BEFORE THE ARIZONA CORPORATION COMMISSION

KRISTIN K. MAYES
Chairman

GARY PIERCE
Commissioner

PAUL NEWMAN
Commissioner

SANDRA D. KENNEDY
Commissioner

BOB STUMP
Commissioner

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

DOCKET NO. RT-00000H-97-0137

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

DOCKET NO. T-00000D-00-0672

NOTICE OF FILING
REPLY TESTIMONY OF DON PRICE

Attached is the Reply Testimony of Don Price filed on behalf of Verizon.

RESPECTFULLY SUBMITTED this 5th day of February, 2010.

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BEFORE THE ARIZONA CORPORATION COMMISSION

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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 TESTIMONY OF DON PRICE ON BEHALF OF VERIZON

February 5, 2010
I. INTRODUCTION

Q. PLEASE STATE YOUR NAME, TITLE, AND BUSINESS ADDRESS.

A. My name is Don Price. I am a Director - State Public Policy for Verizon.

My business address is 701 Brazos, Suite 600, Austin, Texas, 78701.

Q. ARE YOU THE SAME DON PRICE WHO FILED DIRECT TESTIMONY IN THIS PROCEEDING ON VERIZON’S BEHALF ON DECEMBER 1, 2009?

A. Yes, I am.

Q. PLEASE DESCRIBE THE PURPOSE OF YOUR REPLY TESTIMONY.

A. The purpose of my reply testimony is to address various aspects of the direct testimony filed by other parties and reiterate Verizon’s positions on the issues in this proceeding.

Q. DOES THE VARIOUS PARTIES’ TESTIMONY EVIDENCE BROAD SUPPORT FOR REFORMING LECS’ INTRASTATE ACCESS RATES IN ARIZONA?

A. Yes. Staff, Qwest, AT&T, and the ALECA members all agree with Verizon that the Commission should act to reduce excessive access rates. These parties also agree that such reductions would result in benefits including price efficiency, reduced opportunity for arbitrage, elimination of artificial rate differentials resulting from historic (but no longer
relevant) regulatory decisions and distinctions, and a more consistent and rational intrastate switched access rate regime.

There is also wide agreement among the parties that access reform is appropriate for both incumbent local exchange carriers ("ILECs") and competitive local exchange carriers ("CLECs"). Not only do Staff and most of the other parties broadly support access reform, Staff, like Verizon, recommends reducing both ALECA members' and CLECs' intrastate access rates, and has not advocated further reductions in Qwest's rates at this time.¹

Q. HAS VERIZON'S POSITION CHANGED AS A RESULT OF THE ARGUMENTS PRESENTED IN THE OTHER PARTIES' TESTIMONY?

A. No. Verizon's stance on the twelve issues listed in the Arizona Corporation Commission's ("Commission") September 29, 2009 Procedural Order ("Order") remains as set forth in my December 1, 2009 Direct Testimony ("Verizon Direct").²

Verizon continues to recommend that the Commission require all local exchange carriers ("LECs"), including ALECA members and CLECs, to cap their intrastate access charges at the regional Bell Operating Company's ("RBOC")—here, Qwest's—levels. To the extent that any affected carrier chooses not to absorb such reductions, Verizon

¹ See Direct Testimony of Wilfred Shand, on behalf of the Arizona Corporation Commission (Utilities Division), filed January 8, 2010 ("Staff Direct") at 2-3; 11; 26.
² At pages 19-23 of my Direct Testimony, I set forth a summary response to each of the twelve issues following my longer discussion of some of the key policy issues in this proceeding.
continues to advocate that the Commission allow the carrier to recoup any
“foregone” revenue through retail pricing flexibility, and not through an
expansion of the size or scope of the Arizona Universal Service Fund
(“AUSF”). I will explain below Verizon’s rationale in support of its
positions.

Q. **DO YOU HAVE ADDITIONAL INTRODUCTORY COMMENTS?**

A. Yes. I think it is important for the Commission to recognize the unique
industry perspective that Verizon provides. Because Verizon operates as
an incumbent LEC, a competitive LEC, a provider of wireless services,
and as an interexchange carrier, Verizon has not taken—and indeed cannot
take—parochial positions on the crucial public policy issues implicated by
access charge reform.

Q. **HOW IS YOUR REPLY TESTIMONY ORGANIZED?**

A. Because Verizon’s position on the twelve issues in the Order remains
unchanged, my reply testimony will focus on two major issues: the
critical need, at minimum, for the Commission to cap CLECs’ intrastate
switched access rates as expeditiously as possible, and the impropriety of
expanding the AUSF to serve as an insurance policy or recovery
mechanism for “lost” access revenues and LEC profits. In the remainder
of my testimony, I address a few of the key points made by each party in
its direct testimony. Given the volume of testimony that has been filed, it
is neither practicable nor necessary to address every point made by every
party. For that reason, the fact that I do not comment on a particular point made by any party should not be construed as my agreement with that point.

II. AT A MINIMUM, THE COMMISSION SHOULD TAKE IMMEDIATE STEPS TO CAP CLECS' ACCESS RATES

Q. DO YOU AGREE WITH THE JOINT CLECS' RECOMMENDATION THAT THE "COMMISSION SHOULD FIRST ADDRESS RURAL ILEC ACCESS RATES BEFORE ADDRESSING CLEC ACCESS RATES"?

A. No. Contrary to Messrs. Denney's and Garrett's assertions, there is no good reason to delay reform of CLEC access rates in Arizona.³ In fact, the decision to constrain CLEC access rates should be one of the easiest aspects of the Commission's deliberations in this case. CLECs have demonstrated a willingness and ability to charge excessive access rates, and that behavior derives from the fact that, once a customer chooses retail service from a CLEC, other carriers have no choice but to deliver calls to the CLEC even though they must incur the CLEC's unreasonably high access rates. Thus, competition does not discipline the CLEC's access rates.

Mr. Denney's testimony cautions the Commission against "price regulat[ing] CLECs" and argues that there is no justification for the

³ See Direct Testimony of Douglas Denney on behalf of the Joint CLECs, filed December 1, 2009 ("Jt. CLEC Direct"). Mr. Denney asserts at p. 7 of his testimony that "there is ... every reason not to" take action on CLECs' access rates. See also Direct Testimony of Douglas Garrett on behalf of Cox Communications, filed December 1, 2009 ("Cox Direct"). At page 3 of his testimony, Mr. Garrett urges this Commission to "await federal action" before taking steps to reform CLECs' access rates.
Commission to constrain CLECs’ access rates. But as explained in Verizon’s and other parties’ testimony CLEC access rates are not subject to price-disciplining competition in the way that their retail rates are. Furthermore, the numerous regulatory bodies that have examined the issue confirm Verizon’s position. As I noted in my direct testimony, every state commission that has formally considered capping CLEC access rates has concluded that a benchmarking approach is good policy. AT&T witness Dr. Aron testified that at least 17 states have imposed constraints on CLEC access rates.

Reforming and rationalizing CLECs’ intrastate switched access rates is an important component of access reform in Arizona, as it has been in other states. If the Commission takes no other action in this proceeding, it should at least require CLECs to cap their intrastate switched access rates at Qwest’s level. This is consistent with my direct testimony, which recommended that the rates of all Arizona LECs be capped at Qwest’s levels, and cautioned that if the Commission decided to accomplish access reform in stages, it should focus first on the CLECs.

Constraining CLECs’ intrastate switched access rates (by capping them at...

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4 See Jt. CLEC Direct at 5. Mr. Denney’s comment about price regulation of CLECs is meritless, because Article II of the Commission’s rules, entitled “Competitive Telecommunications Services” allows CLECs to price a “competitive telecommunications service” up to the “maximum tariffed rate approved by the Commission.” (R14-2-1102.11) In preparation of this testimony, I reviewed the tariffs of the joint CLECs. Those carriers appear to have significant room to increase retail service rates before reaching the “maximum” rates approved by the Commission.

5 See Verizon Direct at 11, footnote 10.

6 See Direct Testimony of Dr. Debra J. Aron on behalf of AT&T, filed December 1, 2009 ("AT&T/Aron Direct") at 52-53.
Qwest’s levels) is the simplest and most efficient way to begin moving
towards more efficient access pricing. That is because, unlike the ALECA
member companies, CLECs already possess retail pricing flexibility.

Q. DOES STAFF SUPPORT REFORMING CLECS’ INTRASTATE
ACCESS RATES?
A. Yes. Like Verizon, Staff recommends reducing both ALECA members’
and CLECs’ intrastate access rates, and does not advocate subjecting
Qwest’s rates to further reductions at this time. I address the slight
differences in Verizon’s and Staff’s positions below, but the key point is
that Staff agrees that access reductions would result in benefits that
include price efficiency, reduction of arbitrage opportunities, elimination
of differences in rates as a result of regulatory decisions and distinctions,
and establishment of more consistent and rational intrastate switched
access rates, and that reform is appropriate for both CLECs and ILECs
other than Qwest.

Q. WOULD YOU ADDRESS THE JOINT CLECS’ ARGUMENT
THAT THE IXCS WOULD, IN EFFECT, BE GETTING A FREE
RIDE AS A RESULT OF VERIZON’S RECOMMENDATION
THAT CARRIERS SHOULD RECOVER MORE OF THEIR
COSTS FROM THEIR END USERS?
A. Yes. As an initial matter, I think it is important to note how Mr. Denney
frames his argument. He states that Verizon advocates that the rates it
pays “to use a carrier’s network be shifted from the IXC and onto all

7 See Staff Direct at 2-3; 11; 26.
8 Id. at 9.
9 See Jt. CLEC Direct at 41.
customers and carriers doing business in Arizona, whether or not they are using the network that is being utilized by the IXC." Mr. Denney has misinterpreted or misstated Verizon’s position. Verizon advocates giving ILECs increased pricing flexibility to allow them to recover from their own end users any lost access revenue they choose not to absorb, but not allowing them to recover it from the AUSF or any other carrier. There is compelling evidence that the access rates IXCs pay for the use of the LECs’ networks are significantly above the cost of access, as I discuss in more detail below. If Mr. Denney is arguing for continued high access rates, then there are at least two fundamental flaws to his argument. First, he simply assumes, without any explanation, that the status quo is reasonable. This is simply not credible, as the record demonstrates. Second, Mr. Denney’s argument appears to rest on a misconception that somehow all customers are either toll customers or local service customers, but not both. This is wrong, because long distance customers are also local service customers. Creating an artificial construct where local service customers and long distance customers represent distinct customer groups, as Mr. Denney’s argument seems to do, does not reflect how telecommunications services are provided.

Q. IN HIS TESTIMONY, MR. DENNEY OFFERS THAT “CLECS OPERATE IN A COMPETITIVE MARKET.” HAS THE FCC OR ANY OTHER STATE COMMISSION FOUND THAT CLEC SWITCHED ACCESS RATES ARE COMPETITIVE?

10 Id.
A. No. The FCC and state commissions rejected this argument. In adopting a cap on CLEC interstate access charges (at the level of the competing ILEC), the FCC observed that the market for CLEC switched access services "does not appear to be structured in a manner that allows competition to discipline rates."\(^\text{11}\) The FCC found "ample evidence that the combination of the market's failure to constrain CLEC access rates, our geographic rate averaging rules for IXCs, the absence of effective limits on CLEC rates and the tariff system create an arbitrage opportunity for CLECs to charge unreasonable access rates."\(^\text{12}\)

On the state side, not one state commission that has investigated the issue has declined to constrain CLEC intrastate access rates.\(^\text{13}\) Recently, West Virginia joined the growing list of states that have imposed caps on CLECs' switched access rates.\(^\text{14}\) And less than two months ago, the Massachusetts Department of Telecommunications and Cable ("DTC") denied reconsideration of its June 2009 decision capping CLEC rates at the RBOC's (Verizon Massachusetts) level\(^\text{15}\)—action that the DTC found necessary "to correct the market failure regarding CLEC

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\(^{11}\) See Reform of Access Charges Imposed by Competitive Local Exchange Carriers, Seventh Report and Order and Further Notice of Proposed Rulemaking, 16 FCC Rcd 9923 (April 26, 2001) ("CLEC Rate Cap Order") at ¶ 32 (emphasis in original).

\(^{12}\) Id. at ¶ 34.

\(^{13}\) See pages 15-16 of my direct testimony, where I identified the numerous states that have adopted benchmarking approaches like the FCC's as a simple and effective means of reducing CLEC intrastate access rates to reasonable levels.


\(^{15}\) Petition of Verizon New England Inc. et al. for Investigation Under Chapter 159, Section 14, of the Intrastate Access Rates of Competitive Local Exchange Carriers, Order on Motion for Reconsideration or Clarification, D.T.C. 07-9 (December 7, 2009).
intrastate switched access rates." The Massachusetts DTC found that a rate cap based on Verizon’s intrastate switched access rates constitutes “an appropriate mechanism to ensure that CLEC switched access rates are just and reasonable, in the absence of sufficient competition, because ... Verizon’s rates have been found to be just and reasonable.”

Most recently, the New Jersey Board of Public Utilities issued an order capping CLECs’ intrastate access rates at the level charged by the competing ILEC, based on a rejection of the CLECs’ claims: “[T]he Board does not find persuasive the Joint CLECs’ claim that they do not have a monopoly on intrastate access services and that the Board should permit the market to control Intrastate Access Rates.”

Q. ARE THERE CONDITIONS IN ARIZONA THAT MAKE CLEC ACCESS RATES SUBJECT TO RELATIVELY GREATER COMPETITIVE PRESSURE THAN IN OTHER STATES?

A. No. The same factors that prompted the FCC and numerous other states to cap CLECs’ switched access rates apply with equal force to CLEC intrastate access services in Arizona. Indeed, in the absence of market discipline, CLEC rates in Arizona vary significantly from each other as

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17 Id. (emphasis added).

18 In the Matter of the Board’s Investigation and Review of Local Exchange Carrier Intrastate Exchange Access Rates, Docket No. TX08090830, (N.J. B.P.U. Feb. 1, 2010), at 27. Verizon has requested a stay of this decision pending appeal on the ground that the Board did not allow ILECs pricing flexibility and the opportunity to recover lost access revenues that were used by the Board to provide contribution to residential basic exchange services.
well as from the prevailing RBOC rate.\textsuperscript{19} While some CLECs charge reasonable access rates, many others choose to, and can, maintain unreasonably high intrastate switched access rates. As I discussed at pages 8-9 of my direct testimony, CLECs have market power in the provision of access services because carriers have no choice but to use a CLEC’s switched access services when they handle interexchange calls originating from the CLEC’s customers and when they deliver interexchange calls for termination to the CLEC’s customers. Because of this factor, the FCC and other states have concluded that direct constraints on CLEC access rates are the only effective way to discipline those rates.

Q. IS YOUR CONCLUSION THAT REGULATORY INTERVENTION IS REQUIRED SUPPORTED BY THE MASSACHUSETTS DTC’S RECENT DECISION?

A. Yes. In its Final Order (affirmed on reconsideration), the Massachusetts DTC recognized that IXCs cannot decline to terminate calls to CLECs whose access charges they believe are too high.\textsuperscript{20} It thus found that while effective market-based pricing would otherwise constrain access rates, “there is a market failure in the CLEC switched access market.”\textsuperscript{21} It reached this conclusion after finding that the “[e]vidence strongly shows

\textsuperscript{19} Based on its internal, proprietary data, Verizon estimates that CLECs’ intrastate switched access rates in Arizona range from less than 1¢ per minute to nearly 8¢ per minute.

\textsuperscript{20} See MA DTC Order at 5.

\textsuperscript{21} Id. at 6.
that CLECs have market power in providing intrastate switched access
service."  

The Massachusetts DTC found market failures in both the originating and terminating CLEC switched access markets. It concluded that the market for terminating switched access "is not sufficiently competitive because a carrier’s customers do not have competitive alternatives for terminating their calls," leaving IXCs unable to constrain the level of terminating access charges and giving CLECs market power that precludes a sufficiently competitive terminating access market. This inability results from the fact that the cost causer (the party receiving the call) "is insulated from changes in wholesale access prices because they are not the customer of the IXC paying the terminating access charges," and thus "cannot be expected to react in response to changes in [wholesale] price."  

The Massachusetts DTC concluded that "the originating switched access market also is not sufficiently competitive." Although it noted that with originating switched access, the calling party is the cost-causer and "could, theoretically, react in response to high origination rates," it held that because IXCs cannot geographically deaverage their interstate toll rates, doing so for intrastate toll calls "is not practicable" given the

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22 Id. at 9.
23 As the Massachusetts DTC noted, "IXCs do not have the option of purchasing access from another vendor because customers can have only one LEC serving them." Id. at 11.
24 Id. at 10.
25 Id. at 13.
26 Id. at 14.
“unnecessarily burdensome and confusing dual charge situation in which IXCs would be required to separately track and bill an individual customer’s calls by LEC.”

Having found that CLECs possessed market power in both the originating and terminating switched access markets, the Massachusetts DTC concluded that a rate cap based on the RBOC rate was the appropriate solution to ensuring just and reasonable CLEC access rates.

Noting that “every state that has acted on CLEC access rates has implemented a cap, with the majority of those states setting a rate ceiling at the ILEC intrastate rate,” it found that as a result of its newly-ordered rate cap, “a market distortion will be removed, thus furthering competition within the telecommunications industry,” which would, in turn, “result in lower long distance rates for consumers in the Commonwealth.”

Q. MR. DENNEY CONTENDS THAT THE JOINT CLECS’ ACCESS RATES IN ARIZONA ARE “REASONABLE.” HAS HE PROVIDED ANY BASIS FOR HIS CLAIM?

A. No. Mr. Denney simply argues that others have not demonstrated that the joint CLECs’ access rates are “unjust or unreasonable.” The information Mr. Denney provides on the access rates of the joint CLECs is sufficient to demonstrate the very point he argues against. The data presented in Mr. Denney’s Table 1 prove that CLECs are able to charge above-market

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27 Id. at 15-16.
28 Id. at 17; 22-24.
29 Id. at 23-24.
30 Id. at 1.
rates—that is, access rates that exceed those charged by Qwest.\textsuperscript{31} While the retail market for services to end user customers in Arizona is highly competitive, it is clear that the extent of competition for those retail services has no bearing, and in no way provides a constraint, on CLECs' ability to continue charging excessive access rates.

Mr. Denney also claims that the joint CLECs' access rates are "reasonable" based on a comparison between the access rates of the joint CLECs and those of the Verizon and AT&T CLECs. This argument proves nothing. Verizon and other parties are recommending that the Commission impose a general cap on CLECs' access rates, including the Verizon and AT&T CLEC rates. But because no such cap exists today, there is no incentive for Verizon unilaterally to reduce its access rates when other CLECs are not required to do so. To the contrary, I have argued that excessive access rates provide carriers with an artificial competitive advantage. No carrier, Verizon included, would give up such an advantage without knowledge that its competitors must also do the same. Mr. Denney's arguments do not overcome the fact that CLECs have market power in the provision of access services, and that regulatory intervention is warranted.

Q. IS THERE ANY MERIT TO COX'S ARGUMENT THAT THIS COMMISSION SHOULD DO NOTHING AT THIS TIME REGARDING CLECS' ACCESS RATES, BUT RATHER SHOULD

\textsuperscript{31} See Jt. CLEC Direct at 19.
AWAIT ACTION BY THE FEDERAL COMMUNICATIONS
COMMISSION?

A. No. First, the FCC already has established a policy with respect to CLEC access rates. Verizon and others here are asking only that this Commission take action consistent with that policy. The FCC has determined that the market does not constrain CLECs' switched access rates, so direct regulatory intervention in the form of a cap is necessary to ensure that those rates are reasonable. The interstate and intrastate access markets are no different in this regard, and parties here are recommending the same kind of cap in the intrastate jurisdiction that the FCC has already imposed in the interstate jurisdiction, for the same reasons.

The current lack of any reasonableness requirement for CLEC access charges is harmful to both consumers and competition, and thus there is no public policy benefit to Cox's proposal\(^{32}\) to perpetuate the detrimental status quo until some indefinite point in the future.\(^{33}\) This Commission can proceed now with necessary corrective action, and address at a later date any issues that may arise as a result of possible further FCC action, sometime in the future, with respect to CLECs' intrastate access rates.

I also disagree with Cox's assertion that comprehensive national reform is the "only" viable approach to reform of CLEC intrastate access

\(^{32}\) See Cox Direct at 3; 5-6. Mr. Garrett's suggestion that a ten year "transition period" be adopted simply is not credible given the rapid pace of changes in telecommunications.

\(^{33}\) The Federal Communications Commission has been considering intercarrier compensation issues for approximately eight years without taking decisive action.
charges. Cox does not (and cannot) dispute that this Commission now has jurisdiction over intrastate access rates. Although comprehensive national reform is the best approach to fixing problems with the current intercarrier compensation regime as a whole for all carriers, there is no indication that such comprehensive reform is coming anytime soon. As I said, the FCC has already taken action with respect to CLEC access rates, so there is no reason to wait for any further policy direction from the FCC in that regard, as numerous other states have concluded. Cox’s argument is simply an excuse to delay swift action by this Commission and to continue to benefit one subset of service providers to the disadvantage of others.

Q. BOTH COX AND THE JOINT CLECS ARGUE THAT THE COMMISSION SHOULD ALLOW A LENGTHY TRANSITION PERIOD IF IT DECIDES TO CAP CLECS’ ACCESS RATES. DO YOU AGREE?

A. No. As I noted earlier, the CLECs have substantial flexibility under the Commission’s rules to immediately adjust their retail rates to offset any foregone access revenues. Arizona CLECs already have been on notice that a reduction in rates was possible, at a minimum since the Commission initiated the discussion of the issues to be addressed by this docket in December 2001. As the testimonies of various parties have detailed, the FCC and numerous other state commissions consistently have taken steps to reduce CLEC rates to ILEC levels over the last decade. And all

34 See Jt. CLEC Direct at 50-53; Cox Direct at 85.
Arizona CLECs have been tracking ILEC access rates for their own
interstate access charges for years, in accordance with the FCC’s 2001
decision capping CLECs’ interstate switched access rates. In other
words, Arizona CLECs already have had plenty of time and notice to
prepare for a reduction in access charges, such that no additional phase-in
or transition period is necessary.

Q. MR. DENNEY ALSO MAKES THE CLAIM THAT CAPPING
CLECS’ ACCESS RATES COULD RESULT IN
“CONFISCATORY” RATES. IS THERE ANY MERIT TO HIS
ARGUMENT?

A. None whatsoever. I am not a lawyer, but it is my understanding that Mr.
Denney’s reliance on court decisions interpreting traditional regulatory
categories is misplaced, because the rates of CLECs are not “regulated.”
And even if the concept were relevant—which it is not—Mr. Denney
provides no data to support his claim, so the argument is purely
hypothetical.

Furthermore, the argument simply does not make sense. Nothing
in Verizon’s proposal—or the proposals of AT&T or the Staff—would in
any way limit the “cost” that any CLEC can recover from its services. To
the contrary, Verizon acknowledges that CLECs have pricing flexibility
with respect to their retail services and can therefore look to their own end
user customers for recovery of their costs. Verizon’s position is in line

36 See CLEC Rate Cap Order.
37 See Jr. CLEC Direct at 33.
with the FCC's and other states' rules capping CLECs' access rates. In its
2001 decision, the FCC stated the issue as follows:

Similarly, CLECs retain the flexibility to charge their end
users higher rates for the access service to which they
subscribe. Here again, if the CLEC provides a superior
product, the end user likely will be willing to pay for it;
however, if a CLEC attempts to impose an unreasonable
surcharge on its customer, the customer receives accurate
price signals and may be motivated to find an alternative
provider.\(^\text{38}\)

The issue before the Commission is not whether a CLEC can recover its
costs, but rather how to prevent CLECs from imposing excessive costs on
carriers who have no choice but to deliver traffic to and from the CLECs’
end users. None of the access reduction proposals offered by the parties
would limit CLECs’ ability to recover costs from their end users.

In addition, Mr. Denney’s proposal ignores the fact that CLECs’
rates have never been subject to traditional regulatory oversight. As the
FCC explained, reliance on a benchmark rather than some other rate-
setting mechanism for CLECs’ access rates is reasonable because of “the
historical lack of regulation on the process of CLEC ratemaking,”\(^\text{39}\) a
situation that applies with equal force to Arizona and other states.

Q. How do you respond to Mr. Denney’s
Recommendation that, if the Commission chooses
to establish a cap on CLECs’ access rates, it
should use Qwest’s 1999 access rate levels as the
benchmark?

\(^\text{38}\) See CLEC Rate Cap Order at \(\S\) 43.
\(^\text{39}\) Id. at \(\S\) 44.
This is a red herring. Qwest’s current access rates are the result of extensive review by the Commission, and as discussed above, are a reasonable proxy or benchmark for the CLECs. Also, as mentioned earlier, the CLECs have been on notice since at least 2001 that their access rates could be changed in this proceeding.

Q. IS THERE A DIFFERENCE BETWEEN THE STAFF RECOMMENDATION THAT CLECS CAP THEIR INTRASTATE ACCESS RATES AT THE COMPETING ILEC’S RATE, RATHER THAN QWEST’S AND VERIZON’S RECOMMENDATION THAT QWEST’S RATES BE THE BENCHMARK?

A. Yes, but it is a distinction without a difference because the result of Staff’s proposal is the same as Verizon’s. This is because Staff also recommends that ALECA members (ILECs other than Qwest) cap their rates at Qwest’s levels. As Staff recognizes, “[i]f Staff’s access charge rate reformation is adopted by the Commission, the incumbent LEC’s rates will be Qwest’s current intrastate rates.”

Thus, as a practical matter, Staff’s recommendation is identical to Verizon’s – that the intrastate access rates of all LECs in the state, including CLECs, should be capped at Qwest’s levels.

III. NO AUSF EXPANSION TO FUND INTRASTATE ACCESS REFORM

Q. SOME PARTIES SUGGEST EXPANSION OF THE AUSF TO SERVE AS AN ACCESS REVENUE RECOVERY MECHANISM. DOES VERIZON CONTINUE TO OPPOSE SUCH EFFORTS?

\[40\] See Staff Direct at 11.
A. Yes. No party has provided any justification for or concrete evidence of a need to expand the AUSF to subsidize traditional wireline local telephone service in Arizona's current, hypercompetitive intermodal telecommunications environment. Nor has any party demonstrated why other carriers and their customers should be penalized through AUSF assessments because of the fact that customers in the competitive marketplace have availed themselves of service alternatives to the ALECA member companies' services. Rather, the Commission should reduce the member companies’ access rates and allow them to exercise retail pricing flexibility for recovery of foregone access revenues.

To reiterate, as noted in my direct testimony, expansion of the AUSF to fund intrastate access reform would be detrimental to both consumers and carriers by expanding the AUSF beyond its intended purpose (and increasing the contribution burden on consumers), and by encouraging carriers to continue relying on artificial subsidies, which is not appropriate in a competitive environment, rather than operating more efficiently. Expanding the AUSF in this manner (the price tag for which

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41 See Decision No. 70659 (AUSF Amendments Proceeding; Docket No. RT-00000H-97-0137) (Dec. 22, 2008) at 1 (“The AUSF was established to maintain statewide average rates and the availability of basic telephone service to the greatest extent reasonably possible.”); see also Decision No. 63267 (same docket) (Dec. 15, 2000) at 1; Decision No. 56639 (AUSF Establishment Dockets) (Sept. 22, 1989) at 5, 32 (purpose of AUSF is to “ameliorate the upward pressure on basic local rates in rural areas” and “ensure that the high cost of providing wireline local exchange service in rural areas will not diminish the availability of affordable service.

42 See Verizon Direct at 4.
ALECA has calculated at $23 million\(^4\) would simply perpetuate the
anticompetitive *status quo*, under which one set of providers (LECs)
recover network costs from other providers (presently IXCs). Such a
result is incompatible with and harmful to the workings of a competitive
market for communications services.\(^4\)

Q. PLEASE EXPLAIN IN MORE DETAIL THE BASIS FOR YOUR
POSITION.

A. The historic justification for a universal service fund is to ensure that
consumers in all areas have access to basic telephone service at affordable
rates. Basic telephone service traditionally was provided only via wireline
local exchange service. Because the costs of providing wireline local
telephone exchange service in certain rural areas historically tended to be
higher than the costs of providing wireline service in more densely
populated urban areas, all things otherwise equal, the theory was that rates
charged to consumers in those rural areas would tend to be higher and
possibly unaffordable. Universal service funds therefore attempted to
make service in rural areas more affordable by providing an explicit
subsidy to local exchange carriers that offered wireline service to rural
areas. By defraying a portion of the costs of providing wireline service in
rural areas, the fund allowed rural local exchange carriers to charge
affordable rates.

\(^4\) See Direct Testimony of Douglas Duncan Meredith on behalf of the Arizona Local Exchange
Carriers Association, filed December 1, 2009 ("ALECA Direct") at 8-9.
\(^4\) Id. Note particularly ALECA’s proposal that, unlike other contributors to the expanded AUSF,
its members’ contributions to the AUSF would be reimbursed from the AUSF.
Subsequent events, including the rise of competition, technological innovation, and the proliferation of intermodal providers, have dramatically altered that landscape and rendered that justification moot. This is not only true nationally, but also in Arizona. For example, the testimony of Dr. Oyefusi provides evidence that both wireless and broadband services are widely available even in the rural areas of Arizona.\(^\text{45}\) For example, he explains that, as of 2008, 97 percent of Arizona residents over the age of 15 have a wireless phone.\(^\text{46}\) These developments have driven down the costs associated with providing basic telecommunications services in rural areas. (For example, wireless providers often can provide service in rural areas at lower costs than can traditional wireline carriers, and even wireline providers can use new technology to reach rural areas more efficiently and cost-effectively.) The result has been greater choice and lower rates for consumers. These are not new developments, as the Commission’s order in the 2005 Qwest alternative regulation docket noted that “Qwest provides statistics and relies on evidence from Staff and other parties that indicates there is significant CLEC-based competition as well as ‘intermodal’ wireless and VoIP alternatives in Arizona” and that “Qwest provides other examples of significant changes in the telecommunications market... .”\(^\text{47}\) No party has

\(^{45}\) See AT&T/Direct Testimony of Dr. Ola Oyefusi on behalf of AT&T, filed December 1, 2009 ("AT&T/Oyefusi Direct") at 33.

\(^{46}\) Id. at 32.

\(^{47}\) See Opinion and Order, Docket No. T-01051B-03-0454 (March 26, 2006) at 15-16.
presented any evidence that subsidies and/or AUSF expansion are necessary to assure that consumers in all areas of the state have access to affordable service. Without that evidence, any former justification for providing AUSF support to ALECA members is unjustified now.

Q. WHAT ARE THE IMPLICATIONS OF THESE DEVELOPMENTS ON THE ISSUES BEFORE THE COMMISSION IN THIS PROCEEDING?

A. Those parties that support recovery of foregone access revenues through an expanded AUSF are ignoring these very real changes in the telecommunications landscape, and simply assume that all of the historic conditions that originally supported the rationale for universal service funding still exist today. In particular, those parties cling to the assumptions that: (a) universal service mandates access to a traditional landline phone (because the ALECA member companies’ wireline local exchange service is the only service that would be subsidized); (b) the costs of providing telecommunications service to rural areas remain prohibitively high (so there is no requirement that any ALECA member demonstrate that it actually faces high costs); and (c) without a new, explicit subsidy to the ALECA member companies, consumers in rural areas cannot obtain access to basic telephone service at affordable rates from either an ALECA member or some other provider. There is no evidence that any of these assumptions is correct in today’s environment, and no evidence to support a new or expanded subsidy that will
necessarily penalize customers that have already availed themselves of other competitive service options. Rather, when consumers have access to quality services that are being provided by a number of competing carriers and technologies, at affordable rates (as is the case in Arizona today), the goals of universal service are achieved and government subsidies—particularly new ones based solely on anecdotal evidence—are unnecessary.

Q. ARE THERE OTHER REASONS WHY THE COMMISSION SHOULD NOT EXPAND THE AUSF?

A. Yes, and the Joint CLECs and Verizon agree on this point. As Mr. Denney observes in opposing an expanded AUSF, there is no public policy rationale for requiring new, innovative services—including wireless and VoIP—48 to help fund the rural telephone companies’ chosen business models. And that is particularly the case where, as in the instant proceeding, there has been no demonstration that service would otherwise be unaffordable, that alternatives to traditional wireline service do not exist, or that wireline carriers could not provide the service without such funds. The Commission should not burden new services and technologies (and the customers that use them) with legacy regulatory obligations that have outlived their usefulness. Indeed, these service and technology innovations are spurring competition in the telecommunications

48 In addition to the policy reasons not to apply state USF obligations to VoIP services, Verizon will discuss the legal obstacles to doing so in its briefs.
marketplace, thereby providing an impetus for reduced rates in the traditional wireline sector. Burdening such services and customers with unnecessary new fees is the surest way to drive investment dollars away from Arizona. Should the Commission choose to force wireless and VoIP providers to contribute to an expanded AUSF, the result will simply be higher rates, chilling of innovation, reduced investment, and fewer competitive options and fewer benefits for consumers.\textsuperscript{49} For all these reasons, the Commission should not hamper the continued growth of wireless\textsuperscript{50} and VoIP by imposing new fees on customers of these services.

Q. IS THE INTERCARRIER COMPENSATION REGIME FOR WIRELESS CARRIERS THE SAME AS THAT FOR WIRELINE INTEREXCHANGE CARRIERS?

A. No. Unlike wireline interexchange carriers, which operate using the concept of Local Access Transport Areas ("LATAs"), wireless carriers operate using a different concept, that of Major Trading Areas ("MTAs").\textsuperscript{51} The vast majority of Arizona is within one MTA.\textsuperscript{52} Traffic between a wireless customer and an end user of a LEC within an MTA is considered local traffic, pursuant to § 51.701(b)(2) of the FCC's rules,\textsuperscript{53}

\textsuperscript{49} As AT&T's Dr. Aron noted, wireless carriers only pay intrastate access charges in very limited circumstances, and thus, their customers would not directly benefit from the access reductions under consideration here. See AT&T/Aron Direct at 40.

\textsuperscript{50} For example, AT&T's Dr. Aron cited a CDC study published last year that showed that 18.9% of Arizona households are wireless-only. See AT&T/Aron Direct at 95, footnote 111.


\textsuperscript{52} See, e.g., AT&T/Aron Direct at 44.

\textsuperscript{53} See 47 C.F.R. 51.701(b)(2).
and as such, the classification of such traffic for intercarrier compensation purposes is local, meaning that access charges do not apply.54

Conversely, if a wireless call originates in one MTA but terminates to a LEC end user in a separate MTA, that "interMTA" call would be subject to access charges. That situation is minimal in Arizona, as can be verified by review of the interconnection agreements on file with the Commission (such as those between Arizona LECs and Verizon Wireless). One of the agreed terms in many of those agreements is that the interMTA factor used to determine the volume of interMTA traffic subject to access charges generally is zero. In other words, the carriers have agreed that there is so little interMTA traffic in Arizona (if any) that the appropriate traffic factor for compensation purposes is zero. Again, this reflects the fact that the state of Arizona is substantially in one MTA.

Q. GIVÉN THe FACTS, WHAT WOULD BE THE EFFECT OF REQUIRING WIRELESS CARRIERS TO PAY INTO AN EXPANDED AUSF FOR THE PURPOSE OF PRESERVING ALECA MEMBERS' INTRASTATE ACCESS REVENUE STREAMS, AS ALECA RECOMMENDS?
A. In short, the effect would be to force wireless carriers and their customers to subsidize access services that they do not use.

Q. WOULD REQUIRING WIRELESS CARRIERS AND THEIR CUSTOMERS TO CONTRIBUTE TO AN EXPANDED AUSF HAVE OTHER NEGATIVE CONSEQUENCES?
A. Yes. I noted above that wireless carriers have entered into interconnection

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54 See, e.g., AT&T/Aron Direct at 41-44.
agreements with a number of LECs in Arizona. Where parties have agreed that the volume of interMTA traffic is zero, they have thus agreed that the LECs are not due any "access" compensation (because all traffic is compensated at the rate for "local" traffic). A decision to require wireless carriers and their customers to pay into an expanded AUSF in order to replace the ALECA members' foregone access revenues would circumvent and conflict with the agreed terms and intent of the parties' negotiated and Commission-approved interconnection agreements. This is yet another reason why the Commission should not expand the AUSF as proposed by the ALECA members to compensate them fully for foregone access revenues. To do so would be contrary to sound public policy, would not be competitively neutral to providers in the marketplace, and is in no way appropriate in or consistent with a competitive environment.

Q. DO OTHER PARTIES AGREE WITH VERIZON, AT LEAST IN PART?

A. Yes. For example, Dr. Aron acknowledges that allowing the ALECA members to recover foregone access revenue through increased retail rates is "from a purely economic perspective, [a] generally superior" approach. She goes on to explain that such an approach is preferable, because it utilizes "society's scarce resources in a way that maximizes the overall consumer welfare that those resources can produce." Also,

55 Id. at 90.
56 Id. at 91.
Cox’s witness Mr. Garrett points out that the effect of requiring *all* carriers to reduce their intrastate switched access rates but allowing only *certain* classes of carriers to recover such foregone revenues from the AUSF “will inevitably distort competition.”\(^57\) Sprint’s witness Mr. Appleby observes that “[a]llowing LECs to recover revenue from their own end user services exposes that revenue to the rigors and efficiency of competition,”\(^58\) a concept that is echoed by the Joint CLECs’ witness, Mr. Denney.\(^59\) Thus, expanding the AUSF as a means of replacing ALECA members’ foregone access revenues is simply not sound public policy, because of the negative implications on competition and because such an approach fails to maximize consumer welfare.

And Staff observed that with one exception, Qwest is the only Arizona ILEC to have had its rates examined in the past decade, allowing for “no bona fide recent sense” of the remaining ILECs’ financial condition, “other than their assertion that they need AUSF in order to survive the decline in access revenues.”\(^60\) As Staff rightly observed, “it is not equitable to require customers of other companies to subsidize the ALECA members *based solely on anecdotal statements of need.*”\(^61\)

\(^{57}\) See Cox Direct at 5. Even the Joint CLECs concede that AUSF funds should not be used to replace CLEC revenues lost as a result of access reform. See Jt. CLEC Direct at 60.

\(^{58}\) See Direct Testimony of James A. Appleby on behalf of Sprint, filed December 1, 2009 (“Sprint Direct”) at 22.

\(^{59}\) See Jt. CLEC Direct at 10.

\(^{60}\) See Staff Direct at 19.

\(^{61}\) *Id.* (emphasis added).
Q. DOES VERIZON HAVE ANY RECOMMENDATIONS IN THE EVENT THE COMMISSION NONETHELESS PROCEEDS TO EXPAND THE AUSF TO SERVE AS AN ACCESS REVENUE REPLACEMENT MECHANISM?

A. Again, Verizon is strongly opposed to this approach. There has been no factual showing justifying such an expansion of the AUSF. However, if evidence was presented proving that affordable alternatives do not exist at certain specific locations and that AUSF is the only means to assured affordable service to those areas, the Commission must ensure that it tightly constrains the AUSF.

Thus, at minimum, the following conditions would be necessary:

► CLECs have significant pricing flexibility and no legacy policy burdens, and should not receive subsidies for the long-overdue rationalization of their intrastate switched access rates.

► In keeping with Staff's recognition that it is inequitable to require other carriers to subsidize ALECA's members "based solely on anecdotal statements of need," the Commission should not automatically authorize recovery from the AUSF for foregone access revenues. Instead, any carrier seeking recovery from the AUSF for such revenues should not only be required to increase its local retail rates to an appropriate Commission-set benchmark, but should also be required to demonstrate (through a factual showing, and not simply a sworn assertion) that it cannot continue to provide basic local service in a specific area without continuing to receive a subsidy.

► The Commission should cap the size of the AUSF and set an end date for the availability of temporary AUSF subsidies for foregone access revenues that is no more than three years in the future. The fund should not serve as a permanent access revenue replacement mechanism; failure to curtail this possibility would perpetuate the competitive harms created by the current access system (as one set of carriers would continue to subsidize another). The AUSF should be phased out completely within no more than three years of its initiation.
As discussed in more detail below, wireless and VoIP providers should be exempted from contributing to the AUSF for access revenue replacement purposes.

The AUSF, and carriers’ draws from it, should be resized annually to account for reductions in intrastate access minutes of use and access lines. Otherwise, ALECA members would reap the windfall of subsidies based on levels of traffic that have declined over time as a result of competition.

IV. OTHER RESPONSES TO INDIVIDUAL PARTIES

Q. ARE THERE OTHER ISSUES YOU’D LIKE TO ADDRESS IN ADDITION TO THESE TWO MAIN ONES?
A. Yes. I will briefly address a few additional points made by each individual party, starting with Staff.

Staff of the Arizona Commerce Commission ("Staff")

Q. IS THE STAFF’S TESTIMONY GENERALLY ALIGNED WITH VERIZON’S RECOMMENDATIONS?
A. Yes. Staff recognizes that the current intrastate switched access regime is susceptible to arbitrage and that reform would bring a number of benefits.\(^{62}\) Staff and Verizon are in agreement on the core recommendation – that the intrastate switched access rates of both RLECs and CLECs be reduced to Qwest’s levels\(^{63}\) – although Verizon’s proposal would result in more rapid implementation than Staff’s, expediting the benefits of access reform in Arizona.

\(^{62}\) See Staff Direct at 9.
\(^{63}\) Id. at 2. Like Verizon, Staff does not recommend further reductions in Qwest’s intrastate access rates at this time. Id. at 3.
Staff proposes that CLECs’ intrastate switched access rates be capped at the level of the ILECs with which they compete, but as explained above (and as acknowledged by Staff), this ultimately results in the same effect as ordering CLECs to cap their intrastate access rates at Qwest’s levels, because the ILECs’ rates would also be capped at Qwest’s levels.64 In other words, Verizon’s proposal is effectively identical to Staff’s, but presented as a single standard applicable to all LECs.

Q. PLEASE EXPLAIN YOUR STATEMENT ABOVE THAT, COMPARED WITH STAFF’S RECOMMENDATION, VERIZON’S PROPOSAL FOR IMPLEMENTATION WOULD EXPEDITE THE BENEFITS OF ACCESS REFORM IN ARIZONA.

A. Staff’s primary proposal would prohibit ALECA members from recovering lost access revenues from the AUSF unless they have no other source of replacement revenue, and as a result, would require them to make an R14-2-103 filing seeking to increase their local rates.65 After the Commission completed its R14-2-103 review, and depending on the results of the review, the RLEC would then possibly be entitled to seek AUSF funds. If ALECA members would not be required to reduce their intrastate access rates to Qwest’s levels until completion of the investigation and review, then Verizon and Staff’s approaches diverge, since under the Staff’s proposed process, it would take a number of years

64 Id. at 11.
65 Id. at 27.
1 to realize the benefits of access reductions, because a rate case would need
2 to be completed for every ALECA member before reductions could occur.

3 Q. BUT DIDN'T STAFF OFFER AN ALTERNATIVE PROPOSAL?

4 A. Yes. Staff stated that if the Commission wished to proceed with access
5 reform more expeditiously, it could allow ALECA members to obtain
6 temporary AUSF support on a revenue-neutral basis until they had
7 completed a full R14-2-103 proceeding, which would have to be filed
8 within a year of the Commission awarding them temporary AUSF
9 funding. At that time, the Commission would consider whether to allow
10 each RLEC to raise retail rates and/or continue to receive AUSF support
11 on a demonstration that authorized rate increases were insufficient to
12 recover foregone access revenues. \(^{66}\) Staff proposed a staggered filing
13 schedule that would not require the first such R14-2-103 filing to be made
14 until a year after the issuance of an order to reduce access rates, and the
15 last filing not until three and half years after the Commission’s order. \(^{67}\)
16 Adding in the time it would take actually to conduct and complete the
17 R14-2-103 reviews, it would be upwards of four or more years before the
18 “temporary” AUSF support to ALECA members could be terminated.

19 Q. DOES VERIZON AGREE WITH STAFF’S “ALTERNATIVE”
20 PROPOSAL?

\(^{66}\) Id.
\(^{67}\) Id. at 27-28.
A. No, for the following reasons. First, LECs should look to their own customers rather than their competitors (and their customers) for any needed funds. In this regard, the Commission should recognize that the significant intermodal competition that exists in Arizona serves to limit the rates that competitors can charge, so a market mechanism is already in place that ensures consumers have access to services at reasonable rates. Second, a “temporary” fund would take on a life of its own and be extremely difficult to dissolve. Because consumers will bear the burden of any expanded AUSF, it is unreasonable to impose such a burden without evidence that demonstrates it is required and without strict constraints on the fund.

Q. HOW DOES VERIZON’S PROPOSAL DIFFER FROM STAFF’S?

A. Verizon’s proposal would implement all access rate reductions within 30 days of a commission order directing the reductions to be made and would allow the ILECs immediate retail pricing flexibility. Verizon urges the Commission to enter an order capping the intrastate access rates of all LECs at the composite of the Qwest intrastate switched access rate elements for the functions that the LEC at issue actually performs in providing its switched access service.68 Verizon proposes that the order further direct that if a LEC’s current intrastate access rate complies with

68 See Verizon Direct at 20.
the new cap, it should file, within 30 days, a sworn affidavit attesting that
its current intrastate switched access tariff is in compliance with the order.

If a LEC’s current intrastate access rates do not comply with the
new cap, the order would require the LEC to file, within 30 days, both a
new intrastate switched access tariff that complies with the order (bearing
an effective date no later than 30 days after the order) and a sworn
affidavit attesting that the new intrastate switched access tariff complies
with the order. To the extent that the retail rates of any LEC required to
file a new intrastate switched access tariff as a result of the order are not
already subject to pricing flexibility, the LEC could adjust its retail rates
or choose to absorb the reduction with its other revenue streams. Verizon
proposes that the LEC be permitted to quantify the revenue reduction
associated with the ordered access reductions and file proposed retail tariff
changes within 30 days of the order.

Q. WHAT MECHANISM DOES VERIZON RECOMMEND FOR
PROCESSING THE ALECA MEMBERS’ TARIFF FILINGS?

A. Verizon recommends that the Commission allow the ALECA members’
proposed retail rates to become effective on a temporary basis, pending
completion of a simplified earnings review mechanism, along the lines of
the process discussed by Qwest witness Copeland.\textsuperscript{69} Such an approach
would accomplish access reform in a timely manner. In fact, a simplified
review mechanism should be used to implement whatever decision the

\textsuperscript{69} See Qwest/Copeland Direct at 6.
Commission reaches in this proceeding. Procedural delay would be particularly harmful where, as here, there is wide agreement among the parties on the competitive and consumer benefits that would result from access reform in Arizona.

Q. DOES STAFF AGREE WITH VERIZON THAT THE COMMISSION SHOULD PERMIT CARRIERS TO ENTER INTO SWITCHED ACCESS AGREEMENTS?

A. Yes. Like Verizon, Staff supports permitting CLECs to enter into off-tariff switched access agreements. As explained in my direct testimony, the FCC has recognized that market-based mechanisms are the best way to produce efficient prices and promote the public interest. Negotiated intercarrier compensation agreements are the best long-term solution to ensuring the efficiency of telecommunications markets in the face of substantial technological change. Among other advantages, this kind of approach, by virtue of being technologically neutral, adapts more easily to changing technologies, encouraging their introduction without the need to modify the regulatory regime.

Staff suggests that the commission require such agreements to be filed with the commission, require CLECs to modify their tariffs to allow for such agreements, and require CLECs to make the same contractual

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terms available to all similarly situated carriers.\textsuperscript{71} Verizon agrees with
Staff’s suggestions.

Q. \textbf{STAFF RECOMMENDS THAT IXCS SHOULD BE REQUIRED TO MAKE FILINGS CONFIRMING THAT THEY HAVE PASSED THROUGH TO THEIR CUSTOMERS THE SAVINGS THAT WOULD RESULT FROM ACCESS RATE REDUCTIONS.\textsuperscript{72} WHAT IS VERIZON’S POSITION ON STAFF’S PROPOSED FLOW-THROUGH REQUIREMENT?}

A. Verizon certainly agrees that access rate reductions should and will benefit customers.\textsuperscript{73} However, Staff’s proposed flow-through requirement\textsuperscript{74} would constrain the ways in which the customer benefits of access reduction can materialize. As several witnesses have explained, reducing intrastate access rates will enhance competition in the long distance market and thereby benefit consumers. Competition in that market will ensure that retail long distance rates include the effects of access cost savings. This is because of the simple truth that in a competitive market, long distance carriers that refuse to pass along the benefits of cost savings will lose customers to those that do.

In such a highly competitive market,\textsuperscript{75} there is no need for the Commission to impose a rigid flow-through requirement that would constrain the ways in which customer benefits can arise. Cost savings may be reflected in reduced rates, or in rates that stay the same because

\begin{footnotes}
\item[71] See Staff Direct at 3.
\item[72] Id. at 13.
\item[73] See Staff Direct at 12; AT&T/Aron Direct at 105; AT&T/Oyefusi Direct at 40-42
\item[74] Id. at 13.
\item[75] There can be no question that the market for long distance services is highly competitive, in stark contrast with the market for access services.
\end{footnotes}
the savings have offset other cost increases, or in a smaller rate increase than otherwise would have been implemented. Also, competitors in the long distance market may choose to invest the savings in advanced technology, improved service quality or customer service, or they could introduce new services or features, thereby bringing tangible benefits to consumers in other ways. Competition will ensure that such benefits are passed along to consumers in one way or another, obviating the need for regulatory intervention.

Moreover, implementing a flow-through requirement – even if it were otherwise lawful and made sense in a competitive market (and it does not) – would be impractical given the wide variety of long distance services available today. For example, customers can choose from a block-of-time toll calling plan, a flat-rate, all-distance calling package, a pre-paid calling card, or various other plans to satisfy their long distance service needs. Given the differing rate plans and the various ways in which consumers pay for retail interexchange service (e.g., as one component of a bundled service package, flat-rate, per-minute or combination thereof), it would be impractical to impose—and impossible to police—a flow-through requirement. Similarly, since many customers—especially business customers—obtain service via contracts that set forth the rates, terms and conditions of service (often on a multi-state basis), it would be extremely impractical (and likely impossible) to attempt to jury-rig a flow-through requirement that could apply to
contractual arrangements. Nevertheless, if the Commission requires meaningful access reductions, Verizon would be willing to eliminate its Instate Access Recovery Fee, which is paid by certain residential customers in Arizona.  

Q. STAFF OPPOSES ALECA’S PROPOSAL TO USE THE AUSF FOR HIGH COST LOOP FUNDING SUPPORT. DOES VERIZON AGREE WITH STAFF ON THIS POINT?

A. Yes. ALECA’s proposal is nothing more than a solution in search of a problem. ALECA proposes that the Commission create an entirely new fund—and impose additional burdens on all Arizona consumers—without any evidence that the costs at issue are not already being recovered through other rates and without any justification or attempt to tie this to universal service needs. Staff noted that ALECA’s proposal would require approximately $9 million in additional AUSF support and thus recommended that the Commission take no action at this time and instead “await further action with respect to the federal funding mechanism.” 

Verizon agrees wholeheartedly. Staff rightly expresses significant concern about ALECA’s proposal for a substantial additional increase in the AUSF (above and beyond that associated with ALECA’s proposal to expand the AUSF to serve as an access revenue recovery mechanism). I

76 Verizon’s Instate Access Recovery Fee is a monthly fee of $1.40 that is assessed on certain residential customers utilizing the company’s stand-alone long distance service. The fee applies only to those customers who have a minimum amount of long distance usage charges in the billing period. See Arizona Tariff No. 2, Price List, 1st Revised Page A-54.  

77 See Staff Direct at 22-23; ALECA Direct at 11.
agree with Staff’s recommendation that the Commission reject ALECA’s proposal.

Q. DOES VERIZON ALSO AGREE WITH STAFF’S REJECTION OF ALECA’S PROPOSAL TO FUND CENTRALIZED ADMINISTRATION AND AUTOMATIC ENROLLMENT IN LIFELINE AND LINK-UP?

A. Yes, for all the reasons Staff outlines.78

Arizona Local Exchange Carrier Association ("ALECA")

Q. DOES VERIZON AGREE WITH ALECA’S POSITION?

A. For all the reasons I discussed above in Section III of my testimony, I disagree with ALECA’s proposal to allow its members to recover from a greatly-expanded AUSF—on a dollar-for-dollar basis—all of the member companies’ intrastate access revenues foregone as a result of access reform.79

There are, however, a few areas on which Verizon agrees with ALECA witness Mr. Meredith. For example, I agree that reducing intrastate access rates brings about various benefits, including the promotion of competition and a reduction in the incentive to engage in arbitrage. I also concur with his recommendation that the benchmark for ALECA members should be Qwest’s switched access rates, rather than their own interstate rates.

78 Id. at 24-26.
79 See ALECA Direct at 6-8.
Q. DOES VERIZON OBJECT TO ALECA’S PROPOSAL TO
ACHIEVE INTRASTATE ACCESS REFORM USING THE AUSF
AS A “MAKE-WHOLE” MECHANISM?
A. Yes. For all the reasons discussed above in Section III of my testimony,
expanding the current AUSF as suggested by Mr. Meredith, is, among
other things, contrary to sound public policy. The preferable approach, as
noted in my direct testimony, would be to grant those carriers greater retail
pricing flexibility for rate-regulated services, as this would afford rate-
regulated carriers a sufficient opportunity to recover their network costs
from their own customers, rather than from competitors. These
measures would both curtail the artificial subsidies that exist in the current
intrastate access regime, and encourage all carriers to operate efficiently,
as is appropriate in a truly competitive environment.

Cox Arizona Telecom, L.L.C. (“Cox”)

Q. DOES VERIZON AGREE WITH COX’S POSITION IN THIS
PROCEEDING?
A. There is very little agreement. Cox urges the Commission not to take any
action and instead await federal action on access and intercarrier
compensation reform, in part due to the unsupported assertion that
arbitrage can “only” be curtailed by addressing access reform through a
national framework.

Q. DOES COX AT LEAST CONCEDE THAT REFORM WOULD BE
BENEFICIAL?

80 See Verizon Direct at 20, 21; see also AT&T/Aron Direct at 90-91.
81 See Cox Direct at 3; 5-6.
A. Yes and no. On the one hand, by urging the Commission to allow the FCC to act on intercarrier compensation issues, Cox appears to recognize the need for access reform, and to consider it a worthy goal. Yet, Cox appears to dispute the benefits of access reform in light of the "shift in consumer behavior" towards use of alternatives to traditional wireline service. The flaw in Cox's reasoning is that Mr. Garrett ignores that the ongoing failure to reform the access charge system may be a factor in the "shift" to which he refers. That is, the artificial wholesale pricing disparities in the current intrastate access regime may have contributed to customers choosing alternate technologies such as wireless services. Verizon's access reform recommendations would lessen any such disparities, move pricing toward true costs and let the competitive market provide benefits to customers.

Q. COX DOES OFFER SOME RECOMMENDATIONS IN THE EVENT THAT THE COMMISSION DECIDES TO PROCEED WITH ACCESS REFORM NOW RATHER THAN AWAITING FCC ACTION. WHAT ARE YOUR THOUGHTS ON COX'S PROPOSALS?

A. As noted in Section II of my testimony above, I disagree with Cox's recommendation that the Commission focus initially on the intrastate switched access rates charged by RLECs, and address CLEC (and large ILEC) rates later.

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82 Id. at 3.
83 Id. at 4.
84 Id. at 7.
As also noted above, I cannot concur in Cox’s suggestion that the Commission allow CLECs to maintain intrastate access rates that exceed those of the ILECs, and allow CLECs an extended transition period if they ultimately are required to reduce their rates.85

Q. DOES VERIZON AGREE WITH THE JOINT CLECS’ POSITIONS IN THIS PROCEEDING?

A. No. The one area of agreement is on the Joint CLECs’ recommendation that CLECs not be permitted to recover lost access revenue from the AUSF should the Commission decide that it may be appropriate to expand the fund to serve as an access revenue recovery mechanism for some carriers in the state.86 Mr. Denney stated that he was “not aware of any state that has established such a fund for CLEC access revenue recovery,”87 and neither am I. This is for good reason because (as I have discussed in both my direct testimony and here) CLECs are not burdened with the legacy regulations and obligations imposed upon incumbent carriers, and they have substantial pricing flexibility to recover any lost access revenues through retail rate modifications.

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85 Id. at 3.
86 See Jr. CLEC Direct at 60.
87 Id.
Q. WHAT IS VERIZON’S RESPONSE TO THE JOINT CLECS’ RECOMMENDATION THAT THE COMMISSION SHOULD EXPAND THE SCOPE OF THIS PROCEEDING TO “ESTABLISH RATES THAT WIRELESS CARRIERS PAY TO LECS TO TERMINATE INTRASTATE, INTRAMTA TRAFFIC”?  

A. This issue is not within the scope of the proceeding, and the Joint CLECs have provided no valid reason to expand the scope to include the issue. Wireless carriers were not provided notice that the issue would be addressed in this proceeding, and to add this new issue now would be unfair to the various entities that potentially would be affected by including the issue at this late date. Furthermore, I cannot see any reason for expanding the scope of the proceeding as recommended by the Joint CLECs other than to make the Commission’s task more difficult. Given the importance and complexity of the access reform issues already within the scope of the proceeding, the Commission should decline to expand the scope.

My disagreement with the remainder of Joint CLEC’s testimony has been addressed by my discussion above.

Qwest Corporation and Qwest Communications Company, LLC (“Qwest”)

Q. ARE THERE AREAS OF AGREEMENT BETWEEN VERIZON AND QWEST IN THIS PROCEEDING?  

A. Yes. Verizon agrees with several points made by Qwest, and many of those have already been addressed. In addition, Verizon agrees with Qwest that the cost of providing access service need not be a focus of this

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88 See Jr. CLEC Direct at 22.
As explained by several parties, access rates were not originally set based on cost. Instead, they were set well above the economic cost of providing access services to provide a contribution that kept basic local rates artificially low. For all the reasons discussed above, this social policy objective has been met, and with Verizon’s recommendation that all LECs be allowed pricing flexibility to recover lost access revenues, maintaining such contributions is no longer reasonable or appropriate. Furthermore, the FCC established its benchmark for “just and reasonable” CLEC interstate access rates without engaging in an anachronistic cost of service analysis, and this Commission can (and should) do the same in the intrastate context.

Q. ARE THERE ALSO POINTS WHERE QWEST AND VERIZON’S RECOMMENDATIONS DIVERGE?

A. Yes there are. Qwest is amenable to allowing carriers to recover lost access revenues from the AUSF, albeit only if certain benchmarks and prerequisites are met. However, as explained above and in my direct testimony, it is not appropriate to augment the AUSF for such purposes. It is time to stop perpetuating the artificial subsidies of the current access regime and establish policies that allow carriers to recover a greater portion of their network costs from their own end users.

89 See Direct Testimony of Peter B. Copeland on behalf of Qwest, filed December 1, 2009 (“Qwest/Copeland Direct”) at 6.
90 See, e.g., Qwest/Eckert Direct at 3; Qwest/Copeland Direct at 5-6.
Q. DOES QWEST RECOMMEND LETTING ALL CARRIERS THAT ARE REQUIRED TO REDUCE THEIR INTRASTATE SWITCHED ACCESS CHARGES RECOVER THOSE LOST REVENUES FROM THE AUSF?

A. Apparently so (albeit not without making certain threshold showings). However, for the reasons I have mentioned previously (both above and in my direct testimony), it is inappropriate to allow any carriers to recover lost access revenue from the AUSF. It would be particularly egregious to allow CLECs to do so, given their lack of legacy regulation and their substantial ability to recover any access reductions they choose not to absorb from their local retail rates. As I mentioned above, I am unaware of any state that has authorized allowing non-ILECs to recover lost access revenues from a universal service fund, and with good reason.

Sprint Communications Company, L.P., Sprint Spectrum, L.P. and Nextel West Corp. (“Sprint”)

Q. SPRINT URGES IMMEDIATE INTRASTATE ACCESS RATE REDUCTIONS IN ARIZONA – DOES THIS MEAN VERIZON AGREES WITH SPRINT’S PROPOSAL?

A. While Verizon certainly shares Sprint’s goal of rationalizing and reforming the current intrastate switched access charge regime in Arizona, Verizon differs with Sprint on the best means of achieving this goal. Sprint recommends that the Commission require all LECs in Arizona, including Qwest, to mirror their own interstate rates. As discussed both above and in my direct testimony, Verizon believes that Qwest’s intrastate

91 See Direct Testimony of James A. Appleby on behalf of Sprint, filed December 1, 2009 (“Sprint Direct”) at 20-21.
rates should serve as a benchmark for all carriers. Verizon’s proposal satisfies Sprint’s goal of avoiding the necessity of lengthy and expensive cost review proceedings, but has the added benefit of proposing rates that have been subject to the greatest degree of review and have already been found “just and reasonable” by this Commission. For these reasons, Qwest’s current intrastate access rates should be used as the standard for all carriers in the state.

Q. DO YOU AGREE WITH SPRINT THAT IF A LEC WHICH HAS BEEN REQUIRED TO REDUCE ITS INTRASTATE ACCESS RATES SEeks AUSF SUPPORT, THE COMMISSION SHOULD FIRST REQUIRE THE LEC TO DEMONSTRATE SUCH NEED THROUGH A THOROUGH FINANCIAL REVIEW OF ITS TOTAL OPERATIONS?

A. As noted both here and in my direct testimony, Verizon is strongly opposed to expanding the AUSF to serve as an access recovery mechanism. However, if the Commission disregards Verizon’s recommendations, I would agree with Sprint that the Commission should at least require a LEC seeking such support to make a strong factual showing that it cannot recover lost access revenues through revised retail rates, that it can only cover its costs of providing local service with support from the AUSF, and that alternatives are not available to its customers at affordable rates.
AT&T Communications of the Mountain States and TCG Phoenix
(“AT&T”)

Q. IS THERE ANY COMMONALITY BETWEEN AT&T’S AND VERIZON’S POSITIONS IN THIS PROCEEDING?

A. Yes, there is a fair amount of overlap. Verizon neither shares AT&T’s willingness to allow at least partial recovery of access revenues foregone as a result of Commission-ordered rate reductions from the AUSF (which would require increasing the AUSF), nor supports AT&T’s proposal to require all LECs in Arizona to mirror their interstate rates (already addressed above in my response to Sprint). However, as noted in the introductory section of my testimony, I agree with the AT&T witnesses that intrastate access rate reductions in Arizona are sorely needed, and that access reform in Arizona would likely result in lower long distance rates. AT&T appropriately recognizes that a cap on CLECs’ intrastate access rates is warranted, just as the FCC has already implemented on the interstate side.

Q. WITH WHICH ASPECTS OF AT&T’S POSITION IN THIS PROCEEDING DOES VERIZON TAKE ISSUE?

92 See AT&T/Oyefusi Direct at 7; 51-52.
93 See AT&T/Oyefusi Direct at 6; 22; 25. Dr. Oyefusi claims that using carriers’ interstate rates as a benchmark will simplify their access billing because one set of rates will apply to all toll traffic (id. at 45), but this is simply incorrect. Carriers’ billing systems will continue to have to separate traffic into various jurisdictional buckets, and the systems will continue to be populated with specific rates for each distinct type (or jurisdiction) of traffic.
94 See AT&T/Aron Direct at 27-37; 51-65; AT&T/Oyefusi Direct at 40-42. Dr. Oyefusi identifies specific rates that AT&T will reduce if its recommendations are adopted.
95 See AT&T/Oyefusi Direct at 23-24; AT&T/Aron Direct at 86.
One major concern is AT&T's willingness to allow the AUSF to be used as an access recovery mechanism – and thereby to grow precipitously, to the detriment of both carriers and their customers, who would have to finance the expansion of the fund. Although one AT&T witness – an economist – observes that retail price modifications “would be the most economically efficient means” of recovering access revenues foregone as a result of rationalizing Arizona’s current intrastate switched access regime, AT&T does not oppose AUSF expansion as part of intrastate access reform, provided that it is coupled with some degree of recovery through local retail rates. AT&T takes this position while recognizing that safeguards already exist under the current state and federal Lifeline and Link-Up plans to ensure that low-income customers remain on the public switched network, even in the event of retail rate changes. For all the reasons I have discussed, Verizon disagrees with an expansion of the AUSF.

Q. DOES VERIZON ENDORSE AT&T'S PROPOSAL, ECHOED BY SPRINT, THAT THE COMMISSION REQUIRE ALL CARRIERS TO MIRROR THEIR OWN INTERSTATE SWITCHED ACCESS RATES?

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That said, AT&T does state that AUSF recovery for lost access revenues should not be authorized on lines for which the service provider has full pricing flexibility, nor on unregulated bundles. See AT&T/Aron Direct at 88-89. AT&T also cautions against the dangers of allowing AUSF recovery for lost access revenues in the absence of a local service rate benchmark, or a benchmark that is too low, since either condition would increase carriers' draw from the AUSF, creating new economic and competitive distortions (id. at 101) in the effort to remedy the ones caused by the current intrastate access regime. While Verizon remains opposed to AUSF recovery for foregone access revenues, I do agree with these two points made by AT&T if the AUSF does play a role in access reform.

96 Id. at 14; 90-91.
97 Id. at 99.
A. No. While Verizon supports the goal of intrastate switched access rate reductions, it is more appropriate to require all LECs to mirror Qwest’s intrastate switched access rates (versus each LEC’s own interstate rates). AT&T’s Dr. Oyefusi claims that many states have adopted its proposed approach⁹⁹ — which it refers to as a “parity requirement” — but AT&T’s proposal is not the norm for states that have proceeded with intrastate access reform, and I disagree with Dr. Oyefusi’s characterization for a number of the listed states.¹⁰⁰ Typically, there is no parity requirement, or to the extent there is, it is because the state’s largest LEC has either been ordered to, or agreed to, take its intrastate access rates down to interstate levels (but other LECs in the same state have not done so).

Residential Utility Consumer Office ("RUOC")

Q. DOES VERIZON HAVE A RESPONSE TO RUOC'S TESTIMONY?

A. RUOC’s recommendation is that the Commission should carefully consider all arguments and information before reaching a decision, and should act in the public interest, rather than to the benefit of any specific

⁹⁹ See AT&T/Oyefusi Direct at 48 and Exhibit F thereto.
¹⁰⁰ For example, Indiana does not require mirroring of interstate rates. Indiana statute simply provides that intrastate switched access rates that “mirror the provider’s interstate rates” shall be deemed just and reasonable. See Ind. Code § 8-1-2.6-1.5. The Wisconsin statute only requires price-regulated carriers with more than 150,000 access lines to cap their intrastate switched access rates at their interstate levels, but does not require this for all LECs. See Ch. 196.196(2)(b)1., Wis. Stats. In fact, in late 2009, the Wisconsin Commission opened a new docket — PSCW Docket No. 5-TR-105 — to investigate overarching access reform in Wisconsin. In Georgia, Kentucky, Tennessee and other states, AT&T and AT&T alone has an ongoing parity requirement as a result of its election of various types of regulation or pursuant to a settlement. Many of Dr. Oyefusi’s other citations are similarly overstated.
set of carriers.\textsuperscript{101} Verizon agrees with this proposition. However, RUCO offers no specific proposal for achieving it, so there is little to which Verizon can respond.

Q. RUCO WITNESS DR. JOHNSON ARGUES THAT "IT MAKES NO ECONOMIC SENSE TO IMPOSE THE ENTIRE COST OF THE ACCESS LINE, AS PART OF THE PRICE OF LOCAL SERVICE, ON THE PARTICULAR END USER WHO REQUESTS INSTALLATION OF THE LINE."\textsuperscript{102} WOULD VERIZON'S PROPOSALS HAVE THE EFFECT OF IMPOSING "THE ENTIRE COST OF THE ACCESS LINE" ON THE ALECA MEMBERS' END USERS?

A. No. Verizon has proposed that the Commission utilize Qwest's current intrastate access rates as the benchmark for the ALECA members. The Qwest intrastate access rates are set well above economic cost, meaning that those rates contain a contribution toward joint and common costs, including the cost of the local loop. So leaving aside any disagreement I might have with Mr. Johnson's cost allocation theories, the Commission need not be concerned with the scenario Dr. Johnson portrays.

V. CONCLUSION

Q. DOES THIS CONCLUDE YOUR REPLY TESTIMONY?

A. Yes.

\textsuperscript{101} See Direct Testimony of Ben Johnson, PhD, on behalf of RUO, filed January 6, 2010 ("RUO Direct") at 48, for example.

\textsuperscript{102} See RUO Direct at 28.