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BEFORE THE ARIZONA CORPORATION COMMISSION

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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

INITIAL BRIEF OF THE ARIZONA LOCAL EXCHANGE CARRIERS ASSOCIATION

The Arizona Local Exchange Carriers Association ("ALECA") hereby files its Initial Brief in the above-captioned dockets.

RESPECTFULLY SUBMITTED on July 9, 2010.

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INITIAL BRIEF
OF THE
ARIZONA LOCAL EXCHANGE CARRIERS ASSOCIATION

TABLE OF CONTENTS

I. INTRODUCTION

In accordance with the June 25, 2010, Procedural Order in this case, the Arizona Local Exchange Carriers Association ("ALECA") submits its Initial Brief. In its Initial Brief, ALECA will focus on three areas. First, ALECA will describe its final recommendations concerning AUSF and access reform. Second, ALECA will make procedural recommendations to the Commission concerning how to implement ALECA's reforms. Finally, ALECA will offer an alternative recommendation should the Commission determine that access reform is appropriate, but that ALECA members must file rate cases to receive the benefits of that reform.

After it has had the opportunity to review the other initial briefs, ALECA will discuss in its Reply Brief each party's policy and procedural recommendations.

II. CHARACTERISTICS OF ALECA MEMBERS

ALECA consists of eleven independent local exchange carriers and five tribal companies operating in Arizona.[1] The ALECA members primarily serve rural, high-cost areas with low customer density and smaller calling scopes than larger carriers such as Qwest. These companies are extremely high cost, as demonstrated by exhibit WMS-3, attached to ACC Staff witness Wilfred Shand's testimony. WMS-3 shows a weighted average revenue requirement per loop for ALECA of $548.74 compared to $405.72 for Qwest. ALECA members have three sources of revenue to recover costs: local service revenues received from end user customers; access revenues received from other carriers; and public support revenues such as the Arizona Universal Service Fund (AUSF). The operating characteristics of ALECA members, particularly the low customer density, require access and support revenues to maintain telecommunications services that are affordable and comparable to those in urban areas. Moreover, rural service territories lack the other characteristics (dense populations, low cost service areas, large business

[1] ALECA member companies are as follows: Commercial and Cooperative Companies - Arizona Telephone Company; Copper Valley Telephone; Frontier Citizens Utilities Rural; Frontier Communications of the White Mountains; Midvale Telephone Exchange, Inc.; Navajo Communications Company, Inc.; South Central Communications; Southwestern Telephone Company, Inc.; Table Top Telephone Company, Inc.; Valley Telephone Cooperative, Inc.; and Zona Communications; and Tribally-Owned Companies - Fort Mojave Telecommunications, Inc.; Gila River Telecommunications, Inc.; Hopi Telecommunications, Inc.; San Carlos Apache Telecommunications Utility, Inc.; and Tohono O'odham Utility Authority

customer bases) that more readily provide large non-rural carriers the ability to sustain and internally support affordable local rates.

ALECA is proposing to reduce State access rates to Qwest's intrastate levels. This will reduce ALECA's revenues by $23 million annually. The impact, if absorbed by ALECA's customers, would be an increase in local service rates of $10.74.[2] The current weighted residential local rate for ALECA is $12.91/month.[3] A 10.74/month increase would result in a rate of $23.65, before the subscriber line charge of $6.50 ($30.15 with the SLC charge). This would be over $10/month more than Qwest's current State-wide average residential rate of $13.18.[4] If ALECA 's State access rates are benchmarked to Qwest's rates, it is logical to benchmark to Qwest's local rates as well. The Commission has set rates that have made ALECA member's rates affordable and comparable to those in the urban areas of Arizona. Sound public policy requires that the foregone State access revenues be replaced by funds from the AUSF to enable rural carriers to continue investing and maintaining local exchange facilities in the highest cost areas of the State.

III. <u>ALECA REFORM PROPOSALS</u>

ALECA's policy recommendations in these consolidated dockets may be divided into three parts: (1) revenue-neutral access reform; (2) high-cost loop support; and (3) centralized administration and automatic enrollment for Lifeline and Link-Up. ALECA recommends that all three elements of its policy recommendations be financed from funds provided by the AUSF. To fund these recommendations, ALECA also recommends replacing the current AUSF funding mechanism with one based on Arizona jurisdictional revenues from all telecommunications service providers that interconnect to the public switched network.[5]

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[2] Reply Testimony of Douglas Duncan Meredith at 8:19-20.
[3] *Id.* at 6:22 – 7:1.
[4] Direct Testimony of Peter B. Copeland at 6:19:20.
[5] Direct Testimony of Douglas Duncan Meredith at proposed revised Rules 14-2-1204, 1205.

1. **Access Reform**

As explained in the Mr. Meredith's Direct Testimony, ALECA's access reform proposal is straightforward and is similar to the reforms that have already taken place in the interstate regime and in New Mexico and South Carolina. ALECA recommends the Commission reduce the composite intrastate switched exchange access rate of its member companies to the Qwest statewide intrastate composite rate of $0.0220 per minute-of-use, calculate the total revenue reduction associated with this loss, and compensate ALECA's member carriers with funds from the AUSF.[6] Implementing ALECA's access-reform proposal would shift revenues received from intrastate exchange access to high-cost universal service support and provide for revenue-neutral access replacement.

In keeping with its proposal, ALECA recommends the Commission order a revenue neutral shift of revenues from intrastate switched access to the AUSF, using 2009 as the base year. Based on calendar-year 2008 data, Mr. Meredith estimates the aggregate annual amount of AUSF support needed by ALECA members for access revenue replacement is approximately $23 million. ALECA recommends further that the Commission may revisit these AUSF support disbursements every three years and make adjustments to these disbursements as it deems necessary.[7]

Reducing the ALECA members' intrastate access rates to Qwest's statewide intrastate composite rate of $0.0220 per minute-of-use would go a long way toward closing the gap between the members' intrastate and interstate rates. Mr. Meredith testified that the difference between ALECA members' interstate and intrastate composite switched exchange access rates is approximately nine cents per minute-of-use, and he was careful to point out that this difference is an average; for some ALECA members the difference is much greater than nine cents.[8]

Mr. Meredith testified further that when there is a large difference in rates for a similar service, there is a strong financial incentive for purchasers of switched exchange access services,

[6] Meredith Direct, p. 7.
[7] *Id.*, pp. 8-9.
[8] *Id.*, pp. 5-6.

notably the IXCs, to rate intrastate calls as interstate—thereby paying a lower rate for the same network function, i.e., the origination or termination of an interexchange call. This activity is a type of price arbitrage that reduces the legitimate revenues a local exchange carrier should receive. He concluded that if intrastate switched access rates can be reduced—with a corresponding increase in disbursement from a State-based high cost universal service fund—the arbitrage incentive will be eliminated and rural carriers will be able to promote the widespread affordability of basic local exchange services.[9]

The final aspect of ALECA's access reform proposal concerns the structure of the AUSF surcharge. ALECA recommends the AUSF be funded in a competitively and technologically neutral manner. Accordingly, the Commission should adopt a revenue-based surcharge on intrastate retail communications billed revenues of all communications carriers, including LECs, IXCs, wireless carriers, and interconnected VoIP service providers.[10]

2. <u>State High Cost Loop Support</u>

ALECA recommends that a portion of the AUSF support be based on the cost model used to calculate Federal High-Cost Loop Support (HCL). Mr. Meredith explained that the federal HCL model is an algorithm that calculates a company's Study Area Cost Per Loop (SACPL) based on the actual investment, expenses, and loops of the company. The SACPL is then compared to the national average cost per loop (NACPL) and the ILEC receives federal support for a portion of the costs exceeding 115 percent of the NACPL. The information from the federal HCL algorithm is readily available and can be used to develop a State mechanism that complements the federal HCL mechanism.[11]

ALECA proposes the Commission adopt rules establishing support for loop costs that exceed the current federally determined qualification thresholds. Carriers are presently eligible for federal HCL loop costs that exceed 115 percent of the NACPL. Costs in excess of 115

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[9] *Id.*, p. 6.
[10] *Id.*, p. 9.
[11] *Id.*, pp. 9-10.

percent, but less than 150 percent, are eligible for 65 percent federal recovery. Costs in excess of 150 percent are eligible for 75 percent federal recovery. The ALECA proposal would complement this federal support by providing support for the remaining portion of eligible high loop costs. Specifically, for carriers who receive 65 percent federal cost recovery, the State would provide a 35 percent cost recovery. For carriers who receive 75 percent federal recovery of loop costs in excess of the NACPL, the State would provide support of 25 percent for any loop costs in excess of 150 percent.[12]

ALECA's proposed high-cost loop support would be in addition to a revenue-neutral draw from the AUSF to offset intra-state access reductions. As Mr. Meredith testified, ALECA's members serve rural and remote areas of Arizona, and low customer density makes ALECA's members and their customers dependent on high-cost support mechanisms. There are three revenue streams available to the Rural ILECs: local service revenues, access revenues, and universal service support. ALECA's members do not have a large enough customer base to recover a sufficient amount of revenue to cover the cost of providing local service. Under ALECA's proposed high-cost loop support mechanism, local service revenues and access revenues, which have been designed to keep local service rates affordable, would be used to recover loop costs that do not exceed the 115 percent NACPL threshold. All loop costs above this threshold would be recovered through either the existing federal HCL mechanism or through the new State high-cost loop mechanism.[13]

Relying upon 2007 federal HCL disbursements, Mr. Meredith estimates that the Arizona high-cost loop mechanism proposed by ALECA would provide its members with no more than $9 million annually.[14]

[12] *Id.*, p. 10.
[13] *Id.*, pp. 10-11.
[14] *Id.*, p. 11.

3. Centralized Administration of Life Line/Link-Up

ALECA also recommends that the Commission adopt the proposals contained in the Report and Recommendations of the Eligible Telecommunications Carriers (ETCs) on Lifeline and Link-Up Issues, docketed December 21, 2005. In this report, the ETCs recommended that the Department of Economic Security (DES) centrally administer the Lifeline and Link-Up programs of all of Arizona's ETCs and that the DES be reimbursed for the administrative costs incurred from the AUSF. Centralized administration enables automatic enrollment, and as the ETCs recognized, automatic enrollment is a very effective, if not the most effective, form of outreach.[15]

4. Expanded AUSF Funding

To fund these recommendations, ALECA also recommends replacing the current AUSF funding mechanism with one based on Arizona jurisdictional revenues from all telecommunications service providers that interconnect to the public switched network.[16] This revised funding mechanism was also supported by Staff, [17]AT&T,[18] and Qwest.[19]

IV. ALECA'S PROCEDURAL RECOMMENDATIONS

1. Amend the AUSF Rules to Allow Revenue-Neutral Access-Reform Support

Rule 14-2-1202 (A) currently provides:

> The amount of AUSF support to which a provider of basic local exchange telephone service is eligible for a given AUSF support area shall be based upon the difference between the benchmark rates for basic local exchange telephone service provided by the carrier, and the appropriate cost to provide basic local exchange telephone service as determined by the Commission, net of any universal service support from federal sources.

This bare-bones rule has been so-far interpreted only to allow a small local exchange carrier (R14-2-1201-13) to obtain AUSF support for the difference between the cost of providing basic local exchange telephone service and a benchmark rate.

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[15] *Id.*, pp. 11-12.
[16] *Id.* at proposed revised Rule 14-2-1204, 1205.
[17] Direct Testimony of Wilfred Shand at 30:17-24.
[18] Tr. at 494:19-23;516:11 – 517:7.
[19] Direct Testimony of Peter B. Copeland at 8:18 – 9:10.

The Arizona Universal Service Fund ("AUSF") was established by Decision No. 56639 (dated September 22, 1989) and was designed to help off-set high basic local telephone rates in rural areas.[20]

The Commission did not turn to access-charge reform until 2000, when the above-captioned access-reform docket was opened. This was 11 years after the Commission established the AUSF.[21]

Although one could argue that the existing AUSF could be applied to support access-charge reform, to avoid appellate challenges, the best approach would be to explicitly amend the AUSF rules to allow access-charge support. Further, the current rules would provide no guidelines whatsoever for how to apply for such support, how to qualify, and how the Commission would administer the program.

To fill the regulatory void, ALECA submitted draft rules for the Commission's consideration.[22] If adopted, these rules would provide the Commission explicit authority to provide access-charge-reform relief to small local exchange carriers and provide guidelines on how to apply, the standards to qualify for support, and how the program would be administered.

2. Amend the AUSF Rules to Allow High-Cost Loop Support

As discussed above, ALECA also recommends that the Commission allow the AUSF to provide high-cost loop support. This is also not explicitly allowed by the present rules. To make the Arizona AUSF rules consistent with the operation of the Federal High Cost Fund, ALECA has also submitted draft rules for the Commission's consideration.[23]

3. Amend the AUSF Rules to Allow Centralized Administration of Lifeline and Link-Up

ALECA also recommends expanding the AUSF to support centralized administration of Lifeline and Link-Up and has submitted draft rules for the Commission's consideration.[24]

[20] Decision No. 60169, dated April 18, 1997, at ¶ 1.
[21] *Id.*
[22] Direct Testimony of Douglas Duncan Meredith, Exhibits DDM-1 and DDM-2.
[23] *Id.*
[24] *Id.*

4. Amend the AUSF Rules to Expand the AUSF Funding Mechanism

ALECA also recommends replacing the current AUSF funding mechanism with one based on Arizona jurisdictional revenues from all telecommunications service providers that interconnect to the public switched network. ALECA has submitted draft rules to this effect for the Commission's consideration.[25]

V. ALECA'S ALTERNATIVE PROPOSAL

1. Staff And Other Parties' Proposals Would Delay Access Reform

Staff recommends that a revenue-neutral shift of intrastate-access revenues should require a rate case for each ALECA member unless the ALECA member were willing to absorb the access-charge reductions.[26] Mr. Shand suggests "Staff has no bona fide recent sense of the financial condition of the other ALECA companies other than their assertion that they need AUSF in order to survive the decline in access revenues."[27] However the ALECA members are regulated by this Commission and consequently the intrastate rates of the ALECA members are presumed to be reasonable. Staff's recommendation would turn this presumption on its head and effectively require that ALECA members prove that existing intrastate rates are reasonable before they could receive rate relief to offset access-charge reduction.

Staff's recommendation would even further delay access-charge reform. First, as discussed above, ALECA believes that a rule-making would be necessary before the Commission could provide access-charge relief from the AUSF.[28] Staff concedes that a rule-making would be necessary for at least a part of its access-charge reform.[29] Second, requiring each ALECA member to prepare a rate case would be a huge, time-consuming, expensive burden for the ALECA members, which would also burden the resources of Staff and the Commission.

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[25] *Id.* at proposed revised Rule 14-2-1204, 1205.
[26] Direct Testimony of Wilfred Shand at Executive Summary 1-2.
[27] *Id.* at 19:16-18.
[28] Staff does not recommend that the Commission reduce access rates outside a rate case. Tr. at 691:8-11.
[29] Tr. at 711:11-21.

As Judge Rodda stated to Mr. Shand, "Okay. I caution you to watch out what you ask for, too."[30]

This means that rural access-charge reform could take as long as four years if ALECA members are required to file rate cases. Based on past experience, a Commission rulemaking could take as long as two years following the issuance of a final Decision in the above-captioned case. For subsequent, simultaneous rate cases from each ALECA member, two years would also be a reasonable estimate for the time needed for preparation, filing, sufficiency, hearings, briefing, preparation of recommended orders, and open meetings. Assuming that the Commission were to issue a final order in these dockets in the first quarter of 2011, rural access-charge reform would not be anticipated before 2015 if rate cases were required.[31]

2. <u>If Access Reform Will Be Delayed, It May Be Wiser to Wait for the FCC to Implement the Intercarrier Compensation Component of its Broadband Policy</u>

Given the time required to promulgate an amended AUSF rule and to complete a large number of ALECA member rate cases, the Commission may be better served to wait for the FCC to implement its intercarrier compensation reform targets as set out in its "Connecting America: The National Broadband Plan."[32] Stage One of the FCC's Broadband Plan calls for the FCC to adopt a framework for long-term intercarrier compensation reform, while implementing interim measures to curb arbitrage. Stage One is to be completed during the years 2010 and 2011. Stage Two of the FCC's plan calls for moving carriers' intrastate terminating switched access rates to interstate terminating switched rate levels in equal increments over a period of two to four years, that is, from 2012 to 2014 or 2016. After reducing intrastate rates, the Plan says the FCC could continue by reducing interstate rates to reciprocal compensation rate levels. Finally, in the years 2017-2020, Stage Three of the Plan calls for phasing out altogether per-minute rates for

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[30] Tr. at 705:9-10.

[31] Staff's alternative proposal would not materially alter this timeline. Staff estimates that the last required rate filing would not begin until 42 months after a final order in these dockets. Tr. at 665:22-25.

[32] "Connecting America: The National Broadband Plan," pp. 148-151 and Exhibit 8-F "Roadmap for USF/ICC Reform" at p. 144.

origination and termination of telecommunications traffic. Thus, there is ample reason to believe the FCC's actions in regard to intercarrier compensation may be completed before or only shortly after the ACC could promulgate a State rule and complete multiple ALECA rate cases.

VI. CONCLUSION

ALECA recommends that the Commission aggressively move toward AUSF reform by opening a rulemaking docket to implement (1) access-charge reform; (2) AUSF high-cost loop support; (3) AUSF funding of centralized Lifeline and Link-up programs; and (4) a broader, revenue-based AUSF funding mechanism.

RESPECTFULLY SUBMITTED on July 9, 2010.

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