

Suzan DeBusk Paiva
Assistant General Counsel



PUBLIC
VERSION

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

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

August 8, 2007

Via UPS Overnight Delivery

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

DOCUMENT
FOLDER

Re: Verizon North Inc.'s 2007 PCO Filing
and Office of Small Business Advocate v. Verizon North Inc.
Docket Nos. R-00061914, P-00001854 F1000, R-00061914C0001

Verizon Pennsylvania Inc.'s 2007 PCO Filing
and Office of Small Business Advocate v. Verizon Pennsylvania Inc.
Docket No. R-00061915, P-00930715 F1000, R-00061915C0001

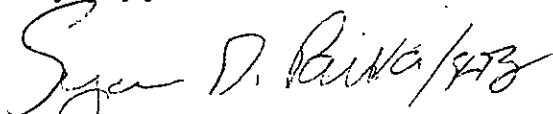
Dear Secretary McNulty:

Enclosed please find an original and three (3) copies two copies of the Joint Settlement Petition of Verizon Pennsylvania Inc., Verizon North Inc., the Office of Small Business Advocate, the Office of Consumer Advocate and the Office of Trial Staff, in the above-named matter. Because an Exhibit to the Joint Settlement Petition includes proprietary information, an expurgated version is being provided for the public record.

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

Very truly yours,

KJR


Suzan D. Paiva

SDP/slb
Enc.

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Via E-Mail and UPS Overnight Delivery
cc: The Honorable Kandace Melillo
Attached Certificate of Service

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

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BEFORE THE PENNSYLVANIA PUBLIC UTILITY COMMISSION SECRETARY'S BUREAU

Verizon North Inc. : R-00061914
2007 Price Change Opportunity Filing : P-00001854F1000
Office of Small Business Advocate : R-00061914C0001
v. :
Verizon North Inc. :
Verizon Pennsylvania, Inc. : R-00061915
2007 Price Change Opportunity Filing : P-00930715F1000
Office of Small Business Advocate : R-00061915C0001
v. :
Verizon Pennsylvania Inc. :

JOINT SETTLEMENT PETITION

Pursuant to 52 Pa. Code § 5.232, Verizon Pennsylvania Inc. ("Verizon PA") and Verizon North Inc. ("Verizon North") (together "Verizon"), the Office of Small Business Advocate ("OSBA"), the Office of Consumer Advocate ("OCA") and the Office of Trial Staff ("OTS") (collectively the "Parties") submit this Joint Settlement Petition setting forth the unanimous agreement of the Parties to settle all of the issues in the above-captioned proceeding. In support of this Joint Settlement Petition, the Parties state as follows:

1. This Joint Settlement Petition constitutes an agreement by all of the Parties to this proceeding to the settlement described herein. All Parties support the settlement, and none oppose it. See 52 Pa. Code § 5.232(b).

2. To the extent factual support is required for this settlement, the Parties rely upon Verizon St. 1.0, the Direct Testimony of Jane K. Fortin, submitted on May 24, 2007

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(attached hereto as Exhibit A); Verizon St. 1.1, the Rebuttal Testimony of Jane K. Fortin submitted on July 13, 2007 (attached hereto as Exhibit B); and OSBA St.1, the Direct Testimony of Allen G. Buckalew, submitted on June 27, 2007 (attached hereto as Exhibit C). The Parties agree that Verizon St. 1.0 and 1.1 and OSBA St. 1 will become part of the record in this proceeding and waive any cross examination of these witnesses.

I. HISTORY OF PROCEEDING

3. On November 1, 2006, Verizon PA and Verizon North made separate filings to implement their 2007 Price Change Opportunities (“PCO”) under the terms of their Commission-approved Chapter 30 Plans and the requirements of the Chapter 30 statute, as amended by Act 183. The factual details of those filings are addressed in Verizon St. 1.0, pages 3-7.

4. On November 9, 2006, the OSBA filed complaints against the Verizon PA and Verizon North PCO filings, raising essentially the same issues against each company. On November 17, 2006, the OCA filed a notice of intervention in each case. The OTS filed a notice of appearance on November 21, 2006.

5. On December 28, 2006 the Commission issued an order on Verizon PA’s 2007 PCO filing, allowing the rate increases to go into effect subject to the findings of the Office of Administrative Law Judge (“OALJ”) as to the issues raised in the OSBA’s complaint.

6. In its December 28 Order the Commission also raised an issue that was not raised in the OSBA complaint – regarding the calculation of the banked amount remaining to be used from the 2006 PCO, and directed that the “issue of accounting

methodology for banking” should be incorporated into the OSBA complaint proceeding before the OALJ. (VZ PA 12/28/06 Order, Ordering ¶ 5).

7. On January 2, 2007, Verizon PA filed a Petition for Reconsideration of the December 28th Order. By Order entered January 11, 2007, the Commission granted Verizon PA’s Petition for Reconsideration.

8. On February 8, 2007 the Commission issued an order on Verizon North’s 2007 PCO filing, allowing Verizon North’s proposed rate increases to go into effect subject to the findings of the OALJ as to the issues raised in the OSBA’s complaint.

9. The two proceedings were consolidated for purposes of litigation.

10. The Commission entered an order at Dockets R-00051227 and R-00051228 on March 22, 2007 resolving all of the issues raised in OSBA’s complaints against Verizon PA’s and Verizon North’s 2006 PCO filings. The Commission modified this order by an order on reconsideration entered April 25, 2007. These two orders are collectively referred to as the “2006 PCO Orders.”¹

11. Some of the issues raised in OSBA’s complaints against Verizon PA’s and Verizon North’s 2007 PCO filings were also raised in the 2006 proceeding and were resolved by the Commission’s 2006 PCO Orders, subject to Verizon’s appeal.

12. On May 24, 2007, Verizon submitted in this proceeding Verizon St. 1.0, the pre-filed direct testimony of Jane K. Fortin. That testimony detailed the three categories of issues to be decided in this case: (i) issues raised in the OSBA’s 2007 PCO complaints that have since been resolved by this Commission’s 2006 PCO Orders in a manner that

¹ Verizon filed a Petition for Review of these Orders with the Commonwealth Court on May 25, 2007 at Docket 988 CD 2007, and that appeal is pending. This settlement is without waiver of Verizon’s right to prosecute that appeal and to make any rate changes in the future necessary to implement any changes to its 2007 PCO filings required as a result of that appeal.

requires no changes to Verizon's 2007 PCO filings; (ii) issues raised in the OSBA's 2007 PCO complaints that have since been resolved by this Commission's 2006 PCO Orders in a manner that does require changes to Verizon's 2007 PCO filing; and (iii) new issues or issues that the Commission specifically directed should be litigated in this proceeding. *See* Verizon St. 1.0 at 8-11.

13. This Settlement Petition details the Parties' agreement as to the resolution of each of the above three categories of issues, as set forth below. This is a unanimous settlement by all parties of all of the issues raised in this proceeding.

II. SETTLEMENT OF ISSUES

A. Issues Resolved By 2006 PCO Orders That Require No Modification To 2007 PCO Filings

14. There are a number of issues that were raised by the OSBA's complaints against the 2007 PCO filings that were resolved by the 2006 PCO Orders and do not require any modification to Verizon's 2007 PCO filings. Those issues are described in Verizon St. 1.0, page 8, line 21, through page 10, line 4, and that discussion is incorporated as though fully set forth in this Settlement Petition as the Parties' agreed-upon resolution of those issues in compliance with the 2006 PCO Orders.

15. The Parties agree that as a result of the Commission's 2006 PCO Orders, no changes are required to Verizon PA's 2007 PCO filings to account for the issues raised in the OSBA's Complaint against Verizon PA's 2007 PCO filing at paragraphs 8(c), 8(d), 8(e), 8(f), and 8(g).

16. The Parties agree that as a result of the Commission's 2006 PCO Orders, no changes are required to Verizon North's 2007 PCO filings to account for the issues raised

in the OSBA's Complaint against Verizon North's 2007 PCO filing at paragraphs 8(c), 8(d), and 8(e).

B. Issues Resolved By 2006 PCO Orders That Require A Modification To 2007 PCO Filings

17. There were two issues that were raised by the OSBA's complaints against the 2007 PCO filings that were resolved by the 2006 PCO Orders and do require modifications to Verizon's 2007 PCO filings. Those issues are described in Verizon St. 1.0, page 10, line 5, through page 10, line 22. The resolution of those issues in compliance with the 2006 PCO Orders is discussed below.

i. Attribution

18. In the 2006 PCO Orders the Commission directed that attribution revenue be removed from Verizon's 2006 and 2007 PCO calculations. Verizon St. 1.0 at page 11, line 5, through page 14, line 14, details the changes that Verizon will make to the 2007 PCO filings of Verizon PA and Verizon North to comply with the Commission's requirement on attribution.

19. The discussion in Verizon St. 1.0 at page 11, line 5, through page 14, line 14, is incorporated as though fully set forth in this Settlement Petition as the Parties' agreed-upon resolution of the attribution issues for the 2007 PCO filings in compliance with the 2006 PCO Orders.

20. Verizon's agreement to make the changes to its 2007 PCO filings is subject to Verizon's appeal at Commonwealth Court Docket 988 CD 2007, and any subsequent appeals. Verizon does not waive the right to alter its 2007 PCO filings or its rates to comply with the ultimate outcome of such appeals.

ii. Line Counts

21. In the 2006 PCO Orders, the Commission directed Verizon to alter its 2007 filing to use actual line counts from June 30, 2006. Verizon St. 1.0 at page 14, line 15, through page 21, line 14, details the changes that Verizon will make to the 2007 PCO filings of Verizon PA and Verizon North to comply with the Commission's requirement on line counts.

22. The discussion in Verizon St. 1.0 at page 14, line 15, through page 21, line 14, is incorporated as though fully set forth in this Settlement Petition as the Parties' agreed-upon resolution of the line count issue in compliance with the 2006 PCO Orders.

23. The discussion of this issue in Verizon St. 1.0 presumes Verizon's use of the April 1, 2005, through March 31, 2006, time period for revenue and change in inflation, which is the time period the parties have agreed to use in this Settlement. Based on the use of the April 1, 2005, through March 31, 2006, time period, the Parties agree that Verizon will use the actual line counts as of March 31, 2006, to make its alterations to the 2007 PCO filings, as discussed in Verizon St. 1.0.

24. Verizon's agreement to make the changes to its 2007 PCO filings is subject to Verizon's appeal at Commonwealth Court Docket 988 CD 2007, and any subsequent appeals. Verizon does not waive the right to alter its 2007 PCO filings or its rates to comply with the ultimate outcome of such appeals.

C. New Issues

i. Intercompany Settlements

25. In the 2006 PCO Orders, the Commission directed Verizon North to remove the revenue line item for intercompany settlements ("ITC Settlements") from its 2006

PCO filing. However, the Commission stated that “[t]his directive is made without prejudice to subsequent Verizon North PCO proceedings but shall apply to Verizon North’s future PCO filings unless Verizon adequately demonstrates in those cases that ITC Settlements are properly classified as noncompetitive revenue for purposes of PCO rate cap calculations.” (3/22/07 Order at 23).

26. OSBA’s complaints against the 2007 PCO filings challenged both Verizon PA’s and Verizon North’s inclusion of revenue from intercompany settlements.

27. Verizon St. 1.0 at page 21, line 17, through page 25, line 5, explains why the particular intercompany settlement revenue that was actually included in Verizon’s 2007 PCO filings was properly classified as noncompetitive revenue for purposes of the 2007 PCO filings.

28. The Parties agree that the evidence provided in Verizon St. 1.0 at page 21, line 17, through page 25, line 5, is sufficient to make the showing required by the Commission’s 2006 PCO Orders that “ITC Settlements are properly classified as noncompetitive revenue for purposes of PCO rate cap calculations.” Accordingly, the Parties agree that Verizon PA and Verizon North properly included intercompany settlement revenue as noncompetitive revenue in their 2007 PCO filings and that no alterations to the intercompany settlements line items in the 2007 PCO filings are required.

ii. Banking

29. Banking refers to the situation where a company does not implement the entire amount of its PCO for a particular year, but saves it for implementation in a future year.² If the PCO is positive, entitling the company to an increase to noncompetitive revenue, then the company could bank all or part of the increase rather than raising rates. Similarly, a company could be permitted to bank some or all of a negative PCO, deferring rate reductions to a future time and keeping the negative value in its bank.

30. In its January 11, 2007 Order in this matter, the Commission directed that the parties in this proceeding determine the methodology for calculating the net amount remaining in Verizon PA's bank.

31. Verizon St. 1.0 at page 29, line 5, through page 45, line 2, and Exhibit A, explains the history of Verizon PA's banking and how the amount remaining in the bank is properly calculated. This discussion is incorporated as though fully set forth in this Settlement Petition as the Parties' resolution of this issue.

32. In particular, the parties agree that the calculation of the cumulative net value in Verizon PA's bank, inclusive of interest, as of January 1, 2007 is properly depicted on Exhibit A to Verizon St. 1.0. Following implementation of the 2007 PCO (and assuming the alterations to the 2006 and 2007 PCOs required to comply with the Commission's March 22 and April 25, 2007 orders as described in Verizon St. 1.0 and agreed to in this Settlement), the cumulative net value is negative \$1,610,536. This cumulative net value is calculated by looking at each year in which money is carried in the bank and netting the value of all the amounts credited and debited for that year to calculate the net value

² The OSBA takes no position on the issue of banking in this Settlement Petition, but does not oppose the Settlement Petition on this issue. The OSBA has no basis on which to question Verizon's assertion that the cumulative net value in the bank as of January 1, 2007 is negative \$1,610,536.

remaining in the bank for that year and then adding that amount to the cumulative net value for the previous year. Interest is then applied to the new cumulative net value.

33. The Parties further agree that this cumulative net of one-time values does not depict what amount is available to be spent on recurring rate changes in the next year. In January of 2008, the full portion of the 2003 and 2006 PCOs that have not been implemented in rates remains available for use as depicted in Table 7 on page 41 of Verizon St. 1.0. The Parties understand that Verizon PA expects to request again in 2008 to use that year's value of the 2003 PCO to cover its state universal service fund ("USF") payment and to account for any gap between the available 2003 PCO funds and the USF payment in the manner described in Verizon Statement 1.0. (See Verizon St. 1.0, page 40, line 1, through page 43, line 2).

34. The Parties agree that the cumulative net value of negative \$1,610,536 depicted on Exhibit A to Verizon Statement 1.0 should not be implemented in a recurring manner because it would reduce the money in the bank to cover the USF payment in future years as described in Verizon Statement 1.0. If the cumulative value in the bank as of January 1, 2007 is to be zeroed out, then the negative \$1,610,536 should be implemented as a one-time credit to some category of noncompetitive rates or through some other means that has the same effect as a one-time credit. On or before the date of filing its 2008 PCO filing, Verizon will make a proposal to the Commission for the implementation of this negative \$1,610,536. The Parties reserve all rights they may have to respond to such a proposal when it is made.

35. The Parties agree that in the future Verizon PA will calculate its cumulative banked value consistently with the way it has been described in Verizon Statement 1.0

and agreed to in this Settlement Petition. Verizon may petition the Commission to add language to Verizon's Chapter 30 plans to more clearly explain this methodology for calculating the cumulative net remainder and future recurring amounts available in the bank and to ensure that it is consistently followed in future years. The Parties agree to work together to make a good faith effort to agree upon such language.

iii. Time Period

36. The 2007 PCO filings of Verizon PA and Verizon North were based on actual noncompetitive revenues for the 12-month period from April 1, 2005 to March 31, 2006. The change in the inflation rate used corresponds to this same period, specifically the change in the rate from the end of the first quarter of 2005 to the end of the first quarter of 2006.

37. For the 2006 PCO, Verizon used the time period from July 1, 2004 through June 30, 2005 as the 12 month period of actual revenue and used the change in the rate of inflation from the end of the second quarter of 2004 to the end of the second quarter of 2005.

38. The Parties agree that Verizon's use of the April 1, 2005 to March 31, 2006 for the 2007 PCO filing should not be altered.

39. The Parties further agree that Verizon will use the April 1-March 31 time period for the 2008 PCO filings of Verizon PA and Verizon North.

40. The Parties further agree that Verizon may propose additional language for insertion into the Chapter 30 plans of Verizon PA and Verizon North to address the issue of which time period Verizon will use on a going-forward basis after 2008. The parties will make a good faith effort to resolve this issue. Failing such a resolution, if Verizon

wishes to propose plan language on this issue, Verizon will file a separate petition, which petition may be litigated in the normal course of Commission practice. Unless and until the Commission approves such new plan language, Verizon will continue to use the April 1-March 31 time period for its PCO filings. If and when new plan language becomes effective, it will govern the time period for Verizon's PCO filings from its effective date forward.

III. GENERAL PROVISIONS

41. This settlement is expressly conditioned upon the Commission's approval, without modification, of all of the specific terms and conditions contained in this Joint Settlement Petition. If the Commission should fail to grant such approval, or should modify any material term or condition within the Joint Settlement Petition, any party may elect to withdraw, in whole or in part, from this agreement upon written notice to the Commission and the other Parties within 20 calendar days of issuance of an adverse final Commission order. In that event, each of the Parties shall have all legal rights that they may have waived by agreeing to this Joint Settlement Petition. The Parties agree to support this Settlement and to make their best efforts to secure its approval by the Commission.

42. If the presiding officer issues a recommended decision approving this Joint Settlement Petition without modification, then the Parties agree to waive the filing of Exceptions and Reply Exceptions.

IV. PUBLIC INTEREST CONSIDERATIONS

43. The resolution of the issues as set forth in this Joint Settlement Petition is in the public interest and should be approved in full.

44. The Settlement achieves a just and fair compromise by all parties to this proceeding, who represent a variety of interests, of the important and contentious issues raised in the proceeding.

45. Approval of the Joint Settlement Petition will avoid the substantial time, expense and uncertainty involved in litigation of issues in this proceeding. By avoiding the necessity of further administrative proceedings and litigation, including possible appeals, the resources of the parties and the Commission will be appropriately conserved.

46. The Parties have attached individual Statements in support of the Settlement to this Petition as required by the ALJ. Verizon's Statement in Support is attached as Exhibit D. OSBA's Statement in Support is attached as Exhibit E. OCA's Statement in Support is attached as Exhibit F. OTS's Statement in Support is attached as Exhibit G.


V. CONCLUSION

Wherefore, the Parties to this Joint Settlement Petition, intending to be legally bound, respectfully request that the Commission approve without modification the terms of this Joint Settlement Petition as the resolution of the issues described herein.


Date: August 8, 2007


Steven C. Gray (Atty No. 77538)
Assistant Small Business Advocate
Office of Small Business Advocate
Suite 1102, Commerce Building
300 North Second Street
Harrisburg, PA 17101
(717) 783-2525
sgray@state.pa.us

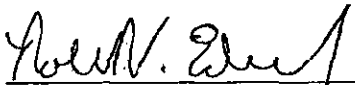
Attorney for the Office of
Small Business Advocate


Joel H. Cheskis (Atty No. 81617)
Assistant Consumer Advocate
Office of Consumer Advocate
555 Walnut Street
Forum Place, 5th Floor
Harrisburg, Pennsylvania 17101-1923
(717) 783-5048
jcheskis@paoca.org

Attorney for the Office of
Consumer Advocate


Suzan D. Parva (Atty No. 53853)
Verizon
1717 Arch Street, 10th Floor
Philadelphia, PA 19103
(215) 466-4755
Suzan.d.paiva@verizon.com

Attorney for Verizon Pennsylvania Inc.
And Verizon North Inc.


Robert V. Eckenrod (Atty No. 84889)
Prosecutor
Office of Trial Staff
Pennsylvania Public Utility Commission
Post Office 3265
Harrisburg, Pennsylvania 17105-3265
(717) 783-6155
roeckenrod@state.pa.us

Attorney for the
Office of Trial Staff

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EXHIBIT A
Public Version Only

VERIZON PENNSYLVANIA INC.
AND VERIZON NORTH INC.
STATEMENT NO. 1.0

VERIZON PENNSYLVANIA INC.'S
AND VERIZON NORTH INC.'S
2007 PCO FILINGS

DOCKET NOS. R-00061914,
P-00001854F1000, R-00061914C000,
R-00061915, P-00930715F1000,
R-00061915C0001

VERIZON PENNSYLVANIA INC.
AND VERIZON NORTH INC.

STATEMENT NO. 1.0
(DIRECT TESTIMONY)

WITNESS: Jane K. Fortin

DATED: May 24, 2007

EXPURGATED VERSION

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I. INTRODUCTION AND BACKGROUND

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Jane K. Fortin. My business address is 1717 Arch Street, 17th Floor,
Philadelphia, PA 19103.

Q. BY WHOM ARE YOU EMPLOYED, AND IN WHAT CAPACITY?

A. I am employed by the Verizon companies, including Verizon Pennsylvania Inc.
("Verizon PA") and Verizon North Inc. ("Verizon North") (collectively "Verizon").
My position is Director of Public Policy for Pennsylvania.

Q. WHAT ARE YOUR RESPONSIBILITIES IN YOUR CURRENT POSITION?

A. My responsibilities include developing strategies to achieve Verizon's public policy
goals and supporting Verizon's advocacy in Pennsylvania and Delaware, including
directing related filings involving the Pennsylvania Public Utility Commission
("PUC" or "Commission").

Q. PLEASE BRIEFLY OUTLINE YOUR EXPERIENCE IN THE TELECOMMUNICATIONS INDUSTRY AND YOUR EDUCATIONAL BACKGROUND.

A. I began my telephone career at Verizon, then Bell of Pennsylvania, in 1974. I
moved through various assignments of increasing responsibility in Information
Systems, Long Range Planning, Construction Budgeting, Network Planning,
Regulatory Affairs and Product Management, culminating in an assignment as
Managing Director, Product Line Management for Long Distance and Basic Local

1 Telephone Service in 1989. I returned to Verizon in 2004, after a number of years as
2 a telecommunications consultant specializing in regulatory issues. I received a B.A,
3 degree from Bryn Mawr College in 1973 and an M.A. degree from the same school
4 in 1975. In 1980, I received a certificate from the University of Pennsylvania's
5 Wharton Management Program.

6 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS**
7 **PROCEEDING?**

8 A. The purpose of my testimony is to provide the factual support necessary for the
9 Commission finally to approve the 2007 Price Change Opportunity ("PCO") filings
10 of Verizon PA and Verizon North. Those issues fall into three categories.

11 *First*, I discuss the changes that must be made to comply with the
12 Commission's recent orders on Verizon's 2006 PCO filings, which resolved certain
13 disputes that also affect the 2007 PCOs.¹

14 *Second*, I present new evidence as directed by the Commission's 2006 PCO
15 Orders relating to the inclusion of access revenue from intercompany settlements as
16 noncompetitive revenue in the 2007 PCOs.

17 *Third*, I present evidence to support Verizon's position on the new issue that
18 the Office of Small Business Advocate ("OSBA") has raised in its complaints
19 against the 2007 PCO filings, regarding moving back by one quarter the time period
20 for collection of revenue data and the change in inflation.

¹ This testimony is without waiver of Verizon's right to appeal the substance of the Commission's decisions, with respect both to the 2006 and 2007 PCOs and the impact on any future PCO filings.

1 In addition, the Commission's January 11, 2007 Order in this matter deferred
2 to this proceeding to determine the proper methodology for calculating the net
3 amount remaining in Verizon PA's bank following implementation of the 2007
4 PCO. I provide the factual testimony to determine that net value for both recurring
5 and one-time amounts, taking into account the changes to the calculations resulting
6 from the 2006 PCO order.

7 **II. HISTORY OF PROCEEDING**

8 **Q. WHAT IS THE SUBJECT OF THIS PROCEEDING?**

9 A. This proceeding involves the separate filings made by Verizon PA and Verizon
10 North on November 1, 2006 to implement their 2007 PCOs under the terms of their
11 Commission-approved Chapter 30 Plans and the requirements of the Chapter 30
12 statute, as amended by Act 183. Because the Verizon companies are subject to an
13 alternative form of regulation under Chapter 30 of the Public Utility Code, their rates
14 for noncompetitive services are regulated through a Price Stability Mechanism
15 contained in their Chapter 30 Plans. This inflation-based formula calculates the
16 allowable annual increase or decrease to total revenue from noncompetitive services
17 based on the change in the rate of inflation over the 12-month period upon which the
18 PCO is calculated. The change in the rate of inflation is based on the annual change
19 in the Gross Domestic Product Price Index ("GDP-PI"), as calculated by the United
20 States Department of Commerce.

21 Following the enactment of "Act 183" at the end of 2004, which replaced the
22 portions of Chapter 30 that had previously sunset at the end of 2003, the Verizon

1 companies' plans now contain an inflation offset of 0.5%. Thus, where the change
2 in the rate of inflation is greater than 0.5%, the company is permitted to increase its
3 revenue from noncompetitive services over the prior year's revenues. The amount
4 of the increase is calculated by a formula that also includes the company's total
5 noncompetitive revenue for the same 12-month period for which the change in
6 inflation was calculated. For Verizon PA the formula is as follows:

$$7 \quad \text{PCO} = (\text{Noncompetitive Revenue}) \times ((\% \text{ Change in GDP-PI}) - 0.5\%)$$

8 Verizon North's formula is more complex, but is intended to achieve the same result
9 (the formula is set forth in Verizon North's filing, which is attached as Exhibit C to
10 this testimony).

11 On November 9, 2006, the OSBA filed complaints against the Verizon PA
12 and Verizon North 2007 PCO filings. Most of the issues raised in the OSBA
13 complaints were also raised by OSBA in its complaints against Verizon's 2006 PCO
14 filings, which had not been finally decided by the Commission at the time of the
15 OSBA's filing. The Commission has since decided the 2006 case, as discussed in
16 more detail below. This proceeding is to determine the changes to Verizon's 2007
17 PCOs required to comply with the Commission's decisions in the 2006 PCO
18 proceeding, and to resolve any issues not resolved by that proceeding. In addition,
19 the Commission has directed this proceeding to address certain issues relating to
20 Verizon PA's banking methodology, which I describe in more detail below.

21 **Q. WHAT REVENUE AND RATE CHANGES DID VERIZON PA AND**
22 **VERIZON NORTH PROPOSE WITH THEIR 2007 PCO FILINGS?**

1 A. Verizon PA's filing detailed the calculations under its price stability mechanism that
2 entitled it to an annual noncompetitive revenue increase of \$19,829,000, and the
3 proposed rate increases that it intended to implement effective January 1, 2007 to
4 recover that revenue. Verizon PA also indicated its intent to make additional rate
5 increases that would use \$485,000 of the \$1.2M recurring increase from its 2006
6 PCO filing that the Commission had allowed Verizon PA to bank. The Proprietary
7 version of Verizon PA's 2007 PCO filing is attached to this testimony as Exhibit B
8 (tariff pages omitted).

9 Verizon North's filing detailed the calculations under its price stability
10 mechanism that entitled it to an annual noncompetitive revenue increase of
11 \$3,420,000, and the proposed rate increases that it intended to implement effective
12 February 15, 2007 to recover a portion of that revenue. The proposed rate increases
13 were projected to yield \$3,340,100 per year, and Verizon North proposed to bank
14 \$79,900 of the ongoing value of the PCO. In addition, Verizon North proposed to
15 account for the one and one half month delay in implementing the increase to the
16 Business Late Payment Charge by banking a one-time increase of \$15,600. The
17 Proprietary version of Verizon North's 2007 PCO filing is attached to this testimony
18 as Exhibit C (tariff pages omitted).

19 **Q. DID THE COMMISSION PRELIMINARILY APPROVE THESE 2007 PCO**
20 **FILINGS AND ALLOW THE RATE CHANGES TO GO INTO EFFECT?**

21 A. Yes. By order entered December 28, 2006, as modified by an order on
22 reconsideration entered January 11, 2007, the Commission found that Verizon PA's

1 calculations “appear to be consistent with the terms of the Company’s Price Stability
2 Mechanism/Price Change Opportunity formula approved in its Chapter 30 Plan.”
3 (12/28/06 Order at 5). The Commission allowed Verizon PA’s proposed rate
4 increases to go into effect on the scheduled date of January 1, 2007, and consistent
5 with its handling of the 2006 PCO matter directed that these rates would remain in
6 effect and would be subject to the findings of the Office of Administrative Law
7 Judge (“OALJ”) as to the issues raised in the OSBA’s complaint.

8 On February 8, 2007 the Commission issued an order on Verizon North’s
9 2007 PCO filing. The Commission found that Verizon North’s calculations “appear
10 to be consistent with the terms of the Company’s Price Stability Mechanism/Price
11 Change Opportunity formula approved in its Chapter 30 Plan.” (2/8/07 Order at 4).
12 The Commission allowed Verizon North’s proposed rate increases to go into effect
13 on the scheduled date of February 15, 2007, and also directed that these rates would
14 remain in effect and would be subject to the findings of the OALJ as to the issues
15 raised in the OSBA’s complaint.

16 **Q. DID THE COMMISSION ALSO DIRECT THIS PROCEEDING TO**
17 **ADDRESS ISSUES RELATING TO BANKING FOR VERIZON PA?**

18 A. Yes. In its December 28, 2006 Order the Commission raised an issue that was not
19 raised in the OSBA complaint – noting that the Commission Staff “disagreed” with
20 Verizon PA’s calculation of the banked amount remaining to be used from the 2006
21 PCO. This issue does not affect the 2007 PCO. Rather, it involves the proper
22 calculation of the amount remaining in Verizon PA’s “bank,” after all relevant

1 values from the banked 2003 negative PCO and the banked 2006 positive PCO are
2 netted.

3 The Commission directed that “the disputed issue of accounting
4 methodology for banking” should be incorporated into the OSBA complaint
5 proceeding before the OALJ. (12/28/06 Order, Ordering ¶ 5). On January 2, 2007,
6 Verizon PA filed a Petition for Reconsideration in which it argued that the
7 Commission had violated its right to due process and the terms of its plan by the
8 manner in which it had addressed the banking issue. Verizon PA argued that, since
9 it had not been provided an opportunity to be heard on this issue, it had not been able
10 to point out before the order was entered that the Commission’s Staff’s calculation
11 of the banked amount that was incorporated into that order was based on
12 fundamental errors, including improperly, inconsistently and unfairly giving Verizon
13 only a one-time credit for a recurring banked increase, while debiting Verizon’s
14 account every year for a recurring banked decrease, thus cancelling out the entire
15 future revenue stream of the 2006 banked increases

16 By Order entered January 11, 2007, the Commission granted Verizon PA’s
17 Petition for Reconsideration. The Commission determined to allow the originally
18 proposed rate increases to go into effect subject to refund, consistent with the
19 requirements of Verizon PA’s plan. The Commission also determined to “withhold
20 any final judgment on the correctness of Verizon’s banking methodology, or any
21 other methodology,” until the matter was fully addressed by the OALJ. (1/11/07
22 Order at 6).

III. MATTERS AFFECTING THE 2007 PCO FILINGS

Q. DID THE COMMISSION RECENTLY ISSUE ORDERS RELATING TO VERIZON'S 2006 PCO FILINGS?

A. Yes. The Commission entered an order on March 22, 2007 resolving all of the issues raised in OSBA's complaints against Verizon PA's and Verizon North's 2006 PCO filings. This order was modified by an order on reconsideration entered April 25, 2007.

Q. ARE THERE ISSUES IN THIS CASE THAT WERE RESOLVED BY THE COMMISSION'S ORDERS IN THE 2006 PCO MATTER?

A. Yes. Most of the issues raised in OSBA's complaints against Verizon PA's and Verizon North's 2007 PCO filings were also raised in the 2006 proceeding and are resolved by the Commission's 2006 Orders, subject to any appeals.

Q. COULD YOU SUMMARIZE THE ISSUES RAISED IN OSBA'S COMPLAINTS AGAINST THE 2007 PCO FILING, AND HOW EACH ISSUE WAS AFFECTED BY THE 2006 PCO ORDERS.

A. Yes. The following issues that were raised in the OSBA's 2007 PCO complaints were resolved in the 2006 PCO proceeding in Verizon's favor and do not require any adjustment to the 2007 PCOs. I understand that these holdings are binding and OSBA cannot re-litigate the issues here. For this reason, I will not be addressing these issues in my testimony.

- In this 2007 case, the OSBA argued that Verizon PA must file numerical support for its business competitive overlay adjustment. (VZ PA 2007 PCO

1 Complaint ¶ 8(c)).² In the 2006 case, ALJ Gesoff's December 13, 2006
2 Recommended Decision ("RD") ruled against OSBA on this issue, holding
3 that VZ PA should not be required to provide this information as part of this
4 or future filings. (RD at 21). OSBA did not file Exceptions to this portion of
5 the RD and so this holding is the Commission's final decision on this issue
6 and is binding on the OSBA for the 2007 PCO proceeding and there is no
7 need to litigate this issue in this proceeding.

8 • In this 2007 case, OSBA argued that the rate increases must be spread
9 equally among all noncompetitive services, including switched access. (VZ
10 PA 2007 PCO Complaint ¶ 8(d); VZN 2007 PCO Complaint ¶ 8(c)). In the
11 2006 case, the Commission ruled against OSBA on this issue. (3/22/07
12 Order at 41-42). This holding is the Commission's final decision on this
13 issue and is binding on the OSBA for the 2007 PCO proceeding and there is
14 no need to litigate this issue in this proceeding.

15 • In this 2007 case, OSBA argued that that Verizon should be required to file
16 numerical support showing how the rate increases comply with the
17 residential rate cap set forth at 66 Pa. C.S. § 3015(a)(3). (VZ PA 2007 PCO
18 Complaint ¶ 8(e); VZ N 2007 PCO Complaint ¶8(d)). In the 2006 case, ALJ
19 Gesoff's RD ruled against OSBA on this issue, holding that VZ PA should
20 not be required to provide this information as part of this or future filings.
21 (RD at 26). OSBA did not file Exceptions to this portion of the RD and so
22 this holding is the Commission's final decision on this issue and is binding
23 on the OSBA for the 2007 PCO proceeding and there is no need to litigate
24 this issue in this proceeding.

25 • In this 2007 case, OSBA argued that Verizon PA's pre-Act-183 rate cap
26 language survived the amendment of Verizon PA's plan to comply with Act
27 183, and therefore still caps the allowable increase to certain business rates.
28 (VZ PA 2007 PCO Complaint ¶ 8(f)).³ In the 2006 case, the Commission
29 ruled against OSBA on this issue. (3/22/07 Order at 36). This holding is the
30 Commission's final decision on this issue and is binding on the OSBA for
31 the 2007 PCO proceeding and there is no need to litigate this issue in this
32 proceeding.

33 • In this 2007 case, OSBA argued that Verizon must allocate part of the
34 increase in noncompetitive service revenue to access rates. (VZ PA 2007
35 PCO Complaint ¶ 8(g); VZN 2007 PCO Complaint ¶ 8(e)). In the 2006

² This issue is not relevant to Verizon North because Verizon North does not perform a business overlay adjustment.

³ This issue is not relevant to Verizon North because Verizon North did not have the pre-Act 183 rate cap language in its plan.

1 case, the Commission ruled against OSBA on this issue. (3/22/07 Order at
2 41-42). This holding is the Commission's final decision on this issue and is
3 binding on the OSBA for the 2007 PCO proceeding and there is no need to
4 litigate this issue in this proceeding.

5 The following issues were resolved in the 2006 PCO proceeding against Verizon
6 and require adjustment to the 2007 filings (subject to Verizon's right to appeal):

- 7 • The OSBA complained for the 2007 PCO that the Commission should not
8 allow attribution of access revenue from competitive services to be included
9 in the noncompetitive revenue used for the PCO calculations. (VZ PA 2007
10 PCO Complaint ¶ 8(a); VZ N 2007 PCO Complaint ¶ 8(a)). The
11 Commission ruled in favor of OSBA on the attribution issue in the 2006
12 Orders. (3/22/07 Order at 16-18; 4/25/07 Order at 10-12). I discuss in more
13 detail later in this testimony the adjustments required to the 2007 PCO to
14 comply with this decision.
- 15 • In this case, OSBA argued that Verizon must use actual line counts at the
16 end of the historic period to calculate its increases, rather than the projected
17 number of lines in service during the period when the rate increases would
18 be in effect. (VZ PA 2007 PCO Complaint ¶ 8(h); VZ N 2007 PCO
19 Complaint ¶ 8(f)). The Commission ruled in favor of OSBA on the same
20 issue in the 2006 Orders. (3/22/07 Order at 50-52; 4/25/07 Order at 18-19).
21 I discuss in more detail later in this testimony the adjustments required to the
22 2007 PCO to comply with this decision.

23 The following issues are either new issues or are issues that the Commission
24 specifically directed should be litigated in this proceeding:

- 25 • In this 2007 case, OSBA complained that the Commission should disallow
26 the revenue line item for access-related intercompany settlements, which is
27 also an issue it raised against Verizon North, only, in the 2006 PCO case.
28 (VZ PA 2007 PCO Complaint ¶ 8(b); VZ N 2007 PCO Complaint ¶ 8(b)).
29 In the 2006 case, the Commission disallowed intercompany settlement
30 revenue for Verizon North based on the facts in the record in that
31 proceeding, but provided Verizon the opportunity to develop a record on this
32 issue to support inclusion of this noncompetitive revenue for future PCOs.
33 (3/22/07 Order at 22-23). I provide this evidence later in this testimony.
- 34 • In this 2007 case, OSBA argued that using the period of April 2005 through
35 March 2006 for the calculation of the 2007 PCO, rather than the July to June
36 period used for the 2006 PCO, would result in an improper calculation. (VZ
37 PA 2007 PCO Complaint ¶ 8(i); VZ N 2007 PCO Complaint ¶ 8(g)). This is

1 a new issue raised for the first time in this proceeding, and I will address it in
2 more detail later in this testimony.

3 **A. Changes In Compliance With The Commission's 2006 PCO Orders**
4

5 *1. Attribution*
6

7 **Q. IN ITS 2007 PCO FILING, DID VERIZON PA ADJUST ITS**
8 **NONCOMPETITIVE REVENUES TO ACCOUNT FOR ATTRIBUTION OF**
9 **ACCESS REVENUE ASSOCIATED WITH COMPETITIVE SERVICES?**

10 A. Yes. As depicted in Attachment A to Verizon PA's November 1, 2006 PCO filing
11 (Exhibit B to this testimony), to comply with this Commission's requirements at the
12 time of the filing regarding the calculation of noncompetitive revenue, Verizon PA
13 adjusted its noncompetitive revenue base by adding **[BEGIN VERIZON**
14 **PROPRIETARY] [END VERIZON PROPRIETARY]** to account
15 for attribution of access revenue included in Centrex Extend Service and
16 IntraLATA Toll Service. This adjustment left a total noncompetitive revenue base
17 for purposes of calculating the PCO of \$705,650,000.

18 **Q. IN ITS 2007 PCO FILING, DID VERIZON NORTH ADJUST ITS**
19 **NONCOMPETITIVE REVENUES TO ACCOUNT FOR ATTRIBUTION OF**
20 **ACCESS REVENUE ASSOCIATED WITH COMPETITIVE SERVICES?**

21 A. Yes. As depicted in Attachment A to Verizon North's November 1, 2006 PCO
22 filing (Exhibit C to this testimony), to comply with this Commission's requirements
23 at the time of the filing regarding the calculation of noncompetitive revenue, Verizon
24 North adjusted its noncompetitive revenue base by adding **[BEGIN VERIZON**
25 **PROPRIETARY] [END VERIZON PROPRIETARY]** to account for

1 attribution of access revenue included in IntraLATA toll service. This adjustment
2 left a total noncompetitive revenue base for purposes of calculating the PCO of
3 \$119,290,000.

4 **Q. IS THIS THE FIRST TIME VERIZON NORTH OR VERIZON PA HAS**
5 **MADE THESE ADJUSTMENTS TO ACCOUNT FOR ATTRIBUTION OF**
6 **ACCESS REVENUE IN CALCULATING THE BASE REVENUE FOR A**
7 **PCO?**

8 A. No. Verizon PA and Verizon North have made the exact same types of adjustments
9 for every PCO filing since the Commission imposed this attribution requirement in
10 the 1990s (including the 2006 PCO).

11 **Q. WHY DID VERIZON PA AND VERIZON NORTH MAKE THESE**
12 **ADJUSTMENTS?**

13 A. These adjustments were required by the Commission. By Order entered August 6,
14 1996 in the Competitive Safeguards Investigation at Docket M-00940587 the
15 Commission directed Verizon to separately account for and “compensate the
16 regulated business for the noncompetitive access services the Company uses to
17 provide its competitive services.” (p. 47). To do so, “the revenues from the rates for
18 access services reflected in the price of competitive services must be included in the
19 total revenue produced by the noncompetitive services.” (p. 46). The Competitive
20 Safeguards Order specifically refers to including this revenue in noncompetitive
21 revenue for PCO filings. (p. 44). The attribution adjustment adds to noncompetitive
22 revenue an amount that reflects the compensation to the regulated business for the

1 noncompetitive access services used to provide the competitive services of
2 IntraLATA toll and Centrex Extend for Verizon PA and IntraLATA toll for Verizon
3 North. Attribution is a mechanism by which the Commission assumes that Verizon
4 pays itself for the noncompetitive service that is a required input to its competitive
5 service, to put it on the same footing with competitors, who have to pay for access to
6 provide similar competitive services.

7 **Q. WHAT DID THE COMMISSION HOLD IN THE 2006 PCO CASE**
8 **REGARDING ATTRIBUTION?**

9 A. The Commission in its March 22, 2007 Order denied Verizon's Exceptions on this
10 issue and adopted the ALJ's recommendation. (3/22/07 Order at 17). The RD had
11 held that Verizon should remove the attribution revenue from the PCO calculations.
12 (RD at 17). The Commission on April 25, 2007 denied Verizon's petition for
13 reconsideration on this issue. Ordering paragraph 2 of that order stated that "the
14 request to include attribution revenue for Verizon Pennsylvania Inc.'s and Verizon
15 North Inc.'s 2006 and 2007 Price Change Opportunity filings is denied," making
16 clear the Commission had decided the issue for the 2007 PCO as well.

17 **Q. WHAT CHANGES ARE REQUIRED TO THE 2007 PCO FILINGS TO**
18 **COMPLY WITH THE COMMISSION'S ORDER IN THE 2006 CASE ON**
19 **ATTRIBUTION?**

20 A. Verizon will have to remove the attribution revenue line item from its
21 noncompetitive revenue for Verizon PA and Verizon North (subject to appeal
22 rights). When carried through the PCO formula, this will have the effect of reducing

1 **Q. HOW DOES VERIZON USE THE ASSUMED DEMAND FOR BASIC DIAL**
2 **TONE LINE SERVICE TO CALCULATE THE RATE INCREASES?**

3 A. The "demand" is the number of basic residential or business lines that Verizon
4 assumes will purchase tariffed basic exchange service in the year that the rate
5 increase is implemented. The assumed business demand for each rate element or
6 density cell is multiplied by the rate increase for that element or cell (and then
7 multiplied by 12 to arrive at an annual figure) to equal the total PCO revenue
8 assumed to be received from business local exchange service. Similarly, the
9 assumed residential demand for each rate element or density cell multiplied by the
10 rate increase for that element or cell (and then multiplied by 12 to arrive at an annual
11 figure) to equal the total PCO revenue assumed to be received from residence local
12 exchange service.

13 **Q. WHAT DEMAND DID VERIZON ASSUME TO CALCULATE THE**
14 **INCREASE TO RESIDENCE DIAL TONE LINE RATES FOR THE 2007**
15 **PCO?**

16 A. Verizon assumed that [BEGIN VERIZON PROPRIETARY] [END
17 VERIZON PROPRIETARY] lines would be purchasing basic residence dial tone
18 line service for Verizon PA and [BEGIN VERIZON PROPRIETARY]
19 [END VERIZON PROPRIETARY] lines would be purchasing basic residence
20 dial tone line service for Verizon North.

21 **Q. HOW DID VERIZON ARRIVE AT ITS ASSUMED DEMAND FOR**
22 **RESIDENCE LINES?**

1 A. Verizon started with the actual number of lines in service purchasing basic
2 residential dial tone line service as of June 2006, which was [BEGIN VERIZON
3 PROPRIETARY] [END VERIZON PROPRIETARY] for Verizon PA
4 and [BEGIN VERIZON PROPRIETARY] [END VERIZON
5 PROPRIETARY] for Verizon North. Based on the trend of line decreases Verizon
6 had been experiencing, Verizon projected the number of lines expected to be in
7 service through June of 2007 – the mid-point of the first year of PCO
8 implementation. That number was [BEGIN VERIZON
9 PROPRIETARY] [END VERIZON PROPRIETARY] for Verizon PA
10 and [BEGIN VERIZON PROPRIETARY] [END VERIZON
11 PROPRIETARY] for Verizon North, which was the residential demand Verizon
12 assumed.

13 **Q. WHAT ARE THE MOST CURRENT ACTUAL FIGURES AVAILABLE**
14 **FOR RESIDENTIAL LINES IN SERVICE FOR VERIZON PA AND**
15 **VERIZON NORTH, AND HOW DOES THIS COMPARE TO WHAT**
16 **VERIZON ASSUMED?**

17 A. The most current available actual figures at the time of submission of this testimony
18 are as of March 31, 2007. It would be most relevant for the Commission to consider
19 the actual lines as of June of 2007 (which is what Verizon projected in its filing). I
20 will update these actual figures as information is available in my rebuttal and/or
21 surrebuttal testimony. The following Table depicts Verizon's actual residential lines
22 as of March 31, 2007 and projects those lines through to June of 2007, assuming that

1 they would continue to decline at the same rate that they have declined in the nine
2 months since June of 2006.

3 **[BEGIN VERIZON PROPRIETARY]**

4
5
6

7
8 **[END VERIZON PROPRIETARY]**

9 **Q. WHAT WERE THE ACTUAL RESIDENTIAL LINES IN SERVICE FOR**
10 **VERIZON PA AND VERIZON NORTH AS OF MARCH 31, 2006 AND**
11 **JUNE 30, 2006?**

12 **A.** The actual number of lines in service purchasing basic residential dial tone line
13 service as of March 31, 2006 was **[BEGIN VERIZON PROPRIETARY]**
14 **[END VERIZON PROPRIETARY]** for Verizon PA and **[BEGIN**
15 **VERIZON PROPRIETARY]** **[END VERIZON PROPRIETARY]** for
16 Verizon North. The actual number of lines in service purchasing basic residential
17 dial tone line service as of June 30, 2006 was **[BEGIN VERIZON**
18 **PROPRIETARY]** **[END VERIZON PROPRIETARY]** for Verizon PA
19 and **[BEGIN VERIZON PROPRIETARY]** **[END VERIZON**
20 **PROPRIETARY]** for Verizon North.

1 **Q. WHAT DEMAND DID VERIZON ASSUME TO CALCULATE THE**
2 **INCREASE TO BUSINESS DIAL TONE LINE RATES FOR THE 2007**
3 **PCO?**

4 A. Verizon assumed that **[BEGIN VERIZON PROPRIETARY]** **[END**
5 **VERIZON PROPRIETARY]** lines would be purchasing basic business dial tone
6 line service for Verizon PA and **[BEGIN VERIZON PROPRIETARY]**
7 **[END VERIZON PROPRIETARY]** lines would be purchasing basic business dial
8 tone line service for Verizon North.

9 **Q. HOW DID VERIZON ARRIVE AT ITS ASSUMED DEMAND FOR**
10 **BUSINESS LINES?**

11 A. Verizon started with the actual number of lines in service purchasing basic business
12 dial tone line service as of June 2006, which was **[BEGIN VERIZON**
13 **PROPRIETARY]** **[END VERIZON PROPRIETARY]** for Verizon PA
14 and **[BEGIN VERIZON PROPRIETARY]** **[END VERIZON**
15 **PROPRIETARY]** for Verizon North. Based on the trend of line decreases Verizon
16 had been experiencing, Verizon projected the number of lines expected to be in
17 service through June of 2007. That number was **[BEGIN VERIZON**
18 **PROPRIETARY]** **[END VERIZON PROPRIETARY]** for Verizon PA
19 and **[BEGIN VERIZON PROPRIETARY]** **[END VERIZON**
20 **PROPRIETARY]** for Verizon North. Verizon then assumed that 5% of measured
21 basic dial tone line customers would migrate to the competitive 24 month term plan
22 that remains available for business customers who wish to lock in their rates for a

1 two-year period. Accordingly, Verizon assumed a demand of [BEGIN VERIZON
2 PROPRIETARY] [END VERIZON PROPRIETARY] for Verizon PA
3 and [BEGIN VERIZON PROPRIETARY] [END VERIZON
4 PROPRIETARY] for Verizon North.

5 **Q. WHAT ARE THE MOST CURRENT ACTUAL FIGURES AVAILABLE**
6 **FOR BUSINESS LINES IN SERVICE FOR VERIZON PA AND VERIZON**
7 **NORTH, AND HOW DOES THIS COMPARE TO WHAT VERIZON**
8 **ASSUMED?**

9 A. The most current available actual figures at the time of submission of this testimony
10 are as of March 31, 2007. It would be most relevant for the Commission to consider
11 the actual lines as of June of 2007 (which is what Verizon projected in its filing). I
12 will update these actual figures as information is available in my rebuttal and/or
13 surrebuttal testimony. The following Table depicts Verizon's actual business lines
14 as of March 31, 2007 and projects those lines through to June of 2007, assuming that
15 they would continue to decline at the same rate that they have declined in the nine
16 months since June of 2006.

17 [BEGIN VERIZON PROPRIETARY]

18
19
20
21

1 [END VERIZON PROPRIETARY]

2 Q. WHAT WERE THE ACTUAL BUSINESS LINES IN SERVICE AS OF
3 MARCH 31, 2006 AND JUNE 30, 2006 FOR VERIZON PA AND VERIZON
4 NORTH?

5 A. The actual number of lines in service purchasing basic business dial tone line service
6 as of March 31, 2006 was [BEGIN VERIZON PROPRIETARY] [END
7 VERIZON PROPRIETARY] for Verizon PA and [BEGIN VERIZON
8 PROPRIETARY] [END VERIZON PROPRIETARY] for Verizon
9 North. The actual number of lines in service purchasing basic business dial tone line
10 service as of June 30, 2006 was [BEGIN VERIZON PROPRIETARY]
11 [END VERIZON PROPRIETARY] for Verizon PA and [BEGIN VERIZON
12 PROPRIETARY] [END VERIZON PROPRIETARY] for Verizon
13 North.

14 Q. WHAT DID THE COMMISSION HOLD IN THE 2006 PCO CASE
15 REGARDING LINE COUNTS?

16 A. The Commission required Verizon PA and Verizon North “to use the business line
17 counts as well as the residential line counts as of June 30, 2005, for their [2006]
18 PSM calculations,” and also to “adhere to using line counts as of June 30 in the
19 future for each year in which it files a PCO filing.” (3/22/07 Order at 50). The
20 Commission denied Verizon’s petition for reconsideration on this issue.

1 **Q. WHAT CHANGES ARE REQUIRED TO THE 2007 PCO TO COMPLY**
2 **WITH THE COMMISSION'S ORDER IN THE 2006 CASE ON LINE**
3 **COUNTS?**

4 A. The line count assumption for basic residential and business rate increases will have
5 to be altered from the projected number of lines to the actual number of lines in
6 service at the end of the historical period of revenue collection. (See 3/22/07 Order
7 at 51). Since Verizon has moved back its historical period for the 2007 filing to end
8 on March 31, 2006, compliance would require using lines from March 31, 2006.
9 These numbers appear in my testimony, above.

10 **Q. HOW WILL VERIZON IMPLEMENT THESE CHANGES?**

11 A. The Commission's April 25, 2007 Order held that Verizon may "roll all rate
12 revisions and refund true-ups from the 2006 and 2007 PCO filings into the 2008
13 PCO." (4/25/07 Order, Ordering ¶ 4). Verizon expects to make that filing
14 November 1, 2007, with rate changes effective January 1, 2008.

15 **B. Additional Issues Raised By OSBA Not Resolved By 2006 PCO Orders**

16 *1. Intercompany Settlements*

17
18
19 **Q. WHAT ARE INTERCOMPANY SETTLEMENTS AND HOW DO THEY**
20 **AFFECT THE PCO CALCULATIONS?**

21 A. "Intercompany settlements" refers to payments made under agreements among
22 ILECs to account for services provided between the companies. These payments are
23 made under various agreements among Pennsylvania ILECs, including the
24 IntraLATA Toll Originating Responsibility Plan ("ITORP"). The Commission has

1 recognized that ITORP is “a toll settlement process through which ILECs reimburse
2 each other for the use of the loop and switching facilities for the termination of
3 intraLATA toll calls that originate in a different service territory than which they
4 terminate.” (*Global Order* footnote 14). The intercompany settlements process is
5 an overall agreement by which a net amount owed by one company to another
6 company is calculated by considering all amounts owed as between the two
7 companies under each of the agreements that is part of the settlement process,
8 including ITORP. Verizon PA and Verizon North have specifically included in their
9 noncompetitive revenue a line item for the revenue they receive from intercompany
10 settlements. This same line item has been included for this and every other Verizon
11 PCO. The Commission has never taken issue with its inclusion, until the OSBA
12 raised the issue with the 2006 PCO.

13 **Q. WHAT DID THE COMMISSION HOLD WITH RESPECT TO**
14 **INTERCOMPANY SETTLEMENTS IN THE 2006 PCO CASE?**

15 A. OSBA had challenged Verizon North’s (but not Verizon PA’s) inclusion of inter-
16 company settlements revenue for 2006, arguing that Verizon had not demonstrated
17 that this was really access revenue. The Commission disallowed Verizon North’s
18 inclusion of intercompany settlements revenue for 2006 because it concluded that
19 Verizon had not provided sufficient proof that all of the revenue was access-related,
20 but it stated that “[t]his directive is made without prejudice to subsequent Verizon
21 North PCO proceedings but shall apply to Verizon North’s future PCO filings unless
22 Verizon adequately demonstrates in those cases that ITC Settlements are properly

1 classified as noncompetitive revenue for purposes of PCO rate cap calculations.”
2 (3/22/07 Order at 23).

3 **Q. WHAT IS THE BASIS FOR VERIZON’S CONTENTION THAT THE**
4 **INTERCOMPANY SETTLEMENT REVENUE IT INCLUDED FOR THE**
5 **2007 PCO IS ACCESS REVENUE THAT IS PROPERLY CLASSIFIED AS**
6 **NONCOMPETITIVE REVENUE FOR PURPOSES OF ITS PCO**
7 **CALCULATIONS?**

8 A. For purposes of including a line item for intercompany settlements for the 2007
9 PCO, Verizon PA included only the revenue from the ITORP agreement. It did not
10 include revenue from other intercompany agreements. For Verizon PA \$2.63
11 million in revenue was included for ITC settlements. This revenue comes from
12 Revenue Account 5084.28, which is only ITORP revenue. Similarly for Verizon
13 North, of the \$1.496 million in intercompany settlement revenue \$1.415 is ITORP
14 revenue. The remainder is also access-related revenue for tandem transport provided
15 to IXC’s jointly with another ILEC, which is Feature Group A access.

16 **Q. WHY IS ITORP REVENUE NONCOMPETITIVE INTRASTATE**
17 **SWITCHED ACCESS REVENUE?**

18 A. The revenue that Verizon receives from other ILECs through the ITORP
19 arrangement is payment of Verizon’s tariffed switched access rates for terminating
20 toll calls from other ILECs’ end users to Verizon’s customers. As this Commission
21 has previously explained:

22 ITORP is an intrastate intraLATA toll settlement process between
23 Pennsylvania local exchange companies ("LECs") that was started on

1 January 1, 1986, whereby each LEC: (1) applies its toll tariff to their
2 customers for origination of intraLATA toll calls in that LEC's territory
3 and books the money collected from these calls as its intraLATA toll
4 revenues (commonly referred to as "bill and keep"); and (2) applies its
5 access charge tariffs to other LECs for terminating toll calls in their
6 territory, as well as for directory assistance and any other ancillary
7 services provided to the other LECs. *Access charges* owed between
8 each LEC are then netted under ITORP on a monthly basis and each
9 LEC will either pay out or receive payment as settlement for that
10 month's terminating access. ITORP was approved to replace the
11 transitional intrastate toll settlement process known as the Toll
12 Compensation Plan which was approved to become effective January 1,
13 1984, until December 31, 1985, and which was developed to replace the
14 similar pre-divestiture pooling arrangement among AT&T, Bell of
15 Pennsylvania and the Pennsylvania independent telephone companies.⁴

16 There can be no doubt that payments received under ITORP are access payments.

17 In fact, this Commission in the *Global Order* recognized that reductions in ITORP
18 payments represent access reductions due to decreases in the tariffed access rates of
19 other ITORP participating carriers. (See, e.g., *Global Order* at 19, 38-39, 44-46,
20 54).

21 **Q. WHY IS ITORP ACCESS REVENUE NOT ALREADY INCLUDED IN THE**
22 **LINE ITEM FOR ACCESS REVENUE IN VERIZON'S FILINGS?**

23 A. While payments made under the ITORP arrangements are payments for access
24 services, they are not billed in the same manner as access charges to non-ITORP
25 carriers. This other access revenue is the source of the standard intrastate access
26 revenue figure in Verizon's filings. Access revenue from ITORP is taken from
27 account 5084.28 and is separately reported under the intercompany settlements line
28 item. This separate reporting is simply a matter of accounting convention; it does

⁴ *Investigation Regarding The IntraLATA Toll Originating Responsibility Plan*, I-00870076, 1994 Pa. PUC LEXIS 130 (Opinion and Order entered December 21, 1994) (emphasis added).

1 not change the fact that ITORP revenues are just as much access revenues as the
2 standard access revenues booked to the main account. Accordingly, to fully report
3 Verizon's revenue from intrastate switched access services it is necessary to account
4 both for the intrastate access revenue from other carriers and for the portion of the
5 intercompany settlements attributable to access payments via ITORP.

6 *2. Revenue Time Period*

7
8 **Q. WHAT TIME PERIOD DID VERIZON USE FOR THE CALCULATIONS**
9 **IN ITS 2007 PCO FILINGS?**

10 A. The 2007 PCO filings of Verizon PA and Verizon North were based on actual
11 noncompetitive revenues for the 12-month period from April 1, 2005 to March 31,
12 2006. The change in the inflation rate used corresponds to this same period,
13 specifically the change in the rate from the end of the first quarter of 2005 to the end
14 of the first quarter of 2006.

15 **Q. IS THIS DIFFERENT FROM THE TIME PERIOD USED FOR THE 2006**
16 **PCO FILINGS?**

17 A. Yes. For the 2006 PCO, Verizon used the time period from July 1, 2004 through
18 June 30, 2005 as the 12 month period of actual revenue and used the change in the
19 rate of inflation from the end of the second quarter of 2004 to the end of the second
20 quarter of 2005.

21 **Q. DOES CHAPTER 30 OR VERIZON PA'S OR VERIZON NORTH'S PLAN**
22 **REQUIRE ANY PARTICULAR 12-MONTH PERIOD TO BE USED?**

1 A. No. Nothing in Act 183 or in Verizon PA's Chapter 30 Plan requires the use of the
2 July to June 12-month time period, and accordingly it is permissible to use the
3 period from April 2005 to March 2006. Verizon PA's plan states that the "revenue"
4 in the PCO formula is Verizon PA's "[i]ntrastate noncompetitive service revenue
5 amount billed by [Verizon PA] for the twelve month period corresponding to the
6 twelve month period in the annual change in the GDP-PI." (Verizon PA Chapter 30
7 Plan at 6). Verizon North's plan is silent on the time period from which the revenue
8 should be taken.

9 **Q. WHY DID VERIZON USE A DIFFERENT TIME PERIOD FOR THE 2007**
10 **FILING?**

11 A. The time period for collection of revenue data was moved back one quarter in
12 comparison with the time frame used in prior PCO filings to allow adequate time for
13 customer notice and changes in the billing system. Specifically, Verizon found with
14 the 2006 PCO that if it had to wait to use revenue data ending on June 30, that data
15 was not actually available in usable form until September. Similarly, the GDP-PI
16 for the end of the second quarter is only available in final form at the very end of
17 September.

18 The Commission requires that customers be given 30 days notice of rate
19 increases. *See, e.g.*, 52 Pa. Code § 53.45. These notices are customarily included in
20 customers' bills. In practice, this regulation means that customers must start
21 receiving notice in the November billing period for increases scheduled to go into
22 effect on January 1, to ensure that even the customers who receive their bill at the

1 end of November receive the full 30 day's notice. To meet programming
2 requirements, the text of the customer notice must be available approximately 6
3 weeks in advance, which means that notices to be included in November bills must
4 be available in mid-September. Thus, if July to June data is used, Verizon's
5 business units do not have sufficient time to determine what rates should be
6 increased, to determine the amount and allocation of the rate increases and to
7 prepare the appropriate customer notices.

8 **Q. IS THERE ANY WAY TO ESTIMATE WHAT THE RESULT WOULD**
9 **HAVE BEEN HAD VERIZON CALCULATED THE 2007 PCO BASED ON**
10 **THE SAME JULY THROUGH JUNE TIME PERIOD USED FOR THE 2006**
11 **PCO?**

12 A. Yes. First, it is simple to determine what the change in the GDP-PI would have been
13 for each scenario. For the April 1, 2005 through March 31, 2006 time period that
14 Verizon used, the change in the GDP-PI was 3.31%. For the July 1, 2005 through
15 June 30, 2006 time period, the change in the GDP-PI was 3.55%. The Table below
16 demonstrates that even accounting for the likelihood of a lower revenue base during
17 the latter period,⁵ the amount of the 2007 PCO for Verizon PA would have been
18 nearly \$1 million higher if the July through June time period had been used. The
19 reason the PCO would have been higher is because the change in the rate of inflation

⁵ To determine what noncompetitive revenue would have been used in the PCO formula if Verizon PA had used the revenue period from July 1, 2005 through June 30, 2006, Verizon PA considered the fact that, based on the difference in revenue between the 2006 and 2007 PCO, Verizon PA has been experiencing a decline in noncompetitive revenue of approximately 12% per year. Verizon thus assumed that if it had used the same time period that was used for the 2006 PCO, the noncompetitive revenues for the 2007 PCO would have been 12% lower than the 2006 PCO revenue.

1 was higher, more than offsetting the expected decline in noncompetitive revenues.
2 In other words, Verizon PA's customers received lower increases for the 2007 PCO
3 because Verizon PA moved back the revenue period by one quarter. The 2007 PCO
4 was thus the best time to move back the revenue period one quarter, because for this
5 year the fact that the historic revenue and inflation period overlapped by one quarter
6 with the period used to calculate the 2006 PCO actually provides a benefit to
7 customers by resulting in a lower rate increase. In the future, Verizon plans to use
8 the March through April time period for each PCO calculation.

9 **TABLE 4: COMPARISON OF VERIZON PA 2007 PCO**
10 **WITH ALTERNATE TIME PERIODS**
11

2007 PCO As Filed		Difference from PCO As Filed
Revenue & Inflation from 4/1/05 to 3/31/06		
Actual Revenue - 12 months ending 3/31/06	\$705,650,000	
Actual Inflation - 1st Qtr 06 over 1st Qtr 05	3.31%	
Offset	0.50%	
PCO Amount	\$19,829,000	
2007 PCO With Alternate Time Period		
Revenue & Inflation from 7/1/05 to 6/30/06		
Estimated Revenue ¹ - 12 months ending 6/30/06	\$682,000,000	
Actual Inflation - 2nd Qtr 06 over 2nd Qtr 05	3.55%	
Offset	0.50%	
PCO Amount	\$20,801,000	\$972,000
¹ Estimate based on the revenue decline between the 06 & 07 PCOs.		

12 While the more complex nature of Verizon North's formula does not lend itself to
13 easy demonstration in a Table as with Verizon PA's, the difference in the change in
14 the rate of inflation portion of the formula would be the same for Verizon North as it
15

1 was for Verizon PA (3.31% with PCO as filed, versus 3.55% if the traditional time
2 period had been used). Even if Verizon North experienced a similar revenue
3 decline as Verizon PA, the higher inflation figure would be expected to result in a
4 higher PCO for Verizon North if the traditional time period were used.

5 **IV. BANKING**

6 **Q. WHAT IS "BANKING" IN CONNECTION WITH A PCO FILING?**

7 A. Banking refers to the situation where a company does not implement the entire
8 amount of its PCO for a particular year, but saves it for implementation in a future
9 year. If the PCO is positive, entitling the company to an increase to noncompetitive
10 revenue, then the company could bank all or part of the increase rather than raising
11 rates. For example, if the PCO entitled the company to increase noncompetitive
12 revenue by \$1 million, then the company could choose to raise rates to obtain
13 \$500,000 in new annual revenue and to bank the remaining \$500,000 for future use.
14 Similarly, a company could be permitted to bank some or all of a negative PCO,
15 deferring rate reductions to a future time and keeping the negative value in its bank.

16 **Q. WHAT ISSUE RELATING TO BANKING HAS THE COMMISSION**
17 **ASKED TO BE ADDRESSED IN THIS PROCEEDING?**

18 A. The Commission has asked for a recommendation regarding the methodology for
19 calculating the net amount remaining in Verizon PA's bank. In its December 28,
20 2006 Order relating to Verizon PA's 2007 PCO filing, the Commission initially set
21 forth the Commission Staff's belief as to what amounts remained in Verizon PA's
22 bank – a calculation that was erroneous in several respects. Verizon PA filed a

1 petition for reconsideration on the grounds that it had never been given the
2 opportunity to be heard on the banking issue to point out the significant errors in the
3 Staff's calculations. Accordingly, Verizon argued that the Commission could not
4 simply adopt the Staff's faulty calculations without providing Verizon an
5 opportunity to be heard on the banking issue. The Commission granted Verizon
6 PA's petition by Order entered January 11, 2007. It rescinded those portions of the
7 order adopting the Staff's banking calculation, and instead directed this proceeding
8 to determine the methodology for determining the amount remaining in Verizon
9 PA's bank. Pending the outcome of this proceeding, the Commission stated that it
10 would "withhold any final judgment" on the correctness of any particular
11 methodology. (1/11/07 Order at 6).

12 **Q. WHAT FACTORS MAKE IT MORE COMPLEX TO CALCULATE THE**
13 **AMOUNT REMAINING IN VERIZON PA'S BANK?**

14 A. The issue of calculating the net remainder in Verizon PA's bank is made more
15 complicated by the fact that the Commission permitted Verizon PA to use its
16 negative PCO from 2003 to fund its USF payments, and to bank any differences
17 between the USF payment and the available funds each year. The Commission also
18 approved Verizon PA's banking of a portion of a positive PCO from 2006.
19 Calculating the net remainder in the bank requires properly accounting for positive
20 and negative values each year to arrive at a cumulative net value in the bank, and
21 also determining what amounts remain available to be spent on a recurring basis for

1 the next year. Before discussing the methodological issues, I will first explain the
2 background of each of the two banked PCOs.

3 **A. History of Banking of the 2003 PCO**

4
5 **Q. WHAT IS THE ORIGIN OF VERIZON'S BANKING OF A NEGATIVE**
6 **AMOUNT FOR THE 2003 PCO?**

7 A. For the year 2003, Verizon PA had a negative PCO in the amount of \$17,718,000.
8 By Order entered September 9, 2003 at docket M-00031694, the Commission
9 authorized Verizon PA to use its 2003 PCO money to fund its required contributions
10 to the Pennsylvania Universal Service Fund ("USF") for the year 2003. The
11 Commission found that "the Commission had legal authority and did modify
12 Verizon Pa.'s Chapter 30 Plan in the *Global Order* to the extent that it approved the
13 Small Company Plan provision regarding the use of negative PCO amounts to
14 support Verizon Pa.'s USF obligations." (9/9/03 Order at 8). The Commission noted
15 that using this PCO money to "support the access reductions in other incumbent
16 local exchange carrier's territories" "supports the universal service purpose" and is
17 "in the public interest." (*Id.* at 9).

18 By order entered October 11, 2005 at Docket P-00930715, the Commission
19 made clear that it was allowing Verizon PA to use this negative PCO to fund its USF
20 payments, with the presumption that it would be used to cover Verizon PA's USF
21 contribution every year, subject to the Commission's annual approval. The
22 Commission noted that its September 9, 2003 order had been limited to the year
23 2003, and had not clearly addressed whether this money could be used every year to

1 offset USF contributions. The Commission clarified that situation by holding that
2 “we shall permit Verizon PA to continue using its 2003 PCO to fund its annual Pa.
3 USF contributions on the condition that Verizon PA request permission to use its
4 2003 PCO in this manner on an annual basis with its annual PCO filing.” (10/11/05
5 Order at 4).

6 The Commission also noted in that October 11, 2005 order that Verizon PA
7 had been permitted to use \$243,517 of the 2003 PCO to support access reductions,
8 so that the remaining negative 2003 PCO available to cover Verizon PA’s USF
9 payments each year is \$17,474,483.

10 **Q. HAS VERIZON PA BEEN USING THE FULL \$17,474,483 TO OFFSET ITS**
11 **USF PAYMENTS EACH YEAR?**

12 **A.** No. The Commission recognized in the October 11, 2005 order that Verizon PA’s
13 annual USF contribution might be smaller than the available 2003 PCO value. It
14 stated that in that event “we shall direct Verizon PA to bank the differences each
15 year to be applied to future Pa. USF obligations and account for this in the annual
16 PCO filings including interest on the banked amounts.” (10/11/05 Order at 4).

17 The amount of Verizon PA’s required contribution to the USF each year has
18 been less than \$17,474,483 and Verizon PA has been left with yearly “differences”
19 to be added to its bank as discussed in the October 11, 2005 order. Thus, the bank
20 has accrued a string of negative amounts (the gap between the 2003 PCO value and
21 the actual USF payment in each year). Every year Verizon is required to debit its
22 bank account by the difference between the available amount of the 2003 PCO --

1 \$17,474,483 – and the amount used to make its USF payment. The chart below
2 depicts the string of one-time gaps between the USF payment and the banked 2003
3 PCO. (The cumulative effect of these differences will be shown later in the
4 testimony, as for some years they must include the offsetting impacts of positive
5 banked amounts from the 2006 PCO. These issues are discussed later in the
6 testimony, as is applicable interest):

7 **TABLE 5: VERIZON PA ANNUAL GAPS BETWEEN**
8 **2003 PCO AND USF PAYMENTS**
9

2003 PCO Status as of	1/1/2004	1/1/2005	1/1/2006	1/1/2007
2003 PCO filed amount	-\$17,718,000	-\$17,718,000	-\$17,718,000	-\$17,718,000
Amount used for access reductions	\$0	\$243,517	\$243,517	\$243,517
State USF Payment	\$17,474,483	\$16,201,846	\$15,841,592	\$15,580,962
Annual Difference	-\$243,517	-\$1,272,637	-\$1,632,891	-\$1,893,521

10

11 **B. History of Banking of the 2006 PCO**
12

13 **Q. WHAT IS THE ORIGIN OF VERIZON'S BANKING OF A POSITIVE**
14 **AMOUNT FOR THE 2006 PCO?**

15 **A.** In its original 2006 PCO filing Verizon PA proposed to bank \$1.229 million of the
16 positive PCO revenue. In its March 22, 2006 order, the Commission approved the
17 proposal to bank this portion of the 2006 PCO. It noted that if the banking were not
18 permitted, then “the only alternatives available to Verizon PA are to (1) forego that
19 portion of the PCO that they desire to bank or (2) increase rates by the full [PCO
20 amount]. In our opinion, we cannot force Verizon PA to forego an increase to which
21 it is entitled. As such, the only option available to Verizon PA would be to make the
22 increases larger than proposed.” (3/22/06 Order at 5). Not wanting to force Verizon

1 PA to raise rates beyond what it had proposed, the Commission approved the
2 banking and agreed that certain banking language from the Sprint/United Chapter 30
3 Plan would be added to Verizon PA's plan.

4 The situation that gives rise to banking in 2006 is conceptually identical to
5 the 2003 situation. In each case there is a recurring total PCO value -- negative
6 \$17,718,000 for 2003 and positive \$14,247,000 for 2006 -- that is not being fully
7 implemented. The 2003 amount is not fully implemented because the sum of
8 Verizon PA's USF contribution and an access rate reduction are less than the full
9 value of the 2003 PCO and the 2006 amount is not fully implemented because the
10 rate increases that Verizon PA implemented in 2006 produce less annually than the
11 full value of the 2006 PCO. In 2006 and 2007, just as in 2003 and subsequent years,
12 Verizon PA is left with yearly gaps between the value of the PCO and the amount
13 implemented in rates. The only difference is that in the 2006 case the bank has
14 accrued a string of positive amounts, (the gap between the 2006 PCO value and the
15 actual rates implemented each year), while in 2003 the accrued amounts are
16 negative. It follows then that every year Verizon's account should be credited with
17 the difference between the available amount of the 2006 PCO and the amount
18 implemented in rates, just as it is debited for the 2003 differences.

19 **Q. WILL THE CHANGES BEING MADE IN COMPLIANCE WITH THE**
20 **COMMISSION'S MARCH 22, 2007 AND APRIL 25, 2007 ORDERS CAUSE**
21 **ANY ALTERATION IN THE BANKED AMOUNT FROM THE 2006 PCO?**

1 A. Yes. When it implements its changes to the 2006 PCO to comply with the
2 Commission's orders Verizon PA will change the banked amount from \$1.229
3 million to \$601,300. The new banked amount will be used in the calculations to
4 follow in this testimony. The methodological issues I am discussing are not altered
5 by the change in this value.

6 **Q. IS THERE ANOTHER ISSUE FROM THE COMMISSION'S MARCH 22,**
7 **2006 ORDER ORIGINALLY APPROVING THE 2006 PCO**
8 **IMPLEMENTATION PROPOSAL THAT AFFECTS THE BANKING**
9 **CALCULATION?**

10 A. Yes. The Commission also approved Verizon PA's proposal "to account for the
11 two-month plus two-day delay in implementation of the 2006 PCO by using a
12 portion of the banked value associated with the Company's 2003 PCO." (3/22/06
13 Order at 7). At the time the March 22, 2006 order was entered, Verizon PA
14 calculated the delay value at \$2,884,301, which was the figure the Commission Staff
15 used in its banking calculations. However, due to the removal of attribution revenue
16 as a result of the March 22, 2007 and April 25, 2007 orders, the overall value of the
17 2006 PCO is reduced (as I depict in Table 1 above). This reduction has the effect of
18 reducing the delay value of the two months of foregone revenue. Under the 2006
19 PCO as revised in compliance with the Commission's recent orders, the delay value
20 is \$2,451,097.

21 **Q. COULD YOU SUMMARIZE THE IMPLEMENTATION AND BANKING**
22 **OF THE 2006 PCO, BOTH WITH THE ORIGINALLY FILED NUMBERS**

1 **AND WITH THE REVISED NUMBERS BASED ON THE COMPLAINEE**
2 **WITH THE COMMISSION'S MORE RECENT ORDERS ON THE 2006**
3 **PCO?**

4 A. Yes. The implementation of the 2006 PCO is depicted in the Table below.

5 **TABLE 6: IMPLEMENTATION OF 2006 PCO AS FILED**
6 **VERSUS COMPLIANCE MODIFICATIONS**
7

	A: As Originally Filed	B. Modified In Compliance
2006 PCO One-Time Values		
2-month Delay Value	\$2,884,301	\$2,451,097
2006 PCO Recurring Values		
a. 2006 PCO Filed Amount	\$16,765,000	\$14,247,000
b. Local exchange and other rate increases	\$15,535,600	\$13,645,700
Difference (a-b) a/k/a Banked Amount (Recurring)	\$1,229,400	\$601,300

8
9 **Q. HAS VERIZON PA BANKED ANY AMOUNTS FROM ANY OTHER PCOS**
10 **BESIDES THE 2006 AND 2003 PCOS?**

11 A. No.

12 **C. Calculating The Net Remainder In The Bank.**

13
14 **Q. HOW DOES ONE PROPERLY CALCULATE THE NET AMOUNT**
15 **REMAINING IN THE BANK FOR VERIZON PA?**

16 A. The net remainder in the bank for a given year is the arithmetic sum of all the
17 negative and positive banked amounts for that year, plus the cumulative sum of
18 banked amounts (if any) remaining from the previous year, plus applicable interest.

19 **Q. HOW DO WE DETERMINE WHAT THE NEGATIVE AND POSITIVE**
20 **BANKED AMOUNTS ARE FOR ANY GIVEN YEAR?**

1 A. These are amounts from current or prior PCOs that have not been fully
2 implemented. For example, the 2003 PCO has not been fully implemented in any
3 year, since the sum of the USF payments and the access reductions are less than the
4 value of the PCO. This difference gives rise to the amounts shown in Table 5,
5 above. The 2006 PCO is a similar example, albeit in a positive direction, since the
6 rates implemented in 2006 fell short of the full value of the PCO (as revised for the
7 PUC's recent decision) by \$601,300. Until additional rate increases are
8 implemented to use up some or all of that difference, it will be added to Verizon
9 PA's bank balance every year.

10 Sometimes, the amounts that have not been implemented have only a one-
11 time effect, so will appear only as a one-time debit or credit, and will not reappear
12 the next year. For example, in 2006 VZ PA delayed the implementation of its PCO
13 by 2 months. For that year only, it did not receive \$2,451,097 it was entitled to, and
14 so received a credit in the bank for that amount, but only for that year.

15 **Q IS THE CUMULATIVE NET VALUE IN THE BANK THE TOTAL**
16 **AVAILABLE TO SUPPORT FUTURE RATE CHANGES?**

17 A. No. It is an historic figure, the value of the account as of a point in time. It does (or
18 should) reflect all deposits and withdrawals up to that point. It says nothing about
19 what may or may not be credited to or debited from the bank account in the future.
20 That is a function of recurring and one-time payments the company may have an
21 obligation to make (like an individual's obligation to pay a mortgage or taxes) or a
22 right to receive (like an individual's right to receive wages or proceeds from the sale

1 of a house). Just as those obligations and rights are not altered by an individual's
2 bank balance at a given point in time, neither are Verizon's future obligations to
3 reduce rates or rights to increase rates impacted by the net cumulative bank value as
4 of a given point.

5 **Q. HOW DID STAFF'S PROPOSAL VIOLATE THESE BANKING**
6 **PRECEPTS?**

7 A. Staff made two errors. First, Staff did not account in the netting of credits and debits
8 in 2007 for that portion of the 2006 PCO that had not been implemented in rates.
9 This was inconsistent with the way Staff treated the negative value of the 2003 PCO
10 that was not implemented in rates, which it has continued to debit from Verizon's
11 account each year from 2003 forward. This error resulted in Staff's faulty
12 calculation of Verizon PA's bank balance for 2007. Second, Staff incorrectly
13 conceptualized the cumulative net bank balance it erroneously calculated, treating it
14 like an obligation to make a recurring rate reduction. That is like the bank requiring
15 a customer who has overdrawn his account by \$500 to pay the bank \$500 every year
16 for the rest of his life.

17 The negative or positive net cumulative amount in the bank at any point in
18 time is a summary up to that point of all the credits and debits to date. If negative, it
19 is the one time amount that the company must pay customers to "wipe the slate
20 clean" for the historic period covered – but only for that period. If Verizon PA had
21 given customers a one-time credit of \$180,890 in 2006 (the cumulative banked
22 amount for that year as shown on Exhibit A), it would have reduced the net

1 cumulative banked amount to zero – but that zero would not mean that Verizon PA
2 had satisfied its future, post-2006 obligations to its customers. Verizon PA's
3 account would properly still be debited in 2007 for the difference between the value
4 of the 2003 PCO and Verizon PA's 2007 USF payments, and it should still be
5 credited for the difference between the value of the 2006 PCO and the lesser value
6 of the rate increases implementing that PCO.

7 **Q. COULD YOU EXPLAIN THE PROPER CALCULATION OF THE**
8 **CUMULATIVE NET VALUES REMAINING IN VERIZON PA'S BANK AS**
9 **OF JANUARY 1, 2007 (FOLLOWING IMPLEMENTATION OF THE 2007**
10 **PCO)?**

11 A. Yes. The calculation of the cumulative net value in Verizon PA's bank, inclusive of
12 interest, as of January 1, 2007 is depicted on Exhibit A to this testimony. Following
13 implementation of the 2007 PCO (and assuming the alterations to the 2006 and 2007
14 PCOs required to comply with the Commission's March 22 and April 25, 2007
15 orders) the cumulative net value is negative \$1,610,536. This cumulative net value
16 is calculated by looking at each year in which money is carried in the bank and
17 netting the value of all the amounts credited and debited for that year to calculate the
18 net value remaining in the bank for that year. A cumulative value is obtained by
19 adding that amount to the cumulative value for the previous year. Interest is then
20 applied to the cumulative net value. For example, if the cumulative net in the bank
21 was -\$2 million in 2006, and the one-year net for 2007 was \$1 million, the
22 cumulative net would be -\$1 million (negative \$ 2 million plus positive \$1 million).

1 To be clear, this cumulative net of one-time values does not necessarily tell
2 you what amount is available to be spent on recurring rate changes in the next year.
3 The net banked amount for any given year is an amount comprised of the net values
4 to date of all the positive and negative banked amounts, such as the gaps between the
5 2003 PCO and the USF payment for a particular year. If the cumulative net of -\$1.6
6 million depicted on Exhibit A were to be implemented, this amount would have to
7 be provided through a one-time credit or through some means that has the same
8 effect as a one-time credit (such as delaying implementation of a subsequent PCO).
9 This would “zero out” the bank balance, but would not eliminate additional debits
10 and credits going forward.

11 In January of 2008, one would have to look at what portions of the banked
12 PCOs have not yet been implemented in rates to determine what recurring PCO
13 values remain in the bank. Following the exact same methodology that the
14 Commission has used for the 2003 PCO, the full portion of the 2006 PCO that has
15 not been implemented in rates remains available for use as of January 1, 2008. This
16 is true whether the net cumulative banked amount for the previous year is negative
17 or positive. The netting in 2007 of any positive banked amounts resulting from the
18 2006 PCO against negative banked amounts resulting from the 2003 PCO does not
19 affect the recurring remainder for either PCO. This amount is depicted in the Table
20 below.

**TABLE 7: RECURRING VALUE OF VERIZON PA BANK
AS OF JANUARY 1, 2008**

	Recurring Value as of 1/1/2008
2003 PCO	
a. 2003 PCO Filed Amount	-\$17,718,000
b. Amount Implemented in Recurring Rates (access reductions)	\$ 243,517
2003 PCO Net Recurring Value	-\$17,474,483^b
2006 PCO	
a. 2006 PCO Filed Amount (revised for compliance)	\$14,247,000
b. Amount Implemented in Recurring Rates 2006	\$13,645,700
c. Amount Implemented in LPC Rates 2007	\$485,000
2006 PCO Net Recurring	\$116,300

Verizon PA expects to use the banked positive of \$116,300 when it implements the 2008 PCO, which will leave only the recurring negative from the 2003 PCO in the bank after that time (i.e., as of January 1, 2009). Verizon PA also expects to request again in 2008 to use that year's value of the 2003 PCO to cover its USF payment, as has already been presumptively approved by the Commission, and to account for any gap between the available 2003 PCO funds and the USF payment in the manner described in this testimony.

Q. WOULD IT BE APPROPRIATE TO REQUIRE VERIZON PA TO MAKE A RECURRING RATE CHANGE INSTEAD OF A ONE-TIME CREDIT OR DEBIT TO "ZERO OUT" A CUMULATIVE BANKED AMOUNT?

A. No. A recurring rate change would have two impacts. First, it would zero out the balance as of a given year, second it would create a new stream of future credits or

⁶ While a recurring balance of \$17,474,483 is on the books as of January 1, 2008, it is already earmarked to cover the USF payment in that year, as discussed earlier in this testimony.

1 debits that would have to be reflected in future years' banking calculations. An
2 example can be seen in the way the implementation of the access rate reduction that
3 occurred in 2005 has been treated (with Staff's concurrence). That reduction
4 created a stream of credits that appear every year from 2005 forward in the amount
5 of \$243,517, crediting Verizon each year for the annual impact of the recurring rate
6 change that was put in place in 2005. Effectively, this recurring rate reduction has
7 permanently reduced the amount available from the 2003 PCO to cover the USF
8 payment. Similarly, if the Commission were to order a recurring rate reduction of
9 \$1,610,536 to offset the cumulative net banked balance in 2007, it would create a
10 stream of future credits equal to that amount that would have to be accounted for in
11 future years' banking calculations. As a practical matter, that would permanently
12 reduce the remaining available recurring value of the 2003 PCO by \$1,610,536
13 ($\$17,474,483 - \$1,610,536 = \$15,863,947$). Once implemented, only \$15,836,947
14 would be available to cover the USF payments. The risk in this situation is that there
15 would not be enough money in the bank to cover the USF payment in future years.
16 It is preferable to have Verizon PA account for the gap each year, rather than
17 permanently eliminate some of the available funds and thereby deprive the
18 Commission of flexibility on this issue. It would be incorrect, however, to require
19 any recurring decrease without compensating Verizon via credits in future years.

20 If the Commission wishes to zero out the bank, the preferable way would be
21 to require action that has the effect of giving a one-time credit to customers in the
22 amount of \$1,610,536 (such as delaying the implementation of a future PCO). The

1 2003 PCO would then remain unchanged and would be handled on a going-forward
2 basis as the Commission directed in its October 11, 2005 order.

3 **Q. THE COMMISSION'S DECEMBER 29, 2007 ORDER AT PAGE 8 REFERS**
4 **TO A "NET BANKED INCREASE" FOLLOWING IMPLEMENTATION**
5 **OF THE 2006 PCO OF \$717,260. DO YOU DISAGREE WITH THE**
6 **STAFF'S CALCULATION UP TO THAT POINT?**

7 A. No. Verizon PA did not disagree with that particular figure. It represents the
8 cumulative net total of one time values through January 1, 2006, calculated using the
9 as filed amounts for the 2006 PCO. Because the compliance changes caused the
10 two-month delay value and the difference between the PCO and the implemented
11 rates (i.e., the banked amount) to change, and because on review it seemed more
12 reasonable to calculate interest after offsetting all positive and negative banked
13 amounts, the cumulative net is now different. As shown on my Exhibit A, it is now
14 a negative \$180,890 as of January 1, 2006.

15 The errors in the Staff's calculations came in their attempt to calculate a
16 cumulative one-time net through January 1, 2007, that ignored the positive banked
17 amounts from the 2006 PCO that had not been implemented in rates, and in
18 attempting to clear the bank by implementing recurring rate decreases without
19 crediting Verizon for the recurring effect of this action.

20 **Q. DID VERIZON PA USE A PORTION OF ITS RECURRING BANKED**
21 **AMOUNT FROM THE 2006 PCO TO FUND ITS INCREASE TO THE**

1 **BUSINESS LATE PAYMENT CHARGE IMPLEMENTED WITH THE 2007**
2 **PCO?**

3 A. Yes. As depicted on Exhibit A, Verizon PA used \$485,000 in banked money to
4 fund the late payment charge increase. This money is then permanently removed
5 from the bank, as I correctly depict on Exhibit A. Therefore, since Verizon will (as
6 revised for compliance) bank \$601,300, after spending \$485,000 of that amount it
7 will be left with \$116,300 recurring value in the bank. The Staff's calculations did
8 not account in the netting of credits and debits in 2007 for that portion of the 2006
9 PCO that had not been implemented in rates, but that Verizon still had a right to
10 receive. This was inconsistent with the way Staff treated the negative value of the
11 2003 PCO that was not implemented in rates, but that customers still have a right to
12 receive, which Staff has continued to debit from Verizon's account each year from
13 2003 forward. This error resulted in Staff's faulty calculation of Verizon PA's bank
14 balance for 2007. Staff then made the further error of using its erroneously
15 calculated net balance as the basis to order a future recurring rate change, without
16 recognizing that such a change would create a new stream of credits that must be
17 accounted for in future years' banking calculations. Furthermore, as discussed
18 above, cumulative net balances, even when correctly calculated, represent only
19 historic periods and are not a measure of what is owed to companies or customers in
20 future periods.

21 The correct methodology for calculating the cumulative net of one-time
22 values is depicted on Exhibit A to this testimony and the proper calculation of the

1 remaining available recurring amounts is depicted on Table 7 above. These
2 calculations should be adopted as the banking methodology in this proceeding.

3 **Q. DOES THAT CONCLUDE YOUR REBUTTAL TESTIMONY?**

4 **A. Yes**

Verizon Pennsylvania Inc.
2007 PCO FILING
PCO Calculation

A. The PSM Formula¹ is:

Price Change Opportunity (PCO) = Revenue x (GDP-PI minus .50%); whereas,
PCO = Authorized annual decrease or increase to be implemented through
tariff rate changes for noncompetitive services.

Revenue = Intrastate noncompetitive service revenue amount billed by
Verizon 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
Fixed Weight Price Index² based upon the most recent quarterly
release of the U.S. Department of Commerce.

B. Percentage Annual Change in GDP-PI:

The percentage annual change in GDP-PI was calculated to be 3.31% by taking the percentage
change in the GDP-PI between the quarters ending March 31, 2005 and March 31, 2006, as
follows:

<u>Quarter Ended</u>	<u>GDP-PI³</u>
3/31/05	111.9
3/31/06	115.6

$$\text{Percentage annual GDP-PI change} = \frac{115.6 - 111.9}{111.9} = 3.31\%$$

C. Calculation of 2007 Price Change Opportunity:

The PSM formula resulted in a positive PCO of \$19,829,000 calculated as follows:

$$\begin{aligned} \text{PCO} &= \text{Revenue}^4 \times (\text{GDP-PI minus } .50\%) \\ \text{PCO} &= \$705,650,000 \times (3.31\% \text{ minus } .50\%) \\ \text{PCO} &= \$19,829,000 \end{aligned}$$

¹ Verizon PA's modified Alternative Regulation Plan at 4-6 (filed June 20, 2005)

² Verizon PA's Alternative Regulation Filing designated the "fixed weight" GDP-PI as the appropriate inflation measure. At its December 19, 1996 Public Meeting, the PUC re-affirmed that VZ-PA should continue to use the "fixed weight" GDP-PI to maintain consistency with prior filings and to continue the PUC's intent "...to utilize the current formula as long as possible."

³ U.S. Department of Commerce Bureau of Economic Analysis's October 27, 2006 release.

⁴ See "D. Intrastate Noncompetitive Services Revenue" on Page 2 of 2

Verizon Pennsylvania Inc.
2007 PCO FILING
PCO Calculation
(\$000's)

D. Intrastate Noncompetitive Services Revenue
Details of 12 Months Billed Revenue (4/05 - 3/06):

Service Category

Exchange Services - Residence		
Exchange Services - Business		
Switched Access		
Business Vertical Services		
Billing (Late Payment/Return Check Fee)		
Premises Transport		
Call Completion		
ITC Settlements		
Miscellaneous		
Subtotal		
Attribution for IntraLATA Toll & Centrex Extend ⁵	+	
Business Competitive Services ⁶	-	
Total Noncompetitive Revenue		

⁵ Attribution for Switched Access Service provided in conjunction with IntraLATA Toll and Centrex Extend Services as required by the Commission.

⁶ This adjustment removes revenue from otherwise non-competitive services that are provided to business customers generating more than \$10,000 in annual total billed revenue ("TBR") in compliance with the PUC's Order in the Global Docket (P-00991648 & P-00991649) declaring all services to customers over that TBR threshold to be competitive.

Verizon North Inc.
2007 PCO FILING
PCO Calculation

A. The PSM Formula⁵ is:

$PSI_t = PSI_{t-1} \times [1 + \%Change\ GDP-PI - 0.5\% \pm Z]$, where,

- 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.
- $\%Change\ GDP-PI$ = The percent change in the Gross Domestic Product Price Index based on the most recent quarterly data available at the time of the annual PSI filing and the corresponding quarter of the previous year.
- $\%$ = Inflation offset.
- Z = The effect of any exogenous changes.

B. Percentage Annual Change in GDP-PI:

The percentage annual change in GDP-PI was calculated by taking the percentage change in the GDP-PI between the quarters ending March 31, 2005 and March 31, 2006, as follows:

<u>Quarter Ended</u>	<u>GDP-PI⁶</u>
3/31/05	111.9
3/31/06	115.6
Percentage annual GDP-PI change = $\frac{115.6 - 111.9}{111.9} = 3.31\%$	

C. Calculation of 2007 Price Change Opportunity:

The PSM formula was calculated as follows:

- $PSI_t = PSI_{t-1} \times [1 + \%Change\ GDP-PI - 0.5\% \pm Z]$
 $= 102.02$ (from last year's filing) $\times [1 + 3.31\% - 0.5\% - 0]$
 $= 104.89$
- $PCO = (Revenue^3 \times (PSI_t/100)) - Revenue^3$
 $= \$119,290,000 \times 1.0489 - \$119,290,000$
 $= \$5,833,000$
- $SPI_t = SPI_{t-1} \times [Proposed\ Revenue/Actual\ Revenue]$
 $= 101.97$ (from last year's filing) $\times [(119,290,000 + 5,833,000)/119,290,000]$
 $= 106.96$
- Per VZ North's Plan the SPI cannot exceed the PSI. Thus the SPI is limited to the PSI level of 104.89 which yields a PCO increase of \$3,420,000.

⁵ Verizon North's Chapter 30 Plan at 10-12 (filed June 20, 2005)

⁶ U.S. Department of Commerce Bureau of Economic Analysis's October 27, 2006 release.

Verizon North Inc.
2007 PCO FILING
PCO Calculation
(\$000's)

D. Intrastate Noncompetitive Services Revenue
Details of 12 Months Billed Revenue (4/05 – 3/06):

Service Category

Exchange Services – Residence		
Exchange Services – Business		
Special Access		
Switched Access		
Billing (Late Payment/Return Check Fee)		
Premises Transport		
Call Completion		
ITC Settlements		
Video/Conferencing		
Subtotal		
Attribution for IntraLATA Toll	+	
Total Noncompetitive Revenue		

SPI

Service Category	Present Revenue (\$000)	Proposed Revenue (\$000)	Revenue Weight of each element to Total Revenue	Revenue Weight times Proposed Price Change
Residence Exchange.				
Business Exchange				
Special Access				
Switched Access				
Billing				
Premises Transport				
Call Completion				
ITC Settlements				
Video/Conferencing				
Attribution				
Total Noncomp. Revenue				

EXHIBIT B

**Is Proprietary
and therefore is not included in this Public
version.**

EXHIBIT B

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

VERIZON PENNSYLVANIA INC.
AND VERIZON NORTH INC.
STATEMENT NO. 1.1

VERIZON PENNSYLVANIA INC.'S
AND VERIZON NORTH INC.'S
2007 PCO FILINGS

DOCKET NOS. R-00061914,
P-00001854F1000, R-00061914C000,
R-00061915, P-00930715F1000,
R-00061915C0001

VERIZON PENNSYLVANIA INC.
AND VERIZON NORTH INC.

STATEMENT NO. 1.1
(REBUTTAL TESTIMONY)

WITNESS: Jane K. Fortin

DATED: July 13, 2007

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I.	INTRODUCTION AND BACKGROUND	1
II.	THERE IS NO BASIS TO ALTER THE TIME PERIOD FOR REVENUE AND CHANGE IN INFLATION ASSUMED IN VERIZON'S 2007 PCO FILINGS	1

I. INTRODUCTION AND BACKGROUND

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Jane K. Fortin. My business address is 1717 Arch Street, 17th Floor,
Philadelphia, PA 19103.

Q. ARE YOU THE SAME JANE FORTIN WHO FILED DIRECT TESTIMONY IN THIS MATTER ON MAY 24, 2007?

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of my testimony is to rebut the Direct Testimony of Allen G. Buckalew submitted on June 27, 2007 on behalf of the Office of Small Business Advocate ("OSBA"). Mr. Buckalew's testimony is limited to the issue of the time period to be used for the 2007 Price Change Opportunity ("PCO") filings of Verizon Pennsylvania Inc. ("Verizon PA") and Verizon North Inc. ("Verizon North") (together "Verizon"), which I discussed at page 25, line 6, through page 29, line 4, of my Direct Testimony.

II. THERE IS NO BASIS TO ALTER THE TIME PERIOD FOR REVENUE AND CHANGE IN INFLATION ASSUMED IN VERIZON'S 2007 PCO FILINGS

Q. WHAT IS OSBA'S POSITION ON THE TIME PERIOD ISSUE, AS DESCRIBED BY MR. BUCKALEW?

A. Mr. Buckalew argues that the Commission should require Verizon to submit new 2007 PCO filings using noncompetitive revenue from the 12-month period of July 1, 2005 through June 30, 2006 and the change in the rate of inflation over that same time period.

1 Verizon actually used noncompetitive revenue and the change in the rate of inflation
2 from the 12-month period of April 1, 2005 through March 31, 2006.

3 **Q. MR. BUCKALEW CONTENDS THAT VERIZON HAS “ALREADY BEEN**
4 **COMPENSATED THROUGH THE 2006 PCO FILING FOR INFLATION FOR**
5 **APRIL, MAY AND JUNE OF 2005.” (BUCKALEW DIRECT AT 6). DO YOU**
6 **AGREE?**

7 A. No. Mr. Buckalew similarly contends at page 7 that Verizon’s proposal would allow it
8 “to be compensated twice for inflation in the same time period.” Mr. Buckalew’s
9 formulation of the issue does not comport with the requirements of Verizon’s price
10 stability mechanism. Verizon is not “compensated” for inflation for particular dates
11 within the 12-month time period. Rather, Verizon is entitled to increase its
12 noncompetitive revenue by a percentage that is calculated based on the change in the rate
13 of inflation from the date at the beginning of a 12-month period to the date at the end of
14 that period. Fluctuations in the rate of inflation during the time period are *not* relevant.
15 For example, in Verizon’s 2007 filing only the rates of inflation on April 1, 2005 and on
16 March 31, 2006 are relevant. The rate of inflation in May and June of 2005 are not
17 relevant to the calculation and so it does not make sense to say that Verizon was
18 “compensated” for inflation during those months. As I explained in my Direct
19 Testimony, the change in the rate of inflation between April 1, 2005 and March, 2006
20 was 3.31%. By contrast, the change in the rate of inflation from July 1, 2005 through
21 June 30, 2006 was higher, at 3.55%. By using the earlier time period Verizon is actually
22 forgoing an additional .24% that it would have been able to obtain if it had used the later

1 time period. Therefore, if it is a question of “compensating” Verizon for inflation, then
2 Verizon is foregoing compensation to which it would otherwise be entitled, rather than
3 obtaining additional compensation. Verizon’s plans provide it the flexibility to make this
4 change, and Verizon determined for the other reasons discussed here and in my Direct
5 Testimony that it was necessary to move back the revenue and inflation time period by
6 one quarter.

7 **Q. MR. BUCKALEW CONTENDS THAT ALLOWING VERIZON TO MOVE**
8 **BACK ITS TIME PERIOD BY ONE QUARTER WOULD “RESULT IN**
9 **DOUBLE DIPPING.” (BUCKALEW DIRECT AT 4). DO YOU AGREE?**

10 A. No. I do not see how Verizon could be “double dipping” if the result of the change is to
11 secure less revenue than it would have secured using the time period Mr. Buckalew
12 wishes Verizon to use. The entire concept of “double dipping” implies an action that
13 would secure more revenue than that to which Verizon is entitled, which is not the case
14 here.

15 **Q. MR. BUCKALEW CONTENDS THAT ALLOWING VERIZON TO MOVE**
16 **BACK ITS TIME PERIOD BY ONE QUARTER WOULD RESULT IN “A**
17 **VIOLATION OF THE CHAPTER 30 RULES.” (BUCKALEW DIRECT AT 4).**
18 **DOES MR. BUCKALEW CITE ANY RULES OR PORTIONS OF THE**
19 **CHAPTER 30 STATUTE OR PLANS THAT PROHIBIT MOVING BACK THE**
20 **TIME PERIOD?**

21 A. No. Mr. Buckalew cites no specific provision in Verizon’s Chapter 30 Plans, the statute
22 or any Commission order or regulation that would preclude Verizon from moving back

1 the time period by one quarter as it has done here. Rather, as I explain in my Direct
2 Testimony, the plans do not require Verizon to use the July to June time period and do
3 not preclude it from moving the time period back by one quarter.

4 **Q. MR. BUCKALEW CONTENDS THAT IF THE COMMISSION APPROVES**
5 **VERIZON'S FILING "IT WILL BE LIKE SAYING THAT VERIZON CAN**
6 **CHOOSE ANY PERIOD IT WANTS IN ORDER TO CALCULATE**
7 **INFLATION." (BUCKALEW DIRECT AT 6). IS THAT WHAT VERIZON IS**
8 **ASKING OF THE COMMISSION?**

9 A. No. Verizon does not intend to arbitrarily use a different time period every time it makes
10 a PCO filing. Verizon intends to use the most recent time period practicable under the
11 circumstances, and its plans allow it to do so. Under the circumstances of the 2007 PCO
12 filings, the April/March period was the most recent time period practicable to use. As I
13 explained in my Direct Testimony, Verizon was required to move the time period back
14 by one quarter in this instance to allow adequate time to do what is needed to implement
15 the PCO. Because the revenue data and the GDP-PI inflation rate for the period ending
16 on June 30 of the year only become available in mid to late September, this does not
17 leave sufficient time to design the rate increases and provide the required customer
18 notice. Indeed, under current programming requirements the text of the customer notice
19 must be ready by mid-September, which requires Verizon to have calculated the
20 proposed rate increases before that time. This is impossible when the revenue and
21 inflation data needed to commence those calculations is not available until mid- to late
22 September.

1 **Q. HAS VERIZON FACED SUCH DIFFICULTIES IN THE PAST WHEN**
2 **IMPLEMENTING ITS PCOS?**

3 A. Yes. The 2006 PCO was the first PCO where, as a result of the change in the inflation
4 off-set with Act 183, Verizon had the opportunity to increase rates, thereby requiring rate
5 design and customer notice. Verizon was not able to make that filing in November, but
6 rather could not make it until December 31, 2005. This resulted in a delay in
7 implementation, and the Commission accounted for that delay value by providing
8 Verizon with a one-time credit in its bank. Moving back the time period avoids this
9 delay and complication to the filing. If the Commission were to require Verizon always
10 to use the July to June time period, as OSBA argues, then it would likely be requiring
11 Verizon to make its filings late every year and risking the need to account for a delay
12 value every year. It is preferable for the company, the commission and its customers to
13 avoid this complication by allowing Verizon to use the April to March time period.

14 **Q. WHAT TIME PERIOD DOES VERIZON ANTICIPATE USING IN FUTURE**
15 **PCO FILINGS?**

16 A. For the 2008 PCO filing, Verizon plans to use the April to March time period. Verizon
17 anticipates that, if all relevant factors remain equal, it would continue to use the April to
18 March time period in future filings. However, if there is a change in the material facts
19 that would allow Verizon to use a different time period (such as customer notice not
20 being required or the necessary revenue or inflation figures being available earlier, for
21 example) Verizon's plans provide the flexibility for Verizon to use a different time
22 period. Verizon's plans allow Verizon to do so without securing advance permission or

1 making any changes to its plans. Verizon's intent is to use the most recent time period
2 practicable under the circumstances, and currently foresees that this would be the April to
3 March time period.

4 **Q. MR. BUCKALEW CLAIMS THAT HE CANNOT "VERIFY" THAT THE 2007**
5 **PCO WOULD ACTUALLY BE HIGHER IF IT WERE RECALCULATED**
6 **USING HIS SUGGESTED JULY TO JUNE TIME PERIOD BECAUSE YOU**
7 **USED ESTIMATED RATHER THAN ACTUAL DATA IN YOUR DIRECT**
8 **TESTIMONY. (BUCKALEW DIRECT AT 7). DID YOU USE ONLY**
9 **"ESTIMATES," AS HE CONTENDS?**

10 A. No. The PCO formula is calculated using noncompetitive revenue over the relevant 12-
11 month period and the change in the rate of inflation from the first date to the last date of
12 the same 12-month period. I did use estimated revenue, but the change in the rate of
13 inflation is based on actual data. By the time my testimony was submitted, the
14 government's official GDP-PI figures were available for all of the relevant quarters.
15 Therefore, I was able to testify based on actual inflation data that the change in the rate of
16 inflation using the April/March time period was 3.31%, while the change in the rate of
17 inflation using the July/June time period was 3.55%. This testimony is not based on
18 estimates.

19 While I did use an estimate of revenue, I believe this estimate was accurate for
20 the reasons discussed below. However, as I also discuss below, given this very large
21 difference in the change in inflation as between the two periods, the PCO would most

1 likely be higher with the July to June time period even if the decline in noncompetitive
2 revenue was somewhat larger than I anticipated.

3 **Q. WHY DID YOU USE AN ESTIMATE OF NONCOMPETITIVE REVENUE?**

4 **A.** I used an estimate of noncompetitive revenue because there is considerable work
5 required to arrive at the noncompetitive revenue figure actually used for a PCO filing and
6 there was not sufficient time to do that work under the expedited schedule provided for
7 the development of the record in this proceeding. In particular, to arrive at a filing-
8 quality noncompetitive revenue figure, Verizon must request data from its financial
9 systems for all actual revenues (interstate, intrastate, regulated, nonregulated) for both
10 companies. This requires writing a query to retrieve the pertinent data from billing
11 systems and slotting that query into the appropriate categories to obtain intrastate
12 noncompetitive revenues, reflecting any changes since prior year (e.g., new services,
13 services moved to competitive). In addition, Verizon must collect and analyze data to
14 compute the business competitive services overlay for Verizon PA. This annual PCO
15 process must be timed to coordinate with normal work activities (e.g., closing the
16 monthly books). Verizon is presently in the process of conducting this analysis for the
17 2008 PCO, and it would not be practicable to try to simultaneously conduct the analysis
18 for the alternative 2007 time period on an expedited basis. My estimate of revenue
19 based on the expected decline in noncompetitive revenue over the pertinent time period is
20 a reasonable proxy for purposes of this testimony, in light of the time and work involved
21 in producing the type of revenue information that would actually be used for a filing.

1 **Q. IS THERE ANY BASIS TO BELIEVE THAT THE USE OF ESTIMATED**
2 **REVENUE WOULD NOT PROVIDE AN ACCURATE ESTIMATE OF THE**
3 **MAGNITUDE OF THE DIFFERENCE IN THE PCO IF IT WERE**
4 **RECALCULATED IN THE MANNER REQUESTED BY MR. BUCKALEW?**

5 A. No. I believe my projection of the magnitude of the difference in the PCO calculation
6 using the different time periods was accurate. I assumed that the total noncompetitive
7 revenue for the 12-month period from July 1, 2005 through June 30, 2006 would be 12%
8 lower than the total noncompetitive revenue from the time period from April 1, 2005
9 through March 31, 2006. The basis for the 12% assumption was the fact that the revenue
10 for the 12-month period ending March 2006 was 9% lower than the revenue for the 12-
11 month period ending June 2005. Given the three-month overlay in the periods, the 9%
12 decline translated into an average of 1% per month in the remaining nine months.
13 Annualizing the 9% yielded the 12% decline used in the estimate.

14 Given the higher inflation rate for the period ending June 2006, revenues would
15 have to have declined by at least 16% to result in a lower PCO amount. The 16% annual
16 decline is highly unlikely given that after nine months the decline was 9%. The decline in
17 each of the three months in the last quarter would have to be more than twice the 1%
18 decline experienced in the previous nine months.

19 **Q. MR. BUCKALEW ARGUES THAT VERIZON SHOULD NOT BE ALLOWED**
20 **TO MOVE BACK ITS TIME PERIOD BY ONE QUARTER BECAUSE “THE**
21 **PRECEDENT WILL BE SET FOR VERIZON (AS WELL AS OTHER**
22 **TELEPHONE COMPANIES THROUGHOUT PENNSYLVANIA), IN FUTURE**

1 **PCO FILINGS, TO SELECT THE PERIOD EACH YEAR WHICH IS MOST**
2 **BENEFICIAL TO THE COMPANIES.” (BUCKALEW DIRECT AT 8). DID**
3 **VERIZON MOVE BACK ITS TIME PERIOD TO SEEK A FINANCIAL**
4 **BENEFIT IN THE FORM OF A LARGER PCO?**

5 A. No. As discussed above and in my Direct Testimony, Verizon moved the time period
6 back by one quarter because that was the only practicable choice in order to be able to
7 make the filing in November to be effective on time. It would have been financially
8 *more beneficial to Verizon not to move back the time period this year.*

9 **Q. DO VERIZON’S PLANS ALLOW IT THE FLEXIBILITY TO USE THE**
10 **APRIL/MARCH TIME PERIOD?**

11 A. Yes. As I explained in my Direct Testimony, nothing in Act 183 or in Verizon’s Chapter
12 30 plans requires the use of the July to June time period as opposed to the April to March
13 time period. Under 66 Pa. C.S. § 3013(b), the Commission cannot modify the terms of
14 Verizon’s plans without Verizon’s express agreement. The plans do not say that Verizon
15 must use the July to June time period, and they do not prohibit moving back the time
16 period (particularly where there is good cause to do so, as has been demonstrated, as
17 here). Section 3013(b) prohibits the Commission from inserting these presently
18 nonexistent requirements or prohibitions into the plan.

19 **Q. DOES THAT CONCLUDE YOUR REBUTTAL TESTIMONY?**

20 A. Yes
21

Verizon Pennsylvania Inc.
2007 PCO Filing
Rate Changes & Revenue Impact

	Old Rate	New Rate	Annual Revenue
Residence Dial Tone Line			
Cell 1	\$5.78	\$6.29	
Cell 2	\$6.08	\$6.59	
Cell 3	\$6.44	\$6.97	
Cell 4	\$6.84	\$7.37	
Business Dial Tone -			
Single Line			
Cell 1	\$11.20	\$11.75	
Cell 2	\$13.70	\$14.25	
Cell 3	\$16.20	\$17.00	
Cell 4	\$18.75	\$19.50	
Multi-Line			
Cell 1	\$10.20	\$10.85	
Cell 2	\$12.70	\$13.35	
Cell 3	\$15.20	\$16.00	
Cell 4	\$17.75	\$18.60	
Business Local Usage			
Local Call Band 1	\$0.065	\$0.078	
<i>(Band 1 rates are per message)</i>			
Local Area Unlimited			
Rate Group A	\$10.70	\$11.95	
Rate Group D	\$15.00	\$16.55	
Rate Group F	\$19.20	\$19.95	
Extended Area Unlimited			
Rate Group A	\$15.00	\$16.55	
Rate Group D	\$19.25	\$19.95	
Rate Group F	\$23.50	\$23.95	
Business Late Payment Charge			
	1.25%	1.50%	
Total Rate Increases			
2007 PCO			
Portion of Banked 2006 PCO			

Verizon North Inc.
2007 PCO Filing
Rate Changes & Revenue Impact

	<u>Old Rate</u>	<u>New Rate</u>	<u>Annual Revenue</u>
	<i>(Monthly)</i>	<i>(Monthly)</i>	
Residence Dial Tone Line			
Cell 3	\$6.44	\$6.97	
Cell 4	\$6.84	\$7.37	
Residence Local Usage			
Local Area Unlimited			
Rate Group A	\$5.82	\$5.92	
Rate Group D	\$7.05	\$7.15	
Rate Group F	\$8.10	\$8.20	
Basic Calling Plan	\$1.13	\$1.23	
Community Calling Plan	\$2.42	\$2.52	
Community Plus Plan	\$3.23	\$3.33	
Business Dial Tone			
Cell 3	\$15.20	\$16.00	
Cell 4	\$17.75	\$18.60	
Business Late Payment Charge	1.25%	1.50%	
Total Rate Increases			
Amount to be Banked			
Total PCO			

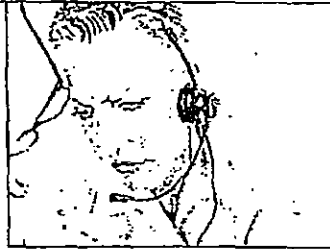
Here's How To Get Lifeline, Lifeline 135 And Link-Up America

Lifeline Service

- You can get *Lifeline Service* if no one claims you as a dependent on their Federal Income Tax, unless you are 60 or older and you are in one of these programs:
- General Assistance (GA)
- Supplemental Security Income (SSI)
- Temporary Assistance for Needy Families (TANF)

OR

- Your yearly income is at or below 100% of the Federal Poverty Guidelines.



Lifeline 135 Service

- You can get *Lifeline 135* if no one claims you as a dependent on their Federal Income Tax, unless you are 60 or older and you are in one of these programs:

- General Assistance (GA)
- Supplemental Security Income (SSI)
- Temporary Assistance for Needy Families (TANF)
- Food Stamps
- Low Income Home Energy Assistance Program (LIHEAP)
- Medicaid
- Federal Public Housing Assistance
- State Blind Pension

OR

- Your yearly household income is at or below 135% of the Federal Poverty Guidelines.
- National School Free Lunch Program

Link-Up America

- You can get *Link-Up America* if you qualify for Lifeline or Lifeline 135.

Here's how to apply for these programs:

- You can apply for Lifeline, Lifeline 135, and Link-Up America by calling your Verizon-Pennsylvania Business Office at 1 800 483-4000.

Try The Latest Innovations

We're always searching for new ways to improve the quality of your communications by developing new products and services that fit your lifestyle and offer you the best choices and value. Visit verizon.com today to learn about some of our latest product offerings.

Important Information For Pennsylvania Customers

Verizon is filing tariff changes with the Pennsylvania Public Utility Commission ("PUC") proposing to increase some residence rates to become effective January 1, 2007, for Verizon Pennsylvania and February 15, 2007, for Verizon North. The new rates will not exceed those shown below, subject to final PUC approval.

Verizon PA & Verizon North

Residence Services	Old Rate	New Rate
<i>Dial Tone Line Cell 1</i>		
Rotary	\$4.85	\$5.36
Touchtone	\$5.78	\$6.29
<i>Dial Tone Line Cell 2</i>		
Rotary	\$5.15	\$5.66
Touchtone	\$6.08	\$6.59
<i>Dial Tone Line Cell 3</i>		
Rotary	\$5.51	\$6.04
Touchtone	\$6.44	\$6.97
<i>Dial Tone Line Cell 4</i>		
Rotary	\$5.91	\$6.44
Touchtone	\$6.84	\$7.37



Verizon North Customers

Local Area Unlimited	\$0.10 per month
Community Calling Plan*	\$0.10 per month
Community Plus Plan*	\$0.10 per month
Basic Calling Plan*	\$0.10 per month

*These services are grandfathered and are not available for new installations.

Work At Home

Let Verizon make working at home really work for you. Verizon has some suggestions to help you make working at home successful. Visit verizon.com today or call your local business office to find the solution that works for you.

Important Information for Pennsylvania Customers

Verizon is filing tariff changes with the Pennsylvania Public Utility Commission ("PUC") proposing to increase some business rates to become effective January 1, 2007 for Verizon Pennsylvania and February 15, 2007 for Verizon North. The new rates will not exceed those shown below, subject to final PUC approval:

Verizon Pennsylvania & Verizon North

<u>Business Services</u>	<u>Old Rate</u>	<u>New Rate</u>
<u>Dial Tone Line Cell 1</u>		
Single-line	\$11.20	\$11.75
Multi-line	\$10.20	\$10.85
<u>Dial Tone Line Cell 2</u>		
Single-line	\$13.70	\$14.25
Multi-line	\$12.70	\$13.35
<u>Dial Tone Line Cell 3</u>		
Single-line	\$16.20	\$17.00
Multi-line	\$15.20	\$16.00
<u>Dial Tone Line Cell 4</u>		
Single-line	\$18.75	\$19.50
Multi-line	\$17.75	\$18.60

The following services will change as follows for Verizon Pennsylvania customers:

	<u>Old Rate</u>	<u>New Rate</u>
Local Area Unlimited - Rate Group A	\$10.70	\$11.95
Local Area Unlimited - Rate Group D	\$15.00	\$16.55
Local Area Unlimited - Rate Group F	\$19.20	\$19.95
Extended Area Unlimited - Rate Group A	\$15.00	\$16.55
Extended Area Unlimited - Rate Group D	\$19.25	\$19.95
Extended Area Unlimited - Rate Group F	\$23.50	\$23.95
Local Calls Band 1	\$0.065/call	\$0.078/call

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

EXHIBIT C

OSBA STATEMENT No. 1

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Verizon Pennsylvania Inc.'s 2007 PCO Filing : Docket No. R-00061915
:

Verizon North Inc.'s 2007 PCO Filing : Docket No. R-00061914
:

Direct Testimony Of

ALLEN G. BUCKALEW

On Behalf Of

The Office of Small Business Advocate

Of the Commonwealth of Pennsylvania

Date Served: June 27, 2007

Date Submitted for the Record: _____

QUALIFICATIONS AND INTRODUCTION

Q. PLEASE STATE YOUR NAME, OCCUPATION, AND BUSINESS ADDRESS.

A. My name is Allen G. Buckalew. I am an Economist specializing in the telecommunications industry at J.W. Wilson & Associates, Inc. Our offices are at 1601 N. Kent Street, Rosslyn Plaza C - Suite 1104, Arlington, VA 22209.

Q. PLEASE OUTLINE YOUR EDUCATIONAL BACKGROUND.

A. I hold an A.A. and a B.S. degree with high honors, both from the University of Florida, and an M.S. degree from George Washington University. My major areas of concentration were economics and telecommunications.

Q. HOW HAVE YOU BEEN EMPLOYED IN THE PAST?

A. Before I entered the University of Florida, I worked for four years in Naval Telecommunications. After graduating from the University of Florida, I worked for four years at the Federal Communications Commission ("FCC") as an Industry Economist in the Common Carrier Bureau and was employed extensively in areas involving telecommunications, economics, accounting, engineering, and policy matters. For example, one of my major projects was "The Economic Implications and Interrelationships Arising from Policies and Practices Relating to Customer Interconnection, Jurisdictional Separations and Rate Structures," (Docket 20003).

This case opened the terminal equipment (e.g., telephone sets, and private branch exchanges ("PBXs")) market in the United States to competition. I also provided economic analysis in several rate cases, including, for example, "Communications Satellite Corporation, Investigation into Charges, Practices, Classifications, Rates and Regulations," (Docket 16070). My major responsibility was to serve as economic advisor and analyst for the Common Carrier Bureau.

After the FCC, I was appointed Associate Director for Telecommunications Research of the National Regulatory Research Institute ("NRRRI") at Ohio State University. My responsibilities at NRRRI focused on telecommunications policy as seen from an analytical perspective that combined accounting, engineering, and economic disciplines. During my employment at the Institute, I completed several studies for state public utility commissions, including "The Impact of Measured Telephone Rates on Telephone Usage of Government and Nonprofit Organizations" (for the Public Utilities Commission of Ohio) and "Toward An Analysis of Telephone License Contracts and Measured Rates" (for the Maryland Public Service Commission). In addition, I have provided several state Commissions with on-site technical and economic assistance. This assistance was related to identifying, explaining and analyzing major issues in telephone cases. Since joining J.W. Wilson & Associates, Inc. in May 1980, I have provided economic analysis in numerous proceedings in most of the states of the United States, Canada, Bolivia, Nepal, Egypt, and Tanzania. I have provided analysis for

the Federal Communications Commission and the United States Department of Justice. For example, I testified on behalf of the Department of Justice in the case that broke up the Bell System. In addition, I have worked for numerous state Attorneys General. For example, I evaluated the merger proposal for Bell Atlantic and NYNEX for the National Association of Attorneys General and the Bell Atlantic and GTE merger proposal for the Pennsylvania Attorney General. I also analyzed the merger proposal for MCI and WorldCom for the California Public Utilities Commission.

Q. ARE YOU A MEMBER OF ANY PROFESSIONAL ORGANIZATIONS AND HONOR SOCIETIES?

A. Yes. I am a member of the Society of Depreciation Professionals, the American Economic Association, Omicron Delta Epsilon (an international honor society in economics) and Beta Gamma Sigma (an honor society in business).

Q. COULD YOU BRIEFLY SUMMARIZE YOUR PROFESSIONAL RESPONSIBILITIES TO DATE?

A. Yes. My primary responsibilities have been to supervise and actively participate in public utility regulatory policy research, especially in the telecommunications field. These responsibilities required the use and application of economic, accounting, and engineering analyses.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I was asked by the Office of Small Business Advocate (OSBA) to analyze the Verizon Pennsylvania (Verizon PA) and Verizon North (collectively Verizon) Price Change Opportunity (PCO) filings. This involved the original filings and the subsequent filings to comply with the Commission's order on last year's PCO filings (2006). I have reviewed these filings, and conclude that the Verizon PA and Verizon North 2007 filings should be rejected.

My analysis indicates that the current PCO should not have been approved by the Commission because, as is discussed below, Verizon North and Verizon PA have already received compensation for the cost of inflation for part of the period requested. To approve the PCO filings of Verizon North and Verizon PA would result in double dipping and a violation of the Chapter 30 rules.

The PCO

Q. WHAT IS THE PCO?

A. Once a year, Verizon PA and Verizon North are allowed an opportunity to change their rates for noncompetitive services, like local exchange service. The process involves two steps.

The first step is to determine the allowed revenue increase by applying the rate of inflation (minus a .5% offset) to noncompetitive services revenue. In this case,

Verizon (Verizon PA and Verizon North) measured the change in GDP-PI (Gross Domestic Product — Price Index) by taking the difference between the quarters ending March 31, 2005 and March 31, 2006. Using these indices, Verizon measured the percent change in the price index as an increase of 3.31% for the period of April 1, 2005 through March 31, 2006. Therefore, Verizon claims to be allowed to increase noncompetitive revenue by 2.81% (3.31% minus .5%).

The second step in the process is to generate the allowed additional revenue by increasing the rates for noncompetitive services. For Verizon PA, this is done by multiplying total noncompetitive revenue times the percentage increase (2.81%) to get the allowed revenue increase. The application to Verizon North is a little different. Verizon North's price stability mechanism constructs a "Price Stability Index" (PSI). Verizon North's offset is also .5%. Verizon North's formula also includes a Z factor, which is for exogenous changes; these changes were zero in this year's filing. Therefore, the rate of inflation would translate into a 2.81% increase allowed on noncompetitive services for both companies if Verizon had done the calculation correctly, which it did not.

Q. IS THERE ANY PROBLEM WITH THE METHOD USED BY VERIZON TO DETERMINE THAT 2.81% ALLOWED INCREASE?

A. Yes. Last year's PCO filing (2006 PCO) for both Verizon PA and Verizon North was based on the inflation rate and the revenues for the period of July 1,

2004 through June 30, 2005. This year's PCO filing (2007 PCO) for both Verizon PA and Verizon North is based on the inflation rate and revenues for the period of April 1, 2005 through March 31, 2006. This is wrong, as both Verizon PA and Verizon North have already been compensated through the 2006 PCO filing for inflation for April, May and June of 2005.

In Verizon Statement 1 (Fortin Direct, pp. 21-26), Verizon admits that the 2006 PCO filing of each company was based on three months which are also included in the period for calculating the 2007 PCO increase for each company. Verizon claims that using the months of April, May, and June of 2005 to calculate both the 2006 PCO and the 2007 PCO is appropriate because nothing in the Chapter 30 Plan of either company prohibits it. I find this troubling. If the Commission allows Verizon to use the same three months in both the 2006 and 2007 PCO filings, that will be like saying that Verizon can choose any period it wants in order to calculate inflation and can then apply the inflation rate from that chosen period to increase rates.

Common sense, past procedure, and both Chapter 30 Plans indicate that Verizon's PCO filings are *annual*; in other words, over a year, Verizon PA and Verizon North are allowed one opportunity to change rates (See Verizon North Plan, p. 14; Verizon PA Plan, pp. 4, 6, and 7). In effect, Verizon's 2007 PCO

proposal would allow Verizon to be compensated twice for inflation in the same time period.

Q. HOW CAN VERIZON'S 2007 PCO FILINGS BE CORRECTED TO REMOVE THE DOUBLE COUNTING?

A. There is no easy fix for the attempt by Verizon PA and Verizon North to be compensated twice for inflation in the same quarter. Verizon's double counting impacts not only the level of inflation, but also the revenues used. Both companies used April 1, 2005 through March 31, 2006 revenue in the 2007 PCO filings. That means that revenue from April, May and June of 2005 was in last year's (2006 PCO) calculations and has already been the basis of compensation to Verizon. Because Verizon is double dipping, its filings are wrong and should be rejected.

In Verizon Statement 1 (Fortin Direct, pp. 27-28), Verizon claims that using the April 1, 2005 to March 31, 2006 measuring period would actually save ratepayers money in the 2007 PCO compared to what ratepayers would owe if a July 1, 2005 to June 30, 2006 period were used. However, Verizon has not presented the data necessary to verify that claim because Ms. Fortin used estimates for the July 1, 2005 to June 30, 2006 time period instead of actual data. See Verizon Statement No. 1, at 27-29.

Furthermore, if the Commission allows Verizon to change the measuring period from PCO filing to PCO filing, the precedent will be set for Verizon (as well as *the other telephone companies throughout Pennsylvania*), in future PCO filings, to select the period each year which is most beneficial to the companies.

Conclusion

Q. WHAT SHOULD THE PUC DO?

- A. Counsel advises that Verizon's 2007 PCO filings violate the Companies' Amended Network Modernization Plans and Chapter 30. Therefore, the Verizon 2007 PCO filings should be rejected. There is no question that Verizon PA and Verizon North have already been compensated for inflation in a quarter of the 2007 PCO filing period.

Verizon should be required to submit new 2007 PCO filings with a proper historic test year (July 1, 2005 through June 30, 2006) with actual revenue and access line counts.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

- A. Yes.

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

EXHIBIT D

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Verizon North Inc.	:	R-00061914
2007 Price Change Opportunity Filing	:	P-00001854F1000
Office of Small Business Advocate	:	R-00061914C0001
v.	:	
Verizon North Inc.	:	
Verizon Pennsylvania, Inc.	:	R-00061915
2007 Price Change Opportunity Filing	:	P-00930715F1000
Office of Small Business Advocate	:	R-00061915C0001
v.	:	
Verizon Pennsylvania Inc.	:	

**VERIZON'S STATEMENT IN SUPPORT OF THE
JOINT SETTLEMENT PETITION**

On August 8, 2007, the parties to this proceeding submitted a Joint Settlement Petition pursuant to 52 Pa. Code § 5.232 setting forth their unanimous agreement to settle all of the issues in the above-captioned proceeding. As directed by the presiding officer's order of July 18, 2007, Verizon Pennsylvania Inc. and Verizon North Inc. (together "Verizon") submit this statement in support of the settlement, to be attached to the Joint Settlement Petition. Verizon urges the Commission to approve this unanimous settlement. Resolution of this proceeding through settlement will conserve Commission and party resources by avoiding further litigation. This settlement provides a reasonable resolution of the disputed issues and will provide certainty on particular matters for future filings. This settlement is in the public interest and should be approved without modification.

I. BACKGROUND

This proceeding involves the separate filings made by Verizon PA and Verizon North on November 1, 2006 to implement their 2007 Price Change Opportunities (“PCOs”) under the terms of their Commission-approved Chapter 30 Plans and the requirements of the Chapter 30 statute, as amended by Act 183. It was undisputed that, under the inflation-based formula that governs annual changes to noncompetitive revenue, the Verizon companies were entitled to a revenue increase with their 2007 PCO filings. However, there were disputes over the details of the filings, including the total amount of the allowed revenue increase and the calculation of the rate changes necessary to recoup that revenue. The Commission also specifically directed the parties to consider in this proceeding the matter of how properly to calculate the net remainder in Verizon PA’s bank, taking into account the impact of banked values from the 2003 and 2006 PCOs.

On November 9, 2006, the Office of Small Business Advocate (“OSBA”) filed complaints against the Verizon PA and Verizon North 2007 PCO filings. On November 17, 2006, the Office of Consumer Advocate (“OCA”) filed a notice of intervention in each case. The Office of Trial Staff (“OTS”) filed a notice of appearance on November 21, 2006.

By order entered December 28, 2006, as modified by an order on reconsideration entered January 11, 2007, the Commission found that Verizon PA’s calculations “appear to be consistent with the terms of the Company’s Price Stability Mechanism/Price Change Opportunity formula approved in its Chapter 30 Plan.” (12/28/06 Order at 5). The Commission allowed Verizon PA’s proposed rate increases to go into effect on the

scheduled date of January 1, 2007, and consistent with its handling of the 2006 PCO matter directed that these rates would remain in effect and would be subject to the findings of the Office of Administrative Law Judge (“OALJ”) as to the issues raised in the OSBA’s complaint. On February 8, 2007 the Commission issued an order on Verizon North’s 2007 PCO filing. The Commission found that Verizon North’s calculations “appear to be consistent with the terms of the Company’s Price Stability Mechanism/Price Change Opportunity formula approved in its Chapter 30 Plan.” (2/8/07 Order at 4). The Commission allowed Verizon North’s proposed rate increases to go into effect on the scheduled date of February 15, 2007, and also directed that these rates would remain in effect and would be subject to the findings of the OALJ as to the issues raised in the OSBA’s complaint.

In its December 28, 2006 Order the Commission raised an issue that was not raised in the OSBA complaint – regarding the calculation of the banked amount remaining to be used from the 2006 PCO. This issue involves the proper calculation of the amount remaining in Verizon PA’s “bank” as of January 1, 2007, after all relevant values from the banked 2003 negative PCO and the banked 2006 positive PCO are netted. The Commission directed that “the disputed issue of accounting methodology for banking” should be incorporated into the OSBA complaint proceeding before the OALJ. (12/28/06 Order, Ordering ¶ 5). On January 2, 2007, Verizon PA filed a Petition for Reconsideration in which it argued that the Commission had violated its right to due process and the terms of its plan by the manner in which it had addressed the banking issue. Verizon PA argued that, since it had not been provided an opportunity to be heard on this issue, it had not been able to point out before the order was entered that the Commission’s Staff’s calculation of the

banked amount that was incorporated into that order was based on fundamental errors, including improperly, inconsistently and unfairly giving Verizon only a one-time credit for a recurring banked increase, while debiting Verizon's account every year for a recurring banked decrease, thus cancelling out the entire future revenue stream of the 2006 banked increases.

By Order entered January 11, 2007, the Commission granted Verizon PA's Petition for Reconsideration. The Commission determined to allow the originally proposed rate increases to go into effect subject to refund, consistent with the requirements of Verizon PA's plan. The Commission also determined to "withhold any final judgment on the correctness of Verizon's banking methodology, or any other methodology," until the matter was fully addressed by the OALJ. (1/11/07 Order at 6).

Most of the issues raised in the OSBA complaints against Verizon's 2007 PCO filings were also raised by OSBA in its complaints against Verizon's 2006 PCO filings, which had not been finally decided by the Commission at the time the OSBA filed its complaints. The Commission has since decided the 2006 case, and that decision provided guidance for the parties' settlement of the 2007 case. The Commission entered an order on March 22, 2007 resolving all of the issues raised in OSBA's complaints against Verizon PA's and Verizon North's 2006 PCO filings. This order was modified by an order on reconsideration entered April 25, 2007. These two orders are referred to collectively as the "2006 PCO Orders." Verizon filed a Petition for Review of the 2006 PCO Orders with the Commonwealth Court on May 25, 2007 at Docket 988 CD 2007, relating to the attribution and line count issues, and that appeal is pending. This settlement is without waiver of

Verizon's right to prosecute that appeal and to make any rate changes in the future necessary to implement any changes to its 2007 PCO filings required as a result of that appeal.

II. TERMS OF THE SETTLEMENT

The parties have reached a comprehensive, unanimous settlement resolving all of the issues to be decided in this proceeding. The terms of the settlement are supported by record evidence in the form of written testimony from Verizon and the OSBA, which the parties have agreed to admit into the record without cross examination, and which are also attached to the Joint Settlement Petition. The settlement resolves all of the issues raised in the OSBA's 2007 PCO complaints and details through the incorporated testimony all changes to Verizon's 2007 PCO filings. It also resolves the issue of the banking methodology.

In particular the parties agreed that as a result of the 2006 PCO orders, two changes are required to the 2007 PCO filings, subject to Verizon's appeal rights. First, Verizon will remove the revenue line item for attribution of access costs from noncompetitive services. As depicted in more detail in Verizon's testimony (St. 1.0 at page 14), the result will be to reduce Verizon 2007 PCOs by over \$3 million. Second, Verizon will use the actual line counts as of March 31, 2006, instead of the projected 2007 line counts used in its filing. The parties agreed that since the 12-month period of April 1, 2006 through March 31, 2006 was used to calculate the revenue and change in inflation for the 2007 PCO filings, the logic of the Commission's 2006 PCO orders would require March 31, 2006 line counts. Because March 31, 2006 line counts are substantially lower than Verizon's actual or projected 2007 line counts (the actual

proprietary numbers are contained in Verizon's St. 1.0), this change will reduce the revenue Verizon is able to collect in implementing its 2007 PCOs.

This Commission's April 25, 2007 Order in the 2006 PCO matter held that Verizon may "roll all rate revisions and refund true-ups from the 2006 and 2007 PCO filings into the 2008 PCO." (4/25/07 Order, Ordering ¶ 4). Accordingly, Verizon will make the changes necessary to implement the attribution and line count adjustments for the 2007 PCO in its 2008 PCO filing, which it expects to make on or about November 1, 2007.

After thoroughly examining the issues, the parties also agreed that no changes would be required with respect to the other issues that OSBA had raised. Many of those issues did not continue to be significant matters of dispute after the 2006 PCO orders, which clearly resolved them.¹ Two of the issues did continue to be matters of dispute, and after thorough consideration and discussion the parties reached a reasonable settlement of those issues.

First, the parties agreed no change was needed to account for the inclusion of revenue from intercompany settlements ("ITC Settlements"). In the 2006 PCO Orders, the Commission directed Verizon North to remove the revenue line item for ITC Settlements from its 2006 PCO filing. However, the Commission stated that "[t]his directive is made without prejudice to subsequent Verizon North PCO proceedings but shall apply to Verizon North's future PCO filings unless Verizon adequately demonstrates in those cases that ITC Settlements are properly classified as noncompetitive revenue for purposes of PCO rate cap calculations." (3/22/07 Order at

¹ Those issues are detailed in Verizon St. 1.0, pages 8-10.

23). The OSBA's complaints against the 2007 PCO filings challenged both Verizon PA's and Verizon North's inclusion of revenue from intercompany settlements. Verizon St. 1.0 at page 21, line 17, through page 25, line 5, explains why the particular intercompany settlement revenue that was actually included in Verizon's 2007 PCO filings was properly classified as noncompetitive revenue for purposes of the 2007 PCO filings. The parties agreed that revenue included in 2007 satisfies the standard set forth in the 2006 Orders.

Second, the parties agreed that there should be no change to Verizon's use of the actual noncompetitive revenues for the 12-month period from April 1, 2005 to March 31, 2006 and the corresponding change in the inflation rate from the end of the first quarter of 2005 to the end of the first quarter of 2006. Verizon had moved back this period by one quarter from that used in the 2006 PCO filings because it found that inflation and revenue data from the July/June time period was not available until September, leaving insufficient time for the rate design and customer notification required for the filing to be made November 1 and effective January 1. The parties agreed that there was a reasonable basis to push back the time period by one quarter, in exchange for Verizon's agreement to consistently use the April/March time period unless and until language is added to the plan governing the time period issue that might more specifically delineate the parameters for using a different time period.

The final issue resolved was the banking issue, which the Commission directed the parties to address in this proceeding. Verizon presented a thorough and detailed explanation of the banking issue in its testimony, which testimony the parties agreed should be admitted into the record and adopted as the settlement of this issue (subject to a

footnote regarding OSBA's position on this issue). Verizon explained that calculating the cumulative net remainder in the bank for Verizon PA, one must account for values from the banked 2003 negative PCO and the banked portion of the 2006 positive PCO. The cumulative net value is calculated by looking at each year in which money is carried in the bank and netting the value of all the amounts credited and debited for that year to calculate the net value remaining in the bank for that year and then adding that amount to the cumulative net value for the previous year. Interest is then applied to the new cumulative net value.

Verizon provided a detailed spreadsheet calculating the cumulative net value of Verizon PA's bank as of January 1, 2007 as Exhibit A to its testimony, demonstrating that this value is negative \$1,610,536. If this cumulative value in the bank as of January 1, 2007 is to be zeroed out, then the parties agreed that this negative \$1,610,536 should be implemented as a one-time credit to some category of noncompetitive rates or through some other means that has the same effect as a one-time credit. The parties also agreed that on or before the date of filing its 2008 PCO filing, Verizon will make a proposal to the Commission for the implementation of this negative \$1,610,536, and the parties reserved all rights they may have to respond to such a proposal when it is made.

The parties also agreed that this cumulative net of one-time values does not depict what amount is available to be spent on recurring rate changes in the next year. In January of 2008, the full portion of the 2003 and 2006 PCOs that have not been implemented in rates remains available for use as depicted in Table 7 on page 41 of Verizon St. 1.0.

Verizon's Exhibit A and Table 7 in its direct testimony depict with real numbers how the cumulative net value of the bank and the recurring values left to spend are calculated. Below is a chart depicting a simple example with theoretical numbers showing how these values would be calculated with a negative PCO of \$17 million, for which \$15 million is used to cover each year's payment to the universal service fund, and a positive PCO of \$18 million, of which \$17 million was implemented in rate increases that recur every year and \$1 million was banked:

ILLUSTRATIVE BANKING TABLE

	2007	2008	2009
2003 PCO	-\$17M	-\$17M	-\$17M
Amount implemented (one-time USF payment)	-\$15M	-\$15M	-\$15M
Amount not implemented	-\$2M	-\$2M	-\$2M
2006 PCO	\$18M	\$18M	\$18M
Amount implemented (recurring rate increase)	\$17M	\$17M	\$17M
Amount not implemented (banked amount)	\$1M	\$1M	\$1M
Single year net (before interest) 2003 + 2006 amounts not implemented	-\$1M	-\$1M	-\$1M
Cumulative net (before interest) Single year net + previous cumulative net with interest	-\$1M	-\$2.025M	-\$3.075M
Interest (on cumulative difference) ²	-\$0.025M	-\$0.050M	-\$0.075M
Cumulative net (with interest) ³	-\$1.025M	-\$2.075M	-\$3.150M

The above Illustrative Table shows a cumulative net of negative \$3.15 million as of January 1, 2009. This is the amount that could be implemented as a one-time credit to

² These are illustrative interest figures only, not based on any particular interest rate.

³ The Illustrative Table presumes that the bank was zeroed out before 2007 and there is no cumulative net carried over from the previous year.

some category of noncompetitive rates or through some other means that has the same effect as a one-time credit, to “zero out” the bank at that time. On January 1, 2010, however, the full recurring value of the 2003 PCO remains available to be spent (and it is presumed \$15 million of it again will be used for that year’s USF payment) and the \$1 million banked from the 2006 PCO remains available to be spent (the other \$17 million having been used in a recurring rate increase that has the effect of using that money for 2010).

III. THIS SETTLEMENT IS IN THE PUBLIC INTEREST AND SHOULD BE APPROVED

“It is the policy of the Commission to encourage settlements.” 52 Pa. Code § 5.231(a). The parties to this proceeding represent various interests impacted by these PCO filings, including the companies, consumers, small business customers and the Commission’s prosecutory staff. The parties have thoroughly examined the record and the competing legal, policy and factual arguments and have reached a reasonable compromise of the disputed issues in this matter. Approval of this settlement will conserve party and Commission resources by avoiding further litigation and will provide for a reasonable resolution of the 2007 PCO filings, taking into account the costs and risks of litigation. It will result in a prompt and certain resolution of the 2007 PCO filings, subject only to the limited issues raised in the pending Commonwealth Court appeal of the 2006 case. It will also provide certainty as to how various issues will be handled in future PCO filings, particularly the time period and the banking issue. Accordingly, this settlement is in the public interest and should be approved without modification. If the settlement is approved by the presiding officer without modification,

the parties have agreed to waive exceptions and reply exceptions, allowing for a prompt resolution of this matter by the Commission.

IV. CONCLUSION

For the foregoing reasons, Verizon respectfully requests that the Commission approve the Joint Settlement Petition without modification as the resolution of this proceeding.

August 8, 2007



Leigh A. Hyer (Atty ID 204714)
Suzan DeBusk Paiva (Atty ID 53853)
Verizon
1717 Arch Street, 10th Floor
Philadelphia, PA 19103
(215) 466-4755
Leigh.a.hyer@verizon.com
Suzan.d.paiva@verizon.com

Attorneys for Verizon Pennsylvania Inc.
And Verizon North Inc.

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SECRETARY'S BUREAU

EXHIBIT E

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Verizon Pennsylvania Inc.'s 2007 PCO Filing	:	Docket No. R-00061915
	:	
Verizon North Inc.'s 2007 PCO Filing	:	Docket No. R-00061914
	:	

**STATEMENT OF THE
OFFICE OF SMALL BUSINESS ADVOCATE
IN SUPPORT OF THE PETITION**

Background

The Small Business Advocate is authorized and directed to represent the interests of the small business consumers of utility services in the Commonwealth of Pennsylvania under the provisions of the Small Business Advocate Act, Act 181 of 1988, 73 P.S. §§ 399.41 - 399.50. Pursuant to that statutory authority, the Office of Small Business Advocate (“OSBA”) filed complaints at Docket Nos. R-00061914 and R-00061915, the November 1, 2006, Price Change Opportunity (“PCO”) filings of Verizon North Inc. and Verizon Pennsylvania Inc. (collectively, “Verizon” or the “Companies”). The OSBA filed testimony, actively participated in the negotiations that led to the proposed settlement, and is a signatory to the Joint Settlement Petition (“Petition”). The OSBA *submits this statement in support of the Petition.*

Issues

The Petition sets forth a comprehensive list of issues that were resolved through the negotiation process. The following specific issues were of particular significance to

the OSBA when it concluded that the Petition was in the best interests of Verizon's small business customers.

(1) In the Verizon North 2006 PCO Filing, Docket No. R-00051227, Verizon North included in its noncompetitive service revenue calculation the amount of \$10,750,000 for Inter-Company ("ITC") Settlements. In the 2006 PCO proceeding, the OSBA successfully argued that Verizon North had not met its burden of proof to establish that the ITC Settlement revenue was properly included in the noncompetitive service revenue calculation. The Pennsylvania Public Utility Commission ("Commission") ordered that the ITC Settlement revenue be excluded from the noncompetitive service revenue calculation, and concluded that the same result would obtain in future PCO filings "unless Verizon adequately demonstrates in those cases that ITC Settlements are properly classified as noncompetitive revenue for purposes of PCO rate cap calculations." *Verizon 2006 PCO Filings*, Docket Nos. R-00051227 and R-00051228 (Order entered March 22, 2007), at 23.

ITC Settlement revenue was included in the 2007 PCO noncompetitive service revenue calculation for both Companies. Verizon Statement No. 1, at 21-25. Two significant changes have occurred in the 2007 PCO filings. First, the ITC Settlement revenue included in the noncompetitive service revenue calculation is only \$2.63 million for Verizon Pennsylvania, and \$1.496 million for Verizon North. *Id.*, at 23. The total of these two amounts is significantly less than the \$10.75 million included for just Verizon North in its 2006 PCO filing. Second, Verizon witness Fortin provides a detailed explanation of why this level of ITC Settlement revenue is properly included in the 2007 PCO noncompetitive service revenue calculations.

Therefore, with the significant reduction in the amounts of the ITC Settlement revenues, as well as the full explanation by Verizon why the revenues are properly included in the noncompetitive service revenue calculations, the OSBA is satisfied that the ITC Settlement revenue is properly classified and included in the Verizon 2007 PCO calculations.

(2) In the Companies' 2006 PCO filings, Verizon used July 1, 2004, through June 30, 2005, as the 12-month "historic period" for the purposes of calculating both the total noncompetitive service revenue and the change in the rate of inflation. In addition, the Commission ordered Verizon to use June 30, 2005, (the last day of the historic period) as the date on which the Companies would calculate their 2006 PCO residential and business line counts. *Verizon 2006 PCO Filings*, at 50. Furthermore, the Commission ordered that "Verizon shall also adhere to using line counts as of June 30 in the future for each year in which it files its PCO filing." *Id.*

In the 2007 PCO filings, Verizon proposed to change its historic period from July 1, 2005, through June 30, 2006, to April 1, 2005, through March 31, 2006. Verizon witness Fortin explained that this change would alleviate certain administrative difficulties that the Companies were encountering with getting the PCO filings completed on time. *See Verizon Statement No. 1*, at 26-27.

The OSBA's concerns on this issue stemmed from the changing of the historic period rather than from the specifics of the period itself. In other words, selecting April to May as the 12-month period is no less "correct" on a theoretical basis than choosing July to June as the 12-month period. If, as Verizon asserts, moving the historic period to begin on April 1st will assist the Companies with their internal administrative tasks, then

the OSBA does not object to the date change. However, what the OSBA steadfastly does not want to see is Verizon's proposing a different historic period for every PCO filing. Not only will this add a level of difficulty (and confusion) for the public advocates, the Office of Administrative Law Judge, and the Commission for every PCO filing, other local exchange carriers ("LECs") around the Commonwealth may be tempted to follow Verizon's lead on this issue. Furthermore, a LEC may be tempted to shift the historic period from PCO filing to PCO filing in an attempt to maximize its annual rate increases. Adding complexity, and controversy, to a LEC's annual PCO filing is not the goal of Chapter 30's alternative form of regulation.

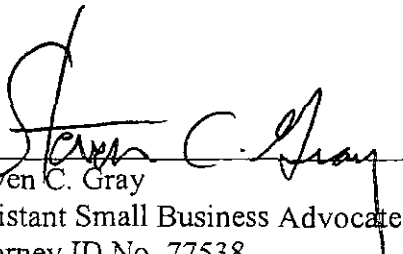
The Petition addresses the OSBA's concerns by setting the historic period as April 1 to March 31 for Verizon's 2007 and 2008 PCO filings. In addition, Verizon will propose language to amend the Companies' Chapter 30 plans in order to fix the historic period with a measure of certainty. Although that proposed language may result in a *litigated proceeding*, the venue will be a more appropriate forum than this 2007 PCO proceeding.

Consequently, the OSBA submits that the Petition provides a just and reasonable solution to the question of the proper historic period for Verizon's PCO filings, now and in the future.

Conclusion

Therefore, for the reasons set forth in the Petition itself, as well as the additional factors that are enumerated in this statement, the OSBA supports the proposed Petition and respectfully requests that the ALJ and the Commission approve the Petition in its entirety.

Respectfully submitted,


Steven C. Gray
Assistant Small Business Advocate
Attorney ID No. 77538

For:

William R. Lloyd, Jr.
Small Business Advocate
Attorney ID No. 16452

Office of Small Business Advocate
Suite 1102, Commerce Building
300 North Second Street
Harrisburg, PA 17101

Dated: August 3, 2007

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

EXHIBIT F

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission	:	
	:	
v.	:	Docket No. R-00061914
	:	
Verizon North, Inc.	:	
	:	
Pennsylvania Public Utility Commission	:	-
	:	
v.	:	Docket No. R-00061915
	:	
Verizon Pennsylvania, Inc.	:	

OFFICE OF CONSUMER ADVOCATE
STATEMENT IN SUPPORT OF THE JOINT SETTLEMENT PETITION

The Office of Consumer Advocate (OCA), one of the signatories to the Joint Settlement Petition (Settlement) in the above-referenced proceeding, recommends that the Pennsylvania Public Utility Commission (Commission) find the August 8, 2007 Joint Settlement Petition of the OCA, Verizon Pennsylvania Inc., Verizon North Inc., the Office of Small Business Advocate (OSBA) and the Office of Trial Staff (OTS) to be in the public interest and approve the Settlement for the following reasons:

I. INTRODUCTION

On November 1, 2006, Verizon North, Inc. and Verizon Pennsylvania, Inc. separately filed their annual Price Change Opportunity (PCO) filings with the Commission. These filings were docketed by the Commission at Docket No. R-00061914 and R-00061915, respectively. These filings proposed to increase rates for noncompetitive services by approximately \$19,829,000, for Verizon Pennsylvania, and by \$3,420,000 for Verizon North, per year based on their annual revenue

increase pursuant to their price cap formula. On November 9, 2006, the OSBA filed separate Formal Complaints in response to the filings. In the *Formal Complaints*, the OSBA contended that the Companies' proposed rates, rules and conditions of service may be unjust, unreasonable, unduly discriminatory and otherwise contrary to law. On November 17, 2006, the OCA filed a Notice of Intervention and Public Statement intervening into both of the proceedings arising from the OSBA's Formal Complaints. The Verizon Pennsylvania proceeding also includes a direction from the Commission in an Order entered January 11, 2007, at this docket to address the banking provisions raised in the Verizon Pennsylvania filing.

A Prehearing Conference was held in the proceeding involving *Verizon Pennsylvania* on January 31, 2007 before Administrative Law Judge Kandace F. Melillo. On February 22, 2007, the Commission issued a Notice establishing a telephonic Prehearing Conference for March 9, 2007 before ALJ Melillo involving the Verizon North filing. Subsequently, by Order entered March 5, 2007, the Verizon North and the Verizon Pennsylvania proceedings were formally consolidated by ALJ Melillo. Pursuant to the procedural schedule established by ALJ Melillo for the consolidated proceeding, Verizon submitted Direct and Rebuttal Testimony on May 24, 2007 and July 13, 2007, respectively. The OSBA filed Direct Testimony on June 27, 2007.

Throughout this proceeding, the Companies, the OCA, the OTS and the OSBA held settlement discussions in an attempt to resolve the contested issues and minimize the need for formal litigation. On August 8, 2007, the parties to the proceeding submitted a unanimous Settlement for approval by ALJ Melillo and the Commission. The OCA files this Statement in Support of the Settlement because the Joint Settlement Petition is in the public interest and should be approved as filed.

II. STATEMENT

A. Introduction.

After a preliminary review of the materials filed by Verizon and Verizon North in support of their 2007 PCO filings, and the Formal Complaints filed by the OSBA in response to those filings, the OCA determined to intervene into the proceedings to protect the interests of the Companies' residential customers. The OSBA averred that the Companies' filings may violate Section 3015(g) of the Public Utility Code. 66 Pa.C.S. § 3015(g). Section 3015(g) limits the ability of telephone companies to change their rates. The OCA further sought to protect consumer interests pertaining to issues regarding Verizon's ability to bank certain allowed increases that the Commission specifically requested be addressed in this proceeding.

As discussed further below, the Settlement addresses each of the contested issues as well as the banking issue raised by the Commission.¹

B. The Settlement Petition Clearly Articulates Verizon's Banking Methodology So That Verizon's Banking Provisions Can Be Applied In A Consistent Manner In Future Cases.

In its Order entered December 28, 2006, the Commission directed that the calculations submitted by Verizon in its 2006 PCO filing appeared to be consistent with the terms of the Company's Chapter 30 plan. December 28th Order at 7. However, the Commission expressed concern that the proposed rate increases may be greater than the Company is allowed to collect. This concern is based on the Commission's interpretation regarding the application of banked increases and decreases used to cover the additional rate and revenue increases beyond the 2007 annual revenue increase. Id. The Commission then denied Verizon's request to use a portion of

¹ Of note, the OSBA raised several issues in its Formal Complaints that were still outstanding from the proceedings involving the Companies' 2006 PCO filings. *See, Docket Nos. R-00051227 and R-00051228* (Order entered March 22, 2007). During the course of litigating the 2007 PCO filings, however, the Commission addressed those issues. As such, those issues no longer need to be resolved in this proceeding regarding the Companies' 2007 PCO filings. The Commission's Opinion and Order regarding the 2006 PCO filings, however, has been appealed to the Commonwealth Court. *See, Docket No. 988 CD 2007*. That appeal is currently pending.

the banked increase from the 2006 PCO filing. Id. at 9.² Banking is the ability of a telephone company to *defer* collecting revenue it is otherwise entitled to collect in lieu of collecting the full amount once allowed.

In response to the Commission's directive in its December 28th Order, Verizon filed testimony of Jane K. Fortin as part of this proceeding as Verizon St. 1.0. In her testimony, Ms. Fortin provided a detailed history of Verizon's banking and also explained the calculations in the current filing. Verizon St. 1.0 at 29-45. Ms. Fortin explained that the "net remainder in the bank for a given year is the arithmetic sum of all the negative and positive banked amounts for that year, plus the cumulative sum of banked amounts (if any) remaining from the previous year, plus applicable interest." Id. at 36. Verizon witness Fortin further explained that the cumulative net value of Verizon's bank is

... calculated by looking at each year in which money is carried in the bank and netting the value of all the amounts credited and debited for that year to calculate the net value remaining in the bank for that year. A cumulative value is obtained by adding that amount to the cumulative value for the previous year. Interest is then applied to the cumulative net value. For example, if the cumulative net in the bank was -\$2 million in 2006, and the one-year net for 2007 was \$1 million, the cumulative net would be -\$1 million (negative \$2 million plus positive \$1 million).

To be clear, this cumulative net of one-time values does not necessarily tell you what amount is available to be spent on recurring rate changes in the next year. The net banked amount for any given year is an amount comprised of the net values to date of all the positive and negative banked amounts, such as the gaps between the 2004 PCO and the USF payment for a particular year. If the cumulative net of -\$1.6 million depicted on Exhibit A were to be implemented, this amount would have to be provided through a one-time credit or through some means that has the same effect

² In response to the December 28th Order, Verizon filed a Petition for Reconsideration and Stay alleging that the Commission violated the Company's due process rights by failing to give Verizon an opportunity to be heard before "eliminating millions of dollars of Verizon PA's PCO entitlement." Verizon Petition for Reconsideration at 1-2. On January 11, 2007, the Commission entered a Reconsideration Opinion and Order allowing Verizon's filings to go into effect subject to investigation and refund in this proceeding. January 11th Order at 6-7.

as a one-time credit (such as delaying implementation of a subsequent PCO). This would 'zero out' the bank balance, but would not eliminate additional debits and credits going forward.

Verizon St. 1.0 at 39-40. Ms. Fortin also addressed other issues related to the Verizon's banking provisions, including calculations made by the Commission's Staff in the December 28th Order.

The OCA accepts this banking methodology as an accurate accounting of Verizon's ability to bank pursuant to its Chapter 30 Plan. The banking provisions in Verizon's Chapter 30 Plans are complicated. In particular, as a large company, Verizon's banking provisions involve significant sums of money and affect a substantial number of consumers. However, Ms. Fortin's explanation of the Verizon methodology represents a reasonable application of the Company's banking provisions. This explanation will allow Verizon's banking provisions to be *implemented consistently and will likely eliminate or reduce any litigation of this issue in future filings* as these banking provisions will continue to be used by Verizon. The public interest is served by having a description of Verizon's banking methodology that can be used in future filings.

As a result, the OCA submits that the Settlement is in the public interest and should be approved.

C. The Settlement Petition Resolves The Issues Raised By The Office of Small Business Advocate In Its Formal Complaints By Ensuring That An Accurate Revenue Determination Is Made In Each Filing.

In its Formal Complaints, the OSBA averred that

1) Verizon PA must not use estimates of customer line counts when allocating the noncompetitive service rate increase among its customers. The actual line counts in existence at the end of the *historic period must be used to calculate the per-line local exchange rate increases.*

2) The Verizon PA 2007 PCO filing uses a measuring period of April 2005 to March 2006. The Verizon PA 2006 PCO filing used

the measuring period of July 2004 to June 2005. The changing of the measuring period, with overlapping months, will result in an improper calculation of Verizon PA's noncompetitive service revenue increase.

OSBA Complaint at 3.³ The instant Settlement should be approved because it provides a resolution to these issues raised by the OSBA that is in the public interest.

Regarding the line counts used in the PCO filings, the Settlement provides that Verizon will use the April 1, 2005 through March 31, 2006 time period to measure revenue and change in inflation. Settlement at 6. The Settlement further provides that "Based on the use of the April 1, 2005, through March 31, 2006, time period, the Parties agree that Verizon will use the actual line counts as of March 31, 2006, to make its alterations to the 2007 PCO filings, as discussed in Verizon St. 1.0." Id. Verizon's line count determination is further discussed by Ms. Fortin in her pre-filed testimony. *See*, Verizon St. 1.0 at 14-21.

Regarding the period in which the change in inflation is measured used in the PCO filings, the Settlement provides that Verizon will use April 1, 2005 to March 31, 2006 for the 2007 PCO, as Verizon originally proposed, and will use the April 1st to March 31st time period for the 2008 PCO filings as well. Settlement at 10-11. Additionally, the Settlement further provides that Verizon will continue to use the April 1st to March 31st time period for its PCO filings on a going-forward basis after 2008. Id. at 10.

The OCA submits that both of these provisions are in the public interest and should be approved by the Commission as part of this proceeding. It is important that the Companies use the same period each year to measure line counts and the change in inflation in their PCO filings. Failure to do so may result in an inaccurate recovery of PCO revenues. For example, if inflation

³ As indicated above, the OSBA also raised several other issues in its Formal Complaint in this proceeding regarding matters in the 2006 PCO proceeding that were not resolved prior to the submission of the 2007 PCO filing. *See*, n. 1, *supra*. The Commission has subsequently resolved those issues so they are now moot. Additionally, the OSBA raised these two remaining issues in its Formal Complaint against both Verizon and Verizon North.


was high during a particular three-month period, and that three-month period was used in two overlapping PCO periods, then Verizon would recover more than they otherwise should be allowed. Similarly, allowing Verizon to vary its point in the year when it measures its line count could allow Verizon to benefit if Verizon can pick and choose which point in the year will maximize its PCO revenues. Requiring Verizon to consistently use a particular point in time during the year to report its line count, and a particular period in which to measure inflation, will result in fair and accurate PCO filings in the future.

As a result, the OCA supports the Settlement because it resolves the issues pertaining to the Companies' filings raised by the OSBA. The Settlement ensures that Verizon will use a consistent period in which to measure inflation and a consistent point in which to measure line counts at least for the 2007 and 2008 PCO filings.

III. CONCLUSION

WHEREFORE, the Pennsylvania Office of Consumer Advocate respectfully requests that the Joint Settlement Petition submitted by Verizon Pennsylvania Inc., Verizon North Inc., the Office of Small Business Advocate, the Office of Trial Staff and the Office of Consumer Advocate be found to be in the public interest and approved as filed.

Respectfully submitted,


Joel H. Cheskis (Attorney ID # 81617)
Assistant Consumer Advocate

Counsel for: Irwin A. Popowsky
Consumer Advocate

Office of Consumer Advocate
555 Walnut Street, 5th Floor
Harrisburg, PA 17120
(717) 783-5048

Dated: August 8, 2007
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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

EXHIBIT G

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Verizon North, Inc.	:	R-00061914
2007 Price Change Opportunity Filing	:	P-00001854F1000
	:	
Office of Small Business Advocate	:	
v.	:	R-00061914C0001
Verizon North, Inc.	:	
	:	
Verizon Pennsylvania, Inc.	:	R-00061915
2007 Price Change Opportunity Filing	:	P-00930715F1000
	:	
Office of Small Business Advocate	:	
v.	:	R-00061915C0001
Verizon Pennsylvania, Inc.	:	

**OFFICE OF TRIAL STAFF
STATEMENT IN SUPPORT OF
JOINT PETITION FOR SETTLEMENT**

**TO THE HONORABLE KANDACE F. MELILLO, ADMINISTRATIVE LAW
JUDGE:**

The Office of Trial Staff (“OTS”) of the Pennsylvania Public Utility Commission (“Commission”), by and through its Prosecutor, Robert V. Eckenrod, hereby respectfully submits that the terms and conditions of the foregoing Joint Petition for Settlement (“Settlement”) is in the public interest and represents a fair, just, reasonable and equitable balance of the interests of Verizon North, Inc. (“Verizon North”), Verizon Pennsylvania, Inc. (“Verizon PA”) (collectively referred to as the “Companies”) and its customers. The parties to this Settlement (“Joint Petitioners”) conducted extensive discovery and negotiation and as a result, OTS, the Office of Consumer Advocate (“OCA”), the Office of Small Business Advocate (“OSBA”) and the Companies have agreed upon the terms

embodied in the foregoing Joint Petition. This request is based upon OTS' conclusion that the Settlement is in the public interest as supported by the following factors:

I. BACKGROUND

1. OTS was established under the provisions of Section 306 of the Public Utility Code, 66 Pa. C.S. § 306, in 1986 and charged with the representation of the public interest in proceedings relating to rates and rate-related services held before the Commission. As a result, in negotiated settlement of positions, it is incumbent upon the OTS to ensure that the public interest is served and to quantify to what extent amicable resolution of any such proceeding will benefit the public interest.

2. On November 1, 2006, Verizon PA and Verizon North, respectively, filed their 2007 Price Change Opportunity ("PCO") plans pursuant to the terms of their Commission approved Chapter 30 plans and the requirements of the Chapter 30 statute, as amended by Act 183.

3. On November 21, 2006, OTS filed a Notice of Appearance.

4. On December 28, 2006, the Commission issued an order directing that the rate increases contemplated by the Companies 2007 PCO filings be allowed to go into effect, subject to the findings of the Office of Administrative Law Judge ("OALJ") as to issues raised in the Complaints filed by OSBA on November 9, 2006. In addition, the Commission directed that the issue of the accounting methodology for banking be addressed in the formal proceeding.¹

¹ As detailed in the Joint Petition for Settlement, on March 22, 2007, the Commission issued orders at Docket numbers R-00051227 and R-00051228 (March 22, 2007) resolving many, if not all, of the issues raised by OSBA's present Complaints, in the Verizon PA's and Verizon North's 2006 PCO filings. Joint Petition for

5. The on-the-record proceeding was assigned to Administrative Law Judge Kandace F. Melillo (“ALJ”) and a prehearing conference was convened on March 14, 2007.

6. Commission Rules and Regulations encourage settlement of proceedings and, consequently, the parties convened frequent conferences and discussion over the course of this proceeding. These discussions ultimately resulted in a comprehensive stipulation of all issues in controversy and an agreement in principle was reached on August 8, 2007.

II. SETTLEMENT TERMS AND PUBLIC INTEREST STATEMENT

7. The specific terms of the settlement are found at Paragraphs 14 through 40 of the Joint Petition. Consequently, the Joint Petition, as proposed, is in the public interest and should be approved by the ALJ and the Commission for the following reasons:

a. The Companies have agreed to make changes to its 2007 PCO Filings to comply with the Commission’s Order that attribution revenue be removed from Verizon’s 2006 and 2007 PCO calculations, subject to the ultimate outcome of Verizon’s appeal to the Commonwealth Court at Docket No. 988 CD 2007. Additionally, the Commission directed Verizon to alter its 2007 filing to use actual line counts from June 30, 2006 and, as part of this settlement, Verizon has agreed to use actual line counts as of March 31, 2006, making alterations to its 2007 PCO filing, subject to the outcome of the

Settlement, p. 4. A Petition for Review of these Orders was filed by the Companies with the Commonwealth Court on May 25, 2007. Resolution of that appeal is pending.

aforementioned appeal. Verizon's acquiescence to make such changes will save the parties considerable time and expense in re-litigating this issue before the Commission pending an ultimate determination for future filings.

b. As part of the Settlement, Verizon has provided further testimony and exhibits that clearly articulate its banking methodology. In the December 28, 2006 Order, the Commission explained that the calculations submitted by Verizon in its prior year PCO Filing appeared to be consistent with the terms of the Companies' Chapter 30 plans, but expressed concern that the proposed rate increases could potentially be more than the Companies were allowed to collect because of a misinterpretation regarding the application of banked increases and decreases. In testimony provided by Verizon witness Jane K. Fortin, a detailed history of Verizon's banking methodology was provided and the calculations used in the present filing were explained. Based upon further analysis as provided by Verizon, it appears that this methodology represents a reasonable application of the Companies' banking provisions. Acceptance of this methodology in this proceeding will ensure that Verizons' banking provisions will be implemented consistently in future proceedings and will reduce the likelihood of litigation on this issue.

8. In addition to the foregoing reasons, based upon OTS' analysis of the filing and the present proposal, acceptance of this proposed Settlement is in the public interest because resolution of this case by settlement rather than litigation will avoid substantial time and expense involved in continuing to formally pursue all issues in this proceeding.

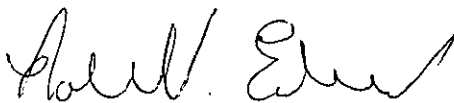
9. OTS further submits that acceptance of the foregoing settlement will negate the need for any direct and cross-examination of witnesses, the preparation of main briefs, reply briefs, exceptions and reply exceptions. The avoidance of any further expense by settlement of this proceeding serves the interests of the Companies, OTS and the customers.

10. OTS' agreement to settle this case is made without any admission or prejudice to any position that OTS might adopt during subsequent litigation in the event the Settlement is rejected by the Commission or otherwise properly withdrawn by any of the Joint Petitioners.

11. If the ALJ recommends that the Commission adopt the Settlement as proposed, OTS has agreed to waive the filing of Exceptions. However, OTS has not waived its rights to file Exceptions with respect to any modifications to the terms and conditions of the Settlement, or any additional matters, that may be proposed by the ALJ in her Recommended Decision. OTS has also reserved the right to file Reply Exceptions to any Exceptions that may be filed by the Company or any formal complainant.

WHEREFORE, the Commission's Office of Trial Staff represents that it supports the Settlement as being in the public interest and respectfully requests that the Administrative Law Judge and the Commission approve the foregoing Settlement, including all terms and conditions contained therein.

Respectfully submitted,



Robert V. Eckenrod
Attorney I.D. No. 84889
Prosecutor
Office of Trial Staff

Pennsylvania Public Utility Commission
Post Office Box 3265
Harrisburg, Pennsylvania 17105-3265
(717) 787-1976

Dated: August 8, 2007

CERTIFICATE OF SERVICE

I, Suzan D. Paiva, hereby certify that I have this day served a copy of the Joint Settlement Petition, upon the participants listed below in accordance with the requirements of 52 Pa. Code Section 1.54 (related to service by a participant) and 1.55 (related to service upon attorneys).


Dated at Philadelphia, Pennsylvania, this 8th day of August, 2007.

VIA E-MAIL AND UPS OVERNIGHT DELIVERY

Joel Cheskis, Esquire
Office of Consumer Advocate
555 Walnut Street, 5th Floor
Harrisburg, PA 17101-1923

Steven C. Gray, Esquire
Office of Small Business Advocate
Suite 1102, Commerce Building
300 North Second Street
Harrisburg, PA 17102

Robert Eckenrod, Esquire
Office of Trial Staff
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120



Suzan D. Paiva
Assistant General Counsel
Verizon Pennsylvania Inc.
1717 Arch Street, 10W
Philadelphia, PA 19103
(215) 466-4755