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

BEFORE THE ARIZONA CORPORATION COMMISSION

KRISTIN K. MAYES
CHAIRMAN

GARY PIERCE
COMMISSIONER

SANDRA D. KENNEDY
COMMISSIONER

PAUL NEWMAN
COMMISSIONER

BOB STUMP
COMMISSIONER

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

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

Docket No. RT-00000H-97-0137

Docket No. T-00000D-00-0672

RUCO’S REPLY BRIEF

The Residential Utility Consumer Office (“RURO”) hereby files its Reply Brief in the above-referenced matter.

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

Several parties have suggested that the Commission may adopt specific amendments and changes to R14-2-1101 et seq. and R14-2-1201 et seq. in this proceeding. RURO disagrees. The Commission’s rulemaking authority is exempt from the Governor’s Regulatory Review Counsel (“GRRC”), but must comply substantially with the rulemaking procedures of the GRRC. See ARS § 41-1057(2). GRRC’s procedures require, and the Commission’s past practice has been to require notice of specific proposed rules to the public along with an
economic impact statement and a statement of effect of the rules on small business.\textsuperscript{1} Id. 

RU CO respectfully submits that this docket is not a substitute for that process. The Commission has not proposed specific rules in this docket to which the public had notice and opportunity to be heard. Nor has the record been sufficiently developed to identify the economic impact on the public or small businesses. Although the Commission may examine general policies relevant to access charges and the AUSF, to complete the rulemaking process, RU CO submits that the Commission will need to notice proposed rules, provide the supporting impact statements, and provide a notice and opportunity to additional public comment pursuant to the requirements of ARS § 41-1057(2).

2. MODIFICATION OF THE SPECIFIC RATES OF UTILITIES REQUIRES A RATE-MAKING PROCEEDING.

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

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

\textsuperscript{2} U.S. West Communications v. Ariz. Corp. Comm'n, 201 Ariz. 242, 245, 34 P.3d 351 (2001) (holding for CLECs are public service corporations and therefore subject to the "fair value" requirement in Sec. 14 of the Constitution, but "fair value" may be used in conjunction with other information in determining rates of a competitive environment).
The Commission may examine the general policy issues related to access charges in this rulemaking proceeding, but any change to a specific Local Exchange Carriers’ ("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 company's access charges or pass through AUSF surcharges, the constitutional 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. Our Supreme Court has 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 rulemaking docket proceeding on AUSF and Access Charges. Accordingly, RU CO has not submitted proposed rule changes herein, but restricts itself to a discussion of the policy considerations related to any subsequent rulemaking.

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

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

4 Scares, 118 Ariz. at 535, 578 P.2d at 616.
maximum annual price increase. AT&T also recommends capping CLEC rates at ILEC levels. AT&T further 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 also recommends setting LEC access rates at interstate levels but recommends a rule change prohibiting ILECs from recovering lost revenue from rate increases or additional AUSF support.

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

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

Again, with the exception of the CLECs, Cox and RURO, the other parties’ proposals require immediate reduction of switched access rates and ignore the “fair value” and

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6 Rebuttal Testimony of Debra Aron at 79.
7 Sprint asserts that the lowering of switched access rates in New Jersey and Massachusetts demonstrates that switched access rates are no longer needed to support high cost loop. High cost loop supported by switched access rates may not be necessary in New Jersey and Massachusettts due to their population densities which according to the U.S.Census exceed 500 people/sq.mile. See U.S. Census Population Density Map attached as Exhibit A. In contrast, Arizona has a reported population density of less than 86 people per sq. mile. Id. Accordingly, the Commission should not rely on the public utility decisions of the New Jersey and Massachusetts Commissions.
rulemaking requirements imposed by the Constitution and statutes. For all of the reasons set forth in section 2 above, RU CO asserts that a reduction in switched access rates and any corresponding increases to rates or AUSF surcharges need to begin with a “fair value” determination in a rate case.

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

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.\(^8\)

The long-standing holding clearly dictates that the long distance carriers not only contribute to the local loop costs, but also other joint and common costs.\(^9\)

\(^8\) Smith vs. Illinois Bell Telephone Company, 282 U.S. 150, 151 (August 1923).

\(^9\) Rejoinder Testimony of Ben Johnson at 10-13.
When it adopted the 1996 Telecommunications Act, Congress added an entirely new section to federal law dealing with universal service—Section 254. Within this context, a portion of §254(k) reads:

[T]he 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.\(^\text{10}\)

As Mr. Johnson points out in his testimony, Congress was aware of the long-standing debate over the proper treatment of these costs, and the desire of many carriers to shift these costs from toll to local services, as well as the propensity of monopolists to attempt to shift costs onto their most captive customers when faced with an increased threat of competition.\(^\text{11}\)

The remaining parts of 254(k) make it clear that the purpose behind these provisions is to prevent placing an excess cost burden on basic local service and other services included within the universal service category. Id. While Congress hasn't mandated the specific allocation procedures to be used, or specified exactly how much of the joint costs can be placed onto the basic exchange category, it is obvious that 100% allocation of these costs onto local exchange service would be contrary to the intent of this passage. Id. Such an extreme shift of cost responsibility 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.

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

\(^{11}\) Direct Testimony of Ben Johnson at 10.
networks without paying much, if any, of the joint and common costs. Id. RUCO acknowledges that wireless carriers have been successful in persuading the FCC to allow them access to local networks without paying much, if any, of the joint and common costs of the network. Id. Likewise, the interexchange carriers have persuaded the FCC to greatly reduce per-minute interstate access charges, and to adopt various other policies that have the effect of shifting costs onto local customers. Id. While the FCC has been persuaded by the arguments of the interexchange and wireless carriers with regard to interstate rates, the Commission should resist reducing intrastate access charges without first carefully contemplating and planning its impact on the AUSF which is funded in part by surcharges based on intrastate toll revenues. Id.

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

AT&T and other long distance carriers assert they will pass reduced access charges on to ratepayers. The question is which ratepayers? If reductions were passed on to ratepayers, does that mean Arizona ratepayers who pay for the local loop would receive the benefit? Moreover, to the extent that an Arizona provider says it will reduce rates to Arizona ratepayers, how will Staff or the Commission monitor the issue? Even if the Commission could mandate reductions in long distance tariffs, is there any question that Arizona ratepayers will pay more? AT&T, Verizon and Sprint sell bundled long distance services, the carriers can simply make up for revenue reductions by increasing the cost of other non-regulated services.
Moreover, with the exception of CLECs, Cox and RUCO, the other parties’ proposals ignore the need to examine the specific costs associated with providing switched access. In considering the appropriate level of switched access rates, the CLECs argue the switched access charges should be premised on actual costs. RUCO generally agrees that actual costs should be used in developing an appropriate switched access rate. RUCO would agree, as Mr. Johnson testified, that for small carriers like the CLECs a generic economic cost study of a typical CLEC’s costs would be sufficient. However, RUCO believes that the examination of costs in all instances should not be restricted to the IXC’s direct costs. Consistent with applicable case law, RUCO believes switched access charges should cover the cost of the local loop and other joint and common costs. RUCO also urges the Commission to consider the proper allocation of costs between regulated and unregulated services of the affected carriers.

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

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

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

14 Rejoinder testimony of Ben Johnson at 10-11.
other unregulated traffic. Because telecom utilities have the ability to use local network facilities for voice and data purposes, the “real” cost of voice traffic may be greatly reduced, and that reduction may not be fully reflected in the cost data reported for intrastate regulatory purposes.

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

\[T\]he FCC has prescribed elaborate rules for allocating incumbent LEC’s accounting costs between regulated and unregulated activities. 20 CFR 64. ALECA’s member companies participating in these proceedings, all comply with FCC rules. Therefore all nonregulated activities of the ALECA members have already been removed and should not be a factor in this proceeding.\footnote{Rebuttal Testimony of Donald Meredith at 11.}

The Commission should not assume that the FCC’s rules are adequate to deal with the issues that are relevant to intrastate switched access reform.\footnote{Rejoinder Testimony of Ben Johnson at 20-22.} The Commission may examine the appropriate allocation of costs for intrastate switched access reform in the context of a fair value analysis. For the Commission to assume, as ALECA suggests, that all matters are resolved by a vague avowal that costs of data traffic has been appropriately allocated would be abdicating its responsibility to ensure the proper allocation of costs. As Mr. Johnson testified, a cavalier dismissal of this important issue is particularly inappropriate when coupled with the ALECA members' opposition to any form of rate case or regulatory review of their existing earnings. Moreover, Congress does not expect states to abdicate their responsibility to determine intrastate switched access rates. The Commission should, in compliance with the applicable law and Constitutional mandates, examine actual cost of switched access attributable to voice traffic and that attributable to nonregulated traffic.
Recently, the FCC has issued “Connecting America: the National Broadband Plan.”\(^ {17} \)
The Plan includes a 10-year framework for long-term intercarrier compensation reform and interim measures to curb arbitrage.\(^ {18} \) Id. at 144. The first stage of the Plan is to be completed in 2010 and 2011. Id. The second stage of the Plan includes modification of carriers’ intrastate terminating switched access rates to interstate terminating switched rates over a period of two to four years between 2010 to 2016. Id. The Plan then calls for phasing out all per minute rates by 2020. Id. Clearly, federal mandates are going to impact any proposal that the Commission may come up with in this docket. In the interest of simplicity and continuity, and in the absence of any pressing or urgent need to modify its rules or hold costly and time consuming rate cases, RUCO urges the Commission to delay any interim changes through this docket which might be nullified or modified by recently announced federal mandates. RUCO is not arguing a delay until 2020. RUCO urges, as do CLECs, Cox and Aleca, that it may be advisable to wait until the FCC rulemaking related to the National Broadband Plan is finalized.

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

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

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

\(^ {17} \) Exhibit 8-F “The Roadmap for USF/ICC Reform.”
\(^ {18} \) RUCO submits that arbitrage will not be eliminated as long as there is any difference between interstate and intrastate access rates. To the extent arbitrage persists, RUCO suggests that a better resolution might be to establish statewide calling scope for local service. T: 77.
cause customers to drop their wireline phone and to not subscribe instead to cable telephony, wireless, or some other form of telephony, would retail rate increases possibly impact goals of universal service.

Nevertheless, it is certainly reasonable to advise the Commission to “think through the consequences” of reducing access rates and develop a plan to minimize any potential adverse consequences.¹⁹

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

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

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¹⁹ Reply Testimony of Debra Aron at 78.
²⁰ Rejoinder Testimony of Ben Johnson at 6-9.
The parties proposing immediate reductions in switched access rates also ignore the issue of the pricing and affordability of the alternatives. As Dr. Johnson testified there are significant differences in the way these services are priced. Id. at 8. He testified that wireless and VoIP services typically are provided as a package offering which includes various enhanced services and long distance services. Id.

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

RUCO asserts that the proposals to immediately reduce switched access also ignore call quality when comparing wireline service to wireless and VoIP service. Wireline services typically provide higher quality, more reliable communication than wireless or VoIP services. Id. Calls placed over land lines are typically dropped less often than calls placed over wireless facilities. Id. Further, land line calls are less subject to weather interference; structural interference; congestion problems; cross talk and their static, noise, fading, and other aspects of poor sound reproduction. Id. Although wireless service offers the advantage of greater mobility, it does not serve as a close substitute for wireline consumers, particularly those in rural high cost loop areas, who care about having consistently accurate, noise-free sound
reproduction. Given a choice between pulling a cell phone out of their pocket or walking across
the room to use a conventional phone, consumers will often choose the latter option because
of these differences in sound quality and reliability.

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

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

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

21 Rejoinder Testimony of Ben Johnson at 18-20.
22 T: 78-80.
inefficiency. As pointed out by Mr. Johnson, if the AUSF guaranteed an incumbent LEC with a poorly designed high cost support system a 100% recovery of their “actual” costs--no matter how high--the Commission would simply be preserving the incumbent LEC’s ability to operate poorly. Allowing incumbent LECs to indefinitely preserve any excess profits they may currently be generating without regard to efficiency, would simply promote and attenuate inefficiently operated high cost systems. Id. Clearly, a properly designed AUSF should not guarantee these firms will continue to receive their existing level of revenues and profits, regardless of how high their current profits, or how little effort they make to control their costs.

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

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

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

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23 Rejoinder Testimony of Ben Johnson 18-20.
1 potential entry may be an important force pressuring these firms to control their costs, and take
2 full advantage of favorable technological trends, thereby ensuring that the AUSF does not
3 place an undue burden on urban customers. Id. RUCO recommends the Commission adopt a
4 properly designed AUSF that is competitively neutral and does not insulate incumbent LECs
5 from the pressures that encourage a typical competitive firm to operate as efficiently as
6 possible.

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

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

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

24 Rejoinder Testimony of Ben Johnson 20-22.
costs to internet access and other non-regulated services. Id. at 21. However, if the Commission were to conclude that individual rate proceedings would impose too large an administrative burden, and are not legally required, then it should at least probe into these issues in the context of a future phase of this proceeding, after collecting detailed accounting information from the carriers and providing an ample opportunity for the parties to conduct detailed discovery of that information. A detailed, carrier-specific fact finding investigation is needed to ensure that urban customers are not required to make higher than necessary payments into the AUSF. As part of this on-going investigation, the Commission should look closely at the appropriate allocation of loop costs between voice, internet and other unregulated services. The Commission should also consider the LECs’ financial strength and revenues from unregulated services when determining a carrier’s ability to absorb reductions in switched access revenue. RU CO is not recommending that the Commission capture the benefit of interstate or unregulated revenues. RU CO is recommending the Commission ensure that a fair and equitable amount of the allocated costs are attributed to the interstate and other unregulated services which benefit from universal service. More succinctly, local basic exchange rates must be based on a reasonable share of the joint and common costs of facilities use to provide other services.

8. EXPANSION OF THE AUSF SHOULD PRECEDE THE REDUCTION OF ACCESS CHARGES.

AT&T argues that access charges are not an effective tool for recovering a portion of network costs and that they should be eliminated by rules adopted through this proceeding.

AT&T’s witness, Debra Aron states:
[Access revenues] create a self-reinforcing downward spiral of support for LECs because high access rates force wireline long distance rates up, which makes wireline long distance service less competitive relative to wireless and other technologies that do not pay access rates to the same extent as do wireline IXCs, or do not pay them at all; customers migrate from wireline to other forms of long distance communication; and access revenues dry up for the LECs that they historically supported.27

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

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

27 Rebuttal Testimony of Debra Aron at 80-81.
9. IXCs SHOULD NOT BE ALLOWED TO USE MARKET POWER TO FORCE LECs TO
ACCEPT LESS THAN TARRIFFED RATES

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

CONCLUSION

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

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

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29 R-4 OrbitCom's response to RUCO DR 1.05.
30 T: 59-61.
If the Commission determines that switched access reform is necessary, then changes to the AUSF will be necessary. RUCO recommends expanding the AUSF to include other carriers who benefit from universal service, including, but not limited to interexchange, wireless and internet access providers. These changes should be considered before lowering switched access rates to avoid drastic impacts on the rates of residential wireline customers. Moreover, recovery from the AUSF should be limited to highest cost loop providers with a demonstrated need based on actual costs. If determination of actual costs is not possible, then the Commission should limit recovery based on an economic cost benchmark, as opposed to an embedded cost calculation. 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. The AUSF support should be portable and competitively neutral.

The Commission should reject the notion of revenue neutrality. Although it may appear palatable at first blush, 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. Consistent with equity and sound ratemaking principles, if ratepayers are expected to bear some burden of access rate reductions via increases in the AUSF or increased local rates, then carriers should also absorb some of the loss of switched access revenue by reduced profit margins or expanded participation in the AUSF.

If switched access reform is contemplated, the Commission should consider the overriding policy goals identified in the testimony of Ben Johnson, including *inter alia*, affordable, high-quality universal basic telecommunications service, fair, just and reasonable rates, including inter-customer equity, rate continuity, economic efficiency and effective
competition. Switched access rates should be based on cost of local loop and other joint and common costs, not just direct costs. The determination of just and reasonable rates should include an examination of how costs are allocated between voice, data and other unregulated traffic. Arizona wireline customers should not bear all of the costs of the local loop while holding wireless, unregulated data providers and long distance carriers harmless. In deference to the goal of gradualism, the Commission should consider phasing in changes to cost allocation 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 to the AUSF.

RESPECTFULLY SUBMITTED this 14\textsuperscript{th} day of September, 2010.

Michelle L. Wood
Counsel

AN ORIGINAL AND THIRTEEN COPIES of the foregoing filed this 14\textsuperscript{th} day of September, 2010 with:

Docket Control
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

COPIES of the foregoing hand delivered/mailed this 14\textsuperscript{th} day of September, 2010 to:

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

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

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

Jeffrey W. Crockett
Bradley S. Carroll
Snell & Wilmer, L.L.P.
One Arizona Center
Phoenix, Arizona 85004-2202
<table>
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<tr>
<th></th>
<th>Name</th>
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<tr>
<td>1</td>
<td>William J. Hayes, General Manager</td>
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<td>2</td>
<td>Nathan Glazier</td>
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</table>
1 Thomas W. Bade
   Arizona Dialtone
   6115 South Kyrene Road, #103
   Tempe, Arizona 85283

2 Craig A. Marks
   Craig A. Marks, PLC
   10645 N. Tatum Blvd.
   Suite 200-676
   Phoenix, AZ 85028

3 William Haas
   McLeodUSA Telecommunications
   6400 SW C Street
   P. O. Box 3177
   Cedar Rapids, Iowa 52406-3177

4 Brad VanLeur
   Orbitcom, Inc.
   1701 N. Louise Ave.
   Sioux Falls, South Dakota 57107

5 Charles H. Carrathers, III
   General Counsel
   Verizon, Inc.
   HQE03H52
   600 Hidden Ridge
   Irving, Texas 75015-2092

6 Rex Knowles
   XO Communications, Inc.
   111 E. Broadway, Suite 1000
   Salt Lake City, Utah 84111

7 Lyndall Nipps
   TW Telecom
   845 Camino Sur
   Palm Springs, CA 92262

8 Scott S. Wakefield
   Ridenour, Hienton & Lewis, PLLC
   Chase Tower
   201 North Central Avenue, Suite 3300
   Phoenix, Arizona 85004-1052

-22-
EXHIBIT A