Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Access Charge Reform	)	CC Docket No. 96-262
	)	
Price Cap Performance Review for Local Exchange Carriers	)	CC Docket No. 94-1
	)	
	)	
Transport Rate Structure and Pricing	)	CC Docket No. 91-213
	)	
	)	
End User Common Line Charges	)	CC Docket No. 95-72
	)	

FIRST REPORT AND ORDER

Adopted: May 7, 1997 **Released:** May 16, 1997

Comment Date: June 26, 1997
Reply Date: July 11, 1997

By the Commission: Commissioners Quello, Ness, and Chong issuing separate statements.

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I.
INTRODUCTION

1. In passing the Telecommunications Act of 1996 (the 1996 Act),[1] Congress sought to establish "a pro-competitive, deregulatory national policy framework" for the United States' telecommunications industry. With this Order, we begin the third part in a trilogy of actions collectively intended to foster and accelerate the introduction of competition into all telecommunications markets, pursuant to the mandate of the 1996 Act.

2. In the *Local Competition Order*,[2] we set forth rules to implement section 251 and section 252 of the Communications Act of 1934, as amended. As with all of Part II of Title II of the Communications Act, those sections, and the rules implementing them, seek to remove the legal, regulatory, economic, and operational barriers to telecommunications competition. Among other things, sections 251 and 252 provide entrants with the opportunity to compete for consumers in local markets by either constructing new facilities, leasing unbundled network elements, or reselling telecommunication services.

3. In the *Universal Service Order*,[3] which we adopt in a companion order today, we take steps to ensure that support mechanisms that are necessary to maintain local rates at affordable levels are protected and advanced as local telecommunication markets become subject to the competitive pressures unleashed by the 1996 Act. When it enacted section 254 of the Communications Act, Congress detailed the principles that must guide this effort. It placed on the Commission and the states the duty to implement these principles in a manner consistent with the pro-competition purposes of the Act, as embodied in, for instance, the interconnection provisions of the Act.[4] It stated that "[t]here should be specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service."[5]

4. Congress also specified that universal service support "should be explicit," and that, with respect to federal universal service support, "[e]very telecommunications carrier that

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[1] Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (codified at 47 U.S.C. §§ 151 *et. seq.*) (1996 Act).

[2] Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, CC Docket No. 96-98, First Report and Order, 11 FCC Rcd 15499 (1996) (*Local Competition Order*), Order on Reconsideration, CC Docket No. 96-98, 11 FCC Rcd 13042 (1996), *petition for review pending and partial stay granted, sub nom.* Iowa Utils. Bd. v. FCC, 109 F.3d 418 (8th Cir. 1996).

[3] Federal-State Board on Universal Service, CC Docket No. 96-45, First Report and Order, FCC 97-157 (rel. May 8, 1997) (*Universal Service Order*).

[4] *See* 47 U.S.C. §§ 251-252.

[5] 47 U.S.C. § 254(b)(5).

provides interstate telecommunications services shall contribute, on an equitable and non-discriminatory basis, to the specific, predictable, and sufficient mechanisms established by the Commission to preserve and advance universal service."[6] As explained further in the Joint Explanatory Statement of the Committee of the Conference, Congress intended that, "[t]o the extent possible, . . . any support mechanisms continued or created under new section 254 should be explicit, rather than implicit as many support mechanisms are today."[7] Congress directed the Commission, by May 8, 1997, to complete a universal service proceeding that "include[s] a definition of the services that are supported by Federal universal service support mechanisms and a specific timetable for implementation."[8]

5. Through our accompanying *Universal Service Order*, we establish the definition of services to be supported by federal universal service support mechanisms and the specific timetable for implementation. Further, through this *First Report and Order* in our access reform docket and our *Universal Service Order*, we set in place rules that will identify and convert existing federal universal service support in the interstate high cost fund, the dial equipment minutes (DEM) weighting program, Long Term Support, Lifeline, Link-up, and interstate access charges to explicit federal universal service support mechanisms. As detailed below, we will identify the implicit federal universal service support currently contained in interstate access charges through three methods.

6. First, we will reduce usage-sensitive interstate access charges by phasing out local loop and other non-traffic-sensitive (NTS) costs from those charges and directing incumbent local exchange carriers (LECs) to recover those NTS costs through more economically efficient, flat-rated charges. Because NTS costs, by definition, do not vary with usage, the recovery of NTS costs on a usage basis pursuant to our current access charge rules amounts to an implicit subsidy from high-volume users of interstate toll services to low-volume users of interstate long-distance services.

7. Second, we will rely in part on emerging competition in local telecommunications markets, spurred by the adoption of the 1996 Act, to help identify the differences between the rates for interstate access services established by incumbent LECs under price cap regulation and those that competition would set. The prices for interstate access services offered by competing providers presumably will not contain any implicit universal service support such as that embedded in the incumbent LECs' access charges. Consequently, the introduction of competition inevitably will help to remove implicit support from the incumbent LECs' access charges where competition develops and also will help to identify the extent of implicit support in other areas.

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[6] 47 U.S.C. § 254(d)-(e).

[7] Joint Explanatory Statement of the Committee of the Conference, S. CONF. REP. NO. 230, 104th Cong., 2d Sess. 131 (1996) (Joint Explanatory Statement).

[8] 47 U.S.C. § 254(a)(2).

8. Third, we will engage in further deliberations on a forward-looking economic cost-based mechanism that we will use to distribute federal support to rural, insular, and high cost areas, beginning in 1999. Based on cost studies the states will conduct during the coming year (or, at a state's election, based upon Commission-developed proxy methods), an estimate of the forward-looking economic cost of providing service to a customer in a particular rural, insular, or high cost area will be calculated. We will distribute federal universal service support based on the interstate portion of the difference between forward-looking economic cost and a nationwide revenue benchmark. The amount of the support will be explicitly calculable and identifiable by competing carriers, and the support will be portable among competing carriers, *i.e.*, distributed to the eligible telecommunications carrier chosen by the customer. It will be funded by equitable and non-discriminatory contributions from all carriers that provide interstate telecommunications services. Through this *First Report and Order*, we direct that federal universal service support received by incumbent LECs be used to reduce or satisfy the interstate revenue requirement otherwise collected through interstate access charges. Accordingly, through both our *Universal Service Order* and this *First Report and Order* on access reform, interstate implicit support for universal service will be identified and removed from interstate access charges, and support will be provided through the explicit interstate universal service support mechanisms.

9. Although these three steps will set in motion a process that will remove implicit universal service support from access charges, it will not remove all implicit support from all access charges immediately. This result is fully in accord with Congress's directives. Although Congress said in the Act that "support *should be* explicit" (emphasis added), it did not provide that support *shall be* explicit.[9] Congress's decision to say "should" instead of "shall" is especially pertinent in light of Congress's repeated use of "shall" in the 1996 Act.[10] Moreover, in the Act's legislative history, Congress qualified its intention that "support mechanisms should be explicit, rather than implicit," with the phrase "[t]o the extent possible."[11] Thus, Congress recognized that the conversion of the existing web of implicit subsidies to a system of explicit support would be a difficult task that probably could not be accomplished immediately. As explained below, we conclude that a process that eliminates implicit subsidies from access charges over time is warranted primarily for three reasons. First, we simply do not have the tools to identify the existing subsidies precisely at this time. Second, we prefer to rely on the market rather than regulation to identify implicit support because we are more confident of the market's ability to do so accurately. Third, even if we were more confident of our ability to identify all of the existing implicit support mechanisms at this time, eliminating them all at once might have an inequitable impact on the incumbent local exchange carriers.

10. Nor, by our orders today, do we attempt to identify or eliminate the implicit universal

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[9] 47 U.S.C. § 254(e).

[10] *See* Joseph Farrell, *Creating Local Competition*, 49 Fed. Comm. L.J. 201, 211 (1996) ("shall" appears 2,036 times in 1996 Act, according to staff analysis).

[11] Joint Explanatory Statement at 131.

service support mechanisms established by state commissions. We recognize that states are initially responsible for identifying implicit intrastate subsidies. For the reasons stated above, we believe the Commission has discretion under the statute to employ pro-competitive, deregulatory policies to aid in the reform of the existing, complex system of universal service. Where pro-competition policies, such as those set forth in sections 251, 252 and 253, can force prices for telecommunications services to competitive levels, and, as a result, eliminate or, at least, substantially eliminate implicit support, the Act grants us the authority to rely on such policies over a period of time. We find that the Act does not require, nor did Congress intend, that we immediately institute a vast set of wide-ranging pricing rules applicable to interstate and intrastate services provided by incumbent LECs that would have enormously disruptive effects on both ratepayers as well as the affected LECs. Indeed, the congressional mandate that we implement pro-competitive, deregulatory policies is a continuing reminder that, wherever feasible, we should select competition instead of regulation as our means of accomplishing the stated statutory goals. Reliance on competition is the keystone that unifies our universal service and access reform orders.

11. Nevertheless, implicit intrastate universal service support is substantial. States have maintained low residential basic service rates through, among other things, a combination of: geographic rate averaging, high rates for business customers, high intrastate access rates, high rates for intrastate toll service, and high rates for vertical features and services such as call waiting and call forwarding. By not mandating immediate Commission action to eliminate these policies and instead by ordering that the Commission and the states together achieve universal service goals,[12] Congress intended that states, acting pursuant to sections 254(f) of the Communications Act, must in the first instance be responsible for identifying intrastate implicit universal service support. Indeed, by our decisions in this Order and in our companion *Universal Service Order*, we strongly encourage states to take such steps.

12. To achieve the vital, historic, and congressionally-mandated purposes of universal service in every state in an era in which competition replaces monopoly, it is necessary that the states and the Commission develop new and effective mechanisms of complementing the activities of each other. Therefore, as states implement their universal service plans, we will be able to assess whether additional federal universal service support is necessary to ensure that quality services remain "available at just, reasonable, and affordable rates."[13] Our decisions in this Order are meant in part to provide some elements of the plan and time sufficient to discharge responsibly an aspect of the federal role in this federal-state universal service partnership.

13. In this *First Report and Order*, we also take the actions necessary to permit the market, in the first instance, to expose any implicit universal service support that we may fail to identify as we implement our federal mechanisms for supporting universal service in insular, rural,

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[12] *See* 47 U.S.C. § 254.

[13] 47 U.S.C. § 254(b)(1).

and high cost areas and to drive access rates toward levels that competition would be expected to produce. Our decision also fulfills the congressional intent that we eliminate the rules that have helped to sustain *de facto* or *de jure* monopolies in access markets and instead create the conditions for competitive entry on a sustainable, long-term basis. That requires, among other things, that we phase out opportunities for inefficient entry that are created primarily by anomalies in the current, monopoly-oriented regime. Consequently, this Order sets forth a plan for removing distortions and inefficiencies in both the current "rate structures" (the term used to describe the manner in which a particular charge is assessed, such as through a per-minute-of-use fee or a flat-rated fee) and "rate levels" (the term used to describe the aggregate size of a particular access charge). By rationalizing the access charge rate structure, we ensure that charges more accurately reflect the manner in which the costs are incurred, thereby facilitating the movement to a competitive market. We also establish, in this *First Report and Order*, a prescriptive mechanism to ensure that, through the operation of price caps and by other means, interstate access charges in areas where competition does not develop will also be driven toward the levels that competition would be expected to produce. The *Price Cap Fourth Report and Order*,[14] which is also the Second Report and Order in this docket and which is also adopted today, modifies the X-Factor in accordance with this plan.

14. In a subsequent order in the present docket, we will provide detailed rules for implementing the market-based approach that we adopt in today's Order. That process will give carriers progressively greater flexibility in setting rates as competition develops, gradually replacing regulation with competition as the primary means of setting prices and facilitating investment decisions. A separate order in this docket will also address "historical cost" recovery: whether and to what extent carriers should receive compensation for the recovery of the allocated costs of past investments if competitive market conditions prevent them from recovering such costs in their charges for interstate access services.

15. By our orders today, we reject the arguments made by some parties that section 254 compels us immediately to remove all universal service costs from interstate access charges.[15] Making "implicit" universal service subsidies "explicit" "to the extent possible" means that we have authority at our discretion to craft a phased-in plan that relies in part on prescription and in part on competition to eliminate subsidies in the prices for various products sold in the market for telecommunications services. Moreover, we have met section 254's clear command that we identify the services to be supported by federal universal service support mechanisms and that we establish a specific timetable for implementation. Under that timetable, we will over the next year identify implicit interstate universal support and make that support explicit, as further provided by

[14] Price Cap Performance Review for Local Exchange Carriers, Fourth Report and Order in CC Docket No. 94-1, and Access Charge Reform, Second Report and Order in CC Docket No. 96-262, FCC 97-159 (adopted May 7, 1997) (*Price Cap Fourth Report and Order*).

[15] *See* Appendix B, Section IV.A.

section 254(e).[16]

16. Coupled with the modifications implemented in our *Universal Service Order*, the changes we put in place today will provide far-reaching benefits to the American people. This Order will restructure access charges, resulting in lower long-distance rates for many consumers, while substantially increasing the volume of long-distance calling. It will promote the spread of competition by replacing significant implicit subsidies with an explicit and secure universal service support system. It will foster competition and economic prosperity by creating an access charge system that is both efficient and fair. We believe that the changes implemented by this Order are necessary to meet the goal set forth in the 1996 Act -- "opening all telecommunications markets to competition."[17]

A. Background

1. The Existing Rate System

17. For much of this century, most telephone subscribers obtained both local and long-distance services from the same company, the pre-divestiture Bell System, owned and operated by AT&T. Its provision of local and intrastate long-distance services through its wholly-owned operating companies was regulated by state commissions. The Commission regulated AT&T's provision of interstate long-distance service. Much of the telephone plant that is used to provide local telephone service (such as the local loop, the line that connects a subscriber's telephone to the telephone company's switch) is also needed to originate and terminate interstate long-distance calls. Consequently, a portion of the costs of this common plant historically was assigned to the interstate jurisdiction and recovered through the rates that AT&T charged for interstate long-distance calls. The balance of the costs of the common plant was assigned to the intrastate jurisdiction and recovered through the charges administered by the state commissions for intrastate services. The system of allocating costs between the interstate and intrastate jurisdictions is known as the separations process. The difficulties inherent in allocating the costs of facilities that are used for multiple services between the two jurisdictions are discussed below.

18. At first, there was no formal system of tariffed charges to determine how the BOCs and the hundreds of unaffiliated, independent LECs would recover the costs allocated to the interstate jurisdiction by the separations rules. Instead, AT&T remitted to these companies the amounts necessary to recover their allocated interstate costs, including a return on allocated capital investment.

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[16] As with any implicit support mechanism, universal service costs are presently intermingled with all other costs, including the forward-looking economic costs of interstate access and any historic costs associated with the provision of interstate access services. We cannot remove universal service costs from interstate access charges until we can identify those costs, which we will not be able to do even for non-rural LECs before January 1, 1999.

[17] Joint Explanatory Statement at 1.

19. In the 1970s, MCI and other interexchange carriers (IXCs) began to provide switched long-distance service in competition with AT&T. However, AT&T still maintained monopolies in the local markets served by its local subsidiaries, the Bell Operating Companies (BOCs). The BOCs owned and operated the telephone wires that connected the customers in their local markets. Other independent (non-Bell) LECs held similar monopoly franchises in their local service areas. MCI and the other IXCs were dependent on the BOCs and the independent LECs to complete the long-distance calls to the end user.

20. For much of the 1970s, MCI and AT&T fought over the fees -- the access charges -- that MCI should pay the BOCs for originating and terminating interstate calls placed by or to end users on the BOCs' local networks. That battle took place before federal regulators, as well as in the federal courts. In December 1978, under Commission supervision, AT&T, MCI, and the other long-distance competitors entered into a comprehensive interim agreement, known as Exchange Network Facilities for Interstate Access (ENFIA), that set rates that AT&T would charge long-distance competitors for originating and terminating interstate traffic over the facilities of its local exchange affiliates.[18] Several years afterwards, AT&T's divestiture was completed, separating the local exchange operations of the BOCs from the rest of AT&T's operations, including AT&T's long distance business. The BOCs maintained monopoly franchises in their local market, but by splitting them off from AT&T's long-distance business, the federal courts removed an incentive for the BOCs to favor AT&T's long distance business over its competitors. Now AT&T competed directly with MCI and the other competitors to provide interstate service, and all of the competitors paid the BOCs for the service of providing the necessary access to end users.

21. In 1978, the Commission commenced a wide-ranging review of the system by which LECs were compensated for originating and terminating interstate traffic. In 1983, following the decision to break-up AT&T, the Commission adopted uniform access charge rules in lieu of earlier agreements.[19] These rules governed the provision of interstate access services by all incumbent LECs, BOCs as well as independents. The access charge rules provide for the recovery of the incumbent LECs' costs assigned to the interstate jurisdiction by the separations rules.

22. The Commission uses a multi-step process to identify the cost of providing access service. First, the rules require an incumbent LEC to record all of its expenses, investments, and revenues in accordance with accounting rules set forth in our regulations.[20] Second, the rules

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[18] For additional background on the ENFIA agreement, *see, e.g.*, Investigation of Access and Divestiture-Related Tariffs, CC Docket No. 83-1145, Phase I and Phase II, Part 1, FCC 85-100, 57 Rad.Reg.2d 1229, 1241 (rel. March 8, 1985).

[19] MTS and WATS Market Structure, Third Report and Order, CC Docket No. 78-72, Phase 1, 93 FCC 2d 241, *recon.*, 97 FCC 2d 682 (1983), *second recon.*, 97 FCC 2d 834 (1984).

[20] These rules are referred to as the Uniform System of Accounts and are contained in Part 32 of the Commission's Rules. *See* 47 C.F.R. §§ 32.1-.9000.

divide these costs between those associated with regulated telecommunications services and those associated with nonregulated activities.[21] Third, the separations rules determine the fraction of the incumbent LEC's regulated expenses and investment that should be allocated to the interstate jurisdiction.[22] After the total amount of interstate cost is identified, the access charge rules translate these interstate costs into charges for the specific interstate access services and rate elements. Part 69 specifies in detail the rate structure for recovering those costs. That is, the rules tell the incumbent LECs the precise manner in which they may assess charges on interexchange carriers and end users.

23. Determining the costs that an incumbent LEC incurs to provide interstate access services and that, consequently, should be recovered from those services, is relatively straightforward in some cases and problematic in others. Some facilities, such as private lines, can be used exclusively for interstate services and, in such cases, the entire cost of those facilities is assigned to the interstate jurisdiction by the separations rules. Most facilities, however, are used for both intrastate and interstate services. The costs of some of these facilities vary depending on the amount of telecommunications traffic that they handle. The separations rules typically assign these traffic-sensitive (TS) costs on the basis of the relative interstate and intrastate usage of the facilities, as measured, for example, by the relative minutes of interstate and intrastate traffic carried by such facilities. By contrast, the costs of other facilities used for both interstate and intrastate traffic do not vary with the amount of traffic carried over the facilities, *i.e.*, the costs are non-traffic-sensitive. These costs pose particularly difficult problems for the separations process: The costs of such facilities cannot be allocated on the basis of cost-causation principles because all of the facilities would be required even if they were used only to provide local service or only to provide interstate access services. A significant illustration of this problem is allocating the cost of the local loop, which is needed both to provide local telephone service as well as to originate and terminate long-distance calls. The current separations rules allocate 25 percent of the cost of the local loop to the interstate jurisdiction for recovery through interstate charges.[23]

24. The Commission has recognized in prior rulemaking proceedings that, to the extent possible, costs of interstate access should be recovered in the same way that they are incurred, consistent with principles of cost-causation. Thus, the cost of traffic-sensitive access services should be recovered through corresponding per-minute access rates. Similarly, NTS costs should be recovered through fixed, flat-rated fees. The Commission, however, has not always adopted rules that are consistent with this goal. In particular, the Commission limited the amount of the allocated interstate cost of a local loop that is assessed to residential and business customers as a flat monthly charge, because of concerns that allowing the flat charges to rise above the specified limits might cause customers to disconnect their telephone service. The residual cost of the loop

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[21] This is governed by Sections 64.901-.904 of our Rules. *See* 47 C.F.R. §§ 64.901-.904.

[22] This step is governed by Part 36 of the Rules. See 47 C.F.R. §§ 36.1-.741.

[23] The general process of separating these costs between the interstate and intrastate jurisdictions is discussed by the Supreme Court in *Smith v. Illinois Bell Tel. Co.*, 282 U.S. 133 (1930).

not recovered from end users through the flat charge is recovered through a per-minute-of-use charge assessed to long-distance carriers.

25. Through the end of 1990, the vast majority of access revenues were governed by "cost-of-service" regulation. Under cost-of-service regulation, incumbent LECs calculate the specific access charge rates using projected costs and projected demand for access services.[24] Thus, for example, if an incumbent LEC projects that it will provide 10,000 total minutes of switching for interstate calls and estimates that it must generate $1,000 dollars in revenue in order to recover the costs of switching that are allocated to the interstate jurisdiction by the separations rules, the access charge for local switching would be set at $0.10 per minute ($1,000/10,000 minutes). In 1991, however, we implemented a system of price cap regulation that altered the manner in which the largest incumbent LECs established their interstate access charges. While most rural and small LECs remained subject to all of the Part 69 cost-of-service rules, generally the largest incumbent LECs[25] are now subject to price cap regulations set forth in Part 61 of our rules.

26. Price cap regulation fundamentally alters the process by which incumbent LECs determine the revenues they are permitted to obtain from interstate access charges for access services. Briefly stated, cost-of-service regulation is designed to limit the profits an incumbent LEC may earn from interstate access service, whereas price cap regulation focuses primarily on the prices that an incumbent LEC may charge and the revenues it may generate from interstate access services. Under the Part 69 cost-of-service rules, revenue requirements are based on embedded or accounting costs allocated to individual services. Incumbent LECs are limited to earning a prescribed return on investment and are potentially obligated to provide refunds if their interstate rate of return exceeds the authorized level. By contrast, although the access charges of price cap LECs originally were set at the cost-of-service levels that existed at the time they entered price caps, their prices have been limited ever since by price indices that have been adjusted annually pursuant to formulae set forth in our Part 61 rules. Price cap carriers whose interstate access charges are set by these pricing rules are permitted to earn returns significantly higher than the prescribed rate of return that incumbent LECs are allowed to earn under cost-of-service rules. Price cap regulation encourages incumbent LECs to improve their efficiency by harnessing profit-making incentives to reduce costs, invest efficiently in new plant and facilities, and develop and deploy innovative service offerings, while setting price ceilings at reasonable

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[24] Since 1981, the Commission has allowed certain smaller incumbent LECs to base their access rates on historic, rather than projected, cost and demand. *See* 47 C.F.R. § 61.39.

[25] The Commission required price cap regulation for the BOCs and GTE, and permitted other LECs to adopt price cap regulation voluntarily, provided that all their affiliates also convert to price cap regulation and that they withdraw from the NECA pools. Policy and Rules Concerning Rates for Dominant Carriers, Second Report and Order, CC Docket No. 87-313, 5 FCC Rcd 6786, 6818-20 (1990) (*LEC Price Cap Order*). Currently, the price cap LECs serve more than 92 percent of the total access lines, based on LECs' 1995 and 1996 Annual Access Tariffs filed with the Commission, and account for almost 91 percent of the total interstate revenues for access services, *see* Universal Service Fund Data Collection, CC Docket No. 80-286, Universal Service Fund 1996 Submission of 1995 Study Results by NECA, Oct. 1, 1996.

levels.[26] In this way, price caps act as a transitional regulatory scheme until the advent of actual competition makes price cap regulation unnecessary.[27]

27. Although price cap regulation eliminates the direct link between changes in allocated accounting costs and change in prices, it does not sever the connection between accounting costs and prices entirely. The overall interstate revenue levels still generally reflect the accounting and cost allocation rules used to develop access rates to which the price cap formulae were originally applied. Price cap indices are adjusted upwards if a price cap carrier earns returns below a specified level in a given year. Moreover, a price cap LEC may petition the Commission to set its rates above the levels permitted by the price cap indices based on a showing that the authorized rate levels will produce earnings that are so low as to be confiscatory. In the past, all or some price cap LECs were required to "share," or return to ratepayers, earnings above specified levels. The new rules adopted in the companion *Price Cap Fourth Report and Order* remove this limit on the maximum returns that can be earned by price cap incumbent LECs.

2. Implicit Subsidies in the Existing System

28. Both our price cap and cost-of-service rules contain requirements that inevitably result in charges to certain end users that exceed the cost of the service they receive. To the extent these rates do not reflect the underlying cost of providing access service, they could be said to embody an implicit subsidy. Some of these subsidies are due to the rate structures prescribed by our rules, which in some cases prevent incumbent LECs from recovering their access costs in the same way they have been incurred. For example, although the cost of the local loop that connects an end user to the telephone company's switch does not vary with usage, the current rate structure rules require incumbent LECs to recover a large portion of these non-traffic-sensitive costs through traffic-sensitive, per-minute charges. These mandatory recovery rules inflate traffic-sensitive usage charges and reduce charges for connection to the network, in essence creating an implicit support flow from end users that make many interstate long-distance calls to end users that make few or no interstate long-distance calls.

29. Several Federal-State Joint Boards have observed that additional subsidies and

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[26] The price cap regulations also give incumbent LECs greater flexibility in determining the amount of revenues that may be recovered from a given access service. The price cap rules group services together into different baskets, service categories, and service subcategories. The rules then identify the total permitted revenues for each basket or category of services. Within these baskets or categories, incumbent LECs are given some discretion to determine the portion of revenue that may be recovered from specific services. Subject to certain restrictions, this flexibility allows incumbent LECs to alter the access charge rate level associated with a given service. For example, within the category of switching services, an incumbent LEC may choose to recover a greater portion of its switching revenues through access charges assessed to one kind of switching service rather than through charges assessed to another switching service. Although the LEC must still observe the switched-access rate structure that is set forth in Part 69 of our rules (which determines what services may be offered and whether charges may be imposed on a per-minute or flat-rated basis), the rate level of the access charge will vary depending on the amount of revenues that the LEC chooses to recover from a given service.

[27] Price Cap Performance Review for Local Exchange Carriers, Second Further Notice of Proposed Rulemaking in CC Docket No. 93-124, and Second Further Notice of Proposed Rulemaking in CC Docket No. 93-197, 11 FCC Rcd 858, 862 (1995) (*Price Cap Second FNPRM*) .

distortions may be due, not only to the rate structure, but to the separations rules that divide costs between the interstate and intrastate jurisdictions. For example, the current separations rules require larger incumbent LECs to allocate the costs of their switching facilities between the interstate and intrastate jurisdictions on the basis of relative use (*i.e.*, if 30 percent of the minutes of use handled by the LEC's switching facilities are interstate long-distance calls, 30 percent of the LEC's switching costs are allocated to the interstate jurisdiction and recovered through interstate access charges). Our rules, however, permit smaller incumbent LECs to allocate a greater share of their switching costs to interstate access services than would result from the relative use allocator. These smaller incumbent LECs multiply the interstate use ratio by a factor (as high as 3) specified in the separations rules. In its *Recommended Decision*, the Joint Board on Universal Service observed that these separations rules "shift what would otherwise be intrastate costs to the interstate jurisdiction,"[28] thereby allowing such LECs to charge lower prices for intrastate services. Similarly, in the *Marketing Expense Recommended Decision*, another Federal-State Joint Board observed that the separations rules allocate a share of the incumbent LECs' retail marketing expenses to the interstate jurisdiction that is unreasonably high, given that the interstate access services consist primarily of wholesale service offerings.[29] To the extent these and other separation rules do not apportion costs between the jurisdictions in a manner that reflects the costs incurred to provide service in each jurisdiction, they might be viewed as generating subsidies from the interstate to the intrastate jurisdiction. These subsidies effectively require incumbent LECs to charge higher rates for interstate services and lower rates for intrastate services than would otherwise occur if the subsidies were eliminated.

30. This "patchwork quilt of implicit and explicit subsidies"[30] generates inefficient and undesirable economic behavior. For example, a rate structure that requires the use of per-minute access charges where flat-rated fees would be more appropriate increases the per-minute rates paid by IXCs and long-distance consumers, thus artificially suppressing demand for interstate long-distance services. Similarly, the possible overallocation of costs to the interstate jurisdiction may, for some consumers, increase long-distance rates substantially, suppressing their demand for interstate interexchange services. Implicit subsidies also have a disruptive effect on competition, impeding the efficient development of competition in both the local and long-distance markets. For example, where rates are significantly above cost, consumers may choose to bypass the incumbent LEC's switched access network, even if the LEC is the most efficient provider. Conversely, where rates are subsidized (as in the case of consumers in high-cost areas), rates will be set too low and an otherwise efficient provider would have no incentive to enter the market.

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[28] Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Recommended Decision, 12 FCC Rcd 87, 187, ¶ 189 (rel. Nov. 8, 1996) (*Joint Board Recommended Decision*). The Joint Board found that this allocation structure, known as DEM (dial equipment minute) weighting, is "an implicit support mechanism that is recovered through the switched access rates charged to interexchange carriers by those carriers serving less than 50,000 lines." *Joint Board Recommended Decision* at 237, ¶ 292.

[29] Amendment of Part 67 (New Part 36) of the Commission's Rules and Establishment of a Federal-State Joint Board, CC Docket No. 86-297, Recommended Decision and Order, 2 FCC Rcd 2582 (1987) (*Marketing Expense Recommended Decision*).

[30] *Local Competition Order* at 15506, ¶ 5.

In either case, the total cost of telecommunications services will not be as low as it would otherwise be in a competitive market. Because of the growing importance of the telecommunications industry to the economy as a whole, this inefficient system of access charges retards job creation and economic growth in the nation.

31. Despite the existence of distortions and inefficiencies, the current system of cross-subsidies has persisted for over a decade. The structure has been justified on policy grounds, principally as a means to serve universal service goals. By providing incumbent LECs with a stream of subsidized revenues from certain customers, the system allows regulators to demand below-cost rates for other customers, such as those in high-cost areas.

3. The Telecommunications Act of 1996

32. The existing system of implicit subsidies and support flows is sustainable only in a monopoly environment in which incumbent LECs are guaranteed an opportunity to earn returns from certain services and customers that are sufficient to support the high cost of providing other services to other customers. The new competitive environment envisioned by the 1996 Act threatens to undermine this structure over the long run. The 1996 Act removes barriers to entry in the local market, generating competitive pressures that make it difficult for incumbent LECs to maintain access charges above economic cost. For example, by giving competitors the right to lease an incumbent LEC's unbundled network elements at cost,[31] Congress provided IXCs an alternative avenue to connect to and share the local network. Thus, where existing rules require an incumbent LEC to set access charges above cost for a high-volume user, a competing provider of exchange access services entering into a market can lease unbundled network elements at cost, or construct new facilities, to circumvent the access charge.[32] In this way, a new entrant might target an incumbent LEC's high-volume access customers, for whom access charges are now set at levels significantly above economic cost. As competition develops, incumbent LECs may be forced to lower their access charges or lose market share, in either case jeopardizing the source of revenue that, in the past, has permitted the incumbent LEC to offer service to other customers, particularly those in high-cost areas, at below-cost prices.[33] Incumbent LECs have for some time been claiming that this process has already made more than trivial inroads on their high-volume

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[31] 47 U.S.C. § 252(d)(1)(A)(i).

[32] In Section VI.A of this Order, we conclude that access charges may not be assessed on unbundled network elements since they are not part of the "cost" of providing those elements, as defined in 47 U.S.C. § 252(d)(1)(A)(i).

[33] *See, e.g.*, H. REP. NO. 204, 104th Cong., 1st Sess. 68 (1995) (The bill "would make such internal subsidies much less viable because deregulation would remove the near-guaranteed returns allowed in a regulated market, and with them the ability of the regulated firm to subsidize high-cost customers.") (Congressional Budget Office cost estimate).

customer base.[34]

33. Recognizing the vulnerability of implicit subsidies to competition, Congress directed the Commission and the states to take the necessary steps to create permanent universal service mechanisms that would be secure in a competitive environment.[35] To achieve this end, Congress directed the Commission to strive to replace the system of implicit subsidies with "explicit and sufficient" support mechanisms.[36] In calling for explicit mechanisms, Congress did not intend simply to require carriers to identify and disclose the implicit subsidies that currently exist in the industry. Rather, as we determine in the *Universal Service Order* adopted today, Congress intended to establish subsidies that were both "measurable" and "portable" -- "measurable" in a way that allows competitors to assess the profitability of serving subsidized end users; and "portable" in a way that ensures that competitors who succeed in winning a customer also win the corresponding subsidy. A system of portable and measurable subsidies will permit carriers to compete for the subsidies associated with high-cost or low-income consumers. In the long run, this approach may even allow us to set subsidy levels through competitive bidding rather than through regulation. By contrast, under the current system of implicit subsidies, the only carriers that will serve high-cost consumers are those that are required to do so by regulation and that are able (because of their protected monopoly positions) to charge above-cost rates to other end users.

34. In the *Universal Service Order*, we establish "explicit and sufficient" support mechanisms to assist users in high-cost areas, low-income consumers, schools, and health care providers. By creating explicit support mechanisms, we establish a system to advance the universal service goals of the 1996 Act that is compatible with the development of competition in the local exchange and exchange access markets. By creating a portable and measurable system of subsidies, we utilize the power of the market to serve universal service goals more efficiently. That order, in short, guarantees that Congress's universal service goals are met in a way that conforms with the pro-competitive and deregulatory goals of the 1996 Act.

B. Access Charge Reform

35. In light of Congress's command to create secure and explicit mechanisms to achieve universal service goals, we conclude that implicit subsidies embodied in the existing system of interstate access charges cannot be indefinitely maintained in their current form. In this Order,

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[34] *See, e.g.*, Reply Comments of Bell Atlantic, CC Docket 94-1 (filed June 29, 1994) at 23-2 (citing attached Kahn Affidavit). *See also* John D. deButts, *An Unusual Obligation*, *in* HERITAGE AND DESTINY 422-32 (1983) (Address of AT&T Chairman to the National Association of Regulatory Utility Commissioners, September 20, 1973).

[35] *See, e.g.*, H. REP. NO. 204, 104th Cong., 1st Sess. 80 (1995) ("The Committee intends that this Joint Board should evaluate universal service in the context of a local market changing from one characterized by monopoly to one of competition.").

[36] *See* 47 U.S.C. § 254(e). *See also* Joint Explanatory Statement at 131 ("To the extent possible, the conferees intend that any support mechanisms continued or created under new section 254 should be explicit, rather than implicit as many support mechanisms are today.").

therefore, we take two steps with respect to the rules governing the interstate access charges of price cap incumbent LECs.[37] First, we reform the current rate structure to bring it into line with cost-causation principles, phasing out significant implicit subsidies. Second, we set in place a process to move the baseline rate level toward competitive levels. Together with the *Universal Service Order*, these adjustments will promote the public welfare by encouraging investment and efficient competition, while establishing a secure structure for achieving the universal service goals established by law. Further, the process we set in place to achieve these goals avoids the destabilizing effects of sudden radical change, facilitating the transformation from a regulated to a competitive marketplace.

1. Rationalizing the Rate Structure

36. In this Order, we reshape the existing rate structure in order to eliminate significant implicit subsidies in the access charge system. To achieve that end, we make several modifications to ensure that costs are recovered in the same way that they are incurred. In general, NTS costs incurred to serve a particular customer should be recovered through flat fees, while traffic-sensitive costs should be recovered through usage-based rates. The present structure violates this basic principle of cost causation by requiring incumbent LECs to recover many fixed costs through variable, per-minute access rates. An important goal of this Order is to increase the amount of fixed costs recovered through flat charges and decrease the amount recovered through variable rates.

37. *Common Line Costs*. Because the costs of using the incumbent LEC's common line (or "local loop") do not increase with usage, these costs should be recovered through flat, non-traffic-sensitive fees. The current rate structure, however, generally allows an incumbent LEC to recover no more than a portion of its interstate common line revenues through a flat-rated Subscriber Line Charge (SLC), which is capped at $3.50 per month for residential and single-line business users, and $6.00 per month for multi-line users. The remaining common line revenues must be recovered through a per-minute Common Carrier Line (CCL) charge assessed on IXCs (which, in turn, may recover these charges through their prices to long-distance customers). In order to align the rate structure more closely with the manner in which costs are incurred, we adjust access rates over time until the common line revenues of all price cap LECs are recovered through flat-rated charges.

38. For primary residential and single-line business lines, however, we decline to implement this goal by increasing the SLC ceiling above its existing $3.50 level as urged by many

[37] With the limited exceptions identified in Section V, the scope of this proceeding is limited to price cap incumbent LECs. As we explain in that section, the need for access reform is most immediate for these carriers, since they are most vulnerable to competition from interconnection and the availability of unbundled network elements. This proceeding will affect the vast majority of all access lines and revenues, because price cap regulation governs more than 90 percent of all incumbent LEC access lines. We will initiate a separate proceeding later this year to examine the special circumstances of small and rural rate-of-return LECs.

companies, including price cap LECs and IXCs.[38] We do not wish to see increases in the price of basic dial tone charged by local exchange carriers to their end users for fear that such increases might cause some consumers to discontinue service, a result that would be contrary to our mandate to ensure universal service.[39] We agree with the Joint Board's finding that increasing the SLC ceiling may make telecommunications service unaffordable for some consumers.[40] Consequently, to the extent that common line revenues are not recovered through the customer's SLC, we conclude that LECs should recover these revenues through a flat, per-line charge assessed on the IXC to whom the access line is presubscribed -- the presubscribed interexchange carrier charge, or PICC.[41] Further, in order to provide IXCs with the opportunity to incorporate these changes into their business plans, we set the PICC for primary residential and single-line business lines at not more than the existing flat-rated line charges for the first year, and we gradually increase the ceiling thereafter until it reaches a level that permits full recovery of the common line revenues from flat charges assessed to both end users and IXCs.[42]

39. For non-primary residential and multi-line business lines, we conclude that affordability concerns do not require us to retain the current ceiling on the monthly SLC. Consequently, we raise the SLC ceiling for these lines to the level that permits incumbent LECs full recovery for their common line revenues, but never more than $3.00 above the current SLC ceiling for multi-line business lines today, adjusted for inflation.[43] Almost all subscribers will pay SLCs below, and often substantially below, the ceiling. The increase in the SLC ceiling for multi-line businesses will be implemented in the first year. To ameliorate the impact that a dramatic increase in the SLC ceiling might have on residential customers, however, the increase for non-primary residential lines will be phased in over time. The data indicate that raising the SLC ceiling

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[38] *See, e.g.,* BellSouth Corporation, BellSouth Telecommunications, Inc. (BellSouth) Comments, Attachment 2 at 20; GTE Service Corporation (GTE) Comments at 26-29, Reply at 20-21; Southwestern Bell Telephone Company (SWBT) Comments at 37-38, Reply at 8; U.S. West, Inc. (U S West) Reply at 27-28; Cincinnati Bell Telephone Company (Cincinnati Bell) Comments at 6-7; AT&T Corporation (AT&T) Comments 51-54, Reply at 25-26; Frontier Corporation (Frontier) Comments at 4, 5-7; Sprint Corporation (Sprint) Comments at 11-15; 50-51; Ad Hoc Telecommunications Users Committee (Ad Hoc) Reply at 4; General Services Administration/United States Department of Defense (GSA/DOD) Comments at 9-11, Reply at 5, 7; Tele-Communications, Inc. (TCI) Comments at 10; Reply at 4-5; Time Warner Communications Holdings, Inc. (Time Warner) Comments at 4-5; WinStar Communications, Inc. (WinStar) Comments at 4; WorldCom, Inc. (WorldCom) Comments at 30-31.

[39] Among the many goals announced in the 1996 Act, Congress declared that telephone service should be available at "affordable rates." 47 U.S.C. § 254(b)(1).

[40] *Joint Board Recommended Decision*, 12 FCC Rcd at 472, ¶ 769 (1996).

[41] Where an end user does not select a presubscribed interexchange carrier, we allow an incumbent LEC to collect this charge directly from the end user.

[42] To the extent that the PICC ceiling prevents full recovery of average per-line common line revenues for primary residential and single-line business lines, the residual amount will be recovered through the PICC imposed upon non-primary residential and multi-line business lines. As described in Section III.A below, as the PICC associated with primary residential and single-line business lines increases, the amount of common line revenues associated with those lines that is recovered through the PICC imposed upon non-primary residential and multi-line business lines will fall to zero.

[43] The $3.00 increase in the SLC cap for these lines is measured on a per-month basis.

to this level will permit incumbent price cap LECs to recover their average common line revenues from 99 percent of their non-primary residential and multi-line business lines.[44] For the remaining lines, many of which are located in rural areas, the SLC ceiling for non-primary residential and multi-line business lines will ensure that end-user charges are not prohibitive or significantly above the national average,[45] thereby advancing universal service goals of affordability and access.

40. In summary, the plan we adopt here phases out significant implicit subsidies in the access charge rate structure, while taking into account universal service concerns of affordability and access. The resulting rate structure is more closely aligned with cost principles. Under this plan, most price cap incumbent LECs will recover their interstate common line revenues through flat-rated SLCs and PICCs.

41. *Switching and Transport Charges*. Following the same pricing principle that flat charges should recover fixed costs and variable charges should recover variable costs, we make several modifications to the rate structure for switching and transport services. Among other things, we move the cost of line-side ports to the common line and require their recovery through flat-rated charges. To the extent permitted by the record, we also direct incumbent LECs to reassign costs in the Transport Interconnection Charge (TIC) in order to comply with principles of cost causation and the D.C. Circuit's recent decision in *CompTel v. FCC*.[46]

2. Baseline Rate Level Reductions

42. The rate structure changes that we implement in this Order eliminate some of the distortions that have characterized the access charge system for over a decade. These changes, however, are not alone sufficient to create a system that accurately reflects the true cost of service in all respects. To fulfill Congress's pro-competitive mandate, access charges should ultimately reflect rates that would exist in a competitive market. We recognize that competitive markets are far better than regulatory agencies at allocating resources and services efficiently for the maximum benefit of consumers. We conclude, consequently, that competition or, in the event that competition fails to develop, rates that approximate the prices that a competitive market would produce, best serve the public interest.

43. The rate restructuring we implement in this Order results in substantial reductions in the charges for usage-rated interstate access services. These reductions move these access charges

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[44] *See* Supporting Material filed with 1996 Annual Access Tariff Filing, filed with Commission on April 2, 1996. This LEC forecast data were used by LECs to set SLC rates that became effective on July 1, 1996.

[45] We have also taken account of concerns raised by rural carriers and consumers groups that the increase in the SLC for non-primary residential lines and multi-lines could lead to substantial price increases in rural areas. Consequently, we are adopting these changes only for price cap incumbent LECs and will review rate structure modifications affecting small, rural carriers in a separate proceeding. *See* Section V.B, *infra.*

[46] *Competitive Telecommunications Ass'n v. FCC*, 87 F.3d 522 (D.C. Cir. 1996).

a long way towards their forward-looking cost levels.[47] Furthermore, in addition to these rate structure adjustments, we also take several steps in this Order to address specific cost misallocations that cause access charges to be set above economic costs. For example, we require incumbent LECs to make an exogenous cost adjustment to reflect the full amortization of certain equal access costs. We also issue a Further Notice of Proposed Rulemaking to consider our tentative conclusion that certain General Support Facility (GSF) costs should be reallocated to detariffed services.

44. We recognize that the prescriptive measures that we implement today represent the first step toward our goal of removing implicit universal service subsidies from interstate access charges and moving such charges toward economically efficient levels. In the NPRM, we identified two separate ways to continue this process in the future -- a prescriptive approach in which we actively set rates at economic cost levels, and a market-based approach that relies on competition itself to drive access charges down to forward-looking costs. We conclude in this Order, based on our experience in exchange access and other telecommunications markets and the record in this proceeding, that a market-based approach to reducing interstate access charges will, in most cases, better serve the public interest. Although the Commission has considerable expertise in regulating telecommunications providers and services efficiently for the maximum benefit of consumers, we believe that emerging competition will provide a more accurate means of identifying implicit subsidies and moving access prices to economically sustainable levels. Further, as discussed above, we believe that this approach is most consistent with the pro-competitive, deregulatory policy contemplated by the 1996 Act. Accordingly, where competition is developing, it should be relied upon in the first instance to protect consumers and the public interest.

45. We acknowledge that a market-based approach under this scenario may take several years to drive costs to competitive levels. We also recognize that several commenters have urged us to move immediately to forward-looking rates by prescriptive measures utilizing forward-looking cost models. We decline to follow that suggestion for several reasons. First, as a practical matter, accurate forward-looking cost models are not available at the present time to determine the economic cost of providing access service. Because of the existence of significant joint and common costs, the development of reliable cost models may take a year or more to complete. This situation might be contrasted with that addressed in our *Local Competition Order*, where we endorsed the use of cost models to estimate the cost of providing unbundled network elements. There, we observed that unbundled elements have few joint and common costs, so that devising accurate cost models for unbundled network elements is more straightforward.[48]

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[47] Economists recognize that substantial progress in driving prices toward forward-looking costs eliminates a disproportionate amount of economic distortion. *See, e.g.*, F. M. SCHERER AND DAVID ROSS, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 662 (1990) (observing that dead weight welfare loss "rises as a quadratic function of the relative price distortion").

[48] *Local Competition Order*, 11 FCC Rcd at 15846, ¶ 678.

46. In addition, even assuming that accurate forward-looking cost models were available, we are concerned that any attempt to move immediately to competitive prices for the remaining services would require dramatic cuts in access charges for some carriers. Such an action could result in a substantial decrease in revenue for incumbent LECs, which could prove highly disruptive to business operations, even when new explicit universal support mechanisms are taken into account. Moreover, lacking the tools for making accurate prescriptions, precipitous action could lead to significant errors in the level of access charge reductions necessary to reach competitive levels. That would further impede the development of competition in the local markets and disrupt existing services. Consequently, we strongly prefer to rely on the competitive pressures unleashed by the 1996 Act to make the necessary reductions.

47. To the extent that some commenters contend that the immediate elimination of all implicit subsidies is mandated by the 1996 Act, we disagree. Neither in the 1996 Act nor its legislative history did Congress state that all forms of implicit universal service support shall be made explicit by May 8, 1997. To the contrary, Congress stated that the conversion of implicit subsidies to explicit support is a goal that "should be" pursued "[t]o the extent possible."[49] Congress most certainly did not state that we must reach that goal by May 8, 1997. Rather, it directed that, by that date, we issue rules that "shall include a definition of the services that are supported by Federal universal service support mechanisms and a specific timetable for implementation."[50] Our companion order satisfies that timetable, and this Order establishes a process that will eliminate some implicit subsidies quickly and more gradually eliminate others.

48. We are confident that the pro-competitive regime created by the Act and implemented in the *Local Competition Order* and numerous state decisions will generate workable competition over the next several years in many cases, and we would then expect that access price levels to be driven to competitive levels. We also recognize, however, that competition may develop at different rates in different places and that some services may prove resistant to competition. Where competition has not emerged, we reserve the right to adjust rates in the future to bring them into line with forward-looking costs. To assist us in that effort, we will require price cap LECs to submit forward-looking cost studies of their services no later than February 8, 2001, and sooner if we determine that competition is not developing sufficiently for the market-based approach to work. We anticipate that the tools needed to complete these cost studies will be available soon, well before this deadline. Indeed, our *Universal Service Order* requires comparable cost models to be ready by 1998. We will then review competitive conditions and the submitted cost studies.

49. As we acknowledged in the NPRM, a market-based approach will permit and, indeed, require us progressively to deregulate the access charge regime as competition develops. In a subsequent order, we will examine specific issues concerning the timing and degrees of pricing

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[49] 47 U.S.C. § 254(e); Joint Explanatory Statement at 131.

[50] 47 U.S.C. § 254(a)(2).

flexibility. That order will identify the competitive triggers that must be met to justify relaxation of specific regulatory constraints. We also recognize the need to examine whether incumbent LECs should be compensated for any historical costs that they have no reasonable opportunity to recover as a result of the transformation from a regulated to competitive marketplace. We recognize that this issue may raise difficult questions of both law and equity, and we intend to respond fully to concerns about historical cost recovery in a subsequent order to be issued this year.

50. Finally, we adopt in this Order our earlier tentative conclusion that incumbent LECs may not assess interstate access charges on information service providers (ISPs). We find that our existing policy promotes the development of the information services industry, advances the goals of the 1996 Act, and creates significant benefits for the economy and the American people. With respect to second and additional residential lines, which are often used by consumers to access ISPs, our goal is to move towards price levels and structures that reflect underlying costs, and thereby to create a neutral market environment in which these lines neither give nor receive subsidies. We will address fundamental questions concerning ISP usage of the public switched network as part of a broader set of issues under review in a related *Notice of Inquiry*.[51]

51. Section II of this Order provides an overview of the rate structure adjustments adopted today. Section III offers detailed explanations of these changes, which include adjustments to the rate structure for the common line, local switching, transport, SS7, and switching, and modifications to the TIC. In Section IV, we adopt a market-based approach to reducing access charges and address several specific rate level adjustments. In Section V, we determine which of the changes adopted in this Order should apply to rate-of-return LECs.

52. Section VI touches upon several additional issues, including the applicability of access charges to unbundled network elements, our treatment of terminating access, and ISPs. We also discuss modifications that may be needed to reconcile our access charge rules with the *Universal Service Order* released today. In Section VII, we issue an FNPRM to seek comment on proposals to alter the current allocation of GSF costs and to allow incumbent LECs to impose a PICC on special access lines.

II. SUMMARY OF RATE STRUCTURE CHANGES AND TRANSITIONS

53. In rationalizing the switched access rate structure in this Order, our primary goal is to ensure that traffic-sensitive costs are recovered through traffic-sensitive charges and NTS costs are recovered through flat-rated charges, wherever appropriate. Because many NTS costs are currently recovered through per-minute charges, the principal effect of our Order is to reduce the amount recovered through per-minute interstate access charges and increase the amounts recovered through flat-rated charges. We phase in these changes over time to ameliorate any

[51] *See* Usage of the Public Switched Network by Information Service and Internet Access Providers, CC Docket No. 96-263, Notice of Inquiry, FCC 96-488 (rel. Dec. 24, 1996).

disruptions these adjustments might cause end users.

A. Common Line Rate Structure Changes

54. Because the cost of using the incumbent LEC's common line does not increase with usage, the costs should be recovered through flat non-traffic-sensitive fees. In this Order we increase the amount of common line revenues recovered through flat-rated charges over time until incumbent LECs can recover all of their interstate common lines revenues through NTS fees.

55. *Primary Residential and Single-Line Business Lines.* We agree with the Federal-State Joint Board on Universal Service that the SLC ceiling for primary residential and single-line business lines should not be increased, because a higher SLC could make telecommunications service unaffordable for some consumers. To the extent common line revenues cannot be recovered through the customer's existing SLC, we conclude that LECs should recover these revenues through a flat, per-line charge (the "primary interexchange carrier charge" or "PICC") assessed, not on the end user, but on the end user's presubscribed interexchange carrier.[52] We set a ceiling on the PICC at the level of existing per-line charges for the first year.

56. In order to give IXCs an opportunity to adjust to the new charge, we gradually increase the PICC ceiling over the next several years until it reaches a level that permits full recovery of common line revenues -- plus a portion of "residual TIC" revenues. To the extent that the ceiling on the primary residential and single-line business PICC does not allow for full recovery of these common line revenues immediately, the remaining revenues will be recovered through a PICC imposed upon non-primary residential and multi-line business lines, and through per-minute charges.

57. As the PICC ceiling for primary residential and single-line business lines increases, the amount of common line revenues transferred to non-primary residential and multi-line business lines will fall to zero. At that point, all common line costs for primary residential and single-line business lines will be recovered through flat-charges on those lines.

58. *Non-Primary Residential and Multi-Line Business Lines.* Because affordability concerns are not as significant for these lines, we permit a modest increase in the SLC to permit recovery of the price cap LEC's average per-line common line revenues, but never to more than $3.00 above the SLC ceiling for multi-line business lines today, adjusted for inflation. To ameliorate the impact that an increase in the SLC might have on residential customers, the increase in the SLC ceiling will be phased in for non-primary residential lines over several years.

59. We also establish a flat-rated PICC on non-primary residential and multi-line business lines. This PICC will cover common line revenues that exceed the ceilings on SLCs and primary

[52] Where an end user does not select a presubscribed interexchange carrier, we allow a price cap LEC to collect this charge directly from the end user.

residential PICCs.[53] We set a ceiling on this PICC in the first year of $1.50 for non-primary residential lines and $2.75 for multi-line business lines, and permit those ceilings to increase gradually thereafter. We anticipate that the actual PICC imposed upon multi-line business lines will, on average, decrease from 1998 to 1999, and for every year thereafter, and will fall to less than $1.00 by 2001.

60. To the extent that the ceilings on SLCs and PICCs do not allow recovery through flat charges of all common line revenues, LECs shall be permitted to impose a per-minute CCL charge assessed on originating minutes.[54] As the PICC cap for non-primary residential and multi-line business lines increases -- and as revenues transferred from primary residential and single-line businesses fall to zero -- the per-minute CCL charge will fall to zero, too. Eventually, we anticipate that most, if not all, price cap LECs will be able to recover the full per-line revenues associated with non-primary residential and multi-line business lines through the SLC, after taking into account the assistance provided through the explicit high-cost universal service support mechanisms. In addition, residual TIC revenues will also be recovered through the PICC on non-primary residential and multi-line business lines. As described more fully below, to the extent that the PICC ceilings prevent full recovery of the residual TIC, the remaining amount will be recovered through a per-minute residual TIC.

B. Other Rate Structure Changes

61. *Switching*. The traffic-sensitive costs of local switching will continue to be recovered through per-minute local switching charges.

62. For price cap LECs, the NTS costs associated with line ports will no longer be included in the local switching charge, and instead will be recovered through the flat-rated common line charges discussed above. Price cap LECs will also assess a monthly flat-rated charge directly on end users that are subscribing to integrated services digital network services, digital subscriber line, or other services that have higher line port costs than basic, analog service. This charge recovers the amount by which the cost of the line port exceeds the cost of a line port for basic, analog service. Costs of local switching attributable to trunk ports are moved to a separate service category within the traffic-sensitive basket. These costs will be recovered through flat-rated monthly charges collected from users of dedicated trunk ports and per-minute, traffic-sensitive charges assessed on users of shared trunk ports. The new rate structure also includes an optional call set-up charge.

63. *Transport*. Effective July 1, 1998, the unitary rate structure option for tandem-

[53] It may also recover some residual TIC revenues and certain marketing expenses, as discussed below.

[54] To the extent that the sum of a LEC's originating local switching charge and any residual per-minute CCL, TIC, and marketing expense (see section IV.D) charges exceeds the sum of its originating local switching, CCL, and TIC charges on December 31, 1997, the excess shall be collected through a per-minute charge on terminating access. We expect that this will only apply to a few LECs, and to none beyond 1998.

switched transmission is eliminated and the costs of tandem-switched transmission must be recovered through the existing three-part rate structure. For price cap LECs, a new flat-rated monthly charge recovers the NTS costs of tandem switching attributable to dedicated ports. A new per-minute rate element recovers the costs of multiplexers used between tandem switch DS-1 port interfaces and the DS-3 circuits used to transport traffic from tandem to end offices. For all incumbent LECs, the formula used to compute the tandem-switched transport rate is based on actual usage of the circuit, rather than an assumed 9000 minutes of use per month.

64. For all incumbent LECs, certain costs currently recovered through the TIC are reassigned to specified facilities charges, including tandem-switching rates. For price cap LECs, those costs of the TIC that remain (the "residual TIC") are recovered through the PICC. To the extent that the PICC ceiling prevents recovery of the entire residual TIC through the flat-rated PICC, the remaining portion will be collected through a per-minute residual TIC. As the ceilings on the PICCs increase, a larger percentage of the residual TIC will be recovered through the PICC. Beginning in July 1997, price cap reductions will be targeted to the per-minute residual TIC until it is eliminated. We expect that the per-minute TIC charge will be eliminated in two to three years. Residual per-minute TICs shall be assessed only on incumbent LEC transport customers, and therefore shall no longer be assessed on competitive access providers (CAPs) that interconnect with the LEC switched network at the end office.

65. *SS7 Signalling*. Price cap LECs may, but are not required to, adopt a rate structure for SS7 signalling that unbundles SS7 signalling functions, as was permitted in the *Ameritech SS7 Waiver Order*.[55]

66. *Retail Marketing Expense*. Price cap LECs may no longer recover certain marketing expenses through per-minute access charges assessed on IXCs. These expenses are recovered from end users through per-line charges on second and additional residential lines and multi-line business lines, subject to ceilings on SLCs. Any residual shall be recovered through the PICCs on these lines and then through per-minute charges on originating access, subject to the exception described in Section III.A, below.

III. RATE STRUCTURE MODIFICATIONS

A. Common Line

1. Overview

67. In the 1983 *Access Charge Order*, the Commission established a comprehensive mechanism for incumbent LECs to recover the costs associated with their provision of access

[55] Ameritech Operating Companies Petition for Waiver of Part 69 of the Commission's Rules to Establish Unbundled Rate Elements for SS7 Signalling, Order, 11 FCC Rcd 3839 (1996) (*Ameritech SS7 Waiver Order*).

service required to complete interstate and foreign telecommunications.[56] The access plan distinguished between traffic sensitive costs and NTS costs incurred by an incumbent LEC to provide interstate access service An incumbent LEC's NTS costs of providing interstate access, or costs that do not vary with the amount of usage, include the common line, or "local loop," which connects an end user's home or business to a LEC central office.[57]

68. In the *Access Charge Order,* the Commission emphasized that its long range goal was to have incumbent LECs recover a large share of the NTS common line costs from end users instead of carriers, and to recover these costs on a flat-rated, rather than on a usage- sensitive, basis.[58] The Commission recognized, however, that a sudden increase in the flat rates imposed by LECs on end users could have a detrimental effect on universal service. For this reason, the rules adopted in 1983 apportioned charges for common line costs between a monthly flat-rated end-user SLC and a per-minute CCL charge assessed to the IXCs. The SLC is based on average interstate-allocated common line costs, which the incumbent LEC may average over an entire region or over a study area,[59] depending on how it files its interstate tariff. These charges currently are the lesser of the per-line average common line costs allocated to the interstate jurisdiction or $3.50 per month for residential and single-line business users, and $6.00 per month for multi-line business users.[60] Any remaining common line revenues permitted under our price cap rules are recovered by incumbent price cap LECs through per-minute CCL charges assessed on the IXCs, and are ultimately recovered by IXCs from end-users through long distance toll

[56] MTS and WATS Market Structure, CC Docket No. 78-72, Third Report and Order, 93 F.C.C. 2d 241 (1983) (*Access Charge Order*), modified, 97 F.C.C. 2d 682 (1983) (*Reconsideration Order),* further modified, 92 F.C.C. 2d 834 (1984) (*Second Reconsideration Order),* aff'd in principal part and remanded in part sub nom. *NARUC v. FCC,* 737 F.2d 1095 (D.C. Cir. 1984), *cert. denied,* 469 U.S. 1227 (1985).

[57] See, e.g., *Access Charge Order*, 93 FCC 2d at 268-69.

[58] *Id.* at 268-269.

[59] A "study area" is usually an incumbent LEC's existing service area in a given state. The study area boundaries are fixed as of November 15, 1984. *MTS and WATS Market Structure: Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, Decision and Order*, 50 Fed. Reg. 939 (*1985 Lifeline Order*).

[60] Revenues permitted under our price cap rules for common line services may be significantly different from the interstate allocated costs assigned to the common line access element by our Part 36 and Part 69 cost allocation rules. For each price cap basket, the rates allowed are determined based on price cap formulas, without reference to interstate allocation of costs. We measure the earnings of price cap carriers by comparing revenues to interstate allocated costs. See 47 C.F.R. §§ 61.45(c), 65.702, & 69.104. The data indicate that only two study areas served by price cap LECs, (Bell Atlantic in the District of Columbia, and GTE in Minnesota) have interstate-allocated common line costs that are less than the current $3.50 SLC. These two study areas represent less than two percent of subscriber lines nationwide. *See* Supporting Material filed with 1996 Annual Access Tariff Filing, filed with Commission on April 2, 1996. (*1996 LEC Annual Access Tariff Forecast Data*.) This LEC forecast data were used by LECs to set SLC rates that became effective on July 1, 1996.

charges.[61]

69. Because common line and other NTS costs do not increase with each additional minute of use transmitted over the loop, the current per-minute CCL charge that recovers loop costs represents an economically inefficient cost-recovery mechanism and implicit subsidy. A rate structure that recovers NTS costs through per-minute charges creates an incentive for customers to underutilize the loop by requiring them to pay usage rates that significantly exceed the incremental cost of using the loop. Additionally, a rate structure that forces high- volume customers to pay significantly more than the cost of the facilities used to service them is not sustainable in a competitive environment because high-volume customers can migrate to a competitive LEC able to offer an efficient combination of flat and per-minute charges, even if the competitive LEC has the same or higher costs than the incumbent LEC.

70. The Federal-State Universal Service Joint Board stated, in its *Recommended Decision*, that primary residential and single-line business lines are essential to the provision of universal service,[62] and that current rates for local services are generally affordable based on subscribership levels.[63] The Joint Board also concluded that the SLC, as a charge assessed directly on local telephone subscribers, has an impact on universal service concerns such as affordability,[64] and recommended that the Commission leave the current SLC ceilings in place for primary residential and single-line business lines.[65] In our companion *Universal Service Order,* consistent with that recommendation, we conclude that we should not raise the current $3.50 SLC ceiling on primary residential and single-line business lines.[66]

71. We adjust the SLC ceilings for multi-line business lines and residential lines beyond the primary connection. Adjusting the SLC ceilings for multi-line business lines and non-primary

[61] The data indicate that incumbent price cap LECs recover approximately 10.4 billion dollars in total common line revenue. Approximately $7 billion of the common line costs are recovered through the SLC, and approximately $3.4 billion are recovered through the CCL charge. Thus, incumbent price cap LECs recover approximately one-third of their common line costs through per-minute CCL charges. *1996 LEC Annual Access Tariff Forecast Data*.

[62] Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Recommended Decision, 12 FCC Rcd 87, 132-133 (rel. Nov. 8, 1996) (*Joint Board Recommended Decision*).

[63] *Id.* at 154. The Joint board noted that "[s]ubscribership levels, while not dispositive on the issue of affordability, provide an objective criterion to assess the overall success of state and federal universal service policies in maintaining affordable rates." *Id.*

[64] *Id.* at 472.

[65] *Id.*at 463. *See also* Separate Statement of FCC Commissioner Rachelle B. Chong, (dissenting from the Joint Board's recommendation that the Commission should lower the SLC for primary residential and single-line business lines). *Id.* at 556.

[66] *Universal Service Order*, Section XII.C.

residential lines will permit incumbent LECs to recover directly from end users more of the common line revenues permitted under our price cap rules for those lines and will reduce the amount of NTS costs related to these lines that are currently recovered through CCL charges. Where the SLC ceilings do not allow the incumbent LEC to recover its price cap common line revenues through end-user charges, the remaining, or "residual" amount will be recovered through flat, per-line charges assessed to each customer's presubscribed interexchange carrier. This presubscribed interexchange carrier charge, or "PICC", will increase gradually until the incumbent price cap LECs' full interstate-allocated common line revenues permitted under our price cap rules are recovered through a combination of flat-rated SLCs and PICCs. To the extent that the flat-rated charges do not recover, during the initial phase, the full interstate-allocated common line revenues permitted under our price cap rules, incumbent LECs may continue to assess the IXCs a per-minute CCL charge based on the costs not recovered through flat-rated charges. This per-minute charge, however, will be generally much lower than today's CCL charge and will be eliminated once all common line revenues are recovered through a combination of SLCs and PICCs.

2. Subscriber Line Charge

a. Background

72. In the NPRM, we proposed to increase the ceiling on the SLC for second and additional lines for residential customers, and for all lines for multi-line business customers, to the per-line loop costs assigned to the interstate jurisdiction.[67] Alternatively, we proposed to eliminate the ceiling for multi-line business customers and for residential connections beyond the primary connection, especially where the incumbent LEC has entered into interconnection agreements and taken other steps to lower barriers to actual or potential local competition.[68] We sought comment on these proposals.[69] We also invited parties to comment on whether any changes that we adopt to the ceiling on SLCs for incumbent price cap LECs should be extended to incumbent rate-of-return LECs, and on the relationship of any such changes to the *Joint Board Recommended Decision.*[70] We sought comment on whether to establish a transition mechanism for this increase if the ceilings on SLCs for multi-line business lines and residential lines beyond the primary connection are increased and whether such a transition could be implemented consistent with

[67] NPRM at ¶ 65.

[68] *Id.*

[69] NPRM at ¶ 65.

[70] *Id.*

section 254, the Act's universal service provision.[71] We sought comment on whether geographic averaging of SLCs is an implicit subsidy that is inconsistent with the requirements of section 254(e), and thus on whether we are required to deaverage SLCs.[72]

b. Discussion

73. The Commission has had the longstanding goal of ensuring that all consumers have affordable access to telecommunications services.[73] In its *Recommended Decision*, the Joint Board stated that current rates for local telephone services are generally affordable and that the SLC, as a charge assessed directly on local telephone subscribers, has an impact on universal service concerns such as affordability.[74] The Joint Board further recommended that the Commission maintain the current SLC ceilings for primary residential and single-line business lines,[75] and we adopt that recommendation in our companion *Universal Service Order*.[76] Numerous parties in this proceeding argue that we should raise or eliminate the SLC ceiling on all lines to permit LECs to recover the full interstate allocated costs of the local loop from end-users.[77] This would increase the average SLC for all residential and single-line business lines from $3.50 per month to $6.10 per month.[78] We conclude that it would be inappropriate to make significant changes to the SLC cap for primary residential and single-line business lines. Primary residential and single-line business lines are central to the provision of universal service. Because of concerns about affordability, and in light of the significant changes that are still underway in this proceeding, in the federal universal service support proceeding, and possible future changes

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[71] *Id.* at ¶ 66.

[72] *Id.* at ¶ 67.

[73] *See, e.g.*, MTS and WATS Market Structure, Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, CC Docket Nos. 78-72, 80-286; Decision and Order, FCC 85-643 (rel. Dec. 27, 1985).

[74] *Joint Board Recommended Decision*, 12 FCC Rcd at 472.

[75] *Id.* at 463.

[76] *Universal Service Order* at Section XII.C.

[77] *See, e.g.*, GTE Service Corporation (GTE) Comments at 26-29, Reply at 20-21; Southwestern Bell Telephone Company (SWBT) Comments at 37-38; Cincinnati Bell Telephone Company (Cincinnati Bell) Comments at 6-7; AT&T Corporation (AT&T) Comments 51-54, Reply at 25-26; Frontier Corporation (Frontier) Comments at 4, 5-7; Sprint Corporation (Sprint) Comments at 11-15; 50-51; Ad Hoc Telecommunications Users Committee (Ad Hoc) Reply at 4; General Services Administration/United States Department of Defense (GSA/DOD) Comments at 9-11, Reply at 5, 7; Tele-Communications, Inc. (TCI) Comments at 10; Reply at 4-5; Time Warner Communications Holdings, Inc. (Time Warner) Comments at 4-5; WorldCom, Inc. (WorldCom) Comments at 30-31.

[78] As discussed below, the data indicate that nationwide, the average interstate allocation of common line costs is $6.10 per line. *1996 LEC Annual Access Tariff Forecast Data*.

to the separations process, we conclude that the current SLC for these lines should not be raised. Consistent with the Joint Board's recommendation and our conclusion in the *Universal Service Order*, therefore, the ceiling on the SLC for primary residential and single-line business lines will remain at $3.50 or the permitted price cap common line revenues per line, whichever is less.

74. With regard to multi-line users, the Joint Board suggested in its *Recommended Decision* that universal service support should not be extended to non-primary residential lines and multi-line business lines because it found that cost of service is unlikely to be a factor that would cause multi-line users not to subscribe to telephone service.[79] Subsequently, the state members of the Joint Board filed a report with the Commission in which they proposed that we retain high cost support for all lines served in high cost study areas during a transition to a forward-looking cost methodology.[80] Consistent with that proposal, we adopt, in our *Universal Service Order*, a modified version of the existing high-cost support system and continue support for all residential and business connections in areas currently receiving high cost support until at least January 1, 1999.[81] We therefore continue to provide high cost support for non-primary residential and multi-line business lines at this time, by allocating a lower portion of these costs to the intrastate jurisdiction than would otherwise be the case.[82] In that order, we also express our concern, however, that providing universal service support for non-primary residential and multi-line business lines in high-cost areas may be inconsistent with our long-term universal service goals, and that overly expansive universal service support mechanisms potentially could harm all consumers by increasing the expense of telecommunications services for all.[83] We state that we will continue to evaluate the Joint Board's recommendation to limit universal service support to primary residential connections and businesses with single connections.[84]

75. We conclude here that it is necessary to adjust the ceilings on the interstate SLCs on both non-primary residential and multi-line business lines in order to create a rate structure that supports our long-term universal service goals, is pro-competitive, and is sustainable in a competitive local exchange market. Section 254 of the Act requires that all consumers have access to basic telephone service at just, reasonable, and affordable rates that are comparable

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[79] *Joint Board Recommended Decision,* 12 FCC Rcd 87 at 133.

[80] State Members Report on the Use of Cost Proxy Models at 3 (dated Mar. 26, 1997).

[81] *Universal Service Order* at Section IV.D and VII.D.

[82] *Universal Service Order* at Section VII.D.

[83] *Universal Service Order* at Section IV.D.

[84] *Universal Service Order* at Section IV.D.

among different regions of the nation.[85] This section of the Act also requires that universal service support be achieved through support mechanisms that are "specific, predictable, and sufficient."[86] Because universal service concerns about ensuring affordable access to basic telephone services are not as great for non-primary residential and multi-line business lines as they are for primary residential and single-line business lines, we must take action to remove the implicit subsidies contained in our current interstate access charges. Thus, we are adopting a rate structure that will permit LECs to recover greater amounts of their costs on a flat-rated basis from end users and to reduce the amount of revenues they must recover through per-minute access charges. Our initial implementation improves upon the current rate structure because it reduces subsidies by recovering more costs from the cost causer. It also creates a rate structure that is more pro-competitive than the existing one by providing for greater flat-rated recovery of NTS costs. Without these modifications, new entrants, which are not subject to the non-cost-causative rate structure requirements, would be in a position to target the incumbent LECs' most profitable, high-volume customers based on regulatory requirements. A loss of profitable customers would increase the incumbent LECs' costs of providing service to the rest of their customers, especially to those in high-cost areas. Consistent with our universal service goal of ensuring that all consumers receive affordable rates that are comparable in different parts of the nation, however, the SLC adjustments will be subject to ceilings to prevent end-user customers in high-cost areas from paying SLCs that are significantly higher than in other parts of the country.

76. In virtually all cases, current SLC ceilings do not permit incumbent LECs to recover their average per-line interstate-allocated common line costs.[87] As a result of the existing SLC ceilings, which have been in place for the past decade, incumbent LECs must recover the shortfall through usage-sensitive CCL charges assessed on IXCs. The IXCs in turn recover most or all of these costs from toll users in the form of per-minute charges, keeping toll rates artificially high and discouraging demand for interstate long distance services. The high per-minute toll charges also create support flows between different classes of customers. For example, because end-user customers vary widely in their use of interstate long distance services, low-volume toll users do not pay the full cost of their loops while high-volume toll users contribute far more than the total cost of their loops. In addition high-volume toll users, who include significant numbers of low-income customers, effectively support non-primary residential and multi-line business customers.[88]

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[85] 47 U.S.C. § 254(b)(3).

[86] 47 U.S.C. § 254(b)(5).

[87] The data indicate that only two study areas served by price cap LECs, (Bell Atlantic in the District of Columbia, and GTE in Minnesota) have interstate-allocated common line costs that are less than the current $3.50 SLC. These two study areas represent less than two percent of subscriber lines nationwide. *See 1996 LEC Annual Access Tariff Forecast Data.*

[88] *See* Robert W. Crandall, *Universal Service Subsidies and Consumer Welfare: Long-distance Access Charges*," Brookings Institution (April, 1997), Table 1, (showing that roughly 30 percent of households with income under $10,000 spend more on long-distance calls than do 50 percent of the households with income over $75,000).

77. In order to create a rate structure that supports our long-term universal service goals, is pro-competitive, and is sustainable in a competitive market, we modify our rate structure requirements to permit incumbent LECs to recover costs in a manner that more accurately reflects the way those costs are incurred. Because common line costs do not vary with usage, these costs should be recovered on a flat-rated instead of on a per-minute basis. In addition, these costs should be assigned, where possible, to those customers who benefit from the services provided by the local loop. Accordingly, the SLC ceilings for non-primary residential and multi-line business lines will be adjusted generally to a level that permits incumbent LECs to recover, directly from the end user, their average per-line interstate common line revenues.[89]

78. For multi-line business lines, the SLC will be adjusted to recover the average per-line interstate-allocated common line costs beginning July 1, 1997. To the extent incumbent price cap LECs, mostly in rural areas, have common line costs that significantly exceed the national average, we establish a ceiling on SLCs for multi-line business lines of $9.00, adjusted annually for inflation. To ameliorate any possible adverse impact of adjustments in SLC ceilings for non-primary residential lines, we adopt an approach that will gradually phase in adjustments in the SLC ceilings for these lines. The SLC for non-primary residential lines will be adjusted initially beginning January 1, 1998. For the first year, beginning January 1, 1998, the SLC ceiling for non-primary residential lines will be adjusted to the incumbent LEC's average per-line interstate-allocated costs, but may not exceed $1.50 more than the current SLC ceiling. Beginning January 1, 1999, the monthly SLC ceiling for these lines will be adjusted for inflation and will increase annually by $1.00 per-line, until the SLC ceiling for non-primary residential lines is equal to the ceiling permitted for multi-line business lines.

79. The data indicate that the long term ceilings we are establishing will permit incumbent price cap LECs to recover their average per-line common line revenues[90] from 99 percent of their non-primary residential and multi-line business lines.[91] For the few incumbent price cap LECs that have common line costs in certain study areas that exceed the ceiling, the ceiling will serve as an economic safeguard for those customers who would otherwise pay significantly higher SLCs.[92] We conclude that maintaining a ceiling for non-primary residential and multi-line business

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[89] As discussed in Section IV.D, below, in addition to the average per-line interstate-allocated common line costs, price cap LECs may include, in the SLC for non-primary residential and multi-line business lines, certain marketing expenses attributable to these lines.

[90] As discussed in Section III.A.3. below, when the multi-line PICC no longer recovers common line revenues, the calculation of the SLC will be changed from one based on interstate allocated *costs* to one based on common line *revenues* permitted under our price cap rules.

[91] *See 1996 LEC Annual Access Tariff Forecast Data*.

[92] The data indicate that twelve study areas served by three price cap LECs (GTE, U S West, and Citizens Utilities) have average common line costs that exceed $9.00. These areas represent less than two percent of subscriber lines nationwide. *See 1996 LEC Annual Access Tariff Forecast Data*.

customers in high-cost areas is a reasonable response to a legitimate universal service concern because, consistent with section 254(b)(3), it ensures that these customers have access to telecommunication services at rates that are comparable to rates charged for similar services in urban areas.[93]

80. We believe that the approach we adopt should prevent widespread discontinuance of lines by multi-line customers. The record indicates that nationwide, the average interstate allocation of common line costs is only $6.10 per line, and that for more than half of multi-line business lines, the interstate common line costs are below the existing $6.00 ceiling.[94] Therefore, when the SLC ceiling is adjusted July 1, 1997, more than half of multi-line business lines will see no immediate increase in their SLC. The $5.00 SLC ceiling for non-primary residential lines for the first year is a net increase of $1.50 per month and the gradual increase, if any, in subsequent years, is designed to allow these customers time to adjust to the new rate structure. Moreover, we expect the rate structure modifications we adopt in this order to benefit the majority of multi-line customers through reductions in per-minute long distance rates. Thus, for many customers, the access restructuring will lead to an overall reduction in their telephone bill. We also note that, because we are adjusting the SLC on non-primary residential lines only to a level that recovers the average interstate allocated costs attributable to the line, to the extent that a customer chooses not to purchase an additional line because of the SLC increase, it is because the benefits of the second line to that customer are less than the average cost of the line.

81. Many parties contend that adjusting the SLC ceiling for non-primary residential lines and multi-line business lines will affect economic development in rural areas.[95] To respond to this concern, with the limited exception of cost allocation to new elements, discussed in Section V, below, we are limiting application of the rate structure modifications we adopt in this Order to incumbent price cap LECs only. Most consumers in rural areas are served by small rate-of-return LECs that are not affected by the SLC adjustment we are adopting. We will review rate structure modifications affecting small, rural carriers in a separate proceeding when we address access charge reform for those carriers. To the extent there are incumbent price cap LECs that serve high-cost areas of the country and have common line costs that exceed the national average, we are maintaining a ceiling on the SLCs for these lines to ensure that subscribers do not pay rates

[93] 47 U.S.C. § 254(b)(3).

[94] *See 1996 LEC Annual Access Tariff Forecast Data.*

[95] *See, e.g.*, Harris, Skrivan & Associates, LLC (Harris, Skrivan & Associates) Comments at 6; TCA-Inc.-Telecommunications Consultants (TCA) Comments at 4; GVNW Inc./Management (GVNW) Comments at 7; John Staurulakis, Inc. (Staurulakis) Comments at 7-9; Western Alliance Comments at 22-24; ITCs, Inc. (ITC) Comments at 3; National Exchange Carrier Association, Inc. (NECA) Comments at 13, Reply at 7-9; Rural Telephone Coalition (Rural Tel. Coalition) Comments at 8; Pennsylvania Internet Service Providers Comments at 8-9; Commercial Internet Exchange Association (CIEA) Comments at 13; Reply at 10.

that greatly exceed the national average.[96]

82. We are not persuaded by arguments that an upward adjustment to a SLC ceiling that was set over a decade ago, and that has never been adjusted for inflation, would violate section 254(b)'s requirement that consumers in all regions of the nation have affordable access to telecommunications and information services at rates that are reasonably comparable to those services provided in urban areas.[97] The data indicate that if the SLC ceilings for business and residential lines had been adjusted annually for inflation since they became effective in 1984 and 1989, respectively, the $6.00 business SLC ceiling would have increased by 1996 to $9.00 per line, and the $3.50 residential and single-line business SLC ceiling would have increased to $4.39 per line.[98] Thus, for multi-line business customers, the SLC ceiling we adopt today is not significantly different from what it would have been, if it had been adjusted for inflation annually. Moreover, to adopt a ceiling lower than $9.00 would effectively create an additional impermissible subsidy for a class of customers not enumerated by Congress in section 254 of the 1996 Act as beneficiaries of fundamental universal service goals. We find that the $9.00 ceiling we adopt today strikes a reasonable balance between our desire to establish a more efficient interstate access charge rate structure consistent with our long-term universal service goals in a competitive local exchange environment, and the need to avoid precipitous rate increases to consumers in high cost areas. Although SLCs in some areas may ultimately be lower than SLCs in high-cost areas, we conclude that $9.00 SLCs remain "reasonably comparable" to those in urban areas.[99]

83. We are also not persuaded that we should maintain the current SLC ceiling for non-primary residential lines because of claims that incumbent LECs will be unable to identify second lines for purposes of billing different SLCs to these lines. Additional telephone lines are a well-established telecommunications product marketed by LECs. This product is supported by a marketing and billing infrastructure that will enable LECs to distinguish non-primary residential lines for purposes of billing different SLCs. We note that we are not defining "primary" or "non-primary" lines in this Order. In a further notice of proposed rulemaking in the Universal Service proceeding, we will address this issue, and release an order defining "primary"and "non-primary"

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[96] We will address access charge modifications as they apply to rate-of-return rural LECs in proceeding later this year. *See* Section V.A, below.

[97] *See, e.g.*, ITC Comments at 3; Rural Tel. Coalition Comments at 8, Reply at 11; TDS Telecommunications Corporation (TDS) Comments at 3-4, Reply at 4; Western Alliance Comments at 23; TCA Comments at 3-4.

[98] Calculations are based on Consumer Price Index for "All Items," *Trends in Telephone Service*, Table 6, (March 28, 1997).

[99] In Section IV.D, below, we conclude that price cap LECs may recover certain marketing expenses through the SLC on non-primary residential and multi-line business lines. That, however, does not affect the SLC ceilings for these lines.

residential lines by the end of the year.[100]

84. We are unpersuaded by arguments that we should forgo these changes on the grounds that increasing the SLC ceilings for non-primary residential lines will create undue incentives for subscribers to order their primary lines from the incumbent LEC and their additional lines from competitors. The changes we adopt in this Order are intended to permit incumbent LECs to move their prices for non-primary residential and multi-line business lines toward more economically efficient levels by substantially reducing implicit subsidies flowing between different classes of customers. Once these subsidies are eliminated and the new universal service regime is fully implemented, incumbent LECs will be able to recover their common line costs from customers through a rate structure that accurately reflects the manner in which these costs are incurred, and through a targeted, portable universal service contribution where necessary. At that point, both incumbent LECs and new entrants should be able to compete efficiently in the local exchange market. Subscribers, therefore, should not have an incentive to use other carriers for their additional lines unless a competitor is operating more efficiently and can offer local exchange service at a lower rate than the incumbent LEC is able to offer. Indeed, the ability of a competitive local exchange carrier to offer local exchange service at a lower rate is precisely the type of competition envisioned by the 1996 Act: it will encourage the incumbent LEC to reduce its costs of providing service in order to meet or beat the prices of its competition.

85. To address the concerns of some commenters that charging a higher SLC for second and additional residential lines will encourage subscribers to order their additional line from competitors, we will permit LECs to charge competitors the higher SLC when the competitor provides a customer with a second line through resale of an incumbent LEC offering. If prior to the development of full competition, we find that disparity between SLC charges on primary and additional residential lines becomes a significant problem, we will reexamine this issue in conjunction with further reforms we adopt in an upcoming order.

86. Certain incumbent LECs have requested that any rule that increases the SLC ceiling for non-primary residential lines should be optional for LECs.[101] We adopt this proposal in part and will not require LECs to charge a higher SLC for non-primary residential lines. Thus, if an incumbent LEC finds that charging higher SLCs leads to a large number of disconnections, it is free to charge less. To the extent price cap LECs choose to charge a SLC that is less than the maximum allowed, however, they may not recover these foregone revenues through the PICC or CCL charges. This restriction is consistent with our current price cap rules, which prevent LECs

[100] *Universal Service Order* at Section IV.D.

[101] *See, e.g.,* Bell Atlantic Telephone Companies and NYNEX (BA/NYNEX) Comments at 33-34; Pacific Telesis (PacTel) Reply at 22; Citizens Utilities Company (Citizens Utilities) Comments at 28-29.

from transferring SLC costs to the CCL charge.[102]

87. Several incumbent price cap LECs argue in favor of deaveraging SLCs, stating that an averaged SLC creates cross-subsidies between high-cost and low-cost areas, in violation of section 254 of the Act.[103] We will resolve this issue, along with issues concerning the timing and degrees of geographic deaveraging, pricing flexibility, and ultimate deregulation in an upcoming order.

3. Carrier Common Line Charge

a. Background

88. Because we are retaining the $3.50 ceiling on SLCs for primary residential and single-line business customers, virtually all price cap LECs will be unable to recover, through the SLC, all of their common line revenues permitted under our price cap rules. In the NPRM, we sought comment on possible revisions to the current CCL charge structure that would allow incumbent price cap LECs to recover these NTS common line costs in a way that reflects the way costs are incurred. We proposed a recovery mechanism suggested by the Joint Board in its *Recommended Decision*[104] that would permit incumbent LECs to recover common line costs not recovered from SLCs through a flat, per-line charge assessed against each end-user's presubscribed interexchange carrier.[105] The Joint Board suggested that the Commission allow incumbent LECs to collect the flat-rated charge directly from end users who have not selected a primary interexchange carrier ("PIC.")[106] We sought comments on this approach and also invited parties to discuss any potential problems created when end-user customers have selected PICs, but use other IXCs for Internet, fax, interexchange, or other interstate services by "dialing-around" the PIC.[107]

89. We also sought comment on several alternative approaches to the per-minute recovery of interstate NTS loop costs proposed by the Competition Policy Institute (CPI), including a "bulk billing" method that would assess a charge against the IXC based upon its

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[102] 47 C.F.R. § 69.104.

[103] *See, e.g.,* U S West Comments at 56; Ameritech Comments at 12-13; BellSouth Comments at 32; GTE Comments at 30-31.

[104] *Joint Board Recommended Decision,* 12 FCC Rcd at 474.

[105] NPRM at ¶¶ 59-63.

[106] *Joint Board Recommended Decision,* 12 FCC Rcd 87 at 474.

[107] NPRM at ¶ 60. Customers are able to "dial-around" their presubscribed interexchange carrier by dialing 10XXX before their area code and 7-digit exchange number.

percentage share of interstate minutes of use or revenues, a "capacity charge," a "trunk port charge," and a "trunk port and line port" charge.[108] We invited parties to comment on whether any changes that we adopt to the recovery of interstate NTS local loop costs for price cap LECs should be extended to rate-of-return LECs, and on the relationship of interstate NTS loop cost recovery to the universal service mechanisms proposed in the *Joint Board Recommended Decision.* We asked parties to address how such an extension to rate-of-return LECs would affect small business entities, especially small incumbent LECs.[109]

90. Additionally, we asked parties to address whether an alternative mechanism for recovering common line costs currently recovered through the CCL charge would be necessary if we were to eliminate the SLC ceiling for certain lines. We asked interested parties to address the extent to which any proposed alternative recovery mechanism for recovering common line costs currently recovered through the CCL charge would affect small business entities, including small incumbent price cap LECs and new entrants. We also sought comment on whether section 254(g) precludes an IXC from charging its customers the flat, per-line monthly rate assessed on that line if the amount of that charge varied among customers in different areas within a state or among customers in different states, and if so, whether conditions exist sufficient to require us to forbear from the application of section 254(g) to IXC recovery of flat-rate CCL charges.[110]

b. Discussion

91. The $3.50 SLC ceiling for primary residential and single-line business customers prevents most incumbent price cap LECs from recovering, through end-user charges, all of the common line revenues permitted under our price cap rules.[111] To the extent that common line revenues are not recovered through SLCs, incumbent LECs will be allowed to recover these revenues through a PICC, a flat, per-line charge assessed on the end-user's presubscribed interexchange carrier.

92. We adopt the Joint Board's recommendation that incumbent LECs may collect directly, from any customer who does not select a presubscribed carrier, the PICC that could otherwise be assessed against the presubscribed interexchange carrier. Assessing the PICC directly against end users that do not presubscribe to a long distance carrier should eliminate the incentive for customers to access long-distance services solely through "dial-around" carriers in order to avoid paying long-distance rates that reflect the PICC. Several parties argue that this

[108] *Id.* at ¶ 61

[109] *Id.*

[110] *Id.* at ¶¶ 62-63.

[111] *See* n.32, above.

type of billing arrangement will create administrative difficulties because it will require LECs to prorate charges for both the end user and the IXC when a customer leaves an IXC in the middle of the billing cycle. To avoid any potential administrative difficulties resulting from customers leaving their presubscribed interexchange carriers in the middle of a billing cycle, we will permit LECs to assess the full PICC at the beginning of each billing cycle.

93. We recognize that this flat, per-line PICC will not prevent customers from "dialing around" their presubscribed long distance carrier to obtain interstate service. Collecting a PICC from a customer, however, in and of itself, creates no incentive for a customer to presubscribe to one carrier and use "dial-around" service of another. If the presubscribed carrier is an efficient competitor, it should be able to offer usage-based rates comparable to the prices of a competitor, thus eliminating any artificial benefits of "dial-around" capability. A combination of lower per-minute long distance rates and attractive long-distance pricing packages that reward customers for increasing their usage of the presubscribed interexchange carrier's services should also help deter customers from using separate long-distance carriers for various services solely because of regulation. There is customer contact value in being a customer's presubscribed interexchange carrier. Regulators have long concluded that the convenience of making a long-distance call by simply dialing "1+" conveys certain advantages.[112] And the advantages of "1+" dialing will only increase if, as many predict, we move to a world in which "one-stop shopping" for a multiplicity of services becomes the primary paradigm for provision of telecommunication services. We conclude that the record does not support a finding that assessing a charge on the presubscribed carrier will artificially encourage "dial-around" traffic to such a degree that we should not adopt access charge modifications that will move substantially toward efficient pricing for common line elements and lower usage charges for long-distance service. If evidence appears to us that our rules do substantially contribute to undue use of "dial-around" capabilities to circumvent presubscribed interexchange services, we stand ready to revisit this issue at a later time.

94. The rate structure we are adopting calls for the single-line PICC ultimately to recover the difference between revenues collected through the SLC and the per-line common line revenues for primary residential lines and single-line business lines permitted under our price cap rules.[113] In order to provide incumbent LECs and IXCs with adequate time to adjust to this rate structure change, we cap the PICC for primary residential and single-line business lines at $0.53 per month for the first year, beginning January 1, 1998, and establish ceilings on increases thereafter. We note that the monthly $0.53 PICC is approximately equal to the current presubscribed per-line charges that are assessed to IXCs for the Universal Service Fund and

[112] *See, e.g., Local Competition Order*, 11 FCC Rcd at 15511.

[113] As discussed in Section III.B, below, line port costs will be reassigned from the local switching rate element to the common line rate element. As discussed in Section III.D, price cap LECs may also recover residual TIC revenues through PICCs.

Lifeline Assistance plan,[114] which are being eliminated in our *Universal Service Order*.[115] Beginning January 1, 1999, the ceiling on the monthly PICC on primary residential and single-line business lines will be adjusted for inflation and will increase by $0.50 per year until the sum of the SLC plus the flat-rated PICC is equal to the price cap LEC's permitted common line revenues per line. In no event shall the sum of the single-line SLC and PICC exceed the sum of the maximum allowable multi-line SLC and multi-line PICC.

95. Sprint asserts that if LECs recover NTS common line costs through deaveraged rates assessed on IXCs, we must forbear from applying section 254(g)[116] to the extent it requires an IXC to average geographically any flat charges an IXC passes on to its customers.[117] WorldCom asserts that IXCs should be permitted to recover their costs in any manner the market will allow, and that unless the Commission forbears with respect to the application of section 254(g) to these costs, IXCs that operate nationally will be forced to average together numerous subscribers' loop costs, and thus use long-distance rates as a vehicle for cross-subsidies that run counter to the overall policies of section 254(b) and (c).[118] We conclude that the information in the record before us does not demonstrate that we are required, by section 10(a) of the Act,[119] to forbear from enforcing section 254(g) as it relates to the manner in which IXCs recover their costs.

96. Section 10(a) of the 1934 Act requires the Commission to forbear from applying any regulation or provision of the Communications Act of 1934 if: (1) enforcement of that provision is unnecessary to ensure that the relevant charges and practices are just and reasonable and not unjustly or unreasonably discriminatory; (2) enforcement of that provision is unnecessary to protect consumers; and (3) forbearance from applying such provision or regulation is consistent with the public interest.[120] We conclude that, on the basis of the current record, IXCs have not demonstrated that forbearance of section 254(g) is warranted at this time.

97. We find that establishing a broad exception to section 254(g) to permit IXCs to pass

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[114] IXCs currently pay $0.0991 for the Lifeline Assistance and $0.4380 for the Universal Service Fund, a total of $0.5371. NECA Transmittal No. 729, F.CC. Tariff No. 5, (filed Nov. 15, 1996).

[115] *See Universal Service Order*, at Sections VII.C and XIII.F.

[116] Section 254(g) requires that "rates charged by providers of interexchange telecommunications services to rural and high cost areas shall be no higher than the rates charged by each such provider to its subscribers in urban areas." 47 U.S.C. § 254 (g).

[117] *See, e.g.*, Sprint Reply at 27.

[118] WorldCom Comments at 34.

[119] 47 C.F.R. § 160.

[120] *Id.*

through flat-rated charges on a deaveraged basis may create a substantial risk that many subscribers in rural and high-cost areas may be charged significantly more than subscribers in other areas. Accordingly, we cannot conclude that enforcing our rate averaging requirement is unnecessary to ensure that charges are just and reasonable. In addition, because assessing subscribers flat-rated charges on a deaveraged basis could lead to significantly higher rates for subscribers in high-cost areas, we find no basis in this record to conclude that it is unnecessary to enforce section 254(g) to ensure protection of consumers or to protect the public interest. In contrast, IXCs cite no countervailing public interest considerations but merely make broad, unsupported assertions of the need to deaverage rates in light of the varying PICC amounts expected to be assessed by incumbent LECs. We also note that IXCs now pay access charges that often vary from location to location and from incumbent LEC to incumbent LEC, and still maintain geographically averaged rates. We therefore conclude that, based on the record before us, the IXCs have not met the test set forth in section 10(a) of the Act, and forbearance of section 254(g) is not warranted.

98. We note that we will continue to examine the issue of whether conditions exist that require us to forbear from application of section 254(g) as it relates to recovery of the PICC costs from subscribers. We will resolve this and other specific issues concerning the timing and degrees of pricing flexibility and ultimate deregulation in an upcoming order.

99. To the extent that the SLC ceilings on all lines and the PICC ceilings on primary residential and single-line business lines prevent recovery of the full common line revenues permitted by our price cap rules, incumbent price cap LECs may recover the shortfall through a flat-rated, per-line PICC on non-primary residential and multi-line business lines.[121] The incumbent LECs will calculate this additional charge by dividing residual permitted common line revenues by the number of non-primary residential and multi-line business lines served by the LEC. For the first year, the ceiling on the PICC will be $1.50 per month for non-primary residential lines and $2.75 per month for multi-line business lines. To the extent that these PICCs do not recover an incumbent LEC's remaining permitted CCL revenues, incumbent LECs will be allowed to recover any such residual common line revenues through per-minute CCL charges assessed on originating access minutes. The per-minute charges shall be calculated based on forecasts of originating access minutes as currently provided in our rules.[122]

100. We generally will not permit incumbent LECs to recover residual common line revenues through per-minute CCL charges assessed on terminating access minutes, because terminating minutes are not likely to be subject to as much competitive pressure as originating

[121] As discussed in Sections III.D and IV.D, price cap LECs may also recover residual TIC revenues and certain marketing expenses through PICCs on non-primary residential and multi-line business lines, subject to the ceilings described below.

[122] 47 C.F.R. § 69.105.

access minutes. As discussed in Section III.D, below, we are similarly adopting a rule that requires that incumbent LECs be allowed to recover certain residual transport interconnection charge costs through access charges assessed on originating minutes. In placing these various residual costs on originating minutes only, however, we do not want to destroy the salutary effects of our access charge reforms by creating higher prices for originating minutes than exist under our current access charge rules. To the extent, therefore, that the sum of local switching charges, the per-minute CCL charge, the per-minute residual TIC, and any per-minute charges related to marketing expenses[123] exceed the current sum of local switching charges and the per-minute CCL charge and TIC assessed on originating minutes, the excess may be recovered through charges assessed on terminating minutes. We emphasize that any such amounts recovered through charges assessed on terminating minutes would be temporary and would be phased out as the non-primary residential SLC ceilings and the PICC ceilings are adjusted, and in any event, no later than July 1, 2000.

101. Beginning January 1, 1999, the PICC will be adjusted for inflation and will increase by a maximum of $1.00 per year for non-primary residential lines and $1.50 per year for multi-line business lines, until incumbent LECs recover all their permitted common line revenues through a combination of flat-rated SLC and PICCs. These increases will cease as the PICCs on primary residential and single-line business lines recover more of the common line revenues permitted under price cap rules. In addition, as the incumbent price cap LECs increase their PICCs for primary residential and single-line business lines, they shall reduce the amount recovered from the residual per-minute CCL charges and reduce their PICCs on non-primary residential and multi-line business lines by a corresponding amount in accordance with the procedures described below. While the plan we adopt today does not eliminate, even on a flat-rated basis, transitional higher rates for business users, it redistributes collection from a very few high-volume users to business users generally. This will permit the charges to be sustainable while we finish refining access charges and implement a forward-looking cost-based universal service mechanism for rural, insular, and high cost areas. We also acknowledge that our plan will require customers with multiple telephone lines to contribute, for a limited period, to the recovery of common line costs that incumbent LECs incur to serve single-line customers. We conclude that this aspect of the plan is a reasonable measure to avoid an adverse impact on residential customers.

102. As the PICC ceilings on primary residential and single-line business lines increase, the residual per-minute CCL charge will decrease until it is eliminated. After the residual per-minute CCL is eliminated, incumbent LECs shall make further reductions due to the increase in the PICC ceilings for primary residential and single-line business lines, first to the PICCs on multi-line business lines until the flat-rated PICCs for those lines are equal to the flat-rated PICCs for non-primary residential lines. Thereafter, incumbent LECs shall apply the annual reductions to both classes of customers equally until the combined SLC and PICCs for primary residential and

[123] *See* Section IV.D, below.

single-line business lines recover the full average per-line common line revenues permitted under our price cap rules, and the additional flat-rated PICCs on non-primary residential and multi-line business lines no longer recover common line revenues.[124] If the incumbent LEC's per-line common line revenues permitted by our price cap rules exceed the SLC ceiling for non-primary residential lines and multi-line businesses, the flat-rated charges will continue to apply to those lines so that the sum of the SLCs and flat-rated charges is equal to the permitted common line revenues. Once the multi-line PICC no longer recovers any common line revenues, the calculation of the SLC will be changed from the average per-line interstate allocation of revenue requirement[125] to the average per-line common line revenues permitted by our current price cap rules. With this change, the LEC will not be able to recover more than the average per-line common line revenues permitted under our price cap rules from any access line. We note that at least one party contends that under our current rules, certain price cap carriers could be required to charge negative carrier common line charges, if the revenues recovered through the SLC, which continues to be developed on a cost-of-service basis, exceed the PCI for the common line basket.[126] This adjustment to the calculation of the SLC will solve any such problem.

103. We are concerned that assessing PICCs on multi-line business lines may create an artificial and undue incentive for some multi-line customers to convert from switched access to special access to avoid the multi-line PICC charges. A migration of multi-line customers to special access could significantly reduce the amount of revenue that could be recovered through per-minute charges, and would result in higher PICCs for the non-primary residential and multi-line business lines remaining on the switched network. We tentatively conclude that we should therefore apply PICCs to purchasers of special access lines as well. The NPRM, however, may not have provided sufficient notice to interested parties that we might apply certain rate structure modifications to special access lines. We therefore seek comment on this issue in Section VII.A, below.

104. We reject claims that a flat-rated, per-line recovery mechanism assessed on IXCs would be inconsistent with section 254(b)[127] which requires "equitable and nondiscriminatory contribution to universal service" by all telecommunications providers.[128] The PICC is not a

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[124] As discussed in Sections III.D and IV.D, below, the PICC will recover TIC revenues and certain marketing expenses in addition to common line revenues. Therefore, multi-line PICCs may continue to recover non-common line revenues, even though SLCs and PICCs for primary residential and single-line business lines recover the average per-line common line revenues permitted under our price cap rules.

[125] 47 C.F.R. § 69.104(c)

[126] *See* Letter from Albert Shuldiner, Counsel for Aliant Communications Co. to William F. Caton, Acting Secretary, FCC, April 30, 1997.

[127] 47 U.S.C. § 254(b).

[128] Sprint Comments at 15-16; AT&T Reply at 28-29.

universal service mechanism, but rather a flat-rated charge that recovers local loop costs in a cost-causative manner. Numerous commenters responding to the NPRM support a flat-rated cost recovery mechanism,[129] and we conclude that the PICC is preferable to the other proposals made in the NPRM. We agree with MCI and the Minnesota Independent Coalition that proposals based on the number of trunks or ports that an IXC purchases from the incumbent LEC may encourage IXCs to use fewer trunks or ports than are needed and thereby have an adverse effect on service quality. We decline to adopt the bulk billing approach set out in the NPRM, as well as Ameritech's proposed Loop/Port Recovery charge and the approach proposed by the Competition Policy Institute, because these mechanisms are substantially affected by usage and do not reflect the NTS manner in which common line costs are incurred. The Alliance for Public Technology's proposed "facilities charge," which is a hybrid system that accounts both for level of use and intensity of use by all telecommunication carriers that use the local network, is flawed because it is based partly on usage and is complex and administratively burdensome. A cost-recovery mechanism that recovers common line costs through flat-rated charges imposed on end-user customers and IXCs is an administratively simple mechanism. Further, under our plan, interstate common line access charges will become more closely aligned with allocated interstate costs than they would be under any of the alternative proposals.

105. The plan we describe above should move us from the pricing scheme that has been in place for more than a decade to a flat-rated pricing scheme that seeks to promote competition, while balancing universal service considerations. We recognize that the modifications we adopt in this Order do not eliminate all the existing support flows. The modifications, however, do move to eliminate subsidies built into the current rate structure, to an extent that is compatible with preserving the universal service goals of providing support to primary residential and single-line business and to customers in high-cost areas pursuant to the mandate of section 254. As we set final support levels for universal service, address any legal issues related to the transition from embedded to forward-looking economic costs, and factor in the development of competition, we will identify and deal with any remaining legal issues relating to the recovery of these revenues. In addition, the plan we are adopting allows incumbent price cap LECs to recover costs in the manner that reflects the way in which they are incurred. We believe that this realignment of rates with costs will reduce the per-minute access charges assessed on IXCs and benefit consumers through lower long-distance rates, as well as create a pro-competitive local exchange market in

[129] *See, e.g.,* United States Telephone Association (USTA) Comments at 55-56; BA/NYNEX Comments at 35-36; BellSouth Comments at 68, Reply at 10-11; PacTel Comments at 64, Reply at 21; U S West Comments at 54; Citizens Utilities Comments at 27-28; Roseville Telephone Company (Roseville Tel.) Comments at 4, 8; Rural Tel. Coalition Comments at 6, Reply at 9; Competitive Telecommunications Association (CompTel) Comments at 29; Cable and Wireless, Inc. (Cable & Wireless) Comments at 10; Excel Telecommunications, Inc. (Excel) Comments at 11; LCI International Telecom Corp. (LCI) Comments at 20-21, Reply at 6; MCI Telecommunications Corporation (MCI) Comments at 77; Public Service Commission of the District of Columbia (District of Columbia Commission) Comments at 3-4; South Dakota Public Utilities Commission (South Dakota Commission) Comments at 3; National Association of Regulatory Utility Commissioners (NARUC) Comments at 13; National Cable Telephone Association, Inc. (NCTA) Comments at 26; American Communications Services, Inc. Reply at 17.

which LECs will be able to compete more efficiently.

4. Common Line PCI Formula

a. Background

106. When we adopted price cap regulation in 1990, we established a separate common line basket in order to balance the price cap goal of economically efficient prices with important goals, such as universal service, that were reflected in common line rates prior to the adoption of price caps. Because common line costs are non-traffic sensitive, growth in demand leads to a reduction in average per-minute common line charges. Therefore, in the *LEC Price Cap Order*, we established a price cap index ("PCI") formula for the price cap basket that differed from the PCI formula we established for the other three baskets, to ensure that carrier common line charges declined as common line demand increased.[130] Specifically, we added a term, "g/2," to the common line PCI formula, to represent half the growth in demand per line in the prior year.[131] This adjustment was made because we originally concluded that both LECs and IXCs have the ability to influence common line growth, and that both LECs and IXCs should benefit from increases in demand.[132]

107. In the *LEC Price Cap Performance Review*, we found that incumbent LECs in fact have little influence over per-minute common line demand, and tentatively concluded that we should remove the "g" term from the common line formula,[133] because including an industry-wide moving average X-Factor in the common line formula might tend to double-count demand growth. We sought comment, in the *Price Cap Fourth Further NPRM*, whether to apply the same PCI formula to the common line basket that we use for the other baskets if we were to adopt a TFP-based X-Factor.[134] We also invited comment on whether we could eliminate g/2 from the common line formula if we retain a separate common line formula.[135] In this Order, we adopt a plan that should quickly convert the CCL charge from a per-minute charge to a flat-rated per-line charge assessed on interexchange carriers. We also revise the common line formula to

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[130] *LEC Price Cap Order*, 5 FCC Rcd at 6793, 6795.

[131] *LEC Price Cap Order*, 5 FCC Rcd at 6795. The Commission did not adopt a common line formula based on an average of the per-line and per-minute approaches, because in some circumstances, this would have produced the anomalous result of CCL rates increasing in response to increases in demand. *Id*. at 6795. The mathematics of the common line formula are explained in detail in Appendix E of the *LEC Price Cap Order*, 5 FCC Rcd at 6942-44.

[132] *LEC Price Cap Order*, 5 FCC Rcd at 6795.

[133] *LEC Price Cap Performance Review*, 10 FCC Rcd at 9079.

[134] *Id.* at 13680.

[135] *Price Cap Fourth Further NPRM*, 10 FCC Rcd at 1368.

reflect the phase out of the CCL charge.

b. Discussion

108. We conclude that the separate common line PCI formula should be eliminated, and that the PCI formula for the traffic-sensitive and trunking baskets should be used for the common line basket, once traffic-sensitive CCL charges have been eliminated. In this Order, we have reduced substantially traffic-sensitive CCL charges, and replaced them with the per-line PICC. The remaining traffic-sensitive CCL charges imposed by incumbent price cap LECs will be reduced and then eliminated over the next two or three years. Once common line costs are recovered solely through per-line charges, increased minutes will not affect common line recovery. Therefore, when the traffic-sensitive CCL charges have been eliminated, it will no longer be necessary to ensure that CCL rates decline as per-minute demand increases. Incumbent price cap LECs that no longer assess per-minute CCL charges will use the same PCI formula for the common line basket as they use for the traffic-sensitive and trunking baskets.

109. In the *LEC Price Cap Order*, we established "g/2" as the common line PCI formula because we believed that because both LECs and IXCs contributed to encouraging common line demand growth, both LECs and IXCs should share in the benefits of common line demand growth.[136] In the *LEC Price Cap Performance Review,* we tentatively concluded that IXCs contributed more to common line demand growth, but declined to revise the common line formula at that time because we were contemplating eliminating the common line PCI formula completely, and because we did not wish to create unnecessary rate churn.[137] To avoid unnecessary rate churn here, we decide to retain "g/2" while carriers continue to charge per-minute CCL charges.

110. We revise sections 61.45(c) and 61.46(d), which govern the common line PCI and API, respectively, to reflect our revisions to the common line rate structure in the common line PCI formula. First, we redesignate section 61.45(c) as 61.45(c)(1) and adopt a new section 61.45(c)(2) that requires price cap LECs to use the separate common line formula only while they continue to charge per-minute CCL charges. Section 61.45(c)(2) also states that the common line PCI will be governed by the same PCI formula LECs use for the traffic-sensitive and trunking baskets. Second, we redesignate section 61.46(d) as 61.46(d)(1), and amend section 61.46(d)(1) to recognize that LECs now impose PICC charges as well as CCL charges on IXCs. We also adopt a new section 61.46(d)(2) to govern PICC charges once per-minute CCL charges have been phased out. These revisions are set forth in Appendix C of this Order.

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[136] *LEC Price Cap Order,* 5 FCC Rcd at 6795.

[137] *LEC Price Cap Performance Review,* 10 FCC Rcd. at 9079-80.

5. Assessment of SLCs and PICCs on Derived Channels

a. Background

111. Integrated services digital network (ISDN) services permit digital transmission over ordinary local loops through the use of advanced hardware and software.[138] ISDN offers data transmission at higher speeds and with greater reliability than standard analog service. Most incumbent LECs currently offer two types of ISDN service, Basic Rate Interface (BRI) service and Primary Rate Interface (PRI) service. BRI service allows a subscriber to obtain two voice-grade-equivalent channels and a signalling/data channel over an ordinary local loop, which generally is provided over a single twisted pair of copper wires.[139] PRI service allows subscribers to obtain 23 voice-grade-equivalent channels and one data signalling channel over two pairs of twisted copper wires.[140] BRI service generally is used by individuals and small businesses, and PRI service generally is used by larger businesses. LEC services other than ISDN use derived channel technology to provide multiple channels over a single facility.[141] The LECs also use derived channel technologies within their networks, for example, to provide customers with individual local loops. In such situations, the end user has not generally requested derived channel service and thus most likely is not aware that the LEC is using this technology.

112. On May 30, 1995, we released a Notice of Proposed Rulemaking seeking comment

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[138] In order for a LEC to provide ISDN, it must have a digital switch in the central office serving the customer, and substitute an ISDN line or trunk card for the standard cards that would otherwise be used in the central office with the loop facilities serving the customer. The customer also must use special ISDN-capable customer premises equipment.

[139] The two voice-grade-equivalent channels, which are called bearer or B channels, can be used for voice local exchange service or for data transmission at speeds up to 64 kbps. The third channel is a 16 kbps data channel, called the delta or D channel, which is used for signalling and packet data services. The Bell Atlantic Telephone Companies Petition for Waiver of Section 69.104 of the Commission's Rules in Connection with ISDN Services (filed Feb. 10, 1995) at 4 n.8 (*Bell Atlantic Waiver Petition*).

[140] In the case of PRI ISDN, the 23 B channels and the D channel can transmit voice or data at speeds up to 64 kbps. When a customer has more than one PRI connection at a given location, all of the B channels can share a single D channel, permitting the customer to obtain 24 voice-grade-equivalent channels for each PRI connection after the first one. *Bell Atlantic Waiver Petition* at 4, n.8

[141] For example, NYNEX Telephone Companies (NYNEX) uses derived channel technology to provide FLEXPATH service, which provides a customer with 24 digital voice-grade-equivalent trunk channels over a T-1 facility between a suitably equipped central office and a digital PBX. PBX Conversion Service, another NYNEX offering, provides digital trunking capability, with up to 24 trunk access lines, between a customer's digital PBX and an analog-to-digital interface located at the central office switch. NYNEX's Data Over Voice service provides customers with a voice-grade channel and a data channel over a single copper pair. Memorandum Opinion and Order, NYNEX Telephone Companies Revisions to Tariff F.C.C. No. 1, 7 FCC Rcd 7938 n.11 (Com. Car. Bur. 1992), *aff'd on recon.*, 10 FCC Rcd 2247 (1995). Several other LECs provide similar services using derived channel technology. *See, e.g.*, Cincinnati Bell Comments at 6.

on the application of SLCs to ISDN and other derived channel services.[142] In that NPRM, we noted that our current rules, which assess one SLC per derived channel, may discourage efficient use of ISDN services,[143] and we sought comment on several options, ranging from continuation of the current rules applying one SLC to each derived channel to requiring LECs to assess one SLC per each pair of copper wires or each physical facility.[144] Other options presented in the NPRM included: (1) basing the application of SLCs on a ratio of the average LEC cost of providing a derived channel service, including the trunk or line card costs, to the average cost of providing an ordinary local loop or T-1 facility; (2) applying one SLC for every two derived channels; (3) reducing the number of SLCs applied to derived channel services while increasing slightly the SLC rates; or (4) giving LECs flexibility concerning the number of SLCs they assess for derived channel services, at the same time adjusting the price cap rules to prevent an increase in CCL charges.[145]

113. In addition to the comments filed in response to the ISDN SLC NPRM, several BOCs provided data on the relative NTS costs of single and derived channel services.[146] The cost data included information about all NTS cost components, including components located in the central office, such as line cards. As shown in Table 1 below, the cost data indicates that the ratio of NTS loop costs of BRI ISDN to standard analog service is approximately 1 to 1. The ratio of NTS loop costs of PRI ISDN to standard analog service, excluding NYNEX's data, is approximately 5 to 1. As shown in Table 2, NYNEX's data appear to be outliers because the ratios of its outside plant and NTS costs for PRI ISDN to standard analog service are almost twice those of other incumbent LECs. NYNEX's data, therefore, are excluded from the

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[142] End User Common Line Charges, CC Docket No. 95-72, Notice of Proposed Rulemaking, 10 FCC Rcd 8565 (1995) (*ISDN SLC NPRM*).

[143] Section 69.104 of the Commission's rules, 47 C.F.R. § 69.104, provides for a monthly per line charge for end users that subscribe to local exchange service, stating that surcharges shall be assessed for each line between the customer's premises and a Class 5 Office that is or may be used for local exchange transmissions. In 1992, NYNEX which had been charging a SLC for each of the voice-grade-equivalent channels provided on a T-1 facility, filed a tariff in which it proposed to assess only one SLC for each T-1 facility used to provide a customer with certain services, even though the T-1 facility provided that customer with up to 24 voice-grade-equivalent channels. The Common Carrier rejected the Transmittal, finding that it did not comply with the commission's Part 69 rules governing assessment of SLCs. The Commission affirmed the Bureau's conclusion that Section 69.104 of the rules requires assessment of a SLC for each derived channel. Memorandum Opinion and Order, NYNEX Telephone Companies Revisions to Tariff F.C.C. No. 1, 7 FCC Rcd 7938, ¶ 2 (Com. Car. Bur. 1992) *aff'd on recon.,* 10 FCC Rcd 2247 (1995).

[144] *ISDN SLC NPRM* at ¶ 21.

[145] *Id*. at ¶¶ 22-23, 27-30, 32-34.

[146] In their responses, three of the BOCs, BellSouth, NYNEX, and Southwestern Bell, asked for confidential treatment of portions of the information submitted. NYNEX publicly filed the information we requested, but submitted as confidential additional information that contained more detailed cost data. The confidential data were not necessary to perform our analysis, and the following tables only include data that was filed on the public record. We have returned to the respective companies data for which confidential treatment was sought.

calculation of the average ratio for PRI ISDN to standard analog service.

TABLE 1

Ratio of costs of standard analog service to BRI ISDN service

	Outside Plant (loop only) costs	All NTS costs
Ameritech	1:1.07	1:1.45
Bell Atlantic	1:1.01	1:1.36
NYNEX	1:0.85	1:1.23
Pacific Bell	1:1.05	1:1.13
US West	1:0.80	1:1.07
Average ratio of costs	**1:0.96***	**1:1.24***

TABLE 2

Ratio of costs of standard analog service to PRI ISDN service

	Outside Plant (loop only) costs	Outside Plant (loop only) costs (excluding NYNEX data)	All NTS costs	All NTS costs (excluding NYNEX data)
Ameritech	1:5.68	1:5.68	1:8.9	1:8.9
Bell Atlantic	1:4.13	1:4.13	1:15.80	1:15.80
NYNEX	1:10.94	excluded	1:27.74	excluded
Pacific Bell	1:4.67	1:4.67	1:8.70	1:8.70
US West	1:5.33	1:5.33	1:10.60	1:10.60
Average ratio of costs	**1:6.5***	**1:4.95***	**1:15.13***	**1:10.5***

*Averages may differ due to rounding.

114. We incorporated by reference, in the current proceeding, all pleadings filed in response to the 1995 ISDN SLC NPRM, as listed in Appendix A of that order.[147] In the NPRM for the current proceeding, we invited comments on the effect of the 1996 Act on determining how many SLCs should be applied to ISDN services. We also sought comment on whether mandatory rate structures or rate caps should be prescribed for ISDN service or other derived channel services.[148]

b. Discussion

115. Consistent with the goal of this Order of realigning cost recovery in a manner that more closely reflects the manner in which those costs are incurred, we conclude that we should establish separate SLC rates for ISDN service based on the NTS loop costs of BRI and PRI ISDN service. We agree with the majority of commenters that a SLC for ISDN service equal to a SLC for single-channel analog service multiplied by the number of derived channels exceeds the NTS costs of ISDN service and therefore artificially discourages efficient use of ISDN. We find that basing ISDN SLCs on relative costs is most likely to assign costs of ISDN service to customers who subscribe to, and benefit from, that service. Further, we find that the current SLC-per-derived channel rule requires LECs to assess charges that are not related to the NTS costs of the service provided.

116. As set out above, the record indicates that the NTS loop costs of PRI ISDN service, excluding switching costs, reflect a cost ratio of approximately 5:1 compared to the NTS loop costs of single-channel analog service. We therefore conclude that we should amend our rules to establish, effective July 1, 1997, a SLC rate for PRI ISDN service equal to five times the incumbent LEC's average per-line interstate-allocated common line costs, subject to a ceiling of five times $9.00, adjusted annually for inflation. Similarly, the record shows that the NTS loop costs of BRI ISDN service, excluding NTS switching costs, when rounded to the nearest half SLC, reflect a 1:1 cost ratio relative to the NTS loop costs of single-channel analog service. Therefore, we here amend our rules to provide for a SLC rate for BRI ISDN service equal to the incumbent LEC's average per-line interstate-allocated common line costs, subject to the same ceilings otherwise applicable to non-primary residential lines. Thus, beginning January 1, 1998, the SLC ceiling for BRI ISDN service will be set at the lesser of the incumbent LEC's average per-line interstate-allocated costs, or $5.00. Each subsequent year, beginning January 1, 1999, the SLC ceiling will be adjusted for inflation and increased by $1.00 per line, until the ceiling equals that permitted for multi-line business lines.

117. The cost data submitted by the BOCs in response to our request for information

[147] All pleadings filed in response to the 1995 *ISDN SLC NPRM* will be so noted.

[148] NPRM at ¶ 70.

includes information about all NTS cost components, including components located in the central office, such as line cards and trunk cards. The data confirm that line cards and trunk cards for PRI ISDN service in particular constitute a significant portion of the total NTS costs that are dedicated to the provision of service to the subscriber, and that ISDN line cards and trunk cards are many times more expensive than the cards used for standard analog service. As discussed in Section III.B, below, LECs will be required to recover the difference between the cost of an ISDN line card and the cost of a line card used for basic, analog service through a separate charge assessed directly on ISDN end users. For purposes of determining the rate levels for ISDN SLCs, therefore, we considered only the NTS loop costs associated with providing ISDN service.

118. As with other non-primary residential and multi-line business lines, incumbent price cap LECs may assess flat-rated PICCs on ISDN service to the extent necessary to recover the shortfall of common line revenues caused by SLC ceilings. Incumbent price cap LECs are permitted to assess one PICC for BRI ISDN service and five PICCs for PRI ISDN service. It is necessary for incumbent LECs to be able to assess up to five PICCs on PRI ISDN service because, as discussed above, the record indicates that the NTS loop costs of providing PRI ISDN service, excluding switching costs, reflect a cost ratio of approximately 5:1 compared to NTS loop costs of single-channel analog service. Because the PICC recovers NTS common line costs not recovered through the SLC, prohibiting incumbent LECs from charging as many as five PICCs for PRI ISDN service could prevent them from recovering the common line costs associated with providing PRI ISDN service in cases where the common line costs exceed the SLC ceiling.

119. Incumbent LECs shall assess PICCs on BRI and PRI ISDN services in conjunction with those on the non-primary residential and multi-line business lines. For the first year, the BRI ISDN PICC will be capped at $1.50 per month, and the PRI ISDN PICC will be capped at $2.75 per month. Each subsequent year these two PICCs shall increase by no more than an inflation adjustment, plus $1.00 and $1.50, respectively.

120. The record does not contain sufficient information to enable us to determine the relative NTS costs of derived channel services other than ISDN. We therefore limit our decision to BRI and PRI ISDN service. We agree with NYNEX that we should not apply the rules we adopt here regarding SLCs when the LEC uses derived channel technology but the end user has not requested derived channel service. Unless a subscriber orders ISDN or another service that requires derived channel technology, we see no reason to vary from our general rule that the incumbent LEC should charge one SLC for each channel regardless of how it is provisioned.[149]

[149] This is consistent with our prior treatment, in other contexts, of derived channel technology. International Business Machines Corporation, Petition for Declaratory Ruling that LADT Services be Offered only through Telephone Company Organizations Separate from Network Operations, Memorandum, Opinion and Order, FCC 85-292 (rel. June 11, 1985) (*LADT Order*); *recon*., FCC 86-122 (rel. Mar 25, 1986).

121. We are not persuaded by PacTel's argument that ISDN service is not an interstate service and should not, therefore, be regulated by the Commission. ISDN lines are not directly assigned to the intrastate jurisdiction, but are treated as common lines. The Commission's jurisdiction thus includes the interstate-allocated portion of the costs of the ISDN lines. The rules we adopt in this order govern only the manner in which LECs recover the interstate-allocated common line costs associated with providing ISDN service.

122. Before the Commission initiated CC Docket No. 95-72, Bell Atlantic, Pacific Bell, GTE, Cincinnati Bell, U S West, and Bellsouth sought waivers of Section 69.104 of the Commission's rules as it applies to ISDN service.[150] In their petitions, these LECs urged the Commission to amend its rules regarding the application of SLCs to ISDN service. We have amended our rules regarding the applications of SLCs to ISDN service. We therefore dismiss the waiver petitions of Bell Atlantic, Pacific Bell, GTE, Cincinnati Bell, U S West, and Bellsouth on the grounds that they are moot.

B. Local Switching

1. Non-Traffic Sensitive Charges

a. Background

123. The local switch connects subscriber lines both with other local subscriber lines and with interoffice dedicated and common trunks. A local switch consists of (1) an analog or digital switching system; and (2) line and trunk cards, which connect subscriber lines and interoffice trunks, respectively, to the switch. Because all of this equipment is deployed within the central office, all of its costs are assigned to the central office switching accounts of the Commission's Uniform System of Accounts and to the local switching category of central office expenses for jurisdictional separations purposes.[151] The interstate portion of these costs is currently recovered through per-minute local switching charges levied on IXCs.[152]

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[150] The Bell Atlantic Telephone Companies Petition for Waiver of Section 69.104 of the Commission's Rules in Connection with ISDN Services (filed February 10, 1995); Pacific Bell Petition for Waiver of Part 69.104 as Applied to Derived Channel Services such as ISDN (filed February 21, 1995); The GTE Telephone Companies Petition for Waiver of Section 69.104 of the Commission's Rules in Connection with ISDN Services (filed March 2, 1995); Cincinnati Bell Telephone Company's Petition for Waiver of Section 69.104 of the Commission's Rules in Connection with ISDN-BRI Services (filed March 16, 1995); U S West Communications, Inc., Petition for Waiver of Section 69.104 of the Commission's Rules as Applied to ISDN Services (filed April 4, 1995); BellSouth Telecommunications, Inc. Petition for Waiver of Section 69.104 of the Commission's Rules in Connection with ISDN Services (filed April 5, 1995).

[151] 47 C.F.R. §§ 32.2001(j), 36.125.

[152] 47 C.F.R. § 69.106.

124. In the NPRM we observed that a significant portion of local switching costs may not vary with usage. For example, the cost of line cards or line-side ports appears to vary with the number of loops connected to the switch, not with the level of traffic over the loops. We tentatively concluded that LECs should not recover these costs through per-minute charges. Instead, we tentatively concluded that it is more reasonable and economically efficient to recover costs of equipment dedicated to individual customers, such as line-side ports and trunk ports associated with dedicated transport, through flat-rated charges. Trunk-side ports not associated with dedicated transport and the central processing portion of the switch, on the other hand, are shared among multiple carriers. We asked if these costs are driven by usage or by the number of lines and trunks served by the switch. We sought comment on whether rate structures for shared local switching facilities should consist of usage-sensitive, flat-rated, or a combination of both flat-rated and usage-sensitive rate elements. We asked commenters to recommend methods of identifying non-traffic-sensitive (NTS) local switching costs.[153]

b. Discussion

125. We conclude that, consistent with principles of cost-causation and economic efficiency, NTS costs associated with local switching should be recovered on a flat-rated, rather than usage sensitive, basis. The record before us indicates clearly that the costs of the line side port (including the line card, protector, and main distribution frame)are NTS. We conclude, therefore, that these costs should be recovered through flat-rated charges. Accordingly, for price-cap LECs, we reassign all line-side port costs from the Local Switching rate element[154] to the Common Line rate elements.[155] For price cap companies, these costs will be recovered through the common line rate elements, including the SLC and flat-rated PICC, described in Section III.A., above.

126. LECs incur differing costs for line ports used in the provision of different services. The SLC and PICC cost recovery mechanisms will recover only the cost of a line port used to provide basic, analog service, whether the end user has basic, analog service, or another form of service. As discussed above, data submitted in response to the ISDN SLC NPRM show that ISDN line cards cost significantly more than line cards associated with a basic, analog, subscriber

[153] NPRM at ¶¶ 72-73.

[154] Currently, NTS costs of line-side ports are recovered through per-minute local switching charges assessed under section 69.106 of our rules, 47 C.F.R. § 69.106.

[155] Part 69 establishes two common line elements, the End User Common Line element, 47 C.F.R. § 69.4(a), and the Carrier Common Line element, 47 C.F.R. § 69.4(b)(2). Price cap LECs currently calculate adjustments to these charges in accordance with 47 C.F.R. § 61.46. Other LECs currently compute these charges in accordance with 47 C.F.R. §§ 69.104 - 69.105.

line.[156] To the extent that the costs of ISDN line ports, and line ports associated with other services, exceed the costs of a port used for basic, analog service, price cap LECs will recover this excess amount through a separate end-user charge.

127. We conclude that the costs of a dedicated trunk port (including the trunk card and DS1/voice-grade multiplexers, if needed) should be recovered on a flat-rated basis because these costs are also NTS in nature. These costs should be recovered from the carrier purchasing the dedicated trunk terminated by that port. Similarly, we conclude that the costs of shared trunk ports should be recovered on a per-minute of use basis from the users of common transport trunks. We therefore establish two separate rate elements for recovery of these costs. Price cap LECs may recover the costs of each dedicated trunk port on a flat-rated basis from the purchaser of the dedicated trunk terminating at the port. In order to ensure that these purchasers of dedicated trunks do not pay the costs of shared trunk ports that they do not use, price cap LECs must also establish a usage-sensitive rate element for recovery of the costs of shared trunk ports. The costs of these shared trunk ports will be recovered on a per minute-of-use basis from users of common transport trunks terminating at these ports. We therefore add a separate category for all trunk port costs within the traffic sensitive basket, 47 C.F.R. § 61.42(e)(1). As with the other categories within this basket, the "trunk ports" category will have an upper service band index of +5 percent and no lower service band index.

128. We do not establish a fixed percentage of local switching costs that incumbent LECs must reassign to the Common Line basket or newly created Trunk Cards and Ports service category as NTS costs. In light of the widely varying estimates in the record, we conclude that the NTS portion of local switching costs likely varies among LEC switches. Accordingly, we require each price cap LEC to conduct a cost study to determine the geographically-averaged portion of local switching costs that is attributable to the line-side ports, as defined above, and to dedicated trunk side ports. These amounts, including cost support, should be reflected in the access charge elements filed in the LEC's access tariff effective January 1, 1998. Once established, this service category, like all others in the traffic sensitive basket, shall be subject to price cap adjustments for inflation and productivity. Although some LECs have obtained

[156] In response to our request for information in *End User Common Line Charges*, CC Docket No. 95-72, all of the BOCs submitted information on the NTS costs of providing ISDN service. *See* Letter and attachments from Anthony M. Alessi, Director, Federal Relations, Ameritech, to William F. Caton, Acting Secretary, Federal Communications Commission, October 23, 1995; Response to Data Request from Bell Atlantic, October 18, 1995; Letter and attachments from W.W. Jordan, Executive Director, Federal Regulatory, BellSouth, to Kathleen Wallman, Chief, Common Carrier Bureau, October 18, 1995; Letter and attachments from Joseph Di Bella, Counsel, NYNEX Government Affairs, to Kathleen M.H. Wallman, October 24, 1995; Letter and attachments from Sheryl L. Herauf, Director, Federal Regulatory Relations, Pacific Telesis, to William F. Caton, October 18, 1995; Letter and attachments from Paul Walters, Attorney, Southwestern Bell, to William F. Caton, October 11, 1995; Letter and attachments from Cyndie Eby, Executive Director, Federal Regulatory, US West, to William F. Caton, October 18, 1995. BellSouth, NYNEX, and Southwestern Bell requested confidential treatment for some of the information they submitted. In concluding that there are greater NTS costs associated with ISDN line cards, however, we did not rely on the allegedly confidential data because data adequate to support our conclusion was not subject to any request for confidential treatment.

authority to geographically deaverage transport rates under a zone density pricing plan, because the costs of trunk ports will remain within the Traffic Sensitive basket, we conclude that trunk port costs should remain geographically averaged for now. We will consider deaveraging of these costs in connection with our assessment of other forms of pricing flexibility in a subsequent Order in this proceeding.

129. We direct all price cap LECs to include in their tariff filings implementing this Order an exogenous downward adjustment to the Traffic Sensitive basket, 47 C.F.R. § 61.42(d)(2), and corresponding exogenous upward adjustment to the Common Line Interstate Access Elements basket, 47 C.F.R. § 61.42(d)(1) to reflect the recovery of the interstate NTS costs of line-side ports from the Common Line rate elements.

130. USTA, SNET, and BA/NYNEX argue that we should not codify any specific local switching rate elements. We disagree. In the NPRM, we proposed to eliminate local switching rate elements only when an actual competitive presence is established for an exchange access service in a relevant geographic area, as measured by (1) demonstrated presence of competition; (2) full implementation of competitively neutral universal service support mechanisms; and (3) credible and timely enforcement of pro-competitive rules.[157] We tentatively concluded in the NPRM that, in the absence of actual competition, the mere availability of unbundled network elements under efficient rate structures would not provide incumbent LECs with sufficient incentive to adopt efficient, cost-causative access rate elements or structures.[158] The record before us indicates that flat-rated pricing for line ports and dedicated trunk ports is efficient, and reflective of cost causation. We will first amend the baseline switched access rate structure to reflect this determination. Then, in a subsequent Report and Order in this docket, we will determine when and under what circumstances we will allow incumbent LECs greater flexibility in designing interstate access rate structures.

131. In addition, despite arguments from BA/NYNEX to the contrary, we find that the benefits to be gained from a more efficient, cost-causative rate structure outweigh the burden of establishing these flat-rate elements. Independent estimates from Cable & Wireless and USTA, both using NYNEX data, indicate that as much as, or even more than, half of local switching costs may be NTS.[159] Since the current, per-minute rate structure for the local switch was established, digital switches have become increasingly predominant in the network.[160] Given

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[157] NPRM at ¶¶ 201-02.

[158] NPRM at ¶ 214.

[159] USTA Comments, Attachment 2 at 31; Cable & Wireless Comments at 12-13.

[160] We adopted the current, per-minute rate structure for local switching in 1983, *MTS and WATS Market Structure*, Phase I, Third Report and Order, 93 F.C.C.2d 241, 304-07 (1983). On reconsideration, we considered AT&T's proposal to redefine the local switching element to provide carriers with flexibility to establish a "transport

USTA's estimate that six percent of the costs of an analog switch and 51 percent of the costs of a digital switch are NTS,[161] we find that local switching costs have become increasingly NTS and now warrant the creation of a NTS recovery mechanism. Including NTS local switching costs in per-minute access charges contributes significantly toward unnecessarily high per-minute long distance rates for all customers. Restructuring rates to reflect more accurately cost-causation will promote competition, reduce per-minute charges, stimulate long-distance usage, and improve the overall efficiency of the rate structure.

132. We also reject proposals to recover the entire NTS portion of local switching costs from the new universal service support mechanisms.[162] In the *Universal Service Order*, we agreed with the Joint Board that we should establish a "nationwide benchmark based on average revenues per line for local, discretionary, interstate and intrastate access services, and other telecommunications revenues that will be used with either a cost model or a cost study to determine the level of support carriers will receive for lines in a particular geographic area."[163] We find that it would be inconsistent with the Joint Board's recommendation if we were to mandate recovery of NTS local switching costs directly from universal service support mechanisms, independent of the revenue benchmark, and the percentage of high cost support recoverable from the federal universal service mechanisms at this time.[164]

133. It is not necessary to await action by the Joint Board on Separations[165] before

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termination" category, containing all equipment in the switch that terminates the line to trunk facilities from the IXC's POP, and a "common switching" category, containing the traffic sensitive local exchange switching used by a carrier. *MTS and WATS Market Structure*, Phase I, Memorandum Opinion and Order, 97 F.C.C.2d 682, 735-37 (1983). In response, we stated that, "[t]he flexibility that AT&T specifically requests for pricing the Local Switching element reflects a belief that our access charge plan should be revised to permit telephone companies to recover their costs for both end user and traffic sensitive access elements through a mixture of non-recurring charges and flat and usage-based periodic charges and that the carriers rather than this Commission should determine what that mixture should be . . . . While we believe that the access charge rules should evolve over time to reflect the menu of access services that AT&T foresees, we believe that the broad discretion AT&T proposes must await the development of the costing tools that can support the additional disaggregation of costs. Therefore we reject this proposal." *Id.* at 736. As digital switches have become increasingly prevalent within the network, we conclude that the time has come to establish some NTS elements for the NTS costs of line and dedicated trunk ports. We will consider questions of additional flexibility in connection with our assessment of the market-based approach to access reform.

[161] USTA Comments, Attachment 2 at 31.

[162] *E.g.*, BellSouth Reply at 10.

[163] *See Universal Service Order* at Section VII.C.5.

[164] *Id.* at Section VII.C.6.

[165] In allocating costs between the intrastate and interstate jurisdictions, the Commission consults with the states through the operation of the Joint Board on Separations. *See* 47 U.S.C. § 410(c); *Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board*, Notice of Proposed Rulemaking and Order Establishing a Joint Board, 78 F.C.C.2d 837 (1980).

revising the recovery mechanisms applicable to the interstate portion of the costs attributed to line ports and dedicated trunk ports. Our revision of the mechanisms used to recover the interstate portion of the costs in Part 32 local switching accounts that the jurisdictional separations process allocates to the interstate jurisdiction will have no direct effect on that allocation because these costs will continue to be separated in Part 36 based on relative dial-equipment-minutes of use. The fact that local switching costs are apportioned between jurisdictions based on a relative interstate and state usage is irrelevant to the choice of pricing structure for recovering those costs, however. Economic efficiency does not require the jurisdictional separation of NTS costs be based on an NTS (flat) factor. The jurisdictional separations process only determines whether the billed charges (flat or variable) are characterized as intrastate or interstate. Economic efficiency does require that NTS costs, regardless of how they are separated, be recovered in each jurisdiction through flat charges. Thus, there was no loss of economic efficiency when the Commission, agreeing with the recommendation of the Joint Board, simplified the separation of local switching by eliminating the former distinction between NTS and traffic-sensitive costs and creating a single switching category that is assigned to the jurisdictions based on dial equipment minutes.[166]

134. On the other hand, economic efficiency will be increased if local switching costs (regardless of the jurisdiction to which they are assigned) are recovered through a combination of flat charges for NTS costs and traffic sensitive charges for the remainder. Because, at the time that the Commission established the current jurisdictional separations process, it did not consider the distinction between the switch and the port that we address today, the current jurisdictional separations process does not distinguish port costs from the costs of the local switch itself.[167] We have the authority and obligation, independent from the Joint Board, to establish appropriate rate structures for recovering the costs the jurisdictional separations process allocates to the interstate jurisdiction.[168] We take steps today to address the fact that the costs of line ports and dedicated trunk ports are more properly recovered for Part 69 purposes from the Common Line and Direct-Trunked Transport rate elements as NTS charges, instead of from the traffic sensitive Local Switching element. We will, however, examine any jurisdictional separations issues presented by NTS switching costs in our upcoming separations NPRM.

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[166] *MTS and WATS Market Structure*, Report and Order, 2 FCC Rcd 2639, 2642 (1987).

[167] 47 C.F.R. § 36.125(b). *See MTS and WATS Market Structure*, Report and Order, 2 FCC Rcd at 2642 (adopting Joint Board recommendation). The Commission subsequently explained that digital switches use concentrators to allow a small number of components to serve a large number of lines, taking advantage of the fact that most lines are unused most of the time. Because increased usage volume per line reduces the concentration level and increases the number of switch components required, the Commission concluded that "the costs of modern digital switches is actually predominantly [traffic sensitive]." *MTS and WATS Market Structure*, Order on Reconsideration and Supplemental Notice of Proposed Rulemaking, 3 FCC Rcd 5518, 5526 (1988). In performing this analysis, therefore, the Commission did not indicate that it gave specific consideration to the costs associated with of line ports and dedicated trunk ports. These components must be provisioned in a 1:1 ratio with lines and trunks, respectively, and their costs do not vary with traffic levels.

[168] *E.g.*, 47 U.S.C. §§ 151, 152, 154(i-j).

135. Costs may vary for shared local switching facilities according to the number of lines connected, or the traffic over those lines.[169] In the former case, the costs of the shared facility may be recovered in the most cost-causative manner by imposing a proportionate share of the costs on each line while, in the latter case, usage-sensitive charges may better reflect cost causation. With respect to such shared local switching facilities, including the switching matrix and shared trunk ports, we gave states flexibility in our interconnection proceeding to establish either per-minute usage charges, or flat-rated charges, as appropriate.[170] In the access context, however, we will continue to require price cap incumbent LECs to recover the costs of shared local switching facilities, including the central processor, switching matrix, and shared trunk ports, on a per-minute basis. On the basis of the information in the record before us, it would be difficult to identify the NTS and traffic-sensitive portions of the costs of shared switching facilities and to verify the accuracy of LEC studies attempting to do so.[171] Therefore, until we gain more experience with rate structures for unbundled network elements that are implemented pursuant to Sections 251 and 252 and that segregate these costs into traffic-sensitive and NTS components, we will continue to adhere to the current, per-minute rate structure for shared switching facilities.

2. Traffic Sensitive Charges

136. In the NPRM, we sought comment on several alternative rate structures for recovery of usage-sensitive local switching costs. Specifically, we sought comment on whether the Commission should require or permit LECs to establish a separate charge for call setup, and if so, whether the charge should be levied on all call attempts, or only completed calls.[172] We also sought comment on whether the Commission should require or permit incumbent LECs to establish peak and off-peak pricing structures for shared local switching facilities,[173] and whether the existing per-minute rate structure adequately reflects the manner in which traffic-sensitive local switching costs are incurred.[174]

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[169] *Compare* Cable & Wireless Comments at 12-13 *and* Citizens Utilities Comments at 30 *and* GSA/DOD Comments at 4 *and* Texas Commission Comments at 11-12 *with* BellSouth Comments, Attachment 2 at 14.

[170] *Local Competition Order* at ¶¶ 810-18.

[171] MCI Comments at 80-82.

[172] NPRM at ¶¶ 75-76.

[173] NPRM at ¶¶ 77-78.

[174] NPRM at ¶ 79.

a. Call Setup Charges

137. Among price cap carriers today, most call setup is performed with out-of-band signalling, generally using the SS7 signalling network.[175] In light of the widely varying estimates of the costs of call setup in the record,[176] we conclude that these costs may be more than a *de minimis* portion of the costs of local switching. The record indicates that these call setup charges are incurred primarily on a per-call rather than a per-minute basis.[177] By requiring recovery the costs of call setup on a per-minute basis, our current rate structure mandates an implicit subsidy running from customers that make lengthy calls to those that make many short-duration calls. Therefore, we find that we should not continue to require the price cap LECs to recover costs of call setup from per-minute local switching charges.

138. Accordingly, we will revise Section 69.106 of our rules[178] to permit, but not to require, price cap LECs to establish a separate per-call setup charge assessed on IXCs for all calls handed off to the IXC's point of presence (POP). As noted earlier, because an incumbent LEC originating an interstate call incurs call setup costs even if the call is not completed at the called location, we permit these LECs to recover call setup charges on all originating interstate calls that are handed off to the IXC's POP, and on all terminating calls that are received from an IXC's POP. With respect to originating call attempts, we agree with the California Commission that, when the call is handed off to the IXC's POP, the incumbent LEC's switches and signalling network have performed their functions and the incumbent LEC has incurred the full cost of call setup.[179] We also permit incumbent LECs to impose a setup charge for terminating calls received from an IXC's POP, whether or not that call is completed at the called location, because the incumbent LEC signalling network in either case must perform its setup function.

139. We conclude that the call setup charge should not be mandatory because some

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[175] Ameritech comments that it uses SS7 for over 95 percent of its customers, that its use of SS7 is increasing, and that other large incumbent LECs probably have comparable figures. Ameritech Comments at 16. For a more detailed description of the operation of the SS7 signalling network, *see* Section III.E.

[176] While Sprint estimates that call setup costs represent approximately two to six percent of the costs of a typical call (Sprint Reply at 14), PacTel estimates that it costs five times more to set up a call than it does to provide a minute of use (PacTel Comments at 68). Using the industry average call duration cited by the California Commission (Reply at 3) of 3.86 minutes, call setup charges would represent a much larger percentage of the total costs of a typical call than Sprint estimates.

[177] *E.g.*, Excel Comments at 12; TRA Comments at 37; Ameritech Comments at 15; PacTel Comments at 69; Citizens Utilities Comments at 30; Frederick & Warinner Comments at 6-7; Minnesota Independent Coalition Comments at 15; Alabama Commission Comments at 8; California Commission at 2-3; Texas Commission at 14; TCI Comments at 12.

[178] 47 C.F.R. § 69.106.

[179] California Commission Reply at 2.

incumbent LECs may determine that call setup costs either are in fact *de minimis* or are otherwise outweighed by the costs of the network and operations support systems (OSS) upgrades necessary to install measurement and billing systems. In such cases, it would be economically inefficient to mandate a separate call-setup charge because the costs of collecting the charge might exceed the revenue collected from the charge itself. We are aware that, by making the call-setup charge permissive only, we may allow certain incumbent LECs' rate structures to continue to subsidize short-duration calls. We nevertheless conclude that we should not mandate separate collection of a call-setup charge in cases where the LEC determines that the costs of eliminating this subsidy exceed the benefits to be gained. In contrast, we find that those incumbent LECs that either have or obtain the ability to implement a call-setup charge should have the flexibility to adopt this cost-causative rate structure.

140. No party disputes the fact that incumbent LECs incur costs of call setup for call attempts, in addition to completed calls. Some parties, however, argue that call setup charges should be assessed only on completed calls in order to reduce customer confusion. We anticipate that consumer confusion will be minimal, however, because the call setup charge we permit will be imposed on IXCs, not end users. We find it unlikely that IXCs would choose to pass this charge along to their customers in the form of a separate charge per call attempt. For instance, IXCs today generally charge their customers for completed long distance calls even though they incur access charges for many uncompleted calls as well.[180]

141. Other commenters state that setup charges imposed on call attempts will result in charges being imposed on a caller that has not received service. LCI asserts that "customers do not expect to pay for uncompleted call attempts, and the carriers are not entitled to recover their costs of uncompleted call attempts,"[181] citing the Commission's decision in *VIA USA, Ltd.*[182] The text cited from that order, however, addresses only customer expectations that have arisen because our current rules make no explicit provision for the recovery of costs of an uncompleted call. We now find that a call setup charge, assessed to an IXC, should not be prohibited because a rate structure that recovers some switching costs through a per-call setup charge on all call attempts is more cost-causative than one limited to the recovery of costs only from completed

[180] IXCs today incur access charges for originating access minutes of use from the time when the originating LEC hands a call off to the IXC's POP, regardless of whether the call is completed at the called location. 47 C.F.R. § 69.2(a). As a result, originating *access* minutes of use are approximately seven percent greater than originating *conversation* minutes of use. IXCs today do not generally choose to bill their customers directly for access minutes of use charged by the LEC for uncompleted calls or for the interval before the called party answers. *See* Federal Communications Commission, Com. Car. Bur., Industry Analysis Division, Telecommunications Industry Revenue: TRS Fund Worksheet Data, 8, fig. 3 (Estimates of Toll Rates and Access Costs per Conversation Minute) (Dec. 31, 1996).

[181] LCI Comments at 26 n.41.

[182] In *VIA USA*, the Commission stated as a factual matter that, "*in the system as currently structured* by facilities-based carriers, customers do not expect to pay for an uncompleted call. Nor do carriers expect to be compensated." 10 FCC Rcd 9540, 9545 (1995) (emphasis added).

calls.

142. Still other commenters argue that, if we permit call setup charges to be imposed for call attempts, we will, at best, open the door to unauditable billing errors or, at worst, facilitate incumbent LEC fraud and duplicity. These commenters argue that the incumbent LEC will be able to generate additional revenue, or degrade the service of IXC competitors, by blocking calls at its own switch. Based on this record, we conclude that these concerns are not well-founded. By permitting a setup charge only for originating call attempts that are handed off to the IXC's POP, we minimize the originating incumbent LEC's incentive to engage in this type of activity because the incumbent LEC will receive no compensation for calls blocked at its own switch. In addition, incumbent LECs have compelling incentives to deliver interstate calls to an IXC's POP. As competition develops for local service, it appears doubtful that an incumbent LEC would find it advantageous to block deliberately interstate calls placed by their end user customers. Such practices would encourage entry by new competitors and increase the interest of affected end users in finding a more reliable service provider. We also find it unlikely that either originating or terminating incumbent LECs would intentionally risk the collection of often significant per-minute access charge revenues on a completed long-distance call in order to collect additional, much smaller per-call setup charges. Finally, we know of no significant allegations of degraded service quality attributable to the very similar current regime, under which incumbent LECs collect at least a full minute of originating access revenues on uncompleted calls delivered to the IXC's POP. We are prepared, however, to investigate claims that an incumbent LEC is blocking calls in an intentional or discriminatory manner.

143. Several large business customers that make substantial numbers of short-duration calls, such as those associated with credit card authorization, automatic teller machine operation, or other transaction-oriented data transfers, argue that imposing a call setup charge will be disruptive to their businesses and may force them to use alternatives to the public switched network.[183] These commenters are the primary beneficiaries of the subsidy that is implicit in the current recovery of call setup costs on a per-minute basis, running from customers that make lengthy calls to those that make many short-duration calls. The existing rate structure may well have encouraged users who make many short duration calls to use the public-switched network in inefficient ways. Rate structures that are aligned with cost causation, on the other hand, should encourage economically-efficient use of the telecommunications network. Transaction-oriented users of the network may be motivated to develop more economically efficient processing methods, with resulting economic benefits. Because this group of IXC customers may need time to adjust to the new rate structure, however, incumbent LECs choosing to impose a per-call setup charge on IXCs may do so, at the earliest, in their access tariff filings effective July 1, 1998. This gives a customer over one year to make any necessary adjustments. This time should be sufficient

[183] CompuServe/Prodigy Comments at 25-29, Reply at 11-12; Bankers Clearing House Comments at 7-8; Ad Hoc Comments at 19-20, Reply at 3-4.

to mitigate any potential disruptive effects of this rate structure change.[184]

144. MCI asserts that there may be costs of call setup in addition to those associated with signalling,[185] such as a portion of the switch central processor costs.[186] We limit the costs that an incumbent LEC may recover through call setup charges, however, to those associated with signalling because we agree with MCI that it would be extremely difficult to separate the costs of the switch CPU and other traffic-sensitive costs into per-message and per-minute portions and to verify that the allocation has been done properly.[187]

145. Several commenters caution that, if we permit a call setup charge, we should also ensure that the charge does not overlap with any SS7-related charges now permitted or developed in this proceeding.[188] Because call setup is one function of the SS7 network, some of these costs may already be recovered through the current Part 69 SS7 rate elements.[189] Currently, Section 69.125 of our rules permits LECs to recover from IXCs only (1) a flat-rated signalling link charge for the Dedicated Network Access Line (DNAL); and (2) a flat rated Signal Transfer Point (STP) port termination charge.[190] While these elements recover the costs of some dedicated SS7 facilities, they do not include the usage-based signalling costs of call setup, including the costs incurred to switch messages at the local STP, to transmit messages between an STP and the

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[184] Our experience with Ameritech's tariffed unbundled SS7 signalling charges indicates that a call setup charge, if implemented, may in fact be relatively small. For call setup purposes, Ameritech has established separate signalling rate elements for SS7 call setup for both direct-trunked and tandem-switched traffic. The first of these, the "ISDN User Part (ISUP) Signal Formulation Charge," is a "per signalling message charge for the formulation of the ISUP message at end offices and tandems" in the amount of .06¢ ($0.0006) per message assessed for both direct-trunked and tandem-switched traffic. The second, the "Signal Transport Charge," is a "per-signalling message charge for the transmission of signalling data between the local STP and an end office SP/SSP" in the amount of .012¢ ($0.00012) per message. The third, the "Signal Switching Charge" is a "per signalling message charge for switching an SS7 message at the local STP" in the amount of .025¢ ($0.00025) per message. The Signal Transport Charge and the Signal Switching Charge are assessed on direct-trunked traffic only. For tandem switched traffic, the "Signal Tandem Switching Charge" is a "per signalling message charge for the bundled provision of multiple instances of signal switching and signal transport for the situation in which tandem routed facilities are provided to the end office" in the amount of .055¢ ($0.00055). The Signal Tandem Switching charge incorporates three instances of transport and two instances of switching at the STP. Both the Signal Switching and the Signal Tandem Switching rate elements include the costs of measuring device and billing system changes. *See Ameritech Operating Companies Tariff FCC No. 2*, Tariff Transmittal No. 982, filed July 5, 1996.

[185] MCI Comments at 82.

[186] MCI Comments at 82-83.

[187] *Id.*

[188] *E.g.*, AT&T Reply at 29; Bankers Clearing House Comments at 4-5; Ad Hoc Comments at 23-25; TCI Comments at 12-13.

[189] 47 C.F.R. § 69.125.

[190] 47 C.F.R. § 69.125.

incumbent LEC's end office or tandem switch, and to process or formulate signal information at an end office or tandem switch.[191]

146. Currently, the setup costs of certain calls may be recovered through database query charges, either for the line information database (LIDB)[192] or the 800 database.[193] In addition, incumbent LECs recover some costs associated with the provision of certain signalling information necessary for third parties to offer tandem switching through the "signalling for tandem switching" rate element.[194]

147. Imposing a call setup charge for interexchange calls should not overlap with any of these existing rate elements. Nevertheless, we clarify that an incumbent LEC choosing to impose a call setup charge may not include in that charge any costs that it continues to recover either through other local switching charges, through charges for dedicated SS7 facilities, or through other signalling charges. In this Order, we also permit incumbent LECs to adopt a more detailed SS7 rate structure, modeled on that currently used by Ameritech under waiver.[195] This SS7 rate structure may permit LECs to recover a significant portion of their call setup costs without an additional call setup charge. Given estimates in the record that SS7 is used to provide signalling for more than 95 percent of the large LECs' customers,[196] we conclude that, in the ordinary case, a price cap LEC will not need to use both the optional SS7 rate structure and a separate call setup charge to recover the costs of call setup. We recognize, however, that some call setup is still performed using in-band, multifrequency (MF) signalling, rather than out-of-band signalling systems. Because SS7 charges will not recover costs of call setup using MF signalling, we do not prohibit the use of both SS7 and call setup charges. We caution LECs adopting both the optional SS7 rate structure and an additional call setup charge, however, that cost support filed with access tariffs must clearly indicate the allocation of individual costs of call setup between these two recovery mechanisms; the same costs cannot be double-recovered using both mechanisms.

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[191] Neither section 69.125 nor any of our other signalling-related cost recovery rules, discussed below, provide for recovery of the costs of these functions. As a result, these costs are recovered through per-minute charges assessed on completed calls. 47 C.F.R. § 69.106. As discussed below, LECs choosing to adopt a separate SS7 signalling rate elements, similar to those established by Ameritech under waiver, may recover a large part of their call setup costs through that mechanism.

[192] 47 C.F.R. § 69.120.

[193] 47 C.F.R. § 69.118.

[194] 47 C.F.R. § 69.129.

[195] *Ameritech Operating Companies Petition for Waiver of Part 69 of the Commission's Rules to Establish Unbundled Rate Elements for SS7 Signalling*, Order, 11 FCC Rcd 3839 (Com. Car. Bur. 1996) (*Ameritech SS7 Waiver Order*). *See* Section III.E.

[196] Ameritech Comments at 16. Ameritech states that, "SS7 technology is currently used for more than 95% of customers in the Ameritech network. This figure is probably comparable for other large [incumbent LECs.]"

b. Peak and Off-Peak Pricing

148. We conclude that we should not now mandate a peak-rate pricing structure for local switching. The record reflects significant practical difficulties that may make it difficult or impossible to establish and enforce a rational, efficient, and fair peak-rate structure as a matter of regulation. For example, the record outlines a variety of difficulties that incumbent LECs will confront in determining peak and off-peak hours with any degree of certainty, based on geographic, user-type, service, and other variations. Moreover, peak usage periods may shift over time as usage patterns change, and as competitors enter the market. Based on these difficulties, some incumbent LECs may find it too costly or too difficult to develop, implement, and maintain a peak-rate structure that will allow them to capture all or most of the benefits this structure could offer.

149. We do recognize the possible efficiency of a peak-rate structure.[197] Accordingly, we will consider whether LECs should have the flexibility to develop such peak and off-peak rate structures for local switching on a permissive basis when we consider other issues of rate structure flexibility in a subsequent Report and Order that we will adopt in this proceeding.

C. Transport

150. Transport service is the component of interstate switched access consisting of transmission between the IXC's point of presence (POP) and LEC end offices.[198] Currently, incumbent LECs offer two basic types of interoffice transport services. The first, direct-trunked transport, uses dedicated circuits for transport between a LEC end office and the LEC serving wire center, or between any other two points the direct-trunked transport customer requests. The second, tandem switched transport, uses common transport facilities to connect the end office to a tandem switch. Common transport circuits may be used to transmit the individual calls of many IXCs and even the incumbent LEC itself. Transport circuits dedicated to a particular access customer connect the tandem switch to the serving wire center. Dedicated entrance circuits carry traffic between the IXC POP and the serving wire center, whether the IXC uses direct-trunked transport or tandem-switched transport.

151. In the NPRM, we expressed concern that some of our current Part 69 rules[199] may require LECs to recover transport costs through rate structures that do not reflect accurately the

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[197] *Local Competition Order* at ¶ 755.

[198] *Transport Rate Structure and Pricing*, Third Memorandum Opinion and Order on Reconsideration and Supplemental Notice of Proposed Rulemaking, 10 FCC Rcd 3030, 3033 (1994) (*Third Transport Reconsideration Order*).

[199] *See*, *e.g.*, 47 C.F.R. §§ 69.110, 69,111, 69.112, 69.124.

way these costs are incurred. We sought comment on possible revisions to many of these rate elements.[200]

1. Entrance Facilities and Direct-Trunked Transport

a. Background

152. Entrance facilities are dedicated circuits that connect an access customer's POP with the LEC's serving wire center. Direct-trunked transport facilities are dedicated trunks that carry an access customer's traffic from the LEC end office to the serving wire center without switching at the tandem switch. In the *First Transport Order*, we mandated an interim rate structure under which entrance facilities and direct trunked transport are priced on a flat-rated basis, which may be distance sensitive.[201] Initial rate levels for direct-trunked transport and entrance facilities were presumed reasonable if they were set equal to the rates for corresponding special access service components (special access service and special access channel termination, respectively).[202] In the NPRM, we tentatively concluded that, because direct-trunked transport and entrance facilities appear to be dedicated to individual customers, a flat-rated pricing structure accurately reflected the way LECs incur the costs of these facilities.[203] We sought comment on this tentative conclusion and on whether incumbent LECs should be permitted to offer transport services differentiated by whether the LEC or the IXC is responsible for channel facility assignments (CFAs).[204] We also sought comment on whether any rules in addition to the interim rules are necessary to govern rate levels for these services.[205]

b. Discussion

153. We conclude that both entrance facilities and direct-trunked transport services should continue to be priced on a flat-rated basis and that charges for these services may be distance-sensitive. In the *First Transport Order*, we found that such a flat charge would facilitate

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[200] See NPRM at ¶¶ 80-95.

[201] *Transport Rate Structure and Pricing*, Report and Order and Further Notice of Proposed Rulemaking, 7 FCC Rcd 7006, 7016-7017 (1992) (*First Transport Order*); *see also* 47 C.F.R. § 69.110.

[202] *Transport Rate Structure and Pricing*, First Memorandum Opinion and Order on Reconsideration, 8 FCC Rcd 5370, 5375 (1993) (*First Transport Reconsideration Order*).

[203] NPRM at ¶ 86.

[204] A channel facility assignment is the actual designation of the routing that a circuit takes within the incumbent LEC network. This assignment may be made either by an IXC purchasing a dedicated circuit, or the incumbent LEC itself.

[205] NPRM at ¶ 86.

competition in the direct-trunked transport market and encourage incumbent LECs to make efficient network decisions.[206] For the same reasons, and because this pricing structure is reflective of the manner in which incumbent LECs incur the costs of provisioning these facilities, we confirm that the interim rate structure the Commission adopted for these facilities should be made final.

154. U S West and Sprint make a persuasive showing that, as carriers expand their use of fiber-optic ring architecture and other modern network designs, transport costs should become less distance sensitive because LECs may transport a call along any one of many paths to its destination based on transient network traffic levels.[207] We conclude, however, that we need not amend our Part 69 rules now to reflect the decreasing sensitivity of transport costs to distance. Our rules permit, but do not mandate, the use of distance sensitive transport charges. Therefore, if an incumbent LEC determines that its transport costs have become less distance sensitive, it may reduce or eliminate the distance-sensitivity of its direct-trunked transport rates. For two reasons, we expect that incumbent LECs will adjust their rates to reflect any change in the distance sensitivity of transport costs. First, as U S West states, ring architecture will be most prevalent, and therefore, will reduce the distance sensitivity of rates most dramatically, in densely populated areas.[208] When an incumbent LEC obtains authority to deaverage access rates geographically, therefore, it may choose to offer a less distance-sensitive pricing structure in more densely populated areas than it does in less densely populated areas. Such a structure would properly reflect the reduced distance sensitivity of the incumbent LEC's costs in more densely populated areas. Second, as competition develops, incumbent LECs will come under increasing market pressures to maintain rates that reflect the nature of the costs underlying the service. If they choose not to do so, we expect that new market entrants will develop competitive service offerings at prices more reflective of underlying costs.

155. We decline Ameritech's request in its comments for immediate flexibility to offer new technologies to switched access customers without obtaining a Part 69 waiver or passing a public interest test.[209] In our Third Report and Order in the *Price Cap Performance Review for Local Exchange Carriers* (*Price Cap Performance Review Third Report and Order*), adopted along with the NPRM in this proceeding, we eliminated the need for a Part 69 waiver for new

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[206] *First Transport Order*, 7 FCC Rcd at 7022.

[207] As Sprint explains, LECs are moving toward ring configurations in response to customer demands for the increased service reliability gained from this architecture's route diversity and self-healing qualities. "With the ring configuration, the tandem-routed traffic and direct-trunked traffic will all be moving in the same ring, and the distance traversed will simply be a function of the provisioning path selected by the LEC for individual traffic. Utilization of available bandwidth between two nodes at any point in time will become a higher priority in the economic determinant of cost than the distance between the two nodes." Sprint Comments at 24.

[208] *See* U S West Reply at 30.

[209] *See* Ameritech Comments at 17-18.

services, and instead required incumbent LECs to file a petition demonstrating that introduction of the new service would be consistent with the public interest.[210] Such petitions will give LECs that desire to do so the opportunity to make their cases and receive the requested flexibility.[211] This procedure significantly streamlined the prior waiver process, and we conclude that the public interest will not suffer if we do not grant incumbent LECs additional immediate flexibility in this area as part of our basic rate structure modifications. We will give further consideration to Ameritech's request for additional flexibility to offer new technologies to switched access customers as part of our assessment of other aspects of pricing flexibility in a subsequent Report and Order in this proceeding.

156. We also will consider whether LECs should be permitted to offer direct-trunked transport services that are differentiated by whether the incumbent LEC or the transport customer is responsible for performing channel facility assignments in connection with our evaluation of other forms of pricing flexibility in a subsequent Report and Order in this proceeding. As MCI argues in its comments, it is unclear whether rates for direct-trunked transport where the LEC controls the CFA should be higher or lower than the rates that apply where the IXC controls the CFA.[212] Although the LEC may be able to make more efficient use of its network facilities when it controls the CFAs itself, this efficiency benefit may be offset by the additional costs the LEC incurs in performing the CFA function. We agree with MCI that an incumbent LEC may be able to increase its network efficiency by retaining or assuming control of CFAs, particularly if an IXC orders a relatively large amount of transport capacity. In those cases, however, rate differentiation based on CFA control appears to be the functional equivalent of a volume discount. As a result, we will consider this issue, along with other pricing flexibility issues, in a subsequent Report and Order planned in this docket.

157. In its comments, USTA requests that we forbear under Section 10 of the Communications Act[213] from regulating services in the interexchange basket, special access, collocated direct-trunked transport, and directory assistance.[214] We will address USTA's request along with other pricing flexibility issues, in a subsequent Report and Order planned in this docket.

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[210] NPRM at ¶¶ 309-310 (contained within the *Third Report and Order* portion of that item). The rule changes implementing this procedure will become effective on June 30, 1997.

[211] *See* 47 C.F.R. § 69.4(g).

[212] MCI Comments at 84-85.

[213] 47 U.S.C. § 160.

[214] USTA Comments at 35-48.

2. Tandem-Switched Transport

a. Background

158. Tandem-switched transport uses trunks that are shared among many IXCs and the LEC itself to carry traffic between the end office and a tandem switch. The tandem switch routes IXC traffic onto an appropriate dedicated trunk that runs between the tandem switch and the serving wire center.[215] An IXC may use tandem-switched transport either as its primary form of transport in lieu of direct-trunked transport, or to carry traffic that overflows from its direct-trunked transport facilities at peak periods. In 1982, the *Modification of Final Judgment* (*MFJ*) established an interim rule that required, until September 1, 1991, BOC charges to IXCs to be "equal, per unit of traffic" of a given type transported between end offices and facilities of the IXCs within an exchange area or within reasonable subzones of an exchange area.[216]

159. The Commission replaced the "equal charge" rule in 1993 with an interim rate structure for tandem-switched transport. This interim structure allows IXCs to choose between two rate structures for the purchase of tandem-switched transport. Both options provide for a per-minute tandem switching charge. Under the first option, an IXC may elect to pay "unitary" per-minute charge for transmission of traffic from the end office, through the tandem switching office, to the serving wire center. This charge may be distance sensitive, with distance measured in airline miles from the end office to the serving wire center. Under the second option, the "three-part rate structure," in addition to the charge for the tandem switch, an IXC may elect to purchase transmission on a bifurcated basis, with the end office-to-tandem portion charged on a per-minute basis, and the tandem-to-serving wire center portion charged as direct-trunked transport facilities, *i.e.*, on a flat-rated basis. Under the three-part rate structure, both portions of the transmission charge may be distance sensitive based on the airline mileage to the tandem office.[217]

160. In adopting the interim rate structure, the Commission stated that initial direct-trunked and tandem-switched transport rates would be presumed reasonable if set based on special access rates in effect on September 1, 1992 using a DS3 to DS1[218] rate ratio of at least 9.6

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[215] An end office local switch may also serve as a tandem switch with certain software upgrades. Therefore, the tandem switching office is also often an end office in its own right. Similarly, an IXC typically uses a large end office, upgraded with additional trunking capacity to handle the IXC's traffic, as its serving wire center.

[216] *United States v. American Tel. and Tel. Co.*, 552 F. Supp. 131, 233-34 (AT&T Consent Decree, Appendix B, Section B(3)), *aff'd sub nom. Maryland v. United States*, 460 U.S. 1001 (1983).

[217] *See First Transport Reconsideration Order*, 8 FCC Rcd at 5372.

[218] A DS1 line is capable of transmitting 24 voice conversations, each digitally encoded at 64 kilobits per second, for a total capacity of 1.544 megabits per second. A DS3 line has 28 times the capacity of a DS1.

to 1.[219] Per-minute tandem-switched transport rates were presumed reasonable if set using a weighted average of DS1 and DS3 rates reflecting the relative numbers of circuits of each type in use in the tandem-to-end office link, and assuming circuit loading of 9000 minutes of use per month per voice-grade circuit.[220]

161. Under the interim rate structure, whether a tandem-switched transport customer elects to purchase tandem-switched transport under the unitary or the three-part rate structure, the LEC imposes a separate, per-minute charge on the tandem-switched transport customer for use of the tandem switch. The Commission set this charge initially to recover only twenty percent of the tandem revenue requirement, in order to: (1) protect small IXCs that use tandem-switched transport as their primary transport mechanism from substantial increases in tandem-switched transport rates;[221] (2) ensure that the interim rate structure did not "endanger the availability of pluralistic supply in the interexchange market" that had developed under the equal charge rule;[222] and (3) allow IXCs a transitional period to reconfigure their networks to eliminate inefficiencies that had developed under the equal charge rule and to prepare for a fully cost-based rate structure.[223] Unlike the direct-trunked and tandem-switched transport rates, which are set using overhead loadings based on special access, the tandem switching rates used higher overhead loadings applicable to switched access.

162. As part of the interim rate structure, the Commission also created the TIC to recover on a per-minute basis from all switched access customers the difference between the Part 69 transport revenue requirement and the revenues projected to be recovered under the interim rate structure.[224] The TIC was explicitly intended to make the transition to the interim rate structure revenue neutral.[225] Among other possible costs, the TIC recovers the remaining 80 percent of the tandem-switching revenue requirement.

163. Portions of the interim transport rate structure were recently remanded to the

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[219] *First Transport Order*, 7 FCC Rcd at 7029. Special access customers use a dedicated trunk running between the customer's premises and the IXC's POP, thereby bypassing the LEC's switched network facilities altogether. This service is primarily used by large volume users in densely populated areas.

[220] *Id.* at 7036-37.

[221] *See Competitive Telecommunications Ass'n v. FCC*, 87 F.3d 522, 526-27 (D.C. Cir. 1996) ("*CompTel*").

[222] *First Transport Order*, 7 FCC Rcd at 7008.

[223] *Id.* at 7016.

[224] *Id.* at 7038.

[225] *Id.*

Commission by the United States Court of Appeals for the District of Columbia Circuit.[226] With respect to tandem-switching rates and the TIC, the Court ordered us either to implement a cost-based rate structure or offer a "rational and non-conclusory analysis in support of [our] determination that an alternative structure is preferable."[227] With respect to overhead loadings, the Court ordered us either to substantiate that our current method of allocating overhead is cost-based, choose a method that is, or provide a reasoned explanation of our decision to pursue a non-cost-based system.[228]

164. In the NPRM, we sought comment on several alternative rate structures for tandem-switched transport service facilities, including: (a) maintaining the interim rate structure, which permits the IXCs to choose between the two pricing alternatives above; (b) eliminating the unitary rate option and requiring the IXCs to purchase tandem-switched transport under the three-part rate structure; or (c) developing another, different rate structure.[229] We also sought comment on whether, in conjunction with any of these pricing options, we should apply to tandem switching any of the options for local switching discussed above, including whether we should establish separate flat-rated charges for the dedicated ports on the serving wire center side of the tandem or other NTS components of the tandem switch, and whether usage-based or flat rates more accurately reflect shared tandem-switching costs.[230] We also sought comment on whether, in conjunction with any of these options, we should permit or require peak load pricing for usage-based charges for tandem-switched transport service, and on whether any portion of tandem-switched transport costs should be recovered from direct-trunked transport customers.

b. Overview of Rate Structure and Rate Level Changes

165. In this section, we summarize the changes we make to the tandem-switched transport rate structure and rate levels below. We conclude that we should require incumbent LECs to implement a cost-based rate structure for tandem-switched transport in four stages over a two year transition period. Unlike our previous transition plans, however, we set forth today, for the first time, the details of a final, cost-based transport rate structure. We have long recognized that non-cost based rate structures can, among other dangers, (1) threaten the long-term viability of the nations's telephone systems; (2) distort the decision whether to use alternative telecommunications technologies; and (3) encourage "uneconomic bypass" of the public switched

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[226] *CompTel*, 87 F.3d 522.

[227] *Id.* at 536.

[228] *Id.*

[229] NPRM at ¶¶ 87-88, 91.

[230] NPRM at ¶ 89.

telecommunications network, raising rates for all.[231]

166. Until today, however, we have limited ourselves to interim transport rate structure plans, such as the equal charge rule and the interim rate structure described above. While the interim rate structure increased the cost-based nature of our transport rate structure, it also included significant non-cost-based elements. We have not, until today, laid out a clear transition plan that describes all the steps necessary to achieve cost-based transport rates. As a result, although all carriers have no doubt been aware of our intention to move to a cost-based rate structure, they have been able only to react to our transitional steps, announced piecemeal. Because we have not announced a definite and detailed end state -- a final, cost-based rate structure -- we have afforded carriers little opportunity to plan, adjust, and develop their networks in preparation for such a rate structure, despite our lengthy period of "transition." Accordingly, because of the potential magnitude of the rate impact of these changes, we conclude that a four-step implementation over a two-year period will minimize the risk of rate shock and allow transport customers to adjust while we move as expeditiously as possible to cost-based transport rates as required by the *CompTel* decision.

167. The first step will occur in incumbent LEC access tariffs to become effective on January 1, 1998. In those tariffs, incumbent price cap LECs must establish new rate elements for recovery of the costs of DS3/DS1 and DS1/voice-grade multiplexers used in conjunction with the tandem switch. The rate element for the dedicated multiplexers on the serving wire center side of the tandem will recover these costs on a flat-rated basis, while the rate element for the multiplexers on the end office side of the tandem will be assessed per minute of use. In addition, incumbent price cap LECs must establish in those tariffs a flat-rated charge to recover the costs of dedicated trunk ports on the serving wire center side of the tandem. None of our existing rate elements currently recovers the costs of either these multiplexers or these dedicated trunk ports. Accordingly, we conclude that those costs are currently recovered through the TIC, and that incumbent price cap LECs must reduce the TIC to reflect the recovery of these costs through the new rate elements. Also on January 1, 1998, all incumbent LECs must take the first of three annual steps to reallocate to the tandem-switching rate element tandem switching revenues currently being recovered through the TIC. In tariffs filed to be effective on that date, we require incumbent LECs to reallocate one third of the portion of the tandem switching revenue requirement that they currently recover through the TIC, excluding signalling and dedicated port costs that we reallocate elsewhere, to the tandem switching rate element.

168. The second step will occur in incumbent LEC tariffs to become effective July 1, 1998. At that time, all incumbent LECs must eliminate the unitary pricing option for tandem switched transport. Instead, incumbent LECs will be required to provide tandem-switched transport under a three-part rate structure as follows: (1) a per-minute charge for transport of

[231] *MTS and WATS Market Structure*, Third Report and Order, 93 F.C.C.2d at 251-252.

traffic over common transport facilities between the LEC end office and the tandem office; (2) a per-minute tandem switching charge; and (3) a flat-rated charge for transport of traffic over dedicated transport facilities between the serving wire center and the tandem switching office. Incumbent LECs will continue to impose separate multiplexing and port charges established on January 1, 1998, as complementary to the three-part rate structure.

169. The third and fourth steps will consist of the reallocation of the remaining portion of the tandem-switching revenue requirement currently recovered through the TIC to the tandem-switching rate element. All incumbent LECs are to reallocate one half of the remaining portion of tandem-switching revenue requirement recovered through the TIC to the tandem-switching rate element in access tariffs to become effective January 1, 1999, and the final portion of the tandem-switching revenue requirement to the tandem-switching rate element in access tariffs to become effective on January 1, 2000. Before performing this reallocation, price cap incumbent LECs must account for X-factor reductions to the tandem-switching revenues permitted under price caps that have occurred since the TIC was created, as described in Section III.C.2.d, below.

c. Rate Structure

170. *Multiplexing Costs.* As discussed above, we direct incumbent LECs to establish separate rate elements for the multiplexing equipment on each side of the tandem switch. LECs must establish a flat-rated charge for DS1/DS3 multiplexers on the serving wire center side of the tandem, imposed pro-rata on the purchasers of dedicated DS3 trunks on the serving wire center side of the tandem, in proportion to the amount of DS3 trunking capacity purchased by each customer. Unlike DS3 rates, rates for DS1 dedicated trunks already include a portion of the DS1/DS3 multiplexer needed for transport.[232] Multiplexing equipment on the end office side of the tandem shall be charged to users of common end office-to-tandem transport on a per-minute of use basis. These multiplexer rate elements must be included in the LEC access tariff filings to be effective January 1, 1998.

171. We sought comment in the NPRM on the claim that:

> The TIC . . . includes the two additional multiplexers needed in order to multiplex a DS3 circuit down to a DS1 level before switching at the tandem, and then back up to DS3 afterward for transmission to an end office. To the extent that analog tandem switches exist, two additional DS1/[voice-grade] multiplexers are needed to achieve the voice-grade interface with the tandem switch.[233]

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[232] *First Transport Order*, 7 FCC Rcd at 7028 n.85.

[233] NPRM at ¶ 106. It is also possible to combine the DS3/DS1 and DS1/voice-grade functions into a single multiplexer.

None of our existing rate elements explicitly recovers the costs of these multiplexers, and we conclude that these costs are currently recovered as part of the TIC. Accordingly, we establish two rate elements for multiplexers used on the serving wire center side of the tandem switch. The first will recover the costs of DS3/DS1 multiplexers used by purchasers of dedicated DS3 transport trunks from the serving wire center to the tandem switch, and may be levied only on purchasers of such DS3 transport. The second will recover the costs of DS1/voice-grade multiplexers used on the serving wire center side of analog tandem switches, and should be levied on purchasers of DS1 or greater capacity dedicated transport from the tandem switch to the serving wire center in proportion to the transport capacity purchased on that route. Like serving wire center-side trunks and trunk ports, both DS3/DS1 and DS1/voice-grade multiplexers on the serving wire center side of the tandem switch are dedicated to individual customers. Accordingly, flat-rated NTS charges for these multiplexers are appropriate.

172. On the end office side of the tandem switch, we establish two additional rate elements. The first will recover the costs of DS3/DS1 multiplexers used on the end office side of the tandem switch. This rate element will be a per-minute charge imposed on each IXC purchasing common transport on the end office-to-tandem link. This charge will be calculated based on actual minutes of use of the common transport circuits and will be assessed on IXCs in a 1:1 ratio with minutes of use of common transport. As with common transport trunks, because these multiplexers are shared among all users of common transport, traffic-sensitive, per-minute charges are appropriate. The second rate element should be assessed only at analog tandems, to recover in a similar manner the costs of DS1/voice-grade multiplexers needed at these analog tandems.

173. Price cap LECs must reallocate revenues currently being recovered through the TIC to these rate elements and begin recovery of multiplexing costs using these rate elements in their access tariffs to become effective January 1, 1998.

174. *Dedicated Tandem Switch Trunk Port Costs*. Price cap incumbent LECs must establish a separate rate element for dedicated trunk ports used to terminate dedicated trunks on the serving wire center side of the tandem switch. LECs incur the costs of these ports on an NTS basis, but currently must recover their costs through per-minute charges for the tandem switch. Because we have allocated 80 percent of tandem-switching costs to the TIC, these port costs may currently be recovered through either per-minute tandem-switching charges, or the per-minute TIC. We now take this opportunity to establish a separate rate element for these costs. Price cap LECs must establish a flat-rated element for dedicated trunk ports on the serving wire center side of the tandem, assessed on the purchaser of the dedicated trunk terminated at that port. This rate element shall be a flat-rated charge assessed on the carrier purchasing the dedicated trunk terminated at that port, and must be also be included in tariff filings to become effective January 1, 1998.

175. *Three-Part Rate Structure*. We also direct all incumbent LECs to discontinue the

unitary rate structure option for the transmission component of tandem-switched transport, effective July 1, 1998. In their access tariffs that take effect on July 1, 1998, incumbent LECs will be required to provide tandem-switched transport under a three-part rate structure as follows: (1) a per-minute charge for transport of traffic over common transport facilities between the LEC end office and the tandem office; (2) a per-minute tandem switching charge; and (3) a flat-rated charge for transport of traffic over dedicated transport facilities between the serving wire center and the tandem switching office. This three part rate structure reflects the manner in which the incumbent LEC incurs the costs of providing each component of tandem-switched transport. By establishing a per-minute, traffic-sensitive rate for the shared common transport trunks and the tandem switch, incumbent LECs will recover these costs from each IXC in proportion to its use. The incumbent LEC, in contrast, incurs the costs of the dedicated serving wire center-to-tandem trunk on an NTS basis because, like other dedicated trunks, the LEC must provision the trunk for the exclusive use of one IXC. Once this capacity is dedicated, the cost of the trunk does not vary with the amount of traffic transmitted by the IXC.

176. The three-part rate structure may cause some tandem-switched transport customers to increase their use of direct-trunked transport relative to tandem-switched transport. As discussed above, making this rate structure change effective on July 1, 1998, will provide tandem-switched transport customers that currently take service under the unitary rate structure with notice of this change sufficient to enable them to adjust their networks to provide service in the most efficient way possible, and to mitigate any sudden effect on rates such a change could have if implemented on shorter notice. In order to encourage transport customers to increase the efficiency of their transport networks quickly, we will require incumbent LECs to waive certain nonrecurring charges until six months after the three-part rate structure becomes mandatory. Therefore, from the effective date of this Order until six months after the effective date of tariffs eliminating the unitary pricing option for tandem-switched transport, the incumbent LECs shall not assess any nonrecurring charges for service connection when a transport customer converts trunks from tandem-switched to direct-trunked transport or orders the disconnection of overprovisioned trunks.[234]

177. When we replaced the equal charge rule in 1991, we stated three principles that would guide our efforts to develop the transport rate structure: (1) to encourage efficient use of transport facilities by allowing pricing that reflects the way costs are incurred; (2) to avoid interference with the development of interstate access competition; and (3) to facilitate full and fair interexchange competition.[235] In 1991, we stated that the interim rate structure was a reasonable first step toward achieving these goals, because it was more cost-based than the equal

[234] This waiver is similar to the one we ordered when we adopted the interim rate structure. *First Transport Order*, 7 FCC Rcd at 7038.

[235] *First Transport Order*, 7 FCC Rcd at 7009. We reiterated these principles in the *First Transport Reconsideration Order*, 8 FCC Rcd at 5372, and the *Third Transport Reconsideration Order*, 10 FCC Rcd at 3035.

charge rule.[236] Even from its inception, however, we have recognized that the interim rate structure represents significant compromises that cause it to fall substantially short of these goals in many ways.[237]

178. First, the unitary rate option does not accurately reflect the manner in which LECs incur costs in providing tandem-switched transport and, therefore, does not provide maximum incentive for IXCs to use transport facilities efficiently. IXCs may order, and LECs must provide, dedicated transport links with NTS costs on the serving wire center-to-tandem route with no assurance that the traffic-sensitive, per-minute revenues collected will cover the NTS costs of the link. As we stated at the time, the unitary rate structure was intended as an interim measure to allow IXCs time to prepare for a fully cost-based transport rate structure.[238] IXCs have now had well over a decade since divestiture to so prepare. We agree with the *CompTel* decision that it is time to bring this period of preparation to a close as expeditiously as possible without causing severe disruption to carriers.[239]

179. Second, by bundling the dedicated and common portions of the transmission component of tandem-switched transport into a single, end-to-end per-minute charge, the unitary rate structure inhibits the development of competitive alternatives to incumbent LEC tandem-switched transport. While we have required incumbent LECs to provide the collocation, signalling, and unbundled network elements necessary for new entrants to compete with incumbent LECs without having to replicate the incumbent LEC's interoffice transport network,[240] we have not corrected the non-cost based aspects of our tandem-switched transport rate structure that reduce incumbent LEC rates for tandem-switched transport services. Several commenters have noted that the tandem-switched transport market, despite our efforts, is subject only to limited competition.[241] Moreover, several competitive entrants have stated that they have the capability and desire to offer some or all of the components of tandem-switched transport on a competitive basis, but that the present, unitary rate structure inhibits the development of

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[236] *First Transport Order*, 7 FCC Rcd at 7016.

[237] *See First Transport Order*, 7 FCC Rcd at 7016, 7021-22; *Third Transport Reconsideration Order*, 10 FCC Rcd at 3047-48.

[238] *Third Transport Reconsideration Order*, 10 FCC Rcd at 3048.

[239] *CompTel*, 87 F.3d at 530.

[240] *See Local Competition Order*; *Expanded Interconnection with Local Telephone Company Facilities*, Memorandum Opinion and Order, 9 FCC Rcd 5154 (1994); *Expanded Interconnection with Local Telephone Company Facilities*, Transport Phase II, Third Report and Order, 9 FCC Rcd 2718 (1994).

[241] *E.g.*, Letter from David Sieradzki, Counsel for WorldCom, Inc., to William F. Caton, Acting Secretary, FCC, February 25, 1997, Encl. at. 4.

competition in this area.[242] In addition, each component of tandem-switched transport is not equally susceptible to competitive entry; it is relatively easier for a new entrant to compete to provide the dedicated serving wire center-to-tandem link than it would be to compete to provide either the tandem switch itself or the myriad common transport end office-to-tandem links. Thus, in order to permit the fullest development of competitive alternatives to incumbent LEC networks, we need to unbundle reasonably segregable components of incumbent LEC transport services and price them in the manner in which costs are incurred.

180. Third, the interim rate structure does not best promote "full and fair" interexchange competition. The unitary rate structure has facilitated the growth of small IXCs to compete with larger carriers. It has achieved this, however, by requiring incumbent LECs to price facilities with NTS costs on a per-minute, traffic sensitive basis, in order to allow small IXCs to offer interexchange services at rates comparable to those offered by larger carriers without regard to whether the charges paid by the small IXCs cover the costs of the facilities that they use. While this structure has protected "pluralistic supply in the interexchange market,"[243] our rules should promote competition, not protect certain competitors. We have recently concluded that no carrier is dominant with respect to domestic, interexchange services.[244] Therefore, to the extent that we designed the interim rate structure to facilitate the growth of small IXCs in competition with AT&T, we find that such protective rules are no longer necessary. In a competitive market,

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[242] *E.g.*, Teleport Comments at 13-14; ALTS Reply at 22. After the comment period closed in this proceeding, Teleport and CompTel proposed a compromise tandem-switched transport rate structure that would (1) retain the unitary rate structure for the transmission component of tandem-switched transport; (2) prohibit incumbent LECs from deaveraging TIC charges within a state for a five year transition period; and (3) provide that IXCs and CLECs that do not use transport facilities supplied by the incumbent LEC would be exempt from paying the TIC for any switched access traffic carried over those facilities. *See Ex Parte* Letter from James M. Smith and Robert C. Atkinson to Hon. Reed E. Hundt, April 16, 1997. Teleport and CompTel characterize this third element of their proposal as the "most important." Exempting IXCs and CLECs that do not use transport facilities supplied by the incumbent LEC from paying the TIC for any switched access traffic carried over those facilities would be consistent with a recent Colorado Commission arbitration ruling. *See TCG Colorado Petition for Arbitration Pursuant to § 252(b) of the Telecommunications Act of 1996 to Establish an Interconnection Agreement with U S West*, Docket No. 96A-329T, Decision Regarding Petition for Arbitration, Decision No. C96-1186 (adopted Nov. 5, 1996). In that decision, the Colorado Commission stated that,

> [I]f [U S West] provides all or part of the transport of an interstate call from the end office to the IXC, then [U S West] is entitled to collect its interstate rates, including [TIC]. If, however, [U S West] is not providing the transport of a call from an end-office switch to an IXC, then [U S West] may not apply its switched access transport rates, including the [TIC], to those calls. We reject arbitrary splits of revenues. In jointly provisioned switched access services, each company will develop and apply its tariffed rates to the portion of service it provides.

Id. at ¶ I.O.7. Clarifying this position on reconsideration, the Colorado Commission stated, "[t]he [TIC] shall be applied on a pro rata basis determined from the proportional distance between the [Teleport] tandem and the end-office of [U S West]." *TCG Colorado Petition for Arbitration Pursuant to § 252(b) of the Telecommunications Act of 1996 to Establish an Interconnection Agreement with U S West*, Docket No. 96A-329T, Order Denying Applications for Rehearing, Reargument, or Reconsideration, Decision No. C96-1344 (adopted Dec. 18, 1996), at ¶ I.B.1.4.

[243] *See First Transport Order*, 7 FCC Rcd at 7007.

[244] *Motion of AT&T to be Reclassified as a Non-Dominant Carrier*, Order, 11 FCC Rcd 3271 (1995).

we believe that we should strive to make our rate structure rules consistent with cost-causation principles, so long as those principles do not conflict with other statutory obligations, such as universal service. As the *CompTel* decision stated, "attempt[ing] to recover costs from IXCs that did not cause those costs to be incurred would impart the wrong incentives to both actual and potential providers of local transport, thereby inducing them to offer an inefficient mix of dedicated, [direct-trunked transport], and tandem-switched service."[245] Because rules that do not reflect cost-causation may cause IXCs to order an inefficient mix of transport services, such rules artificially raise the costs of providing interexchange services. Rules properly reflecting cost-causation, in contrast, will benefit LECs, IXCs, and consumers alike by encouraging competitors to provide service using facilities efficiently. In adopting the interim rate structure, we cited AT&T's estimate that the efficiency benefit to consumers of cost-based pricing and competition could reach $1 billion annually.[246] Our adoption of the three-part rate structure is intended to permit consumers the benefits of even greater service efficiency.

181. We therefore adopt the three-part structure as the final tandem-switched transport rate structure because this structure most closely reflects the manner in which LECs incur the costs of each component of the overall tandem-switched transport service. When combined with our actions with respect to the TIC, our adoption of actual minutes of use as the appropriate factor for determining per-minute rates for common transport circuits, and our allocation of the full cost of the tandem-switch to the tandem-switching rate elements, we expect that this structure will benefit LECs, IXCs, competitive providers of access services, and consumers. Tandem-switched transport facilities are sized to accommodate peak traffic loads, including overflow traffic from IXCs using direct-trunked transport facilities. Several commenters have stated that, until now, these overflow customers have not borne the full costs of these facilities because overflow customers pay only the same per-minute transmission charges applicable to other IXCs.[247] The three-part rate structure will require the IXC purchasing tandem-switched transmission facilities to pay the full NTS costs of the dedicated serving wire center-to-tandem link, without regard for the amount of traffic transported. This benefit, in turn, will substantially increase IXC incentives to use tandem-switched transport efficiently for overflow traffic.

182. Some commenters argue that we should retain the unitary rate structure because tandem-switched transport, as a service, has traditionally been offered on an end-to-end basis. We agree that the transmission component of tandem-switched transport has in fact been *offered*

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[245] *CompTel*, 87 F.3d at 530-531. Even though directly addressing the TIC and not the unitary rate structure, the Court's remarks are apposite because the unitary rate structure does not recover the costs of tandem-switched transport in the way that those costs are incurred and therefore results in the recovery of some costs of the transmission component of tandem-switched transport through the TIC.

[246] *First Transport Order*, 7 FCC Rcd at 7016.

[247] *E.g.*, TCI Comments at 16, Reply at 13-14. *See also* ACC Long Distance Comments at 14-15; Telco Communications Group Comments at 6-7.

on an end-to-end basis, but only pursuant to the requirements of the MFJ and our interim rate structure rules as part of a transition to cost-based rates. We find, however, that the transmission component of tandem-switched transport is not, in fact, *provisioned* by the incumbent LEC on an end-to-end basis. Purchasers of direct-trunked transport purchase an end-to-end service; they purchase from the incumbent LEC transport capacity between two end points. Tandem-switched transport customers, in contrast, purchase use of the tandem switch to route traffic to their POP. By virtue of their decision to choose tandem-switched transport, these customers specifically obligate the LEC to transport their traffic between the serving wire center and the tandem serving a particular end office or group of end offices and to perform the tandem switching function. Because they cause the incumbent LEC to incur the costs of transmitting their traffic between the serving wire center and the tandem, tandem-switched transport customers should, as a matter of cost-causation, pay the costs of reaching the tandem. In providing tandem-switched service, incumbent LECs must provision two separate circuits with distinctly different cost characteristics -- one dedicated, and one shared. Tandem-switched service, therefore, is not provisioned on an end-to-end basis between the end office and serving wire center, but in three parts: (1) transmission from one "end," the end office, to the tandem; (2) the tandem switching function itself; and (3) transmission from the tandem to the other "end," the serving wire center. Just as the tandem-switched transport customer pays a separate charge for the tandem switch, the tandem-switched transport customer should pay separately for the two distinct transmission components.

183. Other commenters argue that the three-part rate structure will create LEC incentives to engage in inefficient network reconfiguration, placing tandems far from end offices and serving wire centers simply to increase tandem-switched transport revenues.[248] These commenters further argue that, if we adopt the three-part rate structure, we need to control this incentive by establishing a process for review of the incumbent LECs' tandem deployment decisions. Based on this record, we conclude that these commenters' fears are not well founded. An incumbent LEC would likely incur substantial costs to reconfigure placement of its tandem switches specifically to disadvantage IXC users of tandem switched transport. Because we expect the three part rate structure to catalyze the development of competition, we conclude that the incumbent LEC would not be likely to incur such costs. Although the incumbent LEC might be able to increase its tandem-switched transmission revenues in the short term to reflect inefficient routing, as more efficiently configured competitors enter the market, the LEC would not be able to sustain such artificially inflated rates and would then need to incur additional costs to reconfigure its network efficiently. Because, under our new competitive paradigm, a multitude of investment opportunities, including wireless services, video, and interLATA toll, may emerge for incumbent LECs, we agree with Ameritech that "[s]uch misspent capital outlays and inefficient

[248] *E.g.*, Sprint Comments at 22.

network configuration simply would not make good business sense."[249]

184. Moreover, the redeployment of tandem switches affects network efficiency with respect to both the incumbent LEC's own local and toll traffic, as well as intrastate and interstate access.[250] Therefore, inefficient network reconfiguration would cause harm both to tandem-switched transport customers and to the incumbent LEC itself. Any additional transport revenues that the incumbent LEC generated through inefficient network reconfiguration would be at least partially offset by the additional costs of transporting the LEC's own traffic in similarly inefficient ways. As discussed above, as competition develops in the local market, we expect that a LEC would be reluctant to take steps to decrease its own efficiency.

185. Some commenters argue that we should retain the unitary rate structure because direct-trunked transport and tandem-switched transport circuits often travel along the same routes using the same physical facilities. These commenters argue, therefore, that it would be unfair or discriminatory to require tandem-switched transport users to purchase transmission based on airline mileage from the end office to the tandem to the serving wire center, while users of direct-trunked transport are permitted to purchase the same route on the basis of airline mileage from end office to the serving wire center directly. Other commenters argue that we should require the LECs to offer both types of transport based on actual route miles, revealing actual LEC network efficiencies and inefficiencies.

186. We disagree with both of these proposed modifications. An IXC purchasing direct-trunked transport requires the incumbent LEC to provide transport service between the end office and the serving wire center. Because the LEC must route direct-trunked transport traffic between only these two points, our rate structure requires the IXC to pay only for the airline mileage between those two points, reflecting the direct mileage route between the locations in the incumbent LEC network designated by the access customer. In contrast, an IXC purchasing tandem-switched transport purchases use of the access tandem switch and therefore requires the incumbent LEC to provide service between the serving wire center and the tandem, and between the tandem and the end office. Under the three part rate structure, the tandem-switched transport customer, like the direct-trunked transport customer, pays for the direct mileage between the locations in the incumbent LEC network designated by the customer -- for tandem-switched transport, the serving wire center to tandem, and the tandem to the end office. Because the IXC has chosen to make use of the LEC tandem switching facilities, it should pay explicitly for the transport necessary to reach the tandem. The direct-trunked transport customer, in contrast, does not make use of the tandem switching facilities; even if the LEC routes direct-trunked transport traffic through the tandem office, this traffic is not switched at the tandem. While the incumbent

[249] Ameritech Reply at 29.

[250] *See* Ameritech Reply at 29.

LEC may choose to route direct-trunked traffic through the tandem office based on its own assessment of whether it is economically efficient to do so, the direct-trunked transport customer pays only for direct mileage between the locations it designated in the network.

187. We are not persuaded by arguments that we should retain the unitary pricing structure because the incumbent LEC, and not the tandem-switched transport customer, has selected the tandem location and, consequently, the tandem-switched transport customer should not pay for the direct mileage to and from the tandem location. The incumbent LEC equally chooses the locations of the serving wire center and end office, and yet access customers routinely pay mileage charges to and from those locations, rather than between the end points of the access service -- the POP and the end user location. Similarly, we find that the three-part rate structure does not discriminate against IXCs using tandem-switched transport. As discussed above, the tandem-switched transport customer, unlike the direct-trunked transport customer, *requires* the incumbent LEC to route its traffic to the tandem, and so should pay the costs of reaching the tandem. In addition, an IXC operating efficiently often may choose to locate its POP at or close to the tandem, if the tandem-switching office also can function as the serving wire center, thus eliminating virtually all of the dedicated transport costs of the tandem-to-serving wire center link. While such an arrangement may be the most efficient transport architecture for tandem-switched transport, our current unitary pricing structure does not reflect the underlying costs of tandem-switched transport transmission facilities and so does not encourage efficient transport architectures.

188. The introduction of more modern network architectures, such as Synchronous Optical Network (SONET) rings, does not alter our conclusion that the three-part rate structure most closely approximates the nature of costs associated with each component of tandem-switched transport. WorldCom, for instance, asserts that the "pyramid" diagram included in the NPRM as Figure 1 is outdated[251] and submits a diagram illustrating interoffice tandem-switched transport in a ring-based network.[252] WorldCom states that the multiple routing options and the reduced distance sensitivity of transport costs in a SONET environment compel retention of the unitary rate structure.[253] We conclude, however, that the differences WorldCom identifies do not support retention of the unitary rate structure because, even in a ring-based network, the three-part rate structure treats direct-trunked and tandem-switched transport consistently. In a fiber-optic or ring-based network, dedicated, direct-trunked transport circuits are given a constant, and exclusive, time slot assignment on a large, time-division multiplexed fiber-optic cable. The incumbent LEC routes traffic for the IXC purchasing the direct trunk into the dedicated circuit or time slot, where it is received elsewhere on the ring or in the network at the serving wire center.

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[251] NPRM at ¶ 24 (diagram follows the paragraph).

[252] WorldCom Reply at iii.

[253] WorldCom Reply at 29-31.

The direction or precise routing of the signal around the ring is irrelevant for purposes of the rate structure because the transport is priced on an airline-mileage basis between the two end points. Capacity dedicated to a particular IXC, however, is not available to the LEC for other purposes.

189. SONET ring architecture offers the LEC the capability to transport large traffic volumes with redundant routing options, but it does not alter the fundamental nature of tandem-switched transport. Tandem-switched transport is functionally very different from direct-trunked transport because, by definition, the incumbent LEC must route an IXC's tandem-switched traffic through the tandem switch serving a particular end office. Whether using a SONET ring or not, the LEC must route its tandem-switched traffic into one of many shared common transport circuits or time slots allocated for transport between the end office and the tandem switch, and onto a *second* dedicated circuit or time slot for transport between the serving wire center and the tandem. Despite parties' arguments to the contrary, the precise routing of the traffic to the tandem, including the direction it may take around a SONET ring, is irrelevant to the rate structure because IXCs purchase transport under the three-part rate structure based on airline mileage to the tandem.

190. As discussed in connection with direct-trunked transport, above, ring network architectures may cause incumbent LECs transport costs to become less distance sensitive. Because our rate structure permits, but does not require, transport rates to be distance sensitive, LECs remain free to establish less distance sensitive transport rates to reflect the changing nature of these costs.

191. We also decline Teleport's suggestion to establish a flat-rated charge for the tandem switch, tied to the amount of dedicated capacity each IXC's serving wire center-side trunk ports provide. While the costs of these dedicated trunk ports are NTS, the record before us does not reflect that all of tandem-switching costs are similarly NTS. Rather, we conclude at this time that the costs of tandem switching likely vary, as do those of local switching, on a traffic-sensitive basis. In light of this conclusion, we find that it would be unreasonable to permit the incumbent LEC to recover all of its tandem-switching costs through flat-rated charges. As with the local switch, until we gain more experience with rate structures for unbundled network elements that are implemented pursuant to Sections 251 and 252 and that segregate switching costs into traffic-sensitive and NTS components, we will continue to adhere to the current, per-minute rate structure for shared switching facilities.

192. We also decline to adopt in full suggestions that we (1) retain the unitary pricing structure for tandem-switched transport, while (2) exempting IXCs and competing LECs that do not use the transport facilities supplied by the incumbent LEC from paying the TIC and (3) preventing the incumbent LEC from deaveraging the TIC within a state during a five year

transition period.[254] We are modifying our rules to prohibit incumbent LECs from assessing any per-minute residual TIC charge on any switched minutes of CAPs that interconnect with the incumbent LEC switched access network at the end office.[255] In doing so, we adopt a position substantially similar to the second enumerated point, above, which Teleport and CompTel characterize as the "most important" feature of this proposal.[256] In addition, we are also taking other measures that will reduce substantially or eliminate the TIC in an expeditious manner. We decline, however, to adopt the other two suggestions. As explained in more detail above, the unitary rate structure is not cost-based in that it requires incumbent LECs to recover costs incurred on an NTS basis through per-minute charges and inhibits the development of competition by bundling reasonably segregable components of tandem-switched transport together and pricing them in a manner that does not reflect cost causation. We conclude that our new paradigm of promoting efficient competition requires that incumbent LECs adopt a cost-based transport rate structure and that entrants providing transport facilities in competition with the incumbent LEC not pay the TIC.

193. Although in their comments in this proceeding the incumbent LECs virtually unanimously favor the three-part rate structure as most consistent with principles of cost-causation, we recognize that incumbent LECs may face competition from competitors that are not limited to the three-part rate structure we adopt for incumbent LECs today. As such competition develops, the incumbent LEC may wish to respond by offering tandem-switched transport on a unitary pricing basis. We will address issues relating to when incumbent LECs should have the flexibility to offer a unitary tandem-switched transport rate structure in connection with our discussion of other pricing flexibility issues in a subsequent Report and Order that we will adopt in this proceeding.

194. *Peak and Off-Peak Pricing.* As with the local switch, we conclude that we should not mandate a peak-rate pricing structure for the tandem switch or common transport at this time. Many of the same practical difficulties with establishing, verifying, and enforcing a rational, efficient, and fair peak-rate structure exist in the context of the tandem switch. We will consider whether incumbent LECs should have the flexibility to develop such peak and off-peak rate structures for local switching on a permissive basis when we consider other issues of rate structure flexibility in a subsequent Report and Order that we will adopt in this proceeding.

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[254] *See* Letter from James M. Smith, President, CompTel, and Robert C. Atkinson, Senior Vice President, Teleport Communications Group Inc., to Hon. Reed E. Hundt, Chairman, FCC, April 16, 1997.

[255] Section III.D.2.b.

[256] *See* Letter from James M. Smith, President, CompTel, and Robert C. Atkinson, Senior Vice President, Teleport Communications Group Inc., to Hon. Reed E. Hundt, Chairman, FCC, April 16, 1997.

d. Rate Levels

195. *Allocation of 80 Percent of the Tandem Switching Revenue Requirement to the TIC.* In establishing the interim transport rate structure, we required incumbent LECs to base their initial tandem switching charge on 20 percent of the interstate tandem-switching revenue requirement. In remanding this portion of the interim rate structure to us, the D.C. Circuit directed us either to implement a cost-based tandem switching rate or offer a rational and non-conclusory analysis in support of our determination that an alternative structure is preferable.

196. Based on the record in this proceeding, we reallocate much of the remaining 80 percent of the tandem switch revenue requirement back to the tandem switching rate elements in three steps. We conclude that this action is most consistent with cost-causation, and with the general approach we are taking in this Order regarding pricing issues. We do not require all of the 80 percent to be reallocated to tandem switching rates because the tandem-switching revenue requirement includes, not only the costs of the tandem switch, but other costs, such as SS7 signalling costs and tandem port costs, which we are requiring to be reallocated elsewhere.

197. Furthermore, if we required the price cap LECs to reallocate, dollar-for-dollar, the entire portion of the tandem switching revenue requirement that we reallocated to the original TIC in the *First Transport Order*, we would deny tandem-switched transport customers the continuing benefits of past X-factor reductions in the revenues permitted under price caps. Therefore, in order to preclude recovery of tandem switching costs in excess of the current revenues permitted under price caps, we direct price cap incumbent LECs first to account in the following manner for the effects of "GDP-PI minus X-factor" reductions to the original portion of the tandem switching revenue requirement allocated to the TIC in the *First Transport Order*. Each price cap LEC first should calculate the percentage of its total original TIC that represented the 80 percent reallocation of its tandem switching costs when the TIC was created. It should then calculate this percentage of its current TIC, which represents the extant portion of the reallocated tandem switching costs. It is this extant portion that the price cap LECs should reallocate to tandem switching as described in the next paragraph.

198. In access tariff filings to become effective on January 1, 1998, incumbent LECs must identify the portion of the tandem-switching revenue requirement currently in the TIC that they reallocate to each rate element, including, as applicable, SS7 signalling, tandem port costs, or other rate elements. They must then reallocate one third of the tandem switching revenue requirement remaining in the TIC to the tandem switching rate element. Effective January 1, 1999, incumbent LECs shall reallocate approximately one half of the remaining amount of the tandem switching revenue requirement in the TIC to the tandem switching rate elements. Effective January 1, 2000, incumbent LECs shall reallocate any portion of the tandem switching revenue requirement remaining in the TIC to the tandem switching rate element. This three-step implementation of this change permits IXCs time to adjust their use of various incumbent LEC transport services, but sets a definite end date in the near future, thus responding to the *CompTel*

decision's concerns regarding the length of the transition to a cost-based transport rate structure.

199. Some commenters argue that, rather than reallocating revenues from the TIC to other rate elements, we should reinitialize tandem-switched transport rates to levels reflecting long run incremental costs, making reallocation of TIC revenues to other transport rate elements unnecessary. We have decided in this Order, however, not to reinitialize access rates based on forward-looking cost principles. We have instead determined that the first step in access reform is to make the current system as economically efficient as is possible within the limits of current ratemaking practices. Thus, the focus of this portion of this proceeding is on the development of cost-causative rate structure rules. While we are taking several prescriptive steps using existing ratemaking methods to reduce initial baseline rates, we are generally adopting a market-based approach, with a prescriptive backdrop, to move rates over time to levels reflecting forward-looking economic costs. We disagree with those commenters that argue that the *Local Competition Order* requires us immediately to prescribe rate levels for access elements based on long-run incremental costs. The *Local Competition Order* addressed, *inter alia*, the pricing of unbundled network elements. While unbundled network elements may be used to provide interstate access services, their availability at TELRIC-based prices does not compel adoption of similar rates for access services. We intend instead to rely on the availability of unbundled network elements to place market-based downward pressures on access rates, subject to a prescriptive backstop. We will further address questions related to reinitialization to TELRIC rate levels in connection with our discussion of the prescriptive approach to access reform.[257]

200. *Use of Switched Access Overhead Loadings for Initial Tandem Switching Rates.* In setting rates, the interim transport rate structure derived both direct-trunked transport rates and tandem-switched transmission rates using relatively low overhead loadings applicable to special access. Tandem switching rates, in contrast, were set using relatively higher switched access overhead loadings. As a result, the tandem switching revenue requirement became relatively high, in comparison to other transport rate elements.

201. Several commenters in this proceeding contend that our use of special access overheads in setting direct trunked transport rates was inappropriate because, while special access is used almost exclusively in high density, generally urban areas, direct-trunked transport and, to an even greater extent, tandem-switched transport are used in less dense areas.[258] In these less dense areas, overhead costs associated with transport may be higher than those associated with special access in urban areas. Some commenters have argued that we should either (1) equalize the overhead loading factors for all transport options by directing that the difference in transport rates is equal to the difference in the long run incremental cost of each transport option (DS3,

[257] *See* Section IV.B.2.

[258] *See, e.g.*, BellSouth Comments at 77, 80.

DS1, and tandem-switched transport); or (2) otherwise ensure that transport customers pay an equal dollar amount of overhead per unit of traffic transported.[259]

202. We conclude that we need to make no change to the overheads attributed to tandem switching. As discussed above, we have decided not to base access prices directly at this time on incremental cost studies, but instead to make significant changes in existing ratemaking practices as the first step in access reform. Our current methods allocate overhead in a reasonable, cost-based manner. In consultation with the Joint Board on Jurisdictional Separations, the Commission established procedures for allocating overhead expenses between the state and interstate jurisdictions.[260] Our Part 69 cost allocation rules in turn allocated interstate direct investment to broad categories, including Central Office Equipment (with respect to both local switching and tandem switching) and Carrier Cable and Wire Facilities (with respect to special access, direct-trunked transport, and tandem-switched transport transmission facilities).[261] Other investment, including overhead, was allocated among these categories in proportion to the dollar amounts of net direct investment allocated to these categories.[262] Similarly, direct expenses, where possible, were allocated to the category to which the expenses are related.[263] Other expenses, including overheads, are allocated on the same basis as other investment, according to relative dollar amounts allocated to the various categories.[264] The Commission has stated that initial allocation of overheads based on relative costs closely approximates an economically efficient method assuming that the elasticity of demands for the various outputs is not too dissimilar.[265]

203. Our Part 69 cost allocation rules, therefore, established category revenue requirements that included overheads allocated generally based on relative costs. Once these initial revenue requirements were established, our Part 69 rules permitted incumbent LECs to recover all costs assigned to each category through the rate elements established for that

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[259] Cable & Wireless Comments at 19.

[260] *See, e.g.*, 47 C.F.R. § 36.192, separating Corporate Operations Expenses, USOA Accounts 6710 and 6720, on the basis of the separation of the Big Three Expenses: Plant Specific Expenses, Plant Non-Specific Expenses, and Customer Operations Expenses.

[261] 47 C.F.R. §§ 69.305 - 69.306.

[262] 47 C.F.R. § 69.309.

[263] *E.g.*, 47 C.F.R. § 69.401.

[264] 47 C.F.R. § 69.411.

[265] *See, e.g.*, *First Transport Order*, 7 FCC Rcd at 7030 n.91.

category.[266] The incumbent LECs were permitted to assign overhead costs among the category rate elements in any way that is just and reasonable and not unreasonably discriminatory.[267] We find that it is reasonable to have set overhead loadings for tandem switching consistently with the overhead loadings for local switching, and disagree with those parties that argue that there is no cost justification for the current allocation of overheads to the tandem switch. The direct costs of both kinds of switching are fundamentally the same in that both types of switches are comprised of ports and a switching matrix. By contrast, the direct costs of transmission consist of outside plant and circuit equipment and certain central office equipment. So long as consistent overhead loading methodologies were used across switching functions, and across transmission functions, we find that a reasonable cross-over is established for access customers between direct-trunked transport and tandem-switched transport. As competition develops, we can also rely on market forces to pressure incumbent LECs to allocate overheads among rate elements in economically efficient ways. We address issues concerning the use of special access prices to initialize direct-trunked transport rates in the interim rate restructure below in our discussion of the TIC.

204. We also decline to adopt a requirement for equalized overhead loadings. Overhead loadings are used to assign costs that do not qualify as the direct costs of a particular service. Reasonable definitions of direct costs often leave in the overhead category costs that might reasonably be deemed attributable to a given service. Thus, if all of a carrier's costs are classified as either "direct costs" or "overheads," the overhead category will likely include costs that should not necessarily apply uniformly to all services. As a result, we think it desirable not to adopt a policy that is too specific and too rigid, and that might not permit recognition of legitimate differences in costing definitions. Furthermore, in a competitive market, it would be mere happenstance if different products or services of a single company recovered uniform amounts of overhead. If we were to require equalized overhead loadings, we would be interfering with the market discipline on which we are primarily relying. We might, for example, prevent an entrant from realizing a reasonable profit opportunity based on a rigid overhead loading requirement.

205. In determining that our existing cost allocation rules reasonably allocated overhead to the initial tandem switching rate element and that we thus need not change the overheads currently attributed to tandem switching, we recognize that the D.C. Circuit in *CompTel* remanded the overhead issue to the Commission for further explanation and stated that the "cost allocation to the tandem switch" under the existing allocation rules "is, by the Commission's own estimation, grossly excessive."[268] The court did not provide a cite for its characterization of the

[266] Since 1991, of course, the amounts recovered by price cap LECs have been subject to the price cap formulae. For all incumbent LECs, however, the relative allocation of overheads was originally established under cost-of-service regulation by the Part 69 cost allocation rules.

[267] 47 U.S.C. §§ 201-202.

[268] *CompTel*, 87 F.3d at 533.

Commission's "estimation," but the court may have been referring to the agency's finding in the *First Transport Order* that "most, *but not all*, of the interstate tandem revenue requirement is attributable to tandem-switched transport."[269] The Commission in that order also identified only one category of costs -- having to do with SS7 technology -- that appeared to be misallocated to tandem switching.[270] Elsewhere in this Order, we have taken steps to address that misallocation of SS7 costs.[271] That correction having been made, we find that our existing rules reasonably allocate overhead to tandem switching for the reasons discussed above.

206. *Use of actual minutes of use rather than an assumed 9000 minutes of use.* For tandem-switched transport rates to be presumed reasonable, the interim rate structure requires incumbent LECs to set per-minute tandem-switched transport rates using a weighted average of DS1 and DS3 rates reflecting the relative numbers of circuits of each type in use in the tandem-to-end office link, and assuming circuit loading of 9000 minutes of use per month per voice-grade circuit.[272] Based on the record before us, we find that continued use of this 9000 minutes of use assumption is no longer reasonable. Many commenters state that their actual traffic levels are substantially lower than 9000 minutes of use per month. Some incumbent LECs, particularly smaller LECs in rural areas, indicate that their actual traffic levels may be as low as 4000 minutes of use per month per voice-grade circuit. Accordingly, we conclude that rates for the common transport portion of tandem-switched transport must be set using a weighted average of DS1 and DS3 rates reflecting the relative numbers of DS1 and DS3 circuits in use in the tandem-to-end office link, and using the actual voice-grade switched access common transport circuit loadings, measured as total actual minutes of use, geographically averaged on a study-area-wide basis, that the incumbent LEC experiences based on the prior year's annual use. Incumbent LECs that deaverage their transport rates under our existing zone-based deaveraging rules[273] may similarly deaverage the actual minutes of use figures that they use to calculate per-minute common transport rates.

207. Our assumption that voice-grade common transport circuits experience uniform loadings of 9000 minutes of use was initially based on 1983 data submitted in the original *MTS and WATS Market Structure* proceeding.[274] In using this assumption as part of the interim rate structure, we stated that, "[t]he 9000 minutes per circuit per month standard serves as a

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[269] 7 FCC Rcd at 7062 (emphasis added).

[270] *Id.*

[271] *See* Section III.D.2.

[272] *First Transport Order*, 7 FCC Rcd at 7036-37.

[273] *See* 47 C.F.R. § 69.123.

[274] *MTS and WATS Market Structure*, Memorandum Opinion and Order, 97 F.C.C.2d at 862.

convenient starting point in the context of a short-term, interim rate structure."[275] We rejected at that time requests to develop a loading factor for small LECs that would reflect their actual, substantially lower circuit loading levels, stating that, "the benefits to be obtained from use of more individualized loading factors are outweighed by the benefits of the administrative convenience of a uniform loading factor and of avoiding verification difficulties."[276] Given the new competitive paradigm embodied in the 1996 Act, we conclude that this assumption must give way to charges based on actual usage levels. The same conversion factor is not appropriate for each incumbent LEC.[277] Because the 9000 minute assumption appears to have substantially overstated the actual traffic levels on many circuits, we now conclude that the current rate structure is unlikely to recover the full costs of common transport. Costs that properly should be recovered from common transport rate elements may currently be recovered through TIC revenues. Because the 9000 minutes of use loading factor has contributed, possibly significantly, to the level of the non-cost-based TIC, we find that continued use of this factor is no longer reasonable.

208. We therefore direct incumbent LECs to develop common transport rates based on the relative numbers of DS1 and DS3 circuits in use in the tandem-to-end office link, and using actual voice-grade circuit loadings, geographically averaged on a study-area-wide basis, that the incumbent LEC experiences based on the prior year's annual use. As discussed above, incumbent LECs that deaverage their transport rates under our existing zone-based deaveraging rules may similarly deaverage the actual minutes of use figures that they use to calculate per-minute common transport rates. As they develop transport rates based on actual minutes of use, we require incumbent LECs to use any increase in common transport revenues to decrease the TIC. These rates must be included in the LEC access tariff filings effective January 1, 1998.

209. We disagree with commenters arguing that the actual number of minutes a circuit is in use is irrelevant in a rate-setting context.[278] These commenters argue that rates should be set based on forward-looking cost studies using Commission-determined "efficient" traffic levels, which they argue may be far higher than either the actual traffic levels, or the 9000 minutes of use assumption. As explained elsewhere, we are not taking the general approach of prescribing rates at forward looking economic costs, and we decline to make an exception in this instance. We are instead reforming access charges so that they more closely reflect the costs imposed by individual access customers. We also do not find it necessary to employ different principles here to ensure that incumbent LECs face sufficient incentives to design their networks to achieve efficient usage

[275] *First Transport Reconsideration Order*, 8 FCC Rcd at 5377.

[276] *Id.*

[277] U S West Reply at 32.

[278] *See, e.g.*, WorldCom Reply at 35.

levels. LECs subject to price cap regulation already have only limited ability to raise rates to cover the costs of inefficient network designs, and are able to benefit from increased profits as their efficiency improves. In addition, as competition develops for local service, all incumbent LECs will face increasing pressure to provide service as efficiently as possible.

D. Transport Interconnection Charge (TIC)

1. Background

210. Under our Part 36 separations rules, certain costs of the incumbent LEC network are assigned to the interstate jurisdiction. The Part 69 cost allocation rules allocate these costs among the various access and interexchange services, including transport. In the *First Transport Order*,[279] we restructured interstate transport rates for incumbent LECs. The restructure created facility-based rates for dedicated transport services based on comparable special access rates as of September 1, 1991, derived per-minute tandem-switched transport transmission rates from those dedicated rates, established a tandem switching rate, and established a TIC that initially recovered the difference between the revenues from the new facility-based rates and the revenues that would have been realized under the preexisting "equal charge rule." Under the equal charge rule, which arose from the AT&T divestiture of the BOCs,[280] the BOCs were required to charge a per-minute, distance-sensitive rate for their transport offerings, regardless of how the underlying costs were incurred. The TIC was intended as a transitional measure that initially made the transport rate restructure revenue neutral for incumbent LECs and reduced any harmful interim effects on small IXCs caused by the restructuring of transport rates.[281] Approximately 70 percent of incumbent LEC transport revenues are generated through TIC charges, or approximately $3.1 billion, according to USTA.[282]

211. The TIC is a per-minute charge assessed on all switched access minutes, including those of competitors that interconnect with the LEC switched access network through expanded interconnection. In the NPRM, we sought comment on how to reduce and eliminate the TIC in a manner that fosters competition and responds to the D.C. Circuit's *CompTel* remand. We sought comment on different methods of recovering the costs currently recovered by the TIC, including: (1) giving the incumbent LECs significant pricing flexibility and allowing market forces to discipline the recovery of the TIC, either alone or in conjunction with a phase-out of the TIC; (2) quantifying and correcting all identifiable cost misallocations and other practices that result in

[279] *First Transport Order*, 7 FCC Rcd 7006.

[280] *United States v. American Tel. and Tel. Co.*, 552 F. Supp. 131.

[281] *First Transport Order*, 7 FCC Rcd at 7038-40.

[282] USTA Comments, Attachment 11.

costs being recovered through the TIC; (3) combining the above approaches, for example, by addressing directly the most significant and readily-corrected misallocations, and then relying on a market-based approach to reduce what remains of the TIC; (4) providing for the termination of the TIC over a specified time, such as three years. We specifically sought comment on the possible reassignment of costs based on several explanations for the amounts in the TIC. The NPRM also sought comment on how the resolution of the issues surrounding the TIC would be affected by decisions on universal service, by the level of any residual costs, and by the adoption of either the market-based or prescriptive approach to access reform.

2. Discussion

212. As a per-minute charge assessed on all switched access minutes, including those of competing providers of transport service that interconnect with the LEC switched access network through expanded interconnection, the TIC adversely affects the development of competition in the interstate access market. First, as discussed more fully below, some of the revenues recovered through the TIC should be recovered through other switched access elements, including transport rates other than the TIC. The TIC, as currently structured, provides the incumbent LECs with a competitive advantage for some of their interstate switched access services because the charges for those services do not recover their full costs. At the same time, the incumbent LECs' competitors using expanded interconnection[283] must pay a share of incumbent LEC transport costs through the TIC. Second, all other things being equal, the usage-rated TIC increases the per-minute access charges paid by IXCs and long-distance consumers, thus artificially suppressing usage of such services and encouraging customers to explore ways to bypass the LEC switched access network, particularly through the use of switched facilities of providers other than the incumbent LEC that may be less economically efficient than incumbent LECs.

213. As we noted in the NPRM, our goal is to establish a mechanism to reduce and eliminate the TIC in a manner that fosters competition and responds to the D.C. Circuit's remand. To that end, we below identify several costs included in the TIC that should be reallocated to other access elements. We conclude, however, that on the present record, we cannot immediately eliminate the TIC entirely through these reassignments. We establish a mechanism that should substantially reduce the remaining TIC over a short, but reasonable period. In addition, we will in the near future refer a broad range of separations issues to a Joint Board for purposes of determining whether certain costs currently allocated to the interstate jurisdiction and recovered through the TIC more properly should be allocated to the intrastate jurisdiction. Finally, we establish the means by which the remaining TIC amounts are to be recovered.

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[283] Under our expanded interconnection rules and policies, competitors may interconnect with the incumbent LEC's facilities at the end office and supply their own transport. For a more detailed discussion of expanded interconnection, *see Expanded Interconnection with Local Telephone Company Facilities*, Memorandum Opinion and Order, 9 FCC Rcd at 5157.

a. Reallocation of costs in the TIC

214. The record in response to the NPRM clearly establishes that some costs in the TIC should be reallocated to other access elements. USTA, in conjunction with the incumbent LECs, submitted extensive comments setting forth an incumbent LEC consensus explanation of the causes for the sums in the TIC and estimates of the amounts associated with each explanation.[284] While the current rulemaking record will not permit us to prescribe specific amounts that individual incumbent LECs must shift from the TIC to specific access rate elements, it does permit us to direct incumbent LECs to make certain cost reallocations and to require them to calculate the appropriate level of the reallocation in the supporting materials filed with the tariffs implementing the changes. Below, we discuss each of the identified causes of costs being included in the TIC and the extent to which costs should be reallocated to other access elements or categories.

215. In this Order, we do not address certain rate structure issues relating to incumbent LECs subject to rate-of-return regulation. These LECs account for relatively few access lines.[285] In some instances we direct price cap LECs to allocate costs to new rate elements that do not currently exist for rate-of-return LECs. We anticipate that we will propose similar rate elements in the forthcoming notice of proposed rulemaking addressing rate structure issues for incumbent LECs subject to rate-of-return regulation. Recognizing the expense and difficulties of modifying billing systems, we conclude that, until the rate structure issues are resolved for rate-of-return companies, the costs allocated to new elements and any residual TIC revenues may continue to be recovered by the incumbent LECs that are not subject to price cap regulation through per-minute TIC rates assessed on both originating and terminating access.

216. As their primary challenge to the incumbent LEC proposals to reallocate costs from the TIC, several parties argue that we should use forward-looking cost principles, or TELRIC, in determining how much to shift from the TIC to other access categories. Some parties advocating the use of such forward-looking cost standards assert that any costs not meeting these forward-looking cost standards should be eliminated from the TIC, and the incumbent LECs should not be permitted to recover those amounts. One group of consumer advocates proposes that we need not complete TELRIC studies before substantially reducing the TIC because BA/NYNEX has already proposed, as part of their access charge reform compromise plan, to eliminate up to 80

[284] USTA Comments, Attachments 10 and 11.

[285] As of December 31, 1995, larger, reporting local exchange carriers (*i.e.*, those with revenues of at least $100 million) account for 92.6 percent of the total presubscribed lines. Federal Communications Commission, CCB, Industry Analysis Division, *Preliminary Statistics of Common Carriers*, Tbl. 2.3, Total Presubscribed Lines for all Local Exchange Companies (July 1996). Thus, small local exchange carriers account for 7.4 percent of the presubscribed lines.

percent of the TIC pending a determination of "service related" costs by the Commission.[286] We conclude, however, that immediate, widespread, prescriptive action is not necessary to pressure access rates toward market-based levels. Instead, we have determined that the most appropriate first step towards access reform is to make the current rate structure as economically efficient as possible within the limits of past ratemaking practices. These practices include setting rates based on interstate-allocated costs, subject to price cap constraints for most large carriers.[287] As we discuss more fully in Section IV, below, we intend in the future to rely primarily on market forces, with a prescriptive backdrop, to move rates toward forward-looking economic cost. Therefore, because we currently are not prescribing a forward-looking cost method for access reform, we will require reassignment of certain TIC revenues based on an analysis of the separated, booked costs already recovered through the TIC.

217. *SS7 costs.* Based on the record before us, we conclude that SS7 costs that are recovered by the TIC should be removed from the TIC and allocated to the traffic-sensitive basket. The record demonstrates that these costs are related to the signalling function and should be recovered through local switching or signalling rate elements. The costs to be removed are the costs of signal transfer points (STPs) that were included in the tandem-switching category for jurisdictional separations purposes and the cost of the link between the end office and the STP that is used only for SS7 signalling. The incumbent LECs shall distribute the STP costs reallocated from the TIC to local switching or, if the incumbent LEC has established an unbundled signalling rate structure, to appropriate SS7 elements, in tariffs filed to be effective January 1, 1998. The incumbent LEC shall distribute the costs of the link between the local switch and the STP that are included in the TIC to local switching or, if provided, to the call-setup charge. This change means that the incumbent LECs' SS7 prices will reflect the full cost of providing SS7 signalling and provide the proper price signals to developers of new services utilizing SS7. We decline to adopt the suggestion of US West that we reallocate SS7 costs to services in the trunking basket. As we conclude below in conjunction with our consideration of the SS7 rate structure, the costs being reallocated are appropriately included in the traffic-sensitive basket.

218. *Tandem switching costs.* Several parties argue that the tandem switching rate must be set to reflect the cost of providing the service. In the preceding section, we modified the existing tandem-switched transport rate structure and revised certain of the pricing rules applicable to elements of tandem-switched transport to establish a cost-based structure and to respond to the court remand in *CompTel v. FCC*. The revised pricing rules applicable to tandem switching include two separate elements -- a flat-rated port charge to be assessed when a port is dedicated to a single customer and a per minute charge to be assessed for the traffic-sensitive

[286] *See* Letter from Brian R. Moir, Esq., Counsel to the International Communications Association, to William F. Caton, Acting Secretary, FCC, April 16, 1997; Letter from G.R. Evans, Vice President, Federal Regulatory Affairs, NYNEX, to William Caton, Acting Secretary, FCC, April 4, 1997.

[287] *See* Section I, above.

portion of the tandem switch. In three approximately equal annual steps, beginning January 1, 1998, we require reallocation of all tandem-switching revenues currently allocated to the TIC to the tandem-switching rate element. As a result of this modification, the total revenues recovered through the tandem switching rates will, subject to price cap limits, increase to the level of costs assigned to the interstate jurisdiction by the separations process at the end of our plan. Equivalent changes to the amounts recovered through the TIC must be made to ensure that over-recovery does not occur. After this adjustment, in accordance with the *CompTel* remand, and to facilitate the development of economically-efficient competition for tandem-switching services, the TIC will not recover any costs that are attributable to tandem switching.

219. *DS1/voice-grade multiplexer costs.* We conclude that the costs of DS1/voice-grade multiplexing[288] associated with analog local switches should be reassigned to the newly created trunk ports category within the traffic sensitive basket. Analog switches require a voice-grade interface on the trunk-side of the end office switch. Our separations rules assign the costs of DS1/voice-grade multiplexers to the cable and wire category. The costs of these multiplexers associated with switched access were originally included in the Part 69 transport revenue requirement. The revised transport rules adopted in 1992 established transport rates based on DS1 switch interfaces, and thus the rates did not include the costs of DS1/voice-grade multiplexers. The costs of the DS1/voice-grade multiplexers are, therefore, included in the TIC. Therefore, the costs associated with DS1/voice-grade multiplexing associated with analog local switches should be reassigned to the trunk ports category within the traffic sensitive basket, to be considered in conjunction with the development of appropriate rates for trunk ports, in tariffs filed to become effective January 1, 1998. This will make recovery of the costs necessary to use an analog switch port equivalent to the recovery of digital switch port costs, in which the multiplexing function is included in the port itself.

220. *Host/remote trunking costs.* We agree with the parties that allege that the costs of host/remote links not recovered by the current tandem-switched transport rates should be included in the tandem-switched transport category. The record reflects that the rates for carrying traffic between the host and a remote switch, for which the tandem-switched transport rates, both fixed and per mile, are assessed, do not recover the full costs of this transmission service. These charges for host/remote service are in addition to charges that an IXC is assessed for either direct-trunked transport, or tandem-switched transport, between the serving wire center and the host end office. This reassignment will ensure that these transmission costs will be recovered from those using the transmission facilities, and must be included in tariff filings to become effective January 1, 1998. We reject NECA's suggestion that we include these costs in local switching on the theory that remote facilities are installed when it is more cost effective to do that than it is to install a new switch at the remote location. That would require all users of local switching to pay

[288] DS1 transport trunks need to be demultiplexed into individual voice-grade circuits before being switched at analog end office switches. DS1/voice-grade multiplexers perform this function.

for these host/remote transmission facilities. Imposing the host/remote transmission cost on the users of host/remote facilities is more cost causative and will facilitate the development of access competition.

221. *Additional multiplexers associated with tandem switching.* Based on the record before us, we conclude that an IXC's decision to utilize tandem-switched transport imposes the need for additional multiplexing on each side of the tandem switch. The revised tandem-switched transport rate structure provides for these multiplexers. For price cap LECs, recovery of the costs associated with the multiplexers should, therefore, be shifted from the TIC to the tandem-switched transport category as of January 1, 1998, as explained in Section III.C. This realignment of costs helps ensure that tandem-switched transport rates are cost based, as required by the *CompTel* decision, and facilitates competitive entry for those services.

222. *Use of actual minutes of use rather than an assumed 9000 minutes of use.* The data in the record provided by USTA and other incumbent LECs support a finding that for many incumbent LECs, especially those serving less densely populated areas, the assumed 9000 minutes of use per circuit is far higher than actual minutes of use. A tandem-switched transport rate derived by dividing the cost of a circuit by an assumed usage level does not recover the costs of the circuit when the actual usage is below that level. The costs not recovered through tandem-switched transport rates based on our current 9000 minutes of use assumption are being recovered through the TIC. In the preceding section, we conclude that the pricing of tandem-switched transport transmission should be based on the actual average minutes of use on the shared circuits and that such pricing would produce a cost-based rate. Accordingly, costs should be removed from the TIC equal to the additional revenues realized from the new tandem-switched transport rates when it is implemented in accordance with the rate structure established in Section III.C.

223. *Central Office Equipment (COE) Maintenance Expenses.* The record in this proceeding demonstrates that allocating COE maintenance expenses on the basis of combined COE investment produces misallocations of these expenses among access services. USTA correctly traces this problem to the Part 36 separations rules; the problem is then tracked in our Part 69 cost allocation rules. Under our current rules, COE maintenance expenses are allocated among separations categories, and then access services, based on the *combined* investment in the three categories of the COE plant being maintained -- Central Office Switching, Operator Systems, and Central Office-Transmission -- rather than on the *individual* investment in each of those categories. As a result, a portion of the expense of maintaining local switches and operator systems is recovered in rates for common line, transport, and special access even though those do not utilize any local switching or operator systems.[289] Correcting this misallocation through changes to Part 36 would require referral to a Federal-State Joint Board and therefore could not

[289] BellSouth Comments at 78.

be done in this proceeding. The misallocation can, however, be corrected by modifying section 69.401 of our rules to provide that the COE expenses assigned to the interstate jurisdiction should be allocated on the basis of the allocation of the specific type of COE investment being maintained, and we make the correction here. This will shift some costs to local switching from common line and transport, and result in more cost-based rates. This shift must be reflected in tariff filings to be effective January 1, 1998. We also plan to refer the underlying separations issue to a Joint Board for its recommendation.

224. *Separations-related causes.* Several incumbent LECs argue that a substantial portion of the TIC can be traced to decisions separating costs between the interstate and intrastate jurisdictions. As explained by USTA and incumbent LECs, the largest portion of the amounts recovered by the TIC results from the differences in the jurisdictional separations allocation procedures for message (*i.e.*, switched) services and special access services, and from the consequent effects of the Commission's decision to use special access rates to establish transport transmission rates when the Commission restructured transport rates. The current jurisdictional separations process separates the costs of message services based on average cost factors; costs of DS1 and DS3 special access services, in contrast, are separated using unit costing methods. Because of the differences in these separations methodologies, special access-derived rates reflect the costs of transport in areas in which special access services are most often offered (urban, higher density areas), and do not reflect the costs of transport in rural, less dense areas. Another alleged separations-related cause of the amounts in the TIC is the use of circuit termination counts in the separations process to allocate costs between special access and switched services before they are allocated between federal and state jurisdictions. This practice appears to allocate costs disproportionately to switched services. The incumbent LECs assert that the use of direct costing methods would assign many of these costs to local and intrastate services and to interstate services other than transport.[290]

225. We find that some of the remaining costs recovered by the TIC result from at least two different causes: (1) the separations process assigned costs differently to private line and message (*i.e.*, switched) services, resulting in costs allocated to special access being lower than those allocated to the message category, even though the two services use comparable facilities -- rates for direct-trunked transport and the transmission component of tandem-switched transport, which are switched services, therefore, do not recover the full amount of separated costs; and (2) the cost of providing transport services in less densely populated areas is higher than that reflected by transport rates derived from those special access rates. The existing record is inadequate to permit us to identify more costs that could clearly be reallocated to interstate services. Furthermore, the record indicates that some residual TIC costs may be appropriately allocated to intrastate services. Because we will soon be considering a Notice of Proposed Rulemaking to

[290] If the Joint Board on Jurisdictional Separations takes action to address this issue, we will then consider what corresponding reallocations should be made.

refer to a Joint Board questions regarding separations, we will leave the determination of the ultimate allocation of the remaining costs recovered by the TIC until the conclusion of that proceeding.

226. Incumbent LEC parties generally contend that special access rates provided an acceptable initializing pricing level for transport transmission services in geographic areas where significant amounts of special access services are provided, but do not reflect the cost of providing transport service in low-density areas in which special access services are not as widespread.[291] We recognize that rates for direct-trunked transport and for the transmission component of tandem-switched transport, because they were established based on special access rates, do not reflect the full cost of providing transport services in higher-cost, rural areas. Because none of our other facilities-based rate elements recover costs reflecting this differential, we conclude that the additional costs of rural transport currently are recovered through the TIC. On the basis of the current record, however, we are unable to quantify these cost differentials. Moreover, based on differences in network architectures, population density variations, topography, and other factors that vary among LECs, we find that transport cost differentials are also likely to vary greatly among incumbent LECs and among study areas served by the same incumbent LEC. We do not believe, however, that we need to quantify these differences in this Order to ameliorate this distortion caused by the current rate structure, because the requirements set forth in the next paragraph will address this issue.

227. If an incumbent LEC deaverages its transport rates, either by implementing zone-density pricing under our rules[292] or by waiver, the underlying predicate is that the costs in low-density areas are higher than those in higher-density areas. The rates it sets for the different areas should reveal a cost differential of at least that magnitude between low-density and high-density areas served by that LEC. When an incumbent LEC deaverages transport rates, therefore, we require it to reallocate additional TIC amounts to facilities-based transport rates, reflecting the higher costs of serving lower-density areas. The reallocation we require here will permit incumbent LECs, in deaveraging their transport rates, to achieve cost-based transport rates while ensuring that a significant portion of costs reflecting the geographic cost difference are removed from the TIC. Each incumbent LEC must reallocate costs from the TIC each time it increases the deaveraging differential. We find that any incumbent LEC that has already deaveraged its rates must move an equivalent amount from the TIC to its transport services. Under any of these scenarios, the costs shall be reassigned to direct-trunked transport and tandem-switched transport categories or subcategories in a manner that reflects the way deaveraging is being implemented by the incumbent LEC. We do not require incumbent LECs that average their transport rates to make a similar reallocation at this time, because of the difficulty in determining the amount to be

[291] *See, e.g.*, USTA Comments at 65; GTE Comments at 38; Aliant Comments at 3. *See also* Cable & Wireless Comments at 21-22.

[292] 47 C.F.R. § 69.123.

reallocated.

228. *Price Cap Implementation issues.* For purposes of phasing out the TIC, we are keeping the TIC in its own service category in the trunking basket. The reallocation of costs from the TIC to other access elements will require price cap LECs to adjust their price cap indices (PCIs) and service band indices (SBIs) to reflect the new revenue streams. To accomplish these reallocations, price cap LECs shall make exogenous adjustments to their PCIs and SBIs that are targeted to the indices in question, rather than applying the exogenous adjustment proportionately across all categories in the affected price cap basket. Thus, when a reallocation occurs within a price cap basket, only the affected SBIs will be adjusted. When the reallocation affects service categories in more than one basket, however, the affected PCIs and SBIs must be adjusted. The upward or downward adjustment to the PCIs and upper SBIs shall be calculated as the percentage of the revenues being added or subtracted from a basket or category, divided by the total revenues recovered through the basket or category at the time of the adjustment. For example, if ten percent of the revenues are being reallocated from a service category, the category upper SBI will be reduced by ten percent. If that revenue amount is only three percent of the PCI for the basket, the PCI is reduced by three percent.

b. Treatment of Remaining Costs Recovered by the TIC

229. *Residual TIC reduction plan.* After the costs identified above have been reallocated to other access services, some costs will continue to be recovered by the TIC. While it is desirable to eliminate the TIC as soon as possible by shifting the costs recovered by the TIC to facilities-based rates, referring separations questions to a Joint Board is the best means of reaching that ultimate objective, as we noted earlier. Even as we make this referral, we will require incumbent LECs to target to the TIC price cap reductions arising in any price cap basket as a result of the application of the "GDP-PI minus X-factor" formula until the per-minute TIC is eliminated, as many parties have suggested.[293] These parties submit that this targeting will permit incumbent LECs to manage the reduction in revenues recovered by the TIC, while reducing the amount at issue in the TIC. Sprint states that, using a targeting approach, we would not need to address the cost allocation issues raised by Part 36 and Part 69.[294] Targeting these price cap reductions to the TIC reduces the TIC over a reasonable period, thereby ultimately substantially reducing what is widely recognized to be an inefficient aspect of the access rate structure. We require price-cap LECs to begin these targeted X-factor reductions to the TIC in tariff filings to become effective July 1, 1997.

230. Targeting PCI reductions to the per-minute TIC will not change the overall revenue

[293] *See, e.g.*, PacTel Comments at 72; Sprint Comments at 29,52; Ameritech Reply at 32-33; BA/NYNEX Comments at 38.

[294] Sprint Reply at 17-18.

levels that our price cap mechanisms permit incumbent LECs to receive. We have reallocated those costs that the record shows are clearly related to other facilities-based elements. The upcoming separations proceeding may provide additional data that will permit us to reallocate more costs to facilities-based rate elements, or to the intrastate jurisdiction. The approach we take is a reasonable response to the D.C. Circuit's remand directive, and establishes a plan that should substantially reduce the TIC within a reasonable period, pending review of the jurisdictional separations process.

231. We reject ALTS' allegation that targeting the productivity factor to the TIC undercuts the rationale for the "just and reasonable" status of all price-cap rates, which ALTS contends is dependant on the widespread application of the X-factor. The targeting approach that we adopt will eliminate anticompetitive aspects of the TIC, which promotes inefficient entry into the transport market by imposing some transport costs on IXCs that do not cause the costs to be incurred. In addition, by spreading current TIC revenues across all price cap PCIs and SBIs, our targeting method does not offer TIC revenues special insulation against the pressures of the competitive marketplace, as would some proposals to bulk-bill the TIC to IXCs. We also decline to adopt the approach of spreading the remaining costs recovered by the TIC proportionately among all transport services, as proposed by State Consumer Advocates.[295] That approach might, because of the unknown nature of the costs that will remain in the TIC, result in an excessive reallocation to transport.

232. The D.C. Circuit instructed us to revise our transport rate structure rules to be more consistent with cost-causation principles. There is conflicting evidence in the record concerning the nature of the costs contained within the residual TIC; these costs may be traffic sensitive or NTS and may be associated with common line, transport or switching services. BA/NYNEX states, without explanation, that the costs in the TIC are NTS in nature.[296] To the extent that some portion of the residual TIC has its origin in the methods used to separate cable and wire facilities between the regulatory jurisdictions, it seems likely that BA/NYNEX is partially correct in this assertion. The evidence, however, does not clearly resolve this issue.

233. If the costs remaining in the residual TIC are NTS, as BA/NYNEX suggests, then traffic-sensitive recovery could artificially raise per-minute rates for interstate access. These higher per-minute access rates could distort the market for interstate toll services by artificially suppressing demand for interstate toll services and by encouraging users that efficiently could make use of the network to instead seek other alternatives. Conversely, if costs remaining in the

[295] State Consumer Advocates Comments at 34-37.

[296] BA/NYNEX Reply at 39-40. USTA and many incumbent LECs proposed recovering the remaining TIC costs through a bulk billing mechanism based on an IXC's share of presubscribed lines or revenues. *See, e.g.*, USTA Comments at 66; BA/NYNEX Comments at 38; PacTel Comments at 72; SNET Reply at 27-28. This proposal to use presubscribed lines is consistent with treating the remaining costs recovered by the TIC as NTS costs.

residual TIC are usage-sensitive, flat-rating may also create a distortion by encouraging inefficient overuse of interstate toll services. Because the limited evidence in the record suggests that at least some amount of the residual TIC represents NTS costs, and because we wish to see that consumers enjoy the benefits of usage of the network to the greatest extent possible, we find that we should err, if at all, on the side of NTS recovery of these costs. For elements not demonstrably reflecting usage-sensitive costs, therefore, we find, on balance, compelling policy arguments in favor of flat-rated pricing because usage-sensitive recovery of any NTS costs artificially suppresses demand for interexchange calling by inflating per-minute rates. In the absence of definitive evidence as to the nature of the residual TIC amounts, we conclude that the public interest would be better served by imposing these costs on IXCs on a flat per-line basis, rather than on a per-minute basis.

234. Accordingly, we seek to migrate the current usage-based charges into flat-rated charges as quickly as possible consistent with avoiding short-term market distortions. We do that by: (1) on July 1, 1997, drawing down the per-minute-of-use residual TIC charge by targeting the price cap productivity (X-factor) adjustment to the trunking PCI and, specifically, the TIC SBI, thus effectively spreading those residual TIC revenues, which otherwise would be recovered exclusively on a minute of use basis, among the universe of (both traffic-sensitive and NTS) access services and moving TIC recovery closer to flat-rated recovery; (2) starting in January 1998, recovering remaining residual TIC revenues through PICC charges each year, subject to the PICC cap; and (3) drawing down any remaining residual per-minute TIC revenues each July by targeting the annual X-Factor adjustments to those revenues.

235. The targeting of price cap productivity reductions to the TIC will be accomplished in the following manner. Because the price cap LECs will not have reallocated facilities-based costs contained in the TIC before they file tariffs to be effective July 1, 1997, we first direct the price cap LECs to compute their anticipated "residual" TIC amount by excluding revenues that are expected to be reassigned on a cost-causative basis to facilities-based charges in the future, pursuant to the transition plan described in this Order. To determine TIC amounts so excluded, NYNEX, BellSouth, U S West, and Bell Atlantic shall use the residual TIC percentage estimates contained in USTA's *ex parte* letter filed May 2, 1997, to compute their respective anticipated residual TICs.[297] SBC Communications shall use the cost data for SWBT, Pacific Bell, and Nevada Bell contained in its *ex parte* letter filed April 24, 1997 to estimate its residual TICs.[298] Each remaining price cap LEC shall estimate a "residual" TIC in an amount equal to 55 percent of its current TIC revenues. For these remaining price cap LECs, we find that this 55 percent level

[297] These percentages are as follows: NYNEX, 77.63 percent; BellSouth, 56.93 percent; U S West, 59.14 percent; and Bell Atlantic, 63.96 percent. *See* Letter from Linda Kent, Associate General Counsel, USTA, to William F. Caton, Acting Secretary, filed May 2, 1997.

[298] These percentages, calculated from TIC data supplied, are: SWBT, 69.11 percent; Pacific Bell and Nevada Bell combined, 53.52 percent. *See* Letter from Todd F. Silbergeld, Director -- Federal Regulatory, SBC Communications, Inc., to William F. Caton, Acting Secretary, April 24, 1997.

represents a reasonable, but conservative estimate. The 55 percent level corresponds approximately to the lowest residual TIC percentage identified in the record, and three of the price cap LECs that submitted data on the record are within a few percentage points of this level. We therefore find that residual TIC estimates at the 55 percent level for companies that have not developed actual percentage estimates on the record will be reasonable, but will also minimize the risk that we will eliminate facilities-based TIC costs with targeted X-factor price cap reductions.

236. The "GDP-PI minus X" adjustments LECs ordinarily would apply to each of their price cap indices (i.e. revenues) for the July 1, 1997, annual filing shall be applied by LECs to reduce their calculated anticipated "residual" TIC revenues. For tariffs to become effective July 1, 1997, the price cap LECs shall calculate the annual price cap reduction resulting from the application of the productivity adjustment to each basket other than the interexchange basket, and shall sum the dollar effects of the adjustment. If the effect is to reduce PCIs, the dollar amount shall be targeted completely to the trunking basket PCI and the TIC SBI, without changing the PCIs or SBIs for any other basket or service category. The percentage reduction in the PCI and SBI shall equal the ratio of the total dollar effect of the price cap annual adjustment to the dollar value of the PCI and SBI, respectively. If the effect of the productivity adjustment would increase the PCIs, the PCIs shall be adjusted in their usual fashion, and no targeting to the TIC shall occur. This avoids exacerbating an already inefficient aspect of the access rate structure.

237. Price cap LECs will begin reallocation of facilities-based TIC components on January 1, 1998. At that time, the price cap LECs should all have actual cost data reflecting the facilities-based components of the TIC. If, at that time, any price cap incumbent LEC determines that its use of the applicable residual TIC estimate, above, resulted in more PCI reductions being targeted to the interconnection charge in its tariff filing to become effective on July 1, 1997, than were required to eliminate the per-minute interconnection charge, then that price cap LEC shall make necessary exogenous adjustments to its PCIs and SBIs to reverse the effects of the excess targeting.

238. For tariff filings to become effective July 1, 1998, and annually in July thereafter, all price cap LECs will have actual cost data reflecting the facilities-based components of the TIC and will be able to target reductions to actual anticipated residual per-minute TIC amounts without resort to the percentage estimates prescribed above. For these filings, "GDP-PI minus X" adjustments similar to those described above shall be targeted to the trunking basket PCI and the TIC SBI to reduce residual per-minute TIC amounts recovered through per-minute originating and terminating access charges.

239. To avoid the adverse effects of per-minute pricing of costs that may be NTS, we require price cap LECs to recover residual TIC amounts not otherwise eliminated by targeted X-factor reductions, described above, through the flat-rated PICC to the extent the PICC is below its ceiling. In order to ensure that primary residential and single line business subscribers do not pay more than their fair share of the residual TIC, however, we prohibit price cap LECs from

charging a PICC on primary residential or single-line business lines that recovers TIC revenues that exceed residual TIC revenues permitted under our price cap rules divided by the total number of access lines. As the PICC caps increase each year, more of the residual TIC charge can be included in the flat-rated PICC. Any residual TIC amounts that cannot be recovered through the PICC shall be recovered on a per-minute basis from originating traffic, subject to a cap on per-minute originating access charges, as explained in Section III.A, above.[299] If this cap is exceeded, the residual TIC shall be recovered through per-minute terminating switched access rates. Although a portion of the residual TIC will be recovered through PICC charges, the TIC will remain in the trunking basket. Therefore, to ensure that excess headroom is not created in the trunking basket, price cap LECs shall include the TIC revenues received from the flat-rated PICC in calculating the API for the trunking basket and the SBI for the TIC.

240. The policies adopted when the TIC was created require incumbent LECs to assess the TIC on all minutes that interconnect with the incumbent LEC switched access network, including minutes that transit a CAP's transport network without using any incumbent LEC transport facilities. As we noted in the NPRM,[300] and as some commenters assert,[301] if the incumbent LEC's transport rates are kept artificially low and the difference is recovered through the TIC, competitors of the incumbent LEC pay some of the incumbent LEC's transport costs. In a recent arbitration between Teleport and US West, the Colorado Commission has precluded US West from imposing the TIC on competitors for the portion of transport that U S West does not provide.[302] We find that our current policy, which requires competitive entrants to pay the TIC even in cases where it provides its own transport, is inconsistent with the procompetitive goals of the 1996 Act. We therefore modify our rules to permit incumbent LECs to assess any per-minute residual TIC charge only on minutes that utilize incumbent LEC transport facilities, and not on any switched minutes of CAPs that interconnect with the incumbent LEC switched access network at the end office.

241. *Other Approaches.* We reject alternative methods for recovering the TIC that were proposed in the record. The majority of the incumbent LEC parties supported recovering any remaining costs in the TIC by bulk billing such amounts to IXCs based on each IXC's share of

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[299] *See* para. 100, above.

[300] NPRM at ¶ 97.

[301] *See, e.g.*, Teleport Comments at 30-32; Time Warner Comments at 12-13, 15.

[302] *See TCG Colorado Petition for Arbitration Pursuant to § 252(b) of the Telecommunications Act of 1996 to Establish an Interconnection Agreement with U S West*, Docket No. 96A-329T, Decision Regarding Petition for Arbitration, Decision No. C96-1186 (adopted Nov. 5, 1996); *TCG Colorado Petition for Arbitration Pursuant to § 252(b) of the Telecommunications Act of 1996 to Establish an Interconnection Agreement with U S West*, Docket No. 96A-329T, Order Denying Applications for Rehearing, Reargument, or Reconsideration, Decision No. C96-1344 (adopted Dec. 18, 1996), at ¶ I.B.1.4; Letter from Judith Herrman, Manager, Federal Regulatory Affairs, Teleport Communications Group, to Richard Lerner, Competitive Pricing Division, FCC, April 11, 1997.

revenues, or presubscribed lines.[303] Other incumbent LECs proposed establishing "public policy" elements to recover the residual TIC.[304] These approaches would insulate TIC costs from the pressures of the competitive market and guarantee incumbent LECs the recovery of these amounts, even where such costs have resulted from inefficiencies that the competitive market -- but not regulators -- detected and otherwise would eliminate. This would be inconsistent with the development of an efficient competitive market. Our resolution of the TIC will allow LECs a reasonable opportunity to recover their costs, without providing a guarantee. We also reject the idea of spreading the remaining costs recovered by the TIC proportionately over all transport services, as suggested by AARP, *et al*. As we noted earlier, some of the remaining costs in the TIC may implicate certain Commission decisions separating costs between the federal and state jurisdictions and thus may be related to services other than transport. We, therefore, believe that awaiting further consideration by a Joint Board is a more practical means of ultimately resolving the TIC issue.

242. Some parties have requested that a portion of the costs recovered by the TIC should be considered to be universal service costs.[305] We do not find this argument persuasive. Elsewhere in this Order, we have reallocated the TIC's identifiable cost components. On the basis of the record before us, we cannot clearly associate the remaining TIC revenues with any particular facilities or services. The parties arguing that these costs are related to universal service have not made any clear showing as to the source of these costs or demonstrated why they believe that these TIC revenues are either costs of universal service that should be recovered from the universal service fund or constituent costs of supported services.

243. We have analyzed the effect of the reallocation of TIC costs and the new recovery procedures on small business entities, including small LECs and new entrants, and find that the changes will facilitate the development of a competitive marketplace by moving incumbent LEC rates toward cost-based levels and by eliminating the ability of incumbent LECs to assess the TIC on switched access minutes that do not use incumbent LEC transport facilities. These pricing revisions may create new opportunities for small entities wishing to enter the telecommunications market.

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[303] *See, e.g.*, USTA Comments at 66; BellSouth Comments at 13-14; PacTel Comments at 72.

[304] *See, e.g.*, U S West Comments at 71-73; SWBT Reply at 11; GTE Comments at 39, 41-44.

[305] *See, e.g.*, WITA Comments at 8; Texas Public Utility Counsel Comments at 21.

E. SS7 Signalling

1. Background

244. SS7 is a network protocol used to transmit signalling information over common channel signalling networks. As described in greater detail in the NPRM, signalling networks like SS7 establish and close transmission paths over which telephone calls are carried.[306] Signalling networks are also used to retrieve information from remote data bases to enable credit card and collect calling. SS7 systems are also used to transmit information needed to provide custom local area signalling services like automatic call back.[307]

245. An SS7 network consists of several primary components -- signalling points, signal transport links, and dedicated lines used for access to an incumbent LEC's signalling network (signal links). Signalling points are nodes in an SS7 network that originate, transmit, or route signalling messages. There are three principal types of signalling points: service switching points (SSPs), service control points (SCPs), and signalling transfer points (STPs). An SSP is a switch that can originate, transmit, and receive messages for call setup and database transactions. An SCP serves as a database that stores and provides information used in the routing of calls, such as the line information database (LIDB) used to validate calling cards or the database that identifies the designated long-distance carrier for toll-free service. An STP is a specialized packet switch that performs screening and security functions and switches SS7 messages within the signalling network.

246. Signal transport links are facilities dedicated to the transport of SS7 messages within the incumbent LEC's signalling network. Finally, dedicated network access lines (DNALs) consist of dedicated circuits that transmit queries between the incumbent LEC's signalling network and the signalling networks of other individual carriers, such as IXCs. A carrier's DNAL is connected to an incumbent LEC's signalling network through a port on an incumbent LEC's STP.

247. Under the interim transport rate structure, incumbent LECs charge IXCs and other access customers a flat-rated charge (dedicated signalling transport) under Part 69 for the use of dedicated facilities used to connect to the incumbent LEC's signalling network. This rate element has two subelements -- a flat-rated signalling link charge for the dedicated network access line (dedicated signalling line) and a flat-rated STP port termination charge.[308] Most other signalling costs, such as costs for switching messages at the STP and transmitting messages within the signalling network, are not recovered through facility-based charges and thus most, if not all, of

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[306] NPRM at ¶¶ 123-25.

[307] *See Ameritech SS7 Waiver Order*, 11 FCC Rcd at 3841 (1996).

[308] 47 C.F.R. § 69.125.

these costs are embedded in the TIC or in the local switching charge and recovered through per-minute-of-use charges. Retrieval of information from databases for toll-free calls and LIDB databases, however, is charged on a per-query basis.[309]

248. In the NPRM, we solicited comment on whether the Commission should revise its rate structure for SS7 services to reflect the SS7 rate structure implemented by Ameritech.[310] In March, 1996, the Commission granted a waiver to Ameritech, allowing it to restructure its recovery of SS7 costs through four unbundled charges.[311] These charges correspond to various functions performed by signalling networks: signal link, STP port termination, signal transport, and signal switching.

249. The Ameritech waiver was granted to allow Ameritech to realign its charges for SS7 services more closely with the manner in which such costs are incurred. Unbundling of SS7 services from transport and local switching ensures that transport and local switching customers do not pay for SS7 services they do not use. Unbundling also enables Ameritech to offer SS7 services to competing providers of local exchange and exchange access services without requiring the purchase of other elements that the competitors do not need.[312] In support of its waiver petition, Ameritech noted that it had received numerous customer requests for such unbundling. It also explained that it had deployed equipment necessary for measuring third-party usage of its SS7 networks, enabling the company to bill its SS7 services separately from its switched access services.[313]

250. The NPRM also requested comment on whether incumbent LECs should be allowed to impose separate charges for ISDN User Part (ISUP) messages and Transaction Capabilities Application Part (TCAP) messages.[314] ISUP messages are used to set up and take down calls. For example, ISUP messages include the initial address message used to establish and close the transmission path used to carry a telephone call.[315] TCAP messages, on the other hand, are used to carry information between SSPs that support particular services, such as toll free services, LIDB services and certain custom local area signalling services (CLASS) like automatic call

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[309] 47 C.F.R. § 69.120.

[310] NPRM at ¶ 127.

[311] *Ameritech SS7 Waiver Order*, 11 FCC Rcd 3839 (1996).

[312] 11 FCC Rcd at 3853.

[313] 11 FCC Rcd at 3848.

[314] NPRM at ¶ 135.

[315] 11 FCC Rcd at 3841-42.

back.[316] We noted that differentiation between charges for ISUP and TCAP messages may be economically justified because TCAP messages tend to be shorter in average length and place lower demands on the signalling network that ISUP messages.[317]

251. The NPRM also requested comment regarding the appropriate placement of SS7 signalling elements in price cap baskets. Currently, STP port termination rates and charges for the signalling link, or DNAL, are placed in the trunking basket.[318] Because both services are dedicated to particular SS7 customers, rates for these elements are flat-rated. We requested comment on whether the STP port termination charge should be placed in its own service category in the traffic-sensitive basket. We noted that interconnectors can provide their own signalling link, exposing that service element to some measure of competition. The STP port termination, on the other hand, is relatively insulated from competitive pressures because it is part of the incumbent LEC's STP and must be purchased from the incumbent LEC under existing network architecture.

2. Discussion

252. As we noted in the *Ameritech SS7 Waiver Order*, the removal of SS7 costs from the local switching and transport interconnection charge rate elements would benefit access customers that pay for these services but do not actually use an incumbent LEC's signalling services. It would also benefit alternative local service providers by enabling them to purchase separate SS7 services from incumbent LECs to support their provision of competing local exchange or exchange access services.[319] Unbundling the individual SS7 components into separate charges would further promote efficiency by ensuring that signalling charges more accurately reflect the costs of providing such services. Competitive service providers could limit their signalling costs by purchasing only the signalling elements they need.[320] Despite these benefits, however, we are reluctant to impose on incumbent LECs the cost burden of installing metering or other equipment needed to measure third party usage of signalling facilities.[321] In granting Ameritech a waiver to implement its unbundled SS7 rate structure, we noted that

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[316] *Id.*

[317] NPRM at ¶ 135.

[318] 47 C.F.R. § 61.42(d)(3); NPRM at ¶¶ 128, 130.

[319] 11 FCC Rcd at 3853.

[320] *Id.*

[321] Bell Atlantic and NYNEX estimate the cost of installing facilities to measure SS7 usage ranges between $15 million and $40 million. BA/NYNEX Comments at 40. Sprint estimates that the cost would run between $15 million and $20 million. Sprint Comments at 31.

Ameritech had previously installed the equipment and other facilities needed to meter independent signalling usage.[322] Although we encourage actions that would promote disaggregation and unbundling of SS7 services, we will not require incumbent LECs to implement such an approach and incur the associated equipment costs of doing so. The record indicates that, as a general matter, the costs of mandating the installation of metering equipment may well exceed the benefits of doing so.[323]

253. Instead, we will permit incumbent LECs to adopt unbundled signalling rate structures at their discretion and acquire the appropriate measuring equipment as needed to implement such a plan. Specifically, incumbent LECs may implement the same unbundled rate structure for SS7 services that we approved in the *Ameritech SS7 Waiver Order*.[324] We recognize, however, that other signalling rate structures may achieve the same benefits that are available under the Ameritech rate structure. Hence, an incumbent LEC may implement an unbundled signalling rate structure that varies from the approach implemented in the *Ameritech SS7 Waiver Order* by filing a petition demonstrating that the establishment of new rate elements implementing such a service is consistent with the public interest.[325] We note, however, that variations in signalling rate structures among incumbent LECs could impose burdens on IXCs if IXCs must adapt to a diverse range of unbundled signalling rate structures.[326] We anticipate that, if incumbent LECs choose to adopt unbundled rate structures for their SS7 network services, they will evaluate how the implementation of these plans will affect their prospective customers.[327]

254. With respect to rate differentiation between ISUP and TCAP messages, the NPRM expressed the concern that imposing rate differentiation may be inconsistent with rate structure simplicity.[328] Several commenters indicate that the costs of implementing rate differentiation would exceed the benefits of such an approach.[329] We further note that commenters offered little, if any, general support for the adoption of rate differentiation. Accordingly, to avoid unnecessary

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[322] 11 FCC Rcd at 3844-45.

[323] USTA Comments at 37; BA/NYNEX Comments at 40; PacTel Comments at 73; GTE Comments at 53.

[324] A carrier could adopt the Ameritech rate structure pursuant to 47 C.F.R. 69.4(g), which permits a carrier to implement rate structures previously approved by the Commission for other carriers.

[325] 47 C.F.R. § 69.4(g).

[326] *See* Sprint Comments at 31.

[327] Sprint suggests that an industry forum may be appropriate to develop an optimum rate structure for unbundled signalling services. Sprint Comments at 31.

[328] NPRM at ¶ 135.

[329] MCI Comments at 89; Time Warner Comments at 17; CompTel Comments at 31-32.

complexity and to avoid the imposition of unnecessary regulatory costs, we will not impose a rate differential between ISUP and TCAP messages.

255. With respect to the placement of SS7 rate elements in price cap baskets, we have previously recognized that the signalling link and the STP port termination are not subject to the same level of competition. As noted in the *Ameritech SS7 Waiver Order*, STP port termination is provided only by incumbents while the signalling link can be provided by SS7 customers themselves or by other alternative providers.[330] Comments filed in this proceeding also acknowledge this competitive disparity.[331] Although Ameritech discounts the risk that STP port termination charges would be used to offset price reductions for the signal link, it nevertheless acknowledges the existence of the competitive differential we suggested in the NPRM. Other commenters argue that the competitive disparity is sufficient to justify concerns that price cap LECs would adjust their rates to account for the competitive differential. Accordingly, we will establish a new STP port termination rate element in the traffic-sensitive basket. Placing these SS7 services in different price cap baskets will ensure consistency with the Commission's general approach of maintaining elements with similar competitive characteristics in the same service baskets.

F. Impact of New Technologies

256. The NPRM requested comment regarding the rate structure treatment of new technologies that enable new telecommunications services and, by enhancing the productivity of telecommunications facilities, lower prices for services in the future. These technologies, which we describe in greater detail in the NPRM, include synchronous optical networks (SONET), Asynchronous Transfer Mode (ATM) switching, and advanced intelligent networks (AIN). We invited commenters to recommend specific rate structure rules that would reflect the manner in which incumbent LECs incur costs when providing services utilizing such new technologies.[332]

257. As a general matter, the Commission is reluctant to adopt detailed rules governing rate structures for recovering the cost of deploying advanced technologies. We note that, in the *Price Cap Third Report and Order*, we adopted rules that permit price cap LECs to petition the Commission for the establishment of one or more switched access rate elements to accommodate new services.[333] Under these rules, petitioners must demonstrate either of the following: 1) that the new rate elements would be in the public interest; or 2) that another LEC has previously

[330] 11 FCC Rcd at 3859. NPRM at ¶ 130.

[331] MCI Comments at 87-88; AT&T Reply at 33-34.

[332] NPRM at ¶ 139.

[333] *Price Cap Third Report and Order* at ¶ 309-10.

obtained approval to establish identical rate elements and that the original petition did not rely upon a competitive showing as part of its public interest justification.[334] Because technological advancements emerge rapidly, the adoption of uniform rate structures corresponding to particular technologies may slow investment in the development of newer technologies or improvements in current technologies. Indeed, as a general matter, incumbent LECs oppose the adoption of uniform rate structures for new technologies, suggesting that strict uniform rules in this regard could inhibit development of such technologies. Accordingly, we will refrain from adopting in this Order specific rate structures with respect to SONET, AIN, or other new technologies. As noted above, however, our rules already accommodate rate element adjustments that may be needed on an ad hoc basis when technological advancements justify such modifications. As particular new technologies become used on a widespread basis, we can always consider whether there is a need for a uniform rate structure at that point.

IV. BASELINE RATE LEVELS

A. Primary Reliance on a Market-Based Approach With A Prescriptive Backdrop and the Adoption of Several Initial Prescriptive Measures

1. Background

258. In the NPRM, we established a goal of encouraging efficient competitors to enter local exchange access markets so that incumbent LECs would face substantial competition for the entire array of interstate access services.[335] As a particular service becomes subject to substantial competition from new providers, we proposed to remove that service from price cap and tariff regulation.[336] We sought comment on two general approaches for a transition to reliance on substantial competition to ensure that interstate access charges are closely related to forward-looking economic costs: a "market-based" approach and a "prescriptive" approach. Under a market-based approach, we would permit market forces to operate as competition emerges, allowing an incumbent to change its prices in response to competitive entry. To that end, we proposed a two-phase approach in which incumbent LECs would be permitted certain pricing flexibility upon a showing that meaningful competitive entry is possible within a particular local exchange and exchange access market, followed by a further relaxation of price cap regulation when meaningful actual competition developed within the market.[337] We did not propose,

[334] 47 C.F.R. § 69.4(g).

[335] NPRM at ¶ 140.

[336] NPRM at ¶ 149.

[337] NPRM at ¶ 140.

however, to abandon the possibility of using the prescriptive tools at our disposal in the event that competition does not develop in some places.

259. As an alternative to the proposed market-based approach, we also sought comment on a prescriptive approach, under which incumbent LECs would be required to change their prices for some or all exchange access services using specific measures adopted by the Commission to more accurately ensure that access charges are closely related to the economic costs of providing interstate access services.[338] We also invited comment whether the two approaches could be merged in some fashion.[339] We emphasized that our ultimate goal under any approach, whether market-based, prescriptive or combined, is to remove from price cap regulation LEC services that are subject to substantial competition. Instead of price cap regulation, we expect eventually to rely on the operation of competitive local markets to prevent incumbent LECs from exercising market power, and thereby to protect consumers.

260. In this section, we endorse the use of a market-based approach generally. Our market-based approach will retain the protection afforded by price cap regulation, while relaxing particular restrictions on incumbent LEC pricing as competition emerges, thereby permitting the development and operation of competitive markets, which will maximize the efficient allocation of telecommunications services and promote consumer welfare. This section also explains how, if competition fails to emerge over time for certain access services in particular geographic areas, we will ensure that the rates for those services reflect the forward-looking economic costs of providing the services. In the NPRM, we sought comment on a number of specific issues concerning the timing and degrees of pricing flexibility and ultimate deregulation. We recognize that we must attend carefully to this task of granting incumbent LECs increased pricing flexibility commensurate with competitive developments, and we will resolve these issues of timing and degree in detail in a subsequent report and order in this docket, where we can more fully discuss these matters.

261. Elsewhere in this Order, we adopt or propose several measures that work within our current price cap structure to lower baseline access charge rate levels consistent with evidence that the revised rate levels better reflect the underlying costs of providing interstate access services. In Section IV.C below, we order an exogenous cost reduction to reflect the completion of the amortization of equal access costs. In Section IV.D, we order reallocation of certain marketing and retail expenses and discuss the reallocation of GSF costs. We issue a further notice on GSF costs in Section VII. In the companion *Price Cap Fourth Report and Order*, which we also adopt today, we modify our current price cap plan by adopting a single productivity offset (X-Factor) of 6.5 percent and eliminating sharing while maintaining the low-end adjustment.

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[338] NPRM at ¶ 141.

[339] NPRM at ¶ 144.

2. Discussion

262. The Commission's objective is the one set forth in the 1996 Act -- "opening all telecommunications markets to competition."[340] Therefore, we must ensure that our own regulations do not unduly interfere with the development and operation of these markets as competition develops. If we successfully reform our access charge rules to promote the operation of competitive markets, interstate access charges will ultimately reflect the forward-looking economic costs of providing interstate access services. This is so, in part, because Congress established in the 1996 Act a cost-based pricing requirement for incumbent LECs' rates for interconnection and unbundled network elements, which are sold by carriers to other carriers. As we have recognized, interstate access services can be replaced with some interconnection services or with functionality offered by unbundled elements.[341] Because these policies will greatly facilitate competitive entry into the provision of all telecommunications services, we expect that interstate access services will ultimately be priced at competitive levels even without direct regulation of those service prices.

263. We decide that adopting a primarily market-based approach to reforming access charges will better serve the public interest than attempting immediately to prescribe new rates for all interstate access services based on the long-run incremental cost or forward-looking economic cost of interstate access services. Competitive markets are superior mechanisms for protecting consumers by ensuring that goods and services are provided to consumers in the most efficient manner possible and at prices that reflect the cost of production. Accordingly, where competition develops, it should be relied upon as much as possible to protect consumers and the public interest. In addition, using a market-based approach should minimize the potential that regulation will create and maintain distortions in the investment decisions of competitors as they enter local telecommunications markets. Finally, under the 1996 Act, implicit universal service subsidies, wherever possible, are to be made explicit and supported by all carriers on an equitable and non-discriminatory basis.[342] To the extent that any implicit subsidies remain in interstate access charges because it was not feasible to identify them or make them explicit, our market-based approach will have the effect of making those implicit subsidies subject to being competed away as competitors offer comparable services at prices that do not include the subsidies. In addition, we note that the rate structure changes we adopt today go a long way towards achieving such ends because the inefficiency produced by distortions in markets "rises as a quadratic function of

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[340] *Joint Explanatory Statement.*

[341] *E.g.*, NPRM ¶¶ 8-9, 170.

[342] 47 U.S.C. § 254.

the relative price distortion."[343] Therefore, the first steps made toward removing distortions caused by our regulations will produce the greatest benefits.

264. The market-based approach to access charge reform that we adopt will not, as some parties assert, expose customers of interstate access services to the unfettered exercise of market power.[344] We will continue to maintain the current mechanisms upon which we rely to ensure that rates for these services are "just and reasonable,"[345] and not unjustly or unreasonably discriminatory.[346] Instead of exposing customers to harm, we expect that permitting incumbent LECs certain kinds of pricing flexibility in response to the development of competition will allow prices for interstate access services to adjust in ways that reflect the underlying economic costs of providing those services without moving outside the range of rates that are just and reasonable. This process of relaxing regulation as competition develops, and ultimately deregulating services subject to effective competition, is well established. For example, many of the types of pricing flexibility discussed in the NPRM are similar to forms of pricing flexibility we have in the past accorded incumbent LECs and IXCs facing increased competition in markets for particular services.[347]

265. Economic teaching also leads to the conclusion that rates for interstate access services will generally move toward the forward-looking economic cost of providing such services in response to increased competition in local exchange and exchange access markets.[348] In addition, competition will do a better job of determining the true economic cost of providing such services. As competitive entry becomes increasingly possible, IXCs that now purchase interstate switched access services from incumbent LECs will be able to bypass those services where the prices (interstate access charges) do not reflect the economic costs of providing the underlying services. Those IXCs can do this by entering the local markets themselves as local exchange service providers, thereby self-providing interstate access services for their new local exchange service customers. They can also seek out competitive providers of comparable services. As customers choose providers other than incumbent LECs as their local providers, interstate access services will come to be priced competitively. Incumbent LECs will have to

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[343] Scherer & Ross, *supra*., at 662.

[344] Appendix B, Section IV.A., *infra*.

[345] 47 U.S.C. § 201.

[346] 47 U.S.C. § 202.

[347] *See, e.g.*, *Expanded Interconnection with Local Telephone Company Facilities*, CC Docket No. 91-141, Report & Order & Notice of Proposed Rulemaking, 7 FCC Rcd 7369 (1992) (geographic deaveraging); *AT&T Communications (Revisions to Tariff FCC No. 12)*, CC Docket No. 87-568, Memorandum Opinion & Order, 4 FCC Rcd 4932 (1989).

[348] *See, e.g.*, Dennis W. Carlton & Jeffrey M. Perloff, *Modern Industrial Organization* 92-93 (2d ed. 1994)

respond to competitors' offerings with lower-priced access services of their own in order to retain customers that would otherwise switch to competitors' networks, further increasing the effect of competition on overall access charge payments.

266. The 1996 Act has created an unprecedented opportunity for competition to develop in local telephone markets. It also has provided this Commission with tools for opening markets to competition, and for implementing our market-based relaxation of regulation so that interstate access charges reflect forward-looking economic costs. We recognize, however, that competition is unlikely to develop at the same rate in different locations, and that some services will be subject to increasing competition more rapidly than others.[349] Accordingly, we anticipate that competition will drive rates for some interstate access services toward more economically efficient levels more rapidly in some areas than rates for other services or in other areas. Where competition develops, we will provide incumbent LECs with additional flexibility, culminating in the removal of incumbent LECs' interstate access services from price regulation where they are subject to sufficient competition to ensure that the rates for those services are just and reasonable, and are not unjustly or unreasonably discriminatory.

267. We also recognize, however, that there will be areas and services for which competition may not develop. Therefore, we shall retain many of the existing safeguards afforded by our price cap regulation, including the productivity offset (X-Factor), which requires incumbent LECs to adjust their access charges to reflect changes in the economic cost of providing service. In addition, we also adopt a prescriptive "backstop" to our market-based approach that will serve to ensure that all interstate access customers receive the benefits of more efficient prices, even in those places and for those services where competition does not develop quickly. To implement our backstop to market-based access charge reform, we require each incumbent price cap LEC to file a cost study no later than February 8, 2001, demonstrating the cost of providing those interstate access services that remain subject to price cap regulation because they do not face substantial competition. The Commission will require submission of such studies before that date if competition is not developing sufficiently for our market-based approach to work. Studies should identify and quantify forward-looking costs, short-run and long-run, that are incremental to providing each such service, and also costs that are common as between various services. These studies are required only for non-competitive services; as stated above, we do not intend to regulate prices of services that are subject to substantial competition.

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[349] The observation that competitive entry will occur in some places, and for some services, more rapidly than others is a corollary to the rule that firms in competitive markets seek to maximize their profits. *See, e.g.*, Carlton & Perloff, *supra*, at 89. To maximize profits, firms naturally seek out those customers and services on which they can generate the most profits. Therefore, some customers are naturally more desirable than others at any given point in time. As competitors attempt to gain the patronage of the customers offering the greatest profit opportunities, they offer lower-priced or more desirable services. These actions have the effect of reducing over time the profitability of serving those particular customers and, as this occurs, the relative profitability of serving other customers or offering other services increases. Therefore, competitors begin seeking to serve these other customers, and entry occurs in new places, or for new services.

268. We have chosen this date in order to give competition sufficient time to develop substantially in the various markets for interstate exchange access services. We have also chosen this date to permit us and all interested parties to take into account the effects of implementing the substantial changes that we adopt in this Order and that we will be adopting elsewhere to satisfy the universal service goals in section 254. By this date, we also expect to have additional regulatory tools by which to assess the reasonableness of access charges. We may, for example, be able to establish benchmarks based on prices for the interstate access services for which competition has emerged, and use the prices actually charged in competitive markets to set rates for non-competitive services and markets. Carriers could be required either to set their rates in accordance with the benchmarks or to justify their rates using their cost studies.

269. We anticipate that the pro-competitive regime created by the 1996 Act, and implemented in the *Local Competition Order* and numerous state commission decisions, will generate competition over the next few years. Further, it would be imprudent to prejudge the effectiveness of those measures at creating competitive local markets. Rather than ignore or interfere with the effects of this developing competition on prices for interstate access services, we find that the public interest is best served by permitting emerging competition to affect access charge rate levels. In addition, the experience we gain from observing the effects of emerging competition on interstate access services will permit us more effectively and efficiently to implement any prescriptive measures that may be needed in the future to ensure that interstate access services remaining subject to regulation are priced in accordance with the forward-looking economic cost of providing those services.

270. Economic logic holds that giving incumbent LECs increased pricing flexibility will permit them to respond to competitive entry, which will allow prices to move in a way that they would not have moved were the pricing restrictions maintained.[350] This can lead to better operating markets and produce more efficient outcomes. Deregulation before competition has established itself, however, can expose consumers to the unfettered exercise of monopoly power and, in some cases, even stifle the development of competition, leaving a monopolistic environment that adversely affects the interests of consumers.[351] Therefore, it is important that we design our market-based approach carefully. We must, among other things, decide which, if any, of the rules setting forth specific competitive triggers and corresponding flexibility as proposed in the NPRM we should adopt. We will resolve these issues in the subsequent report and order in this docket.

271. As set forth in the summary of comments appended to this order, AT&T cites to

[350] *E.g.*, Jean-Jaques Laffont & Jean Tirole, *Creating Competition Through Interconnection: Theory and Practice*, 10 J. Reg. Econ. 227-56 (1996).

[351] *See, e.g.*, Jean Tirole, *The Theory of Industrial Organization* 230 (1988).

Farmers Union Central Exchange, Inc. v. FERC[352] for the proposition that "[r]eliance on competitive forces to constrain exchange access rates, particularly in the presence of strong indications that market forces will not produce the intended results, would be arbitrary and capricious and contravene the Commission's statutory duty to ensure just, reasonable, and nondiscriminatory rates."[353] We disagree with AT&T's assertion. In *Farmers Union*, FERC had stated in its relevant order that ratemaking for oil pipelines should be used solely to prevent price gouging, and had interpreted the Congressional mandate of "just and reasonable" rates as requiring that rates be kept within the zone of commercial reasonableness, not public utility reasonableness.[354] Under this interpretation, FERC had concluded that it would rely primarily on market forces to keep rates reasonable.[355]

272. The court in *Farmers Union* recognized that "[m]oving from heavy to lighthanded regulation . . . can be justified by a showing that . . . the goals and purposes of the statute will be accomplished through substantially less regulatory oversight," but objected to FERC's failure to establish that its new approach would satisfy the "just and reasonable" standard.[356] The court rejected FERC's position that oil pipeline ratemaking should protect only against "egregious exploitation and gross abuse" as being inconsistent with the mandate that Congress had established for FERC.[357] The court concluded that FERC had not shown that market forces were sufficient to rely upon in setting reasonable rates.[358]

273. We reject AT&T's argument that our market-based approach to access charge reform is analogous to FERC's conduct at issue in *Farmer's Union*. Our access charge and price cap rules are designed to ensure that access charges remain within the "zone of reasonableness"[359] defining rates that are "just and reasonable,"[360] and our market-based approach will also be designed to implement this statutory requirement. It will not remove incumbent LECs from

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[352] 734 F.2d 1486, 1508 (D.C. Cir.) (*Farmers Union*), *cert. denied, Williams Pipe Line Co. v. Farmers Union Central Exchange, Inc.*, 469 U.S. 1034 (1984).

[353] Appendix B, Sec. IV.A., *infra*.

[354] *Farmers' Union*, 734 F.2d at 1492.

[355] *Id*.

[356] *Id*. at 1510.

[357] *Id*. at 1502.

[358] *Id*. at 1508.

[359] *Id*. at 1502.

[360] 47 U.S.C. § 201(b).

regulation immediately, but will implement deregulation in steps, as competitive conditions warrant. Throughout the transition to deregulation in the face of substantial competition, we will maintain many safeguards against unjust or unreasonable rates, such as the price cap indices. We will deregulate incumbent LEC services only when it is reasonable to conclude that competition has developed to such an extent that the market will ensure just and reasonable rates.[361]

274. Second, our market-based approach is an eminently reasonable method for pursuing our goal of promoting competition and ensuring the economically efficient pricing of interstate access services. As competition emerges, the market-based approach will permit access charges to move towards the levels that will prevail in competitive markets. During the transition to competitive markets, access services not subject to competition will remain subject to price cap regulation, and we will eventually prescribe rates for those services at forward-looking economic cost levels, to ensure that all consumers reap the benefits of economically-efficient prices. Unlike the FERC regulation at issue in *Farmers Union*, our market-based approach to promoting the development of competitive markets and economically-efficient pricing will not be based on "largely undocumented reliance on market forces . . . ."[362] Instead, we will design our approach so that deregulation occurs only when the reliability of market forces can be fully determined with respect to a particular service. Finally, we observe that FERC's mandate in *Farmers Union* was one of rate regulation due to market failure and concern over monopoly power.[363] In light of the 1996 Act, our mandate is no longer strictly or solely one of rate regulation. Congress has stated its desire to establish "a pro-competitive, deregulatory national policy framework."[364] Our market-based approach will be designed to coincide with and promote this objective.

275. *Price Squeeze Concerns Are Adequately Addressed.* Several parties have argued that current access charge rate levels create the conditions for an anticompetitive price squeeze when a LEC affiliate offers interexchange services in competition with IXCs.[365] A price squeeze, as the term is used by these parties, refers to a particular, well-defined strategy of predation that would involve the incumbent LEC setting "high" prices for interstate exchange access services, over which the LEC has monopoly power (albeit constrained by regulation), while its affiliate is offering "low" prices for long-distance services in competition with the other long-distance carriers. Because interstate exchange access services are a necessary input for long-distance

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[361] Such market-based regulation of prices has been upheld where the market being relied upon is sufficiently competitive and the regulator maintains its authority to step in to ensure that rates remain just and reasonable. *Elizabethtown Gas Co. v. FERC*, 10 F.3d 866, 870-71 (D.C. Cir. 1993).

[362] AT&T Comments at 48 (*citing Farmers Union*, 734 F.2d at 1508).

[363] *Farmers' Union*, 734 F.2d at 1508.

[364] *Joint Explanatory Statement.*

[365] Appendix B, Section IV.A, *infra*.

services, these parties argue that an incumbent LEC can create a situation where the relationship between the LEC's "high" exchange access prices and its affiliate's "low" prices for long-distance services forces competing long-distance carriers either to lose money or to lose customers even if they are more efficient than the LEC's affiliate at providing long-distance services. It is this nonremunerative relationship between the input prices and the affiliate's prices, and not the absolute levels of those prices, that defines a price squeeze. In the most extreme case, a price squeeze involves a monopolist setting input prices that are actually higher than its prices in the output market.

276. Price cap regulation of access prices limits the ability of LECs to raise the prices of the input services. Commenters raising price squeeze concerns argue, however, that a LEC's interexchange affiliate will still be in a position to implement a price squeeze by setting long-distance rates close to the rates for access services, thereby forcing IXCs to charge below-cost rates to retain customers. They argue that LECs' interexchange affiliates have lower costs of providing interexchange services because of their affiliation with monopoly providers of interstate access services, and not as a result of being more efficient. According to these commenters, the relevant economic costs of providing interstate interexchange services will be lower for the LEC affiliate offering interexchange services than for competing IXCs because it only has to recover the true economic cost of providing the interstate access services (since the owners of the LEC and its interexchange affiliate will want the two entities to maximize their joint profits), whereas the IXCs will be forced to pay interstate access charges that are above the true economic cost of providing the underlying services.

277. Absent appropriate regulation, an incumbent LEC and its interexchange affiliate could potentially implement a price squeeze once the incumbent LEC began offering in-region, interexchange toll services. Although no BOC affiliate may offer such services at this time, GTE, SNET, Sprint and other incumbent LECs do have affiliates offering such services. The incumbent LEC could do this by raising the price of interstate access services to all interexchange carriers, which would cause competing in-region carriers to either raise their retail rates to maintain their profit margins or to attempt to maintain their market share by not raising their prices to reflect the increase in access charges, thereby reducing their profit margins. If the competing in-region, interexchange providers raised their prices to recover the increased access charges, the incumbent LEC's interexchange affiliate could seek to expand its market share by not matching the price increase. The incumbent LEC affiliate could also set its in-region, interexchange prices at or below its access prices. Its competitors would then be faced with the choice of lowering their retail rates for interexchange services, thereby reducing their profit margins, or maintaining their retail rates at the higher price and risk losing market share.

278. We conclude that, although an incumbent LEC's control of exchange and exchange access facilities may give it the incentive and ability to engage in a price squeeze, we have in place

adequate safeguards against such conduct. The *Fifth Competitive Carrier Report and Order*[366] requirements aid in the prevention and detection of such anticompetitive conduct. In our recent *In-Region Interexchange Order* we decided to retain the *Fifth Competitive Carrier Report and Order* separation requirements for incumbent LEC provision of in-region interLATA services.[367] These requirements apply both to BOCs and to other incumbent LECs. In addition, as discussed in that order, BOC interexchange affiliates are subject to the safeguards set forth in section 272 of the Act.[368]

279. The *Fifth Competitive Carrier Report and Order* separation requirements have been in place for over ten years, and independent (non-BOC) incumbent LECs have been providing in-region, interexchange services on a separated basis with no substantiated complaints of a price squeeze. Under these separation requirements, incumbent LECs are required to maintain separate books of account, permitting us to trace and document improper allocation of costs and/or assets between a LEC and its long-distance affiliate, as well as to detect discriminatory conduct. In addition, we prohibit joint ownership of facilities, which further reduces the risk of improper allocations of the costs of common facilities between the incumbent LEC and its interexchange affiliate, as discussed at length in the *In-Region Interexchange Order*[369] and the *Non-Accounting Safeguards Order* (addressing the Act's prohibition of BOC joint ownership with its interexchange affiliate pursuant to Section 272).[370] As we also discussed at length in those orders, the prohibition on jointly-owned facilities also helps to deter any discrimination in access to the LEC's transmission and switching facilities by requiring the affiliates to follow the same procedures as competing interexchange carriers to obtain access to those facilities. Finally, our requirement that incumbent LECs offer services at tariffed rates, or on the same basis as

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[366] *Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor*, CC Docket No. 79-252, Fifth Report & Order, 98 FCC 2d 1191, 1198 ¶ 9 (1984) (*Fifth Competitive Carrier Report and Order*).

[367] *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area and Policy and Rules Concerning the Interstate, Interexchange Marketplace*, Second Report and Order in CC Docket No. 96-149 and Third Report and Order in CC Docket No. 96-61, __ FCC Rcd ____, FCC 97-142 (Apr. 18, 1997) (*Dom/Nondom R&O*)

[368] *Id.*

[369] *Id.* ¶¶ 163-69.

[370] *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended*, First Report and Order and Further Notice of Proposed Rulemaking, FCC 96-489 ¶¶ 159-62 (Dec. 24, 1996) (*Non-Accounting Safeguards Order*), *on recon.*, FCC 97-52 (Feb. 19, 1997), *recon. pending*, CC Docket No. 96-149, *petition for summary review in part denied and motion for voluntary remand granted sub nom., Bell Atlantic v. FCC*, No. 97-1067 (D.C. Cir. filed Mar. 31, 1997), *petition for review pending sub nom., SBC Communications v. FCC*, No. 97-1118 (D.C. Cir. filed Mar. 6, 1997) (held in abeyance pursuant to court order filed May 7, 1997).

requesting carriers that have negotiated interconnection agreements pursuant to section 251[371] reduces the risk of a price squeeze to the extent that an affiliate's long-distance prices would have to exceed their costs for tariffed services.

280. Current conditions in markets for interexchange services give us comfort that an anticompetitive price squeeze is unlikely to occur as a result of our decision not to prescribe immediately access charge rates at forward-looking economic cost levels. If an incumbent LEC does attempt to engage in an anticompetitive price squeeze against rival long-distance providers, the provisions of the Act should permit new entrants or other competitors to seek out or provide competitive alternatives to tariffed incumbent LEC access services. For example, under the provisions of section 251,[372] a competitor will be able to purchase unbundled network elements to compete with the incumbent LEC's offering of local exchange access. Therefore, so long as an incumbent LEC is required to provide unbundled network elements quickly, at economic cost, and in adequate quantities, an attempted price squeeze seems likely to induce substantial additional entry in local markets. Accordingly, there should be a reduced likelihood that an incumbent LEC could successfully employ such a strategy to obtain the power to raise long-distance prices to the detriment of consumers.

281. Furthermore, even if a LEC were able to allocate improperly the costs of its affiliate's interexchange services, we conclude that it is unlikely that the LEC's interexchange affiliate could engage successfully in predation.[373] At least four interexchange carriers -- AT&T, MCI, Sprint, and LDDS WorldCom -- have nationwide, or near-nationwide, network facilities that cover every LEC's region.[374] These are large, well-established companies with millions of customers throughout the nation. It is unlikely, therefore, that one or more of these national companies can be driven from the market with a price squeeze, even if effectuated by several LECs simultaneously, whether acting together or independently. Even if it could be done, it is doubtful that the LECs' interexchange affiliates would later be able to raise, and profitably sustain, prices above competitive levels. As Professor Spulber has observed, "[e]ven in the unlikely event that [LECs' interexchange affiliates] could drive one of the three large interexchange carriers into bankruptcy, the fiber-optic transmission capacity of that carrier would remain intact, ready for another firm to buy the capacity at distress sale and immediately undercut the [affiliates']

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[371] *Id*. ¶ 164.

[372] 47 U.S.C. § 251(c)(3).

[373] *See Matsushita Elec. Indus. Co. v. Zenith Radio Corp*., 475 U.S. 574, 589 (1986) ("[P]redatory pricing schemes are rarely tried, and even more rarely successful.").

[374] *Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier*, 11 FCC Rcd 3271, 3304 ¶¶ 60-61 (1996).

noncompetitive prices."[375]

282. Finally, in addition to our regulations and the provisions of section 251 of the Act, the antitrust laws also offer a measure of protection against a possible price squeeze.[376] Although we believe it would not serve the public interest for us knowingly to permit a price squeeze to occur, and to rely entirely on the adequacy of antitrust law remedies to protect the public, we take comfort in the fact that such remedies exist should an anticompetitive price squeeze occur in spite of the safeguards we have adopted.[377] In particular, although a price squeeze engaged in by several LECs, particularly if it involved more than one of the BOCs or GTE, could have a significant impact on interexchange competitors, we believe that the antitrust laws will act as a strong backstop to our own enforcement process so that the risk of such concerted activity is sufficiently limited.[378]

283. *Other Concerns Raised by Commenters*. Several commenters raised concerns that our market-based approach to access charge reform might permit incumbent LECs to engage in cross subsidization, either between competitive and non-competitive services, or between interstate access services and other services such as video distribution.[379] No evidence has been presented, however, indicating any likelihood that current price cap regulation, which is designed, in part, to prevent cross subsidization, might become less effective under a market-based approach to access charge reform. Those price cap regulations will remain in place until there is

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[375] Daniel F. Spulber, *Deregulating Telecommunications*, 12 Yale J. Reg. 25, 60 (1995).

[376] Beginning with Judge Learned Hand's opinion in *United States v. Aluminum Co. of America (Alcoa)*, 148 F.2d 416, 437-38 (2d Cir. 1945), a specific body of precedent has developed under federal antitrust law defining situations where a price squeeze can be actionable as a form of monopolization or attempted monopolization under Section 2 of the Sherman Act. 15 U.S.C. § 2. Under this precedent, a price squeeze can violate the antitrust laws where (1) a firm has monopoly power with respect to an "upstream" product; (2) it sells that product at "higher than a 'fair price,'"; (3) the product is a necessary input for the product being sold by other firms in competition with the monopoly or its affiliate in a "downstream" market; and (4) the monopolist offers the "downstream" product at a price so low that (equally-efficient) competitors cannot match the price and still earn a "living profit." *Alcoa*, 148 F.2d at 437-38. Over time, courts have developed several tests for determining when the relationship between the two prices is sufficiently adverse to competitors that it constitutes an anticompetitive price squeeze. *See, e.g., Bonjorno v. Kaiser Aluminum & Chem. Corp.*, 752 F.2d 802, 808-09 (3d Cir. 1984), *cert.denied*, 477 U.S. 908 (1986); *Ray v. Indiana & Mich. Elec. Co.*, 606 F. Supp. 757, 776 (N.D. Ind. 1984), *aff'd*, 758 F.2d 1148 (7th Cir. 1985).

[377] Because the rates charged by LEC interexchange affiliates will not be regulated, we do not believe that a court would reject a price squeeze claim under the antitrust laws on the grounds that "'normally' a price squeeze will not constitute an exclusionary practice in the context of a fully regulated monopoly." *Town of Concord v. Boston Edison Co.*, 915 F.2d 17 (1st Cir.1990) (J. Breyer), *cert. denied*, ___ U.S. ___, 111 S. Ct. 1337 (1991). Indeed, the court in that case explicitly declined to address the "special problem" posed by a price squeeze allegation against a firm regulated in the input market and undercutting rivals' prices in the unregulated market where inputs are used. *Id*. at 29.

[378] *See Non-Accounting Safeguards Order* FCC 97-142 ¶ 70.

[379] *See* Appendix B, Section IV.A, *infra*.

sufficient competition to prevent an incumbent LEC from charging rates that are not just and reasonable. Therefore, we find that the record does not contain substantial evidence that a market-based approach to access charge reform is any less likely than current regulation to permit incumbent LECs to engage in unreasonable cross subsidization with their interstate access charges.

284. Finally, several commenters based their support for a market-based approach, in part, on arguments that it would reduce, or minimize, administrative burdens. Other commenters, on the other hand, opposed a market-based approach on the grounds that it would increase administrative burdens. Based on the record before us, however, we cannot reach a conclusion as to the relative administrative burdens of the two approaches. Some parts of our proposed market-based approach, such as grants of increased pricing flexibility as competitive conditions warranted, were modeled on waivers that we have granted within the context of our current price cap plan and would likely be necessary even if we had adopted a primarily prescriptive approach to access charge rate level reform. Similarly, some parts of a prescriptive approach, such as annual changes in price cap calculations, will necessarily be a part of our market-based approach. Accordingly, we can see no basis in this record for concluding that a market-based approach to access charge reform will be any more or less burdensome than any other alternative.

B. Prescriptive Approaches

1. Prescription of a New X-Factor

a. Background

285. In the NPRM, we observed that the Commission had initiated a rulemaking proceeding in the *Price Cap Fourth Further NPRM* to examine a number of proposals for revising the productivity offset component of the X-Factor, and to consider related issues such as eliminating sharing obligations and the low-end adjustment mechanism.[380] We invited parties to discuss in this proceeding whether the record developed pursuant to the *Price Cap Fourth Further NPRM* justified increasing the productivity offset, and specifically invited comment on the effects of a forward-looking cost of capital and economic depreciation on total factor productivity (TFP) measurement.[381]

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[380] NPRM at ¶ 233. With respect to the productivity offset, we invited comment on, among other things, basing it on total factor productivity (TFP). TFP is the ratio of an index of a firm's total outputs to an index of its total inputs. NPRM at ¶ 233 n.300, *citing Price Cap Fourth Further NPRM*, 10 FCC Rcd at 12663-71. With respect to sharing, we noted that, although sharing tends to blunt the efficiency incentives otherwise created by the price cap plan, it also serves beneficial functions, and we invited comment on eliminating sharing and establishing other mechanisms to serve those functions. NPRM at ¶ 233 n.301, *citing Price Cap Fourth Further NPRM*, 10 FCC Rcd at 12676-80.

[381] NPRM at ¶ 233. GTE notes that, while the X-Factor received considerable attention in the *Price Cap Fourth Further NPRM* proceeding, the discussion did not focus on the effects of the 1996 Act. GTE Comments at 57.

b. Discussion

286. The commenters generally repeat arguments made in the *Price Cap Fourth Further NPRM* proceeding. For reasons explained in detail in our companion *Price Cap Fourth Report and Order*, we conclude that we should prescribe an X-Factor on the basis of total factor productivity studies, the difference between LEC input price changes and input price changes in the economy as a whole, and the 0.5 percent consumer productivity dividend (CPD). In the companion order we find that this results in an X-Factor prescription of 6.5 percent.

2. Other Prescriptive Approaches

a. Background

287. In the NPRM, we sought comment on four options for a prescriptive approach: reinitializing price cap indices (PCIs) to economic cost-based levels;[382] reinitializing PCIs to levels targeted to yield no more than an 11.25 percent rate of return, or some other rate of return;[383] adding a policy-based mechanism similar to the CPD to the X-Factor;[384] or prescribing economic cost-based rates.[385] We have decided above to rely primarily on a market-based approach, and impose prescriptive requirements only when market forces are inadequate to ensure just and reasonable rates for particular services or areas. We will determine the details of our market-based approach in a future Order. In that Order, we will also discuss in more detail what prescriptive requirements we will use as a backstop to our market-based access charge reform.[386] In this Section, we explain why we have decided not to adopt any specific prescriptive mechanism in this Order.

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[382] NPRM at ¶¶ 223-27.

[383] NPRM at ¶¶ 228-30.

[384] NPRM at ¶¶ 231-32.

[385] NPRM at ¶¶ 236-38.

[386] In Section IV.A of this Order, we state that we will require incumbent price cap LECs to file forward-looking economic cost studies on or before February 8, 2001.

b. Rate Prescription

288. *Background.* We sought comment on prescribing new interstate access rates because simply reinitializing PCIs would not necessarily compel incumbent LECs to establish reasonable rate structures.[387] We also noted, however, that prescribing access rates on a TSLRIC basis could raise common cost allocation issues to a much greater extent than did TELRIC pricing for unbundled network elements.[388]

289. *Discussion.* In Section IV.A, above, we explain why we can and should rely primarily on market forces to cause interstate access rates to move toward economic cost levels over the next several years. Prescribing TSLRIC-based access rates would be the most direct, uniform way of moving those rates to cost. But, precisely because of its directness and uniformity, rate regulation can only be, at best, an imperfect substitute for market forces. Regulation cannot replicate the complex and dynamic ways in which competition will affect the prices, service offerings, and investment decisions of both incumbent LECs and their competitors. A market-based approach to rate regulation should produce, for consumers of telecommunications services, a better combination of prices, choices, and innovation than can be achieved through rate prescription. A market-based approach, with continued price cap regulation of services not subject to substantial competition and with the prescriptive backstop described in Section IV.A, is thus consistent both with the pro-competitive, deregulatory goals of the 1996 Act and with our responsibility under Title II, Part I of the Communications Act to ensure just and reasonable rates.

290. Furthermore, immediate prescription of TSLRIC-based rates would not necessarily move rates to those levels faster than the market-based approach and prescriptive backstop developed in Section IV.A. Some parties that favor a prescriptive approach have asserted that setting access rates immediately at TSLRIC levels would reduce incumbent LEC revenues by $10 billion or more.[389] Were we to make such a rate prescription, we would consider phasing in rate reductions of that magnitude over a period of years, in order to avoid the rate shock that would accompany such a great rate reduction at one time.[390] Finally, because we have adopted a more efficient rate structure for interstate switched access services, it is not necessary to prescribe new rates in order to achieve efficient rate structures, as TRA and TCI recommend. Accordingly, we will not prescribe TSLRIC-based access rates at this time.

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[387] NPRM at ¶ 236.

[388] NPRM at ¶ 237.

[389] *See* NPRM at ¶ 7 and sources cited therein.

[390] *See Investigation of Special Access Tariffs of Local Exchange Carriers*, CC Docket No. 85-166, Phase I and Phase II, Part 1, FCC 84-524, 57 Rad.Reg. 2d 188, 209 (released Nov. 9, 1984).

c. Reinitialization of PCIs on a Rate-of-Return Basis

291. *Discussion*. We reject reinitialization on the basis of any rate of return at this time. As a general matter, the parties advocating a rate-of-return based reinitialization do not provide any persuasive reason for adopting that particular approach. They favor reinitialization largely because they believe interstate access charges should be lower than they are now. As explained above, however, we are adopting a primarily market-based approach to rate level adjustments. The prescriptive backstop to that approach will be based on TSLRIC cost studies and, most likely, applied to geographically deaveraged rates. That approach is more likely to result in rates that are aligned with economic costs than would reinitialization to a particular rate of return on an embedded cost rate base.

292. Moreover, because the basic theory of our existing price cap regime is that the prospect of retaining higher earnings gives carriers an incentive to become more efficient, we believe that rate of return-based reinitialization would have substantial pernicious effects on the efficiency objectives of our current policies.[391] In this regard, we have often expressed concern in past price cap orders that maintaining links between rate levels and a carrier's achieved rate of return would undercut the efficiency incentives price cap regulation was designed to encourage. In the *LEC Price Cap Order*, we rejected a so-called "automatic stabilizer" adjustment to the price cap index that -- like reinitialization -- would have permanently adjusted index levels downward in the event that carriers achieved earnings above a certain rate of return.[392] Similarly, in our 1995 *LEC Price Cap Performance Review Order*, we cited as a disadvantage of AT&T's "Direct Model" method of determining the PCI formula's "X-Factor" the fact that "a target rate of return is a critical factor in measuring productivity."[393] And although we sought comment in the *Access Reform NPRM* on the question of rate of return-based reinitialization of the price cap indices, we once again expressed concern that such action "could have a negative effect on the productivity incentives of the LEC price cap plan."[394] We, of course, have authority to change

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[391] Ad Hoc's suggestion that we require a PCI reinitialization based on the currently-authorized 11.25 percent rate of return -- while administratively simpler than some other ways of changing rate levels -- would undermine productivity incentives by imposing the greatest penalties (rate reductions) on those carriers that had improved their efficiency the most. Reinitialization to another rate of return level, as API suggests, could, in addition, require resolution of complex and time-consuming issues. *See*, *e.g.*, Represcribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers, CC Docket No. 89-624, 5 FCC Rcd 7507 (1990) (taking about a year to resolve all relevant issues raised in prescribing the currently-authorized 11.25 percent rate of return).

[392] *LEC Price Cap Order*, 5 FCC Rcd at 6803. We adopted instead a sharing mechanism that made one-time earnings-related adjustments to PCI levels to ensure that carriers would "share" significant productivity gains in a given year with ratepayers, but would not be penalized by permanent downward adjustments to the track that the PCI otherwise would have taken. We have found that even the sharing mechanism tends to blunt efficiency incentives, and, in part for that reason, we are removing the sharing mechanism as well in Section IV of our companion *Price Cap Fourth Report and Order*.

[393] *LEC Price Cap Performance Review Order*, 10 FCC Rcd at 9034.

[394] NPRM at ¶ 230.

our methods and theories of regulating LEC rates when we believe the purposes of the Communications Act would be better served by doing so. However, we find that, given our consistently critical past statements about rate of return-based adjustments to price caps, a decision now to reinitialize PCIs to any specified rate of return would further undermine future efficiency incentives by making carriers less confident in the constancy of our regulatory policies.

293. In declining to reinitialize PCIs on the basis of carriers' rates of return, we reject GSA/DOD's suggestion that access rates have been excessive merely because the earnings of most price cap carriers have exceeded 11.25 percent, and, in some cases, by substantial amounts. When the Commission adopted price cap regulation, it specifically permitted price cap carriers to earn in excess of 11.25 percent in order to encourage them to become more productive.[395] The Commission also concluded that complaints alleging excessive earnings relative to costs will not lie as long as the carrier is in compliance with the sharing mechanism.[396] In addition, we found in the *LEC Price Cap Performance Review Order* that access rates declined substantially under price cap regulation from 1991 to 1994, in spite of the increases in earnings to which GSA/DOD alluded.[397] Furthermore, the vastly different results among companies[398] show that the incentive plan we have for cost reduction (price caps) largely is working as predicted, whereas a rate-of-return-based scheme would have cost much in terms of inefficiency.

d. Reinitialization of PCIs on a TSLRIC Basis

i. Background

294. In the NPRM, we sought comment on reducing price cap PCIs by an amount equal to the difference between the incumbent LECs' PCIs and the revenues that would be produced by rates set at TSLRIC levels. We noted that a TSLRIC-based PCI reinitialization might be preferable to a TSLRIC-based rate prescription because it would not require us to prescribe common cost allocations.[399] We also sought comment on whether or to what extent we could rely on TELRIC studies developed for pricing unbundled network elements, and whether we should initiate joint board proceedings to rely on state commissions to evaluate the incumbent

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[395] *LEC Price Cap Order*, 5 FCC Rcd at 6787.

[396] *LEC Price Cap Order*, 5 FCC Rcd at 6836.

[397] We found that the cumulative effect of price cap regulation from 1991 to 1994 was approximately $5.9 billion. *LEC Price Cap Performance Review Order*, 10 FCC Rcd at 8986-87. We do not know for certain, but believe that the benefits to access customers would have been smaller under rate-of-return regulation.

[398] *See, e.g.*, 1996 Annual Access Filings, 11 FCC Rcd 7564 (Com.Car.Bur. 1996).

[399] NPRM at ¶ 223.

LECs' TELRIC studies.[400]

ii. Discussion

295. We have decided not to require incumbent LECs to reinitialize PCIs on a TSLRIC basis at this time. As we discuss in Section IV.A above, we expect market forces to develop as a result of the 1996 Act and to drive access rate levels to forward-looking economic costs. Furthermore, the record in this proceeding is unclear on whether there is an accurate and convenient method for determining TSLRIC for purposes of reinitializing PCIs at this time. Specifically, it is unclear whether the TELRIC studies used to develop unbundled network element prices can be used for access services.[401]

e. Policy-Based X-Factor Increase

i. Background

296. In the NPRM, we observed that we adopted a consumer productivity dividend (CPD) to assure that some portion of the benefits of the incumbent LECs' increased productivity growth under price cap regulation would flow to ratepayers in the form of reduced rates. We sought comment on establishing a policy-based mechanism similar to the CPD to force access rates to cost-based levels.[402]

ii. Discussion

297. *Discussion.* We do not require a policy-based X-Factor increase at this time for the same reason we do not require a TSLRIC-based PCI reinitialization; we expect market forces to control access charges effectively in a less intrusive manner.

298. BellSouth and GTE oppose increasing the CPD as an arbitrary and confiscatory measure.[403] SNET claims that increasing the X-Factor merely because the price cap LECs have earned too much, or simply to drive rates down, is essentially an abandonment of price cap regulation, because it would punish incumbent LECs for their efficiency gains made under the

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[400] NPRM at ¶¶ 224-25.

[401] *Universal Service Order* at ¶ 245.

[402] NPRM at ¶¶ 231-32.

[403] BellSouth Comments at 49; GTE Comments at 77-78.

price cap regime.[404] BA/NYNEX and GTE contend that the X-Factor should be chosen to reflect reasonably expected incumbent LEC productivity growth rather than to achieve a specific rate reduction.[405] We emphasize that we have done nothing in this Order to increase the X-Factor. In our companion *Price Cap Fourth Report and Order*, we prescribe a new X-Factor of 6.5 percent, but this prescription is based on detailed studies of LEC productivity growth and input price changes.[406] We decline to increase the CPD,[407] and we reject a proposal to set the X-Factor to target an industry average rate of return of 11.25 percent.[408] Thus, none of our actions in either this Order or our companion Order can properly be characterized as an abandonment of price cap regulation, or as motivated merely by a desire to drive rates down.

C. Equal Access Costs

1. Background

299. In the NPRM, we solicited comment on whether to require incumbent price cap LECs to make an exogenous cost decrease to one or more of their PCIs to account for the completion of the amortization of equal access costs on December 31, 1993.[409]

300. Under court order, the BOCs and GTE were required to provide equal access.[410] This conversion, estimated at more than $2.6 billion, was largely completed by 1990, and involved both capital and non-capital expenditures. Under the *Equal Access Cost Order*, incumbent LECs were required to identify separately the incremental capital investments and the incremental non-capital-related expenses associated with the implementation of equal access. The *Equal Access*

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[404] SNET Reply at 23-24. *See also* BA/NYNEX Reply at 32-33.

[405] BA/NYNEX Reply at 30; GTE Reply at 26-27.

[406] *Price Cap Fourth Report and Order*, Section III.E.

[407] *Price Cap Fourth Report and Order*, Section III.D.5.

[408] *Price Cap Fourth Report and Order*, Section III.B.

[409] NPRM at ¶ 293. We note that through the years, this issue has been referred to as "equal access network reconfiguration" or EANR costs. This is a misnomer, which we correct today. "Equal access" is the provision of exchange access to all interexchange carriers on an unbundled, tariffed basis that is equal in type, quality, and price to that provided to AT&T and its affiliates. *Equal Access and Network Reconfiguration Costs, Memorandum Opinion and Order*, 50 Fed. Reg. 50910 (rel. Dec. 9, 1985) at ¶ 18 (*Equal Access Cost Order*). "Network Reconfiguration" costs are those investments and expenses incurred in connection with structurally conforming the pre-divestiture AT&T network with the LATA boundaries mandated by the MFJ. *Id.* Issues underlying network reconfiguration costs were resolved in the *Equal Access Cost Order* and have not been raised since. *See Id.* at ¶ 22.

[410] *See United States v. AT&T*, 552 F. Supp. 131, 233 (D.D.C. 1982); *United States v. GTE Corp.*, 603 F. Supp. 730, 745 (D.D.C. 1984).

Cost Order directed that the capital investments, which it estimated to comprise approximately 55 percent of the $2.6 billion, be treated pursuant to ordinary accounting and ratemaking principles.[411] The Commission determined that the remaining 45 percent of the expenditures -- which were non-capitalized equal access expenses -- required special treatment:

> [W]e are concerned that these expenditures will cause irregular and substantial fluctuations in revenue requirements associated with equal access. Because they are extraordinary, are for the greatest part expected to be incurred over the next few years, and, therefore, are likely to be distortive of financial results and rate requirements, we find that these equal access expenses should be deferred and amortized.[412]

The Commission ordered that these equal access expenses be separately identified and recorded, and that they be written off over a period of eight years, ending December 31, 1993.[413] In the reconsideration of the *Equal Access Cost Order*, the Commission found that the specific termination date of the eight year amortization of these expenses would "shorten the period during which the unamortized balances are entitled to earn a rate of return."[414] It is clear that the LECs' rate-of-return (ROR) rates included revenue recovery for both capitalized expenditures (recovered through the ordinary depreciation process) and non-capitalized expenses (recovered through the special amortization process).[415] It is also clear that at the time the amortization was imposed, the Commission envisioned an end to the recovery for the amortized expenses and a subsequent decrease in ROR rates.[416]

301. In converting to price cap regulation, the Commission found that equal access conversion was, in large part, completed and that the associated costs, which included both the capitalized expenditures and the amortized expenses, were embedded in the existing rates. As such, the Commission refused to grant LECs an exogenous increase for equal access costs,

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[411] *Equal Access Cost Order*, 50 Fed. Reg. at 50914, ¶ 32 ("[W]e believe that the capital cost of equal access service is best measured in the traditional manner whereby the cost of investments are recovered over their useful lives. This is best accomplished by using FCC prescribed depreciation lives for the classes of property associated with equal access.").

[412] *Equal Access Cost Order*, 50 Fed. Reg. at 50914-15, ¶ 33.

[413] *Equal Access Cost Reconsideration Order*, at 437 ¶ 25.

[414] *Equal Access Cost Reconsideration Order*, at 437 ¶ 25.

[415] *LEC Price Cap Order*, 5 FCC Rcd at 6808, ¶ 180.

[416] *Equal Access Cost Reconsideration Order*, at 437 ¶ 25.

finding that these costs were already accounted for in the existing rates.[417] The Commission also based its decision to deny an exogenous increase on its concern that exogenous treatment of equal access expenditures would create inappropriate incentives for the LECs to inflate the amounts spent on equal access. The Commission noted the difficulty of reviewing equal access costs, as well as the risk that incumbent LECs might willfully or inadvertently shift switched access costs into the proposed equal access category in order to benefit from the requested exogenous increase.[418]

2. Discussion

302. We find that an exogenous cost decrease to account for completion of the amortization of equal access non-capitalized expenses is necessary and appropriate. Although we have addressed this issue in the past and declined to act, we now find that an exogenous decrease is merited. We recognize our decision departs from our past decisions that have declined to impose an exogenous decrease for the completed recovery of these costs. As discussed below, our decision today reverses those decisions and is based on an extensive record from this, and prior proceedings.[419] Our decision today aligns our treatment of the completion of the amortization of equal access costs with two other similar amortizations that were ordered under ROR regulation and carried over into price cap regulation, namely, the exogenous decrease imposed for the completion of the amortization of depreciation reserve deficiencies,[420] and the exogenous decrease imposed for the completion of the amortization of inside wire costs.[421] We are convinced that this treatment is the proper method to ensure that ratepayers are not paying for costs that have already been completely recovered.

303. The need for an exogenous adjustment to account for the expiration of the equal access expense amortization stems from the different ways in which rates are established under ROR regulation, on the one hand, and price cap regulation, on the other hand, and from the Commission's decision to establish initial price cap levels at the outset of price cap regulation on

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[417] *LEC Price Cap Order*, 5 FCC Rcd at 6808, ¶ 180.

[418] *LEC Price Cap Order*, 5 FCC Rcd at 6808, ¶ 180.

[419] In addition to the comments received in this proceeding, our record is supplemented by commentary from interested parties in a number of prior proceedings, including comments filed in connection with the following orders: *LEC Price Cap Order*, 5 FCC Rcd 6786 (1990); *LEC Price Cap Reconsideration Order*, 6 FCC Rcd 2637 (1991); *Commission Requirements for Cost Support Material To Be Filed with 1994 Annual Access Tariffs*, 9 FCC Rcd 1060; *1994 First Annual Access Tariff Order*, 9 FCC Rcd 3705; *Second 1994 Annual Access Order*, 9 FCC Rcd 3519; *1993-1996 Annual Access Tariff Filings*, CC Docket Nos. 93-193 and 94-65, Memorandum Opinion and Order, FCC 97-139 (rel. April 17, 1997).

[420] *LEC Price Cap Order*, 5 FCC Rcd at 6808, ¶ 173.

[421] *LEC Price Cap Reconsideration Order*, 6 FCC Rcd at 2673-2674, ¶¶ 78-82 (imposing exogenous cost decrease for the completion of amortization of inside wire costs).

the basis of existing ROR-derived rates.[422] When converting from ROR regulation to price cap on regulation January 1, 1991, the Commission needed to select a set of "baseline" rate levels to which the price cap index of incremental cost changes would be tied. For that purpose, we chose the ROR-developed rates that were in effect on July 1, 1990.[423] The Commission found that, in general, those rates served as an appropriate starting point for measuring subsequent incremental cost changes under price cap regulation, because they "reflect[ed] the reasonable operation of ROR regulation."[424]

304. In two respects, however, the Commission recognized that existing rates did not reflect equilibrium ROR-derived rates, but rather reflected special corrective adjustments that we had ordered previously. In particular, the Commission noted that existing rates had embedded within them costs associated with Commission-ordered "one-time" amortizations of depreciation reserve deficiencies and inside wiring costs.[425] Had ROR regulation continued, the rates subject to these amortizations would have been reduced when the amortizations were completed. To ensure that ratepayers under price caps would not be required permanently to bear these temporary Commission-ordered, ROR-derived rate adjustments, we directed LECs to make downward exogenous cost adjustments to their price cap indices upon the expiration of those amortizations.[426]

305. Similarly, the Commission ordered amortization of equal access expenses, which also were reflected in baseline rates at the outset of price cap regulation. Under normal ROR

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[422] Under ROR regulation, rates for a particular service are determined annually by a calculation from the ground up of the company-specific costs associated with the provision of that service. Expenses generally are recovered in their entirety through rates in the year in which they are incurred. Asset costs generally are capitalized and recovered over the assets' useful lives through rates that are designed to reflect the annual depreciation expenses associated with the assets and a return on the undepreciated (remaining) portion of the assets. Under price caps, rates are not developed each year through a "ground up" calculation of company-specific costs. Instead, rates are set according to a formula that measures the incremental change in costs each year -- as reflected (a) in the movement of surrogates (*i.e.*, GDP-PI minus X) for so-called "endogenous" costs over which the carrier can exercise some control, and (b) in the company-specific measurement of certain "exogenous" cost changes that are not reflected in the "GDP-PI minus X" variable and are beyond the carriers' control.

[423] *LEC Price Cap Order*, 5 FCC Rcd at 6814, ¶ 230.

[424] *Id.* at ¶ 232.

[425] *See Price Cap Further Notice of Proposed Rulemaking*, 3 FCC Rcd at 3419-23 ¶¶ 413-420. The depreciation reserve deficiency amortization was a "one-time correction device" ordered by the Commission to address the fact that the depreciation rates prescribed by the Commission had significantly overstated the useful lives of LEC assets. The Commission temporarily raised LEC rates to recover that deficiency. *Price Cap Further Notice*, 3 FCC Rcd at 3421-22, ¶¶ 417-18. The inside wiring amortizations provided a mechanism for LECs to recover from regulated ratepayers investments in activities that were regulated at the time the investments were made, but which the Commission had deregulated on a going-forward basis. *Id.*, 3 FCC Rcd at 3422-23, ¶¶ 419-420.

[426] *LEC Price Cap Order*, 5 FCC Rcd at 6808, ¶ 173; *LEC Price Cap Reconsideration*, 6 FCC Rcd at 2673-74, ¶¶ 78-80.

ratemaking principles, those expenses -- which, for the most part, already had been incurred before price cap regulation was initiated -- would have been recovered in the BOCs' rates the same year they were incurred and would no longer have been reflected in rates at the time price caps were instituted. However, as explained *supra*, the Commission required the carriers to amortize these extraordinary expenses over eight years because of the potential fluctuations in revenue requirements associated with equal access.[427] Thus these expenses remained embedded within BOC rates at the outset of price caps even though, for the most part, the extraordinary expenses themselves were no longer being incurred.

306. The specific question of whether the completely amortized equal access expenses should be treated exogenously has been presented to the Commission on a number of occasions.[428] In the past, procedural impediments arising from our rules, as well as the lack of an adequate record, convinced us to decline to impose such treatment at that time. For example, when AT&T raised the issue of downward adjustment for completed amortization of equal access expenses in an annual access charge tariff proceeding, the Common Carrier Bureau found that the issue was beyond the scope of the proceeding because it would require a substantive change to the price cap rules.[429] Similarly, in response to AT&T's and MCI's revisiting the question in both the *First 1994 Annual Access Charge Order* and the *Second 1994 Annual Access Charge Order*, the Commission found that exogenous treatment would require a rule change to section 61.45(d) of the Commission's rules. Because no LEC had filed for a waiver of section 61.45(d), the Common Carrier Bureau found that the issue was not properly presented for investigation.[430]

307. In denying the requests for procedural reasons, the Commission supported its decisions with various rationales. In some instances, these rationales appear now not to have been considered to a sufficient degree. In addressing equal access costs in the orders adopting price cap regulation, the Commission focused primarily on the question of whether future equal access investments and expenses should be treated exogenously because equal access had been

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[427] *Equal Access Cost Order*, 50 Fed. Reg. at 50914-15, ¶ 33 (1985).

[428] *See, e.g., LEC Price Cap Reconsideration*, 6 FCC Rcd at 2667, ¶ 66 n.77; *Commission Requirements for Cost Support Material To Be Filed with 1994 Annual Access Tariffs*, 9 FCC Rcd 1060, 1063, ¶¶ 21-22 (rel. Feb. 18, 1994) (*1994 Annual Access TRP*); *First 1994 Annual Access Charge Order*, 9 FCC Rcd 3705, 3730-37311 at ¶¶ 54-56 (rel. June 24, 1994); *Second 1994 Annual Access Charge Order*, 9 FCC Rcd 3519, 3535-3536 at ¶¶ 36-38 (rel. June 24, 1994).

[429] *1994 Annual Access TRP*, 9 FCC Rcd at 1063, ¶¶ 21-22.

[430] *See First 1994 Annual Access Charge Order*, 9 FCC Rcd at 3731; *Second 1994 Annual Access Charge Order*, 9 FCC Rcd at 3536. *See also 1993-1996 Annual Access Tariff Filings*, CC Docket Nos. 93-193 and 94-65, Memorandum Opinion and Order, FCC 97-139 (rel. April 17, 1997), at ¶ 82.

compelled by regulatory (or judicial) order.[431] We concluded, subject to consideration of waiver requests, that we should not accord exogenous cost treatment to such future equal access conversion costs, because of concerns that exogenous cost treatment would create disincentives to implement equal access in an efficient manner.[432] We did not focus in detail on the logically distinct question of whether equal access expenses that were already embedded within baseline BOC rates pursuant to the temporary "one-time" amortizations (and thus raised no question with respect to future incentives) should be removed through exogenous adjustments when the amortizations expired.[433] Instead, we relegated that issue to a footnote, which denied exogenous cost treatment on the basis of a skeletal analysis that makes no reference to our treatment of the depreciation reserve deficiency and inside wiring amortizations. In the footnote, it is clear that the Commission was not distinguishing between capitalized costs, which were properly treated as depreciated expenses, and non-capitalized expenses, which were actually amortized per the Commission's own requirement.[434] The Commission framed the issue of a downward adjustment in terms of whether the completion of depreciation required a downward adjustment, querying "whether the BOCs will experience any cost change in 1994 [at the completion of the amortization] that stems from factors beyond their control." In support of its implicitly negative answer, the Commission analogized to the absence of a price cap index change when a piece of equipment is fully depreciated, or when a carrier increased or decreased the speed with which it recovered investments.[435] The Commission found that, "[b]ased on a meager factual record presented on the issue of equal access expense, we are reluctant to depart from our practice of not adjusting PCI levels to reflect levels of cost recovery."[436]

308. The Commission's analysis at that time was incomplete. The *Equal Access Cost*

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[431] *LEC Price Cap Order*, 5 FCC Rcd at 6808 ¶¶ 180-181. The amortization requirement had applied only to court-ordered conversion to equal access by the BOCs. The Commission, however, had also had required independent LECs to convert to equal access upon bona fide request.

[432] *See LEC Price Cap Reconsideration*, 6 FCC Rcd at 2666-67, ¶ 66.

[433] *See LEC Price Cap Reconsideration*, 6 FCC Rcd at 2667 n.77. In several subsequent orders addressing BOC tariff filings implementing our price cap rules, we rejected contentions that we order downward exogenous cost adjustments to the carriers' price cap indexes to account for the expiration of the equal access cost amortizations. *See, e.g., 1994 Annual Access TRP*, 9 FCC Rcd at 1063, ¶¶ 21-22. We did so primarily on procedural grounds -- *i.e.*, that the treatment of such amortizations had already been decided in the price cap rulemaking proceeding and that a tariff proceeding was not the proper vehicle for changing that treatment. *Id. See also First 1994 Annual Access Charge Order*, 9 FCC Rcd at 3731; *Second 1994 Annual Access Charge Order*, 9 FCC Rcd at 3536; *1993-1996 Annual Access Tariff Filings*, CC Docket Nos. 93-193 and 94-65, Memorandum Opinion and Order, FCC 97-139 (rel. April 17, 1997), at ¶ 82.

[434] *LEC Price Cap Reconsideration*, 6 FCC Rcd at 2667, ¶ 66 n.77 ("We also decline to adopt MCI's suggestion to treat BOC equal access costs *in the same way we do amortizations*") (emphasis added).

[435] *LEC Price Cap Reconsideration*, 6 FCC Rcd at 2667, ¶ 66 n.77.

[436] *LEC Price Cap Reconsideration*, 6 FCC Rcd at 2667, ¶ 66 n.77.

Order and the *Equal Access Cost Reconsideration Order* explicitly recognized two components of equal access costs -- capitalized, which were to be depreciated, and non-capitalized, which were extraordinary and were to be amortized over a set period.[437] The Commission established different treatment for these two sets of costs based on policy reasons, and ordered an amortization schedule for the non-capitalized costs. The Commission's establishment of this schedule was beyond the incumbent LECs' control. The Commission's analogy to the lack of exogenous treatment for equipment depreciation and changes in the tempo of recovery should have only applied to the capitalized portion of the equal access costs.

309. The Commission explicitly stated in the *LEC Price Cap Order* that completed amortizations of depreciation reserve deficiencies require an exogenous downward adjustment.[438] The Commission found that such an adjustment was necessary to ensure that ratepayers were not paying for a cost that no longer existed. Analytically, the amortized portion of equal access expenses should have been treated in the same fashion as the amortized depreciation reserve deficiency costs. The Commission's imposition of a downward exogenous adjustment for the completion of inside wire amortizations further supports our finding today that an exogenous decrease is appropriate and necessary for the completion of the amortization of equal access non-capitalized expenses.[439]

310. We reject our prior analysis of amortized equal access costs and accord the expiration of equal access cost amortizations the same exogenous cost treatment given to the amortizations of the depreciation reserve deficiencies and inside wiring costs. Both of those amortizations were given exogenous cost treatment when they expired because they reflected temporary, one-time treatment of costs under ROR regulation that, due to the mid-stream switch to price cap regulation, would have become permanent (even though the costs already had been recovered) absent an exogenous cost adjustment. The same is true for equal access cost amortizations.

311. Because this is a rulemaking, we do not face the same procedural impediments as in some of our prior decisions, as explained *supra*. We determine that the record from this proceeding allows us to make a reasoned decision on this issue. We find that an exogenous decrease is necessary in order to adjust the price caps for the completed recovery of the specified equal access non-capitalized expenses that we required be amortized over an eight-year period. Because the current price cap index includes an expense that has now been completely recovered, the price cap should be adjusted downward to account its recovery. Simply stated, we find that

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[437] *Equal Access Cost Order*, at ¶ 33.

[438] *LEC Price Cap Order*, 5 FCC Rcd at 6808, ¶ 173 (discussing exogenous treatment of expiration of amortizations to correct depreciation reserve deficiencies).

[439] *LEC Price Cap Reconsideration*, 6 FCC Rcd at 2673-74, ¶¶ 78-82.

ratepayers should not be forced to pay for a cost that, were it not for the way price cap regulation occurred in this instance, they would no longer be paying. By imposing a downward exogenous adjustment to adjust the PCI for the complete recovery of specific equal access expenses through amortization, we will avoid unfairly imposing a subsidy burden on ratepayers. Our decision in this matter will align charges more closely to costs.

312. Several commenters have argued that they continue to incur costs as a part of the provision of equal access. These ongoing costs are not at issue in the present proceeding. As explained above, the costs at issue were a set of costs that the Commission determined should be amortized for policy reasons. These costs were extraordinary and, if allowed to be imposed in the normal fashion, would have resulted in huge rate fluctuations. We consider the ongoing costs of providing equal access as part of the normal costs of providing telephone service. Exogenous treatment of these costs is unnecessary. In response to BellSouth's contention that the record is inadequate for us to make a decision about an exogenous decrease, we find that the current record provides a sufficient basis for our decision.[440] Furthermore, we note that in the past, the record may have been sufficient, but, as explained above, the Commission's analysis was incorrect.

313. TCA and GCI are concerned about how the Commission will treat cost recovery for LECs that convert to equal access in the future.[441] As we stated in the *LEC Price Cap First Report and Order,* LECs that have not received a *bona fide* request for equal access at the time they become subject to price cap regulation may request a waiver for special treatment of those special conversion costs when the time arises.[442]

314. We hereby direct price cap LECs to make a downward exogenous adjustment to the traffic sensitive basket in the Annual Access Tariff filing that takes effect on July 1, 1997 to account for the completed amortization of equal access expenses.

D. Correction of Improper Cost Allocations

1. Marketing Expenses

a. Background

315. Prior to 1987, incumbent LEC marketing expenses were allocated between the interstate and intrastate jurisdictions on the basis of local and toll revenues. In 1987, a Federal-State Joint Board recommended that interstate access revenues be excluded from the allocation

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[440] BellSouth Comments at 87.

[441] TCA Comments at 5-6; GCI Comments at 8.

[442] *See LEC Price Cap First Report and Order*, 4 FCC Rcd 2873, 3190 at ¶ 657.

factor used to apportion marketing expenses between the interstate and intrastate jurisdictions because marketing expenses are not incurred in the provision of interstate access services.[443] The Commission agreed with the Joint Board's recommendation and adopted new procedures that allocated marketing expenses in Account 6610 on the basis of revenues excluding access revenues.[444] In petitions for reconsideration of the Commission's order, several incumbent LECs argued that the revised separations treatment of marketing expenses would result in a significant, nationwide shift of $475 million in revenue requirements to the intrastate jurisdiction.[445] On reconsideration, the Commission adopted for marketing expenses an interim allocation factor that includes access revenues, pending the outcome of a further inquiry by the Joint Board.[446]

316. In the NPRM, we stated that some of the difference between the price cap LECs' interstate allocated costs and forward-looking costs may be traced to past regulatory practices that were designed to shift some costs from the intrastate jurisdiction to the interstate jurisdiction in order to further universal service goals.[447] We observed that the Commission's decision in the *Marketing Expense Reconsideration Order* to allocate intrastate marketing costs to the interstate jurisdiction was an example of such past regulatory practices.[448] We asked parties to comment on the extent to which the difference between price cap LECs' interstate allocated costs and forward-looking costs is a result of such decisions.[449]

b. Discussion

317. Under current separations procedures, approximately 25 percent of price cap LECs' total marketing expenses are allocated to the interstate jurisdiction.[450] We agree with parties that

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[443] Amendment of Part 67 (New Part 36) of the Commission's Rules and Establishment of a Federal-State Joint Board, CC Docket No. 86-297, Recommended Decision and Order, 2 FCC Rcd 2582 (1987) (*Marketing Expense Recommended Decision*).

[444] MTS and WATS Market Structure, Amendment of Part 67 (New Part 36) of the Commission's Rules and Establishment of a Federal-State Joint Board, CC Docket Nos. 78-72, 80-286, and 86-297, Report and Order, 2 FCC Rcd 2639 (1987).

[445] MTS and WATS Market Structure, Amendment of Part 67 (New Part 36) of the Commission's Rules and Establishment of a Joint Board, CC Docket No. 78-72, 80-286, and 86-297, Memorandum Opinion and Order on Reconsideration and Supplemental Notice of Proposed Rulemaking, 2 FCC Rcd 5349, 5350 (1987) (*Marketing Expense Reconsideration Order*).

[446] *Marketing Expense Reconsideration Order*, 2 FCC Rcd at 5353. *See also* 47 C.F.R. § 36.372.

[447] NPRM at ¶ 249.

[448] NPRM at ¶ 249.

[449] NPRM at ¶ 254.

[450] 1996 ARMIS Access Report.

contend that, because marketing expenses generally are incurred in connection with promoting the sale of retail services, those expenses for the most part should be recovered from incumbent LEC retail services, which are found predominantly in the intrastate jurisdiction. Pursuant to section 410(c) of the Act, however, the Commission must refer any rulemaking proceeding regarding the jurisdictional separation of common carrier property and expenses between interstate and intrastate operations to a Federal-State Joint Board.[451] We intend to initiate a proceeding to review comprehensively our Part 36 jurisdictional separations procedures in the near future. We will refer this issue to the Federal-State Joint Board in CC Docket No. 80-286 for resolution as part of that comprehensive review. We therefore do not reallocate these costs between the interstate and intrastate jurisdictions at this time.

318. In the *Marketing Expense Recommended Decision*, the Joint Board stated that the inclusion of access revenues in the allocation factor for marketing expenses is unreasonable because incumbent LECs do not actively market or advertise access services.[452] Although parties contested the accuracy of this statement on reconsideration, the Commission did not assess incumbent LEC claims that the decision to exclude access revenues in the allocator for marketing expenses was based on an inaccurate perception of the extent to which LECs actively market or advertise exchange access services. The Commission instead referred marketing expense issues back to the Joint Board, with specific instruction to the parties to identify any Account 6610 marketing activities that are related to access services and any such activities that are related to a specific jurisdiction. We continue to recognize that some expenses recorded in Account 6610 may indeed be incurred in the provision of interstate access service, and that this is an issue that must be addressed by the Joint Board when it examines the appropriate allocation factor for marketing expenses. We note, however, that the Commission did not find in the *Marketing Expense Reconsideration Order* that the Joint Board's initial conclusion in the *Marketing Expense Recommended Decision* that incumbent LECs do not market or advertise access services to be inaccurate.

319. We conclude that price cap LECs' marketing costs that are not related to the sale or advertising of interstate switched access services are not appropriately recovered from IXCs through per-minute interstate switched access charges. Pending a recommendation by the Joint Board on a new method of apportioning marketing costs between the intrastate and interstate jurisdictions, we direct price cap LECs to recover marketing expenses allocated to the interstate jurisdiction from end users on a per-line basis, for the reasons we discuss below.

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[451] 47 U.S.C. § 410(c). As noted above, when the Commission reconsidered its decision to exclude interstate access revenues from the allocation factor used to apportion marketing expenses between the interstate and intrastate jurisdictions and adopted an interim allocation factor based on both local revenues and interstate access revenues, it referred the issue back to the Federal-State Joint Board in CC Docket No. 80-286 to recommend a permanent solution. *Marketing Expense Reconsideration Order*, 2 FCC Rcd at 5353.

[452] *Marketing Expense Recommended Decision*, 2 FCC Rcd at 2589.

320. Recovering these expenses from end users instead of from IXCs is consistent with principles of cost-causation to the extent that price cap LEC sales and advertising activities are aimed at selling retail services to end users, and not at selling switched access services to IXCs. Recovery on a per-line basis, while perhaps not precisely reflective of the manner in which marketing costs are incurred, is preferable to the current rule requiring price cap LECs to recover their marketing expenses through per-minute access charges. A price cap LEC's retail marketing costs are not caused by usage of switched access services, and its efforts to sell additional lines, vertical features, and other retail services would only indirectly cause an increase in switched access usage. Per-minute recovery of retail marketing costs thus distorts prices in the long distance and local markets in the same way as does per-minute recovery of other NTS costs.

321. In the past, price cap LEC retail marketing may have focused on the sale of optional vertical features such as call waiting and caller ID, and on features and services designed for business customers. As local competition develops, we would expect that sales expenses would be driven by the price cap LEC's need to respond to competition. In any case, it is beyond our jurisdiction to reassign retail marketing costs to retail services on a truly cost-causative basis. There is probably a relationship, however, between the number of lines purchased by an end user, particularly a business user, and the amount of effort a price cap LEC expends to sell services and features to that end user. Furthermore, as parties have observed in the record in this proceeding, price cap LECs actively market second lines to residential customers.[453] We conclude, therefore, that the most efficient and cost-causative method legally available to this Commission at this time for recovery of price cap LEC retail marketing costs allocated to the interstate jurisdiction is to charge those end users to whom the price cap LECs' marketing is directed -- multi-line business and non-primary residential line end users. We further note that by not permitting price cap LECs to recover these costs from primary residential and single-line business customers, we avoid potential universal service concerns that weigh against increasing charges on these end users.[454]

322. Moreover, continued recovery of interstate-allocated marketing expenses in per-minute switched access charges would raise competitive concerns. Increasingly, IXCs will be competing with incumbent, price cap LECs in the provision of local exchange and exchange access services. By permitting incumbent, price cap LECs to recover from IXCs through interstate switched access charges their costs of marketing retail services, these potential competitors are forced to bear the incumbent, price cap LECs' costs of competing with the IXCs. Assigning recovery of marketing costs to end users, on the other hand, subjects these costs to the competitive pressures of the market.

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[453] CompuServe/Prodigy Comments at 14; America On-Line Reply at 12. *See also* Letter from Bruce K. Cox, Vice President, Government Affairs, AT&T, to William F. Caton, Acting Secretary, Federal Communications Commission, March 19, 1997.

[454] *See* Section III.A.2, *supra*; *see also* Section V.B of the *Universal Service Order*.

323. Marketing expenses are currently recovered through all interstate access rate elements and the interexchange category in proportion to the investment originally assigned to these elements and categories by the Part 69 cost allocation rules.[455] Special access and interexchange services are purchased by, and marketed to, retail customers. It is therefore appropriate to allow rates for those services to continue to include recovery of marketing expenses.[456] Marketing expenses must be removed from all other rate elements by means of downward exogenous adjustments to the PCIs for the common line, traffic sensitive, and trunking baskets. With respect to the trunking basket, the exogenous adjustment shall not reflect the amount of any Account 6610 marketing expenses allocated to special access services. The service band indices (SBIs) within the trunking basket shall be decreased based on the amount of Account 6610 marketing expenses allocated to switched services included in each service category to reflect the exogenous adjustment to the PCI for the trunking basket.

324. After performing the appropriate downward exogenous adjustments described above to the PCIs in the common line, traffic sensitive, and trunking baskets, price cap LECs may recover the revenues related to the Account 6610 marketing expenses removed from these baskets by increasing the SLCs for multi-line business and non-primary residential lines. To prevent end-user charges from exceeding levels we have established earlier in this Order,[457] the amount of marketing expenses to be recovered from multi-line business and non-primary residential lines in their SLCs shall be limited by the ceilings we establish for these SLCs in this Order.[458] To the extent these ceilings prevent full recovery of these amounts, price cap LECs may recover these costs by increasing equally both the non-primary residential line PICC and the multi-line business PICC, not to exceed the ceilings on the PICC for non-primary residential and multi-line business lines.[459] In the event the PICC ceilings prevent full recovery of these expenses, any residual may be recovered through per-minute charges on originating access service, subject to its ceiling. Finally, to the extent price cap LECs cannot recover their remaining marketing expenses through per-minute charges on originating access, any residual may be recovered through per-minute charges on terminating access service.[460] Although these marketing expenses will be recovered through the SLC, they shall not be included in the base factor or considered common

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[455] 47 C.F.R. § 69.403.

[456] For example, in the *SNFA Order*, we found that certain marketing expenses incurred to provide customer contact operations, service order processing, and the billing and administration of special access services are properly included in special access rates. Investigation of Special Access Tariffs of Local Exchange Carriers, CC Docket No. 85-166, Phase I; Phase II, Part 1; and Phase III, Part 1, FCC 97-42 (rel. Feb. 14, 1997) (*SNFA Order*).

[457] *See* Section III.A.2, *supra*.

[458] In future years, these ceilings shall rise as set forth in Section III.A.2, *supra*.

[459] *See* Section III.A.3, *supra*.

[460] *See* Section VI.C, *infra*, for a discussion of terminating access.

line revenues. To prevent price cap LECs from recovering these expenses from access services, we are establishing a separate basket for these marketing expenses.

325. We reject, however, AT&T's assertion that recovery of interstate-allocated marketing expenses through interstate access charges violates the wholesale pricing provisions contained in section 252(d)(3) of the Act.[461] Section 252(d)(3) establishes a pricing standard for the wholesale provision of retail offerings to other carriers that resell the LEC retail services.[462] Section 252(d)(3) does not apply to the pricing of interstate access, which is not a retail service.

2. General Support Facilities

a. Background

326. In the NPRM, we sought comment on other possible cost misallocations that may contribute to the difference between embedded costs and forward-looking costs allocated to the interstate jurisdiction.[463] AT&T suggests that the allocation of embedded general support facilities (GSF) costs, including general purpose computer expenses, among access categories is one such misallocation.[464] This allocation, AT&T contends, results in the inappropriate support of LECs' billing and collection service, which is a nonregulated, interstate service, through regulated access charges.[465] AT&T estimates that $124 million of expenses recovered in interstate access support the nonregulated billing and collection category.[466] Of the $124 million, $60.1 million is included in interstate switched carrier access, and $20.5 million is in interstate special access, with

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[461] AT&T Comments at 66-67. AT&T identifies and quantifies inappropriate retail expenses embedded in current interstate switched access rates based on the requirements of section 252(d)(3) and the criteria for wholesale rate cost studies outlined in the *Local Competition Order*. *See Local Competition Order*, 11 FCC Rcd at 15958.

[462] 47 U.S.C. § 252(d)(3). Section 252(d)(3) provides that wholesale rates will be determined on the basis of retail rates, excluding the portion attributable to marketing, billing, collection, and other costs that will be avoided by the LEC.

[463] NPRM at ¶ 254.

[464] For a more detailed background on GSF misallocation issues, *see* Section VII.B, *infra*.

[465] In 1986, the Commission found that the market for billing and collection service was sufficiently competitive that it was not necessary to require LECs to provide that service as a tariffed common carrier service. The Commission did not, however, preempt state regulation of billing and collection services. *See* Detariffing of Billing and Collection Services, CC Docket No. 85-88, 102 FCC 2d 1150 (1986) (*Billing and Collection Detariffing Order*) *recon. denied*, 1 FCC Rcd 445 (1986). The Commission later decided to treat billing and collection costs as regulated for accounting purposes because such treatment was less likely to misallocate these costs between the interstate and intrastate jurisdictions. Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities, Report and Order, CC Docket No. 86-111, 2 FCC Rcd 1298, 1309 (1987) (*Joint Cost Order*).

[466] AT&T Comments at 67-68, Appendix E at 2.

the remainder recovered by the SLC.[467]

327. The GSF investment category in Part 36 includes assets that support other operations, such as land, buildings, vehicles, as well as general purpose computer investment accounted for in USOA Account 2124.[468] Some incumbent LECs use general purpose computers to provide nonregulated billing and collection services to IXCs. Part 69 allocates GSF investment among the billing and collection category, interexchange category, and the access elements based on the amount of Central Office Equipment (COE), Cable and Wire Facilities (CWF), and Information Origination/Termination Equipment (IO/T) investment allocated to each Part 69 category.[469] Because no COE, CWF, or IO/T investment is allocated to the billing and collection category, no investment in general support facilities, and thus no portion of general purpose computer investment, is allocated to the billing and collection category. Likewise, because expenses related to GSF investment are allocated in the same manner as GSF investment, no GSF expenses, including expenses related to general purpose computers, are allocated to the billing and collection category. To the extent that costs are underallocated to the billing and collection category, incumbent LECs' regulated services recover through interstate access charges costs associated with nonregulated provision of billing and collection services.

b. Discussion

328. We agree with AT&T and WorldCom that the current allocation of GSF costs enables incumbent LECs to recover through regulated interstate access charges costs caused by the LECs' nonregulated billing and collection functions. By shifting some costs from interstate access services to the nonregulated billing and collection category, we would move interstate access rates closer to cost. The NPRM, however, may not have provided sufficient notice to interested parties that we would change in the allocation of LEC interstate costs between regulated interstate services and nonregulated billing and collection activities. We therefore seek comment on this issue in Section VII.B below.

V. ACCESS REFORM FOR INCUMBENT RATE-OF-RETURN LOCAL EXCHANGE CARRIERS

A. Background

329. In the NPRM we concluded that, with limited exceptions, the scope of this proceeding should be limited to incumbent price cap LECs because these carriers face the

[467] AT&T Comments Appendix E at 2.

[468] 47 C.F.R. § 36.111.

[469] 47 C.F.R. § 69.307(c).

potential of significant competition in the interstate exchange access market due to the new duties and obligations imposed upon them by the 1996 Act.[470] We proposed limited exceptions that would subject all incumbent LECs to the rules addressing allocation of universal service support to the interstate revenue requirement, discussed in Section VI.D, below, and to the reforms to the transport rate structure, including the TIC, discussed in sections III.D., above. We invited comment on these tentative conclusions on the scope of this proceeding. We also sought comment on whether we should apply our proposed changes to the common line rate structure to rate-of-return incumbent LECs and whether we should update Part 69 access rules in light of various developments. We further invited comment on the effect of these proposals and tentative conclusions on small business entities, including small incumbent LECs and new entrants.[471] We also noted that we would address access reform for rate-of-return carriers in a separate proceeding in 1997.[472]

B. Discussion

330. We conclude that, with the limited exceptions discussed in Sections III.D and VI.D, the scope of this proceeding should be limited to price cap incumbent LECs.[473] Price cap regulation governs almost 91 percent of interstate access charge revenues[474] and more than 92 percent of total incumbent LEC access lines.[475] Currently, all ten of the incumbent LECs with more than two million access lines and 13 of the 17 non-NECA incumbent LECS with more than 50,000 access lines are subject to price cap regulation.[476] Therefore, even though this proceeding applies only to price cap incumbent LECs, it will nonetheless affect the vast majority of all access lines and interstate access revenues.

331. Small and rural LECs will most likely not experience competition as fast as incumbent price cap LECs. We do not expect small and rural LECs generally to face significant competition in the immediate future because, for the most part, the high cost/ low-margin areas

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[470] NPRM at ¶¶ 50-52.

[471] NPRM at ¶ 53.

[472] NPRM at ¶ 52.

[473] These incumbent LECs are the seven Regional Bell Operating Companies (Ameritech, Bell Atlantic, BellSouth, NYNEX, Pacific Bell, SBC, US West), Citizens, Frontier, GTE, Aliant (formerly Lincoln), SNET, and United/Central.

[474] Universal Service Fund Data Collection, CC Docket No. 80-286, Universal Service Fund 1996 Submission of 1995 Study Results by NECA, Oct. 1, 1996.

[475] Data based on LECs' 1995 and 1996 Annual Access Tariffs filed with the Commission.

[476] Data based on LECs' 1995 and 1996 Annual Access Tariffs filed with the Commission.

served by these LECs are unlikely to be the immediate targets of new entrants or competitors. Moreover, as we noted in the NPRM, all non-price cap incumbent LECs may be exempt from, or eligible for a modification or suspension of, the interconnection and unbundling requirements of the 1996 Act.[477] By contrast, all incumbent LECs that are ineligible for section 251(f) exemption, suspensions, or modifications are incumbent price cap LECs.[478] Because the latter incumbent LECs must fulfill the section 251(b) and (c) duties to provide interconnection and unbundled elements to new entrants, they are likely to face significant competition in the interstate exchange access market before the small and mid-sized rate-of-return incumbent LECs face such competition.

332. We recognize that small and rural rate-of-return LECs face unique circumstances and that a few of these carriers may now have, or may soon receive, bona fide requests for interconnection. Although all rate-of-return carriers may not be completely insulated from competitive pressures, we are not persuaded by arguments that delaying the initiation of an access reform proceeding for these carriers until later this year will have a detrimental impact on their viability. A separate proceeding for small and rural rate-of-return LECs will provide us with the opportunity to conduct a comprehensive review of the circumstances and issues unique to these carriers.

333. We do not agree that Citizens Utilities should be exempt from some of the rules we adopt in this order for price cap companies. The decisions we reach here accommodate many of the concerns that Citizens Utilities, as well as a number of other price cap LECs that serve rural areas, voices in its pleadings. Although Citizens Utilities arguably may face different circumstances than other price cap LECs that serve larger urban and suburban populations, Citizens has indicated, by electing price cap regulation, that it believes it can achieve a higher rate of productivity than smaller rate-of-return LECs and that price cap regulation is more beneficial to it than rate-of-return regulation. Citizens Utilities has not demonstrated that the modifications we are adopting in this proceeding would necessarily affect it differently than other price cap LECs. If Citizens Utilities believes that it cannot remain financially viable as a price cap carrier under the revised access charge regime, it may petition for a waiver of the rule that makes its decision to elect price cap regulation irreversible.[479]

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[477] For example, section 251(f)(1) exempts rural telephone companies from the requirements of section 251(c)(2) until the rural telephone company has received a bona fide request for interconnection, services, or network elements, and the state commission determines that the exemption should be terminated. In addition, section 251(f)(2) permits LECs with fewer than two percent of the nation's subscriber lines to petition a state commission for a suspension or modification of any requirements of sections 251(b) and (c).

[478] *See, e.g.*, USTA Holding Company Report 1996.

[479] In the *LEC Price Cap Order*, the Commission stated that a LEC's decision to elect price cap regulation is irrevocable. Policy and Rules concerning Rates for Dominant Carriers, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786, 6819 (1990).

334. We reject Centennial's suggestion that we adopt access reform modifications for *all* incumbent LECs but then grant waivers for small, rural LECs whose special circumstances warrant different accommodations. For the most part, rate-of-return LECs face a common set of complex issues, different than those faced by price cap LECs, that are better addressed in a separate proceeding. In that proceeding, we will address any differences that may exist between large and small rate-of-return carriers.

335. We therefore limit application of the rules we adopt in this proceeding to the incumbent price cap LECs, with limited exceptions. Because rate-of-return LECs will collect revenues from the new universal service support mechanisms, we address allocation of universal service support to the interstate revenue requirement for all incumbent LECs in Section VI.D. In addition, because rate-of-return incumbent LECs' transport rates were subject to the rules that were remanded by the court in *CompTel v. FCC*,[480] the changes to the TIC that we adopt in Section III.D. pursuant to the court's remand, except for changes that require reallocation of costs to newly-created rate elements, will also apply to rate-of-return incumbent LECs. Finally, in order to prevent double recovery of the costs associated with providing access services to new entrants through the sale of unbundled network elements, we conclude in Section VI.A, below, that our exclusion of unbundled network elements from Part 69 access charges applies to all incumbent LECs.

VI. OTHER ISSUES

A. Applicability of Part 69 to Unbundled Elements

1. Background

336. In the NPRM, we requested comment regarding the potential application of Part 69 access charges to unbundled network elements purchased by carriers to provide local exchange services or exchange access services.[481] We tentatively concluded that unbundled network elements should be excluded from such access charges. We noted that the 1996 Act allows telecommunications carriers to purchase access to unbundled network elements and to use those elements to provide all telecommunications services, including originating and terminating access of interstate calls.[482] We further noted that the 1996 Act requires purchasing carriers to pay cost-based rates to incumbent LECs to compensate them for use of the unbundled network elements.[483]

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[480] *CompTel v. FCC*, 87 F.3d 522.

[481] NPRM at ¶ 54.

[482] *Id.*

[483] *Id.*

Accordingly, we tentatively concluded that the requesting carrier paying cost-based rates to the incumbent LEC would have already compensated the incumbent LEC for the ability to deploy unbundled network elements to provide originating and terminating access.[484]

2. Discussion

337. We will adhere to our tentative conclusion to exclude unbundled network elements from Part 69 access charges. This conclusion applies to all incumbent LECs.[485] As we noted in the *Local Competition Order*, payment of cost-based rates represents full compensation to the incumbent LEC for use of the network elements that carriers purchase.[486] We further noted that sections 251(c)(3) and 252(d)(1), the statutory provisions establishing the unbundling obligation and the determination of network element charges, do not compel telecommunications carriers using unbundled network elements to pay access charges.[487] Moreover, these provisions do not restrict the ability of carriers to use network elements to provide originating and terminating access.[488] Allowing incumbent LECs to recover access charges in addition to the reasonable cost of such facilities would constitute double recovery because the ability to provide access services is already included in the cost of the access facilities themselves. Excluding access charges from unbundled elements ensures that unbundled elements can be used to provide services at competitive levels, promoting the underlying purpose of the 1996 Act.[489] If incumbent LECs added access charges to the sale of unbundled elements, the added cost to competitive LECs would impair, if not foreclose, their ability to offer competitive access services.[490] The availability of access services at competitive levels is vital to the general approach we adopt in this Order, which relies on the growth of competition, including from competitors using unbundled network

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[484] *Id.*

[485] Although our rule applies to all incumbent LECs, we note that small LECs (those with fewer than two percent of the nation's subscriber lines) may petition the appropriate state commission for a suspension or modification of the unbundling requirements of the 1996 Act. 47 U.S.C. § 251(f)(2). In addition, a rural telephone company is exempt from the obligation to provide access to unbundled network elements until it has received a bona find request for unbundled elements. 47 U.S.C. § 251(f)(1). *See also, Local Competition Order*, 11 FCC Rcd at 1611.

[486] 11 FCC Rcd at 15864.

[487] *Id.*

[488] *Id.*

[489] *See* 11 FCC Rcd at 15682.

[490] There would be serious questions about the wisdom of a market-based approach to access reform as advocated by some incumbent LECs, s*ee, e.g.*, Ameritech Comments at 38; Cincinnati Bell Comments at 13, if incumbent LECs could impose access charges on the use of unbundled network elements.

elements, to move overall access rate levels toward forward-looking economic cost.[491] In addition, we note that excluding unbundled network elements from access charges benefits small entities seeking to enter the local service market by ensuring that they can acquire unbundled elements at competitive prices.

338. We disagree with suggestions offered by some commenters that access charges should be imposed on unbundled elements because cost-based rates for such elements would not recover universal service support subsidies built into the access charge regime.[492] Although our plan to implement comprehensive universal service reform is not fully implemented, we believe excluding access charges from the sale of unbundled elements will not dramatically affect the ability of price cap LECs to fulfill their universal service obligations. First, competitors using unbundled network elements to provide interstate services will contribute to universal service requirements pursuant to section 254. Carriers receive no exemption from their obligation to contribute to universal service by using unbundled network elements. Second, rate structure modifications adopted in this Order -- including reallocation of TIC costs, adoption of a mechanism to phase out the TIC, and raising multi-line SLCs -- should reduce the impact on price cap LECs of excluding the recovery of TIC costs in the sale of unbundled network elements. Third, if unbundled network element prices are geographically deaveraged, LECs will receive higher prices when they sell unbundled network elements that embody higher costs. Fourth, because the difference between the level of access charges and the forward-looking economic costs of network elements may include more than universal service support, imposing access charges on the sale of unbundled network elements could recover from market entrants substantially more than amounts used to support universal service. Accordingly, we are not persuaded by suggestions that the universal service obligations of price cap LECs compel the imposition of access charges on the purchase of unbundled network elements by requesting carriers.

339. Although, in the *Local Competition Order*, we allowed application of certain non-cost-based access charges (the CCLC and a portion of the TIC) to unbundled elements, we limited the duration of such application to a transition period ending June 30, 1997 even if access and universal service reform were not completed by the end of the transition period.[493] The transition period was limited in order to minimize the burden on competitive local service providers seeking to use unbundled network elements to offer the competitive services that the 1996 Act sought to promote. The interim application of certain access charges was also limited

[491] Were we to allow the assessment of access charges by incumbent LECs for access services provided by carriers over unbundled network elements, we would be compelled to take a more prescriptive approach to the rate level issue.

[492] PacTel Comments at 55-57. *See also* GVNW Comments at 5.

[493] 11 FCC Rcd at 15866.

to non-cost-based charges because such charges, unlike facilities-based charges, were more likely to include subsidies for universal service. All facilities-based charges were completely excluded from unbundled network elements to prevent double recovery by incumbent LECs of the costs of these facilities when they are purchased by competitive carriers.

340. We are also unpersuaded by suggestions that access charges should be imposed on unbundled elements because provision of competitive service by rebundling the same network elements used by the incumbent LEC to provide access is equivalent to resale of a retail service.[494] First, in the *Local Competition Order*, we recognized major differences between competition through the use of unbundled network elements and competition through resale of an existing retail service offered by an incumbent LEC. We explained, for example, that an entrant relying on unbundled elements rather than resale has the flexibility to offer all telecommunications services made possible by using network elements but also assumes the risk that end users will not generate sufficient demand to justify the investment. The entrant using a resale strategy, however, is limited to offering the retail service itself without the attendant investment risk.[495] Thus, we reject the notion that the rebundling of network elements is equivalent to resale. Second, although we concluded in the *Local Competition Order* that IXCs must continue to pay access charges to incumbent LECs for access services when the end user is served by a competitive carrier reselling the incumbent LEC's retail services, our conclusion was based on the resale provisions of the 1996 Act which limit resale to retail services offered to subscribers or other customers who are not telecommunications carriers.[496] The resale provision does not apply to non-retail services, including access services, that may be offered using the same facilities.[497] Unlike the provision of local exchange services, access services are not services that LECs provide directly to end users on a retail basis. To impose access charges on the sale of unbundled elements would contravene the terms of the resale provision by effectively treating exchange access as a service provided on a retail basis.

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[494] BellSouth Comments at 13; PacTel Reply at 8-10.

[495] 11 FCC Rcd at 15667-68.

[496] 47 U.S.C. § 251(c)(4)(A).

[497] 11 FCC Rcd at 15982-83.

B. Treatment of Interstate Information Services

1. Background

341. In the 1983 *Access Charge Reconsideration Order*, the Commission decided that, although information service providers[498] (ISPs) may use incumbent LEC facilities to originate and terminate interstate calls, ISPs should not be required to pay interstate access charges.[499] In recent years, usage of interstate information services, and in particular the Internet and other interactive computer networks, has increased significantly.[500] Although the United States has the greatest amount of Internet users and Internet traffic, more than 175 countries are now connected to the Internet.[501] As usage continues to grow, information services may have an increasingly significant effect on the public switched network.

342. As a result of the decisions the Commission made in the *Access Charge Reconsideration Order*, ISPs may purchase services from incumbent LECs under the same intrastate tariffs available to end users. ISPs may pay business line rates and the appropriate subscriber line charge, rather than interstate access rates, even for calls that appear to traverse state boundaries.[502] The business line rates are significantly lower than the equivalent interstate access charges, given the ISPs' high volumes of usage.[503] ISPs typically pay incumbent LECs a

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[498] The term "enhanced services," which includes access to the Internet and other interactive computer networks, as well as telemessaging, alarm monitoring, and other services, appears to be quite similar to the term "information services" in the 1996 Act. "Enhanced services" are defined in § 64.702(a) of our rules: "For the purposes of this subpart, the term *enhanced services* shall refer to services, offered over common carrier transmission facilities used in interstate communications, which employ computer processing applications that act on the format, content, code, protocol, or similar aspects of the subscriber's transmitted information; provide the subscriber additional different, or restructured information; or involve subscriber interaction with stored information." The 1996 Act defines "information services" as offering the capability for "generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications." 47 U.S.C. § 153(20). For purposes of this order, providers of enhanced services and providers of information services are referred to as ISPs.

[499] MTS and WATS Market Structure, Memorandum Opinion and Order, Docket No. 78-72, 97 FCC 2d 682, 711-22 (*Access Charge Reconsideration Order*). *See also* Amendments of Part 69 of the Commission's Rules Relating to Enhanced Service Providers, CC Docket No. 87-215, Order, 3 FCC Rcd 2631 (1988) (*ESP Exemption Order*).

[500] The number of U. S. households with Internet access more than doubled over the past year, and approximately 38.7 million Americans over the age of 18 have accessed the Internet at least once. Jared Sandberg, "U.S. Households with Internet Access Doubled to 14.7 Million in Past Year, *Wall Street Journal*, October 21, 1996, at B11.

[501] Network Wizards Internet Domain Survey, January 1997, available on the World Wide Web at <http://www.nw.com/zoneWWW/top.html>.

[502] *ESP Exemption Order*, 3 FCC Rcd at 2631 nn.8, 53. To maximize the number of subscribers that can reach them through a local call, most ISPs have deployed points of presence.

[503] CIEA Comments at 5-6.

flat monthly rate for their connections regardless of the amount of usage they generate, because business line rates typically include usage charges only for outgoing traffic.

343. In the *NPRM*, we tentatively concluded that ISPs should not be required to pay interstate access charges as currently constituted. We explained that the existing access charge system includes non-cost-based rates and inefficient rate structures. We stated that there is no reason to extend such a system to an additional class of customers, especially considering the potentially detrimental effects on the growth of the still-evolving information services industry. We explained that ISPs should not be subjected to an interstate regulatory system designed for circuit-switched interexchange voice telephony solely because ISPs use incumbent LEC networks to receive calls from their customers.[504] We solicited comment on the narrow issue of whether to permit incumbent LECs to assess interstate access charges on ISPs.[505] In the companion *Notice of Inquiry (NOI)*, we sought comment on broader issues concerning the development of information services and Internet access.[506]

2. Discussion

344. We conclude that the existing pricing structure for ISPs should remain in place, and incumbent LECs will not be permitted to assess interstate per-minute access charges on ISPs. We think it possible that had access rates applied to ISPs over the last 14 years, the pace of development of the Internet and other services may not have been so rapid. Maintaining the existing pricing structure for these services avoids disrupting the still-evolving information services industry[507] and advances the goals of the 1996 Act to "preserve the vibrant and competitive free market that presently exists for the Internet and other interactive computer services, unfettered by Federal or State regulation."[508]

345. We decide here that ISPs should not be subject to interstate access charges. The access charge system contains non-cost-based rates and inefficient rate structures, and this Order goes only part of the way to remove rate inefficiencies. Moreover, given the evolution in ISP technologies and markets since we first established access charges in the early 1980s, it is not clear that ISPs use the public switched network in a manner analogous to IXCs. Commercial

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[504] NPRM at para 288.

[505] *Id.*

[506] *See In the Matter of* Usage of the Public Switched Network by Information Service and Internet Access Providers, CC Docket No. 96-263, Notice of Inquiry, FCC 96-488 (rel. December 24, 1996) (*NOI*).

[507] *See, e.g.*, CompuServe/Prodigy Comments at 11; Information Industry Association Comments at 4; Minnesota Internet Services Trade Association Reply at 1.

[508] 47 U.S.C. § 230(b)(2).

Internet access, for example, did not even exist when access charges were established. As commenters point out, many of the characteristics of ISP traffic (such as large numbers of incoming calls to Internet service providers) may be shared by other classes of business customers.

346. We also are not convinced that the nonassessment of access charges results in ISPs imposing uncompensated costs on incumbent LECs. ISPs do pay for their connections to incumbent LEC networks by purchasing services under state tariffs. Incumbent LECs also receive incremental revenue from Internet usage through higher demand for second lines by consumers, usage of dedicated data lines by ISPs, and subscriptions to incumbent LEC Internet access services. To the extent that some intrastate rate structures fail to compensate incumbent LECs adequately for providing service to customers with high volumes of incoming calls, incumbent LECs may address their concerns to state regulators.

347. Finally, we do not believe that incumbent LEC allegations about network congestion warrant imposition of interstate access charges on ISPs.[509] The Network Reliability and Interoperability Council has not identified any service outages above its reporting threshold attributable to Internet usage, and even incumbent LEC commenters acknowledge that they can respond to instances of congestion to maintain service quality standards. Internet access does generate different usage patterns and longer call holding times than average voice usage. However, the extent to which this usage creates congestion depends on the ways in which incumbent LECs provision their networks, and ISPs use those networks. Incumbent LECs and ISPs agree that technologies exist to reduce or eliminate whatever congestion exists; they disagree on what pricing structure would provide incentives for deployment of the most efficient technologies.[510] The public interest would best be served by policies that foster such technological evolution of the network. The access charge system was designed for basic voice telephony provided over a circuit-switched network, and even when stripped of its current inefficiencies it may not be the most appropriate pricing structure for Internet access and other information services.

348. Thus, in our review of the record filed in response to the *NOI*, we will consider solutions to network congestion arguments other than the incumbent LECs' recommendation that we apply access charges to ISPs' use of circuit-switched network technology. We intend rather to focus on new approaches to encourage the efficient offering of services based on new network configurations and technologies, resulting in more innovative and dynamic services than exist today. In the *NOI*, we will address a range of fundamental issues about the Internet and other

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[509] *See, e.g.*, USTA Comments at 81-82.

[510] SWBT Comments at 20; PacTel Reply at 26; Internet Access Coalition Reply at 11-12; America On-Line Reply at 7-9.

information services, including ISP usage of the public switched network.[511] The *NOI* will give us an opportunity to consider the implications of information services more broadly, and to craft proposals for a subsequent NPRM that are sensitive to the complex economic, technical, and legal questions raised in this area. We therefore conclude that ISPs should remain classified as end users for purposes of the access charge system.

C. Terminating Access

349. In the NPRM, we requested comment regarding the regulation of terminating access. We noted that, unlike originating access, the choice of an access provider for terminating access is made by the recipient of the call. The call recipient generally does not pay for the call and, therefore, is not likely to be concerned about the rates charged for terminating access. We suggested that neither the originating caller nor its long-distance service provider can exert substantial influence over the called party's choice of terminating access provider.[512] Thus, even if competitive pressures develop at the originating end as new entrants offer alternatives, the terminating end of a long-distance call may remain a bottleneck, controlled by the LEC providing access for a particular customer.[513] We also recognized, however, that excessive terminating access charges could furnish an incentive for IXCs to enter the access market in order to avoid paying excessive terminating access charges.[514]

1. Price Cap Incumbent LECs

a. Background

350. We requested comment on various alternative special methods for regulating the terminating access rates of price cap LECs. For instance, we sought comment on whether to establish a ceiling on the terminating access rates of price cap LECs equal to the forward-looking economic cost of providing the service. We suggested alternative methods for measuring forward-looking economic cost, including reference to prices in reciprocal compensation arrangements for the transport and termination charges of telecommunications under sections 251(b)(5) and 252(d)(2) or a requirement that terminating rates be based on a TSLRIC study or other acceptable forward-looking cost-based model.[515]

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[511] In particular, we requested data about alleged network congestion, rates paid by ISPs today, alternative network access technologies, and additional services desired by ISPs. *NOI* at ¶¶ 313-317.

[512] NPRM at ¶ 271.

[513] *Id.*

[514] *Id.* at ¶ 272.

[515] NPRM at ¶ 274.

b. Discussion

351. We believe that new entrants, by purchasing unbundled network elements or providing facilities-based competition, will eventually exert downward pressure on originating access rates assessed by incumbent LECs. We agree that excessive terminating access rates could encourage long-distance companies to avoid the payment of such charges by seeking to become the local exchange and exchange access provider for end user customers. These market developments, however, would not fully address the concerns expressed in the NPRM and reflected in comments with respect to the ability of incumbent LECs to charge unreasonable rates for terminating access.

352. We are also not convinced that a significant competitive impact would result from changes in calling patterns between pairs of callers. Commenters have not described any realistic way that users, by changing their calling patterns, could experience savings attributable to differing levels of terminating access charges paid by IXCs.[516] Although one commenter points to high termination charges in foreign countries as affecting the market for overseas calls originating in the United States,[517] such results are less likely to occur for domestic calls, which are much less expensive than international calls and are subject to geographic rate averaging and rate integration requirements.[518] Thus, we are reluctant to base our approach on the expectation that a significant proportion of callers will implement such a strategy.

353. Accordingly, we are establishing regulatory requirements that will address the potential that incumbent LECs could charge unreasonable rates for terminating access. Specifically, we are adopting rules in this Order that, for price cap LECs, will limit recovery of TIC and common line costs from terminating access rates for a limited period, and then eliminate any recovery of common line and TIC costs from terminating access. Under this approach, beginning January 1, 1998, price cap LECs will recover common line and residual TIC revenues through a new flat charge, subject to a ceiling. Remaining common line and residual TIC revenues will then be first recovered through originating access rates, subject to a ceiling. Any remaining common line and residual TIC revenues may then be recovered through terminating rates. As the caps on SLCs applicable to non-primary residential lines and the PICC are raised, none of these residual revenues will be recovered through terminating access charges. When the

[516] We question whether switching carriers would have an immediate impact on the overall cost of long-distance calls between discrete pairs of callers. A local access provider's terminating access charges are spread across an IXC's customer base. As a practical matter, alterations in calling behavior, unless done on a massive scale across the IXC's customer base, are not likely to have an immediate or predictable impact on the bills of two callers seeking to reduce the cost of their long-distance calls to each other.

[517] TCI Comments, Attachment A at 4.

[518] NPRM at n. 357.

increased SLCs and PICCs are fully implemented, recovery of these costs will be more susceptible to competitive forces because IXCs could seek to influence the end user's choice of its provider of local service, and the end user's choice of service provider will determine whether the incumbent LEC is able to recover these costs from the end user.

354. In addition, pending full recovery of all common line and residual TIC costs in flat rate SLCs and PICCs, this approach will put downward pressure on terminating access rates by lowering the overall service revenues derived from terminating access charges. Because competitive pressure is more likely to develop on the originating end of a long-distance call, we can rely to a greater extent on competitive forces to ensure just and reasonable rates under this approach by moving recovery of certain revenues from terminating access to originating access. By stripping terminating access rates of CCL and residual TIC charges and, pending full implementation of the new flat charges, placing more of the burden of TIC recovery on originating access rates, we reduce potential excesses in terminating access charges while exposing the CCL and residual TIC recovery to competitive pressures in the originating access market.

355. The NPRM described proposals linking terminating rates to originating rate levels or shifting costs from terminating to originating access charges.[519] Some commenters support limiting price cap LEC terminating access rates to the level of the LEC originating access rates.[520] If originating access charges are lowered because of competition, the ceiling on terminating access rates would be lowered as well, placing downward pressure on terminating rates. This approach, however, would not substantially affect terminating access rates where originating access rates have not responded to competitive inroads. Moreover, linking an incumbent LEC's terminating access rate to its own originating rate could reduce the incumbent LEC's incentive to lower its originating access rates. Thus, we decline to adopt this method of regulating terminating access rates.

356. The NPRM requested comment on the possibility of eliminating all charges for terminating access by shifting the burden of recovering all costs currently recovered in terminating access rates to originating access charges.[521] We decline to adopt this approach because a complete shift of terminating access costs to originating access conflicts with one of the basic objectives of this proceeding -- to ensure that charges for access services reflect the manner in which the costs of providing those services are incurred. Switching costs, for example, should continue to be recovered in part from terminating access charges because those costs are traffic sensitive and are related to the volumes of both originating and terminating traffic. Moreover, we

[519] NPRM at ¶ 276.

[520] BA/NYNEX Comments at 42; Ohio Commission Comments at 12.

[521] NPRM at ¶ 276.

emphasize that, as discussed in Section III.A, the rate structure we are adopting, which will replace per-minute recovery of the CCL charge and the TIC with flat rate charges, helps to achieve our goal of ensuring that charges for access services reflect the manner in which costs are incurred. Our requirement that incumbent LECs recover a greater portion of common line and TIC costs in originating access rates pending full implementation of flat-rated charges will address concerns about the reasonableness of terminating access charges while providing price cap LECs sufficient latitude to recover the reasonable costs of deploying their facilities to provide terminating access services.

357. The NPRM also discussed the alternative of requiring price cap LECs to establish end user charges for terminating access. This approach would place direct responsibility for the cost of terminating access on the recipient of terminating access services and would expose terminating access to competitive pressures. We noted that wireless companies already charge called parties for receiving calls and requested comment on how we might implement a system of end user charges in the context of access reform and whether its implementation would increase the number of uncompleted calls due to a reluctance by called parties to accept the charges.[522] We agree with commenters that such a change could prove disruptive to consumers of wireline services.[523] After review of the record, which produced few, if any, advocates of such an approach, we conclude that we should not mandate at this time this change in current pricing practices for wireline service.

2. Non-Incumbent LECs

a. Background

358. In the NPRM, we requested comment about whether to impose ceilings on the terminating access rates of non-incumbent LECs.[524] We stated in the NPRM that our policy since the *Competitive Carrier Proceeding*,[525] has consistently been that a carrier is non-dominant unless the Commission makes or has made a finding that it is dominant.[526] We noted that, since the *Competitive Carrier Proceeding*, new entrants into the exchange access market have been

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[522] NPRM at ¶ 275.

[523] Ameritech Comments at 54; LCI Comments at 19; California Commission Comments at 17-18.

[524] NPRM at ¶ 280.

[525] In the *Competitive Carrier Proceeding*, we established a comprehensive framework for determining whether carriers are dominant or non-dominant, classified then existing classes of carriers as either dominant or non-dominant, and promulgated general definitions providing that a carrier will be non-dominant in the absence of a Commission finding of market power. *Competitive Carrier First Report and Order*, 85 FCC 2d at 51 (promulgating 47 C.F.R. § 61.15(A)(2)).

[526] NPRM at ¶ 277.

presumptively classified as non-dominant because they have not been shown to exercise significant market power in their service areas.[527] At the same time, we stated that competitive LECs may possess market power over IXCs needing to terminate calls because the LEC controlling the terminating local loop is the only access provider available to the IXC seeking to terminate a long-distance call on that particular loop.[528] We solicited comment on several alternatives, including whether we should use incumbent LEC terminating access rates as a benchmark to determine the reasonableness of competitive LEC terminating rates. We invited commenters to offer other approaches including, for example, whether we should establish a presumption of reasonableness if the competitive LEC's terminating access rate is no higher than the incumbent LEC's rate in the same geographic market.[529]

b. Discussion

359. We recently noted that the test in deciding whether to apply dominant carrier regulation to a class of carriers is whether those carriers have market power.[530] As we discussed in the *Dominant/Nondominant Order*, in determining whether a firm possesses market power, the Commission has previously focused on certain well-established market features, including market share, supply and demand substitutability, the cost structure, size or resources of the firm, and control of bottleneck facilities.[531] Competitive LECs currently have a relatively small market share in the provision of local exchange and exchange access service. Nonetheless, at first blush,

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[527] *Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor*, CC Docket No. 79-252, Notice of Inquiry and Proposed Rulemaking, 77 FCC 2d 308 (1979) (*Competitive Carrier NPRM*); First Report and Order, 85 FCC 2d 1 (1980) (*First Report and Order*); Further Notice of Proposed Rulemaking, 84 FCC 2d 445 (1981) (*Competitive Carrier Further NPRM*); Second Further Notice of Proposed Rulemaking, FCC 82-187. 47 Fed. Reg. 17,308 (1982); Second Report and Order, 91 FCC 2d 59 (1982) (*Second Report and Order*); Order on Reconsideration, 93 FCC 2d 54 (1983); Third Further Notice of Proposed Rulemaking, 48 Fed. Reg. 28,292 (1983); Third Report and Order, 48 Fed. Reg. 46,791 (1983); Fourth Report and Order, 95 FCC 2d 554 (1983) (*Fourth Report and Order*), *vacated, AT&T Co. v. FCC*, 978 F.2d 727 (D.C. Cir. 1992), *cert. denied, MCI Telecommunications Corp. v. AT&T Co.*, 509 U.S. 913 (1993); Fourth Further Notice of Proposed Rulemaking, 96 FCC 2d 922 (1984); Fifth Report and Order, 98 FCC 2d 1191 (1984) (Fifth Report and Order); Sixth Report and Order, 99 FCC 2d 1020 (1985) (*Sixth Report and Order*), *vacated, MCI Telecommunications Corp. v. FCC*, 765 F.2d 1186 (D.C. Cir. 1985) (collectively referred to as the *Competitive Carrier proceeding*).

[528] *Id.* at ¶ 279.

[529] *Id.* at ¶ 280.

[530] *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area and Policy and Rules Concerning the Interstate, Interexchange Marketplace*, CC Docket Nos. 96-149 and 96-61, Second Report and Order in CC Docket No. 96-149 and Third Report and Order in CC Docket No. 96-61, FCC 97-142 at ¶ 12 (rel. April 18, 1997) *(Dominant/Non-Dominant Order)*.

[531] *Dominant/Non-Dominant Order* at ¶ 93. *See also Implementation of Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934 and Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area*, Notice of Proposed Rulemaking, FCC No. 96-308, CC Docket No. 94-149 at ¶ 133 (rel. July 18, 1996).

there is a concern that a competitive LEC may have market power over an IXC that needs to terminate a long-distance call to a customer of that particular competitive LEC. Therefore, we sought comment on whether and to what extent we should regulate the terminating access charges of competitive LECs.

360. We conclude, based on the record before us, that non-incumbent LECs should be treated as nondominant in the provision of terminating access. Although an IXC must use the competitive LEC serving an end user to terminate a call, the record does not indicate that competitive LECs have previously charged excessive terminating access rates. Nor have commenters provided evidence demonstrating that competitive LECs are, in fact, charging excessive terminating rates. Indeed, the record suggests that the terminating rates of competitive LECs are equal to or below the tariffed rates of incumbent LECs.[532] In addition, the record does not show that competitive LECs distinguish between originating and terminating access in their offers of service. Therefore, it does not appear that competitive LECs have structured their service offerings in ways designed to exercise any market power over terminating access. Accordingly, the concerns expressed in the NPRM about the ability of competitive LECs to exercise market power in the provision of terminating access are not substantiated in the record.

361. Further, as competitive LECs, which have a small share of the interstate access market, attempt to expand their market presence, the rates of incumbent LECs or other potential competitors will constrain the terminating access rates of competitive LECs.[533] Specifically, competitive LECs compete with incumbent LECs whose rates are regulated. The record indicates that long-distance carriers have established relationships with incumbent LECs for the provision of access services, and new market entrants are not likely to risk damaging their developing relationships with IXCs by charging unreasonable terminating access rates.[534] This is especially true with respect to competitive access providers seeking to maintain or expand their access transport, special access, or other services apart from switched access.[535]

362. In addition, we believe that overcharges for terminating access could encourage access customers to take competitive steps to avoid paying unreasonable terminating access charges. If, for example, a competitive LEC consistently overcharged an IXC for terminating access, the IXC would have an incentive to enter a marketing alliance with another competitive LEC in the same market or in other geographic markets where the overcharging competitive LEC seeks to expand. Although high terminating access charges may not create a *disincentive* for the

[532] Spectranet Comments at 7; TCI Comments, Attachment A at 6.

[533] ALTS Comments at 29; American Communications Services Reply at 21; ICG Telecom Group Reply at 23.

[534] *See* WinStar Comments at 5-6; TCI Comments, Attachment A at 9; Cox Communications Reply at 4-5.

[535] ALTS Comments, Attachment B at 14.

call recipient to retain its local carrier (because the call recipient does not pay the long distance charge), the call recipient may nevertheless respond to *incentives* offered by an IXC with an economic interest in encouraging the end user to switch to another local carrier. Such an approach could have particular impact when the IXC has significant brand recognition among consumers. Moreover, as noted in the NPRM, excessive terminating access charges could encourage IXCs to enter the access market in an effort to win the local customer.[536] We believe that the possibility of competitive responses by IXCs will have a constraining effect on non-incumbent LEC pricing.

363. Thus, we will not adopt at this time any regulations governing the provision of terminating access provided by competitive LECs.[537] Because competitive LECs have not charged unreasonable terminating access rates, and because they are not likely to do so in the future, competitive LECs do not appear to possess market power. Thus, the imposition of regulatory requirements with respect to competitive LEC terminating access is unnecessary. We similarly find no reason to adopt a presumption of reasonableness where a competitive LEC's terminating access rates are less than its rates for originating access or less than the incumbent LEC's terminating access rates. Instead, if we need to examine the reasonableness of competitive LEC terminating access rates in an individual instance, we can do so taking into account all relevant factors including relationships to other rates. Thus, if an access provider's service offerings violate section 201 or Section 202 of the Act, we can address any issue of unlawful rates through the exercise of our authority to investigate and adjudicate complaints under section 208.[538] On the basis of the current record, we conclude that reliance on the complaint process will be sufficient to assure that non-incumbent LEC rates are reasonable. We emphasize that we will not hesitate to use our authority under section 208 to take corrective action where appropriate.

364. We will be sensitive to indications that the terminating access rates of competitive LECs are unreasonable. The charging of terminating access rates above originating rates in the same market, for example, may suggest the need to revisit our regulatory approach. Similarly, terminating rates that exceed those charged by the incumbent LEC serving the same market may suggest that a competitive LEC's terminating access rates are excessive. If there is sufficient indication that competitive LECs are imposing unreasonable terminating access charges, we will revisit the issue of whether to adopt regulations governing competitive LEC rates for terminating access.

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[536] NPRM at ¶ 272.

[537] We are examining in a separate proceeding whether tariffing of rates for access services provided by competitive LECs is necessary to assure that such rates are reasonable. *See* Petitions Requesting Forbearance of Hyperion Telecommunications, Inc. (CCB/CPD No. 96-462) and Time Warner Communications (CCB/CPD No. 96-902).

[538] 47 U.S.C. § 208.

3. "Open End" Services

365. In some cases, an IXC is unable to influence the end user's choice of access provider for originating access services because the end user on the terminating end is paying for the call. For example, charges for the "open end" originating access minutes for 800 or 888 services are paid by the recipient of the call. Consequently, the Commission has treated incumbent LEC originating "open end" minutes as terminating minutes for access charge purposes.[539] The NPRM solicited comment on whether such regulatory treatment should be retained for "open end" services under which terminating access rates serve as originating access rates, and whether this approach should be extended to competitive LECs.[540]

366. We continue to believe that "open end" originating minutes should be treated as terminating minutes for access charge purposes. Although few comments were filed regarding this issue, commenters addressing this matter advocate retention of the current regulatory approach.[541] By continuing to treat "open end" originating minutes as terminating minutes for access charge purposes, we recognize that access customers have limited ability to influence the calling party's choice of access provider. Accordingly, access charges for these "open end" minutes will be governed by the requirements we adopt in this Order applicable to terminating access provided by incumbent LECs. Thus, residual common line charges and the per-minute TIC will not be recovered through "open end" originating minutes except to the extent such recovery is permitted under the rules described in Section III.A of this Order.

D. Universal Service-Related Part 69 Changes

367. In the NPRM, we recognized that, because of the role that access charges have played in funding and maintaining universal service, it is critical to implement changes in the access charge system together with complementary changes in the universal service system. In this section, we address the manner in which incumbent LECs must adjust their interstate access charges to reflect the universal service support mechanisms adopted in the *Universal Service Order*.

1. Background

368. In November 1996, pursuant to Section 254 of the Act, the Federal-State Universal Service Joint Board issued its recommendations to the Commission for reforming our system of universal service so that universal service is preserved and advanced, but in a manner that permits

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[539] 47 C.F.R. § 69.105(b)(1)(iii).

[540] NPRM at ¶ 281.

[541] ACTA Comments at 24; WorldCom Comments at 93.

the local exchange and exchange access markets to move from monopoly to competition.[542] In our *Universal Service Order*, we are adopting most of the Joint Board's recommendations relating to the support of rural and high cost areas.

369. Section 254 of the Act requires that any federal universal service support provided to eligible carriers be "explicit"[543] and recovered on an "equitable and nondiscriminatory basis"[544] from all telecommunications carriers providing interstate telecommunications service. In our companion *Universal Service Order*, we agree with the Joint Board that these programs must be replaced with universal service support mechanisms that satisfy section 254.[545]

370. Currently, there are three mechanisms designed expressly to provide support for high cost and small telephone companies: the Universal Service Fund (high cost assistance fund),[546] the Dial Equipment Minutes (DEM) weighting program,[547] and Long Term Support (LTS).[548] An incumbent LEC is eligible for high cost assistance from the current Universal Service Fund if its embedded loop costs exceed 115 percent of the national average loop cost. This program is funded entirely by IXCs.[549] DEM weighting assistance is an implicit support mechanism that permits LECs with fewer than 50,000 access lines to apportion a greater proportion of these local switching costs to the interstate jurisdiction than larger LECs may allocate. Finally, the existing LTS program supports carriers with higher-than average subscriber line costs by providing carriers that are members of the NECA pool with enough support to enable them to charge IXCs only a nationwide average CCL interstate access rate.[550] LTS payments reduce the access charges of smaller, rural incumbent LECs participating in the loop-

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[542] *Joint Board Recommended Decision*, 12 FCC Rcd 87.

[543] 47 U.S.C. § 254(e).

[544] 47 U.S.C. § 254(d).

[545] *See* Section III of the *Universal Service Order*.

[546] 47 C.F.R. § 36.601 *et seq.*

[547] 47 C.F.R. § 36.125(b).

[548] 47 C.F.R. §§ 69.105, 69.502, 69.603(e), 69.612.

[549] Each IXC with at least .05 percent of presubscribed lines nationwide contributes to the fund an amount based on the number of its presubscribed lines. 47 C.F.R. § 69.116.

[550] Prior to 1989 all LECs were required to participate in a pool of carrier common line costs and revenues. Beginning in April 1989, LECs were permitted to withdraw from the pool, but LECs with below average CCL charges that choose to exit the pool are required to contribute enough so that LECs remaining in the pool would be able to charge the same industry average CCL rates they would have charged if the pool were still mandatory for all LECs. *See* MTS and WATS Market Structure; Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, CC Docket Nos. 78-72, 80-286, Report and Order, 2 FCC Rcd 2953 (1987).

cost pool by raising the access charges of non-participating incumbent LECs.

371. In the NPRM, we sought comment on whether incumbent LECs' access charges must be adjusted to reflect elimination of LTS contribution requirements and receipt of explicit universal service funds in order to prevent incumbent LECs from being compensated twice for providing universal service.[551] We proposed a downward exogenous cost adjustment for price cap incumbent LECs to reflect elimination of LTS contribution requirements and any revenues received from any new universal service support mechanisms, and sought comment on how interstate costs must also be reduced to account for explicit universal service support.[552]

2. Discussion

372. In our companion *Universal Service Order*, we conclude that a carrier will continue to receive universal service support based upon the existing LTS, high cost, DEM weighting mechanisms, until the carrier begins to receive support based upon forward-looking economic cost.[553] In the following sections, we will discuss the manner in which incumbent LECs must reduce their interstate access charges to reflect the elimination of the obligation to contribute to LTS, increase their interstate access charges to permit recovery of the new universal service obligation, and, to the extent necessary, adjust their interstate access charges to account for any additional universal service funds received under the modified universal service mechanisms.

a. Removal of LTS Obligation from Interstate Access Rates

373. In our companion *Universal Service Order*,[554] we agree with the Joint Board that LTS payments constitute a universal service support mechanism that is inconsistent with the Act's requirement that support be collected from all providers of interstate telecommunications services on an equitable and non-discriminatory basis[555] and be available to all eligible telecommunications carriers.[556] In that order, we conclude that LTS should be removed from the interstate access charge system. We provide, instead, for recovery of comparable payments from the new federal

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[551] NPRM at ¶ 244.

[552] NPRM at ¶¶ 245-46.

[553] *See* Section VII.D of the *Universal Service Order*.

[554] *See* Section XII.B of the *Universal Service Order*.

[555] 47 U.S.C. § 254(d).

[556] *See* 47 U.S.C. § 254(e).

universal service support mechanisms.[557]

374. Currently, only incumbent LECs that do not participate in the NECA CCL tariff (non-pooling incumbent LECs) make LTS payments and only incumbent LECs participating in the NECA CCL tariff receive LTS support.[558] Non-pooling incumbent LECs' contributions to the common line pool are set annually based on the total projected amount of LTS, converted to a monthly payment amount. Non-pooling incumbent LECs recover the revenue necessary for their LTS contributions through their CCL charges. We agree with commenters that argue that, to the extent we do not reduce interstate access revenues by the amount of LTS contribution currently recovered in the rates, incumbent LECs will double recover. We therefore conclude that incumbent LEC interstate access charges must be reduced to reflect elimination of the obligation to contribute to LTS.

375. Because payments from the existing LTS mechanism will cease on January 1, 1998, incumbent LECs should no longer contribute to the existing LTS fund after that date. For price cap LECs, which were requested to stop participating in the NECA Common Line tariff before coming under price cap regulation, LTS contributions were included in the common line revenue requirement when the PCI for the common line basket was established.[559] We conclude that price cap LECs must make a one-time downward exogenous adjustment to the PCI for the common line basket to account fully for the elimination of their LTS obligations. This exogenous adjustment shall be made in a manner consistent with section 61.45 and other relevant provisions of the Commission's rules.[560]

376. Non-pooling, rate-of-return LECs recover their LTS contributions in the common line revenue requirement.[561] Because current LTS contributors will no longer be making such contributions after January 1, 1998, their CCL charges should be adjusted to account for this change. Rate-of-return LECs that formerly made LTS contributions should recompute their common line revenue requirements based on the elimination of their LTS obligations, and adjust their CCL charges accordingly.[562]

377. We note that the replacement of LTS with comparable support from the new

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[557] *See* Sections VII and XII.B of the *Universal Service Order*.

[558] *See* 47 C.F.R. § 69.105(b)(3)-(4).

[559] *See* 47 C.F.R. §§ 69.501(a).

[560] 47 C.F.R. § 61.45.

[561] *See* 47 C.F.R. § 69.501(a).

[562] *See* 47 C.F.R. § 69.105(b)(4)(ii).

universal service support mechanisms requires us to amend the NECA Common Line tariff rules, which establish the CCL for pooling members at the average of price cap LECs' CCL charges.[563] Under the current LTS support system, NECA annually projects the common line revenue requirement, including an 11.25 percent return on investment, for incumbent LECs that participate in the common line pool.[564] NECA then computes the total amount of LTS support needed by subtracting the amount pooling carriers will receive in CCL revenues and SLCs from the pool's projected revenue requirement, after removing pay telephone costs and revenues. Our rules currently provide that the NECA CCL tariff be set to recover the average of price cap LECs' CCL charges.[565] If we were to retain this rule, our decision eliminating LTS obligations for price cap LECs and requiring them to reduce their CCL charges accordingly would automatically reduce the CCL revenues of NECA pool members. Further, reductions would occur as price cap LECs implemented our decisions in Section III of this Order, which restructures the common line rate structure for price cap LECs to recover common line costs through flat-rated charges instead of the per-minute CCL charge. Because we have deferred consideration of access reform for non-price cap LECs[566] and did not seek comment on this issue in the NPRM, we must address this issue in a future proceeding that undertakes access reform for small, non-price cap LECs.

b. Recovery of New Universal Service Obligations

378. In the *Universal Service Order*, we conclude that assessment of contributions for the interstate portion of the high cost and low-income support mechanisms shall be based solely on end-user interstate revenues,[567] and that assessment of universal support for eligible schools, libraries, and rural health care providers shall be based on interstate and intrastate total end-user revenues.[568] As to the manner in which carriers may recover their contributions to the universal service fund, in our *Universal Service Order* we conclude that carriers may recover universal service contributions via interstate mechanisms.[569] In this Section, we address the manner in which incumbent price cap LECs may recover their universal service contributions. We address non-price cap LECs' recovery of universal service contributions in Section XIII.F of the *Universal*

[563] *See* 47 C.F.R. § 69.105(b)(2).

[564] The actual rate of return that pooling companies earn on a monthly basis is determined by the total rate of return that the pool earns, *i.e.*, the difference between the total costs that the pooling companies submit and the total amount of revenue in the pool, as a percentage of all pooling companies' total common line investment.

[565] *See* 47 C.F.R. § 69.105(b)(2).

[566] *See* Section V.B, *supra*.

[567] *See* Sections VII, VIII, and XIII.F of the *Universal Service Order*.

[568] *See* Sections X, XI, and XIII.F of the *Universal Service Order*.

[569] *See* Section XII of the *Universal Service Order*.

Service Order.

379. Price cap LECs may treat their contributions to the new universal service mechanisms, including high cost and low-income support and support for eligible schools, libraries, and health care, as exogenous changes to their price cap indices (PCIs).[570] Because the only interstate revenues that will serve as the basis for assessing universal service contributions in 1998 will be end-user revenues, we find that price cap LECs recovering their universal service obligation through interstate access charges must recover those contributions in the baskets for services that generate end-user interstate revenues. Because price cap LECs do not recover revenues from end users of services in all baskets, the exogenous adjustment should not be across-the-board. The baskets containing end-user interstate services are the common line, interexchange, and trunking baskets.[571] Price cap LECs electing to recover their universal service obligation through interstate access charges must therefore apply the full amount of the exogenous adjustment among these three baskets on the basis of relative size of end-user revenues. We note, however, that the tandem-switched transport, interconnection charge, and tandem switch signalling service categories[572] in the trunking basket do not recover end-user interstate revenues. In order to prevent recovery from customers of these services, the service band indices (SBI) for these service categories should not be increased to reflect the exogenous adjustment to the PCI for the trunking basket. To reflect the exogenous adjustment to the trunking basket PCI, price cap LECs should, instead, increase the SBIs for the remaining service categories in the trunking basket[573] based on the relative end-user interstate revenues generated in each service category.

380. In 1999, the percentage of price cap LECs' revenues that will be assessed for universal service support may increase as a result of the anticipated increases in high cost, low-income support and support for schools, libraries, and health care in 1999. Price cap LECs shall therefore perform an upward exogenous adjustment to the PCIs for the common line, interexchange, and trunking baskets in the same manner as the exogenous adjustment performed in 1998, to reflect any change in the assessment rate in 1999.

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[570] *See* Section XIII.F of the *Universal Service Order*.

[571] The end-user charges assessed on services in the common line basket are recovered through the SLC; in the interexchange basket, end-user charges are recovered through per-minute toll charges; and in the trunking basket, end user charges are recovered through special access service provided directly to end users.

[572] 47 C.F.R. §§ 61.42(e)(2)(v), (vi), and (vii).

[573] The four remaining service categories in the trunking basket are as follows: (1) voice grade entrance facilities, voice grade direct-trunked transport, voice grade dedicated signalling transport, voice grade special access, WATS special access, metallic special access, and telegraph special access services; (2) audio and video service; (3) high capacity flat-rated transport, high capacity special access, and DDS services; and (4) wideband data and wideband analog services. *See* 47 C.F.R. §§ 61.42(e)(2)(i), (ii), (iii), (iv).

c. Adjustments to Interstate Access Charges to Reflect Additional Support from the Modified Universal Service Mechanisms

381. In our *Universal Service Order*, we conclude that the federal universal service mechanism should support 25 percent of the difference between the forward-looking economic cost of serving the customer and the appropriate revenue benchmark.[574] We further conclude in that order that 25 percent approximates the portion of the cost of providing the supported network facilities that would be assigned to the interstate jurisdiction, and that, by funding these interstate costs, we will ensure that federal implicit universal service support is made explicit. Consistent with our decision in the *Universal Service Order* to fund only interstate costs through the federal universal service fund, we direct incumbent LECs to use any universal service support received from the new universal service mechanisms to reduce or satisfy the interstate revenue requirement otherwise collected through interstate access charges.

382. *Non-Rural Carriers.* In our *Universal Service Order*, we conclude that, until a forward-looking economic cost methodology takes effect on January 1, 1999, non-rural carriers will continue to receive high cost assistance and LTS amounts based on the existing universal service mechanisms.[575] As there will be no change until January 1, 1999 to the support non-rural incumbent LECs currently receive as high cost and LTS support, we conclude that it is not necessary at this time to determine the manner in which non-rural carriers should adjust their interstate access charges to reflect a difference in universal service support. We will address this issue prior to the January 1, 1999, effective date of the forward-looking cost mechanisms for non-rural carriers.

383. *Rural Carriers.* In our *Universal Service Order*, we conclude that rural carriers, as defined in section 153(37) of the Act,[576] shall continue to receive support based on embedded costs for at least three years.[577] Beginning on January 1, 1998, rural carriers shall receive high cost loop support, DEM weighting assistance, and LTS benefits on the basis of the modified support mechanisms.

384. In our *Universal Service Order*, we adopt modified per-line support mechanisms for providing support comparable to the LTS support received under the existing mechanisms. Beginning on January 1, 1998, we will allow a rural carrier's annual LTS support to increase from its support for the preceding calendar year based on the percentage of increase of the nationwide

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[574] *See* Section VII.C.6 of the *Universal Service Order*.

[575] *See* Section VII.D.1 of the *Universal Service Order*.

[576] *See* 47 U.S.C. § 153(37).

[577] *See* Section VII.D.2 of the *Universal Service Order*.

average loop cost.[578] Rural, non-price cap LECs should continue to apply any revenues received from the modified universal service support mechanisms that replace current LTS amounts to the accounts to which they are currently applying LTS support.

385. We also decide in the *Universal Service Order* that, from January 1, 1998 through December 31, 1999, rural carriers shall calculate their high cost support using the current high cost formulas. We conclude that no adjustment to rural incumbent LECs' interstate access charges is necessary at this time because incumbent LECs will continue to use the existing high cost formulas to determine high cost support. As we determine in that order, however, beginning January 1, 2000, rural carriers shall receive high cost loop support for their average loop costs that exceed 115 percent of an inflation-adjusted nationwide average loop cost. The inflation adjusted nationwide average cost per loop shall be calculated by multiplying the 1997 nationwide average cost per loop by the percentage in change in Gross Domestic Product Chained Price Index (GDP-CPI) from 1997-1998.[579] We conclude that rural, non-price cap LECs should continue to apply any revenues received from the modified universal service support mechanism that replace amounts received under the current high cost support system to the accounts to which they are currently applying high cost support.

386. Finally, in our *Universal Service Order*, we adopt the Joint Board's recommendation that a subsidy corresponding in amount to that generated formerly by DEM weighting be recovered from the new universal service support mechanisms.[580] Beginning on January 1, 1998 and continuing until permanent mechanisms for them become effective, rural carriers will receive DEM weighting assistance calculated as follows: assistance will equal the difference between the 1996 weighted DEM factor and the unweighted DEM factor multiplied by the annual unseparated local switching revenue requirement. As with comparable LTS and high cost support, rural, non-price cap LECs should continue to apply any support received from the modified universal service support mechanisms that replaces existing DEM weighting amounts to the accounts to which they are currently applying DEM weighting assistance.

387. Currently, the high cost and DEM weighting support mechanisms shift a portion of the intrastate revenue requirement to the interstate jurisdiction in order to permit LECs to recover a greater percentage of their costs from the interstate jurisdiction. Some non-price cap LECs are concerned that, to the extent that support from the modified universal service mechanisms is not

[578] *See* Section VII.D.2 of the *Universal Service Order*.

[579] *See* Section VII.D.2 of the *Universal Service Order*. The inflation adjusted nationwide average loop cost for the year 2000 shall be calculated in the following manner: 1998 GDP-CPI X 1997 nationwide average loop cost = 2000 inflation adjusted nationwide average loop cost.

[580] *See* Section VII of the *Universal Service Order*.

applied to the intrastate jurisdiction, an intrastate revenue shortfall will occur.[581] In the *Universal Service Order*, we conclude that, until universal service support is based on forward-looking economic cost, carriers should continue to receive amounts from the new universal service mechanisms comparable to existing high cost and DEM weighting support. In that order, we do not alter the existing revenue-shifting mechanisms in place for the current high cost support and DEM weighting at this time.[582] Thus, no intrastate revenue shortfall will occur, because no revenue requirement is being shifted back to the intrastate jurisdiction.

E. Part 69 Allocation Rules

1. Background

388. In the NPRM, we solicited comment on whether it would be appropriate for incumbent price cap LECs to be relieved of complying with Subparts D and E of Part 69 of our rules, which address the allocation of investments and expenses to the access rate elements.[583]

2. Discussion

389. We conclude that at this time we should maintain our Part 69 cost allocation rules. In this Report and Order, we have instituted a phasing out of the CCL charge. Until the per-minute CCL charge is phased out completely and multi-line PICCs do not recover any common line revenues,[584] price cap LECs will need to use these rules to calculate the SLC. Therefore, we decline to eliminate the cost allocation rules at this time. We note that we may revisit this issue when these rules are no longer needed to calculate the SLC.

F. Other Proposed Part 69 Changes

1. Background

390. In the NPRM, we sought comment on revisions necessary to update Part 69 and conform it to the 1996 Act. In the NPRM, we made several proposals that we thought necessary to bring Part 69 current, including: eliminating the rules that provide for a "contribution charge" that may be assessed on special access and expanded interconnection; removing the rule and sections referencing the rule that establishes the equal access rate element; and removing the rule

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[581] *See, e.g.*, Roseville Tel. Comments at 16.

[582] *See* Section VII.D of the *Universal Service Order*.

[583] NPRM at ¶ 294.

[584] *See* Section III.A.

and sections referencing the rule that establishes a rate element for costs associated with lines terminating at "limited pay telephones"; and changing the definition of "Telephone Company" to mean incumbent LEC. We also sought comment on whether rate elements and subelements established pursuant to waiver should be incorporated into Part 69.[585]

2. Discussion

391. The passage of the 1996 Act and the subsequent enactment of implementing regulations requires that we update and revise various sections of Part 69. Sections 69.4(f) and 69.122 of our rules provide for a "contribution charge" that may be assessed on special access and expanded interconnection. These sections are inconsistent with section 254 as amended by the 1996 Act, which requires, *inter alia*, that such carrier contributions be equitable and nondiscriminatory. Furthermore, our rules governing the contribution charge merely allow a LEC to try to justify this charge in the expanded interconnection context. No party has even attempted to justify such a charge in more than four years. Given this and the relevant amendments in the 1996 Act, we find that there is no need for this rate element. We conclude that sections 69.4(f) and 69.122 of our rules, which provide for a "contribution charge" that may be assessed on special access and expanded interconnection, should be deleted.

392. Under Part 69, we required carriers to eliminate any separate equal access charge by January 1, 1994.[586] We conclude, therefore, that section 69.4(d), which established the equal access rate element for a limited duration, should be deleted because of the expiration of the designated time period. Similarly, we conclude that section 69.107, which governs the computation of the equal access rate element charges, and sections 69.308 and 69.410, which concern allocation of costs to that rate element, should be deleted because the designated time period for separate equal access rate elements has expired. We conclude that references to these deleted sections should also be removed from Part 69.[587] To ensure consistency, a new section, designated as section 69.3(3)(12), should be added and should read as follows: "Such a tariff shall not contain any separate carrier's carrier tariff charges for an Equal Access element." Similarly, we conclude that section 69.205, which concerns transitional premium charges for IXCs and others should be deleted because the designated transition period for these charges has expired.

393. Section 69.103 requires incumbent LECs to establish a separate rate element for

[585] NPRM at ¶¶ 295-299.

[586] 47 C.F.R. § 69.4(d).

[587] Section 69.309 refers to section 69.308 and section 69.411 refers to section 69.410.

costs associated with lines terminating at "limited pay telephones."[588] Sections 69.303(a), 69.304(c), 69.307(c), and 69.406(a)(9) concern the allocation of costs to this rate element. Section 276 of the Act and the implementing regulations require a new per call compensation plan, which requires, *inter alia*, that incumbent LECs remove all payphone costs from access charges.[589] This new compensation plan, as well as the payphone dialing parity requirements,[590] have eliminated the need for sections 69.103, 69.303(a), 69.304(c), 69.307(c), and 69.406(a)(9). We conclude that these sections should be deleted.

394. We conclude that codifying previously-granted Part 69 waivers is not necessary at this time. Under the *Price Cap Performance Review Third Report and Order*, a party seeking to introduce a new service may do so by filing a petition showing that the new service is in the public interest.[591] Once that petition for a new service has been granted, carriers seeking to introduce the same service with the same rate structure may do so under expedited procedures.[592] This streamlined alternative for introducing new services should resolve past difficulties encountered with the Part 69 waiver process. The proposed codification of previously-granted waivers is thus unnecessary. We therefore decline to codify previously-granted Part 69 waivers into our rules.

395. NECA and TCA have requested that the Commission extend to all rate-of-return companies, the right to offer new services based on an expedited process, which requires, *inter alia*, a showing that the new service is in the public interest. In the Third Report and Order, we granted to incumbent price cap LECs the right to introduce new services under a streamlined procedure.[593] We will address the request of NECA and TCA when we take up access reform for rate-of-return companies in the near future.

396. In the NPRM, we solicited comment on whether we should adopt regulatory requirements to govern rates for terminating access offered by competitive LECs. In Section VI.C., *supra*, we conclude that we will not adopt such regulatory requirement at this time. For the same reasons, we find it unnecessary to apply any of our Part 69 regulations to competitive

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[588] We note that few, if any, payphone service providers offer this type of service today.

[589] Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, Report and Order, CC Docket No. 96-128, FCC 96-388 (rel. Sep. 20, 1996) (*Payphone Order*), *recon.*, FCC 96-439 (rel. Nov. 8, 1996) (*Payphone Reconsideration Order*), *appeal docketed sub nom., Illinois Public Telecommunications Ass'n v. FCC and United States*, Case No. 96-1394 (D.C. Cir., filed Oct. 17, 1996).

[590] *Payphone Order* at ¶¶ 291-293.

[591] NPRM at ¶ 309.

[592] NPRM at ¶ 310.

[593] NPRM at ¶¶ 309-310.

LECs. We therefore conclude that Section 69.2(hh), which currently defines "Telephone Company" by reference to Section 3(r) of the 1934 Act, should be changed to read as follows: "`Telephone Company' or `local exchange carrier' as used in this Part means an incumbent local exchange carrier as defined in section 251(h)(1) of the 1934 Act as amended by the 1996 Act." There is no indication in the record that competitive LECs have exercised any degree of market power in provision of terminating access or other access services. By definition, non-dominant carriers do not exercise market power. Further, non-dominant carriers possess a negligible share of the current access market and they will be competing with incumbent LECs whose rates are subject to regulation. As a practical matter, the rates of the incumbent LECs will serve as a constraint to some degree on the pricing and practices of non-dominant LECs. We therefore find on this record that it is sufficient to rely on the Section 208 complaint process to assure compliance with the Act by competitive LECs, and that we should not apply Part 69 to them. To the extent that our definitions or our application of Part 69 needs in the future to be expanded to encompass LECs other than incumbent LECs, we can revisit this issue.

VII. FURTHER NOTICE OF PROPOSED RULEMAKING

A. PICCs for Special Access Lines

397. In this Further Notice of Proposed Rulemaking, we seek comment on our proposal to allow incumbent local exchange carriers to impose a PICC on special access lines.

1. Background

398. As discussed in Section III.A., in most cases, the $3.50 SLC ceiling for primary residential and single-line business customers does not allow recovery through the SLC of the average per-line common line revenues permitted under our price cap rules. Similarly, in certain service areas, the $6.00 SLC for multi-line business lines is insufficient to recover the average per-line revenues permitted by price cap regulation. To alleviate this shortfall, we are instituting a number of changes, including raising the ceiling on the SLC for multi-line business and second and additional residential lines.[594] Although this increase in the SLC will recover some of the shortfall, other measures are needed to allow recovery of the common line revenues permitted under our rules.

399. Therefore, we have permitted LECs to recover common line revenues not recovered from the SLC by assessing flat, per-line charges on the end-user's presubscribed interexchange carrier. Specifically, we are permitting LECs to assess a PICC on all lines, subject to ceilings which will be increased each year. To the extent that the revenues from SLCs and PICCs on primary residential lines and single-line business lines are insufficient to recover the full common

[594] *See* Section III.A. for additional revisions to the recovery of common line revenues.

line revenues permitted by our price cap rules for these lines, or the multi-line SLCs are at their ceilings, incumbent LECs shall recover the difference by assessing an additional PICC on non-primary residential and multi-line business lines. To the extent that these PICCs do not recover an incumbent LEC's remaining permitted CCL revenues, incumbent LECs generally shall recover any such residual common line revenues through per-minute CCL charges assessed on originating access minutes.

400. As a result of our new rules, certain multi-line businesses will be paying higher SLCs than they do now. Similarly, as the PICCs are phased in, IXCs initially will be required to pay higher PICCs for a multi-line business end user compared to the PICC paid for a primary residential end user or a single-line business end user.

401. In contrast, users of special access do not pay a SLC. Furthermore, under special access, IXCs do not incur the same local access charges that are incurred by end users using switched access. In light of our most recent changes to charges incurred by multi-line businesses, including the higher SLC and the new multi-line business PICC, it may be cost effective for some multi-line businesses that are currently using switched access to purchase instead special access lines.

402. We are concerned that these facts could lead to the migration of certain businesses from the public switched network to special access, which would result in a decrease in projected revenue from multi-line SLCs. As a result PICCs for all remaining switched access lines will necessarily increase to make up for the loss of revenue.

2. Proposal

403. We tentatively conclude that we should permit price cap LECs to assess a PICC on special access lines to recover revenues for the common line basket. The special access PICC would be no higher than the PICC that an incumbent LEC could charge for a multi-line business line. Under our proposal, the special access PICC would not recover TIC or marketing expense.

404. We acknowledge that our proposal is a departure from established Commission practice that special access will not subsidize other services. Although our proposal is a subsidy, it is temporary in nature and will be phased out as the single-line PICC is phased in. We tentatively conclude that our proposal is necessary for our transition from the per-minute CCL charge to the flat PICC to work.

405. We invite parties to comment on this proposal. We also seek comment on how special access connections should be counted for purposes of assessing a "per line" PICC. Parties should also address the extent to which our proposal affects large and small LECs differently and

how small business entities, including small incumbent LECs and new entrants, will be affected.[595]

406. Consistent with our approach to reform the interstate access charge regime, however, we tentatively conclude that the scope of this proceeding should be limited to incumbent price cap LECs. As discussed in Section V., *supra*, we have limited the scope of access reform, with some limited exceptions, to price cap incumbent LECs.[596] Similarly, we limit the scope of this NPRM. To the extent necessary, we will instead address the effect of these issues on rate-of-return carriers in our separate access reform proceeding for rate-of-return carriers in 1997. In that proceeding, we will have the opportunity to conduct a comprehensive review of the circumstances unique to these carriers. We seek comment on this tentative conclusion regarding the scope of this proceeding. We also invite parties to identify any changes that should be made to other access elements as a result of this proposed change.

B. General Support Facilities Costs

407. As discussed in Section IV. D above, the current allocation of GSF costs enables incumbent LECs to recover through regulated interstate access charges costs associated with the LECs' nonregulated billing and collection functions. In this section, we seek comment on proposed changes in the allocation of price cap LECs' interstate costs between regulated interstate services and nonregulated billing and collection activities.

1. Background

408. The costs that incumbent LECs recover through interstate access charges are determined by a multi-step process. Incumbent LECs first record their investment costs and booked expenses in the accounts prescribed by the Commission's Part 32 Uniform System of Accounts (USOA).[597] They next divide the recorded investment and expenses between regulated and nonregulated services pursuant to Part 64 of the Commission's rules. Incumbent LECs then divide regulated expenses and investment costs between the state and interstate jurisdictions pursuant to the separations procedures prescribed in Part 36 of the Commission's rules.[598] Finally, in accordance with our Part 69 access charge rules, the LEC apportions its regulated interstate

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[595] *See* Regulatory Flexibility Act, 5 U.S.C. §§ 601 *et seq*.

[596] These incumbent LECs are the seven Regional Bell Operating Companies (Ameritech, Bell Atlantic, BellSouth, NYNEX, Pacific Telesis, SWBT, U S West), Citizens, Frontier, GTE, Aliant (formerly Lincoln), SNET, and United/Central.

[597] *See* 47 C.F.R. Part 32.

[598] *See* 47 C.F.R. Part 36.

costs among the interstate access and interexchange service categories.[599]

409. Because the Part 69 access charge rules are applied at the end of this multi-step process, they are written to accommodate the accounts defined by the USOA and the cost categories prescribed by the Separations Manual. In 1987, the Commission revised its access charge rules[600] in response to the Commission's comprehensive revision of both the USOA[601] and the Separations Manual.[602] In its *Part 69 Conformance Order*, the Commission amended Part 69 to reapportion regulated interstate costs, including General Support Facilities (GSF) investment expenses, among the existing access elements.

410. As discussed in Section IV.D above, the GSF investment category in Part 36 includes assets that support other operations, such as land, buildings, vehicles, as well as general purpose computer investment accounted for in USOA Account 2124.[603] Some incumbent LECs use general purpose computer equipment, which is included in the GSF investment category, to provide nonregulated billing and collection services to IXCs.[604] The costs of providing interstate billing and collection service are not, however, treated as nonregulated in the Part 64 cost allocation process. Instead, nonregulated interstate billing and collection costs are identified through the Part 36 and Part 69 cost allocation process. The separations process allocates these costs to the various separations categories based on the separations of the three largest categories of expenses, *i.e.*, plant specific expenses, plant non-specific expenses, and customer operations

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[599] *See* 47 C.F.R. Part 69.

[600] Amendment of Part 69 of the Commission's Rules and Regulations, Access Charges, To Conform It With Part 36, Jurisdictional Separations Procedures, CC Docket No. 87-113, Report and Order, 2 FCC Rcd 6447 (1987) (*Part 69 Conformance Order*).

[601] Revision of the Uniform System of Accounts and Financial Reporting Requirements for Class A and Class B Telephone Companies (Parts 31, 33, 42, and 43 of the FCC's Rules), CC Docket No. 78-196, Report and Order, FCC 86-221 (rel. May 15, 1986) (creating Part 32 of the Commission's rules).

[602] MTS and WATS Market Structure, Amendments of Part 67 (New Part 36) of the Commission's Rules and Establishment of a Federal-State Joint Board, CC Docket Nos. 78-72, 80-286, and 86-297, Report and Order, 2 FCC Rcd 2639 (1987). *See* Part 36 of the Commission's rules, 47 C.F.R. Part 36.

[603] *See* 47 C.F.R. § 36.111.

[604] In 1986, the Commission found that the market for billing and collection service was sufficiently competitive that it was not necessary to require LECs to provide that service as a tariffed common carrier service. The Commission did not, however, pre-empt state regulation of billing and collection services. *See* Detariffing of Billing and Collection Services, CC Docket No. 85-88, 102 FCC 2d 1150 (1986) (*Billing and Collection Detariffing Order*); *recon. denied*, 1 FCC Rcd 445 (1986). The Commission later decided to treat billing and collection costs as regulated for accounting purposes because it found that such treatment was less likely to misallocate these costs between the interstate and intrastate jurisdictions. Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities, Report and Order, CC Docket No. 86-111, 2 FCC Rcd 1298, 1309 (1987) (*Joint Cost Order*).

expenses.[605]

411. In its comments in response to the NPRM, AT&T refers to the allocation of embedded GSF expenses, including general purpose computer expenses, among access categories as a misallocation resulting in an implicit cross-subsidy of incumbent LECs' nonregulated billing and collection services. This allocation, AT&T contends, results in the inappropriate support through regulated access charges of LECs' billing and collection service, which is a nonregulated, interstate service. AT&T estimates that $124 million of expenses recovered in interstate access support the nonregulated billing and collection category.[606] Of the $124 million, AT&T states that $60.1 million is included in interstate switched access, and $20.5 million is in interstate special access, with the remainder recovered by the SLC.[607]

2. Proposal

412. The failure of Part 69 to assign general purpose computer costs to the billing and collection category can be traced to our decision in the *Part 69 Conformance Order* to use an investment-based allocator to apportion general support facilities (GSF) investment.[608] As discussed in Section IV.D above, Section 69.307 of the Commission's rules apportions GSF investment among the billing and collection category, the interexchange category, and the access elements based on the amount of Central Office Equipment (COE), Cable and Wire Facilities (CWF), and Information Origination/Termination Equipment (IO/T) investment allocated to each Part 69 category.[609] This rule appears on its face to provide for an allocation of GSF investment to billing and collection. Because no COE, CWF, or IO/T investment is allocated to the billing and collection category, however, no GSF investment, and thus no portion of general purpose computer investment, is allocated to the billing and collection category. Similarly, because expenses related to GSF investment are allocated in the same manner as GSF investment, no GSF expenses (including expenses related to general purpose computers) are allocated to billing and collection. Price cap LECs' costs allocated to the interstate billing and collection category are

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[605] These three largest categories, or the "Big Three Expenses," are the combined expense groups comprising: (1) Plant Specific Operations Expense, Accounts 6110, 6120, 6210, 6220, 6230, 6310, and 6410; (2) Plant Nonspecific Operations Expenses, Accounts 6510, 6530, and 6540; and (3) Customer Operations Expenses, Accounts 6610 and 6620. 47 C.F.R. § 69.2(e). The "Big Three Expense Factors" are the ratios of the sum of Big Three Expenses apportioned to each element or category to the combined Big Three Expenses. 47 C.F.R. § 69.2(f).

[606] AT&T Comments at 67-68, Appendix E at 2.

[607] AT&T Comments Appendix E at 2.

[608] *Part 69 Conformance Order*, 2 FCC Rcd at 6452.

[609] 47 C.F.R. § 69.307(c).

estimated to be approximately $480 million.[610]

413. As discussed in Section V of the *Access Reform Order*, we limit the scope of access reform, with some limited exceptions, to price cap incumbent LECs. Consistent with our approach to reform the interstate access charge regime, we tentatively conclude that our proposed changes to the allocation of GSF investment will apply only to price cap LECs. We will address the misallocation of rate-of-return LECs' interstate costs between regulated interstate services and nonregulated billing and collection activities in our separate access reform proceeding for rate-of-return carriers in 1997, which will provide us with the opportunity to conduct a comprehensive review of the circumstances unique to these carriers. We seek comment on this tentative conclusion regarding the scope of this proceeding.

414. To the extent that incumbent LECs' costs are underallocated to the billing and collection category, incumbent LECs' regulated services are recovering through interstate access charges costs associated with unregulated services. We therefore tentatively conclude that price cap incumbent LECs' general purpose computer costs attributable to billing and collection should not be recovered through regulated access charges. We seek comment on two options for reassigning these costs to the billing and collection category.

415. Under the first option, a price cap LEC would study the uses of the general purpose computer assets recorded in Account 2124 to determine the percentage of investment in that account that is used for billing and collection activities.[611] That percentage, multiplied by the ratio of the dollar amount in Account 2124 to the dollar amount in Account 2110,[612] which accumulates the total GSF investment, would be applied to the interstate portion of Account 2110 to determine a dollar amount that represents general purpose computer assets used for interstate billing and collection activities. The dollar amount so identified would be attributed directly to the billing and collection category. The remainder of the interstate portion of Account 2110 shall be apportioned among the access elements and the interexchange category using the current investment allocator. General purpose computer expenses recorded in Account 6124 would be treated in a similar fashion to Account 2124.[613] The interstate portion of Account 6124 would be allocated between (a) the billing and collection category and (b) all other elements and categories using the percentage derived for Account 2124. The remainder of Account 6120 (GSF expense)

[610] 1996 ARMIS Access Report.

[611] Investment in general purpose computer equipment is recorded in Account 2124. *See* 47 C.F.R. § 32.2124.

[612] Investment in land and support assets is recorded in Account 2110. *See* 47 C.F.R. § 32.2110.

[613] General purpose computers expenses are recorded in Account 6124. *See* 47 C.F.R. § 32.6124.

would be apportioned based on current GSF allocators.[614] Appropriate downward exogenous cost adjustments would be made to all price cap baskets.

416. Two objections are commonly raised to the use of special studies to make regulatory cost allocations. First, such studies are said to be costly. We recognize that there are costs attached to a special study approach. We note, however, that price cap LECs may already be required to study the use of computer investment in Account 2124 as part of the process of allocating that investment between regulated and nonregulated activities pursuant to the Part 64 joint cost rules. Second, it may be claimed that permitting price cap LECs to use special studies gives them too much discretion and that regulators are unable to ascertain the validity of the studies. To remedy this concern, we propose that each price cap LEC add to its cost allocation manual (CAM) a new section entitled "Interstate Billing and Collection." That section would describe: (1) the manner in which the price cap LEC provides interstate billing and collection services, and (2) the study it uses to determine the portion of Account 2124 investment that it attributes to the billing and collection category. The special study would then be subject to the same independent audit requirements as other regulated and nonregulated cost allocations. In addition, to obtain an independent certification of the validity of the procedures adopted by the price cap LEC, we would instruct the independent auditors to examine the design and execution of the study during the first independent audit following the addition of the billing and collection section to the CAM and to report their conclusions on the validity of the study.

417. Under the second option, we would modify Section 69.307 of our rules to require use of a general expense allocator to allocate the interstate portion of Account 2110 between: (1) the billing and collection category, and (2) all other elements and categories. We propose to use the "Big Three Expense" allocator used elsewhere in Part 69,[615] excluding, however, any account or portion of an account that is itself apportioned based on the apportionment of GSF to avoid circularity. The GSF investment not allocated to the billing and collection category would then be apportioned among the access elements and the interexchange category using the current investment allocator. This would ensure that GSF costs are allocated among all access categories, including the billing and collection category. The interstate portion of Account 6120 would be apportioned among all elements and categories based on the overall apportionment of GSF investment. This option covers only price cap incumbent LECs that provide interstate billing and collection using regulated assets. Carriers that acquire billing and collection services from unregulated affiliates through affiliate transactions or from third parties would continue recording their expenses for acquiring such services in Account 6623,[616] which is already apportioned to the billing and collection category.

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[614] General support expenses are recorded in Account 6120. *See* 47 C.F.R. § 32.6120.

[615] *See* 47 C.F.R. § 69.2(f).

[616] *See* 47 C.F.R. § 32.6623.

418. We invite parties to comment on the feasibility of these two options and propose alternative methods for reassigning general purpose computer costs to the billing and collection category. Parties should also address the extent to which either option affects large and small LECs differently and how small business entities, including small incumbent LECs and new entrants, will be affected.[617] We invite parties to identify any changes that should be made to other access elements as a result of any changes we may make to the GSF allocation procedures.

VIII. FINAL REGULATORY FLEXIBILITY ANALYSIS

419. As required by the Regulatory Flexibility Act (RFA),[618] an Initial Regulatory Flexibility Analysis (IRFA) was incorporated in the NPRM in this proceeding.[619] The Commission sought written public comments on the proposals in the NPRM, including the IRFA. The Commission's Final Regulatory Flexibility Analysis (FRFA) in this Order (the First Report and Order in this Access Charge Reform proceeding) conforms to the RFA, as amended.[620] We provide this summary analysis to provide context for our analysis in this FRFA. To the extent that any statement contained in this FRFA is perceived as creating ambiguity with respect to our rules or statements made in preceding sections of this Order, the rules and statements set forth in those preceding sections shall be controlling.

A. Need for and Objectives of this First Report and Order

420. The Telecommunications Act of 1996 requires incumbent LECs to offer interconnection and unbundled elements on an unbundled basis, and imposes a duty to establish reciprocal compensation arrangements for the transport and termination of calls. The Commission's access charge rules were adopted at a time when interstate access and local exchange services were offered on a monopoly basis, and in many cases are inconsistent with the competitive market envisioned by the 1996 Act. This proceeding is being conducted to revise the Commission's access charge rules to make them consistent with the Telecommunications Act of 1996.

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[617] *See* Regulatory Flexibility Act, 5 U.S.C. §§ 601 *et seq*.

[618] *See* 5 U.S.C. § 603.

[619] NPRM at ¶¶ 321-37.

[620] *See* 5 U.S.C. § 604. The Regulatory Flexibility Act, 5 U.S.C. § 601 *et. seq.*, was amended by the "Small Business Regulatory Enforcement Fairness Act of 1996" (SBREFA), which was enacted as Title II of the Contract With America Advancement Act of 1996, Pub.L. No. 104-121, 110 Stat. 847 (1996) (CWAAA).

B. Summary of Significant Issues Raised by the Public Comments in Response to the IRFA

421. Only one party, Rural Tel. Coalition, commented on the IRFA contained in the NPRM. Rural Tel. Coalition disagrees with our conclusion that rules applying only to price cap LECs will not affect non-price cap LECs in a way that requires analysis under the RFA. According to Rural Tel. Coalition, the decisions made in this Order will "prejudge and prejudice" a later rulemaking addressing access charge reform for non-price cap LECs.[621] In addition, Rural Tel. Coalition argues that non-price cap LECs, which include small incumbent LECs, will be injured if the access reform issues addressed in this Order are not implemented for them as well as price-cap LECs. Finally, Rural Tel. Coalition argues that the Commission impermissibly determined that small incumbent LECs are not small businesses within the meaning of the RFA.[622]

422. Rather than attempt to enact "one size fits all" access charge reform that would risk not fully accounting for the special circumstances of rate-of-return and other non-price cap LECs, we have chosen to address those LECs separately in a proceeding in which we may better focus on their needs. We do not agree with Rural Tel. Coalition that our decisions in this Order will "prejudge and prejudice" our consideration of the issues in a subsequent rulemaking. Although we may often find that the public interest concerns are similar for large and small carriers, our analysis will begin anew, and will address all relevant factors. Moreover, where the special circumstances faced by small incumbent LECs justify different treatment than is accorded price cap LECs in this Order, we will be better able to explain and address those concerns in a separate proceeding. For the reasons set forth in Section V above, we also disagree with Rural Tel. Coalition that small incumbent LECs may be injured by the delay involved in conducting separate rulemakings. Finally, although we are not persuaded on the basis of this record that our prior practice of finding incumbent LECs not subject to regulatory flexibility analysis (because they are not small businesses) has been incorrect,[623] we have fully performed an RFA analysis for small incumbent LECs in this Order, including consideration of any adverse impact of the rules we adopt and consideration of alternatives that may reduce adverse impacts on such entities.

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[621] Rural Tel. Coalition Comments at 4, 32.

[622] *Id*. at 32-35.

[623] *See Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, First Report and Order, 11 FCC Rcd 15499 ¶¶ 1328-30 (1996) (*Local Competition Order*), *motion for stay denied*, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, Order, 11 FCC Rcd 11754 (1996), *partial stay granted*, *Iowa Utilities Board v. FCC*, No. 96-3321, 1996 WL 589204 (8th Cir. 1996).

C. Description and Estimate of the Number of Small Entities To Which the Rules Will Apply:

423. The RFA generally defines "small entity " as having the same meaning as the terms "small business," "small organization," and "small governmental jurisdiction."[624] In addition, the term "small business" has the same meaning as the term "small business concern" under the Small Business Act unless the Commission has developed one or more definitions that are appropriate for its activities.[625] A small business concern is one which: (1) is independently owned and operated; (2) is not dominant in its field of operation; and (3) satisfies any additional criteria established by the Small Business Administration (SBA).[626]

424. Pursuant to 5 U.S.C. § 601(3), the statutory definition of a small business applies "unless an agency after consultation with the Office of Advocacy of the Small Business Administration and after opportunity for public comment, establishes one or more definitions of such term which are appropriate to the activities of the agency and publishes such definition(s) in the Federal Register." SBA has developed a definition of small business for Standard Industrial Classification (SIC) category 4813 (Telephone Communications, Except Radiotelephone). We first discuss the number of small businesses falling within this category, and then we attempt to refine further our estimate to correspond with the categories of telephone companies that are commonly used under our rules.

425. Consistent with our prior practice, our use of the terms "small entities" and "small businesses" does not encompass "small incumbent LECs." We use the term "small incumbent LECs" to refer to any incumbent LECs that arguably might be defined by SBA as "small business concerns."[627] Because the small incumbent LECs subject to these rules are either dominant in their field of operations or are not independently owned and operated, they are, consistent with our prior practice, excluded from the definition of "small entity" and "small business concerns."[628] Out of an abundance of caution, however, for regulatory flexibility analysis purposes, we will consider small incumbent LECs within this analysis and use the term "small incumbent LECs" to refer to any incumbent LECs that arguably might be defined by the SBA as "small business concerns."[629]

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[624] 5 U.S.C. § 601(6).

[625] 5 U.S.C. § 601(3) (incorporating by reference the definition of "small business concern" in 15 U.S.C. § 632).

[626] Small Business Act, 15 U.S.C. § 632 (1996).

[627] *See* 13 C.F.R. § 121.210 (SIC 4813).

[628] *See Local Competition Order*, 11 FCC Rcd at 15499 ¶¶ 1328-30, 1342.

[629] *Id.*

1. Telephone Companies, Except Radiotelephone Companies (SIC 4813)

426. *Total Number of Telephone Companies Affected.* The United States Bureau of the Census ("the Census Bureau") reports that, at the end of 1992, there were 3,497 firms engaged in providing telephone services, as defined therein, for at least one year.[630] This number contains a variety of different categories of carriers, including local exchange carriers, interexchange carriers, competitive access providers, cellular carriers, mobile service carriers, operator service providers, pay telephone operators, personal communications services providers, covered specialized mobile radio providers, and resellers. It seems certain that some of those 3,497 telephone service firms may not qualify as small entities or small incumbent LECs because they are not "independently owned and operated."[631] For example, a PCS provider that is affiliated with an interexchange carrier having more than 1,500 employees would not meet the definition of a small business. It seems reasonable to conclude that fewer than 3,497 telephone service firms are small entity telephone service firms or small incumbent local exchange carriers.

427. According to the *Telecommunications Industry Revenue: Telecommunications Relay Service Fund Worksheet Data (TRS Worksheet)*, there are 2,847 interstate carriers. These carriers include, *inter alia*, local exchange carriers, wireline carriers and service providers, interexchange carriers, competitive access providers, operator service providers, pay telephone operators, providers of telephone toll service, providers of telephone exchange service, and resellers.

428. *Wireline Carriers and Service Providers.* The SBA has developed a definition of small entities for telephone communications companies other than radiotelephone (wireless) companies. According to the SBA's definition, a small business telephone company other than a radiotelephone company is one employing no more than 1,500 persons.[632] The Census Bureau reports that, there were 2,321 such telephone companies in operation for at least one year at the end of 1992.[633] All but 26 of the 2,321 non-radiotelephone companies listed by the Census Bureau were reported to have fewer than 1,000 employees. Thus, even if all 26 of those companies had more than 1,500 employees, there would still be 2,295 non-radiotelephone companies that might qualify as small entities or small incumbent LECs. We do not have information on the number of carriers that are not independently owned and operated, and thus

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[630] United States Department of Commerce, Bureau of the Census, *1992 Census of Transportation, Communications, and Utilities: Establishment and Firm Size*, at Firm Size 1-123 (1995) (*1992 Census*).

[631] 15 U.S.C. § 632(a)(1).

[632] 13 CFR § 121.201, SIC Code 4812.

[633] *1992 Census, supra*, at Firm Size 1-123.

are unable at this time to estimate with greater precision the number of wireline carriers and service providers that would qualify as small business concerns under the SBA's definition. Consequently, we estimate that there are fewer than 2,295 small telephone communications companies other than radiotelephone companies.

429. *Incumbent Local Exchange Carriers*. Neither the Commission nor the SBA has developed a definition for small incumbent providers of local exchange services (LECs). The closest applicable definition under the SBA rules is for telephone communications companies other than radiotelephone (wireless) companies.[634] The most reliable source of information regarding the number of LECs nationwide is the data that we collect annually in connection with the *TRS Worksheet*. According to our most recent data, 1,347 companies reported that they were engaged in the provision of local exchange services.[635] We do not have information on the number of carriers that are not independently owned and operated, nor what carriers have more than 1,500 employees, and thus are unable at this time to estimate with greater precision the number of incumbent LECs that would qualify as small business concerns under SBA's definition. Consequently, we estimate that there are fewer than 1,347 small incumbent LECs.

2. Information Service Providers and Competitive LECs Are Not Affected

430. In Section VIII.B of the NPRM, we sought comment on whether to continue to exempt enhanced service providers (which we now refer to as information service providers, or ISPs) from any requirement to pay access charges. Because we decide to retain the ISP exemption, and do not permit LECs to impose access charges on ISPs at this time, we conclude that the RFA does not require us to consider the effects of any proposed rules on ISPs that fall within the definition of a small entity. Instead, as set forth in Section VI.B above, we find that the proceeding commenced with the Notice of Inquiry issued contemporaneously with the NPRM is the appropriate forum to address the fundamental questions about ISP usage of the public switched network.[636] Similarly, we sought comment in Section VIII.A of the NPRM on whether the public interest would be served by regulating interstate terminating access services offered by

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[634] 13 CFR § 121.201, SIC Code 4813.

[635] Federal Communications Commission, CCB, Industry Analysis Division, *Telecommunications Industry Revenue: TRS Fund Worksheet Data*, Tbl. 1 (Average Total Telecommunications Revenue Reported by Class of Carrier) (December 1996) (*TRS Worksheet*).

[636] *See In the Matter of* Usage of the Public Switched Network by Information Service and Internet Access Providers, Notice of Inquiry, CC Docket No. 96-263, __ FCC Rcd _____ (1996), __ Fed. Reg. _____ (Released December 24, 1996) (NOI). In the NOI, we sought comment on broader issues concerning the development of information services and Internet access. The information provided will give us the data we need to make further reasonable and informed decisions regarding Internet access and other information services, and, if necessary, to craft proposals for a subsequent Notice of Proposed Rulemaking that are sensitive to the complex economic, technical, and legal questions raised in this area.

competitive (non-incumbent) LECs. Because we conclude that the public interest would not be served by imposing any regulations on competitive LECs' interstate terminating access offerings at this time, we conclude that the RFA does not require us to consider the effects of any proposed rules on competitive LECs that fall within the definition of a small entity.

D. Summary Analysis of the Projected Reporting, Recordkeeping, and Other Compliance Requirements

431. In Section V.A above, we adopt changes to transport interconnection charge (TIC) rate structures and transport rate structures to comply with the court order in *CompTel v. FCC*.[637] These changes will affect all incumbent LECs, including small incumbent LECs, and will require small incumbent LECs to make one or more tariff filings reflecting the new rate structures, which will involve the use of legal skills, and possibly accounting, economic, and financial skills.

432. As set forth in Section VI.D above, incumbent LECs, including small incumbent LECs, must reduce their interstate access charges to reflect the elimination of those former universal service obligations that are being replaced with new universal service obligations, increase their interstate access charges to reflect their new universal service obligations, and, to the extent necessary, adjust their interstate access charges to account for any additional universal service funds received under the modified universal service mechanisms. This will require small incumbent LECs to make one or more tariff filings, which will involve the use of legal skills.

E. Burdens on Small Entities, and Significant Alternatives Considered and Rejected

433. *Sections III.C-D: Transport/TIC Rate Structure Changes*. As set forth in Sections III.C-D above, we adopt a new tandem-switched transport rate structure and rate levels that replace the interim rate structure in place prior to today. In addition, we adjust the TIC to reflect the changes made by the new tandem-switched transport rate structure and rate levels. Unlike before, we adopt for the first time a final, cost-based rate structure, which should reduce and minimize uncertainty for those small businesses and small incumbent LECs whose businesses involve these services. Moreover, the new rate structure and rate levels are more closely related to the costs of providing the underlying services, which should minimize the economic impact of these rules on small businesses and small incumbent LECs by minimizing the adverse impacts that can accompany non-cost based regulation.[638]

434. We also adopt a transition plan that will have the effect of giving small businesses

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[637] *CompTel v. FCC*, 87 F.3d 522 (D.C.Cir. 1996).

[638] *See* Section III.C.2.b *supra*.

and small incumbent LECs the opportunity to plan, adjust, and develop their networks with a minimum of disruption for them and their customers. Finally, as set forth in Section III.C-D above, we find that the reallocation of TIC costs and the new recovery procedures will facilitate the development of competitive markets. This is because incumbent LEC rates will move toward cost-based levels and incumbent LECs will no longer have the ability to assess TICs on switched access minutes that do not use their transport facilities. These pricing revisions may create new opportunities for small entities, including small business and small incumbent LECs wishing to enter local telecommunications markets.

435. *Section V: Access Reform for Incumbent Rate-of-Return Local Exchange Carriers*. Our decision to limit access charge reform, with certain specified exceptions, to price cap LECs, which do not include small businesses or small incumbent LECs, should mitigate the potential that access charge reform could have a significant economic impact on any small incumbent LECs. This is because the Commission will address in a separate proceeding the common set of complex issues faced by non-price cap LECs, which are different than those faced by price cap LECs. Moreover, as discussed above in Section V, we find that small incumbent LECs are unlikely to face imminent harm as a result of the continued application of our current access charge rules because all non-price cap incumbent LECs may be exempt from, or eligible for a modification or suspension of, the interconnection and unbundling requirements of the 1996 Act.

436. *Section VI.A: Applicability of Part 69 to Unbundled Elements*. As a result of the exclusion of unbundled elements from Part 69 access charges, described in Section VI.A above, incumbent LECs, including small incumbent LECs, may receive reduced overall levels of interstate access charges as competitors enter local markets using unbundled network elements. They will, however, receive payment for those unbundled network elements pursuant to interconnection agreements under Section 251 of the Act. Moreover, to the extent that small incumbent LECs receive universal service support through interstate access charges, such funding will continue to be received without regard to any loss of revenue from interstate access charges. This is because all universal service support received by small incumbent LECs will be received from the new Universal Service Fund, established in a separate order released today. Finally, we note that section 251 of the Act contains provisions expressly designed to take into account the special circumstances of small incumbent LECs, including those that qualify as rural LECs, with respect to interconnection obligations.

437. Our decisions in Section VI.A above to exclude unbundled elements from the application of Part 69 access charges is likely to facilitate the development of competitive markets. This is because prices for unbundled elements will reflect the costs of those elements, and will not impose on competitors additional charges unrelated to the costs of elements being purchased. Accordingly, as set forth in Section VI.A above, competitors using unbundled elements will contribute to universal service on an equitable and non-discriminatory basis instead of paying implicit subsidies to incumbent LECs (whether in addition to, or in place of, explicit universal service mechanisms). These decisions may create new opportunities for small entities,

including small businesses and small incumbent LECs, wishing to enter local telecommunications markets.

438. *Section VI.C: Terminating Access Services Offered by Non-Incumbent LECs*. As set forth in Section VI.C above, we find that treating new entrants as dominant carriers subject to regulation of their terminating access services until we find otherwise would impose unnecessary regulation, including potentially increased regulatory burdens on small businesses. Instead of imposing such burdens, we find that the imposition of regulatory requirements with respect to competitive LEC terminating access is unnecessary in the absence of some stronger record evidence that competitive LECs have in the past charged unreasonable terminating access rates, or are likely to do so in the future. If there is sufficient indication that competitive LECs are imposing unreasonable terminating access charges, we will revisit this issue.

439. *Section VI.D: Universal Service Related Part 69 Changes*. As set forth in Section VI.D.2.a above, we require that LECs that contribute to the Long Term Support (LTS) program and LECs that receive LTS payments revise their tariffs to reflect the fact that the LTS program is being replaced with explicit support from the new Universal Service Fund implemented pursuant to the *Universal Service Order* adopted today. This will require small incumbent LECs to make one or more tariff filings. The new Universal Service Fund will facilitate the transition to competitive markets while maintaining specific, predictable and sufficient support for universal service as required under section 254 of the Act. Accordingly, the required changes in LECs' tariff filings, including those in tariffs filed by small incumbent LECs, are part of an overall mechanism designed to minimize the economic impact of the 1996 Act on small businesses and small incumbent LECs. The other universal service related changes that we adopt in this Order affect only price-cap LECs, which do not include any small businesses or small incumbent LECs.

F. Report to Congress

440. The Commission shall include a copy of this FRFA, along with this Order, in a report to be sent to Congress pursuant to SBREFA.[639] A copy of this FRFA (or a summary thereof) will also be published in the Federal Register.

IX. PROCEDURAL ISSUES

[639] 5 U.S.C. § 801(a)(1)(A).

A. Paperwork Reduction Act

441. On April 1, 1997, the Office of Management and Budget (OMB) approved all of our proposed information collection requirements in accordance with the Paperwork Reduction Act.[640] The OMB made one recommendation, suggesting that we try "to minimize the number of new filings that firms must create in order to be compliant with the rules adopted . . . allowing firms to use many of the filings they must create in order to demonstrate that they meet the Telecommunications Act of 1996 requirements for provision of inter-LATA services within their operating regions." The recommendation of OMB primarily affects proposals that were not adopted in this Order, but will be the subject of a future Report and Order. At that time, the Commission will consider carefully whether the number of required new filings can be minimized by relying to the greatest extent possible on those filings referenced by OMB in its approval. Furthermore, in this Order, although we have made certain adjustments, we have minimized the paperwork burden where possible. For example, the first inflation adjustment will be done in January 1, 1999, but the next one will not be done until July 1, 2000. This schedule will minimize the number of filings and paperwork burden associated with necessary adjustments for inflation.

442. In the course of preparing this Order, we have decided to modify several of the information collection requirements proposed in the NPRM. For example, price cap local exchange carriers must make a downward exogenous adjustment to the price cap index for the common line basket to account fully for the elimination of their LTS obligations by December 16, 1997 to be effective January 1, 1998.[641] We conclude that these modifications constitute a new "collection of information," within the meaning of the Paperwork Reduction Act of 1995, 44 U.S.C. §§ 3501-3520. These modifications are subject to OMB review and the Commission has requested emergency approval of these modifications to ensure that the requirements may be effective on June 16, 1997. In addition, we will seek final OMB approval for these modifications.

443. The Further Notice of Proposed Rulemaking contains either a proposed or modified information collection. As part of its continuing effort to reduce paperwork burdens, we invite the general public and the OMB to take this opportunity to comment on the information collections contained in the Further Notice of Proposed Rulemaking, as required by the Paperwork Reduction Act of 1995, 44 U.S.C. §§ 3501-3520. Public and agency comments are due at the same time as other comments on the Further Notice of Proposed Rulemaking; OMB comments are due 60 days from date of publication of the Further Notice of Proposed Rulemaking in the Federal Register. Comments should address: (a) whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information shall have practical utility; (b) the accuracy of the

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[640] *Notice of Office Management and Budget Action,* OMB No 3060-0760 (Apr. 1, 1997).

[641] *See* Section VI.D., *supra*.

Commission's burden estimates; (c) ways to enhance the quality, utility, and clarity of the information collected; and (d) ways to minimize the burden of the collection of information on the respondents, including the use of automated collection techniques or other forms of information technology.

B. Initial Regulatory Flexibility Act Analysis

444. Pursuant to the Regulatory Flexibility Act (RFA),[642] the Commission has prepared the following initial regulatory flexibility analysis (IRFA) of the expected impact on small entities of the policies and rules proposed in the Further Notice of Proposed Rulemaking (Further Notice). Written public comments are requested on the IRFA. These comments must be filed in accordance with the same filing deadlines as comments on the rest of the Further Notice, but they must have a separate and distinct heading designating them as responses to the regulatory flexibility analysis. The Secretary shall cause a copy of the Further Notice, including the initial regulatory flexibility analysis, to be sent to the Chief Counsel for Advocacy of the Small Business Administration in accordance with Section 603(a) of the RFA.[643]

445. Reason for action. The Commission has revised its interstate access charge rules to make them consistent with the Telecommunications Act of 1996. As discussed in Section VII.A of the Further Notice, multi-line business customers will pay a higher subscriber line charge as a result of access charge reform, while special access customers do not pay such a charge. In addition, as the PICCs are phased in IXCs will be required to pay a substantially higher PICC for a multi-line business end user compared to the PICC paid for a primary residential end user or single-line business end user. An IXC serving multi-line business customers through special access can avoid paying the PICCs. As discussed in Section VII.B, the current allocation of general support facilities expenses enables incumbent LECs to recover through regulated interstate access charges costs caused by the LECs' nonregulated billing and collection functions.

446. Objectives. In Section VII.A, by proposing to allow LECs to impose a subscriber line charge on special access customers, we seek to prevent a decrease in projected revenue from multi-line subscriber line charges and PICCs caused by the migration of certain multi-line business customers from the public switched network to special access. In Section VII.B, we seek to revise the Commission's current allocation of price cap LECs' interstate costs between regulated interstate access services and nonregulated billing and collection activities to move interstate access rates closer to cost, consistent with the 1996 Act's new competitive paradigm.

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[642] 47 U.S.C. § 603. The RFA, *see* 5 U.S.C. § 601 *et seq.*, has been amended by the Contract With America Advancement Act of 1996, Pub. L. No. 104-21, 110 Stat. 847 (1996) (CWAAA). Title II of the CWAAA is the "Small Business Regulatory Enforcement Fairness Act of 1996" (SBREFA).

[643] 47 U.S.C. § 603(a).

447. Legal Basis. The proposed action is supported by Sections 4(i), 4(j), 201-205, 208, 251, 252, 253, and 403 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 154(i), 154(j), 201-205, 208, 251, 252, 253, 403.

448. Description, potential impact and number of small entities affected. For purposes of this Further Notice, the Regulatory Flexibility Act defines a "small business" to be the same as a "small business concern" under the Small Business Act (SBA), 15 U.S.C. § 632, unless the Commission has developed one or more definitions that are appropriate to its activities.[644] Under the SBA, a "small business concern" is one that: (1) is independently owned and operated; (2) is not dominant in its field of operation; and (3) meets any additional criteria established by the SBA.[645] The Small Business Administration has defined a small business for Standard Industrial Classification (SIC) category 4813 (Telephone Communications, Except Radiotelephone) to be a small entity that has no more than 1500 employees.[646]

449. *Total Number of Telephone Companies Affected.* The proposals in Sections VII.A and VII.B of this Further Notice, if adopted, would affect all LECs that are regulated by the Commission's price cap rules. Currently, 13 incumbent LECs are subject to price cap regulation. We tentatively conclude that all price cap carriers have more than 1500 employees and, therefore, are not small entities.

450. Reporting, record keeping and other compliance requirements. It is not clear whether, on balance, all proposals in this Further Notice would increase or decrease incumbent LECs' administrative burdens.

451. We believe that the reforms proposed in Section VII.A of this Further Notice would require price cap LECs (not small entities) to make at least one tariff filing, and possibly several additional filings, but otherwise should not affect their administrative burdens. The reforms proposed in Section VII.B of the Further Notice may require price cap LECs (not small entities) to study the uses of the general purpose computer assets recorded in Account 2124 to determine the percentage of investment in that account that is used for billing and collection activities, but otherwise should not affect their administrative burdens.

452. Federal rules which overlap, duplicate or conflict with this proposal. None.

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644 *See* 5 U.S.C. § 601(3) (incorporating by reference the definition of "small business concern" in 15 U.S.C. § 632).

645 15 U.S.C. § 632. *See, e.g.*, Brown Transport Truckload, Inc., v. Southern Wipers, Inc., 176 B.R. 82 (N.D. Ga. 1994).

646 13 C.F.R. § 121.201.

453. Any significant alternatives minimizing impact on small entities and consistent with stated objectives. In Sections VII.A and VII.B of this Further Notice, we limit the scope of our proposals to incumbent price cap LECs, thereby not affecting small entities. We seek comment on these proposals and urge that parties support their comments with specific evidence and analysis.

C. Further Notice of Proposed Rulemaking Comment Filing Dates

454. Pursuant to applicable procedures set forth in Section 1.399 and 1.411 *et seq*. of the Commission's rules, 47 C.F.R. Sections 1.399, 1.411 *et seq*., interested parties may file comments in response to the Further Notice of Proposed Rulemaking, including comments ont he information collection requirements, no later than June 26, 1997 with the Secretary, Federal Communications Commission, Washington D.C. 20554. Interested parties may file replies no later than July 11, 1997, except that reply comments on the information collection requirements are due no later than July 28, 1997. To file formally in this proceeding, participants must file an original and twelve copies of all comments, reply comments, and supporting comments. If participants want each Commissioner to receive a personal copy of their comments, an original plus 16 copies must be filed. In addition, parties should file two copies of any such pleading with the Competitive Pricing Division, Common Carrier Bureau, Room 518, 1919 M Street, N.W., Washington, D.C. 20554. Comments and reply comments will be available for public inspection during regular business hours in the FCC Reference Center, Room 239, 1919 M Street, N.W., Washington D.C. 20554.

455. Parties submitting diskettes should submit them along with their formal filings to the Office of the Secretary. Submissions should be on a 3.5 inch diskette formatted in an DOS PC compatible form. The document should be saved in WordPerfect 5.1 for Windows format. The diskette should be submitted in "read only" mode. The diskette should be clearly labelled with the party's name, proceeding, type of pleading (comment or reply comment), docket number, and date of submission.

456. You may also file informal comments electronically via e-mail <access@fcc.gov>. Only one copy of electronically-filed comments must be submitted. You must put the docket number of this proceeding in the subject line (see the caption at the beginning of this Notice, or in the body of the text if by Internet). You must note whether an electronic submission is an exact copy of formal comments on the subject line. You also must include your full name and Postal Service mailing address in your submission.

457. Comments and replies must comply with Section 1.49 and all other applicable sections of the Commission's rules. We also direct all interested parties to include the name of the filing party and the date of the filing on each page of their comments and replies. Comments and replies must also clearly identify the specific portion of this Notice of Proposed Rulemaking to which a particular comment or set of comments is responsive. If a portion of a party's comments

does not fall under a particular topic listed in the Table of Contents of this Notice, such comments must be included in a clearly labelled section at the beginning or end of the filing.

458. Written comments by the public on the proposed and/or modified information collections are due July 28, 1997. Written comments must be submitted by the Office of Management and Budget (OMB) on the proposed and/or modified information collections on or before 60 days after date of publication in the Federal Register. In addition to filing comments with the Secretary, a copy of any comments on the information collections contained herein should be submitted to Judy Boley, Federal Communications Commission, Room 234, 1919 M Street, N.W., Washington, DC 20554, or via the Internet to jboley@fcc.gov and to Timothy Fain, OMB Desk Officer, 10236 NEOB, 725 - 17th Street, N.W., Washington, DC 20503 or via the Internet to fain_t@al.eop.gov.

X. ORDERING CLAUSES

459. Accordingly, IT IS ORDERED, pursuant to Sections 1-4, 10, 201-205, 251, 254, 303(r), and 410(a) of the Communications Act of 1934, as amended, and Section 601 of the Telecommunications Act of 1996, 47 U.S.C. §§ 151-154, 160, 201-205, 251, 254, 303(r), 410(a), and 601, that the ORDER IS ADOPTED.

460. IT IS FURTHER ORDERED that the provisions in this Order will be effective June 17, 1997. We anticipate this date will be at least thirty days after publication of the rules in the Federal Register. If publication of the rules is delayed, however, we find good cause under 5 U.S.C. § 553(d)(3) to make the rules effective less than thirty days after publication, because the local exchange carriers subject to price cap regulation must file tariffs by June 16, in order for them to be effective on July 1, 1997, as required by Section 69.3 of the Commission's rules, 47 C.F.R. § 69.3. In addition, to ensure that the local exchange carriers subject to price cap regulation have actual notice of these rules immediately following their release, we are serving those entities by overnight mail. The collections of information contained within are contingent upon approval by the Office of Management and Budget.

461. IT IS FURTHER ORDERED that the waiver petitions of Bell Atlantic, Pacific Bell, GTE, Cincinnati Bell, U S West, and BellSouth discussed in Section III.A.5., regarding Section 69.104 as applied to ISDN service ARE DISMISSED.

462. IT IS FURTHER ORDERED that the rulemaking proceeding in CC Docket No. 95-72 IS TERMINATED.

463. IT IS FURTHER ORDERED, pursuant to Sections 1-4, 10, 201-205, 251, 254, 303(r), and 701 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 151-154, 160, 201-205, 251, 254, 303(r), and 601, that NOTICE IS HEREBY GIVEN OF the rulemaking

described above and that COMMENT IS SOUGHT on these issues.

FEDERAL COMMUNICATIONS COMMISSION

William F. Caton
Acting Secretary

APPENDIX A

List of Commenters in CC Docket Nos. 96-262, 94-1, 91-213

ACC Long Distance Corp. (ACC Long Distance)
Ad Hoc Telecommunications Users Committee (Ad Hoc)
AirTouch Communications, Inc. (AirTouch)
Alabama Public Service Commission (Alabama Commission)
Alaska Telephone Association
Aliant Communications Co., formerly Lincoln Telephone (Aliant)
Allied Communications Group, Inc. (Allied)
Alliance for Public Technology
ALLTEL Telephone Services Corporation (ALLTEL)
American Association for Adult and Continuing Education, *et al.*
American Assocation for Retired Persons, *et al.* (AARP, *et al.*)
America On-Line, Inc. (America On-Line)
American Library Association
American Petroleum Institute (API)
America's Carriers Telecommunication Association (ACTA)
Ameritech
Association for Local Telecommunications Services (ALTS)
AT&T Corp. (AT&T)
Bankers Clearing House, *et al.*
Bell Atlantic Telephone Companies and NYNEX (BA/NYNEX)
BellSouth Corporation, BellSouth Telecommunications, Inc. (BellSouth)
Cable & Wireless, Inc. (Cable & Wireless)
[People of the State of] California and the Public Utility Commission of the State of California (California Commission)
California Cable Television Association
Cathey, Hutton and Associates
Centennial Cellular Corporation
Cincinnati Bell Telephone Company (Cincinnati Bell)
Citizens for a Sound Economy Foundation (CSE)
Citizens Utilities Company (Citizens Utilities)
Commercial Internet Exchange Association (CIEA)
Communications Workers of America (CWA)
Competition Policy Institute
Competitive Telecommunications Association (CompTel)
CompuServe, Inc. and Prodigy Services Corporation (CompuServe/Prodigy)
Consumer Project on Technology (Consumer Project)
[Public Service Commission of the] District of Columbia (District of Columbia Commission)
Evans Telephone Company, *et al.* (Evans, *et al.*)

Excel Telecommunications, Inc. (Excel)
Florida Public Service Commission (Florida Commission)
Frederick & Warinner, L.L.C. (Frederick & Warinner)
Frontier Corporation (Frontier)
General Communication, Inc. (GCI)
General Services Administration/United States Department of Defense (GSA/DOD)
Gallegos Family Network (Gallegos)
Gray Panthers
GVNW Inc./Management (GVNW)
GTE Service Corporation (GTE)
Harris, Skrivan & Associates, LLC (Harris, Skrivan & Associates)
ICG Telecom Group, Inc. (ICG)
Illinois Commerce Commission (Illinois Commission)
Illuminet
Independent Telephone & Telecommunications Alliance
Information Industry Association
Interactive Services Association
International Communications Association (Intl. Comm. Ass'n)
Internet Access Coalition
ITCs, Inc. (ITC)
IXC Long Distance, Inc.
Kansas Corporation Commission (Kansas Commission)
LCI International Telecom Corp. (LCI)
MCI Telecommunications Corporation (MCI)
Media Access Project, *et al.* (MAP, *et al.*)
Microsoft Corporation (Microsoft)
Minnesota Independent Coalition
Missouri Public Service Commission (Missouri Commission)
National Association of Regulatory Utility Commissioners (NARUC)
National Cable Television Association, Inc. (NCTA)
National Exchange Carrier Association, Inc. (NECA)
New York State Department of Public Service (New York Commission)
Newspaper Association of America
Northern Arkansas Telephone Company
[Commonwealth of] Northern Marianna Islands (Northern Marianna Islands)
[Public Utilities Commission of] Ohio (Ohio Commission)
Ohio Consumers' Counsel
[Public Utility Commission of] Oregon (Oregon Commission)
Ozarks Technical Community College
Pacific Telesis Group (PacTel)
Pennsylvania Internet Service Providers
Personal Communications Industry Association (PCIA)

Puerto Rico Telephone Company (Puerto Rico Tel.)
[Jon] Radoff (Radoff)
Roseville Telephone Company (Roseville Tel.)
Rural Telephone Coalition (Rural Tel. Coalition)
Rural Telephone Finance Cooperative
Rural Utilities Service
SDN Users Association Inc. (SDN Users Association)
Service-oriented Open Network Technologies, Inc. (SONETECH)
South Dakota Public Utilities Commission (South Dakota Commission)
Southern New England Telephone Company (SNET)
Southwestern Bell Telephone Company (SWBT)
Spectranet Interactive, Inc. (Spectranet)
Sprint Corporation (Sprint)
State Consumer Advocates
[John] Staurulakis, Inc. (Staurulakis)
TCA, Inc.-Telecommunications Consultants (TCA)
TDS Telecommunications Corporation (TDS)
Telco Communications Group, Inc. (Telco Communications Group)
Tele-Communications, Inc. (TCI)
Telecommunications Resellers Association (TRA)
Teleport Communications Group Inc. (Teleport)
Tennessee Regulatory Authority (Tennessee Commission)
[Public Utility Commission of] Texas (Texas Commission)
Texas Office of Public Utility Counsel (Texas Public Utility Counsel)
Time Warner Communications Holdings, Inc. (Time Warner)
United States Telephone Association (USTA)
U S West, Inc. (U S West)
Washington Independent Telephone Association (WITA)
Washington Utilities and Transportation Commission (Washington Commission)
Lyman C. Welch
Western Alliance
WinStar Communications, Inc. (WinStar)
WorldCom, Inc. (WorldCom)

List of Replies in CC Docket Nos. 96-262, 94-1, 91-213

ACC Long Distance Corp. (ACC Long Distance)
Ad Hoc Telecommunications Users Committee (Ad Hoc)
Alarm Industry Communications Committee
[State of] Alaska (Alaska Commission)
Aliant Communications Co., formerly Lincoln Telephone (Aliant)
Alliance for Public Technology
ALLTEL Telephone Services Corporation (ALLTEL)
American Association for Adult and Continuing Education, *et al.*
American Assocation for Retired Persons, *et al.* (AARP, *et al.*)
America On-Line, Inc. (America On-Line)
American Communications Services, Inc.
American Petroleum Institute (API)
Ameritech
Arch Communications Group, Inc. (Arch Communications)
Association for Local Telecommunications Services (ALTS)
AT&T Corp. (AT&T)
Bankers Clearing House, *et al*.
Bell Atlantic Telephone Companies and NYNEX (BA/NYNEX)
BellSouth Corporation, BellSouth Telecommunications, Inc. (BellSouth)
[People of the State of] California and the Public Utility Commission of the State of California (California Commission)
Colorado Library Education and Healthcare Telecommunications Coalition
Commercial Internet Exchange Association (CIEA)
Competitive Telecommunications Association (CompTel)
CompuServe, Inc. and Prodigy Services Corporation (CompuServe/Prodigy)
Consumer Project on Technology (Consumer Project)
Cox Communications, Inc. (Cox)
General Communication, Inc. (GCI)
General Services Administration/United States Department of Defense (GSA/DOD)
Georgia Public Service Commission (Georgia Commission)
Consumers' Utility Counsel Division, (Georgia) Governor's Office of Consumer Affairs (Georgia Consumers' Utility Counsel)
GVNW Inc./Management (GVNW)
GTE Service Corporation (GTE)
State of Hawaii (Hawaii Commission)
ICG Telecom Group, Inc. (ICG)
Internet Access Coalition
IXC Long Distance, Inc.
LCI International Telecom Corp. (LCI)
Maine Public Utilities Commission (Maine Commission)

MCI Telecommunications Corporation (MCI)
Media Access Project, *et al.* (MAP, *et al.*)
Minnesota Independent Coalition
Minnesota Internet Services Trade Association
National Cable Television Association, Inc. (NCTA)
National Exchange Carrier Association, Inc. (NECA)
[Public Utilities Commission of] Ohio (Ohio Commission)
Ohio Consumers' Counsel
Pacific Telesis Group (PacTel)
Personal Communications Industry Association (PCIA)
PSINet, Inc. (PSINet)
Puerto Rico Telephone Company (Puerto Rico Tel.)
Roseville Telephone Company (Roseville Tel.)
Rural Telephone Coalition (Rural Tel. Coalition)
Southern New England Telephone Company (SNET)
Southwestern Bell Telephone Company (SWBT)
Sprint Corporation (Sprint)
State Consumer Advocates
TDS Telecommunications Corporation (TDS)
Telco Communications Group, Inc. (Telco Communications Group)
Tele-Communications, Inc. (TCI)
Teleport Communications Group Inc. (Teleport)
Texas Association of Broadcasters
Texas Office of Public Utility Counsel (Texas Public Utility Counsel)
Time Warner Communications Holdings, Inc. (Time Warner)
United States Telephone Association (USTA)
U S West, Inc. (U S West)
WorldCom, Inc. (WorldCom)

APPENDIX B
COMMENT SUMMARY[1]

Table of Contents

[1] Comments arranged with reference to sections of the Order.

III. RATE STRUCTURE MODIFICATIONS

A. Common Line

2. Subscriber Line Charge

1. *Raising or eliminating the SLC cap on non-primary residential lines and multi-line business lines.* Several commenters, including incumbent LECs, IXCs, and cable companies support the proposal to raise or eliminate the SLC cap for multi-line business customers and for residential lines beyond the primary connection to the level necessary to recover the full per-line loop costs assigned to the interstate jurisdiction.[2] Several incumbent LECs are not opposed to raising the SLC for multi-line businesses, but are opposed to increasing the SLC for non-primary residential lines.[3] BA/NYNEX states that raising the SLC cap for multi-line business lines is an appropriate, but small step towards correct recovery of NTS costs.[4] Ad Hoc supports increasing the SLC cap for multi-line business and non-primary residential lines as long as users of those lines do not pay more than the costs the incumbent LEC incurs to provide those lines.[5] SWBT, PacTel and GSA/DOD support raising the SLC to recover NTS common line costs, but argue

[2] *See, e.g.*, Ameritech Comments at 11-12; American Carriers Telecommunication Association (ACTA) Comments at 7; Telecommunications Resellers Association (TRA) Comments at 34-35; Association for Local Telecommunications Services (ALTS) Comments at 24-25; Teleport Communications Group Inc. (Teleport) Comments at 24-25, Reply at 14-16; Time Warner Communications Holdings, Inc. (Time Warner) Comments at 8; Tele-Communications, Inc. (TCI) Comments at 10. *See also* BellSouth Corporation and BellSouth Telecommunications, Inc. (BellSouth) Comments at 69-70 (stating that if the Commission does not provide universal support for second lines, SLC cap for unsupported lines should be removed, giving incumbent LECs the flexibility to raise the SLC on those lines).

[3] *See, e.g.*, United States Telephone Association (USTA) Comments at 56; Bell Atlantic Telephone Companies and NYNEX (BA/NYNEX) Comments at 33; U S West, Inc. (U S West) Comments at 56-57; Southern New England Telephone Company (SNET) Comments at 35; Pacific Telesis Group (PacTel) Comments at 6, 63.

[4] BA/NYNEX Comments at 33.

[5] Ad Hoc Telecommunications Users Committee (Ad Hoc) Comments at 10-11; Reply at 4.

that because loop costs are the same for residential and business lines, there is no economic justification for imposing different SLCs for these lines.[6]

2. Several LECs opposing the proposal to raise the SLC on non-primary residential lines contend that in addition to imposing new charges on the end-user, this method of cost recovery would be administratively burdensome, because no practical way exists to identify second residential lines or lines into second homes.[7] BA/NYNEX argues that charging different SLCs on second lines would require information collection and verification procedures that are not in place today.[8] Other parties also argue that eliminating or raising the SLC cap on additional residential lines will create the incentive for customers to "game" the system by reporting their additional lines under different names or by obtaining additional lines from competitors to avoid paying an additional SLC.[9] BA/NYNEX, PacTel, and Citizens Utilities argue that if the Commission adopts a cost-recovery mechanism that raises the SLC on second residential lines, it should be optional.[10]

3. Most non-price cap LECs and several state commissions and consumer groups oppose increasing or eliminating the SLC cap for multi-line business lines and for residential lines beyond the primary connection.[11] Rural carriers and Internet providers are concerned about the potential negative impact that raising or eliminating the SLC cap on second and additional residential lines and multi-line business lines will have on rural areas. These commenters argue that by reducing

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[6] Southwestern Bell Telephone Company (SWBT) Comments at 12; PacTel Comments at 61-62; General Services Administration/United States Department of Defense (GSA/DOD) Comments at 11.

[7] *See, e.g.*, USTA Comments at 56, Reply at 33; BA/NYNEX Comments at 33; BellSouth Comments at 69; PacTel Comments at 63, Reply at 21; Cincinnati Bell Telephone Company (Cincinnati Bell) Comments at 7-8; National Exchange Carrier Association, Inc. (NECA) Reply at 7-8; Rural Telephone Coalition (Rural Tel. Coalition) Reply at 12-13.

[8] BA/NYNEX Comments at 33.

[9] *See, e.g.*, PacTel Comments at 63, Reply at 21-22; Cincinnati Bell Comments at 7; John Staurulakis, Inc. (Staurulakis) Comments at 8; NECA Comments at 13; Roseville Telephone Company (Roseville Tel.) Comments at 9-10; Minnesota Independent Coalition Comments at 13; Washington Independent Telephone Association (WITA) Comments at 5; Illinois Commerce Commission (Illinois Commission) Comments at 9.

[10] BA/NYNEX Comments at 33-34 (arguing that those LECs that choose not raise SLCs on additional residential lines should retain their CCL recovery); PacTel Reply at 22; Citizens Utilities Company (Citizens Utilities) Comments at 28-29.

[11] *See, e.g.*, Staurulakis Comments at 8-9; GVNW Inc./Management (GVNW) Comments at 6-7, Reply at 6; Roseville Tel. Comments at 9-10; Harris, Skrivan & Associates, LLC (Harris, Skrivan & Associates) Comments at 6; ITCs, Inc. (ITC) Comments at 3; WITA Comments at 5; State Consumer Advocates Comments at 21-22; Rural Tel. Coalition Comments at 7-8; Reply at 12-13; Public Utilities Commission of Ohio (Ohio Commission) Comments at 3, Reply at 3; Public Utility Commission of Texas (Texas Commission) Comments at 6-7; Minnesota Independent Coalition Comments at 12-13; TDS Telecommunications Corporation (TDS) Comments at 3-4, 20-21, Reply at 4; Georgia Public Service Commission (Georgia Commission) Reply at 12-13; Missouri Public Service Commission (Missouri Commission) Comments at 3; Western Alliance Comments at 22-24; Commercial Internet Exchange Company (CIEA) Comments at 13, Reply at 9-11; Competition Policy Institute Comments at 18; Microsoft Corporation (Microsoft) Comments at 5.

demand for additional access lines, this proposal would have a negative impact on Internet usage and economic growth in rural areas.[12] TCA asserts that a reduction in demand for additional access lines will increase the cost of remaining lines, placing an additional burden on the Universal Service fund.[13] Parties opposed to raising the SLC cap also argue that, especially in light of the Universal Service Joint Board's recommendation not to support multi-line business lines and residential lines beyond the primary connection, raising SLCs for these lines will make them unaffordable in rural communities, violating section 254(b) which requires that all consumers have access to rates and services that are "reasonably comparable" with those provided in urban areas.[14]

4. Frontier, Sprint, and AT&T contend that raising the SLC cap only for additional residential lines and multi-line business lines will not solve the problem of uneconomic recovery of loop costs.[15] These IXCs and other commenters, including LECs, consumer groups, and wireless and cable companies, urge the Commission to raise or eliminate the SLC caps on all lines, thus permitting LECs to recover all of the interstate allocated costs of the local loop from end-users.[16] Some of these parties argue that because IXCs do not cause the costs associated with the local loop, assigning any portion of the costs associated with the loop to the IXCs is economically inefficient.[17] Sprint contends that raising the SLC cap for residential users is unlikely to have a significant effect on subscribership.[18] WorldCom states that a subscriber loop is a fixed facility dedicated to the end user and that once the loop has been ordered and installed, the incumbent LEC incurs no additional costs for additional traffic passing over that loop.[19]

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[12] *See, e.g.*, Harris, Skrivan & Associates Comments at 6; TCA Telecommunications Corporation (TCA) Comments at 4; GVNW Comments at 7; Staurulakis Comments at 7-9; Western Alliance Comments at 22-24; ITC Comments at 3; NECA Comments at 13, Reply at 7-9; Rural Tel. Coalition Comments at 8; Pennsylvania Internet Service Providers Comments at 8-9;
CIEA Comments at 13; Reply at 10.

[13] TCA Comments at 4.

[14] *See, e.g.*, ITC Comments at 3; Rural Tel. Coalition Comments at 8, Reply at 11; TDS Comments at 3-4, Reply at 4; Western Alliance Comments at 23; TCA Comments at 3-4.

[15] Frontier Corporation (Frontier) Comments at 6-8; Sprint Corporation (Sprint) Comments at 11-12, 17; AT&T Corp. (AT&T) Reply at 27.

[16] *See, e.g.*, GTE Service Corporation (GTE) Comments at 26-29; SWBT Comments at 37-38; Cincinnati Bell Comments at 6-7; AT&T Comments 51-54, Reply at 25-26; Frontier Comments at 4, 5-7; Sprint Comments at 11-15; 50-51; Ad Hoc Reply at 4; GSA/DOD Comments at 9-11, Reply at 5, 7; TCI Comments at 10; Time Warner Comments at 4-5; WorldCom, Inc. (WorldCom) Comments at 30-31.

[17] *See, e.g.*, AT&T Comments at 51-54, Reply at 28; Frontier Comments at 5; Sprint Comments at 11.

[18] Sprint Comments at 12.

[19] WorldCom Comments at 28-29.

5. Several parties that oppose raising the SLC cap argue that the common line is a joint and common or shared cost that should be recovered from IXCs and other service providers, as well as from the end user.[20] The Texas Public Utility Counsel disagrees with Sprint's assertion that raising the SLC cap will have minimal effect on subscribership.[21] State consumer advocates and the Oregon Commission favor eliminating the SLC entirely and allowing all common line costs to be recovered from the IXCs.[22]

6. USTA and J. Staurulakis argue that because the common line revenue requirement is a much larger percentage of total costs for rate-of-return LECs than it is for most price cap LECs, any changes in the SLC cap adopted for price cap LECs should not be extended to rate-of-return LECs.[23] Roseville argues that any change to the SLC should be optional for rate-of-return LECs.[24]

7. The Illinois Commission, U S West, and Pennsylvania Internet Service Providers argue that if the Commission raises the SLC cap, the increase should be phased in over time.[25] WorldCom and Ad Hoc oppose any transition period for a rate structure change.[26] Ad Hoc states that because an increase in the SLC for second and additional residential lines and multi-line business lines would not result in service disruptions, a transition period is not needed and would delay implementation of an efficient common line rate structure.[27] GVNW asserts that a three-year transition period would not be sufficient in a number of cases.[28]

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[20] *See, e.g.,* American Association for Adult and Continuing Education, *et al.* Comments at 13, Reply at 7-8; Georgia Commission Reply at 11; Rural Tel. Coalition Reply at 4-5; National Association of Regulatory Utility Commissioners (NARUC) Comments at 3, 13.

[21] Texas Office of Public Utility Counsel (Texas Public Utility Counsel) Reply at 4-10.

[22] *See, e.g.,* State Consumer Advocates Comments at 24-27; Texas Public Utility Counsel Comments at 11, Reply at 15; Public Utility Commission of Oregon (Oregon Commission) Comments at 4-5.

[23] USTA Comments at 56-57; Staurulakis Comments at 7-8.

[24] Roseville Tel. Comments at 9-10. *See also* Minnesota Independent Coalition Comments at 5 (arguing that any change to the CCL rate structure should be optional).

[25] Illinois Commission Comments at 10; U S West Comments at 53-55; Pennsylvania Internet Service Providers Comments at 11-12.

[26] WorldCom Comments at 32; Ad Hoc Comments at 11-12.

[27] Ad Hoc Comments at 11-12.

[28] GVNW Comments at 7.

8. *Geographic Deaveraging of the SLC.* The Illinois Commission and several incumbent LECs argue in favor of allowing LECs to deaverage SLCs.[29] They argue that an averaged SLC creates cross-subsidies between high-cost and low-cost areas, in violation of the 1996 Act and that deaveraging the SLC is economically efficient and consistent with cost-causation principles. Several of these parties state that the Commission should permit SLC deaveraging to the same extent that unbundled network elements or network access lines are deaveraged, *i.e.*, within the same geographic areas.[30] Sprint contends that LECs should be required to deaverage the SLC.[31] BA/NYNEX and US West argue that geographic deaveraging should be optional.[32] The Ohio Commission argues that although it may be necessary to deaverage the SLC based on differing loop costs among the individual service areas in an incumbent LEC's service territory, the deaveraged rates must not exceed the current SLC caps.[33]

9. The Washington Utilities and Transportation Commission and BA/NYNEX argue that section 254(e) does not require deaveraged SLC rates.[34] State Consumer Advocates and the New York Commission argue that geographic averaging of the SLC is not an implicit subsidy that is inconsistent with the requirements of section 254(e).[35] BA/NYNEX explains that rates should not be considered subsidized simply because they are averaged, because any rate that is not developed on a customer-specific basis involves averaging.[36] BA/NYNEX also states, however, that if the SLC is deaveraged, it should be subject to the existing $6.00 and $3.50 caps.[37] The Washington Commission states that deaveraged rates may be appropriate in the future, if adequate universal

[29] Illinois Commission Comments at 10; U S West Comments at 56, Reply at 28; Ameritech Comments at 12-13, Attachment B at 19; BellSouth Comments at 32; GTE Comments at 30-31; PacTel Comments at 62-63. See *also* Sprint Comments at 17, 42.

[30] Illinois Commission Comments at 10-11; Ameritech Comments at 12; BA/NYNEX Comments at 46, n.105. *See also* ALLTEL Comments at 11 (supporting geographic deaveraging of SLC based on a minimum of three pricing zones).

[31] Sprint Comments at 17, 42.

[32] BA/NYNEX Comments at 34; U S West Comments at 56, Reply at 28.

[33] Ohio Commission Comments at 5, Reply at 5.

[34] Washington Utilities and Transportation Commission (Washington Commission) Comments at 5; BA/NYNEX Comments at 34.

[35] State Consumer Advocates Comments at 48-49; New York State Department of Public Service (New York Commission) Comments at 7-8.

[36] BA/NYNEX Comments at 34.

[37] *Id.* at 46, n. 105.

service mechanisms are in place.[38]

10. Several commenters oppose deaveraging the SLC.[39] These parties argue that deaveraging the SLC violates the "comparable services and comparable rates" requirement of section 254 and will increase local rates in high-cost areas or increase the burden on the Universal Service Fund. The Texas Public Utility Counsel argues that deaveraging rates is inconsistent with market practices and the social policy embodied in the 1996 Act.[40] It argues further that deaveraging SLC costs would complicate the calculations of Universal Service subsidies and make it more difficult for long distance companies to maintain geographically averaged rates, as required by section 254(g).[41] Time Warner agues that the Commission should not permit geographic deaveraging of SLCs at this time because it will give incumbent LECs opportunity to engage in anticompetitive conduct.[42]

3. Carrier Common Line Charge

11. Most commenters agree that the per-minute CCL charge is economically inefficient because it does not reflect the way in which underlying loop costs are incurred and sends incorrect signals into the marketplace, encouraging inefficient use of telecommunications services and uneconomic bypass of incumbent LEC facilities.[43] BellSouth states that recovering more common line costs through NTS per-line charges "would greatly enhance economic welfare primarily because it would reduce the marginal cost of interstate long-distance calls and therefore would

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[38] Washington Commission Comments at 5.

[39] See, e.g., Minnesota Independent Coalition Comments at 14; TDS Comments at 3, 20; Rural Tel. Coalition Reply at 10; State of Hawaii (Hawaii Commission) Reply at 3, 12-14; Pennsylvania Internet Service Providers Comments at 12-13.

[40] Texas Public Utility Counsel Comments at 13.

[41] *Id.* at 14.

[42] Time Warner Comments at 8-9.

[43] *See, e.g.,* Ameritech Comments at 9; BA/NYNEX Comments at 32; PacTel Comments at 58-64, Reply at 21; SWBT Comments at 35-36; Rural Tel. Coalition Comments at 6; ACC Long Distance Corp. (ACC Long Distance) Comments at 10-11; AT&T Comments at 51-54, Reply at 25-26; MCI Telecommunications Corporation (MCI) Comments at 77; LCI International Telecom Corp. (LCI) Comments at 20-21; WorldCom Comments at 28-29; Frontier Comments at 4; NECA Comments at 10; Ad Hoc Comments at 8-11; Time Warner Comments at 2-4; Winstar Communications (WinStar) Comments 3-5; Teleport Comments at 22-24; GSA/DOD Comments at 7-8; Competition Policy Institute Comments at 1-7; California Cable Television Association Comments at 10; NARUC Comments at 11-12; Public Service Commission of the District of Columbia (District of Columbia Commission) Comments at 3-4; U.S. Department of Justice (DOJ) Comments at 11, 14-15. *But see*, Evans Telephone Company, *et al.* (Evans, *et al.*) Comments at 4-5 (stating that current mix of recovery mechanisms is an appropriate compromise).

greatly expand interstate long-distance calling."[44] Some commenters state that the CCL charge functions as an implicit cross-subsidy from long distance access to local service, and from high-volume users to low-volume users.[45] Although most parties agree that the CCL charge structure should be revised so that incumbent LECs are no longer required to recover any of the NTS costs of the loop from IXCs on a traffic-sensitive basis, they disagree on the best approach to use for assessing that charge.

12. *Flat Per-Line Charge.* Many commenters, including both price cap and non-price cap incumbent LECs, IXCs, and some state commissions support recovering all common line costs or the common line costs not recovered through the SLCs through a flat, per-line charge assessed against the customer's PIC.[46] Several of these parties also support the proposal to bill the customer directly in cases where the customer has not chosen a PIC.[47] Supporters of this approach state that converting the common line charge to a per-line flat charge paid by the customer's IXC is administratively simple and will allow IXCs to recover their costs through a variety of pricing plans, as the market will allow.[48] USTA and BA/NYNEX state that recovering the common line costs through a flat, per-line charge paid by the IXCs will improve economic efficiency and will rebalance rates so that high-volume customers do not overpay, and low-usage customers do not underpay, for interstate use of the local loop.[49] BA/NYNEX, SWBT, and U S West support the flat, per-line charge but argue that if the Commission adopts such a rate structure, it would need to adjust the price cap formula because the existing formula assumes the ability of the LECs to apply usage-based rates to recover network costs that are largely non-

[44] *See* Letter from Robert T. Blau, BellSouth, to Mr. William F. Caton, Acting Secretary, FCC (filed April 25, 1997) at Attachment 1: "Economically-Efficient Access Reform" by Robert W. Crandall, The Brookings Institution, at 1.

[45] WorldCom Comments at 30; Ameritech Comments at 9; GTE Comments at 18, 26.

[46] *See, e.g.,* USTA Comments at 55-56; BA/NYNEX Comments at 35-36; BellSouth Comments at 68, Reply at 10-11; PacTel Comments at 64, Reply at 21; U S West Comments at 54-55; Citizens Utilities Comments at 27-28; Roseville Tel. Comments at 4, 8; Rural Tel. Coalition Comments at 6, Reply at 9; CompTel Comments at 29; Cable & Wireless, Inc. (Cable & Wireless) Comments at 10; Excel Telecommunications, Inc. (Excel) Comments at 11; LCI Comments at 20-21, Reply at 6; MCI Comments at 77; District of Columbia Commission Comments at 3-4; South Dakota Public Utilities Commission (South Dakota Commission) Comments at 3; NARUC Comments at 13; National Cable Television Association, Inc. (NCTA) Comments at 26; American Communications Services, Inc. Reply at 17.

[47] *See, e.g.,* USTA Comments at 55-56, Reply at 32; BA/NYNEX Comments at 36; U S West Comments at 54-55; Citizens Utilities Comments at 27-28; Roseville Tel. Comments at 8; WorldCom Comments at 37; District of Columbia Commission Comments at 3-4; Ad Hoc Reply at 4-5.

[48] *See, e.g.* BA/NYNEX Comments at 35-36; BellSouth Comments at 68 and Attachment 2 at 21-22, Reply at 11; Roseville Tel. Comments at 8; State Consumer Advocates Reply at 6; NARUC Comments at 13.

[49] USTA Comments, Attachment 1 at 7; BA/NYNEX Comments at 35.

traffic sensitive.[50] The Rural Telephone Coalition and Minnesota Independent Coalition assert that a flat-rated, non-traffic sensitive common line charge would be feasible for rate-of-return LECs.[51]

13. Several parties support the proposal to recover common line costs through a flat, per-line charge assessed against the PIC but are opposed to permitting LECs to bill end-users who have not selected a PIC.[52] Cincinnati Bell argues that billing end users who have not selected a PIC would create administrative difficulties because it would require the LEC to prorate charges for both the end user and the IXC when the customer leaves an IXC in the middle of a billing cycle.[53] NARUC suggests that if a customer uses another carrier for other services, a per line charge could be divided among all carriers using the common line on the basis of relative use by the carrier.[54] NARUC opposes any solution that would effectively impose additional flat charges on the end-user.[55]

14. Others commenters state that they support the proposal to assess IXCs a flat, per-line charge as a second-best approach in the event the Commission declines to increase or eliminate the SLC cap, or if increasing the SLC is insufficient to allow incumbent LECs to recover all of their interstate loop costs.[56] PacTel advocates recovering residual loop costs not recovered from an increase in the SLC through bulk billing IXCs on the basis of presubscribed lines.[57] TCI supports the proposal to assess IXCs a flat, per-line rate as a temporary measure, stating that to ensure economic efficiency, common line costs should be directly assigned to the SLC.[58]

15. The Competition Policy Institute and AARP *et al.* argue that the common line costs

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[50] BA/NYNEX Comments at 36; SWBT Comments at 58-59; U S West Comments at 55.

[51] Rural Tel. Coalition Comments at 7; Minnesota Independent Coalition Comments at 6.

[52] *See, e.g.*, Cincinnati Bell Comments at 9-10; Puerto Rico Telephone Company (Puerto Rico Tel.) Comments at 10-13; Rural Tel. Coalition Comments at 6-7.

[53] Cincinnati Bell Comments at 9.

[54] NARUC Comments at 13.

[55] *Id.* at 12.

[56] *See, e.g.,* Ad Hoc at 11-13, Reply 4-5; Cincinnati Bell Comments at 9, Reply at 5-7; Sprint Comments at 14; WorldCom Comments at 30-33; Time Warner Reply at 28.

[57] PacTel Comments at 6, 64. *See also* SWBT Reply at 8-9 (arguing that CCL remaining after adjustments for universal service, LTS, payphone, marketing expense and reallocations to reduce the TIC should be recovered on a flat-rated basis billed to IXCs on a presubscribed line basis as a "public policy element").

[58] TCI Comments at 10-11; Reply 4-5

should be recovered from all telecommunications providers including wireless, enhanced service, and "dial around" providers based on the amount of carriage.[59] Similarly, Alliance for Public Technology proposes that the carrier common line charge and subscriber line charge be replaced with a "common facilities" charge imposed on all telecommunication carriers who use the local network to deliver services.[60] PacTel opposes the proposals made by Competition Policy Institute and Alliance because they would require a usage-sensitive charge.[61]

16. Parties opposed to the flat, per-line charge assessed on IXCs argue that recovering common line costs on a flat-rate basis from IXCs will allow IXCs to pass the cost on to customers as higher rates, reducing demand for long distance service. They further argue that this type of cost recovery will distort the market by encouraging IXCs to bypass the switched network using competitive access providers and by creating a disincentive for IXCs to compete for low-volume long distance users.[62] Other parties argue that the proposal imposes an additional administrative burden on LECs and does not adequately address the problem of "dialing around" the switched network.[63] AT&T and Sprint claim that assessing a flat, presubscribed line charge on IXCs would not eliminate the inefficiencies or the implicit cross-subsidies embedded in the CCL charge.[64] These carriers assert that a flat-rated per-line recovery mechanism would force IXCs to subsidize other service providers, including LECs, wireless carriers, ISPs, and resellers that originate or terminate traffic over the loop but are not subject to the charge. They contend that this would be inconsistent with section 254(b) which requires "equitable and nondiscriminatory contribution to universal service" by all telecommunications providers.[65] Sprint asserts that a flat-rated charge assessed on IXCs will force IXCs to adopt two-part tariffs to avoid being undercut by the usage-based rates of carriers that rely on 10XXX dial-around traffic for their business, but that would not be assessed common line charges.[66]

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[59] Competition Policy Institute Comments at 14-17; American Association for Retired Persons, *et al.* (AARP, *et al.*) Comments at 13-14.

[60] Alliance for Public Technology Comments at 5.

[61] PacTel Reply at 22. *See also* Personal Communications Industry Association (PCIA) Reply at 4 (stating that Alliance's facility charge proposal is inconsistent with the cost-causative principles set forth in the NPRM).

[62] *See, e.g.*, GTE Comments at 29; GSA/DOD Comments at 9-10, Reply at 6.

[63] ALLTEL Comments at 11; Illinois Commission Comments at 6-7; Ameritech Comments at 10-11; ACTA Comments at 6.

[64] AT&T Reply at 28; Sprint Comments at 15-16.

[65] AT&T Reply at 28-29; Sprint Comments at 15-16.

[66] Sprint Comments at 16.

17. *Alternative Recovery Methods*. Several state commissions and incumbent non-price cap LECs support the proposal to recover the CCL charge through bulk billing.[67] The Oregon Commission, ACTA, and the Florida Commission favor recovering the interstate portion of loop costs through a capacity charge assessed on carriers based upon the number of switch trunk ports purchased from the incumbent LEC.[68] The Missouri Commission, the Texas Commission, and the Alabama Commission favor the proposal to assess common line charges based on the number of trunk port and line port connections an IXC has to the switched network.[69] NECA requests flexibility for pool members to recover the CCL charge through either a per-line charge and/or a bulk billing method.[70] Specifically, NECA proposes a method allowing the pool members to charge a nationwide average CCL per-line rate and bulk bill any residual amount.[71]

18. Cable & Wireless, MCI, Teleport, and others oppose the bulk billing, capacity charge, and trunk port charge alternatives because they are based on minutes of use and do not accurately reflect costs.[72] ACTA asserts that bulk billing causes operational and administrative problems.[73] According to Teleport and GCI, bulk billing ensures total recovery for the LEC because the LEC receives the same revenues whether it faces no competition or substantial competition.[74] Several commenters oppose these alternative recovery mechanisms because they are based on historical usage or revenue data.[75] Sprint argues that if a cost recovery mechanism is based on historical usage or revenue data, an interexchange carrier that is losing market share will be penalized, while

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[67] *See, e.g.*, Ohio Commission Comments at 4; Florida Public Service Commission (Florida Commission) Comments at 2; Illinois Commission Comments at 7; Alaska Telephone Association Comments at 10; ALLTEL Comments at 12; Frederick & Warinner, L.L.C. (Frederick & Warinner) Comments at 4; GVNW Comments at 6; Harris, Skrivan & Associates Comments at 6; Roseville Tel. Comments at 8; Puerto Rico Tel. Comments at 11-12; WITA Comments at 4-5.

[68] Oregon Commission Comments at 4-5; ACTA Comments at 5; Florida Commission Comments at 2.

[69] Missouri Commission Comments at 3; Texas Commission Comments at 4-5; Alabama Public Service Commission (Alabama Commission) Comments at 6.

[70] NECA Comments at 10.

[71] *Id. See also* NECA Reply at 6-7.

[72] *See, e.g.*, Cable & Wireless Comments at 10; MCI Comments at 77; Sprint Comments at 13-14; Teleport Comments at 28; People of the State of California and the Public Utility Commission of the State of California (California Commission) Comments at 4.

[73] ACTA Comments at 6.

[74] Teleport Comments at 28; General Communication, Inc. (GCI) Reply at 10.

[75] Sprint Comments at 13; ALTS Comments at 24-25, Reply at 23; American Communications Services, Inc. Reply at 17.

a carrier whose market share is growing will receive a windfall.[76]

19. The Minnesota Independent Coalition and TCA argue that a capacity charge based on trunks is not feasible for smaller LECs because most IXCs serving smaller LECs do not use dedicated trunks.[77] MCI and the Minnesota Independent Coalition argue that imposing NTS costs based on the relative number of trunks or ports may encourage IXCs to use fewer trunks or ports than are needed, leading to adverse impacts on service quality.[78]

20. Ameritech proposes to recover common line costs via a Loop/Port recovery charge that it would assess as a single, aggregate charge per carrier on IXCs based upon their percentage share of state- or region-wide interstate retail revenues.[79] Sprint and Time Warner oppose Ameritech's proposal, stating that such an approach would insulate incumbent LECs from the forces of competition.[80] According to Sprint, long distance carriers entering the local market through unbundled network elements or their own facilities or that purchased access from new entrants would be required to pay Ameritech regardless of the extent to which they utilized Ameritech's loops or switching.[81] Time Warner states that Ameritech's proposal ensures the survival of the local loop bottleneck by eliminating opportunities for low-cost new entrants to compete in the provisioning of local loops.[82]

21. *Impact of 254(g) on Carrier Common Line Charge Recovery*. Excel and the Alaska Commission argue that section 254(g) does not impose any limitations on the Commission's authority to assess flat-rated CCL charges on IXCs because the section pertains to rates charged to "subscribers" or the ultimate end-user, not other carriers.[83] The majority of commenters responding to this inquiry argue that section 254(g) prohibits IXCs from passing their flat-rated

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[76] Sprint Comments at 13.

[77] Minnesota Independent Coalition Comments at 6-7; TCA Comments at 3.

[78] Minnesota Independent Coalition Comments at 7; MCI Comments at 77.

[79] Ameritech Comments at 9-10. Ameritech states that it would initially set its LPR at the revenues from the CCL charge, less payphone and long-term support, plus line-side port costs from local switching plus the information charge, and would transition the LPR to cost over 5 years. *Id.*

[80] Sprint Reply at 12-13; Time Warner Reply at 16-17.

[81] Sprint Reply at 12-13.

[82] Time Warner Reply at 16-17.

[83] Excel Comments at 11; State of Alaska (Alaska Commission) Reply at 3-4;

charges through to end users on a deaveraged basis.[84] USTA argues that although the flat-rate CCL charged to the IXCs should be deaveraged by customer and by region to be consistent with cost-causation principles, it will not conflict with section 254(g) because IXCs can average any disparate flat-rate CCL charges into their rate structure as they have averaged disparate per-minute CCL charges.[85] Sprint and WorldCom argue that forbearance from Section 254(g) would be warranted.[86] Sprint asserts that if incumbent LECs continue to recover NTS costs, particularly common line costs, from the IXCs and these costs are recovered through deaveraged rates charged to the IXCs, forbearance from section 254(g) would be warranted because of the magnitude and variability of these costs.[87] WorldCom argues that IXCs should be free to recover subscriber loop costs assessed by incumbent LECs through a flat charge per line or through any other rate recovery mechanism the long distance market will allow.[88] WorldCom argues further that unless the Commission forbears with respect to application of section 254(g), IXCs will be forced to average common line costs and recover them through long distance rates--a cross-subsidy that runs counter to the overall policies of section 254(b) and (c).[89] Several parties oppose forbearance.[90]

4. Common Line PCI Formula

22. Incumbent LECs argue that TFP incorporates growth into the X-Factor, and that retaining the current separate common line formula would tend to double-count growth.[91] Some

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[84] *See, e.g.,* State Consumer Advocates Comments at 49-51; Rural Tel. Coalition Comments at 27-30; Minnesota Independent Coalition Comments at 8-9,11; Harris, Skrivan & Associates Comments at 7; TDS Comments at 3, 19-20, Reply at 21; Alaska Commission Reply at 3-4; Hawaii Commission Reply at 2.

[85] USTA Comments, Attachment 1 at 7-8, Reply at 33. *See also* Tennessee Regulatory Authority (Tennessee Commission) Comments at 3.

[86] Sprint Reply at 27; WorldCom Comments at 34.

[87] Sprint Reply at 27.

[88] WorldCom Comments at 34-35.

[89] *Id.*

[90] Harris, Skrivan and Associates Comments at 7; Minnesota Independent Coalition Comments at 11; Rural Tel. Coalition Comments at 28-30.

[91] USTA Comments in Price Cap Fourth Further NPRM at 44-45; GTE Comments in Price Cap Fourth Further NPRM at 41-42; Southwestern Bell Comments in *Price Cap Fourth Further NPRM* at 35-36; BellSouth Comments in Price Cap Fourth Further NPRM at 42; Bell Atlantic Comments in Price Cap Fourth Further NPRM at 14; Frontier Comments in Price Cap Fourth Further NPRM at 10; Ameritech Comments in Price Cap Fourth Further NPRM at 8-9; Lincoln Telephone (Lincoln) Comments in *Price Cap Fourth Further NPRM* at 15; U S West Comments in Price Cap Fourth Further NPRM at 25-26; NYNEX Comments in Price Cap Fourth Further NPRM at 29; PacTel Comments in Price Cap Fourth Further NPRM at 15; USTA Reply in Price Cap Fourth Further NPRM at 27-28; U S West Reply in Price Cap Fourth Further NPRM at 34; Frontier Reply in Price Cap Fourth

of those incumbent LECs assert that a separate common line formula might impede certain access reforms that they support.[92] Lincoln claims that common line demand growth output would be reflected as common line output growth in a TFP calculation, and so would transfer the benefits of demand growth to IXCs.[93] Sprint and AT&T maintain that the Commission must retain a separate common line formula, regardless of how the X-Factor is calculated.[94] AT&T argues that a separate common line formula is necessary to avoid giving more revenues to the LECs with the highest common line costs, and to recognize the IXCs' role in promoting common line demand growth.[95] AT&T also asserts that the LECs' claims of double-counting growth have not been adequately substantiated.[96]

23. Southwestern Bell argues that the g/2 term should be removed from the common line formula because common line minutes of use grow more quickly than number of access lines. Southwestern Bell asserts that flat CCL charges would reduce incumbent LECs' revenue growth by about 0.5 percent per year.[97]

5. Assessment of SLCs on Derived Channels

24. *Pleadings filed in response to the ISDN SLC NPRM*.[98] Only one commenter, AT&T, favors retaining the current approach for PRI ISDN service. AT&T does not support assessing a SLC per derived channel for BRI service, but instead favors assessing a SLC for each BRI facility. All of the other parties, including the other IXCs, oppose it. ISDN users, LECs, and equipment manufacturers argue that retaining the current rule will deter ISDN deployment, and will

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Further NPRM at 5-6; Ameritech Reply in Price Cap Fourth Further NPRM at 3.

[92] NYNEX Comments in Price Cap Fourth Further NPRM at 31; Ameritech Reply in Price Cap Fourth Further NPRM at 3; USTA Reply in Price Cap Fourth Further NPRM at 28.

[93] Lincoln Reply in Price Cap Fourth Further NPRM at 9-10 and Attachment A.

[94] Sprint Comments in Price Cap Fourth Further NPRM at 12; AT&T Comments in Price Cap Fourth Further NPRM at 43.

[95] AT&T Reply in Price Cap Fourth Further NPRM at 57-60.

[96] *Id*. at 59.

[97] SWBT Comments at 58-59. According to Southwestern Bell, for the incumbent price cap LECs, CCL minutes of use grew at an average annual rate of 6.8 percent from 1991 to 1995, while access lines grew at an average of 3.0 percent. *Id.* at 59. *See also* BA/NYNEX Comments at 36; U S West Comments at 55; USTA Reply, Attachment 3 at 9-10.

[98] Comments filed in response to our ISDN SLC NPRM, End User Common Line Charges, CC Docket No. 95-72, Notice of Proposed Rulemaking, 10 FCC Rcd 8565 (1995), will be referred to as ISDN Comments and ISDN Reply.

discourage development of new technologies.[99] Almost all of the LECs, user groups, equipment manufacturers, IXCs, and other commenters support a rule that would assess a SLC for each pair of copper wires,[100] or a SLC for each ISDN facility.[101] Some commenters express a preference for one of these approaches, but urge the Commission to adopt one or the other of the two options.[102] Some parties further assert that, if the Commission fails to adopt a rule that assesses a SLC per copper pair or per service, it should adopt a rule based on the actual non-traffic-sensitive costs of providing derived channel services compared to costs of providing conventional local loops.[103] Numerous trade groups, ISDN users, and LECs assert that a SLC per pair of copper wires or a SLC per facility approach would encourage use of advanced services, such as ISDN, that offer numerous potential benefits.[104]

25. The parties also assert that assessing a SLC per facility or pair of copper wires would best reflect the underlying purpose of the SLC, which is to recover non-traffic-sensitive loop costs.[105] Some parties also assert that charging a SLC per facility is consistent with the

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[99] America Online Incorporated, CompuServe Incorporated, GE Information Services, Inc., and Prodigy Services Company (America Online) ISDN Comments at 8-10 (citing *U.S. Industrial Outlook* 1994, U.S. Department of Commerce at 25-1, January 1994, and citing Bell Atlantic Waiver Petition at 7-8, which estimates that requiring a SLC per derived channel would reduce demand for BRI service by about 60 percent and demand for PRI service by about 35 percent). *See also* Cable & Wireless ISDN Comments at 3-4; Microsoft Corporation (Microsoft) ISDN Comments at 4; West Virginia University ISDN Comments at 1; TCA ISDN Comments at 4; Information Technology Industry Council (ITIC) ISDN Reply at 3; Roseville Tel. ISDN Reply at 4; Northern Telecom Inc. (Nortel) ISDN Reply at 5; The Bell Atlantic Telephone Companies (Bell Atlantic) ISDN Reply at 3.

[100] *See, e.g.*, Roseville Tel. ISDN Comments at 2; TCA ISDN Comments at 1; Tennessee Commission ISDN Comments at 2-3.

[101] *See e.g.*, Ameritech ISDN Comments at 2; BellSouth ISDN Comments at 4-5; Cincinnati Bell ISDN Comments at 3, 6; NTCA ISDN Comments at 1-2; NYNEX ISDN Comments at 16; SWBT ISDN Comments at 3; USTA ISDN Comments at 2; 3Com Corp. ISDN Reply at 6.

[102] GTE ISDN Comments at 9-10; ITIC ISDN Comments at 2; NTCA ISDN Comments at 2; Northern Arkansas Telephone Company ISDN Comments at 2-4; CIEA ISDN Reply at 1; 3Com Corporation ISDN Reply at 6-7.

[103] Rural Tel. Coalition ISDN Comments at 4-5; American Petroleum Institute (API) ISDN Comments at 6. *See also* Northern Arkansas Telephone Company ISDN Comments at 2-3 (suggesting that assessing 7 or 8 SLCs for PRI service might be reasonable, based on costs).

[104] America Online ISDN Comments at ii, 1-3; ITIC ISDN Comments at 3-4; Center for Democracy and Technology ISDN Comments at 3; National Public Radio ISDN Comments at 3-4; Microsoft ISDN Comments at 2; Pacific Bell ISDN Comments at 1-2; TCA ISDN Comments at 3. Some parties assert that ISDN will set the new telecommunications standard, competing with, or even replacing, plain old telephone service (POTS). Pacific Bell ISDN Comments at 3; ITIC ISDN Comments at 3. *See also* Northern Arkansas Telephone Company ISDN Comments at 3-4; Center for Democracy and Technology ISDN Comments at 3. Others describe ISDN as a significant but interim step in the development of an advanced communications network. Microsoft ISDN Comments at 2; TCA ISDN Comments at 3-4.

[105] Roseville Tel. ISDN Comments at 2; USTA ISDN Comments at 9; NYNEX ISDN Comments at 3; BellSouth ISDN Comments at 4-5; Pacific Bell ISDN Comments at 4-5; Roseville Tel. ISDN Reply at 3 (asserting that any charge beyond one SLC per service over-recovers non-traffic-sensitive costs).

Commission's goals of eliminating unreasonable discrimination and undue preferences among rates for interstate services, using the local network efficiently, preventing uneconomic bypass, and preserving universal service.[106] Others argue that this approach is administratively simple,[107] that it will reduce the opportunity for uneconomical pricing by competitors,[108] and that it will reduce the likelihood of migration from switched access to dedicated service.[109]

26. Many parties, including LECs and ISDN users, argue that any method for assessing SLCs should be based on the costs of providing ISDN service.[110] Parties opposing the proposal to assess SLCs for derived channel services based on the cost ratio allege that such an approach is too complicated,[111] and that the potential benefits of this approach are outweighed by the substantial effort required to make such a cost comparison.[112] Others object that the proposal set forth in the ISDN SLC NPRM would not take into account the relevant costs. Some companies assert that ISDN service does not increase the average loop costs.[113] Others contend that the additional costs incurred to provide ISDN service are switching costs rather than common line costs.[114]

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[106] USTA ISDN Comments at 8; Roseville Tel. ISDN Comments at 2; Cable & Wireless ISDN Reply at 2.

[107] GTE ISDN Comments at 9-10; SWBT ISDN Comments at 3-4; TCA ISDN Comments at 2; ITIC ISDN Comments at 1-2.

[108] USTA ISDN Comments at 15-16.

[109] API ISDN Comments at 4; Microsoft ISDN Comments at 3; USTA ISDN Comments at 14.

[110] U S West ISDN Comments at 4; California Bankers' Clearing House ISDN Comments at 3-4;Texas Commission ISDN Comments at 6. Some parties that support a cost-based approach contend that assessing one or two SLCs are adequate to recover non-traffic-sensitive line costs of derived channel services. *See* Pacific Bell ISDN Comments at 4; Rochester Telephone Corp. ISDN Comments at 3; TCA ISDN Comments at 2; Tennessee Commission ISDN Comments at 3-4.

[111] USTA ISDN Comments at 12 (urging that it would be difficult to break down average subscriber loop costs without doing the same for other categories of subscribers); AT&T ISDN Comments at 6-7; GTE ISDN Comments at 17.

[112] America Online ISDN Comments at 6-7 (the Commission has discretion to balance strict cost-causation with the need to avoid imposing costs on new technologies that could undermine the economic viability of those technologies); Time Warner ISDN Comments at 5.

[113] SWBT ISDN Comments at 9. *But see* Bell Atlantic Comments at 4-5 and n.13 (recognizing that PRI ISDN service may increase common line costs). *See also* Tennessee Public Service Commission ISDN Comments at 3 (digital upgrades should be considered to be normal part of network evolution, and extra SLCs should not be assessed as a result of such normal network upgrades).

[114] TCA ISDN Comments at 5 and Time Warner ISDN Comments at 5. *See also* NYNEX ISDN Comments at 8-9; Sprint ISDN Reply at 1-2 (U S West proposal improperly includes non-loop plant costs such as line cards, and SLCs are based on average costs rather than service-specific costs. U S West's proposal would necessitate a fundamental reworking of the Commission's Part 69 rules).

27. Few parties commented on our proposal to impose a SLC for every two derived channels. Those who did generally opposed it for many of the same reasons they opposed assessing a SLC per derived channel. For example, parties asserted that such a rule would bear no relationship to the cost of providing service, and would discourage subscription to derived channel services.[115]

28. Several parties also filed comments regarding other modifications to access charges and our price cap rules.[116] In addition, NYNEX asserts that the Commission should not apply the rule we adopt to derived channel technologies that are not apparent to the end user and that are exclusively in the LEC's network infrastructure.[117] NYNEX claims that it would be impossible to identify the subscribers served by such technology, and that it would be inappropriate to treat those subscribers differently.

29. The BOCs subsequently provided data on the relative non-traffic-sensitive costs of single and derived channel services, in response to our request for information.[118] As shown in Table 1 below, the cost data submitted in response to the *ISDN SLC NPRM* indicates that the ratio of NTS loop costs of BRI ISDN to standard analog service is approximately 1 to 1. The ratio of NTS loop costs of PRI ISDN to standard analog service, excluding NYNEX's data, is roughly 5 to 1. As shown in Table 2, NYNEX's data appear to be outliers and are therefore excluded from the calculation of the average ratio for PRI ISDN to standard analog service because the ratios of its outside plant and NTS costs for PRI ISDN to standard analog service are almost twice those of other incumbent LECs.

[115] SWBT ISDN Comments at 9.

[116] *See, e.g.,* SWBT ISDN Comments at 3, 10; Roseville Tel. ISDN Comments at 4; MCI ISDN Comments at 5; NYNEX ISDN Comments at 5; USTA ISDN Comments at 12-13; Time Warner ISDN Comments at 4; America Online ISDN Reply at 8; Pacific Bell ISDN Comments at 5, 7.

[117] NYNEX ISDN Comments at 14.

[118] In their responses, three of the BOCs, BellSouth, NYNEX, and SWBT, asked for confidential treatment of portions of the information submitted. NYNEX publicly filed the information we requested, but submitted as confidential additional information that contained more detailed cost data. The confidential data were not necessary to perform our analysis, and the following tables only include data that was filed on the public record. We have returned to the respective companies data for which confidential treatment was sought.

TABLE 1

Ratio of costs of standard analog service to BRI ISDN service

	Outside Plant (loop only) costs	All NTS costs
Ameritech	1:1.07	1:1.45
Bell Atlantic	1:1.01	1:1.36
NYNEX	1:0.85	1:1.23
Pacific Bell	1:1.05	1:1.13
US West	1:0.80	1:1.07
Average ratio of costs	**1:0.96***	**1:1.24***

TABLE 2

Ratio of costs of standard analog service to PRI ISDN service

	Outside Plant (loop only) costs	Outside Plant (loop only) costs (excluding NYNEX	All NTS costs	All NTS costs (excluding NYNEX data)
Ameritech	1:5.68	1:5.68	1:8.9	1:8.9
Bell Atlantic	1:4.13	1:4.13	1:15.80	1:15.80
NYNEX	1:10.94	excluded	1:27.74	excluded
Pacific Bell	1:4.67	1:4.67	1:8.70	1:8.70
US West	1:5.33	1:5.33	1:10.60	1:10.60
Average ratio of costs	**1:6.5***	**1:4.95***	**1:15.13***	**1:10.5***

*Averages may differ due to rounding.

30. GTE and MCI filed comments, and America Online, NYNEX, Pacific Bell, Southwestern Bell, and US West filed reply comments in response to the cost data. Several of those parties contend that cost ratios should not be used to determine the number of SLCs to be assessed for derived channel services, because SLCs currently are set at arbitrary levels, and do not reflect the actual costs of providing any particular service.[119] Several parties also contend that, even if we decide to assess SLCs for derived channel services based on the relative non-traffic-sensitive costs of those services, we should not include switching costs such as trunk or line cards in our assessment of costs.[120] They argue that a cost-based ratio would be complex to develop, and would create substantial and unnecessary recordkeeping burdens.[121] Many parties also assert that the cost data demonstrate that there is no difference between the non-traffic-sensitive loop costs for standard analog service and BRI service, and that there is not a significant difference in the non-traffic-sensitive loop costs between standard analog service and PRI service,[122] or between digital PBX trunks and PRI service.[123]

31. *Comments filed in response to the Access Reform NPRM.* Comments filed in the current proceeding are consistent with those filed in response to the ISDN SLC NPRM. The majority of commenters support a rate structure that assesses one SLC per ISDN facility,[124] or per pair of copper wires.[125] State Consumer Advocates, argues that assessing SLC based on pairs of wires would inhibit the introduction of new technologies and service because LECs would have a

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[119] GTE ISDN Comments regarding cost data at 3; America Online ISDN Reply regarding cost data at 2; NYNEX ISDN Reply regarding cost data at 3-4.

[120] GTE ISDN Comments regarding cost data at 4; America Online ISDN Reply regarding cost data at 2; ISDN NYNEX Reply regarding cost data at 3-4.

[121] GTE ISDN Comments regarding cost data at 4-7; NYNEX ISDN Reply regarding cost data at 4; SWBT ISDN Reply regarding cost data at 3.

[122] GTE ISDN Comments regarding cost data at 8-10; America Online ISDN Reply regarding cost data at 2 (any difference between providing PRI service and single channel service "is not large and principally is attributable to the fact that PRI ISDN is provided using two twisted copper pairs" rather than one); SWBT ISDN Reply regarding cost data at 3-4 (urging the Commission to assess one SLC per service as an interim rule, pending a separate proceeding on access charge reform). *Accord* Pacific Bell ISDN Reply regarding cost data at 3-4. *See also* U S West ISDN Reply regarding cost data at 1-2 (urging the Commission to bifurcate the treatment of BRI and PRI service, and to issue a decision immediately that would require LECs to assess no more than one SLC for BRI service).

[123] MCI ISDN Comments regarding cost data at 2; NYNEX ISDN Reply regarding cost data at 4.

[124] *See, e.g.,* USTA Comments at 56, Reply at 34; Ameritech Comments at 13; PacTel Comments at 65; GTE Comments at 33; Cincinnati Bell Comments at 8; Sprint Comments at 18; API Comments at 30-32; Compuserve Comments at 19-21, Reply at 9; Microsoft Comments at 7; PSINet Reply at 11; CIEA Comments at 12, Reply at 12; Alarm Industry Communications Committee Reply at 13.

[125] ACTA Comments at 7; Frontier Comments at 7, n.12; Alarm Industry Communications Committee Reply at 13.

financial incentive to keep customers on conventional service.[126] TDS recommends assessing one SLC charge on a BRI ISDN line and no more than two SLCs on a PRI ISDN line.[127] Ad Hoc argues that although assessing SLCs based on derived channels should recover the costs of providing such channels, the Commission has not provided sufficient information to determine whether a ratio of 1.24 to 1 for BRI, and 10.5 to 1 for PRI accurately reflect the costs of those services.[128] PacTel argues that ISDN service is not an interstate service and, therefore, not within the Commission's jurisdiction.[129]

32. Those commenters that oppose assessing a SLC per derived channel argue that imposing one SLC per channel discourages demand for advanced services and inhibits technological development.[130] USTA states that the current multiple SLC rule imposes disproportionate burdens of cost recovery on ISDN users and that changing to a single SLC per facility would be consistent with the objectives of this proceeding.[131]

B. Local Switching

1. Non-Traffic Sensitive Charges

33. The majority of commenters agree with our tentative conclusion that cost-causative principles indicate that costs associated with line cards, line-side ports, and those trunk ports associated with dedicated transport should be recovered through flat-rated charges.[132] Several incumbent LECs argue that there is no need to codify specific rate elements for local switching costs and, instead, advocate flexibility in the rate structure for local switching.[133] BA/NYNEX amplifies this argument by stating that it may be both difficult to quantify the NTS portion of local switching costs, and burdensome to separately charge for trunk ports based on the type of

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[126] State Consumer Advocates Comments at 64-66.

[127] TDS Comments at 22.

[128] Ad Hoc Comments at 13-14.

[129] PacTecl Comments at 65.

[130] *See, e.g.*, SWBT Comments at 13; TCA Comments at 4; ACTA Comments at 7; CompTel Comments at 29-30; Interactive Services Association Comments at 3.

[131] USTA Comments at 56, Reply at 34.

[132] *See, e.g.*, CompTel Comments at 31; USTA Comments, Attachment 1 at 8; AT&T Comments at 55; LCI Comments at 21; PacTel Comments at 66; Rural Tel. Coalition Comments at 9; Alabama Commission Comments at 7-8; Florida Commission Comments at 2; Texas Commission Comments at 8; TCI Reply at 7.

[133] *See, e.g.*, USTA Reply at 34-35; SNET Comments at 37; BA/NYNEX Comments at 39.

transport used by an IXC.[134] BellSouth claims that an adequately-sized universal service fund could replace all implicit support currently provided through interstate access charges that recover NTS costs, thereby reducing the carrier common line charge to zero and recovering fully the NTS portion of local switching charges.[135] The Georgia Commission argues that the assertion that NTS local switching costs are related to the provision of universal service is tantamount to saying that most costs are related to universal service and that the USF should not be the first place to look for recovery of any cost element.[136]

34. Several small LECs and the State Consumer Advocates argue that changes to the rate structure to recover NTS local switching costs on a NTS basis should be left to the Joint Board on Separations.[137] These commenters state that local switching costs formerly were recovered through a combination of TS and NTS charges and that new Parts 32 and 36, when adopted, consolidated these mechanisms because of difficulties in separating the TS and NTS costs of digital switches.[138] Therefore, these commenters argue that, if part of the costs of local switching are to recovered through NTS flat-rated charges, the Joint Board should first expand Part 36 and 69 categories related to NTS local switching equipment.[139] Otherwise, the inconsistent treatment of some local switching costs as TS for purposes of Part 36 but NTS for purposes of Part 69 would improperly transfer costs from the interstate to the intrastate jurisdictions.[140]

35. U S West, Sprint and other commenters argue that to the extent that NTS line-side costs are attributable to the end user, they ought to be recovered from end users.[141] Others, such as TCI, favor an increased SLC, but support a PIC-based charge as a second-best option for

[134] BA/NYNEX Reply at 35.

[135] BellSouth Reply at 10; *see also* USTA Reply at 34.

[136] Georgia Commission Reply at 21.

[137] Frederick & Warinner Comments at 5; Harris, Skrivan & Associates Comments at 6; State Consumer Advocates Comments at 31-32.

[138] *E.g.*, Frederick & Warinner Comments at 5-6; Harris, Skrivan & Associates Comments at 6.

[139] Frederick & Warinner Comments at 5; State Consumer Advocates Comments at 31-32.

[140] State Consumer Advocates Comments at 31-32.

[141] *See*, *e.g.*, U S West Reply at 29; Sprint Comments at 18; Illinois Commission Comments at 11; SWBT Comments at 8; AT&T Reply at 29 (line cards that terminate a subscriber's loop should be flat-rated and charged to the subscriber via the SLC).

recovering NTS local switching costs.[142] Ameritech and ALLTEL propose that NTS local switching costs be recovered by a charge assessed on IXCs on the basis of interstate retail service revenues or minutes of use.[143] Sprint responds that such proposals do not recover these costs on a cost-causative basis, and insulate the incumbent LEC from competition.[144] TCI maintains that the cost of the trunk side ports dedicated to an individual IXC varies directly with the number of trunks dedicated to that IXC.[145] TCI also states, however, that the costs of trunk ports associated with dedicated transport need to be recovered through a separate rate element because an IXC may use a trunk port supplied by the incumbent LEC without using the incumbent LEC's dedicated transport.[146]

36. MCI notes that identifying TS and NTS costs of local switching is not simple, and supports adoption of the proposed rate structure only if cost studies allocating costs between TS and NTS can be performed.[147] The record reflects widely varying estimates of the portion of local switching costs that are NTS. USTA estimates that the NTS portion of local switching costs ranges from 6% for analog switches to 51% for modern, digital switches.[148] ALLTEL reports that NTS local switching costs make up 31 percent of its interstate local switching revenue requirement.[149] SWBT claims NTS local switch costs could be recovered through a flat charge of $0.35 a month per line.[150] Sprint, in contrast, estimates that one-third of local switching costs are NTS, and that recovering those costs directly from end users would add $0.80 per month to end user bills.[151] Cable & Wireless reports that, based on data submitted by NYNEX, at least 49

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[142] TCI Reply at 7; *see also* BellSouth Reply at 11-12 (the mere possibility, speculative at best, that per line charges assessed on IXCs will encourage "dial-around" services, is insufficient reason for the Commission not to establish per line NTS recovery of NTS costs); Sprint Reply at 12-13.

[143] Ameritech Comments at 14; ALLTEL Comments at 12.

[144] Sprint Reply at 12-13.

[145] TCI Comments at 12.

[146] *Id.*

[147] MCI Comments at 81-82; *see also* BA/NYNEX Reply at 35 (it may be difficult to quantify the NTS portion of these costs).

[148] USTA Comments, Attachment 2 at 31.

[149] ALLTEL Comments at 12.

[150] SWBT Comments at 8.

[151] Sprint Comments at 18. In developing this estimate, Sprint used a TELRIC cost study of its New Jersey operations and assumed that the resulting data were representative of price cap LECs as a whole. Sprint estimates that, if end users were charged directly $0.80 monthly for local switching, this change would save IXCs $1.365 billion annually.

percent of the local switching costs are NTS for modern switches.[152]

37. Cable & Wireless and other commenters state that many components of the local switch, such as the central processing portion of the switch, switch fabric, and the trunk-side ports that are not associated with dedicated transport, are shared. These commenters assert that these shared facilities should be priced on a usage-sensitive basis.[153] BellSouth, however, states that in addition to the costs of line cards and the main distribution frame, many other switching costs, *e.g.*, the cost of the switching matrix, depend substantially on the number of lines rather than usage.[154] The Texas Commission disagrees, noting that while growth in the number of dedicated lines or trunks attached to the switch does cause the central processing unit to grow in size, it is usage of these lines or trunks that cause costs.[155] The Rural Tel. Coalition states that, because small carriers lack economies of scale and scope, rural switching costs are higher per minute or per line than urban switching costs.[156]

2. Traffic Sensitive Charges

38. Many IXCs, consumer groups, ESPs, and LECs oppose the establishment of a mandatory call setup charge.[157] Collectively, they raise two primary concerns: (1) the costs of call setup are *de minimis* or difficult to separate from other TS costs;[158] (2) the costs of measuring, tracking and billing for call setup would outweigh the costs of the call setup itself.[159]

39. AT&T argues that a such a mandatory charge would be inconsistent with the rate structure the Commission mandated for the local switching unbundled network element (UNE) because no call setup charge has been established as part of the unbundled local switching rate

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[152] Cable & Wireless Comments at 12-13.

[153] Cable & Wireless Comments at 12-13; Citizens Utilities Comments at 30; GSA/DOD Comments at 4.

[154] BellSouth Comments, Attachment 2 at 14 (Haring and Rohlfs, "Economic Perspectives on Access Charge Reform").

[155] Texas Commission Comments at 11-12; *see also* USTA Comments, Attachment 2 at 31 (notes that the determination of which switch to install is clearly a traffic-sensitive decision).

[156] Rural Tel. Coalition Comments at 10.

[157] *E.g.*, Cable & Wireless Comments at 13-15; Sprint Comments at 19; Bankers Clearing House Comments at 3-4; CompuServe/Prodigy Comments at 25-29, Reply at 11-12; USTA Comments, Attachment 1 at 8, Comments at 57, Reply at 35.

[158] *E.g.*, Cable & Wireless Comments at 13-15; Teleport Comments at 22.

[159] *E.g.*, Cable & Wireless Comments 14; Sprint Comments at 19; Teleport Comments at 22; Bankers Clearing House Comments at 3-4.

structure at either the state or federal level.[160] In addition, AT&T argues that a separate rate element is unnecessary because many of the costs of call setup are now allocated to signalling, and the signalling rate structure proposed in the NPRM includes signalling message charges for all calls.[161]

40. Cable & Wireless asserts that per-call setup costs are too small relative to the other TS costs of local switching to justify a new and separate rate element; therefore, any economic inefficiency resulting from collection on a per-minute basis is *de minimis* and would be offset by increased complexity in the rate structure.[162] LCI states that the current per-minute recovery mechanism has not been controversial in the past, and that imposing a call setup charge on call attempts would result in charges being assessed on a caller who has not received any service.[163] LCI states that, in addition to the LEC's setup costs, the IXC also incurs transport costs associated with call attempts that are not recovered explicitly from the calling party.[164]

41. MCI opposes a separate call setup charge, asserting that it is unclear at best which part of the TS portion of local switching costs are sensitive to call attempts and which part is sensitive to minutes of use. In addition to signalling, MCI hypothesizes that some part of the cost of the central processor may be sensitive to call attempts. Any attempt to separate TS costs into per-message and per-minute categories could involve arbitrary assumptions and, therefore, MCI argues that TS costs of local switching should be left as per-minute charges.[165] MCI states, however, that any call setup charge the Commission does adopt should be assessed only on completed calls because, otherwise, the incumbent LEC will be able to charge for calls blocked by its own switch and will have reduced incentives to ensure quality service on its network.[166]

42. Several large corporate consumers of telecommunications services oppose the imposition of a call setup charge because they assert that the charge would cause churn and would be disruptive to consumers, especially banks with automatic teller machines and businesses that

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[160] AT&T Comments at 56, Reply at 30.

[161] AT&T Reply at 29. Although Ameritech favors the creation of a call setup charge, it asserts that over 95% of its calls are set up using SS7 technology.

[162] Cable & Wireless Comments at 13. *See also* Bankers Clearing House Reply at 3 (Call setup costs associated with call attempts are trivial, because out-of-band signalling permits the likelihood of call completion to be evaluated before a transmission path is established).

[163] LCI Comments at 25-26.

[164] *Id.*

[165] MCI Comments at 82.

[166] MCI Comments at 83; *see also* Bankers Clearing House Reply at 4.

accept credit cards.[167] In addition, Bankers Clearing House argues that neither IXCs nor other third parties have the capability to track or audit call attempts, so assessment of setup charges based on call attempts raises the potential for unauditable billing errors.[168]

43. Several state commissions, incumbent LECs, and others favor the creation of a separate call setup charge. The costs of call setup, these parties argue, do not vary with the length of a call, so a per call charge, rather than the current per-minute recovery of these costs, would be more consistent with cost-causation principles.[169] In addition, under the current, per-minute recovery mechanism, long hold-time calls subsidize short calls and uncompleted calls.[170] Two years ago, the California Commission established mandatory call setup charges intrastate switched access, imposing charges on originating attempts that are handed off to the IXC's POP, and on terminating completions.[171] The California Commission states that this structure is appropriate because, at the point the call is handed off to the IXC's POP, the LEC switch has performed its function and the LEC has incurred the setup cost.[172] In addition, the California Commission reports that, under this structure, it has not encountered problems with LEC duplicity in generating deliberate incompletions.[173]

44. Several parties advocate recovery of call setup costs through a separate signalling rate element. Frederick & Warinner argues that, by performing call setup prior to dedicating a trunk to the call, LECs require fewer transport trunks; this efficiency should be passed along to IXCs in the form of lower access charges. Frederick & Warinner, therefore, suggests that we refer this issue to the Joint Board on Separations so that call setup expenses currently assigned to Central Office Equipment (COE) Category 3 and Interexchange Circuit Equipment Category 4.23 can be reassigned to a separate COE category designed to identify and recover all SS7 call setup

[167] CompuServe/Prodigy Comments at 25-29, Reply at 11-12; Bankers Clearing House Comments at 7-8; Ad Hoc Comments at 19-20, Reply at 3-4.

[168] Bankers Clearing House Comments at 3-4.

[169] *E.g.*, Excel Comments at 12; TRA Comments at 37; Ameritech Comments at 15; PacTel Comments at 69; Citizens Utilities Comments at 30; Frederick & Warinner Comments at 6-7; Minnesota Independent Coalition Comments at 15; Alabama Commission Comments at 8; California Commission at 2-3; Texas Commission at 14; TCI Comments at 12.

[170] PacTel Comments at 68, Reply at 23.

[171] California Commission Comments at 6, Reply at 2-3; PacTel Comments at 68.

[172] California Commission Reply at 2.

[173] California Commission Reply at 2-3.

charges.[174]

45. A number of the parties that favor the principle of a separate call setup charge assert that the Commission should permit, but not require, such a charge.[175] They argue that flexibility will allow incumbent LECs to establish rate structures that are responsive to market conditions.[176] Competition Policy Institute argues that separate call setup charges may be appropriate in light of the increasingly "bursty" use of the network.[177] The Georgia Commission argues that the multiplicity of opinions on this issue points to a need for flexibility,[178] while the Illinois Commission suggests that flexibility will allow incumbent LECs to evaluate whether, and to what extent, such revision to the rate structure would be more efficient than the structure currently in place.[179] U S West supports the establishment of a call setup charge as a permissive rate structure, but cautions that the charge would require billing system changes, would affect different IXCs differently, and may be too small to merit a separate rate element.[180]

46. There is general agreement that LECs incur call setup costs for both completed calls and call attempts. Among commenters favoring a permissive or mandatory call setup charge, however, opinion is split as to whether the charge should be imposed on call attempts. Those parties favoring charges only for completed calls generally argue that this structure would (1) avoid the administrative burden and customer confusion associated with developing a tracking, metering and billing system for call attempts;[181] and (2) deny incumbent LECs the incentive to increase revenues by blocking calls at their own switch.[182] Those parties favoring charges for all call attempts generally argue that this structure would most closely reflect cost-causation

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[174] Frederick & Warinner Comments at 6 (these equipment categories are defined at 47 C.F.R. §§ 36.125, 36.126(b)(2)(iii)). *See also* TCI Comments 12-13, Reply at 9.

[175] *E.g.*, USTA Comments, Attachment 1 at 8, Comments at 57, Reply at 35; BA/NYNEX Comments at 39; BellSouth Comments at 71; PacTel Reply at 23 (PacTel does "not insist" that a call setup charge be mandatory); U S West Comments at 58; Competition Policy Institute Comments at 19; Georgia Commission Reply at 21-22; Illinois Commission Comments at 11-12.

[176] *E.g.*, BA/NYNEX Comments at 39; USTA Comments at 57.

[177] Competition Policy Institute Comments at 19.

[178] Georgia Commission at 21-22.

[179] Illinois Commission at 11-12.

[180] U S West Reply at 29.

[181] *E.g.*, Alabama Commission Comments at 8; Texas Commission Comments at 14.

[182] *E.g.*, MCI Comments at 83.

principles.[183]

a. Peak and Off-Peak Pricing

47. Many commenters, including most IXCs, oppose the creation of either a permissive or a mandatory peak-rate structure, because the complexity of creating and implementing such a structure outweighs any benefits to be gained.[184] These commenters generally argue that: (1) it is impossible to determine peak and off-peak hours with any degree of certainty because peak hours vary with region of the country, type of service, type of user, rate zone, technological advances, and other factors;[185] (2) peak pricing structures would not send efficient market signals, would disadvantage competitors, and would have a *de minimis* impact on usage patterns and incumbent LEC network design because less than 15% of RBOC traffic is interstate access;[186] (3) no state commissions have established a peak pricing rate structure;[187] (4) peak hours may continue to shift over time as competitors enter the market and as the use of telecommuting, the Internet, and other data services increase;[188] and (5) necessary changes to carrier metering and billing systems may outweigh any benefits to be gained.[189]

48. Other commenters, including most incumbent LECs, support a rate structure under which LECs would be permitted, but not required, to price local switching on a peak rate basis. These commenters acknowledge the difficulties cited above, among others, but generally agree that, in principle, economic welfare benefits could be obtained from a peak rate structure by diverting traffic, and associated TS costs, from peak to non-peak hours.[190] Accordingly, these commenters advocate a permissive approach under which incumbent LECs would have the ability to develop peak and off-peak pricing structures on an optional basis in response to local

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[183] *E.g.*, Ameritech Comments at 15; CompuServe/Prodigy Comments at 29; Citizens Utilities Comments at 30.

[184] *See, e.g.*, AT&T Comments at 56-57.

[185] *See, e.g.*, CompTel Comments at 31; Cable & Wireless Comments at 14; LCI Comments at 27; MCI Comments at 83; ALTS Comments at 24; ACC Long Distance Comments at 14; Sprint Comments at 19-20.

[186] AT&T Reply at 30; CompTel Comments at 31; ACC Long Distance Comments at 14.

[187] CompTel Comments at 31.

[188] Cable & Wireless Comments at 14; LCI Comments at 27.

[189] Bankers Clearing House Reply at 5-6; Citizens Utilities Comments at 30. *But see* Excel Comments at 12 (necessary changes to CABS are justified by the public policy benefits of a rate structure change).

[190] *E.g.*, GTE Reply, Appendix D at 15; USTA Comments, Attachment 1 at 8; TCI Comments at 13.

conditions and subject to the limitations of their billing systems.[191] At least one commenter argues that such an approach would be consistent with our recent interconnection decisions.[192]

49. Only Excel supports establishment of a mandatory peak rate structure, arguing that such a structure would more accurately apportion costs among users and would more accurately reflect the incremental costs of additional network capacity during peak hours.[193]

C. Transport

1. Entrance Facilities and Direct-Trunked Transport

50. The majority of commenters supported our tentative conclusion that flat-rate charges are appropriate for entrance facilities and direct-trunked transport service.[194] Those commenters addressing this subject agree that the costs of dedicated direct-trunked transport and entrance facilities are incurred on a flat-rate basis. Both PacTel and the California Commission note that, in California's Open Access Network Architecture and Development Proceeding, the parties reached consensus that costs of entrance facilities and direct-trunked transport should be recovered through flat-rate charges.[195] Several commenters assert that the costs of direct-trunked transport and entrance facilities vary with distance traversed and that rates for these facilities should be distance sensitive.[196] TCI supports distance sensitive flat-rate charges for direct-trunked transport, although it argues in favor of flat rate charges for entrance facilities, apparently

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[191] USTA Comments at 57-58, Reply at 35; Ameritech Comments at 16-17; BA/NYNEX Comments at 40; BellSouth Comments at 71; U S West Comments at 58-59, Reply at 29-30; Citizens Utilities Comments at 30; Frederick & Warinner Comments at 7; Minnesota Independent Coalition Comments at 16; TDS Comments at 24; Competition Policy Institute Comments at 20; Georgia Commission Reply at 21-22; Illinois Commission Comments at 11-12; TCI Comments at 13, Reply at 10; Time Warner Comments at 11-12.

[192] Frederick & Warinner Comments at 7 (*citing Local Competition Order*, ¶¶ 756-757).

[193] Excel Comments at 12.

[194] *See*, *e.g.*, AT&T Comments at 59; Excel Comments at 13; MCI Comments at 84; Ameritech Comments at 18; BA/NYNEX Comments at 41; BellSouth Comments at 71; PacTel Comments at 69; U S West Reply at 30; Citizens Utilities Comments at 30; NECA Comments at 3-4; Alabama Commission Comments at 9; California Commission Comments at 6; Illinois Commission Comments at 12; Sprint Comments at 21; TCI Comments at 14, Reply at 11.

[195] PacTel Comments at 69; California Commission Comments at 6. *See Rulemaking on the Commission's Own Motion to Govern Open Access to Bottleneck Services and Establish a Framework of Network Architecture Development of Dominant Carrier Networks; and Investigation on the Commission's Own Motion into Open Access and Network Architecture Development of Dominant Carrier Networks*, CPUC Docket No. R.93-04-003/I.93-04-002, Consensus Costing Principles/Basic Network Functions; OANAD Cost Methodology Workshops, Filed Aug. 23, 1995 by California Telecommunications Coalition. Texas, also, has adopted flat-rates for these facilities. Texas Commission Comments at 15.

[196] *See*, *e.g.*, AT&T Comments at 60; MCI Comments at 84; Ameritech Reply at 29; U S West Reply at 30; Texas Commission Comments at 15.

without a distance-sensitive component.[197]

51. Some parties advocate certain adjustments in the rate structure for direct-trunked transport and entrance facilities. U S West and Sprint both suggest that, as carriers expand their use of fiber-optic ring architecture, the current distance-sensitive charges for direct-trunked transport should be replaced with "per-ring" rates because ring architecture makes transport costs less distance sensitive in densely populated areas.[198] U S West argues, therefore, that incumbent LECs should have the flexibility to restructure their rates to reflect this change.[199] Ameritech agrees that the current rates for entrance facilities and direct-trunked transport are properly structured, but argues that carriers should have the flexibility to offer switched access customers new technologies, such as SONET, without obtaining a Part 69 waiver or passing a public interest test.[200] SWBT asserts that tariff and rate structure distinctions between special access, direct-trunked transport, and entrance facilities should be eliminated because these distinctions cannot survive in a competitive environment and cause complex billing arrangements for shared use facilities.[201] USTA proposes more sweeping change, arguing that the Commission forbear from regulating collocated direct-trunked transport because this service meets the requirements of Section 10 of the Communications Act.[202]

52. There is considerable division among commenters as to whether incumbent LECs should be permitted to offer transport services differentiated by whether the LEC or the IXC is responsible for channel facility assignments (CFAs). MCI opposes such a differentiation for two reasons. Initially, MCI notes that, while the incumbent LECs claim they can achieve network savings by retaining control of CFAs, IXC provision of CFAs should save the LEC the costs of performing this function. Therefore, it is unclear whether costs should be greater or lower when the IXC performs the CFA. Secondly, MCI argues that, once the LEC enters the interexchange market, it could impute to itself a lower transport charge by providing the CFA to its interexchange subsidiary.[203] SWBT offers two additional reasons why CFA control should not be the basis for rate differentiation: (1) CFA control responsibilities may vary among LECs; and (2)

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[197] TCI Comments at 14, Reply at 11.

[198] Sprint Comments at 21; U S West Reply at 30.

[199] U S West Reply at 30.

[200] Ameritech Comments at 17-18.

[201] SWBT Comments at 14-15. *See also* Ameritech Comments at 18 (arguing that pricing flexibility applicable to special access should be extended to functionally equivalent switched transport services).

[202] USTA Comments at 35-48.

[203] MCI Comments at 84-85.

rate differentiation based on CFA control may become untenable with respect to newer technologies, such as SONET architecture and ATM, which rely less heavily on particular dedicated channels. Currently, SWBT states that CFA control may indicate whether a facility is dedicated or shared.[204] ACTA also opposes pricing differentiation, arguing that the purchase of an incumbent LEC circuit is a simple business transaction and the purchasing IXC should be able to select where the purchased circuit resides.[205]

53. TCI and the Washington Commission support giving the incumbent LECs the flexibility to differentiate direct-trunked transport rates based on whether the customer or the LEC performs CFA functions, as long as the LEC supports the differential with forward-looking cost data and, in the case of the Washington Commission, as long as it does not needlessly complicate the access tariff.[206]

2. Tandem-Switched Transport

a. Rate Structure

54. Except for AT&T, IXC commenters addressing the issue generally support the unitary rate structure and argue that the Commission should retain this pricing option.[207] These commenters argue that the unitary rate structure should remain available because: (1) access transport, as a service, has traditionally been offered on an end-to-end basis;[208] (2) the unitary rate structure promotes full and fair interexchange competition by allowing IXCs time to prepare their networks for fully cost-based pricing;[209] (3) the partitioned rate structure, if required, (a) could provide incentives for incumbent LECs to engage in inefficient network reconfiguration, because access customers have no control over incumbent LEC decisions on the location of tandems, but would be required to pay for access based on these decisions;[210] and (b) would necessitate new rules regulating incumbent LEC tandem deployment decisions;[211] (4) AT&T, by

[204] SWBT Comments at 62.

[205] ACTA Comments at 10.

[206] TCI Comments at 14, Reply at 11-12; Washington Commission Comments at 6..

[207] *E.g.*, Cable & Wireless Comments at 15-17; CompTel Comments at 24-26, Reply at 11-13; MCI Comments at 85-86; TRA Comments at 37.

[208] Cable & Wireless Comments at 16.

[209] Cable & Wireless Comments at 15-16.

[210] Cable & Wireless Comments at 16; *see also* Texas Commission Comments at 17.

[211] Cable & Wireless Comments at 16-17.

virtue of divestiture, inherited POPs in close proximity to a significant number of tandem switches and would therefore enjoy a significant legacy advantage over competitors;[212] (5) "common" and "dedicated" circuits often travel on the same facilities and along the same transmission routes, making disparate rate structures inappropriate;[213] (6) elimination of the unitary structure would raise the price of tandem-switched transport in relation to direct-trunked transport and would therefore discriminate against smaller IXCs;[214] and (7) the unitary rate structure is the only structure consistent with the TSLRIC methodology of estimating costs.[215]

55. TRA additionally argues that the current rate structure, which allows IXCs to choose between the three-part and the unitary rate structure, is most consistent with the principles that costs should be recovered in the way that they are incurred, and from the cost causer.[216] Telco Communications Group requests that we explicitly allocate some common transport costs to dedicated transport rates because common transport facilities are sized to handle peak overflow loads from large carriers that use direct-trunked transport for most traffic.[217]

56. Sprint states that the Commission should retain the unitary rate structure because the three-part rate structure would give incumbent LECs the incentive to route traffic inefficiently by placing tandems far from IXC POPs.[218] Sprint argues that the term "direct trunking" is a misnomer because modern "hub and spoke" or "ring" network architecture often causes direct trunked circuits to travel along the same transmission routes and facilities as tandem switched transport circuits.[219] It would therefore be unfair to require users of tandem-switched transport to pay for the route through the tandem, while allowing direct-trunked transport users to pay based on airline miles between the EO and SWC.[220] According to Sprint, the three-part rate structure would skew interexchange competition in favor of AT&T, which has sufficient traffic to justify direct trunking to individual EOs, and in favor of the BOCs, which could take advantage of their

[212] Cable & Wireless Comments at 17.

[213] CompTel Comments at 25, Reply at 11.

[214] CompTel Comments at 26, Reply at 13.

[215] CompTel Reply at 12-13; TRA Comments at 37.

[216] TRA Comments at 37.

[217] Telco Communications Group Comments at 6-7.

[218] Sprint Comments at 22-23, Reply at 15-16.

[219] Sprint Comments at 23, Reply at 14-15.

[220] *Id.*

own direct trunking to many of their end offices.[221] Sprint suggests that the Commission address the problem of underutilized circuits on the tandem-to-SWC route by allowing incumbent LECs to size trunk bundles between the two points to achieve a reasonable utilization factor.[222]

57. WorldCom states that the Commission should not revisit any of the transport rate structure issues, other than those remanded by the Court.[223] WorldCom offers the following principles, however, if we do decide to reexamine these issues: First, the rate structure should treat dedicated and common transport consistently because both services use the same network facilities. Traffic on dedicated circuits and common circuits travels physically on the same large multiplexed transmission pipe. Routing, most frequently, is identical. Therefore, WorldCom states that it would be unreasonably discriminatory for the Commission to make detailed changes to the rate structure or pricing of tandem-switched transport without making parallel changes to the pricing of dedicated transport.[224] Second, rate structure decisions should be based on the current forward-looking view of the interoffice network. Large capacity fiber optic facilities, including SONET rings, have made transmission costs less distance sensitive. Therefore, WorldCom states that the triangular, "pyramid" diagram the Commission included in the notice is outdated. Because routing is within the sole control of the incumbent LEC and may vary based on momentary traffic loads, the transport customer should pay for transport based on airline miles between the two end points. Pricing of a service on an other than end-to-end basis could penalize users of that service for decisions outside of their control.[225] Third, the Commission should use forward-looking cost methodologies in setting rates. Tandem switching rates based on fully allocated, embedded costs are in conflict with the *Local Competition Order* and with the price cap structure. Therefore, the Commission should reinitialize rates based either on a forward-looking cost study or on the proxy prices adopted in the *Local Competition Order*.[226] In light of these three principles, WorldCom states that it favors retaining the unitary rate structure, and disagrees with arguments that tandem-switched transport is currently underpriced.[227]

58. Most incumbent LECs, AT&T, and some state commissions advocate elimination of

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[221] Sprint Comments at 22-23, Reply at 16.

[222] Sprint Reply at 15.

[223] WorldCom Reply at 26.

[224] WorldCom Reply at 27-28.

[225] WorldCom Reply at 29-32.

[226] WorldCom Reply at 33-34.

[227] WorldCom Reply at 26.

the unitary rate structure for tandem-switched transport.[228] These commenters generally argue that: (1) flat rates for the dedicated SWC-to-tandem link accurately reflect the manner in which the LEC incurs costs for this facility;[229] (2) per-minute rates for the shared tandem-to-EO link correspond to the manner in which the LEC incurs the costs of that facility;[230] (3) mileage charges based on the length of each specific link ordered by a transport customer will encourage carriers to order facilities that minimize routing distances;[231] (5) the three-part rate structure will increase IXC incentives to order efficiently sized transport facilities, thereby increasing network efficiency, conserving trunk and switch capacity, and reducing the current level of underutilized facilities;[232] (6) the unitary rate structure is not competitively neutral, but was designed to avoid significant changes in the costs of transport for small LECs vis-a-vis large ones;[233] (7) the unitary rate structure prices tandem-switched transport below cost, thereby (a) creating a subsidy paid by large IXCs that use direct-trunked transport to small IXCs that use tandem-switched transport;[234] and (b) disadvantaging competitive access providers (CAPs) because they cannot compete with the incumbent LEC's artificially low tandem-switched transport rates;[235] and (8) the unitary rate structure hurts incumbent LECs because the unrecovered costs of the excess mileage are contained in the TIC, making the incumbent LEC's usage-based switched access charges less competitive.[236] AT&T additionally argues that rate shock will not be a problem if prices are set to TELRIC.[237]

59. In addition, SNET argues that AT&T's purported competitive advantage based on the

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[228] AT&T Comments at 59-60, Reply at 32-33; USTA Comments at 60; Ameritech Comments at 19-20, Reply at 29; BA/NYNEX Comments at 41, Reply at 36-38; BellSouth Comments at 73; PacTel Comments at 70; SWBT Comments at 13-14; U S West Comments at 59-60; Citizens Utilities Comments at 31; GTE Reply at 24; SNET Reply at 29-31; NECA Comments at 3, Reply at 2-3, Puerto Rico Tel. Comments at 15-16; Florida Commission Comments at 3.

[229] AT&T Comments at 59-60; Ameritech Reply at 29; BellSouth Comments at 73; SWBT Comments at 14, 64; U S West Comments at 59-60; Florida Commission Comments at 3.

[230] AT&T Comments at 59-60; U S West Comments at 59-60.

[231] AT&T Reply at 33.

[232] BA/NYNEX Comments at 41; Ameritech Reply at 31; SWBT Reply at 15.

[233] BA/NYNEX Reply at 36-37.

[234] U S West Reply at 30-31.

[235] BA/NYNEX Reply at 36-37; *see also* ALTS Comments at 22; Teleport Comments at 14, Reply at 11-12.

[236] BA/NYNEX Reply at 37.

[237] AT&T Reply at 32.

locations of its inherited POPs has been mitigated substantially by the widespread availability of collocation and the presence of many alternative transport providers.[238] Ameritech and U S West state that, even if the Commission mandates the three-part rate structure, it would be too costly to relocate tandems inefficiently to increase transport revenue. Instead, tandems are located to maximize overall network efficiency, generally by placing them near high concentrations of end users and carriers.[239] Inefficient tandem placement would also affect the incumbent LEC's own routing of intraLATA toll and local traffic.[240]

60. CAPs and CLECs generally support the three-part rate structure, arguing that (1) distance-sensitive charges should be based on actual miles, rather than airline miles, reflecting actual LEC network efficiencies or inefficiencies;[241] (2) the unitary rate structure is not cost-based and inhibits competition;[242] and (3) the unitary rate structure discriminates against direct-trunked transport users by allowing tandem-switched transport users to purchase dedicated transport facilities in connection with tandem-switched transport at prices unavailable to others.[243] In addition, Teleport states that, unlike direct-trunked transport, tandem-switched transport is not a single service and does not use a single transmission pathway. Users of tandem-switched transport pay two switching charges and should therefore pay the cost of reaching each switch.[244]

61. Some commenters state that, because tandem-switched transport facilities are sized to handle peak-load overflow traffic from large IXCs that otherwise use direct-trunked transport facilities, some costs of tandem-switched transport should properly be imposed on direct-trunked transport customers.[245] SWBT opposes this argument, noting that, such a service-specific charge would drive users of direct-trunked transport to alternate providers, driving up the rates for small IXCs that remain.[246] SWBT supports recovery of some tandem-switching costs from a

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[238] SNET Reply at 29-31.

[239] Ameritech Reply at 29-30; U S West Reply at 30-31.

[240] Ameritech Reply at 29-30.

[241] ALTS Reply at 22.

[242] ALTS Reply at 22; Teleport Comments at 13-14.

[243] Teleport Comments at 13.

[244] Teleport Reply at 8.

[245] ACC Long Distance Comments at 14-15; Telco Communications Group Comments at 6-7.

[246] SWBT Comments at 63, Reply at 15.

competitively neutral public policy element.[247]

62. TCI supports a rate structure that unbundles the components of tandem-switched transport and permits purchase of needed components from the lowest-cost supplier.[248] TCI states that the costs of the dedicated SWC-to-tandem link are NTS, and should be recovered on a flat-rated basis.[249] TCI states, however, that the costs of the common transport EO-to-tandem link vary, not with minutes of use, but with the trunk capacity attached to the tandem, sized as necessary to carry peak traffic levels.[250] Therefore, the costs of this common transport should also be recovered as a flat rate, capacity-based charge tied to the proportion of dedicated transport the IXC has provisioned on the SWC-to-tandem link.[251] TCI explains that this structure: (1) would be administratively more simple and efficient than the current structure; and (2) would reflect, more accurately than the current system, the costs of providing tandem-switched transport by automatically allocating to overflow users the costs of the peak capacity made necessary by the overflow traffic.[252] TCI would base these charges on airline mileage between the EO and the SWC as a check on the incumbent LEC's ability to choose routing that either increases IXC costs, or discriminates between its own IXC affiliate and unaffiliated IXCs.[253]

63. With respect to the tandem switch itself, MCI supports establishment of a combination of flat-rated and usage sensitive charges, stating that the tandem switch and the local switch are not substantially different and therefore should have the same rate structure. Many commenters state that the dedicated trunk port on the SWC side of the tandem should be priced on a flat-rate basis and charged to the user of the dedicated trunk because these costs are incurred in an NTS manner.[254] BellSouth disagrees with this position, however, stating that there are minimal NTS costs associated with tandem switching and arguing against mandatory disaggregation of tandem switching costs into NTS and TS components. BellSouth, instead,

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[247] SWBT Comments at 63.

[248] TCI Comments at 15, Reply at 12.

[249] TCI Reply at 13.

[250] TCI Comments at 16, Reply at 13.

[251] TCI Comments at 16, Reply at 13-14.

[252] TCI Comments at 16, Reply at 13-14.

[253] TCI Comments at 17, Reply at 14-15.

[254] AT&T Comments at 60, Reply at 33; Ameritech Comments at 20; SWBT Comments at 13-14; Teleport Comments at 19-20, Reply at 11-12.

argues in favor of LEC flexibility to disaggregate as they wish.[255]

64. For many of the same reasons as those opposing a peak and off-peak rate structure for the local switch, several commenters state that they oppose a mandatory peak rate structure for tandem-switched transport.[256] These commenters primarily state that: (1) peak rate pricing would have a *de minimis* impact on the usage patterns and incumbent LEC network design decisions because less than 15% of the BOC interstate traffic is access;[257] and (2) it would be impossible to determine peak and off-peak hours with any degree of certainty or consistency because peak hours vary with the region of the country, type of service, type of user, rate zone, and other factors.[258]

65. Several commenters suggest that LECs should have the flexibility to implement a peak rate structure on a permissive basis.[259] The Texas Commission states that peak and off-peak pricing would allow the LEC to recover a portion of the larger tandem switching capacity necessitated by overflow traffic from large IXCs.[260] The Georgia Commission indicates that the peak rate structure should be optional for both LECs and their customers, and that LECs should not be permitted to offer peak and off-peak pricing until after the proposals have received regulatory review and approval.[261] Excel states that tandem switching services, like local switching, should be subject to peak and off-peak pricing.[262]

66. Teleport states that the Commission could achieve the economic efficiency benefits of a peak rate structure without resorting to time-of-day pricing by establishing a flat-rate pricing structure for the tandem switch, without disaggregating the costs into TS and NTS components. Teleport supports the establishment of flat-rated port charges as reflective of the way LECs incur the costs of dedicated tandem trunk ports. According to Teleport, however, the Commission should carefully examine the portion of tandem switching cost that is arguably TS to determine

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[255] BellSouth Comments at 73.

[256] MCI Comments at 85-86; AT&T Comments at 60, Reply at 33; Cable & Wireless Comments at 17; CompTel Comments at 28; SWBT Comments at 63; U S West Comments at 60.

[257] CompTel Comments at 28.

[258] CompTel Comments at 28; SWBT Comments at 63.

[259] *E.g.*, Ameritech Comments at 19; BellSouth Comments at 73; Georgia Commission Reply at 27; Texas Commission Comments at 16-17.

[260] Texas Commission Comments at 16-17.

[261] Georgia Commission Reply at 27.

[262] Excel Comments at 13.

whether the costs of separate measurement and billing merit the development of separate rate elements for those costs. According to Teleport, tandem switch ports are purchased to provide the purchaser with the ability to place a certain amount of traffic on the switch at its peak period; a flat-rate tandem-switching charge tied to port capacity would therefore reflect the costs of the tandem switch, which is sized to handle peak load traffic.[263]

67. Several commenters request that we update our tandem switched transport rate structure to include the cost of appropriate multiplexing equipment used providing tandem-switched transport.[264]

b. Rate Levels

68. *Allocation of 80 percent of the tandem switching revenue requirement to the TIC.* Both incumbent LECs and CAPs support reallocation from the TIC to tandem switching rates the 80% of tandem switching costs currently recovered through the TIC.[265] Ameritech states that the Commission should accomplish this reallocation by increasing the price cap indices for tandem-switched transport to reflect the full amount of the tandem costs. Ameritech states that this action would be consistent with the Court's remand of the *CompTel* case.[266] Sprint, on the other hand, opposes allocating TIC costs to transport rates, but instead favors setting all rates for transport facilities at TELRIC-based prices within five years.[267]

69. *SS7 signalling costs.* BellSouth states that tandem rates should be revised downward to reflect removal of the 20% of the CCS/SS7 charge that was assigned to the tandem and, at the same time, all CCS/SS7 costs should be assigned to new, signalling rate elements.[268]

70. *Overhead loadings on the tandem-switch.* Cable & Wireless states that, in this proceeding, the Commission should equalize the overhead loading factors for all transport options by directing that the difference in transport rates is equal to the difference in the LRIC of each option (DS3, DS1, and TST). In doing so, the Commission would (1) ensure that all access customers pay the same dollar amount of overhead per unit of traffic; and (2) increase the

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[263] Teleport Comments at 19-20, Reply at 11-12.

[264] USTA Comments at 60; GTE Reply at 24.

[265] Ameritech Comments at 18-19; BellSouth Comments at 74; U S West Comments at 65; ALTS Reply at 22; Teleport Comments at 18.

[266] Ameritech Comments at 19.

[267] Sprint Comments at 26.

[268] BellSouth Comments at 74.

competitive neutrality of the rate structure.[269] The Commission, in contrast, should not provide for an equal percentage of overhead per unit cost of transport because doing so would place small IXCs, which use proportionately more TST, at a disadvantage.[270]

71. WorldCom also supports LEC cost studies that would be used to justify reinitialization of tandem switching rates.[271] WorldCom states that we should use the "lowest of the low" methodology in order to ensure that the incumbent LECs do not discriminate unreasonably in the allocation of overheads (or, for TSLRIC/TELRIC studies, the allocation of forward-looking common costs). Under this methodology, the Commission would require the incumbent LECs to demonstrate that the allocation of overhead loadings or common costs to the tandem switching rate is no greater than the allocation of overhead loadings or common costs to the comparable transport service to which the lowest amount of overhead or common costs have been allocated.[272] The Commission, in enforcing this requirement, could examine the allocation of overheads or common costs to both tandem switching an other specific transport services.[273]

72. CompTel argues that the Commission should prescribe TSLRIC rates for all access services.[274] Recognizing that a "flash-cut" to TSLRIC rates may be infeasible for all access charges, CompTel states that the Commission should establish priorities, prescribing TSLRIC rates first for those access elements that are least subject to the market discipline of competition. In allocating common costs, CompTel argues that the Commission should adopt a "reverse Ramsey" pricing method. Under this method, CompTel argues that we should allocate a relatively small portion of common costs to those access elements that are least subject to competitive market forces, while maintaining access rate elements that may be subject to competitive pressures at current levels for the present.[275]

73. *Use of weighted average DS3/DS1 rates and 9000 minutes of use per month assumption.* AT&T and other commenters state that the Commission should set rates for tandem switching and tandem-switched transport transmission facilities at TELRIC levels established by

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[269] Cable & Wireless Comments at 19.

[270] *Id.*

[271] WorldCom Comments at 55.

[272] WorldCom Comments at 55-56.

[273] WorldCom Comments at 56.

[274] CompTel Comments at 16; *see also* American Communications Services, Inc. Reply at 20-21 (advocating reinitialization of tandem switching rates based on the *Local Competition Order* proxy of $0.0015 per minute).

[275] CompTel Comments at 17.

state commissions in accordance with the *Local Competition Order*.[276] These commenters state that use of TELRIC rate levels will make the benchmark DS3 to DS1 benchmark ratios unnecessary.[277]

74. Many commenters state that the Commission should no longer require carriers to assume 9000 minutes of use per month when setting per-minute rates for shared transport circuits.[278] Some of these commenters favor the use of actual minutes of use.[279] ALLTEL, for example, states that it estimates the usage of tandem-switched trunks at approximately 4000 MOU per month.[280] U S West favors retaining the 9000 minute of use assumption, but permitting LECs to develop its own unique conversion factor if it so chooses.[281] Sprint, in contrast, states that the 9000 MOU assumption is reasonably attainable because the use of tandem-to-EO circuits is largely within the LEC's control.[282] If the LEC chooses to provision these facilities so as to obtain a lower utilization, the LEC's access customers should not bear the costs of this decision.[283] Similarly, if the IXC wishes to order additional facilities, it should be permitted to do so at an additional cost.[284]

75. *Relationship with market based/prescriptive approach.* Sprint opposes any premature relaxation of the Commission's rate structure rules, arguing instead that the market-based approach gives incumbent LECs too much pricing flexibility too soon.[285] Sprint notes, however, that the Commission should permit density-based deaveraging of direct-trunked transport rates immediately.[286] According to Sprint, because there is a much greater demand for

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[276] AT&T Comments at 59; CompTel Reply at 3;

[277] AT&T Comments at 59.

[278] U S West Reply at 32; ALLTEL Comments at 12-13; GVNW Comments at 7, Reply at 7-8; Harris, Skrivan & Associates Comments at 6; Minnesota Independent Coalition Comments at 16.

[279] *E.g.*, GVNW Reply at 7-8; Harris, Skrivan & Associates Comments at 6.

[280] ALLTEL Comments at 12-13.

[281] U S West Reply at 32.

[282] Sprint Comments at 27.

[283] Sprint Comments at 27.

[284] Sprint Comments at 27.

[285] Sprint Comments at 27.

[286] Sprint Comments at 28-29.

special access in high-density areas than there is in low-density areas, direct-trunked transport rates, which are based on special access rates, understate the true cost of direct-trunked transport in less dense areas.[287] Geographic deaveraging of these rates would allow LECs to establish cost-based rates in each density zone.[288]

D. Transport Interconnection Charge (TIC)

76. The issues presented by the existence of the TIC generated substantial comment from all segments of the telecommunications industry. The comments are organized below into three broad groups: (1) causes and possible reassignment of sums in the TIC; (2) approaches that rely on market forces to address any amounts remaining in the TIC after some amounts are reallocated; and (3) approaches that would eliminate or phase out some or all of the TIC.

1. Causes and possible reassignment of amounts in the TIC

77. *General.* USTA and incumbent LECs assert that, to the extent TIC costs can be identified and attributed to specific services, those costs should be recovered from those services.[289] Minnesota Independent Coalition, however, argues that costs that may be easily identifiable and correctable for large LECs may not be for small LECs.[290]

78. Time Warner argues that the TIC was explicitly designed to make all IXCs pay for tandem-switched transport even though some IXCs only use the tandem switch for overflow traffic. According to Time Warner, the TIC distorts competition for switched transport service, and it should not be a surprise that little competition has developed there.[291] Time Warner argues that the Commission must require that the costs associated with the TIC are paid by cost causers and recovered in the manner in which they are incurred, which will require substantial revision to the TIC. Accordingly, Time Warner argues that those costs that can be reasonably attributed to other elements must be so assigned, and that this approach is most consistent with *CompTel v. FCC*.[292] TRA also supports the identification of cost misallocations and other practices that cause

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[287] Sprint Comments at 28-29.

[288] Sprint Comments at 28-29.

[289] *See, e.g.*, USTA Comments, Attachment 10 at 9; PacTel Comments at 6; BA/NYNEX Comments at 36-37; Aliant Comments at 2; SNET Reply at 27-28; Frontier Comments at 9; ALLTEL Reply at 8; TCA Comments at 4; Minnesota Independent Coalition Comments at 17; Alaska Telephone Association Comments at 9; Harris, Skrivan & Associates Comments at 6.

[290] Minnesota Independent Coalition Comments at 17.

[291] Time Warner Comments at 12-13.

[292] Time Warner Comments at 12-13.

costs to be assigned to the TIC and reassigning such costs to various access services and other nonregulated activities, as appropriate.[293]

79. ALTS and ACSI contend that the Commission should quantify and eliminate all readily correctable cost misallocations in its current access tandem switching regime.[294] Teleport also favors an approach in which obvious misallocated costs are reallocated. Teleport, however, would require incumbent LECs to produce for public review a complete report of the costs currently included in switched access and the proportion and type of costs assigned to the TIC. Until this report is analyzed, it will not be possible to identify whether the TIC contains truly "lost" costs, or, rather, costs that have "conveniently" been placed in the only switched access rate element immune from competition.[295]

80. Some consumer groups and consumer advocates recommend identifying misallocated costs and moving them to the appropriate cost element.[296] State Consumer Advocates believe that all remaining costs represent a portion of joint and common costs and should be recovered by increasing all of the transport rate elements.[297]

81. Several state commissions also agree that costs should be reallocated. The Washington Commission is in favor of eliminating the TIC and reassigning costs according to causation. The Washington Commission states that it has eliminated the state equivalent of the TIC, finding that there was no need for it once the company's other transport and switching rates were set to provide appropriate revenue levels.[298] In a similar manner, the Illinois Commission argues that embedded costs currently recovered by the TIC should be reassigned to other rate elements to the extent cost causation can be established, and the incumbent LECs should be given any additional flexibility needed to raise prices within the price cap framework for those rate elements to which costs have been reassigned. The Illinois Commission believes that the entire TIC can be reallocated in this manner.[299] The Georgia Commission states that the FCC must (1) verify the costs that have been loaded onto the TIC; (2) verify the amount of those costs that

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[293] TRA Comments at 36.

[294] ALTS Comments at 26; ACSI Reply at 21.

[295] Teleport Comments at 30-32.

[296] *See, e.g.*, AARP, *et al.*, Comments at 17; Texas Public Utility Counsel Comments at 16; State Consumer Advocates Comments at 36.

[297] State Consumer Advocates Comments at 34-37.

[298] Washington Commission Comments at 7.

[299] Illinois Commission Comments at 12-13.

should be recoverable on a going-forward basis and ensure that the unrecovered amounts resulted purely from regulatory restriction, not competitive pressures; and (3) conduct any restructuring in order to establish cost-based rates that avoid anticompetitive pricing.[300] The Ohio Commission argues that only after incumbent LECs have demonstrated the cost amounts currently in the TIC should any costs be reallocated to tandem switching. In addition, the Ohio Commission states that it is up to state commission to decide how the intrastate portions of TIC-related charges should be recovered.[301]

82. On the other hand, several parties argue that not all costs should be reallocated. Sprint, for example, argues that revenue requirements other than the TELRIC of tandem switching that are assigned to the TIC under current rules should be left in the TIC and phased out.[302] WorldCom asserts that incumbent LEC allegations as to the "costs" of common transport recovered through the TIC are incorrect. WorldCom states that to truly reset transport rates based on costs would require a forward-looking cost study to reinitialize rates for both common and dedicated transport and that mere shifting of TIC costs to other rate elements is inadequate.[303] WorldCom also argues that rates based on forward-looking costs will not be revenue neutral, and incumbent LECs should not be guaranteed recovery of all residual costs.[304]

83. Several parties address the possible relationship of the TIC to universal service. WITA argues that the TIC is an implicit support mechanism for rate-of-return LECs that should be included in the federal universal service support mechanism for rate-of-return LECs.[305] The Texas Public Utility Counsel argues that increased levels of universal service support should be used to offset the amount of the TIC that is earmarked for phase-out.[306] Time Warner, on the other hand, argues that the Commission should not attempt to transfer costs currently recovered through the TIC to universal service because there is no evidence supporting such a decision. Such a decision would be inconsistent with the Joint Board's recommendation that universal service funding should be determined on a forward-looking cost basis.[307]

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[300] Georgia Commission Comments at 32.

[301] Ohio Commission Reply at 5-6.

[302] Sprint Reply at 18.

[303] WorldCom Reply at 34.

[304] WorldCom Reply at 38.

[305] WITA Comments at 8.

[306] Texas Public Utility Counsel Comments at 21.

[307] Time Warner Comments at 15; Time Warner Reply at 21-22.

84. Several parties address the need to adjust PCIs and SBIs if reallocation of TIC costs are permitted or required. BellSouth and BA/NYNEX, for example, state that if the Commission authorizes reassignment of TIC costs, it must permit incumbent LECs to adjust the TIC SBI and other relevant SBIs to ensure they have an opportunity to recover the reassigned costs.[308] In a similar vein, Aliant advocates exogenous cost increases for specific service categories in the trunking basket so that incumbent LECs can recover TIC costs to the extent the market permits.[309]

85. *Tandem Switching Costs.* USTA and the majority of the incumbent LECs assert that the tandem switching revenue requirement being recovered through the TIC should be reassigned and recovered through tandem switching rates.[310] USTA estimates this component of the TIC to be $400 million, or 12.93% of total industry TIC revenues.[311] Ameritech contends that this reassignment would be consistent with *CompTel v. FCC* and would allow incumbent LECs to increase their tandem switching rates to economically rational levels given available market substitutes.[312] NECA states that the tandem-switching costs currently assigned to the TIC can be identified and could be assigned to the tandem-switching rate element, thereby reducing the TIC and increasing tandem-switching revenue for NECA traffic-sensitive pool members by $15.1 million.[313]

86. Cable & Wireless contends that 80 percent of the interstate tandem switching *revenue requirement* was allocated to the TIC, as distinguished from interstate tandem switching *costs*. Cable & Wireless asserts that state commissions have found that the incumbent LEC's LRIC of tandem switching is far below even the 20 percent rate that the Commission set and that it is therefore doubtful that any of the TIC should be allocated to tandem switching on a forward-looking cost basis.[314] Cable & Wireless alleges that the tandem-switching revenue requirement consists, in large part, of overhead and subsidies placed on tandem switching during the "equal charge" era. Cable & Wireless asserts that the Commission should not ignore actual cost data

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[308] BellSouth Comments at 81 n.141; BA/NYNEX Comments at 37.

[309] Aliant Comments at 3.

[310] *See, e.g.,* USTA Comments at 61; BellSouth Comments at 75; GTE Comments at 36; PacTel Comments at 71; SWBT Comments at 9-10; Citizens Utilities Comments at 31; ALLTEL Comments at 13; Puerto Rico Tel. Comments at 17; Roseville Tel. Comments at 11-12; Sprint Comments at 28.

[311] USTA Comments, Attachment 11.

[312] Ameritech Comments at 18-19.

[313] NECA Comments at 5 n.15.

[314] Cable & Wireless Comments at 20.

showing tandem-switching costs to be far less than the revenue requirement indicates.[315]

87. Sprint urges that the Commission not reassign the balance of the tandem switching revenue requirement from the TIC to the tandem switching rate element. It contends that a tandem switching rate that recouped the entire revenue requirement might reduce tandem switching revenues for incumbent LECs because these rates would be so high that the use of tandem switching would be uneconomic for IXCs. In addition, Sprint asserts that the existing tandem switching rates reflect a much higher than reasonable allocation of overhead costs. The tandem switching rate should, according to Sprint, be based on TELRIC costs and should be similar to today's tandem switching charges.[316]

88. *SS7 costs.* USTA and incumbent LECs contend that the Commission should identify the portion of the tandem revenue requirement that recovers the costs of SS7 signal transfer points ("STPs") and the costs of the links between service switching points ("SSPs") and STPs. These costs are associated with providing FGD service and are currently recovered as part of the TIC. USTA asserts that they should be recovered through existing SS7 rate elements.[317] USTA estimates this component of the TIC to be $58.7 million, or 1.89 percent of total industry TIC revenues.[318] BellSouth asserts that the FCC should remove from the TIC the portion of common channel signaling costs that are booked to Category 2 tandem switching and that these costs should be recovered through new rate elements.[319] U S West argues that the costs associated with SS7 signalling should be recovered through transport charges.[320]

89. *Tandem-Switched Transport Transmission Rate Setting.* Most incumbent LECs support a modified tandem-switched transport transmission rate structure that includes: (1) assessment of the SWC-to-access tandem portion as dedicated transport (which includes the cost of DS3/DS1 multiplexing at the tandem office) measured from the SWC to the access tandem; (2) assessment of the access tandem-to-end office portion as tandem-switched transport measured from the access tandem to end office; and (3) the assessment of a multiplexer charge between the access tandem and end office. Incumbent LECs generally assert that the TIC includes the costs of the Commission having adopted a less efficient interim transport rate structure. USTA and

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[315] Cable & Wireless Comments at 21.

[316] Sprint Reply at 18.

[317] *See, e.g.*, USTA Comments at 61; GTE Comments at 36; SWBT Comments at 9-10; Citizens Utilities Comments at 31; NECA Comments at 7-8.

[318] USTA Comments, Attachment 11.

[319] BellSouth Comments at 75-76.

[320] U S West Comments at 65.

incumbent LECs argue that the rates for tandem-switched transport transmission must be increased to reflect the costs of this revised rate structure, thereby shifting costs from the TIC.[321] According to USTA, these changes will result in rates that more accurately capture a LEC's actual costs of providing tandem-switched transport service.[322]

90. Many incumbent LECs also argue that the 9000 MOU assumption should be eliminated in favor of actual MOU levels, contending that actual usage is far less than 9000 MOUs. Among the estimates of actual usage are: U S West, 5700;[323] NECA, approximately 4500;[324] GTE, 5300;[325] and ALLTEL, approximately 4000.[326] NECA states that it would develop a MOU figure that more closely corresponds to the actual rural, low-usage characteristics of its traffic-sensitive pool members, and base its tariff rates on that figure.[327] Minnesota Independent Coalition asserts that the assumed monthly usage of 9000 MOU per transport circuit is unrealistic for low volume, rural routes.[328]

91. WorldCom asserts that actual fill factors, in MOUs per month, on a given transmission facility, are irrelevant; rather, the fill factors that would represent efficient network deployment are far more relevant.[329]

92. *Host-Remote Trunking Rate.* USTA and incumbent LECs state that for service to a remote switch, the tandem-switched transport transmission fixed and per mile/per MOU charge applies for transport between the host and remote switch, but that only a portion of the host/remote revenue requirement is recovered through these rates. They state that the difference is included in the TIC. USTA argues that the costs specific to host/remote transport that are in the TIC should be included in the tandem-switched transport rates because those rate elements are

[321] *See, e.g.,* USTA Comments at 60; BellSouth Comments at 77; Citizens Utilities Comments at 31-32.

[322] USTA Comments at 60.

[323] U S West Comments at 66-67.

[324] NECA Comments at 8 n.22.

[325] GTE Comments at 38.

[326] ALLTEL Comments at 12-13.

[327] NECA Comments at 8 n.22.

[328] Minnesota Independent Coalition Comments at 16.

[329] WorldCom Reply at 35.

currently applied to host/remote connections.[330] USTA estimates this component of the TIC at $160.5 million, or 5.17 percent of total TIC revenues.[331]

93. NECA submits that incumbent LECs install host-remote facilities because these facilities are cheaper than installing a separate end office switch at the remote location. Because the host-remote transport facilities are not dedicated to any particular user, NECA contends that the costs should be removed from the TIC and assigned to the local switching element.[332] NECA states that assigning these revenues, instead, to the costs of tandem-switched transport would disproportionately raise tandem switched transport rates.[333]

94. *DS1/voice-grade multiplexer costs.* USTA and incumbent LECs state that analog switches do not have direct DS1 interfaces and, as such, require a combination of trunk unit ports and a DS1/voice grade multiplexing function to take the traffic to the DS0 level to be switched. Incumbent LECs state that in the analog switching environment, the costs of multiplexing from the DS1 to DS0 level have been assigned primarily to transport, while in the digital switching environment, this function is incorporated in the switch and is assigned to local switching. They assert that the costs of these analog multiplexers were not included in the special access formulas used to derive switched transport rates and are thus included in the TIC. USTA contends that these analog multiplexer costs should be associated with the switching function and assigned to the Local Switching category.[334] NECA states that assigning analog multiplexing costs to the local switching rate element would make the assignment of analog multiplexing costs consistent with the assignment of costs associated with this function in digital switches.[335] USTA indicates that analog switches account for approximately 25 percent of the RBOC lines in service.[336] USTA estimates the "Analog End Office Trunk Switch Ports" component of the TIC at $138.4 million or 4.46 percent of total TIC revenues.[337]

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[330] *See, e.g.*, USTA Comments at 61-62, Attachment 10 at 4; BellSouth Comments at 77; U S West Comments at 65-66; Citizens Utilities Comments at 32; GTE Comments at 37; Minnesota Independent Coalition Comments at 16.

[331] USTA Comments, Attachment 11.

[332] NECA Comments at 6.

[333] NECA Comments at 6 n.18.

[334] *See, e.g.*, USTA Comments at 62; BellSouth Comments at 77-78; PacTel Comments at 71; U S West Comments at 66; GTE Comments at 36.

[335] NECA Comments at 5-6.

[336] USTA Comments, Attachment 10 at 9. *See also* ARMIS 43-07.

[337] USTA Comments, Attachment 11.

95. Cable & Wireless asserts that the costs of analog multiplexers are imposed by direct-trunked transport customers; therefore the costs should be built into the direct-trunked transport rate elements, or a separate DS1:DS0 multiplexing element should be added for direct-trunk transport customers.[338]

96. *Use of special access rates to establish Direct-Trunked Transport Rates.* USTA and many incumbent LECs contend that the TIC results in large part from the fact that the transport rate restructure order repriced switched transport services based on special access high-cap rates despite the fact that, in the past, switched access and special access rates were derived very differently.[339]

97. USTA explains that the local transport equal charge rates were derived from a revenue requirement that was the result of the Commission's Part 36 and 69 cost allocation rules on investments and expenses. This mandated cost allocation process predominantly used general categorizing and averaging of costs across geographic areas, technologies, services, and jurisdictions.[340] Plant investment was the primary driver because expenses generally followed the allocation of the plant. Because there were basically only two rate elements for switched local transport (the per-minute termination charge and the per-minute facility charge), the rates could deviate very little, if at all, from the rate levels resulting from the cost allocation rules. Special access rates, on the other hand, were more heavily based on a unit investment approach which more specifically identified the actual plant used for each service. The unit investments were then used as a basis for loading overheads. In addition, under the cost allocation process, high capacity facilities could be directly assigned to the special access category.[341]

98. USTA therefore asserts that when the transport rate restructure set switched transport rates based on special access rates, the TIC represented the difference in revenues between the two pricing schemes and the differences in the costing methodologies used for each service in the past. The TIC, therefore, represents the averaging of costs across technologies, geographies, services, and jurisdictions that were inherent in the old cost allocation rules that determined the equal charge rates.[342] According to USTA, a detailed direct cost approach demonstrates that the cost allocation rules assign more investment to transport than is actually used in providing the service. The difference in costs is currently in the TIC, even though the

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[338] Cable & Wireless Comments at 21. *See also* Citizens Utilities Comments at 32 (supporting assignment to direct-trunked transport).

[339] *See, e.g.,* USTA Comments at 62-65; BellSouth Comments at 80; GTE Comments at 38.

[340] *See, e.g.,* GTE Comments at 38; Citizens Utilities Comments at 32.

[341] USTA Comments at 63-64.

[342] USTA Comments at 63-64.

costs are actually incurred to provide local services, intrastate services, and/or interstate services other than local transport.[343] USTA estimates this "transport averaging, cost allocations, and cost recovery" component of the TIC at $1.16 billion, or 37.27 percent of the total TIC revenues.[344]

99. USTA and incumbent LECs argue that changes to this structure will require Joint Board action, and that until such action can be taken, these TIC components should be removed from the per-MOU TIC rate and should be bulk-billed to IXCs based on interstate revenues or minutes.[345]

100. USTA alleges that part of the TIC also represents circuit equipment and cable and wire facilities serving longer haul traffic that have an embedded Part 36 cost many times greater than that based on a special access costing methodology. According to USTA, the cost of hauling traffic to scattered local switches in remote areas is much greater than that of hauling the same amount of traffic in larger cities at special access rates. The cost difference is part of the TIC.[346] Citizens Utilities argues that circuit termination costs could be directly assigned for jurisdictional purposes, but that Part 36 requires that circuit equipment be allocated to categories based on average cost per termination.[347] USTA estimates that the investment in interexchange cable and wire is $37.4 million, or 1.21 percent of the total TIC revenues.[348]

101. U S West contends that the cost of interexchange facilities per unit of traffic in sparsely populated areas is several times more than the cost of exchange facilities in densely populated areas. U S West argues that this is part of the reason why special access is less expensive per unit of traffic than transport, and accounts for most of the TIC not attributable to other factors listed in U S West's comments.[349] NECA argues that many of its pool participants do not have high-capacity DS1 or DS3 special access services throughout their service areas because they have no customers that require these services. NECA submits that the areas without demand for DS1 or DS3 special access services have higher transport costs than those areas that do have these services. NECA suggests that the Commission discontinue its reliance on special-access transport rates as a surrogate for local transport costs; NECA would then develop cost-

[343] USTA Comments at 65.

[344] USTA Comments, Attachment 11.

[345] USTA Comments at 66.

[346] *See, e.g.*, USTA Comments at 65; BellSouth Comments at 80; GTE Comments at 38.

[347] Citizens Utilities Comments at 33.

[348] USTA Comments, Attachment 11.

[349] U S West Comments at 69-70.

based transport rates and file them in access tariffs.[350] Aliant asserts that a significant portion of the TIC results from the fact that special access is primarily an urban service while switched transport is primarily a rural service. Aliant states that approximately 77 percent of Aliant's DS1 special access revenue is located in Lincoln, Nebraska, while 79 percent of Aliant's tandem-switched transport and 58 percent of Aliant's DS1 direct-trunked transport revenue is located outside of Lincoln.[351]

102. Cable & Wireless argues that special access is generally less costly than direct-trunked transport because special access, unlike direct-trunked transport, generally is limited in use to low-cost urban areas. Cable & Wireless contends that the additional costs of direct-trunked transport should be removed from the TIC.[352]

103. *Central Office Equipment Maintenance Expenses.* USTA and incumbent LECs argue that the Part 36 and Part 69 rules overstate the assignment of COE maintenance expenses to the TIC.[353] USTA states that by separating COE maintenance expenses on the basis of the combined COE investment, a mismatch occurs to the extent that the expenses associated with maintaining the investment are apportioned differently than the investment being maintained. This results in a portion of COE maintenance expense for local and operator switches being allocated in Part 69 to Common Line, Transport, and Special Access, where there is no switch investment to maintain.[354] USTA estimates COE Maintenance Misallocations at $101.8 million, or 3.28 percent of the TIC.[355] According to USTA, a more cost-causative approach would be to separate the central office expenses based on the separation of the investment being maintained.[356]

104. To accomplish this modification, USTA proposes to modify sections 36.321 and 69.401(b).[357] USTA states that COE switching expenses should be assigned to the Transport elements based on a relationship of interstate tandem switching investment assigned to the

[350] NECA Comments at 7.

[351] Aliant Comments at 3.

[352] Cable & Wireless Comments at 21-22.

[353] *See, e.g.*, USTA Comments at 62-63; BellSouth Comments at 78; U S West Comments at 68-69; Citizens Utilities Comments at 33; GTE Comments at 38.

[354] BellSouth Comments at 78.

[355] USTA Comments, Attachment 11 at 1.

[356] USTA Comments, Attachment 10 at 7.

[357] USTA Comments, Attachment 10 at 7.

Transport element to total Part 69 interstate switching investment, with the remainder being assigned to local switching. According to USTA, COE operator expenses should be assigned to information, interexchange and operator transfer elements based on the relative relationships from assignment of the operator investment to these elements. By using the above-described approaches, USTA states that costs will be removed from the common line, access and transport elements and will be reassigned to the switching element.[358] USTA claims, however, that these changes will require Joint Board action and, until such action can be taken, these TIC components should be removed from the per-MOU TIC rate and should be bulk-billed to IXCs based on interstate revenues or minutes.[359]

105. Cable & Wireless argues that, to the extent that these costs are not related to facilities-based transport, they should be moved out of the TIC and, to the extent that they are NTS, they should be recovered as part of the per-line or per-port local switching costs.[360]

106. *Use of Circuit Terminations in Separating Costs Between Private Line and Message Services*. USTA asserts that Part 36.126 assigns interexchange trunk investment to message joint, interstate private line, and intrastate private line categories and allocates these costs based on the average cost per circuit termination. USTA states that the costs in interexchange circuit equipment categories, except message joint, are jurisdictionally pure and could be directly assigned to jurisdictions if it were permitted by the Part 36 Rules. For the message joint investment classification, traffic usage factors determine the final jurisdictional allocation. USTA states that the distribution of costs to categories and jurisdictions based on direct identification would reduce the TIC by reassigning costs to intrastate and interstate.[361] USTA estimates that the use of circuit Termination Counts misallocates $630.66 million to the TIC, or 20.33 percent of the TIC.[362]

107. Frederick & Warinner argues that differences in the definition of circuit terminations when allocating costs between switched and special access contribute to the TIC, resulting in costs being over-allocated to message trunking facilities and under-allocated to special access. Frederick & Warinner proposes an "equivalent termination count" be used for message circuit equipment in COE Category 4.23 in order to more appropriately reflect how CO transmission

[358] USTA Comments, Attachment 10 at 8.

[359] USTA Comments at 62-63.

[360] Cable & Wireless Comments at 22.

[361] USTA Comments, Attachment 10 at 6; BellSouth Comments at 78-79; U S West Comments at 67-68; Citizens Utilities Comments at 33.

[362] USTA Comments, Attachment 11 at 1.

costs are incurred.[363] Frederic & Warinner generated an "equivalent termination count" based on the ratio of tariffed rates. Using the ratio of NECA's DS1 channel termination rate to the DS0 channel termination rate gives a weighting of 5.2. According to Frederick & Warinner, changing terminations in this way would (1) allocate more costs to special access and less to switched access; (2) bring special access rates closer to those determined by LRIC cost studies; (3) reduce the message toll costs being allocated to various transport elements; and (4) increase the tandem-switched termination rate (using special access rates divided by assumed MOU), thereby reducing the revenue requirement to be collected in the TIC.[364]

2. Market-Based Approaches

108. The incumbent LECs generally support continued recovery of all remaining sums in the TIC after reassigning any identifiable TIC costs to other services. USTA and incumbent LEC parties state that, to a large extent, the TIC reflects costs that the separations and access charge rules assign to interstate local transport.[365] While USTA and incumbent LEC parties state that it is possible to identify the cause of only a portion of the costs included in the TIC,[366] this does not suggest that only a portion of the TIC should be recovered in a post-access reform environment.[367] Ameritech asserts that a large part of the TIC contributes to the incumbent LECs' ability to maintain affordable basic exchange rates.[368] Incumbent LEC parties assert that the TIC represents actual costs that have been assigned to the interstate jurisdiction, and that companies are entitled to recovery of the amount currently assigned to the TIC.[369] Evans *et al.* submits that rate-of-return LECs are recovering jurisdictionally interstate, actual transport costs under the current system, and that any changes to the rate structure must allow continued recovery of the actual, defined revenue requirement.[370] Roseville Tel. states that the remaining TIC costs result from Part 36 rules and should be reassigned to the Interstate Special Access, Interstate Local

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[363] Frederick & Warinner Comments at 8-9.

[364] Frederick & Warinner Comments at 10.

[365] *See, e.g.*, USTA Comments at 59.

[366] *See, e.g.*, USTA Comments at 59; Sprint Comments at 28.

[367] USTA Comments at 58.

[368] Ameritech Reply at 32.

[369] *See, e.g.*, BA/NYNEX Reply at 39; PacTel Comments at 72; NECA Comments at 4 n.11; SNET Comments at 39-40; GVNW Comments at 8; Alaska Telephone Association Comments at 9; Western Alliance Comments at 21-22.

[370] Evans, *et al.*, Comments at 4.

Switching and intrastate jurisdictions.[371]

109. ALTS and ACSI argue that once readily-correctable misallocations are removed, market-based forces should be relied upon to reduce any remaining TIC.[372] Spectranet asserts that the need for a transition period applies as much to new entrants as it does for incumbent LECs because the immediate flash-cutting of access rates to LEC cost will undermine the basis upon which new entrants were planning to enter the local exchange business.[373]

110. Several parties allege that a Federal-State Joint Board pursuant to section 410(c) is required before the TIC can be fully eliminated. NARUC states that solving the TIC issue requires Joint Board action prior to action by the FCC.[374] USTA and incumbent LEC parties assert that many of the changes necessary to eliminate the TIC will require Joint Board action.[375] Frontier states that the FCC should promptly convene a Joint Board to address these issues on a schedule that coincides with the timetable for proposed phase-out of the TIC.[376] Until such action can be taken, these incumbent LEC parties argue that the remaining TIC components should be removed from the per-MOU TIC rate and should be bulk-billed to IXCs based on interstate revenues or minutes.[377] Ameritech asserts that the remainder of the TIC should be billed to interstate providers of telecommunications services in a competitively neutral manner on a flat-rate basis.[378] Roseville Tel. asserts that the remaining portion of the TIC should be recovered through a "Separations Cost" rate element, at least until a Joint Board reforms the separations rules. Roseville Tel. states that this will allow recovery of properly-incurred costs by an explicit mechanism applied equally to all cost-causers (i.e., users of interstate access services).[379] NECA and TDS contend that incumbent LECs should continue to collect the balance of the TIC through a smaller TIC-type charge or through alternative collection arrangement such as bulk-billing. They state that this charge would continue to be collected pending Joint Board action to change

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[371] Roseville Tel. Comments at 11-12.

[372] ALTS Comments at 26; ACSI Reply Comments at 21.

[373] Spectranet Comments at 4.

[374] NARUC Comments at 7.

[375] *See, e.g.*, USTA Comments at 62-63; GTE Comments at 39.

[376] Frontier Comments at 9 n.17.

[377] *See, e.g.*, USTA Comments at 62-63; PacTel Comments at 72; SNET Reply at 27-28; Alaska Telephone Association Comments at 9.

[378] Ameritech Reply at 32.

[379] Roseville Tel. Comments at 12.

the separations rules.[380]

111. BA/NYNEX states that there are two interim solutions to sums remaining in the TIC pending separations changes. First, residual TIC amounts could be recovered from IXCs based on their proportionate share of LEC interstate access minutes. Second, LECs could recover any residual TIC on a per-presubscribed line basis to the IXCs. For price cap purposes, any TIC residual should be in the trunking basket and LECs should be allowed to target price cap reductions to this element. Pending separations changes, these mechanisms would be easy to administer, would not unduly burden the IXCs and would enable the LEC to reduce the amounts at issue through targeting of price cap reductions.[381] BA/NYNEX asserts that the remaining costs recovered through the TIC are primarily NTS and, therefore, should be recovered through a flat-rate charge. According to BA/NYNEX, such flat rate charges would resemble the charges states have adopted for UNEs, would reduce the arbitrage problem, because incumbent LECs would no longer have to charge high per-minute rates compared to the rates for UNEs, and would, when combined with the rates for local telephone lines and the EUCL charge, come close to the UNE rates for local loops and switches in many instances.[382]

112. Several incumbent LECs propose specific mechanisms to recover any remaining TIC costs. U S West recommends that TIC costs that cannot be reassigned to other access rate elements, or are not reassigned pursuant to separations reform, be recovered, at least in part, through increased end user common line charges. U S West also suggests that we establish a separate fund similar to the universal service fund, with IXCs contributing to the fund on a flat-rate basis equal to their percentage share of switched access MOU. U S West further recommends revising the price cap rules to establish a formula for a flat-rated TIC.[383] SWBT proposes establishing a "Public Policy" rate element containing the costs associated with providing transport facilities and services to low-volume, rural areas and a significant portion of tandem switching costs.[384]

113. In a similar vein, GTE proposes permitting incumbent LECs to recover any remaining TIC costs through a flat-rate "regulatory policy cost recovery" charge.[385] Under GTE's proposal, incumbent LECs would submit separations-based cost studies to the FCC showing the

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[380] NECA Comments at 7; TDS Comments at 23-24.

[381] BA/NYNEX Comments at 38.

[382] BA/NYNEX Reply at 39-40.

[383] U S West Comments at 71-73.

[384] SWBT Reply at 11.

[385] GTE Comments at 39, 41-44.

amount of marketing expense erroneously assigned to the interstate jurisdiction under existing FCC rules and residual TIC revenue requirement remaining after reallocation of specific costs to other rate elements.[386] Under GTE's plan, incumbent LECs would make corresponding adjustments to their newly-created "Network Services basket" PCI to reflect removal of marketing expenses and reassignment of TIC costs to other access elements. GTE's regulatory policy cost charge would be assessed on a bulk-billed basis to all telecommunication carriers that purchase interstate switched access, transport and network facilities used to provide interstate services from incumbent LECs. GTE asserts that the method is fair because it charges all carriers using incumbent LEC networks.[387] GTE submits that the regulatory policy charge should be capped at its initial value for one year, although an incumbent LEC would be permitted to charge less than the initial value. GTE argues that the regulatory policy charge should not be subject to price cap regulation because it is an explicit subsidy recovery and not representative of specific services provided to customers. Annual adjustments to the regulatory policy charge would be limited to the changes in costs allocated to the interstate jurisdiction that are being recovered by this charge.[388]

114. Teleport states that once the review of incumbent LEC switched access costs has been completed, the Commission will be able to determine what costs, if any, should remain in the TIC, and how any unrecovered costs can be recovered. Teleport recommends that any residual amounts be recovered through a uniform surcharge on all related rate elements subject to competition, which will ensure that the charges are cost based.[389] Subsequently, Teleport clarified that it believed that the TIC should not be assessed on carriers that do not use incumbent LEC transport facilities.[390] Sprint and Time Warner also recommend that the Commission preclude incumbent LECs from assessing the TIC on traffic that is carried to or from incumbent LEC end offices on the facilities of a competitor because that would require CAPs to pay for the costs of their competitors' services.[391]

115. Time Warner argues that the Commission should reject incumbent LEC proposals to establish a separate recovery mechanism, such as bulk billing, to preserve incumbent LEC revenue requirement recovery because they would reinstate the largely discredited rate base, rate-of-return

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[386] GTE Comments at 42.

[387] GTE Comments at 43.

[388] GTE Comments at 44.

[389] Teleport Comments at 32-33.

[390] Letter from Judith Herrman, Manager, Federal Regulatory Affairs, Teleport, to Richard Lerner, Competitive Pricing Division, April 11, 1997.

[391] Sprint Comments at 30; Time Warner Comments at 15; ACC Long Distance Comments at 12.

regulatory structure and its associated harmful incentives.[392]

116. Several parties commented on pricing flexibility as a vehicle to address costs in the TIC. Aliant argues that after incumbent LECs shift TIC amounts into the appropriate existing or new rate elements, LECs should have the flexibility to shift any remaining TIC amounts into Transport and Tandem Switched zones, noting that this would allow the market to determine if these costs are recoverable.[393] Cable & Wireless states that TIC deaveraging would be acceptable once the charge is purged of inappropriate costs, provided that deaveraging is based on differences in the remaining costs. Cable & Wireless argues that incumbent LECs should not be allowed to recover revenue via the TIC in order to ensure revenue-neutrality in a regulatory environment intended to be devoid of implicit subsidies.[394] If deaveraging is permitted, Cable & Wireless contends that the Commission should ensure that all incumbent LECs deaverage in a consistent manner using geographic zones demarcated by actual cost differences, e.g., cost differences for an efficient local exchange provider using forward-looking technology. Cable & Wireless notes that every study area may not include all zone types, and there may be a need for more than three zones to minimize residual averaging within zones.[395] To the extent that direct-trunked transport rates understate the costs of transport in less-dense areas because they are based on special access rates in high-density areas, Sprint states that the Commission could allow density-based deaveraging of direct-trunked transport rates without the constraints that presently exist.[396]

117. TCA argues that incumbent LECs should be given greater flexibility to add rate elements or change rates as portions of the TIC are more clearly identified.[397] On the other hand, TRA opposes giving the incumbent LECs any significant flexibility as part of any associated transition.[398]

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[392] Time Warner Reply at 22.

[393] Aliant Comments at 3.

[394] Cable & Wireless Comments at 22.

[395] Cable & Wireless Comments at 22-23.

[396] Sprint Comments at 29.

[397] TCA Comments at 4.

[398] TRA Comments at 36.

3. Approaches that Eliminate or Phase Out the TIC

118. Several parties contend that the TIC should be eliminated totally, or that any TIC amounts remaining after making any reallocations warranted by the record should be eliminated. MCI contends that there is no reason for the TIC once access cost elements are set to recover economic cost.[399] MCI argues that the TIC is an uneconomic, unnecessary, make-whole charge that should be eliminated. Moreover, MCI alleges that there is no basis for reallocating some of the TIC amount and renaming the rest the "public policy" rate element, which will force new entrants to pay an indefensible subsidy to their competitors.[400] MCI argues that Part 36 allocates incumbent LEC expenditures, not costs. MCI suggests that it is likely incumbent LEC spending is not at the economically efficient level, given the current absence of effective competition and the price cap plan that does not effectively pass through to ratepayers changes in incumbent LEC costs. MCI states that the Hatfield model indicates that the incumbent LECs' spending is approximately $10 billion above their true costs.[401] Furthermore, MCI contends that the Hatfield model shows that incumbent LECs are not charging less than cost to provide local service.[402]

119. AT&T recommends eliminating the TIC immediately, suggesting that phasing the TIC out over some period might be inconsistent with the court's mandate in *CompTel v. FCC*. AT&T also asserts that the 1996 Act requires access to be priced at TELRIC levels, and contends that anything other than an immediate elimination of the TIC would violate that requirement.[403] AT&T also argues that the TIC should be eliminated immediately because: (1) the current per-minute TIC raises long distance rates above economic levels and restricts long distance usage, to the detriment of consumers ;[404] (2) the 1996 Act requires the Commission to remove implicit subsidies from access, and to price access at TELRIC;[405] (3) the TIC is anticompetitive and inconsistent with the Act's competitive goals because (a) it guarantees incumbent LECs recovery of transport "costs," even when their networks are not used;[406] and (b) it distorts competition by allowing incumbent LECs to price transport facilities below cost and thus below competitors'

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[399] MCI Comments at 87.

[400] MCI Reply at 29.

[401] MCI Reply at 27.

[402] MCI Reply at 27-28.

[403] AT&T Comments at 57-59.

[404] *Accord* WorldCom Comments at 65.

[405] *Accord* MCI Comments at 86; LCI Comments at 28.

[406] *Accord* Sprint Comments at 29-30; Teleport Comments at 14 n.8.

prices; and (4) the Court of Appeals has admonished the Commission to move expeditiously to a cost-based alternative or provide a reasoned explanation of why a departure from cost-based ratemaking is necessary, and no such justification exists here.[407]

120. CompTel asserts that the TIC should immediately be set to zero because by definition, it does not include any costs that will not be recovered by TSLRIC-based rates for other access elements.[408] Similarly, LCI argues that access charges should be priced using TELRIC method, and that the TIC should be eliminated as a non cost-based residual revenue stream that is at odds with the movement to cost-based pricing.[409] NCTA also argues that the TIC should be eliminated immediately.[410] Telco Communications Group advocates reassigning the easily identifiable costs to facility-based elements and phasing out the balance of the TIC. The TIC allows the incumbent LECs to price access below cost and recover the shortfall, regardless of whether the incumbent LEC provides transport facilities to the carrier paying the TIC or not. As a result, Telco Communications Group says a collocated transport provider must meet or beat the incumbent LEC prices and pay the TIC as well.[411] TRA contends that costs in excess of forward-looking economic costs should be eliminated.[412]

121. ACC Long Distance contends that the TIC should be eliminated over a well- defined period of no more than three years.[413] Excel favors reassigning readily identifiable and quantifiable costs and prescriptively phasing out the remainder of the TIC over no more than three years.[414]

122. Ad Hoc supports the Commission's proposal to identify and reallocate costs in the TIC to the extent possible, and to either permit incumbent LECs to write off the remaining TIC costs, or to require incumbent LECs to treat those costs as they treat other residual costs.[415] LCI

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[407] AT&T Reply at 30-31.

[408] CompTel Reply at 2.

[409] LCI Comments at 28.

[410] NCTA Comments at 3, 27.

[411] Telco Communications Group Comments at 5.

[412] TRA Comments at 36.

[413] ACC Long Distance Comments at 12.

[414] Excel Comments at 13-14.

[415] Ad Hoc Comments at 27-29.

argues that incumbent LECs should not be permitted to assess the TIC on terminating traffic because it is not cost-based since there are no TELRIC-based costs to recover.[416] ITC asserts that the TIC should be viewed as a support mechanism and eliminated as part of the USF proceeding.[417]

123. The California Cable Television Association argues that any transport costs recovered by the TIC should be recovered through the transport element with the non-cost subsidy portion prescriptively phased.[418] Time Warner argues that incumbent LECs should be given a limited opportunity to recover costs in the TIC that are unassignable to other elements, such as amortizing them over a five-year period through proportionate allocation to interstate switched access rate elements.[419] TCI argues that the Commission should base all rates for transport facilities on forward-looking costs and phase out the recovery of other TIC cost, which approach, according to TCI, would be most consistent with the Court's remand. If the Commission wishes to allow the incumbent LECs continued recovery of any portion of legacy costs, it should do so through a PIC-based rate element, which would be phased out over time by transferring these costs to the SLC.[420]

124. The Oregon Commission states that any remaining costs should be phased out.[421] The Alabama Commission generally supports a solution in which costs would be reassigned to the transport facility elements to correct identifiable misallocations. The remaining revenue shortfall should be shifted to a separate fund or account, recovered on a competitively neutral basis, and phased out over a reasonable period of time. The Alabama Commission states that the TIC is an implicit subsidy that must be eliminated under the 1996 Act.[422]

125. The Texas Public Utility Counsel supports reassigning to transport facility rate elements those portions of the TIC that can be identified, including the TELRIC of the element plus a reasonable allocation of forward looking common costs, and shifting the remaining revenue shortfall to a specially identified account to be recovered on a competitively neutral basis and phased out over time. Increased levels of universal service support should be used to offset the

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[416] LCI Comments at 20.

[417] ITC Comments at 4.

[418] California Cable Television Association Comments at 12.

[419] Time Warner Comments at 14.

[420] TCI Comments at 20.

[421] Ohio Commission Comments at 5-6.

[422] Alabama Commission Comments at 10-11.

amount of the TIC that is earmarked for phase-out.[423] The Texas Public Utility Counsel argues that the Commission should eliminate unnecessary economic cost recovery.[424] To the extent that there are uneconomic costs embedded in the TIC, AARP, *et al.* argues that they should be eliminated.[425] AARP, *et al.* states that using reductions in the rate of return to reduce the TIC is reasonable.[426]

126. USTA and most incumbent LECs assert that the TIC should not be phased out, contending instead that any costs remaining in the TIC after reallocation should be bulk-billed to the IXCs based on interstate revenues or minutes until reform of the separations process is completed. These parties argue that all incumbent LECs are entitled to full and complete recovery of the TIC amount because the TIC represents actual, real costs that have been assigned to the interstate jurisdiction by the Commission's rules.[427] Puerto Rico Tel. asserts that the Commission is under no obligation to phase out the TIC based on the CompTel remand, and in fact, cannot ignore the real costs underlying the TIC in the guise of access charge reform.[428]

127. Minnesota Independent Coalition argues that there is no basis for assuming that certain investment costs included in the TIC should be removed because of imprudence or because such investments are no longer used or useful. Minnesota Independent Coalition contends that this issue cannot be determined on an industry-wide basis using assumptions that may be wholly inaccurate in the case of individual LECs, but must be determined on a company-by-company basis.[429] Several incumbent LECs contend that failure to allow recovery would constitute a breach of the regulatory contract, a denial of fundamental due process, and a Fifth Amendment taking.[430]

128. Ameritech asserts that a phase out of the TIC should only be mandated: (1) over a sufficiently long period of time (*e.g.*, five years) to permit incumbent LECs and state commissions

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[423] Texas Public Utility Counsel Comments at 21.

[424] Texas Public Utility Counsel Comments at 16.

[425] AARP, *et al.*, Comments at 17. *See also* State Consumer Advocates Comments at 36.

[426] AARP, *et al.*, Comments at 17.

[427] *See, e.g.*, USTA Reply at 36-37; BellSouth Reply at 13-14; U S West Comments at 63-64; SWBT Reply at 12; Aliant Comments at 2; SNET Reply at 27-28; ALLTEL Reply at 8; Puerto Rico Tel. Reply at 11-12; Rural Tel. Coalition Reply at 13-15; TCA Comments at 4; TDS Comments at 23; Western Alliance Comments at 22.

[428] Puerto Rico Tel. Comments at 16-17.

[429] Minnesota Independent Coalition Comments at 17.

[430] Roseville Tel. Comments at 10; Minnesota Independent Coalition Comments at 17.

to manage the revenue loss; (2) if the Commission adopts the market-based approach to access reform, which would give the incumbent LECs sufficient pricing flexibility to manage the revenue loss; and (3) the Commission permits price cap LECs to target mandatory price cap reductions to the TIC during the phase-out period. In addition, Ameritech says states should conduct proceedings to permit incumbent LECs to recover the intrastate portions of the loop and line port costs from end user rates or state universal service fund subsidies, because these facilities currently are partially subsidized from the TIC.[431] The Illinois Commission proposes that to the extent that it is not possible to reallocate the entire TIC to appropriate rate elements, rate reductions required by the price cap mechanism should be focused on the TIC until it is phased out.[432]

129. Several incumbent LECs concur with Ameritech on targeting price cap reductions to the TIC until the TIC is phased out, although disagreeing with Ameritech's idea to phase out the TIC over a fixed number of years. For example, PacTel suggests that, if the Commission continues to use a productivity factor, it could include a new "productivity offset" where the productivity factor could be targeted to the remaining TIC, gradually eliminating it over a number of years.[433] Sprint also proposes to target all of the price cap productivity adjustment at the TIC until it is eliminated. Sprint states that a price cap productivity adjustment would eliminate the TIC in five years or less for all but three price cap LECs, without having to explore in detail the cost components of the TIC, or possibly revise Parts 36 and 69.[434] Sprint indicates that the TIC would be eliminated within 7 years for the other 3 price cap LECs. Sprint states that it may be possible to phase out the TIC immediately if increases in explicit universal service subsidies to price cap LECs, with offsetting reductions in the interstate access charges, are large enough.[435] During the phase out, Sprint contends that the TIC should continue to be recovered on a per-minute basis, instead of using bulk-billing mechanisms based on presubscribed lines or retail IXC revenues. Recovery in bulk would insulate the incumbent LECs from competition because they would recover the TIC even if LEC competitors provided the access.[436]

130. ALTS argues that the Commission should not adopt Sprint's proposal to phase out the TIC by applying the productivity factor against it only. ALTS argues that such targeting would undercut the rationale for the "just and reasonable" status of all price-cap rates, which is

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[431] Ameritech Reply at 32-33.

[432] Illinois Commission Comments at 13.

[433] PacTel Comments at 72; *See also* BA/NYNEX Comments at 38.

[434] Sprint Comments at 29, 51, Exhibit 8; Sprint Reply at 17-18.

[435] Sprint Reply at 17.

[436] Sprint Reply at 19.

the widespread application of the X-factor. According to ALTS, there are no sound policy reasons for Sprint's approach. Instead, the TIC should be curing identifiable cost misallocations and reducing the remainder via competition in the tandem market.[437] ALTS states that a long-term phase down of any remaining costs in the TIC is a fallback option.[438]

E. SS7 Signalling

131. A number of commenters support adopting the Ameritech rate structure for general application to all price cap LECs.[439] TCI argues that an unbundled SS7 rate structure would allow customers and market entrants to obtain access efficiently by purchasing only the SS7 network functions they require. TCI further supports flat-rated charges for signal links and STP port termination.[440] Although Time Warner supports adoption of the Ameritech rate structure, it cautions against the creation of overly detailed rules, suggesting that detailed rules for SS7 services are unnecessary.[441] AT&T supports adoption of the Ameritech rate structure but acknowledges that some LECs lack facilities to measure SS7 usage which justifies delaying implementation of the unbundled rate structure.[442] MCI supports the concept of an unbundled SS7 rate structure, but argues that rates for particular sub-elements could be more cost-based than the Ameritech rate structure.[443] Illuminet also supports general use of the Ameritech rate structure, but urges the Commission to impose strict tariff requirements to ensure that rates are just and reasonable. As for specific elements, Illuminet, like TCI, favors flat-rated charges for signal links and STP port termination because they reflect specific SS7 functions dedicated to specific customers.[444]

132. Generally, incumbent LECs oppose mandating the implementation of the Ameritech SS7 rate structure. BellSouth and GTE oppose a specific rate structure for signalling because it

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[437] ALTS Reply at 24.

[438] ALTS Comments at 26.

[439] TCI Comments at 22-23; Time Warner Comments at 16-17; Illuminet Comments at 2-4.

[440] TCI Comments at 22.

[441] Time Warner Comments at 17.

[442] AT&T Reply at 33-34.

[443] MCI Comments at 87.

[444] Illuminet Comments at 2-4.

would require the acquisition and deployment of equipment to measure usage of SS7 services.[445] In addition, BellSouth argues that the Ameritech rate structure does not provide adequate flexibility to address the use of future signalling services, such as advanced intelligent networks (AIN).[446] Similarly, Bell Atlantic and NYNEX oppose mandating the Ameritech SS7 rate structure because they, too, lack the ability to track costs associated with the use of disaggregated SS7 services.[447] If the Commission imposes an unbundled structure similar to Ameritech's, Bell Atlantic and NYNEX request that the Commission allow recovery of all direct costs incurred to enable billing for specific rate elements. They estimate this cost would range between $15 million and $40 million.[448] Other RBOCs echo similar concerns regarding equipment requirements to measure unbundled SS7 services.[449] Ameritech itself argues against a general requirement that its SS7 rate structure be implemented for all price cap LECs. It contends that its rate structure may not be appropriate on an industry-wide basis and that use of the Ameritech SS7 rate structure should be permissive.[450]

133. Other commenters caution against mandating the Ameritech rate structure. CompTel suggests that Ameritech's SS7 structure may be appropriate in the future, but should not be mandated now because carriers lacking necessary metering equipment would have to develop measuring capabilities that would place significant financial and operational burdens on smaller carriers.[451] Similarly, Worldcom argues that the high costs associated with measurement and billing facilities outweigh the benefits of adopting Ameritech's rate structure on an industry-wide basis.[452]

134. Generally, commenters choosing to discuss the ISUP/TCAP issue do not favor the imposition of separate charges for ISUP and TCAP messages. They expressed concern that the cost of implementing such an approach and monitoring message lengths with sufficient

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[445] BellSouth Comments at 81; GTE Comments at 53.

[446] BellSouth Comments at 82.

[447] Bell Atlantic/NYNEX Comments at 40.

[448] *Id.* at 40 n.95. *See also* USTA Comments at 66 and Reply at 37. Sprint estimates that the cost of metering equipment would run between $15 million and $20 million. Sprint Comments at 31.

[449] PacTel Comments at 73; SBC Comments at 15.

[450] Ameritech Comments at 23. *See also* US West Comments at 73-74.

[451] CompTel Comments at 31-32.

[452] Worldcom Reply at 39-41.

particularity would not justify the benefits to be derived from the proposed rate differentiation.[453] AT&T suggests rate differentiation between ISUP and TCAP messages should be permissive.[454]

135. With respect to the treatment of signalling rate elements in price cap baskets, both MCI and AT&T advocate placing STP port termination in the traffic-sensitive basket while leaving the signalling link in the trunking basket. These commenters argue that STP port termination is not subject to competitive provision which justifies placement in different baskets.[455] AT&T contends that incumbent LECs have an incentive to respond to competitive pressures in their signal link business by raising the level of the STP port charge.[456] Ameritech, on the other hand, opposes shifting STP port charges to the traffic-sensitive basket, arguing that any concern that STP port charges would be used to offset price reductions for the signal link is unfounded. Increases in the STP port termination charge, Ameritech contends, would encourage its customers to find other means to interconnect with the incumbent LEC's network.[457]

F. Impact of New Technologies

136. Incumbent LECs oppose the adoption of specific or detailed rate structures for recovery of costs associated with new technologies. According to USTA, a mandated rate structure would create a disincentive for LECs to invest in the development of new technologies.[458] Ameritech cautions against the adoption of rate structures, arguing that fast changing technology will render detailed rate structures outdated.[459] BellSouth advocates general rate structure guidelines rather than specific rules because flexibility will promote greater customer service choices.[460] GTE also opposes new rate structures for advanced technologies because detailed regulation would impair the ability of incumbent LECs to respond to competition from competitive LECs that also deploy new technologies.[461]

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[453] MCI Comments at 89; Time Warner Comments at 17; CompTel Comments at 31-32.

[454] AT&T Comments at 61.

[455] MCI Comments at 87-88; AT&T Reply at 33-34.

[456] AT&T Reply at 33-34.

[457] Ameritech Comments at 24-25.

[458] USTA Reply at 37. *See also* PacTel Comments at 73.

[459] Ameritech Comments at 25.

[460] BellSouth Comments at 83.

[461] GTE Comments at 53.

137. Other commenters support the development of cost-causative rate structures for certain technologies. AT&T favors adoption of a rate structure for SONET, recommending that this technology be priced on a flat, distance-sensitive basis. AT&T also advocates the establishment of per-message charges to recover the costs of AIN databases.[462] ALTS agrees that cost-causative rate structures for SONET and AIN should be adopted because these technologies are sufficiently mature to permit identification of their costs.[463] Other commenters, however, oppose the adoption of rate structures for new technologies, arguing that the deployment of a new technology to provide access services should lower the costs of providing access and promote efficiency. These commenters argue that new technologies merely change the cost of providing a traditional service and do not justify the adoption of corresponding rate structures.[464]

IV. BASELINE RATE LEVELS

A. Primary Reliance on a Market-Based Approach With Adoption of Several Initial Prescriptive Measures

138. Nearly all commenters agree that competition in markets for local exchange services, including exchange access services, is likely to produce lower interstate access prices. There is sharp disagreement, however, about the extent to which competition has developed, or will soon develop, to the point where it can be relied on to produce lower access charges. It is this disagreement that is largely responsible for parties' differing positions concerning the advisability of adopting either a market-based or a prescriptive approach to access charge reform.

139. *Support for a Market-Based Approach*. DOJ and most LECs support a market-based approach to reform of access charge rate levels. DOJ comments that a market-based approach will permit a more gradual transition to cost-based access charges, which will permit a more orderly and appropriate treatment of issues concerning universal service support and jurisdictional separations.[465] DOJ also recommends that the Commission adopt a prescriptive backdrop to its market-based reform. Incumbent LECs argue that market forces are more reliable and more precise than regulation for aligning rates with costs.[466] They also argue that the efficient

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[462] AT&T Comments at 62-63.

[463] ALTS Reply at 25.

[464] Spectranet Comments at 6; TCI Comments at 24; Illinois Commerce Commission Comments at 14.

[465] DOJ Ex Parte at 17-21.

[466] Alaska Tel. Assoc. Comments at 2-5; Aliant Comments at 3-4; Ameritech Reply at 3-8; BA/NYNEX Comments at 2-4; BellSouth Comments at 11, 14-16, 28-29; Cincinnati Bell Comments at 12-13; GTE Comments at 19-21; Independent Telephone and Telecommunications Alliance Comments at 5; PacTel Comments at 11-17; SNET Comments at 2-3, 6-7; TDS Comments at 28-32; USTA Comments at 32-34; and U S West Comments at 20-29.

operation of competitive markets requires that incumbent LECs be given the pricing flexibility embodied by the market-based approach sooner rather than later.

140. Most incumbent LECs combine their support for a market-based approach with opposition to a prescriptive approach to reforming access charge rate levels. Several incumbent LECs and other parties contend that the prescriptive approach is less likely than the market-based approach to result in economically efficient rates.[467] Some incumbent LECs also argue that a static prescriptive approach would not reflect fluctuations in supply and demand as a competitive market would.[468] Some commenters maintain that the prescriptive approach would result in inefficient rates, and thus skew potential competitors' entry decisions.[469] Cincinnati Bell opposes the prescriptive approach because it could result in more rapid rate reductions than would occur in a competitive market.[470] Citizens Utilities argues that the prescriptive approach would discourage use of unbundled network elements and retard the development of competition.[471]

141. Several commenters claim that the prescriptive approach is essentially an abandonment of price cap regulation, because it would punish incumbent LECs for efficiency gains made under the price cap regime.[472] Some incumbent LECs argue that the Commission determined that the initial price cap rates were reasonable, and that there is no basis to reverse that finding now.[473] BA/NYNEX argues that the prescriptive approach would be substantially similar to rate-of-return regulation, with recurring rate cases needed to recalculate forward-looking costs in light of further technological improvements. BA/NYNEX argues further that this

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[467] *See*, *e.g.*, Ameritech Comments at 48-49, Attachment B at 4; BA/NYNEX Comments at 2; BellSouth Comments at 41; Illinois Commission Comments at 23-25; CSE Comments at 4-5; Cincinnati Bell Comments at 13; GTE Comments at 74; SNET Comments at 23; American Communications Reply at 2-6.

[468] BellSouth Comments at 14-15; USTA Comments, Attachment 1 at 15; BellSouth Reply at 28-30; Ameritech Reply at 7, 19 and Attachment 1 at 16; USTA Reply, Attachment 1 at 10-11, Attachment 2 at 46; Attachment 3 at 7.

[469] Ameritech Comments at 49; PacTel Comments at 5; ALTS Comments at 21-22; Ohio Commission Reply at 6-7; USTA Reply at 10-11; U S West Reply at 7-10. U S West speculates that AT&T and MCI are seeking to limit entry into the local exchange market, in order to delay BOC entry into the long-distance market. U S West Reply at 8-9.

[470] Cincinnati Bell Comments at 13.

[471] Citizens Utilities Comments at 15.

[472] Ameritech Comments, Attachment B at 22-23; BA/NYNEX Comments, Attachment 1 at 4; USTA Comments at 12; PacTel Comments at 30; U S West Comments at 45-46; BA/NYNEX Reply, Attachment 1 at 2, 5-6; GTE Reply at 41. *See also* BellSouth Comments, Attachment 2 at 25 (observing generally that reducing profits too much might adversely affect efficiency incentives).

[473] GTE Reply at 40-41; PacTel Reply at 12; SWBT Reply at 21, *citing LEC Price Cap Order*, 5 FCC Rcd at 6814-17.

would vitiate price cap regulation and create a disincentive for future investment.[474] Some incumbent LECs assert that the prescriptive approach unreasonably discourages incumbent LECs' investment in their networks.[475] AT&T replies that, because price cap LECs would still be able to increase their profits by increasing their productivity growth, price cap regulation and its incentives for investment would remain in effect.[476] Competition Policy Institute argues that the opening of exchange access markets to competition means that lower rates of return are unlikely to stifle innovation, because competitive pressure will spur innovation.[477]

142. According to BellSouth, if access rates do not comport with market-based levels, it is because of regulatory policies rather than incumbent LEC inefficiency. BellSouth opposes the prescriptive approach because it does not address those regulatory policies.[478] Similarly, several parties assert that we cannot adopt a prescriptive approach unless we establish a joint board to increase the allocation of costs to the intrastate jurisdiction.[479]

143. Local exchange carriers generally argue that they already face substantial competition, particularly for exchange access services.[480] In addition, they argue that competition will develop first, and most rapidly, for the very customers that generate the majority of exchange access minutes.[481] In particular, they argue that barriers to entry are quite low in local markets, particularly for the provision of exchange access services, now that unbundled network elements

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[474] BA/NYNEX Comments, Attachment 1 at 7. *See also* BellSouth Reply at 36.

[475] Ameritech Comments at 49; BA/NYNEX Comments, Attachment 1 at 3; BellSouth Comments at 41-42; Ameritech Reply, Attachment A at 11; BA/NYNEX Reply at 15-16; PacTel Reply, Testimony of Bruce Egan at 24-25 (Egan Aff.); USTA Reply at 7-8, 11-12, and Attachment 1 at 1-2; U S West Reply at 7; USTA Reply, Attachment 1 at 9-10. *See also* American Association for Adult and Continuing Education, *et al*. Reply at 9-11.

[476] AT&T Reply at 18.

[477] Competition Policy Institute Comments at 24-25.

[478] BellSouth Comments at 15. *See also* USTA Comments, Attachment 2 at 12-19; U S West Reply at 5-6; USTA Reply, Attachment 1 at 3-4.

[479] BA/NYNEX Comments at 21-23 and Ex. 2; PacTel Comments at 31-32; Illinois Commission Comments at 25-26; Harris, Skrivan & Associates Comments at 3; Oregon Commission Comments at 2-3; TDS Comments at 28; Evans, *et al*. Comments at 10-11; API Reply at 17-18; Ohio Commission Reply at 2-3; Time Warner Reply at 22-23. The Tennessee Commission advises against a "rush to judgment" in this proceeding before a joint board can review separations changes. Tennessee Commission Comments at 2-3.

[480] *E.g.*, Ameritech Comments at 33-35; BellSouth Reply at 20-24; GTE Comments at 10-17; PacTel Comments at 11-15; SWBT Comments at 33-34; SNET Comments at 11-15; USTA Reply at 30; and U S West Comments at 22-23.

[481] *E.g.*, BA/NYNEX Reply at 22-26; Cincinnati Bell Comments at 15-20; and U S West Reply at 36-38.

are available to competitors at cost-based rates.[482] BellSouth states that, regardless of whether the market today is sufficient to restrain access prices, we should still incorporate market principles into the regulatory regime.[483]

144. *Opposition to a Market-Based Approach.* Several parties argue that market forces will not be adequate to drive access rates to forward-looking cost in the near future.[484] AT&T and MCI argue that the provisions of the 1996 Act require that explicit and implicit cross-subsidies have to be removed from interstate access charges, and that this must be done more quickly than can occur under a market-based approach to access charge reform.[485] Intl. Comm. Ass'n also argues that the local exchange and exchange access markets are not competitive, and that we cannot rely on unbundled network elements to drive rates down as long as some of our Part 51 rules are stayed.[486] The Missouri Commission and AT&T argue that competition will be slow to develop, particularly with respect to terminating access.[487] Ad Hoc favors a prescriptive approach, because it ensures that prices will be reduced to forward-looking economic costs regardless of the presence or absence of competition.[488] TDS asserts that both the prescriptive and the market-based approach would increase Commission control over incumbent LEC pricing decisions, and therefore neither are likely to result in efficient pricing.[489]

145. Long-distance carriers, which are the customers of switched access services, argue

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[482] BA/NYNEX Comments at 13; BellSouth Commenst at 23-27; SNET Reply at 2-3, 6-7; and USTA Comments at 32-34.

[483] BellSouth Reply at 27-28.

[484] ACC Long Distance Comments at 9; AT&T Comments at 20-21; ACTA Comments at 20; America On-Line Comments at 11-12; Competition Policy Institute Comments at 9-11; SDN Users Association Comments at 1-2; Internet Access Coalition Comments at 8-9; NCTA Comments at 21; LCI Comments at 8-17; CompTel Comments at 13-15; Excel Comments at 7-9; Florida Commission Comments at 7; California Cable Television Association Comments at 10-11; Tennessee Commission Comments at 4; Texas Public Utility Counsel Comments at 4-5; TRA Comments at 6-18; Washington Commission Comments at 7-8; API Reply at 2-4, 12-15; AT&T Reply at 4-8; GCI Reply at 3-4; IXC Long Distance, Inc. Reply at 3-4; Ohio Consumers Counsel Reply at 7-8; Sprint Reply at 20-21; TCI Reply at 20-22; Telco Communications Group Reply at 3. *See also* Frontier Comments at 10-11; GSA/DOD Comments at 19; State Consumer Advocates Comments at 53; Texas Commission Comments at 23-24 (supporting prescriptive approach in short term, followed by a transition to a market-based approach). TCI recommends a prescriptive approach for incumbent LECs and forbearance for competitive LECs, and describes this as a "combination" approach. TCI Comments at 25-27.

[485] AT&T Comments at 63-71; MCI Comments at 42-43.

[486] Intl. Comm. Ass'n Comments at 2-4.

[487] Missouri Commission Comments at 4-5; AT&T Reply at 6-7.

[488] Ad Hoc Comments at 37.

[489] TDS Comments at 29-31.

that competition in local markets largely does not exist today. In addition, they argue that entry into local markets, which have historically been characterized by monopoly provision of services, will take much longer than will LEC entry into long-distance markets, where many customers are accustomed to switching carriers and the operational support systems and procedures for switching carriers are well developed. AARP *et al*. notes that BellSouth and U S West have advocated a prescriptive approach based on TELRIC in interconnection proceedings in other countries, because competition in those countries is not sufficient to drive rates to cost.[490] According to AARP *et al*., BellSouth has also argued in foreign proceedings that the incumbent has an inherent advantage over new entrants because of factors such as name recognition and customer inertia.[491]

146. Some IXCs and other parties argue that incumbent LECs will fight competitive entry as long as they can.[492] According to LCI and MCI, incumbent LECs are filling interconnection orders slowly and that this is preventing the development of competition.[493] LCI provides a list of service ordering and provisioning procedures that it claims are necessary for local exchange competition to develop, and considers these procedures to be a prerequisite for any market-based reforms.[494] LCI maintains that the incumbent LECs' control of the local networks gives them a competitive advantage, and that the policies adopted in the 1996 Act and the *Local Competition Order* will not lead to competition unless the Commission enforces its rules and properly manages the transition to competition.[495] LCI doubts that resale will lead to competition, because setting wholesale prices at retail minus avoided costs does not permit a new entrant to be profitable enough to construct its own facilities, and because such wholesale pricing is above forward-looking economic cost.[496] MCI maintains that incumbent LECs are using non-recurring charges

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[490] AARP *et al*. Comments at 7-17.

[491] AARP *et al*. Reply at 21-22.

[492] ACC Long Distance Comments at 4-9; AT&T Comments, Attachment A at 20-21; IXC Long Distance, Inc. Comments at 3-4; AARP *et al*. Reply at 7-8; TCI Reply at 22-23. In its reply, IXC Long Distance, Inc. alleges several specific instances in which SWBT and GTE have engaged in anticompetitive conduct to delay interconnection. IXC Long Distance, Inc. Reply at 4-9. GTE denies that any litigation it has initiated was a ploy to delay interconnection. GTE Reply at 35. ACC Long Distance claims it has experienced "repeated delays" in obtaining physical collocation. ACC Long Distance Reply at 5-6.

[493] LCI Comments at 15; MCI Reply at 32-33.

[494] LCI Reply at 3 and Attachment. *See also* AT&T Reply at 14-15; CompTel Reply at 4-5; Sprint Reply at 19-20 and Attachment; WorldCom Reply at 19.

[495] LCI Comments at 8-12.

[496] LCI Comments at 12-13. *See also* ALTS Reply at 11-12 (resale followed facilities-based competition in interexchange market, so resale is less likely than facilities-based competition to provide competitive pressure in access market).

as a means of discouraging competitive entry.[497] AT&T also criticizes incumbent LECs for failing to provide dialing parity and adequate access to operations support systems.[498] According to LCI, the incumbent LECs' local switches do not permit all interconnectors equal access.[499] AT&T asserts that the prohibition against interconnectors using unbundled network elements for access unless they have also won the local customer creates an unreasonable barrier to entry and will ultimately limit the development of local competition.[500] GTE replies that it provides nondiscriminatory access to its operational support systems.[501]

147. AT&T cites to *Farmers Union Central Exchange, Inc. v. FERC*[502] for the proposition that "[r]eliance on competitive forces to constrain exchange access rates, particularly in the presence of strong indications that market forces will not produce the intended results, would be arbitrary and capricious and contravene the Commission's statutory duty to ensure just, reasonable, and nondiscriminatory rates."[503] PacTel challenges the relevance of *Farmers Union*, arguing that the mandate Congress gave FERC was regulatory, whereas Congress in the 1996 Act stated that competition rather than regulation should be used to set rates for telecommunications services.[504]

148. *Support for a Combination of Market-Based and Prescriptive Measures*. ICG recommends four years of phased-in access charge reductions, while competitive LECs construct facilities-based networks. After this period, ICG suggests that some form of a market-based approach would be reasonable.[505] A number of parties, including several state commissions, advocate similar approaches.[506] The District of Columbia Commission recommends that we retain

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[497] MCI Reply at 33-34.

[498] AT&T Reply at 10-12.

[499] LCI Comments at 13. *See also* AT&T Reply at 10.

[500] AT&T Reply at 8-9.

[501] GTE Reply at 35.

[502] 734 F.2d 1486, 1508 (D.C. Cir.) (*Farmers Union*), *cert. denied, Williams Pipe Line Co. v. Farmers Union Central Exchange, Inc.*, 469 U.S. 1034 (1984).

[503] AT&T Comments at 48.

[504] PacTel Reply at 14-16.

[505] ICG Comments at 15-17.

[506] Ad Hoc Comments at 46; Competition Policy Institute Comments at 9-14; Frontier Comments at 10-11; NCTA Comments at 20-24; Alabama Commission at 11-13; District of Columbia Commission Comments at 1-3; Florida Commission Comments at 5; Texas Commission at 23-26; NARUC Comments at 10; MCI Reply at 2-5.

authority to re-impose regulatory control after we permit some pricing flexibility, in case the competitive conditions that warranted granting the pricing flexibility change.[507]

149. WorldCom suggests using a combination of "carrots" and "sticks" to induce the incumbent LECs to facilitate local competition. WorldCom's "carrot" to induce such compliance would be the promise of future pricing flexibility, and the "stick" would be the threat of prescriptive rate changes.[508] Specifically, WorldCom would give incumbent LECs until January 1, 1999, to implement unbundled network element requirements, and then impose prescriptive requirements.[509] USTA argues that the prescriptive approach should be used, if at all, only if there is considerable evidence that current market forces are insufficient to reform the current access market.[510] On the other hand, BellSouth opposes using the prescriptive approach as a "backstop" to a market-based approach, because it does not believe the Commission can specify a set of circumstances that indicate a market failure.[511]

150. The California Commission supports a market-based approach in competitive areas, and a prescriptive approach in areas that are "not sufficiently competitive." The California Commission would define a competitive market as one where a serving wire center is providing unbundled elements to at least one competitor unaffiliated with the incumbent LEC, provided the incumbent meets the other proposed Phase 1 criteria.[512] AT&T maintains that the growth of competition resulting from the availability of unbundled network elements will be slower in rural areas, and so the market-based approach would be less effective in rural areas than in urban areas.[513]

151. Competition Policy Institute recommends imposing prescriptive measures simultaneously with market-based regulatory reforms. In addition to increasing the X-Factor and reinitializing PCIs, Competition Policy Institute suggests that the Commission: (1) facilitate the

[507] District of Columbia Commission Comments at 3.

[508] WorldCom Comments at 72-73. *See also* Ameritech Comments, Attachment B at 22-23; American Communications Reply at 6-7, 15-16.

[509] WorldCom Comments at 89-91.

[510] USTA Comments, Attachment 1 at 15.

[511] BellSouth Comments at 16-17.

[512] California Commission Comments at 7-10.

[513] AT&T Comments at 47-48.

provision of unbundled elements;[514] (2) adopt a time frame for a transition of access charges to economic cost; and (3) annually review the progress of access charges toward economic cost, with the possibility of imposing additional prescriptive rate reductions if required.[515] AT&T argues that since whatever benefits of permitting incumbent LECs additional pricing flexibility do not relate to the levels of access charges, if the Commission insists on permitting additional pricing flexibility, it could do so in conjunction with the prescriptive approach.[516]

152. *Price Squeeze Concerns.* Some IXCs and AARP *et al*. are concerned that BOCs might cross-subsidize long-distance service with access revenues when they are permitted to enter the long-distance market pursuant to section 271, or engage in a price squeeze, unless we adopt a prescriptive approach.[517]

153. A number of incumbent LECs deny that any prescriptive measures are needed to prevent price squeezes because it is almost impossible to engage in a price squeeze profitably.[518] Moreover, the Communications Act or Commission regulations adequately protect against price squeezes.[519] BellSouth also claims that, as long as it sets prices below "general market levels or the costs of a firm's competitors," it has not legally engaged in a price squeeze.[520] U S West argues that the relevant factor for determining whether a carrier has committed a price squeeze is

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[514] Specifically, Competition Policy Institute recommends the following: (1) eliminating the application of access charges to unbundled network elements; (2) monitoring state pricing decisions regarding unbundled network elements for consistency with TELRIC pricing standards; (3) minimize logistical barriers to the provisioning of unbundled network elements; (4) requiring subloop unbundling; (5) establishing an expedited complaint process available to unbundled network element purchasers; (6) periodic performance audits or surveys of the RBOCs' provisions of unbundled network elements; and (7) additional deaveraging of unbundled network element prices. Competition Policy Institute Comments at 26.

[515] Competition Policy Institute Comments at 25-27. *See also* GSA/DOD Comments at 13-15, 20-25; GSA/DOD Reply at 13-17; *NTIA Letter* at 4.

[516] AT&T Comments at 21.

[517] ACC Long Distance Comments at 9; AT&T Comments at 13-17 and Attachment A at 12, 20; Telco Communications Group Comments at 2-4; MCI Comments at 10-11, 14, 41; and Attachment at 12-13; Excel Comments at 4-5; AARP *et al*. Comments at 9-10; LCI Reply at 3-4.

[518] Ameritech Comments at 48; ALTS Reply at 18-19; Ameritech Reply at 22-23; BA/NYNEX Reply at 13; GTE Reply at 36; PacTel Reply at 19; U S West Reply at 10; USTA Reply at 31-32, Attachment 1 at 18, Attachment 3 at 13.

[519] Ameritech Reply at 22; BellSouth Comments at 18, *citing* 47 U.S.C. §§ 272(e)(3), 201, 202, 272(d); ALTS Reply at 17-18, 21; BA/NYNEX Reply at 12-13 and Attachment 1 at 2; GTE Reply at 35-36; PacTel Reply at 20-21; SWBT Reply at 32-34; USTA Reply at 31 and Attachment 3 at 12; U S West Reply, Attachment A at 4-5.

[520] BellSouth Comments at 18, *citing Brooke Group v. Brown & Williamson*, 509 U.S. 209, 223 (1993). *See also* USTA Reply, Attachment 1 at 17.

not the price level, but the margin between price and cost.[521] Alternatively, ALTS asserts that incumbent LECs have sufficient funds to finance price squeezes regardless of whether we adopt a prescriptive approach to access reform.[522] USTA argues that AT&T presents a similar threat of cross-subsidization of local service with long-distance revenues.[523] USTA also alleges that AT&T is seeking to limit competitive entry into the long-distance market.[524] Ameritech asserts that prescribing access rates that are too low might place competitive LECs that rely on unbundled network elements in a price squeeze.[525]

154. *Cross-Subsidization Concerns*. MCI argues that price cap regulation by itself does not eliminate incumbent LEC incentives to engage in anticompetitive cross-subsidization that might occur under a market-based approach.[526] NCTA advocates a prescriptive approach to protect against incumbent LEC cross-subsidization of video or other new services.[527] Similarly, many commenters argue that excessive access charges enable incumbent LECs to cross-subsidize any present or future competitive service.[528] The Texas Commission asserts that it would be difficult to craft accounting rules to prevent incumbent LECs from cross-subsidizing with respect to multiple services in multiple geographical areas.[529]

155. The Georgia Commission recommends that whatever approach we adopt enable the incumbent LEC to recover all its prudently incurred costs rather than trying to shift costs to the intrastate jurisdiction. The Georgia Commission asserts that our first priority should be to facilitate competitive entry, and that price level regulation should be limited to monopoly services, to ensure that monopoly service prices are not too high or used to cross-subsidize competitive

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[521] U S West Reply, Attachment A at 4, *citing United States v. Aluminum Company of America*, 148 F.2d 416 (2nd Cir. 1945).

[522] ALTS Reply at 17.

[523] USTA Reply, Attachment 1 at 15-16.

[524] USTA Reply, Attachment 1 at 18.

[525] Ameritech Reply at 22-23.

[526] MCI Comments, Attachment at 10-13.

[527] NCTA Comments at 9.

[528] AT&T Comments, Attachment A at 9; Ad Hoc Comments at 39-41; GSA/DOD Reply at 15; TCI Reply at 23-24. CompTel argues that the Section 254(k) prohibition against cross-subsidization requires the Commission to prescribe TSLRIC-based rates. CompTel Reply at 10.

[529] Texas Commission Comments at 25-26.

services.[530]

156. *Relative Administrative Burdens of the Possible Approaches.* Some parties argue that determining the extent of competition for each relevant market under the market-based approach would be more burdensome than any of the requirements of the prescriptive approach.[531] Cable & Wireless argues that the litigation surrounding the Phase 1 and Phase 2 determinations, the different negotiated agreements that will be adopted in each state, and the results of the court's review of the *Local Competition Order*, will result in a "patchwork" of different regulatory requirements, which would increase uncertainty in the market.[532]

157. A few parties maintain that the prescriptive approach would be unreasonably burdensome.[533] Teleport argues that a prescriptive approach might require annual reviews to verify that access rates were in fact moving towards costs.[534] ACC Long Distance denies that a prescriptive approach would be burdensome because it maintains that the Commission has substantial experience with such regulation.[535] A number of commenters assert that the prescriptive approach would increase regulatory control over the market, and therefore be inconsistent with the 1996 Act.[536] AT&T replies that both the prescriptive and market-based approaches would retain price cap regulation initially, and so there is no reason to call one more regulatory than the other.[537]

158. *Prescriptive Measures Tailored for Insular or High-Cost Areas.* The Northern Marianna Islands support the prescriptive approach because it would enable the Commission to tailor access charge reforms to the unique circumstances faced in insular or high-cost areas such

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[530] Georgia Commission Reply at 5-7.

[531] Excel Comments at 9-10; Florida Commission Comments at 4-5.

[532] Cable & Wireless Comments at 25-26. *See also* Intl. Comm. Ass'n Comments at 2-3; Kansas Commission Comments at 7-8.

[533] Illinois Commission Comments at 23-25; BellSouth Comments at 42; PacTel Comments at 28-29; ALTS Reply at 15-16; Ameritech Reply, Attachment A at 10; GTE Reply at 42; PacTel Reply at 13-14; USTA Reply at 12.

[534] Teleport Reply at 31-32.

[535] ACC Long Distance Reply at 6.

[536] BellSouth Comments at 41; PacTel Comments at 5; USTA Comments at 11-12; TDS Comments at 29-31; SWBT Comments at 23-24; U S West Comments at 44-45; Aliant Comments at 3-4; Citizens Utilities Comments at 15. *See also* SNET Comments at 26.

[537] AT&T Reply at 18.

as the Northern Marianna Islands.[538] Alternatively, the Alaska Telephone Association argues that a market-based approach would better reflect local economic conditions, and so can be tailored to reflect the concerns of both large and small incumbent LECs.[539]

B. Prescriptive Approaches

1. Prescription of a New X-Factor

159. According to USTA, productivity estimates based on historical studies overstate the productivity potential of price-cap LECs under competition.[540] According to USTA, as incumbent LECs lose customers to competition, their output will decline, and as a result their measured productivity will decline. Therefore, USTA recommends basing the X-Factor on a five-year moving average of the TFP, so that reductions in productivity resulting from competition would be reflected in the X-Factor.[541] USTA claims that the TFP differential (TFP of LECs minus TFP for US economy as whole) is 2.7 percent, and will decrease by 0.4 percentage points each year if the Commission adopts USTA's recommendations for restructuring the CCL charge and the TIC.[542] Most incumbent LECs support USTA.[543] BA/NYNEX argues that productivity growth will decrease as a result of competition unleashed by the 1996 Act, and so basing the X-Factor on a five-year moving average TFP would likely overstate future achievable productivity.[544] Alternatively, BA/NYNEX argues that we could rely on a fixed TFP-based X-Factor for a short period of time, until Bell competition will enable us to deregulate incumbent LECs completely.[545] GTE and SNET contend that growth in competition and recovering more costs through flat rather than usage sensitive rates, will likely depress measured TFP growth.[546]

160. AT&T notes that it recommended at least 8.8 percent in its pleadings filed in

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[538] Northern Marianna Islands Comments at 11-12.

[539] Alaska Telephone Association Comments at 2.

[540] USTA Comments at 19.

[541] USTA Comments at 20.

[542] USTA Comments at 21. *See also* USTA Reply at 41-42; US West Comments at 46-49; SWBT Reply at 37.

[543] BA/NYNEX Comments at 58-60; BellSouth Comments at 50 n.93; SNET Comments at 28-30; U S West Comments at 46-49; Aliant Reply at 3-4; BellSouth Reply at 41-42; SNET Reply at 24-25.

[544] BA/NYNEX Comments at 59. *See also* U S West Comments at 46

[545] BA/NYNEX Comments at 59; BA/NYNEX Reply at 29-30.

[546] GTE Comments at 57-58; SNET Reply at 25-26.

response to the *Price Cap Fourth Further NPRM*.[547] Several commenters recommend setting the X-Factor at 9.9 percent, on the basis of the pleadings of the CARE Coalition filed in response to the *Price Cap Fourth Further NPRM* proceeding.[548] Ad Hoc also recommends increasing the X-Factor for the reasons it explained in its comments in the *Price Cap Fourth Further NPRM*.[549] MCI also supports increasing the X-Factor to 9.9 percent, but only for five years, after which MCI argues that the X-Factor should be based on TFP.[550] A number of price cap LECs maintain that the X-Factors recommended by AT&T and MCI greatly exceed their actual productivity growth under price cap regulation.[551] USTA has identified several purported computational and methodological errors in AT&T's, MCI's, and Ad Hoc's X-Factor proposals in its pleadings filed in response to the *Price Cap Fourth Further NPRM*.[552] Ad Hoc recommends making any fundamental changes to price cap regulation in the price cap proceeding, and focusing on access reform in this proceeding.[553] According to GTE, AT&T and Ad Hoc maintain that incumbent LECs' interstate productivity is greater than their intrastate productivity, and included in their X-Factor recommendations an interstate TFP adjustment to account for this alleged difference in productivity. GTE further opposes any interstate TFP adjustment, because there incumbent LECs provide interstate and intrastate services using the same network, and so it would make no economic sense to assume that interstate productivity is greater than intrastate productivity.[554]

161. PacTel and Aliant propose setting the X-Factor equal to GDP-PI.[555] Sprint argues that the Commission should discontinue the use of the current productivity factor for all baskets except common line, once all access charges have been reduced to geographically deaveraged TELRIC levels.[556] AT&T anticipates that access reform would increase productivity growth,

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[547] AT&T Comments at 70. In its reply, AT&T increases its X-Factor recommendation to 9.0 percent, on the bases of updated data. AT&T Reply at 35 and Attachment G.

[548] API Comments at 27-28; ICA Comments at 4; WorldCom Comments at 91; API Reply at 18.

[549] Ad Hoc Comments at 70; Ad Hoc Reply at 7-14. Ad Hoc also replies that its *Price Cap Fourth Further NPRM* pleadings discredited USTA's X-Factor studies. Ad Hoc Reply at 9-14.

[550] MCI Comments at 25.

[551] BellSouth Comments at 50; BA/NYNEX Reply at 27-29; SWBT Reply at 37-39; Aliant Reply at 3.

[552] USTA Reply at 42-44. *See also* BA/NYNEX Reply at 30-31.

[553] Ad Hoc Reply at 7-8.

[554] GTE Reply at 27-28.

[555] PacTel Comments at 41-42; Aliant Comments at 8.

[556] Sprint Comments at 53.

because reducing rates to cost-based levels would stimulate demand.[557]

2. Rejection of Certain Prescriptive Approaches

a. Rate Prescription

162. TRA and TCI recommend prescribing access rates because reinitializing PCIs would not guarantee that the LECs' rate structures would be reasonable.[558] Similarly, CompTel asserts that only a TSLRIC-based rate prescription can ensure that access rates are at cost-based levels.[559]

163. AT&T argues that a new rate prescription would not necessarily be burdensome, because four access rate elements account for most of the incumbent LECs' access revenue: the per-minute local switching charge, the per-minute tandem switching and common transport rate elements, and the dedicated transport elements. According to AT&T, it would be easy to reprice these four charges at forward-looking economic levels on the basis of existing TELRIC data.[560] Alternatively, AT&T argues that, even if a reinitialization were burdensome, the benefits of TELRIC-based access rates would outweigh those administrative burdens.[561] USTA asserts that the rate prescription suggested by AT&T would recreate rate-of-return regulation, and that its detrimental effects would outweigh the administrative benefits alleged by AT&T.[562] PacTel argues that every error in the estimation of costs used to set prices (both over- and under-estimation) will work to the advantage of entrants since they can choose in each individual case whether to pay for the facilities or resell the services and pay the below-cost access charges.[563] The Florida Commission recommends against adopting prescriptions that would preclude incumbent LECs from lowering prices where competitive conditions warrant it.[564]

164. AT&T denies that adopting a TSLRIC pricing standard would create a serious

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[557] AT&T Reply at 35-36.

[558] TCI Comments at 30-31; TRA Comments at 23. *See also* Washington Commission Comments at 8; AT&T Reply at 24-25.

[559] CompTel Reply at 8-11.

[560] AT&T Comments at 22-24; AT&T Reply at 17-18.

[561] AT&T Reply at 17-18.

[562] USTA Reply at 47 and Attachment 2 at 50.

[563] PacTel Comments at 36.

[564] Florida Commission Comments at 4-5.

common cost allocation problem, because both unbundled network elements and access rate elements correspond to network facilities to a great extent.[565] The Texas Commission argues that it would be easy to develop a reasonable overhead loading factor based on the ratio of overhead costs to revenues, and that use of a single overhead loading factor eliminates the need to develop common cost allocation factors.[566] AirTouch observes that TSLRIC raises common cost allocation issues, and maintains that we must take into account the extent of competition and the different demand elasticities of different services when we address these common cost allocation issues. AirTouch questions whether "a minute is a minute" pricing is necessarily the best means to allocate common costs.[567] Similarly, API argues that the common cost allocation to any particular service should be limited to the amount of common costs that could be recovered in a competitive market.[568] State Consumer Advocates argue that any forward-looking economic cost method should permit incumbent LECs to recover a reasonable allocation of joint and common costs, including joint and common costs associated with the local loop.[569]

b. Reinitialization of PCIs on a Rate-of-Return Basis

165. A number of incumbent LECs argue that reinitializing indexes on the basis of earnings would adversely affect the efficiency incentives of price cap regulation.[570] In particular, PacTel and USTA note that the Commission has criticized earnings-based PCI adjustments in the past, and is contemplating eliminating sharing, because sharing is based on earnings, in the *Price Cap Fourth Further NPRM*.[571] Frontier asserts that represcribing the authorized rate of return would leave other causes of uneconomic access charges unaddressed.[572] GSA/DOD argues that, contrary to the incumbent LECs, the Commission did not want to sever rates from costs when it adopted price cap regulation, because it retained the sharing requirement.[573] Ad Hoc argues that reinitializing rate levels at 11.25 percent, or some other rate of return, would be administratively

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[565] AT&T Comments at 24-25.

[566] Texas Commission Comments at 28-29.

[567] AirTouch Comments at 7-9. *See also* Ameritech Reply, Attachment A at 10.

[568] API Comments at 26.

[569] State Consumer Advocates Comments at 7-13, 54-55.

[570] USTA Comments at 17; BellSouth Comments at 47-48; USTA Reply at 46-47.

[571] PacTel Comments at 37-38; USTA Reply, Attachment 2 at 43.

[572] Frontier Comments at 13.

[573] GSA/DOD Reply at 12-13. *See also* MCI Reply at 7-8.

easy, and that the rate structure rule revisions contemplated in Section III of the NPRM are adequate to ensure that prices of individual services are efficient.[574] API maintains that it is important to reduce rates to cost as soon as possible, and so recommends represcribing the authorized rate of return and reinitializing PCIs on that basis.[575]

166. USTA opposes represcribing the authorized rate of return, because the 1996 Act has created uncertainty regarding the incumbent LECs' cost of capital, and because interest rates have not changed greatly over the past 10 months.[576] USTA also claims that no one has provided adequate reason to reduce the authorized rate of return, and predicts that the cost of capital would increase as the competition faced by incumbent LECs increases.[577] USTA asserts that represcribing the authorized rate of return would adversely affect small incumbent LECs.[578] MCI contends that its submission in the *Preliminary Rate of Return Inquiry* supports reducing the authorized rate of return to 10 percent.[579] USTA claims that MCI bases its represcription recommendation on incorrect calculations.[580] BA/NYNEX maintains that there is no basis in this record for represcribing the authorized rate of return, and argues that a represcription proceeding would be burdensome.[581] PacTel cites the *Preliminary Rate of Return Inquiry NPRM* for the Commission's observation that rate of return prescriptions have little relevance to price cap carriers, and argues that they do not trigger decreases in the price cap indices.[582]

167. GSA/DOD recommends represcribing the authorized rate of return and reinitializing PCIs on that basis, because it believes earnings of carriers under price cap regulation has been

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[574] Ad Hoc Comments at 41-45.

[575] API Comments at 27; API Reply at 8-9, 18. *See also* CPI Comments at 23.

[576] USTA Comments at 16-17.

[577] USTA Reply, Attachment 13 at 3-8.

[578] USTA Comments at 16-17.

[579] MCI Comments at 25.

[580] USTA Reply at 47-48 and Attachment 13.

[581] BA/NYNEX Comments at 25-26.

[582] PacTel Comments at 43-44, *citing* Public Notice, Common Carrier Bureau Sets Pleading Schedule in Preliminary Rate of Return Inquiry, 11 FCC Rcd 3651 (Com.Car.Bur., Accounting and Audits Div., 1996).

excessive.[583] BA/NYNEX opposed a rate-of-return-based reinitialization in its comments,[584] but revised its position in an *ex parte* statement submitted on April 4, 1997. In particular, BA/NYNEX stated that it reached agreement with AT&T on a comprehensive proposal on universal service and access reform that includes, among other things, a reinitialization based on a rate-of-return of 11.25 percent.[585] USTA denies that incumbent LECs have overearned under price cap regulation, and asserts that the incumbent LECs' "economic rate of return" was 8.75 percent from 1991 to 1995.[586] According to SWBT, arguments for decreasing the rate of return are based on non-forward-looking accounting measures that do not accurately measure the incumbent LECs' cost of capital.[587] GTE asserts that the authorized rate of return is too low to reflect the risks faced by incumbent LECs now that they face competition.[588] Ad Hoc argues that services subject to effective competition should be removed from price cap regulation, and that the authorized rate of return should be lowered to reflect the lower risk associated with the services that remain subject to price cap regulation.[589]

d. Reinitialization of PCIs on a TSLRIC Basis

168. Some incumbent LECs argue that reinitializing PCIs using TSLRIC would be equivalent to abandoning price cap regulation in an arbitrary and confiscatory manner.[590] Similarly, BellSouth and BA/NYNEX contend that reinitializing PCIs at TELRIC or TSLRIC levels would destroy price cap regulation by recreating the link between rates and costs.[591]

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[583] GSA/DOD Comments at 13-15; GSA/DOD Reply at 9-10.

[584] BA/NYNEX Comments at 24-27.

[585] Letter from G.R. Evans, Vice President, Federal Regulatory Affairs, NYNEX, to William Caton, Secretary, FCC, April 4, 1997.

[586] USTA Comments at 18 and Attachment 4; USTA Reply at 46. *See also* SWBT Reply at 41. USTA claims that the current rate-of-return prescription of 11.25 percent is an accounting measure rather than an economic measure, and therefore inherently less accurate, because accounting rates of return are based on accounting rather than economic depreciation, book values rather than economic values, and accrued revenues and expenses rather than cash flows. USTA Comments, Attachment 4 at 2. USTA bases its determination of the economic rate of return on values of certain categories of telecommunications equipment as collected by the Bureau of Economic Analysis (BEA), and on dividend payments of the incumbent price cap LECs. USTA Comments, Attachment 4 at 5 and Schedule 1.

[587] SWBT Reply at 43-45.

[588] GTE Comments at 77.

[589] Ad Hoc Comments at 70.

[590] PacTel Comments at 39; GTE Comments at 75-76; USTA Reply at 46-47 and Attachment 2 at 43, 48.

[591] BellSouth Comments at 45; BellSouth Reply at 30-31; BA/NYNEX Comments, Attachment 1 at 8-9. *See also* USTA Reply, Attachment 3 at 17.

BellSouth and USTA claim that price cap regulation has worked very well, and there is no justification for eliminating it.[592] BellSouth also notes that the Commission rejected proposals to revert to cost-of-service regulation in the *LEC Price Cap Performance Review Order*.[593]

169. Ad Hoc recommends reinitializing PCIs to equate with the aggregation of revenues from individual services priced at TSLRIC.[594] Although API supports TSLRIC, it opposes reinitializing indices on a TSLRIC basis because of the time needed to conduct a TSLRIC study.[595] The Florida Commission argues that we could require incumbent LECs to begin reducing their access rates gradually while we are conducting cost studies necessary to calculate TSLRIC levels.[596] MCI maintains that we must "reinitialize" APIs and SBIs, as well as PCIs, to ensure that rates under price cap regulation are at economic cost-based levels.[597]

170. A number of parties argue that proxy models provide only hypothetical and averaged costs, and therefore are not representative of the costs incurred by actual individual carriers, and in particular the costs incurred by small carriers.[598] According to USTA, unless rates are based on actual network costs, rates will not reflect accurately the opportunity costs of using the network.[599] According to PacTel, the proxy models are designed to calculate differences in the costs of serving different geographic areas, not actual costs. Because no one has proposed deaveraging access rates on the basis of Census Block Groups, as measured in the proxy models, PacTel claims that there is no reason to base access rates on the results of the proxy models.[600] Similarly, the Texas Commission questions whether TSLRIC proxy models would produce accurate company-specific costs, as opposed to industry-wide averaged costs. The Texas

[592] BellSouth Reply at 31-34; USTA Reply at 12-13.

[593] BellSouth Reply at 32, *citing LEC Price Cap Performance Review Order*, 10 FCC Rcd at 8973.

[594] Ad Hoc Comments at 70.

[595] API Comments at 27.

[596] Florida Commission Comments at 5.

[597] MCI Comments at 19-24.

[598] Evans, *et al*. Comments at 5-6; TDS Reply at 10-14; Rural Tel. Coalition Reply at 16-17; Minnesota Independent Association Reply at 6; USTA Reply at 14. *See also* PacTel Comments at 36-37; PacTel Reply at 10-11; PacTel Reply, Egan Aff. at 23-24; BA/NYNEX Reply at 14.

[599] USTA Reply, Attachment 2 at 23-24, Attachment 3 at 1.

[600] PacTel Comments at 33-34. *See also* Rural Tel. Coalition Reply at 15-17.

Commission, therefore, supports TELRIC as a pricing standard for access rates.[601] PacTel contends that the proxy models do not place sufficient weight on traffic volume, which PacTel asserts influences costs more than population density or other factors reflected in the models.[602] Southwestern Bell claims that the network assumed by the Hatfield model could not be used to provide service.[603] Southwestern Bell also claims that it has not been able to replicate the results of the Hatfield Model reported by MCI.[604]

171. Airtouch observes that TSLRIC raises common cost allocation issues, and maintains that we must take into account the extent of competition and the different demand elasticities of different services when we address these common cost allocation issues. Airtouch questions whether "a minute is a minute" pricing is necessarily the best means to allocate common costs.[605] Similarly, API argues that the common cost allocation to any particular service should be limited to the amount of common costs that could be recovered in a competitive market.[606] On the other hand, the Texas Commission argues that it would be easy to develop a reasonable overhead loading factor based on the ratio of overhead costs to revenues, and that use of a single overhead loading factor eliminates the need to develop common cost allocation factors.[607] State Consumer Advocates argue that any forward-looking economic cost method should permit incumbent LECs to recover a reasonable allocation of joint and common costs, including joint and common costs associated with the local loop.[608] AT&T denies that adopting a TSLRIC pricing standard would create a serious common cost allocation problem, because both unbundled network elements and access rate elements correspond to network facilities to a great extent.[609]

172. Some state commission oppose the FCC's proposal to place responsibility for cost studies on state commissions, because it would create excessive demands on scarce state

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[601] Texas Commission Comments at 26-27.

[602] PacTel Comments at 34-35; PacTel Reply, Egan Aff. at 26-27.

[603] SWBT Reply at 25.

[604] SWBT Reply at 25-27. *See also* USTA Reply, Attachment 3 at 6.

[605] AirTouch Comments at 7-9. *See also* Ameritech Reply, Attachment A at 10.

[606] API Comments at 26.

[607] Texas Commission Comments at 28-29.

[608] State Consumer Advocates Comments at 7-13, 54-55.

[609] AT&T Comments at 24-25.

commission resources.[610] The Kansas Commission argues that state commissions do not have expertise in reviewing interstate costs.[611] The Florida and Oregon Commissions question whether we have authority under the Communications Act to adopt this proposal.[612] The Florida and Georgia Commissions question whether the FCC would permit different pricing standards for interstate access to be adopted in different states.[613] The Texas Commission recommends giving states the option of reviewing incumbent LEC cost studies.[614] Rather than this Commission directing the states to conduct cost studies, the California Commission recommends permitting state commission to permit the cost studies that they have already begun, and relying on the results of those studies.[615]

e. Policy-Based X-Factor Increase

173. Cable and Wireless supports increasing the X-Factor in equal increments over a five-year period to drive rates to TSLRIC levels.[616] MCI suggests increasing the CPD for each price cap LEC for five years, by the ratio of that carrier's PCI to its API, to eliminate that carrier's headroom.[617] A number of commenters recommend increasing the X-Factor in addition to requiring a reinitialization, to ensure that access rates remain at long-run incremental cost levels.[618] Frontier opposes relying exclusively on an increased X-Factor to force access rates to cost, because it would not affect current rates.[619] Frontier, alternatively, argues that any X-Factor would double-count the TSLRIC-based reinitialization it supports, and so recommends

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[610] Illinois Commission Comments at 23-24; Kansas Commission Comments at 5-6; Oregon Commission Comments at 3-4; Georgia Commission Reply at 4-5.

[611] Kansas Commission Comments at 5-6.

[612] Florida Commission Comments at 9; Oregon Commission Comments at 4. *See also* BellSouth Comments at 46-47; NCTA Comments at 22.

[613] Florida Commission Comments at 9; Georgia Commission Reply at 4-5.

[614] Texas Commission Comments at 27-28.

[615] California Commission Comments at 12-13.

[616] Cable and Wireless Comments at 28-29. *See also* NCTA Comments at 21-22; WorldCom Comments at 91.

[617] MCI Comments at 28.

[618] AT&T Comments at 69-70; ACTA Comments at 21; GSA Reply at 14-15. *See also* WorldCom Comments at 91 (increasing X-Factor is necessary to reflect incumbent LEC productivity growth); TRA Comments at 23 (recommending an X-Factor increase following prescription of new access rates); CPI Comments at 23-25 (reinitialize indices and increase the X-Factor prior to permitting any market-based reforms).

[619] Frontier Comments at 13.

eliminating the X-Factor from the price cap formula after the reinitialization.[620]

174. BellSouth claims that the current 0.5 percent CPD has "outlived its usefulness," and BellSouth and GTE oppose increasing the CPD as an arbitrary and confiscatory measure.[621] SNET claims that increasing the X-Factor merely because the price cap LECs have earned too much, or simply to drive rates down, is essentially an abandonment of price cap regulation, because it would punish incumbent LECs for their efficiency gains made under the price cap regime.[622] BA/NYNEX and GTE contend that the X-Factor should reflect reasonably expected incumbent LEC productivity growth rather than to achieve a specific rate reduction.[623]

175. SNET argues that increasing the X-Factor to force access rates down would not result in a more competitive market, and that treating all price cap carriers the same would disregard fundamental differences in scale and scope, and differences in regional economics between small and midsized elective price cap incumbent LECs on one hand, and the RBOCs and GTE on the other.[624] PacTel argues that increasing the X-Factor would force access rates down in both urban and rural areas, and so would discourage competitive entry in rural areas.[625] PacTel argues that the price reductions caused by the productivity factor perversely apply productivity reductions, which are supposed to replicate competition, to services where prices have already fallen because of actual competition.[626] PacTel recommends resolving price cap issues in other pending proceedings rather than using price cap regulation as a device to lower access rates to levels PacTel considers confiscatory.[627]

C. Equal Access Costs

176. AT&T, NCTA, Sprint, and WorldCom recommend a exogenous cost decrease to

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[620] Frontier Comments at 12 n.22.

[621] BellSouth Comments at 49; GTE Comments at 77-78.

[622] SNET Reply at 23-24. *See also* BA/NYNEX Reply at 32-33.

[623] BA/NYNEX Reply at 30; GTE Reply at 26-27.

[624] SNET Comments at 28-30.

[625] PacTel Comments at 40. PacTel claims to be more subject to harm from the productivity factor than any other LEC because a few highly competitive central offices account for over 75 percent of its traffic, leaving it highly reliant on intraLATA toll services. According to PacTel, intraLATA toll services have become increasingly competitive in California, leaving it unable to invest in its network because of artificial productivity factors. *Id*.

[626] PacTel Comments at 41-42.

[627] PacTel Comments at 39.

remove equal access costs from the incumbent price cap LECs' PCIs.[628] AT&T estimates that equal access costs constitute an annual $110 million dollar subsidy for the LECs.[629] AT&T argues that the Commission previously found that failure to make a downward adjustment would be unfair to ratepayers and perpetuate an implicit cross-subsidy. In light of this, AT&T argues that the Commission should now make a downward adjustment to account for the completion of the amortization of those costs. Sprint argues that without such an adjustment, incumbent LECs would be able to impose charges for other rate elements to recover costs that simply no longer exist. Sprint contends that most of the equal access costs are in the local switching basket, requiring that basket's price cap index to be reduced. To the extent that other baskets were affected, Sprint contends that the appropriate PCI reductions should be made.[630] The Georgia Commission recommends that the Commission verify whether equal access costs continue to be reflected and, if so, make the appropriate adjustments to account for these costs.[631]

177. The BOCs argue that there should be no exogenous cost decrease to account for completion of the amortization of equal access costs.[632] BellSouth argues that, given the Commission's decision not to grant an exogenous increase for these costs during price cap initialization, it would be unfair to require an exogenous decrease now.[633] PacTel and USTA argue that price cap regulation has historically treated equal access costs as endogenous. According to PacTel and USTA, it would be arbitrary to change that treatment for some equal access costs and not others.[634] USTA, Ameritech, and SWBT argue that the Commission has addressed this matter before and correctly concluded that no exogenous treatment was warranted.[635] BellSouth argues that just as in the *LEC Price Cap Performance Review Order*, 10 FCC Rcd at 9094-9095, there is insufficient support for requiring LECs to make an exogenous

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[628] AT&T Comments at 68-69; NCTA Comments at 28; Sprint Comments at 59; WorldCom Comments at 94. *See also* New York Commission Comments at 1 (supporting the removal of equal access costs from access charges).

[629] AT&T Comments, Appendix F (using 1990 Annual Interstate Access Filings of BOCs, AT&T calculates 1990 revenue associated with non-capitalized equal access expenditures and converts to a present day annual revenue estimate by comparison to difference between initial Traffic Sensitive Basket price cap index to 1996 Traffic Sensitive Basket price cap index).

[630] Sprint Comments at 59.

[631] Georgia Commission Reply at 41.

[632] Ameritech Comments at 54-55; BA/NYNEX Comments at 66; PacTel Comments at 24-25; SWBT Comments at 62; USTA Comments at 85.

[633] BellSouth Comments at 88. *See also* BA/NYNEX Comments at 66.

[634] PacTel Comments at 24-25; USTA Comments at 49. *See also* SWBT Reply at 43.

[635] *See, e.g.*, USTA Comments at 85; Ameritech Comments at 55; SWBT Reply at 41.

decrease based on the complete amortization of equal access costs.[636] USTA and SWBT argue that LECs continue to incur new equal access costs that have not been recovered, such as when a LEC must purchase equal access software for a new digital switch.[637]

178. TCA argues that some small LECs have not received a *bona fide* request to convert to equal access. TCA contends that when these LECs make the conversion, they should be allowed the same treatment of their equal access costs as other LECs.[638] Similarly, GCI raises the issue of those LECs that have not converted to equal access. GCI recommends that these LECs be allowed to recover their costs through the Local Switching rate element, rather than a general allocation.[639]

D. Correction of Improper Cost Allocations

1. Marketing Expenses

179. Incumbent LECs and AT&T agree that marketing expenses are inappropriately allocated to the interstate jurisdiction.[640] USTA notes that the net effect of the Commission's decision to include access revenues in the allocation factor for marketing expenses in the *Marketing Expense Reconsideration Order*[641] was to allocate approximately 26 percent of incumbent LECs' total marketing expenses to the interstate jurisdiction.[642] USTA argues that incumbent LECs must be afforded an opportunity to recover the interstate portion of marketing expenses, which it estimates to be $2.2 billion for price cap LECs and $2.4 billion for all incumbent LECs.[643] SWBT estimates that $100 million of its marketing-related costs are allocated to interstate services and recommends that marketing costs be recovered through a

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[636] BellSouth Comments at 87.

[637] USTA Comments at 49; SWBT Reply at 42.

[638] TCA Comments at 5-6.

[639] GCI Comments at 8.

[640] *See, e.g.*, SWBT Comments at 8-9; AT&T Comments at 66-67, Appendix D; *cf.* GTE Comments at 42 (proposing that incumbent LECs prepare separations-based cost studies to show the amount of marketing expense erroneously assigned to the interstate jurisdiction to be used to compute the separations and TIC-related components of a regulatory policy charge).

[641] *Marketing Expense Reconsideration Order*, 2 FCC Rcd at 5353.

[642] USTA Comments, Attachment 2 at 25.

[643] USTA Comments at 79-80, Attachment 16 at 4.

public policy element until separations reform can be completed.[644] Based on 1995 data, GTE estimates that the separations process allocates $84.6 million of its marketing expenses to the interstate jurisdiction.[645]

180. AT&T estimates that inappropriate end user retail expenses recovered through interstate switched carrier access total $840.2 million -- approximately $575 million in direct retail expenses including marketing and customer service costs, and $265 million in indirect retail expenses including general support, corporate operations, and uncollectible revenue.[646] AT&T argues that because access is a wholesale service, not a retail service, this implicit subsidy contained in access charges is improper for three reasons.[647] First, recovery of retail expenses through access charges violates section 252(d)(3) of the Act,[648] which states that wholesale rates will be determined on the basis of retail rates, excluding the portion attributable to marketing, billing, collection, and other costs that will be avoided by the LEC.[649] Second, inclusion of retail costs in access charges violates the fundamental principle that services that should be priced at their long-run incremental cost, resulting in cross-subsidies from access charges to other services.[650] Finally, inclusion of retail costs in access charges violates cost-causation principles, which state that retail costs should be borne by those who cause them, *i.e.*, retail end users.[651]

181. AT&T and WorldCom propose that, pending separations reform that reallocates retail marketing costs to the intrastate jurisdiction, the Commission reassign recovery of such costs from interstate access charges to end users.[652] AT&T's proposal would recover these costs

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[644] SWBT Comments at 8-9.

[645] GTE Reply at 8.

[646] AT&T Comments at 66.

[647] AT&T Comments at 66-67; *cf.* New York Commission Comments at 3 (arguing that retail costs allocated to the interstate jurisdiction that are avoided when competitors resell incumbent LECs' services should be reflected in lower access charges).

[648] 47 U.S.C. § 252(d)(3).

[649] AT&T Comments at 66-67.

[650] AT&T Comments at 67.

[651] AT&T Comments at 67.

[652] AT&T Comments at 53; WorldCom Comments at 71; *see also* Letter from Bruce K. Cox, Vice President, Government Affairs, AT&T, to William F. Caton, Acting Secretary, Federal Communications Commission, March 19, 1997.

from business lines and non-primary residential lines, but not from primary residential lines.[653] The Rural Tel. Coalition opposes recovery of such costs from end users.[654] USTA contends that, until the separations rules are changed, incumbent LECs should continue to recover these costs in current access prices and that the marketing expense allocated to common line should remain in common line.[655]

2. General Support Facility Costs

182. AT&T and WorldCom assert that the Commission should not permit incumbent LECs to recover in access charges the costs caused by the LECs' detariffed billing and collection functions, including those arising from use of GSF and computer costs in providing those functions.[656] According to AT&T's study, $124 million of expenses recovered in interstate access support the nonregulated billing and collection category.[657] Of the $124 million, $60.1 million is included in interstate switched carrier access, and $20.5 million is in interstate special carrier access, with the remainder recovered by the SLC.[658] WorldCom recommends that the Commission correct the Part 32 USOA rules for regulated costs and Part 64 allocation rules to remove this investment from access charges, and should require corresponding reductions in the TIC.[659]

V. ACCESS REFORM FOR INCUMBENT RATE-OF-RETURN LOCAL EXCHANGE CARRIERS

183. The majority of commenters agree generally with our conclusion to limit the scope of this proceeding to price cap LECs.[660] Many parties are concerned, however, about the impact

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[653] Letter from Bruce K. Cox, Vice President, Government Affairs, AT&T, to William F. Caton, Acting Secretary, Federal Communications Commission, March 19, 1997.

[654] Rural Tel. Coalition Reply at 5-6.

[655] USTA Comments at 80.

[656] AT&T Comments at 67, Reply at 34; WorldCom Comments at 71 (proposing that the costs of non-regulated services be removed from the TIC).

[657] AT&T Comments at 67-68, Appendix E.

[658] AT&T Comments, Appendix E at 2.

[659] WorldCom Comments at 71.

[660] *See, e.g.*, Alaska Telephone Association Comments at 3; Frederick & Warinner Comments at 3; NECA Comments at 2; TCA Comments at 2; Sprint Comments at 9; WITA Comments at 2; GSA/DOD Comments at 13.

decisions made in this proceeding may have on some rate-of-return LECs, and urge the Commission to consider the needs of small to mid-sized and rural rate-of-return incumbent LECs when adopting proposals in this proceeding.[661]

184. Cincinnati Bell, ALLTEL, and ITTA oppose delaying access reform for non-price cap LECs.[662] Centennial states that it prefers that the Commission apply its access reforms to *all* incumbent LECs, subject to an appropriate waiver for small, rural LECs whose special circumstances warrant special accommodation, but that at a minimum, the Commission should apply all of its access reforms to all Tier 1 LECs.[663] Centennial argues that a large, Tier 1 LEC, such as PRTC, that already faces active competition from competitive carriers should not be exempt from the new access reform rules.[664]

185. Many commenters stress the need for immediate or prompt access reform for rate-of-return LECs. They contend that rate-of-return LECs are facing increasing competitive pressures and need the ability to respond to changes in the market.[665] Roseville and Frontier recommend that the Commission distinguish between rural and non-rural carriers.[666] Frontier argues that smaller price cap carriers are more similarly situated to non-price cap rural carriers than they are to non-rural carriers and urges the Commission to temporarily exempt all rural LECs, price cap and non-price cap, from the rules adopted in this proceeding.[667] Citizens contends that some of the approaches proposed in the NPRM are not appropriate for price cap LECs that primarily serve rural areas and have a low proportion of business lines.[668] Other commenters assert that rural LECs have a lower percentage of low-cost/high-margin customers, that their access charge revenues represent a higher percentage of their total revenues than they do for the average regional BOC, and that the loss of even a small number of customers can result in a much

[661] *See*, *e.g.*, Staurulakis Comments at 2; GCI Comments at 1-4, Reply at 5-6; Alaska Telephone Association Comments at 3; Rural Tel. Coalition Comments at 2-3; TDS Comments at 6-7; GVNW Comments at 4, Reply at 3; Western Alliance Comments at 1-3.

[662] Cincinnati Bell Comments at 2; ALLTEL Comments 3, 5-7, Reply at 3; ITTA Comments at 4.

[663] Centennial Cellular Corporation Comments 2-3.

[664] *Id.* at 6-7.

[665] *See*, *e.g.*, ALLTEL Comments at 3, 5-7, Reply at 3; Cincinnati Bell Telephone Comments at 2- 3; Roseville Tel. Comments at 6-7, Reply at 4-10; GVNW Comments at 4; ITTA Comments at 4.

[666] Roseville Tel. Comments at 2; Frontier Comments at 5-6 n. 10.

[667] Frontier Comments at 5-6 n. 10.

[668] Citizens Utilities Comments at 3-6, 13-14.

higher proportionate loss of revenue when compared to the markets of typical price cap LECs.[669]

186. For these reasons, some commenters argue that non-price cap LECs need regulatory flexibility and the option of adopting the rate structure changes required for price-cap LECs in this proceeding.[670] NECA, for example, states that because NECA pool carriers' rates represent a wide variety of markets with disparate cost characteristics, the Commission should permit these carriers to have the regulatory flexibility to select and implement rate structure changes adopted in this proceeding pending completion of the separate rate-of-return proceeding.[671]

VI. OTHER ISSUES

A. Application of Part 69 to Unbundled Network Elements

187. Several incumbent LECs disagree with our tentative conclusion to exclude from unbundled network elements the application of Part 69 access charges. PacTel argues that access charges should not be excluded from the sale of unbundled network elements because such charges include subsidies for universal service. Competitors, PacTel argues, will have an economic incentive to purchase unbundled elements to avoid access charges, undermining support for universal service until an explicit universal service funding mechanism is adopted.[672] SBC contends that the Commission has recognized legitimate costs that are recovered through access charges. Recovery of these costs will be reduced if the Commission allows purchasers of unbundled elements to pay substantially less on a per minute basis than they would through interconnection arrangements. SBC estimates that excluding access charges from the sale of unbundled network elements could jeopardize its recovery of $705 million in end user common line loop costs and $683 million in switched access costs based on SBC's 1996 switched access demand levels.[673] USTA contends prices for unbundled elements should include access charges to ensure embedded costs assigned to the interstate jurisdiction are recovered to the extent network elements are used to provide interstate services.[674]

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[669] *See, e.g.*, GVNW Comments at 3-4; ALLTEL Comments at 15.

[670] *See, e.g.*, Aliant Reply at 4-5; ALLTEL Comments at 4, 8, Reply at 3-4; Minnesota Independent Coalition Comments at 2; ITTA Comments at 4; TDS Comments at 10-12, 16, Reply at 4-6; NECA Comments at 9-10, Reply at 6; Roseville Tel. Comments at 2.

[671] NECA Comments at 9-10, Reply at 6.

[672] PacTel Comments at 55-57. *See also* GVNW Comments at 5.

[673] SBC Comments at 51-52.

[674] USTA Comments at 54-55.

188. Other incumbent LEC commenters argue that rebundling network elements is equivalent to offering access services and justifies the imposition of access charges. BellSouth, for example, contends that access charges should apply to competitors that rebundle network elements because rebundled elements constitute an underlying retail service and access charges are applicable when services are purchased for retail sale.[675] PacTel suggests that access customers will perceive unbundled elements as a substitute for access service. By excluding access charges from the sale of unbundled elements, PacTel contends, the Commission would sanction a violation of Section 202(a) of the Communications Act which prohibits unreasonable discrimination in charges for similar services.[676]

189. Smaller LECs whose rates are set under rate-of-return regulation advocate the imposition of access charges on unbundled network elements because a substantial portion of their revenues are derived from state and interstate access charges.[677] Roseville Telephone argues that, absent the imposition of access charges on the sale of unbundled network elements, incumbent LECs will not recover the costs of their underlying facilities because TELRIC prices will not recover costs attributable to federal-state separations policies and a portion of the incumbent LEC's embedded costs.[678]

190. IXCs support the Commission's tentative conclusion to exclude unbundled network elements from Part 69 access charges. Excel agrees with the Commission's rationale that carriers purchasing unbundled elements at cost-based rates have already compensated incumbent LECs for the ability to originate and terminate calls, rendering further compensation unnecessary.[679] Sprint also supports the exclusion of access charges from unbundled network elements, arguing that adding access charges to cost-based prices for unbundled elements would undermine the pro-competitive purpose of the 1996 Act. To the extent prices for unbundled elements do not recover universal service costs, Sprint argues that the Commission should remove implicit subsidies from access charges and have all service providers contribute to universal service through a competitively neutral funding mechanism.[680] Sprint also challenges the view of LEC commenters that rebundling network elements is the equivalent of offering a retail service. According to Sprint, when elements are used to originate and terminate calls, the purchaser of the unbundled

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[675] BellSouth Comments at 13.

[676] PacTel Reply at 8-10. *See also* GVNW Comments at 4-5.

[677] Frederick and Warriner Comments at 4 (stating that 60% of revenues generated by small LECs it represents are derived from state and interstate access charges).

[678] Roseville Telephone comments at 13-14.

[679] Excel Comments at 7.

[680] Sprint Reply at 7.

elements, rather than the incumbent LEC, is offering exchange services using those facilities. Imposing access charges on unbundled elements, Sprint argues, would be similar to having the purchaser of an automobile pay rental fees in addition to the purchase price simply because the automobile is used for transportation whether it is purchased or leased.[681]

B. Treatment of Interstate Information Services

191. *Non-cost-based rates*. ISPs, consumers, and several consumer groups applaud the Commission's tentative conclusion to not require ISPs to pay access charges and urge us to make it our final decision.[682] These commenters state that the current access charge framework consists of non-cost-based rates, that it was designed to address rate discrimination in the interexchange market, as well as to preserve subsidy flows between local and long distances services. They argue that this regime should not be extended to ISPs.[683] Internet Access Coalition states that there is no justification for requiring ISPs to pay charges designed to recover the cost of network features and functions that were designed for voice traffic, features that ISPs neither want nor need.[684]

192. Consumer groups and other commenters assert that the imposition of non-cost-based access fees would diminish consumer use of the Internet and other information services.[685] MAP, *et al.*, claims that usage-based fees might be passed on to consumers, which could diminish total use of the Internet and especially limit use by lower-income citizens.[686]

193. America On-Line states that access charges are inappropriate for ISPs, regardless of

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[681] *Id.* at 6.

[682] *See, e.g.*, American Library Association Comments at 1; MAP, *et al.* Comments at 3; Radoff Comments at 1; Lyman C. Welch Comments at 1; Colorado Library Education and Healthcare Telecommunications Coalition Reply at 1; Gallegos Comments at 2; California Commission Reply at 7; NCTA Comments at 2; America On-Line Comments at 4; CIEA Comments at 3; CompuServe\Prodigy Comments at 4; Information Industry Association Comments at 1-2; Internet Access Coalition at 10-13; Microsoft Comments at 3-4; Minnesota Internet Services Trade Association Comments at 1; Newspaper Association of America Reply at 1; Alarm Industry Communications Committee Reply at 1.

[683] *See, e.g.*, America On-Line Comments at 9; Internet Access Coalition Comments 10-13; American Library Association Comments at 1; NCTA Reply at 10-11.

[684] Internet Access Coalition Comments at 6.

[685] *See, e.g.*, MAP, *et al.* Comments at 3-4; Ozarks Technical Community College Comments at 1; Colorado Library and Healthcare Telecommunications Coalition Reply at 1; Gallegos Comments at 2; CompuServe\Prodigy Reply at 4; PSINet Reply at 9-10; Alarm Industry Communications Committee Reply at 4-6. We received over 300,000 comments from consumers via our electronic mailbox. These commenters overwhelmingly oppose the imposition of access charges on ISPs. Most insist that many consumers will be unable to afford using the Internet if ISPs are required to pay access charges and those charges are then passed on to consumers.

[686] MAP, *et al.* Comments at 4.

whether they consist of non-cost-based rates or are priced at forward-looking costs. America On-Line contends that no matter how access charges are established, they do not and should not apply to ISPs because ISPs are not carriers.[687] America On-Line states that as providers of information services, ISP fall squarely outside of the definition of "telecommunications carriers" as defined in the 1996 Act.[688] Several commenters claim that ISPs are end-users of telecommunications services, and the manner in which they use the local network supports the conclusion that they are end users rather than carriers.[689]

194. Most LECs and a few other commenters call for the imposition of access charges on ISPs.[690] They state that ISPs currently do not pay for their portion of local exchange switching facilities assigned to the interstate jurisdiction.[691] BA/NYNEX states that current usage levels can only be accommodated on the circuit switched network by continuous investment in more network capacity, however, LECs are not recovering their investment under the current pricing structure for ISPs.[692] Some LECs acknowledge that the current framework of access charges should not be applied to ISPs, but rather, ISPs should be charged usage-sensitive "reformed" access charges which do not contain non-cost-based subsidies.[693]

195. PacTel contends that ISPs are not like other business customers, because they do not use local business lines for a mix of originating and terminating calls, and, thus, do not pay outbound usage charges.[694] PacTel further claims that ISPs' current service architectures, while using business lines, look strikingly like the other common carriers' serving arrangements prior to the divestiture of AT&T. According to PacTel, ISPs gain access to LEC loops and switches in order to offer services to end users across all major population centers, just as IXCs do. Further, ISPs do not terminate calls, but provide connection to the Internet or on-line services.[695]

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[687] America On-Line Reply at 6.

[688] *Id.*

[689] *Id.* at 5; *see also,* Information Industry Association Comments at 3; Internet Access Coalition Comments at 10-13; Pennsylvania Internet Service Providers Comments at 21.

[690] BA/NYNEX Comments at 64; PacTel Comments at 74; SONETECH Comments at 19; USTA Comments at 83; U S West Comments at 83; GTE Comments at 18; GCI Comments at 8.

[691] *See, e.g.,* U S West Reply at 42; BA/NYNEX Comments at 64; USTA Comments at 82.

[692] BA/NYNEX Comments at 62; *see also,* PacTel Comments at 76-77.

[693] PacTel Reply at 6; *see also,* USTA Comments at 84; AT&T Comments at 71-72.

[694] PacTel Reply at 27-28.

[695] *Id.*

196. *Implicit subsidy for ISPs.* USTA and several LECs claim that current flat rate pricing schemes for ISPs create an implicit subsidy for ISPs, because the flat rate charges ISPs pay fail to pay for the network resources they use.[696]

197. Compuserve and Prodigy state that the rates for flat-rated business lines used by ISPs already cover their costs, and in some jurisdictions, they provide a subsidy for below cost local exchange residential services.[697] Compuserve and Prodigy assert that regional BOC (RBOC) studies underestimate the revenues the RBOCs are currently receiving from ISP use of business lines.[698]

198. Several ISPs and consumer groups point to the increase in LEC revenues due to increased demand for new telecommunications services associated with ISPs.[699] Most significantly, commenters cite the increase in consumer demand for second lines. Internet Access Coalition refers to an ETI Study [need cite] which found that increased revenue from residential second lines used primarily or exclusively to access on-line services exceeds the increased incumbent LEC costs attributable to the growth of these services by a factor of six-to-one.[700] Internet Access Coalition challenges PacTel's conclusion that the costs of second lines exceed the flat rate charged by Pacific Bell for those lines. Internet Access Coalition states that several incumbent LECs, including PacTel, have, in other forums, expressly attributed their recent high earnings to the surge in demand for second lines.[701]

199. *Network congestion.* Several commenters, most of them incumbent LECs, claim that current network congestion problems are the result of the current pricing policies which allow ISPs to pay flat rates for usage sensitive services.[702] USTA states that congestion caused by ISPs raises network reliability concerns and delays the introduction of new technologies.[703] GCI

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[696] USTA Comments at 82-83; *See, e.g.*, U S West Comments at 83-84; GVNW Comments at 15; ACTA Comments at 24-30.

[697] CompuServe/Prodigy Comments at 12.

[698] *Id.* CompuServe/Prodigy states that it now pays the LECs almost $36 million on an annual basis for the approximately 85,000 local business lines it employs to make available its services to subscribers (85,000 lines x $35 per month per line x 12 months = $35,700,000).

[699] *See, e.g.*, Consumer Project Reply at 3; Internet Access Coalition Comments at 15; America On-Line Comments at 7-9; CIEA Reply at 3-5.

[700] Internet Access Coalition Reply at 7-8.

[701] *Id.*

[702] *See, e.g.*, USTA Comments at 81-82; GVNW Comments at 15; GCI Comments at 9.

[703] USTA Comment at 82.

claims that usage charges set at the proper level should encourage an economically appropriate level of usage and should help alleviate network congestion caused by users who remain on-line for long periods of time.

200. ISPs and consumer groups insist that accounts of network congestion are greatly exaggerated by the LECs.[704] Internet Access Coalition states that the studies presented by the Bell Operating Companies (BOCs) were based on isolated, worst-case situations, and therefore, the studies fail to give an accurate picture of the impact of data traffic on the BOC networks.[705] Commenters claim that the switch problems which occur in a small number of central offices can be resolved with the technologically simple solutions that the incumbent LECs routinely use when end-users other than ISPs create similar congestion anomalies.[706] PSINet asserts that the BOCs were in a position to anticipate increased network traffic because of an increase in the demand for (1) second lines and other services by consumers and (2) business lines by ISPs.[707] PSINet contends that ILECs have been selling excess capacity for several years, and they should have been reinvesting in their networks, making them more responsive to their Internet customers and better able to handle increase in Internet traffic.[708]

201. *Incentive to switch to packet-switched network.* Some LECs contend that without usage charges for the lines connecting the ISPs to their customers, ISPs have little incentive to use services and technologies that lessen the load on the traffic-sensitive portion of the current switched network or to divert Internet traffic from the circuit-switched local network to more efficient packet-switched networks.[709] ACTA states that radically reformed, rational, cost-based access charges borne by ISPs and other users of the telecommunications infrastructure will provide incentives to improve and optimize today's telecommunications infrastructure and stimulate investment which will assure an adequate supply of capacity and services.[710] SONETECH states that it is natural for ISPs to be CLECs and IXCs, and that access charges

[704] *See, e.g.*, Consumer Project Comments at 1; America On-Line Comments at 13-14; CompuServe/Prodigy Comments at 14; Internet Access Coalition Comments at 13; PSINet Comments at 8.

[705] Internet Access Coalition Comments at 13.

[706] *Id.* at 14; *see also* America On-Line Reply at 10.

[707] PSINet Reply at 7-8; *see also,* America On-Line Reply at 12.

[708] PSINet Reply at 7-8.

[709] *See, e.g.*, BA/NYNEX Comments at Attachment 1: Crandall Affidavit at 14-15; PacTel Reply at Attachment 1, Parker Affidavit at 6.

[710] ACTA Comments at 27.

would act as an incentive for ISPs to move in that direction.[711]

202. America On-Line urges the Commission to reject LEC statements which suggest that ISPs have incentives to use inefficient services and facilities that will persist as long as the Commission refrains from imposing its access charge rules.[712] America On-Line and Internet Access Coalition state that ISPs know that their customers want higher speed access to the Internet and other on-line services and to the extent that incumbent LECs, or any other entity, offer an efficient, reliable and economic means to provide ISPs' product to the consumer, ISPs have every incentive to use it to the ultimate benefit of the public.[713] America On-Line states that the ISP market is extremely competitive and every provider has powerful market incentives to offer the most reliable, cost-effective, efficient and quality service it can.[714]

203. CPT claims that usage-based charges on basic voice service and ISDN calls from residential users, and usage-based charges for the unbundled loop undermine the LECs' incentives to deploy technologies that solve congestion problems. Collecting usage fees through the circuit switched netowrk then becomes highly profitable and technologies which eliminate the rationale for those charges would threaten this profit center.[715] CPT proposes that the Commission should leave the pricing of basic voice services as is, and require LECs to eliminate the usage charges on higher bandwidth residential digital services like ISDN, if the call is terminated using the new packet switched service.[716]

204. *Discrimination.* PacTel argues that by not requiring ISPs to pay access charges. the Commission discriminatorily grants a preference in rates to ISPs.[717] PacTel states that ISPs are not like regular business customers, that they are more like IXCs because of the way their customers connect with them.[718]

205. CIEA claims that the mere difference in the payment mechanisms for ISPs and IXCs

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[711] SONETECH Comments at 3-4.

[712] America On-Line Reply at 13-15.

[713] *Id.*; Internet Access Coalition Reply at 11.

[714] America On-Line Reply at 13-15.

[715] Consumer Project Reply at 6.

[716] *Id.*

[717] PacTel Comments at 74-75.

[718] PacTel Reply at 27.

does not show discrimination in favor of ISPs. CIEA explains that IXCs use different aspects of the local exchange network that ISPs and their Internet customers do not use. For example, outdialing, 911 service, and directory assistance services are used by IXCs, but are not required by ISPs. CIEA states that IXCs have more rights and privileges in interconnecting with the local exchange than ISPs do. Furthermore, states CIEA, IXCs and ISPs pay LECs in different ways because all users of the PSTN pay in different ways, based on their pattern of use.[719]

206. America On-Line contends that requiring ISPs to pay access charges would constitute discrimination because other end-users are not required to pay access charges. Internet Access Coalition agrees, stating that treating ISPs like other end-users is not discriminatory since ISPs are end-users. Internet Access Coalition states that ISPs use business lines solely to receive incoming calls, and, thus, they don't pay originating call fees, just like numerous other business customers -- such as call centers, mail order providers, radio talk shows, and many financial institutions.[720]

207. *Anti-competitive acts by LECs*. Several commenters have expressed a concern that assessing access charges on ISPs will lead LECs to engage in anti-competitive activities.[721] Compuserve and Prodigy state that RBOCs function not only as the dominant providers of access upon which the independent ISPS are dependent to reach their customers, but are also competitors to the independent ISPs in providing information services.[722] CompuServe\Prodigy contend that any access charges collected by the parent RBOC from its affiliated ISP merely represents an intra-corporate transfer among RBOC affiliates with no real overall economic effect to the RBOC or its affiliate. Independent ISPs, however, would have to absorb any increase in access charges to stay in business.[723]

208. PacTel counters that the Commission has extensive rules ensuring that the largest LECs, the BOCs, provide interconnection to third-party ISPs that is comparable, including identical prices, to the interconnection that they provide to their own enhanced service operations. Furthermore, states PacTel, the Commission has extensive accounting rules and other safeguards to ensure against LEC cross-subsidies to support their enhanced services operations.[724]

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[719] CIEA Reply at 6-8.

[720] Internet Access Coalition Reply at 10-11.

[721] Consumer Project Reply at 3; CIEA Comments at 8; CompuServe/Prodigy Comments at 15; Internet Access Coalition Comments at 19-20; PSINet at 9-10; SONETECH at 4.

[722] CompuServe\Prodigy Comments at 15.

[723] *Id.*

[724] PacTel Reply at Parker Affidavit p. 5.

C. Terminating Access

1. Incumbent LECs

209. Several IXCs and other commenters supported limiting terminating access rates to forward-looking economic cost. Those advocating that the Commission hold terminating access rates to TSLRIC levels cite the absence of competitive pressures on the terminating access provider. They contend that even as originating access services become more competitive, price cap LECs will retain the ability to exercise market power over terminating access, justifying a prescriptive approach that would limit terminating access rates to forward-looking cost.[725] They also emphasize the likelihood of continued ILEC dominance in the provision of access services in the foreseeable future.[726] A number of commenters support the development of TSLRIC studies as a basis for establishing cost-based rates for terminating access.[727]

210. According to incumbent LECs and other commenters, however, sufficient competitive forces exist to constrain the prices charged for terminating interstate access service. For example, USTA challenges the fundamental premise that, because the called party is not paying for the call, terminating access charges are shielded from downward market pressures. Thus, according to these commenters, if a LEC overprices terminating access relative to originating access, a pair of callers in repeated communications would have an incentive to alter their pattern of calls to favor the lower-priced alternative.[728] Other commenters argue that the availability of unbundled network elements and interconnection arrangements will act as a constraint on potentially excessive terminating access charges as alternative access providers offer competitive services.[729] High terminating rates, these commenters argue, will encourage IXCs to purchase unbundled network elements to complete long-distance calls themselves.[730]

2. Non-Incumbent LECs

211. Competitive LECs urge the Commission to refrain from imposing any direct

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[725] CompTel Comments at 19; Cable & Wireless Comments at 31; ACTA Comments at 23; LCI Comments at 3; TCI Comments at 36; Allied Communications Comments at 3; WorldCom Comments at 92.

[726] AT&T Comments Appendix A at 18; LCI Comments at 3; Cable & Wireless Comments at 31.

[727] *See*, *e.g.*,TRA Comments at 38-39; California Commission Comments at 17; LCI Reply at 6-7.

[728] USTA Comments Attachment 3 at 12; TCI Comments, Attachment A at 4.

[729] USTA Comments at 67; Ameritech Comments at 53; BA/NYNEX Comments at 42.

[730] USTA Comments at 67; Ameritech Comments at 52-53; BA/NYNEX Comments at 42; SNET Comments at 54; BellSouth Reply at 40; SWBT Reply at 46-47.

regulation of their terminating access charges. They contend that competitive LECs lack the kind of market power that would enable them to charge IXCs excessive terminating access rates.[731] Competitive LEC negotiations with IXCs, they explain, have resulted in terminating access charges equal to or below the terminating access rates contained in incumbent LEC tariffs.[732] Commenters assert that IXCs are sophisticated customers with bargaining leverage over competitive LECs and will take necessary actions to discourage excessive charges for terminating access.[733] Other commenters argue that competitive LECs, like incumbent LECs, will restrain their terminating access charges to lower the incentive for IXCs to purchase unbundled network elements to provide their own local access.[734] Spectranet argues that initial dependence of competitive LECs on large volume customers will discourage unreasonable terminating access rates because high rates would entice IXCs to substitute terminating special access for these users.[735] Competitive LECs also express the concern that strict regulation of their terminating access rates would impose an additional burden on their ability to enter the market and compete successfully.[736]

212. Other commenters favor regulation of the terminating access rates of competitive LECs, suggesting that bottleneck control of the called party's loop necessitates some level of regulation.[737] Although incumbent LECs argue that regulation of terminating access is unnecessary, they contend that any regulation of incumbent LEC terminating access should entail equivalent regulatory treatment of competitive LECs because they hold the same degree of market power with respect to the loops they control.[738]

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[731] ALTS Comments at 29; American Communications Services Reply at 21.

[732] TCI Comments, Attachment A at 6 (*citing* Comments of Spectranet International, Inc., CC Docket No. 92-262 at 7).

[733] Spectranet Comments at 7-8; ICG Telecom Group Reply at 23.

[734] ACC Long Distance Reply at 10; Cox Communications Reply at 4-5; Spectranet Comments at 7-8.

[735] Spectranet Comments at 8.

[736] Time Warner Comments at 49-50; WinStar Comments at 5-6.

[737] AT&T Comments at 63; WorldCom Comments at 92; Ohio Commission Comments at 12.

[738] USTA Comments at 67; BA/NYNEX Comments at 42; BellSouth Comments at 86; PacTel Comments at 74; Rural Telco Coalition Comments at 23-24.

D. Universal Service-Related Part 69 Changes

213. Many parties note that the Commission must carefully coordinate access charge reform and universal service reform.[739] Commenters agree generally that, in order to prevent double recovery and remove implicit subsidies, access charges must reflect receipt of universal service support above current levels.[740] Other parties argue, however, that double recovery is unlikely, especially for rural carriers for whom revenues will be insufficient to maintain service in high cost areas, even if access charges remain unchanged.[741] Several non-price cap incumbent LECs argue that it is premature to address the issue of potential double recovery, particularly for small, rural, rate-of-return LECs, until the details of the universal service fund mechanism are established and the Commission has assessed the cumulative impact of the universal service, access reform, and separations proceedings.[742]

214. The Alabama and Texas Commissions express concern that reducing interstate access rates to reflect universal service revenues will divert funds traditionally used to support intrastate high costs to offset interstate rates, which may only be accomplished by a recommendation of a Federal-State Joint Board.[743] These Commissions conclude that a separate component is necessary within the universal service fund that will replace the explicit subsidy reflected in the common line elements of interstate access.[744] The Ohio Commission notes that any downward adjustment of interstate access rates must be based only on the interstate revenues received through the universal service fund mechanism.[745]

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[739] *See, e.g.*, Arch Communications Reply at 1; Alaska Telephone Association Comments at 7; TDS Comments at 27, Reply at 7; Texas Commission Comments at 30; Washington Commission Comments at 9.

[740] *See, e.g.*, Arch Communications Reply at 1; AT&T Comments at 65; Cable & Wireless Comments at 28, n.33 (asserting that the portion of current rates that is universal service subsidy must be separated from rates to comply with the *Universal Service* proceeding); California Commission Comments at 13-14; Internet Access Coalition Comments at 6; PacTel Comments at 50; PCIA Comments at 3-4, Reply at 2-3; Sprint Comments at 54; TCI Reply at 28-29.

[741] *See, e.g.*, Alaska Telephone Association Comments at 7; Western Alliance Comments at 19-20.

[742] *See, e.g.*, Evans, *et al*. Comments at 3; Puerto Rico Tel. Comments at 20-21; TCA Comments at 4-5; TDS Comments at 26, 28, Reply at 7; Western Alliance Comments at 19-20; s*ee also* American Communications Services, Inc. Reply at 8-9 (asserting that Commission should defer access reform until universal service and separations reform are adopted).

[743] Alabama Commission Comments at 14; Texas Commission Comments at 30.

[744] Alabama Commission Comments at 14 (proposing separate components for both high-cost assistance for intrastate services and interstate common cost recovery); Texas Commission Comments at 30-31.

[745] Ohio Commission Comments at 11 (assertign that, if intrastate revenues are used to assess contributions and used to distribute assistance to recipients of universal service support, incumbent LECs that are net beneficiaries of support should be permitted to make downward adjustments to intrastate costs).

215. BA/NYNEX contend that, to the extent universal service payments are intended to cover shortfalls in intrastate payments, a downward adjustment of interstate access rates would in effect be double-counting and would take away the revenue support that the LEC had just received from the universal service fund.[746] Thus, any adjustment to access charges must reflect only the portion of universal service support that covers shortfalls in interstate cost recovery.[747]

216. Several commenters contend that universal service funds should not be used to reduce interstate costs recovered through access charges.[748] These parties argue that neither universal service fund subsidies that keep local exchange rates below cost nor "support funds" that compensate carriers for the discounted portion of the rates for telecommunications services provided to schools, libraries, and rural health care providers, may be used to reduce costs recovered through interstate access charges.[749] Thus, a universal service support payment should not result in a *per se* decrease in interstate access charges unless it is specifically identified as replacing identified means of cost recovery that had previously been afforded by access charges.[750] ALLTEL asserts that, because the LTS and DEM weighting mechanisms are the only components of the proposed universal service plan that have direct relationship to access, other universal service support components are designed to offset cost of providing local service in high cost areas and, as such, do not require a corresponding reduction in access rates.[751]

217. According to the Washington Commission, a possible approach to preventing double recovery is to adopt a presumption that any revenues obtained from the universal service fund would be offset against recovery claimed from access charges, and incumbent LECs would bear the burden of establishing to the regulatory authority that additional recovery was appropriate.[752] NARUC asserts that incumbent LECs should have the burden of demonstrating that double recovery will not occur through the combination of restructured access charges and universal

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[746] BA/NYNEX Comments at 61.

[747] BA/NYNEX Comments at 61.

[748] *See, e.g.*, Ameritech Reply at 34 (opposing attempt to require the recipient carrier to use universal service funds for reducing access charges); Western Alliance Comments at 20; WITA Comments at 9; s*ee also* State Consumer Advocates Reply at 15 (arguing that TIC, interstate transport and interstate switched access are not services that the Joint Board has designated for universal service support); *but see* BA/NYNEX Reply at 6-7 (arguing that certain funds that LECs receive from the new universal service fund may be used to offset current revenues from interstate access services).

[749] *See, e.g.*, Ameritech Reply at 34.

[750] *See, e.g.*, Puerto Rico Tel. Comments at 19; TDS Reply at 7 (arguing that any off-set for interstate access revenues to prevent double recovery must match support from the new mechanism that it is designed to replace).

[751] ALLTEL Comments at 14.

[752] Washington Commission Comments at 9.

service support.[753] TCI argues that incumbent LECs should not be permitted to adjust their price cap indices upwards to permit recovery of their contributions payments unless, at a minimum, they can show that they are actually funded by interstate switched access charges.[754]

218. Several incumbent LECs argue that, to the extent that LECs will have to contribute to any new universal service support mechanism, access charge reduction that would occur as a result of receiving universal service support above current levels must be offset by the amount the LEC has to contribute to the universal service fund.[755] According to PacTel, any exogenous downward adjustment to price cap indices is appropriate to reflect any additional revenues received from the new universal service fund, provided the adjustment is made only to the extent that there is a net revenue increase to the LEC, and the decrease is offset with an exogenous upward adjustment to reflect the extent to which the LEC is unable to pass its own contributions through to its customers.[756] BellSouth contends that unless the Commission establishes a surcharge recovery mechanism to recover LEC contributions to the new universal service fund, then LECs must recover their contributions through an access charge mechanism, such as a per line charge assessed to IXCs.[757]

219. Many of the parties commenting on the issue support the Commission's proposal to account for the receipt of explicit universal service revenues, including LTS, through an exogenous cost adjustment to the price cap indices of incumbent LECs.[758] TCI argues that incumbent LECs will double recover if price caps are not adjusted to recognize the elimination of LTS support obligations.[759] Many incumbent LECs, however, agree that the Commission must remove LTS payments from access charges and recommend that these costs be removed from the CCL charge to comply with the 1996 Act requirement that universal service support payments be

[753] NARUC Comments at 8; *but see* TDS Comments at 28 (no reason to presume federal universal service support causes over-recovery unless it is subtracted from whatever interstate cost allocations are then in effect).

[754] TCI Reply at 30.

[755] *See, e.g.*, BA/NYNEX Comments at 61; BellSouth Comments at 53, n.99; PacTel Comments at 49.

[756] PacTel Comments at 49.

[757] BellSouth Reply at 7, n.11

[758] *See, e.g.*, ACTA Comments at 22; California Commission Comments at 13-14; Internet Access Coalition Comments at 6; Sprint Comments at 54; Texas Commission Comments at 30; TCI Comments at 34, Reply at 29.

[759] TCI Reply at 29-30; *see also* ALLTEL Comments at 14 (arguing that once LTS and DEM weighting and transitioned to the high cost universal service fund, there should be a corresponding dollar-for-dollar reduction in associated access rates).

explicit.[760]

220. Many commenters further propose that price cap LECs should be required to offset access charges by the amount of any increase in universal support payments above current universal service funding, and apply this reduction to the CCL or any new mechanism that replaces it.[761] Other commenters offer more specific proposals for applying adjustments to particular baskets or service categories in a particular order. For example, BellSouth recommends that universal service funds first be applied to reducing the CCL charge, then to the TIC service category in the trunking basket, and finally to the local switching service category in the traffic sensitive basket.[762] Alternatively, Sprint suggests that, if the Commission adopts Sprint's proposal to access reform by eliminating the CCL charge and reducing access rates to TELRIC-based prices, the required reductions in the price cap index be applied first to the TIC and then to the difference between current rates and TELRIC-based rates for traffic sensitive switching and transport. If the Commission does not eliminate the CCL charge, however, Sprint proposes that incumbent LECs should be required to apply their incremental universal service revenues against the price cap indices for both the CCL charge and TIC in equal proportions until both elements are eliminated, and then against rates for traffic-sensitive local switching and transport.[763]

221. Several non-price cap LEC parties assert that there is no need to adjust interstate costs for rate-of-return ILECs to reflect universal service revenues because double recovery is unlikely.[764] For example, WITA asserts that there is no double recovery if the receipt of funds is based on a benchmark that is calculated on a national average revenue per line, including revenue generated from access services because it is only the cost of local service in excess of the benchmark that is funded through the USF mechanism.[765] Evans, *et al.* notes that, because the

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[760] *See, e.g.*, U S West Comments at 53; *see also* Ameritech Comments at 50-51, Reply at 34; BellSouth Comments at 68.

[761] *See, e.g.*, ACTA Comments at 22 (arguing that CCL charges should be reduced to the extent that recovery of LTS from other sources is not offset by a SLC cap reduction); California Commission Comments at 13-14 (asserting that CCL charges should be reduced to the extent universal service funding is directed to support high-cost loops); SWBT Comments at 6 (maintaining that CCL charges should be reduced by the amount of high cost support incumbent LECs receive from the new universal service fund).

[762] BellSouth Comments at 53-54.

[763] Sprint Comments at 54-55.

[764] *See, e.g.*, Alaska Telephone Association Comments at 7; Western Alliance Comments at 20.

[765] WITA Comments at 9; *see also* Cathey, Hutton and Associates Comments at 4 (asserting that recovery will not be "double" but will only alter the amount of costs recovered from access rates versus the amount of costs recovered from the new universal service fund mechanism because access rates will be calculated into the benchmark revenues to be used to offset proxy-based universal service costs); Western Alliance Comments at 21 (arguing that, because the proxy models in *Universal Service* proceeding have deleted DEM weighting and LTS, there is no need to subtract the universal service support payments paid to rural LECs from the interstate costs used to develop rural

present system limits universal service payments to loop costs not included under the interstate gross allocator and makes the offsetting cost reduction to intrastate costs, any new universal service fund system should continue to offset intrastate costs.[766] The Minnesota Independent Coalition contends that either local service rates or universal service revenues must necessarily increase if access charges paid by IXCs decrease.[767]

222. Several parties commented on the way in which non-price cap LECs' interstate access charges should be adjusted to account for removal of implicit LTS subsidies and any increase in explicit universal service support revenues. Most commenters favoring a downward exogenous cost adjustment for price cap LECs' price cap indices also support a similar downward adjustment to non-price cap LECs' access rates.[768] USTA and several other non-price cap LECs assert that rate-of-return companies should be permitted to use funding from any new universal service support mechanisms to offset existing explicit universal service requirements before reducing any Part 69 rates.[769] USTA argues that Part 69 rate reductions, *i.e.*, decreases in the level of this implicit support mechanism, should only take place to the extent that new universal service revenues exceed existing explicit universal service requirements.[770] Roseville Tel. supports allowing non-price cap LECs to continue to use universal service revenues to offset intrastate revenue shortfalls and, for any universal service support greater than the amount currently received (including LTS), use that to reduce the CCL charge and then the SLC.[771] Should the Commission reduce interstate costs to reflect revenues received from any new universal service support mechanism to the extent allocated to the interstate jurisdiction, however, Roseville Tel. cautions that intrastate rates will have to be raised to address the shortfall that is currently covered by universal service support.[772]

223. According to NECA, the Commission should clarify that, absent changes in the separations rules, interstate revenue requirements would continue to be determined as they are

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LECs' access charges).

[766] Evans, *et al*. Comments at 3.

[767] Minnesota Independent Coalition Comments at 18.

[768] *See, e.g.*, PCIA Comments at 3-4; Sprint Comments at 54, n.23.

[769] *See, e.g.*, GVNW Comments at 12; Puerto Rico Tel. Reply at 8; TDS Comments at 27; USTA Comments at 69.

[770] *See, e.g.*, Puerto Rico Tel. Reply at 8; USTA Comments at 69.

[771] Roseville Tel. Comments at 16.

[772] Roseville Tel. Comments at 16.

today.[773] NECA further advocates that the Commission adopt Part 69 rule changes that treat new universal service amounts allocated to the interstate access elements, including DEM weighting and LTS, as revenue streams in the development of interstate access rates.[774] NECA proposes that revenues from the new universal service fund be used to offset the pool common line revenue requirement, in a manner similar to the way the SLC offsets CCL rates.[775] In developing its traffic-sensitive local switching rates, NECA would consider all revenue projected for its common line pooling members, as well as any proxy-based amounts for pooling companies that are allocated to interstate common line.[776] In addition, NECA argues that the Commission should clarify that the per-line rural transition high-cost support amounts from the new universal service fund should continue to be treated as an intrastate expense adjustment recovered from the interstate jurisdiction to help keep intrastate rates affordable.[777] NECA notes that this may require Part 36 rule changes to ensure matching of the expense adjustment with the level of federal universal service funding ultimately adopted.[778]

E. Part 69 Allocation Rules

224. In the NPRM, we solicited comment on whether it would be appropriate for incumbent price cap LECs to be relieved of complying with Subparts D and E of Part 69 of our rules, which address the allocation of investments and expenses to the access rate elements.[779]

225. Many of the commenters recommend that the Commission eliminate Subparts D and E.[780] GTE argues that the allocation rules are outdated and unnecessarily inhibit the introduction of new services and technologies, thereby limiting incumbent LECs' ability to respond to

[773] NECA Comments at 14.

[774] NECA Comments at 14-15.

[775] NECA Comments at 15.

[776] NECA Comments at 15; *see also* TDS Comments at 27 (arguing that LTS should continue to be treated as an interstate revenue stream for the NECA Common Line pool).

[777] NECA Comments at 15; *see also* Evans, *et al*. Comments at 3 (asserting that any new universal service support system should continue to offset intrastate costs).

[778] NECA Comments at 15, n.46.

[779] NPRM at ¶ 294.

[780] Ameritech Comments at 56; BA/NYNEX Comments at 60; BellSouth Comments at 88; GTE Comments at 46-47.

competition.[781] GTE argues that the cost allocation rules, which are predicated on rate base regulation, serve no purpose in GTE's proposed access regime, which includes a simplification of price baskets and an elimination of sharing requirements and low end adjustments.[782] BellSouth contends that it does not use the cost allocation rules for ratemaking, and instead uses them only for internal purposes.[783] BellSouth acknowledges that the cost allocations rules are necessary to complete the ARMIS reports, but contends that with a market-based approach to access reform, neither the ARMIS reports nor the cost allocation rules are necessary.[784]

226. TCI recommends that, commensurate with its suggested hybrid market/prescriptive approach to access reform, the Commission should retain the cost allocation rules until there is substantial competition on a service-by-service basis in a defined geographic market. TCI urges the Commission to proceed cautiously in lifting this type of regulation, contending that premature regulatory flexibility could have anticompetitive consequences due to the incumbent LECs' existing market power.[785] The Georgia Commission contends that the Commission should verify and analyze costs prior to moving to a transitional phase of market-based or prescriptive approach. If the Part 69 rules aid in that process, the Georgia Commission argues that they should be retained.[786]

F. Other Proposed Part 69 Changes

227. The commenters generally agree with the majority of our specific proposals concerning Part 69 revisions.[787] Sprint contends that the NPRM's proposed revisions are non-controversial and should be adopted.[788] Ameritech favors incorporating the previously-granted

[781] GTE Comments at 46-47. *See also* BA/NYNEX Comments at 60 (elimination of sharing mechanism under market-based approach will allow Commission to eliminate onerous cost allocation rules).

[782] GTE Comments at 47.

[783] BellSouth Comments at 88 (although BellSouth uses cost allocation rules to develop exogenous cost data internally, this data can be calculated in other ways).

[784] BellSouth Comments at 88.

[785] TCI Comments at 40. *See also* TCI Reply at 26.

[786] Georgia Commission Reply at 43

[787] *See, e.g.*, Ameritech Comments at 56; BellSouth Comments at 88-90; Sprint Comments at 60; WorldCom comments at 94 (supporting Commission's proposal that clarifies that Part 69 access charge rules apply to incumbent LECs and not to CLECs).

[788] Sprint Comments at 60.

waivers into Part 69.[789]

228. Some commenters expressed dissatisfaction with various parts of our Part 69 proposals. For example, BellSouth objects to the proposal that "Telephone Company" be defined as "incumbent LEC" as set out in section 252(h)(1) of the 1996 Act because it believes that Part 69 should apply to all LECs, not just incumbent LECs. BellSouth argues that until forbearance determinations are made, all LECs remain subject to the Part 69 rules.[790] BellSouth also opposes the proposal to codify the various Part 69 waivers previously granted, arguing that the waiver orders are sufficiently explanatory, the alternative rate structures are too cumbersome to describe, and the end result would be more, rather than less, regulation.[791]

229. GCI suggests modifications to our proposal to eliminate those sections connected to the equal access rate element. GCI contends that some LECs have not fully recovered equal access costs. GCI also notes that in some areas, such as the Alaska bush, where facilities-based interexchange competition has been prohibited, many LECs have not yet implement equal access. To account for these concerns, GCI recommends that section 69.107, which allows carriers to establish a separate equal access rate element, be eliminated. GCI contends that sections 69.308 and 69.410 should be modified to provide that the costs be assigned to the Local Switching element. GCI also recommends that we retain both the reference to section 69.308 found in section 69.309, and the reference to section 69.410 found in section 69.411. GCI contends that recovery through the Local Switching element is preferable to the general allocation that would otherwise be applicable.[792]

230. Ameritech suggests that Part 69 be changed to permit LECs the flexibility to introduce new switched access rate elements without the current barriers.[793] TCA and NECA recommend that rate-of-return LECs be allowed to introduce new services though the expedited process established for incumbent LECs in the Third Report and Order.[794]

231. In response to our request for additional revisions, many commenters suggested that

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[789] Ameritech Comments at 56.

[790] BellSouth Comments at 89.

[791] BellSouth Comments at 90.

[792] GCI Comments at 8. *See also* TCA Comments at 5-6 (equal access rate elements should not be removed because some small LECs who have not received a bona fide request to convert should be allowed same treatment of their equal access costs as other LECs).

[793] Ameritech Comments at 42, 56.

[794] TCA Comments at 6; NECA Comments at 14 (referencing Access Reform Third Report and Order, ¶¶ 309-310).

the Part 69 rules be completely eliminated.[795] Many of the LECs argue that Part 69 rules are unnecessarily restrictive, inhibiting the LECs' abilities to respond to competition, impairing their ability to introduce new services, or failing to account for changes in technology.[796] USTA recommends as part of the market-based Phase I approach, the Commission should replace the current Part 69 rules with streamlined rules that would address the recovery of the CCL, TIC, and depreciation reserve deficiency without codifying specific rate elements.[797] USTA also recommends that Part 69 should be retained for rate-of-return companies, but modified in a separate proceeding to reflect the recovery of the CCL and TIC.[798] NECA argues that Part 69 rules needlessly increase administrative expense.[799]

[795] USTA Comments at 48; Ameritech Comments at 56; BA/NYNEX Comments at 60; BellSouth Comments at 88; GTE Comments at 46-47; NECA Reply at 10; SNET Reply at 14.

[796] GTE Comments at 47; SNET Comments at 19-20; SNET Reply at 14; Internet Access Coalition Comments at 5; NECA Reply at 10; NARUC Comments at 5.

[797] USTA Comments at 48. *See also* USTA Reply at 26 (simplification of price baskets and elimination of Part 69 rules will enhance LECs' economic efficiency).

[798] USTA Comments at 48.

[799] NECA Reply at 10 (elimination or simplification of rules is sound administrative practice irrespective of level of competition).

APPENDIX C - Final Rules

AMENDMENTS TO THE CODE OF FEDERAL REGULATIONS

PART 61 -- TARIFFS

1. The authority citation for Part 61 continues to read as follows:

Authority: Secs. 1, 4(i), 4(j), 201-205, and 403 of the Communications Act of 1934, as amended; 47 U.S.C. 151, 154(i), 154(j), 201-205, and 403, unless otherwise noted.

2. Section 61.3 is amended by revising paragraph (f) to read as follows:

§ 61.3 Definitions

* * * * *

(f) ***Basket.*** Any class or category of tariffed service or charge:

(1) * * *

* * * * *

3. Section 61.42 is amended by revising paragraphs (d) and (e) as follows:

§ 61.42 Price cap baskets and service categories.

* * * * *

(d) * * *

(1) A basket for the common line interstate access elements as described in §§ 69.115, 69.152, 69.154, and 69.157, and that portion of the interstate access element described in § 69.153 that recovers common line interstate access revenues;

(2) A basket for traffic sensitive switched interstate access elements;

(3) A basket for trunking services as described in §§ 69.110, 69.111, 69.112, 69.114, 69.125(b), and 69.155, and that portion of the interstate access element described in § 69.153 that recovers residual interconnection charge revenues;

* * *

(6) A basket for the marketing expenses described in § 69.156, including those recovered through End User Common Line charges and Presubscribed Interexchange Carrier charges.

(e)(1) The traffic sensitive switched interstate access basket shall contain such services as the Commission shall permit or require, including the following service categories:

(i) Local switching as described in § 69.106(f);

(ii) Information, as described in § 69.109;

(iii) Data base access services;

(iv) Billing name and address, as described in § 69.128 of this chapter;

(v) Local switching trunk ports, as described in § 69.106(f)(1);

(vi) Signalling transfer point port termination, as described in § 69.125(c).

(2) * * *

(vi) Interconnection charge, as recovered in §§ 69.153 and 69.155 of this chapter.

* * * * *

4. Section 61.45 is amended by revising paragraph (b), revising paragraph (c) and redesignating it as subparagraph (c)(1), adding new subparagraph (c)(2), adding subparagraph (d)(1)(ix), and adding paragraphs (i), (j), (k), and (l) to read as follows:

§ 61.45 Adjustments to the PCI for local exchange carriers.

* * * * *

(b) Adjustments to local exchange carrier PCIs for the baskets designated in § 61.42(d)(2), (3), (4), (5), and (6) shall be made pursuant to the formula set forth in § 61.44(b), and as further explained in §§ 61.44(e), (f), (g), and (h).

(1) Notwithstanding the value of X defined in § 61.44(b), the X value applicable to the baskets specified in § 61.42(d)(2), (3), and (6) shall be 4.0%, or 4.7%, or 5.3%, as the carrier elects.

* * * * *

(c)(1) Subject to paragraphs (c)(2) and (e) of this section, adjustments to local exchange carrier PCIs for the basket designated in § 61.42(d)(1) shall be made pursuant to the following formula:

* * *

(2) The formula set forth in paragraph (c)(1) shall be used by a local exchange carrier subject to price cap regulation only if that carrier is imposing a carrier common line charge pursuant to § 69.154 of this chapter. Otherwise, adjustments to local exchange carrier PCIs for the basket designated in § 61.42(d)(1) of this chapter shall be made pursuant to the formula set forth in § 61.44(b), and paragraphs (i) and (j) of this section, and as further explained in § 61.44(e), (f), (g), and (h).

(d) * * *

(1) * * *

(ix) the completion of amortization of equal access expenses.

* * * * *

(i)(1) Notwithstanding the provisions of paragraphs (b) and (c), and subject to the limitations of paragraph (j), price cap local exchange carriers that are recovering interconnection charge revenues through per-minute rates pursuant to § 69.124 or § 69.155 shall target, to the extent necessary to eliminate the recovery of any residual interconnection charge revenues through per-minute rates, any PCI reductions associated with the baskets designated in § 61.42(d)(1) and (2) that result from the application of the formula in § 61.44(b), as further explained in § 61.44(e), (f), (g), and (h), to the PCI for

the basket designated in § 61.42(d)(3), with no adjustment being made to the PCIs for the baskets designated in § 61.42(d)(1) and (2) as a result of the application of the formula in § 61.44(b). These reductions are to be made after the adjustment is made to the PCI for the basket designated in § 61.42(d)(3) resulting from the application of the formula in § 61.44(b), as further explained in § 61.44(e), (f), (g), and (h).

(2) Notwithstanding the provisions of paragraphs (b) and (c), and subject to the limitations of paragraph (j), price cap local exchange carriers that are recovering interconnection charge revenues through per-minute rates pursuant to § 69.155 shall target, to the extent necessary to eliminate the recovery of any residual interconnection charge revenues through per-minute rates, any PCI reductions associated with the basket designated in § 61.42(d)(6) that result from the application of the formula in § 61.44(b), as further explained in § 61.44(e), (f), (g), and (h), to the PCI for the basket designated in § 61.42(d)(3), with no adjustment being made to the PCIs for the basket designated in § 61.42(d)(6) as a result of the application of the formula in § 61.44(b). This reduction is to be made after any adjustment made pursuant to subparagraph (i)(1).

(3) Through December 31, 1997, the reduction in the PCI for the basket designated in § 61.42(d)(3) that results from subparagraph (i)(1) shall be determined by dividing the sum of the dollar effects of the PCI reductions that would have applied to the baskets designated in § 61.42(d)(1) and (d)(2) except for the provisions of subparagraph (i)(1) by the dollar amount associated with the PCI for the basket designated in § 61.42(d)(3), and multiplying the PCI for the basket designated in § 61.42(d)(3) by one minus the resulting ratio.

(4) Effective January 1, 1998, the reduction in the PCI for the basket designated in § 61.42(d)(3) that results from subparagraphs (i)(1) (and (i)(2) shall be determined by dividing the sum of the dollar effects of the PCI reductions that would have applied to the baskets designated in § 61.42(d)(1), (d)(2), and (d)(6), except for the provisions of subparagraphs (i)(1) and (i)(2), by the dollar amount associated with the PCI for the basket designated in § 61.42(d)(3), and multiplying the PCI for the basket designated in § 61.42(d)(3) by one minus the resulting ratio.

(j) In determining the extent of the targeting that shall occur pursuant to subparagraphs (i)(1) and (i)(2), local exchange carriers shall compute their anticipated residual interconnection charge amount by excluding revenues that are expected to be reallocated to cost-causative facilities-based charges in the future. To determine interconnection charge amounts so excluded in connection with the July 1, 1997 tariff filings, the local exchange carriers listed below shall use as an estimate of the residual interconnection charge revenues the specified residual interconnection charge percentage: NYNEX, 77.63 percent; BellSouth, 56.93 percent; U S West, 59.14 percent; Bell Atlantic, 63.96 percent; Southwestern Bell Telephone, 69.11 percent; and Pacific Bell and Nevada Bell, 53.52 percent. Each remaining price cap local exchange carrier

shall estimate a residual interconnection charge in an amount equal to 55 percent of its current interconnection charge revenues. For subsequent tariff filings in which the PCI reductions are to be targeted to the interconnection charge, these initial estimates shall be adjusted to reflect the actual amounts that have or will be reallocated. If the use of these estimates results in more PCI reductions being targeted to the interconnection charge than required to eliminate the per-minute interconnection charge, the local exchange carrier shall make the necessary exogenous adjustments to reverse the effects of the excess targeting.

(k) The calculation of the PCI for the basket designated in § 61.42(d)(3) shall include any residual interconnection charge revenues recovered pursuant to §§ 69.153 and 69.155.

(l) The calculation of the PCI for the basket designated in § 61.42(d)(6) shall include any marketing expense revenues recovered pursuant to §§ 69.153 and 69.156.

5. Section 61.46 is amended by revising paragraph (d) and redesignating it as subparagraph (d)(1), adding new subparagraph (d)(2), revising paragraph (e) and redesignating it as subparagraph (e)(1), adding new subparagraph (e)(2), and adding paragraphs (g) and (h) as follows:

§ 61.46 Adjustments to the API

* * * * *

(d)(1) Subject to subparagraph (d)(2) of this section, and in connection with any price cap tariff proposing changes to rates for services in the basket designated in § 61.42(d)(1), the maximum allowable carrier common line (CCL) charges shall be computed pursuant to the following methodology:

$CCL_{MOU} = CL_{MOU} * (1 + \%\text{ change in CL PCI}) - (EUCL_{MOU} + PICC_{MOU}) * 1 / (1 + (g/2))$

where

CCL_{MOU} = the sum of each of the proposed Carrier Common Line rates multiplied by its corresponding base period Carrier Common Line minutes of use, divided by the sum of all types of base period Carrier Common Line minutes of use,

CL_{MOU} = the sum of each of the existing maximum allowable Carrier Common Line rates multiplied by its corresponding base period Carrier Common Line minutes of use, plus each existing maximum allowable End User Common Line (EUCL) rate multiplied by its corresponding base period lines, plus

the common line portion of each existing maximum allowable Presubscribed Interexchange Carrier Charge (PICC) multiplied by its corresponding base period lines, divided by the sum of all types of base period Carrier Common Line minutes of use,

$EUCL_{MOU}$ = maximum allowable End User Common Line rates multiplied by base period lines, and divided by the sum of all types of base period Carrier Common Line minutes of use,

$PICC_{MOU}$ = the common line portion of maximum allowable Presubscribed Interexchange Carrier charge rates multiplied by base period lines, and divided by the sum of all types of base period Carrier Common Line minutes of use, and

g = the ratio of minutes of use per access line during the base period to minutes of use per access line during the previous base period, minus 1.

(2) The formula set forth in subparagraph (d)(1) of this section shall be used by a local exchange carrier subject to price cap regulation only if that carrier is imposing a per-minute carrier common line charge pursuant to § 69.154 of this chapter. Otherwise, adjustments to local exchange carrier APIs for the basket designated in § 61.42(d)(1) of this chapter shall be made pursuant to the formula set forth in paragraph (a) of this section.

(e)(1) In addition, for the purposes of paragraph (d), "Existing Carrier Common Line Rates" shall include existing originating premium, originating non-premium, terminating premium and terminating non-premium rates; and "End User Common Line Rates" used to calculate the CL_{MOU} and the $EUCL_{MOU}$ factors shall include, but not be limited to, Residential and Single Line Business rates, Centrex rates, and the Special Access surcharge.

(2) For purposes of paragraph (d), "each existing Presubscribed Interexchange Carrier Charge" shall include all the charges specified in § 69.153 of this chapter.

* * * * *

(g) The calculation of the API for the basket designated in § 61.42(d)(3) shall include any residual interconnection charge revenues recovered pursuant to §§ 69.153 and 69.155.

(h) The calculation of the API for the basket designated in § 61.42(d)(6) shall include any marketing expense revenues recovered pursuant to §§ 69.153 and 69.156.

6. Section 61.47 is amended by adding paragraph (i) and (j), and subparagraph (g)(7) as follows:

§ 61.47 Adjustments to the SBI; pricing bands.

* * * * *

(g)(7) The initial level of the local switch trunk ports service category designated in § 61.42(e)(1)(v) shall be established to include those costs identified pursuant to § 69.106(f)(1). This level shall be assigned a value of 100 and, thereafter must be adjusted as provided in paragraph (a) of this section, subject to the banding restrictions of paragraph (e).

* * * * *

(i)(1) Through December 31, 1997, notwithstanding the requirements of paragraph (a), if a local exchange carrier is recovering interconnection charge revenues through per-minute rates pursuant to § 69.124 or § 69.155, any reductions to the PCI for the basket designated in § 61.42(d)(3) resulting from the application of the provisions of § 61.45(b) and (i)(1) shall be directed to the SBI of the service category designated in § 61.42(e)(2)(vi).

(2) Effective January 1, 1998, notwithstanding the requirements of paragraph (a), if a local exchange carrier is recovering interconnection charge revenues through per-minute rates pursuant to § 69.155, any reductions to the PCI for the basket designated in § 61.42(d)(3) resulting from the application of the provisions of § 61.45(b), (i)(1), and (i)(2) shall be directed to the SBI of the service category designated in § 61.42(e)(2)(vi).

(3) Through December 31, 1997, the SBI reduction required by subparagraph (i)(1) shall be determined by dividing the sum of the dollar amount of any PCI reduction required by § 61.45(i)(1) and from the application of § 61.45(b) to the basket described in § 61.42(d)(3) by the dollar amount associated with the SBI for the service category designated in § 61.42(e)(2)(vi), and multiplying the SBI for the service category designated in § 61.42(e)(2)(vi) by one minus the resulting ratio.

(4) Effective January 1, 1998, the SBI reduction required by subparagraph (i)(2) shall be determined by dividing the sum of the dollar amount of any PCI reduction required by § 61.45(i)(1) and (i)(2), and from the application of § 61.45(b) to the basket described in § 61.42(d)(3) by the dollar amount associated with the SBI for the service category designated in § 61.42(e)(2)(vi), and multiplying the SBI for the service category designated in § 61.42(e)(2)(vi) by one minus the resulting ratio.

(j) The calculation of the SBI for the service category designated in § 61.42(e)(2)(vi) shall

include any residual interconnection charge revenues recovered pursuant to §§ 69.153 and 69.155.

7. Section 61.48 is amended by adding paragraph (k) to read as follows:

§ 61.48 Transition rules for price cap formula calculations.

* * * * *

(k) *Marketing expenses*. In the January 1, 1998 price cap tariff filing, local exchange carriers shall establish the marketing expense basket designated in § 61.42(d)(6) with an initial PCI and API level of 100. The initial value of 100 for the PCI and API for marketing expenses shall correspond to the marketing expenses described in § 69.156(a).

PART 69 -- ACCESS CHARGES

8. The authority citation for part 69 continues to read as follows:

Authority: 47 U.S.C. §§ 154(i) and (j), 201, 202, 203, 205, 218, 254, and 403.

9. Section 69.1(c) is revised to read as follows:

§ 69.1 Application of access charges.

* * * * *

(c) The following provisions of this part shall apply to telephone companies subject to price cap regulation only to the extent that application of such provisions is necessary to develop the nationwide average carrier common line charge, for purposes of reporting pursuant to §§ 43.21 and 43.22 of this chapter, and for computing initial charges for new rate elements: §§ 69.3(f), 69.106(b), 69.106(f), 69.106(g), 69.109(b), 69.110(d), 69.111(c), 69.111(g)(1), 69.111(l), 69.112(d), 69.114(b), 69.114(d), 69.125(b)(2), 69.301 through 69.310, and 69.401 through 69.412. The computation of rates pursuant to these provisions by telephone companies subject to price cap regulation shall be governed by the price cap rules set forth in part 61 of this chapter and other applicable Commission Rules and orders.

10. Section 69.2 is amended by revising paragraph (hh) to read as follows:

§ 69.2 Definitions.

(hh) "Telephone company" or "local exchange carrier" as used in this Part means an incumbent local exchange carrier as defined in section 251(h)(1) of the 1934 Act as amended by the 1996 Act.

11. Section 69.4 is amended by deleting paragraphs (d) and (f), and subparagraph (b)(1), by revising paragraph (b), and by adding paragraph (h) as follows:

§ 69.4 Charges to be filed.

* * * * *

(b) Except as provided in § 69.4(c), (e), and (h), and in § 69.118, the carrier's carrier charges for access service filed with this Commission shall include charges for each of the following elements:

(1) [Deleted].

* * * * *

(h) In addition to the charges specified in paragraph (b), the carrier's carrier charges for access service filed with this Commission by price cap local exchange carriers shall include charges for each of the following elements:

(1) presubscribed interexchange carrier;

(2) per-minute residual interconnection;

(3) dedicated local switching trunk port;

(4) shared local switching trunk port;

(5) dedicated tandem switching trunk port;

(6) line port costs in excess of basic, analog service; and

(7) multiplexers associated with tandem switching.

12. Section 69.103 is deleted.

13. Section 69.104 is renamed as follows. Paragraphs (a) and (e) are revised as follows:

§ 69.104 End user common line for non-price cap incumbent local exchange carriers.

(a) This section is applicable only to incumbent local exchange carriers that are not subject to price cap regulation as that term is defined in § 61.3(x) of this Chapter. A charge that is expressed in dollars and cents per line per month shall be assessed upon end users that subscribe to local exchange telephone service or Centrex service to the extent they do not pay carrier common line charges. A charge that is expressed in dollars and cents per line per month shall be assessed upon providers of public telephones. Such charge shall be assessed for each line between the premises of an end user, or public telephone location, and a Class 5 office that is or may be used for local exchange service transmissions.

* * * * *

(e) The monthly charge for each residential and single line business local exchange service subscriber shall be the charge computed in accordance with § 69.104(c), or $3.50, whichever is lower.

* * * * *

14. Section 69.105 is renamed as follows. Subparagraphs (b)(7) and (b)(8) are deleted, and paragraph (a) is revised to read as follows:

§ 69.105 Carrier common line for non-price cap local exchange carriers.

(a) This section is applicable only to local exchange carriers that are not subject to price cap regulation as that term is defined in § 61.3(x) of this Chapter. A charge that is expressed in dollars and cents per line per access minute of use shall be assessed upon all interexchange carriers that use local exchange common line facilities for the provision of interstate or foreign telecommunications services, except that the charge shall not be assessed upon interexchange carriers to the extent they resell MTS or MTS-type services of other common carriers (OCCs).

* * * * *

15. Section 69.106 is amended by revising paragraphs (a) and (b), and by adding paragraphs (f) and (g) as follows:

§ 69.106 Local switching.

(a) Except as provided in § 69.118, charges that are expressed in dollars and cents per access minute of use shall be assessed by local exchange carriers that are not subject to price cap regulation upon all interexchange carriers that use local exchange switching facilities for the provision of interstate or foreign services.

(b) The per minute charge described in paragraph (a) shall be computed by dividing the projected annual revenue requirement for the Local Switching element by the projected annual access minutes of use for all interstate or foreign services that use local exchange switching facilities.

* * * * *

(f) Except as provided in § 69.118, price cap local exchange carriers shall establish rate elements for local switching as follows:

(1) Price cap local exchange carriers shall separate from the projected annual revenues for the Local Switching element those costs projected to be incurred for ports (including cards and DS1/voice-grade multiplexers required to access end offices equipped with analog switches) on the trunk side of the local switch. Price cap local exchange carriers shall further identify costs incurred for dedicated trunk ports separately from costs incurred for shared trunk ports.

(i) Price cap local exchange carriers shall recover dedicated trunk port costs identified pursuant to subparagraph (f)(1) through flat-rated charges expressed in dollars and cents per trunk port and assessed upon the purchaser of the dedicated trunk terminating at the port.

(ii) Price cap local exchange carriers shall recover shared trunk port costs identified pursuant to subparagraph (f)(1) through charges assessed upon purchasers of shared transport. This charge shall be expressed in dollars and cents per access minute of use. The charge shall be computed by dividing the projected costs of the shared ports by the historical annual access minutes of use calculated for purposes of recovery of common transport costs in § 69.111(c).

(2) Price cap local exchange carriers shall recover the projected annual revenues for the Local Switching element that are not recovered in subparagraph (1) through charges that are expressed in dollars and cents per access minute of use and assessed upon all interexchange carriers that use local exchange switching facilities for the provision of interstate or foreign services. The maximum charge shall be computed by dividing the projected remainder of the annual revenues for the Local Switching element by the

historical annual access minutes of use for all interstate or foreign services that use local exchange switching facilities.

(g) On or after July 1, 1998, a price cap local exchange carrier may recover signalling costs associated with call setup through a call setup charge imposed upon all interstate interexchange carriers that use that local exchange carrier's facilities to originate or terminate interstate interexchange or foreign services. This charge must be expressed as dollars and cents per call attempt and may be assessed on originating calls handed off to the interexchange carrier's point of presence and on terminating calls received from an interexchange carrier's point of presence, whether or not that call is completed at the called location. Price cap local exchange carriers may not recover through this charge any costs recovered through other rate elements.

16. Section 69.107 is deleted.

17. Section 69.111 is amended by deleting paragraphs (b) and (f), revising paragraphs (a), (c), (d), (e), and (g), and adding paragraph (l) to read as follows:

§ 69.111 Tandem-Switched Transport and Tandem Charge.

(a)(1) Through June 30, 1998, except as provided in paragraph (l), below, tandem-switched transport shall consist of two rate elements, a transmission charge and a tandem switching charge.

(2) Beginning July 1, 1998, except as provided in paragraph (l), below, tandem-switched transport shall consist of three rate elements as follows:

(i) A per-minute charge for transport of traffic over common transport facilities between the incumbent local exchange carrier's end office and the tandem switching office. This charge shall be expressed in dollars and cents per access minute of use and shall be assessed upon all purchasers of common transport facilities between the local exchange carrier's end office and the tandem switching office.

(ii) A per-minute tandem switching charge. This tandem switching charge shall be set in accordance with paragraph (g), excluding multiplexer and dedicated port costs recovered in accordance with paragraph (l), and shall be assessed upon all interexchange carriers and other persons that use incumbent local exchange carrier tandem switching facilities.

(iii) A flat-rated charge for transport of traffic over dedicated transport facilities between the serving wire center and the tandem switching office. This

charge shall be assessed as a charge for dedicated transport facilities provisioned between the serving wire center and the tandem switching office in accordance with § 69.112 of this part.

(b) [Deleted.]

(c)(1) Through June 30, 1998, tandem-switched transport transmission charges generally shall be presumed reasonable if the telephone company bases the charges on a weighted per-minute equivalent of direct-trunked transport DS1 and DS3 rates that reflects the relative number of DS1 and DS3 circuits used in the tandem to end office links (or a surrogate based on the proportion of copper and fiber facilities in the interoffice network), calculated using the total actual voice-grade minutes of use, geographically averaged on a study-area-wide basis, that the incumbent local exchange carrier experiences based on the prior year's annual use. Tandem-switched transport transmission charges that are not presumed reasonable generally shall be suspended and investigated absent a substantial cause showing by the telephone company.

(2) Beginning July 1, 1998:

(i) Except in study areas where the incumbent local exchange carrier has implemented density pricing zones as described in section 69.124, per-minute common transport charges described in subparagraph (a)(2)(i) shall be presumed reasonable if the incumbent local exchange carrier bases the charges on a weighted per-minute equivalent of direct-trunked transport DS1 and DS3 rates that reflects the relative number of DS1 and DS3 circuits used in the tandem to end office links (or a surrogate based on the proportion of copper and fiber facilities in the interoffice network), calculated using the total actual voice-grade minutes of use, geographically averaged on a study-area-wide basis, that the incumbent local exchange carrier experiences based on the prior year's annual use. Tandem-switched transport transmission charges that are not presumed reasonable shall be suspended and investigated absent a substantial cause showing by the incumbent local exchange carrier.

(ii) In study areas where the incumbent local exchange carrier has implemented density pricing zones as described in section 69.124, per-minute common transport charges described in subparagraph (a)(2)(i) shall be presumed reasonable if the incumbent local exchange carrier bases the charges on a weighted per-minute equivalent of direct-trunked transport DS1 and DS3 rates that reflects the relative number of DS1 and DS3 circuits used in the tandem to end office links (or a surrogate based on the proportion of copper and fiber facilities in the interoffice network),

calculated using the total actual voice-grade minutes of use, averaged on a zone-wide basis, that the incumbent local exchange carrier experiences based on the prior year's annual use. Tandem-switched transport transmission charges that are not presumed reasonable shall be suspended and investigated absent a substantial cause showing by the incumbent local exchange carrier.

(d)(1) Through June 30, 1998, the tandem-switched transport transmission charges may be distance-sensitive. Distance shall be measured as airline distance between the serving wire center and the end office, unless the customer has ordered tandem-switched transport between the tandem office and the end office, in which case distance shall be measured as airline distance between the tandem office and the end office.

(2) Beginning July 1, 1998, the per-minute charge for transport of traffic over common transport facilities described in subparagraph (a)(2)(i) may be distance-sensitive. Distance shall be measured as airline distance between the tandem switching office and the end office.

(e)(1) Through June 30, 1998, if the telephone company employs distance-sensitive rates:

(i) A distance-sensitive component shall be assessed for use of the transmission facilities, including intermediate transmission circuit equipment between the end points of the interoffice circuit; and

(ii) A non-distance-sensitive component shall be assessed for use of the circuit equipment at the ends of the interoffice transmission links.

(2) Beginning July 1, 1998, if the telephone company employs distance-sensitive rates for transport of traffic over common transport facilities, as described in subparagraph (a)(2)(i):

(i) A distance-sensitive component shall be assessed for use of the common transport facilities, including intermediate transmission circuit equipment between the end office and tandem switching office; and

(ii) A non-distance-sensitive component shall be assessed for use of the circuit equipment at the ends of the interoffice transmission links.

(f) [Deleted.]

(g)(1) The tandem switching charge imposed pursuant to subparagraph (a)(1) or

(a)(2)(ii), as applicable, shall be set to recover twenty percent of the annual part 69 interstate tandem revenue requirement plus one third of the portion of the tandem switching revenue requirement being recovered through the interconnection charge recovered by §§ 69.124, 69.153, and 69.155, excluding multiplexer and dedicated port costs recovered in accordance with paragraph (l).

(2) Beginning January 1, 1999, the tandem switching charge imposed pursuant to subparagraph (a)(2)(ii) shall be set to recover the amount prescribed in subparagraph (g)(1) plus one half of the remaining portion of the tandem switching revenue requirement then being recovered through the interconnection charge recovered by §§ 69.124, 69.153, and 69.155, excluding multiplexer and dedicated port costs recovered in accordance with paragraph (l).

(3) Beginning January 1, 2000, the tandem switching charge imposed pursuant to subparagraph (a)(2)(ii) shall be set to recover the entire interstate tandem switching revenue requirement, including that portion formerly recovered through the interconnection charge recovered in §§ 69.124, 69.153, and 69.155, and excluding multiplexer and dedicated port costs recovered in accordance with paragraph (l).

(4) A local exchange carrier that is subject to price cap regulation as that term is defined in § 61.3(x) of this Chapter shall calculate its tandem switching revenue requirement as used in this paragraph by dividing the tandem switching revenue requirement that was included in the original interconnection charge by the original interconnection charge, and then multiplying this result by the annual revenues recovered through the interconnection charge, described in § 69.124, as of June 30, 1997.

* * * * *

(l) In addition to the charges described above, price cap local exchange carriers shall establish separate charges for multiplexers and dedicated trunk ports used in conjunction with the tandem switch as follows:

(1) Local exchange carriers must establish a traffic-sensitive charge for DS3/DS1 multiplexers used on the end office side of the tandem switch, assessed on purchasers of common transport to the tandem switch. This charge must be expressed in dollars and cents per access minute of use. The maximum charge shall be calculated by dividing the total costs of the multiplexers on the end office-side of the tandem switch by the serving wire center side of the tandem switch by the projected annual access minutes of use calculated for purposes of recovery of common transport costs in paragraph (c), above. A similar charge shall be assessed for DS1/voice-grade multiplexing provided on the end-office side of analog tandem switches.

(2)(i) Local exchange carriers must establish a flat-rated charge for dedicated DS3/DS1 multiplexing on the serving wire center side of the tandem switch provided in conjunction with dedicated DS3 transport service from the serving wire center to the tandem switch. This charge shall be assessed on interexchange carriers purchasing tandem-switched transport in proportion to the number of DS3 trunks provisioned for that interexchange carrier between the serving wire center and the tandem-switch.

(ii) Local exchange carriers must establish a flat-rated charge for dedicated DS1/voice-grade multiplexing provided on the serving wire center side of analog tandem switches. This charge may be assessed on interexchange carriers purchasing tandem-switched transport in proportion to the interexchange carrier's transport capacity on the serving wire center side of the tandem.

(3) Price cap local exchange carriers may recover the costs of dedicated trunk ports on the serving wire center side of the tandem switch only through flat-rated charges expressed in dollars and cents per trunk port and assessed upon the purchaser of the dedicated trunk terminating at the port.

18. Section 69.122 is deleted.

19. Section 69.123 is amended by adding paragraph (f) to read as follows:

§ 69.123 Density pricing zones for special access and switched transport.

* * * * *

(f)(1) An incumbent local exchange carrier that establishes density pricing zones under this section must reallocate additional amounts recovered under the interconnection charge prescribed in section 69.124 to facilities-based transport rates, reflecting the higher costs of serving lower-density areas. Each incumbent local exchange carrier must reallocate costs from the interconnection charge each time it increases the differential between prices in density zones two and one or between three and one.

(2) Any incumbent local exchange carrier that has already deaveraged its rates on the date these rules become effective must reallocate an amount equivalent to that described in subparagraph (1) from the interconnection charge prescribed in section 69.124 to its transport services.

(3) Price cap local exchange carriers shall reassign to direct-trunked transport and tandem-switched transport categories or subcategories interconnection charge amounts

reallocated under subparagraph (1) or (2) in a manner that reflects the way density pricing zones are being implemented by the incumbent local exchange carrier.

20. Section 69.124 is amended by revising paragraph (a) and subparagraph (b)(1), and by deleting subparagraph (b)(2) to read as follows:

§ 69.124 Interconnection charge.

(a) For telephone companies not subject to price cap regulation, an interconnection charge expressed in dollars and cents per access minute shall be assessed upon all interexchange carriers and upon all other persons using the telephone company local transport network.

(b)(1) For telephone companies not subject to price cap regulation, the interconnection charge shall be computed by subtracting entrance facilities, tandem-switched transport, direct-trunked transport, and dedicated signalling transport revenues from the Part 69 transport revenue requirement, and dividing by the total interstate local transport minutes.

(2) [Deleted]

(c) [Deleted]

21. Section 69.125 is amended by revising paragraph (a) to read as follows:

§ 69.125 Dedicated Signalling Transport.

(a) Dedicated signalling transport shall consist of two elements, a signalling link charge and a signalling transfer point (STP) port termination charge.

* * * * *

22. Section 69.126 is revised as follows:

§ 69.126 Nonrecurring charges.

As of the effective date of the First Report and Order in Access Charge Reform, CC Docket No. 96-262, FCC 97-158, 12 FCC Rcd ___ (1997), incumbent local exchange carriers shall not assess any nonrecurring charges for service connection when an interexchange carrier converts trunks from tandem-switched transport to direct-trunked transport or when an interexchange carrier orders the disconnection of overprovisioned trunks, until six months after the effective date of the tariffs eliminating the unitary pricing option for tandem-switched

transport.

23. New Subpart C is added beginning with section 69.151:

SUBPART C -- COMPUTATION OF CHARGES FOR PRICE CAP LOCAL EXCHANGE CARRIERS

§ 69.151 Applicability.

This subpart shall apply only to telephone companies subject to the price cap regulations set forth in Part 61 of this chapter.

§ 69.152 End user common line for price cap local exchange carriers.

(a) A charge that is expressed in dollars and cents per line per month shall be assessed upon end users that subscribe to local exchange telephone service or Centrex service to the extent they do not pay carrier common line charges. A charge that is expressed in dollars and cents per line per month shall be assessed upon providers of public telephones. Such charge shall be assessed for each line between the premises of an end user, or public telephone location, and a Class 5 office that is or may be used for local exchange service transmissions.

(b) Except as provided in paragraphs (d)-(i), the maximum single line rate or charge shall be computed:

(1) by dividing one-twelfth of the projected annual revenue requirement for the End User Common Line element by the projected average number of local exchange service subscriber lines in use during such annual period, only so long as a per-minute carrier common line charge is assessed or the multi-line PICC defined in § 69.153 recovers common line revenues.

(2) by dividing one-twelfth of the projected annual revenues permitted for the common line basket under the Commission's price cap rules, as set forth in Part 61 of this chapter, by the projected average number of local exchange service subscriber lines in use during such annual period, if no per-minute carrier common line charge is assessed and the multi-line PICC defined in § 69.153 does not recover any common line revenues.

(3) Provided, however, that the charge for each local exchange service subscriber line shall not exceed $9.00 as adjusted by the inflation factor computed under paragraph (k).

(c) The charge for each subscriber line associated with a public telephone shall be equal to

the monthly charge computed in accordance with paragraph (b).

(d)(1) Through December 31, 1997, the monthly charge for each primary residential or single line business local exchange service subscriber line shall be the charge computed in accordance with paragraph (b), or $3.50, whichever is lower.

(2) Beginning January 1, 1998, the maximum monthly charge for each primary residential or single line business local exchange service subscriber line shall be the charge computed in accordance with paragraph (b), or $3.50, whichever is lower.

(e)(1) Through December 31, 1997, the monthly charge for each non-primary residential local exchange service subscriber line shall be the charge computed in accordance with paragraph (b), or $3.50, whichever is lower.

(2) Beginning January 1, 1998, the maximum monthly charge for each non-primary residential local exchange service subscriber line shall be the lower of:

(i) the maximum charge computed in accordance with paragraph (b); or

(ii) $5.00. On January 1, 1999, this amount shall be adjusted by the inflation factor computed under paragraph (k), and increased by $1.00. On July 1, 2000, and in each subsequent year, this amount shall be adjusted by the inflation factor computed under paragraph (k), and increased by $1.00.

(3) Where the local exchange carrier provides a residential line to another carrier so that the other carrier may resell that residential line to a residence that already receives a primary residential line, the local exchange carrier may collect the non-primary residential charge described in paragraph (e) from the other carrier.

(f) Except as provided in paragraphs (n) and (o), the charge for each primary residential local exchange service subscriber line shall be the same as the charge for each single line business local exchange service subscriber line.

(g) A line shall be deemed to be a residential subscriber line if the subscriber pays a rate for such line that is described as a residential rate in the local exchange service tariff.

(h) [reserved]

(i) A line shall be deemed to be a single line business subscriber line if the subscriber pays a rate that is not described as a residential rate in the local exchange service tariff and does not obtain more than one such line from a particular telephone company.

(j) No charge shall be assessed for any WATS access line.

(k)(1) On January 1, 1999:

(i) The ceiling for multi-line business subscriber lines under subparagraph (b)(3) will be adjusted to reflect inflation as measured by the change in GDP-PI for the 18 months ending September 30, 1998.

(ii) The ceiling for non-primary residential subscriber lines under subparagraph (e)(2)(ii) will be adjusted to reflect inflation as measured by the change in GDP-PI for the 12 months ending September 30, 1998.

(2) On July 1, 2000, the ceiling for multi-line business subscriber lines and non-primary residential subscriber lines will be adjusted to reflect inflation as measured by the change in GDP-PI for the 18 months ending on March 31, 2000.

(3) On July 1 of each subsequent year, the ceiling for multi-line business subscriber lines and non-primary residential subscriber lines will be adjusted to reflect inflation as measured by the change in GDP-PI for the 12 months ending on March 31 of the year the adjustment is made.

(l)(1) Beginning January 1, 1998, local exchange carriers shall assess no more than one end user common line charge as calculated under the applicable method under paragraph (e) for Basic Rate Interface integrated services digital network (ISDN) service.

(2) Local exchange carriers shall assess no more than five end user common line charges as calculated under paragraph (b) for Primary Rate Interface ISDN service.

(m) In the event the local exchange carrier charges less than the maximum end user common line charge for any subscriber lines, the local exchange carrier may not recover the difference between the amount collected and the maximum from carrier common line charges or PICCs.

(n) Through December 31, 1997, the End User Common Line charge for a residential subscriber shall be 50% of the charge specified in § 69.152(b) and (d) if the residential local exchange service rate for such subscribers is reduced by an equivalent amount, provided that such local exchange service rate reduction is based upon a means test that is subject to verification.

(o) Subparagraphs (1) and (2) are effective through December 31, 1997.

(1) The End User Common Line charge for residential subscribers shall be reduced to the extent of the state assistance as calculated in subparagraph (2) of this section, or

waived in full if the state assistance equals or exceeds the residential End User Common Line charge under the circumstances described below. In order to qualify for this waiver, the subscriber must be eligible for and receive assistance or benefits provided pursuant to a narrowly targeted telephone company lifeline assistance program, requiring verification of eligibility, implemented by the state or local telephone company. A state or local telephone company wishing to implement this End User Common Line reduction or waiver for its subscribers shall file information with the Commission Secretary demonstrating that its plan meets the criteria set out in this section and showing the amount of state assistance per subscriber as described in subparagraph (2). The reduction or waiver of the End User Common Line charge shall be available as soon as the Commission certifies that the state or local telephone plan satisfies the criteria set out in this subsection and the relevant tariff provisions become effective.

(2)(i) The state assistance per subscriber shall be equal to the difference between the charges to be paid by the participating subscribers and those to be paid by other subscribers for comparable monthly local exchange service, service connections and customer deposits, except that benefits or assistance for connection charges and deposit requirements may only be counted once annually. In order to be included in calculating the state assistance, such benefits must be a single telephone line to the household's principal residence.

(ii) The monthly state assistance per participating subscriber shall be calculated by adding the amounts calculated in subparagraphs (2)(ii)(A) and (B).

(A) The amount of the monthly state assistance per participating subscriber for local exchange service shall be calculated by dividing the annual difference between charges paid by all participating subscribers for residential local exchange service and the amount which would have been charged to non-qualifying subscribers for comparable service by twelve times the number of subscribers participating in the state assistance program. Estimates may be used when historic data are not available.

(B) The amount of the monthly state assistance for service connections and customer deposits per participating subscriber shall be calculated by determining the annual amount of the reductions in these charges for participating subscribers each year and dividing this amount by twelve times the number of participating subscribers. Estimates may be used when historic data are not available.

(p) Through December 31, 1997, in connection with the filing of access tariffs pursuant to § 69.3(a), telephone companies shall calculate for the association their projected revenue requirement attributable to the operation of § 69.104(n) through (o). The projected amount will

be adjusted by the association to reflect the actual lifeline assistance benefits paid in the previous period. If the actual benefits exceeded the projected amount for that period, the differential will be added to the projection for the ensuing period. If the actual benefits were less than the projected amount for that period, the differential will be subtracted from the projection for the ensuing period. Through December 31, 1997, the association shall so adjust amounts to the Lifeline Assistance revenue requirement, bill and collect such amounts from interexchange carriers pursuant to § 69.117 and distribute the funds to qualifying telephone companies pursuant to § 69.603(d).

§ 69.153 Presubscribed interexchange carrier charge (PICC).

(a) A charge expressed in dollars and cents per line may be assessed upon the subscriber's presubscribed interexchange carrier to recover the common line revenues permitted under the price cap rules in Part 61 of this chapter that cannot be recovered through the end user common line charge established under § 69.152, residual interconnection charge revenues, and certain marketing expenses described in § 69.153(a). In the event the ceilings on the PICC prevent the PICC from recovering all the residual common line, residual interconnection charge revenues, and marketing expenses, the PICC shall recover all residual common line revenues before it recovers residual interconnection charge revenues, and all residual interconnection charge revenues before it recovers marketing expenses.

(b) If an end-user customer does not have a presubscribed interexchange carrier, the local exchange carrier may collect the PICC directly from the end user.

(c) The maximum monthly PICC for primary residential subscriber lines and single-line business subscriber lines shall be the lower of:

(1) One twelfth of the sum of annual common line revenues and residual interconnection charge revenues permitted under our price cap rules divided by the projected average number of local exchange service subscriber lines in use during such annual period, minus $3.50; or

(2) $0.53. On January 1, 1999, this amount shall be adjusted by the inflation factor computed under subparagraph (e), and increased by $0.50. On July 1, 2000, and in each subsequent year, this amount shall be adjusted by the inflation factor computed under subparagraph (e), and increased by $0.50.

(d) To the extent that a local exchange carrier cannot recover its full common line revenues, residual interconnection charge revenues, and those marketing expense revenues described in § 69.156(a) permitted under price cap regulation through the recovery mechanisms established in §§ 69.152, 69.153(c), and 69.156(b) and (c), the local exchange carrier may assess

a PICC on multi-line business subscriber lines and non-primary residential subscriber lines.

(1) The maximum monthly PICC for non-primary residential subscriber lines shall be the lower of:

(i) One twelfth of the annual common line, residual interconnection charge, and § 69.156(a) marketing expense revenues permitted under our price cap rules, less the maximum amounts permitted to be recovered through the recovery mechanisms under §§ 69.152, 69.153(c), and 69.156(b) and (c), divided by the total number of projected non-primary residential and multi-line business subscriber lines in use during such annual period; or

(ii) $1.50. On January 1, 1999, this amount shall be adjusted by the inflation factor computed under subparagraph (e), and increased by $1.00. On July 1, 2000, and in each subsequent year, this amount shall be adjusted by the inflation factor computed under subparagraph (e), and increased by $1.00.

(2) If the maximum monthly PICC for non-primary residential subscriber lines is determined using paragraph (d)(1)(i), the maximum monthly PICC for multi-line business subscriber lines shall equal the maximum monthly PICC of non-primary residential subscriber lines. Otherwise, the maximum monthly PICC for multi-line business lines shall be the lower of:

(i) One twelfth of the annual common line, residual interconnection charge, and § 69.156(a) marketing expense revenues permitted under our rules, less the maximum amounts permitted to be recovered through the recovery mechanisms under §§ 69.152, 69.153(c) and (d)(1)(i), and 69.156 (b) and (c), divided by the total number of projected multi-line business subscriber lines in use during such annual period; or

(ii) $2.75. On January 1, 1999, this amount shall be adjusted by the inflation factor computed under subparagraph (e), and increased by $1.50. On July 1, 2000, and in each subsequent year, this amount shall be adjusted by the inflation factor computed under subparagraph (e), and increased by $1.50.

(e) For the PICC ceiling for primary residential subscriber lines and single-line business subscriber lines under subparagraph (c)(2), non-primary residential subscriber lines under subparagraph (d)(1)(ii), and multi-line business subscriber lines under subparagraph (d)(2)(ii):

(1) On January 1, 1999, the ceiling will be adjusted to reflect inflation as measured by the change in GDP-PI for the 12 months ending September 30, 1998.

(2) On July 1, 2000, the ceiling will be adjusted to reflect inflation as measured by the change in GDP-PI for the 18 months ending on March 31, 2000.

(3) On July 1 of each subsequent year, the ceiling will be adjusted to reflect inflation as measured by the change in GDP-PI for the 12 months ending on March 31 of the year the adjustment is made.

(f)(1) Local exchange carriers shall assess no more than one PICC as calculated under the applicable method under subparagraph (d)(1) for Basic Rate Interface integrated services digital network (ISDN) service.

(2) Local exchange carriers shall assess no more than five PICCs as calculated under subparagraph (d)(2) for Primary Rate Interface ISDN service.

§ 69.154 Per-minute carrier common line charge.

(a) Local exchange carriers may recover a per-minute carrier common line charge from interexchange carriers, collected on originating access minutes and calculated using the weighting method set forth in paragraph (c). The maximum such charge shall be the lower of:

(1) the per-minute rate that would recover annual common line revenues permitted less the maximum amounts allowed to be recovered under §§ 69.152 and 69.153; or

(2) the sum of the local switching, carrier common line and interconnection charge charges assessed on originating minutes on December 31, 1997, minus the local switching charges assessed on originating minutes.

(b) To the extent that paragraph (a) does not recover from interexchange carriers all permitted carrier common line revenue, the excess may be collected through a per-minute charge on terminating access calculated using the weighting method set forth in paragraph (c).

(c) For each Carrier Common Line access element tariff, the premium originating Carrier Common Line charge shall be set at a level that recovers revenues allowed under paragraphs (a) and (b). The non-premium charges shall be equal to .45 multiplied by the premium charges.

§ 69.155 Per-minute residual interconnection charge.

(a) Local exchange carriers may recover a per-minute residual interconnection charge on originating access. The maximum such charge shall be the lower of:

(1) the per-minute rate that would recover the total annual residual interconnection charge revenues permitted less the portion of the residual interconnection charge allowed

to be recovered under § 69.153; or

(2) the sum of the local switching, carrier common line and residual interconnection charges assessed on originating minutes on December 31, 1997, minus the local switching charges assessed on originating minutes, less the maximum amount allowed to be recovered under § 69.154(a).

(b) To the extent that paragraph (a) prohibits a local exchange carrier from recovering all of the residual interconnection charge revenues permitted, the residual may be collected through a per-minute charge on terminating access.

(c) Any charge assessed pursuant to paragraph (a) or (b) shall be assessed only upon minutes utilizing the local exchange carrier's local transport service.

§ 69.156 Marketing expenses.

(a) Local exchange carriers shall recover marketing expenses that are allocated to the common line and traffic sensitive baskets, and the switched services within the trunking basket pursuant to §§ 32.6610 and 69.403 of this Chapter.

(b) The expenses described in paragraph (a) may be recovered from non-primary residential subscriber lines, by increasing the end user common line charge described in § 69.152(e). The amount of marketing expenses permitted to be recovered in this manner shall be the total marketing expenses described in paragraph (a) divided by the sum of non-primary residential lines and multi-line business lines. In no event shall the end user common line charge for these lines exceed the lower of the ceilings established in § 69.152(b)(3) and (e)(2)(ii).

(c) The expenses described in paragraph (a) may be recovered from multi-line business subscriber lines, by increasing the end user common line charge described in § 69.152(b). The amount permitted to be recovered in this manner shall be the total marketing expenses described in paragraph (a) divided by the sum of non-primary residential lines and multi-line business lines. In no event shall the end user common line charge for these lines exceed the ceiling established in § 69.152(b)(3).

(d) In the event that the ceilings set forth in paragraphs (b) and (c), and § 69.153(d) prevent a local exchange carrier from recovering fully the marketing expenses described in paragraph (a), the local exchange carrier may recover the remainder through a per-minute assessment on originating access minutes, so long as the charge for originating access does not exceed the amount defined in § 69.155(a)(2) less the maximum permitted to be recovered under § 69.155(a).

(e) In the event that the ceilings set forth in paragraphs (b), (c) and (d), and § 69.153(d) prevent a local exchange carrier from recovering fully the marketing expenses described in paragraph (a), the local exchange carrier may recover the remainder through a per-minute assessment on terminating access minutes.

(f) The amount of marketing expenses that may be recovered each year shall be adjusted in accordance with the price cap rules set forth in Part 61.

§ 69.157 Line port costs in excess of basic, analog service.

To the extent that the costs of ISDN line ports, and line ports associated with other services, exceed the costs of a line port used for basic, analog service, local exchange carriers may recover the difference through a separate monthly end user charge.

24. Subpart C -- Computation of Transition Charge, sections 69.201-69.205, is deleted.

25. Section 69.303 is amended by deleting paragraph (a) and redesignating paragraph (b) as section 69.303.

26. Section 69.304 is amended by deleting paragraph (c).

27. Section 69.305 is amended by revising paragraphs (b) and (d), and adding paragraph (e) to read as follows:

§ 69.305 Carrier cable and wire facilities (C&WF).

* * * * *

(b) Carrier C&WF, other than WATS access lines, not assigned pursuant to paragraphs (a), (c), or (e) of this section that is used for interexchange services that use switching facilities for origination and termination that are also used for local exchange telephone service shall be apportioned to the local Transport elements.

* * * * *

(d) All Carrier C&WF that is not apportioned pursuant to paragraphs (a), (b), (c), and (e) of this Section shall be assigned to the Special Access element.

(e) Carrier C&WF that is used to provide transmission between the local exchange carrier's signalling transfer point and the local switch shall be assigned to the local switching category.

28. Section 69.306 is amended by revising paragraphs (c), (d), and (e) to read as follows:

§ 69.306 Central Office Equipment (COE).

* * * * *

(c) COE Category 2 (Tandem Switching Equipment) that is deemed to be exchange equipment for purposes of the Modification of Final Judgment in United States v Western Electric Co. shall be assigned to the tandem switching charge subelement and the interconnection charge element. COE Category 2 which is associated with the signal transfer point function shall be assigned to the local switching category. COE Category 2 which is used to provide transmission facilities between the local exchange carrier's signalling transfer point and the database shall be assigned to the Line Information Database subelement at § 69.120(a). All other COE Category 2 shall be assigned to the interexchange category.

(d) COE Category 3 (Local Switching Equipment) shall be assigned to the Local Switching element except as provided in paragraph (a) of this section; and that, for telephone companies subject to price cap regulation set forth in Part 61 of this chapter, line-side port costs shall be assigned to the Common Line rate element.

(e) COE Category 4 (Circuit Equipment) shall be apportioned among the interexchange category and the Common Line, Transport, and Special Access elements. COE Category 4 shall be apportioned in the same proportions as the associated Cable and Wireless Facilities; except that any DS1/voice-grade multiplexer investment associated with analog local switches and assigned to the local transport category by this rule shall be reallocated to the local switching category.

29. Section 69.307 is amended by deleting paragraph (c).

30. Section 69.308 is deleted.

31. Section 69.309 is amended to read as follows:

§ 69.309 Other investment.

Investment that is not apportioned pursuant to §§ 69.302 through 69.307 shall be apportioned among the interexchange category, the billing and collection category and access elements in the same proportions as the combined investment that is apportioned pursuant to §§ 69.303 through 69.307.

32. Section 69.401 is amended by revising paragraph (b) to read as follows:

§ 69.401 Direct Expenses.

* * * * *

(b) Plant Specific Operations Expenses in Accounts 6210, 6220 and 6230, shall be apportioned among the interexchange category and access elements on the basis of the apportionment of the investment in Accounts 2210, 2220, and 2230, respectively; provided that any expenses associated with DS1/voice-grade multiplexers, to the extent that they are not associated with an analog tandem switch, assigned to the local transport category by this subsection shall be reallocated to the local switching category; provided further that any expenses associated with common channel signalling included in Account 6210 shall be assigned to the local transport category.

* * * * *

33. Section 69.406 is amended by deleting subparagraph (a)(9).

34. Section 69.410 is deleted.

35. Section 69.411 is amended to read as follows:

§ 69.411 Other Expense.

Except as provided in §§ 69.412, 69.413, and 69.414, expenses that are not apportioned pursuant to §§ 69.401 through 69.409 shall be apportioned among the interexchange category and all access elements in the same manner as § 69.309 Other investment.

36. Section 69.501 is amended by deleting paragraph (a).

37. Section 69.502 is amended to read as follows:

§ 69.502 Base factor allocation.

Projected revenues from the following shall be deducted from the base factor portion to determine the amount that is assigned to the Carrier Common Line element:

(a) End User Common Line charges, less any marketing expense revenues recovered through end user common line charges pursuant to § 69.156;

(b) Special Access surcharges; and

(c) The portion of frozen per-line support that carriers receive pursuant to § 54.303 that is attributable to LTS payments received prior to January 1, 1998.

38. Section 69.611 is deleted.

May 7, 1997

Statement of
Commissioner James H. Quello

RE: FEDERAL-STATE JOINT BOARD ON UNIVERSAL SERVICE (CC Docket No. 96-45),

ACCESS CHARGE REFORM (CC Docket No. 96-262), and

PRICE CAP PERFORMANCE REVIEW FOR LOCAL EXCHANGE CARRIERS (CC Docket No. 94-1).

Today, the Commission has established rules to implement the Universal Service provisions of the Telecommunications Act of 1996, as well as rules to restructure the access charge system while also initiating reductions in the levels of those access charges. I have believed throughout my participation in the debates regarding universal service and access reform that, as much as possible, we should seek to ensure that consumers experience the benefits of our actions. To this same end, we should try to avoid the possibility that total bills for groups of consumers could increase as a result of implementing new universal service programs and moving into a new access charge regime.

Universal Service

This Commission now has taken steps to establish processes for the administration of universal service funds in a way that allows the commitments represented in this section of the 1996 Telecommunications Act to be fulfilled. We have labored to develop a reasonable plan that will provide necessary and sufficient funds for schools and libraries as well as other universal service programs. We also have sought to avoid collection of funds beyond those legitimately needed to help make new and important services available to students and teachers in inner city, suburban and rural schools from Takoma Park, D.C., to Tacoma, Washington, from McAllen, Texas to Mackinac Island on the Upper Peninsula of Michigan.

We have achieved this balance by establishing funding necessary to begin the program at a reasonable level, with a provision that allows schools and libraries to begin the program January 1, 1998. By this time, we would hope that participating groups will have had the opportunity to develop their plans. Our decision to start the program with lower funding in the first six months, increasing in the following years, gives the program early constraint, with flexibility at later periods when greater demand is likely to develop. As a result, I believe this decision provides for new universal service funding within the limits of what consumers around the country are willing to pay.

The issue of what consumers are prepared to pay has been a very difficult one. The need for our attention to the issue, however, has been clearly expressed in many ways. It has required the Commission to balance the need for programs involved in universal service that are critically important to the future of this country with their cost. In this respect, this universal service

proceeding is one of the most important decisions in this agency's history. At the same time, we have heard a consistent message from around the country that consumers and businesses are not necessarily willing to pay for these services through higher total bills for telecommunications services.

With respect to funding for health care subsidies, we have endeavored to make sure that rural, non-profit health care facilities have sufficient funding to meet the needs for providing services in communities that otherwise might not have the same resources that are available in urban communities.

There also are many other policy and market issues that will need to be resolved in a new universal service environment. For instance, I believe it remains to be seen how cable and wireless industries will continue to develop to play a greater role in the telecommunications services that will meet future universal service needs. As these developments occur, the Commission may continue to monitor the equity of contribution and recovery of universal service funds by paging services as well as the extent to which wireless services in general should contribute for intrastate services.

Access Reform

The Commission's actions today on access reform involve two components: (1) several structural changes that will cause access components to move to more reasonable categories and to become subject to competition where possible; and (2) reductions in the current level of access charges, largely accomplished through revision of the productivity and sharing mechanism in LEC price caps.

Where this decision changes the structure of end user charges, as in our treatment of business and residential customers, and consumers with second or multiple lines, I believe our decisions should be -- and are -- characterized by balance. As a result of this necessary reform of the access payment structure, charges should remain within reasonable bounds and should help to promote the development of competition and consumer benefits.

I also believe this Commission would be remiss in our regulatory duties to the American public and responsibilities to our licensees if we were to restructure universal service without concurrently engaging in access charge reform. We have talked about this step for quite some time. Many parties have expressed their views in a very public fashion as to whether or not this step is warranted, or to what degree access charges should be reduced. I believe that this step to restructure and reduce the level of access charges is the right thing to do and this is the right time to do it.

The consumers and users of telecommunications services are the intended beneficiaries of today's actions regarding access reform. Now that these decisions are adopted, I believe it will become clear that we have done our best to ensure that consumers do not bear the burden of implementing the new universal service program and access charge reform. Our actions also represent a fundamental part of the Commission's effort to facilitate competition in the local exchange marketplace, in this case by reducing access charges paid to LECs by interexchange carriers.

The primary vehicle for this reduction is the decision to change the existing combinations of productivity factors, or "x-factors", and sharing options to a single productivity factor of 6.5% accompanied by no sharing obligation. As a result, this decision continues the Commission's efforts to move away from the lingering remnants of rate of return regulation for local exchange carriers. Today's decision will complete the movement of price cap LECs away from the sharing obligations that were part of the past system.

Looking to the Future

I want to emphasize that today's actions represent a first step in many respects.

Concerning universal service, this is not a day to declare victory. There is much left to be done by the Commission, the states, temporary and permanent fund administrators, school districts, libraries, health care facilities, parties developing cost models, and telecommunications companies seeking to provide services and enter new markets. This is definitely an important day, but the real effort is just beginning. That effort will require investment, planning, training in using services, and community, professional, and corporate involvement, and it will only be successful after the continuing involvement, in community after community, by the many parties who have so diligently participated in this proceeding.

The Commission's action to increase the productivity factor not only results in reduced access charges in the first year, but also in further reductions in access charges in subsequent years. In another respect, it may very well become necessary very soon for the Commission to consider how to supplement today's decision to allow for pricing flexibility by LECs as competition develops to a greater level in the local marketplace. One possible way to provide that flexibility might be through relaxing the 6.5% productivity factor where LECs can meet criteria to demonstrate sufficient competition.

At the same time, later steps might also include the potential for checks and balances in the event that competition in the local exchange marketplace does not develop as soon as some seem to expect. Once again, down the road the Commission may need to consider more specific measures to ensure that the platforms necessary for competition truly are available. It is my hope that those steps won't be necessary.

Finally, some parties have warned recently that any actions by this Commission to lower access charges may cause LECs to seek to raise local phone rates. That matter will become an issue for state commissions, and it is my hope that they will respond to any efforts to raise local rates by ensuring that consumers ultimately benefit from federal and state actions to implement the Telecommunications Act of 1996 and any related decisions.

May 7, 1997

Separate Statement
of
Commissioner Susan Ness

Re: Universal Service; Access Reform; Price Cap Review

Today we reach another milestone in our efforts to secure for consumers the myriad benefits made possible by the Telecommunications Act of 1996. We are steadfastly fulfilling the tasks assigned to us by Congress in a manner that will prove the wisdom -- and realize the vision -- of this landmark legislation.

Our pursuit has many facets. We must eliminate impediments to competition, ensure fair rules of engagement for all market participants, safeguard the interests of residential consumers, especially those with limited incomes and those in high cost areas, promote economic efficiency, and lower prices to consumers. Today's orders represent substantial progress on all these fronts.

Much of what we are doing is driven by law and by economics. But the results of our decisions have a human face:

> Will a poor family in Appalachia be able to summon the police or fire department in an emergency?
>
> Will a critically ill patient in a remote region of Montana have her tumor quickly and accurately diagnosed?
>
> Will a curious high-school freshman have an opportunity to view Thomas Jefferson's valedictory letter, in his own aged but still powerful hand?
>
> Will an elderly widow be less hesitant to break her loneliness with longer and more frequent calls to her great-grandchildren?

Today brings us closer to a day when these questions can all be answered "yes."

Fifteen months after enactment of the Telecommunications Act, the transition to a new industry paradigm remains far from complete. The road is not straight, or smooth, or free from peril. But a steady course -- and a shared determination -- can bring us to the desired destination.

We still have far to travel to resolve issues of support for high-cost areas. I believe we have a sound plan and a clear timetable for implementation, but we still face two main obstacles. The proxy models, already impressive feats of cost engineering, still require further refinement

before they can reliably be used to target federal cost support. And a new consensus must be achieved before support essential to maintain affordable telephone service in high-cost states can be drawn from states with lesser need, as I believe the Congress of the United States clearly intended. In the meantime, we can make only incremental changes in the implicit subsidies that currently support the high-cost services provided by large price cap telephone companies.

For the smaller rural companies, change will come even more gradually. This is consistent with Congress's expectation that competition would arrive more quickly in the cities and the suburbs. In the interim, we recognize that rural economies must not face unnecessary dislocations.

The need to avoid harmful dislocations, while also encouraging beneficial change, is crucial to much of what we are doing in the access reform and price cap orders. We are implementing many changes that will help to ensure an orderly transition from monopoly to fair and efficient competition.

In particular, the recovery of more costs through flat-rated charges instead of usage-sensitive charges will reduce the exposure of incumbent telephone companies to "cherry-picking" by new entrants, even as they also expand the range of customers likely to be offered competitive alternatives. Completion of the conversion to a three-part rate structure for tandem-switched transport will eliminate a historical artifact, but allow time for affected carriers to adjust. The new X-factor more accurately reflects the productivity gains that can reasonably be expected from price cap carriers, while avoiding radical reduction of telephone company access revenues and proposals that would have unfairly penalized those companies that have most assiduously conducted themselves in accordance with the incentives we deliberately created.

We prefer to rely on marketplace forces rather than regulation to drive investment decisions and price reductions. Some will fault us for not acting more aggressively; others will complain that we are too heavy-handed. My own view is that each decision, and all of the many issues in these orders, has been approached with balance and sensitivity, fairness and principle.

Not everyone will be satisfied. But no one can say that we have not read the law, considered economic theories and business realities, consulted our consciences, and sought to achieve as much fairness as is humanly possible.

I readily confess that I cannot muster the same passion for restructuring the arcane and impenetrable Transport Interconnection Charge as for devising a completely new regime to provide discounts for schools and libraries to access telecommunications and information services. Though I am fully committed to full realization of all of the universal service provisions, the Snowe-Rockefeller-Exon-Kerry provisions reflect an especially bold vision. For our part, we have used our creativity to harness the magic of competition to reduce the costs of the support program, created incentives to ensure only prudent use of supported services, targeted discounts to minimize the danger of a widening gap between information haves and have-nots, and sought at

every turn to maintain our commitment to competitive neutrality.

Even more important, we have sought to leave crucial decisions in the hands of educators and librarians, scattered throughout the country, rather than in the hands of Washington-based administrators. And, best of all, we have arranged a smooth take-off that will avoid creating unsustainable financial burdens on carriers and consumers, allowing competition and growth and declining prices -- rather than rate increases -- to supply the necessary funds.

In this area, as in the others addressed by today's orders, we have applied all our energy, and all our skill, to make the best decisions, based on our current knowledge and the law. A continuing commitment to constructive dialogue by all interested parties -- telephone companies, long distance companies, wireless companies, small businesses, large businesses, residential consumers, state regulators, and members of Congress -- is critical to continued progress. At the end of the day, fairness to all parties and demonstrable benefits to consumers are the standards by which we will all be judged.

May 7, 1997

Separate Statement of

Commissioner Rachelle B. Chong

Re: *In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, End User Common Line Charges, First Report and Order,* CC Docket Nos. 96-262, 94-1, 91-213, 95-72.

The Commission's access charge system has been a constant landmark in the telecommunications regulatory landscape during the past decade. Charges imposed by this access charge regime were unduly high, because these access charges were part of the funding mechanism for our patchwork quilt "system" of universal service funding.

With the passage of the Telecommunications Act of 1996 ("1996 Act"), however, the days of the current access charge system became numbered. The 1996 Act directed the Commission to create a universal service program that makes sense in a competitive marketplace.[800] Thus, it is appropriate and necessary for the Commission to do a thorough overhaul of our access charge regime in concert with implementation of the new universal service system ordered by the 1996 Act. To the extent possible, implicit subsidies must be identified and removed from access charges, and a sensible transition made to a market forces system where access charges are based on forward-looking economic cost. While I believe that today's decision generally finds the right balance in creating an improved access charge system, I write separately to explain our actions and comment on some aspects of our decision.

In this order, we direct that federal universal service support received by incumbent local exchange telephone carriers be used to reduce the interstate revenue requirement otherwise collected through interstate access charges. Thus, interstate implicit support will be identified and removed from interstate access charges, and instead we will provide universal service support through an explicit support mechanism ordered in our companion *Universal Service* decision.

The existence of universal service support subsidies within access charges, however, only partially explains why access charges create distortions in the marketplace and vast economic inefficiencies. Other culprits which drive access charges up for interexchange carriers include the current rate structures and pricing levels of our access charge system. These overly high charges are eventually passed through to

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800 47 U.S.C. Section 254 (e)(requiring that any universal service support "be explicit and sufficient to achieve the purposes of this section").

long distance consumers in the form of a higher per minute usage rate. This overly high usage rate unduly suppresses demand for long distance services.

Our actions today -- both in this docket and the price cap proceeding -- should bring about a significant drop in access charges and create favorable conditions for competitive entry into the access market. I strongly supported efforts to push the inflated access rates downwards closer towards forward-looking economic cost. While some parties demanded immediate deep cuts in access charges, we have chosen a more measured approach for the transitional period.

First, we create a framework to remove distortions and inefficiencies in the current rate structures and levels, by attempting to ensure that the rates for access are more reflective of the way that costs are actually incurred. Second, we will move residual costs that were traditionally recovered on a per-minute basis into a more efficient flat-rate charge system that will result in lower per minute usage rates. During the early years of our transition, we have targeted business and multiline residential customers to bear the greater share of the burden, in order to keep rates affordable to single line residential and single line business customers.

My one major concern about today's approach is the impact that these increased flat rate charges will have on small business consumers during the early years of the transition. Because the Commission has decided to protect single line customers from any rate increases, the new flat rate charges fall disproportionately upon the shoulders of multiline customers and may have a disparate impact on small businesses who may not be able to afford these costs. I have advocated lessening the impact of the new subscriber line charge levels and flat charges on small businesses, particularly those who do not make many long distance calls and will not experience the full benefits of lower per minute calling rates that will be realized by large businesses with high call volumes. While I believe we cushioned the impact on small businesses to some extent, I acknowledge that some small businesses with low volume calling patterns may see some rate increases. While unfortunate, this is the price we pay for protection of the single line customers.

In sum, we have adopted what I believe to be a balanced and fair approach to access charge restructuring, universal service, and price cap adjustments. We have attempted to accomplish a massive overhaul to both the access charge and universal service systems with the least amount of disruption to consumers. Nevertheless, it is unfortunate but inevitable that there will be some discombobulation as we make a transition to a more competitive marketplace. Ultimately, however, I am confident that the journey to the new competitive world mandated by the 1996 Act will be worthwhile for consumers, as costs flow where they should, and rates readjust to where the market drives them.