

COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION

PUBLIC VERSION**PETITION OF****SPRINT NEXTEL**

**For reductions in the intrastate carrier
access rates of Central Telephone Company
of Virginia and United Telephone-Southeast, Inc.**

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CASE NO. PUC-2007-00108
DOCUMENT CONTROL

REPORT OF ALEXANDER F. SKIRPAN, JR., SENIOR HEARING EXAMINER

January 28, 2009

This proceeding concerns an investigation of Embarq's intrastate carrier switched access rates. I find that Embarq's CCLC should be eliminated over a three-year phase-in period and that Embarq's intrastate access rates should be adjusted to current interstate access rate levels in the fourth year.

HISTORY OF THE CASE

On November 7, 2007, Sprint Communications Company of Virginia, Inc., Sprint Spectrum L.P., Sprintcom, Inc., Nextel Communications of the Mid-Atlantic, Inc., and NPCR, Inc. d/b/a Nextel Partners (collectively, "Sprint Nextel"), filed a Petition with the State Corporation Commission ("Commission") seeking a reduction in the intrastate carrier switched access rates charged by Central Telephone Company of Virginia and United Telephone-Southeast, Inc. (collectively, "Embarq"). On February 15, 2008, the Commission issued an Order Establishing Investigation which, among other things, assigned this matter to a Hearing Examiner for further proceedings.

A Hearing Examiner's Ruling dated April 3, 2008, scheduled a procedural conference for April 10, 2008, to establish a course for this proceeding. Upon motion from Embarq and agreement among the parties, the procedural conference was rescheduled for April 15, 2008, by a Hearing Examiner's Ruling dated April 8, 2008.

On April 15, 2008, the procedural conference was held as scheduled, with representatives from Sprint Nextel, Embarq, AT&T Communications of Virginia, LLC ("AT&T"), the Office of Attorney General's Division of Consumer Counsel ("Consumer Counsel"), and Staff in attendance. Based on the conference, a Hearing Examiner's Ruling dated April 17, 2008, (i) directed Embarq to provide responses to questions contained in the ruling, and (ii) established a procedural schedule. In addition, a Hearing Examiner's Protective Ruling dated April 17, 2008, was entered to facilitate discovery.

On April 21, 2008, Embarq filed a Motion for Modification of Hearing Examiner's Ruling. Embarq requested that directives requiring Embarq to produce its current intrastate switched access costs be modified to permit such studies to be filed coincident with the prefiling

of direct testimony on August 1, 2008. Embarq's motion was granted during oral argument held on April 25, 2008.

A procedural schedule was adopted for this matter by a Hearing Examiner's Ruling dated April 17, 2008 ("*Procedural Ruling*"). The *Procedural Ruling* included a directive for objections to discovery to be filed within five business days following service of discovery and any motions to compel to be filed within ten business days following the service of an objection.

On June 23, 2008, Sprint Nextel filed a motion to compel responses to its first set of interrogatories to Embarq. Sprint Nextel's motion to compel was denied by a Hearing Examiner's Ruling dated July 29, 2008.

On July 14, 2008, AT&T filed a motion to compel regarding its second set of interrogatories to Embarq. AT&T's motion to compel was granted by a Hearing Examiner's Ruling dated July 29, 2008.

On July 14, 2008, Embarq filed a motion to compel responses to its first set of interrogatories to Sprint Nextel. Embarq's motion to compel was denied by a Hearing Examiner's Ruling dated July 29, 2008.

On July 28, 2008, Sprint Nextel filed a motion to compel responses to its second set of interrogatories to Embarq. Sprint Nextel's motion to compel was granted in part and denied in part by a Hearing Examiner's Ruling dated August 12, 2008.

On August 18, 2008, Embarq objected to the ruling regarding its motion to compel responses to its first set of interrogatories to Sprint Nextel. Embarq sought discovery of various assertions made by Sprint Nextel in its original petition in this proceeding.

On August 27, 2008, AT&T filed a motion to compel responses to its fourth set of interrogatories to Embarq. AT&T's motion to compel was granted by a Hearing Examiner's Ruling dated September 24, 2008.

Following a request from Embarq, a Hearing Examiner's Ruling dated August 28, 2008, scheduled a prehearing conference for September 11, 2008, to discuss procedures to be followed subsequent to the filing of rebuttal testimony. Based on the discussions during the prehearing conference, a Hearing Examiner's Ruling dated September 11, 2008, rescheduled the start time of the hearing scheduled to begin at 10:00 a.m. on Monday, September 29, 2008, to 9:00 a.m., Monday, September 29, 2008. In addition, the parties agreed to provide copies of workpapers supporting prefiled rebuttal testimony, and meet on September 22 or 23 to address discovery related to prefiled rebuttal testimony. This ruling also clarified that written comments concerning this proceeding could be filed with the Commission's Document Control Center.¹

¹ Ten comments were received favorable to Embarq's position from the Halifax County Chamber of Commerce; the South Hill Chamber of Commerce; the Washington County Chamber of Commerce; the Charlottesville Regional Chamber of Commerce; Trenton G. Crewe, Jr., Mayor of the Town of Wytheville; Stephen A. Moore, Assistant Town Manager of Wytheville; Glenn Murphy; Shannon Lambert; Joyce Robbins; and Mary Loose DeViney.

On September 10, 2008, Embarq filed a motion to compel responses to its fourth set of interrogatories to Sprint Nextel. Embarq's motion to compel was granted in part and denied in part by a Hearing Examiner's Ruling dated September 22, 2008.

On September 17, 2008, Sprint Nextel filed a motion to compel responses to its third set of interrogatories to Embarq. Sprint Nextel's motion was denied in a Hearing Examiner's Ruling dated September 25, 2008.

On September 29 and 30, 2008, public hearings were held as scheduled. Eric M. Page, Esquire; and Sue E. Benedek, Esquire, appeared on behalf of Embarq. Douglas C. Nelson, Esquire; David E. Anderson, Esquire; and William R. Atkinson, Esquire, appeared on behalf of Sprint Nextel. Mark A. Keffer, Esquire; and Demetrios Metropoulos, Esquire, appeared on behalf of AT&T. Ashley C. Beuttel-Macko, Esquire, appeared on behalf of Consumer Counsel. Robert M. Gillespie, Esquire, represented the Staff. A transcript of the hearings in this matter is filed with this report.

At the hearing in this matter on September 30, 2008, Exhibit No. 51 was reserved for a copy of the web page containing retail prices for Comcast Digital Voice Service. On October 1, 2008, counsel for Embarq filed the pricing list and requested that it be accepted into the record of this proceeding. A Hearing Examiner's Ruling dated October 1, 2008, provided Staff and the parties an opportunity to respond. No responses were filed. Thus, Exhibit No. 51 was admitted to the record in a Hearing Examiner's Ruling dated October 10, 2008.

SUMMARY OF THE RECORD

As provided by the procedural schedule adopted for this case, the parties were permitted to prefile direct testimony on August 1, 2008. The date for the filing of any Staff comments or testimony was September 5, 2008. The parties were given an opportunity to prefile rebuttal testimony on September 19, 2008.

Embarq Direct Testimony

On August 1, 2008, Embarq filed the direct testimony of Richard A. Schollmann, the state executive for Virginia and Tennessee for Embarq Management Company; Henry J. Roth, director – economic costing in the Finance Department of the Embarq Management Company; Christian M. Dippon, vice president of NERA Economic Consulting; and Dr. Brian K. Staihr, director-policy/regulatory economist in the Department of Law and External Affairs for Embarq. A summary of the testimony of each witness is provided below.

Richard A. Schollmann testified that Embarq serves approximately 370,000 access lines in ninety communities in the Commonwealth.² Mr. Schollmann confirmed that Embarq offers its customers a full portfolio of communications services, including local, long distance, wireless,

² Exhibit No. 2, at 3.

high-speed data and video, and has a gross book value of investment in Virginia of approximately \$1.1 billion.³

Mr. Schollmann contended that Embarq's high-cost support has a history spanning seventy years and represents a compact between policymakers and Embarq "to ensure that citizens both in rural and urban areas of Virginia benefit from a reliable and robust telephone network and pay reasonable rates for access to it."⁴ Mr. Schollmann maintained that if Embarq were to recover its current Carrier Common Line Charge ("CCLC") revenue from residential customers the rates would be unaffordable, resulting in rates in excess of the ceiling rates established by the Commission in *Embarq 2008 Modified Alternative Regulation*.⁵ Mr. Schollmann advised that Embarq's development of pricing strategy hinges on the outcome of this proceeding.⁶

Mr. Schollmann testified that a consequence of an access rate reduction "could simply force [Embarq] to invest less in terms of resources in [Embarq]'s Virginia operations."⁷ Mr. Schollmann contended that the only benefits from a reduction in intrastate switched access rates will be "lower costs and higher profits for companies like Sprint and AT&T."⁸ Mr. Schollmann distinguished this case from *Verizon Access*,⁹ where the Commission ordered Verizon to eliminate its CCLC.¹⁰ Mr. Schollmann argued that the concerns expressed by the Commission in *Verizon Access* regarding the inability of interexchange carriers to compete with wireless carriers due to the costs associated with the CCLC are no longer valid as stand-alone long distance is virtually extinct.¹¹

Mr. Schollmann stated that Embarq asks that the Commission maintain its current level of intrastate access charges and consider implementation of a state universal service fund.¹² Mr. Schollmann asserted that Embarq's current levels of intrastate switched access rates are based on costs, and are just and reasonable.¹³

Henry J. Roth presented Embarq's cost study.¹⁴ Mr. Roth contended that because intrastate access rates have been designed to provide support for local exchange service, basic

³ *Id.*

⁴ *Id.* at 4.

⁵ *Id.* at 7-8; *Application of Central Telephone Company of Virginia and United Telephone-Southeast, Inc., For Approval of its New Plan for Alternative Regulation*, Case No. PUC-2008-00008, Final Order (June 20, 2008) ("*Embarq 2008 Modified Alternative Regulation*").

⁶ Exhibit No. 2, at 8.

⁷ *Id.* at 9.

⁸ *Id.*

⁹ *Petition of AT&T Communications of Virginia, LLC, For reductions in the intrastate carrier access rates of Verizon Virginia Inc. and Verizon South Inc.*, Case No. PUC-2003-00091, 2005 S.C.C. Ann. Rep. 201 ("*Verizon Access*").

¹⁰ Exhibit No. 2, at 10.

¹¹ *Id.*

¹² *Id.* at 11.

¹³ *Id.*

¹⁴ Exhibit No. 10, at 3.

local exchange service must be examined to determine whether support is required to cover costs, and if so, the amount needed.¹⁵ Thus, Mr. Roth presented a “full cost study that incorporates the costs of the Local Loop, Transport and Switching operations from which the monthly recurring cost for intrastate regulated retail service was developed.”¹⁶ Mr. Roth testified that the cost study shows that “even with the inclusion of switched intrastate access services in the revenues there is an intrastate regulated retail services revenue shortfall compared to costs.”¹⁷ Furthermore, Mr. Roth reported that Embarq’s intrastate switched access service revenues “do not exceed costs, including support for basic local service, for intrastate switched access service.”¹⁸

Mr. Roth confirmed that Embarq’s cost study for CCLC included an allocation of loop costs and produced results that support an increase in rates.¹⁹

Mr. Roth testified that the costs for regulated intrastate basic local service vary across Virginia; higher costs are found in the more rural, less dense wire centers.²⁰

Christian M. Dippon provided a discussion of the history of access charges, which were introduced with the breakup of the Bell System in the early 1980s to continue the subsidization of basic local rates by toll services.²¹ Since then, Mr. Dippon reported that the FCC has recognized that cutting access charges to cost-based levels could prove disruptive to business operations.²² For Embarq, Mr. Dippon maintained that consideration of access charges involves a balancing of several issues: (i) recovery of common costs; (ii) pricing constraints designed to promote universal service; (iii) provider-of-last-resort obligations; and (iv) competition that is free to focus on the most lucrative customers and areas.²³

Mr. Dippon questioned the justification and arguments made by Sprint Nextel in the petition that initiated this proceeding.²⁴ Mr. Dippon also attacked the comments filed by AT&T in support of the Sprint Nextel petition.²⁵ Mr. Dippon maintained that Embarq’s current intrastate switched access rates provide no competitive advantages to Embarq and provide it with no opportunity to decrease the price of its retail services.²⁶

Mr. Dippon outlined the competition faced by Embarq from CLECs and from intermodal competitors such as wireless, broadband cable, and VoIP.²⁷ Based on changes in the number of

¹⁵ *Id.* at 4.

¹⁶ *Id.*

¹⁷ *Id.* at 5.

¹⁸ *Id.* at 6.

¹⁹ *Id.* at 7-8.

²⁰ *Id.* at 9.

²¹ Exhibit No. 15, at 5-6.

²² *Id.* at 6.

²³ *Id.* at 7.

²⁴ *Id.* at 9-10.

²⁵ *Id.* at 11.

²⁶ *Id.* at 12.

²⁷ *Id.* at 17.

residential and business lines served, Mr. Dippon stated that “Embarq faces strong competition in its nonrural areas and competition has begun to develop in its rural areas.”²⁸ Mr. Dippon testified that the competition Embarq faces in nonrural areas make it unlikely that it can profitably increase retail prices to recover lost intrastate switched access revenue.²⁹ Thus, Mr. Dippon asserted that Embarq would need to recover such lost revenue through a price increase or a decrease in service quality in rural areas.³⁰

Mr. Dippon took the position that it is meaningless to compare Embarq’s Virginia intrastate access rates to its interstate access rates or to its intrastate access rates in other states.³¹ Mr. Dippon pointed out that reductions in interstate access rates have been offset by higher subscriber line charges and by the expansion of explicit subsidy programs.³²

Mr. Dippon stated that reducing Embarq’s intrastate switched access rates will fail to increase competition for several reasons: (i) a reduction in intrastate toll represents only a small portion of either the total voice communication bundle or the voice, data, and video bundle; (ii) Embarq already faces strong competition in many of its nonrural areas; (iii) Embarq no longer has a monopoly for intrastate switched access; and (iv) Embarq faces increasing competition from intermodal competition.³³ Mr. Dippon supported his argument that a reduction in intrastate switched access rates fails to increase competition for long distance by demonstrating that Sprint Nextel has the same rates for areas served by Verizon and areas served by Embarq.³⁴

Mr. Dippon warned that if the Commission chooses to reduce Embarq’s intrastate switched access rates, rural areas could suffer serious economic consequences.³⁵ Specifically, Mr. Dippon advised that a reduction in intrastate switched access rates would cause Embarq to increase rates for basic service for rural customers significantly, reduce service quality, and reduce network investment.³⁶

Mr. Dippon offered the Commission three options:

(1) leave the current [intrastate access] rates as they are, (2) open a full rate rebalancing case that would provide Embarq with more pricing flexibility and that would establish an explicit universal service fund, or (3) remove all regulatory constraints currently imposed on Embarq, including its provider-of-last-resort obligation.³⁷

²⁸ *Id.* at 26.

²⁹ *Id.* at 28.

³⁰ *Id.* at 28-29.

³¹ *Id.* at 29.

³² *Id.* at 29-30.

³³ *Id.* at 31-32.

³⁴ *Id.* at 34-35.

³⁵ *Id.* at 38.

³⁶ *Id.* at 42.

³⁷ *Id.*

Dr. Brian K. Staihr testified that the dramatic changes in the telecommunications market have failed to increase competition or choice for many residents in the more rural, high-cost areas of the Commonwealth.³⁸ Dr. Staihr asserted that if intrastate access charges are lowered, dollars that are used by Embarq to provide service in high-cost rural areas will be given to Sprint Nextel and AT&T.³⁹

Dr. Staihr maintained that the economic facts and marketplace conditions in this proceeding differ significantly from those in *Verizon Access*.⁴⁰ Dr. Staihr contended that the cost study presented by Embarq witness Roth demonstrates that Embarq's switched access rates are appropriate at current levels.⁴¹ Dr. Staihr contrasted the more rural area served by Embarq to the areas served by Verizon and argued that the need for the subsidy provided by switched access revenue is greater for Embarq than Verizon.⁴² Dr. Staihr pointed out that over 87% of the persons served by Verizon are located in wire centers with a density of more than 100 persons per square mile, while less than 50% of the persons served by Embarq are located in wire centers with a density of more than 100 persons per square mile.⁴³ In addition, Dr. Staihr compared Embarq's cost of serving customers on a per-line basis to Verizon's UNE loop rates and concluded that Embarq incurs significantly higher costs than Verizon incurs for serving their rural areas.⁴⁴

Dr. Staihr testified that marketplace conditions have changed dramatically in the years since *Verizon Access*.⁴⁵ Dr. Staihr stated that at the time of *Verizon Access* there were stand-alone interexchange carriers, such as AT&T and MCI/WorldCom, attempting to compete with ILECs for local service.⁴⁶ Dr. Staihr asserted that the interexchange carriers are no longer standalone competitors and that competition today is intermodal and takes place for bundles of service.⁴⁷ Dr. Staihr contended that AT&T and Sprint Nextel have significant wireless interests, which enjoy a competitive advantage of not paying access charges.⁴⁸ Thus, Dr. Staihr maintained that the need to encourage competition as expressed in *Verizon Access* no longer exists in today's marketplace.⁴⁹

Dr. Staihr argued that comparisons of intrastate access rates from other states must take into consideration state universal service funds.⁵⁰ Dr. Staihr supported the institution of a state

³⁸ Exhibit No. 20, at 5.

³⁹ *Id.* at 7.

⁴⁰ *Id.* at 11.

⁴¹ *Id.*

⁴² *Id.* at 13.

⁴³ *Id.* at 14.

⁴⁴ *Id.* at 15-16.

⁴⁵ *Id.* at 17.

⁴⁶ *Id.*

⁴⁷ *Id.* at 18.

⁴⁸ *Id.* at 18-19.

⁴⁹ *Id.* at 19.

⁵⁰ *Id.* at 20.

universal service fund in Virginia.⁵¹ Dr. Staihr also faulted comparisons of intrastate access rates across states for failing to consider that Embarq's cost of providing service varies greatly across states.⁵²

Dr. Staihr raised a basic question of whether the residents of Virginia are better off if dollars associated with intrastate switched access go to Sprint Nextel and AT&T, as opposed to those dollars staying with Embarq.⁵³ Dr. Staihr asserted that because Sprint Nextel's calling plans and services are generally national in scope, the result of any cost savings that Sprint Nextel may enjoy in Virginia, would likely be spread nationwide and be *de minimis* on the residents of Virginia.⁵⁴

Sprint Nextel Direct Testimony

On August 1, 2008, Sprint Nextel filed the direct testimony of James A. Appleby, regulatory policy manager for Sprint Nextel.

James A. Appleby testified that the reduction of the intrastate switched access rates of Embarq is long overdue.⁵⁵ Mr. Appleby contended that all carriers offering voice communications within Virginia, including cable telephony providers, other ILECs, IXC's, and wireless service providers, ultimately pay Embarq's intrastate access charges.⁵⁶ Mr. Appleby stated that if the prices for Embarq's intrastate access services greatly exceed cost, "the customers of Virginia pay high prices and the provider profits unreasonably."⁵⁷ Mr. Appleby maintained that high access rates limit the financial resources of competitors and give Embarq an anti-competitive advantage.⁵⁸ Mr. Appleby asserted that Embarq's high access rates are inconsistent with the development of competition and the subsidies embedded in switched access rates must be eliminated to complete the transition to a competitive telecommunications market.⁵⁹

Mr. Appleby testified that market conditions today are different from the conditions that existed when inflated access rates were created.⁶⁰ Mr. Appleby pointed out that Embarq can provide many new services over the network it uses to provide local exchange service and access services.⁶¹ Mr. Appleby stated that these new services include (i) long distance, (ii) a wider variety of calling features, (iii) broadband DSL, (iv) video, and (v) wireless.⁶² Mr. Appleby calculated that Embarq's average consumer revenue per household has increased from \$49.60 in

⁵¹ *Id.* at 21.

⁵² *Id.*

⁵³ *Id.* at 27-28.

⁵⁴ *Id.* at 28.

⁵⁵ Exhibit No. 24, at 2.

⁵⁶ *Id.* at 4.

⁵⁷ *Id.* at 5.

⁵⁸ *Id.* at 6.

⁵⁹ *Id.* at 7.

⁶⁰ *Id.* at 8.

⁶¹ *Id.* at 8-9.

⁶² *Id.* at 9.

the first quarter of 2005, to \$55.70 in the first quarter of 2008.⁶³ Mr. Appleby urged the Commission to consider both Embarq's Virginia jurisdictional and non-jurisdictional results and eliminate switched access subsidies.⁶⁴

Mr. Appleby asserted that Embarq's intrastate switched access rates are seven to nine times higher than the cost of functionally-equivalent composite rates for reciprocal compensation.⁶⁵ Mr. Appleby calculated that the per-line revenue reduction that would occur if Embarq reduced its intrastate switched access rates to its interstate level, is equal to the subsidy currently embedded in Embarq's intrastate switched access rates.⁶⁶ Mr. Appleby observed that Embarq's intrastate switched access rates are about three to five times higher than similar rates for Verizon Virginia, and are higher than the intrastate switched access rates charged by Embarq affiliates in sixteen of nineteen other states.⁶⁷ Mr. Appleby pointed out that Embarq's Virginia intrastate switched access rates are increasing because the CCLC is designed to recover a fixed revenue amount.⁶⁸

In summary, Mr. Appleby recommended that the Commission reduce Embarq's composite intrastate switched access rate to "the composite economic cost of providing local switching, tandem switching and common transport."⁶⁹ Mr. Appleby further recommended that if the Commission establishes a transition period, "[CCLC] recovery must be reformed in the initial step"⁷⁰

AT&T Direct Testimony

On August 1, 2008, AT&T filed its direct testimony, which was sponsored by E. Christopher Nurse, vice president, regulatory & external affairs, for AT&T's Atlantic Region.⁷¹

E. Christopher Nurse testified that the subsidy embedded in access charges is a "hidden tax" imposed only on interexchange carriers, which has caused interexchange carriers to lose business to wireless carriers, e-mail, instant messaging, VoIP, social web sites, and other forms of communication.⁷² Mr. Nurse stated that from 2005 to 2007, AT&T's statewide Virginia access costs remained virtually the same despite substantial reductions in intrastate access costs

⁶³ *Id.* at 11, Attached JAA-2.

⁶⁴ *Id.* at 14-15.

⁶⁵ *Id.* at 16.

⁶⁶ *Id.* at 17-18.

⁶⁷ *Id.* at 20.

⁶⁸ *Id.* at 20-21.

⁶⁹ *Id.* at 21.

⁷⁰ *Id.* at 22.

⁷¹ As filed, AT&T's direct testimony also listed Dr. Ola A. Oyefusi as co-sponsor. During the hearing, Mr. Nurse presented and sponsored AT&T's direct testimony, with the exception of Dr. Oyefusi's background and qualifications, which were struck.

⁷² Exhibit No. 32, at 5.

by Verizon.⁷³ Mr. Nurse pointed to increases in Embarq's average per-minute access rates as "largely negating the Commission's reform efforts."⁷⁴

Mr. Nurse recommended that the Commission reduce Embarq's intrastate switched access rates toward its interstate switched access rates, principally by eliminating Embarq's CCLC.⁷⁵ Mr. Nurse further recommended that the Commission ensure that Embarq "is given reasonable opportunities to replace lost access revenues through higher retail rates."⁷⁶ However, Mr. Nurse maintained that Embarq's New Plan for Alternative Regulation approved in Case No. PUC-2007-0008 should give Embarq the retail pricing flexibility to offset access reductions.⁷⁷

Mr. Nurse testified that in 2001, the Commission issued its order, *Embarq Access Settlement*,⁷⁸ in which it expected Embarq's intrastate switched access revenues to decline by \$45 million over the 2001-2005 period.⁷⁹ Mr. Nurse pointed out that as a result of an incorrect assumption that access minutes would continue to grow, Embarq's average per-minute CCLC and thus its average per-minute access rates, have been increasing and will continue to increase unless the CCLC is eliminated.⁸⁰ Mr. Nurse stated that Embarq's access rates "remain more than *five times* higher than Embarq's comparable interstate rates and more than *three times* higher than Verizon's intrastate rates."⁸¹

Mr. Nurse asserted that Virginia consumers are harmed by high access charges, which increase the prices consumers pay for wireline long distance service and creates an economic distortion that artificially drives consumers to alternative technologies.⁸² Mr. Nurse stated that it was ironic in that when consumers leave wireline long distance carriers, they often decide to leave wireline telephone service altogether.⁸³

Because AT&T recommended that Embarq's intrastate access rates be reduced to match interstate rates, Mr. Nurse took the position that there is no need to perform a cost study to determine the amount of implicit subsidies to be eliminated.⁸⁴ Mr. Nurse observed that no one has ever asserted that Embarq's interstate rates are below economic cost.⁸⁵

⁷³ *Id.* at 5-6.

⁷⁴ *Id.* at 6.

⁷⁵ *Id.* at 7.

⁷⁶ *Id.*

⁷⁷ *Id.* at 6.

⁷⁸ *Commonwealth of Virginia, ex rel. State Corporation Commission, Ex Parte, In Re: Investigation of the appropriate level of intrastate access service prices*, Case No. PUC-2000-00003, 2001 S.C.C. Ann. Rep. 254 ("*Embarq Access Settlement*").

⁷⁹ Exhibit No. 32, at 10.

⁸⁰ *Id.* at 10-11.

⁸¹ *Id.* at 12. (emphasis in original)

⁸² *Id.* at 15.

⁸³ *Id.*

⁸⁴ *Id.* at 16.

⁸⁵ *Id.*

Consumer Counsel Comments

On August 1, 2008, Consumer Counsel filed comments in lieu of testimony. Consumer Counsel noted that the Commission has recognized that intrastate access charges originally were developed to collect a subsidy from interexchange carriers to support local exchange services and that such an approach is not appropriate in a competitive market.⁸⁶ Consumer Counsel stated that it “has generally supported the approach the Commission has taken to reduce access charges toward a level that reflects the actual cost of access service.”⁸⁷ Nonetheless, Consumer Counsel observed that Embarq has the opportunity in this proceeding to show “that its rates for local exchange telephone services are not sufficient to cover its costs of providing those services.”⁸⁸ Consumer Counsel recommended that any action taken in this case to reduce Embarq’s intrastate access charges, be considered in the context of whether any subsequent local exchange rate increase might be necessary and whether such increases would protect the affordability of basic local exchange telephone service and be in the public interest.⁸⁹

Staff Comments

On September 5, 2008, the Commission’s Division of Communications (“Staff”) filed comments. Staff outlined several Commission decisions that it maintained provided useful insight for this proceeding. Staff first referred to *1987 Access Cost Methodology*⁹⁰ in which the Commission determined that the appropriate methodology for determining intrastate, interLATA access service costs is one based upon long-run incremental cost.⁹¹ Staff contended that Embarq incorrectly applied the methodology adopted in *1987 Access Cost Methodology* when it included all local loop and central office termination costs in its switched access incremental cost studies.⁹² Staff stated that it corrected Embarq’s cost studies to comply with *1987 Access Cost Methodology* and found Embarq’s current intrastate switched access prices to be well above cost.⁹³

In *Embarq Access Settlement*, Staff reported that the companies that currently make up Embarq agreed to a reduction in switched access prices that were estimated to reduce revenue by \$45 million during the period 2001-2005, without any increase in rates for basic local exchange telecommunication services.⁹⁴ Staff acknowledged that the settlement in *Embarq Access Settlement* failed to produce access revenue reductions of \$45 million and that the CCLC recovery mechanism adopted in the settlement was, and still is, a significant problem.⁹⁵

⁸⁶ Exhibit No. 47, at 1-2.

⁸⁷ *Id.* at 2.

⁸⁸ *Id.* at 3.

⁸⁹ *Id.* at 4.

⁹⁰ *Commonwealth of Virginia, ex rel. State Corporation Commission, Ex Parte, In Re: Investigation of the appropriate methodology to determine intrastate access service costs*, Case No. PUC-1987-00012, 1988 S.C.C. Ann. Rep. 232 (“*1987 Access Cost Methodology*”).

⁹¹ Exhibit No. 44, at 2.

⁹² *Id.* at 3.

⁹³ *Id.* at 4.

⁹⁴ *Id.* at 4-5.

⁹⁵ *Id.* at 5.

In *Verizon Access*, Staff stated the Commission found “that reducing the subsidies built into access charges is consistent with subsection (ii) of the local competition policy set forth in § 56-235.5:1,” and ordered Verizon to begin moving intrastate access charges toward cost “to reduce the amount of subsidies included in such charges.”⁹⁶ Staff highlighted the Commission’s finding that Verizon’s alternative regulatory plan “gives Verizon reasonable tools with which to address the access charge reductions required herein if it so chooses.”⁹⁷

Staff stated that in *CLEC Rules*⁹⁸ the Commission conducted a rulemaking to:

require that a CLEC’s intrastate access rates may not exceed the higher of its comparable interstate rate or the intrastate rate of the [ILEC]; provide a short transition period for the CLECs to comply with the access requirement; allow a CLEC to request alternative pricing structures; and provide CLECs with additional pricing flexibility.⁹⁹

Finally, Staff pointed to *Embarq 2008 Modified Alternative Regulation*, in which the Commission approved a new alternative regulatory plan for Embarq. Staff noted that the Commission rejected a proposal by Embarq for an automatic dollar-for-dollar increase to Basic Local Exchange Telephone Services (“BLETS”) rates and Other Local Exchange Telephone Services (“OLETS”) rates to recover reductions in intrastate switched access rates.¹⁰⁰ Nonetheless, Staff affirmed that the Commission granted Embarq the flexibility to (i) include access services in a revenue neutral rate application; (ii) increase rates for OLETS by up to 15% per year; (iii) increase rates for BLETS by up to 10% per year, subject to inflation-adjusted ceiling prices; and (iv) increase price ceilings for BLETS in a revenue neutral filing if in the public interest and affordable.¹⁰¹

Staff presented an analysis of the failure of the settlement in *Embarq Access Settlement* to reduce intrastate access revenues by the expected \$45 million.¹⁰² Staff maintained that Embarq’s average revenue per minute associated with intrastate access revenues has been increasing since 2005, and that CCLC revenue per line has been increasing since 2003.¹⁰³

Staff advised that “[i]t is appropriate to begin reducing the intrastate switched access charges of [Embarq] towards cost.”¹⁰⁴ Staff recommended an approach in this proceeding that is

⁹⁶ *Id.* at 6, quoting *Verizon Access* at 202, 203.

⁹⁷ *Id.*, quoting *Verizon Access* at 203.

⁹⁸ *Commonwealth of Virginia, ex rel. State Corporation Commission, Ex Parte: Amendment of Rules Governing the Certification and Regulation of Competitive Local Exchange Carriers*, Case No. PUC-2007-00033, 2007 S.C.C. Ann. Rep. 259 (“*CLEC Rules*”).

⁹⁹ Exhibit No. 44, at 7.

¹⁰⁰ *Id.* at 8.

¹⁰¹ *Id.* at 8-9.

¹⁰² *Id.* at 9.

¹⁰³ *Id.* at 9-10.

¹⁰⁴ *Id.* at 13.

similar to the approach in *Verizon Access*, which is to restructure the intrastate CCLC component and eliminate the CCLC component “over some reasonable time period.”¹⁰⁵ Staff contended that the timeframe of reducing the CCLC for Embarq should “differ significantly” from the timeframe adopted for Verizon and the CLECs.¹⁰⁶

Staff took issue with the cost studies submitted by Embarq, upon which Embarq contends that its intrastate access service revenues do not exceed costs.¹⁰⁷ Staff maintained that Embarq has misapplied *1987 Access Cost Methodology* by failing to limit loop investment to only the investment associated with multi-line end users.¹⁰⁸ Staff asserted that Embarq also misapplied *1987 Access Cost Methodology* by including a contribution to common costs.¹⁰⁹ Staff calculated that with such changes and notwithstanding any other modifications that may be warranted, Embarq’s intrastate access service revenues exceed cost.¹¹⁰ Staff advised that its evaluation of Embarq’s cost studies is limited and more time would be needed to evaluate the cost studies fully.¹¹¹ Nonetheless, Staff raised concern regarding the extremely short economic service lives and network structure used in Embarq’s cost studies.¹¹²

Staff stated “[t]here is no immediate concern that Embarq’s switched access service prices will fall below its incremental costs.”¹¹³ Staff asserted that the focus of this case should be a phase down and elimination of the CCLC.¹¹⁴ Staff recommended that Embarq’s CCLC be set based upon the settlement in *Embarq Access Settlement* and based on recent access line counts and MOUs to develop per minute CCLC rates.¹¹⁵ Staff recommended that Embarq’s CCLC rates be eliminated “in no more than a four step approach.”¹¹⁶ Staff did not propose a “definitive time line” for its four-step transition period, but advised that the initial reduction in the CCLC “should be significant and implemented as quickly as possible.”¹¹⁷

Staff asserted that the Commission “has no mandate (nor should there be) that requires it to provide a dollar for dollar revenue replacement mechanism for any intrastate access charge reductions.”¹¹⁸ Staff noted that Embarq has a number of regulatory tools and the pricing flexibility to generate additional revenues if it so chooses.¹¹⁹ Staff observed that with a reasonably long transition period to eliminate the CCLC, Embarq’s cost studies may be further

¹⁰⁵ *Id.*

¹⁰⁶ *Id.*

¹⁰⁷ *Id.* at 14.

¹⁰⁸ *Id.* at 15.

¹⁰⁹ *Id.*

¹¹⁰ *Id.* at 16.

¹¹¹ *Id.* at 17.

¹¹² *Id.* at 17-18.

¹¹³ *Id.* at 19.

¹¹⁴ *Id.*

¹¹⁵ *Id.* at 20.

¹¹⁶ *Id.*

¹¹⁷ *Id.* at 21.

¹¹⁸ *Id.*

¹¹⁹ *Id.* at 22.

evaluated and Staff could monitor the impact of any intrastate access charge reductions on Embarq.¹²⁰

Embarq Rebuttal Testimony

On September 19, 2008, Embarq filed the rebuttal testimony of Mr. Schollmann, Mr. Roth, Mr. Dippon, and Dr. Staihr. A summary of the rebuttal testimony submitted by each witness is provided below.

Richard Schollmann pointed to the comments of the Consumer Counsel and asserted that “Embarq has presented facts ‘that are distinguishable from the [Verizon Access] and which warrant a different result.’”¹²¹

Mr. Schollmann took issue with the testimony of AT&T witness Nurse regarding Embarq’s ability to offset reductions in intrastate switched access with increases in retail rates.¹²² Mr. Schollmann maintained that Mr. Nurse’s estimates of additional revenue Embarq can achieve is more than sixty percent more than the revenue that theoretically can be produced by Embarq’s Modified Alternative Regulatory Plan.¹²³ Mr. Schollmann testified that Mr. Nurse was wrong when he stated that Embarq already is collecting higher local revenues as a result of its new plan.¹²⁴ In addition, Mr. Schollmann disagreed with Mr. Nurse’s recommendation that Embarq increase stand-alone residential basic service rates to parity with Verizon because such rates would exceed the ceiling prices established in Embarq’s Modified Alternative Regulatory Plan.¹²⁵

Henry J. Roth disagreed with Sprint Nextel witness Appleby that Embarq has the ability to collect revenues from numerous other services provisioned over the same network.¹²⁶ Mr. Roth disputed Mr. Appleby’s contention regarding revenue growth in Virginia and stated that “there is no revenue growth in Virginia for Embarq since 2002.”¹²⁷ Mr. Roth disagreed with Mr. Appleby’s claim that Embarq’s returns are sufficient to absorb a large reduction in access charges.¹²⁸ Mr. Roth maintained that Embarq’s total earnings in Virginia are irrelevant as Embarq is no longer subject to rate-base, rate-of-return regulation in Virginia.¹²⁹ Mr. Roth testified that Mr. Appleby’s return analysis is flawed in that it improperly uses total company Virginia returns, including non-regulated and interstate earnings.¹³⁰ Mr. Roth pointed out that

¹²⁰ *Id.*

¹²¹ Exhibit No. 4, at 1.

¹²² *Id.* at 2.

¹²³ *Id.*

¹²⁴ *Id.* at 3.

¹²⁵ *Id.* at 4.

¹²⁶ Exhibit No. 12, at 3.

¹²⁷ *Id.* at 5.

¹²⁸ *Id.*

¹²⁹ *Id.*

¹³⁰ *Id.* at 6.

the revenue loss associated with elimination of only the CCLC would be greater than Embarq's 2007 intrastate net income.¹³¹

Mr. Roth defended the use of a cost study in this proceeding and contended that such a study "produces hard facts" and is "responsive to the claims and allegations."¹³² Mr. Roth agreed with AT&T witness Nurse that a cost study for only switched access may not be required, but took the position that a cost study reflects "many of the other factors that must be taken into account when pricing access services."¹³³

Mr. Roth disagreed with Staff's interpretation of *1987 Access Cost Methodology* and Staff's position that the cost study methodology adopted in *1987 Access Cost Methodology* excluded the incremental cost of loops other than multi-line loops.¹³⁴ Mr. Roth pointed out that in *Embarq Access Settlement*, Embarq (then Sprint) was directed by the Commission to supply a cost study using the long-run incremental costing methodology approved in *1987 Access Cost Methodology*, and that Embarq's cost study in this proceeding uses the same methodology as the study submitted by Embarq in *Embarq Access Settlement*.¹³⁵

Mr. Roth defended the economic service lives used in Embarq's cost study as reflecting the economic lives of forward-looking plant placed in the network today.¹³⁶ Mr. Roth also contended that the 12,000 foot CSA is more consistent with a forward-looking loop design and that an 18,000 foot CSA, as proposed by Staff, would require higher investment for extended range cards or coarser gauge cable.¹³⁷

Mr. Roth testified that setting aside the question whether Embarq correctly interpreted *1987 Access Cost Methodology*, the cost study submitted by Embarq correctly determined the appropriate level of Embarq's intrastate switched access rates for Virginia.¹³⁸ Indeed, Mr. Roth stated:

The cost study submitted with my testimony is a comprehensive view of Embarq intrastate regulated retail service costs.¹³⁹

Mr. Roth asserted that his cost studies show that "Embarq, along with this Commission, must find subsidies to fully recover costs in order to continue the quality service these customers have come to expect."¹⁴⁰

¹³¹ *Id.* at 7.

¹³² *Id.* at 8.

¹³³ *Id.*

¹³⁴ *Id.* at 9-10.

¹³⁵ *Id.* at 21-22.

¹³⁶ *Id.* at 24.

¹³⁷ *Id.*

¹³⁸ *Id.* at 26.

¹³⁹ *Id.*

¹⁴⁰ *Id.* at 27.

Christian M. Dippon testified that Sprint Nextel witness Appleby failed to provide any economic support for his assertions (i) that a reduction of Embarq's intrastate switched access rates is long overdue, and (ii) that Embarq's intrastate access rates are inflated and increase the price for all retail voice telecommunications services that require access as an input.¹⁴¹ Mr. Dippon disagreed with Mr. Appleby's attempt to compare intrastate switched access rates to reciprocal compensation rates and stated that such a comparison "makes no sense."¹⁴² Mr. Dippon asserted that there was no economic support for Mr. Appleby's contentions that a reduction in Embarq's switched access rates would benefit customers in Virginia.¹⁴³ Mr. Dippon stated that a reduction in intrastate switched access rates will be paid for by "the citizens of the Commonwealth of Virginia living in (mostly rural) areas with little to no competitive alternative to basic local exchange telephone service"¹⁴⁴

Mr. Dippon noted AT&T witness Nurse's reasons for reducing Embarq's intrastate switched access rates, which he argued are a hidden tax imposed only on interexchange carriers and cause Virginia consumers to pay higher-than-necessary retail rates.¹⁴⁵ Mr. Dippon maintained that arguments presented by Mr. Nurse and Mr. Appleby "directly contradict each other."¹⁴⁶ Mr. Dippon pointed to Verizon's Virginia operating areas and asserted that reduced switched access rates have not slowed down intermodal competition.¹⁴⁷ Mr. Dippon stressed that Mr. Nurse's contention that Virginia consumers are harmed because they pay higher-than-necessary retail rates is unreasonable and there is no evidence or analytical work to support such a contention.¹⁴⁸

Mr. Dippon undertook a statistical analysis to determine whether reducing Embarq's switched access rates will lower the prices for "all retail voice telecommunications services that require access as an essential input," and whether such a reduction "will lead to an increase in long-distance minutes of use"¹⁴⁹ Mr. Dippon testified that his analysis showed that reducing Embarq's switched access rates:

is not likely to benefit the consumers in Virginia as the minimal decrease in Sprint's and AT&T's long distance services will be far outweighed by the cost (i.e., the rate increase and/or quality decrease in high-cost areas) of this proposal[;] . . .

will not lead to more competition as the minimal price decrease . . . will hardly make the IXC's service offerings more competitive, given the fact that wireless providers include free long distance in many of their calling plans . . . [and]

¹⁴¹ Exhibit No. 17, at 3-5.

¹⁴² *Id.* at 5.

¹⁴³ *Id.* at 8.

¹⁴⁴ *Id.* at 9.

¹⁴⁵ *Id.* at 10.

¹⁴⁶ *Id.*

¹⁴⁷ *Id.* at 12-13.

¹⁴⁸ *Id.* at 13.

¹⁴⁹ *Id.* at 16.

is not likely to lead to an increase in long-distance minutes of use because switched access charges are not correlated with long-distance traffic volumes.¹⁵⁰

Mr. Dippon emphasized that Embarq's current CCLC is about four times larger than the CCLC for Verizon prior to its elimination by the Commission.¹⁵¹ Mr. Dippon contended that because of relative size of the CCLC for Embarq, any offsetting revenue increase would have a much greater impact on Embarq's customers.¹⁵² Mr. Dippon criticized AT&T and Staff for suggesting that Embarq's Modified Alternative Regulatory Plan "was not designed to recover lost revenue from a switched access rate reduction."¹⁵³ Mr. Dippon asserted that market forces would compel Embarq to try to raise rates paid by only those customers who have few competitive options.¹⁵⁴

Dr. Brian K. Staihr testified that Staff failed to address the impact of its recommendation on customers.¹⁵⁵ Dr. Staihr stressed that the appropriate level of switched access depends on how customers in Virginia are affected.¹⁵⁶ Dr. Staihr opined that Staff failed to address the impact of its recommendation on customers because its "recommendation is not good for the residents of Virginia."¹⁵⁷

Dr. Staihr disagreed with Staff's interpretation of Virginia Code § 56-235.5:1, and argued that § 56-235.5:1 provides no support for Staff's proposal in this case.¹⁵⁸ Dr. Staihr noted "national efforts" to reform intercarrier compensation, and contended that such efforts are "yet another reason for the Commission to take a measured approach."¹⁵⁹ Dr. Staihr maintained that resolution in *Embarq Access Settlement* no longer makes sense due to the unforeseeable changes in the telecommunications marketplace.¹⁶⁰

Dr. Staihr acknowledged that Embarq's Modified Alternative Regulatory Plan allows Embarq the flexibility to adjust rates upward.¹⁶¹ Dr. Staihr argued that such increases are "both reasonable and fair" because the increases are related to overall price level increases.¹⁶² However, Dr. Staihr contended that such increases would be of no benefit to customers if such increases are "so Sprint [Nextel] and AT&T can pay lower switched access rates"¹⁶³ Thus,

¹⁵⁰ *Id.* at 16-17.

¹⁵¹ *Id.* at 29.

¹⁵² *Id.*

¹⁵³ *Id.* at 31.

¹⁵⁴ *Id.* at 32.

¹⁵⁵ Exhibit No. 22, at 2.

¹⁵⁶ *Id.*

¹⁵⁷ *Id.* at 3. (emphasis in original)

¹⁵⁸ *Id.* at 6-9.

¹⁵⁹ *Id.* at 11.

¹⁶⁰ *Id.* at 12.

¹⁶¹ *Id.* at 17.

¹⁶² *Id.*

¹⁶³ *Id.*

Dr. Staihr asserted that Embarq's Modified Alternative Regulatory Plan is designed to allow Embarq "to 'catch up' to where it should have been all along."¹⁶⁴

Dr. Staihr took the position that differences between Staff and Embarq regarding cost study methodologies do not affect the proper level of switched access prices in Virginia.¹⁶⁵ Dr. Staihr stated that such differences may affect the price floor for switched access, without affecting the proper price for switched access.¹⁶⁶

Dr. Staihr maintained that Sprint Nextel witness Appleby's recommended method for reforming the CCLC charge was "more reasonable than the Staff's recommendation."¹⁶⁷ Dr. Staihr responded to Mr. Appleby's contention that Embarq does not require switched access revenues because it has other sources or revenues, by arguing that "it is equally true that Sprint [Nextel] does not 'require' certain cost savings because Sprint [Nextel] has other sources of cost savings."¹⁶⁸ Dr. Staihr disagreed with Mr. Appleby's emphasis on switched access reductions by CLECs ordered in *CLEC Rules*, and pointed out that CLECs do not operate as carriers of last resort and therefore do not require a switched access subsidy to keep rates affordable in high cost areas.¹⁶⁹

Finally, Dr. Staihr addressed the testimony of AT&T witness Nurse regarding the elimination of the CCLC. Dr. Staihr contended that Mr. Nurse failed to recognize that the CCLC was designed to provide cost recovery.¹⁷⁰ Moreover, Dr. Staihr disagreed with Mr. Nurse's use of the FCC's elimination of the CCLC as support for the elimination of the CCLC in this case.¹⁷¹ Dr. Staihr pointed out that when the FCC eliminated the CCLC, it created an explicit federal universal service fund as a replacement.¹⁷²

Sprint Nextel Rebuttal Testimony

On September 19, 2008, Sprint Nextel filed the rebuttal testimony of Mr. Appleby.

James A. Appleby disagreed with Embarq's contention that reducing access rates would result in reduced investment and service quality.¹⁷³ Mr. Appleby testified that an analysis of the impact of a reduction in access rates must include: (i) the magnitude of the new revenues Embarq could generate from its newly acquired pricing flexibility; (ii) revenues from non-regulated services such as broadband and long-distance; (iii) savings to Embarq's long-distance provider; and (iv) Embarq's current financial strength.¹⁷⁴

¹⁶⁴ *Id.* at 18.

¹⁶⁵ *Id.* at 18-19.

¹⁶⁶ *Id.* at 19.

¹⁶⁷ *Id.* at 21.

¹⁶⁸ *Id.* at 23.

¹⁶⁹ *Id.* at 23-24.

¹⁷⁰ *Id.* at 25.

¹⁷¹ *Id.* at 26.

¹⁷² *Id.*

¹⁷³ Exhibit No. 26, at 3.

¹⁷⁴ *Id.* at 4.

Mr. Appleby responded to Embarq witness Staihr's claim that reducing Embarq's access rates will be of no benefit to customers by pointing to the efforts of this and other commissions to reduce access rates as part of a market transition to a fully competitive market.¹⁷⁵ In response to Embarq witness Dippon's testimony that the market will not permit Embarq to increase prices in areas that are competitive, Mr. Appleby pointed out that for Embarq's bundled service offerings, the reduction in access costs will permit Embarq to lower the toll portion of the bundle, increase the local service portion of the bundle, and keep the total price of the bundle constant.¹⁷⁶ Mr. Appleby also disagreed with Mr. Dippon's assertion that Embarq gains no competitive advantage from high access rates.¹⁷⁷ Mr. Appleby argued that "[t]he higher the access charges the carrier attempting to compete must pay the more Embarq's financial advantage in the retail market increases."¹⁷⁸

Mr. Appleby tied Embarq's rate flexibility under its Modified Alternative Regulatory Plan to reductions in access rates, and asserted that "[t]o permit the local service increases in rural areas without the corresponding access reductions would result in high rates for consumers without realizing the competitive benefits of reducing the implicit switched access subsidy."¹⁷⁹ Mr. Appleby disagreed with Dr. Staihr's argument that a different public policy decision should be applied to Embarq's access subsidies than was applied to Verizon's access subsidies.¹⁸⁰ Mr. Appleby responded to Dr. Staihr's call for a universal service fund for Virginia by stating that such a fund should be considered only if the Commission finds that "the goal of providing universally available telecommunications service at affordable rates is not possible."¹⁸¹

Mr. Appleby reviewed the cost study presented by Mr. Roth and questioned the result that showed that the economic cost derived by Mr. Roth is "higher than all intrastate regulated operating expenses and return in 2007 on a per-line basis."¹⁸² Mr. Appleby disagreed with Mr. Roth's contention that access rates cannot be compared to reciprocal compensation rates.¹⁸³ Mr. Appleby maintained that reciprocal compensation rates are based on the same cost standard that Mr. Roth claimed to use, and provide an economic cost-based rate for switching and transport.¹⁸⁴

AT&T Rebuttal Testimony

On September 19, 2008, AT&T filed the rebuttal testimony of Mr. Nurse.

E. Christopher Nurse testified that AT&T's proposal to eliminate the CCLC and align intrastate and interstate switched access rates is generally consistent with Staff's

¹⁷⁵ *Id.* at 11-12.

¹⁷⁶ *Id.* at 13.

¹⁷⁷ *Id.* at 15.

¹⁷⁸ *Id.* at 16.

¹⁷⁹ *Id.* at 18.

¹⁸⁰ *Id.* at 19.

¹⁸¹ *Id.* at 21.

¹⁸² *Id.* at 22.

¹⁸³ *Id.* at 24.

¹⁸⁴ *Id.*

recommendation in this case.¹⁸⁵ Mr. Nurse acknowledged that AT&T and Staff differ as to the timing of the access reductions, with Staff recommending a phase down over “a reasonable time frame.”¹⁸⁶ According to Mr. Nurse, Embarq’s phase down of access charges began in 2001.¹⁸⁷ Mr. Nurse pointed out that in this proceeding Embarq opposes unifying intrastate and interstate access charges, but in a recent FCC filing, Embarq has proposed that intrastate access rates be reduced and interstate access charges increased to the same level to eliminate artificial arbitrage that is harming competition and investment.¹⁸⁸

Mr. Nurse offered three arguments in response to Embarq’s contention that the Commission should maintain high intrastate access rates in order to continue to subsidize Embarq’s cost of local service.¹⁸⁹ First, Mr. Nurse asserted that Embarq ignores the pricing flexibility it has been granted to raise retail rates, which will permit Embarq to collect more revenues from its own customers and less from consumers outside Embarq’s service territory.¹⁹⁰ Second, Mr. Nurse cited to prior Commission decisions and contended that cross-subsidies cannot be sustained in a competitive market.¹⁹¹ Finally, Mr. Nurse argued that “perpetuating the subsidies in Embarq’s intrastate access rates runs afoul . . .” of the policy established by § 56-235.5:1 (ii) of the Virginia Code.¹⁹²

Mr. Nurse contended that Embarq’s attempts to distinguish itself from Verizon, by maintaining that Embarq’s service territories are more rural and costly to serve, actually show that Embarq has more leeway to increase basic local service rates as it faces less competition.¹⁹³ In addition, Mr. Nurse answered Embarq’s criticism that past reductions in access rates have not affected long-distance prices by pointing out that AT&T’s prices in Virginia have fallen faster than its access expenses.¹⁹⁴

Mr. Nurse defended his recommendation that intrastate access rates should be reduced to interstate levels immediately with several arguments: (i) Embarq already has the necessary pricing flexibility; (ii) Embarq has been on notice since 2001 that access rates will be reduced; (iii) Embarq’s access rates are higher than the Commission intended; and (iv) such reductions will intensify local and long-distance competition throughout the Commonwealth.¹⁹⁵

Mr. Nurse took issue with Embarq’s cost study and contended that because loop costs are non-traffic sensitive and are driven by local exchange service subscriptions, the inclusion of loop costs buries an implicit subsidy for local service in the switched access cost study.¹⁹⁶ Mr. Nurse

¹⁸⁵ Exhibit No. 34, at 4.

¹⁸⁶ *Id.*

¹⁸⁷ *Id.*

¹⁸⁸ *Id.* at 8-9.

¹⁸⁹ *Id.* at 11-13.

¹⁹⁰ *Id.* at 11-12.

¹⁹¹ *Id.* at 12.

¹⁹² *Id.* at 12-13.

¹⁹³ *Id.* at 15.

¹⁹⁴ *Id.* at 16.

¹⁹⁵ *Id.* at 18-19.

¹⁹⁶ *Id.* at 21-22.

cited to prior testimonies of Embarq witness Staihr in which Dr. Staihr took the position that the cost of switched access does not include the cost of the loop.¹⁹⁷ Mr. Nurse restated Embarq's incremental switched access costs: (i) to eliminate loop costs, (ii) to eliminate common costs, and (iii) to correct switch costs.¹⁹⁸ Furthermore, Mr. Nurse noted several other issues with Embarq's cost study.¹⁹⁹ Mr. Nurse confirmed his original conclusion that Embarq's costs of switched access are far below Embarq's interstate access rates of 0.6 cents per minute, and recommended reducing intrastate switched access to correspond with interstate levels.²⁰⁰

DISCUSSION

In its February 15, 2008, Order Establishing Investigation, the Commission directed the Hearing Examiner to:

prepare a report and recommendations that address, at a minimum, the proper level of intrastate switched access rates for the Embarq companies. The Hearing Examiner may consider any issues that are relevant to achieving the proper level of intrastate switched access rates such as whether any transition and/or recovery mechanisms are necessary or warranted.

Embarq's current intrastate switched access rates are \$0.0517 for United and \$0.0426 for Centel.²⁰¹ AT&T characterized these rates as more than five times higher than Embarq's comparable interstate rates.²⁰² Indeed, because Embarq's CCLC component of intrastate switched access is designed to recover a fixed amount and Embarq has been experiencing a decline in MOU, Embarq's intrastate switched access charges are increasing on a per line basis and MOU basis.²⁰³

The Commission has a well-established policy of moving away from high intrastate switched access charges originally designed to subsidize local service. As outlined by Embarq witness Dippon, historically, basic local telephone rates incorporated "a complex set of internal subsidies--from toll to local service, from business to residential service, and from urban to rural areas."²⁰⁴ Carrier access charges were instituted to continue the subsidization of basic local telephone rates when the former Bell System was broken up in the early 1980s.²⁰⁵

In *1987 Access Cost Methodology*, the Commission focused on the "appropriate costing methodology for access service" and stated that "actual prices would be addressed in subsequent

¹⁹⁷ *Id.* at 23-25.

¹⁹⁸ *Id.* at 28, Attachment 5.

¹⁹⁹ *Id.* at 28-33.

²⁰⁰ *Id.* at 33-34.

²⁰¹ Sprint Nextel Brief at 3.

²⁰² AT&T Brief at 14.

²⁰³ Staff Brief at 8, Exhibit No. 34 at 10-11.

²⁰⁴ Exhibit No. 15, at 5.

²⁰⁵ *Id.* at 5-6.

proceedings”²⁰⁶ In *1987 Access Cost Methodology*, the Commission rejected a fully distributed cost approach and adopted a long-run incremental cost methodology, which it defined as “the additional cost caused by supplying additional units of access service, holding all other things unchanged.”²⁰⁷ The Commission determined that long-run incremental costs established “a floor below which access prices must not be allowed to fall.”²⁰⁸ For pricing, the Commission established that “other factors, including contribution to common costs, value of service, and competitive forces in the access service market, must be analyzed when making pricing decisions.”²⁰⁹

In the 2001 *Embarq Access Settlement*, the Embarq companies agreed to a reduction in intrastate access charges that was “estimated to result in a revenue reduction of \$45 million.”²¹⁰ Embarq agreed to reduce its intrastate access charges without any offsetting increase in rates for its basic local exchange telecommunications services.²¹¹ In *Embarq Access Settlement*, the Commission indicated that Embarq’s intrastate access charges would continue to be an issue.

The Commission does not view this Amended Agreement as the last opportunity the parties may have to address the issue of access charges set above cost. . . . The parties remain free, of course, to discuss and negotiate further rate modifications that they may propose to us to take effect after [January 1, 2003], or may thereafter request opening a proceeding to revisit this question. The Commission may find it necessary to take this last step on its own initiative.²¹²

In *Verizon Access*, the Commission agreed that the policy of collecting a subsidy for local exchange services through access charges is “no longer sustainable in the competitive market that has developed in Virginia.”²¹³ The Commission found that “Verizon’s intrastate access charges should be decreased toward cost to reduce the amount of subsidies included in such charges.”²¹⁴ In addition, the Commission found that “reducing subsidies built into access charges is consistent with subsection (ii) of the local competition policy set forth in § 56-235.5:1 of the Code”²¹⁵

In *CLEC Rules*, the Commission, among other things, reduced CLECs’ intrastate access rates to limit any disparity between Verizon’s intrastate access rates and CLECs’ intrastate

²⁰⁶ 1988 S. C. C. Ann. Rep. at 232.

²⁰⁷ *Id.* at 233.

²⁰⁸ *Id.*

²⁰⁹ *Id.*

²¹⁰ 2001 S. C. C. Ann. Rep. at 254.

²¹¹ *Id.*

²¹² *Id.*

²¹³ 2005 S. C. C. Ann. Rep. at 202 (citations omitted).

²¹⁴ *Id.*

²¹⁵ *Id.* at 203.

access rates.²¹⁶ Indeed, in *CLEC Rules*, the Commission limited any disparity between CLEC and ILEC intrastate access rates with the adoption of 20 VAC 5-417-50 E. 1.

E.1. Beginning December 1, 2007, unless otherwise allowed by the commission, prices for a new entrant's intrastate access services shall not exceed the highest of the following:

- a. The new entrant's comparable interstate switched access charge rates.
- b. The aggregate intrastate switched access charge rates of the ILEC in whose service territory the new entrant is providing service. A new entrant may utilize a blended or composite rate to reflect applicable price ceilings of more than one ILEC or to reflect an alternative rate structure to the ILEC.
- c. An intrastate switched access charge benchmark rate of \$.029 per minute for a transition period from December 1, 2007, through March 30, 2008. Effective April 1, 2008, this subdivision no longer applies.

Against this backdrop of movement away from the subsidization of local service through access charges, in this proceeding, staunchly Embarq defended its current level of intrastate access charges. On brief, Embarq organized its defense of current intrastate access charges into six arguments: (i) access reductions are not mandated by statute, or required by Commission decision or policy; (ii) the parties and Staff have failed to demonstrate either the need for access reductions or any benefits from reducing access charges; (iii) Embarq's cost studies demonstrate that current intrastate access rates are necessary to ensure continuation of affordable rates and universal service; (iv) the revenue recovery plans for lost access revenues offered by the parties and Staff are illusory; (v) the Commission should implement a state universal service fund for rural Virginia before reducing access charges affecting rural Virginia; and (iv) emergent activity at the FCC could impact this record. Each of these arguments is discussed below.

A. Access reductions are not mandated by statute, or required by Commission decision or policy.

Virginia Code § 56-235.5:1 provides as follows:

The Commission, in resolving issues and cases concerning local exchange telephone service under the federal Telecommunications Act of 1996 (P.L. 104-104), this title, or both, shall, consistent with federal and state laws, consider it in the public interest to, as appropriate, (i) treat all providers of local exchange telephone services in an equitable fashion and without undue discrimination and, to the greatest extent possible, apply the same rules to all

²¹⁶ 2007 S. C. C. Ann. Rep. at 259.

providers of local exchange telephone services; (ii) promote competitive product offerings, investments, and innovations from all providers of local exchange telephone services in all areas of the Commonwealth; and (iii) reduce or eliminate any requirement to price retail and wholesale products and services at levels that do not permit providers of local exchange telephone services to recover their costs of those products and services.

Embarq contended that the focus of the statute is on local exchange telephone service only, and the statute offers no mandate to protect wireless carriers such as Sprint Nextel, or interexchange carriers such as AT&T.²¹⁷ Furthermore, Embarq argued that “there is no evidence that reductions in Embarq’s intrastate switched access charges will result in competitive offerings from even [Sprint Nextel], AT&T or other wireless and interexchange carriers, much less the local exchange providers addressed in the Local Competition Policy Statute.”²¹⁸

Embarq’s contention is constructed in terms of Sprint Nextel and AT&T in an attempt to limit the analysis of the impact of Embarq’s intrastate access charges. However, during the hearing, Embarq witness Schollman agreed that lowering Embarq’s intrastate access charges would benefit Verizon and other rural local exchange carriers:

Q. Would that include Verizon?

A. I suppose it could be. . . . I guess any body that’s providing long distance service and paying access charges to our two operating companies would apply.

...

Q. That would include rural local exchange carriers in Virginia?

A. Yes, to the extent they are terminating access in Virginia I think it would.²¹⁹

As the record in this case demonstrates, the distinction between providers of local exchange telephone service and the providers of other communication services, including wireless and interexchange, is becoming less and less defined. For example, a growing number of Virginia customers purchase their telecommunication services through “bundles” that include local exchange telephone service and other communication services.²²⁰ Consistent with Mr. Schollman’s testimony, providers of local exchange telephone service in Virginia also provide other communication services and are impacted by the level of subsidies collected through intrastate access charges. AT&T witness Nurse testified that “[m]oving price away from cost

²¹⁷ Embarq Brief at 16.

²¹⁸ *Id.* at 19.

²¹⁹ Schollman, Tr. at 51.

²²⁰ *See, e.g.*, Exhibit No. 35C, Attachment 3.

reduces an efficiency and reduces entrants' ability to compete"²²¹ More importantly from the perspective of the Local Competition Policy Statute, Embarq witness Dippon agreed that Embarq's intrastate switched access revenues contained subsidies that are used to keep Embarq's local service rates low.²²² Mr. Dippon outlined the competition for local exchange telephone service faced by Embarq and the risks faced by Embarq if it increased rates to compensate for the loss of intrastate switched access subsidies.²²³ For example, in rural areas where Embarq currently faces little or no competition for local exchange telephone service, Mr. Dippon conceded that an increase in Embarq's rates could increase competition.

If Embarq were to raise rates in those areas – it all depends. I could see that there's an increase in competition, but the increase in competition comes from the fact that carriers might see there's some money to be made.²²⁴

Likewise, in areas where Embarq currently faces competition for local exchange telephone service, Mr. Dippon took the position that if a loss in subsidy caused Embarq to increase rates in such areas, Embarq's competitors would likely increase their market share.²²⁵

Thus, the subsidies collected through intrastate access charges continue to limit or dampen competition in opposition to the pro-competitive policies embodied in the Virginia Code § 56-235.5:1. Therefore, I find that the Commission's policy of moving away from subsidizing local exchange telephone service through intrastate access charges is consistent with the public interest standards established in Virginia Code § 56-235.5:1: (i) to treat all providers of local exchange telephone service in an equitable fashion, without undue discrimination; (ii) to promote competition from all providers of local exchange telephone service in all areas of the Commonwealth; and (iii) to permit providers of local exchange telephone service to price products and services to recover their costs of those products and services.

Embarq attempted to recast considerations of the public interest narrowly by asking: "Are the rural residents of Virginia better served if the dollars remain with Embarq or if the dollars go to Sprint and AT&T?"²²⁶ Embarq's public interest question is too narrow because the focus of the public interest consideration in Virginia Code § 56-235.5:1 is the entire Commonwealth, all providers of local exchange telephone service and their customers, not just Embarq, its rural customers, and the two telecommunication providers that participated in this proceeding.

In addition, Embarq argued that the proposed reductions in intrastate access charges threaten the availability and affordability of local telephone service in Embarq's rural service territory, which is not in the public interest or consistent with the goal of subsection (ii) of § 56-

²²¹ Nurse, Tr. at 248.

²²² Dippon, Tr. at 103.

²²³ *Id.* at 106-07, 112,

²²⁴ *Id.* at 122.

²²⁵ *Id.* at 112-13.

²²⁶ Embarq Brief at 22, *quoting from* Exhibit No. 20, at 7.

235.5:1.²²⁷ First, I disagree that Virginia Code § 56-235.5:1 (ii) sets affordability of local telephone service in Embarq's rural service territories as a goal. Instead, the goal of this section is to promote competitive product and service offerings in all areas of the Commonwealth. More importantly, "affordability" as public policy was central to the Commission's decision in *Embarq 2008 Modified Alternative Regulation* and Virginia Code § 56-235.5 B. Specifically, in *Embarq 2008 Modified Alternative Regulation* the Commission set the price ceilings for BLETs and OLETs based on statutory "affordability" criteria. Thus, affordability of local telephone service provided by Embarq is assured by limiting any changes in price for BLETs and OLETs that Embarq may require to offset the loss of subsidy through intrastate access charges to the price ceilings established in the *Embarq 2008 Modified Alternative Regulation*.

Furthermore, Embarq asserted that subsection (iii) of § 56-235.5:1 requires that the Commission maintain access charges at their current level to permit Embarq to recover its cost of providing local telephone service to rural Virginians.²²⁸ Such an interpretation turns subsection (iii) on its head. This subsection directs the Commission to "reduce or eliminate any requirement to price retail and wholesale products and services at levels that do not permit providers of local exchange telephone services to recover their costs of those products and services." By requiring the recovery of costs "*of those* products and services," this subsection is designed to reduce or eliminate the very subsidies contained within Embarq's current access charges.

Consequently, while the Commission has flexibility in regard to the pricing of intrastate switched access, Virginia Code 56-235.5:1 continues to represent a statement of public policy against the collection of subsidies. As Embarq pointed out, the movement away from subsidies collected through intrastate access charges represents a change in regulatory policy.²²⁹ However, Embarq's contention that it has an expectation for intrastate access subsidies is unfounded. As discussed above, as early as the 2001 settlement in *Embarq Access Settlement*, the Commission worked to reduce Embarq's intrastate access subsidies. Moreover, the more recent adoption of Virginia Code 56-235.5:1, and the Commission's decisions in *Verizon Access* and *CLEC Rules* all represent continued movement away from the collection of subsidies through intrastate access. Finally, in *Embarq 2008 Modified Alternative Regulation* the Commission equipped Embarq with the tools to manage and replace revenues collected through intrastate access. Indeed, that was one of Embarq's stated purposes for seeking to modify its plan for alternative regulation.²³⁰

As for prior precedent, Embarq maintained *Verizon Access* is not applicable to this proceeding due to the high costs Embarq incurs to serve rural Virginia.²³¹ Embarq argued that "Verizon faces different economic and competitive conditions as it serves different (and generally less rural) geographic areas, has different cost structures, and different economies of scale."²³² Embarq pointed out that the revenues received from intrastate access are greater

²²⁷ Embarq Brief at 22.

²²⁸ *Id.* at 24.

²²⁹ *Id.* at 26-27.

²³⁰ *See*, Dippon, Tr. at 151; Exhibit No. 19, at ¶ 10.

²³¹ Embarq Brief at 31.

²³² *Id.* at 32.

proportionately for Embarq than for Verizon.²³³ Embarq emphasized that “eliminating the CCLC or reducing Embarq’s intrastate switched access rates even more will *affect* Embarq more than it did Verizon.”²³⁴ Embarq insisted that it has a greater need than Verizon for the subsidies in access rates.²³⁵ Finally, Embarq challenged the validity of *Verizon Access* as precedent for this proceeding by asserting that the marketplace has changed since *Verizon Access* as stand-alone interexchange carriers are no longer attempting to compete with ILECs for local service.²³⁶ Embarq contended that today, the “primary competition that takes place is for bundles of service that include all-distance calling, and it is overwhelmingly inter-modal competition.”²³⁷ Therefore, Embarq argued against a “one size fits all” approach based on *Verizon Access*.²³⁸

I agree with Embarq that it faces different economic and competitive conditions, and differs from Verizon in several ways. However, the differences in characteristics can be addressed in the implementation of the policy of reducing an ILEC’s dependence on intrastate access subsidies. For example, Embarq may require a longer transition period over which intrastate access is reduced, and Embarq may require (and indeed, has been provided by the Commission) more pricing flexibility to address the shift away from intrastate access subsidies. As for the policies established in *Verizon Access*, as discussed more fully above, the continued development of the competitive telecommunications market in Virginia, especially the loss of distinction between carriers and the increased popularity of “bundles,” further supports the reduction or elimination of subsidies collected through intrastate access. Thus, I find the Commission’s policy findings in *Verizon Access* – that a subsidy for local exchange services through access charges is no longer sustainable in the competitive market that has developed in Virginia; and that intrastate access charges should be decreased toward cost to reduce the amount of subsidies included in such charges – remain valid for this proceeding.

In summary, I find that a reduction of the subsidies collected through Embarq’s intrastate access is consistent with Virginia Code § 56-235.5:1 as well as Commission precedent and policy.

B. No demonstrated need for or benefits from access reductions.

Embarq asserted that there is no proof that Embarq’s intrastate access rate levels are unjust and unreasonable.²³⁹ Embarq cited to language taken from Virginia Code § 56-235.2 to define “just and reasonable” as rates, tolls, charges or schedules demonstrated, in the aggregate, to provide revenues not in excess of the aggregate actual costs incurred by the utility.²⁴⁰ Virginia Code § 56-235.2 goes on to provide a framework for determining costs, which can be generalized as traditional rate-base-rate-of-return ratemaking. Embarq argued that “Staff and the parties in this case have failed to meet their burden to show that Embarq’s intrastate switched

²³³ *Id.* at 34.

²³⁴ *Id.* at 35 (emphasis in original).

²³⁵ *Id.*

²³⁶ *Id.* at 36.

²³⁷ *Id.* at 36-37.

²³⁸ *Id.* at 37.

²³⁹ *Id.* at 38.

²⁴⁰ *Id.*

access charges are unjust and unreasonable and therefore should be reduced.”²⁴¹ Moreover, Embarq contended that if the Commission “allows a rate to be changed without such an analysis, it has improperly ‘taken’ utility property.”²⁴²

Embarq’s rates are no longer set based on the cost of service standards of Virginia Code § 56-235.2. Instead, Embarq has chosen to have its rates set based on an alternative form of regulation set forth in Virginia Code § 56-235.5.²⁴³ Rather than being based on a determination of cost of service, Embarq’s rates are now determined based on the criteria of Virginia Code § 56-235.5 B.

In regulating telephone services of any telephone company, and notwithstanding any provision of law to the contrary, the Commission, . . . may replace the ratemaking methodology set forth in § 56-235.2 with any alternative form of regulation which:

- (i) protects the affordability of basic local exchange telephone service, as such service is defined by the Commission;
- (ii) reasonably ensures the continuation of quality local exchange telephone service;
- (iii) will not unreasonably prejudice or disadvantage any class of telephone company customers or other providers of competitive services; and
- (iv) is in the public interest. . . .

Pursuant to the statutory standards of Virginia Code §§ 56-235.5 and 56-235.5: 1, Staff and the parties have questioned the size and continuation of the collection of subsidies via intrastate access charges. I find that Staff and the parties have undertaken the proper analysis and that Embarq’s suggestion that this case must be decided based on the cost of service standards of Virginia Code § 56-235.2 should be rejected.

Embarq maintained that there is no evidence that Embarq’s intrastate switched access rates are detrimental to competition or competitors or that an access rate reduction will increase competition.²⁴⁴ In support, Embarq pointed to the testimony of Mr. Dippon as providing compelling reasons why reducing intrastate switched access rates will not increase competition in Virginia.²⁴⁵ Nonetheless, Mr. Dippon also testified that competition is likely to increase if intrastate access subsidies are reduced and Embarq increases other rates.²⁴⁶ Indeed, Mr. Dippon testified that Embarq has few options for increasing prices without benefiting competitors.²⁴⁷ Therefore, I find that Embarq’s own witnesses provided convincing evidence of the detrimental impact on competition of subsidies Embarq collects through its intrastate access charges.

²⁴¹ *Id.* at 39.

²⁴² *Id.*

²⁴³ Exhibit No. 50.

²⁴⁴ Embarq Brief at 41.

²⁴⁵ *Id.* at 43; Exhibit No. 15, at 31-38; Exhibit No. 17, at 12-13.

²⁴⁶ *See*, Dippon Tr. at 106-07, 111-12, 122.

²⁴⁷ *Id.*

C. Embarq's cost studies.

As discussed above, in *1987 Access Cost Methodology*, the Commission determined that it would use long-run incremental costs (defined as “the additional cost caused by supplying additional units of access service, holding all other things unchanged”) to establish “a floor below which access prices must not be allowed to fall.”²⁴⁸ For pricing, the Commission established that “an application to change access rates in the future must justify these rates in a formal proceeding, based upon long-run incremental costs, contribution to common costs, value of service, competitive forces in the access service market, and any other factors we may find proper.”²⁴⁹ As competition in the Commonwealth has developed, and as the Commission has moved away from rate base/rate of return regulation, the Commission, as directed by statute, has placed more emphasis on “competitive” factors when examining and setting intrastate access prices.

The cost studies submitted by Embarq in this case, were not long-run incremental cost studies, and were not designed to establish “a floor below which access prices must not be allowed to fall.” Instead, Embarq presented a comprehensive study that showed “Embarq’s current level of intrastate switched access rates not only recovers the cost of switched access service but also helps recover the cost of basic local service in the company’s high-cost, rural areas.”²⁵⁰ Embarq employed the Total Service Long Run Incremental Costing (“TSLRIC”) methodology, and included the cost of loops and a contribution to common costs.²⁵¹ Rather than determining a “floor,” Embarq’s cost studies are designed to provide a “price” that will permit the recovery of intrastate access costs as well as a determined level of basic local service costs. As Embarq witness Roth explained:

My cost studies identify the cost of basic local service and the cost of the switched intrastate access components separately. It is understood that in pure theoretical costing switched access costs and local loop costs are separate. However, in Virginia it is ordered that local loop costs and central office termination costs are to be included in the cost of switched and special access.²⁵²

Embarq contended that the inclusion of loop costs in its access cost studies is supported by *1987 Access Cost Methodology*, and by *Embarq Access Settlement*.²⁵³ In essence, Embarq argued that because it has been permitted to recover local loop costs through the CCLC, it is appropriate for its current cost study to include local loop costs in its access cost studies.²⁵⁴ Embarq then uses its cost studies to support the continuation of recovering local loop costs through the CCLC.²⁵⁵ Embarq maintained that in *1987 Access Cost Methodology*, the

²⁴⁸ 1988 S. C. C. Ann. Rep. at 233.

²⁴⁹ *Id.*

²⁵⁰ Embarq Brief at 57; Exhibit No. 10, at 17-18.

²⁵¹ Embarq Brief at 58-59.

²⁵² Roth, Tr. at 76.

²⁵³ Embarq Brief at 62, 64.

²⁵⁴ *Id.* at 63-64.

²⁵⁵ *Id.*

Commission adopted a costing methodology that included all local loop and central office termination costs.²⁵⁶ Embarq pointed to the language in ordering paragraph 2,²⁵⁷ and asserted that the Commission did not adopt Staff's recommendation to limit loop and central office termination costs to multi-line end users.²⁵⁸

I disagree. As the Commission discussed more fully in its order, the Commission both limited loop and central office termination costs to multi-line end users and adopted the approach recommended by Staff in the "Cody Report," which was admitted to the record in this proceeding as Exhibit No. 36.

We also find that local loop and central office termination costs should be included in the incremental costs of both switched and special access services. These costs are created as a result of customer demand for telecommunications services on the network. All telephone services need these facilities; however, additional facilities are not always added immediately in response to changes in usage.ⁿ³ Consequently, when switched access incremental cost studies are prepared, local loop and line termination investments associated with multi-line end users should be assigned to switched access service in an appropriate proportion to the incremental usage attributed to these facilities.

ⁿ³ Report of the Division of Communications; Larry J. Cody, September 23, 1987, Exhibit LJC-21, p. 48,²⁵⁹

Consequently, if Embarq wished to prepare switched access incremental cost studies in compliance with the methodology adopted by the Commission in *1987 Access Cost Methodology*, inclusion of local loop and line termination investments would be limited to such investments associated with multi-line end users. Therefore, I find that Embarq's cost studies failed to provide usable price floor information in compliance with the long-run incremental cost methodology established by the Commission in *1987 Access Cost Methodology*.

Embarq distinguished between the long-run incremental cost methodology adopted in *1987 Access Cost Methodology*, which is used as a price floor, and pricing decisions as required in this case.²⁶⁰ Embarq acknowledged that in *1987 Access Cost Methodology*, the Commission limited the long-run incremental cost methodology adopted to determinations of a "price floor."²⁶¹ Embarq also recognized that in *1987 Access Cost Methodology* "at its core, affords

²⁵⁶ *Id.* at 68.

²⁵⁷ Ordering paragraph 2 states: "That local loop and central office termination costs shall be included in the incremental costs of both switched and special access." *1987 Access Cost Methodology* at 234.

²⁵⁸ Embarq Brief at 68.

²⁵⁹ *1987 Access Cost Methodology*, at 233, 234 n.3.

²⁶⁰ Embarq Brief at 69-70.

²⁶¹ *Id.* at 70.

flexibility and discretion to the Commission to make appropriate pricing decisions.”²⁶² Indeed, the Commission explicitly stated that access prices would be based on “*any other factors we may find proper*.”²⁶³ Nonetheless, Embarq took the Commission’s flexible approach to the pricing of access service and attempted to transform it into a binding pricing exercise based solely on its version of fully distributed costs.²⁶⁴ By designing its cost studies to reflect current subsidies of local service provided by access service, Embarq presented a circular argument to justify maintaining the *status quo*. Therefore, I find that Embarq’s cost studies provide little useful evidence for pricing intrastate access charges that are designed to implement current Commission policy and state law that calls for reducing the level of subsidies.

Staff adjusted Embarq’s cost studies to (i) include only loop and central office termination investment associated with multi-line end users; and (ii) eliminate common costs to bring Embarq’s cost studies more in line with the methodology established in *1987 Access Cost Methodology*.²⁶⁵ Staff witness Cummings testified that the purpose of Staff’s adjustments was to determine a price floor.

We only modified Embarq’s switched access cost study for one really simple reason. We modified it to reflect what we believe was in the 1987 order, and we only did that, really, for one reason. . . . [W]e wanted to provide the Hearing Examiner and, hopefully, the Commission with an option, . . . to set an interim price floor.²⁶⁶

Staff’s modifications to Embarq’s cost studies showed that Embarq’s current switched access rates are presently set well above the price floor and there was no danger of dropping below the price floor, even if intrastate access is reduced to interstate access levels.²⁶⁷

D. No viable recovery of lost access revenues presented.

Embarq asserted that the pricing flexibility associated with its Modified Alternative Regulatory Plan would fail to provide sufficient revenues to offset large reductions to intrastate access.²⁶⁸ Embarq also questioned the sources for additional revenues or areas for cost savings outlined by AT&T and SprintNextel.²⁶⁹

Embarq maintained that its Modified Alternative Regulatory Plan was never intended to replace drastic reductions in access charge revenues.²⁷⁰ Instead, Embarq contended that its Modified Alternative Regulatory Plan is to allow Embarq to “catch up” to the level of revenues

²⁶² *Id.* at 71.

²⁶³ *1987 Access Cost Methodology* at 233 (emphasis added).

²⁶⁴ Embarq Brief at 75.

²⁶⁵ Exhibit No. 44, at 15.

²⁶⁶ Cummings, Tr. at 300.

²⁶⁷ Staff Brief at 8; Exhibit No. 45C, Attached Staff Exhibit 5.

²⁶⁸ Embarq Brief at 88.

²⁶⁹ *Id.* at 91-109.

²⁷⁰ *Id.* at 89.

that Embarq should have been collecting from its BLETS services all along.²⁷¹ Embarq acknowledged that it initiated its Modified Alternative Regulatory Plan proceeding, PUC-2008-00008, with the intent to “assure[] Embarq recovery of subsidies lost from reductions in intrastate switched access charges . . . while at the same time safeguarding affordable rates.”²⁷² Specifically, Embarq’s application included the following statement:

The New Plan includes a mechanism by which implicit subsidies in Embarq’s intrastate switched access rates can be reduced without putting at risk Embarq’s ability to serve as a carrier of last resort. The New Plan allows Embarq to recover subsidies lost as the result of access rate reductions by increasing rates for basic local exchange service. The mechanism would produce no increase in Embarq’s net revenues but would shift needed cost recovery from one service to currently subsidized services. This mechanism is often referred to as rate rebalancing.²⁷³

Embarq asserted that in *Embarq 2008 Modified Alternative Regulation* the Commission rejected Embarq’s proposed plan.²⁷⁴ Embarq argued that the plan approved by the Commission merely provides Embarq with the opportunity, but no assurance, that the Commission will permit offsetting revenue neutral end user increases.²⁷⁵

While Embarq is correct in that the Commission rejected Embarq’s proposed alternative regulatory plan as filed, Embarq was not required to adopt the plan approved by the Commission. As provided by Virginia Code § 56-235.5 C 2, because the Commission made modifications to Embarq’s proposed plan, Embarq had the option of continuing under its pre-existing alternative regulatory plan. Embarq chose to adopt the plan modified by the Commission as its Modified Alternative Regulatory Plan. More importantly, this Modified Alternative Regulatory Plan provides Embarq with the flexibility of increasing rates, without further Commission approval as follows:

BLETS – Prices may be increased 10% per year, with an overall ceiling based upon BLETS rates as of January 1, 1995, adjusted for inflation as measured by GDPPI.²⁷⁶

OLETS – Prices may be increased 15% per year.²⁷⁷

Bundled Services – No annual limit or cap.²⁷⁸

²⁷¹ *Id.*

²⁷² *Id.* at 90.

²⁷³ Exhibit No. 19, at ¶ 10.

²⁷⁴ Embarq Brief at 90.

²⁷⁵ *Id.*

²⁷⁶ *Embarq 2008 Modified Alternative Regulation* Attachment A, ¶¶ F2 through F5.

²⁷⁷ *Id.* Attachment A, ¶ F6.

²⁷⁸ Schollman, Tr. at 43-44.

Competitive Services – No annual limit or cap.²⁷⁹

In addition, Embarq's Modified Alternative Regulatory Plan permits Embarq to file for revenue neutral rate changes for BLETs, OLETs, or access charges.²⁸⁰ Such rate applications may be approved by the Commission if it finds the proposed revenue neutral rate change to be in the public interest.²⁸¹

Embarq witness Staihr testified that the pricing flexibility for BLETs in its Modified Alternative Regulatory Plan is designed to permit Embarq to "catch-up" with general price increases that have occurred over the past twenty years, or from the time Embarq's BLETs were last increased.²⁸² Dr. Staihr asserted that "it is both reasonable and fair that consumers should pay rates that (begin to) catch up with overall price levels."²⁸³ However, Dr. Staihr's "catch-up" argument is undercut by the fact that Embarq's BLETs rates **have not been frozen**. As Staff witness Cummings testified, "Embarq has had the ability to raise BLETs rates - - perhaps not by as much as they can do now - - since 1998"²⁸⁴ Given the length of time Embarq has had the flexibility to increase rates for BLETs, but has chosen not to utilize such flexibility, I find it reasonable to consider such flexibility may be used as a means of offsetting the loss of subsidies from intrastate access.

Moreover, Dr. Staihr's testimony regarding the reasonableness of increases that begin to reflect overall price increases, stands in stark contrast to the testimony of Embarq witness Dippon that market constraints limit Embarq's ability to increase rates.²⁸⁵ Dr. Staihr emphasized in real terms, BLETs prices actually decreased.²⁸⁶ More specifically, Dr. Staihr stated that BLETs prices have not changed "while the prices of everything else have increased, on average, more than 87%."²⁸⁷ By contrast, Mr. Dippon contended that "Embarq faces strong competition in its nonrural areas, so even if you would try to increase prices it will be severely limited."²⁸⁸ Mr. Dippon offered no studies regarding (i) the level of competition Embarq faces in its nonrural areas; or (ii) whether the pricing flexibility built into Embarq's Modified Alternative Regulatory Plan is unachievable or illusionary. Indeed, the changes made by the Commission to Embarq's requested plan generally lowered the ceiling or extent to which Embarq could increase prices to further protect affordability.²⁸⁹ Thus, if Embarq's proposed plan in PUC-2008-00008 was designed to provide pricing flexibility to offset lost subsidies from intrastate access and the Commission ultimately limited the extent to which Embarq could increase rates, then Embarq can not claim in this proceeding that it will be unable to increase rates to the level provided in its Modified Alternative Regulatory Plan based on the opinion of a witness without further study.

²⁷⁹ *Id.*

²⁸⁰ *Embarq 2008 Modified Alternative Regulation Attachment A, ¶ G1.*

²⁸¹ *Id.*

²⁸² Exhibit No. 22, at 17.

²⁸³ *Id.*

²⁸⁴ Cummings, Tr. at 307-08.

²⁸⁵ *See*, Dippon, Tr. at 106-07, 111-12, 122.

²⁸⁶ Exhibit No. 22, at 17-18.

²⁸⁷ Exhibit No. 22, at 17.

²⁸⁸ Dippon, Tr. at 112.

²⁸⁹ *See, e.g., Embarq 2008 Modified Alternative Regulation at 9-10.*

Therefore, I find Embark failed to present any convincing evidence that the pricing flexibility built into its Modified Alternative Regulatory Plan cannot be utilized to offset reduced subsidies from intrastate access.

Whether the revenue flexibility of Embark's Modified Alternative Regulatory Plan provides sufficient revenues to offset reductions in intrastate access charges depends upon the timing and extent of the proposed reductions, and upon assumptions regarding available additional revenues.

As reported by Embark, its total annual intrastate access revenue associated with the CCLC is approximately [BEGIN CONFIDENTIAL] [END CONFIDENTIAL].²⁹⁰ Based on 2007 actual results, without the CCLC, Embark's intrastate access rates collected approximately [BEGIN CONFIDENTIAL] [END CONFIDENTIAL] more in annual revenues than would have been collected if intrastate access rates were in parity with current interstate access rates.²⁹¹

In his rebuttal testimony, Embark witness Schollmann confirmed that Embark could increase BLETS rates under its Modified Alternative Regulatory Plan by the full 10% per year for [BEGIN CONFIDENTIAL] [END CONFIDENTIAL].²⁹² In addition, the information presented by Mr. Schollmann shows that [BEGIN CONFIDENTIAL]

[END CONFIDENTIAL].²⁹³ Finally, Mr. Schollmann calculated that if BLETS and OLETS are increased by the maximum amount permitted under Embark's Modified Alternative Regulatory Plan [BEGIN CONFIDENTIAL]

²⁹⁴

²⁹⁰ Derived from Exhibit No. 1C, Attached Exhibit V. Centel CCLC revenue of [BEGIN CONFIDENTIAL] [END CONFIDENTIAL] plus United CCLC revenue of [BEGIN CONFIDENTIAL] [END CONFIDENTIAL].

²⁹¹ Calculated by subtracting the annual CCLC revenue derived above from the revenue reduction in intrastate rates to federal level or [BEGIN CONFIDENTIAL] [END CONFIDENTIAL] shown on Exhibit No. 13, HJR Rebuttal Attachment 1.

²⁹² Exhibit No. 5C, Attachment RAS-Reb 1.

²⁹³ *Id.* For example, [BEGIN CONFIDENTIAL]

[END CONFIDENTIAL].

²⁹⁴ Schollmann, Confidential Tr. at 37; *see*, Exhibit No. 6C.

Category	Current Revenue ²⁹⁵	Plan Year 1 ²⁹⁶	Plan Year 2 ²⁹⁷	Plan Year 3 ²⁹⁸
Centel BLETs				
Centel OLETs				
United BLETs				
United OLETs				
Total				
Increase over Curr. Revenue				

Category	Plan Year 3 ²⁹⁹	Plan Year 4 ³⁰⁰
Centel BLETs		
Centel OLETs		
United BLETs		
United OLETs		
Total		
Increase over Plan Year 3		

[END

CONFIDENTIAL].”³⁰¹ I agree with Mr. Schollmann that continued reductions in access lines will impact the results of the calculations shown above, with the impact increasing with each added year. However, the loss of access lines will impact not only future BLETs and OLETs revenue, but will also impact intrastate access revenue.³⁰² Consequently, if Embarq continues to lose access lines, the level of subsidies provided by intrastate access will also decline, thereby reducing the amount of lost subsidy to recover.

²⁹⁵ Exhibit No. 6C.

²⁹⁶ *Id.*

²⁹⁷ **[BEGIN CONFIDENTIAL]**
[END CONFIDENTIAL].

²⁹⁸ **[BEGIN CONFIDENTIAL]**
[END CONFIDENTIAL].

²⁹⁹ As calculated in the prior table.

³⁰⁰ **[BEGIN CONFIDENTIAL]**
[END CONFIDENTIAL].

³⁰¹ Schollmann, Confidential Tr. at 37-38.

³⁰² The impact of the loss of access lines on future interstate access revenues will be significantly higher if the CCLC component is restructured to a per minute rate.

More importantly, the above calculations are not intended to be a precise prediction of Embarq's future revenues or a Commission-directed increase in rates for BLETs and OLETs. Instead, the above calculations are meant to test the reasonableness of relying on the ratemaking flexibility of Embarq's Modified Alternative Regulatory Plan to offset the loss of subsidies provided by intrastate access if the elimination of the CCLC is phased in over three years and intrastate access rates are reduced to current interstate levels in the fourth year. It should be stressed that the above calculations rely only on increases to BLETs and OLETs. Embarq's Modified Alternative Regulatory Plan also provides it with the flexibility to increase bundled and competitive rates, without limit. As stated above, Embarq has the further option of requesting revenue neutral rate changes for BLETs, OLETs, or access charges.

Sprint Nextel witness Appleby raised an issue that appears to mitigate the impact of a reduction of intrastate access rates on Embarq. Mr. Appleby pointed out that Embarq provides long-distance service through bundles to **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** of its residential access lines.³⁰³ Mr. Appleby testified that Embarq provides this long-distance service through a wholesale long-distance provider.³⁰⁴ Mr. Appleby stated that "[i]t is routine industry practice for wholesale long-distance providers to reflect their costs for access in their rates and adjust them in some manner as their own access costs are raised and lowered."³⁰⁵ Thus, a portion of the intrastate access revenues recorded by Embarq are paid to its wholesale long-distance carrier as an expense. Mr. Appleby contended that a portion of any lost access revenues experienced by Embarq, will be offset by reduced expenses for Embarq's retail long-distance provider from Embarq's wholesale long-distance carrier.³⁰⁶ Mr. Appleby estimated that **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** of the **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** reduced intrastate access revenues if Embarq's intrastate rates are lowered to interstate levels will be passed on as a savings to Embarq's retail long-distance business. All other things remaining equal, the access savings passed on to Embarq's retail long-distance business would mean that the net effect of the reduction in intrastate access rates would be about **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]**, based on Mr. Appleby's estimates. Accordingly, the required rate increases would be substantially less than those calculated above.

Embarq witness Schollmann agreed with Mr. Appleby's assessment that a reduction in intrastate access rates would reduce Embarq's cost of providing bundled long-distance service.³⁰⁷ However, Mr. Schollmann contended that Embarq would likely lower its long-distance rates in response.³⁰⁸ In other words, all other things would not remain equal. On the other hand, Mr. Schollman testified that Embarq's long-distance would likely reduce rates for Virginia customers by "only pennies a month."³⁰⁹ Likewise, Embarq witness Dippon agreed with Mr. Appleby, but asserted that Mr. Appleby failed to consider likely reductions by Embarq's long-distance carrier.

³⁰³ Exhibit No. 27C, at 8 n.12.

³⁰⁴ Exhibit No. 26 at 8.

³⁰⁵ *Id.*

³⁰⁶ *Id.*

³⁰⁷ Schollmann, Tr. at 52.

³⁰⁸ *Id.* at 31-32.

³⁰⁹ *Id.* at 32.

The argument that Mr. Appleby brings forth here is correct in its own, but he sort of misses the other part of it.

It's correct – he's correct, there are, strictly seen, cost savings that Embarq incurs by having to pay less to Sprint, but don't forget it also charges less to Sprint. So it's a wash, entirely a wash.

To make matters worse, it is likely that Embarq will have to pass on the cost savings to its consumers, so at the end it's still worse off than it was before. So at a minimum it's a wash. There are no cost savings.³¹⁰

I disagree with Mr. Dippon's characterization of the access savings as a "wash." As demonstrated above, the pass-through of access savings from Embarq's wholesale long-distance provider to Embarq's retail long-distance service reduces the amount of lost intrastate access charge revenues to be replaced with increased revenues from other sources if the loss of intrastate access revenues is treated in a revenue neutral manner. Thus, these savings are more of an "offset" rather than a "wash." Nonetheless, if Mr. Dippon is correct and Embarq long-distance passes all access cost savings to its customers, then at the absolute worst, the level of additional revenues required to replace lost intrastate access revenues, would remain unchanged, or at the [BEGIN CONFIDENTIAL] [END CONFIDENTIAL] discussed above.

It is not necessary to resolve the level and likelihood of wholesale long-distance savings resulting from the reduction of intrastate access charges that will be passed on to Embarq's retail long-distance customers in Virginia. The resolution of that issue is more appropriate for an application for a revenue neutral rate adjustment. In this case, the issue illustrates means other than an increase in local service rates that may be used by Embarq to offset the loss of subsidies from intrastate access.

Therefore, based on the record of this proceeding, I find that the pricing flexibility in Embarq's Modified Alternative Regulatory Plan provides Embarq with a reasonable opportunity to recover any lost subsidies currently collected through intrastate access charges, if intrastate access charges are adjusted to eliminate the CCLC over three years and adopt current interstate access rates in the fourth year.

E. Implementation of a state universal service fund.

Embarq contended that to ensure affordability of telephone service, the Commission should implement a state universal service fund prior to reducing intrastate access rates.³¹¹ Based on the analysis finding of the prior section, Embarq's Modified Alternative Regulatory Plan provides it with a reasonable opportunity to recover any lost subsidies. Embarq's Modified Alternative Regulatory Plan was established by the Commission to protect the affordability of Embarq's rates. Embarq has made no showing that if its intrastate CCLC is eliminated over a

³¹⁰ Dippon, Tr. at 109.

³¹¹ Embarq Brief at 109-10.

three-year period, and intrastate access rates reduced to interstate levels in the fourth year, the resulting rate increases will exceed the affordability levels of its Modified Alternative Regulatory Plan or otherwise produce unaffordable rates. Therefore, I find that the Commission should not establish a state universal service fund prior to reducing Embarq's intrastate access rates.

F. Possible FCC activity.

Embarq reiterated its position that the Commission should not make any final decision in this proceeding if "the FCC on November 4, 2008, or thereafter acts in a manner that potentially harms rural Virginia."³¹² Embarq advised that it would "file a motion or other appropriate pleading at the appropriate time to address any impact between anticipated FCC action and this record."³¹³ If the Commission decides this proceeding and subsequent FCC action has an impact, Embarq may file an application to address such FCC action. I find no reason for the Commission to delay action in this proceeding based on the possibility of FCC action.

Likewise, the recommended change in the fourth year is to reduce intrastate access rates to current interstate access rates. This recommendation recognizes that interstate access rates may change over the next few years. Limiting the recommendation to current interstate rates eliminates any uncertainty that may be otherwise introduced into the analysis. This recommendation is in no way intended to limit any actions that may be taken if interstate access rates are changed in the future.

In summary, Embarq has failed to present a convincing case for the Commission to abandon its movement away from the subsidization of local service through access charges, or for the continuance of its current level of intrastate access charges.

Several recommendations as to how to reduce the subsidies collected through intrastate access charges were made:

Embarq – offered no recommendation regarding the reduction of intrastate access charges.

Sprint Nextel – recommended immediate elimination of Embarq's CCLC and immediate reduction of Embarq's intrastate switched access rates to parity with its interstate switched access rates.³¹⁴

AT&T – recommended that the Commission reduce Embarq's rates towards cost by eliminating Embarq's CCLC and reducing Embarq's intrastate switched access rates to the level of its interstate switched access rates.³¹⁵ In addition, AT&T recommended that the Commission ensure that Embarq has the flexibility to increase rates for local service so it has the opportunity to rebalance the reduction in intrastate access revenues.³¹⁶

³¹² *Id.* at 112.

³¹³ *Id.*

³¹⁴ Sprint Nextel Brief at 4, 34.

³¹⁵ AT&T Brief at 3, 42.

³¹⁶ *Id.* at 3.

Consumer Counsel – stressed the need to protect the affordability of Embarq’s basic local exchange service.³¹⁷ Consumer Counsel recommended that the Commission eliminate Embarq’s CCLC over a reasonably-long transition period.³¹⁸

Staff – recommended that the Commission restructure Embarq’s CCLC to a per minute rate and then eliminate Embarq’s CCLC in no more than four annual steps.³¹⁹

In making its recommendation for immediate elimination of Embarq’s CCLC and immediate parity with interstate access rates, Sprint Nextel relied upon four financial considerations: (i) the pricing flexibility of Embarq’s Modified Alternative Regulatory Plan; (ii) Embarq’s growing revenue from non-regulated services and long-distance service; (iii) access cost savings for Embarq’s retail long-distance service provider; and (iv) Embarq’s existing financial strength.³²⁰ AT&T pointed to the Commission’s elimination of Verizon’s CCLC in less than one year in *Verizon Access* and the Commission’s six months transition period in *CLEC Rules* in support of its request for a brief transition period.³²¹ AT&T also asserted Embarq has been on notice and has had more than a decade to prepare for intrastate access reform in Virginia.³²² Thus, AT&T urged the Commission “to swiftly implement the full reform that it began (and promised to continue) years ago.”³²³

Staff recognized that its recommended phase-in period exceeded the periods established by the Commission in *Verizon Access* and *CLEC Rules*, but contended that starting subsidy levels inherent in Embarq’s intrastate switched access charges “are considerably higher than those of the other carriers.”³²⁴

In assessing the need for a phase-in period, I agree with Staff that significant weight should be placed on the relative level of subsidies collected through intrastate access charges by Embarq. In addition, I agree with Consumer Counsel that the phase-in period should be designed to protect the affordability of Embarq’s basic local exchange service. Because “affordability” was a central consideration in *Embarq 2008 Modified Alternative Regulation*, the price flexibility and limitations of Embarq’s Modified Alternative Regulatory Plan must be a key consideration in determining a phase-in period. On the other hand, because of the differences in fact and circumstances, I disagree with AT&T and find that *Verizon Access* and *CLEC Rules* offer little useful guidance regarding the length of a phase-in period in this proceeding. That is, while *Verizon Access* and *CLEC Rules* set important policy precedent concerning the elimination of subsidies collected through intrastate access, and the need to move intrastate access rates towards cost, the actual pricing of intrastate access for companies such as Embarq remained on a case-by-case basis. Furthermore, I find that a focus on affordability and Embarq’s Modified

³¹⁷ Consumer Counsel Brief at 5.

³¹⁸ *Id.* at 7-8, 10.

³¹⁹ Staff Brief at 8-9.

³²⁰ Sprint Nextel Brief at 25.

³²¹ AT&T Brief at 31-32.

³²² *Id.* at 32-33.

³²³ *Id.* at 33.

³²⁴ Exhibit No. 44, at 20; Staff Brief at 9.

Alternative Regulatory Plan tends to eliminate the usefulness of Sprint Nextel's revenue growth and financial strength analyses. Finally, I find Sprint Nextel's point regarding cost savings for Embarq's retail long-distance service provider to be well-taken, but in need of further development. As discussed above, such cost savings should be explored as part of any revenue neutral filing Embarq may file.

Based upon these considerations, and upon the calculations made above to determine that the pricing flexibility in Embarq's Modified Alternative Regulatory Plan provides Embarq with a reasonable opportunity to recover any lost subsidies currently collected through intrastate access charges, I find that Embarq's intrastate access charges should be adjusted to eliminate the CCLC over three years and adopt current interstate access rates in the fourth year. In addition, because the phase-in period is measured in years, I find that the Commission should adopt Staff's recommendation to immediately restructure Embarq's CCLC to a per minute rate.

Therefore, I recommend that at the beginning of the first year of the phase-in, the CCLC per minute rates for Centel and United should be set based on year-end 2007 line counts, local switching minutes, and two-thirds (2/3) of the current CCLC revenue targets. At the beginning of the second year of the phase-in, the CCLC per minute rates should be reduced by fifty percent. At the beginning of the third year of the phase-in, the CCLC per minute rates should be eliminated. Finally, at the beginning of the fourth year, intrastate access rates should be adjusted to current interstate access rate levels.

FINDINGS AND RECOMMENDATIONS

In conclusion, based on the pleadings of the parties, I find:

(1) That Embarq's intrastate access charges collect a subsidy for local exchange service from all carriers terminating calls to Embarq's Virginia customers;

(2) That the General Assembly, by enacting § 56-235.5:1 of the Virginia Code, has established a pro-competitive, anti-subsidy public policy for the Commonwealth;

(3) That the subsidies collected by Embarq through its intrastate access charges have a detrimental impact on competition in the Commonwealth;

(4) That Embarq's intrastate access rates will exceed costs even if intrastate access rates are reduced to current interstate access rate levels;

(5) That Embarq's Modified Alternative Regulatory Plan provides Embarq with a reasonable opportunity to recover any lost subsidies currently collected through interstate access charges, if intrastate access charges are adjusted to eliminate the CCLC over three years and adjusted to current interstate access rates in the fourth year;

(6) That the Commission should not establish a state universal service fund prior to reducing Embarq's intrastate access rates;

(7) That the Commission should not delay action in this matter in anticipation of possible FCC action;

(8) That at the beginning of the first year of the phase-in, the CCLC per minute rates for Centel and United should be set based on year-end 2007 line counts, local switching minutes, and two-thirds (2/3) of the current CCLC revenue targets;

(9) That at the beginning of the second year of the phase-in, the CCLC per minute rates should be reduced by fifty percent;

(10) That at the beginning of the third year of the phase-in, the CCLC per minute rates should be eliminated; and

(11) That at the beginning of the fourth year, Embarq's intrastate access rates should be adjusted to its current interstate access rate levels.

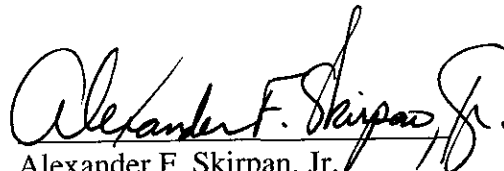
In accordance with the above findings, ***I RECOMMEND*** that the Commission enter an order that:

1. ***ADOPTS*** the findings in this Report; and
2. ***DISMISSES*** this case from the Commission's docket of active cases and passes the papers herein to the file for ended causes.

COMMENTS

The parties are advised that pursuant to Rule 5 VAC 5-20-120 C of the Commission's Rules of Practice and Procedure, any comments to this Report must be filed with the Clerk of the Commission in writing, in an original and fifteen copies, within twenty-one days from the date hereof. The mailing address to which any such filing must be sent is Document Control Center, P.O. Box 2118, Richmond, Virginia 23218. Any party filing such comments shall attach a certificate to the foot of such document certifying that copies have been mailed or delivered to all counsel of record and any such party not represented by counsel.

Respectfully submitted,


Alexander F. Skirpan, Jr.
Senior Hearing Examiner

Document Control Center is requested to mail or deliver a copy of the above Report to:
Douglas C. Nelson, Esquire, and William R. Atkinson, Esquire Sprint Nextel, State Regulatory

Affairs, 233 Peachtree Street, N.E., Suite 2200, Atlanta, Georgia 30303; David Anderson, Esquire, Advantus Law Group, PLLC, 1011 East Main Street, Suite 410, Richmond, Virginia 23219; Mark A. Keffer, Esquire, General Attorney and Associate General Counsel, AT&T Communications of Virginia, 3033 Chain Bridge Road, 3rd Floor, Oakton, Virginia 22185; Eric M. Page, Esquire, LeClairRyan, a Professional Corporation, Riverfront Plaza, East Tower, Post Office Box 2499, Richmond, Virginia 23218-2499; Edward Phillips, Esquire, Embarq, Mailstop NCWKFR0313, 14111 Capital Boulevard, Wake Forest, North Carolina 27587-5900; and C. Meade Browder, Jr., Senior Assistant Attorney General, Division of Consumer Counsel, Office of the Attorney General, 900 East Main Street, Second Floor, Richmond, VA 23219.