

ORIGINAL



0000118118

BEFORE THE ARIZONA CORPORATION COMMISSION

RECEIVED

- 1 KRISTIN K. MAYES
- 2 CHAIRMAN
- 3 GARY PIERCE
- 4 COMMISSIONER
- 5 SANDRA D. KENNEDY
- 6 COMMISSIONER
- 7 PAUL NEWMAN
- 8 COMMISSIONER
- 9 BOB STUMP
- 10 COMMISSIONER

Arizona Corporation Commission 2010 SEP 14 P 1:49

DOCKETED

SEP 14 2010

AZ CORP COMMISSION  
DOCKET CONTROL

DOCKETED BY

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

RUCO'S REPLY BRIEF

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

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

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

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

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

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

19  
20  
21  
22 <sup>1</sup> The Commission's rules do not prescribe a rulemaking process as required by A.R.S. § 41-1057(2).  
23 Nonetheless, the Commission has a well established procedure for its Notice of Proposed Rulemaking. This  
24 process includes notification of proposed rules through the Secretary of State, and completion of economic impact  
statements as they relate to the rule generally, and on small business in particular. The Commission's review  
process also involves an opportunity for public comment.

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

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

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

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

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

<sup>4</sup> *Scates*, 118 Ariz. at 535, 578 P.2d at 616.

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

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

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

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

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

21 \_\_\_\_\_  
22 <sup>6</sup> Rebuttal Testimony of Debra Aron at 79.

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

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

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

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

23 The long-standing holding clearly dictates that the long distance carriers not only contribute to  
24 the local loop costs, but also other joint and common costs.<sup>9</sup>

21 ...

22 ...

---

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

<sup>9</sup> Rejoinder Testimony of Ben Johnson at 10-13.

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

4 ¶254(k) reads:

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

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

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

24 \_\_\_\_\_  
<sup>10</sup> T: 64-65. See also 47 U.S.C. § 254(k) (1996).

<sup>11</sup> Direct Testimony of Ben Johnson at 10.

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

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

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

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

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

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

---

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

<sup>14</sup> Rejoinder testimony of Ben Johnson at 10-11.

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

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

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

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

---

<sup>15</sup> Rebuttal Testimony of Donald Meredith at 11.

<sup>16</sup> Rejoinder Testimony of Ben Johnson at 20-22.

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

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

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

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

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

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

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

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

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

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

---

<sup>19</sup> Reply Testimony of Debra Aron at 78.

<sup>20</sup> Rejoinder Testimony of Ben Johnson at 6-9.

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

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

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

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

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

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

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

24 

---

<sup>21</sup> Rejoinder Testimony of Ben Johnson at 18-20.

<sup>22</sup> T: 78-80.

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

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

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

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

---

<sup>23</sup> Rejoinder Testimony of Ben Johnson 18-20.

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

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

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

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

---

<sup>24</sup> Rejoinder Testimony of Ben Johnson 20-22.

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

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

20 AT&T argues that access charges are not an effective tool for recovering a portion of  
21 network costs and that they should be eliminated by rules adopted through this proceeding.  
22 AT&T's witness, Debra Aron states:

23  
24  

---

<sup>25</sup> T: 79-80.

<sup>26</sup> T: 64-66.

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

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

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

---

<sup>27</sup> Rebuttal Testimony of Debra Aron at 80-81.

<sup>28</sup> Rejoinder Testimony of Ben Johnson at 11-13.

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

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

7       **CONCLUSION**

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

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

23  
24      

---

<sup>29</sup> R-4 OrbitCom's response to RUCO DR 1.05.

<sup>30</sup> T: 59-61.

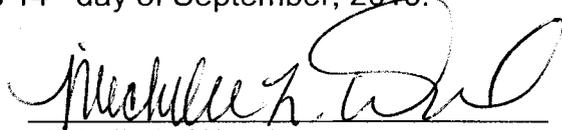
1           If the Commission determines that switched access reform is necessary, then changes  
2 to the AUSF will be necessary. RUCO recommends expanding the AUSF to include other  
3 carriers who benefit from universal service, including, but not limited to interexchange, wireless  
4 and internet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

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

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

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

10 RESPECTFULLY SUBMITTED this 14<sup>th</sup> day of September, 2010.

11 

12 Michelle L. Wood  
13 Counsel

14 AN ORIGINAL AND THIRTEEN COPIES  
15 of the foregoing filed this 14th day of  
16 September, 2010 with:

17 Docket Control  
18 Arizona Corporation Commission  
19 1200 West Washington  
20 Phoenix, Arizona 85007

21 COPIES of the foregoing hand delivered/  
22 mailed this 14<sup>th</sup> day of September, 2010 to:

23 Jane L. Rodda, Administrative Law Judge  
24 Hearing Division  
Arizona Corporation Commission  
400 West Congress  
Tucson, Arizona 85701

Steven M. Olea, Director  
Utilities Division  
Arizona Corporation Commission  
1200 West Washington  
Phoenix, Arizona 85007

Janice Alward, Chief Counsel  
Legal Division  
Arizona Corporation Commission  
1200 West Washington  
Phoenix, Arizona 85007

Jeffrey W. Crockett  
Bradley S. Carroll  
Snell & Wilmer, L.L.P.  
One Arizona Center  
Phoenix, Arizona 85004-2202

1 William J. Hayes, General Manager  
Table Top Telephone Company, Inc.  
2 600 North Second Avenue  
Ajo, Arizona 85321

Nathan Glazier  
Regional Manager  
Alltel Communications, Inc.  
4805 E. Thistle Landing Dr.  
Phoenix, Arizona 85044

3  
4 Dennis D. Ahlers  
Associate General Counsel  
Integra Telecom  
5 6160 Golden Hills Drive  
Golden Valley, MN 55402

Joan S. Burke  
Law Office of Joan S. Burke  
1650 N. First Avenue  
Phoenix, AZ 85003  
Thomas H. Campbell

6  
7 Cathy Murray  
Manager, Regulatory Affairs  
Integra Telecom  
8 6160 Golden Hills Drive  
Golden Valley, MN 55402

Michael Hallam  
Lewis and Roca, LLP  
40 North Central  
Phoenix, AZ 85004

9  
10 Norm Curtright  
Reed Peterson  
Qwest Corporation  
11 20 E. Thomas Road, 16<sup>th</sup> Floor  
Phoenix, AZ 85012

Patrick J. Black  
Fennemore Craig  
3003 N. Central Avenue, Suite 220  
Phoenix, AZ 85012

12  
13 Michael M. Grant  
Gallagher & Kennedy, P.A.  
2575 East Camelback Road  
14 Phoenix, Arizona 85016-9225

Greg L. Rogers  
Senior Corporate Counsel  
Level 3 Communications, LLC  
1025 Eldorado Boulevard  
Broomfield, Colorado 80021

15 Dan Foley  
Isabelle Salgado  
16 AT&T Nevada  
645 East Plumb Lane, B132  
17 P. O. Box 11010  
Reno, Nevada 89520

Arizona Payphone Association  
c/o Karen E. Nally  
Law Office of Karen E. Nally, PLLC  
3420 E. Shea Boulevard, Suite 200  
Phoenix, Arizona 85028

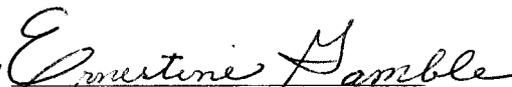
18  
19 Mark A. DiNunzio  
Cox Arizona Telcom, LLC  
1550 West Deer Valley road  
20 MS DV3-16, Bldg. C  
Phoenix, Arizona 85027

Paul Castaneda  
President, Local 7019  
Communication Workers of America  
2501 West Dunlap, Suite 103  
Phoenix, Arizona 85021

21  
22 Michael W. Patten  
Roshka DeWulf & Patten, PLC  
One Arizona Center  
23 400 East Van Buren, Suite 800  
Phoenix, Arizona 85004

Stephen H. Kukta  
Director and Counsel  
Sprint Nextel  
201 Mission Street, Suite 1500  
San Francisco, CA 94105

24

By   
Ernestine Gamble

- 1 Thomas W. Bade  
Arizona Dialtone  
6115 South Kyrene Road, #103  
Tempe, Arizona 85283
- 3 Craig A. Marks  
4 Craig A. Marks, PLC  
10645 N. Tatum Blvd.  
5 Suite 200-676  
Phoenix, AZ 85028
- 6 William Haas  
7 McLeodUSA Telecommunications  
6400 SW C Street  
8 P. O. Box 3177  
Cedar Rapids, Iowa 52406-3177
- 9 Brad VanLeur  
10 Orbitcom, Inc.  
1701 N. Louise Ave.  
11 Sioux Falls, South Dakota 57107
- 12 Charles H. Carrathers, III  
General Counsel  
13 Verizon, Inc.  
HQE03H52  
14 600 Hidden Ridge  
Irving, Texas 75015-2092
- 15 Rex Knowles  
16 XO Communications, Inc.  
111 E. Broadway, Suite 1000  
17 Salt Lake City, Utah 84111
- 18 Lyndall Nipps  
TW Telecom  
19 845 Camino Sur  
Palm Springs, CA 92262
- 20 Scott S. Wakefield  
21 Ridenour, Hienton & Lewis, PLLC  
Chase Tower  
22 201 North Central Avenue, Suite 3300  
Phoenix, Arizona 85004-1052
- 23
- 24

EXHIBIT A

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

