

PENNSYLVANIA PUBLIC UTILITY COMMISSION
HARRISBURG, PENNSYLVANIA 17105-3265

Investigation Regarding Intrastate Access
Charges and IntraLATA Toll Rates of Rural
Carriers and The Pennsylvania Universal
Service Fund

PUBLIC MEETING: July, 19 2012
1189996-OSA
Docket No. I-00040105

AT&T Communications of Pennsylvania, *et al.*
v.
Armstrong Telephone Company-Pennsylvania, *et al.*

Docket No. C-2009-2098380, *et al.*

Implementation of the Federal Communications
Commission Order of November 18, 2011, As
Amended or Revised and Coordination With
Certain Intrastate Matters

Docket No. M-2012-2291824

STATEMENT OF COMMISSIONER JAMES H. CAWLEY
CONCURRING IN PART AND DISSENTING IN PART

Before us for disposition are the original (August 2, 2011) and updated (April 9, 2012) Joint Petition for Reconsideration and Stay filed by the Pennsylvania Telephone Association and CenturyLink (respectively PTA/CTL Joint Petition and PTA/CTL Updated Joint Petition),¹ the original (August 2, 2011) and updated (April 9, 2012) Petition for Reconsideration and Clarification submitted by AT&T Communications of Pennsylvania, LLC *et al.* (respectively AT&T Petition and AT&T Updated Petition),² and associated Answers thereof by various interested and participating parties. I concur with the majority in the proposed disposition of most of the issues in this proceeding. However, for the reasons delineated below I strongly disagree with the majority on the explicit recognition of the November 18, 2011 *FCC Order*³ effects as “exogenous events” for the rural incumbent local exchange carriers (RLECs) that operate under Chapter 30, 66 Pa. C.S. § 3011 *et seq.*, alternative regulation and network modernization plans. Such recognition is legally unfounded under Pennsylvania law and applicable Commission precedent; it cannot be reasonably and practically implemented; and, it creates unnecessary and unaffordable risks for the end-user ratepayers of regulated retail telecommunications services of the RLECs and, potentially, the ratepayers of the non-rural Chapter 30 (Ch. 30) incumbent local exchange carrier (ILEC) telephone companies as well.

A. Fundamental Issues And Applicable Legal Parameters

The potential regulatory treatment of exogenous events that may play a role in the price stability mechanisms (PSMs) in the Ch. 30 alternative regulation and network modernization plans

¹ The August 2, 2011 PTA/CTL Joint Petition was captioned as Joint Petition for Limited Reconsideration and Stay, and it had been submitted by the PTA and The Embarq Telephone Company of Pennsylvania LLC d/b/a CenturyLink.

² The April 9, 2012 AT&T Updated Petition was captioned as the Updated Petition for Reconsideration and Comments of AT&T in Response to the Commission’s Opinion and Order Entered March 20, 2012.

³ *In re Connect America Fund, et al.*, WC Docket Nos. 10-90 *et al.*, (FCC Rel. Nov. 18, 2011), Report and Order and Further Notice of Proposed Rulemaking, *slip op.* FCC 11-161, 26 FCC Rcd 17663 (2011), *appeals pending (USF/ICC Transformation Order* and subsequent related FCC Reconsideration and Clarification rulings, collectively *FCC Order*).

(NMPs) of the RLECs, is largely governed by the terms of their individual NMPs. Section 3019(h) of Ch. 30 specifies the statutory foundation of the NMPs:

Implementation. — The terms of a local exchange telecommunications company's alternative form of regulation and network modernization plans shall govern the regulation of the local exchange telecommunications company and, consistent with the provisions of this chapter, shall supersede any conflicting provisions of this title or other laws of this Commonwealth and shall specifically supersede all provisions of Chapter 13 (relating to rates and rate making) other than sections 1301 (relating to rates to be just and reasonable), 1302 (relating to tariffs; filing and inspection), 1303 (relating to adherence to tariffs), 1304 (relating to discrimination in rates), 1305 (relating to advance payment of rates; interest on deposits), 1309 (relating to rates fixed on complaint; investigation of costs of production) and 1312 (relating to refunds).

66 Pa. C.S. § 3019(h).

The potential treatment of exogenous events and the use of generic exogenous variables in the PSM price cap formulas of the Ch. 30 RLECs were recognized by the Commission in the related NMPs that were first approved under the original version of the Ch. 30 law and were subsequently amended under the current version of the Ch. 30 statute. *See also* 66 Pa. C.S. § 3013. Because the non-competitive service rates that result from the periodic application of the PSM price cap mechanisms of the Ch. 30 RLECs must still meet the just and reasonable standard of Section 1301 of the Public Utility Code, potential ratemaking recognition of any exogenous events requires Commission review under the same standard. 66 Pa. C.S. §§ 1301, 3015(g). *See also Buffalo Valley Tel. Co. v. Pa. Pub. Util. Comm'n*, 990 A.2d 67, 79 (Pa. Cmwlth. 2009) (*Buffalo Valley Tel. v. Pa. PUC*). In summary, not only is the formal recognition of exogenous events and their potential regulatory ratemaking treatment subject to explicit Commission scrutiny and approval, but the resulting rates must also meet the just and reasonable standard.

With its March 20, 2012 Order that led to the limited reopening of the evidentiary record in the instant proceeding, the Commission specifically solicited and received input by the actively participating parties on the potential exogenous event treatment of the *FCC Order* under the Ch. 30 statute and the RLEC NMPs. Certain fundamental legal and technical issues must still be resolved by first ascertaining whether the *FCC Order* has created exogenous events that need to be formally recognized by the PSMs of the Ch. 30 RLECs under Pennsylvania law; and if this is the case whether there is an appropriate ratemaking treatment of such exogenous events that can meet the standard of just and reasonable rates.

B. Alternative Regulation, Price Cap Mechanisms, and Exogenous Events

Generally, when regulated telecommunications carriers operate under alternative regulation and price cap mechanisms, the use of exogenous events and exogenous factors for the ratemaking recovery of costs or expenses is generally and intentionally limited. This is because of a variety of sound reasons. First, price cap regulation usually divorces the net profits of the regulated firm from any regulatory scrutiny. Second, the price cap mechanism through the application of a general economy inflation index, e.g., the Gross Domestic Product Price Index or GDP-PI, captures certain cost trends. Unlike the conventional rate base and rate of return (ROR) regulation and its periodic rate cases for public utilities, the application of price cap mechanisms does not endorse the use of exogenous event revenue recovery for such items as changing labor costs, postal rates, vehicle fleet fuel costs,

purchased public utility services of various types, etc. Such cost variables are deemed to be captured by the GDP-PI. Second, there is a generic emphasis that only certain events that are unique to the particular entity under price cap regulation may cause extraordinary impacts and may need ratemaking recognition through the use of the exogenous factor in a price cap formula. If such an event affects whole segments of a regulated industry it ceases to be unique in character for its individual members. Third, the normal application of a price cap mechanism recognizes that the regulated firm possesses an inherent degree of economic productivity which is properly utilized so that the firm can provide adequate and reliable services at a profit. This is usually expressed in a non-zero productivity factor or inflation offset that is normally subtracted from the inflation index. Statutorily, this productivity offset has been set at zero (0) for the Ch. 30 RLECs with PSMs. 66 Pa. C.S. § 3015(a)(1)(iii). Fourth, entities that are regulated with price cap mechanisms have the obvious incentive to identify and suggest the ratemaking recognition of exogenous events with upward revenue adjustments. Regulators, consumer advocates, and other entities normally and practically lack the capacity to investigate and suggest exogenous factors with downward revenue adjustments. For example, the annual Pennsylvania Universal Service Fund (Pa. USF) support distributions do not play a direct role and do not cause an exogenous factor adjustment in the annual application of the PSMs by the individual Ch. 30 RLECs nor am I suggesting that they should at this time.

When the Commission first dealt with the issue of price cap regulation and the potential recognition and ratemaking treatment of exogenous events under the initial 1993 version of the Ch. 30 law it observed the following:

The Commission ruled that Bell [Bell Atlantic-Pennsylvania, Inc. currently Verizon Pennsylvania Inc. or Verizon PA] should be able to recover its exogenous costs (costs that generally are outside a general index of inflation), under limited circumstances. These circumstances were confined to "...1) jurisdictional shifts where costs are transferred to or from the interstate jurisdiction and where an equal and opposite exogenous adjustment was allowed by the FCC [Federal Communications Commission] under its price cap system, and 2) limited regulatory accounting changes not initiated by Bell."

Pennsylvania Public Utility Commission, *Chapter 30 of the Public Utility Code: Alternative Form of Regulation of Telecommunications Services*, Report to the Governor and General Assembly, (Harrisburg, PA, July 8, 1995), at 34 and n. 29 citing *Re Bell Atlantic-Pennsylvania, Inc.'s Petition and Plan for Alternative Form of Regulation Under Chapter 30*, Docket No. P-00930715, Order entered June 28, 1994 at 83, and Order entered January 23, 1995 at 11-14. *See also* Alternative Regulation Plan of Verizon Pennsylvania Inc. as of August 2008, Docket Nos. P-00930715, P-00930715F1000, R-0051228, dated August 20, 2008 and filed August 19, 2008, Part 1, Sec. A.8, at 7-8 (Verizon PA amended NMP per 2004 version of Ch. 30 law).

Since the enactment of the original Ch. 30 law and the subsequent 2004 passage of its current version, there have been very few and isolated requests for the recognition and ratemaking treatment of exogenous events by RLECs with Ch. 30 PSMs. Such requests have *not* been associated with federal regulatory actions although the FCC instituted a number of major reforms in the interstate intercarrier compensation system that had wholesale effects on broad segments of the regulated telecommunications industry including the Pennsylvania RLECs well before the *FCC Order* of November 18, 2011 ruling. Furthermore, a certain number of these RLEC requests resulted in litigation prior to their final

disposition.⁴ Thus, so far the requests and the regulatory resolution of exogenous events for Ch. 30 RLECs have been far and few between and only for unique circumstances.

C. RLEC Chapter 30 Plans and the *FCC Order*

With its March 20, 2012 Order that led to the limited reopening of the evidentiary record in the instant proceeding, the Commission specifically solicited and received input by the actively participating parties on the potential exogenous event treatment of the *FCC Order* under the Ch. 30 statute and the RLEC NMPs. Certain fundamental legal and technical issues must still be resolved by first ascertaining whether the *FCC Order* has created exogenous events that need to be formally recognized by the PSMs of the Ch. 30 RLECs under Pennsylvania law; and if this is the case whether there is an appropriate ratemaking treatment of such exogenous events that can meet the standard of just and reasonable rates.

An examination of a number of Ch. 30 RLEC NMPs that are on file with the Commission readily and generally discloses the use of the following language that addresses the recognition of exogenous events and their mechanical regulatory application through the use of exogenous variables (“Z” factor) in the corresponding PSM price cap formulas.

11. Except as otherwise noted, any changes or events within the Company’s control are excluded as exogenous events. Notwithstanding any other limitation specified herein, the Company, OTS [Office of Trial Staff – currently Bureau of Investigation and Enforcement], OCA [Office of Consumer Advocate], OSBA [Office of Small Business Advocate], or other parties in interest may request the Commission to make special revenue adjustments beyond the scope of the PSI [price stability index] to recognize exogenous events (“Z”), including but not limited to the following:

- a. jurisdictional shifts in cost recovery where interstate revenues or costs actually change;
- b. subsequent regulatory and legislative changes (state & federal) which affect revenues and/or costs, to the extent not captured in GDP-PI [gross domestic product price index]; and
- c. unique changes in the telephone industry which are not reflected in the overall inflation factor as measured by GDP-PI and are outside the Company’s control.

The institution of a universal service type fund in Pennsylvania and any requirement that the Company participate as a contributor and/or recipient shall be a qualifying exogenous event to the extent the Company is either a net contributor to or net recipient from such fund. Conversion of the Company from average schedule settlements to a cost-based or other format shall be qualifying exogenous events. Any changes to

⁴ See generally *Petition of Denver and Ephrata Telephone and Telegraph Company For Recognition of an Exogenous Event Under Its Alternative Regulation Plan – Denver and Ephrata Telephone and Telegraph Company Price Stability Index/Service Price Index Filing for Year 2003*, Docket Nos. P-00032034, P-00981430, Tentative Order entered October 22, 2004; *Petition of North Pittsburgh Telephone Company For Recognition of an Exogenous Event under Its Alternative Regulation Plan – North Pittsburgh Telephone Company Price Stability Index/Service Price Index Filing for Year 2003*, Docket Nos. P-00032038, P-00981437, Tentative Order entered October 22, 2004; *Petition of ALLTEL Pennsylvania, Inc. For Recognition of an Exogenous Event Under Its Alternative Regulation Plan – ALLTEL Pennsylvania, Inc. Price Stability Index/Service Price Index Filing for Year 2003*, Docket Nos. P-00032047, P-00981423, Tentative Order entered October 22, 2004. (Settlement agreements resolving exogenous event treatment requests and other matters.)

Generally Accepted Accounting Principles (“GAAP”) that are reflected as changes in regulatory accounting requirements for cost determination and ratemaking purposes that will result in cost changes are an exogenous event. Other examples of exogenous events include the implementation of number portability and IntraLATA [local access and transport area] presubscription. Exogenous revenue events shall be flowed through on a dollar-for-dollar basis, utilizing the most recent per book revenue levels, without any investigation or review of earnings. Exogenous expense events shall be flowed through dollar-for-dollar on the basis of review of the single expense item for which an exogenous event is sought without any investigation or review of earnings, utilizing the most recent per book level of such expense. Results shall be adjusted to recognize the impact of any related taxes. The “75-day procedure,” as recited above in paragraph 10, shall apply to such exogenous events.

12. Any revenue shortfall or cost incurred, including administrative costs, less other related revenue increase/cost decreases, if any, associated with a Commission-mandated implementation of new calling scope services such as EAS [extended area service] or extension of basic local exchange services may be recovered by the Company at the time of implementing any extended calling scope service or additional basic local exchange service. This same treatment shall also apply to new Optional Calling Plans.

13. In connection with the implementation of IntraLATA presubscription, the Company shall be permitted to recover related incremental costs as defined by the Commission at Docket No. I-00940034 and in accordance with the methodology set forth in the Global Order. Any revenues received therefrom shall not be included in the calculation of PSI or SPI [service price index]. Further, the Company will also abide with any Commission policy established regarding toll imputation in the design of its intraLATA toll rates. However, the Company shall not be required to pass any imputation test, unless all toll carriers operating in the same serving area agree or are required to comply with the exact imputation test for its serving area as may be imposed on the Company.

14. The Telecommunications Act of 1996 (“TA-96”) was signed into law on February 8, 1996, and is being implemented over time. The regulatory and market changes which will result from TA-96 and applicable regulations have not been incorporated into Plan A. Nothing herein shall be construed to preclude the Company from fully and completely exercising its rights under the Act, which rights are preserved.

15. Should the Company experience a loss of revenue so that its commitment for its Network Modernization Plan is jeopardized, the Company may petition the Commission for appropriate and timely relief under the “75-day procedure.” The Company shall notify the Commission and Chapter 30 parties at Docket No. P-00981425, et al., of such circumstances prior to filing the petition.⁵

⁵ *Amended Streamlined Form of Regulation and Network Modernization Plan of Armstrong Telephone Company – Pennsylvania*, Docket No. P-00981425F1000 (Dated: June 30, 2000, as modified January 22, 2001, as amended March 4, 2005), at 14-16. *See also Amended Streamlined Form of Regulation and Network Modernization Plan of the Bentleyville Telephone Company*, Docket No. P-00981427F1000 (Dated: June 30, 2000, as modified January 22, 2001, as amended March 4, 2005), at 14-16; *Amended Alternative Form of Regulation and Network Modernization Plan of Denver and Ephrata Telephone and Telegraph Company*, Docket No. P-00981430F1000 (Dated: June 30, 2000, as modified January 22, 2001, as amended February 25, 2005), at 13-16; *Amended Streamlined Form of Regulation and Network Modernization Plan of Lackawaxen Telephone Company*, Docket No. P-00981432F1000 (Dated: June 30, 2000, as modified January 22, 2001, as amended March 4, 2005), at 13-16; *Amended Streamlined Form of Regulation and Network Modernization Plan of*

The Ch. 30 Streamlined Regulation Plans of RLECs that do not utilize PSMs but use “Simplified Ratemaking Plans” generally include similar exogenous event provisions.⁶

There is no doubt that the *FCC Order* is having and shall have for the foreseeable future a massive and universal regulatory impact on the operations of numerous telecommunications carriers operating within the Commonwealth, and the RLECs in particular. Such impact is brought about primarily because of the *FCC Order* federal universal service fund (USF) and intercarrier compensation (ICC) reforms. The *FCC Order* reforms in the ICC area cover the operations of regulated telecommunications carriers both in the interstate and intrastate jurisdictions. Although the *FCC Order* has been appealed it has not been legally stayed, and this Commission is proceeding with the implementation of the *FCC Order* directives without waiving any of its own appellate rights in the pending federal appeals.⁷ Similarly, although the reforms in the ICC area are being made under the FCC’s federal administrative authority, the intrastate portion of these reforms remains under the regulatory jurisdiction, oversight, and enforcement of this Commission. *See generally Investigation Regarding Intrastate Access Charges and IntraLATA Toll Rates of Rural Carriers and The Pennsylvania Universal Service Fund, et al.*, Docket Nos. I-00040105, C-2009-2098380 *et al.*, M-2012-2291824, Consolidated Short Form and Protective Order, entered May 10, 2012, at 2 (May 10, 2012 Consolidated Order). Furthermore, although the FCC’s use of its federal administrative authority has utilized the doctrine of federal preemption in moving ahead with the purported federal USF and ICC reforms of the *FCC Order*, such federal preemption does not directly or constructively vacate or otherwise nullify the provisions of Pennsylvania law and the individual NMPs that are based on the Ch. 30 statute.⁸ For example, the *FCC Order* does not halt the periodic and recurring application of the PSM for the individual RLECs, nor does it affect pre-existing and ongoing broadband network deployment commitments of certain RLECs and non-rural ILECs and their enforcement under the relevant and independent Ch. 30 statutory standards. *See generally* 66 Pa. C.S. §§ 3012, 3014(b), and 3015(a)(1)-(2). Thus, the NMPs of the individual Ch. 30 RLECs continue to be operative and legally binding.

The additional evidence that was adduced in the reconsideration phase of this proceeding through the Commission’s March 20, 2012 Order plainly demonstrates that the *FCC Order* ICC reforms are not going to be a “revenue neutral” event for the RLECs. The PTA/CTL Joint Statement specifically states:

Laurel Highland Telephone Company, Docket No. P-00981433F1000 (Dated: June 30, 2000, as modified January 22, 2001, as amended March 4, 2005), at 14-16; *Amended Streamlined Form of Regulation and Network Modernization Plan of the North-Eastern Pennsylvania Telephone Company*, Docket No. P-00981435F1000 (Dated: June 30, 2000, as modified January 22, 2001, as amended March 4, 2005), at 14-16; *Amended Alternative Form of Regulation and Network Modernization Plan of North Pittsburgh Telephone Company*, Docket No. P-00981437F1000 (Dated: June 30, 2000, as modified January 22, 2001, as amended February 25, 2005), at 13-16; *Amended Streamlined Form of Regulation and Network Modernization Plan of Palmerton Telephone Company*, Docket No. P-00981438F1000 (Dated: June 30, 2000, as modified January 22, 2001, as amended March 4, 2005), at 14-16; *Amended Alternative Form of Regulation and Network Modernization Plan of ALLTEL Pennsylvania, Inc.*, Docket No. P-00981423F1000 (Dated: June 30, 2000, as modified January 22, 2001, as amended March 15, 2005), at 22-24.

⁶ *Amended Streamlined Form of Regulation and Network Modernization Plan of Venus Telephone Corporation*, Docket No. P-00981442F1000 (Dated: June 30, 2000, as modified January 22, 2001, as amended March 18, 2005), at 14-16, 25.

⁷ *Pennsylvania Pub. Util. Comm’n v. FCC*, Docket Nos. 11-9900 and 11-9585 (10th Cir. 2011).

⁸ I acknowledge that the FCC’s exercise of federal preemption has other direct and indirect effects on the operation of the Ch. 30 statute and this Commission’s jurisdiction over the providers of intrastate retail and wholesale telecommunications services, e.g., intrastate wholesale switched carrier access services rates. These issues are part of the federal appeals of the *FCC Order* currently pending before the U.S. Court of Appeals for the 10th Circuit. *Pennsylvania Pub. Util. Comm’n v. FCC*, Docket Nos. 11-9900 and 11-9585 (10th Cir. 2011).

As it claimed to be a revenue neutral proposal, the *Rural Access Investigation Order* [July 18, 2011 Order] fit more closely into the rate rebalancing provisions of the Chapter 30 plans. As such, the PUC Order did not invoke the exogenous event provisions included in the Chapter 30 Plans [NMPs]. Moreover, intrastate revenues were at issue, the rate rebalancing provisions further applied.

However, the *Connect America Fund Order* [FCC Order] targets [federal] “Eligible Recovery” based on a combination of certain revenues from interstate access, intrastate access, reciprocal compensation, and universal service support.⁶ As such, this is a “Jurisdictional shift(s) in cost recovery where interstate revenues actually change”⁷, a qualifying exogenous event. This triggers the opportunity for Pennsylvania LECs operating under Chapter 30 plans [NMPs] to seek alternative recovery mechanisms for the [federal] Eligible Recovery revenue which is lost each year. The mechanics of the recovery are different depending upon whether the LEC pursuing such recovery is a Chapter 30 Price Cap or Streamlined Rate of Return company.

^{6/} Local Switching Support is moved from [federal] Universal Service to the Intercarrier Compensation Reform portion of the FCC’s Order. Once moved into this [federal] Eligible Recovery category, it is subject to the same 5% per year reduction applied to other ICC categories.

^{7/} See for example the Amended Final Streamlined Regulation Plan of Citizens Telephone Company of Kecksburg at Page 8.

PTA/CTL, Verified Joint St. of Gary Zingaretti and Jeffrey Lindsey, Docket Nos. I-00040105, C-2009-2098380 *et al.*, April 9, 2012, at 4-5 (PTA/CTL Joint Statement).

The OCA Affidavit specifically states:

With regard to early adopter states, the CAF Order [FCC Order] only recognizes access charge reduction efforts to the extent that local rates have been increased to offset access rate reductions. The CAF Order fails to recognize Pennsylvania’s substantial efforts to [intrastate] access rates by substituting state universal service funding [Pa. USF] for access revenue.³ This failure increases the final bill paid by Pennsylvania residential consumers.

In addition, the CAF Order grants terminating access service users a free-ride on the facilities of access service providers. The users, such as wireless and interexchange carriers, will benefit from a significant cost reduction. Access service providers (Rural ILECs) must simultaneously support their networks and provide free access services to wholesale users of those networks.⁴ Thus, allocating network costs among network users is not an “academic dispute” as AT&T contends.⁵ Rather, as this Commission has long recognized, “the RLECs’ intrastate carrier switched access service NTS [non-traffic sensitive] joint and common costs primarily associated with the RLECs’ local loop plant must be recovered from all users of the RLEC’s [sic] network.”⁶ The Commission then stated that “the retention of a uniform CC [Carrier Charge] rate of \$2.50 per access line per month is a balancing act that takes into account the interests of maintaining competitive equity, collecting a fair share of the intrastate RLEC joint and common costs from carriers that utilize the RLECs [sic] switched access network facilities, and not impacting the existing PaUSF mechanism which is in need of reform in accordance with

the discussion in this Opinion and Order.”⁷ I agree with the Commission that all users of the network should contribute to the support of the NTS joint and common cost.

* * *

Implementation of the [Commission’s] July 2011 Order will have substantial cross-effects with the FCC’s mechanisms of Eligible Recovery and potentially federal CAF [Connect America Fund] support. The cross-effects emerge out of the FCC’s mandate to reduce state terminating access rates and the FCC’s actions that provide alternative sources of revenue that replace, in part, the revenues lost due to access rate reductions.

It must be recognized, however, that the FCC’s proposed revenue offset is not revenue neutral. The [federal] revenue offset in the form of the ARC [access recovery charge] revenue and RM [recovery mechanism] support is limited by the base factor. The CAF Order [*FCC Order*] contains three base factors depending whether the carrier is [federal] Rate-of-Return carrier, a CALLS Study Area, and Non-CALLS Study Area Base Factor. CALLS study areas are [federal] price-cap study areas that participate in the [FCC’s] CALLS Order.¹⁰ Because the CALLS Order was released on May 31, 2000, many of the Rural [federal] price-cap ILECs are Non-CALLS study areas. For those carriers, the base factor is 100% through June 30, 2017 and then decreases to 90 percent per year.¹¹ For these carriers the access reductions will be revenue neutral for the first five years of the program, with complete intrastate access revenue replacement through June 30, 2017.¹²

For [federal] Rate-of-Return carriers, the base factor is 95 percent so that after five years only 77 percent of the FCC mandated intrastate reduction would be recovered through ARC revenues and RM support.¹³ For CALLS study areas, the base factor is 90 percent so that after five years only 59 percent of the FCC mandated intrastate reduction would be recovered through ARC revenues and RM support.¹⁴

* * *

The Commission will have to determine whether the CAF Order [*FCC Order*] implementation constitutes an exogenous event for any particular ILEC. Each ILEC has as part of its Chapter 30 Plan [NMP] a provision for including the impacts of exogenous events on its Price Stability Index. Whether and to what extent the exogenous event provision of any particular plan is triggered is a matter for Commission determination.

Exogenous events are generally defined in the Chapter 30 plans as (1) jurisdictional shifts in cost recovery where interstate revenues or costs actually change and (2) subsequent regulatory and legislative changes which affect revenues and/or costs, to the extent not captured by the GDP-PI.

At this time, I would not estimate of the size of changes resulting from the CAF Order. Instead, I recommend that the Commission require carriers to calculate and file any exogenous event revenue and cost impacts if and when any such requests are made. I further recommend that the Commission consider the impact of any qualifying exogenous events on the future size and function of the Pennsylvania Universal Service Fund.

* * *

Regarding ARC revenue used to create permissible revenue as part of the intrastate regulated revenues used in ILEC annual price stability and price cap formula submissions, my initial response is that traditional Separations revenue rules assign revenue according to the jurisdiction that establishes the rate. Because the FCC established the rate, under a traditional interpretation of the rules, ARC revenue would be considered interstate revenue.

However, these are not traditional events. The FCC has crossed jurisdictional boundaries and re-aligned the [federal] Separations Rules without submitting those changes to the Separations Joint Board [Federal-State Joint Board on Jurisdictional Separations]. Moreover, the CAF Order does not address how ARC revenue and RM support will be treated by the [federal] Separations rules. These revenues are also replacing [federal] LSS [local switching support] which was a mechanism that transferred expense to the interstate jurisdiction. These revenues are replacing intrastate access services. To the extent that the state rate making procedures require revenue to offset either the change associated with the loss of LSS or reduction in intrastate access revenue associated with FCC mandated intrastate rate reductions the Commission should utilize ARC revenue and RM support.

^{3/} To recognize Pennsylvania's effort, the FCC should have added to the local rate the per-line amounts carriers received from the PaUSF when determining the maximum amount of ARC [federal access recovery charge] charges that would be added to residential consumers' bills.

^{4/} The FCC justifies the free-ride given to carriers because it claims that consumers would obtain a benefit from reductions in other rates. That benefit claim has been shown to be illusory and unlikely. See Comments of the National Association of State Utility Consumer Advocates, WC Docket No. 10-90, filed August 24, 2011.

^{5/} AT&T Updated Petition for Reconsideration, page 3.

^{6/} July Order, at 118.

^{7/} Id., at 120-121.

^{10/} In the Matter of Access Charge Reform, et al., CC Docket No. 96-262, *Sixth Report and Order*, FCC 00-193, released May 31, 2000 (CALLS Order). CALLS stands for the Coalition for Affordable Local and Long Distance Service. The Coalition members were AT&T, Bell Atlantic, BellSouth, GTE, SBC, and Sprint.

^{11/} 47 C.F.R. §51.915(b)(9).

^{12/} This statement does not imply that these carriers will not be adversely affected by other reforms. For example, these carriers may lose federal universal service support they currently receive.

^{13/} 47 C.F.R. §51.917(b)(2).

OCA, Affidavit of Dr. Robert Loube, Docket Nos. I-00040105, C-2009-2098380 *et al.*, April 9, 2012, at 4-5, 8-9 and 13-15 (OCA Affidavit).

D. The FCC Order Cannot Be Accorded Exogenous Event Treatment

The determinations of whether the *FCC Order* has created exogenous events that should be recognized under the individual PSMs of the Ch. 30 RLECs, and whether such exogenous events can be accorded the appropriate regulatory treatment under applicable Pennsylvania law are difficult undertakings. The primary difficulty arises from the fact that the *FCC Order* adopts a fundamentally new premise and a new regime for its ICC reforms. This new regime implements a gradual transition of intrastate and interstate terminating switched carrier access charges to "bill and keep" or essentially

zero (0) rates.⁹ This approach deviates from the traditional principle that all users — whether end-users of retail telecommunications services or carriers utilizing wholesale switched access services — of a local landline switched access network contributed to the non-traffic sensitive (NTS) joint and common costs of its facilities (e.g., loop costs, costs of wire and cable facilities). This Commission has consistently abided by this principle. *See generally* May 10, 2012 Consolidated Order at 5; Docket No. I-00040105 *et al.*, July 18, 2011 Order at 118. In our July 18, 2011 Order, we specifically stated that “the recovery of the NTS joint and common costs of the RLECs’ intrastate carrier access services will not be borne by end-user consumers alone.” July 18, 2011 Order at 120. I see no reason to deviate from this overarching principle.

From an operational perspective, the *FCC Order* impacts and will continue to impact the operations of wide segments of the regulated telecommunications industry including the Pennsylvania RLECs for the foreseeable future. Such impacts are universal and do not constitute a unique event for each particular telecommunications carrier that is regulated under a price cap mechanism. Consequently, the *FCC Order* effects would not be normally recognized as exogenous events deserving ratemaking treatment and upward revenue adjustments for the carrier’s regulated services and its ratepayers. The *FCC Order* will also have universal impacts for the end-users of regulated retail landline telecommunications services, e.g., imposition of the federal ARC.

Because of the FCC’s fundamental change in direction regarding both the intrastate and interstate ICC reforms, and in accordance with the PTA/CTL Joint Affidavit and the OCA Affidavit, there is the concrete possibility that the *FCC Order* may trigger “jurisdictional shifts in cost recovery” that may be colored as exogenous events under the NMPs of the Ch. 30 RLECs. Such “jurisdictional shifts in cost recovery” may occur because the replacement of the intrastate and interstate access revenue reductions for the RLECs under the *FCC Order* ICC reforms is not being performed on a “revenue neutral” basis. PTA/CTL Joint Statement at 4-5; OCA Affidavit at 8-9. Furthermore, the RLECs’ potential utilization of the federal Eligible Recovery mechanism (i.e., partial replacement of reduced intrastate and interstate switched access revenues) inclusive of the federal end-user access recovery charge or ARC, and potential resort to the federal Connect America Fund or CAF (the redirected version of the high-cost portion of the federal USF), faces numerous constraints and is not of an indefinite time duration.¹⁰ Thus, there is a distinct possibility that both intrastate and interstate switched carrier access network costs of the RLECs may not be fully recovered under the federal Eligible Recovery mechanism. This is the very unfortunate, unfounded and unsustainable result of the FCC’s change in regulatory direction where the totality of the landline NTS joint and common costs of switched access networks will be borne by their respective end-users alone, while other wireline and wireless providers will be able to use these networks essentially for free under the FCC’s misplaced “bill and keep” ICC regime. However, this is a federally imposed mandate of universal applicability that is not a unique occurrence and cannot qualify as an exogenous event for the Ch. 30 RLECs — or for any other Ch. 30 ILEC for that matter — and their respective PSMs. To do otherwise, we would undermine our own long-standing principle of NTS joint and common cost recovery, and we would implicitly acknowledge that the FCC can exercise jurisdiction over intrastate rates for retail telecommunications services. I do not believe that this is the preferred policy choice or direction for this Commission.

Even if the *FCC Order* effects were to be recognized as an exogenous event, neither the scope nor the timing of a corresponding exogenous factor revenue adjustment would be known with any

⁹ *See generally* *FCC Order*, ¶¶ 737, 801 and Fig. 9, *slip op.* at 241, 271-272; 26 FCC Rcd 17663 (2011), at 17904, 17934-17935.

¹⁰ *See generally* *FCC Order*, ¶¶ 851-853, *slip op.* at 294-298; 26 FCC Rcd 17957-17961.

degree of precision. That is because the intrastate and interstate switched carrier access revenue and rate reductions of the RLECs have commenced going into effect in July 2012, with the subsequent RLEC use of the federal Eligible Recovery mechanism (inclusive of the ARC and the CAF) taking place at a later time, and the process repeating itself under the established time schedule of the *FCC Order* for the federally classified price cap and rate of return (ROR) Pennsylvania RLECs.¹¹

Assuming the prospective recognition of such exogenous events under the NMPs of the Ch. 30 RLECs, their ratemaking treatment presents an additional set of very problematic issues. As the OCA Affidavit has pointed out, the federal jurisdictional separations rules and processes are less than optimal. OCA Affidavit at 14-15. Although various elements of the federal Eligible Recovery mechanism inclusive of the ARC find their origin in the *FCC Order* and if utilized the resulting revenues will be considered interstate, such elements (e.g., the ARC) are also designed to, in part, replace intrastate carrier switched access revenue reductions and thus contribute to a partial recovery of intrastate switched access network costs. However, at this time there is a risk that the FCC jurisdictional separations rules may not be able to properly account for what federal Eligible Recovery support amounts are properly attributable to the intrastate jurisdiction. Nevertheless, as the OCA Affidavit advises, federal Eligible Recovery mechanism support revenues (inclusive of ARC revenues) should play a role in evaluating the potential intrastate ratemaking effects of what could amount to a recognition of exogenous events for the RLECs because of the *FCC Order*.

The biggest obstacle to the recognition *and* ratemaking treatment of the *FCC Order* effects as exogenous events for the Ch. 30 RLECs remains the end result. In this respect, the Commission will essentially be forced to abandon the long-held and valid principle that all retail and wholesale users of landline switched access networks must contribute towards the costs of the related intrastate facilities and especially their NTS joint and common costs. Essentially, if we were to recognize the *FCC Order* intrastate carrier switched access revenue and rate reductions as exogenous events, according them rate making treatment under appropriate but potentially complicated safeguards (e.g., proper recognition of federal Eligible Recovery element support attributable to the intrastate jurisdiction), the resulting residual revenue amounts almost exclusively would have to be absorbed by end-user ratepayers of largely retail local exchange protected services. Thus, the end-user ratepayers of retail local exchange services would have to shoulder an increased and disproportionate share of the RLECs' intrastate switched access network costs, including the NTS joint and common costs of cable and wire facilities.¹² Such an outcome would violate not only the just and reasonable rate standard under Sections 1301 and 3015(g) of the Public Utility Code, 66 Pa. C.S. §§ 1301 and 3015(g),¹³ but it may also violate the requirements of Section 254(k) of the federal Telecommunications Act of 1996 (TA-96). 47 U.S.C. § 254(k).¹⁴

¹¹ The FCC on its own motion suspended for one day and set for investigation the ARC rates contained in the federal "2012 annual access tariffs of all issuing carriers that are charging an ARC in this annual access tariff filing." *In re July 3, 2012 Annual Access Charge Tariff Filings*, (FCC Wireline Competition Bureau, Rel. July 2, 2012), WCB/Pricing No. 12-09, Order, DA 12-1037, ¶ 3, at 2. The associated FCC listing of carriers includes Ch. 30 RLECs operating in Pennsylvania.

¹² *Contrast Joint Petition of Nextlink Pennsylvania, Inc., et al.*, Docket Nos. P-00991648, P-00991649, Order entered September 30, 1999, at 11-56, 196 PUR4th 172, 186-203 (*Global Order*), *aff'd*, *Bell Atlantic-Pennsylvania, Inc. v. Pa. Pub. Util. Comm'n*, 763 A.2d 440 (Pa. Cmwlth 2000), *vacated in part sub nom. MCI Worldcom Inc. v. Pa. Pub. Util. Comm'n*, 844 A.2d 1239 (Pa. 2004). In affirming the Commission's *Global Order* the Commonwealth Court stated: "The record here confirms the soundness of the PUC's view, based on evidence from consumer witnesses, that users of all services, including access, should share in the payment of total network costs, with the cost of the local loop included as an element of that total network." *Id.*, 763 A.2d 480.

¹³ *Buffalo Valley Tel. Co. v. Pa. Pub. Util. Comm'n*, 990 A.2d 67, 79.

¹⁴ Section 254(k), 47 U.S.C. § 254(k), states in relevant part: "The Commission [FCC], with respect to interstate services, and the States, with respect to intrastate services, shall establish any necessary cost allocation rules, accounting safeguards,

For these reasons it is premature at best to entertain at this time any future PSM submissions by the Ch. 30 RLECs that will seek to: (1) Recognize *FCC Order* effects as qualifying exogenous events under their respective Ch. 30 NMPs; and, (2) propose or accord ratemaking treatment to such exogenous events.

The PTA/CTL Joint Statement also suggests that “the anticipated reduction in the authorized rate of return set by the FCC” for the interstate operations of the Ch. 30 RLECs that are federally classified as ROR carriers “may also result in exogenous event filings with the Commission.” PTA/CTL Joint Statement at 6. The PTA/CTL Joint Statement explains that the interstate portion of the network capital investments of these RLECs has “earned a rate of return of 11.25% for more than two decades,” and after having “invested in a network in accordance with obligations set forth in the Chapter 30 plans, Pennsylvania’s RLECs will likely receive a lower return on this investment.” *Id.* A potential and prospective change in a federally authorized ROR level for the interstate operations of the Ch. 30 RLECs, which are federally classified as ROR carriers, does not create the appropriate legal and technically reliable foundation for the submission, recognition, and ratemaking treatment of an exogenous event under the NMPs of the Ch. 30 RLECs.

First, the Ch. 30 RLECs with a price cap method of regulation, including those that are federally classified as ROR carriers, are not subject to any ROR or other profitability constraints for their intrastate operations and capital investments under their respective NMPs. Therefore, if there is a reduction in the federally prescribed ROR of 11.25% for their interstate operations, such a reduction does not need to be accommodated as a legitimate and recognizable exogenous event under the applicable intrastate price cap mechanism. Second, the potential and prospective reduction of the federally prescribed ROR may reflect changes in the financial markets and an appropriate going forward readjustment of a cost of capital and ROR figure akin to the corresponding decisions that are periodically reached by this Commission for public utilities that operate under conventional rate base and ROR regulation within this Commonwealth. The PTA/CTL Joint Statement itself acknowledges that the federal 11.25% ROR figure has not been adjusted for a period of more than twenty years.¹⁵ Third, the potential and prospective FCC adjustment of the 11.25% ROR figure is not yet known, fixed, or measurable. Finally, when the FCC reaches a decision in this area, the affected RLECs can pursue and exhaust the appropriate administrative and/or appellate remedies at the federal level.

The decision reached by the majority on the issue of the exogenous event treatment of the *FCC Order* effects for the Ch. 30 RLECs opens the door to some significant regulatory policy risks. The Commission and its Staff will potentially be asked to reach important legal and factual determinations within a very limited time horizon when individual RLECs seek exogenous event upward revenue adjustments in their periodic (or out of period) PSM submissions. I seriously doubt that the proper evaluation can be made of such submissions in time periods that may range to as short as forty-five days. Nor are the proper ratemaking parameters of such submissions being set by the majority. Essentially, the Commission is inviting continuous and repetitive but unnecessary litigation to resolve disputes arising from these requests for exogenous event relief both by the Ch. 30 RLECs and other non-rural ILECs because of the *FCC Order*.

and guidelines to ensure that services included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services.” See also July 18, 2011 Order at 144.

¹⁵ The FCC “last prescribed the authorized interstate rate of return in 1990, reducing it from 12 percent to 11.25 percent.” *FCC Order*, ¶ 1046, *slip op.* at 388, 26 FCC Rcd 18051.

For these reasons, I respectfully dissent on the issue of the recognition of the *FCC Order* as an exogenous event for the Ch. 30 RLECs, and I concur in the recommended disposition of the other issues in this proceeding.

Dated: July 19, 2012



James H. Cawley
Commissioner