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December 3, 2018

Via Electronic Filing

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street – Filing Room (2 North)
P.O. Box 3265
Harrisburg, PA 17105-3265

RE: Office of Consumer Advocate v Verizon Pennsylvania LLC
Docket Nos. C-2018-3005972 and R-2018-3005792

Dear Secretary Chiavetta:

Enclosed please find Verizon Pennsylvania LLC's Preliminary Objections to the Complaint of the Office of Consumer Advocate in connection with 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: 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 Preliminary Objections to the Complaint of the Office of Consumer Advocate, 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 3rd day of December, 2018.

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

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**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Office of Consumer Advocate,	:		
Complainant,	:		
	:	Docket No.	C-2018-3005972
v.	:		R-2018-3005792
	:		
Verizon Pennsylvania LLC,	:		
Respondent.	:		

NOTICE TO PLEAD

TO THE COMPLAINANT, OFFICE OF CONSUMER ADVOCATE: PURSUANT TO 52 PA CODE, SECTION 5.101(f) YOU MUST FILE AN ANSWER TO THESE PRELIMINARY OBJECTIONS WITHIN TEN (10) DAYS OF THE DATE OF SERVICE.

**PRELIMINARY OBJECTIONS TO THE COMPLAINT
OF THE OFFICE OF CONSUMER ADVOCATE**

Verizon Pennsylvania LLC (“Verizon PA”) preliminarily objects to those portions of the complaint of the Office of Consumer Advocate (“OCA”) against Verizon PA’s 2019 Price Change Opportunity filing (“2019 PCO”) that claim Verizon PA should have made an “exogenous event” adjustment to account for federal and/or state tax savings related to the Tax Cut and Jobs Act (“TCJA”).¹ Verizon PA’s Chapter 30 Plan does not require or permit an exogenous event adjustment for tax changes. Because it is not necessary for the Commission to resolve disputed questions of fact to decide this issue, a hearing is not necessary and these claims should be dismissed preliminarily. 66 Pa. C.S. § 703(b); 52 Pa. Code § 5.21(d). The Commission should dismiss the exogenous event claim as legally insufficient pursuant to 52 Pa. Code § 5.101(a)(4), or, alternatively, grant judgment on the pleadings in Verizon PA’s favor pursuant to 52 Pa. Code § 5.102. In support of these preliminary objections, Verizon PA states as follows:

¹ These allegations are contained in paragraphs 4 (h),(i),(j) and (k) of the OCA’s complaint and corresponding requests for relief.

I. Factual Background

1. On November 1, 2018, Verizon PA made a filing notifying the Commission that the price cap mechanism in the company's Chapter 30 Plan allowed Verizon PA to increase its revenue from noncompetitive services by \$1,303,000. To implement that allowed revenue increase, Verizon PA proposed to increase rates for residence and business services and to bank a portion of the revenue increase opportunity.

2. On November 8, 2018, the OCA filed a complaint against Verizon PA's 2019 PCO filing. That complaint was served by the Commission on November 13, 2018.

3. Paragraphs 4 (h),(i),(j) and (k) of the OCA's complaint allege that Verizon PA failed to make an "exogenous event" adjustment to the calculation of its 2019 PCO to account for tax savings that may have resulted from the TCJA or corresponding reductions in state income tax liability, and that its failure to do so may have resulted in its 2019 PCO being overstated.

4. Verizon PA's Chapter 30 Plan has a provision allowing for special revenue adjustments for services subject to the Price Stability Mechanism ("PSM") based on "exogenous events." This provision was originally adopted in 1994-1995 and states that:

Notwithstanding any other limitation specified in the PSM, Verizon, the Commission Staff, the Office of the Consumer Advocate or the Small Business Advocate may request the Commission to make special revenue adjustments beyond the scope of the PSM that are limited to mechanical regulatory events bearing only on local exchange carriers and may include only changes resulting from: (1) jurisdictional shifts where costs are transferred to or from the interstate jurisdiction and where an equal and opposite exogenous adjustment was allowed by the Federal Communications Commission under its price cap system; and (2) limited regulatory accounting changes not initiated by Verizon.

[fn] The burden of proof in requiring such a revenue adjustment is on the party proposing the change. Any adjustment to revenues must be determined by allocating the total company impact of the underlying event between interstate and intrastate jurisdictions and between

*competitive and noncompetitive services. An application to the Commission for such a change must be filed with sixty (60) days notice. Verizon will file tariffs to implement any approved revenue changes.*²

5. The parties agree that Verizon PA did not make an exogenous event adjustment to its calculations for its 2019 PCO.

II. Legal Standard

6. The Commission's Rules of Administrative Practice and Procedure permit the filing of preliminary objections, a procedure similar to that utilized in Pennsylvania civil practice.³

7. Pursuant to 52 Pa. Code § 5.101(a)(4), a preliminary objection may be filed based on the legal insufficiency of a pleading. In reviewing a preliminary objection for legal insufficiency the Commission must “accept as true all well-pled facts, which are material and relevant, as well as all inferences reasonably deducible therefrom,” but the Commission “is not required to accept as true legal conclusions, unwarranted factual inferences, allegations that constitute argument, or mere opinion.”⁴ The complaint must be dismissed if the Commission finds that “on the face of the complaint the law will not allow recovery.”⁵

8. The standard for granting a motion for judgment on the pleadings is set forth in 52 Pa. Code § 5.102(d)(1). A motion for judgment on the pleadings should be granted

² Although OCA did not quote the exogenous events provision in its complaint, Verizon PA's Chapter 30 Plan is an official document of which the Commission may take administrative notice. The current version was filed on December 14, 2011 and is available on the Commission's website under Docket P-2011-2279673, along with the Commission's August 9, 2012 Secretarial Letter accepting this compliance filing. http://www.puc.state.pa.us/about_puc/consolidated_case_view.aspx?Docket=P-2011-2279673.

³ 52 Pa. Code § 5.101. *See Equitable Small Transportation Interveners v. Equitable Gas Company*, 1994 Pa. PUC LEXIS 69, Docket No. C-00935435 (July 18, 1994).

⁴ *Cohen v. City of Philadelphia*, 806 A.2d 905, 912 (Pa.Cmwlth. 2002), *aff'd*, 576 Pa. 612, 840 A.2d 988 (2003).

⁵ *Id.*

where the pleadings demonstrate that no genuine issue of fact exists and the moving party is entitled to judgment as a matter of law.⁶

9. Section 703 of the Public Utility Code, 66 Pa. C.S. § 703(b), provides that the Commission may dismiss any complaint without a hearing if, in its opinion, a hearing is not necessary or in the public interest. *See also* 52 Pa. Code § 5.21(d). A hearing is necessary only to resolve disputed questions of fact, and is not required to resolve questions of law, policy or discretion.⁷

10. In this case, the question of whether Verizon PA's Chapter 30 plan requires an exogenous event adjustment if the company experiences tax savings from the TCJA or any corresponding reduction in state income taxes does not depend on resolving any questions of fact and can be decided on the face of the OCA's complaint based on the plan language and Commission precedent.

III. OCA's Complaint is Legally Insufficient.

11. Verizon PA is subject to an alternative form of regulation under the terms of Chapter 30 of the Public Utility Code and its Commission-approved alternative regulation plan, also known as a Chapter 30 Plan. Verizon PA's alternative regulation plan was initially approved in 1994.⁸ The most recent version of its plan was filed December 14, 2011 and approved by the Commission on August 9, 2012 at Docket P-

⁶ *Hammerstein v. Lindsay, M.D.*, 440 Pa. Super. 350, 655 A.2d 597, 600 (Pa. Super. 1995).

⁷ *Dee-Dee Cab, Inc. v. Pa. Public Utility Comm.*, 817 A.2d 593, petition for allowance of appeal denied, 836 A.2d 123 (Pa. Commw. 2003); *Lehigh Valley Power Committee v. Pa. Public Utility Comm.*, 563 A.2d 548 (Pa. Commw. 1989); *Edan Transportation Corp. v. Pa. Public Utility Comm.*, 623 A.2d 6 (Pa. Commw. 1993).

⁸ *Re: Bell Atlantic - Pennsylvania, Inc.'s Petition and Plan for Alternative Form of Regulation Under Chapter 30*, Docket No. P-00930715; P-00930715C001; P-00930715C002, 1994 Pa. PUC LEXIS 142 (Opinion and Order entered June 28, 1994) ("1994 Bell Order").

2011-2279673, although the exogenous events language at issue here has not changed since the plan was originally adopted.

12. Chapter 30 expressly supersedes most of the provisions of Chapter 13, the chapter that provides statutory basis for the Commission to regulate public utilities based on cost and earnings, which are replaced by the terms of the company's alternative regulation plan.⁹ Notably, Chapter 30 supersedes traditional ratemaking provisions including 66 Pa. C.S. §§ 1307 (sliding scale of rates),¹⁰ 1310 (temporary rates) and 1311 (valuation and return on public utility property). Under alternative regulation, the Commission no longer holds cost cases for Verizon PA, does not review earnings, and does not guarantee a rate-of-return. Verizon PA bears the risk of changes in costs, including taxes.

13. Under Chapter 30, a company's services fall into two categories, based on whether or not the services are classified as competitive, and the treatment of rates is different for each. The Commission does not regulate the rates of competitive services. 66 Pa. C.S. § 3019(g). The PCO annual rate change opportunity process applies to rates for services classified by the Commission as noncompetitive. For Verizon PA, these services consist of the "protected" stand-alone basic voice service to residential and small

⁹ "The terms of a local exchange telecommunications company's alternative form of regulation and network modernization plans shall govern the regulation of the local exchange telecommunications company and, consistent with the provisions of this chapter, shall supersede any conflicting provisions of this title or other laws of this commonwealth and shall specifically supersede all provisions of chapter 13 (relating to rates and rate making) other than sections 1301 (relating to rates to be just and reasonable), 1302 (relating to tariffs; filing and inspection), 1303 (relating to adherence to tariffs), 1304 (relating to discrimination in rates), 1305 (relating to advance payment of rates; interest on deposits), 1309 (relating to rates fixed on complaint; investigation of costs of production) and 1312 (relating to refunds)." 66 Pa. C.S. § 3019 (h).

¹⁰ Section 1307 is the statutory basis for the State Tax Adjustment Surcharge, or STAS.

business customers in those portions of Verizon PA's service territory where the entire wire center has not been classified competitive.¹¹

14. Noncompetitive services are not rate-of-return regulated, but, instead of the full pricing flexibility provided to competitive services, any changes to the rates for noncompetitive services are governed by the Price Stability Mechanism ("PSM") described in Verizon PA's alternative regulation plan. The PSM is effectively a cap on the total revenue Verizon PA can earn from these noncompetitive services that year, and the cap generally increases each year based on the change in the rate of inflation (the Gross Domestic Product Price Index, or GDP-PI) minus .5%.

15. Verizon PA's plan has a provision allowing for special revenue adjustments for services subject to the PSM based on "exogenous events," but that provision is very narrow and would not allow for an adjustment based on changes in taxes that affect the whole industry or economy generally, like the changes from the TCJA or corresponding state tax changes.

16. Verizon PA's alternative regulation plan contains the same exogenous events provision that was originally adopted by orders entered June 28, 1994 and January 23, 1995 at Docket No. P-00930715, where there was extensive discussion of the appropriate scope of this provision.¹² The exact language adopted by the Commission and currently in the plan is quoted in paragraph 4 above.

¹¹ Intrastate switched access services are also classified as noncompetitive, but terminating intrastate switched access rates are at the end of the process of being reduced to zero and eliminated under binding Federal Communications Commission rules.

¹² When this plan was approved in 1994/95 the original Chapter 30 allowed the Commission to impose terms unilaterally, which is why the Commission determined what the exogenous events provision should say. Following the changes in Chapter 30 from Act 183 in 2004, now "no change to any alternative form of regulation or network modernization plan may be made without the express agreement of both the commission and the local exchange telecommunications company." 66 Pa. C.S. § 3013(b).

17. In the proceeding culminating in the 1994 order, the Commission was faced with a range of proposals for exogenous events language for Verizon PA, and determined to adopt the position advocated by the Pennsylvania Cable Television Association (“PCTA”) and its expert witness, the economist Lee Selwyn, which specifically did *not* allow for exogenous changes due to increases or decreases in taxes for the following reasons:

One-time changes in corporate tax rates, payroll tax rates, local property taxes, or any like cost elements affect firms throughout the economy. Cost impacts arising from exogenous changes, therefore are captured in the GDP-PI inflation index. PCTA St. 1 (Selwyn) at 40. Costs unique to a competitive firm are often not directly recoverable through the prices of its product or service. Given that the PSM is intended, in part, to replicate the “competitive result,” therefore, the exogenous costs identified by the Bell Plan [including tax changes] should not be recoverable through a PSM.¹³

PCTA’s expert witness further explained why he believed very limited exogenous cost language was appropriate, as follows: “Bell’s argument that it requires the flexibility of the exogenous change provision to recover extraordinary cost changes not directly reflected in the basic revenue cap formula are irrelevant in this age of competitive information service. Non-regulated firms must deal with increases in taxes, changes in accounting treatments and rules, new government regulations, natural disasters and various other unanticipated events.”¹⁴ PCTA also opposed provisions that would allow rate reductions if there were decreases in taxes, contending that it was better to strictly limit exogenous changes in either direction.¹⁵ OCA took a position similar to PCTA’s, stating that “OCA recommends that no exogenous cost changes be passed through

¹³ *Re: Bell Atlantic - Pennsylvania, Inc.'s Petition and Plan for Alternative Form of Regulation Under Chapter 30*, Docket No. P-00930715; P-00930715C001; P-00930715C002, 1994 Pa. PUC LEXIS 142 (Opinion and Order entered June 28, 1994) (“1994 Bell Order”) at 114.

¹⁴ *Id.*

¹⁵ *Id.*

directly to ratepayers” because “[o]ne purpose of a price cap mechanism is to remove the pass-through of exogenous cost changes. Any exogenous cost change exceptions must be extremely limited and should be specified in advance.”¹⁶

18. The Commission considered these arguments and adopted PCTA’s proposed exogenous events language (which is the language currently in Verizon PA’s plan) and PCTA’s underlying reasoning, explaining as follows:

Bell’s ability to initiate revenue adjustments for events such as government actions, increases in utility rates, ***or increases in corporate or other tax rates applying to it***, outside of the price cap mechanism, is unreasonable because very few conditions are not reflected in the revised price cap formula recommended by PCTA, which we adopt below. Also, as MCI points out, Bell’s proposal is at odds with Bell’s claim that under a price cap its earnings and cost of providing service are irrelevant. MCI MB at 45. Bell is in a superior position to initiate rate change requests under its Plan because it has first-hand knowledge of its cost changes. This favors its ability to seek and recover exogenous cost increases and puts at a distinct disadvantage those who would seek exogenous cost decreases. Bell’s proposal will create litigation over what is, or is not, beyond Bell’s control and does or does not present “serious financial implications.”

This should be avoided in order to avoid establishing onerous, burdensome requirements on Bell that fail to reduce regulatory delays and costs. Bell Exc. at 7-8. We believe PCTA’s proposal achieves this purpose. It limits exogenous cost changes and designates them before the Plan goes into effect. Accordingly, ***we conclude that rate adjustments for exogenous changes be limited to mechanical regulatory events bearing only on Bell***. These rate adjustments should be limited to changes resulting from 1) jurisdictional shifts where costs are transferred to or from the interstate jurisdiction and where an equal and opposite exogenous adjustment was allowed by the FCC under its price cap system, and 2) limited regulatory accounting changes not initiated by Bell.¹⁷

19. In the 1995 Bell Order, the Commission emphasized the narrow nature of this provision, rejecting Bell’s attempt to take a broader interpretation, and recognized that

¹⁶ *Id.* at 113-114.

¹⁷ *Id.* at 120-122 (emphasis added).

the proper interpretation of the narrow exogenous events language of the plan did not require or permit Bell to reflect a decrease in state corporate income taxes.¹⁸

20. It is evident not only from the plain language of the plan's exogenous events provision, but also from the Commission's reasoning adopting and interpreting it, that the Verizon PA exogenous events provision does not permit a revenue adjustment based on an increase or decrease in taxes. Accordingly the tax changes from the TCJA are not exogenous events under Verizon PA's Chapter 30 plan.

21. While Verizon PA's Chapter 30 plan does not allow for an exogenous event adjustment in this instance, Pennsylvania customers will benefit from cost savings such as those that might ultimately result from the TCJA once federal and state impacts sort themselves out in the marketplace. Indeed, Pennsylvanians will benefit from the tax savings for both the regulated and unregulated portions of Verizon's business because the Verizon group of companies provides a diverse array of services in Pennsylvania and makes a huge investment in this state. It is important to allow the competitive market to work without unneeded regulatory interference. Attempting to foist traditional rate-of-return regulatory concepts upon a company like Verizon PA, which operates in a highly competitive market, would put it at a competitive disadvantage against the myriad of unregulated competitors who will be free to react to the TCJA impacts in the marketplace. The benefits of any savings will be experienced by consumers in the manner that the market finds most efficient, which could be in rates or in enhanced

¹⁸ *Re: Bell Atlantic - Pennsylvania, Inc.'s Petition and Plan for Alternative Form of Regulation Under Chapter 30*, Docket No. P-00930715; P-00930715C001; P-00930715C002, 1995 Pa. PUC LEXIS 1 (Opinion and Order entered January 23, 1995) ("1995 Bell Order") at 17-18 ("Bell unlike other jurisdictional local exchange carrier ('LEC') telephone utility companies, has not sought to modify its existing rates and charges in order to reflect a negative STAS adjustment under the legislated reduction in Pennsylvania's Corporate Net Income Tax rates during the 1994-1997 period.")

investment, new or better services, innovation, or a combination of these. This was part of the reasoning that caused the Commission to adopt the very narrow exogenous events provision that does not permit adjustments due to tax changes, as it agreed with PCTA's conclusion that "[o]ne-time changes in corporate tax rates, payroll tax rates, local property taxes, or any like cost elements affect firms throughout the economy [and] . . . are captured in the GDP-PI inflation index."¹⁹

22. To the extent it alleges that Verizon PA should have made an exogenous event adjustment to its 2019 PCO filing, OCA's complaint must be dismissed as legally insufficient.

WHEREFORE, the Commission should dismiss the portion of OCA's complaint against Verizon PA's 2019 PCO alleging that Verizon PA erroneously failed to make an exogenous events adjustment.

Respectfully submitted,



Dated: December 3, 2018

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¹⁹ 1994 Bell Order at 114.