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September 19, 2003

Via Hand Delivery

ORIGINAL

The Honorable James J. McNulty
Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
2nd Floor North
Harrisburg, Pennsylvania 17101

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

Dear Secretary McNulty:

Please find enclosed nine (9) copies of MCI WorldCom Network Services, Inc.'s ("MCI") Main Brief in the above-referenced access charge proceeding. These copies were inadvertently omitted from the filing that was forward to your office yesterday via Federal Express.

We apologize for any inconvenience this may have caused. Please feel free to call if you have any questions respecting this filing. Thank you for your professional courtesy.

Very truly yours,

Kathleen Misturak-Gingrich

KMG:smb
Enclosures

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

ORIGINAL

MAIN BRIEF

on behalf of

MCI WORLDCOM NETWORK SERVICES, INC. ("MCI")

September 18, 2003

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BEFORE THE
PENNSYLVANIA PUBLIC UTILTY COMMISSION

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Verizon North, Inc.	:	

MAIN BRIEF OF
MCI WORLDCOM NETWORK SERVICES, INC.

I. INTRODUCTION AND STATEMENT OF THE CASE

There is no dispute that the access rates charged by both Verizon Pennsylvania, Inc. ("Verizon") and Verizon North, Inc. ("Verizon North") are well above cost, regardless of a particular company's calculation of "cost." There also appears to be little dispute among the telecommunications companies that access charges can and should be reduced – the question is the amount of the reduction. Although some of the public advocates argue against access reductions, those parties' arguments are based on the false premise that any reductions in access rates must be made up through increases in residential local rates.

This case is an opportunity for the Pennsylvania Public Utility Commission ("Commission") to take another step towards making Pennsylvania a state that encourages a framework for local competition. Above-cost access rates create numerous unfair advantages for the incumbent local exchange carriers ("ILECs") that must be eliminated. The Federal Communications Commission ("FCC") has recognized that access rates must start moving closer to cost, and interstate access rates have therefore dropped significantly, especially in comparison to intrastate access rates. There is absolutely no logical reason for this disparity in rates, and the Commission should begin the process of establishing an intercarrier compensation regime in

Pennsylvania that makes economical and competitive sense and that reflects the costs of providing services.

This Commission has already acknowledged that further access reform and reductions are necessary. The Commission specifically ordered the initiation of further access proceedings after the Global Order. The Commission recognized the need to eliminate any subsidies that above-cost access rates are allegedly recovering. Specifically, the Commission noted, "the sooner that we resolve the reduction and possible elimination of the carrier pool, the better it would be for the competitive environment in Pennsylvania."[1] In fact, the Commission rejected the ILECs' proposal to wait until 2003 to further reduce access rates and instead ordered such reductions to occur by the end of 2001.[2] Obviously, such reductions and reform are long overdue.

Reducing access rates only slightly, but not bringing them to cost, is not a proper solution at this point. The Commission must look at more dramatic reductions that truly remove any subsidies and bring the cost structure and rates into the present time, with a recognition of the present competitive landscape.

II. HISTORY OF THE CASE

Administrative Law Judge ("ALJ") Cynthia Fordham's Order #4 entered in this case on August 28, 2003 clearly and succinctly discusses the history of this case on pages 1-4. MCI WorldCom Network Services, Inc. ("MCI") hereby files this Main Brief in accordance with the revised procedural schedule contained on page 6 of such Order.

[1] *Joint Petition of Nextlink, et al.*, Docket Nos. P-00991648 and P-00991649, Sept. 30, 1999 ("Global Order"), at 59.
[2] Id.

III. IT IS SOUND PUBLIC POLICY TO REDUCE VERIZON AND VERIZON NORTH'S ACCESS RATES TO COST

Access charges are based on an industry regime from the past. As MCI's witness Dr. Michael Pelcovits testified,

> Access charges were first instituted by the FCC in 1984 upon the divestiture of the Bell System into separate local companies (the Regional Bell Operating Companies) which were expected to function as regulated monopolies, and a nationwide long distance company (AT&T) which was expected to compete against other long distance providers such as MCI. The purpose of access charges was to replace intra-company payments previously made within the Bell System with a regulated system of nondiscriminatory fees to be paid by all long distance companies for access to each local network. Shortly after the FCC established access charges for interstate long distance calls, the state regulatory commissions established access charges for intrastate long distance calls.[3]

The telecommunications landscape has changed dramatically since 1984. The Bell companies are no longer protected monopolies. The Bell companies are now providing interstate long distance services and competing with long distance providers such as AT&T and MCI. The industry is moving towards making implicit subsidies explicit to permit a level playing field. Regulated wholesale services are moving to cost in order to eliminate competitive advantages that one carrier may have over another. When a carrier is a party's primary supplier and primary competitor, it is imperative that the regulator ensure a level playing field so that one party does not have an unfair advantage over the other parties, with whom it competes.

As MCI's witness Dr. Pelcovits testified, the FCC has recognized this changed landscape and has made substantially more progress in reducing interstate access rates towards cost:

> Interstate switched access charges have declined steadily since their inception in 1984 for two fundamental reasons: the FCC has tried to reduce interstate access charges to the level of forward-looking cost, and since telecommunications is a declining cost industry, the economic cost of providing access services has fallen substantially. The FCC has implemented its policy of moving interstate switched access charges toward cost in two main ways. First, the FCC adopted a policy of

[3] MCI Statement 1.0 (Pelcovits Rebuttal) at pg. 7.

> shifting recovery from per-minute charges to per-line charges (*i.e.* the SLC and the PICC). Second, over the past ten years, the FCC has required LECs to reduce rates under a price cap regime to reflect productivity improvements in the telecommunications industry. The total effect of productivity adjustments (net of offsets for inflation) over the past 10 years has been about a 70% reduction in prices.[4]

There is absolutely no technical reason for intrastate access rates to be so far above interstate access rates. Terminating an intrastate long distance call is the exact same function as terminating an interstate long distance call, and there is no actual cost difference between the two functions.

However, the Pennsylvania intrastate access rates for Verizon are dramatically higher than the interstate access rates. Specifically, the intrastate per minute switching rates for access are 384% higher than the interstate rates.[5] There is no carrier charge, or its equivalent, at the federal level, which is a large difference in cost.[6] Although the interstate access rates are not at forward looking cost levels, they are at least reduced to a level that is far closer to cost than Verizon's current intrastate access rates. This Commission should similarly take the necessary steps to move access charges to cost.

There are many benefits to consumers that come from reducing access charges to cost. First, reduced access rates will benefit long distance consumers by eliminating the artificially high rates paid to Verizon and Verizon North. Second, reducing access rates to cost eliminates the potential for regulatory distortions and price squeezes that harm competition. Third, reduced access rates eliminate an unfair competitive advantage that Verizon and Verizon North have in the local market.

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[4] Id. at pgs. 13-14
[5] Transcript at pg. 344.
[6] MCI Statement 1.0 at pg. 13.

A. Reduced Access Rates Provide Benefits To Long Distance Customers

If prices are not set properly, it sends the wrong signals about when and how to use a particular service. A firm with significant market power, such as Verizon, will not set prices at cost unless it is compelled to by regulation. Therefore, regulators have an important role to play in controlling market power and driving results that *parallel* the outcome in competitive markets.

By setting rates at cost, it sends the correct pricing signals to the long distance companies. The greatest benefit to Pennsylvania consumers is that long distance carriers will be free to introduce new and creative products and services to the Pennsylvania market. Their ability to do so is currently hampered by the artificially high switched access charges that they must pay Verizon. A reduction in access charges will benefit all consumers of intrastate long distance service. If prices are set above cost, users will consume too little of service and substitute other services which are not as desirable.

In addition, there are long-term detriments to artificially high access rates. As Dr. Pelcovits testified, "To the extent that long distance rates are artificially high, usage will be depressed below optimal levels and technological change will be skewed. Specifically, technologies that rely upon use of long distance will be discouraged, and new services and innovations, which otherwise might have appeared, may fail to materialize."[7]

A major portion of the interexchange carriers' costs are those that Verizon or Verizon North charges for access. If those costs go down, the industry will inevitably respond. As Dr. Pelcovits stated, "If a single firm attempts to price above cost (thereby denying consumers the benefits of static efficiency), then other firms will reduce prices to attract their customers' business."[8] Thus, a reduction in access costs, leading to a reduction in the costs of interexchange

[7] MCI Statement 1.0 (Pelcovits Rebuttal) at pg. 18.
[8] Id. at pg. 17.

carriers ("IXCs"), will benefit consumers through reduced costs, proper pricing signals and encouragement of new services and innovations.

B. Above Cost Access Rates Cause Regulatory Distortions And Price Squeezes

Because switched access charges are a very significant input into the costs of providing long distance service, and because prices in a fully competitive market such as the long-distance market are reflective of costs, above-cost switched access charges push long distance charges above their true social costs. This market distortion results in end user customers either not making certain calls or using alternative technologies, such as wireless.[9] Wireless carriers, for example, pay no originating access charges for any long distance calls placed by their customers, and the terminating access charges are based on calling areas that are substantially larger than those of IXCs.[10] Inside the large calling areas that exist for wireless carriers in Pennsylvania, wireless carriers pay the much lower reciprocal compensation rates.[11] Because of the regulatory disparity between the treatment of wireline and wireless calls, consumer behavior may be artificially influenced by access-related market distortions towards using the wireless technology when they may prefer to use wireline phones.

The Commission can and should minimize the discriminatory treatment of wireline and wireless carriers by reducing intrastate switched access charges to cost. This facilitates consumers making choices among similar services based on real cost differences, rather than on regulatory distortions.

Verizon provides switched access to independent long distance carriers and also competes directly with those same carriers in the long distance market. Verizon has had and

[9] See AT&T Statement 1.0 (Nurse/Kirchberger Rebuttal) at pg. 11-13.
[10] Id. at pgs. 13-14, *See also* K-N Rebuttal Exhibit 1.
[11] Id.

continues to have both the incentive and ability to use above-cost access charges to maintain an unfair and anticompetitive advantage in the Pennsylvania long distance market.

Verizon and Verizon North do not face the same cost structure as their competitors, further accentuating the anticompetitive nature of above-cost access charges. The cost of intrastate switched access to a long distance provider such as MCI is what it pays to Verizon or Verizon North for switched access – the tariffed switched access charges. There is no dispute in this proceeding that those charges exceed Verizon and Verizon North's costs of providing switched access services. When Verizon or Verizon North provide long distance service to its own local customer, instead of incurring the tariffed rate, it incurs the actual cost of providing the access service.[12] Therefore, when Verizon or Verizon North provide long distance service to its local customer, it incurs its actual marginal cost of providing the access service, as compared to the much higher tariffed rate of access charges incurred by its competitors. As Dr. Pelcovits testified, "for Verizon, the tariffed rates are just an internal transfer from one pocket of the corporation to another. Verizon can and will ignore the tariff rates and set prices in the long distance market that squeeze out competitors and increase its own profits."[13]

Under these circumstances, it is easy to see how an ILEC can set prices that create a price squeeze that forces competitors out of the market. A price squeeze exists if the incumbent is able to charge its retail customers a toll price that is less than the cost of providing long distance service combined with the tariffed access rate that Verizon charges to competitors. In this scenario, because Verizon's costs are below that of the IXC, the IXC cannot reasonably compete.

[12] Verizon claims that imputation cures this problem, however, Verizon is wrong. This is merely a fictional transfer of funds from one Verizon company to the other, to the overall benefit of the entire corporation. In the majority of cases, IXCs do not have this same advantage as the costs to the IXC are *real* costs that cannot be made up by another division of the corporation. Verizon's counsel even acknowledged that when a company "pays itself" access charges, it is simply a wash. *See* Transcript at pg. 351.

[13] MCI Statement 1.0 (Pelcovits Rebuttal) at pg. 19.

As an example, suppose the cost of providing long distance service is 2¢/minute for both Verizon and IXCs. Suppose further that the actual cost of providing access is 1¢/minute, but the tariffed rate for access is 3¢/minute. In this scenario, the total cost to Verizon would be 3¢/minute whereas the total cost to an IXC would be 5¢/minute. Thus, Verizon could charge 4.5¢/minute and still make a profit whereas the IXC would lose money if it charged that same rate.[14] The bottom line is that above-cost switched access charges provide the LEC with a significant, artificial advantage which will allow it to take customers away from equally, or more efficient, long distance carriers without having to sacrifice profits.

Dr. Pelcovits points out in his testimony that one can find indirect evidence of a price squeeze by looking at the average revenues derived from access charges to IXCs versus the average revenues derived from access charges to Verizon's affiliated long distance company. As the information contained in Dr. Pelcovits' testimony shows, the average revenue per minute derived from intrastate switched access charges to IXCs exceeds the average revenue per minute derived from access payments by Verizon's affiliate to Verizon. Moreover, while the average revenue per minute derived from IXCs has been increasing from 2001 to 2003, the average revenue per minute derived from Verizon's affiliate has actually been declining in the same time period.[15] This proceeding provides the Commission with an opportunity to eliminate this opportunity for a price squeeze by reducing access charges to cost.

C. Above Cost Access Rates Give Verizon And Verizon North An Unfair Competitive Advantage

As noted above, above cost access rates permit Verizon and Verizon North to engage in a price squeeze, which is a competitive advantage over long distance carriers. In addition, above cost access rates give the incumbents a competitive advantage in the local market.

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[14] Id. at pg. 20.

Above cost access charges pose great danger to competition in the telecommunication industry because of the changes in local telecommunications markets over the past several years. The reason is that the greatest competition in the local telephone market for residential and business customers is coming from the existing, large long distance carriers. To the extent that the incumbents can irreparably damage the long distance carriers before they are able to gain a meaningful foothold in local markets, the incumbents will be able to continue perpetuating their monopoly.

The concern regarding incumbents' advantages are especially inherent in the new world of bundled products. Bundled services have become increasingly popular in the residential telephone markets. Bundling of different packages of services emphasizes the necessity of ensuring that ILECs and CLECs/IXCs face similar cost structures. The cost structure faced by the ILECs is a result of the structure of prices that they pay to their suppliers for inputs into their services. The cost structure faced by the CLECs/IXCs is the result of the rate structure for UNEs and switched access services approved by this Commission. If there is a mismatch in these two cost structures, the ability of competitive service providers to effectively compete may be impaired relative to the incumbent.

A primary example of this mismatch in cost structures that creates a competitive advantage to the ILEC is in the per-minute switching rates. Because of the way switches are designed today, the likelihood of a switch exhausting due to usage is extremely low. As Dr. Pelcovits testified:

> In recent years, the prices charged by switch manufacturers for end office switches has moved from a usage sensitive structure to one driven by the number of lines served by the switch. This price structure follows naturally from the rapidly increasing processing power and rapidly declining cost of the computer chips that perform call processing within

[15] Id. at pg. 22, Table 4.

> the local exchange switch. Switches now are built to be capable of handling the calling needs of all the lines that might potentially be connected, and are said to be line-limited, rather than processor-limited.[16]

In other words, the ILECs' switching costs do not increase as usage by customers increases.[17] On the other hand, because CLECs and IXCs have to pay Verizon on a per-minute basis, their costs do increase based on usage. Thus, when the two different providers offer flat rated services, this competitive advantage of Verizon (who essentially has a flat rated cost structure – the initial cost of the switch) is stark. Verizon does not pay a per-minute cost whereas CLECs do. This competitive disadvantage can only be remedied if the rates for switched access and unbundled local switching are more closely aligned with both the cost structure and the cost level that ILECs actually face.

IV. MARKET FORCES WILL NOT CAUSE ACCESS CHARGES TO BE REDUCED TO COST

Verizon has stated that market based forces are sufficient to bring access charges to the appropriate levels, and that the Commission should allow competition to drive the access rates down.[18] The evidence is clear that competition will most certainly ***not*** drive access rates to cost.

The evidence shows that Verizon and Verizon North have not reduced access rates a single time due to market conditions. In response to questioning by AT&T counsel, Verizon's witnesses admitted that they were not aware of a single instance where Verizon or Verizon North has reduced access rates as a result of market conditions and competition.[19] To the contrary, all reductions have come only when this Commission has ordered such reductions.

Verizon claims that increased competition from unbundled network elements will lead to lower access rates. However, in the past several years when such local competition has

[16] Id. at pg. 30.
[17] See Transcript at pgs. 121-122.
[18] See Surrebuttal Testimony of William E. Taylor at pg. 29.

increased, there have been no reductions to access rates other than those ordered in 1999 in this Commission's Global Order.[20] Thus, at the same time the competitive forces were growing, those competitive market forces did absolutely nothing to drive the behavior of the ILECs to reduce access rates.

The reason for the lack of market pressure on access rates is due to the nature of the market. When a customer originates a long distance telephone call, the long distance carrier has no option but to pay originating access to the local carrier of that customer's choice. The end user customer will not be a constraint on the originating carrier's access rates because the customer does not pay the rates and therefore has no direct incentive to pressure the local carrier to lower its rates. Even if the long distance carrier could somehow incent the customer to use a different local carrier with lower switched access rates, the customer may not have a choice among acceptable local carriers in Pennsylvania. Regardless, once the customer chooses a local carrier, the IXC is bound by that choice and there is no competitive pressure to drive down those rates.

The IXC's hands are tied even more tightly on the terminating end of this call. On the originating end, the only hope the IXC has in reducing its access costs is to win over the customer's local service. However, that cannot happen on the terminating side as the IXC has no control over who the originating customer calls. Currently, although some competition has started to develop, Verizon continues to have the majority of residential local customers.[21] The situation is even less competitive in Verizon North's territory, where local competition is

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[19] Transcript at pgs. 64-65.

[20] See Transcript at pg. 347-349 regarding the fact that MCI has potentially several hundred thousand local customers in Pennsylvania, and according to the FCC report, there were approximately 1.5 million lines served by competitive carriers. While MCI does not necessarily agree with these numbers, Verizon has presented them to show the extent of local competition in Pennsylvania. Assuming they were true and so much competition exists, one would expect under Verizon's theory that access rates should have been reduced as a result of these market conditions. That has not happened.

minimal. Thus, chances are high that a customer will be terminating a call to another Verizon customer (if made within Verizon or Verizon North's territory). In this case, in order to complete the call, and provide long distance service to its customer, the IXC has no choice but to purchase terminating switched access from Verizon. Quite simply, only one loop goes to the called party's house: the IXC has no choice but to buy terminating access from Verizon, because there is no competing carrier with a loop to the called party's house. Thus, the marketplace does not and cannot constrain Verizon on terminating access rates.[22]

Verizon's own cross examination of AT&T and MCI proves this point. Specifically, Verizon introduced MCI's own access rates in Pennsylvania, showing that they are higher than the rates charged by Verizon Pennsylvania.[23] As Dr. Pelcovits testified, because of the nature of the market, competitors do not have an incentive to reduce their access rates below Verizon's.[24] As he stated, "unless regulation forces switched access rates down to TELRIC costs, they're not going to end up there. There is no marketplace pressure that causes them to end up there, because, essentially, once a carrier is the local provider to a customer, that carrier is not disciplined as far as its switched access rates to the long distance carriers. And that applies whether it's a CLEC or an ILEC."[25] However, unlike the ILECs, CLECs do not have nearly the market power of the ILECs to cause competitive harm. As Dr. Pelcovits further testified, "the fact that a CLEC has above-cost access charges I do not believe causes significant competitive problems in the long distance market and is unlikely to cause those type of problems, as opposed to the case of Verizon where I believe there are competitive problems caused by the fact that the

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[21] Transcript at pg. 350.
[22] It should further be noted that even though a CLEC providing local service via UNE-P gets the access revenue at this time, Verizon is arguing that CLECs providing service via UNE-P should not receive access revenues. *See* Transcript at pgs. 218-219. Thus, Verizon is actively attempting to eliminate the exact competition Verizon cites as a basis for leaving access rates to market forces.
[23] Transcript at pgs. 353-357.
[24] Id. at 355-356.

dominant local exchange carrier is charging rates to long distance carriers that are far above cost."[26]

The evidence is clear that market or competitive forces will not serve to reduce access rates in Pennsylvania. Thus, to assist the desired competitive marketplace, this Commission must step in and reduce those rates to cost based levels.

V. ACCESS RATES SHOULD BE SET AT TELRIC LEVELS, PLUS JOINT AND COMMON COSTS

As stated previously, there is no dispute that Verizon and Verizon North's access rates are substantially above cost. Even using Verizon's definition of "cost," Verizon and Verizon North's access rates are nearly $130 million above cost, or nearly 65% above cost.[27] There is surely significant progress that can and should be made to reduce these rates closer to the cost – regardless of how that term is defined.

There are two different types of services that are identical to switched access that can be evaluated for a determination of the proper rate of access charges. Those services are unbundled switching and reciprocal compensation. From a network perspective, the termination of local calls and long distance calls is identical.[28] Thus, there is no valid reason for rates to be different for the exact same services.

Pricing for unbundled network elements are supposed to be set at the Total Element Long Run Incremental Cost or TELRIC of providing each element. TELRIC is fully compensatory of Verizon's forward-looking costs. A comparison of Verizon's intrastate switched access rates to Verizon's rates for the corresponding unbundled network elements demonstrates that Verizon's

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[25] Id. at 356-357.
[26] Id. at 361-362.
[27] Id. at 113-114. *See also* MCI Cr. Exh. 1.
[28] Id. at 71. *See also* MCI Cr. Exh. 2. Although Verizon states in this interrogatory response that there may be "translations" differences, the witness who sponsored the interrogatory response could not identify any cost differences that would result from such translations. Tr. at pg. 126.

intrastate switched access rates currently are set substantially above cost.[29] As Dr. Pelcovits' testimony demonstrates, the access rates are anywhere from 123.6% to an astonishing 1500.00% higher than the current UNE rates.[30] Per minute switching access rates are over 540% higher than unbundled switching rates.[31] Clearly, these access rates need to be reduced to more reasonable levels.

The Carrier Charge should also be immediately eliminated. There is not any cost basis at all for that charge. Terminating or originating a long distance call does not result in any additional incremental cost associated with the loop.[32] Amazingly enough, this is a point on which Verizon and MCI are in complete agreement. In fact, Verizon's economic witness, Dr. Taylor, spends the majority of his Surrebuttal Testimony arguing that access charges should not be used to recover a portion of the local loop. The costs of the loop should not be recovered from IXCs, but should be fully recovered from the cost causer – the end user. As Dr. Taylor testified:

> It is contrary to sound economic principles and an incorrect approach to cost recovery to believe the premise that the loop is a shared cost of telecommunications services that use the loop and must, as a result, be allocated among different services. Unfortunately, any public policy about cost recovery and pricing for regulated services that is based on that premise can only promote economic inefficiency, lead to a wasteful use of society's scarce resources, and distort consumption and production incentives.[33]

[29] It is MCI's position that the current UNE rates are in fact not set at proper TELRIC levels, but are in excess of the correct TELRIC standard. Thus, truly established TELRIC rates for unbundled switching and transport would be even lower, causing the disparity between unbundled rates and access rates to be even greater.
[30] MCI Statement 1.0 (Pelcovits Rebuttal) at pg. 37.
[31] Id.
[32] Id. at pg. 38.
[33] Surrebuttal Testimony of William E. Taylor at pg. 6.

One of Verizon's original proposals included a provision to eliminate the carrier charge.[34] That provision is consistent with MCI's position that access charges should be reflective of cost. Because there is no cost associated with the carrier charge, it should immediately be eliminated.

The carrier charge of Verizon is currently $.63/line/month. The carrier charge of Verizon North is currently a whopping $8.64/line/month.[35] The Verizon/OCA proposal introduced in Verizon's Surrebuttal Testimony does not decrease Verizon Pennsylvania's carrier charge at all. Although it does significantly reduce the carrier charge for Verizon North, that comes at the cost of increasing the per minute switching rate, which is in the exact opposite direction that such rate should go.

The carrier charge exists solely to provide a contribution to the cost of the loop. Given that Verizon itself admits that access rates should not be used to provide a contribution to the loop, the Verizon/OCA proposal must not be adopted as proposed. This Commission should immediately eliminate the carrier charge as it is not reflective of cost and it sends the incorrect economic signals. Continuation of the carrier charge is counter-productive to the desired result of competition in the telecom market.

VI. LOCAL RATES DO NOT HAVE TO INCREASE AS A RESULT OF REDUCED ACCESS RATES

Verizon argues that if the Commission implements any access reductions in this case, Verizon must be permitted to raise rates elsewhere to make up for the reductions. This position reflects a backward-looking view of the regulatory world and market. On the one hand, when it benefits Verizon, Verizon touts the existence of local competition and the competitive environment in Pennsylvania. On the other hand, when it benefits Verizon, it argues for policies

[34] Direct Testimony of Berry/Wirl at pg. 15, *See also* Exhibit MJW-4.
[35] See DMB Exhibit 1.

that are reflective of the monopoly, rate-of-return environment where the regulator protected the incumbent's monopoly profits.

First and foremost, it is important to note that Verizon does not prove that access rates are critical to ensuring that Verizon covers its costs of providing basic local residential service.[36] There are in fact many sources of subsidies towards basic local services. Specifically, rates in urban areas tend to be higher than cost in order to make up for the higher costs of providing service in the rural areas. Rates for business services are generally above the costs of providing such services. Additionally, vertical services are marked up substantially above cost.[37] Thus, it is disingenuous to claim that above-cost access rates are in fact contributing a subsidy towards basic local service.

Second, the days of guaranteed revenues can no longer exist if this Commission wants to have a landscape that encourages competitive entry. CLECs are certainly not guaranteed revenues and are not guaranteed revenue neutral rate increases. ILECs cannot be guaranteed *revenues in a competitive environment either.*

Verizon wants some aspects of the old regulatory regime of guaranteed profits even though Verizon's position in the telecommunications market has changed dramatically. Verizon wants to be compensated if it loses revenue, but does not want to give anything if it gains revenue from new services that it has been permitted to provide. Specifically, when Verizon's access rates were last established, Verizon was not providing in-state interLATA services in Pennsylvania. Verizon has been in the in-state long distance market in Pennsylvania since

[36] Verizon's cost witnesses did not do an analysis to determine whether the retail revenues as a whole cover retail costs. *See* Tr. at 198-201.

[37] See MCI Cr. Exhibits 3 and 4 showing that the amount Verizon charges for services such as Call Waiting, Caller ID, Return Call and Three-Way Calling are often substantially above Verizon's own alleged costs of providing such services. MCI Cr. Exhibits 3 and 5 also show that a large number of customers subscribe to these services, leading to high above-cost revenues for Verizon.

2001.[38] On a national basis, Verizon has gained roughly 25% of the long distance market share in the short time that Verizon has been in the in-state interLATA market.[39] This has certainly led to increased revenue for Verizon as a whole.[40] Just as the Commission will not, and should not, force Verizon to reduce rates to accommodate for this increased revenue and make sure these increased revenues are "revenue neutral," the Commission should not be compelled to require increased rates in order to compensate Verizon for the decreased revenues caused by lower access rates.

It is important to note that MCI is not necessarily opposed to Verizon requesting permission to increase certain rates due to access reductions realized by this case. However, it is MCI's position that such increases are not in fact necessary as Verizon will be fully compensated if access rates are set at TELRIC levels. Thus, this Commission should not refuse to reduce access rates just because the Commission is not willing to increase other rates. Many of the public parties oppose access reductions because they assume that it will automatically lead to increased residential or small business rates. That is a flawed assumption that should be rejected by this Commission.

VII. CONCLUSION

There is no dispute that the intrastate switched access charges of Verizon and Verizon North are substantially in excess of cost. This is detrimental to consumers, who ultimately must pay higher rates for long distance service. Excessive access charges also distort competition between incumbents and long distance providers, who are among the best-positioned companies to enter the local market and break the long-standing bottleneck monopoly of the incumbents.

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[38] Transcript at 224.
[39] Id. at 224-225.
[40] Id. at 225.

The Commission has recognized since 1999 that access rates should be reduced. The FCC has substantially reduced access rates so that they are closer to their costs. The Commission should require Verizon and Verizon North to immediately bring their switched access rates to a level more closely approximating forward looking costs, as embodied in the unbundled switching rates set by this Commission. In addition, the Commission should immediately eliminate the carrier charge. Finally, the Commission should not refuse to reduce access rates just because Verizon may not be able to recover such reductions on a revenue neutral basis.

Respectfully submitted,

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Dated: September 18, 2003

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

CERTIFICATE OF SERVICE

I hereby certify that I have this day caused a true copy of MCI WorldCom Network Services, Inc.'s Main Brief is to be served electronically and via Federal Express, upon the parties of record in Docket No. C-20027195 in accordance with the requirements of 52 Pa. Code Sections 1.52 and 1.54.

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

AT&T COMMUNICATIONS OF PENNSYLVANIA, LLC,	:	ORIGINAL
v.	:	Docket No. C-20027195
VERIZON NORTH INC.	:	

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

EXPURGATED VERSION

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I. INTRODUCTION

Following the Commission's approval several years ago of the parent-level merger that united Verizon North Inc. and Verizon Pennsylvania Inc. ("Verizon") under common ownership, the Commission now is called upon to decide how best to implement the merger condition to set "statewide access rates" for the two companies,[1] and also to respond to a complaint by AT&T of Pennsylvania, LLC ("AT&T") seeking to reduce Verizon North's higher access rates to match the level of Verizon PA's – which are by far the lowest in the state.[2]

Verizon's December 30, 2002 filing proposed a framework to respond to these issues. This framework is virtually identical to the proposal the Commission has since approved as the basis for access rate restructuring for all of the other ILECs in Pennsylvania through the Sprint/RTCC Settlement, finding it to be in the public interest and consistent with the Commission's objectives.[3] Verizon's original filing gave the Commission a range of options for varying degrees of access reductions – all with the essential condition that any access revenue reductions must be offset through basic end-user rate increases, as would be the case with any Chapter 30 rate rebalancing and as required under the plan approved for the other ILECs in the Sprint/RTCC settlement.

During the course of litigation, Verizon and the Office of Consumer Advocate ("OCA") agreed upon a specific plan for implementing access charge reductions for Verizon that fall in the middle of the range of options presented under Verizon's framework. Verizon and OCA

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1 *Joint Application of Bell Atlantic Corporation and GTE Corporation for Approval of Agreement and Plan of Merger*, Docket Nos. A-310200F0002; A-310222F0002; A-310291F0003; A-311350F0002, 1999 Pa. PUC LEXIS 86 (Opinion and Order entered November 4, 1999) ("*Merger Approval Order*").

2 The Commission consolidated AT&T's complaint with Verizon's merger filing. *See Access Charge Investigation per Global Order of September 30, 1999*, Docket Nos. M-00021596, etc., (Order entered May 5, 2003).

3 *Access Charge Investigation per Global Order of September 30, 1999*, Docket Nos. M-00021596 (Opinion and Order entered July 15, 2003) ("*Sprint/RTCC Settlement Approval Order*").

have jointly asked the Commission to adopt their proposal as the resolution of this proceeding. The OCA/Verizon Joint Proposal would adopt uniform access rates and rate structure for the two Verizon companies and would reduce Verizon North's carrier charge of $8.64 per line per month to equal Verizon PA's current carrier charge of $0.63. While the revenue that inter-exchange carriers ("IXCs") pay to Verizon North through access rates would decrease significantly, the impact of the revenue neutral offset to end users is minimized by spreading the recovery over the end-user lines of both companies so that the increase to basic residential local rates would be less than $1 per month per residential line, and the increase to weighted average business rates would also be less than $1.

If implemented, the OCA/Verizon Joint Proposal would leave the two Verizon companies with the lowest carrier charge in the state.[4] It would also result in a residential rate increase less than half the size of the average increase contemplated under the RTCC/Sprint Settlement,[5] and would still leave Verizon's weighted average residential rates lower than the RTCC average and several dollars lower than the $18 level to which some of the other large ILECs are raising their rates.[6] It is a reasonable compromise that is in the public interest.

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[4] Under the Verizon/OCA proposal, both Verizon companies would end up with an IXC carrier charge of $0.63. The lowest carrier charge planned after implementation of the Sprint/RTCC Settlement is $1.22. Tr. 399.

[5] The average increase to weighted average R-1 rates under the proposed implementation of the Sprint/RTCC settlement is **[BEGIN RTCC PROPRIETARY]** **[END RTCC PROPRIETARY]** The largest increase is **[BEGIN RTCC PROPRIETARY]** **[END RTCC PROPRIETARY]** (done in two steps). *See* DMB Exhibit 2 to VZ St. 1.1.

[6] Verizon North's current weighted average R-1 rate is $12.55, while Verizon PA's is $13.33. VZ St. 1.1 (Berry/Wirl Surrebuttal) at 8, n. 6. These averages would increase by less than $1 under the OCA/Verizon proposal. By contrast, the average R-1 rate for the other Pennsylvania ILECs after implementation of the Sprint/RTCC Settlement is projected to be $14.58, with two companies raising their average to $18 and several companies hitting $16 or $17. Exhibit DMB 2 to VZ St. 1.1.

By contrast, the other parties to this proceeding take extreme litigation positions, none of which this Commission should adopt.[7] The OCA, Office of Small Business Advocate ("OSBA") and Office of Trial Staff ("OTS") (the "public advocates") would have this Commission limit its own options for access reform by urging it to take a broad interpretation of the antiquated regulatory concept that the loop is a "joint cost," and to allocate substantial portions of that loop cost to IXCs through access charges. They thus see no need to shift revenue from access charges to basic rates at all. Instead they conclude that the Commission has already reduced Verizon PA's access rates too far, so that IXCs are not paying their proper share of loop costs, and that access rates should be raised to a point that would achieve uniform rates between the two companies with no revenue reduction (resulting in at least a $1.20 carrier charge for each company). The public advocates' extreme litigation position is contrary to this Commission's recent precedent in access pricing and inconsistent with the advocates' own positions in other cases.

First, it is evident from this Commission's recent precedent repeatedly removing implicit subsidies from access rates that the Commission has not been applying the advocates' outdated interpretation of the "loop as joint cost" theory (with substantial allocations to the IXCs) for some time now. Indeed, the Commission relied in the *Global Order* upon ALJ Schnierle's 1998 access recommendation, central to which was his view that the interpretation of the "loop as a joint cost" theory the advocates have raised again here is "doomed to failure" in a competitive environment.[8] Second, the Commission should not condone the advocates' selective arguments

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[7] As noted above, notwithstanding its extreme litigation position, the OCA supports the reasonable compromise proposal of reducing Verizon North's access rates to match Verizon PA's, with offsetting residential rate increases of less than $1.

[8] *Generic Investigation of Intrastate Access Charge Reform*, Docket No. I-00960066 (Recommended Decision, June 30, 1998) ("*1998 Access Recommended Decision*"). *See also Joint Petition of Nextlink Pennsylvania, Inc.*, No. P-00991648-1649 (Opinion and Order entered September 30, 1999) ("*Global*

on this issue. While all the advocates were active supporters of the Sprint/RTCC Settlement, the other ILECs' implementation plans would also appear to fail the exacting standards that the advocates now attempt to apply to Verizon alone. Indeed, ass demonstrated by Verizon Cross Examination Exhibit 10, in testimony filed in a prior case the OSBA has taken the precise opposite position on the "loop as a joint cost" theory.

The Commission should also reject the other extreme presented by the IXCs -- AT&T, MCI and Qwest. Rather than asking for a reasonable amount of revenue to be shifted from access to local rates, these IXCs demand access rates as near to zero as possible – what the OTS characterized as an attempt to get "unlimited free use of the local loop." Not satisfied with the prospect of saving millions of dollars under the OCA/Verizon Joint Proposal, the IXCs argue that rates should immediately mirror interstate rates or should be set based on the hypothetical "TELRIC" methodology required by federal law for leasing network elements to provide local service – both of which would result in rates below Verizon's intrastate costs of providing access. They claim that leaving any "subsidy" in access rates will impede toll competition and drive the IXCs out of business. The record has revealed significant flaws in the IXCs' arguments.

First, toll competition is flourishing under the current access rates. This Commission has already rejected the "price squeeze" argument and held that the toll market is competitive and that "IXCs are setting their rates on a national level using flat rates that have no relationship with the access rates of any specific ILEC," so that access reductions are not necessary to spur toll competition.[9] Indeed, AT&T passes through to its end users the costs it incurs in Pennsylvania

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Order") at 27 ("ALJ Schnierle's Recommended Decision . . . reaches various conclusions regarding the necessity of access reform in a competitive environment and we incorporate those conclusions in that regard in this Order by reference.")

9 *Implementation of the Telecommunications Act of 1996: Imputation Requirements for the Delivery of*

for intrastate access in the form of an "In-State Connection Fee" of $1.95 per line per month, so it obviously need not account for those costs in the prices of its products.

Second, the FCC, which the IXCs urge this Commission to follow, has refused to price interstate access based on cost (TELRIC or otherwise) and instead has repeatedly stated its intention to rely on "market forces" to reach the appropriate rates. Moreover, the IXCs themselves do not price access based on the standards they ask this Commission to impose on Verizon. For example, Qwest, which operates as an ILEC in a number of other states, admits that it has not reduced its own intrastate access rates to mirror interstate rates, the unprecedented step it demands the Commission require of Verizon here. Moreover, AT&T and MCI, both of which provide local service in Pennsylvania, admit that their own intrastate access rates in Pennsylvania are equal to or much higher than Verizon PA's current rates, showing that when it comes to running their own businesses they do not believe that cost-based pricing or interstate mirroring is the proper standard.

Third, but perhaps most important, the IXCs have not shown that access reductions beyond what the OCA and Verizon have proposed are necessary to benefit consumers. Notably, AT&T's witnesses discussed how AT&T prices its long distance products based on the market and refused to commit AT&T to reducing the $1.95 In-State Connection Fee (ostensibly established to recoup intrastate access costs) even if the Commission reduces Verizon's access rates and even after the other ILECs implement the approved settlement to reduce their access rates. This only proves what this Commission has already found -- that the competitive toll market, not the level of intrastate access rates, drives IXC pricing decisions.

IntraLATA Services by Local Exchange Carriers, No. M-00960799 (Opinion and Order entered January 29, 2002) at 14.

All of these facts demonstrate that it is not necessary to slash intrastate access rates in Pennsylvania to the rock-bottom rates these IXCs demand. This Commission has never held that access should be priced at cost, thereby absolving IXCs of ***any*** contribution to the costs of providing local service. While the Commission may want to take a step now to reduce their contribution, and bring both access rates and basic service rates closer to their cost, this Commission must determine where to draw the line to best serve the public interest, including protection of universal service and avoiding rate shock to consumers.

In sum, the answer for the Commission lies between these two extremes, and the OCA/Verizon Joint Proposal provides a reasonable mid-point by providing a significant savings of tens of millions of dollars for the IXCs in Verizon North territory while limiting basic residential rate increases to less than $1.00. The proposal is supported by the record and achieves the Commission's goals of statewide access rates, a lower carrier charge for Verizon North, and replacement of implicit subsidies with explicit charges to end users. As the Commission noted with respect to the RTCC/Sprint Settlement, it is not necessary to "declare the access rates established [here] as the final word on access reform," but rather they can be a "next step" in examining the access issue in "an efficient and productive manner."[10] Accordingly, the Commission should adopt the OCA/Verizon Joint Proposal as the resolution of this proceeding.

II. STATEMENT OF THE CASE

A. Access Pricing Background

This proceeding relates to the switched access rates that IXCs pay to local exchange carriers Verizon PA and Verizon North for originating and terminating intrastate long distance traffic on the facilities of these Verizon companies. After the break-up of AT&T, access charges developed as a

[10] *Sprint/RTCC Settlement Approval Order* at 12.

means for the IXCs to pay for the use of local facilities through "originating access" payments to the local telephone company serving the customer placing the long distance call and "terminating access" payments to the local telephone company serving the customer receiving the call (which may or may not be the same local telephone company). The IXCs pay "interstate" access rates where the calls in question cross state lines. Those rates are exclusively within the jurisdiction of the Federal Communications Commission ("FCC") and are not at issue here. The IXCs pay "intrastate" access rates where the calls remain within the state, but are not local calls but rather intrastate toll calls. Intrastate access rates are governed by this Commission and are the rates that are the subject of this proceeding.[11]

Historically in Pennsylvania and throughout the nation, the pricing of access has not been tied to the cost of providing this service. Regulators used a practice known as "residual pricing" to apply rate increases first to services like toll and access and only as a last resort – or "residually" – for basic local services, resulting in artificially low basic service rates. As this Commission recognized in the *Global Order,*

> [a]ccess charges provide a significant source of ILEC earnings and contain implicit and explicit subsidies for local rates. This combination of earnings and subsidy was approved pursuant to a public policy of encouraging universally available and relatively affordable telecommunications services . . . . Access charges provide a source of earnings while keeping basic local service rates lower than might otherwise be the case in high cost areas.[12]

The Commission further noted that the "combined subsidies" from access rates and other services "is what have helped keep basic local exchange service rates in Pennsylvania at an affordable level over the years."[13]

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[11] VZ St. 1.0 (Berry/Wirl Direct) at 4-5.

[12] *Global Order* at 11.

[13] *Global Order* at 13, n. 9; *see also Global Order* at 15, n. 10 ("residual pricing is a tariff pricing mechanism used by utility regulators in the monopoly environment in which access and toll rates, as well as vertical local services, are priced at rates well above their costs, but at prices that the market will

In the mid-1990's both the Pennsylvania legislature and the U.S. Congress took significant steps to break with the old regulatory model and to open local and long distance telephone markets to competition. In particular, in 1993 Pennsylvania passed the Chapter 30 statute (66 Pa.C.S. § 3001, et seq.) and in 1996 Congress passed the Telecommunications Act of 1996 (47 U.S.C. § 151, et seq.).

With the advent of competition, both the FCC and this Commission have gradually been shifting revenue away from access charges and into explicit end-user charges. This Commission's July 15, 2003 Order approving the Sprint/RTCC Settlement discussed the FCC's reduction of interstate access charges and replacement of that revenue with federal subscriber line charges ("SLCs") that are charged directly to the end-user customers. According to this Commission, the FCC's decisions on interstate access were aimed at an "orderly transition from monopoly to a more competitive environment," ultimately relying upon a "market-based approach, in which competitive forces primarily drive access charges down to cost-based levels," which the FCC found "would serve the public interest better than regulatory-prescribed rates."[14]

Meanwhile in 1997, this Commission instituted a generic investigation to examine the costs and pricing structure of intrastate access charges, which culminated after hearings and briefings in the June 30, 1998 Recommended Decision by ALJ Schnierle. This recommendation concluded that the Commission should reduce access rates in order to reduce subsidies, and should offset those reductions on a revenue neutral basis with increases to basic local services charged directly to the end-users, concluding that "[i]f society wants to replace the monopoly regulation of local telephone

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bear, in order to keep basic local exchange telephone service rates affordable.")

[14] *Sprint/RTCC Settlement Approval Order* at 6-9. *See also In the Matter of Access Charge Reform et al*, CC Docket Nos. 96-262, 94-1, 99-249, and 96-45, Sixth Report and Order in CC Docket Nos. 96-262 and 94-1; Report and Order in CC Docket No. 99-249; and Eleventh Report and Order in CC Docket No. 96-45, rel. May 31, 2000, ("*CALLS Order*"); *Access Charge Reform*, CC Docket No. 96-262, First Report and Order, 12 FCC Rcd 15982 (rel. May 16, 1997) ("*Access Reform Order*").

service with open competition, (as it has indicated by the enactment of Chapter 30 and the Telecommunications Act of 1996), then it must be prepared to allow prices for local telephone service to be more reflective of reality."[15] According to the Recommended Decision, both the price of access and the price of basic local service must be brought closer to their costs in order for the pricing structure to make sense in a competitive environment.

The generic access investigation became part of the Global proceeding, and the Commission resolved the issues in its September 1999 *Global Order*. There, the Commission relied upon Judge Schnierle's Recommended Decision and stated that its goal with regard to access pricing was to "take the necessary steps to strive to replace the system of implicit subsidies with 'explicit and sufficient' support mechanisms to attain the goal of universal service in a competitive environment."[16] The *Global Order* also stated the Commission's intent to open a further investigation of statewide access charges, and required Verizon PA to reduce its intrastate access charges by $89 million annually.

Since the *Global Order*, this Commission has approved a number of Chapter 30 rate rebalancing filings for other ILECs in which access rates were reduced and offset with revenue-neutral increases to basic rates. The Commission has consistently allowed these rate rebalancings to bring the price of access closer to its "cost," while increasing basic local service rates closer to their cost. Thus, the residential rate increases have ranged from $1.03 to $3.77.[17] As the Commission noted in its November 2001 order approving North Pittsburgh's Chapter 30 rate rebalancing plan,

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[15] *1998 Access Recommended Decision* at 58.

[16] *Global Order* at 26-27. While even before the *Global Order*, market forces and Commission orders had decreased Verizon PA's access rates, in compliance with the *Global Order* Verizon PA made approximately $89 million in annual access revenue reductions, which were revenue-neutral through the application of Verizon PA's Price Cap Mechanism. The rates of Verizon North were restructured to some degree in the *Global Order*. VZ St. 1.0 (Berry/Wirl Direct) at 6.

[17] VZ St. 1.1 (Berry/Wirl Surrebuttal) at 10.

consisting of access reductions offset by basic rate increases, "the new competitive market requires telecommunications providers to move their rates closer to the cost of providing service. The instant filing begins the process of eliminating the subsidization of local exchange rates that has been provided by inflated access rates."[18]

The Commission's most recent statement of its policy regarding access pricing was its July 15, 2003 Order approving the Sprint/RTCC settlement that provided the framework for access reductions, offset by revenue-neutral basic rate increases, for all of the non-Verizon ILECs in Pennsylvania.[19] The Verizon proposal at issue in this case was modeled upon and is virtually identical to that approved settlement. The text of the two documents was essentially the same, although of course the resulting rates would be different, as they also varied greatly among the RTCC companies themselves. The RTCC Settlement was endorsed by the public advocates – OCA OSBA and OTS – each of which filed statements in support of the proposal, and was not opposed by the IXCs. The Commission approved the proposal as a reasonable "next step" regarding access pricing, finding that:

> At this juncture, the Commission is persuaded that the proposed access charge reductions are in the public's interest and in accordance with the Commission's objective to reduce implicit subsidy charges such as access charges that impede competition in the telecommunications market. As implicit charges become explicit charges, competitors are better able to compete for local and long distance customers in an ILEC's service territory because IXCs are not hindered by paying ILECs excessive access charges in providing competitive toll services and CLECs are better able to compete with ILEC local service rates that have been kept artificially low as a result of the access charge subsidies. Thus, although our approval of the Joint Proposal will allow the rural ILECs and Sprint/United to raise their local residential monthly service rates up to a cap of $18.00 per month, ($2.00 more than the current $16.00 cap), this increase is incremental so as to avoid customer rate shock, and, at

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[18] *PUC v. North Pittsburgh Telephone Company*, R-00016681 (Opinion and Order entered November 30, 2002) at 7.

[19] The parties to the settlement were the Rural Telephone Company Coalition ("RTCC"), United Telephone Company of Pennsylvania, d/b/a Sprint ("Sprint"), the Office of Consumer Advocate ("OCA"), the Office of Small Business Advocate ("OSBA") and the Office of Trial Staff ("OTS").

the same time, encourages the IXCs, CLECs and wireless telecommunications carriers to compete on a more level playing field with the ILECs.[20]

The Commission is now called upon in this case to determine the appropriate "next step" with regard to access pricing for the Verizon companies.

B. Verizon's Access Rate Rebalancing Filing

On December 30, 2002 Verizon filed a petition to open this proceeding to adopt statewide access rates for Verizon PA and Verizon North. Verizon's petition fulfilled its commitment under the Commission's November 4, 1999 Order approving the Bell Atlantic/GTE merger. In that order this Commission approved the merger by which control of the ILEC formerly known as GTE North, Inc. (now Verizon North) passed to Bell Atlantic Corporation, the parent of the ILEC formerly known as Bell Atlantic-Pennsylvania, Inc. (now Verizon PA). Merger approval was contingent upon certain conditions, including those originally set forth in a Memorandum of Understanding ("MOU") with Pennsylvania's Attorney General. One of the MOU conditions was that "[w]ithin thirty months after merger closing, GTE-North and BA-PA will commence a proceeding for the purpose of determining statewide rates for access charges based upon consolidated cost studies." The MOU cautioned that "[n]othing in this agreement shall prohibit BA-PA and GTE-North from arguing in this combined access rate proceeding that that any additional reductions which the PUC orders as a result of this new proceeding should be implemented ***on a revenue neutral basis***." MOU at paragraph 4 (emphasis added). The Commission's *Merger Order* similarly referred to revenue neutrality, and noted the "substantial impact a proceeding based on consolidated cost studies may have on the ratepayers for BA-PA and GTE North."[21]

The merger closed on June 30, 2000. Therefore, Verizon was required to "commence a proceeding" to determine statewide access rates by December 31, 2002. Verizon did so by the

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[20] *Sprint/RTCC Settlement Approval Order* at 10.

[21] *Merger Order* at 36 (emphasis added).

filing of this proposal. Additionally, earlier in 2002, on March 20, AT&T filed a formal Complaint against Verizon North, demanding that Verizon North's access charges be reduced to a level "no higher" than Verizon PA's due to the fact that they were now owned by the same company. The Verizon filing is also responsive to the claims made in that Complaint.

Verizon's filing, like the RTCC Settlement recently approved by the Commission, provided a flexible framework for access reductions, with the magnitude of the reduction driving the size of the necessary off-setting basic rate increase. Verizon presented data on the revenue impact of various options allowable under the framework, and provided two examples of phased-in increases to weighted average basic residential rates that would be needed to offset, in a revenue neutral manner, reductions in access charges.

Currently, the Verizon companies' access rates, like the other ILECs in Pennsylvania, fall into two major categories: traffic sensitive (TS) charges, which are largely usage based, for switching and transport (the components of access service) and a carrier charge (CC), a flat rate charged per line, per month to the IXCs. Verizon's current traffic sensitive and carrier charges are depicted on Exhibit MJW-1 to Verizon St. 1.0. Additionally, Exhibit DMB 1 to Verizon Statement 1.1 depicts the current composite per minute charge for all of Verizon's traffic sensitive rates, which is **[BEGIN VERIZON PROPRIETARY]**

[END VERIZON PROPRIETARY] The same exhibits depicts the composite per-minute rate when both the traffic sensitive and carrier charge are taken into account, which is **[BEGIN VERIZON PROPRIETARY]** **[END VERIZON PROPRIETARY]** The IXC portion of Verizon PA's carrier charge is currently $0.63, by far the lowest carrier charge in the state. Verizon North's carrier charge is $8.64.[22]

[22] This is the total carrier charge, including the portion imputed to Verizon North and the portion charged to the other ILECs through ITORP. The comparable composite charge for Verizon PA is $0.88. See VZ PA PUC No. 302 (Access Services Tariff) Sec. 6, Sheet 247.

The first step of Verizon's filing allows the two Verizon companies to align their access rate structures without reducing the overall revenues from access. This proposed rate restructure was based predominantly on Verizon PA's current intrastate rate structure, which is much more similar to the interstate access charge structure than Verizon North's current rates. Verizon North has not yet implemented the local transport restructure that Verizon PA introduced several years ago, and this alignment will allow it to do so. Also, Verizon proposed to include for both companies aspects of the recent interstate access reform (four new trunk port charges) that are not yet reflected in Verizon PA's intrastate rate structure. No party objected to the rate alignment and introduction of new port rate elements, so long as the addition of the new port elements was kept revenue neutral within the traffic sensitive rates by subtracting the revenue to be gained from the new elements from another traffic sensitive charge. This restructure is depicted on Exhibit MJW-2 to Verizon Statement 1.0 and would leave the two companies with identical rate elements at identical prices. Verizon calculated the individual rates, weighted based on each company's demand, if there were to be no access revenue reduction. The result was a carrier charge of $1.20 for both companies (reducing Verizon North's but increasing Verizon PA's). The carrier charge would be $1.44 if the addition of the trunk port elements is kept revenue neutral within traffic sensitive rates.[23]

Verizon's filing also provided the flexibility to take the next step and reduce the melded access rates, as long as any reductions are offset by revenue neutral increases to basic rates. For example, the carrier charge could be reduced so that both companies charge the $0.63 currently

[23] Verizon's original calculations subtracted the approximately $17 million in new revenue that would be gained from the addition of the new trunk port rate elements from the carrier charge rather than from traffic sensitive rates, as AT&T has now stated it would prefer. AT&T St. 1.0 (Kirchberger/Nurse Rebuttal) at 27 ("Since the restructuring that Verizon is proposing here will add new traffic sensitive rates, the appropriate place for any such 'offsets' would be in Verizon's existing traffic sensitive rates"). If the Commission were to require revenue-neutrality within traffic sensitive rates, but leave a melded carrier charge with no access revenue reduction, the melded carrier charge would be $1.44, not $1.20. *See* Exhibit DMB 1 to VZ St. 1.1. The OCA/Verizon Joint Proposal, discussed below, does make the trunk port additions revenue neutral within traffic sensitive rates.

applicable to Verizon PA, or the carrier charge could be eliminated altogether. The basic components of the proposal and these two examples were depicted in Exhibits MJW-1 through MJW-4 to Verizon Statement 1.0.

C. The OCA/Verizon Joint Settlement Proposal

During the course of litigation, Verizon and OCA developed a specific proposal for implementation of Verizon's framework, the terms of which were described in Exhibit DMB-1 to Verizon's Statement 1.1. This Joint Proposal is 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 permissible under Verizon's filing. The Joint Proposal by Verizon and OCA provides that, after the initial melding of rates, Verizon's overall average traffic sensitive rates would not be reduced (except that the revenue gained from the addition of the new switch port elements would be reduced from local switching so that the restructure would be revenue neutral within traffic sensitive rates). The IXC carrier charge would be reduced to the level of Verizon PA's current $0.63 -- a reduction of more than 50% from the consolidated rate and a rate about one tenth the price of Verizon North's current carrier charge. The total revenue decrease would be approximately **[BEGIN VERIZON PROPRIETARY] [END VERIZON PROPRIETARY].** The following chart taken from Exhibit DMB 1 to Verizon Statement 1.1 depicts the access rates resulting from the OCA/Verizon Joint Proposal:

*** * * BEGIN PROPRIETARY * * ***

*** * * END PROPRIETARY * * ***

Verizon and OCA agreed that any reductions would be offset by revenue-neutral basic rate increases, and the OCA/Verizon Joint Proposal specifies that no more than $40 million of the access revenue reduction will be recovered through increases to residential basic local service rates on a combined Verizon PA and Verizon North basis, and that any such increases will not exceed $1.00 per residential line. The remainder of the access reduction (that is, the amount above $40 million) would be recovered through increases to business local service rates, again on a combined Verizon PA and Verizon North basis. The increase to weighted average business rates would also be less than $1.00.[24] Verizon and OCA have agreed that no rate changes would occur before January 1, 2004.

III. ARGUMENT

A. THE COMMISSION SHOULD APPROVE VERIZON'S ACCESS FILING, AND SHOULD SELECT THE VERIZON/OCA SETTLEMENT AS THE MOST REASONABLE RESOLUTION OF THIS PROCEEDING

This Commission should adopt the OCA/Verizon Joint Proposal as the resolution of this proceeding. This proposal provides a reasonable result, amply supported by the record and consistent with this Commission's stated goals and its recent order approving the Sprint/RTCC access settlement.

1. The OCA/Verizon Joint Proposal Provides Significant Access Reductions And Savings For The IXCs

First, the OCA/Verizon Joint Proposal provides significant access reductions and savings for the IXCs, amounting to **[BEGIN VERIZON PROPRIETARY]** **[END VERIZON PROPRIETARY]** annually, which is over twice as much as the total $25 million in access reductions that will result from implementation of the RTCC/Sprint Settlement for *all* of the other

[24] Tr. 59, 135 (indicating that the necessary increase to weighted average business rates would be less than 60 cents, although of course any individual customer's rates might by more or less than the average.)

Pennsylvania ILECs taken together.[25] For Verizon North, the effective access rate per minute for one end of a call would be reduced from **[BEGIN VERIZON PROPRIETARY]**

[END VERIZON PROPRIETARY], an over 70 percent reduction. This effective per minute rate that will be applicable to both Verizon companies is about the same as AT&T's own Pennsylvania intrastate access rate and half the magnitude of MCI's Pennsylvania intrastate access rates.[26] The OCA/Verizon proposal will allow Verizon North to join Verizon PA at the forefront of access pricing in Pennsylvania.

The $0.63 carrier charge that remains will be less than half the size of the lowest carrier charge planned after implementation of the RTCC settlement ($1.22) and dramatically lower than the $5.21 average carrier charge of the other ILECs that will be left after implementation of their settlement.[27] Additionally, through the rate melding process the proposal will reduce Verizon PA's composite traffic sensitive per minute rate from **[BEGIN VERIZON PROPRIETARY]**

[END VERIZON PROPRIETARY]. Of the ILECs participating in the Sprint/RTCC settlement, 24 of the 31 will still have ***higher*** composite traffic sensitive rates than **[BEGIN VERIZON PROPRIETARY]** **[END VERIZON PROPRIETARY]** even after they implement their settlement, and all of them will have significantly higher carrier charges than Verizon.[28] Subtracting the trunk port revenue from the local switching rate element (as Verizon PA

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25 *See Sprint/RTCC Approval Order* at 10 ("the Joint Proposal mandates certain filings that in turn will assure access charge reductions of approximately $25 million.").

26 VZ Cr. Ex. 8 and 9; Tr. 358.

27 Tr. 399 (Kubas); OTS St. 1 (Kubas Direct) at 23, 25-26 (average carrier charge after implementation of Sprint/RTCC Settlement will be $5.21, lowest carrier charge will be $1.22 and Sprint's carrier charge will be $7.62).

28 *Access Charge Investigation Per Global Order of September 30, 1999,* No. P-00991648, etc., Rural Telephone Company Coalition Reply Comments, filed Feb. 18, 2003, Exhibit A.

agreed to do as part of the OCA/Verizon Joint Proposal) will reduce Verizon PA's per minute local switching rate from $0.0093 to $0.0069.[29]

It is important to recognize that Verizon PA has been ahead of the curve in implementing intrastate access reductions, so that Verizon PA's access charges are already by far the lowest in Pennsylvania, and indeed are already lower than the rates most or all of the other ILECs contemplate resulting after they implement the Sprint/RTCC Order. As Judge Schnierle noted in his 1998 Recommended Decision, Verizon PA's composite per minute access rate in 1984, when intrastate access charges were first reduced, was 7 cents per minute.[30] By 1998, Verizon PA's access charges had been reduced to 2.7 cents per minute, and Verizon PA's rates were "by far the lowest in the state, and have been trending downward for the past decade."[31] As a result of the 1999 *Global Order*, Verizon PA reduced its access charges by another $89 million, in a revenue-neutral manner through the operation of the price change opportunities of its price cap plan.[32] By 2003, Verizon PA's current composite per-minute access rate is **[BEGIN VERIZON PROPRIETARY]** **[END VERIZON PROPRIETARY]** cents per minute.[33] If the Commission adopts the Verizon/OCA proposal. Verizon PA's composite per minute intrastate access rate would be reduced to **[BEGIN VERIZON PROPRIETARY]** **[END VERIZON PROPRIETARY]** cents per minute, and Verizon North's rate would be reduced from its current **[BEGIN VERIZON PROPRIETARY]** **[END VERIZON PROPRIETARY]**[34]

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29 Tr. 67.

30 *1998 Access Recommended Decision* at 28.

31 *Id.* at 27.

32 VZ St.1.0 (Berry/Wirl Direct) at 6.

33 Exhibit DMB 1 to VZ St. 1.1.

34 *Id.*

Implementation of the OCA/Verizon Joint Proposal therefore would not only reduce Verizon PA's traffic sensitive rates, but would slash Verizon North's annual revenue from access to a fraction of what it is today, and make that company's access rates identical to those of its sister company, Verizon PA, and lower than those of every other ILEC in Pennsylvania. This result is an extremely reasonable resolution of the *Merger Order*'s requirement to set "statewide" access rates for the two companies in "parity" with each other – which the Commission emphasized could be done on a revenue neutral basis if any access revenue reductions were determined to be appropriate. It also grants the precise relief requested in the AT&T complaint.[35]

2. The OCA/Verizon Joint Proposal Requires Modest Increases To Local Rates That Will Provide A Benefit To Local Competition

Second, the OCA/Verizon Joint Proposal begins the process of bringing Verizon's basic local service rates closer to cost, without a dramatic rate increase to the consumer. The OCA/Verizon Joint Proposal limits increases to residential basic rates to less than $1.00, and the required increase to business rates is also projected to be less than $1.00 to the weighted average. The Commission approved the Sprint/RTCC settlement in part because the rate "increase is incremental so as to avoid customer rate shock."[36] The Commission found the incremental steps to be acceptable where the weighted average residential increases ranged as high as **[BEGIN RTCC PROPRIETARY]** **[END RTCC PROPRIETARY]** after the two steps, and the vast majority of the increases in the first step were more than $1.[37] Moreover, the Commission has routinely approved Chapter 30 rate rebalancing filings with weighted average residential rate increases in the range of $1 to over $3 to offset access decreases.[38]

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35 AT&T Complaint at 8 (requesting that this Commission "[r]educe Verizon North, Inc.'s carrier access charges to a level that is no higher than the rate currently charged by Verizon Pennsylvania, Inc.")

36 *Sprint/RTCC Settlement Approval Order* at 10.

37 Exhibit DMB 2 to VZ St. 1.1.

38 VZ. St. 1.1 (Berry/Wirl Surrebuttal) at 10.

As to the proposed business rate increases, they will comply with the provision in Verizon's proposal that "[e]ach ILEC may, at its sole option, increase its weighted average Business line rate by up to the same amount on a dollar basis that its weighted average R-1 rate is increased, but in no event may the B-1 rate be less than the R-1 rate."[39] This provision is identical to the provision in the Sprint/RTCC Settlement that this Commission approved, which stated "[e]ach ILEC may, at its sole option, increase its weighted average Business line rate by up to the same amount on a dollar basis that its weighted average R-1 rate is increased, but in no event may the B-1 rate be less than the R-1 rate."[40] Under that provision, all of the parties to the Sprint/RTCC settlement plan business rate increases of the same magnitude as their residential rate increases. Verizon's proposed business increase will be less than half the size of the average **[BEGIN RTCC PROPRIETARY] [END RTCC PROPRIETARY]** increase to weighted average business rates planned to implement the Sprint/RTCC Settlement and a fraction of the size of the highest business increase planned.[41]

Not only are Verizon's proposed increases modest, but, as AT&T pointed out in its testimony and as ALJ Schnierle also emphasized in his 1998 Recommended Decision, there is a benefit to local competition from raising basic service rates to better reflect costs. AT&T acknowledged that:

> the rate rebalancing proposal in Verizon's petition, if properly applied, could provide a mechanism for bringing local exchange rates in Verizon's service territory more in line with the underlying cost of that service, while at the same time eliminating the inefficiencies and anti-competitive effects of above-cost access charges. As we noted previously, the Commission in fact recognized the competitive benefits of making 'implicit charges explicit' in its Order this week approving the Sprint/RTCC access proposal."[42]

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39 VZ Ex. 1 (Access Proposal) at Elements of Proposal 2(e) and 3(e).

40 *Sprint/RTCC Approval Order*, Attachment A at 2(e) and 3(e).

41 Exhibit DMB 2 to VZ St. 1.1.

42 AT&T St. 1.0 (Kirchberger/Nurse Rebuttal) at 33-34.

Judge Schnierle similarly advised the Commission in 1998 that it is necessary to eliminate subsidies and to raise basic service rates closer to their cost in order for all customers to experience significant local competition.

> [B]efore the advent of local competition, the Commission authorized telephone companies to price access and vertical services well above cost to keep basic service rates as low as possible. . . . [T]his scheme is no longer practical because the rates of various services bear no relationship to their costs, and competitors are encouraged to enter the market for those services that are priced well in excess of costs, while ignoring those markets and services where prices [are] at or below costs. Obviously, one answer to this situation is to permit the ILECs to raise the prices of those services (primarily, residential basic phone service, and business basic service in high cost, i.e., rural areas) that, to now, have been priced below cost, and lower the price of those services (access service and vertical services) that have been priced well above costs.[43]

Since Judge Schnierle's RD was issued, this Commission itself has recognized the tie between rate rebalancing and local competition, noting that "the new competitive market requires telecommunications providers to move their rates closer to the cost of providing service," and approving North Pittsburgh's plan to lower access rates and raise basic service rates because "[t]he instant filing begins the process of eliminating the subsidization of local exchange rates that has been provided by inflated access rates."[44]

Therefore, this modest increase to take a first step to making Verizon's basic service rates more reflective of their costs is reasonable, pro-competitive and will not provide a rate shock to consumers.

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[43] 1998 Access Recommended Decision at 68.

[44] *PUC v. North Pittsburgh Telephone Company*, R-00016681 (Opinion and Order entered November 30, 2002) at 7.

3. The OCA/Verizon Joint Proposal Will Leave Verizon's Basic Residential Rates Substantially Lower Than The $18 Cap Approved In The Sprint/RTCC Settlement

Third, the OCA/Verizon Joint Proposal will still leave the Verizon companies with comparably low residential basic service rates. Verizon's weighted average residential rates, calculated under the same methodology used in the Sprint/RTCC Settlement and in the *Global Order*, are currently $12.55 for Verizon North and $13.31 for Verizon PA.[45] The proposed increase of less than $1 to its residential rates would thus result in weighted average R-1 rates for Verizon PA of less than approximately $14.31 and Verizon North of less than approximately $13.55. These rates are less than the average R-1 rate that will result from implementation of the Sprint/RTCC Settlement **[BEGIN RTCC PROPRIETARY]** **[BEGIN RTCC PROPRIETARY]** and extremely modest in comparison to the $18 rate cap the Commission approved in that order and that several of the other ILECs will approach or meet when they implement the settlement.

The Commission's reasoning in approving the RTCC/Sprint Settlement applies equally to the OCA/Verizon Joint Proposal that is before the Commission here:

> **At this juncture, the Commission is persuaded that the proposed access charge reductions are in the public's interest and in accordance with the Commission's objective to reduce implicit subsidy charges such as access charges that impede competition in the telecommunications market. As implicit charges become explicit charges, competitors are better able to compete for local and long distance customers in an ILEC's service territory because IXCs are not hindered by paying ILECs excessive access charges in providing competitive toll services and CLECs are better able to compete with ILEC local service rates that have been kept artificially low as a result of the access charge subsidies. Thus, although our approval of the Joint Proposal will allow the rural ILECs and Sprint/United to raise their local residential monthly service rates up to a cap of $18.00 per month, ($2.00 more than the current $16.00 cap), this increase is incremental so as to avoid customer rate shock, and, at the same time, encourages the IXCs, CLECs and wireless telecommunications carriers to compete on a more level playing field with the ILECs.**[46]

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[45] VZ St. 1.1 (Berry/Wirl Surrebuttal) at 8.

[46] *Sprint/RTCC Approval Order* at 10.

4. The OCA/Verizon Joint Proposal Satisfies The Requirements Of Section 1325 Of The Pennsylvania Code.

OCA's witness Mr. Dunkel raised the issue of whether Verizon's filing here complies with 66 Pa.C.S. § 1325(a), which provides that:

> (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 of local exchange service is justified based upon the cost of providing that service.
>
> * * *
>
> (c) Definitions.- As used in this section the following words and phrases shall have the meaning 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 of making calls which originate and terminate within the calling area.

Mr. Dunkel contends that since "overall average percentage increase in total intrastate revenues" is zero because this is a revenue neutral proposal, Verizon should not be permitted to raise local rates more than zero percent unless it demonstrates that the increase is "justified based upon the cost of providing that service," in other words that the rates are reasonable in light of the cost.[47]

Dr. Taylor explains that it would be reasonable to conclude that § 1325 was not intended to apply to revenue neutral rate rebalancings under Chapter 30, because this statute was enacted before alternative regulation to protect local exchange service customers from bearing a disproportionate burden of a general rate increase in the traditional rate base, rate-of-return regulatory regime.[48] Since Verizon is not proposing an "increase in total intrastate revenues authorized by the commission," and that terminology is not even relevant to a Chapter 30 company whose rate of

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47 OCA St. 1 (Dunkel Rebuttal) at 24-25.

48 VZ St. 3.0 (Taylor Surrebuttal) at 20.

return is not regulated by the Commission, it would be reasonable to conclude that § 1325 does not even apply here.[49]

Even if the statute does apply, though, Verizon's filing satisfies this statutory standard. The record shows that the weighted average rate for basic local service (total basic residential local service revenue divided by total basic residential lines) is $12.55 for Verizon North and $13.31 for Verizon PA.[50] This rate is calculated under the same method used in the Sprint/RTCC Settlement and in the *Global Order* with regard to the $16 affordability limit (now raised to $18 as a result of the Commission's approval of the Sprint/RTCC Settlement).[51] Verizon's cost study demonstrates that the average monthly cost of the loop and port (which Mr. Dunkel refers to as the dial tone line facility) is **[BEGIN VERIZON PROPRIETARY]**

[END VERIZON PROPRIETARY].[52]

Some of the other parties contend that Verizon should have used UNE rates and inputs to calculate its loop and port costs for dial tone line service. As Mr. Sanford and Ms. Dean explained, it is inappropriate to use UNE rates to estimate dial tone line costs for several reasons. First, Verizon PA's *Tentative Order* UNE rates are based on an extremely hypothetical standard of what it would cost a carrier using the most efficient technology and least cost network configuration to offer service, not what it costs Verizon to offer service. Second, UNE costs necessarily exclude retail costs, and thereby would significantly understate retail dial tone line costs, because they are attempting to reflect the cost of providing only wholesale service. Third, the Commission's *Tentative Order* in the UNE proceeding, from which the parties took their UNE rates, is not final

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49 *But see PUC v. Bell Atlantic-Pennsylvania, Inc.*, No. R-00963550 (Opinion and Order entered December 16, 1996) ("*Rate Rebalancing Order*") (finding that section 1325 applies to any rate proceeding).

50 VZ St. 1.1 (Berry/Wirl Surrebuttal) at 8.

51 VZ St. 1.0 (Berry/Wirl Direct) at 16-17.

52 VZ St. 2.0 (Dean/Sanford Direct) at 20.

and its results and inputs are still subject to change.[53] If one did use the adjusted cost figures posited by the other parties based on the *Tentative Order* UNE rates, however, the cost of the loop and port would be $23.48 for Verizon as a whole and $29.08 for Verizon North taken separately, with a few major necessary adjustments, including accounting for retail costs.[54] Even these adjusted numbers do not fully reflect Verizon's forward-looking dial tone line costs.

Regardless of which dial tone line costs one uses, Verizon's filing satisfies any statutory requirement that the proposed rates be "just and reasonable" in light of the costs. Mr. Dunkel's asserts that Verizon's proposal violates the statute because Verizon allocates 100% of the cost of the dial tone line facility (loop and port) to local service, while Mr. Dunkle and the other advocates' witnesses contend some portion of those costs should be allocated to other services such as access. While Verizon does maintain that, in principle, 100% of these costs should be allocated to local service, Verizon is not seeking a rate increase that would come anywhere close to approaching 100% of the cost of the local facilities, so this dispute is at best academic. Verizon is only seeking here to raise its residential rates by no more than $1.00 – which would result in weighted average residential rates of no more than $13.55 for Verizon North and $14.31 for Verizon PA. Under any view of the requirements of § 1325, Verizon's filing satisfies the statute.

The essence of the statutory requirement is to show that the proposed rates are "just and reasonable" in light of the "cost of providing local exchange service."[55] It is undisputable that the

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[53] VZ St. 2.1 (Dean/Sanford Surrebuttal) at 3-6

[54] *Id.* at 9. The other parties understate the cost of the dial tone line facility not only by improperly using UNE rates, but also by failing to add a factor to account for the fact that UNE rates exclude retail costs, while the cost of the dial tone line must include those costs. *Id.* at 8. Mr. Dunkel's analysis uses a loop and port cost of $18.68 based on the Commission's *Tentative Order* UNE rates. As Mr. Sanford and Ms. Dean explain, even under Mr. Dunkel's own reasoning, it is necessary to increase the UNE rates by a factor to account for the retail costs which are not included in UNE costs but must be included for dial tone line costs. The Commission's current resale discount, estimating the retail costs to be avoided, is 25.69%, so Verizon added this percentage back into the costs, arriving at the figure of $23.48. *Id.* at 9. If Verizon North's higher UNE costs are used, the corresponding final result is $29.08. *Id.*

[55] The statute does not require a finding that the rates are ***below*** the cost, and the Commission might well

first part of the direct cost of providing service is the "usage," which is "the charge of making calls which originate and terminate within the calling area." 66 Pa. C.S. § 1325(c). The parties did not challenge the cost of usage set forth in Verizon's cost study, which Mr. Dunkel used to calculate an average usage cost of **[BEGIN VERIZON PROPRIETARY] [END VERIZON PROPRIETARY]** for the two Verizon companies.[56] The dispute comes in determining what to add to the usage to represent the additional cost of the dial tone line facility (loop and port) to reach the appropriate "cost of providing local exchange service" under the statute.

The advocates contend that only a portion of the loop and port costs should be counted (allocated) to local service, though they do not agree on the percentage that should be allocated. Verizon's Dr. Taylor explained that the most logical reading of § 1325 requires no allocation at all, because the "direct cost of providing the service" must include the entire cost of the dial tone line facility since that facility is essential to being able to provide local service on a stand alone basis, while Mr. Dunkel's interpretation of the statute requires the illogical and uneconomic assumption that the direct cost of the dial tone line service excludes the cost of the dial tone line itself.[57]

Even if (for the sake of argument) some allocation were required, the OCA/Verizon Joint Proposal would satisfy the standard under a number of different allocation scenarios. Mr. Dunkel contends that only 51% of dial tone facility costs should be allocated to local service.[58] Dr. Taylor explained that "Mr. Dunkel's allocation methodology," resulting in a 51% allocation to local service that this Commission has never adopted, "suffers from serious problems."[59] Indeed, applying the

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determine that it is "just and reasonable" in some instances for rates to exceed their costs, such as to subsidize other costs and ensure universal service.

56 OCA St. 1 (Dunkel Rebuttal) at 49-50. Mr. Dunkel calls this figure the TSLRIC floor, by which he means the additional cost that would be incurred to add this service assuming the dial tone line were already existing for other purposes.

57 VZ St. 3.0 (Taylor Surrebuttal) at 18-19.

58 OCA St. 1.0 (Dunkel Rebuttal) at 54.

59 Dr. Taylor explains how Mr. Dunkel's reasoning leading to the 51% figure is contrary to economic

identical analysis Mr. Dunkel used to calculate 51% for local service to determine the percentage to be allocated to each of the other elements that he says use the dial tone line would result in something in the neighborhood of 250% of the loop costs being allocated among the various services – demonstrating the absurdity of his argument.[60]

OTS's Mr. Kubas argues that 74% of the cost of the local loop should be allocated to local service (and 10% to intrastate access), based on this Commission's Universal Service order.[61] The Commission utilized 90% for purposes of sizing a universal service fund for the smaller ILECs.[62] As demonstrated below, certainly under Verizon's cost results, but even under the other parties' improperly understated cost figures, the cost of usage plus the allocated portion of the dial tone line facilities in all instances exceeds $14.31 – which is the highest possible weighted average residential rate that would result from the OCA/Verizon Joint Proposal.

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principles because Mr. Dunkel simply adds shared and common costs to TSLRIC for a service (the additional cost that would be incurred to offer that service assuming all other services are already being offered). As Dr. Taylor explains, the more economically reasonable reading of the statute is to start with the "stand alone" cost of the service – those costs that would be incurred to offer that service if no other service were being offered. VZ St. 3.0 (Taylor Surrebuttal) at 16. Mr. Dunkel's addition of shared and common costs to TSLRIC does not provide an estimate of stand alone costs. *Id.*

60 This impossible result is apparent from Mr. Dunkel's Schedule WDA-1, which reflects how he reaches the 51%. He calculates that the standalone cost of local service is $23.06 and that the standalone cost of all the services that use the dial tone line is $45.58, and then calculates that $23.06 is 51% of $45.58 ($23.06 ÷ $45.58 = 51%). If one used the exact same methodology to calculate the percentage that should be allocated to the other services that use the dial tone line, the result would be to allocate about 250% of the cost of the dial tone line. For example, the share for interstate access would be ($20.33 ÷ $45.58 = 45%); the share for intrastate access would be ($19.60 ÷ $45.58 = 43%); the results would be similar for toll and vertical services. The legislature obviously did not intend such an absurd result when it enacted § 1325.

61 OTS St. 1 (Kubas Direct) at 6-8; Tr. 393.

62 *Formal Investigation to Examine and Establish Updated Universal Service Principles and Policies for Telecommunications Services in the Commonwealth*, No. I-00990035 (Opinion and Order entered January 28, 1997) ("*Universal Service Order*") at 85

[BEGIN VERIZON PROPRIETARY]

[END VERIZON PROPRIETARY]

Therefore, it is not necessary for the Commission to reach the issue in this case of what portion of the costs of the dial tone line facility, if any, should be allocated under § 1325, because whatever the allocation – from 100% to 51% -- the OCA/Verizon Joint Proposal is reasonable based on the cost. In fact, this Commission has approved other rate ILEC rebalancings without discussing or requiring a showing on §1325, indicating that the PUC does not see this issue as a bar to proposals like the one presented here.[63]

B. THE PROPOSED RATE REBALANCING IS A RESTRUCTURE PERMITTED UNDER THE VERIZON CHAPTER 30 PLANS

Although this proposal is made as part of Verizon's compliance with the *Merger Order*, the Verizon companies could have proposed to reduce access rates and increase basic local service rates as routine filings under the rate rebalancing provisions of their Chapter 30 Plans.

[63] *See, e.g.*, OCA Cr. Ex. 7 (including Statement of Commissioner Rolka).

As the Commission recently noted in approving the identical type of access rate restructuring with the Sprint/RTCC Settlement, the reduction of access rates offset with revenue neutral basic rate increases "essentially provides for each RTCC company to do what is permitted under their respective Chapter 30 Plans, that is, restructure rates on a revenue-neutral basis in a manner that does not increase local rates by more than $3.50 per month."[64] Indeed, the Commission has approved numerous Chapter 30 rate rebalancing filings where basic rate increases offset access reductions.[65] In fact, the Commission has noted that this type of rate rebalancing is completely consistent with the goals of Chapter 30. In approving Denver & Ephrata's Chapter 30 revenue neutral rate rebalancing in which basic local residential rates were raised by $2.50 and business rates by $1.00 to offset access reductions, the Commission held that:

> D&E is taking steps under its Network Modernization Plan to enhance its network and to provide advanced services to its customers. Part of the quid pro quo under Chapter 30 in exchange for this network modernization commitment is the ability to adjust its rates in the manner proposed in this filing. Adjustments such as these are necessary to ensure that D&E can maintain the financial viability to continue with network modernization while also facing competitive entry. This filing balances the goals of Chapter 30, consistent with the public interest.[66]

The answer is no different under the Verizon Chapter 30 plans. The bulk of the access revenue reduction proposed under the OCA/Verizon Joint Proposal comes from Verizon North. Verizon North's Chapter 30 Plan provides that "[t]he Company may file tariffs proposing to rebalance and/or restructure its rates for noncompetitive services, either an increase or a decrease."[67] Verizon North's Chapter 30 Plan specifically allows for revenue neutral filings to offset access

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64 *Sprint/RTCC Approval Order* at 10.

65 VZ St. 1.1 (Berry/Wirl Surrebuttal) at 10.

66 *PUC v. Denver and Ephrata Telephone & Telegraph Company*, R-00016682 (Opinion and Order entered November 30, 2001) at 7-8. The PUC made a similar statement in connection with approving Alltel's rate rebalancing increasing residential rates by $2.50 and business rated by $1.00. *PUC v. ALLTEL Pennsylvania, Inc.*, R-00027231 (Opinion and Order entered June 24, 2002) at 6.

67 Verizon North Chapter 30 Plan, Part 3.B.1.

reductions, stating that "[t]he Company may also propose revenue neutral tariff rate changes to implement the results of Commission orders involving generic industry issues."[68] Moreover, since the Commission approved Verizon North's Chapter 30 Plan, its rates are presumed to be just and reasonable.

Verizon North's plan requires cost support for increasing rates on protected services.[69] Verizon's Mr. Sanford and Ms. Dean documented the costs of providing the local exchange services in question, demonstrating that neither current rates, nor rates after rebalancing, will cover the cost of those services. Indeed, as discussed in Section II.A.4 of this Brief, even if one used the understated cost figures proposed by the other parties, Verizon's basic residential service rates are still below cost. Therefore, this proposal to offset the reduction of Verizon North's access rates with increases to its basic service rates is a rate rebalancing permissible under its Chapter 30 Plan and of the type routinely approved by the Commission.

Verizon PA's plan requires "rational reasons" for implementing revenue neutral price changes between market baskets.[70] Verizon has clearly provided such reasons. This Commission itself has already concluded that "implicit subsidies" should be removed from access and made explicit through charges to end-users. The reasons supporting this Commission's policy form the "rational reasons" for transferring this revenue between market baskets under Verizon PA's Chapter 30 Plan. Section 1.C.2 of Verizon PA's Chapter 30 Plan clearly permits Verizon PA to propose revenue-neutral rate increases to offset Commission determinations regarding access pricing, stating that Verizon PA "may propose revenue neutral tariff rate changes and restructures to implement the results of the Commission's evaluation of the consistency of [Verizon's] intrastate access tariff rates

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68 VZ North Chapter 30 Plan Part 3 B 2. *See also* VZ St. 1.0 at 26-27.

69 VZ North Chapter 30 Plan, Part 3.F.2.

70 VZ St 1.0 (Berry/Wirl Direct) at 26.

and structures with its interstate access service tariff pursuant to 66 Pa. C.S.A. Sec. 3007(3)."[71] Judge Schnierle concluded that the terms of Verizon PA's Chapter 30 Plan require revenue neutrality for access reductions, and that even if the Commission believed it were legally empowered to ignore Verizon PA's Chapter 30 Plan, it would be "unwise to do so" in this instance because requiring Verizon PA (or any other Chapter 30 company) "to lower some rates without permitting revenue neutral increases in others" would "frustrate a major purpose of Chapter 30."[72]

The only unusual feature to this rate rebalancing is that Verizon proposes to spread the revenue lost from reduction of Verizon North's access rates as revenue neutral increases across the end user lines of both companies. If Verizon did not do so, obviously the increases to basic local rates in Verizon North would have to be much greater to support the same level of access reductions.[73] The opportunity to reduce access rates with minimal increases to end-user rates is another potential merger benefit to the Verizon North customers.[74]

In fact, it must have been the intent of the *Merger Order* that the scale and scope of Verizon PA could be used to make access reductions possible for Verizon North. Otherwise, if Verizon

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71 Section 3007(c) of the Code states that "Upon the commission's evaluation of the consistency of tariff rates and structures with the interstate access service tariff, revenue-neutral tariff rate changes and restructures may be proposed by local exchange telecommunications companies in order to implement the results of the commission evaluation." 66 Pa. C. S. § 3007(c).

72 *1998 Access Recommended Decision* at 73-74.

73 Simple mathematics shows that Verizon North would not be able to reduce its access rates to the same extent proposed here if it must keep the revenue neutral offsets within itself. Simply to recover the **[BEGIN VERIZON PROPRIETARY]** **[END VERIZON PROPRIETARY]** in revenue under the Verizon/OCA proposal spread only across the 500,000 residential lines of Verizon North would cost over $9.00 per line. Spreading the costs across a larger base of customers, as Verizon has proposed, will mean much smaller increases for each affected customer.

74 Indeed, the residents of Verizon North's territory have already reaped ample benefits from the merger – including the customer savings from a $10 million annual revenue reduction from the roll-in of touch-tone, a $5 million rate reduction, the deployment of equipment to make CLASS service available to 100% of lines and much more. The Merger Order did not contemplate an additional revenue reduction from access decreases, which would benefit IXCs rather than end users. VZ St. 1.0 (Berry/Wirl Direct) at 19, n. 10.

North were required to pay for its access reductions totally within itself, there would have been no reason to tie Verizon North's reductions to the merger. Rather, Verizon North should have been part of the RTCC settlement and allowed to participate a more gradual reduction of access rates through revenue neutral access reductions along with all of those similarly situated companies. This result of spreading the cost of Verizon North's access reductions across the lines of Verizon PA is similar in concept to the Universal Service Fund, in which Verizon PA (and its customers and shareholders) pay for the access reductions of all of the other ILECs in Pennsylvania. If the Commission has the authority to create the Universal Service Fund, it certainly has the authority to approve Verizon's alignment and rebalancing proposal.

C. ANY ACCESS REDUCTIONS MUST BE REVENUE NEUTRAL

An essential component to Verizon's agreement to any access reductions is that they must be offset by revenue-neutral increases to local rates, which, as discussed above, is required by the companies' Chapter 30 Plans. Thus, Verizon's December 30, 2002 proposal provided that:

> This access proposal will be revenue neutral relative to the ILECs implementing a rate change. Absolutely no changes shall be required which are not revenue-neutral. Other access reductions that are not revenue neutral are permissible at the ILEC's sole option, but not required. For purposes of this revenue neutrality requirement, Verizon PA and Verizon North shall be considered as one entity and the implementation of this access proposal may be revenue neutral within the combined Verizon entity as a whole, or within the individual Verizon ILEC, at the ILECs' sole discretion.[75]

1. The Commission Contemplated That Any Access Decreases Made As A Result Of The *Merger Order* Would Be Revenue Neutral

This filing was made largely in compliance with this Commission's 1999 approval of the merger by which control of Verizon North (then GTE North) passed to the parent company of Verizon PA (then Bell Atlantic- Pennsylvania). This merger approval was contingent upon

[75] VZ Ex. 1, Conditions of Proposal paragraph 5.

certain conditions, including those originally set forth in a Memorandum of Understanding ("MOU") with Pennsylvania's Attorney General. One of the MOU conditions was that "[w]ithin thirty months after merger closing, GTE-North and BA-PA will commence a proceeding for the purpose of determining statewide rates for access charges based upon consolidated cost studies."

It was made perfectly clear in the MOU and the Merger Order that Verizon could propose revenue neutrality for any access reductions. "Nothing in this agreement shall prohibit BA-PA and GTE-North from arguing in this combined access rate proceeding that that any additional reductions which the PUC orders as a result of this new proceeding should be implemented ***on a revenue neutral basis***."[76] The Commission's Merger Approval Order noted that "Nothing in the MOU purports to prohibit BA-PA and GTE North from arguing in this combined proceeding that any additional reductions that the Commission orders should be implemented ***on a revenue neutral basis***."[77]

2. Revenue Neutrality Is Consistent With This Commission's Treatment Of Access Reform In Recent Cases

Permitting any reductions to access rates to be revenue neutral is also consistent with this Commission's prior treatment of access reform in *Global Order*, in the numerous Chapter 30 rate rebalancings the Commission has approved over the past few years and in the Commission's approval within the last few months of the Sprint/RTCC settlement.

In the *Global Order*, the Commission recognized that "[a]ccess charges provide a significant source of ILEC earnings and contain implicit and explicit subsidies for local rates" which "have helped keep basic local exchange service rates in Pennsylvania at an affordable level over the years."[78] The Commission relied upon Judge Schnierle's Recommended Decision and stated that its

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[76] MOU at paragraph 4 (emphasis added).

[77] *Merger Approval Order* at 36 (emphasis added).

[78] *Global Order* at 11, 13, n. 9.

goal with regard to access pricing was to "take the necessary steps to strive to replace the system of implicit subsidies with 'explicit and sufficient' support mechanisms to attain the goal of universal service in a competitive environment."[79]

In implementing the access reductions required by the *Global Order*, the Commission was careful to preserve revenue neutrality. For example, for Verizon PA, the Commission carefully matched up each access revenue reduction with money available under negative Price Change Opportunities ("PCOs") under Verizon PA's Chapter 30 Plan, which required Verizon PA to reduce non-competitive rates.[80] Instead of reducing basic service rates by the amounts of the PCOs, Verizon PA reduced access rates and kept basic service rates the same. For the other ILECs the Commission made the access changes revenue neutral in different ways, either by (1) transferring revenue to a carrier charge pool to be recovered through the carrier charge, (2) allowing revenue neutral offsets through local rate increases, and/or (3) allowing contribution from the Universal Service Fund. The Commission clearly recognized that transferring revenue out of access would ultimately require off-setting end-user rate increases when it stated that it would pursue "aggressive access reform as long as the resulting access restructure would be conducive to our goal of promoting universal service and ***would not result in rate shock to the local exchange customer***."[81] The Commission had revenue neutrality in mind when it referred to its future access investigation, stating that "we shall consider the appropriateness of a toll line charge (TLC) to recover any resulting reductions."[82]

Following the *Global Order*, the Commission has approved a number of Chapter 30 rate rebalancing filings for other ILECs in which access rates were reduced and off-set with revenue-

79 *Global Order* at 26-27.

80 *Global Order* at 22-24, 29.

81 *Global Order* at 37.

82 *Global Order* at 60.

neutral increases to basic rates. The Commission has consistently allowed these rate rebalancings to bring the price of access closer to its "cost," while increasing basic local service rates closer to their cost. Thus, the residential rate increases have ranged from $1.03 to $3.77.[83] Typical of all these cases, the Commission noted in its November 2001 order approving North Pittsburgh's Chapter 30 rate rebalancing plan, consisting of access reductions offset by basic rate increases, that "the new competitive market requires telecommunications providers to move their rates closer to the cost of providing service. The instant filing begins the process of eliminating the subsidization of local exchange rates that has been provided by inflated access rates."[84]

In the July 2003 Sprint/RTCC Order, this Commission continued to recognize that an essential part of access reform is moving the implicit subsidies to explicit charges "We further look to the Federal Communications Commission's (FCC) recent decisions in the *CALLS* and *MAG* orders for precedence in ordering implicit charges to become explicit, through either an increase in basic local telephone service rates, or through service line charges on customer bills. This enables other carriers to compete due to reduced subsidies."[85]

3. Revenue Neutrality Is Also In Keeping With Federal Policy In Reducing Interstate Access Rates.

As Dr. Taylor noted, the FCC's CALLS Order, which was the result of complex compromise negotiations with many different elements, resulted in increases in end-user subscriber line charges (SLCs), as well as decreases in access charges.[86]

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83 VZ St. 1.1 (Berry/Wirl Surrebuttal) at 10.

84 *PUC v. North Pittsburgh Telephone Company*, R-00016681 (Opinion and Order entered November 30, 2002) at 7.

85 RTCC Settlement Approval Order at 11.

86 VZ St. 3.0 (Taylor Surrebuttal) at 32.

4. Increasing Basic Local Service Rates Through Revenue-Neutral Offsets Will Have A Pro-Competitive Benefit

As discussed above, making the access reductions revenue neutral through offsetting increases to basic rates provides a benefit to local competition.[87]

5. Revenue Neutrality Is Required By The Verizon Companies' Chapter 30 Plans.

As discussed in Section III. B, above, the Verizon Chapter 30 plans require any rate restructurings to be revenue neutral.

6. MCI's Challenge To Revenue Neutrality Is Unreasonable And Contrary To Commission Precedent, And Was Flatly Rejected By Judge Schnierle

With one exception, the parties to this proceeding do not oppose the concept of revenue neutrality.

While the public advocates' litigation position is that no access reductions are necessary, OCA has agreed to the parameters of a revenue neutral rebalancing as part of the OCA/Verizon Joint Proposal. Two of the three IXCs also support revenue neutrality, although they would like to see more of a decrease to access and therefore a higher revenue neutral offset. AT&T points out the potential benefits to local competition of raising local rates.[88] Qwest also supports the revenue neutral aspect of Verizon's proposal, stating that "[r]evenue neutrality insures that companies are not penalized for the progressive restructuring of rates that are in the long term best interests of competition and consumers. This repricing should result in lower long distance rates and should therefore be revenue neutral to consumers as a whole."[89]

The only party to actively oppose revenue neutrality was MCI. Basically, MCI asserts that the loss of *all* of Verizon PA's intrastate switched access revenues would have a "very small effect"

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87 *1998 Access Recommended Decision* at 58. See also AT&T St. 1.0 (Kirchberger/Nurse Rebuttal) at 33-34.

88 AT&T St. 1.0 (Kirchberger/Nurse Rebuttal) at 33-34.

89 Qwest St. 1.0 (McIntyre Rebuttal) at 11.

on the company and it implies that Verizon should be willing to absorb this revenue loss for the benefit of its competitors.[90] MCI made the same argument in the 1998 access reform proceeding before Judge Schnierle, who rejected "MCI's extreme position" as being "without merit." Judge Schnierle found that there was "no reason to ignore [Verizon PA's] Chapter 30 Plan, and its present status as a company under alternative form of regulation, simply because it would be convenient for [Verizon PA's] competitors to do so," and that requiring access reductions without countervailing increases in other rates in violation of that plan "would be unwise."[91]

> Certainly a major feature of the alternative form of regulation is some assurance of rate stability and freedom from constant litigation over rates. If the Commission were to order [Verizon PA] (or any other Chapter 30 companies, for that matter) to lower some rates without permitting revenue neutral increases in others, it would frustrate a major purpose of Chapter 30. While such action might be justifiable in an extreme situation, I find no reason to recommend such action as part of an effort to reform access charges.[92]

MCI's proposition that the Commission should eliminate virtually all of Verizon's access revenue while requiring it to maintain its current local service rates is contrary to Chapter 30 and would be devastating to the company. In fact, while MCI ignores Verizon North and makes its argument about Verizon PA, the vast majority of the access reductions proposed in the OCA/Verizon Joint Proposal come from Verizon North's revenue (as would be expected in a plan that reduces Verizon North's rates to match the considerably lower Verizon PA rates). Verizon North's intrastate switched access revenues comprise 23% of its total revenues, in line with the percentages for the other RTCC ILECs.[93] As Ms. Berry testified, the entire annual intrastate operating income for Verizon North for 2002 was $36 million, an amount that is far less than the

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90 MCI St.1.0 (Pelcovits Rebuttal) at 24.

91 *1998 Access Recommended Decision* at 73.

92 *Id.* at 73-74.

93 VZ St. 1.1 (Berry/Wirl Surrebuttal) at 22.

[BEGIN VERIZON PROPRIETARY] [END VERIZON PROPRIETARY]

revenue reduction required by the OCA/Verizon Joint Proposal. Under MCI's unreasonable demand that intrastate access rates be slashed below cost, without corresponding revenue offsets, Verizon North would be operating under a considerably higher revenue deficit per year. Similarly, Verizon PA's annual operating income for 2002 was $105 million.[94] Absorbing the kind of drastic access decreases the IXC's demand would also have a significant impact on Verizon PA's intrastate net income.

D. THE IXC DEMANDS FOR EXTREME ACCESS REDUCTIONS GO TOO FAR AND RELY ON ARGUMENTS THIS COMMISION HAS REJECTED

1. Introduction

The IXC parties to this case, AT&T, MCI/WorldCom and Qwest, uniformly demand extreme, rock-bottom access rates for the Verizon companies. All three IXCs propose the complete elimination of Verizon's carrier charge, as well as extreme reductions of the traffic sensitive rates[95] It is perhaps understandable that these parties all want the lowest access rates they might obtain – even lower than the substantial reductions Verizon has proposed – since any additional access reductions by Verizon represent direct revenue savings to the pockets of the IXCs. However, the Commission should keep in mind that Verizon PA's rates are already the lowest in the state, and that the OCA/Verizon Joint Proposal allows for an additional **[BEGIN VERIZON PROPRIETARY]** **[END VERIZON PROPRIETARY]** per year in savings to the IXCs. The IXCs demonstrate that they will never be satisfied, and the Commission need not cater to their extreme demands.

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[94] *Id.*

[95] AT&T and Qwest argue that traffic sensitive rates should be reduced to mirror interstate levels and MCI argues for reductions in traffic sensitive rates to TELRIC levels (the methodology used under federal law for calculating rates for unbundled network elements based on hypothetical costs).

At Qwest's request Verizon calculated the revenue reduction that would be required for Verizon to mirror its interstate access rates.[96] The record shows that to mirror interstate would require a revenue reduction of over **[BEGIN VERIZON PROPRIETARY]** **[END VERIZON PROPRIETARY]** for the two Verizon companies taken together, eliminating over two thirds of Verizon's current intrastate access revenue. If this revenue were offset by an increase to residential lines only, spread across both companies, the required increase would be $3.18 per line per month (nearly $40 a year). If the increase is spread across eligible residential and business lines, the required monthly increase would be $2.62.[97] The OCA/Verizon Joint Proposal, by contrast, provides substantial access reductions with increases of less than a dollar per line, and is therefore likely to be less shocking to the end-users.

The IXCs' demands that the Commission reduce intrastate access rates to cost are flawed on many levels and should be rejected. While the Commission has stated the goal of ***reducing*** implicit subsidies in access rates (a goal that Verizon's proposal accomplishes), the Commission has stopped short of declaring that access should be priced at "cost" and that IXCs should therefore be absolved of any contribution to local service. It should not reach that issue here.

Today's carrier access rates include contribution—that is, exceed incremental and shared fixed cost— to provide a means for recovery of fixed common costs and recovery of costs associated with the public utility franchise obligations of local exchange carriers such as Verizon. These obligations include providing basic residential exchange service at rates that are frequently below the cost to serve certain areas and deploying facilities ubiquitously in order to serve as carriers of last resort. Those obligations impose unique costs on Verizon and other ILECs. Carrier

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[96] There is no record evidence of the rate and revenue requirement under MCI/WorldCom's TELRIC demand, but the resulting rate increases would plainly be even higher than those proposed by Quest.

[97] AT&T Cr. Ex. 7; Qwest Cr. Ex. 1.

access charges, like rates for all other services, should continue to help defray these costs to the extent possible in an increasingly competitive market.[98] As Dr. Taylor testified, from an economic perspective switched access charges still can and should provide some support to the shared fixed and common costs of the network by being priced above incremental cost.[99]

2. The IXC's Have Demonstrated No Reason To Reduce Access Rates To "Cost"

Putting aside the dispute regarding what is the "cost" of access (which is discussed in section III.D.4, below), the IXCs arguments in support of pricing at "cost" do not survive scrutiny. Practically since the inception of access charges – when Verizon PA's composite rate was 7 cents a minute as compared to today's **[BEGIN VERIZON PROPRIETARY] [END VERIZON PROPRIETARY]** cents – the IXCs have been arguing that ILECs have a competitive advantage in the toll market and the IXCs will go out of business unless this Commission prices intrastate access at "cost." The Commission has never accepted their arguments and should not do so now. Contrary to AT&T's and MCI's oft-repeated rhetoric, history and this Commission's own prior holdings demonstrate that it is not necessary for intrastate access rates to be set at "cost" in order for IXCs to be able to compete with Verizon in the in-state long distance market on a fair basis.

First, empirical evidence shows that above-cost access rates are not putting IXCs at a disadvantage in the in-state long distance market. Despite the IXCs' suggestion that something changed when Verizon PA gained permission to offer long distance service across LATA boundaries, in fact both Verizon PA and Verizon North have been offering in-state long distance service, in the form of IntraLATA toll service, in Pennsylvania since divestiture. With intrastate access charges consistently priced above cost, IXC's have still captured a significant portion of the

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[98] VZ St. 1.0 (Berry/Wirl Direct) at 29.

[99] VZ St. 3.0 (Taylor Surrebuttal)l at 30.

IntraLATA toll market, and this Commission has declared the market for IntraLATA toll service to be competitive. This market was opened to equal access competition in July 1997 and September 1996 for Verizon PA and Verizon North, respectively. Verizon PA's market share today is **[BEGIN VERIZON PROPRIETARY]** **[END VERIZON PROPRIETARY]** and Verizon North's market share is **[BEGIN VERIZON PROPRIETARY]** **[END VERIZON PROPRIETARY]**.[100] Clearly, IXCs have been able to successfully compete against the Verizon companies in the toll markets even with the current above-cost access rates. Moreover, the fact that Verizon North, having significantly higher access charges in general, has lost ***more*** intraLATA traffic than Verizon PA provides additional evidence that high access charges are not impeding the IXCs' ability to compete in the in-state long distance market.[101] Irrespective of the fact that switched access services are priced above costs, moreover, the Commission concluded that the market for intraLATA toll services is competitive.[102] Indeed, AT&T's own witness admitted that "the interexchange market is a very, very competitive market."[103]

Second, this Commission has consistently rejected the IXC's "price squeeze" argument, in which they claim that access rates must be reduced to cost or Verizon (or another ILEC) will gain a competitive advantage by pricing its toll calls below the price its competitors must pay for access. The Commission was unconvinced by that argument in the Verizon merger case (where it rejected the IXCs' demand for an immediate reduction of access rates to cost as a merger condition), and found that the terms of the Merger and Global orders regarding access charges and imputation were sufficient to allow the merger to proceed as in the public interest.[104] More recently, the

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100 Verizon St. 3.0 (Taylor Surrebuttal) at 42.

101 *Id.*

102 *See Global Order* at 231.

103 Tr. 270.

104 *Merger Approval Order* at 56-57.

Commission explicitly rejected the price squeeze argument in holding that the non-Verizon ILECs would not even be subject to a requirement to "impute" their access charges in their toll rates:

> We agree with the PTA that there is no evidence that [IXCs] are unable to compete today with the ILECs in the IntraLATA toll market. Further, we take administrative notice of the fact that the toll market is subject to increasingly intense price competition as many IXCs are setting their rates on a national level using flat rates that have no relationship with the access rates of any specific ILEC. Finally, we know of no evidence to refute AT&T's own witness that predatory pricing is extremely unlikely to occur; and, even if predatory pricing does occur, the federal antitrust laws are already available to address this type of conduct. Frankly, we are wary of taking any regulatory action that may discourage the aggressive pricing of toll services by any and all competitors, including ILECs, in that market...[105]

As Dr. Taylor explained, the supposed incentive to price toll rates below access makes no sense, because the ILEC would actually be losing money by taking a retail customer from an IXC and serving it at long distance rates below access charges. The ILEC is better off having an IXC pay it 5 cents a minute than having the end user pay it 4 cents a minute. The price squeeze would only be ultimately profitable if the ILEC could drive all of its competitors from the market – and keep them out -- and then raise its rates sufficiently to recover the lost revenue. That scenario is highly unlikely in the toll market given the great number of large, global companies with deep pockets who have sunk investments in switches and fiber transport to provide this service.[106] Moreover, if the switched access charges became intolerable (unlikely since they have been decreasing steadily over the years), those companies have alternatives, such as dedicated access and leasing UNEs to avoid paying access charges.[107]

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

[106] Verizon St. 3.0 (Taylor Surrebuttal) at 36 (noting that AT&T and MCI have the ability to self-provision access through AT&T's ownership of TCG (the nation's largest competitive access providers ("CAP")), and MCI's ownership of MFS and Brooks Fiber, and that there are abundant alternative access facilities available for CLECs to bypass ILEC access).

[107] *Id.*

Even if the "price squeeze" were theoretically possible, moreover, this Commission has already protected the IXCs from it by imposing an imputation requirement upon Verizon PA, which means that Verizon PA cannot price its toll service below the price that it charges competitors for access because it must affirmatively demonstrate that total toll revenues exceed total imputed switched access and carrier charges on an aggregated toll services level.[108] This imputation rule effectively places Verizon PA in the same position as the IXCs insofar as the pricing of toll services is concerned. Instead of basing its toll price entirely on the incremental cost of the service, Verizon must use its competitors' incremental cost for the access portion of the service: *i.e.*, the tariff price of switched access that IXCs pay to Verizon. Under the Pennsylvania imputation rule, Verizon is neither advantaged nor disadvantaged in the toll market because it supplies access to competitors at a price above incremental cost.[109] Other protections also exist, such as the separate affiliate safeguards in Section 272 of the Telecommunications Act, which require Verizon's long distance affiliate to purchase carrier access from the same tariff under the same terms and conditions as other long distance carriers.[110] The FCC has therefore consistently reiterated its belief that regulatory and non-regulatory safeguards are sufficient to rule out a price squeeze[111]

The implicit premise of the IXCs' argument that access should be priced at "cost" is that end-users will benefit from the extreme reductions in access rates they demand here. The IXCs have not proven that fact, however. To the contrary, this Commission's own holdings and the IXC's admissions on the record demonstrate that toll services to end users are priced based on

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108 *See Global Order* at 232-233.

109 Verizon St. 3.0 (Taylor Surrebuttal) at 35.

110 *Id.*

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

what the market will bear – not based on the magnitude of any particular ILECs intrastate access charges.[112] For example, AT&T passes through to its end users its own supposed "cost" of paying intrastate access charges to Verizon and the other ILECs in the form of an "In-State Connection Fee" of $1.95 per month. According to AT&T's own description of the fee:

> AT&T is charged by your local telephone company in Pennsylvania to carry your AT&T in-state long distance and local toll calls over its lines. In order to help recover these costs, AT&T will begin to include in your monthly bill a $1.95 In-State Connection Fee. [113]

AT&T's witnesses admitted that AT&T charges the same fee state-wide, so that notwithstanding Verizon PA's comparatively low access rates, end users in Verizon PA are paying a higher In-State Connection Fee to compensate AT&T for the substantially higher access rates it pays to the rural ILECs.[114] AT&T has obviously concluded that the toll market in Verizon PA's territory will bear paying rates reflective of higher access rates than Verizon PA actually charges, casting doubts on all of AT&T's complaints about its inability to compete under Verizon PA's current rates. Moreover, AT&T's witnesses have essentially stated the intention to price toll (including its connection fee) based on what the market will bear, and have refused to commit to lowering the $1.95 charge even of Verizon lowers its access charges and even based on the prospect of lower access costs from the rural ILECs with implementation of the RTCC settlement.[115]

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

[113] VZ Cr. Ex. 1. See also VZ Cr. Ex. 2 (AT&T intrastate tariff imposing In-State Connection Fee); VZ Cr. Ex. (material from AT&T's website demonstrating that its fee varies among states and that Pennsylvania's fee is among the highest).

[114] Tr. 274; 322; 326-27.

[115] Tr. 271-272 (Stating that AT&T will change its fee only if it needs to do so to remain competitive in the market, and in responding to the question "it's possible then that even if Verizon reduces its access charges, AT&T will not reduce its in-state connection fee; correct," AT&T's witness states "[a]nything

Therefore, AT&T's own admissions show that there is no urgency to lowering Verizon's access rates beyond what is proposed in the OCA/Verizon Joint Proposal.

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

While the IXC's demand that Verizon be required to reduce its intrastate access rates either to mirror interstate rates or UNE rates, the record shows that none of the IXC parties to this case price their ***own*** intrastate access rates under extremely low standard they seek to impose upon Verizon. For example, both AT&T and MCI operate as competitive local exchange carriers in Pennsylvania, and as such have their own tariffed intrastate access rates. Thus, where an end-user with Verizon long distance service calls a residence or business with AT&T or MCI local service, Verizon pays the access rates contained in these tariffs as terminating access. Similarly, if an AT&T or MCI local customer had Verizon long distance, Verizon would pay these rates as "originating" access whenever the customer placed an intrastate long distance call.

MCI's intrastate originating and terminating access rate per minute is nearly 4 cents a minute – over twice as high as Verizon PA's current per minute rate of **[BEGIN VERIZON PROPRIETARY]** **[END VERIZON PROPRIETARY]**.[116] AT&T's composite per minute intrastate access rate is 1.68 cents per minute for its "AT&T Digital link" customers and 1.96 cents per minute for customers of its TCG affiliate.[117] Certainly these rates, which are in one instance much greater than and in the other roughly equal to Verizon PA's current rates, were not set based on "cost" or under the standards the IXCs demand the Commission to impose on Verizon in this case.

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is possible in a competitive market"). *See also* Tr. 325 (similar response regarding Sprint/RTCC Settlement).

[116] Tr. 358; VZ Cr. Ex 9.

[117] VZ Cr. Ex. 8.

Qwest, moreover, owns the Regional Bell Operating Company formerly known as U.S.West and operates as an incumbent local exchange carrier (like Verizon) in a number of other states. Although Qwest intervened in this case specifically to demand that Verizon be required to reduce its Pennsylvania intrastate access rates to "mirror" its interstate rates -- and that Pennsylvania end-user rates be raised accordingly -- Qwest's witness admitted that Qwest itself has not rebalanced its rates in order to reduce intrastate access rates to mirror interstate in all of the states where it operates as an ILEC.[118]

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

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

It is important to clarify the role of access cost studies in this case. It is neither relevant nor necessary to this proceeding to precisely examine the cost of providing access, because both the FCC and this Commission have consistently rejected the notion that pricing of carrier access should be based exclusively upon cost.[119] The incremental cost of providing access is relevant to define the price floor -- the level below which the price should not be allowed to fall. While Verizon's studies demonstrate that its carrier access rates are above this price floor – though not to the degree the IXCs claim – as discussed above it is appropriate for carrier access charges, like rates for all other

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[118] Tr. 382.

[119] *See, e.g., Access Charge Reform*, CC Docket No. 96-262, First Report and Order, 12 FCC Rcd 15982 (rel. May 16, 1997), ¶ 199 (disagreeing with parties that argued that access rates should be based on long run incremental costs, and relying instead on market-based approach to drive rates);*Access Charge Reform*, CC Docket No. 96-262, Sixth Report and Order, 15 FCC Rcd 12962 (rel. May 31, 200 ("CALLS Order"), ¶ 60 (extending market-based approach for five years).

services, to continue to help defray the ILEC's unique costs of providing universal service, to the extent possible in an increasingly competitive market.[120]

Although the cost studies are of limited relevance, the IXC's criticism of Verizon's cost studies is unfounded. The IXCs contend that Verizon should have used UNE rates or inputs used for calculating UNE rates under the federal "TELRIC" methodology as applied in the Commission's current UNE pricing proceeding for Verizon PA. UNEs are the individual pieces of an incumbent local exchange carrier's network that competing local exchange carriers may lease to provide competing local telephone service under the provisions of the federal Telecommunications Act. Binding Federal Communications Commission ("FCC") regulations establish a methodology, known as "total-element-long-run-incremental-cost" or "TELRIC," to calculate UNE costs.[121] TELRIC costs are not appropriately used to price access.

First, the federal Telecommunications Act of 1996, as interpreted by the FCC, mandates that local interconnection rates be set at TELRIC costs, but there is no such mandate in the Telecom Act for switched access rates. In fact, the FCC has flatly rejected IXC demands to price interstate access at TELRIC costs. In its *Access Charge Reform* proceeding, the FCC reaffirmed this conclusion, holding that "[w]hile unbundled network elements may be used to provide interstate access services, their availability at TELRIC-based prices does not compel adoption of similar rates for access services."[122] In its CALLS Order the FCC again affirmed this approach, and on at least three occasions federal appellate courts have rejected IXC arguments that access should be priced at TELRIC.[123]

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120 VZ St. 1.0 (Berry/Wirl Direct) at 29.

121 47 C.F.R. § 51.501, et seq. *See also AT&T Corp. v. Iowa Utilities Bd.*, 525 U.S. 366 (1999); *Verizon Communications, Inc. v. FCC*, 535 U.S. 467 (2002).

122 *Access Charge Reform*, CC Docket No. 96-262, First Report and Order, 12 FCC Rcd 15982 (rel. May 16, 1997) ¶ 199.

123 *Access Charge Reform*, CC Docket No. 96-262, Sixth Report and Order, 15 FCC Rcd 12962 (rel. May

Second, from a cost perspective TELRIC costs do not represent Verizon's actual expected cost of providing service. TELRIC costs are the costs of a hypothetical network using "the most efficient telecommunications technology currently available and the lowest cost network configuration, given the existing location of the incumbent LEC's wire centers."[124] As Mr. Sanford and Ms. Dean explained, TELRIC, particularly as it has been interpreted and applied by this Commission, is based on a standard that would understate the forward looking costs of access service because in applying the "hypothetical" TELRIC standard this Commission has been extremely optimistic (unrealistically optimistic in many instances) regarding the cost-saving efficiencies that the hypothetical network might gain in providing UNE elements, with the result of severely reducing the rates competitors must pay to use Verizon's network.[125] Of particular relevance to the access study, the Commission's *Tentative Order* switching rates are based on assumptions regarding switch discounts for a hypothetical provider that Verizon indisputably will not obtain itself, with the result of drastically reducing the UNE switching costs, which the other parties improperly compare to Verizon's access costs in this case.[126]

Third, from an economic perspective it does not make sense to apply TELRIC pricing to access. As Dr. Taylor explained, in pricing services — as opposed to network elements — the incremental cost of those services is a price floor only; prices need to reflect market conditions and

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31, 2000) ("*CALLS Order*") ¶ 60; *Texas Office of Public Utility Counsel v. FCC*, 265 F.3d 313, 324-26 (5th Cir. 2001), *cert. denied*, 535 U.S. 986 (2002); *Southwest Bell Telephone v. FCC*, 153 F.3d 523, 546-49 (8th Cir. 1998); *Competitive Telecom. Ass'n v. FCC*, 117 F.3d 1069 (8th Cir. 1997).

[124] 47 C.F.R. § 51.501(b)(1), (d)(1).

[125] VZ St. 2.1 (Dean/Sanford Surrebuttal) at 5 ("Those same unrealistic assumptions about hypothetical costs are entirely inappropriate to be applied when it comes to evaluating Verizon's own forward looking costs of providing access and dial tone line service. Instead, the forward looking assumptions used in Verizon's access and dial tone line studies are correctly based on how Verizon will engineer, install and maintain its network in the future and the resultant cost of providing these services. Verizon's forward looking assumptions are based on its real life experience in providing a real telecommunications network – not a make believe network.")

[126] Id at 6.

to recover the shared and common costs of the firm so that overall the firm can remain viable. Services are not priced at "cost" in competitive markets; indeed, firms could not remain viable if they were required to price all their services at cost.[127] As the FCC recognized when it rejected the proposition that interstate carrier access charges be set at TELRIC, "competition will do a better job of determining the true economic cost of providing such services."[128]

Fourth, the UNE rates and the input decisions from this Commission's current proceeding are not even final and are still subject to change.[129] Particularly, the other parties argue that Verizon should have used a particularly low "cost of capital" input because the Commission used a low value in the UNE case. However, important new directions from the FCC issued after the *Tentative Order* that indicate that the Commission's chosen value is too low even for a UNE study and should be reconsidered.[130] Therefore, even if UNE costs were relevant, the UNE costs in the record are not appropriate to rely upon for this case.

Finally, while the other parties discuss TELRIC pricing and UNE costs, it is important to note that the interstate rates which Qwest and AT&T seek to have Verizon mirror are not based on TELRIC or any other cost study and were never intended to be reflective of costs. Rather they were the product of a negotiated settlement. Indeed, the interstate local switching rate to which AT&T's witnesses refer is actually below Verizon's intrastate access costs, as supported by the testimony of Mr. Sanford and Ms. Dean.

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127 VZ St. 3.0 (Taylor Surrebuttal) at 3.

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

129 Verizon St. 2.1 (Dean/Sanford Surrebuttal) at 4.

130 *In the Matter of Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, CC Docket No. 01-338, Report and Order on Remand (Rel. August 21, 2003 ("Triennial Review Order") at ¶ 677-684.

E. THE LITIGATION POSITIONS OF THE PUBLIC ADVOCATES ARE BASED ON OUTDATED REGULATORY CONCEPTS AND DO NOT ADVANCE THIS COMMISSION'S GOALS

1. Introduction

The litigation positions of the public advocates – OSBA, OTS and OCA – are at the extreme opposite end of the spectrum from the IXCs. These parties do not want Verizon to reduce its access rates at all, and argue that Verizon has not demonstrated that a rate rebalancing would be appropriate here. Rather, they would have Verizon PA raise its current access rates to offset a decrease to Verizon North's current access rates, resulting in uniform rates for the two companies.

OCA has since agreed in settlement with Verizon to a substantial **[BEGIN VERIZON PROPRIETARY]** **[END VERIZON PROPRIETARY]** access revenue reduction, so that both companies would have rates approximately equal to Verizon PA's current rates, with the revenue to be offset with increases to basic residential and business rates. Verizon and OCA are in complete agreement with respect to the settlement. Verizon disagrees with the other advocates – and to the extent it still discusses its initial litigation position in its briefs, with the OCA – regarding the necessity for rate rebalancing here.

Based on the Commission's direction in the *Merger Order* that this proceeding should consider "statewide" access rates for the Verizon companies, the advocates support the rate consolidation that forms the first step of Verizon's proposal.[131] Under this step, the two Verizon companies would end up with the identical rates and rate structure. Based on a consolidation of current carrier charge revenue, spread across the demand of both companies, Verizon calculates a carrier charge of $1.20 for this step – a substantial decrease for Verizon North but a doubling of the rate for Verizon PA.

[131] See Exhibit MJW 1 to VZ St. 1.0.

The Commission should reject the advocates' flawed recommendation to stop at this point. Their argument is based on outdated regulatory principles and a convoluted effort to understate and allocate away Verizon's true costs of providing service in the vain attempt to deny the obvious fact that basic local service rates are subsidized. First, the advocates criticize Verizon's Dial Tone Line cost study and wrongly argue that the actual cost of providing service is lower than the cost Verizon claims. Second, because even their wrongly understated costs are still higher than Verizon's weighted average retail revenue, they attempt to "allocate" away substantial parts of Verizon's costs under the antiquated "loop as a joint cost" theory. In this regard the advocates' position is inconsistent with their active support of the Sprint/RTCC Settlement and with OSBA's arguments in prior proceedings.

2. The Advocates Understate Verizon's Cost of Providing Basic Residential Local Service

As discussed earlier, the advocates improperly understate Verizon's cost of providing local service in a vain attempt to prove that Verizon's local service rates are not being subsidized. Their first mistake is the use of UNE rates from the Commission's *Tentative Order*, which not only are still subject to change, but also are not properly used for this purpose because they are based on hypothetical rather than actual costs and they exclude the retail costs that must be included for dial tone line service.[132] Even if it were proper to use these UNE rates as a starting point – which Verizon does not concede – important adjustments would have to be made as depicted on page 9 of the Surrebuttal Testimony of Mr. Sanford and Ms. Dean.

In another attempt to lowball Verizon's costs of providing service, the advocates rely on NECA loop requirements reported to the FCC for universal service purposes. As Dr. Taylor explained, NECA loop costs do not reflect a company's actual cost of providing service on a going

[132] VZ St. 2.1 (Dean/Sanford Surrebuttal) at 8; Section III.A.4 of this Brief.

forward basis, but rather reflect the embedded or historical record of the costs a firm might have spent in a past accounting period – in other words what the firm paid in the past to acquire and maintain equipment, and operate the enterprise, along with depreciation. The proper view of dial tone line costs to evaluate future pricing decisions, by contrast, should be the forward-looking costs the firm relies upon for planning present and future production and investment decisions.[133] There could be significant differences in the inputs and assumptions that make up an embedded study, such as the NECA loop requirements, as opposed to a forward-looking cost study. For example, installing loop plant is a labor-intensive process and an embedded study might understate labor costs by using past wage levels rather than the wages the company must pay over the relevant forward-looking planning horizon. Similarly, the price of materials might be more expensive than what was paid in past periods.[134] Another significant way that NECA loop costs would understate the forward-looking cost of providing dial tone line service is that they exclude certain retail costs, such as marketing and customer support, which were properly included in the Verizon Dial Tone Line studies.[135]

In addition to the general unsuitability of NECA loop requirements to estimate dial tone line costs, the advocates' presentation of the NECA data is misleading. Mr. Dunkel uses a composite of the Verizon PA and Verizon North NECA results to compare to the average NECA loop costs of the RTCC and Sprint companies in order to contrive an argument that Verizon's costs are lower. NECA actually reports separate loop costs for each Verizon company. In fact, Verizon North is reported as 3 separate companies (former GTE, Contel and Quaker State) that merged over the years to form Verizon North. The NECA data actually demonstrates what Verizon has contended all

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133 VZ St. 3.0 (Taylor Surrebuttal) at 22.

134 *Id.* at 23.

135 *Id.*

along – that Verizon North is no different from Sprint, Alltel and the other RTCC companies for which the Commission has approved an access restructure offset with revenue neutral increases to basic rates. Using the figures contained in Mr. Dunkel's supporting workpapers for WDA-3, the weighted average monthly NECA loop cost of the three companies that comprise Verizon North is $20.27, which is in the range of the monthly costs of the other ILECs depicted on Mr. Dunkel's Exhibit WDA-4.[136] For example, Sprint/United's NECA loop cost is $21.96. Indeed, 9 of the other ILECs have NECA loop costs lower than $22.[137] Even Verizon PA's monthly NECA loop cost is not the lowest among the ILECs (see Frontier PA's much lower $13.21).[138] Therefore, while NECA studies likely understate forward-looking loop costs, the Commission can conclude from this NECA data that Verizon North's loop costs are not significantly different from the other ILECs listed above, all of whom are – with the advocates' active support – raising their residential rates to levels much higher than Verizon North's.[139]

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136 VZ St. 2.1 (Dean/Sanford Surrebuttal) at 11. Performing the adjustments reflected in Analysis 3 on WDA-3 (adding the $1.14 UNE port rate and the 10% mark-up for residential) would yield a NECA cost for Verizon North of $23.53.

137 Schedule WDA-4 to OCA St. 1.0, p. 1 of 1. Those companies are Denver & Ephrata ($21.68); Ironton ($21.97); North Pittsburgh ($21.69); Sprint/United ($21.96); Frontier Lakewood ($18.81); Frontier Oswayo ($19.64); Frontier PA ($13.21; Buffalo Valley ($21.61); and Conestoga ($21.98).

138 The RTCC Settlement, which the Commission approved and the OCA and others supported, will nonetheless allow Frontier PA to raise its residential rates by **[BEGIN RTCC PROPRIETARY]**

[END RTCC PROPRIETARY]. *See* Exhibit DMB-2 to Berry/Wirl Surrebuttal.

139 As depicted on Exhibit DMB 2 to VZ St. 1.1, these companies whose NECA loop costs are roughly the same as Verizon North's will raise their weighted average residential rates to levels ranging from $15 to $18 upon implementation of the Sprint/RTCC Settlement. (Ironton's rates are not depicted). Verizon North is only proposing to raise its weighted average residential rate to approximately $13.55.

3. The Attempt To Allocate Away Substantial Portions Of Verizon's Costs Under The "Loop as a Joint Cost" Theory Is No Longer A Rational Way To Regulate Pricing

The advocates base their resistance to further access reductions on the argument that 100% of the cost of the loop should not be allocated to basic service rates, but rather some portion of loop costs should be allocated to other services. The debate over whether loop costs are joint costs might have been alive in 1996 in the orders OCA quotes, but it makes little sense today.

The parties are correct in noting that in the *Universal Service* proceeding this Commission concluded — contrary to the economic testimony of most parties — that the local loop is a "joint" or shared cost. However, the parties ignore more recent decisions that move away from this conclusion, or adopt conclusions that are flatly inconsistent with the treatment of the local loop as a "joint" cost that should be allocated to other services, like switched access.

First, the Commission granted reconsideration in the *Universal Service* investigation on this very issue. The Commission stated the following regarding loop allocation:

> We agree that it is important that the federal and state funding mechanism be consistent in this respect so that distributions under both do not result in either under-funding or over-funding of BUS in high cost areas. While we continue to believe that the loop is a joint cost which should be allocated among the services that utilize it, **we believe that consistency in this regard with the approach taken by the FCC in its May 8, 1997 Report and Order is critical.**[140]

Subsequently, in the 1998 *Generic Investigation of Intrastate Access Charge Reform*, ALJ Schnierle recognized the problems of treating the loop as a joint cost in an increasingly competitive environment. While he acknowledged that "the Commission has, historically, viewed the loop as a 'joint cost,' Judge Schnierle proceeded to observe:

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[140] *See In re: Formal Investigation to Examine and Establish Updated Universal Service Principles and Policies for Telecommunications Services in the Commonwealth*, Docket No. I-00940035 (Opinion and Order entered July 31, 1997).

> On the other hand, the "loop is a joint cost" theory simply will not work in a competitive environment because it fails to recognize the physical and financial reality that most of the cost of providing a telephone network is incurred in simply providing basic service. If society wants to replace the monopoly regulation of local telephone service with open competition, (as it has indicated by the enactment of Chapter 30 and the Telecommunications Act of 1996), then it must be prepared to allow prices for local telephone service to be more reflective of reality.[141]

The record in the 1998 Access Charge proceeding was the basis for the findings in the *Global Order* that resulted in reducing access charges, and that set the stage for this proceeding. There is nothing in the *Global Order* that suggests that the Commission intended to allocate loop costs to other services, like the cost of switched access. On the contrary, both in the *Global Order* and in subsequent orders (most recently in its recent Order adopting the RTCC access settlement which is the model for Verizon's proposal) the Commission has indicated that it intends to move access charges closer to cost — a cost which does not include allocation of loop costs. Moreover, in testimony filed in prior cases the OSBA has taken the precise opposite position on the "loop as a joint cost" theory.[142]

Finally, the Commission sets rates for UNE loops based on the direct cost of those facilities, and has never allocated UNE loop costs to other services as "joint" or shared costs. As Dr. Taylor pointed out, there is no plausible economic justification to treat these same facility costs as "direct costs" in one context — the UNE loop context — but then to treat them as "joint" or "shared costs" when they are sold as part of retail local exchange services.[143]

Since this Commission stated in its order on reconsideration in the universal service proceeding that "consistency" with the FCC's approach was critical,[144] the FCC's treatment of the

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141 *1998 Access Recommended Decision* at 53.

142 VZ Cr. Ex. 10.

143 VZ St. 3.0 (Taylor Surrebuttal) at 25.

144 PUC *v. Denver and Ephrata Telephone & Telegraph Company*, R-00016682 (Opinion and Order

loop cost is particularly significant. Regarding access pricing, the FCC has decided to recover the *full* cost of the local loop that is allocated to the federal jurisdiction through fixed subscriber line charges that are charged to end-users, not IXCs. A recent FCC decision provides more appropriate guidance for the Commission here.[145] In that decision, the FCC accepted many of the salient features of an integrated proposal by the Coalition for Affordable Local and Long Distance Service ("CALLS") — a group of prominent local exchange and long distance carriers including AT&T and Sprint — for universal service and access charge reform. Most significantly, the FCC decided to replace implicit subsidies historically embedded in the interstate access rate structure with explicit support needed for the interstate portion of the universal service obligation. To this end, the FCC increased the subscriber line charge on residential and business customers with the aim eventually to recover the entire interstate portion of the non-traffic-sensitive local loop in fixed flat-rated charges. The following excerpts from the *CALLS Order* amply demonstrate the FCC's firm commitment to the view that the cost of the local loop is not — and should not — be shared with usage services.

> The Eighth Circuit upheld the Commission's increases to various LEC SLC caps, however, and found that "Texas Counsel's contention that increasing the SLC price ceiling violates the prohibition against using non-competitive services to subsidize competitive services [wa]s unpersuasive." In doing so, the court reaffirmed the *Commission's long standing view that the subscriber "causes" local loop costs, whether the subscriber uses the service for intrastate or interstate calls.* These costs are, in any event, recovered from the end user, either through direct end-user charges or indirectly through higher rates or additional charges paid to IXCs. The court further affirmed the Commission's conclusion *that it was appropriate and rational for the Commission to impose these costs on the end user.* The court concluded as a result that increasing SLC caps on certain lines did not result in a windfall for IXCs.[146]

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entered November 30, 2001) at 7-8.

[145] *See CALLS Order.*

[146] *Id.* ¶95 (footnotes omitted, emphasis added).

The natural corollary of the advocates' argument, moreover, is that the Commission has already priced at least Verizon PA's access rates too low to comport with the loop as joint cost theory. Mr. Kubas, for example, contends that 10% of the cost of the loop should be allocated to intrastate access in the form of a carrier charge. Even under his extremely flawed cost estimate, this would require a carrier charge for Verizon PA of $1.50. Using more accurate cost figures would require a carrier charge in the $4 range. Clearly the Commission in the *Global Order* directing $89 million in access reductions by Verizon PA and resulting in an IXC carrier charge of 63 cents was not applying the "loop as joint cost" theory or allocating substantial portions of the cost to intrastate access. If the Commission, as it seems, has determined to reduce any allocation of costs to intrastate access, it necessarily must increase any allocation to local service.

4. There Is No Basis To Treat Verizon Differently From Sprint And The RTCC ILECs

The final problem with the public advocates' position is that they are engaging in selective advocacy when it comes to access reform. Particularly, all three of them were active parties in support of the Sprint/RTCC Settlement, under which the Commission has approved a rate rebalancing plan for all the non-Verizon ILECs in Pennsylvania allowing them to reduce access rates and offset those reductions with basic rate increases on terms identical to those Verizon has proposed here. While the advocates go to great lengths attempting to justify their unfair and inconsistent treatment of Verizon, their efforts must fail.

All of the same protections and limits that the public advocates asked for and found acceptable for the RTCC Settlement are also proposed to be included for Verizon.. In its statement in support of the RTCC Settlement, the OCA noted that it supports the revenue neutral offsets through basic rate increases because the proposal "includes certain important rate rebalancing limitations." Verizon's proposal contains the same limitations. The OCA notes that

it supports the RTCC filing because it "offer[s] protection concerning the maximum amount that consumers will be required to pay through their basic monthly rates," and "contains no provision allowing a Toll Line Charge." Verizon's proposal is identical in these respects as well. Indeed, because Verizon PA has been ahead of the curve in lowering its access rates – already having by far the lowest access rates in the state – Verizon can achieve a reasonable melding and reduction of the two Verizon companies' access rates without imposing rate increases of the magnitude apparently contemplated under the RTCC Settlement.

While OTS complains that the Verizon proposal is "different" because the Sprint/RTCC carriers all continue to maintain a carrier charge (ostensibly representing a cost allocation to the IXCs) the OCA/Verizon Joint Proposal also would maintain a carrier charge of 63 cents for each company.

The references to Verizon's size also do not serve as a reasoned explanation for agreeing to revenue neutral offsets for other ILECs but not for the Verizon companies. Verizon North is not very different in size and density from some members of the rural coalition whose settlement the advocates OCA actively support.[147] If the advocates' claims are directed to the fact that the Verizon companies are owned by a large and diversified corporate parent, then again the advocates should consider the parentage of the companies whose settlements they did support. For example, Sprint/United is controlled by Sprint – a company with over $26 billion of revenues for the year 2002.[148] According to Sprint's year-end financials, its local

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147 See VZ St 1.0 (Berry/Wirl Direct) at 23-24, noting that Verizon North operates 118 telephone exchanges and serves approximately 700,000 access lines, of which about 500,000 are residential lines and 200,000 are business lines (as of September 30, 2000). Verizon North's entire service territory encompasses 6,797 square miles. Among Pennsylvania local exchange carriers, Verizon North's service territory is most comparable to that of Sprint/United).

148 VZ St. 1.0 at 24 (citing Sprint Reports Fourth Quarter and Full-Year 2002 Results, http://144.226.116.29/PR/CDA/PR_CDA_Press_Releases_Detail/1,3245,1111481,00.html(Sprint is a "global communications company serving more than 26 million business and residential customers in

telecommunications division "continued to outperform the regional Bell companies in most financial metrics."[149] By any reasonable analysis, Sprint/United should not be treated differently than Verizon. Similarly ALLTEL, another party to the settlement OCA supports, is part of ALLTEL Corporation, which bills itself as a conglomerate "with more than 12 million communications customers and nearly $8 billion in revenues, is a leader in the communications and information services industries.[150]

These other ILECs, moreover, are not experiencing the kind of competitive pressure to which Verizon is subject, have not been required to unbundle their networks and make them available at very low wholesale rates, and have not had the level of lines losses Verizon has had. These facts demonstrate that these ILECs may be more financially stable than the Verizon Pennsylvania ILECs -- and are certainly not less financially stable.[151]

If the premise of the advocates' argument that Verizon should be treated differently is the unfounded assumption that Verizon's costs of providing service are somehow vastly different from those of other ILECs, that claim also does not survive scrutiny. As described above, Verizon North's territory is not appreciably different from that of other ILECs for which the OCA has supported revenue neutral offsets, and even Verizon PA has significant rural territory, serving approximately ***1.6 million*** rural access lines in Pennsylvania, more than any other single

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over 70 countries. With approximately 72,000 employees worldwide and nearly $27 billion in annual revenues, Sprint is widely recognized for developing, engineering and deploying state-of-the-art network technologies, including the United States' first nationwide all-digital, fiber-optic network and an award-winning Tier 1 Internet the largest 100-percent digital, nationwide PCS wireless network in the United States."))

148 Id backbone. Sprint provides local voice and data services in 18 states and operates the largest 100-percent digital, nationwide PCS wireless network in the United States."))

149 *Id.*

150 VZ St. 1.0 at 25 (citing ALLTEL Reports Strong Annual Results for 2002; Announces Sale of Division of Information Services Business, http://www.corporate-ir.net/ireye/ir_site.zhtml?ticker=at&script=410&layout=-6&item_id=375978)

company among the rural ILECs. Notably, the NECA universal service loop cost data which the advocates themselves placed in the record demonstrates that Verizon PA's revenue requirement is not the lowest in the state, and that Verizon North's is very much in line with such companies as Sprint, D&E, North Pittsburgh and Conestoga – all parties to the settlement that OCA is supporting.

It is also of note that both Verizon PA's and Verizon North's weighted average residential rates are lower than the current average rate of 12 of the ILECs in the rural settlement, including Sprint/United at $15.88.[152] Indeed, Verizon could implement the $1 increase required by the OCA/Verizon Joint Proposal and its resulting average R-1 rates ***would still be less than Sprint's current weighted average R-1 rates,*** much less the $18 average rate Sprint will achieve after it makes the rate increases authorized by the Sprint/RTCC settlement. Sprint's NECA loop costs, moreover, do not differ appreciably from Verizon North's, but the RTCC settlement will leave Sprint with residential rates almost $4.50 higher than Verizon North's, plus a $7.62 carrier charge. It simply makes no sense for the advocates to actively support allowing Sprint to ***increase*** its rates, and opposing Verizon's much more modest revenue neutral proposal. As it approved the Sprint/RTCC Settlement as being in the public interest, the Commission should approve Verizon's proposal here.

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[151] See, e.g., Exhibit DMB 3 to VZ St. 1.1.

[152] See DMB Exhibit 2 to VZ St. 1.1.

IV. CONCLUSION

For the foregoing reasons, the Commission should approve the OCA/Verizon Joint Proposal as a reasonable resolution of this proceeding.

Respectfully submitted,

Date: September 18, 2003

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IN REPLY PLEASE
REFER TO OUR FILE

September 29, 2003

ORIGINAL

James J. McNulty, Secretary
Pennsylvania Public Utility Commission
P. O. Box 3265
Harrisburg, PA 17105-3265

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

DOCUMENT FOLDER

Dear Secretary McNulty:

Enclosed for filing please find an original and nine (9) copies of the **Reply Brief** of the Office of Trial Staff (OTS) in the above-captioned proceeding.

Copies are being served on all active parties of record.

Sincerely,

Kenneth L. Mickens
Senior Prosecutor
Office of Trial Staff

KLM:em

Enclosure

c: Parties of Record

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

ORIGINAL

AT&T COMMUNICATIONS OF PENNSYLVANIA, INC.	:	
v.	:	DOCKET NO. C-20027195
VERIZON NORTH, INC.	:	

REPLY BRIEF OF THE OFFICE OF TRIAL STAFF

Kenneth L. Mickens
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Dated: September 29, 2003

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I. INTRODUCTION

On December 30, 2002, Verizon Pennsylvania Inc. ("VZ-PA") and Verizon North, Inc. ("VZN") (collectively "Verizon") filed a Joint Petition ("Verizon Joint Petition") regarding the further reduction of their access charges pursuant to the Bell Atlantic-Pa-GTE Merger Order[1], the Global Order of 1999[2] and the generic access charge investigation at Docket No. M-00021596. This joint proposal was published January 18, 2003 at 33 Pa. B. 502. Comments were filed by the Office of Trial Staff ("OTS"), the Office of Consumer Advocate ("OCA"), AT&T Communications of Pennsylvania, Inc. ("AT&T"), Sprint Communications Company & United Telephone Company of Pennsylvania ("Sprint/United"), the Rural Telephone Company Coalition ("RTCC"), the Office of Small Business Advocate ("OSBA") and Qwest Communications Corporation ("Qwest").

The Global Order reduced access charges of all local incumbent exchange carriers operating in Pennsylvania. The Commission opened a proceeding at Docket No. M-00021596 in January 2002 to accommodate the access charge investigation required by the Global Order in the form of a collaborative proceeding.

On March 21, 2002, AT&T filed a formal complaint against VZN seeking to have VZN's access charges reduced to VZ-PA's levels pursuant to the

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[1] See, *Re Joint Application of Bell Atlantic Corporation and GTE Corporation for Approval of Agreement and Plan of Merger*, Docket Nos. A-310200F0002, A-311350F0002 and A-310222F0002 (entered November 4, 1999) ("Merger Order").

[2] See, *Re Nextlink Pennsylvania, Inc.*, Docket No. P-00991649, 93 Pa PUC 172 (entered September 30, 1999) ("Global Order").

requirements in the Commission's Merger Order at Docket No. A-310200F0002. The complaint was docketed at C-20027195. The AT&T complaint, which was initially dismissed by the Chief Administrative Law Judge, was reinstated by a Commission Order entered December 24, 2002. That order also bifurcated the access charge investigation so that all Verizon matters, including the AT&T complaint, would be litigated at Docket No. C-20027195.

Although VZ-PA and VZN agreed to one proposed access charge reduction plan, OTS, Qwest, OCA, OSBA, AT&T and MCI WorldCom ("MCI") have objected to the Joint Petition. By Order entered May 5, 2003, the Commission referred the Verizon Joint Petition to the Office of Administrative Law Judge for evidentiary hearings and a recommended decision. The Commission consolidated the Verizon Joint Petition for Access Charge Reductions with the *AT&T Communications of Pennsylvania, Inc. v. Verizon North, Inc.* complaint at Docket No. C-20027195 regarding VZN's access charges pursuant to the Commission Order entered December 24, 2002. The proceeding at the instant docket will also address Verizon's compliance with the Merger Order directive that VZN and VZ-PA have access charges which are at parity with each other.

In accordance with the Commission's order, the matter was assigned to Administrative Law Judge Cynthia Williams Fordham. A prehearing conference was held May 29, 2003 at which time a litigation schedule was established. Evidentiary hearings were held in Harrisburg August 25-26, 2003.

On September 18, 2003, OTS filed its main brief in this proceeding, setting forth the evidence and law in support of its recommendation that the CC be established at $1.20 for both VZ-PA and VZN and that local residential service rates should not be increased. This reply brief is supplemental to the main brief and is limited to those issues raised by other parties in their main briefs and matters previously addressed by OTS which require additional discussion as a result of statements made in the main briefs of other parties.

II. ARGUMENT

A. VERIZON/OCA JOINT PROPOSAL

1. The Verizon/OCA Joint Proposal Should Be Adopted By The ALJ And Commission.

The Joint Proposal by Verizon and OCA provides that Verizon's overall average "Traffic Sensitive" ("TS") rate would equal the consolidated rate of the current TS rates of the two Verizon companies. Accordingly, the CC rate will be reduced to the level of the VZ-PA current TS rate of $0.63, a reduction of more than 50% from the current consolidated rate. In addition, the agreement provides that no more than $40 million of the access revenue reduction will be recovered through increases to residential basic local service rates on a combined VZ-PA and VZN basis and that any such increases shall not exceed $1.00 per residential line. Verizon St. 1.1, p. 7; Tr. 165-166.

The Joint Proposal should be adopted by the ALJ and the Commission. The determination to support the Joint Proposal was not easily reached. The agreement to set the CC at $.63 for both Companies is an improvement over the original proposal, in that it does not propose to completely eliminate the CC.

However, the Joint Proposal provides that basic residential local exchange rates could be increased by as much as $1.00 per residential line or by as much as $40 million in total. OTS witness Joseph Kubas has testified that local residential exchange customers should not be made to pay more so that IXCs can enjoy lower access charges. OTS St. 1, p. 17. Instead, IXCs should be required to pay their

fair share of the costs of the local loop. See, *Pennsylvania Public Utility Commission v. Bell Atlantic Inc.*, Docket No. R-00963350 (entered December 16, 1996) ("*Bell Atlantic Order*"), Order at p. 23.

The record and Commission precedent indicate that local residential rates are currently priced above cost and that local residential customers are paying at least the 74% of the cost of the local loop as the Commission requires.[3] See, *Formal Investigation to Examine and Establish Updated Universal Service Principles and Policies for Telecommunications Services in the Commonwealth,* Docket No. I-00940035 (entered January 28, 1997) ("*Universal Service Order*"), p. 85. Moreover, Verizon has not demonstrated that the increases to local residential exchange rates have been demonstrated under VZ-PA's or VZN's Chapter 30 Plans as discussed in the OTS main brief at pp. 12-14.

Nevertheless, it appears that a compromise at this juncture is in the best interest of Verizon's ratepayers. Surprisingly, AT&T has apparently reached the same conclusion. In its main brief, AT&T abandoned its original position that the CC should be reduced to zero for both Companies and now supports the adoption of the Joint Proposal. AT&T Main Brief, pp. 2-3. Consequently, perhaps for the

[3] Verizon provided cost studies in this proceeding in an attempt to demonstrate that local exchange service is priced below cost. See, Verizon St. 2.0, Direct Ex. 3. Significantly, OTS witness Mr. Kubas has testified that the cost studies provided by Verizon in this proceeding are worthless because of two major flaws. First, Verizon included 100% of the cost of the local loops to determine the cost of providing dial tone line service.. However, as discussed at pp. 8-9 of OTS' main brief, the loop is a shared cost. Consequently, it is incorrect to recover 100% of its cost from dial tone line service. Second, Verizon employed 12.45% for the cost of money to determine the cost of local exchange service. See, Verizon St. 2.0, p. 7. However, in a recent Commission Order establishing Unbundled Network Element ("UNE") rates, the Commission rejected Verizon's attempt to use 12.95% for the cost of money and instructed Verizon to use 9.83% as an input to determine the cost of UNEs. See, *Generic Investigation Re Verizon Pennsylvania Inc.'s Unbundled Network Elements Rates*, Docket No. R-00016683 (entered November 4, 2002) ("*UNE Order*"), Order at p. 40.

first time in history, OTS and AT&T apparently agree on something. Of course, the reasons that AT&T provides for its support of the Joint Proposal are, typically, not supported by Commission precedent or the record. Accordingly, a response to certain of these statements is provided later in this brief. Responses are also provided to statements made by MCI and Qwest in their main briefs. Unlike AT&T, they continue to argue that the CC should be reduced to zero for both Companies.

B. COMMISSION TELECOMMUNICATIONS DECISIONS

1. AT&T's Unsubstantiated Claims Should Be Rejected.

AT&T's main brief is filled with distortions and misrepresentations of both the record in this proceeding and the implications of previous telecommunications decisions by the Commission, in an effort to demonstrate that the CC rate should eventually be reduced to zero. For example, AT&T argues at pp. 3 and 9 of its main brief that the order in the RTCC Settlement "explicitly recognized that the prospects for widespread and robust competition are being undermined by the plague of overpriced carrier access charges" and that implicit charges, such as access, impede competition. However, AT&T fails to mention that the Commission's order in the RTCC Settlement does not indicate that the CC should be reduced to zero now or at some time in the future. In fact, there is a difference between "overpriced access" and "free unlimited use of the loop," which is AT&T's ultimate goal. Interestingly, AT&T supports the Commission's efforts to

establish "cost based rates," yet advocates that its share of the cost of the local loop should be zero. AT&T Main Brief, p. 7.

AT&T next alleges that "the Commission must reduce access rates to ameliorate the artificial advantage enjoyed by wireless providers..." since they are not required to pay access charges on calls within the Metropolitan Trading Area ("MTA"). AT&T Main Brief, pp. 11-12. However, OCA witness William Dunkel has testified that wireless companies do pay access charges to originate and terminate calls outside the MTA and do pay reciprocal compensation. OCA St. 1-S, pp. 12-13.

More importantly, AT&T fails to mention that, as is the case with interstate services, the Commission does not have jurisdiction over wireless providers. In fact, as described by OTS witness Mr. Kubas, the Federal Communications Commission ("FCC") has jurisdiction over such providers of interstate service and has developed its own policies and costing methods for interstate service. These policies may differ from intrastate policies, as apparently is the case with regard to cost recovery of the local loop. However, there are often sound reasons for the different approaches. See, OTS St. 1-SR, p. 9.

AT&T argues that OTS relies upon anachronistic and anti-competitive concepts of residual local exchange pricing and loop cost allocation in developing its proposal of a $1.20 per month per line CC rate for VZ-PA and VZN. AT&T observes that residual pricing was the means by which local exchange rates were historically established in the context of monopoly telecommunications markets,

ostensibly for the purpose of promoting the concept of universal service. AT&T Main Brief, p. 29. In fact, AT&T has misrepresented the position advocated by OTS witness Mr. Kubas. Mr. Kubas did not employ residual pricing in his analysis. To the contrary, the $1.20 CC is based on the cost that was developed from Verizon's loop cost analysis provided in the UNE case. See, OTS Main Brief, p. 10. Significantly, AT&T failed to refer to a specific statement in Mr. Kubas' testimony in support of this allegation.

AT&T alleges that OTS witness Mr. Kubas relies upon several "older" orders in support of his contention that the loop is properly treated as a joint cost. AT&T further argues that the *Universal Service Order* and the *Bell Atlantic Order* were both issued prior to the 1996 Telecommunications Act, which established a national policy to eliminate implicit subsidies. AT&T Main Brief, p. 29.

Interestingly, AT&T failed to address the Commission's ruling in *Pennsylvania Public Utility Commission v. North Pittsburgh Telephone Company*, Docket No. R-00038087 (entered April 10, 2003) ("*North Pittsburgh Telephone*"), in which the Commission indicates that the CC is an access charge designed to recover a portion of the cost of the local loop that IXCs use in the origination and termination of long distance calls. Order at p. 2. When asked under cross examination if *North Pittsburgh Telephone* was recent enough to be considered current law, AT&T witness N. Christopher Nurse replied "[y]ou have to look at what they are addressing." Tr. 310. In other words, AT&T believes an order is outdated if it does not support the elimination of the CC.

AT&T argues that maintaining "high" access charges will ensure that over a period of time Verizon's competitors – and the benefits that competition can bring to Pennsylvania's long distance customers – will disappear. AT&T Main Brief, p. 28. However, AT&T fails to state (or even imply) in its main brief that it will pass along access charge reductions to its Pennsylvania customers. These so-called benefits are illusory. The evidence indicates that any such reductions would probably not be passed through to customers. In this regard, Verizon argues in its main brief that cross examination of AT&T witnesses indicates that AT&T's new $1.95 "in state" connection fee will not be reduced or eliminated if Verizon's CC charges are reduced or eliminated as a result of this proceeding. Verizon Main Brief, pp. 42-43.

Moreover, fellow IXC, Qwest, boldly claims in its main brief that the Commission should "refrain from requiring IXC carriers in a competitive marketplace to adhere to a regulatory mandate to pass through the savings from any [access] reductions to their end users." Qwest Main Brief, p. 23. The truth of the matter is that the IXCs have no intention of passing through any access reductions to their long distance customers. Accordingly, the ALJ and the Commission should realize that long distance customers will not benefit from lower access charges (as alleged by AT&T) and must act to ensure that these IXCs continue to pay their fair share of the cost of the local loop.

C. CARRIER CHARGE

1. Claims By MCI And Qwest That Verizon's Intrastate Access Charge Should Be Reduced To The Level Of Verizon's Interstate Access Charge Are Without Merit And Should Be Rejected.

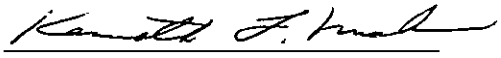
MCI argues in its main brief that Verizon's intrastate switched access rates should be reduced to the level of its interstate switched access rates or to the level of cost because above cost rates give Verizon a competitive advantage, cause regulatory distortions, invites the misreporting of toll data and creates price squeezes. MCI Main Brief, pp. 3-10. Qwest makes similar arguments at pp. 9-16 of its main brief. However, these same arguments have been made to the Commission by MCI and Qwest on numerous occasions and have been repeatedly rejected, for good reasons. First, as discussed earlier in this brief, there is no support in the record for the notion that the CC is not cost based. In this regard, the Commission has found that the CC is a cost based access charge that properly collects from IXCs the costs incurred as a result of allowing access to the local loop. *North Pittsburgh Telephone,* Order at p. 2. Further, the Commission has consistently determined that the local loop is a "joint cost" that should be recovered from the variety of services that use the loop. *Universal Service Order*, p. 82. The local loop is a joint and common facility that is clearly used by IXCs to both initiate and terminate long distance calls. There is no dispute in the record of this case or in Commission precedent on this matter.

In fact, although MCI and Qwest support the complete elimination of the CC in this proceeding, IXCs often collect a CC rate when operating as Incumbent Local Exchange Companies ("ILECs") in other jurisdictions. For example, Qwest operates as an ILEC in several western states and recovers a CC in certain of those states. Tr. 383-386. Also, Qwest's claim that intrastate access charges should be lowered to the level of interstate access charges because the current differences invite toll providers to misreport revenue (Qwest St. 1, p. 14) is not limited to the identification of interstate or intrastate toll. Laws should not be changed because companies may cheat. In fact, what should be examined is the rationale for the different approaches on the federal and state levels. In this regard, OTS witness Mr. Kubas has testified that Qwest has failed to provide a cost study or other support for its position that intrastate access charges should be reduced to the level of interstate access charges. OTS St. 1-SR, pp. 8-10. In short, the record in this proceeding indicates that MCI and Qwest have failed to demonstrate that the CC rate should be eliminated for the Verizon Companies.

III. CONCLUSION

For the reasons stated herein, the positions asserted by OTS should be adopted by the ALJ and the Commission.

Respectfully submitted,



Kenneth L. Mickens
Senior Prosecutor
Office of Trial Staff
Pennsylvania Public
Utility Commission

Dated: September 29, 2003

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

CERTIFICATE OF SERVICE

I hereby certify that I am serving the foregoing **Reply Brief** of the Office of Trial Staff, dated September 29, 2003, either personally, by first class mail, electronic mail, express mail, or by fax upon the persons listed below:

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Dated: September 29, 2003
Docket No. C-20027195

COMMONWEALTH OF PENNSYLVANIA

ORIGINAL

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September 29, 2003

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

Dear Mr. McNulty:

Enclosed for filing are the original and nine (9) copies of the Reply Brief on behalf of the Office of Small Business Advocate in the above-docketed proceeding. As evidenced by the enclosed certificate of service, two copies have been served on all active parties in this case.

If you have any questions, please do not hesitate to contact me.

Sincerely,

Angela T. Jones
Assistant Small Business Advocate

Enclosures
cc: Hon. Cynthia W. Fordham
Administrative Law Judge

Parties of Record

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ORIGINAL

BEFORE THE

PENNSYLVANIA PUBLIC UTILITY COMMISSION

AT&T COMMUNICATIONS OF PENNSYLVANIA, INC.	:	
V.	:	DOCKET NO. C-20027195
VERIZON NORTH INC.	:	

REPLY BRIEF
ON BEHALF OF THE
OFFICE OF SMALL BUSINESS ADVOCATE

Angela T. Jones
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Dated: September 29, 2003

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I. INTRODUCTION AND SUMMARY OF REPLY ARGUMENT

A. Introduction

On March 21, 2002, AT&T Communications of Pennsylvania, Inc. ("AT&T") filed a Formal Complaint docketed at C-20027195 against Verizon North, Inc. ("VZN") to have its access charges reduced to Verizon Pennsylvania, Inc.'s ("VZ-PA's")[1] levels as required in the Merger Order at A-310200F0002. The Complaint, although initially dismissed by Chief Administrative Law Judge Christianson, was reinstated by the Pennsylvania Public Utility Commission ("Commission" or "PUC") by Order entered December 24, 2002. The Office of Small Business Advocate ("OSBA") incorporates by reference to its Main Brief the procedural history of this proceeding. The OSBA, the Office of Consumer Advocate ("OCA"), the Office of Trial Staff ("OTS"), AT&T, MCI WorldCom Network Service, Inc. ("MCI"), Qwest Communications Corp. ("Qwest") and VZ filed Main Briefs on September 18, 2003 pursuant to Order #4 of Administrative Law Judge, Cynthia W. Fordham. Through this Reply Brief, the OSBA will respond primarily to two issues in this proceeding that affect the public interest, and, in particular, the interests of VZ customers--especially its small business customers.

This proceeding has been about establishing the appropriate decrease that should be made to VZ's access charges. All parties agree that access charges are to be reduced following the Commission's Global Order.[2] VZ has offered three proposals, one of which is a joint settlement proposal with OCA. VZ, AT&T, MCI, and Qwest advocate a reduction to access charges that reflects no allocation of the loop to toll or intrastate carrier service. However, AT&T acquiesces

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[1] Verizon Pennsylvania, Inc. and Verizon North, Inc. collectively referred to as "VZ".

[2] Re Nextlink Pennsylvania, Inc., et al., Docket No. P-00991648; P-00991649, 93 PaPUC 172 (September 20, 1999)("Global Order").

to the VZ/OCA joint proposal as a significant first step toward access charge reductions. OCA, OTS and OSBA advocate a reduction to $1.20 with services that access the loop receiving some allocation of cost. OCA, however, maintains the settlement position in the VZ/OCA joint proposal is a reasonable compromise to this issue of access charge reductions.

Any determination of the appropriate reduction to be made to access charges must comply with existing law. Contrary to the positions advocated by the telecommunications carriers, nothing bars the Commission from allocating the loop to services that use it. The FCC has not barred loop allocation to the services that use the loop, indeed the FCC separation rules allocate 25 percent of the loop costs to interstate services.

This proceeding contains a settlement proposal that has not been joined by all of the parties. Partial Settlements have not been favorably received by the Commonwealth Court of Pennsylvania and should not be approved without adjudicating the pros and cons of the partial settlement. Furthermore, a settlement implies that reasonable give and take of all parties has occurred. The VZ/OCA joint proposal was not reached in a manner that balanced the interests of small business customers.

Lastly, settlements are by definition an agreement reached by the signature parties whose settlement positions may differ from their litigation positions. It is disingenuous of VZ to compare this litigation to the unopposed RTCC/Sprint Settlement. [3] The Commission must not require parties' positions in a settlement in a different case to be the same as their positions in a litigated proceeding just because the theme of access reduction exists in both.

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[3] Access Charge Investigation per Global Order of September 30, 1999 Docket Nos. M-00021596, etc., (Opinion and Order entered July 15, 2003)("RTCC/Sprint Settlement").

B. Summary of Reply Argument

On review of the arguments set forth in the Main Briefs of AT&T, MCI, Qwest and VZ, the OSBA submits that VZ has failed to provide substantial evidence required to support any of its access reduction proposals. Although much is made by the parties of the actions on the federal level to change cost allocation of interstate charges to the end-user, there is nothing that obstructs the states from allocating intrastate charges differently. Most notably, the FCC does not prohibit the states from acting differently in allocating intrastate services costs to those that benefit from the facility that is in place delivering the service–the loop. VZ has built into this litigation a partial settlement stipulation that it touts as reasonable. VZ has not provided sufficient detail on the record to logically conclude as much and the information that it has provided is either incomplete or misleading. All of VZ's assertions supporting the VZ/OCA settlement are defective. Thus, the proposal should not be approved. VZ makes comparisons to the unopposed RTCC/Sprint Settlement. Because that settlement did not result from litigation, it is improper to use it as precedent.

II. REPLY ARGUMENT

A. Nothing Exists to Prohibit Allocation of Loop Costs to Services Using the Loop

Reply to VZ M.B. at 49 - 59; AT&T M.B. at 29 - 37; Qwest M.B. at 9 - 23 and MCI M.B. at 14 - 15

The FCC has never had a rule or order that required the state commissions to allocate loop costs to any intrastate service or services. In fact, the rules that determine how loop costs are allocated between the interstate and state jurisdictions can be found in the Section 47 Code of

Federal Regulations, Part 36. The rules do not prescribe how this Commission must allocate intrastate loop cost to services. However, the rules support an allocation of loop costs to the services that use the loop. The fundamental federal principles that underlay the rules for separating telecommunications property between interstate and intrastate are actual use. CFR 47 Part 36.2(a)(1) states: "Separations are intended to apportion costs among categories or jurisdictions by actual use or direct assignment." If local exchange was responsible for 100 percent of the loops costs then the federal rules would assign 100 percent of the loops cost to the local exchange service. However the rules don't assign 100 percent to the intrastate jurisdiction. Part 36.154 assigns 25 percent of the loop costs to interstate because the interstate toll services use the loop, that is the only portion of loop costs over which the FCC has jurisdiction. Indeed the FCC has taken the costs assigned to interstate and established an interstate flat end use charge for incumbent LECs--but that is rate design, not cost allocation. The FCC determines the pricing rules for interstate services and this Commission determines the pricing rules for intrastate services. The FCC has not ordered or required the states to assign the other 75 percent to any service. The recovery of the other 75 percent of the loops costs, the portion allocated to Pennsylvania, is and has always been determined by the Commission. The Commission has recognized and adopted the position that the services that use the loop should share in the cost recovery of the loop. Indeed that is the reason the Commission allocated the intrastate share of loop costs (the residual 75 percent after the FCC takes 25 percent) to all services that use the loop in the Universal Service Order.[4] Allocating zero loop costs to intrastate toll services is wrong.

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[4] In Re: Formal Investigation to Examine and Establish Updated Universal Service Prinicples and Policies for Telecommunications Services in the Commonwealth, Docket No. I-00940035, Opinion and Order entered January 28, 1997 at 82-85 (Universal Service).

B. VZ's Claim Regarding the Terms of the VZ/OCA Settlement Proposal to Business Customers is Disingenuous

Reply to VZ M.B. at 15 - 21

VZ states that the VZ/OCA joint settlement proposal is a reasonable solution and should be adopted by the Commission.[5] VZ describes the joint proposal terms as including an "increase to business rates ... projected to be less than $1.00 to the weighted average."[6] This argument is inappropriate and not straightforward.

The Commission's regulations state,

> a partial settlement is a comprehensive resolution of all issues in which less than all interested parties have joined [versus] a stipulation [which is] a resolution of less than all issues in which all or less than all interested parties have joined."[7]

Although VZ and OCA have called their proposal a joint settlement, it is not. According to the Commission's own definition, at best, the proposal would be a partial stipulation as not all interested parties have joined and it is not a comprehensive resolution of all issues--specifically business customers have no express agreement.

The proposed partial stipulation states the terms and conditions for residential customers and also specifies that the rest of the total reduction in access charges is to be achieved by an offset to another class of services or customers. VZ has then stated, "Although not included in the Joint Proposal, [VZ] would also propose that the remainder of the access reduction (that is the amount

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5 VZ M.B. at 15.

6 Id, at 18.

7 52 Pa. Code § 69.401.

above $40 million) would be recovered through increases to business local service rates, again on a combined [VZ-PA] and [VZN] basis."[8] Obviously, the matter regarding the business customer rate increase has not been settled.

The OSBA believes it is inappropriate to argue here why it did not settle the issue with VZ since settlement negotiations are to be treated as confidential. However, the statement, "the required increase to business rates is ... projected to be less than $1.00 to the weighted average," is misleading.

The weighted average of business customers includes all business customers including those customers that have contracted business local services. These contracts prevail for rates, terms and conditions, over an agreed upon period. By their terms, the contracted services would not be affected by any outcome of this proceeding. However, the weighted average of business customers would include those customers that are served under contract. Since these contract customers cannot be included in the proposed increase, there are fewer business customers to share in the allocation of the offset dollar amount above $40 million. Simple mathematics require that the increase per non-contract business customer would grow the more the subset of contracting business customers grows. The terms or conditions revealing the true effect of the offset for business customers who are not contracting for local exchange service is germane to this proceeding. This information, however, is not found in the record. For this reason the statement made by VZ, "the required increase to business rates is also projected to be less than $1.00 to the weighted average," under the VZ/OCA joint proposal, while not false, is misleading.[9]

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[8] VZ Surrebuttal Testimony Stmt. 1.1, Berry/Wirl at 7, l. 21 - 8, l. 1.

[9] VZ M.B. at 18.

Moreover, the Commonwealth Court has addressed, in part, the issue of non-unanimous settlement stipulations in ARIPPA.[10] The court points out that there is a tendency to place some parties at a severe disadvantage regarding non-unanimous settlements with the burden of proof shifting to the non-consenting parties by forcing them to prove the unreasonableness of the settlement. The court notes that the issue in ARIPPA was not whether the Commission has the ability to approve a non-unanimous settlement; therefore, that issue was not addressed. But, the dicta of the court in ARIPPA expresses concern regarding non-unanimous settlements.[11] Nevertheless, the resolution of the issue in this proceeding must be made on the basis of a finding of facts supported by substantial evidence.

OSBA continues to argue that it does not know what the specific terms of the VZ/OCA joint proposal are for business customers. The record does not establish a ceiling for the business local rate increase; the level of the rate increase for the affected business customers; the length of time the increase will be in effect; the additional amount over $40 million to be allocated exclusively to business customer local exchange services; or identification of other services or customer segments, if any, that will receive some proportionate allocated increase. In short, VZ has failed to provide the substantial evidence necessary to meet its burden of proof.[12]

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[10] See, ARIPPA v. Pa. P.U.C, et al., 792 A.2d 636, 658-660 (Commw., Feb.2002)(ARIPPA).

[11] Id at 659, note 34 (expressly referring to former Commr. Brownell's statement that when a party presents its case on the merits that has neither settled nor met its burden of proof, there is not an alternative solution but to deny the party's issue.).

[12] OSBA M.B. at 9 -12.

C. VZ Cannot Bootstrap the RTCC/Sprint Settlement to Argue Its Litigation Position

Reply to VZ M.B. at 18 - 21 and 56 - 59

VZ compares the terms it proposes in the VZ/OCA joint proposal with what has already been adopted in the RTCC/Sprint Settlement in order to show that the terms here are more favorable to the end user.[13] The underlying assumption is that it is unreasonable to accept harsher terms for the end user in one instance and reject favorable terms in the instant case. Yet, there is no comparison.

The RTCC/Sprint scenario was an unopposed settlement--not a partial settlement stipulation like the VZ/OCA joint proposal. The RTCC/Sprint Settlement most likely caused some parties to reconsider their issues and yield on some in exchange for avoiding the costs and risks of litigation. The terms of a settlement do not necessarily match the firm positions of the parties in litigation. The implication that the partial stipulation in this instance is more favorable than the result of a settled outcome in the RTCC/Sprint case does not mean that the partial stipulation is reasonable overall.

VZ makes much ado about the fact that its proposed basic service rates in the VZ/OCA joint proposal are lower than those rates in the RTCC/Sprint Settlement.[14] However, the OTS witness states that, when VZ was asked to provide comparisons of RTCC/Sprint rates versus VZ proposed rates, it was unable to do so because no rates were proposed.[15] Yet, VZ states, "[its]

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13 VZ M.B. at 18-21.

14 VZ M.B. at 21and 59 for VZ proposals in general.

15 OTS Stmt. No. 1 at 22, l. 11-15.

proposed business increase will be less than half the size of the average...increase to weighted average business rates planned to implement the RTCC/Sprint Settlement..." [16] How can VZ make even that simple calculation when VZ has failed to provide specific numbers for the record? VZ cannot make up its case as it goes along.

In effect, VZ is using the RTCC/Sprint Settlement as precedent for the positions of the OSBA as well as the other public advocates in this litigation. Settlements are negotiated; they are unique to the parties assessing the risks of litigation costs and predicted results at the time upon bargained, stipulated facts and agreements. The RTCC/Sprint Settlement in the section entitled, "Conditions of Proposal" enumerated the following,

> ...This potential agreement is proposed by the parties to settle the instant controversy and is made without any admission against or use that is intended to prejudice any positions which any party might adopt during subsequent litigation, including further litigation in related proceedings.[17]

This bootstrapping of the RTCC/Sprint Settlement with the partial settlement stipulation of VZ/OCA is improper.

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[16] VZ M.B. at 19 (RTCC proprietary information omitted) (Citation is only to those rates proposed to be implemented by the RTCC, there is no reference to rates for business customers within the comparable density cells of the rural companies.).

[17] See, Access Charge Investigation Per Global Order of September 30, 1999, Docket Nos. P-00991648, P-00991649 and M-00021596 (Proposed Settlement Agreement, Phase II), December 16, 2002, Exhibit B at 5, #3 (Attached at the end of this Reply Brief for convenience).

D. The OSBA Position on Loop Allocation is Logical

Reply to VZ M.B. at 53 - 56

VZ notes that the position the OSBA has taken here regarding loop allocation is inconsistent with positions the OSBA has previously adovcated. VZ notes the testimony of the OSBA witness in a 1994 proceeding to justify its assertion.[18] VZ's view of the facts is short-sighted.

The testimony referenced by VZ was given in the Universal Service Order. In the Universal Service Order, the Commission stated,

> We reject the ILECs' arguments that the local loop is not a joint cost because other service which use the loop do not result in any additional costs... [W]e do not accept the ... 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 attribute to local service... We find persuasive the arguments... 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.[19]

The OSBA views this language as rejecting its position referenced in the VZ Cross Exhibit No. 10. Therefore, it would be defeatist for the OSBA to continue to advocate this position. While the OSBA agrees that our advocacy in the instant case is inconsistent with that found in VZ Cross Exhibit No. 10, the inconsistency is appropriate.

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[18] VZ M.B. at 54 note 142.

[19] Id, at 83.

III. CONCLUSION

For the reasons set forth in this Reply Brief, and previously stated in the OSBA's Main Brief, the OSBA respectfully requests the presiding Administrative Law Judge and the Commission to deny the Petition of Verizon Pennsylvania Inc. because Verizon Pennsylvania, Inc. and Verizon North, Inc. failed to carry their burden of proof due to lack of substantial evidence.

Respectfully submitted,

Angela T. Jones
Assistant Small Business Advocate

Dated: September 29, 2003

Exhibit B

EXHIBIT B

RTCC/SPRINT/OCA/OTS/OSBA
JOINT ACCESS PROPOSAL
IN RESPONSE TO THE COMMISSION'S
ACCESS CHARGE INVESTIGATION - PHASE II

Defined Terms

As employed herein, the following terms shall have these specified meanings:

- "ILEC" means an RTCC member or The United Telephone Company of Pennsylvania d/b/a Sprint ("Sprint").

- "RTCC" means Rural Telephone Company Coalition. The RTCC members are ALLTEL Pennsylvania, Inc. ("ALLTEL"), Armstrong Telephone Company - PA, Armstrong Telephone Company - North, Bentleyville Communications Corporation, d/b/a The Bentleyville Telephone Company, Buffalo Valley Telephone Company ("Buffalo Valley"), Citizens Telephone Company of Kecksburg, Citizens Telecommunications Company of New York,[1] Commonwealth Telephone Company ("Commonwealth"), Conestoga Telephone and Telegraph Company ("Conestoga"), Denver and Ephrata Telephone and Telegraph Company ("D&E"), Deposit Telephone Company, Frontier Communications of Breezewood, Inc., Frontier Communications of Canton, Inc., Frontier Communications of Lakewood, Inc., Frontier Communications of Oswayo River, Inc., Frontier Communications of Pennsylvania, Inc. ("Frontier PA"), The Hancock Telephone Company, Hickory Telephone Company, Ironton Telephone Company, Lackawaxen Telecommunications Services, Inc., Laurel Highland Telephone Company, Mahanoy & Mahantango Telephone Co., Marianna & Scenery Hill Telephone Company, The North-Eastern PA Telephone Company, North Penn Telephone Company, North Pittsburgh Telephone Company ("NPTC"), Palmerton Telephone Company, Pennsylvania Telephone Company, Pymatuning Independent Telephone Company, South Canaan Telephone Company, Sugar Valley Telephone Company, Venus Telephone Corporation, and Yukon-Waltz Telephone Company.

- "Larger ILEC," for purposes of this Proposal only,[2] means ALLTEL, Buffalo Valley, Commonwealth, Conestoga, D&E, Frontier PA, NPTC, and Sprint.

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[1] Because Citizens Telecommunications Company of New York has and continues to operate under New York access tariffs, it is not to be deemed a party to this proposal. Likewise, West Side Telephone Company was not included in the Global proceeding and is excluded here.

[2] The designation of larger and smaller ILEC was based upon the factor of 20,000 access lines and was for purposes of this Proposal only, for the purpose of redirecting monies out of the existing USF that were previously allocated to Sprint.

- "Smaller ILEC," for purposes of this Proposal only, means any RTCC member that is not a Larger ILEC.

Elements of Proposal

1) If an ILEC's intrastate traffic sensitive (TS) rates exceed its interstate TS rates, the ILEC may, at its sole discretion, lower its intrastate TS rates to match or move closer to its interstate TS rates, and simultaneously increase its Carrier Charge (CC) by a corresponding revenue neutral amount using the 12 months ended August 31, 2002, or the most current 12 month period, thereby creating a revised CC. An ILEC may, at its sole discretion, lower its intrastate TS rates to match or move closer to its interstate TS rates, and simultaneously increase its Carrier Charge (CC) by a corresponding revenue-neutral amount, again in 2004, using a recent 12 month period, thereby creating a further revised CC. All references to CC herein shall be to the then current revised CC if the ILEC has chosen to implement this element of the proposal.

2) Pursuant to an Order entered adopting this access proposal without modification, and after notice through bill insert, bill message or separately mailed notice to all customers at least 30 days prior to the date of any rate change, each ILEC will increase local rates, based upon one-day tariff compliance filing, to be effective on a date between January 1, 2003 and December 31, 2003 (as to be determined at the sole discretion of the individual ILEC) as follows:

   (a) Each ILEC with a weighted average R-1 rate below $10.83 as of December 31, 2002, will increase its R-1 rates in a manner to achieve a weighted average R-1 rate of $11. If the increase results in R- 1 rates greater than 150% of the current rate, then the increase shall be implemented in two steps, the second of which shall become effective no later than December 31, 2003. This increase shall be subject to the Company's Chapter 30 Plan rate rebalancing limitation with respect to the limitation on calendar year per line increases, i.e. not more than $3.50 per line per month in rate increases in any one year, but shall not be subject to any other Chapter 30 process or requirements. To the extent that any ILEC shall not be able to complete the required rate increase within any year, such rate increase may be deferred to the following year subject to the Company's Chapter 30 Plan rate rebalancing limitations. Any rate rebalancing in excess of that specifically referenced in Paragraph 2 shall be subject to the Chapter 30 Plan rate rebalancing process and requirements.

   (b) Each ILEC with a weighted average R-1 rate between $10.83 - $12 as of December 31, 2002, will increase its R-1 rates in a manner to achieve a weighted average R-1 rate of $13.50.

   (c) Each ILEC with a weighted average R-1 rate between $12.01 - $14 as of December 31, 2002, will increase its R-1 rates in a manner to achieve a weighted average R-1 rate of $15.

(d) Each ILEC with a weighted average R-1 rate between $14.01-$16 as of December 31, 2002, will increase its R-1 rates in a manner to achieve a weighted average R-1 rate of $16.

(e) Each ILEC may, at its sole option, increase its weighted average Business line rate by up to the same amount on a dollar basis that its weighted average R-1 rate is increased, but in no event may the B-1 rate be less than the R-1 rate.

3) Pursuant to an Order entered adopting this access proposal without modification, and after notice through bill insert, bill message or separately mailed notice to all customers at least 30 days prior to the date of any rate change, each ILEC may increase local rates, based upon a one-day tariff compliance filing, to be effective on a date between January 1, 2004 and December 31, 2004 (as to be determined at the sole discretion of the individual ILEC) as follows:

(a) Each ILEC with a weighted average R-1 rate of $11 (or less) as of December 31, 2003 (as described and calculated in Step 2 above) may increase its R-1 rates in a manner to achieve a weighted average R-1 rate of $13.50.

(b) Each ILEC with a weighted average R-1 rate of $13.50 as of December 31, 2003 (as described and calculated in Step 2 above) may increase its R-1 rates in a manner to achieve a weighted average R 1 rate of $15.

(c) Each ILEC with a weighted average R-1 rate of $15 as of December 31, 2003 (as described and calculated in Step 2 above) may increase its R-1 rates in a manner to achieve a weighted average R-1 rate of $17.

(d) Each ILEC with a weighted average R-1 rate of $16 as of December 31, 2003 (as described and calculated in Step 2 above) may increase its R-1 rates in a manner to achieve a maximum weighted average R- 1 rate of $18.

(e) Each ILEC may, at its sole option, increase its weighted average Business line rate by up to the same amount on a dollar basis that its weighted average R-1 rate is increased, but in no event may the B-1 rate be less than the R-1 rate.

Any rate rebalancing in excess of that specifically referenced in Paragraphs 2 and 3 shall be subject to the Chapter 30 Plan rate rebalancing process and requirements.

4) The monthly $16.00 cap on R-1 average rates established in the Global Order and any ILEC-specific weighted average rate cap which may have been established in any individual ILEC's Chapter 30 Plan will be increased for all ILECs to the weighted average $18.00 cap for a minimum three (3) year period January 1, 2004 through December 31, 2006. As to any ILEC which as of July 1, 2002 has hit the $16.00 cap and takes a credit from the USF, the ILEC shall continue to receive and apply the credit but would be limited to recovering from its customers future R-1 increases of $2.00 under the foregoing $18.00 cap reflecting the USF credit in effect as of July 1, 2002. Any approved

future increases in rates above the $18.00 rate cap for any ILEC shall also be recoverable from the USF under the exact same terms and conditions as approved in the Global Order. For example, if ILEC A's R-1 rates are currently $17.25, then their customer is billed $17.25 but receives a credit of $1.25 from USF, receiving a net bill of $16.00. ILEC A could, as of December 31, 2004, implement the provisions of Paragraph 3 hereof, increase its rates, if justified, by $2.00 to $19.25, charge its customers $19.25, reflect a credit of $1.25 to its customers, receive $1.25 from the USF, and then send a net bill to its customers of $18.00. If ILEC A justified an R-1 rate of $20.25, then it would be entitled to $2.25 from the USF and will send a net bill to its customers of $18.00.

5) Pursuant to an Order entered adopting this access proposal without modification, each ILEC shall have the right, in whole or in part, in lieu of raising local service rates as provided in Paragraphs 2 and 3 hereof to raise rates on other services by an equivalent amount, based on a one-day tariff compliance filing.

6) To offset the increase to local rates described above in Paragraphs 2 and 3, each ILEC (except Sprint) will file a compliance tariff(s) to reduce its CC or TS rates, or any combination thereof, by a revenue-neutral amount (depending upon changes undertaken in Paragraph 1, above), effective on dates consistent with the increases in Paragraphs 2 and 3.

7) In addition to any rate modifications undertaken pursuant to Paragraphs 2 and 3, each Smaller ILEC that increases its rates consistent with Paragraph 2, above, or is at the $16.00 capped rates on December 31, 2003, will additionally reduce its CC or TS rates, or any combination thereof, by the equivalent of $2 per line per month effective January 1, 2004 and shall receive an equal (a revenue-neutral) amount of support from the PA USF (annual total for all Smaller ILECs ranging from an estimated $1.8 million to $2.2 million), as provided in Paragraph 8.b. For ease of administration, the amount of additional USF received by the Smaller ILECs under this proposal will be determined as of December 31, 2003, and will be applied effective January 1, 2004 and each year thereafter for the duration of the Pa. USF (as addressed in Paragraph 1 of the Conditions of Proposal.) Beginning in 2005, any growth in access lines shall be accounted for in accordance with the annual USF calculation in 52 Pa. Code §63.165 and the Smaller ILECs' total receipt from the Pa. USF, including the amount provided for herein, shall be included in the Smaller ILECs' prior year funding.

8) (a) To offset the increase to Sprint's local rates described above in Paragraph 2, above, Sprint will file compliance tariff(s) to reduce its CC or TS rates, or any combination thereof, by a revenue-neutral amount (depending upon changes undertaken in Paragraph 1, above) effective on dates consistent with the increases in Paragraph 2.

(b) Beginning on or after January 1, 2004, Sprint will reduce its receipt from the current PA USF equal to the $2 per line per month reduction to the CC or TS, from Smaller ILECs as expressed in Paragraph 7. These dollars (annual total ranging from an estimated $1.8 million to $2.2 million) will be directly paid to the

Smaller ILECs, as described in Paragraph 7, from the PA USF to offset the Smaller ILECs' reduction in access charges on a revenue neutral basis.

9) On/or after January 1 of each year beginning in 2005 each ILEC may request such rate changes or rate rebalancing as are permitted by any Chapter 30 Plans and/or applicable statutory and regulatory provisions.

Conditions of Proposal

1) The only change to the existing universal service fund in PA is that Sprint will be shifting a portion (estimated to be $1.8 m - $2.2m) of its current fund receipt ($9 million) to Smaller ILECs as noted in Paragraphs 7 and 8 above. This Proposal is dependent upon all other aspects of the PA universal service program and the USF regulations remaining intact, including the recovery of rates above the rate cap into the future, specifically beyond December 31, 2003. The existing universal service fund, including the recovery of monies under Paragraph 4 of Elements of Proposal above, and regulations promulgated thereunder shall, as provided in the regulations, continue in place until modified by further Commission rulemaking.

2) Each ILEC reserves the right, subject to Chapter 30 Plan requirements, to change its access rates to ensure that each access rate element at least recovers its cost and the ILEC's service price index continues to be equal to or less than the ILEC's price stability index, in the event the ILEC's access rates are determined to be below cost based upon the development of a cost study.

3) This proposal is made in its entirety and no part hereof is valid or binding unless all components are accepted by all parties. Should any part be specifically modified or otherwise adversely impacted at any later date as to any ILEC or party, the ILEC or party shall have full unilateral rights to withdraw from the plan or revisit the plan in its sole discretion. This potential agreement is proposed by the parties to settle the instant controversy and is made without any admission against or use that is intended to prejudice any positions which any party might adopt during subsequent litigation, including further litigation in related proceedings. This agreement is conditioned upon the Commission's approval of all terms and conditions contained herein, except for the terms of this paragraph. If the Commission should fail to grant such approval or should modify the terms and conditions herein, this agreement may be withdrawn upon written notice to the Commission and all parties within five business days by any of the parties and, in such event, shall be of no force and effect. In the event that the Commission does not approve the Settlement or any party elects to withdraw as provided above and any proceeding continues, the parties reserve their respective rights to submit testimony or other pleadings and briefs in this or a related proceeding.

4) Elements of this Proposal shall constitute rate rebalancings or rate filings as defined and allowed under each ILEC's Chapter 30 Plan only to the extent of determining the maximum amount of an increase allowed per year, but shall not preclude the filing of one additional rate restructuring/rebalancing filing in the calendar year so long as the total

rate rebalancing rate increases do not exceed the maximum annual increase allowed and comply with other Chapter 30 Plan limitations and requirements. That is, implementation of proposed Paragraphs 2, 3 and 5 under Elements of Proposal are not considered rate rebalancings under the Chapter 30 Plans except in determining the maximum limitation on per year line rate increases to monthly dial tone rates. All parties retain all other rights under the approved Chapter 30 Plan to implement or oppose all rate rebalancings and other rate filings permitted under its Chapter 30 Plan. All parties reserve all rights in any proceedings relative to Chapter 30.

5) Increases to weighted average business rates on a dollar basis will be less than or equal to the increases to weighted average residential rates on a dollar basis.

6) This access proposal will be revenue neutral relative to each ILEC implementing a rate change. Absolutely no changes shall be required which are not revenue-neutral. Other access reductions that are not revenue neutral are permissible at the ILEC's sole option, but not required.

7) When notice is sent to each company's customers as provided in Paragraphs 2 and 3 under elements of Proposal, it will also be served upon all parties to this Proposal.

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

CERTIFICATE OF SERVICE

I certify that I am serving two copies of the Reply Brief on behalf of the Office of Small Business Advocate by e-mail and first class mail upon the persons addressed below:

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Date: September 29, 2003

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September 29, 2003

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

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

Dear Secretary McNulty:

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

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

Sincerely,

Joel H. Cheskis
Assistant Consumer Advocate

BTL

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

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

ORIGINAL

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

REPLY BRIEF OF THE
OFFICE OF CONSUMER ADVOCATE

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INFORMATION ALLEGED TO BE PROPRIETARY HAS BEEN DELETED

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I. INTRODUCTION

On December 30, 2002, Verizon Pennsylvania Inc. ("Verizon PA") and Verizon North Inc. ("Verizon North")(collectively referred to as "the Verizon Companies" or "Verizon") filed a Joint Petition regarding the further reduction of their access charges pursuant to the Bell Atlantic-Pennsylvania/GTE Merger Order[1] issued by the Pennsylvania Public Utility Commission on November 4, 1999, the Commission's 1999 Global Order,[2] and the generic access charge investigation docketed at M-00021596. On March 21, 2002, AT&T Communications of Pennsylvania, Inc. ("AT&T") 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 Verizon Companies' Petition and the AT&T Complaint were consolidated by Commission Order on December 24, 2002 and a Prehearing Conference was held on May 5, 2003.

This proceeding was litigated pursuant to the procedural schedule established in the May 5th Prehearing Conference, including evidentiary hearings on August 25 and 26, 2003, and the filing of Main Briefs on September 18, 2003. The Office of Consumer Advocate ("OCA") has fully participated in the proceeding including presenting a witness, filing testimony, cross-examining other parties' witnesses during hearings and filing a Main Brief on September 18th articulating its position. Pursuant to the procedural schedule, the OCA files this Reply Brief to respond to the arguments raised in the Main Briefs of the Verizon Companies, AT&T, MCI Worldcom Network

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[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.

Services, Inc. ("MCI"), Qwest Communications Corporation ("Qwest") and the Office of Trial Staff ("OTS").

II. PROPOSED SETTLEMENT

The main briefs submitted by the parties in this case are substantially devoted to their litigation positions. The OCA devoted the majority of its Main Brief to its litigation position, but also endorsed and supported the Verizon/OCA Joint Proposal ("Joint Proposal" or "Proposal") as an acceptable settlement. OCA M.B. at 33-34.

The OCA continues to support the Joint Settlement Proposal and urges the PUC to adopt such a proposal as an acceptable resolution of this case. OCA also notes the positive comments on the Joint Proposal submitted by Verizon and AT&T in their Main Briefs.

Verizon terms the Proposal as the "most reasonable resolution" of the proceeding and the proposal that should be adopted. Vz. M.B. at 15. Significantly, Verizon explains that the Proposal will result in equal carrier charges for Verizon Pa. and Verizon North and reduce the $8.64 per month Verizon North carrier charge to the $.63 level of Verizon Pa. Id. at 16. Verizon PA has had the lowest composite access charges in Pennsylvania and now Verizon Pa. and Verizon North would have the lowest composite access charges as their access rates would be equal across both companies. Id. at 17. Verizon also explains that the average increases for Residential and Business local rates under this Proposal will be less than $1.00 per month. Id. at 18.

AT&T has now also positively commented upon the Proposal. AT&T M.B. at 37-43. AT&T explains that "the proposal reflects a good faith effort to begin the process of access reform for the Verizon companies, and should be adopted by the

Commission and in accordance with the terms of the proposal, permitted to go into effect on January 1, 2004 as the first step in that process." Id. at 37-38. While the OCA does not propose that further access reductions are necessarily required, OCA appreciates AT&T's support. AT&T explains that the Proposal has responded to AT&T's concerns regarding some traffic sensitive rate restructuring. Id. at 39. AT&T recognizes the Proposal as a "significant step in the right direction." Id. at 41.

OCA reaffirms its support for the Joint Proposal, while continuing to advance its litigation position. Nonetheless, OCA joins Verizon and AT&T in support of the approval of the Joint Proposal. OCA below will continue to argue its litigation position, but wishes to be clear that the adoption of the Joint Proposal would be a positive step forward and would advance access reform.

III. SUMMARY OF REPLY ARGUMENT

The OCA submits that the Verizon Companies' intrastate switched access rates can be restructured to establish uniform access rates that would apply to both Verizon Companies with no rate increases for any other services. In the alternative, the Verizon/OCA Joint Proposal for settlement, as discussed in the August 4, 2003 Surrebuttal Testimony of Verizon witness Debra Berry, should be adopted as a reasonable compromise of this proceeding. This Joint Proposal has been recognized as a reasonable compromise of this proceeding by several parties to this proceeding and should be adopted by the Commission.

The OCA will further respond to various arguments set forth in the parties' main briefs as set forth below.

IV. REPLY ARGUMENT

A. The Commission Must Carefully Consider Issues Of Local Revenues And Network Costs As It Determines The Required Local Rate Rebalancing In This Proceeding.

1. Introduction

Throughout the parties' main briefs the issue of how to compare network costs and local exchange service revenues is frequently discussed. The OCA's primary concern in this proceeding is to properly consider the revenues produced by consumers that purchase local service in comparison to the network costs of the Verizon network. This is essential in order to determine whether and by how much local rates should increase as a result of access reductions. The IXCs should adequately pay for the joint and shared costs of the network so that the shift of such costs to local service consumers is properly considered. In this section, the OCA will discuss the various issues that arise in this proceeding in that area.

2. Cost Based Rates Must Consider All Network Costs

Throughout the IXC main briefs, there is a great deal of discussion about setting "cost based" rates for access services. AT&T M.B. at 4-6, MCI M.B. at 7-8, Qwest M.B. at 9-10. What this advocacy really means is that the IXCs are willing to pay for the additional or incremental costs that they place on the network, but nothing more. In a nutshell, the problem is that everybody wants to use the network, but few are willing to pay for it. "Cost based rates" seems an attractive catch phrase – until one considers that most network costs are not included in such rates.

OCA witness, Mr. William Dunkel, has explained that, as the IXCs have defined cost, this includes only the "incremental" Total Service Long Run Incremental

Cost or TSLRIC cost. OCA St. 1-S at 8. This can be considered as the rate "floor," but should never be considered the level at which rates must be set. Mr. Dunkel explained:

> The TSLRIC is not meant to show the full cost of providing a service, but the TSLRIC is designed for only limited purposes. The TSLRIC defines the point below which a service is being "subsidized." The TSLRIC provides the "floor" for a price. The TSLRIC is not normally accepted as determining the "reasonable" or "fair" price for a service, since it excludes the cost of all of the shared facility. However, the costs of those shared facilities must be incurred in order for that service to be provided. A service should normally be priced above the TSLRIC so that it will cover a portion of the cost of shared facilities that are needed to provide that service (but which are excluded from the calculation of the TSLRIC).

OCA St. 1 at 49. Verizon has also offered a similar argument, i.e. that access charges "still can and should provide some support to the shared fixed and common costs of the network by being priced above incremental costs." Vz. M.B. at 39. Yet, the IXCs argue that this TSLRIC floor is all that they should pay as "cost based" rates.

Such incremental cost pricing concepts simply overlook the fact that most of the network costs are not incremental to any particular service, but shared across the network. Loop costs are an outstanding, and the most significant, example of such shared costs. All Verizon services – including access service – depend to some extent on the existence and use of the loop.

Given these basic network facts, it is untenable that the IXCs would assert that they should bear no responsibility for the recovery of any shared network costs. Clearly, the IXCs sell their services over the Verizon network. It is no more acceptable for the IXCs to make no contribution toward such network costs, than it is for a trucking company to pay nothing for the highways that it uses. The IXCs' offer and insistence – that they must pay no more than the incremental cost of access - is the equivalent of a perennial traveling companion chipping in only for gas money. Every driver knows that gas money

does not really pay for the car – and paying only the incremental costs of access makes no contribution to the network that the IXCs' depend upon.

3. The PUC Has Not Dismissed the Loop as a Joint Cost through the Global Order

Throughout the briefs of Verizon and the IXCs, reference is made to the Recommended Decision[3] in the Generic Investigation of Access Charge Reform and the PUC's supposed adoption of the conclusions contained within that Recommended Decision in the Global Order. For example, AT&T and Verizon allege that the PUC has dismissed the "'loop as a joint cost'" theory by a comprehensive adoption of the Access Charge RD through the Global Order. AT&T M.B. at 32, Vz. M.B. at 54 n.141.

The OCA submits that the Global Order did not adopt all of the conclusions contained within the Access Charge RD. The Commission in the Global Order generally stated that it incorporated from the Access Charge RD "various conclusions regarding the necessity of access reform in a competitive environment."[4] By no means did the PUC adopt all of the determinations announced in the Access Charge RD on joint cost recovery or other issues. For example, the Access Charge RD proposed an intrastate Subscriber Line Charge of $3.50 per month in order to fund access reform.[5] However, in the Global Order, the PUC capped Verizon PA rates through December 31, 2003 – even while requiring substantial access reductions - and approved no intrastate SLC.[6] While adopting certain conclusions regarding access reform, the PUC rejected the

[3] Generic Investigation of Access Charge Reform, Docket I-00960066, Recommended Decision, ALJ Michael Schnierle, June 30, 1998 ("Access Charge RD").
[4] Global Order at 27.
[5] Access Charge RD at 78-81.
[6] Global Order at 194.

type of access reform that the Access Charge RD proposed and did not adopt the rejection of the joint cost analysis.

4. The Commonwealth Court Has Rejected the IXCs' Incremental Cost Arguments

In addition to the above, Verizon writes in its Main Brief that "[t]here is nothing in the *Global Order* that suggests that the Commission intended to allocate loop costs to other services, like the cost of switched access."[7] The Commonwealth Court has disagreed. In the Global Order Appeal, the Commonwealth Court noted the testimony of the OCA witness regarding AT&T's request to reduce access rates to incremental cost. The Commonwealth Court wrote:

> [t]he Office of Consumer Advocate responds to AT & T by submitting that there is no legal authority requiring the PUC to reduce access rates to the incremental cost of access service. OCA witnesses testified that such a reduction could require customers other than the long distance carriers to pay all of the joint and common costs of the network and therefore should be rejected. The logic of that analysis commends it.[8]

The decision of the Commonwealth Court on this point in the Global Order Appeal is illuminating. The Commonwealth Court decided:

> One of the lessons of this proceeding is that the cost of excessively priced elements must be reduced to a point nearer to actual incremental cost, but not so greatly as to eliminate the support such revenue provides to other areas of the system that need that support. The record here confirms the soundness of the PUC's view, based *on evidence* from consumer witnesses, that users of all services, including access, should share in the payment of total network costs, with the cost of the local loop included as an element of that total network.[9]

Thus, it is clear that the Commonwealth Court has ruled that it is entirely appropriate that access services should contribute to the cost of the loop. Loop facility costs must be

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[7] Verizon M.B. at 54.

[8] Bell Atlantic-Pennsylvnaia, Inc., v. Pennsylnvaia Public Utility Commission, 736 A.2d 440, 479 (Commw. Ct. 2000)(footnotes omitted)(Global Order Appeal).

[9] Bell Atlantic-Pennsylvnaia, Inc., v. Pennsylnvaia Public Utility Commission, 736 A.2d 440, 480 (Commw. Ct. 2000)(footnotes omitted).

allocated to all services, like access service, that employ the local loop facility. That is the law.

5. Verizon's Arguments Concerning Section 1325 Must Be Rejected

Rather than providing an appropriate Section 1325 cost study, Verizon attacks the cost study submitted by Mr. Dunkel.[10] The OCA would point out that Verizon has the burden of proving that its section 1325 study is complete and accurate. Here, the OCA has attempted to deduce what costs would constitute a reasonable allocation from multiple sources -- NECA costs and UNE rates -- and has presented testimony that Verizon's proposed loop facility costs and allocations are out of line with reasonable estimates as further explained below. The OCA therefore submits that, given the evidence, Verizon has not carried its burden of proof on this issue under section 1325 by failing to provide an appropriate cost study as required.

In its Main Brief, Verizon proposes that section 1325 of the Public Utility Code does not apply in this proceeding, and it bases this legal conclusion in large part on the testimony of its economic witness Dr. Taylor.[11] Verizon, however, properly indicates in a footnote that what it proposes is not the law, and that the Commission has determined that the law is the opposite of Verizon's position.[12] Verizon explains in its Main Brief that in Bell Atlantic's 1996 rate rebalancing proceeding the Commission issued a "finding that section 1325 applies to any rate proceeding."[13] Although Verizon attempts to avoid the fact that section 1325 applies to this proceeding, Verizon does

[10] Verizon M.B. at 25-26. Part of this attack is Verizon's proposal that Mr. Dunkel would recover 250% of loop costs from all services. Vz. M.B. at 26 n.60. Section 1325 is designed as a cost allocation mechanism to avoid excessive local service rate increases as Mr. Dunkel has explained in his testimony and demonstrated in his schedules. Section 1325 need not be used as any cost allocator to set rates for other services as Verizon suggests. Certainly, the OCA has not proposed recovery of loop costs more than once.
[11] Verizon M.B. at 22.
[12] Verizon M.B. at 23 fn. 49.
[13] Verizon M.B. at 23 fn. 49.

recognize that section 1325 applies under settled PUC precedent. Thus, by noting that section 1325 applies, Verizon implicitly acknowledges that the cost studies required by section 1325 are also necessary.

Verizon also proposes that its cost study satisfies section 1325. This is not correct. Verizon's study is incorrect because it has allocated 100% of its local loop facility costs to local exchange service for the purpose of preparing cost studies in this proceeding.[14] The overstated local loop facility costs submitted by Verizon in this proceeding clearly suffer from this error. In this proceeding, section 1325 requires that Verizon allocate local loop facility costs to all those services that use the local loop, and not just to local exchange service. Given that Verizon has not provided the Commission with appropriate cost studies, it therefore cannot prevail in regard to its position in this litigation.

6. Verizon's Proposed Loop Costs Are Excessive

Verizon's failure to comply with section 1325 in this regard is compounded by the high cost of its loops that it has assigned to local service. Verizon's position is that its loop facility costs are ***PROPRIETARY BEGINS*** ***PROPRIETARY ENDS*** for Verizon and ***PROPRIETARY BEGINS*** ***PROPRIETARY ENDS*** for Verizon North.[15] Such loop costs are excessive and compound the problem of Verizon allocating all such high loop costs to local service. Verizon also explains that, if it had applied the *Tentative Order* UNE rate inputs, it would have produced loop facility costs from the Verizon cost model of $23.48

[14] OCA Cross Exh. No. 6.
[15] Verizon M.B. at 23.

for Verizon and $29.08 for Verizon North given various adjustments.[16] Thus, Verizon's excessive loop costs, as based upon cost model inputs that are at odds with those used by the Commission, cannot be used in any type of cost analysis.

Finally, it is instructive to examine the local loop facility costs that Verizon has submitted to the National Exchange Carriers Association ("NECA"). Those rates indicate that at ***PROPRIETARY BEGINS*** ***PROPRIETARY ENDS*** Verizon has one of the lowest loop facility costs in Pennsylvania.[17] Given the array of data that indicate that Verizon's loop facilities costs are most likely in the range of ***PROPRIETARY BEGINS*** ***PROPRIETARY ENDS*** it is clear that Verizon's proposed look costs are in excess of any acceptable range.

7. Verizon's Arguments Concerning Retail Costs Must Be Dismissed

Verizon also criticizes various parties for calculating the cost of local service without also accounting for some concept of Verizon's "retail costs." Vz. M.B. at 23-24. However, Verizon did not calculate or use such a retail cost as a component of Verizon's own cost of local service in its initial case. Verizon's witnesses Dean and Sanford calculate "an average monthly cost per line for flat-rate local service for residential customers" by simply adding together the costs of a DTL (Dial Tone Line) and usage. Vz. St. 2.0 at 20. While Mr. Dunkel has disagreed with Verizon concerning the proper calculation of the Dial Tone Line cost, Dunkel has also added his Dial Tone Line cost and usage to arrive at the OCA's stand alone cost of local service.

Most importantly, neither Verizon nor OCA has attempted to add an additional amount of "retail costs" in the analyses contained within the initial testimonies.

[16] Verizon M.B. at 24.
[17] OCA Cross Ex. Exh. No. 1.

Moreover, Verizon points out in its Main Brief that "the parties did not challenge the cost of usage set forth in Verizon's cost study, which Mr. Dunkel used to calculate an average usage cost of **[BEGIN VERIZON PROPRIETARY] [END VERIZON PROPRIETARY]** for the two Verizon companies." Vz. M.B. at 25. In short, Verizon and OCA did the same type of analysis – and used the same usage cost – in calculating the cost of local residential service. Verizon has no room to complain about any supposed lack of "retail" costs in its own analysis that the OCA largely replicated.

Even so, Verizon now criticizes Mr. Dunkel for not including some retail costs in his cost analysis. Verizon calculates that Mr. Dunkel's cost of local service should be increased by a 25.69% retail cost adder in order to increase the cost of the local loop by $4.79 per line from $18.69 to $23.48. Vz. M.B. at 24 n.54. As noted above, such a retail cost adder is unnecessary and inconsistent with Verizon's own cost analysis. However, even if such a retail cost adder were made in the Dunkel cost analysis, Verizon's local service revenue would continue to exceed its costs.[18]

8. Verizon Fails to Recognize the Revenues That Consumers Pay For Local Services

A fundamental problem with the Verizon local service cost versus rate analysis is that Verizon consistently understates the rates that consumers pay. First, when Verizon does their revenue versus cost analysis for local service, Verizon avoids referencing the federal Subscriber Line Charge ("SLC") that consumers pay to Verizon in

[18] ***PROPRIETARY BEGINS***

PROPRIETARY ENDS

addition to their tariffed intrastate local service charge. Consumers pay the SLC as a federal rate charge for purchasing local service.

OCA emphasizes that the cost of the local loop is generally assigned 75% to the intrastate jurisdiction, e.g. Pennsylvania, and 25% to the federal jurisdiction. The cost of the loop is then recovered through various Pennsylvania PUC set rates, e.g. local exchange service, Pennsylvania intrastate access and toll rates, and discretionary services, such as Caller ID, etc. This represents most of the revenue that Verizon receives for using the loop. But Verizon also receives revenue from consumers' SLC payments for the use of the same loop. As Mr. Dunkel explained, the weighted average SLC rate for Verizon Pa. and Verizon North is ***PROPRIETARY BEGINS*** ***PROPRIETARY ENDS***. OCA St. 1 at 19.

Verizon must not be permitted to ignore these real dollars that consumers pay for local service. As Verizon is considering the total cost of the loop, i.e. the intrastate and interstate portions of the loop, Verizon must consider all of the interstate and intrastate portions of the revenues related to local service. Yet, Verizon has consistently neglected to include the SLC revenues in its revenue/cost analysis. Mr. Dunkel, however, has consistently added ***PROPRIETARY BEGINS*** ***PROPRIETARY ENDS*** OCA St. 1 at 19, 55, Sch. WDA-2. Mr. Dunkel's OCA revenue/cost analysis avoids the errors in Verizon's analysis as OCA/Dunkel includes all of the local service revenues, while Verizon does not.

Verizon has attempted to respond to its failure to recognize SLC revenues by asserting that the RTCC has also not included their SLC rates in the RTCC settlement document analysis. Vz. St. 1.1 at 17-18. OCA submits that the RTCC document was a settlement and was not submitted as a comprehensive analysis of the RTCC loop costs in comparison with local and SLC revenues in order to justify the proposed local rate increases. In a settlement document, such cost and revenue analysis is not required. In the present litigated rate case, particularly considering the requirements of Section 1325, such a complete revenue/cost analysis is required.

Second, Verizon creates an additional problem – for the first time in its Main Brief – by using an intrastate Verizon local service revenue that differs from the revenues set forth in its direct case. In the Direct testimony of Debra Berry and Michael Wirl, these witnesses stated:

> For the sake of uniformity, the $13.50 was calculated by the method used by the parties to the RTCC Settlement, which involves dividing annual residence basic local revenue (dial tone line and local usage) for 2001 by the residence access lines in service in June 2001.

Vz. St. 1.0 at 17. Verizon used the $13.50 average rate to demonstrate how the Verizon proposed local rate increases would raise local rates in the future. Vz. 1.0, Exh. MJW-6. OCA has consistently used this same $13.50 average local rate calculation in determining the effect of increases and the extent to which Verizon's local rates recover the appropriate costs. OCA St. 1 at 19, 55, Sch. WDA-2.

In Surrebuttal testimony, Verizon introduced into the record through a footnote revised local rate calculations for Verizon Pa. and Verizon North of $13.31 and $12.55 respectively. Vz. St. 1.1 at 8 n.6. Verizon has no explanation as to the nature of such local rate decreases, but speculates that some rate reductions may have been

overlooked in the earlier data. Id. Verizon has not even recalculated an average local rate for the two companies comparable to the $13.50 that it earlier relied upon.

Nonetheless, Verizon now uses $13.31 and $12.55 in its Main Brief to perform a new local service revenue versus cost analysis. Vz. M.B. at 23. The PUC should dismiss such late filed recalculations in this case. These calculations have not been explained adequately upon the record, and are incomparable to the $13.50 average previously relied upon by all parties.[19]

9. OTS Loop Facility Cost Allocation

While the OCA agrees with the Office of Trial Staff ("OTS") that the local loop facilities are a joint and common cost, the OCA will respond to OTS's proposed allocation of the costs of the local loop facility among local exchange rate and other services. The OTS states "...the Commission has determined that 74% of the cost of the local loop should be recovered through local exchange rates" and proposes such a cost allocation of the loop in this case.[20] Further clarification is required concerning the PUC's decision use of such a loop cost allocator.

Approximately six months after it issued the January 28, 1997 Order that is cited by OTS, the Commission reconsidered and revised the cost allocation scheme it had developed in the January 28, 1997 Order;[21] on July 31, 1997, the Commission on reconsideration modified its January 28, 1997 decision on this issue. In the July 31, 1997 Order, the PUC recognized that it should attempt to achieve "a degree of consistency"

[19] Such Verizon evidence is also untimely and should not be relied upon. Evidence that substantially varies from the participant's case-in-chief cannot be used on contested issues of fact. 52 Pa. Code § 5.243(f).
[20] OTS M. B. at 9.
[21] Docket No. R-00940035 (January 28, 1997) (Universal Service Order).

between its universal funding mechanism and that adopted by the FCC.[22] The PUC noted that: "The Pennsylvania costing method allocates loop cost based on [Subscriber Line Usage] SLU, whereas the FCC mechanism does not. GTEN Supplemental Petition at p. 10."[23] The PUC further explained such differences as follows:

> The differences between the FCC's approach and our approach in this respect were also pointed out by the OCA which noted that the Commission has calculated universal service funds by setting a BUS [Basic Universal Service] rate; but that the FCC has calculated BUS costs using a very different approach. OCA Supplemental Petition at p. 9. n3. OCA states that the FCC has used a benchmark of revenue per line for a group of services including local, discretionary and interstate and intrastate access services. OCA Supplemental Petition at p. 8. OCA advocates that the Commission consider modifying some of its cost determination requirements in order to be consistent with the FCC's Universal Service Order.[24]

The PUC went on to agree with the OCA that the PUC's universal service cost allocation mechanism should be consistent with that used by the FCC as advocated by the OCA.[25] The PUC repeated its determination that the loop is a joint cost and rejected its 74% [Subscriber Line Usage] SLU allocator in favor of the FCC approach as "the FCC takes full account of the contributions made by other services by taking into account the revenues received from all of those services in determining BUS funding levels."[26]

In short, the PUC adopted a cost recovery mechanism similar to that proposed by the OCA in this proceeding. When weighing Basic Universal Service costs and revenues, the Commission decided to use all revenues produced from: "local,

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[22] In re: Formal Investigation to Examine and Establish Updated Universal Service Principles and Policies for Telecommunications Services in the Commonwealth, Docket No. I-00940035, Order on Reconsideration at 26 (July 31, 1997).

Verizon also cites the Order on Reconsideration as seeking to maintain consistency between the PUC's cost allocation approach and that of the FCC. Vz. M.B. at 53. However, Verizon fails to explain that such consistency considers all service revenues as applying to loop cost recovery.

[23] Id.

[24] Id. at 25-26.

[25] Id. at 26.

[26] Id. at 27.

discretionary and interstate and intrastate access services."[27] Accordingly, the PUC rejected upon reconsideration its determination to apply 74% of loop costs through a SLU allocator to Basic Universal Service.

B. Qwest's Proposal To Reduce Access Rates And Increase Basic Local Service Rates In Amounts Even Greater Than Proposed By Verizon Is Not "Good For Consumers" As It Contends, But Rather Is Without Merit And Should Be Wholly Rejected.

In its Main Brief, Qwest argues that the Commission should reduce the Verizon Companies' intrastate switched access charges to the interstate levels in a revenue-neutral and a competitively-neutral manner. Qwest argues that Verizon PA's access charges should also be reduced and "the implicit subsidies in Verizon's access charges [be removed] on a revenue-neutral and competitively-neutral basis."[28] Qwest claims that such actions would benefit Pennsylvania consumers. However, Qwest's proposal then includes raising the price of basic local service by *** **BEGIN PROPRIETARY** *** *** **END PROPRIETARY** *** per line to ensure the revenue-neutrality of the access charge reductions.[29]

By arguing that access rates should be reduced through substantial increases in basic local service rates, Qwest seeks to establish a further Pennsylvania precedent whereby ILECs may be allowed to perform such revenue-neutral rate rebalancing in other states. The OCA is very concerned with the *** **BEGIN PROPRIETARY** *** *** **END PROPRIETARY** *** increase to basic local service rates which Qwest proposes which is significantly higher than any of the Verizon Companies' proposals in this proceeding. As a successor to the former Regional Bell

[27] Id. at 26.
[28] Qwest M.B. at 6-7.
[29] Id. at 11.

Operating Company (RBOC) US West, it is understandable that Qwest endorses local rate increases, but as pointed out by Verizon in its Main Brief, Verizon M.B. at 45, Qwest has not followed its own advice regarding access charge reductions in its own states. In any case, Qwest's self-serving claim that its position is intended to benefit Pennsylvania consumers should be rejected.

Qwest's argument that the Verizon Companies' intrastate access rates should be in parity with their interstate access rates is extreme.[30] There is no reason why the Commission should cede its regulatory authority to follow blindly the FCC's determinations. In fact, given the drastic reduction in access charges and equally drastic increase to basic local service rates that such action would require it is clear that Qwest's position in this proceeding should not be adopted.

Furthermore, Qwest's argument that its position is "good for consumers"[31] is without merit and should be wholly rejected. Raising basic local service rates so that other rates may *possibly* be lowered is not "good for consumers." It would be "better" for consumers to avoid all of the local rate increase and not just *possibly* get back a portion of the increase if the IXCs seek to do so by reducing their rates.

Furthermore, increasing the basic local service rate in anticipation of decreasing access charges will not benefit low-volume, long-distance callers. These consumers would be required to pay the basic local service rate increase and not receive the benefit of any possible access charge reduction because they do not make a sufficient number of toll calls. Many low-volume, long-distance callers are low-income customers who cannot afford basic local service rate increases.

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[30] Id. at 19-23.
[31] Id. at 17-19.

Qwest's arguments that raising the basic local service rates will be "good for consumers" because it will further competition[32] is without merit. For example, increasing rates $2 so that a competitor can provide service for $1 less is not "good for the consumers" because it still costs the consumer an additional $1. While Qwest purports to make a pro-consumer argument, none of the public advocates in this proceeding support raising basic local service rates to the extreme extent that Qwest proposes.

After arguing for substantial revenue-neutral access charge reductions and offsetting substantial increases in basis local service rates, Qwest then goes out of its way to argue that the Commission should refrain from requiring carriers "in a competitive marketplace" to pass through the reductions to their end-users.[33] Qwest argues that the interexchange market is "sufficiently competitive to ensure flow-through without the need for carriers to document flow-through to state commissions."[34]

While elsewhere in its Main Brief, Qwest argues that the Commission should be more consistent with recent industry policies to reflect the dramatic change in the industry over the past decade, Qwest here argues that "requiring a flow-through of access charge reductions by IXCs would be an attempt to modify IXC retail rates based on one element of cost of service [that] is an absurd proposition from a traditional ratemaking standpoint."[35] This argument further shows the inconsistency of Qwest's positions in this proceeding. Qwest wants "traditional ratemaking" when it benefits the

[32] Id. at 7, 11-12.
[33] Id. at 23-24.
[34] Id. at 23.
[35] Id. at 24.

Company and "recent policies" when they benefit the Company. Quite simply, Qwest is trying to have its cake and eat it too.

Qwest makes this argument without committing to flow through any access reductions to customers that may arise as a result of this proceeding. As discussed in the Verizon Companies' Main Brief in this proceeding, "this Commission's own holdings and the IXC's admissions on the record demonstrate that toll services to end users are priced based on what the market will bear – not based on the magnitude of any particular ILECs intrastate access charges."[36] Qwest's argument that competitive pressures will force the flow-through of any access reductions is without merit and should be rejected.

Qwest also attacks the OCA for joining with Verizon to establish the Verizon/OCA Joint Proposal because "this proposal is starkly inconsistent with the OCA's vigorous contention that Section 1325 of the Public Utility Code bars as a matter of law any revenue-neutral increases to local rates."[37] As an initial response to this argument, this is a distortion of the OCA's position in this proceeding. The OCA contends in this case, given the facts on the record in this proceeding, that Verizon has not sustained its burden of proof under Section 1325 to support its proposed local rate increases. The OCA has not argued that Section 1325 of the Public Utility Code bars, as a matter of law, any revenue-neutral increases to local rates as Qwest incorrectly contends in its Main Brief.

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[36] Verizon M.B. at 42-43 (noting that this Commission has already determined that IXCs are setting their rates on a national level using flat rates that have no relationship with the access rates of any specific ILEC)(citation omitted).

[37] Id. at 4.

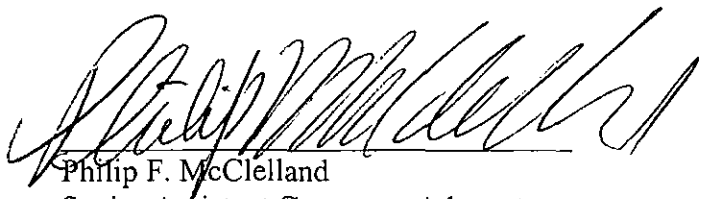
By way of further response, the OCA submits that it is unreasonable for Qwest to criticize the OCA for attempting to reach a reasonable settlement of the contested facts in this proceeding. This Commission encourages settlement and, as discussed in the OCA's Main Brief, the Verizon/OCA Joint Proposal represents a reasonable compromise of this proceeding that achieves the Commission's articulated goals. Qwest was certainly aware of the Joint Proposal and had ample opportunity to join it or to seek modifications. The OCA does not criticize Qwest or the other parties for not joining the Joint Proposal but Qwest should not criticize the OCA for offering a compromise in the interest of settlement.

As such, Qwest's arguments in this proceeding are without merit and should be wholly rejected. Qwest's proposal to reduce access rates and increase basic local service rates is not "good for consumers" as it contends.

IV. 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 testimony of OCA witness William W. Dunkel in this proceeding. In particular, the OCA proposes that Verizon's intrastate switched access rates be restructured 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 29, 2003
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CERTIFICATE OF SERVICE

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

I hereby certify that I have this day served a true copy of the foregoing document, Office of Consumer Advocate's Reply Brief, 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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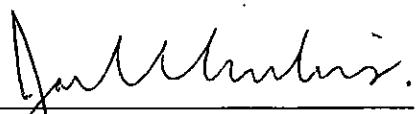

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Re: Complaint of AT&T Communications of Pennsylvania, LLC.
v. Verizon North, Inc. and Verizon Pennsylvania Inc.
Docket No. C-20027195

Dear Mr. McNulty:

Enclosed for filing in the above-referenced proceeding are the original and nine (9) copies of the public version of the Reply Brief of AT&T Communications of Pennsylvania, LLC.. **Please note that an additional copy of the proprietary version of that brief, containing information that is deemed proprietary by Verizon Pennsylvania Inc., is being provided under seal.**

Copies of the proprietary version of the brief are being served on the administrative law judge and on all parties of record as indicated on the attached certificate of service. Please contact me if you have any questions regarding the enclosures.

Very truly yours,

Robert C. Barber

Enclosures

R.I.P

cc: (w/ encl)
The Honorable Cynthia W. Fordham (w/ diskette)
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Docket No. C-20027195

The undersigned hereby certifies that true and correct copies of the Reply Brief of AT&T Communications of Pennsylvania, LLC. were caused to be served on the persons named below by electronic and overnight mail in accordance with the requirements of 52 Pa. Code §§1.52 and 1.54:

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Dated: September 29, 2003

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

AT&T COMMUNICATIONS OF PENNSYLVANIA, LLC.,	
v.	Docket No. C-20027195
VERIZON NORTH, INC.,	
and	
VERIZON PENNSYLVANIA INC.,	

REPLY BRIEF OF
AT&T COMMUNICATIONS OF PENNSYLVANIA, LLC.

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Dated : September 29, 2003

PUBLIC VERSION

INTRODUCTION

The Commission could properly be excused if it found itself bemused – if not confused -- by the discordant positions reflected in the initial briefs of Verizon and the public advocates. On the one hand, the public advocates – OCA, OTS, and OSBA -- ignoring their own recent support for a significant access reform proposal submitted by Sprint and the RTCC, attack proposals for necessary access reductions by the Verizon companies on the basis of a "loop as a joint cost" theory that Verizon correctly discounts as making "little sense."[1] At the same time, Verizon, while properly challenging the public advocates' proposals to increase the companies' access rates, nevertheless attempts to preserve some level of implicit subsidies in its rates with the claim that interexchange carrier should provide support for local exchange rates through above-cost access charges. And to complete this fractious picture, OCA, after challenging the necessity for any access reductions throughout the majority of its brief, joins with Verizon to propose a settled resolution of this case that generally mirrors the structure of the Sprint/RTCC proposal.

Fortunately, the Commission's resolution of that same Sprint/RTCC proposal provides guidance for cutting through this clutter. In its order approving that proposal, the Commission reaffirmed its "objective to reduce implicit subsidy charges such as access charges that impede competition in the

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[1] VZ Main Brief at 53.

telecommunications market."[2] Consistent with that objective, the Commission approved a plan that permitted Sprint and the independent local exchange providers to reduce access rates by a total of $25 million in the first year, with additional, smaller reductions in the second year of the plan. The companies were then permitted to offset these access reductions dollar-for-dollar with increases in basic residential local exchange rates. The Commission found that this plan made not only helped make "implicit charges become explicit charges," but in doing would help encourage the development of a "more level playing field" in Pennsylvania's local and long distance markets.[3]

These same principles apply with even greater force in this case. Verizon already is the overwhelmingly dominant provider of local exchange services in the Commonwealth, and just a few years after gaining entry into the interLATA market already is the third largest long distance carrier in the country. Absent aggressive action by the Commission to eliminate the massive amount of subsidy that currently afflicts Verizon's intrastate access rates – implicit subsidies that by Verizon's own admission exceed **[BEGIN VZ PROPRIETARY]** [4] **[END VZ PROPRIETARY]** – Verizon will be able to leverage that artificial pricing advantage to the detriment of competition and consumers in both the local and toll markets.

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2 *Access Charge Investigation per Global Order of September 30, 1999*, Order, Docket Nos. M-20021596 et al., July 15, 2003 ("Sprint/RTCC Order"), at 10.

3 Id.

4 AT&T Cr. Exh. 7.

Fortunately, the record provides a vehicle for the Commission to carry out its pro-competitive objectives and begin the process of reducing Verizon's intrastate access rates. Specifically, and as a first step towards final reform, the Commission should approve the Verizon/OCA access proposal. As AT&T explained in its Main Brief, although the access reductions expected to result from implementation of that proposal will still leave Verizon's access rates priced substantially in excess of cost, the proposal is a reasonable and good faith plan for commencing access reform for the Verizon companies. It thus should be adopted without further delay.

In taking this step, however, it is important that the Commission recognize that, as Verizon itself notes, implementation of the Verizon/OCA is in fact only "a first step."[5] The bloat that will remain in Verizon's access rates after this particular plan is implemented will not eliminate itself. Only continued action by the Commission will ensure that the process of reform is completed and that the Commission's stated goal of leveling the playing field for all telecommunications providers – ILECS, IXCs, CLEC and wireless providers – is achieved.[6]

In that light, Verizon and some of the public advocates have taken positions in their briefs that seek to deter the Commission from carrying out this important work. While AT&T dealt with the bulk of those arguments in its Main Brief, certain contentions are addressed further below.

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5 VZ Main Brief at 20.

6 See Sprint/RTCC Order at 10.

ARGUMENT

I. VERIZON'S ARGUMENTS IN FAVOR OF MAINTAINING ABOVE-COST ACCESS RATES ARE MERITLESS.

Verizon has advanced a variety of plans in this proceeding for reducing access rates, including one that involved the elimination of the Carrier Charge for both Verizon companies, and now has settled on a proposal that would involve approximately **[BEGIN VZ PROPRIETARY] [END VZ PROPRIETARY]** in total access reductions.[7] In the course of making these proposals, however, Verizon also has made it clear that it has not given up entirely on the artificial pricing advantages it garners from its access rates. To that end, Verizon contends that the Commission should continue to permit implicit subsidies to be recovered in Verizon's above-cost access rates.[8]

This contention is utterly without merit. In fact, it is directly contradicted by Verizon's advocacy in this proceeding. As Verizon explained in its Main Brief, access rates were originally set at many multiples of the cost of providing carrier access service through the practice of "residual pricing."[9] This process, like the public advocates' much-loved "loop is a joint cost" theory, was a legacy of a monopoly environment, in which Verizon was barred from the intrastate long

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7 Verizon's belated characterization of the elimination of the CC as an "extreme" position is more than a little puzzling, given that, as Verizon witness Mr. Wirl admitted, it was Verizon that originally proposed that step. Tr. 77. The fact that Verizon for some reason now is apparently trying to distance itself from that proposal – and then is attacking the IXCs for agreeing with that original plan -- should be taken with more than just a grain of salt.

8 VZ Main Brief at 38-39.

9 See VZ Main Brief at 7-8.

distance market while the IXCs and other potential competitors were foreclosed from entering Verizon's local exchange markets.

That environment was turned on its head in the last decade through the enactment of Chapter 30 in 1993 by Pennsylvania's General Assembly and with the enactment of the Telecommunications Act of 1996 by the Congress. There is now a state and national policy opening all telecommunications markets to competition. As ALJ Schnierle recognized in his Recommended Decision in the Generic Access Investigation, those laws effected a sea change in the regulatory environment, rendering "residual pricing" and "loop allocation" obsolete and requiring that the Commission undertake reforms to ensure that the price of all services more closely reflect their underlying costs.[10]

Verizon acknowledges the impact of these changes in its Brief. As Verizon describes it, Chapter 30 and the Telecommunications Act reflected a "break with the old regulatory model. . . ."[11] According to Verizon, this change prompted the FCC and this Commission to begin "shifting revenue away from access charges and into explicit end user charges."[12] In fact, relying on this regulatory evolution, Verizon dismisses the public advocates' reliance on the

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10 See *Generic Investigation of Intrastate Access Charge Reform*, Docket No. I-00960066, Recommended Decision, June 30, 1998, at 53.

11 VZ Main Brief at 8.

12 Id.

"loop as a joint cost" theory as being "based on outdated regulatory principles" that "make[] little sense today."[13]

On this point, Verizon is absolutely right. And that is also why Verizon is absolutely wrong in contending that, notwithstanding these regulatory changes – and its own rate rebalancing proposals – switched access charges should continue to be priced in excess of cost to provide "support" to the network.[14]

The fact is that Verizon cannot have it both ways. If, as Verizon correctly asserts is the case, the advent of competition in the local exchange market has made "residual pricing" and "loop allocation" obsolete, it cannot also be the case that Verizon's competitors should continue to be required to support Verizon's local exchange services through implicit subsidies buried in its carrier access charges. And the competitive imbalance has only been exacerbated by Verizon's entrance into Pennsylvania's interLATA market. As AT&T witnesses Kirchberger and Nurse testified, "There is simply no justification in law, economics or public policy to require Verizon's long distance competitors to incur access costs that Verizon itself does not bear, much less to subsidize Verizon's operations."[15]

Verizon nevertheless suggests that above-costs access rates are somehow justified by the "unique costs" that Verizon claims flow from its

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13 VZ Main Brief at 50, 53.

14 See VZ Main Brief at 39.

15 AT&T Stmt. 1.0 at 25.

universal service and carrier of last resort "obligations."[16] There are several problems with this contention, however. The first is that it lacks any support in the evidentiary record. Indeed, Verizon put forward no evidence demonstrating the "unique costs" of those :obligations," much less demonstrating that above-cost access rates are necessary to subsidize Verizon's local exchange services.

The second problem with Verizon's argument is that it is again at odds with its advocacy on other points. That is, in arguing for maintaining an implicit subsidy in carrier access rates, Verizon ignores the dictates of the Telecommunications Act to make implicit subsidies explicit. As the Commission found in the Global Order, the Telecommunications Act of 1996 required it to "take the necessary steps to strive to replace the system of implicit subsidies with 'explicit and sufficient' support mechanisms to attain the goal of universal service in a competitive environment."[17] Thus, to the extent that Verizon's universal service and carrier of last resort "obligations" do in fact impose "unique costs," those costs are only properly recoverable through explicit support mechanisms – such as a universal service fund – and not through inflated access rates.

Unable to muster any support for its position in logic or the law, Verizon resorts instead to diversion, arguing that the rates that AT&T and MCI charge for access services are themselves priced above cost.[18] This "but they do it too"

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16 VZ Main Brief at 38.

17 *Joint Petition of Nextlink, et al.*, Docket Nos. P-00991648 and P-00991649, Sept. 30, 1999 ("Global Order") at 26-27.

18 VZ Main Brief at 44. AT&T's access rates, although structured differently, are, in Verizon's words, "roughly equal" to Verizon Pennsylvania's composite rates, VZ

argument does not in any way support Verizon's implicit conclusion that it is appropriate to continue to price access in excess of cost. Just the opposite is true. As MCI witness Dr. Pelcovits explained, the fact that CLEC access rates may exceed costs:

> [J]ust goes to the point, quite frankly, that unless regulation forces switched access rates down to TELRIC cost, they're not going to end up there, and there is no marketplace pressure that causes them to end up there, because, essentially, once a carrier is the local provider to the customer, that carrier is not disciplined as far as its switched access rates to the long distance carriers. And that applies whether it's a CLEC or an ILEC.[19]

In other words, CLEC access pricing is not an excuse for maintaining the inefficient bloat in Verizon's access rates. Rather, it is yet another reason why the Commission must be proactive in forcing all carrier access rates down to cost-based levels.

Finally, in a bizarre reading of the record, Verizon argues that AT&T's In-State Connection Fee ("ISCF") provide another reason for leaving Verizon's access rates priced substantially in excess of cost.[20] The logic underlying this contention is, at best, elusive. Indeed, as even Verizon's brief acknowledges, the ISCF was imposed to help recover the substantial access costs that have been imposed on AT&T by Verizon and other Pennsylvania ILECs.[21] As AT&T witness

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Main Brief at 44, but are much lower than Verizon North's composite rate. See VZ Cr. Exh. 8.

19 Tr. 357.

20 VZ Main Brief at 43-44.

21 VZ Main Brief at 43. VZ Cr. Exh. 1.

Kirchberger explained, the fee was "put in place to recognize that the intrastate access charges are significantly in excess of cost and much, much higher than the interstate access charges. . . ."[22] Thus, far from being a reason for maintaining access rates at their current level, the ISCF is yet another example of the need for reducing those charges.

Verizon nevertheless attempts to make something out of nothing in claiming that Mr. Kirchberger refused to "commit" to reducing the ISCF to reflect any decreases in Verizon's access rates.[23] This is a misleading characterization of his testimony. As Mr. Kirchberger testified at the hearing, the demands of competition in the state's long distance markets will require AT&T to re-examine its pricing in reaction to reductions in access rates.[24] That would include a re-examination not only of the ISCF, but of AT&T's other rates as well.[25] What Mr. Kirchberger was simply not in a position to do at the hearing was to reflect how specific access reductions would be reflected in specific changes in any particular AT&T rate. This is perfectly consistent with the approach taken in this case by Verizon's own witnesses, who, for example, were unable to indicate how

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22 Tr. 268.

23 See VZ Main Brief at 43.

24 Tr. 270.

25 Tr. 270.

the local rate increases for business local exchange customers that would result from adoption of its proposal would actually be implemented.[26]

Overall, Verizon has advanced no legitimate reason for preserving its access rates at levels that exceed the forward-looking incremental cost of providing carrier access services. That is undoubtedly because its advocacy is rooted in the entirely illegitimate desire to maintain the artificial and anti-competitive edge that its access rates continue to provide Verizon in the state's telecommunications markets.[27] Adoption of the Verizon/OCA proposal is a necessary step in ameliorating that problem, but it will not eliminate it. Thus, even after implementation of that proposal, the Commission must continue with its efforts to eliminate the implicit subsidies that will remain in Verizon's intrastate access rates by, at a minimum, bringing those rates to interstate levels.

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[26] See Tr. 139. ("I can tell you at this point we haven't – internally, in Verizon, we don't have a specific proposal for what we would do with business, so it's just not developed at this point.")

[27] Verizon cites to its alleged market share losses in the intraLATA toll market, particularly in Verizon North's service territory, as proof that above-cost access does not impede competition. This view, of course, is out of step with the Commission's determination in the Sprint/RTCC Order that the implicit subsidies in access are hindering competition in all of the state's telecommunications markets, including the toll market. Sprint/ICO Order at 10. Moreover, Verizon's reliance on data from Verizon's North's territory is problematic, given that the "losses" there can be traced to the effects of the Bell Atlantic-GTE merger, and the resulting "sale" of GTE's toll customers to another carrier, rather than any meaningful competition from other IXCs. See Tr. 215-216.

II. AS THE COMMISSIOIN ALREADY HAS DETERMINED, ACCESS REDUCTIONS ARE NECESSARY TO INCREASE THE COMPETITIVENESS OF PENNSYLVANIA'S LOCAL AND LONG DISTANCE MARKETS.

In what amounts to a tantrum disguised as legal argument, OTS assails AT&T's support for Verizon's initial proposal to do away altogether with the Carrier Charge for both Verizon companies as "an opportunity to save money and increase profits."[28] This argument betrays a fundamental lack of understanding of the effects of competition in Pennsylvania's telecommunications markets, and is directly at odds with the Commission's recent determinations in the Sprint/OTS Order. Accordingly, the OTS's statements should be disregarded by the Commission.

As an initial matter, the OTS's claim appears to be premised on the belief that any access reductions that the IXCs may obtain as a result of this proceeding would simply go into their pockets. This belief finds no support in the record. To the contrary, and as was discussed above, AT&T witness Kirchberger testified that the interexchange market "is very, very competitive, especially since now Verizon has entered it as well,"[29] and "competitive market forces are going to send [AT&T] signals that we're going to have to react to."[30] Put another way, the demands of competition will compel carriers to flow access reductions

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28 OTS Main Brief at 14.

29 Tr. 270.

30 Tr. 272.

through to customers. If they do not, they are going to lose those customers to carriers that are reflecting those cost savings in their rates.

This is precisely how the long distance market has operated since equal access was introduced there. Competition in the long distance market has forced prices to drop dramatically. The Commission itself has recognized the link between access reductions and rate reductions, noting that "there has been some demonstrated savings to IXC customers in their long distance calls since April 2000 when the PaUSF was initiated and the initial access reductions [from the Global Order] took effect."[31]

But it is this same competition that is at risk in this case. The unrebutted evidence in this case shows that, with the exception of Verizon's long distance affiliate, the IXCs' intrastate toll traffic in Pennsylvania is declining at precipitous rates. In fact, the annualized 2003 data demonstrates that for all IXCs other than Verizon's long distance affiliate total minutes of use declined from 2001 by nearly about **[BEGIN VZ PROPRIETARY]** .[32] **[END VZ PROPRIETARY]**

The issue in this case thus is not "profitability" of the IXCs, but rather their the continued competitiveness of Pennsylvania's telecommunications markets. The Commission recognized this fact in its order the approving the Sprint/RTCC access proposal, stating that the access reductions that will be implemented as a result of that plan are "in accordance with the Commission's objective to reduce implicit subsidy charges such as access charges ***that impede competition in***

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[31] Sprint/RTCC Order at 11.

[32] AT&T Stmt. 1.0 at 25.

the telecommunications market."[33] Although a signatory to and apparent supporter of the Sprint/RTCC proposal, OTS appears not to have gotten that message.

In that vein, OTS, in its zeal to attack AT&T's motives in this case, contends that AT&T and its witnesses engaged in an "attempted deception" by arguing that the elimination of the Charge is supported by Commission's stated its intent in the Global Order to address the elimination of the carrier pool.[34] This is a contention that reflects OTS's own lack of understanding of the interrelationship between the carrier pool and the carrier charge. As ALJ Schnierle explained in his Recommended Decision in the Generic Access Investigation, the "carrier pool" – or what he called the "flat rate pool" was created by aggregating each ILEC's revenues from the Carrier Common Line Charge ("CCLC") and other non-traffic sensitive access rate elements, as well as each ILEC's imputed access for intraLATA toll.[35] Once that pool was established, a portion of its would then be allocated for recovery from the interexchange carriers based on each such carriers intrastate minutes of use. That portion was to be collected through a new charge –the "carrier charge."[36]

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33 Sprint/RTCC Order at 10 (emphasis added).

34 OTS Main Brief at 15.

35 *Generic Investigation of Intrastate Access Charge Reform*, Docket No. I-00960066, Recommended Decision, June 30, 1998, at 60-64.

36 Id. at 66. See also id. at 80-81

In other words, the carrier charge is the mechanism established by the Commission for collecting from the IXCs a portion – as it turns out, the majority -- of the access revenues that were funneled into the new carrier pools. Without the carrier pool, there would be no carrier charge. In fact, in the very same paragraph of the Global Order cited by AT&T witnesses Kirchberger and Nurse, the Commission melds the two concepts, using the term "Carrier Charge (CC) pool."[37]

Thus, in indicating its intent to "resolve the reduction and possible elimination of the carrier pool,"[38] the Commission was indicating its intent to reduce and eventually eliminate the carrier charge. That OTS appears not to understand that nexus is of no moment. It is only important that the Commission remain committed to that important goal.

CONCLUSION

In approving of the Sprint/RTCC access reform proposal, the Commission demonstrated that it not only understood the competitive problems that are inherent in above-cost carrier access charges, but that it was committed to resolving them. That understanding and commitment are, if anything, even more critical in this case. The evidence shows that the competitive imbalance created by Verizon's excessive access rates is already adversely affecting competition in Pennsylvania's largest toll markets. And that situation will only become more dire if it is allowed to fester.

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37 Global Order at 60.

38 Global Order at 60.

Fortunately, the record not only illuminates the problem, but it offers a roadmap to solving it. As a first step on that road to reform, the Commission should immediately approve and implement the access reductions proposed in the Verizon/OCA settlement. That proposal not only is supported by substantial record evidence, but it is consistent with the objectives enunciated by the Commission in the Sprint/RTCC order. Once that proposal has been implemented, the Commission, again utilizing the record developed in this proceeding, should establish a program for expeditious reform that has as its minimum objective the reduction of Verizon's access rates to levels that match Verizon's interstate access rates.

Respectfully submitted,

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Dated: September 29, 2003

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

REPLY BRIEF

of

MCI WORLDCOM NETWORK SERVICES, INC. ("MCI")

September 29, 2003

EXPURGATED VERSION

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REPLY BRIEF OF
MCI WORLDCOM NETWORK SERVICES, INC.

I. INTRODUCTION

Verizon Pennsylvania, Inc. ("Verizon PA") and Verizon North, Inc. ("Verizon North", collectively, "Verizon") acknowledge in their Main Brief that the trend and precedent is to move access charges towards cost. Verizon recognizes that this Commission has found that implicit subsidies should be removed in order to promote a competitive environment. However, Verizon then urges the Commission to adopt a proposal that does not come close to reducing access charges to their cost and that leaves large "subsidies" in the access rates. Verizon also argues against bringing access charges to either interstate levels or forward looking cost levels, using the inaccurate scare tactic that reduced access rates will lead to large increases in residential rates.

Verizon and the Office of Consumer Advocate ("OCA") have submitted a proposal that does not reduce access rates nearly enough. However, if the Commission were to adopt that proposal, the Commission cannot stop there. The Commission must clearly delineate the next steps to reduce access rates to cost in Pennsylvania for the two largest incumbent local exchange carriers ("ILECs"). The Commission has recognized that keeping access rates above cost creates a negative competitive environment, and the Commission has the full evidentiary record required

in this case to fully reduce access rates to cost, whether on an immediate basis or on a phased down approach.

II. COST BASED ACCESS RATES ARE CRITICAL TO ESTABLISHING A LEVEL PLAYING FIELD

As far back as September 1999, the Commission recognized the need to remove implicit subsidies and make them explicit. Specifically, in the Global Order, the Commission significantly reduced access charges "in order to maintain fair toll competition."[1] At that time, the Commission also recognized that "there have been various significant regulatory developments in both the federal and state arenas that ***require the elimination of implicit subsidies.***"[2] Because the Commission did not fully reduce access rates to cost in the Global Order, the Commission ordered an investigation by January 2001 to "***presumably eliminate all subsidies*** in the access charge rate structure."[3]

The Commission has itself recognized that reducing access rates is necessary to establish a fair competitive environment. Specifically, in its July 15, 2003 Order approving the Sprint/RTCC settlement, the Commission noted that it is a continuing Commission objective to reduce access charges "that impede competition in the telecommunications market."[4] The Commission further noted that the reduction of access rates permits IXCs and CLECs to "compete on a more level playing field with the ILECs."[5]

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[1] Joint Petition of Nextlink Pennsylvania, Inc., et. al., Docket Nos. P-00991648 and P-00991649, Opinion and Order, September 30, 1999 (hereinafter "Global Order") at pg. 18.
[2] Id. at pg. 26 (emphasis added).
[3] Id. at pg. 59 (emphasis added).
[4] Access Charge Investigation per Global Order of September 30, 1999, Docket Nos. M-00021596, Opinion and Order, July 15, 2003 (hereinafter "Sprint/RTCC Order") at pg. 10.
[5] Id.

Verizon's and the public parties' proposals do not accomplish the Commission's goal of reducing access charges to cost by removing whatever "subsidies" exist in such rates, and the Commission should therefore reject such proposals.

A. Verizon's Proposals Do Not Reduce Access Charges Enough and Should be Rejected

It has now been almost three years since this Commission contemplated initiating a proceeding to eliminate any subsidies in Verizon's access charges. There have been no further reductions to access charges beyond those ordered in 1999 as part of the Global Order. Had a proceeding been commenced in 2001 as originally contemplated, presumably access charges would have seen significant reductions by now given the Commission's clear goal of reducing implicit subsidies. Because that proceeding was delayed, it is not an acceptable resolution in this case to leave access rates substantially above cost, thereby continuing the regime of implicit subsidies that are detrimental to the establishment of a competitive market.

Verizon originally proposed two possible scenarios in modifying access rates and structures in Pennsylvania. Both proposals modify the rate structures of Verizon PA and Verizon North so that the rate structures are aligned with the interstate rate structure.[6] Verizon does not, however, align the actual intrastate ***rates*** with the interstate rates. As Verizon knows, mirroring interstate rates would lead to substantial reductions in the intrastate access rates and bring such rates much closer to cost.

Verizon's first proposal would only reduce Verizon North's Carrier Charge ("CC"), but would not reduce Verizon PA's CC at all. Verizon North's CC would be reduced to the current Verizon PA level of $.063 per line. However, Verizon North's per minute switching

[6] Verizon Statement 1.0 (Berry/Wirl Direct) at pg. 12.

rate would actually increase from $.006/minute to $.008884/minute.[7] Under this first proposal, Verizon PA's switching rate would only slightly decrease from $.009336/minute to $.008884/minute.

This first proposal is hardly the elimination of implicit subsidies contemplated by the Commission. Verizon PA's access rates would be reduced only slightly. It is important to note that because Verizon PA is the largest ILEC, interexchange carriers ("IXCs") pay more to Verizon PA in access charges than to any other ILEC in Pennsylvania. Thus, a proposal that either does not reduce, or only slightly reduces, Verizon PA's access charges is completely unacceptable even if Verizon North's rates are reduced. There is no dispute that Verizon PA's access charges are still priced above cost currently, and under this Scenario 1 proposal. Verizon continues to argue that such above-cost rates are due to implicit subsidies. Thus, a failure to reduce Verizon PA's rates is a failure to reduce the implicit subsidies that this Commission has previously recognized should be eliminated.

Even using Verizon's own cost numbers, the current access rates generate approximately **BEGIN PROPRIETARY** **END PROPRIETARY** whereas Verizon estimates the cost to be at approximately **BEGIN PROPRIETARY** **END PROPRIETARY**, leading to a "subsidy" or above-cost revenue amount of **BEGIN PROPRIETARY** **END PROPRIETARY**.[8] Verizon's Scenario 1 proposal would lead to a reduction in revenue of only **BEGIN PROPRIETARY**

[7] Id., See MJW-1 and MJW-3.

[8] Transcript at pg. 114. As noted in MCI's Testimony and Main Brief, MCI does not agree with Verizon's calculation of the cost of access, and instead it is MCI's position that the best estimate of the cost of access is the current UNE rate for unbundled switching. Even the current UNE rate for unbundling switching is a high estimate because it is not a reflection of the proper TELRIC rate for unbundled switching.

END PROPRIETARY.[9] This does not come close to eliminating or significantly reducing access to cost and should therefore be rejected.

Verizon's Scenario 2 is an improvement over Scenario 1, but still does not go far enough. That Scenario contains the same per minute switching rate as Scenario 1, but it contemplates the complete elimination of the CC for both companies. MCI wholeheartedly supports the elimination of the CC. As will be discussed further below, there is absolutely no cost basis for the Carrier Charge, which means that it is either 100% profit, or a 100% subsidy to Verizon. This must be eliminated, especially in a competitive environment. Even Verizon has agreed that access rates should not contribute to the cost of the local loop, which is what the CC is designed to do.

Scenario 2 leads to a reduction in access charge revenue of **BEGIN PROPRIETARY** **END PROPRIETARY**. Yet again, this reduction does not come close to reducing access rates to the level of cost at what Verizon contemplates is the cost of providing access, which is higher than the forward looking cost as reflected in unbundled network element switching rates. In addition, Verizon North's switched access per minute rate would still be increasing and Verizon PA's per minute rate would only decrease slightly. If the Commission adopts Scenario 2, it should either immediately, or in clearly articulated future steps, require the reduction of switched per minute access rates to cost-based levels.

[9] Verizon Statement 1.0 at MJW-3.

B. The OCA/Verizon Proposal Does Not Reduce Access Rates Enough and, If Adopted, Must Be Only a First Step in Bringing Access Rates to Cost

Another proposal introduced in this case is the OCA/Verizon proposal. Verizon has characterized this proposal as a "reasonable compromise" presumably because it is at the mid-point in reductions between Verizon's Scenario 1 and Scenario 2 proposals. The OCA/Verizon proposal reduces Verizon North's CC to the level of Verizon PA's current CC rate. The per minute access charge increases for Verizon North and slightly decreases for Verizon PA. The overall reduction in revenues is **BEGIN PROPRIETARY** **END PROPRIETARY**.

If the Commission were to adopt this proposal by the end of this calendar year, it could be viewed as a first step in access reductions assuming that the reductions are effective in 2003. However, Verizon and OCA do not propose any additional reductions in access, which is what makes the proposal completely unacceptable. The reductions in the OCA/Verizon proposal do not come close to reducing access rates enough, as they leave access rates well above cost. Verizon PA's access rates are barely reduced at all, thereby leaving the rates significantly above cost. Verizon North's switched per minute access rates are still far above cost, and the CC continues to exist for both companies, which has no cost basis at all.

If the Commission adopts the Verizon/OCA proposal, it cannot leave that proposal as the final say on access reductions. Given that this case is almost three years overdue, the Commission should clearly delineate the complete reduction of access rates to cost. It is MCI's position that such rates should be reduced to cost immediately, as there is no justification for the rates to remain at above-cost levels. If the Commission is not willing to reduce such rates immediately, the record is certainly complete enough for the Commission to adopt a phase-down approach that eventually brings access rates to cost within the next several years. There is no

reason to wait for another proceeding for all parties to be forced to come back to the Commission to put on essentially the same case that was presented in this matter. The record has all the information necessary for this Commission to implement either an immediate or a phased-down reduction in access rates to their forward looking costs.

Verizon cites to the FCC favorably by arguing that the FCC has refused to reduce access rates all the way down to cost based levels.[10] However, the FCC has in fact reduced access rates considerably over the years, and the interstate access rates are significantly below intrastate access rates even though there is no legitimate reason for the difference in the rates. The interstate rates are certainly much closer to Verizon's costs than the intrastate rates.

Even though Verizon states that the FCC has not reduced access rates all the way to cost, Verizon still objects to reducing its access charges to interstate levels. The record shows that if the Commission reduces Verizon's intrastate access charges to interstate levels, Verizon would still be earning above-cost revenues. As MCI Cross Exhibit 1 shows, Verizon still earns a composite **BEGIN PROPRIETARY** **END PROPRIETARY** at the interstate access levels. Thus, Verizon is still earning above-cost revenues and therefore reducing access rates to interstate levels would still maintain a subsidy for Verizon.

At a minimum, if the Commission is not willing to reduce access rates to cost immediately, then the Commission should either reduce access rates immediately to interstate levels (which would include an elimination of the CC, since there is no CC at the interstate level), or if the Commission adopts the OCA/VZ proposal to be effective in 2003, then the Commission should order further reductions to interstate levels by a date certain (such as by no later than the end of 2004) and reductions to cost by a date certain (such as by no later than the end of 2005).

C. Contrary to Verizon's Claims, Access Reductions Benefit Both Consumers and Competition

Verizon argued that there is no evidence that access reductions lead to consumer benefits.[11] Verizon obviously did not carefully read the Commission's Opinion and Order in the Sprint/RTCC settlement. The Commission specifically recognized benefits to consumers from the Global Order access reductions. In that Order, the Commission stated:

> Furthermore, there has been some demonstrated savings to IXC customers in their long distance calls since April 2000 when the PaUSF was initiated and the initial access charge reductions took effect. In our *Global Order*, IXCs were required to file annual reports reflecting price reductions and flow through expense savings resulting from the access charge reductions in April, 2000. On June 6, 2000, and November 2, 2000, MCI WorldCom filed reports showing what its savings were from recent access reductions and how they have been flowed through to the Pennsylvania residential and business toll consumers. On May 4, 2000, AT&T filed a tariff showing the flow-through of Verizon-Pa.'s access charge reduction to AT&T's business and residential customers.[12]

In addition to noticeable reductions in access charges that have occurred in the long distance industry, there are other benefits that come as a result of reducing access rates closer to cost. As MCI's witness Dr. Pelcovits testified, pricing access at cost leads to both static and dynamic efficiency gains, which lead directly to benefits to consumers.[13] These benefits include correct pricing signals and correct incentives to provide innovative and new services that are based truly on the market rather than on artificially inflated rates that IXCs must pay.

Verizon claimed that the Commission has in the past rejected arguments that above-cost access rates have a negative impact on competition.[14] Any Commission findings regarding the appropriateness of above-cost access were prior to major changes in the

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[10] Verizon Main Brief at pg. 5.
[11] Verizon Main Brief at pg. 5.
[12] Sprint/RTCC Order at pg. 11.
[13] MCI Statement 1.0 at pgs. 16-18.
[14] Verizon Main Brief at pgs. 39-41.

competitive industry. First and foremost, Verizon was not in the in-state interLATA market until September of 2001. Thus, Verizon did not have a long distance unit competing directly with the IXCs. It is nothing short of a complete ignorance of reality to claim that Verizon has no advantage in the long distance market when charging its primary competitors above-cost access rates.

While Verizon claims that IXCs have a large market share in the intraLATA market, Verizon fails to mention its astronomical success in entering the interLATA long distance market. In the short time Verizon has been in the market, it has gained over 25% of the market[15] and announced in January of 2003 that it had passed Sprint as the third biggest IXC in the country.[16] In addition, Verizon's long distance services are substantially growing while toll minutes for other IXCs in Pennsylvania are decreasing.[17]

Imputation does not cure the discriminatory treatment and cost advantage that Verizon enjoys by charging IXCs above-cost access rates. The fact that Verizon's long distance affiliate "pays" the same above-cost access rates does not affect the overall financial situation of the Verizon parent company. When Verizon's long distance affiliate pays access rates to the Verizon local affiliate, it is simply a paper transaction that transfers the money from one pocket of the company to another. Even Verizon's counsel acknowledged as much when she was questioning MCI regarding the "payment" of access charges when MCI has both the long distance and the local customer. She stated that when an MCI local customer places a call using MCI toll service, "it's a wash as between those two companies."[18] Similarly, when Verizon affiliates handle a long distance call, it's a "wash" and the Verizon company – as a whole – only

[15] Transcript at pgs. 224-225.
[16] AT&T Statement 1.0 at pg. 24; *See also* K-N Rebuttal Exhibit 6.
[17] AT&T Statement 1.0 at pgs. 24-25.
[18] Transcript at pg. 351.

incurs Verizon's actual cost of providing the access service, which is substantially lower than the inflated cost that an IXC must pay for that same service.

The Commission itself has recognized that access rates should be reduced in a competitive environment, and that reducing access rates will lead to a more level playing field.

III. ACCESS REDUCTIONS DO NOT HAVE TO BE REVENUE NEUTRAL

Verizon's Main Brief on the issue of revenue neutrality is full of mischaracterizations about whether revenue neutrality is required. Verizon insists that any reductions to access rates are required to be revenue neutral by the merger conditions and Verizon's Chapter 30 alternative regulation plan. This insistence is highly misleading and flat out wrong.

First, even the cites that Verizon gives to the Merger Order and the MOU demonstrate that revenue neutral increases to access rates are not ***required***.[19] The only thing that the Merger Order and MOU state is that Verizon is allowed to argue for revenue neutrality. Verizon has done so in this case, and therefore the merger conditions have been fully met. Verizon quotes to absolutely no language that requires or even encourages revenue neutrality when access reductions occur, because no such language exists. The fact that Verizon is permitted to argue for revenue neutrality says nothing about whether it is proper for the Commission to adopt such an argument.

Second, Verizon's Chapter 30 plan does not ***require*** revenue neutral rate increases if Verizon reduces its access charges. The language in Verizon's plan as quoted in Verizon's Brief states that Verizon "***may*** file tariffs proposing to rebalance and/or restructure its rates for noncompetitive services, either an increase or decrease."[20] Again, nothing in this language

[19] Verizon Main Brief at pgs. 31-32.
[20] Id. at pg. 28, citing to Verizon North Chapter 30 Plan, Part 3.B.1 (emphasis added).

requires the Commission to approve such tariffs as filed. Similarly, 66 Pa. C.S. §3007, which deals specifically with access charges, states only that revenue-neutral rate changes ***may*** be proposed, but such changes are subject to Commission approval.

The problem with Verizon's position on revenue neutrality is that Verizon is using it as a scare tactic to discourage the Commission from implementing access reductions to either cost or interstate levels. Specifically, in its Main Brief, Verizon claims that it would have to increase residential rates by $3.18 per line per month (nearly $40/year), or it would have to increase both residential and business rates by $2.62 per line per month if intrastate access rates are reduced to interstate levels.

This scare tactic has several flaws. First, as noted above, there is no requirement that the Commission permit rate increases due to access rate decreases. Second, such revenue neutrality assumes that the above-cost access rates are indeed needed to subsidize basic local rates. There is absolutely no proof in the record that access rates are subsidizing basic local rates. To the contrary, there are many other subsidies in Verizon's rates, including subsidies in business rates, urban rates, and in particular in the features Verizon charges to its customers.[21] Third, there is no reason to assume that any increases must come primarily from residential rates or even from business rates.

Verizon cites to the Global Order as a basis for its claim that any access reductions must be offset by revenue neutral rate increases.[22] Yet again, although the Commission permitted revenue neutral recovery of the access reductions in the Global Order, the Commission never required such recovery in the future. Further, in the Global Order, even when the Commission did permit revenue neutral recovery of the access reductions ordered at that

[21] *See* MCI Cross Exhibits 3-5, which show that Verizon receives a large amount of above-cost revenues from its most common features such as Caller ID and Call Waiting.

time, the Verizon PA revenue did not come from increases to residential or business rates, but from Verizon's Price Change Opportunity filings.

The key to revenue neutral recovery is that the Commission must not refuse to reduce access charges solely because it does not want to raise other rates. It is clear that access charges are above cost and are anti-competitive. If the Commission wants to permit revenue neutral recovery of access reductions, but the Commission does not want to recover such revenue from residential customers, then the solution is to find other sources of the revenue recovery, such as PCOs or even the increased revenue realized by Verizon's entry into the in-region interLATA market.

IV. THE PUBLIC PARTIES' POSITIONS IGNORE THE REALITIES OF TODAY'S MARKET AND MUST BE REJECTED

The Public Parties – OCA, Office of Small Business Advocate ("OSBA") and Office of Trial Staff ("OTS") – all argue against access reductions because they are concerned with the corresponding increases in residential and/or business rates. First, their arguments should be rejected because as noted above, there is no requirement that decreases in access rates must lead to increased residential or business rates. Second, their arguments should be rejected because they are based on the outdated and incorrect economic theory that the loop is a shared cost.

It is truly a remarkable thing when the IXCs/CLECs and Verizon agree on an issue. However, with respect to this issue, MCI and Verizon are in complete agreement. The "loop as a shared cost" theory is antiquated and has no place in today's marketplace. Although the Commission may have approved such a theory in the past, the market has changed substantially

[22] Verizon Main Brief at pgs. 32-33.

and the Commission must look at all of those changes in determining whether to continue an outdated policy that makes no sense.

The primary problem with the Public Parties' position is that they actually advocate for increased access rates in the form of an increased CC. That position is patently ridiculous. First, this Commission has recognized the need to reduce access charges. The Public Parties go in exactly the wrong direction by requesting increased access charges. Second, the CC has no basis in cost and should therefore be eliminated, not increased. As MCI's witness Dr. Pelcovits testified, the costs of the loop should be recovered directly from the subscriber or from a competitively neutral universal fund.[23] As Verizon's witness, Dr. Taylor, testified:

> The cost of the local loop is not a shared cost but is incremental to basic local exchange service (in particular, to Dial Tone Line service, which is the service that provides network connectivity to the subscriber). According to the principles of cost causation and efficient pricing, if a cost is incremental, it must be recovered in its entirety from the source that caused that cost, e.g., Dial Tone Line service. Failure to do so would lead to the wasteful use of society's scarce resources, and would distort consumption and production incentives and harm competition for basic local exchange.[24]

OSBA's argument in favor of a higher CC in order for access rates to recover a portion of the loop is in direct contrast to OSBA's prior position. Specifically, OSBA previously recognized that in light of the development of a competitive market, loop costs must be recovered from the cost causer, which is the local end user.[25] OTS objects to increasing residential local rates, yet gladly argues for increased rates on IXCs, even though there is absolutely no cost basis given for such increases.

The Commission must recognize the changed circumstances since it last ruled on the loop being a shared cost. The market has changed dramatically and sharing the cost

[23] MCI Statement 1.1 at pgs. 10-11.
[24] Surrebuttal Testimony of William E. Taylor at pg. 3.

of the loop is no longer a viable or reasonable theory in light of today's competitive environment. At a minimum, the Commission must reject the Public Parties' request to increase access rates in this proceeding, which goes in exactly the wrong direction and would only do more harm to competition and to a level playing field. Even Verizon acknowledges that access rate reductions are warranted in this case.

V. CONCLUSION

Verizon's proposals in this case would leave access rates substantially above cost, and therefore should not be adopted. This case has already been delayed by nearly three years. Thus, it is important for the Commission to immediately reduce access rates to cost, or at a minimum, to reduce intrastate access rates to the same level as interstate access rates.

While all three of Verizon's proposals are flawed, the best proposal is Scenario 2, which leads to the elimination of the Carrier Charge for both Verizon PA and Verizon North. Even if the Commission were to adopt that proposal, or the OCA/Verizon Proposal, the Commission must not stop there. The Commission must use the record in this case to adopt additional reductions that bring access rates to cost within a short time period.

There is no dispute that the intrastate switched access charges of Verizon and Verizon North are substantially in excess of cost. This is detrimental to consumers, who ultimately must pay higher rates for long distance service. Excessive access charges also distort competition between incumbents and long distance providers, who are among the best-positioned companies to enter the local market and break the long-standing bottleneck monopoly of the incumbents.

The Commission has recognized since 1999 that access rates should be reduced. It is time for the Commission to implement its goal of eliminating implicit subsidies by reducing

[25] Verizon Cross Exhibit 10.

access rates to cost-based levels. Contrary to Verizon's claims, the Commission is not required to implement revenue neutral rate increases to offset decreases in the access rates. Even if the Commission determines that it will permit revenue neutral recovery, there are ways to recover the charges other than from residential customers, and therefore the Commission should not refuse to reduce access rates due to fears of increasing other rates.

Finally, the Commission should outright reject the Public Parties' requests to increase access rates in order to contribute to the cost of the loop. As both MCI and Verizon argued, the loop as a shared cost theory is outdated and contrary to proper economic theory. The Commission has clearly recognized that access rates should be reduced, and this case presents the Commission with the ideal opportunity to implement such reductions, thereby creating a level playing field and pro-competitive environment.

Respectfully submitted,

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Dated: September 29, 2003

ACKNOWLEDGEMENT OF RECEIPT & ACCEPTANCE OF SERVICE

AND NOW, to wit, this _____ day of_____, 20__,

the undersigned, as evidenced by execution hereof, acknowledges receipt, and accepts service of RECOMMENDED DECISION an official Commission document entered, issued, or otherwise promulgated under date of NOVEMBER 18, 2003 at Docket No. C-20027195 on behalf of:

STEVEN C GRAY ESQUIRE

ANGELA T JONES ESQUIRE

OSBA

Signature

Kindly sign and date this acceptance of service and acknowledgement of receipt, and, return the same for filing to:

SECRETARY'S BUREAU RECORD RETENTION
PA PUBLIC UTILITY COMMISSION
KEYSTONE BUILDING 2ND FLOOR
400 NORTH STREET
Harrisburg, PA 17105-3265

RJP

ACKNOWLEDGEMENT OF RECEIPT & ACCEPTANCE OF SERVICE

AND NOW, to wit, this 18th day of November, 2003

the undersigned, as evidenced by execution hereof, acknowledges receipt, and accepts service of RECOMMENDED DECISION an official Commission document entered, issued, or otherwise promulgated under date of NOVEMBER 18, 2003 at Docket No. C-20027195 on behalf of:

KENNETH L MICKENS ESQUIRE

OTS

Elaine C. Meisinger
Signature

Kindly sign and date this acceptance of service and acknowledgement of receipt, and, return the same for filing to:

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COMMONWEALTH OF PENNSYLVANIA
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IN REPLY PLEASE
REFER TO OUR FILE

December 8, 2003

ORIGINAL

James J. McNulty, Secretary
Pennsylvania Public Utility Commission
P.O. Box 3265
Harrisburg, PA 17105-3265

DOCUMENT
FOLDER

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

Dear Secretary McNulty:

Please note that the Office of Trial Staff will not be filing Exceptions in the above-cited proceeding.

Sincerely,

Kenneth L. Mickens
Senior Prosecutor
Office of Trial Staff

KLM:pae

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

CERTIFICATE OF SERVICE

I hereby certify that I am serving the foregoing **Letter** of the Office of Trial Staff, dated December 8, 2003, either personally, by first class mail, electronic mail, express mail, or by fax upon the persons listed below:

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Dated: December 8, 2003
Docket No. C-20027195

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December 8, 2003

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

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

Dear Secretary McNulty:

Please be advised that the Office of Consumer Advocate will not be filing Exceptions in the above-captioned proceeding. However, the OCA reserves the right to file Reply Exceptions.

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

Sincerely,

Joel H. Cheskis
Assistant Consumer Advocate

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

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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 Letter Re: Not Filing Exceptions, 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 8th day of December, 2003.

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ORIGINAL

MCI

December 8, 2003

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DEC 0 8 2003

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

Via Overnight Delivery

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

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

Dear Mr. McNulty:

Please find enclosed an original and nine (9) copies of the Exceptions of MCI WorldCom Network Services, Inc.'s to Recommended Decision in the above referenced case. Please note that these Exceptions contain Proprietary information, and an Expurgated copy of the Exceptions is also enclosed. PUBLIC

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

DOCUMENT FOLDER

Very truly yours,

Michelle Painter

Michelle Painter

Enclosures

cc: Service List (as noted)

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ORIGINAL ORIGINAL

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

EXCEPTIONS

Of

MCI WORLDCOM NETWORK SERVICES, INC.

TO RECOMMENDED DECISION

December 8, 2003

EXPURGATED VERSION

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

AT&T Communications	:	
of Pennsylvania, Inc.	:	Docket Number
	:	
v.	:	C-20027195
Verizon North, Inc.	:	

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

AT&T Communications of Pennsylvania, Inc.	:	Docket Number
v.	:	C-20027195
Verizon North, Inc.	:	

EXCEPTIONS OF
MCI WORLDCOM NETWORK SERVICES, INC.
TO RECOMMENDED DECISION

MCI WorldCom Network Services, Inc. ("MCI") files these Exceptions to the Recommended Decision of Administrative Law Judge ("ALJ") Cynthia Fordham issued on November 18, 2003. The ALJ's decision spends the first fifty-seven pages re-stating parties' arguments, and only two pages of actual decision-making with very little, if any, analysis regarding the parties' various arguments in this case.[1] The Commission, in issuing a final decision in this matter, should carefully review the record and engage in more reasoned decision-making.

The ALJ adopted a settlement proffered by Verizon Pennsylvania, Inc. ("Verizon-PA") and Verizon North, Inc. (collectively "Verizon") and the Office of Consumer Advocate ("OCA"). Although that settlement can be viewed as a first start, it is not even close to a final step in much-needed access reform, and should not be the only conclusion reached regarding access reductions in this case. The record is complete in this case, there is extensive evidence on the need to reduce access rates further than the Verizon/OCA settlement, and the Commission has all the information it needs to make a

[1] See Recommended Decision at pgs. 58-59.

final decision on reducing access rates to cost. Contrary to the ALJ's recommendation to push further access rate reform off to an unspecified time and unspecified docket, the Commission should complete access reform as part of this docket.

The ALJ did not even consider the extensive evidence showing that above-cost access rates create numerous unfair advantages for the incumbent local exchange carriers ("ILECs"). The Federal Communications Commission ("FCC") has recognized that access rates must start moving closer to cost, and interstate access rates have therefore dropped significantly, especially in comparison to intrastate access rates. There is absolutely no logical reason for the disparity that exists between interstate and intrastate access rates. The ALJ should have used this case to establish an intercarrier compensation regime in Pennsylvania that makes economical and competitive sense, and that reflects the costs of providing services.

The ALJ ignored this Commission's prior acknowledgements that further access reform and reductions are necessary. The Commission specifically ordered the initiation of further access proceedings after the Global Order. The Commission recognized the need to eliminate any subsidies that above-cost access rates are allegedly recovering. Specifically, the Commission noted, "the sooner that we resolve the reduction and possible elimination of the carrier pool, the better it would be for the competitive environment in Pennsylvania."[2] In fact, the Commission rejected the ILECs' proposal to wait until 2003 to further reduce access rates and instead ordered such reductions to occur

[2] *Joint Petition of Nextlink, et al.*, Docket Nos. P-00991648 and P-00991649, Sept. 30, 1999 ("Global Order"), at 59.

by the end of 2001.[3] Obviously, because such reductions and reform did not occur in 2001, they are long overdue.

Reducing access rates only slightly, as the Verizon/OCA settlement does, but not bringing them to cost, is not a proper solution. The ALJ erred by refusing to look at more dramatic reductions that truly remove any subsidies and bring the cost structure and rates into the present time.

EXCEPTION #1: The ALJ Erred by Refusing to Bring Access Rates to Cost

There is no dispute that Verizon-PA and Verizon North's access rates are substantially above cost. Even using Verizon's definition of "cost," Verizon's access rates are nearly $130 million above cost, or nearly 65% above cost.[4] The Verizon/OCA settlement reduces access rates by less than half of this amount.[5]

The ALJ claimed that the Verizon/OCA settlement was "fair, just and reasonable and in the public interest."[6] However, the ALJ completely ignored other parties' evidence showing that the Verizon/OCA proposal did not go far enough to reduce access rates to cost. In the Verizon/OCA proposal, Verizon-PA's access rates are barely reduced at all, thereby leaving the rates significantly above cost. Verizon North's switched per-minute access rates are still far above cost, and the carrier charge continues to exist for both companies, which has no cost basis at all.

Using the proper definition of cost, one can see that Verizon's access rates are substantially above that amount, and the Verizon/OCA proposal does not reduce rates

[3] Id.
[4] Transcript at 113-114. *See also* MCI Cr. Exh. 1. MCI Reply Brief at 4.
[5] MCI Reply Brief at 6.
[6] Recommended Decision at 59.

enough. In looking at what "cost" is for access rates, there are two different types of services that are identical to switched access that can be evaluated. Those services are unbundled switching and reciprocal compensation. From a network perspective, the termination of local calls and long distance calls is identical.[7] Thus, there is no valid reason for rates to be different for the exact same services.

Pricing for unbundled network elements are supposed to be set at the Total Element Long Run Incremental Cost or TELRIC of providing each element. TELRIC is fully compensatory of Verizon's forward-looking costs. A comparison of Verizon's intrastate switched access rates to Verizon's rates for the corresponding unbundled network elements demonstrates that Verizon's intrastate switched access rates currently are set substantially above cost.[8] As MCI's witness, Dr. Pelcovits' testimony demonstrates, the access rates are anywhere from 123.6% to an astonishing 1500.00% higher than the current UNE rates.[9] Per minute switching access rates are over 540% higher than unbundled switching rates.[10] Clearly, these access rates need to be reduced to more reasonable levels. The Verizon/OCA settlement does not go far enough, and in fact in some cases, increases the rates.

One of the major flaws of the Verizon/OCA proposal is that it maintains a Carrier Charge ("CC") even though most carriers agree that the CC should be eliminated. The

[7] Transcript at 71. *See also* MCI Cr. Exh. 2. Although Verizon states in this Exhibit that there may be "translations" differences, the witness who sponsored the interrogatory response could not identify any cost differences that would result from such translations. Transcript at pg. 126.
[8] It is MCI's position that the current UNE rates are in fact not set at proper TELRIC levels, but are in excess of the correct TELRIC standard. Thus, truly established TELRIC rates for unbundled switching and transport would be even lower, causing the disparity between unbundled rates and access rates to be even greater.
[9] MCI Statement 1.0 (Pelcovits Rebuttal) at pg. 37.
[10] Id.

ALJ did not even address this important issue in evaluating the reasonableness of the Verizon/OCA proposal.

Verizon's initial testimony contained a proposal to eliminate the CC.[11] Verizon subsequently proposed the Verizon/OCA settlement, which maintained a CC. There is not any cost basis at all for that charge, other than the antiquated position that long distance carriers should be forced to contribute towards the cost of a loop. However, terminating or originating a long distance call does not result in any additional incremental cost associated with the loop.[12] Amazingly enough, this is a point on which Verizon and MCI are in complete agreement. In fact, contrary to the Verizon/OCA proposal, Verizon's economic witness, Dr. Taylor, fully agrees that the costs of the loop should not be recovered from IXCs, but should be fully recovered from the cost causer – the end user. As Dr. Taylor testified:

> It is contrary to sound economic principles and an incorrect approach to cost recovery to believe the premise that the loop is a shared cost of telecommunications services that use the loop and must, as a result, be allocated among different services. Unfortunately, any public policy about cost recovery and pricing for regulated services that is based on that premise can only promote economic inefficiency, lead to a wasteful use of society's scarce resources, and distort consumption and production incentives.[13]

Given that the Verizon/OCA proposal maintains the policy of having IXCs contribute to the cost of the loop, it leads to all of the problems even Dr. Taylor agrees come from such a policy.

[11] Verizon Statement 1.0 (Berry/Wirl) at pg. 15.
[12] MCI Statement 1.0 at pg. 38.
[13] Surrebuttal Testimony of William E. Taylor at pg. 6.

The carrier charge of Verizon-PA is currently $.63/line/month. The carrier charge of Verizon North is currently a whopping $8.64/line/month.[14] The Verizon/OCA proposal does not decrease Verizon-PA's carrier charge at all. Although it does significantly reduce the carrier charge for Verizon North, that comes at the cost of increasing the per-minute switching rate, which is in the exact opposite direction that rate should go.

The carrier charge exists solely to provide a contribution to the cost of the loop. Given that Verizon itself admits that access rates should not be used to provide a contribution to the loop, the ALJ's recommendation to adopt the Verizon/OCA proposal without any further reform must be rejected. In addition to reducing per minute access charges to cost, this Commission should immediately eliminate the carrier charge as it is not reflective of cost and it sends incorrect economic signals to the industry. Continuation of the carrier charge is yet another non-cost based charge that is counter-productive to the desired result of competition in the telecommunications market.

EXCEPTION #2: The ALJ Erred by Refusing to Establish a Time Frame to Bring Access Rates to Cost

Although the ALJ acknowledged that other parties requested that the Commission delineate definite access reductions beyond the Verizon/OCA settlement proposal, the ALJ refused to recommend further reductions. The only reason given for this refusal was "in view of the record."[15] That position makes no sense as there was more than ample evidence in the record for the Commission to establish future access reductions.

[14] See Verizon's DMB Exhibit 1.
[15] Recommended Decision at pg. 59.

The ALJ states that the Commission should close this case and "review the impact of current reductions and reduce costs in subsequent proceedings if necessary."[16] That position is untenable. Given that this case is almost three years overdue, waiting for a future unspecified proceeding would be a further delay in doing what the Commission should do in this proceeding. As part of this case, the Commission should clearly delineate the complete reduction of access rates to cost. It is MCI's position that such rates should be reduced to cost immediately, as there is no justification for the rates to remain at above-cost levels. If the Commission is not willing to reduce such rates immediately, the record is certainly complete enough for the Commission to adopt a phase-down approach that eventually brings access rates to cost within the next several years. There is no reason to wait for another proceeding for all parties to be forced to come back to the Commission to put on essentially the same case that was presented in this matter. The record contains all information necessary for this Commission to implement either an immediate or a phased-down reduction in access rates to their forward looking costs.

The FCC has already recognized that access rates should be reduced significantly, and interstate access rates are significantly lower than intrastate access rates. Verizon argued in this case that the FCC has refused to reduce access rates all the way down to cost based levels.[17] However, the FCC has in fact reduced access rates considerably over the years, and the interstate access rates are significantly below intrastate access rates even though there is no legitimate reason for the difference in the rates. The interstate rates are certainly much closer to Verizon's costs than the intrastate rates.

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[16] Id.
[17] Verizon Main Brief at pg. 5.

The record shows that if the Commission reduces Verizon's intrastate access charges to interstate levels, Verizon would still be earning above-cost revenues. As MCI Cross Exhibit 1 shows, Verizon still earns a composite BEGIN PROPRIETARY

END PROPRIETARY at the interstate access levels. Thus, Verizon is still earning above-cost revenues and therefore reducing access rates to interstate levels would still maintain a subsidy for Verizon.

As far back as September 1999, this Commission recognized the need to remove implicit subsidies and make them explicit. Specifically, in the Global Order, the Commission significantly reduced access charges "in order to maintain fair toll competition."[18] At that time, the Commission also recognized that "there have been various significant regulatory developments in both the federal and state arenas that ***require the elimination of implicit subsidies.***"[19] Because the Commission did not fully reduce access rates to cost in the Global Order, the Commission ordered an investigation by January 2001 to "***presumably eliminate all subsidies*** in the access charge rate structure."[20]

The Commission has itself recognized that reducing access rates is necessary to establish a fair competitive environment. Specifically, in its July 15, 2003 Order approving the Sprint/RTCC settlement, the Commission noted that it is a continuing Commission objective to reduce access charges "that impede competition in the telecommunications market."[21] The Commission further noted that the reduction of

[18] Joint Petition of Nextlink Pennsylvania, Inc., et. al., Docket Nos. P-00991648 and P-00991649, Opinion and Order, September 30, 1999 (hereinafter "Global Order") at pg. 18.
[19] Id. at pg. 26 (emphasis added).
[20] Id. at pg. 59 (emphasis added).
[21] Access Charge Investigation per Global Order of September 30, 1999, Docket Nos. M-00021596, Opinion and Order, July 15, 2003 (hereinafter "Sprint/RTCC Order") at pg. 10.

access rates permits IXCs and CLECs to "compete on a more level playing field with the ILECs."[22]

The Verizon/OCA settlement does not accomplish the Commission's goal of reducing access charges to cost by removing whatever "subsidies" exist in such rates, and the Commission should therefore either reject the ALJ's recommendation to adopt such settlement proposal, or clearly establish "next steps" to further reduce access rates to cost in the near future.

At a minimum, if the Commission is not willing to reduce access rates to cost immediately, then the Commission should either reduce access rates immediately to interstate levels (which would include an elimination of the CC, since there is no CC at the interstate level), or if the Commission adopts the Verizon/OCA proposal to be effective as soon as possible, then the Commission should order further reductions to interstate levels by a date certain (such as by no later than the end of 2004) and reductions to cost by a date certain (such as by no later than the end of 2005).

The Commission should not do as the ALJ recommended, which is to yet again wait and review the impact of the current reductions and only reduce rates as part of a subsequent proceeding. The Commission has already recognized the need to eliminate implicit subsidies and further study of this issue is not required. The record is sufficiently developed in this case and there is absolutely no legitimate reason to force the parties to go through yet another proceeding, which will likely involve the exact same evidence that was presented in this matter.

[22] Id.

EXCEPTION #3: The ALJ Erred by Assuming that Reductions in Access Rates Would Lead to Increased Residential and/or Business Rates

In the two pages of decision-making in the Recommended Decision, the ALJ stated that "[t]he parties realize that transferring the reduction in access charges to the end user at one time by increasing the residential and/or business rates would result in rate shock."[23] MCI never made such argument or realization because MCI specifically disagreed that reducing access rates would necessarily lead to an increase in residential and/or business rates.

The ALJ does not even discuss MCI's argument that Verizon is not entitled to automatic revenue neutrality. Because the ALJ does not explain or provide any analysis on why she believes that revenue neutrality is required, it is difficult to rebut her finding. However, there is nothing in the law or in the Bell Atlantic/GTE Merger Order that requires revenue neutrality. Similarly, Verizon's Chapter 30 plan does not *require* revenue neutral rate increases if Verizon reduces its access charges. The language in Verizon's plan states that Verizon "*may* file tariffs proposing to rebalance and/or restructure its rates for noncompetitive services, either an increase or decrease."[24] Again, nothing in this language *requires* the Commission to approve such tariffs as filed. Similarly, 66 Pa. C.S. §3007, which deals specifically with access charges, states only that revenue-neutral rate changes *may* be proposed, but such changes are subject to Commission approval.

Verizon also cites to the Global Order as a basis for its claim that any access reductions must be offset by revenue neutral rate increases.[25] Yet again, although the

[23] Recommended Decision at pg. 58.
[24] Verizon Main Brief at pg. 28, citing to Verizon North Chapter 30 Plan, Part 3.B.1 (emphasis added).
[25] Verizon Main Brief at pgs. 32-33.

Commission permitted revenue neutral recovery of the access reductions in the Global Order, the Commission never required such recovery in the future. Further, in the Global Order, even when the Commission did permit revenue neutral recovery of the access reductions ordered at that time, the Verizon PA revenue did not come from increases to residential or business rates, but from Verizon's Price Change Opportunity ("PCO") filings.

Verizon's position on revenue neutrality is being used as a scare tactic to discourage the Commission from implementing access reductions to either cost or interstate levels. Specifically, in its Main Brief, Verizon claims that it would have to increase residential rates by $3.18 per line per month (nearly $40/year), or it would have to increase both residential and business rates by $2.62 per line per month if intrastate access rates are reduced to interstate levels.

Obviously, this scare tactic worked on the ALJ as she refused to reduce access charges to reasonable levels. However, this scare tactic has several flaws. First, as noted above, there is no requirement that the Commission permit rate increases due to access rate decreases. Second, such revenue neutrality assumes that the above-cost access rates are indeed needed to subsidize basic local rates. There is absolutely no proof in the record that access rates are subsidizing basic local rates. To the contrary, there are many other subsidies in Verizon's rates, including subsidies in business rates, urban rates, and in particular in the features Verizon charges to its customers.[26] Third, there is no reason to assume that any increases must come primarily from residential rates or even from business rates.

[26] *See* MCI Cross Exhibits 3-5, which show that Verizon receives a large amount of above-cost revenues from its most common features such as Caller ID and Call Waiting.

The key to revenue neutral recovery is that the Commission must not refuse to reduce access charges solely because it does not want to raise other rates. It is clear that access charges are above cost and are anti-competitive. If the Commission wants to permit revenue neutral recovery of access reductions, but the Commission does not want to recover such revenue from residential customers, then the solution is to find other sources of the revenue recovery, such as PCOs or even the increased revenue realized by Verizon's entry into the in-region interLATA market.

EXCEPTION #4: The ALJ Erred by Not Considering MCI's Arguments Regarding the Harms Caused by Above-Cost Access Rates

It is unclear from the Recommended Decision whether the ALJ even considered MCI's arguments regarding the various reasons access rates must be reduced to cost. The ALJ recommended adoption of the Verizon/OCA settlement proposal based on the fact that it was supposedly "significant" that OCA, Verizon and OTS were able to agree on the proposal.[27] However, none of the parties that are actually impacted by the access charges agreed on that proposal, and the ALJ did not take that fact into consideration. The ALJ appeared so focused on the impact on retail rates (which isn't even a sure thing) that she ignored the impact on competition and competitors (which is inevitable). This is a serious error. First, as noted above, there is absolutely no requirement that reduced access rates must lead to higher retail rates. Thus, the ALJ's concern regarding reduced access rates leading to higher retail rates is unfounded.

Second, there were numerous arguments on the record that gave this Commission ample reason to reduce access rates closer to cost, which the ALJ ignored or did not properly consider.

The ALJ did not even discuss the evidence showing that the telecommunications industry is moving towards making implicit subsidies explicit to permit a level playing field. Regulated wholesale services are moving to cost in order to eliminate competitive advantages that one carrier may have over another. When a carrier is a party's primary supplier and primary competitor, it is imperative that the regulator ensure a level playing field so that one party does not have an unfair advantage over the other parties with whom it competes.

Because switched access charges are a very significant input into the cost of providing long distance service, and because prices in a fully competitive market such as the long-distance market are reflective of costs, above-cost switched access charges push long distance charges above their true social costs. This market distortion results in end user customers either not making certain calls or using alternative technologies, such as wireless.[28] Wireless carriers, for example, pay no originating access charges for any long distance calls placed by their customers, and the terminating access charges are based on calling areas that are substantially larger than those of IXCs.[29] Inside the large calling areas that exist for wireless carriers in Pennsylvania, wireless carriers pay the much lower reciprocal compensation rates.[30] Because of the regulatory disparity between the treatment of wireline and wireless calls, consumer behavior may be artificially influenced by access-related market distortions towards using the wireless technology when they may prefer to use wireline phones. The Commission can and should minimize the discriminatory treatment of wireline and wireless carriers by reducing intrastate switched access charges to cost. This facilitates consumers making choices among similar services based on real cost differences, rather than on regulatory distortions.

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[27] Recommended Decision at pg. 58.
[28] See AT&T Statement 1.0 (Nurse/Kirchberger Rebuttal) at pg. 11-13.
[29] Id. at pgs. 13-14, *See also* K-N Rebuttal Exhibit 1.
[30] Id.

Verizon provides switched access to independent long distance carriers and also competes directly with those same carriers in the long distance market. Verizon has had and continues to have both the incentive and ability to use above-cost access charges to maintain an unfair and anticompetitive advantage in the Pennsylvania long distance market. While Verizon claims that IXCs have a large market share in the intraLATA market, Verizon fails to mention its astronomical success in entering the interLATA long distance market. In the short time Verizon has been in the market, it has gained over 25% of the market[31] and announced in January of 2003 that it had passed Sprint as the third biggest IXC in the country.[32] In addition, Verizon's long distance services are substantially growing while toll minutes for other IXCs in Pennsylvania are decreasing.[33]

Verizon does not face the same cost structure as its competitors, further accentuating the anticompetitive nature of above-cost access charges. The cost of intrastate switched access to a long distance provider such as MCI is what it pays to Verizon for switched access – the tariffed switched access charges. There is no dispute in this proceeding that those charges exceed Verizon's costs of providing switched access services. When Verizon provides long distance service to its own local customer, instead of incurring the tariffed rate, it incurs the actual cost of providing the access service. Therefore, when Verizon provides long distance service to its local customer, it incurs its actual marginal cost of providing the access service, as compared to the much higher tariffed rate of access charges incurred by its competitors. As Dr. Pelcovits testified, "for Verizon, the tariffed rates are just an internal transfer from one pocket of the

[31] Transcript at pgs. 224-225.
[32] AT&T Statement 1.0 at pg. 24; *See also* K-N Rebuttal Exhibit 6.
[33] AT&T Statement 1.0 at pgs. 24-25.

corporation to another. Verizon can and will ignore the tariff rates and set prices in the long distance market that squeeze out competitors and increase its own profits."[34]

Imputation does not cure the discriminatory treatment and cost advantage that Verizon enjoys by charging IXCs above-cost access rates. The fact that Verizon's long distance affiliate "pays" the same above-cost access rates does not affect the overall financial situation of the Verizon parent company. When Verizon's long distance affiliate pays access rates to the Verizon local affiliate, it is simply a paper transaction that transfers the money from one pocket of the company to another. Even Verizon's counsel acknowledged as much when she was questioning MCI regarding the "payment" of access charges when MCI has both the long distance and the local customer. She stated that when an MCI local customer places a call using MCI toll service, "it's a wash as between those two companies."[35] Similarly, when Verizon affiliates handle a long distance call, it's a "wash" and the Verizon company – as a whole – only incurs Verizon's actual cost of providing the access service, which is substantially lower than the inflated cost that an IXC must pay for that same service.

Under these circumstances, it is easy to see how an ILEC can set prices that create a price squeeze that forces competitors out of the market. A price squeeze exists if the incumbent is able to charge its retail customers a toll price that is less than the cost of providing long distance service combined with the tariffed access rate that Verizon charges to competitors. In this scenario, because Verizon's costs are below that of the IXC, the IXC cannot reasonably compete. As an example, suppose the cost of providing long distance service is 2¢/minute for both Verizon and IXCs. Suppose further that the actual cost of providing access is 1¢/minute, but the tariffed rate for access is 3¢/minute. In this scenario, the total cost to Verizon would be 3¢/minute

[34] MCI Statement 1.0 (Pelcovits Rebuttal) at pg. 19.
[35] Transcript at pg. 351.

whereas the total cost to an IXC would be 5¢/minute. Thus, Verizon could charge 4.5¢/minute and still make a profit whereas the IXC would lose money if it charged that same rate.[36] The bottom line is that above-cost switched access charges provide the ILEC with a significant, artificial advantage which will allow it to take customers away from equally, or more efficient, long distance carriers without having to sacrifice profits. This proceeding provides the Commission with an opportunity to eliminate this opportunity for a price squeeze by reducing access charges to cost.

Above cost access rates also give the incumbents a competitive advantage in the local market. By receiving a substantial costing benefit based on inflated cost structures, the incumbents have an anti-competitive and discriminatory advantage over competitors.

Verizon claimed that the Commission has in the past rejected arguments that above-cost access rates have a negative impact on competition.[37] Any Commission findings regarding the appropriateness of above-cost access were prior to major changes in the competitive industry. Primarily, Verizon was not in the in-state interLATA market until September of 2001. Thus, Verizon did not have a long distance unit competing directly with the IXCs. It is nothing short of a complete ignorance of reality to claim that Verizon has no advantage in the long distance market when charging its primary competitors above-cost access rates.

The concern regarding incumbents' advantages are especially inherent in the new world of bundled products. Bundled services have become increasingly popular in the residential telephone markets. Bundling of different packages of services emphasizes the necessity of ensuring that ILECs and CLECs/IXCs face similar cost structures. The cost structure faced by the ILECs is a result of the structure of prices that they pay to their suppliers for inputs into their

[36] MCI Statement 1.0 at pg. 20.
[37] Verizon Main Brief at pgs. 39-41.

services. The cost structure faced by the CLECs/IXCs is the result of the rate structure for UNEs and switched access services approved by this Commission. If there is a mismatch in these two cost structures, the ability of competitive service providers to effectively compete is impaired relative to the incumbent.

The Verizon/OCA settlement does not come close to eliminating the disparity in costs and the cost advantages realized by Verizon through above-cost access rates. Because the Verizon/OCA settlement does not reduce access rates enough, the proposal will not eliminate the harms that are caused by above-cost access rates.

WHEREFORE, for the reasons stated herein, MCI WorldCom Network Services, Inc. respectfully requests that the Commission reverse Judge Fordham's Recommended Decision, and reduce access rates to cost. Alternatively, MCI recommends that the Commission permit the Verizon/OCA settlement proposal to go into effect, but that the Commission clearly establish future reductions to access rates that will be automatically implemented in the near future.

Respectfully submitted,

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Dated: December 8, 2003

SERVICE LIST

I hereby certify that I have this day caused a true copy of MCI's Exceptions to be served upon the parties of record in Docket NoC-20027195 in accordance with the requirements of 52 Pa. Code Sections 1.52 and 1.54 in the manner and upon the parties listed below.

Dated in Washington, DC on December 8, 2003

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DEC 0 8 2003

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

James McNulty, Secretary
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Commonwealth Keystone Building
400 North Street
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Re: Complaint of AT&T Communications of Pennsylvania, LLC.
v. Verizon North, Inc. and Verizon Pennsylvania Inc.
Docket No. C-20027195

DOCUMENT
FOLDER

Dear Mr. McNulty:

Enclosed for filing in the above-referenced proceeding are the original and nine (9) copies of the public version of the Exceptions of AT&T Communications of Pennsylvania, LLC.. **Please note that an additional copy of the proprietary version of that brief, containing information that is deemed proprietary by Verizon Pennsylvania Inc., is being provided under seal.**

Copies of the proprietary version of the brief are being served on the administrative law judge, the Office of Special Assistants, and on all parties of record as indicated on the attached certificate of service. Please contact me if you have any questions regarding the enclosures.

Very truly yours,

Robert C. Barber

Enclosures

cc: (w/ encl)
The Honorable Cynthia W. Fordham
Office of Special Assistants (w/ diskette)
Service List

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

AT&T COMMUNICATIONS OF PENNSYLVANIA, LLC.	
v.	Docket No. C-20027195
VERIZON NORTH, INC.	
and	
VERIZON PENNSYLVANIA INC.	

EXCEPTIONS OF
AT&T COMMUNICATIONS OF PENNSYLVANIA, LLC.

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Dated : December 8, 2003

PUBLIC VERSION

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

AT&T COMMUNICATIONS OF PENNSYLVANIA, LLC.	
v.	Docket No. C-20027195
VERIZON NORTH, INC.	
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EXCEPTIONS OF
AT&T COMMUNICATIONS OF PENNSYLVANIA, LLC.

INTRODUCTION

In its expeditious resolution of the Sprint/RTCC access proposal, the Commission demonstrated that it not only understands the competitive problems that are inherent in excessive access rates, but that it understands what must be done to correct them.[1] This case presents the Commission with an opportunity to put that same understanding into concrete action, by commencing, once and for all, a comprehensive reform plan for Pennsylvania's largest access providers – Verizon Pennsylvania Inc. and Verizon North Inc.

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[1] *Access Charge Investigation per Global Order of September 30, 1999*, Order, Docket Nos. M-20021596 et al., July 15, 2003 ("Sprint/RTCC Order"). In that decision, the Commission approved a plan that permitted Sprint and the independent local exchange providers to reduce access rates by a total of $25 million in the first year, with additional, smaller reductions in the second year of the plan. The companies were permitted to offset these access reductions dollar-for-dollar with increases in basic residential local exchange rates. Id. at 10. The plan also increased the residential "rate cap" for the companies by $2.00, to $18.00 per month.

The record developed in this case makes a compelling case for that reform. Even after the significant access reductions that the Commission directed in the Global Order, the long distance providers seeking to compete in Verizon Pennsylvania's and Verizon North's service territories still are afflicted with intrastate access rates that exceed Verizon's interstate access rates by at least **[BEGIN VZ PROPRIETARY]** .[2] **[END VZ PROPRIETARY]** And as the toll carriers labor under those inflated rates, new competitors – including wireless carriers and Verizon's own long distance affiliate – have been able to leverage their ability to avoid those same charges to place the access-burdened long distance providers in an more precarious, and entirely artificial competitive disadvantage.

At the same time, the evidence developed here shows that eliminating this anti-competitive burden is far from an insurmountable task. To the contrary, just as it did through the recent Sprint/RTCC access reform proposal, the Commission can reduce and ultimately eliminate the implicit subsidies in Verizon's intrastate access rates in a manner that promotes competition in both the long distance and local exchange markets.

The first step in that process is to adopt the recommendation of Administrative Law Judge Fordham and approve the settlement proposal that has been introduced in this case by Verizon and the Office of Consumer Advocate. As will be discussed below, that proposal is far from perfect. The access reductions proposed by Verizon and the OCA are significant, but still

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[2] AT&T Cr. Exh. 7.

leave rates – at least for the time being – at levels that substantially exceed cost. Nevertheless, adoption of that proposal should jump start the reform process, providing the new momentum necessary for accomplishing the goals the Commission set for itself over four years ago.

At the same time, it is critical that the Commission recognize that adoption of the Verizon/OCA proposal is not an end to the reform process, but rather a beginning. Even after that proposal is implemented considerable work will remain to be done. The needs of competitors and consumers alike will not permit that effort to lag. Indeed, any delay similar to the one that has followed the Global Order could very well doom the prospects for full and fair telecommunications competition in Pennsylvania.

Accordingly, and as will be discussed below, the Commission should reject that portion of the Recommended Decision that recommends deferring additional access reforms for the Verizon companies to some future, yet-to-be-initiated proceeding. That recommendation is not only contrary to the evidence developed in this case, it is plainly out of step with the Commission's recognition of the critical importance of comprehensive access reform. There is simply no need to put off a plan for final reform until tomorrow (or, given the history of this case, many hundreds of tomorrows). Rather, the Commission should take advantage of the comprehensive record that already is before it, and put the Verizon companies on a plan now for reducing their intrastate rates to interstate levels within the next several years.

Exception 1 **Although The Administrative Law Judge Properly Recommended Commission Approval of the Verizon/OCA Settlement Proposal, The ALJ Erred In Recommending That Further Access Reform Be Deferred Until A Future Proceeding.**

Despite a generally one-sided recitation of the record that largely ignores the substantial body of evidence submitted by AT&T demonstrating the need for immediate and aggressive action by the Commission to reduce Verizon's current access reductions, the Administrative Law Judge ultimately recommended that the settlement proposal submitted by Verizon and the OCA should be approved as "fair, just reasonable and in the public interest."[3] This recommendation is supported by the record, and should be adopted by the Commission without further delay.

As AT&T explained in its Main Brief in this case, the Verizon/OCA proposal is far from perfect. Indeed, as the record developed in this case demonstrates, even the **[BEGIN VZ PROPRIETARY]** **[END VZ PROPRIETARY]** in reductions to Verizon North's Carrier Charge that Verizon estimates will result from implementation proposal will still leave that company's access rates far in excess of Verizon's interstate rates. Implementation of the proposal in fact will actually result in an increase --albeit a relatively small one -- in Verizon North's traffic sensitive local switching rate. Moreover, the proposal does nothing to relieve the existing bloat in Verizon Pennsylvania Inc.'s intrastate access rates.

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[3] Rec. Dec. at 59.

Nevertheless, the access reductions contemplated in the Verizon/OCA proposal reflect a significant step in the right direction towards a complete access reform for both Verizon companies. As such, AT&T does not interpose any objection to Commission approval of the proposal. To the contrary, AT&T respectfully urges that the Commission adopt that proposal and, in accordance with the terms of the proposal, permit it to go into effect on January 1, 2004, or as soon thereafter as is practicable as a first step in the reform process.

It is important to recognize, however, that adoption of that proposal would be just that – a first step. Verizon itself has acknowledged that moving its intrastate access rates to interstate levels would require a total access reduction of approximately **[BEGIN VZ PROPRIETARY]** .[4] **[END VZ PROPRIETARY]** Thus, after implementing the access reductions in the Verizon/OCA proposal, the Commission still must address approximately **[BEGIN VZ PROPRIETARY]** **[END VZ PROPRIETARY]** in excessive intrastate carrier access charges.

To that end, AT&T recommended that the Commission seize the opportunity and build upon the record that already has been developed in this case to implement a final comprehensive reform plan for both Verizon companies. For example, assuming that the access reductions necessary to bring Verizon's post-settlement access rates down to interstate levels were offset with local rate increases spread across all of the residential and business lines that Verizon has identified as being subject to such an increase – a total of

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[4] AT&T Cr. Exh. 7.

[BEGIN VZ PROPRIETARY] **[END VZ PROPRIETARY]** – the potential local rate increase would be about $1.57 a month.[5] Stated another way, if the Commission was to implement phased additional reductions in Verizon's access rates over a two-year period, it could largely eliminate the Verizon access problem once and for all at a cost of two local rate increases of less than 80 cents per month.

Unfortunately, the Recommended Decision failed to come to grips with this opportunity for final access reform. Instead, the Administrative Law Judge recommended, "in view of the record," to postpone additional access reform measures to some subsequent proceeding, "if necessary."[6]

This recommendation should be overruled for several reasons. First, it is anything but clear just what "record" supports the substantial delay in completing the reform process that will plainly result from deferring the matter to another case. It certainly cannot be the record developed in this case. To the contrary, that record shows that the access rates charges by both Verizon companies today substantially exceed the cost of providing carrier access services – and, as noted above, will continue to do so even after implementation of the Verizon/OCA proposal.[7] Even Verizon's own witnesses acknowledged that its

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5 See AT&T Cr. Exhs. 5-7. The monthly rate impact is derived by dividing **[BEGIN VZ PROPRIETARY]** **[END VZ PROPRIETARY]** by the total number of access lines identified by Verizon -- **[BEGIN VZ PROPRIETARY]** **[END VZ PROPRIETARY]** – and then again by 12.

6 Rec. Dec. at 59.

7 See AT&T Stmt. 1.0 at 4-5; AT&T Stmt. 2.0 at 10 and OAO Rebuttal Exhibit 4.

access rates are not cost-based, testifying that Verizon's access rates have "not been tied to the cost of providing this service."[8]

The record developed in this case also underscored the severe adverse effect that those Verizon's above cost access rates are having on competition in Pennsylvania's telecommunications markets. This is evident in the growing emergence of wireless carriers, with their "free" long distance calling, as a substitute for traditional wireline toll calls. These wireless carriers wield an artificial cost and pricing advantage over interexchange carriers because, unlike those IXCs, they pay no access charges on calls within their huge "local" calling areas.[9] The IXCs, in contrast, pay those access charges on *all* of the intrastate calls they provide to Verizon's local exchange customers.[10]

Indeed, the record shows that while the charges for completing a call *from* a wireless customer in Philadelphia to a Verizon wireline customer in State College would be less than two-tenths of a cent per minute (assuming that the carrier is paying the tariffed end office call termination rate, rather than an even lower negotiated rate).[11] A wireline long distance call of that same distance

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8 VZ Stmt. 1.0 at 5-6.

9 The "Philadelphia" wireless local calling area, for example, stretches from the beaches of southern New Jersey, through all of the state of Delaware, and all the way to Centre County. AT&T Stmt. 1.0 at 14.

10 AT&T Stmt. 1.0 at 11-18.

11 AT&T Stmt. 1.0 at 14-15. The reciprocal compensation rate drops even lower in those cases where Verizon, through negotiated interconnection agreements, has elected to implement the provisions of the FCC's April 2001 order on compensation for traffic bound for Internet Service Providers ("ISPs"), which requires that Verizon offer to exchange *all* local and ISP-bound traffic with CLECs and CMRS providers at a rate that, as of June 14, 2003, was set as low as $0.0007 per MOU. AT&T Stmt. 1.0 at 15 n. 10. See *In re Intercarrier*

carried by AT&T from a Verizon local exchange customer and completed on the Verizon network will result in total access charges of over 3.5 cents per minute – ***over 17 times more*** than the wireless carrier must pay. This is despite the fact that there is no material difference from the wireless call in Verizon's cost to terminate this wireline call. And this competitive disparity only widens when the wireless provider in question is Verizon's own CMRS affiliate, Verizon Wireless, whose call termination obligations are accomplished via intracompany transfers that have no meaningful impact on Verizon's bottom line.[12]

The result has been a dramatic, accelerating, and unjustified loss of toll traffic for IXCs. In fact, Verizon's own data showed that, based on projections through 2003, the IXCs' access minutes of use in VZ-PA's territory will have dropped since 2000 by nearly **[BEGIN VZ PROPRIETARY]** . **[END VZ PROPRIETARY]** In contrast, the record shows that minutes carried by wireless carriers are increasing substantially,[13] thus showing that the market distortions caused by carrier access charges are inefficiently driving traffic off of the wireline network.

This same record shows that access is skewing competition within the interexchange market itself. This is a direct result of the entrance into the intrastate long distance market in Pennsylvania of Verizon itself, the same company to whom IXCs must pay these inflated access charges. Toll carriers

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Compensation for ISP-Bound Traffic, CC Docket No. 96-98 & 99-68, FCC 01-131, Order on Remand and Report and Order (rel. April 27, 2001).

12 AT&T Stmt. 1.0 at 15.

13 AT&T Stmt. 1.0 at 17-18, K-N Rebuttal Exhibit 3.

now are being forced to compete against Verizon's long-distance plans at the same time that they are being forced to pay access charges that even Verizon admits are set substantially in excess of the cost of that service.

The evidence shows, for example, that Verizon's long distance offerings, and particularly its bundled Freedom plans, include "unlimited" long distance calling at effective retail rates that put IXCs trying to compete with that plan, and who thus must pay access charges to Verizon, in a price squeeze. Verizon is in fact able to offer consumers these plans precisely because its underlying cost of providing carrier access services is nearly zero.[14]

Not surprisingly, Verizon has been able to leverage these advantages to make significant inroads into the state's toll markets in a short period of time. Even as toll minutes for IXCs in Pennsylvania are decreasing overall, Verizon's long distance services are growing substantially. For example, projected minutes for 2003 show that the minutes generated by Verizon's long distance affiliates in VZ-PA's territory grew by nearly **[BEGIN VZ PROPRIETARY] [END VZ PROPRIETARY]** from 2002, the first full year of Verizon's long distance entry in Pennsylvania.[15]

Thus, contrary to the ALJ's recommendation, the "record" developed in this case does not support any delay in completing the reform of Verizon's intrastate access charges. To the contrary, that record makes a compelling case for immediate and aggressive action by the Commission, without further delay.

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[14] AT&T Stmt. 1.0 at 12.

[15] AT&T Stmt. 1.0, K-N Rebuttal Exhibit 7.

Indeed, delay will not make these problems go away. And there should be no question that inordinate delay is exactly what adoption of the ALJ's recommendation in this case will cause. The history of this case alone shows the folly of that course.

As Verizon witnesses Berry and Wirl noted in their testimony,[16] the Commission in its 1999 Global Order recognized the need to move Verizon's access charges to cost-based levels, finding that under the provisions of the Telecommunications Act of 1996 it was required to "take the necessary steps to strive to replace the system of implicit subsidies with 'explicit and sufficient' support mechanisms to attain the goal of universal service in a competitive environment."[17] The evidence described above, however, shows that the reductions it ordered with respect to Verizon Pennsylvania's access rates in the Global Order still left those rates substantially in excess of the incremental cost of providing access services. Moreover, with the exception of the establishment of the Carrier Charge structure, the Commission effectively left the access rates charged by Verizon North (then GTE) *un*touched.[18]

Recognizing that it had only just begun to address the problem of over-priced access, the Commission expressed its intention to commence a new investigation to address reductions in those charges. In fact, the Commission

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16 VZ Stmt. 1.0 at 5-6.

17 *Joint Petition of Nextlink, et al.*, Docket Nos. P-00991648 and P-00991649, Sept. 30, 1999 ("Global Order"), at 26-27.

18 AT&T Stmt. 1.0 at 9.

expressed its belief that "the sooner that we resolve the reduction and possible elimination of the carrier pool, the better it would be for the competitive environment in Pennsylvania."[19] To that end, the Commission ordered the new investigation to commence on January 2, 2001, with a deadline to complete the case – and reduce rates – ***by December 31, 2001***.[20]

Moreover, in its November 4, 1999 Opinion and Order approving – over the objections of AT&T and other parties and the recommendation of the administrative law judge who heard the case – the merger of Bell Atlantic and GTE to form Verizon, the Commission did not adopt GTE and Bell Atlantic's proposal to commence a proceeding 30 months after merger closing "for the purpose of developing access charge parity."[21] Instead, the Commission ordered that the "issue of access charge parity for Bell Atlantic-Pennsylvania, Inc. and GTE North, Inc." would be resolved in the same access proceeding that had been provided for in the September 1999 Global Order.[22]

That investigation, unfortunately, was not initiated on the timetable established in the Global Order. Even more important, it wasn't completed by the end of 2001. Instead, we are now on course that will not result in a Commission order until 2004. Thus, the comprehensive access reforms and reductions that

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19 Global Order at 60.

20 Id.

21 *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, Nov. 4, 1999, at 37.

22 Id. at 46.

the Commission contemplated in the Global Order and the Verizon Merger Order are now more than ***two years overdue***.

To be clear, AT&T is not advocating that the Commission attempt to rectify this history by reducing access to interstate levels in this case right now. But the Commission will not achieve the necessary reforms at all at the pace exhibited in the years of neglect that followed the Global Order. The record emphatically demonstrates that the telecommunications markets in Pennsylvania cannot endure another prolonged wait for comprehensive reform. Consequently, the Commission should not only commence the process for completing reform through the adoption and implementation of the Verizon/OCA proposal, but also complete it in an identified timeframe based on the record in this case, and not some future, inchoate proceeding.

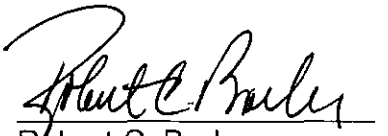
CONCLUSION

For the reasons set forth above, the Commission should approve that portion of the Recommended Decision that recommends the approval of the Verizon/OCA access settlement proposal, but reject that portion of the decision that recommends delaying future reforms to a separate proceeding.

Respectfully submitted,

AT&T COMMUNICATIONS OF PENNSYLVANIA, LLC.

By its Attorneys,



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Dated: December 8, 2003

Certificate of Service
Docket No. C-20027195

The undersigned hereby certifies that true and correct copies of the Exceptions of AT&T Communications of Pennsylvania, LLC. were caused to be served on the persons named below by electronic and overnight mail in accordance with the requirements of 52 Pa. Code §§1.52 and 1.54:

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