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August 20, 2018

**Via Electronic Filing**

Rosemary Chiavetta, Secretary  
Pennsylvania Public Utility Commission  
Commonwealth Keystone Building  
400 North Street – Filing Room (2 North)  
Harrisburg, PA 17120

**RE: Office of Small Business Advocate v Verizon Pennsylvania LLC**  
**Docket Nos. C-2017-2633476 and R-2017-2632523**

Dear Secretary Chiavetta:

Enclosed please find the Main Brief of Verizon Pennsylvania LLC in the above-referenced matter.

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

Very truly yours,

A handwritten signature in blue ink that reads "Suzan D. Paiva/sau".

Suzan D. Paiva

SDP/sau  
Enclosures

**Via E-Mail and First Class Mail**  
cc: Hon. Joel J. Cheskis  
Hon. Andrew Calvelli  
Attached Certificate of Service

**CERTIFICATE OF SERVICE**

I, Suzan D. Paiva, hereby certify that I have this day served a true copy of Verizon Pennsylvania LLC's Main Brief, upon the parties 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 20<sup>th</sup> day of August, 2018.

**VIA E-MAIL AND FIRST CLASS U.S. MAIL**

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**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Verizon Pennsylvania LLC	:	R-2017-2632523
2018 Price Change Opportunity Filing	:	
	:	
Verizon Pennsylvania LLC Amended Alternative	:	P-00930715F1000
Regulation and Network Modernization Plan	:	
	:	
Office of Small Business Advocate v.	:	C-2017-2633476
Verizon Pennsylvania LLC	:	

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**MAIN BRIEF OF VERIZON PENNSYLVANIA LLC**

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Date: August 20, 2018

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## **I. Introduction and Summary of Argument**

The Office of Small Business Advocate's ("OSBA") complaint is not so much a challenge to the rates established by Verizon Pennsylvania LLC's ("Verizon") annual Price Change Opportunity ("PCO) filing as it is an indictment of the Chapter 30 statute itself. OSBA takes issue with the Legislature's decision to cap annual rate increases for noncompetitive *residential* services but not to set any cap for *business* rate increases. OSBA decries the continuing disparity between basic business and residential rates, but this is a difference that has existed for decades and continues to exist, in part, due to this Legislative decision to cap residential rate increases.

OSBA does not present any facts to show that Verizon's actual business rates implemented in this PCO filing are unjust or unreasonable. Instead, it presents hypothetical arguments for an extra-statutory business rate cap or some unspecified future limit on business dial tone line rates. This Commission in 2007 already rejected OSBA's attempt to create a business rate cap where the Legislature chose not to include one and should reject it again here. The change OSBA seeks requires an amendment to the governing statute. Unless and until that happens, the Commission must continue to review Verizon's rate proposals on a case-by-case basis under the plan and applicable law. Under that standard, Verizon's rates in this case must be approved and OSBA's complaint dismissed.

Each of Verizon's business dial tone rates at issue here is lower than or equal to the \$22.25 rate for the same service that was approved by the Commission more than two years ago and has been in effect in Verizon's rural Density Cell 4 since that time. The same \$22.25 rate took effect without challenge this year for the entire territory served by Verizon's sister company, Verizon North LLC. OSBA presents no evidence to show

these specific rates are unjust, unreasonable or violate the plan or any statute, regulation or order.

## **II. Statement of the Case**

Under the alternative form of regulation for incumbent local exchange companies authorized by Chapter 30 of the Public Utility Code,<sup>1</sup> price changes for services designated as “noncompetitive” are governed by a price stability mechanism, which is a complete substitute for the former rate of return process by which the Commission used to set regulated service rates.<sup>2</sup> The price stability mechanism in Verizon’s Chapter 30 plan is known as the “Price Change Opportunity” or “PCO,” an inflation-based formula that calculates the allowable annual increase or decrease to total revenue from noncompetitive services based on the change in the rate of inflation over the 12-month period upon which the PCO is calculated.<sup>3</sup>

If, as here, a revenue increase is allowed, then Verizon has the discretion to propose to increase rates for any noncompetitive service to recover the permitted amount of annual revenue, subject to Commission review and any limitations in its plan or applicable law.

Following the Commission’s March 4, 2015 Order classifying all services in 153 Verizon/Verizon North exchanges as competitive, the retail services that remain classified as noncompetitive and subject to rate increases under this process are primarily basic, stand-alone voice service to residential and non-enterprise business customers located in the remaining exchanges that were not classified competitive.<sup>4</sup>

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<sup>1</sup> 66 Pa. C.S. § 3011, et seq.

<sup>2</sup> Services designated as “competitive” under Chapter 30 have complete pricing flexibility and their rates can be changed at any time at the company’s discretion.

<sup>3</sup> See VZ St. 1.0 at 3 for an explanation of the formula.

<sup>4</sup> *Joint Petition of Verizon Pennsylvania LLC and Verizon North LLC for Competitive Classification of all Retail Services in Certain Geographic Areas and for a Waiver of Regulations for Competitive*

On November 1, 2017, Verizon made its 2018 PCO filing, notifying the Commission that the price cap mechanism in the company’s Chapter 30 plan allowed Verizon to increase its revenue from noncompetitive services by \$1,257,000. To implement the allowed revenue increase, Verizon allocated \$495,100 to residence dial tone line rates (the maximum allowed under Chapter 30); \$27,700 to the business late payment charge (agreed on in a previous settlement); and \$322,300 to Verizon’s bank (credited against the 2003 PCO balance). The remaining \$411,900 was allocated to business dial tone line increases.<sup>5</sup> The proposed revisions to Tariffs Telephone Pa. P.U.C. Nos. 1, 180A, 182, 182A, 185B and 185C were filed and became effective January 1, 2018. The table below summarizes the former and new rates for the affected services.

	<u>Old Rate</u> (monthly)	<u>New Rate</u> (monthly)	<u>Increase</u> (monthly)
<b><u>RESIDENTIAL</u></b>			
<u>Dial Tone Line</u>			
All Cells	\$9.00	\$9.20	\$0.20
<b><u>BUSINESS</u></b>			
<u>Dial Tone Line</u>			
Cell 1	\$15.45	\$18.00	\$2.55
Cell 2	\$17.55	\$20.00	\$2.45
Cell 3	\$21.45	\$22.25	\$0.80
	<u>Old Rate</u>	<u>New Rate</u>	
<u>Late Payment Charge</u>	1.5%	Greater of 1.5% or \$5	

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*Services*, Docket Nos. P-2014-2446303 and 04 (Opinion and Order Entered March 4, 2015). Intrastate switched access service is also classified noncompetitive, but it is subject to pricing constraints under federal law and rates cannot be increased.

<sup>5</sup> VZ St. 1.0 at 2. Verizon’s 2018 PCO filing is attached to its Statement 1.0 as Proprietary Exhibit 1.

The rate increases OSBA challenges here are to the business dial tone line rates. Verizon did not increase the dial tone line rate in Density Cell 4, which remains at \$22.25 and has been in effect for more than two years. Verizon made only a modest increase of \$0.80 in Density Cell 3, to bring it equal to the \$22.25 in Density Cell 4. Density Cells 3 and 4 cover suburban and rural areas and have the largest number of customers for noncompetitive business dial tone line service. While the per-line increases were larger in Density Cells 1 and 2, which cover the cities of Philadelphia and Pittsburgh, the resulting rates for business dial tone line service in those urban areas are still more than \$2 to \$4 lower than the rate for the same service in the suburban and rural Density Cells 3 and 4. Verizon determined that it would be reasonable to try to achieve a common state-wide rate for business dial tone line service, as it has done for the residential dial tone line rate. OSBA took no issue with the 2018 PCO filing of Verizon's affiliate Verizon North LLC, which established a \$22.25 rate for the same business dial tone line service in all of its regulated exchanges.<sup>6</sup> Thus the Commission has found the highest rate Verizon is charging for business dial tone line service to be just and reasonable both through Verizon's existing Density Cell 4 rates and Verizon North's existing territory-wide rates. The business dial tone line rates at issue here are all lower than or equal to that approved rate for the same service.

On November 13, 2017, OSBA filed a complaint against Verizon's 2018 PCO filing. OSBA did not oppose the increase to the business late payment charge (which had been agreed to in a previous settlement) but it contended that the proposed increase and

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<sup>6</sup> Verizon's affiliate, Verizon North LLC, established a Density Cell 3 rate of \$22.25 to match its existing Density Cell 4 rate for the same business dial tone line service and OSBA did not file a complaint against that filing. Those rates were approved by Commission Order entered December 21, 2017 at Docket No. R-2017-2632498. VZ St. 1.0 at 17.

resulting rates for the business dial tone line service are unjust and unreasonable.

Verizon answered OSBA's complaint on November 27, 2017. On December 21, 2017, the Office of Consumer Advocate ("OCA") filed a Notice of Intervention and Public Statement.

By order entered December 21, 2017, the Commission found that Verizon's 2018 PCO filing is "deemed in compliance with its Commission-approved Amended Chapter 30 Plan" and permitted the rate changes "to go into effect as filed and remain in effect during the pendency of the Office of Small Business Advocate Formal Complaint adjudication and be subject to refund pending the findings of the Office of Administrative Law Judge and further Orders of the Commission as necessary." According to the Commission, "[o]ur review of the calculations submitted by Verizon [] indicates that they appear to be consistent with the terms of the Company's Price Stability Mechanism/Price Change Opportunity formula approved in its Chapter 30 Plan . . . Therefore, we shall allow the proposed rate increases to go into effect as filed subject to refund pending the findings of the Office of Administrative Law Judge regarding the complaint filed by OSBA." (12/21/17 Order at 5).

A prehearing conference was held on January 26, 2018, before presiding officers Joel H. Cheskis, Deputy Chief Administrative Law Judge, and Andrew M. Calvelli, Administrative Law Judge. The presiding officers issued a Scheduling Order on January 29, 2018, consolidating the dockets for Verizon's 2018 PCO Filing and the OSBA's complaint and setting a schedule proposed by the parties for the exchange of pre-filed written testimony and an evidentiary hearing. The parties subsequently reached agreement to admit the testimony into the record and waive cross examination. The

hearing scheduled for July 20, 2018 was cancelled and the case proceeded directly to briefing.

### **III. Argument**

#### **A. Legal Framework for Noncompetitive Service Rates.**

##### **1. There Is No Cap On PCO Business Service Rate Increases.**

Notably missing from OSBA's case is any attempt to provide specific evidence to show that the actual business dial tone rates implemented with Verizon's 2018 PCO filing violate applicable law or Verizon's plan. Instead, OSBA makes vague, hypothetical arguments directed at remedying what it views as the unfair disparity between business and residential basic service rates, a difference that is exacerbated by the residential rate cap in 66 Pa. C. S. § 3015(a)(3).

OSBA arbitrarily tries to create business rate caps that do not exist in the statute. First, OSBA's witness Mr. Gillan proposes that the Commission should "limit the increase in the smaller, more rural density cells by the average increase in urban markets."<sup>7</sup> Not only does Chapter 30 contain no such limitation, but also in the present case Verizon did not increase the business dial tone line rate in the rural density cell (Cell 4) at all, and the largest increases were in the urban areas, so this proposal is irrelevant. Next, Mr. Gillan proposes that "the commission could require that Verizon may not maintain a business-to-residential rate relationship of greater than 1.7:1,"<sup>8</sup> but neither Chapter 30 nor Verizon's alternative regulation plan requires rate increases for residential and business customers to have a certain relationship and there is no legal support for this proposal. By proposing to limit business rate increases to a level tied to residential rates, which are capped by statute, OSBA would thwart the intent of the Legislature and effectively create a business rate cap that does not exist in the statute.

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<sup>7</sup> OSBA St. No. 1, Gillan Direct at 12.

<sup>8</sup> *Id.*

This is not the first time OSBA has attempted to bootstrap a nonexistent business rate limitation into Chapter 30 to obtain the same standard for business rates that the Legislature chose to adopt for residential rates. The Commission rejected this argument the last time and it should do so again. There is no question that Chapter 30 limits Verizon's ability to increase *residential* rates in its annual PCO filings, pursuant to 66 Pa. C.S. § 3015(a)(3).<sup>9</sup> The maximum per-line residential increase permitted for this filing was 20 cents,<sup>10</sup> and Verizon complied with that limitation and made the maximum allowed increase to residential rates. But no similar limit exists for business rates.

Section 3015(a)(3) was part of the new Chapter 30 statute enacted in 2004, popularly known as "Act 183." Shortly after Act 183 took effect, OSBA attempted to argue for a limit on business rate increases based on old plan language that predated the new statute, but the Commission disagreed, finding that "[b]ased on our review of the record and the requirements under Act 183, we are not amenable to OSBA's position on this issue. We find that Verizon has the better position on the issue as the language on which OSBA relies for its argument is no longer effective."<sup>11</sup> The Commission agreed with the presiding officer, who had concluded in his recommended decision that "the Legislature in Act 183 considered and rejected the idea of having any rate cap for business rate increases," but rather "chose to allow companies to implement their PCOs by raising business rates without

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<sup>9</sup> That statute states that: "an average rate adjustment for protected residential customer local exchange telecommunications service lines shall be determined by dividing the total protected service revenues associated with such lines, as adjusted by the price stability formula, by the number of such lines, and the rate adjustment for any individual line shall not vary from this average rate adjustment by more than 20%." 66 Pa. C.S. § 3015(a)(3).

<sup>10</sup> VZ St. 1.0 at 8.

<sup>11</sup> *PUC v. Verizon Pennsylvania Inc.*, Docket No. R-00051228, etc. (Opinion and Order entered March 22, 2007) at 36 ("3/22/07 Order").

limitation.”<sup>12</sup> Accordingly, the Commission concluded that “there is no basis for the Commission to direct Verizon PA to limit” its business rate increases.<sup>13</sup> The same conclusion follows in this case.

To the extent OSBA argues that the Commission should require Verizon to make larger increases to residential rates than the statute permits, which would likely have the effect of reducing the business rate increases, the Commission cannot ignore Section 3015(a)(3). While modification or elimination of the residential cap in 66 Pa. C.S. § 3015(a)(3) would provide Verizon more flexibility to consider larger increases to residential rates in future filings, and Verizon is not opposed to considering that option if it were statutorily authorized, the ability to do so would require a Legislative change. In the present filing Verizon and the Commission are required to work within the parameters set by the statute.

## **2. Chapter 30 Contains General Protections For Noncompetitive Service Rates, Including Business Rates.**

OSBA suggests that, if the Commission does not step in and limit business rate increases by creating an extra-statutory cap, those rates will increase on an exponential and unfettered basis. This argument, too, is contrary to the law and the facts. While there is no explicit cap for noncompetitive business services, Chapter 30 is still designed to control increases in these rates.

First, the authorized revenue increase from noncompetitive services each year is limited by a formula tied to the rate of inflation, minus an offset. Therefore, the total amount of new revenue each year is statutorily limited and Verizon does not have discretion to

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<sup>12</sup> *PUC v. Verizon Pennsylvania Inc.*, Docket No. R-00051228, etc., (Recommended Decision dated December 13, 2006) at 31.

<sup>13</sup> 3/22/07 Order at 29.

increase revenue from these services arbitrarily or in an unlimited manner, which the Commission has recognized serves as a protection against increases to these rates.<sup>14</sup>

Second, Chapter 30 relies on competitive pressures to control rates. The statute is designed to allow a company to exercise its own discretion to choose which of its noncompetitive service rates to increase – or to choose not to increase rates at all – based on its own assessment of the marketplace. As discussed below, customers of basic business services have competitive options and can choose to leave Verizon if services are priced too high. Verizon does not always increase basic business rates with its annual opportunity. In recent years Verizon has made no business rate increases in 2011 and 2017. In the 2012 and 2015 PCOs Verizon increased the Density Cell 3 and 4 rates but did not increase the Density Cell 1 and 2 rates.

Third, notwithstanding these safeguards, the Commission still retains authority to review individual rates on a case-by-case basis and may investigate whether the rate is just and reasonable under 66 Pa. C.S. § 1301. OSBA’s testimony seems to presume that Verizon would deny that this Commission retains any authority over the general reasonability of these rates under Section 1301. But that is a legal issue that was already decided by the Commission and the Commonwealth Court. In a 2005 case involving a proposed increase to switched access rates in a PCO filing, the Commission disallowed the increases holding that “the Commission still has the statutory mandate, authority and responsibility under 66 Pa.

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<sup>14</sup> “[T]he provisions of Act 183 limit the pace and magnitude of annual rate increases that are based on inflation. The total amount of new revenue that RLECs can collect each year is statutorily limited and the [incumbent local exchange companies] do not have discretion to increase revenue arbitrarily.” (Pa. P.U.C. July 18, 2011). *Investigation Regarding Intrastate Access Charges and IntraLATA Toll Rates of Rural Carriers and The Pennsylvania Universal Service Fund*, I-00040105, 2011 Pa. PUC LEXIS 1502, \*94-95 (Opinion and Order entered July 30, 2011).

C.S. § 3019(h) to adjudicate whether the proposed rate changes are just and reasonable and non-discriminatory respectively under sections 1301 and 1304 of the Public Utility Code, 66 Pa. C.S. § 1301 and 1304.”<sup>15</sup> This legal conclusion was affirmed on appeal in a Commonwealth Court proceeding where Verizon supported the Commission’s position.

According to the Commonwealth Court:

This Court agrees with the Commission that when read in its entirety, Act 183 does not speak in terms of limiting the Commission's authority. To the contrary, the statute expressly preserves the Commission's authority and responsibility to protect all ratepayers and protected services to ensure rates from proposed annual revenue increases are "just and reasonable." . . . The General Assembly expressly preserved the Commission's authority to protect ratepayers of noncompetitive and protected services and retained that aspect of the Commission's ratemaking authority that authorized it to ensure that any particular increase was just and reasonable under 66 Pa. C.S. § 1301, even if that increase was proposed as part of an annual price change filing.<sup>16</sup>

But while this Commission continues to have the authority to ensure that end user rates are just and reasonable, its decisions in that regard must be based on substantial evidence and must not undermine Chapter 30’s intent that the company, not the Commission, should design the annual rate increases. As discussed below, there is no evidence to indicate that Verizon’s business dial tone line rates proposed here are unreasonable, and the only record evidence shows that they are reasonable.

To the extent OSBA is seeking hypothetical relief, such as some pre-set limit on business rate levels or for the Commission to “warn” Verizon “that future increases to the business will be denied,”<sup>17</sup> the Commission should not make a hypothetical decision based on facts that are not before it. In another context the Commission has rejected setting a

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<sup>15</sup> *Commonwealth Telephone Company PSI/SPI Filing for Year 2005*, No. R-00050551 (Opinion and Order entered August 31, 2005) at 7.

<sup>16</sup> *Buffalo Valley Tel. Co. v. Pa. PUC*, 990 A.2d 67, 79, 84, 2009 Pa. Commw. LEXIS 1728 (Pa. Cmwlth. Ct. 2009).

<sup>17</sup> OSBA St. No. 1, Gillan Direct at 9.

blanket limitation on Chapter 30 rate increases in favor of a case-by-case consideration of the specific rates proposed.<sup>18</sup> OSBA’s legal argument is a theoretical one that need not be answered under the facts presented here. OSBA has not provided any facts to demonstrate that the rates at issue in this case are not just and reasonable, which is the only issue before the Commission in this case. There is no need for – and no facts to support – any finding of what would be a generally reasonable business rate in the future.

**B. OSBA Has Failed To Show That Verizon’s Business Rates Are Not Just And Reasonable.**

**1. These Business Dial Tone Line Rates Have Already Been Established As Just And Reasonable.**

OSBA challenges rates for business dial tone line service of \$18.00 (Density Cell 1), \$20.00 (Density Cell 2) and \$22.25 (Density Cell 3). But these rates are equal to or lower than the rate for the same service that has been approved by the Commission and effective for at least two years in the most rural parts of Verizon’s territory, and that has stood unchallenged by OSBA in other contexts.

The rate of \$22.25 is the existing rate that has been in effect for more than two years in Verizon’s most rural Density Cell 4. In the present filing Verizon made only a modest increase of \$0.80 in Density Cell 3, to bring it equal to the \$22.25 in Density Cell 4. Density Cells 3 and 4 cover suburban and rural areas and have the largest number of customers for noncompetitive business dial tone line service. While the per-line increases

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<sup>18</sup> In rejecting the proposal to cap RLEC residential rates at a blanket \$18 level, the Commission observed that “Act 183 contains safeguards limiting the pace and magnitude of rate increases which are largely tied to the changes in inflation indexes issued by the U.S. Bureau of Economic Analysis (BEA), U.S. Department of Commerce. We agree with Verizon that the total amount of new revenue each year is statutorily limited and the RLECs do not have discretion to increase revenue arbitrarily. We also agree with Verizon that Act 183 does not impose a cap on RLECs' rate increases and does not provide for other carriers to subsidize such rate increases, but presumes that the new revenues are secured through rate changes.” *Investigation Regarding Intrastate Access Charges and IntraLATA Toll Rates of Rural Carriers and The Pennsylvania Universal Service Fund*, I-00040105, 2011 Pa. PUC LEXIS 1502, \*124-25 (Opinion and Order entered July 30, 2011).

were larger in Density Cells 1 and 2, which cover the cities of Philadelphia and Pittsburgh, the resulting rates for business dial tone line service in those areas are still more than \$2 to \$4 lower than the rate for the same service in the suburban and rural Density Cells 3 and 4.

Undercutting its attempt to challenge Verizon's rate increases, OSBA took no issue with the 2018 PCO filing of Verizon's affiliate Verizon North LLC, which established a \$22.25 rate for the same business dial tone line service in all of its regulated exchanges.<sup>19</sup> The Commission has found that the highest rate Verizon is charging for business dial tone line service to be just and reasonable both through Verizon's existing Density Cell 4 rates and Verizon North's existing territory-wide rates. The business dial tone line rates at issue here are all lower than or equal to that approved rate for the same service.

As a percentage, the increases are also reasonable. The largest percentage changes for dial tone line service are in Density Cells 1 and 2 at 17% and 14% respectively but Verizon did not modify these rates with last year's PCO and the resulting rates are still lower than or equal to the business dial tone line rates for Density Cells 3 and 4 of \$22.25. And because many of the wire centers in the urban and suburban areas have been classified as competitive and are no longer subject to the PCO, there are less than 5,600 lines subscribing to business dial tone line service in the remaining noncompetitive wire centers of Density Cells 1 and 2 taken together, and these customers have many service options. The vast majority of the customers subscribing to stand alone business dial tone line service that is still classified as noncompetitive are in Density Cells 3 and 4, where there

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<sup>19</sup> Verizon's affiliate, Verizon North LLC, established a Density Cell 3 rate of \$22.25 to match its existing Density Cell 4 rate for the same business dial tone line service and OSBA did not file a complaint against that filing. Those rates were approved by Commission Order entered December 21, 2017 at Docket No. R-2017-2632498. VZ St. 1.0 at 17.

was minimal or no increase in the rate. There have been no customer complaints about these rate changes, which have already been in effect for nearly 8 months.

## **2. OSBA Has Presented No Evidence To Support Its Assertions.**

Mr. Gillan devoted most of his testimony to legal arguments about why there should be a theoretical upper limit on business rates, but he did not even attempt to establish that the specific rates proposed by Verizon in this case (which the Commission already allowed to take effect) are not just and reasonable. When asked in discovery to state what Mr. Gillan believes to be the “just, reasonable, and nondiscriminatory rate” for Verizon’s basic business service, OSBA did not provide a substantive answer, stating instead that “[t]here is no demonstrated cost justification for Verizon to charge business customers more than its residential customers. The price differential is the product of historic practice....”<sup>20</sup> The fact that business rates are generally higher than residential rates is not new, and is not by definition unreasonable. An examination of the historical tariffed rates shows that this relationship has existed since the days of rate-of-return regulation when the Commission set these rates.<sup>21</sup> The fact that the Commission has approved these rates over the years despite this disparity indicates that the Commission does not view a disparity between basic residential and business rates in and of itself to be unjust or unreasonable. The Legislature’s choice to add Section 3015(a)(3) to the Chapter 30 statute in 2004 shows that it also does not view this disparity as unreasonable.

In response to discovery, OSBA suggested certain factors it believes are relevant to determining if basic business rates are just and reasonable, but none of them demonstrates any fault in the rates in this case. One factor OSBA suggested is

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<sup>20</sup> VZ St. 1.0, Exhibit 2, OSBA Response to Int. I-1(a).

<sup>21</sup> VZ St. 1.0, at 19.

comparison to the “rate for comparable business service in competitive exchanges.”<sup>22</sup> As a result of the competitive reclassification case, all services in many of Verizon’s urban and suburban exchanges are classified as “competitive,” meaning that Verizon has full pricing flexibility for basic business and residential service in those exchanges and their rates are not part of the PCO process. Nevertheless, to avoid customer confusion and unnecessary complexity, Verizon charges the same rate for basic stand-alone business service in the competitive exchanges as it charges in the non-competitive exchanges within the same Density Cell. For example, the current rate for basic business service dial tone line in Density Cell 3 is \$22.25 in all exchanges, whether they are classified competitive or not.<sup>23</sup> Therefore, applying OSBA’s suggested factor shows that the rate increases here are reasonable.

Mr. Gillan’s arguments appear to be based in part on an erroneous understanding of the urban and rural nature of Verizon’s Density Cells. He appeared to assume that Verizon made the largest increase in rural areas. In fact, Density Cells 1 and 2, which had the largest rate increases, are actually the most urban areas of Verizon’s territory, comprising the cities of Philadelphia and Pittsburgh.<sup>24</sup> The rural exchanges are in Density Cell 4, where Verizon did not increase the business dial tone line rate at all.<sup>25</sup>

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<sup>22</sup> VZ St. 1.0, Exhibit 2, OSBA Response to Int. I-1(b).

<sup>23</sup> VZ St. 1.0 at 18.

<sup>24</sup> The Density Cell classifications were originally established decades ago in order to provide a reasonable basis to set different retail rates for the same services in different locations. Density Cells 1 and 2 encompass only urban locations. Density Cell 1 includes all of the Philadelphia and Pittsburgh city exchanges that had a density greater than 9,000 working lines per square mile. Density Cell 2 includes all of Philadelphia and Pittsburgh city exchanges not included in Density Cell 1. Because they are in the more dense urban areas, it is likely that businesses in Density Cells 1 and 2 have access to the *most* variety of potential customers as well as abundant competitive alternatives for their telephone service, which is the exact opposite of Mr. Gillan’s conclusion. VZ St. 1.0 at 10-11.

<sup>25</sup> Density Cell 3 includes areas traditionally classified as suburban, surrounding Philadelphia and Pittsburgh, as well as other wire centers with a density that was greater than 500 working pairs per

Mr. Gillan suggests that businesses in “a large urban area” would be better able to “absorb (or pass on) these increases” and that rate increases in urban areas should be of less concern to the Commission.<sup>26</sup> But if this is what Mr. Gillan believes, then it is not clear why he is criticizing Verizon’s 2018 PCO filing, which made larger increases in the urban Density Cells 1 and 2 to try to bring them up to the level in the rural areas, rather than increasing rates of rural customers. Again, applying OSBA’s own suggested factor shows that the rate increases here are reasonable.

### **3. OSBA’s Arguments Regarding Competition For Business Services Are Wrong And Irrelevant.**

Mr. Gillan asserts that Commission intervention to create an extra-statutory business rate cap is necessary because “competitive pressures” do not otherwise “protect” basic business service customers.<sup>27</sup> But the rates at issue are being changed according to the rules established by the Legislature for noncompetitive services. Therefore, even though there actually is significant competition for business services everywhere (as demonstrated below), these particular rates are being handled under the process the Legislature determined was appropriate in a noncompetitive situation and Verizon followed those rules. Therefore, it is not necessary for Verizon to prove that these rates are subject to “competitive pressures.” Nonetheless, as discussed below, business customers enjoy abundant competitive alternatives in Pennsylvania.

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square mile. Density Cell 4 is basically rural, including all other exchanges that were not included in Density Cells 1, 2 and 3. VZ St. 1.0 at 11

<sup>26</sup> OSBA St. No. 1, Gillan Direct at 11.

<sup>27</sup> OSBA St. No. 1, Gillan Direct at 8.

Mr. Gillan’s theory that the market for small business services is somehow less competitive than for residential services is not supported by the facts.<sup>28</sup> A review of the most recent FCC data for Pennsylvania shows that as of year-end 2016 wireline competitors other than the incumbent local exchange company served 44% of wireline residential lines and 57% of wireline business lines.<sup>29</sup> The fact that more than half the wireline business lines are provided by non-ILECs – before even considering wireless business services discussed below – shows that these customers have abundant competitive options. In 2014, Verizon filed for the reclassification of all services in certain exchanges (including stand-alone business service) as “competitive” under Chapter 30, arguing that all services, even basic business services, face abundant competition. OSBA intervened but did not file testimony or a brief opposing or refuting Verizon’s arguments. The Commission classified basic stand-alone business service as competitive in many areas of the state, finding that there were competitive options for this service.<sup>30</sup>

Through discovery Verizon asked OSBA for the factual basis for Mr. Gillan’s claims about competition for business services, and the responses show that he has no factual basis for these claims. In response to Verizon’s request for the “factual basis” for the statements at page 9 of his testimony regarding competition, and “all studies or other documents” supporting them, Mr. Gillan responded simply that he had “never seen a study for business substitution, nor has he ever had a client...indicate a concern about losing customers to wireless service.” He states that he was only aware of wireless substitution

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<sup>28</sup> OSBA St. No. 1, Gillan Direct at 9.

<sup>29</sup> VZ St. 1.0 at 12-13.

<sup>30</sup> *Id.* at 13.

studies for residential consumers.<sup>31</sup> It should go without saying that the mere fact that Mr. Gillan is not aware of any studies of wireless substitution for business customers does not establish that those customers do not have wireless competition. In fact, there is ample evidence that business customers have real competitive options from wireless, cable and VoIP (Voice over Internet Protocol) services. The record shows that these companies offer services targeted at small businesses and intended to totally replace traditional landline service with mobile phones and applications or VoIP platforms, and that cable companies and VoIP services also compete for small business customers. It is likely that many small businesses in Pennsylvania have taken advantage of these competitive business services.<sup>32</sup> Therefore, OSBA's claims about competition for small business services are irrelevant and wrong.

### **3. Verizon Has Acted Reasonably In Designing Its PCO Implementation.**

OSBA's theme is that Verizon is using business rates as a "check-book of last resort," suggesting that Verizon is simply dumping all the remaining revenue increases on business services without thought.<sup>33</sup> OSBA is wrong. Verizon has designed its 2018 PCO rate increases thoughtfully and made efforts, within the constraints allowed by Chapter 30 and its plan, to minimize the impact on business rates. One of the layers of protection built into Chapter 30 is the fact that competitive pressures will provide an incentive not to price these service beyond what the market will bear, and as discussed above even though these services are classified "noncompetitive" under Chapter 30's terminology does not mean

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<sup>31</sup> See VZ St. 1.0, Exhibit 2, OSBA Response to Int. I-3 and I-4.

<sup>32</sup> VZ St. 1.0 at 14-16.

<sup>33</sup> OSBA St. No. 1, Gillan Direct at 8.

customers are without competitive alternatives. Verizon therefore must act thoughtfully when designing its PCO rate increases.

Verizon's treatment of these business rates is reasonable. First, Verizon did not increase any business rates last year with its 2017 PCO filing. Instead it allocated the entire \$947,000 revenue increase that would have been permitted to take effect January 1, 2017 to its bank. The entire amount was then offset to reduce the banked value of the 2003 PCO that is used to cover Verizon's contributions to the state universal service fund. Therefore, this nearly one million dollar 2017 PCO amount will never be used to increase retail rates. As a result, customers of noncompetitive business service have not experienced a rate increase in two years.<sup>34</sup>

Second, in designing its 2018 PCO rate increases Verizon made reasonable efforts to allocate portions of the revenue increases in ways other than increasing business dial tone line rates. Verizon allocated \$495,100 to residence dial tone line rates, which was the maximum allowed under Chapter 30. Pursuant to a settlement approved last year, Verizon allocated \$27,700 to the business late payment charge, which increased that charge to the maximum rate allowed under the settlement. Verizon also allocated \$322,300 to its bank, which, like last year, will be credited against the 2003 PCO balance and will never be used to increase rates. As a result of these actions, only about one third of the revenue increase was allocated to business dial tone line rates.<sup>35</sup>

Third, Verizon did not increase the dial tone line rate in Density Cell 4, which has the highest Verizon rate for this service at \$22.25, and also covers the most rural portions of Verizon's territory. Density Cell 4 business customers, as a result, will not experience a rate

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<sup>34</sup> VZ St. 1.0 at 9.

<sup>35</sup> Id. at 9-10.

increase for the third consecutive PCO. Verizon made only a modest increase of \$0.80 in suburban Density Cell 3, to bring it equal to the \$22.25 in Density Cell 4. Density Cells 3 and 4 cover suburban and rural areas and have the largest number of customers for noncompetitive business dial tone line service. While the per-line increases were larger in Density Cells 1 and 2, which cover the cities of Philadelphia and Pittsburgh, the rates for business dial tone line service in those areas are still more than \$2 to \$4 lower than the rate for the same service in Density Cells 3 and 4. Verizon determined that it would be reasonable to try to achieve a common state-wide rate for this service, as it has done for residential service.<sup>36</sup>

#### IV. CONCLUSION

For the forgoing reasons the Commission should dismiss OSBA's complaint and allow Verizon's 2018 PCO filing to remain effective without any changes.

Respectfully submitted,



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<sup>36</sup> *Id.* at 10.