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BEFORE THE ARIZONA CORPORATION COM.

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AZ CORP COMMISSION  
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IN THE MATTER OF THE COST OF  
TELECOMMUNICATIONS ACCESS

Docket No. T-00000D-00-06 72

ANSWERS OF AT&T TO  
QUESTIONS CONTAINED IN  
DECEMBER 3, 2001  
PROCEDURAL ORDER

AT&T Communications of the Mountain States, Inc., and TCG Phoenix  
(collectively, "AT&T") hereby file their answers in response to the questions contained  
in the Procedural Order dated December 3, 2001.

**I. INTRODUCTION**

It is beyond serious dispute that control of the bottleneck local telephone facilities over which virtually all telephone calls travel gives incumbent local exchange carriers -- which serve more than 90 percent of the nation's local telephone lines and, in most localities, all consumers -- substantial market power over both consumers and potential competitors that need access to those bottleneck inputs.<sup>1</sup> Furthermore, the interconnection cost regime that applies in a particular case depends on such factors as whether the interconnection party is a local carrier, an interexchange carrier, a wireless

<sup>1</sup> The Federal Communications Commission's ("FCC") most recent release of local competition data indicates that competitive local exchange carrier ("CLEC") market share in Arizona is 7%. *Local Telephone Competition: Status as of June 30, 2001*. Industry Analysis Division Common Carrier Bureau, February, 2001. Table 6.

carrier or an enhanced service provider; and whether the service is classified as local or long distance, interstate or intrastate, or basic or enhanced.

Presumably the main focus of this docket is intrastate switched access charges. Nonetheless, references to related issues (*i.e.*, the appropriate cost standard, unbundled network elements, special access services, universal service, section 271 relief, and the interstate reform processes) points out the need to undertake switched access reform in Arizona in the context of what the FCC terms a “unified intercarrier compensation regime.”<sup>2</sup> Such an approach calls for rationalizing disparate regulations and eliminating arbitrary and non-economic differences in pricing.

Economic cost-based charges best serve the public interest by promoting the twin goals of efficiency (in investment and use) and competitive neutrality. This is true regardless of the jurisdictional or regulatory classification of the traffic, carriers, or customers involved and regardless of the networks or technologies used to provide services. Unsurprisingly, therefore, regulatory arbitrage and monopoly abuse characterize the current regime in which switched access charges (and their functional and technological equivalents) are not based upon economic cost.

## II. QUESTIONS AND ANSWERS

### 1. **Should the Arizona Corporation Commission restructure access charges? Why?**

Yes. Arguably, the coincidence of recent radical changes in the telecommunications industry has fundamentally accelerated the need for access charges reform. Specifically, four fundamental changes have occurred that dictate that reductions

in carrier access charges to cost-based levels are now more than ever a prerequisite to sound telecommunications policy on a going-forward basis. These changes include:

- 1) The rapid acceleration in the pace of technological change both in the telecommunications industry and, importantly, in newly emerging industries that will rely heavily on the telecommunications infrastructure to succeed;
- 2) The reintegration and anticipated reintegration of the Bell operating companies ("BOCs"), here Qwest, into in-region interLATA services. This reintegration radically shifts the economic incentives of the industry participants in a number of ways that compel, as a mitigating factor, elimination of above-cost access pricing; (See also question #19.)
- 3) The inescapable fact that 1 and 2 above have created new and robust sources of revenue growth for local exchange companies that, in turn, undermine traditional claims that access cannot be reduced for fear of financial harm; and
- 4) The cost standards established in the Telecommunications Act of 1996 for the implementation of local exchange competition have exposed regulatory rents masquerading as "implicit subsidies" associated with maintaining carrier access charges above their underlying economic cost.

This Commission's experience with the market-opening provisions of sections 251 and 252 of the Act and those for universal service under section 254 of the Act, make obvious the need for prescriptive action for the reform of the access charge mechanism in Arizona.<sup>3</sup> Primarily, access charges set at many multiples of economic cost, *absent*

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<sup>2</sup> *In the Matter of Developing a Unified Inter-carrier Compensation Regime*, CC Docket No. 01-92, Notice of Proposed Rulemaking, FCC 01-132 (April 27, 2001).

<sup>3</sup> In sum, the Commission first addressed sections 251 & 252 (interconnection and UNE pricing) of the Act following on petitions for arbitration by a number of potential new entrants in the fall of 1996. This proceeding culminated in a Commission Opinion and Order in 1998, which established permanent prices for interconnection and UNEs. *In the Matter of the Petition of American Communications Services, Inc., et al., for Arbitration with U.S. WEST Communications, Inc. of Interconnection Rates, Terms and Conditions*, Docket No. U-3021-96-448, et al. (Jan. 30, 1998). (known as the "First Cost Docket Order" or "Decision 60635"). This Decision, and several of the ACC's original arbitration decisions were appealed to Federal District Court, which upheld some of the ACC's determinations and remanded others. *U.S. WEST v. Jennings*, 46 F. Supp. 2d 1004 (D. Ariz. 1999). In turn, several of the District Court's rulings were appealed to the Court of Appeals and are currently pending. The most recent cost proceeding was opened in 2000 with Phase I of this docket, to establish permanent geographically deaveraged pricing for Qwest's wholesale products and services. The Administrative Law Judge's Phase I Opinion and Order was entered by the ACC. *In the Matter of the Investigation Into Qwest Corp.'s Compliance with Certain Wholesale Pricing Requirements for Unbundled Network Elements and Resale Discounts*, Docket No. T-00000A-00-0194, et al., Phase I Recommended Opinion and Order, Nov. 8, 2001. In summary, although Arizona was one of the first states in the 14-state Qwest region to commence a permanent cost case establishing unbundled network element ("UNE") rates (back in 1996), they have remained at such high rates as to

access reform, have provided the State's incumbent local exchange carriers with an unwarranted revenue war chest with which to block competitive entry.

Moreover, the economic literature on the oft-intertwined "subsidy" question indicates that there is no principled basis today for making a decision to tap long distance voice as a subsidy source for local voice, to the exclusion of other potential subsidy sources.<sup>4</sup> At its core, the central question is why voice customers making calls over certain distances should be singled out to pay inflated prices that other calling groups, whether voice or data, are not singled out to pay. Furthermore, empirical evidence in Arizona reveals that consumers who vote with, among other things, their wallets, view toll services to be as *socially valuable* as local service. Table 1 below reports the average revenue per loop in Arizona for local and toll services for 1999, the last date for which these data are available.

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preclude broad-based competitive entry. Addressing section 254 of the Act and Universal Service, the ACC opened a docket in 1997 and various parties filed comments on a review of the pre-Act Arizona Universal Service Fund rules. This docket has been open for four years until it was recently reinvigorated in September 2001 with an invitation for comments and participation in workshops. This same pattern has occurred in access charge reform. On September 30, 2000, the Commission's Utilities Division Staff ("Staff") filed the request for an investigatory docket to determine if access charges reflect the cost of access. This request languished for well over a year before the Staff filed an additional request for a procedural order, which was issued December 3, 2001.

<sup>4</sup> See for example, Alfred E. Kahn. "The Road to More Intelligent Telephone Pricing" *Yale Journal on Regulation*. 1 (1984) at 139-157; D.L. Kaserman and J.W. Mayo. "Cross-Subsidies in Telecommunications: Roadblocks on the Road to More Intelligent Telephone Pricing." *Yale Journal on Regulation* 78 (Winter 1994): at 119-147; Lawrence E. Gasman. "Universal Service: The New Telecommunications Entitlement." *Cato Policy Analysis* No. 310 (1998); Robert W. Crandall and Leonard Waverman. *Who Pays for "Universal Service"? When Telephone Subsidies become Transparent*. The Brookings Institution (2000).

Table 1. Comparison of End-User Revenues for Local and Toll Services  
(1999 \$ / USF loop/ month)

Service	Ave. \$/month/loop
Local	\$ 28.60
SLC	\$ 5.45
<i>Subtotal Local</i>	<i>\$ 34.05</i>
IntraLATA toll	\$ 6.83
InterLATA toll	\$ 36.95
<i>Subtotal Toll</i>	<i>\$ 43.78</i>
Total Local & Toll	\$ 77.83
%Toll	56.25%

Source: *State by State Telephone Revenue and Universal Service Data*. April, 2001.

Federal Communications Commission Industry Analysis Division Common Carrier Bureau. Table 5, at 17.

On a per loop basis, the average monthly expenditures in Arizona for toll services exceed those for local service, comprising approximately 56% of the combined total.

One must conclude, inescapably, that long distance calling has transcended the notion of a “luxury” service in Arizona.

Finally, states, Arizona included, are not closed economies. What each state does or does not do with the Act and the FCC’s rules that implement it, including the reform of switched access charges, is critical to the development of competition and each state’s position in the national, hence global, economy.

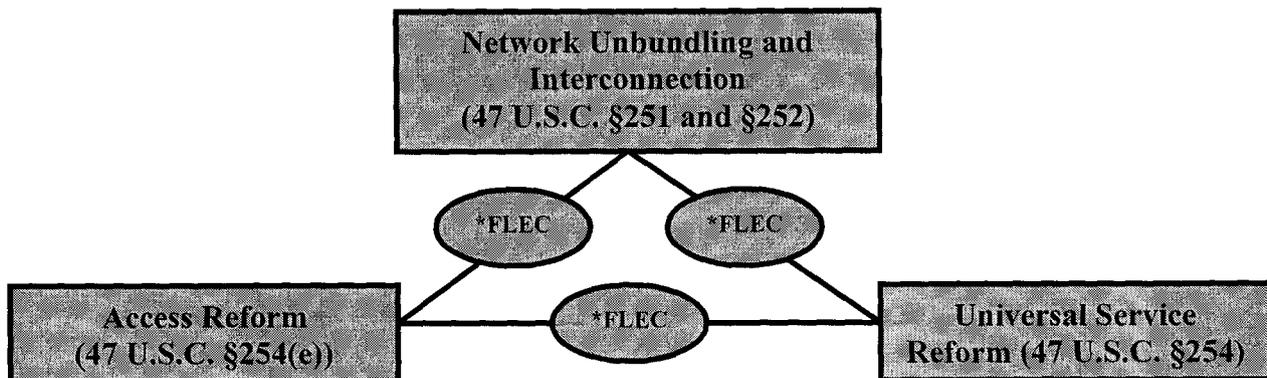
**2. What recommendation to the Commission would AT&T make regarding how intrastate access charges should be reformed?**

AT&T’s recommendation for reform necessarily begins by placing Docket No. T-00000D-00-0672 squarely within the context of the Act and the FCC’s rules that implement it.

Access Reform in Light of the Act and the FCC's Rules

The general purpose of the 1996 Act is, in pertinent part, "to promote competition and reduce regulation in order to secure lower prices and higher quality services for American telecommunications consumers."<sup>5</sup> The FCC's rules that implement the Act comprise three fundamental sets of reform -- the "competition trilogy."<sup>6</sup> The underlying cost logic linking the three reforms is forward-looking economic cost.<sup>7</sup> Figure 1 below is a model of the FCC's national deregulatory framework reflecting (a) the three sets of fundamental reforms, complete with statutory references, (b) the inextricable linkage between and among the reforms, and (c) the temporal precedence for implementation of the three reforms.

**Figure 1.** *The Competition Trilogy*



**\*FLEC = Forward Looking Economic Cost**

Of the three reforms required by the Act and depicted in the model in Figure 1 above, network unbundling and interconnection is the logical precursor to the other two.

<sup>5</sup> 47 U.S.C. §151 *et seq.*

<sup>6</sup> *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket No. 96-98, First Report and Order, FCC 96-325 (rel., Aug. 8, 1996) ¶¶ 6-9 ("Local Competition Order").

<sup>7</sup> 47 U.S.C. §252(d)(1)(c)(3)(i). *Local Competition Order*, ¶ 690 *et seq.*; *Universal Service Order*, ¶ 250(1)-(10).

This is because network elements, whether combined for the provision of basic local services or disaggregated into individual elements for the provision of access services, are functional and technological equivalents. Regulators, therefore, must recognize (and price accordingly) that the existing distinctions in the wholesale inputs for switching and transport UNEs for the provision of local services, and the wholesale inputs for the provision of toll services (*i.e.*, switching and transport access services) are the residual of law and public policy, not of technology and/or economic orthodoxy. That is, “a minute is a minute,” whether that minute is a local minute or a toll minute. Thus, the existing patchwork of regulations that govern the charges a carrier may impose for the transport and termination of traffic originated by customers of other carriers must be rationalized.

Under the 1996 Act and the FCC’s rules, the task of the state regulator changed significantly. Instead of regulating, hence, maintaining for an indefinite period, the monopolist local exchange carriers, regulators are to manage the transition to competition. The reform of carrier access charges is a critical component of that management function. But, more than six years after the passage of the Act, experience has shown that while the FCC’s original strategy is sound, state commissions need to be actively involved in assuring the practical and timely implementation of federal and state law and regulations. What the FCC stated in 1996 at the outset of the reform process is no less true in Arizona today:

Only when all parts of the trilogy are complete will the task of adjusting the regulatory framework to fully competitive markets be finished. Only when our counterparts *at the state level* complete implementing and supplementing these rules will the complete blueprint for competition be in place<sup>8</sup>

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<sup>8</sup> *Local Competition Order*, ¶ 9 (emphasis added).

To transition from monopoly to competition in the provision of local services, it is critical that the entire “solution” be implemented by regulators before further deregulation of the incumbent monopoly proceeds. To do otherwise would be to eliminate the existing regulatory apparatus “without addressing the current state of the market and infrastructure investment thus substituting an unregulated monopolist for a regulated one. While the latter is a problem, the former is likely to be far worse. And, it is simply not a viable option to consider unregulated monopoly control of our telecommunications and information infrastructure.”<sup>9</sup>

#### Policy Options for Access Reform

Access charges should be reformed consistent with the twin goals of efficiency (in investment and use) and competitive neutrality, thus eliminating arbitrary and non-economic differences in pricing. First, without addressing concerns about lost revenue (more about this later), the Commission has multiple policy options at its disposal for the wholesale pricing of switched access including but not limited, to the following:

- Elimination of the non-cost based carrier common line (“CCL”) as the initial action (*see also #5 below*).
- Mirroring of interstate switched access rates -- rural and non-rural (*see also #9d and 20 below*).
- Use of a cost proxy model for the determination of switching and transport rates for all incumbent carriers (*see also #8*).
- CLEC access capped at non-rural carrier rates (once reformed) (*see also #9e and #16 below*).

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<sup>9</sup> James K. Glassman and William H. Lehr. "Competition in Telecommunications and Economic Growth." July 2001, at 8-9.

### Access Reform Is Not Reliant On A State Universal Service Fund

Solely from the standpoint of establishing wholesale prices for switched access services, AT&T urges the Commission to set rates at economic cost *without* reliance on the state universal service fund as a revenue make-whole mechanism. To the extent that the carriers insist that universal service and access charges are hopelessly intertwined, it will be necessary to examine all operating revenue and all current and proposed support mechanisms.<sup>10</sup> This is to ensure that Arizona's consumers will not be taxed for other consumers that are already profitable for these carriers to serve.

**3. Does AT&T recommend the Commission address both switched and special access in an access charge reform proceeding?**

No. Because switched access charges are more directly related to the opening of the local markets for residential and small business consumers in Arizona, the single outcome of this proceeding should be the reform of intrastate switched access charges *and* this should be addressed for all local exchange carriers.

That said, however, special access charges should be viewed as the functional and technological equivalent of high capacity (*i.e.*, DS-1 and DS-3) UNE loops. "Reform" of these access services merely requires the Arizona Commission to lift the current use restrictions.

**4. Parties who desire that switched access charges be reformed often state that switched access charges in general, and the CCL rate element in particular, contain implicit subsidies. Does AT&T agree with this statement?**

Not Necessarily. Although as implied by the question, an interdependency *may*

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<sup>10</sup> This includes current federal high cost support, expanded federal high cost support contemplated by the RTA Report and other taxpayer subsidy mechanisms such as low interest RUS loans.

exist between access charges and universal service (*i.e.*, basic local exchange service), a clear goal of the 1996 Act (specifically, section 254 (e)) is to replace the complex and arcane system of cross subsidies that are implicit in the prices charges for various telecommunications services with a simpler and explicit subsidization mechanism to support the policy objectives of universal service contained in section 254 (b). The Arizona Commission should approach this issue cautiously and avoid adopting prematurely the rhetoric that labels every price above cost an “implicit subsidy.” Some high prices are simply high prices – *precisely* the condition that the competition envisioned by the Act was intended to correct. Alternatively, the commission should begin by defining an “implicit” subsidy as an *implied, alleged, or unproven* subsidy. Significantly, the 1996 Act does not use the term “implicit”, and no more precise definition is required at this time.

Recalling the genesis of “universal service,” much needed light is shed on the debate surrounding so-called “implicit subsidies.” Universal service is a concept that was first advocated by the Chairman of the Bell System, Theodore Vail. At its inception, the concept of “universal service” was a commercial goal -- a goal to establish the Bell System as a monopoly provider of phone service to as many customers as possible. As recounted by its Chairman,

The Bell Company, from the commencement of the business intended to control the business. The intent is not only claimed by all who were parties to the management at the time, but is shown in every record of every transaction in the course of business. *One system, one policy, universal service* is branded on the business in the most distinct terms.<sup>11</sup>

To promote network subscribership, the Bell System’s commercial self-interest

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<sup>11</sup> Brock, Gerald, 1981 *The Telecommunications Industry: The Dynamics of Market Structure*, (1981) at 12 (emphases in the original).

established its pattern of local exchange pricing. For example, as long ago as 1877, the price for a set of telephones was \$40.00 per year for a business and \$20.00 per year for a residence. This pattern has been continued by regulators, but it is one they did not invent. And today, the overall pricing strategy is to have a relatively low fixed price to connect to the network (*i.e.*, for basic service) with relatively higher prices for other “optional” services. In addition, most local tariffs have higher rates in metropolitan areas than in rural areas and higher rates for business than for residential customers.

These pricing patterns do not necessarily mean that residential consumers are subsidized in Arizona today. Whether residential customers are subsidized today depends solely on whether the revenue received from vertical and other services covers the cost to serve and connect them.

Finally, the belief that elevated access charges act to advance the cause of universal service flies in the face of both theoretical considerations and recent empirical evidence indicating that excessive access charges *do not*, in fact, promote increased subscribership to the network. Because the subscribership decision turns upon the total value a household receives from both end-user access and usage (where the latter includes both long distance and toll), a tax on long-distance usage -- which is relatively price elastic -- that is used to subsidize the end-user access, local usage bundle -- which is extremely price inelastic -- is unlikely to increase the number of households opting to subscribe. Indeed, due to the relative elasticities involved, it is quite possible (perhaps even likely) that the historical system has actually lowered subscribership after accounting for other influences. That is, the traditional system of taxing long distance services (by overcharging for carrier access) to provide “implicit” (and untargeted)

subsidies to local exchange services may well have interfered with one of the (if not *the*) principal objectives of universal service -- increasing subscribership. Thus, not only have excessive access charges fostered substantial economic inefficiencies and subverted more rapid growth of local exchange competition, they have not even served the primary purpose for which they were allegedly intended.<sup>12</sup>

## **5. Can implicit subsidies be quantified?**

Probably not with any certitude. But, subsidies, real or imagined, need not impede access reform. The relevant question and what can be quantified for purpose of these comments is: What is the difference between switched access priced at economic cost and the current rates? Whether that difference comprises excess contribution, implicit subsidy or some combination thereof requires an earnings investigation for each carrier. Regardless, that difference needs to be eliminated from access charges.

### **a. What is the appropriate cost standard to be used to determine whether access charges are free of implicit subsidies?**

The appropriate pricing rule for the rate elements comprising intercarrier compensation (including carrier access charges for switching and transport) is forward-looking economic cost. The CCL component of the current intrastate access regime in Arizona is not cost-based and, therefore, a cost standard *per se* is non-existent.

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<sup>12</sup> See for example, David L. Kaserman, John W. Mayo and Joseph E. Flynn, "Cross Subsidization Telecommunications: Beyond the Universal Service Fairy Tale." *Journal of Regulatory Economics*, 2 (Sept. 1990), at 231-250 See also review of literature on the demand for basic telecommunications service reviewed in *Who Pays for "Universal Service"? When Telephone Subsidies become Transparent*, by Robert W. Crandall and Leonard Waverman, Brookings Institution (2000).

**b. What cost standard is used to set interstate access charges?**

In the interstate jurisdiction, the guiding principles of access reform for more than decade have been predicated on two inextricably linked economic principles: (a) cost-based pricing, and (b) cost causation. The logic inherent in the notion of economic cost is that it "looks not to the past -- not how we got where we are -- but to the future: efficiency requires that prices tell customers what incremental resources society *will* use if they take more of a good or service in question, what resources society will save if they consume less of it."<sup>13</sup> And, residing at the heart of the efficiency criterion is accountability (here, cost causation). That is, those who make purchase decisions, and who presumably receive all the benefits of their decisions, should also bear all of the costs of their decisions. To do otherwise is to diminish efficiency, to diminish output relative to input, or in the jargon of economics, diminish the bang for the buck.

Since the passage of the 1996 Act, access reform undertaken by the FCC, for rural and non-rural carriers alike, has driven toward achieving both a rate design and rates that more closely adhere to the principles of rates set at economic cost and cost causation.

- With respect to price cap carriers (generally, non-rural carriers), the most recent action taken to rationalize interstate rates is the adoption by the FCC of the proposal put forth by the Coalition for Affordable Local and Long Distance Service ("CALLS").<sup>14</sup> The target average traffic sensitive ("ATS") rates for Arizona's non-rural carriers is \$0.0055/minute for Qwest, and \$0.0095 for Citizens.
- With respect to rate-of-return (generally, rural) carriers, reform has been furthered by partial reliance on a proposal crafted by the Multi-Association Group (MAG), but it nonetheless is intended to "bring to the American public the benefits of

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<sup>13</sup> Alfred E Kahn and William B. Shew, "Current Issues in Telecommunications Regulation: Pricing." *Yale Journal on Regulation* 4 (2) Spring 1987, at 224.

<sup>14</sup> *In the Matter of Access Charge Reform*, CC Docket No. 96-262; *Price Cap Performance Review for Local Exchange Carriers*, CC Docket No. 94-1; *Low Volume Long Distance Users*, CC Docket No. 99-249; *Federal State Joint Board on Universal Service*, CC Docket No. 96-45; *Sixth Report and Order*, in CC Docket Nos. 96-0262 and 94-1; *Report and Order* in CC Docket No. 99-249; *Eleventh Report and Order* in CC Docket No. 96-45 (rel., May 31, 2000) ("*CALLS Order*").

competition and choice by rationalizing the access rate structure and *driving per minute rates toward lower, more cost based levels.*"<sup>15</sup>

Generally, both sets of reform address cost causation by increasing subscriber line charges for those access rate elements that have no underlying cost basis, such as the carrier common line, and driving traffic sensitive rates, such as local switching, closer to economic cost.

**c. Is this cost standard appropriate for intrastate rates?**

Yes. Assuming that economic cost based charges best serve the public interest by promoting the twin goals of efficiency and competitive neutrality, it follows that this is true regardless of the jurisdictional or regulatory classifications of traffic, carriers, or customers involved and regardless of the networks or technologies used to provide services. Economic cost is the appropriate cost standard for all jurisdictions and for all rate elements comprising intercarrier compensation generally and access charges specifically. Thus, the appropriate pricing rule for switched access rates elements (*i.e.*, switching and transport) is economic cost.

There is no appropriate cost standard for the CCL. But, to the extent that the Commission determines that this revenue stream is necessary to achieve other public policy goals, it should be recovered from the cost-causer, *i.e.* the end user. In the interstate jurisdiction, the application of this principle has resulted in first the creation of,

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<sup>15</sup> *In the Matter of Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256; *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45; *Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation*, CC Docket No. 98-77; *Prescribing the Authorized Rate of return for Interstate Services of Local Exchange Carriers*, CC Docket No. 98-166; *Second Report and Order and Further Notice of Proposed Rulemaking*, in CC Docket No. 00-256; *Fifteenth Report and Order*, in CC Docket No. 94-45; and *Report and Order*, in CC Docket Nos. 98-077 and 98-166; rel., Nov. 8, 2001. ¶ 1 (emphasis added).

and thereafter increases in, the subscriber lines charge. A similar rate design is appropriate for purposes of intrastate access reform.

**6. Should interexchange carrier switched access charges exist?**

Yes. There is a legitimate cost involved when a carrier uses another carrier's network for the origination or termination of traffic. This cost is applicable to interexchange, local, or ISP-bound traffic, thus access charges are a significant component of a unified intercarrier compensation regime.

**7. AT&T's estimate of the extent to which access is priced in excess of economic cost in Arizona.**

Employing the CALLS ATS target rate of \$.0055/ AMOU as a proxy for cost, AT&T estimates the difference between access priced at this proxy cost and the current rates charged by incumbent LECs in Arizona at \$156 million annually. The data used to produce this estimate are summarized in the Table 2 below. Estimates are reported for Qwest, Verizon, Citizens, and the remaining rural carriers reported as a single entity.

Table 2.

Estimate of Arizona ILEC's Excess Contribution from Access Charges

Company	Total Access Revenue (\$000's)	Switched MOUs 1999 DEMs ( 000's)	Switched Access Rate/mou	Proxy Cost	Excess contribution/ mou	Total
	(a)	(b)	a/b = (c)	(d)	c-d = (e)	b x e = (f)
Qwest	\$121,079	2,616,715	\$0.0463	\$0.0055	\$0.0408	\$106,762
Verizon/GTE	\$2,593	21,610	\$0.1200	\$0.0055	\$0.1145	\$2,474
Citizens Group	\$41,592	462,130	\$0.09	\$ 0.0055	\$0.0845	\$39,050
Rural LECs	\$8,313	83,133	\$0.10	\$0.0055	\$0.0945	\$7,856
<b>TOTAL</b>	<b>\$173,577</b>	<b>3,183,588</b>	n/a	n/a	n/a	<b>\$156,067</b>

The calculation of excess contribution for each carrier is reported in column (f) of Table 2. For each carrier, total switched access revenue (column a) is divided by total switching minutes (column b) to determine the current average switched access rate per mou (column c). Excess contribution per mou (column d) is the difference between the proxy cost (or \$0.0055 in column e) and the current switched access rate per mou (column c). Total excess contribution for each carrier is calculated by multiplying the excess contribution rate/mou by total switching mous.

**a. Data Sources and Assumptions used in Developing the Estimate.**

Categorization of Companies. AUSF Rules designate carriers by three categories --

“large,” “medium,” and “small.”<sup>16</sup> For access reform, this system is unnecessary.

Instead, alignment with the interstate definitions, “non-rural” and “rural” suffices and adequately covers all carriers. That is, Qwest and Citizens are “non-rural,” and the remaining carriers are “rural.”<sup>17</sup>

Sources of Access Revenue Data. For Qwest and GTE/Verizon, ARMIS 43-03

Regulated/Non-regulated Revenue, account 5084 State Access is employed. Although data is available for 2000, the data contained in Table 2 is the 1999 Report for consistency with the data for switching mous.

For the Citizens Group and the rural LECs, revenue was estimated by multiplying switched minutes of use by the average switched access rate derived from published tariffs.<sup>18</sup> A weighted average for the 11 rural LECs was calculated using the actual DEM minutes.

Source of Switched MOUs. For all LECs, 1999 State Toll Dial Equipment Minutes (“Intrastate Toll DEMs”) found in the FCC’s Universal Service Monitoring Report,

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<sup>16</sup> A.A.C. R14-2-1201.11-13 (“Definitions”).

<sup>17</sup> The Citizens Group consists of three companies: Citizens Utilities Rural Company, Inc. with an FCC operating company COSA of “CTRC”; Citizens Utilities Company, f/k/a Citizens Telecommunications of Arizona (a/k/a/ Citizens Communications Company of the White Mountains with an FCC operating company COSA of “CTWM”); and Citizens Navajo Communications Company, Inc. with an FCC operating company COSA of “CTNT”. The list of incumbent LECs on the Arizona Corporation Commission’s website there are actually four (4) companies listed for Citizens which share the same corporate address in Salt Lake City: # T-1954B – Citizens Communications Company of Arizona; # T-03213A – Citizens Telecommunications Company of Arizona; # T-03214A – Citizens Telecommunications Company of the White Mountains Inc.; and # T-02115A – Navajo Communications Company, Inc. AT&T was unable to reconcile this number of companies with the FCC information indicating only three (3) Citizens companies operating in Arizona. See, FCC ARMIS Report 43-05, Table V – State Complaints for Years 1993 – 2000, and the FCC’s Universal Service Monitoring Report for October 2001, Table 8.8 “State Toll Dial Equipment Minutes by Study Area” for 1999. The rural LECs in Table 2 consist of the remaining 11 companies from the FCC’s Universal Service Monitoring Report for October 2001, Table 8.8 “State Toll Dial Equipment Minutes by Study Area” for 1999. Those not included are Tohono O’odham and Saddleback Communications.

<sup>18</sup> For example, per the tariffs, the access charges for a two-sided call for Citizens Telecommunications Company of Arizona is \$ 0.2829 (\$ 0.1013 for the originating side and \$ 0.1816 for the terminating side). To arrive at the switched access charge/MOU (for either side), we divided \$ 0.2829 by 2, which yields \$ 0.1415/MOU.

October 2001, Table 8.8 "State Toll Dial Equipment Minutes by Study Area" for 1999.<sup>19</sup>

**8. Should access charges be set at the same rates as unbundled network elements for the same network elements and functionalities?**

This is one viable policy option that is available for Qwest and for that portion of the Citizens operating territory that was formerly GTE. The problem with this approach arises with Arizona's rural carriers. UNE rates for switching and transport have not been determined for these carriers and to adopt such a methodology for them would require time-consuming and costly UNE proceedings for each carrier.

**9. Responses to the following questions will assist the Commission in determining how to proceed with this case from a procedural perspective.**

- a. What procedure does AT&T recommend be used to address switched access charge reform? For example, would you recommend a generic proceeding to address the issues in general with the objective being the reform, restructure and resetting of switched access charges for every LEC in the State?**

AT&T recommends a procedure that ultimately produces a solution encompassing every LEC in the state.

- b. What issues should be addressed in a proceeding to determine whether and to what extent intrastate access charges ought to be reformed?**

See questions 1 and 2.

- c. Should the Commission limit the initial switched access charge proceeding to the largest ILECs in Arizona?**

No, all LECs should be included.

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<sup>19</sup> Available at [http://www.fcc.gov/Bureaus/Common\\_Carrier/Reports/FCC-State\\_Link/Monitor/mrs01-0.pdf](http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/Monitor/mrs01-0.pdf)

- d. Should the Commission address access charge reform for large, intermediate and small local exchange companies (as defined in the Commission's Arizona Universal Service Fund rules) individually? Please explain.**

No. This proceeding should align Arizona ILECs with the definition of rural carrier as set forth in 47 U.S.C. 153 § 3(a)(47); and, hence, all others (here, Qwest and Citizens) are "non-rural."

- e. Should this proceeding address switched access charges assessed by CLECs and/or other telecommunications companies?**

Yes. See (c) above and #16.

- f. How much time do you expect would be required to complete the proceeding?**

After procedural issues are addressed, no more than six months if no earnings investigations are needed and this proceeding remains bifurcated from the universal service fund rulemaking docket.

- 10. For companies that provide access service, please provide the dollar amount of revenues from switched access charges received by rate element, by month, for the period July 1, 2000 through June 30, 2001.**

Confidential information.

- 11. For companies that purchase access service, please provide the dollar amount of the payments for switched access charges made (by company, rate element, and month if possible) for the period July 1, 2000 through June 30, 2001.**

Confidential information.

**12. Is it possible to eliminate the potential that local exchange service providers can exert monopoly power in the access service market by assessing the switching, transport and CCL charges on the end users rather than on interexchange carriers?**

Preliminarily, the elimination of monopoly power in any market requires competition, and there can be no competition without competitors. It is not feasible for competition to establish itself in the face of an entrenched incumbent without a proactive regulatory framework. The current switched access charges regime is resistant to the implied market-based solution because, as argued in a recent Staff White Paper prepared for the Minnesota Commission:<sup>20</sup>

1. Access service prices (and indeed the very service) are invisible to the consumer and such lack of awareness can be a significant impediment to competition;
2. The toll call originator (the purchasing consumer) “has no control over the LEC that terminates the call and, hence, cannot affect the price of terminating access (even if the originator is aware of it).” Also, the access rates on the terminating side of a call are often well above the rates on the originating side;<sup>21</sup>
3. Access rates charged by LECs are in tariffs available to all IXCs on a non-discriminatory basis. Thus, an IXC cannot bargain for a better deal on CCL, for example. Any reform of CCL or switched access rates must apply to the entire community of access purchasers; and
4. The mandate that toll providers must offer statewide toll rates discounts any one LEC’s efforts to reform its access.

All said, shifting costs to the cost-causer is a step toward competitive neutrality so long as (a) the full measure of the revenue stream associated with that cost is fully

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<sup>20</sup> *In the Matter of a Commission Investigation of Intrastate Access Charge Reform*, Docket No. P-999/CI-98-674, O’Grady, Kevin, 2001. “Intrastate Access Charge Reform: Staff Discussion Paper and Proposal.” Before the Minnesota Public Utilities Commission, at 30 & 31.

<sup>21</sup> Arizona LECs are not exceptions to this rule. For example, Citizens Telecommunications Company of Arizona charges approximately 18.2 cents/mou on the terminating side of a toll call and 10.13 cents/mou for originating access.

portable to the carrier that wins the customer, and (b) the cost is recoverable in manner that is permissive rather than mandatory.

**a. Could customers then shop for local exchange service customers for the least cost provider of access in addition to local service, etc.**

Given the constraints outlined above and on a broad scale, this hypothetical is realistic only when access charges are readily identifiable by consumers. Such an outcome is possible if a portable and permissive (*i.e.*, not mandatory) subscriber line charge replaces the excess contribution (in part or in whole) contained in switched access charges today.

A mandatory end user surcharge (such as that commonly employed for cost recovery for high cost support), however, should not be mistaken for a market-based solution to the access problem. The entire point of the Telecommunications Act of 1996 is to provide consumers choice with the intention that competition will drive overall telecommunications prices down. The high-cost subsidy (*i.e.*, universal service) is an exception to this process because universal service subsidies are a protected revenue source not subject to competitive forces. Because competitive forces can never “compete down” a universal service fund made too large, the Commission should be careful not to treat these two cost recovery mechanisms as though they are interchangeable.

**13. Is there is a difference in the costs of providing interstate switched access service versus intrastate-switched access service?**

No. As stated previously, these services and the rate elements that comprise them are technological equivalents, regardless of jurisdiction, type of traffic, or class of customer.

- a. **Please include a description of how costs are defined in your response and how those costs relate to costs allocated to the intrastate jurisdiction under the FCC's Separations rules.**

It is not clear to AT&T how separations rules are relevant for this inquiry but, in any event, jurisdictional separations do not alter the underlying logic of reform, *viz.*, the necessity for cost based rates.

14. **In the CALLS Decision, the FCC implemented changes that would eliminate carrier common line charges and establish an interstate universal service support mechanism.**

For purposes of clarification and consistent with the economic principle of cost causation, the elimination of the CCL in the interstate jurisdiction has resulted in an increase in federal subscriber line charges. The advent of the additional \$650M of universal service funds is for recovery of revenue resulting from the reduction in traffic sensitive rates.

- a. **Should the Commission address the Arizona Universal Service Fund mechanism concurrent with the reform of intrastate access charges?**

No. To achieve the access reform goal(s) set forth above, it is necessary to bifurcate access reform and universal service reform, reuniting them, if necessary, at a later date. That is, even though these reforms may be intertwined, the question inherent in determining the need for a universal service support is not what subsidizes what but rather, on average, is it profitable for ILECs to serve their customers. Inasmuch as consumers will bear the burden of universal service in any event, one of the universal service policy goals of this Commission should be to ensure that Arizonans are not taxed for customers that are already profitable for carriers to serve. Only after access charges

are appropriately designed and cost-based rates have been established, can the extent to which any universal service support is needed be accurately determined.

**15. The FCC released its Access Charge Reform Order (“MAG Order”) for rate of return companies on November 8, 2001. Please comment on the extent to which the ACC should adopt any components of the MAG Order.**

AT&T supports a state access reform that is based on a phased-in regime of mirroring rates between state and interstate jurisdictions. In the event that the Commission adopts such a regime, all rural carriers in Arizona should be included.

**16. Should the Commission address CLEC access charges as part of this Docket?**

Yes, to avoid creating new market failures such as those experienced in, for example, Minnesota and Iowa, where CLECs are seizing the opportunity to unilaterally set access charges that not only exceed a competitive level but that, in fact, exceed the prices that even a monopolist would charge. Indeed the FCC, in its *Fifth Report and Order* in CC Docket No. 96-262, recognized this market failure in that it “may have overestimated the ability of the market place to constrain CLEC access rates.”<sup>22</sup>

Moreover, “requiring IXCs to pay access charges set unilaterally by CLECs is not economically efficient and does not further the goals of the Telecommunications Act of 1996.”<sup>23</sup>

CLEC access charges, therefore, must be set prescriptively to mirror those of the non-rural carrier with the lowest access rates, presumably Qwest. To do otherwise, ensures that the retail rates for long distance service paid for by Arizona’s consumers will

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<sup>22</sup> *Access Charge Reform*, CC Docket No. 96-262; *Fifth Report and Order and FNPRM, Request for Emergency Relief of the Minnesota CLEC Consortium and the Rural Independent Competitive Alliance*, DA-00-1067; *Mandatory Detariffing of CLEC Interstate Access Services*, DA00-1268, ¶ 238.

<sup>23</sup> *Id.*, ¶ 238.

not only remain artificially high generally, but because IXCs are required to average rates, the smallest CLECs are able to “tax” consumers of larger CLECs and ILECs.

The result is significant market failures for both originating and terminating access rates, particularly as it applies to CLECs, but also within the context of the access problem generally. According to industry economist, Dr. Warren-Boulton, “it is important to understand that the provision of originating access and of terminating access by a LEC or CLEC is subject to market failure that creates unique incentives for LECs or CLECs to increase prices to levels well above competitive levels *even* when IXCs can decline to purchase access services from the LEC or CLEC. If LECs and CLECs can force IXCs to buy from them irrespective of price, LECs and CLECs have an incentive to charge even higher prices.” Additionally, these market failures derive from the fact that (a) “an IXC cannot charge different prices for long distance services based on differences in originating or terminating access fees charged by a particular originating or terminating long distance customer’s LEC or CLEC”; and (b) “the local end user does not directly pay for access charges.” In both cases the source of these market failures “is regulatory, not technical.” In sum, the significance of these market failures is that “the connection between the price charged by the LEC or CLEC and the demand for its services is severely attenuated or severed.”<sup>24</sup>

**17. Should additional considerations be taken into account when restructuring and/or setting access charges for small rural carriers?**

No, not unless and until the rural carriers can demonstrate empirically some compelling reason to the contrary. The Commission should be mindful that the recent

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<sup>24</sup> *In Re: FiberComm, L.C., et al. v. AT&T*, Iowa Utilities Board, Docket No. FCU-00-3, Direct Testimony of Frederick R. Warren-Boulton, AT&T Exhibit 2.0 (December 20, 2000), at Pp. 5 -7.

adoption by the FCC of the Rural Task Forces recommendation for the reform of the rural carrier universal service fund is -- in a word -- generous.<sup>25</sup> Moreover, many of the rural carriers in Arizona are active borrowers from the RUS, another taxpayer subsidy program that was, likewise, expanded in 2000.

**18. What is the effect of Qwest's Price Cap Plan on the issues raised in this proceeding as they pertain to Qwest? With regard to Qwest, switched access is a Basket 2 service and special access is a Basket 3 service. What impact does this have, if any, on restructuring access charges in this proceeding as it would pertain to Qwest?**

Qwest's Price Cap plan should have no effect on establishing Qwest's intrastate switched access at cost based rates. The Price Cap Plan established three Baskets as follows:

- Basket 1 consists of Basic/Essential Non-Competitive Services and is capped using an inflation minus productivity indexing mechanism.
- Basket 2 consists of Wholesale Services and the services are capped at existing levels and are subject to the specific pricing rules for wholesale services.
- Basket 3 consists of Flexibly-Priced Competitive Services and is capped at an index, subject to annual updates in the quantity of demand. The additional revenue level for purposes of headroom in Basket 3 is capped at \$25.3 million for the term of the plan, but is subject to an upward adjustment of \$5 million per year in the second and third years of the plan to offset the annual reductions to intrastate switched access.

Switched access rates reside in Basket 2 and are, therefore, capped at existing rates. Additionally, switched access is governed by the specific pricing rules for wholesale services. The stated purpose of this docket is the investigation of the cost of access. It is by now, well understood that intrastate access rates are well in excess of

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<sup>25</sup> Among other things, rural carriers will receive an additional \$1.26 billion in high cost support over the 5 year term of the RTF. *In the Matter of the Federal-State Joint Board on Universal Service*. CC Docket No. 96-45. *Fourteenth Report and Order, Twenty-Second Order on Reconsideration, and Further Notice of Proposed Rulemaking* in CC Docket No. 96-45, and Report and Order in Docket No. 00-256. *rel.*, May 23, 2001. ¶13.

cost. Inasmuch as there are no restrictions against lowering access rates contained in the Price Cap Plan for Basket 2 services (and, by the terms of the plan they cannot be increased), Qwest's Price Cap Plan has no impact on this proceeding.

Moreover, the Commission's order approving Qwest's Price Cap Plan supported achieving parity between intrastate and interstate switched access rates. The order stated, "While we agree that achieving parity between intrastate and interstate switched access rates is a laudable goal, there are many other public policy issues that impact our ability to reach that goal, such as the desirability of imposing an End User Common Line charge. Such decision concerning the structure of toll service charges should occur in a generic docket as it affects more than just Qwest." (Order at 12).<sup>26</sup>

Special access is in Basket 3 and contains all flexibly-priced competitive services. There are price caps for these services, but no restrictions on reductions. As stated previously, the purpose of this docket is to investigate the cost of access. Thus, the only logical result for all access services is a rate decrease and common sense dictates there would not be increases in rates for competitive services. It should be concluded, therefore, Qwest's Price Cap Plan has no impact on this proceeding.

**19. With regard to Qwest, what impact would Qwest receiving Section 271 authority have on the issues raised in this proceeding?**

The looming reintegration of Qwest into the provision of long distance service in Arizona will fundamentally alter the telecommunications industry structure and the nature of competition for both local exchange and long distance services. Two specific

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<sup>26</sup> The terms of the Qwest Price Cap Plan for wholesale services included in Basket 2 provide an exception for switched access services. The plan states, "an exception includes Intrastate Switched Access Services which are to be reduced by \$5 million per year for the duration of the initial term of the Plan, with further reductions in Intrastate Switched Access Service rates taking place during any subsequent term of the Price Cap Plan with the objective of obtaining parity with interstate switched access rates." Qwest's Price Cap

features of the reintegration into the long distance arena have a bearing on the issue of access charge reform. First, the reintegration of Qwest into the interexchange marketplace fundamentally alters the incentives it has for cooperating with competitors. The result of this altered set of incentives is that the Commission must look harder than ever before at ways to eliminate the avenues by which Qwest can discriminate against its downstream rivals. Second, reintegration by Qwest into the interexchange business is likely to lead to a variety of bundled service offerings that will for the foreseeable future dampen the ability of downstream rivals to exert competitive pressure on Qwest in the absence of access charge reductions. It is well worth considering each of these concerns in more detail.

Qwest's Altered Incentives to Cooperate. Seventeen years ago, concerns abounded that a vertically integrated Bell System with monopoly control of local exchange facilities could (and indeed did) use that monopoly power to disadvantage prospective rivals. Among the various tactics it was alleged that the integrated firm had used both price and non-price discriminatory tactics to harm both competitors and competition. To eliminate the prospect that such discriminatory tactics might harm competition, the divestiture agreement structurally separated the upstream monopoly enterprise (controlled by the RBOCs) from the long distance (interLATA) portion of the industry. In doing so, the MFJ altered the RBOCs incentives. Under structural separations, RBOCs had limited incentives to favor one long-distance competitor over another.

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Plan Order, Attachment A at 3d as noted, the Commission's directive was to consider further access reductions for Qwest in a generic docket, as is currently underway.

The principle goal of the 1996 Act is to “promote a pro-competitive deregulatory environment.” Under the Telecommunications Act, an RBOC, like Qwest would be permitted to reintegrate into the Arizona in-region interLATA exchange market upon a demonstration that it has complied with the 14-point checklist and that entry into the market is found to be “in the public interest.” These requirements provided a “carrot” for RBOCs to cooperate with rivals. Specifically, by cooperating with other telecommunications firms that rely on RBOC inputs to compete, local exchange markets would more quickly become fully open to competition and this, in turn, would facilitate the likelihood of policymakers permitting the reintegration of the RBOCs (here, Qwest) into the long distance market.

But, reintegration into the interexchange market fundamentally alters the incentives to cooperate with interexchange carriers in two ways. First, prior to reintegration, Qwest has only limited incentives to engage in discriminatory tactics that might favor one long distance providers over another. Upon reintegration, however, Qwest will have a very clear incentive to engage in discriminatory tactics that are designed to advantage its own downstream affiliate and to disadvantage its downstream (long distance) rivals. Second, upon reintegration, there is no “carrot” of Section 271 to entice good behavior. Thus, regulatory policies that were adequate, (though not fully enforced in Arizona) prior to reintegration into the interLATA market are likely to no longer be adequate to ensure competitive performance by Qwest. While it is possible to hope that the regulatory sanctions are adequate to ensure non-discriminatory behavior, a direct means of eliminating the prospect of discriminatory pricing of access services exists.

Specifically, by setting the price of carrier access to reflect economic cost, the real price faced by Qwest and its downstream rivals will, in fact, be the same. Assuming that (non-price) access impairment could be prevented, reducing access prices would expand total output and prevent distortions of competition in the long distance market.

Reintegration, Bundling and Access Charges. Another characteristic of the reintegrated market likely to emerge is the presence of bundled telecommunications services. Specifically, local and long distance services may be sold under a plan that bundles these together in a single offering at a flat fee that is time and distance sensitive. While bundled offerings hold the promise of providing consumer benefits if provided under competitive conditions, the presence of excessive access charges is likely to undermine these benefits in two ways. First, competitors that face the bundled offering cannot drive the flat prices down to squeeze out excess profits that may be earned by Qwest because these competitors face asymmetrically higher costs as a consequence of excessive carrier access charges that are assessed on a per minute basis. Thus, a fundamental salutary effect of competitive markets is undermined by the perpetuation of uneconomic carrier access charges.

Second, if excessive access charges are continued and widespread bundling of telecommunications services arises, it is likely that competitors may not even be able to make a competitive offering, thereby ensuring monopoly control over customers. It has been recognized for some time that the imposition of supra-competitive carrier access charges can create competitive problems in the market, leading to the exclusion of efficient competitors. The preferred solution to competitive risk posed by the asymmetry

of costs caused by supra-cost access charges is simply to set carrier access charge rates to their respective economic cost.

Despite the recognition of the risks to competition posed by excessive access charges, the regulatory “solution” to date has been to require that rates charges by Qwest in competition with downstream rivals pass an imputation test.<sup>27</sup> Imputation, however, is a costly and ineffective approach that will be increasingly difficult to apply upon the complete reintegration that will come with section 271 approval and the proliferation of competitive services. With the reintegration and the proliferation of bundled service offerings that are certain to arise, the difficulties of imputation will grow exponentially. The far more direct way to eliminate the competitive risk posed by elevated carrier access charges is simply to set such prices at a level that reflect the economic cost of providing access.

#### Arizona Price Squeeze

Exhibit 1, attached to these comments, demonstrates the price squeeze that will likely exist in Arizona and what difference access reduced, at a minimum, to the CALLS ATS rate makes. That is, failure to set switched access at economic cost coupled with the reintegration of Qwest into in-region interLATA toll foreshadows a deleterious effect on competition for toll services throughout the state. The examples contained in Exhibit 1 are explained below.

- Example 1: Margin Analysis. Empirical proof of Qwest’s ability to earn 10.9 cents on each minute of long distance compared with 2.7 cents per minute for an IXC. The difference is directly related to the level of access charges Qwest bills an IXC. As described earlier, the tariffed rate Qwest charges AT&T and other IXCs is 9.3 cents for an originating and terminating minute, while the proxy cost to Qwest, (*i.e.*, CALLS target ATS rate) of providing that minute is 1.1 cents. If Qwest is allowed to continue charging access rates well in excess of forward-

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<sup>27</sup> For Arizona specifically, *see* R14-2-1310 (A)(1).

looking economic cost, it will be impossible for IXCs to compete with Qwest in the long distance market.

- Example 2: Price Squeeze: This example illustrates that where access charges are set at rates in excess of economic cost, Qwest will have the ability to eliminate the margin entirely from an IXC. Assuming Qwest will be required to price its long distance service above cost plus the imputed price of essential services as required by AAC R14-2-1310, the rate must cover the tariffed access rate plus any internal costs Qwest would incur. In this example, the minimum price Qwest would be allowed to charge would be 11.3 cents (9.3 cents access plus 2.0 cents Intra-company costs). In order to compete, IXCs would then be forced to lower their retail rates to match the 11.3 cents per minute charged by Qwest, eliminating any margin. With a gross margin of zero, IXCs will have little incentive to market their services in Arizona, while Qwest retains its margin of 8.2 cents per minute. This is directly related to the difference between the price and the forward-looking economic cost of access. It is, therefore, possible (indeed probable) that Qwest's monopoly in the local market will be extended to the long distance market.

**20. One of the stated objectives of the Qwest Price Cap Plan was to achieve parity between interstate and intrastate access charges. Is this something that should be looked at by the Commission in this proceeding?**

Yes, at a minimum. Moving Qwest's intrastate switched access rates to interstate parity is movement towards one of the stated goals of Qwest's Price Cap Plan.

Moreover, reducing intrastate switched access rates to Qwest's interstate rates over a fixed period of time was originally advanced by Staff in Qwest's recent rate case. Staff's original proposal stated:

I propose that intrastate access prices be reduced by 20 percent per year from their initial levels so that by the end of the initial five year period [of the price regulation plan that was proposed in the initial pre-Settlement testimony] they are equivalent to U S WEST's interstate access charges at July 2000 levels. From that point on, I recommend that intrastate access charges be adjusted to "mirror" the interstate rates.<sup>28</sup>

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<sup>28</sup> *In the Matter of the Application of U S West Communications, Inc. for a Hearing to Determine the Earnings of the Company for Ratemaking Purposes, to Fix a Just and Reasonable Rate of Return thereon and to Approve Rate Schedules*, Docket No. T-01051B-00-0369, Direct Testimony of Harry M. Shooshan III at 12.

This recommendation was both reasonable and generally consistent with the approach that has been adopted in the CALLS settlement, *i.e.*, five-year transition to cost-based access charges, but ultimately was not part of the Qwest Price Cap Plan approved by the Commission.<sup>29</sup> It would have, at the end of the transition period, essentially eliminated the existing disparity between Qwest's Arizona intrastate and interstate switched access charges, and would have made it possible for intrastate toll (and particularly intraLATA toll) competition to develop to the same robust level that prevails in the case of interstate toll services.

Ultimately the Price Cap Plan approved by the Commission did not obtain the stated goal of achieving parity in Qwest's intrastate and interstate access rates. The Commission Order approving Qwest's Price Cap Plan stated:

Although the Settlement Agreement professes a goal of reaching parity between Qwest's intrastate and interstate switched access charges, it does not, at least in its initial three year term reach that goal... While we agree that achieving parity between intrastate and interstate switched access rates is a laudable goal, there are many other public policy issues that impact our ability to reach that goal, such as the desirability of imposing an End User Common Line charge. Such decision concerning the structure of toll service charges should occur in a generic docket as it affects more than just Qwest.<sup>30</sup>

In testimony supporting the Settlement Agreement the Staff stated that the Settlement Agreement (on the Qwest Price Cap Plan) "lowers charges made by Qwest to long-distance carriers by \$15 million over the three years (and eventually to the interstate

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<sup>29</sup> *In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Low-Volume Long Distance Users and Federal-State Joint Board on Universal Service*, CC Docket 96-262, et al., Sixth Report and Order in CC Docket 96-262 and 94-1, Report and Order in CC Docket 99-249, and Eleventh Report and Order in CC Docket 96-45 (May 31,2000).

<sup>30</sup> *In the Matter of the Application of U S West Communications, Inc. for a Hearing to Determine the Earnings of the Company for Ratemaking Purposes, to Fix a Just and Reasonable Rate of Return thereon*

level).”<sup>31</sup> Qwest’s intrastate access rates in Arizona are significantly higher than its interstate access rates that are established by the CALLS order — a rate of .0055 per minute.

**21. Are there other issues besides the rate restructuring and costing issues raised herein that should be addressed by the Commission in this Docket?**

Please see #25.

**22. Are there other State proceedings and/or decisions that you would recommend the “Commission examine before it proceeds with this Docket? Please attach any relevant State commission decisions to your comments.**

A number of state commissions have ordered incumbent carriers to mirror their interstate rates.<sup>32</sup> AT&T supports the mirroring of interstate rates as one policy option for the reform of intrastate access charges. It is instructive to review the approach adopted by two of the states that have adopted reform based on the mirroring principle -- one expedited (Kansas) and the other (Illinois) implemented over a longer period of time.

The Kansas Corporation Commission (“KCC”) approved an industry stipulation whereby SWBT’s intrastate access rates were flash-cut to interstate rates on October 1, 2001, and reduced Sprint/United’s access rates over a four-year period beginning June 1, 2002.<sup>33</sup>

In doing so, the KCC recognized that:

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*and to Approve Rate Schedules*, Docket No. T-01051B-00-0369, Opinion and Order, Decision No. 63487, March 30, 2001 at 12.

<sup>31</sup> *In the Matter of the Application of U S West Communications, Inc. for a Hearing to Determine the Earnings of the Company for Ratemaking Purposes, to Fix a Just and Reasonable Rate of Return thereon and to Approve Rate Schedules*, Docket No. T-01051B-00-0369, Testimony of Harry M. Shooshan III in Support of the Proposed Settlement Agreement, October 27,2000 at 7.

<sup>32</sup> Summary of states mirroring interstate rates by RBOC region: SBC/Ameritech – 5; SBC/SWBT – 1 (Kansas, ICOs are required to mirror respective interstate rates); SWBT/Pacific Bell – 1 (Nevada Bell is required to file intrastate tariffed rates that do not exceed Interstate prices); BellSouth – 2; Verizon – 2; and Qwest – 0.

<sup>33</sup> KCC press release available at: <http://www.kcc.state.ks.us/pi/press/01-18.htm>. KCC Order available at: <http://www.kcc.state.ks.us/scan/200109/20010925145219.pdf> (“Kansas Mirroring Order”)

- A settlement agreement reached by a broad spectrum of carrier and public interests, that rarely concur on rate and policy issues as evidenced by the stipulation between the Staff, SWBT, United/Sprint, and AT&T.
- The only difference between the interstate access service and the intrastate access service is whether the other party to the call is in another state, a fact that does not impact the costs the local exchange company incurs for the service it provides.
- The costs of the loop are fixed, thus recovery of that cost on a fixed rather than variable (minutes of use) basis promotes economic efficiency, and “it is reasonable and appropriate that those costs be recovered through a flat rate charge to the end-user.”<sup>34</sup>
- In the interest of promoting competition as the best vehicle for consumer protection “it must set an appropriate competitive framework to give competition a reasonable chance to emerge and bring lower prices and greater technological choices to Kansas consumers.”<sup>35</sup>

The Illinois Commerce Commission (“ICC”), on the other hand, has implemented the most systematic and comprehensive access charge reform over a longer period of time, carefully synchronized with other pro-competitive policy initiatives. Owing to a steady policy of retail rate rebalancing, commenced in the early 1990’s, customers’ basic local rates were raised to a level that more closely reflected cost. Moreover, shortly after divestiture, the ICC began the process of partially mirroring interstate rates. As a result, at the passage of the Telecommunications Act of 1996, the ICC was well positioned to manage the transition to competition mandated by the Act and the FCC’s rules. Access reform proceedings begun in 1997 adopted a phased approach. Phase I investigated non-cost based rates and Phase II, concluded with an Order in 2000,<sup>36</sup> resulted in:

- The elimination of all non-cost based rate elements;

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<sup>34</sup> *Id.* ¶ 25.

<sup>35</sup> *Id.* ¶ 39.

<sup>36</sup> An electronic copy of this Order, dated March 31, 2000, can be found on the ICC’s website under the caption “Access Charge Reduction Order” at: [http://www.icc.state.il.us/icc/tc/docs\\_arch.asp - access](http://www.icc.state.il.us/icc/tc/docs_arch.asp - access)

- A prohibition against the establishment of any future non-cost based rate elements;
- Permanent elimination of revenue neutrality standards; and most significantly
- Breaking the “mirror” in that the switched access rates for Ameritech and Verizon were to be reduced further to reflect economic cost.<sup>37</sup>

**23. Please provide your recommendations for a procedural schedule in this case.**

AT&T recommends that the terms of the December 3, 2001, Procedural Order be followed. Staff should review the comments and file a recommendation on how the proceeding should proceed. Parties should have an opportunity to respond to Staff’s proposal. Thereafter, a procedural conference should be held.

Generally, AT&T recommends that direct testimony be filed simultaneously. Parties should also be permitted an opportunity to file rebuttal and surrebuttal testimony. Hearings should be held to conduct cross-examination. At the conclusion, briefs should be permitted.

**24. Please comment on the issues raised in Docket No. T-01051B-01-0391, In the Matter of Qwest Corporation’s Tariff Filing to Introduce a New Rate Structure for an Access Service Used By Interexchange Carriers and their relationship to this Docket.**

This issue is moot. Qwest has notified Arizona staff that it will be withdrawing this tariff.

**25. Please comment on any other issues you believe may be relevant to the Commission’s examination of intrastate access charges.**

Competition is the goal that has been the cornerstone of U.S. telecommunications policy for the past thirty years. The country has rightly recognized that market forces,

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<sup>37</sup> Once again, the so-called CALLS interstate rate of \$ 0.0055 for most of the RBOCs is not a rate based on FLEC but is a rate above FLEC.

not government-protected monopolies, deliver the highest quality services, stimulate innovation and bring the newest developments rapidly to the market, and produce the lowest prices to consumers everywhere. In fact, the U.S. telecommunications policy commitment, most recently codified in the landmark Telecommunications Act of 1996 initially forged a path for other countries to follow, hopeful of paving the road to a global information infrastructure with strong U.S. leadership.

While we all look forward to time when all local telephone markets are fully competitive, all customers have multiple suppliers, and rate regulation is unnecessary, more than 6 years after the passage of the Telecommunications Act of 1996, it is all too obvious that this pleasant dream world not only does not exist today, but it is not even on the horizon. In the wake of the collapse of much of the CLEC industry in the past year, many have begun to question whether significant competition outside a handful of major metropolitan areas can be expected even in the mid-term, five to ten years out. Moreover, the once unthinkable -- re-monopolization of the industry -- is no longer unthinkable. Each state, including Arizona, stands at the crossroad between monopoly and a competitive future, with the decisions of the ACC and other state commissions deciding the path its markets will follow.

In simple sum, if all consumers in Arizona are to realize the promise of the Act, *i.e.*, lower prices for telecommunications services through choice of carrier, it is essential that the Commission manage the reform process by undertaking swift prescriptive action, here specifically, switched access reform.

Dated this 8<sup>th</sup> day of March, 2002.

**AT&T COMMUNICATIONS  
OF THE MOUNTAIN STATES, INC.,  
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## CERTIFICATE OF SERVICE

I hereby certify that the original and 10 copies of Answers of AT&T to Questions Contained in December 3, 2001 Procedural Order, regarding Docket No. T-00000D-00-0672, were hand delivered this 8th day of March, 2002, to:

Arizona Corporation Commission  
Docket Control – Utilities Division  
1200 West Washington Street  
Phoenix, AZ 85007

and that a copy of the foregoing was hand-delivered this 8th day of March, 2002 to the following:

Ernest Johnson  
Director - Utilities Division  
Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, AZ 85007

Christopher Kempley  
Chief Counsel - Legal Division  
Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, AZ 85007

Lyn Farmer  
Chief Hearing Officer  
Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, AZ 85007

Maureen Scott  
Legal Division  
Arizona Corporation Commission  
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Phoenix, AZ 85007

and that a copy of the foregoing was sent via United States Mail, postage prepaid, on the 8th day of March, 2002 to the following:

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INC.  
PO BOX 701, 245 S. HILL  
GLOBE, AZ 85502-0000

SOUTH CENTRAL UTAH TELEPHONE  
ASSOCIATION, INC.  
PO BOX 226  
ESCALANTE, UT 84726-0000

SOUTHWESTERN TELEPHONE CO,  
INC.  
PO BOX 5158  
MADISON, WI 53705-0158

TABLE TOP TELEPHONE COMPANY,  
INC.  
600 N SECOND AVENUE  
AJO, AZ 85321-0000

VALLEY TELEPHONE COOPERATIVE  
INC.  
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WILLCOX, AZ 85644

VERIZON CALIFORNIA INC.  
ONE VERIZON WAY - CA500GCF  
THOUSAND OAKS, CA 91362-3811

GREGORY HOFFMAN  
AT&T COMMUNICATIONS OF THE  
MOUNTAIN STATES, INC.  
795 FOLSOM STREET, ROOM 2159  
SAN FRANCISCO, CA 94107-1243

BROOKS FIBER COMMUNICATIONS  
OF TUCSON, INC.  
201 SPEAR STREET 9TH FLOOR  
SAN FRANCISCO, CA 94105

CITIZENS LONG DISTANCE  
COMPANY  
5600 HEADQUARTERS DRIVE  
PLANO, TX 75024

CITIZENS TELECOMMUNICATIONS  
COMPANY OF ARIZONA L.L.C.  
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SALT LAKE CITY, UT 84180

COMM SOUTH COMPANIES INC.  
2909 N. BUCKNER BLVD., STE. 800  
DALLAS, TX 75228-0000

COX COMMUNICATIONS  
20401 NORTH 29TH AVENUE  
PHOENIX, AZ 85027-0000

E.SPIRE  
131 NATIONAL BUSINESS PARKWAY,  
STE. 100  
ANNAPOLIS JUNCTION, MD 20701-  
0000

ESCHELON TELECOM OF ARIZONA,  
INC.  
730 SECOND AVENUE SOUTH SUITE  
1200  
MINNEAPOLIS, MN 55402-0000

INTERMEDIA COMMUNICATIONS  
INC  
ONE INTERMEDIA WAY  
TAMPA, FL 33647-1752

LEVEL 3 COMMUNICATIONS, LLC  
1025 ELDORADO BLVD.  
BROOMFIELD, CO 80021-8869

MCIMETRO  
201 SPEAR STREET 9TH FLOOR  
SAN FRANCISCO, CA 94105

MOUNTAIN  
TELECOMMUNICATIONS, INC.  
2540 E. 6TH STREET  
TUCSON, AZ 85716-0000

CITIZENS TELECOMMUNICATIONS  
COMPANY OF THE WHITE  
MOUNTAINS INC  
4 TRIAD CENTER, STE. 200  
SALT LAKE CITY, UT 84180

COVAD COMMUNICATIONS  
COMPANY  
4250 BURTON DRIVE  
SANTA CLARA, CA 95054-0000

DIGITAL SERVICES CORPORATION  
211 N. UNION ST, STE. 300  
ALEXANDRIA, VA 22314

ELECTRIC LIGHTWAVE, INC.  
4 TRIAD CENTER, STE. 200  
SALT LAKE CITY, UT 84180

GLOBAL CROSSING  
TELEMANAGEMENT, INC.  
180 SOUTH CLINTON  
ROCHESTER, NY 14646-0000

JATO OPERATING CORP.  
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ENGLEWOOD, CO 80111

MAX-TEL COMMUNICATIONS, INC.  
105 N. WICKHAM, P. O. BOX 280  
ALVORD, TX 76225-0000

METROPOLITAN FIBER SYSTEMS OF  
ARIZONA, INC.  
201 SPEAR STREET 9TH FLOOR  
SAN FRANCISCO, CA 94105

NORTH COUNTY COMMUNICATIONS  
CORPORATION  
3802 ROSECRANS, SUITE 485  
SAN DIEGO, CA 92110-0000

ONEPOINT COMMUNICATIONS  
TWO CONWAY PARK, 150 FIELD DR.,  
STE. 300  
LAKE FOREST, IL 60045-0000

REFLEX COMMUNICATIONS, INC.  
83 SOUTH KING STREET, STE. 106  
SEATTLE, WA 98104

SPRINT COMMUNICATIONS  
COMPANY L. P.  
6860 W. 115TH, MS:KSOPKD0105  
OVERLAND PARK, KS 66211

THE PHONE COMPANY/NETWORK  
SERVICES OF NEW HOPE  
6805 ROUTE 202  
NEW HOPE, PA 18938-0000

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1577 SPRING HILL RD. 2ND FLOOR  
VIENNA, VA 22182

360NETWORKS (USA) INC.  
12101 AIRPORT WAY  
BROOMFIELD, CO 80021

ALLIANCE GROUP SERVICES, INC.  
1221 POST ROAD EAST  
WESTPORT, CT 06880-0000

ARCHTEL, INC.  
1800 WEST PARK DRIVE SUITE 250  
WESTBOROUGH, MA 01581-0000

COMMUNIQUE  
TELECOMMUNICATIONS, INC.  
4015 GUASTI ROAD  
ONTARIO, CA 91761-0000

RCN TELECOM SERVICES, INC.  
105 CARNEGIE CENTER  
PRINCETON, NJ 08540-0000

RHYTHM LINKS, INC.  
9100 E. MINERAL CIRCLE  
ENGLEWOOD, CO 80112-0000

TCG PHOENIX  
111 WEST MONROE STREET STE.  
1201  
PHOENIX, AZ 85004

VERIZON SELECT SERVICES, INC.  
6665 N MACARTHUR BLVD,  
HQB02D84  
IRVING, TX 75039-0000

XO ARIZONA, INC.  
3930 E. WATKINS STE 200  
PHOENIX, AZ 85034

ALLCOM USA  
2151 E. CONVENTION CNTR WAY,  
STE 207-A  
ONTARIO, CA 91764-4483

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INC.  
2313 6TH AVE SOUTH  
BIRMINGHAM, AL 35233-0000

MCLEODUSA COMMUNICATIONS  
400 S HIGHWAY 169, SUITE 750  
MINNEAPOLIS, MN 55426

ENHANCED COMMUNICATIONS  
NETWORK, INC.  
37 WINTHROP PLACE  
HAZLET, NJ 07730-0000

ERNEST COMMUNICATIONS, INC.  
6475 JIMMY CARTER BLVD SUITE  
300  
NORCROSS, GA 30071-0000

GST NET, INC.  
4001 MAIN STREET  
VANCOUVER, WA 98663

INDEPENDENT NETWORK SERVICES  
CORP. (FN)  
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PHOENIX, AZ 85004-0000

MCI WORLDCOM NETWORK  
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SAN FRANCISCO, CA 94105

NEXTLINK LONG DISTANCE  
SERVICES, INC.  
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PHOENIX, AZ 85034

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TWO CONWAY PARK SUITE 300  
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PAC-WEST TELECOMM, INC.  
1776 W. MARCH LANE #250  
STOCKTON, CA 95207

SINGLE BILLING SERVICES, INC.  
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EL MONTE, CA 91731-0000

TELIGENT SERVICES, INC.  
8065 LEESBURG PIKE SUITE 400  
VIENNA, VA 22182-0000

GLOBAL CROSSING  
TELECOMMUNICATIONS, INC.  
180 SOUTH CLINTON AVENUE  
ROCHESTER, NY 14646-0000

IG2, INC.  
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5000  
KEW GARDENS, NY 11415-0000

MAIN STREET TELEPHONE  
COMPANY  
200 ITHAN CREEK AVENUE  
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NET-TEL CORPORATION  
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NORTH COUNTY COMMUNICATIONS  
CORPORATION  
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INVERNESS, IL 60067-0000

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WESTMINSTER, CO 80234

TOUCH AMERICA  
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ROSHKA HEYMAN & DEWULF  
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BRADLEY CARROLL  
COX ARIZONA TELECOM LLC  
20401 N 27<sup>TH</sup> AVENUE  
PHOENIX, AZ 85027

VYVX, LLC  
ONE WILLIAMS CENTER, MD 29-1  
TULSA, OK 74172

WILLIAMS LOCAL NETWORK, INC.  
ONE WILLIAMS CENTER, MD 29-1  
TULSA, OK 74172

ERIC HEATH  
SPRINT COMMUNICATIONS CO LP  
100 SPEAR STREET, SUITE 930  
SAN FRANCISCO, CA 94105

ARIZONA REPORTING SERVICE, INC  
2627 N. THIRD STREET, SUITE THREE  
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Carmie Amzuls

# ARIZONA

## The Present Market Structure, Without Access Charge Reform Gives ILECs an Anti-Competitive Advantage Over Competitors

For calls originating and terminating in Qwest's service territory

Example #1-Margin Analysis			
Domestic Dial - 1 Long Distance Call, In-Region, Per Minute			
<u>Qwest</u>		<u>IXC</u>	
Retail Price	14.0 ¢	Retail Price	14.0 ¢
Costs :		Costs :	
CALLS target ATS rate	1.1 ¢	Qwest intrastate access rate	9.3 ¢
Intra-company costs,		Intra-company costs,	
including billing & collection*	<u>2.0</u>	including billing & collection*	<u>2.0 ¢</u>
Network Cost of Goods Sold	3.1 ¢	Network Cost of Goods Sold	11.3 ¢
Gross Margin	10.9 ¢	Gross Margin	2.7 ¢
Example #2-Price Squeeze*			
Domestic Dial - 1 Long Distance Call, In-Region, Per Minute			
<u>Qwest</u>		<u>IXC</u>	
Retail Price	11.3 ¢	Retail Price	11.3 ¢
Costs :		Costs :	
CALLS target ATS rate	1.1 ¢	Qwest intrastate access rate	9.3 ¢
Intra-company costs,		Intra-company costs,	
including billing & collection*	<u>2.0 ¢</u>	including billing & collection*	<u>2.0 ¢</u>
Network Cost of Goods Sold	3.1 ¢	Network Cost of Goods Sold	11.3 ¢
Gross Margin	8.2 ¢	Gross Margin	0.0 ¢

\* Intra-company costs for both Qwest and IXCs are illustrative and not intended to indicate the level of actual costs incurred

\*\* Assumes Qwest follows an imputed cost rule, as required by AAC Rule R-14-2-1310, where price could not be less than the average access rate charged to other firm plus Qwest's cost of goods sold.

### Access rates based on :

IXC Rate - Qwest tariffed rate of 7.8 cents for originating and terminating minutes. Based on Qwest 1999 intrastate switched access revenue and intrastate switched access minutes of use as provided in FCC reports. See AT&T response to #7 Table 2

Qwest tariffed rate      0.0463    2      0.0926

Reducing Qwest's intrastate access revenue by \$15 million over three years as required by the terms of Qwest's price cap plan reduces the access rate from 4.6 cents per minute to 4.0 per minutes. Thus, it does not eliminate or make any significant improvement in the differential between the price and cost of access.

Qwest rate - Surrogate for Forward-Looking Economic Cost (FLEC) based on the CALLS interstate target ATS rate of \$.0055 per minute of use

Interstate rate      0.0055    2      0.011