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.

RUCO'S CLOSING BRIEF MATTERS

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

FACTUAL BACKGROUND

The Arizona Universal Service Fund ("AUSF" or "Fund") was established on September 22, 1989. [Decision No. 56639] The AUSF was designed to help offset high basic local telephone rates in rural areas. One half of the AUSF was derived from local exchange carriers based on the number of access lines, and one half was derived from interLATA and intraLATA
intrastate minutes of use. On March 24, 1996, the Commission adopted rules which
established a new universal service fund mechanism. The AUSF rules expanded the types of
telecommunications providers that contribute to the AUSF and changed the criteria for drawing
from the fund. In 1997, Docket RT-00000H-97-0137 was opened to again review and revise
the AUSF rules.

At the Arizona Corporation Commission's ("Commission") August 22, 2000 Open
Meeting (Docket No. T-02724A-99-0595), then-Chairman Kunasek requested an investigation
into whether access charges for Arizona utilities reflect the cost of access. In 2000, the
Commission opened Docket T-00000D-00-0672 with the intent of analyzing the relationship
between the rates charged and the costs incurred in the provision of access service. "Phase I"
of the docket addressed Qwest's access charges, and "Phase II" was intended to address
access charges for other carriers. By Procedural Order dated December 3, 2001, parties were
directed to provide written comments on a number of issues/questions that had been put forth
by Staff. After parties filed their responses, Staff, on March 28, 2002, filed its procedural
recommendations. By Procedural Order of May 21, 2002, the Commission adopted Staff's
proposed procedural schedule. RUCO and other intervenors filed direct testimony on June 28,
2002. By Procedural Order of July 8, 2002, the procedural schedule in this matter was
suspended.

On September 26, 2003, Staff filed a Request for and Expedited Procedural Conference
("Motion") pursuant to the Commission's directive at the September 19, 2003 Open Meeting to

1 Direct Testimony of Ben Johnson PH.D at 3-6.
2 See September 5, 2000 Memo from Deborah Scott, Director of Utilities Division ("Staff") opening this Docket No.
T-00000D-00-0672.Qwest had opposed the intrastate access charges that the Commission ultimately adopted for
Table Top Telephone Company, arguing that they were not consistent with the access charge rates for other
comparable companies in Arizona. See also Decision No. 62840 at 3 (August 24, 2000).
review Qwest's intrastate access charges on an expedited basis. Staff's Motion raised several
issues that it proposed be considered at the procedural conference. A procedural conference
was held on October 14, 2003. At the procedural conference, the Administrative Law Judge
requested briefs from the parties on the following issues: 1) the legal requirements for
changing access charges pursuant to *Scates v. Ariz. Corp. Comm'n, et al.* and possible
alternatives to deal with such requirements; 2) whether the proceeding should be bifurcated to
consider Qwest's access charges apart from those of other local exchange carriers ("LEC");
and 3) scheduling proposals for both a bifurcated and non-bifurcated proceeding.

The Commission consolidated the AUSF and Access Charge dockets. On October 7,
2008, numerous parties filed issue statements which left the Commission with no clear
consensus on how to proceed. On October 10, 2008, the parties agreed that no further action
should be taken in this consolidated docket until the FCC issued an order on intercarrier
compensation that was expected to be issued the following month. At a January 29, 2009
procedural conference, the parties again advocated disparate approaches to the issues
involved in this docket. Some parties suggested moving forward, while others recommended
waiting for further action by the FCC. ³ During the summer of 2009, the parties participated in

³ See September 29, 2009 Procedural Order at 2. RUCO argues that the Commission's rulemaking authority
must comply substantially to the rulemaking procedures of the Governor's Regulatory Review Council ("GRRC").
See ARS § 41-1057(2). GRRC's procedures require an agency to notice proposed rules to the public along with
an economic impact statement and a statement of effect of the rule on small business. RUCO respectfully
submits that this rulemaking docket is not a substitute for that process. Although the Commission may examine
general policies relevant to access charges and the AUSF, to complete the rulemaking process, the Commission
will need to notice proposed rules and supporting impact statement, and provide a notice and opportunity to
additional public comment pursuant to the requirements of ARS § 41-1057(2). Moreover, changes to rates may
not be effectuated through rulemaking. In order to alter the specific rates of any utility, the Commission will have
to hold a fair value proceeding. See discussion on pages 7-9. Accordingly, RUCO has not submitted proposed
rule changes herein, but restricts itself to a discussion of the policy considerations related to any subsequent
rulemaking.
two workshops. A procedural conference was held on September 6, 2009 to again discuss how this docket should proceed. On September 29, 2009, the Commission concluded:

There does not appear to be a dispute that access charges and AUSF should be reviewed to reflect the current realities in the communications industry, but after years of discussions among the parties, discovery and workshops, no consensus has emerged about how to proceed, much less on the substantive or policy questions. ... The recommendation to conduct an evidentiary hearing appears to be the best means to make progress with the Commission's investigation in these matters.4

The Commission also provided a list of 12 issues to be addressed at the hearing.5 Finally, the Commission established a testimony filing schedule that included filing direct testimony by all parties except Staff and RUCO on December 1, 2009, and by Staff and RUCO on January 6, 2010.

SUMMARY OF THE PARTIES’ POSITIONS

Through this proceeding, the parties have essentially reiterated positions that had been advocated several times over the course of these consolidated dockets. Qwest focuses on AUSF issues, and advocates a wire-center targeted support mechanism that would be uniformly applied to rural and non-rural carriers. Qwest also recommends allowing carriers to recover a portion of "additional costs" from end-users. Verizon recommends capping all LEC switched access rates at Qwest's current levels, arguing that any lost revenues should be collected from increased retail rates. Verizon also recommends leaving the existing AUSF system essentially unchanged. ALECA proposes a revenue neutral approach by which lost revenues from reduced access charges would be recouped from a high cost universal service

4 id. at 3
5 id. at 4-5.
program. ALECA proposes to use Qwest's intrastate access rates to set its members' rates. ALECA also does not believe rate cases should be required for its members.

AT&T recommends ILECs be required to lower access charges to interstate levels, and capping CLEC rates at ILEC levels. AT&T also recommends a revenue neutral approach whereby rate-regulated carriers can recoup lost revenues from price-capped lines. Sprint asserts that subsidies from access charges are no longer needed, since LECs have expanded the types of retail services they provide over their networks. Sprint recommends setting LEC access rates at interstate levels.

The Joint CLECs argue that CLEC access rates need not, and should not, be addressed at this time. When CLEC access rates are modified, the changes should be based on cost, rather than interstate rates or Qwest's intrastate rates. Otherwise, according to the Joint CLECs, changes should be based on Qwest's rates from 1999. In any event, the CLECs recommend a gradual, multi-year approach to access charge reform. Finally, the CLECs recommend the Commission set rates for terminating wireless carriers' intrastate, intraMTA calls. Cox recommends the Commission wait for the FCC to finalize its efforts to reform intercarrier compensation arguing that if the Commission moves forward and includes CLEC access rates in the proceeding, it should proceed slowly and allow CLECs to set rates that are higher than corresponding ILEC rates.

RUCO asserts there is no pressing, emergent need to modify access charges and that specific modification of charges should not be effectuated in the context of a rulemaking proceeding. Specific modification of a carrier's access charges, if any, should occur in the context of a fair value rate case proceeding. RUO urges the Commission to reject the requests for revenue neutral modifications because revenue neutrality may insulate carriers
from revenue reductions, but it does not protect customers against rate increases. Instead, if the Commission determines that modifications are in order, RUCO asserts that the changes should ensure that IXCs bear a fair measure of the cost allocation for support of the local network they utilize, and those changes, if any, be implemented gradually. RUCO asserts that the adverse impact on ratepayers who may suffer increased base rates or be required to make AUSF contributions should be mitigated by requiring the IXCs’ expanded support of the AUSF.

Before undertaking any changes to access rates, RUCO urges the Commission to investigate, in the context of a rate case, the actual costs of network services, the impact on rural ratepayers, the absence of reasonable alternatives, and ensure that carriers’ non-regulated services bear a reasonable share of the cost burden.

With regard to the AUSF, RUCO requests that if the Commission decides to make any changes to the AUSF, the changes should be competitively neutral, provide support to all carriers that maintain universal service in high cost areas identified by use of an economic cost benchmark, be based on fair criteria which are not skewed in favor of any particular technology and be portable. RUCO further asserts that AUSF support should not be granted on a dollar-for-dollar basis to ameliorate the impact of access rate reductions. The determination of the level of AUSF support should be made in the context of a rate case, and only after considering a carrier’s actual need for such funds to mitigate lost revenue from reduced access charges.

Lastly, to ensure the viability of the AUSF, the Commission should consider expanding the funds application to other telecom services which benefit from universal service including, but not limited to, interexchange service, wireless service and internet access service.
THE COMMISSION MAY NOT ALTER SPECIFIC ACCESS CHARGES WITHOUT A FAIR VALUE PROCEEDING

One of the issues in this proceeding is whether the Commission may alter the specific access rates of LECs without a fair value proceeding. As RUCO has argued consistently, the Commission may examine the general policy issues related to access charges in this rule-making proceeding, but any change to a specific LEC's access rates would require the Commission to determine the fair value of a public service corporation's rate base as part of a proceeding in which the Commission establishes its rates. If this proceeding will result in modifications to any public service companies' access charges, the requirement to determine fair value would apply. Article XV, § 14 of the Arizona Constitution requires that the Commission ascertain the fair value of utilities' property when setting rates. The Arizona Courts have recognized two exceptions to the fair value requirement: 1.) implementation of interim rates to deal with an emergency, and 2.) the adjustment of rates pursuant to an existing rate adjustor mechanism. Recently, our Supreme Court ruled that, even if the Commission believes that a determination of fair value is not useful in setting rates, the Constitution requires ascertaining fair value. Clearly, the determination of a utility's fair value is a mandatory step in establishing rates which may not be undermined or replaced by this rule-making proceeding on AUSF and Access Charges.

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7 Scales, 118 Ariz. at 535, 578 P.2d at 616.

REVENUE NEUTRAL MODIFICATIONS OF ACCESS CHARGES VIA RULEMAKING ARE NOT EXEMPT FROM THE FAIR VALUE REQUIREMENT

A revenue neutral "rebalancing" of rates occurs when rates for some services are increased, while rates for other services are decreased in an approximately equal amount. Some of the parties to this proceeding suggest that the Commission may adopt revenue neutral modifications of access charges without ratemaking as an interim measure pending institution of a rate case or as a final resolution of all matters. RUCO disagrees and asserts that revenue neutral rebalancing of access charges is not exempt from the fair value requirement. The Constitution speaks of "rates and charges" that are to be set with the assistance of a fair value determination. Art. XV, §§ 3, 14. The plain meaning of the terms "rates" and "charges" are prices customers are required to pay for particular services. 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. In light of these constitutionally-based requirements, RUCO respectfully submits that the Commission's examination of policy issues regarding access rates may not result in a change to a specific LEC's rates without company-specific proceedings in which the Commission can ascertain fair value, evaluate the degree to which the general policies determined in the first phase are suitable for the particular utility, and implement new access rates as appropriate.

REVENUE NEUTRAL MODIFICATIONS OF ACCESS CHARGES ARE UNFAIR AND UNREASONABLE TO RESIDENTIAL RATEPAYERS.

In addition to sidestepping the ratemaking process, the supporters of revenue neutral modification of access charges also ignore the resulting inequity to ratepayers. As Mr.
Johnson testified, revenue neutrality does not protect customers from rate increases.\(^9\) Instead, it merely ensures that carriers are insulated from revenue reduction.\(^10\) 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.\(^11\) Consistent with the law, equity and sound rate making principles, RUCO urges the Commission to consider these factors before approving reductions to access charges which may significantly increase residential rates, particularly in rural areas, where ratepayers are most vulnerable and least able to afford it. Moreover, RUCO urges the Commission to consider that if ratepayers are expected to bear much of the burden of access rate reductions via increases in either local or AUSF rates, then carriers must also absorb some measure of the burden through reduced profit margins or expanded participation in AUSF.

**IMMEDIATE ELIMINATION OR REDUCTION OF ACCESS CHARGES IS INCONSISTENT WITH FEDERAL LAW, FEDERAL REGULATION AND LONG TERM GOALS OF THE FCC.**

IXCs pay access charges for the origination and termination of long distance calls. As explained in the testimony of Mr. Johnson, when an end user places or receives a toll call, they

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\(^9\) See Direct Testimony of Ben Johnson, PH.D. at 16-19
\(^10\) *Id.* at 18.
\(^11\) *Id.*
typically use a phone line provided by their local exchange carrier. Although the IXC typically bills an end user for the phone call, the IXC normally pays one or more LECs for the use of network facilities which are used in processing the call. These inter-carrier billings are referred to as "switched access charges." The current system of access charges is a continuation of a cost recovery process which has existed since before the AT&T divestiture. Although this cost recovery process has undergone extensive review and modification, it continues to be an important source of revenues for the LECs, and is one of the reasons why local exchange rates remain as low as they are—particularly in rural areas.

IXCs assert that the cost of the local loop should fall exclusively upon the local exchange carriers. IXCs assert that they should not be required to pay for using these networks, or at most they should make only token payments for their use of the local networks arguing that their use of the local networks don't "cause" them to be incurred, and/or because their usage is "incidental" to the primary purpose of those networks, and/or because the costs in questions are classified as "non-traffic sensitive" while access charges and retail toll rates are both "traffic sensitive" rates, access rates should be reduced towards zero. According to the IXCs' argument, the cost of the loop, drop wire, line card, and channel connection are the incremental cost of providing local exchange service, and none of these costs can properly be considered part of the cost of providing switched access.

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12 Id. at 6
13 Id. at 6.
14 Id. at 8-9.
15 Id. at 8-9.
As Mr. Johnson testified, the IXCs' arguments fly in the face of existing law and regulation. Mr. Johnson testified that over 85 years ago, in the landmark decision, *Smith vs. Illinois Bell Telephone Company* ("Smith"), the U.S. Supreme Court provided its guidance on whether switched access rates should be greatly reduced or eliminated.\(^{16}\) Writing for the Court on the question of whether the entire cost of the access line could be charged to a single service, Chief Justice Charles Evans Hughes noted as follows:

In the method used by the Illinois Company in separating its interstate and intrastate business, for the purpose of the computations which were submitted to the court, what is called exchange property, that is, the property used at the subscriber's station and from that station to the toll switchboard, or to the toll trunk lines, was attributed entirely to the intrastate service.... While the difficulty in making an exact apportionment of the property is apparent, and extreme nicety is not required..., it is quite another matter to ignore altogether the actual uses to which the property is put. **It is obvious that, unless an apportionment is made, the intrastate service to which the exchange property is allocated will bear an undue burden.**\(^{17}\)

As exemplified by the holding in *Smith*, the law clearly requires a fair apportionment of local exchange costs between the intrastate and interstate carriers who utilize the infrastructure. It would under *Smith* be unfair and unreasonable to apportion the cost of the local exchange on the local exchange carriers and their ratepayers while holding harmless the interstate carriers who utilize and benefit from the infrastructure.

The requirement to fairly apportion costs between interstate and intrastate carriers is also reflected in federal laws. In the 1996 Telecom Act, Congress reiterated the need to properly allocate local loop costs between both.\(^{18}\) Section 254 provides in pertinent part:

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\(^{16}\) See *Smith vs. Illinois Bell Telephone Company*, 282 U.S. 150, 151 (August 1923).

\(^{17}\) Id. at 151(emphasis added).

The States, with respect to intrastate services, shall establish any necessary cost allocation rules, accounting safeguards, and guidelines to ensure that services included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services.  

Although Congress hasn't mandated the specific allocation procedures to, or specified exactly how much of the joint costs can be placed onto the basic exchange category, it is obvious that the allocation of most or all of these costs onto local exchange service as suggested by some of the parties to this proceeding, would be contrary to the intent of Congress, as indicated and set forth in Section 254(k) as well as the Smith case.

Some of the parties argue that immediate reduction of access charges is essential. In its recently issued executive summary of its proposed National Broadband Plan, the FCC does not reflect the same urgency argued by some parties. To the contrary, the FCC's goals include inter alia:

1. The goal to create the Connect America Fund to support the provision of affordable broadband and voice with at least 4Mbs actual download speeds and shift up to $15.5 billion over the next decade from the existing Universal Service Fund to support broadband.

2. To transition $4.6 billion of the “legacy” High Cost component of the USF designed to support primarily voice services to the CAF over 10 years; and

3. Reforming intercarrier compensation which provides implicit subsidies to telephone companies by eliminating per-minute charges over the next 10 years and enabling adequate cost recovery through the CAF.

19 ld.
20 See Exhibit Cox-3, Executive Summary of National Broadband Plan at XI-XIII.
21 ld.
Clearly, the FCC recognizes that the reform in intercarrier compensation (i.e. access charges and the USF) needs a transition period and will take place over at least a 10-year period of time. Given the FCC's stated goals, RUCO submits that the extreme and immediate shift of cost responsibility suggested by the IXCs would be contrary to the clear intent of the FCC's stated goals, as well as the federal case law and regulation. RUCO further asserts that the elimination or severe reduction in access charges as proposed by the IXCs would force local exchange service to bear more than a reasonable share of the joint and common costs of facilities used in providing local, access, and other services.

THE COMMISSION SHOULD CONSIDER POLICY GOALS ENUMERATED BY DR. JOHNSON IN DETERMINING ACCESS CHARGE MODIFICATIONS

RUCO asserts that in determining the need to modify access charges, the Commission should consider the overriding policy goals aimed at ensuring the availability of quality telecommunications services at the lowest possible cost, while ensuring and encouraging economic growth and technological advancement. Mr. Johnson testified that the policy goals are:

1. the preservation and promotion of affordable, high-quality, universal basic telecommunications service;
2. the maintenance of fair, just and reasonable rates or inter-customer equity;
3. the maintenance of reasonable level of rate continuity;
4. the promotion of economic efficiency, technological innovation; and
5. the encouragement of effective competition.

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22 See Direct Testimony of Ben Johnson, PH.D. at 15.
23 Id. at 15-29.
Mr. Johnson further testified that in considering these policy goals, the Commission should not seek to achieve one of the goals to the exclusion of all others, but that caution and moderation should guide the Commission's analysis. He testified, and RUCO recommends, that goals of economic efficiency should not take precedence over consideration of rate continuity and avoidance of disruptive rate changes.

CONCLUSION

Based on the foregoing, and mindful of the policy goals identified by Dr. Johnson, RUCO makes the following specific recommendations:

1. 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. Many of the proposals offered by other parties would allow toll and switched access customers to avoid paying a reasonable share of the fixed costs of the local exchange networks which make these services possible. This is fundamentally unfair to local exchange customers. Proposals which go too far in shifting the cost burden away from AT&T, Verizon and the other interexchange carriers should be rejected.

2. Drastic rate increases should not be imposed on ratepayers—particularly those living in rural areas, who do not have adequate alternatives.

3. To the extent the Commission is persuaded to move forward with changes to switched access charges, the Commission should take care to ensure that individual customers are not affected excessively. The Commission should not look at overall average impacts—it should consider the impact on customers in specific locations,
and those who use relatively little toll service (and thus will gain little benefit from any
toll rate reductions that may result from access charge reform).

4. While rate continuity does not preclude rate change, the changes should be
implemented gradually and be well justified. More specifically, the Commission
should consider phasing in changes to cost allocations, or reductions to switched
access rates, to ameliorate the adverse impact on ratepayers who will be forced to
pay higher local rates, or make increased payments into the AUSF.

5. While the proposal of revenue neutrality put forth by many of the participants to this
proceeding appears palatable, it isn’t an adequate basis for developing access
reform. Revenue neutrality does not protect customers from rate increases; instead,
it merely ensures that carriers are insulated from revenue reductions. It results in
rates that are unfair and unreasonable. Consistent with equity and sound
ratemaking principals, if ratepayers are to be expected to bear much of the burden of
access rate reductions via increases in the AUSF or increased local rates, then
carriers must also absorb some measure of the burden through reduced profit
margins or expanded participation in AUSF.

6. The Commission should carefully investigate the facts before approving increases to
the price of basic local service. Although this Commission does not have jurisdiction
over the rates charged for unregulated ancillary services like broadband internet,
video service and wireless service, it does have authority and a Constitutional
obligation to ensure that local rates are set at fair and reasonable levels, consistent
with reasonable cost allocation principles. Interstate access and other unregulated
services use a lot of the same network facilities that are used in providing basic local
exchange service, and these unregulated services should bear a reasonable share of the costs of the shared network facilities. Broadband internet and other unregulated services have been growing rapidly; this growth has financially benefited the carriers who provide these services over many of the same network facilities that are used in providing basic local exchange service. Yet there has been very little information provided in this proceeding concerning this subject, or the extent to which these growing services are being allocated an appropriate share of the common network costs.

7. Basic local telephone service should not bear an excessive share of the fixed network costs—either directly through higher local rates in rural areas, or indirectly through higher payments into the AUSF. While it is appropriate for the Commission to consider the possibility of making some reductions to intrastate switched access rates, the Commission should not assume that any such reductions must be offset by increases of exactly the same magnitude through changes to the AUSF or local rates—particularly when these carriers have been experiencing growing revenues from internet access and other unregulated services, which can and should bear a reasonable share of the cost burdens in question.

8. To best support the interest of universal service, any increase in AUSF funding should be tightly targeted at carriers serving customers in the highest cost portions of the state. AUSF payments should be competitively neutral, providing support to all carriers that are helping to maintain universal service in these high cost areas, based upon appropriate criteria which are not skewed in favor of any particular type of carrier or technology. AUSF should be portable to promote effective competition.
9. To better identify high cost areas, for AUSF purposes, the Commission should choose an economic cost benchmark. This is far superior to reliance on embedded cost calculations, and also preferable to a revenue benchmark (which would be the second best choice). The economic cost benchmark should be based on a percentage which exceeds the statewide average by some defined percentage, thereby concentrating support on areas with the highest costs.

10. Before considering expansion of AUSF funding, the Commission should look at the beneficial effects of declining costs and growing use of the carriers' network facilities in providing internet access and other non-jurisdictional services.

11. If the Commission determines to utilize the AUSF as a source of replacement funds to ameliorate the impact of access rate reductions, carriers should not automatically receive a dollar for dollar offset of lost revenue. Carriers should have to demonstrate a need for replacement revenues from the AUSF—preferably under the auspices of a fair value rate case proceeding, in which appropriate cost allocations and other revenue sources are considered.

12. Last, the Commission should look at the options for expanding the revenue base used in the AUSF funding process to include additional carriers, to determine the magnitude of each carrier's contributions into the fund by taking into consideration additional telecom services which benefit from universal service including, but not limited to interexchange service, wireless service, and internet access service.
RESPECTFULLY SUBMITTED this 9th day of July, 2010.

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