

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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

Docket No. I-00040105

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

AT&T Communications of :
Pennsylvania, LLC :
Complainant :

v. :

Docket Nos. C-2009-2098380, *et al.*

Armstrong Telephone Company - :
Pennsylvania, et al. :
Respondents :

**PANEL DIRECT TESTIMONY OF
JEFFREY L. LINDSEY AND MARK D. HARPER**

**ON BEHALF OF
THE UNITED TELEPHONE COMPANY OF PENNSYLVANIA LLC
d/b/a CENTURYLINK**

STATEMENT 1.0

4/15/10
Hby DK

**** PUBLIC VERSION ****

Prefiled: January 20, 2010

1 **I. INTRODUCTION AND PURPOSE OF TESTIMONY**

2 **Q. PLEASE STATE YOUR NAME, TITLE, AND BUSINESS ADDRESS.**

3 **A.** My name is Jeffrey L. Lindsey. I am employed by Embarq Management
4 Company d/b/a CenturyLink as Director, Regulatory Policy. My business address
5 is 5454 West 110th Street, Overland Park, Kansas, 66211.

6

7 **Q. ON WHOSE BEHALF ARE YOU TESTIFYING?**

8 **A.** I am testifying on behalf of The United Telephone Company of Pennsylvania
9 LLC d/b/a CenturyLink (f/d/b/a Embarq Pennsylvania) hereinafter
10 (“CenturyLink” or “Company”).

11

12 **Q. BRIEFLY DESCRIBE YOUR EDUCATION AND PROFESSIONAL**
13 **EXPERIENCE.**

14 **A.** I earned a Bachelor of Science degree in Accounting from Ball State University
15 and an M.B.A. with an emphasis in Finance from the University of Kansas. I am
16 also a C.P.A. (inactive) licensed in the state of Ohio. I have twenty-one years of
17 experience in the communications industry, having been employed since 1989 by
18 Embarq and its predecessors (Sprint Nextel Corporation, Sprint Corporation, and
19 United Telecommunications, Inc.) During my tenure, I have held a variety of
20 responsibilities in regulatory, finance, consumer marketing, and wholesale
21 marketing for local service, long distance, and wireless entities affiliated with
22 Embarq’s predecessors. My current responsibilities include managing regulatory

1 policy matters in the areas of intercarrier compensation reform, universal service
2 reform, retail service deregulation, interconnection agreement (“ICA”)
3 arbitrations, among others. Prior to my current assignment, I served as Director
4 of Federal Government Relations for Embarq’s predecessor company in
5 Washington, D.C. During that time, I actively participated in industry intercarrier
6 compensation reform efforts, universal service reform proceedings, and other
7 matters under consideration by the Federal Communications Commission
8 (“FCC”). My experience has provided opportunities to advocate policy positions
9 before the FCC, U.S. Congressional members and committee staff, and various
10 state public utility commissions, including Pennsylvania. Prior to my position as
11 Director of Federal Government Relations, I managed state regulatory affairs on
12 behalf of Embarq’s predecessor for the states of California, Idaho, Indiana, Ohio,
13 Oregon, and Washington. I have advocated regulatory policy matters before
14 public utility commissions in these and many other states.

15
16 **Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION**
17 **AND ELSEWHERE?**

18 **A.** Yes. In 2009, I submitted testimony and testified at PA PUC Docket No. I-
19 00040105 regarding the Pennsylvania universal service fund. In 2006, I also
20 submitted testimony and testified before the Pennsylvania Commission at Docket
21 No. I-00030096 regarding intercarrier compensation. Additionally, I have
22 submitted testimony and testified in Indiana and New Jersey.

1 **Q. MR. HARPER, PLEASE STATE YOUR NAME, BUSINESS ADDRESS,**
2 **EMPLOYER, AND POSITION.**

3 **A.** My name is Mark D. Harper. My business address is 100 CenturyLink Drive,
4 Monroe, Louisiana, 71203. I am Director – Regulatory Operations and Policy for
5 Embarq Management Company d/b/a CenturyLink.

6
7 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND**
8 **BUSINESS EXPERIENCE.**

9 **A.** I received a Bachelor of Science degree from Washington State University in
10 Pullman, Washington in 1983. My major was in Business Administration with an
11 emphasis in Finance. From 1983 to 1987, I was employed by the international
12 accounting firm of Ernst & Whinney in the Tacoma Telecommunications Group.
13 In that position, I provided financial and regulatory consulting services to
14 telephone companies of all sizes. I was employed by Sprint Corporation
15 (“Sprint”), or its subsidiaries, from 1987 until May 2006. My job duties with
16 Sprint were primarily in federal and state regulatory management including the
17 conformance of costing and access charge systems with FCC rules and the
18 preparation and support of the FCC tariff review plan, the development of pricing
19 strategies for new and existing services for the Company’s local exchange
20 operations and the development and implementation of state regulatory policy and
21 strategy as it pertained to Sprint’s operations in fourteen Midwest states.
22 Effective May 18, 2006, Sprint’s Incumbent Local Exchange Company (“ILEC”)

1 operations, and certain other operations were separated and a new company
2 (Embarq Corporation) was formed. On July 1, 2009 CenturyTel, Inc. and Embarq
3 Corporation completed a merger, I assumed my present position at that time.

4
5 **Q. MR. HARPER, WHAT ARE THE DUTIES AND RESPONSIBILITIES OF**
6 **YOUR PRESENT POSITION?**

7 **A.** In this position, I am responsible for the development and implementation of state
8 regulatory policy and strategy as it pertains to CenturyLink's operations in eight
9 states including Pennsylvania.

10
11 **Q. HAVE YOU TESTIFIED BEFORE THIS COMMISSION OR OTHER**
12 **COMMISSIONS?**

13 **A.** I have not previously testified in Pennsylvania. I have testified before other state
14 Commissions on numerous topics, including on topics such as access charges,
15 universal service policies and funds, and competition. Specifically, I have
16 previously testified before Commissions in the states of Kansas, Missouri,
17 Nebraska, Texas and Virginia.

18
19 **Q. MESSRS. LINDSEY AND HARPER, WAS THIS PANEL TESTIMONY**
20 **PREPARED BY YOU OR PREPARED UNDER YOUR DIRECT**
21 **SUPERVISION AND CONTROL?**

22 **A.** Yes.

1 **Q. WHAT IS THE PURPOSE OF YOUR PANEL DIRECT TESTIMONY?**

2 **A.** The purpose of our testimony is to present CenturyLink’s positions regarding
3 some of the issues identified by the Commission for this proceeding. In addition,
4 our testimony responds to statements made in the direct testimonies of several
5 parties as pre-filed in this proceeding. Specifically, we will respond to several
6 overarching policy issues raised and/or implicated by the direct testimonies of
7 Verizon witness Mr. Don Price (“Price”), AT&T witnesses Mr. E. Christopher
8 Nurse and Dr. Ola Oyefusi (“Nurse and Oyefusi”), Comcast witness Dr. Michael
9 D. Pelcovits (“Pelcovits”) and Sprint witness James A. Appleby (“Appleby”). We
10 shall at times collectively refer to these witnesses and the entities they are
11 testifying on behalf of as the parties seeking access reductions.

12

13 **Q. PLEASE SUMMARIZE THIS PANEL DIRECT TESTIMONY.**

14 **A.** Our Panel Direct Testimony demonstrates that CenturyLink’s existing intrastate
15 switched access rates and rate structure are just and reasonable, are not anti-
16 competitive or discriminatory, and are not harmful to end user consumers. Today,
17 consumers in rural, high-cost areas of the Commonwealth of Pennsylvania
18 directly and tangibly benefit from the vital role that existing intrastate switched
19 access charge levels play in providing support for the availability of the services
20 they demand upon request and at affordable rates. Existing intrastate switched
21 access rates ensure that the promise of universal service is maintained for all rural
22 Pennsylvanians – residential and business customers alike – and that quality,

1 reliable and affordable telecommunications services remain available, particularly
2 in rural and high-cost areas of Pennsylvania. This Commission has a strong
3 history of appropriately balancing pro-consumer and pro-competitive policies that
4 resulting in the existing levels of local rates, a state universal service fund
5 (“USF”) providing ongoing support for rural, high-cost areas, and existing
6 intrastate switched access rates.

7
8 The Commission can be – and should be – proud of the actions it has taken to
9 date. However, with an \$18 monthly rate for residential service and given the
10 state and competition in today’s market, additional end user retail rates increases
11 are no longer a viable option. Additional intrastate switched access reductions in
12 Pennsylvania will reverse the Commission’s policies and upset the balance
13 currently in place protecting the interests of consumers. Consumers, investment
14 in Pennsylvania, jobs, and the public interest are disadvantaged by the
15 “mirroring” proposal (of AT&T, Sprint, Verizon and Comcast) and the
16 benchmark proposal of Verizon. If the Pennsylvania Commission orders further
17 reductions to CenturyLink’s intrastate switched access rates (a result which
18 CenturyLink submits is not necessary or appropriate), the only viable recovery
19 option is the PA USF or a new USF-like mechanism that would ensure the
20 continued provision and maintenance of universal service throughout high- cost
21 rural areas in the Commonwealth.

1 Finally, given recent activity at the federal level, there is absolutely no reason to
2 act prematurely and risk dismantling the Commission’s wisely-implemented
3 policies. There should be no rush to create what, on net, will create harm to rural
4 Pennsylvanians. Indeed, competition has developed notwithstanding the wrongly
5 alleged “high” intrastate switched access rates of Pennsylvania’s rural ILECs.

6
7 In summary, our Panel Direct Testimony demonstrates that the need for further
8 access reductions is not ripe or acute. CenturyLink’s existing intrastate switched
9 access rate levels are just and reasonable. Additional reductions are not necessary
10 or proper. If the Commission determines to reduce RLEC intrastate switched
11 access rates, then any continued reform of access rates should be done in accord
12 with existing Commission policy – *i.e.*, be undertaken in a measured manner with
13 additional funds received from the Pennsylvania USF (as existing or a new USF-
14 like mechanism) and thereby with the aim of balancing the needs of
15 Pennsylvania’s end user consumers on equal footing to that of the claimed
16 competitive interests of the global and gigantic competitive powerhouses seeking
17 intrastate switched access rate reductions in rural areas.

1 **II. OVERVIEW OF THE POSITIONS OF PARTIES SEEKING ACCESS**

2 **REDUCTIONS**

3 **Q. CAN YOU IDENTIFY THE RELIEF SOUGHT BY THE PARTIES**
4 **SEEKING ACCESS REDUCTIONS?**

5 **A.** Yes, I can. Let's start with AT&T and Sprint. While their various claims in
6 support vary slightly, AT&T and Sprint both recommend reducing intrastate
7 switched access rates of all RLECs to levels that would mirror both interstates
8 rates and structures for the respective RLEC. Their direct testimonies do not
9 quantify by RLEC the impact of their rate and rate structure proposals.

10

11 **Q. CAN YOU SUMMARIZE THE RELIEF SOUGHT BY COMCAST IN**
12 **THIS CASE?**

13 **A.** Yes. Comcast also recommends that an RLEC's intrastate switched access rates
14 be priced at the same level as its interstate access rates. (Com. St. 1.0 at p. 11.)

15

16 **Q. COMCAST CLAIMS ITS RECOMMENDATION WILL BENEFIT**
17 **CONSUMERS, CONTROL DISTORTIONS TO THE COMPETITIVE**
18 **PROCESS, AND REDUCE THE INCENTIVE FOR COSTLY AND**
19 **INEFFICIENT RATE ARBITRAGE. IS COMCAST WITNESS**
20 **PELCOVITS CORRECT?**

21 **A.** No. This Panel Direct testimony addresses and debunks how the claim that access
22 reductions enhance competition. The telecommunications marketplace is

1 primarily one of bundling products and services. Switched access reductions will
2 reduce the expenses paid by Comcast, Verizon, AT&T and Sprint – all of which
3 are Fortune 100 corporations and no longer the entities or carriers they were when
4 the Commission in 1999 entered the *Global Order*.

5
6 **Q. COMCAST MAKES A REFERENCE TO “LARGE, NATIONAL RLEC**
7 **CONGLOMERATES.” (COM. ST. 1.0 AT P. 21.) CAN YOU**
8 **COMMENT?**

9 **A.** Yes and others make similar assertions. First, the size or extent of a company’s
10 operations in states beyond Pennsylvania is simply not relevant to the
11 Commission’s consideration of how to balance the interests of Pennsylvania’s
12 rural consumers with the desires of carriers like Comcast to lower their cost
13 structure. The Commission must consider Pennsylvania specific facts when
14 determining how the customers of Pennsylvania will ultimately be impacted by
15 the requests of Comcast, AT&T, Sprint and Verizon. Second, if Comcast is
16 saying that the size of the corporation is relevant to intrastate switched access rate,
17 levels then it follows logically that, because Comcast, AT&T, Verizon, and Sprint
18 are much larger than CenturyLink,¹ CenturyLink’s rates to those carriers should

¹ AT&T serves over 75 million wireless customers and over 25 million LEC customers, in addition to other interests worldwide. As of January 18, 2010, AT&T’s market capitalization was \$152 billion. Similarly, Verizon services over 80 million wireless customers and over 20 million LEC customers, in addition to other interests worldwide. Verizon’s market capitalization as of January 18, 2010, was \$87 billion. Nationwide, Comcast serves more telephone, Internet, and Video customers than CenturyLink. In addition, Comcast recently announced its intent to acquire NBC-Universal, a premier provider of entertainment content in the U.S. As of January 18, 2010, Comcast’s market capitalization was \$47 billion. Sprint serves over 48 million wireless customers nationwide and reported nearly \$36 billion of revenues in 2008. Sprint’s current enterprise value is approximately \$31 billion. CenturyLink is comparatively much smaller,

1 increase. These increases would be significant, as the disparity between the size
2 of CenturyLink and these carriers is vast. To be clear, CenturyLink is not seeking
3 this outcome nor is it supporting this stance. However, the notion that carriers of
4 a certain size do not need intrastate switched access revenues, or USF, to operate
5 effectively and to be able to continue to maintain its COLR obligations is without
6 merit. Third, obviously, larger carriers gain economy of scale benefits, but the
7 overwhelming driver of costs is the population density of the area served. For
8 example, even if all of the low population density areas of Pennsylvania were
9 served by only one large carrier, this carrier would face an immense external
10 funding need simply as a function of population density of the areas it serves in
11 order to fulfill its COLR obligations and universal service policy. Comcast's
12 statement is of no import or relevance.

13
14 **Q. CAN YOU SUMMARIZE VERIZON'S POSITION?**

15 **A.** Yes, I can. Verizon tries to place itself at the center of the pricing universe,
16 compares RLEC access rates with those of Verizon PA, and concludes that
17 RLECs charge unreasonably high switched access rates, which Verizon asserts
18 prejudices competitors. The per minute-of-use benchmark rate calculated and
19 proposed by Verizon is \$0.0172538. (VZ St. 1.0 at p. 19) Verizon also notes that
20 where existing rates are below Verizon's those rates should not be allowed to
21 increase. (VZ St. 1.0, at p. 20) Verizon asserts it is both customer and competitor

serving approximately 7 million voice customers nationally. CenturyLink's market capitalization as of January 18, 2010, was approximately \$10 billion.

1 of the RLEC. (*Id.*, at 5, 17.) Verizon is not recommending specific changes to
2 RLEC's rate structures. (*Id.*, at 16.)

3
4 **Q. WHY SHOULDN'T RLECS BE REQUIRED TO SIMPLY BENCHMARK**
5 **VERIZON SWITCHED ACCESS RATES?**

6 **A.** First, because that is not what the revenue-neutrality provision of Section 3017(a)
7 of the Pennsylvania Public Utility Code requires. Second, because the
8 characteristics of the territories served by CenturyLink are vastly different than
9 the territory served by Verizon. There is absolutely no similarity between
10 CenturyLink and Verizon in Pennsylvania. Verizon enjoys significant benefits in
11 terms of its scale, economies, densities, and cost structures. Verizon PA serves
12 the major cities in Pennsylvania of Pittsburgh and Philadelphia. Verizon serves
13 exponentially more access lines than does CenturyLink, and in some of the most
14 urban areas of Pennsylvania. Use of a grossly inapplicable rate benchmark may
15 "promote equity and competitive parity" (VZ St. 1.0 at 17) for Verizon – not for
16 consumers in rural Pennsylvania.

1 **Q. VERIZON CLAIMS ITS INTRASTATE SWITCHED ACCESS RATES**
2 **ARE AN APPROPRIATE BENCHMARK BECAUSE VERIZON’S RATES**
3 **HAVE “HISTORICALLY BEEN SUBJECT TO THE GREATEST**
4 **REGULATORY SCRUTINY.” CAN YOU COMMENT?**

5 **A. Yes, I can. Verizon’s access rates have absolutely no relationship to CenturyLink.**
6 **If Verizon’s rates have been subject to 100 years of irrelevant “regulatory**
7 **scrutiny,” then it would still be unreasonable to foist onto CenturyLink or any**
8 **other entity – but Verizon. Further, this aspect of Verizon’s self-serving proposal**
9 **does not advance in any way the balancing of important policies needed when**
10 **pricing intrastate switched access rates for rural, high-cost areas of the**
11 **Commonwealth.**

12

13 **Q. YOU MENTIONED LACK OF SIMILARITIES BETWEEN VERIZON**
14 **AND CENTURYLINK. IS VERIZON’S SWITCHED ACCESS RATE AN**
15 **APPROPRIATE BENCHMARK?**

16 **A. No. CenturyLink is not on the same “playing field” as Verizon. Verizon just**
17 **wants to force everyone to play on its playing field under its terms. By foisting a**
18 **non-applicable benchmark rate onto CenturyLink irrespective of the critical**
19 **differences between CenturyLink and Verizon, CenturyLink would not be given**
20 **any meaningful or reasonable opportunity to recover its costs. CenturyLink is**
21 **simply not providing the “exact same service” as claimed by Verizon. (VZ St.**
22 **1.0, p. 5, ln. 22.) While the functionalities are essentially the same, Verizon is not**

1 providing access to the same customers in the same locations with the same
2 population density and dispersion. CenturyLink serves areas that are less
3 significantly less dense and more rural than Verizon. In Pennsylvania, the
4 household per square-mile density of Verizon's service areas is 156, while
5 CenturyLink's household per square-mile density is less than one-third of this
6 amount, at 48. Accordingly, given that the cost characteristics so greatly differ in
7 serving different markets, it is inappropriate to use Verizon's rates as a
8 benchmark for pricing of CenturyLink's intrastate switched access rates in
9 Pennsylvania.

10
11 **Q. CAN YOU PROVIDE AN OVERVIEW OF SOME OF THE MAIN**
12 **THEMES COLLECTIVELY RAISED BY THE PARTIES SEEKING**
13 **ACCESS REDUCTIONS AND BRIEFLY COMMENT ON THE THEMES?**

14 **A.** Yes, there are several discernable themes. First, the parties seeking access
15 reductions claim that the time is ripe for intrastate switched access reductions.
16 For example, even though Verizon's ILEC affiliates in Pennsylvania lag behind
17 the RLECs in terms of access reform (as Mr. Bonsick addresses), Verizon
18 nonetheless claims "it is time" for reductions relative to RLEC intrastate switched
19 access rates. (VZ St. 1.0 at p. 3.) Similarly, other parties seeking access
20 reductions make claims that advent of intermodal competition in the
21 telecommunications marketplace now justify their request for further reductions
22 and for their specific mirroring relief. (*See, e.g.,* AT&T St. 1.1 at p. 3.)

1 **Q. ARE THEY CORRECT THAT THE TIME IS RIPE FOR REDUCTIONS?**

2 **A.** No. As I address below, intercarrier compensation (including intrastate switched
3 access rates) and universal service now have renewed emphasis at the federal
4 level. Pennsylvania has already undertaken significant reform of RLEC intrastate
5 switched access rates (but not Verizon's access rates). Given the risk of greater
6 harm to consumers arising from pending action at the FCC, it is easy for AT&T
7 and Sprint to take the stance that this Commission should press forward
8 irrespective of FCC action. These parties do not face the risks of being wrong.
9 Consumers do. In the final analysis, given the most challenging economic times
10 in recent memory, the arrogance of these parties in placing their profit-seeking
11 motives above consumers' interests remains particularly glaring.

12

13 **Q. PLEASE CONTINUE.**

14 **A.** This first theme is closely followed by their second allegation: The RLECs'
15 existing intrastate switched access rates are anti-competitive, create market
16 distortions, and an unlevel playing field. (VZ St. 1.0 at pp. 3-23; AT&T St. 1.0 at
17 pp. 30-31). Not surprisingly, they claim RLEC switched access rates are "unjust
18 and unreasonable" because the rate levels are not mathematically equal to the
19 "mirroring" (AT&T, Sprint, and Comcast) or the benchmarking (Verizon) that
20 parties seek. They also allege "consumer harm" is caused by existing intrastate
21 switched access rates, but provide only speculative and suspect support for any
22 measurable and durable specific consumer benefits that will supposedly arise

1 from reduced access rates as proposed. The claimed benefits of access reductions
2 are illusory. Even AT&T's so-called rate proposal is hollow, as Mr. Bonsick
3 further addresses. They ignore the direct benefits inuring to consumers today and
4 have not demonstrated benefits; rather, they spout theory and competition-
5 enhancing rhetoric from a bygone era. As addressed below, the days when
6 Candice Bergen is calling consumers to sell competitive long distance services are
7 long gone.

8
9 The Commission has to undertake a net consumer and public interest analysis
10 based upon the record and the applicable law. Today, how are consumers in rural
11 high-cost areas benefiting from the balancing of local rates, the state USF, and
12 intrastate switched access rate policies resulting the Commission's measured and
13 deliberate actions taken to date? What harms will result to consumers in rural and
14 high-cost areas from changing rates and policies? The answers to these questions
15 are not found in the one-sided, end-result oriented proposals of parties seeking
16 access reductions. Today, consumers directly benefit from the Commission's
17 policies, but tomorrow what consumers stand to get under the proposals advanced
18 by parties seeking access reductions is upward pressure in rates and the
19 unraveling of universal service policy in Pennsylvania as it is known. Even if it
20 were true (and it is not) that reducing intrastate switched access rates – *i.e.*, giving
21 expense savings to these carriers – will somehow eliminate market distortions and
22 competition somehow will be enhanced, parties seeking access reductions have

1 failed to demonstrate how consumers in rural high-cost areas of Pennsylvania will
2 benefit on net from further intrastate switched access reductions. None of the
3 parties seeking access reductions has demonstrated what specific products or
4 services would be rendered more competitive with access reductions – as is
5 expected in their direct testimony and the request for mirroring or benchmarking
6 pricing relief. None of the parties seeking access reductions has explained how
7 consumers in rural and high-cost areas of Pennsylvania will supposedly benefit
8 from their pricing proposals if CenturyLink and the other RLECs in Pennsylvania
9 ~~consumers~~ cannot both price competitively and recover their respective costs.
10 Consumers in rural and high-cost areas will be harmed on net by further
11 reductions to access rates as proposed by the parties seeking reductions.

12
13 **Q. HAVE YOU QUANTIFIED THE POTENTIAL IMPACT TO**
14 **CENTURYLINK OF THE PROPOSALS OF THE PARTIES SEEKING**
15 **ACCESS REDUCTIONS?**

16 **A.** Yes. While CenturyLink filed a motion to compel, the following confidential
17 table summarizes the estimated impact of the parties' proposals on CenturyLink,
18 and ultimately its end user customers. The impacts below are based on the
19 proposals of parties seeking access reductions as set forth in their Direct
20 Testimonies. The actual impact will vary based on the timing and details of the
21 final outcome of the case. Given the revenue neutrality requirement of Act 183,
22 demand and the corresponding impact calculations will need to be updated if the

1 Commission issues a final non-appealable order reducing intrastate switched
2 access rates. Further, switched access service also contains many discrete rate
3 elements at both the state and interstate level. Impact estimates like those below
4 are necessarily a simplification. The estimated impact to CenturyLink, and
5 therefore its end user customers, of the parties seeking access reductions is set
6 forth as follows:

7 **BEGIN CTL CONFIDENTIAL**

8

[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

9 **END CTL CONFIDENTIAL**

10
11
12
13 **Q. DO THE THEMES AND THE TESTIMONIES OF AT&T, VERIZON,**
14 **COMCAST, AND SPRINT FULLY SUPPORT THEIR PROPOSALS AND**
15 **DISCLOSE THE CONSUMER IMPACTS OF THEIR POSITIONS?**

16 **A.** No. The proposals seek to drastically reduce switched access revenues without a
17 recovery mechanism, let alone a viable revenue-neutral recovery mechanism, and
18 thereby will dramatically and detrimentally impact rural Pennsylvanians. The
19 parties seeking access reductions would reverse course on the Commission's policy

² This impact is based on mirroring CenturyLink's current interstate switched access rates in Pennsylvania. The current interstate access rates were accomplished as a result of reform of the interstate access rate structure. The reform included an increase to subscriber line charges and explicit support from the Federal Universal Service Fund as an offset to the reduction in interstate access revenues. The proposals of AT&T, Sprint and Comcast do not include these components.

1 and would unravel the important policy objectives in place today due to the
2 Commission’s existing practice of measured and pro-consumer policies. Large per-
3 customer amounts of revenue used to support service to rural consumers will be
4 eliminated. The only purpose will be to shift very small per-customer amounts of
5 expense savings to more urban customers of AT&T, Verizon, Comcast, and Sprint
6 throughout the country, at best. At worst, the dollars currently used to make
7 universal service possible in rural Pennsylvania will shift directly to the corporate
8 coffers of these large carriers. The proposals these parties advance pits vulnerable
9 rural Pennsylvanians, many without competitive options, against AT&T, Verizon,
10 Sprint, and Comcast. These carriers already benefit from lower cost structures as a
11 result of not having regulatory burdens associated with being an incumbent local
12 exchange carrier or having to serve rural high-cost areas. Accordingly, they don’t
13 serve the highest-cost areas. Rewarding them with an even lower cost structure in
14 the form of switched access rate reductions does not produce net consumer benefits.
15 In fact, it produces a ‘net’ deficit as rural consumer harms far outweigh the
16 purported benefits. Continuing the Commission’s current policy is sound public
17 policy. In exchange for the large cost benefits of not having COLR obligations and
18 the ability to serve only in lower-cost (potentially profitable) areas, AT&T, Verizon,
19 Comcast, and Sprint participate in the partial funding of CenturyLink’s COLR and
20 universal service obligations through the payment of its current intrastate switched
21 access rates. Such policy contributes to rural Pennsylvanians enjoying the benefits
22 of this policy, through comparable services and prices and AT&T, Verizon,

1 Comcast, and Sprint benefitting as they are not forced to serve areas where they
2 choose not to serve. Without this funding, or a suitable replacement, the continuing
3 service of rural Pennsylvanians is placed at-risk.

4

5 **Q. ARE PENNSYLVANIA'S RURAL CUSTOMERS PAYING A**
6 **REASONABLE RATE AT THE CURRENT \$18 PRICE POINT?**

7 **A.** Yes. And perhaps more than their fair share. An analysis of CenturyLink's
8 residential retail basic local service rates across its 33-state footprint reveals that
9 only 11% of its customers pay rates higher than the \$18 rate in Pennsylvania.
10 Further, the \$18 rate is 13% higher than the CenturyLink national average rate of
11 \$15.89, providing additional evidence that Pennsylvania's rural consumers are
12 shouldering their fair share of the cost burden, and perhaps a bit more.

1 **III. EXISTING INTRASTATE SWITCHED ACCESS RATE LEVELS**
2 **PROVIDE DIRECT, TANGIBLE, DURABLE BENEFITS TO**
3 **PENNSYLVANIA CONSUMERS**

4
5 **Q. ARE REVENUES FROM SWITCHED ACCESS RATES AT CURRENT**
6 **LEVELS NECESSARY AND CRITICAL COMPONENTS TO**
7 **CONTINUED HIGH-QUALITY SERVICE AT AFFORDABLE RATES**
8 **FOR RURAL PENNSYLVANIA CONSUMERS LIVING IN**
9 **CENTURYLINK SERVICE AREAS?**

10 **A.** Yes, existing intrastate switched access rates and state USF are both critical to
11 ensuring that the benefits rural and high-cost Pennsylvania consumers enjoy today
12 continue in the future. End user consumers demand high quality network services
13 and affordable prices – both of which require continual investment **and**
14 maintenance in CenturyLink’s legacy network. End user consumers also have a
15 voracious appetite for broadband services and continually demand more
16 bandwidth to meet this spiraling demand. Access revenues contribute to the
17 legacy network and the legacy network, in turn, makes broadband service possible
18 in high-cost areas.

1 **Q. ARE YOU SAYING THAT THE REVENUES FROM INTRASTATE**
2 **SWITCHED ACCESS RATES SHOULD BE USED TO SUPPORT OR**
3 **SUBSIDIZE CENTURYLINK’S PROVISIONING OF COMPETITIVE**
4 **BROADBAND SERVICES?**

5 **A. No. We are saying that the fact that the legacy network exists makes more**
6 broadband services possible. If broadband services were required to be built as a
7 separate network than the legacy network, the costs of broadband would be much
8 higher and more cost-prohibitive in more areas; generally the areas where no
9 other competitors serve.

10

11 **Q. WHAT IS THE IMPACT TO RURAL PENNSYLVANIANS IN HIGH-**
12 **COST AREAS IF EXISTING SWITCHED ACCESS RATES ARE**
13 **REDUCED AS PROPOSED IN THIS CASE BY AT&T, SPRINT,**
14 **COMCAST, AND VERIZON?**

15 **A. Obviously, there is harm to consumers in terms of destroying universal service**
16 and the Commission’s policies to- date concerning universal service, as addressed
17 throughout this testimony. Moreover, CenturyLink has committed to 100%
18 broadband availability in Pennsylvania by 2013 and continued reliance on current
19 switched access revenues, or a sufficient replacement in the alternative, is a key
20 component of this commitment. Should the Pennsylvania Commission eliminate
21 or reduce switched access revenues without a realizable revenue offset, this
22 commitment could be jeopardized. CenturyLink is an instrument of the

1 Pennsylvania Commission’s policy and will make best efforts to achieve this
2 objective. However, sufficient funding is required in order to accomplish the
3 task. Pennsylvanians are demanding ever-increasing levels of broadband service,
4 and CenturyLink intends to do its best to comply with Act 183 regarding network
5 infrastructure for broadband availability, as defined and required by Act 183.
6 But, CenturyLink is highly reliant on support to be able to deliver service to the
7 high cost areas that are routinely ignored by other providers.

8
9 **Q. WHAT DO YOU MEAN “HIGHLY RELIANT”?**

10 **A.** When a carrier with COLR obligations provides regulated services in high-cost
11 areas loses a customer in the part of its service area exposed to competition, the
12 costs do not magically “go away.” The costs to make investments, to maintain
13 investments, and to evolve network investments have to be recovered over a
14 smaller set of customers. Further, in the highest cost portions of rural high-cost
15 service areas, where competition is minimal or non-existent, providing service
16 these customers is generally uneconomic. Support from intrastate switched
17 access rates (and the PA USF) is required to continue to serve continue to serve
18 these customers.

1 **Q. PARTIES SEEKING ACCESS REDUCTIONS HAVE STATED THAT**
2 **CENTURYLINK SHOULD JUST BECOME MORE EFFICIENT, LIKE**
3 **THE OTHER COMPETITORS. CAN YOU COMMENT?**

4 **A.** The point is absurd. The competitive playing field is not level when one entity
5 has carrier of last resort obligations and is the instrument of universal policy.
6 Such statements made by these parties show either ignorance of universal service
7 policy or contempt for it.

8

9 **Q. HAVE THE PARTIES SEEKING ACCESS REDUCTION IN THIS CASE**
10 **PROVIDED ANY SUPPORT FOR THEIR ASSUMPTION THAT**
11 **CENTURYLINK CAN BOTH RECOVER ITS COSTS AND PRICE**
12 **COMPETITIVELY IF THE COMMISSION ADOPTS THE MIRRORING**
13 **OR BENCHMARKING PROPOSALS RECOMMENDED IN THIS**
14 **PROCEEDING?**

15 **A.** No. Today, it is already a challenge and today the revenues from local rates, from
16 intrastate switched access rates, and from the state USF enable CenturyLink to
17 continue: (a) to provide quality, reliable service ubiquitously available to all
18 consumers in CenturyLink's service territory; and (b) to maintain its legacy
19 network in some rural and high-cost areas of Pennsylvania. The mirroring and
20 benchmarking proposals of parties seeking access reductions would directly and
21 adversely impact consumers of CenturyLink, including as local rates increase for
22 those consumers who remain with CenturyLink and are faced with further upward

1 pressure on local rates and other competitively priced services. The proposals of
2 parties seeking access reductions result in less network investment, less ability to
3 price competitively, less for consumers. The survey addressed in Dr. Staihr's
4 testimony conclusively demonstrates the infeasibility and inappropriateness of
5 assuming that the RLECs, such as CenturyLink, serving high-cost areas are on an
6 equal playing field in the intermodal competitive marketplace today. The ability
7 to price competitively with carriers that do not have COLR obligations is pure
8 fantasy. AT&T, Sprint and Verizon are focused on business strategies that have
9 nothing to do with consumers in rural America. As Comcast noted in its response
10 to CTL-Comcast 1-23: "Comcast does not have carrier of last resort obligations
11 in Pennsylvania." As to costs, as the record in the recent Pennsylvania universal
12 service proceeding at Docket No. I-00040105 demonstrates, revenues from
13 CenturyLink's residential end-user revenues are insufficient to recover the cost of
14 providing their service.³

15
16 **Q. SPRINT AND OTHERS HAVE ALSO SUGGESTED THAT THE**
17 **ADDITIONAL REVENUES, SUCH AS REVENUES FROM BROADBAND**
18 **SERVICES, JUSTIFY REDUCING INTRASTATE SWITCHED ACCESS**
19 **RATES. DO YOU AGREE?**

20 **A.** No. These revenues from other services are unrelated to switched access charge
21 revenues. To follow this logic, we could then say that to the extent that payors of

³ Testimony of Christy V. Londerholm on behalf of Embarq PA (now CenturyLink), St. 3.0, prefiled January 15, 2009 at 12-15.

1 CenturyLink's switched access charges generate additional revenues, a portion of
2 these revenues should go for increased switched access rates. For example, when
3 AT&T generates new revenues from its U-Verse video service, AT&T would pay
4 a portion of its new revenues to CenturyLink in the form of increased switched
5 access charges. This is ludicrous. So, again following this logic, if CenturyLink
6 creates revenues from a new service, it should serve up credits on its switched
7 access charges? This too, is ludicrous. The outcome of such a policy would not
8 eliminate subsidy, as Sprint desires, but simply shifts it away from services
9 purchased by Sprint. Even if the logic were to be considered, revenue is the
10 wrong financial measure. The margin produced by the new products and services
11 would be a more appropriate measure. Many new products and services initially
12 lose money and a rather large subset never live up to expectations and are
13 eventually discontinued. So, if Sprint's recommendations were to be
14 implemented, a result which CenturyLink certainly opposes, it would only be fair
15 for this consideration to go both ways. If CenturyLink's new product or service
16 produced margin, then switched access rates would be reduced. However, if the
17 new product or service fails to produce income, then to be fair, switched access
18 rates would be increased to recover the difference. Ultimately, CenturyLink
19 believe such a scenario is poor policy and game that none of the parties to this
20 proceeding would want to play. Sprint's suggestion of considering other products
21 and services and their resulting revenues is without merit and should be rejected.

1 **Q. IN YOUR VIEW, IS RECOVERY OF DISPLACED SWITCHED ACCESS**
2 **REVENUES VIA INCREASED RETAIL RATES ON CENTURYLINK**
3 **CUSTOMERS A VIABLE OPTION?**

4 **A.** No. Other means must be utilized.

5

6 **Q. WHAT OTHER OPTIONS ARE AVAILABLE FOR RECOVERY?**

7 **A.** The PA USF is the most obvious choice. The PA USF is already functioning and
8 could be easily changed to accommodate displaced switched access revenues. Of
9 course, the Commission can create other funding mechanisms similar to the PA
10 USF if it so chooses.

11

12 **Q. IS THE CONCEPT OF UNIVERSAL SERVICE VIABLE AND**
13 **NECESSARY IN THE CURRENT COMPETITIVE ENVIRONMENT?**

14 **A.** Absolutely yes. Availability of service must trump competition from a policy
15 perspective in the area of universal service. Availability is a condition precedent
16 to competition as one provider must be present before a second can enter the
17 market to compete. Despite the growth of competition in recent years, the fact
18 remains that many rural Pennsylvanians do not currently have competitive
19 alternatives, and many of them perhaps never will. Policymakers must realize
20 that policies that promote competition in some areas will likely reduce availability
21 in others. To the extent that policies that promote universal availability may
22 slightly distort competition in those areas where competition is present,

1 policymakers must realize that this is a small price to pay to achieve the greater
2 policy goal of universal service. Universal service policy is a very sensitive
3 matter and the Pennsylvania Commission must be very careful as it considers
4 policy changes.

5
6 **Q. ARE CLAIMS OF LOWER SWITCHED ACCESS RATES**
7 **TRANSLATING TO LOWER RETAIL LONG DISTANCE RATES TRUE?**

8 **A.** No. Claims of lower switched access rates equaling lower retail long distance
9 rates are untrue. As more and more retail customers increasingly pay nothing for
10 unlimited nationwide long distance service, how will decreased switched access
11 payments benefit them? Can the price be less than free? The correlation between
12 switched access rate levels and toll prices is very weak or non-existent in today's
13 bundled and intermodal marketplace.

14
15 **Q. CAN YOU COMMENT AS TO CLAIMS THAT CENTURYLINK'S**
16 **SWITCHED ACCESS RATE LEVELS CAUSE DISTORTIONS⁴ AND**
17 **THAT CENTURYLINK'S ACCESS RATES ARE HARMFUL TO**
18 **COMPETITION?**

19 **A.** Yes, I will. In terms of wireless market growth, the claims certainly don't appear
20 to be true. The number of wireless subscribers in Pennsylvania has grown from
21 fewer than 3 million in 1999 to nearly 10 million in 2008, an increase of more

⁴ AT&T St 1.1 at 2.

1 than 300%.⁵ Similarly, local service competition is flourishing in Pennsylvania
2 and does not appear to suffer effects of anticompetitive distortion as claimed by
3 AT&T. The most recent FCC Trends in Telephone Service Report,⁶ released in
4 August 2008 shows that CLECs possess a 20% market share,⁷ above the national
5 average CLEC market share of 18%. Further, historical trending shows that
6 CLEC market share was above the national average in 2001 and has continued to
7 be above that average at every six-month interval the report was compiled through
8 the latest reporting period.⁸ CenturyLink's access lines have declined by
9 approximately 28% since 2000. Clearly, CenturyLink's existing intrastate
10 switched access rate levels do not appear to be "distorting" competition as
11 claimed by AT&T.⁹

12
13 **Q. SHOULD THE COMMONWEALTH OF PENNSYLVANIA CONTINUE**
14 **TO SUPPORT UNIVERSAL SERVICE THROUGH A COMBINATION**
15 **OF EXPLICIT AND IMPLICIT MEANS?**

16 **A. Yes. Intrastate switched access is a critical means of implicit support of the**
17 **universal service and carrier of last resort ("COLR") obligations. If the**
18 **Commission were to take action to and not sufficiently fund the ILEC's unique**
19 **universal service and COLR obligations, carriers must be relieved of them, and a**

⁵ See, graph at <http://mywireless.org/issues/pennsylvania>.

⁶ Federal Communications Commission, "*Trends in Telephone Service*", released August 2008. The report can be downloaded at www.fcc.gov/wcb/iatd/trends.html.

⁷ Ibid, Table 8.5, p. 8-9.

⁸ Ibid, Table 8.6, p. 8-10.

⁹ AT&T St 1.1 at 4.

1 long-held policy of universal service will effectively come to an end. The results
2 of ending universal service policy are clear. Rural network build-out as required
3 by Act 183 for CenturyLink would become unsustainable. Network reliability in
4 rural areas could be significantly impaired. Retail rates in rural areas will come
5 under severe upward pressure and could increase significantly, by multiples of
6 current rates in some areas, in order to fully recover costs. The effect of such a
7 significant policy shift would be to drive many customers, disproportionately lower
8 income customers, off the communications network. Obviously, intrastate
9 switched access revenues and an explicit universal service fund are necessary
10 components to provide reliable communications networks and services at
11 comparable terms to those offered to urban and suburban customers once
12 competition appears in the market. To do less exacerbates the digital divide and
13 is patently unfair to Pennsylvania's rural customers.

14
15 **Q. CAN YOU FURTHER EXPLAIN THE COLR OBLIGATION?**

16 **A.** Yes. ILECs are the only carriers who bear the COLR obligation and are the only
17 carriers who serve many rural Pennsylvanians. The COLR obligation is not
18 merely providing service to new customers. It is much, much more than this one
19 component. COLR is also maintaining and enhancing the ILEC's existing
20 network. Where competition is less than robust, generally in the most rural of
21 areas, Pennsylvania residents are even more dependent on the ILEC network than
22 are residents in other areas. Rural Pennsylvania consumers deserve dependable,

1 communication services at affordable rates. And, indeed, CenturyLink maintains
2 its first-class network architecture and provides an array of services available to
3 all of its customers. CenturyLink is proud of its ongoing commitment to service
4 its customers with desired products and services at affordable prices, which is the
5 end result of the COLR obligation. CenturyLink stands ready to serve
6 prospective customers throughout its service territory. This is a costly policy and
7 contributes to the fact that when a CenturyLink customer disconnects from its
8 highly-fixed cost network, a proportional amount of costs are not eliminated. The
9 fixed cost nature of the network and COLR policy combine to require a continued
10 funding need. Competitive carriers have not accepted the COLR obligation and
11 cannot be expected to do so in the future as there are many customers they will
12 never attempt to serve. Successful implementation of state and federal universal
13 service policy will continue to depend on COLR-bound ILECs delivering high-
14 quality service to rural Pennsylvanians at rates comparable to their urban and
15 suburban counterparts. CenturyLink and rural ILECs stand proud of their
16 historical universal service accomplishments.

17
18 **Q. DO AT&T, VERIZON, SPRINT, OR COMCAST HAVE A VESTED**
19 **INTEREST IN THE LOW-POPULATION DENSITY, HIGH-COST**
20 **PORTIONS OF CENTURYLINK'S SERVICE AREAS?**

21 **A. No.**

1 Q. DOES CENTURYLINK HAVE A VESTED INTEREST IN THE LOW-
2 POPULATION DENSITY, HIGH COST PORTIONS OF ITS
3 PENNSYLVANIA SERVICE AREAS?

4 A. Yes.

5

6 Q. IS IT FAIR TO REQUIRE ALL PROVIDERS, INCLUDING
7 “COMPETITIVE” PROVIDERS, TO CONTRIBUTE TO UNIVERSAL
8 SERVICE POLICY THROUGH, IN PART, INTRASTATE SWITCHED
9 ACCESS CHARGES?

10 A. Yes. To date, universal service policy has been a success, and the contribution to
11 universal service through switched access has been a key component. Switched
12 access revenues have been used, along with other mechanisms, to provide
13 communications services to all consumers at comparable rates, terms and
14 conditions, irrespective of cost. This was largely accomplished through a system
15 of product and geographic cross subsidization. Residential basic local service,
16 particularly in high-cost rural areas, was priced below cost. To recover this
17 difference in the form of implicit support, toll services, switched access services,
18 and business basic local services were typically priced above cost. In a monopoly
19 environment, this system worked quite well as U.S. telephone penetration rates
20 increased from less than 36.9% in 1940 to greater than 97% by 2000.¹⁰ But that
21 monopoly environment is largely a relic of the past. VoIP, wireless, and cable

¹⁰ Universal Service Monitoring Report, Table 6.2, “Historical Telephone Penetration Estimates”, *CC Docket 98-202*, prepared by the Federal and State Staff for the Federal-State Joint Board on Universal Service in *CC Docket 96-45*, p. 6-13, *rel. January 2008*.

1 competitors, are strong and growing competitors in urban and suburban areas, in
2 addition to rural town centers. But competition remains elusive in many rural
3 unincorporated areas. In these rural outlying areas, cable telephony is frequently
4 not available, wireless services are less prevalent (and where they are they tend to
5 offer less reliable service than in more populated areas), and VoIP services that
6 rely on broadband availability are not as readily available. The competitors of the
7 ILEC do not bear the burden COLR obligations and tend to not serve the highest-
8 cost customers in areas of low population density. To compound the problem for
9 these rural consumers, competition in other areas erodes the very implicit subsidy
10 on which consumers of rural ILECs have depended to receive high quality,
11 reliable communications services and rates comparable to urban consumers. For
12 these reasons, it is imperative that intrastate switched access charges, supported
13 by explicit universal service funding, remains available and sufficient to fulfill
14 COLR obligations in a competitive environment.

15
16 **Q. SHOULD ALL PENNSYLVANIA ILECS TO HAVE THE SAME RATES FOR**
17 **SWITCHED ACCESS SERVICES?**

18 **A.** Absolutely not. Verizon has asked that the other RLECs in PA mirror Verizon's
19 switched access rate, but this is not a feasible or reasonable request. The history
20 of rates has been and continues to be is unique to each carrier. Each carrier has
21 evolved over time to arrive at current rate levels, which are fair and reasonable, as
22 determined by this Commission in previous decisions. Each carrier (including

1 CenturyLink) has invested differently over many decades based on their unique
2 circumstances and the varied areas they serve. Among many other variables,
3 circumstances such as placing facilities in varying terrain, such as rocky areas or
4 around/under water, unique average local loop lengths, and unique customer
5 calling patterns impact how a company evolves over time. Additionally, as
6 discussed elsewhere in this testimony, consumer density plays a very large role in
7 the cost to provide service.

8
9 **Q. VERIZON ATTEMPTS TO USE THE CLEC MIRRORING STATUTE IN**
10 **SUPPORT OF ITS BENCHMARKING CLAIM. DO YOU HAVE A**
11 **COMMENT?**

12 **A.** Yes. Section 3017(c) of Act 183 provides: “No telecommunications carrier
13 providing competitive local exchange telecommunications service may charge
14 access rates higher than those charged by the incumbent local exchange
15 telecommunications company in the same territory, unless such carrier can
16 demonstrate that the higher access rates are cost justified.” (Emphasis added.)
17 The components of the statutory requirement are inapplicable and cannot be used
18 to justify Verizon’s benchmarking position.

1 **Q. CERTAIN PARTIES ALSO HAVE SUGGESTED THAT BECAUSE THE**
2 **“FUNCTIONALITY” BETWEEN INTRASTATE AND INTERSTATE IS**
3 **THE SAME, THEN THIS VIEW SHOULD DICTATE PRICING**
4 **DECISIONS. DO YOU AGREE?**

5 **A.** Absolutely not. Let me given an overview of their claims. Comcast (Com. St. 1.0
6 at 6-7) and others (*e.g.*, AT&T St. 1.0 at p. 52) contend that the functionalities
7 used for interstate and intrastate switched access are essentially the same. They
8 further rely upon the FCC’s CALLS order and claim, since there is no cost
9 justification between interstate and intrastate call completion, the two rate
10 schemes should be the same (*i.e.*, at parity). They further assert that because
11 Embarq has not challenged its existing interstate rates, interstate rates should be
12 presumed to be compensatory. The same functionality in their view, therefore,
13 dictates re-pricing intrastate switched access rates to “mirror” interstate rates and
14 structures.

15
16 The functionalities used for interstate and intrastate switched access are essentially
17 the same. However, functionality does not dictate regulatory pricing decisions. By
18 its very nature and due to the explicit finding of the FCC, the CALLS Average
19 Traffic Sensitive (“ATS”) rate of \$.0065 rate applicable to CenturyLink is not based
20 on CenturyLink’s costs in Pennsylvania – or in any particular state. The CALLS
21 target rate arose from a compromise among many parties. Thus, participation in the
22 CALLS plan cannot be used as evidence that CenturyLink’s ATS rate of \$.0065

1 represents the cost of providing switched access in Pennsylvania and cannot be used
2 to assume that the CALLS ATS rate alone is compensatory. Finally, as with the
3 “pick and choose” reality associated with mirroring and parity proposed by AT&T,
4 Sprint, and Comcast in this case, the problem with the “functionality” viewpoint is
5 that ignores the holistic reform also undertaken by the FCC.
6

7 **Q. ARE CENTURYLINK’S SWITCHED ACCESS RATES DISCRIMINATORY?**

8 **A.** No. CenturyLink charges the same rates for all users of its tariffed intrastate
9 switched access services. The rates and the application of those rates are not
10 discriminatory.
11

12 **Q. ARE SWITCHED ACCESS PAYMENTS INCREASING OR DECREASING?**

13 **A.** Decreasing. AT&T, Verizon, Sprint, and Comcast are using less intrastate
14 switched access and paying less every year, a trend that began several years ago
15 and is expected to continue. To the extent that any purported competitive
16 distortions may exist, they are decreasing.
17

18 **Q. WHY ARE SWITCHED ACCESS PAYMENTS DECREASING?**

19 **A.** Primarily for two reasons. First, wireless substitution of wireline basic local
20 telephone service is the biggest driver as customers continue to increasingly take
21 advantage of unlimited long distance calling that is provided routinely by wireless
22 providers. Because wireless carrier local calling areas are larger than wireline

1 local calling areas, wireless carriers enjoy a cost of service input windfall from
2 this intermodal shift. Also, in CenturyLink's Pennsylvania areas, wireless
3 carriers, including AT&T Mobility, Verizon Wireless, and Sprint, enjoy an even
4 larger cost input windfall as wireless local calls are charged at an artificially low
5 rate of \$0.0007 per the terms of the FCC's *ISP Remand Order*.¹¹ This order
6 provided a windfall to wireless carriers in order to stimulate wireless market
7 growth as a seemingly unrelated part of its solution to stem increasing payments
8 to ISPs who were distorting the market via one-way calling schemes.
9 CenturyLink notes that the biggest beneficiaries of these events are AT&T,
10 Verizon, and Sprint. To the extent they cite "harm" from intrastate switched
11 access rates, any such alleged harm is more than offset by the benefits accruing to
12 their wireless operations. The second factor for declining switched access
13 payments is local competition. To the extent that non-ILECs win business from
14 ILECs, ILECs no longer generate switched access revenues for that customer
15 location. CenturyLink notes that most of this competitive loss is to AT&T,
16 Verizon, Sprint, and Comcast in Pennsylvania.

17
18 **Q. DOES THE LONG DISTANCE MARKET STILL EXIST?**

19 **A.** No. As wireline providers increasingly offer bundles services inclusive of
20 unlimited long distance service and wireless plans routinely offer unlimited
21 nationwide calling, the stand-alone long-distance market declined rapidly and for

¹¹ *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Intercarrier Compensation for ISP-Bound Traffic*, 16 FCC Rcd 9151 (2001).

1 all intents and purposes, no longer exists. Does anybody remember the “big 3”
2 IXC’s of the 1980s and 1990s: AT&T, MCI, and Sprint? They no longer exist as
3 long distance companies. AT&T was acquired by SBC Communications (which
4 rebranded itself as AT&T), MCI was acquired by Verizon, and Sprint morphed
5 into a wireless provider. Carriers announced they were exiting the stand-alone
6 long-distance business. For example, Sprint confirmed that it was deemphasizing
7 residential wireline long distance service: “Although we [Sprint] continue to
8 provide voice services to residential customers, we no longer actively market
9 those services.”¹² Meanwhile, Sprint’s 2008 annual SEC 10-K report further
10 indicates that Sprint is not fully passing the savings from access reductions to its
11 customers but retaining portions to support internal gross margin objectives.¹³
12 The days of having your supper interrupted by a telemarketer seeking to get you
13 switch your long distance provider are long gone. In fact, any attempt to sign-up
14 with a carrier for long-distance service would be a difficult proposition. The
15 stand-alone long distance market is dead. And, claims that consumers are
16 somehow harmed because access rates hinder competition in the long distance
17 market (*see, e.g.,* AT&T St. 1.0 at p. 66) are meritless.

¹² Sprint’s 2008 10-K filing with the SEC. at p. 5 attached at Exh. CTL Joint Panel-1.

¹³ In discussing the Costs of Service and Products or Wireline Service Sprint states: “Service gross margin percentage decreased from 32% in 2006 to 31% in 2007 and then increased to 34% in 2008, primarily as a result of revenue growth in our cable IP business and improved access cost rates.” (emphasis added.)

1 **Q. AT&T ALSO CLAIMS THAT BECAUSE CENTURYLINK DOES NOT**
2 **CURRENTLY RECEIVE FEDERAL HIGH COST LOOP UNIVERSAL**
3 **SERVICE FUND SUPPORT FOR ITS PENNSYLVANIA OPERATIONS,**
4 **IT SHOULD NOT QUALIFY FOR ANY SUPPORT AT THE STATE**
5 **LEVEL. IS THIS TRUE?**

6 **A.** No. CenturyLink serves many high-cost areas that would qualify for support
7 under a distribution mechanism more closely aligned with the underlying
8 economics, such as a wire center or exchange level. There is near consensus that
9 the federal universal service fund distribution mechanism is broken and in need of
10 reform. AT&T has multiple filings on the record at the FCC¹⁴ stating so.
11 CenturyLink agrees that the federal mechanism is broken and in need of reform.
12 One of the primary reasons that reform is necessary is the fact that the current
13 monopoly-era system of determining support eligibility is based on the average
14 cost of ILEC study areas. All CenturyLink ILEC operations are part of one study
15 area. Determining costs at a study area average level assumes that high-density
16 low-cost areas can subsidize low-density, high-cost areas. For example, revenues
17 from CenturyLink's large higher-density exchanges such as Carlisle, Butler, and
18 Chambersburg – each with household population densities in excess of 100 per
19 square mile, can provide sufficient implicit support for its small lower-density
20 exchanges such as Clearville, Blain, and East Waterford – each with household
21 population densities of less than 7 per square mile. The impact of such a policy is

¹⁴ AT&T has many filings on the record suggesting reform of the federal universal service fund over the past few years. One recent example is *In the Matter of A National Broadband Plan For Our Future*, GN Docket No. 09-51, at 22.

1 to reduce the amount of explicit USF funding while relying on implicit support.
2 While such policy can work in a monopoly environment, it is a failure in an
3 environment of competition, particularly the current environment of uneven
4 competition whereby competitors ignore high-cost areas while electing to serve
5 only lesser cost areas. Competition has entered the market and is pervasive in
6 areas of greatest margin; the high-density, low-cost areas. This produces the
7 obvious effect of reducing or eliminating the implicit support used to support
8 universal service. Reforming the basis of the federal USF to align more closely
9 with underlying highly variable wire-center or exchange level costs would
10 produce an improved public policy outcome. CenturyLink and others have
11 proposed such reform to the FCC. This reform would end the cross-subsidization
12 of high-cost wire centers by low-cost wire centers. Considered independently,
13 CenturyLink's highest-cost wire centers would likely qualify for federal USF
14 funding under such an improved more economically rational system. It is
15 important to note that such a system would provide funding for the highest cost
16 Verizon wire-centers also, as it faces similar study area averaging problems.
17 Finally, such reform would have the added benefit of targeting funding to areas
18 generally not served by cable providers, a complaint lodged by the National Cable
19 Television Association at the FCC in a petition¹⁵ filed late last year.
20 CenturyLink's comments responding to the petition on January 7, 2010,
21 demonstrate how targeting of USF support mitigates the cable industry's concern.

¹⁵ *In the Matter of Reducing Universal Service Support In Geographic Areas That Are Experiencing Unsupported Facilities-Based Competition*, RM-11584.

1 AT&T's statement that because a carrier does not receive federal high-cost loop
2 support under the current federal mechanism indicates that the carriers do not
3 need support is incorrect.

4
5 **IV. ALLEGED MIRRORING IN OTHER STATES**

6 **Q. IS THE CURRENT SWITCHED ACCESS CHARGE POLICY OF THE**
7 **COMMISSION OUT OF STEP WITH "NUMEROUS" STATES AS**
8 **CLAIMED BY AT&T?**

9 **A.** No. Dr. Oyefusi and Mr. Nurse presented an exhibit market as AT&T Panel
10 Exhibit I. Dr. Oyefusi and Mr. Nurse dramatically overstate and draw misleading
11 conclusions regarding parity between intrastate access charges and interstate
12 switched access rates as allegedly undertaken in other states, particularly as their
13 exhibit relates to incumbent LECs other than the Regional Bell Operating
14 Company ("RBOC"). Simply put, AT&T Panel Exhibit I does not support the
15 conclusion that "Numerous states, including major industrial states such as
16 Massachusetts, Illinois, Ohio, Michigan and Texas, have, in one form or another,
17 required local exchange carriers' intrastate switched access charge rates to mirror
18 their interstate switched access rates, ..." (emphasis added).

19
20 In response, we have prepared an exhibit, in table format, attached hereto as
21 Exhibit CTL Panel Exhibit-1. In the first column, we have set forth the AT&T
22 Exhibit in its entirety. In the second column, CenturyLink's response is provided

1 to the state-by-state review of the “mirroring” and “parity” claims of AT&T.
2 Exhibit CTL Panel-1 first focuses on whether access charge parity is required of
3 any incumbent LEC in that state. Second, Exhibit CTL Panel-1 identifies which
4 incumbent LECs, if any, are impacted by an access charge parity requirement.
5 Third, Exhibit CTL Panel-1 addresses whether an alternative recovery
6 mechanism, such as a state USF, was implemented or enhanced in conjunction
7 with an access charge parity requirement.

8
9 **Q. COULD YOU PROVIDE EXAMPLES FROM CTL PANEL DIRECT**
10 **EXHIBIT A REGARDING THE ALLEGED “MIRRORING” SWITCHED**
11 **ACCESS CHARGE POLICY OF OTHER STATES?**

12 **A.** Yes. The first section of the AT&T Panel Exhibit purports to list that six “states
13 that mandate intrastate/interstate parity by statute for certain carriers”. However,
14 of the states listed, only Maine has mandated interstate/intrastate parity for all
15 ILECs. The Maine statute also provides an opportunity for the Commission to
16 review and does not require parity for a given company if its local rates will rise
17 too dramatically. It is also important to highlight – as AT&T neglects to mention
18 – that Maine also implemented a state USF fund to provide an opportunity to
19 further cushion the impact of intrastate/interstate access rate parity.

20
21 For Texas and Georgia, the intrastate/interstate access rate parity for AT&T came
22 as a result of an election for deregulation or alternative regulation not as a

1 mandate. In Oklahoma, AT&T's own rates still include an intrastate per MOU
2 CCL element and the local switching element is more than double its interstate
3 counterpart.

4
5 The third section of the AT&T Panel Exhibit 1 is titled "states that mandate
6 intrastate/interstate parity by commission order, rule, or tariff, including where
7 subsequently modified". Of the nine states identified there by AT&T, only one,
8 New Mexico, mandated parity for all ILECs in the state as recommended by
9 AT&T. However, unlike AT&T's recommendation for Pennsylvania, the
10 movement of intrastate access rates in New Mexico was accompanied by a local
11 rate cap of \$15.28¹⁶ and a state USF fund to allow recovery of any lost revenue
12 due to the move to parity. Further, AT&T's tariffed intrastate local switching
13 access rate in Alabama is nearly twice as high as its current corresponding
14 interstate rate.

15
16 **Q. SO, BASED ON THE 20 STATES IDENTIFIED BY AT&T, HOW MANY**
17 **STATES HAVE MANDATED PARITY FOR ALL INCUMBENT ILECS?**

18 **A.** As discussed above, only the states of Maine and New Mexico have mandated
19 intrastate/interstate access parity for all ILECs. Moreover, both of these states
20 have also put in place mechanisms to ensure that basic local service rates remain
21 affordable in all areas and that the support that was previously flowing from

¹⁶ The rate cap is set at the Qwest basic local rates for residential; current at \$13.50, plus the Qwest state subscriber line charge of \$1.78.

1 intrastate access charges to support the provision of service in higher cost areas
2 was maintained through a broadly-funded explicit mechanism rather than solely
3 through the ratepayers of the impacted companies.

4
5 **Q. WHAT, IN YOUR OPINION, IS THE USEFULNESS OF THIS TYPE OF**
6 **STATE-BY-STATE COMPARISON?**

7 **A.** State public utility commissions and state legislatures are often faced with similar
8 issues across the country. A survey of the approaches taken in other states may be
9 useful for understanding trends. However, even that usefulness can be quickly
10 rendered meaningless for setting appropriate regulatory policy in a particular
11 state. Caution must be exercised in drawing broad conclusions such as
12 “numerous states” have mandated intrastate/interstate access charge parity
13 without studying the details. Moreover, each carrier is faced with varying cost
14 characteristics and each state commission, or legislature, is faced with varying
15 laws and regulations to work under. It is also important to recognize that where
16 states are in the process of making implicit support for high cost areas more
17 explicit can make different policy solutions and timing appropriate. Finally,
18 variances in the geography and demographics of a state and the size and
19 distribution of ILECs can influence policy outcomes as well. CTL Panel Direct
20 Exhibit A demonstrates the challenge of drawing broad conclusions based on
21 other states’ activity. We (the witnesses for AT&T and CenturyLink) have
22 separately read the various Commission orders, rulings, laws, regulations and

1 settlement and reached different conclusions on the implications of each. Even
2 here in Pennsylvania where the Commission has addressed the level of access
3 charges for the ILEC industry at least twice in major cases there has been
4 significant debate about the scope for this case. Finally, it appears AT&T itself
5 has struggled somewhat in summarizing what states belong on or off, and in
6 which category, on what it characterizes as a listing of “States with
7 Intrastate/Interstate Access Parity.” On February 13, 2009, Mr. Nurse and Dr.
8 Oyefusi filed Exhibit F as an attachment to their Joint Direct Panel Testimony in
9 New Jersey.¹⁷ Exhibit F listed 22 states including Iowa and Nebraska which are
10 no longer contained on the current listing of 20 states filed as Exhibit I. I assume
11 that AT&T has since discovered that no ILECs in Iowa or Nebraska mirror their
12 interstate access charges. AT&T Exhibit I as filed in Pennsylvania also contains
13 additional language in some cases to more clearly portray the current situation
14 with regard to parity in several states and to clarify the application of parity
15 mandates to carriers other than the RBOC. For example, Exhibit I now correctly
16 notes for Texas that “Other statutory provisions, however, shield certain ILEC
17 from the requirement to reduce intrastate access rates to parity with interstate
18 rates.” And for Oklahoma, AT&T Exhibit I clarifies that “There is no current
19 parity requirement for Switched Access rates for Oklahoma.” The point of this
20 comparison is not that witnesses should not continually review their sources in
21 order to ensure their testimony and exhibits are as accurate as possible. Instead, it

¹⁷ AT&T’s document is attached as Exhibit CTL Panel-2.

1 is reinforcing the caution that should be taken when comparing state regulatory
2 policies and making broad conclusions.

3
4 **V. FEDERAL ACTIVITY – PAST AND PRESENT**

5 **Q. HAS THE FCC IMPLEMENTED DRAMATIC SWITCHED ACCESS**
6 **RATE REDUCTIONS WITHOUT REALIZABLE REVENUE OFFSETS**
7 **AS PROPOSED BY AT&T IN THIS INSTANT PROCEEDING?**

8 **A.** No. Although in late 2008, the FCC did consider such action. Former FCC
9 Chairman Martin proposed an ill-conceived intercarrier compensation and
10 universal service reform order¹⁸ that would have produced horrible impacts to
11 rural America in terms of communications and broadband service investment,
12 service, pricing, and innovation. It might even have bankrupted some rural
13 carriers. The Chairman's proposed order would have greatly reduced AT&T's,
14 Verizon's and other carrier's intercarrier compensation and universal service
15 expenditures¹⁹ on the backs of mid-sized rural carriers and the customers served
16 by them: disproportionately high-cost rural customers. The Chairman's order
17 would have drastically reduced mid-sized carrier intercarrier compensation
18 revenues and federal universal service fund receipts without providing an
19 opportunity to recover revenues lost because of the proposed order. Wall Street

¹⁸ See *ISP Remand Order and Intercarrier Compensation/Universal Service Reform*, Order on Remand and Report and Order and Further Notice of Proposed Rulemaking

¹⁹ See, e.g., Wall Street Journal, CALL TRANSFER RATE PLAN IS ON HOLD, The Wall Street Journal (November 4, 2008), ("Analysts say the proposal was worth millions to large phone companies such as AT&T, Inc., Verizon Communications, Inc. and Qwest Communications International Inc. Small and midsize carriers like Embarq Corp. and CenturyTel Inc. would have taken a hit.") Available at <http://online.wsj.com/article/SB122574357296494187.html>

1 analyst Frank Louthan of Raymond James Associates, Inc., released an Equity
2 Research report²⁰ analyzing Chairman Martin’s proposed order noting, “... mid-
3 sized price cap carriers...stand to have an unfunded obligation. This means they
4 have regulatory-imposed obligations to be the carrier of last resort (COLR) in
5 their service territory but will not be able to service those obligations without
6 losing money.” Such an outcome is poor public policy and would be punitive to
7 rural LECs and their customers. Once the impacts of the proposed order became
8 apparent, a firestorm of opposition informed the FCC not to enact this order, and
9 accordingly, it did not. Not surprisingly, this proposed order was supported by
10 AT&T, Verizon, Sprint, and Comcast.

11
12 **Q. DOES THE FCC HAVE A HISTORY OF ORDERS THAT PROVIDE**
13 **REALIZABLE REVENUE OFFSET OPPORTUNITIES?**

14 **A.** Yes. The FCC’s history of orders in this area, notably the Coalition for
15 Affordable Local and Long Distance Services (“*CALLS*”)²¹ in 2000 [complete
16 cites] and the Multi Association Group (“*MAG*”)²² in 2003, includes necessary
17 offsetting revenue recovery provisions, recognizing the importance of these
18 revenues to rural Americans. The FCC provided additional federal universal

²⁰ See *Equity Research, Intercarrier Compensation Reform: Potential Impact from an FCC Order*, Raymond James Associates, Inc. (October 27, 2008) at 3.

²¹ See Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45, *Access Charge Reform*, 15 FCC Rcd 12962 (2000) (“*CALLS Order*”).

²² See Fourteenth Report and Order, Twenty-Second Order on Reconsideration, and Further Notice of Proposed Rulemaking in CC Docket No. 96-45, and Report and Order in CC Docket No. 00-256, *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, 16 FCC Rcd 11244 (2001) (“*MAG Order*”).

1 service funding and increased retail revenue recovery through the federal
2 subscriber line charge (“SLC”). Increasing SLC rates were a viable option in
3 2000 and 2003, given the levels of competition then-present. But they are not a
4 viable option now. As the Pennsylvania survey described above shows, current
5 price levels for local service and current levels of competition mean SLC
6 increases are not now a realistic option for revenue recovery.

7
8 **Q. IN YOUR OPINION, DO THE “MIRRORING” PROPOSALS OF AT&T,**
9 **SPRINT AND COMCAST CAPTURE THE HOLISTIC APPROACH**
10 **TAKEN BY THE FCC TO DATE?**

11 **A.** The “mirroring” proposals of AT&T, Sprint and Comcast are incomplete and far
12 removed from a holistic reform of access rates – as undertaken by the FCC and by
13 the Pennsylvania Commission. The mirroring they seek (along with Verizon’s ill-
14 suited proposal) is not reform, does not continue along the path of reform, and
15 will reverse long-standing policies in Pennsylvania and will significantly harm
16 Pennsylvanians in high-cost areas of the state.

17
18 **Q. IS THE FCC CURRENTLY CONSIDERING FURTHER REFORM OF**
19 **ACCESS CHARGES?**

20 **A.** Yes. As part of its comprehensive National Broadband Plan, due to be submitted
21 to Congress within the next 60 days, the FCC is considering significant reforms to
22 both universal service fund policy and switched access policy.

1 **Q. SHOULD THE PENNSYLVANIA COMMISSION FOLLOW THE FCC’S**
2 **INSTRUCTIVE LEAD OF IMPLEMENTING REFORM ONLY IN A**
3 **HOLISTIC MANNER IN THIS PROCEEDING?**

4 **A.** Yes. It is not a coincidence that shortly after failing to get Chairman Martin’s
5 Proposed Order approved at the FCC, AT&T, Verizon, and Sprint embarked on a
6 crusade to opportunistically seek one-sided switched access reductions at the state
7 level. Well-informed states have resisted these efforts, or in the alternative have
8 enacted more balanced proposals, including limited access rate reductions,
9 incremental universal service funding, and limited realizable retail rate increases.
10 These states also established meaningful time-period transitions to limit the
11 impact on the consumers, the market, and carriers. The Pennsylvania
12 Commission should act cautiously in this matter due to its size, complexity, and
13 sensitivity to ensure that it fully comprehends the impacts of its actions on all
14 constituents, but most importantly the most vulnerable rural Pennsylvanians who
15 live in high-cost areas and have only one service alternative available.
16 Accordingly, the Pennsylvania Commission should consider upcoming FCC
17 actions prior to moving in this proceeding to ensure that its actions are not
18 inconsistent with those of the FCC.

1 **VI. CONCLUSION**

2 **Q. PLEASE SUMMARIZE CENTURYLINK'S PANEL DIRECT**
3 **TESTIMONY.**

4 **A.** The Pennsylvania Commission must defend the most vulnerable of its
5 constituents – its rural Pennsylvania consumers who have been ignored by
6 competitive carriers. AT&T's access complaint, supported by Verizon, Sprint,
7 and Comcast, has launched a direct assault on the continued viability of rural
8 Pennsylvanians as communications consumers by attacking the only carriers who
9 serve them. The Pennsylvania rural ILECs – unlike AT&T, Verizon, Sprint, and
10 Comcast – are not neglecting or abandoning rural Pennsylvania. Pennsylvania's
11 rural ILECs are committed to serving rural Pennsylvanians. AT&T's egregious
12 attempt – joined by Verizon, Sprint and Comcast – to increase profits to the
13 detriment of the very customers they collectively deem unimportant is not in the
14 public interest. CenturyLink is committed to continuing the policy of universal
15 service and supporting rural consumers in high-cost areas of the Commonwealth,
16 despite the efforts of behemoth urban-focused carriers to reduce their costs at the
17 expense of these rural consumers and expand the digital urban/rural divide.
18 Verizon and AT&T would have this Commission ignore the important goal of
19 universal service and focus exclusively on their lofty claims of competition.
20 Their claims of harm due to existing intrastate switched access rate levels remain
21 flawed theories from a bygone era. The alleged benefits from their proposals to
22 reduce those rates remain built upon illusion and fiction. The Pennsylvania

1 Commission must support the rural ILECs who are “standing in the gap” for rural
2 Pennsylvanians and dismiss AT&T’s access complaint.

3

4 **Q. DOES THIS CONCLUDE CENTURYLINK’S PANEL DIRECT**
5 **TESTIMONY?**

6 **A. Yes.**

Exhibit CTL Panel-1

AT&T EXHIBIT I	CENTURYLINK RESPONSE
STATES WITH INTRASTATE/INTERSTATE ACCESS PARITY	THE LABEL FOR THE AT&T EXHIBIT IS MISLEADING. THE EXHIBIT IS CERTAINLY NOT A LIST OF "STATES WITH INTERSTATE/INTRASTATE ACCESS PARITY".
States that Mandate Intrastate/Interstate Parity by Statute for Certain Carriers	
<i>Six states have mandated reduction of intrastate access rates to interstate rate levels by statute, and some have also directed the state utilities commission to ensure compliance through further proceedings and tariff oversight. These states are listed below with a summary of relevant state activities.</i>	<i>Only one state, Maine, has required all ILECs to mirror interstate rates by statute. Maine also has a state USF. Moreover, none of the other states that have implemented a mirroring requirement for rural ILECs (as recommended by AT&T, Sprint and Comcast in this case) have undertaken mirroring without an explicit USF support mechanism.</i>
<p>Maine: In Maine the legislature ordered the commission to ensure intrastate mirroring of interstate switched access rates: "By May 31, 2005, the commission shall ensure that intrastate access rates are equal to interstate access established by the Federal Communications Commission as of January 1, 2003"¹ The Maine public utilities commission implemented the statutory directive by adopting a rule requiring each local exchange carrier to implement access mirroring by June 1, 2003, and to refresh the mirrored rates on June 1 every two years thereafter.²</p>	<p>Maine: The Maine legislature has passed a law that requires all LECs to establish intrastate access rates less than or equal to interstate rates on June 1 of odd numbered years. However, that requirement does not appear to be absolute. The statute reads that the Commission may "consider" corresponding reductions to intrastate access rates and must take into account the impact on basic local rates that would result. The Commission may not require access rate reductions if the result will be an increase of more than 50% in local service rates or an increase of more than 50% in the collection rate for the state universal service fund.</p> <p>Maine also created a state USF effective in April 2003 with the stated purpose of "provid[ing] support from the Fund to local exchange carriers (LECs) that provide local exchange service in areas served by rural incumbent local exchange carriers and that are unable otherwise to meet their allowed intrastate revenue requirement from retail local exchange, other telephone services, and access revenues." Support for each rural carrier is calculated based on an intrastate revenue requirement. Adjustments to that support can</p>

¹ Maine Revised Statutes Annotated, Title 35-A, Chapter 71, Section 7101-B Access Rates (effective May 2, 2003)

² Code of Maine Rules, 65-407 Ch. 280, section 8B (current through Aug. 2008).

Exhibit CTL Panel-1

	<p>be made based on, among other things, changes in access rates.</p>
<p>Texas: The Texas legislature established interstate-intrastate access parity with a directive to incumbent local exchange companies to "reduce both the company's originating and terminating per minute of use switched access rates in each market to parity with the company's respective federal originating and terminating per minute of use switched access rates" on the date the last market of that incumbent carrier is deregulated.³ The statute also requires a "transitioning ILEC" an ILEC for which at least one, but not all, of its markets has been deregulated -that has greater than 3 million access lines, to reach parity after a phased reduction.⁴ The statute further requires incumbent carriers that have established parity to maintain parity on an ongoing basis for all switched access rates.⁵ Importantly, in order to prevent abusive CLEC access rate practices, the statute further requires all telecommunications utilities to charge switched access at rates no higher than (a) the prevailing rates charged by the incumbent carrier serving that area; or (b) a statewide average ILEC composite switched access rate as calculated by the state commission.⁶</p> <p>Other statutory provisions, however, shield certain ILECs from the requirement to reduce intrastate access charges to parity with interstate rates. Specifically, "transitioning" ILECs with fewer than 3 million access lines and "newly designated transitioning" ILECs are governed by other rate reduction provisions that could lead to parity with interstate rates but do not mandate parity. Transitioning carriers are subject to phased rate reductions, but are required to reach parity only when 75% of their exchanges are deregulated by the Commission.⁷ In addition, there are statutory provisions that permit certain ILECs (primarily small and rural companies) to elect incentive regulation under Chapter 59 of the Public Utility Regulation Act. ILECs electing incentive regulation under Chapter 59 are not subject to the requirement that intrastate access be reduced to parity with interstate rates.⁸</p>	<p>Texas: LECs with more than 5 million access lines (AT&T only) that elect to be deregulated under Chapter 65 are required to mirror interstate rates by the end of 2009. Mirroring is not mandated but elective based on deregulation. Other LECs filing an election for deregulation under Chapter 65 are required to reduce intrastate access rates in proportion to the number of markets (exchanges) deregulated to the total number of markets as a condition. So far, only AT&T, CenturyLink (formerly Embarq) and Verizon have any deregulated markets.</p> <p>CenturyLink and Verizon have reduced access rates in compliance with the statute when the Commission has classified exchanges as being deregulated. However, neither company has met the 75% of markets deregulated requirement for full parity. It is important to note that the requirement to reduce intrastate access rates comes only with the election to have one or more markets deregulated. Otherwise, there is no mandate to reduce intrastate access rates to parity with interstate in Texas.</p>
<p>Oklahoma: Oklahoma by statute requires each local telecommunications service provider serving 15% or more</p>	<p>Oklahoma: LECs serving 15% or more of the access lines in the state were required to reduce</p>

³ V.T.C.A. Utilities Code, sec 65.201(a).

⁴ V.T.C.A. Utilities Code, sec 65.202(a).

⁵ *Id.* at sec. 65.201(b) and 65.202(b).

⁶ *Id.* at sec. 52.155(and allows for higher rates only upon commission approval).

⁷ V.T.C.A. Utilities Code, secs. 65.203 & 65.204.

⁸ V.T.C.A. Utilities Code, secs. 59.025(Commission cannot reduce the switched access rates of carriers electing infrastructure commitment under Chapter 59).

Exhibit CTL Panel-1

<p>of the access lines in the state to maintain intrastate switched access tariffs "in parity with the <i>terms and conditions</i> of the interstate access tariffs of that company," and to ensure on an ongoing basis to "maintain the terms and conditions of the intrastate access tariffs of that company so that they are in parity with the terms and conditions of the interstate tariffs of that company."⁹ There is no current parity requirement for Switched Access <i>rates</i> for Oklahoma. Oklahoma had previously required monitoring until certain revenue reduction targets had been met.¹⁰ Oklahoma carriers will no longer be required to flow through any access reductions effective July 1, 2009.</p>	<p>intrastate access rates by \$5M in 1997. Recovery was available from the state USF (the OUSF) to the extent that the \$5M reduction reduces access rates below interstate levels. Intrastate access rates were adjusted annually to remain in parity with interstate rates until an additional \$11.5M in revenue reductions (for a total of \$16.5M in revenue reductions) have been taken. No requirement to continue to maintain parity with interstate rates once the \$16.5M in revenue reductions was made. The LEC can seek recovery of the additional \$11.5M from the OUSF.</p>
<p>Michigan: The Michigan Telecommunications Act requires local carriers with more than 250,000 access lines to establish intrastate MOU access rates that do not exceed their interstate counterparts in order to be considered "just and reasonable."¹¹ Currently, AT&T Michigan and Verizon (soon to be Frontier) are the only local carriers that meet this threshold.</p>	<p>Michigan: AT&T is correct that, for a provider with more than 250,000 access lines, intrastate access rates that do not exceed interstate rates are considered just and reasonable. However, there was no requirement that any LEC must reduce intrastate access rates to parity with interstate. House Bill 4257 was passed on 12/10/09 by the Michigan Legislature requiring parity of intrastate rates with interstate with recovery of lost revenues based on 2008 demand from a newly established Michigan Recovery Mechanism or fund. The bill has been signed by the Governor and implementation proceeding have begun at the Commission</p>
<p>Indiana: By statute, Indiana provides that in any proceeding before the state commission, including any interconnection agreement or statement of generally available terms and conditions, "the commission shall consider the provider's rates and charges for intrastate access service to be just and reasonable if the intrastate rates and charges mirror the provider's interstate rates and charges."¹² The Indiana commission has approved parity arrangements over the years both for large and small incumbent local exchange companies.¹³</p>	<p>Indiana: There is no requirement that all ILECs must mirror interstate rates. Indeed, not all ILECs in the state mirror interstate rates. Intrastate access rates that mirror interstate rates are by statute considered to be just and reasonable.</p> <p>Stipulated settlement in Docket No. 42144 allows carriers to recover lost access revenues from mirroring through increases in the state SLC and a LEC-specific CCL additive.</p> <p>A state USF fund was created in 2002 to help small companies that mirror to offset revenue</p>

⁹ 17 Oklahoma Statutes sec. 17-139.103.D.4(1997).

¹⁰ *Id* at 3.

¹¹ Michigan Compiled Laws, chap. 484.2310, sec. 310(2) (1991).

¹² Indiana Code chap. 8-1-2.6. sec. 1.5(c)(2)(2006).

¹³ *See, e.g. Re: Universal Service Reform. Cause No. 42144.2004 W.L. 1170315 at par. 38. See also, Re: Indiana Bell Telephone Company, Inc., Cause No. 42405 (2004 WL 2309824 at par. 22) (continuing mirroring of Indiana Bell intrastate and interstate switched access rates).*

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	<p>losses from continued mirroring of interstate access rates.</p>
<p>Georgia: By statute enacted in 1995, Georgia required all Tier 1 and Tier 2 local exchange carriers to reduce their switched access rates to interstate levels. The statute mandates for Tier 1 carriers that "The rates for switched access ... shall be no higher than the rates charged for interstate access by the same local exchange company."¹⁴ Based on this requirement, AT&T (the only Tier 1 carrier in Georgia), must maintain parity between its intrastate and interstate switched access charges. The statute required Tier 2 carriers to reduce, by July 1, 2000, their intrastate rates to parity with their July 1, 1995 interstate rates.¹⁵</p>	<p>Georgia: The LEC must <u>elect</u> alternative regulation to be subject to the condition that intrastate switched access rates be lowered.</p> <p>For Tier 1 companies (BellSouth) electing alternative regulation, intrastate access rates shall be no higher than interstate access rates.</p> <p>Tier 2 companies (all other ILECs) electing alternative regulation transitioned intrastate access rates to parity with interstate rates and were allowed to offset revenue losses through increases on basic local rates or additional state universal service funds.</p> <p>A state USF is in place. ILECs may receive explicit subsidies from the fund based upon the difference between the price of service and reasonable costs.</p>

¹⁴ Ga. Code Ann. Sec. 46-5-166(f)(1)(1995).

¹⁵ *Id.* at (f)(2).

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<p align="center">STATES THAT MANDATE INTRASTATE/INTERSTATE PARITY BY STATUTE, BUT DIRECTLY OR INDIRECTLY TIE ACCESS REFORM TO A CARRIER'S PLAN FOR ALTERNATIVE REGULATION/PRICE REGULATION</p>	<p align="center">CENTURYLINK RESPONSE</p>
<p><i>Two states establish intrastate-interstate switched access parity by statute, but tie the reduction to parity to a participating local exchange carrier's plan for alternative regulation. This approach generally produces, at a minimum, a revenue-neutral event.</i></p>	<p><i>No states have established intrastate-interstate switched access parity for all ILECs by statute, but tie the reduction to parity to a participating local exchange carrier's plan for alternative regulation or without explicit state USF support as recommended by AT&T, Sprint and Comcast.</i></p>
<p>Kansas: Kansas statutes provide for reduction of switched access rates to interstate levels, with corresponding allowances for increases in retail local exchange rates: "Subject to the Commission's approval, all local exchange carriers shall reduce intrastate access charges to interstate levels as provided herein. Rates for intrastate switched access, and the imputed access portion of toll, shall be reduced over a three-year period with the objective of equalizing interstate and intrastate rates in a revenue neutral, specific and predictable manner. The Commission is authorized to rebalance local residential and business service rates to offset the intrastate access and toll charge reductions"¹⁶</p>	<p>Kansas: LECs were initially required to reduce intrastate access charges to parity with interstate rates over a three year period as a result of a 1996 statute. The Commission was authorized to rebalance local residential and business rates to offset access and toll reductions. Any reductions not covered through local rate increases were recovered through the KUSF.</p> <p>The Kansas Commission retains discretion over price-cap regulated ILEC access rates and mirroring is not mandatory for AT&T and CenturyLink (formerly Embarq). AT&T was required to mirror interstate access rates in 2002 but CenturyLink was not required to mirror due to the impact on local rates and the Kansas state USF. By statute, small ILECs are required to adjust intrastate rates to mirror interstate rates every two years and also participate in the state USF to effectuate the mirroring.</p>
<p>Wisconsin: Wisconsin statutes establish a system for local exchange companies to elect price regulation, and for price-regulated local companies to reduce intrastate access rates to interstate levels.¹⁷ Price-regulated local exchange carriers with more than 150,000 local lines are directed that "Intrastate access service rates ... may not exceed the utility's interstate rates for similar access services:"¹⁸ The directive includes eliminating half of all carrier common line charges</p>	<p>Wisconsin: Requirement to reduce intrastate access rates to parity with interstate rates is only for those companies electing price regulation. Price regulation plans have typically allowed for local rate increases to offset access reductions.</p> <p>A state USF is available for companies where</p>

¹⁶ Kansas Code chap. 66. Section. 66-205(c)(1996).

¹⁷ See generally, Wis. Stat. Ann. 196.

¹⁸ Id. at 196.196.

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within one year, a prohibition against reinstating these charges, and elimination of all carrier common line charges within the earlier of two years or authorization to provide interLATA services.¹⁹ The statute provided a more graduated scale for access reductions for carriers with fewer than 150,000 lines.²⁰

Wisconsin's statutes also establish a system to allow a telecommunications utility to file for approval of an alternative regulation plan ("ARP")²¹ The statute lists factors that the Commission must assess in considering an ARP, but there is no specific requirement regarding intrastate switched access charge reductions. Carriers typically include such reductions in their plans, but the reductions are not required to establish parity with interstate rates. Typically, these rates are set with reference to benchmarks the Commission established in a 1993 proceeding.

Only Verizon and AT&T have elected price regulation and, therefore, these are the only carriers subject to the state's mirroring requirement. All other independent companies are either regulated through the terms of their alternate regulation plan or have retained rate of return regulation.

the price of service exceeds certain levels. LECs are not required to reduce intrastate access rates to receive state USF.

¹⁹ *Id.* at 196.196(2)(b) 1-3.

²⁰ *Id.* at 196.196(2)(b)3.(c).

²¹ Wis. Stat. Ann. 196.195(12).

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<p align="center">STATES THAT MANDATE INTRASTATE/INTERSTATE PARITY BY COMMISSION ORDER, RULE, OR TARIFF, INCLUDING WHERE SUBSEQUENTIALLY MODIFIED</p>	<p align="center">CENTURYLINK RESPONSE</p>
<p><i>Nine state commissions have instituted mirroring or near-mirroring of interstate switched access rates for local exchange carriers, although two have subsequently modified this approach. These states generally permit carriers to implement some form of alternative price regulation to ensure revenue neutrality.</i></p>	<p><i>Only one state commission, New Mexico, has instituted mirroring or near-mirroring of interstate switched access rates for all local exchange carriers as recommended by AT&T, Sprint and Comcast. However, the New Mexico commission also established a local rate cap of \$15.28 for residential service and implemented a state USF fund to recover remaining lost revenues.</i></p>
<p>Alabama: In 1995, the Alabama Public Service Commission allowed South Central Bell to elect price regulation with various conditions, including requiring South Central Bell to maintain intrastate access charges at a level not to exceed interstate access rates for a period of five years. After expiration of the five year period, South Central Bell was required to continue to cap these rates at "the lower of the intrastate rates in effect on July 1, 1999, or the effective interstate prices and structures approved by the FCC."²² Subsequently, in December 2004, the Commission adopted a Price Flexibility Plan for BellSouth that capped BellSouth's combination of the traffic sensitive per minute charge for originating and terminating switched access service at the then "effective intrastate level (including any non-traffic sensitive rate elements)."²³ Intrastate access rates are no longer required to be at parity with interstate rates.</p> <p>The Price Flexibility Plan for ILECs is the same as BellSouth's for intrastate switched access rates. The Price Flexibility Plan for Large CLECs and the Small CLECs/Toll Service Provider Streamlined Regulation Plan do not address switched access services.</p>	<p>Alabama: The original requirement on South Central Bell to mirror interstate rates was part of an alternative regulation plan elected by SBC more than 10 years ago. The mirroring requirement is no longer applicable to that ILEC.</p> <p>Also, BellSouth's current Alternative Regulatory Plan, effective in 2004, caps the traffic sensitive portion of switched access rates at the effective intrastate level (including NTS rate elements) at the time the plan is implemented. The plan calls for no reductions to intrastate access unless an end user charge or state USF is implemented.</p> <p>For all other ILECs, the traffic sensitive elements are capped at the effective intrastate level (including NTS elements) as of the date of the alternative regulation plan. Intrastate access rates will not be reduced unless an end user charge, increase to local rates, or a state USF is implemented.</p>
<p>Ohio: ILECs in Ohio have been required by the Ohio Public Utilities Commission to mirror their federal access rate structure for intrastate switched access rates, a policy in place since 1987.²⁴ In 2007, the Commission reiterated its</p>	<p>Ohio: Interstate access rates were reduced to mirror interstate in 2003. An intrastate access fee (IAS), similar to the federal SLC charge, was established to help offset reductions in</p>

²² *In re Petition of South Central Bell Telephone Company to Restructure its Form of Regulation, etc.* Docket Nos. 24499, 24472, 24030, 24865, Report and Order, September, Ala. P.S.C. (1995) at par. 9.03.

²³ *In re: Proposed Revisions to the Price Regulation and Local Competition Plan*, Docket No. 28590, Order.

²⁴ *In re Modification of Intrastate Access Charges*, Case No. 00-127-TP-COI, Opinion and Order, (2001 WL 28031)

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<p>support for earlier orders requiring the four largest incumbent local exchange carriers to mirror their then-current interstate switched access rates for intrastate access services.²⁵ At the same time, the Commission also ordered competitive local exchange carriers to mirror their respective interstate rates.²⁶ Note that the Commission has made an exception to the mirroring requirement with respect to the CCLC. The Commission capped the intrastate CCLC at 1987 levels. Nonetheless, Ameritech, CBT and Verizon have taken steps to reduce or eliminate the intrastate CCLC due to merger conditions and alternative regulation plans. ILECs other than the four largest incumbents mirror interstate rates that were in effect a decade ago.</p>	<p>intrastate access revenues.</p> <p>Actions by Ameritech (now AT&T), CBT and Verizon to eliminate the CCLC do not create a requirement on other ILECs to follow suit. These companies elected to eliminate the CCLC as part of other proceedings.</p> <p>Smaller ILECs do not mirror interstate access rates and their rate structures include a CCLC.</p>
<p>Illinois: The Illinois Commerce Commission ("ICC") has aggressively reduced intrastate switched access rates. In 2000, the ICC ordered incumbent local carriers to remove all non-cost based rate elements from intrastate switched access rates, and also to reduce all remaining cost based access rate elements to their underlying long nm service incremental costs, plus a reasonable allocation of shared and common costs.²⁷ Illinois intrastate switched access rates appear to be at or below interstate parity based on tariff filings. The mid-size carriers are under rate-of-return regulation and generally try to mirror interstate rates. The small independent companies' switched access rates are only subject to the ICC's jurisdiction upon carrier complaint. CLECs are not subject to a mirroring requirement; they must only comply with the Commission's "just and reasonable" standard.</p>	<p>Illinois: All ILECs in Illinois are not required to mirror interstate and do not have rates set at parity with interstate.</p> <p>Specifically, in 2001 the Commission determined that, across all small companies, the cost of providing intrastate access services exceeded the revenues received, indicating that there were no subsidies in intrastate access rates. Verizon suggested that it was time to "break the mirror" for small companies. The Commission indicated that it would open a docket to examine intrastate access rates for small companies.</p> <p>Then, in 2003, the Commission stated that "the time has come to divorce the small company intrastate access rates from interstate rates established by the FCC" and determined that small companies with less than 35,000 access lines were no longer required to comply with the mirroring orders in Docket Nos. 83-0142 and 90-0425.</p>
<p>Massachusetts: The Massachusetts Department of Telecommunications and Energy established intrastate mirroring of interstate switched access rates in 2002, while also allowing for retail rate rebalancing: "Currently, intrastate switched access charges are higher than interstate switched access charges. This creates a situation where it</p>	<p>Massachusetts: Verizon entered into a price regulation plan in 1995. In 2002, it introduced a plan whereby it would reduce access rates by \$52M with offsetting increases to residential rates. Verizon's 2002 access rate reductions do not create a requirement for other ILECs to</p>

²⁵ *In the Matter of the Establishment of Carrier-to-Carrier Rules*, Case No. 06-1344-TP-ORD, Entry on Rehearing, Ohio P.U.C. (2007), at par. 29, p. 18.

²⁶ *Id.*

²⁷ *Illinois Commerce Commission, On its Own Motion vs. Illinois Bell Telephone Company et al. Investigation Into Non-Cost Bases Access Charges Rate Elements in the Intrastate Access Charges of Incumbent Local Exchange Carriers in Illinois, etc.* 97-0601, 97-0602 and 97-0516 (Mark 29, 2000), at 46 through 50.

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<p>could cost more for Massachusetts customers to make a call across the state than it does to make a call across the country. The Department concludes that this is inefficient. ... [T]herefore, intrastate switched access charges will be lowered to the more cost-based interstate levels.”²⁸ In noting that the access revenues should be made up by retail rate increases, the Department also stated that "experience has shown that such rate-rebalancing enhances efficiency without negatively impacting universal service.”²⁹</p> <p>In an order issued June 22, 2009, the Department of Telecommunications and Cable issued an Order requiring all CLEC intrastate switched access rates to be at or below Verizon's intrastate switched access rates, which, in turn, are required to be at the levels of Verizon's intrastate switched access rates. The Department required that CLEC rates would be capped at Verizon's rate effective one year from the date of its Order.³⁰</p>	<p>reduce access rates.</p>
<p>New Mexico: New Mexico administrative rules provide that effective January 1, 2008, "a local exchange carriers intrastate switched access charges may not exceed the interstate switched access charges approved by the federal telecommunications commission as of January 1, 2006, and its intrastate switched access elements and structure shall conform to the interstate switched access elements and structure approved by [the FCC]"³¹ The rules also provide a mechanism to require carriers to continue to mirror updated interstate switched access rates.³²</p>	<p>New Mexico: : Effective in 2006, intrastate switched access rates were transitioned to mirror interstate rates over a three-year period with offsetting increases to residential and business basic rates.</p> <p>New Mexico has a high cost state USF. Disbursements are based on the reduction in switched access rates less the revenue derived from a current benchmark rate of \$15.28 for <u>residential basic service</u>.</p>
<p>Kentucky: In 1995, the Kentucky Commission approved a price regulation plan for BellSouth that required BellSouth to implement switched access rates that mirrored analogous interstate access rate elements.³³ The Commission later stated that its earlier Order "clearly and unequivocally required mirroring of interstate access rates as the FCC changed access rates," and required mirroring rates to be</p>	<p>Kentucky: There is no regulatory or statutory requirement to reduce intrastate access rates.</p> <p>BellSouth elected to reduce access rates as part of its overall price regulation plan. BellSouth's actions do not create a requirement for other ILECs to reduce intrastate access rates.</p>

²⁸ *Investigation by the Department of Telecommunications and Energy on its Own Motion into the Appropriate Regulatory Plan to Succeed Price Cap Regulation for Verizon New England, Inc. etc.*, 2002 Mass. PUC Lexis 10 (May 8, 2002), at 36.

²⁹ *Id.*

³⁰ *Petition of Verizon New England, Inc. et al. for Investigation under Chapter 159, Section 14 of the Intrastate Access Rates of Competitive Local Exchange Carriers*, D.T.C. 07-9, Final Order, released June 22, 2009.

³¹ N.M. Admin. Code 17. 11.1 0.8(c)(2005).

³² *Id.* at 17. 11. 10.8(I).

³³ *Application of BellSouth Telecommunications, Inc. d/b/a South Central Bell Telephone Company to Modify Its Method of Regulation*, Case No. 94-121 (1995). Order: 1995 WL 135116 Ky. 1628 (1999), 1999 WL 135116 (Neb. P.S.C.), at 7. The Commission initially exempted the PICC and TIC for originating access and capped terminating rates at the levels of originating rates. The Commission also gave guidelines for residential and business rate rebalancing initiatives. *Id.* at 5.

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<p>effective no later than 30 days after the FCC changed interstate rates.³⁴ The Commission in later years approved further access reductions for BellSouth and Cincinnati Bell, citing public interest benefits associated with removing economically inefficient subsidies.³⁵ In July 2006, statutory revisions effectively changed this regulatory scheme. Current statutory provisions permit telephone utilities the option to elect a price regulation plan as described within the statute.³⁶ Under price regulation, an electing utility's rates for intrastate switched access service "shall not exceed its rates for this service that were in effect on the day prior to the date the utility filed its notice of election."³⁷ Accordingly, Kentucky's switched access rates are capped and no longer need to mirror interstate rates. AT&T-KY filed notice of its price regulation plan election on July 12, 2006.</p>	<p>LECs electing alternative regulation are required to cap intrastate access rates at the rate that was in effect the day prior to the election.</p>
<p>Oregon: In 2001, the Commission approved a Qwest rate rebalancing plan that provided substantial access reform. The Commission required Qwest to reduce switched access rates by decreasing the local switching rate and eliminating the carrier common line charge, a move calculated to "bring Qwest's intrastate switched access rates closer to its currently lower interstate switched access rates ... an equitable development with respect to consumers ...,"³⁸</p>	<p>Oregon: Qwest Rate Rebalancing Plan (Order No. 01-810 issued September 14, 2001). As part of an overall investigation of Qwest's intrastate earnings, a number of rates were reduced. In all, Qwest reduced revenues by \$64.2M annually, including \$21.8M from intrastate access, MTS \$23.4M, EAS \$11.3M, and smaller revenue reductions from other areas. These reductions were offset in part by increases in non-recurring charges (NRCs) and residential R1 rates.</p> <p>Oregon has implemented a state USF in conjunction with access reductions by other LECs. Moreover, parity with interstate is not required.</p>

³⁴ *Telecom Inc. 's Application to Restructure Rates*. Case No. 97-074, Neb. P.S.C. (1997). See also, Tariff Filing of BellSouth Telecommunications, Inc. to Mirror Interstate Rates. Case No. 98-065(1999).

³⁵ See, e.g. *Review of BellSouth Telecomm, Inc. 's Price Regulation Plan*. Case No. 99-434 Ky. P.S.C. (2000), at 5.

³⁶ Ky. Rev. Stat. 278.543.

³⁷ *Id.* at 278.543(4).

³⁸ Re: *Qwest Corporation, UT 125 Phase II*. Order No. 01-810, 213 P.U.R. 4th 78 (2001).

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<p>Tennessee: BellSouth Telecommunications Inc. ("BellSouth") agreed to reduce intrastate switched access charges to achieve parity between intrastate and interstate switched access rates that existed as of August 1, 1995 under agreement with certain interexchange carriers operating in Tennessee. This agreement was never filed with nor approved by the Tennessee Regulatory Authority ("TRA"). On January 31, 1997, BellSouth filed with the TRA a tariff to implement the first step of these reductions. The TRA initiated a docket to consider this tariff filing;³⁹ and issued an Order approving BellSouth's tariff as filed.⁴⁰ The TRA also approved all subsequent tariff filings made to reduce rates under the agreement with IXCs.</p>	<p>Tennessee: There is no regulatory or statutory requirement for all ILECs to mirror interstate access rates. The order cited by AT&T was <u>applicable to BellSouth only</u> and did not create a requirement for other ILECs to mirror interstate rates.</p>
<p>West Virginia: By Order of the Commission in March of 2007 approving Verizon's Market Transition Plan ("MTP"), Verizon will eliminate the carrier common line charge from its intrastate switched access rates and minor interstate traffic-sensitive switched access rates over a phase-in period through year-end 2010. Verizon will be granted pricing flexibility for basic local exchange services commensurate with the revenue reductions attributable to switched access decreases. At the conclusion of the phase-in period, all Verizon intrastate switched access rates are expected to mirror interstate rates.⁴¹ A recent ALJ Recommended Decision, if adopted by the Commission, will require CLECs to mirror Verizon's intrastate rate by year-end 2010 as well.⁴²</p>	<p>West Virginia: There is no statutory or regulatory requirement for ILECs to reduce intrastate switched access rates. Verizon's actions do not create a requirement for other ILECs to reduce intrastate access rates.</p> <p>Verizon Market Transition Plan became effective in 12/2006. The plan calls for intrastate access rates to be consistent with interstate rates. CCLC to be phased out. Prior to phase out of CCLC, intrastate switched access rates to be reduced to interstate levels with offsetting revenue increases to the CCLC.</p> <p>Verizon WV R1 rate = \$29.00.</p>

³⁹ *In Re: Tariff Filing by BellSouth Telecommunications, Inc., to Reduce Intrastate Access Charges*. Docket No. 9700185. Ten. R.A. (1997).

⁴⁰ *Id.* The TRA's Order also required "the long distance companies certified to provide service within Tennessee to file tariffs as described in (TRA) Rule 1220-4-.55(2)(d). That rule requires the long distance companies to flow-through this access reduction to ratepayers in the form of lower long distance rates."

⁴¹ *Petition for Approval of Joint Stipulation and Agreement for Settlement and Joint Petition for Expedited Approval of a Joint Stipulation for a Market Transition Plan for Verizon West Virginia, Inc.*, Case No. 06-1935-T-PC., W.V.P.S.C. (2007).

⁴² *Petition of Verizon West Virginia Inc., et als.*, Case no. 08-0656-T-GI (March 4, 2009).

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STATES THAT BY TARIFF ESTABLISH INTRASTATE ACCESS RATES NEAR PARITY WITH INTERSTATE RATES	CENTURYLINK RESPONSE
<p>Mississippi: The BellSouth terminating intrastate access charges "are currently at parity with the FCC interstate rates and will be adjusted annually subject to a cap at parity."⁴³The intrastate rates in total for a two-ended call are marginally higher than interstate rates (\$0.0095 intrastate vs. \$0.0088 interstate).</p>	<p>Mississippi: There is no statutory or regulatory requirement for ILECs to reduce intrastate access rates. BellSouth <i>elected</i> to reduce access rates to parity with interstate rates, but its actions create no requirement for other ILECs in the state to also reduce access rates.</p>
<p>North Carolina: The current BellSouth per-minute, two-ended intrastate access rate is almost identical to interstate rates at \$0.0092, compared with an interstate rate of \$0.0088.⁴⁴</p>	<p>North Carolina: There is no statutory or regulatory requirement for ILECs to reduce intrastate access rates. BellSouth <i>elected</i> to reduce access rates, but its actions have created no requirement on the part of other ILECs in the state to reduce access rates.</p>

⁴³ BellSouth Telecommunications, Inc., Mississippi, Access Services Tariff, effective January 1, 2008.

⁴⁴ See generally, BellSouth Access Service Tariff, sec. E.6, for Mississippi, North Carolina, Alabama, South Carolina and Florida.

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NEVADA REQUIRES THAT INTRASTATE SWITCHED ACCESS RATES BE CONSISTENT WITH FEDERAL LAW	CENTURYLINK RESPONSE
<p>The rates, terms and conditions for switched and special access services are currently regulated in Nevada and must be consistent with federal law.⁴⁵ Carriers may reduce switched access charges to parity with the associated interstate switched access rates without a rate proceeding. The Public Utilities Commission of Nevada may deregulate switched access services provided by a competitive supplier (AT&T Nevada is one) upon its own motion or acting upon a carrier petition⁴⁶</p>	<p>Nevada Requires that intrastate switched access rates be consistent with Federal law but that does not result in a parity mandate for any ILEC.</p> <p>AT&T the ILEC is mirroring interstate access rates since opting into a legislative alternative regulation plan in 1999 which mandated the mirroring of access rates. No other ILEC is required to mirror.</p> <p>The Nevada Commission adopted new USF rules in December 2008 which allow competitive suppliers that are COLR's to petition the PUC to receive money from the state USF to keep rates for basic service at an affordable level. No mirroring of interstate rates is required. No company is currently receiving funding from the state USF.</p>

⁴⁵ Nevada Revised Statutes 704.68873.

⁴⁶ Nevada Revised Statutes 704.68879.

STATES WITH INTRASTATE/INTERSTATE ACCESS PARITY

States that Mandate Intrastate/Interstate Parity by Statute for Certain Carriers

Six states have mandated reduction of intrastate access rates to interstate rate levels by statute, and some have also directed the state utilities commission to ensure compliance through further proceedings and tariff oversight. These states are listed below with a summary of relevant state activities.

Maine: In Maine, the legislature ordered the commission to ensure intrastate mirroring of interstate switched access rates: "By May 31, 2005, the commission shall insure that intrastate access rates are equal to interstate access established by the Federal Communications Commission as of January 1, 2003."¹ The Maine public utilities commission implemented the statutory directive by adopting a rule requiring each local exchange carrier to implement access mirroring by June 1, 2003, and to refresh the mirrored rates on June 1 every two years thereafter.²

Texas: The Texas legislature established interstate-intrastate access parity with a directive to incumbent local exchange companies to "reduce both the company's originating and terminating per minute of use switched access rates in each market to parity with the company's respective federal originating and terminating per minute of use switched access rates" on the date the last market of that incumbent carrier is deregulated.³ The statute also requires a "transitioning ILEC" – an ILEC for which at least one, but not all, of its markets has been deregulated – that has greater than 3 million access lines, to reach parity after a phased reduction.⁴ The statute further requires incumbent carriers that have established parity to maintain parity on an ongoing basis for all switched access rates.⁵ Importantly, in order to prevent abusive CLEC access rate practices, the statute further requires all telecommunications utilities to charge switched access at rates no higher than (a) the prevailing rates charged by the incumbent carrier serving that area; or (b) a statewide average ILEC composite switched access rate as calculated by the state commission.⁶

Other statutory provisions, however, shield certain ILECs from the requirement to reduce intrastate access charges to parity with interstate rates. Specifically, "transitioning" ILECs with

¹ Maine Revised Statutes Annotated, Title 35-A, Chapter 71, sec. 7101-B Access Rates (effective May 2, 2003).

² Code of Maine Rules, 65-407 Ch. 280, section 8B (current through Aug. 2008).

³ V.T.C.A., Utilities Code, sec. 65.201(a).

⁴ V.T.C.A., Utilities Code, sec. 65.202(a).

⁵ *Id.* at sec. 65.201(b) & 65.202(b).

⁶ *Id.* at sec. 52.155 (and allows for higher rates only upon commission approval).

fewer than 3 million access lines and "newly designated transitioning" ILECs are governed by other rate reduction provisions that could lead to parity with interstate rates but do not mandate parity. Transitioning carriers are subject to phased rate reductions, but are required to reach parity only when 75% of their exchanges are deregulated by the Commission.⁷ In addition, there are statutory provisions that permit certain ILECs (primarily small and rural companies) to elect incentive regulation under Chapter 59 of the Public Utility Regulation Act. ILECs electing incentive regulation under Chapter 59 are not subject to the requirement that intrastate access be reduced to parity with interstate rates.⁸

Oklahoma: Oklahoma by statute requires each local telecommunications service provider serving 15% or more of the access lines in the state to maintain intrastate switched access tariffs "in parity with the *terms and conditions* of the interstate access tariffs of that company," and to ensure on an ongoing basis to "maintain the terms and conditions of the intrastate access tariffs of that company so that they are in parity with the terms and conditions of the interstate tariffs of that company."⁹ There is no current parity requirement for Switched Access *rates* for Oklahoma. Oklahoma had previously required mirroring until certain revenue reduction targets had been met.¹⁰ Oklahoma carriers will no longer be required to flow through any access reductions effective July 1, 2009.

Michigan: The Michigan Telecommunications Act requires local carriers with more than 250,000 access lines to establish intrastate MOU access rates that do not exceed their interstate counterparts in order to be considered "just and reasonable."¹¹ Currently, AT&T Michigan and Verizon (soon to be Frontier) are the only local carriers that meet this threshold.

Indiana: By statute, Indiana provides that in any proceeding before the state commission, including any interconnection agreement or statement of generally available terms and conditions, "the commission shall consider the provider's rates and charges for intrastate access service to be just and reasonable if the intrastate rates and charges mirror the provider's interstate rates and charges."¹² The Indiana commission has approved parity arrangements over the years both for large and small incumbent local exchange companies.¹³

⁷ V.T.C.A., Utilities Code, secs. 65.203 & 65.204.

⁸ V.T.C.A., Utilities Code, secs. 59.025 (Commission cannot reduce the switched access rates of carriers electing infrastructure commitment under Chapter 59).

⁹ 17 Oklahoma Statutes sec. 17-139.103.D.4 (1997).

¹⁰ *Id.* at 3.

¹¹ Michigan Compiled Laws, chap. 484.2310, sec. 310(2) (1991).

¹² Indiana Code chap. 8-1 -2 .6. sec. 1.5 (c) (2) (2006).

¹³ *See, e.g.,* Re: Universal Service Reform. Cause No. 42144.2004 W.L. 1170315 at par.38. *See also, Re: Indiana Bell Telephone Company, Inc.*, Cause No. 42405 (2004 WL 2309824 at par.22) (continuing mirroring of Indiana Bell intrastate and interstate switched access rates).

Georgia: By statute enacted in 1995, Georgia required all Tier 1 and Tier 2 local exchange carriers to reduce their switched access rates to interstate levels. The statute mandates for Tier 1 carriers that "The rates for switched access ... shall be no higher than the rates charged for interstate access by the same local exchange company."¹⁴ Based on this requirement, AT&T (the only Tier 1 carrier in Georgia), must maintain parity between its intrastate and interstate switched access charges. The statute required Tier 2 carriers to reduce, by July 1, 2000, their intrastate rates to parity with their July 1, 1995 interstate rates.¹⁵

States that Mandate Intrastate/Interstate Parity by Statute, but Directly or Indirectly Tie Access Reform to a Carrier's Plan for Alternative Regulation/Price Regulation

Two states establish intrastate-interstate switched access parity by statute, but tie the reduction to parity to a participating local exchange carrier's plan for alternative regulation. This approach generally produces, at a minimum, a revenue-neutral event.

Kansas: Kansas statutes provide for reduction of switched access rates to interstate levels, with corresponding allowances for increases in retail local exchange rates: "Subject to the Commission's approval, all local exchange carriers shall reduce intrastate access charges to interstate levels as provided herein. Rates for intrastate switched access, and the imputed access portion of toll, shall be reduced over a three-year period with the objective of equalizing interstate and intrastate rates in a revenue neutral, specific and predictable manner. The Commission is authorized to rebalance local residential and business service rates to offset the intrastate access and toll charge reductions."¹⁶

Wisconsin: Wisconsin statutes establish a system for local exchange companies to elect price regulation, and for price-regulated local companies to reduce intrastate access rates to interstate levels.¹⁷ Price-regulated local exchange carriers with more than 150,000 local lines are directed that "Intrastate access service rates ... may not exceed the utility's interstate rates for similar access services."¹⁸ The directive includes eliminating half of all carrier common line charges within one year, a prohibition against reinstating these charges, and elimination of all carrier common line charges within the earlier of two years or authorization to provide interLATA

¹⁴ Ga. Code Ann. sec. 46-5-166(f)(1)(1995).

¹⁵ *Id.* at (f)(2).

¹⁶ Kansas Code chap. 66, Sec. 66-2005(c)(1996).

¹⁷ *See generally*, Wis. Stat. Ann. 196-196.

¹⁸ *Id.* at 196.196(2)(b)1.

services.¹⁹ The statute provided a more graduated scale for access reductions for carriers with fewer than 150,000 lines.²⁰

Wisconsin's statutes also establish a system to allow a telecommunications utility to file for approval of an alternative regulation plan ("ARP").²¹ The statute lists factors that the Commission must assess in considering an ARP, but there is no specific requirement regarding intrastate switched access charge reductions. Carriers typically include such reductions in their plans, but the reductions are not required to establish parity with interstate rates. Typically, these rates are set with reference to benchmarks the Commission established in a 1993 proceeding.

Only Verizon and AT&T have elected price regulation and, therefore, these are the only carriers subject to the state's mirroring requirement. All other independent companies are either regulated through the terms of their alternate regulation plan or have retained rate of return regulation.

**States That Mandate Intrastate/Interstate Parity by Commission Order, Rule or Tariff,
Including Where Subsequently Modified**

Nine state commissions have instituted mirroring or near-mirroring of interstate switched access rates for local exchange carriers, although two have subsequently modified this approach. These states generally permit carriers to implement some form of alternative price regulation to ensure revenue neutrality.

Alabama: In 1995, the Alabama Public Service Commission allowed South Central Bell to elect price regulation with various conditions, including requiring South Central Bell to maintain intrastate access charges at a level not to exceed interstate access rates for a period of five years. After expiration of the five year period, South Central Bell was required to continue to cap these rates at "the lower of the intrastate rates in effect on July 1, 1999, or the effective interstate prices and structures approved by the FCC."²² Subsequently, in December 2004, the Commission adopted a Price Flexibility Plan for BellSouth that capped BellSouth's combination of the traffic sensitive per minute charge for originating and terminating switched access service at the then "effective intrastate level (including any non-traffic sensitive rate elements)."²³ Intrastate access rates are no longer required to be at parity with interstate rates.

¹⁹ *Id.* at 196.196(2)(b)1-3.

²⁰ *Id.* at 196.196(2)(b)3.(c).

²¹ Wis. Stat. Ann. 196.195(12).

²² *In Re Petition of South Central Bell Telephone Company to Restructure its Form of Regulation, etc.*, Docket Nos. 24499, 24472, 24030, 24865, Report and Order, September, Ala. P.S.C. (1995) at par. 9.03.

²³ *In Re Proposed Revisions to the Price Regulation and Local Competition Plan*, Docket No. 28590, Order

The Price Flexibility Plan for ILECs is the same as BellSouth's for intrastate switched access rates. The Price Flexibility Plan for Large CLECs and the Small CLECs/Toll Service Provider Streamlined Regulation Plan do not address switched access services.

Ohio: ILECs in Ohio have been required by the Ohio Public Utilities Commission to mirror their federal access rate structure for intrastate switched access rates, a policy in place since 1987.²⁴ In 2007, the Commission reiterated its support for earlier orders requiring the four largest incumbent local exchange carriers to mirror their then-current interstate switched access rates for intrastate access services.²⁵ At the same time, the Commission also ordered competitive local exchange carriers to mirror their respective interstate rates.²⁶ Note that the Commission has made an exception to the mirroring requirement with respect to the CCLC. The Commission capped the intrastate CCLC at 1987 levels. Nonetheless, Ameritech, CBT and Verizon have taken steps to reduce or eliminate the intrastate CCLC due to merger conditions and alternative regulation plans. ILECs other than the four largest incumbents mirror interstate rates that were in effect a decade ago.

Illinois: The Illinois Commerce Commission ("ICC") has aggressively reduced intrastate switched access rates. In 2000, the ICC ordered incumbent local carriers to remove all non-cost-based rate elements from intrastate switched access rates, and also to reduce all remaining cost-based access rate elements to their underlying long run service incremental costs, plus a reasonable allocation of shared and common costs.²⁷ Illinois intrastate switched access rates appear to be at or below interstate parity based on tariff filings.

The mid-size carriers are under rate-of-return regulation and generally try to mirror interstate rates. The small independent companies' switched access rates are only subject to the ICC's jurisdiction upon carrier complaint. CLECs are not subject to a mirroring requirement; they must only comply with the Commission's "just and reasonable" standard.

Massachusetts: The Massachusetts Department of Telecommunications and Energy established intrastate mirroring of interstate switched access rates in 2002, while also allowing for retail rate rebalancing: "Currently, intrastate switched access charges are higher than interstate switched

Approving Alabama Telecommunications Regulation Plan, December, Ala. P.S.C. (2004) at Appendix A, page 9, section 7.C.

²⁴ *In Re Modification of Intrastate Access Charges*, Case No. 00-127-TP-COI. Opinion and Order, (2001 WL 283031) at par. 2, citing *In the Matter of the Commission's Investigation Relative to Establishment of Intrastate Access Charges*, Case No. 83-464-TP-COI, Subfile C (Mary 21, 1982 and March 12, 1987).

²⁵ *In the Matter of the Establishment of Carrier-to-Carrier Rules*, Case No. 06-1344-TP-ORD, Entry on Rehearing, Ohio P.U.C.(2007), at par. 29, p. 18.

²⁶ *Id.*

²⁷ *Illinois Commerce Commission. On Its Own Motion vs. Illinois Bell Telephone Company et al. Investigation Into Non-Cost Based Access Charge Rate Elements in the Intrastate Access Charges of Incumbent Local Exchange Carriers in Illinois, etc.*, 97-0601, 97-0602 and 97-0516 (March 29, 2000), at 46 through 50.

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access charges. This creates a situation where it could cost more for Massachusetts customers to make a call across the state than it does to make a call across the country. The Department concludes that this is inefficient. .. [T]herefore, intrastate switched access charges will be lowered to the more cost-based interstate levels."²⁸ In noting that the access revenues should be made up by retail rate increases, the Department also stated that "experience has shown that such rate-rebalancing enhances efficiency without negatively impacting universal service."²⁹

In an order issued June 22, 2009, the Department of Telecommunications and Cable issued an Order requiring all CLEC intrastate switched access rates to be at or below Verizon's intrastate switched access rates, which, in turn, are required to be at the levels of Verizon's intrastate switched access rates. The Department required that CLEC rates would be capped at Verizon's rate effective one year from the date of its Order.³⁰

New Mexico: New Mexico administrative rules provide that effective January 1, 2008, "a local exchange carrier's intrastate switched access charges may not exceed the interstate switched access charges approved by the federal telecommunications commission as of January 1, 2006, and its intrastate switched access elements and structure shall conform to the interstate switched access elements and structure approved by [the FCC]."³¹ The rules also provide a mechanism to require carriers to continue to mirror updated interstate switched access rates.³²

Kentucky: In 1995, the Kentucky Commission approved a price regulation plan for BellSouth that required BellSouth to implement switched access rates that mirrored analogous interstate access rate elements.³³ The Commission later stated that its earlier Order "clearly and unequivocally required mirroring of interstate access rates as the FCC changed access rates," and required mirroring rates to be effective no later than 30 days after the FCC changed interstate rates.³⁴ The Commission in later years approved further access reductions for BellSouth and

²⁸ *Investigation by the Department of Telecommunications and Energy on its Own Motion into the Appropriate Regulatory Plan to Succeed Price Cap Regulation for Verizon New England, Inc. etc.*, 2002 Mass. PUC Lexis 10 (May 8, 2002), at 36.

²⁹ *Id.*

³⁰ *Petition of Verizon New England, Inc., et al for Investigation under Chapter 159, Section 14 of the Intrastate Access Rates of Competitive Local Exchange Carriers*, D.T.C. 07-9, Final Order, released June 22, 2009.

³¹ N.M. Admin. Code 17. 11.1 0.8(C) (2005).

³² *Id.* at 17. 11. 10.8(I).

³³ *Application of BellSouth Telecommunication, Inc., d/b/a South Central Bell Telephone Company to Modify Its Method of Regulation*, Case No. 94-121 (1995), Order: 1995 WL 135116 Ky. 1628 (1999), 1999 WL 135116 (Neb. P.S.C.), at 7. The Commission initially exempted the PICC and TIC for originating access and capped terminating rates at the levels of originating rates. The Commission also gave guidelines for residential and business rate rebalancing initiatives. *Id.* at 5.

³⁴ *Telecomm. Inc.'s Application to Restructure Rates*, Case No. 97-074, Neb. P.S.C. (1997). *See also*, *Tariff Filing of BellSouth Telecommunications, Inc. to Mirror Interstate Rates*, Case No. 98-065 (1999).

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Cincinnati Bell, citing public interest benefits associated with removing economically inefficient subsidies.³⁵

In July 2006, statutory revisions effectively changed this regulatory scheme. Current statutory provisions permit telephone utilities the option to elect a price regulation plan as described within the statute.³⁶ Under price regulation, an electing utility's rates for intrastate switched-access service "shall not exceed its rates for this service that were in effect on the day prior to the date the utility filed its notice of election."³⁷ Accordingly, Kentucky's switched access rates are capped and no longer need to mirror interstate rates. AT&T-KY filed notice of its price regulation plan election on July 12, 2006.

Oregon: In 2001, the Commission approved a Qwest rate rebalancing plan that provided substantial access reform. The Commission required Qwest to reduce switched access rates by decreasing the local switching rate and eliminating the carrier common line charge, a move calculated to "bring Qwest's intrastate switched access rates closer to its currently lower interstate switched access rates ... an equitable development with respect to consumers . . ."³⁸

Tennessee: BellSouth Telecommunications Inc. ("BellSouth") agreed to reduce intrastate switched access charges to achieve parity between intrastate and interstate switched access rates that existed as of August 1, 1995 under agreement with certain interexchange carriers operating in Tennessee. This agreement was never filed with nor approved by the Tennessee Regulatory Authority ("TRA"). On January 31, 1997, BellSouth filed with the TRA a tariff to implement the first step of these reductions. The TRA initiated a docket to consider this tariff filing,³⁹ and issued an Order approving BellSouth's tariff as filed.⁴⁰ The TRA also approved all subsequent tariff filings made to reduce rates under the agreement with IXCs.

West Virginia: By Order of the Commission in March of 2007 approving Verizon's Market Transition Plan ("MTP"), Verizon will eliminate the carrier common line charge from its intrastate switched access rates and mirror interstate traffic-sensitive switched access rates over a phase-in period through year-end 2010. Verizon will be granted pricing flexibility for basic local exchange services commensurate with the revenue reductions attributable to switched access decreases. At the conclusion of the phase-in period, all Verizon intrastate switched access rates

³⁵ See, e. g., *Review of BellSouth Telecomm, Inc.'s Price Regulation Plan*, Case No. 99-434 Ky. P.S.C. (2000), at 5.

³⁶ Ky. Rev. Stat. 278.543.

³⁷ *Id.* at 278.543(4).

³⁸ *Re: Qwest Corporation. UT 125 Phase II*, Order No. 01-810, 213 P.U.R. 4th 78 (2001).

³⁹ *In Re: Tariff Filing by BellSouth Telecommunications, Inc. to Reduce Intrastate Access Charges*, Docket No. 9700185, Ten. R.A. (1997).

⁴⁰ *Id.* The TRA's Order also required "the long distance companies certified to provide service within Tennessee to file tariffs as described in (TRA) Rule 1220-4-.55(2)(d). That rule requires the long distance companies to flow-through this access reduction to ratepayers in the form of lower long distance rates."

**EXHIBIT CTL
PANEL-2**

are expected to mirror interstate rates.⁴¹ A recent ALJ Recommended Decision, if adopted by the Commission, will require CLECs to mirror Verizon's intrastate rate by year-end 2010 as well.⁴²

States that by Tariff Establish Intrastate Access Rates Near Parity with Interstate Rates

LECs in two states have established by tariff intrastate switched access rates that are virtually at parity with corresponding interstate rates.

Mississippi: The BellSouth terminating intrastate access charges "are currently at parity with the FCC interstate rates and will be adjusted annually subject to a cap at parity."⁴³ The intrastate rates in total for a two-ended call are marginally higher than interstate rates (\$0.0095 intrastate vs. \$0.0088 interstate).

North Carolina: The current BellSouth per-minute, two-ended intrastate access rate is almost identical to interstate rates at \$0.0092, compared with an interstate rate of \$0.0088.⁴⁴

Nevada Requires That Intrastate Switched Access Rates Be Consistent With Federal Law

The rates, terms and conditions for switched and special access services are currently regulated in Nevada and must be consistent with federal law.⁴⁵ Carriers may reduce switched access charges to parity with the associated interstate switched access rates without a rate proceeding. The Public Utilities Commission of Nevada may deregulate switched access services provided by a competitive supplier (AT&T Nevada is one) upon its own motion or acting upon a carrier petition.⁴⁶

⁴¹ *Petition for Approval of Joint Stipulation and Agreement for Settlement and Joint Petition for Expedited Approval of a Joint Stipulation for a Market Transition Plan for Verizon West Virginia Inc.*, Case No. 06-1935-T-PC., W.V.P.S.C. (2007).

⁴² *Petition of Verizon West Virginia Inc. et als.*, Case No. 08-0656-T-GI (March 4, 2009).

⁴³ BellSouth Telecommunications, Inc. Mississippi. Access Services Tariff, effective January 1, 2008.

⁴⁴ *See generally*, BellSouth Access Services Tariff, sec. E.6, for Mississippi, North Carolina, Alabama, South Carolina and Florida.

⁴⁵ Nevada Revised Statutes 704.68873.

⁴⁶ Nevada Revised Statutes 704.68879.

EXHIBIT J

AT&T Panel Direct Testimony of E. Christopher Nurse and Dr. Ola Oyefusi
Docket Nos. C-2009-2098380, *et. al.*

A SNAPSHOT LOOK AT THE “LARGER” RLECS

<u>PTA Company</u>	2008 Revenues ¹	Estimated Revenues Post Merger ²	FORTUNE 1000 Rank 2008 ³	FORTUNE 1000 Rank Post Merger ⁴
Embarq	\$6.1 B	\$8.8 Billion	# 405	# 298
CenturyTel	\$2.6 B		# 753	
Frontier/ Commonwealth	\$2.2 B	\$6.5 Billion	# 834	# 382
Frontier ⁵ - Portion acquired from Verizon	\$4.3 B			
Windstream	\$3.2 B	\$3.4 Billion	# 656	# 641
D&E (Buffalo Valley; Conestoga)	\$0.15B			

¹ Sources: Each company's 2008 Annual 10-K Filing

² Sources: News Releases: CenturyTel/Embarq Investor Presentation 10/27/2008

http://www.centurytelecombarqmerger.com/pdf/presentations/CenturyTel_EMBARQ_IR_Presentation.pdf ; Verizon/Frontier Press Release 5/13/2009 <http://newscenter.verizon.com/press-releases/verizon/2009/verizon-to-divest-wireline.html> ; Windstream/D&E Press Release 5/11/2009

<http://www.snl.com/irweblinkx/file.aspx?ID=4121400&FID=7779482>

³ FORTUNE 500 or FORTUNE 1000 RANKINGS 2008 http://money.cnn.com/magazines/fortune/fortune500/2009/full_list/

⁴ *Id.*

⁵ The operations Frontier will acquire include all of Verizon's local wireline operating territories in Arizona, Idaho, Illinois, Indiana, Michigan, Nevada, North Carolina, Ohio, Oregon, South Carolina, Washington, West Virginia and Wisconsin. In addition, the transaction will include a small number of Verizon's exchanges in California, including those bordering Arizona, Nevada and Oregon. <http://newscenter.verizon.com/press-releases/verizon/2009/verizon-to-divest-wireline.html>

SUMMARY PROFILE OF "LARGER" PENNSYLVANIA RLECS

EMBARQ/CENTURY TEL:

The company was incorporated in 2005 and began operating independently in May, 2006, when former parent Sprint Nextel completed the spin-off of its local telecommunications division. Embarq is the 4th largest local exchange carrier in the U.S., serves approximately 5.7 million access lines (as of the end of 2008), across 18 states and has about 16,000 employees. The company reported operating revenues of \$6.12 billion for the full year 2008 and is in the Fortune 500® list of America's largest corporations.

Embarq provides local voice and data services, including DSL-based Internet access, to consumer, business and wholesale customers. Embarq also provides wireless, video and long-distance voice services to customers within its local service territories through third-party relationships with Sprint Nextel and EchoStar's DISH or Direct TV Network. Business data services include traditional leased lines, frame relay and ATM, along with IP VPN, Ethernet and managed services.

On October 27, 2008, Embarq agreed to be acquired by CenturyTel, another large company⁶, in an all-stock transaction valued at \$11.6 billion, including the assumption of \$5.8 billion of Embarq's debt. The combined company will operate in 33 states, with nearly 8 million access lines and 2 million broadband customers. The merger received approval by the FCC on June 24, 2009.

With the CenturyTel acquisition, the combined company is expected to become the fourth largest incumbent local exchange carrier in the U.S. and approximately number 300 on the Fortune 500 list of America's largest companies.

CenturyTel announced that it believes "synergies" will reach \$400 million annually, composed of approximately \$300 million in cost savings, around \$75 million in additional revenues opportunities, and almost \$30 million in capital efficiencies.

FRONTIER/ COMMONWEALTH TELEPHONE COMPANY

Frontier Communications Corporation⁷: Frontier Communications Corporation (formerly known as Citizens Communications Company through July 30, 2008) was incorporated in the State of Delaware in 1935 as Citizens Utilities Company. In March 2007 Frontier acquired Commonwealth Telephone Enterprises, Inc. which operates in Pennsylvania, in a transaction valued at \$1.1 billion. Frontier is a full-service communications provider and the second largest rural local telephone exchange company in the country. The company offers services to residence and business customers including local and long distance telephone service, directory services, television and Internet services, as well as bundled offerings, wireless Internet data access, data security solutions and specialized bundles for small/medium/large businesses and home offices. During 2008, Frontier added about 57,000 new High-Speed Internet customers and 116,000 bundle or package

⁶ The company issued a press release stating that CenturyTel has been recognized once again by *Forbes* magazine as one of the "400 Best Big Companies in America." This "Platinum 400" list identifies the best of the largest publicly traded companies in America -- from across 26 industry groups -- after a thorough review of financial metrics, Wall Street forecasts, corporate governance ratings and other public information. "Best Companies" list for 8th year", March 12, 2007.

http://www.centurytel.com/Pages/AboutUs/PressRoom/pressRelease.jsp?page=Corporate/Press_Release61.html

⁷ Information based on Frontier's 2008 Annual 10K report, Frontier/Verizon Assets purchase press release, May 13, 2009, and/or Investor Fact Sheet regarding Verizon assets purchase.

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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

Docket No. I-00040105

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

AT&T Communications of :
Pennsylvania, LLC :
Complainant :

v. :

Docket Nos. C-2009-2098380, *et al.*

Armstrong Telephone Company - :
Pennsylvania, et al. :
Respondents :

**PANEL SURREBUTTAL TESTIMONY OF
JEFFREY L. LINDSEY AND MARK D. HARPER**

**ON BEHALF OF
THE UNITED TELEPHONE COMPANY OF PENNSYLVANIA LLC
d/b/a CENTURYLINK**

STATEMENT 1.1

*4/15/10
1st pg JK*

**** PUBLIC VERSION ****

Prefiled: April 1, 2010

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1 **I. INTRODUCTION AND PURPOSE OF TESTIMONY**

2 **Q. MR. LINDSEY AND MR. HARPER, ARE YOU THE SAME WITNESSES WHO**
3 **PREFILED DIRECT TESTIMONY IN THIS PROCEEDING?**

4 **A.** Yes.

5

6 **Q. ON WHOSE BEHALF ARE YOU TESTIFYING?**

7 **A.** We are testifying on behalf of The United Telephone Company of Pennsylvania LLC
8 d/b/a CenturyLink (f/d/b/a Embarq Pennsylvania) hereinafter (“CenturyLink” or
9 “Company”).

10

11 **Q. MESSRS. LINDSEY AND HARPER, WAS THIS PANEL TESTIMONY**
12 **PREPARED BY YOU OR PREPARED UNDER YOUR DIRECT SUPERVISION**
13 **AND CONTROL?**

14 **A.** Yes.

15

16 **Q. WHAT IS THE PURPOSE OF YOUR PANEL SURREBUTTAL TESTIMONY?**

17 **A.** Our testimony responds to statements made in the rebuttal testimonies of several parties
18 as pre-filed in this proceeding. Specifically, we will respond to several overarching
19 policy issues raised and/or implicated by the rebuttal testimonies of Verizon witness
20 Mr. Don Price (“Price”), AT&T witnesses Mr. E. Christopher Nurse and Dr. Ola
21 Oyefusi (“Nurse and Oyefusi”), Comcast witness Dr. Michael D. Pelcovits (“Dr.

1 Pelcovits”), Sprint witness James A. Appleby (“Appleby”), Qwest witness William R.
2 Easton (“Easton”), and OSBA Witness John W. Wilson (“Wilson”).

3
4 **Q. PLEASE SUMMARIZE THIS PANEL SURREBUTTAL TESTIMONY.**

5 **A.** Despite the claims of other parties, CenturyLink is pro-reform. Reform means
6 changing the way that high cost areas are supported in order to ensure that high quality
7 communications services remain available, affordable, and comparable to similar
8 services offered to consumers in lower-cost areas and that the historical, timeless
9 commitment to universal service is maintained. Therefore, reform must be a holistic
10 solution that carefully considers each part of the equation of this highly sensitive issue.
11 Reform is not simply the reduction of access charges for the sake of cost savings to
12 interexchange carrier; carriers that are not even actively pursuing the residential market
13 anymore. And, reform certainly does not mean “squeezing the balloon” so that the
14 support derived from one set of entities is lower while these parties and the
15 Pennsylvania Public Utility Commission (“PA PUC” or “Commission”) look the other
16 way to avoid seeing the very predictable impact of reduced services, increased prices,
17 and an increasingly jeopardized universal service policy. The impact of universal
18 service and access policies on rural Pennsylvanians and the carriers who serve them is
19 very real. If this balloon pops, it will be easy for all to look back in an ex post fashion
20 and see that a one-sided decision in this proceeding contributed the end of universal
21 service policy in the rural areas of Pennsylvania. CenturyLink supports the past reform
22 decisions made by this Commission in the area of access and universal service reform.

1 The PA PUC can stand by these decisions and still remain on the vanguard of policy. It
2 is easy for proponents of immediate access reductions to spout inapplicable, self-
3 serving theories and outmoded cost allocation views that this Commission has never
4 adopted. The proponents of immediate access reductions for the Rural Local Exchange
5 Carriers (“RLECs”), including CenturyLink, do not in any way share or assume the
6 risks of their proposals being wrong for rural Pennsylvanians. They present positions
7 convenient to them and request that the rates they pay be reduced immediately
8 providing rhetoric only on rebalancing as an alleged “opportunity.” Yet, they have
9 done no studies or analyses of the impact of their proposals and, notably, whether their
10 very own proposals are viable and sustainable in rural Pennsylvania.

11
12 CenturyLink supports continued holistic reform in Pennsylvania as this Commission
13 has historically undertaken. Should the Commission desire additional incremental
14 reform, such reform must be holistic, recognizing that consumers are already paying
15 their fair share and, if access rate reductions are ordered, that concomitant recovery to
16 the carriers serving them be made explicit through the Pennsylvania Universal Service
17 Fund (“PA USF” or “Pennsylvania USF”). Under no circumstances should the
18 Commission implement access reductions on a flash cut and “immediate” basis without
19 simultaneously ensuring explicit revenue-neutral recovery through the PA USF.

1 **Q. WHAT IS CENTURYLINK ASKING THE COMMISSION TO DO IN THIS**
2 **PROCEEDING?**

3 **A.** First and foremost, CenturyLink is urging the Commission to reject the proposals by
4 AT&T, Sprint, Comcast and others who support immediate reductions to intrastate
5 access charges to the detriment of Pennsylvania's rural ratepayers and the RLEC's,
6 including CenturyLink, committed to serving these customers. This Commission has
7 already undertaken significant access reform for the RLECs faithfully serving rural
8 Pennsylvania, as CenturyLink witness Mr. Bonsick addressed in Direct Testimony.
9 The parties supporting immediate access reductions in lieu of the balanced, measured
10 approach that this Commission has historically taken with regard to access reform are
11 advocating actions that are not supported by the facts or history. They have not
12 demonstrated the viability of their proposals and have failed to provide any credible
13 evidence that access reductions in today's telecommunications market will benefit
14 Pennsylvania and rural consumers. Contrary to these parties and in unison with the
15 Pennsylvania Telephone Association ("PTA") and the Office of Consumer Advocate
16 ("OCA"), CenturyLink supports a holistic, measured, and balanced approach to
17 continued access reform in and for Pennsylvania that continues to recognize the
18 important role the RLECs play as instruments in carrying-out of this Commission's
19 Carrier of Last Resort ("COLR") /universal service policies. Thus, in light of the
20 absence of facts and credible evidence to support the positions of parties seeking
21 immediate access reductions, CenturyLink's primary position remains that the

1 Commission affirm that the RLECs' existing intrastate switched access rates are just
2 and reasonable.

3
4 Alternatively, as Mr. Bonsick also addresses, if the Commission determines to reduce
5 intrastate switched access rates for the RLECs (including CenturyLink), then a holistic
6 and measure approach to doing so is absolutely critical for continuing this
7 Commission's meaningful and viable COLR/universal service policies. CenturyLink
8 requests that the Commission look to the parties to attempt to reconcile their varying
9 positions. Additionally, in light of recent game-change activity occurring before the
10 Federal Communications Commission ("FCC") and potentially the U.S. Congress (e.g.,
11 FCC action relative to the National Broadband Plan (Connect America) and a
12 comprehensive overhaul of the Federal Universal Service Fund), CenturyLink requests
13 that the Commission coordinate the substance and timing of its decisions and policies
14 with those occurring at the federal level to ensure that rural Pennsylvanians are not left
15 out. Given the changes, any attempt to reconcile positions must recombine both access
16 reform and the structure of the Pennsylvania USF as these two concepts are inextricably
17 linked and are important elements in the continued execution of this Commission's
18 successful COLR/universal service policies. Competition is thriving in Pennsylvania.
19 The need for speed to implement "immediate" intrastate switched access rate reductions
20 has not impacted the development of competition and will not impact competition
21 going forward as the record demonstrates. Coordinated and continued holistic reform
22 can be fashioned in Pennsylvania.

1 **II. SUMMARY AND GENERAL RESPONSE TO POSITIONS OF OTHER**
2 **PARTIES**
3

4 **Q. CAN YOU SUMMARIZE THE POSITIONS OF PARTIES SUBMITTING**
5 **REBUTTAL TESTIMONY?**

6 **A.** Yes, we can. Let's start with AT&T. AT&T retains its interstate mirroring proposal
7 (including elimination of the CCL). However, AT&T now proposes a residential
8 benchmark rate of \$22.00 per month to be increased annually thereafter by \$1.00 per
9 year for a total of three years¹. AT&T's modified proposal utilizes the Pennsylvania
10 USF, but downplays the fund as reliance upon the state USF is not required per AT&T
11 and is capped in its function,² yet the access reductions sought by AT&T would be
12 mandatory. And, of course, AT&T's modified proposal would have intrastate switched
13 access rates mirror interstate rates "immediately" leaving the risks of under-recovery
14 for revenue neutral purposes to be assumed by all but AT&T (and the other proponents
15 of access reductions).

16
17 **Q. WHAT IS THE IMPACT OF AT&T'S PROPOSAL ON CENTURYLINK?**

18 **A.** Based on AT&T's calculations, implementation of their proposal will cause a
19 reduction of [BEGIN CTL CONFIDENTIAL] [REDACTED] [END CTL
20 CONFIDENTIAL] in intrastate access revenues. Under their modified proposal they
21 have estimated CenturyLink's customers would pay an additional [BEGIN CTL

¹ AT&T also proposes further increases at the rate of inflation until the transitional PA USF funding is eliminated.

² See, e.g., AT&T at p. 19 ("Here, AT&T proposes to use the USF solely as a transitional measure for new access revenue reductions that should be implemented now.").

1 **CONFIDENTIAL]** [REDACTED] **[END CTL CONFIDENTIAL]** in rate in Step 1,
2 leaving a “transitional” PA USF amount of **[BEGIN CTL CONFIDENTIAL]**
3 [REDACTED]. **[END CTL CONFIDENTIAL]**

4
5 **Q. ARE AT&T’S CALCULATIONS, BY ALLEGING TO PORTRAY THEIR**
6 **PROPOSAL AS A REVENUE NEUTRAL EVENT, MISLEADING?**

7 **A. Yes. AT&T’s calculations are misleading and reveal their disregard for both the impact**
8 **on CenturyLink’s customers and the revenue neutral requirement under statute. The**
9 **proposal cynically requires the upfront reduction in access charges providing**
10 **immediate savings to AT&T, while magically creating revenues supposedly derived**
11 **from increases of \$4 per month immediately and \$3 more over the next three years**
12 **from the pockets of every CenturyLink PA customer, irrespective of the consumers**
13 **options to select other providers or drop service altogether.**

14
15 The calculations are also misleading because they include all residential lines, whether
16 standalone or in bundles and all business lines, including many that are likely under
17 contract. Just removing residential bundled lines from the formulas would reduce the
18 additional revenues projected by AT&T in Step 1 by nearly **[BEGIN CTL**
19 **CONFIDENTIAL]** [REDACTED] **[END CTL CONFIDENTIAL]** This, under
20 AT&T’s proposal beginning in Step 1 at least **[BEGIN CTL CONFIDENTIAL]** [REDACTED]
21 [REDACTED] **[END CTL CONFIDENTIAL]** would not longer be available to support high
22 costs areas without even taking into account unachievable rate increases to competitive

1 business lines. The result is to create an artificial number that mathematically may be
2 accurate under their assumptions, but in no way represents what should or could even
3 be achieved. No customer's rates can be raised with impunity, but as witnesses from
4 Sprint and Comcast both noted, it is unlikely that the competitive market places would
5 allow the RLECs to increase rates on bundled services. Bundles and business lines are
6 both highly competitive as well as a critical component of the support flows to high
7 cost areas. Therefore, increases to bundle rates and competitive business rates have a
8 doubly negative impact in that many customers will simply choose to leave and move
9 to competitors that do not carry the burden to service rural areas, eliminating not only
10 the opportunity to replace the support from access charges through the \$7 local rate
11 increases, but also eliminating contributions that currently flow from the higher revenue
12 bundle and business customers to supporting high cost areas.

13
14 **Q. AT&T CLAIMS THERE SHOULD BE NO "ARTIFICIAL" RETAIL RATE CAP**
15 **(PAGE 12). BEFORE ADDRESSING OTHER PARTIES, CAN YOU**
16 **COMMENT AS TO CENTURYLINK'S POSITION REGARDING THE**
17 **CONCEPT OF A RETAIL RATE BENCHMARK?**

18 **A.** Generally, yes. In Pennsylvania, and consistent with its advocacy in other states and in
19 the federal jurisdiction, CenturyLink supports retail rate benchmarks for the purposes of
20 ensuring that retail consumers pay their fair share. The current residential benchmark
21 of \$18/month meets the reasonable viability standard. However, the \$22 to \$25 retail
22 residential rate benchmarks proposed by AT&T fail miserably in this regard, and in

1 fact, serve as nothing more than a way to reduce RLEC switched access rates and
2 revenues without providing any degree of meaningful recovery or net consumer
3 benefits. An extreme example makes this point very clear. Let's assume that the PA
4 PUC establishes a retail rate benchmark of \$1,000. Obviously, it would not take very
5 many customers paying \$1,000 per month to recovery displaced revenues. However,
6 the likelihood of getting any customers to pay \$1,000 per month for residential retail
7 local service is remote. So, despite the claimed generosity to RLECs to permit them to
8 recover displaced revenues at rates above market levels, this is simply an unobtainable,
9 unviable option. Obviously, setting the benchmark for USF distribution purposes at
10 \$1,000 would preclude any recovery from USF. From a policy standpoint, retail rate
11 benchmarks, to be effective must be set at levels where market-based recovery up to the
12 benchmarks level is a reasonably viable option. AT&T's proposal – which is not
13 supported by any Pennsylvania-specific study – is unreasonable and inappropriate for
14 Pennsylvania. This Commission is unable to find that AT&T's proposal complies with
15 Section 3017(a)'s revenue-neutral requirement.

16
17 **Q. CAN YOU GENERALLY COMMENT AS TO SPRINT'S REBUTTAL**
18 **TESTIMONY?**

19 **A.** Yes. Given the procedural schedule set for this case (and agreed to by Sprint), it is
20 difficult to address the myriad additional allegations raised in Sprint's Rebuttal
21 Testimony. Generally, in Rebuttal Testimony, Sprint reiterates its request to reduce
22 RLEC intrastate switched access rates to interstate levels, but only increase the PA USF

1 after a cost study and after increases prices for all other services (including all
2 competitive services and service not regulated by the PA PUC). The vast majority of
3 the remainder of Sprint's Rebuttal Testimony focuses on providing additional claims.
4

5 **Q. CAN YOU IDENTIFY THE IMPACT OF SPRINT'S POSITION ON**
6 **CENTURYLINK?**

7 **A.** No, we cannot given the lack of specifics regarding Sprint's proposal. Sprint's Rebuttal
8 Testimony seemingly supports a state USF, but in reality Sprint's proposal only pays
9 lip service to the PA USF. As a result, its proposal undercuts universal service policy
10 in Pennsylvania. For example, Sprint's proposal improperly forces CenturyLink to
11 increase rates of competitive and non-regulated services – just as Sprint has proposed in
12 other jurisdictions - but no Commission, to our knowledge, has accepted. Meanwhile,
13 no studies were performed by Sprint to determine if its rate increases to competitive
14 and non-regulated rates are viable and sustainable. *See*, Sprint responses to discovery
15 (CTL-Sprint 3-1 and 3-2.) at Exhibit CTL Panel-3, attached. Given the flaws in
16 Sprint's proposal, this Commission clearly is unable to make a determination that the
17 proposal complies with Section 3017(a)'s revenue-neutral requirement.
18

19 **Q. CAN YOU GENERALLY HIGHLIGHT THE REBUTTAL TESTIMONIES OF**
20 **VERIZON AND QWEST?**

21 **A.** Yes. The Rebuttal Testimonies of Verizon and Qwest remain unchanged from
22 positions advanced in their respective Direct Testimonies. Qwest and Verizon continue

1 to support reductions in RLEC intrastate switched access rates to Verizon's intrastate
2 switched access rate levels. However, these parties differ as to the policy for dealing
3 with the ramifications of their RBOC-based stance on access reductions.

4
5 Qwest supports pricing intrastate switched access rates to the Verizon intrastate rate
6 level, but also supports recovery from the state USF after a 120-125% benchmark over
7 the current \$18.00 residential benchmark rate. Qwest claims there are no significant
8 cost differences between RLECs and Verizon, other than loop costs (page 7).
9 However, when asked in discovery to provide documents in support of its testimony,
10 Qwest did not provide any. *See*, responses to CenturyLink discovery CTL-Qwest 1-1,
11 1-2, 1-3, and 1-21 at Exhibit CTL Panel-4, attached. Qwest also opposes OCA's
12 replacement of a per-line charge (the CCLC) with a per line USF receipt (page 4).
13 Qwest also claims VoIP service remains outside the Commission's jurisdiction (pages
14 6-7). Finally, Qwest claims there is no need to wait for the FCC and the Commission
15 should reduce RLEC access rates now (pages 14-15).

16
17 Verizon continues to espouse that recovery of rate reductions should only be an
18 "opportunity" and the RLECs should look to increasing rates for noncompetitive
19 services (Price at pages 4, 7, 31, 39-40). Verizon claims the RLECs have not shown
20 that they cannot increase regulated retail rates due to competitive pressures (*id.*).
21 Finally, Verizon steadfastly maintains that a "carrier funded" USF should not be
22 expanded under any circumstances (page 5), claiming that the existing PA USF is a

1 “revenue guarantee” to RLECs and a “tax” that supports RLEC operations and
2 discourages telecommunications investment in Pennsylvania (pp. 5, 42-51).

3

4 **Q. FINALLY, CAN YOU HIGHLIGHT OSBA’S REBUTTAL TESTIMONY?**

5 **A.** Yes. OSBA maintains that no access reductions for the RLECs are appropriate or have
6 been demonstrated.³ Much of OSBA’s Rebuttal Testimony addresses OCA’s proposal
7 (and especially the PA USF) and certain cost allocation arguments. However, OSBA
8 reiterates that if the Commission reduces RLEC intrastate switched access rates, then
9 the residential rate cap (and only the residential rate cap) should be increased to \$20.65
10 per month, based upon 29% increase in the Consumer Price Index (CPI) (pages 14-16).
11 OSBA’s proposal would also include a customer-based test for “customers who do not
12 pass a needs test justifying a greater level of subsidized support” (page 14).

13

14 **Q. DID OSBA PROVIDE ANY RESPONSES TO DISCOVERY THAT ARE**
15 **WORTHY OF HIGHLIGHTING?**

16 **A.** Yes, it did. There were no workpapers, documents and studies used or relied upon by
17 OSBA witness Wilson relative to those portions of his testimony addressing expanded
18 contributions to the PA USF. (CTL-OSBA-1.) Likewise, OSBA witness Wilson did
19 not review or undertake any elasticity studies in support of the \$20.65 per month
20 residential rate. (CTL-OSBA -4 and -5.) OSBA’s discovery responses are attached
21 hereto at Exhibit CTL Panel-5, attached.

³ Mr. Wilson’s reference to RLECs includes CenturyLink. (OSBA response to CTL-OSBA-3.)

1 **Q. CAN YOU HIGHLIGHT COMCAST’S REBUTTAL TESTIMONY?**

2 **A. Yes. Comcast witness Dr. Pelcovits maintains the same position as set forth in Direct**
3 **Testimony: Reduce RLEC intrastate access rates to their interstate levels based upon**
4 **the view of “functionality” (page 10). Comcast would not support any increases to PA**
5 **USF, claiming RLECs have the ability to recover from retail rate or to become more**
6 **efficient. Dr. Pelcovits also undertakes a regression analysis with PTA data to show**
7 **that the “subsidy” is not correlated with density. Dr. Pelcovits concludes that access**
8 **rates are not being use to provide a targeted cross-subsidy to RLECs serving highest**
9 **cost areas of PA (page 9). “Other factors,” he claims, are responsible for the size of the**
10 **access charge subsidy. *Id.***

11
12 **Q. DID COMCAST PROVIDE ANY RESPONSES TO DISCOVERY THAT ARE**
13 **WORTHY OF HIGHLIGHTING?**

14 **A. Yes, it did. In response to CenturyLink-CTL 1-23, Comcast in part stated: “Comcast**
15 **does not have carrier of last resort obligations in Pennsylvania.” *See*, Exhibit CTL**
16 **Panel-6, attached. A point this response demonstrates is just how tenuous the**
17 **COLR/universal service policy in Pennsylvania is unless measured, holistic reform in**
18 **followed by this Commission. Pennsylvania is at a tipping point on these issues. It is**
19 **absolutely critical that reductions in the RLECs’ intrastate switched access rates**
20 **provide revenue-neutral explicit and properly timed support from the PA USF.**

1 **III. PARTIES RAISE NUMEROUS FLAWED CLAIMS IN REBUTTAL**
2 **TESTIMONY**

3
4 **Q. IS EFFICIENCY THE PRIMARY PURPOSE OF UNIVERSAL SERVICE**
5 **POLICY?**

6 **A.** No. The claims the parties, for example Verizon (at page 4), and Comcast (at page 23)
7 regarding inefficiencies are without merit or import. The fact remains that inefficiency
8 has been present in universal service policy since its inception many decades ago.
9 Stated another way, the purpose of universal service policy is promote a social benefit
10 and thus is inherently inefficient when compared to competitive market concepts that
11 would result in a system whereby those Pennsylvanians living in high-cost areas that
12 are uneconomic to serve, not having communications services made available to them,
13 unless they are at prices significantly higher than current prices.

14

15 **Q. IS UNIVERSAL SERVICE POLICY INEFFICIENT?**

16 **A.** Yes. By definition, universal service policy is inefficient. If efficiency were the only
17 consideration, no universal service policy would ever be established. While admittedly,
18 universal service policy does not need to be unnecessarily inefficient, inefficiency
19 cannot be completely removed from universal service policy.

20

21 **Q. WHAT IS THE PRIMARY PURPOSE OF UNIVERSAL SERVICE POLICY?**

22 **A.** The primary purpose of universal service policy is equity, not efficiency. This equity is
23 provided primarily to rural, high-cost consumers who generally do not have viable

1 competitive alternatives available and who would otherwise not have any
2 communications services available without implicit and/or explicit universal service
3 support to provide communications services at affordable prices that are comparable to
4 the rates of other consumers. Complaints about efficiency without regard for the equity
5 to be provided by universal service policy should be troubling to rural Pennsylvania
6 consumers and this Commission.

7
8 **Q. IS CENTURYLINK “INEFFICIENT”?**

9 **A.** No. CenturyLink is not inefficient. By many industry measures, CenturyLink operates
10 in an efficient manner. Comcast (at page 23), and others are projecting the
11 inefficiencies of universal service policies onto CenturyLink specifically, and ILECs,
12 generally. This projection is effectively “shooting the messenger”, by attacking the
13 instrument of universal service policy when they have complaints about the policy.

14
15 **Q. DOES UNIVERSAL SERVICE POLICY FUND “RLEC OPERATIONS” AS**
16 **CLAIMED BY VERIZON (AT PAGES 2, 17)?**

17 **A.** No. Universal service policy funding, including a portion from intrastate switched
18 access charges, is used to fund ILEC universal service/COLR obligations. As the
19 primary instruments of the state and federal universal service/COLR policy, ILECs
20 must be fairly compensated for the cost of fulfilling this social compact. Funding
21 provides an “insurance policy” for universal service – not for RLECs as claimed by
22 Verizon (at page 5). Failure to fund this policy creates an unfunded mandate that

1 competitively disadvantages ILECs and places implementation of universal service
2 policy at-risk. Failure to fully fund also may result in non-ILECs not paying their fair
3 share of the burden of this social obligation. This would produce an unfair outcome
4 that would create a competitive advantage for non-ILECs who would neither be
5 required to serve the highest cost customers nor fully participate in funding the
6 universal service obligation borne by the ILECs to do so.

7
8 **Q. IS ALIGNING PRICES WITH COSTS CONSISTENT WITH UNIVERSAL**
9 **SERVICE POLICY?**

10 **A.** Without full explicit funding from a Universal Service Fund, no. Despite the
11 statements of Comcast (at page 11), along with other parties, advocating to align prices
12 with cost, this is impossible. Universal service policy requires prices for the highest-
13 cost customers to be below cost in support of affordability and comparability
14 objectives. Such policy mandates that some other prices for other customers will be
15 increased to offset the cost of the policy. Part of the cost of universal service policy has
16 been and is borne by intrastate switched access rates. Of course, this creates some level
17 of economic inefficiency, but the social benefits of equity, primarily availability of
18 service for those customers who would not otherwise have it without a universal service
19 policy, more than outweighs the inefficiency, on balance. Claims of competitive
20 “harms” (*see, e.g.*, Verizon at page 2) caused by this inefficiency are vastly overblown,
21 as obvious competition has been growing and thriving in many areas. Finally, despite
22 further claims that every customer should cover their own costs (Verizon at pages 4, 5,

1 9), such an outcome is in direct conflict with a fundamental, historical, tenets of
2 universal service policy to ensure availability, affordability and rate comparability. For
3 carriers such as Verizon and AT&T, as two of the largest and longest serving
4 instruments of universal service/COLR policy throughout America, to advocate such
5 policy is truly astounding. Their advocacy testifies to how far these carriers have
6 wandered from their traditional commitments to rural America as they are increasingly
7 blinded by their desire to serve the “bright lights” of our nation’s largest cities. They
8 are content to cast rural Americans to a second class fate without a functional universal
9 service policy in their pursuit of cost reductions for their predominantly urban
10 customers.

11
12 **Q. IS FUNDING THE UNIVERSAL SERVICE/COLR OBLIGATION**
13 **“GUARANTEEING” RLEC REVENUES?**

14 **A.** No. Verizon’s statements (at page 5) are untrue. Likewise, AT&T wrongly claims that
15 RLECs are seeking guaranteed revenues rather than an opportunity. (AT&T Panel
16 Rebuttal at pages 35-36, 16.) Like other carriers, RLEC revenues are not “guaranteed”
17 today and will not be in the future. Verizon appears to be conflating the funding of the
18 social compact of universal service/COLR obligations with funding RLEC operations.

19
20 **Q. MUST REVENUE RECOVERY OPTIONS BE REASONABLY VIABLE?**

21 **A.** Yes. Recovery of any intrastate switched access revenue displaced by this proceeding
22 must be reasonably expected to be obtainable, or viable. It is obvious to all parties that

1 current levels of competition in most area constrain retail pricing increases, particularly
2 given that residential retail local exchange rates are already above national averages, at
3 the \$18/month rate. Unutilized headroom in excess of [BEGIN CTL
4 CONFIDENTIAL] [REDACTED] [END CTL CONFIDENTIAL] per the terms of
5 CenturyLink's alternative regulation plan gives additional evidence of pricing
6 constraints extant due to current levels of competition. Competition suggests that there
7 is a limit to realizable price and revenue increases, and in many areas we are at that
8 limit or close to it. Policies designed to move retail prices above competitive levels or
9 to preclude USF funding below retail rate benchmarks that are above competitive
10 pricing levels fail to meet the standard of reasonable viability.

11
12 **Q. AT&T (PAGE 28) AND OTHER PARTIES CLAIM THAT, WITH FEDERAL**
13 **USF PROCEEDS, IT IS INCONCEIVEABLE THAT THE RLECS CANNOT**
14 **RECOVER THEIR REMAINING COSTS FROM THEIR OWN CUSTOMERS.**
15 **CAN YOU COMMENT?**

16 **A.** Yes. As we discussed in our direct testimony, and our position remains unchanged,
17 federal USF policy is generally recognized as broken. Nearly all parties have filed
18 statements to this effect at the FCC on multiple occasions. Mid-size ILEC's such as
19 CenturyLink have been particularly underfunded as the current system of study area
20 averaging produces a netting effect whereby high-cost rural areas that would otherwise
21 qualify for federal USF support are included with lower cost suburban or urban areas of
22 the study area. The result is to deny funding to areas that would otherwise qualify for

1 funding. This is a serious problem that must be reform for universal service policy to
2 remain viable in many parts of the country. Federal USF does not address the problem.
3 The state of Pennsylvania must provide a complementary, viable solution to truly tailor
4 a satisfactory universal service policy that works for rural Pennsylvania consumers.

5
6 **Q. DO THE REGULATORY BURDENS OF RLECS EXCEED THOSE OF OTHER**
7 **CARRIERS?**

8 **A.** Yes. Verizon states that it is not good policy for other carriers to fund universal service
9 obligations because, inter alia, these carriers are “subject to their own regulatory
10 burdens.” This argument is illogical as it is nearly universally understood that ILEC
11 regulatory burdens are greater – and in many cases far greater – than the regulatory
12 obligations of non-ILECs – and particularly for RLECs. A policy requiring non-ILECs
13 to fund their fair share of the universal service/COLR obligation is completely fair as
14 non-ILECs do not bear the burden of the COLR and being forced to serve areas where
15 they choose not to serve, in addition to less regulation in the area of prices, service
16 standards, regulatory reporting, etc. These benefits of a lighter regulatory touch
17 translate into very real cost advantages for non-ILECs. Requiring them to fund a
18 portion of the obligation, which they generally pass on to their customers anyway,
19 seems to be a small price to pay in exchange for the benefits received.

1 Q. AT&T AND SPRINT WITNESSES QUOTE PAST TESTIMONY FROM DR.
2 STAIHR FROM OTHER STATES IN AN ATTEMPT TO PORTRAY SUCH
3 PAST TESTIMONY AS INCONSISTENT WITH THE POSITIONS OF OTHER
4 PARTIES (E.G., THE OTS) AND/OR CENTURYLINK IN THIS CASE?

5 A. When putting their theories in context, what Sprint and other carriers seek is to pay
6 nothing toward network costs of providing service to their customers. The “free ride”
7 noted by OTS Witness Kubas is absolutely correct. Moreover, Mr. Appleby, and other
8 parties, uses outmoded, irrelevant allocation of costs theories in order to conflate that
9 this case is about determining policy, not about costs. And, of course, the costing
10 theories they resort to apply to RLECs only. *See*, Exhibit CTL Panel-7, responses to
11 discovery by several parties claiming they have not undertaken any cost analysis to
12 determine *their* costs of providing intrastate switched access services.⁴ To the best of
13 our knowledge, this Commission has never made *pricing* decisions for intrastate
14 switched access rates solely based upon *costing* theories as Sprint and others advocate.
15 Finally, once again, what is most clear in this situation is that facts matter.⁵ Indeed,
16 CenturyLink became subject to alternative rate regulation long ago. The Commission
17 must deal with Pennsylvania law, rates and current state of access reform and those
18 cases/testimony are simply not informative. Thus, Sprint wrongly attempts to foist
19 outmoded and irrelevant theory from testimony from other states and this does

⁴ CTL-Sprint 3-16 and 3-17, CTL-Comcast 2-13, CTL-Qwest 1-20 and 1-21.

⁵ For example, The fact is that In New Jersey, the case was not addressing access reform but instead addressing local rates at \$7.95 per month that had not been raised for 20 years. The Kansas case was in the context of access reform resulting in increases in basic rates to a level of \$17.73 per month for CenturyLink’s customers.

1 absolutely nothing for setting go-forward policy for Pennsylvania given existing and
2 future market conditions. The risks of adopting Sprint's position and being wrong will
3 not be borne by Sprint (or AT&T and the other proponents of non-holistic access
4 reductions). They will be borne by rural Pennsylvanians.

5
6 **Q. AT&T AND SPRINT WITNESSES ALSO REFERENCE AND MAKE**
7 **STATEMENTS REGARDING CENTURYLINK'S FCC UNIFICATION**
8 **FILING. CAN YOU COMMENT?**

9 **A.** Yes, I can. Their statements erroneously address CenturyLink's filing and thus the
10 claims they assert are flawed and pointless. CenturyLink's 2008 FCC unification
11 petition sought to allow CenturyLink (formerly, Embarq) to unify its interstate and
12 intrastate rates in each state on a revenue-neutral basis. The FCC has not acted on
13 CenturyLink's unification petition – just as it has not acted on other proposals and
14 claims of other parties, including AT&T and Sprint. Under its petition, CenturyLink's
15 interstate rates would *increase* and the intrastate access rates would thereby *decrease* to
16 the same level on a state-by-state basis. Under CenturyLink's unification petition, the
17 unification of rates is designed *to preserve the support for the ongoing provision of*
18 *universal service*. This is a critical point ignored by Sprint and AT&T. .

19
20 **Q. IS REVENUE RECOVERY THE KEY ISSUE IN THIS PROCEEDING?**

21 **A.** Yes. Unlike Verizon's statement to the contrary (at page 9), revenue recovery to fund
22 the universal service/COLR obligation is the key issue in this proceeding. It is not, as

1 Verizon suggests, about RLECs imposing excessive costs on other carriers. Yet again,
2 Verizon misses the point of the need to fund the universal service/COLR obligation that
3 makes communications services possible for many rural Pennsylvanians. Verizon has
4 and is in the process of divesting more primarily rural ILEC territory than any company
5 in U.S. history. This action has had a significant impact on its USF and intercarrier
6 compensation advocacy as it is betting that policymakers won't adequately fund
7 universal service/COLR obligations.

8
9 **Q. IS VERIZON'S CONTINUED ADVOCACY OF MOVING RLEC ACCESS**
10 **RATES TO VERIZON'S INTRASTATE ACCESS RATES THE BEST PUBLIC**
11 **POLICY OUTCOME FOR THIS PROCEEDING?**

12 **A.** No. This proposal (advanced by Verizon and Qwest) is just as flawed as those
13 advocating to price intrastate rates at parity with interstate rates. Our position in our
14 Direct Testimony remains unchanged. Each RLEC has a different cost structure and
15 population densities in the areas served. RLEC costs are higher than Verizon's ILEC,
16 largely as a result of these lower population densities. Verizon ILEC's per-customer
17 universal service/COLR obligations are far lower CenturyLink's and the other
18 Pennsylvania RLECs and permits the Verizon ILEC to better withstand competitive
19 losses. The best public policy outcome will recognize the significant differences in
20 serving rural areas and not force solutions based on the vast differences of another
21 carrier.

22

1 **Q. COMCAST WITNESS PELCOVITS (AT PAGE 19) CLAIMS NEAR**
2 **IDENTICAL POINTS WITH THE FCC'S PROPOSAL ON THE PRICING OF**
3 **INTERCARRIER CHARGES. DID THE PA PUC HAVE COMMENTS ABOUT**
4 **INTERCARRIER PRICING IN THAT SAME PROCEEDING?**

5 **A.** Yes. The PA PUC wrote in reply comments on November 26, 2008, "The FCC's
6 proposed "new" incremental cost ("additional costs") standard for replacing the already
7 established total element long-run incremental cost ("TELRIC") standard and
8 methodology, and deriving the costs of access and reciprocal compensation rates, is
9 arbitrary and burdensome. It is clear that the FCC's proposals on the adoption of an
10 incremental cost standard are "results driven" and that a less than sound economic
11 theory must be utilized in order to support a predetermined result." Therefore, it is not
12 irrational to conclude that Mr. Pelcovits's same points are "less than sound economic
13 theory."

14
15 **Q. WILL A CHANGE IN RLEC SWITCHED ACCESS RATES HAVE AN**
16 **IMPACT ON THE AVERAGE PRICE PER MINUTE CHARGED BY IXCS TO**
17 **PENNSYLVANIANS?**

18 **A.** No. Evidence shows that the IXCs charge a national rate and that state specific plans
19 are either no longer offered or, if they are offered, are inconsequential. The rates
20 charged by the IXCs are applied to billions of minutes and are based on national inputs.
21 The Pennsylvania RLEC minutes of use to which the switched access rates are applied
22 are de minimus when compared to the national volumes. Therefore, the impact of the

1 RLECs charging IXCs *any* reduced switched access rate for the small amount of
2 minutes they charge to national IXCs will most likely have no effect on the national
3 average price charged by the IXCs. Data shows that, even excluding the other states
4 intrastate MOU's and Verizon's intrastate MOU which would also be part of the
5 demand factor, the RLEC volumes, as part of this case, represent 0.29% of AT&T's
6 total interstate MOUs. The RLEC volumes are only 1/3 of 1 percent of AT&T's
7 interstate volume and would be less than that if compared to all switched access traffic
8 data. I have attached a chart to put this discussion into perspective. Please refer to
9 **confidential** CTL Attachment A. (The volume information referenced in the chart is
10 based on AT&T confidential discovery responses CTL-ATT 3-4 and 3-5.)
11

12 **Q. IS THE LOOP COSTS THAT AT&T CLAIMS (AT PAGE 28) OF THEIR**
13 **REBUTTAL PANEL TESTIMONY AN ACCURATE REFLECTION OF**
14 **CENTURYLINK'S CURRENT LOOP COSTS?**

15 **A.** No. The NECA filing which AT&T references is used for a singular narrow purpose
16 and does not represent the costs United PA actually incurs today for loop costs. The
17 NECA filing is based upon a study methodology developed over 10 years ago with
18 factors that have not been updated in over 10 years. The methodology of averaging
19 rural high cost areas with lower cost urban areas to determine a national average loop
20 cost should not be construed to mean that the Rural LECs have no high cost loop areas.
21 The *high variability* of costs between urban and rural areas much be recognized by
22 public policymakers in order to maximize public policy outcomes for all.

1 **Q. SPRINT WITNESS APPLEBY STATES THAT THE LINE DROPS TO THE**
2 **CUSTOMER PREMISE IS THE ONLY SUNK COST INCURRED BY AN**
3 **RLEC WHEN A CUSTOMER IS LOST. DO YOU AGREE?**

4 **A.** No. Mr. Appleby incorrectly assumes that all of the feeder and distribution plant
5 investment will be reassigned and that no maintenance will be necessary on these
6 facilities. RLECs, particularly in the most rural areas of the state, may have feeder and
7 distribution facilities serving a only very limited number of customers. The probability
8 of reassignment is inversely correlated to population density; the more rural the area,
9 the less likely the RLEC will be to be able to reuse the facilities. The need to keep
10 these facilities maintained is a reality, due to RLEC universal service/COLR
11 obligations. Mr. Appleby also ignores the service obligations that exist for the RLECs,
12 *which include establishing new service and re-establishing service, meeting and repair*
13 *regulatory standards. These regulatory requirements add costs that do not change*
14 *immediately with loss of an access line.*

15

16 **Q. AT&T, SPRINT, AND VERIZON ARGUE THAT THERE ARE NO COSTS**
17 **ASSOCIATED WITH COLR AND UNIVERSAL SERVICE OBJECTIVES AND**
18 **STATE THAT THE RLECS HAVE NOT PUT FORTH ANY TESTIMONY TO**
19 **PROVE THAT THERE ARE ASSOCIATED COSTS. ARE THESE**
20 **STATEMENTS OF “NO COSTS” TRUE?**

21 **A.** If this were true, then the inverse would then be true also. If there are no costs
22 associated COLR and Universal Service objectives, then policymakers could easily

1 remove these obligations and permit service, marketing, and pricing to be managed
2 based on market conditions. This would certainly improve efficiency, as espoused by
3 these carriers. If there, truly, are no costs associated with these objectives, then it
4 should be no concern of the Commission that Pennsylvanians living in rural high cost
5 areas will receive service at affordable and comparable rates when these obligations no
6 longer exist. Removing these objectives would bring parity into the market place.
7 Additionally, all pricing caps should be removed allowing the rates charged to end
8 users to recover their unique individual costs. The fact that states and the federal
9 government have not taken these steps speaks volumes about such claims of “no cost.”

10
11 **Q. SPRINT WITNESS APPLEBY CONTENDS THAT THE RLECS ARE NOW**
12 **OFFERING A WIDE VARIETY OF SERVICES OVER THE SAME LOCAL**
13 **NETWORK USED HISTORICALLY TO PROVIDE BASIC LOCAL**
14 **EXCHANGE SERVICE, AND THAT REVENUES FROM THESE NEW**
15 **SERVICES SOMEHOW ELIMINATE THE RLECS NEED FOR THE**
16 **SUPPORT INHERENT IN THE INTRASTATE SWITCHED ACCESS RATES**
17 **OR FROM THE PA USF. WHAT IS YOUR REACTION TO THESE CLAIMS?**

18 **A.** Mr. Appleby continues to ignore the facts and continues to create illusions that are just
19 not reality. Mr. Appleby paints the picture that CenturyLink has provided this wide
20 variety of new services without any related costs, which is obviously not true. There
21 are very real world investments and maintenance costs associated with every service
22 offering, some of which may never recovery their costs. CenturyLink shareholders

1 bear the risks of these other services financial viability – not Sprint, other carriers, or
2 consumers. The cost study results CenturyLink referenced in the original access
3 proceeding showed an overall estimated average cost per line of approximately \$42.
4 The costs by wire center were as high as \$120 per line in one of CenturyLink’s most
5 rural exchanges. It is these rural exchanges that create the subsidy need.

6
7 **Q. HAS CENTURLINK PRODUCED A COST STUDY IN THIS PROCEEDING**
8 **FOR BASIC LOCAL SERVICE OR FOR INTRASTATE SWITCHED ACCESS**
9 **SERVICE?**

10 **A.** No. Rates in this proceeding are not going to be set based on cost, eliminating the need
11 to generate detailed CenturyLink specific cost results. CenturyLink referenced the cost
12 study results as presented by Dr. Loube. The HCPM cost model results as presented by
13 Dr. Loube provided a basic understanding of costs which Embarq felt was sufficient for
14 this proceeding. Dr. Loube’s results provide the data necessary to be able to prove the
15 point that current revenues are not sufficient to cover the cost of providing basic local
16 service to Embarq’s customers in Pennsylvania. Had Embarq endeavored to produce a
17 more current independent study the point would have been the same, although the costs
18 would likely have been much higher.

1 Q. SPRINT CLAIMS THE RLECS HAVE FAILED TO PRODUCE FINANCIAL
2 INFORMATION TO PROVE THEIR CASE (PAGES 12-15). DO YOU
3 AGREE?

4 A. No. When Sprint and others⁶ claim that intrastate switched access rates are “excessive”
5 and can be reduced (and instead RLECs should increase their own end user rates and
6 other prices),⁷ what they are effectively implying is that CenturyLink and the other
7 RLECs do not need the revenue from intrastate switched access rates. For several
8 reasons, the claimed lack of financial information is misguided and flawed proposition.

9

10 First, the changes in the telecommunications market make universal service even more
11 important today – not less important – than 10 years ago. The very competitive
12 marketplace they reference as justifying their need for access rate reductions
13 demonstrate the very reason why intrastate switched access rates – and a viable revenue
14 neutral recovery – are absolutely critical to meeting COLR/universal service policies.
15 RLECs’ access rates are not “excessive” nor do they constitute as “overcharges” given
16 such critical policies supported by intrastate switched access revenues. And, the need
17 to maintain these policies is greater because of the competitive marketplace that has
18 evolved. Sprint simply seeks to undo the Commission’s path of taking measured and
19 holistic action concerning access reform when maintaining course is absolutely critical
20 given the new intermodal competitive marketplace.

⁶ For example, OSBA, while agreeing with the RLECs that access reductions are not necessary, nonetheless claims that there is “little knowledge of which RLECs today need a subsidy.” (OSBA Rebuttal p. 17.)

⁷ See, e.g., Verizon Rebuttal at p. 5 (“[T]he fundamental problem, which is that the RLECs are collecting too large a portion of their operating revenues from other carriers instead of their own retail end-users.”).

1 Second, the proponents of access reductions conveniently ignore the fact that RLECs
2 serving less dense, high-cost areas have significant regulatory burdens not shared by
3 those seeking expense savings. If COLR/universal service obligations – and the
4 associated service metrics and requirements associated with being the provider of last
5 resort – were not so costly, then Sprint and the others would be performing this
6 function. They are not. CenturyLink provides safe and reliable service that is
7 ubiquitously available throughout CenturyLink’s service territory. We cannot opt to
8 select to provide service to only the higher revenue-making enterprise customers. Our
9 competitors – many of whom are parties in this case – do just that and disavow the
10 Commission’s jurisdictional reach and/or have no COLR/universal service obligations
11 at all. When CenturyLink loses a customer, such as a large business customer, the
12 costs to continue provide safe and reliable service under Section 1501 of the Public
13 Utility Code, for example, do not go away as Mr. Bonsick addresses. The new reality
14 facing CenturyLink and the other RLECs is that we are unable to recover the high-costs
15 of serving rural Pennsylvania from the remaining customers. CenturyLink simply does
16 not enjoy the densities and the economies of scale as Verizon. Clearly, no
17 demonstration of “financial need” is necessary given realities arising from the very
18 competitive market conditions noted by Sprint and others in justifying their drive for
19 RLEC access rate reductions.

1 **Q. HAVE YOU REVIEWED THE REGRESSION ANALYSIS PERFORMED BY**
2 **COMCAST WITNESS DR. PELCOVITS (AT PAGE 7) IN HIS REBUTTAL**
3 **TESTIMONY?**

4 **A.** Yes.

5

6 **Q. CAN YOU BRIEFLY DESCRIBE THE PURPOSE OF THE REGRESSION**
7 **ANALYSES UNDERTAKEN BY DR. PELCOVITS?**

8 **A.** Yes, I can. First, Dr. Pelcovits undertakes a regression analysis using PTA data
9 allegedly to show that there is no correlation between the density of the area served by
10 an RLEC and its dependence on above-cost switched access rates to “support
11 reasonable local exchange rates.” (page 4.) In other words, Dr. Pelcovits claims that
12 the analysis – and the “number of other regression analyses” claimed to have been
13 undertaken (page 8) – to conclude that access rates are not being used to provide a
14 targeted “cross-subsidy” to RLECs serving highest cost areas of PA. (p. 9). Based upon
15 these analyses, Dr. Pelcovits surmises that “other factors” are responsible for the size of
16 the access charge subsidy. *Id.*

17

18 **Q. DO YOU AGREE WITH ANY OF HIS CONCLUSIONS?**

19 **A.** I agree only with his conclusion that there is very little correlation between the local
20 retail rates of Pennsylvania RLECs and density when measured at a company level.
21 Local rates, along with intrastate switched access rates and other ILEC rates, result
22 from pricing decisions that historically do not correlate. Hence, a regression analysis

1 and any other regression analyses such as those performed by Dr. Pelcovits are
2 unnecessary to confirm this fact and reality. Pricing decisions are based upon policies,
3 not cause and effect rationale and correlations to density or any other factor.

4

5 Moreover, even if you assume that pricing decisions have had any correlative basis
6 over the years (but that is not the case), there are at least two primary reasons why there
7 is little correlation. First, density varies wildly within companies, producing average
8 results that mask meaningful differences at the exchange level. For example, the
9 exchange level density for CenturyLink PA ranges from a high of [BEGIN CTL
10 **CONFIDENTIAL**] [REDACTED] [END CTL
11 **CONFIDENTIAL**] to be relevant, the analysis performed must account for these
12 massive variances. Thus, the company level of analysis undertaken by Dr. Pelcovits is
13 inapposite and inappropriate. Second, as noted above, the pricing of retail local rates is
14 largely a residual of cost and only partially accounts for cost recovery. Additionally,
15 the portion of cost included in retail local rates is highly variable. Of course, when Dr.
16 Pelcovits compares a portion of highly variable costs to highly averaged company level
17 density factors the alleged correlation “fails to turn up any systematic relationship
18 between these two variables.” (page 5.) CenturyLink agrees that Dr. Pelcovits has
19 effectively built an invalid proposition and subsequently disproven it. This regression
20 analysis is, for all practical purposes, meaningless.

1 **Q. WHAT IS THE MORE APPROPRIATE ANALYSIS?**

2 A. Cost is the relevant variable here. Cost is recovered through highly variable portions of
3 switched access, USF, and retail local exchange rates. Dr. Loube has provided a
4 reasonable surrogate for CenturyLink's costs (Exhibit RL-8 from his testimony filed in
5 this proceeding. These costs were addressed in the record at Docket No. I-00040105
6 before Judge Colwell. *See*, OCA Loube Testimony filed December 10, 2008, at Exhibit
7 RL-8. For convenience purposes, they can be used to compare to exchange-level
8 densities in the form of a simple regression.

9

10 **Q. HAVE YOU PERFORMED SUCH ANALYSIS?**

11 A. Yes. An analysis of density and costs, with costs as the dependent variable is included
12 in CTL Panel Attachment B. For CenturyLink exchange level costs, we used OCA
13 witness Dr. Loube's analysis. We used the actual densities of each CenturyLink
14 exchange as the independent variable. *See*, the list of exchanges, their density and their
15 cost – as submitted by Dr. Loube. The statistical analysis of the regressions is included
16 in CTL Panel Attachment C. CenturyLink accepts Dr. Loube's cost analysis in his
17 testimony as a reasonable surrogate of costs for purposes of this analysis in this
18 proceeding, but reserves the right to submit its own cost data.

19

20 **Q. WHAT DOES THE ANALYSIS SHOW?**

21 A. The analysis shows a significant degree of correlation between density and costs. A
22 regression of exchange level costs of CenturyLink as the dependent variable and the

1 logarithm of CenturyLink's exchange level density produces an R-squared of .702.
2 This means that 70.2% of the change in costs can be explained by the change in
3 density. Dr. Pelcovits' simple regressions produced R-squared values of .0028 to a
4 high of .0076. This means that only .28 of one percent to up to 7.6 percent of the
5 change in the value of the retail rate could be explained by the company level density.
6 This means that Dr. Pelcovits ran the wrong regression analysis. This CenturyLink
7 regression analysis very clearly demonstrates that exchange-level cost and density
8 analysis is far superior to an analysis of rates and is far superior to analysis of company
9 level costs and densities.

10

11 **Q. WHAT SHOULD WE CONCLUDE FROM THIS ANALYSIS?**

12 **A.** We should conclude costs are highly variable by exchange. Sound public policy must
13 recognize and account for this fact.

1 **IV. CONSUMER SURVEY**

2

3 **Q. BEGINNING AT PAGE 39 OF THE AT&T PANEL REBUTTAL TESTIMONY,**
4 **AT&T CRITICIZES THE PENNSYLVANIA-SPECIFIC SURVEY SUBMITTED**
5 **BY CENTURYLINK. HAS AT&T OR ANY PARTY OTHER THAN**
6 **CENTURYLINK SUBMITTED A SURVEY THAT MEASURES THE**
7 **REACTION OF PA CONSUMERS TO THE POTENTIAL RATE CHANGES**
8 **FROM THIS PROCEEDING?**

9 **A.** No. In spite of the fact that the most certain result from the implementation of AT&T's
10 recommendation's in this proceeding will be monthly increases in CenturyLink's basic
11 local customer's bills of at least \$7, AT&T has not measured customer's reactions to
12 these increases or their preference for these increases in exchange for the potential or
13 promise of rate reductions for long distance services. Instead, AT&T had taken the easy
14 way out and attacked CenturyLink's presentation of its customer's reactions to the very
15 real prospect of rate increases would be caused by the adoption of AT&T's
16 recommendations in this proceeding.

1 **Q. DOES THE FACT THAT CENTURYLINK “DOES NOT ROUTINELY**
2 **ENGAGE IN THIS TYPE OF SURVEY” MEAN THAT THE “COMMISSION**
3 **SHOULD NOT RELY ON IT” AS CLAIM BY THE AT&T PANEL?⁸**

4 **A.** Of course not. First, the fact that the survey was prepared as part of defending against
5 attempts to increase local rates to accommodate access reductions does not make the
6 survey flawed and does not diminish the import of the survey. AT&T is simply
7 attempting to discredit the voice of CenturyLink’s Pennsylvania consumers. Second,
8 the fact that this is the first time CenturyLink has conducted precisely this type of
9 survey does not in any way diminish the customer’s responses, the survey results, or the
10 import of the survey to this Commission’s deliberations. As any other company,
11 CenturyLink routinely undertakes complicated market research and analyses.
12 Moreover, a party to a proceeding, such as CenturyLink, routinely utilizes outside
13 experts to conduct primary research or analysis that is presented for use in proceedings
14 such as this. Similarly, expert witnesses in administrative proceedings such as this
15 typically and routinely rely upon papers, books and studies of others persons.

16
17 Finally, as Mr. Bonsick’s Direct Testimony noted, this Commission has undertaken a
18 tempered and deliberate approach to intrastate switched access reform over the years.
19 A survey is not a complicated market research endeavor. The survey measures
20 CenturyLink consumer reaction to discrete incremental price increases. The survey is
21 relatively simple and eloquent in its purpose. And, it is particularly useful in case like

⁸ AT&T Panel Testimony, pp 38-39.

1 this where AT&T and other parties are requesting additional rate increases over and
2 above an already relatively high local benchmark residential rate of \$18.00/month.
3 Changing this Commission’s long-standing regulatory policy regarding how and who
4 supports the costs of safe and reliable service in high-cost rural Pennsylvania is at stake
5 and the Pennsylvania consumers in rural areas are most at risk. The Commission has a
6 statutory obligation⁹ to provide that access reductions are implemented in a revenue
7 neutral manner. This requirement from statute is not a shield from the impacts of
8 competition but instead recognition of the critical nature that the support from intrastate
9 access charges plays in ensuring that basic rates remain affordable and that adequate
10 funding is available for the continued maintenance, availability, and expansion of
11 service in high cost areas – all of which are even more important today given the
12 competitive telecommunications market. As the survey demonstrates a large portion of
13 CenturyLink’s customers are price sensitive and highly likely to avoid funding high
14 cost areas by moving to providers that do not share the obligation of CenturyLink to
15 provide service to all.

16
17 **Q. THE AT&T PANEL CRITICIZES THE SURVEY AS BEING**
18 **HYPOTHETICAL”, HOW DO YOU RESPOND?**

19 **A.** First, asking a survey respondent about their reaction to a potential rate increase can be
20 nothing other than hypothetical. The rate increase has not happened and the survey is
21 trying to determine the potential reaction. The survey screened to ensure respondents

⁹ See, Act 183, §3017.

1 were the real-world decision makers regarding telecommunications services in the
2 households contacted. Further, as more fully discussed below when asked about their
3 reaction to the potential prices increases the survey taker presented the customer with
4 the amount of their average bill from CenturyLink. Therefore, the survey was
5 conducted with real world decision makers and using real world facts.

6
7 **Q. WAS THE SURVEY PROCESS “HYPOTHETICAL” AND “FLAWED”¹⁰**
8 **BECAUSE IT DID NOT RELY ON PAST PENNSYLVANIA RATE**
9 **INCREASES OR RATE INCREASES IN OTHER STATES?**

10 **A. No.** The previous Pennsylvania experience simply would not be informative to
11 measure the potential impact of implementation of the proposals of AT&T. Although
12 there has been some shifting of positions, AT&T current position appears to call for an
13 immediate \$4 monthly increase in rates followed by annual \$1 increases up to \$25 and
14 according to AT&T’s estimates would continue to increase until the PA USF funding
15 for CenturyLink is reduced to zero. The most recent increases by CenturyLink were on
16 January 4 and December 16, 2005 and were in the monthly amounts of \$.83 and \$.06,
17 respectively, amounts in total that are less than one seventh of the increases proposed
18 by AT&T.

19
20 Many other factors have changed that would influence consumers’ reactions to price
21 increases today versus nearly five years ago including increased competitive options

¹⁰ AT&T Panel Rebuttal Testimony, p. 40.

1 like cable telephony, increasing acceptance of wireless service when reliable as a
2 complete substitute for wireline service and finally the current near depression like
3 economic conditions including very high unemployment.

4
5 Regarding price increases from other states, quite simply CenturyLink believes that the
6 views of its Pennsylvania customers are most relevant to their anticipated reaction to
7 increases in rates they pay. The facts in other states can vary significantly as well. For
8 example, AT&T conveniently fails to inform the Commission that CenturyLink's New
9 Jersey residential rate prior to the noted increases was \$7.95 per month and currently
10 stands at \$13.45 after the increases noted by AT&T. It is difficult to see what
11 conclusions regarding Pennsylvania customers' reaction to increases to CenturyLink's
12 \$18 rate can be drawn from New Jersey or from much smaller increases in
13 Pennsylvania nearly five years ago.

14
15 **Q. IN FURTHER TRYING TO DISCOUNT THE SURVEY, AT&T CLAIMS THE**
16 **EVIDENCE SHOWS THAT "CENTURYLINK'S CUSTOMERS ARE IN FACT**
17 **MOVING AWAY FROM LOWER PRICED SERVICES, AND MOVING**
18 **TOWARDS HIGHER PRICED BUNDLED SERVICES.¹¹" IS THIS TRUE?**

19 **A. No. The total number of residential lines, including bundles and stand alone lines,**
20 **purchased by CenturyLink's customers has declined by **over 67,000 or nearly 26%****

¹¹ AT&T Panel Rebuttal Testimony, pp. 40 – 41.

1 since January 2007 based on the response to ATT-CTL-3-19¹². Total residential
2 customers have declined in every month of the past three years. The evidence in fact
3 shows that more of CenturyLink's customers are simply moving away from
4 CenturyLink rather than to higher priced products. In fact for every seven stand alone
5 lines that were lost only one bundled line was gained throughout this time period.

6
7 Within the overall declining customer counts, stand alone lines have decreased OVER
8 [BEGIN CTL CONFIDENTIAL] [REDACTED] [END CTL
9 CONFIDENTIAL] while lines included in bundles have increased about [BEGIN
10 CTL CONFIDENTIAL] [REDACTED] [END CTL CONFIDENTIAL] since
11 January 2007. Unfortunately, the number of bundled customers peaked in July 2008
12 and has declined overall in 11 of 17 months since.

13
14 **Q. IS THE SURVEY FLAWED BECAUSE IT DID NOT INFORM THE**
15 **RESPONDENTS ABOUT HOW ITEMS SUCH AS THE INCOME, RELIGION**
16 **OR POLITICAL LIFE MAY INFLUENCE THERE DECISION TO RETAIN**
17 **CENTURYLINK'S SERVICES WHEN PRICES INCREASE?"¹³**

18 **A.** Again, AT&T's misses the point and attempts to make an eloquent and simple survey
19 unnecessarily complicated. It is undeniable that many factors influence a consumer's
20 buying decisions including price. The survey and its results, however, are not flawed

¹² Attachment 6 to the AT&T Panel Rebuttal Testimony.

¹³ See, AT&T Panel Rebuttal Testimony, pp. 41 – 43.

1 because the survey questions did not delve into these unnecessary areas. The pertinent
2 fact is that the remedy sought by AT&T and others would require local rate increases
3 beyond the \$18 local residential rate in effect today. And, the results of the survey
4 demonstrate that the historical approach of rebalancing against local rates and forcing
5 upward pressure on local rates is not a viable go-forward remedy today.

6

7 The survey was simple and to the point and was conducted with the primary decision
8 maker in each household or one that at least shared 50% of those duties regarding
9 telecommunications services. As a primary decision maker, it is fair to assume that the
10 respondent would be well aware of how their income, tastes preferences and other
11 factors would influence their reaction to an increase in the price of CenturyLink's
12 services. By capturing the response of the consumer directly the survey allows these
13 other non-price factors to be considered from the decision makers own perspective.
14 There is no need to "replicate" these factors when the "real-world" decision maker is
15 providing the response.

16

17 **Q. IS THE SURVEY INCONSISTENT WITH TESTIMONY SUBMITTED BY**
18 **CENTURYLINK IN A NEW JERSEY PROCEEDING AS NOTED BY AT&T?¹⁴**

19 **A. No. AT&T wrongly takes Dr. Staihr out of context. Dr. Staihr was testifying about**
20 **customers' potential reaction to increases to the \$7.95 per month basic local rate in**
21 **New Jersey and correctly notes that factors other than price influence how a customer**

¹⁴ AT&T Panel Rebuttal, pp. 42, 44.

1 will react. In this case, CenturyLink has directly asked its customers for their reaction
2 to a price increase. Recognizing that consumers do consider many factors when
3 making the buying decision as Dr. Staihr notes, CenturyLink chose to go directly to
4 those decision makers to gauge their response.

5
6 **Q. AT&T ALSO CRITICIZES THE SURVEY FOR NOT ADVISING PEOPLE**
7 **THAT THERE MIGHT ALSO BE “PRICE DECREASES FOR WIRELINE**
8 **LONG DISTANCE, THAT THE END USER MIGHT CONSIDER A**
9 **“PACKAGE OR BUNDLE”, OR THAT “COMPETITORS MIGHT ALSO**
10 **RAISE THEIR PRICES.” IS THIS A VALID CRITICISM?**

11 **A.** It is ironic that on the one hand AT&T claims that the survey is flawed because it
12 presents “hypothetical” price increases, and now it criticizes that CenturyLink has not
13 included phantom, assumed price changes claimed by AT&T and the proponents of
14 access reductions. Indeed, CenturyLink has no way of knowing how much these
15 hypothetical decreases would be and which products would be affected and whether a
16 specific CenturyLink customer would see any benefit.

17
18 The most certain outcome from the implementation of the recommendations of AT&T
19 Sprint, Comcast and Verizon in this case will be increases in the local rates
20 CenturyLink’s customers must pay. The phantom reductions in rates and the illusory
21 claims of enhanced competition are pure fiction when compared to the real impact of
22 local increases. As addressed in CenturyLink’s Direct Testimony, any assumed (and

1 unproven) benefits from access reductions do not on net outweigh the harms to rural
2 Pennsylvania from those reductions.

3

4 **Q. MR. APPLEBY CLAIMS THE STRUCTURE OF THE SURVEY QUESTIONS**
5 **REGARDING PRICE INCREASES SOMEHOW MAKE THE RESULTS LESS**
6 **“MEANINGFUL”. IS HE CORRECT?**

7 **A.** No. The survey was not designed to determine consumer preference for a specific price
8 point but instead to gauge customer’s reaction to price increases in a straightforward
9 manner. Beginning low and increasing higher as the survey questions do measures at
10 what level, if any, the respondent becomes highly likely to choose another provider.
11 It is hard to avoid the fact that increasing price levels are a “progressively worse
12 situation to evaluate”. But, if there is some irritation level that somehow causes a
13 customer’s reaction to irrationally escalate as the price choices increase, the impact
14 would only be found in a portion of the responses and certainly does not make the
15 conclusion that more customers are highly likely to choose another provider as the
16 prices increases are raised not meaningful. Further, this theory would in no way lessen
17 the 29.5% of customers that answered they are highly likely to leave CenturyLink with
18 just a \$2 monthly increase.

1 **Q. CAN YOU PLEASE FURTHER ADDRESS THE LAST POINT YOU MADE**
2 **THAT 29.5% OF CENTURYLINK’S CUSTOMERS INDICATED A**
3 **LIKELIHOOD OF LEAVING WITH JUST A \$2.00 MONTHLY INCREASE IN**
4 **THEIR LOCAL RATE?**

5 **A. Yes, I can. It is consumers in the high cost rural areas of PA that are most at risk of a**
6 **decision to reduce the support from intrastate access rates without a sustainable source**
7 **of replacement like the PA USF. Adding questions to the survey to remind customers of**
8 **their social habits or the economic situation or changing the method of asking about the**
9 **price increases would not change the clearest and simplest conclusion from the survey.**
10 **When presented with information about their current bill from CenturyLink, over 29%**
11 **of the respondents replied that they were highly likely to cancel their CenturyLink**
12 **home service and use their wireless service or switched to another provider at even a \$2**
13 **monthly increase. As noted in the direct testimony, the loss of a customer in this**
14 **scenario is not only a loss in the opportunity to collect the incremental \$2 increase but**
15 **also the loss of the complete revenue from that customer while CenturyLink would**
16 **retain the majority of the costs.**

17
18 **Q. IS MR. APPLEBY CORRECT THAT “THE QUESTIONS POSED TO THOSE**
19 **CUSTOMERS FAILED TO ELICIT A RESPONSE BASED ON THEIR**
20 **CONSUMPTION OF ALL SERVICES PURCHASED”?**

21 **A. No. The respondents were the primary or an equal decision maker of**
22 **telecommunications services purchased of each household contacted and would be**

1 aware of the services purchased from CenturyLink or any other provider. In addition,
2 as noted in the survey script attached as BKS-1 to the direct testimony each respondent
3 was reminded of their monthly billing for all non-usage sensitive services from
4 CenturyLink prior to the questions regarding price increases. Therefore, each survey
5 respondent had the context under which to evaluate an increase in their CenturyLink
6 billing and Mr. Appleby's claim has no merit.

7
8 **Q. WHAT ARE THE IMPLICATIONS OF MR. APPLEBY'S CONCLUSION**
9 **THAT BUNDLES WILL NOT LIKELY INCREASE SEE A PRICE INCREASE?**

10 **A. I can agree with Mr. Appleby that bundles will not likely see prices increases but not**
11 *with the implications he makes or the conclusion he draws. Due to competition*
12 *CenturyLink cannot increase the price for its bundle customers with any expectation of*
13 *increasing revenues. As noted earlier, in spite of CenturyLink's intentions both total*
14 *lines for many years and bundle lines for nearly a year and a half have been declining.*
15 *Price increases will likely result in more lost bundle customers and will result in further*
16 *losses in revenue support provided from these customers to CenturyLink's higher cost*
17 *areas.*

18
19 The lost support for high cost areas from access charges will necessitate significant
20 increases in basic access line rates. And, as the CenturyLink customer survey
21 demonstrates that increases in rates alone will not provide the necessary support.

1 **V. CROSS-SUBSIDY ALLEGATIONS**

2

3 **Q. MR. APPLEBY’S REBUTTAL TESTIMONY MAKES A SERIES OF BROAD**
4 **ALLEGATIONS, BEGINNING ON PAGE 33, THAT BOIL DOWN TO A**
5 **CLAIM THAT THE RLECS INCLUDING CENTURYLINK ARE**
6 **“ILLEGALLY FUNDING COMPETITIVE BROADBAND”¹⁵. HOW DO YOU**
7 **RESPOND?**

8 **A.** As explained below, Mr. Appleby conflates and misapprehends many different rules
9 and requirements; but the bottom line is that CenturyLink is fully compliant with all
10 Pennsylvania and Federal Communications Commission (FCC) accounting, allocation
11 and separations requirements, and is clearly not in violation of Pennsylvania statute as
12 claimed by Mr. Appleby.

13

14 **Q. WHAT DETERMINES WHEN A SERVICE IS BEING SUBSIDIZED?**

15 **A.** While I am not an economist the definition of when a service is being subsidized is
16 very straight forward. In a multi-product firm if the price for service A is set below the
17 incremental cost of providing service A while the other prices are set above the
18 incremental costs of those services, then service A is being subsidized.

¹⁵ See, Appleby Rebuttal, p. 34.

1 **Q. HOW DOES ACT 183 ADDRESS THE SUBSIDIZATION OF A COMPETITIVE**
2 **SERVICE?**

3 **A.** Section 3016 provides the regulatory framework for competitive services and
4 specifically subsection (d) requires:

5 (1) The prices which a local exchange telecommunications company charges
6 for competitive services shall not be less than the costs to provide the
7 services.

8 Compliance with §3016(d) will prevent subsidization of competitive services by
9 protected services.

10

11 **Q. HAS MR. APPLEBY DEMONSTRATED THAT ANY OF CENTURYLINK'S**
12 **COMPETITIVE SERVICES ARE PRICED BELOW COST AND THEREFORE**
13 **IN VIOLATION OF §3011(4)?**

14 **A.** No, while Mr. Appleby is clearly unhappy about the rate Sprint is paying for intrastate
15 switched access, throughout his hypothetical discussions, he has not provided any
16 concrete support for his claims that competitive services are being subsidized.

17

18 This is not the proper forum for any such claims. To the extent Sprint believed
19 competitive service pursuant to Act 183 were being offered under costs, a complaint
20 about the specific service in question would be the proper way to bring the issue to the
21 Commission.

1 **Q. HAVE THE RLECS “PROVIDED NO PROOF THAT THEIR BASIC LOCAL**
2 **SERVICE RATES ARE INDEED BELOW COSTS”, AS CLAIMED BY MR.**
3 **APPLEBY?¹⁶**

4 **A.** While I cannot be certain what “proof” Mr. Appleby is demanding, the CenturyLink
5 Panel Direct Testimony, filed earlier in this proceeding, on Page 24 stated:

6 “As to costs, as the record in the recent Pennsylvania universal
7 service proceeding at Docket No. I-00040105 demonstrates,
8 revenues from CenturyLink’s residential end-user revenues are
9 insufficient to recover the cost of providing their service.”¹⁷
10

11 As the record in that case will also show, CenturyLink did not submit its own cost study
12 but, instead, after reviewing the costs study and results submitted by the OCA
13 determined that the results were a reasonable approximation for the level and
14 geographic distribution of CenturyLink’s costs. Nonetheless, the results clearly showed
15 that the costs of providing basic local services exceeded the revenues derived from for
16 local voice service.

17
18 Therefore, Mr. Appleby’s inflammatory and unsupported accusations of “illegally
19 funding competitive broadband” and/or “unduly enriching RLECs” are false and his
20 false claims of cross-subsidy are dependent on misinterpretation of the applicable laws
21 and rules through broad use of hypothetical straw men examples.

¹⁶ See, Appleby Rebuttal, page 34.

¹⁷ Testimony of Christy V. Londerholm on behalf of Embarq of PA (now CenturyLink), St. 3.0, prefled January 15, 2009 at pages 12-15.

1 **Q. SHOULD IT BE SURPRISING THAT THE RLECS, INCLUDING**
2 **CENTURYLINK STATE THAT CURRENT ACCESS RATES ARE HELPING**
3 **TO FUND BROADBAND AVAILABILITY OR THAT ANY REDUCTIONS IN**
4 **ACCESS WITHOUT A SUSTAINABLE REPLACEMENT WOULD**
5 **JEOPARDIZE THE ABILITY OF RLECS TO ACHIEVE 100%**
6 **AVAILABILITY OF ALL SERVICES?**

7 **A.** No, it should be neither surprising nor scandalous. Returning to Act 183, the
8 Pennsylvania legislature clearly understood the connection between broadband
9 deployment and providing ILECs the ability to create and maintain sufficient revenues.
10 In fact the first policy goal of the Act speaks to balancing the mandated deployment of
11 broadband with the continuance of alternative regulation for ILECs. Further policy
12 goals include:

- 13 • Strike a balance between mandated deployment and market-driven
14 deployment of broadband facilities and advanced services throughout this
15 Commonwealth and to continue alternative regulation of local exchange
16 telecommunications companies.
- 17 • Maintain universal telecommunications service at affordable rate while
18 encouraging the accelerated provision of advanced services and deployment

1 of a universally available, state-of-the-art, interactive broadband
2 telecommunications network in rural, suburban and urban areas¹⁸

3 • Ensure the efficient delivery of technological advances and new services
4 throughout this Commonwealth in order to improve the quality of life for all
5 Commonwealth residents.¹⁹

6 • Promote and encourage the provision of advanced services and broadband
7 deployment in the service territories of local exchange telecommunications
8 companies without jeopardizing the provision of universal service.²⁰

9 • Recognize that the regulatory obligations imposed upon the incumbent local
10 exchange telecommunications companies should be reduced to levels more
11 consistent with those imposed upon competing alternative service
12 providers.²¹

13 The PA legislature and the Commission clearly understand that a robust network,
14 including increased enhanced network facility and fiber deployment, provides better
15 and more reliable wireline telecommunications services as well as increasing the
16 availability of broadband services. The FCC also understands this vital connection as
17 well and as recent as the National Broadband Plan said the following:

18 Accelerating the pace of investment in broadband networks in high-cost areas
19 will also require consideration of related policy issues that affect revenue

¹⁸ See, Act 183, §3011(2).

¹⁹ See, Act 183, §3011(6).

²⁰ See, Act 183, §3011(12).

²¹ See, Act 183, §3011(13).

1 streams of existing carriers. The ICC system provides a positive revenue stream
2 for certain carriers, which in turn affects their ability to upgrade their networks
3 during the transition to broadband service.

4 Sudden change in USF and ICC could have unintended consequences that slow
5 progress.²²
6

7 **Q. MR. APPLEBY, ON PAGES 34 – 38, DESCRIBES HIS VIEW OF THE**
8 **ACCOUNTING, COST ALLOCATIONS AND SEPARATIONS RULES FOR**
9 **BROADBAND SERVICE. DO YOU AGREE WITH HIS INTERPRETATIONS**
10 **AND CONCLUSIONS?**

11 **A.** No. Mr. Appleby is apparently unaware that the FCC has specifically given guidance
12 for the accounting, cost allocations and jurisdictional separations for the costs
13 associated with broadband services in Report and Order and Notice of Proposed
14 Rulemaking in CC Docket No. 02-33, released September 23, 2005.

15
16 **Q. WHAT HAS THE FCC SAID ABOUT THE ACCOUNTING RULES FOR**
17 **COSTS ASSOCIATED WITH BROADBAND INTERNET TRANSMISSION**
18 **SERVICE?**

19 **A.** The FCC has specifically that broadband Internet transmission service to be classified
20 as a regulated service:

21 Therefore, as specified in section 32.23 of our rules, the provision of this
22 transmission is to be classified as a regulated activity under part 64 “until such
23 time as the Commission decides otherwise.” We do not “decide otherwise” at
24 this time because we find that the costs of changing the federal accounting
25 classification of the costs underlying this transmission would outweigh any

²² Federal Communications Commission, Connecting America; The National Broadband Plan, released March 16, 2010, page 140-141.

1 potential benefits and that section 254(k) of the Act does not mandate such a
2 change.²³

3 Contrary to Mr. Appleby's claims there is nothing improper about the recording of fiber
4 and other investments or expense to enable the provision of broadband Internet
5 transmission as a regulated activity.

6

7 **Q. DID THE FCC PROVIDE ANY JUSTIFICATION FOR THEIR RULING**
8 **REGARDING THE ACCOUNTING TREATMENT OF THE COSTS?**

9 **A.** Yes, in further explaining its decision regarding cost allocations, the FCC said the
10 following:

11 Requiring that incumbent LECs classify the provision of broadband
12 Internet access transmission provided on a non-common carrier basis as a
13 nonregulated activity under part 64 would mean, among other matters, that
14 incumbent LECs would have to develop, and we would have to review,
15 methods for measuring the relative usage that this transmission and the
16 incumbent LECs' traditional local services make of incumbent LECs'
17 transmission facilities.²⁴

18

19 During the period since the adoption of the part 64 cost allocation rules,
20 our ratemaking methods and those of our state counterparts have evolved
21 considerably. This evolution has greatly reduced incumbent LECs'
22 incentives to overstate the costs of their tariffed telecommunications
23 services. Based on the current record, we find that this reduction in
24 incentives diminishes the need for incumbent LECs to apply detailed and
25 burdensome procedures to exclude the costs of providing broadband

²³ Report and Order and Notice of Proposed Rulemaking in CC Docket No. 02-33, released September 23, 2005, Paragraph 130.

²⁴ Report and Order and Notice of Proposed Rulemaking in CC Docket No. 02-33, released September 23, 2005, Paragraph 131.

1 Internet access transmission from their regulated costs. A nonregulated
2 classification therefore would generate at most marginal benefits.²⁵

3
4 As the FCC recognized, there would be little benefit from a complex and contentious
5 proceeding to determine, how to divide the network costs underlying broadband service
6 within the local exchange network, Therefore, recording those costs as regulated
7 pursuant to FCC rules is both compliant and also reasonable.

8
9 **Q. MR. APPLEBY ALSO IMPLIES THAT CENTURYLINK IS NOT PROPERLY**
10 **APPLYING PART 36, JURISDICTIONAL SEPARATIONS²⁶. IS HE**
11 **CORRECT?**

12 **A.** No. Again, the FCC has specifically addressed separations and broadband investment
13 and CenturyLink is fully compliant.

14 We note that the question whether there should be any changes to the jurisdictional
15 allocation of loop costs in light of use of the loop for broadband services was
16 referred to the Federal-State Joint Board on Separations in 1999.

17 This issue remains pending. In any event, separations is now subject to a five-year
18 freeze, and the Joint Board is working on the approach that should follow this
19 freeze; the issues we describe in this Order already fall within this context. After
20 the Joint Board makes its recommendation, we can reexamine the question of how
21 any additional costs that might be assigned to the interstate jurisdiction may be
22 recovered by local exchange carriers.²⁷

23 The investment in broadband Internet transmission of CenturyLink is properly accounted
24 for and allocated to the state and interstate jurisdictions pursuant to FCC and Pennsylvania
25 regulatory rules.

²⁵ *Ibid*, Paragraph 133.

²⁶ *See*, Appleby Rebuttal, pp. 35-36.

²⁷ Report and Order and Notice of Proposed Rulemaking in CC Docket No. 02-33, released September 23, 2005, Paragraph 144.

1 **Q. MR. APPLEBY CONCLUDES HIS DISCUSSION ON PAGE 38, NOT**
2 **SURPRISINGLY, WITH THE PROPOSED REMEDY TO HIS PHANTOM**
3 **ACCOUNTING ISSUES AS A REDUCTION IN INTRASTATE SWITCHED**
4 **ACCESS RATES. HOW DO YOU RESPOND?**

5 **A.** Setting aside the false theories regarding improper accounting, I suggest that the
6 Commission step back at take a larger view of the situation. CenturyLink’s access rates
7 have been set by the Commission at just and reasonable rates over time and in their
8 current structure and level in 1999 with the Global Settlement, less a rate reduction in
9 2003.

10
11 The access rates originally set in 1999 certainly could not be claimed to have been
12 “subsidizing” broadband at that time. The access rates have not increased and have
13 actually decreased during that time. CenturyLink since 1999 has continued to invest in
14 its network and its customers continue to be dispersed throughout it serving territory.
15 While there was growth in total customer’s served in the early years CenturyLink is
16 now facing steady declines since 2004. In spite of the loss in total customers, each year
17 CenturyLink adds new plant to serve new customer locations and must continue to
18 maintain a network capable of serving all who request service, thus exacerbating the
19 cost challenge. Finally, in spite of Sprint’s heightened focus on CenturyLink’s
20 provision of broadband, the reality is that CenturyLink’s total revenues derived from
21 serving customers in Pennsylvania (state, interstate and non regulated) has been flat or
22 declining for the last 5 years.

1 Unlike Sprint, CenturyLink is not and cannot solely be focused on intrastate access rate
2 levels. CenturyLink is not opposed to a rational and sufficient process where the
3 implicit support from intrastate switched access rates is transitioned to other more
4 sustainable support mechanisms like what has been done at the FCC for interstate
5 access purposes. The FCC accomplished reform through reasonable increases in end
6 user rates (subscriber line charges) and an explicit replacement fund.

7
8 Sprint's proposal here involves neither component. To blindly recommend, that any
9 shortfalls must be either recovered from CenturyLink's end users or from
10 CenturyLink's operations is irresponsible and will only result in unaffordable local
11 rates and the inability to maintain or expand telecommunications services in
12 Pennsylvania.

13
14 **VI. SPRINT'S CLAIMS REGARDING STAND-ALONE DSL**

15
16 **Q. ON PAGE 61, MR. APPLEBY BEGINS A DISCUSSION OF "STAND ALONE**
17 **DSL" AND INCLUDES STATEMENTS REGARDING CENTURYLINK'S**
18 **PURE BROADBAND OFFERING. FIRST, IS MR. APPLEBY CORRECT**
19 **WHEN HE STATES A CUSTOMER CAN GET CENTURYLINK'S PURE**
20 **BROADBAND OFFERING WITHOUT ALSO PURCHASING LOCAL**
21 **SERVICE?**

22 **A.** No. Mr. Appleby has apparently misunderstood his interaction with a CenturyTel
23 customer service representative as well as CenturyLink's response to Sprint-CTL 3-2.

1 Pure Broadband is primarily a save offer when customers are disconnecting or an offer
2 targeted to customers that currently do not have basic service with CenturyLink. As
3 such, the offer does not require the purchase of traditional basic local service in
4 addition to or explicitly as part of the bundle. While Pure Broadband service does
5 incorporate a local access line, the access line that is incorporated with Pure Broadband
6 blocks all outgoing calling except 911 and allows incoming calls. The local service
7 portion is tariffed at the PA Commission as Pure Bundle.

8
9 **Q. PLEASE CLARIFY THE PRICING FOR PURE BROADBAND.**

10 **A.** The residential monthly rate for the 1.5 Mbps Pure Broadband service is \$49.95 per
11 month. Pure Broadband marketing efforts are targeted to customers that currently do
12 not subscribe to CenturyLink service and as a save offer when customers are
13 disconnecting their broadband service. CenturyLink offers promotions of Pure
14 Broadband including offers of \$5 and \$10 off the monthly rate. CenturyLink also offers
15 to customers a limited \$20 off promotion of the Pure Broadband service for \$29.95 per
16 month subject to a twelve month commitment. The rate would automatically move to
17 \$49.95 per month at the expiration of the twelve-month promotional period. If the
18 customer chooses instead to disconnect by calling a CenturyLink customer service
19 agent, he/she can receive the \$29.95 per month rate with an additional 12-month
20 commitment via CenturyLink's save desk.

1 **Q. IS IT CORRECT THAT CENTURYLINK “WILL NOT COLLECT RETAIL**
2 **LOCAL SERVICE CHARGES, FEDERAL UNIVERSAL SERVICE FUND**
3 **SUBSIDIES, PA USF SUBSIDIES OR ACCESS OVERCHARGES”, AS**
4 **CLAIMED BY MR. APPLEBY?**

5 **A.** Revenue is allocated for each Pure Broadband customer to CenturyLink Pennsylvania
6 regulated revenue in the amount of the Pure Bundle tariffed rate of \$20 and the
7 Pennsylvania interstate subscriber line charge. The access line with its 911 and
8 incoming calling capabilities would be reportable for Federal USF purposes. Any
9 incoming calling that is interexchange would generate access charges as appropriate.
10 Therefore, the access line associated with Pure Broadband would generate the same
11 revenues as similarly situated access lines not associated with Pure Broadband.

12
13 **Q. IS PURE BROADBAND A WIDELY OFFERED OR SUBSCRIBED SERVICE**
14 **OFFERING?**

15 **A.** No. Less than [BEGIN CTL CONFIDENTIAL] [END CTL CONFIDENTIAL]
16 of CenturyLink’s residential customers in Pennsylvania subscribe to Pure Broadband.
17 As noted above, Pure Broadband is a targeted offering designed to preserve revenues
18 where possible when customers are disconnecting broadband or to perhaps provide
19 broadband to customers that do not currently subscribe to CenturyLink services.

1 **Q. IS MR. APPLEBY CORRECT ABOUT THE RELATIONSHIP OF THE PRICE**
2 **OF THE PURE BROADBAND PRODUCT, CENTURYLINK'S COSTS, AND**
3 **THE ASSOCIATED IMPLICATIONS?**

4 **A. No. Contrary to Mr. Appleby's assertions, the Pure Broadband rate does include a**
5 **tariffed basic local rate component. And, just as the table from Ms. Londerholm's**
6 **testimony shows, CenturyLink's voice revenues are less than CenturyLink's costs to**
7 **provide local exchange service. Any comparison of the Pure Broadband revenue**
8 **(understated as noted below) to the monthly costs of basic service, is an apples to**
9 **oranges comparison. Thus, Mr. Appleby makes incorrect statements and his discussion**
10 **is meaningless.**

11

12 Nonetheless, for the sake of accuracy, corrections should be made to his comparison.

13 First, as noted by Mr. Appleby the \$29.95 rate for 1.5 Mbps Pure Broadband service is

14 a promotional rate. The average rate paid will clearly be a blend of customers on the

15 monthly \$49.95 rate and promotional rates including offers of \$5 and \$10 off monthly.

16 So, the beginning point of \$29.95 is wrong. The average revenue for PA Pure

17 Broadband is approximately **[BEGIN CTL CONFIDENTIAL]** [REDACTED] **[END**

18 **CTL CONFIDENTIAL]**. Second, as pointed out above, there are additional revenues

19 generated from a Pure Broadband line, the same revenues generated by other similarly

20 situated access lines.

1 **VII. VOIP AND WIRELESS AND THE PA USF**

2 **Q. CAN YOU BRIEFLY COMMENT UPON TESTIMONY (E.G., QWEST)**
3 **CONCERNING VOIP AND WIRELESS CONTRIBUTORS TO THE STATE**
4 **USF?**

5 **A.** As addressed in CenturyLink's Direct Testimony, the base of contributors to the
6 Pennsylvania USF should be expanded to include VoIP and wireless carriers. Wireless
7 and VoIP providers, just like CLECs, benefit from a reliable, robust and universally
8 available local switched telephone network. The more customers with whom wireless
9 and VoIP carriers can interface, the more valuable their own networks become. The
10 Rebuttal Testimonies in this proceeding do not alter CenturyLink's position on this
11 point.

12

13 **VIII. CONCLUSION**

14 **Q. DOES THIS CONCLUDE CENTURYLINK'S PANEL SURREBUTTAL**
15 **TESTIMONY?**

16 **A.** Yes.

CTL-Sprint 3-1 Provide a copy of all documents and studies reviewing or analyzing elasticity of demand, as undertaken by Sprint or on behalf of Sprint: (a) regarding actual or potential rate changes relative to bundled services offered by CenturyLink in Pennsylvania; and (b) regarding actual or potential rate changes relative to any local retail services offered by CenturyLink in Pennsylvania. Identify the specific rates and services. Provide study results and all documents and workpapers reviewed and analyzed.

Objection: Sprint objects to the question on the grounds that the question is unduly burdensome, overbroad, and not narrowly tailored, and would cause unreasonable annoyance, oppression, burden and expense. Sprint also objects to the question on the grounds that it seeks information that is subject to the work product doctrine, the attorney-client privilege, or other privilege. Sprint objects on the grounds that the question seeks information that is neither relevant to the subject matter of the proceeding nor likely to lead to the discovery of admissible evidence. Subject to and without waiving the foregoing objections, Sprint will provide a response to CenturyLink's question.

Response:

Sponsored By: James A. Appleby

Sprint has undertaken no such study.

Exhibit CTL Panel-3

CTL-Sprint 3-2 Provide a copy of all documents and studies reviewing or analyzing elasticity of demand, as undertaken by Sprint or on behalf of Sprint: (a) regarding actual or potential rate changes relative to bundled services offered in Pennsylvania by any ILEC individually or collectively; and (b) regarding actual or potential rate changes relative to any local retail services offered in Pennsylvania by any ILEC individually or collectively. Identify the specific rates and services. Provide study results and all documents and workpapers reviewed and analyzed.

Objection: Sprint objects to the question on the grounds that the question is unduly burdensome, overbroad, and not narrowly tailored, and would cause unreasonable annoyance, oppression, burden and expense. Sprint also objects to the question on the grounds that it seeks information that is subject to the work product doctrine, the attorney-client privilege, or other privilege. Sprint objects on the grounds that the question seeks information that is neither relevant to the subject matter of the proceeding nor likely to lead to the discovery of admissible evidence. Subject to and without waiving the foregoing objections, Sprint will provide a response to CenturyLink's question.

Response:

Sponsored By: James A. Appleby

Sprint has undertaken no such study.

Exhibit CTL Panel-4

Pennsylvania
Docket No. I-00040105
United Telephone Company of
Pennsylvania LLC d/b/a CenturyLink 1-
001

INTERVENOR: CenturyLink

REQUEST NO: 001

CTL-Qwest 1-1 Provide a copy of all documents and studies reviewing or analyzing elasticity of demand, as undertaken by Qwest or on behalf of Qwest: (a) regarding actual or potential rate changes relative to bundled services offered by CenturyLink in Pennsylvania; and (b) regarding actual or potential rate changes relative to any local retail services offered by CenturyLink in Pennsylvania. Identify the specific rates and services. Provide study results and all documents and workpapers reviewed and analyzed.

RESPONSE:

No such analysis has been undertaken by or on behalf of Qwest.

Responent: William Easton

Exhibit CTL Panel-4

Pennsylvania
Docket No. 1-00040105
United Telephone Company of
Pennsylvania ILEC d/b/a CenturyLink 1-
002

INTERVENOR: CenturyLink

REQUEST NO: 002

CTL-Qwest 1-2 Provide a copy of all documents and studies reviewing or analyzing elasticity of demand, as undertaken by Qwest or on behalf of Qwest: (a) regarding actual or potential rate changes relative to bundled services offered in Pennsylvania by any ILEC individually or collectively; and (b) regarding actual or potential rate changes relative to any local retail services offered in Pennsylvania by any ILEC individually or collectively. Identify the specific rates and services. Provide study results and all documents and workpapers reviewed and analyzed.

RESPONSE:

No such analysis has been undertaken by or on behalf of Qwest.

Respondent: William Easton

Exhibit CTL Panel-4

Pennsylvania
Docket No. I-00040105
United Telephone Company of
Pennsylvania LLC d/b/a CenturyLink 1-
003

INTERVENOR: CenturyLink

REQUEST NO: 003

CTL-Qwest 1-3 Is it Qwest's position that reducing intrastate switched access rates as proposed by Qwest in this proceeding will only benefit the public interest? If, in Qwest's view, there are any negative or adverse repercussions from intrastate switched access reductions, please identify and explain.

RESPONSE:

It is Qwest's position that reducing intrastate switched access rates to an appropriate level will reduce existing arbitrage opportunities and encourage competition by putting all market participants on a level playing field. Qwest does not believe that there are negative or adverse repercussions related to reducing switched access rates in a revenue neutral and competitively neutral manner.

Respondent: William Easton

Exhibit CTL Panel-4

Pennsylvania
Docket No. I-00040105
United Telephone Company of
Pennsylvania LLC d/b/a CenturyLink I-
021

INTERVENOR: CenturyLink

REQUEST NO: 021

CTL-Qwest 1-21 What are Qwest's costs to provide toll service(s) in Pennsylvania? Provide all documents, studies, calculations and analyses.

RESPONSE:

Qwest has not conducted a cost of service study to isolate its wireline long distance service costs in Pennsylvania.

Respondent: William Easton

Exhibit CTL Panel-5

**Response of the Office of Small Business Advocate to
CenturyLink's Interrogatories**

Set I

Witness: John W. Wilson

CTL-OSBA-4 Reference page 14, lines 10-19. Provide all documents, elasticity studies and analyses concerning the \$20.65 per month residential local exchange rate set forth therein.

Response: There are no related elasticity studies or analyses other than increasing the 1999 cap by 29 percent. The CPI, as reported by the Bureau of Labor Statistics, increased from 167.9 in September, 1999 to 216.7 in January, 2010.

Exhibit CTL Panel-5

Response of the Office of Small Business Advocate to
CenturyLink's Interrogatories

Set I

Witness: John W. Wilson

CTL-OSBA-5 Reference page 15, line 1. Provide all documents, elasticity studies and analyses concerning the \$21 per month residential local exchange rate set forth therein.

Response: See response to CTL-OSBA-3.

Exhibit CTL Panel-5

**Response of the Office of Small Business Advocate to
CenturyLink's Interrogatories**

Set I

Witness: John W. Wilson

CTL-OSBA-3 Reference page 13, lines 7-10. Does Mr. Wilson include
CenturyLink in his reference of "all RLECs"?

Response: Yes.

CTL-Comcast 1-23 Does Mr. Pelcovits have a definition for carrier of last resort? Does Mr. Pelcovits believe Comcast has carrier of last resort obligations in Pennsylvania? If yes, explain what Mr. Pelcovits believes those obligations are.

RESPONSE: Dr. Pelcovits does not have a definition of carrier of last resort, but interprets the term based on the meaning in the relevant Pennsylvania statutes and regulations. Comcast does not have carrier of last resort obligations in Pennsylvania.

Respondent: Michael D. Pelcovits

Position: Consultant

Exhibit CTL Panel-7

Pennsylvania
Docket No. I-00040105
United Telephone Company of
Pennsylvania LLC d/b/a CenturyLink 1-
020

INTERVENOR: CenturyLink

REQUEST NO: 020

CTL-Qwest 1-20 What are Qwest's costs to provide wireline long distance service(s) in Pennsylvania? Provide all documents, studies, calculations and analyses.

RESPONSE:

Qwest Communications Company, LLC has not conducted a cost of service study to isolate its wireline long distance service costs in Pennsylvania.

Respondent: William Easton

Exhibit CTL Panel-7

Pennsylvania
Docket No. I-00040105
United Telephone Company of
Pennsylvania LLC d/b/a CenturyLink 1-
021

INTERVENOR: CenturyLink

REQUEST NO: 021

CTL-Qwest 1-21 What are Qwest's costs to provide toll service(s) in Pennsylvania? Provide all documents, studies, calculations and analyses.

RESPONSE:

Qwest has not conducted a cost of service study to isolate its wireline long distance service costs in Pennsylvania.

Respondent: William Easton

CTL-Comcast 2-13 What are Comcast's costs of providing intrastate switched access service? Provide all studies and documents.

RESPONSE: Respondents objected to this Interrogatory on several grounds. Without waiver of these objections and to the extent Respondents have not objected to this Interrogatory, Respondents provide the following response:

Respondents have not calculated their "costs" of providing intrastate switched access service, as Respondents understand the meaning of "costs" in the context of this interrogatory (*i.e.*, costs calculated pursuant to any commonly employed cost study in the telecommunications industry such as a fully embedded cost study, historical cost study, incremental cost study, marginal cost study, etc.).

Respondent: Elizabeth Murray

Position: Senior Director of Regulatory Affairs
Eastern Division
Comcast Cable Communications, Inc.

CTL-Sprint 3-16 What are Sprint's costs to provide long distance service(s) in Pennsylvania? Provide all documents, studies, calculations and analyses.

Objection: Sprint objects to the question on the grounds that the question is unduly burdensome, overbroad, and not narrowly tailored, and would cause unreasonable annoyance, oppression, burden and expense. Sprint also objects to the question on the grounds that it seeks information that is subject to the work product doctrine, the attorney-client privilege, or other privilege. Sprint objects on the grounds that the question seeks information that is neither relevant to the subject matter of the proceeding nor likely to lead to the discovery of admissible evidence. Sprint objects that some of the information requested, and the manner in which it is requested to be produced, would reveal proprietary information, confidential business information, and trade secrets regarding Sprint's business interests and operations. Subject to and without waiving the foregoing objections, Sprint will provide a response to CenturyLink's question.

Response:

Sponsored By: James A. Appleby

Sprint does not have any cost study or cost modeling that is responsive to this question.

Exhibit CTL Panel-7

CTL-Sprint 3-17 What are Sprint's costs to provide toll service(s) in Pennsylvania?
Provide all documents, studies, calculations and analyses.

Objection: Sprint objects to the question on the grounds that the question is unduly burdensome, overbroad, and not narrowly tailored, and would cause unreasonable annoyance, oppression, burden and expense. Sprint also objects to the question on the grounds that it seeks information that is subject to the work product doctrine, the attorney-client privilege, or other privilege. Sprint objects on the grounds that the question seeks information that is neither relevant to the subject matter of the proceeding nor likely to lead to the discovery of admissible evidence. Sprint objects that some of the information requested, and the manner in which it is requested to be produced, would reveal proprietary information, confidential business information, and trade secrets regarding Sprint's business interests and operations. Subject to and without waiving the foregoing objections, Sprint will provide a response to CenturyLink's question.

Response:

Sponsored By: James A. Appleby

Sprint does not have any cost study or cost modeling that is responsive to this question.

ATTACHMENT A

CONFIDENTIAL

ATTACHMENT B

CONFIDENTIAL

ATTACHMENT C

CONFIDENTIAL

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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

Docket No. I-00040105

RECEIVED

APR 20 2010

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

AT&T Communications of :
Pennsylvania, LLC :
Complainant :

v. :

Docket Nos. C-2009-2098380, *et al.*

Armstrong Telephone Company - :
Pennsylvania, et al. :
Respondents :

**PANEL REJOINDER TESTIMONY OF
JEFFREY L. LINDSEY AND MARK D. HARPER**

**ON BEHALF OF
THE UNITED TELEPHONE COMPANY OF PENNSYLVANIA LLC
d/b/a CENTURYLINK**

STATEMENT 1.2

*4/15/10
Hog JK*

Prefiled: April 8, 2010

1 **I. REJOINDER TO AT&T SURREBUTTAL**

2
3
4 **Q. ARE YOU THE SAME MARK D. HARPER AND JEFF L. LINDSEY WHO**
5 **FILED DIRECT AND SURREBUTTAL TESTIMONY IN THIS**
6 **PROCEEDING?**

7 **A. Yes.**

8
9 **Q. WHAT IS THE PURPOSE OF THIS REJOINDER TESTIMONY?**

10 **A. This Rejoinder Testimony has a two-fold purpose.¹ First, in response to**
11 **addressing claims made by OSBA witness Dr. Wilson, the AT&T Panel**
12 **Surrebuttal Testimony introduced isolated quotes from the testimony of witnesses**
13 **representing CenturyLink, or its predecessors, from other proceedings and states.²**
14 **We would like to provide the context of those proceedings which is missing from**
15 **AT&T's brief quotes, clarify CenturyLink's position in those cases relative to the**
16 **issues before the Commission in this case, and reiterate that the theoretical**
17 **allocation arguments espoused by AT&T are not relevant anymore given the new**
18 **competitive marketplace, including the lack today of "competing providers**
19 **(wireline IXCs)."³ Complete copies of the testimonies referenced are attached**
20 **hereto at Exhibit CTL Panel-8. Second, this Rejoinder Testimony addresses and**
21 **updates the impacts of the various proposals as presented in Surrebuttal**

¹ The lack of addressing other issues in this testimony or in that of CenturyLink witness Mr. Bonsick should not be construed as evidence of CenturyLink's position(s) regarding any such unaddressed issue.

² AT&T Panel Surrebuttal at pp. 9-12.

³ See, e.g., AT&T Panel Surrebuttal at p. 7.

1 Testimony and the need for updated data, if necessary.

2

3 **Q. IN YOUR VIEW, IS THIS PROCEEDING ABOUT ACCESS COSTS OR**
4 **WHAT PORTIONS OF THE ILEC NETWORK SHOULD BE INCLUDED**
5 **WHEN DETERMINING ACCESS COSTS?**

6 **A.** No. CenturyLink has not filed a cost study for intrastate switched access in this
7 docket and neither has AT&T nor any other party. Determining the cost of access
8 is not an issue identified for this proceeding and is it not necessary for
9 determining if intrastate switched access rates should remain unadjusted or
10 whether they should be adjusted for the RLECs in Pennsylvania.

11 We addressed Ms. Londerholm's testimony from the rate cap/^{CASE}USF¹In our
12 Surrebuttal Testimony.⁴ CenturyLink cost studies reflect that loop investment is a
13 direct cost of basic service. There is nothing surprising about Ms. Londerholm's
14 or Dr. Staihr's statements about the relationship of loop costs to an access cost
15 study. What AT&T confuses, however, is that the proper recovery of costs,
16 particularly high rural costs, is not a simple matter of tracing costs to its "causer"
17 and should not be going forward. Such theories do nothing to advance the
18 sustainable support of high quality universal service in high-costs rural areas or
19 recognize the reality of the tension between universal service, affordable rates and
20 intrastate switched access charges. By clinging to testimony applicable to a

⁴ CenturyLink Panel Surrebuttal at p. 57.

1 bygone era, AT&T and others similarly situated seek to create a free ride scenario.
2 What is needed by the Commission is a balancing act between the end users in the
3 high costs areas, carriers that utilize the rural network and explicit support
4 mechanisms like the PA USF – not out-of-context references to irrelevant
5 testimony to support a singular focus on one component of the current support
6 mechanisms.

7
8 **Q. COULD YOU PROVIDE ADDITIONAL CONTEXT FOR THE QUOTES**
9 **FROM DR. STAIHR FROM THE OTHER STATE PROCEEDINGS?**

10 **A.** Yes. Each proceeding is addressed below in the order presented by AT&T.
11 First, the subject of the 1999 Kansas proceeding was the development of a Kansas
12 Universal Service Fund (KUSF) based on a forward looking economic cost model.
13 The proceeding did not address the level of intrastate access charges in any
14 manner. Dr. Staihr’s testimony addresses why the cost of the loop should be
15 included in the cost of basic local telecommunications service when establishing a
16 cost based KUSF. Dr. Staihr went on to say in the same paragraph; “It requires
17 certain individuals to cover more than their fair share, and allows other
18 individuals something of a free ride”.⁵ Dr. Staihr was addressing a marketplace
19 existing then where the end user was paying per minute prices for long distance; a
20 situation now that is only the exception. Important changes have happened in the
21 competitive landscape in telecommunications since 1999. The market for long

⁵ Kansas Docket No. 99-GIMT-326-GIT, Rebuttal Testimony of Brian K. Staihr, May 24, 1999 at p. 6.

1 distance calling is dominated now by the unlimited long distance plans and
2 bundles that include all calling from local to long distance at one rate. The
3 testimony cited by AT&T was applicable to a day when the providers seeking
4 access reductions today were competing in a wireline long distance market.
5 However, today, access reductions to these large, multi-interest corporate entities
6 are about expense savings – pure and simple. The days of Candace Bergen
7 selling long distance plans are over and theories of access cost recovery as AT&T
8 claims are no longer applicable. Moreover, the days of low local rates to
9 rebalance against are gone. Pricing signals to end users from access charges are
10 simply no longer the issue, economic theory notwithstanding.⁶

11
12 Second, the additional Kansas testimony from Dr. Staihr quoted by AT&T was in
13 support of a balanced Stipulation and Agreement jointly reached by the Staff of
14 the Kansas Corporation Commission, Southwestern Bell Telephone Company,
15 AT&T and Sprint (including the United Telephone companies, the predecessor of
16 CenturyLink). The Stipulation called for a three year phased-in reduction of
17 CenturyLink’s intrastate switched access charges in the amount of the revenue
18 generated by specified increases in CenturyLink’s end user rates. The results were
19 a basic residential rate in Kansas of \$17.73 and intrastate access rates reduced to a
20 level that remained above parity with interstate. Dr. Staihr was responding to

⁶ The market place has, in effect, converted access charges from a per minute of use basis to a flat rate charge to the end user.

1 testimony from the Citizens Utilities Ratepayer Board witness arguing that access
2 charges must bear an allocated portion of the loop costs. Rising above the pure
3 economic arguments about cost allocation, CenturyLink's position regarding
4 access reform remains consistent. First, a state USF (as is the case in Kansas)
5 with support determined based on the forward looking economic cost of basic
6 service determined, at a minimum, at the exchange level is the best way to ensure
7 the continued provision of universal service at comparable rates in rural areas.

8
9 Second, reductions in switched access rates that have traditionally provided a
10 portion of the support for these high cost areas can result from the creation of a
11 properly sized state USF or, in some cases, rebalancing of some of the support to
12 the end users in rural areas can be accomplished but only when carefully
13 measured and rates remain comparable.

14
15 Third, in the referenced Missouri proceeding, Dr. Staihr again was addressing the
16 cost causation issue regarding local loops and not recommending a specific level
17 of intrastate access charges.

18
19 Fourth, in Florida, as the heading of the proceeding cited by AT&T indicates, Dr.
20 Staihr filed testimony in the docket before the Commission regarding the
21 implementation of a statute requiring the reduction of intrastate switched access
22 charges to interstate parity in a revenue neutral manner. Costs were not an issue
23 in setting the level of switched access rates in this docket.

1 Nevertheless, Dr. Staihr was responding to the claims by witnesses for the Public
2 Counsel that the local rates could not be raised because loop costs must be
3 allocated to access. As the quote from Dr. Alfred Kahn states, the “politics of
4 setting prices” should not be conflated with the “economics of determining costs”.

5
6 Several Florida specific facts also help provide context to this testimony – context
7 which AT&T’s selective quotes fails to provide. The CenturyLink average
8 residential basic rate was \$9.98 when the process started under the statute and
9 rose to approximately \$14.50 after two revenue-neutral rebalance filings⁷.

10 Subsequently, the Florida legislature repealed the law and access charges are no
11 longer required to be reduced to parity for companies electing to pursue the
12 rebalancing. As a result, the access charges of CenturyLink, Verizon, and AT&T-
13 BellSouth remain above parity with interstate switched access rates.

14
15 **Q. DO YOU HAVE ANY ADDITIONAL COMMENTS REGARDING THE**
16 **IMPACT ANALYSES OF THE VARIOUS PARTIES?**

17 **A.** Yes. In our Direct Testimony we provided estimated impacts to CenturyLink of
18 the proposals of AT&T, Sprint, Verizon and Qwest. AT&T and Verizon also
19 provide their own estimates and, in their Rebuttal and Surrebuttal Testimonies,
20 respectively, have introduced new proposals and calculations. CenturyLink has
21 not conducted an in depth analysis of the impact estimates from the other Parties

⁷ The statute allowed a 2 – 4 year transition to parity for companies that elected to pursue rebalancing. CenturyLink estimated that total average increase would be \$6.86 to reach parity.

1 and likely will not be able to do so before the hearing. For purposes of the
2 hearing, the various estimates are acceptable for understanding the magnitude of
3 the impacts proposed. However, as noted by at least AT&T and Verizon, refined
4 data will be needed to determine the precise impacts, if any, if the Commission
5 determines to adjust RLEC intrastate switched access rates.

6

7 **Q. DOES THIS CONCLUDE YOUR REJOINDER TESTIMONY?**

8 **A. Yes.**

9

1 THE STATE CORPORATION COMMISSION
2 OF THE STATE OF KANSAS
3

4 Before Commissioners: John Wine, Chair
5 Cynthia L. Claus
6 Brian J. Moline
7

STATE CORPORATION COMMISSION

MAY 24 1999

Abby L. Wagoner Docket Room

8
9 In the Matter of an Investigation into the)
10 Kansas Universal Service Fund (KUSF)) Docket No. 99-GIMT-326-GIT
11 Mechanism for the Purpose of Modifying)
12 The KUSF and Establishing a)
13 Cost-based Fund.)
14
15
16
17

18 REBUTTAL TESTIMONY OF BRIAN K. STAIHR

19 On Behalf of Sprint

20 Table of Contents
21
22

23

I.	Introduction	2
II.	Purpose of Testimony	2
	Dr. Ben Johnson	2
	Dr. Robert Mercer	18

1 Q. **Please state your name, title and business address.**

2 A. My name is Brian K. Staihr. I am employed by Sprint as Regulatory
3 Economist. My business address is 4220 Shawnee Mission Parkway,
4 Fairway, Kansas, 66205.

5 Q. **Are you the same Brian Staihr who filed direct testimony in this
6 proceeding on April 27, 1999?**

7 A. Yes I am.

8 Q. **What is the purpose of your rebuttal testimony?**

9 A. In my rebuttal testimony I address certain issues raised in the direct
10 testimonies of Dr. Ben Johnson, on behalf of the Kansas Corporation
11 Commission Staff, and Dr. Robert Mercer, on behalf of AT&T
12 Communications of the Southwest, Inc.

13 **Dr. Ben Johnson**

14 Q. **Are there specific portions of Dr. Johnson's testimony with which
15 Sprint finds itself in agreement?**

16 A. Yes, there are several, some of which I have listed below:

17 Sprint believes, as Dr. Johnson does, that the KUSF mechanism
18 should be competitively neutral (Johnson Direct p. 7), targeted (p.9),
19 portable (p.15), cost-based (p.16) and that the cost upon which the
20 mechanism is based should be forward-looking economic cost (p.20).

21 In addition, Sprint obviously agrees that the KUSF mechanism
22 should be economical, equitable and effective (p.7) but in some cases

1 disagrees with Dr. Johnson's very specific and limited interpretations of
2 these terms.

3 Sprint agrees that costs should be calculated at an area smaller
4 than the study area level (p.50).

5 As stated in my direct testimony and by Dr. Johnson (p.59), Sprint
6 agrees that two of the most important cost-drivers regarding per-line
7 network costs are distance and density, both affected by customer
8 location information and how any model uses that information.

9 Sprint believes that a proper costing methodology (or model)
10 should account for things like rights of way, rivers, mountains and other
11 physical constraints that providers actually encounter when building a
12 network and providing service (p.65). In addition, it is advantageous for a
13 cost study to use the actual number of lines in an area (p. 74).

14 Sprint also believes that, with regard to a proxy model, a "one size
15 fits all" approach is flawed and that model inputs should be refined to
16 reflect Kansas-specific conditions as suggested by Dr. Johnson (p.67-68).
17 Further, as suggested, the KCC should not necessarily limit itself to any
18 model inputs selected by the FCC for federal USF purposes (p.99).

19 Q. **Are there specific portions of Dr. Johnson's testimony with which**
20 **Sprint disagrees strongly?**

21 A. Yes. There are three major issues and several additional issues. The
22 three major issues are:

1) Dr. Johnson subscribes to the politically popular but economically incorrect view that somehow it is beneficial or desirable or efficient that the costs associated with the local loop should be allocated over a variety of services because they are, in his words, joint costs (p.32-48).

2) Dr. Johnson believes that costs should be calculated at two separate zones within a single wire center (p.50-52) and that it is correct to study the costs of one zone as incremental to the costs of another zone within the same wire center (p.54).

These are addressed below, followed by a brief discussion of the additional issues.

Q. Throughout his testimony, beginning on page 32, Dr. Johnson refers to the local loop cost as a ““joint” or “common”” cost.’ With regard to universal service, is this Sprint’s position as well?

A. No. To understand Sprint’s position it is necessary to first lay out a few simple and undeniable facts:

Fact #1 : The local loop is a functionality that allows access to the first point of switching.

Fact #2: This functionality is clearly a key and appropriate part of what we generally refer to as universal service AND what the FCC defines as a

¹ Dr. Johnson actually addresses the loop AND the port, and to simplify the discussion in this section I simply assume inclusion the port whenever referring to the loop.

1 supported service with regard to universal service.* Even if a customer
2 never makes a single call (local, long-distance, whatever) we want that
3 customer to have the capability of making and receiving calls. That
4 capability comes from the loop. Not a portion of the loop, the entire
5 loop.

6 **Fact #3:** There is a cost associated with providing this capability to any customer.

7 **Fact #4:** The cost of providing this capability will vary depending on where the
8 customer is located (in town, out of town). The cost will vary
9 depending on the scale (size) of the provider. But the cost will not vary
10 because of anything the customer does with his or her loop. The
11 importance of this last point cannot be overstated: *Nothing the*
12 *customer does affects the cost of his or her loop, the cost that the*
13 *phone company incurs when providing the customer with the capability*
14 *of placing and receiving calls.*³

15 **Fact #5:** Following directly from the above, the manner in which a customer
16 uses his or her loop has no impact on, and nothing to do with, the cost
17 of that loop and the proper method for recovering the cost.

18 **Fact #6:** Currently, a portfolio of telecommunication services (both inter- and
19 intrastate) makes use of the local loop and roughly the same the
20 portfolio of services provide revenues that are used to compensate the

² The FCC's May 8th Order states specifically that supported service include "Voice grade service to the public switched network with the ability to place and receive calls." (Order, paragraph 22)

³ This is holding constant the customer's initial **choice** of loop. For example, there is clearly a cost difference between a normal copper loop and an ISDN loop.

1 local exchange carrier (LEC) for incurring the cost of the loop. We
2 generally refer to this as allocating the loop cost.

3 Given these facts, the immediate questions that follow are: Is this
4 current allocation the best allocation method? Is it consistent with the
5 universal service goals of the 1996 Telecom Act? Is it sustainable in a
6 competitive market? The answer to all three questions is no.

7 Q. **Why is the current allocation method not the best method?**

a A. Under the current allocation method a customer pays for part of a loop
9 every time he or she makes a toll call through access charges. It is
10 inefficient, uneconomical, and unfair to recover loop costs this way. It
11 makes no sense to recover a cost on a per-minute (or traffic sensitive)
12 basis that is not traffic sensitive. It requires certain individuals to cover
13 more than their fair share, and allows other individuals something of a free
14 ride. Economic costing theory dictates that efficiency is enhanced and
15 social welfare is increased when consumers pay cost-based prices. This
16 is what occurs in competitive markets. This is not what occurs under the
17 current allocation method.

18 Regardless of the direct-cost vs. joint-cost controversy, it is a fact
19 that customers in general are better off if more of the loop cost is
20 recovered on a flat-rate basis because that is the way the loop cost is
21 *caused*. (This flat rate cost recovery concept has been implemented in
22 the interstate jurisdiction via the establishment of the PICC.) Each loop
23 has a cost that is 100% caused by (or created by) each customer's desire

1 to have calling capability. As such, each customer should pay for the loop
2 without regard to minutes of use, quantity of services, etc. This means
3 each customer should pay a flat rate. That is not part of the current
4 allocation method.

5 **Q. But doesn't Dr. Johnson address this issue of cost-causation in his**
6 **testimony, on pages 38-40?**

7 **A.** Dr. Johnson's logic in that section of his testimony is extremely flawed
8 because it is based on how a customer uses the loop (or "line"). He
9 summarizes his thoughts on lines 3-5 of page 40 by stating, "So long as
10 numerous different services require the use of the line, economic theory
11 suggests that all of these different services will contribute toward the cost
12 of the line."

13 Dr. Johnson's statement is based on the (erroneous) argument that
14 is often made along these lines: It is impossible to make a long-distance
15 call without a loop. That is true. And it is impossible to watch cable
16 television without a TV set. But no one suggests that part of the cost of
17 the set should be included in the cable bill. It is impossible to view
18 videotapes without a VCR, but it makes no sense to include part of the
19 cost of the VCR in the cost of the tape. There are innumerable examples
20 of consumers purchasing services that require or use certain devices or
21 tools. That does not mean it is somehow desirable or efficient to include
22 the cost of the device in the cost of the service. And it does not mean that
23 economic theory will dictate that all those services contribute toward the

1 cost of the tool. If it did, every time an individual accessed the Internet
2 over his or her PC the price of the Internet access would include part of
3 the price of the computer!

4 Q. **But couldn't basic local service be viewed in this way as well? As**
5 **one more service that simply uses the device known as the local**
6 **loop?**

7 A. In a sense it could, which leads to question number two from above:
8 What exactly is consistent with the universal service goals of the 1996 Act
9 and the FCC? As Dr. Johnson himself states on page 55 of his testimony,
10 "The FCC also decided that... support should be based upon the forward-
11 looking economic cost of constructing and operating the network facilities
12 and functions used to provide the services supported by the federal...
13 mechanisms."

14 Looking first at the second half of that statement, what are the
15 "services supported. . . by the federal mechanism"? As I stated above in
16 Footnote #2, the FCC defines it as "Voice grade service to the public
17 switched network with the ability to place and receive calls." Looking now
18 at the first half of Dr. Johnson's statement, what are "the network facilities
19 and functions" that offer that capability? The local loop. Even if the loop
20 allows a customer to make use of a dozen other services, the FCC views
21 the loop as an elemental component of universal service. The thing that
22 provides the above-defined functionality must be included *completely*

when calculating the cost of universal service, otherwise the cost study is simply incorrect.

As to whether or not local calling is also a part of what the FCC envisioned as a supported service, in the FCC's Order it specifically states that "usage of, and not merely access to, the local network should be supported." (Order, paragraph 65).

Furthermore, as to the proper means of recovering this loop cost, Dr. Johnson states on page 37 that "it makes no economic sense to recover the entire cost of [the loop] as part of the price of local service." This statement is simply incorrect. A brief examination of the alternatives will show that in fact it makes *more* economic sense to recover the loop cost as a part of basic local service than through any other means currently available.

Q. Please explain.

A. When a consumer pays for part of the local loop through toll charges (and the included access charges) two inefficient things occur. The consumer is paying a traffic-sensitive rate for something that is not traffic sensitive AND the consumer is paying an intervening party (the IXC, who did not incur the cost of the loop) who turns around and pays the proper party (the LEC, who did incur the cost of the loop).

By implementing a PICC and assuming a corresponding reduction in access charges, the FCC took steps toward correcting the first issue. Allowing this payment to go directly to the LEC would be a step toward

1 correcting the second. Theoretically the most economically efficient
2 method for doing this would be a payment to the LEC in two parts: A
3 payment for "access to the public switched network with the ability to
4 place and receive calls" and a separate payment for a local usage
5 component. This, of course, resembles local measured service which is
6 available throughout Sprint's Kansas territories.

7 It makes economic sense to recover the loop cost as a flat rate. It
8 makes economic sense for end users (the *demanders* of access to the
9 switched network) to pay LECs directly (who are the *suppliers* of access
10 to the switched network). And it makes economic sense to allow end
11 users to separate access from usage (as local measured service does) or
12 to combine the two (as local flat rate service does.)

13 **Q. Your third question addressed what is sustainable in a competitive**
14 **market. Dr. Johnson states on page 37 that "the broad pattern of**
15 **cost sharing is -consistent with unregulated markets". Please**
16 **comment.**

17 **A.** There is no question that in a competitive market multi-product firms cover
18 their entire costs, including joint and shared costs, by revenues obtained
19 from their entire product portfolio. But generally those costs are
20 recovered across product lines by charging more or less *to the extent that*
21 *a particular product causes a particular cost to be incurred.* A hotel that
22 also offers meals does not recover a portion of the cost of the hotel room
23 in the price of the meal because if it did, very few people would elect to

1 eat there. Nor does a hotel offering in-room movies recover a portion of
2 the cost of the room OR the cost of the television set in the price of the
3 movie. Yet both the room and the set are "required" in order to enjoy the
4 offered service, which is "in-room" movies!

5 As long as the 1996 Telecom Act requires that rates for
6 telecommunications services be "reasonably comparable" in low-cost and
7 high-cost (urban and rural) areas, the market for local service cannot
8 resemble a truly competitive, unregulated market. But competition can be
9 encouraged by eliminating the extensive system of cross-subsidization
10 that exists today and serves as a barrier to entry. What Dr. Johnson
11 refers to as "cost-sharing" is not the same thing as current implicit subsidy
12 system. To take the hotel analogy (above) a step further, the current
13 practice of recovering loop costs through access charges is akin to
14 recovering a portion of the room costs through in-room movies.
15 Customers who purchase no movies would pay less than the cost of the
16 room, customers who watch 1 movie would pay a portion of the cost of the
17 room, but a smaller portion than the customers watching 6 movies. Such
18 an arrangement does not exist in the competitive market, but does exist in
19 the existing implicit subsidy system.

20 **Q. Issue #2 mentioned above was the area to be used for calculating**
21 **costs and support. First, Dr. Johnson advocates use of different**
22 **sized areas for calculating costs and for administering the fund and**

recommends two zones within a single wire center (p.51-52). Please
2 comment.

3 A. Sprint agrees with Dr. Johnson that it is necessary to achieve a balance
4 between precision and practicality when it comes to calculating costs and
5 support levels for a Kansas USF. When costs are calculated at a study
6 area level the result is to average out high and low cost regions, which is
7 contrary to the idea of targeting support. When costs are calculated at a
8 much finer level, such as a census block group (CBG) there are additional
9 administrative burdens.

10 Two of the proxy models available to the KCC calculate costs at a
11 very low level, the ultimate grid (in the case of the BCPM) and the cluster
12 (in the case of the HAI Model). In these two models those detailed costs
13 can be aggregated up to the CBG, wire center, or study area level.
14 Support can be calculated at all those levels.

15 Because of the way the feeder plant is calculated in the FCC's
16 Synthesis Model those costs are only valid at a wire center level.⁴ In
17 practice, this makes Dr. Johnson's dual recommendations (p.99 and
18 p:107) of 1) a two-zoned approach, using 2) the FCC's Synthesis Model

⁴ In the FCC's Synthesis Model feeder investment is not calculated with regard to specific clusters. Rather, it is calculated for the entire wire center and then distributed over the clusters based on feeder route distance. To verify this, one need only look at the work file associated with any run of the Synthesis Model and compare the relative percentages of feeder investment (per cluster over total) with feeder distance (per cluster over total). They are identical. The result of this is that while the feeder cost may be correct for the entire wire center, it is incorrect for any individual cluster or group of clusters since the investment (and associated costs) contain none of the cluster-specific information such as topography or soil conditions that actually determine the cost of the feeder in that cluster.

1 impossible. A multi-zoned approach within a wire center requires costs to
2 be calculated below the wire center level at some point, which the
3 Synthesis Model is incapable of doing in its present form.⁵

4 Setting that aside, Dr. Johnson claims that funding areas should be
5 larger than costing areas. With regard to the BCPM and the HAI Model
6 that will *always* be the case unless explicit support were to be calculated
7 at the grid or cluster level, which to my knowledge none of those models'
8 sponsors have ever advocated. Because grid or cluster level costs will
9 always be averaged within a CBG, or a wire center, or even a zone, it is
10 necessary to choose the geographic level which allows for targeting,
11 prevents cream skimming, yet is administratively feasible. It will always
12 be the case that costs are calculated at one level and support calculated
13 at another. What is important is that the support area and the serving
14 area (for any LEC, either ILEC or CLEC) be the same.

15 **Q. Dr. Johnson mentions cream skimming on page 107 of his testimony**
16 **and suggests that his two-zoned approach will help avoid this. Does**
17 **Sprint agree?**

18 **A** Theoretically, cream skimming can be mitigated by ensuring that the area
19 (or level) at which support is calculated is also the area designated a

⁵ In a convoluted way the Synthesis Model could be forced to calculate costs at a sub-wire center level by going in ahead of time and eliminating the original location points in, say, Zone 2 so that the only thing left to cluster and build plant to would be the points in Zone 1. Of course, this presupposes that the user has already identified exactly what areas make up each zone, and in that case one would not be using any information out of the model to create zones. Even then, the costs will not serve the purpose intended by Dr. Johnson since the costs that would be subtracted

1 serving area. This is the area which any provider must serve *in its entirety*
2 in order to receive explicit USF. It is not actually dependent on the level
3 itself. But generally the smaller the area the more precisely support can
4 be targeted. When support is targeted it is more difficult to take
5 advantage of the averaging process. In that sense, a sub-wire center
6 zoned approach is definitely preferable to a higher level with regard to
7 avoiding cream skimming. What is most important is that the subsidy area
8 and the serving area be one in the same. However, Sprint does object to
9 that area being larger than the wire center as discussed later.

10 Q. **So Sprint does not really object to a zoned approach?**

11 A. Not at all. Sprint supports the concept. But without objecting to the FCC's
12 Synthesis Model overall, Sprint objects to Dr. Johnson's recommendation
13 that the KCC use the FCC's Synthesis Model at a sub-wire center level.
14 And Sprint strongly objects to Dr. Johnson's proposal to estimate zones
15 using an incremental approach, as detailed on page 54.

16 Q. **Specifically, what is wrong with Dr. Johnson's incremental
17 approach?**

18 A. From an economic point of view, incremental costs generally fall into one
19 of two categories. The first is when one is estimating the cost of
20 producing one additional *unit* of output. This is the standard incremental
21 cost approach of which marginal cost is a special case. The second is

(in the case of Zone 1 being subtracted from total in an attempt to incrementally cost Zone 2) will be grossly overstated.

1 when an *entirely new service or product in its entire volume* is added
2 incrementally to a firm's production. This is what is modeled in the case
3 of a TSLRIC or TELRIC study. Dr. Johnson's "incremental" approach is
4 neither of these two. Instead, his increment is an incremental set of
5 customers, specifically those located in Zone 2 (p.54). For purposes of
6 universal service, any interpretation of costs based on such an
7 "increment" is meaningless.

8 **Q. Why would the costs resulting from such an approach be**
9 **meaningless?**

10 A. Many reasons. First, following Dr. Johnson's example beginning on page
11 54, line 7, when you estimate the stand alone cost of Zone 1, and subtract
12 it from total network cost to obtain an "incremental cost" for Zone 2, you
13 have allocated the entire set of joint and shared costs to Zone 1. For
14 instance, under Dr. Johnson's approach the cost for the housing for the
15 switch would be a part of Zone 1 customer's costs but not of Zone 2
16 customer's costs. This approach would have the effect of understating
17 the Zone 2 costs.

18 Furthermore, as an illustration, assume 4 customers are served off
19 of a single copper cable extending outward from the switch. 3 of the four
20 customers are located 9,000 feet from the switch location, an area that is
21 still Zone 1. Assume the 4th customer lives another 1,000 feet away,
22 which now has become Zone 2. In reality, all 4 customers would share
23 the cost of 90% of the cable and the additional 10% would be allocated to

1 customer 4. In reality, even a forward-looking reality, the fourth customer
2 is the most expensive customer to serve. In Dr. Johnson's proposal, the
3 fourth customer suddenly becomes the least expensive to serve since the
4 provider was already serving the other three! The incremental cost
5 associated with serving the fourth customer involves only 1,000 feet of
6 cable.

7 What is also clearly wrong with this approach is that Dr. Johnson's
8 proposed method ignores the *realities* of serving an incremental set of
9 customers. For example, if in fact 9,000 feet of cable were built, and then
10 an additional 1,000 feet of cable were added, the provider would incur the
11 cost of dispatching a crew twice. The way Dr. Johnson proposes to
12 calculate incremental cost is as follows: The cost of building the entire
13 wire center (which represents the cost of dispatching 1 crew) minus the
14 stand alone Zone 1 cost (which again represents 1 crew), leaving no cost
15 for dispatching a crew to Zone 2.

16 If Dr. Johnson really wanted to use a conditional approach for
17 costing Zone 2 ("Given that you are already serving Zone 1, what is the
18 additional cost to serve Zone 2") then the cost of dispatching a second
19 crew must be included. Otherwise, again, Zone 2 costs would be
20 understated!

21 For purposes of universal service, it is necessary to understand the
22 costs that a new and efficient provider would incur when providing the
23 supported services. The reason for obtaining those costs is to compare

1 them with the price the provider will be allowed to charge (either because
2 of regulation or due to competition) to determine if (and how much) explicit
3 support is needed.⁶ Dr. Johnson's proposal forces the customers located
4 in Zone 1 to bear a disproportionate share of costs, and understates the
5 costs of Zone 2. Because Zone 1 would tend to be the lower cost zone
6 overall, support that was calculated using this method would drastically
7 undersize an explicit KUSF fund.

8 **Q. You mentioned that there were additional issues where Sprint found**
9 **itself in disagreement with Dr. Johnson's position. Would you**
10 **please briefly address some of those issues?**

11 **A. Yes.**

12 **Size of Support Area.** Discussing disaggregation and the appropriate
13 geographic area to be used for calculating support, on page 51 Dr.
14 Johnson states that the size of the universal service fund tends to be
15 inversely related to the size of the geographic areas used in calculation.
16 Small areas ⇒ larger fund, and larger areas ⇒ smaller fund. Dr. Johnson
17 says that the reason for this is modeling error. In fact, the main reason is
18 that there is netting of costs going on at a much larger level when larger
19 areas are used.

20 Dr. Johnson gives an example on the following page (52) of one
21 wire center made up of 9 CBGs: 3 high cost, 3 average cost, 3 low cost. If

⁶ For this purpose the FCC requested that a scorched node approach be used. Dr. Johnson's suggestion is contrary to a scorched node approach.

2 the fund were calculated at the CBG level, this wire center would receive
3 some explicit funding (for the 3 high cost CBGs). If the fund were
4 calculated at the wire center level, this wire center as a whole would be
5 average and receive no funding. While there may be modeling errors in
6 all the models involved and these may have some impact the size of the
7 fund, the fund size is truly determined by the area because of netting.

8 **BCPM vs. HAI Customer Location.** On page 60 Dr. Johnson states that
9 the latest version of the HAI Model (and here I believe he is referring to
10 HAI 5.0a, not HAI 5.1 as filed in this proceeding since it is my
11 understanding HAI 5.1 was not available at the time Dr. Johnson was
12 writing his testimony) is superior to the BCPM Model because it relies
13 upon geocode data which is a better approach.

14 Two pages later, on page 62, Dr. Johnson states that the HAI
15 Model in fact does not actually use this geographic information, that it
16 "simplifies away or ignores important aspects of the geographic data".
17 Given this fact it is difficult to understand Dr. Johnson's earlier statement.
18 Also, one must consider the fact (discussed in my direct testimony) that
19 the HAI Model provides no means of locating customers within their basic
20 unit of analysis, the cluster, whereas the BCPM contains an extensive
21 algorithm for locating customers within its basic unit of analysis, the
22 ultimate grid. When all these facts are considered, Sprint finds no support
for Dr. Johnson's statement that the HAI Model is superior to the BCPM.

1 **Elasticity.** On pages 93-95 Dr. Johnson submits data from various
2 elasticity studies and uses these as general support for his suggestion
3 that the Kansas Commission should “proceed with caution when
4 considering any plans to rebalance rates.” (p.117). Sprint believes that
5 Dr. Johnson’s suggestion that penetration rates might be harmed through
6 rate rebalancing misses a hugely important point: In an overwhelming
7 majority of elasticity studies conducted on telephone service income
8 effects outweigh price effects. That is to say, the way to increase
9 penetration levels is to target lower income households, not target prices
10 which would have the effect of driving them further away from costs.
11 Citing one of Dr. Johnson’s own sources, Lester Taylor, Dr. Taylor writes
12 the following with regard to the demand for basic residential service,
13 “Actually, when all is said and done, the primary factor is really income, or
14 rather its absence.”⁷
15 Given this fact, it is important to note Kansas’ active participation in the
16 newly expanded Lifeline program as outlined in the FCC’s May 7th Order.
17 Combining this with the fact (stated in my direct testimony) that elasticity
18 studies tend to overestimate the responsiveness of customers to price
19 changes for basic telephone service, we conclude that it is extremely
20 unlikely that rate rebalancing will have any significant effect on penetration

⁷ Lester Taylor, Telecommunications Demand in Theory and Practice, Kluwer Academic Publishers, 1994. Page 125.

rates at all. That said, Sprint believes Dr. Johnson's urging for "caution" is somewhat overstated.

Dr. Robert Mercer

Q. Throughout his testimony Dr. Mercer discusses changes that have been made to the most recent version of the HAI Model, HAI 5.1. Have you had an opportunity to analyze the changes discussed and their impact on cost estimates produced by the HAI Model?

A. Sprint has had a limited amount of time to investigate the changes listed in Dr. Mercer's testimony. Sprint looks forward to conducting additional analysis on this newest version of the HAI Model and running sensitivity analyses to determine the impacts of the changes. Given that, Sprint is in a position at this time to offer the KCC its *initial* impressions of the new HAI 5.1. Sprint would also respectfully request that additional information and analysis regarding the HAI 5.1 might be added to the record in the future if all parties agree.

Q. What are Sprint's initial impressions of the HAI changes?

A. It appears that many of the changes made in this newest version of the HAI Model address specific and obvious shortcomings that existed in the previous version of the model. In that sense, they are definitely steps in the right direction.

1 ▪ Basing surrogate locations on roads, as opposed to
2 census block boundaries, is consistent with both the BCPM and the
3 FCC's Synthesis Model.

4 · Allowing the reduced rectangle (which bounds the original
5 point-based polygon) to maintain its orientation is one way of
6 attempting to mitigate the massive distortion of relative customer
7 location that occurs in the HAI Model.

8 · Including *and using* the strand distance (or minimum
9 spanning tree (MST)) as a measure against which distribution route
10 distance should be checked should help avoid the dramatic
11 underbuilding of plant that characterized earlier versions of the HAI
12 Model.

13 **Q. In his testimony Dr. Mercer says that the strand distance or**
14 **MST does not represent the true minimum distribution route**
15 **distance that the model should produce. Is this correct?**

16 **A.** Only in the sense that the route distance compared to a MST
17 should be a measure of distribution plus drop*, and not distribution
18 alone. Aside from that, both Sprint and the FCC believe that some
19 type of a MST or strand distance is a very useful tool for a proxy
20 model to use, or to use as a check against what a model builds.⁹

⁸ Plus connecting cable, to the extent that it is appropriate.

⁹ The Synthesis model utilizes a version of a MST which the FCC refers to as a "variant of the Prim "minimum spanning tree"" and describes as an outside plant design that has "significant

1 The fact is, of course, that usually the length of a minimum
2 spanning tree (or MST) is an *understatement* of the amount of
3 cable that would actually be required to serve customers. This is
4 because the MST assumes the world is flat, assumes that
5 telephone plant can go through natural barriers like mountains and
6 lakes, and ignores the fact that telephone plant tends to be built
7 along roads.

8 Particularly troubling is Dr. Mercer's oft repeated claim that
9 *surrogate customer locations tend to be over-dispersed, and*
10 therefore the HAI Model need not build enough cable to actually
11 reach customer locations because the locations are in the wrong
12 place (p. 22).

13
14 **Q. Has Sprint run the new HAI Model both using and not using**
15 **the strand distance?**

16 A. Yes. Initial results seem to indicate that when the model is run
17 using the strand distance and the available adjustment, route miles
18 are (on average) increased closer toward reasonable levels. Also,
19 the investment and costs produced by the model reflect this
20 increase in outside plant constructed.

advantages in estimating sufficient outside plant". FCC's Fifth Report and Order, p.27 and p.A-11.

1 **Q. Does this then help to solve the well-documented problem of**
2 **the HAI Model underbuilding distribution plant?**

3 **A. In many cases yes, but not in all cases. In the HAI Model**
4 **Methodology provided with Dr. Mercer's testimony, footnote 46,**
5 **page 44, it states "The strand distance is an independent measure**
6 **of the amount of route mileage required to connect all the points**
7 **that represent customer location to each other, appropriately**
8 **adjusted to eliminate drops, since the DRD does not include**
9 **drops."**

10 This means that the amount of distribution, not distribution-
11 plus-drop, that the HAI builds should (at a minimum) equal the
12 strand distance when a user enables the option. It does not in
13 every case. In several density zone, when the HAI Model is run for
14 Sprint/United Telephone of Kansas with the strand adjustment
15 enabled, the total distribution route distance is still less than the
16 total strand distance."

17 However, the correction does appear to be effective in the
18 lower density zones, which are of most concern for universal
19 service purposes. Sprint strongly supports the HAI Sponsors
20 efforts in making this much-needed adjustment. However, Sprint's
21 own enthusiasm is tempered somewhat by the HAI Sponsors'

1 refusal to use their new adjustment in their own filings. It is also
2 tempered by the fact that because of the proprietary nature of the
3 HAI model data, the strand distances have been calculated outside
4 the model and cannot be validated. They must simply be taken as
5 given.

6 **Q What about the other adjustments, discussed on pages 24 and**
7 **25, that suggest the HAI Model builds sufficient cable to reach**
8 **the corners of the cluster rectangle?.**

9 A. It appears as though this adjustment is *not* being made in all cases.
10 But because of the closed nature of the HAI Model's preprocessing
11 it is extremely difficult to say if this "adjustment" is having the
12 desired effect, or any effect at all.

13 Dr. Mercer states that the surrogate points in the HAI 5.1 are
14 now distributed along roads, not CB boundaries. The result of this
15 change is, in essence, the model using a new and different set of
16 clusters than the set that was used in last version of the HAI Model,
17 Version 5.0a. (A quick glance at total cluster area validates this
18 fact.) Therefore direct comparisons cannot be made between what
19 the model would have built, prior to this correction, and what the
20 model currently builds, since the model may be building to different
21 locations.

¹⁰ For example, in the 650-850 density zone the DRD falls short of the strand distance by 37,107 feet; in the 850-2550 zone the DRD falls short of the strand distance by 22,406 feet; in the 2550-

1 Ideally one would be able to compare the previous HAI
2 results with the 5.1 results, holding constant the set of points and
3 clusters used. This would reveal the stand-alone effect of the
4 purported change in distribution (making sure the corners of the
5 rectangle are reached, etc.) Unfortunately, this is not possible.

6 In its initial investigation Sprint was unable to find evidence
7 of the adjustments discussed on pages 24-25. In fact, Sprint found
8 evidence exactly to the contrary: that this purported adjustment
9 appears not to be taking place in the HAI 5.1 in every case. For
10 example, in the model documentation it states that any cluster with
11 4 location or more will build a distribution distance that is "the sum
12 of the height and twice the width of the rectangle." (HAI
13 Documentation, p.44). In Sprint's Kansas territories there are
14 clusters" in the HAI database, for example, with 4 customer
15 locations, 7 lines, an area of approximately 2.9 square miles and
16 an aspect ratio (height over width) of 1.76. Some simple
17 calculations using these figures indicate that the associated
18 rectangle has an approximate height of 2.26 miles, and a width of
19 1.28 miles. Therefore if the HAI model is doing what the
20 documentation indicates, there should be $(2.26 + (2*1.28)) = 4.84$
21 miles of distribution built in this cluster, given the four locations.

5000 density zone the DRD falls short by 26,161 feet.

¹¹ Main clusters, not outlier clusters.

1 The total amount of distribution that the HAI 5.1 builds in this
2 cluster is zero (0). For just this one cluster, the model is short over
3 25,000 feet of distribution. And recall, this amount is supposed to
4 be built even "if the user does not invoke the normalization option"
5 (HAI Documentation, p.44).

6 **Q. On pages 30-32 Dr. Mercer lists several reasons why he feels**
7 **the KCC should not adopt the Synthesis Model (or HCPM) and**
8 **should instead adopt the HAI 5.1. Would you please respond**
9 **to each?**

10 **A.** Yes. First, Dr. Mercer states that the Synthesis Model is not yet
11 completed. As stated in my direct testimony, Sprint agrees that the
12 model continues to be refined but sees that as no reason to default
13 to the HAI Model. The fact that the HAI Sponsors have just now
14 released Version 5.1 of their own model indicates that they
15 understand the process of refining a complex model is ongoing. In
16 fact, during numerous earlier state proceeding I cannot recall the
17 HAI Sponsors suggesting that another proxy model should be used
18 because their own would soon be refined or changed. Given the
19 incentives that exist at the Federal level for the Synthesis to be
20 completed and made operable, it is quite unlikely that the Model's
21 unfinished status should cause the KCC concern.

22 Second, Dr. Mercer suggests that the Synthesis cannot be
23 thoroughly tested because of its unfinished status. This is

1 incorrect. Sprint (and other parties, including AT&T at the Federal
2 level) have been testing the Synthesis Model for months.”

3 Third, the Synthesis Model is written in Turbo Pascal. Sprint
4 agrees that this is a concern and has suggested to the FCC that
5 the programming language be changed to something more
6 approachable. The FCC is aware of parties’ concerns.

7 Fourth, the optimization routines add a layer of complexity
8 and increase computer run time. The issue of computer run time is
9 actually a non-issue: the idea that one model should be chosen
10 over another because it runs faster is nonsensical. And Dr.
11 Mercer’s characterization that the optimization routines built into
12 the Synthesis are a detriment is particularly confusing since the
13 HAI documentation on page 4 touts the “Numerous optimization
14 routines” for outside plant and the “Enhanced optimizing algorithm”
15 for SONET transport rings that are found in Dr. Mercer’s own
16 model.

17 Fifth, Dr. Mercer makes the claim that the Synthesis Model’s
18 database adds an additional step beyond those required to develop
19 the HAI database and that parties who want to use the Synthesis
20 database are inconvenienced by having to sign a proprietary
21 agreement and pay for the database.

¹² For example, see FCC *ex parte* presentations, CC Dockets 96-45 and 97-160, from AT&T and MCI/WorldCom dated March 17, 1999, March 30, 1999, May 5, 1999.

1 Sprint finds this claim hugely ironic given the inconvenience
2 and expense it has incurred over the past two years attempting
3 merely to view (not even purchase) the source of the HAI
4 database. First, the fact that the Synthesis Model's preprocessing
5 contains an additional step only illustrates the superiority of the
6 Synthesis' customer location algorithm over the HAI's. The
7 "gridding" of customers into microcells within clusters that Dr.
8 Mercer refers to is a key component of the Synthesis Models ability
9 to model and build to specific customer locations *within* their
10 clusters. By contrast, the HAI Model simply distributes customers
11 uniformly within its clusters. It is this difference that the FCC cited
12 in its Fifth Report and Order, "The HAI also sacrifices accuracy by
13 assuming that customers are dispersed uniformly within its
14 distribution areas." (Fifth Report and Order, paragraph 58). The
15 reason that the Synthesis Model does not sacrifice accuracy is
16 *because* it contains this additional step.

17 Second, the fact that a user must sign an agreement and
18 pay a (nominal) fee to use the Synthesis database is hardly a
19 hardship compared with the HAI Sponsors insistence that parties
20 must travel to Pennsylvania and pay for computer rentals at PNR &
21 Associates, in addition to signing agreements, in order to merely
22 view that data used in the HAI Model's preprocessing. It is true, as
23 Dr. Mercer writes, that there is a database "packaged" with the HAI

1 Model. However, that database is not the actual data upon which
2 serving areas are created, as it is in the Synthesis Model. Rather,
3 the database packaged with the HAI Model is the end result of an
4 extensive pre-processing using proprietary data and algorithms that
5 is not available to users. The proprietary nature of this data has
6 been discussed in many proceedings. On the other hand, the
7 Synthesis Model database does contain the actual points (or lets a
8 user input his or her own) that are used for clustering and
9 subsequent building of outside plant.¹³ For Dr. Mercer to claim “the
10 HAI database is packaged in the model” (p.31) is somewhat
11 misleading.

12 Finally, Dr. Mercer states that the Synthesis Model does not
13 estimate the cost of unbundled elements (UNEs) and he views this
14 as a shortcoming. It is my understanding the KCC was presented
15 with the option of using the HAI Model for estimating UNE costs
16 and chose not to select the HAI for this purpose. (Docket No. 97-
17 SCCC-I 49-GIT). Therefore, this is a non-issue.

18 Overall, the majority of Dr. Mercer's reasons for the KCC not
19 choosing the Synthesis Model are spurious at best.

¹³ It is possible to run the Synthesis Model from ground zero, in which points are clustered by the model as it runs, or to utilize a set of already clustered points. In the second case, it is possible to use of set of clusters that are based on the same proprietary data that is used in the HAI Model. However, a user is not required to use this data OR anything based on this data. For instance, Sprint has run the Synthesis Model using its own road surrogate data.

1 **Q. Mercer then lists several reasons why the KCC should choose**
2 **the HAI Model 5.1. Are there specific areas mentioned that**
3 **require comment?**

4 **A. Most of Dr. Mercer's reasons for preferring the HAI Model are non-**
5 **specific and in most cases could be applied to any of the three**
6 **models currently available. All three models are based on sound**
7 **economic costing principles and all three may be used in any**
8 **jurisdiction. The BCPM and the Synthesis Model are both publicly**
9 **available, and his claim that the HAI is a publicly available model is**
10 **accurate only to the extent that the model platform is available.**
11 **The underlying data is still not available to all interested users. His**
12 **claim that the HAI Model alone has been subjected to intense**
13 **scrutiny is not only completely without basis but incomprehensible,**
14 **given that Dr. Mercer himself has participated in multiple**
15 **proceedings in which the BCPM was scrutinized right alongside the**
16 **HAI Model.**

17
18 **Q. Are there specific reasons the KCC should not adopt the HAI**
19 **Model?**

20 **A. Yes. Sprint has also sponsored the testimony of Mr. John Holmes**
21 **who addresses many of the engineering shortfalls of the HAI**
22 **Model. In addition to those issues, the fact that the HAI Model has**
23 **always used (and continues to use) proprietary data as its source**

1 means that the model "and all underlying data" (Order, paragraph
2 250) are not available to all interested parties. Obviously, this is a
3 significant problem. Most recently, the FCC has opted for running
4 their Synthesis Model using all road surrogate data, and without
5 using proprietary geocoded data.¹⁴ While I certainly cannot speak
6 for the FCC, it is a fact that the FCC is concerned about availability
7 of data and that PNR & Associates have made the road surrogate
8 data truly available (that is, all interested parties can have the data
9 on their own personal computers). The same cannot be said for
10 *the geocoded data that the HAI Model uses.*

11 In addition, the fact is that the purported "adjustments" made to HAI
12 5.1 do not appear to be taking place in every case. The model
13 builds less than the strand distance, even when a user invokes the
14 option that supposedly causes the model to match that distance.
15 More importantly, the building of distribution to the corners of the
16 rectangles does not seem to be taking place. As a result the model
17 continues to underbuild the network. Given the limited amount of
18 time available for analysis prior to filing this rebuttal testimony,
19 Sprint looks forward to continuing its analysis of the HAI 5.1 in the
20 near future.

¹⁴ This fact is validated by the ex parte filing made to the FCC by MCI on May 5th, 1999 in which the MCI representatives refer to the FCC's non-use of geocoded data as one of several issues that "remain unaddressed". In the ex parte, the reason given for why this is an issue is that using road data "raises significantly computed average monthly costs and USF." Sprint cannot help but

1 **Q. If the KCC were to go ahead and use the HAI Model, as Dr.**
2 **Mercer suggests, how should the model be run?**

3 **A.** In such a situation it would be absolutely imperative that the HAI
4 Model be run using the strand distance option and an appropriate
5 multiplicative adjustment. If these are not used, the HAI Model will
6 certainly underbuild distribution areas as it has previously, and as
7 has been noted by the FCC. The "adjustment" of building to the
8 corners of the rectangles must also be made functional in every
9 case, which it currently is not. Also, the model would have to be
10 populated with accurate, Kansas-specific, company-specific inputs.
11 Sprint is also sponsoring the testimony of Jim Severance who
12 addresses the input issue. The issues raised by Mr. Holmes would
13 have to be addressed and corrected. This would involve significant
14 re-writing of the model. Finally, the original geocoded data would
15 have to be made *truly* available in order to understand the nature of
16 the model's preprocessing and specifically to validate the strand
17 distances (or MSTs) that are now a part of the model and which a
18 user currently has no way of validating.

19 **Q. Does this conclude your rebuttal testimony?**

20 **A.** Yes it does.

wonder whether the use of road data would remain an issue for MCI if it resulted in *lowering*
monthly costs!

THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

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Before Commissioners:

John Wine, Chair
Cynthia L. Claus
Brian J. Moline

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In the Matter of the General Investigation)
Into the Reformation of Intrastate)
Access Charges.)

Docket No. 01-GIMT-082-GIT

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**REBUTTAL TESTIMONY
OF
BRIAN K. STAIHR
ON BEHALF OF
SPRINT**

July 13, 2001

REBUTTAL TESTIMONY OF BRIAN K. STAIHR

1 **I. Introduction**

2 **Q. Please state your name, title and business address.**

3 A. My name is Brian K. Staihr. I am employed by Sprint Corporation as
4 Senior Regulatory Economist in the Department of Policy and Regulatory
5 Affairs. My business address is 6360 Sprint parkway, Overland Park,
6 Kansas 66251.

8 **Q. Are you the same Brian K. Staihr who filed direct testimony on May
9 31, 2001?**

10 A. Yes I am.

11 **II. Purpose**

12 **Q. What is the purpose of your rebuttal testimony?**

13 A. In my rebuttal testimony I address three specific issues raised in the direct
14 testimony of Bion C. Ostrander on behalf the Citizens' Utility Ratepayer
15 Board. The issues I address are 1) penetration rates for telephone service
16 in Kansas, 2) affordability of basic rates in Kansas, and 3) the
17 economically flawed argument that the local loop is a shared or a common
18 cost among multiple services.

19

20 **III. PENETRATION RATES**

21 **Q. On page 16 of his testimony witness Ostrander claims that the proposed
22 rate re-balancing in the Stipulation and Agreement come "...at a time**

1 when Kansas is one of the few states in the nation with problems
2 regarding penetration levels for telephone service.” Does Sprint agree
3 with this assessment?

4 A. No. It should be noted that Mr. Ostrander does not define or explain what
5 he considers these “problems” to be. He offers no evidence, no statistics,
6 no data whatsoever suggesting that penetration levels in Kansas are
7 decreasing, or are lower than the national average, or are lower than
8 those of comparable states, or are somehow a “problem”. On page fifteen
9 he does state that penetration levels in Kansas show “little or no growth”
10 and he calls this a “disturbing trend”. However, Mr. Ostrander omits one
11 important fact: Penetration levels in Kansas have shown less growth than
12 national averages because they started out significantly higher than the
13 national average rate.

14 According to the FCC’s Common Carrier Bureau Industry Analysis
15 Division, in 1984 the national average penetration level was 91.6%. At
16 that time in Kansas, the penetration level was 94.3% or 2.7% above the
17 national average. In 2000 the national average penetration rate was
18 94.4%, and the penetration rate in Kansas was 94.8%, 0.4% above the
19 national average.’ During the years from 1984 to 2000 the amount of
20 variation across state penetration levels was reduced by nearly fifty
21 percent, as measured by the FCC data’s standard deviations. For
22 example, in 1984 there were a dozen states with penetration rates that

¹ *Telephone Subscribership in the United States*, Industry Analysis Division, Common Carrier Bureau, FCC.
Released March 2001.

2 were fully 4% above or below the national average. But in 2000 not a
3 single state had a penetration rate that was 4% above the national
4 average, and only two states have rates that are 4% below the national
5 average. In a nutshell, penetration rates are converging. And as
6 penetration rates converge it is not surprising that Kansas' rate, which
7 started out significantly higher than average, should increase less than the
8 rates in some states that were well below average. But contrary to what
9 Mr. Ostrander would suggest, this represents neither a "problem" nor a
"disturbing trend".

10 Furthermore, the Stipulation and Agreement should actually help to ease
11 any concerns Mr. Ostrander might have regarding the penetration rate for
12 basic service in Kansas. Because it has been mandated that access
13 charge reductions will flow through to the end user in the form of toll
14 charge reductions, Kansas consumers will see lower toll bills as a result of
15 the Stipulation and Agreement. It is well known, among those who study
16 consumer demand, that the reason many customers choose not to have
17 telephone service is because of high long-distance calling charges. Put
18 simply, in certain cases it is easier for consumers to have no service than
19 it is to control or curtail toll calling. In addition, disconnection from the
20 network takes place because of non-payment of toll charges. This is one
21 of the key reasons that access to toll blocking was included in the FCC's
22 list of services to be supported by universal service in its first universal

1 service order.² In the Order the Commission stated "Studies demonstrate
2 that a primary reason subscribers lose access to telecommunications
3 service is failure to pay long distance bills."³ Although that section of the
4 Order generally refers to the customer being disconnected because of
5 non-payment, the fact is that non-subscribership, either as a result of
6 action on the part of the customer or on the part of the carrier, is often
7 caused by high toll charges. Lower toll charges, which would be brought
8 about by the Stipulation and Agreement, can help keep customers on the
9 network. Obviously services such as toll blocking can help as well, but
10 some end-users may be unaware that such options exist. Because the
11 Stipulation and Agreement will lead to lower toll charges, the effect on
12 penetration levels should only be positive.

13 For Kansas, telephone penetration has increased over time, and remains
14 slightly above the national average. Mr. Ostrander's concerns are
15 misplaced, and the data does not support his claims that Kansas has a
16 "problem" with regard to penetration rates.

17
18 **IV. AFFORDABILITY**

19 **Q. On pages 16-17 of his testimony Mr. Ostrander states that "If local**
20 **rates are increased on the basis that they are currently "affordable", I**
21 **believe it will be necessary to find that long distance rates are**
22 **currently "unaffordable". He goes on to state that because no**

² FCC USF Report and Order, CC Docket 96-45, released May 7, 1997 (USF Order).

³ USF Order, paragraph 385

1 **information suggests that long distance rates are unaffordable,**
2 **access reductions are not necessary. Please comment.**

3 A. Mr. Ostrander has somehow misinterpreted both the goals of the 1996
4 Telecom Act and the intentions behind the Stipulation and Agreement.
5 The two goals of rate re-balancing, which involves the removal of implicit
6 subsidies, are to move rates closer to costs and to make rate structures
7 more reflective of the underlying costs of providing the services.

8 The issue at hand is not whether local rates are currently affordable; they
9 clearly are. This affordability is obviously a necessary condition for rate
10 re-balancing, but it is not "the basis" for rate re-balancing. Nor does
11 affordability (or non-affordability) of long distance rates play any part in
12 need to rate re-balance. To the extent that access charges (or a portion
13 thereof) serve as an implicit subsidy for loop costs and basic service, it is
14 desirable to reduce them and allow the rates charged for basic service to
15 come closer to covering the costs of basic service. In the process, the
16 rates that IXCs are charged for access to the LECs network come closer
17 to cost, and long-distance charges to end users also come closer to cost.
18 The goal, which is both economically efficient and social-welfare-
19 enhancing, is to allow rates for all services to approach costs regardless of
20 the direction the rate must move in order to get there. Clearly, if the rate
21 has to move "up" then it is correct to be concerned about affordability.
22 This concern is the basis for having an explicit high-cost universal service
23 fund. But the fact that toll rates are currently affordable, as Mr. Ostrander

1 states (and as Sprint also believes) is no reason to leave in place an
2 inefficient and undesirable system of implicit subsidies.

3 Furthermore, it is also detrimental to perpetuate a system in which the
4 cost of a non-traffic sensitive item, the local loop, is recovered through a
5 traffic-sensitive mechanism, access charges. Sprint witness Harper, in his
6 direct testimony, explains the advantages to customers of the more
7 equitable system that Sprint supports as part of the Stipulation and
8 Agreement.

9

10 v. **LOOP AS A COMMON COST**

11 **Q. Throughout his testimony (p.7, p.9, p.18) Mr. Ostrander makes**
12 **reference to “common” loop costs. He also advocates that these**
13 **“common” loop costs be recovered over a variety of services,**
14 **including access. Please comment.**

15 **A.** This issue, as raised by Mr. Ostrander, is really two separate issues. The
16 first issue is whether or not the cost of the local loop is properly defined as
17 a common cost or a direct cost. The second issue is, regardless of how
18 the cost is defined, what is the proper way to recover the cost? In
19 economic terms, the first issue determines the second: for the sake of
20 economic efficiency the cost must be recovered from the parties that
21 causes the cost to be incurred in the first place. In political terms,
22 sometimes the method of cost recovery has not been directly aligned with
23 the cost causer because of other concerns, e.g. social welfare issues.

1 With regard to the claim that the loop is a common cost, it is Sprint's
2 position, a position supported by the majority of today's leading regulatory
3 economists, that the cost of the loop is not a common or shared cost, but
4 a direct cost of access to the public switched network.⁴

5 Because this issue has been argued extensively for many years, and
6 because innumerable pages of testimony have been filed on this issue
7 with the Kansas Corporation Commission, the FCC, and undoubtedly
8 every other state commission or board across the country, in the name of
9 efficiency I will not repeat all of Sprint's arguments here.⁵ Instead, I
10 include below a quote from Dr. Alfred Kahn, testifying on this subject
11 before the Pennsylvania Public Utility Commission. This is followed by six
12 simple facts:

13 "The arguments proffered by these witnesses [that the loop is a shared
14 cost] are the most persistent weeds in the regulatory garden. Other
15 mainstream economists and I have dealt with and debunked these claims
16 for years-and I suppose this will remain our task for as long as parties to
17 proceeding such as this insist on conflating the politics of setting prices
18 with the economics of determining costs."⁶
19

20 Fact #1: The local loop is a functionality or capability that allows an end-
21 user to have access to the first point of switching. It provides the end-user
22 with the opportunity to place and receive calls.

⁴ Rather than include a long list of names in this testimony, I refer the reader to a 1994 article in the Yale Journal on Regulation by Dr. Steve Parsons entitled "Seven Years After Kahn and Shew: Lingerin Myths on Costs and Pricing Telephone Service." The article provides an excellent discussion and overview of this topic.

⁵ Sprint will gladly provide any interested party with a portfolio of arguments, articles, testimony and transcripts addressing this issue and supporting the position that the loop is not a common or shared cost.

Rebuttal Testimony of Dr. Alfred Kahn before the Pennsylvania Public Utility Commission, Docket No. I-940035, February 15, 1996. ⁶

1 Fact #2: That functionality comes from the loop. Not a portion of the loop,
2 the entire loop.

3 Fact #3: There is a cost that the LEC incurs when it provides this
4 capability to a customer.

5 Fact #4: Nothing the end-user does affects the cost of his or her loop, the
6 cost that LEC incurs when providing the customer with this opportunity of
placing and receiving calls.

8 Fact #5: Following directly from Fact #4, the manner in which a customer
9 uses his or her loop has no impact on, and nothing to do with, the cost of
10 that loop or the proper method for recovering that cost.

11 Fact #6: Currently, a portfolio of telecom services (both inter- and intra-
12 state, both regulated and non-regulated) makes use of the local loop. And
13 many of the same services provide revenues that are used to compensate
14 the LEC for incurring the cost of the loop. We generally refer to this as
15 allocating the cost of the loop.

16 It appears that Mr. Ostrander believes this current allocation method is the
17 best allocation method. Sprint believes it is not. Sprint believes that it is
18 inefficient, that it is not consistent with the goals of the 1996 Telecom Act,
19 and that it is not sustainable in a competitive market. Every time a
20 customer makes a toll call he or she pays a part of a loop cost through
21 access charges. It is simply uneconomical and unfair to recover loop
22 costs this way. The box below lists two hypothetical but representative
23 customers, with different monthly calling patterns. For purposes of

1 illustration, let's assume the two live side by side, and that the costs that
2 the LEC incurred to provide their loops is exactly the same for both
3 customers.

End User	Basic R1 Rate	Local Minutes of Use (per Month)	Toll Minutes of Use (per Month)	Total Usage
Ms. White	\$16.00	350	20	370
Mr. Brown	\$16.00	150	100	250

4
5 Under this hypothetical, as long as access charges include a subsidy to
6 recover loop costs, Mr. Brown is paying more in loop costs every month
7 than Mrs. White despite the fact that the costs of their loops are the same.
8 Even using the erroneous argument of usage as some type of justification,
9 Mr. Brown is using his local loop less than Ms. White but paying more.
10 Sprint is at a loss to understand how Mr. Ostrander can consider this cost-
11 allocation method either economical or equitable. It is not economical
12 because recovery of a flat rate cost on a per minute basis is inconsistent
13 with economic efficiency. It is inequitable because there is no justifiable
14 reason whatsoever that Mr. Brown should pay more in loop costs every
15 month than Ms. White.

16 To the extent that the Stipulation and Agreement moves toward recovering
17 a flat-rate cost on a flat rate basis, and reduces the inequities illustrated
18 above, it is a step toward a better method for recovering loop costs.

19

20 **Q. Does this conclude your rebuttal testimony?**

21 **A. Yes it does.**



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August 28, 2002

Secretary
Missouri Public Service Commission
200 Madison Street, Suite 650
P. O. Box 360
Jefferson City, MO 65102
VIA FEDEX

FILED

AUG 29 2002

Missouri Public
Service Commission

Re: In the Matter of an Investigation of the Actual Costs Incurred in Providing Exchange Access Service and the Access Rates to be Charged by Competitive Local Telecommunications Companies in the State of Missouri
Case No. TR-2001-65

Dear Sir:

Enclosed are an original and two (2) copies each of the **HC and NP Surrebuttal Testimony of Randy G. Farrar**, and the **Surrebuttal Testimony of Dr. Brian R. Stalhr**, on behalf of Sprint in the above-captioned matter. The filing category for this filing is 11 Telephone Specific Issues – Other Telephone Specific Issues. I would appreciate your filing the same and returning filed-stamped copies.

Pursuant to the Commission's Order Adopting Procedural Schedule, Clarifying the Scope of this Proceeding, and Concerning Motion to Waive Service Requirement and Motion to Compel Discovery issued on March 14, 2002 ("Order"), copies of the foregoing are being served on counsel for all represented parties in this case. This cover letter is being served on unrepresented parties pursuant to the Order, advising all unrepresented parties that you may obtain a copy of the referenced documents upon request from the filing party at no cost.

Please direct any further questions or requests to Vickie Worrel at 913-315-9135.

Very truly yours,

Lisa Creighton Hendricks

/vw

cc: Counsel for All Represented Parties of Record w/enclosures
All Unrepresented Parties of Record w/o enclosures

EXHIBIT No.:
ISSUES:
WITNESS:
SPONSORING PARTY:
TYPE OF EXHIBIT:
CASE No.:
DATE PREPARED:

ACCESS COSTS
BRIAN K. STAIHR
SPRINT
SURREBUTTAL TESTIMONY
TR-2001-65
AUGUST 28, 2002

BEFORE THE MISSOURI PUBLIC SERVICE COMMISSION

In the Matter of an Investigation of the Actual)
Costs Incurred in Providing Exchange Access)
Service and the Access Rates to be Charged by)
Competitive Local Exchange Telecommunications)
Companies in the State of Missouri.)

Case No. TR-2001-65

FILED

AUG 29 2002

SURREBUTTAL TESTIMONY

OF

BRIAN R. STAIHR

**Missouri Public
Service Commission**

ON BEHALF OF

SPRINT COMMUNICATIONS COMPANY, L.P.

AND

SPRINT MISSOURI, INC.

August 28, 2002

**BEFORE THE PUBLIC SERVICE COMMISSION
STATE OF MISSOURI**

In the Matter of an Investigation of the)
Actual Costs Incurred in Providing Exchange)
Access Service and the Access Rates to be)
Charged by Competitive Local Exchange)
Telecommunications Companies in the)
State of Missouri.)

Case No. TR-2001-65

AFFIDAVIT OF BRIAN K. STAIHR

STATE OF KANSAS)
) ss:
COUNTY OF JOHNSON)

I, Brian K. Staihr, being of lawful age and duly sworn, depose and state on my oath the following:

1. I am presently Senior Regulatory Economist for Sprint Corporation.
2. I have participated in the preparation of the attached Surrebuttal Testimony in question and answer form to be presented in the above entitled case;
3. The answers in the attached Surrebuttal Testimony were given by me; and,
4. I have knowledge of the matters set forth in such answers and that such matters are true and correct to the best of my knowledge and belief.



Brian K. Staihr

Subscribed and sworn to before me on this 26th day of August, 2002.



NOTARY PUBLIC

My Appointment Expires:

MICHAEL G. McCAIN
Notary Public, State of Kansas
My Appt. Exp. 4/26/2003

1 2) the incorrect statement that a service is not providing a subsidy to another
2 service if it is priced below its stand-alone cost.
3

4 **II. LOOP COSTS AS A COMPONENT OF THE COST OF SWITCHED ACCESS**
5

6 Q. *You stated above that it is incorrect to allege that the cost of providing the service
7 known as switched access includes the cost of the network element known as the
8 local loop. On page 11 of her rebuttal testimony, lines 18-21, Ms. Meisenheimer
9 suggests that SWBT's cost study "provides no meaningful insight" because it
10 does not include loop costs (or a portion of loop costs). Please comment.*
11

12 A. Ms. Meisenheimer's statement on that page, and some of the references she
13 presents on the following page, are classic examples of the misunderstanding that
14 has permeated countless regulatory proceedings regarding the cost of the loop, the
15 cost of basic service, and the proper methods for estimating and recovering those
16 costs. In a nutshell, Ms. Meisenheimer has failed to distinguish an economic
17 exercise—*calculating a cost*—from a political (or policy) decision—*how that cost
18 should be recovered once it is calculated*. It is my understanding that the subject
19 of this phase of this proceeding is determining the actual cost of switched access,
20 not how that cost should be recovered. The failure to distinguish between the two
21 lies in the fact that, historically, access *charges* have been used as a mechanism
22 for recovering a portion of loop costs. That is not the same thing as the loop cost
23 being a component of the cost of switched access. Again, as discussed at length

1 in my rebuttal testimony, Ms. Meisenheimer continues to mistakenly treat *joint*
2 *use* of the loop as evidence that the loop is a joint cost. The first sentence on page
3 12 of her rebuttal testimony is an example of this, where she states, "Joint use of
4 the telecommunications network supports a shared cost allocation to all services
5 that makes [sic] use of that network." To demonstrate the flaw in this argument,
6 we need only replace the words "telecommunications network" with the words
7 "telephone handset" (since the handset is used for all telecom services): "Joint
8 use of the telephone handset supports a shared cost allocation to all services that
9 make use of that handset." Is Ms. Meisenheimer suggesting that the cost of
10 switched access should include a portion of the telephone handset? Her testimony
11 does not make such a suggestion, but to be consistent with her own argument she
12 would have to advocate that a portion of the cost of customer premise equipment
13 (CPE) must be contained in the costs of all services that require the use of CPE.

14
15 Q. *But doesn't Ms. Meisenheimer include citations from various parties in support of*
16 *her position?*

17
18 A. The citations that Ms. Meisenheimer provides from NARUC and from the Public
19 Service Commission of Missouri on page 12-13 of her rebuttal testimony are
20 *normative* statements; that is, statements that advocate a certain policy position,
21 not statements of fact. And both statements address the political issue of cost
22 recovery, not the economic issue of cost calculation. As the NARUC citation
23 makes very clear, the issue being discussed in that statement is how the loop cost

1 should be recovered, not how the loop cost is calculated. The same holds true for
2 the statement from the Public Service Commission of Missouri.

3
4 Q. *What about the citation from the FCC on page 12?*

5
6 A. Two points are worth noting regarding the FCC citation. First, it is taken from a
7 1997 Notice of Proposed Rulemaking (NPRM), Notice of Inquiry, and Third
8 Report and Order in the FCC's access reform docket, CC Docket #96-262. In the
9 section that Ms. Meisenheimer cites (Section VI. "Prescriptive Approach to
10 Access Reform," Subsection C.4) the FCC was seeking comment on the policy
11 issue of how access *rates* should be set in the event that they (the FCC) decided to
12 adopt a prescriptive approach to access reform. At the time this NPRM was
13 written the FCC had not yet decided whether to take an active role or a more
14 passive, market-based role in reforming access charges. The first point worth
15 noting is that when the FCC finally did adopt their prescriptive stance regarding
16 access reform the result was the CALLS Order that Ms. Meisenheimer references
17 on pages 5-7 of her rebuttal testimony. The purpose of the CALLS Order was
18 (and is) "removing implicit subsidies in access charges and recovering costs from
19 those services that cause them."¹ By explicitly using the term "subsidies" the
20 FCC is acknowledging that access charges are recovering the costs of some
21 service other than switched access. And the CALLS Order also explicitly states

¹ CALLS Order (Sixth Report and Order in CC Docket No. 96-262, Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45), released May 31, 2000, paragraph 166.

1 that the costs being addressed are loop costs.² Therefore, regardless of the
2 wording of the NPRM that Ms. Meisenheimer cites, it is clear that the FCC's
3 actions reveal that they believe loop costs are not part of the cost of switched
4 access.

5
6 The second point worth noting is that, as Sprint witness Randy Farrar has stated in
7 his testimony, when the FCC calculates the forward-looking economic cost of
8 basic service as part of the calculation of federal universal service support the
9 FCC includes the local loop *in its entirety* in that calculation. According to the
10 FCC's actions, 100% of the cost of the loop is included in the cost of basic
11 service. So by default, 0% of the cost of the loop is included in the cost of
12 switched access. Now, it is true that after the FCC has calculated the cost of basic
13 service they make a political decision regarding how much of that cost should be
14 supported by a Federal fund. But the policy decision does not enter into the cost
15 calculation. Neither should it in this case.

16
17 At some point in the future it is possible that the Commission will make the
18 conscious policy decision that access *rates* should continue to recover a portion of
19 the cost of the local loop. Or the Commission may decide, as the FCC did, that
20 implicit subsidization of that type is inconsistent with a smoothly functioning
21 competitive market. But that decision is not at issue in this phase of the
22 proceeding. The issue at hand is to determine the actual cost of switched access,

² CALLS Order paragraph 120.

1 and the actual cost of switched access does not include the cost of the loop, any
2 more than it contains the cost of the telephone handset.

3

4 **III. STAND ALONE COST AS A TEST OF THE EXISTENCE OF A SUBSIDY**

5

6 Q. *You also stated above that it is incorrect to claim that a service or good is not*
7 *providing a subsidy unless it is priced above its stand-alone cost. Do parties*
8 *make this claim in rebuttal testimony?*

9

10 A. Yes. In the rebuttal testimony of Mr. Dunkel on behalf of the Office of Public
11 Counsel (page 3) he refers to Dr. Johnson's testimony and agrees with Dr.
12 Johnson in making the (erroneous) statement that "a service is not producing a
13 subsidy unless it is priced above its stand-alone cost." Dr. Johnson himself
14 repeats his mis-statement when he writes on pages 2-3 of his rebuttal testimony
15 that the stand-alone costs he has produced are relevant because they are useful in
16 "determining whether a particular service is actually subsidizing another service."
17 And Ms. Meisenheimer, on page 11 of her rebuttal testimony, refers to SWBT's
18 filing and says that, because SWBT chose not to introduce a stand-alone cost
19 study, SWBT cannot support claims that access subsidizes other services.

20

21 Q. *Dr. Johnson, Ms. Meisenheimer, and Mr. Dunkel all seem to believe that it IS*
22 *correct to state that a service priced below its stand-alone cost is not providing a*
23 *subsidy. Yet in your rebuttal testimony you explained how this is incorrect and*

1 *you provided a very simple demonstration of how this does not hold in the case of*
2 *a multiple-product firm. Please comment.*

3

4 A. It is worth noting that, in both the direct and rebuttal testimonies of Dr. Johnson
5 and Ms. Meisenheimer, neither witness provides a citation or source when they
6 state that “economic theory” supports their position.³ Nor does Mr. Dunkel
7 provide a citation or source other than Dr. Johnson. This is unfortunate, because
8 the economic literature is clear that the test must be applied both to individual
9 services and to groups of services. In other words, taking a single service (offered
10 by a multi-service firm) and determining that its price is below its stand-alone
11 cost tells you nothing. It is necessary to take each subset of services that the
12 service could be part of and compare the prices of the subset of services to that
13 group’s stand-alone cost. Only then can any conclusions be made regarding the
14 existence of cross-subsidies. And no party in this proceeding has done that,
15 which is understandable given the complexity involved in attempting such
16 calculations. In short, Dr. Johnson’s and Mr. Dunkel’s claims that switched
17 access is not providing a subsidy in Missouri have no foundation.

18

19 Q. *The economic literature is clear is with regard to the fact that subsets of services*
20 *must be examined, not just individual services?*

21

³ Dr. Johnson provides a reference from William Baumol regarding stand-alone costs and price ceilings, but no reference regarding stand-alone costs as a test of cross-subsidy.

1 A. Yes. As stated in my rebuttal testimony, Dr. Gerald Faulhaber was the first to
2 formalize this theory in an article from 1975 and in that seminal work he
3 specifically refers to the necessity of testing subsets of services for cross-subsidy.⁴
4 In a 1998 article from the Journal of Regulatory Economics Dr. Steve Parsons
5 discusses Dr. Faulhaber's work and explicitly states that the stand-alone cost test
6 requires "that the revenue from a service *or subset of services* be less than or
7 equal to the cost of providing that service *or subset of services* independently"
8 (emphasis added) for prices to be subsidy-free.⁵
9
10 Furthermore, (and also as stated in my rebuttal testimony), my investigation
11 included a study of the positions of several colleagues having expertise in this
12 area, including Dr. Parsons and Dr. Faulhaber, with respect to the application (and
13 mis-application) of the stand-alone cost test. Attached is a short white paper by
14 Dr. Faulhaber, described as an "explication of the principles" contained in his
15 earlier (1975) work, which is consistent with my position presented in my rebuttal
16 testimony: that the stand-alone cost test must be applied to all individual services
17 and all groups of services in order to determine the presence (or absence) of
18 subsidies. The white paper is publicly available at Dr. Faulhaber's website.⁶
19

⁴ Gerald R. Faulhaber, "Cross-Subsidization: Pricing in Public Enterprises", *American Economic Review*, Volume 65, Issue 5, December 1975, pages 969 and 970.

⁵ Steve Parsons, "Cross Subsidization in Telecommunications", *Journal of Regulatory Economics*, 13:157-182, 1998.

⁶ See Schedule BKS-S-1.

The white paper can be found at <http://rider.wharton.upenn.edu/~faulhaber/talks.html>.

1 Q. *Why is it so important to understand that the stand-alone cost test, as conducted*
2 *by Dr. Johnson, proves nothing with regard to the existence (or non-existence) of*
3 *subsidies?*

4
5 A. If one were to mistakenly conclude, based on the result of a single stand-alone
6 cost test, that access charges at their current levels were not subsidizing another
7 service (such as basic local service) then a person or a Commission might
8 conclude that it was acceptable to reduce access charges without a corresponding
9 re-balancing of local rates. Such a conclusion would, of course, be incorrect.
10 Local service is subsidized in Missouri and if the Commission (for whatever
11 reason) sought to reduce the *source* of the subsidy—that is, access charges—it
12 would be necessary to allow local rates to move closer toward their costs. In
13 other words, incorrect conclusions regarding the applicability of a single stand-
14 alone cost test could lay the groundwork for significant policy errors down the
15 road. For that reason, it is important to understand the significance (or lack
16 thereof) of the results that Dr. Johnson has presented.

17
18 Q. *Does that conclude your surrebuttal testimony?*

19
20 A. Yes it does.

21
22
23

CROSS-SUBSIDY ANALYSIS WITH MORE THAN TWO SERVICES

Professor Gerald R. Faulhaber
Professor, Wharton School, University of Pennsylvania
August 11, 2002

The purpose of this note¹ is to address certain misperceptions regarding the proper interpretation and application of the principles of my paper, "Cross-Subsidization: Pricing in Public Enterprises,"² the first work in the economics literature to rigorously define the concept of cross-subsidy. This paper has been of some use in subsequent scholarly research as well as regulatory proceedings in which cross-subsidization is an issue.

Unfortunately, the principles of cross-subsidy analysis established in my 1975 paper have not always been applied correctly. In this note, I address a specific question regarding the use of the "stand-alone cost" (SAC) test in a multi-service firm to determine the presence or absence of cross-subsidy. In brief, the stand-alone cost of any service or group of services of an enterprise is the cost of providing that service (at the existing or "test" demand level) or group of services by themselves, without any other service that is provided by the enterprise. A closely related concept is that of "incremental cost" (IC). The incremental cost of a service or group of services is the additional cost of providing that service or group of services over and above the cost of providing all the remaining services. For example, suppose an enterprise produced five services, $i = 1, 2, 3, 4, 5$, for a total cost of $C(12345)$, and the stand-alone cost of services 2, 3, 4, 5 were $C'(2345)$, then the incremental cost of service 1 is $IC(1) = C(12345) - C'(2345)$. In the paper, I use both incremental cost and stand-alone cost as tools to define subsidy-free prices. In brief, if the revenues of a regulated enterprise just cover total economic costs, then all prices are subsidy-free if the revenues of each service and each group of services is at least as great as the incremental cost of that service or group of services; equivalently, prices are also subsidy-free if the revenues of each service and each group of services is no greater than the stand-alone cost of that service or group of services. I show in the paper that under the assumption that revenues equal economic costs, these two tests for cross-subsidy are equivalent.

The specific question is: if two (out of three) services offered by an enterprise individually have revenues less than stand-alone cost, can we conclude that no cross-subsidy is being provided to the third service?

An example will help illustrate the question, and my answer. Suppose we have Services 1, 2, and 3. The three services share a common cost of \$100, which must be incurred if

¹ This note was prepared at the request of Sprint to clarify some questions concerning the application of my earlier work on cross-subsidy to address questions that have arisen in regulatory proceedings. It is not an endorsement of any regulatory position of Sprint or any other party. This note is an explication of the principles contained in my earlier work and does not constitute any deviation or modification of that work for any purpose.

² *American Economic Review*, 65(5), December 1975, 966-977.

any or all of the services are offered. Over and above this common cost, each service has an incremental cost of \$75.³ The total cost of all three services together is therefore $\$100 + \$75 + \$75 + \$75 = \$325$. The stand-alone cost of each service is \$175, as each of the services if provided by itself would have to incur the common cost and its incremental cost. Suppose the revenues from Service 1 were \$140 and the revenues from Service 2 were \$150, each less than their individual stand-alone cost of \$175. Can we conclude that the price structure is subsidy-free and no subsidy is being provided to Service 3?

If the enterprise is regulated and the total revenues are just equal to the total cost, then total revenues must equal \$325. Since the revenues from Service 1 and Service 2 together are \$290, it must be the case that the revenues from Service 3 are \$35, clearly less than Service 3's incremental cost. This would suggest that there is a subsidy, or at the very least perhaps a contradiction, in that the SAC is satisfied for all services individually (which would suggest that there is no subsidy) but the IC test is violated for Service 3 (which would suggest that there is a subsidy).

The answer is that at the revenues and costs of the example, there is a subsidy. The reason is very clear in the original 1975 paper: both the SAC and the IC tests must be applied not only to each service individually, but to *all possible groups of services*. The importance of groups of services was a key insight of the 1975 paper, but is often missed in regulatory applications. However, applying these tests to groups of services is absolutely vital to determining the presence or absence of cross-subsidy. Applying these tests merely to individual services cannot be thought of as an approximation, or "good enough." It is a fatal error, as it is in the above example.

When we apply the full set of tests to the revenues and costs of the example (assuming total revenue equals total cost), we find the following:

Services	Revenues	Stand-Alone Cost	Incremental Cost
1	\$140	\$175	\$75
2	\$150	\$175	\$75
3	\$35	\$175	\$75
1 & 2	\$290	\$350	\$150
1 & 3	\$175	\$250	\$150
2 & 3	\$185	\$250	\$150
1 & 2 & 3	\$325	\$325	\$325

It becomes immediately clear from this table that while each service passes its individual stand-alone test, Services 1 and 2 *together* fail their *combined* SAC test, as shown in the shaded row of the table, in which revenues for the two services together are \$290, while the stand-alone costs of these two is \$250.

While the definition of cross-subsidy and the arithmetic of the example are clear, the economic logic of it may not be so clear. For a complete exposition of the issue, the

³ For example, if each service produced 7500 units at a constant marginal cost of \$0.01, incremental cost would be \$75.00.

original article is the best and clearest source. However, I quote in brief from this article to motivate the above mathematical definition: "If the provision of any commodity (or group of commodities) by a multicommodity enterprise subject to a profit constraint leads to prices for the other commodities no higher than they would pay by themselves, then the price structure is *subsidy-free*" [italics in original]. In the example, the provision of Service 3 through the profit-constrained enterprise leads to higher prices for Services 1 and 2. If Service 3 were eliminated from the product set of the enterprise, then total costs would decline from \$325 to \$250, and the current revenues from Services 1 and 2 of \$290 would exceed \$250. Therefore, the price of at least one of the remaining services would have to decrease in order for total revenues to equal total costs. Thus, the provision of Service 3 (at these revenues and costs) "leads to higher prices for the other commodities higher than they would pay by themselves." Result: subsidy.

The example of the question provides an excellent opportunity to focus on the role of *groups* of services, rather than just services individually, in cross-subsidy analysis. The importance of groups of service in cross-subsidy analysis is impossible to over-emphasize, and yet it may be overlooked in regulatory work. Unfortunately, as the simple example shows, such oversight can lead to fatal errors in the analysis. Clearly, performing the subsidy analysis on all groups of services may substantially increase the cost analyses needed to support the subsidy analysis. But avoiding the hard work will almost surely lead to a flawed analysis, as in the example.

Further Considerations for Practical Application of Subsidy Analysis

The simplicity of the example belies a host of both theoretical and practical complexities in the application of subsidy analysis in practice. In brief, these complexities are easily accommodated without undermining the basic theory. I describe several such complexities and outline their resolution below:

The case of total revenues not equal to total cost. In price-regulated enterprises, the norm would be that total revenues would equal total economic cost. In non-regulated enterprises, the norm would be that total revenues would at least equal and possibly exceed total economic cost (we ignore the case of long-run losses, as the enterprise would shortly go out of business). In this case, the equivalence of the SAC tests and the IC tests no longer holds, but the concept of cross-subsidy is still valid. Under these assumptions, the stockholders of the firm become a "player" and the analysis must consider effects on this group as well as on services. The focus of cross-subsidy analysis shifts entirely to the IC tests; the SAC tests are not helpful under conditions of positive economic profits.

The services in question are cross-elastic. This case is dealt with in the paper, and requires some adjustment in the cross-subsidy test to consider incremental revenues as well as incremental costs. With cross-elasticities, the removal of a service may result not just in a loss of that service's revenue, but in changes to the revenues of other services as well. This effect must be accounted for in the practical application of the test, as described in the original article.

How are the firm's services defined? This seemingly simple question masks a number of important issues. For example, suppose a service actually consists of many different "rate elements," one for each component of the service. Is each rate element a service, for purposes of subsidy analysis? How about a tapered rate schedule? Is every element of the taper a separate service?

In brief, the answer is that anything the enterprise assigns a separate price to can and should be treated as a separate service. If for other purposes the word "service" is reserved for a larger grouping of component prices, then this larger grouping is included in the subsidy test as a group of services, as discussed above. The more detailed analysis ensures that customers that use some service components more intensely than others will not inadvertently be subsidizing customers with other component usage patterns within the larger service grouping.

A more difficult problem arises if the enterprise bundles services together into a single price that could more logically be offered separately. In this case, treating the bundle with its single price may lead to problems. Presumably, if regulators are concerned that bundling may produce hidden subsidies, then they may require the services to be unbundling and priced separately.⁴ Clearly, this would facilitate the subsidy analysis. However, absent an unbundling directive from regulators, such analysis would not be possible.

Shouldn't we be more concerned with customers being subsidized rather than services? This issue was taken up in my paper (with S. Levinson), "Subsidy-Free Prices and Anonymous Equity,"⁵ in which I examine the relationship between services being subsidy-free and customers being subsidy-free. The most stringent form of customer subsidy-free is called "anonymous equity;" the requirement that services be subsidy-free is a necessary but not sufficient condition for prices to be anonymously equitable. Therefore, the classic cross-subsidy analysis is the most helpful starting point for a more complete analysis of possible subsidy flows among customers.

What is the proper method for measuring incremental and/or stand-alone cost? While these cost definitions are quite clear conceptually, the practical implementation of measurement methods has been perhaps the most vexing problem in regulatory economics over the past forty years. Dispassionate scholars disagree on cost measurement methods, and parties to regulatory proceedings usually have very different views of appropriate methods. The FCC uses TELRIC (Total Element Long Run Incremental Cost) as a basis for cost advice to the states for pricing unbundled network elements from incumbent local exchange companies to competitive local exchange companies, but this standard has been hotly disputed in the courts and by academics. The measurement issues are beyond the scope of cross-subsidy analysis, although clearly the value of the analysis depends critically upon the validity of the cost estimates.

⁴ Unbundling of local loops for telephone companies was mandated by the Telecommunications Act of 1996, and implemented by the Federal Communications Commission and state regulators. This unbundling required separate prices be set for each unbundled element.

⁵ *American Economic Review*, 71(5), December 1981, 1083-1091.

1 **BEFORE THE PUBLIC SERVICE COMMISSION**

2 **DIRECT TESTIMONY**

3 **OF**

4 **DR. BRIAN K. STAIHR**

5
6 **I. BACKGROUND/PURPOSE**

7
8 **Q. Please state your name, title, and business address.**

9 **A. My name is Brian K. Staihr. I am employed by Sprint Corporation as Senior Regulatory**
10 **Economist in the Department of Law and External Affairs. My business address is 6450**
11 **Sprint Parkway, Overland Park, Kansas 66251.**

12
13 **Q. Please briefly describe your educational background and work experience.**

14 **A. I hold a B.A. in Economics from the University of Missouri-Kansas City, and an M.A.**
15 **and Ph.D. in Economics from Washington University in St. Louis. My field of**
16 **specialization is Industrial Organization, including Regulation.**

17
18 I began working with Sprint's Regulatory Policy Group in 1996. In my current position
19 I am responsible for the development of state and federal regulatory and legislative
20 policy for all divisions of Sprint Corporation. I am also responsible for the coordination
21 of policy across business units. My particular responsibilities include 1) ensuring that
22 Sprint's policies are based on sound economic reasoning, 2) undertaking or directing
23 economic/quantitative analysis to provide support for Sprint's policies, and 3)
24 conducting original research. The specific policy issues that I address include universal
25 service, pricing, costing (including cost of capital), access reform, reciprocal

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1 compensation and interconnection, local competition, and more.

2

3 In my position I have appeared before the Florida Public Service Commission, the
4 Kansas Corporation Commission, the New Jersey Board of Public Utilities, the
5 Pennsylvania Public Utility Commission, the North Carolina Utilities Commission, the
6 Public Service Commission of South Carolina, the Public Service Commission of
7 Nevada, the Texas Public Utilities Commission, the Illinois Public Service Commission,
8 the Oregon Public Utility Commission, and the Missouri Public Service Commission. I
9 have also worked extensively with the Federal Communication Commission's staff and
10 presented original research to the FCC. My research has also been used in
11 congressional oversight hearings.

12

13 In January 2000 I left Sprint temporarily to serve as Senior Economist for the Federal
14 Reserve Bank of Kansas City. There I was an active participant in the Federal Open
15 Market Committee process, the process by which the Federal Reserve sets interest rates.
16 In addition, I conducted original research on telecommunication issues and the effects of
17 deregulation. I returned to Sprint in December 2000.

18

19 For the past eight years I have also served as Adjunct Professor of Economics at Avila
20 University in Kansas City, Missouri. There I teach both graduate and undergraduate
21 level courses.

22

23 Prior to my work in Sprint's Regulatory Policy Group I served as Manager-Consumer
24 Demand Forecasting in the marketing department of Sprint's Local Telecom Division.
25 There I was responsible for forecasting the demand for services in the local market,

1 including basic local service, and producing elasticity studies and economic and
2 quantitative analysis for business cases and opportunity analyses.

3
4 **Q. What is the purpose of your testimony?**

5 **A.** The purpose of my testimony is to discuss how the removal of implicit subsidies is
6 consistent with—and necessary for—the development of a healthy and sustainable
7 competitive market for basic local telecom services throughout the state of Florida, a
8 competitive market that will simultaneously 1) provide benefits and choices to the
9 largest number of Florida's residents possible, and 2) operate on a level playing field for
10 all competitors. Sprint-Florida, Inc. (Sprint) is also co-sponsoring (with BellSouth and
11 Verizon) the testimony of Dr. Kenneth Gordon, who addresses these same issues in a
12 general sense, and from a state-wide and nation-wide perspective. My testimony
13 addresses why the removal of implicit subsidies will have an even greater impact, and is
14 even more critically needed, in the portions of Florida served by Sprint.

15
16 **II. IMPLICIT SUBSIDIES AND COMPETITION**

17
18 **Q. Why is the removal of implicit subsidies, such as those found in access charges,**
19 **necessary for the development of a healthy competitive market for basic telecom**
20 **services in Florida?**

21 **A.** The relationship between implicit subsidies and competition is something of a double-
22 edged sword: On one hand, competition erodes the ability to maintain artificially
23 imposed implicit subsidies. On the other hand, the existence of implicit subsidies
24 inhibits full and fair competition for all customers. Both of these effects are
25 economically undesirable, and unfortunately we see evidence of both of these effects in

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1 Florida today.

2

3 With regard to the first point—competition eroding the ability to maintain implicit
4 subsidies—the only way that any firm can successfully maintain a pricing structure
5 based on implicit subsidies is if the firm is able to control two things: the *source* of the
6 subsidy and the *target* of the subsidy. In a regulated monopoly environment this is
7 possible. In a competitive environment it is not, because the source of the subsidy is (by
8 definition) some customer paying a price that exceeds cost. And in a competitive
9 environment prices that exceed cost attract entry. For the entrant, the difference
10 between price and cost is not a *subsidy* but simply a *margin* (unless the entrant is
11 somehow required to serve both the customer providing the subsidy and the customer
12 receiving the subsidy). If the entrant prices the service at a slightly lower margin (but
13 still above cost), and underbids the incumbent firm, the entrant succeeds in capturing
14 that margin and therefore eroding the incumbent' s needed subsidy.

15

16 With regard to the second point—implicit subsidies inhibiting full and fair competition
17 for all customers—a pricing structure based on implicit subsidies divides the universe of
18 potential customers into two distinct subsets: the attractive customers who are providing
19 the subsidy (margin) and the unattractive customers who require the subsidy and are,
20 therefore, unprofitable to serve on an individual basis at current prices.

21

22 **Q. Do the implicit subsidies contained in access charges inhibit the development of**
23 **local competition?**

24 **A. Absolutely.** Since the passage of the 1996 Telecom Act the FCC has indicated that
25 access charges represent implicit subsidies and that implicit subsidies are antithetical to

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1 effective and healthy competition. In its very first Access Reform Order (*First Report*
2 *and Order* in CC Docket 96-262 released May 16, 1997) the FCC stated that “implicit
3 subsidies also have a disruptive effect on competition, impeding the efficient
4 development of competition in both the local and long-distance market” (*Id.* at ¶ 30).
5 More recently, the FCC, with the adoption of its CALLS Order in May 2000, (*Sixth*
6 *Report and Order* in CC Docket Nos. 96-262 and 94-01, *Report and Order* in CC
7 Docket No. 99-249, *Eleventh Report and Order* in CC Docket 96-45, released May 31,
8 2000 (“CALLS Order”)) undertook exactly the same type of reform that we are
9 discussing here today: converting implicit subsidies generated on a per-minute-of-use
10 basis to flat-rate charges directly recovered from the cost-causer (the end-user).
11 Although that Order obviously addressed interstate access rates, rather than intrastate
12 rates, the issue is identical. The CALLS Order states,

13 “Where existing rules require an incumbent LEC to set access charges above
14 cost for a high-volume user, a competing provider of local service can lease
15 unbundled network elements at cost, or construct new facilities, thereby
16 undercutting the incumbent’s access charges”

17 which has the effect of...

18 “jeopardizing the source of revenue that, in the past, has permitted the
19 incumbent LEC to offer service to other customers, particularly those in high-
20 cost areas, at below-cost prices.” (CALLS Order at ¶ 24)

21
22 Notice that this quote from the CALLS Order addresses both of the points discussed
23 above. It clearly illustrates how competition erodes implicit subsidies. But it also
24 makes specific reference to a “high-volume user.” Obviously any access charge that
25 would be above cost for a high-volume user would also be above cost for a low-volume

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1 user, and theoretically a competitor could enter a market and capture either user. But
2 the implication is that low-volume users are not the customers that would motivate the
3 competitive entry. They are, as I described above, the competitively-unattractive
4 customers. This phenomenon is particularly visible when we examine various UNE-P
5 based offerings currently available from competitive local providers. For example,
6 MCI's "The Neighborhood" Offering, which starts at a price of \$49.99 in many states,
7 offers virtually no price benefit to a very low-volume toll user; the offer is priced so as
8 to attract high-volume toll users. So while an offer such as "The Neighborhood" does
9 provide certain customers with an alternative provider for basic local service, it is not
10 really a viable alternative for many other customers. Rebalancing rates for basic local
11 service will create a situation where competitors will find that, on average, a larger
12 percentage of the residential market is financially attractive to serve.

13

14 Clearly the *degree* or the *magnitude* of the implicit subsidy plays a significant role in the
15 disruption of healthy competition. All else held equal, the larger the amount of implicit
16 subsidy that a customer is *providing*, the more attractive that customer is to a
17 competitor. But the larger the amount of implicit subsidy that is *required* to cover the
18 cost of serving any customer, the less likely a competitor will find that customer
19 attractive. When customers living in high-cost areas pay the same retail rates for service
20 as customers living in lower cost areas (or in some cases pay even *lower* retail rates than
21 low-cost customers) the magnitude of the implicit subsidy associated with the high-cost
22 customers effectively serves to discourage would-be competitors. The task at hand in
23 this proceeding, which is to reduce the magnitude of the implicit subsidy and allow
24 retail rates to approach costs, is exactly the mechanism needed to encourage, rather than
25 discourage, competitive entry. As the FCC states in another CALLS-related order,

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1 ‘Competitors are more likely to enter high-cost areas if the
2 incumbent LECs’ rates are closer to cost...’ *Cost Review*
3 *Proceeding for Residential and Single-Line Business Subscriber*
4 *Line Charge (SLC) Caps, Access Charge Reform, Price Cap*
5 *Performance Review for Local Exchange Carriers, Order, 17*
6 FCC Rcd. 10868.

- 7
- 8 **Q. Why would Sprint, as an incumbent local telephone company in Florida, want to**
9 **encourage competition?**
- 10 **A.** Competition is a fact, and it is here in Florida today. But in many cases, the type of
11 competition that exists is not particularly healthy or sustainable, nor is it taking place on
12 a level playing field. First, cream-skimming and arbitrage opportunities account for
13 much of the competitive activity we see. This leaves the incumbent carrier, with its
14 carrier-of-last-resort status, in the unenviable position of losing the customers whose
15 revenues cover the costs of serving them, and retaining the customers whose revenues
16 do not cover the costs of serving them. Second, incorrect signals are sent to potential
17 competitors. Competitors that might actually be less efficient than the incumbent can
18 enter a market in pursuit of the margin (subsidy) that the customers provide. Third,
19 advances in technology are quickly blurring the competitive lines across different
20 service offerings as inter-modal competition grows at a rapid pace. Competition from
21 standard telephony providers is matched by competition from wireless companies, cable
22 television companies, and even electric power companies. Not only do these forms of
23 competition also erode the much-needed implicit subsidies—particularly in the case of
24 wireless calling replacing wire-line long distance, and the associated loss of access
25 revenue—but they exacerbate the problem created by the incumbent’s carrier-of-last-

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1 resort status. For example, when a customer “cuts the cord” and replaces his or her
2 wireline phone with a wireless phone, the revenues associated with that customer go
3 away, but some of the costs of serving that customer do not; the company is still
4 obligated to maintain the network to the customer’s premises.

5
6 By allowing local rates to approach costs for more and more customers, a true win-win
7 situation is created in the competitive market: A larger number of basic local service
8 customers become attractive to competitors (which means more customers will be
9 offered choices). And competitive entry will occur when it is efficient and sustainable,
10 not when it is inefficient. With rate rebalancing, incumbents will still incur competitive
11 losses. But when the incumbent loses a customer it will only lose that customer’s
12 revenues, not the revenues needed to cover the costs of serving that customer plus
13 another (subsidized) customer. The incumbent will still be affected negatively, because
14 it will have to continue to incur some costs for customers from whom it receives no
15 revenues. But every loss will not be a “double-hit” to much-needed revenues.

16
17 One additional point is worth making with regard to competition. Because the
18 telecommunications industry is witnessing such significant growth in inter-modal
19 competition, the absence of a level playing field increases the potential for competitive
20 distortion. As cable companies, wireless companies and even electric power companies
21 compete with ILECs for customers, the maintaining of implicit subsidies (which the
22 ILEC has but which these other firms are not obligated to have) combined with a lack of
23 pricing freedom (which the other firms *do* have but ILECs do not) create an even greater
24 hurdle that ILECs must overcome in order to remain financially viable in an
25 increasingly competitive marketplace.

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The cable television industry is quickly moving into the voice market and conducting telephony trials across the nation, including the state of Florida. Many of these trials utilize voice over Internet protocol (VOIP) technology, which raises important questions regarding the long-term sustainability of the implicit subsidies found in access charges. And because of the extensive penetration of cable television networks, it is highly likely that many residential customers in less-urban areas will, if cable companies are given the right incentives to enter, be able to choose between telephone companies and cable companies for their telephony services. Removing the implicit subsidies that currently exist in prices will help competition to develop in two ways: it will level the playing field between inter-modal competitors, and it will not force other technologies such as cable telephony to compete head-to-head against *subsidized* prices for basic local service.

Another potential competitor, with a network even more ubiquitous than that of the cable industry, is the electric power industry. The FCC is currently examining the state of broadband offerings over power lines (BPL) (FCC Docket No. ET 03-104), and BPL technology is capable of providing voice telephony service. As with the case of the cable industry, the electric power industry is in a position to provide alternatives to customers in less-urban areas if the proper pricing incentives exist in the market and therefore, as stated above, competition is better served when alternate providers are not forced to compete with artificially subsidized prices.

Last, but perhaps most importantly, in purely economic terms it is the wireless industry that is, in many ways, best suited to offer an alternative to wireline basic local service in

1 all areas of Florida, including the less urban regions. If wireless companies are faced
2 with the correct economic incentives—again, such as not needing to compete against
3 artificially subsidized prices for basic local service—they will find it financially feasible
4 to offer Florida’s residents even more alternatives for basic local service.

5

6 **Q. Will rate re-balancing have a different competitive impact for customers who only**
7 **purchase basic local service on (essentially) a stand-alone basis, compared to**
8 **customers who purchase additional services or large amounts of toll?**

9 A. In many cases, such as the UNE-P based offerings discussed above, it is the customers
10 who purchase only basic local service that are currently least attractive to competitors.
11 Rate rebalancing will make them relatively more attractive since it will be more
12 profitable for competitors to serve them when their rates cover—or come closer to
13 covering—the costs of providing service.

14

15

16 **III. IMPLICIT SUBSIDIES IN THE AREAS SERVED BY SPRINT-FLORIDA**

17

18 **Q. How does the magnitude of implicit subsidies found in Sprint’s serving territory**
19 **compare with the areas served by BellSouth and Verizon?**

20 A. As Sprint witness John Felz discusses in his testimony, Sprint’s basic local service rates
21 are lower, on average, than both BellSouth’s and Verizon’s basic local service rates. If
22 Sprint’s costs were also lower than BellSouth’s and Verizon’s then the magnitude of
23 implicit subsidy might be roughly the same. However, evidence supports the conclusion
24 that the costs that a competitor would incur in Sprint’s territory are, on average, higher
25 than the costs a competitor would incur in BellSouth’s or Verizon’s territories. This

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1 fact, combined with Sprint's lower rates, translates to a larger degree of implicit
2 subsidization and a greater hurdle for would-be competitors to overcome in Sprint's
3 service areas.

4
5 **Q. What evidence supports the conclusion that the cost a competitor would incur in**
6 **Sprint's territory are, on average, higher than the costs a competitor would incur**
7 **in BellSouth's and Verizon's territory?**

8 **A.** All else held equal, the cost of providing basic local service is dominated by the cost of
9 the local loop. On average, throughout Sprint's local serving territory the cost of the
10 loop accounts for over 90% of the cost of providing basic local service. And average
11 loop costs (as well as the overall costs of service) increase as density and concentration
12 of customers decrease. This is simply a function of the economies of networks,
13 combined with the presence of a certain fixed costs. For example, the FCC, in its
14 universal service cost model proceeding, indicated that "the most significant portions of
15 network costs" were affected by "the location of customers relative to the wire center."
16 *Fifth Report and Order* in CC Docket Nos. 96-45 and 97-160, released October 28,
17 1998, ¶ 27.

18
19 If we compare density and concentration characteristics among Sprint, BellSouth, and
20 Verizon in Florida we find dramatic differences. As Exhibit BKS-1 shows, BellSouth
21 and Verizon serve regions that are, respectively, three and four times more concentrated
22 than Sprint's serving territory. For a new competitor this difference would translate to a
23 measurable cost difference, whether the competitor was overbuilding or simply
24 purchasing unbundled elements.

25

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1 **Q. If implicit subsidies really represent a hurdle to competitive entry, then shouldn't**
2 **we see less competitive entry in Sprint's serving territory?**

3 **A.** Yes, we should see less competitive entry and we do see less competitive entry in
4 Sprint' s territory. According to the FCC's Local Competition Report released June
5 2003, in the state of Florida CLEC lines accounted for 13% of all end-user switched
6 access lines at the end of 2002. (These figures do not reflect the competitive situation in
7 regions served by companies with less than 10,000 lines.) Another data source, the
8 Florida Commission's own Annual Report on Competition (released in December 2002)
9 indicates that CLEC lines in Florida accounted for 13% of all end-user lines as of June
10 30, 2002. These two sources, although they reflect slightly different timeframes, are
11 consistent enough to give us a "bound of reasonableness" regarding the overall level of
12 competitive activity throughout the state of Florida. According to the FCC data, Florida
13 at year-end 2002 was roughly in line with the nationwide average for competitive
14 activity, which was also 13% of end-user switched access lines. (However, Florida's
15 competitive activity was more heavily weighted toward business customers than the
16 national average. This is discussed in the testimony of Dr. Ken Gordon.)

17
18 By comparison, the level of competitive activity in Sprint's serving territory at year-end
19 2002 was significantly below this statewide average of 13%. Using forms filed with the
20 FCC, it is possible to estimate the percent of end-user switched access lines served by
21 competitors in Sprint's Florida serving territory on December 31, 2002 to be
22 approximately 3.4%. In all likelihood, this figure of 3.4% actually overstates the level
23 of competitive activity in Sprint's territory (see Exhibit BKS-2).

24

25 Furthermore, the largest portion of this 3.4% is actually made up of resold lines, rather

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1 than some form of facilities-based competition. This is a dramatic departure from the
2 type of competition seen in the remainder of the state. According to the Florida
3 Commission's Annual Report on Competition, resold lines accounted for approximately
4 14% of competitive activity statewide (as measured by CLEC lines) in 2002. By
5 comparison, resold lines account for over 56% of the competitive activity in Sprint's
6 Florida service territory. The reason that this fact is notable is that high network costs
7 (and the need for implicit subsidies to cover them) do not inhibit competitive entry when
8 the competitor is a reseller, because the reseller does not undertake network investments,
9 nor does the reseller incur network costs in the form of cost-based UNEs. The fact that
10 reselling accounts for such a significantly larger percentage of the competitive activity
11 in Sprint's Florida service territory underscores the fact that the higher costs of serving
12 Sprint's customers have effectively discouraged other forms of competition in many
13 areas.

14
15 **Q. How can we be sure that Sprint's dramatically lower levels of competitive activity**
16 **are not attributable to some factor other than the presence of implicit subsidies?**

17 **A.** The characteristics of Sprint's serving territory speak for themselves. The low density
18 and high-dispersion of Sprint's customers affect many aspects of a potential business
19 case, from network-related expenses (higher costs by necessity translate to higher UNE
20 rates) to marketing expenses. Any competitor entering Sprint's territory is faced with,
21 on average, lower rates to compete against and higher costs to incur. If Sprint's
22 customers are unattractive to competitors for some additional reason (for example,
23 perhaps on average they might generate lower vertical feature revenue or lower access
24 revenue) this simply adds further support for the removal of high implicit subsidies
25 since doing so will help to make Sprint's customers more attractive to competitors.

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1

2 Because Sprint's residential local service rates are lower and its costs are higher, the
3 current implicit subsidy system is an even greater barrier to competition in Sprint's
4 territory than in other portions of Florida. Therefore, as Sprint witness John Felz states
5 in his testimony, it will be necessary to allow greater movements in Sprint's residential
6 local service rates to bring about a comparable level of competitive inducement seen in
7 other regions of the state.

8

9 **Q. But doesn't that mean that residential local service rates would possibly increase**
10 **more in Sprint's territory than in other regions?**

11 **A.** Yes, but there are counter-balancing factors that must be considered. First, it is
12 important to keep in mind that inter-exchange carriers (IXCs) are required to flow
13 through the access charge reductions that accompany the rate rebalancing. This includes
14 elimination of the "in state connection fee." As a result, toll customers currently paying
15 such a fee to an IXC—regardless of their level of usage—will benefit as this charge is
16 eliminated. Also, because per-minute access charges will be reduced, many customers'
17 total bills (for all telecom services) will, on average, decline as well. So although basic
18 rates will rise, toll rates will fall and in many cases the effects will offset each other

19

20 Second, if the status quo were to continue, the persistent erosion of subsidy by
21 competitors (who naturally target higher-margin customers) would force incumbent
22 carriers to either scale back investment in their networks or seek increases in residential
23 rates or both. Residential customers are not well served when carriers cannot afford to
24 invest in improving their networks. But they benefit greatly when technological
25 advances and the new services that accompany them, are made available to as many

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1 residents as possible. Sprint is currently investigating several different technological
2 advances in its local serving areas in all of its states, including Florida, as part of its
3 overall network-upgrading plans. These include the migration of circuit-to-packet
4 switching, fiber-to-the-home solutions, voice over DSL offerings, and more. The ability
5 to undertake capital investment to upgrade the network, which will allow Sprint (and all
6 carriers) to offer new and enhanced services to customers, depends on the company
7 being able to cover the costs of serving its customers. In a competitive market, all
8 telecom carriers must perform something of a balancing act; they must undertake the
9 capital investment needed to stay competitive and offer innovative products, but they
10 must do so while managing their profitability and maintaining sufficient revenue flow
11 from their current products in a world of decreasing revenues and increasingly tight
12 investor capital. Currently, the ability of carriers to pull off this balancing act is
13 hindered by an implicit-subsidy-based pricing regime that creates an entire subset of the
14 population that must be served but is unprofitable to serve at current prices.

15

16 **Q. But how can raising residential rates benefit Sprint's residential customers?**

17 A. The benefit to Sprint's residential customers will come through increased choices
18 brought about by competition, and enhanced service offerings and innovation that are
19 stimulated by competition. When alternative technologies are forced to compete with
20 subsidized prices—as they are currently—technologies that have genuine efficiency
21 advantages can be kept out of the market. If prices move closer toward actually
22 reflecting costs, all customers will be better served because firms will be able to
23 compete for their business with prices that reflect legitimate differences in costs, not
24 simply differences in cross-subsidization.

25

1 It is true that many residential consumers currently enjoy paying below-cost rates for
2 their telecom services. Most consumers would enjoy paying below-cost based rates for
3 *any* good or service. But these artificially low prices are unsustainable in the face of
4 competition, and they come at a cost: fewer options among services, less innovation,
5 and—in large portions of Sprint’s serving territory —no competitive choices.

6
7 **IV. EFFECTS ON SUBSCRIBERSHIP AND UNIVERSAL SERVICE**

8
9 **Q. In his testimony Sprint witness John Felz concludes that the rebalancing will not**
10 **adversely affect universal service in Florida. As an economist do you agree with**
11 **that conclusion?**

12 **A.** Yes. Economic evidence supports Mr. Felz’ conclusion: The proposed rate re-
13 balancing will not have a negative effect on universal service. Economists who have
14 studied the demand for basic telephone service know that econometric studies have
15 demonstrated that it is income, rather than price, that plays the largest role in a
16 customer’s choice of whether or not to subscribe to basic telephone service. As
17 economist Lester Taylor cited in his seminal 1994 text, “Actually, when all is said and
18 done, the primary factor [affecting access to the public switched network] is really
19 income, or rather its absence.” (Lester Taylor, *Telecommunications Demand in*
20 *Theory and Practice*, Kluwer Academic Publishers, 1994.) Given this fact, the most
21 efficient and effective way to address any potential non-subscription to basic service is
22 through explicit subsidization in cases of low income, such as the state and Federal
23 Lifeline and Link-Up programs, not by artificially suppressing prices for everyone.
24 As Mr. Felz notes, the rates for low-income/Lifeline customers will not increase as a
25 result of the proposed rate rebalancing. Therefore, the select set of customers for

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1 whom a rate increase *might* have an effect on their decision of whether or not to
2 subscribe to the network will be the very customers who will not see an increase.

3
4 One additional point is worth mentioning with regard to universal service. With the
5 amazing growth of wireless service and other technological alternatives, customers
6 now have choices as to *how* they access the public switched network. The Associated
7 Press recently reported that, nationwide, 7.5 million residents have "cut the cord" and
8 now access the public switched network only through their mobile phone.
9 (See www.cnn.com/2003/TECH/08/04). In any market that contains services that act
10 as substitutes for one another, a change in the price of one service will affect the
11 demand for the other. This will be the situation in Florida as well. As the prices of
12 basic wire-line service move closer to their true economic costs, it is possible that
13 some customers will evaluate their need for both a wire-line and wireless phone. In
14 some cases these customers may opt to forgo wire-line access to the public switched
15 network, as millions have already done. It is important that the Commission recognize
16 two facts: First, customers making this choice do not represent any type of universal
17 service concern; these customers remain connected to public switched network, they
18 have simply chosen to utilize a different mechanism. Second, this phenomenon is
19 actually beneficial because markets operate efficiently when consumers make choices
20 based on prices that reflect the underlying costs of services. Markets do not operate
21 efficiently when customers make choices based on prices that misrepresent the
22 underlying costs.

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1 **Q. Is there any concern that, even if the rebalancing has no universal service**
2 **impacts, that customers might experience some level of “rate shock” when they**
3 **are faced with rates that come closer to costs?**

4 **A. Not really. First, as Sprint witness John Felz discusses, Sprint has had experience**
5 **with rate rebalancing in other states and “rate shock” has not been a problem. Nor is**
6 **there any evidence that “rate shock” was a concern when the federal subscriber line**
7 **charge (SLC) increased as a result of the FCC’s CALLS Order. But more importantly,**

earn a reasonable profit in that it is a
and would not engage in pricing plans

8 *Sprint is like every other company that seeks to*
9 *company that wants to hold on to its customers,*
10 *that had the opposite effect.*

11

12 **Q. Does this conclude your testimony?**

13 **A. Yes it does.**

14

15

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EXHIBIT BKS-1

Density and Customer Concentration Data for Sprint, BellSouth and Verizon in Florida
(Source: USAC and BLR)

Access Lines Per Square Mile	
BellSouth	341
Verizon	465
Sprint	94
Average Land Area Per Wire Center (square miles)	
BellSouth	92
Verizon	49
Sprint	211
Access Lines Per Wire Center	
BellSouth	31,424
Verizon	22,664
Sprint	14,307

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EXHIBIT BKS-2

Explanation of Competitive Activity Level

All companies having more than 10,000 access lines file form 477 with the FCC to report the level of competitive activity taking place within their serving territories. According to Sprint's filings, as of December 31, 2002 there were slightly over 55,800 competitive lines (either resold or UNE-based) in its Florida serving area. Because companies do not report pure facilities-based competitive activity it is necessary to estimate the number of facilities-based (or 'CLEC -owned') lines in an area. Using nationwide numbers from the FCC's Local Competition Report we find that, on average, resold and UNE-based lines account for approximately 74% of competitive lines. If we divide Sprint's UNE-based and re-sold lines by this 74%, we can arrive at an estimate of Sprint's total competitive lines. Applying this figure to Sprint's Florida-specific lines, we would estimate that total competitive lines would equal $[55,800 / .74]$ or 75,405.

This figure, 75,405, as a percentage of Sprint's total Florida lines—approximately 2,200,000—equates to $[75,405 / 2,200,000]$ or 3.4%. The reason this figure, 3.4%, is most likely overstated is because, based on the geographic characteristics of Sprint's serving territory it is highly likely that Sprint actually has less pure-facilities-based competitive activity than the national average. This would mean that the 74% used above should actually be a higher percentage, which would (when used as the denominator in line 14 above) produce a smaller number of total competitive lines, and a percentage somewhat less than 3.4%.

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BEFORE THE PUBLIC SERVICE COMMISSION
REBUTTAL TESTIMONY
OF
BRIAN K. STAIHR

I. INTRODUCTION

Q. Please state your name, title and business address.

A. My name is Brian K. Staihr. I am employed by Sprint as Senior Regulatory Economist. My business address is 6450 Sprint Parkway, Overland Park, Kansas 66251.

Q. Are you the same Brian K. Staihr who filed direct testimony in this proceeding on August 27, 2003?

A. Yes I am.

Q. What is the purpose of your rebuttal testimony?

A. In my rebuttal testimony I address one issue raised in the testimony of Mr. Gregory L. Shafer, testifying on behalf of the Commission staff. I also respond to one issue raised in the testimony of Dr. David Gabel, testifying on behalf of the Office of Public Counsel.

II. MR. GREGORY L. SHAFER

Q. In general, does Sprint agree with the arguments contained in Mr. Shafer's testimony?

1 A. Sprint agrees with many of Mr. Shafer's points. For example, on page 9 of his
2 testimony he states that "the improvement in the cost/price relationship for basic local
3 exchange service as reflected in the companies petitions will be a signal to competitors
4 that the potential for profitability is improved" and Sprint agrees with this statement.

5
6 But Sprint disagrees with Mr. Shafer's suggestion that the adjustments to the price for
7 basic local service that have been proposed by Sprint should be implemented over a
8 different timeframe than the adjustments proposed by BellSouth and by Verizon. Mr.
9 Shafer suggests that Sprint should adjust its prices in four steps, rather than three steps
10 (a process that has been proposed by all three companies). And he proposes that these
11 four steps take place over a longer period of time than the period over which
12 BellSouth and Verizon would make their adjustments.

13
14 **Q. What reason does Mr. Shafer provide as to why the adjustments proposed by
15 Sprint should take place over a longer period of time?**

16 A. On page 5 of his testimony he claims that this adjustment will "put Sprint's residential
17 customers more on par with those of BellSouth and Verizon in terms of the amount of
18 the increase they receive at any one time." It appears that Mr. Shafer is concerned
19 with the fact that the magnitude of Sprint's adjustments—while extremely small from
20 the point of view of an average consumer's disposable income—is larger than that of
21 adjustments made by the other companies.

22
23 **Q. Is there an obvious reason why the amount of the adjustment proposed by Sprint
24 should be larger?**

25 A. Yes. As Mr. Shafer himself states on page 4 of his testimony, Sprint's intrastate

1 access charges are higher than those of BellSouth. Therefore, re-balancing what is a
2 relatively higher rate (the access rate) requires a relatively larger adjustment on the
3 other side (the basic local side).

4
5 I believe that Mr. Shafer's suggestion is fueled by an understandable, but - in the
6 context of this legislatively specified process - misplaced concern regarding the
7 concept of "rate shock" on the part of Sprint's customers, because in his testimony he
8 follows his description of the suggested revision to Sprint's proposed adjustments with
9 a discussion of rate shock (Shafer testimony, page 6). While he does not explicitly
10 state in his testimony that he believes the adjustment proposed by Sprint will cause a
11 problem stemming from rate shock, he argues that the Legislature had a desire to
12 "temper rate impacts on consumers." What Mr. Shafer overlooks is that Sprint's
13 proposal already includes a factor that will "temper rate impacts on customers" in the
14 sense that Sprint is including an additional customer benefit of approximately \$1.00 to
15 \$1.25 for customers by including in its proposal a "five free call allowance" on
16 extended calling services (ECS). This additional customer savings has the effect of
17 helping to mitigate any perceived differential between Sprint's proposal and
18 BellSouth's and Verizons' proposals in terms of customer impact.

19
20 **Q. Does Mr. Shafer provide any evidence, analysis, data, or studies to suggest that**
21 **Sprint's proposed adjustments will have a different impact on customers than**
22 **BellSouth's proposed adjustments or Verizon's proposed adjustments?**

23 **A. No.**

24

25

1 Q. Does Mr. Shafer make any reference to any other known example of problems
2 stemming from “rate shock” to use as a benchmark against which to measure
3 Sprint’s proposed adjustment?

4 A. No.

5

6 Q. Are his concerns regarding the possibility of problems stemming from “rate
7 shock” valid?

8 A. Not really. As discussed in my direct testimony and the testimony of Sprint witness
9 John Felz, Sprint has engaged in rate rebalancing in other states and it is our
10 experience that horror stories regarding the effects of “rate shock” are massively
11 exaggerated. We simply have not seen negative effects of re-balancing rates; we have
12 not seen large numbers of customers opting to discontinue service; we have not seen
13 material volumes of complaints filed with state commissions; and we have not seen
14 any evidence to suggest that any customer’s overall quality of life was negatively
15 affected by rate rebalancing.

16

17 Also, it is useful to clarify exactly what we mean by “rate shock.” The fact that a
18 consumer might be faced with a price adjustment that he or she finds disagreeable
19 does not constitute “rate shock.” Obviously all consumers would be happy to never
20 see price increases on the goods and services they buy. And obviously all consumers
21 would love to pay prices that are below cost—as in the case of basic local telephone
22 service in Sprint’s Florida serving territory—for everything they buy. But price
23 adjustments occur throughout any market economy, and prices tend toward cost in a
24 market economy, and the fact that many local service customers have grown
25 accustomed to reaping the benefits of cross-subsidization for years is no reason to

1 attempt to maintain an inefficient, unsustainable pricing mechanism any longer than
2 necessary.

3

4 Finally, when examined in the context of personal income per capita for the state of
5 Florida, the magnitude of the difference between Sprint's proposed adjustment and
6 Verizon's (or BellSouth's) proposed adjustment is simply too miniscule to suggest
7 that Sprint's adjustment would have some effect on consumers that the other firms'
8 adjustments would not have. Using data contained in the direct testimony of Sprint
9 witness John Felz, I find that the difference between Sprint's proposed adjustment and
10 Verizon's proposed adjustment amounts to a difference of 6/100ths of one percent of
11 monthly personal income per capita in Florida. Mr. Shafer offers no explanation or
12 analysis as to why he believes such a miniscule difference makes Sprint's proposed
13 adjustment problematic (in his view).

14

15 **Q. Aside from the fact that Mr. Shafer's concerns are not justified, are there**
16 **additional reasons to reject his proposed change to Sprint's timeline?**

17 **A. Yes, there are two additional reasons.**

18

19 First, as discussed in the direct testimony of Dr. Ken Gordon, one of the key
20 advantages of all three companies acting together is that IXC's will be able to
21 aggregate and coordinate their access cost reductions (Gordon Direct page 16). By
22 placing Sprint on a different timeline than BellSouth and Verizon, the Commission
23 forces the IXC's to adjust the implementation of the reductions unnecessarily.

24

25 But more importantly, also as discussed in Dr. Gordon's testimony, it is important to

1 avoid unnecessary marketplace distortions that could affect the purchase decisions of
2 end-users (Gordon Direct page 15). Mr. Shafer, in suggesting that Sprint extend its
3 timeframe beyond that of BellSouth and Verizon, introduces exactly such a distortion.
4 The result of Mr. Shafer's suggestion would be that Sprint could be perceived as
5 continuing to raise rates long after the other incumbent companies have stopped
6 raising theirs. As Dr. Gordon discusses, the result would be that regulatory
7 scheduling, rather than the relative costs and benefits, could become the driving force
8 behind customer purchase decisions to opt for one provider or another.

9
10 **III. DR. DAVID GABEL**

11
12 **Q. In his testimony Dr. Gabel suggests that the Companies' petitions should not be**
13 **approved because they "have not made a showing that BLTS (basic local**
14 **telephone service) is supported and therefore there is no record to support the**
15 **proposed rebalancing." In your experience has Dr. Gabel taken this position**
16 **before?**

17 **A. Yes. In fact, Dr. Gabel has espoused this position for years. More than a decade ago**
18 **Dr. Gabel's position was that the loop is not a direct cost of basic service but rather is**
19 **a common cost to be allocated across multiple services such as basic service and toll.¹**
20 **The result of such a claim, of course, is that only a portion of loop costs would be**
21 **attributed to the provision of local service, therefore one could claim that the prices**
22 **charged for local service (purportedly) already covered the cost, and that local service**
23 **is not supported.**

¹ See "Pricing of Telecommunications Services" by David Gable and Mark Kennet, *Review of Industrial Organization*, 1993.

1 Many other economists working in telecommunications today disagree with Dr.
2 Gabel's point of view on that subject. Because this issue has been argued extensively
3 for many years, and because innumerable pages of testimony have been filed on this
4 issue with the Florida Commission, the FCC, and undoubtedly every other state
5 commission or board across the country, in the name of efficiency I will not repeat all
6 of arguments here. Instead, I include below a quote from Dr. Alfred Kahn, testifying
7 on this subject before the Pennsylvania Public Utility Commission:

8 "The arguments proffered by these witnesses [that the loop is a shared cost] are
9 the most persistent weeds in the regulatory garden. Other mainstream economists and
10 I have dealt with and debunked these claims for years—and I suppose this will remain
11 our task for as long as parties to proceeding such as this insist on conflating the
12 politics of setting prices with the economics of determining costs."²

13

14 **Q. Is Dr. Gabel making the same argument—that the loop is a shared cost—in his**
15 **testimony in this proceeding?**

16 **A.** It is a variation on that theme. In this proceeding Dr. Gabel does not argue for
17 allocating loop costs to services such as toll. Rather, he suggests that there are other
18 services that fall within the category of basic local telephone service and certain costs
19 associated with the loop should be considered shared costs among these services when
20 calculating TSLRIC (Gabel page 29.) Sprint witness Kent Dickerson responds to Dr.
21 Gabel's arguments in his rebuttal testimony and explains that, using Dr. Gabel's own
22 approach to TSLRIC (as put forth in a 1996 white paper) it is still a fact that basic
23 local service is supported.

² Rebuttal testimony of Dr. Alfred Kahn before the Pennsylvania Public Utility Commission, Docket No. I-940035, February 15, 1996.

1 Q. Is Dr. Gabel's contention—that basic local service is not supported—consistent
2 with the FCC's views on the subject?

3 A. Not at all. As Mr. Dickerson correctly points out, when the FCC calculates the cost of
4 basic local service for purposes of universal service support it includes the cost of the
5 entire loop in its cost calculation (Dickerson page 10). And the FCC has explicitly
6 stated that access charges contain implicit subsidies that have permitted carriers to
7 charge below-cost prices, particularly in high-cost areas (CALLS Order paragraph 24).
8 Of course, as I indicated in my direct testimony (and as Dr. Gabel cites) the loops
9 accounts for the majority of the costs of basic local service in high-cost areas. So the
10 cost of the loop is the thing that, in essence, determines that a high-cost area is in fact
11 a high-cost area. And according to the FCC, access charges are the things that have
12 kept prices below cost in those areas. So clearly, according to the FCC, basic local
13 service is being supported and access charges are the thing doing the supporting.

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15 Q. Does this conclude your testimony?

16 A. Yes, it does.

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