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April 4, 2008

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PUBLIC SERVICE
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Ms. Elizabeth O'Donnell
Executive Director
Kentucky Public Service Commission
P.O. Box 615
Frankfort, KY 40602

RE: Case No. 2007-00162

Dear Ms. O'Donnell:

Enclosed please find an original and ten copies of Verizon's Post Hearing Brief. Please indicate receipt of this filing by your office by placing a file stamp on the extra copy and returning to me via our runner.

Very truly yours,

STOLL KEENON OGDEN PLLC

Douglas F. Brent

Enclosures

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COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

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PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF NORTH CENTRAL TELEPHONE COOPERATIVE CORPORATION TO ADJUST RATES AND CHARGES FOR BASIC LOCAL EXCHANGE SERVICE EFFECTIVE NOVEMBER 12, 2007	))))	CASE NO. 2007-00162

VERIZON'S POST HEARING BRIEF

In a series of decisions over the past dozen years the Commission has said it will end the outdated policy of requiring long distance carriers to subsidize the basic service rates of local carriers. North Central Telephone Cooperative Corporation's ("NCTC") rates were set under that outdated policy. As a result, NCTC has very low basic rates but it charges other carriers an astonishing fifteen cents per minute to terminate a call from within Kentucky. That is fifteen times higher than its interstate rate, and triple the intrastate rate NCTC charges in Tennessee. In setting new rates for NCTC, the Commission should correct this anticompetitive situation by lowering access rates.

INTRODUCTION

Verizon provides competitive interexchange services throughout Kentucky through several authorized carriers.[1] Verizon purchases tariffed access services from NCTC in Kentucky and in Tennessee, and, in Kentucky, pays an exorbitant rate for them. NCTC now seeks a basic service rate increase, claiming those rates are below cost. But in twenty-four years NCTC has

[1] MCImetro Transmission Access Transmission Services LLC, d/b/a Verizon Access Transmission Services, MCI Communications Services, Inc. d/b/a Verizon Business Services, Bell Atlantic Communications, Inc. d/b/a Verizon Long Distance, NYNEX Long Distance Company d/b/a Verizon Enterprise Solutions, TTI National, Inc., Teleconnect Long Distance Service & Systems d/b/a Telecom*USA and Verizon Select Services, Inc. (collectively, "Verizon").

not moved its local rates toward their costs. Instead, it kept local rates artificially low using huge subsidies from interexchange carriers.

During this twenty-four year period NCTC not only survived; it has flourished. It has created a CLEC subsidiary. It began providing long distance service and wireless service. It has entered the cable television business. These ventures created such demand that NCTC recently embarked upon a $15 million hybrid fiber-copper network project which will include fiber-to-the-home facilities. This project will "support a full service network enabling North Central to provide a complete array of advanced services including video, high-speed Internet access, virtual private networks, and multiple voice lines to its rural customers."[2] The project will allow NCTC to reach the large untapped broadband market its CEO has already identified.[3] It will also create more new revenue sources from which NCTC can recover its network expenses.

NCTC and its wholly-owned CLEC have already generated millions in earnings[4] from long distance, broadband, video and wireless services. There is no reason for Kentucky long distance carriers and their customers to subsidize NCTC any longer. NCTC's Kentucky access rates must come down.

ARGUMENT

I. A GENERAL RATE CASE IS A PROPER TIME FOR THE COMMISSION TO REBALANCE RATES IN ACCORDANCE WITH ITS WELL-ESTABLISHED POLICY ON NTS COST RECOVERY.

Although NCTC applied only to adjust rates for basic service, in a KRS 278.190 rate case, proposed increases are not considered in isolation, but typically involve a broad

[2] *Application of North Central Telephone Coop. Corp. for a Certificate of Public Convenience and Necessity for the Construction of Fiber Optic Cable in Allen County, Kentucky*, Order granting CPCN, p. 2, Case No. 2007-00432 (January 15, 2008).

[3] Rowland Direct Testimony, p. 7.

[4] Transcript of Evidence, p. 57.

examination of a company's revenues, expenses, and other rates.[5] Consequently, the Commission has determined that this case is an appropriate time for it to review NCTC's access revenues.[6] If the Commission determines to move NCTC's basic local rates closer to their costs, as NCTC has requested,[7] that decision should also require a reduction in switched access rates. Otherwise, the new basic service rates would simply create a windfall for NCTC.[8] Established rate-making principles, as well as the Commission's pro-competitive history, mandate the reduction of NCTC's access rates.

A. Well Established Commission Policy Requires Local Carriers to Recover Expenses from Retail Customers Rather than from Competitors

Before the divestiture of AT&T in the early 1980's, non-traffic sensitive costs for local networks were recovered through separations and settlements processes between AT&T, its subsidiary operating companies, and various independent companies. Those settlements were provided under negotiated "division of revenue" contracts.[9] The initial federal and state "access tariffs" supplanted those "division of revenue" contracts.[10] The Kentucky Commission acknowledged this in 1984 when it first approved intrastate access tariffs.[11] While the "division of revenue" contracts are gone, one vestige remains: outdated subsidies. Because the initial

[5] *See generally Kentucky Industrial Utility Customers v. Kentucky Utilities Co.*, 983 S.W.2d 493, 497 (Ky. 1998).

[6] *Order granting Verizon's Motion to Intervene* (November 27, 2007).

[7] *See* Transcript of Evidence, p. 52, Underhill (financial statements show the carrier is "currently not charging enough to recover their cost.")

[8] Of course, under KRS 278.541-544 the Commission's rate-setting authority is limited to rates for basic service and access services. If NCTC believes other retail rate adjustments are needed, it can accomplish those later on its own.

[9] *See United States v. American Tel. & Tel. Co.*, 552 F. Supp. 131, 196 (D.D.C. 1982).

[10] *See Motion of Cincinnati Bell Inc. for Declaratory Ruling*, 93 F.C.C. 2d 35, 45 (1983); *see also United States v. Western Elec. Co.*, 569 F. Supp. 990, 994 (D.D.C. 1983).

[11] *Investigation of Toll and Access Charge Pricing and Toll Settlement Agreements*, Order Case No. 8838, at 5, 14 (November 20, 1984) (describing the arrangements as prohibited under the Modified Final Judgment).

intrastate access tariffs were intended to be revenue neutral, they effectively locked in the subsidies that were in place as part of the pre-divestiture settlements process. The subsidies were recast by the Commission in the form of intrastate NTS cost allocation factors.[12] Long distance carriers were thus required to pay a large part of the cost of local calling networks by means of Commission-approved tariffs containing these subsidies. NCTC's current NTS rates were set approximately fifteen years ago. Only a few years later the Commission held that these subsidies should be reduced, and then eliminated. But NCTC's rates have never been adjusted.[13]

As an unfortunate result, NCTC's tariffed rate for terminating switched access, derived from the legacy "Non-Traffic Sensitive Revenue Requirement" ("NTSRR"), is among the highest in the state, at nearly *nine dollars per line per month*.[14] NCTC's response to post-hearing request No. 1 shows that NCTC charges Verizon nearly three times as much to terminate intrastate interexchange traffic to NCTC in Kentucky as it charges for the identical service in Tennessee. Furthermore, NCTC's Kentucky intrastate rate is nearly *fifteen times higher* than its Kentucky interstate rate.

NCTC does not claim its costs are higher in Kentucky than Tennessee.[15] Nor does NCTC claim that its Kentucky rate is cost-justified.[16] Surely the rate disparity is not justified by regulatory policy. And there is no irony in the fact that the unregulated Tennessee access rate is far lower than the regulated rate in Kentucky. The Kentucky rate reflects an outdated pricing

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[12] *See Id.*

[13] Transcript of Evidence, p. 52.

[14] Verizon Hearing Exhibit 2.

[15] Transcript of Evidence, p. 51-52.

[16] Transcript of Evidence, p. 49.

philosophy that is a holdover from an obsolete regulatory paradigm, an era that predates meaningful telecommunications competition.

Today, federal and state policymakers and regulators, including this Commission, understand the benefits of reducing unduly high access charges. This Commission has identified a need for access reform and has found that removing subsidies from switched access rates and pricing services more closely to their costs is in the public interest.[17] In approving access reductions for other carriers over the past decade, the Commission has cited such public interest benefits as removing subsidies and pricing services more closely to their costs.[18] Now that NCTC has asked the Commission to review its own rates, it is time for the Commission to apply that policy to NCTC. Rate review for local rates necessarily implicates access rates and non-traffic sensitive cost recovery. As the Commission said more than eight years ago, "The NTSRR is a non-cost based access charge that is used to support local access rates. The Commission has, through other proceedings, used excess revenues . . . to reduce NTSRR and *has an established policy of working to eliminate the NTSRR*."[19] As the FCC has observed, economically efficient competition and the consumer benefits it yields cannot be achieved as long as carriers seek to recover a disproportionate share of their costs from other carriers, rather than from their own end

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[17] *Inquiry into Universal Service and Funding Issues*, Adm. Case No. 360, Order (June 18, 1997); see also Certification of the Carriers Receiving Federal Universal Service High-Cost Support, Adm. Case No. 381 (March 24, 2000) ("*2000 Certification Order*").

[18] *Review of BellSouth Telecomm., Inc.'s Price Regulation Plan*, Order, Case No. 99-434 ("*BellSouth Price Plan Review*"), at 9-10 (Aug. 3, 2000); *see also Tariff Filing of BellSouth Telecommunications, Inc. to Mirror Interstate Rates*, Order, Case No. 98-065 ("*BellSouth Mirroring Order*"), at 4-5 (March 31, 1999); *Cincinnati Bell Telephone*, Case No. 98-292, Order at 13-14 (Jan. 25, 1999).

[19] *2000 Certification Order* at 2, (*emphasis added*).

users.[20] Indeed, the FCC emphasized that such irrational access rate structures "lead to inefficient and undesirable economic behavior."[21] The Kentucky Commission reached a similar conclusion when, almost thirteen years ago, it approved an access rate reduction as part of BellSouth's initial "price cap" plan.[22]

An irrational rate structure such as NCTC's reduces incentives for local entry by firms that might be able to provide service more efficiently than the LEC charging the unduly high access rates, and may as suppress demand for the services of carriers that must pay these rates.[23] Allen County, Kentucky is an example. No carrier has entered the Kentucky market to compete with NCTC's heavily subsidized local rates.[24] Moreover, any interexchange competition there has waned. During cross examination, NCTC's CEO acknowledged that while NCTC's long distance affiliate had tariffed a flat rate "unlimited" long distance calling plan, NCTC does not permit customers to subscribe to it.[25] NCTC could not maintain such a posture if it perceived any competitive threat from interexchange carriers. This rate case provides the opportunity to address that situation by altering NCTC's irrational pricing structure.

Verizon does not propose access rate reductions as a means of reducing NCTC's overall revenues, but to rationalize rate structures. If NCTC has legitimate network costs to recover, it can and should have flexibility to recover those costs through rates for the services it provides to

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[20] *See generally Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Low-Volume Long Distance Users; Federal-State Joint Board On Universal Service*, Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45, 15 FCC Rcd 12962 (May 31, 2000) ("*CALLS Order*").

[21] *Id.*, ¶ 129.

[22] *See Application of BellSouth Telecomm., Inc. d/b/a South Central Bell Tel. Co. to Modify Its Method of Regulation,* Case No. 94-121, Order at 22 (July 20, 1995).

[23] *See CALLS Order*, ¶ 114.

[24] *See* Transcript of Evidence, p. 20.

[25] Transcript of Evidence, p. 18.

its customers. But when the Commission sets NCTC's new basic local service rates, it should also eliminate the patently unreasonable and anachronistic subsidy in NCTC's terminating access rates.

Commission intervention will not be necessary for NCTC to undertake any additional retail rate rebalancing it may deem appropriate after access rates are reduced. Under Kentucky law, NCTC already has total retail pricing flexibility for its nonbasic local and toll services, *see* KRS 278.544(4), as well as for its broadband services, *see* KRS 278.5462(1)(b), and it now has a diverse suite of services and a broader customer base from which to recover its network costs.

B. NCTC'S Bylaws Require that Members, including Interexchange Carriers, be Provided Service at Cost

In accordance with Article I, Section I of NCTC's bylaws, any customer, upon receipt of telecommunications and communications service, instantaneously becomes a member of the cooperative. *See* testimony of Thomas M. Strait, at 5. Verizon receives its access services as a customer of NCTC. Accordingly, Verizon is a member of the cooperative. Like any other member, it deserves to be treated fairly, and in accordance with the cooperative's bylaws. In short, Verizon is entitled to receive cost-based rates for the telecommunications services it purchases.

NCTC claims that Verizon cannot be a member of the cooperative, arguing that Article I, Section 1.2(c) of the bylaws "expressly exclude interexchange carriers from membership in the cooperative."[26] And at the hearing, NCTC's CEO described his company as "democratic" when it comes to rate setting, yet added that Verizon has no voice in that democracy because, "Verizon is not a member of the cooperative."[27]

[26] Sur-reply to Verizon's Motion to Intervene, p.2.

[27] Transcript of Evidence, p. 25.

NCTC is wrong on both counts. Section 1.2(c) of the bylaws states:

> Exchange and interexchange carriers who *participate with* the Cooperative in the provision of telecommunications services to members are neither members nor patrons *by virtue of division of revenue contracts*. (emphasis added)

This language has no applicability whatsoever to Verizon. This section of the bylaws on its face states only that participation in a "division of revenue contract" alone is not sufficient to confer membership on another carrier. But as we have seen, division of revenue contracts are a thing of the past.[28] Verizon and NCTC are parties to no such agreement. Moreover, Verizon does not "participate with" NCTC in providing telecommunications service. In this context, "participate with" means the joint provision of a toll service, *e.g.*, where a Primary Toll Carrier bills all originating toll revenue from NCTC exchanges and shares revenue with NCTC. This speaks to the era before NCTC entered the long distance business on its own ten years ago.[29] Obviously Verizon has no "participatory" relationship with NCTC: the companies are, instead, interexchange competitors (while Verizon is at the same time an NCTC customer).

This section does not apply to Verizon—or, in fact, to modern telecommunications reality at all. Since this section of the bylaws is irrelevant, it affects neither Verizon nor the Commission. Verizon is entitled to the rights of membership, including cost-based rates.

II. IF THE PSC CANNOT DETERMINE THE COSTS OF PROVIDING INTRASTATE ACCESS SERVICE, THE TENNESSEE RATE SHOULD BE MIRRORED ON AN INTERIM BASIS.

NCTC did not file a cost study in this case. NCTC's failure does not, however, prevent the Commission from setting a reasonable rate for intrastate terminating access service. In response to data requests, NCTC disclosed its full rate for terminating access, and separated the NTSRR rate on a per minute basis. These figures, taken from NCTC's response to Verizon data

[28] *See* cases cited in notes 9-11.

[29] *See* Transcript of Evidence, p. 110 (noting year of formation for North Central Communications).

request number 7 and NCTC's response to post hearing request number 1, appear in the table below:

Switched Access Rate, Per Minute	INTERSTATE Originating	Terminating	INTRASTATE Originating	Terminating, Total	Terminating, NTSRR only
Tennessee	$0.01025	$0.01071	$0.03902	$0.03917	none
Kentucky	$0.01175	$0.00976	$0.01394	$0.15023	$0.121359
Rate Difference				**$0.11106**	**$0.121359**

The table demonstrates that NCTC's rate for intrastate termination in Kentucky is 11.1 cents per minute *higher* than the corresponding Tennessee rate. This difference is nearly equal to the NTSRR rate loaded on terminating switched access. There is no NTSRR in Tennessee. The Commission may presume that the terminating rate in Tennessee has a closer relationship to NCTC's costs than the Kentucky rate does, since by definition, the Kentucky NTSRR is non-cost based.[30] Simply by removing the NTSRR-based rate in Kentucky, the Commission will set a rate approximately equal to the rate NCTC charges in Tennessee.

Alternatively, the Commission could simply require NCTC to match its Tennessee rate in Kentucky. Such a requirement would yield a slightly higher rate than complete removal of the NTSRR. Equalizing the rates could be accomplished through a reduction to the NTSRR.

Equalizing the rates would be consistent with NCTC's testimony about its philosophy for rate setting across the state boundary. Two of NCTC's witnesses made the same point. First, Mr. Rowland testified that "it is North Central's policy to maintain uniform rates in Kentucky

[30] *See* cases cited in note 17.

and Tennessee; . . ."[31] Later, at the close of the hearing Chairman Goss asked Mr. Underhill whether it was the intention of the company that the rates set for Kentucky should also apply in Tennessee. Mr. Underhill answered forcefully: "I believe that's correct. Equal service; equal rates."[32] Verizon agrees. NCTC is providing the same access service in Tennessee that it provides in Kentucky. The rates should be the same.

If the Commission requires parity with the current Tennessee rate, as Verizon requests, it should require the new Kentucky rate to remain in effect pending a future rate application. Ordering these changes now will permit NCTC to make appropriate adjustments not only to its basic rates set by the Commission, but also to its nonbasic rates and rates for non-utility services like subscription video and broadband.

[31] Rowland Direct Testimony, p. 4.

[32] Transcript of Evidence, p. 111.

CONCLUSION

NCTC has done a remarkable job of reinventing itself. It has expanded to become far more than a provider of plain old telephone service. It has expanded into long distance, broadband, wireless, and subscription video services. To Verizon's knowledge, NCTC is the first incumbent in Kentucky to begin an exchange-wide fiber-to-the-home project. The reinvented NCTC has no need for, and should not receive, an unreasonably large, outdated access subsidy from interexchange carriers. The Commission should reduce that subsidy in NCTC's rates now.

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the foregoing Motion for Full Intervention has been served by hand on those persons whose names appear below this 4th day of April, 2008.

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