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BEFORE THE ARIZONA CORPORATION COMMISSION

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COMMISSIONERS

KRISTIN K. MAYES, Chairman
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP

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

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1 **I. INTRODUCTION**

2 This proceeding gives the Commission a critical opportunity to give Arizona consumers
3 much-needed and long-overdue relief from the monopoly-era legacy of high intrastate switched
4 access charges that continues to shackle Arizona communications markets. After more than two
5 years of workshops and testimony filings, virtually all the participants in this proceeding agree
6 that the old system is crumbling and that access charge reform is needed. The Commission
7 should take a meaningful step forward for consumers, as AT&T proposes, and move intrastate
8 access rates to interstate levels—a goal to which Qwest agreed and which the Commission stated
9 as its objective nine years ago.

10 **A. Access Charge Reform.** In the bygone monopoly era, switched access rates were
11 set well above costs to provide an “implicit subsidy” for basic local service. Despite the
12 fundamental changes that have since occurred—notably, the explosion in competition among
13 carriers and alternative technologies that do not have to pay such subsidies—and despite reforms
14 to interstate access charges adopted by the Federal Communications Commission (“FCC”) and
15 many states, those subsidies still remain embedded in Arizona intrastate switched access rates.
16 Qwest, the largest local exchange carrier (“LEC”), charges intrastate access rates that are more
17 than *double* its corresponding interstate rates. Competitive LEC (“CLEC”) intrastate rates are
18 several multiples of their interstate rates. The ALECA members’ overall average intrastate
19 access rate is approximately *seven times higher* than their interstate average. Verizon’s average
20 intrastate rate is *more than 40 times higher* than its average interstate rate.

21 These massive price disparities have nothing to do with any difference in the underlying
22 service. To the contrary, the access functions at the originating or terminating ends of a call are
23 virtually identical whether the call goes to or comes from an interstate or intrastate location.

1 Rather, the disparity exists because the FCC has reduced implicit subsidies in *interstate* rates,
2 while the Commission has yet to complete its reforms of *intrastate* rates.

3 High intrastate access charges harm Arizona consumers in many ways. Some are
4 obvious, while others are insidious. First, access charges are a substantial component of the
5 costs for interexchange carriers (“IXCs”) like AT&T to provide wireline long-distance service to
6 retail consumers. Thus, high access charges keep the prices for in-state wireline long-distance
7 calls much higher than they should be. And because IXCs must average their long-distance
8 rates, consumers all over Arizona pay higher wireline long-distance prices than they should.

9 Second, high access charges tilt the competitive playing field. Wireline long-distance
10 providers face competition from alternative technologies that are *not* saddled with the burden of
11 access subsidies. Consumers today can order goods and services over the Internet; socialize
12 through Internet-based services like Twitter, Facebook and MySpace; send a text message to a
13 friend via mobile phone; correspond via electronic mail; or obtain government forms through a
14 website with a mouse click. Voice services are available not only from local phone companies
15 and long-distance carriers, but also from cable operators, wireless providers and Voice over
16 Internet Protocol (“VoIP”) providers like Vonage, Skype or Magic Jack.

17 Fair competition is always welcome, but high intrastate access rates imposed on just one
18 form of communication mean that competition is not fair. Under the monopoly-era access
19 charge regime which persists today, consumers are choosing alternative technologies over
20 wireline long-distance service—not because of any real difference in quality, service or the true
21 underlying cost of the services, but because high access charges make wireline long-distance
22 service look like less of a bargain. If that artificial burden were removed or at least lightened,
23 wireline IXCs could compete more aggressively. In turn, all competing technologies would
24

1 compete on a more equal footing and be forced to become more efficient, more innovative and
2 more attuned to consumer needs. The results will be a more competitive, consumer-focused
3 Arizona communications market.

4 Third, Arizona consumers also pay the hefty administrative costs of maintaining inflated
5 intrastate access charges. Under the present system, LECs maintain two sets of prices for the
6 same service: one set for access service on interstate calls and a second, much higher set for the
7 same service on intrastate calls. This dual pricing produces costs to maintain a purely artificial
8 regime and creates opportunities and incentives for gaming and arbitrage. Because there is no
9 material difference in the underlying functionality or cost, carriers that charge for access have an
10 incentive to classify traffic as intrastate (or to “pump” up their access volumes) so they can
11 charge more, while carriers that pay access charges have an incentive to shift traffic to the
12 cheaper, interstate jurisdiction. These incentives further distort the market and lead to costly
13 disputes. And, as Sprint’s witness testified, “traffic pumping” is not only an incentive, but also
14 an unfortunate reality in Arizona.

15 More fundamentally, however, high intrastate access charges cannot be sustained in
16 today’s competitive market. Competition from alternative technologies has continued to mount
17 and more and more consumers are disconnecting their traditional wireline phones altogether to
18 avoid the pass-through of excessive access charges. Ironically, because high access charges
19 drive customers and usage away from the wireline networks, they are now drying up the stream
20 of implicit subsidy revenue that they were intended to generate to support wireline local
21 exchange service.

22 To address these problems, AT&T proposes a comprehensive, balanced approach:
23
24

- 1 ● reduce the incumbent LECs' ("ILECs") intrastate switched access
2 rates to the level of the ILECs' *interstate* rates (which already
3 reflect reductions in implicit subsidies adopted by the FCC) and
4 continue to mirror interstate rates and rate structure going forward;
- 5 ● "cap" the CLECs' intrastate switched access rates at the level of
6 the ILEC with which they compete (just as the FCC has done with
7 interstate rates); and
- 8 ● institute these reforms without delay, using the Arizona Universal
9 Service Fund ("AUSF") to facilitate the transition as detailed
10 below.

11 Over 20 other states have undertaken access charge reform. Research shows that long-
12 distance rates in those states are significantly lower than in states that have not yet instituted
13 reforms. The Commission can and should afford Arizona consumers the same relief.

14 **B. The Arizona Universal Service Fund.** The AUSF gives the Commission a
15 powerful tool to smooth the transition for all carriers and their customers towards competitive
16 pricing of local exchange and access service. The reason why access rates were set at artificially
17 high levels was to generate an implicit subsidy for incumbent LECs that were required to provide
18 local service to some customers at artificially low levels. That was the *quid pro quo* of the
19 monopoly era. But, that arrangement simply cannot be sustained in today's competitive markets.

20 Economic principles and common sense suggest that the access side of the long-obsolete
21 monopoly-era *quid pro quo* should be reduced to a more rational level, while the other side of
22 that compact (local exchange prices) should be *increased* to a more rational level. Access charge
23 reductions should be implemented promptly, because the old access charge regime simply cannot
24 and should not be sustained any longer and because access reductions will pave the way for
 increased broadband investment. At the same time, the offsetting local price increases can be
 implemented gradually—using the AUSF as a transitional tool—so that consumers do not see

1 sharp increases in local service rates, while incumbent LECs still have a fair opportunity to make
2 up for the reduction in access revenue during the transition.

3 The way to accomplish all these objectives is straightforward:

- 4 ● give incumbent LECs flexibility to raise their basic local service
5 rates (if they choose to do so), but limit the increases by setting a
reasonable "benchmark" rate of \$18 per month;
- 6 ● limit each ILEC's increase in monthly basic local service rates to
7 \$2 each year, until that ILEC's price reaches the \$18 benchmark;
and
- 8 ● to the extent the opportunity to increase local service rates is not
9 enough to recover the reduction in access revenues, allow the
incumbent LEC to obtain support from the AUSF for the revenue
10 reduction that remains.

11 A benchmark rate of \$18 per month is reasonable for consumers. At the same time, that
12 benchmark would give carriers the opportunity to recover the bulk of the intrastate access
13 revenue reductions resulting from the decrease to interstate rates and structures. As a result, the
14 additional support to be drawn from the AUSF would be modest. In the first year of AT&T's
15 plan, AUSF support would be approximately \$20 million per year: spread over Arizona
16 telecommunications revenues, that would result in a contribution factor of only 0.79%. In the
17 fourth year of AT&T's plan, AUSF support would be reduced to \$16 million per year, resulting
18 in a contribution factor of 0.60%.

19 **C. AT&T's Procedural Recommendations.** AT&T's proposal is straightforward
20 and simple to implement. On the access side, the Commission should order ILECs to file tariffs
21 within 60 days of the Commission's decision, which reduce their intrastate switched access rates
22 to parity, in both structure and level, with their interstate rates. The ILECs can do so by simply
23 copying and pasting their existing interstate tariffs, which are publicly available, into their
24 intrastate tariffs; or they could simply revise the intrastate tariffs to incorporate the interstate

1 tariffs by reference. As interstate access rates are reduced in the future, the Commission should
2 require ILEC and corresponding CLEC intrastate rates to continue mirroring interstate rates and
3 rate structure.

4 The Commission should also order CLECs to file tariffs within 60 days "capping" their
5 intrastate rates at the level of the ILEC with which they compete. As with the ILECs, the
6 Commission would simply be telling the CLECs to do in relation to intrastate traffic what they
7 have already been doing on the interstate side for years. To enforce its decision, the
8 Commission's Decision should also authorize and instruct Staff to bring an order to show cause
9 against any ILEC or CLEC that fails to comply with these directions within 60 days of the failure
10 to comply.

11 With respect to AUSF support, the Commission should approve amending text for the
12 AUSF Rules in this Decision and refer those revisions for public notice, comment and adoption
13 in compliance with the Administrative Procedures Act. AT&T's recommended amending text is
14 Exhibit C to Dr. Oyefusi's Reply Testimony (AT&T-9) and, for convenience, is attached as
15 Exhibit 1 hereto. AT&T's primary recommended revisions to the current Rules include
16 (i) broadening the contribution base of the AUSF to intrastate retail telecommunications revenue
17 and (ii) laying out procedures and formulae to determine the amount of an eligible carrier's
18 access revenue replacement support. To the extent ILECs require AUSF support to recover
19 revenue reductions resulting from access rate reforms prior to passage of the Rules amendments,
20 Staff has stated that ILECs can be allowed to receive temporary AUSF surcharge revenues to
21 offset access charge reductions on an interim basis.

22 Finally, to the extent that ILECs or CLECs require adjustments to local rates (or
23 maximum local rates) to offset access revenue reductions, appropriate filings should be made at
24

1 the same time the intrastate access rate revisions are filed. They should be accompanied by data
2 demonstrating the revenue neutrality of the combined requests.

3 **II. BACKGROUND**

4 **A. Switched Access Charges.**

5 Switched access service generally refers to the service that a LEC provides to IXC's to
6 transport the portion of an interexchange call that originates or terminates on the LEC's
7 facilities.¹ The LEC has the local loop and central office switch that connect an end user to the
8 rest of the public switched telecommunications network.² IXC's obtain access to this local
9 exchange infrastructure in order to "originate" intrastate and interstate long-distance calls from
10 customers served by the LEC and to complete or "terminate" long-distance calls from their own
11 customers to local exchange customers served by the LEC.³

12 Access to the local network for originating or completing a call is essentially the same, no
13 matter where the call goes in between the points of origination and termination: that is, whether
14 the call is interstate or intrastate.⁴ For an interstate or intrastate call, the originating LEC simply
15 takes the call from the caller to the IXC's local point of presence, while the terminating LEC
16 simply takes the call from the IXC's local point of presence to the call's destination.⁵ As a
17 result, there is no dispute that the cost of switched access is identical in all material respects for
18 interstate and intrastate calls.⁶

20 ¹ AT&T-1 (Aron Direct, Public) at 16; *see also* AT&T-7 (Oyefusi Direct, Public) at 13.

21 ² AT&T-7 (Oyefusi Direct, Public) at 13.

22 ³ *See* AT&T-1 (Aron Direct, Public) at 16-17; AT&T-7 (Oyefusi Direct, Public) at 13; ALECA-1 (Meredith Direct)
at 4; Q-1 (Eckert Direct) at 4.

23 ⁴ AT&T-1 (Aron Direct, Public) at 20-22; AT&T-7 (Oyefusi Direct, Public) at 14-15.

24 ⁵ AT&T-1 (Aron Direct, Public) at 16-17; AT&T-7 (Oyefusi Direct, Public) at 14.

⁶ AT&T-1 (Aron Direct, Public) at 17, 20-22; AT&T-7 (Oyefusi Direct, Public) at 14-15; HR TR 228 (Garrett).

1 While the end user chooses the LEC that provides its retail local exchange service, the
2 IXC does not and cannot choose which LEC will originate or terminate a call (and thus, cannot
3 choose the LEC that provides access service and bills switched access charges to the IXC).⁷
4 Rather, this choice “is made solely by the customer.”⁸ For originating access, the IXC does not
5 choose the originating LEC; the end user making the call does that.⁹ For terminating access, the
6 IXC does not choose the people that its end user calls (the originating end user making the calls
7 does that), nor does the IXC choose the terminating LEC that serves the end user at the
8 terminating end of the call (the terminating end user does that).¹⁰ The IXC must deliver the call
9 to the terminating LEC that serves the telephone number for the called party, regardless of the
10 price that the LEC charges for terminating access.¹¹

11 Thus, in contrast to a competitive market, the wholesale access market is unable to
12 discipline the prices charged by the LECs, because the decision-makers (the end users) simply do
13 not confront the prices charged by those LECs.¹² IXCs are stuck with whichever LECs that the
14 originating and terminating end users happen to choose for their retail local service and the IXCs
15 are also stuck with whatever unchecked prices those LECs impose.

16 **B. The Problem of Implicit Subsidies.**

17 Prior to 1996, local telephone service and local exchange carriers were regulated as
18 natural monopolies. Monopoly service providers were required to provide universal service to
19

20 _____
21 ⁷ AT&T-1 (Aron Direct, Public) at 86.

22 ⁸ AT&T-3 (Aron Reply, Public) at 13.

23 ⁹ See AT&T-1 (Aron Direct, Public) at 86.

24 ¹⁰ See AT&T-1 (Aron Direct, Public) at 86.

¹¹ AT&T-3 (Aron Reply, Public) at 12.

¹² AT&T-3 (Aron Reply, Public) at 12-16.

1 all customers in their assigned territories at prices regulated by state commissions.¹³ They served
2 high-cost customers (*e.g.*, customers in rural areas) through a system of “implicit subsidies,”
3 under which the rates paid by some customers were overstated (*i.e.*, in excess of the rates
4 necessary to adequately recover costs) in order to subsidize understated, below-cost rates for
5 other customers.¹⁴ Historically, the switched access charges that LECs charged to IXC were set
6 above the associated cost in order to provide implicit support for below-cost local service.¹⁵

7 The implicit subsidies embedded in access charges constitute a “hidden surcharge” to
8 consumers.¹⁶ Access charges are a significant component of the cost of providing long-distance
9 service, so high access charges force long-distance providers (like AT&T) to maintain higher
10 retail prices for long-distance service.¹⁷ And, because those retail prices are averaged statewide,
11 high access charges harm consumers across Arizona who have to pay these higher-than-
12 necessary rates.¹⁸

13 These historical subsidies can no longer be sustained, given the robust competition that
14 exists from new technologies and carriers.¹⁹ Today, for instance, consumers can make a long-
15 distance call from a wireless phone or by using VoIP, or they can communicate by texting or
16 electronic mail.²⁰ Those alternative services do not bear the same burden of these access
17

18 _____
19 ¹³ AT&T-7 (Oyefusi Direct, Public) at 16; *see also* AT&T-1 (Aron Direct, Public) at 22-24.

20 ¹⁴ AT&T-1 (Aron Direct, Public) at 25; AT&T-7 (Oyefusi Direct, Public) at 16.

21 ¹⁵ AT&T-1 (Aron Direct, Public) at 25; AT&T-7 (Oyefusi Direct, Public) at 16; ALECA-1 (Meredith Direct, Public)
22 at 5; HR TR 314 (Aron).

23 ¹⁶ AT&T-7 (Oyefusi Direct, Public) at 16; *see also* AT&T-1 (Aron Direct, Public) at 25-26; Q-1 (Eckert Direct,
24 Public) at 4.

¹⁷ AT&T-1 (Aron Direct, Public) at 55-58; AT&T-7 (Oyefusi Direct, Public) at 21.

¹⁸ AT&T-7 (Oyefusi Direct, Public) at 21.

¹⁹ AT&T-1 (Aron Direct, Public) at 26-27; AT&T-7 (Oyefusi Direct, Public) at 17, 34, 39-40.

²⁰ AT&T-1 (Aron Direct, Public) at 74-75; AT&T-7 (Oyefusi Direct, Public) at 17, 32.

**HIGHLY CONFIDENTIAL – USE RESTRICTED PER PROTECTIVE ORDER IN
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1 subsidies that wireline IXCs must shoulder.²¹ Accordingly, the retail prices for those competing
2 services are lower, because they do not reflect those hidden charges.²²

3 For example, wireless providers do not pay intrastate access charges, except on in-state
4 calls that (i) cross the boundary of a Major Trading Area (“MTA”) and (ii) terminate to a LEC
5 customer.²³ These constraints greatly limit the applicability of access charges to wireless
6 carriers, because their MTAs are much larger than the local calling areas for wireline calls.²⁴
7 There are only three MTAs in all of Arizona and two of them go well beyond the State’s
8 borders.²⁵ By contrast, there are hundreds of individual local calling areas in Arizona.²⁶ In
9 addition, Arizona’s two largest cities, Phoenix and Tucson, are in the same MTA.²⁷

10 The competitive impact is huge: the fees charged by LECs for intra-MTA wireless calls
11 are many times lower than the LECs’ access fees for Arizona intrastate long-distance.²⁸ For
12 example, Qwest’s intrastate access charge per minute on wireline calls of [BEGIN HIGHLY
13 CONFIDENTIAL INFORMATION] [REDACTED] [END HIGHLY CONFIDENTIAL
14 INFORMATION] is more than 24 times the rate for terminating intra-MTA wireless calls;
15 likewise, Cox’s wireline access rate of [BEGIN HIGHLY CONFIDENTIAL
16 INFORMATION] [REDACTED] [END HIGHLY CONFIDENTIAL INFORMATION] cents per
17 minute is over 24 times its rate for intra-MTA wireless calls.²⁹ So, if an AT&T customer in

18 _____
19 ²¹ AT&T-1 (Aron Direct, Public) at 74-75.

²² AT&T-1 (Aron Direct, Public) at 74-75.

20 ²³ AT&T-1 (Aron Direct, Public) at 40.

21 ²⁴ AT&T-1 (Aron Direct, Public) at 41-44 & Figures 2-3.

22 ²⁵ AT&T-1 (Aron Direct, Public) at 41-44 & Figures 2-3.

²⁶ AT&T-1 (Aron Direct, Public) at 41-44 & Figures 2-3.

²⁷ AT&T-1 (Aron Direct, Public) at 41.

23 ²⁸ AT&T-2 (Aron Direct, Confidential) at 45-46 & Table 3.

24 ²⁹ AT&T-2 (Aron Direct, Confidential) at 45-46 & Table 3.

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1 Phoenix makes a wireline call to a friend in Parker, AT&T has to pay about [BEGIN HIGHLY
2 CONFIDENTIAL INFORMATION] [REDACTED] [END HIGHLY CONFIDENTIAL
3 INFORMATION] cents *per minute* in originating access charges to the ILEC serving Phoenix
4 (Qwest) and [BEGIN HIGHLY CONFIDENTIAL INFORMATION] [REDACTED] [END HIGHLY
5 CONFIDENTIAL INFORMATION] cents per minute in terminating access charges to the
6 ILEC serving Parker (Verizon).³⁰ But, if that same Phoenix customer makes the same call from
7 her wireless phone, the wireless carrier would pay *nothing* in originating access charges and only
8 [BEGIN HIGHLY CONFIDENTIAL INFORMATION] [REDACTED] [END HIGHLY
9 CONFIDENTIAL INFORMATION] cents per minute to Verizon for terminating the call.³¹ In
10 other words, AT&T would pay over 26 times more than the wireless provider for what is
11 essentially the same service.

12 That is only the beginning. Whether access charges even apply to VoIP traffic is a
13 disputed area that the FCC has not resolved.³² And, some alternative technologies (like
14 computer-to-computer voice calling, electronic mail and Facebook) are not subject to the access
15 charge regime at all.³³

16 Naturally, consumers seek to avoid paying for implicit subsidies where they can, so they
17 have flocked to alternative technologies not burdened by those subsidies. According to a 2009
18 report by the Center for Disease Control, more than one of every five American homes has now
19 “cut the cord” entirely and the trend is accelerating.³⁴ Other technologies, such as VoIP and
20 broadband, have similarly flourished (in large part, because of the artificial advantage that results

21 _____
³⁰ AT&T-2 (Aron Direct, Confidential) at 72.

22 ³¹ AT&T-2 (Aron Direct, Confidential) at 72-73.

23 ³² AT&T-1 (Aron Direct, Public) at 46-47.

24 ³³ AT&T-1 (Aron Direct, Public) at 47.

³⁴ AT&T-7 (Oyefusi Direct, Public) at 39-40.

**CONFIDENTIAL – USE RESTRICTED PER PROTECTIVE ORDER IN
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1 when they do not have to pay the same subsidies that their competitors, the wireline IXCs, have
2 to pay) and Arizona consumers continue to migrate to VoIP suppliers like Comcast or Vonage.³⁵

3 Fair competition is welcome. But, these implicit subsidies distort competition by placing
4 a burden solely on *one* set of competitors—wireline IXCs—while leaving others arbitrarily
5 advantaged. Thus, high access rates distort the market. As Dr. Aron put it: “The[] vast
6 differences in rates charged by the local exchange company for the same access functionality
7 substantially disfavors the wireline IXC and confers a competitive advantage” on competitors
8 “for no reason related to their relative efficiencies or value of service provided.”³⁶

9 The result has been extremely detrimental to wireline long-distance carriers and their
10 customers. Artificially high intrastate switched access rates are a significant component of long-
11 distance prices. In Arizona, AT&T’s average intrastate access expenses per minute for 2008
12 were about [BEGIN CONFIDENTIAL INFORMATION] [REDACTED] [END CONFIDENTIAL
13 INFORMATION] of AT&T’s intrastate long-distance revenues per minute.³⁷ Even more
14 striking is the fact that ALECA’s average intrastate access rates *exceed* AT&T’s average long-
15 distance prices (by a wide margin).³⁸ So, AT&T actually *loses* money on every call to or from
16 an ALECA end user on the access charges *alone*—in other words, before AT&T’s other costs to
17 provide long-distance service are even taken into account.³⁹

18 High access costs distort the marketplace by artificially driving consumers to substitute
19 technologies (such as wireless) that are not saddled with these subsidies and by punishing those
20

21 ³⁵ AT&T-7 (Oyefusi Direct, Public) at 32-34.

22 ³⁶ AT&T-1 (Aron Direct, Public) at 73.

23 ³⁷ AT&T-2 (Aron Direct, Confidential) at 56-57 & Figure 4.

24 ³⁸ AT&T-8 (Oyefusi Direct, Confidential) at 27-28.

³⁹ AT&T-8 (Oyefusi Direct, Confidential) at 27-28.

1 consumers who do stay with wireline technology.⁴⁰ The fact that AT&T and other wireline IXC
2 cannot compete when they pay such excessive intrastate access rates is demonstrated clearly by
3 the [BEGIN CONFIDENTIAL INFORMATION] ■ [END CONFIDENTIAL
4 INFORMATION] drop in Qwest's intrastate access minutes in just the last two years.⁴¹
5 Nationwide, intrastate long-distance minutes have declined by 30% in just six years (from 2000
6 through 2006).⁴² In Arizona, ILECs have lost 30% of their access lines since 2003 and, in the
7 last two years alone, the line loss has averaged 8% per year.⁴³

8 **C. The FCC's Significant Access Reforms.**

9 With regard to *interstate* calls, the FCC has recognized for years the harms posed by
10 implicit subsidies and high access charges and has instituted significant reforms.⁴⁴ Congress
11 recognized in 1996 the harms of implicit subsidies and directed the FCC to eliminate implicit
12 subsidies or replace them with explicit subsidies and move all interstate access rates towards
13 cost-based levels.⁴⁵ In response, the FCC implemented significant access reforms with the
14 release of its *Access Charge Reform Order* in 1997, which required the structure of interstate
15 access fees to more closely reflect costs.⁴⁶ In 2000, recognizing that further reductions to
16 switched access fees were warranted, the FCC released its *CALLS Order*, which adopted
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18

19 ⁴⁰ AT&T-1 (Aron Direct, Public) at 74-76.

20 ⁴¹ AT&T-8 (Oyefusi Direct, Confidential) at 6.

21 ⁴² AT&T-1 (Aron Direct, Public) at 27.

22 ⁴³ AT&T-7 (Oyefusi Direct, Public) at 39 (citing ILEC data submitted to NECA).

23 ⁴⁴ ALECA-1 (Meredith Direct) at 5.

24 ⁴⁵ Telecommunications Act of 1996, Preamble; and, First Report and Order, *In re Implementation of the Local Competition Provisions in the Telecommunications Act of 1996 and Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, 11 FCC Rcd. 15,499 (1996).

⁴⁶ First Report and Order, *In re Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Transport Rate Structure and Pricing; End User Common Line Charges*, 12 FCC Rcd. 15,982 (1997), ¶ 6.

1 additional interstate access charge reforms.⁴⁷ The FCC concluded that the *CALLS Order* would
2 benefit consumers by producing lower long-distance prices and would promote “the
3 development of greater facilities-based residential competition.”⁴⁸ The FCC implemented
4 further reductions of interstate access rates for ILECs governed by rate-of-return regulation in
5 the 2001 *MAG Order*.⁴⁹

6 The FCC turned to CLEC access rates in 2001 and established “caps” on CLEC interstate
7 access rates.⁵⁰ The FCC concluded that CLECs have market power in the provision of switched
8 access services and required that CLECs’ interstate access rates in any geographic area be
9 “capped” at the corresponding interstate access rates of the ILEC in that area.⁵¹ Although the
10 FCC described these caps as an “interim measure” (with an eye towards additional reductions in
11 the future), the caps remain in place today and the FCC has continued to reiterate its conclusion
12 that CLECs have market power.⁵²

13 After issuing a 2001 Notice of Proposed Rulemaking, the FCC has continued to articulate
14 the need for further access reform and the detrimental effect that the current regime of ad hoc,
15 excessive and mismatched rates has on competition and consumers. In 2008, then-FCC
16 Chairman Martin noted that legacy intercarrier compensation regimes “impose significant
17 inefficiencies on users and distort carriers’ investment incentives,” posing an “obstacle to the

18 ⁴⁷ *In re Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers: Low-Volume Long-*
19 *Distance Users; Federal-State Board on Universal Service*, before the Federal Communications Commission,
15 FCC Rcd. 12,962 (2000) (hereinafter, “*FCC CALLS Order*”).

20 ⁴⁸ *FCC CALLS Order* at ¶¶ 28, 35, 42.

21 ⁴⁹ *In re Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent*
Local Exchange Carriers and Interexchange Carriers and Federal-State Joint Board on Universal Service, et al.,
16 FCC Rcd. 19613 (2001).

22 ⁵⁰ *In re Access Charge Reform & Reform of Access Charges Imposed by Competitive Local Exchange Carriers*,
Seventh Report and Order and Further Notice of Proposed Rulemaking, 16 FCC Rcd. 9923 (2001) (hereinafter,
“*FCC Order Capping CLEC Access Charges*”).

23 ⁵¹ *FCC Order Capping CLEC Access Charges*, ¶¶ 31, 51-52.

24 ⁵² AT&T-1 (Aron Direct, Public) at 30.

1 transition to an all-IP broadband world.”⁵³ Most recently, earlier this year, the FCC delivered to
2 Congress a *National Broadband Plan*, authored by FCC staff.⁵⁴ The *National Broadband Plan*
3 recognized that “[t]he current ICC [InterCarrier Compensation] system is not sustainable” and
4 “creates opportunities for access stimulation.”⁵⁵ As the *Plan* explains:

5 Local companies incurred a traffic-sensitive cost to “switch” or connect a call from the
6 long-distance company to the carrier’s customer. The per-minute rates charged to the
7 long-distance carrier were set above cost and provided an implicit subsidy for local
8 carriers to keep residential rates low and promote universal telephone service. ICC has
9 not been reformed to reflect fundamental, ongoing shifts in technology and consumer
10 behavior, and *it continues to include above-cost rates*. The current ICC system is *not*
11 *sustainable* in an all-broadband Internet Protocol (IP) world where payments for the
12 exchange of IP traffic are not based on per-minute charges, but instead are typically
13 based on charges for the amount of bandwidth consumed per month. . . . *Most ICC rates*
14 *are above incremental cost, which creates opportunities for access stimulation, in*
15 *which carriers artificially inflate the amount of minutes subject to ICC payments.*⁵⁶

16 While the FCC has recognized the problems of implicit subsidies and taken action to
17 address those problems on the interstate side, it has not instituted comprehensive reform, despite
18 years of deliberation.⁵⁷ The *National Broadband Plan* recommends comprehensive reform—
19 with the ultimate goal of eliminating all access charges entirely—but, there is no concrete
20 commitment that reform will be implemented anytime soon. In fact, the FCC is instituting over
21 60 separate rulemakings to discuss the *Plan*’s recommendations. Under its proposed schedule,
22 intercarrier compensation is #20 on the list: the FCC would not even issue a notice of proposed
23 rulemaking on intercarrier compensation until the fourth quarter of this year.⁵⁸

20 ⁵³ Order on Remand and Report and Order and Further Notice of Proposed Rulemaking, *In the Matter of High-Cost*
21 *Universal Service Support and Federal-State Joint Board on Universal Service, et al.*, before the Federal
22 Communications Commission, FCC 08-262 (released November 5, 2008), Appendix A at ¶ 189.

21 ⁵⁴ Connecting America: The National Broadband Plan, available at <http://www.broadband.gov/plan/8-availability>.

22 ⁵⁵ *National Broadband Plan*, p. 142.

23 ⁵⁶ *National Broadband Plan*, p. 142 (emphasis added).

24 ⁵⁷ AT&T-1 (Aron Direct, Public) at 31.

⁵⁸ *Broadband Action Agenda*, available at <http://www.broadband.gov/plan/broadband-action-agenda.html>.

1 On the intrastate side, over 20 states have also confronted the problem of implicit access
2 subsidies by requiring carriers to reduce access charges and many of those states have followed
3 the significant reforms the FCC has already adopted for interstate rates.⁵⁹ Several states have
4 also reduced CLEC access rates, either by “capping” those rates at ILEC levels or by including
5 CLECs in rate reductions applied generally to all LECs.⁶⁰ States have implemented access
6 reforms by giving LECs increased flexibility to increase retail rates for local services and/or by
7 giving ILECs support from state universal service funds. The *National Broadband Plan*
8 endorses this approach. It proposes that intrastate access rates be reduced to interstate levels as
9 part of a transition to full reform and recommends that the “FCC should also encourage states to
10 complete rebalancing of local rates to offset the impact of lost access revenues.”⁶¹ As the *Plan*
11 explains, rebalancing access and local rates “would encourage carriers and states to . . . move
12 away from artificially low \$8–\$12 residential rates that represent old implicit subsidies to levels
13 that are more consistent with costs.”⁶² The *Plan* also cites the Pennsylvania Commission’s
14 recommendation that the FCC account for state efforts as part of any federal reform.⁶³

15 **III. DISCUSSION**

16 **A. The Commission Should Reduce the ILECs’ Intrastate Switched Access** 17 **Rates to Parity With Their Interstate Rates and Keep Them in Parity With** 18 **Interstate Rates.**

19 **1. The Existing Monopoly-Era Subsidies Cannot Be Sustained in** 20 **Today’s Competitive Marketplace.**

21 Virtually all of the participants in this proceeding agree there should be *some* reduction in
22 the LECs’ intrastate switched access rates. The Commission’s Utilities Division Staff, AT&T,

23 ⁵⁹ AT&T-1 (Aron Direct, Public) at 48-51.

24 ⁶⁰ AT&T-1 (Aron Direct, Public) at 52-54.

⁶¹ *National Broadband Plan*, p. 148.

⁶² *National Broadband Plan*, p. 148.

⁶³ *National Broadband Plan*, p. 143, n.65.

1 Sprint, Qwest, Verizon and ALECA all support reductions. It is easy to see why this consensus
2 exists when one reviews the evidentiary record.

3 First, there is no dispute—nor could there be—that the LECs’ current access rates include
4 massive implicit subsidies for local service. Even though the functions and cost of interstate and
5 intrastate switched access are virtually identical,⁶⁴ Qwest’s intrastate switched access rates are
6 more than double its interstate rates.⁶⁵ On average, the ALECA members’ intrastate switched
7 access rates are about *seven times higher* than their corresponding interstate rates.⁶⁶ Verizon’s
8 average intrastate access rate is more than *40 times higher* than its interstate rate.⁶⁷ All of the
9 CLECs’ intrastate rates are several times higher (in many cases, more than ten times higher) than
10 the corresponding interstate rates.⁶⁸ At the hearing, Cox’s Mr. Garrett admitted “that there is
11 quite a spread” between interstate and intrastate per-minute access charges; “[i]n fact, the
12 intrastate rate is approximately 11 times higher than the interstate rate.”⁶⁹

13 Even more startling, Verizon’s intrastate switched access rates are more than 200 times
14 the corresponding cost-based rates for terminating local calls, even though the cost of
15 terminating a call is the same, whether that call comes from a local or long-distance location.⁷⁰
16 The same disparities undoubtedly apply to the other LECs—who refused to even provide
17 information about local call termination rates in discovery.⁷¹ Given these figures, it comes as no
18 surprise that no LEC has even claimed—much less presented evidence—that its current intrastate

19 _____
⁶⁴ AT&T-1 (Aron Direct, Public) at 17, 20-22; AT&T-7 (Oyefusi Direct, Public) at 14-15; HR TR 228 (Garrett).

20 ⁶⁵ AT&T-2 (Aron Direct, Confidential) at 36 & Table 1.

21 ⁶⁶ AT&T-1 (Aron Direct, Public) at 37.

22 ⁶⁷ AT&T-2 (Aron Direct, Confidential) at 36-37 & Table 1.

23 ⁶⁸ AT&T-2 (Aron Direct, Confidential) at 39 & Table 2.

24 ⁶⁹ HR TR 232.

⁷⁰ AT&T-1 (Aron Direct, Public) at 38.

⁷¹ AT&T-1 (Aron Direct, Public) at 38 & n.39.

1 switched access rates are justified by actual costs. As ALECA's Mr. Meredith put it, "right now
2 the access regime has implicit supports built into it. That's why these rates are so high."⁷²

3 There is also no dispute that today's inflated intrastate access charges harm competition
4 or that reducing access rates will benefit the State and its consumers. Staff recognizes several
5 benefits of switched access reform: namely, "[p]rice efficiency," the "[r]eduction of arbitrage
6 opportunities," the "[e]limination of differences in rates that occur because of regulatory
7 decisions," the "[e]stablishment of more consistent and rational intrastate switched access rates"
8 and "[a] reduction in toll rates."⁷³ ALECA acknowledges the "large difference in rates for a
9 similar service"—intrastate and interstate access—creates "a strong financial incentive" for
10 "price arbitrage" that "appears to be contrary to the Commission's policy to preserve and
11 promote the widespread affordability of basic local exchange services throughout rural
12 Arizona."⁷⁴ At the hearing, ALECA's witness further acknowledged "that the end user
13 customers help pay for the [access] inputs used for long-distance service."⁷⁵ Qwest testified that
14 "the continued viability of the entire system is undermined" because "different technologies pay
15 different rates for similar calls"; moreover, with today's large disparities between interstate and
16 intrastate access rates, "the door is open to market distortion and arbitrage opportunities."⁷⁶ And,
17 when asked about the benefits of access reform at the hearing, Qwest's witness, Mr. Copeland,
18 acknowledged: "I listened to [AT&T witness] Dr. Aron's answers to your questions this
19 morning, and I thought all of her answers were appropriate and reasonable."⁷⁷

20 _____
21 ⁷² HR TR 207.

22 ⁷³ S-1 (Shand Direct, Public) at 9, 12.

23 ⁷⁴ ALECA-1 (Meredith Direct) at 6.

24 ⁷⁵ HR TR 147.

⁷⁶ Q-1 (Eckert Direct, Public) at 4.

⁷⁷ HR TR 427.

**HIGHLY CONFIDENTIAL – USE RESTRICTED PER PROTECTIVE ORDER IN
DOCKET NO. RT-00000H-97-0137**

1 The implicit subsidies in intrastate access charges hurt competition in Arizona. IXC
2 compete against e-mail, instant messaging, wireless carriers, VoIP providers and social
3 networking websites that are not saddled with the same high access charges that the IXCs must
4 pay.⁷⁸ For example, an IXC may pay [BEGIN HIGHLY CONFIDENTIAL
5 INFORMATION] [REDACTED] [END HIGHLY CONFIDENTIAL INFORMATION] times
6 more in access fees to the ILEC for an identical call than would a wireless provider.⁷⁹ The
7 expenditures incurred by the IXCs burdened with such interconnection fees are astronomical:
8 *every day*, IXCs pay \$155,000 more than if intrastate switched access rates were set at interstate
9 levels.⁸⁰ Reforming access rates will allow different technologies and companies to compete
10 more closely and fairly on their merits.⁸¹ Consumers will reap the benefits, as competitive
11 choices and outcomes will be based more on real factors like quality and efficiency rather than
12 artificial costs imposed by regulation.

13 More fundamentally, it is clear that the monopoly-era subsidy regime is unraveling and
14 cannot be sustained in today's competitive market.⁸² To avoid the cost of implicit subsidies,
15 consumers are indisputably placing more and more calls through wireless phones or VoIP, or
16 using e-mail or turning to other alternative technologies.⁸³ More and more consumers are
17 "cutting the cord" and disconnecting their traditional wireline phones altogether.⁸⁴ As a result,
18 high access charges are causing LECs to lose subsidies from access charges *and* revenues from
19

20 ⁷⁸ AT&T-1 (Aron Direct, Public) at 74-75; AT&T-7 (Oyefusi Direct, Public) at 17, 32; HR TR 346 (Aron).

21 ⁷⁹ AT&T-2 (Aron Direct, Confidential) at 71.

22 ⁸⁰ AT&T-7 (Oyefusi Direct, Public) at 38.

23 ⁸¹ AT&T-1 (Aron Direct, Public) at 75-78, 82; AT&T-7 (Oyefusi Direct, Public) at 21-22.

24 ⁸² AT&T-1 (Aron Direct, Public) at 26-27; AT&T-7 (Oyefusi Direct, Public) at 17, 34, 39-40.

⁸³ AT&T-1 (Aron Direct, Public) at 26-27; AT&T-7 (Oyefusi Direct, Public) at 17, 32-36.

⁸⁴ AT&T-7 (Oyefusi Direct, Public) at 39-40.

1 local service.⁸⁵ Instead of *supporting* local networks, as was originally intended, high access
2 charges threaten to destroy their competitive viability.⁸⁶ As Qwest puts it: “With the advent of
3 competition, allowing implicit subsidies becomes increasingly difficult”; indeed, “[w]hen
4 different technologies pay different rates for similar calls, the continued viability of the entire
5 system is undermined.”⁸⁷

6 **2. Through Reform, Arizona Consumers Will Enjoy Lower Long-**
7 **Distance Rates.**

8 Because switched access service is a wholesale input for long-distance service, high
9 switched access charges drive higher prices for retail long-distance service. Reforming intrastate
10 access rates, therefore, will drive lower long-distance prices for the benefit of Arizona
11 consumers. Staff rightly acknowledges that “[a] reduction in toll rates is a benefit” of access
12 reform.⁸⁸ Basic economic theory dictates that any rational company—even a *pure* monopolist
13 that is completely unregulated—will decrease prices if its incremental costs fall, because
14 reducing prices in that circumstance maximizes its profits.⁸⁹ Obviously, a company that faces
15 competitive pressures—particularly IXC’s, who indisputably face competitive pressures from
16 multiple technologies that do not bear the same access cost burden—has even more incentive to
17 lower its prices when its costs decrease.⁹⁰ As economist Dr. Debra Aron testified:

18 You know, it is not a surprise that carriers pass through access rate reductions. It is not
19 because carriers are altruistic or are seeking to look good in front of regulatory
20 commissions. It is a fact of economics that even if you are a monopolist, even if you face

21 ⁸⁵ AT&T-1 (Aron Direct, Public) at 26-27; AT&T-7 (Oyefusi Direct, Public) at 32-36.

22 ⁸⁶ AT&T-1 (Aron Direct, Public) at 26-27; AT&T-7 (Oyefusi Direct, Public) at 32-36.

23 ⁸⁷ Q-1 (Eckert Direct, Public) at 4.

24 ⁸⁸ S-1 (Shand Direct, Public) at 12.

⁸⁹ AT&T-1 (Aron Direct, Public) at 66.

⁹⁰ AT&T-1 (Aron Direct, Public) at 66-67.

1 no competition at all, if your variable costs . . . go down, it is profit maximizing to lower
2 your price.

* * *

3 Competition reinforces that fact. . . . [T]he more competition you have, the less flexibility
4 you have to make any decisions over your price, you just have to follow the constraints of
5 the market. But even without competition, a rational firm is going to lower its price.
6 And that's what we see them [IXCs] doing.⁹¹

7 The empirical data prove this basic economic truth. Dr. Aron performed a
8 comprehensive analysis of historical data of AT&T's intrastate access costs and intrastate long-
9 distance prices from 2004-2009 for all 50 states.⁹² Dr. Aron's analysis found a strong positive
10 correlation between AT&T's intrastate access cost and AT&T's intrastate long-distance price: in
11 states or years where the access cost is higher, the long-distance price charged also tends to be
12 higher.⁹³ On the interstate side, even a casual glance at the historical data since 1996 shows that
13 as per-minute interstate access charges have decreased, so too have interstate long-distance
14 prices decreased.⁹⁴ Based on a statistical regression analysis, Dr. Aron predicted that reducing
15 intrastate access rates to "parity" with the corresponding interstate rates would result in a
16 reduction of 19-42% from AT&T's current intrastate long-distance prices in Arizona.⁹⁵ While
17 no one can predict all the complex interactions that make up prices in a competitive market,
18 AT&T has made the same concrete commitment for Arizona that it is already implementing in
19 New Jersey (where the Board of Public Utilities has ordered all LECs to reduce intrastate
20 switched access rates to interstate parity): if the Commission adopts AT&T's proposal for

21 _____
22 ⁹¹ HR TR 301-02.
23 ⁹² AT&T-1 (Aron Direct, Public) at 60-65.
24 ⁹³ AT&T-1 (Aron Direct, Public) at 61-62 & Fig. 6.
⁹⁴ AT&T-1 (Aron Direct, Public) at 58-59 & Fig. 5.
⁹⁵ AT&T-1 (Aron Direct, Public) at 65.

1 interstate parity, AT&T will eliminate its \$1.49 per line monthly in-state connection fee for
2 stand-alone long-distance customers and will reduce its in-state rates for prepaid calling cards.⁹⁶

3 **3. It Makes No Sense to Maintain Vastly Different Rates for Interstate**
4 **and Intrastate Access.**

5 In addition to the benefits that access charge reform provides by promoting fair
6 competition and reducing long-distance rates, intrastate switched access charges should be
7 reduced to, and maintained at, interstate levels, because it is undisputed that interstate and
8 intrastate access are essentially the same service. LECs provide materially the same function to
9 originate and terminate a call, whether that call comes from or goes to an interstate or intrastate
10 location.⁹⁷ Cox witness Garrett admitted on cross-examination “that the functionality that Cox
11 uses in Arizona to provide interstate originating and terminating switched access does not
12 materially differ from the functionality Cox uses to provide intrastate originating and terminating
13 switched access service.”⁹⁸ ALECA’s Mr. Meredith similarly agreed “that generally ALECA
14 member companies employ the same network functionality, whether originating or terminating
15 inter or intrastate calls.”⁹⁹ Because the LEC is performing the same service and using the same
16 facilities, there is no justification for different rates.

17 Nevertheless, the access rates for intrastate and interstate calls remain widely disparate.
18 These disparities are unjustified and lead to nonsensical results. Under the current rate structure,
19 the price Qwest charges AT&T to terminate a call is substantially higher if a call comes from a
20 neighboring town in Arizona than if it comes from New York.¹⁰⁰

21 _____
⁹⁶ AT&T-7 (Oyefusi Direct, Public) at 42.

22 ⁹⁷ AT&T-1 (Aron Direct, Public) at 17, 20-22; AT&T-7 (Oyefusi Direct, Public) at 14-15.

23 ⁹⁸ HR TR 227-228.

24 ⁹⁹ HR TR 134.

¹⁰⁰ AT&T-1 (Aron Direct, Public) at 22.

1 Qwest acknowledges that the substantial gap between interstate and intrastate rates means
2 that “the door is open to market distortion and arbitrage opportunities,” including “traffic
3 pumping activities.”¹⁰¹ ALECA likewise recognizes that “a large difference in rates for a similar
4 service” encourages “price arbitrage”; conversely, “[i]f switched access rates can be reduced . . .
5 the arbitrage incentive will be eliminated or reduced.”¹⁰² As Dr. Aron put it, “[e]xcessive access
6 charges create artificial arbitrage opportunities”; “[w]hen access charges substantially exceed
7 cost, there is money to be made by receiving those fees.”¹⁰³

8 In addition, carriers have a greater incentive to misclassify traffic in order to avoid high
9 access rates, which results in the inefficient routing of calls, attempts to mislabel calls and
10 attempts to deliver traffic without sufficient information for the LEC to determine the
11 jurisdictional nature of the call.¹⁰⁴ All of the resources expended on identifying whether traffic is
12 interstate or intrastate and ensuring that traffic is not intentionally or accidentally misclassified
13 are simply “a deadweight loss to the economy that would be decreased or avoided if interstate
14 and intrastate access rates were the same.”¹⁰⁵

15 “Call pumping,” also called “traffic pumping,” is a prime example of the arbitrage that is
16 encouraged by the present access charge regime. The term refers to practices by which some
17 LECs have artificially stimulated additional phone traffic (for which they bill access charges).
18 “For example,” the *National Broadband Plan* observes, “companies have established ‘free’
19 conference calling services, which provide free services to consumers while the carrier and
20

21 ¹⁰¹ Q-1 (Eckert Direct, Public) at 4.

22 ¹⁰² ALECA-1 (Meredith Direct) at 6.

23 ¹⁰³ AT&T-1 (Aron Direct, Public) at 78-79.

24 ¹⁰⁴ AT&T-1 (Aron Direct, Public) at 80-81.

¹⁰⁵ AT&T-1 (Aron Direct, Public) at 81; *see also* HR TR 345 (Aron) (explaining that access reform will result in
“the reduction in incentives for arbitrage” and avoid the “dead weight loss” of policing the current system).

1 conference call company share the [access] revenues paid by interexchange carriers.”¹⁰⁶ Other
2 companies have established similar arrangements for chat lines, which often feature content of a
3 sexually explicit nature.¹⁰⁷ The incentive to establish such arrangements exists because “[m]ost
4 [access] rates are above incremental cost”; as a result, “investment is directed to free conference
5 calling and similar schemes for adult entertainment that ultimately cost consumers money.”¹⁰⁸

6 High access rates create powerful incentives for LECs to engage in traffic pumping—and
7 this record shows that at least one LEC has acted on those incentives and made “traffic pumping”
8 an all-too-real phenomenon in Arizona. Sprint’s witness, Mr. Appleby, testified that “Sprint is
9 aware of one CLEC in Arizona that is, in fact, engaging in traffic pumping.”¹⁰⁹ In addition,
10 Mr. Appleby knew of another CLEC that operates in Arizona and has been “pumping” traffic in
11 other states.¹¹⁰ The access reform proposed by AT&T will curb that practice and remove
12 incentives for other carriers to engage in such schemes.

13 **4. Other States Have Reduced Intrastate Access Rates to Parity With**
14 **Interstate Levels.**

15 Nine years ago, this Commission recognized an ultimate goal to reduce intrastate
16 switched access rates to parity with the corresponding interstate rates.¹¹¹ Other states have
17 already implemented that same policy, reducing intrastate switched access rates to more
18 reasonable and sustainable levels and using interstate access rates as a benchmark for intrastate
19

20 _____
21 ¹⁰⁶ *National Broadband Plan*, at p. 142.

22 ¹⁰⁷ AT&T-7 (Oyefusi Direct, Public) at 46.

23 ¹⁰⁸ *Id.*

24 ¹⁰⁹ HR TR 454.

¹¹⁰ HR TR 454.

¹¹¹ Decision No. 63487, p. 12, & Attachment A, p. 2.

1 rates to take advantage of reforms implemented at the federal level.¹¹² While states
2 implementing parity have done so in different ways (some by statute; others by commission
3 order; still others as a condition of alternative regulation), their basic policy choice has been the
4 same.

5 To take a recent example, on February 1, 2010, the New Jersey Board issued an order
6 finding that intrastate and interstate access services “do not materially differ,” and that “*any*
7 *disparities* in... Intrastate and Interstate Access Rates *should be eliminated.*”¹¹³ Accordingly, the
8 Board ordered the state’s principal incumbent LECs (Verizon and CenturyLink) to mirror their
9 interstate access rates and ordered all CLECs to mirror the resulting intrastate rates of the ILECs
10 in their respective service territories.¹¹⁴ The Board also found “that a reduction of Intrastate
11 Access Rates will benefit customers because there is a relationship between reduced access
12 charges and toll reductions.” The record also shows that not only will market discipline drive
13 IXC rates lower, but AT&T has committed to eliminate an in-state connectivity fee and reduce
14 the decrement rate on prepaid calling cards (just as it has already done in New Jersey, where the
15 state’s Board has ordered LECs to reduce their intrastate switched access rates to parity with the
16 corresponding interstate rates).¹¹⁵

17 In short, many other states have recognized the consumer and competitive harms caused
18 by implicit subsidies and excessive intrastate access rates and have determined that intrastate
19 access rates should be reduced to parity with interstate rates. States implementing these reforms

20 ¹¹² AT&T-1 (Aron Direct, Public) at 48-51.

21 ¹¹³ *In re Board’s Investigation and Review of Local Exchange Carrier Intrastate Exchange Access Rates*, NJ BPU
Docket No. TX08090830, Order, February 1, 2010, p. 27 (emphasis added).

22 ¹¹⁴ *Id.* at p. 29. The New Jersey Board did not authorize the creation of a universal service fund for incumbents and
23 instead adopted a three-year phase-in plan for access charge reductions. As described in Sections I.C and I.E below,
no phase-in plan is necessary for the implementation of access reductions in Arizona, as the Commission here can
use the State’s universal service fund as a transitional mechanism.

24 ¹¹⁵ *Id.*

1 have brought significant direct benefits to consumers in the form of reduced long-distance prices.
2 Moreover, reforms have also driven incalculable additional benefits that come from promoting
3 fair competition and reducing opportunities for harmful arbitrage. This Commission should
4 follow the same policy in Arizona—exactly as it has planned to do for years.

5 **B. As the FCC Has Already Done on the Interstate Side, the Commission**
6 **Should “Cap” the CLECs’ Intrastate Switched Access Rates at the Level of**
7 **the ILEC With Which They Compete, Now and in the Future.**

8 As demonstrated above, the subsidies in the LECs’ intrastate switched access charges
9 harm consumers by: (i) artificially increasing the wholesale cost (and, thus, the retail price) of
10 retail long-distance service; (ii) burdening wireline IXCs with an unfair competitive
11 disadvantage and, thus, preventing consumers from realizing the benefits of full and fair
12 competition; and (iii) creating incentives for harmful arbitrage. All of those conclusions apply
13 with even more force to the CLECs’ access charges.

14 For incumbent LECs, the monopoly-era policy of implicit subsidies is obsolete and
15 unsustainable in today’s competitive market. For the CLECs, though, the rationales for those
16 subsidies were *never* applicable.¹¹⁶ Unlike the incumbents, CLECs need not serve all customers
17 (or any customers they do not want to serve), nor do they have to provide universal service to
18 high-cost residential customers.¹¹⁷ To the contrary, the CLECs serve who they want, where they
19 want, when they want and they have much more pricing flexibility than ILECs.¹¹⁸ Thus, for the
20 CLECs, access charge subsidies are nothing but a naked handout: money doled out to carriers

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22
23 ¹¹⁶ AT&T-7 (Oyefusi Direct, Public) at 24; AT&T-9 (Oyefusi Reply, Public) at 23.

24 ¹¹⁷ AT&T-9 (Oyefusi Reply, Public) at 23.

¹¹⁸ AT&T-9 (Oyefusi Reply, Public) at 23.

1 with absolutely no *quid pro quo*, no increase in service to high-cost areas and no reduction in
2 local service rates.¹¹⁹

3 The untenable results these handouts create are obvious. The CLECs' intrastate access
4 rates are substantially *higher* than the already-too-high intrastate switched access rates charged
5 by Qwest.¹²⁰ In addition, CLEC intrastate rates are in all cases several times higher than their
6 corresponding interstate rates (which the FCC has capped at ILEC levels).¹²¹

7 Despite raking in these massive subsidies, CLECs opposing access reform do not have
8 carrier of last resort obligations and almost all of them do *not* serve a single residential customer
9 in any high-cost area or, for that matter, anywhere in this State.¹²² Instead, these CLECs serve
10 mostly business customers, which historically have been a *source* of subsidies rather than a
11 beneficiary (in other words, business customers have paid *higher* retail rates than residential
12 customers).¹²³ Not surprisingly, the CLECs opposing reform are well-heeled, billion-dollar,
13 multi-state or even multi-national corporations swimming in revenues: ranging from Integra
14 Telecom (annual revenue of \$0.7 billion for 2008) to XO (\$1.5 billion revenue in 2008) to
15 PAETEC (\$1.6 billion).¹²⁴ Clearly, these are not mom-and-pop stores that need handouts to
16 survive.

17 The FCC has repeatedly held that CLECs hold market power over switched access
18 service, which allows them to charge excessive rates. Recognizing the harm that those excessive
19 CLEC access rates produce, the FCC has adopted reforms on the interstate side, requiring

20 _____
¹¹⁹ AT&T-9 (Oyefusi Reply, Public) at 23.

21 ¹²⁰ AT&T-3 (Aron Reply, Public) at 23; AT&T-10 (Oyefusi Reply, Confidential) at 23-24.

22 ¹²¹ AT&T-2 (Aron Direct, Confidential) at 39 & Table 2.

23 ¹²² AT&T-9 (Oyefusi Reply, Public) at 24.

24 ¹²³ AT&T-9 (Oyefusi Reply, Public) at 24.

¹²⁴ AT&T-9 (Oyefusi Reply, Public) at 25 & OAO Reply, Ex. B thereto.

1 CLECs to “cap” their interstate switched access rates at the level of the predominant ILEC rates
2 (and, as discussed above, the FCC has reduced ILEC rates).¹²⁵ On the intrastate side, the
3 Commission can take advantage of these already-implemented reforms by adopting the same
4 caps on *intrastate* traffic, just as several other states have already done.¹²⁶ The CLECs have
5 ample pricing flexibility and can seek more, if necessary, to rebalance their local service rates if
6 they feel any need to adjust those rates.¹²⁷

7 The CLECs’ main response is the claim that they lack market power. Contrary to the
8 CLECs’ assertion, however, CLECs do have monopoly power *in the provision of wholesale*
9 *switched access service*, even though they face competition for retail local service.¹²⁸ In a truly
10 competitive market, the buyer can avoid suppliers that charge too much. But when an IXC’s
11 customer dials a CLEC’s customer, the IXC has no choice but to direct the call to the CLEC’s
12 network for termination, no matter what access rates the CLEC imposes.¹²⁹ Likewise, when the
13 IXC’s customer chooses a CLEC for local service and places a switched call over the CLEC line,
14 the IXC has no choice but to take the call from the CLEC’s network and pay the CLEC’s
15 originating access charge.¹³⁰

16 As Qwest puts it, IXCs do not “have any choice in what LEC originates or terminates a
17 long-distance call”; thus, “[s]witched access has long been identified as a terminating
18 monopoly.”¹³¹ Likewise, RUCO’s witness, Dr. Johnson, “agree[d] that CLECs . . . have some

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20 ¹²⁵ *FCC Order Capping CLEC Access Charges*, 16 FCC Rcd. 9923, ¶ 31.

21 ¹²⁶ AT&T-1 (Aron Direct, Public) at 52-54.

22 ¹²⁷ AT&T-3 (Aron Reply, Public) at 35; AT&T-7 (Oyefusi Direct, Public) at 70.

23 ¹²⁸ AT&T-1 (Aron Direct, Public) at 86-87; AT&T-7 (Oyefusi Direct, Public) at 23; AT&T-3 (Aron Reply, Public)
24 at 11-22.

¹²⁹ AT&T-3 (Aron Reply, Public) at 12-13; AT&T-7 (Oyefusi Direct, Public) at 23.

¹³⁰ AT&T-7 (Oyefusi Direct, Public) at 23.

¹³¹ Q-1 (Eckert Direct, Public) at 5.

1 degree of power over the pricing of the [access] charges that they impose on other carriers.”¹³²
2 Staff, too, recognizes that IXC’s lack any “competitive alternative” for originating or terminating
3 calls to or from CLEC customers. Therefore, “Staff recommends that CLEC’s maximum
4 switched access rates be capped at the incumbent LEC’s rates.”¹³³

5 Moreover, IXCs cannot pass the appropriate signals on to their retail customers so that
6 *they* can avoid CLEC’s with high access charges. Obviously, AT&T cannot tell its customers that
7 they cannot choose a CLEC as their local exchange carrier, nor can it tell customers that they
8 can’t call homes or businesses that buy a CLEC’s local service.¹³⁴ In addition, AT&T cannot
9 charge a retail customer higher long-distance rates if that customer chooses a CLEC with high
10 access charges (or if the retail customer calls a home or business served by a high-priced CLEC),
11 because, by law, AT&T must offer the same averaged rate to *all* customers over a large
12 geographic area.¹³⁵

13 The CLEC’s suggestion that they deserve massive subsidies, because their access costs
14 are higher than those of the incumbents, is equally baseless. In the first place, the CLEC’s—who
15 obviously know what their own costs are—did not bother to present any hard cost evidence to
16 support their assertions.¹³⁶ More fundamentally, even if one accepts, for the sake of argument,
17 the CLEC’s assertion that their costs are *higher* than the incumbents’ costs, then the IXCs should
18 not be forced to subsidize the CLEC’s inefficiencies.¹³⁷ Burger King is free to make burgers
19 inefficiently at a cost of \$10 each if it wants, but no one would suggest that McDonald’s should

20 ¹³² HR TR 67.

21 ¹³³ S-2 (Shand Direct, Public) at 10-11; *see also* HR TR 658-59.

22 ¹³⁴ AT&T-7 (Oyefusi Direct, Public) at 23.

23 ¹³⁵ AT&T-1 (Aron Direct, Public) at 86-87; AT&T-3 (Aron Reply, Public) at 15-16, 18-19; AT&T-7 (Oyefusi
Direct, Public) at 23.

24 ¹³⁶ AT&T-3 (Aron Reply, Public) at 26-28.

¹³⁷ AT&T-3 (Aron Reply, Public) at 26-27 & n.31.

1 be forced to pay Burger King a subsidy for inefficient operations if consumers are not willing to
2 pay Burger King more than \$6 for its burgers. Instead, the CLECs should do what other
3 businesses have to do if they want to stay competitive: (i) become more efficient and reduce
4 their costs, (ii) be willing to accept lower profits or (iii) increase their retail prices and then offer
5 better services so that retail consumers will *want* to pay higher retail prices.

6 **C. The Commission Should Reduce the LECs' Intrastate Switched Access Rates**
7 **Without Delay.**

8 Access rate reductions should be implemented immediately for several reasons. First, as
9 discussed in Section III.A.1, *supra*, the evidence is overwhelming that high intrastate access rates
10 are distorting the markets and need to be reformed as soon as possible. Second, Arizona
11 consumers have already waited years for access reform and should not have to wait any longer to
12 enjoy the lower rates for long-distance service that accompany access reductions. Third, the
13 Commission can give consumers immediate relief from the harm caused by excessive access
14 charges while using the Arizona universal service fund to cushion the transition to more rational,
15 yet still affordable, local retail rates. Thus, there is no need for any further delay or transition
16 period in reducing the LECs' intrastate access rates. As ALECA's Mr. Meredith acknowledged
17 at the hearing, "it is wise and actually prudent to take a first step in access reform now" and "it
18 will be beneficial to do that now as opposed to wait."¹³⁸

19 At the hearing, several attorneys and witnesses talked about a "glide path" to access
20 reform. AT&T's approach gives all parties a more than sufficient "glide path." Most
21 importantly, consumers will receive a glide path on local service rates, with basic monthly rates
22 constrained by an \$18 benchmark and with increases in basic monthly rates limited to \$2 each
23

24 ¹³⁸ HR TR 180.

1 year. LECs will receive a glide path on access revenues, as AT&T's recommendation allows
2 them to rebalance access rate reductions with increased flexibility for local service rates and,
3 where necessary, with AUSF support. Moreover, AT&T does not propose here that LEC access
4 rates be reduced to cost; rather, AT&T merely proposes that the Commission take the interim
5 step of reducing the LECs' intrastate access rates to mirror rates that the LECs have already been
6 charging on the interstate side for several years (and requiring LECs to continue mirroring
7 interstate rates in the future).

8 Qwest has been on notice for nine years of this Commission's plan to implement
9 interstate parity and it has already taken several transitional steps towards that goal.¹³⁹ CLECs
10 have been telling their investors about the likelihood of access rate reductions for years as
11 well.¹⁴⁰ This Commission stated the goal of interstate parity in 2001 and this proceeding has
12 already taken well over two years. Access reform is long overdue.

13 **D. The Commission Should Reject Qwest's Self-Serving "Not in My Back Yard"**
14 **Approach.**

15 Qwest supports access reform, except when it comes to Qwest's own access charges.
16 Thus, Qwest makes the self-serving proposal that the Commission order all *other* LECs to reduce
17 their intrastate switched access rates to match Qwest's rates and, thus, give Qwest a free pass on
18 access reform. The result is that Qwest's access revenues remain high, while its access expenses
19 (paid to other LECs) drop and its profits go up.¹⁴¹

20 ALECA and Staff agree with AT&T that all ILECs' intrastate switched access rates
21 should eventually be reduced to "parity" with the corresponding interstate rates; indeed, they

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¹³⁹ HR TR 561-62 (Eckert); *see also* Decision No. 63487, p. 12, & Attachment A, p. 2.

23 ¹⁴⁰ AT&T-3 (Aron Reply, Public) at 33-34 & Ex. DJA-R2.

24 ¹⁴¹ HR TR 565.

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1 believe that all access charges should ultimately be reduced to cost or even zero.¹⁴² But for now,
2 they ask the Commission to adopt the Qwest proposal in the apparent view that Qwest is offering
3 a middle ground.

4 With all due respect to ALECA and Staff, Qwest’s proposal is no middle ground at all.
5 To the contrary, for the largest ILEC (Qwest) and the great majority of access traffic in the
6 State—[BEGIN HIGHLY CONFIDENTIAL INFORMATION] [REDACTED]
7 [END HIGHLY CONFIDENTIAL INFORMATION]¹⁴³—to accept Qwest’s approach means
8 the Commission would do nothing about most of the consumer, market and competitive harms of
9 the current system.¹⁴⁴ That is not a middle ground, but instead is an extreme position.

10 Access reform is hardly comprehensive or meaningful if the largest LEC gets a free pass
11 and most of the problems of the current system are left untouched.¹⁴⁵ Because IXC’s average
12 their long-distance prices on a statewide basis, the benefits of access reform will be
13 overwhelmingly muted if the largest ILEC in the State does not reduce its access rates.¹⁴⁶ A
14 significant amount of the benefit that could have been achieved from the three years of efforts by
15 the Commission, its Staff, the Administrative Law Judge and the parties in this proceeding will
16 not be realized if Qwest’s “don’t look at me” approach is adopted.

17 By contrast, AT&T’s proposal *is* a reasonable middle ground and consistent with this
18 Commission’s years-old stated objective. As ALECA has noted, access reform will ultimately

21 ¹⁴² HR TR 145 (Meredith) (“to avoid the arbitrage issue. . . you would need to have the [intrastate] rates at or very
close to each [interstate] level”).

22 ¹⁴³ AT&T-5 (Aron Rejoinder, Confidential) at 10.

23 ¹⁴⁴ AT&T-9 (Oyefusi Reply, Public) at 9.

24 ¹⁴⁵ AT&T-9 (Oyefusi Reply, Public) at 9.

¹⁴⁶ AT&T-3 (Aron Reply, Public) at 69.

1 reduce access rates all the way down to the associated incremental cost or even zero.¹⁴⁷ Indeed,
2 the *National Broadband Plan* contemplates that all per-minute intercarrier charges will
3 eventually be eliminated.¹⁴⁸ Here, AT&T proposes a simple and modest reform, mirroring
4 access rate reductions that the FCC adopted years ago (and that carriers have been working with
5 for years) on the interstate side and continuing to mirror those rates in the future. To smooth the
6 transition, AT&T has proposed that Arizona ILECs be given the opportunity to rebalance local
7 rates up to a reasonable benchmark and to recover any remaining access revenue reductions from
8 the AUSF. In short, AT&T offers a plan to accommodate all legitimate interests.

9 To confirm that AT&T's "parity" plan between interstate and intrastate rates is both
10 reasonable and necessary, the Commission need look no further than ALECA. In its Initial
11 Responses to Staff's Lists of Issues, filed January 7, 2008, "ALECA recommend[ed] that the
12 Commission bring intrastate switched access rates into equality with interstate rates, where
13 equality necessarily means matching both the level and structure of interstate rates."¹⁴⁹ In its
14 accompanying "white paper," ALECA agreed that "differences in intrastate and interstate access
15 charges can no longer be sustained in a competitive environment, especially where technology
16 has enabled telephone calls to circumvent access charges altogether."¹⁵⁰ ALECA then called for
17 "immediate reform" to reduce its members' intrastate switched access rates to the corresponding
18 interstate levels.¹⁵¹ As recently as May 29, 2009, ALECA advocated in favor of parity with
19 interstate rates and pointedly *against* the use of Qwest's rates as a target.¹⁵²

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21 ¹⁴⁷ HR TR 180-81 (Meredith).

22 ¹⁴⁸ *National Broadband Plan* at p. 148.

23 ¹⁴⁹ AT&T-13, "Updated Access Charge Questions" at 1.

24 ¹⁵⁰ AT&T-13, Ex. A ("The Case for Arizona Access Charge Reform") at 6-7.

¹⁵¹ AT&T-13, Ex. A at 11.

¹⁵² AT&T-14 & HR TR 141-43.

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1 In addition, Qwest’s approach suffers from several other problems. First, while it would
2 reduce the intrastate rates for some LECs, the reductions would not be all that significant and
3 would not give consumers meaningful relief.¹⁵³ Qwest’s average intrastate switched access rate
4 per minute is still quite high ([BEGIN HIGHLY CONFIDENTIAL] ██████████
5 [END HIGHLY CONFIDENTIAL]¹⁵⁴) and, in fact, is among the highest rates for a Bell
6 operating company in the nation.¹⁵⁵

7 Second, Qwest’s approach would still leave a large disparity between interstate and
8 intrastate switched access rates. Qwest’s average intrastate rate of [BEGIN HIGHLY
9 CONFIDENTIAL] ██████████ [END HIGHLY CONFIDENTIAL]¹⁵⁶ is more than
10 double its average interstate rate.¹⁵⁷ It is also much higher than the average interstate access
11 rates of other Arizona ILECs (whose overall average rate is 1.66 cents per minute on the
12 interstate side).¹⁵⁸ Such large disparities make no sense, because interstate and intrastate
13 switched access services provide virtually the same functionality and have virtually the same
14 underlying cost.¹⁵⁹ Moreover, the disparities Qwest wants to maintain sustain the opportunities
15 and incentives for harmful arbitrage and continue the administrative inefficiencies of maintaining
16 two separate, very different sets of charges for the same underlying services.¹⁶⁰ As ALECA
17 explained, “unifying or equalizing the rates for each jurisdiction [interstate and intrastate] will
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19 ¹⁵³ AT&T-4 (Aron Rejoinder, Public) at 10-11; AT&T-3 (Aron Reply, Public) at 69.

20 ¹⁵⁴ AT&T-2 (Aron Direct, Confidential) at 36, 45-46 & Tables 1 and 3.

21 ¹⁵⁵ AT&T-3 (Aron Reply, Public) at 72.

22 ¹⁵⁶ AT&T-2 (Aron Direct, Confidential) at 36, 45-46 & Tables 1 and 3.

23 ¹⁵⁷ AT&T-2 (Aron Direct, Confidential) at 36 & Table 1; AT&T-9 (Oyefusi Reply, Public) at 17; *see also* AT&T-4
(Aron Rejoinder, Public) at 10.

24 ¹⁵⁸ AT&T-1 (Aron Direct, Public) at 37.

¹⁵⁹ AT&T-1 (Aron Direct, Public) at 17, 20-22; AT&T-7 (Oyefusi Direct, Public) at 14-15; HR TR 228 (Garrett).

¹⁶⁰ AT&T-1 (Aron Direct, Public) at 78-81; AT&T-7 (Oyefusi Direct, Public) at 45-48.

1 remove the incentive for carriers to provide incomplete call detail records or to seek routing
2 alternatives” while “[m]oving to Qwest’s intrastate access rates would not address rate arbitrage
3 encouraged by an individual company’s variance between intrastate and interstate access
4 rates.”¹⁶¹

5 Third, Qwest’s proposal will be more difficult to implement. It would force all ILECs to
6 adapt their billing and accounting systems to accommodate new rate structures and amounts that
7 only Qwest uses today.¹⁶² By contrast, AT&T proposes that LECs simply apply, to intrastate
8 calls, the exact same rate structures and amounts that they already use for interstate calls.¹⁶³ In
9 this regard, AT&T’s approach is even more simple than maintaining the status quo, under which
10 LECs have to maintain and charge two separate sets of prices for precisely the same access
11 service.¹⁶⁴

12 Simply stated, the real beneficiary of Qwest’s proposal is Qwest.¹⁶⁵ Qwest’s long-
13 distance affiliate will save money when other LECs’ access charges (most notably, CLEC access
14 charges) are reduced.¹⁶⁶ Meanwhile, Qwest itself will continue to charge and collect the exact
15 same, excessive access rates that it charges today.¹⁶⁷

16 Access reform should not be designed to favor any carrier. Instead, it should *level* the
17 competitive playing field and, thus, serve the *public* interest of consumers all over the State.¹⁶⁸
18 The Commission should not adopt any policy that favors Qwest at the expense of Arizona

19 ¹⁶¹ AT&T-14; HR TR 142.

20 ¹⁶² AT&T-9 (Oyefusi Reply, Public) at 20.

21 ¹⁶³ AT&T-9 (Oyefusi Reply, Public) at 20.

22 ¹⁶⁴ AT&T-1 (Aron Direct, Public) at 80-81.

23 ¹⁶⁵ AT&T-9 (Oyefusi Reply, Public) at 9.

24 ¹⁶⁶ AT&T-9 (Oyefusi Reply, Public) at 9.

¹⁶⁷ AT&T-9 (Oyefusi Reply, Public) at 9-10.

¹⁶⁸ AT&T-9 (Oyefusi Reply, Public) at 10.

1 consumers, who are being denied the benefits of full competition, because AT&T and other long-
2 distance carriers are forced to bear the brunt of the LECs' access charges, while competing
3 providers using different technologies are not.¹⁶⁹

4 The Commission should address the access charge issue now by requiring all Arizona
5 LECs to reduce their intrastate switched access rates to parity with their interstate rates. As
6 Dr. Aron reasoned, "I see no justification, really for taking a half measure, for going through all
7 of this proceeding with all of the evidence marshaled and resources invested and the opportunity
8 to do what the FCC did almost a decade ago and what state after state is now doing and take a
9 half step."¹⁷⁰

10 **E. The Commission Should Allow ILECs to "Rebalance" Local Rates Up to a**
11 **Reasonable Benchmark and to Recover the Remaining Access Revenue**
12 **Reductions from the AUSF.**

13 **1. AT&T's Proposal Represents a Reasonable Middle Ground for the**
14 **Recovery of Access Charge Reductions.**

15 The parties' proposals in this case cover the entire spectrum of possible approaches for
16 LECs to recover the reductions in revenue that result from reducing the implicit subsidies in
17 intrastate switched access rates. At one extreme, Verizon's direct testimony proposed that the
18 recovery come entirely from increases in local service rates, with no additional support from the
19 Arizona Universal Service Fund ("AUSF"). In Verizon's words, "the Commission should not
20 expand the AUSF to serve as an 'access recovery mechanism' for carriers that are required to
21 reduce their intrastate access rates to just and reasonable levels."¹⁷¹ At the other extreme,
22 ALECA proposes that there be *no* increase in local service rates and that the AUSF be expanded

22 ¹⁶⁹ AT&T-9 (Oyefusi Reply, Public) at 10.

23 ¹⁷⁰ HR TR 340.

24 ¹⁷¹ VZ-1 (Price Direct, Confidential) at 18. At the hearing, Verizon's Mr. Price indicated that it might support some
AUSF support subject to stringent "needs" testing.

1 to fund the entire recovery—and, as well, to make up for an alleged “shortfall” in federal
2 universal service support.¹⁷²

3 Each side represents one of two valid, but competing, concerns. On Verizon’s hand,
4 today’s unrealistically low local service rates are a barrier to competition; using the AUSF to
5 subsidize rates at those levels would be anti-competitive and would place too heavy a burden on
6 Arizona consumers. After all, AUSF money does not fall from the sky; ultimately, it comes
7 from the consumers that buy telecommunications service from providers that contribute to the
8 AUSF. On ALECA’s hand, using local service rates to fund *all* access reductions would result in
9 local rate increases that the Commission and consumers might find too sudden.

10 The Commission need not choose either of these two extremes. AT&T’s proposal
11 represents a middle ground that reasonably serves *both* interests. First, the Commission can
12 permit (but not require) ILECs to raise their local service rates—but only up to a reasonable
13 “benchmark” monthly rate of \$18 per month.¹⁷³ To make the transition even smoother, the
14 Commission can also give consumers a “glide path” up to that benchmark by limiting each
15 ILEC’s rate increase to \$2 per year until that LEC reaches the benchmark.¹⁷⁴

16 For example, if an ILEC currently charges \$10 per month for basic local service, it would
17 not increase its rates to the \$18 benchmark immediately. Instead, it would increase its rate to
18 \$12 in the first year of AT&T’s plan, \$14 in the following year and so on, until the rate reaches
19 the \$18 benchmark. Alternatively, if an ILEC is charging \$17 per month for basic local service,
20 it can increase that rate to \$18 in the first year. Or, if the ILEC’s rate is already \$18 or more per
21 month, no further increase would be imputed. This approach is fully consistent with the

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172 ALECA-1 (Meredith Direct, Public) at 8-11.

23 173 HR TR 531 (Oyefusi); AT&T-7 (Oyefusi Direct, Public) at 60-62.

24 174 HR TR 529-30 (Oyefusi); AT&T-7 (Oyefusi Direct, Public) at 63-68.

1 *National Broadband Plan's* recommendation that the FCC "encourage states to complete
2 rebalancing of local rates to offset the impact of local access revenues" and "move away from
3 the artificially low \$8-\$12 residential rates that represent old implicit subsidies to levels that are
4 more consistent with costs."¹⁷⁵

5 Second, the AUSF can be used to compensate for any reduction in access revenues not
6 recoverable through the opportunity to increase the basic local service rate. An ILEC would be
7 eligible for AUSF support, calculated in two simple steps:

- 8 (1) determine the total reduction in access revenues that each ILEC would incur from
9 reducing intrastate rates to parity with the corresponding interstate rates; and
- 10 (2) subtract the increase in revenues that ILEC would receive, assuming it increased
11 its monthly local rate by the amount the Commission permits (limited by the \$18
12 benchmark and the maximum \$2-per-month annual increase).¹⁷⁶

13 The results of this process are reasonable from all perspectives. With regard to local
14 service, the maximum rate for basic local service will still be only \$18 per month, an eminently
15 reasonable amount. The *current* rate cap for New York is \$23, while Pennsylvania has an \$18
16 cap.¹⁷⁷ End users across the country pay \$50 or more for bundled packages and other services
17 from newer technologies like wireless and broadband, where prices are free from artificial
18 subsidies.¹⁷⁸ Based on a study of 14 Arizona ILECs, if monthly rates had simply increased at the
19 rate of inflation from the last monthly rate changes, today's weighted average retail rate would
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21 ¹⁷⁵ *National Broadband Plan*, p. 148.

22 ¹⁷⁶ AT&T-7 (Oyefusi Direct, Public) at 69-70. It bears repeating that nothing in AT&T's proposal *requires* any
ILEC to increase its local service rates by any amount. Rather, AUSF support simply *assumes* that the ILEC has
increased its local service rates by the amount permitted as a step to calculating AUSF support.

23 ¹⁷⁷ AT&T-7 (Oyefusi Direct, Public) at 60.

24 ¹⁷⁸ AT&T-7 (Oyefusi Direct, Public) at 60.

1 be \$17.50¹⁷⁹—and remember, that is a very conservative amount, because past local rates were
2 held at artificially low levels by subsidies.

3 Qwest has proposed a benchmark of \$16.45, which is based on 125% of weighted
4 average retail rates. As AT&T's Dr. Oyefusi testified, that falls at the very low end of a
5 reasonable range.¹⁸⁰ Arizona's statewide average retail rate of \$13.16 is well below the national
6 average of \$15.62.¹⁸¹ (No doubt, this is due, in large part, to the fact that Arizona rates for local
7 service have been largely unchanged for years and have been held at artificially low levels by
8 implicit subsidies). Applying Qwest's 125% factor to the national average would yield a
9 benchmark of \$19.53, well above the \$18 proposed by AT&T here.

10 At the same time, AT&T's proposal will also keep AUSF support within reasonable
11 limits. In the first year of AT&T's plan, the total AUSF support will be about \$20 million,¹⁸²
12 meaning that providers would contribute only 0.75% of Arizona telecommunications revenues to
13 the fund.¹⁸³ By contrast, ALECA's plan would require a \$32 million total payment and a 1.2%
14 contribution factor.¹⁸⁴ These figures are about 50% higher than AT&T's plan, even though
15 AT&T's plan gives consumers substantially more relief in the form of reduced access charges.

16 **2. Only ILECs Should Be Allowed to Receive AUSF Support for the**
17 **Recovery of Access Revenue Reductions.**

18 In giving Arizona consumers relief from high access charges, universal service support
19 for the incumbent LECs is a sensible transitional tool. Traditionally, ILECs were forced to

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21 ¹⁷⁹ AT&T-7 (Oyefusi Direct, Public) at 59-60.

22 ¹⁸⁰ AT&T-7 (Oyefusi Direct, Public) at 56-57 & n.62.

23 ¹⁸¹ AT&T-7 (Oyefusi Direct, Public) at 56, n.62.

24 ¹⁸² AT&T-7 (Oyefusi Direct, Public) at 60-61.

¹⁸³ AT&T-7 (Oyefusi Direct, Public) at 59.

¹⁸⁴ AT&T-9 (Oyefusi Reply, Public) at 20.

1 charge artificially low rates for local service and forced to be ready, willing and able to serve all
2 customers in their service areas. Thus, incumbent LECs charged high switched access rates to
3 subsidize local service at artificially low prices and to promote universal service in rural areas.
4 This was the basic *quid pro quo* of the monopoly era.

5 As just about everyone recognizes, these subsidies are not sustainable and can no longer
6 be relied upon to support an incumbent LEC's provision of universal service in Arizona. So, the
7 State and its consumers can no longer pay incumbents the *quid* of high access charges. Of
8 course, the *quo*—universal service at reasonable rates—is still a worthy goal. As detailed above,
9 the Commission can ensure that the State continues to achieve its universal service objectives by
10 allowing ILECs to recover the reductions in access revenue through (i) increases in local rates,
11 up to a reasonable benchmark, coupled with (ii) explicit support through the AUSF. These will
12 serve as the new *quid pro quo* in today's competitive markets.

13 By contrast, CLECs stand in a very different position from the incumbent LECs. Unlike
14 ILECs, CLECs do not have an obligation to provide service to any customer. Instead, CLECs
15 can pick and choose the geographic areas they wish to serve, the retail customers they wish to
16 target and the prices they charge to those customers in order to maximize their return on
17 investment. In other words, CLECs don't have to provide service at artificially low prices to
18 anyone anywhere. Not surprisingly, then, most CLECs do not even serve any residential
19 customers. For CLECs, high access charges and universal service are not *quid pro quos*:
20 handing a subsidy to a CLEC is just handing a subsidy to the CLEC with no benefits for
21 universal service.

22 Only ILECs should be eligible for access replacement support through the State's
23 universal service fund. As Verizon's Mr. Price testified at the hearing, "CLECs don't have
24

1 carrier of last resort obligations. They are not required to serve residential subscribers. They
2 entered the market at a time when they should have known that competitive forces had the ability
3 to impact their business plans.”¹⁸⁵ Thus, he succinctly concluded, “CLECs should not in any
4 way, shape or form be entitled to recover those revenues from a state fund.”¹⁸⁶

5 **IV. CONCLUSION**

6 AT&T respectfully requests that the Commission enter its Decision:

7 (1) directing the ILECs to file a tariff reducing their intrastate switched access rates to
8 parity with their corresponding interstate rates, within 60 days of the effective date of its
9 Decision, and to maintain that parity with interstate rates in the future;

10 (2) directing the CLECs to file a tariff “capping” their intrastate switched access rates
11 at the level of the corresponding rates of the ILECs with which they compete, within 60 days of
12 the effective date of its Decision, and to maintain that parity with the ILEC’s rates in the future;

13 (3) authorizing and instructing Staff to bring an order to show cause against any
14 ILEC or CLEC which does not file tariffs as specified above;

15 (4) authorizing ILECs and CLECs to file for approval adjustments to local rates or
16 maximum local rates on a revenue neutral basis to offset access revenue reductions;

17 (5) authorizing ILECs to seek temporary AUSF support under the existing AUSF
18 Rules, if necessary, to offset access revenue reductions;

19 (6) adopting proposed modifications to the AUSF Rules as described herein and as
20 attached as Exhibit 1; and

21 (7) referring the proposed modifications to the AUSF Rules for public notice,
22 comment and adoption pursuant to the Administrative Procedures Act.

23 ¹⁸⁵ HR TR 415.

24 ¹⁸⁶ HR TR 399.

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RESPECTFULLY SUBMITTED this 9th day of July, 2010.

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EXHIBIT 1

ARIZONA ADMINISTRATIVE CODE
TITLE 14. PUBLIC SERVICE CORPORATIONS; CORPORATIONS AND ASSOCIATIONS;
SECURITIES REGULATION
CHAPTER 2. CORPORATION COMMISSION FIXED UTILITIES
ARTICLE 12. ARIZONA UNIVERSAL SERVICE FUND

R14-2-1201. Definitions

In this Article, unless the context otherwise requires, the following definitions shall apply:

1. "Administrator" is the person designated pursuant to R14-2-1212 to administer the AUSF and perform the functions required by this Article.
2. "Arizona Corporation Commission" or "Commission." The regulatory agency of the state of Arizona having jurisdiction over public service corporations operating in Arizona.
3. "Arizona Universal Service Fund" or "AUSF" is the funding mechanism established by this Article through which surcharges are collected and support paid in accordance with this Article. The AUSF shall consist of two separate support funds: the "AUSF High Cost Support Fund" and the "AUSF Access Revenue Replacement Support Fund."
4. ~~"AUSF Support~~AUSF High Cost Support" is the amount of money, calculated pursuant to this Article, which a provider of basic local telephone exchange service is eligible to receive from the AUSF High Cost Support Fund pursuant to this Article.
5. ~~"AUSF Support~~AUSF High Cost Support Area" is the geographic area for which a local exchange carrier's eligibility to receive ~~AUSF support~~AUSF High Cost Support is calculated.
6. "Basic local exchange telephone service" is telephone service that provides the following features:
 - a. Access to 1-party residential service with a voice grade line;
 - b. Access to touchtone capabilities;
 - c. Access to an interexchange carrier;
 - d. Access to emergency services, including but not limited to emergency 911;
 - e. Access to directory assistance service;
 - f. Access to operator service;
 - g. Access to a white page or similar directory listing; and
 - h. Access to telephone relay systems for the hearing and speech impaired.

7. "Benchmark rates" for a telecommunications services provider are those rates approved by the Commission for that provider for basic local exchange telephone service, plus the Customer Access Line Charge approved by the Federal Communications Commission.

8. "Commercial Mobile Radio Service" is any radio communication service carried on between mobile stations or receivers and land stations, or by mobile stations communicating among themselves, that is provided for profit and that makes available to the public service that is connected to the public switched network.

9. "Comparability standard rate" is the rate level set by the Commission and used to compute the revenue that may be recovered by local exchange carriers from their end-user customers for residential and business local exchange services in order to offset revenues lost as a result of the Commission's reform of intrastate switched access rates. This revenue may not be recovered from a fund. "Conversion Factor" is a multiplier that is used to convert a quantity of interconnecting trunks for both wireless and wireline customers into equivalent access lines, for the sole purpose of developing Category 1 surcharges. The value of the Conversion Factor shall be 10 until completion of the review provided for in R14-2-1216.

10. "Interconnecting Trunk" is a 1-way or 2-way voice grade or equivalent voice grade switched message transmission channel furnished by a local switched access provider to a provider of wireless services or to a wireline customer of such local switched access provider to interconnect the provider of wireless services or wireline customer to the public switched network.

11. "Intermediate Local Exchange Carriers" are incumbent providers of basic local exchange telephone service with more than 20,000 access lines but fewer than 200,000 access lines in Arizona.

12. "Large Local Exchange Carriers" are incumbent providers of basic local exchange telephone service serving 200,000 or more access lines in Arizona.

13. "Small Local Exchange Carriers" are incumbent providers of basic local exchange telephone service with 20,000 or fewer access lines in Arizona.

14. "Total Service Long Run Incremental Cost" is the total additional cost incurred by a telecommunications company to produce the entire quantity of a service, given that the telecommunications company already provides all of its other services. Total Service Long Run Incremental Cost is based on the least cost, most efficient technology that is capable of being implemented at the time the decision to provide the service is made.

15. "U.S. Census Blocks" are geographic areas defined by the U.S. Department of Commerce. The areas, which define the way in which census data is aggregated, generally contain between 250 and 550 housing units.

R14-2-1202. Calculation of ~~AUSF Support~~ AUSF High Cost Support

A. The amount of ~~AUSF support~~ AUSF High Cost Support to which a provider of basic local exchange telephone service is eligible for a given ~~AUSF support~~ AUSF High Cost 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.

B. For a small local exchange carrier, the ~~AUSF support~~ AUSF High Cost Support area shall include all exchanges served by the local exchange carrier in Arizona. The appropriate cost of providing basic local exchange telephone service for purposes of determining ~~AUSF support~~ AUSF High Cost Support for a small local exchange carrier shall be the embedded cost of the incumbent provider. For any request for ~~AUSF support~~ AUSF High Cost Support by a small local exchange carrier filed more than three years after the effective date of this Article, the ~~AUSF support~~ AUSF High Cost Support area shall be the geographic areas as determined by the Commission.

C. For an intermediate local exchange carrier, the ~~AUSF support~~ AUSF High Cost Support area shall be either all exchanges in Arizona served by that carrier, or such other support area as may be approved by the Commission. The appropriate cost of providing basic local exchange telephone service for purposes of determining ~~AUSF support~~ AUSF High Cost Support for an intermediate local exchange carrier shall be the embedded cost of the incumbent provider. For any request for ~~AUSF support~~ AUSF High Cost Support by an intermediate local exchange carrier filed more than three years after the effective date of this Article, the ~~AUSF support~~ AUSF High Cost Support area shall be geographic areas as determined by the Commission, and the appropriate cost of providing basic local exchange telephone service for purposes of determining ~~AUSF support~~ AUSF High Cost Support shall be the Total Service Long Run Incremental Cost of the incumbent provider. In the event that the FCC adopts a somewhat different forward-looking costing methodology and/or a different geographic study/support area for the Federal universal service fund program, a local exchange carrier may request a waiver from this rule in order to utilize the same cost study methodology and/or geographic study areas in both jurisdictions.

D. For a large local exchange carrier, the ~~AUSF support~~ AUSF High Cost Support area shall be U.S. census block groups, and the appropriate cost of providing basic local exchange telephone service for purposes of determining ~~AUSF support~~ AUSF High Cost Support shall be the Total Service Long Run Incremental Cost. In the event that the FCC adopts a somewhat different forward-looking costing methodology and/or a different geographic study/support area for the Federal universal service fund program, a local exchange carrier may request a waiver from this rule in order to utilize the same cost study methodology and/or geographic study areas in both jurisdictions. Any request for ~~AUSF support~~ AUSF High Cost Support by a large local exchange carrier shall include a Total Service Long Run Incremental Cost study, or cost study based on FCC adopted methodology, of basic local exchange service. The cost study shall be developed and presented in a manner that identifies the cost for the individual support areas for which AUSF funding is being requested.

R14-2-1202A. Calculation of AUSF Access Revenue Replacement Support.

A. Purpose of AUSF Access Revenue Replacement Support.

The purpose of the AUSF Access Revenue Replacement Fund is to facilitate the reduction of implicit subsidies formerly contained in intrastate switched access rates, and to make such subsidies explicit to the extent subsidies for basic local exchange service are to be maintained for the promotion of universal service at affordable rates.

B. Amount of Support.

The amount of AUSF Access Revenue Replacement Support that an eligible provider of basic local exchange service may obtain shall be computed on an annual basis as the difference between (1) the eligible provider's "access shift" as calculated in part (1) of this rule, and (2) the eligible provider's "imputed access replacement revenue," as calculated in part (2) of this rule.

1. An eligible provider's "access shift" shall be equal to that provider's intrastate access minutes for a base period to be determined by the Commission, multiplied by the difference between the average per-minute intrastate access rate and the carrier's average per-minute interstate access rate for that base period.

(a) An eligible provider's average per-minute intrastate access rate shall be computed as the provider's total intrastate switched access revenues for the base period, divided by the provider's total intrastate switched access minutes for the base period.

(b) An eligible provider's average per-minute interstate access rate shall be computed as the provider's total interstate switched access revenues for the base period, divided by the provider's total interstate switched access minutes for the base period.

2. An eligible provider's "imputed access replacement revenue" shall be equal to the difference between comparability standard rates established by the Commission and the provider's basic residential and business exchange rates in effect as of December 31, 2009, multiplied by the number of residential and business lines served by the carrier as of December 31, 2009, with the number of business lines to include each line providing the customer with an Arizona place of primary use, including lines delivered through tariffs other than the basic business local exchange service tariff. To the extent an eligible provider's basic residential or business exchange rate in effect as of December 31, 2009 exceeds the comparability standard rate, that actual rate shall be used in place of the applicable comparability standard rate in computing the provider's imputed access replacement revenue.

R14-2-1203. Request for AUSF Support

A provider of basic local exchange telephone service may request that the Commission authorize AUSF support with a filing under R14-2-103 or other method as the Commission may prescribe, and upon compliance with all applicable rules set forth in R14-2-1101 through R14-2-1115. A request for AUSF support shall include a statement describing the need for such funding. The Commission shall determine the appropriate cost of providing basic local exchange service for each ~~AUSF support~~ AUSF High Cost Support area for which ~~AUSF support~~ AUSF High Cost Support is requested and shall calculate in accordance with R14-2-1202 the amount of ~~AUSF support~~ AUSF High Cost Support, if any, to which the applicant is entitled. The Commission shall also determine in accordance with R14-2-1202A the amount of AUSF Access Revenue Replacement Support, if any, to which the applicant is entitled.

R14-2-1204. Funding of the AUSF

A. The AUSF shall be funded in accordance with this Article by all telecommunications service providers that interconnect to the public switched network. Within 30 days of the effective date of this Article, and thereafter on or before October 1 of each year, each telecommunications provider shall provide to the Administrator a list of all other telecommunications providers that interconnect to its facilities or network.

B. The AUSF shall be funded in a competitively neutral manner on the basis of intrastate telecommunications revenue, as described in R14-2-1205.
~~equally by toll and local customers of the providers of telecommunications services, and shall be assessed in the following manner:~~

~~1. Category 1— Providers of basic local exchange service, as discussed in R14-2-1204(B)(1)(a), and other service providers as required under R14-2-1204(B)(1)(a)(i) or permitted under R14-2-1204(B)(3)(b), shall be considered providers of Category 1 service.~~

~~a. One half of the AUSF funding requirement will be collected through Category 1 service providers. Category 1 AUSF assessment will be based upon access lines and interconnecting trunks, and assessed by providers of local switched access as either an access line or interconnecting trunk surcharge. The “per access line” surcharge to be in place during a given year will be calculated by the Administrator using the total number of access lines and equivalent access lines deriving from interconnecting trunks that were in service for all Category 1 service providers on October 1 of the previous year. Access lines shall include business and residence lines, public access lines, and other identifiable access lines. All wireless providers including but not limited to paging and other Commercial Mobile Radio Service providers, that interconnect to the public switched network will contribute to the AUSF under the requirements of Category 1. The number of interconnecting trunks obtained from the local access provider by the wireless provider shall be utilized in conjunction with a Conversion Factor to determine AUSF support from such wireless provider by means of a surcharge on such interconnecting trunks. A wireless provider that fails to contribute to the AUSF as required by this Article shall be subject to termination of its interconnection arrangements pursuant to R14-2-1214(C).~~

~~b. On or before November 1 of each year, each Category 1 local switched access service provider shall provide to the Administrator the number of access lines and number of interconnecting trunks that were in service on October 1 of that year. The Administrator will use these numbers together with the Conversion Factor in calculating the per access line surcharge and per interconnecting trunk surcharge for the following year. The Administrator will multiply the total number of interconnecting trunks by the Conversion Factor to obtain an equivalent number of access lines for the purpose of calculating the surcharges.~~

~~2. Category 2— Providers of intrastate toll service, or other service providers as permitted under R14-2-1204(B)(3), shall be considered providers of Category 2 service and shall be assessed AUSF charges as follows:~~

~~a. One half of the AUSF funding requirement will be collected through Category 2 service providers. The Category 2 AUSF assessment will be based on total Arizona intrastate toll revenue, and assessed as a percent of revenue. The percent of revenue assessment to be in place during a given year will be calculated by the Administrator using the annual Arizona intrastate revenue for all Category 2 service providers for the previous year.~~

~~b. On or before November 1 of each year, each Category 2 service provider shall report to the Administrator the total Arizona intrastate revenue collected between August 1 of the current year and August 1 of the previous year. The Administrator will use this revenue so reported to calculate the AUSF assessment rate for the following year.~~

~~3. New telecommunications service providers.~~

~~a. Telecommunications providers that begin providing basic local exchange service after the effective date of this Article shall be assessed AUSF charges pursuant to R14-2-1204(B)(1). Telecommunications providers that begin providing toll service after the effective date of this Article shall be assessed AUSF charges pursuant to R14-2-1204(B)(2).~~

~~b. All other telecommunications service providers that interconnect to the public switched network and begin providing telecommunications service after the effective date of this Article, shall choose to be considered either a Category 1, Category 2, or both Category 1 and Category 2 service provider. Such election shall be made in writing to the Administrator within 30 days of beginning to provide telecommunications service in Arizona, with a copy to the Director of Utilities. Written concurrence of the Director of Utilities must be received by the Administrator for such selection to be effective. Such selection will be irrevocable for a period of at least three years.~~

~~4. A telecommunications provider that provides both Category 1 and Category 2 services shall be assessed AUSF charges pursuant to both R14-2-1204(B)(1) and R14-2-1204(B)(2).~~

R14-2-1205. Calculation of Surcharges

~~A. The Administrator will calculate the total AUSF support~~ AUSF High Cost Support and AUSF Access Revenue Replacement Support due all local exchange carriers who have been granted ~~AUSF support~~ such support by the Commission. Administrative costs and audit fees will be added to this amount. The amount of any excess funds in the AUSF will then be subtracted to determine the total funding requirement. The surcharge rate shall be equal to the total annual funding requirement divided by the sum of intrastate retail telecommunications revenue for all contributing carriers in Arizona for the immediately preceding calendar year, and may be adjusted to account for any material deficit or surplus projected to exist at the start of the fund year.

~~B. Each contributing company's monthly contribution shall equal the state USF surcharge rate multiplied by its intrastate retail telecommunications revenues in Arizona for the month. The funding requirements from Category 1 and Category 2 service providers will then be calculated. One half of the funding will be obtained from Category 1 providers through surcharges applied to access lines and interconnecting trunks in service. The other half will be obtained from Category 2 providers through surcharges on intrastate toll revenues.~~

~~B. For the purpose of determining the surcharges, the Administrator will develop growth factors to apply to the total reported access lines and toll revenues. Such growth factors will be calculated at 1/2 of the estimated annual percentage growth in access lines and in toll revenues.~~

~~C. Category 1 Surcharge. One half of the total annual AUSF support approved by the Commission for all eligible recipients will be obtained from Category 1 service providers. A monthly per access line surcharge and a monthly per interconnecting trunk surcharge required to obtain this funding will be calculated as follows:~~

- ~~1. Adding together the number of access lines and equivalent access lines for all Category 1 service providers, adjusted by the growth factor;~~
- ~~2. Dividing the total annual AUSF support approved by the Commission for all eligible recipients by 2 to obtain the portion of AUSF support required from Category 1 service providers;~~
- ~~3. Dividing the amount of Category 1 AUSF support calculated in subsection (C)(2) by the sum of access lines calculated in subsection (C)(1) to yield the per access line surcharge;~~
- ~~4. Dividing the per access line surcharge calculated in subsection (C)(3) by 12 to determine the monthly access line assessment;~~
- ~~5. Multiplying the surcharge obtained in subsection (C)(4) by the Conversion Factor to determine the monthly interconnecting trunk surcharge.~~

~~D. Category 2 Surcharge. One half of the total annual AUSF support approved by the~~

~~Commission for all eligible recipients will be obtained from Category 2 service providers. A percent of revenue surcharge required to obtain this funding will be calculated as follows:~~

- ~~1. Totaling the annual intrastate toll revenues of all Category 2 service providers, adjusted by the growth factor;~~
- ~~2. Dividing the total AUSF support approved by the Commission for all eligible recipients by 2 to obtain the portion of AUSF support required from Category 2 service providers;~~
- ~~3. Dividing the amount of Category 2 AUSF support requirement calculated in subsection (D)(2) by the total annual intrastate toll revenues calculated in subsection (D)(1) to arrive at a percentage of revenue surcharge.~~

EC. Recipients of lifeline or other low-income support shall be exempt from paying a Category 1 surcharge.

R14-2-1206. Implementation

A. Any provider of telecommunications service may file either an AUSF tariff or price list, if appropriate, establishing a flow-through mechanism to collect the surcharge approved by the Commission and calculated by the Administrator.

~~B. On or before the 20th day of each month, each Category 1 telecommunications service provider, including wireless providers, responsible for collecting AUSF surcharges shall remit to the Administrator the AUSF surcharge, including any surcharge on wireless providers, collected by that provider during the preceding month. The Category 1 provider shall submit such documentation of AUSF revenues from the AUSF surcharge as may be required by the Administrator.~~

~~C. Only carriers that are incumbent local exchange carriers, and have obligations to serve as a carrier of last resort as of October 1, shall be eligible to receive AUSF Support for the subsequent calendar year.~~

~~C. On or before the 20th day of each month, each Category 2 service provider responsible for collecting AUSF surcharges shall remit to the Administrator the AUSF surcharge collected by that provider during the third preceding month. The Category 2 provider shall submit such documentation of AUSF revenues from the AUSF surcharge as may be required by the Administrator.~~

~~D. Eligible recipients of AUSF support are:~~

~~1. Providers of telecommunications service engaged in providing basic local exchange telephone service in Arizona which have obtained a Commission order authorizing payments from the AUSF; and~~

~~2. Providers that become entitled to AUSF support based upon the provisions of R14-2-1206(E).~~

~~E. If the Commission approves AUSF support to a provider of telecommunications service for a defined area, such AUSF support shall also be available to competitive providers of basic local exchange service in the same defined area that are contributing to the AUSF, and that are willing to provide service to all customers in the specific AUSF support area as defined by the Commission. The AUSF support to which the competitive provider is eligible shall be calculated on a percustomer basis, at the same level at which the incumbent provider of telecommunications service receives AUSF support, and shall not result in an increase in the total AUSF support available for the specific census block groups or study area. If basic exchange service is provided through the resale of another carrier's local loop facilities, AUSF support will only be available to the retail service provider if AUSF support is not included in the wholesale price for the resold local service. This Section shall not apply to small local exchange carriers nor to the universal service support being received by any telecommunications service provider as of the effective date of this Article.~~

OA0 Reply Exhibit C

~~F. For small local exchange carriers and for any basic local exchange telephone service provider receiving universal service support as of the effective date of this Article, the AUSF support shall not be available to competitive providers of basic local exchange service prior to completion of the review provided for in R14-2-1216. Following completion of the review, AUSF support provided to small and intermediate local exchange carriers shall be available to all competitive providers of basic local exchange service in the same defined area that are contributing to AUSF, and that are willing to provide service to all customers in the specific geographic study area as defined by the Commission, unless otherwise ordered by the Commission.~~

~~G. Defined area, study area, geographic area, and support area mean the same area during the first three years of the effective date of this Article. After the first three years, they will still have the same meaning unless otherwise ordered by the Commission.~~

R14-2-1207. Calculation of Monthly Payments and the Associated Collections

~~A.~~

~~For the monthly Category 1 AUSF payment, each provider of local switched access shall remit to the Administrator an amount equal to the number of access lines in service on the first day of the month, times the monthly surcharge per access line plus the number of interconnecting trunks in service on the first day of the month, times the monthly interconnecting trunk surcharge.~~

~~B.~~ The monthly AUSF payment that each Category 2 provider shall remit to the Administrator is an amount equal to its monthly intrastate ~~to~~ retail- telecommunications service revenue times the monthly surcharge percentage determined in accordance with R14-2-1205.

~~C.~~ Payments must be received by the Administrator by the 20th day of each month. If the payment amount is greater than \$10,000, then it shall be wire transferred to the Administrator.

D. The Administrator shall enter into an appropriate non-disclosure agreement with each telecommunications service provider to assure that information necessary to allocate AUSF funding obligations and to calculate surcharges is reported, maintained, and used in a manner that will protect the confidentiality of company specific data. The Administrator shall not use confidential data for any purpose other than administering the AUSF.

R14-2-1208. Monthly AUSF Disbursements

A. AUSF disbursement shall be made 30 days following the date of AUSF collections.

B. The Administrator shall not make AUSF support payments to a provider of telecommunications service until the Administrator has received a copy of a Commission decision authorizing the provider to receive such support.

R14-2-1209. Procedures for Handling AUSF Rate Changes

A. ~~Category 1 and Category 2~~ AUSF surcharges shall be revised when the Commission authorizes new or revised AUSF payments to any provider of telecommunications service. The Administrator shall calculate the new AUSF flow-through surcharges in accordance with this Article, which surcharges shall become effective upon the Commission's approval of the new or revised AUSF payments.

B. An annual calculation to revise AUSF flow-through surcharges shall be made by the Administrator on ~~Dec~~November 1 of each year with an effective date the following January 1. The flow-through surcharges shall be calculated so that the total AUSF funding will equal the AUSF revenue requirements, plus administrative costs as well as any corrections and true-ups. No later than ~~Dec~~November 1 of each year, the Administrator shall provide notice to the Commission and all telecommunication service providers who pay into the AUSF of the flow-through surcharge rates for the following calendar year. By December 1, the Commission shall adopt a new surcharge rate for the following year and shall provide notice of that rate to all telecommunications providers that pay into the AUSF.

R14-2-1210. Statement of Participation of All Telecommunications Service Providers in the AUSF

A. Within 30 days of the effective date of this Article, each telecommunications service provider shall provide a letter to the Administrator acknowledging that provider's obligation under this Article to pay-collect and remit the proceeds of AUSF surcharges. Failure to provide such a letter shall be grounds for termination after written notice from the Administrator of the provider's interconnection with the public switched network.

B. Any telecommunications service provider which begins providing telecommunications service after the effective date of this Article shall, within 30 days of beginning to provide intrastate service in Arizona, provide a letter to the Administrator acknowledging that provider's obligation under this Article to make monthly payments for the local and/or toll portion, as appropriate, of the AUSF contribution in accordance with this Article. Failure to provide such a letter shall be grounds for denying to the provider interconnection with the public switched network.

R14-2-1211. Duties and Responsibilities of the AUSF Administrator

The Administrator shall:

1. Develop, obtain, and, on or before ~~Dec~~November 15 of each year, file with the Commission such information and documentation as the Administrator deems necessary for the establishment and calculation of the ~~Category 1 and Category 2~~ surcharges for the succeeding year. Such a filing shall also be made each time the Commission authorizes a change in the AUSF funding requirement.
2. Monitor the AUSF payments of all telecommunications providers.
3. Oversee the billing of AUSF surcharges.
4. Prepare the necessary forms to be used in reporting the AUSF collections and disbursements and maintain monthly records.
5. Coordinate the collection and disbursement of AUSF monies in accordance with this Article.
6. Prepare an annual report that provides a detailed accounting of the AUSF collections and disbursements and that identifies the annual cost of administration. The report shall be filed with the Commission on or before April 15 of each year.
7. Monitor procedures for auditing the AUSF collections and disbursements. The audit function shall be performed by an independent outside auditor.

R14-2-1212. Interim Administrator

~~US WEST Communications, Inc., will serve as interim Administrator of the AUSF and will perform the functions detailed herein that are required of the Administrator for a transition period until a private, neutral third party is appointed by the Commission to serve as Administrator of the AUSF. A neutral third party selected through the competitive bid process shall be appointed no later than July 1, 1997.~~

R14-2-1213. Guidelines for Auditing the AUSF

A. The AUSF records covering both collections and disbursements shall be audited at the end of the first year following the designation of a third party administrator. The AUSF records will then be audited at least once every other year in the subsequent years of operations.

B. The records shall be examined for accuracy and the existence of effective internal controls to ensure that the AUSF is being administered appropriately and properly.

C. An independent external auditor selected by the Commission shall be utilized to provide an unbiased audit opinion concerning the AUSF administration procedures and controls.

D. Any costs for conducting audits will be deducted from the revenues of the AUSF prior to disbursement of funds.

R14-2-1214. Enforcement of Collection of Delinquent AUSF Amounts

A. The Administrator shall issue past due notices to each provider of telecommunications service that is 15 days or more delinquent in submitting its AUSF payments to the Administrator. A copy of this notice shall be provided to the Commission.

B. AUSF support payments shall be withheld from any provider of telecommunications service that is delinquent in submitting its AUSF payments to the Administrator. Each provider of telecommunications service will be fully liable for any accrued interest owing on its AUSF contributions that remain unpaid for 30 days. Such delinquent AUSF payments will begin accruing interest at the rate of 1 and 1/2% per month beginning with the 31st day until such amount is paid in full along with all accrued interest.

C. The ~~local switched access service provider~~ Administrator shall promptly notify the Commission ~~and the Administrator~~ of the identity of any wireless provider which fails or refuses to pay its AUSF surcharge. Such notice shall also be directed to the wireless provider. If the wireless provider has not paid the amount due within 30 days of such notice, the interconnection provider to such wireless provider shall terminate the wireless provider's interconnection until the full amount together with all accrued interest, is paid in full (unless the payment is in bonafide dispute and the wireless carrier has paid the undisputed amount).

D. Failure by a telecommunications service provider to comply with the provisions of this Article may result in sanctions as determined by the Commission.

R14-2-1215. AUSF Annual Report

A. On or before April 1 of each year, the Administrator shall file with the Commission an annual report which shall summarize the preceding year activity and contain the following:

1. A statement of AUSF collections and disbursements.
2. A record of the total cost of administration of the AUSF.
3. Audit reports from the audits conducted during the year.

B. A copy of the annual report shall be provided to each provider of telecommunications service who contributes to the AUSF.

R14-2-1216. Review Process

A. Not later than three years from the effective date of this Article, the Commission staff shall initiate a comprehensive review of this Article and shall provide the Commission with recommendations regarding any necessary changes to the Article. Any interested party may also make such recommendations. The Commission shall consider these recommendations in such proceeding as the Commission deems appropriate.

B. The costs used to calculate AUSF funding levels for a given provider or ~~AUSF support~~ AUSF High Cost Support area shall be reviewed by the Commission at least every three years following the effective date for any authorized ~~AUSF support~~ AUSF High Cost Support for the provider or study area. The Commission may reduce the authorized funding level and require that the AUSF surcharge be recalculated on the basis of this review.

R14-2-1217. Supersession of Existing USF Mechanism

The universal service funding mechanism initially approved by the Commission in Decision No. 56639 (September 22, 1989) is superseded by this Article, except that any calculation, contribution or collection of, or entitlement to, universal service fund support approved by the Commission prior to the adoption of this Article shall remain in effect until otherwise ordered by the Commission or until the application of this Article leads to a different result.