service to which the exchange property is allocated will bear an undue burden--to what extent is a matter of

34. 282 U.S. 131 (1930).

controversy. We think this subject requires further consideration, to the end that by some practical method the different uses of the property may be recognized and the return properly attributable to the intrastate service may be ascertained accordingly.³⁵

In this way, the United States Supreme Court determined that when interstate services use the dial tone line facility they must also pay for some portion of its cost. This is the same principle from which the OCA argues that Verizon should not be permitted to isolate one aspect of dial tone line facility usage, *i.e.* local exchange service, and require that service to pay for 100% of this facility for the purpose of access reform.

Moreover, the PUC has also recognized the principle that shared usage should lead to shared cost recovery in more than just the Opinion and Order of 1996. In the PUC'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.³⁶

The OCA emphasizes that "an appropriate portion" of loop cost recovery from basic universal service is not 100% recovery from this service. Thus, the way that Verizon states that it allocates costs in the Petition by allocating 100% of loop cost to local Exchange Service is not in agreement with the PUC order on this point.

35. Smith v. Illinois Bell Telephone Co., 282 U.S. 131, 150-51 (1930).

36. Universal Service Investigation, Docket No. I-00940035 at 12 (August 31, 1995).

The OCA emphasizes that dial tone line costs were considered by the PUC as “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” in the Universal Service Order as cited above. In fact, the Commission has looked to the FCC for the definition of what comprises “common costs” and adopted the reasoning of the FCC in its Opinion and Order in the 1996 Bell rate rebalancing case.³⁷ The FCC has also determined that loop costs are common costs for the purposes of unbundling. The FCC has written that:

[t]he term “common costs” refers to costs that are incurred in connection with the production of multiple products or services, and remains unchanged as the relative proportion of those products or services varies (e.g., the salaries of corporate managers). Such costs may be common to all services provided by the firm or common to only a subset of those services or elements. If a cost is common with respect to a subset of services or elements, for example, a firm avoids that cost only by not providing each and every service or element in the subset. For the purpose of our discussion, we refer to joint and common costs as simply common costs unless the distinction is relevant in a particular context.

As discussed in greater detail below, separate telecommunications services are typically provided over shared network facilities, the costs of which may be joint or common with respect to some services. The costs of local loops and their associated line cards in local switches, for example, are common with respect to interstate access service and local exchange service, because once these facilities are installed to provide one service they are able to provide the other at no additional cost.³⁸

Thus, the FCC also considers that the local loop is a joint or common cost.

37. Pennsylvania Public Utility Commission v. Bell Atlantic-Pennsylvania, Inc., Docket Nos. R-00963556 et al., Opinion and Order at 17-18, 23-24 (December 16, 1996).

38. In the Matter of: Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98 at ¶¶ 676, 678 August 8, 1996 (emphasis added).

Current FCC regulations also consider the loop as a joint or common cost of providing many services. The very definition of the loop is as follows:

Subcategory 1.3 -- Subscriber or common lines that are jointly used for local exchange service and exchange access for state and interstate interexchange services (emphasis added).³⁹

The FCC reaffirmed its position regarding the joint and common nature of the loop in a May 1995 decision concerning NYNEX's request for a waiver of the Part 69 access charge rules. In that decision, the Commission stated:

While our jurisdiction extends only to interstate telecommunications services, the joint and common character of the facilities providing exchange access and local exchange service means that the regulatory climate for interstate telecommunications services affects the development of competition in the interstate access market.⁴⁰

Various state commissions have come to similar conclusions. In a decision of the Washington Utilities and Transportation Commission the Washington Commission stated:

The Commission finds . . . that the cost of the local loop is not appropriately included in the incremental cost of local exchange service. The local loop facilities are required for nearly every service provided by the Company to a customer. Neither local service nor in-state long distance service nor interstate long distance nor vertical features can reach a customer without the local loop. Should USWC cease to provide any one of these services, its need for a local loop to provide the remaining services would remain. The cost of the local loop, therefore, is not incremental to any one service. It is a shared cost that should be

39. 47 C.F.R. § 36.154 (emphasis added).

40. In the Matter of NYNEX Telephone Companies Petition for Waiver, 10 FCC Rcd. 7445 at ¶ 39 (May 4, 1995) (emphasis added).

recovered in the rates, but no one service is responsible for that recovery.⁴¹

Also, the Colorado Public Utilities Commission in its cost allocation regulations discussed the manner by which rates should be set in view of cost studies performed for any service.⁴² There, the Colorado Public Utilities Commission Colorado regulations stated:

As an example, consider the access loop. The access loop is not a separate service but rather is an input necessary for the provision of many telecommunications services. As such, costs associated with the access loop will not appear in the total service long run incremental cost of any single service requiring the access loop but will appear as part of the total service long run incremental cost of the entire group of services requiring the loop. Consequently, prices must be set so that the sum of the revenues from all services requiring the access loop covers not only the sum of the total service long run incremental costs for the individual services but also the shared cost of the loop.⁴³

The Florida Public Service Commission also ruled as follows:

Upon consideration, we must reject the proposition that no NTS costs should be recovered from access charges. We agree with Quincy, Sprint, FACT and Public Counsel's arguments on this issue. Further, we believe that the IXCs, through their respective toll customers, benefit from the existence of the local network and that they should make a contribution towards its support.

As we stated in Order No. 12265, in response to previous attempts to persuade us to accept the "no NTS" position, "The notion that an IXC should pay nothing for the subscriber loop because its use does not impose additional costs on the LEC is ill founded and contrary to common business practice, which is to charge

41. Washington Utilities and Transportation Commission v. US West Communications, Inc., Docket No. UT-950200, 169 PUR4th 417, 476-77 April 11, 1996 ("US West") (emphasis added).

42. 4 CCR 723-30, Rule 4(2)(a)(iii).

43. 4 CCR 723-30, Rule 4(2)(a)(iii).

customers for use of fixed cost facilities in the price for goods and services." It is appropriate that each service provide some contribution toward the fixed costs common to those services.⁴⁴

The Missouri Public Service Commission at the time of the AT&T/Bell divestiture also rejected Petitions to implement subscriber line charges on the basis that the loop is a shared costs and a subscriber line charge would merely be shifting toll costs to local service rates. In that Order the Missouri Public Service Commission stated:

The Commission, having considered the various arguments of the parties, is persuaded, and finds, that the cost of a local loop can arise from a demand for local and/or long-distance service. Therefore, local loop costs should properly be recovered through contributions from at least three services: local exchange, carrier access and toll. The local loop has no value to any customer, unless other customers are connected. The loop is in place to satisfy customers' demands for both long-distance and local service. This Commission finds and concludes that the local loop now gives a telephone subscriber access to an integrated telephone network which includes local exchange capabilities, and interstate and intrastate long distance (toll) capabilities as well. Since both local exchange service and toll service make use of the local loop, both services should contribute to the cost of the local loop.⁴⁵

These cases make very clear that the local loop does not represent a cost which should be assigned 100% to local exchange service. Therefore, the Commission should deny the Petition because the Petition does not contain cost studies that comply with section 1325 of the Public Utility Code.

D. The Commission Is Under No Obligation To Allow VPA And VN To Engage In Revenue Neutral Rate Rebalancing Of The Type Proposed In The Petition.

44. Re: Investigation into Nontraffic-Sensitive Cost Recovery, Docket No. 860984-TP, Order No. 18598, Fla. PSC, 89 PUR4th 258, 265-66 (1987).

45. Re: Southwestern Bell Telephone Company, Case Nos. TR-83-253 and TR-83-288, 26 MO.P.S.C. (N.S.) 344, 381 (1983).

In the introductory section of its Petition, VPA and VN state that the Petition should be granted in part because "...the Commission has explicitly recognized that Verizon's Petition for statewide access rates should also be revenue neutral."⁴⁶ Verizon's statement is incorrect. When asked to justify this statement, through interrogatories, Verizon responded: "See the Bell Atlantic/GTE Merger Docket...at page 36. See also the Global Order Docket...at page 60."⁴⁷ The portion of the Merger Order that Verizon uses to support its statement provides that "[n]othing in the MOU purports to prohibit BA-PA and GTE North from arguing in this combined proceeding that any reductions that the Commission orders should be implemented on a revenue neutral basis."⁴⁸ Clearly, a Commission statement that there is no prohibition against making an argument is a far cry from the "explicit" recognition that Verizon imputes to the Commission's statement.

Next, Verizon's response points to the Commission's Global Order to justify its assertion that the Commission has "explicitly recognized" that Verizon's Petition should be revenue neutral.⁴⁹ At the section of the Global Order cited in support of Verizon's statement the Commission wrote that it would "...consider the appropriateness of a toll line charge (TLC) to

46. In re the Joint Applications of Bell Atlantic Corporation and GTE Corporation for Approval of Agreement and Plan of Merger, Docket Nos. A-310200F002, A-311350F002, A-310291F003; Access Charge Investigation per Global Order of September 30, 1999, Docket Nos. P-00991648, P-00991649, M-00021596; and AT&T Communications of Pennsylvania, Inc. v. Verizon North Inc., Docket No. C-20027195, Joint Petition of Verizon Pennsylvania Inc. and Verizon North Inc. Regarding Access Rate Reform at 1 (December 30, 2002).

47. Response of Verizon Pennsylvania Inc. to Set I Interrogatory No. 1 of Office of Trial Staff, Docket No. M0021596 (January 9, 2003).

48. Merger Order at 36 (emphasis added).

49. Response of Verizon Pennsylvania Inc. to Set I Interrogatory No. 1 of Office of Trial Staff, Docket No. M0021596 (January 9, 2003).

recover any resulting reductions [from its access investigation].”⁵⁰ Again, considering whether the addition of a TLC surcharge is appropriate is clearly not a blanket endorsement of substantial local rate increases to offset access reductions on a dollar for dollar basis.

Moreover, the OCA submits that a local rate increase not the first option that the Commission should consider in the context of Verizon’s access reform. In this context, for example, it would be more suitable for VN to cover its access rate reductions by simply recovering those reductions out of their excess earnings. According to the most recent PUC quarterly earnings reports, Verizon North reported an equity return of 15.84% for the period ending in the fourth quarter of 2001 and 13.60% on the second quarter of 2002.⁵¹ The OCA does not oppose VN access reductions in order to achieve parity with VPA access rates, but OCA does oppose the related increase in local service rates. While VN profit levels are not considered in the context of VN’s annual Chapter 30 price filings, the OCA submits that it may be appropriate to consider such factors in this proceeding. Again, while VN and VPA were required to bring their access charges into parity by the merger order and while the companies were permitted to argue that such reductions should be done on a revenue neutral basis, there is nothing in the Order that mandates VN or VPA local service consumers to pay for those access reductions through increased rates.

E. The Customers Of VPA Cannot Be Made To Support The Access Charge Reductions Sought By VN.

It appears that the type of rate rebalancing contemplated by Verizon in the attachments to the Petition would require VPA customers to pay for much of the VN access rate

50. Global Order at 60.

51. Pennsylvania Public Utility Commission, Bureau of Fixed Utility Services Report on the Quarterly Earnings of Jurisdictional Utilities for the period ended September 30, 2002 at Attachment A, Pg. 3.

reductions through local rate increases. Even now that the merger is complete, VPA and VN are still operating as two separate companies. As a result, the customers of VPA cannot be made to pay for the access charge reductions of VN. VN cannot charge higher fees to the customers of VPA without providing any services to those customers. Any Petition that contemplates charging customers for no service rendered would violate section 1301 in that it is impossible that those charges could be just or reasonable.

In addition, to allow VN to assess fees on the customers of VPA would violate the market basket restrictions established by the VPA (Bell Atlantic-Pennsylvania) Chapter 30 filing. In a March 1, 1996 Opinion and Order the Commission wrote:

Under the market Basket Concept, Bell is permitted to propose revenue neutral adjustments within each market basket of services. In addition, to the extent that there are rational reasons why revenue neutral adjustments cannot be confined to those market baskets from a public policy standpoint, Bell may be permitted to also propose revenue neutral changes between market baskets.⁵²

In the December 16, 1996 rate rebalancing Opinion and Order, the Commission stated that "rational reasons" were those that demonstrated "why such a restriction [on cross-market basket rate rebalancing] is not feasible or advisable from a public policy standpoint."⁵³ Bell's arguments in that case included: 1) that dial tone line costs are not joint or shared costs, 2) the allocation of dial tone line costs to other services is illogical, 3) that as policy matter, the allocation of dial tone line costs to other services will encourage cross-subsidy among customers and customer classes, and 4) that the discussion surrounding the proper allocation of loop costs is

52. Public Utility Commission v. Bell Atlantic-Pennsylvania, Inc., Docket Nos. R-00963556 et al., Opinion and Order at 2 (March 1, 1996).

53. Public Utility Commission v. Bell Atlantic-Pennsylvania, Inc., Docket Nos. R-00963556 et al., Opinion and Order at 22-23 (December 16, 1996).

actually an argument over the proper recovery of those costs.⁵⁴ The Commission found none of these reasons to be rational.⁵⁵ The Commission wrote:

[i]n the Alternative Regulation Order, Ordering Paragraph No. 7, Bell was given the opportunity to propose revenue neutral "cross" market basket proposals to the extent it provided rational reasons, i.e. reasons why such a restriction is not feasible or advisable from a public policy standpoint. In this proceeding, we conclude that Bell has not met its burden of demonstrating any rational reasons for us to permit the Company to cross market baskets.⁵⁶

Thus, if those reasons were not compelling for Bell to rate rebalance between its own market baskets, they would not be compelling to justify increases in VPA's local service rates for the benefit of rate rebalancing within a separate operating company, i.e. VN. Thus, the market basket restriction is enough to prevent VPA local service ratepayers from paying for the access reductions of VN.

Regardless of the legal justifications for not allowing VN to assess charges against the customers of VPA, the Petition is wrong-minded simply as a matter of fairness. It would be inequitable to the customers of VPA if the Commission were to allow VPA local rates to increase in order to reduce the access rates of VN. While the OCA agrees that it may be appropriate and advantageous for VN and VPA to consolidate their operating companies and finally function as one public utility, they have chosen not to take that step. Instead, they have selectively chosen to tap in to the vast revenues already paid by VPA local service customers in order to offset some of the reduction in VN access charges. VN and VPA continue to operate

54. Id. at 21-22.

55. Id. at 22-23.

56. Id. at 23.

under separate Chapter 30 Alternative Regulation Plans – neither of those plans allows revenue neutral rate rebalancing revenues to flow from VN to VPA, as Verizon is proposing here.

Again, the OCA does not believe these access reductions should be paid for by VN customers either. Rather, those reductions should be paid for from VN's existing profits.

F. The Procedure Verizon Proposes Violates Due Process Requirements Because It Does Not Provide Adequate Notice Of A Rate Increase.

The Pennsylvania Supreme Court has determined that utility customers are entitled to certain due process guarantees in regard to utility rate increases.⁵⁷ The Commonwealth Court has written that “[a]s an administrative body, the Commission is bound by the requirements of due process. Due process requires that ratepayers have notice of a proposed increase in their rates and a meaningful opportunity to respond to the Petition.”⁵⁸ Simply filing a Petition offering a range of categories and potential increases does not give the notice that is due to consumers in a contested proceeding.

OCA emphasizes that when VPA filed its rate rebalancing case in 1996, it provided detailed notice on a nonproprietary basis concerning the extent to which it sought to increase rates in order to accomplish various types of rate reductions. The PUC cited to this notice in its March 1, 1996 Order suspending the proposed rate changes.⁵⁹

57. See Barasch v. Pennsylvania Public Utility Commission, 507 Pa. 561, 493 A.2d 653 (1985).

58. Enron Capital & Trade Resources Corp. v. The Peoples Natural Gas Co., Docket No. R-00973928C0001 at 40 (August 24, 1998)(citations omitted) citing Cohen v. Pennsylvania Public Utility Commission, 468 A.2d 1143 (Pa. Cmwlth. 1983), aff'd sub nom. Barasch v. Pennsylvania Public Utility Commission, 507 Pa. 561, 493 A.2d 653 (1985).

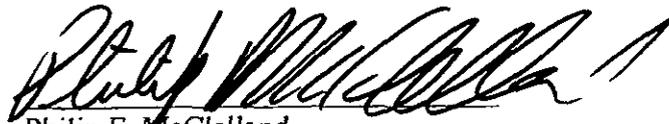
⁵⁹ Public Utility Commission v. Bell Atlantic-Pennsylvania, Inc., Docket Nos. R-00963556 et al., Opinion and Order at 3-8 (March 1, 1996).

Verizon clearly knows the size of any increases that are calculated in the body of the attachments. Those increases must be made public if this rate increase proceeding is to comport with the due process requirements that apply to all rate proceedings.

III. CONCLUSION

For all the foregoing reasons, the Office of Consumer Advocate respectfully requests that the Commission deny the Petition.

Respectfully submitted,



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Dated: February 18, 2003

72273

CERTIFICATE OF SERVICE

Re: In re the Joint Application of Bell Atlantic Corporation and GTE Corporation for Approval of Agreement and Plan of Merger
Docket Nos. A-310200F0002; A-311350F0002; A-310222F0002 and A-310291F0003
Access Charge Investigation per Global Order of September 30, 1999,
Docket Nos. P-00991648, P-00991649, M-00021596 and
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 Comments, 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 18th day of February, 2003.

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ATTACHMENT A

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News Release

Verizon Reduces Rates by \$5 Million For Former GTE Customers in Pennsylvania

Company Simplifies Rate Structure, Creates Consistent Rates Statewide

July 23, 2002

Media contact:
[Lee Gierczynski](#), 412-633-5574
[Sharon Shaffer](#), 215-963-6200

ERIE, Pa. -- The cost of local phone service just went down for more than 500,000 Verizon residential customers in the former GTE service area of Pennsylvania. Customers will see the savings beginning with their Verizon phone bills mailed after July 22.

The decrease ranges from seven cents to \$8.57 per month. In addition, some 125,000 customers will see a slight increase in their monthly bill, with half of them seeing an increase of less than 50 cents per month. Customers' rate changes will depend on the type of calling plan they subscribe to and their rate group classification.

The rate cut amounts to a \$5 million decrease statewide and fulfills a commitment made in Pennsylvania by GTE and Bell Atlantic when the companies merged two years ago to form Verizon. The company pledged to reduce residential rates in the former GTE service area and to streamline the former GTE rate structure in Pennsylvania to mirror that of Bell Atlantic.

"Our goal was to ensure that all our Pennsylvania residential customers' basic rates matched as closely as possible," said Daniel J. Whelan, president and CEO of Verizon Pennsylvania. "With these changes, all Verizon customers in similarly sized local calling areas throughout the commonwealth are paying similar rates for basic phone service."

To satisfy its merger commitment, Verizon eliminated certain charges and realigned the rate structure and rate group classifications for all former GTE customers. The company consolidated 18 rate groups into three and re-classified the rate groups for its telephone exchanges to reflect the number of phone lines in a particular exchange's local calling area. The changes affected former GTE customers throughout the state, including those in Emmaus, Erie, Franklin, Hershey, Johnstown, Oil City, Somerset and York.

More than 80 percent of residential customers will see a decrease in their monthly basic local rates. More than 60 percent of the decreases will be between \$1 and \$2 per month. Eighteen percent of residential customers will experience a modest increase based on their new rate group categories. The increase ranges from four cents to \$2.44 per month.

"We're making sure that rates reflect the number of telephone lines in customers' local calling areas -- some of which have grown significantly over the years," said Whelan. "With the vast majority of customers seeing

email

password

a decrease as a result of these changes, customers will benefit from a more accurate reflection of their local calling areas."

Verizon will continue to provide several existing optional local calling plans *only to those customers who currently subscribe to a plan and remain at their present location*. Those plans include Basic Calling, Community Calling, Community Plus, Premium Calling and Unlimited with Measured.

In addition, Verizon will convert existing two- and four-party customers to individual dial-tone service over the next year in the former GTE service area. The company is eliminating party-line service because of the inability to provide state-of-the-art emergency 911 service and the inability of these customers to obtain modern telecommunications features and services.

This rate reduction and streamlining is the latest in a series of benefits *Verizon customers have enjoyed since the merger's completion two years ago*. Verizon also has:

- Extended the availability of several popular calling services to 100 percent of its customers;
- Introduced two new options for limited-income households;
- Eliminated the monthly Touch-Calling charge paid by former GTE customers in Pennsylvania, and
- Capped residential rates for basic local service through 2003.

Verizon Communications (NYSE:VZ) is one of the world's leading providers of communications services. Verizon companies are the largest providers of wireline and wireless communications in the United States, with 133.8 million access line equivalents and approximately 29.6 million wireless customers. Verizon is also the largest directory publisher in the world. With more than \$67 billion in annual revenues and nearly 248,000 employees, Verizon's global presence extends to more than 40 countries in the Americas, Europe, Asia and the Pacific. For more information on Verizon, visit www.verizon.com.

####

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ATTACHMENT B

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission	:	Docket Nos.
	:	R-00963556
	:	R-00963556
AT&T Communications of Pennsylvania, Inc.	:	R-00963550C0001
Office of Consumer Advocate	:	R-00963550C0002
Central Atlantic Payphone Association	:	R-00963550C0003
Kurt Richter	:	R-00963550C0004
Joseph A. Henchy	:	R-00963550C0005
John D. Lewis	:	C-00967866
and	:	
Office of Small Business Advocate,	:	
Pennsylvania Cable Television Association	:	
MCI Telecommunications Corporation	:	
Intervenors	:	
v.	:	
Bell Atlantic-Pennsylvania, Inc.:	:	

DOCUMENT
FOLDER

DOCKETED
OCT 16 1996

RECOMMENDED DECISION

Before
Louis G. Cocheres
Administrative Law Judge

October 8, 1996

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I. HISTORY OF THE PROCEEDING

On January 10, 1996, Bell Atlantic - Pennsylvania, Inc. ("Bell" or "Company" hereafter) filed revisions to its tariffs: Telephone Pa. P.U.C. Nos. 1, 1A, 180A, 182, 182A, 185B, 185C, 296 and 302, to become effective on March 17, 1996 (alternately "Rate Rebalancing Filing").¹ Bell's filing was made pursuant to Section 1308(b) of the Public Utility Code, 66 Pa.C.S. §1308(b). The filing proposed to restructure and rebalance Bell's Residential, Local and Toll Service rates, Business Local and Toll Service rates and Switched Access rates on a revenue neutral basis. Bell's tariff filing, as proposed, would result in an increase of approximately \$41,598,000 to the protected residential service rates class.

On January 16, 1996, Bell also filed revisions to its Local Tariff-Telephone Pa. P.U.C. 1. This tariff filing was docketed at No. R-00963556 and proposed to establish a late payment charge for residential customers, proposed to become effective March 17, 1996.

Subsequently, Notices of Appearance, Formal Complaints and Interventions were filed by numerous parties. The active participants to this proceeding were as follows: the Commission's Office of Trial Staff ("OTS"), the Office of Consumer Advocate ("OCA"), the Office of Small Business Advocate ("OSBA"), the Pennsylvania Cable Television Association ("PCTA"), the Central Atlantic Payphone Association ("CAPA"), AT&T Communications of

¹ The procedural history has been adopted, with minor editing, from the recitation of the Office of Consumer Advocate taken from its Main Brief.

Pennsylvania, Inc. ("AT&T"), MCI Telecommunications Corp., Inc. ("MCI"), and John Lewis, an individual customer of Bell. In addition, two customers, Kurt Richter and Joseph A. Henchy, were inactive participants.

By Opinion and Order, entered March 1, 1996, we suspended Bell's Rate Rebalancing filing until September 17, 1996, and instituted an investigation to determine the lawfulness, justness and reasonableness of the proposed tariff changes. In addition, this Commission incorporated by reference the evidentiary record contained in the Universal Service Investigation proceeding, at Docket No. I-00940035, into the record to be developed in this case.

By Opinion and Order, entered March 15, 1996, we suspended Bell's filing to implement a residential late payment charge, at Docket No. R-00963556, and consolidated that proceeding with Bell's Rate Rebalancing filing. We also extended the suspension period concerning the consolidated proceeding for an additional three months, or until December 17, 1996.

On April 1, 1996, a Prehearing Conference was held before presiding Administrative Law Judge ("ALJ") Louis G. Cocheres. A procedural schedule for formal hearings was established at that time and requests for Public Input hearings were presented to the ALJ.

On April 25, 1996, the notice of Public Input hearings was issued. Public Input hearings were scheduled in the following areas of Pennsylvania: Warren (June 24), Sharon (June 25), Uniontown (June 26), Pittsburgh (June 27), Allentown (July 8), Media (July 9), Reading (July 10), and Philadelphia (July 11).

Additional Public Input hearings were held on August 21, 1996, in Harrisburg and State College.

On April 5, 1996, the OCA filed a motion to declare nonproprietary, Bell's cost calculations by wire center. Bell filed a pleading in opposition to the OCA's Motion. By Prehearing Order No. 4 (Order No. 4), dated May 17, 1996, ALJ Cocheres granted the OCA's motion and required that Bell disclose to the public the results of its cost calculation by wire center. The effective date of Prehearing Order No. 4 was stayed until the Commission entertained the following material question:

Does the application of sections 3(45), 251(c) and 252(d)(1) of the Telecommunications Act of 1996 prevent Bell Atlantic-Pennsylvania, Inc. from establishing entitlement to a protective order for proprietary information contained in a wire center cost study (Exhibit RES-100.XLS TOT WC CALC) in accordance with Commission regulations at 52 Pa. Code §5.423(a)?

On June 18, 1996, we entered an Opinion and Order addressing the certified question and continued to classify this information as proprietary. We allowed further briefing on this issue.

On July 19, 1996, the OCA filed a motion to declare nonproprietary Bell's dial tone line cost by cell and a range of wire center costs. The OCA's motion was denied.

On April 26, 1996, in accordance with the procedural schedule established at the Prehearing Conference, Bell filed its direct testimony. On May 31, 1996, the OCA, CAPA, AT&T and MCI individually filed their direct testimony in the case. Bell

filed its rebuttal testimony on July 3, 1996, and surrebuttal testimony was filed by the OCA, AT&T, CAPA and MCI on July 24, 1996. Bell filed its rejoinder outlines on July 31, 1996.

Formal hearings were held in Harrisburg on August 5, 1996, through August 7, 1996. The evidentiary record closed on August 21, 1996, after the final Public Input hearing.

On July 31, 1996, the Coalition For A Competitive Commonwealth filed a Formal Complaint which was docketed at number R-00963550C0006. The formal complaint of the Coalition For A Competitive Commonwealth was severed and was heard on September 10, 1996. A separate Recommended Decision was issued in the matter on November 5, 1996. Said complaint will be disposed of by separate Opinion and Order.

II. ISSUES

A. INTRODUCTION

ALJ Cocheres has, unequivocally, rejected almost all of the rebalancing proposals put forth by Bell in this matter. He noted that:

... The Company proposals are many and complicated. Customers who use the same services in the same density cells can be billed differently. Customers in different density cells using the same services may or may not be billed differently. If my recommendations are rejected and closer study of the Company proposals is required, the Commission should be aware that these nuances exist.

I note that my overall negative recommendation should not be construed as opposition to the concept of rate rebalancing. Rate rebalancing as a response to competition and a regulatory tool can be appropriate, but this particular plan is not.

(R.D., p. 6).

Conceptually, then, the ALJ's recommendations and our disposition of the issues in the instant proceeding should not be construed as broad based precedent for the proper role of rate rebalancing in the regulation of telecommunications service providers.

B. THE FREEZE

The OCA and PCTA devoted substantial resources to address the issue of whether Bell was unable to raise the rates for the protected classes until January 1, 2000. These parties

argued, essentially, that ~~protected services~~ were subject to a rate freeze set forth in the Commission's Opinion and Order in Bell's Chapter 30 petition proceeding. Re: Bell Atlantic-Pennsylvania, Inc., 82 Pa. P.U.C. 194 (June 28, 1994) (hereafter, alternately, "Alternative Regulation Order"). (R.D., pp. 7-8).

Bell responded by referencing this Commission's Opinion and Order in Re: Bell Atlantic-Pennsylvania, Inc., Opinion and Order, entered October 30, 1995, at Docket No. P-00930715 (Slip Opinion). (October 1995 Order). (Id.).

On consideration of the positions of the parties, ALJ Cocheres agreed with the position of Bell. He noted:

... The Commission has already decided this issue. Acting on the Company's petition and pursuant to Section 703(g) of the Public Utility Code (66 Pa. C.S. §703(g)), the Commission ruled that the Company was granted the discretion to request revenue neutral price changes on protected services prior to December 31, 1999. Further, because the parties had questioned the Commission's

~~Section 3002 defines protected services as~~

1. Telecommunications service provided to business or residential consumers that is necessary for completing a local exchange call.
2. Touch-tone service.
3. Switched-access service.
4. Special-access service.
5. Ordering, installation, restoration and disconnection of these services.

authority to act during the pendency of an appeal, the October 1995 Order expressly conditioned the effectiveness of this clarification of the June 1994 Order on the withdrawal of the pending Petition for Review in the Commonwealth Court at Docket No. 0501 C.S. 1995. Slip Op. at 14-22. When the appeal was withdrawn, the Opinion and Order became operative.

(R.D., p. 8).³

We agree with the recommendation of ALJ Cocheres. We have previously considered this issue and intend that our reasoning and discussion in the October 1995 Order should govern. There have been no considerations raised by the OCA or the PCTA which cause us to alter our position previously set forth therein. And, contrary to the positions of the OCA and the PCTA, the public interest has been promoted by this Commission's consideration of the issues involved in this proceeding. The Exceptions of the parties are denied consistent with our discussion.

C. CROSS-SUBSIDY

Fundamental to the ALJ's recommendations is his conclusion that Bell's underlying premise, namely that two kinds of rate subsidies exist in the design of current rates, was erroneous.

³ ALJ Cocheres further noted that the OCA, and the PCTA, who were all parties who actively participated in opposing Bell's request for clarification of the Alternative Regulation Order (Slip Op. at 15) did not, apparently, appeal the October 1995 Order. Accordingly, he felt bound by the findings, determinations and directives of the October 1995 Order. 66 Pa. C.S. §316.

Bell's Rate Rebalancing filing proceeded from the premise that business customers subsidized the residential customers. To remedy this problem, the Company proposed an overall decrease to business customers and an overall increase to residential customers. Thus, Bell continued that it was necessary to spread revenue changes between market baskets to maintain neutrality. (R.D. at 9 citing Bell M.B., pp. 1, 3-4, 7, 32-33, 41-43, 45-46. Bell R.B., pp. 11-13, 15-16).

Also, Bell claimed that the urban residential customers paid more than their fair share of costs and, consequently, subsidized rural and other high cost residential customers.⁴ By lowering urban residential rates and raising rural and other high cost residential rates, Bell proposed that it was moving both groups within one market basket closer to cost. (R.D., p. 9 citing Bell M.B., pp. 2-5 18-23, 27-28. Bell R.B., pp. 24-25).

ALJ Cocheres rejected Bell's position. We set forth his reasoning, below:

In order to agree with Bell's proposal, one must first accept their basic premises, i.e., business rates subsidize residential rates, and urban residential and business rates subsidize rural residential rates. Bell M.B., p. 4. As indicated in far more detail in the next chapter, I do not accept the Company's basic starting point. Indeed, I have concluded that residential rates cover their costs. Consequently, I find that the

⁴ Bell, at page 3, n. 3 of its Exceptions on this issue asserts that the ALJ mischaracterizes its position here. Bell clarifies that its position is that residential dial tone line service - one of the components of local exchange service - is below cost. Bell further states that the combination of dial tone line rates and certain local usage packages could exceed the combined cost of those services. (Id.).

Bell proposals, if adopted, would cause cross-subsidization in favor of the business customers, contrary to the legislative policy found in the Public Utility Code. 66 Pa. C.S. §3001(3).

* * *

... Since Bell's petition to receive alternate rate regulation has already been granted, I find that its subsequent rate proposals must be evaluated in view of this legislative guidance. June 1994 Order. If Bell were correct and residential rates were below costs, how then can this Commission consider raising the rural residential rates (the most competitively unattractive customers) while urban residential customers' rates (customers more likely to see the benefits of competition) do not go up as much? Even in this noncompetitive class, are the rural customers being asked to subsidize the urban ones? Is this result permissible? Considering the statutory goals, I think not.

The cross-subsidy is more obvious between the protected residential class and the competitive business class.⁵ If one accepts my premise that residential local exchange service pays its own way, then how can this Commission justify raising rates on the protected residential class to offset dollar for dollar, a rate decrease to the competitive business class? Again, in view of the statute's guidance, no justification is possible.

In other words, I regard this portion of the proposal (a dollar for dollar matching between market baskets) as a request to cover or guarantee a given revenue stream to the Company in the face of competition. As such, it attempts to shift the risk of competition to noncompetitive services. This shift runs contrary to one purpose for granting Bell

⁵ We do note that the business class of services are "protected services" under Chapter 30.

alternative rate regulation, i.e., in return for loosening the controls on competitive services, the shareholders were required to assume the uncertainties of the marketplace. This particular form of "revenue neutrality" is exactly the kind which should be avoided.

(R.D., pp. 9-11).

The specific areas of consideration are noted below, consistent with the presiding ALJ's discussion of said issues.

Exceptions

Prior to our consideration of the specific areas addressed by ALJ Cocheres, we note the Exception of AT&T concerning his rejection of the premise that there is cross subsidy from urban residential customers to rural and other high cost residential customers.

At page 23 of the R.D., ALJ Cocheres states as follows:

However, I am not accepting the OCA's particular allocation proposal in this proceeding. I am merely pointing out that a change in the allocation of the specific costs that are at issue here (i.e., dial tone line costs and broadband network costs) can produce results far different than those on which Bell based its proposed rebalancing of rates in this proceeding. My basic conclusion remains: Because Bell's allocation of dial tone line and broadband network costs are clearly flawed, its claim that local exchange service is being subsidized by other services and its resulting rate rebalancing proposals, are unsupported and must be rejected.

AT&T, at pages 6-8 of its Exceptions, notes that the above-quoted finding, though not central to the adjudication of the instant proceeding, is in error and will be significant in other pending and future dockets. A number of cost studies⁶ and their results have been submitted in the record states AT&T, and although the studies vary in their treatment and allocation of joint and common costs, including lo. r costs, they all identify a significant subsidy to high cost customers from low cost customers. See AT&T Exc., p. 7. The parties have only disagreed as to the amount of the subsidy.

Disposition

On consideration of the Exception of AT&T concerning this issue, we conclude that the language of ALJ Cocheres, though not central to the disposition of the issues here is, nevertheless, important for our consideration of matters in other pending proceedings, namely our Universal Service Investigation. Consequently, we shall reject the conclusion of the presiding ALJ at page 23 of the R.D. as, inter alia, overly broad, and note that ~~our general concurrence with the ALJ's conclusions that Bell did not meet its burden of proof in this Rate Rebalancing proceeding, is without prejudice to our consideration of the existence of subsidies by lower cost (generally more urban) to higher cost (generally more rural) customers in other pending Commission dockets.~~

⁶ AT&T notes that the Universal Service Investigation includes the following models in the record, the Hatfield Model (sponsored by AT&T and MCI), the Benchmark Cost Model (sponsored by Sprint/United), the Johnson Model (sponsored by the OCA), results of the "Bellcore model" (sponsored by Bell), and the results of the GTE Model (sponsored by GTE). (AT&T Exc., p. 7, n. 7).

D. FLAWED COST ALLOCATIONS

1. Dial Tone Line Costs

Bell asserted that its Dial Tone Line rates were currently set below its dial tone line costs, particularly for residence local exchange customers. (R.D. at 11). Thus, Bell concluded that dial tone line service was being subsidized by other services. ALJ Cocheres rejected this assertion due in major part to the fact that Bell chose to allocate 100% of the local loop costs to the dial tone line component.

~~Bell's position was that dial tone line is a complete service in and of itself, rather than a component of the many services Bell provides.~~ (R.D., p. 11 citing Bell R.B., pp. 34-35). For this reason, Bell allocated 100% of its local loop costs to the dial tone line component of local exchange service.

Bell contended that dial tone line is a separate and distinct service, and that most experts agreed with this position. See Bell R.B., pp. 34-35.

The presiding ALJ disagreed with Bell's determination that the dial tone line is a separate and distinct service which, as a consequence, necessitates the 100% allocation of costs to this component. We set forth his reasoning in detail:

... the OCA has pointed out, the dial tone line is the facility that connects the customer to the Company's switching equipment. OCA M.B., p. 79. As such, it is more accurate to view it as a component of all the telecommunications services that depend on it, rather than as a separate service. In addition to local exchange service, such services would include intraLATA and interLATA toll services, CLASS or optional services, and non-published

or non-listed telephone service. Thus, the costs associated with dial tone line should be viewed as joint or common costs of those services, and should be allocated across those services instead of being assigned totally to local exchange service, as Bell asserted. Id. at 80-82.

* * *

... the OCA cited a number of decisions of state regulatory commissions, as well as state and federal statutes in support of the principle that dial tone line represents a component whose costs should be shared among the services that utilize it. OCA M.B., pp. 84-91. Perhaps most significant in this regard is Section 1325 of the Public Utility Code.⁷

Section 1325(c) goes on to define the cost of providing local exchange service as "[t]he direct cost of providing the service plus a share of the costs of the dial tone line, allocated in proportion to the stand-alone cost of each class of service which utilizes the dial tone line." 66 Pa. C.S. §1325(c).

7

Section 1325(a) states:

(a) **General Rule.**--In any rate proceeding pursuant to section 1308 (relating to voluntary changes in rates), no public utility shall be granted a percentage increase in local exchange service unless that percentage increase is just and reasonable. In no event shall the public utility be granted an increase in local exchange rates which is greater than the overall average percentage increase in total intra-state revenues authorized by the commission unless the utility proves by record evidence that a greater percentage increase for local exchange service is justified based upon the cost of providing that service.

Thus, the statute recognizes the costs of the dial tone line as shared costs, and requires that only a portion of these costs be allocated to local exchange service.

Bell contended that Section 1325 did not apply to its rebalancing proposal because it is only applicable to situations where an overall percentage increase in rates is requested.

* * *

... Bell is wrong in its contention; Section 1325 does apply to Bell's rate rebalancing filing. As set forth in Section 1325(a), this statute applies to "any rate proceeding pursuant to section 1308 (relating to voluntary changes in rates)." 66 Pa. C.S. §1325(a). (Emphasis added.) The statute is clearly applicable in this case. If Bell's proposal is revenue neutral as it claims, then the overall average percentage increase in total intrastate revenues which it is proposing is zero. Thus, as the OCA argued, Bell's proposed increases to local exchange service cannot be granted unless Bell is able to prove that "a greater percentage increase for local exchange service is justified based upon the cost of providing that service." OCA M.B., p. 136.

(R.D., pp. 12-14).

Bell also asserted that, even if Section 1325 did apply to the instant, Rate Rebalancing filing, it has, in fact, shown that its proposed increases to dial tone line service "are justified based upon the 'cost of providing that service' as required by the statute." (R.D., p. 14). This alternative position was also rejected by ALJ Cocheres. Because Bell steadfastly maintained that dial tone line is a separate service, the ALJ concluded that Bell could not justify its proposed rate increase in view of the statutory definition. (Id.). Bell's position was, in the view of the presiding ALJ, inconsistent with the language of Section 1325(c).

66 Pa. C.S. §1325(c). ALJ Cocheres referenced the testimony of certain of Bell's laymen witnesses, as espousing a position inconsistent with the allocation of 100% of costs to the dial tone line component.

As an example, the testimony of Bell's witness, Dr. Taylor was cited wherein he stated:

... BA-PA did not add to the direct cost of the Dial Tone line service an additional amount representing an allocation of these same Dial Tone line costs to Dial Tone line service, as the statute appears to suggest. Any additional assignment of Dial Tone line costs to Dial Tone line service would entail double-counting of those costs and would be illogical and inconsistent with economic costing principles. In any event, since BA-PA's residence Dial Tone line rates do not currently cover their direct costs, they certainly could not cover their direct costs plus some allocation of additional costs.

(R.D., p. 15 citing Bell St. No. 3.0 (Taylor), p. 15).

Also, Bell's witness Mr. Sanford asserted that "[a] stand-alone cost study for dial tone line service under section 1325 would require double counting since the study would have to included [sic] the direct costs of providing dial tone service 'plus a share of the costs of the dial tone line.'" (Id., citing Bell St. No. 2.0 (Sanford) p. 9). Consequently, the ALJ observed that "[t]he testimony of Bell's witnesses would seem to be credible if dial tone line could be considered to be a separate service, as Bell contends. However, neither Bell nor I are in a position to conclude that the statute [Section 1325] is illogical and can thus be ignored."

The ALJ concluded that "[t]he only reasonable and proper conclusion in light of the language of Section 1325(c) is that dial tone line must be treated as a component of multiple services whose costs must be allocated among these services, and not as a separate service."

Two other considerations influenced ALJ Cocheres' conclusion to reject the proposed allocation of 100% of dial tone line costs to the dial tone line component. First, he was persuaded by language in this Commission's Universal Service Investigation proceeding that held that local loop costs should, for universal service purposes, be considered joint or shared costs. The OCA pointed out the following language in our Order entered September 5, 1995, Slip Op. at 12 in the Universal Service Investigation which stated in part:

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.

(R.D., p. 16 citing OCA St. 3S, p. 25).

Second, ALJ Cocheres observed that the Federal Communications Commission ("FCC") has recently determined that loop costs are joint or common costs of providing service. As the FCC stated in its interpretation of the Telecommunications Act of 1996 (47 U.S.C. § 201, et seq.) ("Act" hereafter), when services are priced for unbundling:

The term "common costs" refers to costs that are incurred in connection with the production of multiple products or services, and remains unchanged as the relative proportion of those products or services varies (e.g., the salaries of corporate managers). Such costs may be common to all services provided by the firm or common to only a subset of those services or elements. If a cost is common with respect to a subset of services or elements, for example, a firm avoids that cost only by not providing each and every service or element in the subset. For the purpose of our discussion, we refer to joint and common costs as simply common costs unless the distinction is relevant in a particular context.

* * *

As discussed in greater detail below, separate telecommunications services are typically provided over shared network facilities, the costs of which may be joint or common with respect to some services. The costs of local loops and their associated line cards in local switches, for example, are common with respect to interstate access service and local exchange service, because once these facilities are installed to provide one service they are able to provide the other at no additional cost.

(R.D., p. 17 citing OCA M.B. citing In the Matter of: Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, August 8, 1996 at ¶¶ 676, 678).

Exceptions

Bell excepted to ALJ Cocheres' recommendation. Bell explains that its local exchange service rate structure has two components - Dial Tone Line service and local usage service options. All customers must subscribe to Dial Tone Line service, which is a flat rate charge designed to cover the cost of the dial

tone line facility, i.e. the loop which extends from the telephone company's central office to each customer's premises. (Bell Exc., p. 4). Bell goes on to note that the Dial Tone Line service facility is dedicated to a specific customer but does not vary based on the level of telephone usage. Therefore, the Dial Tone Line service should be recovered from the subscribing customer. (Id.). On the basis of the foregoing, Bell states that virtually all experts agree that Dial Tone Line service is a separate and distinct service and dial tone line costs should not be allocated to other services. (Id.).

Bell then repeats four arguments supportive of its view that it is erroneous to reject its proposal based on its determination to allocate 100% of dial tone line costs to this service.

Bell argues that dial tone line costs do not meet the economic definition of joint or shared costs. To the contrary, Bell states that most economists agree that the dial tone line is a separate service with its own separate demand. (Bell Exc., p. 5).

Bell next states that the allocation of dial tone line costs to other services is illogical. Here, Bell admits that the dial tone line portion of the loop facility is, in fact, used for all telecommunications services. However, Bell counters that this fact does not mean that the costs are joint or common, or that they are appropriately allocated to other services. Bell would analogize the argument that dial tone line costs are joint or shared costs, to the argument that the telephone set (which is necessary for local calls, toll calls and all other telephone services), is such a service. Bell attempts to draw attention to the logic of this position by noting that no one would argue that the telephone set is not a separate facility with separate costs. Also, Bell notes that no one could logically argue that the costs of telephone

sets should be allocated to the cost of other telephone services, like toll and access, simply on the basis that the set is a necessary component of all telecommunications services. (Bell Exc., p. 6).

Next, Bell argues that as a matter of policy, the allocation of dial tone line costs to other services will ensure the continuation of cross-subsidies among customers and customer classes. (Id.).

Finally, Bell distinguishes the arguments that favor allocating loop costs to other services as an argument over the proper recovery of these costs. Even were this Commission to agree with the theory that a significant portion of the loop costs should be "recovered" from long-distance carriers and their customers, (a theory with which Bell states the Commission should not agree), one should not confuse cost recovery with cost causation, argues Bell, by incorrectly allocating loop costs to the costs of other services. (Bell Exc., p. 7).

In this Exception, Bell also replies to the observations of ALJ Cocheres that Section 1325 of the Public Utility Code and the FCC discussion in its Local Competition Order suggest that the allocation of 100% of dial tone line costs to the dial tone component is unreasonable.

With regard to Section 1325, Bell takes the view that this section does not require the allocation of loop costs at all, but merely limits increases on local exchange service to the overall average percentage increase for all other services. Consequently, asserts Bell, this section has no applicability to revenue neutral changes within local exchange market baskets of services as no overall percentage increase is being sought. (Bell

Exc., p. 8). Bell then makes the point that the definitions of Section 1325 are not to apply to other sections of the Public Utility Code and there is no basis for extending these definitions to a different context than the very limited context addressed in Section 1325. (Bell Exc., p. 9).

With regard to the FCC's Local Competition Order, Bell states that said order merely reflects the FCC's treatment of loop costs for purposes of separation between the interstate and intra-state jurisdictions. (Id.)

Finally, Bell states that the parties to the Commission's Universal Service Investigation disagreed with the characterization of loop costs as joint or shared costs.

AT&T also excepted to ALJ Cocheres' recommendation. AT&T supports the ALJ in his result only. (AT&T Exc., p. 4). AT&T agrees with the position of Bell, "... that allocation of 100% of local loop costs to local exchange services is the only economically sound way to allocate costs under the incremental cost study analysis approach endorsed by all parties to this proceeding." AT&T takes the view that a 100% allocation is appropriate because local exchange service is a separate service with separate costs and is the cost causer of the local loop costs. (AT&T Exc., p. 4).

However, although AT&T disagrees with the ALJ regarding his allocation of local loop costs, it believes that the correct result was reached with the determination that Bell's local exchange service, on a statewide, total service basis, is not subsidized by other services. Under AT&T's view, Bell's position on cross-subsidization is erroneous, and is driven by the failure to include all of the revenues associated with local exchange service in its cost study analysis. AT&T specifically targets for

criticism Bell's cross-subsidization position. AT&T asserts that Bell's position is based on a "manipulation" of the revenue side of the cost analysis equation to exclude consideration of revenues associated with the subscriber line charge ("SLC") and the portion of interstate common carrier line charge ("CCLC") revenues associated with recovering dial tone line costs. (AT&T Exc., pp. 4-5).

According to AT&T, once the revenue equation is corrected to include all revenues Bell receives either from its local exchange services or as federal support for the dial tone line, Bell's own cost study (even with 100% local loop allocation) demonstrates that local exchange service, in the aggregate, provides a contribution above costs. (AT&T, Exc., p. 5). On the basis of the foregoing, AT&T concludes that Bell has not met its burden of proof of demonstrating that its \$41 million increase to local service revenues is just and reasonable. AT&T sees the issue as one of Bell being motivated to isolate its revenues from competitive risk. (Id.)

Disposition

On consideration of the position of the parties, we shall, hereby, adopt the recommendation of ALJ Cocheres, consistent with our reasoning delineated, below.

Initially, we must start from the alternative regulation compact which we approved for Bell in our June 28, 1994 Opinion and Order. In the Alternative Regulation Order, Ordering Paragraph No. 7, Bell was given the opportunity to propose revenue neutral "cross" market basket proposals to the extent it provided rational reasons, i.e. reasons why such a restriction is not feasible or advisable from a public policy standpoint. In this proceeding, we

~~conclude that Bell has not met its burden of demonstrating any rational reasons for us to permit the Company to cross market baskets.~~

~~Also, we 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.⁸ It is without question that the dial tone serves as the platform from which a host of telecommunications services, are, in fact, provided. We have recognized this in several proceedings, including our Universal Service Investigation, and in Pa. P.U.C. v. Breezewood Telephone Company, 74 Pa. PUC 431 (1977), as has the FCC in its Local Competition Order.~~

Consequently, while there may be some merit to Bell's distinction that the debate over the proper allocation of loop costs 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 yet, endorse any competing percentage allocation⁹ of local loop costs, we find that 100% allocation to

⁸ Dial tone line costs, more appropriately called local loop costs, are the costs associated with providing local loop service. These costs are recovered in part from the following: (a) DTL rates on a local basis; (b) intrastate access charges on an intrastate toll basis; (c) interstate access charges on an interstate basis, as well as from the SLC.

⁹ We note that the OCA and the OTS, have variously asserted that because the local loop is a shared facility, that allocating 50% of the direct cost of the local loop to the dial

one component is not reasonable and does not result in a revenue neutral impact.

We are also constrained to agree with ALJ Cocheres concerning his interpretation of Section 1325 and its applicability to this proceeding. Section 1325 applies to any rate proceeding. Where the words of a statute are clear and unambiguous, they should be given their ordinary meaning. We disagree with Bell that there is any need to go outside of the clear and unambiguous language of Section 1325 to interpret its applicability to this matter.

Finally, we note that an additional consideration supports our determination to adopt the ALJ in his result. That consideration pertains to the revenue portion of the equation. As AT&T points out, if one considers SLC and CCLC revenues as part of the equation, the dial tone line rates clearly recover their costs.¹⁰

On the basis of the foregoing, we shall adopt the ALJ's conclusion on this issue. This does not mean that we endorse all aspects of his reasoning except as expressly noted, above.

2. Broadband Network Costs

The OCA also sponsored evidence which showed that Bell incorrectly calculated narrowband service costs and wire center

tone line is a reasonable compromise. See, for example, OTS R.Exc., p. 3.

¹⁰ In this regard, we note that the OCA also states "As Bell properly recovers some cost of its dial tone line from carrier access service, it should not also recover 100% of its dial tone line costs from local exchange service as well. See OCA R.Exc., p. 2.

costs. ALJ Cocheres, while he did not accept the OCA's particular proposal mechanism in this proceeding, generally agreed with the OCA that a change in the allocation of the specific costs, namely broadband network costs, can produce results significantly different from those on which Bell based its proposed rebalancing. (R.D., p. 23).

With regard to common costs¹¹, the OCA argued that Bell did not properly divide broadband costs between those attributable to narrowband service and broadband service. (R.D., p. 18 citing OCA M.B., pp. 98, 100-102). A portion of the broadband facilities are used in common to render both narrowband and broadband service. The OCA asserted that the costs of the common facilities should be divided between the narrowband and broadband services. ALJ Cocheres construed the testimony of Bell's witness Mr. Sanford, as evidence that Bell did separate broadband from narrowband costs, but made no allowance for common costs. (R.D., p. 19 citing Bell St. No. 2.1 (Sanford), p. 22). Bell's testimony divides the broadband equipment into two categories, i.e., broadband and narrowband (or voice grade). The costs of facilities which could be used to render narrowband service were allocated to that service with no regard to whether the same facilities could also render broadband service. The ALJ concluded that the result of the Company's failure to make this allocation is that narrowband users would have been paying for all or 100% of the broadband common facilities costs and that the narrowband local loop costs are unduly inflated. (Id., citing OCA St. No. 3S (Dunkel), pp. 64-65).

¹¹ Since a portion of broadband facilities are dedicated to render narrowband service exclusively, the costs for those facilities were, in fact, allocated to narrowband service. ALJ Cocheres, after reviewing Bell St. No. 2.1 (Sanford), p. 22, concluded that, in actuality, the parties did not disagree on this subject. (R.D., p. 18).

We note that Bell has not, apparently, filed an Exception to the ALJ's treatment of the narrowband issue. Consistent with our reasoning below, we accept the ALJ recommendation in its result.¹²

E. RESIDENTIAL ISSUES

We include a description and discussion of the salient features of Bell's rate proposals for the various residential rate classes¹³ as taken from the R.D. The presiding ALJ regarded the decreases as a package with the increases.

1. Touch Tone Charges

Bell proposed to eliminate current touch tone charges for all residential and business customers. (R.D., pp. 24-25 citing Bell M.B., pp. 19-20 and App 1, p. 1).

Exceptions

Bell generally excepts to the ALJ's dismissal, out of hand, of its proposal concerning touch-tone charges.¹⁴ Bell refers this Commission to its Appendix A and states that touch-tone

¹² See OCA R.Exc., p. 10, n. 8.

¹³ As noted by ALJ Cocheres, when the Company refers to its average residential customer, it is referring to a customer who purchases Touch Tone Service, Dial Tone and the Local Unlimited Usage Option Package. The record reflects that these customers constitute the vast majority of this customer class. In addition, the rates outlined here do not demonstrate how the substantial minority of customers who use the Budget and Standard Plans (measured usage) received much higher increases.

¹⁴ We note that all proposals not specifically addressed were considered rejected by the ALJ. (R.D., p. 7),

decreases offset the Dial Tone Line increases by \$33 million. (Bell Exc., p. 13, n. 31).

Disposition

We note that Bell's Rate Rebalancing filing included the elimination of the separate charge for residence customers' touch-tone service. Based on Bell's revenue numbers appearing as Appendix A of Bell's Replies to Exceptions, the residence touch-tone revenue reduction would be offset by a like amount increase in residential dial tone line service rates.

Bell asserts that a majority of its residential customers subscribe to touch-tone service as evidenced by a subscription rate nearing 80%. While it is true that elimination of the separate touch-tone charge and "roll-in" to the dial tone line service rate would be both revenue neutral to Bell and, arguably, a savings for those customers who have touch-tone today (100% of Bell's residential customers would share the cost of what 80% pay for touch-tone today), the 20% of Bell's customers who today choose rotary dial service would face an increase in dial tone line rates.

Inclusion of touch-tone in the dial tone line service rate make some intrinsic sense, and, in fact, is consistent with this Commission's definition of basic universal service which includes touch-tone capabilities. We are of the opinion, however, that an increase in rates to 20% of the residential customers is troublesome. We shall, therefore, give Bell the alternative of rolling touch-tone rates into residential dial tone lines if Bell can present a method whereby the existing customers who do not subscribe to touch-tone can be grandfathered as long as they are at their existing domicile. The "roll-in" would therefore not affect existing customers since existing touch-tone customers will have no

rate decrease and existing customers who do not subscribe to touch-tone will have no increase.

2. Dial Tone Line Charges

Bell proposed to increase dial tone line charges for all residential customers in all four of its density cells.¹⁵ The increases for single party residential lines ranged from a low in cell one of \$2.80 to a high in cell four of \$2.95 monthly. (R.D., p. 25 citing Bell M.B., pp. 19-20 and App. 1, p. 1). Consistent with his view expressed throughout the R.D., ALJ Cocheres concluded that Bell failed to justify its proposed dial tone line increases. (Id.). On this basis, the ALJ recommended their rejection.

Exceptions

Bell excepted to the ALJ's recommendation to reject its proposal to increase dial tone line charges for all residential customers. Bell initially faults the ALJ for failing to employ the proper standard of review for this proposal. (Bell Exc., p. 12). Substantively, Bell explains that it has proposed to raise rates for residential Dial Tone Line service for the first time in over a decade. (Bell Exc., p. 13). It argues that even including the SLC, dial tone line rates do not currently recover their costs in any density cell. (Id.). Thereafter, Bell refers to data (proprietary) setting forth the current rate, plus SLC, the cost, and the proposed rate with touch-tone and SLC. This data purports

¹⁵ A density cell is a group of wire centers whose customers share a common population density range per wire center. Cell one customers are located in the most densely populated urban areas. Cell four customers are located in the least densely populated rural areas.

to show that the current rate is below the apparent cost. (Bell Exc., pp. 13-14).¹⁶

Disposition

We find that the disposition of this issue is to be governed by certain of the overall observations of the presiding ALJ whose result we have adopted. While the rejection of Bell's proposal was not discussed at length in the R.D., we shall adopt the ALJ decision in his result. We shall, consistent with our discussion regarding dial tone line costs, reject Bell's proposal as based on an unsupported premise.

3. Measured Usage Charges

Bell described its proposal as follows:

BA-PAs rate rebalancing proposal simplifies the current usage structure. Rates for most local usage packages are decreased. It contains a consistent per minute rate for calls in Bands 2 through 6, regardless of initial/additional minutes for each rate period. The proposal reduces the time of day rate period structure to two rate periods: Day and night/Weekend. In addition, although no change is proposed in the day rate for Metro Call Band 1 calls (which remains \$.07 per call), BA-PA proposes an increase in the night/weekend rate from \$.028 to \$.035 per call for Metro Call band 1 calls.

(R.D., p. 25, citing Bell M.B., pp. 20-21). (Footnotes omitted.)

At page 25 of the R.D., ALJ Cocheres observed that the only local measured usage plans offered by Bell are the Standard

¹⁶ Bell did not include intrastate and interstate CCLC revenues in this presentation.

and Budget Plans.¹⁷ Both plans stood to receive net increases from the Rate Rebalancing proposal. ALJ Cocheres agreed with the evaluation of the proposal by the OCA when it described the impact of the proposed plans as follows:

... Bell ratepayers subscribing to the Standard Usage option without Touch Tone will experience basic local service increases of 45%, 44%, 42% and 40% in Density Cells 1 through 4 respectively.³⁵ Those Standard Usage customers with Touch Tone will experience 26%, 26%, 25% and 24% increases in Cells 1 through 4. Id.

Obviously, the impact of Bell's proposals on those ratepayers subscribing to the Budget Usage option is even more significant. With percentage increases of 77%, 72%, 67% and 62% in Density Cells 1 through 4,³⁶ these customers experience some of the maximum percentage increases under Bell's proposal. Only Lifeline customers experience greater percentage increases in their basic local service rates or Touch Tone.

³⁵AT&T Exh. Darrah Rebuttal (Surrebuttal) Exhibit 1. Percentages do not include Subscriber Line Charge.

³⁶OCA Exh. WWD-3. Percentages do not include Subscriber Line Charge or Touch Tone.

(R.D., p. 26 citing OCA M.B., p. 45).

ALJ Cocheres, while not necessarily accepting the OCA's calculation of the percentages, did agree that the Budget and Standard Plan customers would have received an increase according to Bell's proposal. (R.D., p. 26).

¹⁷ This does not appear to be an accurate observation. Bell, in fact, does offer other measured usage packages.

We find no Exceptions referenced to this particular issue. Finding no exceptions germane to this question, we shall, therefore, adopt the ALJ's conclusion.

4. Lifeline and Affordability

The OCA presented the monthly Lifeline charge for budget measured usage customers in the following chart:

Lifeline Customer With Budget Measured Usage Option

	<u>Present Rate</u>	<u>Proposed</u>	<u>\$ Increase</u>	<u>% Increase</u>
Density Cell 1 Dial Tone Line Service	\$1.15	\$3.95	\$2.80	243%
Density Cell 2 Dial Tone Line Service	\$1.45	\$4.30	\$2.85	196%
Density Cell 3 Dial Tone Line Service	\$1.85	\$4.75	\$2.90	156%
Density Cell 4 Dial Tone Line Service	\$2.25	\$5.20	\$2.95	131%

(OCA Exh. WWD-2 at 1. OCA M.B., p. 56).

According to Bell, the proposed monthly range for Lifeline rates is \$4.95 to \$6.20.¹⁸ ALJ Cocheres observed that the apparent difference between the OCA numbers and the Company numbers

¹⁸ This range was calculated by assuming that a Lifeline customer would choose budget service. Dial Tone Line charges range from \$6.45 (cell one) to \$7.70 (cell four), plus \$3.50 Subscriber Line Charge (SLC), less \$5.00 Lifeline Credit. Bell St. No. 1.1 (Eichenlaub) at 30.

is the result of different methods of calculation. He noted that the OCA did not add the SLC and used only half (\$2.50) of the Lifeline Credit which was deducted from the Dial Tone Line cost. (The \$5.00 Lifeline Credit is normally deducted half from the SLC and half from the Dial Tone Line.) (R.D., p. 31).

The presiding ALJ was unpersuaded as to the usefulness of the OCA's or Bell's analysis of the impact of the instant filing on rates for the Lifeline customers. He remarked:

The difference in these methods of calculation proves the truth of the Mark Twain quote: "There are three kinds of lies: lies, damned lies and statistics." As expected, the OCA argued that the range of increase for Lifeline customers was 131% to 243%. OCA M.B., pp. 58-61. These percentages are eye-catching for the class of customers who can afford increases least. On the other hand, Bell argued that the proposed increases resulted in a range from \$.16 to \$.21 per day for Lifeline service. Bell M.B., p. 26. Bell R.B., p. 23. Obviously, Bell's numbers sound less expensive than one \$.25 pay phone call per day.

Both arguments are factually correct and generally useless to help resolve the underlying policy question. The real issue is: How much can poor customers afford to pay for monthly telephone service? No party presented evidence which could be used to correctly decide this issue. For instance, there was no statistical study (perhaps violating Mark Twain's wise advice) demonstrating how much low and very low income families could pay for phone service. Instead, there was nothing more than a range of proposed increases, i.e. \$2.80 through \$2.95, and an assertion that the increase was fair and affordable. Bell M.B., p. 26. Bell R.B., pp. 23-24. While this argument mimics the statutory policy of the Public Utility Code (66 Pa. C.S. §3001(1)), this kind of evidence is hardly enough for me to use to recommend

that the customers who must watch every penny closely should endure a nearly \$3.00 monthly rate increase. The most affordable of the rates should be the proposed Lifeline rate. Based on this record, I cannot come to that conclusion.

(R.D., pp. 31-32).

Disposition

Because of our conclusions elsewhere, determining that Bell has not met its burden under either Section 1325 or this Commission's Alternative Regulation Order, we need not express an opinion as to the merits of either the OCA or the Company's analysis.

F. COMPETITION

One of the cornerstones of Bell's case is its assertion that "Competitive Pressure Mandates Rate Rebalancing Now." (R.D., p. 29 citing Bell M.B., p. 10).

ALJ Cocheres concluded that the nexus between the existence of competition and the need for rate rebalancing (and particularly this Rate Rebalancing filing) is missing from this case. ALJ Cocheres was unpersuaded that the fact that Bell has lost minimal market share in the intraLATA toll market and that other well financed, large competitive carriers are authorized to render service in Bell's territory, supported the competitive necessity for the instant filing. The ability of competitors to capture part of Bell's market share, did not, in his view, diminish Bell's continuing dominance of the vast majority of the market. (R.D., pp. 30-31). He found it difficult to see a link between the "threat" of competition and the need for rate relief

when Bell's quarterly reports show substantial income evidencing robust financial health in the newly emerging competitive environment. See, OCA St. 1 (Catlin), p. 5 and Ex. TSC-1.

Disposition

We address the above-cited opinions as dicta, and not essential to our disposition of the issues in this proceeding. This Commission, as a result to the Act, and Chapter 30 of the Public Utility Code, is faced with the daunting task of promoting competition while establishing appropriate pricing signals which may require decreasing the prices of certain services which are above cost, and proportionately increasing the prices of other services, while protecting the consumer from unreasonable price increases.

G. TOLL AND ACCESS ISSUES

1. Automatic Savings Plan

In AT&T Communications of Pennsylvania, Inc., et al v. Bell Atlantic-Pennsylvania, Inc., Docket Nos. R-00953394C0002, R-00953396C0002-C0004, R-00953409C0001 and C0004, (Order adopted June 20, 1996) we granted Bell the authority to implement an Automatic Savings Plan ("ASP"). Currently, Bell's ASP provides customers with a 20% discount on qualifying intraLATA toll calls of \$20 or more per month. Bell proposed to expand its ASP in this proceeding. The Company's current proposal would provide a 10% discount on qualifying intraLATA toll calls between \$5 - \$19.99 per month. Bell argued that the plan was reasonable, was not anti-competitive, did not result in a price squeeze and was not subject to an imputation requirement. (R.D., pp. 31-32).

AT&T argued that the original ASP was anti-competitive and that the proposed extension was as well. AT&T explained that the proposed rate resulted in a price squeeze for competing carriers. It asserted that Bell was using its dominance in the intraLATA market to strengthen its toll position without properly reducing access costs. (R.D., p. 32 citing AT&T M.B., pp. 17-23. AT&T R.B., pp. 9-11).

The OCA argued that the decreased toll revenue resulting from the proposed ASP could not be used to justify far larger increases in dial tone rates. The OCA disputed the Company claim that the toll reductions from the new ASP would offset the massive increases in dial tone line charges. The OCA concluded that the residential ratepayers should not be required to fund losses on a competitive toll reduction plan. (*Id.*, citing OCA M.B., pp. 54-55. OCA R.B., pp. 17-18).

ALJ Cocheres generally agreed with OCA, *i.e.*, the proposed reduction in revenues is so small in comparison to the proposed increase for the residential customers that the reduction can hardly be used to justify the increase. He did not find the AT&T position persuasive. He observed that this Commission has previously rejected the arguments raised by AT&T when the original ASP was proposed and AT&T has offered no additional arguments in this case which change that conclusion. (R.D., pp. 32-33).

Exceptions

Bell excepted to the R.D. It states that the proposed expansion will extend the benefits of toll discounts to customers with lower toll bills who do not currently have any discounts

available to them. (Bell Exc., p. 22). Bell, also notes that these toll reductions total \$6.8 million. (Id.).

AT&T also excepted to the R.D. AT&T objects to the dicta in the R.D. which it suggests indicates that had the general rate rebalancing proposal of Bell been acceptable, it would have been permissible to include the subject toll reductions without consideration of whether the proposals were competitively fair or caused a price squeeze for competitors. (AT&T Exc., p. 9). AT&T asserts that the emphasized dicta is contrary to AT&T v. Bell, supra, in that the discount plans at issue should be subject to an imputation test.

Disposition

On consideration of the R.D., and Exceptions thereto, we conclude that granting Bell the authority to expand the ASP is beneficial to residential ratepayers. However, as noted in our discussion of Bell's proposal for a late payment charge, we shall condition our discussion of this issue upon Bell's use of the ASP as a revenue neutral offset to the late payment charge.

Bell's proposed ASP provides customers with an automatic 10% savings when they make between \$5.00 and \$19.99 of qualifying intraLATA toll calls per month. What is clear from Bell's proposal is that residential customers will receive reduced rates. Therefore, this is a benefit. Consequently, we shall not adopt the ALJ recommendation, but shall approve the proposal. What is not clear from the Company's filing, however, is where should the revenue neutral adjustment come from to offset the decrease. Consequently, we shall reference our discussion of the Company's proposed late payment charge to answer the previously cited question.

With regard to the Exceptions of AT&T, we shall deny them consistent with our initial approval of the ASP. We find that AT&T has raised no considerations in its opposition to the ASP which we have not previously rejected.

2. Business MTS Flat Rate

Bell proposed restructuring business MTS rates to eliminate time of day and distance sensitive rates and to create a postalized rate of \$.10 per minute (\$.07 per minute for certified speech and/or disabled business customers). Bell further proposed to change the service rates for WATS, Maximum Value Plan and Optional Business Calling Plus. See Bell M.B., p. 36.

AT&T contended that this proposal was a questionable response to competition and that Bell's pricing advantage, when taken with its dominant service provider position in the business and commercial intraLATA toll market, was anticompetitive. AT&T argued that Bell's proposal placed its competitors in a price squeeze which prevented effective competition. AT&T St. 1.0 (Darrah), pp. 17, 22-23. AT&T M.B., p. 23. Bell asserted that, since no imputation was required under Chapter 30, there was no price squeeze. (R.D., p. 33 citing Bell M.B., p. 37).

The OSBA asserted that Bell's position that, "most business customers will experience a net decrease in their bills," was unsupported by any Bell calculations. (R.D., p. 33 citing, inter alia, OSBA R.B. p. 2).

The ALJ rejected Bell's proposal based upon his previous finding that alleged reductions in this plan are at the

expense of unwarranted residential increases. In the alternative, ALJ Cocheres further concluded that Bell is not required to meet an imputation test and that, consequently, a price squeeze would not occur. (Id.).

3. Metropolitan Area Unlimited Plus Service (MAUPS)

ALJ Cocheres, for reasons similar to his general conclusion that Bell did not make a substantial case, dismissed Bell's proposal for Metropolitan Area Unlimited Plus Service ("MAUPS").

Exceptions

Bell, in its Exceptions, notes that MAUPS is an expansion of its existing service. This service is proposed in response to specific customer requests in the outer or second tier Philadelphia and Pittsburgh suburbs for an optional calling package that would give unlimited local calling into the Philadelphia and Pittsburgh metropolitan areas. (Bell Exc., p. 24).

On consideration of the Exceptions of Bell, we shall reject the ALJ recommendation concerning this tariff offering. MAUPS is a new service offering. No existing customers will experience a rate increase. Only those customers choosing to purchase the service will be subjected to a new rate. To the extent that customers find Bell's proposed rates objectionable, they can choose not to subscribe to the service and avoid the proposed rates. Therefore, consistent with our discussion with regard to Local Transport Access Service Rates, we shall allow Bell the alternative to offset the revenue increase from Local Transport Access Service with the decreases from MAUPS.

4. Local Transport Access Service Rate

Bell proposed the restructuring of switched access local transport rates to create a rating distinction between direct and tandem routed traffic. Direct trunked transport will be flat-rated on a distance sensitive basis. Tandem transport will be rated on a usage (per minute of use) and distance sensitive (per mile) basis. Bell explained that this proposal was uncontested. See Bell M.B., pp. 38-39. The Company denied that this proposal would result in a price squeeze. Bell M.B., pp. 39-40.

AT&T accepted Bell's proposal as a first step, if universal service and competition in all telecommunications markets were to be achieved. (R.D., p. 35). However, AT&T criticized the proposal as a revenue decrease which was insignificant compared to the access contributions that were embedded in Bell's carrier access charges. AT&T also believed that the Company's refusal to decrease access rates further was inconsistent with the FCC's view that reducing access was necessary for the development of competition. AT&T R.B., pp. 12-13. MCI also complained that the access rate reduction was inadequate when compared to toll reductions. MCI R.B., pp. 9-11.

The ALJ recommended acceptance of the local transport Access Service Rate restructuring proposed by Bell primarily because it substantially mirrors the structure which has been adopted at the federal level. Unlike the interstate structure, it does not include the Residual Interconnection Charge

("RIC").¹⁹ AT&T and MCI accepted the proposal, but wanted a bigger reduction. However, there is no record evidence to quantify their criticism. The ALJ also endorses the AT&T position that the proposal is at least a first step in the right direction if universal service and competition in all telecommunications markets are to be achieved.

Exceptions

Bell filed exceptions to the ALJ's recommendation arguing that the ALJ correctly approved its proposed reduction of its access charge through a Local Transport Restructure but erred in failing to approve a revenue increase to offset the \$17 million reduction and make it revenue neutral. Bell argues that its Chapter 30 Plan contains no provision that would require it to reduce rates without permitting an offsetting increase to make that change revenue neutral. Similarly, Bell continues, Chapter 30 requires access charge reductions to be revenue neutral. As a result, the ALJ's omission must be corrected and Bell must be permitted to offset this rate reduction in a revenue neutral manner.

Disposition

According to Bell's Chapter 30 Alternative Regulation Plan that was approved with modifications, we can only permit price changes that are revenue neutral. In reviewing the record in this proceeding, we have determined that there are a number of

¹⁹ The RIC is a non-cost based element developed by the FCC to maintain revenue neutrality for the local transport rate element on a stand alone basis. Since this revenue neutral filing was intended to minimize subsidies to the extent possible, a RIC was not proposed. Bell St. 1.0 (Eichenlaub), p. 19.

elements in Bell's rate rebalancing proposal that are uncontested and/or new service offerings that could reasonably be combined to yield a neutral offset to the Local Transport Access Service Rate. ~~We are willing to permit Bell to increase the rates for noncompetitive, nonprotected services in order to realize a revenue neutral filing. These noncompetitive, nonprotected services as identified in Appendix A of Bell's Exceptions include: Terminating Feature Group A, Residential Return Call, Business Return Call, Calling Card Surcharge and Business Remote Call Forwarding.~~ Therefore, we will grant Bell's exceptions in this regard and permit it to file revenue neutral increases as discussed above.

H. UNIVERSAL SERVICE VS. RATE REBALANCING

Both AT&T and MCI strenuously asserted that Bell's rate rebalancing proposals should, at a minimum, be postponed until after the Commission implements a universal funding mechanism. AT&T M.B., pp. 29-42. MCI M.B., *passim*. AT&T R.B., pp. 1-9. MCI R.B., pp. 12-14. Bell argued that rate rebalancing moves prices closer to costs which promotes efficient market entry and competition. Further, the Company maintained that the establishment of a universal service fund was not a prerequisite to rate rebalancing and that the absence of such a fund in Pennsylvania should not be used to delay implementation of the Bell proposal. Bell M.B., pp. 8-10. Bell R.B., pp. 46-47.

ALJ Cocheres concluded as follows:

Even though I cannot recommend the adoption of Bell's proposal, I have concluded that each of the concepts can function independent of the other. MCI provided the following discussion of the operation of a universal

funding mechanism which helps demonstrate my point:

Contrary to Bell's second argument, there is also no need or advantage to rebalance immediately in order to reduce the amount of the subsidy which ultimately will be provided from the universal service fund. The amount of subsidy required by the universal service fund will be determined solely by the following factors: (1) the universal service rate established by the Commission; (2) the forward looking costs of providing local service in regions where costs are higher than the universal service rate; and (3) the numbers of subscribers eligible for subsidies in each such high cost area. So long as Bell and other local exchange carriers are all permitted to charge the Commission established universal service rate at the time the universal service fund is implemented, the subsidy required from the fund will not depend at all on whether Bell had previously been permitted to rebalance its rates.

This fact can be simply illustrated through the following example. Assume that the monthly universal service rate is set at \$20; that the monthly cost of providing basic local service is \$35 in the only region where costs exceed the universal service rate; and that there are 100,000 subscribers in this high cost region eligible for subsidies. Assume further that Bell's existing rate for basic local service is \$12 and that Bell is permitted to increase this charge to the universal service rate at the time the fund is implemented.

Under these assumptions, the monthly subsidy required from the universal service fund would be \$1,500,000 [(\$35-\$20) x 100,000]. Obviously, the size of this subsidy does not depend at all upon Bell's pre-existing \$12 rate for basic local service. Rather, the required subsidy would still be \$1.5 million per month even if Bell had earlier been permitted to increase its rate for basic local service from \$12 to \$16. Thus contrary to Bell's contention, rebalancing prior to the establishment of a universal service fund does not reduce the amount of the subsidy which ultimately will be required.

(R.D., pp. 37-38 quoting MCI M.B., pp. 15-16).

Two observations complete the ALL's discussion of this issue. First, ALJ Cocheres determined that the numerical example was compatible with this Commission's description of the universal funding mechanism contemplated by the pending investigation and final-form rulemaking. Rulemaking to Establish a Universal Service Funding Mechanism; 52 Pa. Code §63.141, et seq., Final-Form Rulemaking Order, entered June 21, 1996, at Docket No. L-00950105 (Slip Op. at 10).

Second, the ALJ concluded that the MCI quotation demonstrates that rate rebalancing (whether it occurs before, after or during the establishment of a universal service fund) has no impact on the formation and operation of the fund. Accordingly, the ALJ concluded that, if Bell had proposed an acceptable rebalancing plan, there would have been no need to postpone implementation pending the formation of a universal service fund. (R.D., p. 39).

Exceptions

AT&T and MCI filed Exceptions to the ALJ's conclusion. The OSBA filed Replies to the Exceptions. Both AT&T and MCI take issue with the proposed coordination and impact of rate rebalancing and the establishment of a universal service funding mechanism.

Disposition

In a recent order considering the scope of matters to be considered in Application of MFS Intelenet of PA., Inc., Docket No. A-310203.F2, et al. (Order entered December 9, 1996), (MFS - Phase III) we have committed to the disposition of an appropriate universal service funding mechanism for on or about December 19, 1996. We hereby adopt the reasoning of the ALJ, recognizing our timetable for coordinating universal service concepts in the context of rate rebalancing.

I. BUSINESS ISSUES

1. Parties' Positions

The OSBA asserted that it supported the concept of rate rebalancing in general, but contended that Bell failed to provide evidence to justify its particular rebalancing proposal in this proceeding. OSBA M.B., pp. 6-7. Specifically, the OSBA argued that:

Bell has failed to prove how its proposed rates in its revised local business usage rate structure either adjust rates to competitive market levels or bring the rates closer to cost. Bell has also failed to

prove its claim that its plan results in no additional revenue to BA-PA.

Id., at 8.

Like the OSBA, CAPA also took issue with Bell's proposed restructuring of its business local usage rates. CAPA's specific objection was related to Bell's proposal to replace the \$.07 per message rate with a \$.03 per minute rate for Metro Call Band 1 calls. With regard to this proposal, CAPA argued as follows:

Commission regulations require the independent payphone provider [IPP], who is a direct competitor to the provision of payphone services by Bell to offer a local call to the consumer at a rate not to exceed Bell's rate, i.e., twenty-five cents (25¢), and to offer that twenty-five cent (25¢) call for a minimum of ten (10) minutes. Thus, as Bell has proposed to restructure its rates that ten (10) minute call will cost the independent payphone provider thirty cents (30¢), but the IPP can only charge twenty-five cents (25¢) for the same call.

It doesn't take a rocket scientist to figure out that every ten (10) minute call will cost more than can be recovered for the call. The IPP who is a captive customer of Bell now and for the foreseeable future has no option to escape this predatory pricing by Bell.

CAPA M.B., p. 5 (Footnote omitted). CAPA contended that Bell's proposed restructuring of Metro Call Band 1 rates would result in substantial increases to independent payphone providers. Id., at 9. CAPA submitted that the proposed rate was confiscatory and anti-competitive. Id., at 7.

In response, Bell argued that "the appropriate analysis to determine whether BA-PA's plan is anticompetitive for payphone providers should focus on local service for them in the aggregate, not on the basis of a single ten minute call." Bell M.B., p. 35. Bell contended that the record evidence in this case "indicates that the average payphone call is less than four minutes in duration and the majority of payphone calls are less than two minutes in duration." Id. Bell noted that for calls of two minutes or less, payphone providers would pay less than they do under the current rate structure. Id. Finally, Bell argued that "because of the availability of reduced-cost ValuPak usage service and the elimination of the charge for touch tone, which more than offsets the proposed increases in business dial tone line rates in urban areas, it is likely that many payphone providers will experience overall reductions in their cost structure, a fact conveniently overlooked by CAPA." Id., at 36.

ALJ Cochères agreed substantially with the OSBA and CAPA with regard to the issues they raised. See R.D., pp. 39-46. We shall adopt the ALJ recommendation, as modified by our discussion of the following issues:

2. Business Touch-Tone Rates

Bell has proposed elimination of the separate charge for business touch-tone service, and the offsetting increase to business dial tone line service. These changes, which net approximately \$26 million and which is contained entirely within the business protected market basket, were not opposed by any party and were not specifically addressed by the ALJ. The ALJ, however, does state that any issue not specifically addressed is to be deemed rejected.

Bell has excepted to the ALJ's failure to approve the roll-in of business touch-tone rates and argues that, since touch-tone subscription is virtually ubiquitous among businesses, this rate change will result in virtually no change for the vast majority of business subscribers. As a result, Bell requests that this proposal be adopted.

We have reviewed the record in this proceeding concerning this issue and we note that the Office of Small Business Advocate did not contest this issue. We agree with Bell and we find its proposal to be reasonable. As a result, we will approve Bell's proposal with respect to Business Touch-Tone Rates.

3: Business Subscriber Issues

Bell's rate rebalancing proposal includes decreases to certain business subscriber services. Specifically, Bell has proposed to reduce business toll rates, the non-recurring charges for new business subscribers, and direct inward dialing termination charges. Inasmuch as these issues are related, we will briefly discuss each issue before reaching a determination.

a. Business Toll Rates

Bell has proposed a restructuring of and a reduction to its toll rates for business customers in the following manner. First, Bell proposes a restructuring of business Message Toll Service ("MTS") rates to eliminate time of day and distance sensitivity and to create a postalized rate of \$.10 per minute. Second, Bell proposes a reduction of WATS rates to reflect changes in the MTS rate schedule. Third, Bell proposes reducing the usage rates for the Maximum Value Plan ("MVP") so that they maintain a proper relationship with the MTS rates. Finally, Bell

proposes reducing rates for Business Calling Plus Service. These four reductions total approximately \$28 million.

The ALJ does not directly address this issue except to note generally that he declined to recommend the proposed decreases. (R.D., p. 24) The only party to challenge the decrease was AT&T which objected to Bell's proposal to create a postalized rate of \$.10 per minute and to eliminate time of day and distance sensitivities. However, AT&T did not file exceptions on this issue.

Bell excepted to the ALJ's failure to recommend the proposed reductions in business toll rates and argues that all of its proposed business toll changes should be approved.

b. Non-Recurring Charges for New Business Subscribers

Bell has proposed to reduce the non-recurring connection charge for business and coin service from \$75.00 to \$50.00 for the initial line and \$75.00 to \$30.00 for each additional line installed at the same time as the initial line. This proposal results in a \$6 million decrease.

The ALJ does not directly address this issue except, once again, we note that, generally, he declined to recommend the proposed decreases. The only party to object to this proposal was MCI, which claimed that such a reduction in the non-recurring connection charge would create a below-cost price which today covers cost. MCI has not filed any Exceptions to the Recommended Decision on this issue.

Bell has filed Exceptions to the ALJ's failure to approve the reduction of the non-recurring charges for new

business customers arguing that the proposal is fair, pro-competition, and should be approved.

c. Direct Inward Dialing Termination Charges

Bell has proposed to reduce the Direct Inward Dialing ("DID") termination charge from \$30.50 to \$25.00. DID service permits incoming calls to customer premises equipment to automatically reach a specific number without the aid of an attendant. This proposal, which will result in a decrease of \$3.9 million, was not opposed by any party and was not specifically addressed by the ALJ.

Bell filed Exceptions to the ALJ's failure to recommend the reduction in Direct Inward Dialing termination charges arguing that the purpose of this filing is to position the monthly recurring rate closer to market value and that it should be approved within a total revenue neutral package.

Disposition

Based on a review of the record in this proceeding, we support Bell's proposal to reduce the rates of these business services. Lowering business customer's telephone rates will enhance the attractiveness of the Commonwealth for new businesses as well as encouraging existing business to remain in the Commonwealth. Businesses that choose to locate and/or expand within the Commonwealth do so with consideration of the infrastructure costs. Telecommunications plays an important role in that infrastructure and, therefore, in the economic development of Pennsylvania. Reliable, capable and competitively priced telecommunications services are a prerequisite to a vibrant, growing economy, and will provide a means to increase economic

development within the Commonwealth and improve its business climate.

On the basis of the foregoing, we observe that the ALJ has not specifically addressed certain reductions in the rates for business telecommunications services proposed by Bell. Consequently, our Opinion and Order issued herein does not adopt the ALJ recommendation. We will permit Bell to make certain decreases in rates for business telecommunications services.

J. LATE PAYMENT CHARGES (R-00963556)

Bell argued that assessing a late payment charge on residential customers whose bills are overdue was a new service which was not governed by revenue neutrality requirements under Chapter 30 because it was not a price change or an adjustment to existing rates. See Bell M.B, pp. 48-49.

The OCA pointed out that to the extent the late payment charge would be collected on protected services, it should be considered a revenue increase and subject to revenue neutrality and to Bell's price stability mechanism. The OCA asserted that the charge was not for a new service because no new product was added. Finally, it noted that whatever costs were associated with the dealing with delinquent accounts were already incorporated into the current rate structure. Thus, allowing the added recovery of late charges would permit a double recovery for an item already contained in the current rate structure. OCA M.B., pp. 140-142. OCA R.B., pp. 22-23.

ALJ Cocheres agreed with the OCA. He reasoned as follows:

There is no new service being offered by Bell. Late charges are simply the collection of additional dollars from residential customers who don't pay their bills on time. In this instance, it is a revenue enhancement technique. Some portion of the residential customers have always paid their bills late. This proposal would raise additional money from the protected class which should already be compensating the Company for this problem. The proposal should be subject to market basket neutrality. Bell has proposed no offset for this increase. The rate increase should be denied.

(R.D., pp. 46-47).

Exceptions

Bell excepted to the R.D. on this issue. Bell notes that no party objected to the substance of the charge (1.24% and projected to generate \$6.6 million). Bell notes that the OCA argued that the charge should be subject to the revenue neutral provisions of Bell's Alternative Regulation Plan, and that the charge be deemed a protected service. (Bell Exc., p. 31).

Bell asserts that such a charge should not be governed by the revenue neutral provisions of its Alternative Regulation plan as protected services are defined by statute, but should be governed by the provisions of 52 Pa. Code Chapter 64. (Id.).

Disposition

On consideration of the Exceptions of Bell, we note that currently, 26 of the 38 telephone companies operating in the Commonwealth have a late payment charge. We believe, therefore, that it is only fair to allow Bell, which serves approximately 80% of the customers in the Commonwealth, to impose a late

payment charge for customers who pay their bill late. Such a charge is an acceptable vehicle for incentive payment. Bell's proposal would follow the guidelines for late payment charge as defined in 52 Pa. Code § § 64.12 and 64.16. In our view, Bell's proposal is governed by the revenue neutral requirement. This charge, however, is not a protected telephone service as defined by 66 Pa. C.S. § 3002. Accordingly, Bell shall be given the option of accepting a late payment charge as the revenue neutral offset to the ASP.

K. Proprietary Information

At pages 47 through 51, ALJ Cocheres discusses the OCA position concerning the proprietary treatment of Bell's wire center costs and further, his failure to require the disclosure of Bellcore²⁰ model calculations. ALJ Cocheres concluded that these issues were rendered moot. In both cases, the ALJ did not rely upon the underlying data, and further declared the end result of the studies produced, inter alia, by the data so flawed as to be unworthy to support his recommendation.

Exceptions

The OCA filed Exceptions to the ALJ recommendation. The OCA supports the ALJ recommendation to not rely upon the underlying data concerning both the Bellcore studies and Bell's wire center costs. It files Exceptions on these matters, primarily, to preserve the issue of the access to these sources of data.

²⁰ Bell Communications Research, Inc. Bellcore did intervene in the instant proceeding.

Disposition

We agree with ALJ Cocheres that the dispute over the disclosure of Bell's wire center costs and Bellcore data is moot for purposes of this proceeding. We note that in MFS - Phase III, there is the possibility that Bell's positions regarding the treatment of Bellcore data will be revised so as to accommodate reasonable disclosure. With respect to Bell's wire center costs, we note that the OCA does not appear to be aggrieved by the discovery rulings of this Commission based on our conclusion that Bell has not, in most cases, met its burden of proof required by the Alternative Regulation proceeding. On the basis of the foregoing, we shall adopt the ALJ conclusion. These discovery issues are moot.

III. ORDER

1. That, with the exception of those services which we shall specify, below, the proposed Rate Rebalancing filings at Docket No. R-00963550 are hereby rejected as unjust, unreasonable and unlawful.

2. That the Local Transport Access Service Rate proposed by Bell Atlantic-Pennsylvania, Inc., as identified in the Recommended Decision is hereby approved consistent with the body of this Opinion and Order. Further, Bell Atlantic is hereby required to file the necessary revision to Access Tariff-Telephone Pa. P.U.C. No. 302, which conforms to this approval on one day's notice after receipt of the Commission's Order.

3. That Bell Atlantic-Pennsylvania, Inc., is hereby given the alternative to file revisions to its Local General Tariff-Telephone Pa. P.U.C. No. 1 to establish a late payment charge for residential customers at Docket No. R-00963556 consistent with the body of this Opinion and Order.

4. That Bell is hereby given permission to file revisions to Local Exchange Tariffs Nos. 180A, 182, 182A, 185B and 185C pertaining to the Automatic Savings Program consistent with this Opinion and Order.

5. That, consistent with our discussion in this Opinion and Order, Bell is hereby given permission to file revisions to its tariffs supported by ample evidence and in accordance with its Chapter 30 Alternative Regulation Order, proposing rates for the following non-competitive, non-protected services: Metropolitan Area Unlimited Plus Service, Terminating Feature Group A, Residential Return Call, Business Return Call, Calling Card Surcharge and Business Remote Call Forwarding

services so as to yield a combined revenue neutral offset to the Local Transport Access Service Rate.

6. That, consistent with our discussion in this Opinion and Order, Bell is hereby given the alternative to file revisions to its tariffs to "roll-in" its residence touch-tone rates into residential dial tone line rates if Bell can present a method whereby the existing residential customers who do not subscribe to touch-tone service can be "grandfathered" as long as they remain at their existing domicile.

7. That, consistent with this Opinion and Order, Bell's Automatic Savings Plan is hereby approved contingent upon its accepting the Late Payment Charge as the revenue neutral offset to the Automatic Savings Plan.

8. That a y filing made in accordance with the above, shall be made within thirty (30) days of the entry of this Opinion and Order.

9. That, consistent with our discussion in this Opinion and Order, Bell's proposal with respect to Business touch-tone service is hereby approved.

10. That the complaint of AT&T Communications of Pennsylvania, Inc. at Docket No. R-00963550C0001 is hereby sustained in part and dismissed in part.

11. That the complaint of the Office of Consumer Advocate at Docket No. R-00963550C0002 is hereby sustained in part and dismissed in part.

12. That the complaint of the Central Atlantic Payphone Association at Docket No. R-00963550C0003 is hereby sustained.

13. That the complaint of Kurt Richter at Docket No. R-00963550C0004 is hereby sustained.

14. That the complaint of Joseph A. Henchy at Docket No. R-00963550C0005 is hereby sustained.

15. That the complaint of John D. Lewis at Docket No. C-00967866 is hereby dismissed.

16. That the Petition To Intervene of Bell Communications Research, Inc., is hereby granted.

17. That the record at Docket Nos. R-00963550, R-00963550C0001-C0005, R-00963556 and C-00967866 be marked closed.

BY THE COMMISSION


John G. Alford
Secretary

(SEAL)

ORDER ADOPTED: December 12, 1996

ORDER ENTERED: December 16, 1996

PENNSYLVANIA PUBLIC UTILITY
COMMISSION ET AL V. BELL
ATLANTIC-PENNSYLVANIA

PUBLIC MEETING -
DECEMBER 12, 1996
DEC-96-OSA-310*
DOCKET NO. R-963550,
ET AL.

STATEMENT OF COMMISSIONER JOHN HANGER

The Pennsylvania Public Utility Commission (PUC) is today telling millions of Bell Atlantic-Pennsylvania customers that the rate cap is still alive. All of the rate increases for protected, non-competitive services that Bell had submitted in its January 10, 1996 Petition to rebalance rates are rejected by the Commission's Final Order.

Any increase in rates for local phone service would violate the rate cap imposed by the Commission in the June 28, 1994 Order on Bell's Petition for Alternative Regulation. That Order imposed a cap on all of Bell's non-competitive, protected services before December 31, 1999 when it said: "That the rates for protected services are, hereby, frozen until December 31, 1999."

That rate cap is the principal consumer benefit in the Commission's 1994 Order that implemented Act 67 of 1993. The rate cap is particularly important to customers who live in rural areas where local phone competition will take longer to become a reality.

It also must be remembered that the Commission's June 28, 1994 Order gave Bell substantial financial incentives to invest in Pennsylvania and deploy a broadband network. In fact few, if any states, gave more financial incentives for network modernization since Bell has a price cap of GDP-PI minus 2.93% and keeps all profits, even if profits exceed a normal utility return.

In return for these incentives, Bell was to accelerate deployment of the broadband network. In June 1996, Bell made its most recent filing that reports on its progress in modernizing its network. The Commission must finally make time to review formally that filing to make sure that the ratepayers are getting the modernized network on the required schedule for which they are paying.

A promise made should be a promised kept. The Commission has kept its promise to Bell Atlantic-Pennsylvania by maintaining the financial incentives it received in 1994. Today the Commission keeps its promise to Bell's millions of customers that their rates for basic service will not increase before December 31, 1999.

December 12, 1996

DATED

John Hanger
JOHN HANGER, COMMISSIONER

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, Pennsylvania 17105-3265

PENNSYLVANIA PUBLIC UTILITY
COMMISSION, *et al.*

v.

BELL ATLANTIC- PENNSYLVANIA, INC.

PUBLIC MEETING-
DECEMBER 12, 1996
DEC-96-OSA-310*
DOCKET NOS. R-00963550,
et seq.

DISSENTING STATEMENT OF COMMISSIONER DAVID W. ROLKA

I am pleased that protected rates for residential customers will not increase as a result of this proceeding. This outcome is consistent with my interpretation of the PUC's June 28, 1994 Opinion and Order in Bell's alternative regulation proceeding. This result attains because of the rejection of Bell's proposed increases to Dial Tone Line prices. The proposed Dial Tone Line price increases were the cornerstone of Bell's rate rebalancing filing, the primary purpose of which was to increase residential basic service to levels closer to, but not to, Bell's definition of cost. The Commission majority, however, properly concluded that Bell did not meet its burden of proving that Dial Tone Line price increases were justified.

Having rejected the proposed Dial Tone Line price increase of \$41.5 million, I must agree with the ALJ's conclusion that the concomitant rate decreases should likewise be rejected at this time, since the rebalancing filing was an integrated, unseverable composition of various price changes. I must dissent with the conclusion in the Opinion and Order to selectively approve certain components of the rebalancing filing which would effectuate rate decreases and some rate increases. The one exception, which I support, is the access charge reductions only because the prices are based on the Company's interstate rates on file with the FCC. I nonetheless believe that this decrease should not be implemented as part of this Chapter 30 rate rebalancing filing and instead should be accomplished in a separate docket or proceeding.

I have no objection in principle to the rate decreases proposed by Bell Atlantic as part of the original rate rebalancing package. Recognizing, however, that I do not support the corresponding rate increases, I do not believe that the PUC should approve the rate decreases as part of this proceeding. It makes more sense to confer complete discretion to the Company to pursue these rate decreases as a separate matter, rather than having those decreases provide a new impetus to rate rebalance. This is especially appropriate given the Company's pending \$13 million rate reduction arising from its annual price change opportunity calculation. The majority's Opinion and Order is silent on this point, and does not indicate whether or not the permitted rate decreases may be offset with revenue neutral increases.

I consider the entire discussion of Universal Service appearing in the opinion to be dicta and of no significance. I observe that the subject of Universal Service is once again scheduled for consideration by the Commission on December 19, 1996.

Dec 16, 1996
DATED

David W. Rolka
DAVID W. ROLKA, COMMISSIONER

PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17105

Public Meeting held December 12, 1996

Commissioners Present:

John M. Quain, Chairman, Concurring & Dissenting in part
Lisa Crutchfield, Vice Chairman, Concurring & Dissenting in part
John Hanger, Concurring & Dissenting in part-Statement attached
David W. Rolka, Concurring & Dissenting in part-Dissenting Statement
Robert K. Bloom, Concurring & Dissenting in part attached

Pennsylvania Public Utility Commission	Docket No. R-00963550 R-00963556
AT&T Communications of Pennsylvania, Inc.	R-00963550C0001
Office of Consumer Advocate	R-00963550C0002
Central Atlantic Payphone Association	R-00963550C0003
Kurt Richter	R-00963550C0004
Joseph A. Henchy	R-00963550C0005
John D. Lewis	CONSUMER ADVOCATE C-00967866

and

Office of Small Business
Advocate,

Pennsylvania Cable Television
Association

MCI Telecommunications
Corporation, Inc.

Intervenors

v.

Bell Atlantic - Pennsylvania, Inc.

OPINION AND ORDER

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I. HISTORY OF THE PROCEEDING

On January 10, 1996, Bell Atlantic - Pennsylvania, Inc. ("Bell" or "Company" hereafter) filed revisions to its tariffs: Telephone Pa. P.U.C. Nos. 1, 1A, 180A, 182, 182A, 185B, 185C, 296 and 302, to become effective on March 17, 1996 (alternately "Rate Rebalancing Filing").¹ Bell's filing was made pursuant to Section 1308(b) of the Public Utility Code, 66 Pa.C.S. §1308(b). The filing proposed to restructure and rebalance Bell's Residential, Local and Toll Service rates, Business Local and Toll Service rates and Switched Access rates on a revenue neutral basis. Bell's tariff filing, as proposed, would result in an increase of approximately \$41,598,000 to the protected residential service rates class.

On January 16, 1996, Bell also filed revisions to its Local Tariff-Telephone Pa. P.U.C. 1. This tariff filing was docketed at No. R-00963556 and proposed to establish a late payment charge for residential customers, proposed to become effective March 17, 1996.

Subsequently, Notices of Appearance, Formal Complaints and Interventions were filed by numerous parties. The active participants to this proceeding were as follows: the Commission's Office of Trial Staff ("OTS"), the Office of Consumer Advocate ("OCA"), the Office of Small Business Advocate ("OSBA"), the Pennsylvania Cable Television Association ("PCTA"), the Central Atlantic Payphone Association ("CAPA"), AT&T Communications of

¹ The procedural history has been adopted, with minor editing, from the recitation of the Office of Consumer Advocate taken from its Main Brief.

Pennsylvania, Inc. ("AT&T"), MCI Telecommunications Corp., Inc. ("MCI"), and John Lewis, an individual customer of Bell. In addition, two customers, Kurt Richter and Joseph A. Henchy, were inactive participants.

By Opinion and Order, entered March 1, 1996, we suspended Bell's Rate Rebalancing filing until September 17, 1996, and instituted an investigation to determine the lawfulness, justness and reasonableness of the proposed tariff changes. In addition, this Commission incorporated by reference the evidentiary record contained in the Universal Service Investigation proceeding, at Docket No. I-00940035, into the record to be developed in this case.

By Opinion and Order, entered March 15, 1996, we suspended Bell's filing to implement a residential late payment charge, at Docket No. R-00963556, and consolidated that proceeding with Bell's Rate Rebalancing filing. We also extended the suspension period concerning the consolidated proceeding for an additional three months, or until December 17, 1996.

On April 1, 1996, a Prehearing Conference was held before presiding Administrative Law Judge ("ALJ") Louis G. Cocheres. A procedural schedule for formal hearings was established at that time and requests for Public Input hearings were presented to the ALJ.

On April 25, 1996, the notice of Public Input hearings was issued. Public Input hearings were scheduled in the following areas of Pennsylvania: Warren (June 24), Sharon (June 25), Uniontown (June 26), Pittsburgh (June 27), Allentown (July 8), Media (July 9), Reading (July 10), and Philadelphia (July 11).

Additional Public Input hearings were held on August 21, 1996, in Harrisburg and State College.

On April 5, 1996, the OCA filed a motion to declare nonproprietary, Bell's cost calculations by wire center. Bell filed a pleading in opposition to the OCA's Motion. By Prehearing Order No. 4 (Order No. 4), dated May 17, 1996, ALJ Cocheres granted the OCA's motion and required that Bell disclose to the public the results of its cost calculation by wire center. The effective date of Prehearing Order No. 4 was stayed until the Commission entertained the following material question:

Does the application of sections 3(45), 251(c) and 252(d)(1) of the Telecommunications Act of 1996 prevent Bell Atlantic-Pennsylvania, Inc. from establishing entitlement to a protective order for proprietary information contained in a wire center cost study (Exhibit RES-100.XLS TOT WC CALC) in accordance with Commission regulations at 52 Pa. Code §5.423(a)?

On June 18, 1996, we entered an Opinion and Order addressing the certified question and continued to classify this information as proprietary. We allowed further briefing on this issue.

On July 19, 1996, the OCA filed a motion to declare nonproprietary Bell's dial tone line cost by cell and a range of wire center costs. The OCA's motion was denied.

On April 26, 1996, in accordance with the procedural schedule established at the Prehearing Conference, Bell filed its direct testimony. On May 31, 1996, the OCA, CAPA, AT&T and MCI individually filed their direct testimony in the case. Bell

filed its rebuttal testimony on July 3, 1996, and surrebuttal testimony was filed by the OCA, AT&T, CAPA and MCI on July 24, 1996. Bell filed its rejoinder outlines on July 31, 1996.

Formal hearings were held in Harrisburg on August 5, 1996, through August 7, 1996. The evidentiary record closed on August 21, 1996, after the final Public Input hearing.

On July 31, 1996, the Coalition For A Competitive Commonwealth filed a Formal Complaint which was docketed at number R-00963550C0006. The formal complaint of the Coalition For A Competitive Commonwealth was severed and was heard on September 10, 1996. A separate Recommended Decision was issued in the matter on November 5, 1996. Said complaint will be disposed of by separate Opinion and Order.

II. ISSUES

A. INTRODUCTION

ALJ Cocheres has, unequivocally, rejected almost all of the rebalancing proposals put forth by Bell in this matter. He noted that:

... The Company proposals are many and complicated. Customers who use the same services in the same density cells can be billed differently. Customers in different density cells using the same services may or may not be billed differently. If my recommendations are rejected and closer study of the Company proposals is required, the Commission should be aware that these nuances exist.

I note that my overall negative recommendation should not be construed as opposition to the concept of rate rebalancing. Rate rebalancing as a response to competition and a regulatory tool can be appropriate, but this particular plan is not.

(R.D., p. 6).

Conceptually, then, the ALJ's recommendations and our disposition of the issues in the instant proceeding should not be construed as broad based precedent for the proper role of rate rebalancing in the regulation of telecommunications service providers.

B. THE FREEZE

The OCA and PCTA devoted substantial resources to address the issue of whether Bell was unable to raise the rates for the protected classes until January 1, 2000. These parties

argued, essentially, that ~~protected services~~ were subject to a rate freeze set forth in the Commission's Opinion and Order in Bell's Chapter 30 petition proceeding. Re: Bell Atlantic-Pennsylvania, Inc., 82 Pa. P.U.C. 194 (June 28, 1994) (hereafter, alternately, "Alternative Regulation Order"). (R.D., pp. 7-8).

Bell responded by referencing this Commission's Opinion and Order in Re: Bell Atlantic-Pennsylvania, Inc., Opinion and Order, entered October 30, 1995, at Docket No. P-00930715 (Slip Opinion). (October 1995 Order). (Id.).

On consideration of the positions of the parties, ALJ Cocheres agreed with the position of Bell. He noted:

... The Commission has already decided this issue. Acting on the Company's petition and pursuant to Section 703(g) of the Public Utility Code (66 Pa. C.S. §703(g)), the Commission ruled that the Company was granted the discretion to request revenue neutral price changes on protected services prior to December 31, 1999. Further, because the parties had questioned the Commission's

~~Section 703(g) defines protected services as~~

1. Telecommunications service provided to business or residential consumers that is necessary for completing a local exchange call.
2. Touch-tone service.
3. Switched-access service.
4. Special-access service.
5. Ordering, installation, restoration and disconnection of these services.

authority to act during the pendency of an appeal, the October 1995 Order expressly conditioned the effectiveness of this clarification of the June 1994 Order on the withdrawal of the pending Petition for Review in the Commonwealth Court at Docket No. 0501 C.S. 1995. Slip Op. at 14-22. When the appeal was withdrawn, the Opinion and Order became operative.

(R.D., p. 8).³

We agree with the recommendation of ALJ Cocheres. We have previously considered this issue and intend that our reasoning and discussion in the October 1995 Order should govern. There have been no considerations raised by the OCA or the PCTA which cause us to alter our position previously set forth therein. And, contrary to the positions of the OCA and the PCTA, the public interest has been promoted by this Commission's consideration of the issues involved in this proceeding. The Exceptions of the parties are denied consistent with our discussion.

C. CROSS-SUBSIDY

Fundamental to the ALJ's recommendations is his conclusion that Bell's underlying premise, namely that two kinds of rate subsidies exist in the design of current rates, was erroneous.

³ ALJ Cocheres further noted that the OCA, and the PCTA, who were all parties who actively participated in opposing Bell's request for clarification of the Alternative Regulation Order (Slip Op. at 15) did not, apparently, appeal the October 1995 Order. Accordingly, he felt bound by the findings, determinations and directives of the October 1995 Order. 66 Pa. C.S. §316.

Bell's Rate Rebalancing filing proceeded from the premise that business customers subsidized the residential customers. To remedy this problem, the Company proposed an overall decrease to business customers and an overall increase to residential customers. Thus, Bell continued that it was necessary to spread revenue changes between market baskets to maintain neutrality. (R.D. at 9 citing Bell M.B., pp. 1, 3-4, 7, 32-33, 41-43, 45-46. Bell R.B., pp. 11-13, 15-16).

Also, Bell claimed that the urban residential customers paid more than their fair share of costs and, consequently, subsidized rural and other high cost residential customers.⁴ By lowering urban residential rates and raising rural and other high cost residential rates, Bell proposed that it was moving both groups within one market basket closer to cost. (R.D., p. 9 citing Bell M.B., pp. 2-5 18-23, 27-28. Bell R.B., pp. 24-25).

ALJ Cocheres rejected Bell's position. We set forth his reasoning, below:

In order to agree with Bell's proposal, one must first accept their basic premises, i.e., business rates subsidize residential rates, and urban residential and business rates subsidize rural residential rates. Bell M.B., p. 4. As indicated in far more detail in the next chapter, I do not accept the Company's basic starting point. Indeed, I have concluded that residential rates cover their costs. Consequently, I find that the

⁴ Bell, at page 3, n. 3 of its Exceptions on this issue asserts that the ALJ mischaracterizes its position here. Bell clarifies that its position is that residential dial tone line service - one of the components of local exchange service - is below cost. Bell further states that the combination of dial tone line rates and certain local usage packages could exceed the combined cost of those services. (Id.).

Bell proposals, if adopted, would cause cross-subsidization in favor of the business customers, contrary to the legislative policy found in the Public Utility Code. 66 Pa. C.S. §3001(3).

* * *

... Since Bell's petition to receive alternate rate regulation has already been granted, I find that its subsequent rate proposals must be evaluated in view of this legislative guidance. June 1994 Order. If Bell were correct and residential rates were below costs, how then can this Commission consider raising the rural residential rates (the most competitively unattractive customers) while urban residential customers' rates (customers more likely to see the benefits of competition) do not go up as much? Even in this noncompetitive class, are the rural customers being asked to subsidize the urban ones? Is this result permissible? Considering the statutory goals, I think not.

The cross-subsidy is more obvious between the protected residential class and the competitive business class.⁵ If one accepts my premise that residential local exchange service pays its own way, then how can this Commission justify raising rates on the protected residential class to offset dollar for dollar, a rate decrease to the competitive business class? Again, in view of the statute's guidance, no justification is possible.

In other words, I regard this portion of the proposal (a dollar for dollar matching between market baskets) as a request to cover or guarantee a given revenue stream to the Company in the face of competition. As such, it attempts to shift the risk of competition to noncompetitive services. This shift runs contrary to one purpose for granting Bell

⁵ We do note that the business class of services are "protected services" under Chapter 30.

alternative rate regulation, i.e., in return for loosening the controls on competitive services, the shareholders were required to assume the uncertainties of the marketplace. This particular form of "revenue neutrality" is exactly the kind which should be avoided.

(R.D., pp. 9-11).

The specific areas of consideration are noted below, consistent with the presiding ALJ's discussion of said issues.

Exceptions

Prior to our consideration of the specific areas addressed by ALJ Cocheres, we note the Exception of AT&T concerning his rejection of the premise that there is cross subsidy from urban residential customers to rural and other high cost residential customers.

At page 23 of the R.D., ALJ Cocheres states as follows:

However, I am not accepting the OCA's particular allocation proposal in this proceeding. I am merely pointing out that a change in the allocation of the specific costs that are at issue here (i.e., dial tone line costs and broadband network costs) can produce results far different than those on which Bell based its proposed rebalancing of rates in this proceeding. My basic conclusion remains: Because Bell's allocation of dial tone line and broadband network costs are clearly flawed, its claim that local exchange service is being subsidized by other services and its resulting rate rebalancing proposals, are unsupported and must be rejected.

AT&T, at pages 6-8 of its Exceptions, notes that the above-quoted finding, though not central to the adjudication of the instant proceeding, is in error and will be significant in other pending and future dockets. A number of cost studies⁶ and their results have been submitted in the record states AT&T, and although the studies vary in their treatment and allocation of joint and common costs, including local costs, they all identify a significant subsidy to high cost customers from low cost customers. See AT&T Exc., p. 7. The parties have only disagreed as to the amount of the subsidy.

Disposition

On consideration of the Exception of AT&T concerning this issue, we conclude that the language of ALJ Cocheres, though not central to the disposition of the issues here is, nevertheless, important for our consideration of matters in other pending proceedings, namely our Universal Service Investigation. Consequently, we shall reject the conclusion of the presiding ALJ at page 23 of the R.D. as, inter alia, overly broad, and note that ~~our general concurrence with the ALJ's conclusions that Bell did not meet its burden of proof in this Rate Rebalancing proceeding, is without prejudice to our consideration of the existence of subsidies by lower cost (generally more urban) to higher cost (generally more rural) customers in other pending Commission dockets.~~

⁶ AT&T notes that the Universal Service Investigation includes the following models in the record, the Hatfield Model (sponsored by AT&T and MCI), the Benchmark Cost Model (sponsored by Sprint/United), the Johnson Model (sponsored by the OCA), results of the "Bellcore model" (sponsored by Bell), and the results of the GTE Model (sponsored by GTE). (AT&T Exc., p. 7, n. 7).

D. FLAWED COST ALLOCATIONS

1. Dial Tone Line Costs

Bell asserted that its Dial Tone Line rates were currently set below its dial tone line costs, particularly for residence local exchange customers. (R.D. at 11). Thus, Bell concluded that dial tone line service was being subsidized by other services. ALJ Cocheres rejected this assertion due in major part to the fact that Bell chose to allocate 100% of the local loop costs to the dial tone line component.

~~Bell's position was that dial tone line is a complete service in and of itself, rather than a component of the many services Bell provides. (R.D., p. 11 citing Bell R.B., pp. 34-35).~~ For this reason, Bell allocated 100% of its local loop costs to the dial tone line component of local exchange service.

Bell contended that dial tone line is a separate and distinct service, and that most experts agreed with this position. See Bell R.B., pp. 34-35.

The presiding ALJ disagreed with Bell's determination that the dial tone line is a separate and distinct service which, as a consequence, necessitates the 100% allocation of costs to this component. We set forth his reasoning in detail:

... the OCA has pointed out, the dial tone line is the facility that connects the customer to the Company's switching equipment. OCA M.B., p. 79. As such, it is more accurate to view it as a component of all the telecommunications services that depend on it, rather than as a separate service. In addition to local exchange service, such services would include intraLATA and interLATA toll services, CLASS or optional services, and non-published

or non-listed telephone service. Thus, the costs associated with dial tone line should be viewed as joint or common costs of those services, and should be allocated across those services instead of being assigned totally to local exchange service, as Bell asserted. Id. at 80-82.

* * *

... the OCA cited a number of decisions of state regulatory commissions, as well as state and federal statutes in support of the principle that dial tone line represents a component whose costs should be shared among the services that utilize it. OCA M.B., pp. 84-91. Perhaps most significant in this regard is Section 1325 of the Public Utility Code.⁷

Section 1325(c) goes on to define the cost of providing local exchange service as "[t]he direct cost of providing the service plus a share of the costs of the dial tone line, allocated in proportion to the stand-alone cost of each class of service which utilizes the dial tone line." 66 Pa. C.S. §1325(c).

⁷ Section 1325(a) states:

(a) **General Rule.**--In any rate proceeding pursuant to section 1308 (relating to voluntary changes in rates), no public utility shall be granted a percentage increase in local exchange service unless that percentage increase is just and reasonable. In no event shall the public utility be granted an increase in local exchange rates which is greater than the overall average percentage increase in total intra-state revenues authorized by the commission unless the utility proves by record evidence that a greater percentage increase for local exchange service is justified based upon the cost of providing that service.

Thus, the statute recognizes the costs of the dial tone line as shared costs, and requires that only a portion of these costs be allocated to local exchange service.

Bell contended that Section 1325 did not apply to its rebalancing proposal because it is only applicable to situations where an overall percentage increase in rates is requested.

* * *

... Bell is wrong in its contention; Section 1325 does apply to Bell's rate rebalancing filing. As set forth in Section 1325(a), this statute applies to "any rate proceeding pursuant to section 1308 (relating to voluntary changes in rates)." 66 Pa. C.S. §1325(a). (Emphasis added.) The statute is clearly applicable in this case. If Bell's proposal is revenue neutral as it claims, then the overall average percentage increase in total intrastate revenues which it is proposing is zero. Thus, as the OCA argued, Bell's proposed increases to local exchange service cannot be granted unless Bell is able to prove that "a greater percentage increase for local exchange service is justified based upon the cost of providing that service." OCA M.B., p. 136.

(R.D., pp. 12-14).

Bell also asserted that, even if Section 1325 did apply to the instant, Rate Rebalancing filing, it has, in fact, shown that its proposed increases to dial tone line service "are justified based upon the 'cost of providing that service' as required by the statute." (R.D., p. 14). This alternative position was also rejected by ALJ Cocheres. Because Bell steadfastly maintained that dial tone line is a separate service, the ALJ concluded that Bell could not justify its proposed rate increase in view of the statutory definition. (Id.). Bell's position was, in the view of the presiding ALJ, inconsistent with the language of Section 1325(c).

66 Pa. C.S. §1325(c). ALJ Cocheres referenced the testimony of certain of Bell's laymen witnesses, as espousing a position inconsistent with the allocation of 100% of costs to the dial tone line component.

As an example, the testimony of Bell's witness, Dr. Taylor was cited wherein he stated:

... BA-PA did not add to the direct cost of the Dial Tone line service an additional amount representing an allocation of these same Dial Tone line costs to Dial Tone line service, as the statute appears to suggest. Any additional assignment of Dial Tone line costs to Dial Tone line service would entail double-counting of those costs and would be illogical and inconsistent with economic costing principles. In any event, since BA-PA's residence Dial Tone line rates do not currently cover their direct costs, they certainly could not cover their direct costs plus some allocation of additional costs.

(R.D., p. 15 citing Bell St. No. 3.0 (Taylor), p. 15).

Also, Bell's witness Mr. Sanford asserted that "[a] stand-alone cost study for dial tone line service under section 1325 would require double counting since the study would have to included [sic] the direct costs of providing dial tone service 'plus a share of the costs of the dial tone line.'" (Id., citing Bell St. No. 2.0 (Sanford) p. 9). Consequently, the ALJ observed that "[t]he testimony of Bell's witnesses would seem to be credible if dial tone line could be considered to be a separate service, as Bell contends. However, neither Bell nor I are in a position to conclude that the statute [Section 1325] is illogical and can thus be ignored."

The ALJ concluded that "[t]he only reasonable and proper conclusion in light of the language of Section 1325(c) is that dial tone line must be treated as a component of multiple services whose costs must be allocated among these services, and not as a separate service."

Two other considerations influenced ALJ Cocheres' conclusion to reject the proposed allocation of 100% of dial tone line costs to the dial tone line component. First, he was persuaded by language in this Commission's Universal Service Investigation proceeding that held that local loop costs should, for universal service purposes, be considered joint or shared costs. The OCA pointed out the following language in our Order entered September 5, 1995, Slip Op. at 12 in the Universal Service Investigation which stated in part:

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.

(R.D., p. 16 citing OCA St. 3S, p. 25).

Second, ALJ Cocheres observed that the Federal Communications Commission ("FCC") has recently determined that loop costs are joint or common costs of providing service. As the FCC stated in its interpretation of the Telecommunications Act of 1996 (47 U.S.C. § 201, et seq.) ("Act" hereafter), when services are priced for unbundling:

The term "common costs" refers to costs that are incurred in connection with the production of multiple products or services, and remains unchanged as the relative proportion of those products or services varies (e.g., the salaries of corporate managers). Such costs may be common to all services provided by the firm or common to only a subset of those services or elements. If a cost is common with respect to a subset of services or elements, for example, a firm avoids that cost only by not providing each and every service or element in the subset. For the purpose of our discussion, we refer to joint and common costs as simply common costs unless the distinction is relevant in a particular context.

* * *

As discussed in greater detail below, separate telecommunications services are typically provided over shared network facilities, the costs of which may be joint or common with respect to some services. The costs of local loops and their associated line cards in local switches, for example, are common with respect to interstate access service and local exchange service, because once these facilities are installed to provide one service they are able to provide the other at no additional cost.

(R.D., p. 17 citing OCA M.B. citing In the Matter of: Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, August 8, 1996 at ¶¶ 676, 678).

Exceptions

Bell excepted to ALJ Cocheres' recommendation. Bell explains that its local exchange service rate structure has two components - Dial Tone Line service and local usage service options. All customers must subscribe to Dial Tone Line service, which is a flat rate charge designed to cover the cost of the dial

tone line facility, i.e. the loop which extends from the telephone company's central office to each customer's premises. (Bell Exc., p. 4). Bell goes on to note that the Dial Tone Line service facility is dedicated to a specific customer but does not vary based on the level of telephone usage. Therefore, the Dial Tone Line service should be recovered from the subscribing customer. (Id.). On the basis of the foregoing, Bell states that virtually all experts agree that Dial Tone Line service is a separate and distinct service and dial tone line costs should not be allocated to other services. (Id.).

Bell then repeats four arguments supportive of its view that it is erroneous to reject its proposal based on its determination to allocate 100% of dial tone line costs to this service.

Bell argues that dial tone line costs do not meet the economic definition of joint or shared costs. To the contrary, Bell states that most economists agree that the dial tone line is a separate service with its own separate demand. (Bell Exc., p. 5).

Bell next states that the allocation of dial tone line costs to other services is illogical. Here, Bell admits that the dial tone line portion of the loop facility is, in fact, used for all telecommunications services. However, Bell counters that this fact does not mean that the costs are joint or common, or that they are appropriately allocated to other services. Bell would analogize the argument that dial tone line costs are joint or shared costs, to the argument that the telephone set (which is necessary for local calls, toll calls and all other telephone services), is such a service. Bell attempts to draw attention to the logic of this position by noting that no one would argue that the telephone set is not a separate facility with separate costs. Also, Bell notes that no one could logically argue that the costs of telephone

sets should be allocated to the cost of other telephone services, like toll and access, simply on the basis that the set is a necessary component of all telecommunications services. (Bell Exc., p. 6).

Next, Bell argues that as a matter of policy, the allocation of dial tone line costs to other services will ensure the continuation of cross-subsidies among customers and customer classes. (Id.).

Finally, Bell distinguishes the arguments that favor allocating loop costs to other services as an argument over the proper recovery of these costs. Even were this Commission to agree with the theory that a significant portion of the loop costs should be "recovered" from long-distance carriers and their customers, (a theory with which Bell states the Commission should not agree), one should not confuse cost recovery with cost causation, argues Bell, by incorrectly allocating loop costs to the costs of other services. (Bell Exc., p. 7).

In this Exception, Bell also replies to the observations of ALJ Cocheres that Section 1325 of the Public Utility Code and the FCC discussion in its Local Competition Order suggest that the allocation of 100% of dial tone line costs to the dial tone component is unreasonable.

With regard to Section 1325, Bell takes the view that this section does not require the allocation of loop costs at all, but merely limits increases on local exchange service to the overall average percentage increase for all other services. Consequently, asserts Bell, this section has no applicability to revenue neutral changes within local exchange market baskets of services as no overall percentage increase is being sought. (Bell

Exc., p. 8). Bell then makes the point that the definitions of Section 1325 are not to apply to other sections of the Public Utility Code and there is no basis for extending these definitions to a different context than the very limited context addressed in Section 1325. (Bell Exc., p. 9).

With regard to the FCC's Local Competition Order, Bell states that said order merely reflects the FCC's treatment of loop costs for purposes of separation between the interstate and intrastate jurisdictions. (Id.)

Finally, Bell states that the parties to the Commission's Universal Service Investigation disagreed with the characterization of loop costs as joint or shared costs.

AT&T also excepted to ALJ Cocheres' recommendation. AT&T supports the ALJ in his result only. (AT&T Exc., p. 4). AT&T agrees with the position of Bell, "... that allocation of 100% of local loop costs to local exchange services is the only economically sound way to allocate costs under the incremental cost study analysis approach endorsed by all parties to this proceeding." AT&T takes the view that a 100% allocation is appropriate because local exchange service is a separate service with separate costs and is the cost causer of the local loop costs. (AT&T Exc., p. 4).

However, although AT&T disagrees with the ALJ regarding his allocation of local loop costs, it believes that the correct result was reached with the determination that Bell's local exchange service, on a statewide, total service basis, is not subsidized by other services. Under AT&T's view, Bell's position on cross-subsidization is erroneous, and is driven by the failure to include all of the revenues associated with local exchange service in its cost study analysis. AT&T specifically targets for

criticism Bell's cross-subsidization position. AT&T asserts that Bell's position is based on a "manipulation" of the revenue side of the cost analysis equation to exclude consideration of revenues associated with the subscriber line charge ("SLC") and the portion of interstate common carrier line charge ("CCLC") revenues associated with recovering dial tone line costs. (AT&T Exc., pp. 4-5).

According to AT&T, once the revenue equation is corrected to include all revenues Bell receives either from its local exchange services or as federal support for the dial tone line, Bell's own cost study (even with 100% local loop allocation) demonstrates that local exchange service, in the aggregate, provides a contribution above costs. (AT&T, Exc., p. 5). On the basis of the foregoing, AT&T concludes that Bell has not met its burden of proof of demonstrating that its \$41 million increase to local service revenues is just and reasonable. AT&T sees the issue as one of Bell being motivated to isolate its revenues from competitive risk. (Id.)

Disposition

On consideration of the position of the parties, we shall, hereby, adopt the recommendation of ALJ Cocheres, consistent with our reasoning delineated, below.

Initially, we must start from the alternative regulation compact which we approved for Bell in our June 28, 1994 Opinion and Order. In the Alternative Regulation Order, Ordering Paragraph No. 7, Bell was given the opportunity to propose revenue neutral "cross" market basket proposals to the extent it provided rational reasons, i.e. reasons why such a restriction is not feasible or advisable from a public policy standpoint. In this proceeding, we

~~conclude that Bell has not met its burden of demonstrating any rational reasons for us to permit the Company to cross market baskets.~~

~~Also, we generally agree with the analysis of the A.C. 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.⁸ It is without question that the dial tone serves as the platform from which a host of telecommunications services, are, in fact, provided. We have recognized this in several proceedings, including our Universal Service Investigation, and in Pa. P.U.C. v. Breezewood Telephone Company, 74 Pa. P.U.C. 431 (1977), as has the FCC in its Local Competition Order.~~

Consequently, while there may be some merit to Bell's distinction that the debate over the proper allocation of loop costs 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 yet, endorse any competing percentage allocation⁹ of local loop costs, we find that 100% allocation to

⁸ Dial tone line costs, more appropriately called local loop costs, are the costs associated with providing local loop service. These costs are recovered in part from the following: (a) DTL rates on a local basis; (b) intrastate access charges on an intrastate toll basis; (c) interstate access charges on an interstate basis, as well as from the SLC.

⁹ We note that the OCA and the OTS, have variously asserted that because the local loop is a shared facility, that allocating 50% of the direct cost of the local loop to the dial

one component is not reasonable and does not result in a revenue neutral impact.

We are also constrained to agree with ALJ Cocheres concerning his interpretation of Section 1325 and its applicability to this proceeding. Section 1325 applies to any rate proceeding. Where the words of a statute are clear and unambiguous, they should be given their ordinary meaning. We disagree with Bell that there is any need to go outside of the clear and unambiguous language of Section 1325 to interpret its applicability to this matter.

Finally, we note that an additional consideration supports our determination to adopt the ALJ in his result. That consideration pertains to the revenue portion of the equation. As AT&T points out, if one considers SLC and CCLC revenues as part of the equation, the dial tone line rates clearly recover their costs.¹⁰

On the basis of the foregoing, we shall adopt the ALJ's conclusion on this issue. This does not mean that we endorse all aspects of his reasoning except as expressly noted, above.

2. Broadband Network Costs

The OCA also sponsored evidence which showed that Bell incorrectly calculated narrowband service costs and wire center

tone line is a reasonable compromise. See, for example, OTS R.Exc., p. 3.

¹⁰ In this regard, we note that the OCA also states "As Bell properly recovers some cost of its dial tone line from carrier access service, it should not also recover 100% of its dial tone line costs from local exchange service as well. See OCA R.Exc., p. 2.

costs. ALJ Cocheres, while he did not accept the OCA's particular proposal mechanism in this proceeding, generally agreed with the OCA that a change in the allocation of the specific costs, namely broadband network costs, can produce results significantly different from those on which Bell based its proposed rebalancing. (R.D., p. 23).

With regard to common costs¹¹, the OCA argued that Bell did not properly divide broadband costs between those attributable to narrowband service and broadband service. (R.D., p. 18 citing OCA M.B., pp. 98, 100-102). A portion of the broadband facilities are used in common to render both narrowband and broadband service. The OCA asserted that the costs of the common facilities should be divided between the narrowband and broadband services. ALJ Cocheres construed the testimony of Bell's witness Mr. Sanford, as evidence that Bell did separate broadband from narrowband costs, but made no allowance for common costs. (R.D., p. 19 citing Bell St. No. 2.1 (Sanford), p. 22). Bell's testimony divides the broadband equipment into two categories, i.e., broadband and narrowband (or voice grade). The costs of facilities which could be used to render narrowband service were allocated to that service with no regard to whether the same facilities could also render broadband service. The ALJ concluded that the result of the Company's failure to make this allocation is that narrowband users would have been paying for all or 100% of the broadband common facilities costs and that the narrowband local loop costs are unduly inflated. (Id., citing OCA St. No. 3S (Dunkel), pp. 64-65).

¹¹ Since a portion of broadband facilities are dedicated to render narrowband service exclusively, the costs for those facilities were, in fact, allocated to narrowband service. ALJ Cocheres, after reviewing Bell St. No. 2.1 (Sanford), p. 22, concluded that, in actuality, the parties did not disagree on this subject. (R.D., p. 18).

We note that Bell has not, apparently, filed an Exception to the ALJ's treatment of the narrowband issue. Consistent with our reasoning below, we accept the ALJ recommendation in its result.¹²

E. RESIDENTIAL ISSUES

We include a description and discussion of the salient features of Bell's rate proposals for the various residential rate classes¹³ as taken from the R.D. The presiding ALJ regarded the decreases as a package with the increases.

1. Touch Tone Charges

Bell proposed to eliminate current touch tone charges for all residential and business customers. (R.D., pp. 24-25 citing Bell M.B., pp. 19-20 and App 1, p. 1).

Exceptions

Bell generally excepts to the ALJ's dismissal, out of hand, of its proposal concerning touch-tone charges.¹⁴ Bell refers this Commission to its Appendix A and states that touch-tone

¹² See OCA R.Exc., p. 10, n. 8.

¹³ As noted by ALJ Cocheres, when the Company refers to its average residential customer, it is referring to a customer who purchases Touch Tone Service, Dial Tone and the Local Unlimited Usage Option Package. The record reflects that these customers constitute the vast majority of this customer class. In addition, the rates outlined here do not demonstrate how the substantial minority of customers who use the Budget and Standard Plans (measured usage) received much higher increases.

¹⁴ We note that all proposals not specifically addressed were considered rejected by the ALJ. (R.D., p. 7),

decreases offset the Dial Tone Line increases by \$33 million. (Bell Exc., p. 13, n. 31).

Disposition

We note that Bell's Rate Rebalancing filing included the elimination of the separate charge for residence customers' touch-tone service. Based on Bell's revenue numbers appearing as Appendix A of Bell's Replies to Exceptions, the residence touch-tone revenue reduction would be offset by a like amount increase in residential dial tone line service rates.

Bell asserts that a majority of its residential customers subscribe to touch-tone service as evidenced by a subscription rate nearing 80%. While it is true that elimination of the separate touch-tone charge and "roll-in" to the dial tone line service rate would be both revenue neutral to Bell and, arguably, a savings for those customers who have touch-tone today (100% of Bell's residential customers would share the cost of what 80% pay for touch-tone today), the 20% of Bell's customers who today choose rotary dial service would face an increase in dial tone line rates.

Inclusion of touch-tone in the dial tone line service rate make some intrinsic sense, and, in fact, is consistent with this Commission's definition of basic universal service which includes touch-tone capabilities. We are of the opinion, however, that an increase in rates to 20% of the residential customers is troublesome. We shall, therefore, give Bell the alternative of rolling touch-tone rates into residential dial tone lines if Bell can present a method whereby the existing customers who do not subscribe to touch-tone can be grandfathered as long as they are at their existing domicile. The "roll-in" would therefore not affect existing customers since existing touch-tone customers will have no

rate decrease and existing customers who do not subscribe to touch-tone will have no increase.

2. Dial Tone Line Charges

Bell proposed to increase dial tone line charges for all residential customers in all four of its density cells.¹⁵ The increases for single party residential lines ranged from a low in cell one of \$2.80 to a high in cell four of \$2.95 monthly. (R.D., p. 25 citing Bell M.B., pp. 19-20 and App. 1, p. 1). Consistent with his view expressed throughout the R.D., ALJ Cocheres concluded that Bell failed to justify its proposed dial tone line increases. (Id.). On this basis, the ALJ recommended their rejection.

Exceptions

Bell excepted to the ALJ's recommendation to reject its proposal to increase dial tone line charges for all residential customers. Bell initially faults the ALJ for failing to employ the proper standard of review for this proposal. (Bell Exc., p. 12). Substantively, Bell explains that it has proposed to raise rates for residential Dial Tone Line service for the first time in over a decade. (Bell Exc., p. 13). It argues that even including the SLC, dial tone line rates do not currently recover their costs in any density cell. (Id.). Thereafter, Bell refers to data (proprietary) setting forth the current rate, plus SLC, the cost, and the proposed rate with touch-tone and SLC. This data purports

¹⁵ A density cell is a group of wire centers whose customers share a common population density range per wire center. Cell one customers are located in the most densely populated urban areas. Cell four customers are located in the least densely populated rural areas.

to show that the current rate is below the apparent cost. (Bell Exc., pp. 13-14).¹⁶

Disposition

We find that the disposition of this issue is to be governed by certain of the overall observations of the presiding ALJ whose result we have adopted. While the rejection of Bell's proposal was not discussed at length in the R.D., we shall adopt the ALJ decision in his result. We shall, consistent with our discussion regarding dial tone line costs, reject Bell's proposal as based on an unsupported premise.

3. Measured Usage Charges

Bell described its proposal as follows:

BA-PAs rate rebalancing proposal simplifies the current usage structure. Rates for most local usage packages are decreased. It contains a consistent per minute rate for calls in Bands 2 through 6, regardless of initial/additional minutes for each rate period. The proposal reduces the time of day rate period structure to two rate periods: Day and night/Weekend. In addition, although no change is proposed in the day rate for Metro Call Band 1 calls (which remains \$.07 per call), BA-PA proposes an increase in the night/weekend rate from \$.028 to \$.035 per call for Metro Call band 1 calls.

(R.D., p. 25, citing Bell M.B., pp. 20-21). (Footnotes omitted.)

At page 25 of the R.D., ALJ Cocheres observed that the only local measured usage plans offered by Bell are the Standard

¹⁶ Bell did not include intrastate and interstate CCLC revenues in this presentation.

and Budget Plans.¹⁷ Both plans stood to receive net increases from the Rate Rebalancing proposal. ALJ Cocheres agreed with the evaluation of the proposal by the OCA when it described the impact of the proposed plans as follows:

... Bell ratepayers subscribing to the Standard Usage option without Touch Tone will experience basic local service increases of 45%, 44%, 42% and 40% in Density Cells 1 through 4 respectively.³⁵ Those Standard Usage customers with Touch Tone will experience 26%, 26%, 25% and 24% increases in Cells 1 through 4. Id.

Obviously, the impact of Bell's proposals on those ratepayers subscribing to the Budget Usage option is even more significant. With percentage increases of 77%, 72%, 67% and 62% in Density Cells 1 through 4,³⁶ these customers experience some of the maximum percentage increases under Bell's proposal. Only Lifeline customers experience greater percentage increases in their basic local service rates or Touch Tone.

³⁵AT&T Exh. Darrah Rebuttal (Surrebuttal) Exhibit 1. Percentages do not include Subscriber Line Charge.

³⁶OCA Exh. WWD-3. Percentages do not include Subscriber Line Charge or Touch Tone.

(R.D., p. 26 citing OCA M.B., p. 45).

ALJ Cocheres, while not necessarily accepting the OCA's calculation of the percentages, did agree that the Budget and Standard Plan customers would have received an increase according to Bell's proposal. (R.D., p. 26).

¹⁷ This does not appear to be an accurate observation. Bell, in fact, does offer other measured usage packages.

We find no Exceptions referenced to this particular issue. Finding no exceptions germane to this question, we shall, therefore, adopt the ALJ's conclusion.

4. Lifeline and Affordability

The OCA presented the monthly Lifeline charge for budget measured usage customers in the following chart:

Lifeline Customer With Budget Measured Usage Option

	<u>Present Rate</u>	<u>Proposed</u>	<u>\$ Increase</u>	<u>% Increase</u>
Density Cell 1 Dial Tone Line Service	\$1.15	\$3.95	\$2.80	243%
Density Cell 2 Dial Tone Line Service	\$1.45	\$4.30	\$2.85	196%
Density Cell 3 Dial Tone Line Service	\$1.85	\$4.75	\$2.90	156%
Density Cell 4 Dial Tone Line Service	\$2.25	\$5.20	\$2.95	131%

(OCA Exh. WWD-2 at 1. OCA M.B., p. 56).

According to Bell, the proposed monthly range for Lifeline rates is \$4.95 to \$6.20.¹⁸ ALJ Cocheres observed that the apparent difference between the OCA numbers and the Company numbers

¹⁸ This range was calculated by assuming that a Lifeline customer would choose budget service. Dial Tone Line charges range from \$6.45 (cell one) to \$7.70 (cell four), plus \$3.50 Subscriber Line Charge (SLC), less \$5.00 Lifeline Credit. Bell St. No. 1.1 (Eichenlaub) at 30.

is the result of different methods of calculation. He noted that the OCA did not add the SLC and used only half (\$2.50) of the Lifeline Credit which was deducted from the Dial Tone Line cost. (The \$5.00 Lifeline Credit is normally deducted half from the SLC and half from the Dial Tone Line.) (R.D., p. 31).

The presiding ALJ was unpersuaded as to the usefulness of the OCA's or Bell's analysis of the impact of the instant filing on rates for the Lifeline customers. He remarked:

The difference in these methods of calculation proves the truth of the Mark Twain quote: "There are three kinds of lies: lies, damned lies and statistics." As expected, the OCA argued that the range of increase for Lifeline customers was 131% to 243%. OCA M.B., pp. 58-61. These percentages are eye-catching for the class of customers who can afford increases least. On the other hand, Bell argued that the proposed increases resulted in a range from \$.16 to \$.21 per day for Lifeline service. Bell M.B., p. 26. Bell R.B., p. 23. Obviously, Bell's numbers sound less expensive than one \$.25 pay phone call per day.

Both arguments are factually correct and generally useless to help resolve the underlying policy question. The real issue is: How much can poor customers afford to pay for monthly telephone service? No party presented evidence which could be used to correctly decide this issue. For instance, there was no statistical study (perhaps violating Mark Twain's wise advice) demonstrating how much low and very low income families could pay for phone service. Instead, there was nothing more than a range of proposed increases, i.e. \$2.80 through \$2.95, and an assertion that the increase was fair and affordable. Bell M.B., p. 26. Bell R.B., pp. 23-24. While this argument mimics the statutory policy of the Public Utility Code (66 Pa. C.S. §3001(1)), this kind of evidence is hardly enough for me to use to recommend

that the customers who must watch every penny closely should endure a nearly \$3.00 monthly rate increase. The most affordable of the rates should be the proposed Lifeline rate. Based on this record, I cannot come to that conclusion.

(R.D., pp. 31-32).

Disposition

Because of our conclusions elsewhere, determining that Bell has not met its burden under either Section 1325 or this Commission's Alternative Regulation Order, we need not express an opinion as to the merits of either the OCA or the Company's analysis.

F. COMPETITION

One of the cornerstones of Bell's case is its assertion that "Competitive Pressure Mandates Rate Rebalancing Now." (R.D., p. 29 citing Bell M.B., p. 10).

ALJ Cocheres concluded that the nexus between the existence of competition and the need for rate rebalancing (and particularly this Rate Rebalancing filing) is missing from this case. ALJ Cocheres was unpersuaded that the fact that Bell has lost minimal market share in the intraLATA toll market and that other well financed, large competitive carriers are authorized to render service in Bell's territory, supported the competitive necessity for the instant filing. The ability of competitors to capture part of Bell's market share, did not, in his view, diminish Bell's continuing dominance of the vast majority of the market. (R.D., pp. 30-31). He found it difficult to see a link between the "threat" of competition and the need for rate relief

when Bell's quarterly reports show substantial income evidencing robust financial health in the newly emerging competitive environment. See, OCA St. 1 (Catlin), p. 5 and Ex. TSC-1.

Disposition

We address the above-cited opinions as dicta, and not essential to our disposition of the issues in this proceeding. This Commission, as a result to the Act, and Chapter 30 of the Public Utility Code, is faced with the daunting task of promoting competition while establishing appropriate pricing signals which may require decreasing the prices of certain services which are above cost, and proportionately increasing the prices of other services, while protecting the consumer from unreasonable price increases.

G. TOLL AND ACCESS ISSUES

1. Automatic Savings Plan

In AT&T Communications of Pennsylvania, Inc., et al v. Bell Atlantic-Pennsylvania, Inc., Docket Nos. R-00953394C0002, R-00953396C0002-C0004, R-00953409C0001 and C0004, (Order adopted June 20, 1996) we granted Bell the authority to implement an Automatic Savings Plan ("ASP"). Currently, Bell's ASP provides customers with a 20% discount on qualifying intraLATA toll calls of \$20 or more per month. Bell proposed to expand its ASP in this proceeding. The Company's current proposal would provide a 10% discount on qualifying intraLATA toll calls between \$5 - \$19.99 per month. Bell argued that the plan was reasonable, was not anti-competitive, did not result in a price squeeze and was not subject to an imputation requirement. (R.D., pp. 31-32).

AT&T argued that the original ASP was anti-competitive and that the proposed extension was as well. AT&T explained that the proposed rate resulted in a price squeeze for competing carriers. It asserted that Bell was using its dominance in the intraLATA market to strengthen its toll position without properly reducing access costs. (R.D., p. 32 citing AT&T M.B., pp. 17-23. AT&T R.B., pp. 9-11).

The OCA argued that the decreased toll revenue resulting from the proposed ASP could not be used to justify far larger increases in dial tone rates. The OCA disputed the Company claim that the toll reductions from the new ASP would offset the massive increases in dial tone line charges. The OCA concluded that the residential ratepayers should not be required to fund losses on a competitive toll reduction plan. (*Id.*, citing OCA M.B., pp. 54-55. OCA R.B., pp. 17-18).

ALJ Cocheres generally agreed with OCA, *i.e.*, the proposed reduction in revenues is so small in comparison to the proposed increase for the residential customers that the reduction can hardly be used to justify the increase. He did not find the AT&T position persuasive. He observed that this Commission has previously rejected the arguments raised by AT&T when the original ASP was proposed and AT&T has offered no additional arguments in this case which change that conclusion. (R.D., pp. 32-33).

Exceptions

Bell excepted to the R.D. It states that the proposed expansion will extend the benefits of toll discounts to customers with lower toll bills who do not currently have any discounts

available to them. (Bell Exc., p. 22). Bell, also notes that these toll reductions total \$6.8 million. (Id.).

AT&T also excepted to the R.D. AT&T objects to the dicta in the R.D. which it suggests indicates that had the general rate rebalancing proposal of Bell been acceptable, it would have been permissible to include the subject toll reductions without consideration of whether the proposals were competitively fair or caused a price squeeze for competitors. (AT&T Exc., p. 9). AT&T asserts that the emphasized dicta is contrary to AT&T v. Bell, supra, in that the discount plans at issue should be subject to an imputation test.

Disposition

On consideration of the R.D., and Exceptions thereto, we conclude that granting Bell the authority to expand the ASP is beneficial to residential ratepayers. However, as noted in our discussion of Bell's proposal for a late payment charge, we shall condition our discussion of this issue upon Bell's use of the ASP as a revenue neutral offset to the late payment charge.

Bell's proposed ASP provides customers with an automatic 10% savings when they make between \$5.00 and \$19.99 of qualifying intraLATA toll calls per month. What is clear from Bell's proposal is that residential customers will receive reduced rates. Therefore, this is a benefit. Consequently, we shall not adopt the ALJ recommendation, but shall approve the proposal. What is not clear from the Company's filing, however, is where should the revenue neutral adjustment come from to offset the decrease. Consequently, we shall reference our discussion of the Company's proposed late payment charge to answer the previously cited question.

With regard to the Exceptions of AT&T, we shall deny them consistent with our initial approval of the ASP. We find that AT&T has raised no considerations in its opposition to the ASP which we have not previously rejected.

2. Business MTS Flat Rate

Bell proposed restructuring business MTS rates to eliminate time of day and distance sensitive rates and to create a postalized rate of \$.10 per minute (\$.07 per minute for certified speech and/or disabled business customers). Bell further proposed to change the service rates for WATS, Maximum Value Plan and Optional Business Calling Plus. See Bell M.B., p. 36.

AT&T contended that this proposal was a questionable response to competition and that Bell's pricing advantage, when taken with its dominant service provider position in the business and commercial intraLATA toll market, was anticompetitive. AT&T argued that Bell's proposal placed its competitors in a price squeeze which prevented effective competition. AT&T St. 1.0 (Darrah), pp. 17, 22-23. AT&T M.B., p. 23. Bell asserted that, since no imputation was required under Chapter 30, there was no price squeeze. (R.D., p. 33 citing Bell M.B., p. 37).

The OSBA asserted that Bell's position that, "most business customers will experience a net decrease in their bills," was unsupported by any Bell calculations. (R.D., p. 33 citing, inter alia, OSBA R.B. p. 2).

The ALJ rejected Bell's proposal based upon his previous finding that alleged reductions in this plan are at the

expense of unwarranted residential increases. In the alternative, ALJ Cocheres further concluded that Bell is not required to meet an imputation test and that, consequently, a price squeeze would not occur. (Id.).

3. Metropolitan Area Unlimited Plus Service (MAUPS)

ALJ Cocheres, for reasons similar to his general conclusion that Bell did not make a substantial case, dismissed Bell's proposal for Metropolitan Area Unlimited Plus Service ("MAUPS").

Exceptions

Bell, in its Exceptions, notes that MAUPS is an expansion of its existing service. This service is proposed in response to specific customer requests in the outer or second tier Philadelphia and Pittsburgh suburbs for an optional calling package that would give unlimited local calling into the Philadelphia and Pittsburgh metropolitan areas. (Bell Exc., p. 24).

On consideration of the Exceptions of Bell, we shall reject the ALJ recommendation concerning this tariff offering. MAUPS is a new service offering. No existing customers will experience a rate increase. Only those customers choosing to purchase the service will be subjected to a new rate. To the extent that customers find Bell's proposed rates objectionable, they can choose not to subscribe to the service and avoid the proposed rates. Therefore, consistent with our discussion with regard to Local Transport Access Service Rates, we shall allow Bell the alternative to offset the revenue increase from Local Transport Access Service with the decreases from MAUPS.

4. Local Transport Access Service Rate

Bell proposed the restructuring of switched access local transport rates to create a rating distinction between direct and tandem routed traffic. Direct trunked transport will be flat-rated on a distance sensitive basis. Tandem transport will be rated on a usage (per minute of use) and distance sensitive (per mile) basis. Bell explained that this proposal was uncontested. See Bell M.B., pp. 38-39. The Company denied that this proposal would result in a price squeeze. Bell M.B., pp. 39-40.

AT&T accepted Bell's proposal as a first step, if universal service and competition in all telecommunications markets were to be achieved. (R.D., p. 35). However, AT&T criticized the proposal as a revenue decrease which was insignificant compared to the access contributions that were embedded in Bell's carrier access charges. AT&T also believed that the Company's refusal to decrease access rates further was inconsistent with the FCC's view that reducing access was necessary for the development of competition. AT&T R.B., pp. 12-13. MCI also complained that the access rate reduction was inadequate when compared to toll reductions. MCI R.B., pp. 9-11.

The ALJ recommended acceptance of the local transport Access Service Rate restructuring proposed by Bell primarily because it substantially mirrors the structure which has been adopted at the federal level. Unlike the interstate structure, it does not include the Residual Interconnection Charge

("RIC").¹⁹ AT&T and MCI accepted the proposal, but wanted a bigger reduction. However, there is no record evidence to quantify their criticism. The ALJ also endorses the AT&T position that the proposal is at least a first step in the right direction if universal service and competition in all telecommunications markets are to be achieved.

Exceptions

Bell filed exceptions to the ALJ's recommendation arguing that the ALJ correctly approved its proposed reduction of its access charge through a Local Transport Restructure but erred in failing to approve a revenue increase to offset the \$17 million reduction and make it revenue neutral. Bell argues that its Chapter 30 Plan contains no provision that would require it to reduce rates without permitting an offsetting increase to make that change revenue neutral. Similarly, Bell continues, Chapter 30 requires access charge reductions to be revenue neutral. As a result, the ALJ's omission must be corrected and Bell must be permitted to offset this rate reduction in a revenue neutral manner.

Disposition

According to Bell's Chapter 30 Alternative Regulation Plan that was approved with modifications, we can only permit price changes that are revenue neutral. In reviewing the record in this proceeding, we have determined that there are a number of

¹⁹ The RIC is a non-cost based element developed by the FCC to maintain revenue neutrality for the local transport rate element on a stand alone basis. Since this revenue neutral filing was intended to minimize subsidies to the extent possible, a RIC was not proposed. Bell St. 1.0 (Eichenlaub), p. 19.

elements in Bell's rate rebalancing proposal that are uncontested and/or new service offerings that could reasonably be combined to yield a neutral offset to the Local Transport Access Service Rate. ~~We are willing to permit Bell to increase the rates for noncompetitive, nonprotected services in order to realize a revenue neutral filing. These noncompetitive, nonprotected services as identified in Appendix A of Bell's Exceptions include: Terminating Feature Group A, Residential Return Call, Business Return Call, Calling Card Surcharge and Business Remote Call Forwarding.~~ Therefore, we will grant Bell's exceptions in this regard and permit it to file revenue neutral increases as discussed above.

H. UNIVERSAL SERVICE VS. RATE REBALANCING

Both AT&T and MCI strenuously asserted that Bell's rate rebalancing proposals should, at a minimum, be postponed until after the Commission implements a universal funding mechanism. AT&T M.B., pp. 29-42. MCI M.B., passim. AT&T R.B., pp. 1-9. MCI R.B., pp. 12-14. Bell argued that rate rebalancing moves prices closer to costs which promotes efficient market entry and competition. Further, the Company maintained that the establishment of a universal service fund was not a prerequisite to rate rebalancing and that the absence of such a fund in Pennsylvania should not be used to delay implementation of the Bell proposal. Bell M.B., pp. 8-10. Bell R.B., pp. 46-47.

ALJ Cocheres concluded as follows:

Even though I cannot recommend the adoption of Bell's proposal, I have concluded that each of the concepts can function independent of the other. MCI provided the following discussion of the operation of a universal

funding mechanism which helps demonstrate my point:

Contrary to Bell's second argument, there is also no need or advantage to rebalance immediately in order to reduce the amount of the subsidy which ultimately will be provided from the universal service fund. The amount of subsidy required by the universal service fund will be determined solely by the following factors: (1) the universal service rate established by the Commission; (2) the forward looking costs of providing local service in regions where costs are higher than the universal service rate; and (3) the numbers of subscribers eligible for subsidies in each such high cost area. So long as Bell and other local exchange carriers are all permitted to charge the Commission established universal service rate at the time the universal service fund is implemented, the subsidy required from the fund will not depend at all on whether Bell had previously been permitted to rebalance its rates.

This fact can be simply illustrated through the following example. Assume that the monthly universal service rate is set at \$20; that the monthly cost of providing basic local service is \$35 in the only region where costs exceed the universal service rate; and that there are 100,000 subscribers in this high cost region eligible for subsidies. Assume further that Bell's existing rate for basic local service is \$12 and that Bell is permitted to increase this charge to the universal service rate at the time the fund is implemented.

Under these assumptions, the monthly subsidy required from the universal service fund would be \$1,500,000 [(\$35-\$20) x 100,000]. Obviously, the size of this subsidy does not depend at all upon Bell's pre-existing \$12 rate for basic local service. Rather, the required subsidy would still be \$1.5 million per month even if Bell had earlier been permitted to increase its rate for basic local service from \$12 to \$16. Thus contrary to Bell's contention, rebalancing prior to the establishment of a universal service fund does not reduce the amount of the subsidy which ultimately will be required.

(R.D., pp. 37-38 quoting MCI M.B., pp. 15-16).

Two observations complete the ALL's discussion of this issue. First, ALJ Cocheres determined that the numerical example was compatible with this Commission's description of the universal funding mechanism contemplated by the pending investigation and final-form rulemaking. Rulemaking to Establish a Universal Service Funding Mechanism; 52 Pa. Code §63.141, et seq., Final-Form Rulemaking Order, entered June 21, 1996, at Docket No. L-00950105 (Slip Op. at 10).

Second, the ALJ concluded that the MCI quotation demonstrates that rate rebalancing (whether it occurs before, after or during the establishment of a universal service fund) has no impact on the formation and operation of the fund. Accordingly, the ALJ concluded that, if Bell had proposed an acceptable rebalancing plan, there would have been no need to postpone implementation pending the formation of a universal service fund. (R.D., p. 39).

Exceptions

AT&T and MCI filed Exceptions to the ALJ's conclusion. The OSBA filed Replies to the Exceptions. Both AT&T and MCI take issue with the proposed coordination and impact of rate rebalancing and the establishment of a universal service funding mechanism.

Disposition

In a recent order considering the scope of matters to be considered in Application of MFS Intelenet of PA., Inc., Docket No. A-310203.F2, et al. (Order entered December 9, 1996), (MFS - Phase III) we have committed to the disposition of an appropriate universal service funding mechanism for on or about December 19, 1996. We hereby adopt the reasoning of the ALJ, recognizing our timetable for coordinating universal service concepts in the context of rate rebalancing.

I. BUSINESS ISSUES

1. Parties' Positions

The OSBA asserted that it supported the concept of rate rebalancing in general, but contended that Bell failed to provide evidence to justify its particular rebalancing proposal in this proceeding. OSBA M.B., pp. 6-7. Specifically, the OSBA argued that:

Bell has failed to prove how its proposed rates in its revised local business usage rate structure either adjust rates to competitive market levels or bring the rates closer to cost. Bell has also failed to

prove its claim that its plan results in no additional revenue to BA-PA.

Id., at 8.

Like the OSBA, CAPA also took issue with Bell's proposed restructuring of its business local usage rates. CAPA's specific objection was related to Bell's proposal to replace the \$.07 per message rate with a \$.03 per minute rate for Metro Call Band 1 calls. With regard to this proposal, CAPA argued as follows:

Commission regulations require the independent payphone provider [IPP], who is a direct competitor to the provision of payphone services by Bell to offer a local call to the consumer at a rate not to exceed Bell's rate, i.e., twenty-five cents (25¢), and to offer that twenty-five cent (25¢) call for a minimum of ten (10) minutes. Thus, as Bell has proposed to restructure its rates that ten (10) minute call will cost the independent payphone provider thirty cents (30¢), but the IPP can only charge twenty-five cents (25¢) for the same call.

It doesn't take a rocket scientist to figure out that every ten (10) minute call will cost more than can be recovered for the call. The IPP who is a captive customer of Bell now and for the foreseeable future has no option to escape this predatory pricing by Bell.

CAPA M.B., p. 5 (Footnote omitted). CAPA contended that Bell's proposed restructuring of Metro Call Band 1 rates would result in substantial increases to independent payphone providers. Id., at 9. CAPA submitted that the proposed rate was confiscatory and anti-competitive. Id., at 7.

In response, Bell argued that "the appropriate analysis to determine whether BA-PA's plan is anticompetitive for payphone providers should focus on local service for them in the aggregate, not on the basis of a single ten minute call." Bell M.B., p. 35. Bell contended that the record evidence in this case "indicates that the average payphone call is less than four minutes in duration and the majority of payphone calls are less than two minutes in duration." Id. Bell noted that for calls of two minutes or less, payphone providers would pay less than they do under the current rate structure. Id. Finally, Bell argued that "because of the availability of reduced-cost ValuPak usage service and the elimination of the charge for touch tone, which more than offsets the proposed increases in business dial tone line rates in urban areas, it is likely that many payphone providers will experience overall reductions in their cost structure, a fact conveniently overlooked by CAPA." Id., at 36.

ALJ Cochères agreed substantially with the OSBA and CAPA with regard to the issues they raised. See R.D., pp. 39-46. We shall adopt the ALJ recommendation, as modified by our discussion of the following issues:

2. Business Touch-Tone Rates

Bell has proposed elimination of the separate charge for business touch-tone service, and the offsetting increase to business dial tone line service. These changes, which net approximately \$26 million and which is contained entirely within the business protected market basket, were not opposed by any party and were not specifically addressed by the ALJ. The ALJ, however, does state that any issue not specifically addressed is to be deemed rejected.

Bell has excepted to the ALJ's failure to approve the roll-in of business touch-tone rates and argues that, since touch-tone subscription is virtually ubiquitous among businesses, this rate change will result in virtually no change for the vast majority of business subscribers. As a result, Bell requests that this proposal be adopted.

We have reviewed the record in this proceeding concerning this issue and we note that the Office of Small Business Advocate did not contest this issue. We agree with Bell and we find its proposal to be reasonable. As a result, we will approve Bell's proposal with respect to Business Touch-Tone Rates.

3. Business Subscriber Issues

Bell's rate rebalancing proposal includes decreases to certain business subscriber services. Specifically, Bell has proposed to reduce business toll rates, the non-recurring charges for new business subscribers, and direct inward dialing termination charges. Inasmuch as these issues are related, we will briefly discuss each issue before reaching a determination.

a. Business Toll Rates

Bell has proposed a restructuring of and a reduction to its toll rates for business customers in the following manner. First, Bell proposes a restructuring of business Message Toll Service ("MTS") rates to eliminate time of day and distance sensitivity and to create a postalized rate of \$.10 per minute. Second, Bell proposes a reduction of WATS rates to reflect changes in the MTS rate schedule. Third, Bell proposes reducing the usage rates for the Maximum Value Plan ("MVP") so that they maintain a proper relationship with the MTS rates. Finally, Bell

proposes reducing rates for Business Calling Plus Service. These four reductions total approximately \$28 million.

The ALJ does not directly address this issue except to note generally that he declined to recommend the proposed decreases. (R.D., p. 24) The only party to challenge the decrease was AT&T which objected to Bell's proposal to create a postalized rate of \$.10 per minute and to eliminate time of day and distance sensitivities. However, AT&T did not file exceptions on this issue.

Bell excepted to the ALJ's failure to recommend the proposed reductions in business toll rates and argues that all of its proposed business toll changes should be approved.

d. Non-Recurring Charges for New Business Subscribers

Bell has proposed to reduce the non-recurring connection charge for business and coin service from \$75.00 to \$50.00 for the initial line and \$75.00 to \$30.00 for each additional line installed at the same time as the initial line. This proposal results in a \$6 million decrease.

The ALJ does not directly address this issue except, once again, we note that, generally, he declined to recommend the proposed decreases. The only party to object to this proposal was MCI, which claimed that such a reduction in the non-recurring connection charge would create a below-cost price which today covers cost. MCI has not filed any Exceptions to the Recommended Decision on this issue.

Bell has filed Exceptions to the ALJ's failure to approve the reduction of the non-recurring charges for new

business customers arguing that the proposal is fair, pro-competition, and should be approved.

c. Direct Inward Dialing Termination Charges

Bell has proposed to reduce the ~~Direct Inward Dialing~~ ("DID") termination charge from \$30.50 to \$25.00. DID service permits incoming calls to customer premises equipment to automatically reach a specific number without the aid of an attendant. This proposal, which will result in a decrease of \$3.9 million, was not opposed by any party and was not specifically addressed by the ALJ.

Bell filed Exceptions to the ALJ's failure to recommend the reduction in Direct Inward Dialing termination charges arguing that the purpose of this filing is to position the monthly recurring rate closer to market value and that it should be approved within a total revenue neutral package.

Disposition

Based on a review of the record in this proceeding, we support Bell's proposal to reduce the rates of these business services. Lowering business customer's telephone rates will enhance the attractiveness of the Commonwealth for new businesses as well as encouraging existing business to remain in the Commonwealth. Businesses that choose to locate and/or expand within the Commonwealth do so with consideration of the infrastructure costs. Telecommunications plays an important role in that infrastructure and, therefore, in the economic development of Pennsylvania. Reliable, capable and competitively priced telecommunications services are a prerequisite to a vibrant, growing economy, and will provide a means to increase economic

development within the Commonwealth and improve its business climate.

On the basis of the foregoing, we observe that the ALJ has not specifically addressed certain reductions in the rates for business telecommunications services proposed by Bell. Consequently, our Opinion and Order issued herein does not adopt the ALJ recommendation. We will permit Bell to make certain decreases in rates for business telecommunications services.

J. LATE PAYMENT CHARGES (R-00963556)

Bell argued that assessing a late payment charge on residential customers whose bills are overdue was a new service which was not governed by revenue neutrality requirements under Chapter 30 because it was not a price change or an adjustment to existing rates. See Bell M.B, pp. 48-49.

The OCA pointed out that to the extent the late payment charge would be collected on protected services, it should be considered a revenue increase and subject to revenue neutrality and to Bell's price stability mechanism. The OCA asserted that the charge was not for a new service because no new product was added. Finally, it noted that whatever costs were associated with the dealing with delinquent accounts were already incorporated into the current rate structure. Thus, allowing the added recovery of late charges would permit a double recovery for an item already contained in the current rate structure. OCA M.B., pp. 140-142. OCA R.B., pp. 22-23.

ALJ Cocheres agreed with the OCA. He reasoned as follows:

There is no new service being offered by Bell. Late charges are simply the collection of additional dollars from residential customers who don't pay their bills on time. In this instance, it is a revenue enhancement technique. Some portion of the residential customers have always paid their bills late. This proposal would raise additional money from the protected class which should already be compensating the Company for this problem. The proposal should be subject to market basket neutrality. Bell has proposed no offset for this increase. The rate increase should be denied.

(R.D., pp. 46-47).

Exceptions

Bell excepted to the R.D. on this issue. Bell notes that no party objected to the substance of the charge (1.24% and projected to generate \$6.6 million). Bell notes that the OCA argued that the charge should be subject to the revenue neutral provisions of Bell's Alternative Regulation Plan, and that the charge be deemed a protected service. (Bell Exc., p. 31).

Bell asserts that such a charge should not be governed by the revenue neutral provisions of its Alternative Regulation plan as protected services are defined by statute, but should be governed by the provisions of 52 Pa. Code Chapter 64. (Id.).

Disposition

On consideration of the Exceptions of Bell, we note that currently, 26 of the 38 telephone companies operating in the Commonwealth have a late payment charge. We believe, therefore, that it is only fair to allow Bell, which serves approximately 80% of the customers in the Commonwealth, to impose a late

payment charge for customers who pay their bill late. Such a charge is an acceptable vehicle for incentive payment. Bell's proposal would follow the guidelines for late payment charge as defined in 52 Pa. Code § § 64.12 and 64.16. In our view, Bell's proposal is governed by the revenue neutral requirement. This charge, however, is not a protected telephone service as defined by 66 Pa. C.S. § 3002. Accordingly, Bell shall be given the option of accepting a late payment charge as the revenue neutral offset to the ASP.

K. Proprietary Information

At pages 47 through 51, ALJ Cocheres discusses the OCA position concerning the proprietary treatment of Bell's wire center costs and further, his failure to require the disclosure of Bellcore²⁰ model calculations. ALJ Cocheres concluded that these issues were rendered moot. In both cases, the ALJ did not rely upon the underlying data, and further declared the end result of the studies produced, inter alia, by the data so flawed as to be unworthy to support his recommendation.

Exceptions

The OCA filed Exceptions to the ALJ recommendation. The OCA supports the ALJ recommendation to not rely upon the underlying data concerning both the Bellcore studies and Bell's wire center costs. It files Exceptions on these matters, primarily, to preserve the issue of the access to these sources of data.

²⁰ Bell Communications Research, Inc. Bellcore did intervene in the instant proceeding.

Disposition

We agree with ALJ Cocheres that the dispute over the disclosure of Bell's wire center costs and Bellcore data is moot for purposes of this proceeding. We note that in MFS - Phase III, there is the possibility that Bell's positions regarding the treatment of Bellcore data will be revised so as to accommodate reasonable disclosure. With respect to Bell's wire center costs, we note that the OCA does not appear to be aggrieved by the discovery rulings of this Commission based on our conclusion that Bell has not, in most cases, met its burden of proof required by the Alternative Regulation proceeding. On the basis of the foregoing, we shall adopt the ALJ conclusion. These discovery issues are moot.

III. ORDER

1. That, with the exception of those services which we shall specify, below, the proposed Rate Rebalancing filings at Docket No. R-00963550 are hereby rejected as unjust, unreasonable and unlawful.

2. That the Local Transport Access Service Rate proposed by Bell Atlantic-Pennsylvania, Inc., as identified in the Recommended Decision is hereby approved consistent with the body of this Opinion and Order. Further, Bell Atlantic is hereby required to file the necessary revision to Access Tariff-Telephone Pa. P.U.C. No. 302, which conforms to this approval on one day's notice after receipt of the Commission's Order.

3. That Bell Atlantic-Pennsylvania, Inc., is hereby given the alternative to file revisions to its Local General Tariff-Telephone Pa. P.U.C. No. 1 to establish a late payment charge for residential customers at Docket No. R-00963556 consistent with the body of this Opinion and Order.

4. That Bell is hereby given permission to file revisions to Local Exchange Tariffs Nos. 180A, 182, 182A, 185B and 185C pertaining to the Automatic Savings Program consistent with this Opinion and Order.

5. That, consistent with our discussion in this Opinion and Order, Bell is hereby given permission to file revisions to its tariffs supported by ample evidence and in accordance with its Chapter 30 Alternative Regulation Order, proposing rates for the following non-competitive, non-protected services: Metropolitan Area Unlimited Plus Service, Terminating Feature Group A, Residential Return Call, Business Return Call, Calling Card Surcharge and Business Remote Call Forwarding

services so as to yield a combined revenue neutral offset to the Local Transport Access Service Rate.

6. That, consistent with our discussion in this Opinion and Order, Bell is hereby given the alternative to file revisions to its tariffs to "roll-in" its residence touch-tone rates into residential dial tone line rates if Bell can present a method whereby the existing residential customers who do not subscribe to touch-tone service can be "grandfathered" as long as they remain at their existing domicile.

7. That, consistent with this Opinion and Order, Bell's Automatic Savings Plan is hereby approved contingent upon its accepting the Late Payment Charge as the revenue neutral offset to the Automatic Savings Plan.

8. That any filing made in accordance with the above, shall be made within thirty (30) days of the entry of this Opinion and Order.

9. That, consistent with our discussion in this Opinion and Order, Bell's proposal with respect to Business touch-tone service is hereby approved.

10. That the complaint of AT&T Communications of Pennsylvania, Inc. at Docket No. R-00963550C0001 is hereby sustained in part and dismissed in part.

11. That the complaint of the Office of Consumer Advocate at Docket No. R-00963550C0002 is hereby sustained in part and dismissed in part.

12. That the complaint of the Central Atlantic Payphone Association at Docket No. R-00963550C0003 is hereby sustained.

13. That the complaint of Kurt Richter at Docket No. R-00963550C0004 is hereby sustained.

14. That the complaint of Joseph A. Henchy at Docket No. R-00963550C0005 is hereby sustained.

15. That the complaint of John D. Lewis at Docket No. C-00967866 is hereby dismissed.

16. That the Petition To Intervene of Bell Communications Research, Inc., is hereby granted.

17. That the record at Docket Nos. R-00963550, R-00963550C0001-C0005, R-00963556 and C-00967866 be marked closed.

BY THE COMMISSION


John G. Alford
Secretary

(SEAL)

ORDER ADOPTED: December 12, 1996

ORDER ENTERED: December 16, 1996

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, Pennsylvania 17105-3265

PENNSYLVANIA PUBLIC UTILITY
COMMISSION ET AL V. BELL
ATLANTIC-PENNSYLVANIA

PUBLIC MEETING -
DECEMBER 12, 1996
DEC-96-OSA-310*
DOCKET NO. R-963550,
ET AL.

STATEMENT OF COMMISSIONER JOHN HANGER

The Pennsylvania Public Utility Commission (PUC) is today telling millions of Bell Atlantic-Pennsylvania customers that the rate cap is still alive. All of the rate increases for protected, non-competitive services that Bell had submitted in its January 10, 1996 Petition to rebalance rates are rejected by the Commission's Final Order.

Any increase in rates for local phone service would violate the rate cap imposed by the Commission in the June 28, 1994 Order on Bell's Petition for Alternative Regulation. That Order imposed a cap on all of Bell's non-competitive, protected services before December 31, 1999 when it said: "That the rates for protected services are, hereby, frozen until December 31, 1999."

That rate cap is the principal consumer benefit in the Commission's 1994 Order that implemented Act 67 of 1993. The rate cap is particularly important to customers who live in rural areas where local phone competition will take longer to become a reality.

It also must be remembered that the Commission's June 28, 1994 Order gave Bell substantial financial incentives to invest in Pennsylvania and deploy a broadband network. In fact few, if any states, gave more financial incentives for network modernization since Bell has a price cap of GDP-PI minus 2.93% and keeps all profits, even if profits exceed a normal utility return.

In return for these incentives, Bell was to accelerate deployment of the broadband network. In June 1996, Bell made its most recent filing that reports on its progress in modernizing its network. The Commission must finally make time to review formally that filing to make sure that the ratepayers are getting the modernized network on the required schedule for which they are paying.

A promise made should be a promised kept. The Commission has kept its promise to Bell Atlantic-Pennsylvania by maintaining the financial incentives it received in 1994. Today the Commission keeps its promise to Bell's millions of customers that their rates for basic service will not increase before December 31, 1999.

December 12, 1996

DATED

John Hanger

JOHN HANGER, COMMISSIONER

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, Pennsylvania 17105-3265

PENNSYLVANIA PUBLIC UTILITY
COMMISSION, *et al.*
v.
BELL ATLANTIC- PENNSYLVANIA, INC.

PUBLIC MEETING-
DECEMBER 12, 1996
DEC-96-OSA-310*
DOCKET NOS. R-00963550,
et seq.

DISSENTING STATEMENT OF COMMISSIONER DAVID W. ROLKA

I am pleased that protected rates for residential customers will not increase as a result of this proceeding. This outcome is consistent with my interpretation of the PUC's June 28, 1994 Opinion and Order in Bell's alternative regulation proceeding. This result attains because of the rejection of Bell's proposed increases to Dial Tone Line prices. The proposed Dial Tone Line price increases were the cornerstone of Bell's rate rebalancing filing, the primary purpose of which was to increase residential basic service to levels closer to, but not to, Bell's definition of cost. The Commission majority, however, properly concluded that Bell did not meet its burden of proving that Dial Tone Line price increases were justified.

Having rejected the proposed Dial Tone Line price increase of \$41.5 million, I must agree with the ALJ's conclusion that the concomitant rate decreases should likewise be rejected at this time, since the rebalancing filing was an integrated, unseverable composition of various price changes. I must dissent with the conclusion in the Opinion and Order to selectively approve certain components of the rebalancing filing which would effectuate rate decreases and some rate increases. The one exception, which I support, is the access charge reductions only because the prices are based on the Company's interstate rates on file with the FCC. I nonetheless believe that this decrease should not be implemented as part of this Chapter 30 rate rebalancing filing and instead should be accomplished in a separate docket or proceeding.

I have no objection in principle to the rate decreases proposed by Bell Atlantic as part of the original rate rebalancing package. Recognizing, however, that I do not support the corresponding rate increases, I do not believe that the PUC should approve the rate decreases as part of this proceeding. It makes more sense to confer complete discretion to the Company to pursue these rate decreases as a separate matter, rather than having those decreases provide a new impetus to rate rebalance. This is especially appropriate given the Company's pending \$13 million rate reduction arising from its annual price change opportunity calculation. The majority's Opinion and Order is silent on this point, and does not indicate whether or not the permitted rate decreases may be offset with revenue neutral increases.

I consider the entire discussion of Universal Service appearing in the opinion to be dicta and of no significance. I observe that the subject of Universal Service is once again scheduled for consideration by the Commission on December 19, 1996.

Dec 16, 1996
DATED

David W. Rolka
DAVID W. ROLKA, COMMISSIONER

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

ORIGINAL

AT&T Communications of Pennsylvania
Inc. :

v. :

Verizon North Inc. :

Docket No. C-20027195

MAIN BRIEF OF THE
OFFICE OF CONSUMER ADVOCATE

DOCUMENT
FOLDER

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SEP 18 2003

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

INFORMATION ALLEGED TO BE PROPRIETARY HAS BEEN DELETED

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I. INTRODUCTION AND SUMMARY

On December 30, 2002, Verizon Pennsylvania Inc. and Verizon North Inc. (collectively referred to as "the Verizon Companies") filed a Joint Petition regarding the further reduction of their access charges. This Petition was filed pursuant to the Bell Atlantic-Pennsylvania/GTE Merger Order¹ issued by the Pennsylvania Public Utility Commission on November 4, 1999, the Commission's 1999 Global Order² and the generic access charge investigation docketed at M-00021596. On March 21, 2002, AT&T Communications of Pennsylvania, Inc. filed a formal complaint against Verizon North seeking to have Verizon North's access charges reduced to Verizon PA's levels pursuant to the requirements in the Commission's Merger Order. The Office of Consumer Advocate ("OCA") intervened in AT&T's complaint proceeding on April 10, 2002. AT&T's Complaint was docketed at C-20027195 and was initially dismissed by Chief Administrative Law Judge Christianson but was later reinstated by Commission Order entered December 24, 2002.

The Commission's December 24, 2002 Order also bifurcated the access charge investigation so that all access issues pertaining to Verizon, including AT&T's complaint, would be litigated at the C-20027195 docket. Separately, the Commission also established a proceeding to address the access charges of the Sprint/United Telephone Company and the Rural Telephone Company Coalition ("RTCC"), all other Pennsylvania incumbent local exchange carriers ("ILECs") other than the Verizon

¹ Re: Joint Application of Bell Atlantic Corporation and GTE Corporation for Approval of Agreement and Plan of Merger, 93 PaPUC 395 (November 4, 1999)("Merger Order").

² Re: Nextlink Pennsylvania, Inc., 93 PA PUC 172 (Sept. 30, 1999)("Global Order"), 196 PUR 4th 172, aff'd sub nom, Bell Atlantic-Pennsylvania, Inc. v. Pennsylvania Public Utility Commission, 763 A.2d 440 (Pa.Cmwlth 2000)("Global Appeal Order"), alloc. granted.

Companies. That proceeding was docketed at M-00021596 and a settlement of that matter was approved by Commission order entered on July 15, 2003.³

With regard to the Verizon Companies' Petition, the Commission referred that Petition to the Office of Administrative Law Judge for evidentiary hearings and a recommended decision on May 5, 2003. The matter was assigned to Administrative Law Judge Cynthia Williams Fordham and a prehearing conference was held on May 29, 2003 wherein a procedural schedule was established. Pursuant to that procedural schedule, the parties submitted direct, rebuttal and surrebuttal testimony and evidentiary hearings were held on August 25th and 26th, 2003. The OCA fully participated in the proceeding before ALJ Fordham including presenting a witness and cross-examining other parties' witnesses during hearings.

The OCA submits this Main Brief to articulate its position in this matter. In particular, the OCA proposes that Verizon's intrastate switched access rates be restructured on a revenue neutral basis, to establish uniform access rates that apply to both Verizon Companies, with no rate increases for any other services. There is no legal or cost justification to raise basic rates for Verizon customers in this proceeding. Such a determination is within the Commission's discretion and supported by substantial evidence of record.

However, in an effort to resolve the issues in this proceeding, the OCA supports the settlement proposal presented by Verizon witness Debra M. Berry in her Surrebuttal Testimony dated August 4, 2003 ("Verizon/OCA settlement proposal"). In that proposal, the OCA agreed to an increase of no more than \$40 million to residential

³ Access Charge Investigation Per Global Order of September 30, 1999, Docket No. M-00021596, Order (entered July 15, 2003)("Sprint/RTCC Order").

basic local service rates on a combined Verizon PA and Verizon North basis and that any such increase will not exceed \$1.00 per residential line per month. Such additional revenues would then be used to reduce the Verizon North access rates so that they are in parity with the Verizon PA access rates and otherwise in compliance with relevant Commission orders. The Verizon/OCA settlement proposal is a viable alternative disposition of this proceeding, which is in the public interest.

II. ARUGMENT

A. The Verizon Companies' Proposal and Relevant Precedent.

1. Introduction

The issue of access charges has existed since the onset of interexchange competition nearly three decades ago. Prior to that time, one company owned both the local telephone exchange network as well as the network used to carry calls long distance. At the time of divestiture, however, access charges were introduced to create a compensation system whereby long distance carriers ("IXCs"), who then owned the long distance network, paid ILECs, who still owned the local exchange network, to originate and terminate their long distance calls. No long distance calls could be made without the use of the local network to originate and terminate such calls. The IXCs incorporated the access charge and other costs into their cost of providing the long distance service; access charges represent a portion of the underlying cost of long distance service.

Access charges were created both for interstate long distance calls and intrastate long distance calls. Since divestiture, the Federal Communications Commission ("FCC") as well as various state commissions, including this Commission,

have analyzed ILECs' access charges in an effort to further enable the competitive provisioning of long distance services. This Commission addressed the issue of access charges in both the Global Order and the Merger Order from which this proceeding emanates. The Commission's actions on access charges have been supported by the Commonwealth Court as being within the Commission's discretion and supported by competent evidence.

2. *The Commonwealth Court has held that each and every service that uses local loop facilities must share in the support of that part of the telephone network.*

The Commission began its review of intrastate access charges in 1997 with a generic investigation of the issue⁴ and resolved to further initiate a generic investigation of the issue which became a part of the Global Order. In the Global Order, the Commission concluded that the Common Carrier Line Charge ("CCLC") of Verizon was to be changed from a per minute charge to a per line charge on the view that the CCLC is a non-traffic sensitive charge.⁵ The Commission further determined to reduce the traffic-sensitive switched access charges of Verizon to foster competition in regional traffic.⁶ The Commission, therefore, effectively lowered access charges.

This portion of the Global Order, however, was appealed by several parties. Among them, AT&T, as well as other IXCs, argued that the reduction did not go far enough but resulted in rates that were "excessively high and not supported anywhere in the record."⁷ AT&T further argued that Verizon's access rates are many times greater

⁴ 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) ("Universal Service I").

⁵ Global Order, 93 Pa. PUC at 193.

⁶ Id.

⁷ Global Appeal Order, 763 A.2d at 479

than their incremental cost such that further reductions are necessary.⁸ However, the Commonwealth Court rejected AT&T's arguments and initially determined that it was not logical for customers other than the long distance carriers to pay all of the joint and common costs of the network.⁹

In rejecting AT&T's arguments, and recognizing the Commission's expertise in this area, the Commonwealth Court further determined 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."¹⁰ It is not appropriate to place 100% of the cost of local loop facilities on basic service. Each and every service that uses local loop facilities, including access, must share in the support of that part of the telephone network. The Commonwealth Court further affirmed the Commission's determination regarding access charges in the Global Order and stated that the record confirms the soundness of the Commission's view, based on evidence from consumer witnesses, and that initiating a gradual transition in improving the placement of cost burdens is a valid approach in establishing rate structure.¹¹

The Commonwealth Court has affirmed the Commission's Global Order where it continued to require access services to pay some portion of the local loop facilities costs. It is not appropriate to place 100% of the cost of local loop facilities on basic service. The Commonwealth Court has affirmed the Commission's access charge reductions in the Global Order as an appropriate exercise of the Commission's discretion and supported by competent evidence.

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Id.

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Id.

¹⁰ Id. at 480.

¹¹

Id. (citations omitted).

3. *The Commission's Global Order and Merger Order do not require specific access charge reductions but only that the Carrier Charge pool be "reduced" in some respects and that the Verizon Companies' access charges be in "parity" with each other.*

In the Global Order, the Commission reduced access charges of all ILECs operating in Pennsylvania and directed that a universal service fund ("USF") be established to enable rural ILECs and Sprint/United to reduce access charges and intraLATA toll rates while keeping basic service prices under a \$16.00 per month cap.¹² As part of the access charge reform conducted by the Commission in the Global Order, the Commission specifically initiated this proceeding. In doing so, the Commission stated

We believe that the sooner we resolve the reduction and possible elimination of the carrier pool, the better it would be for the competitive environment in Pennsylvania. Therefore, we shall initiate an investigation on or about January 2, 2001, to further refine a solution to the question of how the Carrier Charge (CC) pool can be reduced. At its conclusion but no later than December 31, 2001, the pool will be reduced.¹³

Despite the delay in commencing the investigation, this instant proceeding is the investigation that the Commission sought in the Global Order.

Significantly, the Commission in the Global Order does not provide specificity regarding what should happen to each ILEC's access charges in determining the degree to which it seeks to have the Carrier Charge ("CC") pool "reduced." The Commission's direction in the Global Order regarding access charges is susceptible to varying interpretations as to the exact treatment of the various ILECs' access charges that should arise from this proceeding. For Verizon-Pa specifically, the Commission also

¹² Global Order at 188-207.

¹³ Id. at 207.

provided that “BA-PA’s Carrier Charge will be included in the Commission investigation that will be initiated on or about January 2, 2001, to resolve further reductions and potential elimination of the Carrier Charge (CC) pool.”¹⁴ Here, too, the Commission requires “reductions” in the CC pool and does not indicate the specific treatment of Verizon Pa’s access charges through the initiation of this proceeding.

The Global Order was affirmed *en banc* in its entirety by the Commonwealth Court where some parties had appealed the Global Order alleging that the access reductions were insufficient. The Commonwealth Court, however, recognized that “the record here and the statutory powers of the PUC support the PUC’s decision to reduce Bell’s access charges at present to an extent justified by current information, and to define a future proceeding to consider further access charge reductions.”¹⁵ The Commonwealth Court further stated “this Court’s decisions have supported the exercise of sound discretion by the PUC in these matters. The PUC must be credited with having expertise in specialized areas provided that the decision is, as here, supported by competent evidence.”¹⁶ Thus, the Commonwealth Court ruled that no specific access reductions were required.

In the Merger Order, the Commission approved the merger of Bell Atlantic and GTE contingent upon the Companies agreeing to certain conditions articulated in a Memorandum of Understanding (“MOU”) between the Verizon Companies and the Pennsylvania Office of Attorney General, that was an active party in the proceeding before the Commission. One of the conditions in the MOU was that “a proceeding for the purpose of determining statewide rates for access charges based upon

¹⁴ Id. at 193.

¹⁵ Global Appeal Order at 479.

¹⁶ Id. at 480 (citations omitted).

consolidated cost studies” would be commenced within thirty months after the merger closing.¹⁷ More specifically, the Commission stated

We also note that there is a significant issue in the MOU regarding a proceeding to determine statewide access charges for both GTE North and BA-PA. The MOU provides, in pertinent part, that within 30 months after the merger closing, the Joint Applicants will commence a proceeding for the purpose of developing access charge parity for both companies based on consolidated costs studies.¹⁸

The Commission then specifically provided that the access charge issues related to the Merger Order would be “rolled-in” and made a part of the Commission’s statewide investigation pertaining to access charges.¹⁹

4. *The Commission has recently acted on the issue of access charge reductions in its Sprint/RTCC Order.*

The Commission most recently acted on the issue of access charge reductions in its July 10, 2003 Public Meeting where it approved the Sprint/RTCC Joint Settlement filed by Sprint, RTCC, OCA, the Office of Trial Staff, the Office of Small Business Advocate, AT&T and MCI Worldcom in the M-00021596 proceeding which was bifurcated by the Commission as discussed above on December 24, 2002.²⁰ In that proceeding, the Commission encouraged Sprint and the RTCC to establish a Joint Proposal amongst all the interested parties for the Commission’s approval wherein the non-Verizon ILECs would reduce their access rates pursuant to the Global Order.

¹⁷ Merger Order 93 Pa. PUC at 413; *citing*, Memorandum of Understanding. The merger closed on June 30, 2000. Therefore, the proceeding discussed above was to commence on or before December 31, 2002.

¹⁸ Id.

¹⁹ Id.

²⁰ *See*, footnote 3, *supra*.

Verizon witnesses Debra Berry and Michael Wirl discuss the relationship of the Verizon Companies' initial proposal filed on December 30, 2002 to the Sprint/RTCC settlement that was approved on July 10, 2003.²¹ The Sprint/RTCC Joint Settlement reduced access rates and increased local rates on a revenue neutral basis so that Sprint's and the RTCC ILEC's intrastate Traffic Sensitive ("TS") access rates could be lowered if those rates exceeded the RTCC ILEC's interstate TS access rates. Such rebalancing would be done in a multi-phased process over the course of several years. The Sprint/RTCC settlement will reduce the CC pool as sought by the Commission in the Global Order. The OCA supported the Sprint/RTCC settlement because the facts and circumstances evident in that proceeding for those particular ILECs warranted such a settlement.

Verizon witnesses Berry and Wirl claim that the Verizon proposal filed on December 30, 2002 is "modeled upon and virtually identical in substance to" the Sprint/RTCC settlement.²² However, as OCA witness William W. Dunkel²³ testified, the Verizon Companies are different from the Sprint/RTCC companies in several respects and should be treated differently in terms of their access charge reduction. In particular, Mr. Dunkel noted that Verizon PA's current access rates are already much lower than those of the RTCC and Sprint and that Verizon's December 30, 2002 proposal provides greater access reductions than the Sprint/RTCC settlement.²⁴ Mr. Dunkel further testified that the rural companies who were part of the Sprint/RTCC settlement generally have

²¹ Verizon St. 1.0 at 8.

²² Id.

²³ William W. Dunkel is a consultant providing services in telephone rate proceedings. He is the principal of William Dunkel and Associates which was established in 1980. Since 1980, Mr. Dunkel has provided consulting services in telephone regulatory proceedings throughout the country and participated in over 140 state regulatory telephone proceedings before over half of the state commissions in the United States. OCA St. 1 at 1; *see also*, Appendix A attached to OCA St. 1.

²⁴ Id. at 64-65.

higher costs on average than Verizon as the weighted average National Exchange Carrier Association (“NECA”) loop cost for the Sprint/RTCC ILECs as a group is 30% higher than the Verizon-Pa’s NECA loop costs.²⁵ Mr. Dunkel also noted that Verizon states in its testimony that its access rates are very different than the other companies’ rates and the Verizon Companies indicated that their rates were “ahead of the curve” and “already having by far the lowest access rates in the state.”²⁶

Furthermore, in the Sprint/RTCC Order, the Commission also recognized the distinctions between the Verizon Companies and the non-Verizon Companies. In the Sprint/RTCC Order approving the settlement, the Commission discussed FCC white papers that highlighted several important differences between rural and non-rural carriers. The Commission noted

As documented in a series of white papers prepared by the Rural Task Force, which was constituted by the FCC to study the differences between the provision of telecommunications services in rural and non-rural areas, rural carriers generally have higher operating and facilities costs due to lower subscriber density, smaller exchanges and limited economies of scale. Significantly, rural carriers rely more heavily on revenues from access charges and universal service support in order to provide ubiquitous and affordable local service.²⁷

Clearly then, the Verizon Companies, by their own admission and elsewhere, are distinctly different from the Sprint/RTCC Companies and should be treated differently for purposes of further reducing their access rates. The Commission was correct in bifurcating these proceedings because the issues and facts surrounding each proceeding are different.

²⁵ Id. at 62; *see also*, Schedule WDA-4.

²⁶ Id. at 63, *quoting*, Verizon St. 1.0 at 23.

²⁷ Id.; *quoting*, Sprint/RTCC Order at 7.

5. *Verizon's proposals to meet its access charge obligations in the Global Order and Merger Order should not be adopted.*

In its December 30, 2002 filing made pursuant to the Commission's Merger Order, the Verizon Companies provide two options for achieving the access charge reductions that the Commission seeks. The proposal provides phased-in increases to weighted average basic rates to offset access reductions in a revenue neutral manner.²⁸ The Verizon proposal provides that any increases to basic services rates would not be implemented prior to the expiration of applicable rate caps on January 1, 2004 and allows the Verizon Companies the option to view the two companies as a single entity to spread the rate increases over a larger amount of lines.²⁹ The Verizon Companies' proposal allows the Companies to align their rates based predominantly on Verizon PA's current intrastate rate structure.

More specifically, the Verizon Companies proposal would allow each Verizon entity to rates its weighted average R-1 rates to \$15 and make offsetting access reductions on January 1, 2004 in the first step and then raise their weighted average R-1 rates to \$17 if further access reductions are deemed necessary in a second step.³⁰ Verizon then provides two scenarios under which such access reductions would be implemented which would result in an increase in R-1 rates of approximately **[BEGIN PROPRIETARY] [END PROPRIETARY]** per line per month and **[BEGIN**

²⁸ Verizon Petition at 4.

²⁹ Id.

³⁰ Id. at 5.

PROPRIETARY] **[END PROPRIETARY]** per line per month, respectively in Scenarios 1 and 2.³¹

Under scenario 1, Verizon would reduce its CC to **[BEGIN PROPRIETARY]** **[END PROPRIETARY]** per line, per month, which is the current Verizon PA CC and the combined CC and TS rate on a per minute basis would be **[BEGIN PROPRIETARY]** **[END PROPRIETARY]**.³² The intrastate switched access revenues would be reduced by approximately **[BEGIN PROPRIETARY]** **[END PROPRIETARY]** under this scenario. Under scenario 2, Verizon would completely eliminate the CC and the total switched access rate on a per minute basis would be **[BEGIN PROPRIETARY]** **[END PROPRIETARY]**.³³ The intrastate switched access revenues would be reduced by an additional **[BEGIN PROPRIETARY]** **[END PROPRIETARY]** under scenario 2 thus raising the sum of the intrastate switched access reductions under both scenarios to a total of **[BEGIN PROPRIETARY]** **[END PROPRIETARY]**.³⁴

In its June 25, 2003, Direct Testimony filed in this proceeding in support of its Petition, the Verizon Companies also demonstrated how it could meld the rate structures of the two companies without an overall access rate reduction. In Berry/Wirl Direct Exhibit MJW-2, Verizon has provided an example of a “revenue-neutral access restructuring” that it believes would achieve parity rates, as required under the Merger Order. Under this structure, Verizon would charge a CC of **[BEGIN PROPRIETARY]**

³¹ See, Berry/Wirl Exhibit MJW-6.

³² See, Berry/Wirl Exhibit MJW-3.

³³ See, Berry/Wirl Exhibit MJW-4.

³⁴ Id.

[END PROPRIETARY] per line, per month and TS charges which total [BEGIN PROPRIETARY] [END PROPRIETARY] per minute.³⁵ This alternative would not require any increase to basic service rates. As discussed by OCA witness Dunkel, the OCA does not oppose this proposal.³⁶

As discussed further below, increases to basic service rates greater than the overall percent rate increase would violate Section 1325 of the Public Utility Code. Moreover, the substantial basic rate increases proposed by the Verizon Companies' are unjustified and inconsistent with regulatory precedent and proper cost recovery. Therefore, the OCA submits that the Verizon Companies' proposals in their December 30, 2002, Petition should be rejected.

6. *Conclusion*

Access charges have been heavily litigated and hotly contested at both the state and federal levels since their inception three decades ago. This Commission in particular has addressed the issue of access charge reductions in the Global Order, the order approving the merger of Bell Atlantic-Pennsylvania and GTE-North and, most recently, in the Sprint/RTCC Order entered July 15, 2003. It is the OCA's position that the basic rate increases proposed by Verizon in its filing are not supported. Nevertheless, as set forth below, the OCA would support the compromise proposal set forth by Verizon in its Surrebuttal Testimony as an acceptable resolution of this proceeding.

³⁵ See, Berry/Wirl Exhibit MJW-2.

³⁶ See, OCA St. No. 1 at 17.

B. The Verizon Companies' Petition Should Be Rejected Because The Cost of Access Must Include Only The Joint And Common Costs of Facilities Used to Provide Access.

1. *Introduction*

Pennsylvania law is clear regarding the type of cost allocation issues raised in this proceeding. Here, both AT&T and Verizon would allocate 100% of the cost of local loop facilities to basic local service. By so doing, they request that the Commission ignore settled law and adopt a position at odds with the Commission's requirement that all services that use the local loop facilities pay for some share of the joint and common costs of operating the telephone network.

The Commission has determined that all services that use the local loop facility must bear an appropriate share of the joint and common costs of that facility. The OCA submits that because Verizon did not allocate any cost of the local loop facility to services other than basic service, Verizon's filing in support of its proposals is fundamentally incomplete. Therefore, the Commission must reject those proposals.

2. *The Commission has repeatedly determined that loop facilities costs are joint costs*

The Commission has recognized the principle that shared usage should lead to shared cost allocations on more than one occasion. 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.³⁷

The OCA emphasizes that “an appropriate portion” of loop cost recovery from basic universal service is not 100%. Thus, the way that Verizon states that it allocates costs in its proposals, by allocating 100% of loop cost to local exchange service, is not in agreement with the Commission order on this point. The OCA emphasizes that dial tone line costs were considered by the Commission as “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” in the Universal Service Order as cited above.

The Commission also addressed this issue in the Universal Service Investigation in its January 28, 1997 Order where it explained that IXCs use the local network for access and stated as follows:

We reaffirm our findings in our September 5, 1995 Order at Docket No. L-00950105 that the local loop is a “joint cost”, not a direct cost of providing only those services included in the definition of 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. For universal service funding purposes, not allocating a portion of the local loop to all the services which utilize it fails to give recognition to the fact that the loop is used to provide many services in addition to BUS.

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

³⁷ Universal Service Investigation, Docket No. I-00940035, Opinion and Order at 12 (August 31, 1995).

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

...

We reject the ILEC's arguments that the local loop is not a joint cost because other services which use the loop do not result in any additional cost. We do not find the arguments of Bell's expert witness Dr. [Alfred] Kahn persuasive on this point. In particular, we do not accept the basis of Dr. Kahn's argument that because the loop is needed for local service and the incremental cost of the loop does not increase to provide other services, that its full cost must be attributed to local services. This same argument could be made with respect to toll service. Since the loop is necessary to provide toll service, it could at the same time be argued that the full cost should be allocated to toll, and in so doing the incremental cost to provide local service would be zero. Moreover, since the installation of an additional subscriber loop increases the capacity available for placing and receiving all three types of calls, the telephone company cannot increase the capacity for local calls without concurrently increasing the capacity for toll calls. We find persuasive the arguments of [OCA witness] Dr. Johnson that the local loop clearly fits within the definition of a joint cost since access capacity is simultaneously expanded for multiple services in fixed proportions (one more line is available in each case). Only if there is congestion at a particular time is there any tradeoff between use of the local loop for different purposes.³⁸

Thus, the Commission has clearly 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 - - access services among them. In regard to that required cost allocation, OCA witness Dunkel testified that Verizon's filing ignores this requirement altogether.³⁹ Thus, Verizon's filing is an unacceptable basis on which to adopt its original access reform proposal.

The Commission has attempted other allocation methods only to return to allocating local loop facilities costs across all services that use the local loop. In

³⁸ See, Universal Service I, footnote 4, *supra* (citations omitted).

³⁹ OCA St. No. 1 at 23.

Universal Service I, the Commission proposed to allocate the local loop facility costs to universal service based on total minutes-of-use related to local exchange service.⁴⁰ The Commission later revised this minute-of-use scheme in the Commission's Universal Service Investigation Order on Reconsideration.⁴¹ The Commission noted in the Order on Reconsideration "we continue to believe that the loop is a joint cost which should be allocated among the services that utilize it . . ."⁴² The Commission then determined that it would follow the cost allocation method used by the FCC at that time and the cost produced by a universal service model would be compared with the revenue produced by a number of services, including "inter and intralata CCL, intralata toll, vertical services and basic service."⁴³ The Commission commented that the FCC approach "takes full account of the contributions made by other services by taking into account the revenues received from all of those services in determining B[asic] U[niversal] S[ervice] funding levels."⁴⁴

By reverting back to the type of cost allocation required in its Universal Service Investigation, the Commission confirmed that its approach of allocating local loop facilities costs to all services, is the correct approach. As noted above, the Commonwealth Court has recognized the Commission's expertise in the area of access

⁴⁰ Universal Service I at 84.

⁴¹ Formal Investigation to Examine and Establish Updated Universal Service Principles and Policies for Telecommunications Services in the Commonwealth, Docket No. I-0094035, Opinion and Order at 36 (July 31, 1997)("Universal Service II").

⁴² Id.

⁴³ Id. at 15.

⁴⁴ Id. at 13. The OCA also notes that, as the PUC did not implement a cost model based Universal Service Fund, no specific allocation of loop costs to determine Universal Service Fund cost recovery was implemented. Instead, the PUC adopted a compromise Universal Service Fund through the Global Order. Global Order 93 Pa. PUC at 188-207.

charges and supports its exercise of discretion in this area.⁴⁵ Verizon's filing in this proceeding does not conform to that approach, and for that reason must be rejected.

3. *Other state commissions have concluded that local loop facilities costs are properly allocated across all the services that use the local loop.*

Various state commissions have come to conclusions similar to the Pennsylvania Commission. In a decision of the Washington Utilities and Transportation Commission, the Washington Commission stated:

The Commission finds . . . that the cost of the local loop is not appropriately included in the incremental cost of local exchange service. The local loop facilities are required for nearly every service provided by the Company to a customer. Neither local service nor in-state long distance service nor interstate long distance nor vertical features can reach a customer without the local loop. Should USWC cease to provide any one of these services, its need for a local loop to provide the remaining services would remain. The cost of the local loop, therefore, is not incremental to any one service. It is a shared cost that should be recovered in the rates, but no one service is responsible for that recovery.⁴⁶

Also, the Colorado Public Utilities Commission in its cost allocation regulations discussed the manner by which rates should be set in view of cost studies performed for any service.⁴⁷ There, the Colorado Public Utilities Commission regulations stated:

As an example, consider the access loop. The access loop is not a separate service but rather is an input necessary for the provision of many telecommunications services. As such, costs associated with the access loop will not appear in the total service long run incremental cost of any single service requiring the access loop but will appear as part of the total service long run incremental cost of the entire

⁴⁵ See, page 7, *supra*.

⁴⁶ Washington Utilities and Transportation Commission v. US West Communications, Inc., Docket No. UT-950200, 169 PUR4th 417, 476-77 April 11, 1996 ("US West")(emphasis added).

⁴⁷ 4 CCR 723-30, Rule 4(2)(a)(iii).

group of services requiring the loop. Consequently, prices must be set so that the sum of the revenues from all services requiring the access loop covers not only the sum of the total service long run incremental costs for the individual services but also the shared cost of the loop.⁴⁸

The Missouri Public Service Commission at the time of the AT&T/Bell divestiture also rejected Petitions to implement subscriber line charges on the basis that the loop is a shared costs and a subscriber line charge would merely be shifting toll costs to local service rates. In that Order the Missouri Public Service Commission stated:

The Commission, having considered the various arguments of the parties, is persuaded, and finds, that the cost of a local loop can arise from a demand for local and/or long-distance service. Therefore, local loop costs should properly be recovered through contributions from at least three services: local exchange, carrier access and toll. The local loop has no value to any customer, unless other customers are connected. The loop is in place to satisfy customers' demands for both long-distance and local service. This Commission finds and concludes that the local loop now gives a telephone subscriber access to an integrated telephone network which includes local exchange capabilities, and interstate and intrastate long distance (toll) capabilities as well. Since both local exchange service and toll service make use of the local loop, both services should contribute to the cost of the local loop.⁴⁹

These cases make very clear that the local loop facilities are a joint and common cost, and do not represent a cost that should be assigned 100% to local exchange service. It is beyond dispute that the existence of many services depends on the ability to use the local loop facilities. Accordingly, loop costs should be recovered from each of the services that depend on the local loop. The OCA submits that recovery of this common cost must be shared across all services that employ loop facilities. Verizon,

⁴⁸ Id.

⁴⁹ Re: Southwestern Bell Telephone Company, Case Nos. TR-83-253 and TR-83-288, 26 MO.P.S.C. (N.S.) 344, 381 (1983).

however, incorrectly bases its cost analysis in this case on the assumption that the loop cost must be entirely recovered from only one service -- local exchange service. Verizon has not shown any Pennsylvania regulation, statute, or case that would support such a theory.

4. *The United States Supreme Court has affirmed the principle that loop facilities costs should be allocated to all services that use the loop.*

The principle that dial tone line costs should be recovered from the many services that use it was the basis upon which the United States Supreme Court required a portion of the dial tone line cost to be recovered from interstate service. In Smith v. Illinois Bell Telephone,⁵⁰ the Supreme Court considered an appeal by the City of Chicago, which opposed the assignment of 100% of loop costs to intrastate service. The Court considered how the loop cost must be recovered from both the intrastate and interstate jurisdictions and ruled as follows:

In the method used by the Illinois Company in separating its interstate and intrastate business, for the purpose of the computations which were submitted to the court, what is called exchange property, that is, the property used at the subscriber's station and from that station to the toll switchboard, or to the toll trunk lines, was attributed entirely to the intrastate service.

While the difficulty in making an exact apportionment of the property is apparent, and extreme nicety is not required, only reasonable measures being essential [citations omitted] it is quite another matter to ignore altogether the actual uses to which the property is put. It is obvious that, unless an apportionment is made, the intrastate service to which the exchange property is allocated will bear an undue burden--to what extent is a matter of controversy. We think this subject requires further consideration, to the end that by some practical method the different uses of the

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Smith v. Illinois Bell Telephone, 282 U.S. 133, 51 S.Ct. 65, 75 L.Ed. 255 (1930).

property may be recognized and the return properly attributable to the intrastate service may be ascertained accordingly.⁵¹

In this way, the United States Supreme Court determined that when interstate services use the dial tone line facility they must also pay for some portion of its cost. This is the same principle from which the OCA argues that Verizon should not be permitted to isolate one aspect of dial tone line facility usage, *i.e.* local exchange service, and require that service to pay for 100% of this facility for the purpose of access reform.

5. *The FCC has defined common costs to include the cost of local loop facilities.*

The Commission has looked to the FCC for the definition of what comprises “common costs” and adopted the reasoning of the FCC in its Opinion and Order in the 1996 Bell rate rebalancing case.⁵² The FCC has also determined that loop costs are common costs for the purposes of unbundling. The FCC has written that:

[t]he term “common costs” refers to costs that are incurred in connection with the production of multiple products or services and remains unchanged as the relative proportion of those products or services varies (*e.g.*, the salaries of corporate managers). Such costs may be common to all services provided by the firm or common to only a subset of those services or elements. If a cost is common with respect to a subset of services or elements, for example, a firm avoids that cost only by not providing each and every service or element in the subset. For the purpose of our discussion, we refer to joint and common costs as simply common costs unless the distinction is relevant in a particular context.

As discussed in greater detail below, separate telecommunications services are typically provided over shared network facilities, the costs of which may be joint or

⁵¹ *Id.*, 282 U.S. at 150-51 (1930).

⁵² *Pennsylvania Public Utility Commission v. Bell Atlantic-Pennsylvania, Inc.*, Docket Nos. R-00963556 *et al.*, Opinion and Order at 17-18, 23-24 (December 16, 1996).

common with respect to some services. The costs of local loops and their associated line cards in local switches, for example, are common with respect to interstate access service and local exchange service, because once these facilities are installed to provide one service they are able to provide the other at no additional cost.⁵³

Thus, the FCC also considers that the local loop is a joint or common cost.

Current FCC regulations also consider the loop as a joint or common cost of providing many services. The very definition of the loop is as follows:

Subcategory 1.3 -- Subscriber or common lines that are jointly used for local exchange service and exchange access for state and interstate interexchange services (emphasis added).⁵⁴

The FCC reaffirmed its position regarding the joint and common nature of the loop in a May 1995 decision concerning NYNEX's request for a waiver of the Part 69 access charge rules. In that decision, the Commission stated:

While our jurisdiction extends only to interstate telecommunications services, the joint and common character of the facilities providing exchange access and local exchange service means that the regulatory climate for interstate telecommunications services affects the development of competition in the interstate access market.⁵⁵

Finally, the FCC recognizes in the Triennial Review Order,⁵⁶ released August 21, 2003, the many uses of the local loop. As the FCC stated: "thus, in the instant case, we take into account the fact that there are a number of services that can be provided over the stand-alone loop, including voice, voice over xDSL (ie, VoDSL), data

⁵³ 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) (emphasis added).

⁵⁴ 47 C.F.R. § 36.154 (emphasis added).

⁵⁵ In the Matter of NYNEX Telephone Companies Petition for Waiver, 10 FCC Rcd. 7445 at ¶ 39 (May 4, 1995) (emphasis added).

⁵⁶ 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)("Triennial Review Order"), at para 258.

and video services.”⁵⁷ As such, the cost of the local loop should be shared over many different services.

6. *Conclusion*

It is clear that this Commission regards local loop facilities costs as a shared cost among all the services that use the local loop. It is also clear that other state commissions, the FCC and the United States Supreme Court support this view. While Verizon and AT&T would attempt to confound the Commission’s clear requirements with policy arguments favoring the allocation of all costs directly to the consumer, it remains the law that each and every service that uses local loop facilities must share in the support of that part of the telephone network. Such law has been found by the Commonwealth Court in the Global Appeal Order to be an appropriate exercise of the Commission’s discretion and supported by competent evidence.⁵⁸

C. The Verizon Companies’ Petition Should Be Rejected Because The Allocation Of 100 Percent Of the Loop Facility Costs to Local Service Violates Section 1325 Of Public Utility Code.

The Commission cannot approve the access reform options presented by the Verizon Companies in this proceeding because those options do not comply with section 1325 of the Public Utility Code. Section 1325 of the Public Utility Code limits increases in local exchange service rates, and requires utilities to file certain cost studies where local rate increases are sought.⁵⁹

⁵⁷ Id. at para. 258.

⁵⁸ *See*, page 7, *supra*.

⁵⁹ Pennsylvania Public Utility Commission et al v. Bell Atlantic – Pennsylvania, Inc., Docket No. R-00963550, Opinion and Order at 23-24 (December 16, 1996)(attached hereto as Appendix A).

Section 1325 provides:

(a) General rule.--In any rate proceeding pursuant to section 1308 (relating to voluntary changes in rates), no public utility shall be granted a percentage increase in local exchange service unless that percentage increase is just and reasonable. In no event shall the public utility be granted an increase in local exchange rates which is greater than the overall average percentage increase in total intrastate revenues authorized by the commission unless the utility proves by record evidence that a greater percentage increase for local exchange service is justified based upon the cost of providing that service.

(b) Generic studies permitted.--The commission, after notice and hearing, may promulgate regulations setting forth appropriate methods of calculating the stand-alone costs of telecommunication services.

(c) Definitions.--As used in this section the following words and phrases shall have the meanings given to them in this subsection:

"Cost of providing local exchange service." The direct cost of providing the service plus a share of the costs of the dial tone line, allocated in proportion to the stand-alone cost of each class of service which utilizes the dial tone line.

"Local exchange service." The intrastate charge for access to the telephone network plus the charge for making calls which originate and terminate within the same calling area.⁶⁰

The Commission has determined that Section 1325 applies to the type of revenue neutral rate rebalancing proposed in this case.⁶¹ In fact, in a case very similar to the present one, the Commission rejected Verizon's prior attempt to engage in revenue neutral access reform in 1996 based on Verizon's non-compliance with Section 1325. The Commission should reject the access reform proposals before it in this proceeding under the precedent of that 1996 case.

⁶⁰ 66 Pa.C.S. § 1325 (emphasis added).

⁶¹ Pennsylvania Public Utility Commission v. Bell Atlantic-Pennsylvania, Inc., Docket Nos. R-00963556 et al., Opinion and Order at 24 (December 16, 1996).

In the 1996 case, Bell sought to “restructure and rebalance its Residential, Local and Toll Service rates, Business Local and Toll Service rates and Switched Access rates on an allegedly revenue neutral basis.”⁶² The ALJ decided, and the Commission affirmed, “[s]ection 1325 does apply to Bell’s rate rebalancing filing. As set forth in Section 1325(a), this statute applies to ‘any rate proceeding pursuant to section 1308 (relating to voluntary changes in rates).’ 66 Pa. C.S. §1325(a) (Emphasis added.) The statute is clearly applicable in this case.”⁶³

While Verizon’s current access proposals affect rates differently than the 1996 rate rebalancing, this is an identical proceeding in terms of the applicable requirements. Section 1325 requires the Verizon Companies to make certain cost allocations in support of its request to increase local service rates. They have not done so here. In fact, the Verizon Companies make no attempt in this proceeding to determine what the appropriate cost allocations under section 1325 might be.⁶⁴ In addition, information concerning the cost studies filed by Verizon in response to discovery in this proceeding indicates that the current studies suffer the same fatal flaw as those filed in Verizon’s rejected 1996 filing: current cost studies would improperly allocate local loop costs.

In the January 1996 Verizon PA rate rebalancing proceeding, in order to prove that its local exchange rate increases were justified based upon costs associated with providing local exchange service, Bell filed certain types of cost studies. Then, as now, Bell asserted that 100% of the local loop costs should be assigned to the dial tone

⁶² Id. at 2.

⁶³ Id. at 14.

⁶⁴ See, OCA Cross Examination Exhibit No. 6 (Verizon response to OCA Data Request 1-3; Verizon North response to OCA data request 2-3).

component of local exchange service.⁶⁵ The result of that flawed allocation was that Bell caused the costs of local service to appear to be well above the rates that Bell charged for that component of local service. The Commission properly determined that that allocation was incorrect.⁶⁶

The Commission determined that the correct approach was to allocate the total cost of the local loop facility across all services that use the local loop facility; that is, to treat the loop facility as a joint and common cost of all services that use that facility.⁶⁷ The Commission determined that “the costs associated with dial tone line [facilities] should be viewed as joint or common costs of those services, and should be allocated across those services instead of being assigned totally to local exchange service, as Bell asserted.”⁶⁸ The Commission also found that section 1325 directs that the costs of the dial tone line are “shared costs, and requires that only a portion of these costs be allocated to local exchange service.”⁶⁹ The Commission added that “[t]he only reasonable and proper conclusion in light of the language of section 1325(c) is that dial tone line must be treated as a component of multiple services whose costs must be allocated among these services and not as a separate service.”⁷⁰ The Commission concluded, “because Bell has steadfastly maintained that dial tone line is a separate service, the Company cannot justify its proposed rate increase in view of the statutory definition. In other words, Bell’s position is inconsistent with the language of section

⁶⁵ Pennsylvania Public Utility Commission v. Bell Atlantic-Pennsylvania, Inc., Docket Nos. R-00963556 et al., Recommended Decision at 11-12 (October 8, 1996), (adopted in December 16, 1996 Opinion and Order).

⁶⁶ Id. at 11.

⁶⁷ Id.

⁶⁸ Id. at 12.

⁶⁹ Id. at 13.

⁷⁰ Id. at 15.

1325(c).”⁷¹ Thus, the Commission must now reject the Verizon Company’s proposals for the very same reason that the Commission rejected the 1996 rate rebalancing – misallocation of the cost of the loop facilities.

Of all the services that use the local loop facility, of particular interest here are access services. As noted above, the Commonwealth Court has affirmed the Commission’s Global Order decision where it continued to require access services to pay some portion of the local loop facilities costs.⁷² The Commonwealth Court stated:

The record here confirms the soundness of the PUC’s view, 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 a total network.⁷³

Yet, in this proceeding, the Verizon Companies continue to assign local loop facility costs to all those services that use the local loop when the Commission reasoned in the 1996 rate rebalancing filing that “[t]hus, while we do not, as 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.”⁷⁴

The Commission should not approve the original proposal of the Verizon Companies because Verizon openly admits that it asks the Commission to endorse the same misallocation of local loop facility costs that the Commission rejected in 1996. The allocation of loop facilities costs across all services that use the local loop, and not just to local service, is a central feature of the requirements of section 1325, as is clear from the discussion of that section above. The Verizon Companies admit that they allocate no

71

Id.

72

Global Appeal Order, 763 A.2d at 480.

73

Id. (footnotes omitted).

74

Pennsylvania Public Utility Commission v. Bell Atlantic-Pennsylvania, Inc., Docket Nos. R-00963556 et al., Opinion and Order at 23-24 (December 16, 1996).

portion of the local loop facilities costs to any service other than local service. When asked what share of the costs of the dial tone line were allocated to other services, the Verizon Companies responded “[i]t is Verizon PA’s position that Dial Tone Line is a separate service and the costs should not be allocated to other services. Therefore, Dial Tone Line costs were not allocated to different classes of service.”⁷⁵

Given the Commission’s conclusion that allocating 100% of the local loop costs to local service is not the type of cost allocation that section 1325 permits, the Commission cannot approve the local rate increases proposed by Verizon. Thus, the Commission must reject the Verizon Companies access reform proposals.

D. Verizon’s Petition Should Be Rejected Because The Proposed Local Loop Facility Costs Are Grossly Inflated And Unreasonable.

Verizon’s proposed local loop facility cost of \$41.52 is more than double any reasonable analysis of Verizon’s actual costs. OCA witness Dunkel’s simple comparison of the various measures of local loop costs vividly illustrates that Verizon’s proposed costs are far out of line.⁷⁶ The following summary of Mr. Dunkel’s comparison shows how this is true:

[BEGIN PROPRIETARY]

[END PROPRIETARY]

⁷⁵ OCA Cross Examination Exhibit No. 6. Verizon Pennsylvania and Verizon North provided an identical response to the Interrogatories of the OCA, OCA Set I-2 and OCA Set II-2 respectively.

⁷⁶ OCA St. No. 1 at 35

Verizon testified that the local loop is the same facility as a dial tone line.⁷⁷ That is to say, that all of the above costs are for the very same network facility. From the above it is clear that Verizon's proposed rate is not only more than double the current and tentative UNE rates, but it is also more than double Verizon's actual costs as they are reported to NECA. Thus, it is clear that Verizon's proposed rate is over-inflated because both the forward-looking UNE rate and the actual rates are consistently less than Verizon's proposed rate.

Verizon witness Taylor devotes much effort to dissuade this Commission from making these clear comparisons.⁷⁸ It is irrelevant whether UNE costs may be compared to NECA costs as Verizon witness Taylor testifies. What is relevant is that the Commission may compare both UNE rates and NECA rates to local loop facilities costs to determine if Verizon has overstated its proposed local loop facility costs far in excess of any realistic cost.

As OCA witness Dunkel demonstrated, Verizon has priced basic local exchange rates well in excess of Verizon's incremental costs of providing that service. Verizon claims that basic local exchange service is subsidized by other services.⁷⁹ That is, Verizon argues that it sells basic local exchange service for less than it costs Verizon to provide the service, and that other services offered by Verizon pick up the tab for basic local service. This is not the case. OCA witness Dunkel analyzed Verizon's costs and revenues and determined that on a TSLRIC basis, Verizon has a margin of **[BEGIN PROPRIETARY] [END PROPRIETARY]** over its cost of providing basic

⁷⁷ Verizon St. No. 2.0 at 16.

⁷⁸ Verizon St. No. 3.0 at 22.

⁷⁹ Verizon St. No. 2.0 at 3; Verizon St. No. 1.0 at 5.

local exchange service.⁸⁰ Clearly, Verizon's revenues exceed its incremental costs for this service by a wide margin. It is beyond doubt that when the revenues for a given service exceed costs, subsidy is an impossibility.⁸¹ Thus, such is the case with Verizon's basic local exchange service. This reasoning has received support in other states.⁸²

As OCA witness Dunkel testified, the incremental cost of basic residential local exchange service is properly calculated without including any portion of the local loop facilities cost. While Mr. Dunkel pointed out that the ultimate price of a service should be greater than its TSLRIC cost, because every service should bear a portion of the cost of its shared facilities, Verizon's TSLRIC cost of **[BEGIN PROPRIETARY]** **[END PROPRIETARY]** for basic local exchange service is the appropriate cost to use for any subsidy analysis. By not using this cost, Verizon has failed to use the appropriate cost in this instance.

The OCA has also done a stand-alone cost analysis as required by Section 1325. While TSLRIC cost studies exclude the costs of shared facilities, stand-alone costs include all costs necessary to provide a service on a stand alone basis. As Section 1325 also requires loop costs to be shared between services in the final cost analysis, OCA witness Dunkel testified that the appropriate share of the local loop facilities allocated to basic local exchange service is **[BEGIN PROPRIETARY]** **[END PROPRIETARY]**.⁸³ Thus, Verizon's "cost of providing local exchange service" under the requirements of section 1325 is **[BEGIN PROPRIETARY]** **[END**

⁸⁰ OCA St. No. 1 at 44.

⁸¹ Id. at 47.

⁸² Id. at 45.

⁸³ Id. at 53.

PROPRIETARY] per month.⁸⁴ Given that Verizon receives **[BEGIN PROPRIETARY] [END PROPRIETARY]** per month in revenue for that same service alone, subsidy is therefore an impossibility.⁸⁵ In fact, it is important to note that residential basic local exchange service provides more contribution per line than all other services combined.⁸⁶ This clearly implies that if a subsidy is occurring, it is residential basic local exchange service that subsidizes other services, not the other way round. The OCA points out that access services provide the lowest contribution, **[BEGIN PROPRIETARY] [END PROPRIETARY]** per line, of any intrastate service that utilizes local loop facilities.⁸⁷ Thus, it is impossible that intrastate access services provide a subsidy because the revenues produced are well below the stand-alone cost of providing that service.⁸⁸

The FCC has addressed these issues relating to access charges in its Triennial Review Order as it relates to the establishment of unbundled network elements (“UNEs”).⁸⁹ In particular, the FCC discusses the relationship of loop costs to loop rates and recognizes that local rates that are lower than local loop costs are not necessarily unprofitable.⁹⁰ Furthermore, the FCC discusses allocating joint and common costs and recognizes the difficulty related in such a task but ultimate worth of doing such allocation.⁹¹

In the Triennial Review Order, the FCC also explains how the new impairment standard created by the FCC addresses concerns raised by the D.C. Circuit

⁸⁴ Id. at 55.

⁸⁵ Id.

⁸⁶ Id. at 57.

⁸⁷ Id. at 58.

⁸⁸ Id. at 59.

⁸⁹ Triennial Review Order at paras. 154-169.

⁹⁰ Id. at para. 157.

⁹¹ Id.

Court of Appeals in its USTA⁹² decision. The D.C. Circuit stated that the rates for telecommunications services historically has included implicit support flows between different classes of customers and geographic areas and that these implicit support flows still exist in many of the rates regulated by state commissions.⁹³ The FCC also describes the nature and extent of existing implicit support flows. The FCC further noted that these implicit support flows have been justified as supporting the universal availability of local exchange services at affordable rates.

The FCC, however, also noted the complexity of the issue and stated that the existence of “below cost” residential local exchange service rates does not mean that such customers are “unprofitable” to serve.⁹⁴ The FCC stated:

Determining whether a customer class is desirable to serve requires a comparison of costs and all potential revenues for the class, which will substantially exceed the local exchange service rate. In addition, describing certain rates as being “above or below cost” itself involves complex questions concerning how costs should be defined. In the context of implicit support flows, describing a rate as “below cost” typically means that the rate is lower than the incumbent LECs fully distributed historical cost of providing service.⁹⁵

The FCC then also recognized that “in addition, economic theory does not provide a clear answer to the question of how joint and common and fixed costs should be allocated for costing purposes. This is particularly problematic in the telecommunications industry due to the very high proportion of joint and common costs and fixed costs.”⁹⁶

⁹² United States Telecom Ass’n v. FCC, 290 F.3d 415 (D.C. Cir. 2002)(“USTA”).

⁹³ Triennial Review Order at para. 156.

⁹⁴ Id. at para. 157.

⁹⁵ Id.

⁹⁶ Id. at footnote 515.

The OCA submits that the basic local exchange rate is not subsidized just because local rates are lower than total loop costs. As OCA witness Dunkel testified, Verizon PA's residential basic local exchange rate is much greater than its incremental costs.⁹⁷ Allocating joint and common costs is difficult but, nonetheless, is a task that must be done under Pennsylvania law. No increase in residential basic local exchange services is warranted at this time. That is true because, as discussed above, residential basic local exchange service contributes to the local loop facility well in excess of other services as analyzed under section 1325.⁹⁸

E. The Verizon/OCA Joint Proposal For Settlement Of This Proceeding Provides A Reasonable Compromise That Achieves The Commission's Goals.

In addition to the OCA proposal set forth above as discussed by OCA witness Dunkel, the OCA and Verizon have developed a Joint settlement proposal for the Commission to consider as an additional alternative to resolve the issues present in this proceeding. The OCA offers this compromise in settlement without prejudice to its litigation position offered above. The Verizon/OCA Joint Proposal represents a reasonable compromise of the issues involved in this proceeding that achieves the Commission's goals.. The specifics of the Verizon/OCA Joint proposal are attached to the Surrebuttal Testimony of Verizon witnesses Debra M. Berry and Michael J. Wirl, Verizon Statement 1.1, as Exhibit DMB-1. The OCA supports the Verizon/OCA Joint Proposal as a reasonable resolution of this proceeding.

⁹⁷ OCA St. No. 1 at 43-51.

⁹⁸ Id. at 59-60.

The Joint proposal by Verizon and OCA provides that Verizon's overall average TS rate would equal the consolidated rate of the current TS rates of the two Verizon companies. The CC will be reduced to the level of Verizon PA current traffic rate of [BEGIN PROPRIETARY] [END PROPRIETARY] resulting in a total revenue decrease of approximately [BEGIN PROPRIETARY] [END PROPRIETARY].⁹⁹ The Joint Proposal specifies that this revenue decrease will be offset by no more than \$40 million from increases to residential basic local service rates on a combined Verizon PA and Verizon North basis, and that any increases will not exceed \$1.00 per residential line, per month.¹⁰⁰ Verizon has proposed that the remainder of the access reduction would be recovered through increases to other local service rates, again on a combined Verizon PA and Verizon North basis.¹⁰¹ The Verizon/OCA Joint Proposal provides that no rate changes would occur before January 1, 2004.

The Joint Proposal represents a compromise on behalf of both parties and represents a level of access reductions and revenue neutral increases in the mid-range of the options under Verizon's filing as illustrated by examples provided in both Verizon's Direct Testimony and the OCA's Rebuttal Testimony. The Joint Proposal's limit of no more than \$1.00 on any increases to basic residential service is reasonable.

Therefore, the OCA submits that the Verizon/OCA Joint Proposal is a reasonable compromise of the issues involved in this proceeding that achieves the Commission's goals. The OCA submits that the Commission should adopt the Verizon/OCA Joint Proposal as discussed in Verizon Statement 1.1 and Verizon Exhibit DMB-1.

⁹⁹ See, Verizon St. 1.1 at 7 and Verizon Exhibit DMB-1.

¹⁰⁰ Id.

¹⁰¹ Id. at 7-8.

III. CONCLUSION

WHEREFORE, the Pennsylvania Office of Consumer Advocate respectfully submits that the Petition filed by Verizon Pennsylvania Inc. and Verizon North Inc. be modified consistent with the above referenced testimony of OCA witness William W. Dunkel. In particular, the OCA proposes that Verizon's intrastate switched access rates be restructured on a revenue neutral basis, to establish uniform access rates that apply to both Verizon Companies with no rate increases for any other services. In the alternative, the OCA submits that the Verizon/OCA Joint Proposal, as discussed by Verizon witness Debra Berry, should be adopted as a reasonable compromise of this proceeding.

Respectfully submitted,



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Dated: September 18, 2003
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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

APPENDIX A

PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17105

Public Meeting held December 12, 1996

Commissioners Present:

John M. Quain, Chairman, Concurring & Dissenting in part
Lisa Crutchfield, Vice Chairman, Concurring & Dissenting in part
John Hanger, Concurring & Dissenting in part-Statement attached
David W. Rolka, Concurring & Dissenting in part-Dissenting Statement
Robert K. Bloom, Concurring & Dissenting in part attached

Pennsylvania Public Utility Commission	Docket No. R-00963550 R-00963556
AT&T Communications of Pennsylvania, Inc.	R-00963550C0001
Office of Consumer Advocate	R-00963550C0002
Central Atlantic Payphone Association	R-00963550C0003
Kurt Richter	R-00963550C0004
Joseph A. Henchy	R-00963550C0005
John D. Lewis	CONSUMER ADVOCATE C-00967866

and

Office of Small Business
Advocate,

Pennsylvania Cable Television
Association

MCI Telecommunications
Corporation, Inc.

Intervenors

v.

Bell Atlantic - Pennsylvania, Inc.

OPINION AND ORDER

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I. HISTORY OF THE PROCEEDING

On January 10, 1996, Bell Atlantic - Pennsylvania, Inc. ("Bell" or "Company" hereafter) filed revisions to its tariffs: Telephone Pa. P.U.C. Nos. 1, 1A, 180A, 182, 182A, 185B, 185C, 296 and 302, to become effective on March 17, 1996 (alternately "Rate Rebalancing Filing").¹ Bell's filing was made pursuant to Section 1308(b) of the Public Utility Code, 66 Pa.C.S. §1308(b). The filing proposed to restructure and rebalance Bell's Residential, Local and Toll Service rates, Business Local and Toll Service rates and Switched Access rates on a revenue neutral basis. Bell's tariff filing, as proposed, would result in an increase of approximately \$41,598,000 to the protected residential service rates class.

On January 16, 1996, Bell also filed revisions to its Local Tariff-Telephone Pa. P.U.C. 1. This tariff filing was docketed at No. R-00963556 and proposed to establish a late payment charge for residential customers, proposed to become effective March 17, 1996.

Subsequently, Notices of Appearance, Formal Complaints and Interventions were filed by numerous parties. The active participants to this proceeding were as follows: the Commission's Office of Trial Staff ("OTS"), the Office of Consumer Advocate ("OCA"), the Office of Small Business Advocate ("OSBA"), the Pennsylvania Cable Television Association ("PCTA"), the Central Atlantic Payphone Association ("CAPA"), AT&T Communications of

¹ The procedural history has been adopted, with minor editing, from the recitation of the Office of Consumer Advocate taken from its Main Brief.

Pennsylvania, Inc. ("AT&T"), MCI Telecommunications Corp., Inc. ("MCI"), and John Lewis, an individual customer of Bell. In addition, two customers, Kurt Richter and Joseph A. Henchy, were inactive participants.

By Opinion and Order, entered March 1, 1996, we suspended Bell's Rate Rebalancing filing until September 17, 1996, and instituted an investigation to determine the lawfulness, justness and reasonableness of the proposed tariff changes. In addition, this Commission incorporated by reference the evidentiary record contained in the Universal Service Investigation proceeding, at Docket No. I-00940035, into the record to be developed in this case.

By Opinion and Order, entered March 15, 1996, we suspended Bell's filing to implement a residential late payment charge, at Docket No. R-00963556, and consolidated that proceeding with Bell's Rate Rebalancing filing. We also extended the suspension period concerning the consolidated proceeding for an additional three months, or until December 17, 1996.

On April 1, 1996, a Prehearing Conference was held before presiding Administrative Law Judge ("ALJ") Louis G. Cocheres. A procedural schedule for formal hearings was established at that time and requests for Public Input hearings were presented to the ALJ.

On April 25, 1996, the notice of Public Input hearings was issued. Public Input hearings were scheduled in the following areas of Pennsylvania: Warren (June 24), Sharon (June 25), Uniontown (June 26), Pittsburgh (June 27), Allentown (July 8), Media (July 9), Reading (July 10), and Philadelphia (July 11).

Additional Public Input hearings were held on August 21, 1996, in Harrisburg and State College.

On April 5, 1996, the OCA filed a motion to declare nonproprietary, Bell's cost calculations by wire center. Bell filed a pleading in opposition to the OCA's Motion. By Prehearing Order No. 4 (Order No. 4), dated May 17, 1996, ALJ Cocheres granted the OCA's motion and required that Bell disclose to the public the results of its cost calculation by wire center. The effective date of Prehearing Order No. 4 was stayed until the Commission entertained the following material question:

Does the application of sections 3(45), 251(c) and 252(d)(1) of the Telecommunications Act of 1996 prevent Bell Atlantic-Pennsylvania, Inc. from establishing entitlement to a protective order for proprietary information contained in a wire center cost study (Exhibit RES-100.XLS TOT WC CALC) in accordance with Commission regulations at 52 Pa. Code §5.423(a)?

On June 18, 1996, we entered an Opinion and Order addressing the certified question and continued to classify this information as proprietary. We allowed further briefing on this issue.

On July 19, 1996, the OCA filed a motion to declare nonproprietary Bell's dial tone line cost by cell and a range of wire center costs. The OCA's motion was denied.

On April 26, 1996, in accordance with the procedural schedule established at the Prehearing Conference, Bell filed its direct testimony. On May 31, 1996, the OCA, CAPA, AT&T and MCI individually filed their direct testimony in the case. Bell

filed its rebuttal testimony on July 3, 1996, and surrebuttal testimony was filed by the OCA, AT&T, CAPA and MCI on July 24, 1996. Bell filed its rejoinder outlines on July 31, 1996.

Formal hearings were held in Harrisburg on August 5, 1996, through August 7, 1996. The evidentiary record closed on August 21, 1996, after the final Public Input hearing.

On July 31, 1996, the Coalition For A Competitive Commonwealth filed a Formal Complaint which was docketed at number R-00963550C0006. The formal complaint of the Coalition For A Competitive Commonwealth was severed and was heard on September 10, 1996. A separate Recommended Decision was issued in the matter on November 5, 1996. Said complaint will be disposed of by separate Opinion and Order.

II. ISSUES

A. INTRODUCTION

ALJ Cocheres has, unequivocally, rejected almost all of the rebalancing proposals put forth by Bell in this matter. He noted that:

... The Company proposals are many and complicated. Customers who use the same services in the same density cells can be billed differently. Customers in different density cells using the same services may or may not be billed differently. If my recommendations are rejected and closer study of the Company proposals is required, the Commission should be aware that these nuances exist.

I note that my overall negative recommendation should not be construed as opposition to the concept of rate rebalancing. Rate rebalancing as a response to competition and a regulatory tool can be appropriate, but this particular plan is not.

(R.D., p. 6).

Conceptually, then, the ALJ's recommendations and our disposition of the issues in the instant proceeding should not be construed as broad based precedent for the proper role of rate rebalancing in the regulation of telecommunications service providers.

B. THE FREEZE

The OCA and PCTA devoted substantial resources to address the issue of whether Bell was unable to raise the rates for the protected classes until January 1, 2000. These parties

argued, essentially, that ~~protected services~~ were subject to a rate freeze set forth in the Commission's Opinion and Order in Bell's Chapter 30 petition proceeding. Re: Bell Atlantic-Pennsylvania, Inc., 82 Pa. P.U.C. 194 (June 28, 1994) (hereafter, alternately, "Alternative Regulation Order"). (R.D., pp. 7-8).

Bell responded by referencing this Commission's Opinion and Order in Re: Bell Atlantic-Pennsylvania, Inc., Opinion and Order, entered October 30, 1995, at Docket No. P-00930715 (Slip Opinion). (October 1995 Order). (Id.).

On consideration of the positions of the parties, ALJ Cocheres agreed with the position of Bell. He noted:

... The Commission has already decided this issue. Acting on the Company's petition and pursuant to Section 703(g) of the Public Utility Code (66 Pa. C.S. §703(g)), the Commission ruled that the Company was granted the discretion to request revenue neutral price changes on protected services prior to December 31, 1999. Further, because the parties had questioned the Commission's

~~Section 703(g) defines protected services as~~

1. Telecommunications service provided to business or residential consumers that is necessary for completing a local exchange call.
2. Touch-tone service.
3. Switched-access service.
4. Special-access service.
5. Ordering, installation, restoration and disconnection of these services.

authority to act during the pendency of an appeal, the October 1995 Order expressly conditioned the effectiveness of this clarification of the June 1994 Order on the withdrawal of the pending Petition for Review in the Commonwealth Court at Docket No. 0501 C.S. 1995. Slip Op. at 14-22. When the appeal was withdrawn, the Opinion and Order became operative.

(R.D., p. 8).³

We agree with the recommendation of ALJ Cocheres. We have previously considered this issue and intend that our reasoning and discussion in the October 1995 Order should govern. There have been no considerations raised by the OCA or the PCTA which cause us to alter our position previously set forth therein. And, contrary to the positions of the OCA and the PCTA, the public interest has been promoted by this Commission's consideration of the issues involved in this proceeding. The Exceptions of the parties are denied consistent with our discussion.

C. CROSS-SUBSIDY

Fundamental to the ALJ's recommendations is his conclusion that Bell's underlying premise, namely that two kinds of rate subsidies exist in the design of current rates, was erroneous.

³ ALJ Cocheres further noted that the OCA, and the PCTA, who were all parties who actively participated in opposing Bell's request for clarification of the Alternative Regulation Order (Slip Op. at 15) did not, apparently, appeal the October 1995 Order. Accordingly, he felt bound by the findings, determinations and directives of the October 1995 Order. 66 Pa. C.S. §316.

Bell's Rate Rebalancing filing proceeded from the premise that business customers subsidized the residential customers. To remedy this problem, the Company proposed an overall decrease to business customers and an overall increase to residential customers. Thus, Bell continued that it was necessary to spread revenue changes between market baskets to maintain neutrality. (R.D. at 9 citing Bell M.B., pp. 1, 3-4, 7, 32-33, 41-43, 45-46. Bell R.B., pp. 11-13, 15-16).

Also, Bell claimed that the urban residential customers paid more than their fair share of costs and, consequently, subsidized rural and other high cost residential customers.⁴ By lowering urban residential rates and raising rural and other high cost residential rates, Bell proposed that it was moving both groups within one market basket closer to cost. (R.D., p. 9 citing Bell M.B., pp. 2-5 18-23, 27-28. Bell R.B., pp. 24-25).

ALJ Cocheres rejected Bell's position. We set forth his reasoning, below:

In order to agree with Bell's proposal, one must first accept their basic premises, i.e., business rates subsidize residential rates, and urban residential and business rates subsidize rural residential rates. Bell M.B., p. 4. As indicated in far more detail in the next chapter, I do not accept the Company's basic starting point. Indeed, I have concluded that residential rates cover their costs. Consequently, I find that the

⁴ Bell, at page 3, n. 3 of its Exceptions on this issue asserts that the ALJ mischaracterizes its position here. Bell clarifies that its position is that residential dial tone line service - one of the components of local exchange service - is below cost. Bell further states that the combination of dial tone line rates and certain local usage packages could exceed the combined cost of those services. (Id.).

Bell proposals, if adopted, would cause cross-subsidization in favor of the business customers, contrary to the legislative policy found in the Public Utility Code. 66 Pa. C.S. §3001(3).

* * *

... Since Bell's petition to receive alternate rate regulation has already been granted, I find that its subsequent rate proposals must be evaluated in view of this legislative guidance. June 1994 Order. If Bell were correct and residential rates were below costs, how then can this Commission consider raising the rural residential rates (the most competitively unattractive customers) while urban residential customers' rates (customers more likely to see the benefits of competition) do not go up as much? Even in this noncompetitive class, are the rural customers being asked to subsidize the urban ones? Is this result permissible? Considering the statutory goals, I think not.

The cross-subsidy is more obvious between the protected residential class and the competitive business class.⁵ If one accepts my premise that residential local exchange service pays its own way, then how can this Commission justify raising rates on the protected residential class to offset dollar for dollar, a rate decrease to the competitive business class? Again, in view of the statute's guidance, no justification is possible.

In other words, I regard this portion of the proposal (a dollar for dollar matching between market baskets) as a request to cover or guarantee a given revenue stream to the Company in the face of competition. As such, it attempts to shift the risk of competition to noncompetitive services. This shift runs contrary to one purpose for granting Bell

⁵ We do note that the business class of services are "protected services" under Chapter 30.

alternative rate regulation, i.e., in return for loosening the controls on competitive services, the shareholders were required to assume the uncertainties of the marketplace. This particular form of "revenue neutrality" is exactly the kind which should be avoided.

(R.D., pp. 9-11).

The specific areas of consideration are noted below, consistent with the presiding ALJ's discussion of said issues.

Exceptions

Prior to our consideration of the specific areas addressed by ALJ Cocheres, we note the Exception of AT&T concerning his rejection of the premise that there is cross subsidy from urban residential customers to rural and other high cost residential customers.

At page 23 of the R.D., ALJ Cocheres states as follows:

However, I am not accepting the OCA's particular allocation proposal in this proceeding. I am merely pointing out that a change in the allocation of the specific costs that are at issue here (i.e., dial tone line costs and broadband network costs) can produce results far different than those on which Bell based its proposed rebalancing of rates in this proceeding. My basic conclusion remains: Because Bell's allocation of dial tone line and broadband network costs are clearly flawed, its claim that local exchange service is being subsidized by other services and its resulting rate rebalancing proposals, are unsupported and must be rejected.

AT&T, at pages 6-8 of its Exceptions, notes that the above-quoted finding, though not central to the adjudication of the instant proceeding, is in error and will be significant in other pending and future dockets. A number of cost studies⁶ and their results have been submitted in the record states AT&T, and although the studies vary in their treatment and allocation of joint and common costs, including local costs, they all identify a significant subsidy to high cost customers from low cost customers. See AT&T Exc., p. 7. The parties have only disagreed as to the amount of the subsidy.

Disposition

On consideration of the Exception of AT&T concerning this issue, we conclude that the language of ALJ Cocheres, though not central to the disposition of the issues here is, nevertheless, important for our consideration of matters in other pending proceedings, namely our Universal Service Investigation. Consequently, we shall reject the conclusion of the presiding ALJ at page 23 of the R.D. as, inter alia, overly broad, and note that ~~our general concurrence with the ALJ's conclusions that Bell did not meet its burden of proof in this Rate Rebalancing proceeding, is without prejudice to our consideration of the existence of subsidies by lower cost (generally more urban) to higher cost (generally more rural) customers in other pending Commission dockets.~~

⁶ AT&T notes that the Universal Service Investigation includes the following models in the record, the Hatfield Model (sponsored by AT&T and MCI), the Benchmark Cost Model (sponsored by Sprint/United), the Johnson Model (sponsored by the OCA), results of the "Bellcore model" (sponsored by Bell), and the results of the GTE Model (sponsored by GTE). (AT&T Exc., p. 7, n. 7).

D. FLAWED COST ALLOCATIONS

1. Dial Tone Line Costs

Bell asserted that its Dial Tone Line rates were currently set below its dial tone line costs, particularly for residence local exchange customers. (R.D. at 11). Thus, Bell concluded that dial tone line service was being subsidized by other services. ALJ Cocheres rejected this assertion due in major part to the fact that Bell chose to allocate 100% of the local loop costs to the dial tone line component.

~~Bell's position was that dial tone line is a complete service in and of itself, rather than a component of the many services Bell provides. (R.D., p. 11 citing Bell R.B., pp. 34-35).~~
For this reason, Bell allocated 100% of its local loop costs to the dial tone line component of local exchange service.

Bell contended that dial tone line is a separate and distinct service, and that most experts agreed with this position. See Bell R.B., pp. 34-35.

The presiding ALJ disagreed with Bell's determination that the dial tone line is a separate and distinct service which, as a consequence, necessitates the 100% allocation of costs to this component. We set forth his reasoning in detail:

... the OCA has pointed out, the dial tone line is the facility that connects the customer to the Company's switching equipment. OCA M.B., p. 79. As such, it is more accurate to view it as a component of all the telecommunications services that depend on it, rather than as a separate service. In addition to local exchange service, such services would include intraLATA and interLATA toll services, CLASS or optional services, and non-published

or non-listed telephone service. Thus, the costs associated with dial tone line should be viewed as joint or common costs of those services, and should be allocated across those services instead of being assigned totally to local exchange service, as Bell asserted. Id. at 80-82.

* * *

... the OCA cited a number of decisions of state regulatory commissions, as well as state and federal statutes in support of the principle that dial tone line represents a component whose costs should be shared among the services that utilize it. OCA M.B., pp. 84-91. Perhaps most significant in this regard is Section 1325 of the Public Utility Code.⁷

Section 1325(c) goes on to define the cost of providing local exchange service as "[t]he direct cost of providing the service plus a share of the costs of the dial tone line, allocated in proportion to the stand-alone cost of each class of service which utilizes the dial tone line." 66 Pa. C.S. §1325(c).

⁷ Section 1325(a) states:

(a) **General Rule.**--In any rate proceeding pursuant to section 1308 (relating to voluntary changes in rates), no public utility shall be granted a percentage increase in local exchange service unless that percentage increase is just and reasonable. In no event shall the public utility be granted an increase in local exchange rates which is greater than the overall average percentage increase in total intra-state revenues authorized by the commission unless the utility proves by record evidence that a greater percentage increase for local exchange service is justified based upon the cost of providing that service.

Thus, the statute recognizes the costs of the dial tone line as shared costs, and requires that only a portion of these costs be allocated to local exchange service.

Bell contended that Section 1325 did not apply to its rebalancing proposal because it is only applicable to situations where an overall percentage increase in rates is requested.

* * *

... Bell is wrong in its contention; Section 1325 does apply to Bell's rate rebalancing filing. As set forth in Section 1325(a), this statute applies to "any rate proceeding pursuant to section 1308 (relating to voluntary changes in rates)." 66 Pa. C.S. §1325(a). (Emphasis added.) The statute is clearly applicable in this case. If Bell's proposal is revenue neutral as it claims, then the overall average percentage increase in total intrastate revenues which it is proposing is zero. Thus, as the OCA argued, Bell's proposed increases to local exchange service cannot be granted unless Bell is able to prove that "a greater percentage increase for local exchange service is justified based upon the cost of providing that service." OCA M.B., p. 136.

(R.D., pp. 12-14).

Bell also asserted that, even if Section 1325 did apply to the instant, Rate Rebalancing filing, it has, in fact, shown that its proposed increases to dial tone line service "are justified based upon the 'cost of providing that service' as required by the statute." (R.D., p. 14). This alternative position was also rejected by ALJ Cocheres. Because Bell steadfastly maintained that dial tone line is a separate service, the ALJ concluded that Bell could not justify its proposed rate increase in view of the statutory definition. (Id.). Bell's position was, in the view of the presiding ALJ, inconsistent with the language of Section 1325(c).

66 Pa. C.S. §1325(c). ALJ Cocheres referenced the testimony of certain of Bell's laymen witnesses, as espousing a position inconsistent with the allocation of 100% of costs to the dial tone line component.

As an example, the testimony of Bell's witness, Dr. Taylor was cited wherein he stated:

... BA-PA did not add to the direct cost of the Dial Tone line service an additional amount representing an allocation of these same Dial Tone line costs to Dial Tone line service, as the statute appears to suggest. Any additional assignment of Dial Tone line costs to Dial Tone line service would entail double-counting of those costs and would be illogical and inconsistent with economic costing principles. In any event, since BA-PA's residence Dial Tone line rates do not currently cover their direct costs, they certainly could not cover their direct costs plus some allocation of additional costs.

(R.D., p. 15 citing Bell St. No. 3.0 (Taylor), p. 15).

Also, Bell's witness Mr. Sanford asserted that "[a] stand-alone cost study for dial tone line service under section 1325 would require double counting since the study would have to included [sic] the direct costs of providing dial tone service 'plus a share of the costs of the dial tone line.'" (Id., citing Bell St. No. 2.0 (Sanford) p. 9). Consequently, the ALJ observed that "[t]he testimony of Bell's witnesses would seem to be credible if dial tone line could be considered to be a separate service, as Bell contends. However, neither Bell nor I are in a position to conclude that the statute [Section 1325] is illogical and can thus be ignored."

The ALJ concluded that "[t]he only reasonable and proper conclusion in light of the language of Section 1325(c) is that dial tone line must be treated as a component of multiple services whose costs must be allocated among these services, and not as a separate service."

Two other considerations influenced ALJ Cocheres' conclusion to reject the proposed allocation of 100% of dial tone line costs to the dial tone line component. First, he was persuaded by language in this Commission's Universal Service Investigation proceeding that held that local loop costs should, for universal service purposes, be considered joint or shared costs. The OCA pointed out the following language in our Order entered September 5, 1995, Slip Op. at 12 in the Universal Service Investigation which stated in part:

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.

(R.D., p. 16 citing OCA St. 3S, p. 25).

Second, ALJ Cocheres observed that the Federal Communications Commission ("FCC") has recently determined that loop costs are joint or common costs of providing service. As the FCC stated in its interpretation of the Telecommunications Act of 1996 (47 U.S.C. § 201, et seq.) ("Act" hereafter), when services are priced for unbundling:

The term "common costs" refers to costs that are incurred in connection with the production of multiple products or services, and remains unchanged as the relative proportion of those products or services varies (e.g., the salaries of corporate managers). Such costs may be common to all services provided by the firm or common to only a subset of those services or elements. If a cost is common with respect to a subset of services or elements, for example, a firm avoids that cost only by not providing each and every service or element in the subset. For the purpose of our discussion, we refer to joint and common costs as simply common costs unless the distinction is relevant in a particular context.

* * *

As discussed in greater detail below, separate telecommunications services are typically provided over shared network facilities, the costs of which may be joint or common with respect to some services. The costs of local loops and their associated line cards in local switches, for example, are common with respect to interstate access service and local exchange service, because once these facilities are installed to provide one service they are able to provide the other at no additional cost.

(R.D., p. 17 citing OCA M.B. citing In the Matter of: Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, August 8, 1996 at ¶¶ 676, 678).

Exceptions

Bell excepted to ALJ Cocheres' recommendation. Bell explains that its local exchange service rate structure has two components - Dial Tone Line service and local usage service options. All customers must subscribe to Dial Tone Line service, which is a flat rate charge designed to cover the cost of the dial

tone line facility, i.e. the loop which extends from the telephone company's central office to each customer's premises. (Bell Exc., p. 4). Bell goes on to note that the Dial Tone Line service facility is dedicated to a specific customer but does not vary based on the level of telephone usage. Therefore, the Dial Tone Line service should be recovered from the subscribing customer. (Id.). On the basis of the foregoing, Bell states that virtually all experts agree that Dial Tone Line service is a separate and distinct service and dial tone line costs should not be allocated to other services. (Id.).

Bell then repeats four arguments supportive of its view that it is erroneous to reject its proposal based on its determination to allocate 100% of dial tone line costs to this service.

Bell argues that dial tone line costs do not meet the economic definition of joint or shared costs. To the contrary, Bell states that most economists agree that the dial tone line is a separate service with its own separate demand. (Bell Exc., p. 5).

Bell next states that the allocation of dial tone line costs to other services is illogical. Here, Bell admits that the dial tone line portion of the loop facility is, in fact, used for all telecommunications services. However, Bell counters that this fact does not mean that the costs are joint or common, or that they are appropriately allocated to other services. Bell would analogize the argument that dial tone line costs are joint or shared costs, to the argument that the telephone set (which is necessary for local calls, toll calls and all other telephone services), is such a service. Bell attempts to draw attention to the logic of this position by noting that no one would argue that the telephone set is not a separate facility with separate costs. Also, Bell notes that no one could logically argue that the costs of telephone

sets should be allocated to the cost of other telephone services, like toll and access, simply on the basis that the set is a necessary component of all telecommunications services. (Bell Exc., p. 6).

Next, Bell argues that as a matter of policy, the allocation of dial tone line costs to other services will ensure the continuation of cross-subsidies among customers and customer classes. (Id.).

Finally, Bell distinguishes the arguments that favor allocating loop costs to other services as an argument over the proper recovery of these costs. Even were this Commission to agree with the theory that a significant portion of the loop costs should be "recovered" from long-distance carriers and their customers, (a theory with which Bell states the Commission should not agree), one should not confuse cost recovery with cost causation, argues Bell, by incorrectly allocating loop costs to the costs of other services. (Bell Exc., p. 7).

In this Exception, Bell also replies to the observations of ALJ Cocheres that Section 1325 of the Public Utility Code and the FCC discussion in its Local Competition Order suggest that the allocation of 100% of dial tone line costs to the dial tone component is unreasonable.

With regard to Section 1325, Bell takes the view that this section does not require the allocation of loop costs at all, but merely limits increases on local exchange service to the overall average percentage increase for all other services. Consequently, asserts Bell, this section has no applicability to revenue neutral changes within local exchange market baskets of services as no overall percentage increase is being sought. (Bell

Exc., p. 8). Bell then makes the point that the definitions of Section 1325 are not to apply to other sections of the Public Utility Code and there is no basis for extending these definitions to a different context than the very limited context addressed in Section 1325. (Bell Exc., p. 9).

With regard to the FCC's Local Competition Order, Bell states that said order merely reflects the FCC's treatment of loop costs for purposes of separation between the interstate and intra-state jurisdictions. (Id.)

Finally, Bell states that the parties to the Commission's Universal Service Investigation disagreed with the characterization of loop costs as joint or shared costs.

AT&T also excepted to ALJ Cocheres' recommendation. AT&T supports the ALJ in his result only. (AT&T Exc., p. 4). AT&T agrees with the position of Bell, "... that allocation of 100% of local loop costs to local exchange services is the only economically sound way to allocate costs under the incremental cost study analysis approach endorsed by all parties to this proceeding." AT&T takes the view that a 100% allocation is appropriate because local exchange service is a separate service with separate costs and is the cost causer of the local loop costs. (AT&T Exc., p. 4).

However, although AT&T disagrees with the ALJ regarding his allocation of local loop costs, it believes that the correct result was reached with the determination that Bell's local exchange service, on a statewide, total service basis, is not subsidized by other services. Under AT&T's view, Bell's position on cross-subsidization is erroneous, and is driven by the failure to include all of the revenues associated with local exchange service in its cost study analysis. AT&T specifically targets for

criticism Bell's cross-subsidization position. AT&T asserts that Bell's position is based on a "manipulation" of the revenue side of the cost analysis equation to exclude consideration of revenues associated with the subscriber line charge ("SLC") and the portion of interstate common carrier line charge ("CCLC") revenues associated with recovering dial tone line costs. (AT&T Exc., pp. 4-5).

According to AT&T, once the revenue equation is corrected to include all revenues Bell receives either from its local exchange services or as federal support for the dial tone line, Bell's own cost study (even with 100% local loop allocation) demonstrates that local exchange service, in the aggregate, provides a contribution above costs. (AT&T, Exc., p. 5). On the basis of the foregoing, AT&T concludes that Bell has not met its burden of proof of demonstrating that its \$41 million increase to local service revenues is just and reasonable. AT&T sees the issue as one of Bell being motivated to isolate its revenues from competitive risk. (Id.)

Disposition

On consideration of the position of the parties, we shall, hereby, adopt the recommendation of ALJ Cocheres, consistent with our reasoning delineated, below.

Initially, we must start from the alternative regulation compact which we approved for Bell in our June 28, 1994 Opinion and Order. In the Alternative Regulation Order, Ordering Paragraph No. 7, Bell was given the opportunity to propose revenue neutral "cross" market basket proposals to the extent it provided rational reasons, i.e. reasons why such a restriction is not feasible or advisable from a public policy standpoint. In this proceeding, we

Conclude that Bell has not met its burden of demonstrating any rational reasons for us to permit the Company to cross market baskets.

Also, we 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.⁸ It is without question that the dial tone serves as the platform from which a host of telecommunications services, are, in fact, provided. We have recognized this in several proceedings, including our Universal Service Investigation, and in Pa. P.U.C. v. Breezewood Telephone Company, 74 Pa. PUC 431 (1981), as has the FCC in its Local Competition Order.

Consequently, while there may be some merit to Bell's distinction that the debate over the proper allocation of loop costs 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 yet, endorse any competing percentage allocation⁹ of local loop costs, we find that 100% allocation to

⁸ Dial tone line costs, more appropriately called local loop costs, are the costs associated with providing local loop service. These costs are recovered in part from the following: (a) DTL rates on a local basis; (b) intrastate access charges on an intrastate toll basis; (c) interstate access charges on an interstate basis, as well as from the SLC.

⁹ We note that the OCA and the OTS, have variously asserted that because the local loop is a shared facility, that allocating 50% of the direct cost of the local loop to the dial

one component is not reasonable and does not result in a revenue neutral impact.

We are also constrained to agree with ALJ Cocheres concerning his interpretation of Section 1325 and its applicability to this proceeding. Section 1325 applies to any rate proceeding. Where the words of a statute are clear and unambiguous, they should be given their ordinary meaning. We disagree with Bell that there is any need to go outside of the clear and unambiguous language of Section 1325 to interpret its applicability to this matter.

Finally, we note that an additional consideration supports our determination to adopt the ALJ in his result. That consideration pertains to the revenue portion of the equation. As AT&T points out, if one considers SLC and CCLC revenues as part of the equation, the dial tone line rates clearly recover their costs.¹⁰

On the basis of the foregoing, we shall adopt the ALJ's conclusion on this issue. This does not mean that we endorse all aspects of his reasoning except as expressly noted, above.

2. Broadband Network Costs

The OCA also sponsored evidence which showed that Bell incorrectly calculated narrowband service costs and wire center

tone line is a reasonable compromise. See, for example, OTS R.Exc., p. 3.

¹⁰ In this regard, we note that the OCA also states "As Bell properly recovers some cost of its dial tone line from carrier access service, it should not also recover 100% of its dial tone line costs from local exchange service as well. See OCA R.Exc., p. 2.

costs. ALJ Cocheres, while he did not accept the OCA's particular proposal mechanism in this proceeding, generally agreed with the OCA that a change in the allocation of the specific costs, namely broadband network costs, can produce results significantly different from those on which Bell based its proposed rebalancing. (R.D., p. 23).

With regard to common costs¹¹, the OCA argued that Bell did not properly divide broadband costs between those attributable to narrowband service and broadband service. (R.D., p. 18 citing OCA M.B., pp. 98, 100-102). A portion of the broadband facilities are used in common to render both narrowband and broadband service. The OCA asserted that the costs of the common facilities should be divided between the narrowband and broadband services. ALJ Cocheres construed the testimony of Bell's witness Mr. Sanford, as evidence that Bell did separate broadband from narrowband costs, but made no allowance for common costs. (R.D., p. 19 citing Bell St. No. 2.1 (Sanford), p. 22). Bell's testimony divides the broadband equipment into two categories, i.e., broadband and narrowband (or voice grade). The costs of facilities which could be used to render narrowband service were allocated to that service with no regard to whether the same facilities could also render broadband service. The ALJ concluded that the result of the Company's failure to make this allocation is that narrowband users would have been paying for all or 100% of the broadband common facilities costs and that the narrowband local loop costs are unduly inflated. (Id., citing OCA St. No. 3S (Dunkel), pp. 64-65).

¹¹ Since a portion of broadband facilities are dedicated to render narrowband service exclusively, the costs for those facilities were, in fact, allocated to narrowband service. ALJ Cocheres, after reviewing Bell St. No. 2.1 (Sanford), p. 22, concluded that, in actuality, the parties did not disagree on this subject. (R.D., p. 18).

We note that Bell has not, apparently, filed an Exception to the ALJ's treatment of the narrowband issue. Consistent with our reasoning below, we accept the ALJ recommendation in its result.¹²

E. RESIDENTIAL ISSUES

We include a description and discussion of the salient features of Bell's rate proposals for the various residential rate classes¹³ as taken from the R.D. The presiding ALJ regarded the decreases as a package with the increases.

1. Touch Tone Charges

Bell proposed to eliminate current touch tone charges for all residential and business customers. (R.D., pp. 24-25 citing Bell M.B., pp. 19-20 and App 1, p. 1).

Exceptions

Bell generally excepts to the ALJ's dismissal, out of hand, of its proposal concerning touch-tone charges.¹⁴ Bell refers this Commission to its Appendix A and states that touch-tone

¹² See OCA R.Exc., p. 10, n. 8.

¹³ As noted by ALJ Cocheres, when the Company refers to its average residential customer, it is referring to a customer who purchases Touch Tone Service, Dial Tone and the Local Unlimited Usage Option Package. The record reflects that these customers constitute the vast majority of this customer class. In addition, the rates outlined here do not demonstrate how the substantial minority of customers who use the Budget and Standard Plans (measured usage) received much higher increases.

¹⁴ We note that all proposals not specifically addressed were considered rejected by the ALJ. (R.D., p. 7),

decreases offset the Dial Tone Line increases by \$33 million. (Bell Exc., p. 13, n. 31).

Disposition

We note that Bell's Rate Rebalancing filing included the elimination of the separate charge for residence customers' touch-tone service. Based on Bell's revenue numbers appearing as Appendix A of Bell's Replies to Exceptions, the residence touch-tone revenue reduction would be offset by a like amount increase in residential dial tone line service rates.

Bell asserts that a majority of its residential customers subscribe to touch-tone service as evidenced by a subscription rate nearing 80%. While it is true that elimination of the separate touch-tone charge and "roll-in" to the dial tone line service rate would be both revenue neutral to Bell and, arguably, a savings for those customers who have touch-tone today (100% of Bell's residential customers would share the cost of what 80% pay for touch-tone today), the 20% of Bell's customers who today choose rotary dial service would face an increase in dial tone line rates.

Inclusion of touch-tone in the dial tone line service rate make some intrinsic sense, and, in fact, is consistent with this Commission's definition of basic universal service which includes touch-tone capabilities. We are of the opinion, however, that an increase in rates to 20% of the residential customers is troublesome. We shall, therefore, give Bell the alternative of rolling touch-tone rates into residential dial tone lines if Bell can present a method whereby the existing customers who do not subscribe to touch-tone can be grandfathered as long as they are at their existing domicile. The "roll-in" would therefore not affect existing customers since existing touch-tone customers will have no

rate decrease and existing customers who do not subscribe to touch-tone will have no increase.

2. Dial Tone Line Charges

Bell proposed to increase dial tone line charges for all residential customers in all four of its density cells.¹⁵ The increases for single party residential lines ranged from a low in cell one of \$2.80 to a high in cell four of \$2.95 monthly. (R.D., p. 25 citing Bell M.B., pp. 19-20 and App. 1, p. 1). Consistent with his view expressed throughout the R.D., ALJ Cocheres concluded that Bell failed to justify its proposed dial tone line increases. (Id.). On this basis, the ALJ recommended their rejection.

Exceptions

Bell excepted to the ALJ's recommendation to reject its proposal to increase dial tone line charges for all residential customers. Bell initially faults the ALJ for failing to employ the proper standard of review for this proposal. (Bell Exc., p. 12). Substantively, Bell explains that it has proposed to raise rates for residential Dial Tone Line service for the first time in over a decade. (Bell Exc., p. 13). It argues that even including the SLC, dial tone line rates do not currently recover their costs in any density cell. (Id.). Thereafter, Bell refers to data (proprietary) setting forth the current rate, plus SLC, the cost, and the proposed rate with touch-tone and SLC. This data purports

¹⁵ A density cell is a group of wire centers whose customers share a common population density range per wire center. Cell one customers are located in the most densely populated urban areas. Cell four customers are located in the least densely populated rural areas.

to show that the current rate is below the apparent cost. (Bell Exc., pp. 13-14).¹⁶

Disposition

We find that the disposition of this issue is to be governed by certain of the overall observations of the presiding ALJ whose result we have adopted. While the rejection of Bell's proposal was not discussed at length in the R.D., we shall adopt the ALJ decision in his result. We shall, consistent with our discussion regarding dial tone line costs, reject Bell's proposal as based on an unsupported premise.

3. Measured Usage Charges

Bell described its proposal as follows:

BA-PAS rate rebalancing proposal simplifies the current usage structure. Rates for most local usage packages are decreased. It contains a consistent per minute rate for calls in Bands 2 through 6, regardless of initial/additional minutes for each rate period. The proposal reduces the time of day rate period structure to two rate periods: Day and night/Weekend. In addition, although no change is proposed in the day rate for Metro Call Band 1 calls (which remains \$.07 per call), BA-PA proposes an increase in the night/weekend rate from \$.028 to \$.035 per call for Metro Call band 1 calls.

(R.D., p. 25, citing Bell M.B., pp. 20-21). (Footnotes omitted.)

At page 25 of the R.D., ALJ Cocheres observed that the only local measured usage plans offered by Bell are the Standard

¹⁶ Bell did not include intrastate and interstate CCLC revenues in this presentation.

and Budget Plans.¹⁷ Both plans stood to receive net increases from the Rate Rebalancing proposal. ALJ Cocheres agreed with the evaluation of the proposal by the OCA when it described the impact of the proposed plans as follows:

... Bell ratepayers subscribing to the Standard Usage option without Touch Tone will experience basic local service increases of 45%, 44%, 42% and 40% in Density Cells 1 through 4 respectively.³⁵ Those Standard Usage customers with Touch Tone will experience 26%, 26%, 25% and 24% increases in Cells 1 through 4. Id.

Obviously, the impact of Bell's proposals on those ratepayers subscribing to the Budget Usage option is even more significant. With percentage increases of 77%, 72%, 67% and 62% in Density Cells 1 through 4,³⁶ these customers experience some of the maximum percentage increases under Bell's proposal. Only Lifeline customers experience greater percentage increases in their basic local service rates or Touch Tone.

³⁵AT&T Exh. Darrah Rebuttal (Surrebuttal) Exhibit 1. Percentages do not include Subscriber Line Charge.

³⁶OCA Exh. WWD-3. Percentages do not include Subscriber Line Charge or Touch Tone.

(R.D., p. 26 citing OCA M.B., p. 45).

ALJ Cocheres, while not necessarily accepting the OCA's calculation of the percentages, did agree that the Budget and Standard Plan customers would have received an increase according to Bell's proposal. (R.D., p. 26).

¹⁷ This does not appear to be an accurate observation. Bell, in fact, does offer other measured usage packages.

We find no Exceptions referenced to this particular issue. Finding no exceptions germane to this question, we shall, therefore, adopt the ALJ's conclusion.

4. Lifeline and Affordability

The OCA presented the monthly Lifeline charge for budget measured usage customers in the following chart:

Lifeline Customer With Budget Measured Usage Option

	<u>Present Rate</u>	<u>Proposed</u>	<u>\$ Increase</u>	<u>% Increase</u>
Density Cell 1 Dial Tone Line Service	\$1.15	\$3.95	\$2.80	243%
Density Cell 2 Dial Tone Line Service	\$1.45	\$4.30	\$2.85	196%
Density Cell 3 Dial Tone Line Service	\$1.85	\$4.75	\$2.90	156%
Density Cell 4 Dial Tone Line Service	\$2.25	\$5.20	\$2.95	131%

(OCA Exh. WWD-2 at 1. OCA M.B., p. 56).

According to Bell, the proposed monthly range for Lifeline rates is \$4.95 to \$6.20.¹⁸ ALJ Cocheres observed that the apparent difference between the OCA numbers and the Company numbers

¹⁸ This range was calculated by assuming that a Lifeline customer would choose budget service. Dial Tone Line charges range from \$6.45 (cell one) to \$7.70 (cell four), plus \$3.50 Subscriber Line Charge (SLC), less \$5.00 Lifeline Credit. Bell St. No. 1.1 (Eichenlaub) at 30.

is the result of different methods of calculation. He noted that the OCA did not add the SLC and used only half (\$2.50) of the Lifeline Credit which was deducted from the Dial Tone Line cost. (The \$5.00 Lifeline Credit is normally deducted half from the SLC and half from the Dial Tone Line.) (R.D., p. 31).

The presiding ALJ was unpersuaded as to the usefulness of the OCA's or Bell's analysis of the impact of the instant filing on rates for the Lifeline customers. He remarked:

The difference in these methods of calculation proves the truth of the Mark Twain quote: "There are three kinds of lies: lies, damned lies and statistics." As expected, the OCA argued that the range of increase for Lifeline customers was 131% to 243%. OCA M.B., pp. 58-61. These percentages are eye-catching for the class of customers who can afford increases least. On the other hand, Bell argued that the proposed increases resulted in a range from \$.16 to \$.21 per day for Lifeline service. Bell M.B., p. 26. Bell R.B., p. 23. Obviously, Bell's numbers sound less expensive than one \$.25 pay phone call per day.

Both arguments are factually correct and generally useless to help resolve the underlying policy question. The real issue is: How much can poor customers afford to pay for monthly telephone service? No party presented evidence which could be used to correctly decide this issue. For instance, there was no statistical study (perhaps violating Mark Twain's wise advice) demonstrating how much low and very low income families could pay for phone service. Instead, there was nothing more than a range of proposed increases, i.e. \$2.80 through \$2.95, and an assertion that the increase was fair and affordable. Bell M.B., p. 26. Bell R.B., pp. 23-24. While this argument mimics the statutory policy of the Public Utility Code (66 Pa. C.S. §3001(1)), this kind of evidence is hardly enough for me to use to recommend

that the customers who must watch every penny closely should endure a nearly \$3.00 monthly rate increase. The most affordable of the rates should be the proposed Lifeline rate. Based on this record, I cannot come to that conclusion.

(R.D., pp. 31-32).

Disposition

Because of our conclusions elsewhere, determining that Bell has not met its burden under either Section 1325 or this Commission's Alternative Regulation Order, we need not express an opinion as to the merits of either the OCA or the Company's analysis.

F. COMPETITION

One of the cornerstones of Bell's case is its assertion that "Competitive Pressure Mandates Rate Rebalancing Now." (R.D., p. 29 citing Bell M.B., p. 10).

ALJ Cocheres concluded that the nexus between the existence of competition and the need for rate rebalancing (and particularly this Rate Rebalancing filing) is missing from this case. ALJ Cocheres was unpersuaded that the fact that Bell has lost minimal market share in the intraLATA toll market and that other well financed, large competitive carriers are authorized to render service in Bell's territory, supported the competitive necessity for the instant filing. The ability of competitors to capture part of Bell's market share, did not, in his view, diminish Bell's continuing dominance of the vast majority of the market. (R.D., pp. 30-31): He found it difficult to see a link between the "threat" of competition and the need for rate relief

when Bell's quarterly reports show substantial income evidencing robust financial health in the newly emerging competitive environment. See, OCA St. 1 (Catlin), p. 5 and Ex. TSC-1.

Disposition

We address the above-cited opinions as dicta, and not essential to our disposition of the issues in this proceeding. This Commission, as a result to the Act, and Chapter 30 of the Public Utility Code, is faced with the daunting task of promoting competition while establishing appropriate pricing signals which may require decreasing the prices of certain services which are above cost, and proportionately increasing the prices of other services, while protecting the consumer from unreasonable price increases.

G. TOLL AND ACCESS ISSUES

1. Automatic Savings Plan

In AT&T Communications of Pennsylvania, Inc., et al v. Bell Atlantic-Pennsylvania, Inc., Docket Nos. R-00953394C0002, R-00953396C0002-C0004, R-00953409C0001 and C0004, (Order adopted June 20, 1996) we granted Bell the authority to implement an Automatic Savings Plan ("ASP"). Currently, Bell's ASP provides customers with a 20% discount on qualifying intraLATA toll calls of \$20 or more per month. Bell proposed to expand its ASP in this proceeding. The Company's current proposal would provide a 10% discount on qualifying intraLATA toll calls between \$5 - \$19.99 per month. Bell argued that the plan was reasonable, was not anti-competitive, did not result in a price squeeze and was not subject to an imputation requirement. (R.D., pp. 31-32).

AT&T argued that the original ASP was anti-competitive and that the proposed extension was as well. AT&T explained that the proposed rate resulted in a price squeeze for competing carriers. It asserted that Bell was using its dominance in the intraLATA market to strengthen its toll position without properly reducing access costs. (R.D., p. 32 citing AT&T M.B., pp. 17-23. AT&T R.B., pp. 9-11).

The OCA argued that the decreased toll revenue resulting from the proposed ASP could not be used to justify far larger increases in dial tone rates. The OCA disputed the Company claim that the toll reductions from the new ASP would offset the massive increases in dial tone line charges. The OCA concluded that the residential ratepayers should not be required to fund losses on a competitive toll reduction plan. (*Id.*, citing OCA M.B., pp. 54-55. OCA R.B., pp. 17-18).

ALJ Cocheres generally agreed with OCA, *i.e.*, the proposed reduction in revenues is so small in comparison to the proposed increase for the residential customers that the reduction can hardly be used to justify the increase. He did not find the AT&T position persuasive. He observed that this Commission has previously rejected the arguments raised by AT&T when the original ASP was proposed and AT&T has offered no additional arguments in this case which change that conclusion. (R.D., pp. 32-33).

Exceptions

Bell excepted to the R.D. It states that the proposed expansion will extend the benefits of toll discounts to customers with lower toll bills who do not currently have any discounts

available to them. (Bell Exc., p. 22). Bell, also notes that these toll reductions total \$6.8 million. (Id.).

AT&T also excepted to the R.D. AT&T objects to the dicta in the R.D. which it suggests indicates that had the general rate rebalancing proposal of Bell been acceptable, it would have been permissible to include the subject toll reductions without consideration of whether the proposals were competitively fair or caused a price squeeze for competitors. (AT&T Exc., p. 9). AT&T asserts that the emphasized dicta is contrary to AT&T v. Bell, supra, in that the discount plans at issue should be subject to an imputation test.

Disposition

On consideration of the R.D., and Exceptions thereto, we conclude that granting Bell the authority to expand the ASP is beneficial to residential ratepayers. However, as noted in our discussion of Bell's proposal for a late payment charge, we shall condition our discussion of this issue upon Bell's use of the ASP as a revenue neutral offset to the late payment charge.

Bell's proposed ASP provides customers with an automatic 10% savings when they make between \$5.00 and \$19.99 of qualifying intraLATA toll calls per month. What is clear from Bell's proposal is that residential customers will receive reduced rates. Therefore, this is a benefit. Consequently, we shall not adopt the ALJ recommendation, but shall approve the proposal. What is not clear from the Company's filing, however, is where should the revenue neutral adjustment come from to offset the decrease. Consequently, we shall reference our discussion of the Company's proposed late payment charge to answer the previously cited question.

With regard to the Exceptions of AT&T, we shall deny them consistent with our initial approval of the ASP. We find that AT&T has raised no considerations in its opposition to the ASP which we have not previously rejected.

2. Business MTS Flat Rate

Bell proposed restructuring business MTS rates to eliminate time of day and distance sensitive rates and to create a postalized rate of \$.10 per minute (\$.07 per minute for certified speech and/or disabled business customers). Bell further proposed to change the service rates for WATS, Maximum Value Plan and Optional Business Calling Plus. See Bell M.B., p. 36.

AT&T contended that this proposal was a questionable response to competition and that Bell's pricing advantage, when taken with its dominant service provider position in the business and commercial intraLATA toll market, was anticompetitive. AT&T argued that Bell's proposal placed its competitors in a price squeeze which prevented effective competition. AT&T St. 1.0 (Darrah), pp. 17, 22-23. AT&T M.B., p. 23. Bell asserted that, since no imputation was required under Chapter 30, there was no price squeeze. (R.D., p. 33 citing Bell M.B., p. 37).

The OSBA asserted that Bell's position that, "most business customers will experience a net decrease in their bills," was unsupported by any Bell calculations. (R.D., p. 33 citing, inter alia, OSBA R.B. p. 2).

The ALJ rejected Bell's proposal based upon his previous finding that alleged reductions in this plan are at the

expense of unwarranted residential increases. In the alternative, ALJ Cocheres further concluded that Bell is not required to meet an imputation test and that, consequently, a price squeeze would not occur. (Id.).

3. Metropolitan Area Unlimited Plus Service (MAUPS)

ALJ Cocheres, for reasons similar to his general conclusion that Bell did not make a substantial case, dismissed Bell's proposal for Metropolitan Area Unlimited Plus Service ("MAUPS").

Exceptions

Bell, in its Exceptions, notes that MAUPS is an expansion of its existing service. This service is proposed in response to specific customer requests in the outer or second tier Philadelphia and Pittsburgh suburbs for an optional calling package that would give unlimited local calling into the Philadelphia and Pittsburgh metropolitan areas. (Bell Exc., p. 24).

On consideration of the Exceptions of Bell, we shall reject the ALJ recommendation concerning this tariff offering. MAUPS is a new service offering. No existing customers will experience a rate increase. Only those customers choosing to purchase the service will be subjected to a new rate. To the extent that customers find Bell's proposed rates objectionable, they can choose not to subscribe to the service and avoid the proposed rates. Therefore, consistent with our discussion with regard to Local Transport Access Service Rates, we shall allow Bell the alternative to offset the revenue increase from Local Transport Access Service with the decreases from MAUPS.

4. Local Transport Access Service Rate

Bell proposed the restructuring of switched access local transport rates to create a rating distinction between direct and tandem routed traffic. Direct trunked transport will be flat-rated on a distance sensitive basis. Tandem transport will be rated on a usage (per minute of use) and distance sensitive (per mile) basis. Bell explained that this proposal was uncontested. See Bell M.B., pp. 38-39. The Company denied that this proposal would result in a price squeeze. Bell M.B., pp. 39-40.

AT&T accepted Bell's proposal as a first step, if universal service and competition in all telecommunications markets were to be achieved. (R.D., p. 35). However, AT&T criticized the proposal as a revenue decrease which was insignificant compared to the access contributions that were embedded in Bell's carrier access charges. AT&T also believed that the Company's refusal to decrease access rates further was inconsistent with the FCC's view that reducing access was necessary for the development of competition. AT&T R.B., pp. 12-13. MCI also complained that the access rate reduction was inadequate when compared to toll reductions. MCI R.B., pp. 9-11.

The ALJ recommended acceptance of the local transport Access Service Rate restructuring proposed by Bell primarily because it substantially mirrors the structure which has been adopted at the federal level. Unlike the interstate structure, it does not include the Residual Interconnection Charge

("RIC").¹⁹ AT&T and MCI accepted the proposal, but wanted a bigger reduction. However, there is no record evidence to quantify their criticism. The ALJ also endorses the AT&T position that the proposal is at least a first step in the right direction if universal service and competition in all telecommunications markets are to be achieved.

Exceptions

Bell filed exceptions to the ALJ's recommendation arguing that the ALJ correctly approved its proposed reduction of its access charge through a Local Transport Restructure but erred in failing to approve a revenue increase to offset the \$17 million reduction and make it revenue neutral. Bell argues that its Chapter 30 Plan contains no provision that would require it to reduce rates without permitting an offsetting increase to make that change revenue neutral. Similarly, Bell continues, Chapter 30 requires access charge reductions to be revenue neutral. As a result, the ALJ's omission must be corrected and Bell must be permitted to offset this rate reduction in a revenue neutral manner.

Disposition

According to Bell's Chapter 30 Alternative Regulation Plan that was approved with modifications, we can only permit price changes that are revenue neutral. In reviewing the record in this proceeding, we have determined that there are a number of

¹⁹ The RIC is a non-cost based element developed by the FCC to maintain revenue neutrality for the local transport rate element on a stand alone basis. Since this revenue neutral filing was intended to minimize subsidies to the extent possible, a RIC was not proposed. Bell St. 1.0 (Eichenlaub), p. 19.

elements in Bell's rate rebalancing proposal that are uncontested and/or new service offerings that could reasonably be combined to yield a neutral offset to the Local Transport Access Service Rate. We are willing to permit Bell to increase the rates for

~~noncompetitive, nonprotected services in order to realize a revenue neutral filing. These noncompetitive, nonprotected services as identified in Appendix A of Bell's Exceptions include: Terminating Feature Group A, Residential Return Call, Business Return Call, Calling Card Surcharge and Business Remote Call Forwarding.~~ Therefore, we will grant Bell's exceptions in this regard and permit it to file revenue neutral increases as discussed above.

H. UNIVERSAL SERVICE VS. RATE REBALANCING

Both AT&T and MCI strenuously asserted that Bell's rate rebalancing proposals should, at a minimum, be postponed until after the Commission implements a universal funding mechanism. AT&T M.B., pp. 29-42. MCI M.B., *passim*. AT&T R.B., pp. 1-9. MCI R.B., pp. 12-14. Bell argued that rate rebalancing moves prices closer to costs which promotes efficient market entry and competition. Further, the Company maintained that the establishment of a universal service fund was not a prerequisite to rate rebalancing and that the absence of such a fund in Pennsylvania should not be used to delay implementation of the Bell proposal. Bell M.B., pp. 8-10. Bell R.B., pp. 46-47.

ALJ Cocheres concluded as follows:

Even though I cannot recommend the adoption of Bell's proposal, I have concluded that each of the concepts can function independent of the other. MCI provided the following discussion of the operation of a universal

funding mechanism which helps demonstrate my point:

Contrary to Bell's second argument, there is also no need or advantage to rebalance immediately in order to reduce the amount of the subsidy which ultimately will be provided from the universal service fund. The amount of subsidy required by the universal service fund will be determined solely by the following factors: (1) the universal service rate established by the Commission; (2) the forward looking costs of providing local service in regions where costs are higher than the universal service rate; and (3) the numbers of subscribers eligible for subsidies in each such high cost area. So long as Bell and other local exchange carriers are all permitted to charge the Commission established universal service rate at the time the universal service fund is implemented, the subsidy required from the fund will not depend at all on whether Bell had previously been permitted to rebalance its rates.

This fact can be simply illustrated through the following example. Assume that the monthly universal service rate is set at \$20; that the monthly cost of providing basic local service is \$35 in the only region where costs exceed the universal service rate; and that there are 100,000 subscribers in this high cost region eligible for subsidies. Assume further that Bell's existing rate for basic local service is \$12 and that Bell is permitted to increase this charge to the universal service rate at the time the fund is implemented.

Under these assumptions, the monthly subsidy required from the universal service fund would be \$1,500,000 [(\$35-\$20) x 100,000]. Obviously, the size of this subsidy does not depend at all upon Bell's pre-existing \$12 rate for basic local service. Rather, the required subsidy would still be \$1.5 million per month even if Bell had earlier been permitted to increase its rate for basic local service from \$12 to \$16. Thus contrary to Bell's contention, rebalancing prior to the establishment of a universal service fund does not reduce the amount of the subsidy which ultimately will be required.

(R.D., pp. 37-38 quoting MCI M.B., pp. 15-16).

Two observations complete the ALL's discussion of this issue. First, ALJ Cocheres determined that the numerical example was compatible with this Commission's description of the universal funding mechanism contemplated by the pending investigation and final-form rulemaking. Rulemaking to Establish a Universal Service Funding Mechanism; 52 Pa. Code §63.141, et seq., Final-Form Rulemaking Order, entered June 21, 1996, at Docket No. L-00950105 (Slip Op. at 10).

Second, the ALJ concluded that the MCI quotation demonstrates that rate rebalancing (whether it occurs before, after or during the establishment of a universal service fund) has no impact on the formation and operation of the fund. Accordingly, the ALJ concluded that, if Bell had proposed an acceptable rebalancing plan, there would have been no need to postpone implementation pending the formation of a universal service fund. (R.D., p. 39).

Exceptions

AT&T and MCI filed Exceptions to the ALJ's conclusion. The OSBA filed Replies to the Exceptions. Both AT&T and MCI take issue with the proposed coordination and impact of rate rebalancing and the establishment of a universal service funding mechanism.

Disposition

In a recent order considering the scope of matters to be considered in Application of MFS Intelenet of PA., Inc., Docket No. A-310203.F2, et al. (Order entered December 9, 1996), (MFS - Phase III) we have committed to the disposition of an appropriate universal service funding mechanism for on or about December 19, 1996. We hereby adopt the reasoning of the ALJ, recognizing our timetable for coordinating universal service concepts in the context of rate rebalancing.

I. BUSINESS ISSUES

1. Parties' Positions

The OSBA asserted that it supported the concept of rate rebalancing in general, but contended that Bell failed to provide evidence to justify its particular rebalancing proposal in this proceeding. OSBA M.B., pp. 6-7. Specifically, the OSBA argued that:

Bell has failed to prove how its proposed rates in its revised local business usage rate structure either adjust rates to competitive market levels or bring the rates closer to cost. Bell has also failed to

prove its claim that its plan results in no additional revenue to BA-PA.

Id., at 8.

Like the OSBA, CAPA also took issue with Bell's proposed restructuring of its business local usage rates. CAPA's specific objection was related to Bell's proposal to replace the \$.07 per message rate with a \$.03 per minute rate for Metro Call Band 1 calls. With regard to this proposal, CAPA argued as follows:

Commission regulations require the independent payphone provider [IPP], who is a direct competitor to the provision of payphone services by Bell to offer a local call to the consumer at a rate not to exceed Bell's rate, i.e., twenty-five cents (25¢), and to offer that twenty-five cent (25¢) call for a minimum of ten (10) minutes. Thus, as Bell has proposed to restructure its rates that ten (10) minute call will cost the independent payphone provider thirty cents (30¢), but the IPP can only charge twenty-five cents (25¢) for the same call.

It doesn't take a rocket scientist to figure out that every ten (10) minute call will cost more than can be recovered for the call. The IPP who is a captive customer of Bell now and for the foreseeable future has no option to escape this predatory pricing by Bell.

CAPA M.B., p. 5 (Footnote omitted). CAPA contended that Bell's proposed restructuring of Metro Call Band 1 rates would result in substantial increases to independent payphone providers. Id., at 9. CAPA submitted that the proposed rate was confiscatory and anti-competitive. Id., at 7.

In response, Bell argued that "the appropriate analysis to determine whether BA-PA's plan is anticompetitive for payphone providers should focus on local service for them in the aggregate, not on the basis of a single ten minute call." Bell M.B., p. 35. Bell contended that the record evidence in this case "indicates that the average payphone call is less than four minutes in duration and the majority of payphone calls are less than two minutes in duration." Id. Bell noted that for calls of two minutes or less, payphone providers would pay less than they do under the current rate structure. Id. Finally, Bell argued that "because of the availability of reduced-cost ValuPak usage service and the elimination of the charge for touch tone, which more than offsets the proposed increases in business dial tone line rates in urban areas, it is likely that many payphone providers will experience overall reductions in their cost structure, a fact conveniently overlooked by CAPA." Id., at 36.

ALJ Cochères agreed substantially with the OSBA and CAPA with regard to the issues they raised. See R.D., pp. 39-46. We shall adopt the ALJ recommendation, as modified by our discussion of the following issues:

2. Business Touch-Tone Rates

Bell has proposed elimination of the separate charge for business touch-tone service, and the offsetting increase to business dial tone line service. These changes, which net approximately \$26 million and which is contained entirely within the business protected market basket, were not opposed by any party and were not specifically addressed by the ALJ. The ALJ, however, does state that any issue not specifically addressed is to be deemed rejected.

Bell has excepted to the ALJ's failure to approve the roll-in of business touch-tone rates and argues that, since touch-tone subscription is virtually ubiquitous among businesses, this rate change will result in virtually no change for the vast majority of business subscribers. As a result, Bell requests that this proposal be adopted.

We have reviewed the record in this proceeding concerning this issue and we note that the Office of Small Business Advocate did not contest this issue. We agree with Bell and we find its proposal to be reasonable. As a result, we will approve Bell's proposal with respect to Business Touch-Tone Rates.

3. Business Subscriber Issues

Bell's rate rebalancing proposal includes decreases to certain business subscriber services. Specifically, Bell has proposed to reduce business toll rates, the non-recurring charges for new business subscribers, and direct inward dialing termination charges. Inasmuch as these issues are related, we will briefly discuss each issue before reaching a determination.

a. Business Toll Rates

Bell has proposed a restructuring of and a reduction to its toll rates for business customers in the following manner. First, Bell proposes a restructuring of business Message Toll Service ("MTS") rates to eliminate time of day and distance sensitivity and to create a postalized rate of \$.10 per minute. Second, Bell proposes a reduction of WATS rates to reflect changes in the MTS rate schedule. Third, Bell proposes reducing the usage rates for the Maximum Value Plan ("MVP") so that they maintain a proper relationship with the MTS rates. Finally, Bell

proposes reducing rates for Business Calling Plus Service. These four reductions total approximately \$28 million.

The ALJ does not directly address this issue except to note generally that he declined to recommend the proposed decreases. (R.D., p. 24) The only party to challenge the decrease was AT&T which objected to Bell's proposal to create a postalized rate of \$.10 per minute and to eliminate time of day and distance sensitivities. However, AT&T did not file exceptions on this issue.

Bell excepted to the ALJ's failure to recommend the proposed reductions in business toll rates and argues that all of its proposed business toll changes should be approved.

b. Non-Recurring Charges for New Business Subscribers

Bell has proposed to reduce the non-recurring connection charge for business and coin service from \$75.00 to \$50.00 for the initial line and \$75.00 to \$30.00 for each additional line installed at the same time as the initial line. This proposal results in a \$6 million decrease.

The ALJ does not directly address this issue except, once again, we note that, generally, he declined to recommend the proposed decreases. The only party to object to this proposal was MCI, which claimed that such a reduction in the non-recurring connection charge would create a below-cost price which today covers cost. MCI has not filed any Exceptions to the Recommended Decision on this issue.

Bell has filed Exceptions to the ALJ's failure to approve the reduction of the non-recurring charges for new

business customers arguing that the proposal is fair, pro-competition, and should be approved.

c. Direct Inward Dialing Termination Charges

Bell has proposed to reduce the ~~Direct Inward Dialing~~ ("DID") termination charge from \$30.50 to \$25.00. DID service permits incoming calls to customer premises equipment to automatically reach a specific number without the aid of an attendant. This proposal, which will result in a decrease of \$3.9 million, was not opposed by any party and was not specifically addressed by the ALJ.

Bell filed Exceptions to the ALJ's failure to recommend the reduction in Direct Inward Dialing termination charges arguing that the purpose of this filing is to position the monthly recurring rate closer to market value and that it should be approved within a total revenue neutral package.

Disposition

Based on a review of the record in this proceeding, we support Bell's proposal to reduce the rates of these business services. Lowering business customer's telephone rates will enhance the attractiveness of the Commonwealth for new businesses as well as encouraging existing business to remain in the Commonwealth. Businesses that choose to locate and/or expand within the Commonwealth do so with consideration of the infrastructure costs. Telecommunications plays an important role in that infrastructure and, therefore, in the economic development of Pennsylvania. Reliable, capable and competitively priced telecommunications services are a prerequisite to a vibrant, growing economy, and will provide a means to increase economic

development within the Commonwealth and improve its business climate.

On the basis of the foregoing, we observe that the ALJ has not specifically addressed certain reductions in the rates for business telecommunications services proposed by Bell. Consequently, our Opinion and Order issued herein does not adopt the ALJ recommendation. We will permit Bell to make certain decreases in rates for business telecommunications services.

J. LATE PAYMENT CHARGES (R-00963556)

Bell argued that assessing a late payment charge on residential customers whose bills are overdue was a new service which was not governed by revenue neutrality requirements under Chapter 30 because it was not a price change or an adjustment to existing rates. See Bell M.B, pp. 48-49.

The OCA pointed out that to the extent the late payment charge would be collected on protected services, it should be considered a revenue increase and subject to revenue neutrality and to Bell's price stability mechanism. The OCA asserted that the charge was not for a new service because no new product was added. Finally, it noted that whatever costs were associated with the dealing with delinquent accounts were already incorporated into the current rate structure. Thus, allowing the added recovery of late charges would permit a double recovery for an item already contained in the current rate structure. OCA M.B., pp. 140-142. OCA R.B., pp. 22-23.

ALJ Cocheres agreed with the OCA. He reasoned as follows:

There is no new service being offered by Bell. Late charges are simply the collection of additional dollars from residential customers who don't pay their bills on time. In this instance, it is a revenue enhancement technique. Some portion of the residential customers have always paid their bills late. This proposal would raise additional money from the protected class which should already be compensating the Company for this problem. The proposal should be subject to market basket neutrality. Bell has proposed no offset for this increase. The rate increase should be denied.

(R.D., pp. 46-47).

Exceptions

Bell excepted to the R.D. on this issue. Bell notes that no party objected to the substance of the charge (1.24% and projected to generate \$6.6 million). Bell notes that the OCA argued that the charge should be subject to the revenue neutral provisions of Bell's Alternative Regulation Plan, and that the charge be deemed a protected service. (Bell Exc., p. 31).

Bell asserts that such a charge should not be governed by the revenue neutral provisions of its Alternative Regulation plan as protected services are defined by statute, but should be governed by the provisions of 52 Pa. Code Chapter 64. (Id.).

Disposition

On consideration of the Exceptions of Bell, we note that currently, 26 of the 38 telephone companies operating in the Commonwealth have a late payment charge. We believe, therefore, that it is only fair to allow Bell, which serves approximately 80% of the customers in the Commonwealth, to impose a late

payment charge for customers who pay their bill late. Such a charge is an acceptable vehicle for incentive payment. Bell's proposal would follow the guidelines for late payment charge as defined in 52 Pa. Code § § 64.12 and 64.16. In our view, Bell's proposal is governed by the revenue neutral requirement. This charge, however, is not a protected telephone service as defined by 66 Pa. C.S. § 3002. Accordingly, Bell shall be given the option of accepting a late payment charge as the revenue neutral offset to the ASP.

K. Proprietary Information

At pages 47 through 51, ALJ Cocheres discusses the OCA position concerning the proprietary treatment of Bell's wire center costs and further, his failure to require the disclosure of Bellcore²⁰ model calculations. ALJ Cocheres concluded that these issues were rendered moot. In both cases, the ALJ did not rely upon the underlying data, and further declared the end result of the studies produced, inter alia, by the data so flawed as to be unworthy to support his recommendation.

Exceptions

The OCA filed Exceptions to the ALJ recommendation. The OCA supports the ALJ recommendation to not rely upon the underlying data concerning both the Bellcore studies and Bell's wire center costs. It files Exceptions on these matters, primarily, to preserve the issue of the access to these sources of data.

²⁰ Bell Communications Research, Inc. Bellcore did intervene in the instant proceeding.

Disposition

We agree with ALJ Cocheres that the dispute over the disclosure of Bell's wire center costs and Bellcore data is moot for purposes of this proceeding. We note that in MFS - Phase III, there is the possibility that Bell's positions regarding the treatment of Bellcore data will be revised so as to accommodate reasonable disclosure. With respect to Bell's wire center costs, we note that the OCA does not appear to be aggrieved by the discovery rulings of this Commission based on our conclusion that Bell has not, in most cases, met its burden of proof required by the Alternative Regulation proceeding. On the basis of the foregoing, we shall adopt the ALJ conclusion. These discovery issues are moot.

III. ORDER

1. That, with the exception of those services which we shall specify, below, the proposed Rate Rebalancing filings at Docket No. R-00963550 are hereby rejected as unjust, unreasonable and unlawful.

2. That the Local Transport Access Service Rate proposed by Bell Atlantic-Pennsylvania, Inc., as identified in the Recommended Decision is hereby approved consistent with the body of this Opinion and Order. Further, Bell Atlantic is hereby required to file the necessary revision to Access Tariff-Telephone Pa. P.U.C. No. 302, which conforms to this approval on one day's notice after receipt of the Commission's Order.

3. That Bell Atlantic-Pennsylvania, Inc., is hereby given the alternative to file revisions to its Local General Tariff-Telephone Pa. P.U.C. No. 1 to establish a late payment charge for residential customers at Docket No. R-00963556 consistent with the body of this Opinion and Order.

4. That Bell is hereby given permission to file revisions to Local Exchange Tariffs Nos. 180A, 182, 182A, 185B and 185C pertaining to the Automatic Savings Program consistent with this Opinion and Order.

5. That, consistent with our discussion in this Opinion and Order, Bell is hereby given permission to file revisions to its tariffs supported by ample evidence and in accordance with its Chapter 30 Alternative Regulation Order, proposing rates for the following non-competitive, non-protected services: Metropolitan Area Unlimited Plus Service, Terminating Feature Group A, Residential Return Call, Business Return Call, Calling Card Surcharge and Business Remote Call Forwarding

services so as to yield a combined revenue neutral offset to the Local Transport Access Service Rate.

6. That, consistent with our discussion in this Opinion and Order, Bell is hereby given the alternative to file revisions to its tariffs to "roll-in" its residence touch-tone rates into residential dial tone line rates if Bell can present a method whereby the existing residential customers who do not subscribe to touch-tone service can be "grandfathered" as long as they remain at their existing domicile.

7. That, consistent with this Opinion and Order, Bell's Automatic Savings Plan is hereby approved contingent upon its accepting the Late Payment Charge as the revenue neutral offset to the Automatic Savings Plan.

8. That any filing made in accordance with the above, shall be made within thirty (30) days of the entry of this Opinion and Order.

9. That, consistent with our discussion in this Opinion and Order, Bell's proposal with respect to Business touch-tone service is hereby approved.

10. That the complaint of AT&T Communications of Pennsylvania, Inc. at Docket No. R-00963550C0001 is hereby sustained in part and dismissed in part.

11. That the complaint of the Office of Consumer Advocate at Docket No. R-00963550C0002 is hereby sustained in part and dismissed in part.

12. That the complaint of the Central Atlantic Payphone Association at Docket No. R-00963550C0003 is hereby sustained.

13. That the complaint of Kurt Richter at Docket No. R-00963550C0004 is hereby sustained.

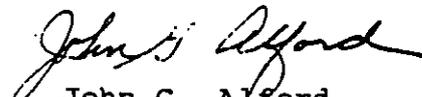
14. That the complaint of Joseph A. Henchy at Docket No. R-00963550C0005 is hereby sustained.

15. That the complaint of John D. Lewis at Docket No. C-00967866 is hereby dismissed.

16. That the Petition To Intervene of Bell Communications Research, Inc., is hereby granted.

17. That the record at Docket Nos. R-00963550, R-00963550C0001-C0005, R-00963556 and C-00967866 be marked closed.

BY THE COMMISSION


John G. Alford
Secretary

(SEAL)

ORDER ADOPTED: December 12, 1996

ORDER ENTERED: December 16, 1996

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, Pennsylvania 17105-3265

PENNSYLVANIA PUBLIC UTILITY
COMMISSION ET AL V. BELL
ATLANTIC-PENNSYLVANIA

PUBLIC MEETING -
DECEMBER 12, 1996
DEC-96-OSA-310*
DOCKET NO. R-963550,
ET AL.

STATEMENT OF COMMISSIONER JOHN HANGER

The Pennsylvania Public Utility Commission (PUC) is today telling millions of Bell Atlantic-Pennsylvania customers that the rate cap is still alive. All of the rate increases for protected, non-competitive services that Bell had submitted in its January 10, 1996 Petition to rebalance rates are rejected by the Commission's Final Order.

Any increase in rates for local phone service would violate the rate cap imposed by the Commission in the June 28, 1994 Order on Bell's Petition for Alternative Regulation. That Order imposed a cap on all of Bell's non-competitive, protected services before December 31, 1999 when it said: "That the rates for protected services are, hereby, frozen until December 31, 1999."

That rate cap is the principal consumer benefit in the Commission's 1994 Order that implemented Act 67 of 1993. The rate cap is particularly important to customers who live in rural areas where local phone competition will take longer to become a reality.

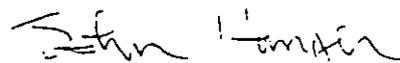
It also must be remembered that the Commission's June 28, 1994 Order gave Bell substantial financial incentives to invest in Pennsylvania and deploy a broadband network. In fact few, if any states, gave more financial incentives for network modernization since Bell has a price cap of GDP-PI minus 2.93% and keeps all profits, even if profits exceed a normal utility return.

In return for these incentives, Bell was to accelerate deployment of the broadband network. In June 1996, Bell made its most recent filing that reports on its progress in modernizing its network. The Commission must finally make time to review formally that filing to make sure that the ratepayers are getting the modernized network on the required schedule for which they are paying.

A promise made should be a promised kept. The Commission has kept its promise to Bell Atlantic-Pennsylvania by maintaining the financial incentives it received in 1994. Today the Commission keeps its promise to Bell's millions of customers that their rates for basic service will not increase before December 31, 1999.

December 12, 1996

DATED



JOHN HANGER, COMMISSIONER

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, Pennsylvania 17105-3265

PENNSYLVANIA PUBLIC UTILITY
COMMISSION, *et al.*
v.
BELL ATLANTIC- PENNSYLVANIA, INC.

PUBLIC MEETING-
DECEMBER 12, 1996
DEC-96-OSA-310*
DOCKET NOS. R-00963550,
et seq.

DISSENTING STATEMENT OF COMMISSIONER DAVID W. ROLKA

I am pleased that protected rates for residential customers will not increase as a result of this proceeding. This outcome is consistent with my interpretation of the PUC's June 28, 1994 Opinion and Order in Bell's alternative regulation proceeding. This result attains because of the rejection of Bell's proposed increases to Dial Tone Line prices. The proposed Dial Tone Line price increases were the cornerstone of Bell's rate rebalancing filing, the primary purpose of which was to increase residential basic service to levels closer to, but not to, Bell's definition of cost. The Commission majority, however, properly concluded that Bell did not meet its burden of proving that Dial Tone Line price increases were justified.

Having rejected the proposed Dial Tone Line price increase of \$41.5 million, I must agree with the ALJ's conclusion that the concomitant rate decreases should likewise be rejected at this time, since the rebalancing filing was an integrated, unseverable composition of various price changes. I must dissent with the conclusion in the Opinion and Order to selectively approve certain components of the rebalancing filing which would effectuate rate decreases and some rate increases. The one exception, which I support, is the access charge reductions only because the prices are based on the Company's interstate rates on file with the FCC. I nonetheless believe that this decrease should not be implemented as part of this Chapter 30 rate rebalancing filing and instead should be accomplished in a separate docket or proceeding.

I have no objection in principle to the rate decreases proposed by Bell Atlantic as part of the original rate rebalancing package. Recognizing, however, that I do not support the corresponding rate increases, I do not believe that the PUC should approve the rate decreases as part of this proceeding. It makes more sense to confer complete discretion to the Company to pursue these rate decreases as a separate matter, rather than having those decreases provide a new impetus to rate rebalance. This is especially appropriate given the Company's pending \$13 million rate reduction arising from its annual price change opportunity calculation. The majority's Opinion and Order is silent on this point, and does not indicate whether or not the permitted rate decreases may be offset with revenue neutral increases.

I consider the entire discussion of Universal Service appearing in the opinion to be dicta and of no significance. I observe that the subject of Universal Service is once again scheduled for consideration by the Commission on December 19, 1996.

Dec 16, 1996
DATED

David W. Rolka
DAVID W. ROLKA, COMMISSIONER

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission	:	Docket Nos. R-00963550
	:	R-00963556
AT&T Communications of Pennsylvania, Inc.	:	R-00963550C0001
Office of Consumer Advocate	:	R-00963550C0002
Central Atlantic Payphone Association	:	R-00963550C0003
Kurt Richter	:	R-00963550C0004
Joseph A. Henchy	:	R-00963550C0005
John D. Lewis	:	C-00967866
and	:	
Office of Small Business Advocate,	:	
Pennsylvania Cable Television Association	:	
MCI Telecommunications Corporation	:	
Intervenors	:	
v.	:	
Bell Atlantic-Pennsylvania, Inc.:	:	

RECOMMENDED DECISION

Before
Louis G. Cocheres
Administrative Law Judge

October 8, 1996

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I. RECOMMENDATION SUMMARY

I recommend that almost all of the proposed changes be rejected. Even though this Commission has previously ruled that Bell Atlantic-Pennsylvania, Inc. (Bell or Company) could increase the rates for the protected classes, the Commission should not authorize revenue increases from the protected classes to cross-subsidize the competitive services. The Company's representation that residential local exchange service is subsidized, is based on badly flawed cost allocation methodologies and an unwillingness to properly apply Section 1325 of the Public Utility Code. None of the proposed residential rate increases have been justified.

There is no nexus between the need for these proposals and the beginning of competition in Bell's territory.

Except for reducing local transport access service rates, none of the toll and access changes should be approved. There is insufficient proof that the proposed business rate reductions will generate the savings suggested by the Company or that the proposals will result in revenue reductions at all.

The late payment charge filing should be rejected because it will generate more revenue from the residential class with no corresponding decrease to allow for revenue neutrality.

The OCA's argument to make public certain proprietary information is moot.

II. HISTORY OF THE PROCEEDING

On January 10, 1996, Bell Atlantic - Pennsylvania, Inc. filed revisions to its tariffs: Telephone Pa. P.U.C. 1, 1A, 180A, 182, 182A, 185B, 185C, 296 and 302, to become effective on March

17, 1996 (Rate Rebalancing Filing).¹ Bell's filing was made pursuant to Section 1308(b) of the Public Utility Code, 66 Pa.C.S. §1308(b), and proposed to restructure and rebalance its Residential, Local and Toll Service rates, Business Local and Toll Service rates and Switched Access rates on an allegedly revenue neutral basis. If Bell's tariff filing were approved as proposed, protected residential service rates would increase by \$41,598,000.

On January 16, 1996, Bell also filed revisions to its Local Tariff-Telephone Pa. P.U.C. 1. This tariff filing was docketed at R-00963556 and proposed to establish a late payment charge for residential customers, to become effective March 17, 1996.

Subsequently, Notices of Appearance, Formal Complaints and Interventions were filed by numerous parties. Specifically, the active participants to this proceeding were as follows: the Office of Trial Staff (OTS), the Office of Consumer Advocate (OCA), the Office of Small Business Advocate (OSBA), Pennsylvania Cable Television Association (PCTA), Central Atlantic Payphone Association (CAPA), AT&T Communications Services of Pennsylvania, Inc. (AT&T), MCI Telecommunications Corp. (MCI), and John Lewis, a customer of Bell. In addition, two customers, Kurt Richter and Joseph A. Henchy, were inactive participants.

¹The Office of Consumer Advocate set forth a comprehensive procedural history in its Main Brief which I have adopted with minor editing.

By Opinion and Order, entered March 1, 1996, the Pennsylvania Public Utility Commission (Commission) suspended Bell's rate rebalancing filing until September 17, 1996, and instituted an investigation to determine the lawfulness, justness and reasonableness of Bell's proposed tariff changes. In addition, the Commission incorporated by reference the evidentiary record contained in the Universal Service proceeding, at Docket No. I-00940035, into the record to be developed in this case.

By memorandum dated March 8, 1996, the Office of Administrative Law Judge requested that, pursuant to Section 1308(b) of the Public Utility Code, the Commission suspend Bell's filing for an additional three months. By Opinion and Order, entered March 15, 1996, the Commission suspended Bell's filing to implement a residential late payment charge, at Docket No. R-00963556, and consolidated that proceeding with Bell's rate rebalancing filing. The Commission also extended the suspension period concerning the consolidated proceeding for an additional three months, or until December 17, 1996.

On April 1, 1996, a Prehearing Conference was held before presiding Administrative Law Judge (ALJ) Louis G. Cocheres. A procedural schedule for formal hearings was established at that time and requests for public input hearings were presented to the ALJ.

On April 25, 1996, the Commission issued a notice of public input hearings scheduled in the following areas of

Pennsylvania: Warren (June 24), Sharon (June 25), Uniontown (June 26), Pittsburgh (June 27), Allentown (July 8), Media (July 9), Reading (July 10), and Philadelphia (July 11). Additional public input hearings were held on August 21, 1996, in Harrisburg and State College.

On April 5, 1996, the OCA filed a motion to declare nonproprietary, Bell's cost calculations by wire center. On April 29, 1996, Bell filed its Opposition to OCA's Motion. On May 6, 1996, the undersigned heard oral argument on OCA's Motion and Bell's Opposition thereto.

By Prehearing Order No. 4 (Order No. 4), dated May 17, 1996, the undersigned granted OCA's motion and required that Bell disclose to the public the results of its cost calculation by wire center. The effective date of Prehearing Order No. 4 was stayed until answer by the Commission of the following material question:

Does the application of sections 3(45), 251(c) and 252(d)(1) of the Telecommunications Act of 1996 prevent Bell Atlantic-Pennsylvania, Inc. from establishing entitlement to a protective order for proprietary information contained in a wire center cost study (Exhibit RES-100.XLS TOT WC CALC) in accordance with Commission regulations at 52 Pa. Code §5.423(a)?

On June 18, 1996, the Commission entered an Opinion and Order addressing the certified question and continued to classify this information as proprietary. The Commission allowed further briefing on this issue.

On July 19, 1996, the OCA filed a motion to declare

nonproprietary Bell's dial tone line cost by cell and a range of wire center costs. On the final day of formal hearings, the OCA's motion was denied.

On April 26, 1996, in accordance with the procedural schedule established at the Prehearing Conference, Bell filed its direct testimony. On May 31, 1996, the OCA, CAPA, AT&T and MCI individually filed their direct testimony in the case. Bell filed its rebuttal testimony on July 3, 1996, and surrebuttal testimony was filed by the OCA, AT&T, CAPA and MCI on July 24, 1996. Bell filed its rejoinder outlines on July 31, 1996.

Formal hearings were held in Harrisburg on August 5, 1996, through August 7, 1996. The evidentiary record closed on August 21, 1996, after the final public input hearing.

On July 31, 1996, the Coalition For A Competitive Commonwealth filed its complaint, which was docketed at number R-00963550C0006. Since the complaint was filed so close to the beginning of the formal hearings and the end of the record, the complaint was severed and was heard on September 10, 1996. A separate recommended decision will be prepared for that case.

III. ISSUES

A. INTRODUCTION

As noted above, almost all of the rebalancing proposals put forth by the Company have been rejected. In general, Bell submitted a weak case. I recommend that the Commission approach the Company's carefully worded case presentation cautiously. Too

much emphasis is placed on the words, "typical" and "average" "customers." These words obscure two impacts of this proposal. First, the words do not present the impact on customers who are not typical or average. While these customers do not represent the majority of the Company's customers, they are a significant minority, and this Commission has an obligation to analyze what effect the Bell proposals have on them.

Second, while average or typical customers do constitute the majority of Bell's customers, the fact that they are in the majority does not mean they are treated identically. The Company proposals are many and complicated. Customers who use the same services in the same density cells can be billed differently. Customers in different density cells using the same services may or may not be billed differently. If my recommendations are rejected and closer study of the Company proposals is required, the Commission should be aware that these nuances exist.

I note that my overall negative recommendation should not be construed as opposition to the concept of rate rebalancing. Rate rebalancing as a response to competition and a regulatory tool can be appropriate, but this particular plan is not.

What follows is not a discussion of every issue raised by every party. Rather, it is an explanation of my reasons for denying the vast majority of the relief requested. The major theme of this recommendation is to emphasize that almost the entire plan as proposed by Bell should be rejected. A few elements, both

especially good and especially bad, have been highlighted. Since Bell does not need Commission approval to lower rates, I have made little effort to analyze those elements of the proposal. Because the proposed rate reductions were made in tandem with a group of rate increases for the alleged purpose of achieving rate neutrality, Bell may not want to implement some or all of the reductions at this time. Certainly, given the overall negative recommendation, the Company should be granted some flexibility in planning its next rate response.

In order to remove any doubt about the disposition of any issue, I note that any arguments raised by a party which are not explicitly examined below are denied.

B. THE FREEZE

Large portions of the briefs of the OCA and PCTA were devoted to the issue of whether Bell was unable to raise the rates for the protected classes until January 1, 2000. Essentially, they argued that protected services were subject to a rate freeze set forth in the Commission's Opinion and Order in Bell's Chapter 30 petition proceeding. Re: Bell Atlantic-Pennsylvania, Inc., 82 Pa. P.U.C. 194 (June 28, 1994). (June 1994 Order). OCA M.B., pp. 10-30. OCA R.B., pp. 2-4. PCTA M.B., pp. 8-19. PCTA R.B., pp. 2-4.

Bell responded by asserting that there was no freeze and that the Commission had already concluded this issue in Bell's favor. Bell M.B., pp. 41-42. Bell R.B., pp. 3-11. The Company cited the Commission's Opinion and Order in response to Bell's

Petition for Rescission or Amendment. Re: Bell Atlantic-Pennsylvania, Inc., Opinion and Order, entered October 30, 1995, at Docket No. P-00930715 (Slip opinion). (October 1995 Order).

I agree with Bell. The Commission has already decided this issue. Acting on the Company's petition and pursuant to Section 703(g) of the Public Utility Code (66 Pa. C.S. §703(g)), the Commission ruled that the Company was granted the discretion to request revenue neutral price changes on protected services prior to December 31, 1999. Further, because the parties had questioned the Commission's authority to act during the pendency of an appeal, the October 1995 Order expressly conditioned the effectiveness of this clarification of the June 1994 Order on the withdrawal of the pending Petition for Review in the Commonwealth Court at Docket No. 0501 C.S. 1995. Slip Op. at 14-22. When the appeal was withdrawn, the Opinion and Order became operative.

Finally, I note that the OCA, OTS, PCTA, CAPA and MCI were all parties who actively participated in opposing Bell's request for clarification of the June 1994 Order. Slip Op. at 15. Neither the OCA nor PCTA have represented that they appealed the October 1995 Order. I have assumed that they have not. Accordingly, the findings, determinations and order have become final and are binding on them by operation of law. 66 Pa. C.S. §316.

C. CROSS-SUBSIDY

Bell asserted that two kinds of rate subsidy exist in the

design of current rates. First, the business customers paid more than their fair share and subsidized the residential customers. To remedy this problem, the Company proposed an overall decrease to business customers and an overall increase to residential customers. Thus, Bell continued that it was necessary to spread revenue changes between market baskets to maintain neutrality. Bell M.B., pp. 1, 3-4, 7, 32-33, 41-43, 45-46. Bell R.B., pp. 11-13, 15-16.

Second, the Company claimed that the urban residential customers paid more than their fair share and subsidized rural and other high cost residential customers. The Company continued that by lowering urban residential rates and raising rural and other high cost residential rates, it was moving both groups within one market basket closer to cost. Bell M.B., pp. 2-5, 18-23, 27-28. Bell R.B., pp. 24-25.

In order to agree with Bell's proposal, one must first accept their basic premises, i.e., business rates subsidize residential rates, and urban residential and business rates subsidize rural residential rates. Bell M.B., p. 4. As indicated in far more detail in the next chapter, I do not accept the Company's basic starting point. Indeed, I have concluded that residential rates cover their costs. Consequently, I find that the Bell proposals, if adopted, would cause cross-subsidization in favor of the business customers, contrary to the legislative policy found in the Public Utility Code. 66 Pa. C.S. §3001(3).

More specifically, Chapter 30 states as follows:

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

* * *

(3) Ensure that rates for noncompetitive telecommunications services do not subsidize the competitive ventures of providers of telecommunications services.

66 Pa. C.S. §3001(3). Since Bell's petition to receive alternate rate regulation has already been granted, I find that its subsequent rate proposals must be evaluated in view of this legislative guidance. June 1994 Order. If Bell were correct and residential rates were below costs, how then can this Commission consider raising the rural residential rates (the most competitively unattractive customers) while urban residential customers' rates (customers more likely to see the benefits of competition) do not go up as much? Even in this noncompetitive class, are the rural customers being asked to subsidize the urban ones? Is this result permissible? Considering the statutory goals, I think not.

The cross-subsidy is more obvious between the protected residential class and the competitive business class. If one accepts my premise that residential local exchange service pays its own way, then how can this Commission justify raising rates on the protected residential class to offset dollar for dollar, a rate decrease to the competitive business class? Again, in view of the

statute's guidance, no justification is possible.

In other words, I regard this portion of the proposal (a dollar for dollar matching between market baskets) as a request to cover or guarantee a given revenue stream to the Company in the face of competition. As such, it attempts to shift the risk of competition to noncompetitive services. This shift runs contrary to one purpose for granting Bell alternative rate regulation, i.e., in return for loosening the controls on competitive services, the shareholders were required to assume the uncertainties of the marketplace. This particular form of "revenue neutrality" is exactly the kind which should be avoided.

D. FLAWED COST ALLOCATIONS

1. Dial Tone Line Costs

Bell argued throughout this proceeding that local exchange service was subsidized by other services. Specifically, Bell asserted that its Dial Tone Line rates were currently set below its dial tone line costs, particularly for residence local exchange customers. Bell M.B., p. 47. Thus, Bell concluded that dial tone line service was being subsidized by other services. However, I find this assertion to be erroneous due to the way Bell has chosen to allocate the costs.

Bell's position is that dial tone line is a complete service in and of itself, rather than a component of the many services Bell provides. Bell R.B., pp. 34-35. For this reason, Bell allocated 100% of its local loop costs to the dial tone line

component of local exchange service, causing dial tone line costs to appear to be well above the Dial Tone Line rates for local exchange service. Bell's conclusion, therefore, is that dial tone line service is being subsidized by other services.

However, as the OCA has pointed out, the dial tone line is the facility that connects the customer to the Company's switching equipment. OCA M.B., p. 79. As such, it is more accurate to view it as a component of all the telecommunications services that depend on it, rather than as a separate service. In addition to local exchange service, such services would include intraLATA and interLATA toll services, CLASS or optional services, and non-published or non-listed telephone service. Thus, the costs associated with dial tone line should be viewed as joint or common costs of those services, and should be allocated across those services instead of being assigned totally to local exchange service, as Bell asserted. Id. at 80-82.

Bell contended that dial tone line is a separate and distinct service, and that most experts agreed with this position. Bell R.B., pp. 34-35. However, the OCA cited a number of decisions of state regulatory commissions, as well as state and federal statutes in support of the principle that dial tone line represents a component whose costs should be shared among the services that utilize it. OCA M.B., pp. 84-91. Perhaps most significant in this regard is Section 1325 of the Public Utility Code. Section 1325(a) states:

(a) **General Rule.**--In any rate proceeding pursuant to section 1308 (relating to voluntary changes in rates), no public utility shall be granted a percentage increase in local exchange service unless that percentage increase is just and reasonable. In no event shall the public utility be granted an increase in local exchange rates which is greater than the overall average percentage increase in total intrastate revenues authorized by the commission unless the utility proves by record evidence that a greater percentage increase for local exchange service is justified based upon the cost of providing that service.

66 Pa. C.S. §1325(a). Section 1325(c) goes on to define the cost of providing local exchange service as "[t]he direct cost of providing the service plus a share of the costs of the dial tone line, allocated in proportion to the stand-alone cost of each class of service which utilizes the dial tone line." 66 Pa. C.S. §1325(c). Thus, the statute recognizes the costs of the dial tone line as shared costs, and requires that only a portion of these costs be allocated to local exchange service.

Bell contended that Section 1325 did not apply to its rebalancing proposal because it is only applicable to situations where an overall percentage increase in rates is requested. Bell argued that:

. . . BA-PA's filing is revenue neutral -- it raises some rates and reduces others. BA-PA has requested no overall percentage increase in intrastate rates and will gain no additional revenues as a result of its rebalancing plan. Section 1325 clearly evinces an intent to ensure that residential consumers are not disproportionately burdened when a utility requests an overall rate

increase - a circumstance that does not exist here.

Bell M.B., pp. 46-47. Bell is wrong in its contention; Section 1325 does apply to Bell's rate rebalancing filing. As set forth in Section 1325(a), this statute applies to "any rate proceeding pursuant to section 1308 (relating to voluntary changes in rates)." 66 Pa. C.S. §1325(a). (Emphasis added.) The statute is clearly applicable in this case. If Bell's proposal is revenue neutral as it claims, then the overall average percentage increase to total intrastate revenues which it is proposing is zero. Thus, as the OCA argued, Bell's proposed increases to local exchange service cannot be granted unless Bell is able to prove that "a greater percentage increase for local exchange service is justified based upon the cost of providing that service." OCA M.B., p. 136.

Bell asserted that, even if Section 1325 did apply to its filing, it has, in fact, shown that its proposed increases to dial tone line service "are justified based upon the 'cost of providing that service' as required by the statute." Bell M.B., p. 47. However, because Bell has steadfastly maintained that dial tone line is a separate service, the Company cannot justify its proposed rate increase in view of the statutory definition. In other words, Bell's position is inconsistent with the language of Section 1325(c). 66 Pa. C.S. §1325(c). Indeed, to consider dial tone line as a separate service would lead one to believe that the language of Section 1325(c) was illogical, a conclusion which some of Bell's

laymen witnesses advocated. For example, Bell's Dr. Taylor stated:

BA-PA did not add to the direct cost of the Dial Tone line service an additional amount representing an allocation of these same Dial Tone line costs to Dial Tone line service, as the statute appears to suggest. Any additional assignment of Dial Tone line costs to Dial Tone line service would entail double-counting of those costs and would be illogical and inconsistent with economic costing principles. In any event, since BA-PA's residence Dial Tone line rates do not currently cover their direct costs, they certainly could not cover their direct costs plus some allocation of additional costs.

Bell St. No. 3.0 (Taylor), p. 15. Similarly, Bell's Mr. Sanford asserted that "[a] stand-alone cost study for dial tone line service under section 1325 would require double counting since the study would have to included the direct costs of providing dial tone service 'plus a share of the costs of the dial tone line.'"

Bell St. No. 2.0 (Sanford) p. 9. After convincing themselves the statute was illogical and inapplicable, they were conveniently able to ignore it. The testimony of Bell's witnesses would seem to be credible if dial tone line could be considered to be a separate service, as Bell contends. However, neither Bell nor I are in a position to conclude that the statute is illogical and can thus be ignored. The only reasonable and proper conclusion in light of the language of Section 1325(c) is that dial tone line must be treated as a component of multiple services whose costs must be allocated among these services, and not as a separate service. Bell cannot avoid application of the statute, no matter how much it dislikes

the result.

As the OCA points out, some additional guidance on this issue can also be found in the Commission's Order adopted August 31, 1995 in the Universal Service investigation at Docket No. I-00940035. This Order stated in part:

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.

OCA St. 3S, p. 25, citing Universal Service Investigation, Order, entered September 5, 1995, at Docket No. I-00940035 (Slip Op. at 12). Moreover, the Federal Communications Commission (FCC) has recently determined that loop costs are joint or common costs of providing service, as it stated in its interpretation of the Telecommunications Act of 1996 when services are priced for unbundling:

The term "common costs" refers to costs that are incurred in connection with the production of multiple products or services, and remains unchanged as the relative proportion of those products or services varies (e.g., the salaries of corporate managers). Such costs may be common to all services provided by the firm or common to only a subset of those services or elements. If a cost is common with respect to a subset of services or elements, for example, a firm avoids that cost only by not providing each and every service

or element in the subset. For the purpose of our discussion, we refer to joint and common costs as simply common costs unless the distinction is relevant in a particular context.

* * *

As discussed in greater detail below, separate telecommunications services are typically provided over shared network facilities, the costs of which may be joint or common with respect to some services. The costs of local loops and their associated line cards in local switches, for example, are common with respect to interstate access service and local exchange service, because once these facilities are installed to provide one service they are able to provide the other at no additional cost.

OCA M.B., at 87, citing In the Matter of: Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, August 8, 1996 at ¶¶ 676, 678. (Emphasis added by the OCA.) At the time of preparation of this Recommended Decision, there was an unconfirmed report that the United States Court of Appeals for the Eighth Circuit had temporarily stayed this recently adopted series of regulations. Although the status of the federal regulations may be clouded, state law and this Commission have made it clear that the local loop or dial tone line costs must be shared among the services that utilize the local loop. Thus, Bell's allocation of 100% of local loop costs to the dial tone line component is inappropriate.

2. Broadband Network Costs

The OCA also sponsored evidence which showed that Bell

incorrectly calculated narrowband service costs and wire center costs. Having heard the Company's response to both criticisms, I generally agree with the OCA.

Preliminarily, since a portion of broadband facilities are dedicated to render narrowband service exclusively, the costs for those facilities should be allocated to narrowband service. Bell did so, and the OCA did not dispute it. In addition, I note that a portion of broadband facilities are dedicated to render broadband service exclusively. The OCA did not mention these costs. OCA St. No. 3.0 (Dunkel), pp. 72-73. However, the Bell witness believed the OCA had suggested that all broadband costs had been charged to narrowband service. He explained that the Company had separated fiber feed costs and excluded exclusive broadband costs from the study. Bell St. No. 2.1 (Sanford), p. 22. (See the quoted testimony below.) In actuality, the parties did not disagree on this subject. Bell did not allocate all broadband costs to narrowband services.

However, with regard to common costs, the OCA argued that Bell did not properly divide broadband costs between those attributable to narrowband service and broadband service. OCA M.B., pp. 98, 100-102. A portion of the broadband facilities are used in common to render both narrowband and broadband service. The OCA asserted that the costs of the common facilities should be divided between the narrowband and broadband services. Bell's witness testified that the costs of all facilities used to render

narrowband service were allocated to narrowband customers. Bell's witness, Mr. Sanford, stated:

Q: What voice grade broadband capable costs are included in your study?

A: Only the voice grade broadband capable equipment required to provide voice grade service. For example, only the costs of the fiber strands that are required for the specific electronics equipment are included in the study. In other words, the cost of remaining pairs that may be used for other services such as dedicated services, interoffice facilities and eventually video have not been included in these costs.

Bell St. No. 2.1 (Sanford), p. 22. I regard the above answer as evidence that Bell did separate broadband from narrowband costs, but made no allowance for common costs. Bell's testimony divides the broadband equipment into two categories, i.e., broadband and narrowband (or voice grade). The costs of facilities which could be used to render narrowband service were allocated to that service with no regard to whether the same facilities could also render broadband service. The result of the Company's failure to make this allocation is that narrowband users would have been paying for all or 100% of the broadband common facilities costs and that the narrowband local loop costs are unduly inflated. OCA St. No. 35 (Dunkel), pp. 64-65.

Bell's cost methodology did not stop after calculating the narrowband local loop costs. Bell continued by calculating the "average" loop cost by wire center. In wire centers which had broadband facilities, the Company calculated the narrowband loop

costs. It also recognized the existence of broadband loops in the same wire centers and calculated a cost for them as well. The Company then combined the two in a weighted average (which was directly related to the number of loops from each service) to determine the "average" wire center loop cost.

The OCA took issue with this methodology. It presented evidence that the cost of broadband loops almost always exceeded the cost of the narrowband loops. OCA Cross-Exam. Ex. No. 12 was a proprietary Bell study which showed by wire center that broadband loop costs exceeded the costs of narrowband loops in the vast majority of the centers. The OCA continued with two more related points: First, the inclusion of the broadband loop costs generally inflated the wire center average. And second, why include broadband costs in the average at all?

Bell's response was a weak one. It noted that in some wire centers broadband loops were less expensive than narrowband loops. Bell St. No. 2.1 (Sanford), pp. 19-20. The witness continued by indicating that changes in the method for calculating fiber and copper deployment costs lowered the current narrowband system costs. Id. at 20-22. And finally, it criticized the OCA's adjustment of the Bell cost study in which the OCA witness allocated 50% of the common broadband costs from narrowband to broadband services. Id. at 22-24.

These responses do not deflect the OCA criticism. First, the OCA did not claim that all broadband loop costs exceeded

narrowband loop costs. Instead, the OCA proved by a Company wire center study that the vast majority of broadband loop costs exceeded narrowband costs. Second, the problem with the change in deployment cost methodology is that it basically indicates that Bell placed an arbitrary cap on copper costs with no regard to the amount of copper in the system. While this cap has the effect of lowering copper costs (and corresponding narrowband costs), it also increases the Company's credit for fiber placement without regard to the actual existence of fiber on the system. Neither adjustment enhances the credibility of the Bell methodology. Third, I have not recommended that the OCA adjustment should be accepted; I am recommending that the Bell study be rejected because it unduly inflates the narrowband loop costs and the wire center average loop costs, as well. Finally, I agree with the OCA to the effect that the whole scheme of allocating broadband costs to the local loop and, in turn, to the dial tone line costs is inappropriate. This allocation violates the Commission's conclusion in Bell's Chapter 30 proceeding that the protected classes would not pay for the deployment of the broadband network. June 1994 Order, 82 Pa. P.U.C. at 257-258.

3. Conclusion

In light of Bell's cost allocation errors as discussed above, I conclude that Bell's claim that dial tone line service is being subsidized is not supported by the evidence in this case. Indeed, the record contains an OCA alternative allocation of costs

which attempts to correct the flaws in Bell's cost analysis. The OCA plan produces quite different results, leading to quite a different conclusion from that of the Company. The OCA revised Bell's cost study by allocating 50%² of the local loop costs to local exchange service instead of 100%.³ OCA M.B. p. 91. The OCA further revised Bell's cost study by allocating to narrowband service 50% of the cost of common facilities that are used by both narrowband and broadband services. Id. at 101. Those costs that are related exclusively to either narrowband or broadband services were assigned 100% to those services in the OCA's study. Id. Given the OCA's revisions⁴, the evidence exists that revenues for residence local exchange service exceed costs, both in the aggregate as well as for each individual density cell. Id. at 104-105. See also OCA St. No. 3.0 (Dunkel), pp. 49, 70, 74-75 and Sch. WWD-4. OCA St. No. 3S (Dunkel), pp. 64-65 and Sch. WWD-30. The

²As noted above, Section 1325(c) of the Public Utility Code defines the cost of providing local exchange service as "[t]he direct cost of providing the service plus a share of the costs of the dial tone line, allocated in proportion to the stand-alone cost of each class of service which utilizes the dial tone line." 66 Pa. C.S. §1325(c). The OCA has determined the stand-alone cost of residential local exchange service to be 49.95% of the stand-alone cost of all other services that utilize the dial tone line. OCA M.B., pp. 138-139. Thus, the OCA utilized a 50% allocation factor to allocate local loop costs to dial tone line.

³OTS supports the OCA's 50% allocation in this proceeding. OTS M.B., p. 5.

⁴In addition to the revisions discussed herein, the OCA also made a minor change to the allocation of billing costs in Bell's cost study. OCA M.B., p. 103. OCA St. No. 3.0 (Dunkel), Sch. WWD-4 at 2.

record could support the conclusion that there is no subsidy.

However, I am not accepting the OCA's particular allocation proposal in this proceeding. I am merely pointing out that a change in the allocation of the specific costs that are at issue here (i.e., dial tone line costs and broadband network costs) can produce results far different than those on which Bell based its proposed rebalancing of rates in this proceeding. My basic conclusion remains: Because Bell's allocation of dial tone line and broadband network costs are clearly flawed, its claim that local exchange service is being subsidized by other services and its resulting rate rebalancing proposals, are unsupported and must be rejected.

E. RESIDENTIAL ISSUES

As I explained above, the Company's proposal for residential customers was related to two central ideas. First, the residential class was subsidized by the business class. Second, the rural and other high cost customers were subsidized by the urban residential customers. I emphasize again that I have rejected both of these premises.

What follows is a brief description of Bell's rate proposals for the various residential rate classes. Even though the rates were cleverly designed to keep "typical" rural residential customer rates slightly lower than "typical" urban residential customer rates, the net effect was to raise the overall contribution from the rural customers.

Note also that the residential customers were scheduled for a series of rate increases and decreases. At the risk of continuing to be repetitious, I repeat that I am specifically declining to recommend the proposed rate decreases. Although it would be easy to pick these proposed decreases like ripe fruit from a tree, I regard the decreases as a package with the increases. Given my general negative reaction to the whole package, the Company should be given the flexibility to redesign its future proposals in light of the guidance it receives from the Commission.

Finally, the Commission should understand that the charges listed below are only the tip of the iceberg. When the Company refers to its average residential customer, it is referring to a customer who purchases Touch Tone Service, Dial Tone and the Local Unlimited Usage Option Package. The record reflects that these customers constitute the vast majority of this customer class. As I said earlier, Bell's rate proposal is numerically large and complex; do not expect average customers to have the same rates for the same packages in the same cell or different rates for the same packages in different cells. In addition, the rates outlined below do not demonstrate how the substantial minority of customers who use the Budget and Standard Plans (measured usage) received much higher increases.

1. Touch Tone Charges

Bell proposed to eliminate current touch tone charges for all residential and business customers. Bell M.B., pp. 19-20 and

App 1, p. 1.

2. Dial Tone Line Charges

Bell proposed to increase dial tone line charges for all residential customers in all density cells.⁵ The increases for single party lines range from a low in cell one of \$2.80 to a high in cell four of \$2.95 monthly. Bell M.B., pp. 19-20 and App. 1, p. 1. As indicated throughout this decision, Bell failed to justify its proposed dial tone line increases.

3. Measured Usage Charges

Bell described its proposal as follows:

BA-PA's rate rebalancing proposal simplifies the current usage structure. Rates for most local usage packages are decreased. It contains a consistent per minute rate for calls in Bands 2 through 6, regardless of initial/additional minutes for each rate period. The proposal reduces the time of day rate period structure to two rate periods: Day and night/Weekend. In addition, although no change is proposed in the day rate for Metro Call Band 1 calls (which remains \$.07 per call), BA-PA proposes an increase in the night/weekend rate from \$.028 to \$.035 per call for Metro Call band 1 calls.

Bell M.B., pp. 20-21. (Footnotes omitted.) Bell's description of these adjustments is somewhat misleading. The only local measured usage plans offered by Bell are the Standard and Budget Plans. Both plans received net increases from the proposal. The OCA

⁵A density cell is a group of wire centers whose customers share a common population density range per wire center. Cell one customers are the most dense urban customers. Cell four are the least dense rural customers.

correctly evaluated these proposed plans as follows:

... Bell ratepayers subscribing to the Standard Usage option without Touch Tone will experience basic local service increases of 45%, 44%, 42% and 40% in Density Cells 1 through 4 respectively.³⁵ Those Standard Usage customers with Touch Tone will experience 26%, 26%, 25% and 24% increases in Cells 1 through 4. Id.

Obviously, the impact of Bell's proposals on those ratepayers subscribing to the Budget Usage option is even more significant. With percentage increases of 77%, 72%, 67% and 62% in Density Cells 1 through 4,³⁶ these customers experience some of the maximum percentage increases under Bell's proposal. Only Lifeline customers experience greater percentage increases in their basic local service rates or Touch Tone.

³⁵AT&T Exh. Darrah Rebuttal (Surrebuttal) Exhibit 1. Percentages do not include Subscriber Line Charge.

³⁶OCA Exh. WWD-3. Percentages do not include Subscriber Line Charge or Touch Tone.

OCA M.B., p. 45. While I do not necessarily accept OCA's calculation of the percentages, I do agree that the Budget and Standard Plan customers would have received an increase according to Bell's proposal.

4. Lifeline and Affordability

The OCA presented the monthly Lifeline charge for budget measured usage customers in the following chart:

Lifeline Customer With Budget Measured Usage Option

	<u>Present Rate</u>	<u>Proposed</u>	<u>\$ Increase</u>	<u>% Increase</u>
Density Cell 1 Dial Tone Line Service	\$1.15	\$3.95	\$2.80	243%
Density Cell 2 Dial Tone Line Service	\$1.45	\$4.30	\$2.85	196%
Density Cell 3 Dial Tone Line Service	\$1.85	\$4.75	\$2.90	156%
Density Cell 4 Dial Tone Line Service	\$2.25	\$5.20	\$2.95	131%

OCA Exh. WWD-2 at 1. OCA M.B., p. 56. According to Bell, the proposed monthly range for Lifeline rates is \$4.95 to \$6.20.⁶ The apparent difference between the OCA numbers and the Company numbers is the result of different methods of calculation. The OCA did not add the Subscriber Line Charge (SLC) and used only half (\$2.50) of the Lifeline Credit which was deducted from the Dial Tone Line (DTL) cost. (The \$5.00 Lifeline Credit is normally deducted half from the SLC and half from the Dial Tone Line.)

The difference in these methods of calculation proves the truth of the Mark Twain quote: "There are three kinds of lies: lies, damned lies and statistics." As expected, the OCA argued that

⁶This range was calculated by assuming that a Lifeline customer would choose budget service. Dial Tone Line charges range from \$6.45 (cell one) to \$7.70 (cell four), plus \$3.50 Subscriber Line Charge (SLC), less \$5.00 Lifeline Credit. Bell St. No. 1.1 (Eichenlaub) at 30.

the range of increase for Lifeline customers was 131% to 243%. OCA M.B., pp. 58-61. These percentages are eye-catching for the class of customers who can afford increases least. On the other hand, Bell argued that the proposed increases resulted in a range from \$.16 to \$.21 per day for Lifeline service. Bell M.B., p. 26. Bell R.B., p. 23. Obviously, Bell's numbers sound less expensive than one \$.25 pay phone call per day.

Both arguments are factually correct and generally useless to help resolve the underlying policy question. The real issue is: How much can poor customers afford to pay for monthly telephone service? No party presented evidence which could be used to correctly decide this issue. For instance, there was no statistical study (perhaps violating Mark Twain's wise advice) demonstrating how much low and very low income families could pay for phone service. Instead, there was nothing more than a range of proposed increases, i.e. \$2.80 through \$2.95, and an assertion that the increase was fair and affordable. Bell M.B., p. 26. Bell R.B., pp. 23-24. While this argument mimics the statutory policy of the Public Utility Code (66 Pa. C.S. §3001(1)), this kind of evidence is hardly enough for me to use to recommend that the customers who must watch every penny closely should endure a nearly \$3.00 monthly rate increase. The most affordable of the rates should be the proposed Lifeline rate. Based on this record, I cannot come to that conclusion.

F. COMPETITION

One of the cornerstones of Bell's case is its assertion that "Competitive Pressure Mandates Rate Rebalancing Now." Bell M.B., p. 10. The Company's main brief trumpets a quote from this Commission's Chairman: " 'the pace of emerging competition is intense and expected to continue.' " Id. My response is that, if the best Bell can do is to propose this rate rebalancing plan and quote the Chairman out-of-context, then its cornerstone is crumbling.

The Chairman stated:

Competitive/Anti-competitive

While it is clear that full competition does not presently exist in this area, it is equally clear that some level of competition does exist. More importantly, the pace of emerging competition is intense and expected to continue.

For example, in October 1995, this Commission certified four (4) new competitive local exchange providers: MFS Intelenet of Pennsylvania, Inc. (MFS); MCI Metro Access Transmission Services, Inc. (MCI); ETC; and, TCG Pittsburgh (TCG). In December, 1995, the Commission ordered the implementation of intraLATA Presubscription to begin in June, 1997. In February of 1996, the United States Congress enacted the Telecommunications Act of 1996 (Federal Act) which further opens competition in the local exchange market. More recently, pursuant to the Federal Act, eleven (11) telecommunications carriers have requested interconnection negotiations in order to provide local exchange service in Pennsylvania.

Thus, during this period of transition to sufficient competition, I agree with the ALJ

that these tariffs should remain in effect for it provides Bell with the opportunity to respond to the market place as it continues to evolve. However, because it is clear that some competition currently exists, I disagree with the ALJ's characterization that these tariffs are anti-competitive. Therefore, I would grant Bell's exceptions on this point.

AT&T Communications of Pennsylvania, Inc., et al., v. Bell Atlantic-Pennsylvania, Inc., Motion of Chairman John M. Quain, at Public Meeting of June 20, 1996, at Docket Nos. R-00953394C0002 et al. at 1-2.

I agree with the Chairman and the majority for which he spoke. I would apply his comments to this case in the following manner: First, "full competition does not presently exist..., it is equally clear that some level of competition does exist." Second, and "[m]ore importantly, the pace of emerging competition is intense and expected to continue." Id. at 1. Third, this is a "period of transition to sufficient competition..." And lastly, "it is clear that some competition currently exists..." Id. at 2.

Unfortunately for Bell, the nexus between the existence of competition and the need for rate rebalancing (and particularly this plan) is missing from this case. The facts that Bell has lost minimal market share in the intraLATA toll market and that other well financed, large competitive carriers are authorized to render service in Bell's territory and have been bragging about their ability to capture part of Bell's market share, do not diminish Bell's continuing dominance of the vast majority of the market.

Bell's position was not enhanced by its robust financial health either. I do not mean to say that any utility must be showing a loss or operating barely above its costs to prove there is a viable threat from competition. However, I find it difficult to see a link between the "threat" of competition and the need for rate relief when Bell's quarterly reports show such substantial income. See, OCA St. 1 (Catlin), p. 5 and Ex. TSC-1.

In short, the existence of some competition does not make this plan attractive, in the public interest, affordable, in compliance with the Bell Chapter 30 plan or in compliance with the Public Utility Code. Bell's reliance on the existence of competition as a justification for its proposals is misplaced.

G. TOLL AND ACCESS ISSUES

1. Automatic Savings Plan

Bell proposed to expand its Automatic Savings Plan (ASP) in this proceeding. Currently Bell's ASP provides customers with a 20% discount on qualifying intraLATA toll calls of \$20 or more per month. The Company's current proposal would provide a 10% discount on qualifying intraLATA toll calls between \$5-19.99 per month. Bell's current ASP was accepted in a recent Commission action.⁷ Bell argued that the plan was reasonable, was not anti-competitive, did not result in a price squeeze and was not subject to an

⁷AT&T Communications of Pennsylvania, Inc., et al v. Bell Atlantic-Pennsylvania, Inc., Docket Nos. R-00953394C0002, R-00953396C0002-C0004, R-00953409C0001 and C0004, Motion of Chairman John M. Quain at Public Meeting of June 20, 1996.

imputation requirement. Bell M.B., pp. 30-32.

AT&T argued that the original ASP was anti-competitive and that this extension was also. AT&T explained that the proposed rate resulted in a price squeeze for competing carriers. It asserted that Bell was using its dominance in the intraLATA market to strengthen its toll position without properly reducing access costs. AT&T M.B., pp. 17-23. AT&T R.B., pp. 9-11.

The OCA argued that the decreased toll revenue resulting from the proposed ASP could not be used to justify far larger increases in dial tone rates. The OCA disputed the Company claim that the toll reductions from the new ASP would offset the massive increases in dial tone line charges. It concluded that the residential ratepayers should not be required to fund losses on a competitive toll reduction plan. OCA M.B., pp. 54-55. OCA R.B., pp. 17-18.

This proposal is another example of a rate reduction which was packaged with the alleged need for a large rate increase to residential ratepayers. Since I have already concluded that Bell failed to justify the need for the increase, there is no reason to require implementation of this particular revenue reduction. Indeed, I generally agree with OCA, i.e., the proposed reduction in revenues is so small in comparison to the proposed increase for the residential customers that the reduction can hardly be used to justify the increase. Further, I do not find the AT&T position persuasive. This Commission already rejected those

arguments when the original ASP was proposed; AT&T has offered no additional arguments in this case which change that conclusion.

2. Business Flat Rate

Bell proposed restructuring business MTS rates to eliminate time of day and distance sensitivity and to create a postalized rate of \$.10 per minute (\$.07 per minute for certified speech and/or disabled business customers). Bell further proposed to change the service rates for WATS, Maximum Value Plan and Optional Business Calling Plus. Bell M.B., p. 36. The Company asserted that, since no imputation was required under Chapter 30, there was no price squeeze. Bell M.B., p. 37.

AT&T contended that this proposal was a questionable response to competition and that Bell's pricing advantage, when taken with its dominant service provider position in the business and commercial intraLATA toll market, was anticompetitive. AT&T argued that Bell's proposal placed its competitors in a price squeeze which prevented effective competition. AT&T St. 1.0 (Darrah), pp. 17, 22-23. AT&T M.B., p. 23.

The OSBA asserted that Bell's position that, "most business customers will experience a net decrease in their bills," was unsupported by any Bell calculations. OSBA R.B. p. 2. Bell M.B., pp. 3, 19, 32.

I reject this proposal based upon my previous finding that alleged reductions in this plan are at the expense of unwarranted residential increases. In the alternative, I find that

Bell is not required to meet an imputation test and that, therefore, a price squeeze would not occur.

3. Metropolitan Area Unlimited Plus Service (MAUPS)

Bell's proposal would have been an expansion of an existing service. This plan was a response to "second tier" Philadelphia and Pittsburgh suburban customer requests for an optional local calling plan. Bell St. 1.1 (Eichenlaub), pp. 20-21. Tr. 1156.

AT&T considered MAUPS to be a "preemptive strike" by Bell against its competitors. AT&T contended that competitors could not compete for this traffic from a toll standpoint because of high access charges. Further, competitors could not compete by providing alternative local service because there are no competitors in a position to offer local services. AT&T M.B., p. 25. AT&T St. 1.0 (Darrah), p. 26.

Although perhaps acceptable on a stand alone basis, I recommend rejection of MAUPS as part of the total rebalancing plan. It is yet another example of using residential service increases to fund toll reductions. Since the proposed residential increases are not justified, this toll decrease is not acceptable.

I also reject AT&T's argument that MAUPS is a "preemptive strike" against competition. The AT&T argument is weakened by its own witness Darrah's statement that he would "be highly surprised that customers really would sign up for that [MAUPS]. It would appear to be a losing proposition for most customers." Tr. 1166.

Furthermore, the same witness conceded on cross-examination that AT&T (as a local service provider) or any other local service provider could offer a similar service based on its own customer requirements. Tr. 1163. Under these circumstances, MAUPS is hardly a "preemptive strike" against competition.

4. Local Transport Access Service Rate

Bell proposed the restructuring of switched access local transport rates to create a rating distinction between direct and tandem routed traffic. Direct trunked transport will be flat-rated on a distance sensitive basis. Tandem transport will be rated on a usage (per minute of use) and distance sensitive (per mile) basis. Bell explained that this proposal was uncontested. Bell M.B., pp. 38-39. The Company denied that this proposal would result in a price squeeze. Bell M.B., pp. 39-40.

AT&T accepted this proposal as a first step, if universal service and competition in all telecommunications markets were to be achieved. AT&T M.B., p. 43. However, AT&T criticized the proposal as a revenue decrease which was insignificant compared to the access contributions that were embedded in Bell's carrier access charges. AT&T also believed that the Company's refusal to decrease access rates further was inconsistent with the Federal Communication Commission (FCC) view that reducing access was necessary for the development of competition. AT&T R.B., pp. 12-13. MCI also complained that the access rate reduction was inadequate when compared to toll reductions. MCI R.B., pp. 9-11.

I recommend acceptance of the local transport Access Service Rate restructuring proposed by the Company primarily because it substantially mirrors the structure which has been adopted at the federal level. Unlike the interstate structure, it does not include the Residual Interconnection Charge (RIC).⁸ AT&T and MCI accepted the proposal, but wanted a bigger reduction. Unfortunately, there is no record evidence to quantify their criticism. I endorse the AT&T position that the proposal is at least a first step if universal service and competition in all telecommunications markets are to be achieved.

H. UNIVERSAL SERVICE VS. RATE REBALANCING

Both AT&T and MCI strenuously asserted that Bell's rate rebalancing proposals should, at a minimum, be postponed until after the Commission implements a universal funding mechanism. AT&T M.B., pp. 29-42. MCI M.B., passim. AT&T R.B., pp. 1-9. MCI R.B., pp. 12-14. Bell argued that rate rebalancing moves prices closer to costs which promotes efficient market entry and competition. Further, the Company maintained that the establishment of a universal service fund was not a prerequisite to rate rebalancing and that the absence of such a fund in Pennsylvania should not be used to delay implementation of the Bell

⁸The RIC is a non-cost-based element developed by the FCC to maintain revenue neutrality for the local transport rate element on a stand alone basis. Since this revenue neutral filing was intended to minimize subsidies to the extent possible, a RIC was not proposed. Bell St. 1.0 (Eichenlaub), p. 19.

proposal. Bell M.B., pp. 8-10. Bell R.B., pp. 46-47.

After sorting through the parties' basic posturing, I found less disagreement on this issue than initially appeared. Although MCI and AT&T both preferred the establishment of a universal service fund first, both recognized that rate rebalancing could occur subsequently. Bell allowed that both could occur at the same time.

Even though I cannot recommend the adoption of Bell's proposal, I have concluded that each of the concepts can function independent of the other. MCI provided the following discussion of the operation of a universal funding mechanism which helps demonstrate my point:

Contrary to Bell's second argument, there is also no need or advantage to rebalance immediately in order to reduce the amount of the subsidy which ultimately will be provided from the universal service fund. The amount of subsidy required by the universal service fund will be determined solely by the following factors: (1) the universal service rate established by the Commission; (2) the forward looking costs of providing local service in regions where costs are higher than the universal service rate; and (3) the numbers of subscribers eligible for subsidies in each such high cost area. So long as Bell and other local exchange carriers are all permitted to charge the Commission established universal service rate at the time the universal service fund is implemented, the subsidy required from the fund will not depend at all on whether Bell had previously been permitted to rebalance its rates.

This fact can be simply illustrated through the following example. Assume that the monthly universal service rate is set at

\$20; that the monthly cost of providing basic local service is \$35 in the only region where costs exceed the universal service rate; and that there are 100,000 subscribers in this high cost region eligible for subsidies. Assume further that Bell's existing rate for basic local service is \$12 and that Bell is permitted to increase this charge to the universal service rate at the time the fund is implemented.

Under these assumptions, the monthly subsidy required from the universal service fund would be \$1,500,000 $[(\$35-\$20) \times 100,000]$. Obviously, the size of this subsidy does not depend at all upon Bell's pre-existing \$12 rate for basic local service. Rather, the required subsidy would still be \$1.5 million per month even if Bell had earlier been permitted to increase its rate for basic local service from \$12 to \$16. Thus contrary to Bell's contention, rebalancing prior to the establishment of a universal service fund does not reduce the amount of the subsidy which ultimately will be required.

MCI M.B., pp. 15-16. Only two observations are necessary to complete this discussion. First, the numerical example is completely compatible with this Commission's description of the universal funding mechanism contemplated by its own investigation and final-form rulemaking. Rulemaking to Establish a Universal Service Funding Mechanism; 52 Pa. Code §63.141, et seq., Final-Form Rulemaking Order, entered June 21, 1996, at Docket No. L-00950105 (Slip Op. at 10). Second, without intending to do so, the quotation demonstrates that rate rebalancing (whether it occurs before, after or during the establishment of a universal service fund) has no impact on the formation and operation of the fund. Accordingly, I have concluded that, if Bell had proposed an acceptable rebalancing

plan, there would have been no need to postpone implementation pending the formation of a universal service fund.

I. BUSINESS ISSUES

The OSBA and CAPA both raise specific arguments with regard to Bell's proposed rate rebalancing plan as it relates to business customers. These arguments will now be addressed.

1. Parties' Positions

The OSBA asserted that it supported the concept of rate rebalancing in general, but contended that Bell failed to provide evidence to justify its particular rebalancing proposal in this proceeding. OSBA M.B., pp. 6-7. Specifically, the OSBA argued that:

Bell has failed to prove how its proposed rates in its revised local business usage rate structure either adjust rates to competitive market levels or bring the rates closer to cost. Bell has also failed to prove its claim that its plan results in no additional revenue to BA-PA.

Id., at 8.

The OSBA questioned Bell's ability to propose just and reasonable rates and Bell's claim that business customers will experience a decrease in rates in light of the lack of solid data with regard to business customer calls. Id., at 8-13. The OSBA asserts that "Bell's witness [Eichenlaub] was uncertain how many calls business customers make at various times, did not know volumes in peak and off peak periods, and did not know what percentage of business customers are multi-line business

customers." Id., at 9-10 (Footnote omitted). The OSBA further contended that Bell provided no evidence to support its assertion that the average business call was two minutes in duration. Id., at 10-12. Although Bell relied upon its Subscriber Line Usage Study (SLUS) to support its determination of average call duration, the OSBA pointed out that the SLUS was ten years old and cannot be considered accurate in light of the impact of technological innovations which occurred over the past ten years. Id., at 12.

Because of what it saw as a significant lack of supporting evidence, the OSBA questioned the validity of Bell's proposed restructuring of business local usage rates. Specifically, the OSBA was troubled by Bell's proposed elimination of its time-of-day distinctions, arguing that such an elimination ignores the cost differentials that exist between on-peak and off-peak calling. Id., at 13-16. Furthermore, the OSBA questioned Bell's replacement of its per-message rates with a per-minute rate for calls made within Metro Call Band 1. The OSBA contended that this change further increased the inequity that already existed through Bell's use of full-minute pricing.⁹ Id., at 16-18. Therefore, because Bell's proposed business local usage rates would ignore time-of-day cost differentials and would extend the full-

⁹Full-minute pricing is a method of pricing a call whereby each fraction of a minute is rounded up to the next full minute for purposes of determining the charge for that call. For example, a customer who makes a call with a duration of two minutes and one second would be billed for a three minute call. OSBA M.B., p. 16.

minute pricing concept to Metro Call Band 1, the OSBA argued that Bell would experience increased revenues with no clear connection to its actual costs. Thus, the OSBA concluded that Bell's claim of revenue neutrality in this case was suspect. Id., at 18-19.

In response, Bell asserted that it was not required to show that its rebalancing plan would be revenue neutral in each of its elements. Bell maintained that its plan was revenue neutral in the aggregate and that most business customers would experience a net decrease in their bills as a result of the proposed changes. Bell R.B., p. 43. Bell contended that the change from per-message rates to a per-minute rate for local business calls was necessary to address the disparity of charging toll usage on a timed basis while local usage was charged on a per-call basis. Id., at 43-44. With regard to the issue of supporting evidence, Bell contended that the OSBA simply ignored information that Bell provided in answers to discovery requests from other parties, as well as other information that it made available. Id., at 44-46.

Like the OSBA, CAPA also took issue with Bell's proposed restructuring of its business local usage rates. CAPA's specific objection was related to Bell's proposal to replace the \$.07 per message rate with a \$.03 per minute rate for Metro Call Band 1 calls. With regard to this proposal, CAPA argued as follows:

Commission regulations require the independent payphone provider [IPP], who is a direct competitor to the provision of payphone services by Bell to offer a local call to the consumer at a rate not to exceed Bell's rate,

i.e., twenty-five cents (25¢), and to offer that twenty-five cent (25¢) call for a minimum of ten (10) minutes. Thus, as Bell has proposed to restructure its rates that ten (10) minute call will cost the independent payphone provider thirty cents (30¢), but the IPP can only charge twenty-five cents (25¢) for the same call.

It doesn't take a rocket scientist to figure out that every ten (10) minute call will cost more than can be recovered for the call. The IPP who is a captive customer of Bell now and for the foreseeable future has no option to escape this predatory pricing by Bell.

CAPA M.B., p. 5 (Footnote omitted). CAPA contended that Bell's proposed restructuring of Metro Call Band 1 rates would result in substantial increases to independent payphone providers. Id., at 9. CAPA submitted that the proposed rate was confiscatory and anti-competitive. Id., at 7.

In response, Bell argued that "the appropriate analysis to determine whether BA-PA's plan is anticompetitive for payphone providers should focus on local service for them in the aggregate, not on the basis of a single ten minute call." Bell M.B., p. 35. Bell contended that the record evidence in this case "indicates that the average payphone call is less than four minutes in duration and the majority of payphone calls are less than two minutes in duration." Id. Bell noted that for calls of two minutes or less, payphone providers would pay less than they do under the current rate structure. Id. Finally, Bell argued that "because of the availability of reduced-cost ValuPak usage service

and the elimination of the charge for touch tone, which more than offsets the proposed increases in business dial tone line rates in urban areas, it is likely that many payphone providers will experience overall reductions in their cost structure, a fact conveniently overlooked by CAPA." Id., at 36.

2. Conclusion

I agree substantially with the OSBA and CAPA with regard to the issues they raise. First, as the OSBA correctly argues, Bell has provided no solid evidence to truly support its proposed changes in its local business usage rate structure. Certainly Bell has supplied detailed cost information and has set forth what it claims to be the bill and revenue effects of its proposals. Bell St. No. 2.0, Appendix I; Bell St. No. 1.0, pp. 18, 29, Appendix C; Bell Rate Rebalancing Filing, Appendix C. However, the full development of these cost and revenue figures is somewhat of a mystery since Bell has not set forth on the record the calculations illustrating the actual derivation of these numbers. The absence of this data would not have been crucial, if Bell witnesses were able to provide satisfactory answers to questions regarding business customer usage. OSBA M.B., pp. 9-10; Tr. 840, 841, 845. Although Bell made vague references to various studies and to information available in certain interrogatory responses (Tr. 841, 906, 914-915, Bell R.B., pp. 44-45), the fact remains that no clear evidence exists on the record to support the rate structure changes that Bell proposed or the revenue claims that Bell made. Moreover,

any such revenue claims are suspect to the extent that they are based on an outdated SLUS and on a proposed increase to the Dial Tone Line rate. (At the risk of continuing to be repetitious, the Dial Tone Line Rate is based on a cost analysis that I have already found to be flawed.) For these reasons it is not possible to determine whether or not the proposed business local usage rates are truly cost based, nor is it possible to be entirely certain of the resulting bill and revenue effects.

In addition to the lack of evidence to support the Company's proposed changes to its business local usage rates, Bell has provided no convincing proof that the changes it proposes are even necessary, or that they would result in a substantially better rate structure than that which currently exists. Even assuming that Bell witness Sanford's cost information for business local usage is accurate, I note that in comparing the existing rates with this cost information the existing rates are already above the costs for all call bands. Bell St. No. 2.0, Appendix I, p. 5. Yet, Bell's proposed changes appear to result in a further increase to business local usage customers. Bell Rate Rebalancing Filing, Appendix C.

Moreover, as the OSBA pointed out, the proposed elimination of the time-of-day distinctions in the rates raises questions with regard to the relationship of the proposed rates to the cost of service. As the OSBA noted, Bell witnesses agreed that there are differences in the costs of providing service between on-peak and off-peak periods. OSBA M.B., pp. 14-15. Thus, it seems

entirely reasonable that such differences should be reflected in rates, as they currently are. Accordingly, I question the elimination of this aspect of the Company's rate structure, as well.

Finally, although the proposed change from a per-message rate to a per-minute rate would seem to have some cost justification based on the cost information provided by Mr. Sanford (assuming once again that this information is indeed accurate), I must agree with CAPA that this proposed change would definitely be harmful to independent payphone providers (IPPs). Though there may be some disagreement among the parties as to the duration of the average business call, it is a matter of mathematical certainty that, for calls of a certain duration¹⁰, IPPs would be required to pay more for a local call in Metro Call Band 1 than they are permitted under the applicable regulation¹¹ to charge their own customers for that same call. Thus, Bell's proposed per-minute rate would result in a situation whereby IPPs would lose money in providing calls above a certain length. Furthermore, this fact is not changed by the possibility that IPPs may experience decreases in other rate components or that they could take advantage of Bell's ValuPak service. As CAPA contends, it is unfair and anticompetitive for Bell to set rates that will deliberately create

¹⁰Under the practice of full-minute pricing, any call above 8 minutes would produce a charge exceeding 25¢.

¹¹52 Pa. Code §63.97(d) and (e)

the potential for revenue losses to IPPs.

For all the reasons discussed above, I find that Bell's proposed changes to its business local usage rates are not justified. I conclude, therefore, that these proposed changes must be rejected.

J. LATE PAYMENT CHARGES (R-00963556)

Bell argued that assessing a late payment charge on residential customers whose bills are overdue was a new service which was not governed by revenue neutrality requirements under Chapter 30 because it was not a price change or an adjustment to existing rates. Bell M.B, pp. 48-49.

The OCA pointed out that to the extent the late payment charge would be collected on protected services, it should be considered a revenue increase and subject to revenue neutrality and to Bell's price stability mechanism. The OCA asserted that the charge was not for a new service because no new product was added. Finally, it noted that whatever costs were associated with the dealing with delinquent accounts were already incorporated into the current rate structure. Thus, allowing the added recovery of late charges would permit a double recovery for an item already contained in the current rate structure. OCA M.B., pp. 140-142. OCA R.B., pp. 22-23.

I agree with the OCA. There is no new service being offered by Bell. Late charges are simply the collection of additional dollars from residential customers who don't pay their

bills on time. In this instance, it is a revenue enhancement technique. Some portion of the residential customers have always paid their bills late. This proposal would raise additional money from the protected class which should already be compensating the Company for this problem. The proposal should be subject to market basket neutrality. Bell has proposed no offset for this increase. The rate increase should be denied.

K. PROPRIETARY INFORMATION

1. Residential Costs

On April 5, 1996, the OCA filed a motion to declare certain Bell cost information nonproprietary. In Prehearing Order No. 4, dated May 17, 1996, the undersigned certified a material question to the Commission relating to the release of that information to the public. By Opinion and Order, entered June 18, 1996, this Commission answered the certified question in the negative and reversed Prehearing Order No. 4. The Opinion and Order had the effect of continuing to classify the information as proprietary. The Opinion and Order also specified that the ruling was without prejudice to the parties' ability to raise the issue again and solicited further briefing on the issue. Opinion and Order at 17-18.

On July 19, 1996, the OCA filed a second motion to declare related Bell cost information nonproprietary. After hearing oral argument on the motion on August 7, 1996, the motion was denied. Tr. 1471-1496.

Initially, only the OCA briefed this issue. It argued:

OCA's position on this issue is very simple. Bell cannot ask for a rate increase - and the Commission cannot approve any such rate increase -- unless the most important evidence demonstrating why that increase is necessary is disclosed to the public. In sum, if the Commission determines to allow Bell to rebalance rates closer to cost, then the Commission must disclose to consumers the costs relied upon by the Commission.

Specifically, OCA seeks to declare nonproprietary a range of wire center costs, from the lowest to the highest Bell wire center, and Bell's average dial tone line cost by cell so that this information could be released to the public.

OCA M.B., p. 144. (Emphasis in the original.) The OCA explained that it made its second motion because it believed that the requested information was the least restrictive form for the data and would fall outside the purview of the Commission's regulations. 52 Pa. Code §5.423. The OCA asserted that the Constitutions of the United States and Pennsylvania and the common law required that the judicial process be a public one which opens up the decisional process to scrutiny. According to the OCA, maintaining secrecy jeopardized the integrity of the process. The OCA continued that Bell had failed to carry its burden of demonstrating entitlement to the proprietary designation. It concluded by claiming that to deprive the public of the requested cost information would restrict the opportunity to make meaningful public input. OCA M.B., pp. 146-159.

Bell responded by noting that the OCA was the proxy for

the public's access to the data. The Company argued that any information previously released was not nearly as sensitive as what the OCA now sought. Bell explained that the information sought in the second motion would reveal its price floors to its competition. The Company regarded this information as highly sensitive and very harmful if released. Bell asserted that the data met the criteria established in the regulation (52 Pa. Code §5.423) and was entitled to its protection. Bell R.B., pp. 48-52.

Since I have already ruled on the OCA's motions, I will not extensively review the basis for my decisions. Prehearing Order No. 4, dated May 17, 1996. Tr. 1493-1496. Instead, I note that the Commission regulation (52 Pa. Code §5.423) and the cases¹² cited by the OCA establish a balancing test. Basically, that test weighs the public interest against the potential harm to the business seeking protection. Each time the OCA has raised the issue, the undersigned or the Commission has ruled that the facts favor the utility. Now that the record is closed, the only real addition to the situation is my overall recommendation to reject the majority of the filing (especially including the residential proposals). Accordingly, the issue of revealing Bell's residential costs is moot.

¹²See, Hutchinson v. Luddy, 398 Pa. Superior Ct. 505, 581 A.2d 578 (1990); reversed in part, 527 Pa. 525, 619 A.2d 276 (1991), which is quoted on page 149 of the OCA main brief. Zenith Radio Corp. v. Matsushita Electric Industrial Co., 529 F. Supp. 866 (E.D. Pa. 1981).

2. Bellcore Models

The OCA also challenged Bell's failure to disclose its cost formulas and calculations which were based on Bellcore cost models. The OCA recognized that Bell's licensing agreement with Bellcore did not allow for disclosure of the formulas and that Bellcore refused to make the disclosure. However, the OCA argued that Bell should not be able to use cost study results to support an increase and not demonstrate how the numbers are calculated. It regarded the failure to disclose these formulas as a failure to carry Bell's burden of proof. Further, any use of these formulas to justify a rate increase was considered a deprivation of the OCA's due process rights. OCA M.B., pp. 105-109.

In response, Bell noted that the Commission had accepted Bell cost results in two prior cases which were based on the same cost models, even after the OCA made the same arguments. It continued by noting that in the Universal Service case, the OCA had filed a motion to compel which it withdrew. In the instant case the OCA made no attempt to compel disclosure. Since the license agreement did allow for conditional disclosure upon order from a regulatory body and since the OCA failed to obtain such an order, Bell concluded that it had not been relieved of its obligation not to disclose the data. Bell R.B., pp. 52-55.

Also in response to the OCA argument, by letter dated September 6, 1996, Bell Communications Research, Inc., (Bellcore)

filed a petition to intervene¹³ and a memorandum in support of the proprietary nature of its computer costing models. Bellcore argued that its models had been developed at great expense and that the models were entitled to a proprietary consideration. Bellcore asserted that the disclosure of the models would irreparably harm Bellcore. Bellcore continued that administrative law judges in recent prior cases (as well as the Federal Communications Commission, federal and state courts) had upheld Bellcore's proprietary interest. Finally, it contended that there was a less intrusive method than disclosure for the OCA to test the models, i.e., Bell had agreed to run the models using OCA inputs. Bellcore Memo, pp. 5-17.

This issue is moot. As was noted above in far greater detail, the Company's cost allocation methodologies are severely flawed. Since I am rejecting the vast majority of the filing in this case, I am not relying on the outputs from any of the Bellcore models; and I don't recommend that the Commission do so either.

L. COMPLAINTS

1. AT&T Communications of Pennsylvania (C0001)

AT&T was an active party in this proceeding. It was primarily concerned about toll charges, access fees and interconnection fees. Since Bell's local transport access service rates were recommended and since Bell's toll proposals were not

¹³No party opposed or filed a response to the petition to intervene. Accordingly, the petition will be granted below.

recommended, AT&T's complaint is sustained in part and denied in part in conformity with the recommendations in this decision.

2. Office of Consumer Advocate (C0002)

The OCA was an active party in this proceeding. It was primarily concerned about proposed increases and decreases to residential service. Since no changes to residential service are recommended, its complaint is sustained in part and denied in part in conformity with the recommendations in this decision.

3. Central Atlantic Payphone Association (C0003)

CAPA was an active party in this proceeding. It was primarily concerned about the proposed increases for business service for payphone providers. Since no increases to business service are recommended, its complaint is sustained.

4. Kurt Richter (C0004)

Mr. Richter was an inactive party in this proceeding. His complaint protested the proposed rate increases. Since no increases are being recommended, his complaint is sustained.

5. Joseph A. Henchy (C0005)

Mr. Henchy was an inactive party in this proceeding. His complaint protested the proposed rate increases. Since no increases are being recommended, his complaint is sustained.

6. John D. Lewis (C-00967866)

Mr. Lewis was an active party in this proceeding. His complaint was divided into twelve sections which challenged current rate design issues (e.g., the disparity in rates for the same

services to residential and business customers), as well as certain Yellow Pages advertising charges. Although his complaint did not challenge any of the specific proposals in the subject Bell filings, Mr. Lewis clearly believed that his complaint was directly related to the instant proceeding. I agreed. His complaint was consolidated with this case by Prehearing Order No. 5, dated June 19, 1996 (Slip opinion).¹⁴

As noted previously, I am recommending that almost none of the changes proposed by Bell be implemented. Comparison of my recommendations to Mr. Lewis' complaints reveals that none of the disparities about which he was concerned were changed and that none of the remedies he requested were granted. Accordingly, his complaint is dismissed.

IV. ORDER

NOW THEREFORE, IT IS RECOMMENDED:

1. That, with the exception of the Local Transport Access Service Rate identified in Paragraph 2 below, the Bell Atlantic-Pennsylvania, Inc., filed revisions to its Local General Tariff-Telephone Pa. P.U.C. No. 1, Message Toll Service Tariff-Telephone Pa. P.U.C. No. 1A, Local Exchange Tariffs Nos. 180A, 182, 182A, 185B and 185C, WATS Tariff-Telephone Pa. P.U.C. No. 296, and Access Tariff-Telephone Pa. P.U.C. No. 302 at Docket No. R-00963550 are hereby rejected as unjust, unreasonable and unlawful.

¹⁴The Yellow Pages advertising issues were dismissed for lack of jurisdiction. Prehearing Order No. 5, Slip op. at 3-4.

2. That the Local Transport Access Service Rate proposed by Bell Atlantic-Pennsylvania, Inc., as identified in the Recommended Decision is hereby approved. Further, Bell Atlantic is hereby required to file the necessary revision to Access Tariff-Telephone Pa. P.U.C. No. 302, which conforms to this approval on one day's notice after receipt of the Commission's Order.

3. That the Bell Atlantic-Pennsylvania, Inc., filed revisions to its Local General Tariff-Telephone Pa. P.U.C. No. 1 to establish a late payment charge for residential customers at Docket No. R-00963556 is hereby rejected as unjust, unreasonable and unlawful.

4. That the complaint of AT&T Communications of Pennsylvania, Inc. at Docket No. R-00963550C0001 is hereby sustained in part and dismissed in part.

5. That the complaint of the Office of Consumer Advocate at Docket No. R-00963550C0002 is hereby sustained in part and dismissed in part.

6. That the complaint of the Central Atlantic Payphone Association at Docket No. R-00963550C0003 is hereby sustained.

7. That the complaint of Kurt Richter at Docket No. R-00963550C0004 is hereby sustained.

8. That the complaint of Joseph A. Henchy at Docket No. R-00963550C0005 is hereby sustained.

9. That the complaint of John D. Lewis at Docket No. C-00967866 is hereby dismissed.

10. That the Petition To Intervene of Bell Communications Research, Inc., is hereby granted.

11. That the record at Docket Nos. R-00963550, R-00963550C0001-C0005, R-00963556 and C-00967866 be marked closed.



LOUIS G. COCHERES
Administrative Law Judge

DATED: October 8, 1996

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

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, 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:

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