BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

MIKE GLEASON, Chairman
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
KRISTIN K. MAYES
GARY PIERCE

IN THE MATTER OF THE REVIEW AND POSSIBLE REVISION OF ARIZONA UNIVERSAL SERVICE FUND RULES, ARTICLE 12 OF THE ARIZONA ADMINISTRATIVE CODE.

IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS.

Pursuant to the Procedural Order entered in these docketts dated November 28, 2007, AT&T Communications of the Mountain States, Inc. and TCG Phoenix (collectively referred to as "AT&T") file these reply comments on access charge reform and possible revisions to the Arizona Universal Service Fund ("AUSF") Rules.

INTRODUCTION

A variety of parties, including Qwest, rural incumbents, competing local exchange carriers, interexchange carriers and the Residential Utility Consumers Office ("RUCO"), filed opening comments covering a wide range of issues on access charge reform and the AUSF. Those comments indicate several important areas of consensus. First, with respect to the need for access charge reform, there is nearly universal agreement that the present intrastate switched access charges are too high. And, with respect to the manner in which access charges should be reformed, no one disputes that the costs of intrastate switched access services are the same as the costs of the corresponding interstate switched access services. Thus, reducing intrastate
switched access charges to mirror the rates and structure for their interstate counterparts (as AT&T and several other parties suggest) represents an indisputably reasonable step towards access charge reform. The Commission should accordingly institute proceedings to more fully develop a record and reach a decision on this and other proposed reforms.

Turning to the AUSF, several parties agree that explicit AUSF subsidies should be used to compensate local exchange carriers for at least part of the loss of implicit subsidies that would result from access charge reform. Qwest presents a reasonable middle ground, under which incumbent local exchange carriers would be allowed to increase retail local exchange rates up to an affordable “benchmark” level set by the Commission, with AUSF support limited to compensating those carriers for losses not already recovered through the increase in retail rates.

The specific definitions and details for implementing revisions to the AUSF should be the subject of further comments and/or proceedings.

Given the level of agreement demonstrated by the comments, AT&T suggests that the Commission give the parties 90 days to refine and discuss their positions with others, in an effort to reach further consensus. First, the parties should be given 60 days to discuss procedural and substantive issues concerning both the AUSF and access charge issues. Following that initial 60-day period, AT&T recommends that the Commission schedule two workshops for the April 2008 time frame. The Commission could then set a Procedural Conference for early May, so that Staff and the parties can outline the results of the discussion and workshop process and present their recommendations to the Administrative Law Judge on how best to proceed.
DISCUSSION

I. Access Charge Reform Questions

Nearly all parties—including incumbent LECs that currently receive revenues from intrastate switched access charges—agree that those charges are presently too high and contain substantial implicit subsidies. “ALECA recommends that the Commission permit its member companies to bring their state switched access rates into equality with their interstate rates.” ALECA Comments, at 1. Qwest also “supports access reform,” and maintains that “[r]ate restructuring will enhance the long-term health of the industry.” Qwest Comments, Ex. B, at 1 (Question 1). Likewise, Time Warner states (at 1, 2) that “switched access rates in Arizona are still priced far above cost” and urges that “[t]he Commission should move quickly to . . . reform the access subsidy system.” Verizon observes that “many carriers’ intrastate access charges are substantially higher than those of Qwest” and accordingly “agrees that access reductions would be appropriate in Arizona.” Verizon Comments, at 3-4, 5. RUCO states (at 1) that “it would be reasonable for the Commission to investigate opportunities to reduce access charges.”

It would be virtually impossible to dispute the need for intrastate switched access charge reform given two undisputed facts. No one argues with the premise that the rates charged for intrastate switched access are much higher than corresponding interstate rates. And no one disputes that the costs of intrastate switched access are the same as the corresponding interstate costs: a point that the Commission specifically asked the parties to address in their comments. Given these facts, it is self-evident that (i) the rates for intrastate switched access should be reduced and (ii) reducing those rates to the level and structure of the corresponding interstate charges would be a reasonable step towards intrastate switched access charge reform. AT&T, ALECA and Time Warner advocate this approach.
Access rate reform would not require the Commission to perform cost studies the way Integra suggests (at 4-5, 8). The amount of implicit subsidy in Arizona access rates is massive; or, as ALECA puts it (at 3), "[w]hether or not classified as subsidies, there is little question that the contribution from switched access charges defrays a large portion of the costs ALECA’s member companies incur supplying basic local exchange service in rural Arizona." The Commission need not calculate and eliminate every last penny of that contribution. Rather, the Commission should take a measured step to reduce the amount of the contribution by reducing intrastate switched access rates to the level and structure of federal rates and then allow carriers to recover the reduction through restructuring of local exchange rates and, in some cases, through explicit subsidies from the AUSF. Thus, ALECA correctly “believes it is not only unnecessary but also counterproductive to attempt to quantify implicit subsidies.” ALECA Comments, at 6.

Verizon similarly recommends (at 4) that the Commission “need not (and should not) engage in the time-consuming, anachronistic process of trying to evaluate each carrier’s ‘cost’ of providing access service” and Time Warner agrees (at 5) that “[t]he Commission would not need to undertake a comprehensive rate proceeding.”

Only one party, Integra, objects to access charge reform, and it only objects to such reform “at least as applied to competitive local exchange carriers (CLECs).” Integra Comments, at 3. As AT&T showed in its opening comments, however, there is ample reason to reform CLEC access charges as well as ILEC access charges. The only question is whether to reform CLEC rates now, along with ILEC rates, or open a second proceeding. In no case should CLEC access charge reform be delayed indefinitely.

The access reforms developed in this proceeding also should apply to Qwest, though perhaps on a slightly different timetable than they apply to other parties. Qwest believes that
lowering switched access rates promotes efficient competition in the long distance market and reduces arbitrage opportunities. Qwest Comments, Ex. B, p. 1. Qwest, moreover, already envisions that such reforms should apply to it as well as others: “For example, Qwest may be able to reduce switched access rates to FCC levels, and do so by increasing other service rates or establishing one flat rate charge.” Qwest Comments, Ex. B, p. 2. It would be administratively inefficient not to apply the reforms adopted here to Qwest.

AT&T understands that Qwest’s implementation of such reforms may have to be delayed somewhat because Qwest now is operating under a price regulation plan that will not expire until March 2009. A necessary delay in implementation, however, does not mean that the Commission cannot develop an access charge policy in this phase of the proceeding that is applicable to Qwest upon the expiration of its current price regulation plan. The Commission can and should include a finding in its decision in this proceeding that the access reforms adopted apply to Qwest upon the expiration of Qwest’s current price regulation plan.

II. Universal Service Issues

Generally, the commenting parties agree that any reductions to intrastate switched access charges as a result of the above-described reforms should be revenue neutral: that is, that the affected carriers should be allowed an opportunity to make up the loss of revenues through increases in rates for other services, through explicit subsidies from the AUSF or through some combination of the two. The comments differ mainly in the recommended allocation between rate increases and AUSF subsidies. At one end of the spectrum, Verizon argues (at 7) that “[t]he Commission should not use AUSF funds to make up revenues lost from access charge reform” and recommends (at 5) that the Commission instead allow affected LECs to “propose retail tariff changes to offset these lost revenues.” At the other end, “ALECA recommends the Commission
permit its members to recover from the AUSF the full amount of foregone intrastate access
revenue produced by access reform.” ALECA Comments, at 4. RUO supports “the general
concept of phasing down the [Carrier Common Line charge] and expanding the role of the
AUSF” but does not recommend a dollar-for-dollar offset; similarly, RUO appears to
acknowledge some need for increases in other rates “without necessarily increasing [those] rates
on a dollar-for-dollar basis.” RUO Comments, at 6.

Qwest’s comments propose a middle ground that serves as a reasonable starting point.
Qwest recommends (Ex. A, at 5-6) that the Commission determine a retail rate affordability
benchmark and allow LECs to (i) recover access revenue reductions through increases to local
exchange rates up to the benchmark and (ii) recover any remaining access rate reductions from
the AUSF. The Commission should consider using this balanced approach as a baseline for
further discussion to determine the details of AUSF revisions. At the same time, the parties can
discuss and possibly agree upon the details of AUSF procedures.

Two specific issues warrant special mention here. First, AUSF support should be limited
to carriers meeting a specific set of criteria, including a requirement that the carrier accept the
obligation to serve as a “carrier of last resort” (“COLR”): that is, the requirement to be ready
and able to provide a specified level of basic service to all customers in its designated area. The
COLR undertakes the core function of providing truly universal service; other providers simply
serve the customers they deem to be profitable. Giving other carriers the same support that
COLRs receive—without requiring them to undertake the same obligation to be ready to serve
all customers—is not “competitively neutral.” To the contrary, it unfairly disadvantages the
COLR, a result fundamentally at odds with promoting universal service and with the critical role
that the COLR plays in achieving and maintaining universal service.
The second issue relates to possible changes to the methodology for assessing AUSF contributions. As AT&T explained in its opening comments, the existing AUSF contribution methodology may impose disproportionate burdens on some service providers. Currently, the AUSF rules specify that one-half of AUSF funding is to be borne by “Category 1” providers (largely local exchange carriers and wireless carriers) on the basis of access lines and interconnecting trunks, respectively, and one-half of AUSF funding is to be borne by “Category 2” service providers, i.e., providers of intrastate toll service (or other service providers as permitted under R14-2-1204(B)(3)) on the basis of intrastate toll revenues.\(^1\) Thus, the contribution methodology varies depending on the type of service provider and service. Moreover, the 50-50 allocation of AUSF funding responsibility may bear no relationship to the providers’ level of activities in Arizona relative to one another. The Commission should accordingly consider a broader, and more competitively neutral, funding methodology. As a first step, the Commission could follow the FCC’s current approach, under which all contributions would be assessed on the basis of retail telecommunications revenues. Further, the FCC is currently considering a change in the federal assessment methodology, under which assessments would be based on telephone numbers and connections (as opposed to retail revenues, as is currently the case). Both Qwest (Ex. A, at 11) and Verizon (at 6) suggest that the Commission follow suit if the FCC adopts such a change, so as to ensure consistency between state and federal funding and to provide for simpler administration. AT&T agrees that the Commission should adopt such a revision to the assessment methodology if the FCC makes that revision at the federal level.

\(^1\) See R14-2-1204.
CONCLUSION

For the reasons set forth above, AT&T respectfully recommends that the Commission
(i) give the parties 60 days to discuss their positions amongst each other and attempt to reach
further consensus, (ii) provide for two workshops to be held in April 2008 and (iii) schedule a
Procedural Conference for May 2008, at which Staff and the parties would discuss the results of
their discussions and workshops and present recommendations to the Administrative Law Judge
on the most appropriate and efficient way to proceed.

RESPECTFULLY SUBMITTED this 4th day of February, 2008.

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