

COMMONWEALTH OF PENNSYLVANIA



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June 3, 2010

Rosemary Chiavetta  
Secretary  
Pennsylvania Public Utility Commission  
Commonwealth Keystone Building  
400 North Street  
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

AT&T Communications of Pennsylvania,  
LLC, *et al.* v. Armstrong Telephone  
Company - Pennsylvania, *et al.*  
Docket No. C-2009-2098380 *et al.*

Dear Secretary Chiavetta:

Enclosed for filing is the Reply Brief of the Office of Consumer Advocate, in the above-referenced proceeding.

Copies have been served upon all parties of record as shown on the enclosed Certificate of Service.

Sincerely,

A handwritten signature in black ink, appearing to read "Joel H. Cheskis".

Joel H. Cheskis  
Assistant Consumer Advocate  
PA. Attorney ID# 81617

Enclosures

cc: All parties of record  
Hon. Kandace F. Melillo, ALJ

127089

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

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REPLY BRIEF OF THE  
OFFICE OF CONSUMER ADVOCATE

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## I. INTRODUCTION

On May 13, 2010, the Office of Consumer Advocate (“OCA”), AT&T Communications of Pennsylvania, LLC (“AT&T”), the Office of Small Business Advocate (“OSBA”), Verizon Pennsylvania, Inc., 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”), Comcast Phone of Pennsylvania, LLC d/b/a Comcast Digital Phone and Comcast Business Communications LLC d/b/a Comcast Long Distance (“Comcast”), Qwest Communications Company (“Qwest”), The United Telephone Company of Pennsylvania LLC d/b/a Embarq Pennsylvania (“CenturyLink”), Sprint Communications Company, L.P., Sprint Spectrum, L.P., Nextel Communications of the Mid-Atlantic, Inc., and NPCR, Inc. (collectively “Sprint”), the Pennsylvania Telephone Association (“PTA”) and the Pennsylvania Public Utility Commission’s (“Commission”) Office of Trial Staff (“OTS”) filed Main Briefs setting forth their positions on the various issues raised in this proceeding. The OCA submits that its Main Brief provides the Commission and Your Honor with a comprehensive discussion of the issues in this proceeding and fully addresses many of the contentions raised by the other active parties in their Main Briefs.

As discussed in the OCA’s Main Brief, the OCA recommended a four-step, comprehensive proposal to resolve the issues addressed in this proceeding and related proceedings. The OCA’s comprehensive proposal would allow for the reduction of intrastate access rates in a manner that respects the need for affordable, universal telecommunications service as well as the need to maintain the financial integrity of the rural local exchange carriers (“RLECs”). The OCA’s comprehensive proposal can be summarized as follows:

1. RLEC intrastate access rates should be set equal to their respective interstate rates, including the elimination of the carrier common line charge;
2. RLEC residential basic local exchange rates that are below 120 percent of the Verizon Pennsylvania weighted average residential basic local exchange service rate should be increased to that level, subject to an affordability constraint, while RLEC rates that are above 120 percent of the Verizon weighted average rate remain at their current levels;
3. Any remaining revenue required to offset the revenue decrease associated with access rate reductions should be recovered from the Pennsylvania Universal Service Fund; and
4. The revenue base of the Pennsylvania Universal Service Fund should be enlarged to include any service provider that uses the public switched telecommunications network at any point in providing their service.

So there is no misunderstanding, step four of the OCA proposal would require the Commission to establish a further proceeding where the issue of expanding the base of contributors to the Pennsylvania Universal Service Fund ("PA USF") would be considered by the Commission.

The OCA recognizes that not all portions of this proposal can be implemented by the Presiding Officer, Administrative Law Judge ("ALJ") Kandace F. Melillo, or the Commission, in this phase of the Commission proceeding. With respect to the expansion of the PA USF, the OCA acknowledges that this part of the OCA comprehensive proposal would need to be considered for implementation in a subsequent proceeding. Nonetheless, the OCA comprehensive proposal addresses all of the issues raised by the Commission in its investigation, as well as the ninety-six (96) complaints filed by AT&T on March 19, 2009. While this proposal has some overlapping and interlocking aspects that cover multiple areas, such a comprehensive proposal is precisely what is needed to lower the RLECs' intrastate access rates while promoting universal service.

The OCA files this Reply Brief in response to certain assertions made by the other parties to this proceeding in their Main Briefs filed on May 13, 2010.

## **II. SUMMARY**

As the OCA demonstrated in its Main Brief filed on May 13, 2010, the Commission must balance the goal of universal service and the goal of promoting competition as part of the federal and state telecommunications laws. The OCA has presented a comprehensive proposal in its Main Brief that addresses the various issues raised in the Commission's investigation and the complaints filed by AT&T. The OCA's comprehensive proposal remains the most reasonable resolution of the multitude of issues presented in this proceeding. In fact, several parties have expressed agreement with many aspects of the OCA's comprehensive proposal. For example, to varying degrees, AT&T, Sprint and Qwest agree that a benchmark rate should be set for the RLECs' basic local exchange rate and that at least a portion of the revenue needed to offset intrastate access rates beyond the benchmark would come from the PA USF.

In contrast, other parties to this proceeding have raised arguments in support of their positions to lower access rates that may jeopardize universal service. Such arguments are without merit and must be rejected. As discussed further below:

- there is no record evidence demonstrating that the RLECs' intrastate access rates subsidize their basic local exchange rates, as Verizon and others have argued;
- ratemaking analyses proposed by Sprint to determine whether the RLECs' can receive PA USF funds to offset reductions in their intrastate access rates are irrelevant in Pennsylvania since Pennsylvania state telecommunications law has replaced traditional rate base/rate of return ratemaking;
- Sprint's reliance on actions of other state commissions to support its position that the Pennsylvania Commission should reduce the RLECs' intrastate access rates in this proceeding fails to consider

the unique circumstances of providing telecommunications services in Pennsylvania;

- arguments by Verizon that the impact of basic service rate increases to offset any reduction in the RLECs' intrastate access rates can be addressed through the federal Lifeline program are incorrect; and

- Verizon's argument that the PA USF has expired is incorrect.

Such arguments, and others set forth below, should be rejected. Instead, the Commission must recognize that its obligation to maintain and enhance universal telecommunications service is an ongoing obligation and does not end after a certain period of time.

The OCA comprehensive proposal should be adopted in this proceeding. No other party has presented a proposal that comprehensively addresses the dual goals of universal service and promoting competition in a manner that is just and reasonable. The OCA's comprehensive proposal respects both state and federal telecommunications law in a manner that is fair and equitable.

### III. REPLY ARGUMENT

#### A. Should The RLECs' Intrastate Switched Access Rates Be Reduced?

1. RLEC Intrastate Access Rates Should Be Reduced, But Only As Part Of A Comprehensive Proposal That Also Allows The Commission To Meet Its State And Federal Universal Service Obligations.

As set forth in the OCA's Main Brief, the OCA agrees that the RLECs' intrastate access charges should be reduced, but *only if* such reductions are part of a comprehensive proposal that protects basic service rates and is fair to the RLECs that provide basic local service.

As OCA witness Dr. Loube testified, the OCA supports reducing the RLECs intrastate access rates because "the current system is inequitable and subject to regulatory arbitrage."

OCA St. 1 at 7. Dr. Loube concluded that the only practical way to eliminate arbitrage is to adopt the “One Rate” solution:

A first best just and reasonable solution to the intercarrier compensation problem would allow each carrier to establish one terminating rate and one originating rate for all types of minutes used by all types of carriers. The rate would be equal to the sum of all terminating (originating) revenue divided by all terminating (originating) minutes. This rate would lower the intrastate access rates and probably lower the interstate access rates. At the same time, the reciprocal compensation rate for local competition and the rate wireless carriers pay for terminating intra-MTA calls would increase. There would be no loss in revenue, and, therefore, no requirement to increase local rates, the federal subscriber line charge, or federal and state universal service payments. By having one rate for all services and carriers, it would establish a level playing field and eliminate arbitrage incentives.

Id. at 7-8.<sup>1</sup> This Commission, however, does not have the authority to establish this “One Rate” solution. Id. at 8. Dr. Loube noted that, “in order to establish such a plan, the Commission would have to obtain the cooperation of the FCC. Given the very low (approaching zero) probability that the FCC would join in establishing such a plan, the Commission must seek to establish a second best alternative.” Id. Because of this, Dr. Loube recommended intrastate access rate reductions as part of the OCA comprehensive proposal as the next best alternative to resolve the inequities, and opportunities for arbitrage, that are present in the current intercarrier compensation system. Id. at 9-18.

Though the OCA supports reducing the RLECs’ intrastate access rates for the reasons identified by Dr. Loube, and as part of the OCA’s comprehensive proposal, the OCA urges the Commission to reject the arguments for access reductions proposed by parties such as AT&T, Verizon and Sprint, as such proposals fail to promote and enhance universal service and are based on flawed assumptions and arguments.

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<sup>1</sup> An “MTA” is a Major Trading Area and represents the areas within which a wireless carrier charges reciprocal compensation for terminating calls. OCA St. 1 at n.2.

2. There Is No Record Evidence Demonstrating That The RLECs' Intrastate Switched Access Rates Subsidize Their Basic Local Exchange Rates.

In their Main Briefs, several parties argue that the RLECs' intrastate switched access rates should be reduced because they subsidize their basic local exchange rates and that such subsidization is bad for both competition and consumers. *See*, AT&T M.B. at 20-25, Sprint M.B. at 23-25, Comcast M.B. at 6. These arguments are without merit and should be rejected. There is no record evidence to support a finding that the RLECs' intrastate access rates subsidize their basic local exchange rates.

A service is subsidized if its price is less than its incremental cost, and a service pays a subsidy if its price is above the stand-alone cost of service. OCA St. 1 at 70.<sup>2</sup> A subsidy is implicit if it is embedded in rates charged, but not disclosed as such. *Id.* at 71. As such, the rates for one group of services are set higher than cost and the revenue generated by the above-cost rate is used to maintain rates below cost for a second group of services. *Id.* OCA witness Dr. Robert Loubé testified that:

Relying on the standard definition of a subsidy, it is my position that rates for local service are not being subsidized because those rates are above the incremental cost of service. In addition, I note that access rates are not providing a subsidy to other services, because there are no studies showing that access rates are above the stand-alone cost of service.

*Id.* at 69. Dr. Loubé concluded that "because the network, and not any individual customer receives the subsidy, it is reasonable to provide the subsidy to the local exchange carrier that provides a variety of services to its end-user and carrier customers." *Id.* at 70.

Dr. Loubé noted that the first step in determining whether a subsidy exists is to define the incremental cost of a service. *Id.* at 71. The formal definition of incremental cost of a service is

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<sup>2</sup> *Citing*, Faulhauber, G.R., Cross-subsidization: pricing in public enterprise. *American Economic Review* 65, 966-977.

the difference between the total cost of providing all of the services and the stand-alone cost of providing the services other than the service under investigation. Id.<sup>3</sup> Dr. Loubé testified that several state and federal decisions find that the cost of the local loop is excluded from the cost of basic local exchange service because it is a shared cost of many services that use the loop. Id. at 72-74 (citations omitted). Dr. Loubé then relied on his analysis of the incremental cost of two RLECs performed in the portion of the proceeding conducted by ALJ Susan D. Colwell to support his claim that basic local service rates are greater than the incremental cost of service. Id. at 74. Dr. Loubé testified:

That analysis shows that a reasonable estimate of incremental cost of service is well below the rate for that service. The testimony supports a conclusion that the overwhelming majority of the cost of service is associated with the loop cost. The results of my analysis are consistent with the results generated by the FCC for rural wire centers served by Verizon PA. While my analysis must be qualified because of data limitations, it is the only attempt that has been made to quantify the incremental cost of service for a Pennsylvania RLEC. Moreover, because it was conducted on a limited scale, my analysis did not impose a huge cost of gathering the required inputs that would have been necessary if every one of the over 1200 rural study areas nationwide had been required to provide inputs into the study. Finally, if the Commission chooses not to rely on my analysis, then there is nothing in the record to either support or deny a claim that any RLEC residential customers are currently being subsidized, because neither AT&T, which has claimed repeatedly again that such a subsidy exists, nor the RLECs, nor Verizon has offered a single alternative incremental cost study.

Id. at 75. As a result, there is no record evidence that demonstrates that the RLECs' basic local service rates are subsidized.

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<sup>3</sup> *Citing*, Baumol, W.J. and Sidak, J.G., *Toward Competition in Local Telephony*. MIT Press, 1994, p. 83. This is the same definition of incremental cost of service as used by Verizon in prior proceedings before the Commission. *See, AT&T Communications of Pennsylvania, LLC. v. Verizon North, Inc.*, Docket No. C-20027195, Direct Testimony of William W. Dunkel dated July 18, 2003 at 47.

The Commission should, therefore, reject any argument that the RLEC intrastate access rates should be reduced because they subsidize basic local service rates.

3. Sprint's Cost And Ratemaking Arguments Are Irrelevant To Chapter 30.

In its Main Brief, Sprint argues that the issue of whether the RLECs' intrastate access rates should be reduced is dependent on the RLECs' costs of service. Sprint further argues that the RLECs' costs of service should determine how any revenues lost from intrastate access rate reductions should be reallocated. Sprint M.B. at 8, 45-48, 51-56, 65. Sprint also criticizes the RLECs for "hav[ing] no idea what their cost of access or basic local exchange service is." *Id.* at 65. Sprint's arguments, however, fail to consider that traditional cost of service determinations are not a relevant consideration in Pennsylvania telecommunications regulation as a result of the enactment, and subsequent re-enactment, of Chapter 30 to the Pennsylvania Public Utility Code. As a result, Sprint's arguments are without merit and should be rejected.

It is axiomatic that Chapter 30 constituted a substitution for rate-base/rate-of-return proceedings for all Pennsylvania local exchange carriers.<sup>4</sup> Yet, Sprint seeks to impose rate-base/rate-of-return type requirements on the RLECs in order to receive revenue offsetting any access rate reductions ordered as a result of this proceeding. As Dr. Loube testified:

[Sprint witness] Mr. Appleby wishes to determine the state jurisdictional revenue requirement. He suggests that this should be done by first applying Part 64 rules to separate the RLECs non-regulatory costs from its regulatory costs. Next, he would use a fully distributed cost model that incorrectly assigns the entire cost of the loop to basic service customers to determine the cost of providing local service because such an extreme allocation is the only way to support his claim that local service is being subsidized.

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<sup>4</sup> The RLECs' Commission-approved Chapter 30 plans, for example, specifically provide that "the [Price Stability Mechanism] is a substitution of traditional rate base/rate of return regulation and is the exclusive basis upon which the Company's noncompetitive rates will be regulated on and after the date of Commission approval." *See, Petition of Buffalo Valley Telephone Company for Approval of a Streamlined Form of Regulation And Network Modernization Plan*, Docket No. P-00981428F1000 (approved June 3, 2005) at 9. The RLECs' Commission-approved Chapter 30 plans were expressly made a part of this record by the ALJ Melillo. Tr. 688-689.

He would consider all vertical service revenue and revenue earned by affiliates selling complementary services as pro forma support revenue that could be used to offset the reduction in access revenue. Finally he would make PA USF support contingent on a showing that the TELRIC cost of service is above the AT&T inflation adjusted benchmark. Each of Mr. Appleby's adjustments may be relevant in a rate-of-return proceeding. However, unless there is a change in the Pennsylvania law, I have been advised by counsel, that those adjustments cannot be implemented.

OCA St. 1-S at 20. If Sprint desires to have the RLECs' costs of providing service considered in determining whether those companies are entitled to offset reductions in intrastate access rates, Sprint must first seek a change in Pennsylvania law from the General Assembly. Until such time as the law is changed, Sprint's arguments pertaining to costs of service are irrelevant and do not support Sprint's position.

4. The Commission Should Reject Arguments To Reduce Access Charges That Do Not Reflect The Current State Of The Telecommunications Industry.

a. Introduction.

In advocating for a reduction in the RLECs' intrastate access rates in a manner that may jeopardize universal service, AT&T and Verizon make arguments in their Main Briefs that fail to consider the current state of the telecommunications industry. Such arguments should be rejected. As the Commission seeks to resolve the delicate balance of universal service and competition, the Commission must do so in a way that is forward-looking, comprehensive and long-term so that universal service and the competitive provision of telecommunications services can both be properly supported as required by state and federal telecommunications law.

b. AT&T.

AT&T relies extensively in its Main Brief on a Recommended Decision by ALJ Michael Schnierle from 1998 for the proposition that, among other things, an unwillingness to rebalance

rates suggests an unwillingness to trust the market to bring about lower prices. AT&T M.B. at 7. While ALJ Schnierle provided many insights and recommendations to the Commission, his Recommended Decision was written at a time when competition in the telecommunications industry was at an early stage of development. At the time, the federal Telecommunications Act of 1996 (“TA-96”)<sup>5</sup> was newly enacted and state commissions were embarking on the authorization of competitive local exchange carriers (“CLECs”) to provide competing service.

At that time, it was the expectation of many that the competitive pressures from CLECs, as well as the nascent wireless industry and the potential of cable telephony, would, in fact, keep basic local service rates at affordable levels. Now, however, while competition may exist in certain portions of the state for customers who are willing to pay \$100-\$150 dollars per month for packages of local, long distance, data and video services, it is not at all clear that competitive forces can maintain basic service rates in rural areas at reasonable levels, while also assuring the financial integrity of the RLECs who are the *only* entities that have an obligation to serve in those rural areas.

It is also important to recognize that ALJ Schnierle’s Recommended Decision was, at the time, made a part of the Commission’s “Global proceeding.”<sup>6</sup> The Global proceeding concluded with a Commission Order establishing a cap on basic local service rates and the creation of the PA USF to keep basic rates affordable.<sup>7</sup> As such, ALJ Schnierle’s decision that AT&T frequently cites in its Main Brief in this proceeding did not deter the Commission from imposing basic service caps and creating the PA USF as part of the Global Order.

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<sup>5</sup> 47 U.S.C. § 151, *et seq.*

<sup>6</sup> In re: Nextlink PA, 93 Pa PUC 172 (Sept. 30, 1999) (Global Order), *aff’d*, Bell Atlantic-Pennsylvania, Inc. v. Pa.P.U.C., 763 A.2d 440 (Pa. Cmwlth 2000) (Global Order Appeal), *vacated in part sub nom*, MCI WorldCom, Inc. v. Pa.P.U.C., 844 A.2d 1239 (Pa. 2004).

<sup>7</sup> Id., 93 Pa PUC at 238-244, 258-264.

The Commission should reject AT&T's arguments that fail to reflect the current state of the telecommunications industry in Pennsylvania.<sup>8</sup> Instead, the Commission should implement the OCA's comprehensive proposal as a forward-looking, long-term solution to the many issues raised in this proceeding.

c. Verizon.

In its Main Brief, Verizon argues that the RLECs' intrastate access rates are not just and reasonable because they are "too high" since they are higher than Verizon's intrastate access rates. Verizon M.B. at 13. This argument and standard fail to recognize that there may be multiple reasons why, in today's telecommunications environment, a rate is set at a certain level. When setting the RLECs' intrastate access rates, and determining how access rate reductions, if any, should be offset under 66 Pa. C.S. § 3017(a), the Commission must keep in mind the universal service goals articulated in both state and federal communications laws. The Commission should reject any argument that the RLECs' intrastate access rates are unjust and unreasonable simply because they are set at a level higher than another telecommunications company. The Commission must consider its obligation under both state and federal laws to promote and enhance universal service before determining whether the RLECs' intrastate access rates are "too high."

Verizon also argues that the RLECs' current intrastate access rates "harm consumers." See, Verizon M.B. at 15. There is no record evidence in this proceeding that demonstrates that

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<sup>8</sup> AT&T also relies significantly in its Main Brief on positions advocated by one RLEC, the Buffalo Valley Telephone Company ("Buffalo Valley"), in a 2003 proceeding involving Buffalo Valley's annual Price Stability Mechanism ("PSM") filing made pursuant to its Commission approved Chapter 30 plan. See, e.g., AT&T M.B. at 9, 12-13, 21-22, 25, 30, 54. Since 2003, however, the General Assembly has enacted Act 183 of 2004 to replace the original Chapter 30 of the Public Utility Code. Act 183 no longer requires the reduction of intrastate access charges to a certain level. Compare, 66 Pa. C.S. § 3007 (repealed) to 66 Pa. C.S. § 3017; see also, OCA M.B. at 10, 23-24. AT&T's extensive reliance on Buffalo Valley's 2003 filing made under a different regulatory regime does not reflect the current state of the telecommunications industry and should be rejected.

consumers are harmed in today's telecommunications environment by the RLECs' current intrastate access rates. Conversely, there is no evidence that demonstrates that consumers will in fact benefit if the RLECs' intrastate state access rates are reduced. This is particularly true as there are no longer any stand-alone long distance companies to pass through any reductions in intrastate access rates since their interexchange services are now offered in bundled packages. *See*, OCA M.B. at 24-25. This is also true as witnesses for AT&T, Verizon and Sprint also recognized under cross-examination that their toll minutes in Pennsylvania have been decreasing during the past several years. Tr. 272 and 243 and OCA Cross Exam Exh. No. 2.

The Commission should reject Verizon's arguments that fail to reflect the current state of the telecommunications industry in Pennsylvania and that will jeopardize universal service.

5. The Commission Should Reject Arguments That The RLECs' Intrastate Access Rates Should Be Reduced In Pennsylvania Because Intrastate Access Rates Have Been Reduced In Other States.

In its Main Brief, Sprint provides extensive argument regarding other states that have reduced intrastate access rates in support of its position that the Commission should do the same here. Sprint M.B. at 38-45. Sprint's argument fails to recognize the unique circumstances of providing telecommunications services in Pennsylvania that distinguish actions in other states.

In particular, the Pennsylvania RLECs have specific network modernization obligations pursuant to Chapter 30. In fact, every RLEC, except for CenturyLink, accelerated its deployment of broadband services to 100% of their service territory by December 31, 2008.<sup>9</sup> CenturyLink has committed to provide broadband service to 100% of its service territory by December 31, 2013.<sup>10</sup> CenturyLink also offers a Bona Fide Retail Request program which

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<sup>9</sup> 66 Pa. C.S. § 3014(b)(1)(ii).

<sup>10</sup> 66 Pa. C.S. § 3014(b)(2).

requires the company to provide broadband service within one year to a community that has met certain requirements.<sup>11</sup> As AT&T witness Nurse recognized on cross-examination: “Pennsylvania tends to be at the forefront” of broadband initiatives. Tr. 186. These obligations are significant given the rural nature of the RLECs’ service territories and that, in Pennsylvania, increases in revenue from the RLECs’ overall rates for noncompetitive services are capped at the rate of inflation.<sup>12</sup> Importantly, under Pennsylvania law, any Commission-ordered reductions in access rates must be offset on a revenue neutral basis.<sup>13</sup>

The Commission should give little weight to the argument that the RLECs’ intrastate access rates in Pennsylvania should be reduced because other states have also reduced intrastate access rates. Reducing rural access rates significantly without countervailing increases in universal service funding may jeopardize universal service in Pennsylvania. RLECs in Pennsylvania have significant network modernization obligations, and are limited in the extent to which they can raise rates for basic local exchange services without rendering such rates unreasonable and unaffordable.

B. If The RLECs’ Intrastate Switched Access Rates Should Be Reduced, To What Levels Should They Be Reduced And When?

1. Rate Levels.

The OCA submits that its Main Brief provides the Commission with a comprehensive discussion of the issue of the rate level for the RLECs’ intrastate access rates, if they are reduced, and fully addresses many of the contentions raised by the other active parties in their Main Briefs. *See*, OCA M.B. at 27-31. The OCA provides no further discussion of this issue at this time.

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<sup>11</sup> 66 Pa. C.S. § 3014(c).

<sup>12</sup> 66 Pa. C.S. § 3015(a)(1)(iii).

<sup>13</sup> 66 Pa. C.S. § 3017(a).

2. Timing.

Several parties argued in their Main Brief that the Commission should reduce the RLECs' intrastate access rates now, and not wait until the Federal Communications Commission ("FCC") acts in its pending proceeding regarding intercarrier compensation. *See, e.g.,* AT&T M.B. at 34. As discussed in the OCA's Main Brief, the OCA does not oppose the Commission acting in this proceeding before the FCC acts in its proceeding, so long as Pennsylvania consumers are not required to pay twice for the same access reduction. Furthermore, any reductions in the RLECs' intrastate access rates must be done contemporaneous with increases in universal service funding to cover a portion of the revenue reductions. *See, OCA M.B. at 31-33.* The OCA cautions, however, that it is still unclear what impact action by the FCC will have on Pennsylvania's intrastate rates. *Id.* at 31. The Commission should strive to avoid a situation where Pennsylvania consumers are paying twice for the same access reduction. *Id.* at 31-32, *citing, OCA St. 1 at 59.*

C. If The RLECs' Intrastate Switched Access Rates Should Be Reduced, How Should Any Revenue Reductions Be Recovered In Compliance With 66 P.A.C.S. Section 3017?

1. Meaning of Revenue Neutrality Requirement Under Section 3017.

The OCA submits that its Main Brief provides the Commission with a comprehensive discussion regarding the meaning of the revenue neutrality requirement under Section 3017 of the Public Utility Code.<sup>14</sup> *See, OCA M.B. at 34-38.* The OCA provides no further discussion of this issue at this time.

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<sup>14</sup> 66 Pa. C.S. § 3017.

2. Rate Increases.

a. The Lifeline Discount Will Not Offset Any Increases In Basic Local Service Rates That May Be Implemented As A Result Of This Proceeding.

In its Main Brief, Verizon argues that the PA USF should not be used to offset any reductions in the RLECs' intrastate access rates, in part, because "to the extent there is a universal service concern for isolated individuals based on unique circumstances, this can be addressed with Lifeline service and/or through the rulemaking recommended by ALJ Colwell." Verizon M.B. at 54-55. This argument represents a fundamental misunderstanding of the Lifeline discount, will jeopardize universal service in Pennsylvania, and should be rejected.

Dr. Loube testified regarding the impact of any rate increase on those customers who receive the Lifeline discount. Tier 1 of the federal Lifeline program compensates carriers for the federal Subscriber Line Charge ("SLC") (\$6.50) while Tier 2 provides a carrier with \$1.75 for each Lifeline customer if the carrier reduces the customer's bill by \$1.75. OCA M.B. at 40; *citing*, OCA St. 1 at 56.<sup>15</sup> Because these are fixed dollar discounts, any increase to basic local exchange service would *increase* the overall rate paid by Lifeline customers but would *not* increase the Lifeline discount. The rate paid by Lifeline customers would increase by the same amount as the basic local service rate increase. *Id.* The same is true for any increase applied to the RLECs basic local exchange service rate as a result of the companies' annual Price Stability Mechanism filings made pursuant to their respective Commission-approved Chapter 30 plans.

For example, if an RLEC's current basic local exchange rate is \$18.00, and with the \$6.50 SLC, the total bill is \$24.50 (ignoring other taxes, fees and surcharges for purposes of this hypothetical), the Lifeline customer actually pays \$18.00 per month for basic service (\$24.50

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<sup>15</sup> Currently, only the Verizon companies provide a Tier 2 discount in Pennsylvania. All other Pennsylvania companies provide the Tier 1 discount which is fully funded by the federal universal service fund.

minus \$6.50). If the RLEC's basic local service rate increases \$2.00 as part of this proceeding, and all else remains equal, the Lifeline customer will now pay \$20.00 per month for basic service (\$26.50 minus \$6.50). The Lifeline customer will pay the full \$2.00 increase. The Lifeline discount will not prevent the low-income basic service customer from paying the additional \$2.00 per month.

As a result, the Lifeline discount will not address any "universal service concern for isolated individuals based on unique circumstances," as Verizon argues, if the RLECs' basic local exchange rate increases. While the OCA would welcome an expansion of the Lifeline service so that more Pennsylvanians can receive the discount, Verizon's arguments are simply incorrect in the context of this proceeding.

b. The OCA's Affordability Analysis Pertains To The Entire Bill For Basic Local Service And Not Just The Basic Local Service Rate.

In their Main Briefs, Verizon and AT&T argue that even the OCA's own affordability analysis supports increasing the basic local exchange rate benchmark beyond what the OCA has proposed in this proceeding. Verizon M.B. at 34-35; AT&T M.B. at 50-51. AT&T argues, for example, that "the OCA affordability analysis yields results for basic rates ... well above the \$22 benchmark rate level that AT&T is proposing in this case." AT&T M.B. at 50-51. The OCA has made it clear, however, that the affordability analysis presented by OCA witness Roger Colton in the portion of the investigation conducted by ALJ Colwell was a *total basic service bill* analysis, not just a basic service rate analysis. Parties' arguments that fail to recognize this distinction must be rejected.

The OCA has explained that:

[a] rate is not the same as the bill. The bill includes the basic local exchange rate plus the subscriber line charge plus the E-911 charge plus the Federal Universal Service Fund charge plus the PA relay

charge plus Touch-tone charges plus other charges. OCA witness Roger D. Colton clearly specifies the relationship between the bill and the rate in his Schedule RDC-4 submitted in the proceeding before ALJ Colwell.

OCA M.B. at 44; *quoting*, OCA St. 1 at 19-20; *see also*, OCA Exh. RL-6. As a result, AT&T is not comparing apples to apples when arguing that the basic local service rate can increase substantially and still be affordable under the OCA's analysis. AT&T M.B. at 50-51. There are more charges than the basic local service rate that a customer is required to pay in order to receive basic local telephone service. Parties repeated arguments that the "OCA's own affordability analysis" supports a higher basic service exchange benchmark rate are without merit and must be rejected.

In addition, both Verizon and AT&T argue that the "OCA's affordability analysis is conservative, at best." AT&T M.B. at n.121; *see also*, Verizon M.B. at 34. These parties argue that Mr. Colton's analysis assumed that consumers should only spend 0.75% of their income on basic local service. Adjusting that assumption up to 1%, they argued, would result in an affordability level of \$43, not \$32. *Id.* Such an adjustment, however, is not appropriate and should be rejected.

The OCA's affordability analysis was extensively debated and discussed in the portion of the investigation conducted by ALJ Colwell. *See*, OCA M.B. (Colwell) at 19-26.<sup>16</sup> In that proceeding, Mr. Colton, a nationally recognized expert on low-income utility issues who has testified and published extensively in this area, testified why 0.75% is the appropriate affordability threshold. OCA witness Colton recommended an affordability threshold of 0.75% of Pennsylvania's rural median household income based on a market basket methodology. OCA St. 2 (Colwell) at 20. Mr. Colton testified:

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<sup>16</sup> ALJ Melillo specifically recognized that the evidentiary record established in the portion of the investigation conducted by ALJ Colwell is available for use in this proceeding. Tr. 270.

I derive the affordable local telephone percentage of income through application of a market basket methodology. The market basket methodology is the accepted mechanism for assessing the affordability of household expenses in Pennsylvania. Through a market basket approach, I assess telephone expenditures in light of both total household income, and total household expenditures on other household necessities.

Id. This threshold provides a reasonable measure to ensure the availability of affordable basic telephone service to all residential customers. Mr. Colton proposed that the Commission, to the extent practicable, use a methodology that is consistent with the methodology used by other Pennsylvania state government agencies to assess the affordability of basic household necessities. Mr. Colton specifically conducted the affordability analysis using a 0.75% threshold and a 1% threshold and found the 0.75% threshold to be a more reasonable constraint on the overall telephone bill when also considering the comparability analysis proposed by Dr. Loubé.

Verizon also argues that the FCC's own data reveals that "households in the lowest quintile of household income in 2006 spent on average 3.11% of their total household expenditures on telephone service." Verizon M.B. at n.63. This argument was also previously addressed by Mr. Colton in the portion of the proceeding conducted by ALJ Colwell. Mr. Colton testified that the FCC's data regarding all monthly telephone expenditures includes not only basic local exchange service but also wireless service, internet access and numerous other services. OCA St. 2-S (Colwell) at 2-3. Verizon's argument then would assume that "the monthly price of basic local telephone service, standing alone, would be equal to the *combined* monthly price of wireless service, domestic long-distance service, internet service, cable television service, and non-basic telephone service." Id. at 4 (emphasis in original). Such a comparison is untenable and should be rejected. The OCA's proposal to maintain affordable

rates by limiting the total basic local service bill to no more than 0.75% of the Pennsylvania statewide median rural household income is reasonable and well supported by record evidence.

The Commission should adopt the OCA's affordability analysis as part of its resolution of the various issues in this proceeding. No other party has submitted evidence regarding affordability in either this proceeding or the portion of the investigation conducted by ALJ Colwell.

3. Pennsylvania USF.

- a. If The Commission Determines That The RLECs' Intrastate Access Rates Are To Be Reduced On A Long-Term Basis, The Commission Must Ensure Universal Service Support On A Long-Term Basis As Well In Order To Satisfy Its State And Federal Universal Service Obligations.

Both state and federal law require the Commission to maintain universal telecommunications services at affordable rates.<sup>17</sup> The OCA recognizes that, while the manner in which the Commission satisfies its universal service obligations may change, these obligations are not temporary but remain in place until changed by Congress and the Pennsylvania General Assembly. Nonetheless, the Commission must reject any argument that the PA USF has already expired or that the initial level of the PA USF as set forth in the OCA's comprehensive proposal is fixed.

First, in its Main Brief, Verizon argues that "the Global Order USF was a temporary measure" and that "this arrangement was clearly intended to be temporary." Verizon M.B. at 43. Verizon cites the Global Order for the proposition that "[t]he interim funding mechanism that we create through this order will function until December 31, 2003, or until the subsequent []

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<sup>17</sup> 47 U.S.C. § 254(b)(1); 66 Pa. C.S. § 3011(2).

investigation develops a new process, *whichever occurs first.*” Id.; quoting, Global Order at 243 (emphasis added by Verizon).

The Commission has already addressed the December 31, 2003 deadline quoted by Verizon. On July 15, 2003, the Commission approved a settlement of a generic proceeding that reduced the RLECs’ intrastate access charges and increased the \$16.00 cap on residential basic local exchange service to \$18.00.<sup>18</sup> That settlement provided that “any approved future increases in rates above the \$18.00 rate cap for any ILEC shall also be recoverable from the USF under the exact terms and conditions as approved in the Global Order.”<sup>19</sup> In approving the settlement, the Commission stated that “the Pa USF will continue beyond December 31, 2003, until amended through a rulemaking proceeding.”<sup>20</sup> As a result, the Commission clearly has addressed the December 31, 2003 deadline and extended the PA USF. Verizon’s argument to the contrary must be rejected.

Moreover, the Commission’s determination in the Global Order that the PA USF was “temporary,” as Verizon argues, was only as to the mechanism, not the statutory obligation to promote and enhance universal service. To the extent the Commission determines to discontinue the PA USF, which the OCA submits it should not do, it must replace that universal service support mechanism with another universal service support mechanism to ensure that its universal service obligations are satisfied. The Commission recognized its universal service obligations in the Global Order when stating that:

- “this [universal service] section also recognizes that in the transition from monopoly to competition, the small ILECs need a

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<sup>18</sup> Access Charge Investigation per Global Order, Docket No. M-00021596, Order (entered July 15, 2003).

<sup>19</sup> Id. at 18.

<sup>20</sup> Id. at 11.

financial transition mechanism to enable them to continue to exist,” Global Order at 240;

- “with the subsequent enactment of Chapter 30, the Commission now has explicit regulatory authority to take appropriate actions to maintain universal service at affordable rates,” Id. at 242; and

- “Indeed, we view the establishment of a Universal Service Fund as an essential element of the series of rate level and rate structure changes embodied in this opinion and order.” Id.

The Commonwealth Court explicitly affirmed the creation of the PA USF when affirming the Global Order in its entirety.<sup>21</sup> As such, Verizon’s arguments that the PA USF was temporary fail to recognize that the Commission’s obligation to maintain and enhance universal service is ongoing. The PA USF in its original structure may have been a transition to another universal service support mechanism, but it was not a transition to no universal service support at all.

Second, any argument raised by Verizon that the initial level of the PA USF set by the OCA comprehensive proposal is “permanent” is also without merit and should be rejected. Verizon M.B. at 42. In the OCA’s comprehensive proposal, the PA USF itself will remain in effect until further Commission action. As the OCA demonstrated in its Main Brief, however, the *size* of the OCA proposed PA USF will in fact decrease over time. OCA M.B. at 50. Under the OCA’s comprehensive proposal, the RLECs’ access to funds from the PA USF is tied to setting their own rates at 120% of Verizon’s weighted average basic local exchange rate. Id. Given that the Verizon state-wide average rate increases annually, Tr. 186-187, the OCA proposal will, in fact, reduce support from the PA USF annually.

As Dr. Loubé explained:

In the first year, PA USF support replaces the access revenue reduction associated with the OCA comprehensive plan’s access rate recommendation. In the second and all future years, the

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<sup>21</sup> Global Order Appeal, 763 A.2d at 492-492.

benchmark would increase as the Verizon average state-wide rate increases. Under the OCA's comprehensive plan, the RLECs will have the opportunity to increase local revenue by the difference between the current benchmark (\$17.09) and the new benchmark times the number of lines in the second year times 12 months. For example, if the carrier serves 10,000 lines and the benchmark increases to \$17.50, then the PA USF support would decrease by \$49,200 (41 cents times 10,000 lines times 12 months) in the second year, and with every further increase in the benchmark, the fund size would also decrease. Based on the 2,044,768 lines served by RLECs in 2008, the decrease for the entire fund would be approximately \$10 million in the second year (41 cents times 2,044,768 times 12 months).

OCA M.B. at 50; *see also*, OCA St. 1-S at 15. Therefore, any arguments that the initial level of the PA USF contained within the OCA's comprehensive proposal is "permanent," are without merit and must be rejected.

b. Verizon's Reliance On The United States Supreme Court *Brooks Scanlon* Decision To Support Its Positions In This Proceeding Is Unfounded.

In its Main Brief, Verizon argues that the PA USF should not be used to offset any reductions in the RLECs' intrastate access rates because "expanding the USF will impose huge new regulatory burdens on other regulated carriers, which are not tenable in today's competitive markets." Verizon M.B. at 46-50. In making this argument, Verizon cites to the United States Supreme Court decision Brooks-Scanlon v. Railroad Comm'n of La., 251 U.S. 396, 399 (1920), for the proposition that "a carrier cannot be compelled to carry on its regulated business at a loss." Id. at 48. The OCA submits, however, the Supreme Court decision in Brooks-Scanlon, does not support Verizon's proposal in this proceeding.

In Brooks-Scanlon, the Louisiana Commission considered whether a sawmill that operated a railroad would be permitted to abandon railroad service entirely given that the railroad

was operating at a loss.<sup>22</sup> The Supreme Court found that the Louisiana Commission improperly attempted to consider the profits of the sawmill in determining whether the railroad should be permitted to abandon its railroad service. Brooks-Scanlon is distinguishable from this proceeding, in part, because no utility is attempting to abandon service and, in part, because no utility is being forced to support its regulated service with profits from unregulated businesses. Instead, this proceeding pertains to the level of rates that may be set for a regulated service, *i.e.* intrastate access rates.

As such, Verizon's argument regarding Brooks Scanlon should be rejected.

D. General Legal Issues.

1. Retroactivity Of Any Access Rate Reductions.

The OCA submits that its Main Brief provides the Commission with a comprehensive discussion regarding the application of Section 1309(b) of the Public Utility Code to this proceeding.<sup>23</sup> *See*, OCA M.B. at 53-56. The OCA provides no further discussion of this issue at this time.

2. Compliance.

The OCA has no position on this issue in response to any argument made by another party to this proceeding in their Main Brief. As the OCA maintained in its Main Brief, the OCA will actively review any compliance filings made as a result of the Commission's Order in this proceeding to ensure that the Commission's directives are properly adhered to. OCA M.B. at 56.

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<sup>22</sup> Brooks-Scanlon, 251 U.S. at 398.

<sup>23</sup> 66 Pa. C.S. § 1309(b).

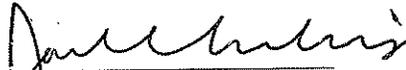
#### IV. CONCLUSION

WHEREFORE, the Pennsylvania Office of Consumer Advocate respectfully requests the Pennsylvania Public Utility Commission adopt the following four steps as a resolution of the issues presented in the Commission's intrastate access charge proceeding for rural local exchange companies:

1. RLEC intrastate access rates should be set equal to their respective interstate rates, including the elimination of the carrier common line charge;
2. RLEC residential basic local exchange rates that are below 120 percent of the Verizon Pennsylvania weighted average residential basic local exchange service rate should be increased to that level, subject to an affordability constraint, while RLEC rates that are above 120 percent of the Verizon weighted average rate remain at their current levels;
3. Any remaining revenue required to offset the revenue decrease associated with access rate reductions should be recovered from the Pennsylvania Universal Service Fund; and
4. The revenue base of the Pennsylvania Universal Service Fund should be enlarged to include any service provider that uses the public switched telecommunications network at any point in providing their service.

The OCA respectfully submits that all of these four components should be adopted in their entirety. The OCA recognizes that any expansion of the base of contributors to the Pennsylvania Universal Service Fund, however, must be done in a separate proceeding.

Respectfully submitted,



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Dated: June 3, 2010  
127594

CERTIFICATE OF SERVICE

Re: 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, *et al.* v. Armstrong Telephone Company – Pennsylvania, *et al.*  
Docket No. C-2009-2098380, *et al.*

I hereby certify that I have this day served a true copy of the foregoing document, the Office of Consumer Advocate's Reply Brief, upon parties of record in this proceeding in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant), in the manner and upon the persons listed below:

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