

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Verizon Pennsylvania LLC and Verizon North LLC

v.

**Metropolitan Edison Company, Pennsylvania Electric Company, and Pennsylvania Power
Company
Docket No. C-2020-3019347**

**Rejoinder Testimony
of
William P. Zarakas**

List of Topics Addressed

**FCC Formula Rates
Bargaining Power**

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1 **II. THE FCC'S CABLE AND TELECOM RATES ARE NOT BASED ON FULLY**
2 **ALLOCATED COST METHODOLOGY**

3 **Q. Please summarize Dr. Tardiff's claim that cable rate and the old and new telecom**
4 **rates are the result of fully allocated cost approaches.**

5 A. Dr. Tardiff asserts that a pole attachment rate is based on a fully allocated cost methodology
6 if the utility charges the attacher for more pole space than is required for the physical
7 attachment itself.¹ For context, recall that a pole may be divided into usable and unusable
8 space. Dr. Tardiff contends that a pole attachment rate that includes any contribution to
9 covering the cost of the pole's unusable space, no matter how modest, means that the rate
10 is based on a fully allocated cost methodology.² However, as Dr. Tardiff himself shows in
11 Table 1 in his rebuttal testimony, the rates derived under the cable rate and old telecom rate
12 formulas are significantly different – suggesting that they must be based on two completely
13 different fully allocated cost methodologies. This is the case. As I discuss below, the old
14 telecom rate is based on a per capita fully allocated cost methodology,³ while the new
15 telecom rate formula – which produces a pole attachment rate that is nearly identical to that
16 produced under the FCC's cable rate formula – is not. Specifically, the majority of the
17 common costs of unusable pole space are shared across all attachers (on a per capita basis)
18 in the old telecom rate, while attachers contribute much less than this amount under the
19 cable and new telecom rate formulas.

20

¹ Verizon St. 3.1, p. 9.

² See Verizon St. 3.1, pp. 9-10.

³ As I discuss below, 2/3 of the costs of unusable pole space are allocated to attachers based on a per capita fully allocated cost methodology.

1 **Q. Please elaborate on the reasons that the cable rate formula and the old telecom rate**
2 **formula produce different pole attachment rates.**

3 A. As I indicated above, a primary difference in the derived rates can be attributed to the
4 treatment of unusable space in the rate calculation. Under the cable rate formula, rates are
5 derived from the percentage of usable pole space that a cable company attachment occupies
6 applied to the total annual cost of a pole. For a 37.5 foot pole, this means that a cable
7 attacher would pay a pro rata share, equal to 1/13.5 or about 7.4%, of the total annual pole
8 cost. In contrast, under the old telecom rate formula, a telecom attacher pays a pro rata of
9 the cost associated with usable pole space and also pays a *per capita* share of the cost
10 associated with 2/3 of the pole's unusable space. In this instance, for the same 37.5 foot
11 pole on which the telecom attacher is using the same space as is a cable attacher, the
12 telecom attacher would pay between 11.2% of the annual cost of a pole (in urban areas)
13 and 16.9% in non-urban areas. This also demonstrates that neither the new telecom rate
14 nor the old telecom rate allocates all common costs to attachers.

15
16 **Q. Please explain the fully allocated cost methodology.**

17 A. Inclusion of "fully allocated costs" generally refers to the inclusion of an appropriate
18 portion of common (or shared or joint costs) in the rate for a service. Specifically, the total
19 rate (for a service) is the sum of the direct costs that can be attributed to the provision of
20 the service plus the above-referenced portion of common costs. As the name suggests, in
21 network industries such as the electricity and telecommunications industries, the provision
22 of services is typically enabled by a large common infrastructure. The pool of such
23 common costs must be allocated to the various classes of customers and services in order
24 for the utility to fully recover the costs that it incurred in providing service.

1 The Pennsylvania Public Utility Commission (“Commission”) is well aware of the
2 issues associated with the allocation of common costs, as this issue arises whenever a cost
3 of service study is conducted and rates are set. Utilities typically develop cost allocation
4 manuals to codify their cost allocation methodology. Ideally, common costs can be
5 allocated based on evidence of cost causation, however it is frequently the case that
6 common costs need to be allocated more generally.

7 Dr. Tardiff and Dr. Calnon indicate that the FCC’s cable and telecom rate formulas
8 are based on fully allocated cost methodologies because, according to them, the resulting
9 rates include a contribution to the costs associated with unusable pole space, no matter how
10 modest.⁴ Contrary to Dr. Tardiff’s and Dr. Calnon’s assertions, the FCC contrasts the cable
11 rate formula, which allocates the costs associated with unusable pole space using a pro rata
12 allocation approach, with the old telecom rate formula, which is indeed based on per capita
13 fully allocated cost methodology. Even then, however, under the old telecom rate formula,
14 only 2/3 of the unusable space is allocated amongst attachers. This means that 1/3 of the
15 pole’s common costs are directly assigned to the electric distribution utility, which, from a
16 fully allocated cost standpoint, creates a subsidy to attachers at the expense of electric
17 utility ratepayers.

⁴ See Verizon St. 3.1, pp. 9-10; see also Verizon St. 2.1, pp. 48-49.

1 **Q. Do the various FCC rate formulas incorporate common costs into pole attachment**
2 **rates?**

3 A. Yes.⁵ However, there is a significant difference between how common costs are
4 incorporated into the cable rate formula compared to the case for the old telecom rate. As
5 I indicated above, under the cable rate formula, attachers are charged a pro rata portion of
6 total annual pole costs, which means that the rate includes a *pro rata* portion of the unusable
7 space. Under the old telecom rate, attachers are charged for a *per capita* share of only 2/3
8 of the common cost associated with unusable pole space and 1/3 of the common cost is
9 directly assigned to the electric distribution utility. This difference in the allocation of the
10 costs associated with unusable pole space explains why the cable rate formula produces
11 rates that cover 7.4% of annual pole costs, while the old telecom rate formula produces
12 rates that cover between 11.2% and 16.9% of annual pole costs.

13 In its 2011 Pole Attachment Order, the FCC acknowledged that, at the time, there
14 were two separate methodologies to determine the maximum rates for pole attachments.⁶
15 The FCC indicated that the old telecom rate was based on a fully allocated cost
16 methodology (with the caveat that 1/3 of the common costs associated with unusable space
17 were directly assigned to the utility), which “recovers costs that the pole owner incurs
18 regardless of the presence of attachments,”⁷ while the cable rate was *not* based on fully
19 allocated costs.⁸

⁵ In my Rebuttal Testimony, I mistakenly described the FCC’s cable rate formula as an approach where attachers made *no* contribution to the costs associated with the unusable portion of the pole. FirstEnergy St. 2-R, p. 4. As I discuss in this Rejoinder Testimony, under the FCC’s cable rate formula, attachers pay a pro rata share of the total annual pole cost, which includes the costs associated with usable and unusable pole space. However, the rate charged to cable attachers is less than the rate that would be charged if a fully allocated cost methodology were employed.

⁶ 2011 Pole Attachment Order, ¶ 131.

⁷ 2011 Pole Attachment Order, ¶ 141.

⁸ 2011 Pole Attachment Order, ¶ 142.

1 **Q. Does the old telecom rate formula actually apply a fully allocated cost methodology?**

2 A. In its old telecom rate formula, the FCC applies a per capita fully allocated cost
3 methodology, however only 2/3 of the costs of unusable pole space are included in the
4 formula. This carve out and direct assignment of common costs in the rate formula, makes
5 it less than fully allocated in its purest sense.

6 The Conference Report for the Telecommunications Act of 1996 (“TA96”)
7 provides insight into how Congress thought a fully allocated cost methodology should be
8 applied to the calculation of pole attachment rates. The Conference Report states that the
9 (old) telecom rate should be “based on a ‘fully allocated cost’ formula,” and that the FCC
10 should “recognize that the entire pole, duct, conduit, or right-of-way other than the usable
11 space is of *equal benefit* to all entities attaching to the pole and therefore apportion the cost
12 of the space other than the usable space *equally among* all such attachments.”⁹ Fully
13 allocating the costs of unused pole space therefore involved dividing the associated cost by
14 the number of attachers (i.e., a per capita based allocation) in contrast to the pro rata cost
15 allocation approach used in the cable rate formula. This per capita approach to allocating
16 the cost of unusable pole space is at odds with Dr. Tardiff’s claim that such an approach
17 would result in a “disproportionate amount of common cost” being allocated to attachers.

18 In addition, Congress subsequently reduced the amount of unused space to be
19 allocated between the electric distribution utility and attachers sharing in the costs of this
20 space by 1/3 (i.e., 2/3 of the unusable pole space). As a result, in the old telecom rate, the
21 FCC applied a per capita fully allocated cost methodology to 2/3 of the unusable pole space.

22

⁹ H.R. Rep. No. 104-458 at 206, reprinted in 1996 U.S.C.C.A.N. at 220.

1 **Q. Does the FCC represent that the cable and new telecom rate formulas apply a fully**
2 **allocated cost methodology?**

3 A. No. In its 2011 Pole Attachment Order, the FCC concluded that it has leeway in
4 determining what types of costs are included in pole attachment rates (i.e., direct, common
5 or some combination of both),¹⁰ and that it is not bound to use a fully allocated cost
6 methodology.¹¹ That is, unlike the representations made by Dr. Tardiff and Mr. Canlon,
7 the FCC is not suggesting that the cable and (new) telecom rate formulas are based on fully
8 allocated cost methodologies.

9
10 **Q. What reason did the FCC give for changing its telecom rate formula from the fully**
11 **allocated cost approach that it used with respect to the old telecom rate?**

12 A. The FCC stated that it decided to replace the old telecom rate (which applied a per capita
13 allocation of 2/3 of the cost associated with unusable pole space) with the new telecom rate
14 (which produces rates similar to those derived under the cable rate formula) in order to
15 advance the deployment of broadband by lowering input costs.¹² Therefore, the FCC's
16 decision has the practical implication of purportedly advancing the goal of broadband
17 deployment while, at the same time, shifting the costs associated with unusable pole space
18 away from pole attachers and onto the electric utilities and their ratepayers.

19

¹⁰ 2011 Pole Attachment Order, ¶ 160.

¹¹ 2011 Pole Attachment Order, ¶¶ 162-163.

¹² 2011 Pole Attachment Order, ¶¶ 133-134.

1 **Q. Do you agree with Dr. Tardiff’s claim on page 10, n.14 of Verizon St. 3.1 that the pole**
2 **attachment rates under discussion are not being subsidized?**

3 A. No. Dr. Tardiff has conflated adequate compensation and unconstitutional takings with
4 rate subsidization. The U.S. Supreme Court found, in 1987, that the FCC’s cable rate
5 provides pole owners with adequate compensation, and thus did not result in an
6 unconstitutional taking.¹³ It is in this context that Dr. Tardiff is able to state that “rates in
7 the FCC’s range are not being subsidized, because they produce revenue that more than
8 covers the cost of providing the required space.”¹⁴ However, the U.S. Supreme Court’s
9 finding concerning adequate compensation does not equate to a finding that pole
10 attachment rates are not subsidized from a ratemaking cost of service standpoint. Guidance
11 from the TA96 Conference Report — *i.e.*, that a pole’s unusable space “is of equal benefit
12 to all entities attaching to the pole” and should therefore be apportioned equally among all
13 attachments — provides a reasonable starting point for developing pole attachment rates
14 in the subject case.¹⁵

15 Table 1 provided in Dr. Tardiff’s Surrebuttal Testimony is instructive in
16 demonstrating the degree to which the cable and new telecom rates are subsidized by
17 electric utility ratepayers in the absence of a per capita fully allocated costing approach.¹⁶

18 Dr. Tardiff’s table provides two points of comparison: (1) the subsidy amount relative to a
19 100% fully allocated cost methodology (*i.e.*, when 100% of unusable space costs are

¹³ 2011 Pole Attachment Order, ¶ 129.

¹⁴ Verizon St. 3.1, p. 10, n.16.

¹⁵ A fully allocated cost allocation methodology can be followed even if a portion of the unusable pole space is assigned exclusively to the pole owner, as was the case with the FCC’s old telecom rate formula.

¹⁶ Dr. Tardiff’s Table 1 also contains an error in the space occupied column. Dr. Tardiff indicates that the total pole height is 37.5 feet, with 24 feet in unusable space and 13.5 feet in usable space. However, the sum of the space occupied in Dr. Tardiff’s Table 1 equals 14.5 feet. The utility space occupied, the residual amount in Dr. Tardiff’s table, should therefore be reduced from 10.5 feet to 9.5 feet. This will have the effect of increasing the space paid for space occupied column for the electric company.

1 allocated among all pole attachers on a per capita basis, which is what FirstEnergy sought
2 to demonstrate with its fully allocated rate methodology in Mr. Schafer's rebuttal
3 testimony); and (2) the subsidy amount relative to the FCC's old telecom rate approach to
4 fully allocated costs (i.e., when 2/3rds of the unusable space costs are allocated among all
5 pole attachers on a per capita basis). Under above scenario 1, cable and telecom attachers
6 are subsidized by more than \$48 per pole,¹⁷ while under scenario 2, those attachers are
7 subsidized by more than \$23 per pole.¹⁸

8
9 **Q. Does the Commission need to consider other factors in its determination of pole**
10 **attachment rates?**

11 A. Yes, there are legal issues and requirements associated with rate subsidization and price
12 discrimination. As indicated above, setting pole attachment rates at the old or new telecom
13 rates involves, from a fully allocated cost of service perspective, a subsidization by electric
14 utility customers. Counsel has advised me that, in this regard, the Commission possesses
15 discretion in determining whether such subsidization is reasonable, however it also is
16 required to recognize its action in a clearly articulated statement.

17

¹⁷ Per Dr. Tardiff's Table 1, under scenario 1, electric utility ratepayers bear the residual cost equal of \$105.56 per pole under the cable rate formula and \$105.65 per pole under the new telecom rate formula, while under a 100% fully allocated cost, the residual cost would be just \$57.20 per pole. $\$105.56 \text{ less } \$57.20 = \$48.36$; and, $\$105.65 \text{ less } \$57.20 = \$48.45$.

¹⁸ Per Dr. Tardiff's Table 1, under scenario 2, electric utility ratepayers bear the residual cost equal of \$105.56 per pole under the cable rate formula and \$105.65 per pole under the new telecom rate formula, while under the fully allocated cost approach used in the old telecom rate, the residual cost would be \$82.20 per pole. $\$105.56 \text{ less } \$82.20 = \$23.36$; and, $\$105.65 \text{ less } \$57.20 = \$23.45$.

1 **III. BARGAINING POWER**

2 **Q. Please comment on Dr. Tardiff’s statement that, if both FirstEnergy and Verizon lack**
3 **bargaining power, then pole attachment rates will never be adjusted to the FCC’s just**
4 **and reasonable range, on page 21 of Verizon St. 3.1.**

5 A. A significant portion of Verizon’s case against FirstEnergy involves trying to demonstrate
6 that FirstEnergy has bargaining power over Verizon with respect to pole attachments and
7 arguing against evidence that I provide proving the contrary. However, in the above-
8 referenced passage in his rebuttal testimony, Dr. Tardiff forges a new path, arguing that
9 FirstEnergy would have an advantage in rate negotiations over Verizon even if both parties
10 have *equal* bargaining power.¹⁹ That is, Dr. Tardiff claims that if neither party had
11 bargaining power, then “the status quo would prevail and the status quo vis-à-vis rental
12 rates substantially favors FirstEnergy.”²⁰

13 I disagree with Dr. Tardiff that negotiation between the two parties, assuming that
14 neither has outsized bargaining leverage over the other, will inevitably result in a
15 continuation of the status quo. However, within the context of the subject Joint Use
16 Agreements, it is likely that negotiations between the two parties (again assuming that
17 neither party has outsized bargaining power) will result in a more equal sharing of the
18 unusable pole space costs than prescribed in the FCC’s cable and telecom rate formulas.
19 This means that, under conditions of equivalent bargaining power within the context of a
20 joint use arrangement, Verizon would likely be charged pole attachment rates that are

¹⁹ Dr. Tardiff mischaracterized the state of play in which neither party possesses bargaining power. Dr. Tardiff stated that, in such a circumstance, both of the parties “lack bargaining power.” It is more accurate to say that both parties have equal bargaining power, or that neither party holds outsized bargaining leverage.

²⁰ Verizon St. 3.1, p. 21.

1 higher than the bounds of the FCC's range (i.e., between the new telecom and old telecom
2 rates).

3
4 **Q. Does not such an outcome prove that FirstEnergy has bargaining power, as Verizon
5 contends?**

6 A. No. In a position of equivalent bargaining power (with Verizon), FirstEnergy would seek
7 to recover its costs under a fully allocated cost methodology. This would lead to a pole
8 attachment rate equal to or exceeding the fully allocated rate calculated by FirstEnergy that
9 Dr. Tardiff shows in Table 1 of his rebuttal testimony.²¹ In practice, a range of additional
10 factors and considerations (which add or subtract the costs and cost allocations) influence
11 the actual negotiation outcomes.

12
13 **Q. Why wouldn't a negotiation among parties with equal bargaining power result in
14 rates that are within the FCC's rate range?**

15 A. Primarily because the FCC's rate range is a regulatory construct and intentionally excludes
16 per capita sharing of common pole costs. As discussed above, these rates were designed
17 to advance the goal of broadband deployment, which resulted in shifting the costs
18 associated with unusable pole space away from pole attachers and onto electric utility
19 ratepayers. Bringing the pole attachment rates into this range reflects adherence to a

²¹ Table 1 included in Dr. Tardiff's rebuttal testimony calculates a hypothetical per capita based fully allocated rate based on the assumption of five attaching entities, including the electric utility and an incumbent local exchange carrier ("ILEC"). Following from this hypothetical, in a bilateral negotiation where both parties enjoy positions of comparable bargaining leverage, a likely outcome would involve the parties splitting (albeit not necessarily evenly) the residual cost of the pole; i.e., after the payments from other attachers are taken into account. The case also exists in which there are fewer than five attaching entities, in which case the rates paid by the electric utility and the ILEC would be higher than the rates shown in Dr. Tardiff's table.

1 regulatory requirement more so than it would reflect the balancing of bargaining
2 positions.

3
4 **Q. Do you agree with Dr. Tardiff's claim, on page 21 of Verizon St. 3.1, that the high cost**
5 **of replicating the Verizon poles used by FirstEnergy is irrelevant to any assessment**
6 **of bargaining power?**

7 A. No. I included this consideration in my analysis of FirstEnergy's potential bargaining
8 power because bargaining power is only actionable to the extent it can be exercised. While
9 Verizon may be theoretically more dependent upon access to FirstEnergy than vice versa
10 (because FirstEnergy owns more poles than Verizon), in practice FirstEnergy is
11 nonetheless exceptionally dependent upon Verizon for pole access. Replacing roughly
12 one-quarter of the poles that FirstEnergy uses in Pennsylvania would be exceptionally
13 costly – that is, under the unlikely assumption that local governments would allow
14 FirstEnergy to duplicate existing poles. Furthermore, it is exceptionally unlikely that the
15 Commission would allow higher pole costs (due to the high costs of replicating Verizon's
16 pole) into the Companies' revenue requirements. Thus, the high cost to FirstEnergy and
17 its ratepayers of replacing Verizon's poles, if such an undertaking could be completed at
18 all, is a practical constraint on FirstEnergy exercising bargaining power, if it were
19 otherwise present.

20
21 **Q. Does the regulation of pole attachments have an effect on potential bargaining power?**

22 A. Yes. In my rebuttal testimony and above in this rejoinder testimony, I provided reasons
23 that any potential bargaining power that FirstEnergy might have from its majority
24 ownership of poles position has been mitigated. The presence of regulation is an additional

1 mitigating factor. Counsel has informed me that, prior to the implementation of FCC pole
2 attachment regulation, the Commission regulated pole attachments in Pennsylvania. Thus,
3 attachers have had ongoing recourse to regulators to challenge the pole attachment rates
4 offered by electric utilities. It is not surprising, then, that pole attachment rates charged by
5 FirstEnergy to Verizon that arose from the 2009 Joint Use Agreement negotiations exceed
6 the old telecom rate set by the FCC, as they would reflect the sharing of common costs that
7 would be expected to arise under negotiations where neither party has a significant
8 bargaining advantage over the other.

9
10 **IV. CONCLUSION**

11 **Q. Does this conclude your rejoinder testimony?**

12 **A.** Yes, it does.