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September 2, 2010

Rosemary Chiavetta, Secretary
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400 North Street
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Re: Investigation Regarding Intrastate Access
Charges and IntraLATA Toll Rates of Rural
Carriers, and the Pennsylvania Universal
Service Fund
Docket No. I-00040105

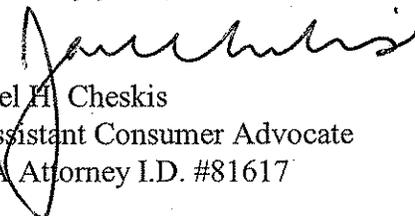
AT&T Communications of Pennsylvania,
LLC, *et al.* v. Armstrong Telephone Company
– Pennsylvania, *et al.*
Docket No. C-2009-2098380 *et al.*

Dear Secretary Chiavetta:

Enclosed for filing please find the Office of Consumer Advocate's Exceptions, in the
above-captioned proceeding.

Copies have been served in accordance with the enclosed Certificate of Service.

Sincerely yours,


Joel H. Cheskis
Assistant Consumer Advocate
PA Attorney I.D. #81617

Enclosure

cc: Parties of Record
Cheryl Walker Davis/OSA
Hon. Kandace Melillo

*117396

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 Exceptions, 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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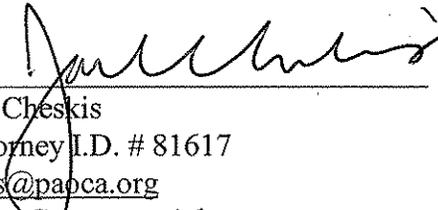
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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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.* :

EXCEPTIONS OF THE
OFFICE OF CONSUMER ADVOCATE

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Dated: September 2, 2010

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I. INTRODUCTION

In 1993, the Pennsylvania General Assembly added Chapter 30 to the Pennsylvania Public Utility Code declaring it to be the policy of this Commonwealth, among other things, to “maintain universal telecommunications service at affordable rates” and to “encourage the competitive supply of any service in any region where there is market demand.”¹ These policies were specifically articulated again by the General Assembly in 2004 after the original Chapter 30 expired and Chapter 30 was re-enacted with the passage of Act 183.² The underlying issue in this proceeding is how to balance the twin goals of maintaining universal service and promoting the competitive provision of telecommunications services, while at the same time ensuring the recovery of the joint and common costs of the public switched telephone network (“PSTN”) of Pennsylvania’s rural telephone companies (“RLECs”).

On August 3, 2010, the Pennsylvania Public Utility Commission (“Commission”) issued the Recommended Decision of Administrative Law Judge (“ALJ”) Kandace F. Melillo addressing ninety-six (96) consolidated complaints filed by AT&T Communications of Pennsylvania, LLC (“AT&T”) against Pennsylvania’s thirty-two RLECs. The Recommended Decision also addresses issues raised in a previously stayed Commission investigation regarding the RLECs’ intrastate access charge rates that was consolidated with the AT&T complaints. The AT&T complaints and the Commission’s investigation raise issues pertaining to the appropriate level of the RLECs’ intrastate access charges that will promote competition and maintain universal service in the RLECs’ service territory. Access rates are the rates that RLECs charge

¹ See, 66 Pa. C.S. §§ 3001(1)(repealed) and 3001(8)(repealed).

² 66 Pa. C.S. §§ 3011(2) and 3011(8).

long-distance companies, or interexchange carriers (“IXCs”), for access to the local telephone network to provide interexchange services.

In her Recommended Decision, the ALJ recommends a plan that reduces the RLECs’ intrastate access rates to their interstate levels over a two to four year period. R.D. at 137-140. Under the ALJ’s plan, revenue required to offset each step of the reduction in intrastate access rates is recovered by the RLECs through a corresponding increase to other noncompetitive rates, specifically basic local exchange rates. Under the ALJ’s plan, residential basic local exchange rates initially increase to \$18.00 and then continue to increase until basic local service rates reach the affordability constraint established by the ALJ of \$23.00 for residential basic local exchange service. R.D. at 138-140. The intrastate access rates are correspondingly reduced until they reach the interstate access rate level.

To implement this plan, the ALJ recommended that the first reduction in the RLEC intrastate access rates will be offset with increases to basic local exchange rates up to a weighted average residential rate for each RLEC of \$18.00, with business rates also receiving increases. R.D. at 138.³ This increase will occur 6-12 months from the entry of a final Commission Order in this matter. One year later, and then each of the following two years, the RLECs, as necessary, may increase their basic local exchange rate above \$18.00 while simultaneously reducing their intrastate access rates to their interstate rates in a revenue neutral manner. R.D. at 138-140. These revenue neutral changes are to be achieved in 1/3 increments, meaning that 1/3 of any remaining difference is to be eliminated in each phase, subject to the affordability

³ This plan applies only to those RLECs whose intrastate access rates currently are higher than their interstate levels and, for those RLECs whose intrastate rates are higher than their interstate rates, this plan applies only to the extent needed to get to parity. R.D. at 135. In addition, because of the size of the required increase to reach \$18.00, the increase to Citizens of Kecksburg would be phased in over two steps. Id.

constraint. The ALJ directed that each RLEC file a plan consistent with her Recommended Decision to implement the reductions in intrastate access rates required by her recommendation.

The Office of Consumer Advocate (“OCA”) supports many of the provisions in the ALJ recommendation. The OCA supports a comprehensive plan that would reduce the RLECs’ intrastate access rates to their interstate levels to promote competition for interexchange services and, at the same time, establish a mechanism for basic local exchange rates to remain just and reasonable. The OCA also agrees that offsetting increases in residential basic local exchange rates should be subject to an affordability constraint as proposed by OCA witness Roger Colton in a prior phase of this proceeding.⁴ Through its witness in this phase of the proceeding, Dr. Robert Loube,⁵ the OCA presented a comprehensive four-part proposal to promote competition and maintain the universal provision of telecommunications services while establishing a just and reasonable mechanism to recover the joint and common costs of the network.

The four steps of the OCA’s comprehensive plan presented in this proceeding were as follow:

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

⁴ Roger D. Colton is a principal in the firm of Fisher Sheehan & Colton, Public Finance and General Economics. Mr. Colton provides technical assistance to a variety of public utilities, state agencies and consumer organizations on rate and customer service issues for telephone, water/sewer, natural gas and electric utilities. Mr. Colton’s work focuses on low-income utility issues, and he has testified and published extensively in this area. *See*, OCA St. 2 (Colwell) at 1-3, Attachment RC-1.

⁵ Dr. Robert Loube is the Vice President of Rolka Loube Saltzer Associates. His consulting practice centers on providing expert advice to state agencies involved in telecommunications regulation. Prior to joining Rolka Loube Saltzer Associates, Dr. Loube worked at the Federal Communications Commission, the Public Service Commission for the District of Columbia and the Indiana Utility Regulatory Commission on issues associated with incremental cost, rate design, competition, universal service and separations. OCA St. 1 at 1. Dr. Loube received his Ph.D in Economics from Michigan State University in 1983. *See*, OCA Exh. RL-1.

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.⁶

While the details of the OCA comprehensive proposal vary from the plan recommended by the ALJ, the two plans have some common elements.

The ALJ's Recommended Decision is consistent, in many respects, with elements of the OCA's proposal. For example,

- both the ALJ recommendation and the OCA comprehensive proposal reduce the RLECs' intrastate access rates and structure to their interstate levels;
- the ALJ recommended plan includes an initial reduction in intrastate access rates that may be offset by increases in RLEC basic local exchange rates up to \$18.00 whereas the OCA comprehensive proposal requires RLECs to increase their basic local exchange rate up to \$17.09 as an initial step;⁷
- both the ALJ recommendation and the OCA comprehensive proposal include an affordability constraint to ensure that the RLECs' basic local exchange rates remain consistent with state and federal law that requires rates to be affordable; and
- both the ALJ recommendation and the OCA comprehensive proposal reduce intrastate access rates and increase basic local exchange rates, albeit over different "glide paths."

⁶ The OCA has recognized that issues regarding expanding the base of contributors to the PA USF have specifically been excluded from this proceeding. The OCA recommends, however, that this issue be considered as part of a separate proceeding established by the Commission.

⁷ As discussed further below, the \$17.09 figure represents 120% of the Verizon weighted average rate which the OCA proposed be used as part of its comparability analysis. The Verizon rates will likely increase January 1, 2011, which would cause 120% of the Verizon weighted average rate to increase as well.

These elements provide a reasonable framework for resolution of the disparate positions in this proceeding. IXCs benefit by the reduction in access rates, but are still required to contribute for their use of the PSTN. Most basic local exchange customers will see an increase in their basic local exchange rates but such increases are phased in over time and are subject to an affordability constraint. The RLECs will see a reduction in access revenues but will continue to receive support for the PSTN. After extensive litigation and development of an evidentiary record in this and related proceedings, several parties have taken positions that incorporate these concepts.⁸ Overall, the similar components of the ALJ recommendation and the OCA's comprehensive proposal will promote competition and maintain universal telecommunications service while ensuring proper recovery of the joint and common costs of the PSTN.

The OCA respectfully submits, however, that portions of the Recommended Decision should be modified or clarified by the Commission to be in the public interest. Significantly, the ALJ failed to recommend any "comparability" analysis as part of her proposal. In OCA's view, the rates charged by the RLECs must be maintained not only at a level that is affordable but at a level that is comparable to the rates charged by Pennsylvania's major urban incumbent local exchange carrier ("ILEC"), Verizon. The ALJ, however, relied solely on an affordability analysis to ensure that basic local exchange rates remain just and reasonable. In addition, the ALJ's recommendation regarding the affordability analysis must be clarified so that it is clear that the affordable rate should not be exceeded and that any charges above that level should be recovered from the Pennsylvania Universal Service Fund ("PA USF"). Furthermore, in

⁸ For example, under certain circumstances, many parties agree with reducing the RLECs' intrastate access rates to their interstate levels. Many parties also agree that a reasonable benchmark of basic local service rates, adjusted over time, is appropriate. Many parties also agree that the RLECs should receive support to maintain the PSTN as they continue to carry the obligation of universal service.

implementing her affordability constraint, it appears that the ALJ did not consider or account for the fact that the taxes, fees and surcharges on the local exchange bill, as well as rural median family income, may change, thus affecting the resulting affordable rate over time. Other portions of the recommendation must also be modified. Adopting these clarifications or modifications will ensure basic local exchange rates remain just and reasonable and assist the Commission in fulfilling its universal service obligations.

Nonetheless, the ALJ properly recognizes in her Recommended Decision that:

the challenge for the Commission is to issue a comprehensive ruling which appropriately balances the major considerations (access charges, local service rates, and the PA USF), some of which were addressed in a separate limited proceeding before ALJ Colwell, in a manner which is consistent with law, the evidence of record, and good public policy.

R.D. at 17. Likewise, the ALJ properly recognizes the importance of a “‘glide path’ for access reductions with a known destination.” R.D. at 78. The OCA submits that the Commission should modify the Recommended Decision consistent with the discussion below while adopting those elements of the ALJ’s recommendation that properly balance the twin goals of universal service and competition under state and federal telecommunications policy.

II. EXCEPTIONS

OCA Exception No. 1 – The ALJ Erred By Recommending That Basic Local Exchange Rates Can Be Raised Based Solely On An Affordability Analysis Without Consideration Of A Comparability Analysis. (R.D. at 115-116; OCA M.B. at 17-21, 41-43).

1. Introduction.

In her Recommended Decision, the ALJ recommends that reductions in the RLECs’ intrastate access rates be offset with increases in basic local exchange rates constrained only by

an affordability analysis. In doing so, the ALJ failed to recognize that the RLECs' basic local exchange rates should also satisfy a comparability analysis in order to be found just and reasonable. Instead, the ALJ recommended that:

After considering the parties' arguments, I conclude that the federal comparability statute at 47 U.S.C. § 254(b)(3) is not applicable to the Commission. I conclude also that Verizon's rates are not an appropriate benchmark as they are subject to modification in the pending Verizon Access Charge proceeding and the \$14.25 weighted average Verizon rate includes density cells which are not urban. Accordingly, I decline to use any comparability analysis in considering a benchmark level for rate rebalancing purposes, consistent with ALJ Colwell's determination that comparability should not be considered.

R.D. at 115 (citations omitted). The ALJ's recommendation to increase basic local exchange rates without considering a comparability benchmark should be modified.

2. The RLEC Rates Should Be Developed Using Both A Comparability Analysis And An Affordability Analysis.

As discussed in the OCA four-part proposal, to be just and reasonable, the RLEC basic local service rates should not exceed 120 percent of the Verizon Pennsylvania weighted average residential rate with affordability serving as a constraint on such rates. OCA M.B. at 17-21.

OCA witness Dr. Loube set forth the OCA's proposal as follows:

Using the 120% target, the current just and reasonable comparability benchmark would be \$17.09. The benchmark is 120% of the current weighted average Verizon Pennsylvania rate of \$14.25. In the proceeding before ALJ Colwell, the OCA argued that rates should be no higher than 120% of the current weighted average Verizon Pennsylvania rate, also known as the comparability standard. However, that standard was constrained by two conditions. First, given that 120% of the Verizon rate is less than the current \$18 cap on residential basic local exchange service, rates between the comparability standard and \$18 would still be considered reasonable and would not have to be reduced. The second condition is an affordability constraint. The affordability standard is based on Pennsylvania median family income. If increases in the Verizon rate drove the comparability

standard above the affordability standard, then the affordability standard would be a binding constraint, and the just and reasonable basic residential rate would be based on the affordability standard. In this case, I am relying on the same comparability standard to establish a price floor that is a prerequisite for receiving PA USF support.

OCA St. 1 at 14-15.⁹ As such, the OCA's proposal recognizes that to meet the just and reasonable standard, RLEC basic local service rates should be set in a manner that ensures that they are both affordable and comparable, as set forth in the federal Telecommunications Act of 1996 ("TA-96").¹⁰

Federal law supports the adoption of a comparability standard when determining just and reasonable rates for various telecommunications services. Section 254(b) of TA-96 requires the Federal Communications Commission ("FCC") to use the principle of rate comparability in designing the federal universal service fund:

(3) Access in rural and high cost areas – Consumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high cost areas, should have access to telecommunications and information services, including interexchange services and advanced telecommunications and information services, that are *reasonably comparable* to those services provided in urban areas and that are available at rates that are *reasonably comparable* to rates charged for similar services in urban areas.¹¹

⁹ Dr. Loubé added that the comparability benchmark will change every year in which Verizon Pennsylvania changes its basic residential rate. OCA St. 1 at 15. Using this standard, twenty-two RLECs would be required to increase their rate to match the benchmark in order to receive PA USF support, ranging from 10 cents to \$3.60, with the exception of Citizens of Kecksburg which would receive an increase of \$6.09. *Id.* The OCA has proposed, and continues to propose, that the increase to bring Citizens of Kecksburg rates to the OCA's recommended \$17.09 level, or the ALJ's initial \$18.00 level, should be phased in over time. The ALJ agreed that the initial Citizens of Kecksburg rate increase should be phased in over time. R.D. at 135.

¹⁰ *See*, 47 U.S.C. § 254(b).

¹¹ 47 U.S.C. § 254(b)(3) (emphasis added).

According to the FCC, “the primary federal role in ensuring the statutory goal of reasonably comparable rural and urban rates for non-rural carrier customers is to enable reasonable comparability *among* states.”¹² The FCC has further noted that, on the other hand, “we agree with the Joint Board that the states should continue to have primary responsibility for ensuring reasonably comparable rural and urban rates” within the state.¹³ The FCC continued:

The 1996 Act makes clear that Congress intended preserving and enhancing universal service to be a shared federal and state responsibility. The legislative history of the 1996 Act also indicates that Congress intended the states to continue to have the primary role in implementing universal service for intrastate services.¹⁴

As the FCC notes, it is the responsibility of this Commission to ensure reasonably comparable rural and urban rates within the Commonwealth. The comparability standard set forth by OCA witness Loube is a reasonable means to meet this responsibility.

The concept of comparability in telecommunications regulation is also reflected in state law. For example, Section 3014(k) of the Public Utility Code requires ILECs to “reasonably balance deployment of its broadband network between rural, urban and suburban areas within its service territory, as those areas are applicable, in accordance with its approved network modernization plan.”¹⁵ An ILEC, therefore, cannot first deploy broadband to urban exchanges and suburban exchanges and then to rural exchanges, but must do so in a balanced manner. In addition, Section 3015(a)(3) ensures reasonable comparability between a nonrural ILEC’s inflation-based revenue increase allowed pursuant to their Chapter 30 plans and the specific

¹² In the Matter of the Federal-State Joint Board on Universal Service, CC Docket No. 96-45, 18 FCC Rcd. 22559, Order on Remand (rel. Oct. 27, 2003) at ¶ 18 (emphasis added).

¹³ Id., ¶ 21.

¹⁴ Id.

¹⁵ 66 Pa. C.S. § 3014(k).

increase for residential basic local exchange service.¹⁶ Specifically, the increase to residential basic local exchange rates can be no larger than 120% of the overall increase allowed to the ILEC.

This Commission can also be guided by numerous other state commissions that have established a comparability standard for determining rural rates or implementing a state universal service fund. For example, in Maine, in order to be eligible for state universal service funding, a rural carrier had to adopt Verizon Maine's basic local exchange rates before it received funding. *See*, OCA St. 1 at 10.¹⁷ In New Hampshire, the Public Utilities Commission recently approved a petition by several rural carriers that included the requirement that the rural carriers cannot exceed the rates of the largest ILEC operating in New Hampshire. *Id.*¹⁸ In Wyoming, the state universal service fund provides rate support such that no customer bill is greater than 130% of the state-wide average rate. *Id.* at 10.¹⁹ In Nebraska, the Commission revised the residential rate benchmark in 2006 to \$19.95 when the average urban rate at the time was \$17.95, a difference of 11% ($\$19.95 / \$17.95 = 1.11$). *Id.* at 11-12.²⁰ In California, the Public Utilities Commission set a benchmark rate for 17 small rural carriers equal to 150% of the California urban rate. *Id.* at 12.²¹

¹⁶ 66 Pa. C.S. § 3015(a)(3).

¹⁷ *Citing*, Maine Public Utility Commission, Chapter 288. Verizon no longer provides ILEC services in Maine.

¹⁸ *Citing*, New Hampshire Public Utilities Commission, Kearsage Telephone Co., Wiltion Telephone Co., Hollis Telephone Co. and Merrimack County Telephone Co., Petitions for Approval of Alternative Form of Regulation, DT 07-027, Order Regarding Joint Settlement Agreement, Order No. 24.852, April 23, 2008.

¹⁹ *Citing*, 2007 Annual Telecommunications Report, Wyoming Public Service Commission, page 37.

²⁰ *Citing*, In the Matter of the Nebraska Public Service Commission, on its own motion, to make adjustments to the universal service fund mechanism established in NUSF-26, Application No. NUSF-50, Order, December 19, 2006, ¶¶ 22, 31-34.

²¹ *Citing*, Public Utilities Commission of the State of California, Resolution T-17122, January 10, 2008.

It is therefore reasonable that this Commission adopt a comparability standard, in conjunction with an affordability standard, when setting just and reasonable RLEC basic local exchange rates. The ALJ erred by recommending that the RLEC basic local exchange rates be raised without regard to comparability.

3. The ALJ's Reasons For Rejecting The Use Of A Comparability Analysis Are Without Merit.

In failing to recommend the adoption of a comparability analysis in addition to an affordability analysis, the ALJ incorrectly relies on the Commonwealth Court's recent decision in the Buffalo Valley case.²² The ALJ further errs in determining that Verizon's rates are not appropriate for use in a comparability analysis. Both of these decisions should be rejected.

First, the ALJ's reliance on the Commonwealth Court's Buffalo Valley decision in failing to adopt a comparability analysis for basic local exchange rates, should be rejected. In Buffalo Valley, three RLECs, who are also parties to this case, appealed a Commission Order denying them the opportunity to obtain funds from the PA USF they claimed they were allowed to recover pursuant to their respective annual inflation-based Price Stability Mechanism filings contained in their Chapter 30 plans. The RLECs had argued that such support was an appropriate use of the PA USF to ensure that their rural rates were reasonably comparable to urban rates and relied on Section 254(b) of TA-96 in making such an argument. In affirming the Commission's decision, the Commonwealth Court noted the Commission's argument that this federal law "has no bearing on a rural ILEC's receipt of monies from the PA USF."²³

This decision, however, is distinguishable from the issues in this investigation. In Buffalo Valley, the RLECs sought PA USF funds for their *inflation-based annual rate*

²² Buffalo Valley Telephone Company, et al. v. Pa. P.U.C., 990 A.2d 67 (Cmwlth Ct. 2009).

²³ Id., 990 A.2d at 86.

increases. The issue in this investigation is how to reduce *intrastate access rates* while maintaining just, reasonable and affordable basic local service rates. This is exactly what the Commission argued in Buffalo Valley case that the PA USF is supposed to be used for. The ALJ's reliance on Buffalo Valley in rejecting the use of a comparability standard in this case is inapposite. Section 254(b) provides a reasonable guide for the establishment of just and reasonable basic local service rates when rebalancing intrastate access rates, as evidenced by its usage by numerous other state commissions as discussed above.

Second, the Commission should reject the ALJ's concern that Verizon's rates are not an appropriate benchmark because they are subject to modification in the pending Verizon access charge proceeding.²⁴ Verizon's basic local exchange rates change on an annual basis pursuant to their Commission-approved Chapter 30 plan. This is in addition to any changes that may be ordered by the Commission as part of its investigation of Verizon's intrastate access rates. The OCA's plan recognizes such changes and easily accommodates any changes to the Verizon basic service rate as a simple mathematical equation. In fact, telecommunications service providers' contributions to the PA USF also change on an annual basis pursuant to the PA USF regulations.²⁵ Therefore, it is unreasonable to reject the use of Verizon rates for comparability purposes because they are currently under investigation. The fact that Verizon's basic local exchange rates may change should not deter the Commission from adopting a comparability standard for RLEC basic local exchange rates based on the Verizon basic local exchange rate.

Additionally, the ALJ rejects the use of Verizon's rates as an appropriate benchmark since the \$14.25 weighted average Verizon rate includes density cells which are not urban. R.D.

²⁴ See, AT&T Communications of Pennsylvania, Inc. v. Verizon North, Inc. and Verizon Pennsylvania, Inc., Docket No. C-20027195.

²⁵ 52 Pa. Code § 63.169.

at 115. The OCA used the average of all Verizon rates because that Company serves the great majority of customers across the Commonwealth, including all of the major urban areas. Even if the ALJ wished to consider only Verizon's urban rates as the baseline, however, that is not a basis for rejecting the need for a comparability analysis altogether.

4. Conclusion.

The ALJ erred by establishing a benchmark level for basic local exchange services that fails to incorporate a comparability analysis in addition to an affordability analysis. Substantial state and federal law support the use of a comparability analysis when setting the RLECs' basic local exchange rates. The RLECs' basic local exchange rates should not exceed 120% of the Verizon weighted average rate, as discussed in the OCA's comprehensive proposal. The ALJ's Recommended Decision should be modified to ensure that the RLEC basic local exchange rates are both affordable and comparable.

OCA Exception No. 2 – The ALJ's Recommended Decision Regarding The Affordable Rate Should Be Clarified On Two Points. (R.D. at 115-116).

1. Introduction.

In her Recommended Decision, the ALJ correctly recognizes the importance of the OCA's affordability analysis. The ALJ states: "I recommend that the Commission use the OCA affordability rate of \$23.00 (net of taxes and other fees) and \$32.00 on a total bill basis for analyzing the affordability of local service rates that are rebalanced as a result of this investigation." R.D. at 116. The ALJ correctly noted that the affordability analysis presented by

the OCA is the only record evidence on affordability in this investigation or the portion of the investigation conducted by ALJ Susan D. Colwell. R.D. at 115.²⁶

The OCA supports the ALJ's recommendation to adopt the OCA affordability analysis, but submits that the ALJ's Recommended Decision is unclear on two points. First, the ALJ did not affirmatively state in her Recommended Decision that the affordable rate should not be exceeded and that any additional amounts beyond the affordable rate required to offset reductions in the RLECs' intrastate access rates should come from the PA USF. Second, the ALJ does not clearly recognize that the individual line items on the basic local telephone bill can, and do, change. Thus, the affordable rate for basic local service, which the ALJ identifies as \$23.00, may change over time. The Commission should clarify these points by specifically stating in its Order that the RLECs' basic local exchange rate cannot exceed the affordability rate and that the affordability rate should be periodically refreshed to address changes in the taxes, fees and surcharges required to receive basic local telephone service, as well as changes in Pennsylvania rural median household income.

2. As Affordability Is A Fundamental Keystone Of Pennsylvania Telecommunications Regulation The Recommended Decision Must Be Clarified To State That The Affordable Rate Cannot Be Exceeded.

In 1993, the Pennsylvania General Assembly made clear in its landmark revisions to Pennsylvania telecommunication law that, even while promoting the competitive provision of local telephone service, competition was not to be promoted at the expense of universal service. In the original Chapter 30 legislation (Act 67 of 1993), since replaced by the new Chapter 30 (Act 183 of 2004), the very first line of that Act declared that:

§ 3001. Declaration of Policy.

²⁶ The evidentiary record in the portion of the proceeding conducted by ALJ Colwell was specifically incorporated into the record of this proceeding by ALJ Melillo. Tr. 270.

The General Assembly finds and declares that it is the policy of this Commonwealth to:

(1) Maintain universal telecommunications service at *affordable* rates²⁷

When Chapter 30 was re-enacted in 2004, the universal service provision contained in the original Section 3001(1) was recodified in Section 3011(2). Section 3011(2) provides:

§ 3011. Declaration of Policy.

The General Assembly finds and declares that it is the policy of this Commonwealth to:

(2) Maintain universal telecommunications service at *affordable* rates²⁸

As a result, affordability is a fundamental guideline that must be recognized when setting basic local exchange service rates in order to maintain universal telephone service at just and reasonable rates.

The Commission has recognized the need to take steps to maintain affordable telephone service – particularly in rural areas – as competitive pressures in other areas could create pressure to increase rates where there previously were no such competitive pressures. As a result, in the 1999 Global Order, the Commission established the PA USF.²⁹ The PA USF was designed to keep rural rates affordable and comparable to urban rates as reductions in access

²⁷ 66 Pa. C.S. § 3001(1)(emphasis added).

²⁸ 66 Pa. C.S. § 3011(2)(emphasis added). The re-enacted Chapter 30 of the Public Utility Code also requires telephone companies to: “(3) Ensure that customers pay only reasonable charges for protected services which shall be available on a nondiscriminatory basis.” 66 Pa. C.S. §§ 3011(3). “Protected service” includes, among other things, “service provided to residential or business consumers that is necessary to complete a local exchange call.” 66 Pa. C.S. § 3012.

²⁹ 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).

charges were implemented. The Commonwealth Court explicitly affirmed the creation of the PA USF when affirming the Global Order in its entirety by noting “the concern has always been to provide public service in telecommunications with affordability and reasonable uniformity in services and costs.”³⁰

Universal telephone service principles have also been at the foundation of our Nation’s telecommunications policy since the passage of the Federal Communications Act of 1934.

Section 151, for example, provides in pertinent part:

Purposes of Act; Federal Communications Commission created. For the purpose of regulating interstate and foreign commerce in communication by wire and radio *so as to make available, so far as possible, to all the people of the United States,* a rapid, efficient, nationwide, and world-wide wire and radio communication service with adequate facilities at reasonable charges...³¹

Since that time, it has been the policy of the United States to ensure that as many Americans as possible have access to affordable telephone service.

Federal law has been especially concerned about the high cost to provide telephone service to rural areas due to the geographic character of these areas. In 1996, Congress enacted TA-96 to, in part, provide greater statutory guidance on universal service funding for “high cost” customers in rural areas as well as for low-income customers.³² Subsequently, federal law established a Universal Service Fund through which “high cost” rural and insular regions of the Nation can receive support for their basic service from other interstate customers.³³ The concept

³⁰ Global Order Appeal, 763 A.2d at 492-93.

³¹ 47 U.S.C. § 151 (emphasis added).

³² 47 U.S.C. § 254(b)(3).

³³ In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45, 12 FCC Rcd. 8776, 1997 WL 236383 (rel. May 8, 1997) (“1997 FCC Order”).

of affordability is also important in Section 254 of TA-96 where Congress articulated as a universal service principle that “quality services should be available at just, reasonable and affordable rates.”³⁴

The ALJ correctly notes that the only evidence of record on affordability in this proceeding is the testimony of OCA witness Roger Colton provided in the portion of the investigation conducted by ALJ Colwell. Dr. Loube relied on the OCA affordability analysis presented by Roger Colton in preparing his comprehensive proposal presented in this proceeding. OCA St. 1 at 21. Dr. Loube noted that affordability of local service depends on the relationship between the overall local bill and median family income, i.e., the ability to pay. *Id.*

In light of this significant statutory and regulatory precedent at both state and federal levels, the ALJ was correct to specifically recommend that the OCA affordability analysis be adopted in this proceeding. Such recommendation, however, must be modified or clarified to affirmatively state that basic local exchange customers should not be charged more than the affordable rate and that any excess above that level must be paid from the PA USF.

3. The Affordability Constraint Must Be Periodically Refreshed To Recognize That Line Items On A Bill For Basic Local Exchange Service, As Well As Rural Median Household Income, Can, And Do, Change.

The ALJ adopted the OCA’s affordability analysis and concluded that the affordable rate for basic local service was \$23.00. The ALJ’s recommendation to adopt the OCA’s affordability analysis does not clearly recognize, however, that the individual line items that are required to be

³⁴ 47 U.S.C. § 254(b)(1). The FCC stated in its implementation of Section 254(b)(1) of TA-96 that the concept of affordability has two components: (1) an absolute component and (2) a relative component. 1997 FCC Order at ¶ 110. In the 1997 FCC Order, the FCC referenced the use of a percentage of income standard in assessing the relative component of affordability of telephone service. *Id.* Examining the “relative component” of affordability, however, the FCC said, “takes into account whether consumers are spending a *disproportionate amount of their income* on telephone service.” *Id.* (emphasis added). The FCC noted that “subscribership levels do not reveal whether consumers are spending a *disproportionate amount of income* on telecommunications services.” *Id.* (emphasis added).

paid in order to obtain basic local service can, and do, change. This includes the Subscriber Line Charge (“SLC”) and various other state and federal taxes, fees and surcharges. This critical element was not addressed by the ALJ. To properly implement the affordability constraint, the affordable rate will need to be periodically refreshed.

In her Recommended Decision, the ALJ notes that “the only affordability analysis provided of record was Mr. Colton’s in the ALJ Colwell portion of the proceeding.” R.D. at 115; *citing*, OCA St. 2 (Colwell) at 20. The ALJ then notes the specific requirements in Chapter 30, as recognized by the Commission, to ensure that local service rates be reasonable and affordable and recommends:

that the Commission use the OCA affordability rate of \$23.00 (net of taxes and other fees) and \$32.00 on a total bill basis for analyzing the affordability of local service rates that are rebalanced as a result of this Investigation. This rate would increase if the Pennsylvania median rural household income increases over time.

R.D. at 116. The ALJ’s recommendation does not fully recognize, however, how taxes, fees and surcharges impact the affordability of the local telephone bill.

As Mr. Colton testified in the proceeding before ALJ Colwell, overall affordability can be measured in a relative sense by examining the burden which those costs impose on a household as a percentage of income. OCA St. 2 (Colwell) at 12. In noting the need for affordable basic local exchange service in order to maintain universal telecommunications service in rural and high cost areas of Pennsylvania, Mr. Colton testified that, to be affordable, “the overall local telephone bill for Pennsylvania rural customers should be no higher than 0.75% (three-quarters of one percent) of the Pennsylvania rural median household income.” *Id.* at 20. Mr. Colton added “that number is currently \$31.00 but this level must cover not only the basic monthly rate discussed above, but all the Subscriber Line Charge (SLC) and all applicable

taxes, fees and surcharges that are required to obtain basic local exchange service.” *Id.* at 25.³⁵ As part of his analysis, Mr. Colton examined bills provided by the RLECs in discovery that include “all such items that a customer has to pay in order to obtain basic local service.” *Id.* at 26. Mr. Colton then subtracted the various charges identified in the discovery responses from the \$32.00 affordable overall local telephone bill to determine a \$23.00 affordable basic local exchange rate. *See*, OCA Exh. RL-6. Such charges include the SLC, the E-911 charge, the federal universal service charge, the PA relay charge and any other unavoidable local charges. Therefore, the OCA affordability constraint must be periodically refreshed to recognize that the line items on a bill for basic local exchange service, as well as rural median household income, can, and do, change.

For example, it should be noted that the federal SLC is currently \$6.50 for most of the RLECs. OCA Exh. RL-6.³⁶ This charge is included in the taxes and fees that a customer is required to pay in order to obtain basic local exchange service. The federal SLC, however, may increase as a result of the FCC’s current intercarrier compensation proceeding.³⁷ In fact, some parties to this proceeding, have advocated for an increase in the SLC in that FCC proceeding to as high as \$10.00.³⁸ If the FCC increases the SLC from \$6.50 to \$10.00, this must be taken into account in determining the affordable basic local exchange rate.

In addition, and as the ALJ acknowledged, the affordability analysis presented in the OCA comprehensive proposal must be periodically adjusted based on changes in the

³⁵ The \$31.00 figure was subsequently increased to \$32.00 by Mr. Colton during the evidentiary hearing conducted by ALJ Colwell. Tr. 131-132 (Colwell).

³⁶ The Embarq SLC is \$4.86 and the Windstream SLC is \$6.30. OCA Exh. RL-6.

³⁷ In the Matter of Developing a Unified Intercarrier Compensation Regime, CC Docket No. 01-92, FCC-05-33, Further Notice of Proposed Rulemaking (rel. March 3, 2005).

³⁸ *See*, Missoula Plan Workshop, Docket No. M-00061972, Presentation of AT&T, *et al.*, (Sept 11, 2006) at 10.

Pennsylvania rural median household income. To the extent that Pennsylvania rural median household income increases or decreases, the affordable rate increases or decreases as well. Therefore, the amount by which the RLECs can increase their basic local exchange rate to offset reductions in intrastate access rates will change as the Pennsylvania rural median household income changes.

The Commission should clarify that the affordable rate of \$23.00 presented by the ALJ based on the OCA's affordability analysis will need to be periodically refreshed to reflect changes in taxes, fees, surcharges and Pennsylvania rural median household income.

4. Conclusion.

The Commission should adopt the OCA's affordability analysis, as the ALJ recommends. In doing so, however, the Commission should also affirmatively state that the affordable rate to RLEC consumers is not to be exceeded, and that any additional charges must come from the PA USF. The Commission should also clarify that the affordable rate will need to be periodically refreshed to reflect changes to taxes, fees, surcharges as well as the Pennsylvania median rural household income.

OCA Exception No. 3 – The ALJ's Determination That Access Reductions Should Be Offset Without Additional Funding From The Pennsylvania Universal Service Fund Is Premature. (R.D. at 34, 44, 131-133; OCA M.B. at 17, 20-22; OCA R.B. at 4-5).

1. Introduction.

In her Recommended Decision, the ALJ recommended that "access reductions and associated revenue neutral rebalancing, be phased-in without additional PA USF funding at this time." R.D. at 131. The OCA submits that the ALJ's recommendation is premature. Instead,

details regarding the specific use, structure and size of the PA USF should be resolved in the further proceeding recommended by ALJ Colwell.

Under the plan recommended by ALJ Melillo, details regarding the PA USF need not be determined until after the RLECs have completed the first stage of access reductions and offsetting increases in basic local exchange rates. The OCA would acknowledge that the first step of access reductions (up to the \$18.00 proposal by the ALJ or the \$17.09 proposal by the OCA) can be offset by non-competitive service rate increases. The ALJ, however, would allow up to four years for some RLECs to reduce their intrastate access rates to their interstate levels. As a result, the issue of whether the PA USF should be used to offset the later year reductions in intrastate access rates need not be finally determined at this time. Specifically, the Commission could adopt the ALJ's proposal to increase basic local service rates to \$18.00 (or the OCA's proposal to increase basic local service rates to \$17.09) without having to address the issue of whether *additional* access reductions should be funded from increases in basic local service rates or from the PA USF. That issue can be decided in the investigation into the size and scope of the PA USF recommended by ALJ Colwell. As a result, the ALJ's determination to not expand the PA USF to offset reductions in intrastate access rates in future years is premature.

Nonetheless, if the Commission determines to address the use of additional PA USF funding in this proceeding, the OCA submits that the ALJ recommendation must be modified as discussed further below.

2. The Pennsylvania Universal Service Fund Should Be Used To Offset Reductions In Intrastate Access Rates While Keeping Other Rates For Telecommunications Services Comparable And Affordable.

Using the PA USF to offset reductions in the RLEC intrastate access rates is consistent with the goals and objectives of the PA USF. The Commission's regulations creating the PA

USF specifically provide: “the purpose of the Fund is to maintain the affordability of local service rates for end-user customers while allowing rural telephone companies to reduce access charges and intraLATA toll rates, on a revenue-neutral basis, thereby encouraging greater competition.”³⁹ In prohibiting the possible expansion of the PA USF to offset further intrastate access rate reductions, the ALJ’s recommendation is inconsistent with this explicit statement of purpose and policy of the PA USF.

As noted above, the Commonwealth Court affirmed the Commission’s position regarding the use of the PA USF for the purpose of offsetting intrastate access rate reductions in the Buffalo Valley decision, *supra*. In affirming the Commission’s decision to prohibit three RLECs from using the PA USF to recover revenue above the rate cap that they were allowed to recover pursuant to their respective inflation-based Price Stability Mechanisms contained in their Chapter 30 plans, the Commonwealth Court noted that the PA USF is to be used to offset reductions in intrastate access rates. The Commonwealth Court stated:

Again, this Court defers to the Commission’s interpretation of its own regulations and prior orders. According to the Global Order the PA USF was created to fund rate increases *“tied to access or toll rate reductions.”* The Commission was keenly aware of the purpose for which the PA USF was established, the policy reasons for the PA USF and its limitations. The issue of whether to expand the current PA USF to include reimbursement for increased revenues is presently pending before the Office of Administrative Law Judge at the Commission. The Commission’s rejection of Petitioners’ arguments was based on its conclusion that the PA USF was available only in the limited situation where a carrier rebalanced revenues by reducing access rates. The Commission’s conclusion is supported by the express terms of the Global Order which make no mention that the fund was ever intended to subsidize annual alternative revenue increases. Given the language of the regulations, the Global Order, and the Commission’s pending investigation, this Court concludes that the Commission’s

³⁹ 52 Pa. Code § 63.161(3).

refusal to reimburse Petitioners from the PA USF for rate increases above the \$18 rate cap was not clearly erroneous.⁴⁰

In contrast, however, in her Recommended Decision, the ALJ would appear to prohibit the use of the PA USF to offset any further reductions in the RLECs' intrastate access rates – a use that the regulations, the Commission, and the Commonwealth Court specifically allow. Instead, the ALJ requires that such revenue come from increases to noncompetitive rates.⁴¹ The Commission should not accept the ALJ's recommendation to reduce the RLEC intrastate access rates to interstate levels without considering any additional funding from the PA USF.

Using the PA USF to offset further reductions in access charges is consistent with the universal service process at the federal level. In its major orders reducing the federal carrier common line access charges, the reductions in access charges were replaced by increases in universal service support. For example, the FCC established two universal service mechanisms in those orders to help replace the revenue associated with elimination of the federal carrier common line charge ("CCLC"). OCA M.B. at 22; *citing*, OCA St. 1 at 49-50; *see also*, OCA Exh. RL-9. Those mechanisms are the Interstate Access Support ("IAS") and the Interstate Common Line Support ("ICLS"). Dr. Loube noted that the total common line support the RLECs receive from the ICLS and the IAS in Pennsylvania is \$35.5 million. *Id.*⁴² Thus, the

⁴⁰ *Buffalo Valley*, 990 A.2d at 83 (emphasis in original).

⁴¹ While the ALJ has determined that such revenue be recovered from "noncompetitive rates," the focus in her recommendation is that such revenue be recovered from basic local exchange rates.

⁴² The IAS mechanism for price cap carriers is a fund that is disaggregated by carriers' unbundled network element ("UNE") zones and customer type. OCA St. 1 at 51. Eight of 10 Pennsylvania price cap carriers receive IAS support for a total of \$20.2 million, including \$8.6 million to Verizon Pennsylvania, the largest recipient. *Id.*; *see also*, OCA Exh. RL-10. The ICLS mechanism for rate of return carriers provides each carrier with the difference between the carrier's interstate common line revenue and interstate common line revenue requirement and guarantees a specified return on the common line portion of the carrier's interstate revenue requirement. *Id.* at 51-52. All 26 of Pennsylvania's interstate rate-of-return carriers receive ICLS support for a total annual amount of \$30.1 million. *Id.* at 52. On a per-line basis, the range of support varies from \$1.04 to \$37.38 per month. *Id.*; *see also*, OCA Exh. RL-11.

FCC provided a competitively neutral and explicit approach by increasing both universal service funding and end-user charges. The FCC did not reduce interstate access rates without also ensuring a replacement universal service mechanism. This Commission must do the same.

As such, the OCA submits that, once a basic local exchange rate that meets both the comparability standard and the affordability constraint are determined, any additional amount above that rate that is still required to reduce the RLECs intrastate access rates to their interstate levels should come from the PA USF.

3. The Commission Should Consider The Expansion Of The Base Of Contributors To The Pennsylvania Universal Service Fund In The Separate Rulemaking Proceeding Recommended By ALJ Colwell.

To minimize the impact on current PA USF contributors of using the PA USF to offset further reductions in intrastate access rates, the Commission should consider enlarging the base of contributors to the PA USF to include any service provider that uses the public switched telephone network (“PSTN”) at any point in providing their service. OCA M.B. at 20-21.

The OCA recognizes that the Commission specifically precluded any determination regarding the base of contributors to the PA USF from discussion in this portion of the investigation.⁴³ The Commission, however, also specifically precluded this issue from the portion of the investigation that was conducted by ALJ Colwell.⁴⁴ If the Commission conducts the investigation of the PA USF recommended by ALJ Colwell, the Commission should give the parties an opportunity to fully discuss and develop the issue of whether the base of contributors to the PA USF should be expanded since it is a necessary element of universal service reform.

⁴³ Investigation Regarding Intrastate Access Charges and IntraLATA Toll Rates of Rural Carriers and the Pennsylvania Universal Service Fund, Docket No. I-00040105, Opinion and Order (entered December 10, 2009) at 23-24.

⁴⁴ Investigation Regarding Intrastate Access Charges and IntraLATA Toll Rates of Rural Carriers and the Pennsylvania Universal Service Fund, Docket No. I-00040105, Order (entered October 9, 2008) at 3.

The Commission need not make this decision now but, under ALJ Melillo's recommendation, has two to four years to conduct a separate rulemaking proceeding to determine the appropriate base of contributors to the PA USF since her plan recommends phased reductions in intrastate access rates over a two to four year period.

If the base of contributors to the PA USF is enlarged, however, it is clear that the ALJ's Finding of Fact #84 would not be correct. In Finding of Fact #84, the ALJ finds that "under the OCA proposal, the Verizon ILECs would have a net PA USF funding increase of \$27 million in addition to the \$17.2 million they already pay annually." R.D. at 44; *see also*, R.D. at 133. If the base of contributors to the PA USF is enlarged to include all service providers that use the PSTN at any point in providing their service, however, Verizon's initial additional PA USF contribution would only be \$2 million, not \$27 million. *See*, OCA St. 1 at 17. The ALJ's Finding of Fact #84 fails to recognize that if the Commission expands the base of contributors to the PA USF, as many other states have done, the burden on the Verizon ILEC and other current contributors to the PA USF would be substantially reduced. *See*, OCA M.B. at 20-21. The OCA recommends, however, that the Commission address this issue in the subsequent proceeding proposed by ALJ Colwell in order to ensure a comprehensive resolution to issues pertaining to access charges, local service rates and the PA USF.

As such, the Commission should consider expansion of the base of contributors to the PA USF in a separate proceeding.

4. Using The PA USF To Offset A Portion Of The Reductions In Intrastate Access Charges Recognizes That All Users Of The Public Switched Telephone Network Should Pay Their Share Of The Joint And Common Costs Of That Network.

The ALJ's recommendation to reduce the RLECs' intrastate access rates without additional support from the PA USF fails to recognize that all users of the PSTN should

contribute to pay their share of the joint and common costs of the network. The ALJ's recommendation is consistent with the position of some parties to this proceeding that advocated that the access revenue reductions should be offset solely with increases to retail end-user customers. *See e.g.*, Verizon M.B. at 28-40. The ALJ's recommendation should be rejected.

OCA witness Dr. Loube demonstrated why such positions are without merit and should be rejected. As noted by Dr. Loube:

My concern is that Mr. Price's insistence on recovering access revenue reductions from retail end-user customers is based on the false premise that carriers should obtain all of their revenue from their retail customers. Wholesale customers are also customers of the company. When Verizon provides long distance services to customers of the RLECs, every call that is transported over Verizon's long distance network terminates or originates on RLEC loop facilities. Thus, wholesale customers, such as Verizon's long distance network, consume the services provided by the facilities and equipment of every carrier, and wholesale customers should not be provided with a free-ride on those facilities and equipment.

OCA St. 1-S at 5.

Dr. Loube further added:

The local loop provides multiple services such as access to long-distance carriers, Internet data services and in some instances video services. Thus, the entire loop expense is not incurred solely to provide local service. It has been incurred to provide the multitude of services that it provides and cost recovery is the responsibility of all of those services.

Id. at 21. This principle has been recognized as far back as the United States Supreme Court decision Smith v. Illinois Bell Telephone Co.,⁴⁵ and affirmed by the FCC and this Commission

⁴⁵ Smith v. Illinois Bell Telephone Co., 282 U.S. 133 (1930).

numerous times.⁴⁶ These principles require all users of the PSTN to pay their fair share of the joint and common costs of that network.

The joint and common network plant generally consists of the plant outside customers' homes that connects each customer to a telephone company's central office. As Dr. Loubé testified:

The plant consists of cables and wires, poles, trenches and conduit, and electronic equipment that is situated in the field. This plant is used to provide all of the services the customer wishes to consume and all of the services that other carriers wish to provide. This plant allows the customer to make a local call and it also allows a long distance carrier or a wireless carrier to complete a call. This plant is not directly assignable to any one service, such as access or local exchange or data transport service. None of those services, however, can be provided without this plant.

OCA M.B. at 1; *see also*, OCA St. 1 at 3. Revenue to pay for the joint and common network is obtained from local and access rates, as well as state and federal universal service funds.

All users of the PSTN should support the network. Such support is necessary for the maintenance and enhancement of the PSTN. If IXC's did not contribute to supporting their share of the PSTN by paying just and reasonable intrastate access rates, then placing the entire burden to support the PSTN on basic local exchange services would cause those rates to become unjust, unreasonable and unaffordable. As OCA witness Dr. Loubé testified, the OCA is recommending the elimination of the carrier common line charge ("CCLC") paid by IXC's "in order to create greater fairness among the carriers that interconnect with the RLECs. Eliminating the carrier charge creates greater fairness because not all long distance carriers pay it." OCA St. 1 at 11-

⁴⁶ *See e.g.*, Verizon Pennsylvania, Inc. et al. v. CTSI, LLC, et al., Motion of Vice Chairman James H. Cawley, Docket Nos. C-20077332 and C-20066987, August 7, 2008 at 3.

12.⁴⁷ Dr. Loubé added, however, that it would be unfair to eliminate the state CCLC without adopting other portions of the OCA proposal that ensured that all parties who use the PSTN continue to support it. As stated by Dr. Loubé:

If the Commission does not adopt the entire package, then the result of eliminating the state carrier common line charge would be extremely harmful to RLECs and their residential customers because of the lost revenue from service providers that also use the local loop. The RLECs would be left with the choice of either financial insolvency or of establishing rates that are so high that they are not just, not reasonable and not affordable. That choice cannot be considered to be in the public interest.

Id. at 12. As such, Dr. Loubé recognized the vital role that the current level of intrastate access rates play in maintaining and enhancing the PSTN and ensuring the universal provision of telecommunications service at affordable rates. While the OCA supports reducing the RLECs intrastate access rates to their interstate levels, all users of the PSTN must still pay their share of the joint and common costs of that network. The best way to do this in a competitively neutral manner is through the PA USF.

The RLECs' current intrastate access rates require all users of the PSTN to pay for their use of the joint and common costs of the network. If the Commission determines to reduce the RLECs' intrastate access rates, however, the Commission should do so only in a manner that requires all users to pay a reasonable share of those costs rather than imposing all those costs on non-competitive basic exchange rates.

⁴⁷ Dr. Loubé noted that "the current system is inequitable and subject to regulatory arbitrage" but that the Commission does not have the authority to establish the first best just and reasonable solution to the intercarrier compensation problem which would require FCC approval. OCA St. 1 at 7-8; *see also*, OCA R.B. at 4-5. Dr. Loubé further testified that "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 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." Id. at 7. Given the high improbability that the FCC would agree to impose such a scheme for interstate rates, Dr. Loubé instead recommended the OCA comprehensive proposal. Id. at 8.

5. The ALJ's Reasons For Not Using The Pennsylvania Universal Service Fund To Offset Further Reductions In Intrastate Access Rates Should Be Rejected.

a. Introduction.

The ALJ's determination not to expand the PA USF to help offset reductions in the RLECs' intrastate access charges is based on several incorrect determinations. The OCA submits that, contrary to the ALJ's recommendation, the PA USF should be used to offset reductions in the RLECs intrastate access rates.

b. The Commission must consider the unique nature of telecommunications service among other utility services.

The ALJ sets forth her primary reason for her recommendation as follows: "the principal reason why I am not recommending PA USF expansion is the compelling record 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." R.D. at 132. This concern, however, fails to consider the unique nature of telecommunications services among other utility services. That is, customers of Verizon receive more value in their telephone service if they can call, and be called by, rural customers of the RLECs. Moreover, the more customers that have access to basic local exchange services, the more customers that the IXCs can sell their interexchange services to. Therefore, there is no compelling evidence of any negative impact on Verizon's customers if Verizon is required to continue to contribute to the PA USF to offset further reductions in the RLECs intrastate access rates. As noted above, the impact on Verizon customers that the ALJ fears would only occur if the Commission expands the size of the PA USF without also expanding the base of contributors to the PA USF as has been done in other states.⁴⁸

⁴⁸ Dr. Loube testified that 14 of 21 states that currently have state universal service funds require wireless carriers to contribute to those funds. OCA St. 1 at 18 (citations omitted).

c. Interstate access rates do not support the costs of the local network.

In supporting her position not to expand the PA USF, the ALJ states that “the RLECs’ interstate rates required to be mirrored herein do provide a contribution to the joint and common costs of the network and therefore, IXC’s will continue to support that network, albeit at a lower level.” R.D. at 133. This statement is not accurate. Interstate access rates recover costs assigned to traffic sensitive functions of the network and a return on the investments needed to provide traffic sensitive functions.⁴⁹ There are no joint and common loop facilities or expenses assigned to those access functions.⁵⁰ Therefore, interstate access rates do not help recover the joint and common costs of the PSTN, and placing 100% of the burden to reduce the RLECs intrastate access rates to their interstate levels on basic exchange rates is not reasonable.

d. It is unreasonable to allow IXC’s to pay zero toward any further reduction in intrastate access rates.

The ALJ determined in her Recommended Decision that the IXC’s should pay *nothing* with regard to their usage when reducing the RLECs’ intrastate access rates in a revenue neutral manner. The ALJ has determined instead that 100% of the intrastate access rate reductions should be made revenue neutral through increases to noncompetitive rates. The ALJ has not required the IXC’s to contribute anything to offset her suggested intrastate access rate reductions. A zero payment by the IXC’s and other users of the PSTN cannot be considered reasonable.

In fact, the ALJ’s conclusion contradicts the ALJ’s Finding of Fact #15 which states that “it is inequitable to impose a disproportionate subsidy burden on one industry segment.” R.D. at 34; *citing*, OCA St. No. 1; Tr. 478. Yet, the ALJ’s recommendation creates just such an inequity

⁴⁹ In the Matter of Federal-State Joint Board on Universal Service, CC Docket 96-45, FCC 01-304, Fifteenth Report and Order, (rel. Nov. 8, 2001).

⁵⁰ Id. at ¶¶ 61-68.

by requiring 100% of the intrastate access rate reductions to be recovered from noncompetitive rates. The burden to offset the RLEC intrastate access rate reductions should be shared across all users of the PSTN, not just basic local exchange customers. Again, the best way to do this on a competitively neutral basis is through the PA USF. The Commission cannot find that it is inequitable to impose a disproportionate subsidy burden on one industry segment and then require 100% of the revenue needed to offset intrastate access rate reductions to come from RLECs' noncompetitive basic service rates.

6. Conclusion.

The ALJ's determination not to allow use of the PA USF to offset further reductions in intrastate access rates is premature. The purpose of the PA USF is to offset reductions in intrastate access rates in a manner that is competitively neutral and that helps to preserve universal service. Using the PA USF to offset reductions in intrastate access rates will ensure that all users of the PSTN pay their portion of the joint and common cost of the network. The ALJ's recommendation to the contrary should be rejected.

OCA Exception No. 4 – The ALJ's Recommendation To "Abolish" The \$18.00 Residential Rate Cap Should Be Rejected Or Clarified. (R.D. at 116-118).

In her Recommended Decision, the ALJ states that the \$18.00 cap on residential basic local exchange rates should be "abolished" for rebalancing purposes. R.D. at 118. The OCA submits that, while it arguably might be appropriate, under certain circumstances, to increase the \$18.00 rate cap over time to the \$23.00 affordability level recommended by the ALJ, it would certainly be incorrect for the Commission to "abolish" the rate cap altogether. In fact, when read in its entirety, it appears that the ALJ is effectively replacing the \$18.00 rate cap with a \$23.00

affordability constraint. The OCA agrees that the Commission can raise the \$18.00 cap but the concept of a cap or a constraint should not be abolished.

The basic local service residential rate cap is an important consumer protection for users of basic local exchange service for rural Pennsylvania telephone companies. The Commission originally established a cap for basic local exchange rates as part of its Global Order, *supra*, which the Commonwealth Court approved in its entirety on appeal. In the Global Order, the Commission determined:

we conclude that as to all [rural] ILECs, a rate ceiling will be implemented which caps the one-party residential local rates of each such ILEC, including charges for dial-tone, touchtone, and local usage, at \$16.00 per month until December 31, 2003. As set forth below, if such ILEC's one-party residential rate is above \$16.00 per month, and is found to be just and reasonable by the Commission, the revenue associated with the difference between the rate ceiling and the approved rate will be recovered from the Pennsylvania USF.⁵¹

The Commission recognized when discussing the rate cap that the "USF, as presently constructed, will operate to eventually reduce customer bills."⁵² The Commonwealth Court specifically recognized, when affirming the Global Order that "the concern has always been to provide public service in telecommunications with affordability and reasonable uniformity in services and costs."⁵³

As a result, in the Global Order, the Commission adopted the proposal of the rural telephone companies that rural companies with average monthly residential basic local service rates above \$16.00 will receive a Universal Service credit in an amount that will effectively

⁵¹ Global Order at 263.

⁵² Id. at 264.

⁵³ Global Order Appeal, 763 A.2d at 492.

reduce the rate actually paid by customers to \$16.00.⁵⁴ Similarly, business rates were given a proportionate credit.⁵⁵

In 2003, the \$16.00 rate cap was increased to \$18.00 pursuant to a settlement of the parties to a generic proceeding investigating the rural telephone companies' intrastate access charges.⁵⁶ In that proceeding, the Commission again affirmed 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 same terms and conditions as approved in the Global Order."⁵⁷ The Commission provided as an example that "if an ILEC could justify a residential rate of \$20.25, then it would be entitled to \$2.25 from the USF and will send a net bill to its customers of \$18.00."⁵⁸

The rate cap for rural telephone companies was also reflected in the re-enactment of Chapter 30 through Act 183 of 2004. The existence of a residential rate cap was specifically recognized by Representative Adolph, the prime sponsor of House Bill 30 which became Act 183, on the floor of the House of Representatives during the legislative debates. Representative Adolph stated that:

Finally, Mr. Speaker, as amended by the Senate, HB 30 recodifies existing section 1301 of the Public Utility Code, which states that rates shall be just and reasonable. Additionally, the legislation grandfathers rate change limitations contained in network

⁵⁴ Global Order at 204.

⁵⁵ Id., see also, Id. at 263 (establishing a \$16.00 "rate ceiling" for the rural telephone companies and requiring the revenue associated with the difference between \$16.00 rate ceiling and the approved rate to be recovered from the Pa USF).

⁵⁶ Access Charge Investigation per Global Order of September 30, 1999, Docket Nos. M-00021596, *et al.*, Order (entered July 15, 2003) (Rural Access Settlement Order).

⁵⁷ Id. at 18.

⁵⁸ Id. The Commission declared that the rate cap would be in effect for a *minimum* of three years and provided no end date. Additionally, when the Commission approved the Rural Access Settlement Order, it also determined that the PA USF will continue "beyond December 31, 2003, until a further Commission rulemaking Order determines otherwise," Rural Access Settlement at 12, thereby further ensuring this important source of funding for the RLECs.

modernization plans, *and keep in mind that there is an \$18 cap for basic telephone services.*⁵⁹

While the \$18.00 level of the rate cap was not carved in legislative stone, the principle of a cap to protect rural customers was reflected in Section 3015(g) which, as noted by Representative Adolph, “grandfathered” into law the existing protections from the previously approved Chapter 30 plans.⁶⁰

In 2005, the rate cap was subsequently re-affirmed as part of the Commission’s approval of the rural telephone companies’ Amended Chapter 30 plans filed pursuant to the passage of Act 183 in 2004.⁶¹ Those Plans provided the following consumer protection:

Pursuant to the Global Order entered September 30, 1999, the Commission instituted a transitional universal service funding mechanism, i.e., the Pennsylvania USF, with a projected termination date of December 31, 2003. During the pendency of the Pennsylvania USF, the Company retains the right to change and rebalance its intrastate rates in accordance with the [Price Stability Plan], and if such rates are found to be just and reasonable, they shall be permitted to become effective. Further, should the new rates exceed the \$16.00 monthly residential rate ceiling and applicable business rate ceiling established in the Global Order for the duration of the Pennsylvania USF, the Company is permitted to recover the revenue difference arising from application of the Global Order rate ceilings from the Pennsylvania USF. By Order entered July 15, 2003, at Docket No. M-00021596, et al., the Commission approved modifications to the Global Order including a continuation of the USF and an increase of the \$16.00 residential cap to \$18.00.⁶²

⁵⁹ Leg. Journ. Nov. 19, 2004 at 2161 (emphasis added). *See also*, Leg. Journ. Nov. 25, 2003 at 2252.

⁶⁰ 66 Pa. C.S. § 3015(g). Section 3015(g) provides: “**Rate change limitations.** -- Nothing in this chapter shall be construed to limit the requirement of section 1301 (relating to rates to be just and reasonable) that rates shall be just and reasonable. The annual rate change limitations set forth in a local exchange telecommunications company’s effective commission-approved alternative form of regulation or any other commission-approved annual rate change limitation shall remain applicable and shall be deemed just and reasonable under section 1301.” *Id.*

⁶¹ *See e.g.*, Petition for Amended Alternative Regulation and Network Modernization Plan of Conestoga Telephone and Telegraph Company, Docket No. P-00981429F1000, Order (entered June 3, 2005). The RLECs’ respective Chapter 30 Plans were admitted into the record of this proceeding by the ALJ. Tr. 688-689.

⁶² *Id.* at 18-19.

As a result, pursuant to the Global Order, the Rural Access Settlement Order and the Commission Orders approving the RLECs' Amended Chapter 30 plans, the principle of a cap on residential basic local exchange service has been established.

As discussed above, the ALJ's proposal in this proceeding is to allow increases in the basic local exchange rate to offset reductions in intrastate access rates first by increasing the basic local exchange rate to \$18.00, then by increasing the basic local exchange rate in 1/3 increments necessary beyond the \$18.00 level to reduce the RLECs' intrastate access rates to their interstate levels constrained by an affordability level of \$23.00. R.D. at 138-139.⁶³ As such, the ALJ's recommendation does not "abolish" the residential basic local exchange rate cap but increases the level of the cap. The cap is a vital consumer protection as an affordability constraint that should be maintained by the Commission as part of this proceeding. The OCA agrees that it is reasonable that a constraint should be maintained and adjusted, in reasonable increments, over time as circumstances (i.e., inflation, median income, etc.) change over time. Doing so will help maintain universal telecommunications service. The ALJ's reference to "abolish" the basic local exchange rate cap seems inconsistent with the rest of her decision.

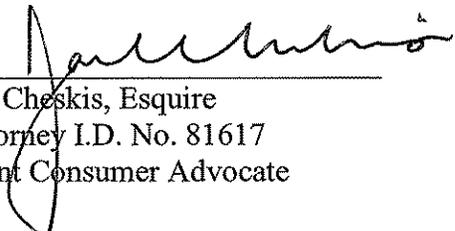
As such, the ALJ's recommendation to "abolish" the cap on residential basic local exchange service should be rejected or clarified to be consistent with the remainder of her Recommended Decision. It appears that the ALJ did not intend to abolish the rate cap in its entirety but, rather, to raise the rate cap from its current level to a level based on the OCA affordability constraint.

⁶³ As set forth in Exception No. 2, the OCA submits that the ALJ's recommendation on this point should be clarified to ensure that the \$23.00 level is a cap on residential basic local exchange rates. *See*, pages 14-17, *supra*.

III. CONCLUSION

For the reasons set forth above, and for the reasons set forth in the OCA's Main Brief and Reply Brief, the OCA respectfully submits that the ALJ erred in finding that 100% of the burden to offset reductions in the RLECs intrastate access rates should come from noncompetitive local exchange rates. Nonetheless, there are many areas of agreement or similarity between the ALJ's Recommended Decision and the OCA's proposal presented in this proceeding. For example, both the ALJ and the OCA agree that the RLECs' intrastate access rates should be reduced to their interstate level, over a "glide path," and constrained by an affordability analysis. The Commission should modify the ALJ's recommendation consistent with the discussion above to ensure that the RLECs' basic local exchange rates are both affordable and comparable to Verizon's rates. The OCA further submits that the ALJ's recommendations regarding the scope and structure of the PA USF should be addressed in the further rulemaking recommended by ALJ Colwell.

Respectfully Submitted,



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