

1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 KRISTIN K. MAYES
CHAIRMAN
3 GARY PIERCE
COMMISSIONER
4 SANDRA D. KENNEDY
COMMISSIONER
5 PAUL NEWMAN
COMMISSIONER
6 BOB STUMP
COMMISSIONER

7
8 IN THE MATTER OF THE REVIEW AND
9 POSSIBLE REVISION OF ARIZONA
10 UNIVERSAL SERVICE FUND RULES,
11 ARTICLE 12 OF THE ARIZONA
12 ADMINISTRATIVE CODE.

Docket No. RT-00000H-97-0137

11 IN THE MATTER OF THE
12 INVESTIGATION OF THE COST OF
TELECOMMUNICATIONS ACCESS.

Docket No. T-00000D-00-0672

13 **RUCO'S REPLY BRIEF**

14
15 The Residential Utility Consumer Office ("RUCO") hereby files its Reply Brief in the
16 above-referenced matter.

17
18 **1. MODIFICATION OF COMMISSION RULES REQUIRES NOTICE OF SPECIFIC
19 RULES AND ANALYSIS OF THE ECONOMIC IMPACT ON ARIZONA RATEPAYERS
20 AND SMALL BUSINESSES.**

21 Several parties have suggested that the Commission may adopt specific amendments
22 and changes to R14-2-1101 et seq. and R14-2-1201 et seq. in this proceeding. RUCO
23 disagrees. The Commission's rulemaking authority is exempt from the Governor's Regulatory
24 Review Counsel ("GRRC"), but must comply substantially with the rulemaking procedures of
the GRRC. See ARS § 41-1057(2). GRRC's procedures require, and the Commission's past
practice has been to require notice of specific proposed rules to the public along with an

1 economic impact statement and a statement of effect of the rules on small business.¹ Id.
2 RUCO respectfully submits that this docket is not a substitute for that process. The
3 Commission has not proposed specific rules in this docket to which the public had notice and
4 opportunity to be heard. Nor has the record been sufficiently developed to identify the
5 economic impact on the public or small businesses. Although the Commission may examine
6 general policies relevant to access charges and the AUSF, to complete the rulemaking
7 process, RUCO submits that the Commission will need to notice proposed rules, provide the
8 supporting impact statements, and provide a notice and opportunity to additional public
9 comment pursuant to the requirements of ARS § 41-1057(2).

10
11 **2. MODIFICATION OF THE SPECIFIC RATES OF UTILITIES REQUIRES A RATE-
MAKING PROCEEDING.**

12 Some of the parties to this proceeding assert that the Commission may promulgate
13 rules which alter the specific access rates and AUSF surcharges. To the extent that a utility's
14 rates and charges must be altered in compliance with a properly promulgated rule
15 modification, those changes to rates may not be effectuated through this rulemaking docket.
16 In order to alter the specific rates of any utility, the Commission will have to hold a fair value
17 proceeding.²

21
22 ¹ The Commission's rules do not prescribe a rulemaking process as required by A.R.S. § 41-1057(2).
23 Nonetheless, the Commission has a well established procedure for its Notice of Proposed Rulemaking. This
24 process includes notification of proposed rules through the Secretary of State, and completion of economic impact
statements as they relate to the rule generally, and on small business in particular. The Commission's review
process also involves an opportunity for public comment.

² *U S West Communications v. Ariz. Corp. Comm'n*, 201 Ariz. 242, 245, 34 P.3d 351 (2001) (holding for CLECs
are public service corporations and therefore subject to the "fair value" requirement in Sec. 14 of the Constitution,
but "fair value" may be used in conjunction with other information in determining rates of a competitive
environment).

1 The Commission may examine the general policy issues related to access charges in
2 this rulemaking proceeding, but any change to a specific Local Exchange Carriers' ("LEC's")
3 access rates would require the Commission to determine the fair value of a public service
4 corporation's rate base as part of a proceeding in which the Commission establishes its rates.
5 If this proceeding will result in modifications to any public service company's access charges or
6 pass through AUSF surcharges, the constitutional requirement to determine fair value would
7 apply. Article XV, § 14 of the Arizona Constitution requires that the Commission ascertain the
8 fair value of utilities' property when setting rates.³ The Arizona Courts have recognized two
9 exceptions to the fair value requirement: 1.) implementation of interim rates to deal with an
10 emergency, and 2.) the adjustment of rates pursuant to an existing rate adjustor mechanism.⁴
11 Our Supreme Court has ruled that even if the Commission believes that a determination of fair
12 value is not useful in setting rates, the Constitution requires ascertaining fair value.⁵ Clearly,
13 the determination of a utility's fair value is a mandatory step in establishing rates which may
14 not be undermined or replaced by this rulemaking docket proceeding on AUSF and Access
15 Charges. Accordingly, RUCO has not submitted proposed rule changes herein, but restricts
16 itself to a discussion of the policy considerations related to any subsequent rulemaking.

17
18 **3. ACCESS RATES SHOULD BE BASED ON COSTS OF THE LOCAL LOOP AND
OTHER JOINT AND COMMON COSTS.**

19 AT&T and Sprint urge the Commission to adopt rules reducing access charges to the
20 interstate rate. AT&T proposed to reduce ILECs' intrastate access rates to interstate rates
21 immediately, but phase in price increases over time to replace that revenue by setting a
22

23 ³ *State v. Tucson Gas*, 15 Ariz. 294, 303, 138 P. 781, 785 (1914); *Simms v. Round Valley Light & Power Co.*, 80
24 Ariz. 145, 151, 294 P.2d 378, 382 (1956); *Scates v. Ariz. Corp. Comm'n*, 118 Ariz. 531, 534, 572 P.2d 612, 615
(App. 1978).

⁴ *Scates*, 118 Ariz. at 535, 578 P.2d at 616.

⁵ *U S West Communications v. Ariz. Corp. Comm'n*, 201 Ariz. 242, 245 ¶ 12, 34 P.3d 351, 254 (2001).

1 maximum annual price increase.⁶ AT&T also recommends capping CLEC rates at ILEC levels.
2 AT&T further recommends a revenue neutral approach whereby rate-regulated carriers can
3 recoup lost revenues from price-capped lines. Sprint asserts that subsidies from access
4 charges are no longer needed, since LECs have expanded the types of retail services they
5 provide over their networks. Sprint also recommends setting LEC access rates at interstate
6 levels but recommends a rule change prohibiting ILECs from recovering lost revenue from rate
7 increases or additional AUSF support.⁷

8 Verizon, Qwest, ALECA and Staff propose immediately reducing LECs' intrastate access
9 charges to Qwest's intrastate rate and permitting LECs to recover lost revenue via increased
10 AUSF funding or rates.

11 RUCO, Cox and CLECs maintain that an immediate reduction of intrastate access rates
12 is premature and unnecessary. If reduction in access rates is contemplated, RUCO asserts
13 that intrastate access charges should be based on the inter-exchange carriers' ("IXCs") fair
14 share of the actual cost of the local loop, and other joint and common costs. If after closer
15 examination, the Commission determines the reduction of access rates is necessary, RUCO
16 proposes the expansion of the AUSF via the inclusion of wireless and broadband providers.
17 RUCO also proposes limiting LECs' recovery from AUSF to just high cost loop expenses of
18 providers with a demonstrable need.

19 Again, with the exception of the CLECs, Cox and RUCO, the other parties' proposals
20 require immediate reduction of switched access rates and ignore the "fair value" and

21 _____
22 ⁶ Rebuttal Testimony of Debra Aron at 79.

23 ⁷ Sprint asserts that the lowering of switched access rates in New Jersey and Massachusetts demonstrates that
24 switched access rates are no longer needed to support high cost loop. High cost loop supported by switched
access rates may not be necessary in New Jersey and Massachusetts due to their population densities which
according to the U.S.Census exceed 500 people/sq.mile. See U.S. Census Population Density Map attached as
Exhibit A. In contrast, Arizona has a reported population density of less than 86 people per sq. mile. Id.
Accordingly, the Commission should not rely on the public utility decisions of the New Jersey and Massachusetts
Commissions.

1 rulemaking requirements imposed by the Constitution and statutes. For all of the reasons set
2 forth in section 2 above, RUCO asserts that a reduction in switched access rates and any
3 corresponding increases to rates or AUSF surcharges need to begin with a “fair value”
4 determination in a rate case.

5 The AT&T and Sprint proposals presume that long distance carriers should only pay for
6 their direct costs, and ignore the legal requirement that long distance carriers contribute toward
7 the appropriate recovery of loop costs and other joint and common costs. As RUCO’s witness,
8 Ben Johnson, pointed out in his direct testimony in Smith vs. Illinois Bell Telephone Company,
9 the U.S. Supreme court rejected the costing approach proposed by AT&T & Sprint. The U.S.
10 Supreme held:

11 In the method used by the Illinois Company in separating its
12 interstate and intrastate business, for the purpose of the
13 computations which were submitted to the court, what is called
14 exchange property, that is, the property used at the subscriber's
15 station and from that station to the toll switchboard, or to the toll
16 trunk lines, was attributed entirely to the intrastate service.... While
17 the difficulty in making an exact apportionment of the property is
18 apparent, and extreme nicety is not required..., it is quite another
19 matter to ignore altogether the actual uses to which the property is
20 put. It is obvious that, unless an apportionment is made, the
21 intrastate service to which the exchange property is allocated will
22 bear an undue burden....⁸

18 The long-standing holding clearly dictates that the long distance carriers not only contribute to
19 the local loop costs, but also other joint and common costs.⁹

21 ...

22 ...

24 ⁸ Smith vs. Illinois Bell Telephone Company, 282 U.S. 150, 151 (August 1923).

⁹ Rejoinder Testimony of Ben Johnson at 10-13.

1 When it adopted the 1996 Telecommunications Act, Congress added an entirely new
2 section to federal law dealing with universal service--Section 254. Within this context, a
3 portion of

4 ¶254(k) reads:

5 [T]he States, with respect to intrastate services, shall establish any
6 necessary cost allocation rules, accounting safeguards, and
7 guidelines to ensure that services included in the definition of
universal service bear no more than a reasonable share of the joint
and common costs of facilities used to provide those services.¹⁰

8 As Mr. Johnson points out in his testimony, Congress was aware of the long-standing
9 debate over the proper treatment of these costs, and the desire of many carriers to shift these
10 costs from toll to local services, as well as the propensity of monopolists to attempt to shift
11 costs onto their most captive customers when faced with an increased threat of competition.¹¹
12 The remaining parts of 254(k) make it clear that the purpose behind these provisions is to
13 prevent placing an excess cost burden on basic local service and other services included
14 within the universal service category. Id. While Congress hasn't mandated the specific
15 allocation procedures to be used, or specified exactly how much of the joint costs can be
16 placed onto the basic exchange category, it is obvious that 100% allocation of these costs onto
17 local exchange service would be contrary to the intent of this passage. Id. Such an extreme
18 shift of cost responsibility would force local exchange service to bear more than a reasonable
19 share of the joint and common costs of facilities used in providing local, access, and other
20 services.

21 AT&T ignores the long-standing Supreme Court holding and the congressional mandate
22 of Section 254, and argues that the FCC has allowed interexchange carriers access to local
23

24 ¹⁰ T: 64-65. See also 47 U.S.C. § 254(k) (1996).

¹¹ Direct Testimony of Ben Johnson at 10.

1 networks without paying much, if any, of the joint and common costs. Id. RUCO
2 acknowledges that wireless carriers have been successful in persuading the FCC to allow
3 them access to local networks without paying much, if any, of the joint and common costs of
4 the network. Id. Likewise, the interexchange carriers have persuaded the FCC to greatly
5 reduce per-minute interstate access charges, and to adopt various other policies that have the
6 effect of shifting costs onto local customers. Id. While the FCC has been persuaded by the
7 arguments of the interexchange and wireless carriers with regard to interstate rates, the
8 Commission should resist reducing intrastate access charges without first carefully
9 contemplating and planning its impact on the AUSF which is funded in part by surcharges
10 based on intrastate toll revenues. Id.

11 To do as AT&T and Sprint suggest would not only violate existing Supreme Court
12 holding, it would be bad public policy. It would permit long distance carriers like AT&T free or
13 nearly free use of local infrastructure and eliminate a substantial source of AUSF support. The
14 cumulative impact of AT&T's proposal would be to foist the entire expense of the high cost
15 loop on ratepayers via increased AUSF pass through surcharges or higher rates. Allowing
16 long distance carriers to increase their revenues with no guarantee that lowered access
17 charges would be passed along to long distance customers¹² and shifting the full costs of the
18 local infrastructure on to Arizona ratepayers is unfair, bad public policy and ignores the body of
19 law requiring interexchange carriers to contribute toward the local loop and other joint and
20 common costs.

21
22 ¹²AT&T and other long distance carriers assert they will pass reduced access charges on to ratepayers. The
23 question is which ratepayers? If reductions were passed on to ratepayers, does that mean Arizona ratepayers
24 who pay for the local loop would receive the benefit? Moreover, to the extent that an Arizona provider says it will
reduce rates to Arizona ratepayers, how will Staff or the Commission monitor the issue? Even if the Commission
could mandate reductions in long distance tariffs, is there any question that Arizona ratepayers will pay more?
AT&T, Verizon and Sprint sell bundled long distance services, the carriers can simply make up for revenue
reductions by increasing the cost of other non-regulated services.

1 Moreover, with the exception of CLECs, Cox and RUCO, the other parties' proposals
2 ignore the need to examine the specific costs associated with providing switched access. In
3 considering the appropriate level of switched access rates, the CLECs argue the switched
4 access charges should be premised on actual costs. RUCO generally agrees that actual costs
5 should be used in developing an appropriate switched access rate. RUCO would agree, as
6 Mr. Johnson testified, that for small carriers like the CLECs a generic economic cost study of a
7 typical CLEC's costs would be sufficient.¹³ However, RUCO believes that the examination of
8 costs in all instances should not be restricted to the IXCs' direct costs.¹⁴ Consistent with
9 applicable case law, RUCO believes switched access charges should cover the cost of the
10 local loop and other joint and common costs. Id. RUCO also urges the Commission to
11 consider the proper allocation of costs between regulated and unregulated services of the
12 affected carriers.

13 RUCO witness, Ben Johnson, testified that there have been favorable downward cost
14 trends in the industry which should not be ignored. Id. at 18-19. He urged the Commission to
15 consider that in more recent years, costs have reduced due to the ability to spread the cost of
16 utility poles and other fixed plant investment across both voice and data traffic. Id. As internet
17 traffic has grown, Mr. Johnson testified that the effective cost per unit of information
18 communicated has continued to decline sharply over time. Id. RUCO asserts that these cost
19 trends should facilitate a downward trend in costs for the ALECA members and the CLECs.

20 RUCO asserts that in examining costs, the Commission should consider the proper
21 cost allocation of overall costs attributable to voice traffic and the costs attributable to data or
22

23 ¹³ T: 68-70. CLECs serve disparate geographic markets and have have long-term contracts with customers which
24 may not be immediately modified. Accordingly, CLECs may not be able to absorb a reduction of switched access
revenues. Commission will need to examine the issue on a case by case basis and consider phasing in any
changes applicable to CLECs. See also. T: 81-82.

¹⁴ Rejoinder testimony of Ben Johnson at 10-11.

1 other unregulated traffic. Because telecom utilities have the ability to use local network
2 facilities for voice and data purposes, the “real” cost of voice traffic may be greatly reduced,
3 and that reduction may not be fully reflected in the cost data reported for intrastate regulatory
4 purposes.

5 ALECA asserts that the Commission should not go through the trouble of examining
6 how unregulated services affect the share of network cost borne by regulated intrastate
7 services. ALECA’s witness, Mr. Meredith testified that:

8 [T]he FCC has prescribed elaborate rules for allocating incumbent
9 LEC’s accounting costs between regulated and unregulated
10 activities. 20 CFR 64. ALECA’s member companies participating in
11 these proceedings, all comply with FCC rules. Therefore all
12 nonregulated activities of the ALECA members have already been
13 removed and should not be a factor in this proceeding.¹⁵

14 The Commission should not assume that the FCC's rules are adequate to deal with the
15 issues that are relevant to intrastate switched access reform.¹⁶ The Commission may examine
16 the appropriate allocation of costs for intrastate switched access reform in the context of a fair
17 value analysis. For the Commission to assume, as ALECA suggests, that all matters are
18 resolved by a vague avowal that costs of data traffic has been appropriately allocated would be
19 abdicating its responsibility to ensure the proper allocation of costs. As Mr. Johnson testified,
20 a cavalier dismissal of this important issue is particularly inappropriate when coupled with the
21 ALECA members' opposition to any form of rate case or regulatory review of their existing
22 earnings. Moreover, Congress does not expect states to abdicate their responsibility to
23 determine intrastate switched access rates. The Commission should, in compliance with the
24 applicable law and Constitutional mandates, examine actual cost of switched access
attributable to voice traffic and that attributable to nonregulated traffic.

¹⁵ Rebuttal Testimony of Donald Meredith at 11.

¹⁶ Rejoinder Testimony of Ben Johnson at 20-22.

1 Recently, the FCC has issued "Connecting America: the National Broadband Plan."¹⁷
2 The Plan includes a 10-year framework for long-term intercarrier compensation reform and
3 interim measures to curb arbitrage.¹⁸ Id. at 144. The first stage of the Plan is to be completed
4 in 2010 and 2011. Id. The second stage of the Plan includes modification of carriers' intrastate
5 terminating switched access rates to interstate terminating switched rates over a period of two
6 to four years between 2010 to 2016. Id. The Plan then calls for phasing out all per minute rates
7 by 2020. Id. Clearly, federal mandates are going to impact any proposal that the Commission
8 may come up with in this docket. In the interest of simplicity and continuity, and in the absence
9 of any pressing or urgent need to modify its rules or hold costly and time consuming rate
10 cases, RUCO urges the Commission to delay any interim changes through this docket which
11 might be nullified or modified by recently announced federal mandates. RUCO is not arguing a
12 delay until 2020. RUCO urges, as do CLECs, Cox and Aleca, that it may be advisable to wait
13 until the FCC rulemaking related to the National Broadband Plan is finalized.

14
15 **4. THE COMMISSION SHOULD NOT LOWER ACCESS RATES WITHOUT REGARD TO
HOW IT MIGHT IMPACT ON UNIVERSAL SERVICE.**

16 With the exception of RUCO, CLECs and Cox, the parties have ignored the potential
17 impact on universal service which may result from proposals to eliminate or significantly
18 reduce switched access rates and recap revenue via AUSF pass through surcharges. Dr.
19 Aron, AT&T's witness states:

20 ...even if increasing retail wireline prices caused some customers
21 to drop their wireline telephone service, this would not necessarily
22 have any effect at all on universal service or telephone penetration
if those customers choose to rely on other technologies to meet
their communications needs. Only to the extent that price increases

23
24 ¹⁷ Exhibit 8-F "The Roadmap for USF/ICC Reform."

¹⁸ RUCO submits that arbitrage will not be eliminated as long as there is any difference between interstate and intrastate access rates. To the extent arbitrage persists, RUCO suggests that a better resolution might be to establish statewide calling scope for local service. T: 77.

1 cause customers to drop their wireline phone and to not subscribe
2 instead to cable telephony, wireless, or some other form of
3 telephony, would retail rate increases possibly impact goals of
4 universal service.

5 Nevertheless, it is certainly reasonable to advise the Commission to
6 “think through the consequences” of reducing access rates and
7 develop a plan to minimize any potential adverse consequences.¹⁹

8 The parties supporting an immediate reduction of switched access rates seem to
9 presume, without evidence, that alternative means of communication exist in all parts of
10 Arizona.²⁰ There is no record here to establish that wireless or VoIP services are readily
11 available or reliable substitutes in rural Arizona. Id. Indeed, the common experience of
12 Arizona residents would dictate otherwise. In less densely populated and rural areas of
13 Arizona, wireless and VoIP are not available or reliable alternatives. The parties have glossed
14 over the inherent differences between wireline service and "alternatives" such as wireless and
15 VoIP service. Id. According to Dr. Johnson, for most customers, wireless (and VoIP) services
16 primarily function as complements to wireline service, rather than direct substitutes. Id. Some
17 customers may purchase wireless service for use while driving around the certain urban or
18 populated centers in the state, or when visiting the nearby towns and cities, but in many
19 remote areas wireless carriers' call quality is grossly inferior to that provided by the regular
20 phone line. Id.

21 There is no evidence in this proceeding concerning call quality in specific locations
22 within the state, or the extent to which wireless and broadband alternatives are available. Id.
23 Absent more evidence concerning these issues, the Commission should not assume that the
24 universal service goal could be maintained even without the state's rural wireline carriers. Id.

¹⁹ Reply Testimony of Debra Aron at 78.

²⁰ Rejoinder Testimony of Ben Johnson at 6-9.

1 The parties proposing immediate reductions in switched access rates also ignore the
2 issue of the pricing and affordability of the alternatives. As Dr. Johnson testified there are
3 significant differences in the way these services are priced. Id. at 8. He testified that wireless
4 and VoIP services typically are provided as a package offering which includes various
5 enhanced services and long distance services. Id.

6 Dr. Johnson testified that the wireless industry continues to price its services with
7 respect to anticipated usage levels. Id. As a result, wireless and VoIP services are generally
8 priced far higher than an incumbent's stand-alone basic exchange service. In contrast, Dr.
9 Johnson testified that wireline services are typically priced on a flat fee (unlimited local usage)
10 basis. Id. As such, the pricing structure of wireline services typically allows users to pick up
11 the phone as often as they want, and allows them to talk to others in their local calling area as
12 much as they want, without having to be concerned they might receive a large bill at the end of
13 the month. Id. Pricing of wireless based on anticipated usage level or bundled pricing
14 represents a significant expense over and above unlimited local calling area basic exchange
15 rates for wireline.

16 RUCO asserts that the proposals to immediately reduce switched access also ignore
17 call quality when comparing wireline service to wireless and VoIP service. Wireline services
18 typically provide higher quality, more reliable communication than wireless or VoIP services.
19 Id. Calls placed over land lines are typically dropped less often than calls placed over wireless
20 facilities. Id. Further, land line calls are less subject to weather interference; structural
21 interference; congestion problems; cross talk and their static, noise, fading, and other aspects
22 of poor sound reproduction. Id. Although wireless service offers the advantage of greater
23 mobility, it does not serve as a close substitute for wireline consumers, particularly those in
24 rural high cost loop areas, who care about having consistently accurate, noise-free sound

1 reproduction. Given a choice between pulling a cell phone out of their pocket or walking across
2 the room to use a conventional phone, consumers will often choose the latter option because
3 of these differences in sound quality and reliability.

4 Even if the minority of people who have abandoned wireline service in favor of wireless
5 or VoIP services is increasing, RUCO maintains that wireless and wireline services continue to
6 be complementary services, rather than close substitutes, especially in rural Arizona. Id. at 9.
7 The Commission cannot simply ignore the public policy benefits of offering universally
8 available, reasonably priced wireline local service throughout the state – nor can the
9 Commission assume that wireless or broadband cable service will provide an adequate, cost-
10 effective alternative to traditional basic local exchange service in rural areas on the record
11 before it. Thus, it is reasonable to continue to provide support for the high cost of providing that
12 service – through intrastate access charges, the AUSF, or a combination of the two.

13 **5. GUARANTEED “REVENUE NEUTRAL” RECOVERY FROM AUSF WITHOUT**
14 **EXAMINATION OF COSTS OR CONSIDERING PROPER COST ALLOCATION**
15 **PROMOTES INEFFICIENCY.**

16 ALECA agrees to decrease its members’ switched access charges without an
17 examination of costs or revenues, as long as its members have the ability to recover all lost
18 revenue from an expanded AUSF. ALECA asserts that its members would lose \$23 million if
19 switched access rates are lowered to Qwest’s intrastate switched access rate.²¹ Many parties
20 agree with ALECA’s position. For all of the reasons discussed above, RUCO disagrees that
21 ALECA members should be allowed to recover 100 percent of the revenue lost due to a
22 reduction in switched access charges.²² Cox and CLECs concur in large part with RUCO’s
23 position. RUCO asserts that the adoption of ALECA’s proposal would lead to greater

24 ²¹ Rejoinder Testimony of Ben Johnson at 18-20.

²² T: 78-80.

1 inefficiency. As pointed out by Mr. Johnson, if the AUSF guaranteed an incumbent LEC with a
2 poorly designed high cost support system a 100% recovery of their “actual” costs--no matter
3 how high--the Commission would simply be preserving the incumbent LEC’s ability to operate
4 poorly. Allowing incumbent LECs to indefinitely preserve any excess profits they may currently
5 be generating without regard to efficiency, would simply promote and attenuate inefficiently
6 operated high cost systems. Id. Clearly, a properly designed AUSF should not guarantee
7 these firms will continue to receive their existing level of revenues and profits, regardless of
8 how high their current profits, or how little effort they make to control their costs.

9
10 **6. AN EXPANDED AUSF SHOULD BE COMPETITIVELY NEUTRAL.**

11 ALECA seeks 100 percent recovery of its high cost loop, but because CLECs are not
12 carriers of last resort (“COLR”) under existing rules, CLECs will not be afforded the same
13 recovery. As Mr. Johnson testified, if the AUSF were to be greatly expanded as suggested by
14 ALECA and structured in a manner which makes it exclusively available to the incumbent
15 LECs, this may largely insulate them from pressures to operate as efficiently as possible, to
16 adopt cost-effective new technologies, and to improve their work processes.²³ Mr. Johnson
17 stated that an expanded AUSF, which is not competitively neutral, would make life easier for
18 the owners and managers of the ALECA member firms, but it would not advance the public
19 interest. Id.

20 Consistent with Mr. Johnson’s testimony, RUCO urges the Commission to restructure
21 recovery from the AUSF in a manner that ALECA members would be provided encouragement
22 and incentives to cut their costs as much as possible, and to continually increase their
23 efficiency. Id. Even if there is little actual competitive entry into rural markets, the threat of
24

²³ Rejoinder Testimony of Ben Johnson 18-20.

1 potential entry may be an important force pressuring these firms to control their costs, and take
2 full advantage of favorable technological trends, thereby ensuring that the AUSF does not
3 place an undue burden on urban customers. Id. RUCO recommends the Commission adopt a
4 properly designed AUSF that is competitively neutral and does not insulate incumbent LECs
5 from the pressures that encourage a typical competitive firm to operate as efficiently as
6 possible.

7
8 **7. THE COMMISSION SHOULD CONSIDER CARRIERS' EXISTING FINANCIAL
9 STRENGTH AND RETURNS BEFORE GRANTING DOLLAR FOR DOLLAR AUSF
10 SUPPORT TO REPLACE LOST SWITCHED ACCESS REVENUE.**

11 ALECA and AT&T argue that AUSF increases can appropriately be authorized
12 automatically on a "revenue neutral" basis to replace lost switched access revenue without
13 looking closely at the earnings of carriers or the impact of growth in internet access and other
14 non-jurisdictional services. A policy of "revenue neutrality" is appealing to carriers, since it
15 protects them from adverse changes in their revenues, but it is not fair to customers because it
16 does not insulate them from rate increases. AUSF (or local rate) increases should not be
17 approved merely because the rate changes would be "revenue neutral." As Mr. Johnson
18 testified, revenue neutrality fails to protect customers from bill increases, fails to ensure that
19 the public interest is protected, and it is not a sufficient basis for waiving the requirement that
20 rate changes be accomplished in the context of appropriate findings concerning fair return on
21 fair value.²⁴

22 Preferably, the Commission should consider reductions in access charges in
23 conjunction with individual rate case proceedings, which would allow the Commission to
24 closely examine all of these issues, including the appropriate allocation of shared network

²⁴ Rejoinder Testimony of Ben Johnson 20-22.

1 costs to internet access and other non-regulated services. Id. at 21. However, if the
2 Commission were to conclude that individual rate proceedings would impose too large an
3 administrative burden, and are not legally required, then it should at least probe into these
4 issues in the context of a future phase of this proceeding, after collecting detailed accounting
5 information from the carriers and providing an ample opportunity for the parties to conduct
6 detailed discovery of that information.²⁵ A detailed, carrier-specific fact finding investigation is
7 needed to ensure that urban customers are not required to make higher than necessary
8 payments into the AUSF. As part of this on-going investigation, the Commission should look
9 closely at the appropriate allocation of loop costs between voice, internet and other
10 unregulated services. The Commission should also consider the LECs' financial strength and
11 revenues from unregulated services when determining a carrier's ability to absorb reductions in
12 switched access revenue. RUCO is not recommending that the Commission capture the
13 benefit of interstate or unregulated revenues. RUCO is recommending the Commission
14 ensure that a fair and equitable amount of the allocated costs are attributed to the interstate
15 and other unregulated services which benefit from universal service.²⁶ More succinctly, local
16 basic exchange rates must be based on a reasonable share of the joint and common costs of
17 facilities use to provide other services.

18 **8. EXPANSION OF THE AUSF SHOULD PRECEDE THE REDUCTION OF ACCESS**
19 **CHARGES.**

20 AT&T argues that access charges are not an effective tool for recovering a portion of
21 network costs and that they should be eliminated by rules adopted through this proceeding.

22 AT&T's witness, Debra Aron states:
23

24 _____
²⁵ T: 79-80.

²⁶ T: 64-66.

1 [Access revenues] create a self-reinforcing downward spiral of
2 support for LECs because high access rates force wireline long
3 distance rates up, which makes wireline long distance service less
4 competitive relative to wireless and other technologies that do not
5 pay access rates to the same extent as do wireline IXCs, or do not
6 pay them at all; customers migrate from wireline to other forms of
7 long distance communication; and access revenues dry up for the
8 LECs that they historically supported.²⁷

9 RUCO acknowledges that the FCC has been expanding the discrepancy between
10 federal and state interconnection compensation policies and placed downward pressures on
11 the support local exchange carriers receive from intrastate switched access charges.²⁸ The
12 FCC has preempted state regulation of wireless and broadband internet access services, and
13 it is allowing wireless carriers to originate and terminate in-state long distance calls on the
14 wireline local exchange networks without requiring these carriers to pay intrastate switched
15 access charges. Id.

16 Due to the pressures exerted by these federal policies, RUCO has acknowledged that it
17 may be helpful to reduce reliance on switched access rates and to concurrently expand
18 reliance on the AUSF as the primary mechanisms used to support the high cost of phone
19 service in rural Arizona. Id. at 12. However, AT&T is putting the cart before the horse. Before
20 the Commission can lower access charges and eliminate or significantly reduce the support for
21 high cost loop, it needs to fortify its AUSF. RUCO has suggested two ways in which to replace
22 AUSF support lost to reduced access charges. Namely, RUCO recommends broadening the
23 scope of the AUSF to include participation from wireless and broadband carriers for its
24 intrastate business, if feasible, and limiting reimbursement from the AUSF fund to high cost
loop providers with a demonstrated need based on an economic cost based benchmark.

²⁷ Rebuttal Testimony of Debra Aron at 80-81.

²⁸ Rejoinder Testimony of Ben Johnson at 11-13.

1 **9. IXCs SHOULD NOT BE ALLOWED TO USE MARKET POWER TO FORCE LECs TO**
2 **ACCEPT LESS THAN TARRIFFED RATES**

3 Evidence presented during the hearing indicated that some of the IXCs used their
4 market power to exact private and secret agreements for less than tariffed rates.²⁹ RUCO
5 submits that the IXCs' actions are inappropriate and emphasize the need for the Commission
6 to retain regulatory oversight over the switched access market.³⁰

7 **CONCLUSION**

8 Contrary to the assertions of the interexchange carriers, the sky is not falling and there
9 is no urgency mandating changes to switched access rates, at this junction. The variations
10 between intrastate and interstate switched access charges is completely understandable and
11 practical when one considers that switched access rates are utilized as a means of ensuring
12 that IXCs contribute to the cost of using Arizona's high cost loop. The FCC's reductions in
13 interstate rates do not necessitate a reduction in intrastate rates.

14 Although a desire to curb arbitrage has been expressed by some of the parties, the
15 solution may well be affected by recent FCC activity. Indeed, the recently issued "Connecting
16 America: The National Broadband Plan," issued by the FCC includes a framework for long-
17 term intercarrier compensation reform and interim measures to curb arbitrage. The National
18 Broadband plan may nullify or seriously impact any steps the Commission may decide to take
19 in this docket. If the Commission accepts RUCO's position that rulemaking and fair value
20 determinations are a necessary predicate to switched access and AUSF reform, the
21 Commission may well decide that its limited resources are better spent on more compelling
22 issues.

23
24

²⁹ R-4 OrbitCom's response to RUCO DR 1.05.
³⁰ T: 59-61.

1 If the Commission determines that switched access reform is necessary, then changes
2 to the AUSF will be necessary. RUCO recommends expanding the AUSF to include other
3 carriers who benefit from universal service, including, but not limited to interexchange, wireless
4 and internet access providers. These changes should be considered before lowering switched
5 access rates to avoid drastic impacts on the rates of residential wireline customers. Moreover,
6 recovery from the AUSF should be limited to highest cost loop providers with a demonstrated
7 need based on actual costs. If determination of actual costs is not possible, then the
8 Commission should limit recovery based on an economic cost benchmark, as opposed to an
9 embedded cost calculation. The economic cost benchmark should be based on a percentage
10 which exceeds the statewide average by some defined percentage, thereby concentrating
11 support on areas with the highest costs. The AUSF support should be portable and
12 competitively neutral.

13 The Commission should reject the notion of revenue neutrality. Although it may appear
14 palatable at first blush, it isn't an adequate basis for developing access reform. Revenue
15 neutrality does not protect customers from rate increases; instead, it merely ensures that
16 carriers are insulated from revenue reductions. Consistent with equity and sound ratemaking
17 principles, if ratepayers are expected to bear some burden of access rate reductions via
18 increases in the AUSF or increased local rates, then carriers should also absorb some of the
19 loss of switched access revenue by reduced profit margins or expanded participation in the
20 AUSF.

21 If switched access reform is contemplated, the Commission should consider the
22 overriding policy goals identified in the testimony of Ben Johnson, including *inter alia*,
23 affordable, high-quality universal basic telecommunications service, fair, just and reasonable
24 rates, including inter-customer equity, rate continuity, economic efficiency and effective

1 competition. Switched access rates should be based on cost of local loop and other joint and
2 common costs, not just direct costs. The determination of just and reasonable rates should
3 include an examination of how costs are allocated between voice, data and other unregulated
4 traffic. Arizona wireline customers should not bear all of the costs of the local loop while
5 holding wireless, unregulated data providers and long distance carriers harmless. In
6 deference to the goal of gradualism, the Commission should consider phasing in changes to
7 cost allocation or reductions to switched access rates, to ameliorate the adverse impact on
8 ratepayers who will be forced to pay higher local rates, or make increased payments to the
9 AUSF.

10 RESPECTFULLY SUBMITTED this 14th day of September, 2010.

11
12 _____
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Counsel

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EXHIBIT A

Population Density for States and Puerto Rico: July 1, 2009

