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AZ CORP COMMISSION
DOCKET CONTROL

BEFORE THE ARIZONA CORPORATION COMMISSION

KRISTIN K. MAYES
Chairman

GARY PIERCE
Commissioner

PAUL NEWMAN
Commissioner

SANDRA D. KENNEDY
Commissioner

BOB STUMP
Commissioner

IN THE MATTER OF THE REVIEW AND POSSIBLE REVISION OF ARIZONA UNIVERSAL SERVICE, FUND RULES ARTICLE 12 OF THE ARIZONA ADMINISTRATIVE CODE.	DOCKET NO. RT-00000H-97-0137
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS.	DOCKET NO. T-00000D-00-0672

NOTICE OF FILING
DIRECT TESTIMONY OF DON PRICE

Attached is the Direct Testimony of Don Price filed on behalf of Verizon California, Verizon Business Services, and Verizon Long Distance.

RESPECTFULLY SUBMITTED this 1st day of December, 2009.

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Arizona Corporation Commission
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of the foregoing filed this 1st day of December, 2009, with:

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Docket Control – Utilities Division
1200 W. Washington Street
Phoenix, Arizona 85007

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BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE REVIEW AND POSSIBLE REVISION OF ARIZONA UNIVERSAL SERVICE FUND RULES, ARTICLE 12 OF THE ARIZONA ADMINISTRATIVE CODE.	)))))	**DOCKET NO. RT-00000H-97-0137**
IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS.	)))	**DOCKET NO. T-00000D-00-0672**

DIRECT TESTIMONY OF

DON PRICE

ON BEHALF OF VERIZON

December 1, 2009

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME, TITLE, AND BUSINESS ADDRESS.

A. My name is Don Price. I am a Director - State Public Policy for Verizon. My business address is 701 Brazos, Suite 600, Austin, Texas, 78701.

Q. MR. PRICE, PLEASE DESCRIBE YOUR EDUCATIONAL AND PROFESSIONAL BACKGROUND.

A. I have more than 30 years experience in the communications industry, the vast majority of which is in the public policy area. I worked for the former GTE Southwest in the early 1980s. In 1983 I moved to the Texas Public Utilities Commission. There, I acted as a Commission analyst and witness on rate-setting and policy issues. In 1986, I became Manager of Rates and Tariffs, and was responsible for Staff analyses of rate design and tariff policy issues in all telecommunications proceedings before the Commission. I joined MCI in 1986, where I spent 19 years focused on public policy issues in telecommunications, including issues of intercarrier compensation and coordination of positions in interconnection agreement negotiations.

With the close of the Verizon/MCI merger in January 2006, I assumed my current position as Director – State Regulatory Policy for Verizon Business. I work with various corporate departments, including those

involved with product development and network engineering, to develop and coordinate policies permitting Verizon Business to offer enterprise and wholesale products to meet customer demands.

During my career, I have testified before state regulators in at least 22 states on a wide range of issues in many types of proceedings and on a variety of topics, including various intercarrier compensation issues, and technical and policy issues arising in interconnection agreement arbitrations with local exchange carriers. I earned both a Master's and Bachelor's degree in sociology from the University of Texas at Arlington in 1978 and 1977, respectively.

Q. PLEASE DESCRIBE THE PURPOSE OF YOUR TESTIMONY.

A. On September 29, 2009, the Arizona Corporation Commission ("Commission") issued a Procedural Order ("Order") identifying twelve issues to be addressed at the March 16, 2010 hearing in these companion dockets, and directing parties to file their written direct testimony by December 1, 2009. The purpose of my testimony is to present the position of Verizon California, Verizon Business Services and Verizon Long Distance (collectively, "Verizon") on those issues.

Q. WHAT IS VERIZON'S POSITION?

A. The Commission seeks input on a number of issues involving intrastate access charges and the Arizona Universal Service Fund ("AUSF"). While

I address all twelve issues identified in the Order in Section V below, my testimony focuses primarily on the need to reform certain local exchange carriers' intrastate switched access rates. I also explain below that AUSF reform is neither necessary nor appropriate.

Q. PLEASE SUMMARIZE VERIZON'S POSITION ON INTRASTATE SWITCHED ACCESS RATES.

A. Verizon recommends that the Commission require all local exchange carriers ("LECs"), including competitive LECs ("CLECs"), to cap their intrastate access charges at the regional Bell Operating Company's—here, Qwest's—levels. This will promote efficient intrastate access rates for all carriers in Arizona by driving the most excessive access rates toward more efficient levels. Qwest's intrastate access rates are an appropriate benchmark for this purpose because they have been subject to the greatest regulatory scrutiny and strictest discipline, and thus represent a just and reasonable price for access. Using Qwest's rates as a benchmark would reduce market distortions and promote competitive equity by prompting carriers with the highest access rates to recover more of their network costs from their own customers, rather than from other carriers (and their customers) through access rates.

Because the establishment of a benchmark will require a reduction in the access rates charged by some LECs, I also suggest that the Commission consider granting greater retail pricing flexibility for rate-regulated

services to afford rate-regulated carriers a sufficient opportunity to recover their network costs. Carriers should recoup any lost revenue through their rates for retail services, rather than by seeking expansion of the AUSF. Of course, CLECs already have unfettered retail pricing flexibility because they are not subject to rate regulation and may price their retail services as they wish.

Q. DOES VERIZON TAKE A POSITION ON CHANGES TO THE AUSF RULES?

A. Verizon generally recommends that the AUSF rules remain unchanged (with two minor exceptions identified below). Based on comments filed earlier in these dockets, we anticipate that a number of parties to this docket will urge expansion of both the size and scope of the AUSF. However, that result would be detrimental to both consumers and carriers by increasing the contributions needed to fund the AUSF beyond its intended purpose,[1] and by encouraging carriers to rely on artificial subsidies rather than to operate efficiently, as appropriate in a competitive environment.

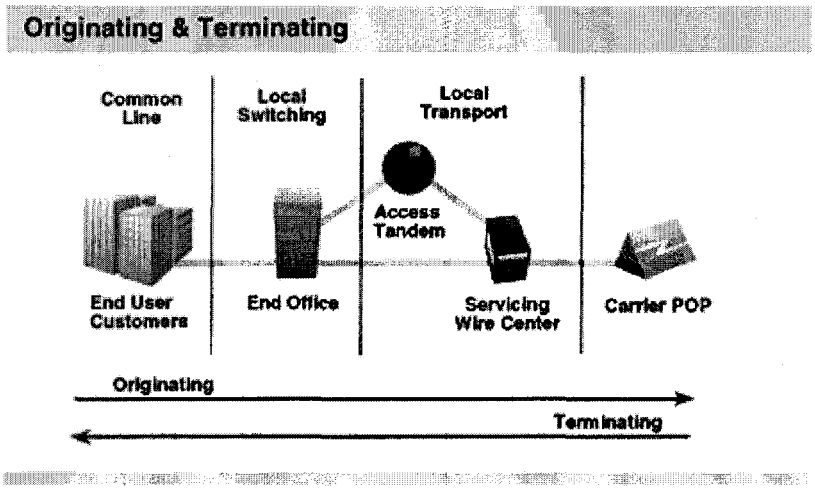
[1] *See* Decision No. 70659 (AUSF Amendments Proceeding; Docket No. RT-00000H-97-0137) at 1 ("The AUSF was established to maintain statewide average rates and the availability of basic telephone service to the greatest extent reasonably possible.") (Dec. 22, 2008); *see also* Decision No. 63267 (same docket) at 1 (Dec. 15, 2000); Decision No. 56639 (AUSF Establishment Dockets) at 5, 32 (purpose of AUSF is to "ameliorate the upward pressure on basic local rates in rural areas" and "ensure that the high cost of providing wireline local exchange service in rural areas will not diminish the availability of affordable service") (Sept. 22, 1989).

II. OVERVIEW OF SWITCHED ACCESS

Q. WHAT IS SWITCHED ACCESS?

A. Switched access is a service provided by LECs to other carriers for originating or terminating interexchange or "toll" calls (the origination and termination of local calls is governed by reciprocal compensation, the rates for which are typically lower than access rates). Access charges generally apply to calls that begin and end in different local calling areas. Interstate access charges apply to calls that originate and terminate in different states and are regulated by the Federal Communications Commission ("FCC"). Intrastate access charges apply to calls that originate and terminate in different local calling areas within the same state and are regulated by state commissions.

The diagram below illustrates how switched access works. The "Carrier POP" is the interexchange carrier's ("IXC's") "point of presence" or "POP." The diagram shows how an interexchange call is delivered either to or from the IXC's POP through connection with the LEC. Switched access charges compensate the LEC for the connection between the end user and the POP or other interconnection point.



If the interexchange call originates in one state but terminates in another, switched access charges are billed at the interstate rate in the carrier's FCC tariff. If the interexchange call originates and terminates within a state, then it is billed at the intrastate access rate, which is under the state commission's jurisdiction. The switched access rates at issue in this proceeding are the rates that LECs charge IXCs and other carriers to originate or terminate interexchange calls that begin and end in Arizona.

Q. HOW HAVE ACCESS CHARGES TRADITIONALLY BEEN SET?

A. Historically, state and federal regulators jointly created a regulatory pricing system where business and toll rates (both in-state and interstate) were set above the cost of providing these services to provide a contribution to basic residential rates, thereby promoting federal and state universal service objectives.

AT&T traditionally had a monopoly on long distance communications, and there was no "access" provided to other companies to the long

distance network. This industry structure started to change in the 1960s and 1970s with the introduction of private line and then switched service competition in the long distance market. With the advent of increasing interexchange competition and the divesture of the former Bell System in 1984, interstate and intrastate access charges were established so that interexchange carriers could compensate LECs for providing switched access service. Because of universal service concerns, regulators sought to maintain in access charges the contribution flow from long distance to local service that was present in retail long distance charges. In other words, to maintain the rate structure that enabled basic exchange service rates to remain low when toll revenue was available to offset the costs of basic service, both interstate access rates and intrastate access rates were purposefully set at artificially high levels to keep basic exchange service rates low.

With the onset of local service competition in the 1990s, CLECs entered markets without the legacy obligations of the incumbents, and also without traditional regulation of their rates, whether retail rates charged to end users or access rates charged to other carriers.

Q. DOES THE COMMISSION CURRENTLY REGULATE INTRASTATE ACCESS RATES?

A. For some carriers, yes. The Commission has scrutinized and reduced Qwest's intrastate access rates several times over the past few years,

recognizing that reducing high access charges promotes competition and is in the public interest.[2] However, the Commission has not addressed switched access rates comprehensively. For example, the Commission does not currently impose any such discipline on CLECs' intrastate switched access rates, even though the same reasons that spurred the FCC to regulate CLECs' *inter*state switched access rates (as discussed further below) hold true in the *intra*state context.

A. <u>CLEC Access Rates</u>

Q. DO CLECS HAVE MARKET POWER IN THE PROVISION OF SWITCHED ACCESS SERVICES IN ARIZONA?

A. Yes. Although CLECs are not generally perceived as possessing significant market power, they do hold such power in the switched access marketplace—particularly as relates to terminating switched access services. Market power exists where consumers are unable to switch suppliers in response to price changes. Given the nature of switched access services, carriers that purchase switched access services are not able to switch suppliers. Carriers have no choice but to use a CLEC's switched access services when they handle interexchange calls originating from the CLEC's customers and when they deliver interexchange calls for termination to the CLEC's customers. A toll provider cannot refuse to

[2] *See* Decision No. 68604 (Qwest 2006 price cap order) at 19; *see also* Decision No. 63487 (Qwest 2001 Price Cap Order) at 24 ("Under the Second Revised Settlement Agreement and Price Cap Plan, consumers benefit from … lower switched access rates.").

deliver a call to a CLEC's end user,[3] and thus cannot avoid that CLEC's terminating access charges—it is completely at the mercy of the carrier from which the called party obtains local exchange service. CLECs thus have market power in the provision of these services.

Q. BUT ISN'T THE SAME TRUE OF ILECS SUCH AS QWEST?

A. As noted above, the Commission has scrutinized and reduced Qwest's intrastate access rates several times over the past few years. As a result, in the absence of market forces, its intrastate access rates have been disciplined by regulatory intervention. However, the rates of many other smaller ILECs in Arizona have not been subject to similar scrutiny and discipline. For these carriers, the answer is yes: they continue to have market power that enables them to charge intrastate access rates today that exceed levels that are just and reasonable.

Q. DOES PERMITTING CLECS TO COLLECT ACCESS CHARGES IN EXCESS OF QWEST'S DISTORT THE MARKET?

A. Yes. Permitting CLECs to collect unreasonably high intrastate access rates provides those companies with a competitive advantage because they are able to recover disproportionately more of their costs from other carriers rather than from their own end users. Purchasers of switched

[3] As a general rule, common carriers are legally obligated to complete calls to any end users that their customers desire to call, including end users of CLECs with unreasonably high access rates. As the FCC has stated, "no carriers, including interexchange carriers, may block, choke, reduce or restrict traffic in any way." *In the Matter of Establishing Just and Reasonable Rates for Local Exchange Carriers* and *Call Blocking by Carriers*, WC Docket No. 07-135, Declaratory Ruling and Order, DA 07-2863 (June 28, 2007), ¶ 6.

access services are thus forced to help fund the retail service offerings of their direct competitors in the same service areas. This is contrary to federal policy, as discussed below.

Q. IS THERE ANY REASONED BASIS TO ALLOW ARIZONA CLECS TO CHARGE INTRASTATE ACCESS RATES HIGHER THAN QWEST'S?

A. No. There is no principled justification for CLECs to continue to charge intrastate access rates that are higher than Qwest's rates.[4] These newer market entrants have no obligation to serve residential customers, let alone residential customers in rural or other high-cost areas, and do not bear the historical legacy of having to maintain low, regulated retail prices for residential consumers throughout their service areas. CLECs also have the opportunity to use the most efficient mix of technologies and network configurations possible, and should be able to operate at least as efficiently as the incumbent carriers with their legacy networks. Verizon recommends capping CLECs' intrastate switched access rates at Qwest's levels even though this would require its own CLEC affiliate in Arizona to reduce its intrastate access rates (and the revenues derived from those rates).

[4] A handful of Arizona CLECs currently charge intrastate access rates that are lower than Qwest's. If the Commission adopts Verizon's proposal, it should make clear that these CLECs may not increase their rates to Qwest's levels, which would be contrary to the purposes of reforming the intrastate access charge regime.

Q. HAS THE FCC already ADDRESSED THE ISSUE OF ENSURING JUST AND REASONABLE CLEC switched access RATES?

A. Yes. To address this issue at the federal level, the FCC eight years ago established a benchmark policy whereby CLECs' per minute interstate access charges are capped at the interstate access charge rates of the ILEC with which the CLEC competes.[5] CLEC access charges that do not exceed the benchmark are presumed to be just and reasonable.[6] The FCC explained its benchmark policy as follows:

> [A] benchmark provides a bright line rule that permits a simple determination of whether a CLEC's access rates are just and reasonable. Such a bright line approach is particularly desirable given the current legal and practical difficulties involved with comparing CLEC rates to any objective standard of "reasonableness." Historically, ILEC access charges have been the product of an extensive regulatory process by which an incumbent's costs are subject to detailed accounting requirements, divided into regulated and non-regulated portions, and separated between the interstate and intrastate jurisdictions. Once the regulated, interstate portion of an ILEC's costs is identified, our access charge rules specify in detail the rate structure under which an incumbent may recover those costs. This process has yielded presumptively just and reasonable access rates for ILECs.[7]

[5] *CLEC Rate Cap Order* at ¶ 40; 47 C.F.R. § 61.26 (b). *See also* discussion of the terminating access monopoly, particularly as it relates to CLECs, in Nuechterlein, Jonathan E., and Weiser, Philip J., "Digital Crossroads," The MIT Press (2007) at 310-313.

[6] The FCC allows CLECs to charge rates higher than those of the ILEC only through negotiated arrangements – not through a tariff. The FCC reasoned that if a CLEC provides a superior quality of access service, or if it has a particularly desirable subscriber base, an interexchange carrier may be willing to contract to pay access rates above the benchmark.

[7] *CLEC Rate Cap Order* at ¶ 41.

The FCC's rule was prompted by "persistent" concerns that CLEC access rates varied dramatically and were frequently well above the rates charged by ILECs operating in the same area. The FCC's price cap was, therefore, intended to prevent CLECs from imposing excessive access charges on interexchange carriers and their customers.[8]

Q. SO ALL ARIZONA CLECS ARE ALREADY REQUIRED TO COMPLY WITH THE FCC'S ACCESS RATE CAP?

A. Yes. All Arizona CLECs already must comply with the FCC rule for interstate switched access rates, and the rate cap mechanism Verizon has proposed for both CLEC and ILEC rates in Arizona would be calculated in this same, familiar way. As noted, the FCC requires CLECs to benchmark to the competing ILEC's rate. Assuming all carriers move to this single, uniform rate, as Verizon recommends, the competing ILEC rate as to all CLECs will be the Qwest rate. If the Commission declines to move all ILECs to Qwest's rate, then it should require CLECs to benchmark to the competing ILEC's rate.

B. <u>ILEC Access Rates</u>

Q. ARE ILECS' INTRASTATE SWITCHED ACCESS RATES ALSO IN NEED OF REFORM?

A. Yes. Although the Commission has disciplined Qwest's rates, many small Arizona ILECs charge intrastate access rates that are many multiples of

[8] *Id.* at ¶¶ 32-34.

Qwest's. As with excessive CLEC access rates, this distorts the telecommunications marketplace and impairs competition and the consumer benefits it was intended to bring.

Q. IS THERE ANY REASON TO ALLOW OTHER ARIZONA ILECS TO CHARGE INTRASTATE ACCESS RATES HIGHER THAN QWEST'S?

A. No. The Commission should benchmark the other ILECs' rates to the prevailing market rate—that is, the rate of the largest carrier, Qwest. If the benchmarked rate would deny certain ILECs the opportunity to recover their costs, then the Board should give them greater retail pricing flexibility for their rate regulated services. Verizon takes this position even though it has an ILEC affiliate offering intrastate switched access services in Arizona at rates that currently exceed Qwest's, and would be required to reduce those rates if the Commission adopts Verizon's recommendation.

III. THE COMMISSION SHOULD ESTABLISH AN INTRASTATE ACCESS RATE BENCHMARK

Q. WHY SHOULD THE COMMISSION ESTABLISH AN INTRASTATE ACCESS RATE BENCHMARK?

A. Doing so would be a simple and effective means to quickly move the most excessive switched access rates in Arizona to more efficient levels. A benchmark will promote equity and competitive parity and reduce market distortions by prompting carriers with the highest access rates to recover

more of their network costs from their own customers, rather than from other carriers and their customers through access rates. Allowing companies to shift too much of their costs to switched access purchasers (and their retail customers) places a disproportionate burden on other carriers in the state—and ultimately, their customers—to subsidize those companies' services.

Q. WHAT IS THE BEST WAY FOR THE COMMISSION TO EVALUATE THE INTRASTATE SWITCHED ACCESS RATES ASSESSED IN ARIZONA?

A. Different carriers often employ different access rate structures. For example, some carriers may apply a single local switching rate element to all traffic; others may charge different rates for originating and terminating traffic. Some may impose additional monthly recurring charges, surcharges and/or fees on customers purchasing intrastate switched access services.

Given the existence of such varying rate structures, it is useful to compare carriers' average access revenues per minute ("ARPM"). The ARPM analysis takes into account all of the usage-based access rate elements that the carrier charges its access customers, and generally provides a more "apples-to-apples" comparison of the aggregate, per-minute rate than a review that compares only particular rate elements.

Q. have you conducted any arpm analysis of intrastate switched access rates in arizona?

A. Yes. As discussed in Verizon's January 4, 2008 comments, a comparison of the ARPMs of Qwest and other carriers that bill Verizon intrastate access charges in Arizona confirms that many carriers' intrastate access charges are substantially higher than Qwest's. Indeed, some carriers have rates that are 400% to 1000% higher than Qwest's.[9]

Q. WHAT RATE SHOULD SERVE AS THE BENCHMARK?

A. The intrastate switched access rates of the largest ILEC in the state—in this case, Qwest—should serve as the benchmark. As noted above, Qwest's intrastate access rates have historically been subject to the most regulatory scrutiny, ensuring that they represent a just and reasonable rate.

Q. IS VERIZON ASKING THE COMMISSION TO SET SPECIFIC SWITCHED ACCESS RATES FOR SPECIFIC LECS?

A. No. Verizon requests that the Commission establish a benchmark that would impose a ceiling on the intrastate access rates that LECs may charge, just as the FCC and numerous other states have done.[10] Although

[9] Verizon's ARPM calculations for specific companies are confidential.

[10] *See, e.g., Reform of Access Charges Imposed by Competitive Local Exchange Carriers*, Seventh Report & Order and Further Notice of Proposed Rulemaking, 16 **FCC** Rcd 9923 (2001) ("*CLEC Rate Cap Order*"); *Order Instituting Rulemaking to Review Policies Concerning Intrastate Carrier Access Charges*, **California** D. 07-12-020 in Rulemaking 03-08-018, Final Opinion Modifying Intrastate Access Charges (Dec. 6, 2007) (capping CLEC rates at no higher than Verizon's or SBC's rate, plus 10%); *DPUC Investigation of Intrastate Carrier Access Charges*, Decision, **Connecticut** D.P.U. Docket No. 02-05-17 (2004), 2004 Conn. PUC Lexis

1 caps have most often targeted CLEC access rates, the principle underlying

2 such caps applies equally to all LECs—that is, a company should not be

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15, at *45 (capping CLEC rates at SBC's then-current rate); **Delaware** Code, Title 26, § 707(e) (capping all service providers' switched access rates at the level of the largest ILEC in the state); **Indiana** Code § 8-1-2.6-1.5 (a carrier's switched access rates are just and reasonable if they mirror its interstate switched access rates); *TDS Metrocom, Inc., Petition for Arbitration*, Arbitration Decision, **Illinois** Comm. Comm'n Docket No. 01-0338, at 48-50 (Aug. 8, 2001) and *Arbitration Between AT&T Comm. of Illinois, Inc. and Ameritech, Arbitration Decision*, Illinois Comm. Comm'n Docket No. 03-0239, at 149-51 (Aug. 26, 2003) (a CLEC may not charge an ILEC more for terminating intrastate switched access than the ILEC charges the CLEC); 199 **Iowa** Admin. Code 22.14(2)(d)(1)(2) (prohibiting CLECs from charging a carrier common line charge if it would render the CLEC's rate higher than the competing ILEC's rate); **Louisiana** PSC General Order No. U-17949-TT, App.B, Section 301 (k)(4) (May 3, 1996) (CLECs must charge non-discriminatory switched access rates that do not exceed the competing ILEC's rates); Code of **Maryland** Regulations § 20.45.09.03(b) (capping all LECs' switched access rates at the level of the largest LEC in Maryland); *Petition of Verizon New England Inc. et al. for Investigation Under Chapter 159, Section 14, of the Intrastate Access Rates of Competitive Local Exchange Carriers*, Final Order, **Massachusetts** D.T.C. 07-9 (June 22, 2009) (capping CLEC switched access rates at Verizon's level); *Access Rates to Be Charged by Competitive Local Exchange Telecommunications Companies in the State of Missouri*, Report and Order, **Missouri** P.S.C. Case No. TO-99-596, 2000 Mo. PSC Lexis 996, at *28-31 (June 1, 2001) (capping CLEC access rates at the competing ILEC's level); *In the Matter of the Commission, on Its Own Motion, Seeking to Conduct an Investigation into into Intrastate Access Charge Reform and Intrastate Universal Service Fund*, **Nebraska** Pub. Serv. Comm'n Application No. C-1628/NUSF, Progression Order #15, at ¶ 9 (Feb. 21, 2001) ("absent a demonstration of costs, a CLEC's access charges, in aggregate, must be reasonable comparable to the ILEC with whom they compete"); **New Hampshire** PUC § 431.07 (CLECs cannot charge higher rates for access than the ILEC does); **New York** P.U.C. Case 94-C-0095, Order, at 16-17 (Sept. 27, 1995), N.Y. P.U.C. Opinion 96-13, at 26-27 (May 22, 1996), and N.Y. P.S.C. Opinion 98-10, 1998 N.Y. PUC Lexis 325, at 26-27 (June 2, 1998) (benchmarking CLEC access charges to the level of the largest carrier in the LATA); *Establishment of Carrier-to-Carrier Rules*, Entry on Rehearing, **Ohio** P.U.C. Case No. 06-1344-TP-ORD, at 16-18 (Oct. 17, 2007) (capping CLECs' switched access rates at the level of the competing ILEC); *Investigation into the Modification of Intrastate Switched Access Charges*, Opinion and Order, Case No. 00-127-TP-COI (requiring four ILECs' intrastate switched access rates to mirror their interstate access rates); 66 **Pennsylvania** Consolidated Statutes § 3017 (c) (prohibiting CLEC access rates higher than those charged by the incumbent in the same service territory, absent cost justification); **Texas** P.U.C. Subst. Rule § 26.223 (a CLEC may not charge a higher rate for intrastate switched access than the ILEC in the area served or the statewide average composite rates published by the Texas P.U.C. and updated every two years); *Amendment of Rules Governing the Certification and Regulation of CLECs*, Final Order, **Virginia** State Corp. Comm. Case No. PUC-2007-00033 (Sept. 28, 2007) (a CLEC's switched access rate cannot exceed the higher of its interstate rate or the rate of the competing ILEC); **Washington** Admin. Code § 480-120-540 (requires CLECs' and ILECs' terminating access rates to be no higher than their local interconnection rate, or depending on their regulatory status, incremental cost). In **West Virginia**, a Hearing Examiner's recommendation to cap CLEC switched access rates at the competing ILEC's level is pending approval by the Commission. *Petition by Verizon West Virginia Inc. Requesting that Commission Initiate a General Investigation of the Intrastate Switched Access Charges of Competitive Local Exchange Carriers Operating in WV*, Case No. 08-0656-T-GI.

CONFIDENTIAL – SUBJECT TO

PROTECTIVE ORDER IN DOCKET NO. RT-00000H-97-0137

allowed to charge above the prevailing market rate—which, in Arizona, is Qwest's rate.

LECs with existing intrastate access rates below the benchmark should not, of course, be permitted to raise their rates. Such a result would have the aberrant effect of encouraging some LECs to *increase* the amount of costs shifted to other carriers, which would obviously undermine the economic efficiency that establishing a cap is intended to drive.

Q. HOW SHOULD THE COMMISSION SET THE BENCHMARK?

A. The benchmark rate should be determined by calculating the composite of the Qwest intrastate switched access rate elements for the functions that the LEC at issue actually performs in providing its switched access service. Therefore, the benchmark rates will vary with the switched access functions the LEC performs and the miles of transport, where applicable. Based on Verizon's proprietary calculations, Qwest's composite rate is approximately ***BEGIN CONFIDENTIAL _____ END CONFIDENTIAL*** per minute of use.

CHANGES TO THE AUSF RULES

Q. DOES VERIZON ADVOCATE FOR SIGNIFICANT MODIFICATIONS TO THE CURRENT AUSF RULES?

A. No. As noted earlier, Verizon generally recommends that the AUSF rules remain unchanged. There is no evidence that the current fund is not meeting its goals, such that it must be increased.

Expansion of the size and/or scope of the AUSF—as proposed in prior comments filed by a number of parties to these dockets—would harm both consumers and carriers. Verizon thus urges the Commission to focus on the critical issue of intrastate switched access charges, rather than on rule changes that would expand the size and/or scope of the AUSF beyond its purpose. In particular, the Commission should not expand the AUSF to serve as an "access recovery mechanism" for carriers that are required to reduce their intrastate access rates to just and reasonable levels. Such an approach would simply perpetuate the anticompetitive *status quo,* under which these providers recover their network costs from someone other than their own end users.

Q. DOES VERIZON PROPOSE ANY MODIFICATIONS TO THE AUSF RULES?

A. As addressed in Section V of my testimony, Verizon proposes two minor modifications. The first is elimination of R14-2-1206(E), which makes AUSF support available to any competing carrier operating in the same

area as a carrier that has qualified for AUSF disbursements. The other is to incorporate a *de minimis* exception that relieves carriers whose AUSF assessment would be less than $500/month from contributing to the fund, in recognition of the reality that the costs of compliance would exceed the contribution amount. Verizon's rationale is explained below.

IV. VERIZON'S RESPONSES TO THE ISSUES IN THE ORDER

Q. DOES VERIZON HAVE A POSITION ON ANY OF THE TWELVE ISSUES IDENTIFIED IN THE ORDER?

A. Yes. My testimony thus far collectively addresses a number of the issues identified in the Commission's Order, but I also offer a brief individual response to each issue below.

1. What carriers should be covered by access reform?

As discussed above, the intrastate access rates of all Arizona LECs (save Qwest, whose rates should serve as a benchmark) should be subject to reform. If the Commission wishes to stage the reform process, it should concentrate first on the CLECs. Reform of CLEC rates will be the quickest and easiest way to move toward more efficient access pricing, because the CLECs' retail rates have never been constrained and they have no carrier-of-last-resort types of obligations.

2. To what target level should access rates be reduced?

The Commission should cap the intrastate access rates at Qwest's intrastate switched access rate. Because Qwest's intrastate switched access rates have been subject to the greatest degree of regulatory scrutiny and have been deemed just and reasonable,[11] using its rates as a benchmark will help ensure that all intrastate switched access rates charged in Arizona are just and reasonable.

[11] *See* Decision No. 68604 (Qwest 2006 price cap order) at 31.

3. What procedures should the Commission implement to achieve the desired reduction in access rates?

The Commission should enter an order capping the intrastate access rates of all LECs at the composite of the Qwest intrastate switched access rate elements for the functions that the LEC at issue actually performs in providing its switched access service. The order should further direct that if a LEC's current intrastate access rates comply with the new cap, it shall file, within 30 days, a sworn affidavit attesting that its current intrastate switched access tariff is in compliance with the order. If a LEC's current intrastate access rates do not comply with the new cap, the order should require it to file, within 30 days, both a new intrastate switched access tariff that complies with the order (bearing an effective date no later than 30 days after the order) and a sworn affidavit attesting that the new intrastate switched access tariff complies with the order.

The order should also permit any LEC that is required to file a new intrastate switched access tariff as a result of the order and whose retail rates are regulated to quantify the revenue reduction associated with the ordered access reductions and propose retail tariff changes to offset those lost revenues within 30 days of the order, if the LEC chooses to do so. LECs whose retail rates are unregulated already have this flexibility. The Commission should also retain jurisdiction to investigate and compel compliance with the order.

4. Should carriers be permitted to contract for access rates that differ from their tariffed rates?

Yes. As the FCC has recognized, market-based mechanisms are the best way to produce efficient prices and promote the public interest.[12] Negotiated intercarrier compensation agreements are the best long-term solution to ensuring the efficiency of telecommunications markets in the face of substantial technological change. Among other advantages, this kind of approach, by virtue of being technologically neutral, adapts more easily to changing technologies, encouraging their introduction without the need to modify the regulatory regime. Until the industry can fully transition to a regime of commercially negotiated agreements, however, the Commission needs to ensure that access rates are set and maintained at a level that will promote competition and economic efficiency. As a first step toward the ideal of negotiated intercarrier compensation

[12] *See Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Low-Volume Long Distance Users; Federal-State Joint Board On Universal Service*, Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45, 15 FCC Rcd 12962, ¶ 178 (May 31, 2000) ("*CALLS Order*").

arrangements, the Commission should set a benchmark to which other carriers' rates should move (and from which carriers may choose to later negotiate deviations). As Verizon has explained, the most appropriate benchmark is Qwest's intrastate switched access rate.

5. What revenue sources should be made available to carriers to compensate for the loss of access revenues?

To the extent carriers choose not to absorb access reductions ordered in this proceeding, the Commission should give them sufficient retail rate flexibility to recover lost access revenues from the retail rates they charge their own customers. Above all, the Commission should reject proposals to permit access revenue recovery from the AUSF, which should remain small and devoted to its primary purpose of establishing reasonably comparable rates between urban and high-cost areas.[13] Expanding the AUSF would have the inefficient and undesirable result of continuing to subsidize carriers that prefer to dip into their competitors' pockets to replace lost access revenue, rather than recovering those revenues from their own customers. Such a result is incompatible with a healthy, competitive market for communications services.

6. How much of access cost recovery, if any, should be shifted to end users? What showing should be required for such a shift? What should be the role of "benchmark" rates and how should benchmarks be set?

As noted above in response to Issues 3 and 5, the Commission should give carriers sufficient retail rate flexibility to recover lost access revenues through their retail rates, since it is appropriate for carriers to recover their network costs from their own end users, rather than from their competitors. A quantification of the revenue reduction associated with the ordered access reductions, supported by affidavit, should constitute a sufficient showing to permit recovery of up to that that amount via retail rates. Establishment of "benchmark" rates is not necessary under this approach.

7. Procedurally what will be required of a carrier if it seeks a "revenue neutral" increase in local rates?

As recommended in response to Issues 3, 5 and 6, the Commission should permit a rate-regulated carrier that chooses to quantify the revenue reduction associated with any ordered intrastate switched access reductions and propose retail tariff changes to offset those lost revenues to

[13] *See* Decision No. 70659 at 1; *see also* Decision No. 63267 at 1; Decision No. 56639 at 5, 32.

do so within 30 days of an order requiring intrastate switched access rate reductions by filing new tariffs and an affidavit attesting to compliance with the Commission order. The Commission should retain jurisdiction to investigate and compel compliance with the order.

8. Assuming that AUSF funds will also be used as a compensating revenue source, what specific revisions (including specific recommended amendment language) to the existing rules are needed to allow use of AUSF funds for that purpose?

The Commission should not authorize the use of AUSF funds as an access revenue recovery mechanism. To do so would go far beyond the original purpose of the fund, and would be bad public policy for the reasons previously discussed.

9. Which carriers should be eligible for AUSF support?

To the extent that this question assumes that the AUSF should be transformed into an access recovery mechanism, Verizon vigorously disagrees with that assumption. No carrier should be eligible for access revenue recovery from the AUSF.

10. What should be supported by AUSF? Access replacement only? High cost loops? Line extensions? Centralized administration and automatic enrollment for Lifeline and Link-up?

AUSF funds should be limited to supporting basic local exchange telephone service, as defined in R14-2-1201(6). The Commission should not expand that definition, or the scope of AUSF-supported offerings, to include any other services (including those proposed in Issue 10).

11. What should be the basis of AUSF contributions and what should be the structure of any AUSF surcharge(s)?

Other than the *de minimis* exception proposed in response to Issue 12 below, Verizon recommends no changes to the existing AUSF contribution and surcharge structure provisions, but reserves its right to respond to other parties' testimony on reply.

12. Any other specific revisions to the AUSF rules.

Only one carrier per geographic area should be entitled to AUSF support, regardless of the technology used by that carrier. The Commission should, therefore, eliminate R14-2-1206(E), which makes AUSF support available to any competing carrier operating in the same area as a carrier

that qualified for AUSF disbursements. There is no justification for supporting duplicative coverage in an area that is already being served by a carrier receiving AUSF support.

In addition, the Commission should implement a *de minimis* exception that would exclude carriers whose AUSF assessment would be less than $500/month from contributing to the fund, since the cost of generating and processing reports and payments would exceed the contribution amount.[14] The Commission could accomplish this by amending R14-2-1204 to add a new section C. that reads as follows:

> C. Notwithstanding the other provisions of this Article, no telecommunications service provider whose AUSF funding obligation totals less than $500 per month shall be subject to an AUSF funding assessment.

V. CONCLUSION

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

[14] For example, Texas has such an exception. *See* Texas P.U.C. Rule 26.420(f)(3)(C).