STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Proceeding to examine Issues Related to a Universal Service Fund

Case No. 09-M-0527

PUBLIC

EVIDENTIARY HEARING

Monday, February 14, 2011
10:10 a.m.
NYS Public Service Commission
Three Empire State Plaza, 19th Fl.
Albany, New York 12223

BEFORE: HOWARD A. JACK, ALJ

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(Prior to the commencement of the proceedings, Exhibits 1-86 were marked for identification.)

ALJ JACK: On the record. Good morning. I call case 09-M-0527, Universal Service Fund. This is Phase II, and this phase of the case focuses on issues related to the need for and, if needed, the features, characteristics and conditions pertinent to a long term, State Universal Service High Cost Fund to ensure availability of affordable local, residential, basic telephone service.

I'm Administrative Law Judge Howard Jack. Today we here to conduct an evidentiary hearing to receive testimony on the issues raised and to conduct questioning of the witnesses. The date for this evidentiary hearing was set out in a ruling issued on November 18, 2010 and notice issued on January 28, 2011.

To help ensure a clean record, as well as for the convenience of all present here in this room, please use a microphone when speaking for the record. In addition, it will be very helpful if you will state your name each time as you begin to speak, so that will help the reporter immensely.

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I would like to begin by taking appearances now. Please speak slowly and clearly into a microphone and spell your last name for the benefit of the reporter. If you have a business card with you, it would also be helpful if you would leave one with the reporter.

Shall we start with staff?

MS. MCCAULEY: Maureen McCauley, staff counsel for the Department of Public Service.

ALJ JACK: Why don't we just go around the table.

MS. BURGESS: Mary Burgess for AT&T Communications of New York, Inc.

MR. SCHIFMAN: Good morning, Your Honor, Ken Schifman, S-C-H-I-F-M-A-N, for Sprint Nextel Corporation.

MS. THOMAS: Good morning. Michele Thomas, T-H-O-M-A-S, on behalf of T-Mobile Northeast, LLC.

MR. ARFAA: Good morning. Chris Arfaa, A-R-F-, as in Frank, -A-A, also on behalf of T-Mobile, LLC, also Southwest Partnership doing business as Verizon Wireless.

MR. FITZGERALD: The law firm of Dewey and LeBoeuf, LLP, by Brian T. FitzGerald on behalf

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of tw telecom of new york, lp; Paetec Communications, Inc.; Level 3 Communications, LLC.

MR. MOORMAN: Thomas J. Moorman with the law firm of Woods and Aitken, LLP, on behalf of the NYSTA Smaller ILECs.

MR. OVERCASH: James Overcash, O-V-E-R-C-A-S-H, on behalf of NYSTA Smaller ILECs.

MR. RIGBERG: Saul Rigberg, R-I-G-B-E-R-G, for the New York State Consumer Protection Board.

MS. HELMER: Maureen Helmer, H-E-L-M-E-R, of Hiscock and Barclay, for the Cable Telecommunications Association of New York.

MR. HANIFIN: Christopher Hanifin, H-A-N-I-F-I-N, also of Hiscock and Barclay, LLP, for CTANY.

MR. POST: Joseph Post, Verizon New York, Inc., representing Verizon New York, Inc.

MR. CLEMONS: Keefe Clemons. Keefe is spelled K-E-E-F-E C-L-E-M-O-N-S, for Verizon New York, Inc.

ALJ JACK: Is that everybody? Do we have anyone who wasn't able to fit at the table? All right, thank you.

In accord with the active parties'

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agreement on the order in which to take up their witnesses and panels, is AT&T ready to proceed with its witness? Oh no, wait a minute. No, I have NYSTA is up first. Is NYSTA prepared with its witnesses?

MR. OVERCASH: Your Honor, we are prepared for our witnesses. If you want to take up the matter too, we've got witnesses that we are not going to cross. We've been asked this morning by one counsel to announce that on the record so that their witness could not be required to attend, if that was Your Honor's decision.

ALJ JACK: Yes, let's get that on the record right now, and that was Rochelle Jones; was that the witness you're referring to?

MR. OVERCASH: Correct, your Honor.

ALJ JACK: And now we talked earlier off the record about reserving Exhibit No. 87 for the direct and rebuttal testimony and affidavit of David Conn who is testifying on behalf of -- try to keep everything straight here.

MR. OVERCASH: He's on behalf of T-Mobile, your Honor.

ALJ JACK: Yes, T-Mobile. And now we'll reserve Exhibit No. 88 for the direct and

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rebuttal testimony of Rochelle Jones and the affidavit that accompanies it.

All right, then are we ready to bring up the panel for the NYSTA Smaller ILECs?

MR. RIGBERG: Your Honor, I understand there will be no cross of CPB's witness, Gregg Collar, so I have an affidavit prepared, so if we can mark that for identification, I guess, as Exhibit 89?

ALJ JACK: Exhibit 89 then, for identification, will be the direct and rebuttal testimony of Gregg Collar and accompanying affidavit.

(Exhibit 89 was marked for identification.)

MR. HANIFIN: Your Honor, this is Chris Hanifin from the Cable Telecommunication Association of New York, CTANY. We had circulated yesterday two exhibits that we were looking to use for cross-examination. We would like, since we're continuing --

ALJ JACK: Why don't we take --

MR. HANIFIN: -- the administrative matters, do you want us to mark --

ALJ JACK: No. I think we'll wait and mark those for identification when you come to the

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point of using them in your cross-examination.

MR. HANIFIN: Thank you, Your Honor.

MR. OVERCASH: Your Honor, I have a couple more matters. This is James Overcash, NYSTA Smaller ILECs. We had a couple of other witnesses that we were not expected to ask any cross on. If there are other parties that may ask cross, we want to just, at least, put those names on the record. If everyone wanted to waive, they could, I suppose, at this time. We have not talked to everyone. The first would be the witness for CTANY, Richard Ansaldo. We're not going to have cross for them. CPB had also requested cross. I don't know if you're waiving on him or not.

MR. RIGBERG: Yeah, the CPB, we would waive on the cross of Mr. Anseldo as well.

ALJ JACK: All right, but I do see Mr. Anseldo is here today, so I don't know. Maybe we should take him up early so that he won't have to come back or sit around and maybe come back tomorrow, but we'll look at that a little later in the day. We'll see how things go and then see if we can avoid having Mr. Anseldo having to return again tomorrow.

MR. RIGBERG: Thank you, your Honor.

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ALJ JACK: Thank you. This is all very helpful.

Do we have anything else then that the parties want to --

MS. HELMER: Judge, this is Maureen Helmer again.

ALJ JACK: Yes.

MS. HELMER: If we're going to do Mr. Anseldo earlier, then I would suggest that the exhibits that Chris had just suggested we do now, we do when Mr. Anseldo is sworn in so that he can sponsor those exhibits so that if there are any questions about them.

ALJ JACK: That will be fine. Let's go off the record.

(Discussion was held off the record.)

ALJ JACK: Back on the record. So we will address those additional cross-examination exhibits of CTANY -- that's C-T-A-N-Y -- when we get to the witnesses they wish to use them in cross examination. And don't ask me about my grammar there.

Are we ready with the NYSTA Smaller ILECs panel?

MR. MOORMAN: Tom Moorman. Yes, Your

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Honor.

ALJ JACK: Proceed please. Would you please state your full names for the reporter. Please spell them for her advantage too?

MR. WATKINS: Steven E. Watkins, S-T-E-V-E-N, E. Watkins, W-A-T-K-I-N-S.

MR. SCHWENZFEIER: Kevin Schwenzfeier, S-C-H-W-E-N-Z-F-E-I-E-R.

ALJ JACK: Could you please stand. Raise your right hand.

S T E V E N E. W A T K I N S,

K E V I N S C H W E N Z F E I E R,

having been first duly sworn by the ALJ, was examined and testified as follows:

ALJ JACK: Thank you. Mr. Moorman.

MR. MOORMAN: Thank you, Your Honor.

Tom Moorman, counsel for NYSTA Smaller ILECs.

DIRECT-EXAMINATION

BY MR. MOORMAN:

Q Mr. Watkins, could you please give us your employer and business address?

A Yes. My business address is 2154 Wisconsin Avenue, Northwest, Washington, D.C., Suite 290, zip code 20007. I'm a self-employed consultant, telecommunications management consultant.

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Q Mr. Schwenzfeier, would you give us your business address and your employer?
A Yes, I'm employed by ACM, Inc., with a business address at 120 Erie Boulevard, Schenectady, New York 12305.
Q Mr. Watkins and Mr. Schwenzfeier, are you here today on behalf of a party to this proceeding?
A (Panel) Yes.
Q And that party is?
A (Steve Watkins) The NYSTA Smaller ILECs.
Q Did you have cause to file corrected direct testimony, rebuttal testimony, in this case 09-M-0527?
A (Steve Watkins) Yes.
Q Do you have in front of you the corrected testimony?
A (Kevin Schwenzfeier) Yes, we do.
Q And are these the copies of the corrected direct and rebuttal testimonies that you have had filed in this proceeding?
A (Steve Watkins) Yes.
Q With respect to that testimony, did that also include 26 exhibits, 17 exhibits and your direct testimony and an additional nine exhibits in your rebuttal testimony?
A (Steve Watkins) That sounds correct.

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Q Do you have any additional corrections to any of those testimonies?
A (Kevin Schwenzfeier) Yes, we have one minor correction to our rebuttal testimony.
Q Please continue.
A (Kevin Schwenzfeier) The correction would be at page 83, line 12, the words "not necessarily" would need to be inserted between the words "would" and "be" so that the sentence would begin "Those cost-cutting efforts would not necessarily be fully recognized."
Q Subject to that additional correction, if I were to ask you the questions as set forth in your prefiled direct testimony and rebuttal testimony, would your answers be the same as set forth in those prefiled testimonies?
A (Panel) Yes.

MR. MOORMAN: Your Honor, I move for introduction into evidence the direct and rebuttal testimony according to the list of prefiled exhibits, Exhibit No. 5 through Exhibit No. 30, into the record as evidence in this proceeding.

ALJ JACK: I think we'll grant your motion with respect to admission of the direct and rebuttal testimony at this point. At this point, we're going to hold off on entering any of the exhibits into evidence, but they are marked for

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identification as Exhibits 5 through 30.

(Testimony inserted as ordered.)

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Proceeding to Examine Issues Related to a Universal Service Fund — **Case 09-M-0527**

DIRECT TESTIMONY

of

STEVEN E. WATKINS
&
KEVIN F. SCHWENZFEIER

on behalf of the

NEW YORK STATE TELECOMMUNICATIONS ASSOCIATION, INC.
SMALLER ILEC MEMBER GROUP
(THE "NYSTA Smaller ILECs")

December 31, 2010 (with modifications served on February 11, 2011, see Page 103)

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	a. Whether the need, or lack of need, for such a fund or program can, as a practical matter, be determined (i) on a generic basis; or (ii) only on a case-by-case basis, considering a particular carrier's service area or a discrete portion of its service area and the particular circumstances of the carrier, service area, or portion of service area.	
	b. (i) The purposes the fund or program, if any, would serve; (ii) what alternatives might be available to fulfill those purposes and meet the claimed need; and (iii) the relative merits and drawbacks of such a fund or program compared with those of the available alternatives.	

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3. Should a benchmark rate (or other benchmark be established? If so, at what level (e.g., for a benchmark rate, the comparable Verizon rate, some percentage above or below the Verizon rate some other method)? **94**

DIRECT TESTIMONY OF STEVEN E. WATKINS & KEVIN SCHWENZFEIER ON BEHALF OF THE NYSTA SMALLER ILEC MEMBER GROUP
December 31, 2010

I. INTRODUCTION

Q. Please state the name, business address, and telephone number of the witnesses.

A. Steven E. Watkins and my business address is 2154 Wisconsin Avenue, N.W., Suite 290, Washington, D.C., 20007, and business phone number of (202) 333-5276. Kevin F. Schwenzfeier and my business address at 120 Erie Boulevard, Schenectady, New York, 12305, and business phone number of (518) 374-2552.

Q. Have the witnesses prepared and attached further information regarding their background and experience?

A. Yes, this information is included as Exhibit __ (NYSTA-1) and Exhibit __ (NYSTA- 2**)** to this testimony.

Q. On whose behalf are the witnesses testifying?

A. The witnesses are testifying on behalf of New York State Telephone Association, Inc. ("NYSTA") Smaller Incumbent Local Exchange Carrier member group to be referred to herein collectively as the "NYSTA Smaller ILECs" or individually as a "NYSTA Smaller ILEC." This group is comprised of 31 rural local exchange carriers. Each NYSTA Smaller ILEC is an incumbent local exchange carrier ("ILEC") and a Rural Telephone Company as those terms are defined in the 1996 revisions to the Communications Act of 1934, as amended (the "Federal Act").

Q. Who are the member companies included within the NYSTA Smaller ILECs?

A, The following companies make up the NYSTA Smaller ILECs group: Armstrong Telephone Company – NY, Berkshire Telephone Corporation, Cassadaga Telephone Corporation, Champlain Telephone Company, Chautauqua & Erie Telephone Company, Chazy & Westport Telephone Corporation, Citizens Telephone Company of Hammond, New York, Inc., Crown Point Telephone Corporation, Delhi Telephone Company, Deposit Telephone Company, Dunkirk & Fredonia Telephone Company, Edwards Telephone Company, Empire Telephone Corporation, Fishers Island Telephone Corporation, Germantown Telephone Company, Inc., Hancock Telephone Company, Margaretville Telephone Company, Middleburgh Telephone Company, Newport Telephone Company, Nicholville Telephone Company, Oneida County Rural Telephone Company, Ontario Telephone Company, Inc., Oriskany Falls Telephone Company, Pattersonville Telephone Company, Port Byron Telephone Company, State Telephone Company, Taconic Telephone Company, Township Telephone Company, Trumansburg Telephone Company, Vernon Telephone Company, and Warwick Valley Telephone Company. Although previously noted as a member of the NYSTA Smaller ILECs, Windstream New York, Inc. is not joining in this testimony.

Q. Are you sponsoring any exhibits associated with your testimony other than

that noted above?

A. Yes, we are also sponsoring Exhibit __ (NYSTA-3) through Exhibit __ (NYSTA-17). Exhibit __ (NYSTA-3) is a copy of a March 3, 2010 memorandum issued by the New York Public Service Commission ("Commission") in Case 09-C-0361. Exhibit __ (NYSTA-4) is a copy of the National Regulatory Research Institute paper dated January 19, 2010 entitled "State High Cost Funds: Purposes, Design and Evaluation"; Exhibit __ (NYSTA-5) are responses of Verizon Wireless to the NYSTA Smaller ILEC Information Requests ("IRs") issued in this proceeding; Exhibit __ (NYSTA-6) is an analysis of calling packages derived from company websites and responses to various IRs issued in this proceeding; Exhibit __ (NYSTA-7) is a copy of certain responses from T-Mobile to IRs issued by the NYSTA Smaller ILECs in this case; Exhibit __ (NYSTA-8) is a copy of certain responses from AT&T Communications of New York, Inc. to IRs issued by the NYSTA Smaller ILECs in this case; Exhibit __ (NYSTA-9) is a copy of certain responses from Sprint to IRs issued by the NYSTA Smaller ILECs in this case; Exhibit __ (NYSTA-10) is a copy of certain responses from Time Warner Cable, Inc. to IRs issued by the NYSTA Smaller ILECs in this case; Exhibit __ (NYSTA-11) is a copy of a response from Cablevision Systems Corporation to IRs issued by the NYSTA Smaller ILECs in this case; Exhibit __ (NYSTA-12) is a copy of certain franchise agreements provided by Time Warner Cable, Inc. and Commission Staff in response to IRs issued by the NYSTA Smaller ILECs in this

case; Exhibit __ (NYSTA-14) is a copy of comments of the Commission filed with the Federal Communications Commission ("FCC") in WC Docket No. 06-122 on September 9, 2009; Exhibit __ (NYSTA-16) is a copy of the supplement response by Staff to an IR issued by the NYSTA Smaller ILECs in this case; and Exhibit __ (NYSTA-17) is a copy of a recent advertisement from Verizon New York, Inc. regarding a service package. We note that two of the Exhibits -- Exhibit __ (NYSTA-13) and Exhibit __ (NYSTA-15) -- are filed pursuant the terms of the December 11, 2009 protective order in this proceeding and, respectively, address coverage area issues and sizing of the State Universal Service Fund ("SUSF").

Q. Can you provide a general summary of your testimony?

A. Yes. For all of the reasons stated herein, the NYSTA Smaller ILECs are requesting that the Commission, in this proceeding, establish a SUSF that provides the basis for the continued deployment, operation, and maintenance of networks in the rural areas of the State of New York operated by the NYSTA Smaller ILECs. The NYSTA Smaller ILECs are common carriers that agree to commit to the principles of universal service and to Commission jurisdiction and oversight with respect to their operations and funding levels. Through this commitment by the subject common carriers, the Commission would ensure that the size of the SUSF that addresses the issues in this Phase II of this proceeding is subject to a Commission-determination of the actual cost of such deployment,

operation, and maintenance of such rural networks, while ensuring the availability of at least one network within all of the NYSTA Smaller ILECs' rural service areas to serve all end users.

Likewise and for all of the reasons stated herein, the NYSTA Smaller ILECs submit that the need and justification for the SUSF is amply demonstrated. Three of the NYSTA Smaller ILECs have already been shown, through the rate case process, to require external funding disbursements through the Transition Fund and the financial records of the Commission demonstrate that the NYSTA Smaller ILECs are financially not earning their respective and necessary Return on Equity ("ROE") that have sustained the state-of-the-art networks over which universally available local services at affordable and comparable rates has been achieved. A SUSF is needed to ensure that today's level of universal service is maintained on a going-forward basis.

At the same time, the Commission's oversight is critical to maintaining and advancing the Commission's universal service policies. In light of the cost and operating challenges of providing service to less densely populated areas, there needs to be a universal service provider that is obligated to respond to Commission policies and requirements as well as Commission inquiries. Only then can there be assurance that the hallmarks of a rational universal service policy for rural areas of the State of New York is achieved – high quality local service at affordable and comparable rates throughout a service territory.

Commission oversight provides assurance that no regression of universal service within the rural areas will occur, and, at the same time, affords the opportunity for the Commission to continue to realize its universal service public policy goals.

In a manner fully consistent with the existing rules and regulations of the Commission and FCC, the SUSF proposal contained herein anticipates a dynamic and evolving SUSF program for the costs of providing local service that are not recovered through Commission-prescribed intrastate regulated rates. If Commission-prescribed rates do not generate sufficient revenue to provide a reasonable opportunity to recover the cost of service and a return on investment, the SUSF will be an available option for universal service to continue to be available at reasonable and comparable rates.

The commitments made and obligations undertaken by the NYSTA Smaller ILECs are for the entire certificated service area they serve and the deployment of a network throughout that service area. The Commission's decision implementing the current Transition Fund recognized this fact as the recovery contemplated by that fund was for the overall recovery shortfall that would be experienced by an eligible NYSTA Smaller ILEC based on the network it deployed, operated, and maintained. *See generally Order Adopting Comprehensive Plan,* Case 02-C-0595, issued and effective December 23, 2003. While parties' positions may differ, the NYSTA Smaller ILECs fully expect that, arising from the Commission decision establishing the Transition Fund, the

Commission understood the need for an on-going recovery mechanism being available where Commission-prescribed intrastate regulated rates were insufficient to recover the cost of deploying, operating and maintaining a network. Thus, the NYSTA Smaller ILECs believe that the Transition Fund needs to "transition" to something and that "something" is the SUSF as described herein.

II. PURPOSE OF THIS TESTIMONY

Q. What is the purpose of this Direct Testimony?

A. The purpose of this testimony is to set forth the policy basis for the establishment of a long-term SUSF in the State of New York in the form proposed by the NYSTA Smaller ILECs (to be referred as the "SUSF Plan" or just the "Plan"). This testimony will specifically respond to the Phase II issues set forth in the *Ruling on Phase II Procedures* issued by Administrative Law Judge Jack on November 18, 2010 in this proceeding. This testimony will address the important universal service policy objectives to be served by the Plan as well as potential counter productive approaches which the NYSTA Smaller ILECs believe should be avoided. This testimony will demonstrate that there is a need to establish a SUSF to ensure reliable telecommunications networks and universal availability of affordable telecommunications service in New York to succeed the Transition Fund established by the Commission in December, 2003 in Case 02-C-0595, as well as the appropriateness of establishing an appropriate benchmark local service rate applicable to the SUSF proposal as described herein.

Q. How will this Direct Testimony be organized?

A. An overview of national and New York specific universal service policies will be discussed in Section III. In Section IV, a summary of the NYSTA Smaller ILECs' Plan for a permanent SUSF is presented. In Section V, this testimony will address the specific issues in the context of the Phase II issues in the *Ruling on Phase II Procedures*.

Q. Is the NYSTA Smaller ILECs' Plan intended to address all potential policy changes in the industry in the next several years?

A: No. As a practical matter, that would not be possible. Instead, the NYSTA Smaller ILECs' Plan is intended to address a specific and focused set of needs consistent with the current operation and intent of the Transition Fund. These needs are demonstrated and addressed in Section V of this testimony. The needs and Plan represent an extension of the purposes of the current Transition Fund, and those purposes include the ongoing, immediate need for funding for universal service providers where affordable and comparable rates would not yield sufficient cost recovery as those concepts are defined today.

However, the NYSTA Smaller ILECs recognize that there are a number of possible changes in the industry that could result from the FCC's current deliberations concerning the National Broadband Plan, the Federal Universal Service Fund, intercarrier compensation, and other policy matters which this Plan does not and is not intended to address. Accordingly, the NYSTA Smaller

ILECs positions expressed herein are confined solely to this focused SUSF Plan and should not be construed to reflect on other possible changes in the industry or to prejudice any position the parties may have on future issues. It is not our intention herein to provide analysis or policy discussion about what could only be speculation about the future. Yet, at the same time, the SUSF structure proposed herein is sufficiently dynamic to allow the Commission to address future needs.

Q. What possible changes in the industry are you referencing?

A. The FCC has a series of proceedings that have been started or will be begin shortly. These proceedings involve issues regarding changes in the Federal Universal Service Fund ("FUSF") as well as an anticipated set of issues regarding intercarrier compensation. As a result, it is only prudent that the potential for policy changes in federal programs be anticipated for accommodation in the future into any SUSF proposal that the Commission considers.

Q. Can you describe some of the policy changes that are being considered?

A. At the federal level, these potential policy changes include, by way of example, a universal service policy approach focusing more on broadband services networks, potential alternate methods of determining costs, alternative methods for the distribution of funding to carriers, and other novel approaches not utilized today. Of course, it remains to be seen if, when and the degree to which these potential changes deviate from current universal service policies.

Q. Given the unanswered policy variables about the future, would it make more sense to delay decisions on a SUSF for state purposes?

A. Absolutely not. The current needs with respect to the establishment of a SUSF as discussed later are real. Carriers are currently experiencing under-recovery stresses that need to be addressed now and cannot await other more dramatic changes that may, or may not, occur.

III. OVERVIEW OF UNIVERSAL SERVICE POLICIES.

A. NATIONAL EXPERIENCE

Q. What is universal service?

A. It is a social and economic goal for our nation to ensure, to the greatest extent possible, ubiquitous local exchange telecommunications service to all citizens regardless of location, usage, or the cost of networks required to serve those individuals. Over the last century, telecommunications policies on both the state and federal level have been designed to achieve this objective. Furthermore, these policies as applied in the federal jurisdiction envision that rates for such ubiquitous services should be affordable and reasonably comparable across the nation. Moreover, and most important, these policies have, in practice, fostered a regulatory plan under which network providers' cost recovery (and in this case, the intrastate jurisdictional costs) is structured across the revenues to be derived from the available intrastate regulated service offerings in a manner such that the price for local exchange services has been established and held to comparable and

affordable levels. This, in turn, has led to a network with high levels of service penetration that provides a communication system for individuals, businesses and emergency services – universal service – as well as a network for other carriers to use for their competitive service offerings. With respect to the latter, we note that wireless carriers depend on the NYSTA Smaller ILECs' wireline networks to provide wireless services in the rural areas that the wireless carriers serve. Generally, the only portion of the wireless carrier's network that is wireless is the transmission between the tower antenna and the customer's wireless service phone. In fact, the wireless carriers are customers of the NYSTA Smaller ILECs and obtain "backhaul" circuits that allow connections between their tower site locations and switches.

Q. What are the policies and regulatory programs that have served these goals?

A. These policies developed originally through the jurisdictional cost separations rules under which carriers like the NYSTA Smaller ILECs' separate their operations and costs between the interstate and intrastate jurisdictions. The costs allocated to the interstate jurisdiction under this process have been recovered from interstate services, which, for the most part, are long distance-related services (*i.e.*, interexchange services). The general concepts under which costs are allocated to, and consequently cost recovery is obtained from, interstate interexchange services were also applied within the States to separate costs between local service and intrastate interexchange services. The combination of

these processes resulted in a concerted policy effort to recover costs from interexchange services in a manner so as to maintain local service rates at the most affordable levels to maximize local service subscribership.

These policies also allowed and encouraged carriers to commit capital to invest in networks and provide service offerings in the higher cost and otherwise challenging areas of the nation because the policies and practices provided a predictable and reasonable opportunity to recover network costs. To make a long story short, it was the adoption of these cost recovery policies and practices that led historically to the provision of service in those rural areas not served by the much larger carriers.

Q. How have these cost recovery mechanisms evolved in more recent years?

A. In the early 1980s, together with the break-up of the Bell system, interexchange service cost allocations, within the federal jurisdiction, were transformed to the access charge process. Local exchange carriers recovered these access-related costs from interexchange carriers through the application of access charges, and interexchange carriers recovered those costs, in turn, from their long distance service users. A similar set of issues were addressed by the Commission in its Case 28425 which lead to the establishment of intrastate access services similar to those provided in the interstate jurisdiction.

Over the last two decades, in the federal jurisdiction, some of this cost recovery responsibility has been gradually shifted from the interexchange services

sources to explicitly identified FUSF sources. Potential reallocation of cost recovery from different sources remains an issue under review by both federal and state policymakers today.

Q. What are the explicit programs to which the cost recovery was transferred?

A. The recovery of loop-related plant costs (*i.e.*, local distribution plant) in areas with lower density of customers and higher than average loop costs was addressed by the adoption by the FCC of an explicit program generally referred to as the High Cost Loop ("HCL") plan. The recovery of switching-related costs of carriers operating smaller switches, where the cost per unit of switching is higher, was first addressed through jurisdictional allocation factors (so called "DEM weighting"). This additional cost recovery was eventually transferred to an explicit Local Switching Support ("LSS") plan. Finally, common line costs previously recovered from interexchange services via the common line access charge (still yet another portion of loop cost recovery) were transferred by the FCC, during a transition for some carriers, to a new Interstate Common Line Support ("ICLS") plan.

As a general matter, all of these FUSF programs (except ICLS) were designed to address cost recovery of networks where costs were higher than average. Again, these cost recovery policies were designed in part to ensure that the intrastate costs remaining to be recovered from end users for local services are kept at a level to ensure comparable and affordable basic rates by, in some

instances, allocating more costs from the intrastate jurisdiction to the interstate jurisdiction and recovering those costs through the explicit FUSF programs just discussed.

Q. Are there any common themes to observe here?

A. Yes. These cost allocation and recovery policies were, in all cases, designed to address the cost recovery challenges of network providers committing to serve higher cost, less dense service areas. In return for committing to invest in, maintain and operate network facilities to serve these higher cost areas, the cost allocation and recovery policies provided the carrier a reasonable opportunity and expectation of recovery of their costs. Secondly, after all cost recovery obtained through access charges and explicit FUSF sources has been applied, the remaining costs to be recovered in the intrastate jurisdiction, primarily through local service rates, are maintained at reasonable levels. In a very successful way, the plan led to the development and maintenance of ubiquitous telecommunications networks with reasonably comparable and affordable local service rates. In applying these policies, and particularly for the types of carriers such as those that generally comprise the NYSTA Smaller ILEC group, the cost allocation and recovery methods have been applied to the recovery of actual recorded costs using uniform accounting practices.

Q. What is the meaning of the distinction that costs are determined based upon uniform accounting practices?

A. This is intended to distinguish the methods that apply to the generally smaller and more rural ILECs (the recording of actual costs as reflected through the use of the Part 32 Uniform System of Accounts) from mathematical models of costs applied to the very large ILECs. Currently, for federal USF purposes for rural companies, high cost support is determined according to financial accounting results. That is the same approach that should be applied here under the SUSF Plan as proposed herein for Phase II of this proceeding.

Q. But what about mathematical cost models?

A. The federal policymakers have almost two decade's long experience in attempts to use mathematical models of costs. To date, those attempts have not been successful for application to the generally smaller and more rural ILECs. The FCC, in conjunction with an assembled Rural Task Force, has recognized several times that models of costs would be used for smaller, rural ILECs if and only if validation is obtained that the results are accurate and would serve the objectives of universal service sufficiently. To date, it remains the decision of the FCC not to use models for the smaller ILECs. In our view and that of many others in the industry, the ability of a mathematical model to reflect all of the variables of cost and to predict accurately all cost characteristics of smaller and more rural ILECs remains questionable.

Q. Why is it difficult to use cost models to estimate costs of smaller and more rural ILECs?

A. It is difficult to choose a set of easily obtainable, publicly available variables that can be input into a mathematical model to predict costs for what are a diverse set of network characteristics and service areas. The number of variables actually considered by engineers in designing and constructing a network is large and beyond the scope of simple formulas that utilize only a limited number of variable inputs. Models undeniably result in the use of shortcuts that deviate from actual network design. While the inaccuracies may be tolerable when applied across a very large LEC, where errors in one area offset errors in another or are masked when averaged across a very large operation, that is the not the case when applied to the wide variety of smaller ILECs. As a result, serious questions remain regarding the potential efficacy of any model for application to networks of smaller, more rural ILECs. As such, modeling should also be avoided here. In any event, academic theory and designer's assumptions as used in models should not become the enemies of the real outcome that is necessary to address the universal service goals.

Q. Has the FCC attempted to use modeling of costs for other purposes in recent times?

A. Yes. In the context of the recent activity on the Connect America Fund examination of broadband network costs, the FCC has attempted to use a modeling process. However, in comments with the FCC and analysis provided in comments, the accuracy of the modeling process for that purpose has been met

with significant skepticism and criticism, particularly when applied to the areas served by rural telephone companies.

Q. What are the principles and policy goals that Congress adopted to serve our universal service policy and network cost recovery?

A. The goals for universal service are embodied in the list of principles that Congress adopted with the Telecommunications Act of 1996 (which were the 1996 revisions to the Federal Act). The most relevant principles for purpose here are:

> (1) Quality and rates -- Quality services should be available at just, reasonable, and affordable rates.
>
> (2) Access to advanced services -- Access to advanced telecommunications and information services should be provided in all regions of the Nation.
>
> (3) Access in rural and high cost areas -- Consumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high cost areas, should have access to telecommunications and information services, including interexchange services and advanced telecommunications and information services, that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas.
>
> (4) Equitable and nondiscriminatory contributions -- All providers of telecommunications services should make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service.
>
> (5) Specific and predictable support mechanisms -- There should be specific, predictable, and sufficient Federal and State mechanisms to preserve and advance universal service.

Q. What guidance should one take from these federal statutory provisions?

A. The statutory objectives include support for ubiquitous telecommunications networks that provide advanced services that are made available to all consumers in higher cost, and lower density areas on a comparable basis to that which is available to consumers in lower cost areas, and provided at reasonable rates comparable to those that apply in the lower cost areas. The rate criterion includes both the principles of affordability and comparability. The advanced services criterion anticipates an evolving set of modern services. Additionally, the federal policy indicates that there should be both federal and state plans to support these goals, and such plans should be constructed to be specific, predictable, and sufficient to achieve the objectives. While these are somewhat generalized principles, they are completely consistent with the objectives of the NYSTA Smaller ILECs' Plan.

B. NEW YORK STATE UNIVERSAL SERVICE POLICIES

Q. What is the general regulatory framework under which the NYSTA Smaller ILECs operate?

A. The NYSTA Smaller ILECs have been and are regulated by the Commission as "rate of return" carriers. This means that for purposes of assessing a company's earnings and determining a need for a local rate increase, an intrastate revenue requirement computation is performed. The intrastate revenue requirement is equal to a company's regulated intrastate operating expenses and taxes (as adjusted by Staff and approved by the Commission), plus a fair *rate of return* on

investment. The rate of return includes a component that is set to recover a company's cost of debt, as well as a Commission-established and authorized intrastate return on equity component. Local rates increases are authorized by the Commission to provide the company an opportunity to recover its intrastate revenue requirement. This rate-of-return regulatory treatment is described in more detail later in this testimony. In instances where the resulting local rate would exceed the previously-considered benchmark rate, the Commission has limited that local rate increase to the benchmark rate. The current Transition Fund has, to date, been utilized to provide the necessary additional revenue for three carriers to recover revenue requirement shortfalls that they would otherwise have experienced.

As discussed further below, in a manner consistent with the Commission's existing rate of return, rate case and Transition Fund processes, the proposed SUSF has been designed as a rate of return, cost-based fund. Funding needs are determined based on any computed intrastate revenue requirement shortfalls (Commission-approved intrastate costs that are unable to be recovered through the proposed SUSF local Benchmark Rate discussed herein).

Q. From a practical perspective, how have the NYSTA Smaller ILECs operated under this rate of return framework?

A. The NYSTA Smaller ILECs have until recent times operated under a regulatory framework where they were generally the sole facilities-based wireline provider

in their service area. As part of their opportunity to recover their expenses and earn a reasonable rate of return on their investment, they commit, from a practical perspective, to be the Carrier of Last Resort ("COLR") within their entire certificated service area and thus are expected to provide affordable and reliable service to all subscribers within the service area upon reasonable request.

Q. What does this COLR obligations require the NYSTA Smaller ILECs to do?

A. To meet this COLR obligation, the NYSTA Smaller ILECs engineer, build, and maintain their networks based on anticipated demand of *all* potential users in their service area, including the deployment of a network with the necessary amount of switching capacity and plant facilities to assure the ability to provide service to all within a reasonable period following a request.

The NYSTA Smaller ILECs serve proportionately more rural, less densely populated areas (small towns and surrounding areas) than do the largest ILECs. These areas tend to be characterized by higher per-unit network costs, lower customer density, and relatively lower volumes of usage. These characteristics arise as a result of the demographics of their service areas in which their networks are concentrated.

Q. What have been the general results of the NSYTA Smaller ILECs meeting their COLR obligations?

A. As a general matter, the service areas of the NYSTA Smaller ILECs were those that, historically, the larger AT&T system did not want to serve. Over many

decades, the NYSTA Smaller ILECs have brought quality telecommunications services to their small town and rural areas despite the associated challenges of serving these lower density areas. Additionally, as discussed later in this testimony and as the attached exhibit demonstrates, the Commission has recognized that the NYSTA Smaller ILECs have generally *exceeded* Commission-established quality of service objectives. *See* Exhibit __ (NYSTA-3).

Supporting the challenges of deploying, maintaining and operating quality networks in the rural areas served by the NYSTA Smaller ILECs has been a recognized objective of regulatory policies at both the federal and state levels. These regulatory policies have allowed the NYSTA Smaller ILECs to commit capital to build and operate networks across their entire areas. The regulated, primarily single-provider environment of the past has afforded policymakers the ability to coordinate this regulatory plan with stable and predictable results regarding the deployment of networks in rural areas that advances and supports the goal of "universal service." The results have led to a virtually ubiquitous network throughout the NYSTA Smaller ILECs' respective service areas (both within the generally small town centers they serve and to all other users in areas outside of those small town centers) and to the provision of telecommunications services to virtually all end users.

In general, local service rates for users in their service areas have been set

by applying a residually based cost recovery approach whereby access charge revenue sources and universal service high cost recovery have been available in a manner that results in local rates being set to recover the difference between the carrier's intrastate revenue requirement and those aggregate sources. The SUSF Plan proposed in this proceeding, supplements and reinforces these policies.

Q. With this as background, what should the overall objective be for a State Universal Service Fund in New York?

A. The universal service policies embodied in the federal set of rules represent an excellent first step. However, the federal rules, by themselves, do not address the remaining recovery of intrastate costs, particularly with respect to the portion recovered by local service rates. As such, States need to address intrastate cost recovery in order to satisfy and complete the policy application objectives.

To do so, many States have established State Universal Service plans that complement the federal plan and address the intrastate portion of costs to ensure the same objectives. *See* Exhibit __ (NYSTA-4). The combination of plans is necessary in many cases to ensure the expected policy results – maintenance of a ubiquitous, reliable communications network. This is achieved by providing cost recovery for ubiquitous service providers in higher cost areas that is established in a manner such that local service rates are maintained at reasonably comparable and affordable levels. The SUSF Plan proposed by the NYSTA Smaller ILECs is based upon these objectives. The Plan will also address cost recovery of each

universal service provider so that it can continue to build, maintain and operate reliable state-of-the-art networks.

Q. Please provide a general overview of the existing universal service policies in New York.

A. The Commission, in a statement of policy, has previously defined universal service as:

> . . . the goal of ensuring that all residents have access to affordable basic telephone service, access to public safety, health, education, and assistance services, and are able to participate in society. . . . [T]he goal of ensuring quality service at reasonable rates is primary.

Proceeding on Motion of the Commission to Examine Issues Related to the Transition to Intermodal Competition in the Provision of Telecommunications Services, Statement of Policy on Further Steps Toward Competition in the Intermodal Telecommunications Market and Order Allowing Rate Filings, Case 05-C-0616, April 11, 2006 ("*Competition III Order*") at p. 70.

In its *Competition III Order*, the Commission established a universal service policy that encompassed a quality, flat rate, stand-alone basic telephone service that would be universally available, subject to a regulated rate cap, throughout each NYSTA Smaller ILECs' service area at a reasonable, affordable rate. Moreover, the individual nine elements comprising that basic local service offering (without additional features associated with local service offerings) were identified in an earlier Commission decision:

* Single Party Access Line
* Access to Local/Toll Calling
* Local Usage
* Tone Dialing
* Access to Emergency Services
* Access to Assistance Services
* Access to Telecommunications Relay Services
* Directory Listing
* Privacy Protections

Proceeding on Motion of the Commission to Examine Issues Related to the Continuing Provision of Universal Service and to Develop a Regulatory Framework for the Transition to Competition in the Local Exchange Market, Opinion and Order Adopting Framework, Case 94-C-0095, May 22, 1996 ("*Competition II Order*") at p. 10. Accordingly, the Commission generally has defined in its *Competition II Order* and confirmed in its *Competition III Order* the elements of the basic local service definition that forms part of the basis of a universal service offering in New York that must be present in any universal service package.

C. THE CURRENT TRANSITION FUND

Q. Please describe the current Transition Fund, the anticipated expiration of which has caused this phase of the proceeding to be instituted.

A. The current Transition Fund emerged and evolved from a Commission decision in 2003 regarding the eventual elimination of the then-existing New York Intrastate Access Settlement Pool, Inc. ("Access Pool"). *Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of the New York*

Intrastate Access Settlement Pool, Inc. for Traffic Sensitive Access Rates, Order Adopting Comprehensive Plan, Case 02-C-0595, issued and effective December 23, 2003 ("*Comprehensive Plan Order*"). This decision followed a series of collaborative discussions among the participating parties and ultimately resulted in the Commission adopting a comprehensive plan for the transition away from pooling for many of the NYSTA Smaller ILECs. Pooling, in general, refers to the process whereby the costs of intrastate access services for carriers were "pooled" to develop a uniform rate that all such local exchange carriers utilized in providing interexchange access services to long distance carriers. In doing so, the *Comprehensive Plan Order* included two significant actions. First, the Commission announced the phase-out of the Access Pool. Second, the Commission established the Transition Fund.

Q. With the elimination of the Access Pool, what purpose did the Transition Fund address?

A. The intended purpose of the Transition Fund was stated by the Commission as follows:

> It may be drawn on if we decide in a rate case, after considering pertinent factors, that a company's local service rates (which are not to exceed a benchmark equal to the Verizon rate for the comparable local rate group) are insufficient to meet its intrastate revenue requirements and allow the company to continue providing reliable service at just and reasonable rates.

Id. at pp. 4-5.

Thus, the Commission established a fund comprised of a sum of monies that could be used to allow proper levels of intrastate cost recovery for certain of the NYSTA Smaller ILECs when their rates for intrastate regulated services did not generate sufficient revenue to recovery the Commission-approved level of intrastate costs.

Q. How did the Commission's decision regarding the Transition Fund trigger the need for this current proceeding?

A. The Transition Fund was established with a finite contribution base with the recognition that its dollar resources would eventually be depleted. Based on this fact, the Commission noted the fact that the:

> Plan provides for establishment of a separate "Fund Track" of this proceeding to consider issues related to any funding arrangement designed to replace the Transition Fund. . . Discussions in the Fund Track would begin following a ruling by an Administrative Law Judge, in response to a party's application, that the Transition Fund may be exhausted within 18 months.

Id. at p. 5.

The anticipated notice was issued on August 3, 2009, and was recognized by the Commission as the basis for the establishment of this current proceeding.

Q. Please describe the process whereby a company has been authorized to draw revenues from the Transition Fund.

A. Generally, a company would qualify to receive distributions from the Transition Fund upon a finding by the Commission, in the context of a rate case, that the

revenues to be derived through the application of the company's local residential rates, not to exceed a benchmark level, and other intrastate rates are insufficient to meet its intrastate revenue requirement. As a result of this recovery framework, the NYSTA Smaller ILECs that receive Transition Fund disbursements can continue to provide reliable service. As defined by the Commission's Staff, the intrastate revenue requirement is the amount which is: ". . . intended to provide the company the opportunity to earn a fair rate of return in the rate year." *See* Staff Report Regarding the Transition Fund, Case 09-M-0527, dated October 2, 2009, at p. 3.

Q. Have any of the NYSTA Smaller ILECs needed to avail themselves of this opportunity?

A. Yes. Three companies have, to date, submitted rate cases to demonstrate the need for additional cost recovery from the Transition Fund. These cases involved a thorough review by Commission Staff of the company's costs, revenues, operations and compliance with various Commission policies and requirements which, in turn, is approved by the Commission in an order resolving the rate case. This process will be discussed in more detail later in this testimony. Based upon the Commission's findings and quantification of need in these cases, a company eligible for Transition Fund support receives monthly disbursements from the Transition Fund.

Q. What annual levels of Transition Fund dollars do these companies receive?

A. The three companies currently receiving Transition Fund support are Crown Point Telephone Corporation (which currently receives $236,068 annually from the Transition Fund), Newport Telephone Company (which currently receives $103,055 annually from the Transition Fund), and Oneida County Rural Telephone Company (which currently receives $240,863 annually).

Q. What general observations can be drawn regarding the three companies currently receiving Transition Fund support?

A. Regardless of any similarities or differences among these three companies, the Commission, through its rate case process and in adherence to its universal service policies and objectives, has determined that each of these companies qualifies for, and is in need of, the additional revenues currently provided by the Transition Fund. As a result of the rate case process, each company's need has been determined based upon its own circumstances. Similarly, the Plan proposed by the NYSTA Smaller ILECs in this proceeding provides for such an "individualized" evaluation in order to provide the necessary assurances with respect to the actual recovery of costs for the eligible NYSTA Smaller ILECs upon expiration of the Transition Fund. This assurance and recovery, in turn, allows the companies to continue to function in their unique roles as universal service providers.

Q. Other than the decision that established the Transition Fund, has the Commission ever recognized the need for funding aimed at aspects of

universal service in other areas?

A. Yes. In addressing other aspects for meeting its universal service goals, the Commission has created a fund called the Targeted Accessibility Fund ("TAF"). The TAF provides recovery for certain programs that the Commission has deemed necessary to meet certain social policy programs to fulfill certain aspects of universal service such as Lifeline, Enhanced 911, and Telecommunications Relay Service. The funding for TAF is based on assessments on all certified telecommunications carriers operating in the State of New York.

Q. Are there any concluding remarks to be made about the overview of universal service policies discussed above?

A. Yes. The NYSTA Smaller ILECs commend the Commission for its attention to the need for a SUSF. As changes occur in the telecommunications marketplace in New York, it is incumbent on this Commission to provide a stable and predictable plan with regard to rate design and cost recovery for the NYSTA Smaller ILECs and their rural customers. The NYSTA Smaller ILECs are currently the only providers of universal service within their respective service areas, which this Commission has also recognized by its designation of these carriers as Eligible Telecommunications Carriers ("ETCs") under federal law. Moreover, the NYSTA Smaller ILECs are, to the best of our understanding, the only entities that have demonstrated their willingness, as facilities-based carriers, to be subject to the Commission's full jurisdiction and regulatory oversight in their respective

provisioning of intrastate basic local exchange services. The revenues that the NYSTA Smaller ILECs have historically derived from Commission-designed rate structures has been an integral component of the cost recovery that has enabled these companies to build and operate quality ubiquitous networks and services in the rural parts of the State. The design of a SUSF in New York should continue to recognize the historical significance of the fundamental cost allocation and recovery realities and be flexible to accommodate additional future Commission cost recovery decisions.

Accordingly, the NYSTA Smaller ILECs' believe that the Commission should seek an overall reasonable level of cost recovery among the various sources. The adopted plan must balance the cost recovery relationship between basic local rates, receipts from other intrastate regulated services provided by the NYSTA Smaller ILECs, and SUSF requirements in a manner that will continue to achieve the successful accomplishment of universal service objectives.

IV. SUMMARY OF THE NYSTA SMALLER ILECS' PLAN FOR A STATE UNIVERSAL SERVICE FUND

Q. For purposes of the responses to the Phase II Issues discussed in Part V to follow, please provide a brief summary of the NYSTA Smaller ILECs' Plan for a SUSF.

A. 1. Calculation of SUSF Disbursements to Eligible Carriers. Eligible carriers would receive disbursements from the SUSF to recover those regulated intrastate

costs (including the opportunity to earn a reasonable return) that would not be recovered by the application of local service rates (to be discussed below in the context of Benchmark Rates), intrastate access rates and any other regulated intrastate service rates. In other words, the SUSF distribution to an eligible carrier would be equal to total regulated intrastate costs minus revenues derived from the application of the Benchmark Rate (or the transition thereto) minus intrastate revenues that would be derived from the application of intrastate access charges and the rates for other regulated intrastate services. Carriers that fully recover their costs through the application of these intrastate rates would not qualify to receive any SUSF. The determination of the total regulated intrastate cost to be used in this calculation would generally be the same as the existing Commission methods utilized for the current Transition Fund distributions.

2. Benchmark Rate. The Plan envisions the establishment of a Benchmark Rate (or sometimes referred to herein as the "Benchmark") equal to $15.22. As proposed, the operation of the SUSF effectively ensures that no carrier would have to recover from its end users more than the Benchmark Rate, thereby ensuring an affordable and comparable rate for all of the end users located throughout the entire service area of the NYSTA Smaller ILEC.

3. Local Revenue Recovery Calculation. The calculation of SUSF disbursements discussed above envisions the determination of the revenues that would be received by the application of (and as necessary the transition to) the Benchmark

Rate. For a company that qualified for SUSF, the local service rate increase would be capped at the Benchmark. Any revenue needed above the Benchmark would be made to the company through SUSF disbursements. Additionally, depending on the company's current local rate in relation to the Benchmark Rate, the NYSTA Smaller ILEC would be given the opportunity to impute a local revenue recovery calculation based on a transition to the Benchmark above its current local rates.

4. Carrier Eligibility for SUSF Disbursements. Carriers that are eligible for SUSF disbursements should satisfy the following conditions: (a) they must operate on a common carrier basis; (b) they must commit to offer and provide ubiquitous facilities-based service throughout the entire service area of the NYSTA Smaller ILEC; (c) they must be subject to all of the Commission's rules and jurisdiction that currently apply to the NYSTA Smaller ILECs; and (d) they must operate under the provisions of the proposed Plan. Obviously, these conditions make the NYSTA Smaller ILECs eligible, but would also make other carriers eligible to the extent that such other carriers operate under identical regulatory requirements. This issue will be discussed further under the eligibility discussion below in Section V. However, for the NYSTA Smaller ILECs currently receiving Transition Fund disbursements today, that recovery will be migrated immediately to the SUSF with no further showings unless such company elects to make one. This will enable these NYSTA Smaller ILECs the necessary

cost recovery that the Commission has already determined is necessary from the rate case process that underlies the SUSF Plan outlined herein.

5. SUSF Administration. Administration of the fund and disbursements should be performed by the same administrator as currently administers the TAF which is the Targeted Accessibility Fund of New York, Inc.

6. Contribution Methodology and Carriers' Recovery of Contributions. All providers of telecommunications services in the State of New York should be required to contribute to the funding mechanism in order to support the State of New York's universal service goals. This should include the widest base of carriers operating within New York, including, by way of example, all ILECs, competitive LECs, cable telecommunications providers, long distance carriers, and wireless carriers. Moreover, based on the *Declaratory Ruling* in WC Docket No. 06-122 issued on November 5, 2010 by the FCC addressing a petition filed by the Nebraska Public Service Commission and the Kansas Corporation Commission, the Commission should also consider assessing SUSF contributions on nomadic VoIP providers.

There are two methods that policymakers across the country have studied or applied for purposes of calculating a carrier's contribution obligation to Universal Service Funds. The most prevalent method that we understand is in use today is to base an individual carrier's contribution obligation on its relative share of its total intrastate retail service revenues to that of the entire operating industry

intrastate retail revenue in the given jurisdiction (which in this case would be New York). Another method would be to base a carrier's obligation on its relative number of telephone numbers assigned and used in the State of New York. While there are pros and cons to each approach, the preference of the NYSTA Smaller ILECs is the first method under which all carriers that operate in New York would contribute. This issue will be discussed further in Section V.

7. Ongoing Review of the Plan. Presuming that there are not fundamental changes in policy regarding immediate actions such as those that may occur at the federal level as previously discussed, the Plan anticipates that the Commission would review the objectives, policies, and effectiveness of focused nature aspects of the Plan after five years of operations. Any decision regarding what process should be employed to address any changes in the potential policy changes as discussed above should await the details of those changes, if any, during the initial period. This approach will allow for sufficient data to be available with respect to the operation of the SUSF before any changes are made with respect to the initial, focused purpose for the SUSF noted herein. The proposal by the NYSTA Smaller ILECs is sufficiently dynamic with respect to recovery to address the impact of other regulatory and industry changes before the five year review, if necessary.

8. Size of Anticipated Funding. Consistent with the specifics of this Plan, projections of the funding needs will be discussed in Section V.

V. PHASE II ISSUES

Q. How is this section of your testimony organized?

A. The Phase II issues list from Appendix A to the Judge's November 18, 2010 procedural ruling are inserted in *italics* within the text of this Direct Testimony. And, where appropriate, the subheadings are used to describe specific elements of the responses to those issues.

1. Is there a need to establish a State Universal service High Cost Fund, or other form of support program to ensure universal availability of affordable basic residential telephone service in New York, to succeed the Temporary Transition Fund Extension approved by the Commission's July 16, 2010, order in Phase I of this proceeding?

a. Whether the need, or lack of need, for such a fund or program can, as a practical matter, be determined (i) on a generic basis; or (ii) only on a case-by-case basis, considering a particular carrier's service area or a discrete portion of its service area and the particular circumstances of the carrier, service area, or portion of service area.

b. (i) The purposes the fund or program, if any, would serve; (ii) what alternatives might be available to fulfill those purposes and meet the claimed need; and (iii) the relative merits and drawbacks of such a fund or program compared with those of the available alternatives.

A. THERE IS AN ABSOLUTE NEED FOR A LONG-TERM SUSF

Q. Is there a need for a SUSF Fund in New York to succeed the Temporary Transition Fund?

A. Yes.

Q. What basis do you have for this conclusion?

A. First, there are some obvious reasons why a SUSF is needed at this time. As discussed above, there are already NYSTA Smaller ILEC companies that have demonstrated the need pursuant to the Transition Fund plan. That need continues even once the Transition Fund is exhausted. As such, each of the three NYSTA Smaller ILECs that are currently receiving Transition Fund disbursements should have their respective disbursements migrated immediately to the SUSF in order to ensure these companies can continue to receive the level of intrastate regulated cost recovery that the Commission has already determined and approved through the rate case process. Absent that result, these companies' ability to continue to provide universal service will be undermined as they will experience significant intrastate regulated cost recovery shortfalls.

Second, as suggested by the information related to the 31 NYSTA Smaller ILECs in the context of potential fund size discussed later in this testimony, other NYSTA Smaller ILECs can be expected to experience significant under-recovery of their intrastate allocated costs which will have to be addressed in the context of universal service objectives and funding. Simply speaking, if there is no recovery via a SUSF, these carriers may find it necessary to recover these costs through higher local rates that would strain the principles of affordability and comparability. Additionally, if there is under recovery, the ability of these carriers to continue to commit to reliable, ubiquitous carrier-of-last-resort service throughout their entire service area would be in question.

Third, we understand that in a later phase of this proceeding, the Commission will likely consider changes in the structure and level of intrastate access charges. The simple truth is that the NYSTA Smaller ILECs have only a limited number of intrastate revenue sources for the recovery of intrastate costs: local rates, access charges, other regulated intrastate services and a SUSF. If recovery decreases in any of these intrastate sources, the obvious impact is that the loss in cost recovery will have to be addressed across the other, unaffected sources. Some carriers may be able to accommodate such changes solely through changes in local rates, but others will likely find that the cost recovery shift cannot be addressed solely through local rates without placing affordable and comparable rates and universal service in jeopardy. A SUSF would be required to address these shifts in costs.

For these reasons alone, completing the fundamental decision making, as well as the establishment and operation of a SUSF now, in the course of this phase of this proceeding, represents prudent and sound public policy.

Q. Has the National Regulatory Research Institute provided any comments on the challenges confronting more rural ILECs like the NYSTA Smaller ILECs?

A. Yes. On Page 44 of their July 2009 paper *Carrier of Last Resort: Updating a Traditional Doctrine* (the National Regulatory Research Institute paper or "NRRI Paper" (a full copy of which can be obtained at:

http://www.nrri.org/pubs/telecommunications/COLR_july09-10.pdf.), the authors state:

> Many customers now have two wires to their homes that can provide telephone service, one from the telephone company and one from the cable company. In addition, wireless substitution is gradually reducing the number of wireline subscribers. Approximately 20% of U.S. homes now report using only wireless phones.
>
> The overall effect has been a dramatic reduction in ILEC lines and ILEC revenues from switched services. Over the period of 1999 through 2007, ILECs nationally lost 28 percent of their switched lines. In some urban and suburban areas the ILEC can have a foreseeable market share of 50% or less. In sum, a financial and operational failure by an ILEC-COLR is no longer a highly implausible event that can safely be ignored by state COLR policies.

Q. Will increases in the NYSTA Smaller ILEC companies' local service rates necessarily improve their financial condition?

A. No. On Page 44 of the NRRI Paper, the authors state:

> Competition also limits the ILEC's ability to raise subscriber rates. Even where a state commission grants a rate increase to an ILEC, increased revenues can no longer be assumed. Demand elasticity for local exchange service can be high in a multivendor environment, and rate increases can actually reduce a COLR's subscriber revenue.

Q. Does it appear that the Commission agrees with the above quotation from the NRRI Paper you reference?

A. Yes. Since March 2008, Staff has been identifying each NY ILEC as being in either a "competitive" or "not competitive" market, depending upon the make-up of their respective multivendor environments. Specifically, the Commission stated in its March 4, 2008 Order that

> a market is defined as competitive if a company that raises its prices loses revenue on an aggregate basis. Based on a price elasticity analysis from Competition III, that situation occurs when a substantial majority of a company's customers have access to both wireless and cable alternatives to landline service.

Case 07-C-0349, In the Matter of Examining a Framework For Regulatory Relief, Order Adopting Framework, Issued and Effective March 4, 2008 (the "*Framework Orde*r") at pp 1-2.

Q. Did the NRRI Paper draw any conclusions on whether or not states should provide universal service funding?

A. Yes. On page 45 of the NRRI Paper, the authors concluded that:

> If ILECs continue to lose customers and are constrained by competition from raising prices to restore lost revenues, universal service funding is the only remaining tool that can ensure continued ubiquitous service. If federal universal funding proves to be insufficient, the problem of maintaining ubiquitous and reliable voice service from COLRs falls on the states.

Q. What are the potential consequences of not establishing a SUSF?

A. In effect, absent a SUSF, the NYSTA Smaller ILECs will not be provided a reasonable opportunity to address the intrastate regulated under-recovery of their costs through the assessment of affordable and comparable local rates. This policy, in turn, will require the NYSTA Smaller ILECs to cut investment, maintenance and costs that will lead to a degradation of service quality, forced efforts to sell at a time such ILECs are projecting future financial losses (raising the logical question of why any rational buyer might be interested at any price), or

ultimately, enter bankruptcy.

Q. Are these types of issues simply speculation?

A. No. Based on the discovery in this proceeding, some parties may be contending that constructs such as bankruptcy, acquisition, consolidation and/or outsourcing of functions may be used as a means of avoiding the need for a SUSF. While we do not know whether these concepts will be raised by parties in this proceeding, as a general matter it is questionable what rational basis can be used to impose such requirements upon a NYSTA Smaller ILEC, particularly with respect to the fact that the SUSF Plan being proposed relies upon the Commission's rate case review process to establish the costs that will be recovered from a SUSF by a NYSTA Smaller ILEC (or other entities to the extent they comply with the same requirements and showing). Regardless, it seems appropriate to avoid any policies that create a threshold for SUSF recovery that relies on a company showing that they pursued elements that either resulted in their sale or in closing their doors before SUSF recovery would be permitted. Thus, decisions arising from this Phase II should not result in a diminution of universal service to any customer such as, for example, lower quality service.

Q. Are there other less immediate but yet still important reasons to support the need for a SUSF?

A. Yes. If a SUSF is in place, the Commission and the parties will be ready to address the possible universal service implications of other, yet unknown

regulatory and policy changes that may occur in the industry.

As discussed earlier in this testimony, there are a number of potential policy changes that may need to be addressed in the future. In the federal regulatory arena, changes in the FUSF plan and intercarrier compensation policies, including possible changes in access charges, are expected and likely. It remains to be seen what the residual impact of possible federal changes will be on the intrastate jurisdiction. Furthermore, changes in these mechanisms at the federal level may require some form of parallel changes in the intrastate arena. While the immediate need for a SUSF is demonstrated herein, we have not attempted to address what would be speculation about future regulatory and policy changes.

Regardless, any implications with respect to universal service objectives including, most notably, the recovery of overall intrastate-allocated network costs across the available sources and the resulting impact on the level and affordability of local service rates can be addressed more readily if a dynamic SUSF framework such as that suggested herein is already in place.

Q. Are there further reasons why a SUSF should be established to address regulatory policies in New York?

A. Yes. The Commission can use this proceeding to establish a stable SUSF and strengthen its efficacy with a more formal and complete plan. For example, a more permanent and complete contribution methodology, with full participation

of all providers, is needed to ensure a more equitable plan and a more secure and predictable future. Likewise, establishing the SUSF now will recognize that all carriers benefit from the ability to receive traffic from and send traffic to all consumers within the State of New York, including those competing providers that are served through the networks of the NYSTA Smaller ILECs.

Q. Is the need for a SUSF confined to policies that solely address residential service?

A. No. The Phase II issue statement by Judge Jack as set forth above is framed in the context of availability and affordability of *residential* local service, but the objectives of universal service are not merely directed to residential consumers. While the basic policy goal of providing universal service fund disbursements to maintain reasonable, comparable and affordable basic rates is often reviewed in terms of evaluating residential rates and a proper benchmark, the cost recovery aspects of this policy are not confined to residential service.

Some parties in this proceeding may be suggesting that the SUSF should somehow be limited to some subset of customer class (*e.g.*, residential service users). The NYSTA Smaller ILECs caution against such arbitrary treatment which is likely to be counter-productive. The cost of providing state-of-the-art networks, designed and built to serve all customers on an intrastate common carrier/carrier-of-last-resort basis, does not start or end with one class of customer, to the exclusion of other classes. The cost recovery dynamics from the

available intrastate regulated recovery sources – local service, access services, other intrastate regulated services and SUSF – are related to overall network costs, not classes of customers. The NYSTA Smaller ILECs incur network costs to serve all consumers upon reasonable request, the total expected demand, and regardless of classification as a business, residential, low-volume or high-volume customer.

Q. Would limiting a SUSF plan to one class of customers be counter-productive?

A. Yes. If universal service network cost recovery support were somehow denied on some arbitrary basis to exclude some classes of customers, the network costs would still remain affecting prices to all customers, thereby raising issues regarding continued demand for the services that are affected by increased prices. This dynamic would simply make the task of supporting the entirety of the network costs greater than would otherwise be the case if the company still derived service revenue fully from the excluded class of customers.

Q. Have other States recognized the need for a SUSF?

A. Yes. *See* Exhibit __ (NYSTA-4).

B. THE ACTUAL LEVEL OF THE SUSF SHOULD BE DETERMINED ON A "CASE-BY-CASE" APPROACH BASED ON THE INTRASTATE COSTS OF THE CARRIER

Q. Considering that you have concluded that there is a definite need for a SUSF

to be established now to address the already identified needs, can the SUSF Plan be determined, as a practical matter, on a generic basis or only on a case-by-case basis?

A. The meaning of "generic basis" and "case-by-case basis" may be different for different parties with respect to this question. The NYSTA Smaller ILECs specific response is that their proposed Plan under Phase II (which, as explained earlier in this testimony is focused solely on the immediate cost recovery needs as currently embodied in the Transition Fund purposes) envisions a *case-by-case* evaluation of each carrier's intrastate regulated costs to determine whether there is a need to recover some of these costs from a SUSF. Should other needs for the SUSF arise other than those needs being addressed herein, other more generic approaches may be justified or warranted. The immediate SUSF Plan under Phase II envisions case-by-case eligibility and quantification using the Commission-approved process that currently is used to determine Transition Fund eligibility. It is sufficient for this Phase II of this proceeding only to demonstrate that these case-by-case situations will arise, and therefore a SUSF should be put in place. Regardless, these needs already exist and new ones will arise. Accordingly, the need for a Plan has been demonstrated on the basis of existing facts and highly likely future expectations, and those future events can be addressed under the NYSTA Smaller ILECs' Plan on a case-by-case basis or depending on future events, if deemed appropriate, a more generic basis. This

testimony and the facts demonstrate the general need for the establishment of a SUSF regardless of how one considers the terms "generic" or "case-by-case."

C. THE PROPER LEVEL OF INTRASTATE UNIVERSAL SERVICE FUNDING MUST BE BASED ON THE COST RECOVERY OF THE ENTIRE NETWORK SERVING THE ENTIRE AREA, WHICH FOR THE NYSTA SMALLER ILECS IS THEIR RESPECTIVE COMMISSION-DEFINED SERVICE AREA.

Q. Should the consideration of a particular carrier's need for SUSF examine the entire service area or a discrete portion of its service area?

A. That consideration and the related cost and revenue calculation should be based on the entire service area of the NYSTA Smaller ILECs. The entire service area is the area in which the NYSTA Smaller ILEC must provide universal service. Accordingly, the service area represents the overall geographic area in which a network is built and operated for which SUSF cost recovery should be made available. It is this entire service area for which network costs are calculated that determine under the NYSTA Smaller ILECs' Plan whether there is a need for SUSF disbursements to maintain universal service at comparable and affordable rates. By analogy, this is what is done on the federal level with respect to the FUSF disbursements for the NYSTA Smaller ILECs.

For this purpose, the areas for which SUSF disbursements should be provided should not be subdivided across service areas. The NYSTA Smaller ILECs (unlike other carriers) do not build or maintain networks only to serve

concentrated or dense pockets of customers within their service areas nor can they under the current regulatory environment in which the NYSTA Smaller ILECs operate. Historically, for carriers like the NYSTA Smaller ILECs, carriers design networks around small town customer concentrations and the associated outlying areas and place switches and network facilities around these customer locations to maximize network design, given the requirement to serve all. Network wire centers have been placed in locations to balance the resulting loop lengths with the number of wire centers required and the relative costs of different configurations across the service area. For the majority of the NYSTA Smaller ILECs, their entire service area (including, for example, the cluster of exchanges served and connected by inter-office trunking) forms the geographic basis for their coordinated network costs.

1. Various considerations and circumstances should be rejected in developing the SUSF Plan.

Q. Are there other "particular circumstances" of a carrier, service area, or portion of a service area to consider with respect to the need for SUSF disbursements?

A. Yes. As discussed below in the context of eligible carriers and standards for recipients of SUSF funding, there are regulatory conditions with which a carrier should be required to comply for purposes of qualification to receive SUSF disbursements. If the universal service policy objectives discussed herein are

going to be met, there must be a sufficient level of accountability by carriers to the Commission.

Q. Are there other "particular circumstances" that should be avoided with respect to the need for SUSF disbursements?

A. Yes. While it would appear based on the filings made prior to the Judge's November 18, 2010 order in this proceeding that some parties will be contending that there is no need for a SUSF, we cannot, at this time, know how those parties may advance their positions. We will, therefore, wait to address the specifics of those positions in our rebuttal testimony. At the same time, however, based on discovery questions and filings made by certain of the parties with the Judge, general observations to some potential positions can be made now. For example, some parties may contend that there should be no need for SUSF funding to a NYSTA Smaller ILEC in an area in which other entities compete. In other words, these parties may claim that the existence of some form of competitive service provider negates the need for SUSF.

2. The existence of competitors does not negate the need for a SUSF.

Q. Does the existence of competitive service within the service area of a NYSTA Smaller ILEC negate the need for SUSF?

A. No. With that said, we need to make sure first that we are properly defining the concept in this question regarding "competitive services" based on the facts or the

lack of facts as the case may be. First, the "competition" that is being experienced by the NYSTA Smaller ILECs is from entities that are not subject to the Commission's jurisdiction. Additionally, this "competition" generally occurs in the lower cost, more dense parts of each service area. There are generally two types of "competition." There are cable digital phone providers that utilize a Competitive Local Exchange Carrier ("CLEC") to provide the Public Switched Telephone Network ("PSTN") interconnection that allows the exchange of traffic between the cable digital phone provider and the NYSTA Smaller ILEC. There are also wireless providers that are not, to date, subject to the Commission's jurisdiction and have demonstrated in discovery so far that they generally have little willingness to share information with any party herein.

For example, Verizon Wireless objects to and generally refuses to provide any responses to the discovery questions that the NYSTA Smaller ILECs submitted. Exhibit ___ (NYSTA-5). In general, Verizon Wireless' refusal is based on its contention that the Commission has no jurisdiction with respect to Verizon Wireless services even if those services were to have some implication with respect to Universal Service in New York. *See, e.g., id*. at p. 2.

Second, neither of these two classes of providers offers, subject to Commission jurisdiction, service throughout the entire service areas of the NYSTA Smaller ILECs. Thus, while they may provide a service that appears competitive to that offered by a NYSTA Smaller ILEC, that fact should not be

viewed in isolation since this proceeding addresses universal service issues, a set of issues that even the 1996 revisions to the Federal Act recognizes are distinct. Third, the telephone service offerings of these providers do not meet the Commission's definition of universal service. To the best of our knowledge, no cable or wireless provider provides a stand-alone basic local service offering, as is required of the NYSTA Smaller ILECs.

Finally, and with respect to the wireless service offerings, there really has been no measure of the true signal strength of the coverage that the wireless providers claim is reflected in their system contours. Put another way, the wireless providers have provided no fact to show that telephone call quality availability can be achieved by their respective systems such as within homes or buildings located in the entire service areas of the NYSTA Smaller ILECs, a fact that is solely within their control to provide.

Q. With these caveats, and substantively, does the existence of competitive service within the service area of a Smaller ILEC negate the need for SUSF?

A. No, for several public policy reasons that reflect the facts that we just relayed. The NYSTA Smaller ILECs acknowledge that alternative service providers exist in portions of their rural service areas and represent a degree of competition. However, the competitors that currently operate within the Smaller ILEC service areas – cable digital phone providers and wireless carriers -- do not provide carrier-of-last-resort or ubiquitous service across the entire service area. Nor, for

example in the case of cable voice offerings, do they provide Lifeline service to income qualified consumers in any portion of the ILEC's service area. Moreover, the services that these carriers provide are not true "substitutes" for the carrier-of-last-resort services provided by the NYSTA Smaller ILECs.

Moreover, there are shortcomings that undermine any notion of substitutability of the other providers' services as universal service. These shortcomings manifest themselves in a comparison of service offerings and their prices, the quality and reliability of services, the availability of services, and the level of accountability of the providers to the Commission and the public. The competitors have not been willing to commit, or cannot commit, to a ubiquitous network as do the NYSTA Smaller ILECs.

Regardless of any substitutability or ubiquitous service criteria of competitors, there may still be a need to address each universal service providers' network cost recovery, including cost recovery from a SUSF, so as to ensure reasonably affordable and comparable basic local service rates as the universal service principles require.

3. The competitors' services and prices do not constitute universal service offerings.

Q. How do the service offerings and prices of the competitors deviate from the principle of substitutability for universal service?

A. A basic tenet of universal service policy is the terms under which local exchange

service is available to all consumers. Predominantly, neither the wireless nor cable operators offer stand-alone basic local exchange service in the areas served by the NYSTA Smaller ILECs. Instead, these competitive providers typically bundle various combinations of local, toll, custom calling features, Internet access, and video entertainment services.

A sample of competitive cable digital phone and wireless provider service offerings within the NYSTA Smaller ILEC areas is set forth in Exhibit __ (NYSTA-6). For comparison purposes, the lowest monthly price (excluding temporary promotional discounts) that would be available to a residential customer seeking only to obtain basic local telephone service, regardless of whether the price reflects a stand-alone or bundled service offering, is set forth on this Exhibit based on the information derived from discovery responses in this proceeding or from their web sites as noted on the Exhibit. As a result, and based on what we can glean from the information available, the lowest prices for a consumer seeking only basic local telephone service ranged from $49.95 to $84.90. *See id.*

Q. What observations and conclusions can be drawn from the comparison of service offerings and prices of the competitive providers?

A. Based on the method by which the digital phone providers and wireless carriers have rate designed their services, the ability to provide an "apples-to-apples" comparison is difficult and otherwise not in compliance with the Commission's

directive that universal service is based on a stand alone local service offering. Thus, based on the bundling that is occurring, a customer must pay for a multitude of services beyond local exchange service, services that the customer may not want or be able to afford. These "extras" range from custom calling features to toll calling to broadband Internet service to video service. While we explain later why the current $23.00 benchmark should be reduced, even in comparison to that current statewide stand-alone local service rate benchmark, the rates for these alternative bundled packages that include local service can be viewed as considerably higher. Regardless, in order to be authorized by the Commission as a "substitutable" universal service provider, that provider should be required to advertise and offer affordable local exchange service, on a stand-alone basis, consistent with the Commission's established universal service policies and subject to the Benchmark Rate proposed herein. These services would be required to be offered to all customers within a service area designated by the Commission, which should be the entirety of a NYSTA Smaller ILEC's service area.

4. The quality and reliability of the competitors' services may not satisfy universal service objectives.

Q. How is service quality and reliability implicated with respect to universal service substitutability?

A. The Commission has placed a high degree of importance on service quality, even in a competitive industry:

> Importantly, nothing in this order removes our continued rigorous oversight of service quality, and we continue to monitor and ensure adequate service quality pursuant to the Public Service Law. . . .
>
> However, the existence of competition, even if it is effective and thriving, may not ensure reliable networks, and there is too much at risk for the people and the State to conclude otherwise. Protecting public health, safety and welfare remains essential and requires that we continue monitoring and enforcing network reliability, consistent with our responsibilities under the Public Service Law.

Competition III Order at pp. 38 and 90, respectively.

Moreover, as telecommunications carriers certified by the Commission, all of the NYSTA Smaller ILECs are required to adhere to reporting requirements and standards and, over the years, have proven themselves to be committed to providing an exceptional level of service quality and reliability. For example, Part 603.3 of Title 16 NYCRR, Service Standards Applicable to Telephone Companies lists nine performance metrics that must be developed and maintained by telecommunications carriers that provide local exchange service, as well as the related performance thresholds that the carriers are expected to meet or exceed. These metrics are designed to measure a carrier's performance in the areas of maintenance, installation, and network and answer time.

Q. How have the NYSTA Smaller ILECs performed with regard to service quality and reliability?

A. As note previously, their performance is excellent. The NYSTA Smaller ILECs, as well as other ILECs and CLECs in New York, provide the Commission Staff

with certain service quality metrics that measure a company's network reliability, the Customer Trouble Report Rate ("CTRR"). Commission Staff also accumulates its own data on end-user service quality based on complaints. The Commission analyzes these metrics annually and recognizes companies that have provided exemplary service by awarding service quality commendations. The NYSTA Smaller ILECs, as a whole, have historically performed exceptionally well, with 29 out of 32, or 91%, receiving commendations in 2009. *See* Exhibit __ (NYSTA – 3). Out of 701 possible opportunities since the program's inception, the NYSTA Smaller ILECs have received 536 commendations, or 76% of the time. With 2009 commendations exceeding the 22 year historic average, indications are that even with economic and financial challenges facing them today, the NYSTA Smaller ILECs remain committed to their roles as universal service providers and continue to provide the high level of service quality encouraged by the Commission.

Q. Can these performance metrics be expected to continue without concern?

A. No. If conditions continue to lead to a significant decline in earnings and if recovery mechanisms like a SUSF are not available, the result will be a lack of capital to fund network maintenance and upgrades, operations and maintenance, and it will become more difficult for the NYSTA Smaller ILECs to maintain this high level of service quality.

Q. But, hypothetically, if other entities are willing to provide service within the

areas served by the NYSTA Smaller ILECs, do you think that the Commission's concerns regarding service quality can be lessened?

A. No. This question uncovers the very fallacy that may be portrayed in the positions taken by others in this case. Universal service policy and the establishment of concrete plans to advance it require service commitments that are enforceable and can be relied upon. In order to be enforceable and thus relied upon, the entities that are the "universal service" providers must be subject to the Commission's jurisdiction and oversight. Any entity that seeks to be a universal service provider or any analysis that suggests that such universal service policy need not be applied in a given area based on the existence of other providers must be premised on the ability of the Commission to exercise jurisdiction over that other service provider in order to ensure that any universal service policy objective is achieved.

Q. How does your fallacy contention square with the facts?

A. Hypothetically, if the Commission were to say that wireless service is available throughout the State of New York (which it is not) and that there is no need for a SUSF because of wireless availability (which of course is unsupportable based on the lack of facts as to actual service availability and quality of service in New York by wireless providers in the record developed to date), one need only look at the discovery responses from the wireless carriers to demonstrate the fact that they, as a general matter, do not want to subject themselves to Commission

jurisdiction. Thus, the Commission, in the hypothetical that we have postulated, would be saying that universal service can be achieved in the State of New York by entities over which the Commission has no oversight with regard to their operations or telephone services.

Q. Has the Commission addressed this issue recently?

A. Yes, for wireless carriers. In its December 17, 2010 decision regarding Verizon New York, Inc. service quality issues, the Commission stated:

> Although wireless service continues to expand in New York and in some instances is a viable substitute for wire line service, wireless is not yet directly and seamlessly substitutable for all wireline service. The unsatisfactory reliability of wireless signals in certain areas of the state and the infirmities of wireless 911 emergency service mentioned by PULP render the service as still not an adequate substitute for wireline service for all customers at this time.

Order Adopting Verizon New York Inc.'s Revised Service Quality Improvement Plan with Modifications, Case 10-C-0202, issued and effective December 17, 2010 at pp. 15-16 (footnote omitted). We considerably doubt that the Commission would state such a thing and then pursue a universal service policy that leaves it to entities not subject to its jurisdiction to achieve the Commission's universal service goals.

We also note that the Commission in its *Competition III Order* apparently thought that it could rely on the "trust" factor for good corporate citizenship as a means, for example, of ensuring network reliability which is a critical component

of universal service. Specifically, the Commission said:

> To the extent we do not have authority to impose reliability rules and reporting requirements on some providers (the lack of which compromises our ability to address public safety and other mandates), we would expect such providers to be willing to voluntarily provide any necessary information (on a proprietary basis if necessary) to ensure that the health, safety and welfare of the citizens of New York are adequately protected.
>
> The safety and welfare of New Yorkers rises above the need of any single provider or any category of providers

Competition III Order at p 95 (footnote omitted).

Regardless of the desires of the Commission reflected in this quote, the record in this proceeding, and in particular the responses of the wireless carriers to discovery, demonstrates that any such reliance is not justified.

Q. So if the Commission has jurisdiction over the entities that operate within a NYSTA Smaller ILEC's service area, does that resolve the issue?

A. No. Commission jurisdiction is only the start of the required analysis. As described above, the Commission remains committed to ensuring continued network reliability. Therefore, regardless of whether the Commission's service quality requirements and standards continue into the future in their present form, or in some altered form, *all* telecommunications service providers that have been authorized by the Commission to serve as a universal service provider should be required to adhere to the same service quality reporting requirements and standards, to the extent possible recognizing the differing underlying

technologies, irrespective of whether that provider is a NYSTA Smaller ILEC, a cable digital phone provider or a wireless provider. The Commission's authority under Public Service Law to initiate an investigation, call for testimony, direct that companies make specific improvements, and if necessary, institute a penalty proceeding (*Competition III Order*, page 91, fn 172) should extend to all universal service providers. These obligations will ensure equal accountability to the Commission by all universal service providers.

Q. Is there any example that would demonstrate the need for the application of common requirements across all universal service providers?

A. Yes. Let us take wireless service as an example. The wireless carriers themselves do not, unequivocally, guarantee the availability of service. In responses to discovery, T-Mobile (wireless) states that it provides coverage maps of its service coverage and that each map "predicts likely coverage." Exhibit ___ (NYSTA-7) Response to Information Request #14). T-Mobile goes on to recognize correctly that it "does not and cannot guarantee service availability since several varying factors related to radio propagated services, such as commercial mobile radio service, always exist – such as signal strength, consumer equipment, traffic volumes, terrain, structures, foliage, weather and other conditions." *Id*. (Response to Information Request #15); *see also id.* (Responses to Information Requests Nos. 16-19).

Similarly, AT&T's wireless affiliate admits that its maps depicting service show "approximate voice coverage . . . ." Exhibit ___ (NYSTA-8) (Response to Information Request #14). While AT&T's response indicates that there are a number of "limitations on the availability of any services," AT&T goes on to acknowledge that the "[a]ctual coverage area may differ substantially from map graphics, and coverage may be affected by such things as terrain, weather, foliage, buildings and other construction, signal strength, customer equipment and other factors." Accordingly, AT&T also does not guarantee coverage. *Id*. AT&T's wireless affiliate sets forth three levels of wireless service characterized by "Best," "Good," "Moderate," and "Partner." *Id*. Even for the "Best" category, AT&T admits that its wireless service may not be available within buildings. For the "Good" category, service is "possibly" available in "some" buildings. For the "Moderate" category, users may not have service in vehicles or in buildings. *Id*. In its responses to a series of additional Discovery questions, the wireless affiliate of AT&T provides similar answers with respect to the shortcomings. *Id*. Finally, AT&T admits that its does not guarantee coverage for those areas shown on the maps as its service areas. *See id*. (Response to Information Request #15).

Q. What about Sprint and Verizon Wireless?

A. Sprint's wireless operation provides similar answers to these questions. *See* Exhibit ___ (NYSTA-9). Sprint acknowledges that it makes maps available regarding approximate coverage of service. *Id*. (Response to Information Request

#14). In response to Information Request #17, Sprint admits that, for several reasons, there are holes in its coverage as depicted on maps: "CDMA coverage can be negatively impacted by capacity on the network, weather, tree foliage, etc. RF propagation tools are not able to accurately predict these types of temporary performance problems." *Id*. (Response to Information Request # 17). Sprint avoids recognition of the other possible factors that may affect wireless service availability. Although recognizing the negative impacts in its response to Information Request #17, Sprint surprisingly and inconsistently claims that it can guarantee service availability. *Id*. (Response to Information Request #15). Sprint's claim of guaranteed service is not credible.

Finally, as explained above, Verizon Wireless chose to avoid answers to these service availability questions.

5. The competitors' services are not ubiquitously available.

Q. Is each NYSTA Smaller ILEC a common carrier?

A. Yes. Each Smaller ILEC is a Telecommunications Carrier and a Common Carrier.

Q. Can a NYSTA Smaller ILEC unreasonably discriminate in deciding whether to provide service to customers located across its ILEC-certificated service area?

A. No.

Q. For the cable television operators that also provide a digital phone offering within the NSYTA Smaller ILECs' service areas, has any cable operator committed to provide telecommunications service to all customers across the entire service area of the ILEC?

A. No. The cable providers' commitment, if any, in its franchise agreement is to provide cable television service; there is no commitment regarding telephone services. Moreover, for their cable television services, the cable providers offer their retail form of local service only to customers whose homes or businesses are passed by their cable television network, which does not cover the entire service area of a NYSTA Smaller ILEC. Furthermore, just because a home or business is passed by facilities used to provide cable television service, there is no assurance or commitment that those facilities can always be used to provide telecommunications services. In any event, the cable operators have not made any universal service commitment. As discussed below, in the final analysis, the cable operators concentrate their service within areas where there are a higher density of homes passed.

Q. How do cable operators decide where they will provide or expand their cable television service?

A. In response to the NYSTA Smaller ILECs' discovery requests, Time Warner Cable, Inc. ("TWC") explains that it expands its network in response to requests from residents and/or franchising authorities. Exhibit ___ (NYSTA-10)

(Response to Information Request #6). TWC goes on to explain that it is its own determination regarding costs of particular projects, and its decision is based on the nature of the requests, the terms of its franchise agreement, and its independent judgment regarding costs and benefits regarding the unique circumstances of any possible service project. *Id*.

Q. Has Time Warner committed to provide service ubiquitously?

A. It appears that TWC may make cable television commitments within the boundaries of towns and villages, and it may make commitments to serve in more densely homes-passed areas, but there is no commitment to universal service telecommunications service.

Q. Do the NYSTA Smaller ILECs apply the same degree of independent judgment regarding costs and benefits in deciding whether to serve customers?

A. No. Within their incumbent LEC service area, the NYSTA Smaller ILECs commit to serve any and all customers upon reasonable demand and effectively do so.

Q. What about Cablevision Corp.'s decision-making process for service expansion?

A. Cablevision indicates a similar business decision process for service provision and expansion including evaluation of the interest by potential customers, expected return on any investment to be made, franchise and regulatory requirements, and

competitive issues. *See* Exhibit ___ (NYSTA-11). Accordingly, neither TWC Cable nor Cablevision includes universal service for telecommunications services considerations in their respective investment decisions.

Q. Do you have any basis for your statement that cable television operators concentrate their service within higher density areas of home-passed?

A. Yes. In response to the NYSTA Smaller ILECs' discovery requests, both Staff and TWC provided copies of some of the franchise agreements under which TWC operates for an illustrative set of ILECs (44 franchise agreements for those franchising areas associated with the NYSTA Smaller ILECs including Crown Point Telephone Corporation; Empire Telephone Corporation; Nicholville Telephone Company; Ontario Telephone Company, Inc.; Pattersonville Telephone Company; Trumansburg Telephone Company; Newport Telephone Company; and Oneida Country Telephone Company). We have attached a sample of those agreements as Exhibit ___ (NYSTA-12).

There are common themes in those agreements that set forth conditions of where, and under what terms, TWC must or may provide service.

Q. What are those common themes?

A. The agreements refer generally to both FCC and Commission rules' requirements regarding cable television services, but not to any requirements or rules regarding telecommunications service. *See, e.g., id.,* Town of Crown Point agreement, Sections 3 and 12(c).

The agreements also generally address the current required area for cable television service. Many include the currently served area as within the "primary" service area. *See, e.g., id.,* Town of Batavia agreement, Section 16. Most of the agreements specify a home-per-mile-passed threshold above which primary service is required. *See, e.g., id.*, Town of Crown Point agreement, Section 12(c) (at 35 occupied residential dwelling units per mile); Village of Holland Patent agreement, Section 12 (20 homes per mile); Town of Batavia agreement, Section 16 (12 dwelling units per mile); Village of Newport agreement, Section 2.02 (25 homes per mile for aerial plant and 30 homes per mile for underground plant); Town of Fairfield agreement, Section 2.02 (same as for the Village of Newport); and Town of Western agreement, Section 12 (no apparent threshold, only comply with Section 895.5 of the Commission's rules). The point to this discussion of the threshold provisions is that there is no definite requirement for service to those areas with density below the threshold. Instead, most typically, there is a cost determination, quote process, and sharing of costs among any new customers for expansion areas that determines whether cable television service is expanded to unserved areas. *See, e.g., id.*, Town of Crown Point agreement Section 12(c); and Village of Newport agreement, Section 2.02 (A). There also appears to be a variety of other caveats that affect the decision to expand cable television service to areas not currently served including the degree to which consumers are committed to taking service. *See, e.g.*, Village of Holland

Patent agreement, Section 12(c). It also appears that expansion requirement terms and conditions may be limited in some cases only to that area defined as the primary area. *See, e.g.,* Town of Batavia agreement, Section 16.4.

Q. Are there any indications about the selective market coverage of cable operators?

A. Yes. As set forth in Exhibit ___ (NYSTA-13)(CONFIDENTIAL SUBJECT TO PROTECTIVE ORDER IN NY PSC CASE 09-M-0527) regarding the responses of the NYSTA Smaller ILECs with respect to percentage of service area covered by a cable television company, the NYSTA Smaller ILECs report significantly less than 100 % of cable company coverage for almost all of the company areas.

Q. What criteria form the basis for cable operators' actual selective market coverage?

A. As reflected in the TWC discovery responses, TWC enters into franchise agreements with local jurisdictions that limit the area where the cable operator is required to provide it cable television service. In doing so, TWC does not obligate itself to provide service in areas where there is a lower density of homes to be passed.

Q. Are the public policy issues being discussed with respect to the establishment of a SUSF confined to the cable television operator's choice of area served within a cable television franchising area?

A. No. The evaluation must be with respect to the entirety of the NYSTA Smaller

ILEC service area and for all consumers located there, not just the higher density homes passed areas. The only universal service provider that exists today throughout the entirety of such geographic area and that has a demonstrated commitment to serve subject to the Commission's jurisdiction is each of the NYSTA Smaller ILECs.

Q. Are the cable television operators that serve in the areas of the NYSTA Smaller ILECs subject to Commission authority or oversight with respect to telecommunications service quality, price, or area served?

A. No, not that we are aware of.

Q. Are ubiquitous service and carrier-of-last-resort considerations important here?

A. Yes. As the principles of universal service require, one of the regulatory goals to be served by State and FCC plans is to ensure that services included in the definition of universal service are provided at rates that are affordable and comparable. The NYSTA Smaller ILECs are the only common carriers under the Commission's jurisdiction that fulfill this goal within the entirety of their respective service areas. Moreover, the NYSTA Smaller ILECs have been designated ETCs for FUSF purposes. As such, they are generally the only carriers which comply with the federal requirements to provide universal service.

Q. As the incumbent universal service provider, will the NYSTA Smaller ILECs continue to have the responsibility to maintain their networks to all

customers in their service areas?

A. Yes, that is their current status. Each NYSTA Smaller ILEC deploys, operates and maintains its telecommunications network to serve all users within its certificated area upon reasonable request. This means that each NYSTA Smaller ILEC continues to maintain a network that remains available in the subset areas where competitors also provide service. Consequently, it is the entire network of the NYSTA Smaller ILEC for which cost must be recovered, and it is the cost recovery of that entire network of the NYSTA Smaller ILEC that must be considered in determining whether SUSF is needed to ensure that local service rates are held to comparable and affordable levels.

Q. Do any other providers have the responsibility to provide ubiquitous service, or has any other provider committed to such responsibility?

A. No.

Q. In light of your discussion, what are the conclusions that can be drawn here?

A. There are several inescapable conclusions: (1) the NYSTA Smaller ILECs provide reliable universal services in all regions and for all consumers within their certificated service areas – their competitors do not; (2) the NYSTA Smaller ILECs as universal service providers have the obligation to stand ready to serve all consumers across their entire service area, even those that may be customers of competitive providers; (3) the NYSTA Smaller ILECs build and maintain a network to serve all consumers in all regions of their service areas; (4) the

NYSTA Smaller ILECs must have a reasonable expectation that they will be able to recover the costs of their ubiquitous network if they are expected to invest in state-of-the-art networks and maintain a reliable network; (5) without an opportunity to have access to cost recovery from a SUSF, the NYSTA Smaller ILEC would be impeded in its ongoing commitment to build and maintain a state-of-the-art network, may have to sacrifice service quality, and/or would be forced to raise prices for its remaining customers to levels above those that would be comparable or affordable. For these reasons, a SUSF is needed regardless of whether other carriers compete.

Q. What is the NYSTA Smaller ILECs' response to the Commission Staff's report (Preliminary Staff Report on Cable and Wireless Phone Coverage, dated December 22, 2009, submitted in this case (the "December 22nd document")) which purports to show that there are only a very few areas within the Smaller ILEC service areas that are not already served by competitors?

A. The information set forth in that report with regard to expected service coverage by competitors in the NYSTA Smaller ILEC service areas is premised on the fundamental fallacy that the competitors provide services that are truly substitute services. As explained above, they are not. Moreover, the December 22nd document is, as its title implies, "preliminary" and informal in nature. The December 22nd document was prepared solely by Staff. Many of the statements

in the December 22nd document refer to presumed facts, information, and/or concepts that remain undefined. There are also unexplained inconsistencies between the data contained in the report. Moreover, Staff's analysis in the December 22nd document is based on information apparently obtained from third parties. Staff, nor for that matter, other parties, have not yet submitted in testimony what information within the December 22nd document that Staff will deem to be facts; what factual evidence, if any, Staff intends to submit in its testimony regarding the contents of the December 22nd document, or what factual conclusions Staff may draw from the December 22nd document and relay those conclusions in its testimony. Once Staff's testimony is presented and the December 22nd document is addressed by Staff, the NYSTA Smaller ILECs will respond to it.

Q. Are there any additional observations that you would like to provide at this time?

A. Yes. Any substantive analysis of the document will be dependent on the answers to several general questions such as, but not necessarily limited to:

1. What specific data did the Staff use in its development of the December 22nd document and/or its future testimony?
2. What is the specific meaning of, and application, of the specific terminology used throughout the December 22nd document?

3. With respect to the individual data sources, what is the meaning of the data with respect to the subject matter of the December 22nd document, what assumptions have been made about the data with respect to the subject matter of the December 22nd document, and whether the data and such assumptions support the facts and/or conclusions in the December 22nd document?

4. With respect to the individual data sources, what analysis, if any, did Staff perform to ascertain the accuracy of its data and whether the data actually supports the stated purpose for which the data was used in the December 22nd document? If additional analysis was performed, what is the substance and results of that analysis?

5. What is the meaning of, specific relevance in this proceeding, and factual conclusions with respect to the concept and nature of, "substitutability" of services provided by competitors of the NYSTA Smaller ILECs?

6. How can, if at all, the inconsistencies in the December 22nd document be reconciled?

The NYSTA Smaller ILECs further note that they have concerns over the alleged scope of the areas within the geographic areas of the State of New York that are served by cable television providers and by wireless providers preliminarily identified by Staff, the reliability of any preliminary conclusions and suggested facts presented by Staff, and the overall relevance of Staff's

preliminary analysis in any event to the issues in this proceeding. Ultimately, when Staff files its testimony and we understand how Staff may use the December 22nd document, further explanation and analysis along these lines can be undertaken.

D. THE NYSTA SMALLER ILECS' PLAN SERVES AND ADVANCES THE UNIVERSAL SERVICE GOALS.

Q. What are the purposes to be served by a State USF?

A. The purposes to be served are those already discussed above in response to the question of whether there is a need for a long-term fund. Those purposes include, by way of example only, the need to ensure adequate intrastate cost recovery not only for existing Transition Fund recipients but for all NYSTA Smaller ILECs, as well as any other eligible carrier, and the ability to charge comparable and affordable rate.

Q. Does the Smaller ILEC Plan serve these purposes?

A. Yes. The SUSF would provide necessary network cost recovery support to eligible telecommunications carriers, enabling them to provide reliable, affordably and comparably priced local services throughout their entire service areas.

E. ALTERNATIVE APPROACHES.

Q. Other than the NYSTA Smaller ILECs' Plan, what other approaches to State universal service objectives are under review?

A. The *Ruling on Phase II Procedures* dated November 18, 2010 includes a set of

issues for discussion in this proceeding. The order does not propose specific alternatives for review or comment. Of course, the NYSTA Smaller ILECs, for the reasons set forth herein, maintain that their Plan is the best approach to achieve the relevant State universal service goals. However, the other parties to this proceeding may very well have other ideas and approaches that they will set forth in their initial round of testimony. As necessary, the NYSTA Smaller ILECs will review any worthy proposals and will comment on any alternatives in the rebuttal testimony phase of this proceeding.

V. PHASE II ISSUES

2. If a State Universal Service High Cost Fund, or other support program, is established:

a. Who is eligible for the fund or program (e.g., pool companies only, non-pool LECs, CLECs, wireless companies, individual telephone users, etc.)?

Q. Which entities should be eligible to receive disbursements from a SUSF?

A. For a particular service area, SUSF disbursements should be available only to common carriers that provide facilities-based service throughout the entire service area and operate under the same regulatory requirements and commitments as do the NYSTA Smaller ILECs. As a prerequisite to eligibility for SUSF, a common carrier should also be designated as an ETC as that is defined for FUSF purposes. Of course, the need for SUSF recovery, and therefore eligibility, would also depend on a network cost and revenue showing that demonstrates that SUSF

funding is needed so as to maintain affordable and comparable rates. The NYSTA Smaller ILECs plan sets forth the specifics of that network cost and revenue demonstrations.

The proposed SUSF for Phase II would be a "cost based" funding mechanism. Therefore, any eligible provider would be required to provide the Commission with sufficient financial, accounting and usage information (such as that provided by the three NYSTA Smaller ILECs that currently receive Transition Fund disbursements). With this information and subject to regulatory requirements and oversight, the Commission and its Staff would perform the same in-depth review that it does with the NYSTA Smaller ILECs today to determine if the network cost and revenue parameters lead to the need for increased rates and/or SUSF disbursements. This information and review would be necessary to ensure confidence in any decision to make SUSF dollars available to an eligible carrier, and would rely upon Commission practices and procedures that have been demonstrated to work. And, since the current NYSTA Smaller ILECs that receive Transition Fund disbursements have been through this process, their respective Transition Fund disbursement amounts should migrate immediately to the SUSF.

Moreover, this NYSTA Smaller ILECs' proposal to demonstrate both eligibility and the level of SUSF disbursements would apply equal treatment and requirements for any entity seeking SUSF disbursement status. Only through a rate case form of cost showing would there be the necessary scrutiny to

demonstrate the need for SUSF associated with this Phase II. (Should other needs for the SUSF arise, other than those being addressed in this current phase of the proceeding, other approaches may be justified or warranted.) This Phase II cost based approach as used in rate case presentations is currently the most useful and effective way to measure need.

b. What are the eligibility requirements for competitive companies (e.g., federal eligible telecommunications carrier guidelines or other criteria) or other recipients of support?

Q. What are the eligibility requirements that the NYSTA Smaller ILECs propose?

A. Any eligible entity should provide the 9 services that are taken from the FCC's rules and Commission's orders. With respect to the FCC's rules, the FCC's definition established elements of universal service which are proper to use at this time under 47 C.F.R. § 54.100(a):

(1) Voice grade access to the public switched network. . .;

(2) Local usage. . .;

(3) Dual tone multi-frequency signaling or its functional equivalent. . .;

(4) Single-party service or its functional equivalent. . .;

(5) Access to emergency services. . .;

(6) Access to operator services. . .;

(7) Access to interexchange service. . .;

(8) Access to directory assistance. . .; and

(9) Toll limitation for qualifying low-income consumers [as defined in 47 C.F.R. § 54.400(d)].

In addition, however, the proposal is also based on the following network and operation elements already established by the Commission as part of the commitments it expects of the common carriers it regulates:

1. CALEA compliance;
2. Consumer protections, including privacy;
3. Geographic diversity of critical routes, critical facility stand-alone capability;
4. Authority to inspect and direct repairs;
5. Major outage reporting;
6. Facility protection requirements;
7. Priority restoration requirement (TPS);
8. Back-up powering to ensure continuity of service; and
9. Adoption of industry standards/best practices (NRIC, NEC, NESC); and
10. Compliance with service quality standards.

Thus, these 19 requirements (or their functional equivalents) are those service and operational requirements that the proposal contemplates would be provided and/or complied with in order for a common carrier to be considered a universal service provider for New York SUSF purposes.

c. Who would contribute to the fund or other support program (e.g.,

wireline companies, wireless companies, Voice over Internet Protocol provider companies, cable companies)?

Q. How should the dollars needed for disbursements to eligible carriers be obtained?

A. The funding of a SUSF should come from contributions from all telecommunications services providers providing retail services in New York. The objective should be to include the widest base of contributors to include wireless telecommunications service providers, underlying telecommunications providers or the affiliates of the cable operators, and the entire set of traditional telecommunications service providers (the TAF contributors).

Q. Are Commercial Mobile Radio Service ("CMRS") providers subject to the Commission's authority to include them in the base of contributors?

A. The NYSTA Smaller ILECs' position is that the CMRS providers should be included and that the Commission has sufficient authority and can exercise that authority to require the CMRS providers to be contributors to the SUSF. While admittedly we are not attorneys, we can read the plain wording of the Public Service Law and that plain wording incorporates a provision that provides for the re-establishment of jurisdiction over cellular telephone service providers which seem, logically, to be able to be used here to ensure that the wireless providers would be subject to a contribution requirement for the SUSF.

Q. To what section are you referring?

A. Specifically, Section 5(6)(a) of the New York Public Law which states:

> 6. a. Application of the provisions of this chapter to cellular telephone services is suspended unless the commission, no sooner than one year after the effective date of this subdivision, makes a determination, after notice and hearing, that suspension of the application of the provisions of this chapter shall cease to the extent found necessary to protect the public interest.

Q. Has there been notice to the wireless providers in your view?

A. Yes. Notice was issued by the Commission to undertake the policy issues arising from the exhaustion of the Transition Fund. And, all interested parties and carriers were provided the opportunity to participate in this proceeding. In fact, several wireless providers – for example Verizon Wireless, AT&T and T-Mobile – have been active participants in this proceeding and therefore are clearly on notice of the issues that will be addressed by the Commission. Moreover, hearings are scheduled to be held in this proceeding. Thus, under the section noted above, the Commission should make the necessary findings to require the wireless providers to be contributors to the SUSF.

Q. What public interest protections are at issue here?

A. In the NYSTA Smaller ILECs' view, protecting the public interest is paramount when considering universal service policies. Universal service not only considers the ability for all consumers within the State of New York to have the ability to call all other New Yorkers, but also ensures the interconnectivity and provisioning of networks over which those communications will be carried.

Q. Why would it be most preferable to include the widest base of contributing

carriers?

A. All users of the public telecommunications network in New York are the ultimate beneficiaries of the goals achieved by universal service policies in that it maximizes participation by all consumers, and maximizes the robustness of the public network. All New Yorkers benefit from the success of universal service policies. By ensuring that the contribution base fully encompasses all telecommunications services providers, the contribution is distributed across all of those end users that are the ultimate beneficiaries.

In comments filed in the FCC's proceeding regarding similar contribution issues brought to the FCC by the States of Kansas and Nebraska, this Commission supported including all carriers:

> . . . [I]t is critical for the FCC to declare that state commission efforts to implement an appropriate intrastate funding mechanism supported by revenues from all carriers conducting business within its borders, including nomadic interconnected VoIP providers, does not frustrate federal rule or policy but are fully consistent with serving the public interest.

NYPSC Comments in Nebraska/Kansas Nomadic VOIP Proceeding, WC Docket No. 06-122, dated September 9, 2009 (pages 5-6)(attached hereto as Exhibit ___ (NYSTA-14).

Q. How would the contributing telecommunications services providers recover the contributions?

A. They would be allowed to recover these contribution amounts through an

identified surcharge to their retail customers. This surcharge would be a line item on the end user bill for service and thus recovered directly from the end user and not from a carrier. As a result, this approach would not affect any particular carrier's earnings and would not place any carrier or group of carriers at a competitive disadvantage with other providers.

d. How would contribution levels be calculated (e.g., Targeted Accessibility Fund formula or some modified or alternative approach)?

Q. How would each provider's share of contribution be calculated?

A. The NYSTA Smaller ILECs have identified two possible methods that could be used for calculating each provider's contribution obligation.

The first method is to base each provider's relative contribution obligation to that of the total based on the relationship of that provider's intrastate end user retail revenue for telecommunications services to the total of all intrastate retail telecommunications end user service revenue for all providers in the State. In practice, this would require an assessment ratio to be applied to a provider's intrastate retail revenue to determine the contribution amount. The assessment ratio would be calculated by the administrator of the SUSF by dividing the SUSF total dollar funding requirement by the total intrastate retail revenues for all contributing providers. This is effectively the same assessment process used for the FUSF today.

The second method would also use a proportional basis allocation, but it

would be based on the portion of in service telephone numbers assigned to end users in the State by a particular contributing provider. In this case, an assessment ratio would be calculated equal to the total SUSF dollar funding requirement divided by the total number of in service telephone numbers for all contributing providers.

In each case, as discussed above, the contributing carrier would recover its contribution from its own end users through explicitly identified surcharges.

Q. Do the NYSTA Smaller ILECs have a preference?

A. Both methods have advantages and disadvantages. The NYSTA Smaller ILECs have presented both approaches for the Commission's review and consideration. However, in total and at this time, the NYSTA Smaller ILECs prefer the intrastate retail revenue method.

Q. Please explain the basis for this preference.

A. Under the relative revenue approach, the ultimate recovery from end users is aligned with the relative amount of intrastate revenues collected from that consumer. Since the amount paid by an individual consumer for services reflects that particular consumer's "demand" for service and presumably the value of what that customer receives, revenues would distribute the funding to consumers based on their use and value derived from the services provided.

The relative quantity of numbers in service method would not allocate contribution ultimately to consumers in this way. Each consumer with a single

telephone number would be ultimately responsible for the same contribution through its service provider. That would appear to introduce inequities in that a consumer with only one telephone number that purchases services with a revenue value of $25 per month would contribute the same as another consumer with only one telephone number that purchases services that amount to $100 per month. Obviously, the latter consumer has a greater need for the network and/or derives greater value from the use of that network. That consumer's contribution should parallel that greater value.

Q. How would cable digital phone providers be assessed since you indicated that those entities are not subject to the Commissioner jurisdiction?

A. While that is true based on our understanding, the cable digital phone provider uses a Commission-certificated CLEC for the interconnection of the combined network of the cable digital phone provider and the CLEC to the PSTN. And, it is only through the combination of these two networks – that being provided by the cable digital phone provider and that being provided by the CLEC – which the exchange of traffic to and from the PSTN can occur. Thus, the Commission could direct the CLEC to report the end user retail revenue derived by the cable provider from its digital phone service offering as part of that CLEC's intrastate end user revenues, with the recovery of those contributions left between the contract terms and conditions that have been established between the CLEC and the cable digital phone provider.

Q. Would your proposal require the Commission to determine that cable digital phone is a telecommunications service?

A. No. The Commission would simply need to find that when the CLEC that has the interconnection to the PSTN delivers local traffic to the PSTN for termination, that is a "jointly provided" service between the CLEC and the cable digital phone provider and, thus, from the CLEC's perspective (over which the Commission's jurisdiction cannot be questioned) the retail end user revenues of the cable digital phone provider associated with this jointly provided service should be reported by the CLEC for determining that CLEC's SUSF contribution obligation.

e. Who should administer the fund or other support program (e.g., some successor in interest of the New York Intrastate Access Settlement Pool, Inc., the Targeted Accessibility Fund of New York, Inc., and some other entity)?

Q. Who should administer the SUSF?

A. The current administrator of the TAF is perfectly situated to take on the duty of the new SUSF. It is our understanding that the Targeted Accessibility Fund of New York, Inc. has properly handled the responsibilities for the TAF and there is no reason not to expect the same for this additional universal service program.

f. Should the fund or other support program be reevaluated periodically or sunset after a number of years?

Q. Should there be a periodic reevaluation or sunset?

A. Because universal service is an on-going public policy goal and is implemented through the on-going commitments of the NYSTA Smaller ILECs, a sunset

should not be established. Regardless of what changes may occur in the industry, the need for policy attention to universal service objectives does not go away. The NYSTA Smaller ILECs recommend that a five year window be established, at which time the Commission can evaluate the SUSF to determine whether some modifications of the original intended purpose are warranted at that time. During the course of the next five years, this situation may change, and the proposed window will enable the Commission to monitor and assess the changes and react accordingly. Of course, the evaluation of the current purpose – an extension of the Transition Fund objectives defined in terms similar to those applied for Transition Fund purposes – is separate and apart from any modifications or expansion of State universal service policies to address other potential changes in the industry including, by way of example, those that may occur at the federal level (and which have been discussed previously in this testimony). Regardless of whether there are other changes to address, the 5-year window will allow the Commission to have real world facts to review about the operation of the Phase II form of SUSF and provides a reasonable time period to gather such facts.

g. Should the overall size of the fund or support program cost be limited? If so, at what level should that limit be set; or what methodology should be used to determine that limit?

Q. Should the overall size be limited?

A. No. The success of any universal service policy is dependent on the achievement of the principles and goals. It is a results-oriented plan. Therefore, the size of the

SUSF should be established such that it will continue to be sufficient to provide the necessary network cost recovery support to eligible universal service providers in the manner described herein. The actual size of the SUSF at any given time will be dependent upon the number of companies receiving cost recovery disbursements from it, the timing of any requests for funding since not all of the NYSTA Smaller ILECs would be requesting SUSF disbursements all at once, and the then-Commission-determined disbursement amount for the individual companies.

Q. Have the NYSTA Smaller ILECs performed any estimates to calculate the potential size of the SUSF under its Plan?

A. Yes. At this time, based upon 2009 financial data, access lines and local rates taken from Commission reports and/or tariffs filed by the NYSTA Smaller ILECs, it is estimated that the SUSF, assuming that all of those NYSTA Smaller ILECs that would qualify under the calculation of costs and revenues as described herein would seek SUSF recovery, would be approximately $10.3 million and assumes that all NYSTA Smaller ILECs would be using the Benchmark Rate. For these existing universal service providers, the question of whether or not this level would ever be reached would depend upon a number of factors. These factors include whether a company decides to seek support with the required filings, the timing of those rate filings, the results of the rate case determination, as well as ongoing changes in revenues and expenses in the future. The above amount

compares to the state's other universal service policies achieved by the TAF of $41,396,757 in 2008 based on Staff's report from October of last year presented in this proceeding.

Q. How did you estimate this amount?

A. In general, this SUSF level noted above was determined by estimating an intrastate revenue requirement shortfall for each Smaller ILEC. That revenue shortfall was calculated by first subtracting the company's intrastate ROE, as found on Schedule 10 of the 2009 PSC Annual Reports, from the Commission's most recent authorized intrastate ROE for each NYSTA Smaller ILEC (*i.e.*, the shortfall in allowed return on equity). That difference was then multiplied by the amount of intrastate revenue required to increase the intrastate ROE by 1% (as found on Schedule 10 of the NYSTA Smaller ILECs' respective Annual Reports) to compute the revenue requirement shortfall. It should be noted that pro forma offset adjustments to these computed revenue requirement shortfalls were made for any companies that received authorized local rate increases in 2010 based on the most recent round of *Framework Orde*r compliance filings. Next, the difference between each company's current local rate and the benchmark rate (the "local increase") was multiplied by its total access lines to determine the amount of revenues that could be generated through a rate increase up to the residential benchmark rate (by using total access lines, it is presumed that business rates would be increased by the same dollar amount as residential rates). Finally, if a

company's local service revenue increase was not sufficient to offset its intrastate revenue requirement shortfall, the difference was computed, and that difference represents the needed SUSF funding level. A copy of the calculation used in estimating the size of the SUSF can be found in Exhibit ___ (NYSTA-15) CONFIDENTIAL SUBJECT TO PROTECTIVE ORDER IN NY PSC CASE 09-M-0527.

Q. Do you have an estimate of the impact that the SUSF surcharges would have on the customer's rates?

A. Yes. Based on an estimated 45.9 million telephone numbers in service in New York State based on the FCC's "Trends in Telephone Service" released in September, 2010 at Table 18.3, the surcharge would be a minimal $0.02 per month per telephone number in use. Based on an estimated $11.2 billion in New York intrastate end user revenues (FCC 2009 Universal Service Monitoring Report, Table 1.13), the surcharge for a customer with $25 in billed intrastate charges would likewise be approximately $0.02 per month. Again, similar to the sizing of the SUSF, the likelihood that this level of surcharge, while minimal, would ever be reached would be dependent on factors such as whether a company decides to seek support with the required filings, the timing of those rate filings, the results of the rate case determination, as well as ongoing changes in revenues and expenses in the future.

h. What standards should apply to determine the amounts of

payments from the fund or extent of other form of support from the program to an eligible recipient?

Q. What standards should apply with respect to an eligible provider's determination of intrastate network cost to be considered in the calculation of potential SUSF support?

A. For Phase II purposes, a company seeking SUSF support would first be required to file a rate case with the Commission to demonstrate the need just as has been done for Transition Fund disbursements. (Should other needs for the SUSF arise other than those being addressed herein, other approaches may be justified or warranted.) A company would be eligible for SUSF recovery arising from this Phase II upon a finding by the Commission that the revenues generated by the Benchmark Rate along with the revenues associated with all other intrastate regulated services would not be sufficient to provide the company with the ability to recover its intrastate regulated costs, including an opportunity to earn a fair rate of return on its investment. The intrastate ROE used in determining the fair rate of return would be the intrastate ROE, as traditionally determined by Staff, and approved by the Commission, in its mini rate case proceedings. Those current intrastate ROEs, as used in our SUSF size estimate, can be found in confidential Exhibit __ (NYSTA-15).

Q. Should return components on other operations be considered here?

A. No. Use of any earning measures for jurisdictions other than the intrastate

regulated jurisdiction or experience outside of the regulated operation of the company should not be considered. There are rigid rules that determine the cost allocation between and among jurisdictions, regulated and non-regulated operations, and affiliate operations.

Q. Has the Commission previously confirmed this form of earnings measure, *i.e.*, limited to regulated intrastate operations of the ILEC?

A. Yes. In a proceeding involving Verizon New York, Inc., the Commission explained why operations apart from intrastate regulated services operation are not to be considered:

> Some parties suggest that Verizon's wireline competitive losses in New York should only be considered in the context of profits made in other competitive lines of business and regulated profits made in other states by Verizon New York Inc.'s parent company. This would be a significant departure from the traditional approach of reviewing jurisdictional costs and associated revenues . . . . Investors do not typically continue to support one project simply because another unrelated project is profitable. We decline to rely on non-jurisdictional earnings to offset jurisdictional losses.

Competition III Order, at p. 55, n. 112. The Commission also recognized the industry rules separate these non-regulated operations from intrastate regulated operations:

> Under existing rules and regulations much of the revenue from these new product lines do not contribute to intrastate earnings, and are not available to offset state revenue deficiencies.

Id. at p. 56, n.114. Moreover, the Commission enunciated the jurisdictional principle this way:

> Some parties commented that using the ROE subject to separations potentially exceeds the Commission's jurisdiction (ROE subject to separations includes intrastate and interstate revenues and costs). To avoid this concern, the companies' most recently reported 2006 intrastate ROEs will be used as a starting point.

*Framework Orde*r at p. 9.

Q. Are there other considerations?

A. Yes. Equally as important as consideration of the proper jurisdiction within which a company provides intrastate universal services is the level of the intrastate ROE to be applied in the SUSF process. Under the NYSTA Smaller ILECs' Plan, the SUSF calculation methodology, as described herein, uses the company-specific intrastate ROEs used by the Commission in determining rate flexibility eligibility in the most recent round of the Case 07-C-0349 Framework for Regulatory Relief rate reviews. *See* Exhibit __ (NYSTA-16). These are generally the same authorized ROEs that would be used by the Commission in the context of a current mini rate case proceeding. Once again, similar to its acknowledgement of the proper jurisdiction to be considered in rate cases, the Commission has also provided insight as to the appropriate level of the intrastate ROE to be used, indicating that ROEs below its authorized intrastate ROEs are considered. When discussing ROEs in the context of local rates and rate increase eligibility, the Commission has also provided insight as to the appropriate level of the intrastate ROE to be used, indicating that ROEs below its authorized intrastate

ROEs are considered. When discussing ROEs in the context of local rate increase eligibility, the Commission has characterized ROEs that are *below* its authorized ROE levels as "inadequate", "depressed" and "sub par":

> In an attempt to streamline regulation, companies who are not facing a significant level of competition but have inadequate returns on equity will be permitted non-basic rate flexibility and $2.00 annual basic rate increases for two years provided that the allowed return on equity is not exceeded. This framework, which is not part of Competition III, recognizes that earnings of the small, independent companies that do not face a significant level of competition have, nevertheless, been depressed in recent years. (Framework Order, pages 2-3)
> . . .
>
> 3. Inadequate competitive presence and a sub par adjusted intrastate ROE. Companies that fall in Scenario 3 are not able to demonstrate that more than 69% of their customers have two competitive options, but their adjusted ROE is below the allowed level.

Framework Order at p. 13.

Thus, it would be illogical to assume that the Commission would use anything other than its authorized intrastate ROEs, certainly not inadequate, sub par or depressed ROEs, in setting an appropriate ROE for ratemaking and universal service purposes.

Q. Can you summarize the NYSTA Smaller ILECs' position on the proper ROE?

A. In summary, it is the NYSTA Smaller ILECs' position that appropriate SUSF eligibility standards should follow those standards traditionally employed in the

context of a rate case, including the in-depth analyses performed by Staff on the company's costs and operations, the ROEs that allow the company an opportunity to earn a fair rate of return, and the Commission's review and approval of those rate case findings.

Q. Please describe the Commission Staff's rate case process.

A. For purposes of this proceeding, it is the rate case process, traditionally referred to as a "mini rate case" that is used to determine each of the current Transition Fund recipients' disbursements. It is also the process that has been used by every NYSTA Smaller ILEC that has filed for a local rate increase for the past several years and anticipated to be used for the purposes described herein and was also used for the disbursements made from the Transition Fund. Under the mini rate case process and in accordance with PSL Section 92 (2)(c), the allowed rate increase is limited to the greater of $300,000 or 2.5% of the company's intrastate revenues. The intended outcome of a rate case filing is to produce a level of revenues sufficient to allow the company to recover its intrastate costs, as adjusted by Staff, and to provide the company with the opportunity to earn a fair rate of return on its investment. As described more fully by the Staff Finance Panel in its testimony at page 7, In The Matter of St. Lawrence Gas Company, Case 08-G-1392, April 2009:

> A fair rate of return for a regulated utility is one that enables it to provide safe and adequate service to its customers, while at the same time assuring it continuing support in the capital markets for

> both its debt and equity securities, at terms that are reasonable given the company's risk.
>
> Common equity investors may share in, but are not guaranteed a portion of the utility's residual earnings. The fair rate of return, therefore, allows the utility to recover its prudently incurred costs of debt and preferred stock, while providing its common equity investors the opportunity to earn a return that is commensurate with the risk of their investment.

In a mini rate case, Commission Staff incorporates a ROE into its intrastate revenue requirement calculation that is generally based on current market conditions and the company's capital structure. For a mini rate case, the filing company submits its initial request, which generally includes financial information for the preceding calendar year, adjusted to reflect various future known and measurable changes in expenses such as staffing levels, salaries, benefits and property taxes. Other than changes in federal HCL disbursements (which is treated by the Commission as intrastate revenue), adjustments to future revenues are generally not allowed. The company's filing also includes supporting calculations and documentation, such as federal and state tax filings, audit report(s), Part 36 Jurisdictional Cost Study (used in developing intrastate expense and rate base separations factors), rate base (net investment), allocation procedures used in assigning costs to nonregulated/affiliate operations, rate design and a host of other miscellaneous schedules and compliance documentation. Commission Staff then begins its internal process of reviewing the submitted documentation, followed by the issuance of multiple supplemental data requests

and an on-site review(s) at the company's business office. Based on the most recent mini rate cases, the amount of time required to process a mini rate case, from the date of the initial filing to final consideration at the Commission session, has generally taken, on average, 8 months.

Q. Is the Commission Staff's review in the context of a mini rate case rigorous?

A. Absolutely. The Staff review involves an in-depth review of all elements of the company's operating expenses and rate case adjustment categories. These inquires and significant in-depth reviews include areas such as: (1) regulated payroll expense; (2) work functions of the company employees, including a review of the type of work being performed and the distribution of each individual employee's time between regulated and nonregulated/affiliate operations; (3) all other "common" cost elements whose allocations could be impacted by the company's nonregulated/affiliate operations, such as building and vehicle usage, external accounting and legal services and any other expenses that could be considered to follow payroll, such as benefits and office supplies; (4) the reasonableness of, and costs associated with, the benefits package offered by the company to its employees, such as health insurance and retirement benefits; (5) the company's depreciation reserve requirements to estimate the appropriate level of depreciation expense and to assess the reasonableness of the company's depreciation reserve; and (6) review of a substantial number of the company's invoices to examine the nature and level of those costs, as well as the company's

allocations to regulated and nonregulated/affiliate operations.

Q. Given the explanation of this process, what are the conclusions that can be drawn with respect to the use of this process for SUSF purposes?

A. In summary, Staff's rate case review process is extremely thorough and critical. The relatively small size of the average NYSTA Smaller ILEC makes it possible for Staff to perform its rate case review at a level that would be impractical, if not impossible, for the other larger ILECs or alternative telecommunications providers in New York. As a result, there are very few, if any, elements of the company's operations that are not scrutinized in detail.

3. Should a benchmark rate (or other benchmark be established? If so, at what level (e.g., for a benchmark rate, the comparable Verizon rate, some percentage above or below the Verizon rate, some other method)?

Q. Should the Benchmark Rate for SUSF purposes be established?

A. Yes. The NYSTA Smaller ILECs propose that the national average urban local rate be used as the foundation for the Benchmark calculation. The FCC, in CC Docket No. 96-45, Joint Petition of the Wyoming Public Service Commission and the Wyoming Office of Consumer Advocate for Supplemental Federal Universal Service Funds for Customers of Wyoming's Non-Rural Incumbent Local Exchange Carrier, Order on Remand and Memorandum Opinion and Order, Adopted and Released April 16, 2010 (page 25), identified a national average urban local rate, which included the subscriber line charge ("SLC") and federal universal service charge ("FUSC"), of $19.57. The NYSTA Smaller ILECs

recognize that this $19.57 national average urban local rate was based on 2006 data and suggest that it be updated to 2009 (consistent with the use of 2009 costs), based on a three-year inflation factor of 6%, yielding an inflation-adjusted national average urban local rate of $20.74.

Q. Based on the inflation-adjusted $20.74 national average urban local rate discussed above, what would the associated tariff local Benchmark Rate be?

A. As described earlier, the $20.74 rate included SLC and FUSC rate components. For purposes of our calculation, we incorporated a standard residential SLC of $6.50 and then an associated FUSC of $1.01. Removal of these two rate elements would result in a pure local service rate of $13.23. The NYSTA Smaller ILECs propose that, in order to be eligible for SUSF, the Benchmark Rate be set at a level above this $13.23 price and, for this purpose, incorporate the 115% threshold that is currently used in determining federal HCL disbursements for rural ETCs. Therefore, the resultant Benchmark Rate would be $15.22.

Q. Do the NYSTA Smaller ILECs believe that a benchmark based on a nationwide average local urban rate is reasonable?

A. Yes. This methodology is reasonable for the following reasons:

(1) Use of an average nationwide urban local rate is fully consistent with the third principle of universal service enacted by Congress (set forth earlier in this testimony) – access to telecommunications in rural areas that are reasonably

comparable to that available in *urban* areas at rates reasonably comparable to rated changed in *urban* areas.

(2) This method recognizes, as did the FCC, that *local tariff* rates are not the only cost a customer is required to incur in order to purchase stand-alone basic local service. In addition to the tariff local rate, residential customers are generally charged a federally prescribed SLC and the associated FUSC. Customers, when determining their cost of local service, would likely view the entirety of these rate elements as their real rate for local service, since these three rate elements – the local service rate, the SLC, and the FUSC -- are, in essence, unavoidable. Therefore, the entire, *real* charge for stand-alone basic local exchange service under our proposal is $22.73 ($15.22 + $6.50 + $1.01), excluding other taxes and surcharges, and should be considered a reasonable and affordable price *for the service being purchased*. This price does not include features or unlimited toll and, as such, should be considered and assessed on an apples-to-apples basis.

Q. Is there a third reason justifying the reasonableness of the NYSTA Smaller ILECs' Benchmark Rate?

A. Yes, with a number of subsidiary points. When the Commission first established a benchmark rate in its *Competition III Order* at page 61, it stated:

> We therefore conclude that based on competitive offerings, cost, our interest in ensuring incumbent carriers are able to maintain a secure and reliable network, and our goal of

> maintaining universal service, a flat rate basic service offering with a statewide basic service rate cap of $23.00 is justified.

The "competitive offering" aspect of this statement took into consideration two local rates being charged by Verizon ($24.95 and $22.00) and one by AT&T ($22.95), and the Commission set the benchmark cap between these prices, stating "[t]his reflects both an established competitive price and a new competitive price and we therefore conclude that a $23.00 rate cap is just and reasonable." *Id*. at p. 60. The NYSTA Smaller ILECs, in reviewing this "competitive pricing" rationale, offer the following observations:

(i) If one were to reevaluate the "competitive" rates that supported the Commission's prior benchmark determination, then consideration should now be given to a current $24.99 Verizon service offering that includes basic local exchange service , as well as *unlimited nationwide toll calling* (including calling to Puerto Rico, Guam and the U.S. Virgin Islands, as well as Canada). *See* Exhibit __ (NYSTA-17). This is not a promotional offering or temporary discount, it is guaranteed for the life of the service plan. For purposes of comparisons, such as was previously undertaken by the Commission, the NYSTA Smaller ILECs suggest that the value for basic service inherent in this package price would imply a "competitive" local-only rate element well below the $24.99 package price.

(ii) The $24.95 Verizon rate considered by the Commission in its

Competition III proceeding represented an unlimited local calling plan for Verizon's Downstate customers. Customers in any of Verizon's seven Downstate Home Regions (New York City, Nassau, West Suffolk, East Suffolk, Lower Westchester, Upper Westchester and Rockland) can place unlimited local calls to any other customers within their Home Region for this $24.95 price. Clearly, the ability to call hundreds of thousands, even millions, of customers on a flat-rated local basis makes Verizon's Downstate plan considerably more valuable than the $23.00 benchmark currently applied in the NYSTA RLEC service areas, where the number of customers that can be reached on a local basis is substantially lower. The Commission, in its *Competition III Order* at page 67, fn 135, recognized that:

> Another basis we have long used to approve different rates for the same service in different areas is the number of local, non-toll phone numbers available to the customer. Rate groups have been based on this value-based approach where the service rate increases with the number of local phones that can be contacted.

To even come close to resembling the calling scope of Verizon's $24.95 Downstate plan, customers of the NYSTA Smaller ILECs would have to incur additional toll costs, likely putting their comparable price in excess of $30, even $40. In recognition of the more limited local calling scope in the NYSTA RLEC service areas, the current $23.00 benchmark should be more reflective of their local calling scopes and reduced.

(iii) The $22.00 Verizon rate considered by the Commission in its Competition III proceeding represented the price for Verizon's Upstate Regional Value calling package. While the Commission's *Competition III Order* did not reference it, this package also included *unlimited intraLATA toll calling* (Case 05-C-1303, Order Denying Petitions Requesting Suspension and Hearing on Tariff Filing, Issued and Effective December 6, 2005, page 1). Therefore, the NYSTA Smaller ILECs suggest that the value for local service inherent in this package price would imply a "competitive" local-only rate element well below the $22.00 package price. Additionally, similar to item (ii) above, the inclusion of unlimited intraLATA toll calling makes the calling scope significantly larger than the smaller calling areas of the NYSTA Smaller ILECs and, as such, the $23.00 benchmark rate should be more reflective of their limited local calling scopes and reduced.

Q. Are there additional aspects of the Commission's Competition III proceeding that support the reasonableness of the methodology used to calculate the NYSTA Smaller ILECs' Benchmark Rate?

A. Yes. The "cost" aspect of the Commission's statement referenced above took into consideration a forward-looking basic service costing analysis referenced in the *Competition III Order* at page 58:

> As we described in Case 05-C-1303, forward-looking costs for a basic offering, including forward-looking retailing costs, range from $22 downstate to $26 upstate.

However, a review of the Appendix contained in the Case 05-C-1303 Order cited above indicates that this $22 to $26 range was for Verizon's Regional Essentials calling package that included up to three features and unlimited intraLATA toll calling. For purposes of an apples-to-apples basic service costing comparison, the $26 upstate cost should first be reduced by (1) the $6.39 SLC identified in the Appendix and (2) the $3.75 cost associated with the three calling features. Therefore, the NYSTA Smaller ILECs suggest that the relevant cost comparison for local basic service only should have been the resultant $15.86 cost, less the unquantified cost associated with the unlimited intraLATA toll calling, a figure well below the $26.00 cost referenced in the Comp III Order.

Q. Based on all of these points, what conclusions have you reached?

A. Based on the foregoing discussions, the $15.22 local tariff benchmark rate described above (total charge of $22.73 including the SLC and FUSC) provides a rational standard for stand-alone local service, upon which appropriate SUSF eligibility and quantification determinations can be made.

Q. You are asking that the Commission change its prior $23 benchmark decision, correct?

A. Yes. The reasons for doing so are straightforward. In addition to the reasons noted above, the NYSTA Smaller ILECs fully understand that such change may require the Commission to revisit its *Competition III Order,* but only in the

context of the NYSTA Smaller ILECs and their respective service areas. However, while the 2006 decision may have been proper for statewide competitive *pricing* analytical frameworks, this case now addresses universal service which raises a significantly different set of long-term considerations. Moreover, by approving the extension of the Transition Fund in July, the Commission fully recognized that the benchmark rate would be subject to discussions in this Phase II.

Q. Are there any public safety concerns that should be considered when analyzing the affordability of the benchmark rate?

A. Yes. In a July 2009 on-line article published by wirelessandmobilenews.com titled *911 Emergency Keep Landline and Cell, Says AT&T, "*AT&T and the National Emergency Number Association (NENA) released survey findings showing the need for households to establish home emergency communications plans that include a 'home base' with a corded landline phone in addition to a cell phone for making emergency calls." Brian Fontes, NENA Chief Executive Officer, was quoted as saying: "The more choices you have to reach 9-1-1 in an emergency, the better, and a corded landline phone should be one of those options. It provides the security of a home phone line connection to 9-1-1 so that in most cases first responders know your home address." The general public shares the same belief. The survey of 2,000 households took place in June 2009. Of the respondents, "80% felt that it is important to have both a corded landline

and a cell phone in their home in case of emergency because it provides options to dial 9-1-1 reliably and quickly." In addition, Joey Schultz, AT&T vice president of consumer marketing, is quoted as saying "At AT&T, we understand how important communications are during an emergency, and our priority is to provide customers with reliable services and multiple options to stay in contact."

The higher the benchmark rate, the higher the number of New Yorkers that will decide to cut their landline service, potentially endangering their safety as a result. New Yorkers should not be forced to make such decisions.

Q, What should the Commission do with respect to those NYSTA Smaller ILECs that currently are charging local rates above the proposed benchmark?

A. Any company in that situation would need to make its demonstration in the SUSF process outlined herein with respect to the local rate levels it believes are justified.

Q. Does this end your testimony?

A. Yes, at this time.

ERRATA

Page 12, Line 21: Delete “services” replace with “service”

Page 14, Line 11: Delete “has” replace with “have”

Page 20, Line 6: Delete “obligations” replace with “obligation”

Page 22, Line 16: Delete word “a” replace with “an”

Page 26, Line 4: Delete “recovery” replace with “recover”

Page 33, Line 19: Delete “is”

Page 53, Line 25: Delete “note” replace with “noted”

Page 69, Line 5: Delete “have” replace with “has”

Page 72, Line 9: Delete entire line

Page 81, Line 10: Delete “Commissioner” replace with “Commission’s”

Page 89, Lines 18: Delete “Once again, similar to its”

Page 89, Lines 19-24: Delete all

Page 90, Line 1: Delete “ROEs are considered.”

Page 94, Line 10: Add “)” after the words “(or other benchmark”

Page 96, Line 2: Delete “rated changed” replace with “rates charged”

Page 97, Line 17: Delete “purposes” replace with “purpose”

Page 97, Line 18: Delete “comparisons” replace with “comparison”

Page 100, Line 11: Delete “Comp III Order” replace with “*Competition III Order*”

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CASE 09-M-0527 STEVEN E. WATKINS & KEVIN F. SCHWENZFEIER

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Proceeding to Examine Issues Related to a Universal Service Fund — **Case 09-M-0527**

REBUTTAL TESTIMONY

of

STEVEN E. WATKINS
&
KEVIN F. SCHWENZFEIER

on behalf of the

NEW YORK STATE TELECOMMUNICATIONS ASSOCIATION, INC.
SMALLER ILEC MEMBER GROUP
(THE "NYSTA Smaller ILECs")

January 28, 2011 (with modifications served February 11, 2011 see page 123)

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CASE 09-M-0527 STEVEN E. WATKINS & KEVIN F. SCHWENZFEIER

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b. ***(i) The purposes the fund or program, if any, would serve; (ii) what alternatives might be available to fulfill those purposes and meet the claimed need; and (iii) the relative merits and drawbacks of such a fund or program compared with those of the available alternatives.***

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CASE 09-M-0527 STEVEN E. WATKINS & KEVIN F. SCHWENZFEIER

REBUTTAL TESTIMONY OF
STEVEN E. WATKINS & KEVIN F. SCHWENZFEIER
ON BEHALF OF THE NYSTA SMALLER ILEC MEMBER GROUP
January 28, 2011

I. INTRODUCTION

Q. Please state the name, business address, and telephone number of the rebuttal witnesses.

A. Steven E. Watkins and my business address is 2154 Wisconsin Avenue, N.W., Suite 290, Washington, D.C., 20007, and business phone number of (202) 333-5276. Kevin F. Schwenzfeier and my business address at 120 Erie Boulevard, Schenectady, New York, 12305, and business phone number of (518) 374-2552.

Q. Did you file direct testimony in this proceeding?

A, Yes. We filed, as a panel, direct testimony with the State of New York Public Service Commission ("Commission") in this proceeding on December 31, 2010 (to be referred to as the "NYSTA Direct").

Q. On whose behalf are the witnesses testifying?

A. The witnesses are testifying on behalf of New York State Telephone Association, Inc. ("NYSTA") Smaller Incumbent Local Exchange Carrier member group to be referred to herein collectively as the "NYSTA Smaller ILECs" or individually as a "NYSTA Smaller ILEC." The companies that make up the NYSTA Smaller ILEC group are those listed on p. 2 of the NYSTA Direct.

Q. What is the purpose of your rebuttal testimony?

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A. The purpose of this rebuttal testimony is to respond to the direct testimonies of the other parties filed on December 31, 2010 in this proceeding including: (1) the Policy Panel filed by the Commission's Staff ("Staff Policy Direct"); (2) the USF Mechanism Panel filed by the Commission's Staff ("Staff USF Mechanism Direct"); (3) the Substitutability Panel filed by the Commission's Staff ("Staff Substitutability Direct"); (4) the White Spots Panel filed by the Commission's Staff ("Staff White Spots Direct"); (5) Gregg C. Collar on behalf of the NYS Consumer Protection Board ("CPB Direct"); (6) E. Christopher Nurse on behalf of A&T Communications of New York, Inc, and its regulated affiliates ("AT&T Direct"); (7) Richard L. Ansaldo on behalf of the Cable Telecommunications Association of New York, Inc. ("CTANY Direct"); (8) Peter N. Sywenki on behalf of Sprint Nextel ("Sprint Direct"); (9) David R. Conn on behalf of T-Mobile ("T-Mobile Direct"); (10) Rochelle D. Jones on behalf of tw telecom, Level 3 Communications LLC, and PAETEC Communications, Inc. ("CLEC Coalition Direct"); and (11) Paul B. Vasington and Harold E. West, III on behalf of Verizon New York, Inc. ("Verizon Direct").

Q. Are you sponsoring any exhibits associated with your testimony other than that noted above?

A. Yes, we are also sponsoring Exhibit __ (NYSTA- 18) through Exhibit __ (NYSTA-26). Exhibit __ (NYSTA-18) is a discovery response from CTANY;

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Exhibit __ (NYSTA-19) is a discovery response from Verizon; Exhibit __ (NYSTA-20) is a copy of the "Telephone Regulatory Convergence Matrix" from Case 05-C-0616; Exhibit __ (NYSTA-21) is a set of 911 newspaper stories; Exhibit __ (NYSTA-22) are discovery responses by Verizon, one to the Staff and one to the NYSTA Smaller ILECs; Exhibit __ (NYSTA-23) is a copy of a paper submitted on behalf of the National Telecommunications Cooperative Association, Inc. by Dale E. Lehman, PhD; Exhibit __ (NYSTA-24) is a confidential exhibit submitted pursuant to the Protective Order in the proceeding; Exhibit __ (NYSTA-25) is a comparison of the nationwide loops cost; and Exhibit __ (NYSTA-26) is also confidential exhibit submitted pursuant to the Protective Order in the proceeding.

Q. How will you organize the remainder of this rebuttal testimony?

A. We will respond to specific issues presented by the other parties' direct testimony and will attempt to include those responses, based on the subject matter, within the sections following each of the Phase II issues list from Appendix A to Judge Jack's November 18, 2010 procedural ruling. For ease of reference and recognition, the Phase II issue statements that follow within this rebuttal testimony are shown in *italics*. Further, we will reference various Commission actions in this rebuttal, and we use the same reference to those decisions as used in the NYSTA Direct. We also note that it would be cumbersome if not

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unworkable to address each and every statement that a witness or panel of witnesses stated in their respective direct cases. Accordingly, any statement that is not specifically objected to in this rebuttal that is otherwise contrary to the State Universal Service Fund ("SUSF") plan set forth in the NYSTA Smaller ILECs' direct testimony (the "NYSTA Plan" or the "Plan") is disputed.

Q. Before we turn to the Phase II issues, do you have any initial reactions to any of the direct testimony of the other parties?

A. Yes. We focus our primary review on the testimony of the Commission Staff in that it contains a relatively inclusive set of discussions regarding the relevant issues. In general, the direct testimonies of the Commission Staff provide significant confirmation of the need for a SUSF, in many ways similar to the positions set forth by the NYSTA Smaller ILECs as contained in our direct testimony. Staff confirms that "[u]niversal service ensures that all residents of the state have access to affordable and reliable basic telephone services." Staff Policy Direct at p. 6, lines 21-23. Even though policies favoring competition have been adopted over the years, Staff also confirms the Commission's directive that "competition cannot come at a price that threatens universal service." *Id.* at p. 7, lines 10-19. In other words, competitive policies do not trump universal service goals. The NYSTA Smaller ILECs agree.

Staff further concludes that a SUSF funding structure would provide

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revenues and cost recovery to the NYSTA Smaller ILECs in a manner "to avoid raising rates to an unreasonable level . . . ." *Id*. at p. 19, lines 8-10. The NYSTA Smaller ILECs also agree with this consideration.

Finally, consistent with the NYSTA Plan, the Staff USF Mechanism Panel, among other proposals it calls "key principles," sets forth a SUSF concept that would provide disbursements to eligible service providers to provide for the recovery of costs that would not be recovered via service rates calculated at a benchmark level. *See, e.g.*, Staff USF Mechanism Direct at p. 8, line 22 through p. 9, line 2. While Staff's proposal would, improperly, only allow for a "partial" recovery of the costs over a benchmark rate, as opposed to the NYSTA Plan, their concepts are generally consistent with the Plan that the NYSTA Smaller ILECs set forth in their direct testimony. *See, e.g.*, NYSTA Direct at pp. 30-34.

A. SUMMARY OF THE GENERAL CONCERNS WITH STAFF'S PROPOSAL.

Q. Are there any general observations that you would like to make?

A. Yes. First, as a general matter, the Staff's view of the purpose of the SUSF needs to be amplified. Second, we have significant concerns regarding the apparent narrowed geographic focus of the Staff's testimony and coverage report. Finally, we have concerns regarding the placement of more onerous regulatory demonstrations on the NYSTA Smaller ILECs under the Staff's proposal.

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Q. The Commission Staff discusses the "regulatory compact." What reaction do you have to the Staff USF Mechanism Panel's statement on page 14 of its testimony that "the regulatory compact is almost broken"?

A. The Staff USF Mechanism Panel provides the following observation:

> Given its limits on the ability to control competitive entry, there has been a realization by the Commission of the possibility that companies can no longer be made whole on an intrastate regulated basis as a result of market share losses (i.e., the regulatory compact is almost broken).

Page 14, lines 17-23. Needless to say, "almost broken" and "broken" are two very different concepts. Should this Commission somehow find that it is no longer committed or willing to allow the NYSTA Smaller ILECs the opportunity to recover their intrastate costs, including a fair rate of return on their investments, then the regulatory compact will indeed be broken. This is of particular concern in light of the NYSTA Smaller ILECs' unique roles as universal service providers and carriers of last resort within their respective rural service areas. This proceeding is as much about the future of universal service in New York State – the continued provisioning of safe and reliable telecommunications networks and services at comparable and affordable prices – as it is about SUSF funding. What Staff does not acknowledge in its discussion is that it is not the NYSTA Smaller ILECs who have "almost broken" the regulatory compact, nor could they. The

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NYSTA Smaller ILECs are regulated under the full panoply of regulations that pre-date the advent of full competition.

If the Commission finds that it is no longer committed to honoring the regulatory compact that it established with the NYSTA Smaller ILECs and under which the NYSTA Smaller ILECs made their network investment decisions, then, by extension, the Commission will have "changed horses in mid-stream" and created a significant integrity gap between what it suggested the NYSTA Smaller ILECs should do and the on-going universal service goals that the Commission has proclaimed for decades as critical. And, if this is truly the case, then the future of safe, reliable and affordable telecommunications services in New York State will be in serious jeopardy since it is only the NYSTA Smaller ILECs that are, in the first instance, subject to the Commission's oversight and jurisdiction for their universal service offerings.

Q: Are these serious issues?

A. Yes. These are serious issues that the Commission must decide in this proceeding and its decisions will have real life consequences. If the regulatory compact should "break," so too will many of the NYSTA Smaller ILECs. Likewise, it will be difficult to understand why the Commission deems it appropriate *not* to provide for the recovery by the NYSTA Smaller ILECs of some of the costs that were incurred by them at the direction of and in reliance on the Commission's

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regulatory compact with each of them.

Q. What amplification is necessary with respect to Staff's discussion as to need for and the intended purpose of its proposed SUSF?

A. The Staff Policy Panel has stated that:

> If these companies fail, customers with no other access to an affordable and ***substitutable provider*** could be without dial tone altogether (page 18, lines 21-23) (emphasis added***)***
>
> Creation of a funding structure to make certain that customers ***with no other alternative to the service provided by an incumbent*** will continue to have access to reliable basic telephone service at an affordable rate. This funding structure would provide a way to avoid raising rates to an unreasonable level in the event that customers in any part of the state risk losing phone service or have nothing but lower tier or unaffordable service available. (page 19, lines 4-13) (emphasis added)

While we are troubled by some of the context within which these statements are made, we do see threads of principles upon which rational policy decisions can be based. For example, it appears from these statements that Staff believes that *all customers* must continue to have access to the networks and services of a universal service provider. The NYSTA Smaller ILECs would add, however, that such provider must be committed to and subject to the authority of the Commission's universal service objectives as well as all other rules and regulations of the Commission, in order to ensure that any universal service policies can, in fact, be enforced.

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At the same time, however, universal service is not only about the "white spot" areas where customers may have no alternative providers, "substitutable" or not. It is also about the ability for all consumers, regardless of location, to have access to the safe, high quality, reliable, affordable networks and services of a Commission-authorized universal service provider that is subject to the Commission's jurisdiction and oversight and is obligated to comply with the Commission's directives as a result of that jurisdiction. Moreover, universal service is about providing for a universal service environment where SUSF disbursements are not triggered at the time of some imminent bankruptcy of a NYSTA Smaller ILEC, but rather encourages healthy companies that are able to deploy, upgrade, maintain and operate rural networks. The quotes from the Staff Policy Panel may appear to overlook these aspects of universal service, but we trust Staff will agree with them.

Q. Can you outline your concerns regarding the apparent narrowed geographic focus of the Staff's testimony as well as placing more onerous regulatory demonstrations on the NYSTA Smaller ILECs under the Staff's proposal?

A. Yes, but we do note that these points will be addressed in greater detail below. First, there appears to be an improperly narrow focus contained in Staff's testimony and Staff Report to only those portions of the NYSTA Smaller ILECs' service areas where there are no alternative service providers operating or

available to provide service to customers in those areas. We are concerned that some parties my interpret Staff's "findings" as somehow confining SUSF solely to those areas. We will address the flaws associated with this potential interpretation later in this testimony.

Second, Staff appears to use this universal service proceeding to propose potentially more onerous regulatory requirements for the NYSTA Smaller ILECs than those that already burden these companies. Part of the public policy problem which we are addressing in this proceeding arises from the fact that the NYSTA Smaller ILECs are subject to disparate and more onerous and controlling regulatory requirements than their competitors. Instead of subjecting the current universal service providers to more burdensome requirements, the Commission should be looking for ways to lessen those burdens and to equalize the requirements among the NYSTA Smaller ILECs and their competitors. While this policy goal goes beyond the current Phase II of this proceeding, the NYSTA Smaller ILECs recognize that there needs to be accountability built into any process for receiving SUSF disbursements and our Phase II SUSF proposal does that in a manner that would be used for all potential recipients of Phase II SUSF – the rate case process that has been used and fully tested by the Commission.

Q. Based on these comments, are the NYSTA Smaller ILECs in lock step with Staff's proposal?

A. No. While the basic tenets of Staff's direct testimonies are consistent with those of the NYSTA Smaller ILECs, the witnesses also present other opinions with which we disagree and that are of great concern. We will address those issues in greater detail in the subject matter sections of this rebuttal. Nonetheless, it is always easier to work from a general set of agreed-upon principles – the most important of which is the need for a SUSF. For the reasons stated herein and in the NYSTA Direct, the NYSTA Plan improves upon the Staff's proposals.

B. SUMMARY OF THE GENERAL CONCERNS WITH THE OTHER PARTIES' POSITIONS.

Q. Are there any general observations that you would like to make?

A. Yes. We want to note that certain parties assert that the Commission, in its 2006 *Competition III Order*, determined that a universal service fund was unnecessary at that time and that this conclusion somehow governs the analysis now. These assertions are incorrect and will be discussed in greater detail later in our testimony.

Q. Can you summarize generally some of the other concerns you have with the positions of the other parties?

A. The positions of some of the other parties are rooted in an inaccurate presumption that "universal services" are already available from alternative providers and, therefore, there is no need for a SUSF. Other parties also have an unfounded presumption that universal service principles can be addressed solely by attention

to those areas where alternative providers do not exist (*i.e.*, so-called "white spots"). Moreover, other parties (such as Verizon in the Verizon Direct at pp. 48-58) present proposals and positions that are beyond the scope of this proceeding and/or suggest approaches far afield from, or counterproductive to, the need to address the immediate need for a continuing SUSF. Further, some parties propose the application of a benchmark rate for local service that would simply be too high to satisfy any semblance of comparability or affordability pursuant to universal service principles. Again, these aspects of the other parties' direct cases are addressed in more detail below.

II. PHASE II ISSUES

1. Is there a need to establish a State Universal service High Cost Fund, or other form of support program to ensure universal availability of affordable basic residential telephone service in New York, to succeed the Temporary Transition Fund Extension approved by the Commission's July 16, 2010, order in Phase I of this proceeding?

a. Whether the need, or lack of need, for such a fund or program can, as a practical matter, be determined (i) on a generic basis; or (ii) only on a case-by-case basis, considering a particular carrier's service area or a discrete portion of its service area and the particular circumstances of the carrier, service area, or portion of service area.

b. (i) The purposes the fund or program, if any, would serve; (ii) what alternatives might be available to fulfill those purposes and meet the claimed need; and (iii) the relative merits and drawbacks of such a fund or program compared with those of the available alternatives.

A. THERE IS AN ABSOLUTE NEED FOR A LONG-

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TERM AND CONTINUING SUSF.

Q. Does the Commission's Staff recognize the need for a SUSF mechanism?

A. Yes. Staff recognizes that the current Transition Fund will end, and that, generally, there remain conditions to be addressed by a continuing form of a State Universal Service Fund. *See*, *e.g.*, Staff Policy Direct at pp. 9-14.

Q. Do other parties recognize the need for a SUSF mechanism?

A. Yes. AT&T proposes that "the current rate-case driven process continue to be used as the gateway to funding by additional small companies." See AT&T Direct at p. 2, lines 41-43. AT&T also proposes that the Transition Fund disbursements should continue for the three NYSTA Smaller ILEC members currently receiving Transition Fund disbursements. *See* AT&T Direct at p. 14, lines 261-262.

Q. Do other parties question the need for a SUSF?

A. Yes.

Q. What are the reasons cited by those parties in favor of no continuing SUSF?

A. They cite such things as the Commission previously determining that there is no need for a SUSF and that such determinations should likewise govern the issue now, the size of the SUSF would be uncontrolled, and the establishment of the SUSF would stifle competition. Moreover, some parties improperly suggest, therefore, that there should be no extension of the Transition Fund disbursement

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levels to the three NYSTA Smaller ILECs currently receiving those funding levels.

Q. With respect to certain parties' contentions concerning the 2006 *Competition III Order*, do you believe that these parties provide an accurate portrayal of what the Commission decided?

A. Absolutely not. The parties making such claims reference various statements found in the Commission's *Competition III Order* in support of their efforts to suggest that the Commission has concluded for all time that a SUSF is not necessary. For example, Sprint (Sprint Direct at p.3, lines 15-17) states that "The Commission recognized the extent of competition in 2005 and determined that no state universal service fund was necessary", referencing the *Competition III Order* at page 70. Similarly, T-Mobile (T-Mobile Direct at p. 2, lines 18-19) provides the following excerpt from pages 75-76 of the *Competition III Order*:

> … that a state high cost universal service fund is unnecessary at this point, and that any further decision on this issue should await the conclusion of the FCC's pending dockets examining universal service, universal service funding, and intercarrier compensation.

However, these parties, as well as other parties that may be making similar contentions, conveniently omit a very important consideration recognized by the Commission in making the statement that is being quoted.

Q. What is this critical omission?

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A. The parties fail to acknowledge one of the key findings upon which the Commission based its conclusion that no SUSF was necessary at the time the *Competition III Order* was issued. That key finding was that the Commission had concurred with its Staff's September 21, 2005 White Paper issued in that proceeding, and thus stated at page 70 of the decision that:

> The White Paper and the majority of the parties saw no need for the creation of a high cost fund in New York, noting that ***the existing Transition Fund is available to a company whose local rates are insufficient to meet its intrastate revenue requirement***. (emphasis added)

That conclusion was based on the following Staff findings at page 56 of its White Paper:

> We agree with the majority of parties that the need for creation of a high cost fund has not been demonstrated. ***The existing Transition Fund***, which can be drawn on through a rate case where a local company's local service rates are insufficient to meet its intrastate revenue requirement, ***has not yet been tapped.*** (emphasis added)

Taken in context, therefore, the Commission's statement that there was no then-current need for a SUSF was based on the circumstances at that point in time, not for all time.

Q. Are there other aspects of the *Competition III Order* that parties may be overlooking but are nonetheless important to this proceeding?

A. Yes. The Commission clearly equated the Transition Fund to a high cost universal service fund in its *Competition III Order*, indicating that various

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mechanisms have been implemented to help achieve its universal service goals, including "a Transition Fund to address high cost service areas for small companies …" (page 70). Even though labeled incorrectly as the TAF, AT&T also recognizes that the current Transition Fund is a state universal service fund. *See* AT&T Direct at p. 11, line 205 through p. 12, line 207.

Q. Are the quotes cited from earlier Commission decisions suggesting that there is no need for a SUSF (*see, e.g.*; T-Mobile Direct at p. 2, lines 18-21; Sprint Direct at p. 3, lines 15-17; and Verizon Direct at p. 5, line 15 through p. 6, line 2) logically relevant here ?

A. No. As discussed earlier, the other parties have referenced discussions by the Commission that avoids the proper context. As Staff confirms, the Commission has a long standing commitment to Universal Service. *See* Staff Policy Direct at p. 7, lines 2-19. Prior Commission statements about whether a specific fund was necessary must be understood in the context of the fact that, at the time, the Transition Fund was expected to sufficiently address the needs for some period of time, and therefore, "there was no need to discuss a more permanent funding mechanism." *Id*. at p. 14, line 20 through p. 15, line 5. The situation has changed, just as those earlier decisions and the establishment of the Transition Fund had anticipated. *See id*. at p. 15, line 11 through p.19, line 1. Ultimately, the genesis of this proceeding confirms that the Commission understood that its

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earlier decisions anticipated the examination of the issues in this proceeding when the Transition Fund had run its course.

Q. Would the form of SUSF proposed by the NYSTA Smaller ILECs lead to an uncontrollable fund size as some parties contend (*see, e.g.*, CLEC Coalition Direct at p. 3, lines 10-12 and p. 7, line 9-12)?

A. No. The NYSTA Plan requires a rate case form of showing for purposes of determining funding disbursements to eligible universal service providers. For the NYSTA Plan here, actual costs, revenues and rates are reviewed in the process. The rate case process will ensure significant control over the Phase II funding requirement under the oversight and experience of the Commission in rate case proceedings.

Q. Would the existence of a continuing SUSF stifle competitive investment and competition in New York markets as suggested by some parties (*e.g.*, CLEC Coalition Direct at p. 4, lines 21-22?

A. No, the claims are, at best, exaggerated. No facts were provided that would suggest that the operations of the NYSTA Smaller ILECs have encouraged or discouraged competitive entry. In fact, the only demonstration based on facts was provided by the NYSTA Smaller ILECs and that was that the cable television providers have systematically ensured that their cable television systems do not need to be deployed in any area of a NYSTA Smaller ILEC where the density of

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customers is low. *See* NYSTA Direct at p. 60, line 16 through p. 68, line 9 and accompanying exhibits. Thus, any concerns that SUSF will infringe on competition within the NYSTA Smaller ILEC service is baseless.

Q. Do you have any specific comment on the contentions raised by CTANY and Verizon that the Transition Fund or SUSF would hinder current or future competitive markets in New York State?

A. Yes. CTANY suggests that if the Transition Fund concept lives on, that competitors will have to "decide whether they can even compete against a rate which is below the $23 benchmark rate." CTANY Direct at p. 12, lines 18-20. The CTANY witness also states that "[t]o allow [Transition Fund] recipients to charge less than the cost of service, and particularly below the $23 benchmark rate, makes it less likely that other voice providers will enter zones that are only served by the currently-subsidized ILEC." *Id*. at p. 34, lines 9-13. In addition, the Verizon Panel suggests that "[s]ubsidization of incumbent providers through the creation of a new fund could further deter new entry and may even lead existing competitors to exit the market." Verizon Direct at p. 25, lines 18-20.

Q. Do you agree with these contentions?

A. No. We would note that, if the price of a NYSTA Smaller ILEC's voice services was the only criteria used to determine marketplace entry of cable television providers (which we believe is not the case), then such contention does not seem

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to hold true in reality. **CONFIDENTIAL SUBJECT TO PROTECTIVE ORDER IN NY PSC CASE 09-M-0527:** **********
****
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****
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**********.
END CONFIDENTIAL SUBJECT TO PROTECTIVE ORDER IN NY PSC CASE 09-M-0527.

Q. Have any of the parties opposing a SUSF offered any factual evidence in support of their "competitive harm" claims?

A. No. For example, CTANY and Verizon were each asked the following question in discovery:

> Please identify any instances, in New York and nationwide, where [a CTANY member cable company] [Verizon Wireless or any other wireless carrier] has not entered, or has exited, a rural telephone market because of the local rates charged, or funding received, by a rural incumbent local exchange carrier ("ILEC"). In any instances where such a decision was made, please identify the rural ILEC's local rates that were in effect at the time of that decision.

CTANY, in responding to our discovery, provides no factual evidence but, instead, merely reiterates its prior statements that

> decisions with respect to provision of service in a particular market is generally not based upon a single factor, but rather is generally based upon a series of complex factors including: interest of current and potential customers; return on investment (ROI); franchise and regulatory obligations, and competitive issues (which might include ILEC subsidies and current rates).
>
> Exhibit __ (NYSTA -18).

The fact that CTANY references profit motives in its response only highlights the fact that its members do not operate as universal service providers under their existing corporate structures like the NYSTA Smaller ILECs operate. Verizon, in responding to NYSTA discovery, also provided no factual evidence but, instead, provided its "assumption" that "rational, profit-maximizing companies would respond to economic signals, such as the availability of subsidies from a state universal service, that would reduce the benefits of providing service in a particular area, holding all else equal." Exhibit __ (NYSTA -19). In addition, as we demonstrated in the NYSTA Direct, cable providers offer telephone services only within their cable television franchise areas at rates that are regionalized. Wireless carriers also offer services at rates that are, for the most part, nationalized. Therefore, it is highly improbable that any showing could be made that the rates charged and/or funding received by the NYSTA Smaller ILECs has had, or would have, any impact on the decisions of a cable or wireless provider to enter or exit a competitive market.

Q. What response do you have to AT&T's suggestions (*e.g.*, AT&T Direct at p. 2 and pp. 20-21) that the issues in this proceeding can be addressed merely by

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extending the current Transition Fund and its mechanics for an interim period of a few years?

A. The AT&T proposal represents merely a partial stop-gap approach that would impose arbitrary constraints on the SUSF (*see, e.g.*, AT&T Direct at p. 2, line 38 through p. 3, line 54) and delay any resolution of the important and fundamental basic policy decisions related to a SUSF. Moreover, there is no need or purpose in arbitrarily capping the SUSF to the detriment of its intended purposes. *See* NYSTA Direct at pp. 83-86 regarding the projected fund size under the NYSTA Plan.

In any event, AT&T's proposal would require all of the parties to conduct another proceeding later to review the same principles and methods under review here. The expenditure of those resources is not necessary since the NYSTA Plan includes provisions for accountability, predictability and sustainability for a proper SUSF. But setting aside this point, there are advantages of moving to a plan such as the NYSTA Plan in the course of this proceeding, as opposed to AT&T's partial stop-gap approach.

Q. Can you explain what those advantages would be?

A. The establishment of a stable form of SUSF now which would, in turn, allow for a recovery mechanism to be available for *both* immediate and future needs. Acting now will address the under recovery by companies, and any potential for access

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charge and other regulatory changes through the creation of a stable and formal funding process with full participation. *See, e.g.*, NYSTA Direct at p. 36, line 12 through p. 37, line 15; and p. 40, line 18 through p. 42, line 5. For these reasons alone, the AT&T partial stop-gap proposal should be rejected.

Q. What response do you have to the Commission Staff suggestion (Staff USF Mechanism Direct at p. 7, lines 12-18) that there should be an additional collaboration effort among the parties, consistent with Staff's "key principles," prior to putting in place a continuing SUSF?

A. Although admirable, the NYSTA Smaller ILECs do not believe this is a viable or practical approach. The parties have already spent significant time (approximately six months or so) and resources attempting unsuccessfully to collaborate around the same key issues that the Staff USF Mechanism panel discusses as reflected in the settlement agreement for the extension of the Transition Fund approved by the Commission in July of last year. Leaving aside the clear lack of consensus, it would be impossible to complete any such collaboration, provide time for the administrator to calculate funding requirements, to collect funds, and to have funds in place prior to the expiration of the Transitional Fund which is September 30, 2011. And, even if this was ordered, Staff's proposal does not appear to contemplate what would occur if consensus was not reached. For similar reasons as set forth above in response to

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the AT&T proposal, sound policymaking dictates that the industry proceed with a resolution of the issues within the schedule for this Phase II associated with the continuing SUSF.

B. FOR PURPOSES OF THE POLICIES DECIDED IN PHASE II OF THIS PROCEEDING, THE ACTUAL LEVEL OF THE SUSF DISBURSEMENT SHOULD BE DETERMINED ON A "CASE-BY-CASE" APPROACH.

Q. Do the parties agree that, if a continuing SUSF is established in this proceeding, the level of disbursement to recipients should be determined on a case-by-case basis?

A. Yes, that is the general consensus. Our references, however, to a "case-by-case basis" means an individual company showing at a later point in time based on actual costs to determine eligibility and funding disbursement amounts. The essence of the Staff USF Mechanism Panel testimony proposes the same process. *See* Staff USF Mechanism Direct at p. 8, lines 15-19. While offering opposing arguments on some issues, AT&T nevertheless also recognizes the merits of this case-by-case approach. *See* AT&T Direct at p. 2, lines 41-43 ("current rate-case driven process . . . to be used as the gateway to funding . . . ."). And, since the three NYSTA Smaller ILECs that are receiving Transition Fund disbursements have already been through the rate case process, these companies would continue to receive that level of Phase II funding from the SUSF until that company's next

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rate case. *See, e.g.,* NYSTA Direct at pp. 30-34.

Q. Should there be some form of specific showing (*see, e.g.*, CLEC Coalition Direct at p. 3, lines 5-8) in this Phase II proceeding as the precedent for the establishment of a continuing SUSF?

A. No. As Judge Jack has concluded, this proceeding does not involve any company specific showings at this point in time. For this reason alone, the CLEC Coalition's criticisms (however baseless) with respect to the NYSTA Smaller ILECs should be rejected.

Nevertheless, the record demonstrates that there is a need for a continuing form of SUSF based on the record in this proceeding. Examination of company-specific demonstrations associated with a NYSTA Smaller ILEC's actual needs from a SUSF is not necessary to reach the conclusion that a SUSF mechanism is needed at this time. For example, as to the three NYSTA Smaller ILECs receiving Transition Fund disbursements today, the Commission has already determined through the rate case process the need for funding. Moreover, as Judge Jack noted, pro forma demonstrations of need could be provided and that was done by the NYSTA Smaller ILECs in the direct testimony based on reviewable data filed with the Commission in the annual reports. *See* NYSTA Direct at p. 36, lines 12-21 and p. 84, line 9 through p. 86, line 6. Thus, the need for the SUSF has been established. Moreover, from a public policy perspective,

the need to establish a SUSF has already been demonstrated in the NYSTA Direct and need not be repeated here. Staff also developed its own pro forma analysis. *See* Staff USF Mechanism Direct at pp. 33-35.

C. THE EXISTENCE OF ALTERNATIVE PROVIDERS DOES NOT NEGATE THE NEED FOR A STATE USF.

Q. Does the existence of alternative providers and/or some forms of competition in parts of the NYSTA Smaller ILECs' service areas obviate the need for any SUSF as suggested by some parties (*see, e.g.*, T-Mobile Direct at p. 3, lines 2-5; Verizon Direct at p. 3, line 19 through p. 4, line 7)?

A. No.

Q. Generally, what are the positions of the other parties regarding the existence of alternative providers' services within the service areas of the NYSTA Smaller ILECs?

A. Several of the parties' witnesses believe incorrectly that, because there are competitive service providers operating in the territories of the NYSTA Smaller ILECs, there should be no need for a SUSF. This position is based upon a mistaken belief that if there is a service provider other than the NYSTA Smaller ILEC, such provider can take over in the event that the NYSTA Smaller ILEC cannot continue to operate as the universal service provider. *See, e.g.*, Verizon Direct beginning at p. 11; Sprint Direct at p. 3, lines 7-14; T-Mobile Direct at p. 4,

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lines 3-13; and to a lesser degree Staff USF Mechanism Direct at p. 9, line 10 through p. 10, line 1. Of course, no such demonstration has been made by these parties that this would occur; no firm commitment to serve all customers within the entirety of the NYSTA Smaller ILECs' service areas upon reasonable request has been made other than by the NYSTA Smaller ILECs themselves.

Q. Is this the only aspect of the parties' positions that are objectionable?

A. No. There are two apparent, equally objectionable corollaries that the other parties also raise. The first is the notion that universal service policy need only address the "white spot" areas and not the areas in which alternative service providers exist. *See, e.g.*, Staff Policy Direct at p. 11, line 23 through p. 12, line 3; CLEC Coalition at p. 4, lines 5-7; and Verizon Direct at p. 50, lines 11-12. The second is that the policymakers can find new providers to "cover" the white spots in the event that the existing incumbent provider fails. *See, e.g.*, Staff USF Mechanism Direct at p. 10, lines 10-13; and Verizon Direct at p. 49, lines 13-18.

Q. What do you mean by "White Spots"?

A. The terminology has been used by parties in this proceeding to mean those areas within a NYSTA Smaller ILEC's service area where there is no alternative service provider. In determining whether an alternative service provider exists in an area, the discussion has generally examined cable digital phone providers and wireless providers (*i.e.*, Commercial Mobile Radio Service providers as defined

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by the Federal Communications Commission ("FCC")).

Q. Does the existence of competitive service providers within the service area of a NYSTA Smaller ILEC negate the need for SUSF?

A. No. The other parties' testimony related to the existence of alternative service providers is flawed and potentially misleading in the following ways:

1. Most of the other parties' discussion of the availability of competitive services from alternative providers within the service areas of the NYSTA Smaller ILECs completely neglects the fact that those services are not substitutes for the universal services provided by the NYSTA Smaller ILECs and that the alternative service providers are not substitute universal service providers.

2. Most of that testimony also fails to recognize that wireless services are not reliable enough to constitute substitute universal services.

3. The other parties' analyses fail to acknowledge that the other alternative providers' telecommunications services (the digital phone services of cable companies) are not available ubiquitously throughout the entire service areas of the NYSTA Smaller ILECs. The cable companies explicitly deploy service based on service to the more densely populated areas.

4. The other parties' assertions attempt to avoid the fact that the alternative service providers and the services they provide are not subject to sufficient Commission authority so as to guarantee any universal service result, regardless of the quality or ubiquity of their service offerings.

1. The Competitors' Services Are Not Substitutes For The Universal Services Provided By The NYSTA Smaller ILECs.

Q. What criteria should be applied to determine whether a service provider is offering a substitute universal service?

A. The NYSTA Smaller ILECs set forth the criteria in their direct testimony,

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emphasizing that alternative service providers do not provide reliable, carrier-of-last-resort or ubiquitous services across the entire service area of any NYSTA Smaller ILEC. This testimony concluded that the competitive service providers do not provide substitute universal service. *See, generally*, NYSTA Direct at pp. 47-71.

Q. What analysis did Staff provide regarding evaluation of substitute universal services?

A. The Staff Substitutability Panel set forth what it views as a comprehensive set of criteria that would form the basis to determine whether a substitute universal service provider exists. *See, generally*, all of the Staff Substitutability Direct testimony. Without repeating that testimony in detail, the Staff Substitutability Panel first discusses how regulation should be applied to any provider considered to be a substitute provider (Staff Substitutability Direct at p. 5, line 24 through p. 8, line 5) and then lists a set of "essential components" to consider in the examination of substitutability (on p. 8 and following). These essential components include: (1) availability of service; (2) affordability of service; (3) consumer protections; (4) reliability of service; and (5) quality of service. *Id*. at p. 8 lines 9-12.

The NYSTA Smaller ILECs commend the Staff Substitutability Panel for recognizing these essential components. They are almost identical to conditions

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under which the NYSTA Smaller ILECs operate as carriers of last resort ("COLR") and universal service providers, but the alternative providers do not, as explained in the NYSTA Direct. However, as an aside, while the list includes an affordability rate criterion, it improperly omits recognition of "comparability" of rates and services as an equal principle of universal service. *See* NYSTA Direct at p. 10, line 9 through p. 11, line 4; p. 17, lines 15-22; and p. 18, lines 5-6. As will be discussed later in this rebuttal testimony, comparability is ultimately the key criterion in determining a proper benchmark rate.

Q. Does the Staff Substitutability Panel conclude how the Commission would *evaluate* these essential components for service providers other than the NYSTA Smaller ILECs?

A. No. The NYSTA Smaller ILECs commit to service and subject themselves to regulatory requirements that comply with the list of essential components, and the NYSTA Smaller ILECs' regulatory treatment is documented and subject to review by the Commission for compliance. The Commission has authority over the NYSTA Smaller ILEC and exercises that authority to make sure that the NYSTA Smaller ILECs conform to these components. As such, the NYSTA Smaller ILECs submit to the oversight of the Commission as part of the COLR obligations they have and the universal service provider commitment under which they operate. However, no other providers of competitive services operate under

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these conditions. Therefore, there is no real way for the Commission to *evaluate* or *ensure* the essential components for service providers that are not subject to the Commission's oversight with respect to these criteria. A Telephone Regulatory Convergence Matrix, issued in a Staff White Paper on September 21, 2005, in Case 05-C-0616, lists the various requirements under which the NYSTA Smaller ILECs must operate. *See* Exhibit __ (NYSTA-20).

Indeed, at the very heart of the analysis of the Staff Substitutability Panel's set of essential components are expectations of the ability of the Commission to *evaluate* a service provider and, obviously, to ensure that any compliance with the essential components is maintained. ("The purpose of the discussion is to identify characteristics which the Commission should consider in evaluating . . . services . . . ." Staff Substitutability Direct at p. 5, lines 4-9.) But any such evaluation is not possible for the alternative service providers because the Commission does not exercise any authority over those providers with respect to the essential components of universal service, and as demonstrated in the NYSTA Direct, those service providers have generally made clear that it is their belief that they are not subject to any such Commission authority. *See* NYSTA Direct at p. 47, line 19 through p. 48, line 17.

Q. Is there any conclusion that must be drawn from the Staff's discussion of substitutability criteria applied to the specifics of the issues in this case?

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A. Yes. Setting aside the need for the alternative providers being subject to the Commission's jurisdiction and oversight, if one examines in detail the specific essential components set forth by Staff, one finds that none of the existing alternative providers satisfy the list of requirements. If one accurately and completely applies the Staff's criteria, there is no area within any NYSTA Smaller ILEC service area in which a substitute universal service is available today. Accordingly, the entire service area of each of the NYSTA Smaller ILECs would be a large "white spot" because no alternative provider satisfies the necessary criteria everywhere or anywhere within that area. This conclusion is all the more supported when one considers these facts in light of the preeminent issues once the SUSF policy framework is established -- the Commission needs to be able to assert jurisdiction over the universal service provider in order to ensure that the Commission's universal service policies are properly implemented. Any type of "not-to-worry-because-they-will-be-good-corporate-citizens" theory to obviate the need for this Commission jurisdiction and oversight is imprudent. The provision of universal service in a rural area presents real costs and real challenges, and the Commission must ensure that it has the ability to ensure that these services are provided and the challenges addressed.

Q. Was Staff able to *evaluate* thoroughly the services of the alternative service providers to determine substitutability?

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A. No. Staff apparently submitted discovery to the alternative service providers that are parties in this proceeding seeking information to shed light on the criteria but did not come to any conclusion. *See* Staff Substitutability Direct at p. 10, lines 4-19. Staff attaches a 322 page exhibit (Staff Exhibit ___ SP _ 1) which is simply the collection of responses, without drawing any conclusions. Regardless of the responses, however, and for all of the reasons already set forth in the NYSTA Direct, the alternative providers do not satisfy the essential component criteria set forth by Staff.

Moreover, no matter how any of these alternative providers may have answered the discovery questions, their answers reflect their unilaterally designed and voluntary service terms for which no one can guarantee or monitor their continuance. Neither proper evaluation nor compliance can be assured with respect to a provider that is not subject to sufficient oversight of the Commission and its universal service obligations.

2. The Competitors' Services Are Not Reliable Throughout The Entire Service Areas For All Users.

Q. Do some parties presume that wireless service, where advertised or predicted to exist, is routinely available and reliable?

A. Yes. *See, e.g.*, Sprint Direct at p. 6, lines 1-14; T-Mobile Direct at p. 4, line 3 through p.6, line 11. These parties blindly follow the proposition that, just

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because service offering maps and radio propagation models may predict that wireless service should be available, we as well as the Commission should be able to confidently assume that reliable wireless service is actually available all the time to everyone at all locations.

Q. Is this consistent with the wireless carriers' responses to discovery and what the public knows as the shortcomings of reliability of wireless services?

A. No. The wireless carriers that responded to information requests affirmed that wireless service is not guaranteed simply because service may be indicated by maps or models, and that there are many factors that can negatively affect service. *See* NYSTA Direct at p. 56, line 5 through p. 60, line 12.

Q. Did any other party recognize that wireless service is not routinely available always and is not necessarily reliable as to constitute a substitute universal service?

A. Yes. The Consumer Protection Board also recognizes the shortcomings of wireless service and the factors that make such service less than fully reliable. *See* CPB Direct at p. 20, lines 26 through p. 22, line 4. Verizon, in fact, quotes from the Commission's own words which recognize that actual customers do not "view wireless service as a complete substitute for traditional wireline service." Verizon Direct at p. 18, lines 6-7 quoting from the Commission's *Competition III Order*.

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Q. What response do you have to the Staff's field inspection reviewing coverage of wireless service availability in the Crown Point ILEC service area (Staff White Spots Direct at pp. 21-29)?

A. Mr. Yakel, on behalf of the Commission Staff, conducted a non-scientific "survey" of the area using two wireless mobile phones he apparently obtained from Verizon Wireless and AT&T Wireless to "spot check" wireless service availability. *See* Staff White Spots Direct at p. 22, lines 16-19. These spot checks appear to have been made inside or near a vehicle during his field survey. *Id*. at lines 14-16 (reviewed "odometer"). Mr. Yakel did not provide specific information about the location or nature of each spot check. Nevertheless, Staff recognizes, for universal service analysis, that a service is available only "if that service can be used at that household's exact geographic location." Staff Substitutability Direct at p. 11, lines 1-5. A spot at the end of a consumer's driveway at a point on the country road does not constitute that household's location; it is the rooms within the house where residents need universal service.

Q. Did Mr. Yakel indicate that he went into any house?

A. No. And, from a practical perspective, he could not have entered the property of a significant cross section of residences to check availability without the home or business owner's permission. Likewise, if he did do this, then his explanation of his methodology is lacking in such detail. Further, Mr. Yakel's spot checks also

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did not attempt to test availability of wireless service in the context of the various factors which make wireless service less than completely reliable. We have already noted some of those factors in the NYSTA Direct at p. 58, line 8 through p. 60, line 12, and they include signal strength variations, different customer phone equipment, traffic volume issues, terrain, structures, foliage, and weather. Moreover, Mr. Yakel's spot checks used two specific mobile phone devices to determine signal strength (presumably the signal "bars" typically shown on mobile phones), but did not attempt to place and complete actual calls which would be necessary to determine real world reliability in those areas. Ultimately, the Staff field survey does not change the only rational conclusion that can be reached about the lack of full reliability of wireless service in the NYSTA Smaller ILECs' service areas that we have stated and which has been corroborated by the wireless carriers' own statements.

Q. Did Verizon Wireless provide any testimony that would invalidate the responses of the other wireless providers about factors that make wireless service unreliable and, consequently, not guaranteed?

A. No. Verizon Wireless refused to answer the NYSTA Smaller ILECs' information requests about these factors (while the other wireless providers did), and Verizon Wireless chose not to file any direct testimony in this proceeding.

Q. Are there any concerns about the reliability of cable companies' digital

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phone services?

A. Yes. All of the same availability, safety, consumer protections, reliability, and quality of service criteria set forth by the Staff Substitutability Panel in its direct testimony for purposes of the discussion of substitutability are also relevant in evaluating reliability of cable companies' digital phone services. The Staff Substitutability Panel includes access to emergency services under the availability criteria. Staff Substitutability Direct at p. 11, lines 12-13. Under the consumer protection heading, connection to E911 is listed. *Id*. at p. 15, lines 22-23. The specific reliability criteria include maintenance of uninterrupted service. *Id*. at p. 20, line 21 through p. 21, line 10. Moreover, quality of service includes, among other objectives, timeliness of repairs to restore service after an outage. Id. at p. 29, lines 5-16. The NYSTA Smaller ILECs agree that these matters are properly included within any consideration of universal service.

Q. Is there some reason why you have noted these specific yardstick measures of service?

A. Yes. These are examples of conditions of reliability for which the predominant cable provider in many of the NYSTA Smaller ILEC service areas – Time Warner Cable ("TWC") – has experienced difficulties in achieving in recent times. As the attached news stories indicate, TWC has experienced service problems with attempts to call 911 emergency services in recent weeks. *See* Exhibit__(NYSTA-

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21). While these difficulties may be an isolated problem for TWC, these difficulties suggest that cable companies are not providing the same level of service as the incumbents.

3. The Competitors' Do Not Provide Substitute Services Ubiquitously To All Users Throughout The Entire Service Areas Of Each Of The NYSTA Smaller ILECs.

Q. Have any of the NYSTA Smaller ILECs submitted information about the extent of competitive services available in their service territories?

A. Yes. The NYSTA Smaller ILECs have reported this form of information to the Commission to detail the level of *competitive* service available in their service areas as a prerequisite to different regulatory treatment in what is deemed to be competitive areas. *See Order Adopting Framework* in Case 07-C-0349 (March 4, 2008).

Q. Have the other parties in this proceeding confused the significance of the various types of information about competitors?

A. Yes. For purposes of determining whether ILECs should be afforded greater pricing flexibility in their service offerings to compete with other providers in competitive areas, the Commission has analyzed the extent to which any and all forms of competitive services may be available in an incumbent's service area. This analysis only evaluates whether the incumbent is subject to competitive pressure from the offerings of other providers. This analysis, from the standpoint

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of measuring competition, has included wireless and digital phone services of cable companies as services which present competitive alternatives and affect the marketplace in which the incumbent must operate. However, this analysis is not performed for purposes of determining whether any other competitive service provider is providing a substitute universal service. As such, while the other parties' witnesses can find quotes from the Commission addressing these issues for purposes of evaluating the competitive marketplace that indicate that digital phone and wireless are sufficiently the same as to present a competitive impact (*see, e.g.*, T-Mobile Direct at p. 8, lines 1-3), those statements only address competitive marketplace forces, and have failed to note the very different purposes of this proceeding – the establishment of a rational universal service framework for rural areas of the State of New York.

In stark contrast, however, when the Commission is evaluating the competitors with respect to criteria such as reliability, ubiquity, and consumer protection related to universal service substitutability, the Commission has recognized the shortcomings. For example, the CPB at p. 19, line 17 through p. 20, line 6 of its testimony noted that the Commission in its *Competition III Order* makes statements about network reliability and concludes that "even . . . effective and thriving" competition does not ensure reliable networks. That is our exact point here. In addition, the CPB, on p. 21, lines 19-24 also cites the same

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Commission decision as did the NYSTA Smaller ILECs in their direct testimony that concludes that wireless services are not sufficiently reliable to constitute substitutable universal services.

Q. Did the Commission define "universal service" in its *Competition III Order*?

A. Yes. The Commission defined universal service at p. 9 of its *Competition III Order* as "the goal of ensuring that all residents have access to affordable basic telephone service, access to public safety, health, education, and assistance services . . . ." Of course, from a different viewpoint – one in which there is an examination of only whether the incumbent should be allowed more flexibility to change rates in response to the competitive marketplace – competitors exist and customers may choose to use their services regardless of whether those competitors provide affordable service or access to public safety, health, education, and assistance services, to name only a few universal service considerations. Nonetheless, the point is that the analysis of the existence of a competitive marketplace that is affecting the incumbent's ability to compete is an entirely different and separate exercise from determining whether substitutable universal service offerings of competitors exist.

Q. Does the Staff Report on Cable and Wireless Coverage dated December 22, 2009 ("Staff Report") demonstrate that there are substitute universal services ubiquitously available throughout the service areas of the NYSTA

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Smaller ILECs?

A. No. As the Staff White Spot Panel admits, its analysis did not consider whether the service of a provider it was examining for coverage reporting purposes was a substitute universal service. *See* Staff White Spot Direct at p. 12, lines 10-15. The Staff White Spot Panel also acknowledges that its "findings are best viewed" in a "generalized way." *Id*. at p. 11, lines 22-24. Again, it should also be noted that the mere existence of a service provider as a competitor is not an indication of whether that competitor is providing substitute universal service, a point that the Staff White Spots Panel seems to confuse. *See id*. p. 12, line 14 ("substitutable") versus line 24 ("are strong competitors").

Regardless of whether the services offered by the competitors constitute substitute universal services, the information contained in the Staff Report contains discrepancies about which the NYSTA Smaller ILECs have concerns and have already reviewed in their direct testimony. *See* NYSTA Direct at p. 65, lines 4-10 and p. 68, line 10 through p. 71, line 4, and Exhibit ___ (NYSTA-3)(CONFIDENTIAL SUBJECT TO PROTECTIVE ORDER IN NY PSC CASE 09-M-0527). Regardless, the existence of these competitors does not negate the need to address the cost recovery requirements of the true COLR network of the NYSTA Smaller ILEC that continues to serve the universal service goals even where the competitors may provide service.

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Q. Was the Staff Report updated for purposes of the Staff White Spots Panel testimony?

A. It appears that it was not updated even though, in response to discovery requests, some of the NYSTA Smaller ILECs updated their information that Staff had used in portions of the original report.

Q. How could one explain the discrepancies in coverage based on the data approaches used by Staff compared to coverage reported by the NYSTA Smaller ILECs?

A. As an initial observation, the Staff Report's methods appear to rely in some instances upon aggregated information (*e.g.*, cable company reported franchise-wide or state-wide build-out) that may be inaccurate when applied to the subset areas that constitute the NYSTA Smaller ILEC service areas. *See, e.g.*, Staff Report, Exhibit ___ WSP_ 1 at p. 17, second paragraph (". . . information from certificates of confirmation (COC) to construct an aggregate map," and ". . . Staff estimated the number of residents and households in non-cable franchise areas and/or without cable modem services available"); p. 17, third paragraph ("To determine the number, Staff used aggregated service data provided by cable company Annual Financial Reports . . . ."). Furthermore, while aggregated information may be representative of average coverage characteristics, such "average" likely is not representative of the specific rural areas served by the

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NYSTA Smaller ILECs. Moreover, Staff may have made assumptions about the meaning and significance, or lack thereof, of the data reviewed, and has drawn conclusions that go beyond its actual significance. *See, e.g., id.* at p. 2, third paragraph (use of American Roamer Inc. information that predicts wireless service availability apparently based on engineering studies and mathematical models that do not take into account all factors that affect service availability). Accordingly, the data approach used by Staff provides a less reliable estimate.

Q. Would the information from the NYSTA Smaller ILECs be more reliable than the other information set forth in the Staff Report?

A. Yes. The managers of the NYSTA Smaller ILECs have a hands-on, direct understanding of the degree of service from competitors (regardless of whether the competitors are universal service substitutes) such as cable operations actually deployed within their service areas. They do not rely on aggregated information or assumptions about what some form of public data is assumed to show.

Q. Can you provide some examples of the specific information that the NYSTA Smaller ILECs would use?

A. In many instances, the cable operators attach their cable facilities to poles owned and operated by the NYSTA Smaller ILEC. This first-hand information provides the management personnel with actual information upon which they base their estimates. Likewise, and as mentioned above, the NYSTA Smaller ILECs also

have experience with reporting this form of information to the Commission to detail the level of *competitive* service available in their service areas. Most importantly, however, the Commission, in its *Framework Order*, has already accepted the methods used by the NYSTA Smaller ILECs in reporting this type of competitive activity information and concluded at p. 8 that "`[w]e have reviewed these submissions and view this methodology as being reasonably accurate.'" *See* NYSTA Direct at p. 39, lines 7-9.

For wireless service, apart from any use of over-generalized maps predicting signal level from a theoretical viewpoint, the NYSTA Smaller ILECs also have first-hand experience using or attempting to use wireless services throughout their service areas. Through their own use and that of the consumers they know and serve in those service areas, they understand the drawbacks of wireless service availability and reliability in rural areas.

Q. Does the analysis performed by Verizon (Verizon Direct at p. 12, line 8 through p. 13, line 5) change your conclusions here?

A. No. The Verizon analysis appears to be similar to that performed by Staff, and consequently, our comments are the same. The Verizon analysis is also premised on the incorrect proposition that wireless service coverage should be considered a universal service substitute when wireless service has been shown not to be a substitute. Moreover, wireless service is presumed to be available to the extent

that the same American Roamer information predicts that it may exist, regardless of whether that model accurately predicts all factors of wireless service. If the wireless service predictions were removed, one would obtain a different picture with respect to the actual voice-quality/two-way conversation availability of the service. For other services analyzed by Verizon, there was no recognition of whether the services constitute a form of substitutable universal service, or not.

4. Attempts To Target SUSF Only To "White Spot" Areas Would Be Unworkable And Counter-Productive.

Q. What do you mean by targeting SUSF to "white spot" areas?

A. This is a somewhat vague concept introduced by some witnesses building upon the "white spot" analysis that Staff has undertaken.

Q. On what basis do you believe that Staff and other parties are building upon this "white spot" analysis with respect to establishing SUSF need?

A. Staff discusses this concept in the context of areas "dependent on one provider" for "affordable, reliable and adequate telephone service." Staff Policy Direct at p. 10, lines 13-15. And to address such areas, Staff suggests that there would be the "[c]reation of a funding mechanism to make certain that customers with no other alternative to the service provided by an incumbent will continue to have access to reliable basic telephone service at an affordable rate." *Id*. at p. 19, lines 4-8.

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Other parties offer similarly vague suggestions. The CLEC Coalition suggests that analysis "should focus on only the portion of a rural incumbent local exchange carrier's . . . service territory that has no viable competitive alternative," but fails to explain what that means in application. *See* CLEC Coalition Direct at p. 4, lines 2-4. Sprint adds that "any support must be strictly limited to those 'very few areas of the state' that have no competitive phone alternatives," but does not explain how that could be done in any rational or productive manner. Sprint Direct at p. 12, lines 16-17.

Q. What response do you have to these vague suggestions?

A. Universal Service principles and objectives cannot be achieved simply by attention only to the so-called "white spot" areas. It is not viable for any service provider to serve only "white spots." Moreover, these "white spot only" suggestions are inconsistent with Staff's correct analysis.

Q. To what inconsistencies are you referring?

A. When asked what the ramifications have been to rural companies as a result of competitive entry, the Staff Policy Panel responds that the results have been:

> Revenue deterioration, exacerbated by the need to continue sustaining its networks, including all of their outside plant facilities, even though portions of their customer bases are lost. Pieces of the network cannot simply be switched off because there are fewer customers connected to the network.

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Staff Policy Direct at p. 17, lines 5-11. Thus, as this quote acknowledges, the real point is that even though there may be "white spot" areas, the NYSTA Smaller ILECs nevertheless maintain their entire network, even in the non-"white spot" areas, because these companies operate as the only COLR. In our direct testimony, the NYSTA Smaller ILECs explained at length that it is the entire network of the ILECs that is at issue, and it is in this area that these carriers operate as COLRs. *See* NYSTA Direct at pp. 45-46 (regarding the entire network serving the entire area), pp. 49-50 (regarding carrier-of-last-resort issues), pp. 60-66 (regarding the selective market entry of competitors), pp. 66-67 (regarding the fact that the NYSTA Smaller ILECs serve as universal service providers throughout the entirety of their service areas, and have continued responsibility to maintain their networks for service, even in areas where competitors exist and the ILEC has fewer customers than it once did). Moreover, the NYSTA Smaller ILECs serve as back-up network service providers to the customers of the competitors in the non-"white spot" areas, regardless of the level of subscribership in those areas.

Ultimately, it would be imprudent from a public policy perspective to construct a universal service plan solely to address so-called "white spot" areas. The NYSTA Smaller ILEC, which serves the "white spot" areas, does so only in conjunction with service to all other areas in its certificated service territory.

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Denying network cost recovery attention to the non-"white spot" areas neglects the fact that it is that entire, integrated network for which that incumbent incurs cost.

Q. For argument sake, what if this vague concept discussed by the other witnesses meant that, if SUSF disbursements were only targeted to "white spots," the NYSTA Smaller ILEC would cease to serve the non-"white spot" areas?

A. This would leave the non-"white spot" areas in which the NYSTA Smaller ILEC competes with one less competitor. Leaving aside wireless, the non-"white spot" areas would then be left to a single monopoly wireline provider – the cable digital phone service provider – where that provider has wireline facilities. Moreover, that new monopoly provider would provide service without being subject to Commission jurisdiction. In this case (assuming the NYSTA Smaller ILEC or some entity served only the "white spot"), the entire service area would be "dependent on one provider" for "affordable, reliable and adequate telephone service," and that provider would not be subject to full Commission oversight. Thus, except for wireless, the customers in the previously non-"white spot" areas, are now "customers with no other alternative to the service" provided by the non-regulated digital phone service provider. Staff Policy Direct at p. 19, lines 5-6.

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Q. Would a NYSTA Smaller ILEC that has demonstrated a need for SUSF continue to operate if its service were confined by universal service policies to only the "white spots"?

A. No. Such an approach would hasten the demise of the current COLR. Moreover, this policy approach would require the Commission to address the same constrained policy and "foreseeable crisis" options that the Staff Policy Panel properly concluded should be avoided. *See* Staff Policy Direct at p. 12, lines 3-16. The NYSTA Smaller ILECs agree with the Staff Policy Panel that a proper SUSF funding mechanism should work to avoid crisis such as COLR bankruptcies and/or companies having no choice but to exit the market and leave areas of New York without universal service.

5. Attempts To Induce Alternative Providers To Take Over "White Spots" Would Likewise Fail To Address The Universal Service Objectives.

Q. What do you mean by inducing alternative providers to take over white spots?

A. This is another vague suggestion with similar ramifications. Verizon discusses the concept that "funding should be provided to only one company per location" and then clarifies that to mean "the company that would be willing . . . to make service available to any customers that do not already have adequate access to the services of other providers." Verizon Direct at p. 49, lines 13-18. This contention

sounds to us like "white spots" are the "locations." This notion also involves the possibility of competitive bidding for "white spot" areas which will be discussed more generally below. The Staff USF Mechanism Panel briefly mentions the notion of "possibly fund[ing] the build out of the substitutable provider(s) network(s) to reach all customers currently served by the ILEC." Staff USF Mechanism Direct at p. 10, lines 10-13. This, again, looks like a policy to address "white spots."

When asked by the Commission Staff in discovery about "who will provide telecommunications services to existing customers" if the ILEC were to exit an area, Verizon responded inconsistently that its testimony did not envision "withdrawal of the company's basis retail service." We are not sure what Verizon means. Also, when asked if Verizon plans on entering any other area, its says no. *See* Exhibit __ (NYSTA-22).

Q. What reaction do you have to this suggestion?

A. These approaches would lead to many of the same inappropriate and imprudent results as set forth in the discussion above about concentrating on white spots for SUSF purposes. These suggestions presume the demise of the NYSTA Smaller ILEC. As such, this would remove a regulated COLR in favor of a non-regulated single wireline provider or wireless and, as of today, the Commission has no willing provider other than the NYSTA Smaller ILECs to assess for purposes of

determining whether the Commission's universal service objectives are ensured. This would appear to be a step backwards in policymaking – leaving wireless aside, the entire area would then be served by a single, monopoly, non-regulated, facilities-based wireline provider.

D. IT IS NOT A RATIONAL POLICY ALTERNATIVE SIMPLY TO DO AWAY WITH ANY CONTINUING SUSF.

Q. What would be the consequences if a SUSF were not continued?

A. As discussed in the NYSTA Direct, if there is no SUSF, the otherwise eligible NYSTA Smaller ILECs would be unable to recover their regulated intrastate costs through affordable and comparable local rates. This, in turn, would affect their ability to continue to invest in their network, and would cause reductions in maintenance and operations that would inevitably lead to degradation of service quality or no service in some rural areas. *See* NYSTA Direct at p. 39, lines 21 through p. 40, line 1. It should be noted that the Commission's Staff acknowledged similar adverse consequences. For example, the Staff Policy Panel concludes that if no SUSF is established, the likely result would be reduced investments, reduced maintenance, service quality problems, "have" and "have-not" networks, and inferior service to rural areas. *See* Staff Policy Direct at p. 11, lines 14-23. Staff goes on to observe that this result could proceed to a worse case of there being no provider in some areas, thereby leaving the Commission

with no other policy choice but to address a crisis. *See id*. at p. 11, line 23 through p. 12, line 5. The NYSTA Smaller ILECs agree with Staff that this would not be prudent public policymaking. *See id*. at p. 12, lines 13-16.

E. OTHER PROPOSALS ARE EITHERUNWORKABLE, COUNTER-PRODUCTIVE AND/OR MISGUIDED.

Q. What response do the NYSTA Smaller ILECs have to Verizon's suggestion that funding should be based on competitive bidding by potential recipients (Verizon Direct at pp. 49-51)?

A. The use of a competitive bidding process to determine which company should receive SUSF disbursements is untested and would not otherwise serve the public interest and is, in any case, beyond that which can be addressed, as a practical matter, in Phase II of this proceeding based on the September 30, 2011 end date of the Transition Fund. Verizon suggests that SUSF should be provided only to one provider, *i.e.*, the one that is willing to accept the least amount of funding while providing universal service. Verizon's theory, however, fails to recognize the obvious. The carrier that agrees to receive the least funding will merely design and provide its service to a level constrained by the available revenues and support dollars. To "win" the auction, the carrier must plan to provide the "cheapest" and least costly form of service, not the most efficient as Verizon suggests. In the course of the review of the FCC proposals for competitive

bidding in the context of the federal universal service policies, the result of this process would be what has been referred to as "the race to the bottom."

In any event, it is not necessary in this proceeding to debate in detail all of the fallacies and defects in this competitive bidding theory. Rather, it is sufficient to note that the suggested approach fails to recognize that for a bidding process to make sense, the service and/or product to be provided must be specified in absolute detail, otherwise the bidding carrier does not know exactly what it may be committing to do. The service here is very complex, and the choice of the scope of the service to be provided (*e.g.*, service elements, location, and length of time for the winning bidder for network investments that are intended to last decades) are critical components of any proposal with dramatically different analysis and effects depending on one's choice. The service would also have to be defined on the basis of service quality. Moreover, no one can anticipate what services or quality the public may demand as universal services in future, and the bidding process cannot possibly reflect unknown service aspects for the future.

Q. Are there other problems with Verizon's "auction" proposal?

A. Yes. Apart from the almost impossibility of being able to define exactly what service obligation a carrier would be bidding on to win, there would be no identifiable basis upon which to determine later whether the winning bidder carrier was actually satisfying the commitments of the defined services. There

has been no explanation of what form of oversight could apply to make certain that the winning bidder actually carries out its obligations, or how the inevitable ambiguities between different views of what is required would be resolved.

Furthermore, this suggested process presents negative consequences for universal service policy. The unpredictability of the service arrangement about which a carrier is bidding, and the unpredictability of what may be expected of the winning bidder in the future, would place a chilling effect on universal service to those same areas most in need of this policy objective. Otherwise committed carriers, like the NYSTA Smaller ILECs, would either avoid the uncertainty and dangers of a competitive bidding process, or if they did participate, they would be inhibited later in investing in network plant, particularly for large investments in networks which are intended to be used for decades, for fear of the funding dollars being the victim of unpredictable policies and service requirements being subject to erratic expectations. Indeed, these uncertainties are similar to those where, as here, the NYSTA Smaller ILECs are confronted with uncertainty with regard to recovery of intrastate regulated costs and their continuing universal service provider status. These are the same consequences that justify the need for a more predictable SUSF to emerge from this proceeding.

Q. Is there anything more that you would like to add about a possible competitive bidding universal service support approach?

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A. The record is this proceeding need not be further burdened with debate over this issue which is, from a practical perspective, incapable of being properly addressed in the current phase of this proceeding. In any event, for general discussion and the explanation of the dangers of a competitive bidding process for universal service purposes, the fallacies and further practical issues are described in length in the attached Exhibit__ (NYSTA-23) paper of Professor Dale Lehman, *The Use of Reverse Auctions for Provision of Universal Service* which has been filed by the rural telephone industry representatives in the various federal universal service proceedings.

Q. What response do you have to Verizon's suggestion (Verizon Direct at pp. 34-36) that an expected comprehensive reform program at the federal level to refocus universal service policy on broadband policy should "caution" the Commission against moving forward here, for fear of incompatibility?

A. While the FCC (and even Congress) may have many proposals under review at this time, some of which may place more policy significance on universal service aspects for broadband networks, these proposals do not obviate the critical need to move forward in this proceeding now. As the Commission Staff properly concludes from a purely practical point of view, the "Transition Fund will end September 31, 2011. It is highly doubtful that these federal matters will be resolved by then." Staff Policy Direct at p. 14, lines 11-12.

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Again, it is necessarily beyond the scope of this Phase II of this proceeding to speculate about what the FCC or Congress may do with telecommunications policy in the near or distant future. Instead, this proceeding should go forward and put in place a stable, sufficient and predictable SUSF process and funding as is being proposed by the NYSTA Smaller ILECs.

Even if one might find some need to address Verizon's discussion regarding broadband at the federal level, many, if not all, of the same policy issues that are discussed by the NYSTA Smaller ILECs in this proceeding with respect to telecommunications services policies would also be relevant to broadband service issues. And, as the information submitted in this proceeding illustrates, where the NYSTA Smaller ILECs have built and operate COLR networks for telephone service, they also significant levels of broadband access service (generally in the form of DSL service). While some of the analysis and industry dynamics related to broadband service may be a shift somewhat from those directly and solely relevant to local services, the scope of those issues in the context of universal service policies is very much the same. Accordingly, the work and decisions that the Commission should and will likely make in this proceeding are more likely to enhance the ability of the Commission to incorporate a turn in the road towards a focus more on broadband than to hinder New York's universal service policies as Verizon's testimony appears to suggest.

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Q. Did the CLEC Coalition suggest that bankruptcy could be used as a determinant for the need for SUSF?

A. Yes. At page 6, lines 10-14, of its testimony, the CLEC Coalition suggests that:

> The Commission could establish protocols for an emergency fund that would be created and funded only upon a showing that an entity is facing imminent bankruptcy and requires support to maintain service while it reorganizes and emerges from bankruptcy.

Q. Do the NYSTA Smaller ILECs agree with this contention?

A. No. The NYSTA Smaller ILECs strongly disagree. Allowing a universal service provider to reach the point where its ability to offer telephone service is seriously at risk is not a rational alternative. The CLEC Coalition's contention is even more suspect when considering the likelihood that the NYSTA Smaller ILEC is the sole landline universal service provider throughout the entire service area subject to the Commission's jurisdiction. The severe and detrimental cost-cutting efforts that might be undertaken by an ILEC forced to the brink of bankruptcy would certainly affect its ability to continue in its role as sole universal service provider, putting the reliability and safety of its network in jeopardy, as well as that of the customers that rely on that network.

Q. Has the Commission recently had the opportunity to state its position on bankruptcy, specifically with regards to a rural ILEC?

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A. Yes. In its August 23, 2010 decision in Case 09-C-0595 the Commission, at pages 10 made statements to the effect that bankruptcy would be a "worst case scenario" and then at page 11stated that:

> [t]he risk for customers is not so much the end result of this transaction, …, but rather the financial pressures of excessive cost cutting by the Company in an effort to pre-empt a bankruptcy. These cost cutting measures could endanger safe and reliable service.

There is no guarantee that a small, rural ILEC, pushed to the brink of bankruptcy, would have the means or incentive to reverse the downward spiral in which it may find itself. In the event that "imminent" bankruptcy could result in a universal service provider going out of business, the Commission would be put in the undesirable position of having to designate a new, substitutable Eligible Telecommunications Carrier ("ETC") to serve that area, as required by the 1996 revisions to the Communications Act of 1934, as amended (the "Act"). At the present time, there appears to be no viable candidates to assume such an ETC role. Clearly, the better solution would be to address proactively the needs of the universal service provider by making available the necessary SUSF funding far *before* bankruptcy becomes a possibility, thereby avoiding the concerns expressed by the Commission.

Q. Where would one find the above-referenced requirement for the Commission to designate a new ETC?

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A. Section 214 of the Act describes the responsibilities of the FCC and State Commissions with respect to the designation of ETCs and the provisions associated with the relinquishment of a carrier's ETC designation and universal service obligations.

Q. Do some parties make reference to exiting the market by a NYSTA Smaller ILEC?

A. Yes. Verizon observes that "if demand has declined to the point where it is not economic for a company to maintain facilities . . . , then the company should be freed of any obligation it may have . . . to provide its own retail service in those area." Verizon Direct at p. 48, lines 7-11. T-Mobile adds that "there is no reason to conclude that, should an ILEC petition the Commission to exit a market, another carrier would not fill the gap to provide . . . basic telephone service." T-Mobile Direct at p. 10, lines 10-13. Of course, these parties provide no explanation of how these suggestions can be reconciled with the requirements of Section 214, the service and rate regulation in New York, or how they would insure the entry by some other carrier to fill a gap. Also, as discussed above, in response to discovery, Verizon claims that it did not mean that another carrier would take over.

2. If a State Universal Service High Cost Fund, or other support program, is established:

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a. Who is eligible for the fund or program (e.g., pool companies only, non-pool LECs, CLECs, wireless companies, individual telephone users, etc.)?

b. What are the eligibility requirements for competitive companies (e.g., federal eligible telecommunications carrier guidelines or other criteria) or other recipients of support?

Q. What are the parties' positions regarding which entities should be eligible to receive SUSF disbursements?

A. As set forth in the NYSTA Direct testimony, eligibility for SUSF should be dependent on the provision of the nine services taken from the FCC's rules and the requirements in the relevant Commission orders. *See* NYSTA Direct at p. 74, line 10 through p. 75, line 20. These requirements, together with (i) the express agreement to be subject to the Commission's jurisdiction and oversight, (ii) a demonstration of SUSF need based on a rate case cost and revenue calculation, and (iii) the expectation that the provider is ubiquitously providing universal services across the entirety of the NYSTA Smaller ILEC's service area, forms the effective eligibility requirements as set forth by the NYSTA Smaller ILECs.

Q. Does Staff directly address SUSF eligibility?

A. No. However, its SUSF qualification mechanism parallels that of the NYSTA Smaller ILECs in that there would also be a rate of return rate case form of showing to demonstrate need. *See* USF Mechanism Panel at p. 8, line 11 through p. 9, line 8. As such, nothing in Staff's proposal (other than certain SUSF

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"mechanics" discussed later in this testimony) would appear to conflict with the NYSTA approach to this eligibility issue, particularly because to subject oneself to a rate case carries with it the fact that you are subjecting yourself to the Commission's jurisdiction and oversight.

We also note that AT&T adds that eligibility should be limited to the 31 rate of return ILECs as a means to insure a small size for the SUSF. *See* AT&T Direct at p. 13, lines 244-251. While we do not oppose that threshold qualification as it relates to issues being raised in this Phase II of this proceeding, the NYSTA Plan's eligibility requirements would not limit any other company from participating in the SUSF should it wish to subject itself to the same level of review and operational oversight that each of the NYSTA Smaller ILECs are willing to do as outlined in the NYSTA Plan. This approach is, in the NYSTA Smaller ILEC's view, properly confined to only those entities that demonstrate the actual need for SUSF disbursements.

Verizon, in turn, proposes that competitive bidding should be utilized to determine SUSF eligible service providers. Verizon Direct at p. 49, line 13 through p. 51, line 14. The competitive bidding proposal of Verizon is discussed as a separate matter earlier in this rebuttal testimony.

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The other parties do not appear to address this issue directly, primarily because their position (wrong as it has been demonstrated to be) is that there is no need for a SUSF.

c. Who would contribute to the fund or other support program (e.g., wireline companies, wireless companies, Voice over Internet Protocol provider companies, cable companies)?

Q. What was the NYSTA Smaller ILECs' position regarding what entities should contribute to the SUSF?

A. The funding of a SUSF should come from contributions from all telecommunications services providers providing retail services in New York. The objective should be to include the widest base of contributors, including wireless telecommunications service providers, underlying telecommunications providers such as the affiliates of the cable operators, and the entire set of traditional telecommunications service providers (the TAF contributors).

Q. Is there general agreement with this approach?

A. Yes. The Staff USF Mechanism Panel agrees that "[a]ll telecommunications providers benefit from their participation in New York markets" and "regardless of whether they are regulated, they have an obligation to ensure that the State's Universal Service objectives are met." Staff USF Mechanism Direct at p. 30, lines 7-15. Thus, Staff properly concludes that all providers of telephone services in New York, regardless of their regulatory status, should be contributors to the

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SUSF. This conclusion is mirrored by AT&T which agrees that "all telecommunications carriers statewide – all incumbent local exchange carriers . . . , all certified CLECs, all competitive access providers, all wireless carriers, all interconnected Voice over Internet Protocol . . . providers, including all cable telephony providers should contribute . . . ." AT&T Direct at p. 3, line 61 through p. 4, line 66. As a result, each of these parties' positions are consistent with the NYSTA Smaller ILECs' approach to ensure that the widest possible group of SUSF contributors be established by the Commission.

Q. Do some parties disagree?

A. Yes. Other parties either favor a contribution base that excludes them as a contributor or propose a contributor base that would exclude carriers that are subject to less regulation, such as wireless carriers and Voice over Internet Protocol ("VoIP")-based telecommunications service providers. *See, e.g.*, T-Mobile Direct at p. 18, lines 12-16 and 20-22; and Verizon Direct at p. 54, line 7 through p. 55, line 14. These parties' positions should be rejected because, as a general matter, these classes of entities benefit from the existence of the NYSTA Smaller ILECs' respective networks as those networks allow these entities' end users to have calls placed to them as well as calls made by them to the areas served by each of the NYSTA Smaller ILECs.

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Q. Have any parties questioned the Commission's authority to establish a SUSF or to require companies to contribute to a SUSF?

A. Yes. Verizon provides the following statement with regards to these issues:

> … but there are also important legal issues bearing on the creation and operation of a fund. These include the extent of the Commission's authority to create and require contributions to a fund, and the question of whether requiring contributions from companies that are themselves not earning a reasonable return would violate Section 97 of the Public Service Law or the constitutional prohibition on takings without just compensation. (page 5, lines 1-7)

While Verizon indicates that such legal issues will be addressed in its briefs, the NYSTA Smaller ILECs note, for the record, that many companies, such as all ILECs, CLECs and long distance carriers operating in New York, are currently required to contribute to the Targeted Accessibility Fund ("TAF") established by the Commission, regardless of their specific earnings situation.

CONFIDENTIAL SUBJECT TO PROTECTIVE ORDER IN NY PSC CASE 09-M-0527: **********

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**********. **END CONFIDENTIAL SUBJECT TO PROTECTIVE ORDER IN NY PSC CASE 09-M-0527.**

Q. Is Verizon's contention regarding its losses at page 29 of its direct testimony relevant to the inquiry here?

A. No. Verizon has elected to operate under an incentive regulatory plan, rather than rate of return regulation. Verizon made that election and its earnings, therefore, are not at issue. Likewise, both Staff and the NYSTA Smaller ILECs, as well as CPB, support the flow-through of SUSF contributions assessed on as large a number of contributing entities as possible, and the flow-through of those contributions as an end user surcharge. Thus, Verizon would not be paying anything into the SUSF from its own "pockets."

Q. Have any other parties commented on this issue?

A. Yes. CTANY also indicates its uncertainty with the Commission's authority to establish a fund through statements such as "[i]f the subsidy could be legally justified …" (page 31, lines 6-7) and "Assuming new contributions to a [Transition Fund] can be legally sustained …" (page 34, lines 18-19). While we do not address the Commission's legal authority to establish a fund in our

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testimony, a related uncertainty of CTANY regarding the authority of the Commission to require cable telephone providers to contribute to the fund could also be anticipated. Such discussions and deliberations should be made in context of the authority granted to the Commission by Public Service Law:

> 1. The jurisdiction, supervision, powers and duties of the public service commission shall extend under this chapter:
>
> . . . . . .
>
> d. To every telephone line which lies wholly within the state and that part within the state of New York of every telephone line which lies partly within and partly without the state and to the persons or corporations owning, leasing or operating any such telephone lines. (PSL, Article 1, Section 5)

Factually, we can see no serious question or debate that the cable companies providing digital phone service own and operate "lines" within the state and that these lines carry telephone calls. Thus, from a non-legal perspective, factually, the cable television digital phone providers are operating "telephone lines." .

d. How would contribution levels be calculated (e.g., Targeted Accessibility Fund formula or some modified or alternative approach)?

Q. What are the parties' positions regarding the determination of contribution levels?

A. The NYSTA Smaller ILECs identified two possible methods -- relative intrastate retail revenues and the proportional share of telephone numbers deployed in New York – as a way of establishing an entity's contribution responsibility; the NYSTA Smaller ILECs also stated preference for the relative intrastate retail

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revenue approach. *See* NYSTA Direct at p. 79, line 10 through p. 82, line 9. AT&T generally agrees with an intrastate revenue approach. AT&T Direct at p. 18, lines 368-378. "Each contributor would then pay that fraction of its intrastate revenues towards the fund." *Id*. at lines 377-378.

The retail revenue based approach, as NYSTA proposes, effectively parallels the current federal approach which utilizes *retail* revenue for telecommunications services as the assessment basis. As Verizon observes, "[u]nless and until the FCC adopts a system other than one based on interstate revenues . . . , this Commission should not, on its own, attempt to re-invent the wheel." Verizon Direct at p. 56, lines 6-8. The NYSTA Smaller ILECs agree that there is no real need to devote resources now to some other approach for determining a contributor's basis for SUSF contributions.

Q. What intrastate revenues should be included for assessment purposes?

A. The revenues to be assessed with the contribution factor should be the intrastate, regulated telecommunications services revenues derived from retail service charges to end users, and that should be the revenue base included in the denominator for the determination of the contribution factor. Only retail revenues assessed to actual end users should be used. Revenues that one carrier receives from another carrier (*i.e.*, access charge receipts or other intercarrier compensation) are not retail revenues and are not obtained from end users. From

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the paying carriers' point of view, what one carrier pays to another carrier in the form of intercarrier, non-retail compensation should be excluded as it is not revenue from end users. *See* CLEC Coalition at p. 8, lines 2-4 regarding improper adjustments used in the TAF contribution process. By assessing contribution responsibility on a corresponding basis to retail revenues that actual end users pay, the contribution obligation is distributed consistent with the relative value each end user derives for its use of services. *See* NYSTA Direct at p. 80, lines 14-19. Thus, it is only logical that intrastate retail revenues are the relevant measure, not total intrastate revenues, since the SUSF charge would be tied directly to the end user benefit that is received from his/her/its ability to make and/or receive calls from the customers served by the NYSTA Smaller ILECs.

Q. Is there a question as to how to determine the intrastate retail revenues for the contributors?

A. No. The questions that arise with respect to how to determine the intrastate retail revenues for interconnected VoIP and wireless carriers have already been addressed by the federal process. AT&T does a fine job of explaining these details in its direct testimony (*see* AT&T Direct at p. 17, lines 338-352) and referencing that discussion addresses any complexities that may arise. *Id*.

Q. What response do you have to the Staff USF Mechanism Panel's discussion of using phone numbers as the basis for SUSF contributions?

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A. The NYSTA Smaller ILECs recognize, generally, that the relative number of in-service telephone numbers of each service provider is also a possible allocation basis for contribution responsibility and is under consideration by the FCC and some other states. However, the reasons for the preference for a relative retail revenue basis as set forth in the NYSTA Direct testimony still stand. *See* NYSTA Direct at p. 80, line 8 through p. 81, line 8. We agree with Verizon that this proceeding need not become the experiment with some other approach. It is also AT&T's view that "[i]t is simply not worth the time and expense to design and implement a contribution regime based on a [telephone-number] methodology." AT&T Direct, p. 3, note 3.

Q. What comment do you have on the Staff discussion with respect to numbers to determine intrastate use (Staff USF Mechanism Direct at p. 31, line 20 through p. 32, line 12)?

A. The question on p. 31 of the Staff USF Mechanism Direct asks whether it would be necessary to examine numbers to determine how they are used for interstate or intrastate services. But the numbers approach for SUSF contribution purposes would allocate equal contribution responsibility to each telephone number assigned in New York regardless of what use the end user makes of that telephone number. The Staff USF Mechanism Panel's discussion on p. 32 (in the answer to that question) is discussing the allocation of *revenues* to ascertain the portion that

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is related to New York. Regardless of what was intended by that Staff discussion, while an application based on telephone numbers may be somewhat simpler, it is less fair. At the same time, the adjustments made in the revenue approach are already addressed with existing procedures and should not be a concern. *See* AT&T Direct at p. 17, lines 338-352.

e. Who should administer the fund or other support program (e.g., some successor in interest of the New York Intrastate Access Settlement Pool, Inc., the Targeted Accessibility Fund of New York, Inc., and some other entity)?

Q. Which entity do the parties believe should be the administrator of a SUSF?

A. Many of the parties agree that the current administrator of the TAF should also be the administrator of the form of SUSF under consideration here. *See, e.g.,* Staff USF Mechanism Panel at p. 33, lines 10-18; CLEC Coalition at p. 10, lines 1-5; and AT&T Direct at p. 19, lines 387-389. The TAF is already a form of universal service fund, and there is no need to duplicate its functions with some other administrator. Thus, these parties, like the NYSTA Smaller ILECs, agree that the TAF administrator should administer the SUSF. This result will not only allow a proven entity to administer the SUSF but will allow efficiencies to be built into the process of both the TAF and the SUSF by allowing one entity to administer both funding aspects of the Commission's universal service policies in the State of New York. Thus, Sprint's concerns similar to those of Verizon have been addressed. *See* Sprint Direct at p. 15, lines 10-13.

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Q. What response do you have to Verizon's suggestion that the administrator of a SUSF should be assigned through competitive bidding?

A. If there were no existing universal service funding administrator, then that suggestion might be worth consideration. However, there is already a TAF administrator whose abilities are known and time tested. Moreover, as AT&T observes in another context: "far more money has been expended arguing about that fund" than the likely size of the fund. AT&T Direct at p. 2, lines 34-36. Similarly, we see no need to expend more resources to debate and decide on what would be the duplication of the functions of an already existing administrator. The Commission should not and need not waste time and resources debating a new and unnecessary regime.

f. Should the fund or other support program be reevaluated periodically or sunset after a number of years?

Q. Should the SUSF established in this Phase II proceeding by subject to a "sunset" provision?

A. No. Some of the witnesses confuse periodic review of the universal service plan with some form of absolute "sunset" provision which would simply terminate the plan. *See, e.g.*, Verizon Direct at p. 58, lines 13-16. While the prospect for periodic review with respect to how the Commission's universal service objectives are being achieved through the SUSF is reasonable, it does not follow that there should be any expectation that the SUSF would simply stop. As

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discussed in the NYSTA Direct, universal service goals are ongoing and the policies must continue to address those goals. *See* NYSTA Direct at p. 82, lines 23 through p. 83, line 16.

Q. How do you respond to the witnesses suggestions for a schedule for periodic review?

A. While the other parties may have different ideas of what their long term expectations may be for an SUSF, they generally recognize that some time should elapse before any periodic review. For example, the Staff USF Mechanism Panel recognizes a "three-to-five" year time for examination and potential extension. *See* Staff USF Mechanism Direct at p. 33, lines 4-7. AT&T, for its partial stop-gap proposal, recommends reevaluation in three years. *See* AT&T Direct at p. 19, lines 397-399. Regardless of what any party believes the scope of any periodic review would be, once an SUSF is established, the SUSF should continue in place under the policy decisions in this proceeding over a sufficient amount of time so that there is a significant experience base upon which a future review can be made. More importantly, once the policy decisions are established in this proceeding, it would be burdensome and unnecessarily costly to conduct another proceeding similar to this one to reconsider the same issues here unless sufficient time has passed. Regardless, periodic review may best serve the purpose of refining and adjusting the basic framework in light of the experience observed.

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Therefore, the NYSTA Smaller ILECs proposed and maintain that a time period more to the longer end of the time period suggestions makes most sense.

Q. Would the NYSTA approach be able to address other changes that might arise in the interim prior to any more comprehensive review?

A. Yes. As discussed in our Direct Testimony, the five year cycle for review of the NYSTA Plan that arises from this Phase II consideration is appropriate, but there may be other industry changes, separate and apart from the specific framework here, which may require addressing by an additional state universal service mechanism. We recognize the need for separate flexibility to address these changes (*e.g.*, the broadband plan, changes in the federal universal service fund ("FUSF"), changes in intercarrier compensation, changes in cost recovery rules, and other policies beyond those considered in this proceeding), and the NYSTA Plan envisions the necessary flexibility to address these events as they may occur. *See* NYSTA Direct at p. 8, line 17 through p. 10, line 6; and p. 83, lines 10-13.

g. Should the overall size of the fund or support program cost be limited? If so, at what level should that limit be set; or what methodology should be used to determine that limit?

Q. What response do have to the other witnesses' analyses with respect to the expected SUSF size?

A. Regardless of any party's view of what an appropriate fund size should be, the NYSTA Smaller ILEC plan would yield a more than manageable fund size.

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Q. What would the expected SUSF surcharge be based on witnesses' excepted SUSF size?

A. Three parties provided an estimate expressed on the basis of the average "per customer per month" charge associated with their SUSF proposal:

Staff USF Mechanism Panel:	< $0.01
NYSTA Smaller ILECs:	$0.02
AT&T:	$0.03 - $0.06

As can be seen, the average estimated charges range from less than 1 penny to 6 cents per month and are, therefore, minimal. In fact, AT&T, which computed the highest estimated charges, characterized the result as "only" 3 cents and 6 cents. *See* AT&T Direct, page 3, lines 59-61. At these levels, no one can rationally contend that any end user would be burdened or penalized. This is particularly true in light of the customer benefits that are derived by ensuring that all New Yorker's continue to have the ubiquitous availability of a safe, reliable, high quality network that is provided by a telecommunications carrier committed to meeting and advancing the Commission's universal service objectives and willing to comply and be subject to the enforcement of all Commission-established requirements. This universal service benefit holds true regardless of what carrier or provider a given customer might subscribe to -- we all derive value from being able to place calls to, and receive calls from, anyone or any place in the State of New York.

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Q. What comments do you have on T-Mobile's contention that New York LECs received 15% more in FUSF in 2010 than they did 10 years ago?

A. Apparently T-Mobile provided this position in an effort to suggest that since the FUSF is increasing, either the NYSTA Smaller ILECs do not need SUSF or that, if there is a SUSF, its size should be limited. In either event, T-Mobile is wrong. Specifically, Mr. Conn states the following:

> New York LECs are projected to receive $46.6 million in Federal Universal Service Fund ("FUSF") support in 2010 as of the fourth quarter, a more than 15% increase over the $40.3 million in FUSF support New York LECs were projected to receive ten years ago. (page 11, lines 4-6)

Mr. Conn's assertion is inaccurate. In total, the FUSF disbursements received by all New York LECs have, in fact, remained roughly constant. Of the $6.3 million increase cited by Mr. Conn, over $5 million is due to FUSF now being provided to *wireless carriers* that were ineligible to receive support in 2000. The FUSF disbursements received by the 31 NYSTA Smaller ILECs have actually decreased by nearly $4 million, or 13%, over that same10 year period. These findings are based on a review of Appendix HC1 (4Q2000) and Appendix HC01 (4Q2010), found in the same USAC reports cited by Mr. Conn at page 11 of his testimony.

Q. Do you have any comment on T-Mobile's reference to the potential adverse impacts of state USF surcharges on basic telephone service affordability?

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A. Yes. T-Mobile's remarks are not credible given the size of the expected SUSF arising from this Phase II. In supporting his opposition to a New York SUSF, Mr. Conn states that "… the Colorado Consumer Counsel has recommended changes that would cut the existing Colorado high-cost fund nearly in half" (T-Mobile Direct at p. 14, line 13 through p. 15, line 1) and goes on to find that:

> In this regard, both consumer advocates cited the adverse impact state USF surcharges have on the affordability of basic telephone service". (page 15, lines 4-5)

Mr. Conn then suggests that:

> This Commission must consider the consumer impact of a state universal service high cost fund or other support program, which would impose an additional surcharge on New York consumers. (page 15, lines 3-7)

It should be noted, however, that the Colorado Docket cited by Mr. Conn in footnote 46 of his testimony indicates that the Colorado state high cost fund in question was approximately $62 million – 6 times larger than the SUSF being proposed by the NYSTA Smaller ILECs and in a state with ¼ of the population of New York State. As we have summarized in our testimony, the SUSF charges proposed by the various parties are minimal, ranging on average from less than one penny to 6 cents per month per customer. As such, these charges would not have an adverse impact on the affordability of basic telephone service in New York State.

h. What standards should apply to determine the amounts of

payments from the fund or extent of other form of support from the program to an eligible recipient?

Q. Do you agree with the mechanics of the Staff USF Mechanism Panel's proposed SUSF?

A. Conceptually, we appreciate the overall SUSF mechanism for Phase II of this proceeding as proposed by Staff. That mechanism has as its basis the very same type of review mechanism that the NYSTA Smaller ILECs have proposed – a rate case review. However, there are three specific components of what Staff has proposed in its mechanism with which the NYSTA Smaller ILECs take issue – (1) the use of a total company ROE in determining the revenue requirement associated with SUSF eligibility; (2) the use of a benchmarking or modeling tool as a surrogate for actual company costs; and (3) the suggestion that an "impairment" analysis be undertaken and potentially used as a revenue requirement adjustment.

Q. Please explain your disagreement with Staff's proposed use of a total company ROE to be used in determining the revenue requirement associated with SUSF eligibility.

A. The use of a total company ROE has previously been suggested by parties, other than Staff. For example, as presented in the NYSTA Direct at p. 89, lines 1-8, the Commission has stated the following on page 9 of the *Framework Order*:

> Some parties commented that using the ROE subject to

> separations potentially exceeds the Commission's jurisdiction (ROE subject to separations includes intrastate and interstate revenues and costs). To avoid this concern, the companies' most recently reported 2006 intrastate ROEs will be used as a starting point.

Thus, the Commission has already addressed, and disregarded, the notion of using a total company ROE in determining intrastate revenue requirements.

Q: Is this finding by the Commission – the use of only intrastate ROEs -- unique?

A: No. Other, even more direct, explanations on this jurisdictional issue have been provided by the Commission and its Staff. For example, the Commission stated at page 18 of its September 30, 1993 decision in Case 28425 that:

> [w]hile on a total company basis, the company may earn in excess of the intrastate benchmark return on equity, it nevertheless, is entitled to a recovery of the loss on its intrastate operations. This is because the Commission's authority extends only to intrastate rates and operations; the Federal Communications Commission has jurisdiction over the company's interstate operations.

Likewise, the Commission has also stated at p. 13 of the "New York State Department of Public Service 2009 Financial Statistics of the Major Investor-Owned Utilities in New York State" that:

> [t]he earned ROE's shown in this report are not necessarily the same ROEs that would be calculated by staff during a formal proceeding. For example, in the telecommunications industry there are large differences between total company booked ROEs and the ROEs determined in rate proceedings. This is due in part to the fact that the Public Service

> Commission has jurisdiction over the intrastate operations only, while the total company booked ROEs include both intrastate and interstate jurisdictional operations.

Staff has provided no citations to any Commission change in policy or other rulings since the time these explanations were provided that would alter the Commission's prior determinations. Therefore, it is the NYSTA Smaller ILECs' position that the proposal by Staff, or any other party, to use any measure of return other than the "intrastate" ROE on intrastate jurisdiction regulated operations would be inconsistent with past and present Commission findings on this issue and should be rejected.

Q. Does Staff make any attempt to justify its deviation from prior Commission findings on this jurisdictional ROE issue?

A. Yes. The Staff USF Mechanism Panel direct testimony offered a variety of explanations in an attempt to justify and support its position, each of which should be rejected. We will respond to each of these explanations individually. The first explanation provided was as follows:

> First, in the current environment, competitors do not market their product on a local or intrastate basis but provide a complete package of services that include, at a minimum, local calling, intrastate toll calling, long distance calling and various features such as caller ID. Most packages are offered at a discount relative to the sum of the a la carte rates. This makes it difficult to properly allocate package revenues to intra and interstate piece parts. (page 12, line 22 to page 13, line 8)

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Staff has failed to explain why the way "competitors" market their products and services, and any discounts provided, are in any way relevant to the establishment of the appropriate jurisdictional ROE associated with the regulated intrastate service offerings of the NYSTA Smaller ILECs. There is no need for Staff to "allocate package revenues to intra and interstate piece parts" for the competitive providers until and unless one of those competitors seeks to receive SUSF disbursements. And, it is only then that such "competitor" would need to make the same demonstration that Staff would require of the NYSTA Smaller ILEC. In the interim, however, the NYSTA Smaller ILECs are required to comply with intrastate tariff requirements and the Commission's Uniform System of Accounts ("USOA") and, as such, file rates and maintain revenue accounts that make identification of their regulated, intrastate end user revenues readily available.

Q. Was there an additional effort by the Staff to justify its position?

A. Yes, the Staff went on to state the following:

> Second, all products are provided by the same network and personnel. Common and joint costs associated with the use of the same network and personnel are notoriously difficult to allocate. Cost allocations, as established by the Federal Communications Commission (FCC), have become even more problematic since allocation factors have been frozen at antiquated levels. (page 13, line 8-16)

The existence of common and joint use networks and personnel is nothing new. The FCC's and the Commission's accounting rules, in conjunction with Parts 36

Jurisdictional Separations rules and 64 cost allocation rules were designed and put into place to address this joint use situation and to provide a consistent methodology for allocating a company's network costs and operating expenses between the interstate and intrastate jurisdictions. Staff's references to joint costs being "notoriously difficult to allocate" and the existence of frozen interstate allocation factors are irrelevant; appropriate jurisdictional cost allocations are being made pursuant to existing federal and state rules. Further, any issues with the FCC's cost allocations that Staff deems "problematic" would be more appropriately addressed directly to the FCC in a separate pleading or proceeding outside of the current universal service proceeding. This state-specific universal service proceeding should not be used as an end-run around any concerns that Staff may have with the way the FCC's current rules are written and applied across the country.

Q. Was there a third reason provided by Staff to justify its deviation from prior Commission findings on this jurisdictional ROE issue?

A. Yes. Staff stated the following:

> Finally, investors consider total company operations when making investment decisions. (page 13, lines 16-18)

We agree that, in general, investors may very well consider the total operations of a company, but that consideration is informed by the way the NYSTA Smaller ILECs are regulated and the separation of their operations between the interstate

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and intrastate jurisdiction. As such, the more proper consideration is the regulatory environment in which the NYSTA Smaller ILECs operate and the impact that the decisions arising from the regulatory authority – whether it be by the FCC or a state commission – has on investors.

Moreover, looking at total company operations does not negate or minimize the rules and regulations that require separate jurisdictionalization of network and operations nor the need for the FCC and state regulators to address the underlying jurisdictional revenue and cost allocation issues, including rate setting and universal service support issues, independently. In fact, as previously cited in the NYSTA Direct at p. 88, the Commission has already recognized and addressed this "total company investor" versus "jurisdictional" situation and found that:

> Investors do not typically continue to support one project simply because another unrelated project is profitable. We decline to rely on non-jurisdictional earnings to offset jurisdictional losses.

Competition III Order, at p. 55, n. 112. Therefore, interstate ("non-jurisdictional") earnings are properly excluded in determining intrastate revenue requirements. Thus, for the many reasons cited herein, the Staff proposal to use total company ROEs for purposes of determining intrastate revenue requirements and SUSF eligibility should not be considered.

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Q. Can you describe the Staff's proposed use of a benchmarking or modeling tool to be used in determining the revenue requirement associated with SUSF eligibility?

A. Yes. When asked for an example of how the Commission can consider adjusting the level of a company's operating expenses in a state universal service funding mechanism, the USF Mechanism Panel, responded as follows:

> An additional adjustment will be made to ensure the company's operating expenses are in line with those of efficiently operating companies. For example, a benchmarking tool such as the Cost per Access Line (CPAL) comparisons, used to make financial adjustments in several cases, can be used to establish the "efficient" cost per line for the company. (page 27, line 19 to page 28, line 6)

Further, the USF Mechanism Panel goes on to cite several cases in which it claims this CPAL benchmarking tool was used to make "financial adjustments" (page 28, line 9 to page 29, line 1).

Q. Do you agree with the Staff's statements?

A. No. First, it is important to note that the CPAL benchmarking tool used in determining eligibility for the $2.00 annual local rate increases under the Commission's *Framework Order*, as cited by Staff, serves a limited function.

> ***Because companies will not be subjected to a full rate case review of their books***, the reported intrastate ROE will be adjusted to reflect the portion of intrastate unexplained cost levels, both high and low. ***Adjustments for costs that exceed the expected level will serve as a surrogate for potential rate case adjustments***, and will increase the ROE. Adjustments for

> costs that are less than expected recognize companies that have found efficiencies and will reduce the reported ROEs. ***(emphasis added)***

Framework Order at p. 10. It is clear that this CPAL benchmarking tool was to be used as an estimation tool in the absence of a full rate case. That is not the situation we have here. The SUSF mechanism proposed by the NYSTA Smaller ILECs and Staff requires a rate case filing and, therefore, the companies seeking SUSF "will be subjected to a full rate case review of their books", thereby eliminating the need for this cost "surrogate." Second, as we discussed later in our testimony, several companies have made significant cost reductions over the past several years. Those cost cutting efforts would be fully recognized or incorporated into any adjustments Staff might propose based on its Framework CPAL Model, as it is currently designed.

Q. Does the Staff USF Mechanism Panel maintain that any CPAL benchmarking finding would automatically become a revenue requirement adjustment?

A. No. Staff offers the following qualification with regard to its proposed CPAL benchmarking adjustments:

> The burden will be on the company to demonstrate why it should be allowed more for purposes of establishing state universal service fund levels.

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Staff USF Mechanism Direct at p. 28, lines 6-9. Contrary to Staff's statement, the NYSTA Smaller ILECs are not looking for "more". The NYSTA Smaller ILECs are seeking to recover only their regulated intrastate costs, including the opportunity to earn a reasonable return on investment, and will seek SUSF support only where there is a residual level of intrastate costs that are not recovered from the application of Benchmark Rate and rates for other Commission-prescribed intrastate regulated services to the demand units for those services. And, in doing so, the NYSTA Smaller ILECs have proposed that any company seeking SUSF disbursements will file a rate case and will subject their books, records and operations to a full review by Staff and, therefore, ultimately the Commission.

Additionally, Staff appears to have the "burden of demonstration" approach backwards. The "burden" should not be on a company to demonstrate why it should not receive *less* than its rate case-adjusted intrastate revenue requirement. Once that intrastate revenue requirement has been established, that ends the inquiry under intrastate rate of return regulation under which each of the NYSTA Smaller ILECs operate. Even if it were appropriate to go one step further (which it is not), the "burden" should more appropriately rest on Staff's shoulders. Staff is the party with the responsibility to review, identify and subsequently justify any proposed adjustments to a company's costs, based on the

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specific facts and circumstances of that company. Arbitrary "efficiency" adjustments based on modeling "tools" and comparisons to other, often "dissimilarly situated," companies is not sufficient or defensible.

Q. Does this mean that companies should not strive for efficiencies and, thus, reduce the need for a SUSF?

A. Of course not. However, to artificially impose unjustifiable "efficiencies" is not the prudent answer. Regardless of the level of a company's book costs, history has shown that the Commission's rate case process results in cost adjustments to the company's revenue requirement prior to setting local rates or determining funding levels. If Staff believes that some additional, but not yet identified or quantified, "efficiencies" might be achievable, then a process outside of the rate case should be established whereby Staff and the company can explore these possibilities in a systematic and logical manner. If any "efficiencies" are ultimately achieved through this external process, an adjustment to that company's SUSF funding levels may then be appropriate. A cost modeling process that "assumes" further efficiency savings can be made and, thus, reduces a company's revenue requirement regardless of any factual showing that such savings are attainable, or even realistic, is both unfair and indefensible.

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Q. Do you agree with Staff's discussion of "stranded plant" and its proposed use of an "impairment" analysis to be used in determining the revenue requirement associated with SUSF eligibility?

A. No. Staff's proposed impairment analysis, depending upon its results, could have the effect of requiring a company to "write down" a portion of its plant assets, thereby reducing the revenue requirement (by reducing depreciation expense and return) considered by the Commission in determining SUSF disbursements. A key aspect of Staff's position is what it considers to be the existence of "Stranded Revenue Requirement."

Q. Can you explain Staff's proposal in this regard?

A. According to the Staff USF Mechanism Panel, the plant-related aspects of this stranded revenue requirement include "stranded investment" and "underutilized investment," which Staff defines as:

> Stranded investment (stranded plant) refers to utility plant that a company has prematurely retired from service due to competitive losses. Underutilized investment includes plant still in service, but for which utilization drops due to migration of customers to a competitor.

Id. at p. 16, lines 11-14. These impairment and stranded/underutilized plant concepts, according to the Staff USF Mechanism Panel, could lead to potential revenue requirement adjustments to reflect the possibility that:

> First, so long as there is a competitive entrant that is positioned to take away market share from the incumbent, an

> incumbent in an industry experiencing declining costs associated with technological change that has been occurring in the telecommunications industry may not be able to set prices to recover the full original cost of its investment in older technologies.
>
> Second, to the extent that an industry exhibits large fixed costs, like the telecommunications industry, the loss of customers to competitors might lead an incumbent company to recover more of its fixed investment costs, on a per unit basis, from its remaining customers. However, such increases in unit prices would likely not be sustainable as the incumbents customers would switch to the competitive provider in reaction to these higher price increases. (page 25, lines 2-20)

Id. at p. 25, lines 2-20. Thus, it is the possibility that a company may not be able to recover the original cost of its investments, due to potential competitive pricing constraints, that appears to lead Staff to its impairment analysis and plant write off proposal.

Q. Can you explain generally some of the NYSTA Smaller ILEC's disagreement with this aspect of the Staff's proposal?

A. The NYSTA Smaller ILECs have continually maintained their COLR role, as they are still required to do, and operate under disparate and substantially more burdensome regulatory treatment than their competitors, while those competitors select their markets and select the terms of their own service offerings. As the Staff Policy Panel correctly observes, the "reality today is that years of 'partial' competitive pressures in independent phone service territories has called into question the financial viability of some of the operations." Staff Policy Direct at

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p. 17, lines 11-15. This proceeding must address these dangers through the establishment of a continuing SUSF – denying the companies the opportunity to recover their network investments is not a viable option.

Q. Are Staff's impairment analysis and stranded plant write down proposals justified, given the regulatory environment and expectations under which the NYSTA Smaller ILECs built and operate their networks?

A. No. Staff's impairment analysis proposal neglects glaring facts contrary to the suggested treatment. The NYSTA Smaller ILECs are COLRs and maintain plant and incur expenses to remain ready to serve (even as back-up) all customers, even those served by competitor providers. *See* NYSTA Direct at p. 19, line 18 through p. 20, line 17. As Staff elsewhere also recognizes, "pieces of the network cannot simply be switched off because there are fewer customers. . . ." Staff Policy Direct at p. 17, lines 5-15.

The suggestion that the plant values of the NYSTA Smaller ILECs should be written down and that these companies should be denied cost recovery is a very dangerous proposition. The NYSTA Smaller ILECs committed investment dollars, continue to honor those commitments today, and are still recovering those investment costs for plant they built and operate to serve as the COLR to all. If the NYSTA Smaller ILECs were not the COLR, they could have (and would have) resorted to a selective market coverage as other providers do today (*i.e.*,

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only to customers where the density is high, and only to other customers if those customers are willing to make high payments to ensure no loss to the provider). *See* NYSTA Direct at p. 60, line 16 through p. 63, line 3. The NYSTA Smaller ILECs, under those very different conditions, would have limited their investments only to areas and to customers from which they believe they can make a profit. They have not done that, and that was not the bargain under which those investments were made.

Q. Please explain, in practical terms, how this "unrecoverable" plant situation might be related to the depreciation rates being used by a company.

A. In certain situations, stranded or underutilized plant (unrecoverable plant) may exist because of the conservative depreciation practices employed by Staff in the context of its periodic depreciation reviews and rate cases. Staff, in performing its depreciation reviews, has recommended depreciation rates for the various plant accounts that it believes were appropriate for a given company. Generally, the Staff-recommended rates are lower than the depreciation rates in use by the company at the time of the study. If, based on Staff's recommendation, a company decides to lower its depreciation rates, its plant will be depreciated at a slower pace going forward, resulting in a higher future net book value and, thus, subjecting the company to a higher probability that its plant may not be fully recoverable through its prices.

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Additionally, Staff performs an assessment of the overall level of a company's depreciation reserve as part of its analysis. If Staff believes that the reserve is too high (excessive), Staff will often recommend an additional downward adjustment to the company's depreciation rates in order to reduce the reserve to a level it believes is more appropriate. Both the depreciation rate adjustment and the reserve excess adjustment serve to *increase* the potential "unrecovered" portion of the original cost of a company's investment and, thus, *increase* a company's exposure to the stranded/underutilized plant situation described earlier.

In retrospect, these recommended depreciation rates did not, in the final analysis, depreciate their plant on a reasonable timetable. The prevailing policy of keeping depreciation rates low means that these companies have been denied proper cost recovery for decades. The NYSTA Smaller ILECs should not be penalized now because of this past depreciation policy.

Q. Does Staff consider the impacts of competition when performing its depreciation studies?

A. Staff's depreciation studies are based, in large part, on an analysis of historic plant retirement experience that can date as far back as 50 years, depending upon the type of plant being studied. These historic retirement analyses are used in determining the average services lives for plant accounts, upon which the

depreciation rates will be computed. In some cases, adjustments are made to the historic lives, however, to the best of our knowledge, Staff's depreciation studies have rarely, if ever, considered the impacts of competition on the service lives and life expectancy of a company's plant. Had these competitive influences been addressed by Staff, it is likely that their recommended depreciation rates would have been higher and their purported reserve "excesses" smaller, resulting in a lower level of potentially "unrecoverable" plant than exists today. This policy is partially responsible for the potential stranded/underutilized plant issues that Staff is now trying to address through its proposed impairment analysis and stranded plant write down -- treatment that could ultimately penalize a company unfairly.

Q. Are you saying that if depreciation rates had been properly determined by Staff at the outset, that the concept of Staff's impairment analysis and plant write downs would be acceptable to the NYSTA Smaller ILECs?

A. No. Staff's past depreciation practices have certainly, in some instances, made the potential "unrecoverable" plant dilemma worse. Even if Staff's recommended depreciation rates had been appropriately designed to reflect the depreciation-related impacts of competition that Staff itself now identifies, it is likely that some companies would still find themselves restricted in their ability to fully recover their investments and, therefore, be required to perform Staff's suggested impairment analysis in order to be eligible for SUSF support.

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We have a significant concern with the fact that the NYSTA Smaller ILECs made significant network investments at a time when the Commission's regulatory compact was "intact," with the expectation that they would be allowed the opportunity to earn a reasonable return on their investments (at the time of those investments, there was no reason to presume otherwise) in exchange for the universal service commitments they were operating under. Staff's "mid-course" suggestion that the recovery of these good faith investments could now somehow be in jeopardy is unacceptable. Further, even in these current times of competition and strained cost recovery opportunities, the NYSTA Smaller ILECs, in their roles as universal service providers and COLRs, have continued to invest in their systems to improve and maintain the high quality, reliable telecommunications networks and services that the Commission still encourages, recognizes and relies upon in fulfilling its universal service objectives and goals. However, their ability to continue these investments is now in serious jeopardy.

Q. Do you have any final comments regarding Staff's proposed impairment analysis and potential plant write down adjustment?

A. Yes. At pages 20 to 24, the Staff USF Mechanism Panel describes the situation whereby two publicly-held New York ILECs – Frontier of Rochester and Verizon – recognized impairment losses in their financial statements. According to Staff,

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the companies each wrote down significant portions of their plant investment and reported those write-downs in their SEC financial statements.

Q. Were Frontier of Rochester or Verizon required, by the GAAP accounting rules, to make concurrent plant write-downs on the financial statements filed with the Commission, for regulatory and/or rate making purposes?

A. Based on our reading of Staff's testimony, while not required by GAAP rules, both companies did make plant write-downs on their regulated Commission financial reports. However, in both instances, these write-downs were made in conjunction with alternative regulatory plans being sought by the companies, Frontier in its Open Market Plan and Verizon in its Incentive Plan. Therefore, based on our reading of Staff's testimony, the companies agreed to such write-downs in exchange for Commission approval of their alternative regulatory plans. Such is not the case here. The NYSTA Smaller ILECs are rate of return regulated and are not seeking a change to that treatment.

Q. Please summarize your position regarding the three components of the Staff USF Mechanism Panel that you have taken issue with.

A. As discussed above, the three specific components of Staff's SUSF mechanism with which we take issue – the use of a total company ROE, the use of a benchmarking or modeling tool as a surrogate for actual company costs and the application of an "impairment" analysis would all result in less revenue than is

required by a company to recover its intrastate operating expenses (as reviewed and adjusted by Staff in a rate case) and the opportunity to earn a reasonable return on its investment. So long as the NYSTA Smaller ILECs continue to successfully fulfill their unique roles and meet their obligations as universal service providers throughout their entire service areas, and continue to invest in those networks as necessary, nothing short of full recovery should be considered or accepted. This NYSTA Smaller ILEC universal service philosophy is entirely consistent with the Commission's previous findings in its Competition Orders and is succinctly summarized by the Staff Policy Panel as follows:

> In the Competition II order, the Commission stated "that the goal of ensuring the provision of quality telecommunications services at reasonable rate is primary, and although other goals may be important, attainment must not come at the expense of that primary goal." In other words, another goal such as competition cannot come at a price which threatens universal service.

Staff Policy Direct at p. 7, lines 10-19. However, Staff, in the current Phase II proceeding, proposes a SUSF mechanism that is very much "competitively" influenced and will not likely allow universal service providers the ability to recover their costs – an outcome that will certainly have the potential to "threaten universal service".

Q. Can you summarize the process that the NYSTA Smaller ILECs propose for obtaining SUSF disbursements?

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A. The process that any NYSTA Smaller ILEC should follow to obtain SUSF funds should not be more burdensome than that which applies today for the Transition Fund. Such an additional burden would certainly be placed on the NYSTA Smaller ILECs with regards to Staff's impairment analysis, as discussed above.

Q. Would the NYSTA Smaller ILECs consider Staff's proposed Annual Attestation to be an additional burden?

A. It is unclear to us precisely what Staff contemplates with regards to its attestation requirement. The Staff USF Mechanism Panel proposes that companies receiving SUSF be required to file an annual certification "containing auditable financial and operational information with the Commission." Staff USF Mechanism Direct at p. 30, lines 2-4. If that required information is effectively contained within the existing filing requirements of the NYSTA Smaller ILECs, the answer would likely be no. However, any additional annual reporting requirements may certainly be considered burdensome.

Q. Is there anything more you would like to say about the methods to be used for SUSF disbursement purposes?

A. Yes. The methods set forth in the NYSTA Smaller ILEC Plan are acceptable and sufficient for the Phase II purposes under review in this proceeding, at least for the near future. Those methods subject recipients to a rigorous evaluation before the Commission. However, in the future, the Commission should consider

alternative methods to further streamline the processes to avoid unnecessary costs to the companies that are already stressed and in need of SUSF funding. The length of time, expense, and uncertainties associated with the rate case process are counterproductive and many times wasteful to the resources of the universal service providers and the Commission Staff. Accordingly, the Commission should turn a critical eye to reducing the burdens of this process. In any event, it will not be appropriate to expose these NYSTA Smaller ILECs to such burdens for other, future State USF mechanisms that may be adopted, *e.g.*, access charge restructuring.

Q. Are there any indications that certain parties may not have fully comprehended the Commission's process in determining Transition Fund eligibility and disbursement process?

A. Yes. CTANY, through Mr. Ansaldo, at page 9, line 9 to page 10, line 10, and again at page 11 line 19 to page 12, line 1, of his direct testimony implies that the procedures used by the Commission for purposes of determining rate flexibility and $2.00 local rate increases eligibility under the *Framework Order* issued in Case 07-C-0349 in March of 2008 were somehow also used in determining Transition Fund eligibility and levels of disbursements. This is absolutely incorrect, and Mr. Ansaldo's assertions to the contrary should be disregarded. In no instance was the *Framework Order* procedure used for funding purposes.

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Q. Do any parties claim that there are other "non-competitive," negative impacts associated with funding?

A. Yes. CTANY's witness Mr. Ansaldo, for example, asserts "[m]y analysis concludes that the availability of [Transition Fund] subsidies has provided a disincentive to innovate and lower costs" (CTANY Direct at p. 6, lines 15-18) and "… it is likely the very existence of this proceeding creates an environment where Crown Point and some other ILECs might be inclined to rely on the prospects of a continued TF subsidy rather than independently solving their problems." *Id*. at p. 17, lines 7-12.

Q. Is there information available that would disprove CTANY witness Ansaldo's assertions that the availability of funding has provided a disincentive to lower costs?

A. Yes. A review of the expense levels of two of the existing Transition Fund recipients demonstrates that significant costs savings have indeed been sought and achieved. Based on data from the NYSTA Smaller ILECs' PSC Annual Reports, from 2003 (which was the year prior to the effective date of the Commission's Comprehensive Plan establishing the Transition Fund) to 2009, Crown Point's operating expenses declined by approximately $550,000 (from $2.05 million to $1.5 million), or 27%. Oneida County's expenses declined by approximately $1.4 million (from $3.75 million to $2.33 million), or 38%, over that same period.

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While Newport's expenses increased slightly, by approximately $170,000 (from $2.67 million to $2.8 million), or 6% over that same period, as both Mr. Ansaldo (CTANY Direct at p. 20, lines 3-5) and the Commission have acknowledged (Case 04-C-1518, Order Approving Rate Increase, issued and effective May 27, 2005, at p. 6), Newport is recognized as a low cost company. And, considering that inflation over that same six year period was approximately 17%, Newport's 2009 costs are, in essence, 11% lower than 2003 on an inflation-adjusted basis. This 17% inflation rate makes the expense reductions of Crown Point and Oneida County even that much more pronounced, resulting in inflation-adjusted reductions of 44% and 55%, respectively. To infer, as Mr. Ansaldo has done, that the existence and availability of the Transition Fund has provided a "disincentive" to reduce costs is factually unfounded.

Q. Do you have any other data that would demonstrate that the NYSTA Smaller ILECs' costs are not as high or unwarranted as CTANY witness Ansaldo might suggest?

A. Yes. The NYSTA Smaller ILECs expenses, when compared to 700 similarly sized ILECs nationwide, are significantly lower. Based on the 2009 data submitted to NECA for purposes of determining federal High Cost Loop ("HCL") support, the NYSTA Smaller ILEC operating expenses (on a per line basis) were 34% lower than their peers nationwide. An additional measure of cost

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comparability are the FUSF's High Cost Loop ("HCL") support payments received by the ILECs which, in addition to expenses, take into account other cost components such as return on investment and operating taxes. Once again, the NYSTA Smaller ILECs outperform their rural ILEC peers nationwide, having HCL support payments that are, on average, 75% lower than the nationwide average of their peers. *See* Exhibit __ (NYSTA-25). These findings are particularly noteworthy when one considers the fact that, even while the New York State companies have lost many lines in the competitive telecommunications market in New York, , the NYSTA Smaller ILECs have nonetheless managed to keep their relative, *per line*, cost levels well below those of their peers across the country.

Q. CTANY's witness, Mr. Ansaldo, devotes considerable attention to the expenses and CPALs of the "independent" ILECs, including comparisons to ILECs that have been acquired by holding companies. Do you have any comments regarding his purported findings and conclusions?

A. Yes. Mr. Ansaldo compares the costs of Crown Point to holding company ILECs ("HoldCos"), in general, and Edwards (TDS), specifically. Mr. Ansaldo appears to suggest the fact that Crown Point's (approximately 800 access lines) having total wages that were $270,000 higher than Edwards' (approximately 1,800 access lines), is somehow inappropriate or unexpected. However, that is exactly the

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result one would expect when comparing the wage expenses of an independent ILEC to a HoldCo. The HoldCo generally has fewer employees on its books; instead relying on the parent company to provide many of the HoldCo's labor-related services. The parent company generally recoups its labor (and other) costs from the HoldCo via a distributed chargeback. If one were to instead look at the remaining "Other" expense category for these two companies (where a HoldCo's chargeback costs would generally reside), Crown Point had approximately $750,000 while Edwards had $1.6 million. Thus, Mr. Ansaldo's attempt to isolate and compare only the wages of an independent ILEC to those of a HoldCo, in a vacuum, produced misplaced results and conclusions.

Q. Do you have any comments on CTANY witness Ansaldo's claims that HoldCos are generally performing better than independent ILECs because of their successful responses to competition?

A. Yes. All of the TDS, Fairpoint and Lynch HoldCos properties in New York were acquired by large, out-of-state corporations. These sales were not likely attributable to the efforts and foresight of the independent ILEC "owners" as an effort to make their companies more efficient in response to competition, especially since they would no longer be the owners of their companies. It is equally wrong to make any assumption about cause and effect today given the fact that the last purchase by any one of these entities in the State of New York

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was the purchase of Berkshire Telephone Corporation in 2003. Thus, since cable telephony, the main wireline competitor in the NYSTA Smaller ILECs' service areas did not materialize until some time after the acquisitions, Mr. Ansaldo's effort to use rhetoric over fact should be rejected. It is more likely that these purchase decisions, many years ago, were made by the large acquiring corporations in attempts to expand their nationwide operations for what we expect would be a number of unique corporate goals and objectives.

Q. Do you have any comments on CTANY witness Ansaldo's observations regarding the Frontier Holdco?

A. Yes. Mr. Ansaldo specifically highlights the Frontier companies and their approach to competition, stating:

> The Frontier companies, which include Citizens NY, Ogden, Ausable Valley, Frontier of NY, Frontier of Rochester, Seneca Gorham and Sylvan Lake have rationalized costs and operations to remain competitive. (page 18, lines 17-21)
>
> As already mentioned, one need only look at the costs data for the Frontier companies to see how they have ***responded to a challenging environment in a more self-reliant and pro-competitive manner.*** (emphasis added)

CTANY Direct at p. 25, lines 16-19. However, there has been no demonstration regarding the truth of Mr. Ansaldo's inference, that the Frontier companies' successful "response" to competition was somehow attributable to competitive foresight on the part of the acquired companies. All of Rochester Telephone's

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acquisitions of the current Frontier ILECs in New York State (i.e., Ausable Valley, Highland, Seneca Gorham and Sylvan Lake) occurred between 1974 and 1988, at a time when an ILEC's competitive response to future cable and wireless telephone service could not have been a driving force behind Rochester Telephone's acquisition strategies. Even if, however, competition was somehow a driving factor in these earlier acquisition and/or merger decisions, only minimal activity, by any holding company, has occurred in New York State for a very long time (only one acquisition of a small rural ILEC has occurred in the last 12 years). Therefore, to assert that the small, rural, independent members of the NYSTA Smaller ILECs are somehow mismanaging their companies, when these large, national corporations are apparently no longer pursuing merger or acquisition strategies in New York State, is groundless.

While Mr. Ansaldo has apparently touted acquisitions as a solution for competitive response by the NYSTA Smaller ILECs, the Commission has recently presented a different spin on this acquisition issue in its decision of August 23, 2010 in Case 09-C-0595 at page 10, footnote 12, when it stated:

> We perceive this as a major advantage of an ESOP over a leveraged buyout transaction where the owners are likely to be out of state and the acquired company only a small part of the acquirer's business and attention.

And further in footnote 12 that,

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> We find that this ownership transition should benefit the Company's customers because the ESOP transaction provides for an orderly ownership transition for the company *by leaving concerned motivated employee/owners in place to run the company going-forward* …." (emphasis added)

Thus, the Commission has expressed the positive benefits associated with the operations of independently held and operated ILECs and these benefits should not be so readily discounted.

Q. Do you have any final comments in response to CTANY statements that have been made regarding the Transition Fund, or rate cases in general, that would serve to improve the accuracy of the record in this proceeding?

A. Yes, we have several. First, at page 20, lines 19-20, CTANY witness Ansaldo asserts that "no recognition" was given by the Commission to the "strong equity ratios and low debt burdens" of Newport and Oneida County in its rate case reviews and Transition Fund authorizations. However, contrary to this assertion, the Commission has a long-established policy of setting authorized ROEs at levels that are reflective of the equity ratio of a given company. This ROE policy is recognized by Staff, as well as the NYSTA Smaller ILECs, in their respective SUSF mechanism proposals. Both parties used ROEs that varied based upon the individual company's equity ratio – the higher the equity ratio, the lower the assumed risk, and the lower the authorized ROE.

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Second, CTANY witness Ansaldo claims, in reference to Oneida County's approval for Transition Fund support, that "[t]his withdrawal occurred even though the company, again, did not and was not going to charge the $23 benchmark rate." CTANY Direct at p. 22, lines 12-14. This statement is inaccurate as both the Commission's January 16, 2009 decisions and Oneida County's actions demonstrate. The Commission's decision in Case 08-C-0610, at p. 25, clearly indicates the company's intent to charge the $23 rate. "The company plans to phase in the increases in two increments." And Oneida County, in fact, did implement these rate increases in February 2009 and February 2010. Regardless of the facts here, the concept of imputing the Benchmark Rate for SUSF calculation purposes is a valid consideration and is discussed elsewhere in this rebuttal testimony.

Q. Do you have any additional comments regarding this witness' purported findings and conclusions?

A. Yes. Third, Mr. Ansaldo described Oneida County's rate case findings, specifically those associated with its extensive non-regulated affiliate operations, and concluded that:

> The difficulty of separating true ILEC costs from those of its competitive telephone affiliates should, in similar cases in the future, disqualify an ILEC from obtaining subsidies from other voice providers.

CTANY Direct at p. 23, lines 8-12. The fact that a company may have a complex organizational structure, potentially requiring some additional Staff analysis, should in no way impact its need for SUSF. Mr. Ansaldo's suggestion that a company's need for SUSF somehow be tied to the "simplicity" of the Staff analysis is disconcerting and not one that should be considered. Ironically, Mr. Ansaldo's contention runs counter to the holding company framework that he suggests (albeit wrongly) is the solution to cost containment. Holding companies are not typically simple structures, such as when the organization has multiple operations within and outside the State.

Q. Do you have more comments regarding Mr. Ansaldo's purported findings and conclusions?

A. Yes. Continuing, fourth, Mr. Ansaldo implies that "The rationale allowing the subsidized ILECs to actually collect their higher costs from better earning providers or from customers in other service territories is weak." *Id*. at p. 30, lines 15-18. To clarify, the ILEC is not being subsidized; the ILEC is recovering its costs. Likewise, the "better earnings" statement is irrelevant because there will always be companies "earning" at levels higher than what the FCC or the Commission may allow for ILECs or higher than what the ILECs are actually earning. Stripping away these unnecessary characterizations, this becomes an especially perplexing argument. Taking the statement (with the terms

"subsidized" and "better earning providers" removed) at face value, the "rationale" about which Mr. Ansaldo complains is precisely what Congress contemplated as one of the driving policies in designing the universal service provisions of the 1996 revisions to Act, and is one of the principles that serves as the foundation for all of the FCC universal service funding mechanisms. The shared social responsibility for funding these universal service mechanisms is "blind" to the specific financial condition of the contributing companies. To describe this fundamental national universal service policy as "weak" is, in itself, a weak and uninformed portrayal by the witness. One final point is worth noting: Mr. Ansaldo references "better earning providers" but does not mention the fact that these "providers" may very well include his client's members, and the record reflects that their cable television offerings, and thus digital phone service, is a result of a selective density threshold that means they are not required to provide service in lower density, higher cost to serve areas.

Q. Do you have any final comment regarding this witness' purported findings and conclusions?

A. Yes. Finally, Mr. Ansaldo portrays the funding that Crown Point has received in the past as a failure:

> The future of one of the [Transit Fund] recipients, Crown Point, requires some separate focused attention, and that focus should not be on any increase in [Transition Fund] levels which has clearly not succeeded in the past.

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Id. at p. 33, lines 17-20. Mr. Ansaldo's criticism is sorely misplaced. Mr. Ansaldo does not even attempt to reconcile his statements with how the more than approximately **CONFIDENTIAL SUBJECT TO PROTECTIVE ORDER IN NY PSC CASE 09-M-0527: ***** END CONFIDENTIAL SUBJECT TO PROTECTIVE ORDER IN NY PSC CASE 09-M-0527.** of Crown Point's customers with no landline telephone alternative would have had telephone service available to them (as well as those that might have a wireless option, but continue to rely on landline services from Crown Point in their homes) in the absence of such funding. While Mr. Ansaldo might ignore them, these consumers should not be ignored, particularly since it is highly questionable whether Crown Point would be in business today, attempting to meet its universal service and carrier of last resort obligations, without Transition Fund disbursements. Mr. Ansaldo's statements also fail to consider how those Crown Point consumers would be served without a universal service provider available to them that is subject to Commission jurisdiction and oversight. The fact that universal service is available in Crown Point's service area is testament to the fact that the Transition Fund's purpose is realized and that the funding received by Crown Point has, by no means, been a failure. Now with the SUSF proposal put forth by the NYSTA Smaller ILECs, the future success of the Commission's

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universal service goals will have an even higher probability of being attained and maintained.

Q. Have any other parties provided testimony related to the costs of the NYSTA Smaller ILECs?

A. Yes. AT&T, at pages 6-8 of its direct testimony, makes several incorrect assumptions and assertions regarding the loop costs of smaller carriers and the intrastate costs that the Commission examines in a rate case. We will respond to each of these false assertions individually.

Q. AT&T claims that "perhaps 90%" of the total costs of smaller carriers are loop costs (AT&T Direct at p. , note 6). Do you agree with that assertion?

A. No. Small carriers have significant switching and transmission equipment related costs, in addition to loop costs. For example, a review of the NYSTA Smaller ILECs' 2009 HCL data submissions, found at: https://www.neca.org/cms400min/NECA_Templates/PublicInterior.aspx?id=1190 indicates that loop costs are closer to 60% of total costs, not the 90% that Mr. Nurse suggests. Therefore, AT&T's attempt to minimize the costs to be considered in this proceeding by focusing solely on inaccurate loop cost characterizations is flawed and should not be relied upon.

Q. Please respond to AT&T's assertions regarding the magnitude of the NYSTA Smaller ILECs' loop costs.

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A. Mr. Nurse asserts that the loop costs of the NYSTA Smaller ILECs are capped at $30 per loop per month as the result of support from various federal USF programs. (page 6, line 124) This $30 figure was based on 2008 cost data. However, it should be noted that if this stale data were updated to the most current 2009 data year, and using Mr. Nurse's calculation, the resultant loop cost would have been $32. Setting aside this mathematical update, Mr. Nurse goes on to state that 25% of that loop cost is allocated to the interstate jurisdiction, and thus, "the high costs of the NYSTA companies are effectively capped, leaving only a modest cost to be recovered in the intrastate jurisdiction." AT&T Direct at p. 7, lines 129-130. Further, Mr. Nurse asserts that "This reduced cost is, essentially, the starting point in a rate-case examination by the staff." *Id*. at p. 7, fn8.

Q. Do you agree with AT&T's characterization of the costs that would serve as "the starting point in a rate-case examination by the staff"?

A. No. First, by Mr. Nurse's own calculation, his $30 loop cost already reflects removal of the 25% interstate allocation referenced above. Therefore, contrary to his assertion at p. 6, line 127 to p. 7, line 131 of the AT&T Direct, there would be no further reduction to his purported $30 loop cost. Second, Mr. Nurse's assertion that his estimated "modest" loop costs would be the "starting point" costs examined by staff in a rate case is misplaced. Staff, in its rate case process, would not examine and base local rates on loop costs only, but on *all* costs that

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are allocated to the intrastate jurisdiction. And, as demonstrated above, AT&T's assertion regarding the relationship of loop costs to total costs was significantly overstated. Therefore, the total intrastate costs that would truly be examined by Staff in a rate case would be significantly higher than AT&T's purported "modest" cost estimates.

3. Should a benchmark rate (or other benchmark be established? If so, at what level (e.g., for a benchmark rate, the comparable Verizon rate, some percentage above or below the Verizon rate, some other method)?

Q. Do the NYSTA Smaller ILECs believe that a local benchmark rate at, or above, $23.00 is appropriate?

A. No, they do not. The NYSTA Smaller ILECs determined that a local service Benchmark Rate should be $15.22. *See* NYSTA Direct at p. 95, lines 5-14.

Q. Several parties suggest that in order to be eligible for state universal service funding, the Benchmark Rate must be set for a company at or above the current $23.00 Verizon-based statewide benchmark rate. How do respond to these proposals?

A. We will respond individually to the specific proposals offered by parties suggesting that the current $23.00 Verizon benchmark be *increased*. The NYSTA Direct Testimony provided numerous arguments describing why the $23 Verizon-based benchmark rate, even at its current level, is inappropriate.

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CONFIDENTIAL SUBJECT TO PROTECTIVE ORDER IN NY PSC CASE 09-M-0527: ********** ********** ********** ********** **********. **END CONFIDENTIAL SUBJECT TO PROTECTIVE ORDER IN NY PSC CASE 09-M-0527.**

Q. Please respond to Sprint's suggestion that the current $23.00 Verizon-based benchmark should be raised.

A. Sprint proposes that before becoming eligible for funding, a consumer should be expected to at least pay a reasonable amount and that should be "at least the $23 benchmark previously established by the Commission in 2006 in the Comp III Order" (Sprint Direct at p. 13, lines 14-16) and, further, that "it would not be unreasonable to establish a higher benchmark." *Id*. at p. 13, lines 16-17. In support of increasing the current Verizon $23 benchmark, Sprint cites the following:

> More than three years ago, the California PUC declared that a rate of $36 is an appropriate benchmark rate in its evaluation of universal service.

Id. at p. 13, n.11. However, a review of the California PUC Order cited in footnote 11, Interim Opinion Adopting Reforms to the High Cost Fund-B

Mechanism, Decision 07-09-020, September 6, 2007 (the "*California Order*") reveals that any attempted comparison by Sprint of the $23 Verizon benchmark to the $36 benchmark is misplaced.

Q. What basis do you have for suggesting that Sprint's position is misplaced?

A. As a review of the *California Order* indicates, the $36 California benchmark rate contemplated not only a basic local rate component, but, in addition, the $6.50 federal SLC and an unidentified level of features and toll services. It is highly probable that if these extra costs included in the California PUC's $36 benchmark were removed, the resulting stand-alone basic local service rate would be well "below" the current $23 Verizon-based benchmark, a finding consistent with, and supportive of, the positions outlined in the benchmark section of our direct testimony**.**

Q. Did the California Order require carriers to charge the benchmark rate in order to be eligible for funding?

A. No. The California Order was very specific in addressing this issue. At page 47**,** the California Commission stated the following:

> The $36 benchmark, however, is in no way intended to serve as a cap on basic rate levels, or as a determination that retail rates for basic service alone as high as $36 would be affordable. Likewise, this benchmark level does not indicate that we believe it is appropriate for basic service to rise to a level of $36 per line.

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Moreover, as explained on page 2 and page 19, footnote 24, the California benchmark addressed the state's 4 largest carriers (Verizon, A&T, Frontier, and Sure West) and the state's $434.6 million high cost fund (CHCF-B), applicable to those 4 carriers.

Q. Please respond to AT&T's suggestion that the current $23.00 Verizon-based benchmark should be raised.

A. AT&T (AT&T Direct at p. 15, lines 295-298) proposes:

> [t]hat the Commission should consider increasing the benchmark rate up to the federal comparability rate for rural carriers of 125% of the $23 urban rate for carriers seeking to draw from the fund. That would yield a benchmark rate of $28.75.

It is our understanding that the FCC assesses rate comparability based on the following Section 254(b)(3) provision:

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

Therefore, instead of using a benchmark based solely on Verizon's urban rate in New York State, as AT&T proposed, a more consistent and appropriate basis

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would have been to use the average nationwide urban rate for the reasons we have explained previously in our Direct Testimony.

Q. Do you have any indication as to how Verizon's $23.00 urban residential rate compares with urban residential local rates nationwide?

A. Yes. Based on the FCC's 2008 Reference Book of Rates, Price Indices, and Household Expenditures for Telephone Service (Table 1.3), as of October 15, 2007, Verizon's five sampled cities in New York State were higher than all but three of the remaining 90 cities sampled across the country. In addition, while Verizon's residential urban rate in New York averaged approximately $35 (including touchtone, SLC and taxes), the nationwide average was $25.62, *nearly $10 lower*. Further, Verizon's urban rates in the other 23 Verizon cities sampled across the country ranged from $18.43 to 29.93 (including touchtone, SLC and taxes), again indicating that its New York State rates are well above the norm, even within its own organization. Therefore, if one were to use this federal comparability measure for universal service benchmarking purposes, it should be an amount equal to roughly $10 less than Verizon's current $23.00 urban residential rate in New York State. This would produce a result consistent with the $13.23 average residential urban rate used as the foundation in developing the NYSTA Smaller ILEC proposed benchmark rate of $15.22. *See* NYSTA Direct at p. 94, line 14 through p. 95, line 14.

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Q. Does AT&T offer any additional statements in an effort to support its proposal to increase the current $23 Verizon-based benchmark?

A. AT&T did provide some additional statements as follows:

> … the current benchmark for rural ILECs is the same as the statewide benchmark for large urban ILECs; the benchmark for rural areas could be higher to reflect the higher costs of serving less dense, more rural areas (page 15, lines 302-305)

Q. Do you agree with what AT&T stated?

A. No, the NYSTA Smaller ILECs do not. These statements appear to be a belief generally held by many – that the costs for the NYSTA Smaller ILECs, being small and rural in nature, are higher than those of Verizon, with its significant urbanized populations and economies of scale and scope. However, a comparison of the 2009 regulated operating expenses of the 31 NYSTA Smaller ILECs versus Verizon, as reported in their 2009 PSC Annual Reports, demonstrates just the opposite -- the average NYSTA Smaller ILECs' cost per access line ("CPAL") was $800, while Verizon's was $1,041, or 30% higher. Therefore, AT&T's assertion that the benchmark rate could be higher to reflect the purported higher costs of the NYSTA Smaller ILECs is misplaced. **Q. Please respond to Verizon's suggestion that the current $23.00 Verizon-based benchmark should be raised.**

A. At pages 45-46 of its direct testimony, Verizon proposes an approach similar to AT&T, using a variation of the FCC's "reasonable comparability test". Verizon,

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like AT&T, proposes to start with the current Verizon urban residential rate in New York. As described above, this comparability test calls for "nationwide" comparability and we have already demonstrated that Verizon's urban residential rates in New York State are significantly higher than the rest of the country, as well as within its own organization nationwide (based on the sampled Verizon cities discussed above). Accordingly, we do not believe that Verizon's proposal should be adopted.

Q. Do you have any comments regarding the presumed business benchmark rate used by Staff in computing its $5.6 million SUSF estimate?

A. Yes. Staff's SUSF Model increased each company's business rates by the same "percentage" that resulted from increasing a company's current residential rates to the $23 residential benchmark. A review of Staff's calculations shows that several of the increases resulted in rate levels that could be viewed as excessive. For example, many of Staff's proposed business rate increases exceeded $20.

Q. Are rate levels of this magnitude consistent with Staff's position on a business benchmark rate?

A. While a business benchmark rate does not exist today, a reading of Staff's testimony does not support such a disparate rate differences between basic residential and business local exchange services. At page 29, lines 14-18 of its direct testimony, the Staff USF Mechanism Panel states:

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> To receive funding, a company's business basic local service rate should not be set lower than the company's residential basic local service.

This stated position is entirely consistent with the local rate increases authorized under the Commission's Framework Order, whereby a company's $2.00 residential rate increases are not to result in residential rates exceeding business rates. However, Staff's suggested business rate increases for purposes of determining SUSF eligibility, to levels *well above* the $23 residential rate, appear to be inconsistent with its own testimony and prior Commission actions.

Q. What is the significance of these excessive rate increases in relation to the size of Staff's proposed SUSF?

A. As a result of the excessive rate increases, we would consider the estimated revenues generated by those increases to be significantly inflated. Since these increased revenues are used as an offset to the need for SUSF, we would therefore consider Staff's proposed SUSF to be understated.

Q. How were business rate increases addressed by the NYSTA Smaller ILECs in their SUSF calculation?

A. Business rates were increased by the same dollar amount as the residential rate increases, thereby maintaining the same dollar difference between the adjusted residential and business rates. This approach is more in line with Staff's statements and prior Commission actions, since the resulting business rates were

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not brought to the extreme levels found in Staff's SUSF model. The higher revenues assumed in Staff's SUSF calculations may very well not be realized given the potential loss of business customers with such excessive rates.

Q. Under the federal comparability test referenced by AT&T and Verizon, is it a requirement that a company charge the estimated "comparable" rate in order to qualify for federal support?

A. No. Under Section 54.309 of the FCC's rules, the federal High Cost Model ("HCM") applicable to non-rural telephone companies (a classification that does not apply to the NYSTA Smaller ILECs) uses a cost-based benchmark for purposes of determining eligibility for, and quantification of, HCM disbursements. HCM support determinations are independent of the local rates being charged by the recipients. Therefore, it is not, and should not be, a foregone conclusion or precondition that any benchmark rate ultimately established in this proceeding for funding purposes must necessarily be the rate actually charged.

Q. Exactly how is the benchmark rate to be used in the context of the NYSTA Plan?

A. It is the rate to be applied for purposes of calculating what additional SUSF cost recovery support may be needed to meet the recipient's intrastate revenue requirement as determined in the rate case process. NYSTA Direct at p. 30, line

21 through p. 31, line 12. The Benchmark Rate would be used for this calculation only (" . . . minus revenues derived from the application of the Benchmark Rate . . . ." *Id*. at p. 31, lines 5-6). As such, the Benchmark Rate is for calculation purposes and represents a ceiling above which the Plan would not require local rates to rise ("As proposed, the operation of the SUSF effectively ensures that no carrier would have to recover from its end users more than the Benchmark Rate . . . ." *Id*. at p. 31, lines 14-16). However, the application of the Benchmark Rate as a ceiling, and for purposes of calculating SUSF disbursements, does not prohibit a recipient carrier from electing to recover less from, and charge less than the Benchmark Rate to, its end users for local service. In other words, it would be appropriate for the Commission to authorize the Benchmark Rate as the maximum rate that could be tariffed, but the recipient carrier would have the flexibility to determine just how much it wants to actually charge.

Q. Do the other parties' witnesses have the same understanding of the Benchmark Rate calculation process?

A. No. For example, Staff (admittedly in the context of discussing another issue regarding business rates) states as a presumed fact that the customer must be paying the Benchmark Rate. Staff USF Mechanism Direct at p. 29, lines 6-10. (The NYSTA Smaller ILECs discuss earlier in this rebuttal testimony the Benchmark Rate for business lines which appears to be the subject that Staff is

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addressing at p. 29.) Similarly, the CLEC Coalition witness believes that SUSF should only be available to an entity that demonstrates to the Commission that it is currently charging the benchmark rate. CLEC Coalition Direct at p. 11, lines 8-10. On the other hand, Sprint properly recognizes the same application of the Benchmark Rate as NYSTA included in its plan: "And if a particular company does not charge its customers the adjusted benchmark rate, then any payments from a fund should be based as if the company does charge its customers the adjusted benchmark rate." Sprint Direct at p. 13, lines 17-19.

Q. Should the eligible SUSF carrier be forced to charge the Benchmark Rate to qualify for SUSF funding?

A. No. While the disbursements from the SUSF may be calculated based on the application of a suitably comparable Benchmark Rate, there can be no requirement for a carrier to charge that rate. The current rate of return environment under which the NYSTA Smaller ILECs operate is understood *to allow them a reasonable opportunity to recover their costs* including the application of a reasonable ROE. But that *reasonable opportunity* is not a requirement that forces the NYSTA Smaller ILEC to recover at that rate level – a position that is consistent with the federal HCM approach and the California experience discussed above.

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Q. Is the imputation concept discussed immediately above as important as setting the Benchmark Rate to a level that is reasonably comparable and affordable for the customers of the NYSTA Smaller ILECs?

A. Both concepts are critically important. First, the Benchmark Rate forms the basis for potential SUSF cost recovery support and works as the effective ceiling for local rates to ensure that rates will not be set at an unreasonably high level. Unreasonably high local rates would undermine the purpose of universal service policy – it would deny sufficient SUSF to carriers that properly need it, and it would, in turn, lead to local rates for the rural users of the NYSTA Smaller ILECs that are higher than reasonably comparable levels. As discussed herein, the analysis of the other parties regarding their proposed Benchmark Rate appears to be purposely distorted to favor a Benchmark Rate that would be higher than prudent or proper. Moreover, once a Benchmark Rate is established, and no matter what that level may be, it is important to recognize that no carrier is required to charge that rate.

Q. Do you have any comments regarding the continuation of a $23 residential benchmark proposed by Staff?

A. Yes. It appears that Staff has not considered the ramifications of the Commission's *Framework Order*. In this order at pp. 1-2, the Commission concluded:

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> We adopt here a regime to set rates for the independent telephone companies that considers both the level of competition in each company's territory and the earnings level of each company. For this analysis, a market is defined as competitive if a company that raises its prices loses revenue on an aggregate basis. Based on a price elasticity analysis from Competition III, that situation occurs when a substantial majority of a company's customers have access to both wireless and cable alternatives to landline service. Given the data provided in this case, we can make such a finding if the estimates are that more than 69% of customers have such alternatives.

This Commission's order presents important considerations relating to the establishment of a benchmark rate for universal service that would require many of the NYSTA Small Companies to raise their local rates, in some cases significantly, if the benchmark rate is $23. Related to the Commission's findings, the Staff USF Mechanism Panel describes a "death spiral" situation where increases in prices cause more customers to leave, resulting in a further increase in prices and, consequently, greater need for SUSF. *See* Staff USF Mechanism Direct at p. 25, line 17 through p. 26, line 1. The Commission's *Framework Order* supports the conclusion that a benchmark rate for SUSF purposes should be much lower than $23.

Q. Does this end your rebuttal testimony?

A. Yes.

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CASE 09-M-0527 STEVEN E. WATKINS & KEVIN F. SCHWENZFEIER

ERRATA

Page 19, Line 7: Delete “in” following “approximately”

Page 33, Line 16: Delete “lines” replace with “line”

Page 49, Line 12: Delete “its” replace with “it”

Page 50, Line 15: Delete “lines” replace with “line”

Page 52, Line 14: Add the word “the” before “future”

Page 57, Line 2: Delete “pages” replace with “page”

Page 58, Line 10: Delete “area” replace with “areas”

Page 70, Line 15: Delete “by” replace with “be”

Page 72, Line 19: Insert “you” following “What response do”

Page 72, Line 22: Delete “ILEC” replace with “ILECs’”

Page 90, Line 20: Delete “services” replace with “service”

Page 92, Line 3: Delete comma following the word “intact”

Page 99, Line 9: Delete second comma following “New York”

Page 115, Line 19: Insert new paragraph following “misplaced.”

MR. MOORMAN: Thank you, Your Honor. The witnesses are available for cross-examination.

ALJ JACK: Do the parties have an agreed order of cross-examination for this panel?

MR. POST: Your Honor, Joseph Post for Verizon. Verizon will waive cross-examination of the NYSTA panel.

ALJ JACK: Thank you. Staff had no cross-examination for this panel, if I -- according to the matrix that I have.

MS. MCCAULEY: That's correct, Your Honor.

ALJ JACK: AT&T?

MS. BURGESS: AT&T does have a few questions for this panel, Your Honor.

ALJ JACK: Would you proceed.

CROSS-EXAMINATION

BY MS. BURGESS:

Q Would you please turn to page 36 in your direct testimony. I'm going to direct my questions to the panel generally. How many companies currently receive distributions from the existing fund in New York?

A (Kevin Schwenzfeier) Three companies.

Q And for what reason do you believe that those companies need to draw from the Fund?

A (Kevin Schwenzfeier) Pursuant to the Commission rate cases they participate in, the Commission determined that they would not be able to fully recover their costs at various benchmark rates that were in place over the years.

Q And how many companies do not draw from the Fund?

A (Kevin Schwenzfeier) Out of the NYSTA Smaller ILECs?

Q Yes.

A (Kevin Schwenzfeier) Twenty-eight.

Q For what reason do they not need to draw from the Fund?

A (Kevin Schwenzfeier) They have not appeared before the Commission in a rate case that demonstrated a need for such funding.

Q Please turn to page 31 in your direct testimony, lines 13 and 14. You say that the Plan envisions the establishment of a benchmark rate equal to $15.22. If the current benchmark rate in New York is $23, what is the rationale for a reduction in the current benchmark rate?

A (Steve Watkins) We set forth that rationale at much later in this direct testimony. Just generally, we're not certain in the context of the way we're defining benchmark rate that the former $23 is -- the benchmark rate, and we set forth a number of reasons why. The more reasonable

benchmark rate that's comparable is in the $15 range.
Q And how will significantly reducing that benchmark rate support the goal of the Universal Service and promote efficient operations and effective cost-cutting measures for companies?
A (Steve Watkins) It will assure that the rate that is charged is no higher than the rate that's comparable to the urban rate across the country.
Q How will that rate compare to the companies' cost of service?
A (Steve Watkins) That's a matter to be determined in the rate case process that determines how much the company can recover through its rates versus how much it would have to get through the State Universal Service Fund.
Q If the rates for service and universal service are linked, why reduce the benchmark and drive such an increase in the Universal Service Fund?
A (Steve Watkins) I think I just answered that. Because the benchmark rate that we are proposing is more consistent with the comparable rate which is the principle of Universal Service that's supposed to be served.
Q Please turn to page 84 in your direct testimony, lines 11 through 16. You say that the Fund would be approximately $10.3 million. Is that a cap on the Fund that you proposed?

A (Kevin Schwenzfeier) The $10.3 million is a calculation based on the most currently available data for the companies, and that is the level that would be computed based on the revenue requirement needs of those companies prior to any type of rate case analysis.

Q So it could be a starting point? It could end up more than 10.3 million?

A (Kevin Schwenzfeier) Based on the 2009 numbers, it would not be more than 10.3 million.

MS. BURGESS: I have one question on NYSTA, Exhibit 15, and there is a confidential version of that exhibit. My question is rather general in nature, and I believe it can be answered without reference to specific confidential figures.

ALJ JACK: All right, proceed.

MS. BURGESS: It's Exhibit 19 in the list that Your Honor circulated last week, but it was submitted as NYSTA 15.

Q How will lowering the benchmark --

A (Steve Watkins) Wait, wait. We don't have the exhibit.

Q How will lowering the benchmark to $15.22 effect the companies' rates?

A (Steve Watkins) I'm not sure we understand your question.

Q If the Commission lowers the benchmark to $15.22, what would end-user rates be for the companies in Exhibit 15?

A (Steve Watkins) Certainly, the ones that qualify for SUS, they would not be any higher than the $15.22. Is that the --

Q So end-users would see no difference in their rates resulting from a benchmark change?

A (Steve Watkins) Sorry, repeat that.

Q The end-users' rates would not change when the benchmark is changed?

A (Steve Watkins) Some may change.

Q And would the change be driven by the change in the benchmark?

A (Steve Watkins) That, and or their election as to where they set -- whether they apply for State USF or not.

(Kevin Schwenzfeier) It would be whatever the rate outcome from the rate case proceeding. Whatever the Commission establishes, that's the rate.

Q Please turn to page 39 in your testimony.

ALJ JACK: Is that direct or rebuttal?

MS. BURGESS: Direct.

Q Page 39, you talk about an NRII paper. What is NRII's role in administering Universal Service Funds in New York or other states?

A (Steve Watkins) I don't know that they have any role.
Q Do you know that they don't play any role?
A (Steve Watkins) I don't know one way or the other. My understanding is they're an academic think tank organization that has interest in the state regulatory world and prepared this paper regarding State Universal Service Funds and all of the issues that arise.
Q Are you aware whether NRII has provided any other suitable alternatives to the creation of State Universal Service Funds?
A (Steve Watkins) I'm not aware, no.

MS. BURGESS: I don't have any further questions, Your Honor.

ALJ JACK: Thank you. Does the Cable Telephone Association have questions?

MS. HELMER: A couple, Your Honor. Thank you. My name is Maureen Helmer with Cable Telecommunication Association of New York.

CROSS-EXAMINATION
BY MS. HELMER:
Q Starting with your initial testimony on page 5, lines 12 through 13, you mention that a State Universal Service Fund is needed to ensure that, quote, today's level of universal services maintain. What do you mean by

today's? Literally today's?
A (Steve Watkins) That means that the companies that we represent have achieved the universal service principles and objectives and for them to continue to achieve those and maintain success of those objectives, the SUFS is necessary.
Q Is that attached to a particular number of customers in the State that are currently served?
A (Steve Watkins) Well, certainly for the ones served by -- client companies.
Q As of what date?
A (Steve Watkins) I'm not sure that we gave any thought to any specific date. It was a general statement.
Q Okay, thank you. On page 14, line 7, and also line 20, but generally is it not your position that a universal service fund is needed to serve rural areas because these are higher cost, quote, higher cost, less dense areas?
A (Steve Watkins) That's one reason.
Q And can't the argument be made in some of these cases that the small number -- excuse me. I withdraw that. Isn't it the case that some of these companies have very few customers for the amount of overhead that these companies have to carry?
A (Steve Watkins) I don't know that -- that's something that would be evaluated in the rate case

process. We didn't undertake that analysis for purposes of this generic proceeding.

Q To the extent that some of these companies have small numbers of customers, which I think has been evidenced by yourself throughout here and also in our exhibits, is this a truly rural issue, or are there urban companies that also have small and decreasing numbers of customers?

A (Steve Watkins) I'm not certain what you're asking.

Q I'm asking whether, to the extent that per-line costs are high for certain companies because they have a small number of lines for the amount of overhead they have to carry, is that a uniquely rural problem?

A (Steve Watkins) I would not think so.

Q Thank you. On page 20, lines 2 and 3, you note that the ILECs committee, quote, from a practical perspective to COLR responsibilities, is this a tacit acknowledgment that there is no statutory requirement for COLR in New York, or do you believe that there is a statutory requirement?

A (Steve Watkins) I'm sorry, you went too fast.

MR. MOORMAN: Excuse me, Tom Moorman. Could you give us the page and line number again?

MS. HELMER: Page 20, lines 2 and 3. I'll wait for the witnesses to find that. I'm

sorry.

ALJ JACK: Could the reporter please read that question back.

Q Do you need the question read back?

A (Steve Watkins) You can read it, yes, please.

Q Okay. On page 20, lines 2 and 3, you note that rural ILECs committee, quote, from a practical perspective, unquote, to COLR responsibilities, carrier of last-resort responsibilities --

THE COURT REPORTER: Could you please speak up?

MS. HELMER: Yes. Is that better? Wasn't getting into the microphone.

Q From a practical perspective to COLR, carrier of last resort, responsibilities, is this a tacit acknowledgment that there are no statutory requirements for COLR, or can you point to a statutory requirement for COLR responsibilities?

A (Steve Watkins) Neither. In fact --

MR. MOORMAN: Your Honor, I object. I'm pretty sure that counsel for CTANY just asked for a legal opinion, and these witnesses are not legal -- they're not attorneys, and they're not here to profess a legal opinion, so I object to the question, Your Honor.

ALJ JACK: That sounds like it calls for a legal opinion.

Q Can I ask then what the meaning of "from a practical perspective" is in your testimony?

A (Steve Watkins) They do, in fact, provide service across their entire service territory. They hold themselves out to provide service to everybody in their service territory. They have commitments to continue to provide service to everyone in their service territory regardless of whether some of those subscribers are now served by other competitive providers. Those are the practical considerations that led to that sentence.

(Kevin Schwenzfeier) If I might add to that the fact that they're eligible telecommunication carriers as well.

Q Thank you. Can we go to page 36 please.

A Okay.

Q On page 36 and elsewhere, do you note that current recipients of the Fund should be able to migrate to the new Universal Service Fund immediately without further review; is that correct?

A (Steve Watkins) That's correct.

Q Does that mean that they would also reduce their rates to your proposed benchmark rate of $15.22 immediately?

A (Steve Watkins) I think that would require another proceeding to ascertain the effects of doing so.
Q Then what do you mean by they should migrate over to the new SUSF immediately?
A (Steve Watkins) That whatever support dollars they're getting today we would presume would be transferred to the new Plan.
(Kevin Schwenzfeier) That's demonstrated in our exhibit as well.
Q Thank you. So that in other words, if they did want to reduce their benchmark rates in their rates and take further dollars from the new fund they would have to come in for new review?
A (Steve Watkins) I don't know that we actually thought about that, but that sounds possible.
Q Okay, thank you. Pages 40 to 41 of your direct testimony, on those pages you state that your proposed fund will be handy to meet a whole host of potential regulatory changes at the state and federal level. Does this mean that the $10.4 million estimate in your testimony could be significantly higher over the term of this fund?
A (Steve Watkins) The $10.4 million did not take into account any of these possible future changes.
Q So that, in other words, this fund could be

substantially larger than what you are suggesting it would be at the beginning if the Commission adopted all of the various aspects of it that you suggest?

A (Steve Watkins) It wouldn't be this fund. It would be this fund and another fund.

Q Well, then what do you mean by the fact that the proposed fund would be handy to meet these purposes?

A (Steve Watkins) The proposed funding, and getting the process in place, would have something in place that would provide the mechanics to address other changes that might come in the future which is not part of this particular proceeding.

Q Okay, I'd like to return to your rebuttal testimony please. On page 10, lines 10 to 13, it's my understanding that throughout your testimony you argue that universal service can only be provided by carriers subject to the current panoply of regulations; is that a correct characterization of your testimony?

A (Steve Watkins) That is our eligibility requirement, yes.

Q If you look at lines 10 through 13, they read -- please correct me if I misstate this -- Instead of subjecting the current Universal Service providers to more burdensome requirements, the Commission should be looking for ways to lessen these burdens and to equalize the

requirements among the NYSTA Smaller ILECs and their competitors, unquote. If the Commission granted your wish here and equalized the regulation of the Smaller ILECs with their competitors, would that then eliminate the need for this fund in your opinion?

A (Steve Watkins) No. And that's something suggesting that should be done in the future, we are -- our proposal for the Fund at this point is to apply the same level of regulatory requirements as applied to that.

Q So you're not suggesting that regulatory requirements should be eased for the Smaller ILECs?

A (Steve Watkins) As a separate issue into the future, I believe -- we do believe that's something that should be looked into.

Q Thank you. On page 97, the discussion of Crown Point -- I'm sorry, 97 of the rebuttal testimony, you note that Crown Point has, in response to witness Ansaldo's testimony --

ALJ JACK: Excuse me. Okay, I just want to make sure we are not going to get into anything that's confidential at this point. If we do -- I mean if there are questions about confidential matters, I just want to make sure that we take them up at the end of the cross-examination so that we can clear the room.

MS. HELMER: Yeah, I'm just checking. I don't see anything on page 97, your Honor, that reflects confidential information.

ALJ JACK: I'm looking back at my notes. No, I don't think there is anything on the page.

MS. HELMER: Okay, thank you, Your Honor.

Q I'm sorry, on page 97, you testified that Crown Point has reduced its overall expenses by 27 percent, is that correct?

A (Steve Watkins) It would be helpful if you direct us to a line when you ask a question.

Q Thirteen to twenty.

A (Kevin Schwenzfeier) Okay, that's correct.

Q Has that been sufficient, even in combination with the Transition Funds that Crown Point has received, to establish a healthy and sustainable company?

A (Kevin Schwenzfeier) Can you repeat the question please.

Q Has the use of the Transition Funding for Crown Point been sufficient to create or allow for a healthy and sustainable company from a financial perspective?

A (Kevin Schwenzfeier) It's been helpful in serving the purpose I believe that it was intended for, and that

was allowing Crown Point to continue to fulfill its role as a universal provider in its territory.

Q And do you consider Crown Point at this point to be a healthy company financially?

A (Kevin Schwenzfeier) Based on a general review of its earnings in 2009, I would say the level of those earnings were below what one might consider to be healthy.

Q Subject to check, if I were to tell you that Crown Point's equity ratio is slightly more than 2 percent, do you consider that indicia of a financially healthy company?

A (Steve Watkins) No, it doesn't. Neither way. We're not certain that we know the answer to that question.

Q Is part of your testimony that a universal service fund is necessary in order to have healthy companies?

A (Steve Watkins) You're asking whether the healthiness has anything to do with the level of equity, and we're not certain we know the answer to that question.

Q Okay, thank you. On pages 119 to 120 of your rebuttal testimony, you make the argument there and elsewhere that recipients should not be required to impose the benchmark rate?

A (Steve Watkins) Lines?

Q Lines 11 on.

A (Steve Watkins) Yes.
Q 11 through 13. In other words, it would be appropriate for the Commission to authorize the benchmark rate as the maximum rate that could be tariffed but the recipient carrier would have the flexibility to determine just how much it wants to actually charge. My question is, if the Commission has decided that a particular rate with a particular amount of transition funding associated with that rate would be sufficient to allow for a healthy company, and if the company chose not to charge the benchmark rate, for whatever reasons, resulting in an unhealthy company from a financial perspective, how has that served universal service goals?
A (Steve Watkins) It's possible that charging less than the benchmark is still possible without causing an unhealthy company. The State Universal Fund disbursement is calculated at the allowed return, and the companies certainly can choose to earn something a little less than the allowed return, so that's within the bounds of still maintaining a healthy company but not having to charge the full benchmark rate.
(Kevin Schwenzfeier) And I would just like to add to that. It's not unusual or uncommon for a benchmark rate not to need to be charged in order to receive funding. That's exactly what happens today at the federal

level with all the companies that receive federal funding. There is no requirement to charge a specific rate.

Q Would you agree, however, that if not charging that benchmark rate resulted in an unhealthy company, that that would be an interest for the Commission with respect to providing universal service?

A (Steve Watkins) If the situation got to be that the company did not take in enough revenue to cover its cost, then some action would have to be taken to correct it.

Q Let's go to page 100 please, line 2.

SPEAKER: In the rebuttal?

MS. HELMER: In the rebuttal, yes.

This is still in the rebuttal testimony.

Q On page 100 you note that CTANY witness Anseldo fails to recognize that some of the employees of the HoldCo are typically recorded on the books at the holding company level and that these costs are recovered from the regulated ILECs through a distributed charge-back. Is this an accurate characterization?

A (Kevin Schwenzfeier) I'm not sure I understood the first part of the sentence, but it's not that the employees of these companies are at the holding company; they are employees of the holding company providing services for these companies.

Q And then that's paid for by the HoldCo through the distributed charge-back, is that correct?

A (Kevin Schwenzfeier) The HoldCo recovers its costs through that distribution.

Q Thank you.

MS. HELMER: Your Honor, I would like to mark as an exhibit the following document. This is taken from the PSC's website. I would note, Your Honor, that during, at least, informal conversations earlier on, it was agreed that all of the annual reports of the telephone companies would be taken judicial notice of. The exhibit we're about to ask for identification on is part of the Commission's five-year book, which is a compilation of the information from the annual reports. I'd like to mark it for an exhibit and also ask that you take judicial notice of it.

ALJ JACK: You have copies, an official copy for me and a copy for the other --

MS. HELMER: Yes, we do, Your Honor.

ALJ JACK: And for the witnesses?

MS. HELMER: Yes, we do, Your Honor.

ALJ JACK: Thank you. Exhibit 90 for identification is financial information on distribution of revenues from NYSPSC website,

quote, Five-year Book, end of quote, based upon Telco filed annual reports.

(Exhibit 90 was marked for identification.)

MS. HELMER: Your Honor, we also forwarded that document to all of the parties last night, so they at least have it electronically.

ALJ JACK: Thank you.

MS. HELMER: Did you give a copy to the witnesses? Just wait a moment for --

And I note, Your Honor, we put the full website so that if anyone wanted to see the other five-year books, or other information from that part of the website, they could find it easily.

Q I would just ask you to look at the first page. My question is really directed at the categories as opposed to the particular numbers on the pages. What this shows are the revenues from various companies; the first one is Altel New York. This is all public information. It's gleaned from the annual reports of the telephone companies that are filed. Under each of the categories there are a series of costs listed -- wages and benefits, depreciation, other, total operation, income taxes, other taxes and capital costs. Can you please identify which of these categories the distributed charge-back would fall into?

A (Kevin Schwenzfeier) It's my understanding that it would fall into line five, "other operating expenses."

Q Okay, thank you very much.

MS. HELMER: I have a second exhibit, Your Honor, I would like to mark for identification. This is a compilation. The first two columns have already been submitted as an exhibit to witness Ansaldo's testimony as page 17 of Exhibit 3, known as "Other Operating Expense Data added to the PSC Website."

ALJ JACK: Ms. Helmer, if you could hold on just a second. I think it would be useful to get a cross-reference to the exhibit number for identification that has been assigned to Mr. Anseldo's exhibit.

MS. HELMER: The first two columns originally came from Exhibit 3.

ALJ JACK: And that is Exhibit 3 for identification right now, not just Exhibit 3 of his testimony, right?

MS. HELMER: Correct.

ALJ JACK: Okay. All right, Exhibit 91 for identification comprises what is identified at the top of the page as page 17 of EXH3C.09-M-0527 with other operating expense data

added from PSC website. And that reference to Exhibit 3 is Exhibit 3 which is part of the exhibits submitted with Mr. Ansaldo's testimony.

(Exhibit 91 was marked for identification.)

MR. HANIFIN: Your Honor, this is Chris Hanifin from Hiscock and Barclay for CTANY. At this point would it be appropriate to move into the record Exhibit 90 and 91 marked for identification?

ALJ JACK: No. We're going to hold off, just as we are with other exhibits. We're going to hold off on moving things into evidence till later. Toward the end of the proceeding we'll deal with that.

MS. HELMER: May I proceed, Your Honor?

ALJ JACK: Yes, you may.

MS. HELMER: Okay, sorry.

BY MS. HELMER:

Q Would you please look at the exhibit that we just marked for identification? That's Exhibit 91; it's a one-page exhibit. The first column, as I mentioned, is the wages and benefits from the earlier exhibit; the second line is the total access, total cost per access line for the earlier exhibit; and the third column,

subject to check, of course, taken from the exhibit that we just showed to you, is the other operating expense per access line. Would you agree that if there are additional costs for employees that are not reflected in the wages and benefits per access line in the first column, that they would be contained in the third column, "Other Operating Expenses Per Access Line"?

A (Steve Watkins) Yes.

MS. HELMER: We have no further questions for this witness, Your Honor.

ALJ JACK: Thank you.

MR. HANIFIN: Your Honor, I apologize. I have one follow-up from an earlier party cross-examination.

ALJ JACK: Go ahead.

CROSS-EXAMINATION

BY MR. HANIFIN:

Q Gentlemen, AT&T asked you about the $10.3 million fund and whether that level was based or computed on revenue need for the companies. You had mentioned for 2009 that that was the correct figure. If the need level increased, would it be true that the fund would quarterly increase?

A (Kevin Schwenzfeier) Not necessarily.

Q Can you explain that?

A (Kevin Schwenzfeier) The fund is a dynamic calculation based not only on cost but the revenues available to a company and the adjustments the Commission might find in a rate case at that given point in time. An increase in costs wouldn't necessarily mean an increase in need.

Q Okay, so assuming the revenue was no different, the revenue is static, and the Commission makes no adjustment, then there would be fluctuation for the need of that fund, correct?

A (Kevin Schwenzfeier) Mathematically, yes.

MS. HELMER: We have no further questions right now, Your Honor.

ALJ JACK: Thank you. Verizon Wireless, T-Mobile, do you have any cross of this panel?

MR. POST: No, your Honor.

ALJ JACK: CPB?

MR. RIGBERG: No, Your Honor.

ALJ JACK: The Facilities CLEC -- that's C-L-E-C, all caps -- Coalition.

MR. FITZGERALD: Thank you, Your Honor. We have a few questions for this panel.

CROSS-EXAMINATION

BY MR. FITZGERALD:

Q Good morning, panel. My name is Brian FitzGerald. My questions today for the panel are going to be in the rebuttal testimony.

ALJ JACK: Any closer to the microphone, Mr. FitzGerald?

MR. FITZGERALD: There we go. Is that better?

ALJ JACK: That's better, thank you.

Q Panel, my questions today are going to be on your rebuttal testimony and working off the public version for purposes of any line numbers or page references.

A (Steve Watkins) They are the same.

Q Great. I'd like to turn to page 5 of your rebuttal testimony, specifically lines 2 and 3. Now, in that section you talk about certain rates being at unreasonable levels. Do you see that?

A (Steve Watkins) It's a quote from the staff, I believe.

Q Would you agree with me that what constitutes a reasonable level of rates may change over time?

A (Steve Watkins) That's possible.

Q Is it likely?

A (Steve Watkins) I'm not sure that -- that would require speculation. For purposes here, we're proposing a comparable rate as the reasonable rate.

Q Is it your belief that that reasonable rate is based on economic demographics?
A (Steve Watkins) No. It's simply based on comparing it to the average urban rate.
Q And is that reasonable rate based on any particular geographic area? In other words, does it have to be an urban rate, or can it be a rural area of development?
A (Steve Watkins) I believe the principle stated in the Federal Act is comparability to urban rates.
Q And in New York, specifically, would it have to be comparison to an urban rate or to a rural rate?
A (Steve Watkins) I don't think there is any definitive requirement at this point. We're suggesting that we follow the principles as outlined in the Federal Act for comparability.
Q Is it this panel's testimony that any increase in the existing tariff local rates by the NYSTA Smaller ILECs would result in an unreasonable rate level?
A (Steve Watkins) I think, consistent with our testimony, requiring the rates to rise above what we have made the benchmark comparable rate, in our view, would be unreasonable, yes.
Q Are any of the rates of the rural ILECs, the Smaller NYSTA ILECs above that benchmark rate at this time?

A (Steve Watkins) Yes, I believe they are.
Q Let's turn to page 7, lines 1 and 2 of your testimony. Now you state there that the Smaller ILECs are regulated under the full panoply of regulations that predate the advent of full competition. Do you see that?
A (Steve Watkins) Yes.
Q From this statement then I take it that the panel is very familiar with the panoply of regulations that apply, the NYSTA Smaller ILECs, is that correct?
A (Steve Watkins) Generally.
Q And by that statement is the panel suggesting that full competition exists today across the State, including within the NYSTA Smaller ILECs service territories?
A (Steve Watkins) I don't understand the connection to that statement to this portion of the testimony.
Q Well, you said that it predates the advent of full competition in line 2.
A (Steve Watkins) The use of the words "full competition" is just meaning a point in time when competition was allowed. It didn't mean that we were making any qualitative conclusion as to the extent of competition. Perhaps a poor choice of words, but that's not what we meant.
Q Isn't it true that the NYSTA Smaller ILECs could petition this Commission in New York for relief from the

full panoply of rate regulation that they're subject to today?

A (Kevin Schwenzfeier) I suppose that's possible, yes.

Q Yet, the NYSTA Smaller ILECs have not petitioned regulatory relief to date, is that correct?

A (Steve Watkins) I'm not certain as to the exact status of them all. There may be different treatments.

Q Are you aware of any? I'm sorry, please finish.

A (Steve Watkins) I'm finished.

Q Are you aware of any that have petitioned for regulatory relief?

A (Steve Watkins) Full regulatory relief?

(Kevin Schwenzfeier) I know -- I'm not aware of any petition before the Commission, but I know over the years there have been various proceedings, or examinations, into the potential for reducing some of these obligations. Some of them may still be open. I'm not sure how they were ultimately resolved, but there have been reviews of that in the past.

Q Are you familiar with the operation of competitive local exchange carriers and the level of regulation that they receive in New York?

A (Steve Watkins) Generally, but not exactly.

Q Would you agree with me that that level of

regulation is the last in the full panoply that you referred to earlier in your testimony?

A (Steve Watkins) I think we would agree with that, yes.

Q Let's turn to page 64 of your rebuttal testimony, and specifically I'm looking at lines 8 through 9. You reference there Verizon's choice to operate under an incentive regulatory plan rather than a rate of return regulation. Do you see that?

A (Steve Watkins) Yes.

ALJ JACK: Excuse me, Mr. FitzGerald, could you give me that page number again please?

MR. FITZGERALD: Your Honor, I believe it's page 64, lines 8 to 9.

ALJ JACK: Thank you.

Q Are the NYSTA Smaller ILECs today willing to seek similar price cap type of regulation?

A (Steve Watkins) I don't believe so.

Q Are the NYSTA Smaller ILECs today willing to move to a CLEC-type-lightened regulation with no guarantee of rate recovery?

A (Steve Watkins) I don't think so.

Q In your understanding are CLECs, as lightened regulated entities, obligated to comply with Commission directives?

A (Steve Watkins) I am certain that there is a list that they're required to comply with and others at which they aren't. I don't know exactly what they all are. I believe we have an attachment to our testimony that attempted to summarize some of the regulatory requirements.

Q You would agree that they are subject to Commission directives, correct?

A (Steve Watkins) Some directives.

Q Would you agree with me that the full panoply of regulations that you cite, the NYSTA Smaller ILECs, are subject to includes not only obligations but also certain regulatory rights and benefits?

A (Steve Watkins) That's reasonable.

Q That's a yes?

A (Steve Watkins) Yes.

Q Now, as part of those panoply of rights, are the NYSTA Smaller ILECs granted a right to file rate cases seeking recovery of their costs plus a return on equity, isn't that right?

A (Kevin Schwenzfeier) They're required to file a rate case in order to raise their rates, yes.

Q And as part of that rate case filing, would they also seek a return on equity?

A (Kevin Schwenzfeier) They seek an opportunity to

earn a reasonable return on their investment, yes.
Q And that return on investment would be above their cost of operating business, correct?
A (Steve Watkins) No, I don't think we would agree with that. That's part of their cost of business.
Q Now, entities subject to the full panoply of Commission regulation, isn't it true that the NYSTA Smaller ILECs can also petition the Commission for immediate, reasonable, temporary increases of rates should they find it necessary for providing adequate and sufficient service subject to recall?
A (Kevin Schwenzfeier) I'm not aware of that specific provision.
Q So you didn't consider that at all in your analysis of the need for the Fund, is that correct?
A (Steve Watkins) We're not aware of any such option.
Q And, again, my question was to you, did you include that option or consider that option for purposes of determining the need for a universal service fund in New York?
A (Kevin Schwenzfeier) I honestly don't follow the question. Our proposal contemplated a rate case filing to bring rates up to a maximum of the benchmark rate.
Q Are you aware that the Smaller ILECs in New York

can file for temporary rates for immediate rate increases if they find the need?

A (Steve Watkins) We're not aware.

Q Thank you. Let's turn to page 7, lines 5 to 6. Specifically, I'm looking to the language about networking investment decisions. Do you see that?

MR. HANIFIN: Is that on the rebuttal?

MR. FITZGERALD: Yes, it's all on rebuttal.

Q Is the panel with me? Is it this panel's position that the Commission is prohibited from altering the rate recovery of the NYSTA Smaller ILECs in perpetuity?

A (Steve Watkins) I don't think the two of us have taken a position on that.

Q Well, you talked about in your testimony the Commission changing horses in midstream. Do you see that section?

A (Steve Watkins) Yes.

Q What did you mean by that phrase?

A (Steve Watkins) We were talking about the investment, and we have committed as carrier of last resort in anticipation of recovery, and we were reacting to the staff's proposals that would create new rules and requirements to reduce that recovery.

Q On page 7, line 20, and I believe it continues on

to page 8, line 1 of your testimony, you make the statement that the Smaller ILECs incurred costs at the direction of, and a reliance on, the Commission's regulatory compact. Do you see that?

A (Steve Watkins) Yes.

Q Can you specify for me exactly where the Smaller ILECs were directed to make any specific investments?

A (Steve Watkins) I'm sure there are examples where, for quality-of-service purposes and through collaboration with Commission staff over the years, to comply with their regulatory requirements, they were asked to invest in certain things. Don't have any specific example. I suspect, if we tried, we could find some.

MR. FITZGERALD: Your Honor, I would take that as an on-the-record request for the panel to provide me the specifics of where any one of the Smaller ILECs were directed to make a specific investment.

A (Kevin Schwenzfeier) I don't have a lot of familiarity with it, but I know there was a proceeding -- or there was a project, if you will, a while back that dealt with the redundancy facilities of various ILECs, and certain offices that didn't meet certain criteria were required, I believe, to add additional facilities to meet the Commission's objectives. I don't have any more

familiarity than that with it, but they were required to invest dollars to achieve those Commission objectives.

Q And was that done pursuant to a Commission order?

A (Kevin Schwenzfeier) I don't know if it was an order. I don't know if it was a letter from the Commission directing them to do something. I don't know the formality of how that request was made.

Q All right, panel, I think we're in agreement then that the NYSTA Smaller ILECs today are rate regulated utilities, is that correct?

A (Steve Watkins) Correct.

Q As such, isn't it true that the NYSTA Smaller ILECs today control the timing of when they file their next rate request?

A (Kevin Schwenzfeier) Yes.

Q And the NYSTA Smaller ILECs, they could elect to stay out and not come back to the Commission seeking rate relief for as long as they wanted to, isn't that correct?

A (Kevin Schwenzfeier) Or unless the Commission found -- the Commission would have the authority to call them in, but the company -- barring that, the company, yes, has that opportunity.

Q The authority to call them in, that would occur under the same section of the Public Service Law that we were talking about earlier for temporary rates, isn't that

correct?
A (Kevin Schwenzfeier) I don't know.
Q But you just told me that you knew that they had the knowledge and the ability of the Commission to call them in. What are you basing that on?
A (Kevin Schwenzfeier) General knowledge of the Commission's authority, no specific provision. It's been my understanding that the Commission monitors the earnings of these companies and has the ability to pursue appropriate action if, indeed, something needs to be done.
Q Let's turn to page 23. Specifically, I'm looking at lines 20 -- strike that. I guess, panel, is it your testimony that the NYSTA Smaller ILECs of today are receiving Transition Fund disbursements from the temporary fund, should continue to get that funding until their next rate case?
A (Steve Watkins) I think that's what that says.
Q Great. We agree on that then. Can you specify for me today exactly when those rate cases will be filed?
A (Panel) No.
Q Isn't it true that they have no obligation to file a new rate case?
A (Steve Watkins) Other than Mr. Schwenzfeier explaining in the course of their regulation, the Commission may call them in to do a rate case.

Q Let's jump to page 56, lines 12 and 14 of your rebuttal testimony. Are you there yet?
A (Steve Watkins) Yes.
Q Sort of a related question, you talk there about --
THE COURT REPORTER: Could you speak up please?
Q You talk there about the point where the provider may reach a point where -- offers services at risk. Is that generally correct for that section?
A (Steve Watkins) Yes.
Q Are you aware of the recent banker T filing by Fairpoint Communications and its New York ILEC subsidiaries, Berkshire Telephone Corporation --
THE COURT REPORTER: Sir, slow down.
Q -- and Taconic Telephone Corporation?
A (Steve Watkins) I'm aware. I don't know the details.
Q Are you aware of any termination of service or any impact on customer service as a result of those filings?
A (Steve Watkins) Not aware.
Q Are you aware that Fairpoint successfully emerged from bankruptcy on January 24, 2011?
A (Steve Watkins) Honestly, I don't know the circumstances.
Q Let's turn to page 86, lines 4 to 7. I think there

that you object to --

SPEAKER: Not there yet.

Q Is the panel there?

A (Panel) Yes.

Q You object there to the potential write-down of plant assets, is that correct?

A (Steve Watkins) Yes.

Q Isn't it true that other New York utilities that are fully regulated have been required to write down assets in the past as a result of Commission action?

A (Steve Watkins) We don't know that's true.

Q So this panel has no knowledge of the restructuring of the electric utility industry at all?

A (Steve Watkins) I don't follow the electric industry.

Q Are you aware of any write-downs by New York Telephone as a result of changes in its regulatory regime?

A (Steve Watkins) We don't understand the reasons or the circumstances under which that took place.

Q Isn't it true that New York Telephone has written down those assets, though?

A (Steve Watkins) I believe that's true. We're not familiar with the specifics.

MR. FITZGERALD: Your Honor, I have no further questions for this panel.

ALJ JACK: Thank you, Mr. FitzGerald. Sprint?

MR. SCHIFMAN: Yes, Your Honor, I have questions. My name is Ken Schifman.

CROSS-EXAMINATION

BY MR. SCHIFMAN:

Q Good morning, panel. I'm here representing Sprint. And let's turn to the exhibit that is attached to your direct testimony; it's Exhibit 15 of your direct testimony; it's the exhibit with the calculations of the State Universal Service Fund. I believe your counsel gave it to you earlier.

MR. SCHIFMAN: For identification on the exhibit list, it's 19, Your Honor.

ALJ JACK: Just a second.

MR. MOORMAN: Your Honor, could we go off the record for just a second?

ALJ JACK: Off the record.

(Discussion was held off the record.)

ALJ JACK: On the record.

BY MR. SCHIFMAN:

Q Okay, panel, you have before you Exhibit 19, the confidential version of it. Are there any companies on your list of NYSTA ILECs who are not going to receive State Universal Service Funds as you calculated?

A (Kevin Schwenzfeier) This calculation shows the potential for funding. Whether or not a company received funding would depend on whether or not it pursued a rate case with the Commission and the results of those findings.

Q Okay, but there are calculations on there that show some companies not receiving any funds at all, is that correct?

A (Kevin Schwenzfeier) That's correct.

Q Okay, and why is that?

A (Kevin Schwenzfeier) Because the combination of their revenue requirement needs and their revenues at the benchmark did not make them eligible for the need for funding.

Q So does that mean they're over-earning? They're earning more than their authorized rate of return?

A (Kevin Schwenzfeier) No. It means they were able to recover their costs at some level of rates lower than the benchmark.

Q Right, but is it because they are getting a reasonable return on investment without accessing the proposed State Universal Service Fund?

A (Kevin Schwenzfeier) It's because, based on this calculation, they were achieving the PSC authorized rate of return we used in the calculation.

Q They were achieving more than the PSC authorized rate of return, is that correct?
A (Kevin Schwenzfeier) No.
Q Well, if they're not -- if they're receiving -- if they're not achieving more than the PSC authorized rate of return, then why are they not getting access to the State Universal Service Funds that --
A (Kevin Schwenzfeier) Because they were able to increase their rates to a level that didn't exceed the benchmark.
Q And if they do increase their rates to that level, all the way to the bench mark level, they'll have revenue that exceeds the authorized rate of return, is that right?
A (Kevin Schwenzfeier) I don't presume that the Commission would allow them to increase their rates to achieve an over-earnings level.
Q So you calculated that they just get to increase or decrease their rates just to the benchmarks so that they earn exactly the authorized rate of return?
A (Kevin Schwenzfeier) This calculation presumes a revenue requirement for all of the companies that would be -- depends on the Commission authorized ROE.
Q I'm just trying to figure out why some are zero.
A (Kevin Schwenzfeier) A basic example, if a company's rates were $10 and raising them to 12 allowed

them to earn the Commission authorized rate of return, there would be no need to raise those rates further or a need for bumping.

Q Okay, and what if they already right now, without changing their rates, exceed the Commission's authorized rate of return, what's the impact of that?

A (Kevin Schwenzfeier) There would be no need for funding or no need for a rate increase.

Q And then do you propose -- is it possible that any excess earnings that companies may have could be used to decrease the size of the Fund for the other companies?

A (Kevin Schwenzfeier) First of all, I'm not sure that situation exists here, so it's all hypothetical.

Q Okay, but answer my hypothetical. It's taken as a hypothetical.

A (Kevin Schwenzfeier) Restate that please.

Q If there's excess -- if certain companies don't need to increase their rates to reach a benchmark, can those earnings be used to decrease the size of the Fund, potential fund for the other company?

A (Steve Watkins) No, that's not part of our plan. The evaluation of companies that may be over-earning is a different regulatory process, and we would expect that process to operate separate and apart from this SUSF.

Q Okay, and so you'd rather tax other people's

customers rather than getting the money from your own customers?

A (Steve Watkins) No. Everybody would contribute alike, and if there is an over-earning situation that needs to be addressed, it will be addressed just like it's always addressed, and that company would lower its rates.

Q In your exhibit, do any of these companies, are they getting more than $250 per access line for your proposal for State Universal Service Funding?

A (Kevin Schwenzfeier) Getting more than $250 per line, is that your question?

Q Yes.

A (Kevin Schwenzfeier) It's hard to say from what is here on the exhibit.

Q And how would we figure that out using your exhibit?

A (Kevin Schwenzfeier). It would be a division of the last column labeled SUSF divided by the company's access lines.

Q And then do we have to divide it again by 12 --

A (Kevin Schwenzfeier) If you want a monthly, yes.

Q To get a monthly number? Okay. And this $10.2 million that you're proposing under your process, how long will each of these companies get their share of this $10.2 million? Is this fund set to end at any point in time?

A (Steve Watkins) We have not proposed that there would be a definite end to the overall State Universal Service Fund Plan. And again, the ongoing state regulatory process that reviews companies' operations from time to time, and would require carriers from time to time to come in and do rate cases, should continue to operate.
Q And how often should companies have to come in and do rate cases to determine if their funding is appropriate?
A (Steve Watkins) That would depend upon that analysis by staff as currently applies.
Q And how long will it take for the staff, in your estimation, to do each of these rate cases to determine funding.
A (Steve Watkins) Initially?
Q Yes.
A (Kevin Schwenzfeier) I don't think we can make any estimate. All we can say is historically it takes anywhere from six to eight months to process a rate case.
Q Per company rate? So what you're proposing here is for 30 some odd companies to come in and do six-to-eight-month-rate cases in order to access funding?
A (Kevin Schwenzfeier) We're not proposing that any company come in for a rate case. This shows what would happen if over time all companies came for rate cases and

were granted full recovery of the rate case request. The timing of those would be up to the company.

Q And what do you anticipate -- you guys represent the companies here. When do you anticipate these companies will be coming in for the rate cases to try to get access to any funds that are set up?

A (Kevin Schwenzfeier) I have no knowledge of when that might be.

Q Have you talked to the companies about that?

A (Kevin Schwenzfeier) No.

Q Why are you proposing funds if they don't know -- to be made available to them if they don't know when they are going to come to access to them?

A (Kevin Schwenzfeier) My understanding is the purpose of this proceeding was to -- for staff to determine the need for and to establish a fund. The need for that fund and the need of any individual company would follow.

Q You certainly have some idea that the companies want access to this funding, is that right?

A (Steve Watkins) We certainly know that, by this information, some may be more interested in others in the future and some may step forward and need to pursue a rate case, yes.

Q Based on your analysis, most of the NYSTA Smaller

ILECs in the State would seem to want to come in, is that correct, for a rate case to get access to additional funding?

A (Kevin Schwenzfeier) We don't know what they are thinking as far as coming in for a filing.

(Steve Watkins) There is a lot of considerations other than simply the result on this paper.

Q Cost of doing that type of case?

A (Steve Watkins) Correct.

Q Is that right?

A (Steve Watkins) Correct.

Q What do the costs get assigned to when they do that case?

A (Steve Watkins) It's assigned to the normal accounting process. I'm not sure.

Q Meaning what?

A (Steve Watkins) They go to the appropriate accounts and get recovered through the appropriate allocation of accounts to the overall cost allocation recovery rules.

Q So the cost of this proceeding goes to the same accounts in your view?

A (Steve Watkins) More or less, yes.

Q Okay, let's turn to page 21 of your rebuttal testimony please. And I'm looking at lines 18 through 20

and then up through -- 1 through 4 on page 22. Have you had a chance to look at that?

A (Steve Watkins) Yes.

Q And I believe Miss Burgess from AT&T asked you some questions about this, but this is where you're talking about any immediate -- the need to set up a fund for any immediate and future needs. So in other words, there might be some regulatory changes in your view that the NYSTA ILECs would need to access funding, is that right?

A (Steve Watkins) They would be -- yes, in addition to these, yes.

Q Okay, and you're aware that the FCC issued an NPRM this last week on intercarrier compensation and Universal Service Fund changes, is that right?

A (Steve Watkins) Yes.

Q And you're aware that the FCC is talking about the reduction of intrastate access charges nationwide, is that correct?

A (Steve Watkins) That's among the proposals, yes.

Q And if the NYSTA ILECs access charges are reduced as part of that FCC proceeding, does this fund that you're proposing to be set up play into any of those reductions that may come at the federal level?

A (Steve Watkins) Just -- the only way I quibble with your question is this particular fund is set up to

address the specifics of the under-recovery as we've calculated. There might be additional funding needed to address access, yes, that's entirely possible.

Q Okay, and I was a little confused with some of your answers to Miss Burgess's questions. You seem to indicate that it might be a separate fund, but are you talking to recover access reductions, for example? Is that what you're proposing, or are you proposing to recover any access reductions made at the federal level here in this fund?

A (Steve Watkins) We're not proposing anything at all about access at this point in time. We're only proposing a plan to address the specifics as the exhibit we were discussing.

Q But one of your -- your testimony says, Hey, well, we need a fund here in order to address future changes in the regulatory environment. So I'm just trying to get a feel for what future changes in the regulatory environment may do to the size of the Fund, to the length of this Fund, how the ILECs access this Fund.

A (Steve Watkins) The purpose of the statement is having a mechanism in place and a process in place will make it easier to address future needs as they may arise.

(Kevin Schwenzfeier) Having a contribution methodology, knowing how contributions might be collected

and assessed.
Q So if the feds reduce your universal service funding, are you suggesting that this fund be used to replace any reductions that the feds make in your universal service funding for the NYSTA ILECs?
A (Steve Watkins) We haven't taken any position on anything that might occur in the future. All we said, having the mechanism in place may make it easier to address needs that might arise in the future.
Q Well, why don't we just cap this fund and say whatever this fund is, it is; if you want to come back to address future needs and, you know, we can set up a different fund for that?
A (Steve Watkins) That remains to be seen.
Q But in other words, you want it to be flexible enough to have access reductions, or USF reductions, or regulatory changes that effect the NYSTA ILECs be put into this fund, is that right?
A (Steve Watkins) We certainly think that developing all the mechanisms now would be beneficial from a policy standpoint in the future, if and when we need to address all those other issues.
Q So the 10.2 million that we see in Exhibit 19 is not -- in no way a cap to the size of the fund because you want it to be able to address any future regulatory

changes, right?
A (Steve Watkins) That's presuming that we understand what those future regulatory changes may be. We're not proposing any particular position on any future change. We're just saying that having this in place, the writing is on the wall. There may need to be additional Universal Service recovery dollars created to address other changes that occur in the future.
Q But if the feds have a program for replacing Universal Service revenue in some way, you wouldn't suggest that you also get state universal service funding to replace whatever happens at the federal level, right?
A (Steve Watkins) I think you might have misphrased your question.
Q I said the federal, if the FCC comes up with a program to reform universal service and they come up with some way, transition mechanism, for the NYSTA ILECs as part of that transition process, you wouldn't propose to also get money out of this fund that you're proposing here to address whatever federal changes happening, are you?
A (Steve Watkins) There is a lot of speculation in your question, but no, if the federal jurisdiction fully addresses something, we wouldn't expect to also address it here, but that's a lot of if's in the form of your question.

Q So the funds that you propose here on Exhibit 15, or Exhibit 19, as it's marked, is that only for the provision of basic local phone service by the NYSTA ILECs?
A (Kevin Schwenzfeier) That's to allow for the recovery of the NYSTA ILECs' cost above a certain benchmark level.
Q And are those costs only related to the provision of basic local fund service?
A (Kevin Schwenzfeier) It's difficult to say.
Q Why is that?
A (Kevin Schwenzfeier) Because there has been no calculation here of a basic local service cost. It's a revenue -- intrastate revenue requirement issue.
Q Isn't that what we're here for, to ensure that customers in the NYSTA ILEC areas have basic access only to basic local phone service? Isn't that the universal service that we're talking about?
A (Steve Watkins) Yes, and it falls out as one of the components in the mechanics of what we had proposed.
Q Your intrastate costs are more than the cost of just provide basic, local phone service, right?
A (Steve Watkins) There are other things we do in the State that have costs have associated with them and have revenues associated with them, and we consider that in the calculation of total revenues available versus

total intrastate regulated cost.
Q The switch is that your companies own -- are used to provide basic, local phone service, is that correct?
A (Steve Watkins) Yes.
Q Okay, and they're also used to provide other services like call waiting, caller I.D., three-way calling, is that right?
A (Kevin Schwenzfeier) Yes.
Q Are those services basic, local phone service?
A (Kevin Schwenzfeier) no.
Q And intrastate cost that you're talking about would include the costs to provision switches with those additional services, is that right?
A (Kevin Schwenzfeier) As well as the revenues associated with those services, yes.
ALJ JACK: Off the record.
(Discussion was held off the record.)
ALJ JACK: Back on the record. We'll take a short break now. Let's resume again at 10 minutes to 12. Off the record.
(A brief recess was taken.)
ALJ JACK: Back on the record.
BY MR. SCHIFMAN:
Q Hello, panel. Before the break we were talking a little bit about the types of services that your fund that

you're proposing is meant to support. And I found a place in your testimony that maybe we could explore a little bit -- page 6 of your direct testimony, lines 4 through 7. And there you say the SUSF proposal contained herein anticipates a dynamic and evolving SUSF program for the cost of providing local service that are not recovered through Commission prescribed, intrastate regulated rates. Do you see that?

A (Steve Watkins) Yes.

Q Okay, and so the local service that you're talking about there, is that basic, local service?

A (Steve Watkins) Yes.

Q Okay, does it include anything else in addition to basic, local service?

A (Steve Watkins) Your question is not specific to the point that we were trying to make, but the ultimate purpose of the SUFS that we have proposed is to ensure that there is enough recovery of revenue plus SUSF so these companies aren't required to charge something higher than a comparable rate. There are other operations within the state of things they do that create costs and revenues but they are considered in the calculation process.

Q Those other services are considered in the calculation process over and on top of the cost in revenues related to the provision of basic, local service,

is that right?
A (Steve Watkins) That's correct.
Q So this fund is more than just for the provision of basic, local service; that's what you're saying?
A (Steve Watkins) Not really. It's designed to be certain that the recovery from the basic, local service charge is maintained at a reasonable, comparable level; that's the purpose.
Q But you're not separating out only the costs of providing basic, local service and the revenues obtained from providing basic, local services, is that right?
A (Steve Watkins) We are not sure that there is even any definition of how to do that.
Q Okay. So the answer is no?
A (Steve Watkins) No.
Q Do you have any customers that take broadband service from one of your clients, or their affiliates, that also do not take your local voice service?
A (Kevin Schwenzfeier) I think there is some limited.
Q In other words, somebody buys DSL and then utilizes Vonage, or some other type of voice-over-IP service for voice service, right?
A (Kevin Schwenzfeier) The only aspect of that that I can comment to is that I believe there are some companies that are offing DSL only. What the customer

does with that, I don't know.
Q Okay, and so does your State Universal Service Fund provide support for those lines where the customers are purchasing DSL only?
A (Steve Watkins) No.
Q Okay, or the cost of providing DSL only considered in the calculation of the funding?
A (Kevin Schwenzfeier) No.
Q Okay, or how are the intrastate and the interstate costs separated there for the provision of DSL services?
A (Kevin Schwenzfeier) Through the FCC Part 36 Separations Rules.
Q Okay, and so that loop that provides DSL service, what's the percentage that goes to intrastate versus interstate?
A (Kevin Schwenzfeier) For a DSL only service offering, it would be 100 percent interstate.
Q And if that loop is utilized to provide local service and DSL service, what's the percentages?
A (Kevin Schwenzfeier) Twenty-five percent interstate, roughly?
Q And 75 percent intrastate?
A (Kevin Schwenzfeier) Yes.
Q Okay. Let's turn to page 80 of your rebuttal testimony please. In here you're rebutting staff's

adjustments where staff utilized, in essence, a total company before separations, total company operations, you're criticizing staff's use of total company rather than just intrastate regulated, is that right?

A (Kevin Schwenzfeier) Yes.

MR. POST: What page is that?

MR. SCHIFMAN: Page 80.

Q And is one of the reasons why you criticized staff, taking the position that staff did, because the PSC doesn't have jurisdiction over revenues that are not intrastate regulated revenues?

A (Kevin Schwenzfeier) Revenues or costs, yes.

Q Okay. As far as contributions to the Fund, though, you're suggesting that all carriers in the State that have -- either regulated or non-regulated need to pay into the fund that you're attempting to establish, is that right?

A (Steve Watkins) That provide retail telecommunication-like services, yes.

(Kevin Schwenzfeier) Intrastate.

(Steve Watkins) Intrastate.

Q Okay, so if we don't -- if the PSC doesn't have jurisdiction over a wireless company, for example, or voice-over-IP company, for example, you suggest that either the wireless or the voice-over-IP company pay into

the State funding you're establishing, right?
A (Steve Watkins) We haven't yet agreed whether the Commission has jurisdiction over those entities for purposes of this funding or not. We think they do.
Q Okay. Let's assume the Commission doesn't, okay? Even if the Commission doesn't have authority, would you suggest that those companies pay into the State Universal Service Fund that you're proposing to set up?
A (Steve Watkins) As part of our plan, that is what we propose. We don't -- two witnesses here don't take a position on the analysis of the question.
Q On page 79, right before that -- this is also in your attempt to rebut staff's use of the jurisdictional ROE. And you quote some testimony from staff, I guess, on the bottom of page 78. It talks about competitors do not market their product on a local or intrastate basis but provide a complete package of services. Do you see that?
A (Kevin Schwenzfeier) What page are you on please?
Q I'm sorry, I confused you. I'm on the bottom of page 78, lines 18 through 26. You quote staff's testimony there. Then on the next page, at the top of 79, you say staff has failed to explain why the way competitors market their products and services are in any way relevant to the establishment of the appropriate jurisdictional ROE. Do you see that?

A (Kevin Schwenzfeier) Yes.
Q Do the NYSTA ILECs that you represent, do they market their services in bundles?
A (Kevin Schwenzfeier) Some of them do, yes.
Q Okay, so they don't just market basic local phone service as the only option that they offer in the market place, right?
A (Kevin Schwenzfeier) That's correct, but they have books that allow them to segregate the revenues into the appropriate intrastate and interstate accounts.
Q I'm not asking about how they separate their books and everything. I'm just asking about how they market their services. They market their services as bundles, right? If I go to the website, I'm going to see -- get a bundle of local, long distance and DSL from your friendly, local phone company, right?
A (Kevin Schwenzfeier) Yes.
(Steve Watkins) That misses the point of the sentence in the testimony that you refer to, though.
Q Your counsel can ask you about that later.
MR. MOORMAN: Your Honor, this is Tom Moorman for NYSTA Smaller ILECs. It would seem to me that, for continuity of the record, Mr. Watkins had observed something in response to the question. The fact that Mr. Schifman tried to cut him off is

irrelevant. For purposes of explaining fully the response, Mr. Watkins should be able to continue.

MR. SCHIFMAN: Well, every hearing I've been in, Your Honor, the attorney gets to ask questions; the witness answers those questions. If counsel wants to develop something on redirect, then they're certainly allowed to do that. But if it's not responsive to the question, then I don't see any need to burden the record here.

MR. MOORMAN: Well, Your Honor -- Tom Moorman for the NYSTA Smaller ILECs. Mr. Watkins, obviously, believed it was relevant to the response -- to the question that Mr. Schifman raised, so I would appreciate the acknowledgment then, Mr. Schifman and Mr. Watkins can continue because they believed it was relevant to the question that you raised.

MR. SCHIFMAN: There is no acknowledgment from me, Your Honor.

ALJ JACK: No, I didn't think there was. At this point, you know, we've gone far enough down from the continuation of whatever the answer was, but I think it's better to proceed with the cross-examination at this point, and Mr. Moorman can take that up on redirect, if he

thinks it's necessary. But I'm not going to hold witnesses to, you know, a yes-or-no answer if they need to explain their answer in further detail.

MR. SCHIFMAN: Thanks, Your Honor.

BY MR. SCHIFMAN:

Q Which one of the panel has responded to the discovery in this case? I'm specifically thinking of Sprint's questions to the NYSTA Smaller ILECs. Either of you, or do I need to direct my questions to one or both of you?

A (Steve Watkins) You have to tell us which discovery you're talking about.

Q Well, the question I'm thinking about has to do with video services. We asked if the NYSTA ILECs, or their affiliates, provide video services in the State. And the response back was none of the NYSTA ILECs provide the services identified in this request as part of their intrastate regulated ILEC operations. And so I just want to ask some questions about that response.

A (Steve Watkins) We can both respond.

Q Okay, so do the affiliates of the NYSTA ILECs provide video in the state of New York?

A (Kevin Schwenzfeier) Yes.

Q Okay, and do those affiliates utilize the network of the NYSTA ILECs in providing that service; the same

loops used?
A (Kevin Schwenzfeier) In some instances, yes.
Q And I'll ask that same question for DSL. Are the same loops used when NYSTA ILEC, or their affiliate, provides DSL service in the state of New York?
A (Kevin Schwenzfeier) Well, the NYSTA ILEC is the company providing the DSL service.
Q Okay, and those same loops that are used to provide basic service also are used to provide DSL service, right?
A (Steve Watkins) Yes.
Q And are you proposing here, as part of your fund, to count the revenues from the DSL service, or the video services that are provided, in determining the revenue requirements for the NYSTA ILECs?
A (Steve Watkins) No, neither one is part of the regulated intrastate operations of the telephone companies. The costs and the revenues associated with those activities get allocated through the accounting, regulated and non-regulated rules and the jurisdictional separations process of both the costs and the revenues associated with the -- are a separate matter from the regulated intrastate operations.
Q All right, so the costs for the loop that provides video service, are any of those costs allocated to the intrastate jurisdiction?

A (Kevin Schwenzfeier) The cost of the loop would follow the part 36 requirements.
Q Okay, but none of the revenues from video are utilized for calculating the intrastate revenue requirement, right?
A (Steve Watkins) You don't include revenues to calculate a revenue requirement. Revenue requirement comes from costs.
Q Okay, that's a good clarification. That's a bad question. None of the revenues from video service are utilized in determining whether or not the revenue requirement is met, is that correct?
A (Steve Watkins) We have not considered revenues from non-regulated television services as part of the calculation for this process, no.
Q Okay. You attached to your, I think, direct testimony the report from NRII, is that true?
A (Steve Watkins) Yes.
Q And it's about various state universal service funds that have been set up around the country, right?
A (Steve Watkins) That's correct.
Q Okay. Are you aware of any other state that has a state universal service fund that is basically modeled after the same model that you're proposing here, in other words, a rate-of-return based, cost-allocation-based type

of fund that doesn't look at the cost -- or the forward-looking cost of providing the service?

A (Steve Watkins) I believe there are several that are similar. They may not be identical, but yes you examine the intrastate costs and you subtract out what you receive from other services. And if you can't recover through local rates, reasonable local rates, there is a state universal service fund that kicks in.

Q A rate-of-return-based methodology?

A (Steve Watkins) The methodology for determining the cost may actually be less burdensome, less complicated is what we are proposing here. We are proposing the rate case process here, because that was the process that was in place that the Commission seems to be comfortable with. But the general idea, you have a set of costs in the State and you recover some from your regular services and there is more to be recovered, then that gets recovered through a state USF. It's a common theme in most of the state universal service funds.

Q Is your methodology that you're establishing a market-driven and incentive-based policy for distributing state USF?

A (Steve Watkins) It's a cost-based, revenue-based calculation purpose for serving the principles and objectives of a universal service.

Q So it's not market driven. Competition has no effect here on what your revenue requirements are?
A (Steve Watkins) I'm not sure I understand what you would mean -- market driven to mean as an adjective to a state universal service fund.
Q Well, usually state universal service funds look at forward-looking costs and determine impacts and promote competition; they're not talking about rate-based regulations. So I'm trying to look at -- the FCC has talked about transitioning to market-driven and incentive-based policies in their federal universal service policies, and I'm wondering how that squares with your proposal here.
A (Steve Watkins) What specifically are the proposals that you believe are the market-driven proposals?
Q I'm looking at the NPRM from the FCC. You have no knowledge about that?
A (Steve Watkins) I do, but I'm not sure what you're suggesting we analyzed here for purposes of this proceeding.
Q Okay, we'll move on. Okay, let's go to page 88 of your rebuttal. And, really, I'm looking at lines 7 through 20, your criticism of staff's impairment analysis. I guess, what I'm trying to find out is when is there a

point -- where is the reasonableness point here? You suggest that -- well, I'll ask this question. Is it ever reasonable in this rate case consideration for a plan to be written down based on the number of customers being served over the network?

A (Steve Watkins) We haven't considered that question in detail.

Q What is your opinion? Is there any type -- say, for example, NYSTA ILEC had a thousand lines last year and a cable competitor and wireless took 90 percent of their lines. Is it appropriate at that time to write down the plan, the investment in the plan?

A (Steve Watkins) We haven't considered the criteria which would make it appropriate.

(Kevin Schwenzfeier) I'm assuming that there's -- that the company is still -- I think in that answer we assume the company is still required to serve all of the customers in its territory.

Q So if a thousand-line company lost 90 percent of market share, they have a hundred customers left, your answer is that they have to serve those hundred customers, right?

A (Kevin Schwenzfeier) It's the carrier of last resort, yes.

(Steve Watkins) Actually, they have to be

stand-ready to serve all of the customers, even the ones that are served by somebody else.

Q Yeah, but at what point -- how long -- if a cable company has a customer for ten years, at what point is it reasonable to write down the cost of the network investment?

A (Steve Watkins) Not for the foreseeable future, but the long-term question we haven't really considered.

Q All right, let's go back to page 62 of your rebuttal. I believe this is the part. Hopefully, I don't have the reference wrong, but if we can just clarify a few questions here. One of the reasons you suggest that wireless carriers contribute to the Fund is because CMRS carriers benefit from the existence of the NYSTA ILECs?

A (Steve Watkins) Where are you referring to in our testimony?

Q Well, I guess -- I think I wrote down the wrong page number here, so I'll just ask it generally in your testimony. You suggest that wireless carriers pay into the Fund, is that correct?

A (Steve Watkins) Yes.

Q Is one of the reasons because you say that wireless carriers benefit from the existence of the NYSTA ILECs network?

A (Steve Watkins) Yes. The wireless carriers

end-users are capable of calling the NYSTA ILECs end-users and benefit from the ability to complete those calls.

Q And do the NYSTA ILECs also benefit from the existence of the CMRS carriers because the NYSTA customers can call the CMRS customers, right?

A (Steve Watkins) Yes.

Q Okay, and one of the reasons that they sell the service is that they can receive calls from wireless carriers too, right?

A (Steve Watkins) Sure.

Q Sure. And so since there is a benefit involved from -- flowing from NYSTA to CMRS carriers, should there be a fund set up for CMRS carriers from the NYSTA ILECs in order for the CMRS carriers to make sure that their networks are appropriate and sufficient to receive those calls?

A (Steve Watkins) We haven't proposed such a fund, but it's not totally impossible. I would like to point out, though, that the NYSTA Smaller ILECs are also contributing to this because they derive a benefit contributing to our proposed State Universal Service Fund.

Q Are ILEC, the NYSTA ILEC services substitutable for CMRS services?

A (Steve Watkins) I don't think our -- our testimony didn't address that issue. You would have to define what

you mean by that.
Q Your testimony addresses that CMRS is not substitutable for NYSTA ILEC services. I'm asking about the inverse of that.
A (Steve Watkins) Again, you would have to define what you mean by that.
Q I'll define it the same way that you mean.
A (Steve Watkins) No, I don't think that makes sense.
Q Your testimony defines substitutable, right? And basically you say CMRS is not substitutable because we're not assured of providing service in your -- in the home of every NYSTA ILEC customer.
A (Steve Watkins) It's not reliable across the entire service area, correct.
Q Is NYSTA ILEC service reliable in every place that wireless serves?
A (Steve Watkins) The NYSTA wire-line carrier service is reliable across the entire service area.
Q Okay, but a hundred feet outside of a NYSTA ILEC customer's house where they can receive a wireless call, they can't necessarily receive an ILEC call, is that right?
A (Steve Watkins) If that's the way you want to define substitutability.

Q Okay, is that right?
A (Steve Watkins) Yes.
Q If I'm driving down the highway and I have a flat tire, I can't pick up my NYSTA ILEC telephone to make a call to Triple A, right?
A (Steve Watkins) That's correct.
Q But I can use my wireless phone, correct?
A (Steve Watkins) Maybe.
Q On page 45 of your rebuttal, you criticize some testimony from Sprint and other parties saying that Universal Fund principles and objectives -- I'm reading from line 10 through 13 -- cannot be achieved simply by attention only to the so-called "white spot" areas. It's not viable for any service provider to serve only white spots; do you see that?
A (Steve Watkins) No. Where are you?
Q Page 45 of rebuttal, lines 10 through 13.
A (Steve Watkins) Sorry, go ahead.
Q Have you seen it, Mr. Watkins?
A (Steve Watkins) Yes.
Q Would you agree with me that the "white spot" areas are more expensive to serve for the NYSTA ILECs?
A (Steve Watkins) I generally think that's probably true, yes.
Q Your fund doesn't propose only to fund the "white

spot" areas; it proposes to fund the entire service territory for the NYSTA ILECs, right?

A (Steve Watkins) That is correct.

Q So is this -- in any way can we characterize this fund as a high-cost fund?

A (Steve Watkins) In certain -- in certain ways it is a high-cost fund to the extent that it addresses the ultimate rate-making and rate results from the costs that these carriers incur and to the extent that some of them are higher costs. Certainly, as you just said, the white spots are. The reason why we propose that the plan address the entire service area is because no one viably only provides service to the "white spots" only.

Q But would you agree with me that it's not a high cost fund in the city centers of the various towns that the NYSTA ILEC serve?

A (Steve Watkins) Maybe we could say that. I'm not sure what distinction that means.

Q As far as receiving funds -- receiving revenues from the Fund, what kind of -- how are we assured that the funds aren't going to be utilized to buy a DSLAM for the provision of DSL service?

A (Kevin Schwenzfeier) I think the reliance would be upon the Commission in the rate case process to determine what costs -- what the companies' costs are, what the

companies' ability to recover those costs are through rates up to the benchmark. And if those costs aren't recoverable at that level and there is funding available and the Commission ultimately determines what those costs are, it will be recovered.

Q Okay, so if a company has revenues of a million bucks and expenses of 1.2 million and they get 200,000 from the Fund under your calculation, what checks are in place under your proposal to ensure that the 200,000 isn't being used to market DSL services or goes to buy a DSLAM or anything else that's over and above basic, local service?

A (Kevin Schwenzfeier) I guess I'd have to say there are no formalized checks here. The only check would be -- one of the checks would be a self-imposed check, I guess, on the company, and that it's been shown that it has 1. -- whatever number you said. It has a certain level of costs that it will incur, and it needs the revenues to cover those costs. Those costs will not go away.

Q Okay, on page 64 of your rebuttal -- actually, talking about the surcharge that will appear on -- oh, you say -- at the top of page 64 you say --

ALJ JACK: Hold on just a second. You're on a confidential -- oh, you're at the top.

MR. SCHIFMAN: Thank you very much. I

didn't see that.
Q Is the proposed surcharge that NYSTA is proposing here -- that's the only thing that I want to ask on the record here -- is that confidential?
A (Kevin Schwenzfeier) No.
Q So the proposed surcharge is around two cents per customer per month, is that right?
A (Kevin Schwenzfeier) At the maximum level of the fund, yes.
Q Okay. And your contention is that that does not effect affordability for the customers, is that right?
A (Kevin Schwenzfeier) Yes.
Q Okay. At what level would a surcharge effect affordability?
A (Kevin Schwenzfeier) I don't know.
Q Fifty cents?
A (Kevin Schwenzfeier) I don't know.
(Steve Watkins) We haven't undertaken any analysis because it was unnecessary.
Q Okay, unnecessary because you just think two cents is fine, but anything else you don't know?
A (Steve Watkins) I think within the benchmark rate they were proposing an additional two cents. We're convinced as a matter of -- without further analysis that that result would be affordable.

Q But there is no cap on the size of your fund, is that right?
A (Kevin Schwenzfeier) There is no formal cap on the size of it, but you can intuitively look at the costs going into it and recognize that it's not going to go up in orders of magnitude to 50 cents or a dollar based on the level of those costs.
Q If regulatory changes are made, however, at the federal level that the NYSTA ILECs want to put in this fund, the surcharge possibly could go up, is that right?
A (Steve Watkins) We haven't considered those for purposes of this proceeding.
Q But you have considered those as a reason why a fund needs to be set up, right?
A (Steve Watkins) As a general matter of having the mechanics in place.
Q For the companies that are charging $23 a month right now, the benchmark rate, are you proposing to reduce their rates as part of this process to the $15.22?
A (Steve Watkins) In the course of a rate case to demonstrate eligibility for SUSF, that would be one thing that they could propose doing, yes.
Q Okay, so you're actually proposing having the companies reduce the amount of money they get from their own customers and asking all the other carriers in this

room to pay those moneys to that company and their customers; is that what you're proposing?

A (Steve Watkins) Yes. Those customers are already enduring, in our view, a local service rate that's above a reasonably comparable rate. Probably, shouldn't have gone that high to begin with. That's just where they find themselves at in the course of business here.

Q But in prior questioning, in response to CTANY, you said you guys are providing universal service today as it stands. So there's -- I mean those customers are getting universal service today at the rate that it stands, right?

A (Steve Watkins) Yes. They aren't getting them at a comparable rate.

ALJ JACK: Off the record.

(Discussion was held off the record.)

ALJ JACK: All right, maybe this is a good time to break for lunch. It is now 12:30. We will take our lunch break and return at 1:30 p.m.

(Lunch recess was taken.)

ALJ JACK: Okay, on the record. Mr. Moorman, you had redirect for the panel?

MR. MOORMAN: Yes, your Honor. This is Tom Moorman for NYSTA Smaller ILECs.

REDIRECT-EXAMINATION

BY MR. MOORMAN:

Q To the panel. Do you remember the conversations and the discussion you had with Mr. FitzGerald, who is the attorney for the CLEC coalition?

A (Steve Watkins) Yes.

Q Just to make sure that the record is clear and there is no question in the record, does the panel view rate of return as a guarantee of rate recovery?

A (Kevin Schwenzfeier) No. Rate of return regulation allows a company the opportunity to earn a return on its investment.

MR. MOORMAN: Nothing further, Your Honor. Thank you. Is there any recross?

MR. SCHIFMAN: No, Your Honor.

ALJ JACK: Very good. Panel, thank you very much. You are dismissed. We would have normally taken up staff right now, but it seems to be this might be an advantageous time to bring Mr. Anseldo up and enter his direct and rebuttal testimony and have him attest to his exhibits, and then he won't have to come back. Does that sound acceptable?

Mr. Ansaldo, would you stand and raise your right hand please?

R I C H A R D L. A N S A L D O,
having been first duly sworn by the ALJ, was examined and testified as follows:

ALJ JACK: You may be seated. Thank you.

DIRECT-EXAMINATION

BY MR. HANIFIN:

Q This is Chris Hanifin for CTANY. Can you please state your name.

A Richard L. Ansaldo.

Q And your address?

A P.O. Box 2542, Albany, New York, zip code 12220.

Q And in what capacity are you appearing here today?

A I'm appearing here as a utility consultant for CTANY.

Q Did you file testimony in this proceeding?

A Yes, I did.

Q Prior to today?

A Yes.

Q What did that entail?

A A set of initial testimony filed on December 31 with an exhibit and a set of rebuttal testimony filed on January 28 with an exhibit.

Q And those exhibits would be 3 and 4 respectively?

A Yes.

Q With respect to prefiled Exhibit 90, do you know what this is?
A Yes. This is the information used in the cross-examination of the NYSTA witnesses which came from the Commission's website.
Q How do you know that?
A I know that because I compiled it from the Commission's website.

MR. HANIFIN: Your Honor, I move what's been premarked as Exhibit 90 into the record.

ALJ JACK: Well, we're going to hold off on all of the exhibits at this point. We're going to wait until the end.

Q Mr. Ansaldo, what I'm going to hand you what has been premarked exhibit for identification number 91. Do you know what this is?
A Yes.
Q What is it?
A This is the information that was already in page 17 of my prefiled exhibit in the initial phase of the case, with a third column added which took the information from other operating expense showing Exhibit 90 and listed it in the third column.
Q And how do you know that exhibit is what you just

explained to us?
A Because I compiled it.
Q Okay. Mr. Ansaldo, with your direct and rebuttal testimony and exhibits and prefiled Exhibit 90 and 91, do you have any additional corrections or explanations to make today?
A No, I do not. I believe we prefiled all of our corrections.

MR. HANIFIN: Subject to Exhibits 90 and 91 going into the record, I move the remainder of everything into the record, Your Honor, and make the witness available for cross-examination.

ALJ JACK: The prefiled testimony, direct and rebuttal testimony of Mr. Ansaldo will be entered into the record as if given orally at this point in the transcript.

(Testimony inserted as ordered.)

BEFORE THE
STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

In the Matter of

Case 09-M-0527 – Proceeding to Examine Issues Related to a Universal Service Fund

Submitted:
December 31, 2010

Prepared Direct Testimony of:

Richard L. Ansaldo
Utility Consultant
On Behalf of Cable
Telecommunications Association
of New York, Inc.

I. Introduction.

Q. Please state your name and business address.

A. Richard L. Ansaldo, P.O Box 2542, Albany, NY 12220.

Q. By whom are you employed and in what capacity?

A. I am a self-employed utility consultant and in this proceeding I am providing testimony for the Cable Telecommunications Association of New York, Inc. (CTANY). Information about CTANY can be found at http://www.cabletvny.com/.

Q. Would you please summarize your educational and professional background?

A. I received my Bachelors degree in Business Administration and Accounting from SUNY Albany in 1972 and then pursued additional courses in accounting, finance, and economics. I have also received a Graduate Certificate in Regulatory Economics from SUNY Albany. My professional experience includes 1 ½ years with the General Electric Company, and 2 ½ years with the New York State Department of Labor in accounting

and auditing positions. In September of 1976, I joined the Staff of the Department of Public Service where I progressed to Section Chief in the Office of Accounting and Finance in 1982. I testified in approximately 45 proceedings involving rate and policy issues, primarily at the New York Public Service Commission or "Commission". I have also testified before the Federal Energy Regulatory Commission and the Connecticut Department of Utility Control. I have participated and supervised financing reviews, merger requests, financial forecasts, rate cases, and policy cases.

II. Scope and Summary of Testimony.

Q. What is the scope of your testimony in this proceeding?

A. I am analyzing the financial and policy issues related to the Commission's ongoing examination of the issues related to the "Transition Fund" ("TF") as discussed in the July 16, 2010 order which initiated this case, Case 09-M-0527 – Proceeding to Examine Issues Related

to a Universal Service Fund, Order Adopting Terms Of Phase I Joint Proposal (Issued and Effective July 16, 2010). The original fund, instituted by the Commission in Case 02-C-0595, Proceeding on Motion of the Commission as to the Rates, Charges, Rules, and Regulations of the New York Intrastate Access Settlement Pool, Inc. for Traffic Sensitive Access Rates, Order Adopting Comprehensive Plan (Issued and Effective December 23, 2003), provided temporary measures for incumbent local exchange carriers ("ILECs") as access charges and revenues declined. The funding for the original TF payments was supplied by rural communications providers from an access charge pool and the recipients of TF monies were ILECs who presumably could not otherwise provide service at a rate as low as the benchmark rate, currently identified as $23 per month. In this proceeding, a temporary extension to the TF was approved by the Commission to allow time for the issues in this case to be developed/re-examined. While the TF as temporarily extended is currently capped at $600,000,

there is currently no indication of a limit to the subsidy level that proponents might advocate. The latest Commission Order detailing its evolving approach regarding a competitive transition policy for the ILECs it regulates was issued on March 4, 2008 in Case 07-C-0349, In the Matter of Examining a Framework For Regulatory Relief, Order Adopting Framework (Issued and Effective March 4, 2008))(the "2008 Framework Order"). Now that we have seen how the approach in that Order has been applied, it is time to reconsider the entire concept of the TF, eliminate the TF, and directly deal with issues involving rate levels and financial stability, with direct focus on those problems.

Q. From your review, what is your overall conclusion?

A. My overall conclusion based on my review of Commission Orders, ILEC annual reports, financial data, and discovery in this proceeding, is that the TF is not effective for promoting the Commission's goals of universal service, maintaining or fostering financial

stability of rural ILECs, and promoting competition. My testimony will show that of the three ILECs that have received TF subsidies, two did not need it, and the third has structural and inefficiency issues that the TF only exacerbates. In fact, the existence of a TF skews the competitive market and promotes unhealthy subsidies which harms competition.

Q. How does the TF skew the competitive market and promote unhealthy subsidies?

A. First, I have serious concern regarding the efficacy of continuing the fund in light of the lack of demonstrable justification by the recipient rural ILECs to rationalize their price and cost structures, as contemplated by the Commission's vision, discussed many times, including in Case 05-C-0616, Proceeding on Motion of the Commission to Examine Issues Related to the Transition to Intermodal Competition in the Provision of Telecommunications Services, Statement of Policy on Further Steps Toward Competition in the Intermodal Telecommunications Market and Order

Allowing Rate Filings (Issued and Effective on April 11, 2006). There, at page 3, for example, the Commission said "As we continue to transition to an environment where network platforms, devices, and software applications converge to blur the lines between traditional voice telephone and other more advanced and integrated products, our long-standing belief that competition is the most efficient way to ensure quality telecommunications at reasonable rates is now being realized as well as tested. We have pursued competitive telecommunications markets because competition spurs innovation, promotes investment, encourages efficiency, and maximizes customer choice. Competition also disciplines providers' behavior, reducing the need for governmental regulation." My analysis concludes that the availability of TF subsidies has provided a disincentive to innovate and lower costs. Second, I will discuss the three ILEC TF recipients, Crown Point Telephone (Crown Point), Newport Telephone (Newport) and Oneida County Rural Telephone (Oneida), and how those distributions did

not serve the Commission's stated interests. I conclude that the TF has become an ineffective rubric that discourages prudent business decisions which would promote financial stability. Third, I will address my concerns with the $23 benchmark rate established by the Commission and the fact that TF subsidy recipients are not appropriately applying this rate as part of prudent business actions. Lastly, to the extent that there is arguably a real issue with rural ILECs which requires Commission intervention, I suggest that the Commission consider other solutions for both rate levels and financial stability including, without limitation, consolidations, mergers, and other restructuring of ILECs. To this end, the evidence thus far in this case shows that little if anything has been accomplished by the TF mechanism to address the problem purportedly intended to be addressed here – a problem affecting less than approximately one-half of one percent of " … upstate property locations which have no alternative cable modem or wireless services available" according to

the Preliminary Staff Report on Cable and Wireless Phone Coverage (the “Staff Whitepaper”), page 7 (Redacted Report), December 22, 2009. The Commission has clearly embraced the fact that competition and innovation should be the driving force to bringing choice of services to all New York customers, including rural customers. The 2009 Staff White Paper graphically shows how these policies have succeeded. My final conclusion is that the prospect of extending ILEC TF subsidies frustrates these advances.

Q. Are you submitting an exhibit in this proceeding?

A. Yes, my exhibit is labeled Exhibit ____ and it contains 17 pages (plus a cover page). The Exhibit contains summary financial data which is contained in both the ILEC responses to interrogatories in this case and the Commission’s website. Although this information is publicly available and already contained in the interrogatory responses in this case, I included the information here for easy reference to the points I make in my analysis.

III. Impact upon Competition and Rationalization of ILEC Price and Cost Structures.

Q. You mentioned that the Commission should consider whether the TF is necessary in light of competitive progress and the failure of ILECs to address their price and cost structures costs. Could you elaborate on this point?

A. Yes. Based on my review of the TF mechanism and the resulting disbursements to date, the lynchpin of the decision to distribute TF monies is the revenue requirement deficiency determination, which relies on the rate of return: the greater the deficiency, the higher the TF award. This review process is discussed in some detail in Case 07-C-0349, In the Matter of Examining a Framework for Regulatory Relief, Order Adopting Framework (issued and effective March 4, 2008)(the “2008 Framework Order”), where it is stated at page 10, “Because companies will not be subjected to a full rate case review of their books, the reported intrastate ROE will be adjusted to reflect

the portion of intrastate unexplained cost levels, both high and low. Adjustments for costs that exceed the expected level will serve as a surrogate for potential rate case adjustments, and will increase the reported ROE. Adjustments for costs that are less than expected recognize companies that have found efficiencies and will reduce the reported ROE." This relatively simple procedure, which attempted to reduce excessive costs, while well intended, did not go far enough. As a consequence, a company can be awarded more TF by not responding to industry cost pressures. The simple model used by Staff does not provide enough scrutiny and does not set a high enough hurdle to trigger subsidies from other companies and their customers. One modification to consider would be for Staff and the Commission to look at the "package" of combined return on equity and officers salaries, to get a better picture of the rural companies' real cost structure. I see little evidence that the rural ILECs were ever required to explain what measures they have taken to respond to economic pressures except

through encouraging multi-year rate cases. In some cases, I have seen that after determining the TF disbursement level, the TF recipients were allowed to choose to not actually charge the $23 benchmark rate, leaving the revenue deficiency intact. That decision did further damage to competition because the Commission had already recognized that the $23 benchmark was likely below the cost of service for the qualifying rural ILECs. Charging a rate lower than $23 therefore clashes with the interest of spurring competitive service options.

Q. In general terms, what did your review of TF disbursements reveal?

A. I reviewed the calculations and assumptions which used to disburse the TF to Crown Point, Newport and Oneida, and, as applied, the results did not serve the interests enumerated by the Commission in its vision. First, in hindsight, the Department should apply far more scrutiny to expense levels than the adjustments which result from the regression model used in the

2008 Framework Order (cited above), or any of the adjustments made in the rate orders where TF monies were dispersed. For example, Crown Point has the highest cost for Wages and Benefits per access line of any ILEC in the State. To the extent that Staff's model resulted in an adjustment, Crown Point continued to pay the higher salaries in 2009, resulting in stated financial indicia that look weak to any creditor. All three TF recipients showed negative earnings in their 2009 annual reports. Therefore, if there were a public interest in stabilizing the recipient TF ILEC's financial profile, that interest was not met. With the possibility of more TF, an ILEC would unlikely feel a sense of urgency when it comes to responding to competition or other sources of reductions in revenues. Perversely, if the TF concept lives on, competitors will be required to pay the salaries of the recipient ILECs while they decide whether they can even compete against a rate which is below the $23 benchmark rate. Again, keep in mind that the $23 benchmark rate is presumably below the

rate which the recipient ILECs would need to charge, if they were allowed their full cost of service.

IV. TF Distributions to Crown Point Telephone (Crown Point), Newport Telephone (Newport) and Oneida County Rural Telephone (Oneida) corporations did not serve the Commission's stated interests.

Q. With regard to Crown Point Telephone Corporation, can you discuss its receipt of TF monies and the result?

A. Yes. In Case 04-C-1002, Joint Proposal of Public Service Commission Staff and Crown Point Telephone Corporation Concerning Crown Point Telephone Corporation's multi-Year Rate Plan, As Recommended and So Ordered by the Commission (Issued and Effective December 14, 2007) (the "Crown Point 2007 ARSO"), the Commission allowed Crown Point to drawdown an additional $84,083 from the TF for, at that point, a cumulative total of $189,654 and increase rates for 2008 and 2009 to the benchmark rate. But it is clear from the discussion in the ARSO that Crown Point was not going to actually charge the $23 benchmark rate

and initially would not even change rates. In reviewing Crown Point's financial performance for the year 2009, I see several alarming factors.

Q. What does your review show?

A. Based on the information provided in Crown Point's 2009 Annual Report to the Commission on the Commission's website at http://documents.dps.state.ny.us/public/Common/ViewDoc.aspx?DocRefId={6D984741-45FA-4B06-BDEC-224FEFAA94FE}, it paid salaries to its three officers of $78,951, $72,800, and $68,094 for that year. In that same year it incurred a loss (negative net income) of $219,326, and negative net cash flow from operations. While it incurred positive cash flow of $291,226 from depreciation, it invested only $145,035 in new plant. The depreciation and net plant investment relationship, which indicates a declining asset base, is not unusual for the ILEC industry at this point in time, but in Crown Point's situation the declining asset base is a concern for the company's financial

viability because as of year end 2009 it has $3,306,649 of outstanding debt and only $2,859,510 in net plant. Stated another way, its debt burden is not declining with its asset base. Page 59 of Crown Point's annual report details the issuances of debt, but leaves blank the required information regarding maturity dates. Particularly alarming is Crown Point's reported cost per access line of $1,643 (Exhibit ____, page 5), which dramatically exceeds the State average of $985 (Exhibit _____, page 1). Also, Crown Point's Wages and Benefits cost per access line, $859, is significantly higher than the $507 average for the entire ILEC statewide average. More glaring is that the $859 of salaries and benefits for Crown Point is almost as high as the entire $862 cost per access line for holding company associated ILECs as shown on page 17 of Exhibit _____. The combination of all factors, such as the declining customer base identified in Staff's Whitepaper, the business-as-usual salaries, the operating loss, the negative cash flow, and the debt that exceeds net utility plant,

could, to some, call out for a growing and much larger subsidy. But it actually shows the negative impacts of an ILEC being allowed to rely on a subsidy and the need to, but failure to, consider consolidation, restructuring, and other remedies. Crown Point has been allotted the lion's share of the TF, which is identified in Staff's report as $303,200 and the subsidy strategy provides what I believe is an unintended disincentive for Crown Point to adjust its business model. It is incongruous that the company continues to pay its historical salary levels to its officers while at the same time, refusing to increase its rates due to "...recognition of the difficult economic times facing its customers." See Case 09-C-0431 – Minor Rate Filing of Crown Point Telephone to Increase its Annual Revenues by $159,628, Order Authorizing Rate Increase (Issued and Effective December 28, 2009), page 2, footnote 3. Finally, the asset base is not sufficient to allow for refinancing of debt coming due at undisclosed dates. A debt default or financial emergency does not serve the

interests of ratepayers, or any of the voice providers in the State. There needs to be a complete analysis, justification, and rationalization of what Staff intends to recommend for Crown Point in the future, in terms of size, duration, goals, and endpoint. The company's financial condition is certainly not stabilized by the subsidy and it is likely the very existence of this proceeding creates an environment where Crown Point and some other ILECs might be inclined to rely on the prospects of a continued TF subsidy rather than independently solving their problems. To make matters worse, any subsidy as applied to this company serves as a direct penalty against consumers of competitive carriers who have built their systems without such subsidies.

Q. You mentioned the salaries of Crown Point's officers of $78,951, $72,800, and $68,094 for the year 2009. Why do you believe those levels, in the context of providing TF then, now, or in the future are of concern?

A. Please recall that salaries and Wages and Benefits per access line need to be viewed in the context of Crown Point's size and financial situation. Crown Point has one of the smallest ILEC service territories in the State, and one of only a few that have not partnered with others in the context of mergers. Crown Point has only about 800 access lines, yet its total Wages and Benefits dramatically exceed the averages in the State. If one looks to small ILECs that have merged, the differences become clearer. For example, Crown Point reports $561,755 of total compensation for employees on page 100 of its 2009 Annual Report to the Commission. Edwards Telephone Company, which is a member of the TDS system reports total Wages and Benefits of $294,113 of its 2009 Annual Report to the Commission. Edwards is identified as serving 1,806 customers in the Staff Whitepaper. The Frontier companies, which include Citizens NY, Ogden, Ausable Valley, Frontier of NY, Frontier of Rochester, Seneca Gorham and Sylvan Lake have rationalized costs and operations to remain competitive. The success of the

Frontier companies is confirmed by the Staff's regression model used in 2008 Framework Order (see above, Case 07-C-0349). But of even greater significance is the high debt burden and low earnings, and viewed in that entire context, it seems that Crown Point's only plan of action for survival is a subsidy from other companies and customers outside of their service territory. Lastly, these officers' salaries must be viewed in the context of the community and its socio-economic standards which, as mentioned previously, Crown Point identified as a reason not to charge the $23 benchmark rate. While these salaries may not seem excessive out of context, when viewed in the context of the cost levels of many other small ILECs, the negative returns year after year, its cash flow situation, its debt burden, and the socio-economic situation in its own service territory, the salaries and entire cost structure are quite alarming.

Q. What is the financial situation for the other TF recipients, Newport and Oneida?

A. The Wages and Benefits expense category generally track historical levels like those of Crown Point, but fortunately, Newport and Oneida have very small debt burdens, and their total cost per access line, of $802 and $931, respectively, is actually below the average cost per access line in the State of $985 (See pages 11, 13, and 1, respectively, of Exhibit _____). While both Newport and Oneida reported operating losses in 2009, their modest debt burdens, and lower than average cost per access line, suggest that they should not qualify for any subsidy in the future. As mentioned earlier, Staff should consider a metric which combines officers' salaries with return on equity to measure the real return that owners are receiving on their invested capital. The focus on the singular rate of return trigger suggests that the rural company need not even demonstrate overall "hardship" in terms of its comparative statewide cost level, and there was no recognition of the relatively strong equity ratios and low debt burden. While the TF should not be continued in any form, if the

Commission decides, nonetheless, that it should, the hurdle that a recipient company needs to clear to get TF needs to be much higher than that used by the Commission to set rates in the stand alone service territory.

Q. Did you review the latest distribution of TF for Oneida Telephone?

A. Yes. In Case 08-C-0610, Minor Rate Filing of Oneida County Rural Telephone Company to Increase it Annual Revenues by About $227,757 in its PSC No. 13 Telephone Tariff, Order Authorizing Rate Increase (Issued and Effective January 16, 2009) (the “Oneida Order”), the Commission authorized Oneida to use the TF. The Oneida Order notes at pages 3 and 4 that Oneida has many “majority owned subsidiaries” and “overlapping individual ownership”; many of Oneida’s “regulated employees perform both regulated and non-regulated functions”; “65.9% of OCRT’s (Oneida’s) payroll should be allocated to the Company’s non-regulated operations”; “transactions are not arms-length and

require a careful review process to determine whether regulated operations are cross-subsidizing non-regulated affiliates". The Oneida Order goes on to point out that the cost allocation manual is not being followed and does not properly apportion expenses. It is noted that the corporate structure is extremely complex, "made more difficult by the fact that some....affiliates are jointly owned by.....directors and officers." In the final analysis, the Commission adopted Staff's adjustments to the rate filing, but Oneida was still allowed to take an additional $83,018 from the TF. This withdrawal occurred even though the Commission did not require the company to charge the $23 benchmark rate.

Q. In your opinion, what policy issues does the TF distribution to Oneida raise?

A. Oneida's financial condition, at this point, is almost entirely dependent on its non-regulated operations. Commission actions will have little effect on the company's financial stability, since 81.1% of its

revenues come from non-regulated sources. Its customers are served by competitive options, and Oneida was identified by the 2008 Framework Order in (cited above, Case 07-C-0349) as “Competitive”. (See Appendix D of that Order). It is difficult to see how under the framework as discussed in the March 4, 2008 Framework Order, one would have envisioned that Oneida would have been provided TF. The difficulty of separating true ILEC costs from those of its competitive telephone affiliates should, in similar cases in the future, disqualify an ILEC from obtaining subsidies from other voice providers.

Q. Are you suggesting that the TF recipients structured their costs and allocations to maximize their TF receipts?

A. While my review indicates that there would be an incentive to do this, I am looking forward, as suggested in the Commission 2008 Framework Order (Case 07-C-0349), and recommending changes to the system in the future. The point is simply that the system that

the Commission and Staff pursue going forward should be changed to better serve the interests of the State. The Commission should, in my opinion, end the TF. However, assuming any public interest basis can be developed to justify the continuation of a TF and the Commission were to decide to continue it, it should be administered much more stringently in the future. Subsidies from other companies and customers in other service territories are extraordinary measures, and the justification for being awarded a subsidy should be compelling. A streamlined process is problematic. Among other things, companies requesting TF should be required to submit financial forecasts demonstrating their viability and efforts to control all costs.

V. The Commission should consider other solutions for both rate levels and financial stability of ILECs, including consolidations/mergers/other restructuring.

Q. Can you be specific about a proposal that would rationalize the business models of high cost ILECs?

A. No. I cannot be specific about proposals that might

involve reorganization, sale, merger, or joint venture. Those analyses and actions will result from the correct pressures and incentives (most importantly the elimination of disincentives) by the Commission and its Staff, the first of which would be stop contributions to, and awards from, the TF. The subsidy, at best, only encourages the status quo for companies that don't choose to respond to the quickly evolving environment, and penalizes those companies that have responded.

Q. Is there any indication from the responses to interrogatories and from data on the Commission's website that other companies have rationalized their businesses and responded to competitive pressures?

A. Yes. As already mentioned, one need only look at the cost data for the Frontier companies to see how they have responded to a challenging environment in a more self-reliant and pro-competitive manner. All of the Frontier companies have dramatically lower costs for Wages and Benefits than any of the TF recipients. For

convenience I have included that data, supplied by the companies and on the Commission's website, in my Exhibit (Exhibit _____, pages 4-15). As can be seen, the Wage and Benefits per access line range from $74.10 for Seneca Gorham and Sylvan Lake to $185.27 for Rochester Telephone. These Wages and Benefits are a fraction of the level paid by the three TF recipients. Additionally, the Frontier companies have maintained their profitability and financial viability. It would be a perverse incentive, if as a result of their actions, they had to pay into a fund to support companies that pay relatively high wages to their officers in an environment of business challenges, including a declining customer base. It is interesting the Staff's own regression analysis, the results of which are shown at page 4 of Appendix B of the 2008 Framework Order (cited above, Case 07-C-0349) confirms this result. Virtually every company that has partnered or merged, has an actual cost level below that predicted by the model, and most rural companies which have not done so have actual cost

levels above the model's prediction.

VI. Concerns with the $23 benchmark rate and how TF subsidy recipients are not appropriately applying this rate.

Q. Would you please discuss your concerns about the $23 benchmark rate?

A. I have reviewed how the benchmark rate was established and understand the rationale of allowing pricing flexibility, and allowing incumbents to move up to that rate. However, the rationale for allowing a rural ILEC to be subsidized, if the real cost of service exceeds $23, should be re-examined, in view of the Commission's own stated interests and rationale. In Case 05-C-0616, Proceeding on Motion of the Commission to Examine Issues Related to the Transition to Intermodal Competition in the Provision of Telecommunications Services, Statement of Policy on Further Steps Toward Competition in the Intermodal Telecommunications Market and Order Allowing Rate Filings (Issued and Effective on April 11, 2006) at

pages 53 and 54, the Commission stated, “While these rate structures were appropriate in a monopoly environment, they may not be viable given the competitive intermodal market. For example, our forward-looking cost studies show that rural areas (where rates are low) are more expensive to serve than urban areas (where rates are higher). Yet regulated rates have suppressed rural rates to levels below those in urban areas, thereby discouraging investment in the telephone infrastructure. We believe it imperative to change this rate structure to reflect the realities of the market and to better reflect the cost of providing service. To accomplish this purpose, we adopt the recommendation to allow the incumbents to file tariffs to provide for a basic service offering subject to the limitation described below. Existing rates differ and may continue to differ; incumbents will be allowed to charge any rate up to the limitation.” Those observations by the Commission were stated in April 2006 and now, during this proceeding to re-examine the issues, it is time

for the Commission to reconsider whether the $23 benchmark rate, which was apparently below the actual cost of service for rural companies, should be eliminated or raised for the rural ILECs. When applied to rural ILECs, the $23 benchmark rate understates the cost of service and impedes competition by alternative providers. As the Commission recognized in Case 08-C-0610, Minor Rate Filing of Oneida County Rural Telephone Company to Increase it Annual Revenues by About $227,757 in its PSC No. 13 Telephone Tariff, Order Authorizing Rate Increase (Issued and Effective January 16, 2009) (the "Oneida Order") at page 24, that, " . . . companies should compete on price and quality of their product offerings . . . [and under the Fund], companies are not being required to raise their actual rates to the benchmark to receive revenues from the Transition Fund . . . The existence of the Transition Fund skews the competitive market by allowing telephone companies, who have argued and demonstrated that they are operating in a competitive market, to be subsidized

with the fund." The TF is a regulatory perversity which unfairly burdens other voice providers' customers and provides disincentives for the ILEC to rationalize its business model. Furthermore, in constraining a rural ILEC's rates to the already artificially low benchmark, there seems to be a presumption in more recent Commission orders that if an ILEC's service territory does not offer some alternative voice service for 100% of its customers, then **all** ratepayers in that service territory are entitled to have rates brought down to a theoretical $23 per month rate, by virtue of an assessment on other voice providers in the State, including other ILECs, wireless providers and other voice providers, including the CTANY members. The rationale allowing the subsidized ILECs to actually collect their higher costs from better earning providers or from customers in other service territories is weak.

Q. Could you discuss your findings regarding the counterproductive effects and incentives as a result

of TF subsidies?

A. As should be fairly clear by now, the availability of TF subsidies penalizes efficient voice providers and their customers and rewards companies that have not responded well to the evolving technology and reduced subsidies in the industry. If the subsidy could be legally justified and was sustainable, it begs the question as to why all ILECs in New York would not prefer to have their rates underwritten by other competitive voice providers. There also seems to be some presumption in the formation of the TF, that rural ILECs need support for their overall financial condition, to remain “viable.” However, after dipping into the TF for the subsidy, they can then choose not to charge the true cost of service or at least the benchmark rate, but continue their historical salary levels and cost structures, as their customer base erodes. In conclusion, the aftermath of the TF rate case process is that voice competitors subsidize high cost ILEC providers at a theoretical benchmark rate below what Staff believes is the actual cost, and then

are left to compete against a rate which is even lower than the rate that they subsidized. The recipient ILECs then have no incentive, and even a disincentive, to restructure their operations (economize, merge, restructure, or partner) to lower their costs. The recipient ILECs then continue with historical salary levels, and customers are provided with fewer competitive alternatives. Finally, the ILECs achieved rate of return still appears subpar, because, at the lower rates, its earnings are lower than a traditional revenue requirement would support.

VII. Conclusion and Summary.

Q. Would you please summarize the major points of your testimony?

A. 1. The Commission should re-examine the goals and need for the TF and the TF should be eliminated or quickly phased out. The Commission should consider alternatives to a TF subsidy, including (among other things) a more through review of other approaches, including encouraging consolidation, merger, or other

restructuring of ILECs if it finds their existing cost of service so excessive that they can't justify charging existing customers those costs.

2. Recipient high cost ILECs have not justified their cost structures and should be required to do so in a request for a rate increase or subsidy (new or continuing).

3. Data provided by non-recipient ILECs (e.g., Frontier and TDS) and Staff's own analysis in the 2008 Framework Order shows that costs, even in rural areas, can be held down to lower levels, while maintaining profitability.

4. The recipients of the funds do not have a proper incentive to rationalize, consolidate or merge their business with others, in order to lower the cost per access line.

5. The future of one of the TF recipients, Crown Point, requires some separate focused attention, and that focus should not be on any increase in TF levels which has clearly not succeeded in the past.

6. The Commission should consider whether the $23

benchmark rate is properly justified as the “correct” rate for presumably higher cost rural companies, especially going forward.

7. Assuming a benchmark rate is relevant under current market conditions, it does not serve the interest of expanding service options and competition for voice service in rural areas if a benchmark rate is set below the actual cost of service.

8. To allow TF recipients to charge less than the cost of service, and particularly below the $23 benchmark rate, makes it less likely that other voice providers will enter zones that are only served by the currently-subsidized ILEC.

9. A TF recipient’s choice to charge less than the $23 rate also results in published financial data which shows subpar financial performance, thus, not serving the “financial stability” interest.

10. Assuming new contributions to a TF can be legally sustained and the Commission decides to continue the fund, the Staff and Commission should require any TF recipient to provide a financial forecast detailing

its business plan to demonstrate how the TF subsidy it receives actually serve all relevant interests: expanded competitive service, efficiency/cost effectiveness, and financial viability. The hurdle that an ILEC needs to clear to receive TF should be higher than what is used for 'ratemaking as usual' determinations.

Q. Does this conclude your prefiled direct testimony?

A. Yes, thank you.

[Exhibit ____ - Attached]

BEFORE THE
STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

In the Matter of

Case 09-M-0527 – Proceeding to Examine Issues Related to a Universal Service Fund.

January 28, 2011

Prepared Rebuttal
Testimony of:

Richard L. Ansaldo
Utility Consultant
On Behalf of Cable
Telecommunications Association
of New York, Inc.

Q. Please state your name and business address.

A. Richard L. Ansaldo, P.O Box 2542, Albany, NY 12220.

Q. Have you testified previously in this proceeding?

A. Yes. I submitted pre-filed testimony on December 31, 2010 for the Cable Telecommunications Association of New York, Inc. (“CTANY”)

Q. What is the purpose of this additional testimony?

A. Through this testimony I intend to show that the information received in response to interrogatories and the pre-filed testimony of the parties in this case confirms my position, as stated in my pre-filed testimony, namely, that (1) a Transition Fund (“TF”) to subsidize rural incumbent carriers is not in the public interest; (2) the current TF has frustrated the

very goals it was ostensibly created to address; and (3) even if a fund is deemed appropriate by the New York Public Service Commission (the "Commission"), the Department of Public Service Staff's ("Staff") proposal fails to apply the principles annunciated in its own testimony and those contained in Commission Orders resulting in an excessive and unnecessary proposed "State Universal Service" Fund.

Q. Which pre-filed testimony will you respond to in your additional testimony?

A. I will address the testimony of the four separate Staff Panels: the Staff Policy Panel ("PP"); the Staff White Spots Panel ("WSP"); the Staff Substitutability Panel ("SP"); and the Staff Universal Service Fund Mechanism Panel("USFP"). The observations I will make about Staff's support for a TF are relevant to the testimony of other parties supporting the subsidy.

Q. Have you prepared an Exhibit as part of this testimony?

A. Yes. I have attached a 21 page Exhibit (Exh_____) consisting of Staff's response to CTANY's second set of interrogatories 7 through 12 (CTANY-DPS Staff-7 through CTANY-DPS Staff-12) on pages 1 to 4, Staff's response to Verizon-DPS Stafff-1 on pages 5 through 9, financial data from the Commission's website, public information from Armstrong Telephone's parent website, Appendix D from Case 07-C-0349, In the Matter of Examining a Framework For Regulatory Relief, Order Adopting Framework (issued and effective March 4, 2008)(listed on page 19 of my Exhibit; "March 2008 Framework Order"), and data compiled from financial data in rural Incumbent Local Exchange Carriers ("ILEC") Annual Reports that bear upon the reliability of the Staff's $5.6 million annual estimate of TF need.

Q. Please summarize your key findings from the review of the pre-filed testimony of Staff.

A. 1. The pre-filed testimony of the four Staff panels, taken as a whole, is inconsistent with the telecommunications policies of the Commission.

a. The four Staff panels' testimony collectively is antithetical to Commission policy promoting competition.

b. The Commission has previously stated its clear intent to rely on competitive markets to achieve universal service and other goals and addressed the market issues in what Staff erroneously refers to as a duopoly.

c. In developing its $5.6 million annual estimate of transition fund needs, Staff has not followed the Commission's previous Framework Orders that sought to impose an element of cost discipline on ILEC reported costs.

2. There are significant inconsistencies between the Staff panel testimonies that make it

difficult to understand Staff's overarching position. For example:

a. The findings of the WSP confirm that customer choice is progressing throughout the state, yet the SP contends that there are currently **no** adequate substitutes for ILEC service.

b. The PP recognizes that the benchmark rate for rural ILECs should be above $23, but the SP and USFP suggest that the $23 rate is the correct rate.

c. The USFP recognizes that the Commission requires telephone companies to become more efficient in order to respond to competitive pressures. Notwithstanding this clear Commission directive, Staff proposed a TF based upon unadjusted ILEC reported 2009 financial data. This data includes costs that Staff and the Commission have not historically included in rates, even in the absence of a request for subsidies from other carriers. As such, if a TF

can be justified at all, the rough $5.6 million TF estimate of Staff is excessive.

3. To uphold the Commission's stated vision that ILECs should become more efficient, Staff should not have recommended the need for **any** TF, because the more efficient ILECs do not qualify for a subsidy, even under Staff's rough estimating procedure.

a. In deciding whether to advocate for a TF, Staff should have modeled ILEC costs reflecting ILEC "best practices" to determine likely costs consistent with the Commission's vision which requires efficiency and innovation by ILECs. This sound economic principle has been adopted by the PSC in countless ratemaking and interconnection proceedings through its use of forward-looking costs based on the most efficient future network.

b. Any TF need is likely very limited (if at all) and establishing that fund before requiring applicants to become more efficient

sends the wrong message to ILECs and harms customers in non-subsidized areas since they ultimately have to fund the subsidy. Any TF should be funded only as determined necessary (i.e., not funded in advance) after full vetting of any recipients' needs and the efficiencies it has obtained on its own initiative, including consideration of corporate restructuring.

4. Staff should also recognize that traditional ratemaking paradigms such as "return on equity" and "return on rate base" may not be good indicators of the financial health of family-owned companies. A company officer may well be able to maximize the real return on investment by minimizing federal income tax obligations if the entity accepts a lower rate of return at the corporate level, and a higher salary on a personal level.

5. My review shows only one utility, Crown Point Telephone Corporation ("Crown Point"), suffering from clear financial difficulties. As

stated in my prior testimony, the Staff and Commission should focus special attention on that one company. The current financial difficulties could be self-imposed by the way the company is managed, and the situation has only deteriorated over the last decade, in spite of, and perhaps even because of the TF subsidy. Nonetheless, the responsibility for Crown Point should not rest on the shareholders and customers of other voice providers in New York State.

STAFF'S POSITION IS INTERNALLY INCONSISTENT AND IS ALSO IN CONFLICT WITH THE COMMISSION'S VIEW OF COMPETITION AND ITS TELECOMMUNICATIONS POLICY.

Q. Is Staff's testimony relative to the substitutability of telephone service consistent with the other Staff panels?

A. Staff's testimony is not consistent with the rest of the testimony or Commission precedent. For example, the primary concern of the WSP

would appear to be those rural ILECs which have **some** customers without alternative voice service. There are only 14 companies with such areas according to Appendix D of the March 2008 Framework Order (in Case 07-C-0349, listed on page 19 of my Exhibit), and except for Crown Point, the customers without alternatives are a modest percentage of any ILEC's customer base. However, the definition of an alternative or "substitutable" voice provider proposed by the SP ignores customer preferences for more affordable and innovative services and instead relies on criteria that would require price regulation as the main determining factor. The SP testimony asks that to be considered a substitutable service, providers must adhere to many, if not most, of the same regulatory requirements to which ILECs must adhere. In fact, at pages 12 and 13 the SP testimony states, "The Commission has established a long-standing commitment to keeping basic residential

service at the lowest rates possible, so as to achieve a regulatory goal of realizing the highest penetration level possible of residential telephone service subscription. Therefore, in order for a basic residential service offered by an alternative service provider to be deemed substitutable, it should be affordable with price protections, and Lifeline or an equivalent service should be made available to low-income customers." The SP is clear in its assertion that under current policy, notwithstanding the fact that competitive providers have led the way in innovation and efficiency and enhanced overall customer choice, nothing is an adequate substitute for ILEC telephony because those services are, in essence, not price regulated. In failing to recognize that actual market adoption is the most significant indicator of substitutability, Staff ignores the best determinant for substitutability – the consumer.

Q. Is Staff's Substitutability testimony consistent with prior Commission findings and policy?

A. The SP testimony is totally at odds with past and present Commission policy. For example, in Case 05-C-0616, Proceeding on Motion of the Commission to Examine Issues Related to the Transition to Intermodal Competition in the Provision of Telecommunications Services, Statement Of Policy On Further Steps Toward Competition In The Intermodal Communications Market And Order Allowing Rate Filings (issued April 11, 2006) ("April 2006 Policy Order"), the Commission stated at page 4, "In short, the provision of telephone service is no longer a natural monopoly.", and at page 6, "We have pursued competitive telecommunications markets because competition spurs innovation, promotes investment, encourages efficiency, and maximizes customer choice." In contrast, the SP seems to support an endless monopoly service.

Presumably, one reason for the initiation of this proceeding is the perceived potential financial impact on ILECs of the reduced number of access lines. It is an anomaly that Staff supports a massive and undisciplined increase in the subsidy rather than requiring ILECs to become more efficient. Furthermore, in an about-face from previous statements and Commission findings in prior cases, the SP states at page 7 of its testimony that, even for customers served with alternatives to ILEC service, a "***duopoly could***" result in inadequate price protection. The SP's duopolies concern is in sharp contrast to previous Staff analysis provided to the Commission. The Commission noted in the April 2006 Policy Order at page 25 that, "The White Paper also notes that competitive measurements such as the Herfindahl-Hirschman Index (HHI) or other examinations of competitors' market shares are a static analysis which fail to recognize the dynamic nature of

the market. Staff argues that markets are contestable in most of the State because competitors can quickly enter and eliminate any supra-normal profit-seeking by the incumbents. Apart from the market shares of the competitors, the White Paper argues, the threat of imminent competition already serves as a significant constraint on incumbent behavior." In the same Statement of Policy in the April 2006 Policy Order at page 39, the Commission noted, "We are also not convinced that our actions should be restrained by a concern that the telephone market is or is becoming a duopoly."

Q. Did the Staff SP provide any new analysis to support its position that a duopoly would be a concern?

A. No. Staff only expresses what "could" happen under conditions of a duopoly, and seems to have abandoned previously held views and Commission findings about contestable markets. Also

puzzling is Staff's very limited view of the number of competitors in an area, namely two (a duopoly). Most areas are served by more than one cell provider. Also, most areas have cable and broadband services, dish TV options, free digital transmission via Federal Communications Commission's requirements, and internet service with phone service provided by DSL and other media. These services are expanding and some of these services have not been addressed by Staff's white spots analysis and cell service "spot-check" as described in Staff's WSP testimony. Moreover, Staff's WSP testimony recognized on page 18 that in the short months since the initial White Paper was submitted in this proceeding, additional competitive cable franchises were approved and wireless service coverage in the State has increased by 4.7% to almost 90% of the State. The markets are clearly contestable as Staff had once correctly observed and the Commission has held.

Q. You stated that Staff's rough estimating method for its $5.6 million funding need was inconsistent with prior Commission Framework Orders. Does Staff reject the Commission's call for ILECs to become more efficient in response to competitive pressures?

A. No, in fact, the rationale provided in the testimony suggests that Staff supports the Commission's vision and still believes in requiring ILECs to become efficient. For example, at page 26 of the USFP testimony it states "If an incumbent company has done very little to become more cost efficient as competition intensifies, it would be unfair to allow it to draw from a fund, which includes contributions from companies that have taken steps to become more efficient, operating in other competitive areas of the state. As noted, as early as 1996, the Commission stated that its goal was for the ILECs to operate as though they

were facing the consequences of competitive pressures." Therefore, the Commission has required a showing of some efficiencies. Also, in Case 07-C-0349, In the Matter of Examining a Framework for Regulatory Relief, As Recommended and So Ordered (issued and effective December 18, 2009) ("2009 ARSO"), drafted by Staff and approved by the Commission, there was an affirmation that the model used by Staff was under continued development and refinement. The footnote on Page 4 of the 2009 ARSO states, "Staff proposes four changes to the cost model estimation methodology explained in Appendix B of the March 4, 2008 Order. These methodological changes allow for a better matching of cost model inputs and outputs, which will result in a better estimate of unexplained CPAL. The changes are as follows: 1) use allowed return on equity specific for each year in creating the annual economic capital cost variable (Appendix B, page 5, footnote 7); 2)use

mid-year access lines instead of end-of-year access lines for residence and business line cost function outputs (Appendix B, page 5, second paragraph); 3) revise the Warwick Valley Telephone area factor from 2.0 to 1.6 to reflect that only approximately 37.5% of its service territory stretches into New Jersey (Appendix B, page 5, footnote 6); and 4) instead of using $50,000 for the labor price for Oriskany Telephone, use the average wage rate of the 37 other smaller telephone companies (Appendix B, page 5, footnote 8).”

Q. Then how is the Staff testimony related to the TF inconsistent with established Commission policy?

A. Staff has inconsistently applied these principles to the continued existence, proposed size, and scope of the TF. The USFP correctly observed at page 27, line 19, through page 29, line 1, that cost efficiencies would be imputed

to ILECs in the rate setting process used to determine TF need. On page 19 of my Exhibit, I included the last page of the March 2008 Framework Order (in Case 07-C-0349, cited above) which shows adjusted returns on equity after Staff used its model to adjust reported earnings levels by the ILECs. In this case, as confirmed by Staff's response to Information Request CTANY-DPS Staff-8, included as pages 2 and 3 of my Exhibit ____, Staff indicated "No reductions to the expenses reported by the companies in their 2009 Annual Reports were assumed." That approach fails to impose the efficiency disciplines required in prior Framework Orders (as identified throughout this testimony).

IN RECOMMENDING A FUNDING LEVEL, STAFF SHOULD HAVE RE-EXAMINED THE CURRENT BENCHMARK RATE $23 AND STAFF WAS INCONSISTENT IN ITS VIEWS REGARDING THE APPROPRIATENESS OF THE $23.

Q. Please discuss Staff's use of the $23 benchmark line rate and Staff's inconsistent support for that rate.

A. Staff fails to provide a rationale for keeping the benchmark rate at only $23, especially in the context of a company seeking a subsidy from other companies and their customers. One can only assume that both Staff (and more so NYSTA at a newly proposed benchmark of only $15.22) fear that increasing the line price might cause more customers to abandon landline service from incumbent providers, and therefore want to keep the price artificially low price. This was not a policy goal in any Commission Order, and in fact, clearly undermines competition. The Commission has long observed that the $23 benchmark rate was low even when it was

originally set. For example, in Case 05-C-0616, Proceeding on Motion of the Commission to Examine Issues Related to the Transition to Intermodal Competition in the Provision of Telecommunications Services, Statement Of Policy On Further Steps Toward Competition In The Intermodal Telecommunications Market And Order Allowing Rate Filings (Issued and Effective April 11, 2006) (the "April 2006 Policy Order") at pages 58 and 59, the Commission stated, "As we described in Case 05-C-1303, forward-looking costs for a basic offering, including forward-looking retailing costs, range from $22 downstate to $26 upstate. We recognize that these estimates of forward looking costs allow for more usage than the average message rate customer actually consumes. But we also acknowledge that our forward looking costs were determined based on the most efficient telecommunications technology currently available and the lowest cost network

configuration given the existing location of incumbent's wire centers. Because of ongoing technological improvement (among other things), such forward looking estimates fall well below the costs the incumbents had historically incurred in constructing their network. Thus, these costs do not always allow the incumbents to recover the costs of the actual network that is being used to serve basic customers. For these reasons, the use of forward looking costs to constrain prices is overly aggressive and rates above that level can still represent a fair balancing of customer and shareholder interests." There is simply no good explanation by proponents of the TF as to why they continue to advocate a rate as low as the $23 rate (or again, in NYSTA's case, an even lower rate). Also, the different Staff panels appear to have conflicting views regarding the $23 rate as well. The PP, for example, states at pages 19 and 20: "Q. Do you think customers in high cost

areas should pay more for basic residential service than other customers? A. Rural New York customers should not pay rates for local service that are substantially higher than those paid by customers in urban and suburban areas. Doing so violates the Commission's policy on universal service. Q. Can you define substantially higher? A. Not at this point. As discussed in the mechanism panel, customer rates will be based upon all the facts and circumstances in situations where a company seeks support in the form of universal service funds." The PP recognizes cost drivers for Rural ILECs that would (and should) push the rate above $23, but then declines judgment at this point, in favor of universal service over competition.

Q. In your view, did Staff come to an appropriate judgment in balancing universal service against competition?

A. In my opinion, these two issues do not belong on opposite sides of a scale. Competition is not a goal, but a means to several public policy goals: innovation, efficiency, pricing, customer service, and even universal service. Competition has made enormous strides in meeting all of these goals. This is especially true regarding universal service, as evidenced by the Staff's December 22, 2009 White Paper and the additional Staff testimony regarding competitive entry included in its WSP.

Q. Could you please elaborate on Staff's conflicting positions regarding the $23 benchmark rate?

A. The SP states at page 13: "Q. What is considered by the Commission to be an affordable rate for basic residential service? A. The Commission has established a benchmark rate of $23 per month as a cap applicable to all local exchange telephone companies under its

jurisdiction. Therefore, the Commission at this time identifies $23 per month as an affordable rate for basic local service for New York's residential customers. Other services subscribed to by individual customers such as toll and optional features are non-basic and therefore not subject to an affordability requirement." These excerpts from Staff's testimony show that a portion of Staff agrees that the $23 rate is a 'low ball' or below cost rate for rural ILECs. However, the remaining testimony shows no basis for steadfastly retaining that rate, especially in view of the Commission and Staff's support for competition.

STAFF'S $5.6 MILLION ROUGH ESTIMATE OF TF NEED OVERSTATES ANY REASONABLE MEASURE OF TF NEED.

Q. How did Staff determine its $5.6 million estimate?

A. Staff reviewed the 2009 ILEC Annual Reports to the Commission and used the companies' reported

return on equity as the basis for determining the ILECs' revenue deficiency. The reported return on equity does not include any ratemaking adjustments. Staff then computed how much additional revenue would be necessary to bring the ILECs' return on equity up to the level which would be allowed in a full rate case. The only adjustment made by Staff was a deduction of revenues that some ILECs would need in order to achieve the $23 benchmark rate. In other words, Staff assumed the Commission would require the ILECs to charge at least the benchmark rate, consistent with recent Commission rulings. The additional revenue that would be generated by charging this rate was then deducted from the revenue deficiency.

Q. What is wrong with this approach?

A. Staff has never relied directly upon unadjusted ILEC reported costs in the rate setting process, and in particular when determining if an ILEC

has been entitled to TF monies. That is a fundamental reason why Staff developed a cost per access line (CPAL) model which is referred to in Commission Orders and in the USFP testimony at pages 27-28.

Q. Can you provide examples of how a failure to follow prior Commission practices results in an overstated need for a TF?

A. Yes, but rather than going down the whole list of 17 companies that Staff included in the $5.6 million annual TF estimate, it is more instructive and realistic to focus primarily on the first few of the 10 out of the 17 on Staff's list of potential recipients that were identified as "Not Competitive" on Appendix D of the March 2008 Framework Order (in Case 07-C-0349, cited above). In other words, 7 out of Staff's 17 companies have been determined to be "Competitive". While the amounts estimated for all of the ILECs suffer from the failure to be

adjusted through the use of Staff's CPAL model, it would be more practical to view only those companies that contain customers with no competitive alternatives. While Staff's data can be interpreted in different ways, there are only 10 companies from Staff's list of 17 potential recipients that were labeled as "Not Competitive" on Appendix D of the March 2008 Framework Order (in Case 07-C-0349, cited above) as shown at page 19 of my Exhibit ___. As can be seen on page 21 of my Exhibit, the total estimates for those 10 companies is $4.4 million.

Q. Could you please discuss how you believe some of the estimates for the 10 companies are overstated?

A. First, I will discuss Armstrong Telephone Corporation ("Armstrong"), which received the second largest allocation of TF monies under the USFP testimony. Armstrong is allotted $731,271

under the Staff calculation, based only on a reported return on equity of minus 23.96% shown on page 15 of its annual report. That same annual report, which can be viewed at: http://documents.dps.state.ny.us/public/Common/ViewDoc.aspx?DocRefId={788C20CE-56CA-477D-AB97-0AD14DADB151} contains glaring omissions and questionable cost allocations that are highly unusual compared to any other ILEC. For example, there are no reported officer salaries or compensation. Many of the schedules are not filled out or contain zeros. A review of the schedules from the Commissions' website, which I have included at pages 10 through 13 of my Exhibit _____, show Armstrong's cost per access line data. As reported, the categories seem highly irregular and expenses are likely misclassified, most notably, "Other Operations Expense" of $941 per access line, which is about three times the New York State average for that category; that one expense category exceeds the

entire cost per access line average of $882 for the holding company rural ILECs shown at page 17 of my pre-filed direct testimony in this case (filed on December 31, 2010). The information in Armstrong's Annual Report, as stated, is not reliable for the purposes of making any revenue deficiency determination. It is also instructive that Armstrong is privately held, and the New York regulated telephone operation is a miniscule element in the Armstrong holding company family. Page 14 of my Exhibit ___ shows the Armstrong holding company description of itself from its website at: http://www.agoc.com/overview.htm and the 25 employees in the New York operations pale in comparison to the over 2000 employees in the Armstrong family system. The Armstrong holding company group is involved in telephone operations in four states, Ponderosa restaurants in Pennsylvania and Ohio, is the 16th largest (Utility) multi-system operator in the nation

and through Guardian Protection Services is the nation's largest privately held security company. The relative size of the New York operations compared to the larger Armstrong holdings does not mean that New York regulators should be unconcerned about the company's incentive to provide adequate service. However, the other interests and priorities of Armstrong have arguably negatively impacted the quality of the information the holding company is willing to provide in the public annual report to the Commission for its regulated operations. Perhaps because of its complex corporate structure, transparency should be a very important element of TF eligibility for this company and, currently, that does not exist. I also note that Armstrong's residential monthly rate, according to Staff's responses, is $15.99, not $23 (see, DPS Staff-VZ-1 and its SUSF Quantification worksheets). Perhaps a company as sophisticated as Armstrong has made a

business decision not to ask for higher rates. And as discussed earlier in my testimony, privately held companies may make a rational choice to minimize income taxes to pay salaries directly to the owners, instead of paying taxes at the corporate level and then distributing earnings through taxable dividends. Such a choice is well within their discretion as privately held companies, but that business strategy can be easily misinterpreted in traditional utility ratemaking, where the focus is revenue deficiencies based upon a regulated rate of return. Also, Armstrong's cost per access line of $1,613 is so high that it suggests that the company is either grossly inefficient or there is an improper allocation of costs among its related, regulated and unregulated, entities. In the final analysis, based upon the information available publicly, if looked at in its entirety, Armstrong should be eliminated entirely from Staff's rough

quantification. The $731,271 estimate included in the Staff analysis is simply not credible.

Q Can you provide another example of problems with Staff's TF estimate?

A. Yes. The next company on Staff's list is Champlain Telephone Corporation ("Champlain"). Champlain reported a negative return on equity, and Staff used that number to compute $151,557 of funding need. However, as seen on page 12 of my Exhibit, Champlain's Annual Report to the Commission shows that its top officer had a total individual compensation of $631,230. That level of salary would seem to warrant an adjustment, which Staff did not make, before determining that the company qualifies for a subsidy from the shareholders and customers of other companies. The best evidence available which strongly suggests that Staff would not support a subsidy for Champlain is Staff's own analysis in the March 2008 Framework Order (in

Case 07-C-0349, cited above), at Appendix D, attached as page 19 of my Exhibit ___. There, using its CPAL model, which reduces costs that are disproportionately high, Staff adjusted Champlain's 2006 earned return up to a **positive** 43.44%. It is very reasonable to assume that Champlain will not qualify for TF monies and should therefore be removed from Staff's list.

Q. Do you have another example of a company that was assumed in Staff's analysis to qualify for TF monies?

A. Yes. Next on Staff's list was Chazy and Westport Telephone Corporation ("Chazy"), receiving a seemingly relatively inconsequential $21,080 of TF monies. Two observations should disqualify Chazy from receiving any TF monies. First, the company was deemed "Competitive" in the Commission's March 2008 Framework Order (in Case 07-C-0349, cited above). Second, its top officer's individual compensation totaled

$243,698. A thriving company which is profitable and competing successfully in the marketplace might choose to pay its top officer that level of compensation, but a company that is potentially one of the “losers” (See PP testimony, Page 9, line 21), and facing a “death spiral” should not have its revenues, and, therefore, salaries, subsidized by other companies’ shareholders and customers.

Q. Would you please discuss a few more companies on the list of 10 companies?

A. The next company on the list is Crown Point, and I have already discussed the need for a separate review of its financial situation. After Crown Point, Empire Telephone Corporation (“Empire”) is the next company on the list with a material TF estimated need of $434,251. Interestingly, Empire has not been a high cost provider and according to the Commission’s statistics on its website, Empire’s 2009 Cost Per Access Line was

$829, which was below average. However, according to Staff's calculations provided in response to DPS Staff-VZ-1 and its SUSF Quantification worksheets)(See page 6 of my Exhibit ___), the rate of return deficiency relied on by Staff's use of Annual Report figures would raise Empire's cost of service by $1,091,830. Of that amount, $657,579 would come from Empire raising its rates to the benchmark level, and the remaining $434,251 would come from TF subsidies. Since Empire charged a basic rate of $12.26 in 2009, movement to $23 will require a rate increase of $10.74 or 87%. However, Empire's officers are well compensated, with key officers receiving compensation packages of $249,019, $175,793, $139,864, and $156,278. (See pages 4 and 5 of Empire's 2009 Annual Report at: http://documents.dps.state.ny.us/public/Common/ViewDoc.aspx?DocRefId={8938B346-9C3F-487A-AB20-82D702004A8E})

It seems highly unlikely that the company would choose to raise its rates by 87%. But assuming it attempted to do so, it is unlikely that a $434,251 subsidy could also be justified in view of the officers' salaries. These salaries may be a reasonable tax minimizing business strategy for Empire, but they cannot be properly used to justify a revenue deficiency as was done in Staff's rough estimate. Again, Staff's model ignores the logical restraint that some companies have shown, trading off traditional notions of return on equity for satisfactory compensation. Like the other companies I have discussed, it is highly unlikely that Empire would qualify for TF monies.

Q. Please discuss the next TF recipient on Staff's list of "Not Competitive" ILECs.

A. The next company is Germantown Telephone Corporation ("Germantown") and, based upon the company's 2009 reported return on equity,

Staff's estimate provides Germantown with a hypothetical $640,023. Germantown, however, filed for a rate increase in 2009, so we can get a reasonable idea of what Staff and the Commission would do with the company's claimed expense levels (see, Case 09-C-0532, Minor Rate Filing of Germantown Telephone Company Inc. to Increase its Annual Revenues by $300,000 in its PSC No. 9 Telephone Tariff, Order Authorizing Rate Increase (issued and effective February 12, 2010) ("Germantown Rate Order"). The Germantown Rate Order for can be seen at: http://documents.dps.state.ny.us/public/Common/ViewDoc.aspx?DocRefId={AADFC692-53CF-4322-A71B-BEC50502AF0B}. The Germantown Rate Order shows that Germantown's requested rate increase was adjusted downward by $407,064 due to various issues, including excessive officer salary, misallocation of expenses which are more properly allocated to competitive affiliates, and failure to follow its cost allocation

manual. It is reasonable to assume that if Germantown were to request another rate increase and TF monies, it would be denied a substantial portion of the request, and it might too decide to trade off officers' compensation for return on equity.

Q. Could you please discuss the largest assumed recipient of TF subsidies in Staff's calculation, Newport Telephone Corporation?

A. Under Staff's estimation method in this case, Newport Telephone Corporation ("Newport") is allocated the largest TF subsidy of $873,027 per year. Newport is one of the three companies that have been allotted TF subsidies under the temporary TF subsidy plan now in place. In Staff's White Paper it is noted that Newport has been given a total of $98,400 of TF subsidies. However, Newport's latest Rate Order in Case 06-C-1257, Joint Proposal of Public Service Commission Staff and Newport Telephone Co.,

Inc.'s Multi-Year Rate Plan, As Recommended And So Ordered (issued November 13, 2009) (the "November 2009 ARSO") holds at page 2 that, "Newport should be authorized to withdraw an additional $36,348 from the TF, up to $103,055 annually ($8,588 per month) starting December 1, 2009. The November 2009 ARSO can be referenced at: http://documents.dps.state.ny.us/public/Common/ViewDoc.aspx?DocRefId={1019E4BD-09C1-4F63-8340-BDBF0657AF97}.

From the information in the November 2009 ARSO, it is possible that under Staff's current ratemaking paradigm, without increasing the requirement to become more efficient, Newport may receive TF monies. However, rather than providing subsidies which have failed to encourage Newport (and ILECs like it) to become more efficient, the Commission should increase pressure on ILECs to rationalize their business

models, end the dependence upon artificial support mechanisms, and improve their long-term stability. But even without increasing that pressure, in view of the recent finding allowing an annual drawdown of $103,055 annually, the Staff's rough estimate of $873,027 annually is greatly overstated. In other words, Staff failed to recognize adjustments that the Commission has already ordered for Newport.

Q. What have you concluded from your review of the rough estimate that Staff made for the TF?

A. The review shows that the rough estimating procedure used by Staff, which was based only on unadjusted reported 2009 earnings from ILEC Annual Reports, overstates the size of any needed state TF. Neither the adjustments that Staff has made in actual rate cases, nor the adjustments that it has made previously in Framework Orders using its CPAL model were used when developing the $5.6 million estimate.

Therefore, the estimate greatly exceeds any funding that Staff would actually recommend if TF requests were made by an ILEC. It further fails to recognize that many companies included as potential recipients may show logical restraint from raising rates and may refrain from applying for funds in order to continue to maintain high officer salaries or to avoid regulatory scrutiny.

Q. What are your recommendations based on your findings?

A. Putting the policy objections to the TF aside for the moment, the review showed that even if one believes a TF is necessary and appropriate, the need is very small and overfunding a TF reserve, especially in advance of a proven need, is inappropriate. The overfunding would not only remove any sense of urgency that the potential recipients ILECs have to rationalize their business models, but it would create a

disincentive for the ILECs to do so. As shown in my initial testimony, the higher cost companies are almost exclusively those companies that have not merged or partnered. If Staff applies a proper CPAL model to rate-case quality data, ILECs will then have all the incentive that they need to rationalize their business models.

Q. Can you identify additional issues regarding funding levels?

A. Again, ignoring for a moment the serious policy issues involving the creation of a fund, there are at least two additional issues: (1) under Staff's approach, once a company qualifies for TF monies, it receives a subsidy which artificially lowers customer rates to the $23 benchmark. Therefore, an ILEC with a few customers without competitive alternatives receives the same support as an ILEC with a similar financial profile which has hundreds of customers without competitive alternatives.

That observation is spelled out more clearly if one were to review page 16 of Staff's UNREDACTED 2009 White Paper. (2) Now that Staff has furnished its quantification of the $5.6 million annual TF estimate, it is clear that Staff seems to envision restoring or maintaining a rate of return similar to what might be awarded in a case where no subsidy is under consideration. There is no rationale provided as to why an ILEC deserves to have a "normal utility profit level" of about 10%, paid for by the shareholders and customers of other companies, especially considering that the other companies have adapted, or are adapting to the competitive environment with innovation and cost cutting measures without rate of return guarantees.

Q. Could you please discuss recommendations for preconditions on an ILEC receiving TF monies?

A. The recipient ILEC should actually reduce its expense levels to those included in rates by the

Commission. For example, let us assume the Commission found that salary levels for officers were excessive. It serves no interest to then adopt a “hands off” approach to the company’s expense levels once rates are set. Without restrictive pre-conditions, the ILEC’s financial condition will remain at risk, and given the observation of what has occurred so far, ILECs will continue prior officer salary levels and rely on continued TF subsidies. Stated returns will remain low and creditors will not view the ILEC’s financial condition as stabilized. Also important, appropriate incentives or TF requirements should be in place to ensure that the recipient seriously considers corporate mergers and other appropriate corporate restructurings. If any TF monies are provided to any ILEC, accountability is a serious matter and must be dealt with explicitly.

Q. Are there other pre-conditions that the Commission should consider if it provides TF monies to an ILEC?

A. Yes. In CTANY's information request at CTANY-DPS Staff-12, included in my Exhibit _____ at page 4, Staff was asked if it considered the transfer of funds from one company to another a loan. Staff responded that the IRS has ruled that these are taxable revenues, not proceeds from loans. I do not view that portion of the answer dispositive of the issue. Instead, the issue is fair accountability and how to discipline the recipient ILECs to fulfill the Commission's public interest goals. The IRS would arguably not restrict the Commission from requiring ILECs to pay back the contributors to the fund, especially upon sale of their business or nonconformance with the conditions that should be required to obtain monies. Additionally, in response to CTANY-DPS Staff-12, Staff contended that PSL Section 101 "prohibits

the issuance of loans for operating expenses." I do not believe that answer adequately considered the Commission's options in this area. First, a precondition could certainly be explored that involves surrendering the nonqualified portion of officers' pension plans, the transfer of portions of stock ownership from these closely held ILECs, or directing the TF monies directly to construction expenditures, which are explicitly within the scope of PSL 101. Again, accountability moving forward is critical and the almost "no strings attached" nature of Staff's existing proposal is a serious shortcoming and of concern.

Q. Does this conclude your testimony?

A. Yes.

ALJ JACK: I understand that there is no cross-examination for Mr. Ansaldo, is that correct? Mr. Ansaldo, you are excused. Thank you.

And now we're ready for the staff witnesses. Ms. McCauley, who would be your first panel?

MS. MCCAULEY: Your Honor, what I propose to do is the New York State Department of Public Service has four panels as witnesses. And what I propose to do is to call them one at a time. Starting with the order of the panels will be "White Spot, Substitutability, Mechanism and Policy."

ALJ JACK: In that order.

MS. MCCAULEY: In that order, Your Honor, yes.

ALJ JACK: Can we bring the "White Spot" panel up?

(Discussion was held off the record.)

J O S E P H P. Y A K E L,

R I C H A R D E. S C H U L E R, JR.

having been first duly sworn by the ALJ, was examined and testified as follows:

ALJ JACK: Thank you.

DIRECT-EXAMINATION

BY MS. MCCAULEY:

Q Good afternoon, panel.

A Good afternoon.

Q Are you appearing on behalf of a party to this proceeding?

A (Joseph Yakel) Yes.

Q Is that party the New York State Department of Public Service?

A (Panel) Yes.

Q Did you file testimony in this proceeding?

A (Joseph Yakel) Yes.

Q Did you file both direct and rebuttal testimony?

A (Joseph Yakel) Yes.

Q Do you have that testimony before you?

A (Joseph Yakel) Yes.

Q Was this testimony prepared by you or under your direction and supervision?

A (Panel) Yes.

Q If I asked the same questions contained in that testimony today, would your answers be the same?

A (Joseph Yakel) Yes.

(Richard Schuler) With one correction.

(Joseph Yakel) Yes, just one minor correction. On my direct testimony for the white spots, on page 2, line 17 and 18, the dates of my appointment with AR Cable

Services and Cable Vision Systems was from 1988 to 1993. That's the only minor change to the testimony.

Q Thank you, Mr. Yakel.

With that correction, do you adopt this testimony as your sworn testimony?

A (Panel) Yes.

MS. MCCAULEY: Your Honor, I request that the documents entitled "Direct and Rebuttal Testimony of the White Spot Panel" be copied into the record as if given orally.

ALJ JACK: Motion is granted.

(Testimony inserted as ordered.)

BEFORE THE
STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

In the Matter of

Proceeding to Examine Issues Related to a
Universal Service Fund

Case 09-M-0527

December 2010

Direct Testimony of:

White Spots Panel

Richard E. Schuler, Jr.
Joseph P. Yakel

State of New York
Department of Public Service
Three Empire State Plaza
Albany, New York 12223-1350

Q. Mr. Schuler, please state your name and business address.
A. Richard E. Schuler, Jr. My business address is Three Empire State Plaza, Albany, New York, 12223.
Q. By whom are you employed and in what capacity?
A. I am employed by the New York State Department of Public Service. I am Chief, Utility Programs of the Regulatory Research Section of the Office of Regulatory Economics.
Q. Please briefly state your educational background and professional experience.
A. I received a Bachelor of Arts Degree in Economics from Cornell University in 1985, a Certificate in Regulatory Economics from the State University of New York at Albany in 1989, a Master of Arts in Economics from the State University of New York at Albany in 1991, and a Ph. D. in Managerial Economics from the Rensselaer Polytechnic Institute in 1998. From 1985 to the present I have been employed by the Department of Public Service. My work at the Department has mainly focused on telecommunications regulation issues. I have

previously testified before the New York State Public Service Commission.

Q. Mr. Yakel, please state your name and business address.

A. Joseph P. Yakel. My business address is Three Empire State Plaza, Albany, New York, 12223.

Q. By whom are you employed and in what capacity?

A. I am employed by the New York State Department of Public Service as a Utility Analyst 3 in the Office of Telecommunications, Network Reliability Section.

Q. Please state your educational background and professional experience.

A. I received an Associate of Applied Science in Electronic Technology from Big Bend Community College in 1997, and a Bachelor of Science Degree from Regents College in 2002. From 1993 to 1998, I was employed by A-R Cable Services and Cablevision Systems Corporation, with cable television work-related experience in installation, service, headend operations, outside plant maintenance, construction and design. In October 1993, I joined the New York State Commission on Cable Television (CCTV) as a

Telecommunications Field Investigator. In 1996, CCTV was merged with the Department of Public Service (DPS). Between 1993 and 2000, I have performed numerous technical and public safety inspections of telecommunications systems across New York State, for both the Department of Public Service (DPS), and the New York State Commission on Cable Television (CCTV). My Department of Public Service Investigator Badge number is 514. Since 1996, I have worked in the Office of Telecommunications in the Service Quality, Carrier Performance and Network Reliability Sections. From 1983 through 2005, I served in the United States Army, with various electronics and communications occupational specialties, retiring in 2005 as a Chief Warrant Officer 3, Electronics Systems Maintenance Officer. I have participated in various Department proceedings. I have not previously testified before the New York State Public Service Commission.

Q. What is the purpose of your testimony?

A. We will summarize the Staff Coverage Report that was distributed to the parties in this case on

December 22, 2009. We will also discuss the extent to which updated input information impacts upon the results of the Coverage Report. Finally, we will describe the results of a field inspection relevant to information presented in the coverage report.

Q. Is the White Spots Panel sponsoring any exhibits?

A. Yes. Exhibit___WSP_1, Exhibit___WSP_2, Exhibit___WSP_5, Exhibit___WSP_6A, Exhibit___WSP_6B, Exhibit___WSP_7, Exhibit___WSP_8A, Exhibit___WSP_8B, Exhibit___WSP_9A, Exhibit___WSP_9B, Exhibit___WSP_10A, Exhibit___WSP_10B, Exhibit___WSP_11A, Exhibit___WSP_11B, Exhibit___WSP_12, Exhibit___WSP_13A, Exhibit___WSP_13B, Exhibit___WSP_14A, Exhibit___WSP_14B and Exhibit___WSP_15.

Staff December 2009 Coverage Report

Q. Are you adopting the Staff Coverage Report as part of your testimony?

A. Yes. The public version of the Coverage Report is included as Exhibit___WSP_1.

Q. Did the Coverage Report reference areas without competitive phone service alternative(s) by a specific name?

A. Yes. The report referenced non-competitive phone service areas as "white spot" areas. In white spot areas, the only phone service available to customers was provided by the incumbent local exchange carrier.

Q. Please describe the analyses performed in the Staff Coverage Report.

A. The report identified areas of the state lacking cable facilities and wireless service. The report then counted the number of customers located in those areas without cable phone or wireless phone availability. In addition, the report identified and counted New York State residences in the service areas of the incumbent local exchange carriers (ILECs) receiving Transition Fund payments for which wireless or cable modem service is unavailable.

Q. What methodologies did the Coverage Report rely upon to identify areas of the state lacking cable facilities and wireless service?

A. The Report utilized three methodologies: a

Geographic Information Service (GIS) mapping based method; a method which relied upon coverage percentages reported by the ILECs in Case 07-C-0349 and; a method based upon the review of cable company franchise and related information.

GIS Mapping Method

Q. Please describe the white spots estimation method in the report which relied upon a GIS mapping analysis.

A. The Department's GIS unit used ArcView mapping software in conjunction with a variety of detailed datasets. By combining dataset overlays with other reference information, such as ILEC service territory boundaries and customer locations, competitive phone service coverage maps were produced. Further analysis of the individual coverage maps allowed Staff to count the number of customer locations in each ILEC service territory that were also within wireless and cable coverage areas. For the wireless analysis, Staff used wireless coverage data from American Roamer Inc. (www.americanroamer.com). The American Roamer

maps rely upon generally accepted methodologies to identify wireless service areas and those areas without coverage. Residential and commercial customer location points were obtained from the New York State Office of Real Property Services (ORPS). After overlaying the cable and wireless coverage maps on the incumbent telephone service territory boundaries and business and residential household locations within those boundaries, the DPS GIS unit was able to count the number of customer locations within each ILEC service territory. Counts of the customer locations within wireless and cable coverage areas could also be made.

ILEC Percentage Method

Q. Please describe the white spots estimation method in the report which relied upon coverage percentages reported by the ILECs.

A. Staff used percentages filed by the ILECs in the "Small Telco Framework Proceeding", (Case 07-C-0349). As part of that proceeding, letters were sent to the small incumbent telephone companies requesting the percentage of residences in the ILEC's telephone service territory that have

competitive cable telephone service available to them (not including satellite telephone service)and the percentage of customers in the ILEC's telephone service territory that have non-affiliate wireless telephone service available to them. The analysis relied upon end-of-year-2003 access line counts as a proxy for the number of residences in each ILEC service territory. Staff estimated a lower and an upper bound for the percentage of customers without cable and/or wireless alternatives based upon the minimum and maximum possible overlapping of these two alternatives.

Cable Franchise Information Method

Q. Please describe the white spots estimation method in the report which utilized cable company franchise and related information.

A. Cable service coverage and mapping was developed from cable franchising information and US Census data, and supplemented with other GIS datasets. To estimate the total number of residents and households in New York State that do not have cable or cable modem service available, Staff used a multi-step process. Staff used

information from Certificates of Confirmation (COC) and Annual Financial Reports (AFR) to construct an aggregate map of the state's cable franchise areas. The map also distinguished those municipalities that lacked cable networks or cable modem services. The map overlay was used in conjunction with US Census data and AFR information to estimate the number of residents and occupied households in those areas without cable or cable modem services available.

Q. Please describe the general demographics of New York State when the 2009 Staff Coverage Report was prepared.

A. New York State is comprised of 62 counties. Within the 62 counties are 1,544 incorporated municipalities (cities, towns and villages).

Q. Were you able to identify whether or not a cable network was at least partially built and operated in each of the individual municipalities within each of the 62 counties?

A. Yes.

Q. How many of the state's 62 counties had a cable network providing service to at least portions of every one of their respective incorporated

municipalities?

A. Twenty-five counties.

Q. How many counties in the state did not have a cable network providing service to at least some portion of every one of their incorporated municipalities?

A. Thirty-seven counties. A list of counties and municipalities without cable networks is included in Exhibit___WSP_1, pages 19-21.

Q. Please identify the general areas of the state and the number of municipalities without cable networks.

A. The Coverage Report indicated that the areas of the state without cable networks were scattered among 94 upstate rural communities, ranging from the Southern Tier, to Central New York, to parts of the Capital Region, the Hudson Valley and into the Adirondack Region.

Q. Please identify the general areas of the state and the number of municipalities with cable networks, but which were without cable phone capabilities, when the Coverage Report was prepared.

A. Areas of the state with cable networks, but

whose networks were without cable phone capability numbered 26 and were located primarily in the Adirondack and the Capital regions.

Coverage Report Summary

Q. The Coverage Report's various analyses indicated different aggregate results as to the extent of non-cable or non-wireless availability. How should the results of the various individual analyses be viewed?

A. The individual analyses represent different snapshots of competitive phone services availability and non-availability, using different methodologies and alternative data sets. For example, the "Number without Cable" analyses on Page 3 of the Coverage Report ranged from approximately 42,000 to 182,000, depending on the particular methodology and data review. The individual analyses results varied, but collectively, they all positively indicated that cable white spots numbered in the tens of thousands, at least. The Coverage Report's findings are best viewed in this generalized way. In addition, much of the data used in the

analysis was initially generated by parties to this proceeding. As indicated in the Coverage Report, Staff remains willing to discuss updating these analyses if better information becomes available.

Q. What did the Coverage Report indicate regarding the substitutability of cable phone and wireless phone for the incumbent's basic local exchange service offering?

A. The Coverage Report did not address phone substitutability. The Staff Substitutability Panel will address how cable and/or wireless based phone services can be deemed by the Commission as substitutable for incumbent phone service. We have analyzed the availability of both of these phone service alternatives because some parties in this proceeding may contend that one or both of these phone alternatives are substitutable for incumbent phone service. Notwithstanding the substitutability determination, dramatic customer gains of cable and wireless phone providers over the past several years indicates that both alternatives are strong competitors for at least a subset of

incumbent phone customers. Thus, it is important that data regarding the availability of both of these alternatives be presented in this proceeding for the purposes of understanding the market context in which we are considering new universal funding policies and requirements.

Additional Granular Report Details

Q. Please provide more granular details of the Coverage Report's findings.

A. The Coverage Report indicated that intermodal phone competition and availability was most robust in urban areas, and to a lesser extent in suburban and rural areas of the state. However, despite overlapping availability of intermodal phone service providers in some areas, the report showed that there were many areas of the state without wired or wireless competitive phone alternatives available. These non-competitive phone service areas included several sub-groups: 1) Incorporated municipalities without any cable network; 2) Incorporated municipalities with a cable network serving some, but not all residents, and the

cable network supported cable modem or cable phone services; 3) Incorporated municipalities with a cable network serving some, but not all residents, but the cable network did not support cable modem or cable phone services; 4) communities with limited or no wireless phone coverage; 5) communities with some combination of sub-groups 1, 2, 3 and/or 4. The report concluded, via the varying analyses that were conducted, that, although there is significant phone competition in New York State, and portions of the state have overlapping intermodal competitive phone services available, there were, and still are, tens of thousands of New Yorkers, spread across many regions of the state, without access to competitive phone services. These white spot areas and customers do not have intermodal phone service alternatives.

Q. Can you provide two specific examples of regions without cable networks, denoted as sub-group 1?

A. Yes. One example is in the Southern Tier: Allegany County has 39 incorporated municipalities, and of those, nine

municipalities did not have a cable network. Another example is in the Adirondack Region: Hamilton County has 11 incorporated municipalities, and of those, four did not have a cable network. Maps of these sub-group 1 examples are contained in Exhibit___WSP_6A and Exhibit___WSP_6B.

Q. Please provide two specific examples of municipalities with cable networks that supported cable modem or cable phone services, and served some, but not all, of the municipality, denoted in sub-group 2.

A. The Town of Crown Point, in Essex County is an example. Another example is the Town of Trenton in Oneida County. A portion of each municipality was served by a cable network. At the time of the Coverage Report, and today as well, both of these towns were served by separate incumbent local exchange carriers that received Transition Funds, and which qualify to receive Temporary Transition Fund Extension (TTFE) funding through September 2011. A map depicting cable network coverage in the Town of Crown Point is shown as Exhibit___WSP_5.

Q. Please provide two specific examples of municipalities with cable networks that served some, but not all, of its municipal residents, but the cable networks did not support cable phone service, denoted as sub-group 3.

A. The Town of Ancram, in Columbia County is an example. The Town of Petersburgh, in Rensselaer County is another example. A portion of each municipality was served by a cable network that did not provide cable phone service. Cable phone was not an available competitive phone option for those municipal residents with cable service available. Maps depicting these two non-cable modem service areas are shown in Exhibit___WSP_7A.

Q. Please provide two specific examples of areas without wireless coverage, denoted as sub-group 4.

A. One example is Franklin County. Approximately 35% of the entire county's geographic region had no wireless service available. The towns of Duane and Waverly within the county, had no wireless service available to approximately 80% of their respective municipalities. Another

example is Delaware County. Approximately 40% of the entire county's region had no wireless service available. The Town of Andes within the county had no wireless service available to approximately 70% of the municipality. The approximate size of the areas without wireless service was based on visual review of American Roamer wireless maps. Maps depicting wireless availability/non-availability in these areas in October 2009 and updated as of October 2010 are shown in Exhibit___WSP_8A, Exhibit___WSP_8B, Exhibit___WSP_9A, and Exhibit___WSP_9B.

Q. Please provide two specific examples of areas without cable and wireless coverage, denoted as sub-group 5.

A. The Town of Hardenburgh in Ulster County is an example. The Town of Redfield in Oswego County is another example. In both examples, the towns have no cable network and a large portion of the town's geographies have no wireless service. Maps depicting these cable and wireless network non-availability areas in October 2009 and updated as of October 2010 and are shown in Exhibit___WSP_10A, Exhibit___WSP_10B,

Exhibit___WSP_11A, and Exhibit___WSP_11B.

Updates Since the 2009 Coverage Report was Issued

Q. Have there been any changes in New York's telecommunications landscape, with respect to white spots, cable, or wireless service since the Coverage Report was issued?

A. Yes.

Q. Please explain.

A. Since the 2009 Coverage Report was issued, additional competitive cable franchises were approved. Two cable franchise transfers are pending for Time Warner Cable. Two new companies, New Visions Powerlines Communications, Inc. and Slic Network Solutions, Inc., are pending entrance into the competitive cable market with two and one cable franchises pending, respectively. Updated American Roamer Wireless map data, vintage October 2010, was acquired by the Department's GIS Section, and compared with the American Roamer maps used in the Coverage Report. Overall, wireless service coverage in the state has increased by 4.7%, from 85.2% to 89.9% since the Coverage report was issued. The coverage additions are

primarily in some previously unserved areas of the Adirondacks, Catskills and the Interstate 88 corridor. Sizeable areas of the Adirondack region and other smaller areas in the state, approximating 10% of the state's geography, remain without wireless service. There are 92 incorporated municipalities statewide without cable networks, down slightly from the 94 identified in the Coverage Report. There are 26 cabled communities without cable broadband service, the same number as in the Coverage Report. Maps comparing wireless service on a statewide basis in October 2009 and October 2010 are included as Exhibit___WSP_13A and Exhibit___WSP_13B. An updated list of the municipalities without cable franchises or cable modem service is included as Exhibit___WSP_12. Statewide maps showing cable franchise areas, broadband availability and non-cable service areas as of October 2009 and October 2010 are depicted in Exhibit___WSP_14A and Exhibit___WSP_14B.

Q. Has any other additional GIS mapping data become available since the 2009 coverage report was

issued?

A. Yes. AT&T has recently provided Staff with GIS mapping files of its network coverage in response to IR DPS-ATTwireless-4. A comparison of the AT&T maps with the American Roamer October 2010 update indicated that the two map sets were very similar in aggregate service coverage of the state. The AT&T maps indicated coverage of 248 square miles less than was indicated by the 2010 American Roamer maps (approximately 0.6%).

Q. Has updated coverage percentage information been provided by the ILECs since the 2009 coverage report was issued?

A. Yes. Updated coverage information related to competitive cable and wireless phone coverage was provided in response to Staff's first and fourth sets of information requests. However, this recently provided data is still being analyzed by Staff as it may be incomplete and/or inconsistent with the data that was utilized in the 2009 Coverage report, or in Case 07-C-0349.

Q. Are you aware of any activities or proposals that could potentially alter New York's

telecommunications landscape in the future?

A. Yes. We are aware of several federal stimulus grants that have been awarded for proposed broadband network construction in parts of the state. These proposals appear to have project completion dates over the next 2-5 years. If these broadband networks are completed, additional competitive phone services will be available. Cable white spots may or may not decrease in size, depending upon where the new networks are constructed. These activities and projects are summarized in Exhibit___WSP_2.

Field Inspections

Q. Mr. Yakel, did you perform any field investigations to determine the extent of cable or wireless services availability, as analyzed in the Coverage Report?

A. Yes. I performed a field investigation of the Town of Crown Point, Essex County on April 8, 2010.

Q. Please explain why this town was selected for your field investigation.

A. The Town of Crown Point was selected since Crown Point Telephone Company has been a past recipient of Transition Funds.

Q. Mr. Yakel, please describe your field investigation in the Town of Crown Point.

A. I used a large scale map that depicted all roadways in the municipality, and identified the wire center boundaries of the incumbent local exchange carrier, Crown Point Telephone Company. The map was used to trace the routes along which I visually inspected outside plant facilities to determine where the cable television network was constructed, and where there were no cable network facilities. Odometer readings were noted as I traced the roadway and reviewed the outside plant facilities. I also had two active cell phones (the first from Verizon Wireless and the second from AT&T Wireless) which were used to spot-check wireless service availability. I noted device signal strengths as the field inspection proceeded and marked the wireless spot-check locations on the map.

Q. Please describe your observations of the cable network in the town.

A. The cable television network architecture in Crown Point is a hybrid fiber-coax (HFC) design, similar to that deployed in many other franchise areas of the state. The coaxial cable portion of the network, used to distribute services to customers, was primarily constructed in the more densely populated, southeast portion of the town. I observed approximately 22 miles of cable network outside plant facilities in the town.

Q. Please describe your observations about wireless phone service availability in the Town of Crown Point.

A. There was no wireless service available in the western portion of the town along parts of Old Furnace Road and Hog Back Road; wireless service was non-available in central portions of the town, along parts of Army Hill Road, Breed Hill Road, White Church Road, and Creek Road; wireless service was generally available in the most densely populated southeast portion of the town where the cable network was constructed; wireless service was generally available up through the northeast portion of the town, along

Route 9N, Trimble Road and Lake Road. There was some wireless service available in the area of Hogan Hill Road, which was depicted as a non-wireless-service area in the American Roamer wireless coverage map used for the Coverage Report.

Q. Have you created a map of the Town of Crown Point, showing your observation of the cable outside plant facilities and wireless service spot-check locations?

A. Yes. This map is included as Exhibit___WSP_5.

Q. Please summarize the results of the Crown Point field investigation.

A. In general, competitive phone networks and service were available to some portions of the town's residents. In some areas, wireless phone service and cable phone service availability overlapped with the incumbent phone network. In other areas, only one or the other of the phone competitors had some service availability to potential customers. In some areas, there was no competitive phone service available at all.

Q. Please compare your field investigation results with the cable municipality analysis in the

Coverage Report.

A. The Coverage Report's analysis of cable network availability in Crown Point relied on cable company-provided data contained in its 2008 AFR, which identified the number of cable subscribers in the town, the estimated percentage of network penetration, and the miles of outside plant facilities constructed. The cable company's subscriber count in the town is shown on page 23 of Exhibit___WSP_1. My observations of the cable network outside plant facilities mileage, and subsequent comparison of the cable network overlay with Office of Real Property (ORPS) location points in the town is generally consistent with the cable company-provided AFR data. I estimated that the cable network outside plant facilities were likely constructed along 1/2 or less of the entire town's roadways. Wireless service coverage was generally the same as depicted by the American Roamer wireless map used in the Coverage Report. In areas where the America Roamer map indicated no wireless service, I observed no signal strength indications on the test cell phones. In other

areas where the American Roamer map depicted wireless service coverage, signal strength on the test cell phones varied from one-to-several bars, providing a general indication that some level of wireless service was available in those locations.

Q. Did you review any other information related to the cable network in the Town of Crown Point which supports or challenges your field inspection observations or conclusions?

A. Yes. Crown Point Telephone Company provided an analysis of cable network in the Town of Crown Point. The company analysis was conducted on October 2010, and identified as NYSTA Exhibit ST-I-01-09-01. It was provided as a confidential response to Staff information request DPS-Rural Coalition-1, which asked: "What percentage of residences in your telephone service territory currently have a competitive cable telephone service available to them? This response should not include satellite telephone service." This response is included as confidential Exhibit___WSP_15.

Q. Please summarize the Crown Point Telephone

Company analysis of the cable network in the Town of Crown Point.

A. The Crown Point Telephone Company analysis listed 24 specific roads within the town, and for each road, indicated the number of poles with cable network facilities attachments, and the potential number of customers that could be served from the cable facilities. A review of the company's analysis data indicates that the number of town customers that had competitive cable service available was approximately 45.65%. The company percentage of cable network availability is similar to the cable company AFR estimate. Both companies estimate that nearly half of the town's homes or customers do not have access to the cable network and therefore, do not have access to competitive cable phone service.

Q. Would you change any of the Coverage Report's findings about the availability and extent of cable phone services in Crown Point's service territory?

A. No. The field investigation, the cable company's 2008 and 2009 AFR data, and the phone

company cable network analysis confirm that a substantial geographic portion of the town has no cable outside plant infrastructure. Therefore, a considerable number of premises in the town do not have access to cable network services. The extent of cable phone service availability/non-availability in the town appears to be unchanged since the Coverage Report was prepared.

Q. Would you change any of the Coverage Report's findings about the availability and extent of wireless phone services in Crown Point's service territory?

A. I would update the Coverage Report's findings about wireless service availability to reflect that there are a few areas of the town which have wireless service today, which were not indicated in the American Roamer map that was current when the Coverage report was prepared. However, overall, the field investigation results support the Coverage Report's finding that there are considerable portions of the Town of Crown Point with limited or no access to wireless service. The October 2010 update to

the American Roamer wireless map indicates that wireless service is now available in the area of Hogan Hill Road. This additional wireless service area availability supports the observation I made during my field investigation of this particular road.

Q. Does this conclude your testimony at this time?

A. Yes.

BEFORE THE
STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

In the Matter of

Proceeding to Examine Issues Related to a
Universal Service Fund

Case 09-M-0527

January 2011

Rebuttal Testimony of:

White Spots Panel

Richard E. Schuler, Jr.
Joseph P. Yakel

State of New York
Department of Public Service
Three Empire State Plaza
Albany, New York 12223-1350

Q. Have the identified panel members testified before in this proceeding?
A. Yes.
Q. What is the purpose of your testimony?
A. We will respond to testimony presented by other parties in this case regarding Staff's analyses of geographic phone coverage by alternative service providers. More specifically, we will respond to testimony of the NYSTA Smaller ILECs, T-Mobile, The Consumer Protection Board, and Verizon New York.
Q. Is the White Spots Panel sponsoring any exhibits?
A. Yes. Exhibit___WSP_20, Exhibit___WSP_21A, Exhibit___WSP_21B, Exhibit___WSP_21C, Exhibit___WSP_22, Exhibit___WSP_23A, Exhibit___WSP_23B, Exhibit___WSP_24, Exhibit___WSP_25, Exhibit___WSP_28, Exhibit___WSP_29, Exhibit___WSP_30, Exhibit___WSP_31, and Exhibit___WSP_32.

NYSTA Smaller ILECs Testimony Rebuttal

Q. On page 68 of its testimony, the NYSTA Smaller ILECs state that, with regard to the Preliminary Staff Coverage Report of December 2009, "The

information set forth in that report with regard to expected service coverage by competitors in the NYSTA Smaller ILEC service areas is premised on the fundamental fallacy that the competitors provide services that are truly substitute services." Is this an accurate statement?

A. No. The Staff Coverage Report was clear that the substitutability of any alternative, competitive phone service providers in New York State was not considered as part of the Coverage Report analysis. We made no such statement(s) or inferences in the Coverage Report, or in our initial testimony that competitive phone service providers are either truly substitutable or not. Page 12 of our White Panel Testimony explicitly states that "the Coverage Report did not address phone substitutability."

T-Mobile Testimony Rebuttal

Q. On Page 10 of its testimony, T-Mobile indicates "wireless service is ubiquitous in New York". Is the coverage information provided by the wireless providers in this proceeding consistent with T-Mobile's statement?

A. No. In the aggregate, based on American Roamer

coverage map files for AT&T, Sprint Nextel, T-Mobile and Verizon Wireless, wireless service coverage may *potentially* be available to approximately 90% of the state. On an individual basis, wireless service coverage from these same four largest companies ranges from approximately 40% to 86%. Wireless service in New York State is neither ubiquitous in the aggregate or on an individual company basis. Even where coverage maps indicate wireless service *may* exist, companies have indicated that they cannot guarantee availability. T-Mobile responded to NYSTA IR#15 (included in Exhibit___NYSTA-7), which asked, "Do you guarantee service availability in all areas shown to have coverage on your Coverage Maps? If not, why not?", by stating that T-Mobile "cannot guarantee service availability since several varying factors related to radio propagated services, such as commercial mobile radio service, always exist – such as signal strength, consumer equipment, traffic volumes, terrain, structures, foliage, weather and other conditions." AT&T similarly indicated it cannot

guarantee service coverage in response to NYSTA IR#15 (Exhibit___NYSTA-8). Verizon Wireless addressed its own wireless service availability in response to NYSTA IR#15 (included in Exhibit___NYSTA-5), with a link to the Verizon Wireless website that depicted the company's coverage map and associated literature. According to the Verizon Wireless website, its "Coverage Locator maps depict predicted and approximate wireless coverage. The coverage areas shown do not guarantee service availability, and may include locations with limited or no coverage. Even within a coverage area, there are many factors, including customer's equipment, terrain, proximity to buildings, foliage, and weather that may impact service. Some of the Coverage Areas include networks run by other carriers, the coverage depicted is based on their information and public sources, and we cannot ensure its accuracy." Thus, as several wireless companies have similarly concurred, even in areas where their coverage maps indicate that service should be available, service may not be available due

to natural, manmade or other connecting carrier issues beyond the control of the wireless companies. Statewide maps depicting aggregate wireless service coverage areas for AT&T, Sprint Nextel, T-Mobile and Verizon Wireless are provided in Exhibit___WSP_20, Exhibit___WSP_22, Exhibit___WSP_23A, Exhibit___WSP_23B, Exhibit___WSP_24, and Exhibit___WSP_25. AT&T provided three individualized GIS datasets depicting 'Moderate', 'Good', and 'Best' wireless service coverage for New York State, under Confidential Cover. These maps are depicted as Confidential Exhibit___WSP_21A, Exhibit___WSP_21B, and Exhibit___WSP_21C.

Q. T-Mobile indicates that areas without coverage generally correspond with state forests and forest preserves where few, if any, people appear to reside. Do you agree with this statement?

A. No. Staff conducted an analysis of residential premises within the boundaries of the two largest state forest and forest preserves, the Adirondack State Park and Catskill State Park. Both state parks contain many thousands of

residential premises. There are a total of 83,509 residential premises within the Adirondack Park. Of those, 14,256, or 17.1% are located in wireless white spot areas. There are a total of 20,962 residential premises in the Catskill region. Of those, 3,301, or 15.7%, are located in wireless white spot areas (i.e., wireless service is not available.) For demonstration purposes, we have included Exhibit___WSP_28, Exhibit___WSP_29, and Exhibit___WSP_30. The first two exhibits depict residential premises in Hamilton and Franklin counties, both counties within the Adirondack State Park region, without cable or wireless phone service options. The third exhibit depicts residential premises in Ulster County, residing within the Catskill State Park region, without cable or wireless phone service options.

Q. T-Mobile states, on page 10 of its testimony, that, "even if there are inhabited areas where the ILEC is the sole provider, there is no reason to conclude that, should the ILEC petition the Commission to exit the market, another carrier would not fill the gap in time

to provide residents with continuous access to basic telephone service." Do you agree with this conclusion?

A. No. The Town of Milan, Dutchess County, is an example which illustrates that an alternative carrier, such as the cable company, which also provides phone service, could not readily fill the gap in time to provide residents with uninterrupted access to basic telephone service if the ILEC were to exit the market. As indicated in the publicly available franchise agreement between Cablevision and the Town of Milan, full deployment of alternative cable phone services in the town is estimated to take five years from the November 2008 issue date of the Certificate of Confirmation for the town's cable franchise with Cablevision. Exhibit A, Page 29 of the Town of Milan franchise agreement says, "The construction of the Franchisee's HFC (Hybrid Fiber/Coax) Network will extend to the territorial limits of the Municipality. At present, Franchisee's anticipated schedule (with schedule dates measured from the month that the NY PSC issues the confirmation order approving

this franchise) calls for 0% deployment at 6 months, 5% deployment at 12 months, 10% deployment at 18 months, 20% deployment at 24 months, 30% deployment at 30 months, 40% deployment at 36 months, 55% deployment at 42 months, 70% deployment at 48 months, 85% deployment at 54 months and 100% deployment at 60 months ('deployment' meaning activation of the system, ready to market to residents). This schedule is subject to further review and modification by the Franchisee consistent with Section 895.5(b)(I) of the NY PSC rules and regulations; provided, however, that Franchisee shall provide to the Municipality and the NY PSC of any material changes to this schedule. A map of the Municipality's Territorial Limits is attached."

Q. Has Cablevision, the Franchisee, provided the NY PSC with any material changes to this schedule?

A. No.

Q. Mr. Yakel, were you able to verify the extent to which the cable network has been deployed in the town, per Cablevision's franchise agreement?

A. Yes. I conducted a visual inspection of the

town and its cable network on January 10, 2011.

Q. Mr. Yakel, please summarize the methodology of your visual inspection of the cable network in the Town of Milan.

A. My visual inspection incorporated a reference map which outlined the municipal boundaries of the town, and included all municipal roadways within Milan. Using the municipal boundaries, roadways, pole line and rights-of-way as guides, I made observations of where the cable network infrastructure was constructed and deployed, and where cable infrastructure was absent.

Q. Does the cable network serve the entire town?

A. No. The cable network is presently constructed and deployed only in the southwest corner of the town, bordering the Town of Rhinebeck to the west and the Town of Clinton to the south. I observed approximately 15 miles of outside cable plant facilities in this portion of Milan.

Q. Can all of the presently constructed cable network that you observed in the town currently provide service to residents?

A. No. Approximately 13 miles of the 15 miles of cable plant that I observed was deployed to

serve town residents. Approximately 2 miles of outside cable plant was inactive, unspliced coaxial cabling, lacking distribution taps, directional couplers, amplifiers or power supply interconnections. Those portions of the coaxial cable network were not yet deployed, meaning they were not active and available for marketing to town residents. A map depicting my observations of the cable network in the Town of Milan is included as Exhibit___WSP_31. A copy of Cablevision's petition for a Certificate of Confirmation, Commission Order granting franchise waiver, and the franchise agreement between the company and the Town of Milan is included as Exhibit___WSP_32.

Q. Based on the franchise agreement between Cablevision and the Town of Milan, when should the cable network be deployed in 100% of the Town of Milan and able to service all residents?

A. Sixty (60) months after granting the franchise agreement, or about November 2013, the cable network should be fully deployed and able to serve all town residents.

Q. Based upon your observations of the cable

network currently deployed in the Town of Milan, would the cable company be able to 'fill the gap' in time to provide all town residents with continuous, uninterrupted access to basic telephone service if the ILEC exited the market today or in the near term?

A. No.

Verizon and CPB Testimony

Q. CPB argues that there are discrepancies in Staff's Coverage Report. Verizon presents a GIS related analysis which produces different results than Staff's 2009 GIS mapping analyses. Does Staff believe that these two discrepancies stem from the same basis?

A. Yes. The CPB's contention relates primarily to Staff's GIS mapping analysis on page 8 of the Staff Coverage Report. CPB refers to figures on cable modem service availability in some telephone company service areas. For some companies, such as Crown Point for example, the cable modem availability percentages shown on page 8 of the Staff Coverage Report differed from the cable modem availability percentages listed on page 16 of the report. It is

important to keep in mind that the page 8 and page 16 analyses relied upon different data sources. The cable modem availability data used for the page 16 analysis was provided by the incumbent telephone companies, as part of the Small Telco Framework Case, 07-C-0349. The cable modem data included in the page 8 analysis was based upon an older vintage cable mapping dataset that was essentially the same as could be obtained from the New York State Office of Cyber Security & Critical Infrastructure Coordination (OCS/CSCIC). OCS/CSCIC collected the dataset through voluntary cooperation of broadband service providers at that time. With respect to Verizon's more recent GIS analysis of competitive phone services, it is Staff's understanding that Verizon's analysis identified more residential premises without cable modem service because Verizon used CSCIC/OCS's more recent and refined cable coverage information. Staff's Coverage Report GIS mapping method was essentially the same as the Verizon method, but available cable modem data has changed between then and now. Since the Verizon method relied

upon updated data, it likely produced a different estimate of cable modem availability/non-availability than the Staff analysis of two years ago.

Q. Is Verizon's more recent GIS mapping analysis of Crown Point similar to what Staff observed in its field visit?

A. Yes. Moreover, the results of the Verizon analysis are also similar to the figures provided by Crown Point as indicated on page 16 Staff Coverage Report. The Staff field visit to Crown Point also corroborated the page 16 analysis, insofar as the extent of cable network coverage, and cable modem availability/non-availability in the town.

Q. Does this conclude your testimony at this time?

A. Yes.

BY MS. MCCAULEY:

Q Mr. Yakel, Mr. Schuler, did you also prepare exhibits filed with your testimony to this proceeding?

A (Panel) Yes.

Q Do you have those exhibits before you?

A (Panel) Yes.

Q Were these exhibits prepared by you or at your direction?

A (Panel) Yes.

MS. MCCAULEY: Your Honor, these exhibits have been premarked as White Spots 39 through 72, and I will move them into the record at the appropriate time.

ALJ JACK: Very well, yes. They have all been given those numbers for identification?

MS. MCCAULEY: Yes. Your Honor, with that, the panel is available for cross-examination.

ALJ JACK: Again, do the parties have any preferred order of cross-examination to which they've agreed? Verizon, do you have any cross-examination?

MR. POST: No, Your Honor.

ALJ JACK: The NYSTA Smaller ILECs?

MR. OVERCASH: No, Your Honor.

ALJ JACK: AT&T?

MS. BURGESS: No, Your Honor.

ALJ JACK: Cable Television Association?

MR. HANIFIN: This is Chris Hanifin. No, Your Honor.

ALJ JACK: Verizon Wireless and T-Mobile?

MR. ARFAA: This is Chris Arfaa. No cross.

ALJ JACK: CPB?

MR. RIGBERG: No cross.

ALJ JACK: The Facilities CLEC Coalition?

MR. FITZGERALD: No cross, Your Honor.

ALJ JACK: Sprint?

MR. SCHIFMAN: Sprint has no cross.

ALJ JACK: Very well. Panel, you are excused. Thank you.

MS. MCCAULEY: Next, Your Honor, I'd like to call the Substitutability Panel.

ALJ JACK: Thank you.

P A T R I C E O' C O N N O R, JR.

L E O N A R D S I L V E R S T E I N,

R O B E R T J. L A U R E N Z O,

R I C H A R D E. S C H U L E R, JR.

M I C H A E L R O W L E Y,

having been first duly sworn by the ALJ, was examined and testified as follows:

DIRECT-EXAMINATION

BY MS. MCCAULEY:

Q Good afternoon, panel. Are you appearing on behalf of a party to this proceeding?

A (Panel) Yes.

Q Is that party the New York State Department of Public Service?

A (Panel) Yes.

Q Did you file testimony in this proceeding?

A (Panel) Yes.

Q And with the exception of Miss O'Connor, was that testimony -- and Mr. Silverstein -- was that testimony both direct and rebuttal?

A (Michael Rowley and Robert Laurenzo) Yes.

Q And Mr. Silverstein, was the testimony that you filed direct only?

A (Leonard Silverstein) Yes.

Q And Ms. O'Connor, was the testimony that you filed rebuttal only?

A (Patrice O'Connor) Yes.

ALJ JACK: Off the record one moment.

(Discussion was held off the record.)

ALJ JACK: Back on the record.

Q Do you have that testimony before you?

A (Michael Rowley) Yes.

Q Was this testimony prepared by you or under your direction and supervision?

A (Michael Rowley and Robert Laurenzo) Yes.

Q If I asked you the same questions contained in that testimony today, would your answers be the same?

A (Michael Rowley and Robert Laurenzo) Yes.

Q Do you adopt that testimony as your sworn testimony?

A (Michael Rowley and Robert Laurenzo) Yes.

MS. MCCAULEY: Your Honor, I request that the document entitled "Direct and Rebuttal Testimony of the White Spot Panel" be copied into the record as if given orally.

ALJ JACK: That was the Sustainability Panel, rather?

MS. MCCAULEY: Oh, I'm sorry, Substitutability Panel, I'm sorry.

ALJ JACK: Yes. Without objection, the direct and rebuttal testimony of the staff Substitutability Panel will be copied into the record as if given orally today.

(Testimony inserted as ordered.)

BEFORE THE
STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

In the Matter of

Proceeding to Examine Issues Related to a
Universal Service Fund

Case 09-M-0527

December 2010

Direct Testimony of:

Substitutability Panel

Robert J. Laurenzo
Michael Rowley
Richard E. Schuler, Jr.
Leonard Silverstein

Q. Mr. Laurenzo, please state your name and business address.

A. Robert J. Laurenzo. My business address is Three Empire State Plaza, Albany, New York 12223.

Q. By whom are you employed and in what capacity?

A. I am employed by the New York State Department of Public Service as a Utility Supervisor in the Office of Telecommunications, Intercarrier Operations Section.

Q. Please briefly state your educational background and professional experience.

A. I graduated from Siena College in June, 1980, with a Bachelor's Degree in Business Administration. I have been employed at the Department of Public Service since June of 1981, working in the Department's Office of Accounting and Finance until May, 1984, and since that time in the Office of Telecommunications. I have previously testified before the Commission.

Q. Mr. Rowley, please state your name and business address.

A. Michael J. Rowley. My business address is 90 Church St., New York, NY 10007.

Q. By whom are you employed and in what capacity?
A. I am employed by the New York State Department of Public Service as a Utility Supervisor in the Office of Telecommunications, Network Reliability Section.
Q. Please briefly state your educational background and professional experience.
A. I received a Bachelor of Engineering, Electrical Engineering Degree from Manhattan College in February, 1988. I have been employed by the Department since September 1989 in the Office of Telecommunications. My current responsibility is managing the Network Reliability Section.
Q. Mr. Schuler, please state your name and business address.
A. Richard E. Schuler, Jr. My business address is Three Empire State Plaza, Albany, New York 12223.
Q. By whom are you employed and in what capacity?
A. I am employed by the New York State Department of Public Service. I am Chief, Utility Programs of the Regulatory Research Section of the Office of Regulatory Economics.

Q. Please briefly state your educational background and professional experience.

A. I received a Bachelor of Arts Degree in Economics from Cornell University in 1985, a Certificate in Regulatory Economics from the State University of New York at Albany in 1989, a Master of Arts in Economics from the State University of New York at Albany in 1991, and a Ph. D. in Managerial Economics from the Rensselaer Polytechnic Institute in 1998. From 1985 to the present I have been employed by the Department of Public Service. My work at the Department has mainly focused on telecommunications regulation issues. I have previously testified before the Commission.

Q. Mr. Silverstein, please state your name and business address.

A. Leonard Silverstein. My business address is Three Empire State Plaza, Albany, New York 12223.

Q. By whom are you employed and in what capacity?

A. I am employed by the New York State Department of Public Service as a Utility Consumer

Assistance Specialist in the Office of Consumer Policy, Residential Advocacy section.

Q. Please briefly state your educational background and professional experience.

A. I received both a Bachelor of Arts degree in Political Science and a Master of Public Administration degree from the University at Albany. Before joining the Department of Public Service, I held positions of increasing responsibility with the New York State Assembly for nearly seven years, and subsequently worked as a Regulations Analyst at what is now the New York State Governor's Office of Regulatory Reform for about eight years. I have been employed by the Department of Public Service since 2001. I work in the Office of Consumer Policy where my responsibilities include advocating positions on behalf of residential customers in utility rate proceedings, oversight of utility customer service operations, developing utility service quality incentive programs and evaluating utility low-income programs. I have previously testified before the Commission.

Q. What is the purpose of the panel's testimony?
A. We will describe the essential, core characteristics of basic residential telephone service. The purpose of the discussion is to identify characteristics which the Commission should consider in evaluating whether services offered by alternative service providers, such as cable and wireless, are an adequate substitute for traditional telephone service.
Q. Is the Substitutability Panel sponsoring any exhibits?
A. Yes, two. Exhibit___SP_1 and Exhibit___SP_2.
Q. Why is it important to determine substitutability of telephone services offered by alternative service providers?
A. In this proceeding we are seeking to determine if a funding mechanism is necessary to keep incumbent telephone companies solvent for purposes of achieving the Commission's universal service goals. A funding mechanism would not be necessary if the phone services offered by competitive providers could be used to maintain universal service.
Q. How should the characteristics of telephone

service offered by an alternative service provider be evaluated to determine whether or not that service is substitutable?

A. The evaluation should begin with an analysis of the current regulatory requirements for incumbent local exchange carriers (ILECs). ILECs are subject to Public Service Law and Commission rules and regulations regarding the provision of telephone service. In essence, these rules and regulations have defined the parameters of what has traditionally characterized reasonable phone service. Inherent in these rules and regulations are items that should be of great importance to deem services offered by alternative service providers as substitutable, whether or not the providers are regulated.

Q. Should all of these rules and regulations be applicable to alternative service providers in order for their services to be deemed substitutable?

A. No. It would be unnecessary to expect that all of the rules and regulations now in place for regulated telephone companies be adhered to by

the alternative service providers. However, essential components of these rules and regulations should be identified and considered key and relevant to any alternative service provider that replaces the ILEC.

Q. Can competition in an unregulated telecommunications market ensure that basic residential phone service is available, affordable and reliable?

A. No. The pricing and quality levels that could come about in an unregulated environment might differ from those that would result via regulation, especially in areas served by only two providers (i.e. duopoly).

Q. Does this mean that consumers could end up with unaffordable prices and/or poor service quality if there were no regulatory constraints?

A. Yes. The general level of service quality, reliability and customer service could be much less than what would be realized under regulation.

Q. Why shouldn’t we let the interactions between telephone providers and consumers determine critical aspects, such as price and service

quality, of basic residential telephone service?
A. Universal service is essential to the social and economic interests of New York State. To have these critical aspects determined solely by the competitive marketplace is far too risky.
Q. What are the essential components that need to be considered when determining if an alternative service is substitutable?
A. The essential components that need to be considered are availability, affordability, consumer protections, reliability, and quality of service. Unless and until an alternative service is in place which has characteristics for each of these components as outlined below, we do not believe that the customers have a reasonable substitutable basic residential phone service from which to choose.
Q. Please generally describe why the consideration of customer expectations regarding availability, affordability, consumer protections, reliability and quality of service is vital for deeming an alternative service as substitutable.
A. The Commission has traditionally monitored a number of aspects of telephone service. These

have been laid out in tariffs, in reliability protocols, and in the Commission's rules and regulations (e.g., Parts 602, 603 and 609). We are not suggesting that all of these tariff filing requirements and other rules and regulations must be adhered to by alternative service providers in order for their services to be deemed substitutable. However, we are suggesting that for a service to be substitutable for what basic telephone subscribers are receiving from their ILECs today, that service has to meet the same expectations of those customers regarding the prices and quality of their service.

Q. Do customers expect that their basic residential service is protected by each and every rule and regulation?

A. No. Customers have formed expectations regarding their phone service. For example, they expect the same quality of service they have experienced in the past. Similarly, customers do not expect sudden increases in rates or lack of other customer protections. Thus, basic consumers' expectations have been

formulated via service protections brought about by tariff filings and various rules and regulations.

Q. Has Staff attempted to determine whether the services offered by alternative service providers have the components and characteristics of basic residential telephone service necessary for them to be deemed substitutable for universal service purposes?

A. Yes. Staff Exhibit___SP_1 contains the cable phone, ILEC and wireless phone providers' responses to Staff's third set of information requests in this proceeding. These information request responses provide information on the availability, affordability, reliability, consumer protection and service quality characteristics of the residential phone services provided by cable and wireless providers.

Availability:

Q. Please describe what availability considerations are vital for deeming basic residential telephone service offered by alternative service providers as substitutable.

A. From an individual household's perspective an alternative phone service can only be a substitute for the incumbent's telephone service if that service can be used at that household's exact geographic location.

Q. Please describe the basic service option that should be available to all residential customers.

A. Basic service, as defined in Case 94-C-0095 (Competition II Proceeding) includes a single party access line, access to local and toll calling, local usage, tone dialing, access to emergency services, access to assistance services, access to telecommunications relay services, directory listing and privacy protections. Subscribers to basic residential service pay a monthly flat rate for local service which gives them access to the local calling area as determined by their local exchange company, and to the Operator, N11 Services and emergency services (911).

Q. Do you believe that for an alternative service to be deemed substitutable that a directory listing should be provided?

A. In our view, it is necessary that the alternative service provider submit customer information to a directory listings database (unless the customer requests that its listing not be made publicly available).

Q. Does this mean that every alternative service provider must provide a printed directory before it can be deemed substitutable?

A. No. However, customers' listings should be made available so that information service providers, internet directory publishers and alternative printed directory publishers will be able to include that alternative provider's customers' listing information in their various products.

Affordability:

Q. Why is affordability vital in deeming basic residential telephone service offered by alternative service providers as substitutable?

A. The Commission has established a long-standing commitment to keeping basic residential service at the lowest rates possible, so as to achieve a regulatory goal of realizing the highest penetration level possible of residential telephone service subscription. Therefore, in

order for a basic residential service offered by an alternative service provider to be deemed substitutable, it should be affordable with price protections, and Lifeline or an equivalent service should be made available to low-income customers.

Q. What is considered by the Commission to be an affordable rate for basic residential service?

A. The Commission has established a benchmark rate of $23 per month as a cap applicable to all local exchange telephone companies under its jurisdiction. Therefore, the Commission at this time identifies $23 per month as an affordable rate for basic local service for New York's residential customers. Other services subscribed to by individual customers such as toll and optional features are non-basic and therefore not subject to an affordability requirement.

Q. Do you believe that for an alternative telephone residential basic service to be deemed substitutable it should be priced no higher than the Commission's benchmark rate level?

A. Yes. A higher rate for basic residential

service may be considered unaffordable by some customers. This may result in these customers disconnecting from the telephone network rather than paying the higher price, thus adversely affecting universal service and telephone penetration levels.

Q. Why is it important that alternative service providers offer Lifeline or similar services to low-income subscribers?

A. Access to basic telephone service at a Lifeline rate for low-income residential customers should be available from any alternative service provider if they wish to be deemed substitutable. Without a Lifeline service option, universal service objectives would not be met for customers who could not afford to pay the market/benchmark rate for telephone service.

Q. Does alternative telephone service need to be rate regulated in order for services to be deemed substitutable?

A. No. Residential customers will need some protection against rate increases that may either be too high or make basic services unaffordable. This becomes a much greater issue

when the alternative service is the only option available in a given geographic area. In order for an alternative service to be deemed substitutable, the provider will have to demonstrate to the Commission that these customers will be protected against unchecked rate increases. Options for keeping rates affordable include voluntary agreement to rate regulation for basic residential telephone services or other means of showing the Commission that these customers will be protected without direct Commission oversight of rates.

Consumer Protections:

Q. Please describe what consumer protection considerations are important for deeming basic residential telephone service offered by alternative service providers as substitutable.

A. There are several consumer protections and services that regulated telephone companies provide that should also be provided by an alternative telephone company: 1) connection to E911; 2) operator "0-" service; 3) the provision of telecommunication relay services for the deaf

and hard-of-hearing; 4) consumer complaint procedures; 5) intercept services; 6) notification prior to suspension of service; 7) special protections for medical emergencies and for the elderly, blind or the disabled; 8) deferred payment agreements for payment-troubled customers when necessary to maintain service; and, 9) call blocking.

Q. Why is it important for customers to have access to E911?

A. Access to E911 is essential because customers need to be able to connect to live emergency personnel at all hours of the day.

Q. Should an alternative service provider provide access to a live operator for "0-"calls?

A. Yes. If a customer dials "0-," a live operator should answer and be capable of connecting the call to appropriate emergency services if necessary.

Q. Why should an alternative service provider provide telecommunication relay services?

A. Provision of telecommunication relay services or TRS, helps deaf, hard-of-hearing, deaf-blind and speech disabled individuals communicate. Using

TRS, any end-user in New York can obtain the assistance of a relay operator who will facilitate a telephone conversation between a voice telephone caller and another caller who uses a text telephone (TTY), a captioned telephone in place of a telephone. It is important for individuals to continue to be able to access the TRS, so that they will be able to communicate effectively, for example with the hearing population.

Q. Why should an alternative service provider adhere to customer complaint procedures?

A. PSC complaint procedures help customers resolve their issues and concerns with the telecommunication companies and protect customers from unwarranted charges and unsatisfactory service. An alternative service provider should agree to a similar complaint resolution mechanism in order to be deemed substitutable. They should also provide access to their customers with live representatives during normal business hours for customer service, and at all hours of the day for receiving customer trouble reports.

Q. Why do certain residential customers need special protections?

A. Special protections for residential customers with medical emergencies, and for the elderly, blind and disabled are important so that if these customers have trouble making payments they will have their services maintained as long as possible. The elderly, blind and disabled need special protections in order to have access to doctors, social services, and emergency services.

Q. How should an alternative service provider notify customers prior to termination of service for non-payment?

A. Prior to the termination or suspension of service, an alternative service provider should provide advance written notice or notification by telephone so that all reasonable attempts are made to maintain uninterrupted telephone services.

Q. Why should an alternative service provider offer residential customers a deferred payment agreement option?

A. Customers having trouble making payments may

need additional time to catch up on their phone bills. To promote universal service, it is important for alternative service providers to offer deferred payment agreements so that these customers are given an opportunity to pay overdue balances over a longer period of time than normally expected.

Q. Should an alternative service provider make intercept services available?

A. Yes. If a customer changes location or has a number change, an alternative company should provide a recording to notify callers to that the number has changed.

Q. Should an alternative service provider offer call blocking services?

A. Yes. Certain NXX codes are designated for special use only, such as chat lines, and residential customers should have the option of having these codes blocked so that the services offered by dialing numbers in these codes, which may contain adult content, are not available to anyone using that residential phone.

Q. Please characterize the customer protections that you outlined.

A. Out of all the currently-required customer protections in place by the Commission, we believe that these protections are the most important and should be continued if residential services offered by an alternative service provider are to be deemed substitutable.

Reliability:

Q. Please describe why reliability should be a key factor for deeming an alternative service substitutable?

A. Maintaining reliable telecommunications services is paramount to the Commission's mission, irrespective of competition, the mode of delivery, or regulatory classification. We believe it is in the public interest that all networks be similarly reliable, especially in areas where there is only one provider.

Q. How does the Commission currently ensure that telecommunications networks operate safely and reliably?

A. The Commission's rules and regulations include several requirements telephone service providers must follow which are intended to maintain safe and reliable service and minimize the frequency

and extent of service interruptions. They include: network outage reporting; the filing of emergency plans and continuity of operations plans; compliance with industry safety standards and other applicable industry best practices; and, implementation of measures that enhance network resiliency, such as critical route diversity, stand-alone switch capability, and back-up powering for essential facilities and equipment.

Q. Are you proposing application of reliability rules and regulations to providers of alternative services?

A. Not at this time. However, we believe a commitment to following basic reliability principles, comparable to existing ILEC requirements, should be considered when determining what is a substitutable service.

Q. Describe the Commission's service outage reporting requirements.

A. Commission regulations require that telephone service providers report major service interruptions to Staff. Major outages include: newsworthy events; outages caused by storms or

commercial power loss; service problems affecting public access to critical services (911, operator services, Telephone Relay Service, police, fire departments, or emergency medical services, Emergency Alert System information); major network node and/or telecommunications traffic concentration point failures lasting more than five minutes; extensive network congestion or call blockage; equipment or cable failure affecting 1,000 or more subscribers; service problems affecting a public transportation terminal, hospital, national defense installation, large residential and commercial building or complex, or other major customer, such as a utility or other telecommunications service provider. Guidelines specify that providers report outages on a timely basis, i.e., within one hour of occurrence, and update Staff routinely on progress until services are restored.

Q. Why is outage reporting so important?

A. The timely reporting of network outages is critical to the Department's support of public safety and emergency response activities in the

state, as well as for monitoring restoration progress. Agencies such as the New York Department of Homeland Security, the State Emergency Management Office (including the State Police), the Governor's Office and other county and municipal public safety agencies rely on the Department's real-time assessment of telecommunications network status to coordinate and respond to emergencies.

Q. Should an alternative service provider comply with the Commission's outage reporting guidelines?

A. Alternative service providers should report service outages pursuant to existing Commission guidelines. In fact, since August 2006, many alternative providers have agreed to voluntarily comply with those guidelines and have reported service interruptions as they have occurred. To be deemed substitutable, we believe that alternative service providers should demonstrate their consistent adherence to outage reporting guidelines, comparable to the timeliness, accuracy and depth of reporting by existing telephone service providers.

Q. What is network resiliency?
A. Network resiliency describes the ability of a network to withstand adverse events and conditions, such as power outages, severe storms, or man-made emergencies, and still remain operable.
Q. Describe why network resiliency is important and what measures an alternative provider could take for its service to be deemed substitutable?
A. Implementing resiliency measures eliminates single points of failure in a network and is critical for sustaining service following common events like cable cuts, commercial power loss, and more significant events like severe storms. Regulated telephone service providers are required to implement such measures like geographic route diversity between critical points in the network, and stand-alone capability at remote switching locations to ensure local service operability if connectivity to the main switch is lost. To be deemed substitutable, an alternative provider should demonstrate that it implements adequate measures that mitigate service disruptions due to adverse

conditions and emergency situations and maintains local service availability similar to existing incumbent telephone service.

Q. Describe why back-up power capability is critical for network reliability and resiliency.

A. Back-up power capability in a network is essential to maintain telephone service during a commercial power outage, which often occurs concurrent with emergency events and severe storms when communication is critical to public safety. Telephone, cable and wireless networks all rely on commercial power to operate, however their network powering architectures differ, thus, their ability to withstand commercial power loss does also.

Q. Describe how telephone networks provide resiliency in their powering architecture.

A. Incumbent telephone networks are designed and constructed to withstand temporary loss of commercial power. ILECs, for instance, maintain service during power outages by equipping their centralized office switching facilities with automatic, independent power generation, deploying battery back-up and/or portable power

generation at nearly all facilities in its outside plant and, where applicable, independently powering customer telephones. Some fiber networks achieve power resiliency by deploying passive equipment in the field that does not require commercial power to operate, and also equip the customer premise with battery back-up for telephone operation. Alternative providers also deploy varying degrees of back-up powering in their networks, but that ability may not extend to nearly all customer locations like that of the incumbent service provider.

Q. Should a substitutable alternative service have the same power resiliency capability as incumbent telephone service?

A. Yes. Substitutable alternative service should be reasonably capable of providing "end-to-end" operating capability in the event of a short-term loss of commercial power.

Q. Describe why compliance with national standards and best practices is important and what relative Commission requirements exist.

A. To ensure that telephone networks operate safely and provide adequate protection for the public

and telephone company personnel, the Commission requires that service be installed and operate compliant with national standards, such as the National Electric Safety Code (NESC), and the National Electric Code (NEC). In addition, the Commission expects that network operation be guided by relevant industry best practices, such as guidelines established by the Communications Security, Reliability and Interoperability Council (CSRIC), formerly the Network Reliability Interoperability Council. Currently, the Commission requires facilities-based telephone service providers to annually attest its compliance with applicable NEC and NESC standards.

Q. Should a substitutable alternative telephone service adhere to the same safety standards and best practices?

A. Yes. In fact, we expect that alternative services already comply with applicable NESC, NEC standards and CSRIC best practices. For substitutability purposes an alternative service provider should attest to NESC and NEC compliance similar to that required by existing

telephone providers.

Quality of Service:

Q. Please describe what service considerations are vital for deeming an alternative service as substitutable.

A. Given the importance of retaining reasonable quality on the performance of these characteristics to overall health and safety, regulatory oversight should continue with regard to the incidence of service troubles, repair timeliness, repair office answering performance and circuit blockages. In general, customers should expect a similar level of service on these service-related characteristics from a substitutable provider if that provider becomes their only basic local service option.

Q. Why is it important that the Commission or other regulatory body have the ability to oversee performance related to the incidence of service troubles?

A. Trouble report rates are indicative of the overall condition of the telecommunications network and are a key indicator of network reliability. Management of a network, or

government oversight of the network, without monitoring a comprehensive overall service indicator such as the customer trouble report rate, is unrealistic.

Q. Why is repair timeliness an important characteristic?

A. Customers should continue to expect that when they call their phone provider about a service trouble, or an out-of-service condition, that it will be fixed in a timely fashion. It is often the case that phones go out of service during emergency conditions. Customers and safety organizations must retain the ability to communicate. Service outages can have severe financial impact on businesses which rely upon phone service for sales purposes.

Q. Why is it important that alternative service providers monitor repair office answering performance?

A. If repair office phones are not answered in a timely fashion, service outages experienced by customers will be longer in duration.

Q. Is oversight of circuit blockages critical to ensure network reliability?

A. Yes. Customers should expect a very limited degree of "all circuits busy" when attempting to place a call.

Q. In order to monitor and regulate performance with regard to the incidence of service troubles, repair timeliness, repair office answering performance and circuit blockages, is it necessary that providers of telephone service measure and record their performance on these aspects of service provision?

A. Yes.

Q. Is it Staff's position that the basic services offered by alternative service providers can only be deemed substitutable if those providers retain records on their performance associated with respect to the incidence of service troubles, repair timeliness, repair office answering performance and circuit blockages?

A. Yes.

Q. Is Staff proposing that the alternative service providers meet the current service quality standards regarding the incidence of service troubles, repair timeliness, repair office answering performance and circuit blockages that

apply to the incumbent ILECs?

A. No.

Q. Is Staff proposing alternative standards for these alternative providers?

A. No. Staff is merely proposing that the Commission or other oversight body have the ability to effectively evaluate service quality problems if the need arises. Thus, the oversight body should be able analyze the quality of service provided by alternative telephone providers, as those alternative phone providers measure it, and determine if consumers are being provided an adequate level of service quality. Sufficient service quality records should be available, upon request, for any particular oversight body to look at if it appears that poor service quality is being realized in a given area.

Summary:

Q. For purposes of ensuring universal service, what have you concluded regarding the substitutability of phone services provided by competitors to the incumbent local exchange telephone companies in New York State?

A. Unless and until it can be shown that an alternative basic residential telephone service being offered has characteristics related to availability, affordability, consumer protections, reliability and quality of service which meet the parameters discussed above, we do not believe that the residential customers in an ILEC service territory have a reasonably substitutable basic phone service to choose from. We believe that the Commission should examine the critical characteristics of the services offered by alternative service providers before declaring those services substitutable. An itemized list of what Staff believes should be provided in this regard is shown in Staff's Exhibit___SP_2.

Q. Does this conclude your testimony at this time?

A. Yes.

BEFORE THE
STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

In the Matter of

Proceeding to Examine Issues Related to a
Universal Service Fund

Case 09-M-0527

January 2011

Rebuttal Testimony of:

Substitutability Panel

Robert J. Laurenzo
Patrice O'Connor
Michael Rowley
Richard E. Schuler, Jr.
Leonard Silverstein

Q. Have all identified panel members testified before in this proceeding?

A. Yes, except for Patrice O'Connor.

Q. Ms. O'Connor, please state your full name and business address.

A. Patrice O'Connor. My business address is Three Empire State Plaza, Albany, NY 12223.

Q. By whom are you employed and in what capacity?

A. I am employed by the New York State Department of Public Service as a Utility Consumer Program Specialist 4 in the Office of Consumer Policy.

Q. Please state your educational background and professional experience.

A. I received a Bachelor of Arts degree in Sociology from the State University of New York, Plattsburgh in May 1980, and received a Masters degree in Public Administration from Pennsylvania State University in August 1981. Prior to joining the Department, I was employed by the New York State Legislature. I was hired by the Department as an Associate Utility Management Analyst in April 1985, working in the

Office of Utility Efficiency and Productivity. Since February 1999 I have worked in the Consumer Advocacy and Education Section of the Office of Consumer Services. From February 1999 until October 2007 I was responsible for consumer telecommunications issues including the low income telephone Lifeline program and telephone service quality. I also participated in telephone rate proceedings. My current position is in the Office of Consumer Policy.

Q. Have you previously testified before the Commission?

A. Yes.

Q. What is the purpose of the panel’s rebuttal testimony?

A. The purpose of this rebuttal testimony is to respond to statements made by other parties regarding substitutability.

Q. Is the Substitutability Panel sponsoring any exhibits in this rebuttal testimony?

A. No.

Q. In both T-Mobile's and Verizon's testimony, at pages 7 and 17, respectively, the parties argue that the Commission has found that telephone services offered by alternate service providers are close substitutes for traditional wireline local service in the eyes of consumers. Is that Staff's understanding of the Commission's current position regarding the substitutability of alternate service providers?

A. No. In its most recent statement on the subject, made December 17, 2010 in Case 10-C-0202, the Commission stated that "wireless is not yet directly and seamlessly substitutable for all wireline service" (Order at Page 15). The Commission went on to state that reliability of wireless signals is unsatisfactory in certain areas of the state, which would include the mountainous areas where cell service is either very spotty or unavailable.

Q. Verizon, T-Mobile and several other parties indicate in their direct testimony that there is little need for regulation of alternative providers to ensure the availability, affordability, consumer protections,

reliability, and quality of basic telephone service. Do you agree with this contention?

A. No. Staff disagrees with the contention that "consumer demand thus regulates service quality and price more rapidly and efficiently than any regulatory body could" (T-Mobile, p. 9) because competition in an unregulated telecommunications market alone is very unlikely to ensure that basic residential phone service is universally available, affordable, reliable and reflective of adequate consumer protections and service quality. Moreover, Staff thinks that it is entirely likely that consumers could end up with unreasonably high prices and/or unreasonably poor service quality if there were no regulatory constraints in an area where the ILEC has exited the market and only one alternative provider remains as a monopoly provider, or even if two alternative providers remain after the ILEC were to exit (a duopoly).

Q. Do you agree with Verizon's testimony at page 17 which states that a "market based test" should determine price points and quality standards for basic residential telephone service.

A. No. The reason the Commission implemented a uniformity rule in the Competition III Order (and subsequent pricing flexibility orders) is because competition in one area of the state cannot be reasonably relied upon to ensure reasonable prices in other geographic areas where competition is lacking.

Q. Why is it important that at least some form of regulatory oversight remain?

A. Given the essential nature of universal telephone service for New York State’s economic growth and for ensuring the health and safety of its citizenry, the Commission simply cannot risk that these vital public interests will be adequately maintained and protected solely by market forces.

Q. The T-Mobile testimony at page 8 cites Staff’s 2007 New York Residential Telecommunications Consumer Survey to support its position that the Commission has already found that VoIP and wireless services are sufficiently close substitutes for wireline service. Do you come to the same conclusion based on the survey’s results?

A. No. The Staff survey cited by the witness found that 69% of respondents subscribe to cellular phone service yet only 22% of respondents said they would consider disconnecting their home phone to rely exclusively on cell phones. Those respondents identified “reliability of the cell phone, static, bad service quality and reception, and bad sound clarity as reasons for not substituting cell service for wire-line service” (survey at page 6). The survey results and responses support a finding that most residents prefer to keep their landline service even when wireless service is available. Contrary to the T-Mobile testimony, the survey supports a finding that wireless service is primarily a complement to landline service rather than a substitute for most residents.

Q. T-Mobile’s direct testimony beginning at page 12 argues that the creation of a state universal service high cost fund in New York would undermine the affordability of basic telephone service to consumers. Does Staff agree with this contention?

A. As indicated in Mechanism panel testimony, Staff

is proposing a funding *mechanism*, only to be implemented if a need arises. Staff's proposal assesses carriers based on the amount of telephone numbers used in their operation, and, as specified in the Mechanism panel testimony, is likely to be less than a penny per month per telephone number. The decision to pass this cost onto customers would be up to the carrier assessed. An additional penny or less per month will not have any significant impact on a consumer's telephone bill and will certainly not act to undermine a consumer's ability to afford telephone service.

Q. Does this conclude your rebuttal testimony at this time?

A. Yes.

BY MS. MCCAULEY:
Q Substitutability Panel, did you also prepare exhibits filed with your testimony for today's proceeding?
A (Michael Rowley and Robert Laurenzo) Yes.
Q And do you have those exhibits before you?
A (Robert Laurenzo) Yes.
Q Were those exhibits prepared by you or at your direction?
A (Panel) Yes.

MS. MCCAULEY: Your Honor, these exhibits have been premarked for ID as Substitutability 33 and 34, and I will move them into the record at the appropriate time.

ALJ JACK: Thank you.

MS. MCCAULEY: With that, the Substitutability Panel is available for cross-examination.

ALJ JACK: Verizon?

MR. POST: No, Your Honor.

ALJ JACK: AT&T?

MS. BURGESS: Just a couple of questions, Your Honor.

CROSS-EXAMINATION
BY MS. BURGESS:
Q Good afternoon, panel.

A (Panel) Good afternoon.
Q Would you please turn to page 2 in your rebuttal testimony. On that page you cite a December 17, 2010 Commission decision in case 10-C-0202, in which the Commission stated that, quote, Wireless is not yet directly and seamlessly substitutable for all wireline service.
MR. LAURENZO: Do you mean page 3?
MS. BURGESS: Yes, thank you.
Q In staff's opinion are there any areas of the State where wireless service is an alternative service or substitute for landline service?
A (Robert Laurenzo) Staff hasn't made a determination at this time that there is substitutable provider in the State at any location.
Q So you're not able to say at this time whether there's any current circumstance in which wireless could be considered a substitute for basic landline?
A (Robert Laurenzo) Based on the information we have today.
MS. MCCAULEY: I have no further questions.
ALJ JACK: Thank you. CTANY.
MR. HANIFIN: Yes, Your Honor. This is Chris Hanifin.

CROSS-EXAMINATION

BY MR. HANIFIN:

Q Just to follow-up on the wireless coverage. You're not suggesting that a negative -- you're expressing no opinion for clarification, correct?

A (Robert Laurenzo) We don't have enough information available at this time to say that there is a substitutable wireless company doing business in New York right now.

Q Turn to page 5 of your direct testimony, lines 20 through 23, please. In that cited testimony you state that a funding mechanism would not be necessary if phone service is offered by competitive providers could be used to maintain universal service, correct?

A (Robert Laurenzo) That's correct.

Q As you define universal service in that testimony, you're not intending -- is it not true that you're not intending to conflict with that of what is currently in the Commission's orders, correct?

A (Robert Laurenzo) I'm sorry --

MS. MCCAULEY: Your Honor, I'm not sure the question can be answered as a single response.

Q Let me rephrase it to be a little more clear, perhaps. Your definition isn't intended to conflict with

that the Commission has previously espoused in its orders, is it?

A (Richard Schuler) What we're trying to say in this portion of the testimony is once the Commission makes the substitutability determination, if that service is provided everywhere by competitive providers, there would be no need for a mechanism.

Q So then you would agree that your testimony is intended to be consistent with prior Commission orders to define universal service, right?

MS. MCCAULEY: Your Honor, I'm not sure that the Commission has defined universal service. It may be assuming facts that aren't in evidence.

MR. HANIFIN: The Commission's orders are public record, Your Honor, and have the full force and effect of law. And certainly staff, in defining universal service, has looked at that. So I'm asking if their definition on page 5 is intended to conflict or expand or change what the Commission has previously defined as universal service.

A (Robert Laurenzo) I wouldn't characterize it that way. The purpose of this section of the testimony is to indicate that once an alternative service provider is

deemed substitutable by the Commission then the funding would not be necessary for the incumbent of the exchange company.

Q In maintaining universal service, were you trying to change -- in that lines 22 to 20 -- or, excuse me, lines 20 to 23 of your direct testimony where you talk about competitive providers being used to maintain universal service, was there any effort on your part to expand that which the Commission has previously espoused as being the components of what universal service constitutes?

A (Robert Laurenzo) I don't believe so.

Q Okay. On page 13, lines 9 through 19 of your direct testimony, you discussed the $23 benchmark rate established by the Commission as being a cap applicable to all local exchange companies under its jurisdiction, correct?

A (Robert Laurenzo) Yes.

Q Do you recall whether the Commission has stated that the $23 benchmark rate is above or below the cost for a rural local exchange carrier?

A (Robert Laurenzo) We don't know.

Q On page 12, and I apologize for some jumping here. On page 12, lines 19 through 24 of your direct testimony, you introduce the lowest rates possible definition. Is

this intended to differ or be the same as the Commission's standard under the Public Service Law with respect to safe and reliable service and just and reasonable rates?

A (Richard Schuler) The same.

Q Okay, very good.

MR. HANIFIN: Your Honor, CTANY has no further questions for the panel. Thank you, panel.

ALJ JACK: The next party that I had an indication that might have cross-examination is CPB.

MR. RIGBERG: No questions, Your Honor.

ALJ JACK: Then the only other one was Sprint.

MR. SCHIFMAN: Thank you, Your Honor. I do have questions.

CROSS-EXAMINATION

BY MR. SCHIFMAN:

Q Good afternoon, panel.

A (Panel) Good afternoon.

Q Turn to page 11 of your direct testimony please, really, lines 6 through 24. Is the universal service that you're talking about in your testimony, is it basic, local service and nothing in addition to that?

A (Richard Schuler) In general, yes.

Q Okay, and so staff's opinion is that in order for universal service to be provided, any potential state fund should only fund basic, local service, is that correct?
A (Richard Schuler) Can you point us to a -- is this still the same section?
Q The same section. I'm just building on basic, local service and wondering whether, in staff's opinion, should the fund only fund basic, local services as you've defined it here in your testimony.
A (Robert Laurenzo) This testimony doesn't talk to that point. This just lists a certain criteria we think should be central to -- for an alternate provider to be substitutable, and I think maybe that question might be asked of a different panel, perhaps, policy.
Q Okay, that's fine. Turn back to page 9 of your testimony, lines 9 through 14, and it's talking about regarding the prices for substitutable services. Is the price that you're talking about for substitutable services for basic local $23?
A (Richard Schuler) This section of the testimony refers to the rates that customers are currently paying.
Q And that's up to $23, right?
A (Richard Schuler) Yes, depending upon what area for basic service, correct.
Q Okay, so in staff's opinion customers of NYSTA

ILECs, not all of them, but some of the areas are paying up to $23 for basic, local service. You consider that to be universal service, right, at that price, and substitutable?

MS. MCCAULEY: That was two questions.

Q All right I'll start with the first one. Do you consider that to be universal service?

A (Richard Schuler) I think that's the rate for the service that we would like to see universally available.

Q Any other opinion?

A (No response.)

Q And are you saying that a rate less than that or more than that means that universal service is not available?

A (Robert Laurenzo) No, we're not saying that. We're saying that for an alternate service provider to be deemed substitutable, that should be the maximum they should charge for basic service, residential customers.

Q Okay. Then on page 13 of your testimony, lines 9 through 15, you're affirming -- you're saying that the $23 rate is the affordable rate in the State, right?

A (Robert Laurenzo) That's right.

Q Okay, so is that in all areas of the State, in your opinion?

A (Robert Laurenzo) Yes. The benchmark applies for

statewide.
Q Okay, so each of the NYSTA ILECs, even if they're currently charging $10, $23 is an affordable rate, in your opinion?
A (Robert Laurenzo) The $23 is an affordable rate, is that your question?
Q Yeah, even if they're currently charging less than that.
A (Richard Schuler) We may have rate shock concerns, but in the long run, yes.
Q No further questions.

ALJ JACK: Do you have any redirect?

MS. MCCAULEY: No, Your Honor, no redirect.

ALJ JACK: Thank you, panel. You're excused.

MS. MCCAULEY: The next, Your Honor, the White Spot or the Mechanism Panel.

R I C H A R D E. S C H U L E R, JR.
C H A R L E S R E U B E N S,
R O B E R T J. L A U R E N Z O,
D E B O R A H L A B E L L E,
P A T R I C K J. B A R R Y,
R I C H A R D L E A R Y,

having been first duly sworn by the ALJ, was examined and

testified as follows:

ALJ JACK: Thank you. Please be seated.

DIRECT-EXAMINATION

BY MS. MCCAULEY:

Q Good afternoon, Mechanism Panel. Are you appearing on behalf of a party to this proceeding?

A (Panel) Yes.

Q Is that party the New York State Department of Public Service?

A (Panel) Yes.

Q Did you file testimony in this proceeding?

A (Panel) Yes.

Q With the exception of Mr. Leary, did you file direct and rebuttal testimony in this proceeding?

A (Panel) Yes.

Q Mr. Leary, did you file rebuttal testimony only?

A (Richard Leary) Yes.

Q Do you have that testimony before you?

A (Panel) Yes.

Q Was that testimony prepared by you or under your direction and supervision?

A (Panel) Yes.

Q If I asked the same questions contained in that testimony today, would your answers be the same?

A (Panel) Yes.
Q Do you adopt this testimony as your sworn testimony?
A (Panel) Yes.

MS. MCCAULEY: Your Honor, I request that the document entitled "Direct and Rebuttal Testimony of the Mechanism Panel" be copied into the record as if given orally.

ALJ JACK: Without objection, the direct testimony and the rebuttal testimony of the staff USF Mechanism Panel will be copied into the record as if given orally today.

MS. MCCAULEY: Thank you, Your Honor.

(Testimony inserted as ordered.)

BEFORE THE
STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

In the Matter of

Proceeding to Examine Issues Related to a
Universal Service Fund

Case 09-M-0527

December 2010

Direct Testimony of:

USF Mechanism Panel

Patrick J. Barry
Debra Labelle
Robert Laurenzo
Charles Reubens
Richard E. Schuler, Jr.

Q. Mr. Barry, please state your full name and business address.
A. My name is Patrick J. Barry. My business address is Three Empire State Plaza, Albany, New York 12223.
Q. Mr. Barry, by whom are you employed and in what capacity?
A. I am employed by the New York State Department of Public Service as a Supervisor in the Office of Accounting and Finance.
Q. Please outline your educational background and professional background.
A. I graduated from the State University of New York at Albany in 1986 with a Masters Degree in Business Administration and a course concentration in finance. Prior to that, I received a Bachelor of Business Administration from Siena College. In March 1987, I joined the Department of Public Service.
Q. Please describe your duties for the Office of Accounting and Finance.
A. As a Supervisor of Accounting and Finance I am responsible for managing the activities of a unit of auditors, accountants, and financial

analysts located throughout New York State on a variety of projects, including their participation in major proceedings before the Public Service Commission. Since 2006, my main responsibilities have been associated with New York Electric and Gas Corporation and the many small independent telephone companies across New York State. Activities that I or my staff have been involved in include examinations of accounts, records, documentation, policies and procedures of regulated utilities to develop issues for electric, gas, and telecommunications rate proceedings, settlements, financing approvals, fuel and gas adjustment clause reviews, rate of return reviews, mergers and acquisitions, use of revenues cases, reorganizations and restructurings, financial forecasting, and other general accounting and financial investigations. I have previously testified before the Commission.

Q. Ms. LaBelle, please state your full name and address.

A. My name is Debra LaBelle. My business address is Three Empire State Plaza, Albany, New York 12223.

Q. Ms. LaBelle, by whom are you employed and in what capacity?

A. I am employed by the New York State Department of Public Service as a Utility Supervisor in the Carrier Performance section in the Office of Telecommunications.

Q. What is your educational background and professional experience?

A. In May 1988, I received a B.S. in Mechanical Engineering from Rensselaer Polytechnic Institute. In July 1990, I joined the Department of Public Service as a Junior Engineer and, through a series of promotions, have advanced to my current position in the Office of Telecommunications. I have participated in various proceedings. I have not previously testified before the Commission.

Q. Mr. Laurenzo, please state your full name and business address.

A. My name is Robert J. Laurenzo. My business address is Three Empire State Plaza, Albany, New York 12223.

Q. By whom are you employed and in what capacity?

A. I am employed by the New York State Department of Public Service as a Utility Supervisor in the Office of Telecommunications, Intercarrier Operations Section.

Q. Please state your educational background and professional experience.

A. I graduated from Siena College in June, 1980, with a Bachelor's Degree in Business Administration. I have been employed at the Department of Public Service since June of 1981, working in the Department's Office of Accounting and Finance until May, 1984, and since that time in the Office of Telecommunications. I have previously testified before the Commission.

Q. Mr. Reubens, please state your full name and business address.

A. My name is Charles R. Reubens. My business address is Three Empire State Plaza, Albany, New York 12223.

Q. By whom are you employed and in what capacity?

A. I am employed by the New York State Department of Public Service as a Supervisor, Office of Accounting & Finance.

Q. Please state your educational background and professional experience.

A. I graduated from the Rochester Institute of Technology with a Bachelor of Science degree in Accounting in August 1975. I have been employed by the Department of Public Service since June 1977 in the Office of Accounting and Finance. I have participated in numerous rate proceedings, finance cases and various other matters as well as generic policy proceedings instituted by the Commission related to electric, gas, water and telephone companies. However, my main focus since the early 90's has been telecommunications. I have testified in numerous Commission proceedings and am a Certified Public Accountant in the State of New York.

Q. Mr. Schuler, please state your full name and business address.

A. My name is Richard E. Schuler, Jr. My business address is Three Empire State Plaza, Albany, New York 12223.

Q. By whom are you employed and in what capacity?
A. I am employed by the New York State Department of Public Service. I am Chief, Utility Programs of the Regulatory Research Section of the Office of Regulatory Economics.
Q. Please briefly state your educational background and professional experience.
A. I received a Bachelor of Arts Degree in Economics from Cornell University in 1985, a Certificate in Regulatory Economics from the State University of New York at Albany in 1989, a Master of Arts in Economics from the State University of New York at Albany in 1991, and a Ph. D. in Managerial Economics from Rensselaer Polytechnic Institute in 1998. From 1985 to the present I have been employed by the Department of Public Service. My work at the Department has mainly focused on telecommunications regulation issues. I have previously testified before the Commission.

Introduction

Q. What is the purpose of your testimony?
A. We are proposing the key principles for the

structure of a state universal service funding mechanism. As described below and more fully in the Staff Policy Panel's testimony, such a funding mechanism should be in place before the Temporary Transition Fund Extension (TTFE) is exhausted.

Q. Why are you only proposing "key principles" rather than a specific structure for a state universal service funding mechanism?

A. Input from all the stakeholders in this proceeding is needed to develop a specific mechanism. If the Commission determines there is a need for a state universal service funding mechanism and addresses the key principles outlined below, the parties can collaborate to provide the Commission a proposed specific mechanism in adequate time for the mechanism to be in place before the TTFE is exhausted.

Q. How your testimony organized?

A. Our testimony will address the following:

1. Requirements for Receiving Funds
    a. Process
    b. Alternative Substitutable Providers
    c. Financial Considerations

d. Rate Considerations

e. Annual Attestation

2. Fund Contributors.

3. Term of Fund

4. Fund Administration.

5. Quantification

Q. Is the USF Mechanism Panel sponsoring any exhibits?

A. Yes, two - Exhibit___MP_1 and Exhibit___MP_2.

1. Requirements for Receiving Funds

a. Process

Q. What steps should a company take to request funding?

A. A company should request state universal service funding as part of a general rate case filing under the Commission's rules of procedure (16NYCRR, Subchapter D, Rate Proceedings).

Q. How will it be determined that a requesting company qualifies for state universal service funding?

A. The first step will be to determine, through the traditional rate of return rate case process, that a company's revenue requirement cannot be

met by setting basic local service rates at the benchmark level. If such a determination is made, a further analysis will be used to determine the funding level for an eligible company. Our proposed key principles for performing that analysis are provided below in the sections entitled "Financial Considerations" and "Rate Considerations."

b. Substitutable Alternative Providers

Q. Should the existence of a substitutable alternative provider in the service territory of an incumbent local exchange company (ILEC) be considered when determining a company's eligibility for universal service funding?

A. Yes.

Q. Will an ILEC requesting universal service funding qualify for such funding if there is a substitutable provider serving its territory?

A. If the substitutable provider (alone or in tandem with another substitutable provider) can provide service to all existing customers in the entire service territory of the ILEC requesting funding, without reliance on the ILEC, there would be no reason to provide funding to the

requesting company.

Q. Are there scenarios in which an ILEC would qualify for universal service funding with a substitutable provider present in its service area?

A. Yes. In cases where the substitutable provider(s) does not cover the entire service territory, a determination will be made to either provide funding to the ILEC to continue operations, or possibly fund the build out of the substitutable provider(s) network(s) to reach all customers currently served by the ILEC.

Q. How will this determination be made?

A. Total costs and efficiencies will need to be considered when making this determination. Each scenario will need to be analyzed individually, a mixed bag approach. In some cases, the most efficient solution may be to provide funding to the ILEC to continue operations. However, in some cases, the percentage of customers without access to substitutable alternative networks may be so small that a more economical solution will be to fund the build-out of a nearby alternative

provider's network. There may be scenarios where the most efficient solution is a combination of funding continued operations of an ILEC in certain areas and the build out of a substitutable alternative provider's network in other areas of an ILEC's service area. A flowchart that depicts how a request for state universal service fund relief would be considered based upon whether or not a substitutable provider(s)is present in a given service territory is provided in Exhibit___MP_1.

Q. How can the Commission determine if an alternative service provider is substitutable?

A. Staff's views regarding whether or not an alternative provider should be deemed as being substitutable are discussed in the panel testimony on substitutability.

c. Financial Considerations

Q. Will the financial considerations for receiving state universal service funding you recommend be the same as those used for receiving funds from the current Transition Fund?

A. No. We recommend the financial basis for receiving universal service funding go beyond

the company's intrastate operations considered in a traditional rate case under current Commission rules. Staff believes that an analysis of total company regulated operations would be more appropriate in determining eligibility for state universal service funding.

Q. What does "total company regulated operations" mean?

A. By "total company regulated operations," we are referring to the total amounts on the ILEC's books less amounts related to non-regulated operations. These amounts are reported in Column (e), Subject to Separations, on Schedule 9 of the ILEC Annual Reports filed with the Commission each year.

Q. Why do you conclude the total company approach to be more appropriate?

A. We conclude that the companies' eligibility for drawing from a state universal service funding mechanism should be determined on a "total company" rather than intrastate only basis for a number of reasons. First, in the current environment, competitors do not market their product on a local or intrastate basis but

provide a complete package of services that includes, at a minimum, local calling, intrastate toll calling, long distance calling and various features such as caller ID. Most packages are offered at a discount relative to the sum of the a la carte rates. This makes it difficult to properly allocate package revenues to intra and interstate piece parts. Second, all products are provided by the same network and personnel. Common and joint costs associated with the use of the same network and personnel are notoriously difficult to allocate. Cost allocations, as established by the Federal Communications Commission (FCC), have become even more problematic since allocation factors have been frozen at antiquated levels. Finally, investors consider total company operations when making investment decisions. For all of these reasons, relying upon intrastate only as opposed to total company results is becoming increasingly at odds with the revenues and costs relevant to the competitive marketplace.

Q. Should there be considerations in determining eligibility for state universal service funding

that differ from the traditional rate case analysis?

A. Yes. The Commission should consider adjustments not normally made in traditional rate cases – such as plant write-downs and consideration of additional operating efficiencies.

Q. Why should the Commission consider adjustments not previously considered under traditional rate of return regulation?

A. Technological change has allowed competitive telecommunications offerings to flourish in the vast majority of the state. The result is a telecommunications environment that is very different than the environment in which the Commission first established its universal service goals under traditional rate of return regulation. Given its limits on the ability to control competitive entry, there has been a realization by the Commission of the possibility that companies can no longer be made whole on an intrastate regulated basis as a result of market share losses (i.e., the regulatory compact is almost broken).

Q. What has been the financial impact of these

changes on the ILECs regulated by the Commission?

A. The ILECs have experienced competitive losses as a result of technological changes and policies to promote competition, the financial effects of which are discussed in the Policy Panel testimony.

Q. Has the Commission ever addressed whether ILECs should recover competitive losses from a state funding mechanism?

A. Yes. In the Competition II Order (Case 94-C-0095, Opinion and Order Adopting Regulatory Framework, Opinion No. 96-13 (issued May 22, 1996), p. 14), the Commission indicated that ILEC's should not fully recover competitive losses from a state universal service fund, summarizing "Such a funding mechanism would not guarantee any company perpetual recovery of its total costs, but instead would ensure that remaining captive customers continue to have affordable services available to them." Exhibit___MP_2 contains additional related Commission statements regarding ILEC cost recovery in light of increased competition and

technological change.

Q. Did the Competition II Order define competitive losses?

A. Yes it did so in terms of Stranded Plant/Stranded Revenue Requirement.

Q. What are Stranded Plant and Stranded Revenue Requirement?

A. Stranded revenue requirement consists of stranded investment (Stranded Plant), underutilized investment, and revenues lost to competition. Stranded investment (Stranded Plant) refers to utility plant that a company has prematurely retired from service due to competitive losses. Underutilized investment includes plant still in service, but for which utilization drops due to migration of customers to a competitor (Competition II Order, p. 27).

Q. Did the Competition II Order address ILEC stranded cost recovery in a competitive environment?

A. Yes. It put the ILECs on notice that the Commission may not allow recovery of stranded plant from captive customers in a competitive environment.

Q. What are the implications of the Commission's Competition II Order on the state universal service funding mechanism you propose?

A. ILECs should not expect to fully recover competitive losses and/or stranded costs from a state universal service funding mechanism.

Q. What is the consequence of an ILEC not fully recovering competitive losses and/or stranded costs?

A. It has accounting consequences that are likely to have a significant impact on the company's financial statements.

Q. Please describe these accounting consequences beginning with the definition of Generally Accepted Accounting Principles (GAAP)?

A. GAAP is a widely accepted set of rules, conventions, standards, and procedures for reporting financial information, as established by the Financial Accounting Standards Board (FASB). The financial statements companies are required to file with the Securities and Exchange Commission (SEC) must comply with GAAP. The current single source of authoritative nongovernmental U.S. GAAP is the FASB Accounting

Standard Codification (ASC).

Q. Does GAAP provide special rules for public utilities and other companies with regulated operations?

A. Yes. ASC Topic 980, Regulated operations, special rules for public utilities and other companies with regulated operations that meet all of the following specified criteria:

1. The enterprise's rates for regulated services or products provided to its customers are established by or are subject to approval by an independent, third-party regulator or by its own governing board empowered by statute or contract to establish rates that bind customers.

2. The regulated rates are designed to recover the specific enterprise's costs of providing the regulated services or products.

3. In view of the demand for the regulated services or products and the level of competition, direct and indirect, it is reasonable to assume that rates set at levels that will recover the enterprise's costs can be charged to and collected from customers. This criterion requires consideration of anticipated

changes in levels of demand or competition during the recovery period for any capitalized costs.

Q. What happens when a regulated entity ceases to meet any of the criteria?

A. ASC Topic 980-20-40-2 requires that it stop using the special rules and specifies how the enterprise must report that event in its general-purpose external financial statements. Specifically, the regulated entity must reflect the discontinuation by eliminating from its balance sheet the effects of any actions of regulators that had been recognized as assets and liabilities pursuant to the special rules but would not have been recognized as assets and liabilities by enterprises in general. However, the carrying amounts of plant, equipment, and inventory measured and reported pursuant to the special rules cannot be adjusted unless those assets are impaired, in which case the carrying amounts of those assets must be reduced to reflect that impairment.

Q. What are FASB's asset impairment rules?

A. ASC 360-10-35 requires companies to (a)

recognize an impairment loss only if the carrying amount of a long-lived asset is not recoverable from its undiscounted cash flows and (b) measure an impairment loss as the difference between the carrying amount and fair value of the asset. Long-lived assets must be tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. No longer meeting the criteria to apply the special GAAP rules for rate regulated entities would trigger the need for performing a test for recoverability.

Q. Have any New York ILEC's recognized an impairment loss in their financial statements?

A. Yes. Verizon and Frontier of Rochester, the two largest incumbent telephone companies in the state made dramatic write downs of their historic plant during the last two decades when they stopped using the special GAAP rules for regulated entities after the Commission adopted regulatory plans that significantly moved the companies away from traditional rate of return regulation.

Q. Please describe Frontier of Rochester's plant

write-down.

A. Frontier of Rochester wrote down its plant after the Commission approved the Open Market Plan (OMP)in 1993(Cases 93-C-0103 and 93-C-0033, Opinion No. 94-25, Rochester Telephone Corporation – Open Market Plan (issued November 16, 1994). In its Annual Report to the SEC for calendar year 1995, Frontier of Rochester stated that it discontinued applying the special GAAP rules based "upon changes in regulation and increasingly rapid advancements in telecommunications technology and other factors increasing the level of competitors in markets served by the Company. The discontinuance of regulatory accounting methods resulted in a non-cash post-tax extraordinary charge of $112.1 million, net of applicable income taxes of $68.4 million, primarily caused by the reduction in the recorded value of long-lived telephone plant assets."

Q. Please describe Verizon's plant write-down.

A. Verizon wrote down its plant after the Commission approved the Performance Regulatory Plan (PRP) in 1995 (Case 92-C-0665, Opinion No.

95-13, New York Telephone – Performance Regulatory Plan (issued August 16, 1995)). The footnote in Verizon's Annual Report to the SEC for calendar year 1995 describing the impact of going off the special GAAP rules for regulated entities included:

> Telephone plant and equipment was adjusted through an increase in accumulated depreciation, to reflect the difference between recorded depreciation and the amount of depreciation that would have been recorded had the Company not been subject to rate regulation. Gross plant was written off where fully depreciated, and non-plant regulatory assets and liabilities were eliminated from the balance sheet. The after-tax extraordinary charge recorded consists of $1.8 billion for the adjustment to telephone plant and equipment and $0.5 billion for the write-off of non-plant regulatory assets and liabilities. The net decrease of $2.8 billion to telephone plant and equipment was supported by a depreciation analysis, which

identified inadequate depreciation reserve levels which the Company believes resulted principally from the cumulative under-depreciation of telephone plant and equipment as a result of the regulatory process. An impairment analysis was performed that did not identify any additional amounts not recoverable from future operations.

Q. Did the financial statements Verizon filed with the Commission starting in 1995 fully reflect this write-down?

A. No. Verizon originally only made this change for the financial statements that it filed with the SEC. The financial statements it filed with the Commission continued to reflect the higher plant balances. However, as part of the regulatory plan adopted by the Commission succeeding the PRP, the Verizon Incentive Plan (VIP), Verizon agreed that the financial statements reported to the Commission for regulatory reporting purposes would also reflect the plant write-offs and other impacts of going off the special account rules for rate regulated

entities (Case 00-C-1945 et al, Verizon New York Inc. – Verizon Incentive Plan; Order Instituting Verizon Incentive Plan (issued February 27, 2002)).

Q. Has any New York ILEC stopped using the special GAAP accounting rules for regulated entities and written down plant besides Verizon and Frontier of Rochester?

A. We are not aware than any ILEC other than Verizon and Frontier of Rochester have stopped using the special rules and written down plant.

Q. If the Commission determines there is no need for a state universal service funding mechanism or it will not allow full recovery of embedded costs, will these ILECs need to do a GAAP impairment analysis?

A. Based on the information available to us, yes. The third criteria for using the special GAAP rules for rate regulated entities would no longer be met and an impairment analysis likely resulting in a plant write-down would be required.

Q. From an economic perspective, in general terms, how do a company’s assets lose value as a result

of competition?

A. In two ways. First, so long as there is a competitive entrant that is positioned to take away market share from the incumbent, an incumbent in an industry experiencing declining costs associated with technological change that has been occurring in the telecommunications industry may not be able to set prices to recover the full original cost of its investment in older technologies. Second, to the extent that an industry exhibits large fixed costs, like the telecommunications industry, the loss of customers to competitors might lead an incumbent company to attempt to recover more of its fixed investment costs, on a per unit basis, from its remaining customers. However, such increases in unit prices would likely not be sustainable as the incumbents customers would switch to the competitive provider in reaction to these higher price increases. These customer defections could engender further attempts to raise prices as a means of recovering fixed investment costs, which would result in an additional loss of customers. Such a situation

is often referred to as a "death spiral."

Q. Is seeking to fund investment cost recovery from an outside funding source one way of avoiding a death spiral?

A. Yes.

Q. Is this solution reasonable?

A. Not always. If an incumbent company has done very little to become more cost efficient as competition intensifies, it would be unfair to allow it to draw from a fund, which includes contributions from companies that have taken steps to become more efficient, operating in other competitive areas of the state. As noted, as early as 1996, the Commission stated that its goal was for the ILECs to operate as though they were facing the consequences of competitive pressures.

Q. Provide an example of how the Commission could consider plant write-downs in a state universal service funding mechanism.

A. A company requesting state universal service funding will be required to file a GAAP impairment analysis along with its request for state universal service funding. The impairment

analysis will assume no state universal service funds are available beyond the benchmark rate, and will also show the level of impairment at varying increments in the company's rate for basic local service until no impairment exists. The impairment analysis will also include information regarding the impact on the company's financial statements, ability to raise capital and potential credit problems, and ability to modernize and maintain its existing network. The Commission will then have the information necessary to make a determination on the appropriate rate for basic service and level of state universal service funds based upon the company's facts and circumstances. The company will subsequently determine whether and to what extent an impairment charge should be taken on its books.

Q. Provide an example of how the Commission can consider adjusting the level of a company's operating expenses in a state universal service funding mechanism.

A. An additional adjustment will be made to ensure the company's operating expenses are in line

with those of efficiently operating companies. For example, a benchmarking tool such as the Cost per Access Line (CPAL) comparisons, used to make financial adjustments in several cases, can be used to establish the "efficient" cost per line for the company. The burden will be on the company to demonstrate why it should be allowed more for purposes of establishing state universal service funding levels. The Commission has used this tool to make financial adjustments in several cases including Case 07-C-0349, In the Matter of Examining a Framework for Regulatory Relief; Case 02-C-0595, Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of the New York State Access Settlement Pool, Inc. for Traffic Sensitive and Non-Traffic Sensitive Access Rates; Case 04-C-1002, Crown Point Telephone Corporation's Multi-Year Rate Plan; Case 02-C-1294, Minor Rate Filing of Chazy & Westport Telephone Corporation; Case 06-C-1257, Newport Telephone Company's Multi-Year Rate Plan, and Case 92-C-0665, Investigation Performance-Based Incentive Regulatory Plans for

New York Telephone Company – Track 2.

d. Rate Considerations

Q. What rate considerations should be taken into account in determining state universal service funding?

A. In order to qualify for state universal service funds, a company's basic local service rate should be set at, and residential customers must be paying, the company's Commission authorized rate for residential basic service. Currently a statewide benchmark does not exist for business basic local service rates. Historically, business rates have typically been higher than residential rates. To receive funding, a company's business basic local service rate should not be set lower than the company's Commission authorized rate for residential basic local service.

e. Annual Attestation

Q. Will a company receiving state universal service funding be required to file an annual certification of need and attest to the proper use of state universal service funding?

A. Yes. Companies receiving state universal

service funding will be required to file an annual certification containing auditable financial and operational information with the Commission.

2. Fund Contributors

Q. If it is determined that state universal service funding is necessary, who should be required to provide funding for it?

A. All telecommunications providers benefit from their participation in New York State markets. Thus, regardless of whether they are regulated, they have an obligation to ensure that the State's Universal Service objectives established by this Commission are met.

Q. How does Staff propose to identify the telecommunications providers that should pay into the fund?

A. For the purposes of the proposed funding mechanism, Staff proposes using phone numbers for customers located in New York State.

Q. How should the allocation of funding responsibility be determined?

A. The estimated size of the fund would be divided

by total numbers utilized in New York State, as reported by those providers that get numbers directly from the North American Numbering Plan Administration (NANPA). Using this method would result in a charge per-number utilized.

Q. What are the advantages of the utilized numbers method Staff is proposing?

A. The primary advantage is the ease of administration. Based on a fund estimate of approximately $5 million, as discussed more fully below, the contribution level is likely to be less than a penny per month per telephone number.

Q. How will contributions to a funding mechanism be recovered by contributors?

A. Our proposal is to allow companies the option of including a surcharge on customer bills to recover contributions made to a state universal service funding mechanism.

Q. Will it be necessary for some providers to examine their customer base to determine whether or not the numbers are being used for interstate service, or intrastate service in another state, based on service addresses?

A. Yes, any such use would result in no payment or partial payment to the state universal service fund for these customers, in compliance with the FCC's ruling concerning contribution methodology for allocating interconnected VoIP revenues between federal and state jurisdictions. This FCC "double-assessment" protection also applies to wireless customers. However, the utilized numbers method could be readily adjusted to meet FCC safe harbor concerns. In sum, the utilized numbers method is a relatively easy and efficient approach for assessing contributions.

3. Term of Fund

Q. For how long should the fund be in effect?

A. The fund should be of limited term with an opportunity for exploring the issue of whether it needs to be extended. Given the potential for dramatic changes in the regulatory landscape at the federal level, along with the continued rapid pace of technological change, it is impossible to formulate a funding mechanism that reasonably anticipates all future market realities. Also, it is possible that funding

may no longer be necessary at some point in the future. Thus, it only makes sense to revisit the funding need and funding mechanism after a limited period of time. Therefore, the term of the fund should be limited to three-to-five years with an examination for a potential extension at the end of that term.

4. Fund Administration

Q. How will the Fund Administration be handled?

A. The fund should be administered by the New York Intrastate Access Settlement Pool (NYIASP). NYIASP is the current administrator of the Targeted Accessibility Fund (TAF), a fund that assesses all regulated telecommunications carriers to support Lifeline, Telecommunications Relay, E911 and the Public Interest Payphone program in New York.

5. Quantification

Q Have you attempted to quantify the impacts of the state universal service funding mechanism you propose?

A. Yes. We have made a rough estimate of

approximately $5 million being paid out of the fund annually.

Q. Please describe how you calculated the $5 million estimate.

A. We began by comparing the actual "Subject to Separation" return on common equity (ROE) reported by the ILECs on Schedule 10, Line 4, column a of their 2009 Annual Report to the Commission to an estimate of the allowed ROE each company would be allowed in a traditional rate case. We then multiplied the difference by the additional revenues required to provide an additional 1% ROE as reported by each company on Line 5, column a, of the 2009 Annual Reports to determine each company's total revenue requirement deficit. We then computed the maximum amount eligible companies could withdraw from a state universal service funding mechanism, by deducting from this amount an estimate of the additional revenues the company would have received in 2009 if its residential rates had been raised to the $23 benchmark rate and its business rates had been raised to an equivalent amount for the full year of 2009.

The $5 million represents the total estimated payments to 15 companies.

Q. How did you estimate the allowed ROE each company would be allowed in a traditional rate case?

A A Discounted Cash Flow and Capital Asset Pricing Model analysis was performed on a group of companies deemed comparable to the small telephone companies in New York. After the ROE for the group was calculated, adjustments were made to determine each company's individual ROE based upon the financial risk each company was facing based on the capital structure reported on Schedule 10 of the company's 2009 Annual Report.

Q. Does this conclude your testimony at this time?

A. Yes.

BEFORE THE
STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

In the Matter of

Proceeding to Examine Issues Related to a
Universal Service Fund

Case 09-M-0527

January 2011

Rebuttal Testimony of:

USF Mechanism Panel

Patrick J. Barry
Debra Labelle
Richard Leary
Robert Laurenzo
Charles Reubens
Richard E. Schuler, Jr.

Q. Have all identified panel members testified before in this proceeding?
A. Yes, except for Richard Leary.
Q. Mr. Leary, please state your full name and business address.
A. My name is Richard Leary. My business address is Three Empire State Plaza, Albany, New York 12223.
Q. Mr. Leary, by whom are you employed and in what capacity?
A. I am employed by the New York State Department of Public Service in the Office of Accounting and Finance as a Public Utilities Auditor II.
Q. What is your educational background and experience?
A. I am a May 2002 graduate of the State University of New York at Brockport with a Bachelor of Science degree in Accounting. In August 2002, I joined the firm of Fisher, Schacht, and Oliver, Certified Public Accountants, as a Staff accountant. In March of 2003, I joined the New York State Department of Taxation and Finance as a Tax Auditor Trainee and advanced to the position of Tax Auditor I. I joined the New York State Department of Public Service in November 2006, as a Public Utilities Auditor I. I progressed to my current position as a Public Utilities Auditor II through open statewide competitive examinations. My work since I joined the Department of Public Service has

included the examination of electric, gas, telephone, and water rate cases, accounting petitions, and other general accounting matters.

Q. Have you previously testified before the Public Service Commission?

A. Yes. I have testified in Case 07-W-0508 Long Island Water Corporation-Rates and in Cases 09-E-0715 et. al. New York State Electric & Gas Corporation and Rochester Gas & Electric Corporation-Rates. In addition, I have participated in the following rate cases: Case 08-C-0017-Nicholville Telephone Company, Case 08-C-0610-Onieda Country Rural Telephone, Case 09-C-0431-Crown Point Telephone Corporation, and Case 09-C-0532-Germantown Telephone Corporation.

Q. What is the purpose of your testimony?

A. We are responding to statements made by the parties concerning the use of CPAL models in conjunction with an in depth revenue requirement review. We will respond to incorrect characterizations regarding the Commission's benchmark for basic local service. Finally, we will discuss parties' statements regarding the use of telephone numbers as the basis for a funding collection method.

Q. In response to DPS-NYSTA-16, NYSTA raises concerns regarding the inaccurateness of the CPAL modeling concept. Do these concerns have merit?

A. No. The CPAL models used in Cases 02-C-1293 and Case 07-C-0349 both relied upon actual annual report data and are both well suited for examining the recent comparative cost efficiency of the existing ILECs. These CPAL models do not raise "concerns expressed regarding the misapplication or inaccurateness of the modeling concept" to a level even close to that of the engineering replacement cost analyses utilized in FCC proceedings. As indicated in Exhibit NYSTA-4, page 16, the engineering replacement cost models that have been used by the FCC estimate the cost of constructing a new telephone network. The “proxy cost” type models used by the FCC require that assumptions be made regarding engineering and construction algorithms. In contrast, the CPAL type models Staff proposes are more suited for examining comparative cost efficiency of the existing ILECs. The CPAL type models do not indicate what costs might look like 5 or 10 years down the road if, hypothetically speaking, the entire network were to be replaced with the most efficient forward looking technology. In fact, the accuracy of the cost model used for Case 07-C-0349 is confirmed by the fact that the cost model explained 99.3% of the variation in the data upon which it was estimated.(Page 3 of Appendix B, Order issued March 4, 2008 in Case 07-C-0349).

Q. CTANY indicates on page 20 of its testimony that salaries for some of the small ILECs’ officers are unreasonably high, and that a metric which combines officers’ salaries

with return on equity should be used to evaluate whether USF funding is necessary. Is CTANY's proposal inconsistent with Staff's?

A. No. Staff's CPAL adjustment incorporates wage and benefit level benchmarking.

Q. CTANY indicates on page 18 of its testimony that small ILECs could partner with other ILECs to achieve savings. Does Staff agree with CTANY's contention?

A. Yes, joining forces with other ILECs in order to achieve economies of scale in purchasing and hiring is one way of managing down input costs. Joining forces would also allow the joint venture to more efficiently allocate resources.

Q. On page 20 of its testimony, the NYSTA panel indicates that its members have high costs due to the rural, less populated and less dense characteristics of their service areas. Does the Staff panel agree with this contention?

A. This contention has merit, but it does not explain the totality of the NYSTA members' high cost problems. The CPAL type models Staff proposes can allow for the identification of the portion of costs which are due to costlier service territory characteristics and the portion of costs which relate to the smaller ILECs' inability to manage down input costs.

Q. On pages 96-99 of its testimony, NYSTA presents value of service arguments to justify the reasonableness of its proposed benchmark rate. NYSTA observed that the rates the Commission considered when setting the $23 benchmark for

basic service were for offerings that either provided features not included in the definition of basic service or wider calling areas than those available to its subscribers for the basic service rate. It concluded that because these services inherently provided more value, that the competitive local-only rate element would be well below the rates for those services. Is this a valid argument for lowering the current benchmark rate for basic service?

A. No. In its Competition III Order, the Commission moved away from a rate structure based on the size of local calling areas, stating on page 53 of the Order that "While these rate structures were appropriate in a monopoly environment, they may not be viable given the competitive intermodal market," and set a statewide benchmark for basic service. The Commission did not preclude carriers from including more value to the basic service offering by including features or expanding calling areas, it set a minimum offering to be provided, and set a statewide cap for such offering.

Q. Did NYSTA offer any other observations related to the establishment of the $23 benchmark to support its proposed benchmark?

A. Yes. On pages 99-100 of its testimony, NYSTA states that when the Commission took into consideration a forward-looking basic service cost of $22 downstate and $26 upstate, those costs were for Verizon's Regional Essentials calling package that included up to three features and

unlimited intraLATA toll calling. And in order to do an "apples-to-apples basic service costing comparison" NYSTA states the $26 should be reduced by the costs associated with the features and the expanded calling area, as well as the $6.39 Subscriber Line Charge (SLC).

Q. Does this observation have merit?

A. No. As stated previously, the Commission abandoned a rate structure based on value of service (including size of local calling area and/or features) when it set a statewide benchmark. And the rates for offerings considered by the Commission when setting the $23 benchmark rate did not include the SLC.

Q. A number of parties have indicated that a collection method based upon intrastate revenues would be preferable to a numbers-based approach as proposed by Staff. What does Staff find problematic with an intrastate revenues-based approach?

A. Given the wide disparity of intrastate revenues per customer allocated by providers (Confidential Exhibit MP___4), it seems that a numbers based approach provides a more competitively neutral method to assess carriers for universal service purposes.

Q. Does Staff have a final observation after reading the testimony of the parties in this proceeding?

A. Yes. It is Staff's contention, as well as that of several other parties in this case, that the dollars being proposed for the fund are not burdensome to the aggregate customers

of local phone service in New York State. There also appears to be a general agreement that if a new fund is implemented, it should be for a temporary period of time or subject to review in the future. This is understandable given the potential sea change mandates that may be adopted by the FCC in the near future regarding access charges, federal USF and other issues. Taking these factors into consideration, the amount of resources required to further litigate this case seems wasteful, especially in light of likely FCC mandates that could cause a revisitation of this issue in the near future. Accordingly, Staff suggests that the parties use the time before hearings in this case to explore whether a settlement endorsing a temporary fund is feasible.

Q. Does this conclude your testimony at this time?

A. Yes.

BY MS. MCCAULEY:
Q Did you also prepare exhibits filed with your testimony to this proceeding?
A (Panel) Yes.
Q Do you have those exhibits before you?
A (Panel) Yes.
Q Were these exhibits prepared by you or at your direction?
A (Panel) Yes.

MS. MCCAULEY: Your Honor, these exhibits have been premarked as Mechanism 35 through 38, and I will move them into the record at the appropriate time. With that, the Mechanism Panel is available for cross-examination.

ALJ JACK: Thank you. On cross-examination, NYSTA Smaller ILECs, do you have cross-examination for this panel?

MR. MOORMAN: Yes, Your Honor. I'm Tom Moorman of NYSTA Smaller ILECs.

CROSS-EXAMINATION
BY MR. MOORMAN:
Q If you would turn to page 8 of your direct testimony? On page 8, lines 13 to page 9, you outline the general terms or process that staff proposes for a company to receive State Universal Service Funding, is that

correct?
A (Deborah LaBelle) Yes.
Q Thank you. You would agree with me that there are three NYSTA Smaller ILEC companies currently receiving Transition Fund disbursements -- Crown Point Telephone Corporation, Newport Telephone Company and Oneida County Rural Telephone Company?
A (Deborah LaBelle) Yes.
Q Would you also agree with me that the funding for these companies that the companies receive from the Transition Fund under the extension of that transition fund is said to is expire on September 30, 2011?
A (Deborah LaBelle) Yes.
Q And subject to check, would you agree with me that the rate case process under which these companies receive Transition Fund disbursements takes approximately six to eight months?
A (Deborah LaBelle) That's a reasonable estimate.
Q Would you also agree with me that the extension of the Transition Fund, the settlement agreement that was entered into by the parties, anticipated the Commission would act in this Phase II by July 1, 2011?
A (Deborah LaBelle) I believe that's what is outlined in the Joint Proposal by the Commission.
Q Okay. Assuming the Commission was to adopt the

status proposal for the State Universal Service Fund, including, assuming arguendo, the adoption of the staff's proposed showing in addition to the traditional rate case, okay? On October 1, 2011, what happens to these three companies funded under your proposed mechanism?

A (Deborah LaBelle) That would depend -- those companies are free to file for rate relief between now and that time.

Q They are free to file for rate relief at this time even though the requirements associated -- assuming my hypothetical, that the requirements that you would otherwise impose, we don't know if the Commission would adopt those, reject those, modify those, is that correct?

A (Deborah LaBelle) Yes.

Q Nothing further.

ALJ JACK: AT&T.

CROSS-EXAMINATION

BY MS. BURGESS:

Q Good afternoon, panel.

A (Panel) Good afternoon.

Q Please turn to your rebuttal testimony, page 4. At line 6, you indicate that you agree with CTANY that Small ILECs could partner with other ILECs to achieve savings, is that correct?

A (Charles Reubens) That's what it says.

Q So do you agree that greater efficiencies might be gained by mergers and consolidations of Small ILECs?
A (Richard Schuler) That's possible.
Q How does the Commission's current review system provide incentives for companies to achieve greater efficiencies?
MS. MCCAULEY: Could we have a page reference?
MS. BURGESS: The same page. They're talking about the possibility for --
MS. MCCAULEY: Okay.
MS. BURGESS: -- greater efficiencies, and I'm asking about how the current system achieves that goal.
A (Richard Schuler) The current system of rate of return regulation?
Q Correct.
A (Richard Schuler) There's a regulatory lag incentive.
(Patrick Barry) And to the extent that rates are set at a specific cost, they have a chance to go out and beat those costs, and that would lead to efficiencies.
Q Please turn to page 6 in your rebuttal testimony. Beginning on line 23 and going through the top of page 7, you say that the Fund should be for a temporary period of

time or subject to review in the future. Was staff's original estimated $5 million fund based on the establishment of a temporary fund, or is that a change in your testimony?

A (Charles Reubens) The calculation had nothing to do with whether the temporary recommendation. It was an independent calculation.

Q So for what period of time was the original recommendation intended?

A (Charles Reubens) The recommendation is as in the testimony, but the calculation was based on the annual report data that's described in the testimony.

Q So would it be for three years, four years, or five years?

A (Charles Reubens) Whatever the Commission picks out, I guess, as far as -- I'm not quite understanding your question, I guess.

Q You are given a three-to-five year range.

A (Charles Reubens) Right.

Q How are we going to know what the actual term is?

A (Charles Reubens) Specific within the range?

Q Yes.

A (Charles Reubens) Whether it's three, four or five? We're flexible, I guess. That's to be determined.

Q So if it's a three-year fund, how much money are we

talking about?
A (Charles Reubens) Three times 6 or 5.6, I guess. That's -- you assume that's correct, but that's not a projection, so I --
Q And a five-year fund?
A (Charles Reubens) Again, five times a five-six, if you assume that's a projection, which it's not.
(Deborah LaBelle) I would like to add something. The projected 5 million or 5.6, staff's calculation, was a worst case scenario. It did not factor in rate case adjustments. It assumed all companies would file with no adjustments. So the worst-case scenario, that would be an annual number.
Q Under what conditions does staff believe that a fund would no longer be necessary?
A (Richard Schuler) I think that was answered by the last panel in the case where the Commission were to find that a competitive provider was substitutable and that provider provided service to the entirety of a service area, we would no longer view the Fund as being necessary.
Q Okay, please turn to page 35 in your rebuttal testimony.
A We don't have page 35.
Q There is a reference to 15 companies?
A (Charles Reubens) That was revised, but --

Q Okay.
A (Charles Reubens) Seven.
Q All right, thank you for that clarification. I don't have any further questions.
ALJ JACK: CTANY.
CROSS-EXAMINATION
BY MR. HANIFIN:
Q Thank you. Chris Hanifin for CTANY. Hello, panel.
A (Panel) Hello.
Q On page 8, lines 15 through 18 of your direct testimony, this will assume that a fund is approved by the Commission. Do you agree with the NYSTA witnesses that ILECs should request universal service subsidies as part of a general rate case filing?
A (Patrick Barry) Yes.
Q Okay, turn to page 9, lines 1 through 3 -- or on page 8, beginning lines 22 through 24, excuse me, on page 9, lines 1 through 3 of the direct testimony. You state that one of the first steps is that a company must set basic, local service rates at least the benchmark level, correct?
A (Patrick Barry) That's what it says, yes.
Q And that was assuming the $23 rate that has been discussed extensively here today, correct?
A (Patrick Barry) That was our assumption.

Q Do you recall whether the Commission has stated that the $23 rate is above or below cost for rural ILEC?
A (Patrick Barry) I don't recall myself. Maybe, Rick?
(Richard Schuler) I'm getting confused what panel this is.
Q Okay, I think earlier -- the confusion is with mine, I apologize. On pages 3, lines 1 through 24 of your rebuttal testimony, excuse me, you discussed the cost per access line, or CPAL models, as being well suited for examining the comparative cost efficiency of the existing ILECs, correct?
A (Charles Reubens) Yes.
Q And part of that CPAL analysis includes the compensation wage and benefits into the benchmarking, correct?
A (Richard Schuler) It can, yes.
Q Does it routinely? Is that a common factor in the analysis?
A (Richard Schuler) I believe so.
Q Do you agree that before any ILEC receives a subsidy fund from a presumed universal -- state universal service fund, if one were to be established, that an ILEC would need to demonstrate some type of efficiencies, or cost-cutting measures, or cost rationalization, correct?

A (Richard Schuler) I think the last term you used is probably the best. They would have to rationalize their cost.

Q And, lastly, in response to the CTANY interrogatory, the CTANY DPS8, staff 8, excuse me, the panel did not apply any adjustments to the ILEC rates when calculating the size of the transition fund that they discussed in your testimony, correct?

A (Charles Reubens) You're talking the 5.6 million.

Q Yes.

A (Charles Reubens) No, it did not.

Q Thank you very much, panel. I appreciate it.

ALJ JACK: Thank you, Mr. Hanifin.

Next, CPB?

MR. RIGBERG: No questions, Your Honor.

ALJ JACK: And Sprint?

MR. SCHIFMAN: Thank you, Your Honor.

CROSS-EXAMINATION

BY MR. SCHIFMAN:

Q Good afternoon, panel.

A (Panel) Good afternoon.

Q Let's go to the exhibit in your direct testimony. It's a confidential exhibit, but we're not going to get into the confidential numbers, the calculation of the

Fund. I think you replaced it. It used to total 5 million. Now it's totaling 5.6 million.

MR. SCHIFMAN: Counsel, do you know what exhibit that is? I don't see it on the --

MS. MCCAULEY: Two?

MR. REUBENS: It was an IR response we provided the spreadsheet for.

Q Okay. It was an exhibit to the CTANY testimony; do you guys recall that?

MS. MCCAULEY: No. Is there some other way that you can --

MR. SCHIFMAN: I just want to talk to them about their calculations.

Q I assume you have your calculations of the 5.6 million. Do you have that exhibit or that information request response?

A (Charles Reubens) Familiar with it.

MS. MCCAULEY: Why don't you just ask the questions and see where we go?

Q Okay. Do some of the companies listed receive zero dollars under the staff Mechanism Panel recommendations?

A (Charles Reubens) There are zeros showing, yes.

Q Okay, do you know how many companies that is?

A (Charles Reubens) I haven't added them all.

Q Okay. More than 10?

A (Charles Reubens) Make it subject to check, I guess.
Q Okay, and so what does that mean when they -- under your calculation they're not receiving any state USF dollars?
A (Charles Reubens) That the calculation shows that under the assumptions made in that calculation they wouldn't be entitled to receive any state USF.
Q Does that mean there -- have revenues that are over and above their revenue requirement?
A (Charles Reubens) Right now or because we made an adjustment for revenues they could get if they raised their rate, the benchmark. It's not already there. So what revenues are you talking about? The historic revenues, the performer revenues?
Q The performer revenues with the adjustment up to the benchmark.
A (Charles Reubens) Well, the calculation would indicate that the revenues they had were enough to make the allowed rate of return.
Q Is it possible that means they're achieving more than the allowed rate of return?
A (Charles Reubens) It's possible.
Q Okay.
A (Charles Reubens) Under that calculation, based on

everything, all the reasons -- we described how we do the calculation. There was a lot of assumptions. You assume all of that.

(Deborah LaBelle) I'd like to add something. What the spreadsheet does and the calculation does is it allows a company's rate go up to the point where they're earning the allowed rate of return. It does not bring every company up to the benchmark.

Q It brings every company up to the benchmark rate, rate, correct? Twenty-three dollars?

A (Deborah LaBelle) It brings every company up to either the benchmark, if necessary, or the rate that is necessary for the company to earn an allowed rate of return.

Q Okay.

A (Deborah LaBelle) If it's not necessary to go above $10, then the spreadsheet doesn't bring you above $10.

Q Let's go to your direct testimony on page 12. I'm looking at the question that starts on page -- or line 7, and it talks about total company regulated operations. So the way that your calculation works is a staff recognizes revenues that are not just intrastate revenues, is that right?

A (Charles Reubens) Yes.

Q Okay, and but you don't include DSL revenues, do you?
A (Charles Reubens) We include the total company to the extent they're included in the intra -- interstate that they would be part of the calculation.
Q Okay, so the retail revenues that the companies receive from DSL is included in the --
A (Charles Reubens) It depends how they're accounting for DSL. It depends how they're accounting for DLS revenues. Some companies, I understand, do two affiliates. We haven't done any study to determine how companies account for DSL.
Q Okay, so some do and some don't; is that your answer?
A (Charles Reubens) I don't know. We haven't done the study to determine how they do it.
Q Do you think DSL revenues should be included in the calculation of total company revenues?
A (Charles Reubens) We haven't thought about it.
Q But you thought enough about it to say that we're not just going to include intrastate revenues, right?
A (Charles Reubens) Yes.
Q What's the rationale for not just including intrastate revenues?
A (Charles Reubens) Just for purposes of a state

USF, we should go beyond the traditional intrastate for the reasons given in our testimony. There are issues with the allocation factors and stuff, and we think makes intrastate only somewhat misleading.

Q Because those factors were frozen a long time ago?

A (Charles Reubens) Correct.

Q Okay, and in one of your testimonies you say that one of the reasons is because the parties market their services?

MS. MCCAULEY: Could we have a page reference?

MR. SCHIFMAN: Let me just ask a general question, and then if we need to get to a page reference we will.

Q In your view, do companies market their services as an integrated whole, the interstate and intrastate portion of those services?

A (Richard Schuler) They often times do that.

Q Is that one of the reasons for looking at more than just the intrastate revenue base?

A (Charles Reubens) Yes, because that ends up -- it requires an allocation among the various services that are offered in a -- with it. It makes it more cloudy exactly what is intrastate.

Q I believe Miss Burgess asked a question about what

type of efficiencies are built into your system: Are there any incentives for efficiencies to be utilized and or gained as part of this process? I believe one of the answers was, well, they could go out and beat the costs that they have submitted, and that would lead to efficiencies. Is there -- first of all, I want to make sure I characterized that right. Is that correct, sir?

A (Richard Schuler) I don't think you characterized Miss Burgess' question correctly.

Q Okay, well, maybe you can explain to me what you meant by your answer to say that they could have lower costs and that would lead to efficiencies.

A (Patrick Barry) well, in the context of a one-year case, and especially in multi-year cases, it's possible that they would be able to achieve efficiencies below the cost levels that they have justified in the rate case. That is what I was talking about.

Q Wouldn't that lead then for a just and reasonable rate to be -- either a local rate to be lower, or access charges lower, or universal service payments to be lower also?

A (Patrick Barry) If they achieve these efficiencies and they come in for filing rates again, or the Commission brings them in, yes, there would be lower rates. All else equal.

Q Under your plan, though, is there a yearly review, or less, to determine whether or not those efficiencies are being achieved and whether they should continue to get access to the funds?

A (Patrick Barry) Well, I think if the company has got funds. We haven't had attestation that would be required that they're still -- and some financial data to prove that they're still justifying in the Fund, but let me --

Q Is there something else you want to add?

A (Patrick Barry) Yes, we do want to add something. We're just double checking.

Q Okay.

A (Patrick Barry) I think I'll just stick with the answer to that. If you read on page 29 to 30, the companies receiving State Universal funding will be required to file annual certification, containing auditable financial and operational information with the Commission. Now, at that time we would have a chance to review.

Q Do you believe a fund that's set up on a rate-of-return regulated basis incents (sic) companies to be as efficient if a fund was based on forward-looking costs?

A (Patrick Barry) That's not our proposal.

Q I understand it's not your proposal, but I'm trying to -- I'm trying to get some information to the Commission to determine what your opinion would be on that.
A (Patrick Barry) I don't think we've really done a study on it.
Q Okay, so you haven't considered a fund based on forward-looking costs, is that right?
A (Richard Schuler) I think our proposal is forward looking.
Q It's not based on embedded costs of the ILECs?
A (Charles Reubens) As the starting point, but in the financial considerations portion of our testimony, starting on page 11, we talk about the steps we're taking away from traditional cost-of-service regulation of the Fund.
Q So you propose to make adjustments to the embedded costs?
A (Charles Reubens) Right. We haven't made a specific proposal. We've given a couple options. Another one could can be forward-looking costs, I guess.
Q Okay, and do you have an opinion as to whether or not your proposals are more or less efficient than a fund that's purely based on forward-looking costs analysis of the networks?
A (Richard Schuler) I think the impairment analysis

ought to reflect similar considerations as would a forward-looking analysis that I think you're asking about, but if you would like more, I'd ask you to clarify your question.

Q No, I'm not asking for more. I'm just trying to determine what type of analysis you've done and whether or not you've compared your proposal to other types of universal funds that states implement.

A (Charles Reubens) No, but we considered a hard recommendation, and we changed it to options because we quickly realized that time just didn't permit us to do the type of analysis that you're indicating.

Q Okay. I believe one of the panel participants mentioned that the 5.6 million is the -- did you say it's the cap or the most that can be --

A (Charles Reubens) It's not a cap. It's not a cap. There is a lot of confusion about that number. It was a number that we calculated, essentially, for the Policy Panel to use to show the relatively small size of this in relation to the total telecommunications revenue. It was not an estimate -- our estimate of what would be paid out. It's not a cap. It's a number based on certain assumptions. As Debby indicated, we assume no rate case adjustments which always happen in rate cases, things like that. We make other recommendations beyond traditional

rate case adjustments that aren't reflected in there. Again, it was just to put a number out there to indicate what -- a very conservative estimate of what could possibly happen under certain circumstances to show the relative small size of the market.

Q And what opinion do you have of any changes to intercarrier compensation or federal universal service that the FCC is considering? Or does staff's mechanism allow for the potential of adding to the State Universal Service Fund based on the results of those proceedings?

MS. MCCAULEY: That's way beyond the scope of direct.

MR. SCHIFMAN: I guess I disagree with that objection, because I think, you know, we're proposing a fund. I believe on page 7 of the rebuttal, it talks about, This is understandable, given the potential C change mandates that may be adopted by the FCC in the near future regarding access charges, federal USF and other issues. So what I'm asking is the potential C changes that you state in your testimony regarding the access, federal USF and other issues, how are you proposing your fund to address those? Are you saying those should not be addressed as part of the fund or they should be?

MS. MCCAULEY: I just want to point out that you're asking a general question and eliciting a specific response. I'm not sure the panel can answer with specifics.

A (Patrick Barry) No, that whole phraseology that Counsel is reading, that's about the temporary nature of the fund, not any mechanics of the Fund itself.

Q Okay, so is that a yes or no, or do you anticipate your fund to accommodate reductions in access charges at the federal level or not?

A (Patrick Barry) I can't speak for what the Commission will do.

Q Well, what is staff's proposal? No opinion?

A (Patrick Barry) As the NOPR, or whatever the term they use at the FCC, is a few days old, we haven't really had time to consider it.

Q One of the questions was regarding whether or not there are any substitutable carriers at this point in time. I believe this panel was asked a question about that, and you mentioned that there was no substitutable carriers out there.

A (Patrick Barry) I believe that was the Substitutability Panel that preceded us.

Q So the question was how long would this fund last? And I believe the answer was, well, until there is a

substitutable carrier out there. Do you remember that question and answer?

A (Patrick Barry) That's not our testimony, though. It's three to five years is what we propose, which may or may not be the answer to whether there's a substitutable provider. But I assume if a substitutable provider is found, perhaps the term of the fund would be truncated.

Q And if it's not found, you said your proposal is three to five years, is the length of the fund?

A (Patrick Barry) Yes, with the process for review at the end of such term.

Q And there was mention that the 5.6 million was not a cap. Is there any type of cap that staff has proposed to the size of the Fund?

A (Deborah LaBelle) No, staff is not proposing a cap.

MR. SCHIFMAN: I have no further questions.

MS. MCCAULEY: No redirect, Your Honor.

MR. MOORMAN: I would like to know if I could ask a follow-up question on cross based on a question that Mr. Hanifin asked the panel?

MR. SCHIFMAN: Yes, you may.

CROSS-EXAMINATION

BY MR. MOORMAN:
Q Do you recall Mr. Hanifin talked to you about page 8, lines 15 to 18, roughly, talking about the filing of the rate case; do you remember that?
A (Deborah LaBelle) In the direct testimony?
Q In the direct testimony, that's right. Do you remember that?
A (Patrick Barry) Yes, we recall.
Q So let's just, today the company is at $23; what sort of rate case would they file?
A (Charles Reubens) Well, they wouldn't be filing a rate case if they're looking for lower rates, chances are, so they would have to file a rate case asking for USF funding.
(Richard Schuler) But they might have other rates that could be raised. They have discretionary services, you know, business offerings, wholesale rates.
Q And that sort of rate case filing -- earlier you had acknowledged that a rough estimate, or a good estimate, I think -- a reasonable estimate, maybe, is, I think, what you had said, was six to eight months. So that rate case would not be completed by the time the Transition Fund would -- the extension would expire on 9/30/11, is that correct?
A (Deborah LaBelle) Based on the assumption that it

would take six to eight months, yes. However, companies have been on notice since the joint proposal was approved that this fund would run out September 30 of '11.

MR. MOORMAN: Nothing further.

ALJ JACK: Do you have any redirect?

MS. MCCAULEY: Yes, I do. I have one, Your Honor.

DIRECT-EXAMINATION

BY MS. MCCAULEY:

Q Panel, you've been asked questions about access charges and their applicability to the mechanism that this panel is proposing. Is it your understanding that access charges will be taken up at another phase of this proceeding?

A (Robert Laurenzo) Yes.

ALJ JACK: Is there any recross? Thank you, panel. You are excused. Off the record for a moment.

(Discussion was held off the record.)

ALJ JACK: Back on the record please. Call the next panel.

MS. MCCAULEY: I'd like to call the Policy Panel.

L E O N A R D S I L V E R S T E I N,

D E B O R A H L A B E L L E,

W A Y N E B R I N D L E Y

G R E G O R Y P A T T E N A U D E,

having been first duly sworn by the ALJ, was examined and testified as follows:

ALJ JACK: Please proceed.

MS. MCCAULEY: Thank you.

DIRECT-EXAMINATION

BY MS. MCCAULEY:

Q Good afternoon, Policy Panel. Are you appearing on behalf of a party to this proceeding?

A (Wayne Brindley) Yes.

Q Is that party the New York State Department of Public Service?

A (Panel) Yes.

Q Did you file direct testimony in this proceeding?

A (Panel) Yes.

Q Do you have that testimony before you now?

A (Panel) Yes.

Q Was this testimony prepared by you or under your direction and supervision?

A (Panel) Yes.

Q If I asked you the same questions contained in that direct testimony today, would your answers be the same?

A (Panel) Yes.

Q Do you adopt this testimony as your sworn

testimony?

A (Panel) Yes.

MS. MCCAULEY: Your, Honor, I request that the document entitled "Direct Testimony of the Policy Panel" be copied into the record as if given orally.

ALJ JACK: Without objection, the direct testimony of the staff Policy Panel will be copied into the record as if given orally today.

(Testimony inserted as ordered.)

BEFORE THE
STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

In the Matter of

Proceeding to Examine Issues Related to a
Universal Service Fund

Case 09-M-0527

December 2010

Direct Testimony of:

Policy Panel

Wayne Brindley
Debra LaBelle
Gregory C. Pattenaude
Leonard Silverstein

Q. Mr. Brindley, please state your full name and address.

A. My name is Wayne Brindley. My business address is 90 Church St., New York, New York 10007-2919.

Q. Mr. Brindley, by whom are you employed and in what capacity?

A. I am employed by the New York State Department of Public Service as Deputy Director of the Office of Accounting and Finance.

Q. What is your educational background and professional experience?

A. I received a Bachelor of Business Administration degree, cum laude from Niagara University in May 1976. I received a Certificate in Information Systems Auditing from New York University in 1994, and have completed all course work for a Masters Degree in Performance Management and Information Systems Auditing from New York University. I am a Certified Information System Auditor (Certification Number 9515369). Since June 1977, I have been in the employ of the Department's Office of Accounting and Finance in

positions of increasing responsibility leading to my current position. I have participated in every Verizon-NY general rate proceeding post-divestiture and have experience in all the utility industries regulated by the Commission, with an emphasis in the telephone industry. In 1987, I co-authored, Report on NYNEX Corporation and Affiliates, submitted to the NARUC Subcommittee on Accounts, and in 1989 I was the overall project leader, Report on Bell Communications Research, prepared by the NARUC Multi-State Audit Team, submitted to the NARUC Subcommittee on Accounts. In 1995 I received a Departmental Certificate of Reward for my work on New York Telephone Performance Regulatory Plan. In 1999, I was a Team Leader in the development of the Performance Assurance Plan, a key component of the first successful 271 application in the United States by New York Telephone. In 2000 I was designated the Telecommunications Policy Chief for the Office of Accounting & Finance. I am currently

responsible for the work of the Management Audit unit in the Office of Accounting and Finance. I am a member of the NARUC Subcommittee on Accounts and the Information Systems Audit and Control Association. I have previously testified before the Commission.

Q. Ms. LaBelle, please state your full name and address.

A. My name is Debra LaBelle. My business address is Three Empire State Plaza, Albany, New York 12223.

Q. Ms. LaBelle, by whom are you employed and in what capacity?

A. I am employed by the New York State Department of Public Service as a Utility Supervisor in the Carrier Performance section of the Office of Telecommunications.

Q. What is your educational background and professional experience?

A. In May 1988, I received a B.S. in Mechanical Engineering from Rensselaer Polytechnic Institute. In July 1990, I joined the Department of Public Service as a Junior

Engineer and, through a series of promotions, have advanced to my current position in the Office of Telecommunications. I have participated in various proceedings. I have not previously testified before the Commission.

Q. Mr. Pattenaude, please state your full name and address.

A. My name is Gregory C. Pattenaude. My business address is Three Empire State Plaza, Albany, New York 12223.

Q. Mr. Pattenaude, by whom are you employed and in what capacity?

A. I am employed by the New York State Department of Public Service as a Chief in the Office of Telecommunications.

Q. What is your educational background and professional experience?

A. In June 1979, I received a B.S. in Electrical Engineering from Union College. In September 1979, I joined the Department of Public Service as a Junior Engineer and, through a series of promotions, have advanced to my current position in the Office of Telecommunications. I have participated in various proceedings, and have

previously testified before the Commission.

Q. Mr. Silverstein, please state your full name and address.

A. My name is Leonard Silverstein. My business address is Three Empire State Plaza, Albany, New York 12223.

Q. Mr. Silverstein, by whom are you employed and in what capacity?

A. I am employed by the New York State Department of Public Service as a Utility Consumer Assistance Specialist in the Office of Consumer Policy, Residential Advocacy section.

Q. What is your educational background and professional experience?

A. I received both a Bachelor of Arts degree in Political Science and a Master of Public Administration degree from the University at Albany. Before joining the Department of Public Service, I held positions of increasing responsibility with the New York State Assembly for nearly seven years, and subsequently worked as a Regulations Analyst at what is now the New York State Governor's Office of Regulatory Reform for about eight years. I have been

employed by the Department of Public Service since 2001. I work in the Office of Consumer Policy where my responsibilities include advocating positions on behalf of residential customers in utility rate proceedings, oversight of utility customer service operations, developing utility service quality incentive programs and evaluating utility low-income programs. I have previously testified before the Commission.

Q. What is the purpose of your testimony?

A. The purpose of our testimony will be to define Universal Service, discuss what the Commission has done to assure Universal Service, and propose a solution to ensure the continuation of Universal Service.

Q. Is the Policy Panel sponsoring any exhibits?

A. Yes, two. Exhibit___Policy_1 and Exhibit___Policy_2.

Q. What is Universal Service?

A. Universal service ensures that all residents of the state have access to affordable and reliable basic telephone service.

Q. Has the Commission previously addressed

Universal Service?

A. Yes. The Commission has a long time commitment to Universal Service. In its 1996 Competition II Order, and its 2006 Competition III Order, the Commission defined Universal Service as "the goal of ensuring that all residents have access to affordable basic telephone service so they may communicate with anyone else; access public safety, health, education, and assistance services; and participate fully in society." In the Competition II order, the Commission stated "that the goal of ensuring the provision of quality telecommunications services at reasonable rates is primary, and although other goals may be important, attainment must not come at the expense of that primary goal." In other words, another goal such as competition cannot come at a price which threatens universal service.

Q. What devices have regulators used historically to ensure the provision of telephone service to all New Yorkers?

A. Historically, regulators ensured accessible, affordable and reliable telephone service to all

New Yorkers, primarily, but not totally, for residential customers through the rate setting process. This process took the form of pricing some services above costs to underwrite service to higher-cost customers or just to keep rates lower than they would have been on a pure economic basis. Some examples would include pricing business, discretionary residential services and toll/access charges above costs to maintain the affordability of local service to residential customers. Another device used by both Federal and State regulators is needs-based assistance, specifically Lifeline services. For those citizens in New York State who lack the economic resources to obtain phone service, regulators have established a discounted service which is underwritten by other customers.

Q. Did the Competition orders referred to previously also discuss competition?

A. Yes. The orders established policies to open competition in the local market. The policies were implemented to establish a deregulated, competition-orientated telecommunications market. The focus of these policies was

breaking down market barriers to entry, ensuring an acceptable market structure, lessening regulation where appropriate, while remaining cognizant of the need to maintain universal service.

Q. Have the pro-competitive policies been successful?

A. Yes. Regulatory efforts to establish a competitive telecommunications market in New York have clearly been a success. Wireless and cable providers have made tremendous advances into the traditional landline business providing many customers with a choice of alternative providers, each offering a myriad of bundled calling plans.

Q. How has competition impacted universal service?

A. Benefits of competition have accrued mainly to those customers in more densely populated areas. Competition produces both “winners” (i.e., companies that succeed and customers who have choices) and “losers” (i.e., companies that fall short and customers who are at risk of losing basic service). As noted above, regulatory efforts in the past have been competition-

oriented while maintaining universal service goals. In this proceeding, we are now focused on what happens to the "losers" in the competitive marketplace. Because universal service is such an important social and economic goal, we must ensure universal service while also encouraging competition which has brought so many benefits to society as a whole.

Q. Do you believe Universal Service is being challenged?

A. Yes. We are now at the point where, in our judgment, the viability of companies delivering affordable, reliable and adequate telephone service to those New Yorkers dependent on one provider needs to be ensured.

Q. What is threatening viability?

A. A combination of declining revenues and customer base with a fixed cost structure.

Q. Why can't prior pricing policies be used in the current market?

A. Competition tends to price goods and services at cost, limiting the regulators ability to cross-subsidize by over-pricing more discretionary services to achieve universal service goals.

Q. Is the inability to cross-subsidize in the current market an expected result of prior policies?

A. Yes. It is a reflection of the past success of the industry and government's efforts to introduce competition into the telephone market. To pretend there is no downside to competition, specifically a negative impact to universal service would be shortsighted.

Q. Do you believe action must be taken to ensure universal service?

A. Yes.

Q. What is the risk if nothing is done?

A. We are likely to see reductions in new investments, and reduced maintenance by incumbents, leading to potential service quality problems in the long run, setting the stage for a two-tier network where customers in rural areas are provided inferior service in comparison to their more urban counterparts, either in terms of the service quality or traditional consumer protections to which they have been accustomed. Worst case scenario would be that an existing provider would go out-of-

service, leaving customers in white spot areas (i.e., no alternative provider) without service entirely. Without a fund mechanism in place, the Commission's options will be constrained, limited to reacting to a foreseeable crisis. The Commission could choose to allow local rates to rise to levels that will be unaffordable for many customers, ultimately contributing to the "death spiral" for many rural carriers. Or, the Commission could leave local rates at the current benchmark, resulting in revenue deficiencies for the rural carrier or, ultimately, bankruptcy. We do not consider these undesirable options to be substitutes for prudent public policies for maintaining universal service in New York.

Q. Does the Commission have funding mechanisms to promote universal service already in place?

A. Yes. As the result of a recommendation in the Competition II proceeding, in 1998, the Commission established the Targeted Accessibility Fund (TAF) to fund public benefit programs such as Lifeline, E911, Telecommunications Relay Service and Public

Interest Payphones on a competitively neutral basis. The Lifeline program complements the federal program in assuring that low income households have access to low priced telephone service.

Q. What is the size of TAF?

A. Currently, TAF funds approximately $50 million in reimbursable costs.

Q. Does the Commission have any other funds in place to promote its Universal Service goals?

A. In 2003, the Commission established the Transition Fund to help alleviate the pressure on local service rates in the mostly rural, high cost areas of New York State served by small, independent telephone companies.

Q. Is the Transition Fund a permanent funding mechanism?

A. No. The fund was created primarily using one-time moneys freed from companies that had previously paid into the intrastate access pool. The Comprehensive Plan that created the Transition Fund, approved by the Commission, required discussion of a more permanent funding mechanism when Transition Funding was within 18

months of exhausting.

Q. Is universal service being addressed at the Federal Communications Commission (FCC)?

A. Yes. The FCC has efforts underway to reform access charges and universal service funding, and promote broadband and mobile services.

Q. Could the Commission await the outcome of FCC proceedings before establishing a state universal service funding mechanism?

A. The current Transition Fund will end September 30, 2011. It is highly doubtful that these federal matters will be resolved by then. A mechanism to serve New York interests in the interim is a prudent course of action because universal service is essential to the social and economic interests of New York State.

Q. Did the Competition III Order, issued in March 2006, discuss need for a state high cost universal service fund?

A. Yes. In the Competition III Order, the Commission stated that a state universal service high cost fund was unnecessary at that time. The Transition Fund balance was sufficient to disburse funds for the one company receiving

funds. The first Commission Order to authorize the disbursement of Transition Funding to Crown Point Telephone Corporation was issued in December 2005, and disbursements began in January 2006. In addition, there was no need to discuss a more permanent funding mechanism since the Comprehensive Plan which created the Transition Fund required such a discussion within 18 months of 2015, the projected exhaust date at that time.

Q. What has changed since the time of the Competition III Order?

A. Since that time, two other companies – Newport Telephone Company and Oneida County Rural Telephone Company - have been authorized to receive Transition Funding, changing the forecasted exhaust date of the Transition Fund. As of October 1, 2010, the Transition Fund had a balance of $416,000. The temporary extension adopted by the Commission in July 2010 will add $600,000 to the balance but, per the Commission's Order and agreement among parties, the Transition Fund will end September 30, 2011.

Q. What process did these companies go through in

order to receive funding?

A. All companies were subject to a full rate case examination, including field visits by Staff and a review of the companies' books and records. Two other companies – Germantown Telephone Company and Nicholville Telephone Company – asked for but did not receive Transition Funding due to the Commission's acceptance of staff adjustments to the respective rate filings.

Q. What else has changed since the time of the Competition III Order?

A. Rural carriers' returns had already been dropping from lost revenues, particularly from access charges received from long distance providers. Access lines were decreasing. Growth from second lines, especially for "dial-up" service for Internet access, stopped as alternatives entered the market. In the nearly five years since the Competition III Order, competitive providers have made large inroads into the incumbents' service areas. Exhibit___Policy_1 shows access line totals since 1995. We attribute the losses since 2003 to wireless and cable phone competitors'

successful entry.

Q. What are the operational and financial ramifications to these rural companies as a result of competitive entry?

A. Revenue deterioration, exacerbated by the need to continue sustaining its networks, including all of their outside plant facilities, even though portions of their customer bases are lost. Pieces of the network cannot simply be switched off because there are fewer customers connected to the network. The reality today is that years of "partial" competitive pressure in independent phone service territories has called into question the financial viability of some of these operations.

Q. Are there other considerations, besides competitive entry, that may impact the future financial condition of the incumbents?

A. In a separate Phase of this proceeding, intrastate access charges will be addressed. If intrastate access rates are reduced to interstate access rate levels, the incumbents, including Verizon New York Inc. and the Frontier companies, will collectively experience a gross

revenue loss of approximately $120 million.

Q. Please discuss the financials of the rural incumbent companies over the last five years.

A. Comparing 2005 to 2009, 28 of the 32 small incumbent local exchange carriers companies (i.e., excluding Verizon New York Inc and the Frontier companies) have lower intrastate Returns on Equity (ROE). In addition, as of year-end 2009, 25 companies had negative ROEs, 8 of those with intrastate ROEs lower than -20%, and 2 of those 8 companies with ROEs lower than -40%. Exhibit___Policy_2 shows the returns comparing 2005 and 2009.

Q. Do customers served by the rural incumbent providers have a choice of other providers?

A. Some customers do, but not all. There are customers whose sole source for reliable, affordable phone service is the incumbent.

Q. What might happen if the rural incumbent companies fail financially?

A. If these companies fail, customers with no other access to an affordable and substitutable provider could be without dial tone altogether. Access to critical emergency services, such as

911, would be gone.

Q. Given this risk, what is the best course of action?

A. Creation of a funding structure to make certain that customers with no other alternative to the service provided by an incumbent will continue to have access to reliable basic telephone service at an affordable rate. This funding structure would provide a way to avoid raising rates to an unreasonable level in the event that customers in any part of the state risk losing phone service or have nothing but lower tier or unaffordable service available. Without a funding mechanism in place, the Commission would have no option but to raise basic rates to high cost customers or let companies go under.

Q. Do you think customers in high cost areas should pay more for basic residential service than other customers?

A. Rural New York customers should not pay rates for local service that are substantially higher than those paid by customers in urban and suburban areas. Doing so violates the Commission's policy on universal service.

Q. Can you define substantially higher?
A. Not at this point. As discussed in the mechanism panel, customer rates will be based upon all the facts and circumstances in situations where a company seeks support in the form of universal service funds.
Q. In addition to customers taking responsibility for underwriting, in part, the operations of high cost territories by paying higher rates, how else will universal service be maintained?
A. Maintenance of universal service is a shared responsibility for all participants in the New York State telecommunications market---be they user or provider, wireline or wireless, regulated or non-regulated. Customers will pay higher rates, investors of companies seeking funds may have to write down the value of their plant (as discussed by the mechanism panel) and all New York State market participants will contribute to the universal service funding mechanism. The balancing of this shared responsibility is not something that can be done generically, because facts and circumstances will differ from company to company, and

requires the in-depth review described by the mechanism panel.

Q. Does your conclusion that a fund mechanism is needed guarantee automatic funding for the three companies currently receiving funds?

A. No. There would be no guarantee that a particular company will get funding, or that a company that receives funding now will receive it in perpetuity, or that a company will get full recovery of its embedded costs. That will be determined in an individual company's request for rate relief and/or funding. As will be discussed in other panel testimony, the funding structure Department Staff proposes will provide the Commission with a tool to maintain the current level of universal service in the State.

Q. Has the Commission previously considered the level of funding an incumbent facing competition should be entitled to?

A. Yes. In the Competition II Order, the Commission discussed this at length. Specifically, the Commission considered that limited, transitional funding may be needed for recovery of a portion of incumbents' embedded

costs associated with the provision of basic service in high cost areas. According to the Commission, such funding would not guarantee any company perpetual recovery of its total costs, but instead would ensure that remaining captive customers continue to have affordable service available to them. Staff's current proposal, 15 years later, is in keeping with the Commission's vision.

Q. Do you propose creation of a permanent high cost fund?

A. No. Given the technological and market changes we've previously discussed, our proposal would be temporary and revisited in three to five years. There have been a lot of technological advances in the telecom market in the past 25 years and there are more to come; what is needed in New York is an interim solution.

Q. What would be the size of a potential fund?

A. Approximately $5.6 million per annum, as estimated and discussed by the Mechanism Panel.

Q. How does the potential fund size compare to the overall size of the telecommunications market in New York?

A. This estimate pales in comparison to overall revenues in the telecom industry in New York, which are well in excess of $20 billion. In other words, the fund that is being proposed – worst case – is less than .028% of the overall industry revenues.

Q. Does this conclude your testimony?

A. Yes, at this time.

BY MS. MCCAULEY:

Q Did you also prepare exhibits filed with your testimony in this proceeding?

A (Panel) Yes.

Q Do you have those exhibits before you?

A (Panel) Yes.

Q Were these exhibits prepared by you or at your direction?

A (Panel) Yes.

MS. MCCAULEY: Your Honor, these exhibits have been premarked for ID as policy No. 31 and 32. I will move them into the record at the appropriate time.

ALJ JACK: Thank you.

MS. MCCAULEY: The Policy Panel is available for cross-examination.

ALJ JACK: The New York -- the NYSTA Smaller ILECs.

MR. OVERCASH: No questions.

ALJ JACK: AT&T.

MS. BURGESS: No questions.

ALJ JACK: CTANY.

MR. HANIFIN: Yes, Your Honor. Chris Hanifin.

CROSS-EXAMINATION

BY MR. HANIFIN:
Q Good afternoon, panel.
A (Panel) Good afternoon.
Q Would you turn to page 6, lines 12 through 13 of your direct testimony please? There you stated that the purpose of your testimony was to define "Universal Service," true? Correct?
A (Wayne Brindley) Yes.
Q Now, your definition of Universal Service in the testimony, it's true that that is not intended to conflict with that of the Commission, that the Commission has espoused in previous orders and directives, correct?
A (Wayne Brindley) We are trying to be consistent with past Commission directives; no change contemplated.
Q Much has been discussed about the $23 benchmark rate, and in your testimony you discussed about customers --
A (Wayne Brindley) Cite, please.
Q Sure. Just give me one moment to find the cite. Please, your indulgence just for a minute so I can find it. I apologize.
MS. MCCAULEY: If you have a general, we could help.
MR. HANIFIN: Well, it goes to parity of charging customers statewide, and I'll find the

exact pinpoint cite, if that's necessary. But it's been suggested in previous staff panels that the $23 benchmark rate would go a long way to achieve that parity.

Q And what I wanted to ask is, (A), first do you agree that the $23 benchmark rate would create a level playing field for all customers in the State?

A (Wayne Brindley) Now we have a little problem with your terminology -- level playing field for customers. Help me out please.

Q Okay, would that be a fair rate for the customers to pay in rural and urban areas, the $23 benchmark rate?

A (Wayne Brindley) I believe that's what the Commission established in the last proceeding.

Q And do you recall whether the Commission has stated that the $23 benchmark rate is above or below costs in the rural ILEC areas?

A (Wayne Brindley) I vaguely recall something several years ago that it was above forward-looking costs, but that's the extent of my recollection at this minute.

Q Would it surprise you if the Commission had said that the $23 rate was below cost for a rural ILEC?

A (Wayne Brindley) How are you defining cost? Embedded? I need help.

Q Well, let's look at the embedded because that's the

staff analysis so far on its proposals.
A (Wayne Brindley) Is the $23 rate sufficient to allow the companies to recover embedded cost?
Q Sure.
A (Wayne Brindley) Is that the question?
Q Sure.
A (Wayne Brindley) Well, we have three instances where it's not.
Q Can you explain?
A (Wayne Brindley) Yeah, the three companies that are receiving moneys from the Transition Fund.
Q Okay, and one of those companies isn't charging the $23 benchmark rate, is that true?
A (Wayne Brindley) Yeah, that's correct, but we imputed the extra amounts into the rates as we do in the revenue requirement.
Q Thank you, panel. I have nothing further.
ALJ JACK: Thank you. CPB?
MR. RIGBERG: No questions, your Honor.
ALJ JACK: Sprint.
CROSS-EXAMINATION
BY MR. SCHIFMAN:
Q Good afternoon, panel.
A Good afternoon.

Q A couple of questions, going to page 22 of your direct testimony. And towards the bottom of the page you estimate based on what the USF Mechanism Panel said of potential fund size of 5.6 million, is that right?
A (Wayne Brindley) That's correct.
Q Tell me what, if any, analysis you did comparing that 5.6 million, or looking at that 5.6 million in relationship to the 40 or more million dollars that these companies get from the federal Universal Service Fund?
A (Wayne Brindley) Can I have that reread please?
Q I'll rephrase it, if you want me to say it again.
A Yes, say it again please.
Q I just want to know what analysis you did of the federal Universal Service Fund receipts that these companies receive and how they play into the 5.6 million fund size?
A (Wayne Brindley) Well, again, this number was developed by the previous panel, but my assumption would be that when they were evaluating historic results that the federal money, to the extent that it's applicable to intrastate operations --
THE COURT REPORTER: Slow down please.
Q And do you think the federal money that these companies receive, is it used just to provide interstate services or intrastate services, or both?

A (Wayne Brindley) Well, money is fungible, so it's very hard to pick out exactly where it goes, but the federal USF allocates money specifically -- I'll slow down, I'm sorry -- specifically to both the interstate and the intrastate jurisdiction.

Q Okay, and these companies today are operating, except for the three that get Transition Funds, they're operating as Universal Service providers with only access to the federal Universal Service Funds and without access to the additional State Universal Service Funds that are being proposed here?

A (Wayne Brindley) Yes.

Q All right, that's all the questions I have. Thanks.

ALJ JACK: Is there any other cross-examination of this panel? Miss McCauley, do you have any redirect?

MS. MCCAULEY: Your Honor, could I have a moment?

ALJ JACK: Yes, go off the record for a couple.

(Discussion was held off the record.)

ALJ JACK: Okay, we're ready to go? Back on the record. Miss McCauley.

MS. MCCAULEY: No redirect, Your

Honor.

ALJ JACK: Thank you, panel. You are excused. That completes the staff panel. Now I think next we will be taking up Verizon, but why don't we take -- we've been going about an hour and 20 minutes. Let's take a break, and we'll come back at 3:00.

(A brief recess was taken.)

ALJ JACK: On the record? We now have the Verizon panel. Panel, would you please rise? Please raise your right hand.

H A R O L D W E S T,

P A U L V A S I N G T O N,

having been first duly sworn by the ALJ, was examined and testified as follows:

ALJ JACK: Thank you. Please be seated.

DIRECT-EXAMINATION

BY MR. POST:

Q Mr. Vasington, Mr. West, you're appearing here today on behalf of Verizon, New York, Inc., is that correct?

A (Panel) Yes.

Q Do you have both before you a document dated December 31, 2011, entitled "Initial Testimony of Verizon

New York, Inc"?
A (Harold West). Yes.
Q Does that document have a correction marked on page 42?
A (Paul Vasington) Yes, it does.
Q You also have before you a document dated January 28, 2011 entitled "Rebuttal Testimony of the Verizon New York, Inc. Panel"?
A (Panel) Yes.
Q Does that document have any corrections marked on it?
A (Paul Vasington) I don't believe so.
Q Does each page have the legend "Confidential Version" at the top?
A (Harold West) Yes.
Q Do you also have before you a document with the same date and title with the legend "Redacted Version" at the top?
A (Paul Vasington) Yes, we do.
Q Do the three documents you've just identified -- the initial panel testimony, the confidential version of the rebuttal testimony and the redacted version of the redacted testimony -- constitute your prefiled initial and rebuttal testimony in this proceeding?
A (Harold West) Yes.

Q If I asked you today the questions set forth in those three documents, would you provide the answers set forth in those documents?
A (Paul Vasington) Yes.
Q Are the three documents true and correct to the best of your knowledge, information and belief?
A (Panel) Yes.
Q Do you also have before you documents labeled in the upper right-hand corner "Exhibit 82, Exhibit 83, Exhibit 84, Redacted; and Exhibit 84, Confidential"?
A (Paul Vasington) Yes.
Q Are those documents -- Exhibits A, B and C respectively -- your initial testimony?
A (Paul Vasington) Yes.
Q Do you have before you documents labeled in the upper right-hand corner "Exhibit 85, Confidential; Exhibit 85, Redacted, 'Exhibit 86, Confidential; and Exhibit 86 Redacted?
A (Harold West) Yes.
Q Are these exhibits A and B respectively to your rebuttal testimony?
A (Harold West) They are.
MR. POST: Your Honor, I would ask that the initial and rebuttal testimony of the Verizon panel be admitted into the record of this

proceeding as if given orally.

ALJ JACK: Without objection, the initial panel testimony of Verizon New York, Inc. and the rebuttal testimony of Verizon New York, Inc. will be copied into the record as if given orally here today.

(Testimony inserted as ordered.)

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Joseph A. Post
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February 10, 2011

Honorable Howard A. Jack
Administrative Law Judge
New York State Department of Public Service
Three Empire State Plaza
Albany, New York 12223

Re: Case 09-M-0527

Dear Judge Jack:

Attached please find the corrected Initial Panel Testimony of Verizon New York Inc. The corrected testimony differs from the testimony filed on December 31, 2010 in the following respect: on page 42, line 9, "nationwide" has been changed to "New York."

Respectfully submitted,

Joseph A. Post

cc: Active Party List
Honorable Jaclyn A. Brilling

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Proceeding to Examine Issues Related to a Universal Service Fund	**Case 09-M-0527**

INITIAL PANEL TESTIMONY OF VERIZON NEW YORK INC.

PAUL B. VASINGTON
HAROLD E. WEST, III

Panel Members

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December 31, 2010

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CASE 09-M-0527
INITIAL TESTIMONY OF THE VERIZON NEW YORK INC. PANEL

I. INTRODUCTION

Q. What is the purpose of this testimony?

A. This testimony is submitted by Verizon New York Inc. ("Verizon") to explain why the Commission should *not* create a new fund to provide financial support for certain independent telephone companies ("ITCs")[1] following the depletion of the "Transition Fund" that was authorized by the Commission in 2003.[2] The testimony also proposes alternative measures that the Commission might take to address potential universal service issues in the ITC service areas, and discusses the manner in which a fund should be designed and operated if — contrary to the views set forth in this testimony — one is established.

Q. Does this testimony address each of the issues set forth in Appendix A to Judge Jack's November 18, 2010 "Ruling on Phase II Procedures"?

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[1] The term "ITC" is generally used to refer to incumbent LECs other than former Regional Bell Operating Companies or their successors in interest. Thus, in New York, the term would refer to all ILECs other than Verizon. However, we use the term here as a convenient designation for potential fund recipients, reflecting the fact that this proceeding has its roots in a petition filed by a group of ITCs urging the establishment of a state Universal Service Fund. In using the term, Verizon is *not* assuming that every ITC in the State would be eligible for participation in a fund (if one is created), or that non-ITC companies would *not* be eligible to participate. Issues related to eligibility for funding are discussed elsewhere in this testimony.

[2] The Transition Fund was approved by the Commission on December 23, 2003 as part of a comprehensive plan to phase out the State's Intrastate Access Pool. *See* Case 02-C-0595, "Order Adopting Comprehensive Plan" (issued and effective December 23, 2003) (the "*Transition Fund Order*").

A. Yes. Exhibit A to this testimony summarizes Verizon's position on each of the issues identified in Judge Jack's Appendix, and lists the sections in this testimony where each such position is discussed.

Q. Who are the members of the witness Panel sponsoring this testimony?

A. The members of the Panel are Mr. Paul B. Vasington and Mr. Harold E. West III.

Q. Mr. Vasington, please describe your background and experience.

A. I am a Director – State Public Policy for Verizon Services Corp. I have a Bachelor of Arts degree in Political Science from Boston College and a Master's degree in Public Policy from Harvard University, Kennedy School of Government. I have been employed by Verizon since February 2005.

Before my employment with Verizon, from September 2003 to February 2005, I was a Vice President at Analysis Group, Inc. Prior to that, from May 2002 to August 2003, I was Chairman of the Massachusetts Department of Telecommunications and Energy ("MDTE"). I also served as a Commissioner at the MDTE from March 1998 to May 2002. Prior to my term as a Commissioner, I was a Senior Analyst at National Economic Research Associates, Inc. from August 1996 to March 1998. Before that, I was in the Telecommunications Division of the Massachusetts Department of Public Utilities, first as a staff analyst from May 1991 to

December 1992 and then as telecommunications division director from December 1992 to July 1996.

Q. Mr. West, please describe your background and experience.

A. I am employed by Verizon Services Corp. as Director – Regulatory Support. I graduated from Princeton University in 1980 with a Bachelor of Sciences in Engineering. In 1991, I completed an Executive Masters program at the University of Pennsylvania and received a Master of Sciences in engineering. I began working for New Jersey Bell (a predecessor of Verizon's affiliate Verizon New Jersey Inc.) in 1980 as a central office equipment engineer. I then held positions of increasing responsibility in Service Costs, Rates, Product Management, Sales, and Regulatory. I began my current position in December 1994. In this position, I have testified before public utility commissions across the country, as well as the Federal Communications Commission ("FCC"), on various marketing, policy and pricing issues associated with competitive entry into telecommunications markets.

Q. Please provide a brief outline of this testimony.

A. This testimony begins by showing that a fund is not necessary and should *not* be created simply to provide financial assistance to ITCs, in order to protect the companies themselves or their investors. As we demonstrate, robust facilities-based competition exists in virtually all areas of the State,

and so a fund is not needed to preserve universal service. Moreover, a fund would have a number of undesirable effects, including the deterrence of competition in ITC service areas, the creation of inappropriate incentives for the ITCs themselves, and the imposition of unfair burdens on other regulated carriers and their customers. Accordingly, the Commission should not create a new fund to replace the Transition Fund.

We go on to discuss measures that the Commission might take *without* creating a fund in order to protect the financial integrity of troubled ITCs (if the Commission determines that to be a legitimate objective), and to ensure that ITC functions, if any, that are necessary to the continued existence of universal service are maintained.

Finally, although Verizon opposes the creation of a fund, the testimony goes on to consider how a fund should be designed and operated if one were to be created. For example, we explain why any funding made available to ITCs should be strictly limited to what is necessary to address specific, defined universal service objectives. Funding should not be a blank check that guarantees that an ITC will be able to realize its "revenue requirement" and thereby achieve a rate of return as specified in a traditional rate case, or that it will be made whole for past or ongoing competitive revenue losses.

Q. Does the testimony address all issues relevant to the creation of a fund?

A. No. In particular, this testimony is limited to factual and policy issues, but there are also important legal issues bearing on the creation and operation of a fund. These include the extent of the Commission's authority to create and require contributions to a fund, and the question of whether requiring contributions from companies that are themselves not earning a reasonable return would violate § 97 of the Public Service Law or the constitutional prohibition on takings without just compensation. Such issues will be addressed in the briefs submitted by the Company in this proceeding.[3]

Q. As a matter of sound regulatory policy, who should bear the burden of proof on issues relating to the establishment and operation of a fund?

A. The burden should be on the parties who support the creation of such a fund.

Q. Why?

A. A universal service fund providing explicit financial support to "high cost" ITCs would be a new feature of the New York regulatory landscape. Proposals to create some form of high-cost funding arrangement have been put before the Commission on a number of occasions over the last

[3] To the extent that statements as to Verizon's positions on matters of law are included in this testimony, they will be addressed and justified in Verizon's legal briefs. They are not offered as factual or policy conclusions of the Panel members.

two decades, and the Commission has consistently declined to adopt them.[4] Although in 1998 the Commission created a fund known as the Targeted Accessibility Fund, or "TAF," the TAF has the narrow purpose of advancing a limited number of clearly-defined public policy objectives by providing support for E911, Telecommunications Relay Service, and Lifeline. It does not provide general financial support for ITCs with purportedly high costs, low revenues, or inadequate rates of return. In view of this history, as well as the competitive markets that now exist throughout the State, the burden should be on the proponents of a fund to demonstrate the need for and appropriateness of such a significant change in direction by the Commission.

Q. Doesn't the Transition Fund provide a precedent for the creation of a fund?

A. No. The Transition Fund was explicitly created as a temporary device utilizing a fixed source of funding. Moreover, it was known that the

---

[4] *See, e.g.,* Case 28425, "Opinion and Order on Pooling, Collocation and Access Rate Design" (Op. No. 92-13) (issued and effective May 29, 1992), at 5 (leaving "some matters for future resolution, including . . . whether to establish a 'high cost fund' to ensure that secondary carriers with high costs will not have to charge access rates significantly above the statewide average"); Cases 94-C-0095 and 28425, "Order Resolving Issues Related to Independent Telephone Companies' Access Charges, the 1998 Ice Storm and Other Matters" (issued and effective December 4, 1998), at 9 (finding no need to "begin development of a rate affordability fund at the present time"); Case 05-C-0616, "Statement of Policy on Further Steps Toward Competition in the Intermodal Telecommunications Market and Order Allowing Rate Filings"

(continued . . .)

Transition Fund would likely be fully spent within a limited period of time. The very name "Transition Fund" indicates the expectation that the Fund would mediate a transition to financial self-reliance on the part of the funded companies. Although the settlement that created the Transition Fund also established a process (the "Fund Track") for considering possible successor arrangements, there was no guarantee that any such arrangement would be put in place. Indeed, one of the issues listed for consideration in such a future proceeding was the fundamental one of whether a successor fund should be created at all.[5] The Commission specifically noted that it had approved the settlement creating the Transition Fund:

> without any prejudgment of the need for or nature of a longer-term universal service fund that might follow exhaustion of the Transition Fund . . . . The Plan defers all such matters to the Fund Track . . . and recognizes . . . that all parties reserve their rights as to the positions they will take in the Fund Track. Accordingly, we need not comment further on those matters.[6]

(. . . continued)

(issued and effective April 11, 2006) ("*Competition III Order*"), at 75-76 (agreeing with Staff's conclusion that a state high cost fund "is unnecessary at this point . . . .").

[5] *See* Case 02-C-0595, "Comprehensive Plan, Phase II" (attached to *Transition Fund Order*), ¶ 10(a) ("A separate Fund Track will be established to address all issues associated with the need for, establishment of, administration of, and recovery of disbursements from any funding arrangement designed to replace the Transition Fund described herein."); *id.* ¶ 10(b) ("The Issues to be addressed in this Fund Track include, but are not limited to, the following: 1. Should a fund be established?").

[6] *Transition Fund Order* at 11.

Thus, the mere existence of the Transition Fund provides no guarantee of or justification for the creation of a successor fund.

II. THE PURPOSES OF A FUND

Q. If a fund is to be created, what purpose should it serve?

A. Proponents of high-cost funding arrangements have generally argued that financial support for ITCs is necessary to ensure the maintenance of universal service — in other words, the continued provision of service to the ITCs' customers by the ITCs. In reality, however, the issues of financial support for ITCs and universal service for customers are separate and distinct. While the universal availability of some form of telephone service at a just and reasonable price may be an appropriate public policy goal, given the many facilities-based competitive carriers that are ready, willing, and able to provide service in the ITCs' service areas, external funding for the business model of one particular group of providers — the incumbent ITCs — is not necessary to ensure the continuation of universal service for the benefit of consumers. Reliance on existing competition, and encouraging the entry of new competitors, are far better mechanisms for protecting universal service than the creation of a new fund to support incumbent providers.

Q. Is the protection of existing service providers a sufficient justification for the creation of a fund, if a fund is not necessary to preserve universal service?

A. No. There can be no policy justification (and, as Verizon will show in its briefs, no legal justification) for creating a fund merely in order to protect service providers or their investors from the financial consequences of competition. Moreover, as we demonstrate in this testimony, such a fund would have a number of undesirable side-effects, including unfair impacts on other service providers, deterrence of legitimate competition, and the creation of inappropriate incentives for the funded companies.

. If the Commission concludes that there are legitimate interests of existing providers that need to be addressed, they should be dealt with through other Commission initiatives, or through Commission forbearance. For example, inadequate rates of return can be addressed, to the extent feasible, through the standard rate-case mechanism. If the financial problems of the ITCs are attributable to legacy regulatory obligations, certainly those obligations should be relaxed or eliminated as responsibility for serving customers passes to the competitive market. The Commission should also be cautious about impairing existing revenue streams on which carriers have historically relied to support legacy regulatory burdens, where the associated rate levels are just and reasonable.

However, the Commission has recognized that ILECs must take predominant responsibility for their own financial well-being by containing costs and pursuing revenue growth opportunities in response to secular declines in

their traditional wireline business. Providers must also recognize the risks of a competitive market and cannot expect a guaranteed rate of return which, in any event, the Commission no longer has the power to ensure through the rate-case mechanism. As the Commission observed over fourteen years ago:

> As we move toward a more competitive environment, local telephone companies must be ready to compete effectively with entrants to their markets who are able to successfully price at or below the incumbents' costs. Thus, the incumbents must institute, now, revenue enhancing and cost-cutting measures. Incumbent carriers should also have the flexibility to meet their competition.[7]

Therefore, no provider can claim to have been caught unawares by changes in technology, competition, and consumer demand, and there should be a heavy burden on any company that claims a new fund should be created in order to provide it with external financial help today and going forward. To the extent that the Commission wishes to address the financial problems of ITCs, it should do so using mechanisms that do not involve the creation of a new fund. A proposal for such a mechanism is discussed in Section IV of this testimony.

[7] Case 94-C-0095, "Opinion and Order Adopting Regulatory Framework" (Op. No. 96-13) (issued and effective May 22, 1996) ("*Framework Order*"), at 13.

III. CREATION OF A FUND IS NOT NECESSARY IN ORDER TO PRESERVE UNIVERSAL SERVICE, AND WOULD HAVE A NUMBER OF UNDESIRABLE CONSEQUENCES

A. The Widespread Availability of Competitive Alternatives

Q. Is support of incumbent ITCs necessary to preserve universal service in New York?

A. It is not. Intermodal providers offer facilities-based alternatives to the services provided by incumbent LECs in virtually every part of the State.

Q. What evidence is there of this?

A. In a study based on 2004 data conducted in connection with the Commission's *Competition III* proceeding, Staff concluded that 89.53% of New Yorkers had at least two facilities-based, *i.e.*, intermodal, alternatives available to them.[8] In 2007, Staff, "as a follow-up to the Comp III Proceeding," carried out a statistically-validated telephone survey of approximately 1,500 residential consumers in New York.[9] Using a modified, "more granular" approach based on that survey, Staff concluded that the

[8] *See* Case 05-C-0616, Department of Public Service, "Telecommunications in New York: Competition and Consumer Protection" (September 21, 2005), Appendix E, Table 1.

[9] *See* New York State Department of Public Service, "New York State Residential Telecommunications Consumer Survey" (April 20, 2007), at 3.

percentage of consumers with two or more intermodal options had increased to 95%.[10]

In late 2009, Staff conducted a study in this proceeding and concluded that "most of New York's 19 million residents have alternative phone options."[11] One of Staff's analyses, for example, found that only about one-half of one percent of upstate property locations has no cable modem or wireless service available.[12]

Q. Other than Staff's studies, is there any other evidence of the widespread availability of intermodal competition in New York?

A. Yes. Exhibit B describes a new analysis of competition in the ITC service areas. This study utilized: (a) Census Bureau data and related geospatial data sets to identify the locations of households in the service areas of the ITCs[13]; (b) data from the State Office of Cyber Security to identify the areas in which cable modem service or fixed wireless broadband service is available; and (c) American Roamer data to identify

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[10] *Id.* at 3-4, 7-9, 40-43. The survey results were conservative since Staff's telephone survey of State residents excluded cellular numbers — thus by fiat eliminating a significant group of customers utilizing a competitive alternative to traditional wireline service.

[11] Case 09-M-0527, "Preliminary Staff Report on Cable and Wireless Phone Coverage" (December 22, 2009), at 2.

[12] *Id.* at 7.

[13] Specifically, Verizon's study was based on the group of ITCs who, under the NYSTA umbrella, are supporting the creation of a fund in this proceeding (*i.e.*, the "NYSTA Smaller ILECs").

CMRS service areas. The study demonstrates that over 99 percent of the households in the ITC service areas have at least one intermodal alternative available to them, and over 82 percent have at least two alternatives. A detailed description of the methodology and results of the study is provided as Exhibit B to this testimony.

Q. What implications do these findings have for this proceeding?

A. The studies show that competitive services are available to all but a *de minimis* percentage of customers throughout the ITC service areas — including the areas served by the ITCs that are likely to seek financial support if a new fund is created. In fact, the percentage of households currently without intermodal alternatives is less than the percentage of customers without telephone service in 2008 (2.1 percent — *see* Response to CTANY-DPS-1 — a level that is generally considered sufficient to constitute "universal service"). Thus, the findings and study demonstrate that the goal of universal service in the ITC territories in New York is not dependent on the services of the ITCs themselves, and that subsidizing those providers to ensure the continuation of universal service is unnecessary. At a minimum, external financial support for an ITC would be a significantly overbroad regulatory response to the problem of ensuring the continued existence of universal service, a

problem that technology and competition have already solved in any event.

Q. How should the Commission assess whether the alternatives examined in these studies (principally wireless service and cable modem service) provide adequate substitutes, for universal service purposes, for the circuit-switched landline service provided by the ITCs?

A. The adequacy of alternatives to traditional providers should be judged by the test of the market — *i.e.*, whether there is substantial consumer acceptance of the alternative. No other test is as accurate, as meaningful, and as consistent with the Commission's stated policy favoring market discipline through competition — where competition exists — over market discipline through traditional regulation. Competition is about the primacy of *customer* choice; it is a mechanism that enables customers to decide for themselves what they want and to "vote with their feet," rather than having regulators decide for them what features, functionalities, and services they want or "need."

The NYSTA Smaller ILECs question the relevance of alternative services to the issues in this case on the grounds that such services:

> are not subject to the Commission's telecommunications service regulatory oversight, may not be the same level of voice grade communications provided by the NYSTA Smaller ILECs, are not provided on a common carrier (or, in some instances, a Commission overseen intrastate common carrier)

> and carrier of last resort basis, and are not provided by entities like the NYSTA Smaller ILECs that have demonstrated and continue to demonstrate their universal service commitment within their respective service areas.[14]

However, it is clear that the consumers themselves do not agree with the ITCs' perception that only their own tightly-regulated services could possibly meet consumer needs. The telecommunications market has been transformed by network convergence and, from a consumer's viewpoint, the relevance of technological or regulatory distinctions between service providers has evaporated. Cable companies and other broadband providers compete with traditional telephone services and facilitate competition by VoIP providers. Wireless mobile companies now compete for voice services, as well as for data services, and text messages substitute for both voice messages and e-mail. The changing consumer preferences that this revolution in communications technology has fostered must be taken into account in determining whether intermodal services are adequate substitutes for traditional services. In fact, the Commission has noted the importance of consumer acceptance to the question of whether a service can be considered a viable alternative:

[14] Response to VZ-NYSTA-7.

> Our experience and the record in this proceeding reveal that competition in New York's telecommunications markets has evolved dramatically over just the past few years.
>
> . . . Every month tens of thousands of customers in New York switch from their incumbent local exchange service providers to intermodal competitors to obtain savings and innovative, value-added services.[15]
>
> . . . We find that these services are widely available in New York and that from the perspective of customer demand *they are sufficiently close substitutes* for traditional wireline local service.[16]

Thus, the Commission should *not* require that alternative providers or technologies be subject to the regulatory framework established for traditional wireline POTS service (tariffing, service quality metrics, intra- and interLATA equal access, etc.) in order to "count" for universal service purposes. That test, which could be applied only by ignoring actual market evidence, would also impose an artificial and unreasonable barrier to new and innovative technologies, and would be unnecessary to ensure just and reasonable rates and service. Indeed, in a wide range of competitive industries across the economic spectrum, it is the market, not regulation, that determines the acceptability of alternative services and service providers.

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[15] *Competition III Order* at 4.

[16] *Id.* at 33 (emphasis supplied; footnote omitted).

Q. Do commercially available wireless and VoIP services meet this market-based test?

A. Yes. At a minimum, wireless service and VoIP service (both fixed and nomadic) have achieved widespread consumer acceptance and indeed in some areas are achieving deployment levels equal to or exceeding those of incumbent providers. Almost five years ago, in the *Competition III Order*, the Commission stated:

- "We note that the FCC also recently concluded that facilities-based digital phone and wireless are sufficiently close substitutes for wireline local service. . . . Although the FCC found the record inconclusive regarding application based VOIP services (i.e., 'over-the-top' VOIP), in part because customers must separately obtain broadband access, it noted that some proportion of mass market consumers may view these services as substitutes for wireline local service."[17]

- "In our judgment, consumers view these offerings as close substitutes to wireline local service."[18]

- "Regarding application-based VoIP services, we recognize that they have different service characteristics, like self installation, and may not be viewed widely as close substitutes. But given that in excess of 35% of New Yorkers already subscribe to some kind of high speed broadband service, these customers could subscribe to an application based VoIP service being offered by a number of providers such as Vonage without an additional subscription to broadband. Moreover, the FCC recently required that these interconnected VoIP services provide E911 capability similar to that offered by traditional carriers. Vonage, for example, offers an unlimited calling plan for $24.99 per month. In view of the potential significant cost savings, and the FCC's

[17] *Id.* at 33 n.72.

[18] *Id.* at 34.

requirement that such providers offer E911, we believe these services can also serve as a close substitute for traditional wireline service for a significant number of New York consumers."[19]

- "Subscriptions to wireless services have increased dramatically in the past few years. Although the [Staff] White Paper recognized that not all customers will view wireless service as a complete substitute for traditional wireline service, we agree with the White Paper that a growing number of customers are willing and able to consider wireless as a close substitute for wireline service. A recent survey reported that about 9.4% of US wireless subscribers already use a wireless phone as their primary phone."[20]

Developments since 2006, when the *Competition III Order* was issued, corroborate the Commission's conclusions. With respect to wireless service, one such development is the growing percentage of "cord-cutters" who forego landline service altogether in favor of wireless alternatives. According to the most recent report on cord-cutting by the Centers for Disease Control, "More than one of every four American homes (26.6%) had only wireless telephones . . . during the first half of 2010 — an increase of 2.1 percentage points since the second half of 2009. In addition, nearly one of every six American homes (15.9%) received all or almost all calls on wireless telephones despite having a landline."[21] The percentage of households with

[19] *Id.* at 34-35 (footnotes omitted).

[20] *Id.* at 35 (footnotes omitted).

[21] Blumberg S.J., Luke J.V., "Wireless substitution: Early release of estimates from the National Health Interview Survey, January-June 2010" (National Center for Health Statistics, December

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only landline service has decreased from 23.8% (in the first half of 2007) to only 12.9% (in the first half of 2010).[22] The trend toward wireless-only households will only accelerate as the segment of the population that never subscribed to wireline service continues to grow. Indeed, more than half of adults aged 25-29 (51.3%) now live in households with only wireless telephones,[23] and as of June 2009, there were 18.2 million wireless subscribers in New York, and only 10.9 million wireline and VoIP subscribers, combined.[24]

Whatever conclusions may be drawn from the ubiquitous availability of wireless service in other regulatory contexts, it is clear from market experience that wireless service meets the minimal standards for addressing universal service requirements. That wireless carriers are often treated as Eligible Telecommunications Carriers in the federal universal service program is further evidence that wireless service is adequate for this social policy purpose.

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2010) (the "*CDC Study*"), available at http://www.cdc.gov/nchs/data/nhis/earlyrelease/wireless201012.htm.

[22] *CDC Study*, Table 1.

[23] *Id.* at 2.

[24] FCC, "Local Telephone Competition: Status as of June 30, 2009," Tables 8 and 17 (rel. Sept. 2010), available at http://www.fcc.gov/Daily_Releases/Daily_Business/2010/db1122/DOC-301310A1.pdf.

With respect to VoIP, the Commission's conclusions are supported by data on the increasing consumer acceptance enjoyed by VoIP-based telephony in general, and cable company "digital voice" products in particular:

- As of June 30, 2009, interconnected VoIP services provided by non-ILECs in New York represented about 25% of the total of all switched access and interconnected VoIP lines in the State.[25]

- Cable companies served more than 22 million residential voice customers as of the end of 2009.[26] Analysts predict that the number of mass market customers switching to cable voice services will continue to increase and that cable companies will serve an estimated 23-24 million residential voice subscribers by the end of 2010, and 25 million subscribers by the end of 2012.[27]

- The cable industry itself trumpets that telephone consumers are now benefiting from "true competition": "A quarter century after the initial breakup of the original AT&T telephone monopoly, true competition has come to the market for phone service, thanks to cable's facilities-based offering. Gaining both powerful features and cost efficiency by utilizing digital Voice over Internet Protocol (VoIP) technology on the same hybrid fiber-coaxial network that

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[25] *Id.*, Table 9.

[26] *See March 2010 Bundle Report* (22.3 million subscribers as of the end of 2009); Timothy Horan *et al*., Oppenheimer, *1Q10 Wireline Preview*, at 14, Exhibit 12 (Apr. 13, 2010) (21.4 million subscribers as of the end of 2009); Christopher King *et al*., Stifel Nicolaus, *3Q09 Battleground Report: Telcos vs. Cable*, at 11 (Nov. 16, 2009) (22.3 million subscribers as of 3Q09).

[27] Timothy Horan *et al*., Oppenheimer, *1Q10 Wireline Preview*, at 14, Exhibit 12 (Apr. 13, 2010) (estimating cable will serve 22.8 million voice subscribers by the end of 2010 and 24.8 million voice subscribers by the end of 2012); *see March 2010 Bundle Report* at 12 (estimating that cable will serve 24 million voice subscribers in 2010).

carries video and Internet data signals, cable telephone service is high in both quality and affordability."[28]

- Vonage, the largest over-the-top VoIP provider, serves approximately 2.4 million subscribers nationwide, a more than six hundred percent increase from December 2004.[29] Clearwire offers voice and Internet bundles over its extensive 4G WiMax network covering more than 34 million people in 27 U.S. markets.[30] Clearwire reported that as of the Fourth Quarter of 2009, it had approximately 688,000 retail and wholesale subscribers, and expects that its 4G network will cover up to 120 million people in 2010 and also anticipates that its 4G subscriber level will triple.[31] Skype's "SkypeOut" service, which allows customers to make VoIP-originated calls to wireline and wireless phones for a fee, has grown from 4.1 billion minutes in 2006 to 10.6 billion minutes in June 2009.[32]

Indeed, even some governmental agencies, hospitals, and emergency service providers — the types of customers who would be most likely to be sensitive to reliability and service quality concerns — have chosen to switch to competitive alternatives in recent years. *See* Exhibit C to this testimony.

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[28] NCTA 2007 Industry Overview at 13.

[29] *See* Vonage Press Release, "Vonage Holdings Corp. Reports Fourth Quarter and Full Year 2009 Results" (Feb. 25, 2010), available at http://ir.vonage.com/releasedetail.cfm?ReleaseID=447133; Vonage Press Release, "Vonage Crosses 400,000 Line Mark" (Jan. 5, 2005), available at http://ir.vonage.com/releasedetail.cfm?ReleaseID=194545.

[30] *See* Clearwire News Release, "Clearwire Reports Fourth Quarter and Full Year 2009 Results" (Feb. 24, 2010), available at http://investors.clearwire.com/phoenix.zhtml?c=198722&p=irol-newsArticle&id=1394717.

[31] *Id.*

[32] *See* eBay Inc., Form 10-Q at 20 (SEC filed July 29, 2009) (data for minutes 1H09 and 1H08); eBay Inc., Form 10-K at 51 (SEC filed Feb. 20, 2009) (data for 2006 and 2008).

Q. Has the Commission addressed the standards that a service must meet in order to "count" for universal service purposes?

A. Yes. The Commission has specifically identified the features and functionalities that constitute the "basic service" whose ubiquitous availability is the goal of the State's universal service policy. In its 1996 *Framework Order*, the Commission stated:

> As the competitive transition evolves, we will continue to ensure the provision of basic telephone service, at an affordable rate, to New York's customers. Basic service is a dynamic term that refers to those telephone services deemed essential to minimally acceptable access to, and use of, the public telecommunications network. Those services deemed to be basic should be made universally available.[33]

The Commission went on to conclude that the list of basic services should include these features and functionalities:

- Single Party Access Line
- Access to Local/Toll Calling
- Local Usage
- Tone Dialing
- Access to Emergency Services
- Access to Assistance Services
- Access to Telecommunications Relay Services

[33] *Framework Order* at 9.

- Directory Listing
- Privacy Protections

Q. Do wireless and VoIP services provide these functionalities?

A. VoIP and wireless service obviously provide the equivalent of a single-party access line, as well as access to local and toll calling, local usage, and tone dialing. Moreover, both wireless and VoIP providers are required to provide access to emergency services, access to relay service, and privacy protections.[34]

Although intermodal providers do not necessarily list their customers' names in White Pages directories by default, consumers no longer believe that a default White Pages listing is necessary or even a particularly important aspect of their service.[35] (If they did believe this, so many of them would not

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[34] *See, e.g.*, Wireless Communications and Public Safety Act of 1999, Pub. L. No. 106-81, 113 Stat. 1286 (1999); and New and Emerging Technologies 911 Improvement Act of 2008, Pub. L. No. 110-283, 122 Stat. 2620 (2008), *codified in relevant part at* 47 U.S.C. § 222. *See also* 47 C.F.R. § 20.18; 47 C.F.R. §§ 9.1 *et seq.*; *Implementation of the NET 911 Improvement Act of 2008,* WC Docket No. 08-171, Report and Order (rel. Oct. 21, 2008); 47 U.S.C. § 255; *Implementation of Sections 255 and 251(a)(2) of The Communications Act of 1934, as Enacted by the Telecommunications Act of 1996: Access to Telecommunications Service, Telecommunications Equipment and Customer Premises Equipment by Persons with Disabilities; Telecommunications Relay Services and Speech-to-Speech Services for Individuals with Hearing and Speech Disabilities*, WC Docket No. 04-36, *et al.,* Report and Order, 22 FCC Rcd 11275 (rel. June 15, 2007). *See also* 47 C.F.R §§ 64.2001 *et seq*.; and *Implementation of the Telecommunications Act of 1996; Telecommunications Carriers' Use of Customer Proprietary Network Information and Other Customer Information; IP-Enabled Services*, CC Docket No. 96-115, WC Docket No. 04-36, Report and Order and Further Notice of Proposed Rulemaking (rel. Apr. 2, 2007).

[35] *See* Case 10-C-0215, "Order Granting Waiver with Conditions" (issued and effective October 15, 2010), at 10 ("Customers today have many options in terms of locating telephone

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be "cord-cutting" and migrating to wireless service only.) The Commission should no longer require this as an aspect of universal service. Similarly, access to live-operator-based "assistance" services should no longer be required as an aspect of universal service. Customers can place calls or obtain information in a wide variety of ways, and competing providers should be willing to offer alternatives and compete for customers based (in part) on the convenience and quality of the alternatives that they provide.

Q. Does the fact that some intermodal providers may not offer Lifeline service mean that their services are not adequate for universal service purposes?

A. No. First of all, some wireless carriers do provide discounted Lifeline service in New York utilizing federal subsidies.[36] Moreover, the wide variety of price plans and price points offered by wireless carriers enables customers to obtain service at affordable rates with or without specially discounted Lifeline service. In any event, the existence of customers with special needs, such as

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numbers. Statistics suggest that telephone directories are not nearly as valuable as they were even a decade ago."); Michael Felberbaum, "Dark Days for White Pages: Companies Yank the Cord on Residential Phone Books as Use Fades," AP Newswires (Nov. 11, 2010) ("Fewer people rely on paper directories for a variety of reasons: more people rely solely on cell phones, whose numbers typically aren't included in the listings; more listings are available online; and mobile phones and caller ID systems on land lines can store a large number of frequently called numbers.").

[36] *See* the Universal Service Administrative Company website at www.lifelinesupport.org/li/tools/disbursements. (Lifeline disbursements to New York carriers can be identified by selecting "NY" as the State and using the "Find" button.) Among the carriers listed are Tracfone and Virgin Mobile.

Lifeline customers, is not a sufficient rationale for propping up an ailing incumbent provider. More efficient, narrowly-targeted alternatives for meeting any such needs exist, such as modifying the TAF so that TAF funds that would otherwise be paid to ITCs to support their Lifeline services could be used to provide vouchers or other direct subsidies to eligible customers in order to help them pay for intermodal services.

B. The Creation of a Fund Would Deter Competitive Entry into ITC Service Areas

Q. Aside from the fact that an explicit mechanism for providing financial support to ITCs is unnecessary to ensure the continued existence of universal service, what other conclusions can be drawn from the near-ubiquitous existence of facilities-based competition in this State, as demonstrated by the Staff and Verizon studies?

A. The studies show that robust competition is present in virtually all areas of the State, except for a very small number of “white spot” areas. This demonstrates the importance of adopting measures that will provide incentives for competitive entry into the remaining white spots, and of avoiding measures that will deter such entry. Subsidization of incumbent providers through the creation of a new fund could further deter new entry and may even lead existing competitors to exit the market. Accordingly, the creation of a universal service fund would not only be unnecessary but would actually be counterproductive, since it would hinder

competition, which is the best guarantor of universal service, price and service discipline, and innovation.

Q. Could the problem of deterring competition be addressed by providing similar levels of funding to competitive providers in any area in which funding is provided to an ITC?

A. No. Such a "solution" would create significant public policy concerns of its own, as is illustrated by the widely-acknowledged problems experienced by the federal High-Cost Fund (particularly the creation of subsidies that are unnecessary to sustain universal service, and the resulting explosive growth in fund size) as a result of the federal mandate to provide high-cost support to competing and incumbent providers at equal levels.[37]

C. A Fund Would Create Inappropriate Incentives for ITCs

Q. How would the creation of a fund affect the economic incentives of the ITCs?

A. The availability of funding based simply on a showing of financial need by an incumbent wireline provider would not solve the underlying problems that led to that need. Rather, it would simply further delay resolution of

[37] *See, e.g.,* 47 C.F.R. § 54.307; Federal Communications Commission, "Connecting America: The Broadband Plan" (March 2010) ("*National Broadband Plan"*), at 148 & nn.103-05 (labeling support of multiple competitive carriers for voice service in a particular area as "clearly inefficient"); *High-Cost Universal Service Support*, WC Docket No. 05-337, CC Docket No. 96-45, Order, 23 FCC Rcd 8834 (rel. May 1, 2008).

the hard questions that incumbent companies need to confront — how, in a competitive market, those carriers can become self-sustaining without burdening competitors and their customers. The creation of a fund at this point would provide little in the way of consumer benefits while creating a class of permanently dependent providers — which is obviously not a development that the Commission should encourage.

D. A Fund Would Impose an Unfair Burden on Other Service Providers and Their Customers

Q. Are there other reasons why the Commission should not establish a fund?

A. Yes. Support for a fund would be an unfair and unreasonable burden to impose upon the competitors that would be called upon to provide the funding, particularly Verizon, and on the customers of those companies.

Q. Why?

A. Verizon suffers from its own formidable financial challenges in New York as a result of many of the same factors that are affecting the ITCs: legacy regulatory obligations, high fixed costs associated with the maintenance of a legacy network, and competitive inroads on revenues. Four and a half years ago, in the *Competition III Order*, the Commission concluded that "[m]any consumers are taking advantage of [competitive] options and are reaping the benefits of technology and competition; as a result, former monopoly

providers are losing customers, lines, usage, and revenues."[38] The Commission in that Order also recognized "the availability of real competitive alternatives and actual competitive gains that competitive carriers are achieving. These market forces are constraining incumbent prices and indeed are forcing incumbent prices down. This, in turn, reduces financial margins on previously more profitable products . . . ."[39]

These realities are reflected in Verizon's financial metrics. For calendar year 2009 (the year of Verizon's most recent Annual Report to the Commission):

- Verizon's intrastate return on common equity was *negative* 142.96%.[40]
- Its total-company net income was *negative* $1.16 *billion*,[41] and its total-company net operating income was *negative* $852.5 million.[42]
- Its total-company cash flow from operating and investing activities was *negative* $1.02 billion.[43]

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[38] *Competition III Order* at 35.

[39] *Id.* at 54 (footnote omitted).

[40] *See* Annual Report of Verizon New York Inc. for the Year Ended December 31, 2009 to the State of New York Public Service Commission ("Report"), Schedule 10, Line 4(b). The corresponding total-company figure was *negative* 55.9%.

[41] Report, Schedule 12, Line 48(c) minus Line 22(c). This figure excludes the income in Account 7355, "Equity in Earnings of Affiliated Companies," a large part of which is income from Verizon's *nationwide* long distance operations. (Those operations currently reside in a subsidiary of Verizon New York Inc.). Such income should not be included in an assessment of Verizon's performance in this State.

[42] *Id.*, Schedule 12, Line 16(c).

[43] *Id.*, Schedule 13, Line 18(b) + Line 40(b) – Line 13(b). This figure excludes dividends from subsidiaries and affiliates; *see* footnote 41. The predominant component of "investing activities" is additions to telephone plant.

These figures are not short-term anomalies, but part of a consistent trend that is documented in the following data from Verizon's annual reports to the Commission for calendar years 2005 through 2009:[44]

	Dollars in Millions			
YEAR	NET INCOME	NET OPER. INCOME	CASH FLOW	ROE
2005	– 474.5	– 360.1	-451.9	– 44.7%
2006	– -849.8	– 719.3	-924.5	– 73.6%
2007	– 942.1	– 927.9	-472.8	– 46.0%
2008	– -920.8	– 638.2	-1,000.6	– 48.7%
2009	– 1,155.1	– 852.5	-1,021.5	–143.0%

The picture is not nearly so grim for the companies that are now seeking funding.[45] For 2009, the net income of the regulated New York telecommunications industry as a whole — excluding Verizon — was *positive* $165.4 million, with total net operating income of *positive* $127.5 million. The net income of Class B telecommunication companies[46] was *positive* $34.8 million and their net operating income was *positive* $20.5 million. The ROE for the total industry excluding Verizon was *positive*

[44] All income and cash flow figures are total company numbers, and are given in $ M. Net income excludes Account 7355 and cash flow excludes dividends from affiliates. Cash flow is for operating and investing activities combined. ROE is calculated on an intrastate basis.

[45] Data derived from http://www.dps.state.ny.us/5yrbook/index5yr.htm, files 2009tela-c.pdf and 2009teld-f.pdf. Values for some missing entries in these reports were requested from and provided by Staff.

[46] Class B telephone corporations are those with annual revenues less than $100 million. 16 NYCRR § 661.1(a). The companies seeking draw-downs from a successor fund would presumably all fall within this group.

7.7%, and the ROE for Class B telecommunications companies was *positive* 5.8%.

This is not to say that some individual ITCs did not have negative values for some key financial metrics in 2009. Nevertheless, it would clearly be unjust and unreasonable to look to Verizon to subsidize other companies whose financial metrics are no worse than — and in many cases significantly better than[47] — Verizon's own, particularly in view of the facts that:

- Verizon is not seeking such funding itself (but rather is seeking to address its own financial challenges through cost reductions, obtaining relief from outdated legacy regulatory obligations, and the pursuit of new revenue opportunities);
- the company would under most contribution formulas be the predominant contributor to a fund; and
- notwithstanding the financial challenges that it faces, Verizon is aggressively investing in its infrastructure in the State.

Indeed, imposing such an obligation on Verizon would violate the paramount federal and state policies against taking without just compensation, as well as with the policies underlying § 97 of the Public Service Law — which requires the Commission, in deciding whether a

[47] For example, of the four companies that currently draw from the Transition Fund or that have a funding application "in the pipeline" — Crown Point, Oneida County, Newport, and Germantown — three were cash-flow-positive in 2009. Only Crown Point had a reported ROE

(continued . . .)

regulated telephone corporation should be required to reduce its rates, to give "due regard, among other things, to a reasonable average return upon the value of the property actually used in the public service." Requiring a company that already has a negative rate of return to subsidize other companies cannot constitute "due regard . . . to a reasonable average return . . . ." Certainly such due regard is no less appropriate when the Commission is seeking to impose funding obligations on a regulated company than when it is seeking to compel such a company to reduce its rates. Even if imposing such obligations were lawful (and, as Verizon will show in its briefs, it is not), it would be manifestly *un*just and *un*reasonable.

Q. Would this problem be adequately addressed if Verizon were permitted to increase its existing rates — or to impose new end-user surcharges — in order to recover the amount of its contributions?

A. No. Creating a surcharge would not solve the fundamental problems resulting from the creation of a fund. In addition, such a surcharge would not only harm consumers, but would also unfairly harm Verizon. Because New York has an extraordinarily competitive telecommunications market,

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(. . . continued)

worse than Verizon's; the other three companies had ROEs of negative 0.7%, negative 1.5%, and negative 8.5%.

Verizon may be unable to pass the contribution burden on to its own customers, in which case it would bear additional revenue losses. Thus, allowing Verizon to charge higher rates might merely convert a direct financial burden (*i.e.*, a funding obligation) into an indirect one (*i.e.*, further diminution of revenues due to competitive losses). For this reason, there should be no mandate for any company to impose a surcharge.

Although general rate relief measures (such as additional pricing flexibility) may mitigate the financial impact of a funding obligation to some extent, it cannot be assured to eliminate it totally. The precise magnitude of the net impact would depend upon the amount of the funding obligation that is imposed on Verizon, the nature of the rate relief granted,[48] and other relevant factors. And, as Verizon will demonstrate in its briefs, the Commission cannot impose a funding obligation on Verizon absent rate relief or other measures that are *shown* to be adequate to offset the adverse impact of the obligation on Verizon's already-negative rate of return.

[48] An important factor is that Verizon *already* has broad pricing flexibility for virtually all non-basic retail residence services.

Q. Should the imposition of such burdens on Verizon and other service providers be a matter of concern to the Commission?

A. Yes. Impairing the financial ability of the funding companies to invest and to serve their own customers would hardly advance the goal of universal service. The FCC recognized this fact in an order that it issued earlier this year, noting that "[s]everal courts" had determined that "over-subsidizing universal service programs can actually undermine the statutory principles set forth in [47 U.S.C. § 254(b)]" and concluding that "a proper balancing inquiry must take into account our generally applicable responsibility to be a prudent guardian of the public's resources.[49] As the FCC noted, courts have also weighed in on this issue. In upholding a cap on high cost support for Competitive Eligible Telecommunications Carriers, the United States Court of Appeals for the D.C. Circuit concluded last year that the FCC must exercise fiscal responsibility with universal service funding by "balanc[ing] the risks of excessive subsidization with the principles set forth in § 254(b)" and "consider not only the possibility of pricing some customers out of the market altogether, but the need to limit the

[49] *High-Cost Universal Service Support* and *Federal-State Joint Board on Universal Service*, WC Docket No. 05-337 and CC Docket No. 96-45, Order on Remand and Memorandum Opinion and Order, 25 FCC Rcd 4072 (rel. Apr. 16, 2010) ("*High-Cost Support Remand Order*"), ¶ 29.

burden on customers who continue to maintain telephone service."[50] The court concluded that it was "entirely reasonable" for the FCC to "consider its interest in avoiding excessive funding from consumers."[51] The D.C. Circuit echoed the Fifth Circuit's earlier findings in its *Alenco* decision.[52]

E. The Likely Implementation of Significant Structural Changes in Federal Universal Service Support as a Result of the National Broadband Plan Militates Against the Creation of New State Support Mechanisms

Q. How does the National Broadband Plan bear on the Commission's consideration of a fund?

A. Under Section 8.3 of the National Broadband Plan, the FCC proposes to adopt a "comprehensive reform program" that will re-purpose the federal High-Cost support program "from primarily supporting voice communications to supporting a broadband platform that enables many

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[50] *See Rural Cellular Ass'n v. FCC*, 588 F.3d 1095, 1102 (D.C. Cir. 2009) ("*Rural Cellular*").

[51] *Rural Cellular*, 588 F.3d at 1103.

[52] *See Rural Cellular*, 588 F.3d at 1102. *Alenco* recognized that the FCC's "broad discretion to provide sufficient universal service funding includes the decision to impose cost controls to avoid excessive expenditures that will detract from universal service." *See Alenco Comms, Inc. v. FCC*, 201 F.3d 608, 620-21 (5th Cir. 2000). The *Alenco* court also noted that "excessive funding may itself violate" the Act by "detract[ing] from universal service by causing rates unnecessarily to rise, thereby pricing some consumers out of the market." *Id.*, 201 F.3d at 620. The Tenth Circuit expressed similar concerns in its *Qwest II* decision, acknowledging that "excessive subsidization arguably may affect the affordability of telecommunications services, thus violating the principle in § 254(b)(1)." *See Qwest Comm's Int'l Inc. v. FCC*, 398 F.3d 1222, 1234 (10th Cir. 2005).

applications, including voice."[53] Ultimately, the proposal is to "end all financial support for networks that only provide 'Plain Old Telephone Service' (POTS)."[54]

Such a program would obviously have a profound effect on federal high-cost funding and on the business plans of carriers that currently receive such funding. In 2009, the NYSTA companies received $27,829,264 in total, federal USF support.[55] Changes to the federal fund in turn will have an equally significant effect on the need for and structure of state high-cost funds. As the FCC noted in the Plan, "Reform requires federal and state coordination," and the "FCC should seek input from state commissions on how to harmonize federal and state efforts to promote broadband availability."[56]

The recommendations of the National Broadband Plan will be the subject of much discussion in the near future. The FCC has already begun to initiate the multiple universal service reform proceedings contemplated by the Plan. The Commission should be cautious about putting in place a

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[53] *National Broadband Plan* at 141.

[54] *Id.* at 143.

[55] See Response to VZ-NYSTA-6, Exhibit VZ-I-06-01-01.

[56] *National Broadband Plan* at 143.

new regulatory initiative that could fail to harmonize with — or indeed could even impair — federal efforts and policies in this area.[57]

F. Summary

Q. Please summarize your conclusions concerning the desirability of creating a fund that would benefit financially troubled incumbent LECs.

A. The creation of a fund would promote unfair and unreasonable outcomes, and would be inconsistent with the public interest. Accordingly, a fund should not be created. Instead, to the extent it becomes necessary to address the problems of financially-troubled ILECs (but only to that extent), the Commission should utilize the other alternatives that are discussed in Section IV.

Q. Should a fund nevertheless be created as a precautionary measure, in case the Commission should conclude at some point in the future that the need for funding outweighs the concerns outlined above?

[57] *See In re State Universal Service Fund,* Docket No. NOI-08-2, "Order Terminating Inquiry" (Iowa Utilities Bd Aug. 25, 2010), at 2 (determining that the "federal reforms [proposed in the National Broadband Plan] make it difficult at this time for the Board to move ahead with its inquiry into the SUSF. It is not yet clear how the ultimate changes to the USF and ICC will affect Iowa consumers. Without more information about how consumers will be affected, the Board cannot determine whether an Iowa USF is appropriate and what level of support would be necessary to maintain universal service at reasonable rates for Iowa consumers. Further, the extent to which Iowa will mirror federal reforms by directing universal service support to broadband instead of voice service is not yet known. For these reasons, the Board concludes that its present inquiry into a SUSF should be terminated.").

A. No. It is important to recognize that the creation of the fund would have many of the adverse consequences discussed above even before any determinations are made regarding the specific levels of funding that should be paid to particular providers. The mere existence of a fund may well hinder the expansion of competition in rural service areas, since it would send a message to competitive providers that the incumbent providers may be able to offer service on a subsidized basis.[58] By deterring the expansion of competition, a fund would thus undermine the goal of universal service rather than advance it. It would also send the wrong signals to the incumbent providers themselves, who will be less likely to undertake major structural changes in their business models — such as mergers and joint ventures aimed at achieving economies of scope and scale — if they believe that there is a significant chance that funding will be available to compensate them for any revenue requirement shortfalls. A fund could also impose upon the contributing companies a contingent obligation of uncertain magnitude, thus exacerbating their own financial burdens, which, in at least some cases, are more substantial than those faced by the potential fund recipients. Finally,

[58] *See Competition III Order* at 63 ("If rural rates more accurately reflect service costs, competitors may be able to extend their infrastructure and services to these areas. If nothing is done to adjust these subsidized rates, however, competition will be impeded and the benefits of intermodal services may be delayed or even denied in certain areas.").

creating a fund and keeping it in readiness would entail non-trivial transaction costs that would have to be borne by the industry (and, ultimately, by its customers).

IV. AN ALTERNATIVE PROCESS FOR ADDRESSING ANY DEMONSTRATED FINANCIAL PROBLEMS OF INCUMBENT LECS

Q. It has been suggested that financial support of troubled incumbent LECs is necessary in order to preserve ITC functions essential to the maintenance of universal service, such as the provision of retail service in any "white spot" areas that might exist. Do you agree?

A No. The Commission should *not* assume that these concerns can be addressed only by creating a fund and thereby inviting all of the harms discussed in the previous section. Instead, the Commission should carefully assess the existence, nature, and magnitude of the supposed problem, and should address it in the most narrowly targeted and efficient manner possible.

Q. What framework would you propose for addressing such issues?

A. Verizon proposes a process that will ensure that before a financially-troubled LEC seeks support from other companies (other than payments in accordance with its approved tariffs for services that it actually renders), the company itself will conduct a rigorous and disciplined review of alternatives that will enable it to address its own financial problems while continuing to provide all functions necessary to the maintenance of universal service within

its existing service area — and will implement the most practicable, reasonable, and efficacious of the alternatives that it identifies.

The first necessary step in such a review would be to determine the *minimum* set of services and functions that the ITC would need to provide in order to ensure the continued existence of universal service within the company's service area, giving due recognition to the availability of competitive alternatives.

Next, the company should review the measures it could take to achieve or maintain financial health while assuring that the identified services and functions will continue to be available. Such a review should be similar to the type of review that might be conducted by a consultant or investment banker advising a troubled company. All alternatives should be "on the table" for purposes of such a review, including alternatives that would make fundamental structural changes in the company's business model. Such structural changes might include the following:

- the sale or spin-off of a portion of the company's business;
- the outsourcing of particular functions; or
- mergers, acquisitions, joint ventures, and other transactions that might create economies of scope or scale.

We emphasize that because of jurisdictional limitations, the Commission would not be able to compel the company to adopt all — or perhaps any — of the alternatives identified in such a study. Clearly, however, it could decline

to consider any funding proposal unless and until such a study is conducted and the Commission determines that no practicable, reasonable alternative to exogenous funding would be consistent with the continued existence of universal service.

Q. How would the Commission determine whether the company's review was adequate?

A. The filing company would be required to provide notice of its study to all regulated telephone corporations in the State and to all intermodal providers that indicate their interest in receiving such notice. All would have the ability to review and comment on the study. Confidential information included in the study could be protected through the issuance of a protective order or through application of the Commission's existing FOIL regulations.

The study would be reviewed by Staff based on its own expertise and in light of the comments of the parties. Staff would make a recommendation to the Commission as to the adequacy of the study.

Q. What role would retail rate increases play in this type of proceeding?

A. The alternatives considered in such a study would have to include an increase in the company's monthly retail basic service rate, as well as its other retail rates, to the highest just and reasonable levels.

Q. How could such a rate ceiling be determined?

A. Currently, in ITC rate cases in which funding is sought from the Transition Fund, the Commission uses the Verizon basic local-service flat rate of $23/month as a "benchmark rate" for residential basic local service. Funding is considered when a company cannot meet its revenue requirement without increasing its basic local service rates above this benchmark. As we show below, this benchmark is far lower than is necessary to ensure just, reasonable, and affordable rates that will permit the continued maintenance of universal service. (Moreover, some companies have not yet increased their basic rates even to this benchmark level.)[59]

Q. Why is the $23 benchmark conservative as a ceiling for ILEC basic service rates?

A. The benchmark was originally set in the *Competition III Order*, primarily based on a determination that such a rate would be reasonably cost-based and consistent with market prices. The Commission did not make

[59] *See* Case 07-C-0349, Letter from Harter Secrest & Emery to Hon. Jaclyn A. Brilling (October 26, 2010) (enclosing tariff amendments proposing to increase Champlain Telephone Co.'s monthly residential basic local service rates to the range $15.23 to $16.32); *id.*, Letter from NYSTA to Hon. Jaclyn A. Brilling (October 26, 2010) (increase to $17.99/month for Armstrong Telephone Co.); *id.*, Letter from NYSTA to Hon. Jaclyn A. Brilling (October 26, 2010) (increase to $11.78/month for Cassadaga Telephone Corp.); *id.*, Letter from NYSTA to Hon. Jaclyn A. Briling (October 26, 2010) (increase to range of $13.65 - $15.15/month for Ontario Telephone Co.). *See also* Response to VZ-NYSTA-8.

any findings that higher rates would necessarily be unaffordable or would compromise universal service.[60]

Moreover, the $23 rate represents a small portion of the median household income in New York. When the EUCL and applicable fees, taxes, and surcharges are taken into account, a $23 monthly rate would correspond to a monthly bill of about $36-$37, depending upon the area of the State. According to Census Bureau data, the median household income in New York for 2008-09 was $50,243/year.[61] The Department of Housing and Urban Development projects 2010 ~~nationwide~~ New York median family income of $55,300 for non-metro areas, which roughly corresponds to the areas served by smaller ILEC providers.[62] Thus, it seems reasonably conservative to use $50,000/year, or $4,167/month, as a reference income level.

A monthly bill of $36.50 represents less than 0.88 percent of this median household income. Certainly there is no basis for any claim that such a small percentage represents an absolute "affordability" ceiling. The FCC has determined that average household expenditures for telephone

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[60] *See* discussion in *Competition III Order* at 53-64. *See also* Response to CTANY-DPS-2, and orders cited therein.

[61] *See* http://www.census.gov/hhes/www/income/data/incpovhlth/2009/statemhi2_09.xls.

service (including the full range of wireless and wireline service) amount to over 2% of total household expenditures, or about $94/month as of 2008.[63] Clearly, reasonable increases in the amount allocated to basic service within this overall household telecommunications budget will not lead households to abandon their ability to communicate by telephone. Indeed, since most households currently have some form of cellular service, it is not surprising that households are becoming more likely to decrease their overall telecommunications budget — if they feel a need to do so — by "cutting the cord" and eliminating their wireline service altogether, as the following discussions show:

> [T]he truth is that despite the troubled economy, Americans are still spending money on wireless and broadband services, which is helping to keep phone companies much healthier than other industries. That said, the industry is feeling the pinch.

(. . . continued)

[62] *See* http://www.novoco.com/low_income_housing/resource_files/income_limits/2010_medians.pdf.

[63] *See* Industry Analysis & Technology Division, Wireline Competition Bureau, FCC, "Reference Book of Rates, Price Indices, and Household Expenditures for Telephone Service" (2008), available at http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-284934A1.pdf) ("*Reference Book*"), Table 2.1 (expenditures on telephone service for 2006 [most recent year reported] represent 2.67% of total household expenditures for rural households, 2.21% for urban households, and 2.25% for all households). *See also* Industry Analysis and Technology Division, Wireline Competition Bureau, "Trends in Telephone Service" (September 2010), available at http://www.fcc.gov/Daily_Releases/Daily_Business/2010/db0930/DOC-301823A1.pdf), Table 3.1 (showing total household expenditures and telephone expenditures for 1981-2008).

> Specifically, phone companies are seeing a more rapid decline in their traditional telephone businesses.[64]
>
> In a high-tech shift accelerated by the recession, the number of U.S. households opting for only cell phones has for the first time surpassed those that just have traditional landlines. It is the freshest evidence of the growing appeal of wireless phones.
>
> Twenty percent of households had only cells during the last half of 2008, according to a Centers for Disease Control and Prevention survey released Wednesday. That was an increase of nearly 3 percentage points over the first half of the year, the largest six-month increase since the government started gathering such data in 2003.
>
> The 20 percent of homes with only cell phones compared to 17 percent with landlines but no cells.
>
> That ratio has changed starkly in recent years: In the first six months of 2003, just 3 percent of households were wireless only, while 43 percent stuck to landlines.[65]

Such a phenomenon does not indicate a failure of universal service, but rather the growing tendency to connect to the network through alternative intermodal services.

Q. Are there other ways to assess whether telephone rates will remain affordable at levels above the current benchmark?

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[64] Reardon, Marguerite, "Wireless Saving Phone Companies During Recession," CNET News, (Jan. 29, 2009), available at http://news.cnet.com/8301-1035_3-10151807-94.html.

[65] "One Way to Cope with Recession: More Cell Phone Users Dropping Their Landline," AARP Bulletin Today (May 6, 2009).

A. Yes. Another approach to the affordability question might be based on the FCC's "reasonable comparability" test under § 254(b)(3) of the Telecommunications Act.

Q. Please explain.

A. Section 254(b)(3) states that

> [c]onsumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high cost areas, should have access to telecommunications and information services, including interexchange services and advanced telecommunications and information services, that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas.

47 C.F.R. § 54.316(a) implements this provision of the Act by requiring states

> annually to review the comparability of residential rates in rural areas of the state served by non-rural incumbent local exchange carriers to urban rates nationwide, and to certify to the Commission and the Administrator as to whether the rates are reasonable comparable, for purposes of section 254(b)(3) . . . .

Part (b) of the same Rule establishes a "safe harbor" test under which "a state may presume that the residential rates in rural areas served by non-rural incumbent local exchange carriers are reasonably comparable to urban

rates nationwide if the rates are below" a benchmark equal to "the most recent average urban rate plus two weighted standard deviations."[66] The most recent computation of this benchmark rate sets it at 143% of the average urban rate.[67] Applying this factor to Verizon's $23 per month "benchmark" rate gives a comparable rural rate of $32.89. While a "comparability" standard is not necessarily the same as an "affordability" standard, the principle behind the requirement in the Act was to ensure that the benefits of competition in more densely populated areas would be shared in less populated areas. Therefore, a reasonable rate in urban areas provides a benchmark for what a reasonable rate is in more rural areas.[68]

Q. How would such analyses account for the needs of the poorest customers?

A. Such customers' needs will be adequately addressed by the continued availability of Lifeline service, whether from the ILEC or through a modification to the TAF that would permit direct Lifeline subsidies for

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[66] *See generally High-Cost Support Remand Order.*

[67] *Reference Book*, Table 1.13.

[68] It should also be noted that the FCC intended to apply the factor to a broader range of rates, rather than just to a basic service rate. Nevertheless, the role of the factor as a fairness-based benchmark for comparing rural and urban rates is maintained whether it is used to compare a

(continued . . .)

eligible customers, as proposed above. In addition, consideration for the needs of the poorest customers must also include an accounting for any added funding burdens placed on the contributing carriers' poor customers. The facile identification of "poor customers" with "rural ITC customers" is simply not valid. For example, the county in the State with the lowest median household income is Bronx County, in which Verizon is the sole incumbent LEC.

Q. Do you have any other recommendations concerning the use of reference or benchmark rates for retail basic local service?

A. We have two additional recommendations. First, if any type of retail rate ceiling is utilized, it should be adjusted periodically for inflation. Second, a benchmark rate should not ignore the fact that many providers and customers are migrating to service packages that include, but are not limited to, basic local service (and that will obviously be priced somewhat above the basic local service rate level). If some sort of reference rate level is utilized, it should be flexible enough to be applicable to such service bundles.

(. . . continued)

full "market basket" of urban rates to a comparable market basket of rural rates, or simply to compare basic urban rates to basic rural rates.

Q. What role would regulatory relief play in the overall process of assessing a troubled ITC's options?

A. If as a result of the assessment process described above, a company proposes to withdraw from providing all or a portion of the regulated services that it currently provides pursuant to its tariffs and the Commission's common carriage regulations, then the Commission should limit the company's obligations accordingly. For example, if demand has declined to the point where it is not economic for a company to maintain facilities in the company's current service area, then the company should be freed of any obligation it may have under its existing tariffs to provide its own retail service in those areas. Also, a company should be given the right to de-average its rates to better reflect the cost characteristics of white spot areas, subject to the constraint of maintaining just and reasonable rates that will permit the continued existence of universal service in such areas. Aside from providing additional support for the filing company, such measures will stimulate competitive entry into areas currently classified as white spots.

V. PRINCIPLES THAT SHOULD GOVERN THE OPERATION OF A FUND, IF ONE IS CREATED

Q. In the preceding sections of this testimony, you have argued against the creation of a fund. Do you have any recommendations concerning the design and operation of a fund, if the Commission concludes that it is both lawful and desirable to create one?

A. Yes. While Verizon does not believe that it would be either lawful or desirable to create a fund, for the reasons set forth herein and in its briefs, if the Commission does adopt a fund, Verizon makes the recommendations set forth below. These recommendations are not in any way an admission of the feasibility or lawfulness of a fund and are made solely in response to the ALJ's direction.

A. If a Fund Is Established, Eligibility for Funding and the Amount of Funding Provided Should Be Determined by Competitive Bidding

Q. If a fund is established, how should the Commission determine which company in any given area will be eligible to receive distributions from the fund?

A. First of all, for the reasons described above, funding should be provided to only one company per location. That company should be the one that demonstrates that it is the most efficient provider of universal service in that location — that is, the company that would be willing, for the least amount of funding, to make its service available to any customers that do not already have adequate access to the services of other providers. It is quite possible that alternative providers would be able to provide service in such areas for far less than it would cost to sustain the entire current level of operations of an incumbent LEC. For example, wireless

carriers might be able to add incremental coverage at a cost that is less than maintaining an ILEC's network.

Q. Would the incumbent ITC nevertheless be eligible to be considered as a potential fund recipient?

A. Yes, but only to the extent that it demonstrates that it is the most efficient provider.

Q. How can the most efficient provider be identified?

A. There are many ways to identify the provider best able to serve an area with the lowest subsidy. In the National Broadband Plan, the FCC proposes to utilize some form of competitive bidding to select a single subsidized high-cost provider in those areas where there would be no provider without support.[69] If this Commission determines to move forward with a fund — which it should not do — it makes the most sense that the distribution mechanism be patterned after the process that the FCC ultimately adopts. Moving ahead of or independent from the FCC with a different process would be a poor use of resources and inconsistent with the FCC's request in the National Broadband Plan for coordinated action. The FCC has already taken steps to establish

[69] *National Broadband Plan* at 145.

workable competitive bidding mechanisms for universal service, consistent with the National Broadband Plan.[70]

Q. How would this process work if the incumbent was the only provider willing to provide ubiquitous adequate service within the service area?

A. In a competitive bidding context it is possible to impute results from an area where there are multiple bids to areas with similar characteristics that lack multiple bidders.

Q. What should be the scope of the geographic area for which such bidding is conducted?

A. Bids should be solicited only for the services and areas identified as necessary for the maintenance of universal service.

Q. Should there be any restrictions on a company's eligibility to submit a bid?

A. No. Any viable company that is authorized under law to provide service should be permitted to bid.

[70] *Universal Service Reform — Mobility Fund,* WT Docket No. 10-208, Notice of Proposed Rulemaking (rel. Oct. 14, 2010) (laying out a detailed proposal for distribution of universal service funding to build wireless infrastructure in those few areas that still lack access to 3G wireless coverage).

B. Strict Standards Should Limit the Amount of Funding That Will Be Provided If a Competitive Bidding Process Is Not Utilized

Q. If, despite the considerations discussed above, the Commission decides to create a fund, how should eligibility for such a fund be determined?

A. A number of rules should be established to ensure that the funding arrangement: (a) is strictly limited to the maintenance of such specific services in such specific areas as are found necessary to advance universal service; and (b) will minimize unfairness to other companies and their customers.

First, applicants should have the burden of justifying their request for funding, and their applications should be submitted to strict scrutiny in open proceedings in which funding contributors, among others, have a full opportunity to participate.

Second, in all aspects of the administration of the fund, the Commission should recognize the fundamental principle that funding should be provided only to the extent necessary to ensure the continuation of universal service.

Q. If a competitive bidding process is not utilized, how should the Commission determine the amount of funding that an entity would receive?

A. The assumptions governing rate cases — and in particular the assumption that a company is entitled to a level of revenue that will meet its "revenue requirement" — should not apply in funding determinations. Rather, the level of funding provided should be the minimum necessary to ensure the continuity of universal service, given, among other things, the availability of competitive alternatives. Moreover, this minimum should be determined on the assumption that the company seeking funding has raised or will raise its retail rates to the maximum just and reasonable level (determined in accordance with the preceding discussion), and that it has taken structural measures reasonably calculated to improve its financial picture. Of course, under this framework there would be no guarantee that the company would be able to recover its historical or "embedded" costs.

Q. If the Commission determines that a company is entitled to pay-outs from a fund, how long should the entitlement continue?

A. The Commission should establish an abbreviated annual process for determining whether fund recipients continue to meet the standards for funding. As we will discuss later in this testimony, any fund itself should be subject to review in two years, and, additionally, all funding determinations should sunset after three years, and a recipient company

should be required to make a new, full showing to support its claim for funding for the ensuing three-year period.

C. If a Fund Is Established, VoIP Providers and Cellular Providers May Not and Should Not Be Required to Contribute to the Fund

Q. If a fund is established, who should be required to contribute to the fund?

A. Only regulated service providers should be required to contribute to a fund (as is the case with the TAF). In particular, CMRS providers and VoIP providers (whether facilities-based or application-based) should be exempt from any contribution obligation.

Q. Why?

A. Even if there were not legal barriers such as Publ. Serv. L. § 5(6) to requiring intermodal providers to contribute to a fund (as Verizon will show in its briefs), the Commission should decline to take such action as a matter of State policy.

Q. Please explain.

A. There is no public policy rationale for requiring new, innovative services — including wireless and VoIP — to help fund the chosen business models of other telephone companies. And that is particularly the case where there has been no demonstration that service would otherwise be unavailable or unaffordable, that alternatives to traditional wireline service do not exist, or that wireline carriers could not provide the service without such funds. The

Commission should not burden new services and technologies (and the customers that use them) with legacy regulatory obligations that have outlived their usefulness, and with the associated costs of those obligations. Indeed, these service and technology innovations are spurring competition in the telecommunications marketplace, thereby providing an impetus for reduced rates in the traditional wireline sector. Burdening such services and customers with unnecessary new fees would simply punish their customers for choosing to use competitive services, and could drive investment dollars away from New York. Should the Commission choose to force wireless and VoIP providers to contribute to a fund, the result will be higher rates, the chilling of innovation, reduced investment, and fewer competitive options and fewer benefits for consumers. For all these reasons, the Commission should not hamper the continued growth of wireless and VoIP by imposing new fees on customers of these services.

D. If a Fund Is Established, Contributions Should Not Be Required from Regulated Companies That Are Not Themselves Earning a Reasonable Rate of Return

Q. Should regulated companies that are themselves not earning a reasonable rate of return be required to contribute to a fund?

A. No. As explained above, such a requirement would be inconsistent with fundamental fairness, with the policies underlying the Public Service Law, and with the federal and State constitutions.

E. If a Fund Is Established, the Contribution Obligation Should Be Allocated Among Contributing Companies on the Basis of Regulated Intrastate Revenues

Q. On what basis should the total contribution allocation be allocated among regulated providers?

A. Unless and until the FCC adopts a system other than one based on interstate revenues to fund universal service, this Commission should not, on its own, attempt to re-invent the wheel. In addition to the complexity of creating an entirely new funding mechanism for any state universal service fund, the burden on fund contributors to administer dual state and federal contribution systems would be significant. Thus, we recommend the adoption of a system similar to that currently used for the TAF, in which contributions are based on regulated intrastate revenues. However, if the revenue-based TAF mechanism is used as a model for contributions to any fund that the Commission should create, we would recommend one easy-to-implement change in that mechanism. Currently, TAF contributions are assessed on the basis of intrastate revenues net of intercarrier payments such as switched access, UNE, and resale charges.[71] The intercarrier payment offset should be eliminated, since it

[71] Cases 94-C-0095 and 28425, "Opinion and Order Establishing Access Charges for New York Telephone Company and Instituting a Targeted Accessibility Fund" (Op. No. 98-10) (issued and effective June 2, 1998), at 39-40.

has the inappropriate effect of penalizing the provision of facilities-based service.

Q. Please explain.

A. Consider two carriers with identical services, rates, volumes, and revenues. One is facilities-based, and therefore provides service by investing in its own network. The second is non-facilities-based, and instead of paying for its own network, makes wholesale payments to another carrier for the use of that carrier's network. We may assume for purposes of this hypothetical that the cost-based wholesale rates paid by the non-facilities-based carrier are no higher than the internal costs incurred by the facilities-based provider to maintain its network. Even though the two carriers are similarly situated with respect to revenues and costs, the non-facilities-based carrier would make much smaller TAF contributions by virtue of the intercarrier offset. We describe this result as inappropriate because it penalizes network investment, contrary to the strong public policy of this State and country. Whether or not the Commission is willing to eliminate the offset for purposes of the TAF itself, this flawed mechanism certainly should not be carried over to a new fund.

F. If a Fund Is Established, Contributing Companies Should Be Entitled to Recover the Amount of Their Contributions Through End-User Surcharges

Q. Should carriers who are required to contribute to the fund be permitted to recover their contributions through end-user surcharges?

A. Yes. Although as indicated above such surcharges could adversely affect a carrier's competitive position — and therefore contributing providers should not be *required* to impose a surcharge — such providers should at least have the discretion to decide for themselves whether such a mechanism could mitigate the contribution burden.

G. Other Issues

Q. If a fund is created, should it be subject to a sunset provision?

A. Yes. Any such fund that is created should be subject to Commission review after a period of no more than two years, and the Commission's initial order establishing the fund should make it clear that no carrier should assume or rely upon the continued existence of the fund beyond that point.

Q. Why should there be a sunset review after a fixed period?

A. *First*, a sunset review will minimize service-provider reliance on the fund, and will thus create an incentive for structural changes that will enable a provider to move towards financial self-sufficiency.

Second, technology, market structure, and regulation in the communications industry have changed rapidly in the last several years, and every indication

is that such changes will accelerate in the future. As noted above, one important factor in this regard is the National Broadband Plan, which will undoubtedly have a profound effect on the need for and appropriateness of state universal service funding mechanisms. A sunset period will ensure that appropriate changes are made in the fund to reflect these external changes.

Q. Should a fund provide support for broadband services?

A. No. Broadband is a highly competitive service provided over multiple technological platforms and special state funding mechanisms are not needed to encourage its deployment. As the Commission observed in the *Competition III Order*, "While we agree that broadband is an increasingly valuable tool with a variety of social, political, and economic applications, we remain convinced that competitive markets are the best tool to ensure appropriate, widespread deployment."[72] In short, there is no evidence of a market failure that requires regulatory intervention.

In any event, the National Broadband Plan recently issued by the FCC contemplates some form of funding mechanism for broadband deployment in unserved areas,[73] so it would be premature for state regulators to adopt new funds that may be duplicative or even inconsistent with new federal initiatives.

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[72] *Competition III Order* at 76.

[73] *See generally National Broadband Plan* § 8.3.

The Plan states that "[a] comprehensive reform program is required to shift from primarily supporting voice communications to supporting a broadband platform that enables many applications, including voice. This reform must be staged over time to realign these systems to support broadband and minimize regulatory uncertainty for investment."[74]

Even aside from funding that will potentially become available under the National Broadband Plan, there are other sources of funding available to subsidize broadband deployment. The American Recovery and Reinvestment Act provides funding for two national broadband service development and expansion programs: (1) the Rural Utilities Service program, which provides loans and grants for broadband projects focused on rural areas; and (2) the Broadband Technology Opportunities Program, a broader broadband stimulus program to be administered by the NTIA that targets unserved and underserved areas. Federal law thus provides a comprehensive nationwide approach to stimulate investment in broadband where such stimulation is needed.

Accordingly, there is no need for the Commission to use a fund to subsidize an ITC's broadband offerings, and indeed it would be counterproductive to do so.

[74] *National Broadband Plan* at 141.

Q. How should a fund be administered?

A. The administrative responsibility should be assigned through competitive bidding. Obviously, only neutral parties — *i.e.*, ones with no financial interest in contributing to or drawing from the fund — should be eligible to participate in such competitive bidding.

Q. Should there be a cap on the fund?

A. Yes. If a fund is created, in order to avoid excessive harm to the contributing companies, total fund payouts per year should be capped at the current size of the Transition Fund.

VI. SUMMARY AND CONCLUSIONS

Q. Please summarize your testimony concerning the establishment of a fund for the benefit of financially-troubled ITCs.

A. There is no need for such a fund. Competitive alternatives are present throughout the State and obviate the need to provide financial support to particular carriers who may not be the lowest cost providers in a particular area. In fact, a fund would interfere with the competitive process and would be a detriment to consumers and providers. It would also create inappropriate incentives for funded companies. Providers like Verizon, which themselves face severe financial challenges in this State, and who would be the primary contributors to a fund, should not be required to subsidize the business models of other carriers. For these reasons, the

Commission should reject funding proposals and instead implement non-fund solutions to the extent that some measures are deemed necessary to ensure the maintenance of universal service in the ITC service areas. If the Commission decides, nonetheless, to create a fund, it should be targeted to the few, if any, remaining areas without competitive alternatives, should adopt strict rules relating to eligibility and to the amount of funding to be provided, should sunset after a fixed period of time, should not burden new technologies, including wireless and VoIP, and it should not subsidize broadband deployment.

* * *

Q. Does this conclude the Panel's initial testimony?

A. Yes.

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January 28, 2011

Honorable Howard A. Jack
Administrative Law Judge
New York State Department of Public Service
Three Empire State Plaza
Albany, New York 12223

Re: Case 09-M-0527

Dear Judge Jack:

Attached please find the Rebuttal Testimony of the Verizon New York Inc. Panel.

Respectfully submitted,

Joseph A. Post

Joseph A. Post

cc: Active Party List
Honorable Jaclyn A. Brilling

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Proceeding to Examine Issues Related to a Universal Service Fund	**Case 09-M-0527**

REBUTTAL TESTIMONY OF THE VERIZON NEW YORK INC. PANEL

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January 28, 2011

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CASE 09-M-0527
REBUTTAL TESTIMONY OF THE VERIZON NEW YORK INC. PANEL
***** REDACTED VERSION *****

I. INTRODUCTION

Q. What is the purpose of this rebuttal testimony?

A. This testimony sets forth the response of Verizon New York Inc. ("Verizon") to the initial testimony filed by other parties to this proceeding on December 31, 2010. The testimony is sponsored by the same witness Panel as Verizon's initial testimony.

Q. How is this rebuttal testimony organized?

A. We begin with a general overview of the other parties' testimony, and then move on to separate discussions of the parties' positions on specific fund-related issues.

Q. Does your rebuttal address every point made in each party's initial testimony?

A. No. Our purpose is to provide a guide to the differences between Verizon's position and the positions of the other parties, and to point out the errors of fact, policy, and analysis underlying the positions that differ from Verizon's. We therefore do not address points that are not material to the overall funding issues in this case, that are repetitive of those made by other parties, that are adequately addressed in our initial testimony, or that would more appropriately be addressed in post-hearing briefs.

II. OVERVIEW OF THE INITIAL TESTIMONY

A. Summary of Verizon's Position

Q. As background to your discussion of other parties' testimony, please summarize Verizon's position in this case, as set forth in its own initial testimony.

A. There is no need to establish a fund to ensure universal availability of adequate and affordable basic telephone service in New York. Competition has provided virtually all consumers with alternatives to incumbent local exchange carrier-provided services, and a fund would have a number of undesirable effects. Thus, universal service should be encouraged and maintained not by the creation of a fund, but by encouraging more competition.

A fund should not be created simply to protect Independent Telephone Companies ("ITCs") or their investors by compensating them for competitive losses or ensuring that they achieve a reasonable return. To the extent that the Commission wishes to address the financial problems of ITCs, it should do so using mechanisms that do not involve the creation of a new fund.

If, however, the Commission does establish a fund, funding should be provided to only one company per location, determined through competitive bidding. Any viable company that is authorized under law to provide service should be permitted to bid. Only regulated service providers should be

required to contribute to a fund (as is the case with the Targeted Accessibility Fund, or "TAF"). In particular, commercial mobile radio service ("CMRS") providers and voice-over-Internet-Protocol ("VoIP") providers (whether facilities-based or application-based) should be exempt from any contribution obligation. Contribution levels should be calculated using a system similar to that currently used for the TAF — in which contributions are based on regulated intrastate revenues — with, however, one important change: The intercarrier payment offset should be eliminated, since it penalizes the provision of facilities-based service.

Any fund that is created should be subject to Commission review after a period of no more than two years. All individual funding determinations should sunset after three years, and a recipient company should be required to make a new, full showing to support its claim for funding for the ensuing three-year period. (Of course, the life of any individual funding determination would be subject to the continued existence of the fund, as determined in the Commission's sunset review.) If a fund is created, in order to avoid excessive harm to the contributing companies, total fund payouts per year should be capped at the current size of the Transition Fund ("TF").

If competitive bidding is not utilized to identify fund recipients, funding should be provided only to the extent necessary to ensure the continuation of universal service, given, among other things, the availability of competitive

alternatives. Funding determinations should be based on the assumption that the company seeking funding will raise its retail rates to the maximum just and reasonable level, and that it will take all reasonably appropriate measures to improve its financial picture while continuing to provide any functions necessary to the maintenance of universal service. The Commission should establish an abbreviated annual process for determining whether fund recipients continue to meet the standards for funding. Applicants should have the burden of justifying their requests for funding, and their applications should be subject to strict scrutiny in open proceedings.

B. General Reactions to Other Parties' Initial Testimony

Q. How do the parties' positions compare with Verizon's?

A. CTANY, the Facility CLEC Coalition, T-Mobile, and Sprint all agree with Verizon that there is no need to create a new fund, and that such a fund would have undesirable effects. On the other hand, the NYSTA Smaller ILECs (sometimes referred to here as just "NYSTA," or "ITCs"), CPB, and Staff all support the creation of a fund. AT&T essentially recommends a continuation of the existing TF with some modifications.

Of course, there are important differences within both the pro-fund and anti-fund camps on a number of issues. Staff's proposal, for example, would result in a less "open-handed" fund than NYSTA supports — NYSTA's proposal would essentially guarantee small ILECs a "reasonable return" at

the expense of their competitors (among other companies), while allowing them to lower their retail rates to, or maintain them at, levels significantly below the current "benchmark" rate. To the extent that it recognizes that a return guarantee is neither feasible nor desirable in today's world, Staff's position is somewhat closer to the spirit of Verizon's proposals than are the positions of NYSTA and CPB. Nevertheless, creation of any new fund would have detrimental consequences for competition, fairness, and, indeed, for universal service itself; Verizon, therefore, cannot support Staff's overall approach. Moreover — to Verizon's great surprise and disappointment — Staff's proposal seems to be based on the view, set forth in the testimony of the Staff Policy Panel, that competition is the problem, rather than the solution, for achieving and maintaining universal service. As we discuss below, that view is squarely in conflict with the policy guidance provided by the Commission, most notably its *Competition III* decision. It is, in any event, an unsound basis for the development of a universal service policy.

Q. Please explain.

A. The parties who advocate a new fund state that they are concerned about the impact of technological and market change on the achievement of traditional social policy goals, such as universal service. And no party to this case knows better than Verizon how the evolution of technology and changes in market structure have lowered the profitability of traditional wireline telephone

service. But fears about the impact of competition on the wireline telecommunications industry have been voiced for the past thirty years, as the industry has changed and evolved; yet customers continue to benefit from the changes that competition has wrought.

The proposals of the pro-fund parties are structured in a way that would protect not universal service itself, but a particular, backward-looking and narrow vision of universal service — in effect, the universal availability of a particular product (traditional wireline basic telephone service), offered by a particular type of provider, and subject to the same level of regulatory oversight that has prevailed for many decades. But customers are increasingly making a different choice by shifting away from traditional stand-alone POTS to service bundles, which may include less regulated services offered over wireless or Internet Protocol networks. A regulatory model that recognizes the primacy of customer choice should adapt to this vision of universal service, rather than oppose it.

The Commission should not let the very few customers who live in "white spot" areas at this point in time become the "tail that wags the dog." There is no basis for the view that their future needs can be addressed only by creating a fund today that guarantees incumbent LECs the full recovery of their traditionally-determined "revenue requirement."

C. AT&T

Q. In your summary of the views of the parties, you put AT&T in a third category, apart from Verizon and the other anti-fund parties, and the varying pro-fund views of Staff, CPB, and NYSTA. What does AT&T propose?

A. AT&T advocates a three-year extension of the TF,[1] at 150% of the current fund for 2011, growing to 200% by 2013. Under AT&T's proposal, existing recipients would continue to receive funding, additional companies could petition for support, and any party could petition for an investigation if the "cap" on the fund is reached. Also, AT&T argues that wireless and VoIP providers should contribute to the fund. (*See* AT&T at 2-3.)[2]

Q. Please comment on AT&T's proposal.

A. AT&T seeks to position its proposal as a "middle ground" between the views of other parties. It suggests that the proposal is a non-controversial "quick fix" that can be adopted on an interim basis so that the Commission can move quickly on to issues that are more important to AT&T — in particular, access charges. *See, e.g.,* AT&T at 12 ("Pragmatically, . . . the Commission can simply extend the TAF [*sic*] on a limited, transitional basis and then

[1] AT&T's testimony appears to confuse the TF with the TAF, but we assume from context that its intent was to refer to the TF.

undertake the necessary step of addressing intrastate switched access reform."). In reality, however, its proposal is much more than a simple continuation of current policy for a short, additional period. As Verizon explained in its initial testimony, the TF was explicitly created as a temporary resource supported by a fixed source of funding and utilizing an existing contribution mechanism (the TAF formula). The Temporary Transition Fund Extension agreed to by the parties and approved by the Commission did not change the fundamental character of the TF — indeed, that Extension was put in place simply in order to allow sufficient time for the litigation of the important policy, legal, and factual issues that are being addressed in this proceeding. The AT&T proposal, on the other hand, would institutionalize this temporary arrangement and even permit it to expand significantly by at least doubling the fund over three years, and allowing for even more growth beyond that. More significantly, AT&T would expand the fund's contribution base to include wireless and VoIP providers — a highly significant change from the status quo with important legal and policy implications. In fact, AT&T's proposal would represent a major *departure* from current policy —

(. . . continued)

[2] Initial testimony is cited here and below by the name of the party sponsoring the testimony and the page number. References to Staff's testimony indicate the particular Staff Panel that sponsored the testimony.

one that should not be considered without careful analysis of the underlying legal and policy issues. AT&T's "middle ground" rhetoric is simply a device designed to persuade the Commission that it can implement a new fund without worrying about those issues. AT&T is wrong. The issues surrounding the creation of a fund are too important to be resolved in the curtailed manner that AT&T proposes.

Q. Please describe the harms that could result if AT&T's proposal were to be adopted.

A. Although AT&T argues that its interim proposal would impose no more than a minimal burden on any party, the fact is that it would fail to provide any safeguards against the indefinite expansion of the fund. The risk of such unanticipated expansion is illustrated by the experience of the Federal High-Cost USF,[3] and by NYSTA's and Staff's projections of likely fund size — $10 and $5.6 million, respectively — both of which are considerably above AT&T's estimate that the fund would grow to $2 million by 2013. The fact is that once a fund is established, proposals to change or restrict it are likely to meet delay and resistance because those who receive funding will quickly become dependent on it. For this reason, it is extremely important that the

[3] T-Mobile testified that the federal quarterly USF contribution factor was 6.68 percent ten years ago, and it is proposed to increase to 15.5 percent for the current quarter. *See* T-Mobile at 11.

Commission establish the right policy from the beginning. AT&T's proposal to expand and institutionalize a fund would undermine that important objective.

D. Staff

Q. What does Staff propose?

A. Staff supports the creation of a limited-duration (three- to five-year) fund.[4] Staff testified that the creation of a fund will be necessary "to make certain that customers with no other alternative to the service provided by an incumbent will continue to have access to reliable basic telephone service at an affordable rate." (*See* Staff Policy Panel at 19, 22.) Under Staff's proposal, a company seeking funding will be required to undergo a full rate case review which will determine whether the company's revenue requirement can be met by setting basic local service rates at the benchmark level.[5] If the revenue requirement cannot be met, "a further analysis will be used to determine the funding level for an eligible company." (*Id.* at 9.) This "further analysis" would entail a review of the company's "total company regulated operations" (*id.* at 12), and would include consideration of

[4] Staff has proposed "key principles" to guide the development of a fund, rather than specific details. (Staff Mechanism Panel at 7.)

"adjustments not normally made in traditional rate cases — such as plant write-downs and consideration of additional operating efficiencies." (*Id.* at 13-14.)

The existence of "substitutable alternative providers" in a company's service area would also be taken into account in determining eligibility for funding under Staff's proposal. If substitutable providers cover the company's entire service area, then no funding would be provided. If such providers do *not* cover the entire service area, then the most efficient alternative for serving white spot areas would be identified. That alternative might be "provid[ing] funding to the ILEC to continue operations," or "fund[ing] the build out of the substitutable provider(s) network(s) to reach all customers currently served by the ILEC." (*Id.* at 10; *see also* Staff Mechanism Panel Exhibit MP-1.)

The fund proposed by Staff would require contributions from all participants in the market, including wireless and VoIP providers, assessed on the basis of utilized telephone numbers, with the option for contributors to assess a customer surcharge. Staff estimates the size of the fund at $5.6 million,[6] but

(. . . continued)

[5] Staff proposes a business benchmark as well as a residence benchmark. The benchmark for business basic local service "should not be set lower than the company's Commission authorized rate for residential basic local service." (*Id.* at 29.)

[6] Staff initially estimated the size of the fund at $5 million. This was corrected to $5.6 million in Staff's response to CTANY-DPS-8.

does not appear to recommend a cap on the funding levels. (*See* Staff Mechanism Panel at 33-35.)

Q. Please comment on the policy background of Staff's proposal.

A. As noted previously, the Staff Policy Panel appears to view competition and universal service as being in conflict. Specifically, the Staff Policy Panel states that "[b]enefits of competition have accrued mainly to those customers in more densely populated areas. Competition produces both 'winners' (i.e., companies that succeed and customers who have choices) and 'losers' (i.e., companies that fall short and customers who are at risk of losing basic service)." (Staff Policy Panel at 9.) "To pretend there is no downside to competition, specifically a negative impact to universal service would be shortsighted." (*Id.* at 11.) Even more troubling, Staff appears to be testifying that regulated outcomes are preferable to competitive outcomes, stating that competition in an unregulated telecommunications market cannot ensure that basic residential phone service is available, affordable and reliable. (Staff Substitutability Panel at 7.)

Q. Please respond to the Policy Panel's approach.

A. Competition certainly can cause stress to specific business plans or technologies, particularly those of an industry segment, such as the smaller ILECs, who have not changed much in response to the evolution of telecommunications technology and market structure. This stress can lead

companies to improve and re-invent themselves, or to their being replaced in the market by other companies. This fundamental aspect of competition was famously referred to by the economist Joseph Schumpeter as "creative destruction." It is not in itself a reason for tempering the Commission's longstanding support for competition. Nor does it represent any threat to universal service. As Verizon's initial testimony demonstrated, the influx of competitive providers into the ITC service areas has resulted in an increase in consumer choice in those areas.

The notion that competition has benefited only customers in densely populated areas is simply not accurate. Certainly, competitive infrastructure investment and increased customer choice came first to more densely populated areas, but at this point — as Verizon's testimony demonstrates — all customers have benefited from competition, and almost every customer has a choice of service provider. Staff Exhibit_Policy_1 shows clearly that the pace of access line loss is virtually the same for the industry as a whole as it is for the smaller, more rural carriers.

Q. Is the Policy Panel's approach consistent with the *Competition III Order*?

A. No, it is not. In that Order, the Commission emphasized the continued importance of the pro-competitive policies that it had been espousing for almost two decades. It noted, for example, that:

> The telecommunications infrastructure is the backbone of the information age. The rapid growth of information technologies is altering the financial aspects of the industry in New York State and throughout the nation. Technology is changing the nature of telecommunications services and accelerating the rate and level of competition in a historically monopolistic industry. *Failure to adapt New York's regulatory regime to these changing dynamics will place the State at a competitive disadvantage by stifling investments and upgrades to the telecommunications infrastructure that is supporting the State's economic activities.*[7]

The Commission went on to observe that achieving the objective of economic development "requires a level playing field where all telecommunications service providers have the proper market incentives to invest in infrastructure"[8] and declared that it seeks "to maintain New York as the most competitive market in the nation for new telecommunications services by eliminating unnecessary, bureaucratic and anachronistic requirements that hamstring investment and the expansion of competition."[9] It expressed its faith that "competition spurs innovation, promotes investment, encourages efficiency, and maximizes customer choice."[10]

The Staff Policy Panel's proposals are inconsistent with the Commission's vision. Establishing a fund to support ITCs is unnecessary to support

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[7] *Competition III Order* at 3 (emphasis supplied).

[8] *Id.*

[9] *Id.*

universal service; and will undermine the pro-competitive policies set forth in the *Competition III Order* by tilting the level playing field, imposing new "unnecessary, bureaucratic and anachronistic requirements," deterring innovation and investment, and discouraging efficiency.

Q. In what other respects are the views of the Staff Policy Panel misguided?

A. The Panel's analysis depends upon a false dichotomy. Specifically, the Panel states that "[t]he Commission could choose to allow local rates to rise to levels that will be unaffordable for many customers, ultimately contributing to the 'death spiral' for many rural carriers. Or, the Commission could leave local rates at the current benchmark, resulting in revenue deficiencies for the rural carrier or, ultimately, bankruptcy." (Staff Policy Panel at 12.) The Panel repeats this theme later in its testimony, stating that "[w]ithout a funding mechanism in place, the Commission would have no option but to raise basic rates to high cost customers or let companies go under." (*Id.* at 19.)

Q. In what respects is this misguided?

A. In its initial testimony, Verizon proposed a valid and workable alternative to a fund that would address the ITCs' financial problems without compromising universal service. Rather than assuming that the absence of a fund will lead

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(. . . continued)

[10] *Id.* at 6.

to unaffordable rates or else to a "death spiral" for ILECs, Staff should investigate the extent to which the Commission can permit and indeed even encourage the kind of meaningful restructuring and regulatory forbearance that will ensure the continuity of universal service without the unfairness, competitive deterrence, and incentives for inefficient behavior that a fund would create.

Q. Please comment on the funding limitations in Staff's proposal.

A. Although establishment of any new fund would be inappropriate, Staff at least recognizes that a fund should come with significant constraints. Verizon's recommendations on the mechanics of a fund (should one be established) mirror the Staff's proposals to some extent. For example, the testimony of the Staff Mechanism Panel clearly recognizes that a fund should not guarantee ITCs recovery of their full "revenue requirement" as it would be determined in a traditional rate case, but rather should only provide sufficient funding to ensure the continued existence of universal service. (Staff Mechanism Panel at 13-17.) Verizon agrees with that general recommendation (*see* Verizon at 52), assuming that the Commission chooses to establish a fund. We also agree that the presence of alternative providers in an ITC's service area would generally warrant a reduced level of funding. (*Id.* at 9-11.) However, as we discuss in greater detail later in Section III(B), below, Staff's

assessment of what constitutes an adequate alternative provider is too narrow.

Q. Do you agree with the Staff Mechanism Panel's recommendation that the Commission assess the finances of an ITC seeking funding on a total-company basis? (Staff Mechanism Panel at 11-13.)

A. The question of what financial metrics should be applied by the Commission is less relevant to Verizon's testimony than to Staff's. Verizon does not recommend that the Commission conduct a rate-case inquiry or any other type of formal inquiry into an ITC's finances, even if a fund is established. Rather, we recommend that funding be provided based on competitive bidding. (Verizon at 49-51.) We also recommend alternatively that ITCs seeking funding should first be required to demonstrate that they could not become profitable by restructuring their operations without compromising the continued existence of universal service. That analysis would be conducted by the ITC itself, although it would be circulated for comment and subject to Commission review for reasonableness. We made it clear that the ITC's analysis should mirror the type of review of the ITC's business operations that would be made by an investment banker or a management consultant, and thus would be based on financial metrics relevant to investors rather than on regulatory accounting constructs. Nevertheless, our proposal does

not contemplate any sort of formal financial assessment by the Commission or Staff.

E. NYSTA

Q. What are the NYSTA Smaller ILECs proposing in this case?

A. A summary is provided in their initial testimony at pages 30-34. Simply put, they propose to create a new fund that would distribute to any eligible carrier an amount equal to the difference between their intrastate revenues and costs, as determined in a traditional rate case. Residence basic service revenues would be limited by a benchmark rate of $15.22 per customer per month (compared to the current benchmark of $23) or by a "transition" to that rate. The process of evaluating carrier eligibility and funding would be the same as is used today for the TF. All providers, including wireless and VoIP providers, would be required to contribute to the fund, based on their intrastate revenues. The "objectives, policies, and effectiveness of focused nature aspects [*sic*] of the Plan" would be reviewed after five years, although there would be no sunset provision. NYSTA estimates the size of the fund at roughly $10.3 million per year, but it would not be capped. (*See* NYSTA at 84; NYSTA Exhibit 15.) In fact, NYSTA describes its proposed fund as "dynamic," which apparently means that the size of the fund can change to accommodate changing costs and revenues, no matter what causes those changes: competition, inefficiency, changes in policy, etc.

Q. What are your general views on the NYSTA proposal?

A. The fund proposed by NYSTA would be unlimited in size and indefinite in time — in effect, a bottomless purse that the ITCs could dip into at any time to restore their profits to "reasonable" levels. Regardless of the choices customers make in the future, or how federal policy changes, the fund will ensure their profitability. In essence, the NYSTA Smaller ILECs are proposing that fund recipients would be permanently dependent on the Commission to tax other providers — including providers with significantly worse financial metrics than the companies drawing from the fund — in order to support their unchanged businesses. In return for this protection, they agree to be regulated by the Commission indefinitely — in effect, a return to the early twentieth century paradigm of comprehensive regulation and a guaranteed rate of return — and a complete reversal of the Commission's policy of fostering the evolution of a tightly regulated market into a fully competitive one.

Q. Please comment on the relationship between the creation of a fund and the supposed status of the ITCs as "carriers of last resort" ("COLRs").

A. NYSTA, supported by CPB, contends that the ITCs' supposed status as COLRs warrants the creation of a fund. Thus, CPB states at pages 9 -10 that "[f]inancial constraints" due to the lack of a fund "would also jeopardize the ability of these carriers to continue to satisfy their carrier of last resort

responsibilities." NYSTA develops this theme at greater length at pages 19-22 of its testimony.

Q. Do ILECs such as the NYSTA members in fact have COLR obligations in New York?

A. No. Indeed, on a number of occasions the Commission has specifically denied that it recognizes COLR as a special legal status. In 1996 the Commission stated that "we believe it is unnecessary to designate a 'carrier of last resort' to guarantee continued service availability."[11] It also stated that it had "not designated [Verizon] as a carrier of last resort."[12] The Commission reaffirmed this rule twelve years later: "To date, the Commission has not seen a need to establish a COLR for telecommunications carriers and has instead relied on migration rules for exiting carriers."[13]

Q. What, then, are CPB and NYSTA referring to?

A. They are either mistaken about COLR obligations or they are referring to the fact that the Commission's common carriage rules generally require regulated telephone corporations to offer service in accordance with their

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[11] Case 94-C-0095, "Opinion and Order Adopting Regulatory Framework" (Opinion No. 96-13) (issued and effective May 22, 1996), at 10.

[12] Cases 94-C-0095, 95-C-0657, and 91-C-1174, "Order Directing Tariff Revisions" (issued and effective November 21, 1996), at 14 n.1.

[13] Case 07-C-0349, "Order Adopting Framework" (issued and effective March 4, 2008), at 16 n.23.

tariffs to willing customers within their service areas. For example, Rule 605.2(a) states that "[t]elephone corporations operating as common carriers must provide publicly offered conduit services on demand to any similarly situated user on substantially similar terms, subject to the availability of facilities and capacity. Such services shall be provided by a telephone corporation on a first-come, first-served basis unless a party is able to show in a timely fashion that such provision would be unreasonable or unless otherwise ordered by the commission." Moreover, as a historical matter, the "publicly offered" — *i.e.*, tariffed — services of an ILEC are generally offered over a large, contiguous service area and include a full spectrum of services. These comprehensive tariffs, combined with the Commission's common carriage regulations, put ILECs in a different position from that of other providers, which are either lightly regulated or else not subject to the Commission's jurisdiction at all, and thus have a greater ability to choose geographic service areas and rosters of services that reflect market rather than regulatory imperatives.

Q. Aren't the obligations that you've described tantamount to being a COLR?

A. No. The common carriage regulations only bind the ITCs to their tariffed service offerings, and telephone corporations have the power to amend their tariffs, subject only to the Commission's ability to suspend or reject such amendments. Verizon's position in this proceeding is that the Commission

should forbear from suspending or rejecting an ITC's attempt to limit its service offerings or to exit from non-white-spot geographical areas. In explicitly adopting such a policy, the Commission would be assisting ITC efforts to help themselves without raising concerns about compromising universal service goals. In contrast, NYSTA and CPB suggest that the ITCs are stuck with their alleged COLR obligations, and thus the Commission must create a fund as fair compensation for, and in recognition of, those obligations. Verizon disagrees. The Commission should as well.

F. CPB

Q. What does CPB propose?

A. CPB proposes the creation of a fund, but provides little detail about what it should look like. In general terms, the fund that CPB proposes would determine funding on a case-by-case basis using a rate case methodology. The fund would be capped and would be reviewed after five years. Contributions would be calculated on the basis of either revenues or phone numbers, and all providers, including wireless and VoIP, would be required to contribute.

Q. Please comment on CPB's proposal.

A. CPB is the only "pro-fund" party that recommends a cap on funding, at least recognizing that there is a need to limit the fund "so that the burden to all ratepayers is not excessive." (CPB at 24.) In all other respects, CPB's

recommendations and the justifications offered for them echo the positions of the other parties, so our criticisms of those other parties' proposals, as described above, also apply to the CPB proposal.

III. COMPETITION HAS BEEN SUCCESSFUL IN ENSURING UNIVERSAL SERVICE IN NEW YORK

A. The Availability of Competitive Alternatives

Q. In your Direct Testimony, you described the results of a Verizon study of competition in the ITC service areas. (Verizon at 12-13 and Exhibit B.) Is the data and analysis presented by Staff's White Spots Panel consistent with Verizon's study?

A. Yes. Despite some differences in approach and time period, both studies support the same general conclusion — competitive alternatives are available today to all but a very few households in the ITC service areas.

Q. What additional information does the Staff White Spots Panel provide concerning the change in white spots over time?

A. The Panel's testimony demonstrates that the availability of competitive alternatives is expanding (and white spots are therefore contracting or disappearing). For instance, the Staff White Spots Panel indicates that "[o]verall, wireless service coverage in the state has increased by 4.7%, from 85.2% to 89.9% since the [2009] Coverage report was issued." (Staff White Spots Panel at 18.) The panel further notes that "there are 92 incorporated

municipalities statewide without cable networks, down slightly from the 94 identified in the [late 2009] Coverage Report." (*Id.* at 19.) This expansion of alternative facilities, along with the observation of Staff that the "federal stimulus grants . . . have been awarded for proposed broadband network construction in parts of the state . . ." (*id.* at 21), clearly show that the availability of competitive alternatives is growing in the territories served by the NYSTA Smaller ILECs.

Q. Did the NYSTA testimony present any quantitative data on competition in their service areas?

A. No. The NYSTA testimony acknowledges the general presence of cable and wireless alternatives but does not present any data on coverage and downplays the existence of competition: "The NYSTA Smaller ILECs acknowledge that alternative service providers exist in ***portions*** of their service area and represent ***a degree of*** competition." (NYSTA at 49; emphasis supplied.)

NYSTA's testimony is not totally consistent in this respect. For example, NYSTA claims that increases in local rates will not improve the financial condition of the member companies. (NYSTA at 38.) In support of this position, NYSTA cites the following passage from a National Regulatory Research Institute ("NRRI") report:

> Competition also limits the ILECs ability to increase subscriber rates. Even where a state commission grants a rate increase, increased revenues can no longer be assumed. Demand elasticity for local exchange service can be high in a multi-vendor environment, and rate increases can actually reduce a COLR's subscriber revenue.

Yet NYSTA does not explain how competition that purportedly exists in only "portions" of a provider's territory (NYSTA at 49) or that only serves the "lower cost, more dense parts of each service area" (*id.* at 48) could possibly be sufficient to constrain aggregate revenues.

Q. Did other parties discuss competition in their testimony?

A. Yes. Data cited by T-Mobile indicate the rapid pace with which consumers have substituted and continue to substitute wireless and cable services for traditional wireline service. (T-Mobile at 4-7.)

B. The Substitutability of Competitive Alternatives

Q. How should the substitutability of alternative providers be judged for the purpose of evaluating the need for a fund?

A. As we testified at pages 13-14 of our initial testimony, the adequacy of alternatives to traditional providers should be judged by the test of the market — *i.e.*, whether there is substantial consumer acceptance of the alternative.

Q. Staff, NYSTA, and CPB describe regulatory jurisdiction and various Commission regulatory requirements as pre-requisites to being considered as alternative providers for universal service purposes. (*See, e.g.,* Staff

Substitutability Panel at 5-10; NYSTA at 23; CPB at 10-11.) Are they correct?

A. No. They are expanding the Commission's definition of universal service without citing any precedent or authority to support such expansion. The list of "features and functionalities" set forth in the 1996 *Framework Order* (*see* Verizon at 22-23) and reaffirmed in the *Competition III Order*, does not assume any particular technology, service platform, pricing strategy, level of regulatory oversight, build-out, or network service quality.

Q. Does the Staff Substitutability Panel offer any empirical evidence to support its claim that the "core characteristics" of regulation that it identifies are important to or expected by consumers?

A. No. Staff's position on this important point is purely conclusory. Indeed, the empirical evidence, marshaled in Verizon's initial testimony, shows that consumers do regard intermodal services as substitutes for traditional ILEC services, despite their differences from traditional telephone services.

Q. Are there other flaws in Staff's view that certain "core" regulatory constraints are essential to meeting consumer needs or expectations?

A. Yes. The various aspects of service discussed in the testimony of the Staff Substitutability Panel — the availability of "blocking," for example — are simply parts of an overall "package" of benefits offered by a provider — a package that includes price, functionality, billing options, and branding, as

well as numerous other aspects of the customer experience. In any competitive market, the packages offered by different providers will vary widely. Customers, by choosing one provider over another, make their own decisions as to which aspects of the overall package are most important to them. One customer, for example, might choose a credit card issuer that always has live, U.S.-based service representatives answer its customer's calls. Another customer might prefer to forgo that aspect of service in exchange for a lower annual percentage rate, or a "frequent purchaser" rebate program of some sort. A wireless service provider may offer a less extensive 4G coverage area but a more popular handset; another provider may offer a different package of benefits. One wireless service provider may offer a lower price while another offers a lower level of dropped calls. In each case, the customer can find a provider that meets his or her preferences. None of these trade-offs — and the increased range of consumer choice that they make possible — would exist if all aspects of service were strictly constrained by regulations. Requiring a company to offer a particular benefit increases a provider's costs, and makes it less able or willing to offer a different benefit. Thus, regulation tends to restrict the range of options available to consumers.

Q. Should individual competitors be required to offer service throughout an ITC's entire service area in order for them to "count" in assessing the need for a

ILEC's services, as some parties have suggested? (*See, e.g.,* NYSTA at 48, 61.)

A. No. We have demonstrated that more than 99 percent of households have intermodal options, and that the coverage of alternative networks is growing. There is no need to impose any sort of "build-out" requirement on competitors as an alternative to a fund. All that matters is the extent of the services provided by alternative providers collectively.

Q. What process does Staff envision for determining whether an alternative to traditional wireline service is "substitutable"?

A. Staff appears to contemplate a situation in which substitutable providers would somehow apply for that "status." For example, the Staff Substitutability Panel refers to a situation in which the substitutable provider must meet certain standards "if they wish to be deemed substitutable." (Staff Substitutability Panel at 14.) Whatever the merits of Staff's substantive view of the substitutability criterion, this concept of evaluating alternative providers as some sort of "applicants" in the funding process is impractical and inappropriate. It would require competitors to take affirmative action to apply for a status that may well be irrelevant to their own interests, and that they will not be motivated to seek. If their applications were contested, they would be required to pay counsel to represent their interests in a proceeding before the Commission. Even if a reasonable substitutability standard were to be

adopted, and even if numerous substitute providers in fact satisfied the standard, the application process alone would virtually assure that no provider would be deemed to qualify.

Q. NYSTA and CPB question whether providers that offer bundles rather than stand-alone basic telephone service can be considered adequate substitutes for an ILEC's service. (*See, e.g.,* NYSTA at 52; CPB at 11-12.) Please comment.

A. Again, NYSTA and CPB are seeking to impose conditions that are inconsistent with the dictates of the market. The Commission has concluded that:

> bundled telecommunication services, VoIP, and wireless are all in competition with unbundled wireline services, as the incumbent's continuing loss of lines and access minutes strongly suggests.[14]

In today's marketplace, competitors typically compete to supply customers' overall communications needs, including access to local and toll calling capability, optional vertical services, internet access, and other data services. Inherent to the issue of whether bundled services are substitutes for à la carte services is the question of whether the two sets of services are in the same product market. This question has been dealt with recently by several

[14] *Competition III* Order at 40.

commissions. The California Public Utilities Commission ("CPUC") concluded that bundled and à la carte services should not be included in separate product markets:

> We find that the historic practice of defining each telecommunications service as constituting a separate "market" is no longer relevant in today's technologically diverse telecommunications environment. Concepts like "Basic Local Exchange Service," "long distance service," "call waiting service," "call forwarding service," and "pay phone service," make little sense in an era dominated by telecommunications sold through bundled services.[15]

Similarly, the Virginia Commission found "that if a cable company is presently offering local telephone service in a geographic market area, *in any price or bundled configuration*, it meets the 'potential for competition' standard …" The Virginia Commission reasoned that "[s]ince that cable company has already invested the capital and human resources necessary to offer telephone service, there are no significant barriers to entry to prevent that cable provider from competing directly on price with Verizon for [basic service], should Verizon raise its [basic service] prices."[16] This ruling confirms the principle (and the market reality) that alternative providers do not

[15] CPUC Decision 06-08-030 in Rulemaking 05-04-005 (August 24, 2006).

[16] See Case No. PUC-2007-00008, "Order on Application" (December 14, 2007) at 20-21 (emphasis supplied).

need to offer an identical service at an identical price in order to be considered "like or substitute" services.

That more than **[BEGIN PROPRIETARY]** [redacted] **[END PROPRIETARY]** percent of residential wireline customers in Verizon's New York service area have transitioned to some form of service bundle is strong evidence that bundled packages compete with à la carte services.[17] Even consumers that purchase à la carte services generally purchase a number of services, such as vertical services, toll services and long distance services. In effect, even if they don't purchase a formally marketed "bundle," they build their own homemade bundles.

Information provided by the NYSTA Smaller ILECs in response to Verizon's Fifth Set of Information Requests demonstrates that customers clearly view alternative services and bundles as substitutes. For the NYSTA companies who are able to break out their number of access lines between residential non-basic and basic, stand-alone lines, the data show that most of these companies have lost **[BEGIN PROPRIETARY]** [redacted] **[END PROPRIETARY]** of their stand-alone basic service residential lines from 2006 to 2010. The pace of access line loss for basic, stand-alone residential

[17] Verizon Confidential Response to NYSTA-VZ-3.

lines *exceeds* their total residential access line loss rate. These facts are shown in Confidential Exhibit A to this testimony, which is a compilation of responses of the NYSTA Smaller ILECs to Verizon's information requests. This evidence clearly demonstrates that ITC residential customers are substituting basic, stand-alone lines with ILEC-provided bundles or with services from alternative providers. If these customers are not electing alternative forms of service, where are they going?

Q. How should the affordability of bundled service offerings be assessed?

A. The popularity of broadband, cable and wireless services imply that the price of phone service can be viewed as the incremental cost of adding voice service to the consumer's existing service(s). For example, a competitor might offer a video-and-internet bundle for $90/month and a "triple play" offer adding telephone for $110/month. In this case, the real price of competitor-provided voice service would be $20/month. For this reason, NYSTA is incorrect to include in its Exhibit 6 the price of broadband service as part of Cablevision's price for telephone service. Its approach is tantamount to including the cost of housing as a relevant factor in comparing the costs of wireline and wireless service, on the grounds that a customer cannot have wireline residential service without a residence to put it in.

Alternatively, the price of the bundle as a whole could be candled not against a basic service "benchmark" rate, but against the FCC data for mean

household expenditures on *all* communications service, using an approach similar to that discussed in Verizon's initial testimony.

Q. Several parties highlight the importance of emergency services, relay services, and privacy protections. Do alternative providers meet these requirements?

A. Yes. *See* Verizon at 23 n.34.

Q. But CPB states that "[w]hile alternative service providers allow a customer access to E911 services, they cannot guarantee access with the same degree of confidence as a wire line service." (CPB at 21-22.) Is this correct?

A. No. CPB's statement appears to be based on the fact that intermodal services frequently require a power source, such as batteries for a CMRS handset or commercial power for a VoIP service. However, even conventional services can be provided over fiber, in which case they would depend on the availability of electricity from commercial power and/or batteries, and the Commission has approved tariff amendments that recognize the customer's responsibility to provide power where required. (*See, e.g.,* Verizon Tariff No. 1, § 1(A)(5).) As we discussed earlier, universal service does not require a particular technology, in this case copper wire over which electrical power can be sent to the customer's home. Every technology has drawbacks and limitations. If a tree falls in a storm and takes out the copper twisted pair running to a house or neighborhood, a wireless

phone might be the better option to reach emergency services. Indeed, more than half of all calls made to emergency service providers are now made from wireless phones.[18]

No provider can guarantee that its service will be available at all times. Presumably even customers of the NYSTA Smaller ILECs experience occasional service outages or other service-affecting situations. CPB's desire for a guarantee is unrealistic, and its testimony fails to demonstrate that alternative networks are inferior to traditional networks in providing access to emergency services.

Q. NYSTA argues that customers who choose to discontinue their landline service are "potentially endangering their safety as a result." (NYSTA at 102.) Do you agree?

A. Of course not. This is obviously scare-mongering and hyperbole. The only "evidence" that NYSTA cites for this contention is a July 2009 online article that recommended that customers keep both a landline and wireless phone in order to increase choices to reach 911. But this does not lead to the conclusion that customers who choose to go wireless-only are endangering their safety. If it did, then it would make just as much sense to subsidize

[18] *See* FCC Consumer Facts, Wireless 911 Services, http://www.fcc.gov/cgb/consumerfacts/wireless911srvc.html.

CMRS providers in order to ensure that all customers have a wireless phone as a second alternative for emergency calling in addition to their ILEC-provided wireline phone. Also, the survey cited in the article found that "80% [of 2,000 surveyed households] felt that it is important to have both a corded landline and a cell phone in their home in case of emergency . . ." (NYSTA at 101-102.) Yet, according to the Centers for Disease Control, *more than one out of four households* (26.6%) had "cut the cord" by the first half of 2010. (Verizon at 18.) The fact that at most only 73.4% of households even have a wireline phone shows that the survey cited by NYSTA does not accurately reflect consumer preference.[19]

Q. Some parties highlight what they consider to be specific weaknesses of cable and wireless telephony. (CPB at 13-22; Staff Substitutability Panel at 10-31 and Exhibit _SP_1; NYSTA at 52-71.) Do you agree with their conclusions?

A. No. Assertions that alternative services are insufficient to meet consumer needs cannot be squared with the same parties' statements (and the uncontestable fact) that consumers in growing numbers are making different choices for themselves. Also, to a large degree these assertions of the

[19] The number is in fact even less than 73.4%, since the CDC report also estimates that 2% of households have no telephone service at all. *See* Blumberg S.J., Luke J.V., "Wireless substitution: Early release of estimates from the National Health Interview Survey, January-June 2010" (National Center for Health Statistics, December 2010) at Table 1.

limitations of wireless and VoIP are related to the fact that these services are not regulated by the Commission. We have already discussed the fact that regulatory oversight is not a component of universal service, nor is it relevant to an evaluation of substitutability. Where new and less regulated services gain consumer acceptance, the appropriate policy response is to reduce the legacy obligations of traditional providers, not to try to extend those obligations to the new providers.

Wireless and VoIP networks and services are different from traditional, copper-based ILEC networks and services. That is not disputable. But the notion that these differences make these services inadequate for universal service purposes conflicts with reality, as confirmed in data recently updated by the FCC. As of the end of 2009, *46 percent* of all residential wirelines in the state were provided by non-ILECs, and of these non-ILEC lines, *almost 90 percent* are interconnected VoIP lines.[20] And as of December 2009, there were 18.9 million wireless subscribers in New York, and only 3.4 million ILEC residential wireline and VoIP subscribers, combined.[21] The assertion of

[20] FCC, "Local Telephone Competition: Status as of December 31, 2009," Table 9 (rel. Jan. 2011).

[21] *Id.*, Tables 9 and 17.

alternative network limitations runs up against the reality of the facts about customer choices.

IV. BENCHMARK RATES AND AFFORDABILITY

Q. As part of universal service policy, is it important that service be affordable?

A. Yes. But it is also important to note that the affordability concerns related to the low-income population are addressed with targeted support, such as Lifeline, rather than through broad-based high-cost funding or through general rate levels. And it is also important to remember that affordability is not necessarily defined in terms of current rate levels and certainly is not defined as keeping rates as low as possible.

Q. Do any of the other parties define affordability in that manner?

A. Yes, both implicitly and explicitly. For example, CPB testified that "[t]he inability of small, rural telephone companies to rely upon a TF or SUSF may lead to higher rates for basic service within the ILEC's service territory. *Higher rates would undermine the principles of affordability and comparability of rates*." (CPB at 9; emphasis supplied.) The Staff Substitutability Panel goes even further, arguing that the Commission's universal service policy includes "a long-standing commitment to keeping basic residential service *at the lowest rates possible*." (Staff Substitutability Panel at 12-13; emphasis supplied.)

Q. How should affordability be defined?

A. Affordability should not be defined either in terms of the current, artificially low rates of the NYSTA ILECs or as "the lowest rates possible." Nothing in Commission precedent can be read to support either contention. In fact, the Commission has rebalanced rates for some providers (such as Verizon) to more efficient levels and has explicitly noted the need for local service rates to better reflect underlying cost levels:

> If rural rates more accurately reflect service costs, competitors may be able to extend their infrastructure and services to these areas. If nothing is done to adjust these subsidized rates, however, competition will be impeded and the benefits of intermodal services may be delayed or even denied in certain areas.[22]

The subsidy system described by NYSTA in its testimony has been so "successful" that the rates for the NYSTA Smaller ILECs are in many cases well below the rates charged by Verizon, even though the smaller companies assert that they have higher costs. The chart provided by AT&T in its testimony usefully lists the rates of all ILECs in New York. The rates of the smaller ILECs can increase considerably before they enter the realm of comparability, let alone of affordability.

Q. Do other parties agree with Verizon that the $23/month benchmark rate that is currently applied in connection with the TF is too low?

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[22] *Competition III Order* at 63.

A. Yes. AT&T argues that "the Commission should relax the current benchmark price cap, and it should set the benchmark price cap for local companies that seek TAF [*sic*] support at up to the comparability cap of 125% of the Verizon urban rate." (AT&T at 3.) Of note, AT&T also provides an analysis of the federal support that NYSTA Smaller ILECs receive, and determines that, after federal high-cost support and loop recovery are taken into account, NYSTA Smaller ILECs only require at most $29.09 of recovery from intrastate sources, and in some cases much less than that. (AT&T at 8.) This $29.09 figure is well below Verizon's estimate of the federal urban-rural comparability rate.

CTANY testifies that "it is time for the Commission to reconsider whether the $23 benchmark rate, which was apparently below the actual cost of service for rural companies, should be eliminated or raised for the rural ILECs. When applied to rural ILECs, the $23 benchmark rate understates the cost of service and impedes competition by alternative providers." (CTANY at 28.) The Facility CLEC Coalition "believes that the benchmark rate should be set at 10% above the Verizon New York, Inc. or Frontier Communications of Rochester, Inc. rate for comparable service in the same geographic area," and that recipients should have an ongoing obligation to prove that the benchmark rate remains reasonable. (Facility CLEC Coalition at 12.)

Sprint contends that, "[i]n practical terms, a 'reasonable amount' [for consumers to pay for basic local phone service] should mean ***at least*** the $23 benchmark . . . In fact, to reduce the burden on others, it would not be unreasonable to establish a higher benchmark," noting that the California commission has declared that a rate of $36 is an appropriate benchmark for evaluating universal service. (Sprint at 13 and n.11; emphasis in original.)

Q. What does Staff say about a benchmark rate?

A. The Staff Mechanism Panel testifies that "[i]n order to qualify for state universal service funds, a company's basic local service rate should be set at, and residential customers must be paying, the company's Commission authorized rate for residential basic service." (Staff Mechanism Panel at 29.) Although it is not totally clear whether the Panel is using the term "authorized rate" as a synonym for the "benchmark rate," it does appear that the Panel supports the use of the current residence benchmark. (The Panel also proposes a benchmark for basic business services.)

Staff also testifies that "[r]ural New York customers should not pay rates for local service that are substantially higher than those paid by customers in urban and suburban areas. Doing so violates the Commission's policy on universal service," but they state that they cannot define a substantiality threshold "at this point." (Staff Policy Panel at 19-20.)

Verizon's position is consistent with Staff's concern that rates in rural areas not be "substantially" higher. As set forth in our initial testimony, "substantially" can be defined in this context with reference to federal law and to the rules related to the comparability of urban and rural rates.

Q. What is CPB's position on the appropriate benchmark rate?

A. CPB would calculate the benchmark on a company by company basis, arguing that requiring each company to charge the current statewide benchmark would "almost certainly" result in customers being unable to afford telephone service. (CPB at 16.) To accomplish this, CPB would use "a weighted average of the median income in the specific ILEC service territory versus the statewide average household income." (*Id.*)[23] However, determinations by the Commission of "just and reasonable" rate levels can not and should not be based on geographically fine-grained assessments of income levels, economic conditions, and costs of living for particular individuals or areas. Such a pricing regime would not be administrable, would deter competitive entry into rural areas, and would deviate from the

[23] CPB states that "[w]ith the rising cost of utility bills (i.e., gas and electric), a disproportionate share of consumers' income goes towards the payment of these services." (CPB Testimony at 16.) There is no basis on which to consider electric and natural gas rates when setting a benchmark for telephone service rates. Simply because the Commission regulates all of these services, there is no rationale to consider them to be part of a utility "basket," such that an increase in one or more components calls for a decrease in another.

Commission's objective of setting reasonably cost-based rates. Finally, consideration of income levels must also include an accounting of any added funding burdens placed on the contributing carriers and their own poorer customers. The facile identification of "poor customers" with "rural ITC customers" is simply not valid. For example, the county in the State with the lowest median household income is Bronx County,[24] in which Verizon is the sole incumbent LEC. CPB's mechanism would require Bronx County customers to subsidize customers in rural areas based only on the rural area's income levels.

Q. What is NYSTA's position on the appropriate "benchmark" rate?

A. NYSTA takes the extreme position that the appropriate benchmark rate is $15.22, which it bases on the FCC's recent calculation of the *nationwide* average urban local-service rate. (NYSTA at 94.)[25]

Q. Please respond to NYSTA's benchmark proposal.

A. First, NYSTA's reason for proposing a very low benchmark rate is made abundantly clear by the chart that AT&T provides on page 8 of its initial

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[24] *See* file est09ALL.xls, available at http://www.census.gov/did/www/saipe/data/statecounty/data/2009.html.

[25] The rate was $19.57 per month. NYSTA adjusted this 2006 rate for inflation ($20.74), backed out the federal Subscriber Line Charge and the Federal Universal Service Charge ($13.23), and then multiplied the resulting rate by 115%, which NYSTA explains as "the threshold that is currently used in determining federal HCL disbursements for rural ETCs." (NYSTA at 95.)

testimony, which demonstrates that the weighted-average residential local rate of the NYSTA Smaller ILECs is less than $12 per month. NYSTA's efforts to obtain funding that would insulate its smaller members from the effects of competition, efficiency, and regulatory change would be undermined if those companies were actually required to charge their customers a rate that more fully reflected costs and market conditions.[26] In any event, there is no justification for setting New York rural rates based on an index of nationwide urban rates, as is shown by the fact that the Commission-established New York benchmark is some 74% higher than NYSTA's adjusted urban local-service benchmark rate of $13.23.

Q. NYSTA seeks to justify its proposed benchmark rate on the grounds that some of the retail rates that the Commission took into account in setting the benchmark provided greater value than is provided by local service in the ITC service areas, either because (a) those rates apply to bundled service offerings rather than stand-alone basic service; or (b) the downstate unlimited local calling plan gives a customer access to more call recipients within the local calling area. (NYSTA at 97-99.) Please comment.

[26] NYSTA is correct that, in some cases an increase in retail rates to the benchmark level may lower the company's revenues (due to demand restriction effects in a competitive market). This is not a reason to lower the benchmark, however, but rather a reason to apply it judiciously. If higher net revenues can be achieved at a rate below the benchmark, then there is no reason to increase rates all the way to the benchmark. (*See* NYSTA at 38.)

A. The facts concerning these offerings were well known to the Commission at the time it established the $23 benchmark in the *Competition III Order*. By arguing that the benchmark rate was wrong when the Commission set it in 2006, NYSTA is simply seeking to re-litigate an issue that was a subject of considerable input from the parties, and careful consideration by the Commission, in *Competition III*. In any event, as the excerpt from the *Competition III Order* quoted at pages 96-97 of NYSTA's testimony makes clear, the $23 benchmark rate was the result of a discretionary balancing of a number of factors. It was not intended to be simply an average of the rates of certain comparable services or service packages.

Furthermore, NYSTA's theory that the rate of a local service package should be proportional to the number of customers in the local service area would tend to result in higher rates in densely-populated areas and lower rates in sparsely-populated rural areas — precisely the opposite of the rate relationships that would be appropriate on the basis of cost and efficient pricing.

Nor does NYSTA make a case for re-evaluation of the benchmark rate based on a subsequently-offered package that includes unlimited nationwide toll calling for a rate $2 *above* the benchmark. (NYSTA at 97.)

Q. NYSTA also argues that the Commission was mistaken in the *Competition III Order* in determining that the benchmark rate bore a reasonable relationship

to the forward-looking costs of basic local service. (NYSTA at 99-100.) Is NYSTA correct?

A. No. NYSTA's argument is based on an approximate margin analysis that the Commission presented in an appendix to its order in Case 05-C-1303.[27] The analysis found that the cost of certain service offerings that the Commission deemed relevant to its benchmark determination ranged from $21.80 per month to $30.33 per month.[28] The Commission found that these costs were below the revenues that Verizon derived from the services, and thus rejected a competitor's predatory pricing claim. NYSTA seeks to adjust these costs by deleting the $6.39 Subscriber Line Charge ("SLC") referred to in the Appendix. However, the SLC was included as a part of the *revenues* that Verizon derived from these services, not as an element of their costs. There is thus no basis for adjusting the cost in that manner. NYSTA also proposed to delete "the $3.75 cost associated with the three calling features [included in one of the services]," a figure for which it cites no support whatsoever. Aside from these considerations, it bears repeating once again that the Commission knew what it was doing at the time it set the benchmark rate,

[27] Case 05-C-1303, "Order Denying Petitions Requesting Suspension and Hearing on Tariff Filings" (issued and effective December 6, 2005), Appendix.

[28] These costs were obtained by adding TELRIC-derived network costs to an estimate of forward-looking retail costs.

and there is no basis for arguing here that the Commission should have made a different determination in 2006.[29]

V. A FUND WOULD HAVE UNDESIRABLE CONSEQUENCES

Q. Do other parties agree with Verizon about the harms that would result from the creation of a fund?

A. Yes. The Facility CLEC Coalition and Sprint highlight the same risks and harms that Verizon does. (Facility CLEC Coalition at 4-5; Sprint at 6-7.) T-Mobile highlights the risk that a fund could impair the affordability of service for customers who pay the contributions, citing the opinions of consumer advocates in other states. (T-Mobile at 14-16.) T-Mobile also sees the same risks to competition as those noted by Verizon, Sprint, and the Facility CLEC Coalition. (*Id.* at 18.) It is CTANY's testimony, however, that provides the most comprehensive description of the way in which creation of a fund will create inappropriate incentives for the ITCs.

[29] Verizon is *not* arguing that the benchmark can never be changed — indeed, the need for and appropriate level of a benchmark rate were specifically identified in the settlement agreement that created the TF as issues to be examined in the "Fund Track" that would consider post-TF funding arrangements. Rather, our position is that any such change has to be supported by more cogent reasons than the claim that the Commission was mistaken in setting Verizon's basic service rate in 2006.

A. A New Fund Would Create Inappropriate Incentives for the ITCs

Q. Please comment on the significance of CTANY's testimony for the incentive issue.

A. The thorough analysis of the finances of the TF recipients by CTANY witness Richard Ansaldo — a former Section Chief in Staff's Office of Accounting and Finance — demonstrates that a fund is precisely the wrong solution to the ITCs' financial problems, because it will not eliminate, but rather perpetuate and enhance, those problems.[30] As CTANY's testimony puts it, "the availability of TF subsidies has provided a disincentive to innovate and lower costs." (CTANY at 6.) Mr. Ansaldo's analysis thus confirms Verizon's position that ITCs should be required to consider changes in their way of doing business before asking other carriers to support them through the creation of a new fund.

Q. How does the benchmark-rate issue previously discussed bear on the incentive question?

A. As Verizon and other parties have noted, many NYSTA companies currently maintain basic service rates well below the Commission's $23/month benchmark rate. In their initial testimony, the NYSTA

companies not only oppose the increases in the benchmark rate proposed by Verizon and other parties, but they actually call for a significant *decrease* in that rate, to $15.22/month. (NYSTA at 31, 94-101.) The defects of the analysis that led the NYSTA companies to that rate have already been addressed. It is worth noting here, however, that the NYSTA companies' current rates, and their attempt to reduce the benchmark, not only demonstrate that they need less money than they claim, but also show that — because rate-of-return regulation tends to insulate them from hard economic realities — they are not behaving as rational economic agents responding to market realities; rather, they are seeking protection from those realities through government support. The conflict between their proposal and the promotion of market-based policies is only exacerbated by the fact that their rates — and proposed benchmark — are well below Verizon's basic-service costs (as determined by the Commission in the *Competition III Order*),[31] and thus presumably even further below their own costs, based on their claim to be "high-cost" providers.[32]

(. . . continued)

[30] Mr. Ansaldo's conclusions were also supported by a contrasting analysis of the financial condition of the Frontier companies.

[31] *See Competition III Order* at 58-60.

[32] *See* NYSTA at 14 (referring to "the cost recovery challenges of network providers committing to service higher cost, less dense service areas"); *id.* at 18, 22. *See also Competition III Order*

(continued . . .)

This unwillingness on the part of the ITCs to take appropriate steps — such as reasonable rate increases — to solve their own problems will only be exacerbated by the creation of a new fund. Staff's Mechanism Panel also clearly recognizes the incentive problem.[33]

B. A SUSF Would Impose Unfair Burdens on Other Service Providers and Their Customers

Q. In your initial testimony, you compared Verizon's financial metrics to those of smaller ILECs. Do you have anything to add on this point based on information provided by other parties in their testimony?

A. Yes. We have prepared a comparison of Verizon's ROE with: (a) the ITCs' actual ROEs (from NYSTA's testimony and the Commission's "five year report"; and (b) their "authorized" ROEs (as assessed by NYSTA). The chart is provided as Confidential Exhibit B to this rebuttal testimony. It confirms Verizon's analysis that it would be inappropriate to expect Verizon to provide

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(. . . continued)

at 45 ("Using forward-looking cost studies, the [Staff] White Paper also concludes that the cost of serving metropolitan areas is less than the cost of serving less densely populated areas of the state."). The *Competition III Order* also concluded that "[r]ates below identified forward looking costs are not only anti-competitive, but they also suggest that rates are not even contributing to recovery of the costs of a hypothetical forward-looking network, let alone the one that actually exists." (*Id.* at 59.)

[33] Staff Mechanism Panel at 26 ("If an incumbent company has done very little to become more cost efficient as competition intensifies, it would be unfair to allow it to draw from a fund, which includes contributions from companies that have taken steps to become more efficient, operating in other competitive areas of the state. As noted, as early as 1996, the Commission stated that its goal was for the ILECs to operate as though they were facing the consequences of competitive pressures.").

contributions to subsidize the operations of companies whose financial condition is comparable to, or even better than, its own.

C. The National Broadband Plan Militates Against the Creation of a New York SUSF

Q. Your initial testimony discussed the implications of the National Broadband Plan for this proceeding. Have other parties addressed this issue?

A. Yes. NYSTA's testimony recognizes that the National Broadband Plan will cause significant changes in universal service support — although it fails to draw the obvious conclusion that a state fund to support voice services might be inconsistent with the FCC's plans. Instead, it appears to be focusing on how changes in federal support will require additional funding at the state level. (NYSTA at 8, 41.)

Q. Why do you say that NYSTA "appears" to be focusing on how federal changes will require additional state funding?

A. Although the testimony never comes right out and says it, it certainly hints at that possibility. For example, NYSTA testifies that "there are a number of possible changes in the industry that could result from the FCC's current deliberations concerning the National Broadband Plan, the Federal Universal Service Fund, intercarrier compensation, and other policy matters which this Plan [the SUSF advocated by NYSTA] does not and is not intended to address … *Yet, at the same time, the SUSF structure proposed herein is*

sufficiently dynamic to allow the Commission to address future needs." (NYSTA at 8-9; emphasis supplied.) Also, "there are a number of potential policy changes that may need to be addressed in the future … It remains to be seen what the residual impact of possible federal changes will be on the interstate jurisdiction. Furthermore, changes in these mechanisms at the federal level may require some form of parallel changes in the intrastate arena … Regardless, any implications with respect to universal service objectives including, most notably, *the recovery of overall intrastate-allocated network costs across the available sources and resulting impact on the level and affordability of local service rates can be addressed more readily if a dynamic SUSF framework such as that suggested herein is already in place*." (NYSTA at 41; emphasis supplied.)

What NYSTA is hinting at here is the creation of a fund that will be "dynamic" enough to grow significantly in order to replace with state funding any decrease in federal funding that may result from repurposing the federal high-cost support to fund the deployment of broadband services.

Q. Do you agree with NYSTA's apparent assessment that the NBP will result in a reduction of federal high-cost support to New York ITCs?

A. Not at all. It is unclear at this point what changes in the federal high-cost funding mechanism will be created under the rulemakings contemplated in the NBP, which is precisely why it would be prudent for the Commission to

hold off on creating a new state funding structure for traditional voice services prior to knowing how the federal system will operate. Waiting for more certainty is certainly preferable to putting in place a "dynamic" system that will insulate smaller ILECs from any effect of federal changes by automatically imposing an increased burden on contributors to an intrastate fund. It also should be noted that the "wait" might not be long: The FCC's tentative agenda for its February 8, 2011 meeting includes an item for "A Notice of Proposed Rulemaking to get broadband to all of rural America and spur investment and job creation, by modernizing the Universal Service Fund and intercarrier compensation (ICC) system while cutting waste and inefficiency."[34]

Q. Staff contends that the state TF will run out prior to any federal action. (*See* Staff Policy Panel at 14.) Doesn't that suggest that there will be a need for some form of state funding mechanism prior to the development and implementation of the FCC's plans?

A. No. As we and other parties have stated, competition and innovation are helping to address universal service concerns. It is the dynamism of the market, and not the faux dynamism of a self-executing fund, that the Commission should rely on to address universal service. Also, Staff's

[34] http://www.fcc.gov/Daily_Releases/Daily_Business/2011/db0119/DOC-304157A1.pdf.

concerns on this point appear to be related to the financial health of the smaller ILECs that will lose a source of funding when the TF runs out, and we have proposed an alternative mechanism to address that issue.

VI. ALTERNATIVES FOR ADDRESSING THE SMALLER ILECS' FINANCIAL PROBLEMS

Q. To the extent that smaller ILECs are having financial problems, as Verizon and Staff acknowledge in their testimony, are there alternatives to a fund that the Commission should consider?

A. Yes. Verizon's proposal is set forth in Section IV of its initial testimony. Essentially, it would require ILECs seeking funding to demonstrate that they could not structure their business in a way that would alleviate their financial problems without discontinuing any of the functions that are necessary for the preservation of universal service (taking account, of course, the available alternatives to their retail services).

Q. Does Staff's testimony provide any support for this proposal?

A. Staff's views on Verizon's proposal undoubtedly will be stated in its rebuttal testimony. However, we note that the Staff Mechanism Panel at least supports the underlying premise of the proposal by recognizing that an ILEC seeking support should be required to show that it has tried to solve its own problems. Specifically, it states that:

> If an incumbent company has done very little to become more cost efficient as competition intensifies, it would be unfair to

> allow it to draw from a fund, which includes contributions from companies that have taken steps to become more efficient, operating in other competitive areas of the state. As noted, as early as 1996, the Commission stated that its goal was for the ILECs to operate as though they were facing the consequences of competitive pressures.[35]

Q. Can the objectives of Verizon's proposal be satisfied through the type of rate-case process proposed by NYSTA?

A. No. First, there are limits to what even the most thorough rate case review can accomplish in terms of promoting efficient operations. Many regulators, including this Commission, have adopted alternative regulatory plans, such as price caps, to address the widely-recognized limitations of traditional rate case reviews. Moreover, there are significant limitations on what a Commission can compel a company to do in a rate case in terms of mandating fundamental structural changes in a company's business model. It makes much more sense to require the company itself to convincingly demonstrate that it cannot address its financial problems itself as a precondition to seeking a discretionary remedy such as funding.

Q. Is there any precedent for the Commission to encourage structural changes to a company's business model?

[35] Staff Mechanism Panel at 26.

A. Yes. The Commission has previously provided incentives to promote small water company mergers or acquisitions in order to achieve the benefits of economies of scale. In that case, the Commission did not mandate that the water companies take such steps, but stated that "The guiding principal [*sic*] in granting acquisition incentives will be to increase customer benefit … To foster a transformation of small non-viable water companies into entities better able to serve, acquisition incentives may be provided in certain cases . . ."[36]

Q. NYSTA argues that ILECs need to be kept in business in order to provide backhaul and similar functions to intermodal providers. (NYSTA at 11.) Please comment.

A. If it were true that the ITCs were integral to the operations of intermodal competitors, then one would expect those competitors to be strongly supportive of the ITCs' position in this case. Yet no intermodal competitor has spoken in favor of the creation of a fund, and several, including CTANY, T-Mobile, and Sprint, explicitly oppose it. Clearly, these competitors have

[36] *See* Staff Response to CTANY-DPS-5; and Case 93-W-0962, "Statement of Policy on Acquisition Incentive Mechanisms for Small Water Companies" (issued and effective August 8, 1994), at 2-3. The "rational basis" for the Commission to impose a requirement for smaller ILECs who request universal service funding to demonstrate that they have considered all alternatives is at least as strong as the basis cited by the Commission in fostering "a transformation of small non-viable water companies."

weighed the harms from the creation of a fund against any harms that theoretically could result from the absence of a fund, and come down on the side of not creating a fund. Perhaps it is because they recognize that even if an ILEC should go out of business, its backbone network would undoubtedly be purchased by another provider. (*See* Staff Mechanism Panel, Exhibit MP-1.)

VII. PRINCIPLES THAT SHOULD GOVERN THE OPERATION OF FUND, IF ONE IS CREATED

Q. Do the parties advocating the creation of a fund agree with your recommendations that if a fund is created, fund recipients should be identified through competitive bidding, and that "[a]ny viable company that is authorized under law to provide service should be permitted" to participate in the bidding process?

A. No. Staff contemplates rate-case reviews for "applicants," which presumably would limit funding to those companies that are rate-of-return regulated — *i.e.*, the smaller ILECs. But Staff also suggests that instead of providing funding to the ILEC, it might be more efficient to fund a substitutable alternative provider to expand its coverage area to reach all customers. (See Staff Mechanism Panel at 10-11.) We agree with Staff that if a fund is established funding should be awarded only to the most efficient provider.

However, we believe that that provider should be identified by competitive bidding, not through a Staff investigation.

CPB states that "[a]ny company that is committed to providing universal service in an entire ILEC service area and agrees to subject itself to Commission jurisdiction including complying with service quality and consumer protections would be eligible." (CPB at 23.) But CPB also states that "[o]n a case-by-case basis, any company that wishes to draw from the fund must show the need in a Commission rate case proceeding," and that "[a]ccess to funds would depend on case-by-case evaluation of each NYSTA Small ILEC's situation . . ." (*Id.* at 22, 25.) Therefore, it is not clear whether CPB would support competitive bidding , as long as the "winning" bidder was subject or agreed to be subject to rate-of-return regulation.

NYSTA claims that funding should be open to any provider, as long as the provider meets NYSTA's specified criteria, which include: (1) service that adheres to the nine aspects of universal service; (2) service that adheres to ten additional requirements that NYSTA claims its members are subject to as regulated carriers; and (3) rate case regulation. In other words, funding eligibility would be open to any carrier that looks and operates exactly like a NYSTA ILEC.

In practical reality, under the qualification criteria offered by these three parties, it is obvious that the only "qualified" funding recipients would be NYSTA Smaller ILECs.

Q. Would these proposals suffice to ensure that funding is limited to only amounts necessary to ensure universal service?

A. No. Each of these proposals would impose unnecessary requirements on alternative providers. By limiting the pool of eligible providers, they would limit the potential for identifying more efficient, lower-cost providers than the ILEC. Thus, the proposals would tend to require higher fund payouts than would be necessary to preserve universal service.

Q. Does Verizon agree with Staff's proposal for an "annual attestation" requirement under which any recipient "will be required to file an annual certification containing auditable financial and operational information with the Commission." (Staff Mechanism Panel at 30.)

A. Verizon supports the basic idea of an annual review, although Staff's view of what type of certification would be necessary would obviously be tailored to the substantive funding requirements proposed by Staff, which differ from those proposed by Verizon.

Q. What are the problems with NYSTA's proposals for the administration of a fund?

A. As we described earlier, NYSTA's proposal would simply provide the recipient with the difference between its intrastate costs and revenues, with no cost accounting changes, no annual attestation, and no change to currently-authorized ROEs, even though under NYSTA's proposal the recipients are insulated from all marketplace, technological, and regulatory risks. NYSTA claims that applicants will have to undergo a rate case examination, similar to the review currently applied for TF applicants, but CTANY's testimony highlights the inadequacies of the TF process.[37]

Q. Do the parties supporting a fund believe that there should be a cap on funding?

A. CPB does, though it does not indicate what the cap should be. Under AT&T's proposal, the TF would be allowed to double to roughly $2 million per year by 2013, but this would not be a hard cap — it could be modified upon request. NYSTA estimates the initial size of its proposed fund at $10 million per year, while Staff estimates the size of its proposed fund at $5.6 million per year, but neither NYSTA nor Staff propose a cap. In fact, as noted earlier, NYSTA's proposed fund is designed to be "dynamic" in that it will grow

[37] NYSTA also would grandfather the current TF recipients into the new SUSF, without any further showing required *(see* NYSTA at 73), while Staff would not treat current recipients any differently than other potential applicants. (Staff Policy Panel at 21.)

automatically if costs increase, or revenues decrease, or if regulatory changes affect intrastate cost accounting.

If a fund is created, in order to avoid excessive harm to the contributing companies, total fund payouts per year should be capped at the current size of the Transition Fund. This is particularly important because of the pending changes to universal service funding at the federal level, as discussed earlier. If there is a need for any funding in the interim, it should be strictly limited in order to minimize both the burdens on contributors and the disincentives for recipients to make necessary changes.

Q. How do the other parties address the question of who should contribute to a fund, if one is created?

A. Sprint and T-Mobile agree with Verizon that it would be inappropriate and counterproductive to the goals of competition, innovation, and investment to require contributions from intermodal providers. The parties who support contributions from intermodal providers argue for this expansion of the current system largely on the basis that providers benefit from having access to the largest possible pool of customers to communicate with. However, any purported "network effects" benefits as they relate to voice telephone service are increasingly attenuated in an environment where a substantial amount of

calling has shifted to wireless networks,[38] and where e-mail, instant messaging, text messaging, Facebook messages, and other new forms of communication are growing in popularity. Thus, intermodal service providers create positive network externalities just as traditional voice providers do. The existence of such externalities thus provides no justification for a unidirectional flow of funds from intermodal providers to traditional wireline companies. Moreover, as Verizon observed in its initial testimony, the Commission should promote the evolution of new technologies and new services, rather than trying to tax them to support the legacy network and operations of companies who have not adapted.

Q. If there is to be a fund, how should contributions be calculated?

A. The other parties' initial filings present two options for allocating the contribution obligation, one based on assigned or working telephone numbers, and one based on regulated intrastate revenues. In addition, the Facility CLEC Coalition recognizes, as Verizon has, that if contributions are allocated on the basis of regulated intrastate revenues, there should be no wholesale offset.

[38] As Verizon and several other parties pointed out in initial testimony (*see* Verizon at 18), more than 40% of American homes either had only a wireless phone or received all or almost all calls on wireless telephones despite having a landline.

Several parties (Staff and the Facility CLEC Coalition) advocate that contributions be calculated on the basis of phone numbers but do not specify exactly how such a system would work. AT&T provides the best analysis of why it would not make sense to adopt a new phone-number-based contribution system in this case:

> While fund contributions could be assessed on a telephone-number basis (a proposal that AT&T generally supports and that the FCC may adopt), it simply is not worth the time and expense to design and implement a contribution regime based on that methodology and to replace the existing contribution framework (which is assessed as a percentage of intrastate revenue). If the FCC does develop such a number-based contribution regime, the Commission could then consider mirroring the FCC's approach, thereby saving the time and effort that would be spent designing a regime from scratch (and the time and effort that carriers would spend implementing a regime that is not currently used today). (AT&T at 3, n.3.)

Beyond the point made by AT&T, however, number-based mechanisms would only be necessary if contributions are to be obtained from intermodal providers who do not track revenues by jurisdictional category, and thus do not have regulated intrastate revenues. Such mechanisms would have no clear advantage in the regime proposed by Verizon, in which no contributions would be sought from intermodal providers.

Q. Should there be a time limit or "sunset" review for a fund, if one is created?

A. Yes. Any fund should be subject to review in two years, and, additionally, all individual funding determinations should sunset after three years, and a

recipient company should be required to make a new, full showing to support its claim for funding for the ensuing three-year period (subject, of course, as to any Commission determinations as to the overall life of the fund). These basic sunset concepts have broad support in the initial testimony,[39] although the details of the parties' proposals do differ.

Q. If a fund is created, should carriers have the option of recovering contributions through a customer surcharge?

A. Yes. Contributing providers should not be *required* to impose a surcharge — but such providers should at least have the discretion to decide for themselves whether such a mechanism could mitigate the contribution burden. There is broad support from the parties for carriers to have the option of recovering contributions through a customer surcharge.[40]

VIII. MISCELLANEOUS ISSUES

Q. AT&T and Sprint reference intrastate access charges in their testimony. Are access charge levels part of this phase of the investigation?

A. No. These parties are clearly more focused on the prospect of access charge reductions than on universal service issues. We decline to comment

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[39] *See* AT&T at 12, 19; CPB at 24; Sprint at 14; Staff Policy Panel at 22; Staff Mechanism Panel at 33; and Facility CLEC Coalition at 10.

[40] *See* NYSTA at 78-79; Sprint at 14-15; Staff Mechanism Panel at 31; and Facility CLEC Coalition at 9.

on access charges here, since the procedural schedule adopted by the ALJ and the Commission clearly contemplate that insofar as they need to be litigated, they will be addressed in the next phase of this proceeding.

Q. Some parties offer their views on legal issues. Are you responding here to that testimony?

A. No. Neither of us is an attorney. Therefore, although some parties address legal issues concerning the Commission's authority to create a fund and other matters, Verizon will reserve its discussion of such issues for its briefs.

* * *

Q. Does this conclude the Panel's rebuttal testimony?

A. Yes.

MR. POST: The panel is available for cross-examination.

ALJ JACK: Thank you. The NYSTA Smaller ILECs?

MR. MOORMAN: No questions.

ALJ JACK: AT&T.

CROSS-EXAMINATION

BY MS. BURGESS:

Q Good afternoon, panel.

A Good afternoon.

Q Can you please turn to page 55 in your direct testimony? At line 15, if a fund is established contributions should not be required for regulated companies that are not themselves earning a reasonable rate of return. Are you suggesting there that any Verizon company would fall into the category of not earning a reasonable rate of return?

A (Paul Vasington) We provided some information on the rate of return that Verizon is currently earning, and it's considerably a large negative number.

Q And how would you define reasonable as used in this context?

A (Harold West) At least not negative.

Q And is Verizon's rate of return regulated or incentive regulated?

A (Harold West) incentive.
Q Please turn to page 8 of your direct testimony.
MR. POST: I'm sorry, could I have that page?
MS. BURGESS: Page 8.
Q You state there that reliance on existing competition and encouraging the entry of new competitors are far better mechanisms for protecting universal service than creating a new fund to support incumbent providers. Is it your position that competition and new competitors are sufficient in New York to protect universal service?
A (Harold West) Yes.
Q No further questions.
ALJ JACK: Thank you. I understand that CPB has no questions, is that correct?
MR. RIGBERG: That is correct.
ALJ JACK: I'm showing no one else who had estimated cross-examination time for this panel. Is there any further cross-examination? Any redirect, Mr. Post?
MR. POST: No, Your Honor.
ALJ JACK: Thank you, panel. You are excused.
MR. WEST: Thank you, Your Honor.
ALJ JACK: The next panel would be --

or the next witness will be AT&T.

E. C H R I S T O P H E R N U R S E,

having been first duly sworn by the ALJ, was examined and testified as follows:

ALJ JACK: Thank you. Please be seated.

DIRECT-EXAMINATION

BY MS. BURGESS:

Q Please state your name and business address for the record?

A Good afternoon. My name is E. Christopher Nurse. My business address is 1120 20th Street Northwest, Suite 1,000, Washington, D.C. 20006. I'm regional vice president of regulatory external affairs for AT&T's Atlantic region.

Q Did you file testimony in this proceeding?

A Yes, I did.

Q Do you have before you the corrected and direct testimony and revised rebuttal testimony of E. Christopher Nurse?

A Actually, I have the original drafts. I don't have the ones that were repaginated, but the substance is the same.

Q And do you have a document that is premarked Exhibit 1 that accompanied your direct testimony?

A Which is the --
Q Your CV?
A Yes.
ALJ JACK: Off the record just a moment.
(Discussion was held off the record.)
ALJ JACK: Back on the record. Off the record.
(Discussion was held off the record.)
ALJ JACK: Okay, let's go back on the record.
BY MS. BURGESS:
Q Was the testimony prepared by you or under your supervision?
A Yes, it was.
Q And the exhibit as well?
A Yes.
Q And if I were to ask you the questions in the testimony today, would your answers be the same as appear therein?
A Yes, substantively they would.
Q Do you adopt this testimony as your sworn testimony in the proceeding?
A Yes, I do.
MS. BURGESS: Your Honor, I request

that the testimony be copied into the record as if given orally.

ALJ JACK: Without objection, the corrected direct testimony of E. Christopher Nurse on behalf of AT&T communications of New York, Inc, as regulated affiliates, as well as his corrected rebuttal testimony, on behalf of the same parties, will be accepted into the record and copied into it as if given orally here today.

(Testimony inserted as ordered.)

STATE OF NEW YORK

PUBLIC SERVICE COMMISSION

Proceeding to Examine Issues Related To a Universal Service Fund	**Case 09-M-0527**

CORRECTED DIRECT TESTIMONY OF E. CHRISTOPHER NURSE

FILED ON BEHALF OF

AT&T COMMUNICATIONS OF NEW YORK, INC. AND ITS REGULATED AFFILIATES

February 7, 2011

I. INTRODUCTION - WITNESS QUALIFICATIONS AND PURPOSE

Q. MR. NURSE, PLEASE STATE YOUR FULL NAME, ADDRESS AND CURRENT RESPONSIBILITIES.

A. My name is E. Christopher Nurse, and my business address is 1120 20th Street, N.W., Suite 1000, Washington, D.C., 20036. I am Regional Vice President, Regulatory & External Affairs, for AT&T's Atlantic Region, which extends from Virginia to Maine. Among my other duties, I am responsible for presenting the perspectives of AT&T companies on a broad range of state regulatory and legislative matters, including initiatives to reform inter-carrier compensation, most commonly involving access charges and universal service funds.

Q. PLEASE STATE YOUR EDUCATIONAL BACKGROUND.

A. I received a B.A. in Economics from the University of Massachusetts at Amherst. In 1996, I received a Masters in Business Administration from Southern New Hampshire University in Manchester, New Hampshire.

Q. WHAT IS YOUR EXPERIENCE IN THE TELECOMMUNICATIONS INDUSTRY?

A. I have 29 years of experience in the telecommunications industry, including over twelve years with AT&T through its acquisition of my previous employer, Teleport Communications Group, Inc. ("TCG"). Prior to starting work for TCG in 1997, I was a Telecommunications Analyst with the New Hampshire Public Utilities Commission ("PUC") from 1991 until 1997, entrusted with a broad range of responsibilities. Assigned to the PUC's engineering department, I was the lead analyst or a contributing

analyst for nearly all telecommunications matters before the New Hampshire Commission.

Q. HAVE YOU APPEARED AS A WITNESS IN REGULATORY PROCEEDINGS?

A. Yes. I have testified before state commissions in Connecticut, Delaware, the District of Columbia, Florida, Georgia, Kansas, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Oklahoma, Pennsylvania, Vermont, Virginia and West Virginia. I have also presented testimony to the Federal Communications Commission. Exhibit A illustrates the various proceedings in which I have participated.

Q. PLEASE GIVE US A SUMMARY OF YOUR DIRECT TESTIMONY.

A. New York has had something akin to a state universal service fund ("USF") for a number of years. This Transition Fund was extended by Order of the NYPSC, in 2010, and is forecast to exhaust its current funding source in September 2011.[1] The fund's size amounts to approximately $1M a year. Far more money has been expended arguing about that fund than would likely be expended by its temporary, limited extension. This is simply a wasteful debate that is not worth the candle.

AT&T Communications of New York, Inc. and its regulated affiliates ("AT&T") propose that the fund be extended for three years at its current funding level for its current funding recipients. To achieve a pragmatic balance between a reduced funding level on the one hand, and an unlimited funding level on the other, AT&T proposes that the current rate-case driven process continue to be used as the gateway to funding by additional small companies (the New York State Telecommunications Association or

[1] Case 09-M-0527, *Universal Service Fund*, Order Adopting Terms of Phase I Joint Proposal (issued July 16, 2010).

"NYSTA" members, see Appendix B hereto listing small companies). The overall fund, however, should be limited by an overall funding cap of 150% of the current fund level in 2011, 175% in 2012, and 200% in 2013. To further reduce the possible demands on the fund, the Commission should relax the current benchmark price cap, and it should set the benchmark price cap for local companies that seek fund[2] support at up to the comparability cap of 125% of the Verizon urban rate. In the unlikely event that the aggregate approved claims for fund support (pursuant to final commission orders) exceed the overall funding cap, a party (or the Commission on its own motion) could reopen this investigation during the three-year extension period. Since all the NYSTA small companies are rate-of-return regulated, there is no material concern for small companies that could not be addressed by this regime.

Given the *de minimis* size and temporary nature of the fund, the Commission should not waste time and resources debating and overhauling the method for determining fund expenditures. The projected funding level for the fund is less than $1 million. That is only .001, or one-tenth of one percent, of the state's intrastate revenue base (which is over $10 billion). Put another way, fund contributions would be only 3 cents on an end user's $30 monthly bill for intrastate services. If the fund doubled, the assessment would only be approximately 6 cents.[3] As fund contributors, all telecommunications carriers statewide—all incumbent local exchange carriers ("ILECs"),

[3] While fund contributions could be assessed on a telephone-number basis (a proposal that AT&T generally supports and that the FCC may adopt), it simply is not worth the time and expense to design and implement a contribution regime based on that methodology and to replace the existing contribution framework (which is assessed as a percentage of intrastate revenue). If the FCC does develop such a number-based contribution regime, the Commission could then consider mirroring the FCC's approach, thereby saving the time and effort that would be spent designing a regime from scratch (and the time and effort that carriers would spend implementing a regime that is not currently used today).

including the NYSTA small companies, all certified CLECs, all competitive access providers, all wireless carriers, all interconnected Voice over Internet Protocol ("VoIP") providers, including all cable telephony providers should contribute based on their intrastate revenues.

The Commission's authority to assess contributions on ILECs and CLECs is unquestioned. In addition, the FCC has established authority for states to create state USFs and levy assessments on wireless carriers and interconnected VoIP carriers[4], such as Vonage.

The FCC's order likewise extends to cable telephony providers to the extent they are Interconnected VoIP providers. Interconnected VoIP and Commercial Mobile Service Providers should be permitted to estimate their intrastate revenues for fund contribution purposes using: 1) the inverse of the FCC's "safe harbor;" 2) a proprietary company-specific traffic study; or 3) identifying their actual intrastate end-user retail telecommunications revenues in the manner that is consistent with the methodology each provider uses to determine its contributions to the federal universal service fund. In addition, CMRS and interconnected VoIP providers should be permitted to determine their intrastate telecommunications revenues assessable by the State of New York (as opposed to other states) based on the revenues of customers having a "place of primary use"[5] in New York. *See also Kansas/Nebraska Preemption Order* ¶¶18-22.

[4] Interconnected VoIP providers are not intrastate service providers but may be assessed intrastate USF fees. See the FCC's "*Kansas/Nebraska Preemption Order":* Declaratory Ruling, Adopted October 28, 2010 and released on November 5, 2010, *In re Universal Service Contribution Methodology, Petition of Nebraska Public Service Commission and Kansas Corporation Commission for Declaratory Ruling or, in the Alternative, Adoption of Rule Declaring that State Universal Service Funds May Assess Nomadic VoIP Intrastate Revenues,* WC Docket No. 06-122.

[5] *See* 4 U.S.C. § 122.

Interconnected VoIP providers shall not be considered intrastate telecommunications services but shall be required to contribute to the fund.

AT&T's limited, balanced approach stabilizes the situation in New York, while more complex issues are resolved in the federal arena (and while the state undertakes a more global review of intercarrier compensation), without undue risk or harm to either the small company incumbents or the contributing companies. This interim extension essentially preserves the status quo, without prejudice to any longer term outcome.

Q. PLEASE DESCRIBE HOW YOUR TESTIMONY IS ORGANIZED.

A. In Section II of my direct testimony, I provide some historical background of the TAF, the Commission's orders, and the Small Companies. In Section III, I discuss the three issues that Judge Jack's order asked the parties to address in this proceeding:

(1) Is there a need to establish a State Universal Service High Cost Fund in New York?

(2) If a State Universal Service High Cost Fund, is established: Who would draw from the fund, and who would contribute to the fund?

(3) Should the Commission establish a benchmark rate for basic local service, and if so, at what level?

II. BACKGROUND

Q. PLEASE GIVE A BRIEF DESCRIPTION OF THE HISTORY OF THE TAF.

A. In its May 22, 1996 *Competition II* Order (Case 94-C-0095), the Commission generally adopted the concept of the TAF, which was designed to fund programs like Lifeline, emergency services, and telecommunications relay services for the hearing impaired, on an explicit, competitively neutral basis. The Commission instituted the TAF by an order

issued on June 2, 1998 in Cases 94-C-0095 and 28425, which also ordered reductions in access charges. The Commission stated that contributions to the fund would be assessed based on relative regulated intrastate gross revenue.

Q. CAN YOU PROVIDE A BRIEF OVERVIEW OF THE NYSTA SMALL COMPANIES ?

A. The NYSTA small companies are, with the exception of Windstream, genuinely "small" averaging around 3,000 lines. Largely as a function of their small size, and frequently their low customer density, many of them have high unit costs – before one considers the federal USF support they receive.

Q. WHAT IS THE POLICY IMPORT TO THIS COMMISSION OF THE FEDERAL USF TREATMENT OF NYSTA SMALL COMPANIES?

A. Prior to federal USF treatment, most of the NYSTA small companies start out with high costs – some of them with costs three times higher than other carriers. But that is not the whole story. *Regardless* of the small companies' starting costs, the federal universal service program for high-cost loop support provides support sufficient to reduce each small company's loop cost to a maximum of about $30 for the 2009 support year, as shown in the chart below.[6] The federal support program is like an insurance policy with a $30 deductible: regardless of the gross cost, the "insured" carrier pays only the $30 deductible per loop, with the federal program covering costs above $30. In addition, 25% of the loop cost is jurisdictionally allocated to the interstate jurisdiction.[7] Thus, between

[6] Generally, loop costs are the overwhelming majority of total costs for smaller carriers, perhaps 90% of total costs. There is, however, a Local Switching Support program to support the higher unit cost of small scale LEC switching costs.

[7] For small companies, under 50,000 lines, switching costs are allocated to the interstate jurisdiction proportionate to relative minutes of use. Smaller companies are further supported with a double or triple

interstate allocation and federal universal service funding support, the high costs of the NYSTA companies are effectively capped, leaving only a modest cost to be recovered in the intrastate jurisdiction.[8] The chart below provides an overview of the NYSTA small companies' cost, federal support, and residual costs for recovery from the state jurisdiction.

weighting of their proportional allocation to the interstate jurisdiction, up to a maximum of 85%. This can greatly reduce the intrastate costs remaining to be recovered.

[8] This reduced cost is, essentially, the starting point in a rate-case examination by the staff.

NY USF Loop Costs & Support - 2009 Support Year

No.	Company (Study Area Name)	Total Unseparated Cost Per Loop (Annual)	Total Unseparated Cost per Loop (Monthly)	Total Intrastate Cost Per Loop (Monthly)	Nat'l Avg. Cost Per Loop (Monthly)	Intrastate Loop Cost, Net of F-USF (Monthly)	Number of Supported Loops	Total F USF Loop Support Ecxl LSS (Monthly)	FUSF Support- Per Loop Excl. LSS (Monthly)	Residence Local Rate
		(a)	(b)=(a)/12	(c)=(b)x.75	(d)	(e) = lesser of (c) or $29.09	(f)	(g)	(h) = (g)/(f)	
	Non-Price Cap Companies (FCC)									
1	ARMSTRONG TEL CO-NY	$ 766	$ 63.81	$ 47.86	$ 32.42	$ 29.09	3,142	$ 119,404	**$ 38.00**	$15.99
3	CASSADAGA TEL CORP	470	39.15	29.36	32.42	29.09	1,225	12,737	**10.40**	$9.78
4	CHAMPLAIN TEL CO	501	41.73	31.30	32.42	29.09	5,291	66,653	**12.60**	$13.59
7	CITIZENS HAMMOND NY	887	73.94	55.45	32.42	29.09	1,815	84,723	**46.68**	$12.23
8	CROWN POINT TEL CORP	934	77.86	58.39	32.42	29.09	1,073	56,698	**52.84**	$17.81
9	DELHI TEL CO	538	44.80	33.60	32.42	29.09	4,239	77,332	**18.24**	$9.72
12	EDWARDS TEL CO	604	50.37	37.78	32.42	29.09	2,334	44,760	**19.18**	$11.02
16	HANCOCK TEL CO	494	41.14	30.85	32.42	29.09	1,767	29,099	**16.47**	$11.37
20	NICHOLVILLE TEL CO	655	54.61	40.96	32.42	29.09	2,227	57,911	**26.00**	$19.24
22	ONTARIO TEL CO, INC.	506	42.17	31.63	32.42	29.09	3,997	58,279	**14.58**	$12.40
25	PORT BYRON TEL CO	540	45.03	33.77	32.42	29.09	3,080	42,220	**13.71**	$10.50
28	TOWNSHIP TEL CO	605	50.40	37.80	32.42	29.09	3,581	64,199	**17.93**	$13.19
29	TRUMANSBURG TEL CO.	553	46.08	34.56	32.42	29.09	5,770	103,752	**17.98**	$17.50
24	PATTERSONVILLE TEL	463	38.58	28.94	32.42	28.94	1,153	16,571	**14.37**	$16.58
6	CHAZY & WESTPORT	455	37.89	28.42	32.42	28.42	3,527	24,954	**7.08**	$17.35
21	ONEIDA COUNTY RURAL	453	37.73	28.30	32.42	28.30	3,276	33,247	**10.15**	$12.69
15	GERMANTOWN TEL CO	439	36.57	27.43	32.42	27.43	2,759	26,854	**9.73**	$11.43
26	STATE TEL CO	420	35.04	26.28	32.42	26.28	7,640	44,415	**5.81**	$8.59
14	FISHERS ISLAND TEL	418	34.85	26.14	32.42	26.14	1,031	8,245	**8.00**	$17.00
19	NEWPORT TEL CO	409	34.05	25.54	32.42	25.54	3,424	26,697	**7.80**	$23.00
13	EMPIRE TEL CORP	401	33.42	25.07	32.42	25.07	6,848	51,997	**7.59**	$11.97
23	ORISKANY FALLS TEL	373	31.06	23.30	32.42	23.30	607	1,393	**2.29**	$18.75
30	VERNON TEL CO	360	30.02	22.51	32.42	22.51	2,286	14,903	**6.52**	$13.30
2	BERKSHIRE TEL CORP	334	27.85	20.89	32.42	20.89	5,144	29,476	**5.73**	$10.11
10	DEPOSIT TEL CO	333	27.75	20.81	32.42	20.81	8,036	28,861	**3.59**	$12.85
17	MARGARETVILLE TEL CO	311	25.91	19.44	32.42	19.44	4,184	12,780	**3.05**	$9.35
5	CHAUTAUQUA & ERIE	309	25.74	19.30	32.42	19.30	9,550	41,862	**4.38**	$8.43
27	TACONIC TEL CORP	309	25.71	19.29	32.42	19.29	26,891	81,164	**3.02**	$11.11
18	MIDDLEBURGH TEL CO	305	25.45	19.09	32.42	19.09	6,733	14,418	**2.14**	$9.39
31	WARWICK VALLEY-NY	287	23.89	17.92	32.42	17.92	13,452	42,426	**3.15**	$8.62
11	DUNKIRK & FREDONIA	222	18.48	13.86	32.42	13.86	7,151	43,482	**6.08**	$13.98
	Weighted Average ot Tot.	$ 400.83	**$ 33.40**	$ 25.05		$ 23.05	153,233	1,361,508	**$ 8.89**	**$11.93**
	Price Cap Companies (FCC)									
4	FRONTIER-SYLVAN LAKE	443	36.91	27.68	32.42	27.68	13,221	20,944	**1.58**	$9.04
9	CITIZENS-FRONTIER-NY	429	35.74	26.81	32.42	26.81	13,746	6,162	**0.45**	$13.47
10	CITIZENS-FRONTIER-NY	428	35.67	26.76	32.42	26.76	23,797	63,810	**2.68**	$13.47
11	CITIZENS-FRONTIER-NY	402	33.46	25.10	32.42	25.10	218,097	316,574	**1.45**	$13.47
2	FRONTIER-AUSABLE VAL	395	32.92	24.69	32.42	24.69	6,151	35,715	**5.81**	**$13.81**
12	FRONTIER-ROCHESTER	367	30.57	22.93	29.76	22.93	315,350	-	-	$12.62
1	FRONTIER COMM OF NY	361	30.05	22.54	32.42	22.54	56,398	65,767	**1.17**	$10.28
6	WINDSTREAM NY-FULTON	346	28.86	21.65	32.42	21.65	33,112	175,497	**5.30**	$12.85
13	VERIZON NEW YORK	335	27.90	20.93	29.76	20.93	7,408,210	540,291	**0.07**	$23.00
3	FRONTIER-SENECA GORH	329	27.43	20.57	32.42	20.57	7,982	11,600	**1.45**	$13.48
8	WINDSTREAM RED JACKT	306	25.49	19.12	32.42	19.12	1,594	2,205	**1.38**	$12.85
7	WINDSTREAM-JAMESTOWN	282	23.50	17.62	32.42	17.62	36,973	38,603	**1.04**	$12.85
5	OGDEN TEL DBA FRNTER	227	18.94	14.20	32.42	14.20	16,387	-	-	$12.40
	Weighted Average or Tot.	$ 338.26	**$ 28.19**	$ 21.14		$ 21.14	8,151,018	$ 1,277,167	**$ 0.16**	**$ 22.06**

Notes:

Residence local rates represent the average based on tariffs in effect on Sept. 2009.

ICLS includes the SLC revenue. IAS does not include SLC revenue.

High Cost support is based on reported 2009 FCC USAC data.

The three highlighted/shaded companies currently also receive NY state TAF support.

For Cost Data - **Universal Service Fund Data: NECA Study Results**

2007 Report, USF10R07.ZIP (433K) submitted 9/30/10

http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/Monitor/usf10r07.zip

For high cost support data - **December 2009 Monitoring Report.** Released 12/09.

III. DISCUSSION OF ISSUES STATED IN JUDGE JACK'S NOVEMBER 18, 2010 RULING ON PHASE II PROCEDURE

Issue #1: Is There a Need to Establish a State Universal Service High-Cost Fund in New York?

Issues 1a & 1b. Is there a need to establish a State Universal Service High Cost Fund, or other form of support program to ensure universal availability of affordable basic residential telephone service in New York, to succeed the Temporary Transition Fund Extension approved by the Commission's July 16, 2010, order in Phase I of this proceeding? This issue includes consideration of: a. Whether the need, or lack of need, for such a fund or program can, as a practical matter, be determined (i) on a generic basis; or (ii) only on a case-by-case basis, considering a particular carrier's service area or a discrete portion of its service area and the particular circumstances of the carrier, service area, or portion of service area.
b. (i) The purposes the fund or program, if any, would serve; (ii) what alternatives might be available to fulfill those purposes and meet the claimed need; and (iii) the relative merits and drawbacks of such a fund or program compared with those of the available alternatives.

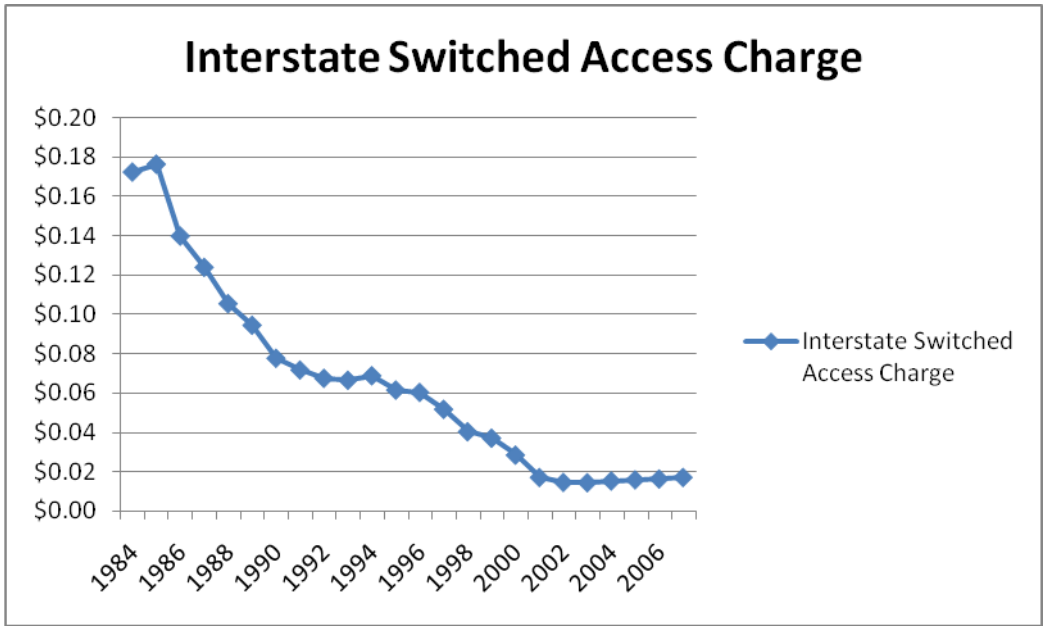
Q. IN THE ABSTRACT, WOULD IT BE POSSIBLE TO ANSWER JUDGE JACK'S QUESTIONS AT THIS TIME?

A. Not really. On a blank page, the question of whether to establish a state USF should be inextricably linked with the need for reforming intrastate switched access charges, a question this Commission has deferred to a subsequent phase of the proceeding. In the bygone era of local phone monopoly franchises, New York (like many other states) supported artificially low rates for basic local service through a scheme of implicit subsidies. The monopolist charged artificially high rates for long-distance "toll" calls to implicitly subsidize local service. Because local and long-distance services were a closed monopoly system, customers had little choice but to pay the high toll rates.

Even with the breakup of The Bell System and the advent of competition in the long-distance market, the old scheme of implicit subsidies remained. The local phone monopolies (the ILECs) subsidized artificially low rates for local service by charging high rates for "access" to long-distance interexchange carriers ("IXCs") like AT&T.

But with the evolution of technology and the enactment of the federal Telecommunications Act of 1996, the old monopoly system has crumbled. Today, consumers have a wide array of choices for long-distance communications: they can use e-mail, or text messaging, or wireless phones, or VoIP, or social networking sites like Twitter and Facebook. Thus, consumers can (and do) avoid wireline long-distance service, and in large (and growing) numbers are using alternative technologies than wireline phone service altogether.

Recognizing that the old system of implicit subsidies is unsustainable, the FCC has adopted significant reductions to switched access charges for interstate calls. The chart below illustrates the decline in interstate access charges from 1984-2006.



Source: FCC Report, *Trends in Telephone Service, August 2008*

These reforms have substantially removed the *implicit* subsidies in access rates and reformed them through a combination of *explicit* increases to end user rates (the

Subscriber Line Charge, now $6.50) and *explicit* subsidies in the $7 billion federal Universal Service Fund. Explicit subsidization is both more efficient and more transparent. Many states, including Massachusetts and Maine, and recently New Jersey, have followed suit for intrastate calls, and the FCC has encouraged such reforms. New York has implemented some access reductions, but it is well behind the pack, as over half the states in the country have undertaken substantial reforms.

Thus, if the Commission were considering whether to establish a USF for *explicitly* supporting local service on a blank slate, it would have to consider reforms to the existing system of *implicit* support provided by intrastate switched access. Working within the parameters the Commission has established, the question of intrastate switched access reform has been deferred to the next phase of this proceeding, Thus, in addressing a state high-cost USF in the current phase of the proceeding, AT&T is mindful of the potential need to rebalance certain implicit access subsidies to a state fund (to the extent they cannot be reasonably rebalanced to local rates) and will recommend a fund structure that could readily accommodate that outcome if the Commission determined such an approach was in the public interest in the subsequent access review. I will return to this design attribute briefly at the end of this testimony, but generally I will defer discussion of the merits of access reform for subsequent opportunities in accordance with the procedure established by the Commission.

Q. IS THERE A SIMPLE ANSWER TO JUDGE JACK'S QUESTIONS FOR THIS PHASE OF THE PROCEEDING?

A. Fortunately, yes, because the Commission is not writing on a blank slate. New York has essentially had a *de minimis* state USF for a number of years. The current fund is

currently funding three small New York ILECs – one with fewer than a thousand lines -- at a comparatively modest level of $1M a year.

In the context of New York's intrastate telecommunications market, which easily exceeds $10 billion, the fund corresponds to an assessment of one-tenth of one percent of revenue. Far more money and resources would be expended ***arguing*** over it – its history, its rationale and its future – than would likely be ***expended*** by a temporary, limited extension. Indeed, the parties have already expended several times more resources than the size of the fund, debating the economic policy perspectives on competition, the intricacies of technology, and the nearly religious debate of "good" subsidies and "bad" subsidies. Pragmatically, given the *state-specific* legal, economic, and regulatory particulars of New York, the Commission can simply extend the fund on a limited, transitional basis and then undertake the necessary step of addressing intrastate switched access reform. Logically, the question of access reform should be considered concurrently with the USF question for the longer term. But for the short term, AT&T's proposal allows the Commission to implement short-term measures for USF support during the period it considers access reform.

Q. WHAT IS THE LIMITED EXTENSION THAT AT&T PROPOSES?

A. AT&T proposes that the fund be extended for three years, which should be more than enough time for the Commission to complete its examination of intrastate switched access charges. The extension should also be limited in *amount*, because AT&T's proposal is designed simply to preserve and stabilize the *status quo*, not to create some very large new entitlement scheme. AT&T proposes that the Commission set a soft cap on NY USF support. For 2011 (or the first full year), the cap should be 150 percent of

the current fund level. The cap should then increase slightly to 175 percent of the current fund for 2012 and 200 percent for 2013.

Issue # 2: If a State Universal Service High Cost Fund, is established: Who would draw from the fund, and who would contribute to the fund?

Issue 2.a. Who is eligible for the fund or program? (*e.g.*, pool companies only, non-pool LECs, CLECs, wireless companies, individual telephone users, *etc.*)?

Q. WHICH CARRIERS CURRENTLY RECEIVE FUND SUPPORT?

A. Currently, three small rate-of-return ILECs receive support from the fund: Newport, Oneida, and Crown Point. At this time, only the NYSTA small companies are eligible to draw.

Q. WHICH CARRIERS SHOULD BE ELIGIBLE FOR SUPPORT DURING THE LIMITED EXTENSION PERIOD THAT AT&T PROPOSES?

A. Given the limited size and the temporary, transitional nature of the fund proposed by AT&T, the fund draw should be limited to the 31 intrastate, rate-of-return RLECs: the NYSTA "Small Companies," just as it is today. Excluding Windstream, the other 31 Small Companies collectively serve fewer than 110,000 residential lines, or a little over three thousand lines each on average. These companies best fit the current, limited nature of the fund, so the Commission could allow them to be eligible for support without any dramatic shift in the relative size of the USF, in its underlying philosophy, or in its impact on the competitive market.

To be clear, AT&T proposes that during this three-year transition period, USF support would not be provided to wireless carriers, CLECs, cable telephony providers, competitive access providers, Interconnected VoIP providers, Internet Service Providers, Interexchange Carriers, nor the large ILECs Frontier and Verizon. Whatever arguments such providers might make for support, addressing those arguments would undoubtedly

swallow the parties and the Commission in a long, complex, and contentious debate about the political questions of which carriers "deserve" support, which do not and why, and how best to deal with all the competing technologies. Every carrier and industry group could make some case for support, and then make some case for rejecting the claims of its competitors. Obviously, the Commission should not terminate the fund and pull the rug out from under the three carriers drawing from the fund. Conversely, however, the Commission should not simply write blank checks to everyone that would lead to explosive growth in the fund. And it is simply not worthwhile for the Commission to sort through and address all these claims—many of which are more academic than pragmatic--before it takes up the question of switched access reform. The better course for now is simply to preserve the *status quo*, with some modest leeway during the temporary transitional period.

Issue 2.b. What are the eligibility requirements for competitive companies (*e.g.*, federal eligible telecommunications carrier guidelines or other criteria) or other recipients of support?

Q. WHAT ELIGIBILITY REQUIREMENTS SHOULD THE COMMISSION ADOPT FOR THESE SMALL COMPANIES TO RECEIVE SUPPORT DURING THE THREE-YEAR TRANSITION PERIOD?

A. The three companies that receive fund support today should be grandfathered into the fund for the transition period, until and unless the Commission issues a final order in a rate case involving one of those carriers (at which point their continued eligibility would depend on the outcome of the rate case).[9] Other "Small Companies" would be eligible to draw from the fund if they meet two qualifying criteria: (1) a rate case showing the need

[9] As an exception, on a revenue-neutral basis, the Commission could increase the benchmark rate, and reduce the existing carriers' state USF draw on a dollar-for-dollar basis.

for support, and (2) a rate design that meets or exceeds an appropriate benchmark rate to be established by the Commission.

During the transition period, Small Company carriers would be eligible to file rate cases as they do today (and as the existing support recipients did to demonstrate eligibility). If a Small Company is successful in showing that its prudent intrastate costs (net of interstate USF support) are higher than the Commission's benchmark rate (currently $23 per line per month), then the carrier would be eligible to draw from the fund.

Q. SHOULD THE COMMISSION CONSIDER INCREASES TO THE BENCHMARK RATE?

A. Yes. The Commission should consider increasing the benchmark which has been frozen since the Comp III decision. The Commission should consider increasing the benchmark rate up to the federal comparability rate for rural carriers of 125% of the ($23) urban rate for carriers seeking to draw from the fund. That would yield a benchmark rate of $28.75 per line per month. (Note that the updated benchmark should apply equally to all recipients, including the three carriers that currently draw fund support based on the $23 benchmark, but could be structured otherwise).

Updating the benchmark will serve several purposes. First, the local rate benchmark should be updated in light of inflation. Second, the current benchmark for rural ILECs is the same as the statewide benchmark for large urban ILECs; the benchmark for rural areas could be higher to reflect the higher costs of serving less dense, more rural areas. Third, an updated benchmark would reduce the demands on the USF. Particularly in light of the limited, transitional nature of the USF as proposed by AT&T,

contributors should not be asked to fund subsidies just so rural rates can be held at artificially low levels. Also, as I noted earlier, the Commission should also cap the aggregate support amount for 2011 (the first year of the plan), 2012, and 2013 at 150 percent, 175 percent and 200 percent respectively, of the current fund draw.

Issue 2c. Who would contribute to the fund or other support program (*e.g.*, wireline companies, wireless companies, Voice over Internet Protocol provider companies, cable companies)?

Q. WHO SHOULD CONTRIBUTE TO THE USF?

A. AT&T supports the broadest allowable contribution base for a state USF. This is the most equitable, competitively neutral approach. Fund contributors should thus include:

- all telecommunications carriers statewide
    - all ILECs, including Verizon and Frontier and the NYSTA small companies;
    - all Commission-certified CLECs, (Level 3, OneComm, etc)
- all wireless carriers (including, for example, Verizon Wireless, T-Mobile, Sprint, and AT&T Mobility),
- all interconnected VoIP providers, including, among others,
- Over-the-top (also referred to as nomadic) interconnected VoIP providers (such as Vonage),
- All fixed location interconnected VoIP providers (including cable interconnected VoIP providers (such as Cablevision, Time-Warner Cable, and Comcast).

The Commission's authority to assess ILECs and CLECs is unquestioned. The federal Act explicitly delegates authority to states to determine how state-level universal service programs should be funded so long as they are "not inconsistent with the Commission's rules." 47 U.S.C. § 254(f).

States are also permitted to require CMRS and interconnected VoIP providers (including cable operators, to the extent that they provide interconnected VoIP services) to contribute to state universal service funding mechanisms so long as such contribution requirements do not burden federal universal service support mechanisms.[10] Interconnected VoIP and Commercial Mobile Service Providers should be permitted to estimate their intrastate revenues for fund contributrion purposes using the inverse of the FCC's "safe harbor"; a proprietary company-specific traffic study; or to identify their actual intrastate end-user retail telecommunications revenues in the manner that is consistent with the methodology each provider uses to determine its contributions to the federal universal service fund. In addition, CMRS and interconnected VoIP providers should be permitted to determine their intrastate telecommunications revenues assessable by the State of New York (as opposed to other states) based on the revenues of customers having a "place of primary use"[11] in New York. Interconnected VoIP providers shall not be considered intrastate telecommunications services but shall be required to contribute to the fund.

Issue 2d. How would contribution levels be calculated (*e.g.*, Targeted Accessibility Fund formula or some modified or alternative approach)?

Q. WHAT METHOD SHOULD THE COMMISSION USE FOR CALCULATING THE ASSESSMENTS DUE FROM EACH PARTICULAR CONTRIBUTOR?

A. AT&T proposes a simple method for calculating each contributor's assessment. The proposed numerator is essentially the expected annual disbursement from the fund

[10] *See* 47 U.S.C. § 254(f).
[11] *See* 4 U.S.C. § 122.

(currently about $1 million) plus a reasonable allowance for an administrator's fee (e.g. $50,000), plus a working cash reserve, such as two month's disbursement, minus any carryover balance from the existing fund. So for the first year the numerator might be $1 million or perhaps as high as $1.2 million (including the administrator's fee, plus the additional 2 months working cash reserves.)

AT&T's proposed denominator is the combined New York intrastate revenues of the ILECs, CLECs, Wireless carriers, and Interconnected VoIP providers (including cable operators, to the extent they provide interconnected VoIP services). The ILECs and CLECs already report intrastate revenue. The Commission can collect the revenue data from the other providers in the compliance phase of this proceeding. Based on publicly available data, AT&T estimates that intrastate revenue in New York is nearly $13 billion.[12] Assuming a range of possible fund sizes between one and two million, in the numerator, and intrastate revenue of $13 billion in the denominator, the contribution rate would be approximately 0.008% to 0.016% of intrastate revenues. This is a sufficient record basis from which to make the policy decision. Each contributor would then pay that fraction of its intrastate revenues towards the fund.

Issue 2e. Who should administer the fund or other support program (*e.g.*, some successor in interest of the New York Intrastate Access Settlement Pool, Inc., the Targeted Accessibility Fund of New York, Inc., some other entity)?

Q. SHOULD THE COMMISSION TAKE THE TIME AND EFFORT TO LOCATE A NEW ADMINISTRATOR FOR THE FUND?

[12] See Table 15.6 of the recent FCC *Trends in Telephone Service*, *Industry Analysis and Technology Division Wireline Competition Bureau*, report dated September 2010, which shows total NY intrastate revenues of $12.852B. http://www.fcc.gov/Daily_Releases/Daily_Business/2010/db0930/DOC-301823A1.pdf

A. No. The fund proposed by AT&T here is so small and transitional that it is hardly worth bidding for an administrator. The Commission and the Department should simply continue with the current administrator.

Issue 2f. Should the fund or other support program be reevaluated periodically or sunset after a number of years?

Q. DOES AT&T PROPOSE THAT THE TEMPORARY EXTENSION OF THE FUND BE REEVALUATED?

A. Yes, AT&T's proposed temporary extension of the current fund, as modified, should be re-evaluated in three years, with that proceeding commencing two years from the date of a final order in this phase of the proceeding. This would give the Commission a year to evaluate the next steps. By that time, the Commission will hopefully have completed its examination of intrastate switched access charges, and in addition it may have the benefit of additional FCC guidance on universal service funding approaches.

Q. WOULD THIS MEAN THAT THE COMMISSION COULD NOT REVISIT THE FUND IN THE INTERIM?

A. No. In the unlikely event that the fund exhaustion is forecast, the Commission can reopen the examination on its own motion or in response to a petition. AT&T is simply saying that the Commission should have two years before it *has* to revisit the matter, but that it will retain the power to review the fund sooner if that turns out to be necessary.

Issue 2g. Should the overall size of the fund or support program cost be limited? If so, at what level should that limit be set; or what methodology should be used to determine that limit?

Q. DOES AT&T PROPOSE THAT THE OVERALL SIZE OF THE FUND BE LIMITED?

A. Yes, for each year of the proposed interim three year extension. As I noted earlier, for 2011, AT&T proposes limiting the fund to 150 percent of the current fund, or about $1.5 million. For 2012, AT&T proposes an overall limit of 175 percent or $ 1.75 million, and for 2012, AT&T proposes an overall limit of 200% or $2 million. As I noted earlier, the Commission could review the fund and these annual limits in response to a petition or on its own motion.

Issue 2h. What standards should apply to determine the amounts of payments from the fund or extent of other form of support from the program to an eligible recipient?

Q. HOW SHOULD THE COMMISSION DETERMINE SUPPORT AMOUNTS FOR ELIGIBLE RECIPIENTS?

A. For AT&T's proposed interim extension, the Commission should continue to use the same rate-of-return rate case methodology that it uses today. In practice, this method has worked well, and there is simply no need to reinvent the wheel. Since the rate-of-return method necessarily gives the NYSTA small companies a reasonable opportunity for a fair return at their authorized rate, there is little risk of harm to incumbents. Likewise, the assessment level is very small, and only interim, so there is little risk of harm to contributors. And because the base of contributors would be more broad than with today's fund, the fund will be more competitively neutral.

Issue 3. Should a benchmark rate (or other benchmark be established? If so, at what level (*e.g.*, for a benchmark rate, the comparable Verizon rate, some percentage above or below the Verizon rate, some other method)?

Q. SHOULD THE COMMISSION ESTABLISH A BENCHMARK RATE, AND HOW?

A. Yes a benchmark rate should be established in connection with drawing from the fund. The benchmark could be a rate as high as 125% of the Verizon retail urban rate. Verizon's current urban retail rate is $23 so the new benchmark could be as high as $28.75, before taxes and fees. Then in a rate-of-return case, after reviewing prudent investment and expense, the Commission would establish a revenue requirement and in the rate design of that process, and in so doing the Commission could consider a new benchmark for that ILEC of up to $28.75. Additional intrastate revenue would be considered in the rate case process, with the residual recovered from the state USF.

IV. CONCLUSION

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes.

STATE OF NEW YORK

PUBLIC SERVICE COMMISSION

Proceeding to Examine Issues Related To a Universal Service Fund	**Case 09-M-0527**

CORRECTED REBUTTAL TESTIMONY OF E. CHRISTOPHER NURSE

FILED ON BEHALF OF

AT&T COMMUNICATIONS OF NEW YORK, INC. AND ITS REGULATED AFFILIATES

February 10, 2011

Q. Please state your name and affiliation.

A. My name is E. Christopher Nurse, Regional Vice President, Regulatory and Legislative Affairs, and I filed direct testimony on behalf of AT&T and its regulated affiliates on December 31, 2010.

Q. Please state the purpose of your rebuttal testimony.

A. This rebuttal testimony responds briefly to discrete aspects of proposals and policy positions presented in the direct testimony of some of the other parties to this proceeding, specifically: the NYSTA Smaller ILECs and Verizon.

Q. Can you summarize your testimony?

A. As I described in my direct testimony, AT&T takes a pragmatic and realistic approach to resolving the near-term/midterm needs to stabilize the Temporary Transition Fund Extension ("TTFE"), which is functioning as a USF in New York, and to balance the conflicting needs of the fund recipients relative to the fund contributors. AT&T's proposal avoids wasteful entanglement in the academic, hypothetical, and theoretical arguments that ensue when parties try to present their solutions to all the complex issues inherent in universal service (and to advance their own interests). Accordingly AT&T recommended that:

1. The current qualification process continue to be used for any future applicants for the fund. This needs-based showing is already a known and workable routine for carriers, Staff and the Commission.
2. The fund operates for a three-year period subject to a soft cap on the total fund size. The level of funding in year one should be 150% of the existing TTFE funding level, and

increase to 175% and 200% in the second and third years respectively. In the unlikely event the soft cap would be exceeded within the next three years, a review would be triggered to consider the merits of requiring additional funding, if and when that might be necessary. For administrative ease, the fund administrator can continue as it is today.

3. At the end of the second year of the fund extension, the Commission should open an investigation to determine, based on then-current facts and applicable laws, rules, and orders, whether, if, and how the fund should be terminated or renewed.
4. At that time, the Commission can then can also synchronize the fund's explicit support mechanisms with its findings on the implicit subsidy mechanism in the incumbent carriers' switched access charges. The Commission can also consider any other changes that the FCC has made in the area of Intercarrier Compensation and Universal Service under its National Broadband Plan initiative[1].

Q. What is your overall observation of the testimony filed by the other parties?

A. My overall observation is that all the parties are simply making too much of the relatively narrow matter. There is no need to "split the baby," or try to untie the Gordian Knot; while enormous resources—millions of dollars literally—will have been consumed in addressing the small need that presently exists in New York. A small, simple and temporary fund is all that is called for here.

Q. Do you agree with the NYSTA Smaller ILECs that the need and justification for a state Universal Service Fund have been "amply demonstrated (p. 5)" in this proceeding?

[1] 47 C.F.R. Sec. 54.307, Federal Communications Commission. "Connecting America: The Broadband Plan" (March 2010) ("National Broadband Plan").

A. No, not even close. Contrary to what the NYSTA Smaller ILECs contend, they have not met the burden of demonstrating that a Universal Service Fund of the enormous size and unsupported nature they advocate is justified for New York.

While it may be true that some of the smaller ICOs have high costs that would justify state USF support beyond the federal support they already receive, such companies would be cared for under AT&T's proposed fund, because New York's historical regime is already set up to consider such applications. At the current time, any Universal Service Fund for New York need only address residual support beyond the federal support. It is simply not necessary to create a "revenue assurance fund" for all companies at this time.

Q. Have the NYSTA companies asked for support that is outside the scope of the docket?

A. Yes, the Commissions established this docket to address "high costs" exclusively. The NYSTA companies' proposal to address issues that purportedly relate to "low income" users is plainly outside of the scope of the case.

Q. Do you agree with the NYSTA Smaller ILECs (p. 10) that decisions regarding a state USF for New York should not be delayed pending policy decisions at the federal level?

A. Generally, yes. However, the Commission should not address the question of explicit support (through a state USF) on a comprehensive or long-run basis until it has addressed the *implicit* support that local carriers receive from switched access charges (which the Commission has already committed to do in a subsequent phase of this proceeding). For now, the Commission should instead adopt AT&T's proposal, which cares for USF issues on a limited, transitional basis. As it happens, this approach has the added benefit of allowing the

Commission to review and consider any FCC decisions on USF issues while providing a safety net to small carriers. The ability to subsequently consider these developments gives further support to the approach advocated by AT&T -- that the Commission maintain the levels of support in the TFFE on a transitional basis, but revisit the issue in three years. This is a reasonable balance between doing nothing now, and doing something permanent now, in the face of potential developments in the area of implicit subsidies that might affect the USF analysis.

Q. Please comment on Verizon's USF proposal should the commission decide to create a state USF.

A. As discussed in its initial comments, AT&T recommends the continuation of a fund on a limited basis for a three year term. Verizon argues that a state fund is not necessary to preserve universal service in New York (VZ direct, p.11), but if the Commission nonetheless decides to create a fund that it should be designed along the lines of what the FCC is looking at doing under its National Broadband Plan (p. 48-51). Verizon describes the fund design as one that would entail a) funding on a competitive bidding process; b) funding to only one provider per location; c) that any provider legally authorized to provide service, including incumbent local provider, be eligible for support; and d) with a distribution mechanism patterned after that established by the FCC in its national broadband plan. Verizon further argues that such a design would facilitate consistency and coordinated state action with the FCC's process.

If the Commission were to address USF issues on a long-term, comprehensive basis, AT&T would not necessarily agree with all of Verizon's arguments (i.e., for example, limiting or excluding interconnected VOIP providers from contributing to the USF (Verizon Direct Testimony pp. 54-55)). But AT&T is open to undertaking a review of Verizon's proposals upon

expiration of the transitional USF AT&T proposes and the FCC has more fully developed the National Broadband Plan, so New York's efforts could be consistent with the FCC's process. The more important point for now is that the Commission does not need to address these broader USF issues now, and should not address them until it has considered switched access reforms. AT&T's proposal is the most practical solution to resolving a short term/mid term issue while providing a framework for making important updates to the state USF based on related issues at the state level (namely, switched access reform) and the federal level (any decisions regarding USF/Intercarrier Compensation).

Q. Does AT&T agree with Verizon's proposal that if a fund is created it should be based on strict standards limiting the amount of funding and ensuring applicant justify the need for funding in specific areas for specific services deemed necessary to provide universal service (VZ Direct, p.52)?

A. Generally, yes. When New York addresses USF on a comprehensive, long-term basis, AT&T would be open to reviewing these proposals in that context. But for now, the limited transitional fund extension proposed by AT&T, governed by the existing approach that the Commission has already used, is sufficient to ensure that USF support is limited and directed to real needs.

Q. Please comment on the NYSTA Small ILECs' proposal that the Commission establish a new benchmark rate of $15.22 (p. 95).

A. The NYSTA proposal is utterly unreasonable because it would actually *lower* the existing $23 benchmark to $15.22, which is completely unrealistic and unsustainable. The NYSTA companies provide no evidence of any problems with the current $23 rate. There simply is no

support for such a proposition in the real-world marketplace. In today's highly competitive environment, if the existing benchmark is too high and if a $15 rate is sustainable, carriers would be lowering their rates on their own without need for Commission regulation. The NYSTA proposal is grotesquely unbalanced and presumably is an attempt to use artificially low rates as a reason to justify huge levels of USF support. The proposed artificially low rates are like proposing an arbitrary "free steak dinner for everyone in the state" – it might sound good on the surface, until you think about how to pay for it. This is a serious investigation and it calls for serious proposals.

Q. Beyond the level of NYSTA's USF proposal, do you have additional criticism regarding the structure of NYSTA's proposed benchmark for state USF payments?

A. The NYSTA proposal proposes a local rate cap structure based strictly on an average rate; this is laughable. Obviously, this is a fatally flawed approach whereas roughly half the lines would be above the average rate.[2] For comparison, for non-rural companies, like Verizon, servicing rural areas—the FCC comparability test is a cap of the national average ***plus two standard deviations.*** Under the FCC comparability standard, local rates are "too high" only when they substantially exceed the average, exceeding the average by two standard deviation, so that they are addressing the high "tail" end of the population, not essentially half of the population.

Q. What should the benchmark be and why?

A. The benchmark rate should be *increased* to $28.75 to reflect both inflation and the higher costs of serving rural areas, and to reduce demands on the USF.

[2] Assuming a normally distributed population.

Verizon proposed a benchmark of 143% which has a solid foundation. AT&T had proposed $28.75 125% of the $23 rate cap to reflect:

- Parity with the Verizon customers, the overwhelming majority of ILEC customers in NY
- Inflation since the $23 local rate cap was established
- The higher costs of serving rural areas should be somewhat reflected in rural rates, and then support should kick in to keep rates affordable

and to reduce demands on the USF, and recognize the harm and burden of unnecessarily high support contributions by carriers and customers.

Q. Do you agree with the Staff estimates that their proposed fund would be $5 million dollars annually (USF Mechanics Panel, p.31)?

A. No. As AT&T, Verizon and other parties have proposed, the benchmark should be increased above the current $23 to the $29-$33 range ($28.75 and $32.89, respectively). At that point, higher cost carriers will be presenting a higher price to their customers more truthfully reflecting the underlying costs and more accurately signaling prices more reflective of costs. Such higher prices will tend to attract more competitive entry, and engage customers in high cost areas in bearing at least some portion of the higher cost (of course, staying well within affordability constraints). Thus, Staff's fund size estimate would be considerably smaller if it appropriately incorporated an undated funding benchmark rate.

Q. Staff proposed a term of three to five years, which overlaps with AT&T's three-year term proposal. Do you agree with this proposal?

A. Yes, three years is a reasonable time frame for this environment. AT&T agrees with staff's conclusion: " The fund should be of limited term with an opportunity for exploring the issue of whether it needs to be extended. Given the potential for dramatic changes in the regulatory landscape at the federal level, along with the continued rapid pace of technological change, it is impossible to formulate a funding mechanism that reasonably anticipates all future market realities ... Thus, it only makes sense to revisit the funding need and funding mechanism after a limited period of time."

Q. Do you agree with the proposition that the state USF should be used only to support residential service?

A. If the Commission were to address the USF on a comprehensive basis, I would agree. As stated earlier, the Commission should not and need not address USF comprehensively now. The fund we propose here is so limited, and temporary, that we need not consider such issues.

Q. Do you agree with the parties that would exclude interconnected VoIP and wireless providers from contributing to the USF (Verizon p. 54, T-Mobile p. 18)?

A. No. Support for universal service should be broadly based and competitively neutral. Consequently, both interconnected VoIP providers and CMRS providers should be included as contributing providers. To be clear, from a competitively neutral perspective, both fixed and nomadic, interconnected VoIP providers should be included as contributing providers.

Q. Can you summarize your recommendation?

A. Yes. Keep it simple. A three-year plan with a review starting in two-years provides the reasonable balance between the proposals on either extreme. This will provide the needed bridge

to the future, without overly complicating the instant process, nor prejudicing the next stage in the two-year review.

Q. Does this conclude you testimony?

A. Yes

MS. BURGESS: The witness is available for cross-examination.

ALJ JACK: NYSTA Smaller ILECs.

MR. OVERCASH: I have cross-examination, Your Honor. Thank you.

CROSS-EXAMINATION

BY MR. OVERCASH:

Q Mr. Nurse, good afternoon. My name is James Overcash. I had a question in your rebuttal testimony, and I believe I'm using the repaginated version on page 3. The line about halfway down the page -- it's started on line 53 on the version I'm looking at -- states, the NYSTA companies' proposal to address issues that reportedly relate to low income users is plainly outside of the scope of the case.

A Yes.

Q Do you see that?

A Yes.

Q Can you tell me what part of the NYSTA direct testimony you're referring to with that testimony?

A Yes. Where the NYSTA parties propose to lower the benchmark to the 15/22 based on my gross specific income figures. That effectively is a low income fund as opposed to a high cost fund.

Q Just to follow up. The low income nature of your

comment goes to the mechanism or the calculation that NYSTA put forward to calculate the benchmark rate that they propose.

A The lowering of the benchmark rate, yes. The lowering of the benchmark rate is not driven by high cost. The lowering of the benchmark rate in your proposal is driven by low income considerations in some of the service areas.

Q Thank you. I have no other questions.

ALJ JACK: CPB has indicated that it has no cross-examination of this panel and no other party had indicated any cross. Is there any other cross-examination for this witness? Hearing none, is there any redirect?

MS. BURGESS: No, your Honor.

ALJ JACK: Thank you, Mr. Nurse. You are excused. And we have one other witness; that would be from Sprint.

P E T E R N. S Y W E N K I,

having been first duly sworn by the ALJ, was examined and testified as follows:

ALJ JACK: Thank you. Please be seated.

DIRECT-EXAMINATION

BY MR. SCHIFMAN:

Q Good afternoon, Mr. Sywenki. Could you please state your full name and business address for the record?
A Yes. My name is Peter N. Sywenki, S-Y-W-E-N-K-I. My business address is 6450 Sprint Parkway, Overland Park, Kansas 66251.
Q Who do you work for, Mr. Sywenki?
A I work for Sprint Nextel Corporation.
Q What's your title?
A My title is director, regulatory policy.
Q Thank you. Mr. Sywenki, did you cause to be filed a direct and rebuttal testimony in this case, the rebuttal testimony being a non-confidential version and a confidential version?
A Yes.
Q And did you prepare that testimony?
A Yes, I did.
Q Okay, and do you have any changes to that testimony?
A I have none.
Q Okay, and Mr. Sywenki, if I asked you the questions that are contained in that testimony, would your answers be the same or substantially the same?
A Yes, they would.
Q Okay. Mr. Sywenki --
MR. SCHIFMAN: Well, I would just move

into the record the direct testimony and the confidential and non-confidential versions of Mr. Sywenki's rebuttal testimony as if given orally here today.

ALJ JACK: Without objection, the direct testimony and the rebuttal testimony of Peter N. Sywenki will be copied into the record as if given orally here today.

(Testimony inserted as ordered.)

BEFORE THE NEW YORK PUBLIC SERVICE COMMISSION

Proceeding to Examine Issues Related to a Universal Service Fund	**)** **)**	**CASE 09-M-0527**

SPRINT NEXTEL

DIRECT TESTIMONY

OF

PETER N. SYWENKI

FILED DECEMBER 31, 2010

Introduction

Q. Please state your name and business address.

A. My name is Peter N. Sywenki. My business address is 6450 Sprint Parkway, Overland Park, Kansas 66251.

Q. On whose behalf are you testifying?

A. I am testifying in this proceeding on behalf of Sprint Nextel.

Q. By whom are you employed?

A. Sprint United Management Company ("Sprint United"), which is the management subsidiary of Sprint's parent entity, Sprint Nextel Corporation ("Sprint Nextel", i.e., as itself and its affiliated operating companies).

Q. What is your position with Sprint United?

A. I became Director – Regulatory Policy in October of 2002.

Q. What are your principal responsibilities?

A. I am responsible for developing, supporting and advocating state and federal regulatory and legislative policy for Sprint Nextel.

Q. Please describe your educational and business experience.

A. I received a Bachelor of Science degree in Business Administration with majors in Finance and Marketing from Elizabethtown College in 1987. I have worked in the telecommunications industry for 23 years. I started my career at United Telephone Company in Carlisle, Pennsylvania and have held various positions at Sprint Nextel with a wide array of responsibilities, including carrier settlements, cost separations and allocation, regulatory reporting, access rate development, interconnection agreement negotiation and arbitration, and public policy development and advocacy on behalf of Sprint Nextel's wireless and wireline (CLEC, IXC and former ILEC) interests.

Q. Before what state and or federal regulatory commissions have you testified?

A. I have provided testimony in Florida, Indiana, Maryland, Missouri, Nebraska, Nevada, New York, Pennsylvania, Texas, Virginia, and Wyoming. I have also made public policy presentations before the Federal Communication Commission ("FCC"), the National Association of Regulatory Utility Commissioners ("NARUC"), and several state commissions.

Q. What is the purpose of your testimony?

A. My testimony will address the "Phase II Issues" identified in "Appendix A" for this proceeding regarding whether to establish a New York state universal service high cost fund or other form of support program. Specifically, my testimony will demonstrate that: 1) there is no need to establish a state universal service fund or other form of carrier-support mechanism in New York; 2) creating a state universal

service fund or other form of carrier support mechanism will harm consumers and competition; and 3) the Commission can and should pursue other alternative measures to promote competition and efficiency rather than establishing a carrier fund or support mechanism.

Q. Please summarize Sprint's position.

A. Evidence demonstrates phone service is available throughout New York and there is no universal problem that needs to be addressed by establishing a New York state universal service fund. The goal of universal voice service has been met and indeed has been surpassed. Advances in technology and competition have brought New York consumers and businesses something better than a universal voice monopoly, namely universal choice -- multiple providers competing through different technology platforms allowing people to communicate using a variety of visual and audible formats. The New York commission can and should adopt policies that promote and accelerate universal choice. The Commission recognized the extent of competition in 2005 and determined that no state universal service fund was necessary.[1] The same is even more true today as competition has continued to develop at a rapid pace. In this phase of the proceeding, promoting and accelerating the consumer benefits brought about by advanced technology and competition means the Commission must reject creation of a new state company-support fund. Such a fund would be counterproductive to the goal of universal choice and

[1] Statement of Policy on Further Steps Towards Competition in the Intermodal Telecommunications Market and Order Allowing Rate Filings, *Proceeding on Motion Of the Commission to Examine Issues Related to the Transition to Intermodal Competition in the Provision of Telecommunications Services*, CASE 05-C-0616, (April 11, 2006) ("Comp III Order"), p. 70.

contrary to the public interest. If, however, the Commission decides to establish a support program, it should strictly limit its size, its duration, and assessments.

Phase II Issue 1.

Is there a need to establish a State Universal Service High Cost Fund, or other form of support program to ensure universal availability of affordable basic residential telephone service in New York, to succeed the Temporary Transition Fund Extension approved by the Commission's July 16, 2010, order in Phase I of this proceeding? This issue includes consideration of:

a. Whether the need, or lack of need, for such a fund or program can, as a practical matter, be determined (i) on a generic basis; or (ii) only on a case-by-case basis, considering a particular carrier's service area or a discrete portion of its service area and the particular circumstances of the carrier, service area, or portion of service area.

b. (i) The purpose the fund or program, if any, would serve ; (ii) what alternatives might be available to fulfill those purposes and meet the claimed need; and (iii) the relative merits and drawbacks of such a fund or program compared with those of the available alternatives.

Q. What principle should guide the Commission's deliberations regarding whether to establish a New York fund?

A. Naturally, incumbents seek measures to solidify their incumbency while challengers promote measures to enable competition. The overarching principle

which should guide the commission in this proceeding, as in other proceedings, is the welfare of all New York's citizens, not the welfare of a particular company or companies. In order to follow this principle, the Commission must reject the antiquated, monopoly-era "universal service fund". The old universal service fund approach of designating a single telephone company for exclusive funding throughout a monopoly service territory is woefully outdated and counterproductive. To date, the Commission has authorized funding for three NYSTA small ILECs that will be expiring. The commission should not extend or expand this outdated concept by establishing a replacement fund in New York. The citizens of New York are already burdened with company-welfare programs in the form of federal high-cost funding[2] and through inflated traffic taxes imposed by LECs on New York in-state calls.[3] Adding the burden of a new state company-welfare fund on the citizens of New York on top is simply piling on. The Commission should focus squarely on New York consumers by promoting competition among companies and encouraging efficiency.

Q. What information is readily available regarding the availability of telecommunications service in the state of New York?

A. According to the FCC's most recent "Trends in Telephone Service" report, as of 2008 the "Percentage of Occupied Housing Units with Telephone Service" was

[2] Annual payments from New York to federal universal service programs exceed $440M (See Table 1.12 Universal Service Support Mechanisms by State, FCC USF Report).

[3] New York LECs impose switched access rates for New-York in-state calls which are far greater than the access rates imposed for interstate calls and far greater than the intrastate switched access rates imposed by LECs in other states in the region.

97.9% -- the highest level of all years reported.[4] And according to the Commission staff report on cable and wireless phone coverage, "…most of New York's 19 million residents have alternative phone options…"[5], and "…very few areas of the state have no competitive phone alternatives."[6] In fact, using a variety of analysis methods, the staff found that the percentage of customer locations (or residence lines, or housing units depending on the method) without options ranged from 0.08% to 1.9%. To be clear, the staff report conclusions and analyses measured the extent to which New York residences have ***alternatives*** to phone services offered by New York's incumbent telephone companies. In other words, not only do New York residents have universal availability of service, ***nearly all*** New York citizens (as high as 99.2%) have universal ***choice***. Non-incumbent telephone companies have obviously invested significantly, and continue to invest in New York to bring its citizens the benefits of competition – innovation, efficiency, and improved value.

Q. How should this evidence inform the commission in making a general determination about the lack of need for a fund?

A. This information should provide the Commission confidence in the ubiquity of service availability in New York and skepticism toward calls for creation of new universal service or other carrier-welfare funds. In fact, the Commission can and should narrow its examination of this matter to those limited instances in which

[4] FCC Trends in Telephone Service, Industry Analysis and Technology Division, September 2010, Table 16.4 Telephone Penetration by State.
[5] Preliminary Staff Report on Cable and Wireless Phone Coverage, Case 09-M-0527, December 22, 2009, Page 2.
[6] Id, page 3.

there is only a single provider. And in those areas, the Commission should promote competition and efficiency for the benefit of the citizens that reside in these areas.

Q. In those limited instances where phone service is currently available from a monopoly provider, is it necessary to create a company-welfare fund for that provider?

A. No. There is no apparent universal phone service problem in New York and to the extent a real problem arises, a pre-arranged company-welfare fund is likely not the only solution and is certainly not the best solution.

Q. You've stated that an exclusive company-welfare fund harms consumers and competition. Would you please elaborate?

A. Yes. There are essentially 3 ways a company may use the proceeds of such a fund. First, it may simply take the proceeds directly to its bottom line and thereby boost its profits. Second, it may use the proceeds to fund operations in areas and for services in which it faces competition thereby permitting it to offer its services at artificially low prices to gain a competitive advantage over non-recipient providers. Third, it may use the proceeds to fund operations in areas or services for which it is the only provider. It should be obvious that the first two uses, pure profit and favoring a single competitor, are plainly contrary to the public interest. The first is merely undue enrichment at the expense of other companies and ultimately all consumers. The second clearly distorts competition at the expense

of other companies and consumers. While the third use may on the surface be considered to contain some public merit, it too presents public harm because the first two potential uses exist and because there is a very strong inclination for a recipient of funds toward those first two uses. Moreover, even if the natural inclination toward the first two uses could be overcome and funds were dedicated solely to the operations of the single entity in the areas and services for which it is the only provider, such funding would allow the recipient to offer services in those monopoly areas and for those monopoly services at an artificially low price thereby deterring competitive entry. In summary, it is obvious that any of the uses on their own or in any combination is good for the company that is designated the exclusive recipient, however, all three uses conflict with the public interest.

Q. What is your understanding of the concerns of the providers urging the commission to create a new universal service fund exclusively for their use?

A. As I understand it, the service providers urging creation of such a fund are concerned that without it they may not be capable of continuing to provide service throughout their current service territories under existing Commission rules. This concern seems to stem mainly from a regulatory constraint on the price of basic local telephone service and the contention of the fund proponents that the current price is below the local telephone company's cost of providing basic local telephone service.

Q. Is there an alternative, other than creating an exclusive company welfare fund, which can better address this concern?

A. Yes. The direct approach to addressing this concern is to lift the price restriction on basic local service pricing, thereby permitting providers to recover their cost of providing basic local telephone phone service directly from those customers that obtain basic local telephone service from the provider.

Q. If the price of basic local service is permitted to increase, will this render basic local service unaffordable?

A. Not necessarily. First, as indicated earlier, this concern is limited to those instances where consumers have no alternatives to incumbent phone service, i.e., the "…very few areas of the state (which) have no competitive phone alternatives."[7] In all other areas, prices are constrained by competition. Second, "affordability" is relative to a consumer's level of wealth or income and dependent upon a consumer's other expenditures. What is affordable phone service to Bill Gates may not be affordable to a person on food-stamps. What is affordable phone service for a person with low housing expenditures may not be affordable to a person with high housing costs. In any event, consumer needs-based programs such as Lifeline and Link-up which provide discounted services to those consumers which have a demonstrated need for discounted service provide a far superior means to ensuring affordable service because they are designed to support consumers in a direct, targeted, and individual-consumer-

[7] Id, page 3.

centered fashion. In the Comp III Order, the Commission stated, "Moreover, our required Lifeline service for low-income consumers should maintain affordability and further our goal of universal service."[8] Lifeline service continues to be available in New York and has been expanded by the influx of wireless eligible telecommunications carriers who provide a substantial monthly number of wireless minutes for free to qualifying consumers.[9] This stands in stark contrast to exclusive company-welfare mechanisms in which a single provider is selected by the government to receive support with a hopeful expectation that the proceeds of the fund are used benevolently. The Commission can rely on competition to ensure affordable service in areas where consumers have alternatives and should rely on individual-needs-based programs to ensure availability of affordable service for the rest.

Phase II Issue 2.

If a State Universal Service High Cost Fund, or other support program, is established:

a. Who is eligible for the fund or program (e.g., pool companies only, non-pool LECs, CLECs, wireless companies, individual telephone users, etc.)?

b. What are the eligibility requirements for competitive companies (e.g., federal eligible telecommunications carrier guidelines or other criteria) or other recipients of support?

[8] Comp III Order, p. 63.

[9] See e.g. , Offer of Assurance Wireless in New York where qualifying customers receive 250 free monthly minutes and a free wireless phone. http://assurancewireless.com/Public/Welcome.aspx

c. Who would contribute to the fund or other support program (e.g., wireline companies, wireless companies, Voice over Internet Protocol provider companies, cable companies)?

d. How would contribution levels be calculated (e.g., Targeted Accessibility Fund formula or some modified or alternative approach)?

e. Who should administer the fund or other support program (e.g., some successor in interest of the New York Intrastate Access Settlement Pool, Inc., the Targeted Accessibility Fund of New York, Inc., some other entity)?

f. Should the fund or other support program be reevaluated periodically or sunset after a number of years?

g. Should the overall size of the fund or support program cost be limited? If so, at what level should that limit be set; or what methodology should be used to determine that limit?

h. What standards should apply to determine the amounts of payments from the fund or extent of other form of support from the program to an eligible recipient?

3. Should a benchmark rate (or other benchmark be established? If so, at what level (e.g., for a benchmark rate, the comparable Verizon rate, some percentage above or below the Verizon rate, some other method)?

Q. If the Commission determines to pursue establishment of a state universal service fund or other support program, how can it eliminate, or at least minimize the harms, discussed in the previous section of your testimony?

A. As already discussed, the evidence indicates there is no universal service problem in New York. The additional burden to consumers and the competitive distortions introduced by such funds militate against creating such a fund. If, however, the Commission feels compelled to establish a fund, the Commission can and should take measures to eliminate, or at least minimize, the harms to New York consumers and to competition by 1) limiting the size and scope of support, if any; 2) limiting the duration of support, if any; and 3) limiting assessments.

Q. How should the Commission limit the size and scope of any support program?

A. The Commission should first eliminate the burden on New York citizens caused by inflated switched access rates before adding any new burden. However, Sprint understands that the matter of access overcharges is to be addressed in other proceedings or in later phases of this proceeding. Here, then, I will focus on ways the Commission can and should minimize the size and scope of any new support mechanism. First, any support must be strictly limited to those "very few areas of the state" that "have no competitive phone alternatives". Those areas of the state that have options for voice telephony service simply need no support. This means that ILECs that have competition throughout their service area should not receive any support. And for those ILECs where competition for its customers does not exist in only a portion of its territory, any support must be restricted to that portion of its territory. The Staff White Paper refers to those areas as the "white spots". Second, any support must be strictly limited to those customers which

subscribe to standalone basic local telephone service. Prices for other services obtained by consumers from telephone companies and/or their affiliates (bundles, long distance, internet, television) are not constrained by regulation and therefore need no support. For example, discovery responses show that the NYSTA small ILECs have DSL available to large percentages of their customers. Universal service support should not be made available where DSL television, or other bundled services are available to cover the cost of providing service. Third, any support should only be provided upon a showing that the basic local service customer is paying a reasonable price for basic local phone service along with a showing that the price does not cover the economic cost of providing basic service. Before demanding support from others, a non-lifeline qualifying consumer that is not required to pay the entire cost of the basic local phone service the consumer obtains should be expected to at least pay a reasonable amount. In practical terms, a "reasonable amount" should mean ***at least*** the $23 benchmark previously established by the Commission in 2006 in the Comp III Order.[10] In fact, to reduce the burden on others, it would not be unreasonable to establish a higher benchmark.[11] And if a particular company does not charge its customers the adjusted benchmark rate, then any payments from a fund should be based as if the company does charge its customers the adjusted benchmark rate.

[10] Comp III Order, pp. 60-61. The Commission should at least increase this benchmark in order to account for inflation.

[11] More than three years ago, the California PUC declared that a rate of $36 is an appropriate benchmark rate in its evaluation of universal service. See, **INTERIM OPINION ADOPTING REFORMS TO THE HIGH COST FUND-B MECHANISM,** *Order Instituting Rulemaking into the Review of the California High Cost Fund B Program*, California Public Utilities Commission, Decision 07-09-020; Rulemaking 06-06-028 (September 6, 2007), **2007 Cal. PUC LEXIS 429, at *6-7.**.

Q. How should the Commission limit the duration of any support program?

A. If the Commission starts a new support program, it should establish a firm end-date, e.g., no more than 3 years. Knowing the end date allows all parties to adapt accordingly. To the extent a party is unable to adapt in that time frame and believes that phone service will not be available without support, it could petition for extension of support, but any such petition should be required to identify all measures the petitioning party has undertaken to adapt, the location of each New York citizen which will no longer have phone service available, and the date upon which phone service will cease to be available.

Q. How should the Commission limit assessments to any support program?

A. I am not aware whether the Commission has explicit authority to create a new set of assessments on New York service providers. Obviously, before assessing an entity for a new fund, the Commission should first clearly establish its authority to do so. However, even if it is determined that it has the authority to create new assessments on New York service providers the Commission should limit assessments to those service providers which support establishment of a new fund and which draw from the fund. Providers opposed to establishing a fund, providers deemed ineligible to draw from the fund, and providers which may be eligible but choose not to draw from the fund should not be assessed. Presumably, those companies urging establishment of a new support program expect to be beneficiaries of the program and therefore should be willing to be assessed to fund the program. If the Commission determines it has the authority

to create new assessments and determines to assess providers that oppose creation of the new fund and which do not draw from the fund, these providers must be permitted to recover the assessments from their customers and must be permitted to direct any customer complaints about assessment recovery fees to the Commission.

Q. Who should administer the fund or other support program (e.g., some successor in interest of the New York Intrastate Access Settlement Pool, Inc., the Targeted Accessibility Fund of New York, Inc., some other entity)?

A. If a fund is implemented, Sprint supports a neutral third party administrator of any state universal service fund that can manage the fund with a minimum amount of administrative costs so as not to add to the burden imposed on any funding carriers and their customers.

Q. Please summarize your direct testimony.

A. There is no universal service problem in New York, and certainly no problem that cannot be addressed in a manner that does not require creation of an exclusive company-welfare fund. The expiration of the Transition Fund for which three ILECs have received funds does not trigger the need for all small ILECs in the state to begin receiving money from customers of competitive and other carriers around the state. Such funds burden all New York consumers and distort competition to the detriment of New York consumers. If, however, the

Commission decides to establish a support program, it should strictly limit its size, its duration, and assessments as recommended above.

Q. Does this conclude your Direct Testimony?

A. Yes.

BEFORE THE NEW YORK PUBLIC SERVICE COMMISSION

Proceeding to Examine Issues Related to a Universal Service Fund	**)** **)**	**CASE 09-M-0527**

SPRINT NEXTEL

REBUTTAL TESTIMONY

OF

PETER N. SYWENKI

FILED JANUARY 28, 2010

REDACTED VERSION

Introduction

Q. Please state your name and business address.

A. My name is Peter N. Sywenki. My business address is 6450 Sprint Parkway, Overland Park, Kansas 66251.

Q. Are you the same Peter N. Sywenki who provided direct testimony in this proceeding?

A. Yes, I am.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of this testimony is to respond to the direct testimony of NYSTA Smaller ILEC witnesses Steven E. Watkins and Kevin F. Schwenzfeier regarding aspects of the SUSF approach they recommend. Specifically, I respond to the suggestions that the Commission 1) should limit its consideration in determining need for a new state fund to a narrow list of revenue sources, and 2) should require support to all lines based on a basic local service benchmark. There are many issues in the NYSTA testimony and the testimony of others that I do not address here, which should not be interpreted as Sprint agreement with that testimony. My direct testimony already demonstrated that a state universal service fund is unnecessary and that the Commission should focus any universal service efforts in New York on New York customers rather than creating a carrier welfare fund.

Q. On page 37 lines 3-5 of their direct testimony, Mr. Watkins and Mr. Schwenzfeier state "the NYSTA Smaller ILECs have only a limited number of intrastate revenue sources for the recovery of intrastate costs: local rates, access charges, other regulated intrastate services, and a SUSF." In determining whether a fund is needed, should the Commission limit its consideration to these sources of revenue?

A. No. Today's networks are capable of generating revenue from a number of services that were not available in the past. In determining whether a fund is needed, the Commission should not limit its consideration to a narrow list of traditional state regulated revenues and ignore the significant revenue opportunities available from the provision of retail and wholesale services including high-speed internet access, video-entertainment, bundled service packages, and special access. These services provide significant revenue opportunities. When asked in discovery regarding the percentages of homes and businesses passed in NYSTA ILEC service territory by multi-channel video service provided by the NYSTA ILECs or one of its affiliates, the NYSTA ILECs stated that "none of the NYSTA Smaller ILECs provide the services identified in this request as part of the their intrastate regulated ILEC operations."[1] I interpret that response to mean that at least some of the NYSTA Smaller ILECs or their affiliates provide multi-channel video services using network elements that provide traditional voice service and from which they obtain significant revenue

[1]NYSTA Small ILEC Response to Sprint Information Request #5.

streams, but they do not count the revenues from such services as part of their regulated intrastate revenues. Of course, their demands for a fund are calculated using a narrow list of regulated intrastate revenues and neglect the apparent revenue available from the provision of multi-channel video services.

Q. What about the opportunity for the NYSTA Small ILECs to obtain revenues from DSL or other high speed broadband services from the network that also provides voice services?

A. Sprint asked in discovery the percentages of homes and businesses passed in each NYSTA ILEC service territory by DSL or other high speed broadband services. The NYSTA Smaller ILECs response to this request indicates impressive deployment of DSL capability which has notably been accomplished without the creation of a state universal service fund. Also, the responses confirm my suspicion that the NYSTA Smaller ILECs have the ability to obtain significant revenues from the delivery of high speed broadband services. Of the 32 NYSTA Smaller ILECs, **Begin Confidential Information** *** [redacted] ***End Confidential Information** make DSL or other high speed broadband services available to **Begin Confidential Information** *** [redacted] ***End Confidential Information** % of the homes and businesses passed. Of the remaining **Begin Confidential Information** *** [redacted] ***End Confidential Information,** NYSTA Smaller ILECs, **Begin Confidential Information** *** [redacted] ***End Confidential Information** make DSL or other high speed broadband services available to between **Begin Confidential Information** *** [redacted] ***End Confidential**

Information % of the homes and businesses passed. Of the remaining **Begin Confidential Information** *** [redacted] ***E**nd Confidential Information,* NYSTA Smaller ILECs, **Begin Confidential Information** *** [redacted] ***End Confidential Information** make DSL or other high speed broadband services available to between **Begin Confidential Information** *** [redacted] ***End Confidential Information** % of the homes and businesses passed.[2]

Q. Have others recognized that additional sources of revenue are relevant to universal service fund considerations?

A. Yes. More than two years ago the FCC recognized in its universal service/intercarrier-compensation proceeding, "far from the regulated monopolies of years past, significant marketplace developments have resulted in additional revenue opportunities for carriers."[3] In that proceeding, the National Association of State Utility Consumer Advocates stated that "[i]ntercarrier compensation, SLCs, and USF are but three of the numerous spigots from which dollars flow to fill up the telephone companies' revenue buckets"[4] and "By way of illustration, using their common loop platform, carriers are now generating billions of dollars in digital subscriber line ("DSL") revenues that they did not generate five or ten

[2] NYSTA Small ILEC Response to Sprint Information Request # 4 and exhibits provided in response to Sprint Information Request #2.

[3] In the Matter of High-Cost Universal Service Support (WC Docket No. 05-377),Federal-State Joint Board on Universal Service (CC Docket No. 96-45), Lifeline and Link Up (WC Docket No. 03-109), Universal Service Contribution Methodology (WC Docket No. 06-122), Numbering Resource Optimization (CC Docket No. 99-200), Implementation of the Local Competition Provisions in the Telecommunications Act of 1996 (CC Docket No. 96-98), Developing a Unified Intercarrier Compensation Regime (CC Docket No. 01-92), Intercarrier Compensation for ISP-Bound Traffic (CC Docket No. 99-68), IP-Enabled Services (WC Docket No. 04-36), Order on Remand and Report and Order and Further Notice of Proposed Rulemaking, Adopted November 5, 2008, at pg A-139.

[4] Id. NASUCA Sept. 30, 2008 Ex Parte Letter at 6.

years ago."[5] Free Press observed that "the unregulated revenue streams of rate-of-return and price cap Local Exchange Carriers serving in high-cost areas" are the "500 pound gorilla in the room", adding that "these revenues" should be "considered in the discussions of 'need' for the purposes of universal service."[6] In a report on state high cost funds, National Regulatory Research Institute (NRRI) stated, "Modern telecommunications networks provide multiple services, only some of which are regulated in the traditional sense. States should consider whether to include revenue from unregulated operations in the *Revenue* term of any cost-based support mechanism.[7]

Q. Can you provide an illustration of the significant revenue potential on modern networks?

A. Consider just one service offered by NYSTA Smaller ILECs, high-speed internet access. New high-speed internet access subscriptions on just 10% of the lines served by the NYSTA Smaller ILECs would generate more revenue than the alleged revenue requirement "shortfall" calculated by Staff.[8] This rudimentary illustration is not an attempt to predict future broadband adoption rates or

[5] Id. Comments of the National Association of State Utility Consumer Advocates to Refresh the Record, CC Docket Nos. 96-45, 02-6, 01-92, 00-256, 96-262, 99-68, 80-256, WC Docket Nos. 05-337, 07-135, 06-122, 05-195, 03-109, 02-60 at 6 (filed July 7, 2008) (NASUCA July 7, 2008 Supp. Comments).
[6] Id. Free Press Oct. 13, 2008 Ex Parte Letter at 6.
[7] (NYSTA-4); NRRI, State High Cost Funds: Purposes, Design, and Evaluation, January 19, 2010, pg 48.
[8] According to Staff workpapers, NYSTA smaller ILECs serve **Begin Confidential Information** *** [redacted] ***End Confidential Information** residential and single line business access lines. Assuming an average monthly price of $40 for high-speed internet access, subscription by 10% of these lines would generate **Begin Confidential Information** *** [redacted] ***End Confidential Information** in annual revenue **Begin Confidential Information** *** [redacted] ***End Confidential Information** compared to the $5,372,718 "Potential Additional Annual Fund Drawdown" calculated by Staff.

revenue, it merely points out that a new state fund is not the only recourse for the NYSTA Smaller ILECs to generate new revenue.

Q. Do other telephone companies have plans to address "shortfalls" in traditional regulatory revenue mechanisms?

A. Yes. For example, CenturyLink has explained to its investors its strategy to offset reductions in intrastate switched access revenue and universal service funds.

> "During the last several years (exclusive of acquisitions and certain non-recurring favorable adjustments), we have experienced revenue declines in our voice and network access revenues primarily due to declines in access lines, intrastate access rates and minutes of use, and federal support fund payments. To mitigate these declines, we plan to, among other things, (i) promote long-term relationships with our customers through bundling of integrated services, (ii) provide new services, such as video and wireless broadband, and other additional services that may become available in the future due to advances in technology, wireless spectrum sales by the Federal Communications Commission ("FCC") or improvements in our infrastructure, (iii) provide our broadband and premium services to a higher percentage of our customers, (iv) pursue acquisitions of additional communications properties if available at attractive prices, (v) increase usage of our networks and (vi) market our products and services to new customers." (CenturyLink 3rd quarter 2009 – 10Q, page 18, filed with the Securities Exchange Commission on Nov. 9, 2009).

In other words, facing reduced reliance on traditional regulatory revenue streams and outdated subsidy mechanisms, this telephone company plans to intensify its focus on customers and generating revenue by bundling services, providing new services, increasing broadband penetration, and marketing products and services to new customers. The Commission should encourage all New York service providers to increase their attention on broadband adoption and marketing

attractive services to customers rather than trying to force outdated regulatory carrier-to-carrier transfer mechanisms.

Q. The NYSTA Smaller ILECs propose state funding of all lines in a service territory using a stand-alone basic local rate benchmark. Please comment.

A. A stand-alone basic local service benchmark can only make sense if only stand-alone basic service lines are eligible for support, if any. As discussed above, modern networks are capable of providing more than basic local service and the NYSTA Smaller ILECs can and do offer more than basic local service on these lines. If the benchmark is based on stand-alone basic local service, then only those lines capable of providing standalone basic local service should be subject to support, if any. If all lines were to be eligible for support, then the benchmark should be set at a level that takes into consideration all the services those lines are capable of providing such as local calling features, long distance service, DSL service and video service. A benchmark that takes those services into account would be much higher than a standalone basic service benchmark. In other words, if a benchmark is used, it should match the service(s) to be supported. Since basic local service presumably is the focus of support, then only basic local service lines should be eligible for support, if any is needed. If funding is provided for those lines over which customers can and do subscribe to additional services other than basic local service and the benchmark is based on a standalone basic local service rate, funding would then inappropriately subsidize services other than basic local service. To summarize, if the Commission establishes a

fund and support is based on a stand-alone basic local service benchmark, support should be limited to those lines for which support is intended, i.e., lines providing stand-alone basic local service.

Q. Does this conclude your Rebuttal Testimony?

A. Yes.

MR. SCHIFMAN: And I tender Mr. Sywenki for cross-examination.

ALJ JACK: The NYSTA Smaller ILECs.

MR. MOORMAN: Thank you, Your Honor.

CROSS-EXAMINATION

BY MR. MOORMAN:

Q Good afternoon, Mr. Sywenki. My name is Tom Moorman from NYSTA Smaller ILECs.

A Good afternoon.

Q Do you have your direct testimony available?

A Yes, I do.

Q Would you turn to page 2? In lines 5 and 6, you indicate there that you have held a wide variety of responsibilities including carrier settlements, cost separations and allocations, is that correct?

A Yes. Early in my career, when I worked for the United Telephone Companies, which were part of Sprint before they got spun off, I did do that.

Q Are you generally familiar with Part 32 of the FCC's rules?

A I'm generally familiar with the accounts, yes.

Q And their called the "Uniform System of Accounts"?

A Yes.

Q And are you generally familiar will Part 64 of the FCC rules regarding the allocation of costs between

incumbent, local exchange carriers, regulated and non-regulated operations?

A I'm aware of those rules, yes.

Q And are you generally familiar with the FCC's Separations Rules, Part 36?

A I am familiar with those rules.

Q Would you agree with me that Part 36 rules are those rules that are used to allocate an incumbent, local exchange carrier's regulated costs between interstate and intrastate jurisdictions?

A Yes.

Q And would you also agree with me that prior to conducting the Part 36 separations process that the non-regulated costs identified through Part 64 are removed?

A Yes.

Q Thank you. Turning to page 6 of your rebuttal testimony -- are you there?

A Yes.

Q On line 6 to 23 of your rebuttal testimony, you reference the CenturyLink, 3rd Quarter 2009 10Q report. Do you see that?

A Sorry, I was looking at my direct. Page 6 of my rebuttal?

Q Rebuttal.

A I'm there.
Q And, again, on page 6, lines 6 to 23, or roughly 6 to 23 of your rebuttal testimony on that page, you reference the CenturyLink, 3rd Quarter 2009 10Q report, is that correct?
A Yes.
MR. MOORMAN: Your Honor, I would like to have marked for identification purpose, I believe, Exhibit 92, is it?
ALJ JACK: Do you have copies?
MR. MOORMAN: Yes, I do. There is a copy of the CenturyLink 10Q report.
ALJ JACK: I have a document entitled "CenturyLink, Inc., (CTL) 10Q Quarterly Report pursuant to Sections 13 or 15(d), filed on 11/09/2009, file period 09/30/2009, Thomson Reuters, Westlaw Business. It will be marked for identification as Exhibit 92.
(Exhibit 92 was marked for identification.)
BY MR. MOORMAN:
Q Mr. Sywenki, is this the report that your quote came from that you find on page 6 of your rebuttal testimony?
A Yes, it appears to be.
MR. MOORMAN: Your Honor, I'd like to

offer this as -- I'd like to offer this as Exhibit 92 at the appropriate time for completeness of the record.

ALJ JACK: We'll deal with admission of exhibits when we finish with the witnesses, but it has been marked for identification as Exhibit 92.

MR. MOORMAN: Your Honor, I have no further questions.

ALJ JACK: And I understand from Mr. Rigberg that CPB has no cross now for this witness. Is there any other cross-examination of this witness? Is there any redirect?

MR. SCHIFMAN: Yes, Your Honor.

REDIRECT-EXAMINATION

BY MR. SCHIFMAN:

Q Mr. Sywenki, Mr. Moorman asked you some questions regarding the separations process and cost allocation rules contained in the FCC rules. Do you recall those questions?

A I do recall those.

Q Mr. Sywenki, do you have any comments regarding the applicability of those rules and the effectiveness of those rules in today's hotly-competitive-telecom environment?

A Yeah. I think it was mentioned earlier that the Separations Rules are being reviewed for necessary changes to reflect the fact that the Separations factors are frozen in 2000; Separations Rules were written before the internet, before wireless, before DSL services were widely offered. And I think that Separations Joint has been meeting for a long time to discuss what changes need to be made to that process. It's clearly not a modern form of accounting that takes into consideration all of the services that are available today.

Q And are you aware of any academic papers that have been written on that topic recently?

A Yeah. In fact there is --

MR. MOORMAN: Your Honor, I object as being beyond the scope of cross. He already asked whether or not -- I specifically asked him about specific parts of the FCC rules, and he answered a question that I didn't object to because, okay, he's allowed to ask one follow-up. But now he's asking for additional articles. I forgot exactly what the counsel had said, but it's clearly beyond the scope of cross-examination of this witness.

ALJ JACK: I think it's going too far, Mr. Schifman.

MR. SCHIFMAN: Okay, I'll withdraw

that question. I have nothing further.

ALJ JACK: Thank you. If there is no further -- is there any recross?

MR. MOORMAN: No, your Honor.

ALJ JACK: You're excused, Mr. Sywenki. Thank you. That complete completes our witnesses.

I believe the next item of business would be admission of exhibits into evidence. We have 92 exhibits that have been marked for identification. Is there any objection to the admission of any of those exhibits into evidence at this point?

MR. SCHIFMAN: Your Honor, you said Exhibits 87 though 92?

ALJ JACK: No, we have 92 exhibits.

MR. SCHIFMAN: So you're asking in total.

ALJ JACK: Yes, I was asking about all of them, 1 through 92. I'm not hearing any objections to admission of any of those exhibits into evidence. And in the absence of any objection, Exhibits 1 through 92 are entered in evidence.

(Exhibits 1-92 were received into evidence.)

ALJ JACK: Are there any matters of housekeeping that we need to take up before we adjourn this hearing?

MR. FITZGERALD: Your Honor, just to clarify. As to the affidavit of Rochelle Jones, we will submit that for insertion into the record as Exhibit number 88.

ALJ JACK: Yes.

MR. FITZGERALD: We didn't have that with us today, obviously, but we will submit it very quickly.

ALJ JACK: Thank you. If you could submit that in a PDF, the affidavit in a PDF format, that well be helpful.

Anything? Mr. Overcash?

MR. OVERCASH: Your Honor, James Overcash. We had two discovery responses that we wanted to admit into exhibits, but we can delineate them as 93 and 94. Do we normally hand out copies if people want to object to those at this point?

ALJ JACK: Yes, please hand those out. We're off the record.

(Discussion was held off the record.)

ALJ JACK: Okay, let's go back on the record. While we were off the record, we discussed

several additional exhibits, and I have marked for identification Exhibit 93, which is the "NYSTA ILECs First Set of Discovery Requests to," and this is all small letters, tw telecom of new york, lp." No capital letters.

Exhibit 94 for identification will be "New York State Department of Public Service Staff Responses and Objections to the Discovery Requests of the NYSTA Smaller ILEC Companies."

And Exhibit 95 for identification will be "NYSTA Smaller ILECs Supplemental Confidential Exhibits to Requests from the Cable Telecommunications Association of New York, Inc.," dated January 27, 2011. And that would be in confidential and redacted versions.

Now I understand that by stipulation of the parties, all three of these exhibits can be admitted into evidence, is that correct? Any objection? Very good. Exhibits 93 through 95 for identification are admitted in evidence.

(Exhibits 93 - 95 were marked for identification and received into evidence.)

ALJ JACK: The other thing we discussed while we were off the record was a stipulation among the parties that if they have

additional adverse discovery responses from other parties that they wish to use in their briefing that they may attach those responses to their briefs. And those will be considered as admitted in evidence. Does that comport with everyone's understanding? Very good, thank you.

Is there anything more that we need to take up as a housekeeping? Mr. Arfaa.

MR. ARFAA: Thank you, Judge. I just wanted to state for the record that T-Mobile will be submitting Mr. Conn's affidavit as Exhibit 88 (sic). The other one is direct and rebuttal testimony. It's our understanding that upon receipt those testimonies will be deemed in evidence for the record.

ALJ JACK: Yes. They've already been, in essence, on a reserve basis.

(Exhibits 87, 88 were marked for identification and received into evidence.)

MR. ARFAA: It will be Exhibit 87.

ALJ JACK: Is there anything else? Then I will remind you, your initial trial briefs will be due in one month, or four weeks from tomorrow. That's March the 15th. Reply briefs are due on March the 25th. I thank you all. This was

very expeditiously handled; I appreciate that. And we are adjourned.

(Whereupon, the matter, in the above-entitled proceedings, concluded at 3:45 p.m.)

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C E R T I F I C A T E

I, Kyle Alexy, a Shorthand Reporter and Notary Public in and for the State of New York, do hereby certify that the foregoing record taken by me is a true and accurate transcript of the same, to the best of my ability and belief.

_____

Kyle Alexy

DATE: February 24, 2011