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

I. INTRODUCTION.

Most parties agree that it is appropriate for the Arizona Corporation Commission ("Commission") to take action at this time to reduce the switched access rates charged by Incumbent Local Exchange Carriers ("ILEC") and Competitive Local Exchange Carriers ("CLECs") for access to their networks. These rates in the past have made a significant contribution to the joint and common costs of ILECs in particular which have helped to keep local rates affordable in the past.

The evidence in the record supports the adoption of Staff's position in this case. Staff is recommending a reduction to rural ILEC switched access rates to the higher of Qwest's intrastate rates or the small ILEC's interstate rates. Staff is also recommending that CLEC intrastate switched access rates be set at the rates of the ILEC in the service area in which it is providing service. Staff recommends no change to Qwest Corporation's ("Qwest") access rates as a result of this proceeding since Qwest's switched access rates have already undergone two agreed upon reductions in its Price Cap Plan Docket. However, if the Commission determines that Qwest's access rates should be changed, those changes can be implemented in the Price Cap Plan docket.

When carriers are unable to simply absorb such reductions, Staff recommends several alternatives. First, carriers should have the option of revenue neutral rate rebalancing, subject to their meeting certain criteria and subject to the Commission's approval. If carriers seek to offset reductions in access revenues through the Arizona Universal Service Fund ("AUSF"), ILECs should be required to demonstrate need through the filing of a rate case under R14-2-103. Staff also recommended an alternative process, which would involve a waiver to the AUSF rules, to permit carriers to obtain AUSF subsidies temporarily until a rate case could be filed under R14-2-103.

Staff believes that its proposals are reasonable and in the public interest and, respectfully, requests that the Commission adopt them.

II. DISCUSSION.

A. <u>The Arizona Local Exchange Carriers Association ("ALECA")</u>.

ALECA notes in its Initial Brief that it consists of eleven independent local exchange carriers ("LECs") and five tribal companies operating in Arizona and that these companies serve largely rural, high-cost areas with low customer density and smaller calling scopes than Qwest.[1] ALECA makes three policy recommendations in this case including (1) revenue neutral access reform; (2) high cost loop support; and (3) centralized administration and automatic enrollment for Lifeline and Link-Up.[2] ALECA argues that all three of these policy recommendations should be financed through the AUSF.[3] Most of the parties in this Docket, including Staff, take issue with ALECA's proposals, which would dramatically increase the size of the AUSF.

Like Staff, ALECA proposes that the intrastate switched access rates of its member companies be reduced to Qwest's intrastate levels.[4] ALECA states that this will amount to a reduction in ALECA member company collective revenues of approximately $23 million (using 2008 data).[5] ALECA also states that the impact if absorbed by ALECA's customers would be an increase in local service rates of $10.74 per month.[6] ALECA's witness Meredith testified that the reduction to Qwest's intrastate switched access charge levels would go along way "toward closing the gap between the members' intrastate and interstate rates."[7]

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[1] ALECA Initial Br. at 1.
[2] ALECA Initial Br. at 2.
[3] *Id.*
[4] *Id.* (Staff's proposal was modified slightly so that ALECA member (and other small rural non-ALECA member) rates would be reduced to the higher of Qwest's intrastate switched access rates or the small ILEC's interstate switched access rates).
[5] *Id.* (ALECA proposes that the Commission use 2009 data in determining the amount of access charge reductions).
[6] *Id.*
[7] ALECA Initial Br. at 3.

First, Staff and the other parties do not support ALECA's proposal for revenue neutral access reform financed solely through funds from the AUSF. Most parties, including Staff, believe there has to be a showing of need through the filing of information under A.A.C. R14-2-103 before AUSF funds are available. Many of the ALECA member companies have not had their rates examined by the Commission in some time. It would not be appropriate, in Staff's opinion, to simply allow a dollar for dollar offset from the AUSF without some showing of need.

ALECA takes issue with Staff's proposals which would require a demonstration of need before AUSF funds could be obtained.[8] ALECA argues that while the rates of its member companies have not been subject to examination in some time, the existing rates of its members were approved by the Commission and thus, there is a presumption of reasonableness with respect to those rates.[9] ALECA argues Staff's proposal for rate cases would significantly delay the process by as much as four years if rate cases are required.[10] ALECA loses sight of the fact that Staff also believes that some carriers may be able to make up any lost access charge revenues through revenue neutral rate rebalancing. Staff also believes steps could be taken to expedite the processing of rate filings by ALECA members including consolidation of some aspects of the individual filings. Staff has also proposed an alternative which would allow access charge reform to proceed initially with offsets through the AUSF; to be followed up with a rate case filing. This interim AUSF relief would be subject to refund if during the subsequent rate case proceeding, it is determined that the payments to the carrier were excessive. In order to utilize this option, the Commission would, at a minimum, have to temporarily waive the rate case filing requirement in the current rules.

Second, ALECA states that while one could argue that the existing AUSF could be used to support access charge reform, to avoid appellate challenges, rule changes should be made to specifically allow support for access charge reductions.[11] Staff agrees that rule changes would be required to specifically allow support for access charge reform. Staff also agrees with ALECA's

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[8] *Id.* at 8.
[9] *Id.*
[10] *Id.* at 8-9.
[11] ALECA Initial Br. at 7.

observation that the current rules give no guidance with respect to how to apply for support for access charge reductions, how to qualify, and how the Commission would administer the program.[12]

ALECA also proposes significant changes to the current AUSF for high cost loop support. Staff and several of the other parties oppose such revisions to the AUSF at this time. Staff believes it is important at this time to focus upon access charge reform and the rule changes necessary to accomplish this reform. This is in and of itself a huge undertaking and attempting to revise the AUSF in other major respects is not advisable at this time. ALECA proposes that this portion of AUSF support be based on the cost model used to calculate Federal High-Cost Loop Support.[13] Since the Federal funding mechanism is undergoing significant changes right now, Staff recommends the Commission wait on any revisions to the high cost portion of the AUSF until there is more certainty regarding the changes to the Federal funding mechanism. Right now, high cost disbursements from the AUSF total $769,000. Under ALECA's proposal for high cost loop support, this amount would increase to at least $9 million annually based upon 2007 Federal HCL disbursements.[14]

ALECA's third policy recommendation is for adoption of the proposals contained in the Report and Recommendation of Eligible Telecommunications Carriers ("ETCs") on Lifeline and Link-Up issues docketed on December 21, 2005.[15] The Report recommended the Department of Economic Security ("DES") centrally administer the Lifeline and Link-Up programs of all Arizona ETCs in the future and that DES be reimbursed for its costs.[16] Staff recommends that Arizona ETCs be authorized to implement the recommendations contained in the Industry Report. Staff does not recommend, however, that recovery of the costs of implementing these recommendations be recoverable from the AUSF. If the projections contained in the industry report are accurate, the incumbent local exchange companies stand to gain $38 million a year in additional revenues that they would not receive absent the federal programs. Given that potential increase in revenues, Staff believes that the beneficiaries of these funds should contribute the relatively small amount of money they would have to spend in order to reap the potentially massive return on those expenditures.

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[12] *Id.*
[13] ALECA Initial Br. at 4.
[14] ALECA Initial Br. at 5.
[15] ALECA Initial Br. at 6.
[16] *Id.*

B. Cox and the Joint CLECs.

Both Cox Arizona Telcom, LLC ("Cox") and the Joint CLECs (consisting of "Eschelon Telcom of Arizona; Mountain Telecommunications, Inc.; Electric Lightwave, LLC; McLeodUSA Telecommunications Services, Inc. dba PAETEC Business Services; tw telecom of arizona llc; and XO Communications Services, Inc.) believe that it is premature for the Commission to address AUSF revisions and access charge reform at this time.[17] These parties note that the Federal Communications Commission ("FCC") has recently issued its National Broadband Plan which will modify the "landscape" with respect to universal service and intercarrier compensation.[18] They claim it makes little sense for the Commission to proceed given the proposed schedule and scope of the FCC's proposals.[19] Staff disagrees. The proposals for access charge reform in this docket are consistent with the FCC proposals. It is important for the Commission to move ahead with intrastate access charge reform. Indeed, the FCC has encouraged State commissions to proceed with reform rather than wait for the culmination of proceedings at the Federal level.[20]

Both parties also argue that if the Commission does decide to proceed it should only look at the rural ILEC's access charges in this phase of the proceeding. Because the record establishes that Interexchange Carriers ("IXCs") and other providers do not have a choice with regard to originating and terminating access for most end-users, and most CLEC access rates are set far above cost, Staff opposes the CLEC's suggestion to focus only on the rural ILECs in this phase of the proceeding.

Cox and the Joint CLECs also question the need for access charge reform at this time.[21] They state that the only beneficiaries will be interexchange carriers such as AT&T and Sprint and there is no assurance that consumers will benefit in the end since IXCs may not pass through the access charge reductions to their end user customers.[22] Staff believes the record is replete with reasons which support proceeding with intrastate switched access charge reform at this time. Further, AT&T and Sprint have agreed to eliminate or make certain reductions to their rates if the Commission

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[17] Cox Initial Br. at 1; Joint CLECs Initial Br. at 1.
[18] *Id.*
[19] *Id.*
[20] National Broadband Plan at 148 (Recommendation 8.7).
[21] Cox Initial Br. at 2; Joint CLECs Initial Br. at 2.
[22] Cox Initial Br. at 1-2; Joint CLECs Initial Br. at 3.

undertakes access charge reform. In addition, Staff has recommended that IXCs be required to demonstrate that they have flowed through the benefits of access charge reform to their end-user customers.

Cox and the Joint CLECs also raise due process concerns suggesting that all affected parties need sufficient opportunity to be heard to ensure that the reduction in rates is not confiscatory or illegal.[23] They suggest that a rulemaking that sets a default rate may be sufficient if all affected carriers are allowed to prove that their intrastate access rates should be higher than the default rate.[24] Staff believes that the current process will provide all parties with sufficient due process including opportunity for input. First, all affected carriers received notice of this proceeding. Most of these carriers are participants in this proceeding. Second, this proceeding will likely be followed by a rulemaking proceeding which implements the policy determinations of the Commission. Finally, under Staff's proposal and most other parties, individual ILEC proceedings would be needed to actually reduce rates and rate rebalance or determine rates in the context of an A.C.C. R14-2-103 proceeding. With respect to the CLECs, Staff has recommended that to the extent a CLEC believes its costs are higher than the ILEC's, it should be allowed to make a demonstration before the Commission. For these reasons, Staff does not believe that due process is a legitimate concern.

The Joint CLECs and Cox also argue that any mandatory reductions should be implemented over time.[25] The Joint CLECs and Cox have been on notice for some time that such reductions were likely. The Joint CLECs and Cox already have pricing flexibility that will allow them to increase other rates to make up for lost switched access charge revenues. The Commission is likely to give the CLECs time upfront in which to make any compliance filings. To the extent they need to increase any maximum rate levels, they may make filings with the Commission which will take time to resolve. Cox states that its experience has been that raising maximum rates in its tariff is often a "**slow** and difficult process."[26] In the end, Staff believes that the process itself as discussed above will provide sufficient transition time for the CLECs. Nonetheless, Staff does acknowledge that the

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[23] Cox Initial Br. at 2; Joint CLECs Initial Br. at 2.
[24] *Id.*
[25] Cox Initial Br. at 2; Joint CLECs Initial Br. at 2-3.
[26] Cox Initial Br. at 10.

FCC and some States have given the CLECs a transition period. While the reductions to reflect Qwest's intrastate switched access rates are significant, they are not as significant as taking CLEC rates down to interstate levels. According to AT&T, "[a]ll of the CLECs' intrastate rates are several times higher (in many cases, more than ten times higher) than the corresponding interstate rates."[27] AT&T also notes that Cox's witness admitted that its intrastate rate is approximately 11 times higher than the interstate rate.[28]

Cox also argues that more revenue sources, such as a state Subscriber Line Charge ("SLC"), may be needed to help offset revenue decreases associated with access charge reform.[29] This issue has not been subject to much if any discussion in this Docket. Staff opposes the adoption of a state SLC to offset access charge reductions.

Finally, Cox and the Joint CLECs argue that carriers should be able to contract for access rates that differ from their tariffed rates if the carrier's tariff contemplates such arrangements.[30] Cox states that it does not oppose Staff's recommendation that future switched access service agreements with IXCs or other providers be filed at the Commission.[31] However, it expresses concern regarding the confidentiality of certain sensitive information in the agreements.[32] Staff would oppose any determination now that certain information in the agreements is confidential and subject to redaction. If a company believes that information in an agreement is confidential, it may discuss the issue with Staff at the time of filing and seek a determination from the Commission if necessary.

C. <u>The Residential Utility Consumer Office ("RUCO")</u>.

RUCO did not offer a specific proposal for access charge reform and/or changes to the AUSF to accomplish such reform. RUCO does not believe that there is any pressing need to modify access charges and that specific modification should not be effectuated in a rulemaking proceeding.[33] Staff disagrees and as noted earlier, believes the record contains substantial evidence why the Commission should proceed with intrastate access charge reform at this time.

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[27] AT&T Initial Br. at 17.
[28] *Id.*
[29] Cox Initial Br. at 10.
[30] Cox Initial Br. at 12.
[31] Cox Initial Br. at 12.
[32] *Id.*
[33] RUCO Initial Br. at 5.

RUCO also argues that the Commission cannot change access charges of any carrier without a fair value finding.[34] RUCO goes on to argue that revenue neutral modifications of access charges are not exempt from the fair value requirement.[35] RUCO states that even if a rate rebalancing holds the overall revenue level of the utility constant, the changes to "rates and charges" for particular services triggers the fair value requirement.[36] Staff would note that its first recommendation is for the rate changes to take place in the context of a rate proceeding particularly when AUSF funding is requested. Staff's proposal with respect to revenue neutral rate rebalancing would involve the ILEC submitting certain financial information to the Commission with respect to fair value rate base and rate of return. This information and other information submitted would be analyzed by Staff to determine whether rate rebalancing without a formal rate case was appropriate. Staff believes that this process would comply with the fair value requirement. Even under Staff's alternative proposal, which allow for interim AUSF funding, certain financial information would be required; and a determination would initially be made whether such an approach was appropriate for the particular carrier.

RUCO also argues that revenue neutral rate rebalancing is unfair to ratepayers since it merely ensures that carriers are insulated from revenue reductions.[37] RUCO states that the rhetoric of revenue neutrality rings hollow, once it becomes clear that these carriers are attempting to not only avoid the normal requirement for rate changes to be adopted in the context of a fair value rate case proceeding, but also attempting to sidestep a detailed examination of growth in unregulated services and the determination of an appropriate allocation of costs between basic local service switched access service and the various unregulated services, including broadband internet access service.[38] Staff disagrees. Under Staff's various process proposals for revenue neutral rate changes discussed above, the carrier would have to submit sufficient financial information for Staff to determine that the process is appropriate. While Staff agrees that it is important to ensure that cost allocation

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[34] RUCO Initial Br. at 7.
[35] *Id.* at 8.
[36] *Id.*
[37] RUCO Initial Br. at 9.
[38] *Id.*

requirements for regulated versus nonregulated services are being followed, issues such as this can be examined during discovery.

Furthermore, some small ILECs may have elected to have their broadband internet access service treated as a "telecommunications service," which is a permissible option under FCC Orders.[39] Appropriate cost allocation would likely again be handled pursuant to FCC rules. Staff agrees that this is an issue that may in some cases be appropriate for examination; but in and of itself should not preclude revenue neutral rate rebalancing as proposed by Staff. Again, compliance issues such as this can be examined in the discovery process.

RUCO also argues that the Commission should not change its long-standing practice of allocating only a reasonable portion of loop costs and other non-traffic sensitive joint and common costs to basic local exchange services.[40] Staff agrees with RUCO's observation. Staff envisions that a discovery period would be allowed with respect to any filing by a carrier for rate rebalancing or AUSF funds where issues such as this could be explored.

RUCO, like the Joint CLECs and Cox, suggests that a phase-in of reductions to switched access charge or a transition period may be necessary to ameliorate any adverse impacts on rate payers.[41] Staff does not agree. The process itself, proposed by Staff and other parties, is designed to ameliorate any adverse impacts on rate payers. Further phase-in periods or transition periods for the ILECs should not be necessary, at least under the Staff proposals. Even the process likely to be followed by CLECs will not result in immediate reductions. But there should be enough time built into the process to allow for a smooth transition. If a CLEC cannot meet any deadlines imposed, it can always ask for a waiver or an extension of time.

RUCO urges the adoption of an economic cost benchmark to better identify high cost areas and suggests that AUSF support should be portable from one carrier to another.[42] Staff does not support revisions to the AUSF rules which go beyond the changes necessary to accomplish access

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[39] *See Appropriate Framework for Broadband Access to the Internet Over Wireline Facilities et al.,* CC Docket Nos. 02-33, 95-20, 98-10, WC Docket Nos. 04-242, 05-0271, *Report and Order and Notice of Proposed Rulemaking,* 20 FCC Rcd 14853.

[40] RUCO Initial Br. at p. 14.

[41] RUCO Initial Br. at 15.

[42] RUCO Initial Br. at 17.

charge reform at this time. Indeed, most of the prefiled testimony and oral testimony offered by witnesses at the evidentiary hearing focused upon access charge reform and the revisions to the AUSF necessary to implement access charge reform. Attempting to undertake access charge reform at the same time as other significant revisions to AUSF is not advisable. Moreover, such changes may be premature before the FCC acts to revise the Federal funding mechanism.

D. Qwest.

Qwest's proposal would apply to the rural ILECs in Arizona and the CLECs.[43] Under Qwest's proposal, these entities would be required to lower their intrastate switched access rates to the Qwest composite rate or the rate previously approved by the Commission for Qwest in an earlier phase of this proceeding and the Qwest Price Cap Docket.[44] Qwest's position is similar to Staff's but Staff does not recommend use of the "composite" rate and Staff's proposal calls for use of the higher of Qwest's intrastate switched access rates or the ILECs interstate switched access rates.

Staff agrees with Qwest that use of Qwest's access rates is more gradual, lessens the need rural LECs may have to draw from the AUSF, and provides a significant step toward eliminating implicit subsidies.[45] Qwest witnesses have also testified that reducing all LEC's intrastate access rates to Qwest's levels, would be the best means of reducing traffic pumping and arbitrage schemes.[46]

Staff finds unnecessary Qwest's further proposal that access rates be stepped down in a multi-year transition period.[47] Qwest argues that the Staff's proposal is flawed because it does not provide for such a transition period.[48] Under Staff's various proposals, however, the likelihood of rate shock is minimized. First, Staff would only recommend approval of revenue neutral rate rebalancing after reviewing certain criteria including the sufficient financial information for a fair value and fair value rate of return finding. Staff's primary proposal where AUSF is requested would require a rate case to set the appropriate benchmark rate for the company and make a determination as to whether AUSF funding was necessary. Staff's alternative proposal involving use of the AUSF would provide for a

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43 Qwest Initial Br. at 2.
44 *Id.*
45 *Id.* at 3.
46 Qwest Initial Br. at 21.
47 *Id.*
48 Qwest Initial Br. at 21.

temporary waiver of the AUSF's current requirement for a rate case before any disbursement from the fund and would allow interim draws from the fund until a rate case could be filed and processed. But even under this last proposal, sufficient financial information would be required to ensure this was appropriate.

For AUSF support, Qwest advocates the use of a statewide benchmark which would be set at 125% of the average retail rates, plus a showing of need by filing Rule 103 information.[49] Qwest's benchmark would come to approximately $16.45 which is based on 125% of weighted average retail rates. ILECs would be required to first bring their rates up to the statewide benchmark before becoming eligible for AUSF funds. Staff opposes the use of a statewide benchmark since it would essentially create a uniform local service rate across the State, which would not at all be reflective of the costs of serving the different areas of the state. Such an approach may also put a heavier burden on the AUSF than Staff's various proposals. Qwest also claims that it could accept Staff's individual company specific benchmarks, but believes that its approach is the preferred approach.[50]

Staff does agree with Qwest that other proceedings would be necessary to implement the findings that come out of this Docket. Both Staff and Qwest are in agreement that a rulemaking would ultimately be necessary to modify the AUSF rules to provide for a process to allow for AUSF disbursement for access charge reform.[51] However, Qwest's argues that its approach is preferred over Staff's because it is simpler, easier to administer and will permit carriers to begin access reform faster.[52]Qwest argues that under its proposal, carriers could immediately begin to reduce access and increase local rates on a revenue neutral basis; and reduce the balance of the access rates down to the target level after necessary AUSF rule changes are made and the carrier has demonstrated need.[53] This is not necessarily true, however. Staff would also permit revenue neutral rate rebalancing where it makes sense. Staff's second alternative for AUSF funding would allow interim AUSF funding pending the completion of a rate case. While Staff's primary proposal would require the filing of a rate case to demonstrate need where AUSF is requested, Staff believes that there are various ways to

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[49] Qwest Initial Br. at 39.
[50] Qwest Initial Br. at 34.
[51] Qwest Initial Br. at 39.
[52] *Id.*
[53] *Id.*

streamline such filings. Moreover, to implement Qwest's proposal for AUSF draws, there would also have to be a demonstration of need. Further, even with Qwest's rate rebalancing proposal, Qwest and others acknowledge that a proceeding to set the benchmark rate would first be necessary.[54]

Qwest also argues that Staff's alternative proposal which would allow carriers to seek a waiver of the AUSF rules, and obtain interim AUSF support, is not "optimal" for several reasons.[55] Staff agrees that this approach is not "optimal." Staff has recommended it for consideration only if the Commission desires to implement access charge reform immediately. Qwest is correct, however, that under this alternative, ILECs will obtain AUSF support on an interim basis without proof of need, demonstrated under R 14-2-103 at least while the rate case is pending. However, Staff suggests that if this approach is adopted, a carrier be required to submit sufficient financial information upfront so a determination of fair value and fair value rate of return can be made and other information to ensure it's an appropriate approach for the particular carrier. Qwest further argues that this is an impermissible burden on it and other companies that contribute to the AUSF.[56] Staff would note that it would be temporary and followed up by a rate case, and there would ultimately be a refund obligation depending upon the findings in the subsequent rate case..

On the issue of CLEC access charges, Qwest states that this Docket needs to address the policy of Arizona with regard to contracts between providers of switched access services and their captive IXC customers.[57] Qwest agrees with the Staff that these agreements should be filed with the Commission and that other providers need to be given an opportunity to avail themselves of such contracts.[58]

In addition, as discussed above, Qwest proposes that the CLECs' intrastate access rates should be set at the Qwest intrastate level.[59] Staff's and AT&T's proposal is to cap CLEC rates (both originating and terminating) at the rate for the ILEC in whose service territory they operate.[60] A cap as recommended by Staff is similar to the approach taken by the FCC with respect to CLEC's

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[54] Tr. at 445:20-446:3; 321:10-21.
[55] Qwest Initial Br. at 42.
[56] Qwest Initial Br. at 42.
[57] *Id.*
[58] *Id.*
[59] Qwest Initial Br. at 27.
[60] Direct Dr. Oyefusi, Ex. AT&T-7 at 9.

interstate switched access charges in 2001. In addition, Staff's proposal is recommended because it allows the CLECs to obtain higher rates if it can demonstrate that its costs justify such a result.

Finally, Staff agrees with Qwest that CLECs do not need access to AUSF to replace lost access revenues for several reasons.[61] Unlike ILECs, CLECs do not have carrier of last resort obligations. In addition, very few CLECs provide service to residential consumers. CLECs also have pricing flexibility and can raise and lower their prices now without Commission approval.

E. **AT&T and Sprint.**

AT&T and Sprint are the two largest interexchange carriers participating in this proceeding and both favor immediate access charge reform. Sprint for instance states that the current disparity in access rates impairs competition, increases administrative costs, encourages arbitrage, and deprives customers of retail price reductions and other benefits.[62] Sprint also states that the "LECs' current and potential revenue growth from non-regulated services, along with the pricing flexibility some LECs have for their retail services, makes the collection of subsidies from competing carriers in the form of inflated access rates unnecessary and anti-competitive."[63] Both carriers advocate that the Commission promptly order the ILECs (including Qwest) to set their intrastate switched access rates and rate structures (for each access element) equal to the equivalent interstate switched access rate and rate structure.[64] Both also advocate that the CLECs cap their aggregate switched access rates at the aggregate rate of the ILEC the CLEC is competing against.[65]

Staff opposes setting the rural ILECs switched access rates at interstate levels at this time as proposed by AT&T and Sprint. The primary beneficiaries of access charge reform are the IXCs such as AT&T and Sprint, so of course they are going to want intrastate rates set at interstate levels as soon as possible. While Staff believes this a sound policy objective, the Commission should not require rural ILECs to achieve parity between interstate and intrastate switched access rates, before Qwest the largest ILEC in the state.

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[61] *See* Qwest Initial Br. at 27.
[62] Sprint Initial Br. at 2.
[63] Sprint Initial Br. at. 6.
[64] *See*, e.g., Sprint Initial Br. at 1.
[65] *Id.*

Taking rural ILECs to Qwest's switched access rate levels will achieve significant benefit and is as an interim step. Staff also agrees with Qwest that traffic pumping affects the ILEC more than any other carrier. It occurs because of a significant difference between high rural switched access rates and lower urban switched access rates.[66] Staff's proposal would be more effective at eliminating traffic pumping than the AT&T and Sprint proposal since under Staff's proposal, intrastate switched access rates would be the same for most carriers. Moreover, it is important to recognize that Qwest's intrastate switched access charge reductions are occurring over time. There is no reason for rural ILECs to be treated any differently and in fact given their small size and high cost areas, there is even more reason to phase in access charge reform over time.[67]

Both AT&T and Sprint also believe that Qwest should be required in this proceeding to reduce its intrastate switched access charges to interstate levels.[68] Qwest has already undergone two intrastate switched access rate reductions in the first phase of this case. This phase should address the rural ILEC and CLEC access charges. Qwest's rates can once again be addressed in the Price Cap Docket. Staff also opposes the Sprint and AT&T recommendation because bringing Qwest to interstate levels will necessarily mean that the rural ILECs and CLECs will all be brought down to interstate levels under most of the proposals in this case, a result which would likely put a significant additional burden on local service rates and the AUSF. For instance, one need only consider the data presented by AT&T in its Initial Brief to get an understanding of what the AT&T and Sprint proposal would mean.

> Qwest, the largest local exchange carrier ("LEC"), charges intrastate access rates that are more than double its corresponding interstate rates. Competitive LEC ("CLEC") intrastate rates are several multiples of their interstate rates. The ALECA members' overall average intrastate access rate is approximately seven times higher than their interstate average. Verizon's average intrastate rate is more than 40 times higher than its average interstate rate.[69]

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[66] *See* Qwest Initial Br. at 22.
[67] Tr. at 650:25-651:23. ..
[68] Sprint Initial Br. at 31.
[69] AT&T Initial Br. at 1.

Staff agrees with both Sprint and AT&T with regard to CLEC access rates, that they be set no higher than the access rates of the ILEC within a CLEC's service area. The FCC has successfully used this approach to bring CLEC interstate switched access charges more in line with costs.[70]

Sprint supports recovery of any lost access charge revenue through increases to ILEC retail rates only. Sprint believes that recovery from the AUSF is neither necessary nor appropriate.[71] However, it would agree to limited recovery from the AUSF for standalone basic residential lines when an ILEC can demonstrate that its local service cost exceeds a benchmark of 125% of the statewide average local rate.[72] Staff's views on recovery through the AUSF and statewide benchmarks were set forth above.

AT&T, on the other hand, favors using the AUSF as a transitional tool "so that consumers do not see sharp increases in local service rates, while incumbent LECs still have a fair opportunity to make up for the reduction in access revenue during the transition."[73] More specifically, AT&T's proposal would work as follows:

> 1. give incumbent LECs flexibility to raise their basic local service rates (if they choose to do so), but limit the increases by setting a reasonable "benchmark" rate of $18 per month;
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> 2. limit each ILEC's increase in monthly basic local service rates to $2 each year, until that ILEC's price reaches the $18 benchmark; and
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> 3. to the extent the opportunity to increase local service rates it not enough to recover the reduction in access revenues, allow the incumbent LEC to obtain support from the AUSF for the revenue reduction that remains.[74]

AT&T states that in the first year of AT&T's plan, AUSF support would be approximately $20 million and in year four, AUSF support would be reduced to $16 million.[75]

Staff believes that AT&T's proposal suffers from several significant flaws. First, Staff does not support the use of the statewide benchmark proposed by AT&T. The $18.00 rate

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[70] *See* Sprint Initial Br. at 34.
[71] *Id.* at 36.
[72] *Id.* at 37.
[73] AT&T Initial Br. at 5.
[74] *Id.*
[75] *Id.*

appears to have been somewhat arbitrarily developed. AT&T states that it apparently looked at the rate of inflation from the last monthly rate changes, and calculated that today's weighted average retail rate would be approximately $17.50.[76] The use of such a benchmark would essentially result in a uniform local service rate statewide which is not at all reflective of the underlying cost to provide service in many rural areas. Individual benchmarks for each company as proposed by Staff witness Shand is superior because it would take into account the specifics of each company's underlying costs and be developed after consideration of other information as well. AT&T's proposal also does not contain any type of "need" assessment which Staff believes is important and which is contained in the proposals of many other parties to this proceeding, including Staff.

AT&T also claims that its proposal is much simpler to administer than other proposals, including Staff's. The Commission would order ILECs to file tariffs within 60 days of a decision to reduce their intrastate switched access rates to interstate levels. CLECs would be required to file tariffs within 60 days capping their intrastate rates at the level of the ILEC with which they compete. But, AT&T conceded that as to AUSF support, a rulemaking would be necessary, which broadened the contribution base of the AUSF to intrastate retail telecommunications revenue, and which laid out the procedures and formulae to determine the amount of an eligible carrier's access revenue replacement support.[77] Further, several parties have indicated that proceedings would be necessary to set a statewide benchmark where one is required. So it is very questionable as to whether AT&T's proposal is simpler to administer.

AT&T also believes that it is appropriate to require ILEC and CLEC intrastate rates to continue to mirror interstate rates and rate structure, if interstate rates are reduced in the future. Staff is concerned with the implications of such an approach. Perhaps a better approach would be to require the ILEC and CLEC to make a filing at the time Qwest's rates are reduced proposing switched access rate reductions for the Commission's consideration.

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[76] AT&T Br. at 39.
[77] *Id* at 6.

Neither AT&T nor Sprint support the Staff's recommendation with respect to requiring IXCs to demonstrate that they have passed through the savings associated with access charge reductions to their end-user customers. AT&T notes that historically on the interstate side, data shows that as per-minute interstate access charges have decreased, interstate long-distance rates have decreased as well.[78] AT&T and Sprint both state that such historical trends should be demonstration enough; as well as their commitment to eliminate their in-state connection fee for stand-alone long-distance customers and the in-state rates for prepaid calling cards.[79] It is important that benefits be realized by end user customers in the form of intrastate long-distance reductions. While AT&T testified at the hearing that it would be difficult to demonstrate such pass-throughs, it conceded that it could be done.[80]

E. <u>Verizon.</u>

Verizon recommends that the Commission set a rate cap for intrastate switched access services, and require all ILECs and CLECs to charge no more than the intrastate switched access rates of Qwest in Arizona.[81] Verizon believes that all LECs in Arizona should be charging the same intrastate switched access rates.[82]

With respect to CLECs, Verizon states that the CLECs would simply follow the same methodology they use to comply with the FCC rules.[83] Verizon states that the cap would be set using the composite of Qwest's intrastate switched access rate elements for the functions that the CLEC actually performs in providing switched access service.[84] Thus, if a CLEC does not use tandem switching to provide service to another carrier, its cap would not include Qwest's tandem switching rate.[85] Verizon also would have CLEC rates track any adjustments to the Qwest intrastate access rates in Arizona in the future to be in compliance with the effective rate cap.[86]

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78 *Id.* at 21.
79 *Id.* at 22.
80 Tr. at 336:11-13...
81 Verizon Initial Br. at 2.
82 Verizon Initial Br. at 27.
83 *Id.*
84 *Id.*
85 *Id.*
86 Verizon Initial Br. at 28.

Verizon states that access charge reform is critical with respect to the small ILECs in Arizona.[87] It states that it found from a review of the carriers' average access revenues per minute (ARPM) that many LECs' intrastate access rates in Arizona are 400% to 1000% higher than Qwest's.[88] It also states that its proposal to establish a uniform benchmark rate at Qwest's intrastate rate is superior to AT&T's recommendation that each carrier match its interstate rates because the evidence shows that there are significant variations among the ILECs' interstate rates.[89] Verizon notes that it does not oppose Staff's revised recommendation to reduce the ILEC's rates to the higher of Qwest's intrastate switched access rates or their interstate rates.[90]

Verizon states that all carriers, CLECs and ILECs should be permitted to make revenue neutral changes to their retail rates without having to undergo a rate case, a fair value determination, or any other detailed review of their financial circumstances.[91] Staff supports the concept of revenue neutral rate rebalancing as long as certain criteria are met and subject to Commission approval. As discussed above, a carrier would still have to submit financial information (albeit more limited in nature) to allow the Commission to make a fair value determination. The Staff would consider this information and other information such as the magnitude of the increase requested and the likely need for AUSF to determine whether a rate case may be a more appropriate vehicle to accomplish reform.

Verizon also urges the Commission not to allow any carrier to replace lost access revenues with AUSF funds.[92] Verizon states: "...insulating one set of providers from competition at the cost of another is incompatible with a healthy, competitive market for communications services."[93] If a carrier is able to show that it cannot reasonably rate

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[87] Verizon Initial Br. at 47.
[88] *Id.*
[89] Verizon Initial Br. at 49-50.
[90] Verizon Initial Br. at 49 (footnote 93).
[91] *Id.* at 3.
[92] *Id.*
[93] *Id.*

rebalance its rates, instead of a subsidy from the AUSF, Verizon advocates that the Commission permit the carrier to phase in the remainder over a transition period.[94]

Verizon states that if the Commission rejects its position that AUSF funding should not be used as a replacement mechanism for lost access charge revenues, there should be very strict preconditions put in place.[95] A carrier should first be required to increase its local rates to a benchmark rate.[96] Verizon supports the adoption of a statewide benchmark rate and opposes Staff's recommendation to set individual company specific benchmarks.[97] Verizon argues that Staff's recommendation would be too complex and time-consuming, since it would involve a rate case.[98] However, Staff has demonstrated above that there will be a need for additional proceedings no matter what party's position is adopted in this case. Even Verizon acknowledges that under its proposal there would be a need for an additional proceeding to establish rate benchmarks for an ILECs' residential and business local exchange services.[99]

Verizon also objects to Staff's alternative B which would allow carriers to receive temporary AUSF funding pending the conclusion of a rate case.[100] Verizon opposes the notion of 100% recovery upfront of all access charge reductions. It also believes that under Staff's alternative B proposal, the process (given Staff resource constraints) could continue for several years, which would inappropriately allow carriers to receive 100% temporary AUSF recovery of all access charge reductions from other carriers' customers for a lengthy period of time.[101] Verizon also argues that a temporary fund could take on a life of its own and be extremely difficult to dissolve.[102] Staff's alternative B proposal was designed to allow access charge reform to proceed immediately if that was the Commission's desire. But, this was not Staff's primary recommendation. Staff would be the first to acknowledge that its

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[94] Verizon Initial Br. at 53.
[95] *Id.* at 67.
[96] *Id.*
[97] *Id.* at 69.
[98] *Id.* at 70.
[99] *Id.* at 71.
[100] *Id.* at 61.
[101] Verizon Initial Br. at 62.
[102] *Id.*

alternative B proposal has its drawbacks. Staff believes that revenue neutral rate rebalancing combined with its alternative A primary recommendation is the best means to accomplish reform.

Verizon also believes that it is important for the AUSF to be a temporary mechanism only.[103] Verizon supports capping the AUSF and setting an end date for the availability of temporary AUSF subsidies, terminating them completely no more than three years out.[104] Staff does not believe that this is feasible. If the Commission's end goal is for intrastate switched access rates mirror interstate rates for all providers, further reform will be necessary. The Commission could perhaps limit fund draws once interstate levels are reached, AUSF support for access reform would no longer be available.

III. CONCLUSION.

Staff's proposals for intrastate access charge reform are superior to the proposals by other parties. Staff's proposals will result in needed reforms in a reasonable and fair manner and should be adopted.

RESPECTFULLY SUBMITTED this 14th day of September, 2010.

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103 *Id.* at 67.
104 *Id.*

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