

COMMONWEALTH OF PENNSYLVANIA



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September 17, 2010

Rosemary Chiavetta, Secretary  
PA Public Utility Commission  
Commonwealth Keystone Bldg.  
400 North Street  
P.O. Box 3265  
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

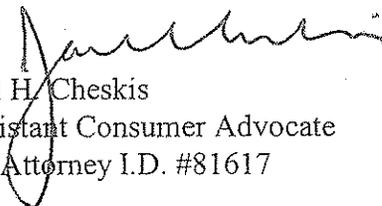
AT&T Communications of Pennsylvania,  
LLC, *et al.* v. Armstrong Telephone Company  
– Pennsylvania, *et al.*  
Docket No. C-2009-2098380 *et al.*

Dear Secretary Chiavetta:

Enclosed for filing please find the Office of Consumer Advocate's Reply 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

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 EXCEPTIONS OF THE  
OFFICE OF CONSUMER ADVOCATE

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Dated: September 17, 2010

## TABLE OF CONTENTS

I.	INTRODUCTION.....	1
II.	SUMMARY .....	5
III.	REPLY EXCEPTIONS.....	6
	OCA Reply Exception No. 1 - The ALJ’s Recommendation To Adopt \$23.00 As The Current Affordable Rate Does Not Establish A Rate That Is Too Low. (AT&T Exception No. 3, Verizon Exception No. 3, Sprint Exception No. 2; ALJ R.D. at 115-116; OCA M.B. at 17-22).....	6
1.	Introduction .....	6
2.	To Maintain Affordable Telephone Service, The Total Bill For Basic Local Exchange Service Should Be No More Than 0.75% Of Pennsylvania Rural Median Household Income .....	7
3.	The 0.75% Figure Should Be Tied To Basic Telephone Service Only, Not Total Household Expenditures On All Telecommunications Services.....	12
4.	Conclusion.....	16
	OCA Reply Exception No. 2 - The ALJ’s “Glide Path” For Reducing The RLEC Intrastate Access Rate Is Reasonable In The Absence Of Additional Support From The PA USF. (AT&T Exception No. 1; Sprint Exception No. 1; ALJ R.D. at 138-140; OCA M.B. at 17-22).....	16
	OCA Reply Exception No. 3 - The ALJ Correctly Rejected Verizon’s Proposal To Reduce The RLECs’ Intrastate Access Rates To The Level Of Verizon’s Intrastate Access Rates. (Verizon No. 1; ALJ R.D. at 90; OCA M.B. at 28-29).....	20
	OCA Reply Exception No. 4 - The ALJ Correctly Recognized That The RLECs’ Basic Local Exchange Rates Must Be Constrained. (OSBA Exception No. 3; ALJ R.D. at 116; OCA Exception at 31-35) .....	22

OCA Reply Exception No. 5 – The Commission Should Reject Any Attempt To Allow Companies' Contributions To The Pennsylvania Universal Service Fund To Be Recovered As A Line Item Surcharge. (AT&T Exc. No. 1).....24

IV. CONCLUSION .....26

## TABLE OF CITATIONS

### Cases

Bell Atlantic-Pennsylvania, Inc. v. Pa.P.U.C., 763 A.2d 440 (Pa. Cmwlth 2000), *vacated in part sub nom.*, MCI WorldCom, Inc. v. Pa.P.U.C., 844 A.2d 1239 (Pa. 2004).....23

### Statutes

47 U.S.C. § 254(b)(1) .....15

66 Pa. C.S. § 3017(a).....2

### Administrative Decisions

Access Charge Investigation per Global Order of September 30, 1999, Docket Nos. M-00021596, *et al.*, Order (entered July 15, 2003).....23

In re: Nextlink PA, 93 Pa PUC 172 (Sept. 30, 1999).....23, 25

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) ..... 15

Petition for Amended Alternative Regulation and Network Modernization Plan of Conestoga Telephone and Telegraph Company, Docket No. P-00981429F1000, Order (entered June 3, 2005).....23

### Miscellaneous

Connect America Fund, a National Broadband Plan for Our Future, FCC Docket Nos. WC 10-90, GN 09-51, WC 05-337 and FCC 10-51 ..... 19

Leg. Journ. Nov. 19, 2004 at 2161 .....23

## I. INTRODUCTION

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 rural local exchange carriers (“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.

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. More specifically, 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.

On September 2, 2010, several parties filed Exceptions to ALJ Melillo’s Recommended Decision, including AT&T, the Office of Consumer Advocate (“OCA”), the Office of Small Business Advocate (“OSBA”), the Pennsylvania Telephone Association (“PTA”), The United

Telephone Company of Pennsylvania LLC d/b/a CenturyLink (“CenturyLink”), Verizon Pennsylvania, Inc., et al. (collectively “Verizon”), Sprint Communications Company L.P., et al. (collectively “Sprint”) and Qwest Communications Company (“Qwest”). The OCA supported certain aspects of the ALJ’s decision but filed Exceptions contending that 1) the ALJ erred by recommending that basic local exchange rates can be raised without consideration of a rate comparability analysis; 2) the ALJ’s recommendation regarding an affordability constraint should be adopted, with two clarifications; 3) the ALJ’s determination to preclude additional use of the Pennsylvania Universal Service Fund (“PA USF”) to offset access reductions is premature; and 4) the ALJ’s statements regarding whether the cap on residential basic local exchange service should be continued should be clarified or rejected.

As the ALJ recognized, the challenge for the Commission is to issue a comprehensive ruling which appropriately balances the major considerations of access charges, local service rates and the PA USF “in a manner which is consistent with the law, the evidence of record and good public policy.” R.D. at 17. Access charges, local service rates and universal service funding constitute the three primary sources of revenues for the RLECs. If one source of revenues, access charges, is reduced, the lost revenue must be made up from one of the other two sources of revenues, local rates or the universal service fund, in order to maintain revenue neutrality as required by Chapter 30.<sup>1</sup>

The OCA has not opposed the reduction in intrastate access charges at this time, but the OCA would condition this reduction on a number of further actions by the Commission in this proceeding and in a future proceeding. Specifically the OCA would allow an increase in the basic local service rates for RLEC customers to offset reductions, but *only* up to the level at

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<sup>1</sup> Section 3017(a) of the Public Utility Code requires that “the commission may not require a local exchange telecommunications company to reduce access rates except on a revenue neutral basis.” 66 Pa. C.S. § 3017(a).

which RLEC rates are still *comparable* to Verizon's rates.<sup>2</sup> In OCA's view, any remaining rate increases should come from an expanded PA USF. The OCA recognizes, however, that the scope and size of the PA USF – particularly the inclusion of wireless and Voice over Internet Protocol (“VoIP”) providers as contributors to that fund – will not be decided in this case, but rather will be the subject of a further Commission rulemaking proceeding.

The ALJ recognized the difficulty of trying to offset the entire reduction in access charges through immediate and drastic increases to basic service rates. Unfortunately, the ALJ concluded – prematurely in OCA's view – that the PA USF funding should not be increased to offset access reductions. Rather, she proposed that access charges be reduced and that basic service rates be increased, over a two-to-four year “glide path” without resorting to the use of the PA USF. The ALJ also did not adopt any comparability standard, as proposed by OCA and PTA, but instead stated only that rates should be subject to the OCA's proposed affordability constraint, which is currently \$23.00.

In their Exceptions, AT&T, Verizon and Sprint generally argue that the reductions in access charges are too slow and/or that the increase in basic service charges are insufficient. For the reasons stated by the OCA and the PTA in their Briefs and Exceptions, the OCA submits that increases in basic local service rates *without* access to increases PA USF funding will be harmful to the RLECs and their customers.

The PTA has effectively demonstrated in its Exceptions why reducing the RLEC intrastate access rates with unconstrained offsetting increases to basic local exchange rates is unsound and unreasonable:

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<sup>2</sup> The OCA proposed a comparability standard of 120% of the Verizon statewide average rate, or \$17.09, while the PTA has proposed a standard of 115% of the Verizon urban rate, or \$18.94. *See*, PTA Exception at 5. The OCA further proposed that the rates for basic service be subject to an *affordability* constraint, based on a percentage of Pennsylvania rural median household income.

Currently, the RLEC territories are a mix of strong competition in more populated areas and less to (or none) in the more rural areas. The record shows that cable voice coverage is available to 58.5% of the total households in Pennsylvania on a *state-wide* basis and to a lesser degree in the RLECs' territories. Wireless service overlap is not complete in rural Pennsylvania either where "large gaps" in coverage still exist. Whether the degree of competition is 30, 40 or 50%, there are still substantial areas of Pennsylvania served by only one carrier – the PTA companies.

The dilemma is that one, unified tariffed rate is set and applied to both sectors of the RLEC's business, competitive and noncompetitive. The Commission must continue to be mindful, as it always has, of the customer who has no options, and set rates that continue to be comparable and affordable. At the same time, the rate should not be set so high that it cannot be sustained by the RLEC in the competitive areas. With little or no changes in local rates, the PTA companies have experienced a 17% decline in access lines over the last three years.

PTA Exc. at 5-6 (emphasis in original). The OCA agrees with the PTA. Reducing intrastate access rates to their interstate levels with offsetting increases to basic local exchange rates that are not reasonably constrained and without additional PA USF support would be unsound public policy and contrary to the Commission's obligations to maintain universal telecommunications service.

As such, the OCA files these Reply Exceptions in response to the Exceptions filed by AT&T, Verizon and Sprint. In particular, and as discussed further below, the OCA submits that the Commission should reject any arguments that the "glide path," or time period, in which the ALJ has directed increases in the RLECs' basic service rates be accelerated at this time. Furthermore, the OCA submits that the Commission should reject any arguments that the \$23.00 affordable rate for rural residential basic local exchange service is too low. The Commission should also reject Verizon's argument that the ALJ's plan does not reduce the RLECs' intrastate

access rates far enough. Reducing the RLECs' intrastate access rates even lower than their interstate rates would be unreasonable.

Finally, the OCA will reply, in part, to the Exceptions of the OSBA to the extent that the OSBA argues against the continuation of a rate cap for residential customers, the OCA would urge the Commission to reject that Exception as well. The OCA agrees, however, that if limits are placed on increases to rural residential basic local service rates, then concomitant and proportionate protections should be applied to rural companies' small business basic service rates as well.

## II. SUMMARY

The OCA supports certain aspects of the ALJ's recommendation for a plan to balance the major considerations of access charges, local service rates and universal service in a manner that is consistent with the law, the evidence of record and sound public policy. 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 ALJ has provided a *partial* framework for resolution of the disparate positions in this proceeding designed to promote competition and maintain universal telecommunications service while ensuring the proper recovery of the joint and common costs of the public switched telephone network.

Nonetheless, as the OCA discussed in its Exceptions, there are areas of the ALJ's Recommended Decision that must be modified by the Commission to be in the public interest. The Exceptions of some of the other parties, however, would exacerbate the concerns raised by the ALJ's framework regarding the impacts on basic local service rates of RLEC customers. In

particular, the Commission should reject any contention that a \$23.00 affordable rate is somehow too low. Furthermore, the Commission should reject arguments that the ALJ's plan provides too long a time period to implement access reductions in the absence of additional PA USF support needed to offset the access rate reductions. Finally, the Commission should reject any argument that advocates for the RLECs' intrastate access rates being reduced even lower than their interstate levels.

### III. REPLY EXCEPTIONS

OCA Reply Exception No. 1 - The ALJ's Recommendation To Adopt \$23.00 As The Current Affordable Rate Does Not Establish A Rate That Is Too Low. (AT&T Exception No. 3, Verizon Exception No. 3, Sprint Exception No. 2; ALJ R.D. at 115-116; OCA M.B. at 17-22).

1. Introduction.

In their Exceptions, AT&T, Verizon and Sprint criticize the ALJ's recommendation to adopt the OCA's affordability analysis presented by Roger Colton in the portion of the investigation conducted by ALJ Colwell. The OCA was the only party to present an analysis of rate affordability in either the portion of the investigation conducted by ALJ Colwell or the portion conducted by ALJ Melillo. The results of the OCA's affordability analysis demonstrate that the *current* basic local exchange rate for rural residential customers can be no more than \$23.00 and still meet the affordability standard.<sup>3</sup> The OCA has noted in its Exceptions, however, that the ALJ's recommendation should be modified or clarified to recognize that the affordability

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<sup>3</sup> The OCA has advocated that the affordability standard should be coupled with a comparability analysis. See, OCA Exc. at 6-13. As a result, the RLEC basic local exchange rates would increase to \$17.09 as an initial step. This figure represents 120% of the Verizon weighted average rate of \$14.25 (14.25 x 1.2 = 17.09). OCA Exh. RL-2. Similarly, the PTA has proposed a comparability standard tied to 115% of the Verizon urban rates. Such resulting comparable rate is \$18.94. PTA Exc. at 5. Under the OCA's proposal, any amount beyond the comparability analysis and the affordability analysis needed to offset reductions in the RLEC intrastate access rates would be recovered from the PA USF.

constraint should be periodically refreshed to recognize that taxes, fees and surcharges on a bill for basic local exchange service, as well as rural median household income, can, and do, change. As a result, the \$23.00 rate could, in fact, prove to be too high if taxes, fees and surcharges go up, or rural median household income goes down. The Commission, however, should reject any arguments that the current affordability level of \$23.00 established by the ALJ is somehow too low based on the record evidence.

2. To Maintain Affordable Telephone Service, The Total Bill For Basic Local Exchange Service Should Be No More Than 0.75% Of Pennsylvania Rural Median Household Income.

AT&T, Verizon and Sprint argue that the \$23.00 residential affordable rate for basic local service established by the ALJ is too low. In particular, AT&T and Verizon claim that using 0.75% of Pennsylvania rural median household income to establish the affordability constraint, which is used to determine the \$23.00 figure, is inadequate. AT&T Exc. at 36; Verizon Exc. at 6. AT&T and Verizon argue that the affordability rate should be based on 1% of Pennsylvania rural median household income, not 0.75%. As the ALJ noted in her Recommended Decision, the only affordability analysis provided of record was Mr. Colton's testimony in the portion of the proceeding conducted by ALJ Colwell.<sup>4</sup> ALJ Melillo found Mr. Colton's affordability analysis to be persuasive and reasonable. In the portion of the investigation conducted by ALJ Colwell, Mr. Colton provided substantial evidence in support of his use of 0.75% of the Pennsylvania rural median household income as the appropriate figure for determining an affordable basic local exchange rate for rural Pennsylvanians.

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<sup>4</sup> 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. References to evidence from ALJ Colwell's portion of the proceeding are recognized by "(Colwell)" in the cite.

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:

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 used two primary sources of data in his analysis: (1) the Self-Sufficiency Standard in Pennsylvania and (2) the American Chamber of Commerce Research Association (ACCRA). OCA St. 2 (Colwell) at 21. ACCRA publishes data on the relative cost of living for more than 300 metropolitan areas throughout the United States. Id. at 21. This data is used by the Center for Rural Pennsylvania, a legislative agency of the Pennsylvania General Assembly, to periodically determine the relative cost of living in Pennsylvania's rural and urban areas. Id. at 21-22. Mr. Colton testified:

My current inquiry involves a determination of the affordability of basic local telephone service. In order to obtain data on this, I need a source of data that confines its reporting exclusively to basic local telephone service (along with appurtenant fees and taxes.) The ACCRA survey explicitly limits its pricing data for "telephone service" to a "private residential line, basic local rate, fees and taxes." The technical documentation for the ACCRA survey explicitly instructs local personnel collecting data that "the price you report must include monthly base rate, the federal long distance access fee, any other mandatory monthly charges (such as

a “911” fee in many areas), the Touchtone fee, and all taxes. Don’t include *options* features such as call-forwarding and call-waiting.”

Id. at 22 (emphasis in original).<sup>5</sup>

Mr. Colton next analyzed the bills from eight different metropolitan areas in Pennsylvania (Erie, Indiana County, Johnstown, Lancaster, Philadelphia, Pittsburgh, Williamsport and York) from the ACCRA data. Id. at 23-24. Mr. Colton combined these basic local telephone bills with self-sufficiency budgets from the counties in which these communities are located. He found that a Pennsylvania household would spend between 0.75% and 1.00% of the county’s self-sufficiency budget for basic local telephone service. Id. at 23. Mr. Colton then applied this data to Pennsylvania’s rural counties specifically by identifying the 48 counties that the Center for Rural Pennsylvania identified as “rural” and, for each of these counties, using the Self-Sufficiency standard for a four-person household. Id. The calculations showed that “at a 0.75% level, the total local bills fall between \$25 and \$30 for 36 of Pennsylvania’s rural counties. At a 1.0% of income level, the total local bills fall between \$33 and \$41 for 29 of Pennsylvania’s 48 rural counties.” Id. at 24; *see also*, Schedule RDC-2 (Colwell).

First, Mr. Colton compared the results of the application of 0.75% of income standard for each county to the application of this standard to the average of county median incomes reported for Pennsylvania counties. The average of the median incomes reported for 2008 was \$50,261 for Pennsylvania’s rural counties. The 0.75% of income standard yields a total monthly local bill

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<sup>5</sup> Mr. Colton testified that ACCRA data is better than other sources of data such as the U.S. Department of Labor’s annual Consumer Expenditures Survey (CEX) because, as discussed further below, the CEX data on telephone service is not limited to basic local service but also includes telecommunications services such as mobile service, pager services, long distance charges, installation or repair of telephone line and others. OCA St. 2 (Colwell) at 23. Mr. Colton testified that the CEX data is too broad to be helpful when assessing the affordability of local telephone service. Id.

(including fees and surcharges) of \$31. Id.<sup>6</sup> Mr. Colton found that this result was consistent with the applicability of the 0.75% of income standard using the self-sufficiency budget analysis.

Second, Mr. Colton compared the results of the 0.75% of income standard to the Standard Utility Allowance (SUA) offered for local telephone service by the Pennsylvania Food Stamp program. OCA St. 2 (Colwell) at 25. Mr. Colton testified:

The SUA is promulgated by states for Food Stamp recipients to use in determining whether they qualify for an “excess shelter deduction” under the Food Stamp program. In making that determination, a household may use either its actual home utility bills or may use the SUA promulgated by the State. In comparing the results of my analysis to SUA, I can assess whether there is consistency with an affordability standard for limited income households. Food Stamp eligibility is, with some exceptions not relevant here, set at 130% of the Federal Poverty Level.

Id. at 25-26. Mr. Colton concluded: “the SUA is designed to address basic local telephone service (including fees and taxes) for Food Stamp recipients. The Pennsylvania telephone SUA for Fiscal Year 2008 was \$31.” Id. at 26.

Mr. Colton concluded that the Commission “should establish an affordability constraint on basic local telephone service (including fees and surcharges) based on a percentage of income.” Id. Mr. Colton testified:

The appropriate percentage of income to use is 0.75% of the average statewide non-metropolitan median income published annually for each state by HUD. This proposed 0.75% of income standard is based on data that has been used, and found to be reliable, by other state agencies for official purposes. Moreover, the results of an application of the 0.75% of income standard are consistent with other officially published state standards that use (or incorporate) local telephone bills.

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<sup>6</sup> The \$31.00 figure was subsequently updated to \$32.00 during cross examination of Mr. Colton in the portion of the investigation conducted by ALJ Colwell. Tr. 131-132 (Colwell).

Id. at 27-28. Mr. Colton compared the \$31 SUA for Fiscal Year 2008 to the actual residential telephone bills provided in discovery by the rural ILECs. Id. at 26. In the discovery request, Mr. Colton specifically requested that the residential telephone bills include “all such items that a customer has to pay in order to obtain basic local service.” Id. Of the 31 companies providing illustrative bills, Mr. Colton found that 18 of the companies had bills between \$20 and \$25 per month, while 13 had bills between \$25 and \$30 per month. Id. at 26-27.

Mr. Colton concluded that “all of the rural companies’ monthly rates currently fall below the \$31 affordability line (0.75% of income). Thus, the affordability ‘constraint’ would not come into play under current rates.” Id. at 28. Again, it is important to note that Mr. Colton’s \$31.00 local phone service constraint includes necessary taxes, fees and surcharges such as the federal Subscriber Line Charge (“SLC”).<sup>7</sup> When these fees are removed, it produces the \$23.00 affordability constraint adopted by ALJ Melillo.

Finally, both AT&T and Verizon criticize the ALJ’s Recommended Decision for stating: “I have been cited to no analysis of record to support the 1% level or any level other than 0.75%.” AT&T Exc. at 36, *citing*, R.D. at 116; Verizon Exc. at 6, *citing*, R.D. at 116. Both AT&T and Verizon argue that Verizon presented evidence demonstrating that 1% is more appropriate. Id. Both companies, however, fail to recognize that the ALJ did consider the rebuttal evidence presented by Verizon, as well as cross-examination conducted of Mr. Colton by Verizon, but chose to accept the OCA analysis presented by Mr. Colton. The full quote of what ALJ stated is:

As to affordability, I observe, as recognized by Verizon, that the only affordability analysis provided of record was Mr. Colton’s in the ALJ Colwell portion of the proceeding. While Verizon witness

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<sup>7</sup> The federal SLC is currently \$6.50 for all of the RLECs, except for Embarq and Windstream whose SLC’s are \$4.86 and \$6.30, respectively. OCA Exh. RL-6.

Price critiqued Mr. Colton's analysis in that proceeding, and Verizon's counsel questioned Mr. Colton about the impact of raising the household income percentage level to 1%, I have been cited to no analysis of record to support the 1% level or any level other than 0.75%.

R.D. at 115-116. As such, the ALJ was aware of Verizon's response to Mr. Colton's affordability analysis but determined to accept Mr. Colton's testimony as reasonable.<sup>8</sup>

As such, there is substantial record evidence that supports the use of 0.75% of Pennsylvania rural median household income when determining an affordable basic local exchange rate. The Commission should reject arguments to the contrary.

3. The 0.75% Figure Should Be Tied To Basic Local Telephone Service Only, Not Total Household Expenditures On All Telecommunications Services.

AT&T, Verizon and Sprint argue that the 0.75% level is too low because Federal Communications Commission ("FCC") data shows that the lowest quintile of household income in 2006 spent on average 3.11% of their total household expenditures on telephone services and the average household expenditure for telephone service for rural households was 2.62% of total household expenditures. AT&T Exc. at 36-37; Verizon Exc. at 6-7; Sprint Exc. 5-6. AT&T, Verizon and Sprint, therefore, argue that it is not appropriate to use 0.75% of Pennsylvania rural median household income when determining the affordable rate. These arguments are without merit and should be rejected.

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<sup>8</sup> As evidenced from the ALJ's statement, Verizon previously recognized Mr. Colton's analysis as "the only affordability analysis provided of record." R.D. at 115. While Verizon provided rebuttal testimony in response to Mr. Colton's affordability analysis, and cross-examined Mr. Colton on his affordability analysis, Verizon did not provide its own affordability analysis. Nor did any other party provide an affordability analysis. Therefore, the ALJ's statement that she had "been cited to no analysis of record to support the 1% level or any level other than 0.75%," is correct. Verizon cannot criticize the ALJ for "erroneously concluding" that there was no other affordability analysis provided in the record of this proceeding when Verizon itself has recognized that to be the case.

First, Mr. Colton noted the difference between relying on data that focuses on expenditures on *all* telecommunications services, and data that focuses specifically on basic local telephone service:

The FCC “Reference Book” that [Verizon witness] Mr. Price cites makes clear that the FCC relies upon data generated through the U.S. Bureau of Labor Statistics (BLS) Consumer Expenditures Survey (CEX). The CEX data on telecommunications expenditures, however, is not limited to local telephone service. The Information Book published by BLS for the Quarterly Interview Survey component of the Consumer Expenditures Survey (April 1, 2004, at 15) reports that included in “telephone expenses” are the following:

- residential service;
- mobile/cellular service;
- pager/beeper services;
- Basic (local) service charge;
- domestic long distance charge;
- International long distance charge;
- “telephone related services such as caller ID, call waiting, call forwarding, or voice mailboxes” (but not including data services);
- installation or repair of telephone line(s);
- telephone or pager purchases or rentals;
- Internet access or data services;
- cable or satellite television services;
- DSL or ISDN charges; and
- non-telephone related rentals or purchases.

OCA St. 2-S (Colwell) at 2-3 (citations omitted).

Mr. Colton also responded to Verizon’s argument that, even if the FCC report considered more than just local service, that the 0.75% standard would be too low even assuming that only half of the total telecommunications expenditures were used for basic local telephone service. *See, Id.* at 3; *citing*, Verizon St. 1.1 (Colwell) at 26. Mr. Colton demonstrated, however, that such an assumption is unsupported and would “require the PUC to find, with no empirical basis, 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 access, cable television service, and non-basic telephone service (e.g., call waiting, call forwarding, caller ID, voice mail), amongst other items.” *Id.* at 4 (emphasis in original).

AT&T, Verizon and Sprint’s arguments that the 0.75% figure is too low because FCC data reveals that households spend more on “telephone services” is an apples-to-oranges comparison and must be rejected. As AT&T recognizes elsewhere in its Exceptions, “end users across the country pay \$50.00 or more on *bundled packages* and other services.” AT&T Exc. at 38 (emphasis added). AT&T’s argument is not addressed solely to basic local exchange service. The cost to consumers of *all* communications services is not the subject of this investigation. The 0.75% figure should be tied solely to basic local telephone service for purposes of establishing an affordable rate because basic local telephone service is the minimum service necessary to ensure the provision of universal telecommunications services and is the appropriate focus of this proceeding. The costs of discretionary non-basic telephone service, mobile services, pager services, internet services, etc., should not be used in establishing an affordable rate for basic local exchange service.

Second, these arguments provide an inappropriate comparison with total *household expenditures* on all telephone services, rather than *household income*. The correct focus is on percentage of household income, not percentage of household expenditures. Focusing on percentage of household expenditures, instead of percentage of household income, fails to consider the “relative” aspect of affordability, as required by the FCC. As Mr. Colton testified, this approach involves the extent to which expenditures can be made without undue hardship to the household. OCA St. 2-S (Colwell) at 3.

In its implementation of Section 254(b)(1) of the Telecommunications Act of 1996, the FCC stated that the concept of affordability has two components: (1) an absolute component and (2) a relative component.<sup>9</sup> 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, 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 “subscriberhip levels do not reveal whether consumers are spending a *disproportionate amount of income* on telecommunications services.” Id. (emphasis added).

OCA witness Colton described the distinctions between the absolute component and the relative component discussed in the 1997 FCC Order. Mr. Colton testified: “[t]he absolute component references whether a household has the ability to obtain the service at all,” and “[t]he relative component references whether a household has the ability to obtain the service without serious detriment to the household.” OCA St. 2 (Colwell) at 11. Both aspects of affordability need to be considered in evaluating whether telephone service is affordable in Pennsylvania. Id. Mr. Colton testified that “[t]he generally-recognized mechanism for measuring the ‘affordability’ of household expenses involves assessing the ‘burden’ which those expenses impose on a household as a percentage of income.” Id. at 12. This analysis is based on the premise that rural basic telephone rates should be reasonably comparable to non-rural rates within the affordability constraint. Id. at 4.

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<sup>9</sup> 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) at ¶ 110. Section 254(b)(1) provides: “**Universal Service Principles.**— The Joint Board and the Commission shall base policies for the preservation and advancement of universal service on the following principles: (1) Quality and rate.—Quality services should be available at just, reasonable and affordable rates.” 47 U.S.C. § 254(b)(1).

As such, the 0.75% figure should pertain to household income and should be tied to basic telephone service only, not all telecommunications services. The arguments of AT&T, Verizon and Sprint to the contrary are misguided and should be rejected.

4. Conclusion.

The OCA submits that the ALJ's recommendation to adopt an affordability constraint is reasonable and the \$23.00 affordable rate recommended by the ALJ provides a reasonable current estimate of an upper bound for an affordable rate. The only record evidence provided in either portion of this investigation demonstrates that the total bill for basic local exchange service should be no more than 0.75% of Pennsylvania rural median household income to maintain affordable telephone service. The 0.75% figure should be for basic telephone service only, not total household expenditures on all telecommunications services. As such, the Commission should reject any arguments that the \$23.00 affordability standard proposed by the ALJ is too low.

OCA Reply Exception No. 2 - The ALJ's "Glide Path" For Reducing The RLEC Intrastate Access Rate Is Reasonable In The Absence Of Additional Support From The PA USF. (AT&T Exception No. 1; Sprint Exception No. 1; ALJ R.D. at 138-140; OCA M.B. at 17-22).

In their Exceptions, both AT&T and Sprint argue that the time period in which the ALJ recommends the RLECs' intrastate access rates be reduced is too long and should be shortened so that the RLECs' intrastate access rates are lowered sooner than provided in the ALJ's plan. AT&T argues, for example, that the ALJ "erred by delaying critical access reform for an additional two-to-four years." AT&T Exc. at 5-30. Sprint argues that "the recommended schedule for access reform is unnecessarily long." Sprint Exc. at 3-5.

The OCA comprehensive proposal would have provided an immediate reduction in intrastate access rates to their interstate levels offset first by increases in the basic local exchange rate to a level comparable to 120% of the Verizon weighted average rate, constrained by an affordability analysis, with any additional support needed to maintain revenue neutrality to come from the PA USF. OCA M.B. at 17-22. The ALJ, however, neither adopts a comparability standard nor relies on the PA USF to offset access rate reductions. As a result, the glide path included in her recommended plan attempts to mitigate the impact of her recommended increases in basic local exchange services by phasing the increases in over a two-to-four year period. If the Commission adopts the ALJ's position to increase basic local exchange rates without regard to comparability and without the use of the PA USF, such glide path is clearly necessary.<sup>10</sup>

In the absence of PA USF support for further access rate reductions to prevent excessive local rate increases, the OCA submits that a reasonable "glide path" for access charge rate reductions is necessary. The ALJ proposes to reduce the RLEC intrastate rates with offsetting increases in basic local exchange rates up to an \$18.00 weighted average, followed by corresponding 1/3 increases in the basic local exchange rates each of the next three years to offset reductions as necessary to reach parity with interstate rates. The OCA submits that any increase above the \$18.00 level (or the \$17.09 level proposed by the OCA, or the \$18.94 level proposed by the PTA) should come from the PA USF. If the Commission determines, however, not to allow any increases to be recovered from the PA USF, the Commission should ensure a gradual glide path as recommended by the ALJ.

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<sup>10</sup> The OCA agrees with the Exceptions of the PTA that the ALJ erred by not adopting a comparability standard as well as an affordability constraint. PTA's proposed comparability standard would effectively cap residential local service rates at \$18.94, rather than \$23.00.

AT&T argues that “it is imperative that the Commission establish just and reasonable rates immediately – not at some point in the future.” AT&T Exc. at 6. AT&T’s argument, however, fails to recognize that the increases recommended by the ALJ could more than double the basic local exchange rate for some customers. Citizens of Kecksburg, for example, currently has a basic local exchange rate of \$11.00. OCA Sch. RL-6. While the ALJ agreed with the OCA proposal to implement any initial increases to Kecksburg rates in phases, R.D. at 135, increasing the Kecksburg rate from \$11.00 to \$18.00 within one year, as would be done by the ALJ over a one-year period, represents an increase of 63.6%  $((\$18-\$11)/\$11 = 0.636)$ . After the ALJ’s recommended plan is fully implemented in four years, the total increase to Kecksburg’s rates could be as high as 109%  $((\$23-\$11)/\$11 = 1.09)$ .

Adopting the positions to immediately reduce the RLECs’ intrastate access rates without additional PA USF support would cause rate shock given the extreme size of the increases in basic local exchange rates that would occur. The Commission should avoid such impact by utilizing the PA USF. Failing that, the Commission should allow for basic local exchange rates to increase over the “glide path” recommended by the ALJ.

AT&T argues that “immediate implementation of access reductions will not give rise to customer rate shock” because “the Commission has been ‘phasing in’ access reduction for over a decade,” first as part of the Commission’s 1999 Global Order and then again in 2003 approving a settlement of the RLECs’ intrastate access rate investigation. *See*, AT&T Exc. at 23, 25 (citations omitted); *see also*, Sprint Exc. at 3. This argument, however, misplaces the focus of “rate shock.” That is, the RLECs have been aware of the Commission’s intention to further reduce their intrastate access rates, but customers, those who would pay the increases, have not been aware of potential further increases in their basic local exchange rate. While customers

have seen increases in basic local exchange rates to offset intrastate access rate reductions in 1999 and in 2003, the increase from 1999 to 2003 was not as great as what the interexchange carriers are advocating in their Exceptions.

Finally, the OCA notes that the FCC recently released a “National Broadband Plan” (“NBP”). Although the FCC has yet to formally adopt any of the numerous recommendations provided in that plan, the NBP provides that intercarrier compensation be reformed over a ten year period.<sup>11</sup> The Commission here should adopt a reasonable time period to ensure that intrastate access reform is conducted in a just and reasonable manner.

If the Commission determines to entertain a shorter transition period, record evidence in this proceeding demonstrates how intrastate access rates could be reduced more quickly and dramatic increases to basic local exchange rates could still be avoided through the use of the PA USF. *See*, OCA Exc. at 21-28. The OCA submits that the PA USF should be used to offset reductions in intrastate access rates while keeping other rates for telecommunications services comparable and affordable. *Id.* at 21-24. Although decisions regarding the structure and size of the PA USF are to be deferred to the separate rulemaking proceeding recommended by ALJ Colwell, the Commission should consider in that proceeding expanding the base of contributors to the PA USF to ensure that all users of the public switched telephone network pay their share of the joint and common costs of that network. *Id.* at 24-28. In this manner, both competition and universal service will be promoted.

As such, the OCA submits that the Commission should reject the Exceptions filed by AT&T and Sprint that argue that the RLECs’ intrastate access rates should be reduced more quickly than as provided for in the plan presented by the ALJ. As set forth in the OCA’s original

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<sup>11</sup> Connect America Fund, a National Broadband Plan for Our Future, FCC Docket Nos. WC 10-90, GN 09-51, WC 05-337 and FCC 10-51 at xiii.

comprehensive proposal in this case, access charges can be reduced to interstate levels at this time, but only if a substantial portion of those reductions are offset by increased support from the PA USF.

OCA Reply Exception No. 3 - The ALJ Correctly Rejected Verizon's Proposal To Reduce The RLECs' Intrastate Access Rates To The Level Of Verizon's Intrastate Access Rates. (Verizon No. 1; ALJ R.D. at 90; OCA M.B. at 28-29).

In its Exceptions, Verizon argues that “the Commission should leave open the possibility of setting a uniform statewide benchmark intrastate switched access rate for the RLECs in the future.” Verizon Exc. at 1-3. Verizon argues that “while the RD would implement an appropriate *interim* step for now, it may be appropriate in the future to consider additional RLEC access reductions and to look at a more equitable uniform benchmark rate.” *Id.* at 2 (emphasis in original). Verizon advocated in testimony that the benchmark rate should be Verizon’s current intrastate access rate. This rate is less than the RLEC interstate access rate for 29 RLECs. The OCA submits that the Commission should reject any position that advocates for the RLECs intrastate access rates to be even lower than their interstate access rates, as the ALJ recommends.

OCA witness Dr. Loubé testified, “the Commission should not adopt the Verizon plan because the Verizon plan would establish unreasonably low intrastate access rates for the RLECs.” OCA M.B. at 28; *citing*, OCA St. 1 at 33. Dr. Loubé added that such a proposal is unreasonable, in part, “because the accompanying revenue neutral rate increases would harm universal service.” *Id.* Dr. Loubé further noted that Verizon argued against benchmarking RLEC basic local service rates to Verizon’s basic local service rates in the portion of the investigation conducted by ALJ Colwell but now recommends benchmarking the RLECs’ intrastate access rates to Verizon’s intrastate access rates in this proceeding. *Id.* Dr. Loubé

identified several reasons why the RLECs' intrastate access rates should not mirror Verizon's intrastate access rates.

First, the fact that intrastate access rates are higher in rural areas than in urban areas is reasonable given that telephone costs are usually influenced by economies of scope and scale and it is reasonable to expect that the cost to serve Philadelphia, for example, is lower than the cost to serve for any of the RLECs. Id. Second, Dr. Loubé noted that the additional RLEC revenue loss associated with reductions in RLEC intrastate access rates to Verizon's rates generates an additional \$13.1 million in revenue loss for the RLECs over and above the losses resulting from setting intrastate rates at interstate levels. Id.; *see also*, OCA Exh. RL-7. Third, the benchmarking examples that Verizon cited to support this recommendation did not require a competitor operating in its service territory to match the access charges of another ILEC as Section 3017(c) of Chapter 30 requires. Id. at 28-29; *citing*, OCA St. 1 at 37.

Furthermore, Verizon's argument ignores the fact that the RLEC traffic sensitive costs may be higher than Verizon's traffic sensitive costs. As Dr. Loubé testified:

The RLEC traffic sensitive costs are approximately equal to their interstate traffic sensitive rates. The Verizon traffic sensitive rate is less than the RLEC interstate traffic rate for 29 of 30 PTA RLECs. Thus, if the RLECs were to adopt the Verizon traffic sensitive rate, 29 of the 30 PTA RLECs would be required to sell traffic sensitive access services at below cost.

Id.; *quoting*, OCA St. 1-S at 3-4. Dr. Loubé noted that Verizon's comparisons are skewed by the inclusion of the carrier common line charge on a per minute basis and that "any comparisons between Verizon and RLEC rates should compare the traffic sensitive rates separate from the combination of traffic sensitive and common line rates." Id.

As such, it is not reasonable to reduce the RLECs' intrastate access rates below their interstate levels, as Verizon argues. Verizon's Exception to the contrary should be rejected.

OCA Reply Exception No. 4 - The ALJ Correctly Recognized That The RLECs' Basic Local Exchange Rates Must Be Constrained. (OSBA Exception No. 3; ALJ R.D. at 116; OCA Exception at 31-35).

The OSBA's primary position in this proceeding is that RLEC access charges have not been found to be excessive and therefore should not be reduced. OSBA M.B. at 22. However, the OSBA proposed that, if the Commission decides that the RLECs' access charges should be reduced, such reductions would be made on a case-by-case basis for each RLEC based on the company's own rates and access costs. In its Exceptions, the OSBA argued that the ALJ erred when she failed to adopt the OSBA's proposal. OSBA Exc. at 10-14.

In addition, the OSBA Excepted to the ALJ's adoption of the OCA's affordability standard. OSBA Exc. at 15-18. OSBA argues that the affordability standard will create a cap for residential rates only, and not business rates. OSBA Exc. at 15-18. OSBA argues that there should either be no cap for residential rates or a cap for both residential and business rates. OSBA Exc. at 17. The OCA submits that the Commission should reject any argument that, if the RLEC access rates are reduced, then there should be no cap on basic local exchange service rates when offsetting the reduction in access rates.

The OCA submits that, while a rate standard based on either comparability or affordability can and should change over time, it would certainly be incorrect for the Commission to "abolish" the affordability constraint altogether as the OSBA requests. *See*, OCA Exc. at 31-35. As the OCA demonstrated in its Exceptions, there is extensive statutory, regulatory and appellate history supporting a cap on basic local exchange rates. In 1999, the Commission originally established a cap for basic local exchange rates as part of its Global

Order which the Commonwealth Court approved in its entirety.<sup>12</sup> 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.”<sup>13</sup>

In 2003, the cap on basic local exchange rates was again recognized by the Commission when approving a settlement of a generic proceeding investigating the RLEC’s intrastate access rates. There, the Commission noted 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.”<sup>14</sup> In 2004, the cap for rural telephone companies was also reflected in the re-enactment of Chapter 30 through Act 183 of 2004 when Representative Adolph, the prime sponsor of House Bill 30 which became Act 183, noted on the floor of the House of Representatives: “keep in mind that there is an \$18 cap for basic telephone services.”<sup>15</sup> Finally, the cap on rural basic local exchange services was reaffirmed by the Commission as part of the approval of the RLECs’ amended Chapter 30 plans filed subsequent to the passage of Act 183. In those Orders, the Commission noted that the RLECs were permitted to recover amounts beyond the rate cap from the PA USF, not customers.<sup>16</sup>

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<sup>12</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. Cmwith 2000)(Global Order Appeal), *vacated in part sub nom*, MCI WorldCom, Inc. v. Pa.P.U.C., 844 A.2d 1239 (Pa. 2004).

<sup>13</sup> Global Order Appeal, 763 A.2d at 492.

<sup>14</sup> Access Charge Investigation per Global Order of September 30, 1999, Docket Nos. M-00021596, *et al.*, Order (entered July 15, 2003).

<sup>15</sup> Leg. Journ. Nov. 19, 2004 at 2161.

<sup>16</sup> *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.

The PTA recognizes the importance of a need for a cap given the unique nature of telephone service amongst the other utility industries. As the PTA noted, an initial cap on residential basic local exchange rates of \$18.94 (equating 115% of the Verizon urban rate) will help ensure that the RLECs satisfy their obligations of modernizing the public switched telephone network to provide broadband services as well as act as the carrier of last resort for basic local exchange service throughout their service territory. As the PTA notes: “Whether the degree of competition is 30, 40 or 50%, there are still substantial areas of Pennsylvania served by only one carrier – the PTA companies.” PTA Exc. at 6. Those customers must still be provided with basic telephone service and just, reasonable and affordable rates. The Commission must ensure that those rates remain constrained by a reasonable cap that is both comparable and affordable.

The OSBA recommendation to eliminate any cap on residential basic local exchange rates should be rejected. The OCA agrees, however, that if limits are placed on increases to rural company residential basic local service rates, then concomitant and proportionate protections should be applied to each rural company’s small business basic local service rates as well.

**OCA Reply Exception No. 5 – The Commission Should Reject Any Attempt To Allow Companies’ Contributions To The Pennsylvania Universal Service Fund To Be Recovered As A Line Item Surcharge. (AT&T Exc. No. 1).**

In its Exceptions, AT&T argues that the ALJ erred by delaying critical access reform for an additional two-to-four year period. AT&T Exc. at 7-30. In making that argument, AT&T argues that its proposal to immediately reduce intrastate access charges, offset in part by a temporary increase to the PA USF, should be adopted. AT&T argues that “if the Commission nevertheless is concerned that Verizon and other carriers will be harmed by the temporary

increase to the PA USF, the Commission can waive the regulation that prohibits carriers from recovering PA USF contributions as a line item surcharge.” AT&T Exc. at 29; *citing*, 52 Pa. Code § 63.170. The OCA submits that the Commission should not allow contributions to the PA USF to be recovered through line item surcharges.

In the Global Order, *supra*, the Commission addressed a myriad of issues, including the implementation of rate caps and rate ceilings.<sup>17</sup> In doing so, the Commission determined that if a local telephone company’s basic local exchange rate exceeded the rate cap, and is found to be just and reasonable by the Commission, the revenue associated with the difference between the rate cap and the approved rate will be recovered from the PA USF.<sup>18</sup> As part of that determination, the Commission specifically precluded the use of any surcharge by companies to recover from consumers their contribution to the PA USF. The Commission provided:

Additionally, we conclude that there shall be no SLC assessed on the bills of any ILEC which is designed to recover revenues associated with the reduction of either switched access rates or toll rates unless and until determined by the Commission in the context of the investigation described in Section II of this Opinion and Order.<sup>19</sup>

The Commission should not modify that position as part of this proceeding and cannot simply “waive” this prior determination, particularly as the parties have had no notice or opportunity to be heard regarding this issue.

As such, the Commission should reject any attempt to allow companies’ contributions to the PA USF to be recovered as a line item surcharge.

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<sup>17</sup> Global Order, 93 PaPUC at 258-264.

<sup>18</sup> Id., 93 PaPUC at 263.

<sup>19</sup> Id., 93 PaPUC at 264.

**IV. CONCLUSION**

WHEREFORE, the Pennsylvania Office of Consumer Advocate respectfully submits that the Commission should adopt the ALJ's Recommended Decision to the extent that decision is consistent with the OCA's comprehensive proposal to ensure that the RLECs' access rates and basic local service charges are set at just and reasonable levels. The Exceptions filed by AT&T, Verizon, Sprint and OSBA to the contrary should be rejected.

Respectfully submitted,



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Dated: September 17, 2010  
133753

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 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:

Dated this 17th day of September, 2010.

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