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September 2, 2010

VIA ELECTRONIC FILING
Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street, 2nd Floor
Harrisburg, PA 17120

Re: Investigation Regarding Intrastate Access Charges and IntraLATA Toll Rates of Rural Carriers and the Pennsylvania Universal Service Fund
Docket No. I-00040105

and

AT&T Communications of Pennsylvania, LLC, TCG New Jersey, Inc. and TCG Pittsburgh, Inc. v. Armstrong Telephone Company-Pennsylvania, et al.
Docket No. C-2009-2098380, et al

Dear Secretary Chiavetta:

Enclosed please find the Verizon Companies' Exceptions to the Recommended Decision, filed on behalf of Verizon Pennsylvania Inc., Verizon North Retain Co., Bell Atlantic Communications, Inc. d/b/a Verizon Long Distance, MCImetro Access Transmission Services, LLC d/b/a Verizon Access Transmission Services, and MCI Communications Services, Inc., in the above captioned consolidated matter.

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

Very truly yours,

Suzan D. Paiva

SDP/slb
Enc.

Via E-Mail and First Class Mail
cc: Cheryl Walker Davis, Director, OSA
The Honorable Kandace F. Melillo
Certificate of Service

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the Verizon companies' Exceptions, 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 2nd day of September, 2010.

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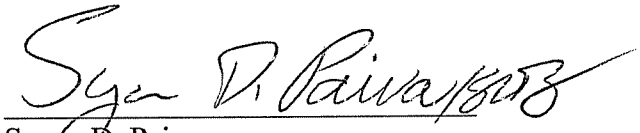

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Investigation Regarding Intrastate Access Charges and IntraLATA Toll Rates of Rural Carriers and the Pennsylvania Universal Service Fund	:	Docket No. I-00040105
AT&T Communications of Pennsylvania, LLC Complainant	:	
v.	:	Docket No. C-2009-2098380, et al.
Armstrong Telephone Company - Pennsylvania, et al. Respondents	:	

EXCEPTIONS OF VERIZON

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Dated: September 2, 2010

INTRODUCTION

The Recommended Decision of Administrative Law Judge ("ALJ") Kandace F. Melillo, issued on August 3, 2010, ("RD") sifts admirably through a huge factual record and a wide array of conflicting legal and policy argument on extremely difficult issues to arrive at a generally reasonable resolution to this proceeding. The RD rejects certain of Verizon's[1] positions and accepts others, but on the whole gets it right by recommending that RLEC intrastate access rates be reduced through a rebalancing of revenue to retail rates for other noncompetitive services, without involving the state Universal Service Fund ("USF"). Accordingly, Verizon urges that the Commission promptly adopt the RD. Pursuant to 52 Pa. Code § 5.533, Verizon files these limited exceptions to request that the Commission consider certain process improvements and clarifications when it enters its final order.

EXCEPTIONS

Verizon Exception 1: The Commission Should Leave Open The Possibility Of Setting A Uniform Statewide Benchmark Intrastate Switched Access Rate For The RLECs In The Future.

The RD concludes correctly that the RLECs' intrastate access rates are too high and must be reduced. (RD at 90). The RD rejects Verizon's and Qwest's proposal that RLEC switched access rates should be reduced to a uniform benchmark rate of 1.7 cents per minute (the rate Verizon PA charges for the same intrastate switched access service), and instead finds that the RLECs should be required to reduce their intrastate switched access rates to match their own interstate switched access rates. (*Id.*)

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[1] These exceptions are filed on behalf of Verizon Pennsylvania Inc., Verizon North Retain Co., Bell Atlantic Communications, Inc. d/b/a Verizon Long Distance, MCImetro Access Transmission Services, LLC d/b/a Verizon Access Transmission Services, and MCI Communications Services Inc. (collectively "Verizon").

Verizon supports the RD's conclusion that "it is time for the Commission to implement a plan or 'glide path' for access reductions with a known destination." (RD at 78). Because it is important to make progress in the right direction, Verizon will not except to the RD's recommendation that matching each RLEC's interstate rates should be the "known destination" for this particular proceeding, and the RD's rejection of Verizon's uniform benchmark proposal. As the RD correctly noted, Verizon is "not opposed to adopting AT&T's mirroring proposal *as an interim measure*, if the Commission is reluctant to move a particular carrier all the way down to Verizon's benchmark rate." (RD at 81) (emphasis added).

Verizon files this limited exception to ask the Commission to recognize that, while the RD would implement an appropriate *interim* step for now, it may be appropriate in the future to consider additional RLEC access reductions and to look at a more equitable uniform benchmark rate. As the RD recognized, after matching their own interstate rates, some RLECs will be left "still charging in the range of 4 cents a minute." (RD at 81). The RD also concludes that a uniform benchmark would potentially reduce incentives for traffic pumping. (RD at 91). But the RD finds it to be "more reasonable" to match the RLECs' interstate rates primarily because this would avoid an additional $13.1 million in revenue to be rebalanced. The RD's finding also relies on the RLECs' admission that their interstate access rates cover their costs and provide a reasonable return, as well as a potential future change in Verizon's rates. (*Id*). None of these conclusions would rule out setting a uniform access rate benchmark in the future to eliminate disparities in what carriers are permitted to charge for the same intrastate switched access service and to allow the Commission to address access pricing issues in

the future on a more equitable industry-wide basis. Indeed, the FCC's Broadband Plan contemplates that after all carriers' intrastate rates are reduced to match their interstate levels, then terminating intrastate switched access rates "would transition . . . to a uniform rate per carrier, which is an important step to eliminate inefficient economic behavior." (AT&T St. 1.3 (Panel Surrebuttal) Att. 1 at 150).

Verizon Exception 2: The Commission Should Make Certain Process Improvements To The Phased-In Rate Rebalancing.

The RD concludes that "access reductions and associated revenue neutral rebalancing" should be "phased-in without additional PA USF funding." (RD at 131). The ALJ then recommends a detailed time line under which the majority of the RLECs would reach parity with their interstate switched access rates in four years, while the others would reach it in three years.[2]

Verizon was the proponent of a phased-in approach for the rate rebalancing and supports the RD's recommendation. The specific details of the rebalancing, however, were devised by the ALJ based on the record and Verizon did not previously have the opportunity to review or comment on them. While Verizon largely supports the approach, Verizon suggests the following reasonable modifications to improve the process.

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[2] The RD concludes that the RLECs' rate rebalancing should be phased in over a two to four year period. (RD at 43, FOF 75). The RLECs in "Group A" (those with current R-1 rates below $18) would reduce access rates over four phases while those in Group B (those with current R-1 rates at or above $18) would reduce access rates over three phases. (RD, Annex C). According to the record, all but four of the RLECs fall into Group A and so the majority of the RLECs would be given four years to reach interstate parity. *See* AT&T St. 1.2 (Panel Rebuttal) Attachment 5; PTA St. 1 (Zingaretti Direct) Exhibit GMZ-13 (CenturyLink, Frontier Oswayo River, TDS- Mahonoy & Mahantango and TDS- Sugar Valley would be the only carriers in Group B). For the Group A RLECs, Phase I would increase their R-1 rates to $18, while the remaining phases would complete the necessary increases in three equal stages, for a total of four years to reach interstate levels. The Group B RLECs would implement the necessary increases in three equal stages over three years.

- ***Any necessary instructions on the manner and format of calculations should be included in the final order.*** The RD would require the Commission's Bureau of Fixed Utility Service ("FUS") to "post a notice on the Commission's website depicting the manner and format of the rate rebalancing calculations to be performed and documented by the RLECs" within 30 days of final order entry. (RD at 155, Ordering ¶ 6). Verizon respectfully suggests that it would be better to include any directions on the manner and format of calculations in the final order itself, so as to reduce the potential for delay and disputes.

- ***The Commission should clarify the RLECs' obligations surrounding the rebalancing calculations.*** The RD would have the RLECs "file their rate rebalancing calculations with the Commission, with a copy to [FUS]" within sixty days of final order entry. (RD at 155, Ordering ¶ 7). To avoid unnecessary delays, Verizon respectfully suggests that the Commission make clear that the RLECs' filings must include all work-papers in their native format and all underlying assumptions, filed on a proprietary basis as needed, and that this filing must be served on all parties to this proceeding. Additionally, if the Commission includes its specific instructions in the final order, as discussed above, then this filing should be made within 30 days of order entry.

- ***The Commission should ensure that technical conferences do not delay the rebalancing.*** The RD concludes that the PTA's suggestion of "technical conferences" is reasonable. (RD at 45, FOF 90). Verizon advocated a compliance filing procedure with formal comments, (Verizon Main Br. at 59-60), and continues to believe this would be a reasonable process to finalize the specifics of the rebalancing. If the Commission prefers to use technical conferences to attempt to answer questions and resolve disputes, then the technical conferences should not provide a basis to delay the rebalancing. For example, the RD appears to contemplate that the rate reductions would occur after "approval of the finalized calculations and projections" by FUS following the technical conferences. (RD at 155, Ordering ¶ 9). The Commission should set a deadline for FUS to provide such approval. Further, if there is any disagreement with FUS's resolution, the Commission should commit to addressing it at the next public meeting after FUS's approval has been provided. The Commission should also make clear that the Phase I rate rebalancing must occur within six months of final order entry. (*See* RD at 155, Ordering ¶ 10) (tariff supplements implementing the Phase I rebalancing to be filed "within 6-12 months" of final order entry).

Verizon respectfully requests that the Commission make the above process changes to the ALJ's rebalancing recommendation.

Verizon Exception 3: The Commission Should Not Conclude That $23 Is The Affordability Level For RLEC Residential Basic Local Service.

The RD recommends that the Commission use $23 as the level to analyze the affordability of local service rates that are rebalanced as a result of this investigation. (RD at 116). The RD notes that if a particular RLEC reaches the $23 R-1 rate level before it is able to rebalance its access rates down to interstate levels "the Commission will need to consider whether complete mirroring can be accomplished for that particular RLEC, consistent with universal service goals." (*Id.*) In other words, at that point the Commission would have to undertake a more in-depth individual analysis of that RLEC before more rebalancing could occur. The RD makes very clear that it is "not treating the $23.00 rate as a benchmark for purposes of triggering USF support" and concludes that the USF should not be expanded to fund RLEC access reductions. (RD at 116). Because the benchmark is not linked to the USF in any way, Verizon does not except to the RD's limited use of a $23 residential rate level. Verizon, however, requests two clarifications with regard to the use of the $23 benchmark.

First, the Commission should instruct the RLECs to design their rate rebalancings to minimize residential rate increases and take reasonable steps to avoid exceeding the $23 level. As the RD found, "[t]he RLECs have made no effort to design a rebalancing that would minimize residential rate increases." (RD at 40, FOF 58). RLECs should be required to make such an effort, as the ALJ correctly found that "[e]ach and every RLEC has room for access rebalancing if approached with an open mind to optimum rate design." (RD at 40, FOF 57). For example, the RD specifically found that the RLECs' "business rates are relatively low and could be increased" in greater proportion to residential rate increases if needed to keep residential rates lower. (RD at 40, FOF 59).

Accordingly, the Commission should direct that a particular RLEC, if necessary to avoid having the residential rates exceed $23: (i) increase its business rates in a greater proportion to residential rates until they reach the national average of $36.59 and (ii) reasonably consider additional increases to other noncompetitive rates. (*See* RD at 117).

Second, even if it uses $23 as a benchmark to control residential rate increases, the Commission should not assume or conclude that $23 is in fact the limit of affordability. The $23 figure is based on testimony submitted by OCA's witness in the earlier phase of the case before ALJ Colwell that relied on the very conservative assumption that the average customer would spend only 0.75% of his income on basic local service. The record shows that the "affordability" level for a residential basic service rate, based on the OCA's own methodology, may be much higher. Verizon pointed out that if that assumption regarding household spending were adjusted upward only slightly, to 1%, then the resulting affordability level would equate to a benchmark of $34. (Verizon Main Br. at 35). The RD erroneously concluded that "I have been cited to no analysis of the record to support the 1% level or any level other than 0.75%," and therefore did not consider any other affordability level above $23. (RD at 116). But in fact Verizon submitted sworn testimony and supporting facts demonstrating that a 1% or higher assumption is more reasonable than OCA's 0.75% assumption. Verizon's witness testified that, according to the FCC's own data, households in the lowest quintile of household income in 2006 spent on average 3.11% of their total household expenditures on telephone services and the average household expenditure for telephone services for rural households was 2.62% of total household expenditures. (Phase I, Verizon St. 1.1 (Price Rebuttal) at 25-26 and Exhibit 3). One could thus reasonably conclude that

households could afford to spend 2.6% on local service. But if only half of the average rural household expenditure were for basic local service (1.3% of total expenditures), that would be $43.25 per month. This evidence demonstrates that OCA's affordability estimate based on the assumption that customers cannot afford to spend more than 0.75% of household income on local service is conservative and too low. (*Id.* at 25-26). Given that the record shows most RLECs can rebalance their access revenue without exceeding that $23 R-1 level, (Verizon Main Br. at 37-38), the Commission should not conclude that $23 is the affordability level. Rather, although not necessary to alter the RD's use of the conservative affordability for present purposes, the Commission should leave the option open to use a higher affordability level in the future or for an individual RLEC following closer examination in this proceeding.

Verizon Exception 4: The Commission Should Not Consider AT&T's Interim USF Increase Proposal As An Alternative To The RD's Well-Reasoned Primary Recommendation.

The RD concludes correctly that the state USF should not be used to provide any funds to replace the RLECs' access revenue and that the RLECs should look to their own retail rates for other noncompetitive services to rebalance the revenue. The RD was right to specifically reject proposals to increase the state USF to provide more revenue to the RLECs. As the ALJ explained, "[t]he principal reason why I am not recommending PA USF expansion is the compelling record evidence of its negative impact on Verizon ILEC customers, many of whom are also rural, and the lack of countervailing evidence that these PA USF payments are necessary to fulfill RLEC universal service/COLR commitments." (RD at 132). The RD found that unrebutted evidence showed that the OCA and AT&T USF proposals would increase the Verizon ILECs' net annual funding

burden to the RLECs by millions of dollars, and concluded that "[t]here simply has been no showing of need for these massive subsidy transfers," which would harm "Verizon's own customers and the customers of other carriers that pay into the PA USF" because "if these companies are forced to divert even more resources to funding other carriers" they would "have fewer resources to invest in new and innovative products and services." (RD at 133). The RD also found that the Commission's current USF regulations do not provide for an increase in the size of the fund, and that with the RD's recommended course of action "this legal stumbling block is avoided." (RD at 132).

But the RD goes on to state that "[i]n the event the Commission disagrees with the recommendation that the PA USF not be expanded at this time . . . then I recommend, as an alternative, that the Commission consider adopting the AT&T modified rebalancing proposal" that temporarily expands the USF to allow for an immediate access reduction. (RD at 136). The RD is careful to note that this "is not my preferred approach" and that a rulemaking to change the current USF regulations may still be required. (*Id.*).

The RD's primary recommendation to avoid any use of the state USF is the correct one and the alternative recommendation should be rejected. Any attempt to expand the USF, even on a purportedly temporary basis, would be bad for consumers and for competition and is not authorized by current law. The AT&T proposal would have the RLECs reduce their access rates to interstate levels immediately, so that AT&T immediately begins enjoying the benefits of access savings, but would have other carriers temporarily replace the RLECs' access revenue with a transfer of their own revenue through the state USF, so that RLEC retail rates could be increased slowly over a period of years. But as the RD correctly concluded, there is no benefit to be gained by shifting

this revenue to the USF to secure a larger immediate access reduction, as opposed to the more administratively simple stepping down of the RLECs' access rates over time.

First, considerable litigation and debate can be avoided simply by reducing the RLECs' rates, phased-in over a few steps. At a minimum, AT&T's proposal would require a rulemaking since the current regulations do not provide a process to increase the size of the fund in this manner even on a temporary basis, as the RD concluded. (RD at 132). It will also invite legal debate and potential appeals over the Commission's lack of authority to expand the USF for this purpose.[3] Indeed, imposing such an additional regulatory burden on the Verizon ILECs, on top of other regulatory burdens and the loss of lines and revenues due to competition, would raise significant confiscation issues that would need to be fully addressed prior to such a scheme going into effect. (RD at 122 (citing *Brooks-Scanlon v. Railroad Comm'n of La.*, 251 U.S. 396, 399 (1920) (a carrier cannot be compelled to carry on its regulated business at a loss)). In short, AT&T's own proposal to create a transitional USF will foster the exact type of delay AT&T seeks to avoid, without corresponding benefit. By far the simpler approach is to leave the revenue

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[3] The RD does not specifically decide whether the current version of Chapter 30 authorizes the expansion of the USF under the facts presented here. Although the RD "is not troubled by the lack of specific mention of universal support funding in Act 183," (RD at 132), it does not go on to address Verizon's additional legal arguments that, in light of the pro-competitive policies of the new Chapter 30, the factual evidence on competitive and consumer harms and the lack of explicit statutory USF authorization, the Commission could not conclude today that forcing regulated carriers to transfer their own revenue to the RLECs is necessary "to ensure the protection of customers" in a manner "consistent with this chapter." 66 Pa. C.S. § 3019(b)(3). This provision is the successor provision to the old Chapter 30 language under which the Commonwealth Court upheld the Commission's authority to create the current USF in the *Global Order*. Also of note, the Commonwealth Court affirmed the *Global Order* USF primarily because it found that Verizon's predecessor, Bell of Pennsylvania, was estopped from challenging the Commission's legal authority to establish the USF, but that argument would not apply in the present case. In short, simply because the Commonwealth Court affirmed the Commission's actions under a different statute and a different factual record ten years ago does not mean that an attempt to expand the USF to fund RLEC access reductions would survive legal scrutiny today.

in access rates and take those rates down in defined steps over a period of time, as the RD recommends, and the RD has demonstrated that such an approach is feasible.

Second, the unrebutted evidence shows that AT&T stands to benefit – at the substantial expense of the Verizon ILECs and their customers – by transferring the revenue out of access rates immediately to the state USF on a temporary basis, because this change in the source of RLEC revenues would shift approximately $8.5 million in annual payment responsibility away from the IXCs (through access rate reductions) and to the Verizon ILECs (through USF assessment increases).[4] Simply put, the AT&T transitional USF proposal would benefit AT&T at the expense of the Verizon ILECs and their customers, and there is no public benefit making that approach superior to one that simply steps down the access rates over time, as recommended by the RD.

Third, shifting the revenue to another carrier-funded source, even on a temporary basis, does nothing to ameliorate the adverse impact on customers both of the contributing carriers (because those carriers have less money to spend serving their own customers) and of the RLEC (because their customers still face diminished opportunities for competitive alternatives and the RLECs will continue to have diminished incentives to engage in service, product and network innovation). (Verizon St. 1.1 (Price Rebuttal) at 48-49). Pennsylvania's telephone carriers already provide over $33 million each year in a direct revenue transfer to the RLECs through the current USF. As ALJ Colwell recently explained, the USF "is not 'free money' to be plundered at will and without

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[4] AT&T's proposal to temporarily increase the USF by $19.6 million would shift the funding burden away from the IXCs and to the Verizon ILECs and their customers. If the $19.6 million is transferred to a "temporary" USF under the same rules that apply to the current USF, the Verizon ILECs would pay $10 million of that $19.6 million, where they would only have paid $1.5 million if the revenue stayed in access rates – a net increase in the Verizon ILECs' funding burden of $8.5 million. (Verizon St. 1.2 (Price Surrebuttal) at 12).

concern for its origins or for whether it is the best use of the money." (Colwell 7/23/09 RD at 87). In fact, "[t]he PA USF is a fund which exists because the ratepayers of other telecommunications providers have paid the money, unwittingly, as a hidden tax." (*Id.*) It is unsupportable from both a policy and a legal basis to expand, even on a temporary basis, the very same state USF that ALJ Colwell recently concluded was hopelessly flawed and in need of a complete overhaul.[5]

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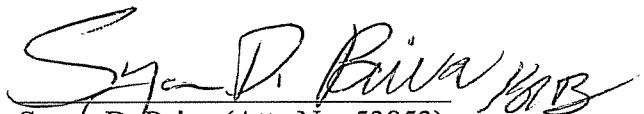
[5] The RD also dismisses Verizon's argument that if any USF involvement is considered – which it should not be – then the Commission should first use the approximately $8.4 million in excess funds being paid out to the RLECs each year under the current USF before it considers increasing the current USF. (Verizon Main Br. at 57-58). The RD concluded that Verizon's proposal would require impermissible retroactive revision to the Pennsylvania USF regulations. (RD at 134). The RD is wrong on this particular detail. The USF regulations address the collection of contributions to the fund and provide a formula that caps the fund at its current size except for any "[i]ncrease in funding requirement due to growth in access lines of recipient carriers." 63 Pa. Code § 63.165(b). But the regulations do not address how the funds are paid out as among the various RLECs. In fact, the Commission has in the past approved changes in the way the funds are distributed among the RLECs without a rulemaking. *Access Charge Investigation per Global Order of September 30, 1999,* Docket Nos. M-00021596, etc. (Opinion and Order entered July 15, 2003) (approving transfer of $1.8 to $2.2 million in USF receipts from CenturyLink's predecessor to certain of the other RLECs). Verizon agrees with the RD's primary recommendation that the USF should not be implicated at all. But if the Commission considers using the USF it should redistribute the excess $8.5 million in the existing fund rather than attempting to increase the size of the USF.

CONCLUSION

For the foregoing reasons, the Commission should adopt the RD as its resolution of this proceeding, but also should consider the above modifications and clarifications to improve the recommended rate rebalancing process.

Respectfully submitted,



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Dated: September 2, 2010