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September 18, 2003

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Commonwealth Keystone Bldg.  
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PA PUBLIC UTILITY COMMISSION  
SECRETARY'S BUREAU

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

Dear Secretary McNulty:

Enclosed please find for filing an original and nine (9) copies of the Office of Consumer Advocate's Main 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

Enclosures

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

CERTIFICATE OF SERVICE

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

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

Dated this 18th day of September, 2003.

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PA PUBLIC UTILITY COMMISSION  
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**Re: AT&T Communications of Pennsylvania Inc. v.  
Verizon North, Inc.  
Docket No. C-20027195**

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Dear Mr. McNulty:

Enclosed for filing are the original and nine (9) copies of the Main 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

RJP

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**ORIGINAL**

**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**AT&T COMMUNICATIONS OF  
PENNSYLVANIA, INC.**

**V.**

**VERIZON NORTH INC.**

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**DOCKET NO. C-20027195**

**DOCUMENT  
FOLDER**

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**MAIN BRIEF  
ON BEHALF OF THE  
OFFICE OF SMALL BUSINESS ADVOCATE**

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**DOCKETED**

**SEP 22 2003**

**Non-Proprietary Version**

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Assistant Small Business Advocate**

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**Dated: September 18, 2003**

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

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STATEMENT OF THE QUESTIONS INVOLVED

- A. Issue: Whether Verizon – Pennsylvania, Inc. and Verizon North, Inc. as the utilities at issue in the complaint, has the burden of proof?

Answer: Yes

- B. Issue: Whether Verizon – Pennsylvania, Inc. and Verizon North, Inc. have satisfied their burden of proof?

Answer: No

- C. Issue: Whether the Joint Proposal of Verizon – Pennsylvania, Inc. and Verizon North, Inc. is prohibited by 66 Pa. C.S. Section 1325(a)?

Answer: Yes.

- D. Issue: Whether the recommended access carrier charge at \$1.20 for both Verizon – Pennsylvania, Inc. and Verizon North, Inc. without any offsetting increases is just and reasonable?

Answer: Yes.

- E. Whether the Verizon - Pennsylvania, Inc., Verizon North, Inc. and the Office of Consumer Advocate Joint Proposal suffers the same limitations as the other proposals?

Answer: Yes.

## NON-PROPRIETARY VERSION

### I. INTRODUCTION

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

The Global Order directed, among other things, local incumbent exchange carriers ("ILECs") operating in Pennsylvania to reduce access charges. The Global Order established a Pennsylvania Universal Service Fund to enable rural ILECs and Sprint to reduce access charges and intraLATA toll charges while maintaining a cap on residential basic service of \$16.00/month. The Global Order directed an investigation to be initiated by January 2001 to determine primarily how the carrier charge ("CC") could be reduced.

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<sup>1</sup> Re Joint Application of Bell Atlantic Corporation and GTE Corporation for Approval of Agreement and Plan of Merger, Docket Nos. A-310200F0002, A-311350F0002 and A-310222F0002 (November 4, 1999) ("Merger Order").

<sup>2</sup> Re Nextlink Pennsylvania, Inc., et al., Docket No. P-00991648; P-00991649, 93 PaPUC 172 (September 20, 1999) ("Global Order"); 196 P.U.R. 4<sup>th</sup> 172, *aff'd sub nom. Bell Atlantic-Pennsylvania, Inc. v. Pa. P.U.C.*, 763 A.2d 440 (Pa. Cmwlth. 2000), *alloc. granted*.

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The access charge investigation was delayed because of VZ-PA's Section 271 hearings in 2001. The Pennsylvania Public Utility Commission ("Commission" or "PUC") opened a docket at M-00021596 in January, 2002 to accommodate the access charge investigation required by its Global Order.

On March 21, 2002, AT&T filed a Formal Complaint docketed at C-20027195 against VZN to have its access charges reduced to VZ-PA's 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 Commission by Order entered December 24, 2002. This Order also bifurcated matters concerning access charges such that VZ's access charges were under Docket No. C-20027195 proceeding while the RTCC and Sprint access charge settlement maintained another docket.

The VZ Petition proposed access charge reductions similar in methodology to those presented by RTCC/Sprint in their settlement proposal. OSBA, OCA, OTS, AT&T, Qwest, and MCI WorldCom Network Service, Inc. ("MCI") objected to the VZ Petition. In its May 5, 2003 Order, the Commission referred the VZ Petition to the Office of Administrative Law Judge for evidentiary hearing and a recommended decision.

On May 29, 2003 an Initial Prehearing Conference was convened. OSBA, OCA, OTS, AT&T, MCI, Qwest, RTCC and Sprint participated in the prehearing conference. On June 9, 2003 a Prehearing Order #2 was issued which established the hearing schedule, modified some discovery rules, and proposed training for access to VZ's cost studies.

## NON-PROPRIETARY VERSION

The active participants to this proceeding are AT&T, OCA, OSBA, OTS, MCI and Qwest. After VZ-PA served its initial Petition and testimony, responsive testimony was served by all active parties on July 18, 2003. On August 4, 2003, VZ-PA, AT&T, MCI, OCA and OTS filed surrebuttal testimony. Hearings were held before Administrative Law Judge Cynthia Williams Fordham ("ALJ") on August 25 and 26, 2003. In accordance with Order #4, Main Briefs are to be filed on or before September 18, 2003. Reply Briefs are due on or before September 29, 2003. The OSBA submits this Main Brief in compliance with Order #4.

## II. SUMMARY OF ARGUMENT

This case originated as a Complaint against a VZ Petition proposing both increases in some rates and offsetting decreases. By statutory mandate, the burden of proof is upon VZ to show the proposed rates are just and reasonable.<sup>3</sup> Additionally, an increase in local exchange service cannot exceed the overall average percentage increase in total intrastate revenues unless affirmatively proven by the Petitioner as justified by the cost of providing the service.<sup>4</sup>

Section 315(a) of the Public Utility Code places the burden of proof on VZ-PA in this proceeding.<sup>5</sup> As demonstrated herein, VZ has not met its burden of proof. Thus, its Petition

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<sup>3</sup> 66 Pa. C.S. § 315(a).

<sup>4</sup> 66 Pa. C.S. § 1325(a).

<sup>5</sup> 66 Pa.C.S. § 315(a).

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for reducing access charges combined with an increase in residential and, perhaps, business customers' local exchange service should not be approved.

Pursuant to business customers, VZ has not provided any detail regarding the amount of the increase or the actual components of the business service rates that will be affected. VZ claims its proposal is flexible similar to the RTCC/Sprint proposal yielding VZ discretion in implementation of access charge reductions. VZ simply fails to meet its statutory burden of proof obligations and erroneously claims the discretion to fix rates that belongs only to the Commission.

Section 1325(a) of the Public Utility Code places an additional constraint upon increases in local exchange service requiring the utility to prove any increase in local exchange rates be justified by its costs if it exceeds the overall average percentage increase to total intrastate revenues.<sup>6</sup> This VZ Petition presents a revenue neutral rate change, meaning that the overall net effect is a zero increase in intrastate revenue. Yet, both residential and some business customers<sup>7</sup> will experience increases in local exchange service that exceed their allocated share of local loop cost. VZ's proposal is prohibited by statute.

The public advocates offer a recommendation for the carrier charge that does not violate Section 1325 of the Public Utility Code. Nothing prohibits allocation of access costs to different services that utilize the local loop. The public advocates' recommendation allocates some cost responsibility to the toll carriers.

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<sup>6</sup> 66 Pa. C.S. § 1325(a).

<sup>7</sup> Business customers that receive local exchange service through a contract with VZ will not be affected by the increase proposed herein.

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III. ARGUMENT

A. VZ-PA Carries the Burden of Proof

The purpose of this proceeding is to establish traffic sensitive and non-traffic sensitive intrastate and intraLATA access rates for entities that use the local loop of VZ-PA and VZN in the course of their business handling consumers' telecommunications services within VZ service territories. This case is a rate case where VZ is requesting that increases in residential, and perhaps business services, be offset by decreases in access charges in a revenue neutral manner. Necessarily, this proceeding is subject to the statutory mandates in the Pennsylvania Public Utility Code.

VZ has requested three different options; each would allegedly accomplish its revenue neutral rate changes. One option reduces VZN's carrier charge ("CC") to [BEGIN VZ PROPRIETARY] \_\_\_\_\_ [END VZ PROPRIETARY] while increasing R-1 and perhaps B-1 rates to offset the reduced carrier charge.<sup>8</sup> The second option eliminates the CC altogether, thus requiring a greater increase in R-1 and B-1 rates to offset this reduction. Neither of these two options provides any allocation of increases to the R-1 and B-1 rates. The detail found in the record is a worst case scenario of an increase to the R-1 rates only which would yield a weighted average increase of [BEGIN VZ PROPRIETARY] \_\_\_\_\_ [END VZ PROPRIETARY] and [BEGIN VZ PROPRIETARY] \_\_\_\_\_ [END VZ PROPRIETARY] under options one and two, respectively.

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<sup>8</sup> VZ-PA carrier charge is at [BEGIN VZ PROPRIETARY] \_\_\_\_\_ [END VZ PROPRIETARY]. This option brings VZN's carrier charge in line with VZ-PA's carrier charge.

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The third option is a Joint proposal of VZ and OCA (“VZ/OCA Proposal”). This option presents a reduced VZN CC of [BEGIN VZ PROPRIETARY] \_\_\_\_\_ [END VZ PROPRIETARY] resulting in a total revenue decrease of [BEGIN VZ PROPRIETARY] \_\_\_\_\_ [END VZ PROPRIETARY].<sup>9</sup> It also specifies that no more than \$40 million of the access revenue reduction will be recovered through increases in residential basic local service rates of VZN and VZ-PA combined and any increase will not exceed \$1.00 per residential line. VZ proposed that the remainder of access reductions be recovered through increases to business local service rates over the combined VZN and VZ-PA service territories. The VZ/OCA Proposal would not be effective until January 1, 2004.<sup>10</sup>

Section 315(a) of the Public Utility Code states, “in any proceedings upon complaint involving any proposed rate increases, the burden of proof to show that the rate is just and reasonable shall be upon the public utility.”<sup>11</sup>

The Pennsylvania Supreme Court has held that the term, “burden of proof” means a duty to establish a fact by a preponderance of the evidence.<sup>12</sup> This term “preponderance of the evidence” means that one party has presented evidence which is more convincing by even the smallest amount, than the evidence presented by the other side or to preclude all reasonable inferences to the contrary.<sup>13</sup> If a party has satisfied its burden of proof, it must

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<sup>9</sup> VZ Stmt. No. 1.1 at 7.

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

<sup>11</sup> 66 Pa. C.S. § 315(a).

<sup>12</sup> Se-Ling Hosiery v. Margulies, 364 Pa. 45, 70 A.2d 854 (1950).

<sup>13</sup> Burleson v. Pa. P.U.C., 501 Pa. 433, 437, 461 A.2d 1234, 1236 (1983).

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then be determined whether the opposing party has submitted evidence of “co-equal” value or weight to refute the first party’s evidence.<sup>14</sup>

Moreover, any Commission order must be based on substantial evidence.<sup>15</sup> The term “substantial evidence” as defined by the Pennsylvania Courts means such relevant evidence as a reasonable mind might accept as adequate to support a conclusion. More is required than a trace of evidence or a suspicion of the existence of a fact sought to be established.<sup>16</sup>

Commission precedent on this issue is clear:

A utility’s burden is to affirmatively establish the reasonableness of its claim. It is not the burden of another party to disprove the reasonableness of a utility’s claims.<sup>17</sup>

VZ therefore bears the burden of proving by the preponderance of evidence to reduce the CC to any level resulting in increases to the residential and business local service rates as those options proposed is just and reasonable.

The Courts have held that the burden of proof does not shift to the party challenging a utility’s proposal.<sup>18</sup> While the burden of going forward may shift, the burden of convincingly establishing compliance with the facts supporting the statutory criteria afforded

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<sup>14</sup> Morrissey v. PA Dept. Of Highways, 225 A.2d 895 (1967).

<sup>15</sup> Dutchland Tours, Inc. V. Pa. P.U.C., 337 A.2d 922, 925 (Pa. Cmwlth., 1975).

<sup>16</sup> Murphy v. Dept. of Public Welfare, White Haven Center, 480 A.3d 382, 386 (Pa. Cmwlth. , 1994); Erie Resistor Corp. v. Unemployment Compensation Bd. Of Review, 166 A.2d 96, 97 (Pa. Cmwlth., 1961); Dutchland Tours, Inc. v. Pa. P.U.C., 19 Pa. Cmwlth. Ct. 1, 337 A.2d 922 (1975), as quoted in Norfolk & Western Railway Co. v. Pa. P.U.C., 489 Pa. 109, 128 (1980).

<sup>17</sup> Pa. P.U.C. v. Equitable Gas Co., 57 Pa. P.U.C. 423, 44, note 37 (1983).

<sup>18</sup> Berner v. Pa. P.U.C., 382 Pa. 622, 631; 116 A.2d 738, 744 (1955).

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competitive declaration of business services at the end of the proceeding rests with VZ.<sup>19</sup>

VZ must establish a prima facie case and demonstrate that:

[T]he elements of that cause of action are proven with substantial evidence that enables the party asserting the cause of action to prevail, precluding all reasonable inferences to the contrary.<sup>20</sup>

Accordingly, VZ is to be held to the evidentiary standard of establishing by substantial evidence that the proposed reductions offset by increases comply with Section 1325(a) of the Public Utility Code. It is VZ's burden to prove each element of its rate request with convincing and substantial evidence.<sup>21</sup> As shown through the remainder of the Brief, the record evidence demonstrates that VZ has failed to meet its burden of proof under Section 1325(a).

**B. VZ Lacks Substantial Evidence Necessary to Meet its Burden of Proof**

The burden of proving the justness and reasonableness of a proposed rate increase is on the utility. Evidence supplied by a utility to meet this burden must be substantial.<sup>22</sup> The Commonwealth Court found that, although the evidence in the record may be explained or interpreted in different ways, if the treatment of the evidence's shortcomings is not unreasonable, a finding that the utility did not establish substantial evidence of proof is

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<sup>19</sup> Replogle v. Pennsylvania Electric Co., 54 Pa. P.U.C. 528, 530 (1980).

<sup>20</sup> Burleson v. Pa. P.U.C., 501 Pa. 433, 437, 461 A.2d 1234, 1236 (1983).

<sup>21</sup> Pa. P.U.C. v. National Fuel Gas Distribution Corp., 84 Pa. P.U.C. 134, 167-68.

<sup>22</sup> Johnstown v. Pa. P.U.C., 133 A.2d 246 (Pa. Super. 1957).

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valid.<sup>23</sup> In Lower Frederick Township Water Co., the shortcomings of the record were: (1) mismanagement; (2) the facts asserted by the underlying witness were elusive and imprecise; (3) the nature and extent of debt in question was not proven in the record by the utility.

OSBA finds similar shortcomings here. VZ stated it “**may**, at its sole option, increase its weighted average business line rate by up to the same amount on a dollar basis that the weighted average R-1 rate is increased...”<sup>24</sup> VZ’s witness changed her testimony in describing the plan which initially read, “Verizon’s plan allowed for the increase to be placed on residential rates, **or** for some of the increase to be placed on business rates,” to “... **and** for some of the increase to be placed on business rates.”<sup>25</sup> VZ’s witness characterized the first two options discussed as increases for residential and business customer local services as, “**pric[ing] things out looking at residence, without making a specific proposal, and reserving the right to put some of the increase on business...**”<sup>26</sup> VZ’s witness confirmed that Exhibit MJW-6 provides no specific proposal for business customers.<sup>27</sup> The VZ witness characterized the VZ/OCA Proposal as one that “zeroed in to a greater extent on residence

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<sup>23</sup> Lower Frederick Township Water Co., v. Pa. P.U.C., 48 Pa. Commw. 222; 409 A.2d 505, 507 (Pa. Commw. 1980).

<sup>24</sup> VZ Exhibit 1, Attachment A, Elements Proposal, 2) (e) at 2 (Emphasis added.).

<sup>25</sup> Tr. at 144 to 45. See also, VZ Stmt. No. 1.1 at 4 (Emphasis added.).

<sup>26</sup> Tr. at 143, l. 15-17 (Emphasis added.).

<sup>27</sup> Tr. at 149-50.

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and capped the overall revenue amount that we would seek to recover from residence...” when describing the specifics of the proposal.<sup>28</sup>

When the VZ witness was asked specifically what the offset would be per line if it were to be split between residential and business customers stated, **[BEGIN VZ PROPRIETARY]** \_\_\_\_\_

\_\_\_\_\_.<sup>29</sup> **[END VZ PROPRIETARY]** When again asked about the specifics of the proposal for business customers, the VZ witness replied, “we haven’t put an entire proposal on paper, it hasn’t been developed, ...to the extent that your questions are leading in the realm of defining more and more and more what we might do, there’s a point at which I can’t really go further and be definitive because it hasn’t been developed yet.”<sup>30</sup>

At best, the VZ supporting witness can be characterized as a generalist. Clearly, it is not unreasonable to characterize the witness’s testimony as not supporting VZ’s proposed increase in local exchange service.

With regard to the business customer increase, the only notice given by VZ on the record is that there **may** be an increase.<sup>31</sup> The extent of the increase to business customers and any justification for it is not found. The specifics regarding any increase to business

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<sup>28</sup> Tr. at 143, l. 18-21.

<sup>29</sup> Tr. at 139, l. 23-25.

<sup>30</sup> Tr. at 146, l. 25 - 147, l. 8.

<sup>31</sup> Only with the third late introduced option under the VZ/OCA Proposal do we even know the quantity of the increase for business customers. The other options lack that information.

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customers is not in the record. The testimony of the sponsoring witnesses who were to provide the substantial evidence supporting the increase for business customers is simply not definitive.

In short, VZ did not carry its burden of proof because there is no substantial evidence to support notice of a rate increase to business customers. VZ has in essence said that they will increase business customers' local exchange service rates but they do not know how much that increase will be or what components will make up the local exchange service until after they get approval to increase the rates.<sup>32</sup> This is absurd.

**C. VZ's Proposed Options Violate Section 1325(a) of the Public Utility Code.**

Verizon stated its belief that no portion of the cost of the "local loop" should be recovered through access charges and dial tone line rates should be set to cover 100% of the cost of the local loop.<sup>33</sup> Pennsylvania Public Utility Law requires the dial tone line to be specifically allocated.<sup>34</sup> VZ was asked to provide the "stand-alone cost of each class of service which utilizes the dial tone line. VZ's response was that the information was not

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<sup>32</sup> VZ-PA's B-1 rate has components. They include dial tone line and message service rate. The B-1 rate is not clearly defined within the record. The sponsoring witness was not sure how to define "business local exchange rates" but arrived at just two components: (1) dial tone single line businesses and (2) dial tone multi-line businesses. The witness agreed that businesses contracting for service with VZ-PA or VZN are exempt from any proposed increased from these proceedings. See, Tr. at 145 l. 12 - 147 l. 8.

<sup>33</sup> OCA Stmt. No. 1.0 at 21 citing VZ response to OTS Data Request 1-13.

<sup>34</sup> 66 Pa. C.S. § 1325 (c). In defining "cost of providing local exchange service" it states it is the direct cost 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.

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available.<sup>35</sup> Furthermore, VZ did not investigate whether the costs to provide dial tone line service are covered by the revenues received from the customer classes using dial tone line services. Counsel for MCI posed the question:

Q: Is it [VZ's] position that the residential retail revenues overall cover the cost of providing residential retail service?

A: We didn't do that analysis. We didn't perform that analysis.

\* \* \*

Q: What about business revenues? Have you done any type of analysis to determine whether [VZ's] business revenues cover or exceed [VZ's] costs?

A: No.

Q: Would you expect that [VZ's] business revenues cover the cost of providing the service to business customers?

A: We haven't done that analysis, so I really am not positive.<sup>36</sup>

It is not reasonable for VZ to shift cost responsibility for access charges to two customer classes, residential and business dial tone line customers without providing justification. Access lines are part of the integrated telephone network; they are not subscriber facilities in terms of cost responsibility and the local loop is a variable cost in the long run. The shift to local exchange ratepayers is not supported by marginal cost pricing

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<sup>35</sup> OCA Stmt. No. 1.0 at 23.

<sup>36</sup> Tr. at 198 - 99.

## NON-PROPRIETARY VERSION

principles.<sup>37</sup> Local telephone utilities have an incentive to overstate the access line costs that could be recovered from captive local exchange customers.

The loop is an element of current telephone communication services that is being continually improved and changed. At some point, new technology may replace the loop facilities as we know them today. Today, the local loop is essential for local calls, toll calls (both intrastate and interstate), DSL (digital subscriber line), to name a few services.<sup>38</sup> When a loop carries both voice and data, it must withstand tolerances and quality standards much higher than required for just voice grade services alone. This distinction in local exchange services should be acknowledged in the allocation of the loop. For example, one local exchange company has recommended a 50/50 allocation of the local loop regarding local exchange service and DSL.<sup>39</sup> This recommendation by a local exchange carrier ("LEC") suggests that not all LECs solicit 100% of the loop costs to be borne by the captive end user of local exchange service. Section 1325 (a) of the Public Utility Code states that local exchange service rates cannot be increased by an amount that exceeds the overall percentage increase of intrastate revenues unless it is proven that an increase in local exchange service rates is justified based on the cost of providing that service.<sup>40</sup> The option proposed by VZ

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<sup>37</sup> Revised OSBA Stmt. No. 1 at 10 - 11.

<sup>38</sup> Tr. at 455 - 56.

<sup>39</sup> Tr. at 459 - 60.

<sup>40</sup> 66 Pa. C.S. § 1325(a).

## NON-PROPRIETARY VERSION

of a zero CC allocates 100% of the local loop cost to the end users of local exchange service only without any justification.

VZ has not justified the proposed increase based on the cost to provide the service. As mentioned above, VZ did not provide the stand-alone cost of providing the dial-tone line service. Consequently, the amount of the local exchange service rate increase cannot exceed the overall percentage increase of intrastate revenue—or zero percent.

Because the VZ Proposal of zero CC requires a significant increase in local exchange service rates, it violates Section 1325 of the Public Utility Code.

Furthermore, the VZ Proposal of **[BEGIN VZ PROPRIETARY]** \_\_\_\_\_ **[END VZ PROPRIETARY]** CC also requires a significant increase in local exchange service rates.

This proposed allocation also violates Section 1325 of the Public Utility Code.<sup>41</sup>

### **D. The Public Advocates' Recommendation of a CC at \$1.20 is Reasonable**

Independently, without collaborating with each other, all three (3) public advocate offices concluded that a CC at \$1.20 is reasonable for the recovery of non-traffic sensitive access costs allocated to intrastate jurisdictional services.<sup>42</sup> All of the public advocates found it reasonable to allocate some charge to toll carriers for the local loop.<sup>43</sup> The OSBA relied

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<sup>41</sup> The same comments go to the VZ/OCA Settlement Proposal although the OCA by inference of a Settlement has agreed to allow the violation in exchange for other terms negotiated terms of the settlement such as the time period the agreement stays in place.

<sup>42</sup> See OCA Stmt. No. 1 at 5, point (3) and 12, l. 26- 13, l. 9; OTS Stmt. No. 1 (Revised) at 18; Tr. at 389 l. 2 - 11; Revised OSBA Stmt. No. 1 at 16, l. 22 - 17, l. 7.

<sup>43</sup> See OCA Stmt. No. 1 at 31, l. 25 - 32, 10; OTS Stmt. No. 1 (Revised) at 7, l. 3 - 8, l. 13; Revised OSBA Stmt. No. 1 at 7, l. 8-13; Tr. at 455, l. 19 - 457, l. 22.

**NON-PROPRIETARY VERSION**

upon the FCC ordered assignment of loop costs at 25% to interstate toll use. The OSBA then assumed equal availability between local and toll where toll is further divided equally between interstate and intrastate yielding a 25% intrastate factor for intrastate toll access.<sup>44</sup>

The OSBA analysis originated with the VZ claim of [BEGIN VZ PROPRIETARY] \_\_\_ [END VZ PROPRIETARY] for the loop cost. \$1.20 is just [BEGIN VZ PROPRIETARY] \_\_\_ [END VZ PROPRIETARY] of the cost of a loop. The OSBA witness, Mr. Buckalew testified,

At this level, toll carriers are contributing very little to a resource that is an integral part of their operations. Without access to the loop the toll carriers would be out-of-business. ... [T]oll carriers contribute very little to use this crucial resource because the FCC adopted end user charges.<sup>45</sup>

The proposed CC of \$1.20 is minimal cost recovery for intrastate toll carriers' use of the local loop. Lower recovery levels for the CC are not reasonable as they transfer the cost of the loop away from toll carriers and onto local exchange end users.<sup>46</sup> There is nothing prohibitive about allocating access costs to different services.<sup>47</sup>

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<sup>44</sup> Revised OSBA Stmt. No. 1 at 12, l. 13-16.

<sup>45</sup> Id., at 6, l. 8-12.

<sup>46</sup> Id., at 5, l. 13-14.

<sup>47</sup> See, Id., at 15, l. 18 - 16, l. 19, citing, Alfred E. Kahn, The Economics of Regulation, (1970), Volume I, at 78.

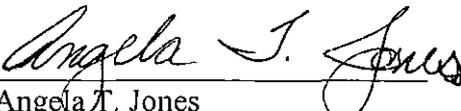
**NON-PROPRIETARY VERSION**

Lastly, the OCA witness has gone through an analysis to show that the CC charge at \$1.20 would not violate Section 1325 of the Public Utility Code.<sup>48</sup> This evidence was not rebutted and is neither unjust or unreasonable.

**IV. CONCLUSION**

For the reasons set forth in this Main Brief, the OSBA respectfully requests that the presiding Administrative Law Judge, Cynthia Williams Fordam, and the Commission deny Verizon Pennsylvania, Inc.'s and Verizon North, Inc.'s Petition to decrease the level of recovery of loop costs by reducing the carrier charge and offset the reduction by increasing local exchange service rates for end users. Additionally, the OSBA requests the presiding Administrative Law Judge, Cynthia Williams Fordam, and the Commission to approve the recommendation of a \$1.20 carrier charge for both Verizon Pennsylvania, Inc. and Verizon North, Inc. to recover access costs with no increase to local exchange service rates.

Respectfully submitted,

  
Angela T. Jones  
Assistant Small Business Advocate

Dated: September 18, 2003

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<sup>48</sup> See OCA Stmt. No. 1 at Schedule WDA-1 pages 1 and 2 of 2.

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

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PA PUBLIC UTILITY COMMISSION  
SECRETARY'S BUREAU

**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

In Re The Joint Application of :  
Bell Atlantic Corporation and GTE :  
Corporation for Approval of Agreement :  
And Plan of Merger :  
:  
AT&T Communications of Pennsylvania, Inc. :  
v. Verizon North, Inc. :

Docket No. C-20027195

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**MAIN BRIEF OF QWEST COMMUNICATIONS CORPORATION**

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Re Nextlink Pennsylvania, Inc., Docket No. P-00991648; P-00991649, 93 PaPUC 172  
(September 30, 1999) (“Global Order”); 196 P.U.R. 4<sup>th</sup> 172, aff’d sub nom. 3, *passim*

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**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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Bell Atlantic Corporation and GTE	:	
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And Plan of Merger	:	Docket No. C-20027195
	:	
AT&T Communications of Pennsylvania, Inc.	:	
v. Verizon North, Inc.	:	

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**MAIN BRIEF OF QWEST COMMUNICATIONS CORPORATION**

---

**I. INTRODUCTION**

Qwest Communications Corporation (“Qwest”) submits its Main Brief to the Pennsylvania Public Utility Commission (“Commission”) proposing to effectuate a restructure of the intrastate carrier access charges Verizon Pennsylvania Inc. (“Verizon-PA”) and Verizon North, Inc. (“Verizon-North”)(collectively “Verizon”).

The Qwest family of companies provides a variety of telephony services throughout the United States.<sup>1</sup> Having merged with U S WEST, Qwest Communications International Inc. is the holding company for all of the Qwest companies.<sup>2</sup> Qwest Communications Corporation, the party in this proceeding, is (a) one of the country’s largest interexchange carriers (“IXCs”), paying switched access charge expenses to incumbent LECs (“ILECs”); (b) a facilities-based competitive LEC (“CLEC”) that competes for the customers of ILECs in more than two dozen cities; and (c) one of the nation’s largest providers of Internet backbone services and of various

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<sup>1</sup> Qwest St. No. 1.0, p. 3.

<sup>2</sup> *Id.*

other services based on Internet protocol (“IP”).<sup>3</sup> Alternatively, Qwest Corporation is one of the nation’s largest ILECs, collecting switched access revenues from IXCs.<sup>4</sup> In participating in this proceeding, Qwest has considered and addressed the issues raised from the collective perspective of the various entities within the Qwest corporate family.<sup>5</sup>

Having various types of service providers in the Qwest family of companies permits Qwest to understand the access charge issues from the perspective of various types of market participants and allows Qwest to balance the respective interests within its corporate family in much the same way the Commission will work to balance the interests of the parties in this proceeding.<sup>6</sup> As a result, of all of the parties participating in this proceeding, Qwest probably comes the closest to sharing the Commission’s own broad-based concern for the future development of the telecommunications industry as a whole, and not just any particular segment of that industry.

Accordingly, Qwest cautions the Commission against merely ordering Verizon to set the switched access rates at parity between Verizon-North and Verizon-PA. Instead, the record in this proceeding supports requiring revenue-neutral and competitively-neutral reductions in Verizon’s intrastate switched access charges to the level of parity with interstate rates.<sup>7</sup> In addition, Qwest encourages the Commission to defer to the marketplace instead of instituting an unnecessary regulatory mandate for IXCs to pass through any reductions to end user customers.<sup>8</sup>

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<sup>3</sup> *Id.*

<sup>4</sup> *Id.*

<sup>5</sup> Qwest St. No. 1.0, pp. 6, 13; Tr. at 378-380.

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

<sup>7</sup> Qwest St. No. 1.0, p. 6; AT&T St. No. 1.0, pp. 8, 26, 33; Tr. 380, 384-385.

<sup>8</sup> Qwest St. No. 1.0, p. 7.

## II. BACKGROUND

On December 30, 2002, Verizon filed a separate Joint Petition (“Verizon Joint Petition”) regarding the further reduction of their access charges pursuant to the Bell Atlantic-Pa.-GTE *Merger Order*,<sup>9</sup> the *Global Order* of 1999<sup>10</sup>, and the generic access charge investigation at M-00021596. This joint proposal was published January 18, 2003 at 33 Pa. B. 502. Comments were filed by the Office of Consumer Advocate (“OCA”), AT&T Communications of Pennsylvania, Inc. (“AT&T”), Sprint Communications Co & United Telephone Co of Pa (“Sprint/United”), the Rural Telephone Company Coalition (“RTCC”), the Office of Small Business Advocate (“OSBA”) and Qwest Communications Corporation (“Qwest”).

Although Verizon-PA and Verizon-North agreed to one proposed access charge reduction plan, Qwest, OCA, OTS, OSBA, AT&T and MCI WorldCom objected to the Joint Petition. AT&T and MCI WorldCom emphasized the need to move switched access rates to cost. Qwest mentioned the need to mirror interstate access charges. AT&T, MCI WorldCom, OCA, and OSBA objected to the revenue-neutral reductions. OTS requested that the Commission deny Verizon’s Joint Proposal for the following reasons: Verizon is subject to a rate freeze through December 31, 2003; no cost studies were filed to support the proposal; and other rates besides residential could be increased, including business rates and optional services, or Verizon could adjust the Price Stability Mechanism to get to revenue-neutral. OTS further requested that the Commission reject Verizon’s proposed elimination of the carrier charge.

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

<sup>10</sup> *Re Nextlink Pennsylvania, Inc.*, Docket No. P-00991648; P-00991649, 93 PaPUC 172 (September 30, 1999) (“*Global Order*”); 196 P.U.R. 4<sup>th</sup> 172, *aff’d sub nom. Bell Atlantic-Pennsylvania, Inc. v. Pennsylvania Public Utility Commission*, 763 A.2d 440 (Pa.Cmwlth. 2000), *alloc. granted*.

Given that there were contested, material factual issues, 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 C-20027195 regarding Verizon-North's access charges pursuant to the Commission *Order* of December 24, 2002. The case at C-20027195 will also address Verizon's compliance with the *Merger Order* directive that Verizon-North and Verizon-PA have access charges which are at parity with each other.

Verizon-PA and Verizon-North jointly submitted Direct Testimony on June 25, 2003. On July 18, 2003, Rebuttal Testimony was submitted by AT&T, MCI WorldCom, Qwest, OCA, OTS, and OSBA. Qwest's witness in this proceeding was Mr. Scott McIntyre, who testified in support of adjusting intrastate access rates to parity with interstate rates in a revenue-neutral and competitively-neutral manner, without mandating IXC flow-through of reductions. Verizon, AT&T, and OCA submitted Surrebuttal Testimony on August 4, 2003. On August 25 and 26, 2003, parties participated in a hearing before Administrative Law Judge Cynthia Fordham to conduct cross-examination of other parties.

OCA along with Verizon have also proposed a settlement position that provides for increases of up to \$40 million from residential basic local service and an increase up to, but not more than \$1.00 per residential line across the Verizon PA/Verizon North customer base.<sup>11</sup> Not only is this proposal starkly inconsistent with 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, but

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<sup>11</sup> Verizon Exhibit DMB 1; Tr. 437-443, 447-448.

the reduction in access charges reflected in the OCA/Verizon alternative settlement simply falls short in terms of adequate movement toward interstate access charges.

However, based on the record established in this proceeding, it is clear that the Commission should require revenue-neutral and competitively-neutral reductions in Verizon's intrastate switched access charges to the level of parity with interstate rates.<sup>12</sup> The reduction of **Begin Proprietary \$\_\_\_\_\_ End Proprietary** contemplated in the OCA/Verizon alternative settlement proposal could be considered, at best, an appropriate first step in an established multi-phase reduction of access charges, which calls for total access charge reductions of **Begin Proprietary \$\_\_\_\_\_ End Proprietary** until parity with interstate rates is achieved. In addition, the record also evidences the duty of the Commission to defer to the marketplace instead of instituting an unnecessary regulatory mandate for IXCs to pass through any reductions to end user customers.<sup>13</sup>

### III. ARGUMENT

#### A. **RESTRUCTURING THE SWITCHED ACCESS RATES TO ACHIEVE PARITY BETWEEN THE VERIZON ILECs FAILS TO SATISFY THE COMMISSION'S OBLIGATION TO PROTECT PENNSYLVANIA CONSUMERS THROUGH ENSURING CONTINUED COMPETITION**

Several parties argue that in this proceeding the Commission should require only that Verizon establish parity between its rates for both its Verizon ILEC entities in Pennsylvania.<sup>14</sup> These parties erroneously point to the directives of the Commission in the *Merger Order* as a basis for their argument.<sup>15</sup> Certainly, the Commission in the *Merger Order* directed that a future

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<sup>12</sup> Qwest St. No. 1.0, p. 6; AT&T St. No. 1.0, pp. 8, 26, 33; Tr. 380, 384-385.

<sup>13</sup> Qwest St. No. 1.0, p. 7.

<sup>14</sup> Tr. 155; Verizon St. No. 1.1, p. 7; OCA St. No. 1-S, p. 23; OCA St. No. 1.0, pp. 13, 17-19; OTS St. No. 1.0, p. 4.

<sup>15</sup> *Merger Order* at 56-57.

Qwest urges the Commission to embrace its obligation to Pennsylvania consumers and carriers to continue promoting competition in Pennsylvania by removing the implicit subsidies in Verizon's access charges on a revenue-neutral and competitively-neutral basis. Indeed, the Commission has recently reiterated its commitment "to reduce implicit subsidy charges such as access charges that impede competition in the telecommunications market."<sup>20</sup> The Commission went on to explain that "[a]s implicit charges become explicit charges, competitors are better able to compete for local and long distance customers in an ILEC's service territory because IXCs are not hindered by paying ILECs excessive access charges in providing competitive toll services and CLECs are better able to compete with ILEC local service rates that have been kept artificially low as a result of the access charge subsidies."<sup>21</sup> Removing the implicit subsidies in Verizon's access charges requires reducing intrastate access rates to interstate rates on a revenue-neutral and competitively-neutral basis, as well as eliminating the Carrier Charge ("CC").

It is clear that removing the implicit subsidies by restructuring Verizon's access charges will benefit Pennsylvania consumers. Fostering competition in the local and long distance markets brings unequivocal advantages to Pennsylvania consumers.<sup>22</sup> Deferring consideration of the appropriate reduction of Verizon's intrastate switched access charges to a future proceeding would needlessly postpone the substantial benefits of such reductions to Pennsylvania consumers.

Alternatively, postponing the access charge restructuring will only expose Pennsylvania consumers to a more significant rate shock at a subsequent time. As explained in specific detail below, the FCC appears to continue moving in a direction that significantly reduces interstate

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<sup>20</sup> *Global Order* at 10.

<sup>21</sup> *Id.*

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

switched access rates while permitting carriers to recapture lost revenues through a subscriber line charge.<sup>23</sup> If the federal interstate rates continue to decrease, waiting two more years to reduce intrastate rates appropriately can only result in a significantly greater rate impact on Pennsylvania consumers, not to mention the detrimental impact on competing IXCs.<sup>24</sup>

If the Commission had intended for this proceeding to produce the narrow result of parity only between the Verizon ILECs, the Commission could have limited the scope of the proceeding to only considering how to establish parity between the existing switched intrastate access rates of Verizon-North and Verizon-PA. In fact, consolidating the AT&T Complaint into this proceeding provides further indication to the parties that the Commission intended to consider access charge reductions in the context of this proceeding.<sup>25</sup> Relying on these indications from the Commission, the parties have expended significant resources in this proceeding to litigate not only the need to restructure Verizon's intrastate switched access charges, but also the specific costing issues necessary to require the revenue-neutral and competitively-neutral reduction of Verizon's access charges. Accordingly, Qwest urges the Commission to proceed with establishing the necessary revenue-neutral and competitively-neutral reductions to Verizon's access charges in Pennsylvania. As explained further below, the

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<sup>23</sup> See Section II.C describing the impact of *In the Matter of: Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Low-Volume Long Distance Users and Federal-State Joint Board On Universal Service*, CC Docket Nos. 96-262, 94-1, 99-249 and 96-45, Sixth Report And Order, Report And Order and Eleventh Report And Order, FCC 00-193, 15 FCC Rcd. 12962 (2000) ("CALLS Order"); *In the Matter of: Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers, Federal-State Joint Board on Universal Service, Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation and Prescribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, CC Dockets Nos. 00-256, 96-45, 98-77 and 98-166, Second Report And Order And Further Notice Of Proposed Rulemaking, Fifteenth Report And Order and Report And Order, FCC 01-304, 16 FCC Rcd. 460 (2001) ("MAG Order").

<sup>24</sup> Qwest St. No. 1.0, p. 17.

<sup>25</sup> *Order Initiating Proceeding* at 7-8.

record supports reducing Verizon's intrastate switched access rates to its interstate rates through a revenue-neutral and competitively-neutral mechanism.

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

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

As the record demonstrates, reducing intrastate switched access charges to interstate levels in a revenue-neutral and competitively-neutral manner will ensure that access charge restructuring does not penalize any particular class of consumers or carriers.<sup>26</sup> AT&T explains that "the Commission should instead require the [Verizon ILEC] companies to reduce their traffic sensitive intrastate access rates to the level of Verizon's interstate access rates."<sup>27</sup> In fact, revenue neutrality and competitive neutrality ensure that local exchange carriers, incumbent and competitive carriers alike, are not penalized for the progressive restructuring of rates that are in the long term best interests of competition and consumers in Pennsylvania.<sup>28</sup>

Moving to parity with interstate rates should include adopting Verizon's interstate traffic-sensitive rates, and eliminating the CC charge. There is no question that the CC, which IXCs pay to Verizon for intrastate long distance services, "is the clearly identifiable subsidy", which

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

<sup>27</sup> AT&T St. No. 1.0, p. 8.

<sup>28</sup> Qwest St. No. 1.0, p. 7.

“has no direct access cost component and therefore represents pure contribution.”<sup>29</sup> Providing intrastate long distance service over the local loop requires no additional functionality and generates no additional cost to the local carrier.<sup>30</sup> In fact, access services for intrastate telecommunications are identical with access services provided for interstate telecommunications, though no CC is required for interstate.<sup>31</sup> While there is no question that the loop carries all of these “other services”,<sup>32</sup> no entity using the local loop other than the IXCs pay a CC charge, including providers of interstate long distance, wireless, DSL or IP-based telephony services.<sup>33</sup> It is not competitively-neutral to depend solely on intrastate toll services to fund the entire universal service needs of basic customers in the Verizon territory. The CC imposed upon providers of intrastate long distance services, therefore, must be an implicit subsidy of the local service, which must be made an explicit charge.<sup>34</sup>

Mr. McIntyre further explained that the historic policies of implicit subsidies underlying current access rates were no longer valid. “While the elimination of the [CC] is an important and essential step in the process state commissions should undertake to transform past decisions into more up-to-date, pro-competitive policies, eliminating the price discrepancy between state and interstate rates is equally important.”<sup>35</sup> “The other less obvious form of subsidy falls under the

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<sup>29</sup> Qwest St. No. 1.0, p. 8; AT&T St. No. 1.0, pp. 26-28; MCI St. No. 1.0, p. 37; MCI St. No. 2.0, p. 10; Tr. 314-315.

<sup>30</sup> Qwest St. No. 1.0, p. 17; Verizon St. No. 3.0, pp. 3-11; MCI St. No. 1.0, pp. 38-39.

<sup>31</sup> Tr. at 278-279, 423.

<sup>32</sup> OCA St. No. 1.0, p. 48; OSBA St. No. 1.0, p. 9; OTS St. No. 1.0, p. 6.

<sup>33</sup> AT&T St. No. 1.0, pp. 12, 18-19; Tr. 234, 278-279, 406, 423.

<sup>34</sup> *See Global Order* at 10; *see also* AT&T St. No. 1.0, pp. 8-9; Tr. 263-280; 408.

<sup>35</sup> Qwest St. No. 1.0, p. 5; *see also* Qwest St. No. 1.0, p. 10.

guise of public policy efforts to keep basic exchange rates low” by “maintaining relatively high rates for [traffic-sensitive] switched access rate elements”.<sup>36</sup> In fact, Qwest explained that:

Prior to the divestiture of the Bell System, and the proliferation of competition in the long distance market, long distance rates were kept high in support of low local service rates for public policy reasons. The concept of universal service drove this implicit subsidy in toll rates. Toll service was still considered somewhat of a luxury. It made sense, from a policy perspective, to keep these rates artificially high to promote the concept of universal local service. . . . [W]hile the original intent of high switched access rates might have been to support the [non-traffic-sensitive] costs of local service, there is no identifiable trail for this hidden support.<sup>37</sup>

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

Qwest’s recommendation to set intrastate access charges at interstate levels would require a reduction in access charges of approximately **Begin Proprietary \$ \_\_\_\_\_ End Proprietary**.<sup>38</sup> According to Verizon PA’s data, approximately 3,624,000 residential lines and 773,000 business lines are available for a revenue neutral increase in rates.<sup>39</sup> Spreading cost responsibility for a reduction in intrastate access charges to interstate levels—only to local customers not purchasing packages—would therefore result in no more than a total of **Begin Proprietary \$ \_\_\_\_\_ End Proprietary** increase per line on a revenue neutral basis, which is reasonable.<sup>40</sup>

Reducing intrastate switched access rates to interstate rates and removing the CC, while shifting support for other services to end-users, will create an economically sound and competitively-neutral rate structure, which will encourage vigorous competition in the market for telecommunications services to the benefit of all Pennsylvania consumers. Based on these

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<sup>36</sup> Qwest St. No. 1.0, pp. 8, 9.

<sup>37</sup> *Id.*, p. 9.

<sup>38</sup> AT&T Cross Exh. 7.

<sup>39</sup> AT&T Cross Exhs. 5-6.

concepts, Qwest encourages the Commission to establish switched access rate reductions in Pennsylvania, which can be accomplished in a revenue-neutral and competitively-neutral manner.

**1. Achieving Certain Public Policy Goals and Establishing Competitively-Neutral Pricing Platforms are Largely Responsible for the Desire of Regulators to Reform the Switched Access Charges.**

When participants in a marketplace are required to bear different costs for the same function as other market participants, the market—including the participants, the investors and the consumers—will adapt accordingly. “Lowering access rates to interstate levels on a revenue-neutral and competitively-neutral basis will not only reduce industry problems concerning arbitrage and accurate billing, it will encourage competitive investment, reduce confusion among customers, and create long-term benefits for all consumers.”<sup>41</sup> Bringing intrastate access rates in line with interstate rates on a revenue-neutral and competitively-neutral basis will continue to encourage competition by putting all market participants on a level playing field.

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

“The existing disparities between the interstate and intrastate access charge structures invite [sic] rate arbitrage.”<sup>42</sup> Participants in a competitive market often modify their businesses to find lower-priced alternatives to lower their operational costs. Such alternatives created by differences in interstate and intrastate access charges provide the ability and the incentive to IXC

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<sup>40</sup> AT&T Cross Exh. 7.

<sup>41</sup> Qwest St. No. 1.0, p. 5.

<sup>42</sup> Qwest St. No. 1.0, p. 14. In fact, Qwest also explains in footnote 4. that “[i]n an *ex parte* filed with the FCC in support of its recent petition to withdraw its FCC tariff on physical collocation, Verizon stated that one of the reasons supporting the move was the elimination of tariff shopping and the “dual [federal and state] regulatory scheme.” Therefore, in other contexts, Verizon has supported the elimination of rate arbitrage opportunities that exist between the intrastate and the interstate jurisdictions.”

carriers to disguise the origin of the calls to change the jurisdiction of calls from intrastate to interstate when the interstate access services costs significantly less.<sup>43</sup>

Specifically, the ILEC often cannot determine whether a call is local, intrastate or interstate—for instance, “when a customer uses a dedicated link to an IXC for both local and long-distance calls.”<sup>44</sup> These customers and other carriers have “the incentive and ability to disguise toll calls as local calls.”<sup>45</sup> Thus, “the other carrier benefits from the favorable terms of local interconnection—including being paid for terminating calls, while avoiding carrier access.”<sup>46</sup>

However, a high degree of regulatory intervention is far from ideal to address these understandable types of market behavior. Qwest submits that “[a] much better solution is to rationalize the rate structure in order to fix the problem.”<sup>47</sup> The Commission has identified this opportunity for arbitrage as a reason for reducing intrastate switched access rates to the interstate rates. In fact, the Commission recognized that mirroring intrastate access rates to interstate rates is “a step towards making the charges closer to cost and closer to the interstate access charges will help to avoid arbitrage and will help competition enter the ILECs territories.”<sup>48</sup> “With a rational rate structure where intrastate rates are at parity with interstate rates, payments of CLECs and IXCs would depend on the activities that the ILEC performs on their behalf—not on what is reported on the honor system in the different jurisdictions.”<sup>49</sup>

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<sup>43</sup> Qwest St. No. 1.0, p. 14; MCI St. No. 1.0, pp. 17-18; Verizon St. No. 3.0, p. 3.

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

<sup>45</sup> *Id.*

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

<sup>47</sup> *Id.*

<sup>48</sup> *RTCC Settlement Order* at 11.

<sup>49</sup> Qwest St. No. 1.0, p. 14.

Once these rate arbitrage opportunities are eliminated, businesses and investors alike can make economic decisions based upon a stable regulatory environment rather than transitory, niche business opportunities.<sup>50</sup> Qwest explained that:

In the current environment, some investments are based on niche services that may only be short-term arbitrage opportunities. Other investments may only be viable if regulatory rules stay the same, while still others may rely on regulatory rules changing in the future. This environment puts all investing on shaky ground. As a consequence, consumers pay the price in the form of limited competition that is not equally available to all customers. Indeed, robust competition requires that archaic regulatory rate platforms be changed to competitively-neutral structures that can be sustained over the long term.<sup>51</sup>

There is no doubt that markets with clear competitively-neutral regulatory schemes generate efficient investing in capital expenditures that benefit not only the carriers, but the consumers.<sup>52</sup>

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

Artificially high access charges condoned by the Commission artificially discriminate between traditional wireline technologies and newer wireless and IP-based technologies, in violation of the fundamental principles of the 1996 Act—the market, not the regulator, should ultimately determine the optimal telecommunications technology to be deployed.<sup>53</sup> Mr. McIntyre also explained how “[c]arriers pass uneconomic costs on to their customers in a variety of ways, most of which will be hidden from the consumer.”<sup>54</sup> Alternatively, providers not

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<sup>50</sup> *Id.*, pp. 12, 29.

<sup>51</sup> *Id.*, p. 7.

<sup>52</sup> *Id.*, p. 17.

<sup>53</sup> See *In the Matter of Deployment of Wireline Services Offering Advanced Telecommunications Capability*, 15 FCC Rcd. 385, 390 (1999); *In the Matters of Deployment of Wireline services Offering Advanced Telecommunications Capability and Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, 14 FCC Rcd. 20912, 20953 (1999); *In the Matter of Federal-State Joint Board on Universal Service*, 12 FCC Rcd. 8776, 8801-03 (1997).

<sup>54</sup> Qwest St. No. 1.0, p. 15.

subject to uneconomic costs can provide services at lower prices, making their offerings more attractive to consumers.<sup>55</sup> This phenomenon may explain the movement of consumers to wireless and IP-based telephony services where no access charges are paid.<sup>56</sup>

Such movement evidences the discriminatory impact of the current access charge regime in Pennsylvania on services utilizing the traditional wireline network.<sup>57</sup> MCI further explains that:

To the extent that long distance rates are artificially high, usage will be depressed below optimal levels and technological change will be skewed. Specifically, technologies that rely upon use of long distance will be discouraged, and new services and innovations, which otherwise might have appeared, may fail to materialize. The social costs of these effects are difficult to measure, but are certainly an important consideration for the Commission.

For instance, there are more than half as many consumers using wireless service than are using wireline service in Pennsylvania. According to a recent FCC Report, while 8.2 million customers use wireline telephony in Pennsylvania, the number of wireless customers in Pennsylvania has increased to 5.3 million.<sup>58</sup> Movement of consumers off of the legacy wireline network to wireless and IP-based telephony services also impacts certain regulatory mechanisms, such as universal service fund contributions, which have been put in place to protect the ability of all consumers to utilize the wireline network.

The Commission should restructure access charges in Pennsylvania in a competitively-neutral manner that does not favor non-wireline services over wireline services, but instead provides consumers the ability to make informed decisions about their telephony service.

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<sup>55</sup> Qwest St. No. 1.0, p. 15; AT&T St. No. 1.0, pp. 11-12, 14-17; MCI St. No. 1.0, p. 17; Tr. 278.

<sup>56</sup> AT&T St. No. 1.0, pp. 11-12, 14-17; MCI St. No. 1.0, p. 17; Tr. 278-279.

<sup>57</sup> See also AT&T St. No. 1.0, pp. 14-17; MCI St. No. 1.0, p. 18.

<sup>58</sup> *Trends in Telephone Service*, Federal Communications Commission, Wireline Competition Bureau, Industry Analysis and Technology Division (Aug. 7, 2003) at 7-4, 11-4.

“Because these uneconomic costs are hidden from the consumer, the consumer has a difficult time making sound economic choices”<sup>59</sup> among providers of telecommunications services, such as local and long distance carriers. The FCC has recognized the need to rebalance the compensation for carriage of traffic in a manner that “establishes a straightforward, economically rational pricing structure which enables consumers to make a choice among competing providers through head-to-head comparisons and better promotes competition by sending potential entrants economically correct entry incentives”.<sup>60</sup> Indeed, revenue-neutral and competitively-neutral reductions in access charges “will allow for robust competition without pricing anomalies that confuse customers.”<sup>61</sup>

“Reducing intrastate switched access rates, on a revenue-neutral basis, to the level of their interstate counterparts will eliminate these uneconomic costs from the carrier’s calculation of the price for its services.”<sup>62</sup> “This, in turn, will afford consumers rates that more accurately reflect costs in their decision-making process for choosing a local and/or long distance provider.”<sup>63</sup>

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

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

Switched access rates differ from state to state and from LEC to LEC and from CLEC to CLEC. IXCs price their services in the aggregate. Where one state, LEC or CLEC has higher than average switched access rates, the IXC must decide

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

<sup>60</sup> *CALLs Order*, ¶ 78.

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

<sup>62</sup> Qwest St. No. 1.0, p. 15.

<sup>63</sup> Qwest St. No. 1.0, p. 15; *see also* AT&T St. No. 1.0, p. 18.

whether to create a specific rate plan for the area or accept lower contribution when pricing its services for that area.

Maintaining several area-specific rate plans imposes greater costs on IXCs than managing a single rate plan or a few rate plans. Alternatively, an IXC that decides to maintain a single rate plan incurs costs in the form of lower contribution that the carrier must recover in some other way. In either case, the carrier may choose to withhold some services in an area or create higher priced plans in order to compensate for the disparity in intrastate switched access rates. Ultimately, the customer pays the price for this inefficiency.<sup>64</sup>

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

**2. Revenue Neutrality Ensures that No Carriers are Penalized for the Progressive Restructuring of Rates which are in the Long-Term Best Interests of Competition and Consumers.**

The record specifically supports the reduction of intrastate access rates while at the same time shifting support for local services to end-users.<sup>65</sup> Verizon explains the concept of allocating the cost of the loop to the cost causer—the end user.

“From an economic perspective, the function of the local loop is to enable an end-user to gain *connectivity* to the network. The end-user’s decision to gain connectivity to the network causes the telephone company to incur costs, which are the costs of providing the local loop facility that connects the customer to the network. These facilities are dedicated to that end-user for the purpose of connecting to the network. The connectivity gained by use of the loop is a pre-condition for being able to receive various forms of *usage* services, e.g., local calling, long distance (toll) calling, Internet calling, Call Waiting and other custom features, voice messaging, etc. That is, the local loop is the single delivery vehicle used by various providers of usage services to bring their services to the end-user. But merely because the loop is “used” by other services does not mean that the local loop is a shared facility and, hence, a source of shared cost.

... According to the principles of cost causation and efficient pricing, if the cost is incremental, it must be recovered in its entirety from the source that caused that cost, e.g., basic Dial Tone Line Service in this instance. On the other hand, if the cost is

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<sup>64</sup> Qwest St. No. 1.0, p. 15; *see also* Tr. 270-271, 326-328.

<sup>65</sup> Qwest St. No. 1.0, pp. 10-13; AT&T St. No. 1.1, p. 25; Tr. 116-119; Verizon St. No. 3.0, pp. 3-11.

shared, then it may be recovered from the different services that share the local loop.<sup>66</sup>

Achieving a shift to the cost causer—the local end user customer—will create an economically sound and competitively-neutral rate structure that will encourage vigorous competition in the market for telecommunications services to the benefit of all consumers. Moreover, revenue-neutral cost shifts are eminently fair given the cost of access and the cost of local exchange service for Verizon-PA and Verizon-North.<sup>67</sup>

There are a number of ways in which a competitively-neutral and revenue-neutral offset mechanism could be accomplished, including through state universal support funding or subscriber line charges (“SLCs”).<sup>68</sup> OCA also explains that the switched access reductions could be offset in “Other Local Exchange revenues”.<sup>69</sup> It is important to note that the Commission has acknowledged that imposing a SLC should be considered as part of this investigation, and consequently deferred examination of the appropriateness of a SLC to this proceeding.<sup>70</sup> Another approach Verizon proposed is to allocate some of the offset to the local business customers.<sup>71</sup>

The type of mechanism adopted does not matter, as long as the offset is moved to a different revenue stream. One party suggests that the revenue be offset by merely creating another charge which the IXC must pay to provide intrastate long distance services.<sup>72</sup> This suggestion does not effectuate a reduction in access charges. Furthermore, the offset merely

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<sup>66</sup> Verizon St. 3.0, p. 3.

<sup>67</sup> See AT&T St. No. 2.0, pp. 1-12, 33; Verizon St. No. 2.0, p. 20-24; Tr. 116-117, 173-174.

<sup>68</sup> Verizon St. No. 3.0, p. 3; Tr. 129, 449-450.

<sup>69</sup> OCA St. No. 1-S, p. 15.

<sup>70</sup> *Global Order* at 83-84.

<sup>71</sup> Verizon St. No. 1.1, p. 21; Tr. 134-140; Qwest Cross Exhibit 1; AT&T Cross Exhs. 5-7.

<sup>72</sup> OCA St. No. 1.0, pp. 7, 12.

proliferates a non-competitively-neutral cost recover mechanism as the intrastate IXCs would still be the only type of carrier paying the charge.

Offsetting access charge reduction in a competitively-neutral and revenue-neutral manner is also consistent with the FCC's access charge reform plan. The FCC increased an existing flat-rated interstate subscriber line charge to offset reductions in interstate switched access charges.<sup>73</sup> With this flat-rated charge on end user bills, the FCC has begun to shift support for local service to end users in a way that is consistent with sound principles of cost causation.<sup>74</sup> The FCC has indicated that its decisions will continue to reflect this philosophy in current and future proceedings, as the competitive nature of the telecommunications industry continues to evolve. This Commission's policies should remain consistent with FCC policies and direction.

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

Indeed, the timing is right for the Commission to close the jurisdictional gap between interstate switched access rates and the intrastate switched access rates, which incumbent and competitive local exchange carriers charge in Pennsylvania, especially with the FCC's restructure of interstate switched access rates through implementation of its *CALLS* and *MAG Orders*.<sup>75</sup> If the Commission closes the jurisdictional gap between interstate switched access rates and switched access rates in Pennsylvania, the Commission will have taken an important step toward a more sensible, pro-competitive intercarrier compensation scheme. Not doing so will only widen the gap between the policies pursued by the state jurisdiction and the FCC as it moves further toward its broader intercarrier compensation goals.

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<sup>73</sup> *CALLs Order*, ¶¶ 64-128; see also Qwest St. No. 1.0, p. 12; AT&T St. No. 1.1, p. 9; MCI St. No.1.0, pp. 13-14.

<sup>74</sup> *CALLs Order*, ¶¶ 64-128; see also Qwest St. No. 1.0, p. 12.

<sup>75</sup> Qwest St. No. 1.0, pp. 2, 16; Tr. 111, 234.

In the record, AT&T explains that the 1996 Telecommunications Act established a nationwide goal to “replac[e] those implicit support mechanisms with explicit, targeted, and competitively neutral universal service support mechanisms.”<sup>76</sup> At the federal level, the FCC appears to continue moving in a direction that significantly reduces interstate switched access rates. Accordingly, the FCC has directly addressed removing any implicit support for local service out of access rates at the interstate level.

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

The sea change . . . was the passage of the Telecommunications Act, which fundamentally changed the landscape, that fundamentally changed the national policy of protected monopoly LECs having implicit subsidies and achieving universal service through intra-company subsidies and from access subsidies to local, expressly changed and explicitly required support to be implicit.

Judge Schnierle recognized that. Society made a change in the passage of the Telecommunications Act and moved to a competitive local market and that there were certain changes that would be necessary in access and local pricing to do that.<sup>77</sup>

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

Switched access is included as part of the FCC’s pending intercarrier compensation docket and will continue to receive attention in anticipation of the 2005 expiration of the *CALLS* and *MAG* plans. The FCC is considering a bill-and-keep regime for the exchange of most, if not all, intercarrier traffic, including switched access. When the next generation of FCC rulings on

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<sup>76</sup> AT&T St. No. 1.1, p. 9; *see also* Tr. 307.

<sup>77</sup> Tr. 309.

access reform is implemented, Pennsylvania should be in a position to follow that lead and allow competitors to respond with services and pricing that is most beneficial for customers. To the degree that Pennsylvania lags behind this progress, Pennsylvania consumers will lag behind the benefits available from fair and balanced competition. It is important to follow the FCC's lead in revenue-neutral access reform, but not to follow too slowly or Pennsylvania customers will continue to pay for the lag.

The FCC most recently restructured interstate switched access as part of its *CALLS* and *MAG Orders*. In the *CALLS Order*, the FCC instituted an access restructure for price cap ILECs that included a reduction of interstate switched access rates and an increase in the End User Common Line ("EUCL") charge to certain maximums. In fact, the FCC recently approved another increase in the cap for the federal residential EUCL to \$6.50 per access line.<sup>78</sup> The result of these FCC actions is to shift recovery of some end user revenues from usage sensitive access charges to flat rated monthly end user line charges, consistent with principles of cost causation. A similar restructure has been adopted for non-price cap ILECs through the *MAG Order*. Restructuring intrastate switched access rates by requiring Verizon to reduce its rates on a revenue-neutral basis is consistent with the FCC's most recent restructuring actions.<sup>79</sup> If this revenue-neutral restructure of intrastate switched access charges is adopted, a significant step toward more rational economic pricing for intercarrier compensation will be accomplished.

Most importantly, in the Commissions recent *Order* of July 15, 2003, approving the Joint Procedural Stipulation of June 5, 2003 filed by the Rural Telephone Company Coalition and

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<sup>78</sup> *Cost Review Proceeding for Residential and Single-Line Business Subscriber Line Charge (SLC) Caps, Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers*, CC Docket Nos. 96-262, 94-1, Order, FCC 02-161 (June 5, 2002) ("*SLC Order*").

<sup>79</sup> Qwest St. No. 1.0, p. 12.

other supporting parties, the Commission clearly signaled its preference for proposals, which moved access charges closer to cost and closer to interstate rates.

We further look to the Federal Communications Commission's ("FCC") recent decisions in the *CALLS* and *MAG* orders for precedence in ordering implicit charges to become explicit, through either an increase in basic local telephone service rates, or through service line charges on customer bills. This enables other carriers to compete due to reduced subsidies. **While the Joint Proposal does not require a rural ILEC or Sprint/United to mirror interstate access charges, the fact that this is a step toward making the charges closer to cost and closer to the interstate access charges will help to avoid arbitrage and will help competition enter the ILECs territories.**<sup>80</sup>

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

It is clear that the Commission should expressly adopt the policy position that intrastate access rates must be at parity with interstate access rates.<sup>81</sup> Indeed, the Commission has acknowledged that the *CALLS Order* demonstrates an appropriate preference for a coordinated approach to access charges at the state and federal levels.<sup>82</sup> Qwest describes that the FCC has indicated its intentions to continue with the philosophy of moving "the support for local services back to the end user in a way that is consistent with cost causation . . . in its current and future proceedings as the competitive nature of telecommunications continues to evolve."<sup>83</sup> Qwest also

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<sup>80</sup> *RTCC Settlement Order* at 11.

<sup>81</sup> See also Qwest St. No. 1.0, p. 7, 12; AT&T St. No. 1.0, pp. 8, 26; MCI St. No. 1.0, p. 33.

<sup>82</sup> *Order Initiating Proceeding* at 3; *RTCC Settlement Order* at 6-9.

<sup>83</sup> Qwest St. No. 1.0, p. 17.

drives IXC's average rate per minute down in Pennsylvania year after year. In this competitive environment, it simply is not possible for any IXC to keep prices artificially high when faced with declining costs.<sup>87</sup> In other words, IXCs must reduce rates in response to access charge reductions out of competitive necessity. The result is most evident at the federal level with decreased interstate long distance rates.<sup>88</sup> Competition on its own will result in full and accurate flow-through.

Likewise, the Virginia State Corporation Commission recognized that mandating IXC flow-through of reductions is unwarranted. In its own access charge reduction docket, the Virginia commission stated that “[w]e have long relied upon market forces in Virginia to establish prices for interexchange services and find no evidence in the record here to suggest that that particular market will fail to continue to provide its benefits to Virginia consumers.”<sup>89</sup> Contemplating regulatory oversight over commission-mandated flow-through of reduced access charge reductions, therefore, is necessary. Accordingly, Qwest suggests that the Commission defer to the marketplace instead of instituting an unnecessary regulatory mandate for IXCs to pass through any reductions to end user customers.

Requiring 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. This is an absurd proposition from a traditional ratemaking standpoint. Such a directive would reflect a complete lack of regulatory confidence in what is Pennsylvania's most robust competitive market.

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<sup>87</sup> See MCI St. No. 1.0, p. 17; Tr. 272.

<sup>88</sup> Qwest St. No. 1.0, p. 10.

<sup>89</sup> *In re: Investigation of the Appropriate Level of Intrastate Access Service Prices of Verizon Virginia, Inc.*, Virginia State Corporation Commission, Case No. PUC000242, Order at 6 (2000).

#### IV. CONCLUSION

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

- a. Restructuring Verizon's intrastate switched access rates beyond merely creating parity between the existing rates of Verizon-North and Verizon-PA;
- b. Adopting a clear policy position that the ILECs' intrastate access rates must be at parity with interstate access rates;
- c. Reducing Verizon's intrastate switched access charges to the interstate level in a revenue-neutral and a competitively-neutral manner; and
- d. Refraining from imposing additional regulations in a competitive IXC environment that mandate a flow-through of any resulting reductions of intrastate access charges to end user customers.

Respectfully submitted,



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September 18, 2003

VIA HAND DELIVERY

James J. McNulty, Secretary  
Pennsylvania Public Utility Commission  
Commonwealth Keystone Building  
400 North Street  
Harrisburg, PA 17102

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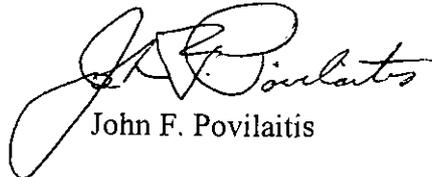
PA PUBLIC UTILITY COMMISSION  
SECRETARY'S BUREAU

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

Dear Secretary McNulty:

Enclosed please find an original and nine (9) copies each of the Proprietary and Non-Proprietary Main Briefs of Qwest Communications Corporation. Copies of the briefs have been served in accordance with the attached Certificate of Service.

Very truly yours,

  
John F. Povilaitis

Enclosures  
JFP/cc

c: Certificate of Service  
The Honorable Cynthia W. Fordham

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BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

In Re The Joint Application of :  
Bell Atlantic Corporation and GTE :  
Corporation for Approval of Agreement :  
And Plan of Merger :  
AT&T Communications of Pennsylvania, Inc. :  
v. Verizon North, Inc. :

Docket No. C-20027195

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PA PUBLIC UTILITY COMMISSION  
SECRETARY'S BUREAU

MAIN BRIEF OF QWEST COMMUNICATIONS CORPORATION

NONPROPRIETARY VERSION

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Dated: September 18, 2003

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**BEFORE THE  
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Corporation for Approval of Agreement	:	
And Plan of Merger	:	Docket No. C-20027195
	:	
AT&T Communications of Pennsylvania, Inc.	:	
v. Verizon North, Inc.	:	

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**MAIN BRIEF OF QWEST COMMUNICATIONS CORPORATION**

---

**I. INTRODUCTION**

Qwest Communications Corporation (“Qwest”) submits its Main Brief to the Pennsylvania Public Utility Commission (“Commission”) proposing to effectuate a restructure of the intrastate carrier access charges Verizon Pennsylvania Inc. (“Verizon-PA”) and Verizon North, Inc. (“Verizon-North”)(collectively “Verizon”).

The Qwest family of companies provides a variety of telephony services throughout the United States.<sup>1</sup> Having merged with U S WEST, Qwest Communications International Inc. is the holding company for all of the Qwest companies.<sup>2</sup> Qwest Communications Corporation, the party in this proceeding, is (a) one of the country’s largest interexchange carriers (“IXCs”), paying switched access charge expenses to incumbent LECs (“ILECs”); (b) a facilities-based competitive LEC (“CLEC”) that competes for the customers of ILECs in more than two dozen cities; and (c) one of the nation’s largest providers of Internet backbone services and of various

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<sup>1</sup> Qwest St. No. 1.0, p. 3.

<sup>2</sup> *Id.*

other services based on Internet protocol (“IP”).<sup>3</sup> Alternatively, Qwest Corporation is one of the nation’s largest ILECs, collecting switched access revenues from IXCs.<sup>4</sup> In participating in this proceeding, Qwest has considered and addressed the issues raised from the collective perspective of the various entities within the Qwest corporate family.<sup>5</sup>

Having various types of service providers in the Qwest family of companies permits Qwest to understand the access charge issues from the perspective of various types of market participants and allows Qwest to balance the respective interests within its corporate family in much the same way the Commission will work to balance the interests of the parties in this proceeding.<sup>6</sup> As a result, of all of the parties participating in this proceeding, Qwest probably comes the closest to sharing the Commission’s own broad-based concern for the future development of the telecommunications industry as a whole, and not just any particular segment of that industry.

Accordingly, Qwest cautions the Commission against merely ordering Verizon to set the switched access rates at parity between Verizon-North and Verizon-PA. Instead, the record in this proceeding supports requiring revenue-neutral and competitively-neutral reductions in Verizon’s intrastate switched access charges to the level of parity with interstate rates.<sup>7</sup> In addition, Qwest encourages the Commission to defer to the marketplace instead of instituting an unnecessary regulatory mandate for IXCs to pass through any reductions to end user customers.<sup>8</sup>

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<sup>3</sup> *Id.*

<sup>4</sup> *Id.*

<sup>5</sup> Qwest St. No. 1.0, pp. 6, 13; Tr. at 378-380.

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

<sup>7</sup> Qwest St. No. 1.0, p. 6; AT&T St. No. 1.0, pp. 8, 26, 33; Tr. 380, 384-385.

<sup>8</sup> Qwest St. No. 1.0, p. 7.

## II. BACKGROUND

On December 30, 2002, Verizon filed a separate Joint Petition (“Verizon Joint Petition”) regarding the further reduction of their access charges pursuant to the Bell Atlantic-Pa.-GTE *Merger Order*,<sup>9</sup> the *Global Order* of 1999<sup>10</sup>, and the generic access charge investigation at M-00021596. This joint proposal was published January 18, 2003 at 33 Pa. B. 502. Comments were filed by the Office of Consumer Advocate (“OCA”), AT&T Communications of Pennsylvania, Inc. (“AT&T”), Sprint Communications Co & United Telephone Co of Pa (“Sprint/United”), the Rural Telephone Company Coalition (“RTCC”), the Office of Small Business Advocate (“OSBA”) and Qwest Communications Corporation (“Qwest”).

Although Verizon-PA and Verizon-North agreed to one proposed access charge reduction plan, Qwest, OCA, OTS, OSBA, AT&T and MCI WorldCom objected to the Joint Petition. AT&T and MCI WorldCom emphasized the need to move switched access rates to cost. Qwest mentioned the need to mirror interstate access charges. AT&T, MCI WorldCom, OCA, and OSBA objected to the revenue-neutral reductions. OTS requested that the Commission deny Verizon’s Joint Proposal for the following reasons: Verizon is subject to a rate freeze through December 31, 2003; no cost studies were filed to support the proposal; and other rates besides residential could be increased, including business rates and optional services, or Verizon could adjust the Price Stability Mechanism to get to revenue-neutral. OTS further requested that the Commission reject Verizon’s proposed elimination of the carrier charge.

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

<sup>10</sup> *Re Nextlink Pennsylvania, Inc.*, Docket No. P-00991648; P-00991649, 93 PaPUC 172 (September 30, 1999) (“*Global Order*”); 196 P.U.R. 4<sup>th</sup> 172, *aff’d sub nom. Bell Atlantic-Pennsylvania, Inc. v. Pennsylvania Public Utility Commission*, 763 A.2d 440 (Pa.Cmwlth. 2000), *alloc. granted*.

Given that there were contested, material factual issues, 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 C-20027195 regarding Verizon-North's access charges pursuant to the Commission *Order*. of December 24, 2002. The case at C-20027195 will also address Verizon's compliance with the *Merger Order* directive that Verizon-North and Verizon-PA have access charges which are at parity with each other.

Verizon-PA and Verizon-North jointly submitted Direct Testimony on June 25, 2003. On July 18, 2003, Rebuttal Testimony was submitted by AT&T, MCI WorldCom, Qwest, OCA, OTS, and OSBA. Qwest's witness in this proceeding was Mr. Scott McIntyre, who testified in support of adjusting intrastate access rates to parity with interstate rates in a revenue-neutral and competitively-neutral manner, without mandating IXC flow-through of reductions. Verizon, AT&T, and OCA submitted Surrebuttal Testimony on August 4, 2003. On August 25 and 26, 2003, parties participated in a hearing before Administrative Law Judge Cynthia Fordham to conduct cross-examination of other parties.

OCA along with Verizon have also proposed a settlement position that provides for increases of up to \$40 million from residential basic local service and an increase up to, but not more than \$1.00 per residential line across the Verizon PA/Verizon North customer base.<sup>11</sup> Not only is this proposal starkly inconsistent with 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, but

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<sup>11</sup> Verizon Exhibit DMB 1; Tr. 437-443, 447-448.

the reduction in access charges reflected in the OCA/Verizon alternative settlement simply falls short in terms of adequate movement toward interstate access charges.

However, based on the record established in this proceeding, it is clear that the Commission should require revenue-neutral and competitively-neutral reductions in Verizon's intrastate switched access charges to the level of parity with interstate rates.<sup>12</sup> The reduction of **Begin Proprietary \$\_\_\_\_\_ End Proprietary** contemplated in the OCA/Verizon alternative settlement proposal could be considered, at best, an appropriate first step in an established multi-phase reduction of access charges, which calls for total access charge reductions of **Begin Proprietary \$\_\_\_\_\_ End Proprietary** until parity with interstate rates is achieved. In addition, the record also evidences the duty of the Commission to defer to the marketplace instead of instituting an unnecessary regulatory mandate for IXCs to pass through any reductions to end user customers.<sup>13</sup>

### III. ARGUMENT

#### A. **RESTRUCTURING THE SWITCHED ACCESS RATES TO ACHIEVE PARITY BETWEEN THE VERIZON ILECs FAILS TO SATISFY THE COMMISSION'S OBLIGATION TO PROTECT PENNSYLVANIA CONSUMERS THROUGH ENSURING CONTINUED COMPETITION**

Several parties argue that in this proceeding the Commission should require only that Verizon establish parity between its rates for both its Verizon ILEC entities in Pennsylvania.<sup>14</sup> These parties erroneously point to the directives of the Commission in the *Merger Order* as a basis for their argument.<sup>15</sup> Certainly, the Commission in the *Merger Order* directed that a future

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<sup>12</sup> Qwest St. No. 1.0, p. 6; AT&T St. No. 1.0, pp. 8, 26, 33; Tr. 380, 384-385.

<sup>13</sup> Qwest St. No. 1.0, p. 7.

<sup>14</sup> Tr. 155; Verizon St. No. 1.1, p. 7; OCA St. No. 1-S, p. 23; OCA St. No. 1.0, pp. 13, 17-19; OTS St. No. 1.0, p. 4.

<sup>15</sup> *Merger Order* at 56-57.

proceeding be held to develop “access charge parity between BA-PA and GTE North”.<sup>16</sup> These parties interpret this requirement to mean that all the Commission must achieve in this proceeding is ordering Verizon to set intrastate switched access charges in which rates for Verizon-North and Verizon-PA are at parity with each other. This is an inappropriate interpretation of the *Merger Order*.

In fact, the *Merger Order* states that creating parity between the Verizon ILEC companies must be achieved as “a part of the Commission’s statewide investigation pertaining to access charges” pursuant to the *Global Order*.<sup>17</sup> The *Merger Order* recognizes that “in the *Global Order*, we have provided for an investigation to achieve *permanent solutions* to access charge reform on or about January 2, 2001.”<sup>18</sup> All indications provided in the *Merger Order* demonstrated that the Commission intended to ensure that Verizon’s access rates be uniform statewide *once* the Commission implemented additional reductions to access charges.

Making Verizon’s access charges uniform across the state was *not* to be performed in substitution for reductions in Verizon’s access charges. As recognized by the Commission in this proceeding, “[t]he mandated access charge investigation was delayed because of Verizon’s Section 271 hearings in January and February of 2001.”<sup>19</sup> Though this proceeding has been delayed two years beyond the date established in the *Global Order*, this is the proceeding in which the access charge reform required by the *Global Order* was intended to take place.

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<sup>16</sup> *Merger Order* at 57 (*emphasis added*).

<sup>17</sup> *Id.* (*emphasis added*).

<sup>18</sup> *Id.*

<sup>19</sup> *In Re The Joint Application of Bell Atlantic Corporation and GTE Corporation for Approval of Agreement And Plan of Merger, AT&T Communications of Pennsylvania, Inc. v. Verizon North, Inc.*, Docket No. C-20027195. Order (May 1, 2003)(“*Order Initiating Proceeding*”) at 3.

Qwest urges the Commission to embrace its obligation to Pennsylvania consumers and carriers to continue promoting competition in Pennsylvania by removing the implicit subsidies in Verizon's access charges on a revenue-neutral and competitively-neutral basis. Indeed, the Commission has recently reiterated its commitment "to reduce implicit subsidy charges such as access charges that impede competition in the telecommunications market."<sup>20</sup> The Commission went on to explain that "[a]s implicit charges become explicit charges, competitors are better able to compete for local and long distance customers in an ILEC's service territory because IXCs are not hindered by paying ILECs excessive access charges in providing competitive toll services and CLECs are better able to compete with ILEC local service rates that have been kept artificially low as a result of the access charge subsidies."<sup>21</sup> Removing the implicit subsidies in Verizon's access charges requires reducing intrastate access rates to interstate rates on a revenue-neutral and competitively-neutral basis, as well as eliminating the Carrier Charge ("CC").

It is clear that removing the implicit subsidies by restructuring Verizon's access charges will benefit Pennsylvania consumers. Fostering competition in the local and long distance markets brings unequivocal advantages to Pennsylvania consumers.<sup>22</sup> Deferring consideration of the appropriate reduction of Verizon's intrastate switched access charges to a future proceeding would needlessly postpone the substantial benefits of such reductions to Pennsylvania consumers.

Alternatively, postponing the access charge restructuring will only expose Pennsylvania consumers to a more significant rate shock at a subsequent time. As explained in specific detail below, the FCC appears to continue moving in a direction that significantly reduces interstate

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<sup>20</sup> *Global Order* at 10.

<sup>21</sup> *Id.*

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

switched access rates while permitting carriers to recapture lost revenues through a subscriber line charge.<sup>23</sup> If the federal interstate rates continue to decrease, waiting two more years to reduce intrastate rates appropriately can only result in a significantly greater rate impact on Pennsylvania consumers, not to mention the detrimental impact on competing IXCs.<sup>24</sup>

If the Commission had intended for this proceeding to produce the narrow result of parity only between the Verizon ILECs, the Commission could have limited the scope of the proceeding to only considering how to establish parity between the existing switched intrastate access rates of Verizon-North and Verizon-PA. In fact, consolidating the AT&T Complaint into this proceeding provides further indication to the parties that the Commission intended to consider access charge reductions in the context of this proceeding.<sup>25</sup> Relying on these indications from the Commission, the parties have expended significant resources in this proceeding to litigate not only the need to restructure Verizon's intrastate switched access charges, but also the specific costing issues necessary to require the revenue-neutral and competitively-neutral reduction of Verizon's access charges. Accordingly, Qwest urges the Commission to proceed with establishing the necessary revenue-neutral and competitively-neutral reductions to Verizon's access charges in Pennsylvania. As explained further below, the

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<sup>23</sup> See Section II.C describing the impact of *In the Matter of: Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Low-Volume Long Distance Users and Federal-State Joint Board On Universal Service*, CC Docket Nos. 96-262, 94-1, 99-249 and 96-45, Sixth Report And Order, Report And Order and Eleventh Report And Order, FCC 00-193, 15 FCC Rcd. 12962 (2000) ("CALLS Order"); *In the Matter of: Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers, Federal-State Joint Board on Universal Service, Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation and Prescribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, CC Dockets Nos. 00-256, 96-45, 98-77 and 98-166, Second Report And Order And Further Notice Of Proposed Rulemaking, Fifteenth Report And Order and Report And Order, FCC 01-304, 16 FCC Rcd. 460 (2001) ("MAG Order").

<sup>24</sup> Qwest St. No. 1.0, p. 17.

<sup>25</sup> *Order Initiating Proceeding* at 7-8.

record supports reducing Verizon's intrastate switched access rates to its interstate rates through a revenue-neutral and competitively-neutral mechanism.

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

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

As the record demonstrates, reducing intrastate switched access charges to interstate levels in a revenue-neutral and competitively-neutral manner will ensure that access charge restructuring does not penalize any particular class of consumers or carriers.<sup>26</sup> AT&T explains that "the Commission should instead require the [Verizon ILEC] companies to reduce their traffic sensitive intrastate access rates to the level of Verizon's interstate access rates."<sup>27</sup> In fact, revenue neutrality and competitive neutrality ensure that local exchange carriers, incumbent and competitive carriers alike, are not penalized for the progressive restructuring of rates that are in the long term best interests of competition and consumers in Pennsylvania.<sup>28</sup>

Moving to parity with interstate rates should include adopting Verizon's interstate traffic-sensitive rates, and eliminating the CC charge. There is no question that the CC, which IXCs pay to Verizon for intrastate long distance services, "is the clearly identifiable subsidy", which

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

<sup>27</sup> AT&T St. No. 1.0, p. 8.

<sup>28</sup> Qwest St. No. 1.0, p. 7.

“has no direct access cost component and therefore represents pure contribution.”<sup>29</sup> Providing intrastate long distance service over the local loop requires no additional functionality and generates no additional cost to the local carrier.<sup>30</sup> In fact, access services for intrastate telecommunications are identical with access services provided for interstate telecommunications, though no CC is required for interstate.<sup>31</sup> While there is no question that the loop carries all of these “other services”,<sup>32</sup> no entity using the local loop other than the IXCs pay a CC charge, including providers of interstate long distance, wireless, DSL or IP-based telephony services.<sup>33</sup> It is not competitively-neutral to depend solely on intrastate toll services to fund the entire universal service needs of basic customers in the Verizon territory. The CC imposed upon providers of intrastate long distance services, therefore, must be an implicit subsidy of the local service, which must be made an explicit charge.<sup>34</sup>

Mr. McIntyre further explained that the historic policies of implicit subsidies underlying current access rates were no longer valid. “While the elimination of the [CC] is an important and essential step in the process state commissions should undertake to transform past decisions into more up-to-date, pro-competitive policies, eliminating the price discrepancy between state and interstate rates is equally important.”<sup>35</sup> “The other less obvious form of subsidy falls under the

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<sup>29</sup> Qwest St. No. 1.0, p. 8; AT&T St. No. 1.0, pp. 26-28; MCI St. No. 1.0, p. 37; MCI St. No. 2.0, p. 10; Tr. 314-315.

<sup>30</sup> Qwest St. No. 1.0, p. 17; Verizon St. No. 3.0, pp. 3-11; MCI St. No. 1.0, pp. 38-39.

<sup>31</sup> Tr. at 278-279, 423.

<sup>32</sup> OCA St. No. 1.0, p. 48; OSBA St. No. 1.0, p. 9; OTS St. No. 1.0, p. 6.

<sup>33</sup> AT&T St. No. 1.0, pp. 12, 18-19; Tr. 234, 278-279, 406, 423.

<sup>34</sup> *See Global Order* at 10; *see also* AT&T St. No. 1.0, pp. 8-9; Tr. 263-280; 408.

<sup>35</sup> Qwest St. No. 1.0, p. 5; *see also* Qwest St. No. 1.0, p. 10.

guise of public policy efforts to keep basic exchange rates low” by “maintaining relatively high rates for [traffic-sensitive] switched access rate elements”.<sup>36</sup> In fact, Qwest explained that:

Prior to the divestiture of the Bell System, and the proliferation of competition in the long distance market, long distance rates were kept high in support of low local service rates for public policy reasons. The concept of universal service drove this implicit subsidy in toll rates. Toll service was still considered somewhat of a luxury. It made sense, from a policy perspective, to keep these rates artificially high to promote the concept of universal local service. . . . [W]hile the original intent of high switched access rates might have been to support the [non-traffic-sensitive] costs of local service, there is no identifiable trail for this hidden support.<sup>37</sup>

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

Qwest’s recommendation to set intrastate access charges at interstate levels would require a reduction in access charges of approximately **Begin Proprietary \$\_\_\_\_\_ End Proprietary**.<sup>38</sup> According to Verizon PA’s data, approximately 3,624,000 residential lines and 773,000 business lines are available for a revenue neutral increase in rates.<sup>39</sup> Spreading cost responsibility for a reduction in intrastate access charges to interstate levels—only to local customers not purchasing packages—would therefore result in no more than a total of **Begin Proprietary \$\_\_\_\_\_ End Proprietary** increase per line on a revenue neutral basis, which is reasonable.<sup>40</sup>

Reducing intrastate switched access rates to interstate rates and removing the CC, while shifting support for other services to end-users, will create an economically sound and competitively-neutral rate structure, which will encourage vigorous competition in the market for telecommunications services to the benefit of all Pennsylvania consumers. Based on these

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<sup>36</sup> Qwest St. No. 1.0, pp. 8, 9.

<sup>37</sup> *Id.*, p. 9.

<sup>38</sup> AT&T Cross Exh. 7.

<sup>39</sup> AT&T Cross Exhs. 5-6.

concepts, Qwest encourages the Commission to establish switched access rate reductions in Pennsylvania, which can be accomplished in a revenue-neutral and competitively-neutral manner.

**1. Achieving Certain Public Policy Goals and Establishing Competitively-Neutral Pricing Platforms are Largely Responsible for the Desire of Regulators to Reform the Switched Access Charges.**

When participants in a marketplace are required to bear different costs for the same function as other market participants, the market—including the participants, the investors and the consumers—will adapt accordingly. “Lowering access rates to interstate levels on a revenue-neutral and competitively-neutral basis will not only reduce industry problems concerning arbitrage and accurate billing, it will encourage competitive investment, reduce confusion among customers, and create long-term benefits for all consumers.”<sup>41</sup> Bringing intrastate access rates in line with interstate rates on a revenue-neutral and competitively-neutral basis will continue to encourage competition by putting all market participants on a level playing field.

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

“The existing disparities between the interstate and intrastate access charge structures invite [sic] rate arbitrage.”<sup>42</sup> Participants in a competitive market often modify their businesses to find lower-priced alternatives to lower their operational costs. Such alternatives created by differences in interstate and intrastate access charges provide the ability and the incentive to IXC

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<sup>40</sup> AT&T Cross Exh. 7.

<sup>41</sup> Qwest St. No. 1.0, p. 5.

<sup>42</sup> Qwest St. No. 1.0, p. 14. In fact, Qwest also explains in footnote 4. that “[i]n an *ex parte* filed with the FCC in support of its recent petition to withdraw its FCC tariff on physical collocation, Verizon stated that one of the reasons supporting the move was the elimination of tariff shopping and the “dual [federal and state] regulatory scheme.” Therefore, in other contexts, Verizon has supported the elimination of rate arbitrage opportunities that exist between the intrastate and the interstate jurisdictions.”

carriers to disguise the origin of the calls to change the jurisdiction of calls from intrastate to interstate when the interstate access services costs significantly less.<sup>43</sup>

Specifically, the ILEC often cannot determine whether a call is local, intrastate or interstate—for instance, “when a customer uses a dedicated link to an IXC for both local and long-distance calls.”<sup>44</sup> These customers and other carriers have “the incentive and ability to disguise toll calls as local calls.”<sup>45</sup> Thus, “the other carrier benefits from the favorable terms of local interconnection—including being paid for terminating calls, while avoiding carrier access.”<sup>46</sup>

However, a high degree of regulatory intervention is far from ideal to address these understandable types of market behavior. Qwest submits that “[a] much better solution is to rationalize the rate structure in order to fix the problem.”<sup>47</sup> The Commission has identified this opportunity for arbitrage as a reason for reducing intrastate switched access rates to the interstate rates. In fact, the Commission recognized that mirroring intrastate access rates to interstate rates is “a step towards making the charges closer to cost and closer to the interstate access charges will help to avoid arbitrage and will help competition enter the ILECs territories.”<sup>48</sup> “With a rational rate structure where intrastate rates are at parity with interstate rates, payments of CLECs and IXCs would depend on the activities that the ILEC performs on their behalf—not on what is reported on the honor system in the different jurisdictions.”<sup>49</sup>

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<sup>43</sup> Qwest St. No. 1.0, p. 14; MCI St. No. 1.0, pp. 17-18; Verizon St. No. 3.0, p. 3.

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

<sup>45</sup> *Id.*

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

<sup>47</sup> *Id.*

<sup>48</sup> *RTCC Settlement Order* at 11.

<sup>49</sup> Qwest St. No. 1.0, p. 14.

Once these rate arbitrage opportunities are eliminated, businesses and investors alike can make economic decisions based upon a stable regulatory environment rather than transitory, niche business opportunities.<sup>50</sup> Qwest explained that:

In the current environment, some investments are based on niche services that may only be short-term arbitrage opportunities. Other investments may only be viable if regulatory rules stay the same, while still others may rely on regulatory rules changing in the future. This environment puts all investing on shaky ground. As a consequence, consumers pay the price in the form of limited competition that is not equally available to all customers. Indeed, robust competition requires that archaic regulatory rate platforms be changed to competitively-neutral structures that can be sustained over the long term.<sup>51</sup>

There is no doubt that markets with clear competitively-neutral regulatory schemes generate efficient investing in capital expenditures that benefit not only the carriers, but the consumers.<sup>52</sup>

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

Artificially high access charges condoned by the Commission artificially discriminate between traditional wireline technologies and newer wireless and IP-based technologies, in violation of the fundamental principles of the 1996 Act—the market, not the regulator, should ultimately determine the optimal telecommunications technology to be deployed.<sup>53</sup> Mr. McIntyre also explained how “[c]arriers pass uneconomic costs on to their customers in a variety of ways, most of which will be hidden from the consumer.”<sup>54</sup> Alternatively, providers not

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<sup>50</sup> *Id.*, pp. 12, 29.

<sup>51</sup> *Id.*, p. 7.

<sup>52</sup> *Id.*, p. 17.

<sup>53</sup> See *In the Matter of Deployment of Wireline Services Offering Advanced Telecommunications Capability*, 15 FCC Rcd. 385, 390 (1999); *In the Matters of Deployment of Wireline services Offering Advanced Telecommunications Capability and Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, 14 FCC Rcd. 20912, 20953 (1999); *In the Matter of Federal-State Joint Board on Universal Service*, 12 FCC Rcd. 8776, 8801-03 (1997).

<sup>54</sup> Qwest St. No. 1.0, p. 15.

subject to uneconomic costs can provide services at lower prices, making their offerings more attractive to consumers.<sup>55</sup> This phenomenon may explain the movement of consumers to wireless and IP-based telephony services where no access charges are paid.<sup>56</sup>

Such movement evidences the discriminatory impact of the current access charge regime in Pennsylvania on services utilizing the traditional wireline network.<sup>57</sup> MCI further explains that:

To the extent that long distance rates are artificially high, usage will be depressed below optimal levels and technological change will be skewed. Specifically, technologies that rely upon use of long distance will be discouraged, and new services and innovations, which otherwise might have appeared, may fail to materialize. The social costs of these effects are difficult to measure, but are certainly an important consideration for the Commission.

For instance, there are more than half as many consumers using wireless service than are using wireline service in Pennsylvania. According to a recent FCC Report, while 8.2 million customers use wireline telephony in Pennsylvania, the number of wireless customers in Pennsylvania has increased to 5.3 million.<sup>58</sup> Movement of consumers off of the legacy wireline network to wireless and IP-based telephony services also impacts certain regulatory mechanisms, such as universal service fund contributions, which have been put in place to protect the ability of all consumers to utilize the wireline network.

The Commission should restructure access charges in Pennsylvania in a competitively-neutral manner that does not favor non-wireline services over wireline services, but instead provides consumers the ability to make informed decisions about their telephony service.

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<sup>55</sup> Qwest St. No. 1.0, p. 15; AT&T St. No. 1.0, pp. 11-12, 14-17; MCI St. No. 1.0, p. 17; Tr. 278.

<sup>56</sup> AT&T St. No. 1.0, pp. 11-12, 14-17; MCI St. No. 1.0, p. 17; Tr. 278-279.

<sup>57</sup> See also AT&T St. No. 1.0, pp. 14-17; MCI St. No. 1.0, p. 18.

<sup>58</sup> *Trends in Telephone Service*, Federal Communications Commission, Wireline Competition Bureau, Industry Analysis and Technology Division (Aug. 7, 2003) at 7-4, 11-4.

“Because these uneconomic costs are hidden from the consumer, the consumer has a difficult time making sound economic choices”<sup>59</sup> among providers of telecommunications services, such as local and long distance carriers. The FCC has recognized the need to rebalance the compensation for carriage of traffic in a manner that “establishes a straightforward, economically rational pricing structure which enables consumers to make a choice among competing providers through head-to-head comparisons and better promotes competition by sending potential entrants economically correct entry incentives”.<sup>60</sup> Indeed, revenue-neutral and competitively-neutral reductions in access charges “will allow for robust competition without pricing anomalies that confuse customers.”<sup>61</sup>

“Reducing intrastate switched access rates, on a revenue-neutral basis, to the level of their interstate counterparts will eliminate these uneconomic costs from the carrier’s calculation of the price for its services.”<sup>62</sup> “This, in turn, will afford consumers rates that more accurately reflect costs in their decision-making process for choosing a local and/or long distance provider.”<sup>63</sup>

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

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

Switched access rates differ from state to state and from LEC to LEC and from CLEC to CLEC. IXCs price their services in the aggregate. Where one state, LEC or CLEC has higher than average switched access rates, the IXC must decide

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

<sup>60</sup> *CALLs Order*, ¶ 78.

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

<sup>62</sup> Qwest St. No. 1.0, p. 15.

<sup>63</sup> Qwest St. No. 1.0, p. 15; *see also* AT&T St. No. 1.0, p. 18.

whether to create a specific rate plan for the area or accept lower contribution when pricing its services for that area.

Maintaining several area-specific rate plans imposes greater costs on IXC than managing a single rate plan or a few rate plans. Alternatively, an IXC that decides to maintain a single rate plan incurs costs in the form of lower contribution that the carrier must recover in some other way. In either case, the carrier may choose to withhold some services in an area or create higher priced plans in order to compensate for the disparity in intrastate switched access rates. Ultimately, the customer pays the price for this inefficiency.<sup>64</sup>

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

**2. Revenue Neutrality Ensures that No Carriers are Penalized for the Progressive Restructuring of Rates which are in the Long-Term Best Interests of Competition and Consumers.**

The record specifically supports the reduction of intrastate access rates while at the same time shifting support for local services to end-users.<sup>65</sup> Verizon explains the concept of allocating the cost of the loop to the cost causer—the end user.

“From an economic perspective, the function of the local loop is to enable an end-user to gain *connectivity* to the network. The end-user’s decision to gain connectivity to the network causes the telephone company to incur costs, which are the costs of providing the local loop facility that connects the customer to the network. These facilities are dedicated to that end-user for the purpose of connecting to the network. The connectivity gained by use of the loop is a pre-condition for being able to receive various forms of *usage* services, e.g., local calling, long distance (toll) calling, Internet calling, Call Waiting and other custom features, voice messaging, etc. That is, the local loop is the single delivery vehicle used by various providers of usage services to bring their services to the end-user. But merely because the loop is “used” by other services does not mean that the local loop is a shared facility and, hence, a source of shared cost.

. . . According to the principles of cost causation and efficient pricing, if the cost is incremental, it must be recovered in its entirety from the source that caused that cost, e.g., basic Dial Tone Line Service in this instance. On the other hand, if the cost is

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<sup>64</sup> Qwest St. No. 1.0, p. 15; *see also* Tr. 270-271, 326-328.

<sup>65</sup> Qwest St. No. 1.0, pp. 10-13; AT&T St. No. 1.1, p. 25; Tr. 116-119; Verizon St. No. 3.0, pp. 3-11.

shared, then it may be recovered from the different services that share the local loop.<sup>66</sup>

Achieving a shift to the cost causer—the local end user customer—will create an economically sound and competitively-neutral rate structure that will encourage vigorous competition in the market for telecommunications services to the benefit of all consumers. Moreover, revenue-neutral cost shifts are eminently fair given the cost of access and the cost of local exchange service for Verizon-PA and Verizon-North.<sup>67</sup>

There are a number of ways in which a competitively-neutral and revenue-neutral offset mechanism could be accomplished, including through state universal support funding or subscriber line charges (“SLCs”).<sup>68</sup> OCA also explains that the switched access reductions could be offset in “Other Local Exchange revenues”.<sup>69</sup> It is important to note that the Commission has acknowledged that imposing a SLC should be considered as part of this investigation, and consequently deferred examination of the appropriateness of a SLC to this proceeding.<sup>70</sup> Another approach Verizon proposed is to allocate some of the offset to the local business customers.<sup>71</sup>

The type of mechanism adopted does not matter, as long as the offset is moved to a different revenue stream. One party suggests that the revenue be offset by merely creating another charge which the IXC must pay to provide intrastate long distance services.<sup>72</sup> This suggestion does not effectuate a reduction in access charges. Furthermore, the offset merely

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<sup>66</sup> Verizon St. 3.0, p. 3.

<sup>67</sup> See AT&T St. No. 2.0, pp. 1-12, 33; Verizon St. No. 2.0, p. 20-24; Tr. 116-117, 173-174.

<sup>68</sup> Verizon St. No. 3.0, p. 3; Tr. 129, 449-450.

<sup>69</sup> OCA St. No. 1-S, p. 15.

<sup>70</sup> *Global Order* at 83-84.

<sup>71</sup> Verizon St. No. 1.1, p. 21; Tr. 134-140; Qwest Cross Exhibit 1; AT&T Cross Exhs. 5-7.

<sup>72</sup> OCA St. No. 1.0, pp. 7, 12.

proliferates a non-competitively-neutral cost recover mechanism as the intrastate IXCs would still be the only type of carrier paying the charge.

Offsetting access charge reduction in a competitively-neutral and revenue-neutral manner is also consistent with the FCC's access charge reform plan. The FCC increased an existing flat-rated interstate subscriber line charge to offset reductions in interstate switched access charges.<sup>73</sup> With this flat-rated charge on end user bills, the FCC has begun to shift support for local service to end users in a way that is consistent with sound principles of cost causation.<sup>74</sup> The FCC has indicated that its decisions will continue to reflect this philosophy in current and future proceedings, as the competitive nature of the telecommunications industry continues to evolve. This Commission's policies should remain consistent with FCC policies and direction.

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

Indeed, the timing is right for the Commission to close the jurisdictional gap between interstate switched access rates and the intrastate switched access rates, which incumbent and competitive local exchange carriers charge in Pennsylvania, especially with the FCC's restructure of interstate switched access rates through implementation of its *CALLS* and *MAG Orders*.<sup>75</sup> If the Commission closes the jurisdictional gap between interstate switched access rates and switched access rates in Pennsylvania, the Commission will have taken an important step toward a more sensible, pro-competitive intercarrier compensation scheme. Not doing so will only widen the gap between the policies pursued by the state jurisdiction and the FCC as it moves further toward its broader intercarrier compensation goals.

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<sup>73</sup> *CALLs Order*, ¶¶ 64-128; *see also* Qwest St. No. 1.0, p. 12; AT&T St. No. 1.1, p. 9; MCI St. No.1.0, pp. 13-14.

<sup>74</sup> *CALLs Order*, ¶¶ 64-128; *see also* Qwest St. No. 1.0, p. 12.

<sup>75</sup> Qwest St. No. 1.0, pp. 2, 16; Tr. 111, 234.

In the record, AT&T explains that the 1996 Telecommunications Act established a nationwide goal to “replac[e] those implicit support mechanisms with explicit, targeted, and competitively neutral universal service support mechanisms.”<sup>76</sup> At the federal level, the FCC appears to continue moving in a direction that significantly reduces interstate switched access rates. Accordingly, the FCC has directly addressed removing any implicit support for local service out of access rates at the interstate level.

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

The sea change . . . was the passage of the Telecommunications Act, which fundamentally changed the landscape, that fundamentally changed the national policy of protected monopoly LECs having implicit subsidies and achieving universal service through intra-company subsidies and from access subsidies to local, expressly changed and explicitly required support to be implicit.

Judge Schnierle recognized that. Society made a change in the passage of the Telecommunications Act and moved to a competitive local market and that there were certain changes that would be necessary in access and local pricing to do that.<sup>77</sup>

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

Switched access is included as part of the FCC’s pending intercarrier compensation docket and will continue to receive attention in anticipation of the 2005 expiration of the *CALLS* and *MAG* plans. The FCC is considering a bill-and-keep regime for the exchange of most, if not all, intercarrier traffic, including switched access. When the next generation of FCC rulings on

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<sup>76</sup> AT&T St. No. 1.1, p. 9; *see also* Tr. 307.

<sup>77</sup> Tr. 309.

access reform is implemented, Pennsylvania should be in a position to follow that lead and allow competitors to respond with services and pricing that is most beneficial for customers. To the degree that Pennsylvania lags behind this progress, Pennsylvania consumers will lag behind the benefits available from fair and balanced competition. It is important to follow the FCC's lead in revenue-neutral access reform, but not to follow too slowly or Pennsylvania customers will continue to pay for the lag.

The FCC most recently restructured interstate switched access as part of its *CALLS* and *MAG Orders*. In the *CALLS Order*, the FCC instituted an access restructure for price cap ILECs that included a reduction of interstate switched access rates and an increase in the End User Common Line ("EUCL") charge to certain maximums. In fact, the FCC recently approved another increase in the cap for the federal residential EUCL to \$6.50 per access line.<sup>78</sup> The result of these FCC actions is to shift recovery of some end user revenues from usage sensitive access charges to flat rated monthly end user line charges, consistent with principles of cost causation. A similar restructure has been adopted for non-price cap ILECs through the *MAG Order*. Restructuring intrastate switched access rates by requiring Verizon to reduce its rates on a revenue-neutral basis is consistent with the FCC's most recent restructuring actions.<sup>79</sup> If this revenue-neutral restructure of intrastate switched access charges is adopted, a significant step toward more rational economic pricing for intercarrier compensation will be accomplished.

Most importantly, in the Commission's recent *Order* of July 15, 2003, approving the Joint Procedural Stipulation of June 5, 2003 filed by the Rural Telephone Company Coalition and

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<sup>78</sup> *Cost Review Proceeding for Residential and Single-Line Business Subscriber Line Charge (SLC) Caps, Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers*, CC Docket Nos. 96-262, 94-1, Order, FCC 02-161 (June 5, 2002) ("*SLC Order*").

<sup>79</sup> Qwest St. No. 1.0, p. 12.

other supporting parties, the Commission clearly signaled its preference for proposals, which moved access charges closer to cost and closer to interstate rates.

We further look to the Federal Communications Commission's ("FCC") recent decisions in the *CALLS* and *MAG* orders for precedence in ordering implicit charges to become explicit, through either an increase in basic local telephone service rates, or through service line charges on customer bills. This enables other carriers to compete due to reduced subsidies. **While the Joint Proposal does not require a rural ILEC or Sprint/United to mirror interstate access charges, the fact that this is a step toward making the charges closer to cost and closer to the interstate access charges will help to avoid arbitrage and will help competition enter the ILECs territories.**<sup>80</sup>

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

It is clear that the Commission should expressly adopt the policy position that intrastate access rates must be at parity with interstate access rates.<sup>81</sup> Indeed, the Commission has acknowledged that the *CALLS Order* demonstrates an appropriate preference for a coordinated approach to access charges at the state and federal levels.<sup>82</sup> Qwest describes that the FCC has indicated its intentions to continue with the philosophy of moving "the support for local services back to the end user in a way that is consistent with cost causation . . . in its current and future proceedings as the competitive nature of telecommunications continues to evolve."<sup>83</sup> Qwest also

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<sup>80</sup> *RTCC Settlement Order* at 11.

<sup>81</sup> See also Qwest St. No. 1.0, p. 7, 12; AT&T St. No. 1.0, pp. 8, 26; MCI St. No. 1.0, p. 33.

<sup>82</sup> *Order Initiating Proceeding* at 3; *RTCC Settlement Order* at 6-9.

<sup>83</sup> Qwest St. No. 1.0, p. 17.

explains that “[i]nterstate switched access will continue to decline as the FCC moves closer to a bill and keep regime for all intercarrier compensation.”<sup>84</sup> The active consideration by the FCC of the bill-and-keep regime signals an evolution in access charge policy that Pennsylvania should heed. Adopting sound policy that intrastate access rates in Pennsylvania will mirror interstate access charges will guarantee the continued evolution of the Pennsylvania market.

**C. THE COMMISSION SHOULD REFRAIN FROM REQUIRING CARRIERS IN A COMPETITIVE MARKETPLACE UNDER A REGULATORY MANDATE TO PASS THROUGH THE REDUCTIONS TO THEIR END USERS.**

As a final matter, Qwest urges the Commission to refrain from requiring IXC carriers in a competitive marketplace to adhere to a regulatory mandate to pass through the savings from any reductions to their end users. Qwest agrees with the fundamental premise embodied in the flow-through mechanism—that reductions in intrastate access charges should result in a decrease in the rates end-users pay for toll services. The interexchange market, however, is sufficiently competitive to ensure flow-through without the need for carriers to document flow-through to state commissions.<sup>85</sup>

Qwest understands that theoretically, in a stagnant and non-competitive long distance environment, major IXCs like AT&T and MCI WorldCom theoretically could absorb access reductions without completely flowing them through. Yet Pennsylvania is not a stagnant and non-competitive market. Indeed, almost 500 certified IXCs provide service in Pennsylvania,<sup>86</sup> due to the efforts undertaken by the Commission over the past several decades to promote competition in the IXC market. The fierce competition resulting from this large number of IXCs

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<sup>84</sup> *Id.*, p. 12.

<sup>85</sup> *Id.*, p. 7.

<sup>86</sup> <[www.puc.paonline.com](http://www.puc.paonline.com)>

drives IXC's average rate per minute down in Pennsylvania year after year. In this competitive environment, it simply is not possible for any IXC to keep prices artificially high when faced with declining costs.<sup>87</sup> In other words, IXCs must reduce rates in response to access charge reductions out of competitive necessity. The result is most evident at the federal level with decreased interstate long distance rates.<sup>88</sup> Competition on its own will result in full and accurate flow-through.

Likewise, the Virginia State Corporation Commission recognized that mandating IXC flow-through of reductions is unwarranted. In its own access charge reduction docket, the Virginia commission stated that “[w]e have long relied upon market forces in Virginia to establish prices for interexchange services and find no evidence in the record here to suggest that that particular market will fail to continue to provide its benefits to Virginia consumers.”<sup>89</sup> Contemplating regulatory oversight over commission-mandated flow-through of reduced access charge reductions, therefore, is necessary. Accordingly, Qwest suggests that the Commission defer to the marketplace instead of instituting an unnecessary regulatory mandate for IXCs to pass through any reductions to end user customers.

Requiring 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. This is an absurd proposition from a traditional ratemaking standpoint. Such a directive would reflect a complete lack of regulatory confidence in what is Pennsylvania's most robust competitive market.

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<sup>87</sup> See MCI St. No. 1.0, p. 17; Tr. 272.

<sup>88</sup> Qwest St. No. 1.0, p. 10.

<sup>89</sup> *In re: Investigation of the Appropriate Level of Intrastate Access Service Prices of Verizon Virginia, Inc.*, Virginia State Corporation Commission, Case No. PUC000242, Order at 6 (2000).

#### IV. CONCLUSION

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

- a. Restructuring Verizon's intrastate switched access rates beyond merely creating parity between the existing rates of Verizon-North and Verizon-PA;
- b. Adopting a clear policy position that the ILECs' intrastate access rates must be at parity with interstate access rates;
- c. Reducing Verizon's intrastate switched access charges to the interstate level in a revenue-neutral and a competitively-neutral manner; and
- d. Refraining from imposing additional regulations in a competitive IXC environment that mandate a flow-through of any resulting reductions of intrastate access charges to end user customers.

Respectfully submitted,



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Dated: September 18, 2003

**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

AT&T Communications of Pennsylvania, Inc. :

v. :

Verizon North, Incorporated :

Docket No. C-20027195

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

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September 18, 2003

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SEP 19 2003

James McNulty, Secretary  
Pennsylvania Public Utility Commission  
Commonwealth Keystone Building  
400 North Street  
Harrisburg, PA 17120

PA PUBLIC UTILITY COMMISSION  
SECRETARY'S BUREAU

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 is the original and nine (9) copies of the public version of the Main 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

cc: (w/ encl)  
The Honorable Cynthia W. Fordham  
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.,

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

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Dated : September 18, 2003

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## INTRODUCTION

In its 1999 Global Order, the Commission determined that goal of opening all of Pennsylvania's telecommunications markets to full and fair competition required the establishment of a new paradigm in the pricing of carrier access services. Following the mandates of the Telecommunications Act of 1996, the Commission explicitly rejected the notion that the goals of universal service and competitive markets could be accomplished with excessive subsidies buried in access rates. To that end, the Commission ordered significant reductions in Verizon Pennsylvania's carrier access rates and, just as importantly, directed that the process of reform would conclude at the end of 2001.

That did not happen. The investigation that the Commission had envisioned as the vehicle for completing access reform was not even initiated, much less completed within the timeframe described in the Global Order. And while the reform momentum from the Global Order was squandered, the competitive problems inherent in Verizon's excessive access rates festered. Indeed, the post-Global period has seen the rise of new competitors to the long distance providers – including wireless carriers and Verizon's own long distance affiliate – who have leveraged their unique cost advantages to put the access-burdened long distance providers in an ever steeper downward spiral.

This case presents the Commission with the opportunity to put access reform back on its proper course. The record developed in this case shows that, even after the significant reductions that the Commission established 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 even Verizon's above-cost interstate access rates by at least [BEGIN VZ PROPRIETARY <sup>1</sup> [END VZ PROPRIETARY]

At the same time, the evidence shows that eliminating this anti-competitive burden is far from an insurmountable task. To the contrary, just as it did with respect to the recent Sprint/RTCC access reform proposal,<sup>2</sup> 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 the approval of 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 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,

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<sup>1</sup> AT&T Cr. Exh. 7.

<sup>2</sup> *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.

providing the new momentum necessary for accomplishing the goals the Commission set for itself four years ago.

In that regard, 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 long distance *competition in Pennsylvania*.

Fortunately, the Commission already has recognized the critical importance of this effort. Indeed, its expeditious resolution of the Sprint/RTCC access proposal shows that the Commission understands the problem of excessive access rates, and what must be done to correct it. Now is the time to translate that understanding into action with respect to Verizon's inflated intrastate access charges.

### **ARGUMENT**

#### **I. THE COMMISSION MUST ACT AGGRESSIVELY AND EXPEDITIOUSLY TO REDUCE VERIZON'S CARRIER ACCESS RATES.**

In its order approving the Sprint/RTCC plan for access reductions and local rate rebalancing, the Commission explicitly recognized that the prospects for widespread and robust competition in all of the Commonwealth's telecommunications markets are being undermined by the plague of overpriced

carrier access charges.<sup>3</sup> The record developed in this case shows that, if anything, the competitive problems inherent in inflated access charges are even more pronounced in the territories of Pennsylvania two largest incumbent local exchange carriers – Verizon Pennsylvania and Verizon North. This evidence makes a compelling case for aggressive and immediate action by Commission.

As a predicate matter, there is no legitimate dispute that the access rates charges by both Verizon companies substantially exceed the cost of providing carrier access services. As AT&T witnesses Kirchberger and Nurse testified, on a typical call Verizon provides access on both the originating and terminating ends of the call. For AT&T, each “end” of the call in VZ-PA’s territory costs it approximately \$0.0177837 per minute.<sup>4</sup> On a conversation minute of use (“CMOU”) basis – that is, for an intrastate toll call that is both originated and terminated on Verizon Pennsylvania’s network – the per minute charges amount to over 3.5 cents. And the cost of completing each end of a call in VZ North’s territory is even higher – approximately \$0.0623235 per end, or nearly 12.5 cents per CMOU.<sup>5</sup>

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<sup>3</sup> Sprint/RTCC Order at 10.

<sup>4</sup> AT&T Stmt. 1.0 at 4-5. When the call is originated on Verizon’s network, AT&T also incurs what is known as a non-conversation additive for the first minute of the call. That is, AT&T pays access for the time the call is being set up, for the time the called number is ringing, and if the called number is busy. That additive, of course, effectively increases AT&T’s costs for originating access. AT&T Stmt. 1.0 at 4 n.1.

<sup>5</sup> AT&T Stmt. 1.0 at 5.

The evidence shows that these rates are priced far in excess of Verizon's economic cost of providing carrier access services. Even Verizon witnesses Berry and Wirl acknowledged that its access rates are not cost-based, testifying that Verizon's access rates have "not been tied to the cost of providing this service."<sup>6</sup> The magnitude of that difference, however, was best depicted in the testimony of AT&T witness Oyefusi.

Dr. Oyefusi used the rates for unbundled network elements that currently are in effect for Verizon in Pennsylvania, as well as those that Verizon calculated as being in compliance with the Tentative Order, to develop costs for the corresponding carrier access services offered by Verizon. Those calculations resulted in an approximate access cost of **[BEGIN PROPRIETARY]** **[END PROPRIETARY]** per access minute of use (that is, for just one end of a call).<sup>7</sup> Using the rates from the Tentative Order resulted in an even lower cost of **[BEGIN PROPRIETARY]** **[BEGIN PROPRIETARY]** per AMOU.<sup>8</sup>

The comparison to Verizon's access rate is startling. For example, the rates being charged by Verizon PA are over 9 times the access cost Dr. Oyefusi calculated using the current UNE rates, and over 11 times the cost under the Tentative Order UNE rates. The results are understandably worse for Verizon North. As noted above, VZ-North's current access rates are in excess of an astounding 12 cents per minute if VZ-North completes both ends of the call. That

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<sup>6</sup> VZ Stmt. 1.0 at 5-6.

<sup>7</sup> AT&T Stmt. 2.0 at 10 and OAO Rebuttal Exhibit 4.

<sup>8</sup> Id.

rate is a huge multiple of a properly calculated forward-looking cost of switched access services – **[BEGIN PROPRIETARY]**

**[BEGIN PROPRIETARY]** the estimated cost under the Tentative Order rates.

Verizon's interstate access rates provide another perspective on extent of the intrastate access problem in the Verizon territories. As Dr. Oyefusi testified, Verizon's interstate rates are themselves priced at levels that exceed the incremental cost Verizon incurs in providing access services.<sup>9</sup> Nevertheless, those interstate rates are much lower than Verizon's intrastate rates. For example, Verizon's interstate rate for just the local switching element is \$0.002431,<sup>10</sup> approximately 73 percent lower than the \$0.009 intrastate rate Verizon PA currently charges for the very same element. In fact, Verizon acknowledged in a response to an in-hearing data request that reducing its intrastate access rates to current interstate levels – rates again that are set above cost – would entail a total revenue offset of **[BEGIN VZ PROPRIETARY]**

<sup>11</sup> **[END VZ PROPRIETARY]**

Stated another way, even after the initial efforts the Commission took four years ago in the Global Order to implement carrier access charge reform, it is still faced with at least a **[BEGIN VZ PROPRIETARY]** **[END VZ**

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<sup>9</sup> AT&T Stmt. 2.0 at 12.

<sup>10</sup> AT&T Stmt. 2.0 at 12 (citing Verizon's FCC Tariff #1).

<sup>11</sup> AT&T Cr. Exh. 7.

**PROPRIETARY]** access problem in Verizon's territories. This amply demonstrates that a complete and final resolution of the Verizon access problem is long overdue.

Of course, the Commission already knows that. As Verizon witnesses Berry and Wirl noted in their testimony,<sup>12</sup> 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."<sup>13</sup> 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) untouched.<sup>14</sup>

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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<sup>12</sup> VZ Stmt. 1.0 at 5-6.

<sup>13</sup> *Joint Petition of Nextlink, et al.*, Docket Nos. P-00991648 and P-00991649, Sept. 30, 1999 ("Global Order"), at 26-27.

<sup>14</sup> 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.”<sup>15</sup> 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.<sup>16</sup>

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.”<sup>17</sup> 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.<sup>18</sup>

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. Thus, the comprehensive access reforms and reductions that the

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<sup>15</sup> Global Order at 60.

<sup>16</sup> Id.

<sup>17</sup> *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.

<sup>18</sup> Id. at 46.

Commission contemplated in the Global Order and the Verizon Merger Order are now more than 20 months overdue.

That does not mean that the Commission has lost sight of the necessity for access reform. To the contrary, in its July 2003 Sprint/RTCC Order approving the access reduction proposal submitted by Sprint and other independent local exchange carriers the Commission reiterated its "objective to reduce implicit subsidy charges such as access charges that impede competition in the telecommunications market."<sup>19</sup> The Commission also cogently described the benefits that accrue from access reductions – and, by implication, the substantial competitive impediments created by the existing inflated rates:

As implicit charges become explicit charges, competitors are better able to compete for local and long distance customers in an ILEC's service territory because IXCs are not hindered by paying ILECs excessive access charges in providing competitive toll services and CLECs are better able to compete with ILEC local service rates that have been kept artificially low as a result of the access charge subsidies.<sup>20</sup>

The record developed in this case provides ample proof of the competitive problems that the Commission identified in the Sprint/RTCC Order. In fact, at least two developments in the telecommunications industry since the issuance of the Global Order have made the need for aggressive and immediate access reform absolutely imperative.

The first is the emergence of wireless providers, including Verizon's own wireless affiliate, as well as of Internet services like "instant messaging", as

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<sup>19</sup> Sprint/RTCC Order at 10.

<sup>20</sup> Id.

competitors for consumer long distance customers. As AT&T witnesses Kirchberger and Nurse testified – and as will be discussed further below -- through the use of plans touting “free” long distance calling wireless providers have been winning toll traffic from IXCs like AT&T at alarmingly high – and accelerating -- rates.<sup>21</sup> The understandable attraction of these plans, however, is attributable to the artificial cost and pricing advantage these wireless carriers, who pay no access charges on calls within their huge “local” calling areas, wield over interexchange carriers like AT&T, who pay those access charges on *all* of the intrastate calls they provide to Verizon’s local exchange customers.

The same competitive issues are raised by the second development – Verizon’s entry into Pennsylvania’s long distance market. With the grant of that authority in September 2001 carriers 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. 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.<sup>22</sup>

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<sup>21</sup> AT&T Stmt. 1.0 at 11-12.

<sup>22</sup> AT&T Stmt. 1.0 at 12.

The common thread in both of these developments is the unequal and discriminatory effect of Verizon's above-cost access charges. The relative attraction of the wireless and Verizon long distance offerings is directly related to the cost advantage that those carriers, unburdened by access, enjoy over interexchange carriers.

**A. The Commission Must Reduce Access Rates To Ameliorate The Artificial Advantage Enjoyed By Wireless Providers.**

Inflated access rates give wireless providers a decided --and entirely artificial -- advantage over wireline providers for a very simple reason. That is, for the substantial amount of traffic that normally would be considered as toll calls for wireline carriers, wireless carriers do not pay access. Rather, they are permitted to complete those calls as "local traffic," and thus pay rates for terminating that traffic that are many multiples lower than intrastate access charges.

This phenomenon was described in the rebuttal testimony of AT&T witnesses Kirchberger and Nurse.<sup>23</sup> As they testified, unlike interexchange carriers that are required to make access charge payments to ILECs at both the originating and terminating ends of each long distance call handled by the IXC, wireless carriers pay no access charges whatsoever at the originating end of such calls (because they are placed over the wireless carrier's own network). Perhaps even more important, wireless carriers have been expressly exempted by the FCC from payment of access charges at the terminating end of any long

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<sup>23</sup> AT&T Stmt. 1.0 at 12-18.

distance call to a point that is within the same Major Trading Area ("MTA") as the call originator. Instead, calls completed within the MTA are considered to be "local" calls subject to reciprocal compensation rates, which are cost-based and thus priced at considerably lower levels than access charges.<sup>24</sup>

These MTAs are considerably larger than traditional wireline local calling areas. Nationwide, there are fifty-one MTAs, many of which encompass entire states or even several states.<sup>25</sup> While various areas of Pennsylvania are covered by about 5 different MTAs, the bulk of the state is covered by just two large MTAs. One is MTA 9 (known as the "Philadelphia" MTA). That MTA not only covers most of south New Jersey and all of the state of Delaware, but within Pennsylvania itself the MTA extends from the southeastern part of the

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<sup>24</sup> See *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket No. 96-98, *Interconnection Between Local Exchange Carriers and Commercial Radio Service Providers*, CC Docket 95-185, *First Report and Order*, Rel. August 8, 1996, at para. 1036:

[I]n light of this Commission's exclusive authority to define the authorized license areas of wireless carriers, we will define the local service area for calls to or from a CMRS network for the purposes of applying reciprocal compensation obligations under section 251(b)(5). Different types of wireless carriers have different FCC-authorized licensed territories, the largest of which is the "Major Trading Area" (MTA). Because wireless licensed territories are federally authorized, and vary in size, we conclude that the largest FCC-authorized wireless license territory (i.e., MTA) serves as the most appropriate definition for local service area for CMRS traffic for purposes of reciprocal compensation under section 251(b)(5) as it avoids creating artificial distinctions between CMRS providers. *Accordingly, traffic to or from a CMRS network that originates and terminates within the same MTA is subject to transport and termination rates under section 251(b)(5), rather than interstate and intrastate access charges.*

(Emphasis added).

<sup>25</sup> AT&T Stmt. 1.0 at 14, K-N Rebuttal Exhibit 1.

Commonwealth to as far west as Centre County.<sup>26</sup> The second large MTA in the state, MTA 21 (the "Pittsburgh" MTA), covers almost all of western Pennsylvania, and even extends south into West Virginia.<sup>27</sup>

The size of these MTAs leads inexorably to the artificial cost advantage that wireless providers enjoy. This is because a wireless carrier, which already pays no originating access for calls initiated on its network, also does not pay terminating access charges for calls completed within the same MTA, even if that call crosses LATA boundaries. Instead, the wireless carrier pays much lower reciprocal compensation payments for the termination of that call, which, for a wireline long distance provider like AT&T, would be considered a toll call subject to Verizon's long distance provider.

As AT&T witnesses Kirchberger and Nurse testified, a call placed within the "Philadelphia" MTA – MTA 9 -- in Pennsylvania vividly exemplifies this disparity. Because of the MTA access exemption, a call placed by a Verizon Wireless customer to his daughter, a student (and Verizon local exchange customer) located at Penn State's main campus at State College – an interLATA call -- will incur no originating access charges. The only charges that would apply to the completion of that call would be VZ-PA's local call termination charges of less than two-tenths of a cent per minute (assuming that the carrier is

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<sup>26</sup> AT&T Stmt. 1.0 at 14.

<sup>27</sup> Id.

paying the tariffed end office call termination rate, rather than an even lower negotiated rate).<sup>28</sup>

In contrast, a wireline long distance call of that same distance that is 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.<sup>29</sup>

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<sup>28</sup> AT&T Stmt. 1.0 at 14-15. As Messrs. Kirchberger and Nurse noted, 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 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).

<sup>29</sup> AT&T Stmt. 1.0 at 15. Like wireless carriers, Internet Service Providers also possess a distinct artificial pricing advantage over IXCs because they are exempt from paying carrier access charges. Rather, ISPs currently are permitted to originate or terminate their service through the purchase of end user lines at a local exchange carrier's retail rates – a mechanism that the FCC has found fully compensates the originating LEC -- and compensation to any carrier terminating such traffic comes in the form of cost-based reciprocal compensation rates, rather than above cost access charges. AT&T Stmt. 1.0 at 18-19. See *In the Matter of Access Charge Reform*, CC Docket No. 96-262, First Report and Order, rel. May 16, 1997 ¶ 346.

Thus, even an e-mail message that travels from Philadelphia to Pittsburgh would incur only local call termination charges, at rates as low as \$0.0007 cents per minute. Once again, an IXC carrying a call of the same

Witnesses for both Verizon and the OCA attempt to gloss over this problem with the excuse that local calling areas for wireless carriers have been defined "differently."<sup>30</sup> And apples are defined differently than oranges. In fact, Verizon witness Dr. Taylor acknowledged that it was a "geographic fact" that in Pennsylvania wireless carriers have the opportunity to terminate traffic at reciprocal compensation rates over a much broader area than, for example, wireline local exchange providers.<sup>31</sup> As he noted, "in Pennsylvania there are large MTAs."<sup>32</sup> And OCA witness Dunkel begrudgingly admitted on cross-examination that he was unaware of any wireline local exchange carrier in Pennsylvania that had a local calling area as large as MTAs 9 or 21, the two largest MTAs available to wireless carriers in the Commonwealth.<sup>33</sup>

As far as the wireless carriers themselves are concerned, *vive la difference*. Indeed, wireless carriers have not been shy about utilizing the cost advantage inherent in their access exemption to offer wireless rate plans that carry no toll charges for long distance service. Verizon Wireless and other CMRS carriers have been heavily promoting this "no toll charge" feature of their services. Verizon Wireless, for example, has been advertising its "America's

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distance between two Verizon Pennsylvania local exchange customers would pay per minute access charges that are 50 times more than that rate.

<sup>30</sup> OCA Stmt. 1.1 at 12. Se also VZ Stmt. 3.0 at 42-43.

<sup>31</sup> Tr. 223.

<sup>32</sup> Tr. 223.

<sup>33</sup> Tr. 421.

Choice" Plan, "Where your home calling area stretches coast to coast."<sup>34</sup> The FCC noted this trend in its 2002 report on wireless competition, finding that "many of the calling plans offered by the nationwide wireless carriers include free nationwide long distance."<sup>35</sup>

It also comes as no surprise that the ability of wireless carriers to employ their access exemption as a competitive weapon is having a significant deleterious effect on the long distance market. Verizon's own data concerning access minutes-of-use vividly demonstrates this point. According to information Verizon provided in discovery, the access minutes billed by Verizon Pennsylvania, the largest ILEC in the state, to interexchange carriers for intrastate toll calls have decreased significantly year after year since 2000:

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<sup>34</sup> AT&T Stmt. 1.0 at 16 and n. 11.

<sup>35</sup> *Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993 Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services*, FCC 02-179, Seventh Report, Rel. July 3, 2002, at 33. The FCC noted that one wireless carrier advertised its nationwide calling plans with the slogan, "Never Pay Long Distance Again."

[BEGIN VZ PROPRIETARY]

VZ-PA Billed Intrastate Access Minutes of Use<sup>36</sup>

YEAR	AMOU (millions)	REDUCTION FROM PRIOR YEAR
2000		
2001		
2002		
2003 (annualized)		

[END VZ PROPRIETARY]

Thus, 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] Verizon North also has experienced reductions in billed access minutes, dropping more than [BEGIN VZ PROPRIETARY] [END VZ PROPRIETARY] since 2001.<sup>37</sup>

Significantly, over this same time period the total minutes that wireless carriers have terminated on Verizon's network have increased substantially. In Verizon Pennsylvania's territory alone the projected minutes from wireless carriers for 2003 reflect an increase of over [BEGIN VZ PROPRIETARY]

[END VZ PROPRIETARY] from end of year 2000.<sup>38</sup> This data shows that the market distortions caused by carrier access charges are inefficiently driving traffic off of the wireline network.

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<sup>36</sup> AT&T Stmt. 1.0 at 16-17, K-N Rebuttal Exhibit 2.

<sup>37</sup> AT&T Stmt. 1.0 at 17 and K-N Rebuttal Exhibit 2.

<sup>38</sup> AT&T Stmt. 1.0 at 17-18, K-N Rebuttal Exhibit 3.

The fact that these developments are by-products of FCC regulations does not mean that this Commission lacks the ability to fashion a remedy. To the contrary, this Commission has the power where it is needed most – to reduce intrastate carrier access charges. As AT&T witnesses Kirchberger and Nurse testified, the point is not that the compensation arrangements for wireless carriers are wrong – rather, it is that the costs of terminating all of these calls, which involve the same functionality, should be set at the same low cost-based rate.<sup>39</sup> Then the IXCs and wireless carriers can compete on the merits of their respective service offerings. This is an issue that the Commission has the power to resolve, and that it must confront quickly to eliminate the distortions that are afflicting the Pennsylvania telecommunications market.

**B. The Commission Must Reduce Verizon's Access Charges To Ameliorate The Artificial Competitive Advantage Those Charges Provide To Verizon In The InterLATA Toll Market.**

Access charges already were an inefficient burden on the long distance market before Verizon was given permission to enter that market. While inflated access charges resulted in unnecessarily high rates to customers, however, for the most part they did not tilt the playing field among the IXC competitors. That is, the IXCs who were competing with each other were at least all doing so on an equally inefficient basis, since they all were required to pay Verizon the same bloated rates for originating and completing their calls.

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<sup>39</sup> AT&T Stmt. 1.0 at 18.

That all changed with Verizon's entry. Now, IXCs are being forced to pay above-cost access charges to the same company with whom they must compete in the market. Stated another way, they are being required to subsidize Verizon's operations while also trying to compete with them. Thus, what previously had been inefficient has become anti-competitive as well.

It should be clear that Verizon's long distance affiliates do not pay access in the same way that IXCs do. IXCs pay access charges in the form of real cash that they pay to Verizon and that they in turn must recover from their end user rates. What Verizon incurs when it originates and/or terminates a long distance call is not its tariffed access rate, but rather the short-run incremental cost of that access functionality.<sup>40</sup> As Administrative Law Judge Schnierle put it six years ago, "the lion's share" of the IXC's cost of providing toll service of the cost of service, while Verizon's actual cost to provide access "is almost nil."<sup>41</sup>

Moreover, while Verizon's long distance affiliates are deemed to "pay" access charges to Verizon Pennsylvania Inc. or Verizon North, Inc., those

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<sup>40</sup> AT&T Stmt. 1.0 at.20.

<sup>41</sup> *Petition of Verizon Atlantic-Pennsylvania, Inc. For a Determination of Whether IntraLATA Toll Service Is Competitive Under Chapter 30 of the Public Utility Code*, Recommended Decision, PaPUC Docket No. P-00971293, March 30, 1998, at 13. ALJ Schnierle went on to note that this access price versus access cost differential gave Verizon the opportunity to put its competitors in a price squeeze:

Considering the fact that access charges are a very significant portion of the cost of intraLATA toll, while representing an almost negligible cost to [Verizon], and considering that [Verizon] is a monopoly provider of access in much of its service territory, [Verizon] will be in a position to put many other providers of intraLATA toll in a price squeeze between toll rates and access charges.

Id.

payments still are much different in kind and effect than the access payments being made by the IXCs. Given Verizon's dominance in the Commonwealth – as well as the bundled nature of its calling plans – the vast majority of its intrastate long distance calling will originate and or terminate on VZ-PA's or VZ North's wireline network. As such, the only access "payments" that conceivably would occur in those situations are nothing more than intra-company accounting transactions that have no consequence for the overall bottom line of the Verizon corporation.<sup>42</sup>

The import of this is that the IXCs face not only a large, well-known competitor that already is the dominant provider of local exchange services in the state, but one that possesses a substantial and entirely artificial cost advantage thanks to its excessive access charges.

Like wireless providers, Verizon, not surprisingly, has sought to capitalize on its access advantage by offering pricing plans that result in effective per minute retail rates that squeeze IXCs right up against Verizon's excessive wholesale access rates. For example, Verizon offers a series of bundled service packages that it terms the "Freedom" plans. The basic Freedom plan gives customers a package of unlimited local calling, unlimited use of features such as Voice Mail and Caller ID, unlimited intraLATA toll calling – and unlimited long

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<sup>42</sup> AT&T Stmt. 1.0 at 20-21.

distance calling. Verizon's website estimates the price of this package in Pennsylvania to be \$54.95 per month.<sup>43</sup>

Significantly, Verizon offers all of the underlying aspects of the Freedom bundle, except for the long distance component, as a package called "Local Package Basic," at a monthly price of \$39.95. Thus, stripping out these components shows that Verizon is pricing the addition of unlimited long distance calling anywhere in the United States and Canada at \$15.00 per month.<sup>44</sup>

A simple example demonstrates how this rate puts IXC attempting to compete with Verizon in a price squeeze. Assume that a Verizon customer takes the company's offer of "unlimited" long distance service to heart and uses 15 minutes of intrastate long distance calling per day.<sup>45</sup> In that case, the effective per minute retail rate for long distance service is just about 3.3 cents per minute. An IXC trying to compete with that rate, however, would already be paying over 3.5 cents in access charges, assuming that both ends of the call were completed in VZ-PA's territory.<sup>46</sup> Indeed, the IXC's access costs would only increase if the call were terminated, say, in Verizon North's territory, where the access rates are even higher.

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<sup>43</sup> AT&T Stmt. 1.0 at 21.

<sup>44</sup> See AT&T Stmt. 1.0, K-N Rebuttal Exhibit 4.

<sup>45</sup> This would be in line with the long distance minutes allotted to customers of some of Verizon's stand-alone long distance and wireless plans. For example, Verizon's TalkTime500 Plan gives customers 500 minutes of long distance calling, while its America's Choice wireless calling plans start with 300 minutes of monthly calling. See AT&T Stmt. 1.0 at 22 and n.19, K-N Rebuttal Exhibit 5.

<sup>46</sup> AT&T Stmt. 1.0 at 22.

Thus, with access charges priced far in excess of cost, no efficient IXC can reasonably compete with Verizon's offer of unlimited long distance calling for just \$15.00 per month. If AT&T (or any other IXC) tried to match Verizon's price, they would not even cover their incremental access costs for customers using the service for just 15 minutes of in-state calling per day. Obviously, given that an IXC also incurs other costs above and beyond access expenses (e.g., billing, network costs, customer acquisition), the IXC would be losing money at usage levels well below 15 minutes per day.

While Verizon's Freedom plans squeeze its competitors, Verizon itself generates a very healthy margin from its \$15.00 price. Assuming the same 15 minutes of daily in-state long distance calling, and using the access cost estimates derived by AT&T witness Dr. Oyefusi from Verizon's current UNE rates,<sup>47</sup> Verizon's after-access margin (i.e., Verizon's margin net of its internal access costs) is approximately **[BEGIN PROPRIETARY]**

<sup>48</sup> **[END PROPRIETARY]**

Thus, Verizon can make money with its \$15.00 unlimited calling plan and, so long as its access charges remain far in excess of cost, can also put its competitors out of business.

Notwithstanding this evidence, Verizon witness Dr. Taylor claims that Verizon lacks the incentive to engage in these types of anti-competitive pricing schemes because any gains in revenues from the long distance customers it

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<sup>47</sup> See AT&T Stmt. 2.0 at 10 and OAO Rebuttal Exhibit 4.

<sup>48</sup> AT&T Stmt. 1.0 at 23.

gains would be offset by lost revenues from carrier access services.<sup>49</sup> One obvious problem with his argument, however, is an empirical one – as the evidence concerning its Freedom plans demonstrates, Verizon already is engaging in these tactics.

Just as important, Verizon’s “opportunity cost” argument already has been considered and rejected in prior proceedings before this Commission. In particular, ALJ Schnierle detailed the flaws in Verizon’s claims in a 1998 decision recommending the rejection of VZ-PA’s (then Bell Atlantic-Pennsylvania’s) petition for competitive classification of its intraLATA toll services:

First, to accomplish another objective (like retaining or regaining market share), one can afford to make less money on each transaction of a given type for much longer than one can afford to lose money on each transaction. Second, because toll usage is price elastic (i.e., a rate decrease for toll service tends to increase usage). . . , it is likely that if [VZ-PA] were to significantly reduce its intraLATA toll service rates, [VZ-PA] might actually see an increase in revenue from additional usage that would more than offset any revenues loss. . . . [VZ-PA’s] competitors who depend on [VZ-PA] for access cannot take same advantage of the price elasticity of toll for the simple reason that they cannot price toll below access charges without losing money on each minute of service, regardless of any increase in overall revenue.<sup>50</sup>

Put simply, Verizon’s effort to equate making less money with actually losing money is without merit. The only carriers in danger of “losing money” in these circumstances are the IXCs, for whom Verizon’s access charges are an

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<sup>49</sup> VZ Stmt. 3.0 at 34-35.

<sup>50</sup> *Petition of Verizon Atlantic-Pennsylvania, Inc. For a Determination of Whether IntraLATA Toll Service Is Competitive Under Chapter 30 of the Public Utility Code*, Recommended Decision, PaPUC Docket No. P-00971293, March 30, 1998, at 8.

actual out-of-pocket cost of providing toll service. As ALJ Schnierle summarized the issue, “because access charges represent a major portion of the cost of toll service, and because [Verizon’s] access costs are almost negligible, [Verizon] is in a position to force toll competitors out of any market where there is no alternative to [Verizon’s] access service.”<sup>51</sup>

Verizon also attempted to suggest at the hearings that the pricing of their Freedom plans should not be a source of concern since competitive carriers are offering similar packages of services at rates that are at or below Verizon’s prices.<sup>52</sup> But this attempt to deflect attention from the impact of Verizon’s pricing activities through an “everyone else is doing it” excuse does not hold water. As AT&T witness Nurse explained, it is completely understandable that the plans offered by various CLECs would be priced close to – or even below – the rates for Verizon’s offers because the CLECs are “price takers” in the market:

Being new entrants, they’re price takers in a competitive market. They have to take prices from the market, and being the dominant provider in the market, Verizon would tend to set the prices in the market. So that these [CLEC] packages line up with Verizon’s packages is completely to be expected.<sup>53</sup>

Verizon’s efforts at misdirection also cannot obscure the success that its offers have had in the interLATA market. Earlier this year Verizon announced that it had passed Sprint to become the third largest long distance company in

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<sup>51</sup> Id. at 17.

<sup>52</sup> Tr. 289-293.

<sup>53</sup> Tr. 289.

the country, a feat it had achieved "less than three years after our first FCC approval to provide long distance service. . . ."54

Just as important, data provided by Verizon in discovery shows that, 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.<sup>55</sup> The minutes generated in Verizon North's territory, although smaller in absolute terms, grew by over [BEGIN VZ PROPRIETARY]

<sup>56</sup> [END VZ PROPRIETARY]

In fact, the growth in Verizon's long distance services in Pennsylvania tends to mask the real extent of the decline in minutes being experienced by the IXCs. Stripping Verizon's own long distance minutes from the total industry data discussed earlier in this brief shows that the IXC's minutes are dropping at even more accelerated rate than the gross data would suggest. For example, the total billed access minutes projected for 2003 in Verizon Pennsylvania's service territory reflect a decrease from 2001 – the year Verizon was given approval to enter the Pennsylvania long distance market -- of approximately [BEGIN VZ

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<sup>54</sup> AT&T Stmt. 1.0 at 24, K-N Rebuttal Exhibit 6.

<sup>55</sup> AT&T Stmt. 1.0, K-N Rebuttal Exhibit 7.

<sup>56</sup> Id.

PROPRIETARY] .<sup>57</sup> [END VZ PROPRIETARY] Removing the minutes attributable to Verizon long distance affiliates from that total, however, reveals an even steeper decline of about [BEGIN VZ PROPRIETARY]

.<sup>58</sup> [END VZ PROPRIETARY]

This evidence underscores the necessity for expeditious and forceful Commission action to eliminate Verizon's access advantage and put all competitors in the market on the same footing. Whatever reasons may have existed in the past to force high access charges on long distance carriers to help keep local rates low evaporated the moment Verizon entered the long distance market. As Messrs. Kirchberger and Nurse put it, "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."<sup>59</sup> Permitting that regime to continue will in fact only ensure that, in time, Verizon's competitors –and the benefits that competition previously has brought to Pennsylvania's long distance consumers -- will disappear.

In fact, the data shows that, between Verizon's entry and the growth in wireless substitution for wireline long distance services, the long distance market in Pennsylvania is already in trouble, and the trouble is intensifying. Absent prompt action by the Commission to eliminate the artificial and anti-competitive effect of Verizon's excessive access rates, long distance carriers – except for

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<sup>57</sup> See AT&T Stmt. 1.0 at 24-25, K-N Rebuttal Exhibit 7.

<sup>58</sup> AT&T Stmt. 1.0 at 25.

<sup>59</sup> AT&T Stmt. 1.0 at 25.

Verizon's long distance affiliate – may very well be squeezed out of the Pennsylvania residential market altogether in the not too distant future.

**C. The Commission Cannot Rely On The “Market” To Reduce Verizon’s Access Charges.**

Several Verizon witnesses suggested in testimony in the case that, beyond the access reductions Verizon was itself proposing, further Commission action to reduce access rates was unnecessary. Rather, according to Verizon, the Commission should simply let the “market” work to affect access rates.<sup>60</sup>

This is empty rhetoric. The fact is that it is Commission action, and not competitive market forces, that historically has been the source of reductions in Verizon's intrastate carrier access charges, and it is Commission action that is necessary to remove the remaining bloat in Verizon's access rates. Indeed, the ineffectiveness of market forces as a check on Verizon's rate is demonstrated by the fact that, in every year since the Global Order, the IXC's relative share of Verizon Pennsylvania's Carrier Charge has increased, even as their minutes of use have decreased.<sup>61</sup> This is the case for a very simple reason – there is not *sufficient competition for carrier access services to restrain, much less reduce,* Verizon's access rates.

Even Verizon admits this. Verizon witness Dr. Taylor, for example, was quick to acknowledge on cross-examination that he was “not making the claim

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<sup>60</sup> See, e.g., VZ Stmt. 1.1 at 2; VZ Stmt. 3.0 at 29.

<sup>61</sup> AT&T Stmt. 1.0 at 33.

that the carrier access market in Pennsylvania is a competitive market.”<sup>62</sup> And both Dr. Taylor and Verizon witness Wirl were unable to identify any instance in the past four years –that is, since the last time the Commission acted to reduce Verizon’s access rates – in which Verizon had voluntarily reduced its rates for carrier access in response to the “market.”<sup>63</sup> To the contrary, Mr. Wirl admitted that the current structure and level of access rates for both Verizon companies in Pennsylvania resulted from Commission action in the Global Order.<sup>64</sup>

Contrary to Dr. Taylor’s suggestion, movement in the pricing of interstate access provides little in the way of meaningful support for Verizon’s “market-based” approach to pricing intrastate access. According to Dr. Taylor, competition, in the form of the “threat of bypass,” was the “main reason the FCC gave for its radical reductions in carrier access charges over the years.”<sup>65</sup> The implications of this claim appear to be lost on Dr. Taylor, however. That is, by his own admission, whatever competition existed for interstate access did not compel Verizon to implement “radical reductions” in its interstate access charges of its own volition. Rather, those interstate reductions were the direct result of prescriptive action by the FCC. No less is required here in Pennsylvania.

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<sup>62</sup> Tr. 207-08.

<sup>63</sup> Tr. 65 (Wirl), 209 (Taylor).

<sup>64</sup> Tr. 64-65.

<sup>65</sup> Tr. 208.

**D. The Commission Should Not Be Deterred From Reducing Verizon's Access Rates By Obsolete Concepts Of "Loop Allocation."**

Ignoring altogether the pernicious effects that excessively priced carrier access charges are having on competition in both the long distance and local exchange markets, as well as the fundamental changes in the law and the telecommunications industry that have occurred over the past several years witnesses for the public advocates in this case argue that the Commission should not be reducing access rates at all. Instead, relying on anachronistic and anti-competitive concepts of residual local exchange pricing and loop cost allocation, these witnesses proposes the adoption of a common Carrier Charge ("CC") for the two Verizon companies (that is, for both Verizon Pennsylvania Inc. and Verizon North, Inc.) that is higher than that proposed by Verizon – in fact, a rate that is nearly double the CC per line rate that VZ-PA currently charges.<sup>66</sup>

None of these witnesses, however, recognized that the theories on which they based their proposal already have effectively been rejected by the Commission. The Commission should reaffirm that those prior determinations, and categorically reject these proposals as well.

As an initial matter, the public advocates' testimony shares a common basis in theories of "residual pricing" and "loop allocation." As AT&T witnesses Kirchberger and Nurse explained, "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 universal

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<sup>66</sup> See OTS Stmt. 1.0 at 18; OSBA Stmt. 1.0 at 5; OCA Stmt. 1.0 at 5.

service.<sup>67</sup> This process basically would start with the determination of the telecommunications provider's "revenue requirement" through the now defunct rate-of-return ratemaking analysis. Then, the rates for toll services (and, after the Bell System break-up in 1984, the prices for access services) were set at extremely high levels, with only the remaining (or "residual") amount of the providers' revenue requirement assigned to local exchange services.

To provide an air of legitimacy to this historically popular approach to the pricing of local exchange service, the costs of providing consumers with local access to the telecommunications network were arbitrarily allocated to other telecommunications services that "use" the loop. That is, a certain percentage of loop costs was assigned to be recovered from interexchange carriers, regardless of the amount of long distance traffic that a particular customer generated – or indeed, whether they made any long distance calls at all. In doing so, costs were shifted from residential and single-line business customers to high volume customers (especially large business customers), on the theory the latter were better able to bear these costs.<sup>68</sup>

One consequence of this approach was that it drove the price of long distance service to unreasonably high levels, thus artificially reducing the demand for that long distance calling. Just as important, these policies disconnected the pricing of local exchange service from the true costs of

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<sup>67</sup> AT&T Stmt. 1.1 at 3.

<sup>68</sup> AT&T Stmt. 1.0 at 3.

providing it, making it likely that basic local exchange services in many areas of the Commonwealth are priced below their incremental cost. Finally, by allocating away the cost of providing consumers with network access, these pricing policies fostered the illusion that an acceptable "universal service policy" was to establish artificially low local telephone rates for all subscribers.<sup>69</sup>

Given these problems, it is not at all clear that the system of "residual pricing" and "loop cost allocation" was valid even in the bygone era of the old Bell System monopoly because of the problems.<sup>70</sup> Now, with the enactment of the Telecommunications Act and the establishment of a national policy of full competition in all telecommunications markets, there can be no question that this system is illegitimate.

The Commission already has recognized as much in its post-Telecommunications Act decisions. Indeed, ALJ Schnierle, in his 1998 Recommended Decision in the Generic Access Investigation, described how the sea change in the law brought about by the Telecommunications Act had completely undermined the theories of residual pricing and loop cost allocation:

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<sup>69</sup> AT&T Stmt. 1.0 at 4.

<sup>70</sup> Indeed, The fully distributed cost methodologies for the pricing of local exchange services that are reflected in the testimony submitted by OCA, OTS and OSBA have been roundly criticized in the economic literature for many years. See, e.g., William J. Baumol, et. al. "How Arbitrary is 'Arbitrary?' – or Toward the Deserved Demise of Full Cost Pricing in Regulated Industries," Public Utilities Fortnightly, September 3, 1987, p.16 ff; Alfred E. Kahn "The Road to More Intelligent Telephone Pricing," Yale Journal on Regulation, Vol. 1, 1984 pp. 139-157; and David L. Kaserman and John W. Mayo "Cross-Subsidies in Telecommunications" Roadblocks on the Road to More Intelligent Telephone Pricing," Yale Journal on Regulation, Vol. 11, Winter 1994, pp. 119-148. See AT&T Stmt. 1.1 at 4.

[T]he “loop as 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.<sup>71</sup>

The Commission subsequently adopted ALJ Schnierle’s conclusions in its 1999 Global Order.<sup>72</sup> In doing so, the Commission found that 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.”<sup>73</sup>

These decisions demonstrate that the Commission has recognized that the objective of promoting competition in all telecommunications markets in Pennsylvania requires a complete break with the antiquated ratemaking principles that are central to the OCA, OTA and OSBA witnesses’ testimony. In fact, consistent with its determinations in the Global Order, the Commission just two months ago approved a proposal by Sprint/United and the Rural Telephone Company Coalition to reduce access charges and offset those reductions with increases in basic local exchange rates. As has already been described above,

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<sup>71</sup> *Generic Investigation of Intrastate Access Charge Reform*, Docket No. I-00960066, Recommended Decision, June 30, 1998, at 53.

<sup>72</sup> *Global Order* at 27.

<sup>73</sup> *Id.* at 26-27.

in approving the Sprint/RTCC plan the Commission reiterated its “objective to reduce implicit subsidy charges such as access charges that impede competition in the telecommunications market.”<sup>74</sup> And the Commission also described the competitive benefits that accrue in both the local exchange and long distance markets from making the rates for both local and carrier access services reflect their corresponding costs<sup>75</sup> – a concept that appears to be anathema to the ratemaking schemes being advocated by OCA, OTA and OSBA in this proceeding.

Ignoring these more recent Commission decisions, OTS witness Kubas relied on other several older orders to support his contention that the loop is properly treated as a “joint cost.”<sup>76</sup> Those decisions, however, have no practical relevance to the issues facing the Commission in this proceeding. The two cases on which Mr. Kubas relies – the Universal Service Investigation, and the Bell Atlantic rate rebalancing proceeding – both effectively predate revolutionary developments in the Commonwealth’s telecommunications markets. Both of those cases, for example, were commenced before the Telecommunications Act was enacted in 1996, establishing a national policy to eliminate implicit subsidies.

Moreover, in the more than six years since the latter of the two orders cited by Mr. Kubas was issued in January 1997, the telecommunications industry in Pennsylvania has witnessed the following events: (1) full equal access

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<sup>74</sup> Sprint/RTCC Order at 10.

<sup>75</sup> Id.

<sup>76</sup> OTS Stmt. 1.0 at 5.

competition was commenced in Verizon Pennsylvania Inc.'s intraLATA toll markets, followed by the markets of the remaining Pennsylvania ILECs; (2) the Commission first established rates for Verizon Pennsylvania's unbundled network elements; (3) the Commission reduced the rates for Verizon's UNEs, and set additional terms designed to open local exchange markets to competition in the *Global Order*; (4) Verizon was permitted to enter the state's long distance market, complete with offers that include unlimited local and toll calling; (5) wireless providers have used their artificial pricing advantage over interexchange carriers to provide "free" long distance, making wireless services an increasingly attractive substitute for wireline toll calling, and (6) Internet Service Providers also have been able to use their access exemption to provide services such as Instant Messaging that also are being used as a substitute for toll calls, thus further reducing interexchange providers' minutes of use in Pennsylvania.<sup>77</sup>

These developments conclusively demonstrate that the ratemaking concepts on which the OTS, OSBA and OCA witnesses rely are arbitrary and anti-competitive. For example, continuing to impose excessive access charges on IXCs means that they not only must compete against Verizon, now the nation's third-largest local exchange provider, in the long distance market, but that at the same time they must subsidize Verizon's local exchange operations. The fact that the IXCs also are attempting to compete against the same Verizon

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<sup>77</sup> AT&T Stmt. 1.1 at 5-6.

local exchange services that they are being forced to subsidize only highlights the absurdity of this situation.

The same holds true for the IXCs efforts to compete with wireless competitors. Under Messrs. Dunkel, Kubas and Buckalew's proposal to increase VZ-PA's Carrier Charge, IXCs would be forced to pay Verizon Pennsylvania more than 2 cents per minute to terminate a call from Philadelphia to State College -- not to mention the additional 2 cents to originate it.<sup>78</sup> However, a wireless provider such as Verizon Wireless, owing to its access exemption for intra-MTA traffic, would pay less than two-tenths of a cent per minute in reciprocal compensation to terminate the call through VZ-PA's end office. In other words, OCA, OTS and OSBA would require IXCs to provide over 10 times more "support" to the loop in State College than the wireless provider.<sup>79</sup>

These problems, however, appear to have escaped the attention of the public advocates' witnesses. In fact, OTS witness Kubas acknowledged on cross-examination that he "had not made a determination" whether other "users" of the loop -- such as wireless carriers, Internet Service Providers, and broadband providers -- should provide support for the loop.<sup>80</sup>

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<sup>78</sup> AT&T Stmt. 1.1 at 6.

<sup>79</sup> AT&T Stmt. 1.1 at 6-7. The disparity is even worse in the case of Internet traffic, which, as was described earlier, under the FCC's rules now can be terminated at a per minute rate of just \$0.0007 -- or seven-hundredths of a cent -- per minute. AT&T Stmt. 1.0 at 18-19; AT&T Stmt. 1.1 at 7.

<sup>80</sup> Tr. 406.

In a final twist, OCA witness Dunkel actually argued that a provision in the *Telecommunications Act* – the same statute that, as the Commission determined in the Global Order, required the elimination of the implicit subsidies in carrier access charges -- actually compelled the Commission – in fact, not only this Commission, but all state commissions and the FCC as well -- to allocate a portion of the cost of the loop to carrier access charges.<sup>81</sup> Developments at the federal level demonstrate the patent unreasonableness of his lay interpretation of the statute. As Mr. Dunkel admitted on cross-examination, the FCC does not allocate the “interstate portion” of the loop to access. Rather, he acknowledged that the FCC recovers those costs *directly from retail customers* in the form of the federal Subscriber Line Charge, which has increased in the past several years as the FCC has reduced interstate carrier access rates.<sup>82</sup>

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<sup>81</sup> OCA Stmt. 1.0 at 29.

<sup>82</sup> Tr. 449-450. As AT&T witnesses Kirchberger and Nurse testified, the FCC’s actions in reducing interstate carrier access charges and correspondingly increasing the federal SLC demonstrates that any alleged concerns that carrier access reductions will adversely affect universal service are misplaced. Since the enactment of the *Telecommunications Act*, the FCC has issued several orders that have had the effect of substantially reducing interstate access rates (although to levels that are still set in excess of cost). These reductions, including substantial reductions in the interstate Carrier Common Line Charge, have been offset by increases in end user charges, and specifically the federal Subscriber Line Charge (“SLC”). AT&T Stmt. 1.1 at 9. For example, under the FCC’s Access Charge Reform Order of May 2000 the federal SLC on residential customers was increased by over \$2.00 between June 2000 and July 1, 2003. *In the Matter of Access Charge Reform*, CC Docket No. 96-262, Sixth Report and Order, May 31, 2000.

If the old concept of promoting telephone subscribership by artificially suppressing local exchange rates held true, one might expect that the FCC’s actions would negatively affect universal service. But that has not been the case. In fact, during this same time period that the FCC was implementing this rate rebalancing at the federal level, telephone subscribership in Pennsylvania, for example, actually increased, to the point that the Commonwealth now leads the

In sum, the witnesses for the public advocates have provided no sound basis for refusing to reduce Verizon's access charges, and certainly none for proposals that would actually work to increase the IXCs' access expense and the competitive disadvantages that flow from it. The Commission should reaffirm its determinations in the Global Order and the Sprint/RTCC decision, and explicitly reject these proposals.

II. **THE COMMISSION SHOULD ADOPT THE VERIZON/OCA PROPOSAL AS A FIRST STEP TOWARDS COMPREHENSIVE ACCESS REFORM.**

In Verizon's surrebuttal testimony, Verizon, joined by OCA, introduced a proposal for settling this proceeding that effectively calls for lowering Verizon North's Carrier Charge to the level currently being assessed by Verizon Pennsylvania, and offsetting that reduction with increases in basic local exchange rates for most – but not all -- residential and business customers. According to Verizon's calculations, the reduction in Verizon North's CC would amount to approximately [BEGIN VZ PROPRIETARY] <sup>83</sup> [END VZ PROPRIETARY] Although even a reduction of this magnitude still will leave the carrier access rates for both Verizon companies at levels that are substantially above cost, the proposal reflects a good faith effort to begin the process of access reform for the Verizon companies, and should be adopted by the

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nation with a 98.2 percent penetration rate. "Telephone Subscribership in the United States," FCC Wireline Competition Bureau, Feb. 2003, at 8 and 19-20. AT&T Stmt. 1.1 at 10.

<sup>83</sup> VZ Stmt. 1.1 at 7.

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.

As AT&T understands it, the Verizon/OCA proposal involves at least three steps. First, Verizon proposes to align the intrastate carrier access rates structures from both companies with the structure Verizon currently has in effect at the federal level. This will involve, for example, the introduction of new traffic sensitive rate elements.

AT&T has indicated from the outset of this proceeding that it does not object to Verizon's proposed restructuring.<sup>84</sup> AT&T did, however, express a concern about Verizon's initial proposal to offset the revenue increases that would flow from the introduction of these new traffic sensitive rate elements with decreases in the non-traffic sensitive Carrier Charge.<sup>85</sup> As AT&T witnesses Kirchberger and Nurse testified, the restructuring, while implementing new rate elements, was not introducing new costs.<sup>86</sup> Rather, as Verizon witness Wirl acknowledged, all of the costs associated with the new traffic sensitive elements already were reflected in Verizon's existing above-cost traffic sensitive rates, such as for local switching.<sup>87</sup> Thus, any offset to the revenues associated with the introduction of the new traffic sensitive rate elements should be implemented through decreases in the existing traffic sensitive rate elements.

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<sup>84</sup> See AT&T Stmt. 1.0 at 26.

<sup>85</sup> See Tr. 87.

<sup>86</sup> AT&T Stmt. 1.0 at 27.

<sup>87</sup> Tr. 88.

The Verizon/OCA proposal appears to have responded to AT&T's concerns. According to Verizon witness Wirl, the additional revenue expected to be generated by the new traffic sensitive rate elements – approximately **[BEGIN VZ PROPRIETARY]** **[END VZ PROPRIETARY]** – will in fact be offset with decreases in the local switching rate element.<sup>88</sup>

This ties in with the second aspect of the proposal – the establishment of common traffic sensitive local switching and transport rates for the two Verizon companies. Under Verizon's original proposal, the common local switching rate, for example, would have been established at \$0.0088 per minute.<sup>89</sup> As such, the proposal would have meant only a minimal reduction from Verizon Pennsylvania's current rate of \$0.009 per minute, but a significant increase from Verizon North's current per minute rate for local switching of \$0.006. This would have had the effect of increasing Verizon's overall revenues from its traffic sensitive local switching rate. In fact, based on the 2002 minutes for both Verizon companies, implementation of the new local switching rate would have increased Verizon's access revenues by approximately **[BEGIN VZ PROPRIETARY]** <sup>90</sup> **[END VZ PROPRIETARY]**

The Verizon/OCA proposal still suffers from this problem, albeit to a lesser degree. However, the reductions to the local switching rate that Verizon

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<sup>88</sup> Tr. 88.

<sup>89</sup> See AT&T Stmt. 1.0 at 30.

<sup>90</sup> AT&T Stmt. 1.0 at 30.

proposes to undertake to offset the expected increase in revenues attributable to the traffic sensitive rate restructuring have ameliorated the problem. Mr. Wirl estimated that the common local switching rate that would result from adoption of the Verizon/OCA proposal would be \$0.0069 per minute.<sup>91</sup> Although this still reflects an increase over Verizon North's current rate – as well as a potential revenue increase of less than **[BEGIN VZ PROPRIETARY]** **[END VZ PROPRIETARY]**, according to Verizon's calculations<sup>92</sup> -- AT&T will not interpose an objection to implementation of the proposal on those grounds, in the expectation that these rates –as well as all of the above-cost access charges that would result from the proposal – will be examined as the reform process continues to unfold.

The third aspect of the Verizon/OCA proposal involves the reduction of Verizon North's Carrier Charge to the level of the CC currently being charged by Verizon Pennsylvania – a rate of \$0.63 per line per month.<sup>93</sup> According to Verizon, this will result in a total access reduction of approximately **[BEGIN VZ PROPRIETARY]** **[END VZ PROPRIETARY]**.<sup>94</sup>

This aspect of the Verizon/OCA's proposal is not without its own difficulties. Not the least of those problems is the fact that the proposal leaves Verizon Pennsylvania's Carrier Charge undisturbed, thus continuing to force

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<sup>91</sup> Tr. 89.

<sup>92</sup> Tr. 69.

<sup>93</sup> VZ Stmt. 1.1, DMB Exhibit 1.

<sup>94</sup> VZ Stmt. 1.1 at 7.

IXCs to pay Verizon tens of millions of dollars annually in thoroughly unjustified subsidies.<sup>95</sup> And, even after being reduced to VZ-PA's per line level, Verizon North would continue to collect approximately **[BEGIN VZ PROPRIETARY]** **[END VZ PROPRIETARY]** from the CC as well.<sup>96</sup>

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.

It is important for the Commission to recognize, however, that this proposal is in fact simply a step -- and then only a first step -- in the reform process. It certainly does not get the parties and the Commission to the finish line. To the contrary, as the data developed in this case shows, even after the reductions contemplated in the Verizon/OCA proposal, substantial work remains to completely eliminate the bloat that will remain in both Verizon's intrastate access rates.

Fortunately the evidence developed in this case identifies the scope of the task that remains. As discussed previously, Verizon itself has acknowledged that moving its intrastate access rates to interstate levels would require an access

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<sup>95</sup> AT&T Stmt. 1.0 at 29. According to Verizon's data, revenues collected by Verizon Pennsylvania from the Carrier Charge have ranged from a high of **[BEGIN VZ PROPRIETARY]** **[END VZ PROPRIETARY]** AT&T Stmt. 1.0, K-N Rebuttal Exhibit 8; AT&T Cr. Exh. 2.

<sup>96</sup> Tr. 85; AT&T Cr. Exh. 2.

reduction of approximately [BEGIN VZ PROPRIETARY] <sup>97</sup> [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.

However, that prospect is not nearly as daunting as others might try to make it appear. Assuming that those reductions 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 [BEGIN VZ PROPRIETARY] [END VZ PROPRIETARY] – the potential local rate increase would be about \$1.57 a month.<sup>98</sup> Stated another way, if the Commission were, for example, to implement phased additional reductions in Verizon's access rates over a two-year period, it could largely eliminate the Verizon access proposal once and for all at a cost of two local rate increases of less than 80 cents per month.

The finish line is thus not all that far away. And AT&T is not advocating that the Commission attempt to reach it in one fell swoop. But it will not be reached at all at the pace exhibited in the years of neglect that followed the Global Order. The record emphatically demonstrates that the

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<sup>97</sup> AT&T Cr. Exh. 7.

<sup>98</sup> 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.

telecommunications markets in Pennsylvania cannot endure another prolonged wait for comprehensive reform. Consequently, the Commission should not only commence the race with the implementation of the Verizon/OCA proposal, but complete it in an identified timeframe.

**III. THE COMMISSION SHOULD REJECT VERIZON'S PROPOSED ACCESS COST STUDY.**

In an obvious effort to establish a high price floor for its access services – and thus preserve at least some of the bloat in its access rates – Verizon introduced a study in this case that purported to establish the forward looking incremental cost of carrier access. The evidence developed in this case, however, demonstrates that Verizon's study substantially and improperly overstates the cost of its access services. Accordingly, the Commission should reject it.

Exhibit 1 to Verizon witnesses Dean and Sanford's direct testimony sets forth a list of access rate elements and the corresponding costs that Verizon calculated for each of those elements.<sup>99</sup> For example, the per minute costs that Verizon calculated for Feature Group D Service – which Verizon witnesses Dean and Sanford describe as "the most frequently used access service,"<sup>100</sup> and which are listed as "Local Switching FGD –Originating" and "Local Switching FGD – Terminating" – are **[BEGIN VZ PROPRIETARY]** \$

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<sup>99</sup> VZ Stmt. 2.0, Exhibit 1.

<sup>100</sup> VZ Stmt. 1.1 at 6.

<sup>101</sup> [END VZ PROPRIETARY] In addition, Verizon calculates the fixed cost of transport, listed as “Local Transport Host to Remote Fixed,” to be [BEGIN VZ PROPRIETARY]

<sup>102</sup> [END VZ PROPRIETARY]

Far from accurately portraying the forward looking cost of these rate elements, however, Verizon’s cost study overstates the costs of its switched access services – and especially the rate elements described above. In fact, as AT&T witness Oyefusi testified, there are at least two reasons for concluding that the results of Verizon’s study are inflated.

The first is that Verizon’s calculations in this case were not based on the forward looking costing inputs and assumptions previously established by the Commission in its November 4, 2002 Tentative Order in Docket No. R-00016683, the generic investigation to establish new rates for Verizon Pennsylvania Inc.’s unbundled network elements.<sup>103</sup> According to Verizon’s admissions in discovery, the study Verizon used to develop its alleged access costs for submission in this case differed in at least 6 respects from the studies it submitted to comply with the Commission’s decision in the Tentative Order. The inputs and assumptions it used instead either replicated or closely matched the values that Verizon had

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<sup>101</sup> See AT&T Stmt. 2.0 at 3.

<sup>102</sup> Id.

<sup>103</sup> *Generic Investigation Re Verizon Pennsylvania Inc.’s Unbundled Network Element Rates*, Tentative Order, Docket No. R-00016683, Nov. 4, 2002 (“Tentative Order”).

proposed in Docket R-00016683, but that the Commission rejected as not reflecting proper forward looking cost principles.<sup>104</sup>

For example, Verizon's study in this case used a "Cost of Money" of 12.45 percent – close to the 12.95 percent cost of capital it had proposed in Docket No. R-00016683 – rather than the lower rate of 9.83 percent that had been recommended by ALJ Schnierle and adopted by the Commission in the Tentative Order.<sup>105</sup> It also used shorter depreciation lives in this case than the FCC-approved lives that the Commission approved in the Tentative Order.<sup>106</sup> Verizon also used significantly lower switch discounts for at least two types of switches employed in its network than had been approved in the Tentative Order.<sup>107</sup> And Verizon assumed a far-less forward-looking line technology mix in its access cost study than the Commission had adopted in the Tentative Order.<sup>108</sup>

Verizon argues that it was appropriate to deviate from the Commission's determinations in the UNE pricing case because that case involved the Total Element Long Run Incremental Cost ("TELRIC") methodology, while Verizon's access study involved a Total Service Long Run Incremental Cost ("TSLRIC")

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<sup>104</sup> AT&T Stmt. 2.0 at 4-6.

<sup>105</sup> Tentative Order at 39-41.

<sup>106</sup> Tentative Order at 46-49.

<sup>107</sup> See Tentative Order at 137-142.

<sup>108</sup> See Tentative Order at 80-82.

methodology.<sup>109</sup> This is a distinction that makes utterly no difference. In fact, the Commission, in its original UNE pricing order in the MFS-III proceeding, essentially equated the two costing methodologies.<sup>110</sup> Moreover, as Verizon witness Sanford admitted on cross-examination, the primary difference between a TELRIC cost study and a TSLRIC cost study is that the first calculates the cost of an individual element, while the second captures the cost of a service.<sup>111</sup>

But both methodologies are intended to provide the forward-looking long run incremental cost of the subject being studied. And the inputs that the Commission adopted in the UNE pricing case were intended to do precisely that – establish forward looking incremental costs.

The same cannot be said for the inputs Verizon utilized in the access study it submitted here. Verizon witness Sanford acknowledged that the inputs and assumptions that Verizon used had not been approved by the Commission.<sup>112</sup> Rather, they were based entirely on Verizon's opinion as to what constituted "forward looking" assumptions.<sup>113</sup>

Whatever the rationale for Verizon's failure to use the Commission's forward-looking inputs and assumptions, the general effect of that decision is

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<sup>109</sup> VZ Stmt. 2.1 at 3-4.

<sup>110</sup> *Application of MFS Intelenet of Pennsylvania, Inc.*, Docket Nos. A-310203F0002, et al., Interim Order, April 10, 1997, at 12.

<sup>111</sup> Tr. 186-87.

<sup>112</sup> Tr. 189.

<sup>113</sup> Tr. 189-90.

clear -- the failure to use the Commission-approved inputs and assumptions, especially in the key areas of cost of capital, depreciation, and switch discounts, will improperly inflate the resulting costs. In other words, the inputs and assumptions that Verizon used in its access cost study overstate the cost of switched access services.

The record unfortunately does not reflect the precise effect of Verizon's failure to use the commission-approved values from the tentative order in its access cost study. Both AT&T and the OCA asked Verizon to recalculate its access costs using the values from the Tentative Order. Although Verizon did not object to those requests, it nevertheless refused to comply with them on the ground that it would constitute a burdensome special study.<sup>114</sup>

AT&T witness Oyefusi nevertheless was able to provide assessment of the level by which Verizon has overstated its access costs in this case through a comparison to Verizon Pennsylvania current UNE rates. Indeed, this analysis provided the second basis for concluding that Verizon's access study is unreliable. Specifically, as Dr. Oyefusi testified, the rates Verizon currently charges for unbundled network elements ("UNEs") that perform the same functions as those used in providing access service --such as local switching and common transport -- show that Verizon's access cost results in this case are inflated.<sup>115</sup>

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<sup>114</sup> AT&T Stmt. 2.0 at 6-7, OAO Rebuttal Exhibit 2.

<sup>115</sup> AT&T Stmt. 2.0 at 7.

As a predicate matter, and contrary to Verizon's claims, Verizon's current UNE rates provide a valid basis for evaluating Verizon switched access costs. This is because the unbundled elements in question perform the same functionality as the corresponding access elements. For example, local switching as a UNE is no different than the local switching function that is necessary to provide carrier access services.<sup>116</sup> In fact, a witness for Verizon Pennsylvania Inc.'s predecessor company, Bell Atlantic-Pennsylvania, Inc., recognized that fact in testimony filed about 8 years ago in the original Universal Service Investigation. In that testimony, the BA-PA witness, Ms. Eichenlaub, stated that "from a network perspective, the termination of local calls and toll calls are identical."<sup>117</sup>

Verizon's efforts to run away from the implications of that testimony border on the farcical. Verizon admits, as it must, that Ms. Eichenlaub was correct in her assessment that reciprocal compensation and carrier access involve identical network functionalities.<sup>118</sup> Nevertheless, Verizon claims that this does not mean that the two should be priced the same, suggesting that Ms. Eichenlaub's testimony to that effect was influenced by her advocacy for setting reciprocal compensation rates at the level of carrier access charges.<sup>119</sup>

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<sup>116</sup> AT&T Stmt. 2.0 at 7.

<sup>117</sup> Rebuttal Testimony of Catherine A. Eichenlaub, BA-PA Stmt. 5.1, Docket No. I-00940035, at 16.

<sup>118</sup> AT&T Stmt. 2.0, OAO Rebuttal Exhibit 3.

<sup>119</sup> See VZ Stmt. 1.1 at 18-19.

At best, this argument simply illustrates the unprincipled nature of Verizon's advocacy concerning access pricing. While it is true that Ms. Eichenlaub had testified in support of establishing termination rates for local exchange traffic at access levels, Verizon did not abandon this policy because it concluded that different network functionalities were involved. Rather, it was because Verizon belatedly realized that pricing reciprocal compensation at access levels would cost it – rather than its competitors – substantial amounts of money.

This is borne out by the evidence of record. Verizon's own information shows that there is a significant imbalance between the number of local minutes it terminated on its competitors' networks and the minutes that CLECs completed on Verizon's network.<sup>120</sup> Specifically, in 2002 Verizon's outgoing local exchange traffic was 11 times the number of minutes it received from CLECs.<sup>121</sup> All of this traffic was subject to reciprocal compensation at cost-based rates. As Verizon witness Berry succinctly put it, had that same traffic been subject to access charges, Verizon's payments to the CLECs "would certainly be far higher."<sup>122</sup>

Obviously, it is an entirely different story when the compensation shoe is on the IXCs' foot, since in that case Verizon is, by a wide margin, the net recipient of access payments from the IXCs. However, the fact that Verizon is happy to adjust its advocacy depending on whether it is paying cost-based

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<sup>120</sup> AT&T Cr. Exh. 1.

<sup>121</sup> Tr. 75-76.

<sup>122</sup> Tr. 76.

reciprocal compensation or receiving above-cost carrier access payments does not provide a principled basis for rejecting the simple truth, originally acknowledged by Verizon's own witness, that because the same essential elements are involved in terminating a local call and a long distance call, the costs and rates for each should be the same.

As Dr. Oyefusi's testimony showed, however, that certainly is not the result of Verizon's access study. Rather, his analysis showed that Verizon's current UNE rates for local switching and transport are substantially lower than the alleged costs of those same elements in Verizon's access study.<sup>123</sup>

For example, the current UNE rate for originating end office local switching is \$0.001802 per minute.<sup>124</sup> This is over **[BEGIN VZ PROPRIETARY]**  
**[END VZ PROPRIETARY]** per minute cost that Verizon calculated for originating local switching for Feature Group D access. That is also the case for terminating end office local switching, where Verizon's alleged cost of **[BEGIN VZ PROPRIETARY]**  
**[END VZ PROPRIETARY]** than the current UNE rate of \$0.001615.<sup>125</sup>

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<sup>123</sup> AT&T Stmt. 2.0 at 8-9.

<sup>124</sup> AT&T Stmt. 2.0 at 8 (citing Verizon Pennsylvania Inc.'s Tariff 216).

<sup>125</sup> AT&T Stmt. 2.0 at 8. The same holds true in a comparison between Verizon's alleged access costs and the UNE rates Verizon itself calculated as complying with the Commission's Tentative Order in Docket No. R-00016683. That comparison also shows that the access costs Verizon submitted in this case significantly overstate the forward-looking incremental cost of the relevant access functions. For example, Verizon's compliance filing of December 4, 2002 in

The comparison to current UNE rates also shows that the costs Verizon calculated for transport in this case are inflated. For example, Verizon's alleged cost of fixed transport for access is over **[BEGIN VZ PROPRIETARY]**

**[END VZ PROPRIETARY]** than the effective UNE rate of \$0.000144. And the cost that Verizon calculated for per mile transport is **[BEGIN VZ PROPRIETARY]** **[END VZ PROPRIETARY]** than the effective UNE rate of \$0.000003.<sup>126</sup>

Finally, the rates Verizon charges for local call termination – also known as reciprocal compensation, also show that the results of Verizon's access cost study are unreliable. As noted previously, Ms. Eichenlaub, the former Bell Atlantic witness, had also testified that “theoretically it makes sense for both local interconnection and switched access to be priced at the same level. . . .”<sup>127</sup>

However, the current rate for local call termination at an end office is just \$0.001723 per minute, a rate that is about over **[BEGIN VZ PROPRIETARY]**

**[END VZ PROPRIETARY]** of just the terminating local switching cost that Verizon calculated in this case.<sup>128</sup>

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Docket No. R-0016683 listed a rate for originating end office local switching of \$0.001606 per minute, and a rate for terminating end office local switching of \$0.001378. Both of these rates are lower than the currently effective UNE rates, meaning, of course, that the disparity described above between Verizon's calculations in this case are even more pronounced. AT&T Stmt. 2.0 at 9.

<sup>126</sup> AT&T Stmt. 2.0 at 8-9.

<sup>127</sup> Rebuttal Testimony of Catherine A. Eichenlaub, BA-PA Stmt. 5.1, Docket No. I-00940035, at 14.

<sup>128</sup> AT&T Stmt. 2.0 at 9-10.

In sum, this analysis vividly demonstrates the inherent inaccuracy in Verizon's access cost study. It also provides a benchmark for determining the true forward-looking cost of Verizon's switched access services. Dr. Oyefusi used the UNE rates that currently are in effect for Verizon in Pennsylvania, as well as those that Verizon calculated as being in compliance with the Tentative Order, to develop estimated access costs for Verizon. Those calculations resulted in an approximate access cost of **[BEGIN PROPRIETARY]** **[END PROPRIETARY]** per access minute of use (that is, for just one end of a call).<sup>129</sup>

The relevance of these calculations to this case is three-fold. First, this analysis demonstrates yet again that the cost study Verizon submitted in this case is an unreliable indicator of the cost of its carrier access services, and thus should be rejected by the Commission. Second, it shows that the "price floor" for access is much lower than Verizon would have the Commission believe it is, and thus that the rates for carrier access can be lowered much further than Verizon would prefer. And finally these estimates underscore the extent to which Verizon's current intrastate rates exceed Verizon's forward-looking incremental cost of providing carrier access services, demonstrating once again the necessity from reducing those rates.

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<sup>129</sup> AT&T Stmt. 2.0 at 10. Using the rates from the Tentative Order resulted in an even lower cost of **[BEGIN PROPRIETARY]** **[END PROPRIETARY]** per AMOU.

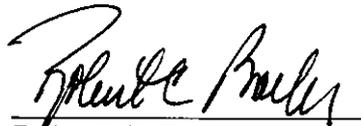
**CONCLUSION**

The record developed in this case provides the Commission with the opportunity to complete the essential work it commenced four years ago in the Global Order by finally and fully reforming Verizon's intrastate carrier access charges. The first step in that effort should be the expeditious approval and implementation of the access reductions proposed in the Verizon/OCA settlement. However, the Commission cannot and must not cease its efforts with the adoption of the Verizon/OCA proposal. Instead, utilizing this record, the Commission should establish a program for further reform that has as its objective the elimination of all of the bloat that afflicts Verizon's intrastate carrier access by bringing those rates at least down to interstate levels.

Respectfully submitted,

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Dated:           September 18, 2003

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Docket No. C-20027195

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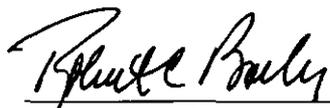
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REFER TO OUR FILE

September 18, 2003

James J. McNulty, Secretary  
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ORDER

Re: AT&T Communications of Pennsylvania, Inc.

v.

Verizon North, Inc.  
Docket No. C-20027195

Dear Secretary McNulty:

Enclosed for filing please find an original and nine (9) copies of the **Proprietary and Non-Proprietary** Versions of the **Main 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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PA PUBLIC UTILITY COMMISSION  
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BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

AT&T COMMUNICATIONS  
OF PENNSYLVANIA, INC.

v.

VERIZON NORTH, INC.

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DOCKET NO.  
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MAIN BRIEF  
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## I. STATEMENT OF THE CASE

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<sup>1</sup>, the Global Order of 1999<sup>2</sup> 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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<sup>1</sup> 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").

<sup>2</sup> 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.

## II. VERIZON'S ACCESS PROPOSAL

The Joint Petition filed by VZ-PA and VZN on December 30, 2002, proposed to restructure and reduce access charges by [ ] and to increase local residential exchange rates to make up the revenue shortfall. According to one of the two scenarios proposed by Verizon, the Carrier Charge ("CC")<sup>3</sup> would be reduced to zero for both companies and local residential exchange rates will have to be increased \$1.90 per month in both of the VZ-PA and VZN service territories.<sup>4</sup> Verizon states that this increase in local residential exchange rates is necessary to keep the Petition revenue neutral. Verizon Joint Petition, p. 6.

However, in the surrebuttal testimony of Debra M. Berry and Michael J. Wirl, Verizon announced the details of a Joint Proposal it had agreed to with OCA. 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

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<sup>3</sup> One component of access charges that Interexchange Carriers ("IXCs") pay is the CC. As recently as April 2003, the Commission defined the CC as 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. *See, Pennsylvania Public Utility Commission v. North Pittsburgh Telephone Company*, Docket No. R-00038087 (entered April 10, 2003) ("*North Pittsburgh Telephone*"), Order at p. 2. The CC was formerly known as the Carrier Common Line Charge ("CCLC"). The CCLC was designed to recover a portion of the cost of the local loop or "common line" through a "per minute" access charge component. In the *Global Order* the Commission directed Bell of Pennsylvania, Inc., GTE North and the other Incumbent Local Exchange Companies ("ILECs") to convert their CCLC to a flat rate "per line" CC on a revenue neutral basis. *See, Global Order*, pp. 23 & 34.

<sup>4</sup> Under the alternative scenario (Scenario 1), Verizon proposes that VZN's CC be reduced to the present VZ-PA rate, which would require an increase to local residential rates of [ ]. *See, Verizon St. 1.0, MJW-6.*

than 50% from the current consolidated rate, resulting in a total revenue decrease of approximately [            ]. 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.

### III. SUMMARY OF ARGUMENT

Under the guise of access reform, VZ-PA and VZN have proposed in this filing to restructure Local Transport and Local Switching rates so that these rates are the same for both companies. This effort is not objectionable as a concept. However, the Companies' original proposal (under Scenario 2) to completely eliminate the CC for both Companies and increase local residential exchange rates by \$1.90 is contrary to Commission precedent and would unfairly shift the cost of providing the local loop (currently being recovered by the CC) to local residential exchange customers. The CC can be effectively reduced without requiring residential local exchange customers to pay an additional \$1.90 per month. The IXC's, namely, AT&T, MCI and Qwest, support the Companies' original proposal to completely eliminate the CC for both Companies because this would allow them to have free unlimited access to the local loop. In fact, the ALJ and the Commission should order the IXC's to pay their own way.

The Companies' Joint Proposal with OCA to set the CC at \$.63 (the current level of the CC for VZ-PA) for both Companies is an improvement over the original proposal, in that it does not propose to completely eliminate the CC. However, even under the Joint Proposal, 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. Clearly this proposal should be rejected as well because the record indicates that IXC's access the local loop in order to initiate and terminate

their long distance calls. Consequently, they should pay their fair share of the costs of the local loop.

The Commission has previously found that it is appropriate for residential local exchange customers to pay approximately 74% of the cost of the local loop. Since the record indicates that these customers are paying in excess of this percentage under current rates, it is unfair to increase residential local exchange rates at this time. Instead, the CC should be set at \$1.20 per month per line in the territories of both VZ-PA and VZN. In addition, a separate CC should be established for VZ-PA, VZN, Intralata Toll Originating Responsibility Plan ("ITORP") and the IXCs. The establishment of CC rates of \$1.20 for both Companies will result in a small revenue increase for Verizon.

Verizon's claim that its access reduction proposal is virtually identical to the RTCC Settlement is totally without merit and should be rejected. In fact, the goals, objectives, methods and final proposed rates of the RTCC Settlement and the Verizon proposal are significantly different. Verizon's claim is simply a blatant attempt to obtain cover from the RTCC Settlement. Similarly, the cost study Verizon has provided in this proceeding is worthless because it includes unrealistic inputs.

Moreover, in order to properly implement this proposal, the Commission should order VZN to include a calculation to determine the CC for the IXCs, ITORP and VZN separately and include these rates in VZN's tariff in the manner that it is currently being provided by VZ-PA.

#### IV. ARGUMENT

##### A. CARRIER CHARGE

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*, p. 2. While most access charges are listed in the company's tariff as a "per minute" or "traffic sensitive" rate, the CC is based upon a "per line" or "non traffic sensitive" rate. The amount each IXC pays is based upon its proportional share of overall access minutes of use. *Global Order*, p. 19. VZ-PA apportions the total CC rate of \$0.88 per month per line to access and toll (both imputed and ITORP). Currently, the portion of the CC that the IXCs pay for access is \$0.63 per line per month for VZ-PA. VZ-PA Tariff No. 302, p. 247. The total CC for VZN is currently \$8.635 per line per month. VZN Tariff No. 9, Section 12, p. 3.<sup>5</sup>

In the Joint Proposal the Companies state that the CC should be set at \$0.63 per line per month for both VZ-PA and VZN. However, the record clearly indicates that the CC should be set at \$1.20 for both Companies to ensure that VZ-PA and VZN are properly compensated for the use of the local loop. As discussed below, the \$1.20 CC rate is supported by Commission precedent and sound telecommunications policy.

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<sup>5</sup> The Joint Petition does not identify the IXC and ITORP portions or the amount that should be attributed to VZN.

1. The Commission Has Consistently Identified The Local Loop As A Joint And Common Cost.

A local loop is the wire that runs from a telephone central office to a customer. The local loop is a joint and common facility that is used by customers to place and receive local calls, intraLATA toll calls, interLATA toll calls and interstate toll calls. The local loop is also utilized to provide premium services such as caller ID, call waiting and other services. OTS St. 1, p. 5. Significantly, the Commission has consistently determined that the local loop is a "joint cost." Moreover, the Commission has found that since the local loop is used by a variety of services, the cost of the local loop should be recovered from those services that use it. *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*"), Order at p. 82; *Pennsylvania Public Utility Commission v. Bell Atlantic Inc.*, Docket No. R-00963350 (entered December 16, 1996) ("*Bell Atlantic Order*"), Order at p. 23.

2. The Allocation Of Costs Of The Local Loop Recommended By OTS Is Reasonable.

OTS witness Joseph Kubas has testified that there should be a cost based access charge which is designed to recover a portion of the cost of providing a local loop. Since there are costs involved in the provision of local loops and toll

calls are carried over local loops, there should be a CC to recover a reasonable portion of the cost of providing local loops. OTS St. 1, p. 10. In this regard, the Commission has determined that 74% of the cost of the local loop should be recovered through local exchange rates. See, *Universal Service Order*, p. 85. Consequently, Mr. Kubas has testified that 26% of the cost of the local loop must be recovered from the other services that also use the local loop. OTS St. 1, p. 6. The remaining five services that use the local loop are: (1) interstate access; (2) intrastate toll; (3) ITORP; (4) intrastate access; and, (5) other services. Building upon the telecommunications policies discussed above, Mr. Kubas has testified that the remaining 26% of costs should be allocated to these five services based upon the following:

Since no Commission policy or order identifies how the remaining 26 percent should be recovered, I believe it appropriate to separate these five services into two groups to determine a reasonable portion of the cost of the local loop that should be recovered from each group. Group "A" would include interstate access and other services, and Group "B" would include intrastate access, ITORP and intrastate toll. Based on my experience and knowledge of the telephone industry, I believe that approximately half of the cost should be recovered from each group. Specifically, I recommended that Group "A" be allocated 12% of the cost of the loop and Group "B" be allocated 14% of the cost of the loop. I allocated slightly more than 50% to Group "B" because I believe that more people use intrastate toll service than interstate and "other" services.

OTS St. 1, p. 7.

Mr. Kubas has further testified that the 14% should be allocated to intrastate access, ITORP and Verizon toll service based upon the market share that

each service represents in the VZ-PA service territory.<sup>6</sup> Id. Significantly, by using these allocations, only 10% of the cost of the local loop would be recovered through the CC paid by IXCs, which is the access component currently designed to recover a portion of the cost of the local loop.

OTS<sup>6</sup> witness Mr. Kubas has testified that since the Companies did not provide a valid cost study in this proceeding which identifies the actual cost Verizon incurs to provide a local loop<sup>7</sup>, he used the cost data provided by Verizon in the recent Unbundled Network Element ("UNE") proceeding. See, Generic Investigation Re Verizon Pennsylvania Inc.'s Unbundled Network Elements Rates, Docket No. R-00016683 (entered November 4, 2002) ("*UNE Order*").

In order to determine the cost Verizon incurs to provide a local loop, OTS witness Mr. Kubas again used the cost data supplied in the *UNE Order* proceeding since Verizon did not submit a valid cost study in this proceeding. In that proceeding the cost of providing a 2 wire basic local loop was determined to be as follows: Density Cell 1 [ ]; Density Cell 2 [ ]; Density Cell 3 [ ]; and, Density

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<sup>6</sup> Based upon a response to an OCA interrogatory, the IXCs currently have 71.4% of the long distance market, VZ-PA has 25.2% and ITORP accounts for 3.4% of the long distance market in the VZ-PA territory. See, TS Ex. 1, Sched. 5. Based upon these proportions, IXCs should pay 10% (71.4% of 14 = 10%) of the cost of the local loop, VZ-PA should impute 3.5% (25.2% of 14 = 3.5%) of the cost of the local loop and ITORP should be allocated 0.5% (3.4% of 14 = 0.5%) of the cost of the local loop. See, OTS Ex. 1, Sched. 2.

<sup>7</sup> Verizon provided cost studies in this proceeding in an attempt to demonstrate that local exchange service is priced below cost. See, Verizon St. 2, 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 local loops to determine the cost of providing dial tone line service. However, as discussed earlier in this 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 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, *UNE Order*, p. 40.

Cell 4 [ ] per month. OTS St. 1, pp. 10-11. In order to determine the weighted average for both Companies on a combined basis, Mr. Kubas multiplied each of these costs times the percentage of lines in each density cell in both VZ-PA and VZN's service territory. This resulted in a weighted average cost of \$15.09 per month per line on a combined company basis. OTS Ex. 1, Sched. 1.

Mr. Kubas then determined that 10% of the cost of the local loop should be recovered from an intrastate CC. In this regard, 10% of the cost Verizon incurs to provide a local loop [ ]. However, in order to keep this filing revenue neutral, a CC of only \$1.20 per month per line should be established at this time. See, OTS Ex. 1, Sched. 2.

(a) Establishing A CC Rate Of \$1.20 Is Revenue Neutral.

Establishing a CC rate of \$1.20 per month per line in the VZ-PA service territory will produce [ ] in annual revenue. OTS Ex. 1, Sched. 3.

Establishing a CC of \$1.20 per month per line in the VZN service territory will produce [ ] in annual revenue. OTS Ex. 1, Sched. 3.

OTS witness Mr. Kubas has recommended that a CC of \$0.08 per month per line be paid by ITORP. As discussed earlier in this brief, he recommends that 0.5% of the cost of the local loop be recovered from ITORP. OTS Ex. 1, Sched. 2. Consequently, 0.5% of the cost Verizon incurs to provide a local loop is equal to \$0.08 per month per line, ( $\$15.09 \times 0.005 = \$0.08$ ). Establishing a CC of \$0.08 per month per line for ITORP in the VZN service territory will produce [ ]

in annual revenue. OTS Ex. 1, Sched. 3. The impact of Mr. Kubas' proposals from a revenue neutral standpoint, is a small revenue increase of \$38,000 for Verizon. OTS St. 1, pp. 19-20; OTS Ex. 1, Sched. 4.

In addition, Verizon is proposing to create access charges for Dedicated End Office Trunk Ports in this proceeding. These new rate elements will increase revenue by [            ]. See, Verizon Attachment B, Scenario 2. OTS witness Mr. Kubas has not objected to these new rate elements. OTS St. 1, p. 12.

- (b) A Separate Calculation Of The CC For IXC's, ITORP And VZN, Should Be Included In Future VZN CC Filings.

OTS witness Mr. Kubas has recommended that the ALJ and Commission require VZN to include, in future CC filings, a calculation to determine the CC for the IXCs, ITORP and VZN separately and include these rates in the VZN tariff, in a manner similar to the way it is currently being provided for VZ-PA. This information will enable the Commission and interested parties to determine the amount of the CC that should be recovered from or imputed to each provider of toll service. Also, since VZ-PA currently provides this information, it will be easier to compare the rates of both Companies. OTS St. 1, p. 20.

- 3. Residential Local Exchange Rates Should Not Be Increased In Order To Provide Access Charge Reductions.

Under Scenario 2 of the Companies' original proposal, local residential exchange rates would have increased by \$1.90 per month per line in order to recover the reduction to access charge revenue of [            ]. However, under the Joint Proposal with OCA, the increase to local residential exchange rates (on a

combined VZ-PA and VZN basis) would apparently be limited to \$1.00 per month per line and the total increase would not exceed \$40 million. Verizon St. 1.1, pp. 7-8.

Although the Joint Proposal to increase local residential exchange rates by a maximum of \$1.00 is certainly better than the original proposal to increase these rates by \$1.90, any increase to local residential exchange rates should be rejected at this time. The proposed increase to local residential exchange rates is being primarily driven by the extent of the reduction proposed for access charges. As discussed earlier in this brief, if the CC were set at \$1.20 the Commission would accomplish the dual goals of properly compensating VZ-PA and VZN for the IXCs use of the local loop and eliminating the need for an increase to local residential exchange rates, which are already set above cost.

In addition, both VZ-PA's and VZN's Chapter 30 Plans prohibit increases in local exchange rates without justification. For example, in VZ-PA's Chapter 30 Plan services provided by VZ-PA are grouped into various "market baskets." The Plan requires VZ-PA to provide "rational reasons" for implementing revenue neutral price changes between market baskets. See, Bell Atlantic Inc. Alternative Regulation Plan, Docket No. P-00930715, filed July 27, 1994, p. 11. (attached as Appendix "A" to this brief). In this regard, VZ-PA has failed to provide any rational reasons for shifting revenue from the "access charge" market basket to the "residential local exchange" market basket.

In VZN's Chapter 30 Plan local residential exchange service is considered a "protected service." As a protected service, VZN's Chapter 30 Plan requires cost support for increasing the rates of protected services. See, VZN Chapter 30 Plan, p. 13. (attached as Appendix "B" to this brief). In this regard, VZN has not provided valid cost support which would justify increasing rates for a protected service such as local residential exchange service.<sup>8</sup>

4. AT&T, MCI And Qwest's Support For Elimination Of The CC Is Profit Driven And Should Be Rejected.

Not surprisingly AT&T, MCI and Qwest<sup>9</sup> have expressed support for Verizon's original proposal (under Scenario 2) to eliminate the CC for both VZ-PA and VZN. See, AT&T St. 1.0, p. 6; Qwest St. 1.0, p. 5; MCI St. 1.0, p. 38. Quite simply, AT&T and MCI view the possibility of access reductions as an opportunity to save money and increase profits. Eliminating the CC will allow AT&T and MCI to have unlimited use of the local loop to originate and terminate toll traffic. OTS witness Mr. Kubas has testified that the amount of money that

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<sup>8</sup> The proposed increase to local residential exchange rates may also be limited by 66 Pa. C.S. §1325(a). The relevant portion of this subsection states "[i]n no event shall the public utility be granted an increase in local exchange rates which is greater than the overall average percentage increase in total intrastate revenues authorized by the commission unless the utility proves by record evidence that a greater percentage increase for local exchange service is justified based upon the cost of providing that service." As discussed above, the Companies have failed to demonstrate that local exchange rates are currently priced below cost.

<sup>9</sup> The comments in this brief concerning AT&T and MCI's positions in support of the elimination of the CC, apply equally to Qwest. Actually, Qwest's support for the elimination of the CC is particularly cynical because Qwest operates as an ILEC in certain western states and recovers a CC in certain of those states. Tr. 383-386. Qwest has also argued that intrastate access charges should be lowered to the level of interstate access charges because the current differences invite toll providers to misreport intrastate traffic as interstate traffic. Qwest St. 1, p. 14. However, the temptation to misreport revenue 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 difference. 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. Accordingly, Qwest's claims should be rejected.

the companies will save depends upon the market share for each company. Since Mr. Kubas is not aware of specific market share data, he relied upon nationwide market share data obtained from TNS Telecoms to determine the market share of each company in Pennsylvania.<sup>10</sup> Based upon this analysis, AT&T and MCI have about 33% and 16%, respectively, of the interLATA intrastate long distance market in Pennsylvania. OTS St. 1-SR, p. 3.

Based upon the TNS Telecoms estimates, if both VZ-PA and VZN's CCs are eliminated, it appears that AT&T will save approximately [            ]. In regard to MCI, it appears that it will save approximately [            ]. OTS St. 1-SR, p. 3. These significant potential savings are driving these companies to support the elimination of the CCs for VZ-PA and VZN without regard to any increases that may be added to residential local exchange rates in order to account for the revenue shortfall.

The justifications for this blatant "money grab" bear witness to the desperate desire of these IXCs to increase their profits. For example, in rebuttal testimony AT&T witnesses Robert J. Kirchberger and E. Christopher Nurse state that the elimination of the CC is long overdue and, referring to page 60 of the *Global Order*, state "[i]n fact, the Commission 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." AT&T

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<sup>10</sup> Data was obtained from the TNS Telecoms website at <http://www.tnstelecoms.com/press-1-7-03.htm>.

St.1.0, p. 9. In fact, the "Carrier Pool" is the name that was given to the Universal Service Support mechanism in the *Global Order*. See, *Global Order*, p. 142. All telecommunications providers pay into the Carrier Pool fund so that customers with high local exchange service bills served by small ILECs can receive a credit on their bill. OTS St. 1-SR, p. 4. In contrast, the CC is a per line access charge designed to recover a portion of the cost of the local loop. OTS St. 1, p. 3.

It is difficult to imagine that the AT&T witnesses are not aware of the differences between the CC and the Carrier Pool. A review of their biographical information indicates that they have testified in numerous telecommunications proceedings in Pennsylvania and other jurisdictions. See, AT&T St. 1.0, pp. 1-3. In fact, the attempted deception is so amateurish that even a casual reader is led to the inevitable conclusion that these witnesses believe either that this Commission is too incompetent or too inattentive to realize the difference. In any event, it is clear that AT&T is attempting to support its position to eliminate the CC by confusing the two terms since the Commission has never indicated that the CC should be eliminated for any ILEC. Tr. 166-167.

The AT&T witnesses also demonstrate their desperation when they argue that the CC "has absolutely no basis in the cost of providing carrier access services." They also state that the CC remains "a pure subsidy element with no basis whatsoever in the ILEC's actual cost of originating or terminating long distance calls." AT&T St. 1.0, p. 28. Similarly, MCI witness Michael D. Pelcovits has testified that access services do not result in any incremental cost,

thus the entire cost of the local loop should be charged to residential local exchange customers. MCI St. 1.0, p. 38.

However, the claims that the CC has no cost basis are not supported by Commission policy and precedent. Contrary to AT&T and MCI's claims, the Commission has consistently found that the local loop is a joint cost which is used in the provision of intrastate toll service. See, Bell Atlantic Order, p. 23. In fact, as recently as April 2003, the Commission determined that the CC does have a cost basis by defining the CC as 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. See, North Pittsburgh Telephone, p. 2.

As demonstrated above, the record indicates that the IXC's claims in support of the complete elimination of the CC for VZ-PA and VZN are not supported in law or fact. Accordingly, their arguments should be rejected.

## B. COMPARISON TO RTCC PLAN

### 1. The Verizon Access Reduction Proposal Is Significantly Different From The RTCC Plan.

Verizon claims that its access charge proposal should be approved by the Commission as filed because it is "modeled upon and virtually identical in substance to the RTCC Settlement proposal filed with the Commission on December 16, 2002." Joint Petition, p. 1. Moreover, Verizon witness Ms. Berry states "[t]he public advocates, such as OCA and OTS, despite the fact that they are actively supporting an identical proposal for revenue neutral access reductions and

rate increases for virtually every other ILEC in Pennsylvania, insist that the Verizon companies should be singled out and denied revenue neutral offsets." Verizon St. 1.0, p. 19.

In fact, the two proposals are significantly different. For example, in the RTCC Settlement, all of the companies propose to reduce intrastate traffic sensitive rates to or towards interstate traffic sensitive rates. Tr. 151. In addition, the RTCC Settlement does not contain any switched access increases or any new switched access charges. Tr. 152. In contrast, Verizon witness Ms. Berry has acknowledged that Verizon is applying the current VZ-PA local transport switching rates in the VZ-PA territory to the VZN service territory and creating new switched access rates under its proposal. Tr. 151-152.

Moreover, if the proposals are virtually identical, the rates should be the same or at least similar. However, when asked in an interrogatory to provide a comparison of the rates in the two proposals to demonstrate this similarity, Verizon witness Ms. Berry states that Verizon is unable to provide such a comparison because no rates were proposed in the instant filing. See, OTS Ex. 1, Sched. 7. Significantly, proposed rates were provided in connection with the RTCC Settlement. In this regard, the average weighted CC for all of the RTCC companies was reduced from \$7.00 per month per line to \$5.21 per month per line. OTS St. 1, p. 23. In contrast, Verizon originally proposed in this proceeding to completely eliminate the CC for both Companies. In fact, the initial proposal to eliminate the CC is significant because Verizon witness Ms. Berry has admitted

under cross examination that the Commission has never approved the elimination of a CC for any company. Tr. 166-167.

There is also a significant difference between the proposed increases in residential local exchange service rates in the two proposals. Under the RTCC Settlement, after the CCs were increased, both residential and commercial local exchange rates were to be increased. This excess revenue was then to be used to reduce the CC. OTS St. 1, p. 23. However, Verizon initially proposed in this proceeding to eliminate the CC and recover the entire revenue shortfall by only increasing residential local exchange rates. This proposal has apparently been modified by the Joint Proposal with OCA; however, it demonstrates the different approaches taken by the RTCC and Verizon. The obvious differences in approach led OTS witness Mr. Kubas to state "the goals, objectives, methods and final rates of the RTCC proposal were much different than the goals, objectives, methods and final rates proposed by Verizon in this Petition." OTS St. 1, p. 24.

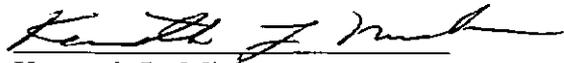
Moreover, the record indicates that if Verizon's plan was truly identical to the RTCC Settlement, the CC would be higher (in all circumstances) than the \$1.20 CC OTS witness Mr. Kubas has proposed for VZ-PA and VZN. For example, if Verizon's CC was made identical to the weighted average CC in the RTCC Settlement, Verizon's CC would be \$5.21 per month per line for both VZ-PA and VZN. On the other hand, if Verizon's CC was made identical to Sprint's CC, it would be increased to \$7.62 per month per line for both Companies. Further, if Verizon's CC was made identical to the lowest CC rate in the RTCC

Settlement, it would be \$1.22 per month per line for both Companies. OTS St. 1, p. 26. This comparison demonstrates both the reasonableness of the \$1.20 CC in comparison to the RTCC rates and that Verizon's claim that its proposal is identical to the RTCC Settlement is false and should be rejected.

V. CONCLUSION

For the reasons stated herein, the positions asserted by OTS witness Mr. Kubas 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 18, 2003

**Appendix "A"**

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Bell Atlantic - Pennsylvania,	)	
Inc.'s Petition and Plan	)	Docket No. P-00930715
for Alternative Form of Regulation	)	
Under Chapter 30	)	

BELL ATLANTIC - PENNSYLVANIA, INC.'S  
ALTERNATIVE REGULATION PLAN  
(modified in compliance with the Commission's  
Opinion and Order entered June 28, 1994)

D. Michael Stroud  
James G. Pachulski  
Julia A. Conover  
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Dated: July 27, 1994

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BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Bell Atlantic - Pennsylvania, )  
Inc.'s Petition and Plan ) Docket No. P-00930715  
for Alternative Form of Regulation )  
Under Chapter 30 )

BELL ATLANTIC - PENNSYLVANIA INC.'S  
ALTERNATIVE REGULATION PLAN

Executive Summary

This Plan for an Alternative Form of Regulation ("Plan") sets forth a new regulatory framework for Bell Atlantic - Pennsylvania, Inc. (Bell or the Company). It is designed to replace the out-moded rate base/rate of return regulatory scheme that has been in place during the last century with a progressive regulatory framework that will accommodate the competitive and technological explosion occurring in the telecommunications industry.

Bell's Alternative Regulation Plan has three principal components: (1) a price stability mechanism (PSM) for noncompetitive services; (2) a competitive services deregulation plan (CSP) together with an initial request for competitive service classification; and (3) a network modernization implementation plan (NMP). The last part of the Plan sets forth additional commitments and obligations regarding such issues as quality of service and privacy. These parts of Bell's Plan are interrelated and interdependent with one another.

Part 1 of the Plan is the price stability mechanism that governs revenue changes for noncompetitive services for the duration of the Plan. The PSM caps protected service rates (e.g., residential and business local exchange and special and switched access rates until December 31, 1999) and limits price changes thereafter. It also constrains noncompetitive service price changes based on an independent inflation index and Commission review, provides for Commission approval of revenue neutral tariff rate adjustments and maintains discounts for disabled customers.

Part 2 of the Plan is the competitive services deregulation plan that provides for the deregulation of the rates and earnings of competitive services, but preserves the Commission's authority over the quality of these services. In addition, the CSP contains stringent safeguards to protect competitors from abuses and to insulate basic ratepayers from the economic risks of competitive services. As part of this Plan, six services are classified as competitive: Billing Services; Directory Advertising; Centrex; Paging; Repeat Call; and Speed Calling.

Part 3 of the Plan is the network modernization implementation plan which describes the Company's commitment to provide universal broadband availability by December 31, 2015. The NMP also describes the Company's plans for reasonably balanced deployment of its broadband network among rural, urban and suburban areas within its service territory and for deployment of broadband facilities in or adjacent to public

rights-of-way abutting public schools, industrial parks and health care facilities.

Part 4 of the Plan describes the Company's ongoing obligations and commitments regarding quality, safety, adequacy, reliability and privacy of telecommunication services and other services or business activities. It also describes the reports that Bell will file with the Commission under the Plan.

## PART 1 - PRICE STABILITY MECHANISM FOR NONCOMPETITIVE SERVICES

**Overview:** The price stability mechanism restrains revenue increases resulting from tariff rate changes for noncompetitive services. The PSM allows total annual revenues from noncompetitive services to increase from the previous year's total revenues from noncompetitive services as a result of tariff rate changes based on the annual change in the Gross Domestic Product Price Index ("GDP-PI"), as calculated by the United States Department of Commerce, less 2.93 percent. In years when the annual change in the GDP-PI is less than 2.93 percent, the Company must file tariff changes to reduce its revenues from noncompetitive services.

The PSM also contains special provisions for protected services. First, it caps protected service rates, such as residential and business local exchange and special access rates, until December 31, 1999.<sup>1</sup> Second, after December 31, 1999, the PSM limits the annual revenue increase from protected services' tariff rate changes to the change in the GDP-PI less 2.93 percent. Finally, when the annual change in the GDP-PI is less than 2.93 percent, protected services revenues must be reduced through tariff rate changes by a pro-rata share of the revenue reduction required for all noncompetitive services.

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<sup>1</sup> In accordance with 66 Pa. C.S.A. § 3007(2), the Plan prohibits switched access rate increases until December 31, 1999, unless Bell can show that, absent an increase, total switched access revenues would be below total switched access cost.

All tariff filings for noncompetitive services under the PSM will be subject to Commission review under 66 Pa. C.S.A. § 1308.

**A. Price Stability Mechanism (PSM) Features**

1. The PSM is based upon Bell's rates in effect on October 1, 1993, as the starting point for rate caps and authorized and required rate changes.

2. The PSM caps revenue increases resulting from tariff rate changes for noncompetitive services. Each year, Bell will calculate its cap --i.e., Price Change Opportunity -- under the following price stability formula:

$$\text{Price Change Opportunity} = \text{Revenues X (GDP-PI - 2.93\%)}$$

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Price Change Opportunity = Authorized annual decrease or increase to be implemented through tariff rate changes for noncompetitive services.

Revenues = Intrastate noncompetitive service revenue amount billed by Bell for the twelve month period corresponding to the twelve month period in the annual change in the GDP-PI.

GDP-PI

= The percentage annual change in the Gross Domestic Product-Price Index based upon the most recent quarterly release of the U.S. Department of Commerce.

If the Price Change Opportunity calculated for the year is positive, Bell may file tariff rate changes for noncompetitive services to recover up to the amount of the Price Change Opportunity for that year or may elect to forego any or all recovery of the Price Change Opportunity for that year. If the Price Change Opportunity for the year is negative, Bell must file tariff rate changes to reduce its revenues by an amount equal to that year's Price Change Opportunity.

3. Within a reasonable time frame after Bell's Plan becomes effective, and within 60 days of the anniversary date thereafter, Bell shall file with the Commission its proposal to implement any required or authorized Price Change Opportunity. The proposal shall include:

- a. The percentage annual change in the GDP-PI based upon the most recent quarterly release;<sup>2</sup>
- b. The calculation GDP-PI minus 2.93%;

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<sup>2</sup> If the Department of Commerce should stop releasing the GDP-PI during the term of the Plan, then, subject to Commission approval, Bell will substitute an alternative index and make any adjustments to the formula necessary to keep it as close to the current formula as possible.

c. The Price Change Opportunity for that year, as calculated under the price stability formula; and

d. If the Price Change Opportunity for that year is positive, proposed tariff rate changes that would increase noncompetitive service revenues by an amount that is less than or equal to the Price Change Opportunity. If the Price Change Opportunity is negative, proposed tariff rate changes that would decrease noncompetitive service revenues by an amount equal to the Price Change Opportunity.

4. Bell's tariff rate change proposals shall be subject to Commission review under 66 Pa. C.S.A. §1308. The proposed tariff rates will be effective within 60 days of filing, subject to refund investigation and recoupment, except if the proposed increase constitutes a "general rate increase." The Commission shall review Bell's tariff rate change proposals to determine whether they are designed to produce revenue changes that comply with the PSM. If the Commission determines that the Company's rate proposals do not comply with the PSM, the Commission may modify them to produce the revenues authorized by the PSM. If the Company's proposals comply with the PSM, the Commission may review the individual price levels proposed by the Company and may modify them on a revenue-neutral basis.

5. Bell shall not be required or authorized to decrease a tariff rate which is at or below incremental cost or results in a price below incremental cost.

6. Bell also reserves the right to forego any tariff rate increases permitted under the PSM.

7. Bell may also propose tariff rate decreases on 30 days notice, that do not result in tariff rates below incremental costs, at any time.

8. Notwithstanding any other limitation specified in the PSM, Bell, the Commission Staff, the Office of the Consumer Advocate or the Small Business Advocate may request the Commission to make special revenue adjustments beyond the scope of the PSM that are limited to mechanical regulatory events bearing only on local exchange carriers and may include only changes resulting from: (1) jurisdictional shifts where costs are transferred to or from the interstate jurisdiction and where an equal and opposite exogenous adjustment was allowed by the Federal Communications Commission under its price cap system; and (2) limited regulatory accounting changes not initiated by Bell.<sup>3</sup>

#### **B. Price Protections for Protected Services**

1. For purposes of this PSM, protected services are grouped into the following four categories:

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<sup>3</sup> The burden of proof in requiring such a revenue adjustment is on the party proposing the change. Any adjustment to revenues must be determined by allocating the total company impact of the underlying event between interstate and intrastate jurisdictions and between competitive and noncompetitive services. An application to the Commission for such a change must be filed with sixty (60) days notice. Bell will file tariffs to implement any approved revenue changes.

a. **Residential Local Exchange Services:** residential dial tone line, local usage, touch tone, and the associated ordering, installation, restoration and disconnection charges, as specified in Appendix 1-1.

b. **Business Local Exchange Services:** business dial tone line, local usage, touch tone, and the associated ordering, installation, restoration and disconnection charges, as specified in Appendix 1-1.

c. **Switched Access Services:** switched access services and the associated ordering, installation, restoration and disconnection charges as specified in Appendix 1-1.

d. **Special Access Services:** special access services and the associated ordering, installation, restoration and disconnection charges as specified in Appendix 1-1.

Subject to Commission approval, Bell retains the right to grandfather or withdraw any service except for the residential budget usage option, Link-Up America and Lifeline service.

2. Rates for services within the protected service categories of Residence Local Exchange Services and Business Local Exchange Services shall not be subject to PSM increases through December 31, 1999.<sup>4</sup> Rates for services within the Special Access Services protected service category shall not be subject to PSM increases through December 31, 1999, unless, absent an increase, total Special Access Services revenues would be below total Special Access Services costs. Rates for services within the Switched Access Services protected service category shall not be subject to PSM increases through December 31, 1999,

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<sup>4</sup> This provision does not apply to DTL cell and/or rate group reclassification filings made pursuant to Bell's Tariff, Pa. P.U.C. No. 180A, Section A.2-3.

unless, absent an increase, total Switched Access Services revenues would be below total Switched Access Services costs.

3. After the period of prohibited price increases described in Section B.2., Bell will apply the price stability formula described in Section A.2. to all protected services revenues to determine the Price Change Opportunity for protected services. If the Price Change Opportunity is positive, Bell may propose tariff rate changes to increase revenues for protected services by no more than the Price Change Opportunity for all protected services. In addition, for Residential Local Exchange Services and Business Local Exchange Services provided to small businesses with three (3) or fewer lines, revenue increases from tariff rate changes are limited to the lesser of (a) GDP-PI less 2.93 percent; or (b) the overall average percentage increase in total noncompetitive service revenues proposed by Bell pursuant to the PSM. If the Price Change Opportunity is negative, Bell must propose tariff rate changes that permit protected services to bear a pro-rata share of the required revenue reduction. However, Bell is not required or authorized to propose any tariff rate reduction that would reduce an individual service price below its incremental cost.

4. The carrier common line revenue cap, as provided for under the Commission's Opinion & Order in Docket No. R-842779,

entered on February 24, 1988, will continue in effect through the term of the PSM.

5. Subject to Commission review and approval, Bell may propose to change the classification of any protected service to a competitive or noncompetitive service.

**C. Revenue Neutral Changes**

1. Notwithstanding any other limitations specified in the PSM, upon notice and subject to Commission hearing and review, Bell may propose revenue neutral adjustments to the rates of its noncompetitive services. Revenue neutral adjustments will be proposed in tariff filings for Commission review under 66 Pa. C.S.A. § 1308. Bell is permitted to effect revenue neutral price changes within each market basket of services, which market baskets of services shall consist of: Residential Local Exchange; Business Local Exchange; Special Access Services; and Switched Access Services; and all other non-competitive services. To the extent that Bell can supply rational reasons as to why the foregoing restriction is not feasible or advisable from a public policy standpoint, Bell may also propose an alternative revenue neutral price change tariff filing that provides for reductions in one market basket to be recovered from services included in other market baskets, which filing would be supplementary to and

not in lieu of the revenue neutral price change tariffs for each market basket.

2. Bell may propose revenue neutral tariff rate changes and restructures to implement the results of the Commission's evaluation of the consistency of Bell's intrastate access tariff rates and structures with its interstate access service tariff pursuant to 66 Pa. C.S.A. § 3007(3). Rate changes and restructures for access services submitted in accordance with this paragraph are subject to Commission approval, after notice and hearing. No rate change or restructure shall be approved if it constitutes or promotes unfair competition.

3. Bell will propose revenue neutral tariff rate changes to implement a Lifeline program for residential customers who are eligible for Bell's Link Up America program. Rate changes submitted in accordance with this paragraph are subject to Commission approval.

**Appendix "B"**

IN THE COMMONWEALTH OF PENNSYLVANIA  
BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Petition of GTE North, Inc. :  
For Alternative Regulation and : Docket No. P-00981449  
Plan for Network Modernization :

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**FINAL  
ALTERNATIVE REGULATION PLAN  
OF  
VERIZON NORTH INC.**

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Dated: Finalized In Compliance with PA PUC Orders Entered July 26, 2001 and April 11,  
2002 and revised On October 10, 2002.

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## EXECUTIVE SUMMARY

This Alternative Regulation Plan ("Plan") introduces a state-of-the-art telecommunications network in Verizon North Inc.'s ("Verizon North" or "the Company") service territory and also provides a new regulatory framework for the Company. It is designed to entirely replace rate base/rate of return regulation and procedures, allowing Verizon North, like many other providers throughout the Commonwealth, to operate under a more efficient and flexible regulatory framework, while continuing to provide consumer and competitive safeguards. Verizon North will deploy an advanced broadband network which will enable the provision of advanced telecommunications services to benefit the disabled by facilitating interaction with the rest of society.

The commitments set forth in this Plan augment those set forth in the July 29, 1999 Memorandum of Understanding ("MOU") between Bell Atlantic - Pennsylvania, Inc., GTE North, Incorporated (now Verizon North) and the Pennsylvania Office of Attorney General, and adopted by the Pennsylvania Public Utility Commission ("Commission") in approving the Verizon parent level merger.

The Plan has four principal components: (1) a Network Modernization Plan ("NMP"); (2) a Competitive Services Deregulation Plan ("CSP"); (3) a Price Stability Plan ("PSP") for Noncompetitive Services; and (4) commitments regarding quality, safety, adequacy and reliability of service. These four parts of the Plan are interrelated and dependent upon one another.

Part 1 of the Plan is the Network Modernization Plan, which describes the Company's commitment to provide universal broadband availability by December 31, 2015.

Part 2 of the Plan is the Competitive Services Deregulation Plan, which allows for the deregulation of the rates and earnings of competitive services, but preserves Commission authority over the quality of these services. In addition, the CSP contains safeguards to protect competitors and basic ratepayers.

Part 3 of the Plan is the Price Stability Plan, which governs price changes for noncompetitive services for the duration of the Plan. The PSP constrains noncompetitive service price changes, based on an independent inflation index and Commission review.

Part 4 of the Plan describes Verizon North's ongoing obligations and commitments regarding quality, safety, adequacy and reliability of telecommunications services and other business activities. It also describes the reports that the Company will continue to file with the Commission. Finally, Part 4 describes the term of the Plan.

## PART 1. NETWORK MODERNIZATION PLAN

### A. Introduction

1. The Company's Network Modernization Plan ("NMP") sets forth the Company's plans to accelerate the modernization of its network, leading to universal broadband availability by December 31, 2015.<sup>1</sup>

2. The NMP explains Verizon North's plans to evolve today's network to provide the levels of bandwidth necessary to support broadband service delivery.<sup>2</sup> Verizon North's evolution to a broadband network will also involve continuing deployment of technologies to economically enhance the central office, signaling, inter-office trunking and distribution plant components of the network. The exchanges within Verizon North's service territory are classified hereunder as either urban or rural according to Attachment A attached hereto and made a part of this Plan.

3. Verizon North expects primarily to rely initially on xDSL technology as the means of providing broadband services to end users, but Verizon North may utilize other existing and future technologies as circumstances may warrant or permit. Verizon North may modify its implementation plans in keeping with broadband availability commitments. The NMP, therefore, does not require the Company to use any specific technology. This Plan does not supercede or modify, in any way, the commitments or obligations made in the Memorandum of Understanding between Verizon North and the Pennsylvania Office

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<sup>1</sup> Absent exceptional circumstances, which circumstances shall be set forth in a petition to the Pennsylvania Public Utility Commission ("Commission"), with all Chapter 30 parties in this proceeding being given notice and the opportunity to respond, and subject to Commission approval.

<sup>2</sup> Where a deployment target is stated in this Plan on the basis of a calendar year, progress to the target shall be measured at the end of that year.

of Attorney General or the Commission's Order(s) regarding the merger of Bell Atlantic and GTE North, Inc.

**B. Digital Switching, Intelligent Network Signaling, Interoffice Trunking and Distribution Facilities**

**1. Digital Switching**

Verizon North already has met the spirit of Chapter 30 by aggressively converting its central office facilities to digital technology. Verizon North's network currently utilizes 100% digital switching technology. Switching elements will be enhanced as required throughout the life of the NMP to meet the evolving demands of service delivery.

**2. Intelligent Network Signaling Capability**

(a) One step in the progression of Verizon North's network is intelligent network signaling capability. This service capability allows telephone companies to provide a variety of call management and call processing services.

(b) Approximately 92% of Verizon North's access lines are already served by intelligent network signaling as of June 30, 2000.

(c) CLASS services will be provided in accordance with the MOU. Specifically, CLASS services shall be made available to 80-85% of Verizon North's access lines that do not have these services within 18-24 months of the date of the consummation of the merger. CLASS services to the remaining Verizon North access lines will be made available no later than six (6) months thereafter.

### 3. Interoffice Trunking

(a) The Company's commitment to universal broadband availability is dependent upon the deployment of broadband capable facilities in its interoffice network. Without this capability in these components of its network, it is not possible to make broadband service universally available. Verizon has already made substantial progress in deploying broadband capability in its interoffice telecommunications network. Verizon currently operates 194 interoffice routes, 153 of which are connected by fiber optic facilities and carry approximately 94% of all interoffice traffic as of June 30, 2000.

(b) Verizon North projects that all interoffice facilities will be transported on fiber optic systems by year-end 2005 in accordance to the following schedule as measured by the percentage of individual T1 circuits working on fiber in the Verizon North interoffice trunking ("IOF") network:

	Present	2002	2004	2005
Fiber IOF Circuits	94.3%	95%	99%	100%

### 4. Broadband Distribution Facilities

(a) The deployment of broadband capability in the distribution network is essential to making broadband services available. For the purpose of this Plan, "broadband capability," "broadband facilities" and "broadband service" are defined as providing or using a bandwidth of 1.544 megabits per second or greater.

(b) Verizon North will deploy broadband capabilities in its distribution network as described in this sub-part. Verizon North expects xDSL technology to be the primary initial means to provide broadband services to end-users. Verizon North may

utilize other existing and future technologies as circumstances may warrant or permit. Verizon North may modify its implementation plans in keeping with broadband availability commitments. The following schedule is the minimum deployment rate of broadband capability that Verizon North will provide, measured as a percentage of access lines that are broadband capable:

	Present	2005	2010	2015
Broadband Availability	22.8%	35%	65%	100%

(c) Verizon North shall reasonably balance deployment of broadband capabilities in its distribution network between urban and rural areas within its service territory. Presently, over 90% of the Company's DSL lines are deployed in urban areas. The Company shall satisfy its obligation to reasonably balance future deployment under Chapter 30 by narrowing the difference between rural and urban broadband deployment as the Plan is implemented.

(d) Verizon North will deploy broadband facilities to public schools, industrial parks and health care facilities within five (5) days of request.

### **C. NMP Reports**

1. The Company will submit an initial NMP report regarding the status of broadband deployment on March 31, 2003, and every two years thereafter. The Company will file an Interim Status Report on or before September 30, 2002. The reports filed will comply with the Commission's directives contained in the Orders

approving this Plan. Absent exceptional circumstances, as set forth in footnote 1 above, Verizon North will meet or exceed its commitment schedule.

## **PART 2 - COMPETITIVE SERVICES DEREGULATION PLAN**

The Company's Competitive Services Deregulation Plan ("CSP") allows for the price and earnings deregulation of any services at all or some locations, which have been, or may be, found by the Commission to be competitive. An initial group of services is addressed below. The Company may submit future requests, however, to classify other services as competitive and may request competitive classification, upon sixty (60) days' notice, for services and/or locations that are found to be competitive for other companies for similar services.

### **A. Competitive Services**

1. The following services are currently deregulated and are classified as competitive under this Chapter 30 Plan: customer premises equipment; inside wire; and voice mail. Tariffs are not required and will not be required for these services.

2. The following additional services are declared competitive for Verizon North: directory advertising; intrastate billing and collection; Centranet; speed call; last number redial; and toll services. The Company will file informational tariffs for these services. For toll services, Verizon North will file tariffs as required by the Commission for interexchange carriers. Existing or new route specific optional calling plans maintained for compliance with the Commission's EAS regulations are not a competitive service.

3. Services not deemed to be competitive under this Plan are classified as "noncompetitive" for purposes of the Price Stability Plan.

4. Competitive services are not to be regulated on any basis, including rates, rate structures, rate base, rate of return or earnings. The Commission will retain its existing general authority over competitive services for the purpose of safety, adequacy and reliability under 66 Pa. C.S. §1501, et seq. Verizon North will continue to monitor service quality standards as set forth in 52 Pa. Code §63.56.

5. When the Company requests that new or existing services be classified as competitive, a sixty (60) day notice procedure shall be followed. The public shall be notified by general newspaper notice, billing insert or bill message. Such request for competitive classification shall be served in hand upon the Office of Trial Staff, the Office of Consumer Advocate, the Office of Small Business Advocate, all intervenors in this Chapter 30 proceeding and any other person as directed by the Commission's Secretary on the day of filing with the Commission. Any complaint or comment in support of, or opposition to, the proposed classification shall be filed with the Commission within twenty (20) days of the original filing. The Company may respond within ten (10) days thereafter. The Commission shall enter an Order within one hundred eighty (180) days of the filing date concerning the service's competitive status; otherwise, the service shall be deemed to be competitive.

6. In the event that the Commission declares a service to be competitive in another company's Chapter 30 proceeding or subsequent filing, such declaration shall then also be applied as a rebuttable presumption in any proceeding filed by the Company requesting that the same or similar service be declared to be competitive under Chapter 30, so long as the markets are substantially similar.

**B. Statutory Protections**

1. The Company shall meet the requirements of Chapter 30 with respect to services deemed to be competitive. 66 Pa. C.S. §3005(e)(1) and (2).

2. By operation of the PSP, the revenues earned and expenses incurred for any noncompetitive service will not cross-subsidize or support any competitive service; therefore, this Plan is in compliance with the requirements of 66 Pa. C.S. §3005(g)(2).

3. There is no cross-subsidy between services when the price charged for each service covers its incremental cost. Incremental cost shall be defined as forward-looking costs directly attributable to the specified service. The price for each of the Company's services deemed to be competitive shall cover its incremental cost. Such cost documentation will be provided only under appropriate proprietary protection.

4. Verizon North will perform its own cost studies in order to comply with competitive costing and pricing safeguards and will share those studies with intervenors under appropriate proprietary agreements.

5. Tariffs or price lists may be required to be filed by the Company for future competitive services under 66 Pa. C.S. §3009(f).

6. Formal challenges to the Company's compliance with the provisions of the CSP can be made only through separate complaint procedures. Any competitor or other party who believes the Company has violated any of the provisions of this CSP may file a complaint with the Commission. That party, however, bears the burden of proof under 66 Pa. C.S. §332(a). The Commission retains the right to institute proceedings on its own motion, and the Company shall have the burden of proof in those proceedings.

### **PART 3 - PRICE STABILITY PLAN FOR NONCOMPETITIVE SERVICES**

The Company's Price Stability Plan ("PSP") sets forth the principles and procedures applicable to changes in the Company's rates for noncompetitive services.

The PSP procedures specify the allowable change (increase or decrease) in rates for noncompetitive services, equal to the annual change in the Gross Domestic Product Price Index ("GDP-PI"), as calculated by the United States Department of Commerce, less an inflation offset and adjusted for any exogenous events. The Company's inflation offset shall be 2.5%. The PSP also addresses revenue neutral rate rebalancing/restructuring and the introduction of new services.

The PSP in this Chapter 30 Plan is in complete replacement of rate base/rate of return regulation for the Company and is the exclusive basis upon which the Company's noncompetitive rates and services will be regulated, upon implementation of this Plan. All tariff filings for noncompetitive services are subject to review under the terms of this Plan. Noncompetitive services are those services that are not declared to be competitive.

#### **A. Price Stability Mechanism ("PSM")**

1. The Price Stability Index ("PSI") is based upon the Company's rates in effect on the date this Final Plan becomes effective, as a starting point. Those rates are just, reasonable, nondiscriminatory and otherwise fully in compliance with all Pennsylvania laws.

2. Annually the Company will calculate the PSI as follows:

$$PSI_t = PSI_{t-1} \times [1 + \% \Delta \text{ GDP-PI} - 2.5\% \pm Z]$$

When:

$PSI_t$  = The new maximum change in price for the noncompetitive service category for the current twelve month period.

$PSI_{t-1}$  = The current maximum change in price for the noncompetitive service category for the previous twelve month period.

$\% \Delta$  GDP-PI = The percent change in the Gross Domestic Product Price Index<sup>3</sup> based on the most recent quarterly data available at the time of the annual PSI filing and the corresponding quarter of the previous year.

Z = The effect of any exogenous changes. Exogenous changes are positive or negative changes in the Company's revenues or expenses as defined in the Plan. In the calculation of the PSI, exogenous changes are expressed as a percentage of the Company's revenue received from intrastate, noncompetitive services.

2.5% = Inflation offset.

3. The Service Price Index ("SPI") tracks the actual total price changes for noncompetitive services. The SPI may not exceed, on a total intrastate basis, the PSI, except as otherwise expressly provided in this Plan.

4. The SPI shall be computed according to the following methodology:

$$SPI_t = SPI_{t-1} [\sum_i V_i (P_i/P_{t-1})]$$

When:

$SPI_t$  = The proposed new SPI value.

$SPI_{t-1}$  = The existing SPI value as of the last approved tariff filing.

$P_i$  = The proposed price for rate element "i."

$P_{t-1}$  = The existing price for rate element "i."

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<sup>3</sup> If the Department of Commerce should cease reporting the GDP-PI during the term of the Plan, then, subject to Commission approval, the Company will substitute an alternative index and make any adjustments to the formula necessary to replicate the current formula as closely as possible.

$V_i$  = The current revenue weight for rate element "i", calculated as the ratio of the revenue for the rate element "i" priced at the existing rate, to the revenue for all noncompetitive services priced at existing rates.

When a new service is incorporated into the index calculations, the revenue for the new service must be included in determining the weights to be used in calculating the SPI. An example of how the PSI and SPI will work is attached as Attachment B.

5. The PSI and SPI will start at 100 in the first PSI and SPI filing under this Plan. Provided, however, that the \$5 million reduction in residential basic local exchange rates required under the MOU (the sole remaining rate decrease contemplated under the MOU and the Commission's approval of the Verizon parent level merger) shall not be calculated as a reduction to the SPI.

6. On or about November 15 of each year, beginning in 2003, the Company shall file with the Commission a PSI and SPI Report. Each such annual filing may be accompanied by tariffs to implement any required or authorized SPI. Such tariffs will contain an effective date one hundred and five (105) days from the date of filing.

7. Proposed rate increases for existing noncompetitive services will become effective subject to the "Tariff Filing Process" set forth below. The Commission shall review the tariff rate change proposals to determine whether they are designed to produce revenues so that the SPI is not greater than the PSI. If the Commission determines that the Company's rate proposals do not comply with this criterion, then the Commission may order the Company to modify them to produce an SPI value which is equal to the PSI. If the Company's proposals comply with this criterion, then the Commission shall approve them subject to the Consumer Protections in Part 3, Section E.

8. Rate increases for existing noncompetitive services will be approved according to the following Tariff Filing Process. The Company will provide fifteen (15) days' advance notice of filing to the Commission and will generally describe the anticipated filing.<sup>4</sup> The Company will provide cost studies, where required, for proposed rate increases. Any and all interventions or complaints shall be due within ten (10) days of such filing. Twenty (20) days shall be reserved for Commission review of recommended decisions, if any, in this process. Responses to interrogatories would be due within ten (10) days of service. A Commission Order must be entered within one hundred five (105) days of the filing; otherwise, the tariff(s) shall become effective as filed, and shall be deemed to be approved. This procedure, as specified in this paragraph, is hereinafter referred to as the "Tariff Filing Process." Provided, however, nothing in this Plan shall preclude the Company from adopting procedures promulgated by the Commission, which are more streamlined.

9. Notwithstanding any other limitations specified herein, the Company, or any other party, may request that the Commission make special revenue adjustments within the scope of the PSI to recognize significant exogenous events that are outside the Company's control as follows:

- (a) Jurisdictional shifts in cost recovery when interstate revenues actually change;
- (b) Subsequent state or federal regulatory and legislative changes which affect revenues or expenses, to the extent they are not captured in GDP-PI; and

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<sup>4</sup> Notice may be provided to the public through newspaper advertisements, bill inserts or bill messages. Notice also will be served upon the OCA, OSBA, OTS and any other Chapter 30 party, as identified by the Commission's Secretary.

(c) Unique changes in the telephone industry that are not reflected in the overall inflation factor as measured by GDP-PI.

For example, future increases in the amount of the Company's required contribution to the Universal Service Fund in Pennsylvania shall be a qualifying exogenous event. Exogenous revenue changes shall be flowed through on a dollar-for-dollar basis, using the most recent per books revenue levels, without any investigation or review of earnings. Exogenous expense changes shall be flowed through, dollar-for-dollar, on the basis of review of that single expense item for which an exogenous change is sought, without any investigation or review of earnings, and using the most recent per books level of such expense. Results shall be adjusted to recognize the impact of gross receipts taxes. The Tariff Filing Process as described herein shall apply to any such exogenous changes.

10. Any revenue shortfall or expense incurred (e.g., expenses associated with capital outlays, operating & maintenance expense, etc.) associated with the extension of local service (less other related revenue increases/expense decreases, if any) may be recovered by the Company at the time of implementing any extended area services. This same treatment shall also apply to Optional Calling Plans.

**B. Rate Restructuring And Rebalancing**

1. The Company may file tariffs proposing to rebalance and/or restructure its rates for noncompetitive services, either an increase or a decrease, upon the implementation date of the Plan. If a proposed tariff would not cause the Company's SPI to exceed the PSI as calculated in the most recent annual filing, then such tariff shall be approved, subject to Part 3, Section E hereof provided that:

(a) The SPI is not greater than the PSI;

- (b) No other rate restructuring/rebalancing filing has become effective in the same calendar year which affects basic local exchange service rates exclusive of changes made pursuant to the PSI/SPI formula and exogenous events;
- (c) The rates for those services which are established by the Commission as universal services do not exceed the level determined by the Commission to be affordable pursuant to the Universal Service proceeding or any successor docket;<sup>5</sup>
- (d) The proposed changes to basic, local rates will not cause an increase in excess of \$3.50 per month to the rates in existence at the end of the preceding year; and
- (e) The rates proposed are consistent with the MOU and the Commission Order approving the Verizon parent level merger.

2. The Company may also propose revenue neutral tariff rate changes to implement the results of Commission orders involving generic industry issues.

3. The Company may make rate decreases at any time and such decreases will be included in the PSI/SPI calculations.

4. The Commission shall review the tariff proposals to determine whether they are within the criteria listed in sub-part B.1. If the Commission determines that the Company's rate proposals are not within these criteria, then the Commission may order the Company to modify them to produce a tariff which does not exceed these criteria. If

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<sup>5</sup> The Global Order entered September 30, 1999 at Docket Nos. P-00991648 and P-00991649 established an affordability rate of \$16.00 for basic residential service, which is currently effective.

the tariff proposals are within the criteria listed in sub-part B.1, then the Commission shall approve them.

**C. Lifeline Service, Link Up Service and Universal Service**

The Company provides Lifeline and Link Up programs for qualifying, low-income residential customers, which programs will remain in effect during the Plan.

**D. New Services**

1. The Company may introduce new services at any time.
2. If a new service is offered which falls within the definition of "protected services," then the Tariff Filing Process, as detailed above, shall apply. Protected services are as follows:

(a) Telecommunications services provided to business or residential customers that are necessary for completing a local exchange call, including touch tone service;

(b) Switched access service;

(c) Special access service; and

(d) Ordering, installation, restoration and disconnection of the above-listed services.

3. Any new service that does not fall within the definition of "protected services" shall become effective upon one day's notice to the Commission.

4. Revenues from new noncompetitive services shall be included in the calculation of PSI and SPI, beginning with the first annual PSI/SPI filing after the new service has been in effect for one year.

5. Verizon North may file special tariffs offering experimental treatment for new services, and such tariffs shall be effective when filed.

**E. Consumer Protections**

1. The requirement that rates remain just and reasonable and subject to Commission oversight shall apply to all rate proposals under the Company's Tariff Filing Process.

2. Cost support shall be provided for rate increase proposals for protected services, where required.

3. Complaints under §1309 of the Public Utility Code against existing rates may only be filed if such rates fail to comply with the terms of this Plan. Section 1309 of the Public Utility Code shall be the exclusive basis for filing complaints against existing rates and such a complaint may be sustained only if such existing rates do not comply with the terms of this Plan.

**PART 4 - ADDITIONAL COMPANY COMMITMENTS AND OTHER TERMS**

**A. Ongoing Regulatory Requirements**

1. All services provided by the Company within the jurisdiction of the Commission shall remain subject to all provisions of 66 Pa. C.S. §1501, et seq., regarding safety, adequacy and reliability of telecommunications services.

2. The Company will continue to monitor service quality for noncompetitive services in compliance with the Commission's regulations at 52 Pa. Code §§63.56.

3. The Company will comply with the Commission's Extended Area Service ("EAS") regulations, as revised by the Universal Service task force, on an interim basis.

The Company may petition for waivers from those regulations as needed and can petition for an automatic waiver if a waiver is granted to a similarly situated company. The Company will continue to provide EAS on required routes, will continue to regroup exchanges as appropriate and will be allowed to implement EAS-related rate increases, subject to restrictions in Section B., paragraph 1 above on Rate Rebalancing.

4. The Company will file affiliated interest agreements, in accordance with 66 Pa. C.S. §2101, et seq., unless such agreements involve services found to be competitive in accordance with this Plan; however, such filings shall constitute notice to the Commission only. Review of the associated costs and benefits shall be deemed to be unnecessary.

5. The Company shall continue to comply with Chapters 63 and 64 of the Commission's regulations as amended from time to time. The Company reserves the right to petition for waivers of those regulations and to petition for an automatic waiver if it is granted to a similarly situated company.

6. Approval of this Plan shall not operate in any way to foreclose the Company from exercising any of its options, pursuant to the enactment of new state or federal legislation.

7. In the event that the Company effects a change either to its depreciation expense or depreciation reserve, Commission approval shall not be required; however, in the event of the reinstatement of any form of rate base/rate of return regulation of the Company, then the Company will request permission from the Commission to establish booked amounts for depreciation at that time.

**B. Reporting Requirements**

1. In addition to Annual PSI and SPI Reports provided in accordance with this Plan, the Company will continue to provide the following reports:

- (a) Network Modernization Plan implementation reports, as required by Section 3003(b)(6) of Chapter 30 and in accordance with Docket No. M-00930441;
- (b) Access line summary in accordance with Docket No. M-900239;
- (c) Pennsylvania Telecommunications Relay Surcharge report in accordance with Docket No. M-900239;
- (d) The Company's annual assessment for regulatory expense in accordance with 66 Pa. C.S. §510(b);
- (e) Measurement of service quality in accordance with 52 Pa. Code §63.56;
- (f) Annual financial reporting requirements; and
- (g) Any reports required under the MOU.

2. Generally, no other reports or audits shall be required of the Company by the Commission, however, should the Commission require any additional reports, the Company retains the right to oppose such submission on the grounds that the benefit of the report or audit will not exceed the attendant expense or administrative time requirements associated therewith.

**C. Term of the Plan**

1. The legislation underlying this Plan has a sunset date of December 31, 2003, absent an act of the General Assembly. In the event that Chapter 30 sunsets, is modified in any way or is repealed, the Company may seek appropriate modifications or revisions to its Plan. The procedures set forth at 66 Pa. C.S. §3004 then shall apply.

2. In the event of any appellate court reversal, remand, vacation, amendment or other modification of any Commission order approving or interpreting this Plan, or any aspect thereof, the Company retains the right to withdraw from the Plan.

**END OF VERIZON NORTH CHAPTER 30 PLAN**

## CLASSIFICATION OF EXCHANGES

(12/15/98)

<u>CLLI NAME</u>	<u>County</u>	<u>Based on FCC County Classification</u>
AIRVILLE	York	Urban
AVONMORE	Westmoreland	Urban
BERNVILLE	Berks	Urban
BERLIN	Somerset	Urban
BROGUE	York	Urban
BOSWELL	Somerset	Urban
BEAVERDALE	Cambria	Urban
CLINTONVILLE	Venango	Rural
CAMBRIDGE SPRINGS	Crawford	Rural
CENTRAL CITY	Somerset	Urban
CONFLUENCE	Somerset	Urban
COOPERSTOWN (Venango Co.)	Venango	Rural
CORRY	Erie	Urban
DELTA	York	Urban
DILLSBURG	York	Urban
DOVER	York	Urban
DAVIDSVILLE	Somerset	Urban
EAST BERLIN	York	Rural
EDINBORO	Erie	Urban
ERIE-East	Erie	Urban
ERIE-Main	Erie	Urban
ERIE-South	Erie	Urban
ERIE-SouthEast	Erie	Urban
ERIE-West	Erie	Urban
FRANKLIN	Venango	Rural
FAIRVIEW	Erie	Urban
FAWN GROVE	York	Urban
FRYSTOWN	Berks	Urban

GRAND VALLEY	Warren	Rural
GLEN ROCK	York	Urban
GIRARD	Erie	Urban
HOOVERSVILLE	Somerset	Urban
JOHNSTOWN	Cambria	Urban
(BENSCREEK)		
JOHNSTOWN	Cambria	Urban
(GEISTOWN)		
JOHNSTOWN-Main	Cambria	Urban
JOHNSTOWN-North	Cambria	Urban
JOHNSTOWN	Cambria	Urban
(WESTMONT)		
JONESTOWN	Lebanon	Urban
LINCOLNVILLE	Crawford	Rural
MCKEAN	Erie	Urban
MYERSTOWN	Lebanon	Urban
MANCHESTER	York	Urban
MEYERSDALE	Somerset	Urban
NEW BEDFORD	Lawrence	Rural
NANTY GLO	Cambria	Urban
NORTH EAST	Erie	Urban
NEW WILMINGTON	Lawrence	Rural
OIL CITY	Venango	Rural
PLEASANTVILLE	Venango	Rural
PRINCETON	Lawrence	Rural
RED LION	York	Urban
ROCKWOOD	Somerset	Urban
ROBESONIA	Berks	Urban
SALTSBURG	Indiana	Rural
SAYRE	Bradford	Rural
SCHAEFFERSTOWN	Lebanon	Urban
SEVEN SPRINGS-	Somerset	Urban
Rockwood		
SOUTH FORK	Cambria	Urban
SHELLSVILLE	Dauphin	Urban
SALISBURY	Somerset	Urban
SOMERSET	Somerset	Urban
SPRING GROVE	York	Urban
SPARTANSBURG	Crawford	Rural
SEWARD	Cambria	Rural
STEWARTSTOWN	York	Urban
STOYSTOWN	Somerset	Urban

TITUSVILLE	Crawford	Rural
UNION CITY	Erie	Urban
VANDERGRIFT - MAIN	Westmoreland	Urban
VANDERGRIFT - SOUTH	Westmoreland	Urban
WRIGHTSVILLE	York	Urban
WOMELSDORF	Berks	Urban
WINDBER	Somerset	Urban
WESLEY	Venango	Rural
WATTSBURG	Erie	Urban
WATERFORD	Erie	Urban
YORK-East	York	Urban
YORK-Main	York	Urban
YORK-North	York	Urban
YORK-South/Loganville	York	Urban
YORK-West	York	Urban
BEAVER SPRINGS	Snyder	Rural
ELKLAND	Tioga	Rural
EMMAUS	Lehigh	Urban
HERSHEY	Dauphin	Urban
HARRISON VALLEY	Potter	Rural
KNOXVILLE	Tioga	Rural
MACUNGIE	Lehigh	Urban
MIDDLEBURG	Snyder	Rural
MANTZVILLE	Schuykill	Rural
MOUNT PLEASANT MILLS	Snyder	Rural
MCKEANSBURG	Schuykill	Rural
SABINSVILLE	Tioga	Rural
SHAMOKIN DAM	Snyder	Rural
SELINGROVE	Snyder	Rural
WESTFIELD	Tioga	Rural
AUBURN	Schuykill	Rural
BEACH LAKE	Wayne	Rural
BUFFALO	Washington	Urban
BROOKSIDE	Lycoming	Urban
BARBOURS	Lycoming	Urban
CHAPMAN LAKE	Lackawanna	Urban
DINGMANS FERRY	Pike	Urban
FRIEDENSBURG	Schuykill	Rural
GALILEE	Wayne	Rural
KEMPTON	Berks	Urban
LOG TAVERN	Pike	Urban

LOYALSOCK-MAIN	Lycoming	Urban
LOYALSOCK-SOUTH	Lycoming	Urban
MILFORD	Pike	Urban
MATAMORAS	Pike	Urban
NEW SMITHVILLE	Lehigh	Urban
NEW TRIPOLI	Lehigh	Urban
PINE GROVE	Schuylkill	Rural
RALSTON	Lycoming	Urban
SHOHOLA	Pike	Urban
TROUT RUN	Lycoming	Urban
TAYLORSTOWN	Washington	Urban

**Verizon North Inc. Alternative Regulation Plan**  
**Price Stability Mechanism**

**Price Stability Index (PSI) Calculation**

Formula:  $PSI_t = PSI_{t-1} \times [1 + \% \Delta GDP-PI - 2.5\% \pm Z]$

1	GDP-PI	Recent Qtr Curr. yr.	102.75
2	GDP-PI	Same Qtr Prior yr.	100.00
3	%Δ GDP-PI	$=(L1-L2)/L2$	2.75%
4	Productivity Offset		2.50%
5	Z Factor		0.00
6	Allowed Change in PSI	$=L3-L4\pm L5$	0.25%
7	$PSI_{t-1}$		100.00
8	$PSI_t$	$=L7*(1+L6)$	100.25

**Service Price Index (SPI) Calculation**

Formula:  $SPI_t = SPI_{t-1} [\sum_i V_i (P_i/P_{t-1})]$

9  $[\sum_i V_i (P_i/P_{t-1})]$

<u>Service</u>	<u>P<sub>t-1</sub></u> (a)	<u>P<sub>t</sub></u> (b)	<u>Curr. Rev</u> (c)	<u>V<sub>i</sub></u> (d=c/sumc)	<u>P<sub>t</sub>/P<sub>t-1</sub></u> (e=b/a-1)	<u>[\sum<sub>i</sub> V<sub>i</sub> (P<sub>t</sub>/P<sub>t-1</sub>)]</u> (f=d*e)
A	10.00	9.50	120,000	1.88%	-5.0%	-0.094%
B	15.00	14.00	45,000	0.70%	-6.7%	-0.047%
C	18.00	17.00	21,600	0.34%	-5.6%	-0.019%
D	8.00	8.00	1,440	0.02%	0.0%	0.000%
E	0.35	0.30	9,450	0.15%	-14.3%	-0.021%
F	5.00	5.40	300,000	4.70%	8.0%	.376%
G	100.00	97.60	1,050,000	16.44%	-2.4%	-0.395%
H	2.50	4.41	37,500	0.59%	76.6%	0.450%
All Other				<u>4,800,000</u>	<u>75.18%</u>	<u>0.000%</u>
Sum				<u>6,384,990</u>		<u>0.25%</u>

10	$SPI_{t-1}$		100.00
11	$SPI_t$	$=L10*(1+L9)$	100.25
12	$PSI_t-SPI_t$	$=L8-L11$	00.00



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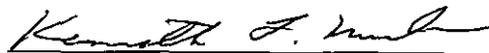
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