Before the
Federal Communications Commission
Washington, D.C. 20554

In the matter of	)	
	)	
Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers	))))	CC Docket No. 00-256
	)	
Federal-State Joint Board on Universal Service	))	CC Docket No. 96-45
	)	
Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation	)))	CC Docket No. 98-77
	)	
Prescribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers	))	CC Docket No. 98-166

SECOND REPORT AND ORDER AND FURTHER NOTICE OF PROPOSED RULEMAKING IN CC DOCKET NO. 00-256, FIFTEENTH REPORT AND ORDER IN CC DOCKET NO. 96-45, AND REPORT AND ORDER IN CC DOCKET NOS. 98-77 AND 98-166

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Reply Comment Date: 60 days from publication in the Federal Register

By the Commission: Chairman Powell and Commissioner Martin issuing statements; Commissioner Copps dissenting and issuing a statement.

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I. INTRODUCTION

1. In this Order, consistent with the Telecommunications Act of 1996,[1] we modify our rules to reform the interstate access charge and universal service support system for incumbent local exchange carriers (LECs) subject to rate-of-return regulation (non-price cap or rate-of-return carriers).[2] Our actions today are based on pending Commission proposals that build on interstate access charge reforms previously implemented for price cap carriers,[3] the

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[1] Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) (1996 Act). The 1996 Act amended the Communications Act of 1934 (Act). 47 U.S.C. §§ 151 *et seq*.

[2] *See infra*, § III.A for descriptions of rate-of-return and price cap regulation.

[3] *See Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation*, CC Docket No. 98-77, Notice of Proposed Rulemaking, 13 FCC Rcd 14238 (1998) (*1998 Notice*). The *1998 Notice* and the comments filed in response thereto are incorporated into the above-captioned proceeding.

record developed in the above-captioned proceedings, and our consideration of the Multi-Association Group (MAG) plan.[4] They are designed to bring the American public benefits of competition and choice by rationalizing the access rate structure and driving per-minute rates towards lower, more cost-based levels, while furthering universal service goals. In the attached Further Notice, we seek additional comment on the MAG incentive regulation plan and other means of providing opportunities for rate-of-return carriers to increase their efficiency and competitiveness.

2. This Order largely completes the interstate access charge and universal service support reforms the Commission initiated following the passage of the 1996 Act.[5] First, the Commission reformed intrastate high-cost support for non-rural carriers.[6] Second, it addressed the interstate access charge and universal service support system for price cap carriers.[7] Third, it reformed intrastate high-cost support for rural carriers.[8] We now adopt interstate access charge and universal service support reforms for rate-of-return carriers.

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[4] The MAG is comprised of the National Rural Telecom Association (NRTA), National Telephone Cooperative Association (NTCA), Organization for the Promotion and Advancement of Small Telecommunications Companies (OPASTCO), and United States Telecom Association (USTA). The MAG plan is attached as Appendix A to the Notice in this proceeding. *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation*, CC Docket No. 98-77, *Prescribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket No. 98-166, Notice of Proposed Rulemaking, 16 FCC Rcd 460, 475 (2001) (*MAG Notice*).

[5] *See Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, End User Common Line Charges*, CC Docket Nos. 96-262, 94-1, 91-213, 95-72, First Report and Order, 12 FCC Rcd 15982 (1997) (*Access Charge Reform Order*) (subsequent history omitted); *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order, 12 FCC Rcd 8776, 9164-65 (1997) (*Universal Service First Report and Order*) (subsequent history omitted); *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Recommended Decision, 12 FCC Rcd 87 (Jt. Bd. 1996).

[6] *See Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Ninth Report and Order and Eighteenth Order on Reconsideration, 14 FCC Rcd 20432 (1999) (*Ninth Report and Order*), *rev'd and remanded for further consideration*, *Qwest Corp. v. FCC*, 258 F.3d 1191 (10th Cir. 2001); *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Seventh Report and Order and Thirteenth Order on Reconsideration, *Access Charge Reform*, CC Docket No. 96-262, Fourth Report and Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd 8077 (1999) (subsequent history omitted); *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Second Recommended Decision, 13 FCC Rcd 24744 (Jt. Bd. 1998); *see infra*, n.8 for a definition of the term "rural carrier."

[7] *Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers*, CC Docket Nos. 96-262 and 94-1, Sixth Report and Order, *Low-Volume Long-Distance Users*, CC Docket No. 99-249, Report and Order, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Eleventh Report and Order, 15 FCC Rcd 12962 (*Interstate Access Support Order*), *aff'd in part, rev'd in part, and remanded in part*, *Texas Office of Public Util. Counsel et al. v. FCC*, No. 00-60434 (5th Cir. September 10, 2001).

[8] *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Fourteenth Report and Order and Twenty-Second Order on Reconsideration, *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256, Report and Order, 16 FCC Rcd 11244 (released May 23, 2001) (*Rural Task Force Order*). The term "rural carrier" refers to local exchange carriers that meet the definition of rural telephone company in section 153(37) of the Act of 1934. 47 U.S.C. § 153(37). Most, but not all, rate-of-return carriers meet this definition.

3. The reforms we adopt today are designed to establish a "pro-competitive, deregulatory national policy framework" for the United States telecommunications industry, and to carry out the universal service policies embodied in the 1996 Act. Specifically, we align the interstate access rate structure more closely with the manner in which costs are incurred, and create a universal service support mechanism to replace implicit support in the interstate access charges with explicit support that is portable to all eligible telecommunications carriers. Our actions are consistent with prior Commission actions to foster competition and efficient pricing in the market for interstate access services, and to create universal service mechanisms that will be secure in an increasingly competitive environment. By simultaneously removing implicit support from the rate structure and replacing it with explicit, portable support, this Order will provide a more equal footing for competitors in the local and long distance markets, while ensuring that consumers in all areas of the country, especially those living in high-cost, rural areas, have access to telecommunications services at affordable and reasonably comparably rates. This Order also is tailored to the needs of small and mid-sized local telephone companies serving rural and high-cost areas, and will help provide certainty and stability for rate-of-return carriers, encourage investment in rural America, and provide important consumer benefits.

4. In implementing the provisions of the 1996 Act, the Commission consistently has taken into consideration the differences between price cap and rate-of-return carriers, as well as the wide diversity among rate-of-return carriers. Fewer than ten large price cap carriers serve the vast majority of access lines nationwide, compared to over 1,300 rate-of-return carriers serving less than eight percent of lines. Rate-of-return carriers are typically small, rural telephone companies concentrated in one area, but they range in size from a few hundred lines to approximately one million, and some have multiple affiliates with operations in several states. They generally have higher operating and equipment costs than price cap carriers due to lower subscriber density, smaller exchanges, and limited economies of scale. They also rely more heavily on revenues from interstate access charges and universal service support.[9]

5. Thus, in 1997, when the Commission adopted interstate access charge reforms for price cap carriers, it recognized the need for more comprehensive review of the issues and circumstances specific to rate-of-return carriers.[10] In 1998, the Commission created a separate docket to undertake such review.[11] While it proposed reforms similar to those adopted for price cap carriers, the Commission recognized that differences between the two groups might warrant a different approach in some matters, including a different transition to more efficient, cost-based rates. This docket remained open in 2000 when the Commission adopted comprehensive access charge and universal service reform for price cap carriers, based in part on a proposal submitted by the Coalition for Affordable Local and Long Distance Service (CALLS).[12] As the Commission observed in the *Interstate Access Support Order*, access charge and universal

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[9] The Rural Task Force documented the nature and scope of these differences in a white paper entitled "The Rural Difference" (White Paper 2). *See infra*, § III.C. The Commission's *1998 Notice*, 13 FCC Rcd at 14244 paras. 15-16, and numerous commenters in the above-captioned proceedings also address such differences.

[10] *Access Charge Reform Order*,12 FCC Rcd at 16126-27 paras. 330-332.

[11] *1998 Notice*, 13 FCC Rcd at 14240 paras. 3-4.

[12] *See Interstate Access Support Order*, 15 FCC Rcd at 12964 para. 1.

service reform presents a series of controversial and interrelated issues without a single, precise solution.[13] "There are instead ranges of reasonable solutions," and the Commission must select one that appropriately balances the competitive and universal service goals set forth in the Act.[14] The consensus represented by the CALLS plan, which was developed by local and long distance telephone companies that represented historically adverse interests, helped the Commission select, from among various legitimate possible approaches, one that achieved its competitive and universal service goals in a manner that is reasonable and in the public interest.[15]

6. The CALLS plan moved the Commission towards its competitive and universal service goals for the access services market, but compounded the need for analogous reform among rate-of-return carriers. Although there may not be significant competition in many high-cost, rural areas, rate-of-return carriers are not insulated from competitive pressures.[16] High per-minute charges may place them at a disadvantage in competing with new market entrants, including neighboring price cap carriers.[17] In addition, higher rates and implicit subsidies may discourage efficient local and long distance competition in rural areas and limit consumer choice.

7. Recognizing the need for reform, four incumbent LEC associations developed the MAG plan, a comprehensive proposal addressing numerous issues facing rate-of-return carriers, including access charge reform and universal service support.[18] The MAG plan was submitted to the Commission on October 20, 2000.[19] The MAG plan represents a significant achievement, bringing together a major segment of the incumbent LEC industry with a broad range of views and interests. The Commission released the *MAG Notice* on January 5, 2001, stating its intention to fully and expeditiously consider the MAG plan. The Commission requested comment on whether it should adopt the MAG plan as an integrated package, as requested by the MAG, or adopt specific aspects of the plan. The Commission specifically invited comment from interested parties that were not MAG members, including competitive carriers, interexchange carriers, and wireless providers, as well as consumer groups and state commissions. The Commission also encouraged input from the Federal-State Joint Board on Universal Service (Joint Board) on the universal service aspects of the MAG plan.

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[13] *See id.* at 12978 para. 38.

[14] *Id.* at 12981-82 para. 49; *see id.* at 12973 para. 27 ("As we devise a transition to a more economically rational approach to access charges and universal service, we need to balance various and sometimes conflicting interests—including promotion of competition, deregulation, maintaining affordability for all, and avoiding rate shock to consumers.").

[15] *Id.* at 12981 para. 49 ("we must exercise our own independent judgment to ensure that any proposal we adopt in this area—even a proposal that reflects a substantial degree of consensus among historically adverse parties—is reasonable and in the public interest.").

[16] ICORE Comments at 4-5 ("Some are located near a larger LEC's town or city, where there exist at least 'edge out' competitive opportunities, while others are almost totally isolated. . . . Some serve one or two large business customers which, if lost to a competitor, would be financially devastating, while others serve only residences and very small businesses. Some face imminent, aggressive competition, while others have as yet to encounter any serious competitive threats.").

[17] *See 1998 Notice*, 13 FCC Rcd at 14239 para. 2.

[18] *MAG Notice*, 16 FCC Rcd at 461 para. 3; *see infra*, § III.A.

[19] *MAG Notice*, 16 FCC Rcd at 460, n. 1.

8. We appreciate the MAG's efforts to develop a consensus among rate-of-return carriers. The MAG plan contains many worthwhile features that, based on our independent consideration of the record and the alternative proposals submitted by other commenters, we adopt in this Order. Commenters have raised significant concerns about certain features of the MAG plan, however, and we are persuaded that some of these concerns have merit. In particular, the MAG proposes that certain access charge reforms be optional, and that only those carriers electing the MAG incentive plan be eligible for new, explicit universal service support to replace implicit support in access charges. We conclude that leaving the removal of implicit support to the discretion of individual carriers is neither consistent with the mandate of the 1996 Act nor justified from a public policy standpoint.[20] We agree with commenters who argue that these proposals could preclude many rate-of-return carriers from fully participating in interstate access charge reform, leading to increased access rate disparities among local telephone companies that is not in the public interest.

9. We also find merit to criticisms of the MAG incentive plan raised by many commenters. The Commission consistently has expressed its commitment to providing incentives for smaller telephone companies to become more efficient and innovative.[21] As proposed, however, the MAG incentive plan does not appear to provide incentives for cost efficiency gains that will benefit consumers through lower rates and improved services. Moreover, we are concerned that the MAG incentive plan could lead to excessive growth in the universal service fund, because it provides for annual increases in per-line support that would not be tied to carrier costs or constrained by any offset for productivity gains.

10. Based on our examination of the record, therefore, we cannot conclude that adoption of the MAG plan in its entirety would benefit consumers and serve the public interest.[22] Although we agree with the MAG that a comprehensive solution to the regulatory issues facing rate-of-return carriers would be ideal, we cannot wait for such a solution. Rather, we conclude that we must proceed with interstate access charge reform for rate-of-return carriers, while continuing to explore alternative regulatory methods that would create benefits for both rate-of-return carriers and their customers.

11. Our actions are consistent with reforms previously implemented for price cap carriers, and will provide a number of consumer benefits. By rationalizing the rate structure for recovery of interstate-allocated loop costs, we are fostering competition for residential subscribers in rural areas by facilities-based carriers. By reducing per-minute switched access rates towards cost-based levels, we are enhancing incentives for interexchange carriers to originate service in rural areas and facilitating long distance toll rate averaging. To a large

[20] *See COMSAT Corp. v. FCC*, 250 F.3d 931, 938-40 (5th Cir. 2001) (holding that Commission cannot allow carriers to choose whether to recover their universal service contributions through interstate access charges because such recovery constitutes an implicit subsidy).

[21] *See, e.g., 1998 Notice*, 13 FCC Rcd at 14240 para. 5; *Regulatory Reform for Local Exchange Carriers Subject to Rate of Return Regulation*, CC Docket No. 92-135, Report and Order, 8 FCC Rcd 4545 (1993).

[22] *See, e.g.,* Alaska Commission Comments at 2; GCI Comments at 2; Sprint Comments at 3-4; *see also* Wyoming Commission Comments at 1-2.

extent, these modifications already have been implemented for the vast majority of subscribers nationwide.

12. At the same time, we have tailored our approach to the specific challenges faced by small local telephone companies serving rural and high-cost areas. Although per-minute switched access charges will be reduced for all rate-of-return carriers, they will retain the flexibility to establish rates based on their own costs in the areas they serve, rather than being forced to conform to a prescribed target rate.[23] Rate-of-return carriers will continue to be permitted to set rates based on the authorized rate of return of 11.25 percent. And the new, uncapped support mechanism that we create will provide certainty and stability by ensuring that the rate structure modifications we adopt do not affect overall recovery of interstate access costs. In this regard, we are mindful of arguments that a cap is necessary to ensure sufficient, but not excessive, universal service funding. As the Commission previously has observed, the amount of implicit support contained in interstate access charges is a difficult, controversial issue without simple or precise solutions.[24] This is particularly so for rate-of-return carriers, given their size, diversity, and regulatory history.[25] Under the circumstances, we are adopting a cautious approach which rationalizes the access rate structure and converts identifiable implicit subsidies to explicit support, without endangering this important revenue stream for rate-of-return carriers. Based on our examination of the record, we conclude that this approach strikes a fair, reasonable balance among the policies of the 1996 Act.

13. Our actions today are not designed as a permanent solution. As we move forward, we will continue to refine our policies to achieve the goals of the 1996 Act. In particular, as the terms of the CALLS plan and the Rural Task Force plan near their respective ends,[26] we anticipate that the Commission will review whether the measures we adopt here continue to be consistent with our competitive goals for the local exchange and exchange access services markets, as well as with our long-term universal service plans.

14. We also remain committed to investigating alternative regulatory methods that would benefit both rate-of-return carriers and their customers. In the attached Further Notice, therefore, we seek additional comment on the MAG incentive plan, and on other means of providing opportunities for rate-of-return carriers to increase their efficiency and competitiveness in the interstate access services market.

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[23] As discussed below, the MAG proposes that carriers electing its incentive plan would have a weighted aggregate target for switched access charges of 1.6 cents per minute, whereas some commenters advocate a lower, mandatory target for all rate-of-return carriers of .95 cents per minute. *See infra*, § IV.B.2.a.

[24] *See Interstate Access Support Order*, 15 FCC Rcd at 12978 para. 38.

[25] *See, e.g., Rural Task Force Order*, 16 FCC Rcd at 11247 paras. 4-5.

[26] *See Rural Task Force Order*, 16 FCC Rcd at 11309-13 paras. 167-77 (approved for five years beginning June, 2001); *Interstate Access Support Order*, 15 FCC Rcd at 12977 para. 37 (approved for five years beginning July 1, 2000).

II. EXECUTIVE SUMMARY

15. In this Order, we take the following actions to reform the interstate access charge and universal service support system for rate-of-return carriers:

- We adopt the MAG proposal to increase Subscriber Line Charge (SLC) caps for rate-of-return carriers to the levels established for price cap carriers. The residential and single-line business SLC cap will increase to $5.00 on January 1, 2002, and may increase up to $6.00 on July 1, 2002, and $6.50 on July 1, 2003, subject to a cost review study for the SLC caps of price cap carriers. The multi-line business SLC cap will increase to $9.20 on January 1, 2002. The revised SLC caps, which conform to those already implemented for most subscribers nationwide, will foster efficient competition and greater choice for consumers, while ensuring that SLC rates in rural areas remain affordable and reasonably comparable to those in urban areas. Lifeline support will be increased in an amount equal to any SLC rate increases for low-income subscribers.

- We modify our rules to allow limited SLC deaveraging, which will enhance the competitiveness of rate-of-return carriers by giving them important pricing flexibility. The SLC deaveraging method we adopt combines the safeguards adopted for price cap carriers with the flexibility of the Rural Task Force universal service support disaggregation scheme, in order to address the significant diversity among rate-of-return carriers.

- We find that the Carrier Common Line (CCL) charge, an inefficient cost recovery mechanism and implicit subsidy, should be removed from the common line rate structure. This measure will rationalize the access rate structure and move per-minute switched access rates towards lower, cost-based levels. To replace the CCL charge, a new universal service support mechanism will be implemented beginning on July 1, 2002. The CCL charge will be eliminated as of July 1, 2003, when SLC caps are scheduled to reach their maximum levels.

- We adopt measures to reform the local switching and transport rate structure. In particular, we shift the non-traffic sensitive costs of local switch line ports to the common line category, and reallocate the remaining costs contained in the Transport Interconnection Charge (TIC) to other access rate elements. These measures align the rate structure more closely with the manner in which costs are incurred and reduce per-minute switched access charges.

- We do not adopt proposals to prescribe a single, target rate for per-minute charges, either on an optional or a mandatory basis. Neither the MAG's proposed rate of 1.6 cents nor the .95-cent rate advocated by other parties are supported by cost data. The reforms that we adopt in this Order will reduce per-minute charges for all rate-of-return carriers, while giving them the flexibility to establish rates based on their own costs in the areas they serve.

- We address proposals to modify the rate structure for general support facilities (GSF) costs, marketing expenses, and special access services. We generally conclude that a different approach is warranted from that adopted for price cap carriers to avoid imposing undue administrative burdens on small local telephone companies serving rural and high-cost areas.

- We create a new universal service support mechanism, Interstate Common Line Support, to convert implicit support in the access rate structure to explicit support that is available to all eligible telecommunications carriers. Interstate Common Line Support will recover any shortfall between the allowed common line revenues of rate-of-return carriers and their SLC revenues, thereby replacing the CCL charge. The new support mechanism will ensure that changes in the rate structure do not affect the overall recovery of interstate access costs by rate-of-return carriers serving high-cost areas.

- We do not adopt MAG proposals to impose new requirements on interexchange carriers regarding optional calling plans, minimum monthly fees, and pass-through of savings from lower access rates. Among other things, we conclude that these requirements are unnecessary, inconsistent with our deregulatory approach to the interexchange services market, and would entail undue administrative costs and burdens.

- Consistent with the MAG proposal, we streamline the rules for the introduction of new switched access services by extending to rate-of-return carriers the same flexibility that price cap carriers now have, with the exception of certain cost support and notice requirements.

- We terminate the above-captioned proceeding for prescription of the authorized rate-of-return, which was set at 11.25 percent in 1990.

- We explain that the Commission, pursuant to the recommendations of the Federal-State Joint Board on Jurisdictional Separations, recently froze jurisdictional separations factors in a manner consistent with the MAG proposal and, therefore, no further action regarding separations is necessary.

- In the attached Further Notice, we seek further comment on the MAG incentive plan and how it might be modified to provide incentives for cost efficiency gains by rate-of-return carriers that will benefit consumers through lower rates and improved services. We also request comment on additional pricing flexibility measures for rate-of-return carriers, and ask for further comment on the MAG's proposed changes to the Commission's "all-or-nothing rule."[27] We also seek comment on merging the Long Term Support mechanism into Interstate Common Line Support as of July 1, 2003, when the CCL charge will be eliminated.

III. BACKGROUND

A. Interstate Access Charges

16. Interstate access charges are tariffed charges imposed by incumbent LECs to recover the costs of providing access to their networks for interstate or long distance service.[28] Part 69 of the Commission's rules establishes a mandatory rate structure for switched access

[27] 47 C.F.R. § 61.41. This rule generally requires rate-of-return carriers that merge with price cap carriers to convert to price cap regulation, in order to protect against cost shifting and other improper actions. *See infra*, § V.C.1.

[28] The Commission uses a multi-step process to identify the cost of providing interstate access service. First, an incumbent LEC reports all of its expenses, investments, and revenues in accordance with the Uniform System of Accounts. 47 C.F.R. §§ 32.1, *et seq.* Second, costs are divided between regulated and nonregulated services. *Id.* at §§ 64.901-64.904. Third, the separations process divides costs associated with regulated services between the state and federal jurisdictions. 47 C.F.R. Part 36.

services.[29] The Commission adopted the Part 69 rules in 1983, following the breakup of AT&T's monopoly over local and long distance service.[30]

17. The Commission has long recognized that, to the extent possible, interstate access costs should be recovered in the manner in which they are incurred. In particular, non-traffic sensitive costs—costs that do not vary with the amount of traffic carried over the facilities—should be recovered through fixed, flat charges, and traffic sensitive costs should be recovered through per-minute charges.[31] This approach fosters competition and efficient pricing. The Part 69 rules, however, are not fully consistent with this goal. For example, the costs of the common line or loop that connects an end user to a LEC central office should be recovered from the end user through a flat charge, because loop costs do not vary with usage.[32] Yet the SLC, a flat monthly charge assessed directly on end users to recover interstate loop costs, has, since its inception, been capped due to affordability concerns. The Commission's rules provide for recovery of rate-of-return carriers' residual interstate loop costs through the CCL charge, a per-minute charge assessed on interexchange carriers.[33] Interexchange carriers, in turn, pass this charge on to their customers in the form of higher long distance rates.

18. By artificially inflating long distance per-minute rates, such rate structure inefficiencies suppress demand for interstate long distance services, and create implicit subsidies from high-volume to low-volume users of interstate long distance service.[34] Implicit subsidies have a disruptive effect on competition in the market for local exchange and exchange access services.[35] In addition, by contributing to rate disparities between rate-of-return and price cap carriers, rate structure inefficiencies may increase the burden of compliance with toll rate averaging requirements[36] and discourage interexchange carriers from competing in rural and high-cost areas, thus limiting consumer choice in those areas.[37]

19. Whereas the Part 69 rules prescribe the rate structure, rate levels are governed by rate-of-return or price cap regulation. Historically, all incumbent LECs were governed by rate-of-return regulation, under which rate levels are directly linked to a carrier's embedded or

[29] 47 C.F.R. Part 69. The Part 69 rules do not prescribe a rate structure for special access services, which employ dedicated rather than shared facilities to route interstate calls.

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

[31] *Access Charge Reform Order*, 12 FCC Rcd at 15992-93 para. 24.

[32] *Id.* at 16013 para. 77 ("Because common line costs do not vary with usage, these costs should be recovered on a flat-rated instead of 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.").

[33] 47 C.F.R. § 69.105.

[34] *See Access Charge Reform Order*, 12 FCC Rcd at 15986 para. 6, 15995-96 para. 30, 16013 para. 76.

[35] *See infra*, § III.B.

[36] *See* 47 C.F.R. § 64.1801(a) ("The rates charged by providers of interexchange telecommunications services to subscribers in rural and high-cost areas shall be no higher than the rates charged by each such provider to its subscribers in urban areas."); *see also* 47 U.S.C. § 254(g).

[37] *See infra*, § IV.B.2.a.

accounting costs.[38] Rate-of-return carriers charge rates that are designed to provide the revenue required to cover costs and to achieve a prescribed return on investment. In 1991, the Commission implemented a system of price cap regulation for the largest incumbent LECs.[39] Price cap regulation provides incentives to increase efficiency and reduce costs by permitting carriers to earn higher returns, so long as their rates are set at or below a cap.[40] While price cap regulation has greater potential rewards for incumbent LECs, it also entails greater risks.[41] Therefore, the Commission made price cap regulation voluntary for most incumbent LECs.[42]

20. Rather than developing their own tariffed rates, rate-of-return carriers may participate in pools administered by the National Exchange Carrier Association (NECA). Pooling carriers charge rates set by NECA, pool their interstate access revenues, and recover their costs from the pools, including a return on investment.[43] Carriers that participate in the common line pool are eligible for Long Term Support (LTS) to reduce their CCL charges.[44] Pooling also serves important risk-sharing and administrative functions for rate-of-return carriers.[45] Because participation in pools, as currently structured, involves significant sharing of financial risks, however, it weakens incentives for carriers to operate efficiently.[46]

B. Universal Service

21. One of the primary purposes of universal service support is to help provide access to telecommunications service in areas where the cost of such service otherwise might be

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[38] *Access Charge Reform Order*, 12 FCC Rcd at 15993 para. 25. The term "embedded costs" refers to a carrier's historic costs, as reflected in its books.

[39] *Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786, 6818-19 para. 262-65 (1990) (subsequent history omitted). Specifically, the Commission mandated price cap regulation for the Regional Bell Operating Companies and GTE, and permitted others to adopt price cap regulation voluntarily, subject to certain conditions.

[40] *See Interstate Access Support Order*, 15 FCC Rcd at 12968-69 paras. 16-17.

[41] Price caps initially were based on the largest carriers' previously approved rates, subject to adjustment by inflation and an offsetting productivity factor or "X-factor" that ultimately reached 6.5 percent. Thus, price cap carriers risked loss of revenue if they failed to achieve sufficient productivity gains.

[42] In particular, the Commission recognized that a single productivity factor could prove unduly burdensome for small and mid-sized incumbent LECs. *See Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Order on Reconsideration, 6 FCC Rcd 2637, 2699 para. 138 (1991).

[43] Some smaller rate-of-return carriers receive compensation based on average schedules rather than their own costs. *See 1998 Notice*, 13 FCC Rcd at 14244 para. 17 ("Average schedule recovery reduces the cost to small rate-of-return LECs of conducting separate cost studies by providing compensation based on cost estimates derived from comparable cost companies.").

[44] *See infra*, § III.B.

[45] *See Regulatory Reform for Local Exchange Carriers Subject to Rate of Return Regulation*, CC Docket No. 92-135, Notice of Proposed Rulemaking, 7 FCC Rcd 5023, 5030 (1992); *MTS and WATS Market Structure*, CC Docket No. 78-72, *Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board*, CC Docket No. 80-286, Memorandum Opinion and Order on Reconsideration, 3 FCC Rcd 4543, 4560 n.108 and accompanying text (1988).

[46] *See Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd at 6819 para. 266.

prohibitively expensive.[47] Historically, this purpose has been achieved both through explicit monetary payments and implicit support flows to enable carriers to serve high-cost areas at below-cost rates. Congress established principles for the preservation and advancement of universal service in the 1996 Act, including the principle that the Commission should create explicit universal service support mechanisms that will be secure in a competitive environment.[48] Congress also articulated a national goal that consumers in all regions of the nation, including rural, insular, and high-cost areas, should have access to telecommunications services at rates that are affordable and reasonably comparable to rates charged for similar services in urban areas.[49] Section 254 provides that federal universal service support mechanisms should be specific, predictable, and sufficient to achieve the purposes of the Act.[50]

22. Three federal universal service mechanisms currently provide explicit support for rate-of-return carriers. LTS provides support for interstate loop costs to rate-of-return carriers that participate in the NECA common line pool.[51] Prior to 1989, all incumbent LECs were required to participate in the common line pool.[52] As of 1989, carriers were allowed to withdraw from the common line pool, provided they made LTS payments to the pool in order to prevent the CCL rates of the remaining carriers from rising significantly above the national average.[53] In 1997, the Commission concluded that LTS should be continued, but that modifications were necessary to make it explicit, portable, and competitively neutral.[54] Therefore, the Commission removed LTS from the interstate access charge system and modified its calculation and

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[47] *Rural Task Force Order*, 16 FCC Rcd at 11251 para. 13.

[48] *See* 47 U.S.C. § 254(e).

[49] *Id.* at § 254(b)(3).

[50] *Id.* at §§ 254(b)(5), (e).

[51] 47 C.F.R. §§ 54.303, 54.311(a).

[52] *See Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Fourth Order on Reconsideration, *Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, End User Common Line Charge*, CC Docket Nos. 96-262, 94-1, 91-213, 95-72, Report and Order, 13 FCC Rcd 5318, 5352 para. 56 (1997) (*Universal Service Fourth Order on Reconsideration*).

[53] *See MTS and WATS Market Structure*, CC Docket No. 78-72, *Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board*, CC Docket No. 80-286, Report and Order, 2 FCC Rcd 2953, 2957 para. 33 (1987) ("This should avoid unnecessary pressures for bypass in high cost areas, preserve toll averaging, and encourage competitive providers of interstate switched services to enter such markets.").

[54] *Universal Service First Report and Order*, 12 FCC Rcd at 9165 para. 757 ("we agree with the Joint Board that LTS payments serve the public interest by reducing the amount of loop cost that high cost LECs must recover from IXCs through CCL charges and thereby facilitating interexchange service in high cost areas consistent with the express goals of section 254.").

distribution scheme.[55] Rate-of-return carriers also receive federal high-cost support for intrastate services through the high-cost loop support mechanism and Local Switching Support (LSS).[56]

23. Rate-of-return carriers also receive implicit support for universal service from various sources, including the interstate access rate structure.[57] For example, recovery of non-traffic sensitive costs through per-minute rates creates an implicit support flow from high- to low-volume users of interstate long distance service.[58] Implicit support is incompatible with a competitive market for local exchange and exchange access services. As the Commission noted in 1997, "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 below cost and an otherwise efficient provider would have no incentive to enter the market."[59] Rate-of-return carriers have expressed particular concern that high per-minute charges may place them at a disadvantage in competing for high-volume customers, jeopardizing an important source of revenue.[60]

C. Prior Commission Actions and Proposals

24. With the passage of the 1996 Act, the Commission undertook reform of both interstate access charges and federal universal service support mechanisms. In 1997, it adopted measures to move interstate access charges for price cap carriers towards lower, cost-based levels by phasing out loop and other non-traffic sensitive costs from per-minute charges, and providing for recovery of such costs through more economically efficient, flat charges.[61] In order to phase out CCL charges, the Commission created the presubscribed interexchange carrier charge (PICC), a flat, monthly charge imposed on interexchange carriers. Among other things, the Commission also shifted the non-traffic sensitive costs of line ports from per-minute local

[55] *Id*. LTS is now calculated by adjusting previous support levels to reflect the annual percentage change in the Department of Commerce's GDP-CPI. *Universal Service Fourth Order on Reconsideration*, 13 FCC Rcd at 5355-56 para. 61. LTS provides approximately $487 million in annual universal service support. *See* Federal Universal Service Support Mechanisms Fund Size Projections and Contribution Base For the Third Quarter 2001, Appendix HC 7 (Universal Service Administrative Company, May 2, 2001).

[56] High-cost loop support provides support for a variable percentage of the loop costs of rural carriers, based on embedded costs averaged over entire study areas. 47 C.F.R. §§ 36.601, 54.301. The Commission recently adopted the Rural Task Force plan for reform of the high-cost loop support mechanism. *See infra*, § III.C. LSS is available to support a portion of the intrastate switching costs of carriers with 50,000 or fewer lines. 47 C.F.R. §§ 36.125(b), 54.301. By providing this federal support for intrastate costs, the Commission assists the states in ensuring that intrastate rates remain affordable and reasonably comparable.

[57] *See Ninth Report and Order*, 14 FCC Rcd at 204441 para. 15 ("In contrast to explicit support, some state rate designs and, to a lesser extent, the federal interstate access charge system, have provided implicit high-cost support flowing from (1) urban areas to rural areas; (2) business customers to residential customers; (3) vertical services to basic service; and/or (4) long distance service to local service.").

[58] *See Interstate Access Support Order*, 15 FCC Rcd at 13046 para. 201.

[59] *Access Charge Reform Order*, 12 FCC Rcd at 15996 para. 30; *see 1998 Notice*, 12 FCC Rcd at 14243 para. 12.

[60] *1998 Notice*, 13 FCC Rcd at 14239-40 para. 2; *see* Innovative Telephone Comments at 4; Roseville Tel. Co. Reply Comments at 4; TDS Comments in CC Docket No. 98-77 at 22.

[61] *Access Charge Reform Order*, 12 FCC Rcd at 15998 para. 35.

switching charges to the common line category,[62] and established a mechanism to phase out the per-minute transport interconnection charge (TIC).[63] The Commission recognized that rate structure modifications alone would not be sufficient "to create a system that accurately reflects the true cost of service in all respects."[64] But it concluded that a market-based approach which relies primarily on competition to drive access charges down to cost-based levels generally would serve the public interest better than prescribing rates.[65]

25. The *Interstate Access Support Order*, in which the Commission adopted, in large part, the CALLS plan, continued the process of access charge and universal service reform for price cap carriers. This order established a more straightforward, economically rational common line rate structure by increasing SLC caps and phasing out the PICC, which suffered from inefficiencies due to the indirect flow of loop costs to end users through interexchange carriers.[66] It also addressed controversy regarding the appropriate size of the X-factor by changing its function from a productivity offset into a tool for reducing per-minute access charges to target levels proposed by the CALLS members.[67] Specifically, the Commission adopted target rates of 0.55 cents for the largest price cap carriers, 0.95 cents for those with subscriber densities of less than 19 per square mile, and 0.65 cents for all other price cap carriers.[68] In addition, the Commission approved an immediate $2.1 billion reduction in per-minute switched access charges, which the CALLS interexchange carrier members committed to pass through to their customers.[69]

26. Furthermore, the Commission established a new interstate access support mechanism, capped at $650 million annually, to replace implicit support in the interstate access charges of price cap carriers. It found $650 million to be a reasonable amount that would provide sufficient, but not excessive, support.[70] In this regard, it observed that a range of funding levels might be deemed "sufficient" for purposes of the 1996 Act, and that "identifying an amount of implicit support in our interstate access charge system to make explicit is an imprecise exercise."[71]

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[62] *Id.* at 16035-40 paras. 125-34. Line ports connect subscriber lines to the switch in the LEC central office. *See id.* at 16034-35 para. 123; *infra*, § IV.B.1.

[63] *Access Charge Reform Order*, 12 FCC Rcd at 16073-86 paras. 210-43; *infra*, § IV.B.1.

[64] *Access Charge Reform Order*, 12 FCC Rcd at 16001 para. 42.

[65] *Id.* at 16001-02 paras. 44-46. The Commission reasoned that a market-based approach was more consistent with the 1996 Act, and that tools for accurately prescribing rates at economic cost levels were not yet available.

[66] *See Interstate Access Support Order*, 15 FCC Rcd at 12970 para. 19.

[67] *Id.* at 13028-39 paras. 160-184; *see Texas Office of Public Utility Counsel v. FCC*, No. 00-60434 at § III.C (remanding X-factor issue for further consideration); *see also supra*, n.41.

[68] 47 C.F.R. 61.3(qq); *see Interstate Access Support Order*, 15 FCC Rcd at 13029 para. 162.

[69] *Interstate Access Support Order*, 15 FCC Rcd at 13025 paras. 151-52.

[70] *Id.* at 13046 para. 202; *see Texas Office of Public Utility Counsel v. FCC*, No. 00-60434 at § III.B (remanding $650 million figure for further analysis and explanation).

[71] *Interstate Access Support Order*, 16 FCC Rcd. at 13046 para. 201 ("The various implicit support flows (*e.g.*, business to residential, high-volume to low-volume, and geographic rate averaging) are not easily severable and

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27. The Commission recently modified its rules for providing intrastate high-cost loop support to rural carriers,[72] based on proposals made by the Rural Task Force and recommended by the Joint Board. The Rural Task Force recommended against use of the Commission's forward-looking mechanism for non-rural carriers to calculate high-cost loop support for rural carriers.[73] Instead, it recommended use for the next five years of a modified version of the existing high-cost loop support mechanism used for rural carriers.[74] The Commission concluded that the Rural Task Force plan would "provide certainty and stability for rural carriers over the next five years," and that the provisions for disaggregation and targeting of high-cost support would "facilitate competitive entry into high-cost areas, bringing the benefits of competition to consumers in rural areas."[75] The Commission also stated its intention to develop "a long-term plan that better targets support to carriers serving high-cost areas, while at the same time recognizing the significant differences among rural carriers, and between rural and non-rural carriers."[76]

28. The foundation for the Rural Task Force plan was a series of six white papers addressing, among other things, the nature and scope of differences between rural and non-rural carriers, as well as the wide diversity among rural carriers.[77] Because the categories of rural and non-rural carrier largely overlap with those of rate-of-return and price cap carrier,[78] the Rural Task Force's findings are pertinent here. The Rural Task Force found that rural carriers are significantly different from non-rural carriers, and that individual rural carriers vary widely from each other. Rural carriers generally serve more sparsely populated areas and fewer large, high-volume subscribers than non-rural carriers.[79] The isolation of rural carrier service areas creates numerous operational challenges, including high loop costs, high transportation costs for personnel, equipment, and supplies, and the need to invest more resources to protect network reliability.[80] In addition, rural carriers generally have fewer customers per switch, higher total

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quantifiable. Moreover, the competitive pricing pressures present during this transitional period between monopoly and competition present additional complexities in identifying a specific amount of implicit support.").

[72] *See Rural Task Force Order*, 16 FCC Rcd at 11249 para. 12.

[73] *Id.* at 11254 para. 18. The Commission determined in 1997 that federal universal service support for all carriers should be based on the forward-looking economic cost of providing the supported services. *Universal Service First Report and Order*, 12 FCC Rcd at 8899-901 paras. 224-229. The Rural Task Force was appointed to assist "in identifying the issues unique to rural carriers and analyzing the appropriateness of proxy cost models for rural carriers." *Id.* at 8917 para. 253; *see Rural Task Force Order*, 16 FCC Rcd at 11253 para. 16.

[74] *Rural Task Force Order*, 16 FCC Rcd at 11253 para. 16. The Rural Task Force's proposed modifications included various upward adjustments to current limits on universal service support for rural carriers. *Id.*

[75] *Id.* at 11249 para. 11.

[76] *Id.* at 11248 para. 8. The Commission stated that it would "consider all options, including the use of forward-looking costs, to determine appropriate support levels for both rural and non-rural carriers." *Id.* at 11310 para. 170.

[77] *See id.* at 11253 para. 17.

[78] *See supra*, n.8.

[79] White Paper 2 at 8-10. The average population density for areas served by rural carriers is 13 persons per square mile, compared with 105 persons per square mile for areas served by non-rural carriers.

[80] *Id.* at 9-10.

investment in plant per loop, and higher plant specific expenses per loop than non-rural carriers, all of which may vary dramatically depending on how many lines they serve.[81]

29. The Rural Task Force recommended a number of access reform principles, which the Commission stated that it would consider in addressing the MAG plan.[82] According to the Rural Task Force, rate disparities between price cap and rate-of-return carriers result from both rate structure and cost differences, and may create significant pressures on interexchange carriers to deaverage toll rates.[83] It recommended that the Commission determine the amount of implicit support within the interstate access rates of rate-of-return carriers by calculating the difference between their current rates and "the appropriate unit prices of interstate access" and then replacing this amount with a new, uncapped support mechanism.[84] The Rural Task Force did not recommend a specific method for determining the "appropriate unit prices of interstate access."[85]

D. The MAG Plan

30. The MAG proposes two regulatory regimes, "Path A" and "Path B," which have some common features.[86] The MAG plan would modify the common line rate structure for all rate-of-return carriers by raising SLC caps to price cap carrier levels, permitting an offsetting reduction in CCL charges.[87] For Path A carriers that participate in the NECA pools, the MAG proposes a weighted aggregate target for all per-minute switched access charges, which would be reduced to 1.6 cents per minute by July 1, 2003.[88] Rate Averaging Support (RAS), a new universal service support mechanism, would recover any shortfall between the allowed revenues of Path A pooling carriers and the sum of their revenues from switched access charges (including SLCs), LTS, and LSS.[89] RAS would not be available to non-pooling incumbent LECs or Path B carriers.

31. Under the MAG plan, carriers that elect Path A would be able to convert from rate-of-return regulation to the MAG incentive plan on a study-area basis at any time during the transition period.[90] Path B carriers would remain under rate-of-return regulation, with the option to elect Path A at any time during the transition period. Incentive-regulated carriers would be compensated based on "revenue per line" (RPL), which would be established using embedded

[81] *Id.* at 11-13.

[82] *See Rural Task Force Order*, 16 FCC Rcd at 11323-25 paras. 202-205.

[83] *Id.* at para. 202; *see* 47 U.S.C. § 254(g); 64 C.F.R. § 1801.

[84] *Rural Task Force Order*, 16 FCC Rcd at 11323 para. 202 (quoting Rural Task Force Recommendation at 31).

[85] *Id.* at 11324 para. 203.

[86] *See MAG Notice*, 16 FCC Rcd at 462 para. 6.

[87] *See id.* at 462 para. 7, 566.

[88] *See id.* at 463 para. 8, 568. Existing switched access rate elements would be retained.

[89] *See id.* at 463 para. 8, 555. RAS also would be available to support the special access rates of Path A pooling carriers.

[90] *See id.* at 463-64 para. 9, 559-62. The MAG proposed that carriers electing Path A at the outset would have five years to convert from rate-of-return to the MAG incentive regulation scheme.

costs and then adjusted for inflation (GDP Price Index) on a going-forward basis. Universal service support (excluding RAS) for incentive-regulated study areas also would be fixed on a per-line basis and adjusted annually for inflation. The MAG plan includes a backstop or low-end adjustment mechanism which would prevent the annual returns of Path A carriers from falling below 10.75 or 10.25 percent, depending on the number of study areas the carrier operates.

32. The MAG plan also includes other significant proposals. The authorized rate of return would be fixed at the current 11.25 percent, terminating the pending represcription proceeding, and jurisdictional separations factors would be frozen.[91] Rate-of-return carriers would be permitted to offer new services without obtaining a Part 69 waiver or making a public interest showing.[92] Interexchange carriers would be required to pass through to consumers any savings from reductions in per-minute switched access charges, to offer consumers in rural and urban areas the same optional calling plans, and not to impose minimum monthly charges on residential consumers.[93]

IV. DISCUSSION

A. Common Line Rate Structure

1. Background

33. As stated above, the Commission established the common line rate structure in the *1983 Access Charge Order*. Its long term goal was for incumbent LECs to recover substantially all of their non-traffic sensitive common line costs on a flat-rated basis from end users.[94] Because of affordability concerns, however, the Commission imposed ceilings or caps on the monthly, flat SLC charges assessed on end users.[95] For rate-of-return carriers, SLCs currently are the lesser of a carrier's average per-line common line costs or $3.50 (for residential and single-line business users) and $6.00 (for multi-line business users).[96] Rate-of-return carriers recover any shortfall in allowed common line revenues through per-minute CCL charges.[97]

34. The Commission modified the common line rate structure for price cap carriers in the 1997 *Access Charge Reform Order*. The Commission reaffirmed its goal for incumbent

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[91] *See id.* at 462 para. 7.

[92] *Id.* at 465 para. 14, 568.

[93] *Id.* at 464-65 para. 13, 564.

[94] *1983 Access Charge Order*, 93 FCC 2d at 285 para. 147-48 (stating that all common line costs other than Universal Service Fund and inside wiring costs would be recovered directly from end users); *see Interstate Access Support Order*, 15 FCC Rcd at para. 64 n.82 ("The Commission found that a subscriber who does not use the subscriber line to place or receive interstate calls imposes the same NTS costs as a subscriber who does use the line. Thus, simply by requesting telephone service, the subscriber causes local loop costs whether [he or s]he uses the service for intrastate or interstate calls.") (citing *1983 Access Charge Order*, 93 FCC 2d at 278 para. 121).

[95] *See Access Charge Reform Order*, 12 FCC Rcd at 16008 para. 68.

[96] 47 C.F.R. § 69.104.

[97] 47 C.F.R. 69.205. As discussed above, carriers that participate in the NECA common line pool are eligible for LTS to reduce their CCL charges. *See supra*, § III.B.

LECs to recover common line costs through flat, rather than per-minute, charges.[98] It did not raise the SLC cap for primary residential and single-line business users above $3.50, however, again due to affordability and universal service concerns.[99] Instead, as previously noted, the Commission created the PICC, a flat, per-line charge imposed on interexchange carriers, to replace the per-minute CCL charge over time.[100] Concluding that universal service concerns were not as great for non-primary residential and multi-line business users, the Commission raised SLC caps for such users to $5.00 and $9.00 per line, respectively (plus future increases for inflation).[101] The Commission stated that "although there might be some disparity between the average multi-line business SLC rate in low- and high-cost areas, the $9.00 cap would ensure that SLC rates in high-cost areas would be 'reasonably comparable' to SLC rates in urban areas."[102]

35. In the *1998 Notice*, the Commission proposed to reform the common line rate structure for rate-of-return carriers in a manner similar to that adopted for price cap carriers.[103] It recognized, however, that this approach would not "align rates with costs as quickly as it will for price cap LECs" because of the higher operating and equipment costs faced by many rate-of-return carriers.[104] The Commission requested comment on whether differences between the two groups might warrant a different approach in some matters.[105]

36. In the *Interstate Access Support Order*, the Commission increased the recovery of common line costs through flat end user charges by price cap carriers. The primary residential and single-line business SLC cap increased from $3.50 to $4.35 on July 1, 2000, and to $5.00 on July 1, 2001.[106] This cap is scheduled to rise to $6.00 on July 1, 2002, and $6.50 on July 1, 2003, subject to justification by a cost study.[107] The Commission also eliminated residential and single-line business PICCs.[108] The Commission concluded that these measures would serve the

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[98] *Access Charge Reform Order*, 12 FCC Rcd at 16013 para. 77.

[99] *Id.* at 16010-11 para. 73.

[100] *Id.* at 16018-26 para. 88-105; *see supra*, § III.C.

[101] *Access Charge Reform Order*, 12 FCC Rcd at 16005 para. 58-60. The Commission also established PICCs for non-primary residential and multi-line business lines. *Id.* at 16022 para. 99.

[102] *1998 Notice*, 13 FCC Rcd at 14247 para. 26 (citing *Access Charge Reform Order*, 12 FCC Rcd at 16014-16 para. 79-83).

[103] *1998 Notice*, 13 FCC Rcd at 14250-51 para. 35 ("similar modifications are needed to remove implicit subsidies and ensure that charges more accurately reflect the manner in which costs are incurred, thereby promoting competition.").

[104] *Id.* at 14251 para. 36; *see id.* at 14252 para. 39 ("If rate-of-return LECs were to implement the revised common line rate structure applied to price cap LECs, multi-line business PICCs and CCL charges would remain higher than those of price cap LECs for the foreseeable future, because rate-of-return LEC common line costs are significantly higher than those of price cap LECs.").

[105] *See id.* at 14240 para. 3, 14251 paras. 36.

[106] *Interstate Access Support Order*, 15 FCC Rcd at 12998 para. 70; 47 C.F.R. § 69.152.

[107] *Interstate Access Support Order*, 15 FCC Rcd at 12998 para. 70; 47 C.F.R. § 69.152.

[108] *Id.* at 12991-92 para. 78; *see id.* at 12996 para. 86 ("although we established the PICC as a charge that LECs assess IXCs instead of an end-user charge to minimize any impact on end users potentially resulting from a higher

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public interest by making the common line rate structure more rational, efficient, and transparent to consumers, consistent with its longstanding access reform goals.[109] It rejected arguments that increasing SLC caps would violate the statutory principles of affordability and reasonable comparability of rates in urban and rural areas.[110] The Commission also observed that customers in rural areas served by rate-of-return carriers would benefit from elimination of passed-through PICC charges and reductions in long distance rates as a result of its actions.[111]

37. In addition, the Commission granted price cap carriers flexibility to deaverage SLC rates under certain conditions, concluding that such flexibility would "enhance the efficiency of the local telephone market by allowing prices to be tailored more easily and accurately to reflect costs and, therefore promotes competition in both urban and rural areas."[112] Specifically, after CCL and PICC charges are phased out, price cap carriers may deaverage SLC rates to no more than four state commission-approved unbundled network element (UNE) loop zones in a study area.[113] They may, however, voluntarily reduce SLC rates at any time.[114] Deaveraging also is subject to additional restrictions. Multi-line business SLC rates within a given zone cannot fall below primary residential and single-line business SLC rates.[115] Deaveraged SLC rates for a given customer class cannot be lower in high-cost zones than in low-cost zones.[116] Deaveraging must be revenue-neutral: deaveraged SLCs cannot generate more revenue than permitted for averaged SLCs.[117] And except for voluntary reductions, a minimum SLC charge within the lowest-cost zone limits the charges that can be imposed in the higher-cost zones, thereby allowing customers outside the lowest cost zone "to share the benefits of SLC deaveraging."[118]

38. The MAG proposes common line rate structure modifications similar to those adopted in the *Interstate Access Support Order,* but with several significant differences. Under

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SLC, the reality in the marketplace is that IXCs have marked-up and passed-through the PICC to end users, thereby imposing higher flat charges for the majority of residential customers than would have occurred had we increased the SLC cap by the amount of the PICC caps.").

109 *Id.* at 12991-994 paras. 77-81, 12997-98 para. 89.

110 *Id.* at 12995-96 paras. 85-86; *see* 47 U.S.C. §§ 254(b)(3).

111 *Interstate Access Support Order*, 15 FCC Rcd at 12996-97 para. 88.

112 *Id.* at 13007 para. 113. SLC rates are based on interstate common line costs averaged over an entire study area, which is usually an incumbent LEC's existing service area within a state. Geographic deaveraging refers to charging different rates in different zones within a study area to reflect the relative cost of providing service within each zone. *See id.* at 13007 para. 114.

113 47 C.F.R. § 69.152(q); *see Interstate Access Support Order*, 15 FCC Rcd at 12989-90 para. 73. The Commission may review and approve use of more than four state-created zones.

114 *See Interstate Access Support Order*, 15 FCC Rcd at 13014 para. 127 ("The proposal provides an incentive to LECs to deaverage voluntarily other than through offset free from the limitations of the proposed safeguards.").

115 47 C.F.R. § 69.152(q)(3).

116 *Id.* at § 69.152(q)(4).

117 *Id.* at § 69.152(q)(5).

118 *Interstate Access Support Order*, 15 FCC Rcd at 12990 para. 73; 47 C.F.R. § 69.152(q)(7).

the MAG plan, SLC caps gradually would rise for all rate-of-return carriers to price cap carrier levels. The residential and single-line business SLC cap initially would rise from $3.50 to $5.00, and thereafter with the SLC caps of price cap carriers, "so long as those amounts are reasonably comparable to the [SLCs] that price cap LECs actually charge[.]"[119] The multi-line business SLC cap would increase from $6.00 to $9.20 over two years.[120] Rate-of-return carriers would be permitted to deaverage SLCs below the wire center level (no more than three zones per wire center), provided that no multi-line business SLC is lower than the lowest residential SLC.[121] The MAG plan also includes provisions for assessment of SLCs for Centrex lines and integrated services digital network (ISDN) service.[122]

39. The SLC cap increases proposed by the MAG would permit offsetting reductions in CCL charges. For Path A pooling carriers, the MAG plan would further lessen such charges by establishing a weighted aggregate target ("Composite Access Rate" or CAR) for all per-minute switched access charges, which gradually would be reduced to 1.6 cents by July 1, 2003.[123] Path A pooling carriers would be eligible for support from a new universal service mechanism to recover any shortfall in their allowed common line revenue.[124]

2. Discussion

40. We adopt the MAG's proposal to increase the recovery of common line costs through SLCs and permit limited SLC deaveraging, with certain modifications that are discussed below. By rationalizing the common line rate structure and moving per-minute switched access rates towards lower, cost-based levels, these measures will encourage efficient competition and promote consumer choice in areas served by rate-of-return carriers. The revised SLC caps, which conform to those already implemented for most subscribers nationwide, will ensure that rates and services in rural areas remain affordable and reasonably comparable to those in urban areas. SLC deaveraging will provide important pricing flexibility for rate-of-return carriers.

41. We do not adopt the MAG proposal to permit certain carriers to continue to assess a CCL charge. As discussed below, the CCL charge is "an inefficient cost recovery mechanism and implicit subsidy."[125] The Commission has taken various measures to phase out the CCL charge for price cap carriers. Rather than leaving this mechanism in place for rate-of-return carriers, as the MAG proposes, we find that it should be removed from the common line rate structure and replaced with explicit, portable universal service support. Consistent with the 1996

[119] *See MAG Notice,* 16 FCC Rcd at 462 para. 7, 566. There would be no separate SLC cap for non-primary residential lines under the MAG plan. *Id.* Lifeline support would increase to cover increased SLCs for low-income customers.

[120] *Id.*

[121] *Id.* Carriers would have to file maps, descriptions, and rates for each cost zone with the Commission. SLC revenues would be imputed to pooling carriers as if their SLC rates were set at the caps.

[122] *Id.*

[123] *Id.* at 463 para. 8, 568.

[124] *Id.* at 463 para. 8, 555. Non-pooling carriers and Path B carriers would not be eligible for such support. *Id.*

[125] *Access Charge Reform Order,* 12 FCC Rcd at 16008 para. 69.

Act, we conclude that this approach strikes a fair and reasonable balance between our competitive goals for the local and long distance telecommunications markets and our mandate to preserve and advance universal service.

a. Residential and Single-Line Business SLCs

42. We adopt the MAG proposal to increase the residential and single-line business SLC cap to the levels established for price cap carriers under the CALLS plan. Thus, the cap will increase to $5.00 beginning on January 1, 2002, and thereafter with the residential and single-line business SLC caps of price cap carriers, up to $6.00 as of July 1, 2002, and $6.50 as of July 1, 2003, subject to cost showings by price cap carriers. For the reasons set forth below, we do not adopt the MAG proposal to condition SLC cap increases on the actual SLC rates of price cap carriers. We do adopt the MAG proposal not to distinguish between primary and non-primary residential lines.

43. We conclude that the residential and single-line business SLC cap levels approved in the *Interstate Access Support Order* are appropriate for rate-of-return carriers. Increasing the recovery of non-traffic sensitive common line costs through flat, end user charges is a longstanding Commission goal.[126] As the Commission has stated, "[b]ecause common line costs do not vary with usage, these costs should be recovered on a flat-rated instead of 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"[127] Our examination of the record reveals a consensus among commenters as to the need for rural access charge reform.[128] Commenters also generally support the MAG proposal to address this need by raising SLC caps to the levels approved for price cap carriers,[129] which were recently upheld by the Fifth Circuit in *Texas Office of Public Utility Counsel v. FCC*.[130] Adoption of the same SLC cap levels for price cap and rate-of-return carriers is consistent with our tentative conclusion in the *1998 Notice* that similar rate structure modifications generally should be adopted for the two groups,[131] and will establish uniformity in SLC cap levels among end users nationwide. This measure will benefit

[126] *1983 Access Charge Order*, 93 FCC 2d at 264-65; *see Interstate Access Support Order*, 15 FCC Rcd at 12990 para. 75 (finding that CALLS plan "furthers the Commission's efforts over the past two decades to eliminate per-minute recovery of common line costs.").

[127] *Access Charge Reform Order*, 12 FCC Rcd at 16013 para. 77.

[128] *See* Home Tel. Co. Comments in CC Docket No. 98-77 at 1-2 ("The problems created by high access rates in the rural areas are well understood and generally agreed to by most parties."); Ad Hoc Comments at 26, Global Crossing Comments at 6-7, Telcom Consulting Assoc. Comments at 4-5, MAG Reply at 4; *see also Rural Task Force Order*, 16 FCC Rcd at 11323 para. 202.

[129] *See* Alabama Rural LECs Comments at 2-3, AT&T Comments at 5, California Commission Comments at 12-13, Competitive Universal Service Coalition Comments at 14, Global Crossing Comments at 4, MAG Comments at 11, Qwest Comments at 2, Sprint Comments at 6, WorldCom Comments at 8, AT&T Reply at 1, Excel Comm'ns Reply at 2, Verizon Reply at 2.

[130] *Texas Office of Public Utility Counsel v. FCC*, No. 00-60434 at § III.A.

[131] *1998 Notice*, 13 FCC Rcd at 14250-51 para. 35; *see id.* at 14240 para. 3 ("While rate-of-return LEC costs generally may be higher than price cap LEC costs due to longer loops or lower economies of scale, the two groups of carriers incur costs in the same manner, and similar economic principles should apply.").

consumers by fostering efficient competition, reducing overall rates, and increasing the transparency of the interstate access rate structure.[132] Furthermore, we believe that it will help to ensure the continued financial viability of local telephone companies serving rural and high-cost areas.[133]

44. We also conclude that the residential and single-line business SLC cap levels we approve here will ensure affordable and reasonably comparable rates in urban and rural areas. The Commission has approached common line rate structure reform cautiously over the years, due to affordability and universal service concerns.[134] It found the SLC cap levels that we approve here for rate-of-return carriers to be affordable and consistent with our universal service goals, however, a decision which the Fifth Circuit recently affirmed.[135] Pursuant to the *Interstate Access Support Order*, new SLC caps have been implemented for the vast majority of access lines nationwide. Telephone subscribership has remained at historic high levels since SLC rates increased for customers of price cap carriers.[136] Adoption of the CALLS plan has benefited consumers through the elimination of passed-through PICC charges and reductions in long distance rates in all service areas, including those of rate-of-return carriers.[137] Consistent with the 1996 Act, the SLC cap levels we approve here will reduce CCL charges, which are an implicit subsidy from high-volume to low-volume users of interstate long distance services, and which have adverse consequences on competition and limit consumer choice.[138] Our action here will establish parity in SLC cap levels among end users nationwide, and the benefits that flow from such parity. In addition, consistent with the MAG proposal and our existing rules for price cap carriers, the potential impact of SLC increases on low-income subscribers will be addressed through increased federal Lifeline support to cover the amount of SLC increases.[139]

45. We also find that our actions will ensure reasonable comparability of SLC rates in urban and rural areas in light of the cost differences between providing common line service in such areas. As discussed above, by capping SLC rates at $6.50, we ensure that no residential or single-line business subscriber will pay in excess of $6.50 per line for common line service. Any

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[132] *See Interstate Access Support Order*, 15 FCC Rcd at 12991-994 paras. 77-81, 12997-98 para. 89.

[133] *See* Home Tel. Co., Inc. Comments in CC Docket No. 98-77 at 1-2 ("The continued financial viability of rural areas and the companies operating in them is dependent upon successful access charge reform, supported as necessary with universal service fund support.").

[134] *See Access Charge Reform Order*, 12 FCC Rcd at 16007-08 para. 68, 16010-11 para. 73.

[135] *Interstate Access Support Order*, 15 FCC Rcd at 12995-96 paras. 85-86 ("The SLC cap was set over a decade ago and was determined to be generally affordable. It has never been adjusted for inflation. Our rate restructuring today will result in lower overall charges than consumers experience with the current SLC and PICC, and a more efficient recovery of common line revenues through flat charges."); *see Texas Office of Public Utility Counsel v. FCC*, No. 00-60434 at § II.A (affirming decision to raise residential and single-line business SLC caps as a "reasoned attempt to maintain the difficult balance between the principles of ensuring affordability and encouraging competition.").

[136] *See* Industry Analysis Division, Common Carrier Bureau, Federal Communications Commission, Trends in Telephone Service, August 2001, Tables 17.1-17.2.

[137] *Interstate Access Support Order*, 15 FCC Rcd at 12996-97 para. 88.

[138] *See infra*, § IV.A.2.d.

[139] *See infra*, § IV.D.2.d.

differences in the SLC rates that subscribers pay in different areas will be reasonable compared to the difference in the cost of serving such areas. For example, our forward-looking economic cost model shows that the cost of providing a local loop in a rural area may be approximately one hundred times greater than the cost in an urban area.[140] Our actions today, however, ensure that any costs above the $6.50 SLC cap will be covered by the new, explicit support mechanism, ensuring that prices remain affordable. In light of the cost of providing this critical link to the telephone network in rural areas, we believe that the revised SLC cap levels that we approve here will ensure reasonable comparability of SLC rates.

46. We do not adopt the MAG proposal to condition SLC cap increases on the actual SLC rates of price cap carriers because we find it to be unnecessary and administratively impractical. The provisions of section 254(b)(3) were intended not to prevent rates from reflecting the costs of serving different areas, but to ensure a fair range of rates.[141] The SLC cap levels that we approve here protect subscribers in rural and high-cost areas by ensuring that no SLC rate may exceed the cap.[142] In addition, it is unclear how the MAG proposal would be implemented: the MAG has not addressed whether price cap carrier rates should be considered on a national, state-to-state, or regional basis, or the number of price cap carriers that must charge the maximum rate before triggering SLC cap increases for rate-of-return carriers.

47. We adopt the MAG proposal to apply the same SLC cap to primary and non-primary residential lines. As stated above, the Commission approved a higher non-primary residential SLC rate for price cap carriers in the *Access Charge Reform Order*.[143] In the *Interstate Access Support Order*, however, the Commission allowed price cap carriers to eliminate the distinction over time, concluding that this would simplify the common line rate structure and eliminate the administrative costs associated with administering the distinction, "which are ultimately borne by consumers."[144] A number of commenters contend that the administrative burdens of implementing the distinction would be greater for small rate-of-return carriers than for price cap carriers.[145] In this regard, we are mindful of the Regulatory Flexibility Act requirement that we consider the potential impact of any such measure on small, local telephone companies.[146] Furthermore, several commenters maintain that higher SLC rates for

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[140] Our forward-looking economic cost model shows a cost of $866.27, without adjusting for overhead costs, to provide a local loop in a Wyoming wire center, compared to a cost of $9.97 in a New York City wire center. Adjusting for overhead costs greatly increases this cost difference. Primary residential and single-line business customers in both service areas, however, currently pay the capped SLC rate for price cap carriers of $5.00. *See* http://www.fcc.gov/ccb/apd/hcpm/ (data for LAKEWYMA in Wy_mount and NYCMNYBS in File NY_NEWY).

[141] *See Interstate Access Support Order*, 15 FCC Rcd at 13012-13 paras. 123-25.

[142] *See id.* at 13013 para. 125.

[143] *Access Charge Reform Order*, 12 FCC Rcd at 16000 para. 39, 16005 para. 58. The average residential SLC charged by price cap carriers is $4.91 for a primary line and $5.93 for a non-primary line.

[144] *Interstate Access Support Order*, 15 FCC Rcd at 13002 para. 100.

[145] *See* NRTA and NTCA in CC Docket No. 98-77 at 26, OPASTCO Comments in CC Docket No. 98-77 at 14-15, John Staurulakis Comments in CC Docket No. 98-77 at 10, 14, TDS Comments in CC Docket No. 98-77 at 13-15, USTA Comments in CC Docket No. 98-77 at 14.

[146] *See* 5 U.S.C. § 601, *et seq.* The Regulatory Flexibility Act has been amended by the Contract with America Advancement Act of 1996, Pub. L. No. 104-121, 110 Stat. 847 (1996).

non-primary residential lines would limit growth of such lines, which are often used for advanced services and represent an important source of revenue for small, local telephone companies.[147] Based on all of these considerations, we will apply the same SLC cap levels to the primary and non-primary residential lines of rate-of-return carriers.

48. Residential and single-line business SLC cap increases above $5.00 for rate-of-return carriers will be conditioned on similar increases for price cap carriers, but we will not conduct a separate cost review proceeding for rate-of-return carriers. Under the CALLS plan, SLC cap increases above $5.00 for price cap carriers are subject to cost justification.[148] If any SLC cap increases above $5.00 are cost-justified for price cap carriers, we believe that a separate showing for rate-of-return carriers would be unnecessary and create undue administrative burdens, because rate-of-return carriers generally have higher common line costs than price cap carriers.[149] This is consistent with our conclusion that parity in SLC cap levels among price cap and rate-of-return carriers is appropriate to ensure reasonable comparability of rates in urban and rural areas.

49. We disagree with commenters who contend that SLC caps should not be increased for rate-of-return carriers.[150] These commenters rely largely on arguments that the Commission considered and rejected in the *Interstate Access Support Order*.[151] We find unpersuasive arguments that consumers will not benefit from SLC cap increases because interexchange carriers have not committed to pass through access charge reductions and, in any event, only a small percentage of the nation's access lines will be affected. The reforms we adopt here further longstanding competitive and universal service goals of the Commission,[152] and will provide a number of important consumer benefits. We do not believe that realization of these benefits should be conditioned on specific commitments to long distance rate reductions. Furthermore, our action here establishes SLC cap level parity among end users nationwide. Consumers in rate-of-return carrier service areas already have benefited from lower long distance

[147] *See* Plains Rural Indep. Cos. Comments at 10, NECA Comments in CC Docket No. 98-77 at 5-6, NRTA and NTCA Comments in CC Docket No. 98-77 at 26-28, USTA Comments in CC Docket No. 98-77 at 12-14.

[148] *Interstate Access Support Order*, 15 FCC Rcd at 12988 para. 70, 12994 para. 83; 47 C.F.R. § 69.152; *see Initiation of Cost Review Proceeding for Residential and Single-Line Business Subscriber Line Charge (SLC) Caps*, CC Docket Nos. 96-262, 94-1, Public Notice, DA 01-2163 (released September 17, 2001).

[149] *See supra*, §§ III.C, IV.A.2.a; *Interstate Access Support Order*, 15 FCC Rcd at 12994-95 para. 84.

[150] *See* ICORE Comments at 14-16, Interstate Telcom Group Comments at 15, John Staurulakis Comments at 2-3, Texas Commission Comments at 3-4, Fred Williamson & Assoc. Comments at 6-7, Alliance of Indep. Rural Tel. Cos. Reply at 6-7, Ronan Tel. Co. Reply at 5, Summit Tel. Co. Reply at 2.

[151] *See Interstate Access Support Order*, 15 FCC Rcd at 12995-1300398 paras. 85-99 (rejecting arguments that, *inter alia*, SLC cap levels approved for price carriers are unaffordable, fail to encourage efficient competitive entry, unfairly exempt interexchange carriers from sharing common line costs, or should not be approved because they will lead indirectly to intrastate access rate increases); *see Texas Office of Public Utility Counsel v. FCC*, No. 00-60434 at § II.B (rejecting argument that CALLS plan violates section 254(k) of the Act).

[152] *See Access Charge Reform Order*, 12 FCC Rcd at 14251 para. 35 (bringing the common line rate structure into line with cost-causation principles and phasing out implicit subsidies "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.").

rates that followed from the access reforms (including SLC cap increases) adopted under the 1997 *Access Charge Reform Order* and the CALLS plan.[153]

50. Finally, we disagree with Interstate Telcom Group's argument that SLC cap levels should be lower for rate-of-return carriers because their customers have smaller local calling areas and most customers perceive SLC increases as equivalent to local rate increases.[154] There is no good reason why customers of higher-cost companies should pay less than customers of lower-cost companies. Increasing SLC rates will allow us to reduce the CCL charge, which is an implicit subsidy from high-volume to low-volume users. Regardless of customer perceptions, SLC increases do not affect local service rates directly, and we believe that concerns about potential perceptions of our actions here are outweighed by the need for access charge reform.[155]

b. Multi-Line Business SLCs

51. We adopt the MAG proposal to increase the multi-line business SLC cap to $9.20 per line, the level established for price cap carriers under the CALLS plan. We conclude that this increase should occur as of January 1, 2002, rather than over a two-year period as proposed by the MAG. We do not adopt the MAG proposal to assess one-ninth of the multi-line business SLC rate on Centrex lines. We adopt the MAG proposal to determine SLCs for Basic Rate Interface and Primary Rate Interface ISDN service in the same manner as for price cap carriers.

52. We conclude that the multi-line business SLC cap approved for price cap carriers is appropriate for rate-of-return carriers. As the Commission observed in 1997, the current multi-line business SLC cap of $6.00 "was set over a decade ago, and . . . has never been adjusted for inflation[.]"[156] Commenters generally support the MAG proposal to establish parity between the multi-line business SLC cap level for rate-of-return and price cap carriers, and this approach is consistent with our proposal in the *1998 Notice* to adopt similar rate structure modifications for the two groups.[157] As discussed above, we find that reforming the common line rate structure in this manner will further our competitive and universal service goals, provide important consumer benefits, and help to ensure the continued financial viability of local telephone companies serving rural and high-cost areas.[158] Consistent with prior Commission

[153] *See Interstate Access Support Order*, 16 FCC Rcd at 12996-97 para. 88 ("the CALLS Proposal will provide rate benefits for rural customers including those not served by price cap LECs. Most IXCs currently assess a flat-rated charge to recover the PICC on all of their subscribers, including those subscribers served by rate-of-return LECs. By eliminating the PICC, we eliminate these charges from the bills of these subscribers as well. . . . Because long-distance providers must offer their geographically-averaged rates to all of their customers, including those served by rate-of-return carriers, rural customers also will benefit from reductions in per-minute rates.").

[154] Interstate Telcom Group Comments at 15.

[155] *See Interstate Access Support Order*, 15 FCC Rcd at 12996 para. 87.

[156] *Access Charge Reform Order*, 12 FCC Rcd at 16015 para. 82. We also note that if presently adjusted for inflation, the $9.20 multi-line business SLC cap would be less than the $6.00 cap established in 1984 (based on Bureau of Labor Statistics, CPI-U).

[157] *1998 Notice*, 13 FCC Rcd at 14250-51 para. 35; *see id.* at 14250 para. 3 ("While rate-of-return LEC costs generally may be higher than price cap LEC costs due to longer loops or lower economies of scale, the two groups of carriers incur costs in the same manner, and similar economic principles should apply.").

[158] *See supra*, § IV.A.2.a; *see also Access Charge Reform Order*, 12 FCC Rcd at 16014-15 paras. 78-82.

actions, we adopt higher SLC caps for multi-line business lines than for residential and single-line business lines, although the costs of providing multi-line business lines are not higher, because universal service concerns are not as great for multi-line business lines.[159]

53. We conclude that the multi-line business SLC cap for rate-of-return carriers should increase to the price cap carrier level of $9.20 on January 1, 2002. We disagree with the MAG's contention that a phased-in transition is necessary to "balance customer concerns about rate shock with the need to improve recovery of common line costs."[160] As WorldCom points out, the Commission increased the multi-line business SLC cap for price cap carriers from $6.00 to $9.00 in a single step in 1997, determining that this approach would not threaten universal service.[161] We are not persuaded that a different approach is warranted here. In addition, we find that our actions will ensure reasonable comparability of SLC rates in urban and rural areas in light of the cost differences between providing common line service in such areas.[162] Moreover, the access charge reform measures we adopt in this Order will facilitate long distance toll rate averaging and optional calling plans that will benefit businesses.

54. We do not adopt proposals to limit the multi-line business SLC cap for rate-of-return carriers to the national average SLC rate for price cap carriers. In this regard, a number of rate-of-return carriers have expressed concerns that multi-line business SLC cap disparities would enable lower-priced price cap carriers to "cherry pick" the high-volume business customers of the higher-priced rate-of-return carriers.[163] We are not persuaded that such a measure is necessary to ensure reasonable comparability of rates in urban and rural areas. As discussed above, the SLC cap protects subscribers in rural and high-cost areas by ensuring that no SLC rate may exceed the cap.[164] Indeed, although the national average rate for price cap

[159] *See Access Charge Reform Order*, 12 FCC Rcd at 16000 para. 38, 16005 para. 58.

[160] MAG Reply at iv; *see MAG Notice*, 16 FCC Rcd at 462 para. 7, 566.

[161] WorldCom Comments at 8-9 ("it is clear that the 1997 increase in price cap carriers' multiline business SLC cap has had no impact on price cap carriers' subscribership, even though that increase was effected in one step and even though millions of price cap carrier lines are now subject to [a] maximum SLC cap of $9.20."); *see Access Charge Reform Order*, 12 FCC Rcd at 16014-15 paras. 78-81.

[162] *See supra*, § IV.A.2.a. As discussed above, our cost model shows that the cost of providing a local loop in a rural area may be approximately one hundred times greater than the cost in an urban area. Using the example set forth above, the SLC rate for multi-line business customers in New York is $8.08, compared to the multi-line business SLC rate of $9.20 being charged in Wyoming. *See supra*, n.140.

[163] *See 1998 NPRM*, 13 FCC Rcd at 14252 para. 37 ("Several entities have expressed concern that the immediate SLC increases to $9.00 will create a large disparity between SLCs charged by rate-of-return LECs and neighboring price cap LECs, and that . . . the lower-cost price cap carriers will be able to 'cherry pick' the high volume business customers of the higher priced rate-of-return LECs. These entities urge the Commission to grant them pricing flexibility and propose that SLCs be set based on the national average or on the neighboring price cap LEC's average SLC."); Evans Tel. Co., *et al*. Comments in CC Docket No. 98-77 at 4, GVNW Consulting Comments in CC Docket No. 98-77 at 6, Home Tel. Co. Comments in CC Docket No. 99-87 at 5-6, Lexcom Tel. Co. in CC Docket No. 98-77 at 13-16, Minnesota Indep. Coalition Comments in CC Docket No. 98-77 at 6-7, 9-10, NRTA and NTCA Comments in CC Docket No. 98-77 at 17-21, OPASTCO Comments in CC Docket No. 98-77 at 3-4, New England Tel. Assoc., Small Co. Members Comments in CC Docket No. 98-77 at 7, John Staurulakis Comments in CC Docket No. 98-77 at 10, 14, TDS Comments in CC Docket No. 98-77 at 15, USTA Comments in CC Docket No. 98-77 at 10-11, Western Alliance in CC Docket No. 98-77 at 13-15.

[164] *See supra*, § IV.A.2.a.

carriers is below the cap, the rates of some price cap carriers are at or near the cap.[165] In addition, to the extent that the proposed measure is intended to protect rate-of-return carriers from competition,[166] we believe that it would be inconsistent with the purpose of SLC caps, which is to ensure affordable and reasonably comparable rates.[167] SLC deaveraging will allow rate-of-return carriers to address their competitive concerns in a more appropriate manner.[168]

55. *Centrex*. We do not adopt the MAG proposal to assess one-ninth of the multi-line business SLC on Centrex lines.[169] Multi-line business PICCs are assessed on the customers of price cap carriers using a 9:1 line-to-trunk equivalency ratio.[170] With regard to multi-line business SLCs, however, the Commission's rules require that Centrex lines be counted in the same manner as any other line between a customer's premises and the LEC central office switch.[171] The MAG offers no justification for departing from this approach. We disagree with Dunkirk and Fredonia Telephone Company that we should adopt the MAG proposal to avoid placing Centrex customers at a disadvantage.[172] Centrex service uses more lines than does PBX service and, therefore, necessarily creates more costs.[173] If a customer chooses to use Centrex, we believe that it should pay for its decision. We also note that the multi-line business PICC is a subsidy mechanism which is being phased out for price cap carriers, whereas SLC charges are assessed on the cost-causer to recover actual costs associated with each additional line.[174]

56. *ISDN Service*. Consistent with the MAG proposal, we adopt the same methods for calculating SLC rates for Basic Rate Interface (BRI) and Primary Rate Interface (PRI) ISDN

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[165] *See, e.g.*, WorldCom Comments at 9 n.12 ("Among the price cap LECs with study areas that assess a $9.20 multiline business SLC are Qwest (Colorado, Montana, New Mexico, Wyoming, and Idaho), GTE (most study areas, including Hawaii, Texas, and Washington), Sprint, and Citizens.").

[166] *See 1998 Notice*, 13 FCC Rcd at 14251-52 para. 37.

[167] *See Access Charge Reform Order*, 12 FCC Rcd at 16007-08 para. 68.

[168] *See infra*, § IV.A.2.c.

[169] *See MAG Notice*, 16 FCC Rcd at 566 ("[e]nd user common line charges for Centrex lines may be assessed based on a per-line charge that is 1/9 of the multi-line business end user common line charge. However, if a Centrex customer has fewer than nine lines, the monthly end user charge for those lines shall be the end user common line charge for one multi-line business.").

[170] *See Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers*,, CC Docket No. 96-262, Second Order on Reconsideration and Memorandum Opinion and Order, 12 FCC Rcd 16606, 16617-18 para. 38 (1997) (*Second Order on Reconsideration*); *id.* at 16615 para. 31 (concluding that, with regard to multi-line business PICCs, "Centrex customers should be treated similarly to PBX customers, because the two arrangements are functionally equivalent.").

[171] 47 C.F.R. §§ 69.104(a), 69.152(a).

[172] Dunkirk & Fredonia Tel. Co. Reply at 2-4.

[173] *Second Order on Reconsideration*, 12 FCC Rcd at 16616 para. 35 ("Centrex arrangements are charged SLCs on a per-line basis, even though this difference results in a higher rate than equivalent PBX arrangements."); *see* AT&T Comments ("each Centrex line is a common line to which a full SLC should apply"), WorldCom Comments at 10 (*citing MTS and WTS Market Structure Memorandum Opinion and Order*, 97 FCC 2d 682, 700 para. 45 (1983)).

[174] *See Second Order on Reconsideration*, 12 FCC Rcd at 16615 para. 31.

service as we currently use for price cap carriers.[175] SLCs for BRI and PRI ISDN service are assessed on the customers of price cap carriers using 1:1 and 5:1 cost ratios, respectively.[176] No commenters have opposed application of these cost ratios to rate-of-return carriers, and we have no reason to believe that different methods would be appropriate for rate-of-return carriers.

c. SLC Deaveraging

57. We also modify our rules today to permit limited SLC deaveraging, which will provide important pricing flexibility for rate-of-return carriers. As discussed below, rate-of-return carriers will be permitted to deaverage SLCs subject to most of the limitations adopted for price cap carriers under the CALLS plan. Whereas price cap carriers may deaverage SLC rates only in accordance with state commission-approved UNE loop zones, however, we conclude that rate-of-return carriers also should be permitted to deaverage SLC rates in accordance with universal service support disaggregation plans established pursuant to the *Rural Task Force Order*. This approach combines the safeguards adopted for price cap carriers under the CALLS plan with the flexibility of the Rural Task Force disaggregation scheme, which we believe is necessary to address the significant diversity among rate-of-return carriers.

58. We conclude that granting rate-of-return carriers more flexibility to deaverage SLC rates will "enhance the efficiency of the local telephone market by allowing prices to be tailored more easily and accurately to reflect costs and, therefore promotes competition in both urban and rural areas."[177] Deaveraging has the added virtue of reducing implicit subsidies created by averaged rates.[178] A number of commenters emphasize the importance of SLC rate deaveraging in enhancing the competitiveness of rate-of-return carriers.[179]

59. In general, we conclude that the limitations and safeguards on SLC rate deaveraging adopted for price cap carriers in the *Interstate Access Support Order* are appropriate for rate-of-return carriers. Multi-line business SLC rates within a given zone will not be allowed to fall below primary residential and single-line business SLC rates.[180] Deaveraged SLC rates for a given customer class cannot be lower in high-cost zones than in low-cost zones.[181]

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[175] *See MAG Notice*, 16 FCC Rcd at 566; *see also 1998 Notice*, 13 FCC Rcd at 14255 para. 48 (proposing to establish SLC rates for ISDN service similar to those adopted for price cap carriers).

[176] 47 C.F.R. § 69.152(l); *see Access Charge Reform Order*, 12 FCC Rcd at 16032 para. 116. The Commission established different SLC rates for BRI and PRI ISDN services based on evidence that the non-traffic sensitive loop costs of the two services differ. Specifically, the Commission determined 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 services[,]" and that "the NTS loop costs of PRI ISDN services, excluding switching costs, reflect a cost ratio of approximately 5:1 compared to the NTS loop costs of single-channel analog service." *Id.*

[177] *Interstate Access Support Order* , 15 FCC Rcd at 13007 para. 113.

[178] *Id.* at 13007 para. 114.

[179] *See, e.g.*, Alaska Rural Coalition Comments at 3, Plains Rural Indep. Cos. Comments at 14, GVNW Consulting Reply at 7, MAG Reply at 10.

[180] *See* 47 C.F.R. § 69.152(q)(3).

[181] *See id.* at § 69.152(q)(4).

Deaveraging must be revenue-neutral: deaveraged SLCs cannot generate more revenue than permitted for averaged SLCs.[182] Rate-of-return carriers may, through voluntary reduction, *lower* SLCs rates in certain disaggregation zones but may not *raise* rates in any disaggregation zones above the SLC caps.[183] For *all deaveraging*, the mandatory SLC caps apply. For purposes of calculating Interstate Common Line Support, SLC revenues will be imputed to rate-of-return carriers as if their SLC rates had been set at the maximum amount.[184] We find that a minimum SLC charge limitation is unnecessary, because rate-of-return carriers are likely to have less latitude than price cap carriers in reducing SLCs due to the above limitations and their higher common line costs.[185]

60. Rate-of-return carriers may deaverage SLCs only in accordance with state commission-approved UNE loop zones *or* with disaggregation plans established pursuant to the *Rural Task Force Order*.[186] Because both SLCs and high-cost loop support under Part 36 of the Commission's rules recover loop costs, the cost characteristics of rate-of-return carrier service areas should be the same for purposes of SLC deaveraging and disaggregation of high-cost loop support. The approach that we adopt provides the flexibility required to address the significant diversity among rate-of-return carriers, most of which lack state commission-approved UNE loop zones,[187] while applying the safeguards built into the Rural Task Force disaggregation scheme. It also minimizes administrative burdens on rate-of-return carriers, as well as confusion among competitive carriers, by ensuring that rate-of-return carriers do not have multiple, overlapping zones within their service areas for universal service support and SLC rates.

d. Recovery of Remaining Common Line Costs

61. We conclude that the CCL charge, which the Commission largely has phased out for price cap carriers, also should be removed from the rate structure of rate-of-return carriers. As discussed below, the CCL charge will be eliminated as of July 1, 2003, when SLC caps are scheduled to reach their maximum levels, and a new universal service support mechanism, Interstate Common Line Support, will be implemented to replace the CCL charge beginning on July 1, 2002.[188] Consistent with the mandate of the 1996 Act, these measures will rationalize the common line rate structure, move per-minute switched access rates towards lower, cost-based levels, and convert implicit support for universal service to explicit support that is secure in an competitive environment.

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[182] *Id.* at § 69.152(q)(5).

[183] *See Interstate Access Support Order*, 15 FCC Rcd at 13014 para. 127 ("The proposal provides an incentive to LECs to deaverage voluntarily other than through offset free from the limitations of the proposed safeguards.").

[184] *See MAG Notice*, 16 FCC Rcd at 567 (proposing that, for purposes of pooling, SLC revenues be imputed to rate-of-return carriers "as if they had been set at the maximum amount"); *infra*, § IV.D.2.

[185] Under the CALLS plan, a minimum SLC rate within the price cap carrier's lowest-cost zone limits the rates in higher-cost zones. *See* 47 C.F.R. § 69.152(q)(7); *Interstate Access Support Order*, 15 FCC Rcd at 12990 para. 73.

[186] *See Rural Task Force Order*, 16 FCC Rcd at 11302-09 paras. 144-64.

[187] *See* 47 U.S.C. § 251.

[188] *See infra*, § IV.D.2.

62. The Commission has concluded that the CCL charge is an "inefficient cost-recovery mechanism and implicit subsidy" which is not sustainable in a competitive environment.[189] As discussed above, the CCL charge permits rate-of-return carriers, to the extent that they cannot recover their non-traffic sensitive interstate loop costs through flat-rated end user charges and LTS, to recover such costs through a per-minute charge imposed on interexchange carriers.[190] Interexchange carriers pass this charge on to their customers in the form of higher long distance rates, "keeping toll rates artificially high and discouraging demand for interstate long distance services."[191] This rate structure creates implicit support flows between different classes of customers.[192] It is not sustainable in a competitive environment because, among other things, "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."[193] Consistent with the Act and with prior reforms adopted for price cap carriers, therefore, we conclude that the CCL charge should be removed from the common line rate structure of rate-of-return carriers.[194]

63. Removing the CCL charge from the common line rate structure of rate-of-return carriers will have a number of important benefits. It will reduce the cost of long distance service and encourage a more efficient level of consumption. It will move per-minute switched access rates towards cost-based levels and promote efficient competition in the exchange access market by permitting both incumbent and competitive carriers to compete for all services based on price.[195] Furthermore, by fostering efficient competition, conversion of the CCL charge to explicit, portable universal service support will lead to lower rates and better service.[196] Currently, the CCL charge is imposed on interexchange carriers that cannot reduce the cost by efficiency gains. By converting the CCL charge to explicit support that is portable to competitive carriers, we will enable competitive carriers that provide service at lower cost to

[189] *Access Charge Reform Order*, 12 FCC Rcd at 16008 para. 69.

[190] *See supra*, §§ III.A, III.B, IV.A.1.

[191] *Access Charge Reform Order*, 12 FCC Rcd at 16013 para. 76.

[192] *See id.* at 16013 para. 76 ("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."); *supra*, § III.B.

[193] *Access Charge Reform Order*, 12 FCC Rcd at 16008 para. 69. In other circumstances, implicit support may undermine efficient competition by permitting an incumbent carrier to price services below cost. *Id.*

[194] *See* 47 U.S.C. § 254(e); *Access Charge Reform Order,* 12 FCC Rcd at 16004-06 paras. 54-60.

[195] *See* Innovative Comments at 2-5 ("As currently constituted, access charges contain implicit subsidies that support universal service. Implicit subsidies are incompatible with today's marketplace"), Telcom Consulting Assoc. Comments at 2, 4 ("[L]ower access rates . . . will greatly reduce the economically inefficient incentives for competitors to pursue high-volume users and will help ensure that all customers will benefits from competition."), AT&T Reply at 6.

[196] *See* Competitive Universal Service Coalition Comments at 5.

pass those cost savings through to rate-paying end users. To remain competitive, incumbent carriers will have greater incentives to create their own efficiencies and reduce their rates.[197]

64. Eliminating the CCL charge also will facilitate compliance with geographic rate averaging and rate integration requirements by interexchange carriers, and encourage interexchange carriers to compete for long distance customers in rural areas.[198] Under section 254(g) of the Act, interexchange carriers bear the cost of averaging on a nationwide basis the different per-minute switched access rates charged by LECs. Wide disparities in switched access rates may create pressure on interexchange carriers to deaverage long distance toll rates, contrary to the requirements of section 254(g).[199] Such disparities also may discourage interexchange carriers from competing to provide service to consumers in the service areas of carriers with high per-minute switched access charges.[200] Rate disparities between rate-of-return and price cap carriers are due partly to cost differences between the two groups and partly to rate structure differences.[201] As a result of the phase out of the CCL charge for price cap carriers, the CCL charge represents a rate structure difference between price cap and rate-of-return carriers that compounds rate disparities between the two groups.[202] Eliminating this difference will reduce such disparities and thereby promote the toll rate averaging policies codified in section 254(g).

65. We adopt the following schedule for phasing out the CCL charge. The current common line rate structure will remain in place until implementation of a new universal service support mechanism, Interstate Common Line Support, to replace the CCL charge beginning on July 1, 2002.[203] From July 1, 2002, to June 30, 2003, rate-of-return carriers may impose a transitional CCL charge on all switched access minutes to recover, for each residential and single-line business line in their study area, the difference between the residential SLC and the lesser of $6.50 or their average cost per line.[204] If the CCL charge were eliminated as of July 1, 2002, prior to SLC caps reaching their maximum permissible level, the size of the new support

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[197] Incumbent rate-of-return carriers also may benefit from access reform in other ways. *See, e.g.,* Innovative Comments at 4 (contending that access reform would permit incumbent carriers to better compete for high-volume customers that may consider the cost of access to interstate service in deciding where to locate their businesses).

[198] *See Access Charge Reform Order*, 12 FCC Rcd at 15996 para. 30.

[199] *See* AT&T Comments at 6-8, GCI Comments at 3, MAG Comments at 8, Sprint Comments at 5-6, Telcom Consulting Assoc. Comments at 5, Wisconsin Commission Comments at 8, AT&T Reply at 7-9; *see also Rural Task Force Order*, 16 FCC Rcd at 11323 para. 202 ("According to the Rural Task Force, rate disparity between price cap and rate-of-return carriers . . . may create significant pressures on interexchange carriers to geographically deaverage toll rates.").

[200] TCA Comments at 5, AT&T Reply at 7-8.

[201] *See Rural Task Force Order*, 16 FCC Rcd at 11323 para. 202; *see infra*, § IV.B.2.a.

[202] *See Access Charge Reform Order*, 12 FCC Rcd at 16004-06 paras. 54-60 (phasing out CCL charge for price cap carriers).

[203] 47 C.F.R. § 69.105.

[204] The multi-line business SLC cap will be increased to $9.20 in a single step on January 1, 2002. We emphasize, however, that the transitional CCL charge will be imposed on all interstate minutes of use, including those for multi-line business lines, although only residential and single-line business lines will be used to determine the amount of revenue needed to be recovered through transitional CCL charges.

mechanism would initially balloon and then shrink in July, 2003.[205] We conclude that a transitional CCL charge is warranted to avoid a sudden, temporary increase in the overall size of the universal service fund. After June 30, 2003, rate-of-return carriers will not be permitted to collect CCL charges from interexchange carriers.

66. We do not adopt the MAG proposal to retain the existing rate structure, including the CCL charge, and provide explicit universal service support to reduce the switched access rates of carriers that elect the MAG incentive plan to an aggregate target of 1.6 cents per minute. As discussed in more detail below, the MAG proposal fails to address inefficiencies and implicit subsidies within the existing rate structure, and would prevent some rate-of-return carriers from fully participating in the benefits of access charge reform.[206] To the extent that the MAG proposal leaves the removal of identifiable implicit support from the interstate access rate structure to the discretion of individual carriers, we also conclude that it is inconsistent with the mandate of the 1996 Act.[207]

67. We also reject proposals to replace the CCL charge with a PICC, or flat, monthly charge assessed on the interexchange carrier to whom an end user is presubscribed.[208] In 1997, the Commission established the PICC as a substitute for the CCL charge in the common line rate structure of price cap carriers.[209] The Commission subsequently concluded, however, that eliminating the PICC would make the rate structure more efficient and more closely aligned with costs.[210] In this regard, it found that most interexchange carriers passed through PICCs to their customers, who ended up paying *more* than they would have if they simply had been charged for interstate loop costs directly by the LEC.[211] Based on our examination of the record, we cannot

[205] *See supra*, § IV.D.2.

[206] *See infra*, § IV.B.2.a; GVNW Consulting Comments at 4 ("without offering [explicit universal service support] as an across-the-board type access rate structure change, the Commission will be missing perhaps the only real opportunity for significant access reform for a potentially large segment of rural independents"); *see also* AT&T Comments at 5-6, 9-10, California Comments at 3, Competitive Universal Service Coalition Comments at 7-13, GCI Comments at 3-4, GSA comments at 6-7, ICORE Comments at 17, Innovative Telephone Comments at 3-4, Fred Williamson & Assoc. Comments at 5, Alaska Rural Coalition Reply at 4-6, Excel Comm'ns Reply at 4-5, Verizon Reply at 5.

[207] *See COMSAT Corp. v. FCC*, 250 F.3d at 938-40 (holding that Commission cannot allow carriers to choose whether to recover their universal service contributions through interstate access charges).

[208] *See* NASUCA Comments at 9; Letter from Bill Maher, Esq., to Jane E. Jackson, Chief, Competitive Pricing Division, and Katherine Schroder, Chief, Accounting Policy Division, Federal Communications Division, at 5 (Sept. 5, 2001).

[209] *See Access Charge Reform Order*, 12 FCC Rcd at 16004-06 paras. 55-60; *supra*, §§ III.C, IV.A.1.

[210] *Interstate Access Support Order*, 15 FCC Rcd at 12991-94 paras. 78-81; *supra*, §§ III.C., IV.A.1.

[211] *Interstate Access Support Order*, 15 FCC Rcd at 12991-92 para. 78 ("Most IXCs currently recover PICCs from their customer through a blended PICC pass-through charge on a per-account basis. This practice results in consumers with only one line paying more than they otherwise would had the LECs simply passed onto them directly the $1.04 worth of permitted revenues that the LEC recovers through the single-line PICC."). We note that the current average multi-line business PICC paid by interexchange carriers to price cap carriers is $1.41, *Trends in Telephone Service*, August, 2001, Table 1.3, Page 1-7, compared to the following PICC charges assessed by the three largest interexchange carriers to multi-line business customers: $3.40 for AT&T (Tariff FCC No. 30, 1st Revised Page 29.3, Section C.3, effective September 14, 2001); $3.65 for WorldCom (Tariff FCC No. 1, 5th Revised

(continued....)

conclude that PICCs would be more appropriate for rate-of-return carriers than they were for price cap carriers. Establishment of a PICC would force interexchange carriers to recover the cost of the PICC from all of their customers, and contribute to rate disparities between the two groups of carriers, thereby increasing the burden on interexchange carriers of compliance with the geographic rate averaging and rate integration requirements of section 254(g).[212] Accordingly, we conclude that the PICC should not be introduced into the common line rate structure of rate-of-return carriers.[213] Consistent with the approach we adopted for price cap carriers in the *Interstate Access Support Order*, we will require a direct recovery of any allowed common line revenues not recovered through the SLC through explicit universal service support.

68. We disagree with commenters that argue that the CCL charge represents an efficient pricing mechanism and does not include implicit support.[214] It is well-established that rate elements like the CCL charge which recover above-cost rates from some end users to support below-cost rates for others constitute implicit support.[215] On that basis we have virtually eliminated CCL charges from the rate structures of price cap carriers. We are not persuaded by commenters that assert otherwise.[216]

B. Local Switching and Transport Rate Structure

1. Background

69. *Local Switching*. 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. The interstate portion of these costs is currently recovered by rate-of-return carriers through per-minute charges levied on interexchange carriers.[217]

70. In the 1997 *Access Charge Reform Order*, the Commission concluded that a significant portion of local switching costs do not vary with usage.[218] In particular, the Commission concluded that the costs of the line port (including the line card, protector, and main

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Page No. 288, Section C.1, effective March 1, 2001); and $4.31 for Sprint (Tariff FCC No. 11, 9th Revised Page 34.1, Section 2.10, effective October 1, 2000).

212 *See infra*, § IV.B.2.a.

213 *See Interstate Access Support Order*, 15 FCC Rcd at 12991-94 paras. 78-81; GSA Comments at 5-6; *see also 1998 Notice*, 13 FCC Rcd at 14250-51 para. 35 (proposing to adopt rate structure modifications for rate-of-return carriers similar to those adopted for price cap carriers).

214 NASUCA Comments at 4-9; *see also* ICORE Comments at 9, John Staurulakis Comments at 3, Interstate Telcom Group Reply at 5.

215 *See Access Charge Reform Order*, 12 FCC Rcd at 15998-16000 paras. 36-40.

216 NASUCA Comments at 4-9; *see also* ICORE Comments at 9, Interstate Telcom Group Reply at 5.

217 *See* 47 C.F.R. § 69.106.

218 *See Access Charge Reform Order*, 12 FCC Rcd at 16035 para. 125.

distribution frame) are non-traffic sensitive and, therefore, required price cap carriers to reassign line-side port costs to the common line category.[219] Price cap carriers were required to conduct cost studies to determine the percentage of local switching costs attributable to line ports.[220]

71. In the *1998 Notice*, the Commission likewise proposed to require rate-of-return carriers to reassign the cost of line ports to the common line category.[221] Acknowledging the small size of many rate-of-return carriers, the Commission also asked about methods other than cost studies that could ease the burden of implementing this proposal.[222] In addition, the Commission proposed to permit rate-of-return carriers to assess a separate, flat-rated charge on end users to recover the amount by which line port costs for ISDN or other services exceed line port costs for basic, analog service.

72. *Transport*. Transport services, also known as interoffice transmission services, carry interstate switched access traffic between the interexchange carrier's point of presence (POP) and the LEC end office that serves the end user.[223] Rate-of-return carriers assess transport charges for entrance facilities,[224] direct-trunked transport,[225] tandem-switched transport,[226] and the transport interconnection charge (TIC). The TIC reflects costs allocated to interstate transport that could not be recovered through facility-based transport rates established under the 1992 interim transport rate structure.[227]

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[219] *Id.*

[220] *Id.* at 16036-37 para. 128.

[221] *1998 Notice*, 13 FCC Rcd at 14257 para. 54.

[222] *Id.*

[223] *Access Charge Reform Order*, 12 FCC Rcd at 16047 para. 150.

[224] Entrance facilities are dedicated facilities that carry interstate traffic between a POP and the LEC central office serving the POP, known as the serving wire center (SWC). *See* 47 C.F.R. § 69.110 (mandating flat-rated charges to recover the costs of entrance facilities).

[225] Direct-trunked transport facilities are dedicated facilities that carry traffic from the LEC office that serves the end user to the SWC, or between any other two points requested by the customer, without being routed through an intervening switch. *See* 47 C.F.R. § 69.112 (mandating flat-rated charges to recover the costs of direct-trunked transport).

[226] Tandem-switched transport routes calls from the SWC to the LEC end office through a tandem switch located between the SWC and the LEC end office. Traffic travels over a dedicated circuit from the SWC to the tandem switch and then over a shared circuit, which carries the calls of many different interexchange carriers, from the tandem switch to the LEC end office. *See* 47 C.F.R. § 69.111 (prescribing a three-part rate structure for recovery of tandem-switched transport costs: a flat-rated charge for the dedicated facility from the SWC to the tandem switch; a per-minute tandem switching charge; and a per-minute charge for common transport from the tandem switch to the LEC end office).

[227] *See Access Charge Reform Order*, 12 FCC Rcd at 16072-73 paras. 210-11. In restructuring transport rates in 1992, the Commission priced tandem switching to include the overhead associated with the local switching category, while pricing direct-trunked transport and the transmission portion of tandem-switched transport to include the lower overhead associated with special access. As an interim measure to protect tandem switch users (small interexchange carriers) and to make the rate restructure revenue-neutral for incumbent LECs, the Commission then reassigned 80 percent of the interstate-allocated cost of tandem switching to the TIC. The TIC is assessed as a per-minute charge on all users of the switched access network. *Id.*

73. To foster competition and efficient pricing in the market for interstate access services, the Commission took steps to reduce and eliminate the TIC in the *Access Charge Reform Order*.[228] The Commission identified and reassigned some TIC costs that were attributable to other access services for price cap and rate-of-return carriers.[229] To phase out the residual TIC for price cap carriers, the Commission applied to the TIC the productivity factor reductions that otherwise would have been applied to all of the price cap baskets, effectively spreading the TIC among the universe of interstate access services.[230] Beginning in January 1998, price cap carriers initially recovered any remaining TIC costs through PICC charges, subject to the PICC cap.[231] Rate-of-return carriers continue to assess a separate TIC charge to recover the residual costs allocated to the TIC.

74. In the *1998 Notice*, the Commission affirmed that "we believe it is important to eliminate the TIC to avoid its potential to adversely affect competitive developments in the marketplace."[232] Among other things, the Commission requested comment on incorporating the TIC into the common line pricing structure, and on whether "spreading the residual TIC proportionately over the other access elements in a manner comparable to that of targeting price cap productivity reductions to the TIC would be practical."[233]

75. *MAG plan.* The MAG proposes to retain the existing access rate structure for rate-of-return carriers, but to establish a target rate or ceiling (Composite Access Rate or CAR) for the per-minute charges of pooling carriers that elect the MAG incentive scheme. It would be reduced to 1.6 cents per minute by July 1, 2003. The MAG also proposes creation of a new universal service support mechanism (Rate Averaging Support or RAS), which would be available only to Path A pooling carriers, to recover any shortfall between the allowed interstate access revenues of Path A pooling carriers and the sum of their revenues derived from switched access rate elements (including SLCs), LTS, and LSS.[234]

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[228] *Id.* at 16073-74 paras. 212-213.

[229] *Id.* at 16074-78 paras. 214-223. The Commission established new rate elements to permit price cap carriers to recover such costs in a more efficient, cost-causative manner, while permitting rate-of-return carriers to recover them through existing rate elements. *Id.* at para. 215; *see 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, Order on Reconsideration, 12 FCC Rcd 10119, 10122-23 paras. 9-12 (1997).

[230] *Access Charge Reform Order*, 12 FCC Rcd at 16083 para. 234. In addition to phasing out the TIC, this measure moved towards its recovery through flat-rated charges, consistent with the Commission's determination that "[f]or elements not demonstrably reflecting usage-sensitive costs, . . . we find, on balance, compelling policy arguments in favor of flat-rated pricing[.]" *Id.* at 16082-83 para. 233.

[231] *Id.* at 16083 para. 234.

[232] *1998 Notice*, 13 FCC Rcd at 14262 para. 70.

[233] *Id.* at 14262 para. 72.

[234] *See MAG Notice*, 16 FCC Rcd at 463 para. 8, 568.

2. Discussion

76. In this section, we adopt measures to reform the access rate structure for local switching and transport services of rate-of-return carriers.[235] In particular, we reallocate the non-traffic sensitive costs of local switch line ports to the common line category, and reallocate remaining costs contained in the TIC to other access rate elements. Together with our actions to reform the common line rate structure, these measures will foster competition and efficient pricing and move the per-minute switched access rates of rate-of-return carriers towards lower, cost-based levels. We do not adopt proposals by the MAG and others to prescribe a single, target rate for rate-of-return carriers, either on an optional or a mandatory basis.

77. First, we address the MAG proposal to prescribe a target rate of 1.6 cents for the per-minute switched access rates of Path A pooling carriers, and alternative proposals to prescribe a mandatory .95-cent target rate for all rate-of-return carriers. For the reasons set forth below, we conclude that these proposals are not supported by cost data and that the non-prescriptive, market-based approach to access charge reform that we adopt is more consistent with the competitive and universal service goals of the 1996 Act. We then address reallocation of local switch line port costs and the costs contained in the TIC, respectively. Finally, we address other pending Commission proposals to modify the local switching and transport rate structure.

a. Analysis of MAG Composite Access Rate Proposal

78. We conclude that the MAG's proposal to retain the existing rate structure and prescribe a target rate of 1.6 cents for the per-minute switched access rates of Path A pooling carriers, known as the CAR proposal, is flawed because it fails to address inefficient, non-cost-based rate elements within the existing rate structure, and would limit interstate access charge reform to a subset of carriers. We also conclude that cost data in the record does not support either the MAG's proposed target rate of 1.6 cents or the .95-cent target rate advocated by other parties. As set forth below, we conclude that the approach to access charge reform that we adopt here, whereby we move rates towards lower, cost-based levels by rationalizing the rate structure and converting implicit subsidies to explicit support, is more consistent with the competitive goals of the 1996 Act and better suited to rate-of-return carriers because of their size, diversity, and regulatory history.

79. The MAG's CAR proposal does not address inefficiencies in the existing rate structure of rate-of-return carriers, focusing instead exclusively on rate level concerns. Thus, line port costs are not addressed and would continue to be recovered through traffic sensitive rates, although they are non-traffic sensitive in character. The MAG's CAR proposal also would retain a TIC rate element, albeit presumably at a lower rate than the present TIC rate. By reallocating line port costs and the TIC instead, we align the rate structure more closely with the manner in which costs are incurred, consistent with longstanding Commission goals.[236]

[235] NECA may incorporate the changes we make in this order into the average schedules to become effective on July 1, 2002.

[236] *See Access Charge Reform Order,* 12 FCC Rcd at 15992-93 para. 24.

80. The MAG's CAR proposal also is flawed because it would remove implicit support within the rate structure only for those companies that elect the MAG incentive regulation scheme. We agree with the many parties that contend that access charge reform is necessary for all rate-of-return carriers.[237] The rate structure modifications that we adopt will increase the efficiency of the rate structure for all rate-of-return carriers and drive their per-minute rates towards lower, cost-based levels, thereby reducing disparities between such rates and those of price cap carriers, which under the CALLS plan are between .55 cents and .95 cents per minute. Reducing rate disparities will facilitate compliance by interexchange carriers with the long distance toll rate averaging and rate integration requirements of section 254(g), and ensure that all rate-of-return carriers fully participate in the benefits of reform. In this regard, a number of commenters argue that the MAG's CAR proposal could lead to increased rate disparities among rate-of-return carriers and create disincentives for interexchange carriers to compete for long distance customers in their service areas.[238]

81. Consistent with prior Commission decisions with regard to price cap carriers, we decline to prescribe the per-minute switched access rates of rate-of-return carriers at forward-looking economic cost levels, as a number of commenters advocate.[239] As the MAG notes, the task of determining the cost of providing service in every area of the country is both difficult and time-consuming.[240] Moreover, a forward-looking economic cost model for rate-of-return carriers is not feasible at this time.[241] The current rates of these carriers are based on interstate-allocated embedded costs, and are limited by the authorized rate of return. The reforms we adopt here will reduce per-minute rates immediately without the need for additional proceedings that would further delay the implementation of access charge reform for rate-of-return carriers, with no guarantee of a more accurate resolution to the cost issue.

82. The MAG advocates prescription of a single, target rate of 1.6 cents for some rate-of-return carriers, arguing that this would constitute an overall percentage reduction in per-minute switched access rates comparable to that approved for price cap carriers under the CALLS plan.[242] This is not a relevant comparison, however. Price cap carriers were subject to the disciplines of the incentives provided by price cap regulation for ten years before adoption of

[237] *See, e.g.*, AT&T Comments at 6-7, GCI Comments at 3-4, GVNW Consulting Comments at 4.

[238] *See, e.g.*, AT&T Comments at 6-7, Fred Williamson and Assoc. Comments at 5.

[239] *Access Charge Reform Order*, 12 FCC Rcd at 16002 para. 46 (the use of forward-looking economic costs could "prove highly disruptive to business operations, even when new explicit universal service support mechanisms are taken into account. Moreover, lacking the tools for making accurate prescriptions, precipitous actions 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 local markets and disrupt existing services."); *see Texas Office of Public Utility Counsel v. FCC*, No. 00-60434 at § II.C (affirming decision not to prescribe rates at forward-looking costs).

[240] MAG Comments at 17.

[241] *See Rural Task Force Order*, 16 FCC Rcd at 11309-13 paras. 167-177.

[242] MAG Comments at 12. Since the MAG plan was filed, rate-of-return carriers have made an annual access tariff filing. As a result, NECA's traffic sensitive rates have increased, suggesting that the rate would no longer be 1.6 cents.

the CALLS plan.[243] Thus, rate-of-return carriers are not at the same starting point as price cap carriers were before adoption of the CALLS plan.

83. We also find the MAG's proposed target rate to be inadequately supported by cost data.[244] No party has attempted to make a cost-based showing to support this proposal.[245] Our examination of the record indicates that many rate-of-return carriers have traffic sensitive costs considerably higher than 1.6 cents per minute.[246] Indeed, the comments filed in the above-captioned proceedings indicate a wide variation in cost patterns, density, and other operational characteristics among rate-of-return carriers.[247] The access charge reform approach that we adopt accommodates this diversity by reallocating costs and removing implicit support to create more efficient rate structures, while allowing carriers to establish rates based on their own costs. Based on examination of the record in the above-captioned proceedings, we have not identified any rate structure modifications, other than the modifications addressed below, that would remove non-cost-based rate elements or implicit subsidies from the rate structure of rate-of-return carriers.

84. Reallocating costs rather than prescribing a single rate also will foster the development of efficient competition in the exchange access market. Rates that reflect an individual carrier's cost of service provide the proper signals to permit a potential entrant to decide whether to enter a particular market. As NASUCA observes, if a target rate were set too low, a barrier to competitive entry would be created.[248] This is particularly so for carriers seeking to provide transport services alone as a means of entering a market. The danger of rate prescription distorting competition for exchange access services is aggravated by the fact that

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[243] *See* Sprint Comments at 6; Letter from John Nakahata, Esq., to Jane E. Jackson, Chief, Competitive Pricing Division, and Katherine Schroder, Chief, Accounting Policy Division, Federal Communications Commission, at 5 (Aug. 28, 2001).

[244] *See, e.g.*, Sprint Comments at 4.

[245] *See id.* at 5.

[246] *See, e.g.*, Plains Rural Indep. Cos. Comments at 11-12 (arguing that MAG's proposed rate is below cost for many rate-of-return carriers because, *inter alia*, both the Hatfield model and the Commission's forward-looking economic cost model estimate that approximately three-quarters of such carriers have access costs of 3 cents per minute or more, and nearly half have access costs of 5 cents per minute or greater), Ronan Tel. Co. Reply at 2-5 (Commission's forward-looking economic cost model shows access costs for rural Montana to be 8 cents per minute); *accord*, John Staurulakis Reply at 3, Ronan Tel. Consumer Advisory Committee Reply at 2-3.

[247] *See, e.g.*, Alaska Rural Coalition Comments at 2-3, Dunkirk and Fredonia Tel. Co. Comments at 2, Evans Tel. Co., *et al.* Comments at 5, GSA Comments at 11, Innovative Tel. Comments at 5-6, ICORE Comments at 4-5, Interstate Telcom Comments at 4, ITTA Comments at 2, Minnesota Indep. Coalition Comments at 4, Missouri Commission Comments at 4, New England Tel. Assoc., Small Co. Members Comments at 1, Plains Rural Indep. Cos. Comments at 5-6, Sprint Comments at 5, Western Alliance Comments at 2-3, 12, GVNW Consulting Reply at 6, John Staurulakis Reply at 2, TDS Reply at 5, Lexcom Tel. Co. Comments in CC Docket No. 98-77 at 7-8, NRTA and NTCA Comments in CC Docket No. 98-77 at 14, Summit Tel. Co. Comments in CC Docket No. 98-77 at 1, USTA Comments in CC Docket No. 98-77 at 2-3, NECA Reply in CC Docket No. 98-77 at 3, NRTA and NTCA Reply in CC Docket No. 98-77 at 8-9; *see also* Rural Task Force White Paper 2 at 9-13.

[248] NASUCA Comments at 16-17.

universal service funding is available only to eligible telecommunications carriers, and relatively few competitive carriers have achieved such status, which requires state certification.[249]

85. Some commenters, including AT&T and other interexchange carriers, advocate a lower, mandatory target rate for all rate-of-return carriers of .95 cents per minute.[250] These parties generally argue that this rate, which under the CALLS plan applies to low-density price cap carriers (fewer than 19 access lines per square mile), is appropriate for rate-of-return carriers because they also are "primarily rural."[251] In a subsequent *ex parte* filing, AT&T and others advocate a variation of this proposal, under which a .25-cent local switching rate would be prescribed, and transport rates would be based on individual carriers' costs.[252] They contend that the latter approach would achieve a total per-minute rate of approximately .95 cents, without adverse impact on the competitive market for transport services. AT&T estimates that its proposal would require approximately $215 million more in universal service support than would be necessary to achieve the MAG's proposed target rate of 1.6 cents per minute.[253]

86. These commenters have failed to demonstrate a sufficient correlation between the costs of low-density price cap carriers and rate-of-return carriers to justify adoption of either the overall .95-cent rate or the .25 cent local switching rate.[254] Many rate-of-return carriers serve areas with population densities significantly lower than 19 access lines per square mile, the threshold for the .95-cent traffic sensitive rate under the CALLS plan. The Rural Task Force found that the average population density in areas served by rural carriers is only about thirteen persons per square mile, compared to 105 persons per square mile in areas served by non-rural carriers.[255] Thus, rural carriers must deploy more transmission facilities to serve their customers and usually employ smaller switches than do carriers serving more densely-populated areas. Rate-of-return carriers also have fewer opportunities than large price cap carriers to achieve cost savings because of their limited size, their lumpy investment patterns, and fluctuating operating

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[249] *See* 47 U.S.C. § 214(e).

[250] *See, e.g.*, AT&T Comments at 6-8,GCI Comments at 3, Global Crossing Comments at 6-7, Sprint Comments at 5.

[251] *See, e.g.*, AT&T Comments at 6-8,GCI Comments at 3, Sprint Comments at 5.

[252] *See* Letter from John T. Nakahata, Esq. to Magalie Roman Salas, Secretary, Federal Communications Commission (July 26, 2001). Under both alternatives, line port costs and all of the costs in the TIC would be reallocated to the common line category.

[253] *See* Letter from John T. Nakahata, Esq., to Jane E. Jackson, Chief, Competitive Pricing Division, and Katherine Schroder, Chief, Accounting Policy Division, Federal Communications Commission, at 2 (Sept. 14, 2001).

[254] In response to the *1998 NPRM*, AT&T proposed that rate-of-return carrier traffic sensitive charges be capped at the nationwide average traffic sensitive rate of price cap carriers. AT&T Comments in CC Docket No. 98-77 at 7. AT&T's earlier proposal appears to be premised on similar reasoning to that supporting the .95-cent proposal. We find the earlier AT&T proposal deficient for the same reasons we find the .95-cent and 1.6-cent proposals to be unacceptable.

[255] Rural Task Force White Paper 2 at 20; *see* Minnesota Indep. Coalition Comments at 4 (15 of the 53 Coalition members for which density data is available have access line density of under five per square mile, and another 18 have access line density of under ten per square mile). As discussed above, the categories of rural and rate-of-return carrier largely overlap. *See supra*, § III.C.

expenses.[256] Thus, based on our examination of the record, we cannot conclude that the proposed .95-cent rate, or the alternative .25-cent local switching rate (which is intended to reduce the overall rate to approximately .95 cents per minute), is representative of the costs of rate-of-return carriers.[257] Rather than prescribing a single, target rate for all rate-of-return carriers, the approach we adopt will drive their per-minute rates down towards price cap carrier levels,[258] while accommodating actual cost differences between different carriers.

87. Several parties argue that we should prescribe a target rate of .95 cents per minute in order to reduce rate disparities between price cap and rate-of-return carriers, regardless of the actual costs of providing service for rate-of-return carriers. These parties contend that significant rate disparities threaten the ability of interexchange carriers to sustain nationwide averaged long distance toll rates.[259] They argue that the BOCs, as they enter the interexchange market through the section 271 process, will gain an unfair competitive advantage over national interexchange carriers because they will be able to offer interstate long distance service from a regional base that reflects the .55-cent traffic sensitive rates of those price cap carriers in the lowest price range.[260] Moreover, some of these parties argue that reduction of rate disparities would encourage all interexchange carriers, both regional and national, to originate service in rural and high-cost areas, thereby increasing consumer choice in those areas.[261]

88. While we recognize that rate disparities may create pressure on interexchange carriers to deaverage long distance toll rates, contrary to the requirements of section 254(g), we reject the proposition that we should address this problem by prescribing below-cost rates. Rate disparities are due partly to rate structure differences that we address in this Order, and partly to actual cost differences between price cap and rate-of-return carriers, as well as among rate-of-return carriers themselves. The measures we adopt in this Order will significantly reduce such rate disparities, consistent with the principle of cost-based access pricing.

89. In addition, the proposal advocated by AT&T and others effectively would eliminate rate disparities by replacing the implicit support for toll rate averaging and rate integration provided for under section 254(g) with explicit universal service funding. It is unclear whether section 254, read as a whole, directs the Commission to make explicit the support for toll rate averaging and rate integration provided for under section 254(g). Moreover, the Commission must strike a fair and reasonable balance among all of the goals and principles

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[256] *See, e.g.*, Townes Telecom. Comments at 1-3, Western Alliance Comments at 6-10, Interstate Telcom Group Reply at 2-6.

[257] *See* John Staurulakis Reply at 3, Ronan Tel. Consumer Advisory Committee Reply at 2-3, Ronan Tel. Co. Reply at 2-5 (Commission's forward-looking economic cost model shows cost of access for rural Montana to be $0.08 per minute).

[258] *See, e.g.*, California Commission Comments at 14.

[259] *See, e.g.*, AT&T Comments at 6.

[260] 47 U.S.C. § 271; *see, e.g.*, AT&T Comments at 7-8; *see also Rural Task Force Order*, 16 FCC Rcd at 11323 para. 202 (rate disparities may create significant pressures on national long distance carriers to geographically deaverage toll rates in the face of competition from regional carriers that originate service in areas with lower access charges).

[261] *See, e.g.*, Telcom Consulting Assoc. Comments at 5, AT&T Reply at 7-8.

of the Act, including both competitive and universal service goals. In this regard, the AT&T proposal is inconsistent with principles of cost-based pricing and, therefore, presents the danger of distorting competition. We also are concerned that the AT&T plan may lead to excessive universal service funding, which "may itself violate the sufficiency requirements of the Act."[262] Finally, based on our examination of the record, we are not persuaded that adoption of the AT&T plan is necessary to ensure the continued ability of carriers like AT&T to comply with section 254(g). The steps we take should lessen AT&T's concern and will hold down the cost of universal service.

b. Line Port Costs

90. We adopt the Commission's proposal from the *1998 Notice* to modify the access rate structure for rate-of-return carriers by reallocating line port costs from local switching to the common line category. To ease the burden of implementing this rate structure modification on small rate-of-return carriers, we will permit them to shift 30 percent of their local switching costs to the common line category in lieu of conducting a cost study.

91. The recovery of line port costs through per-minute local switching charges is inconsistent with the Commission's longstanding policy that non-traffic sensitive costs should be recovered through flat-rated charges.[263] For this reason, the Commission shifted such costs to the common line category for price cap carriers, and proposed to do the same for rate-of-return carriers.[264] Based on our examination of the record, we conclude that reallocating line port costs to the common line category will foster competition and efficient pricing by aligning the rate structure more closely with the manner in which costs are incurred, and move per-minute switched access charges towards lower, more cost-based levels.[265]

92. In 1998, several rate-of-return carriers opposed the reallocation of line port costs to the common line category, arguing that this would only increase their already-high PICC and CCL rates.[266] We note that, instead of being recovered primarily through CCL and PICC charges, the reallocated line port costs generally will be recovered through SLCs or Interstate Common Line Support under the approach we adopt in this Order.

93. Rather than requiring cost studies, as we did for price cap carriers, we will permit rate-of-return carriers to shift 30 percent of their local switching costs to the common line

[262] *Alenco Communications, Inc. v. FCC*, 201 F.3d at 619 ("Because universal service is funded by a general pool subsidized by all telecommunications providers—and thus indirectly by customers—excess subsidization in some cases may detract from universal service by causing rates unnecessarily to rise, thereby pricing some consumers out of the market.").

[263] *See supra*, § III.A.

[264] *1998 Notice*, 13 FCC Rcd at 14257 para. 54; *Access Charge Reform Order*, 12 FCC Rcd at 16035 para. 125.

[265] *Access Charge Reform Order*, 12 FCC Rcd at 16035 para. 125.

[266] *See, e.g.*, MCI Comments in CC Docket No. 98-77 at 17-18, Western Alliance Comments in CC Docket No. 98-77 at 17-18.

category as a proxy for line port costs.[267] We agree with commenters who argue that requiring cost studies for all rate-of-return carriers would be overly burdensome, costly, and time-consuming for small carriers.[268] Several commenters support the use of a proxy to avoid the need for cost studies.[269] By adopting a proxy, we also respond to our obligations under the Regulatory Flexibility Act to minimize administrative burdens on smaller incumbent local telephone companies.[270]

94. We adopt 30 percent of local switching costs as a reasonable proxy for line port costs because this figure is incorporated into the Commission's forward-looking high-cost model for price cap carriers.[271] The model uses 30 percent to allocate local switching costs to the common line category to be included in the calculation of high-cost support. We recognize that rate-of-return carriers' line port costs may vary widely,[272] and are mindful of estimates that line port costs represent significantly more than 30 percent of local switching costs for some carriers.[273] We conclude that the existing record is inadequate to establish an average allocation factor specific to rate-of-return carriers. Adopting the high-cost model's 30 percent factor as a default allocator provides comparability between price cap and rate-of-return carriers.

95. To avoid any undue hardship that may result from selecting a default allocator of 30 percent, rate-of-return carriers also will have the option to submit a cost study to establish the portion of their local switching costs attributable to line port costs. Carriers electing this approach must base their cost studies on geographically-averaged costs, and submit the cost study in support of the tariff filing relying on the cost study. Once a rate-of-return carrier has performed a cost study to support its tariff, it may rely on that cost study for subsequent tariff filings. A rate-of-return carrier electing to use a cost study for a tariff must use the cost study for all elements in the tariff.

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[267] *See* Letter from John T. Nakahata, Esq. to Magalie Roman Salas, Secretary, Federal Communications Commission (July 25, 2001) (proposing use of 30 percent figure from Commission's forward-looking high-cost model as a proxy).

[268] *See, e.g.*, Lexcom Tel. Co. Comments in CC Docket No. 98-77 at 19-20, NECA Comments in CC Docket No. 98-77 at 8, USTA Comments in CC Docket No. 98-77 at 18 n. 43.

[269] *See, e.g.*, GVNW Consulting Comments in CC Docket No. 98-77 at 6-9, Lexcom Tel. Co. Comments in CC Docket No. 98-77 at 19-20, John Staurulakis Comments in CC Docket No. 98-77 at 7; *see also* NECA Comments in CC Docket No. 98-77 at 8, USTA Comments in CC Docket No. 98-77 at 18, n.43.

[270] *See* 5 U.S.C. § 601, *et seq.*

[271] *Federal-State Joint Board on Universal Service Forward-Looking Mechanism for High Cost Support for Non-Rural LECs*, CC Docket Nos. 96-45 and 97-100, Fifth Report & Order, 13 FCC Rcd 20835, 21354-21357 paras 75-80 (1998); *Federal-State Joint Board on Universal Service Forward-Looking Mechanism for High Cost Support for Non-Rural LECs*, CC Docket Nos. 96-45 and 97-100, Further Notice of Proposed Rulemaking, 12 FCC Rcd 18565 para 134 (1997).

[272] *Access Charge Reform Order*, 12 FCC Rcd at 16036-37 para. 128.

[273] John Staurulakis Comments in CC Docket No. 98-77 at 7 (estimating line port costs and associated costs to be 53 percent of the total cost of local switching, "slightly higher than [the 51 percent] previously reported by USTA" and "significantly higher than the 37 percent that NECA has projected").

96. We adopt our proposal to require rate-of-return carriers to recover through a separate end user charge the costs of ISDN line ports and line ports associated with other services that exceed the costs of a line port used for basic analog service.[274] We do not agree with USTA that these additional line port elements should be optional.[275] The new universal service support mechanism that we establish here generally provides support for common line costs not recovered through end user rates. Therefore, if establishment of this line port element were optional, rate-of-return carriers might have a disincentive to charge it and recover the costs in question through universal service support rather than their customers. Customers purchasing these services from rate-of-return carriers find value in them, and should pay comparable rates to those paid by customers of price cap carriers for similar services.

97. Reallocation of line port costs is not intended to reduce or modify the level of support for local switching costs received by small local telephone companies through the LSS program.[276] To ensure that LSS support levels are unchanged by our action, we clarify that the reallocation of line port costs to the common line category each year is to be calculated after the LSS amount has been determined and removed from the interstate local switching revenue requirement. This method should ensure that LSS support levels are not adversely affected and prevent any double recovery.

c. Transport Interconnection Charge

98. We adopt the Commission's proposal in the *1998 Notice* to reform the access rate structure for rate-of-return carriers by eliminating the TIC as a separate rate element. We conclude that the costs recovered through the TIC should be reallocated to all of the access categories. This method is consistent with the approach we used for eliminating the TIC for price cap carriers in the *Access Charge Reform Order*.[277] It will make the access rate structure more economically rational for rate-of-return carriers and drive their traffic sensitive rates towards lower, more cost-based levels.

99. While the TIC recovers interstate-allocated costs of rate-of-return carriers,[278] it is not a cost-based rate element, but an artifact of the 1992 interim pricing structure that was never intended as a permanent measure. We cannot conclude that retention of the TIC would serve the public interest. As a per-minute charge assessed on all switched access minutes, the TIC adversely affects the development of competition in the interstate access market. Competing

[274] *1998 Notice*, 13 FCC Rcd at 14257 para. 56.

[275] USTA Comments in CC Docket No. 98-77 at 18-19.

[276] *See, e.g.,* GVNW Consulting Comments in CC Docket No. 98-77 at 6-9, Western Alliance Comments in CC Docket No. 98-77 at 18, USTA Comments in CC Docket No. 98-77 at 18.

[277] Because the Commission's resolution of the TIC issue for price cap carriers was affirmed in *Southwestern Bell Tel. Co. v. FCC*, 153 F.3d 523 (8th Cir. 1998), we believe that our treatment of the TIC for rate-of-return carriers is consistent with the court's decision in *Comptel Corp. v. FCC*, 87 F.3d 522, 526 (5th Cir. 1996).

[278] In this regard, we note that the Commission, accepting a Joint Board recommendation, recently adopted an interim five-year freeze of Part 36 category relationships and jurisdictional allocation factors for price cap carriers and allocation factors for rate-of-return carriers. *Jurisdictional Separations Reform and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, Report and Order, 16 FCC Rcd 11382 (2001).

providers of transport service that interconnect with the public switched telephone network through expanded interconnection must pay this charge regardless of whether they use the incumbent LEC's transport network. Thus, the TIC unduly increases the cost of competitive entry. To the extent that the TIC recovers non-traffic sensitive costs, it also increases the per-minute access charges paid by interexchange carriers and long-distance consumers, artificially suppressing usage of such services and encouraging customers to explore ways to bypass the public switched telephone network.

100. We conclude that spreading the costs currently recovered through the TIC over all access categories is most consistent with the record before us and with the approach used to eliminate the TIC for price cap carriers. We conclude that the residual TIC costs of rate-of-return carriers are related to the different access categories and represent both traffic sensitive costs, such as switching and transport-related costs, and non-traffic sensitive costs such as those related to the common line or special access services.[279] Thus, it is appropriate to spread these costs over all access categories. The effect of spreading the costs recovered through the TIC over all access categories will be comparable to the economic effect of targeting the productivity increases to reducing the service band index for the TIC, as was done for price cap carriers. The targeting of the productivity reductions to the TIC for price cap carriers had the effect of reducing the TIC and leaving rates for other access services higher than they would have been if the productivity factor had been applied to their price cap index.

101. We conclude that spreading the costs recovered through the TIC among all access categories is preferable to shifting them entirely to the common line category, as urged by some parties.[280] As we found in the *Access Charge Reform Order*, some of the remaining costs recovered by the TIC result from at least two different causes affecting transport services: (1) the separations process assigns costs differently to private line and switched services, resulting in the costs allocated to special access being lower than those allocated to the transport category, even though the two services use comparable facilities; and (2) the cost of providing transport in less densely populated areas is higher than that reflected by transport rates derived from special access rates.[281] Based on our examination of the current record, however, we cannot determine the portion of the costs recovered through the TIC that are truly transport-related. Nevertheless, it is clear that some of the costs recovered through the TIC are related to transport services, and consistency with our cost-causation principles requires the allocation of some of the costs to transport services.

102. The amounts to be reallocated from the TIC to other categories shall be determined based on the projected revenue requirements of rate-of-return carriers for all of the

[279] *Access Charge Reform Order*, 12 FCC Rcd at 16079-80 paras. 225-26. Accordingly, we reject the argument that these costs should be recovered through transport rates only. *See* Letter from Lisa M. Zaina, Vice President, Wallman Strategic Consulting, Inc., to Magalie Roman Salas, Secretary, Federal Communications Commission (Aug. 7, 2001).

[280] *See, e.g.*, Letter from John T. Nakahata, Esq. to Jane E. Jackson, Chief, Competitive Pricing Division and Katherine Schroder, Chief, Accounting Policy Division, Federal Communications Commission, at 6-7 (Sept. 27, 2001).

[281] *Access Charge Reform Order*, 12 FCC Rcd at 16079 para. 225.

access categories, including the special access category. Because the costs recovered through the TIC are being reallocated, the TIC revenues from the transport category shall be excluded from the calculation. In addition, LSS shall be excluded from the calculation because it represents intrastate costs shifted to the interstate jurisdiction as a form of universal service support.[282] For purposes of reallocation, the projected common line revenue requirement shall include LTS, Interstate Common Line Support, and line port costs reallocated to the common line category. Rate-of-return carriers shall not include universal service contributions because these costs are not associated with the carrier's own operations that provide interstate access service.

103. In future tariff years, the total revenues reallocated from the TIC to other access categories will be limited to the total revenues recovered through the TIC for the 12-month period ending June 30, 2001. We conclude that this limitation is necessary because rate-of-return carriers' transport rates are set for each tariffing period, and the residual TIC amount to be reallocated could vary from year to year depending upon transport facility rates. Because a portion of the costs shifted to the common line category will be recovered through universal service support, rate-of-return carriers would have an incentive to set lower transport rates that would increase the amount of transport costs recovered through the TIC, thereby shifting more costs to the common line category. This would have an anti-competitive effect on the development of competition in these rate-of-return carrier service areas, especially in competing for transport services, and unduly increase universal service funding requirements. Accordingly, we establish a dollar limit on the transport costs that may be reallocated, equal to the revenues recovered through the TIC charge for the 12-month period ending June 30, 2001. Transport costs above this amount must be recovered through transport rates.[283] This will prevent rate-of-return carriers from recovering excess amounts from rates for services included in the common line category or from universal service support.

104. Because rate-of-return carriers may enter or leave the NECA traffic sensitive pool based on annual elections, we conclude that it is necessary to establish a procedure to determine the amount of TIC costs associated with each rate-of-return carrier. Then, as individual carriers enter or leave the pool, NECA, or the carrier, will be able to determine the amount of transport costs to be reallocated to the common line category. Specifically, we will require NECA to establish for each rate-of-return carrier that participated in the pool during the tariff year ending June 30, 2001, a dollar limit based on the carrier's traffic volumes and the TIC rate for the 12-month period ending June 30, 2001. Each rate-of-return carrier that was not in the pool during the tariff year ending on June 30, 2001, shall determine its TIC limit and report it to NECA for purposes of administering future pool membership changes.

d. Other Local Switching and Transport Rate Structure Issues

105. *Background*. Consistent with prior reforms adopted for price cap carriers, the Commission proposed a number of other local switching and transport rate structure modifications in the *1998 Notice*. The Commission proposed to require rate-of-return carriers to

[282] *See supra*, n.56.

[283] We choose this period because it is the last period for which carriers established transport rates without knowing that a universal service component would be implicated in future rate-setting for costs recovered through the TIC.

establish the following local switching rate elements: a flat charge for dedicated trunk port costs; a flat charge for the costs of DS1/voice grade multiplexers associated with terminating dedicated trunks at analog switches; and a per-minute charge for shared trunk ports and any associated DS1/voice grade multiplexer costs.[284] The Commission also proposed to adhere to a per-minute rate structure for shared local switching facilities, and to permit rate-of-return carriers to establish a per-message call setup charge.[285]

106. In addition, the Commission proposed to create the following transport rate elements: a flat charge for the costs of trunk ports used to terminate dedicated trunks on the serving wire center side of the tandem switch; and individual charges for multiplexer costs associated with tandem switches.[286] With regard to shared facilities at the tandem switch, the Commission tentatively concluded that "there is no need to create a separate charge for shared trunk ports on the end-office-side of the tandem switch because this trunk port cost is included in the charge for the tandem switch and there is no reason to charge separately for shared trunk ports in the tandem switching context."[287] The Commission also proposed to continue the existing rate structure for Signalling System Seven (SS7) cost recovery by rate-of-return carriers, with an optional structure to reflect the SS7 rate structure approved for Ameritech in a 1996 waiver order.[288] The Commission asked for comment on all of these proposals, and on means of simplifying and reducing the administrative burdens associated with establishing new rate elements.[289]

107. *Discussion*. We will permit, but not require, rate-of-return carriers to establish the above-stated local switching and transport rate elements proposed in the *1998 Notice*. These rate structure modifications are similar to reforms previously implemented for price cap carriers, and will foster efficient pricing by permitting rate-of-return carriers to establish new, cost-causative rate elements. We adopt our proposals to adhere to a per-minute rate structure for shared local switching facilities and not to create a separate charge for shared trunk ports on the end-office-side of the tandem switch.

108. Based on examination of the record, we conclude that these rate structure modifications should be optional to avoid undue administrative burdens on small rate-of-return

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[284] *1998 Notice*, 13 FCC Rcd at 14257 para. 55, 14258 para. 58; *see id.* at n.78. The Commission reassigned the costs of DS1/voice-grade multiplexers from the TIC to the local switching category in the *Access Charge Reform Order*, but did not establish separate rate elements for them. *See* Order on Reconsideration, 12 FCC Rcd at 10123 paras. 9-12.

[285] *1998 Notice*, 13 FCC Rcd at 14258-59 paras. 59-60.

[286] *Id.* at 14261 paras. 67-68. The Commission reassigned multiplexer costs associated with the tandem switch from the TIC to tandem switching in the *Access Charge Reform Order*, but did not create separate rate elements for them. *See* Order on Reconsideration, 12 FCC Rcd at 10123 paras. 9-12.

[287] *1998 Notice*, 13 FCC Rcd at 14261 para. 67.

[288] *Id.* at 14263-64 para. 77; *Ameritech Operating Companies Petition for Waiver of Part 69 of the Commission's Rules to Establish Unbundled Rate Elements for SS7 Signaling*, Order, 11 FCC Rcd 3839 (Com. Car. Bur. 1996) (*Ameritech SS7 Waiver Order*). SS7 is the international standard network protocol used to establish and close transmission paths over which telephone calls are carried. *See 1998 Notice*, 13 FCC Rcd at 14262 para. 73.

[289] *See id.* at 14257 para. 55, 14259 para. 60, 14261 para. 68.

carriers, consistent with the requirements of the Regulatory Flexibility Act.[290] The costs in question represent a comparatively small fraction of carrier access revenues.[291] We agree with commenters that, for some small rate-of-return carriers, the efficiency gains from recovering such costs through new rate elements may not justify the costs of establishing such elements.[292] Making these rate structure modifications optional will allow rate-of-return carriers to make individual determinations as to whether the costs of establishing new rate elements are warranted by the potential efficiency gains.

109. We clarify that, if a rate-of-return carrier decides to establish any of the new local switching rate elements (for the costs of dedicated trunk ports, DS1/voice grade multiplexers associated with terminating dedicated trunks at analog switches, and shared trunk ports and associated DS1/voice grade multiplexer costs), it must do so for all. This is necessary in order to ensure that purchasers of dedicated trunks and associated multiplexers do not pay the costs of shared trunk ports and associated multiplexers that they do not use. To establish rates for trunk ports used to terminate dedicated trunks on the serving wire center side of the tandem switch, carriers may use the rates for dedicated trunk ports at the local switch.[293] Carriers may establish rates for multiplexer costs based on their multiplexer rates for special access services.[294]

110. Rate-of-return carriers may elect to establish a separate per-message call setup charge for all originating interstate calls handed off to the interexchange carrier's POP, and on all terminating interstate calls received from the interexchange carrier's POP, whether or not a call is completed.[295] To prevent any double recovery, call setup charges cannot overlap with any other local switching charges, with charges for dedicated SS7 facilities, or with other signaling charges.[296] The costs that a carrier may recover through call setup charges are limited to those associated with signaling.[297]

111. We adopt the proposal from the *1998 Notice* to continue the existing rate structure for SS7 cost recovery, and to permit rate-of-return carriers to adopt the same optional rate structure for SS7 services currently available to price cap carriers.[298] Thus, rate-of-return carriers may elect to recover SS7 costs through four unbundled charges for the following functions performed by SS7 networks: (1) signal link; (2) signaling transfer point (STP) port

[290] *See* 5 U.S.C. § 601, *et seq.*

[291] *See* MCI Comments in CC Docket No. 98-77 at 17-20.

[292] *See, e.g.*, MCI Comments in CC Docket No. 98-77 at 17-20, USTA Comments in CC Docket No. 98-77 at 18-19.

[293] *See 1998 Notice*, 13 FCC Rcd at 14261 para. 67.

[294] *See id.*

[295] *See id.* at 14258 para. 59 ("at this point the rate-of-return LEC's switches and signaling network have performed their functions and the incumbent LEC has incurred the full cost of its call setup function.").

[296] *See id.*

[297] *See id.* at 14259 para. 60 ("As stated in the Access Charge Reform Order, it would be extremely difficult to segregate the costs of the switch central processing unit and other traffic-sensitive costs into per-message and per-minute portions and to verify that the allocation has been done properly.").

[298] *1998 Notice*, 13 FCC Rcd at 14263-64 paras. 76-78; *Ameritech SS7 Waiver Order*, 11 FCC Rcd at 3841.

termination; (3) signal transport; and (4) signal switching.[299] Unbundling of SS7 services will promote efficiency by ensuring that signaling charges more accurately reflect the costs of providing such services.[300] We will not require such unbundling, however, because the costs of unbundling may exceed the benefits.[301]

C. Other Access Reform Issues

112. In this subsection, we address proposals from the *1998 Notice* concerning general support facilities (GSF) costs, marketing expenses, and special access.

1. General Support Facilities Costs

113. *Background.* The GSF cost category includes assets that support other operations, such as land, buildings, vehicles, and general purpose computer investment.[302] Some rate-of-return carriers use general purpose computer equipment to provide non-regulated billing and collection services to interexchange carriers.[303] The Commission's rules, however, do not allocate any portion of rate-of-return carrier GSF costs to the billing and collection category.[304] To the extent that rate-of-return carriers' costs are under-allocated to the billing and collection category, rate-of-return carriers' regulated services are recovering costs associated with unregulated services through interstate access charges.[305]

114. To address this issue with regard to price cap carriers, the Commission required the use of a general expense factor to allocate the interstate share of four accounts between the billing and collection category and all other rate elements and categories.[306] The allocation to the billing and collection category is determined by applying a modified "Big Three Expense Factor" to the interstate investment recorded in the four accounts.[307] The Commission

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[299] *1998 Notice*, 13 FCC Rcd at 14263 para. 74; *see Ameritech SS7 Waiver Order*, 11 FCC Rcd at 3841.

[300] *See Access Charge Reform Order*, 12 FCC Rcd at 16089-90 para. 252.

[301] *See id.*

[302] *See* 47 C.F.R. § 36.611.

[303] *See 1998 Notice*, 13 FCC Rcd at 14264 para. 79.

[304] *Id.* at 14264-65 paras. 79-80; *see* 47 C.F.R. § 69.307. Section 69.307 provides that GSF costs are to be allocated 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) costs allocated to each Part 69 category. No COE, CWF, or IO/T costs are allocated to the billing and collection category, however. Thus, although the rule appears on its face to provide for an allocation of GSF costs to billing and collection, its application does not result in such an allocation.

[305] *1998 Notice*, 13 FCC Rcd at 14264-65 para. 80.

[306] *Access Charge Reform*, CC Docket No. 96-262, Third Report and Order, 12 FCC Rcd 22430 (1997) (*Third Access Charge Reform Report and Order*). The four accounts are Account 2111 (Land), Account 2121 (Buildings), Account 2123 (Office Equipment), and Account 2124 (General Purpose Computers).

[307] *See 1998 Notice*, 13 FCC Rcd at 14265 para. 81. The "Big Three Expenses" are (1) Plant Specific Operations Expenses (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). The Big Three Expense Factor is calculated separately by each price cap carrier as the ratio of (a) the sum of the Big Three Expenses apportioned to each rate element or cost category to (b) the sum of the combined Big Three Expenses. 47

(continued....)

tentatively concluded in the *1998 Notice* that similar modifications should be adopted for rate-of-return carriers.[308] The Commission requested comment on whether any adjustments to the allocation procedure adopted for price cap carriers would be necessary, the extent to which large and small rate-of-return carriers might be affected differently by the proposed modifications, and the potential impact on small businesses.[309]

115. *Discussion.* We adopt our proposal to require rate-of-return carriers that use general purpose computers to provide non-regulated billing and collection services to allocate a portion of their GSF costs to the billing and collection category. While several parties argue that fixed price long-term contracts preclude future recovery of those costs if GSF costs are reallocated to the billing and collection category,[310] we conclude, as we did for price cap carriers, that this measure is necessary in order to prevent cross-subsidization of non-regulated services by regulated services, and comports with principles of cost causation.[311]

116. Based on our examination of the record, however, we conclude that certain adjustments to the allocation procedure adopted for price cap carriers are warranted for rate-of-return carriers. Rate-of-return carriers are not required to maintain the account detail that provides separate land, buildings, office furniture, and general purpose computer investment detail in order to implement the allocator adopted for price cap carriers.[312] To develop the data necessary to implement the GSF allocator used by price cap carriers would require considerable effort on the part of rate-of-return carriers to identify the amounts related to these four accounts. To accommodate these accounting limitations, we will only require rate-of-return carriers to determine the cost of their investment in general purpose computers. Rate-of-return carriers will then apply the modified Big Three Expense Factor used by price cap carriers to their general purpose computer investment to determine the amount to be allocated to the billing and collection category.[313] We will permit rate-of-return carriers to use the general purpose computer investment amount it develops for a period of three years. While this procedure will allocate less GSF to the billing and collection category than the method used by price cap carriers, it recognizes the limitations of the accounting system and the administrative burdens of

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C.F.R. §§ 69.2 (e) and (f). The Commission modified the Big Three Expense Factor to exclude amounts that are themselves apportioned based on the apportionment of GSF costs. *1998 Notice*, 13 FCC Rcd at 14265 para. 81.

[308] *1998 Notice*, 13 FCC Rcd at 14265-66 para. 82.

[309] *Id.* (noting that "certain small rate-of-return LECs do not maintain accounts below the summary account level").

[310] *See, e.g.*, Fred Williamson & Assoc. Comments in CC Docket No. 98-77 at 11, ICORE Comments in CC Docket No. 98-77 at 5-6, NECA Reply in CC Docket No. 98-77 at 8, NRTA and NTCA Reply in CC Docket No. 98-77 at 15-16.

[311] *See, e.g.*, AT&T Comments at 17-18; *see also Third Access Charge Reform Report and Order*, 12 FCC Rcd at 22430.

[312] *See* 47 C.F.R. § 32.2110.

[313] As with price cap carriers, any GSF investment in Account 2110 not allocated to the billing and collection category will be apportioned among the access elements, the billing and collection category, and the interexchange category using the current investment allocator. The interstate portion of Account 6120 (General Support Expenses) will continue to be apportioned among all elements and categories, including billing and collection. 47 C.F.R. § 69.401(a)(2); *see Third Access Charge Reform Report and Order*, 12 FCC Rcd at 22443-44 para. 35.

developing further disaggregated investment detail, consistent with the requirements of the Regulatory Flexibility Act.[314] To give small rate-of-return carriers ample time to comply with the new allocation procedures, and to permit them to renegotiate their billing and collection contracts, the new procedures will not become effective until July 1, 2002.

117. We clarify that rate-of-return carriers whose billing and collection activities are performed exclusively by service bureaus will continue to allocate GSF pursuant to section 307(c) of our rules, which specifically addresses the situation in which rate-of-return carriers obtain all billing and collection services they provide to interexchange carriers from unregulated affiliates or from unaffiliated third parties. We decline to adopt proposals to exempt from the new allocation procedure carriers with fewer than 50,000 lines.[315] Many of those carriers use billing and collection services exclusively and, therefore, will not be affected. For those carriers that are affected, the cost of determining their general purpose computer investment should be relatively small.

2. Marketing Expenses

118. We do not adopt the tentative conclusion from the *1998 Notice* to require rate-of-return carriers to recover marketing expenses through the common line recovery mechanisms. The Commission previously directed price cap carriers to recover interstate-allocated marketing costs unrelated to the sale or advertising of switched access services from end users on a per-line basis, concluding that such costs should not be recovered from interexchange carriers through per-minute charges.[316] In the *1998 Notice*, the Commission tentatively concluded that rate-of-return carriers' marketing expenses should be recovered in a similar manner.[317] Based on examination of the record, however, we cannot conclude that adoption of such a requirement is warranted for rate-of-return carriers. As a general matter, determining the costs to be reallocated is likely to be more difficult than for price cap carriers, because rate-of-return carriers are not required to keep Class A accounts, which are more detailed.[318] In addition, the costs in question represent only a small portion of rate-of-return carriers' interstate access revenues.[319] Furthermore, we are concerned that such a requirement would permit marketing costs, which are under rate-of-return carriers' control, to be recovered largely from universal service support, because SLC rates for many rate-of-return carriers are likely to be at their ceilings. For these

[314] *See* 5 U.S.C. § 601, *et seq.*

[315] *See, e.g.*, GVNW Consulting Comments in CC Docket No. 98-77 at 10-14, ICORE Comments in CC Docket No. 98-77 at 5-6, NECA Comments in CC Docket No. 98-77 at 6-7.

[316] *Access Charge Reform Order*, 12 FCC Rcd at 16122-23 para. 324; *see Interstate Access Support Order*, 15 FCC Rcd at 13003 paras. 102-03. The Commission reasoned that "recovering these expenses from end users instead of from interexchange carriers is consistent with principles of cost-causation to the extent that LEC sales and advertising activities are aimed at selling retail services to end users, and not at selling switched access services to interexchange carriers." *See 1998 Notice*, 13 FCC Rcd at 14266-67 para. 84.

[317] *1998 Notice*, 13 FCC Rcd at 14267 para. 86.

[318] *See* 47 C.F.R. § 32.2110.

[319] The majority of marketing expenses already are assigned to the common line category because this category includes the largest percentage of carrier investment and expenses. AT&T estimated the total amount of marketing expense in local switching and transport to be $7.9 million. AT&T Comments in CC Docket No. 98-77 at Table 1.

reasons, we conclude that the benefits of requiring rate-of-return carriers to reassign marketing expenses to the common line category would be outweighed by the costs.

3. Special Access Primary Interexchange Carrier Charge

119. We will not apply a presubscribed interexchange carrier charge (PICC) to special access services offered by rate-of-return carriers. In the *1998 Notice*, we invited comment on "whether, if we apply a PICC to special access services offered by price cap LECs, we should apply a PICC to special access services offered by rate-of-return LECs."[320] We recently decided not to impose a PICC on special access services offered by price cap carriers, noting the regulatory changes that had occurred since the proposal was made and the unanimous opposition to the proposal.[321] For the same reasons, and because the common line rate structure for rate-of-return carriers does not include a PICC, we will not apply a PICC to special access services offered by rate-of-return carriers.

D. Universal Service

120. In this section, we establish a new universal service support mechanism, Interstate Common Line Support, to replace implicit support in the interstate access rate structure of rate-of-return carriers. Specifically, we replace the CCL charge with explicit support that will be available to all eligible telecommunications carriers on an equitable, non-discriminatory, and competitively neutral basis. Like the CCL charge, Interstate Common Line Support will provide support for rate-of-return carriers to the extent that SLC caps do not permit them to recover their common line revenue requirements. Consistent with the Act, this new support mechanism will help to ensure the availability of high quality telecommunications service at affordable and reasonably comparable rates after the CCL charge is phased out, and further our policy of promoting telecommunications investment in rural America.

121. Below, we first address the appropriate size and nature of Interstate Common Line Support. We then describe the administration of this new support mechanism, and adopt an implementation schedule. Further, we set forth rules governing the calculation and distribution of Interstate Common Line Support, including disaggregation and targeting of Interstate Common Line Support, and the consequences of transfers of exchanges receiving Interstate Common Line Support. Finally, we address recovery of universal service contributions by rate-of-return carriers, and the Lifeline program.

1. Background

122. One of the primary purposes of universal service support is to help provide access to telecommunications service in areas where the cost of such service otherwise might be prohibitively expensive.[322] Historically, this purpose has been achieved both through explicit

[320] *1998 Notice*, 13 FCC Rcd at 14268-69 para. 90.

[321] *Access Charge Reform*, CC Docket No. 96-262, Order, 16 FCC Rcd 11448, 11449 para. 5 (2001).

[322] *Rural Task Force Order*, 16 FCC Rcd at 11251 para. 13.

monetary payments and implicit support flows to enable carriers to serve high-cost areas at below-cost rates.

123. In the 1996 Act, Congress codified the Commission's historical policy of promoting universal service to ensure that customers in all regions of the nation have access to telecommunications services.[323] Specifically, in section 254 of the Act, Congress instructed the Commission, after consultation with the Joint Board, to establish specific, predictable, and sufficient mechanisms to preserve and advance universal service.[324] Moreover, recognizing the vulnerability of implicit support to competition, Congress directed the Commission and the states to take the necessary steps to create universal service mechanisms that would be sustainable in a competitive environment.[325] To achieve this end, Congress directed that universal service support "should be explicit and sufficient to achieve the purposes of [section 254]."[326]

124. The 1996 Act further establishes as a principle, on which we must base our universal service policies, that quality services should be available across the nation at affordable and reasonably comparable rates.[327] Support mechanisms should also require all providers of telecommunications services to make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service.[328] They should neither unfairly advantage nor disadvantage one provider over another, and neither unfairly favor nor disfavor one technology over another.[329] Thus, any telecommunications carrier, using any technology, including wireless technology, is eligible to receive universal service support if it meets the criteria for "eligible telecommunications carrier" status under section 214(e)(1).[330]

125. Most rate-of-return carriers receive explicit support for intrastate rates through the Part 36 high-cost loop support mechanism and LSS, which provides support for the intrastate switching costs of carriers with fewer than 50,000 access lines.[331] As discussed above, the

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[323] According to the Joint Explanatory Statement, the purpose of the 1996 Act is "to provide for a pro-competitive, deregulatory national policy framework designed to accelerate rapidly private sector deployment of advanced telecommunications and information technologies and services to all Americans by opening all telecommunications markets to competition . . ." Joint Explanatory Statement of the Committee of Conference, H.R. Conf. Rep. No. 458, 104th Cong., 2d Sess. at 113.

[324] 47 U.S.C. § 254(a), (d).

[325] *See* 47 U.S.C. § 254; *see also* H. Rep. No. 204, 104th Cong., 1st Sess. 80 (1995).

[326] 47 U.S.C. § 254(e).

[327] *See id.* at § 254(b)(1) and (3).

[328] *Id.* at § 254(b)(4).

[329] *Universal Service First Report and Order*, 12 FCC Rcd. at 8801-03 paras. 48-51. Besides the universal service principles specified in the 1996 Act, Congress directed that the Joint Board and the Commission be guided by such other principles as they determine to be consistent with the Act, and necessary and appropriate for the protection of the public interest, convenience, and necessity. 47 U.S.C. § 254(b)(7). At the recommendation of the Joint Board, the Commission adopted competitive neutrality as an additional principle for universal service. *Universal Service First Report and Order*, 12 FCC Rcd at 8801-03 paras. 48-51.

[330] *Universal Service First Report and Order*, 12 FCC Rcd. at 8858-59 paras. 145-47; 47 C.F.R. § 54.201.

[331] *See* 47 C.F.R. §§ 36.601, 54.301; *see also supra*, § III.B.

Commission recently modified its rules for providing intrastate high-cost support to rural carriers based on proposals made by the Rural Task Force and recommended by the Joint Board.[332] The Rural Task Force recommended against use of the Commission's forward-looking mechanism for non-rural carriers to calculate high-cost support for rural carriers.[333] Instead, it recommended use for the next five years of a modified version of the already existing high-cost loop support mechanism used for rural carriers.[334] The Commission concluded that the Rural Task Force plan would, with certain modifications, "provide certainty and stability for rural carriers over the next five years," and that the provisions for disaggregation and targeting of high-cost support would "facilitate competitive entry into high-cost areas, bringing the benefits of competition to consumers in rural areas."[335] Rate-of-return carriers also receive explicit support for interstate rates through the LTS program. LTS provides support for interstate loop costs to rate-of-return carriers that participate in the NECA common line pool.[336] In 1997, the Commission modified the LTS program to remove it from the interstate access rate structure.[337]

126. In addition, rate-of-return carriers receive implicit support for universal service from various sources, including the interstate access rate structure.[338] As discussed above, the CCL charge permits rate-of-return carriers, to the extent that they cannot recover their non-traffic sensitive interstate loop costs through economically efficient, flat SLC charges, to recover such costs through a per-minute charge imposed on interexchange carriers, who pass the charge on to their customers in the form of higher long distance rates.[339] This rate structure creates implicit support flows between different classes of customers.[340]

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[332] *See supra*, § III.C.

[333] *Rural Task Force Order*, 16 FCC Rcd at 11254 para. 18. The Commission determined in 1997 that federal universal service support for all carriers should be based on the forward-looking economic cost of providing the supported services. *Universal Service First Report and Order*, 12 FCC Rcd at 8899-901 paras. 224-229. The Rural Task Force was appointed to assist "in identifying the issues unique to rural carriers and analyzing the appropriateness of proxy cost models for rural carriers." *Id.* at 8917 para. 253.

[334] *Rural Task Force Order*, 16 FCC Rcd at 11253-54 para. 17. The Rural Task Force's proposed modifications included various upward adjustments to current limits on universal service support for rural carriers. *Id.* at 11254 para. 18.

[335] *Id.* at 11248-49 paras. 10-11.

[336] 47 C.F.R. §§ 54.303, 54.311(a); *see supra*, § III.B.

[337] *Universal Service First Report and Order*, 12 FCC Rcd at 9164-65 paras. 756-58 ("we agree with the Joint Board that LTS payments serve the public interest by reducing the amount of loop cost that high cost LECs must recover from IXCs through CCL charges and thereby facilitating interexchange service in high cost areas consistent with the express goals of section 254.").

[338] *See Universal Service Ninth Report and Order*, 14 FCC Rcd at 20441 para. 15 ("In contrast to explicit support, some state rate designs and, to a lesser extent, the federal interstate access charge system, have provided implicit high-cost support flowing from (1) urban areas to rural areas; (2) business customers to residential customers; (3) vertical services to basic service; and/or (4) long distance service to local service.").

[339] *See supra*, § IV.A.2.D. Under the Commission's current rules, rate-of-return carriers also recover non-traffic sensitive interstate loop costs through LTS support. *See* 47 C.F.R. §§ 54.303, 54.311(a); *supra*, § III.B.

[340] *See Access Charge Reform Order*, 12 FCC Rcd at 16013 para. 76 ("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

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127. The MAG plan would reduce the CCL charge by permitting rate-of-return carriers to recover an increased portion of their common line costs through SLCs.[341] Under the MAG plan, all rate-of-return carriers would retain LTS support. The MAG plan would further reduce per-minute switched access for some rate-of-return carriers by establishing an uncapped, explicit universal service support mechanism, available only to pooling carriers that opt for the MAG's proposed incentive regulation scheme. Finally, the MAG proposes increases in the Lifeline program commensurate with SLC increases.

2. Discussion

a. Interstate Common Line Support

128. We create the Interstate Common Line Support mechanism to replace the implicit support for universal service now recovered by rate-of-return carriers through the CCL charge. As set forth above, the CCL charge is an inefficient cost recovery mechanism and implicit subsidy that should be removed from the rate structure.[342] The CCL charge represents an important revenue stream for rate-of-return carriers, however, recovering interstate loop costs that they cannot otherwise recover due to the existence of SLC caps. SLC caps, in turn, help to ensure that rates in high-cost, rural areas remain affordable and reasonably comparable to those in urban areas.[343] We find that conversion of the CCL charge to explicit universal service support is consistent with the mandate of the Act, which provides that universal service support "should be explicit[]."[344] It also is consistent with our creation of an explicit support mechanism to replace implicit support for universal service in the access charges of price cap carriers.[345] Interstate Common Line Support will enable rate-of-return carriers serving rural and high-cost areas to continue providing access to quality telecommunications services at rates that are affordable and reasonably comparable to those in urban areas. By ensuring that the rate structure modifications we adopt in this Order do not affect their overall recovery of interstate access costs, Interstate Common Line Support also will help provide certainty and stability for rate-of-return carriers and encourage investment in rural America.

129. As an initial matter, we conclude that determining the appropriate level of interstate support for rate-of-return carriers based on embedded costs is a reasonable and prudent approach in light of the record before us. The Commission concluded in 1997 that federal

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toll users, who include significant numbers of low-income customers, effectively support non-primary residential and multi-line business customers."); *see also supra*, §§ III.A., IV.A.1.

[341] The MAG does not identify to what extent its proposed access rate reductions would reduce the CCL charge, which is the primary source of implicit support. Also, under the MAG proposal, carriers that elect Path B of the MAG's incentive regulation plan would not reform their access rates, except to the extent CCL charge reductions occur as a result of increases to the SLC caps, and Path A carriers that are not members of the NECA pool would not receive explicit universal service support to replace lost revenues from the reformed access rate structure.

[342] *See supra*, § IV.A.2.d.

[343] *See supra*, § IV.A.2.a.

[344] 47 U.S.C. § 254(e).

[345] *See Interstate Access Support Order*, 15 FCC Rcd at 12974-77 paras. 29-35.

universal service support for all carriers should be based on the forward-looking economic cost of constructing and operating the network used to provide the supported services, rather than each carrier's embedded costs.[346] We agree with commenters that favor a forward-looking economic cost methodology as the ideal method for determining appropriate levels of explicit support to replace implicit support within the interstate access charge system of rate-of-return carriers.[347] As the Commission recognized in the *Rural Task Force Order*, however, a forward-looking economic cost mechanism for rural carriers is not feasible at this time.[348] Accordingly, the Commission recently adopted the recommendations of the Rural Task Force and the Joint Board for continued use over the next five years of a modified version of the intrastate high-cost support mechanism for rural carriers, which is based on embedded costs.[349] For the reasons discussed above, we conclude that it is important that we proceed with access charge reform and universal service reform for rate-of-return carriers.[350] Based on our examination of the record, therefore, we conclude that determining the appropriate level of interstate support for rate-of-return carriers based on embedded costs is a reasonable and prudent approach at this time.

130. Based on our examination of the record before us, we also find that it is reasonable and appropriate to size the new Interstate Common Line Support mechanism to provide support equal to the interstate loop costs that rate-of-return carriers do not recover through revenue from SLC rates, *i.e.*, the revenues from CCL charges that rate-of-return carriers otherwise would have received.[351] As the Commission recognized in the *Interstate Access Support Order*, "identifying an amount of implicit support in our interstate access charge system to make explicit is an imprecise exercise."[352] This is particularly so for rate-of-return carriers, given their size, diversity, and regulatory history.[353] Accordingly, we must use our expertise and informed judgment to make a reasonable determination as to what constitutes "sufficient" support for purposes of section 254(e).[354] There are a range of reasonable solutions, and we must select one that strikes a balance among the goals and principles of the Act.[355] Under the circumstances, we are adopting a cautious approach which removes identifiable implicit support from the rate structure by converting the CCL charge to explicit support without affecting overall

[346] *See Universal Service First Report and Order*, 12 FCC Rcd at 8899-901 paras. 224-229.

[347] *See* Ad Hoc Comments at 3-11, California Commission Comments at 2, 8, WorldCom Comments at 12-13, Ad Hoc Reply at 3-7, AT&T Reply at 13-14.

[348] *Rural Task Force Order*, 16 FCC Rcd at 11256 para. 25, 11311-13 paras. 174-77; *see* Indiana Commission Comments at 3, Wisconsin Commission Comments at 3, WorldCom Comments at 13-15, AT&T Reply at 13. As state above, most, but not all, rate-of-return carriers meet the definition of "rural carrier." *See supra*, n.8.

[349] *Rural Task Force Order*, 16 FCC Rcd at 11256 para. 25, 11311-13 paras. 174-77.

[350] *See, e.g., supra*, § I.

[351] We note that, until July 2003 when the CCL charge is phased out entirely, the common line revenues of rate-of-return carriers will include a transitional CCL charge. *See infra*, § IV.D.2.b.

[352] *Interstate Access Support Order*, 15 FCC Rcd at 13046 para. 201.

[353] *See, e.g., Rural Task Force Order*, 16 FCC Rcd at 11247 paras. 4-5.

[354] *See id.* at 11257-58 para. 27 (citing *Alenco Communications, Inc. v.* FCC, 201 F.3d 608, 620 (5th Cir. 2000), and *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393, 425-26 (5th Cir. 1999)).

[355] *See id.*; *Interstate Access Support Order*, 15 FCC Rcd at 12981-82 para. 49.

recovery of interstate loop costs, thereby safeguarding this important revenue stream for rate-of-return carriers. Based on our examination of the record, we conclude that this approach strikes a fair, reasonable balance among the policies of the 1996 Act.

131. We find that it is necessary to act cautiously in sizing the Interstate Common Line Support mechanism. Our examination of the record reveals that rate-of-return carriers generally are more dependent on their interstate access charge revenue streams and universal service support than price cap carriers and, therefore, more sensitive to disruption of those streams.[356] Although their diversity renders problematic simple assumptions about their cost characteristics, many rate-of-return carriers are small, rural carriers that serve high-cost regions. The approach that we adopt will provide these carriers with certainty and stability by ensuring that the access charge reforms we adopt do not affect this important revenue stream. In addition, in the absence of a feasible forward-looking support mechanism, we believe that a carrier's embedded interstate loop costs are a reasonable measure for calculating sufficient, but not excessive, levels of support.[357] Basing Interstate Common Line Support on embedded costs will ensure that carriers only recover their interstate-allocated loop costs, including a regulated rate-of-return. Accordingly, we find that the approach we adopt strikes a fair and reasonable balance among the policies of the 1996 Act.

132. Although we are mindful of arguments that a cap is necessary to ensure "sufficient," but not excessive, universal service funding, we cannot conclude that the establishment of a cap is appropriate under the circumstances. We note that our decision not to cap Interstate Common Line Support is consistent with the MAG proposal, the Rural Task Force recommendation, and other comments in this proceeding.[358] The combination of SLCs, LTS, and CCL charges currently enables rate-of-return carriers to recover all of their allowed interstate common line revenues based on their embedded costs. By limiting the support available to rate-of-return carriers, a cap on Interstate Common Line Support would cause some carriers to

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[356] *See* Interstate Telcom Group Comments at 4 ("Interstate Telcom has studied a representative sample of its clients, and has found that interstate access revenues and federal universal service support comprise an average of 40.56 percent of their revenue bases."); Missouri Commission Comments at 4 ("for year 2000, Missouri rural carriers received high cost support per access line ranging from $81 to $916. . . . Missouri carriers, on average, receiv[ed] greater revenue from subsidies than revenue generated by basic local and local network service revenue."); GVNW Consulting Comments in CC Docket No. 98-77 at 2 ("For [rate-of-return carriers], the access charge revenue stream represents, on average, twice the percentage of their total revenues as it does for an average [RBOC]"); Home Tel. Co., Inc. Comments in CC Docket No. 98-77 at 1 ("Home derives over 50% of its operating revenues from access and universal service related sources."); *see also Universal Service First Report and Order*, 12 FCC Rcd at 8936 para. 294 ("rural carriers generally serve fewer subscribers, serve more sparsely populated areas, and generally do not benefit as much from economies of scale and scope. For many rural carriers, universal service support provides a large share of the carriers' revenues, and thus, any sudden change in the support mechanisms may disproportionately affect rural carriers' operations.").

[357] *See Alenco v. FCC*, 201 F.3d at 619 ("excessive funding may itself violate the sufficiency requirements of the Act."). Under the Commission's rules, a rate-of-return carrier's allowed common line revenues are determined by calculating its interstate-allocated loop costs, based on embedded cost data, plus the authorized rate of return of 11.25 percent. *See infra*, § IV.E.3.; *supra*, n.28.

[358] *See Rural Task Force Order*, 16 FCC Rcd at 11323-24 para. 202; *MAG Notice*, 16 FCC Rcd at 466 para. 18; *see also* Letter from John Nakahata, Esq., to Magalie Roman Salas, Federal Communications Commission, dated July 26, 2001 (proposing "Rural Consumer Choice Plan" without incorporating a cap on support for common line costs).

receive less explicit support than the implicit support they now receive through the CCL charge. A reduction in common line revenues might undermine our universal service goals by creating pressures for certain rate-of-return carriers to reduce service quality, increase local rates, or limit service offerings.[359] Consistent with our policy of promoting investment in telecommunications services for rural America, the absence of a cap will ensure that the rate structure modifications we adopt do not affect the overall recovery of interstate loop costs by rate-of-return carriers.[360]

133. We disagree with commenters who argue that without a cap, universal service funding will grow to an unsustainable size.[361] Unlike the MAG's proposed Rate Averaging Support, which would be tied to inflation for carriers that convert to the MAG incentive scheme,[362] Interstate Common Line Support will be constrained by carriers' embedded costs. Interstate Common Line Support amounts will be recalculated every year, and a carrier's support level will increase only if its common line costs grow faster than its ability to recover such costs through the SLC. Thus, we believe that the approach we adopt involves significantly less risk of unconstrained fund growth than the MAG proposal.[363] Furthermore, we can review our decision against instituting a cap at any time if universal service support levels grow more rapidly than expected.

134. We also disagree with commenters who argue for a cap on the Interstate Common Line Support mechanism based on the fact that we capped the support available to price cap carriers under the *Interstate Access Support Order*.[364] These commenters rely on inapt comparisons to the Commission's action in the *Interstate Access Support Order*. As discussed above, the Commission consistently has taken into consideration the differences between price cap and rate-of-return carriers, as well as the specific challenges faced by small local telephone companies serving rural and high-cost areas.[365] Price cap carriers generally are less dependent than rate-of-return carriers on interstate access charge revenues and universal service support,

[359] *See* 47 C.F.R. § 254(b)(1), (3), (5).

[360] *See, e.g., Rural Task Force Order*, 16 FCC Rcd at 11264 paras. 42-43.

[361] *See* Qwest Comments at 5-6, Sprint Comments at 8-9.

[362] *See MAG Notice*, 16 FCC Rcd at 463-64 paras. 8-9, 519-21. Under the MAG plan, after a carrier initially sets its support amount based on embedded costs in a year selected at the carrier's option, support for that company would grow based on inflation and line growth, and would not be recalculated based on carrier investment.

[363] We agree with commenters that the MAG proposal would permit a carrier to base its support on a year in which its investment was higher than average and then continue to grow its support regardless of whether its investment grew. *See* AT&T Comments at 2, 11, California Commission Comments at 3-4, NASUCA Comments at 22 ("The [RAS] will be increased for no other reason than the fact the GDP-PI increased. The GDP-PI has no relation to the investments required to provide telecommunications services to high cost areas."), Qwest Comments at 3-4, Sprint Comments at 8-9, WorldCom Comments at 14-15, Wisconsin Commission Comments at 10, AT&T Reply at 12-13Verizon Reply at 3-4.

[364] *See* Competitive Universal Service Coalition Comments at 9, Sprint Comments at 9, WorldCom Comments at 13-15, Excel Reply at 4-6, Verizon Reply at 3-4. We note that the United States Court of Appeals for the Fifth Circuit recently remanded the *Interstate Access Support Order* to the Commission for further analysis and explanation of its choice of $650 million as the amount of interstate access support for price cap carriers. *Texas Office of Public Utility Counsel et al. v. FCC*, No. 00-60434 at § III.B.

[365] *See supra*, §§ I, II.

and better able to use various economies of scale to generate cost-saving efficiencies, thereby reducing the relative impact of any revenue reductions resulting from the cap on interstate access support for price cap carriers.[366] Because rate-of-return carriers are particularly sensitive to disruptions in their interstate revenue streams, we do not believe it would be advisable to implement a cap on Interstate Common Line Support for rate-of-return carriers at this time.

135. We also are not persuaded that we should impose a cap on the Interstate Common Line Support mechanism because rural carriers are subject to an indexed cap on high-cost loop support.[367] As the Commission noted in the *Rural Task Force Order*, the indexed cap on the high-cost loop support mechanism has been in place for over seven years.[368] In addition, the Commission cannot rely on state action to help provide support for interstate rates in the same manner that it can for the intrastate costs supported by the Part 36 high-cost loop support mechanism, because the Commission has exclusive jurisdiction over interstate rates.[369]

136. We decline to adopt proposals by the MAG and others to extend the new explicit universal service support mechanism to support traffic sensitive costs.[370] As discussed in detail above, these proposals are not supported by cost data in the record, and are not based on the identification of implicit subsidies within the traffic sensitive rates of rate-of-return carriers.[371] We also reject arguments that we should provide support for traffic sensitive costs to reduce disparities between rate-of-return and price cap carriers, regardless of the actual costs of providing service for rate-of-return carriers.[372]

137. In addition, we reject the MAG's proposal to provide universal service support for special access services. As a number of commenters point out, special access services are not currently included within the definition of services that are supported by the federal universal service mechanisms.[373] The definition of universal service is a matter currently pending before

[366] *See* GVNW Consulting Comments at 2-4.

[367] *See Rural Task Force Order*, 16 FCC Rcd at 11262-66 paras. 40-47.

[368] *See Rural Task Force Order*, 16 FCC Rcd at 11263-64 para. 41. The Commission recently increased the overall size of the rural carrier portion of the high-cost loop fund as if the indexed cap and the corporate operations expense cap had not been in effect for the calendar year 2000. The rural carrier portion of the high-cost loop fund will grow by a rural growth factor equal to rural line growth plus inflation.

[369] *See Qwest Corp. v. FCC*, 258 F.3d at 1203 ("We recognize that the FCC may not be able to implement universal service by itself, since it lacks jurisdiction over intrastate service.").

[370] *See supra*, § IV.B.2.a. We note, however, that our actions reallocating non-traffic sensitive line port costs and portions of the TIC from traffic sensitive rate elements to the common line category will have a consequence similar to these proposals because, as part of the common line rate element, the reallocated costs may be supported by Interstate Common Line Support.

[371] *See id.*.

[372] *See id.*

[373] *See* AT&T Comments at 11, California Commission Comments at 3, 15-21, Competitive Universal Service Coalition Comments at 10, Verizon Comments at 4, WorldCom Reply at 2. Section 254(c) of the Act defines universal service as an "evolving level of telecommunications services that the Commission shall establish periodically[.]" 47 U.S.C. § 254(c)(1). In 1997, based on consideration of the definitional criteria set forth in section 254(c) and the Joint Board's recommendations, the Commission designated "core" services that are eligible for universal service support: single-party service; voice grade access to the public switched telephone network; Dual

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the Joint Board, and any change in the definition is appropriately considered within the context of that proceeding.[374]

138. We do not adopt the MAG proposal to limit the new universal service support mechanism for the interstate loop costs of rate-of-return carriers to incumbent LECs that participate in the NECA pools.[375] As discussed above, limiting the availability of explicit universal service support to replace implicit subsidies within the current access rate structure would prevent some rate-of-return carriers from fully participating in the benefits of access charge reform.[376] Limiting Interstate Common Line Support to members of the NECA common line pool would unduly restrict the ability of rate-of-return carriers to compete by forcing them to choose between universal service support and the freedom to set rates outside the NECA pools.[377]

139. We decline to modify the LTS mechanism at this time. We recognize that LTS's restriction to pooling rate-of-return carriers restricts their ability to compete by setting rates outside the NECA common line pool.[378] We also recognize that, once Interstate Common Line Support is implemented beginning July 1, 2002, the two support mechanisms will serve the same function: both will support interstate common line costs. Nevertheless, we find that retaining the current LTS mechanism is warranted to ensure the stability of membership in the NECA common line pool during the transition to a more efficient common line rate structure.[379]

140. We believe that LTS ultimately should be merged into Interstate Common Line Support, and that participation in the NECA common line pool should not be required for receipt of interstate support. For the reasons discussed above, this measure would enhance the

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Tone Multifrequency signaling or its functional equivalent; access to emergency services; access to operator services; access to interexchange service; access to directory assistance; and toll limitation services for qualifying low-income consumers. *Universal Service First Report and Order*, 12 FCC Rcd at 8807-25 paras. 56-87; *see* 47 U.S.C. § 254(c)(1).

[374] *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Order, 15 FCC Rcd 25257 (2000); *see Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Public Notice, FCC 01-J-1 (Jt. Bd. released Aug. 21, 2001).

[375] *See MAG Notice*, 16 FCC Rcd at 463 para. 8.

[376] *See supra*, § IV.A.2.d.; GVNW Consulting Comments at 4; s*ee also* Alaska Commission Comments at 6, AT&T Comments at 5-6, 9-10, California Commission Comments at 3, Competitive Universal Service Coalition Comments at 7-13, GCI Comments at 3-4, GSA comments at 6-7, ICORE Comments at 17, Innovative Tel. Comments at 3-4, Fred Williamson & Assoc. Comments at 5, Alaska Rural Coalition Reply at 4-6, Excel Reply at 4-5, Verizon Reply at 5.

[377] *See* AT&T Comments at 9-10, California Commission Comments at 3, ICORE Comments at 17-18; *see also infra*, § V.D.

[378] 47 C.F.R. § 54.303(a).

[379] *See Universal Service Fourth Order on Reconsideration*, 12 FCC Rcd at 363 para. 76 (declining to extend LTS to carriers that leave the NECA common line pool prior to implementation of comprehensive reform because, *inter alia*, such a measure "could undermine the pool's usefulness in permitting participants to share the risk of substantial cost increases related to the CCL charge by pooling their costs and, thereby, charging an averaged CCL rate close to that charged by other carriers.").

competitiveness of rate-of-return carriers. Although the Commission previously maintained LTS to ensure the continued usefulness of the pool as a risk-sharing mechanism,[380] we believe that the need for this risk-sharing function will be reduced or eliminated by conversion of the CCL charge to explicit universal service support. Merging LTS into Interstate Common Line Support also would promote administrative simplicity. Once the CCL charge is phased out, the historical purpose of LTS will be eliminated,[381] and carriers now receiving LTS would be eligible for Interstate Common Line Support to meet their common line revenue requirements. Therefore, we tentatively conclude in the attached Further Notice of Proposed Rulemaking that LTS should be merged into Interstate Common Line Support as of July 1, 2003, after which participation in the NECA common line pool will have no bearing on the amount of universal service support a carrier receives.[382] In the Further Notice, we seek comment on this tentative conclusion.

141. Pending conclusion of the Further Notice of Proposed Rulemaking proceeding, any carrier that currently receives LTS will have LTS payments imputed to it for purposes of calculating its Interstate Common Line Support, even if the carrier subsequently foregoes LTS by leaving the NECA common line pool. We find that this measure is necessary to ensure the stability of membership in the common line pool during the phase out of the CCL charge.[383]

b. Administration and Distribution

(i) Calculation and Distribution of Interstate Common Line Support

142. *Calculating Interstate Common Line Support for Rate-of-Return Carriers.* The new Interstate Common Line Support mechanism will provide each carrier with support necessary to meet its common line revenue requirement after recovery of common line revenue from SLCs, other common line end user charges,[384] LTS, and the transitional CCL charge, to the extent it remains. As discussed below, the new mechanism shall become effective on July 1, 2002. Beginning July 1, 2003, common line interstate access charge revenue will consist solely of revenue from SLCs, other common line end user charges, and possibly LTS, pending resolution of the Further Notice of Proposed Rulemaking proceeding regarding LTS. A transitional CCL charge also will be included in common line revenue between July 1, 2002, and June 30, 2003. The Administrator will calculate the amount of Interstate Common Line Support available to a particular rate-of-return carrier's study area by summing, on a study area basis, the carrier's maximum allowable common line revenue from SLCs, other common line end user charges, the transitional CCL charge and LTS, and then subtracting this amount from the

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[380] *See id.*

[381] LTS was created to prevent the CCL rates of pooling carriers from rising significantly above the national average CCL rate. *See supra*, § III.B. The Commission largely has phased out the CCL charge for price cap carriers, and it will be removed from the rate structure of rate-of-return carriers as of July 1, 2003.

[382] *See infra*, § V.D.

[383] 47 C.F.R. § 54.303(a); *see Universal Service Fourth Order on Reconsideration*, 13 FCC Rcd at 5361-62 para. 74.

[384] Specifically, special access surcharges pursuant to 47 C.F.R. § 69.115 and line port costs in excess of basic analog service. *See supra*, § IV.B.2.b.

carrier's projected common line revenue requirement for that study area.[385] In accordance with our rules, for purposes of calculating Interstate Common Line Support, the maximum allowable SLC rate for a given customer class will be the lesser of the SLC caps or the carrier's study area average per-line common line revenue requirement.[386]

143. *Disaggregation and Targeting of Interstate Common Line Support.* Consistent with section 254 of the Act, we conclude that the plan for the geographic disaggregation and targeting of portable high-cost universal service support below the study area level recently adopted in the *Rural Task Force Order* will also apply to Interstate Common Line Support.[387] In the *Rural Task Force Order*, the Commission, after considering comments filed in that proceeding as well as the MAG proposal and other comments filed in this proceeding, determined that rural incumbent carriers should have the option of choosing one of three paths for the geographic disaggregation and targeting of portable high-cost universal service support at or below the study area level.[388] The disaggregation and targeting of Interstate Common Line Support will encourage efficient competitive entry into the study areas of rate-of-return carriers and will ensure that support is used for its intended purpose, consistent with section 254(e) of the Act.[389]

144. Disaggregation allows incumbent carriers to target explicit universal service support to regions within a study area that cost relatively more to serve, ensuring that a competitive entrant receives the targeted support only if it also serves the high-cost region. At the same time, it prevents the competitive entrant from receiving greater support than needed to serve relatively low-cost regions, which, if permitted, would give the competitive carrier a potential price advantage over the incumbent. By providing carriers with the flexibility to choose one of three paths for the disaggregation and targeting of Interstate Common Line Support, this plan also recognizes the diverse geographic and cost characteristics of rate-of-return carriers. The plan will, for example, enable a carrier that serves only a few lines or a very small study area with little geographic variability to choose not to disaggregate, while also permitting a carrier that serves a large number of lines in a study area with both low-cost and high-cost areas to allocate support to multiple disaggregation cost zones. Application of existing rules to the disaggregation and targeting of portable Interstate Common Line Support also will result in minimal additional administrative burdens for rate-of-return carriers.

145. The same three paths will be available for the disaggregation of Interstate Common Line Support as for other types of support pursuant to the *Rural Task Force Order*. A carrier may choose any path, but is subject to rules governing its chosen path once an election is made. Under Path One, a carrier may not disaggregate. Path One is intended to address those

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[385] *See supra*, § IV.D.2.a. (noting that any carrier that currently receives LTS will continue to have LTS imputed to it for the purposes of computing Interstate Common Line Support, even if it foregoes LTS by leaving the NECA common line pool, pending conclusion of the LTS Further Notice of Proposed Rulemaking proceeding).

[386] *See* 47 C.F.R. § 69.104. If a carrier voluntarily reduces its SLC rate for any end user through SLC deaveraging or other means, that reduction will not be reflected in the calculation of support. *See supra*, § IV.A.2.c.

[387] *See* 47 U.S.C. § 254(e).

[388] *Rural Task Force Order*, 16 FCC Rcd at 11302-09 paras. 144-64.

[389] *See id.* at 11302 para. 145.

instances where a carrier concludes that, given the demographics, cost characteristics, and location of its study area, and the lack of a realistic prospect of competitive entry, disaggregation is not economically rational.[390] Under Path Two, a carrier must disaggregate in accordance with a plan approved by the appropriate regulatory authority.[391] In recognition of the important role of state commissions and other appropriate regulatory authorities in facilitating competition, the Commission determined that there should be no constraints on disaggregation and targeting plans under Path Two.[392] Under Path Three, a carrier must self-certify to the relevant regulatory authority either a disaggregation plan of up to two cost zones per wire center or a disaggregation plan that complies with a prior regulatory determination.[393] Disaggregation zones established under Path Three must be reasonably related to the cost of providing service for each disaggregation zone within each disaggregation category of support. Self-certification is meant to reduce administrative burdens on carriers and states, and facilitate the rapid implementation of disaggregation plans. Carriers that fail to select one of the three disaggregation paths within the allotted time—originally 270 days from the effective date of rule adopted in the *Rural Task Force Order*, but extended below—will not be permitted to disaggregate and target support unless ordered to do so by a state commission or other appropriate regulatory authority either on its own motion or in response to a request from an interested party.[394] Likewise, a carrier's choice of disaggregation paths shall remain in place for four years, unless a state commission or other appropriate regulatory authority orders disaggregation and targeting of support in a different manner.[395]

146. Rate-of-return carriers will be required to select identical disaggregation zones for all forms of high-cost universal service support, with the exception of forward-looking intrastate high-cost support received by non-rural carriers that are also rate-of-return carriers.[396] For example, if a rural rate-of-return carrier self-certifies two cost zones per wire center under Path Three, it will be required to disaggregate all forms of high-cost universal service support, including high-cost loop support, LSS, LTS, and Interstate Common Line Support, to the same two cost zones per wire center. Permitting carriers to develop and implement only one disaggregation plan for all types of high-cost universal service support further minimizes the administrative burdens associated with Interstate Common Line Support for rate-of-return carriers, relevant regulatory authorities, and the Administrator.

[390] *Id.* at 11303-04 paras. 148-49.

[391] *Id.* at 11304 para. 150.

[392] Under Path 2, a carrier could, for example, request regulatory approval for a plan to disaggregate support to more than two cost zones per wire center that correspond with existing UNE zones. *Id.* at 11304 para. 150 ("[Under Path Two], a disaggregation and targeting method can be tailored with precision, subject to state approval, to the cost and geographic characteristics of the carrier and the competitive and regulatory environment in which it operates.").

[393] *Id.* at 11304 para. 151.

[394] *Id.* at 11303 para. 147

[395] *Id.* at 11305-06 paras. 153-55

[396] Forward-looking intrastate high-cost support received by non-rural rate-of-return carriers is not subject to disaggregation pursuant to section 54.315.

147. Carriers must allocate the same ratio of high-cost loop support under Part 36, LTS, and Interstate Common Line Support to each disaggregation zone, but may allocate a different ratio for LSS. A carrier's disaggregation plan must be based on cost.[397] Because the high-cost loop, LTS, and Interstate Common Line Support mechanisms each support loop costs and therefore share similar cost characteristics, we see no reason why such support should be allocated differently in different disaggregation zones. On the other hand, a carrier's local switching cost characteristics may differ from its loop cost characteristics in different disaggregation zones. Therefore, to the extent that the cost characteristics of providing loop and switching service in disaggregation zones differ, carriers will be permitted to allocate different ratios of high-cost support between disaggregation zones for LSS than for Interstate Common Line Support, LTS, and intrastate high-cost loop support.[398] This is consistent with section 254(e) of the Act and the *Rural Task Force Order*, and will enable carriers to further target support to high-cost areas, thereby encouraging efficient competitive entry into study areas in which rate-of-return carriers operate.

148. We note that our rules for the disaggregation and targeting of portable Interstate Common Line Support and LTS will apply to both rural and non-rural rate-of-return carriers. Although the vast majority of rate-of-return carriers are rural telephone companies, as that term is defined in section 51.5 of the Commission's rules,[399] a very small number of rate-of-return carriers are non-rural carriers.[400] Non-rural rate-of-return carriers will be required to adopt a disaggregation and targeting path only for their receipt of Interstate Common Line Support and LTS. Non-rural intrastate high-cost support, including forward-looking high-cost support and interim hold-harmless support, will continue to be targeted to high-cost wire centers, consistent with our rules for targeting such support to high-cost wire centers.[401]

[397] *See* 47 C.F.R. § 54.315(d)(2)(ii).

[398] Once ratios are allocated, however, they cannot be reallocated for at least four years, absent an order from the relevant state regulatory agency changing the ratios. 47 C.F.R. § 54.315.

[399] Section 51.5 of the Commission's rules uses the definition of a rural telephone company set forth in section 153(37) of the Act. 47 U.S.C. § 153(37). Under this definition, rural telephone companies are local exchange carriers that either serve study areas with fewer than 100,000 access lines or meet one of three other criteria. We note that, "[a]lthough the Commission uses the rural telephone company definition to distinguish between rural and non-rural carriers for purposes of calculating universal service support, there is no statutory requirement that it do so." *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Tenth Report and Order, 14 FCC Rcd 20156, 20358 para. 458 (1999).

[400] Non-rural carriers are those that do not satisfy one of the criteria in section 153(37) of the Act. Non-rural rate-of-return carriers include Alaska Communications Systems -- ATU, Alltel Ohio, Inc., North State Tel. Co. in North Carolina, PRTC Central of Puerto Rico, Puerto Rico Tel. Co., and Roseville Tel. Co. in California.

[401] *See* 47 C.F.R. §§ 54.309, 54.311; *see also Universal Service Ninth Report and Order*, 14 FCC Rcd at 20471 para. 70, 20476 para. 82. Consistent with the states' primary role in ensuring reasonable comparability of rates within their borders, the Commission has recognized that some states may wish to have federal non-rural high-cost support targeted to UNE cost zones. Sections 54.309 and 54.311 of our rules permit a state to file a petition for waiver of the Commission's targeting rules, requesting to target federal forward-looking high-cost support or interim hold-harmless support to an area different than a wire center. 47 C.F.R. §§ 54.309(c); 54.311(c); *see, e.g., Wyoming Public Service Commission Petition for Waiver of Targeting Requirements Found in Sections 54.309 and 54.311 of the Commission's Rules*, CC Docket No. 96-45, DA 01-612 (Com. Car. Bur. rel. Mar. 9, 2001).

149. Consistent with the *Rural Task Force Order*, we also adopt general requirements that will govern all disaggregation plans.[402] We require that an incumbent carrier's total amount of disaggregated support for a study area equal the total support available in the study area on an aggregated basis. We also require that relative per-line support relationships between disaggregation zones remain fixed over time (except as changes are allowed under our rules) and that such relationships be made publicly available. Further, a competitive eligible telecommunications carrier's per-line support amounts will be based on the incumbent carrier's then-current total support levels, lines, disaggregated support relationships, and customer classes. Finally, the per-line support amounts available to a competitive eligible telecommunications carrier for each zone will be recalculated whenever an incumbent's total annual support or line counts, as indicated by its filings, have changed. As discussed in the *Rural Task Force Order*, these general requirements will ensure that the disaggregation and targeting of support is accomplished in a manner that is consistent with the universal service principles of specificity, predictability, and competitive neutrality.[403]

150. In order to provide rate-of-return carriers with sufficient time to select a disaggregation path, we amend section 54.315 of the Commission's rules to extend by 60 days the period within which carriers will be required to select a disaggregation path to the extent that they are eligible to receive intrastate high-cost loop support, LSS, LTS, or Interstate Common Line Support.[404] Without this extension, carriers would be required to select a disaggregation path for the receipt of high-cost universal service support by March 18, 2002.[405] Instead, we extend until May 15, 2002, the date by which carriers will be required to select a disaggregation path for high-cost loop, LTS, LSS, and Interstate Common Line Support mechanisms.[406] Because the cost characteristics associated with Interstate Common Line Support, LTS, and intrastate high-cost loop support are the same, the disaggregation of Interstate Common Line Support will result in minimal additional administrative obligations for rural rate-of-return carriers. Therefore, we do not believe it is necessary to provide rural rate-of-return carriers with more than 60 additional days to include Interstate Common Line Support in their disaggregation plans. This extended deadline also will provide non-rural rate-of-return carriers with sufficient time to select a disaggregation path for purposes of receiving Interstate Common Line Support.

151. *Calculation of Portable Interstate Common Line Support by Customer Class.* We also adopt rules that will target Interstate Common Line Support by customer class to

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[402] *See Rural Task Force Order*, 16 FCC Rcd at 11307 para. 159.

[403] *See id.* at 11307 para. 160 (citing 47 U.S.C. § 254(b)(5); *Universal Service First Report and Order*, 12 FCC Rcd at 8801-03 paras. 46-51).

[404] As discussed above, we note that non-rural rate-of-return carriers will not be required to choose disaggregation paths for forward-looking non-rural high-cost universal service support.

[405] *See* 47 C.F.R. § 54.315(a) (requiring carriers to select a disaggregation plan within 270 days of the effective date of the rule).

[406] The May 15, 2002, deadline is the date by which carriers must select a disaggregation path. A carrier electing Path Two or Path Three must, by that date, file with the relevant state regulatory authority its proposed disaggregation plan or its self-certified disaggregation plan. State approval of a carrier's proposed disaggregation plan pursuant to Path Two is not required by that date, but the disaggregation plan cannot go into effect until approval is received.

competitive eligible telecommunications carriers located in rate-of-return carrier study areas. In accordance with section 54.307 of our rules, per-loop equivalents of Interstate Common Line Support will be portable to competitive eligible telecommunications carriers.[407] According to the principle of competitive neutrality adopted by the Commission and recommended by the Joint Board, universal service support mechanisms and rules should neither unfairly advantage nor disadvantage one provider over another.[408] Consistent with this principle, the Commission implemented the universal service principles in section 254 of the Act to ensure that universal service support is "portable," in essence, available to all competing eligible telecommunications carriers.[409]

152. As discussed above, we adopt different SLC caps for residential and single-line business lines and for multi-line business lines due to affordability concerns, even though it will typically cost a carrier the same amount, on average, to provision lines to each class of customer.[410] Although the formula for calculating Interstate Common Line Support to be received by an incumbent carrier does not explicitly acknowledge the relationship between customer class and support, the lower residential and single-line business SLC cap effectively means that carriers require more support for those lines than for multi-line business lines to meet their common line revenue requirement. If competitive eligible telecommunications carriers were to receive portable Interstate Common Line Support on a per-line basis without regard to customer class, they would receive less support for residential and single-line business lines than the incumbent, while receiving comparatively greater support for multi-line business lines. We conclude that these differences would create inappropriate incentives for competitive eligible telecommunications carriers to serve each class of customer. Accordingly, we adopt rules for the targeting of portable Interstate Common Line support within disaggregation zones that are consistent with rules adopted in the *Interstate Access Support Order* regarding the portability of interstate support for price cap carriers.[411]

153. In order to ensure that competitive carriers have the proper incentives to serve all customer classes in a rate-of-return carrier's study area, the portable per-line Interstate Common Line Support received by competitive eligible telecommunications carriers will reflect the varying support required to serve each customer class. Once Interstate Common Line Support amounts have been calculated for each eligible rate-of-return carrier's study area, and, if applicable, each disaggregation zone, the Administrator will identify the per-line support available to a competitive eligible telecommunications carrier for each customer class served within each study area. Per-line Interstate Common Line Support available to competitive eligible telecommunications carriers will be based on the extent to which the rate-of-return carrier's average per-line projected interstate common line revenues requirement exceeds the SLC caps for each customer class.

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[407] *See* 47 C.F.R. § 54.307.

[408] *See Universal Service First Report and Order*, 12 FCC Rcd at 8801-02 paras. 46-48, 8932-34 paras. 286-90.

[409] *See* 47 C.F.R. § 54.307; *see also Universal Service First Report and Order*, 12 FCC Rcd at 8932 para. 287.

[410] *See supra*, § IV.A.2.

[411] 47 C.F.R. § 54.807.

154. Within a particular disaggregation zone or undisaggregated study area, portable support will be targeted first to residential and single-line business lines – up to the difference between the residential and multi-line business SLC caps – before allocating the remaining support equally between the customer classes. For example, if Interstate Common Line Support available to a given disaggregation zone is greater than $2.70 (the difference between a capped residential and single-line business SLC of $6.50 and a capped multi-line business SLC of $9.20) multiplied by the rate-of-return carrier's total number of residential and single-line business lines in that disaggregation zone, $2.70 in portable per-line Interstate Common Line Support will be targeted first to the residential and single-line business lines. The remaining portable Interstate Common Line Support then will be allocated equally on a per-line basis to all of the rate-of-return carrier's lines (*i.e*., residential, single-line business, and multi-line business lines) in the disaggregation zone. This measure will maintain the difference in Interstate Common Line Support values for each customer class.

155. *Transferred Interstate Common Line Support*. If a rate-of-return carrier acquires telephone exchanges from another rate-of-return carrier, we conclude that the acquiring carrier may become eligible to receive additional Interstate Common Line Support for the acquired exchanges.[412] This is consistent with rules adopted in the *Interstate Access Support Order* regarding the transfer of interstate access universal service support between price cap carriers.[413] The Administrator shall adjust the Interstate Common Line Support that each carrier receives based on data reported to the Administrator through the filings described below. Interstate Common Line Support for both carriers will be adjusted based on the adjusted line counts contained in the next applicable filing and the per-line support amount associated with those lines. Interstate Common Line Support for the transferred exchanges will continue to be distributed in this manner until it is recalculated in the next funding year and will be subject to a true up based on actual cost data.

156. If a rate-of-return carrier acquires telephone exchanges from an entity other than a rate-of-return carrier, the acquiring rate-of-return carrier may be eligible to receive Interstate Common Line Support for the acquired exchanges. The acquiring rate-of-return carrier will be permitted to adjust its line counts in the next quarterly report to the Administrator and will receive support based on the per-line support available to the acquiring carrier's existing lines at the time of the transfer until the carrier's Interstate Common Line Support is recalculated for the next funding year and subject to true up based on actual cost data. If the acquiring carrier does not serve any lines in the state prior to the transaction, it will be permitted to submit a projected interstate common line revenue requirement for the remainder of the funding year on the date for filing the next quarterly line count report with the Administrator following consummation of the transaction. The acquiring carrier will receive Interstate Common Line Support based on the projected revenue requirement, subject to true up based on actual data. A price cap carrier acquiring exchanges from a rate-of-return carrier will not be eligible to receive Interstate Common Line Support for those exchanges.

[412] In adopting these rules today, we do not alter the Commission's existing rules governing the sale or acquisition of lines by carriers or the definition of study area contained in Part 36 of our rules.

[413] *See Interstate Access Support Order*, 15 FCC Rcd at 13060 para. 225; 47 C.F.R. § 54.801(d).

157. We do not believe that the same concerns that justify the restrictions on the transfer of intrastate high-cost universal service support in section 54.305 of our rules are present here.[414] Section 54.305 of our rules provides that a carrier acquiring exchanges from an unaffiliated carrier shall receive the same per-line levels of intrastate high-cost universal service support for which the acquired exchanges were eligible prior to the transfer. As a result of implementation of different support mechanisms for rural and non-rural carriers, the Commission adopted section 54.305 as a temporary measure to prevent a potential increase in the acquiring carrier's universal service support payments from unduly influencing its decision to acquire exchanges.[415] Because Interstate Common Line Support for rate-of-return carriers and interstate access universal service support for price cap carriers will both be based at least in part on an individual carrier's embedded costs, those support mechanisms do not raise a similar concern.[416] We therefore conclude that section 54.305 does not apply to the transfer of Interstate Common Line Support. Section 54.305 of our rules will continue to apply to the transfer of high-cost loop support under Part 36, non-rural interim hold-harmless support, forward-looking support for non-rural carriers, LTS, and LSS.

(ii) Implementation of Interstate Common Line Support

158. *Schedule for Phasing in Interstate Common Line Support*. As described above, the multi-line business SLC cap will be increased to $9.20 on January 1, 2002, while the residential and single-line business SLC cap will be increased gradually to $5.00 on January 1, 2002, and, consistent with increases to price cap carriers' SLC caps, to $6.00 on July 1, 2002, and to $6.50 on July 1, 2003.[417] We conclude that there may be insufficient time, however, for the Administrator and eligible telecommunications carriers to take necessary actions to effectively implement the new Interstate Common Line Support mechanism by January 1, 2002. In an abundance of caution, we therefore order that the new mechanism shall become effective on July 1, 2002, and the CCL charge will remain in effect as it is now until that time. We will retain a transitional CCL charge during the period of graduated increases in the residential SLC cap.[418] A transitional CCL charge therefore will remain in place between July 1, 2002, and July 1, 2003. If, as a result of cost studies, residential and single-line business SLC caps do not rise in accordance with the schedule, the CCL charge will be phased out on July 1, 2003, and the new Interstate Common Line Support mechanism will provide support for any common line revenues not recovered through the SLCs, other common line end user charges and LTS.[419]

159. *Fund Administration*. We direct the Universal Service Administrative Company (USAC), as Administrator of the federal universal service support mechanisms, to administer the Interstate Common Line Support mechanism. Interstate Common Line Support shall be administered by USAC's High Cost and Low Income Division under the direction of the High

[414] *See* 47 C.F.R. § 54.305.

[415] *See Universal Service First Report and Order*, 12 FCC Rcd at 8942-43 para. 308.

[416] *See Interstate Access Support Order*, 15 FCC Rcd at 13043 paras. 195-96.

[417] *See supra*, § IV.A.2.a.

[418] *See id.* at § IV.A.2.d.

[419] *See id.* at § IV.A.2.a.

Cost and Low Income Committee of the USAC Board. USAC shall keep separate accounts for the amounts of money collected and disbursed for Interstate Common Line Support, and USAC shall account for and recover the administrative expenses that it incurs in connection with administering the Interstate Common Line Support mechanism. USAC also shall include the projected demand and expenses associated with Interstate Common Line Support in the aggregate projections for all of the high-cost support mechanisms that it submits to the Commission on a quarterly basis.

160. *Filing Requirements.* In order for the Administrator to effectively and efficiently implement the Interstate Common Line Support mechanism, we conclude that the filing requirements described below are necessary. We recognize that many rate-of-return carriers are small, rural carriers that are particularly burdened by additional reporting requirements. Accordingly, we intend to limit as much as possible the administrative burdens associated with the new Interstate Common Line Support mechanism, while promoting accurate and efficient distribution of support. Consistent with the Paperwork Reduction Act, we intend to require rate-of-return carriers to file the minimum amount of information necessary for the proper functioning of the Interstate Common Line Support mechanism.[420] In addition, consistent with the Regulatory Flexibility Act, we adopt alternative measures that will enable smaller rate-of-return carriers to file cost data less frequently.[421] At the same time, we also seek not to disrupt NECA's current procedures for the submission of data by members of the common line pool. As we note below, the burdens associated with these new filing requirements are in many cases mitigated because rate-of-return carriers already prepare similar filings pursuant to other Commission rules or as a result of their membership in the NECA common line pool.

161. We discuss below in detail the filing requirements necessary to permit the Administrator to effectively implement Interstate Common Line Support. First, we discuss the annual filing of projected revenue requirements by rate-of-return carriers. Second, we discuss the annual and/or quarterly filing of data to permit the Administrator to "true up" a rate-of-return carrier's Interstate Common Line Support based on actual costs. Third, we discuss the annual and/or quarterly filing of line counts by rate-of-return carriers and competitive eligible telecommunications carriers. Fourth, we address the requirement that rate-of-return carriers choosing to disaggregate their universal service support must file maps describing the boundaries of disaggregation zones in order to permit the Administrator and competitive carriers to determine how support will be targeted.[422] Finally, we discuss the annual filing that carriers will be required to submit certifying that they will comply with section 254(e)'s requirement that universal service funds will be used only to support universal service.

162. *Projected Revenue Requirements.* In order to enable the Administrator to calculate per-line amounts of Interstate Common Line Support, rate-of-return carriers other than average schedule companies shall report to the Administrator their projected common line

[420] *See Paperwork Reduction Act of 1995*, Pub. L. No. 104-13 (1995).

[421] *See* 5 U.S.C. § 601, *et seq.*

[422] As noted below, this filing requirement currently exists for other universal service support mechanisms. In this Order, we merely extend the requirement to apply to Interstate Common Line Support.

revenue requirement for each study area in which they operate.[423] The Administrator shall determine the data that will be included in projected common line revenue requirement filings. We anticipate that the Administrator will require rate-of-return carriers to submit the same carrier common line cost data currently submitted to the Commission in Tariff Review Plans that incumbent LECs and/or NECA file in support of annual revisions to their access service tariffs.[424] Consistent with their average schedule status, average schedule companies will not be required to submit common line revenue requirements, but instead will be required to submit information necessary in order for the Administrator to calculate common line revenue requirements for average schedule companies. In accordance with section 54.705 of our rules, the Administrator shall have authority to perform audits of beneficiaries of the new Interstate Common Line Support mechanism to ensure the accuracy of data submitted.[425] A competitive eligible telecommunications carrier need not file a projected revenue requirement because it will receive per-line Interstate Common Line Support based on the incumbent rate-of-return carrier's support.[426]

163. In order to enable the Administrator to begin distributing Interstate Common Line Support to carriers on July 1, 2002, we will require rate-of-return carriers to submit to the Administrator projected common line revenue requirements for July 1, 2002, to June 30, 2003, by March 31, 2002. Consistent with carrier access tariff filing obligations and NECA's current procedures for the filing of revenue requirements by members of the common line pool, we will permit carriers to submit to the Administrator corrections of their projected common line revenue requirements until April 10, 2002.[427] As described below, after April 10, 2002, any corrections to projected common line revenue requirements shall be made in the form of true ups using actual cost data. Rate-of-return carriers will be required to submit to the Administrator projected common line revenue requirements for subsequent years on the same schedule.

164. We conclude that the filing of this data with the Administrator on this schedule is necessary to permit the Administrator to administer the Interstate Common Line Support mechanism in a predictable manner without significant lag in the distribution of support to rate-of-return carriers. Without the use of projected data, the Administrator would need to wait until embedded cost data was available—possibly for a period of more than a year—to begin distributing support under the mechanism. Moreover, we conclude that the projected data filing should mirror as closely as possible the current data collection practiced by NECA for its tariff filing on behalf of its common line pool members.[428] Because Interstate Common Line Support

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[423] Certain rate-of-return carriers that are members of the NECA common line pool may rely on NECA to develop and file their projected common line revenue requirements.

[424] *See Material to be Filed in Support of 2001 Annual Access Tariff Filings, Tariff Review Plans*, 16 FCC Rcd 10408, 10412-14 paras. 18-26, 10512-48 (Comp. Pric. Div. 2001); *see also* National Exchange Carrier Association, Inc., Access Service Tariff F.C.C. No. 5, Transmittal No. 901, Volumes 2, Section 2, at 4-5, issued Jun. 18, 2001.

[425] *See* 47 C.F.R. § 54.705.

[426] *See id.* at § 54.307.

[427] In order for lawful access service tariffs to be effective by the scheduled effective date of July 1st, carriers must file their access service tariffs by June 15, 2001. *See id.* at §§ 61.58, 69.3.

[428] The vast majority of rate-of-return carriers currently are members of the NECA common line pool. Therefore, most rate-of-return carriers currently submit common line cost data information to NECA. Members of the common

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replaces revenue currently collected through the carriers' tariffed CCL charge, using similar data provided on a similar schedule ensures that Interstate Common Line Support will effectively replace lost CCL charge revenues. Following this filing schedule also mitigates the administrative burden associated with the filing, because many rate-of-return carriers provide similar data to NECA at the same general time.[429] Although we considered a filing process in which the Administrator would utilize NECA's data collections, time constraints associated with the July 1 commencement of the funding year render such a schedule impracticable.[430]

165. We also realize that requiring rate-of-return carriers to file projected common line revenue requirements on an annual basis will impose additional obligations on a small number of rate-of-return carriers. Specifically, rate-of-return carriers that are not part of the NECA common line pool currently are required to file their access tariffs and supporting documentation once every two years.[431] The vast majority of rate-of-return carriers are members of the NECA common line pool. Although these new filing requirements may result in certain rate-of-return carriers determining their common line revenue requirement on a more frequent basis, such projections will be for one year, as opposed to two years. Therefore, the individual filings will be less burdensome. Consistent with section 254 of the Act, we also conclude that the annual filing of projected common line revenue requirements will ensure that total amounts of the Interstate Common Line Support remain more predictable.[432] Annual, as opposed to biennial, filing of projected revenue requirements also will reduce the likelihood of significant adjustments to individual carrier support amounts to reflect actual costs.

166. *True Ups*. We adopt measures to enable the Administrator to "true up" or make adjustments to a carrier's per-line Interstate Common Line Support amounts to account for differences between projected and actual cost data. We note that, in the *Interstate Access Support Order*, the Commission adopted procedures for truing up the access rates of price cap carriers that choose not to participate in the CALLS plan to reflect the results of a forward-

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line pool file such data in accordance with procedures developed by NECA. *See id.* at § 69.605. In order to enable NECA to develop rates for the NECA common line tariff, on an annual basis, members of the common line pool currently submit estimated actual common line costs for the prior year and forecasted common line cost information for the next two years. We note that average schedule companies do not submit cost data to NECA. *See id.* at § 69.606. Instead, the average schedule formulas are used to develop common line revenue requirements and rates for average schedule companies.

[429] NECA collects this data for the purpose of preparing its annual tariff filings. In accordance with our rules, NECA develops its data collections independently. *See id.* at §§ 69.605, 69.606. Rate-of-return carriers that are not members of the common line pool submit forecasted common line costs directly to the Commission as part of their tariff filings. *See id.* at §§ 61.38, 61.39.

[430] We understand that, although projected common line costs are filed by individual carriers with NECA in March or April, carriers do not finalize their reports until early June, in time for NECA to prepare and file its annual interstate access service tariff with the Commission. In order to enable USAC to calculate and begin distributing Interstate Common Line support on July 1of each year, USAC will need the carriers' projected interstate common line revenue requirements by March 31of each year.

[431] *See id.* §§ 61.38, 61.39, 69.3. NECA, on the other hand, files access tariffs on behalf of members of the common line pool on an annual basis.

[432] 47 U.S.C. § 254(b)(5).

looking economic cost study.[433] NECA also currently performs true ups to individual carrier pool settlements.[434] We anticipate that such true ups also will be necessary to ensure that carriers receive per-line amounts of Interstate Common Line Support that accurately reflect actual costs. True ups also will enable carriers that experience unforeseen costs to file actual cost data and receive increased per-line amounts of Interstate Common Line Support. Additionally, true ups will serve to minimize incentives for carriers to overstate projected interstate common line revenue requirements. Through the true-up process, such carriers eventually will receive support that reflects their actual costs.

167. On July 31 of each year, rate-of-return carriers will be required to submit actual interstate common line cost data to the Administrator for the preceding calendar year. This coincides with the date that carriers currently submit similar cost data to NECA under section 36.611 of our rules.[435] The first date for filing actual cost data shall be July 31, 2003. The Administrator shall adjust a rate-of-return carrier's monthly per-line Interstate Common Line Support in the following calendar year (*i.e.*, January 1, 2004 through December 31, 2004) to the extent of any difference between the carrier's projected common line revenue requirement and its actual cost data. Because the July 1, 2003, filing will only include cost data for the first six months that Interstate Common Line Support is available (July 1, 2002, through December 31, 2002), trued-up support amounts distributed in the calendar year 2004 will be based on a prorated share of the 2002 annual cost data (*i.e.*, 50 percent of the 2002 actual costs will be attributed to the final six months of 2002).[436] Trued-up support amounts distributed in subsequent calendar years will be based on complete funding year cost data. We note that competitive eligible telecommunications carriers' per-line support amounts will also be subject to true ups to the extent that the incumbent rate-of-return carrier's support amounts are subject to true up, consistent with section 54.307 of the Commission's rules.[437]

168. In order to provide rate-of-return carriers with opportunities to true up support amounts on a more frequent basis, we will permit carriers to file updated cost data with the Administrator on a quarterly basis. Quarterly true ups will enable carriers that experience

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[433] *See Interstate Access Support Order*, 15 FCC Rcd at 12984-85 paras. 57-62.

[434] For purposes of pooling and settlements, members of the common line pool also submit abbreviated common line cost data and revenues on a monthly basis. Average schedule companies also submit line count data and exchange information on a monthly basis. Members of the common line pool have the option of updating such data (for example, to correct errors or omissions) for purposes of "truing up" or adjusting common line pooling settlements that occur on a monthly basis. Members of the common line pool also submit actual cost data either on a quarterly or annual basis for purposes of truing up settlement amounts. Quarterly cost data is submitted between four to six months after the close of each calendar quarter and annual cost data is submitted between seven to twelve months following the close of the calendar year. Average schedule companies do not submit cost studies for the true-up process. *See supra*, n. 433.

[435] *See* 47 C.F.R. § 36.611. Carriers make this filing to NECA pursuant to NECA's role as Administrator of high-cost loop support under Part 36 of our rules. The embedded cost data that will be filed by rate-of-return carriers pursuant to the filing requirements adopted in this Order is defined under Part 69 of our rules and is different from, though similar to, the loop cost data currently submitted to NECA pursuant to Part 36 of our rules.

[436] Dividing the 2002 costs in this manner avoids the need for carriers to meet any additional reporting burden associated with determining actual costs on a monthly basis, rather than an annual basis.

[437] *See* 47 C.F.R. § 54.307.

unforeseen costs to qualify for increased Interstate Common Line Support amounts. Quarterly true ups also will reduce risks associated with receiving Interstate Common Line Support based on a projected common line revenue requirement. Carriers wishing to submit cost data on a quarterly basis will file such data in accordance with the schedule provided in section 36.612 of the rules.[438]

169. We conclude that these filings are appropriate in order to prevent the over-recovery of revenues by rate-of-return carriers as a result of the distribution of Interstate Common Line Support based on projected costs, and to ensure that rate-of-return carriers that experience costs that are higher than projected are able to meet their revenue requirements. We also note that the existence of true-up processes for members of the NECA common line pool, and of filing requirements for similar data on the same schedule pursuant to Part 36 of our rules, mitigate the administrative burden associated with this filing.

170. *Line Counts*. Consistent with rules adopted in the *Rural Task Force Order*, rate-of-return carriers will file their line counts with the Administrator, by disaggregation zone and customer class, in accordance with the schedule in sections 36.611 and 36.612 of our rules.[439] Line count data for rural rate-of-return carrier study areas in which a competitive eligible telecommunications carrier has not begun providing service will be filed on an annual basis.[440] Line count data will be filed on a regular quarterly basis upon competitive entry in rural rate-of-return carrier study areas.[441] By only requiring rural rate-of-return carriers to file quarterly line count data upon competitive entry, we avoid subjecting rural carriers to additional administrative obligations. We note that non-rural rate-of-return carriers currently are required to file line count data on a quarterly basis regardless of whether a competitor is present and that requirement will not change.[442] These reporting requirements merely alter existing Commission filing requirements so that lines will be reported by customer class.[443] Although we acknowledge this creates an additional administrative burden on carriers, we find that the burden is justified by the importance of ensuring that Interstate Common Line Support is portable on an equitable, non-discriminatory, and competitively neutral basis, as discussed above.

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[438] *See id.* at § 36.612. Like the annual filing requirement, for the purposes of this support mechanism, costs reported in quarterly filings will be attributed to universal service funding years on a prorated basis.

[439] *See id.* at §§ 36.611, 36.612.

[440] *See Rural Task Force Order*, 16 FCC Rcd at 11298-99 paras. 132-135. Rural rate-of-return study areas are those study areas in which a rate-of-return incumbent local exchange carrier that satisfies the definition of rural telephone company in section 153(37) of the Act operates. *See* 47 U.S.C. § 153(37).

[441] *See Rural Task Force Order*, 16 FCC Rcd at 11298 paras. 132-135; *Interstate Access Support Order*, 15 FCC Rcd at 13060 para. 227.

[442] *See Universal Service Ninth Report and Order*, 14 FCC Rcd at 20480-81 para. 92 (mandating quarterly reporting for carriers serving non-rural study areas "[t]o ensure that [universal service support is] based on data from the same reporting periods, and to ensure equitable, non-discriminatory, and competitively neutral treatment of incumbent LECs and competitive eligible telecommunications carriers.").

[443] The Commission's rules currently require that a rural carrier file line counts by disaggregation zone. 47 C.F.R. §§ 36.611, 36.612.

171. In order to enable the Administrator to accurately calculate per-line Interstate Common Line Support amounts and begin distributing support on July 1, 2002, the first date for filing line count data for all rate-of-return carriers and competitive eligible telecommunications carriers operating in study areas served by rate-of-return carriers shall be March 31, 2002, for support distributed in the third calendar quarter. Thereafter, the annual filing date for line-count data in study areas without competitive entry shall be on July 31of each year. We clarify that annual line count data filed on July 31will serve as the basis for support distributed beginning in the fourth calendar quarter. For a rate-of-return carrier serving a study area without competitive entry, the annual line count data will serve as the basis for Interstate Common Line Support distributed through the third quarter of the following calendar year. Line count data that is filed on a quarterly basis will be used to calculate support for the second calendar quarter after the data is filed.[444]

172. In order for the Administrator to calculate appropriate levels of support, line counts must be assigned to disaggregation zones if disaggregation zones have been established within a study area. In addition, the line count information must show residential/single-line business line counts separately from multi-line business line counts. This requirement is consistent with rules adopted in the *Interstate Access Support Order*.[445] The residential/single-line business lines reported may include single and non-primary residential lines, single-line business lines, basic rate interface (BRI) integrated services digital network (ISDN) service, and other related residence class lines. Similarly, the multi-line business class lines reported may include multi-line business, Centrex, primary rate interface (PRI) ISDN and other related business class lines.[446] We acknowledge that requiring rate-of-return carriers to file line count data by customer class will create additional reporting requirements; however, such additional reporting requirements are necessary to enable the Administrator to calculate appropriate levels of Interstate Common Line Support for rate-of-return carriers and their competitors.

173. Competitive eligible telecommunications carriers will file their line counts with USAC, by disaggregation zone and customer class on a quarterly basis, in accordance with the schedule in section 54.307 of our rules.[447] This filing schedule will permit the Administrator to provide support to competitive eligible telecommunications carriers based on the most accurate data feasible, and will not impose significant new filing burdens on competitive carriers. In order to create a common filing schedule for competitive eligible telecommunications carriers and incumbent LECs, we make adjustments to section 54.307, which governs the schedule under which competitive eligible telecommunications carriers file their line count data.[448] Specifically,

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[444] For example, line count data filed on March 31 will serve as the basis for Interstate Common Line Support distributed in the third calendar quarter (beginning July 1).

[445] *See Interstate Access Support Order*, 15 FCC Rcd at 13060 para. 227; 47 C.F.R. § 54.802(a).

[446] Such lines include all business class lines assessed the end user common line charge pursuant to 47 C.F.R. § 69.104.

[447] *See* 47 C.F.R. § 54.307.

[448] *See id.* at §§ 36.611, 36.612, 54.307. Under section 54.307, competitive carriers submit line counts as of December 30 by the subsequent July 31, March 30 line counts by September 30, July 31line counts by December 30, and September 30 line counts by March 30. *Id.* at § 54.307(c)(1)-(4). To make this rule consistent with sections

(continued....)

we make adjustments to dates for counting lines so that they are consistent with dates included in sections 36.611 and 36.612 of our rules for the filing of line counts by incumbent LECs.

174. *Disaggregation Plans.* Consistent with the rules adopted in the *Rural Task Force Order*, to ensure the portability and predictability of support, we also will require rate-of-return carriers that choose to disaggregate universal service support to submit maps to the Administrator in which the boundaries of the designated disaggregation zones are clearly specified.[449] The Administrator will make such maps available for public inspection by competitors and other interested parties. We will require that, when submitting information in support of Path Three self-certification, an incumbent carrier provide the Administrator with publicly available information that allows competitors to verify and reproduce the algorithm used to determine zone support levels. Similarly, we will require carriers electing Path One to submit to the Administrator a copy of certifications to a state commission or appropriate regulatory authority that they will not disaggregate and target support. Carriers selecting Path Two must submit a copy to the Administrator of the order by the state commission or appropriate regulatory authority approving the disaggregation plan submitted, along with a copy of the disaggregation plan itself. These requirements are consistent with the those adopted in the *Rural Task Force Order* and do not impose additional requirements on rate-of-return carriers.[450]

175. *Section 254(e) Certifications*. Section 254(e) provides that a carrier receiving universal service support must use that support "only for the provision, maintenance, and upgrading of facilities and service for which the support is intended."[451] In the *Rural Task Force Order*, we set forth rules requiring a state that wishes to receive federal universal service high-cost support for rural carriers within its territory to file a certification with the Commission stating that all federal high-cost funds flowing to rural carriers in such state will be used in a manner consistent with section 254(e).[452] In addition, in the *Interstate Access Support Order*, the Commission adopted certification rules for the receipt of interstate access support.[453]

176. In the *Rural Task Force Order*, we addressed federal universal service support for intrastate rates and we required states to file a certification of section 254(e) compliance with the Commission because states have jurisdiction over rates for intrastate services. In this Order, we address federal support for interstate rates, a matter over which the Commission has jurisdiction.[454] Thus, to ensure that carriers receiving Interstate Common Line Support and LTS

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36.611 and 36.612, the "as of" dates for the line count data are changed to December 31, March 31, and June 30. The September 30 line count data filed on March 30 remains unchanged.

[449] *See Rural Task Force Order*, 16 FCC Rcd at 11307-08 para. 161; *see also* 47 C.F.R. § 54.315(f).

[450] *Id.* at 11307-08 paras. 160-61.

[451] 47 U.S.C. § 254(e).

[452] *Rural Task Force Order*, 16 FCC Rcd at 11317-20 paras. 187-93; *see also* 47 C.F.R. § 54.314.

[453] *See Interstate Access Support Order*, 15 FCC Rcd at 13062 para. 232.

[454] *See Rural Task Force Order*, 16 FCC Rcd at 11318 n.446 ("Because the Commission has primary jurisdiction over interstate rates, oversight of the use of LTS lies with the Commission. . . . We anticipate addressing certification of LTS when we address interstate access reform in the MAG proceeding." (citations omitted)).

will use that support in a manner consistent with section 254(e), we shall require carriers seeking such support to file a certification with the Commission and the Administrator. This requirement is consistent with rules adopted in the *Interstate Access Support Order*.[455] This certification requirement will be applicable to rate-of-return carriers and competitive eligible telecommunications carriers seeking support from our Interstate Common Line Support mechanism. The certification shall be filed with the Commission and the Administrator on March 31, 2002, at the same time a carrier files its first set of line count data with the Administrator. Such certification shall be filed in CC Docket No. 96-45 annually thereafter on June 30. The certification may be filed in the form of a letter and must state that the carrier will use its Interstate Common Line Support and LTS only for the provision, maintenance, and upgrading of facilities and service for which support is intended. In the event that a certification is filed untimely, the carrier will be not become eligible for support until the second calendar quarter after the certification is filed.[456] Failure to file a certification will preclude a carrier from receiving Interstate Common Line Support or LTS. Carriers that fail to abide by their certification, or otherwise violate section 254(e), shall be subject to enforcement action by the Commission.

c. Carrier Recovery of Universal Service Contributions

177. We hereby effectuate the Fifth Circuit's recent decision in *COMSAT Corp. v. FCC*.[457] In that decision, the court held that incumbent LECs' practice of recovering their universal service contributions through access charges to interexchange carriers constituted an implicit subsidy, and that the Commission's rules permitting that practice to continue at a rate-of-return carrier's discretion violated section 254(e) of the Act.[458] We note that the Common Carrier Bureau recently granted a waiver to NECA to enable rate-of-return carriers to comply with the Fifth Circuit's decision.[459] The waiver permits rate-of-return carriers to include in their tariff filings an end user charge to recover their universal service contributions. Consistent with the *Interstate Access Support Order*, we amend the Commission's rules to require that all incumbent LECs, including rate-of-return carriers, recover universal service contributions only through end user charges. Rate-of-return carriers that have not done so already shall eliminate the recovery of universal service contributions through their access charges.[460] Consistent with the restrictions on the recovery of universal service contributions by price cap carriers, rate-of-

[455] *See* 47 C.F.R. § 54.809; *see also Interstate Access Support Order*, 15 FCC Rcd at 13062 para. 232.

[456] For example, if a carrier files its initial 254(e) certification after March 31, 2002, but on or before June 30, 2002, the carrier would not be eligible for support until the fourth quarter of 2002.

[457] *COMSAT Corp. v. FCC,* 250 F.3d 931, 938-40 (5th Cir. 2001).

[458] *Id.* at 938.

[459] *See Waiver of Sections 69.3(a) and 69.4(d) of the Commission's Rules*, CCB/CPD 01-15, Order, DA 01-1429 (Com. Car. Bur. rel. Jun. 14, 2001) (*NECA Waiver Order*).

[460] *See NECA Waiver Order* at para. 3; 47 C.F.R. § 69.4(d). NECA has implemented an end user charge for the recovery of universal service contributions for carriers that participate in the NECA common line pool.

return carriers shall not assess a separate universal service end user charge on Lifeline customers.[461]

d. Lifeline Support Amounts

178. We adopt the MAG proposal that any increase in the SLC be accompanied by a corresponding increase to the first tier of federal Lifeline support by the amount necessary to cover any increase in the SLC.[462] Such an increase in support is consistent with the principles of the 1996 Act as outlined in the *Universal Service First Report and Order* because it will provide sufficient support to ensure that qualifying low-income consumers have access to telecommunications services at affordable and reasonably comparable rates.[463] Increasing Lifeline support also is consistent with the Commission's action in the *Interstate Access Support Order*, in which it similarly increased Lifeline support commensurate with the SLC cap increases adopted there.[464] Without such an increase in Lifeline support, the SLC increases that we adopt today would negatively and disproportionately affect low-income subscribers by increasing the cost of basic telephone service. Consistent with the Commission's decision in the *Universal Service First Report and Order*, this first-tier Lifeline support shall be available to all qualifying low-income consumers being served by an eligible telecommunications carrier, regardless of whether the carrier charges a SLC.[465] As the Commission stated in the *Universal Service First Report and Order,* an incumbent LEC's SLC is a reasonable proxy for the interstate portion of other eligible telecommunications carriers' costs. Accordingly, allowing eligible telecommunications carriers to receive federal support for providing first-tier Lifeline support is a competitively neutral way to encourage carriers to serve qualifying low-income consumers.[466]

E. Other MAG Proposals

1. Section 254(g)/IXC Requirements

a. Background

179. In section 254(g) of the Act,[467] Congress codified the Commission's pre-existing geographic rate averaging and rate integration policies.[468] The Commission implemented section

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[461] *See Interstate Access Support Order*, 15 FCC Rcd at 13057-58 para. 218-220; *see also NECA Waiver Order* at para. 3.

[462] *See MAG Notice*, 16 FCC Rcd at 519.

[463] *Universal Service First Report and Order*, 12 FCC Rcd at 8954 paras. 332-34.

[464] *Interstate Access Support Order*, 15 FCC Rcd at 13056 paras. 216-17. We further note that rules adopted by the Commission in that order automatically operate by their own terms to achieve the Lifeline increase that we adopt today. 47 C.F.R. § 54.403(a).

[465] *Universal Service First Report and Order*, 12 FCC Rcd at 8970 para. 366.

[466] *Id.* at 8969-70 para. 365.

[467] 47 U.S.C. § 254(g).

[468] *See Policy and Rules Concerning the Interstate, Interexchange Marketplace*, CC Docket No. 96-61, Report and Order, 11 FCC Rcd 9564 paras. 3-5, 9566–69 para. 9 (citing S. Rep. No. 230, 104th Cong., 2d Sess. 1) (1996) *(Geographic Rate Averaging Order).*

254(g) by adopting two requirements.[469] First, providers of interexchange telecommunications services are required to charge rates in rural and high-cost areas that are no higher than the rates they charge in urban areas.[470] This is known as the geographic rate averaging rule. Second, providers of interexchange telecommunications services are required to charge rates in each state that are no higher than in any other state.[471] This is known as the rate integration rule. In the *Geographic Rate Averaging Order,* the Commission explained that geographic rate averaging benefits rural areas by providing a nationwide telecommunications network whose rates do not reflect "the disproportionate burdens that may be associated with common line recovery costs" in rural areas.[472] The Commission also noted that geographic rate averaging ensures that rural customers will share in lower prices resulting from nationwide interexchange competition.[473] Similarly, the Commission enunciated that its policy of integrating "offshore points" such as Hawaii and Alaska into the mainland's interstate interexchange rate structure makes the benefits of growing competition available throughout the nation.[474]

180. The MAG proposes a number of new or additional requirements on interexchange carriers: (1)"[p]roviders of interstate interexchange telecommunications services must offer customers in rural and high-cost areas of the United States the same optional calling plans, including discount or volume-based plans, that are available to their customers in urban areas[;]" (2) "[p]roviders of interstate interexchange telecommunications services in rural and high-cost areas of the United States must pass through to long distance customers the savings that IXCs realize from lower access rates charged by Path A LECs and Path B LECs[;]" and (3) "[p]roviders of interstate interexchange telecommunications services in rural and high-cost areas of the United States are prohibited from imposing minimum monthly charges on their residential customers."[475] According to the MAG, these requirements would help to "ensur[e] that IXCs will comply fully with the geographic averaging of section 254(g) of the Act."[476]

181. As part of the *Interstate Access Support Order*, CALLS members AT&T and Sprint made commitments to pass through to consumers the savings realized from lower switched access rates.[477] The Commission explained that consumers in all areas would benefit from such savings "[b]ecause long-distance providers must offer their geographically-averaged

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[469] *Id.* at 9565-66 para. 2.

[470] 47 C.F.R. § 64.1801; *see Geographic Rate Averaging Order,* 11 FCC Rcd at 9568-69 para. 9, 9574 para. 20.

[471] 47 C.F.R. § 64.1801; *see Geographic Rate Averaging Order,* 11 FCC Rcd at 9588 para. 52.

[472] *Id*. at 9567 para. 6.

[473] *Id*.

[474] *Id*. at 9588 para. 52.

[475] *See MAG Notice,* 16 FCC Rcd at 564.

[476] *See* MAG Reply at iv.

[477] *See Interstate Access Support Order,* 15 FCC Rcd at 12996-97 para. 88 (citing Letter from Joel E. Lubin, Federal Government Affairs, AT&T, to Magalie Roman Salas, Secretary, Federal Communications Commission, at 2 (March 30, 2000) (*AT&T Letter*), and Letter from Richard Juhnke, General Attorney, Sprint, to Magalie Roman Salas, Secretary, Federal Communications Commission, at 2 (filed Feb. 25, 2000) (*Sprint Letter*)).

rates to all of their customers, including those served by rate-of-return carriers."[478] In addition, CALLS members AT&T and Sprint committed to offer basic long distance rate plans with no monthly minimum charge.[479]

b. Discussion

(i) Optional Calling Plans

182. We do not adopt the MAG's proposal for a new rule requiring interexchange carriers to offer the same optional calling plans in urban and rural areas, because interexchange carriers already are under statutory and regulatory obligations to do so. We agree with several commenters that the MAG's proposal is unnecessary and would create undue confusion.[480] Certainly, we share the same goals as MAG in working to ensure that rural Americans receive the benefits of competition and choices in the interexchange services market, and we remain committed to enforcing our long and well-established policy of geographic rate averaging and rate integration in that regard.

183. Under the Commission's rules implementing section 254(g) of the Act, interexchange carriers must offer consumers in rural and urban areas the same optional calling plans.[481] The limited exception to this requirement allows interexchange carriers to offer optional calling plans on a geographically-limited basis as part of a temporary promotion which does not exceed 90 days.[482] Contrary to the suggestions of some commenters, however, this limited exception does not exempt optional calling plans from geographic rate averaging requirements.[483] Indeed, the Commission previously has explained that "we have not in the past exempted from our geographic rate averaging policy entire groups of services, such as contract tariffs, negotiated arrangements, or optional calling plans, where carriers offer discounted rates on a permanent or long-term basis. The record is clear, in fact, that we have required optional

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[478] *Id.*

[479] *Id.* at 13067 para. 243.

[480] *See, e.g.,* Letter from Herbert E. Marks, Esq., and Bruce A. Olcott, Esq., on behalf of State of Hawaii to Katherine Schroder, Chief, Accounting Policy Division, Federal Communications Commission, at 2 (June 18, 2001) (*State of Hawaii Letter*).

[481] 47 C.F.R. § 64.1801.

[482] *See Geographic Rate Averaging Order*, 11 FCC Rcd at 9574 para. 20 ("Temporary promotions involve discounts from basic rate schedules as well as limited sign-up periods for the promotional discount rates."), 9577-78 paras. 27, 29-30 (The Commission permitted carriers "as part of temporary promotions not available throughout a carrier's service area, to offer discounted promotional rates for no more than 90 days " with expectations that this policy "will not, when viewed over a number of years, reflect a pattern of undue discrimination against rural or high-cost areas. Thus, we expect that, viewed over time, temporary promotions will be offered in rural and high-cost areas, as well as to urban customers."); *see also* State of Alaska Reply at 6, State of Hawaii Reply at 4, *State of Hawaii Letter* at 1-5.

[483] *See* Global Crossing Comments at 10, Sprint Comments at 11.

calling plans to be generally available throughout a carrier's service area[.]"[484] Optional calling plans are also subject to rate integration requirements.[485]

184. The Commission defined a temporary promotion as not exceeding 90 days so as to provide a sufficient time for "a targeted promotional offering to attract interest in new or revised services, but not so long as to undermine our geographic rate averaging requirement."[486] Thus, with the exception of short-term, temporary promotions, optional calling plans offered by interexchange carriers are subject to the geographic rate averaging and rate integration requirements set forth in section 254(g) of the Act and our rules.[487]

185. The MAG contends that interexchange carriers have refused to provide the same discounted calling plans to rural areas that are available in urban areas, and therefore, that its proposed rule is necessary to "put[] teeth" into our existing policy and rules.[488] We disagree. First, we are not persuaded that the MAG proposal would strengthen our existing policy and rules. As the MAG acknowledges, the Commission already has "ample authority under the Act to enforce IXCs' obligations pursuant to section 254(g) and regulations that the Commission adopts thereunder."[489] Second, we agree with commenters that adopting new and duplicative requirements may create confusion regarding our rules rather than lending them clarity.[490] Finally, the record does not demonstrate a pattern of undue discrimination against rural and high-cost areas that would warrant reexamination of the efficacy of our existing rules and requirements. In this regard, the record contains general assertions of non-compliance rather than any specific allegations. The record does not indicate a significant number of complaints relating to this issue being filed with the Commission or elsewhere. For these reasons, we do not adopt the MAG proposal to add a new rule that would duplicate existing requirements for interexchange carriers to offer rural and urban areas the same optional calling plans.

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[484] *Geographic Rate Averaging Order*, 11 FCC Rcd at 9577 para. 28.

[485] *Id.* at 9588-89 para. 52 (stating that the Commission did not forbear from applying the rate integration requirement of section 254(g)).

[486] *Id.* at 9578 para. 29.

[487] *See* State of Alaska Reply at 10-11, State of Hawaii Reply at 1-5.

[488] Wisconsin Commission Comments at 7, MAG Reply at 13-14.

[489] MAG Comments at 31. The annual certifications required by our rules "emphasize the importance we place on rate averaging and rate integration requirements of the 1996 Act and put carriers on notice that they may be subject to civil and criminal penalties for violations of these requirements, especially willful violations." *See Policy and Rules Concerning the Interstate, Interexchange Marketplace,* CC Docket No. 96-61, Second Report and Order, 11 FCC Rcd 20730 para. 83 (1996) (*Detariffing Order*); *see also* 47 C.F.R. § 64.1900 (requiring a nondominant interexchange carrier to file an annual certification signed by an officer of the company under oath attesting to the company's compliance with section 254(g) requirements). Because public information about interexchange carrier rates and services will continue to be readily available, either private parties or the Commission are able to initiate enforcement action against carriers that violate our requirements. *See Policy and Rules Concerning the Interstate, Interexchange Marketplace,* CC Docket No. 96-61, Order, 15 FCC Rcd 22321, 22327 para. 15 (2000) (*Detariffing Transition Order*) (requiring IXCs to post information at public information sites and on Internet websites upon detariffing mass-market consumer services, and consistent with section 61.87(b) of the Commission's rules, requiring carriers to indicate on cancelled tariffs the addresses of websites and public information sites where rates, terms and conditions can be found); *see also* 47 U.S.C. § 208 (filing complaints with the Commission).

[490] *See, e.g., State of Hawaii Letter* at 2; *but see* MAG Reply at 14.

(ii) Pass-through

186. We conclude that adoption of the MAG proposal to impose an administrative requirement that requires interexchange carriers to pass through savings from lower access rates to consumers in the form of lower per-minute long distance rates is unwarranted at this time. It is our expectation that competition in the long distance telecommunications market will ensure that consumers realize significant benefits from the access charge reforms that we adopt in this Order. We conclude that the MAG proposal is inconsistent with our deregulatory approach to the highly competitive interexchange services market. We also conclude that the administrative costs of the proposed requirement would outweigh the benefits. Moreover, we will diligently continue to enforce provisions of the Act which are designed to ensure that interstate services and rates offered by interexchange carriers in high-cost and rural areas are just and reasonable.

187. We decline to impose regulatory mandates that might hinder the competitive market for interexchange services and the deregulatory objectives of the 1996 Act. The continuing decline in long distance prices is a significant indication that competition in the long distance market is producing the desired consumer benefits.[491] The MAG's proposed requirement would be inconsistent with the Commission's policy of progressively deregulating interexchange carriers, which, because they lack market power in providing interstate, domestic, interexchange services, are non-dominant.[492] The Commission previously rejected a similar proposal, finding that market forces would compel interexchange carriers to pass through access charge reductions.[493] Unlike the MAG proposal, the pass-through approved in the *Interstate Access Support Order* was a voluntary commitment by certain interexchange carriers.[494] Accordingly, we believe that we should rely on competition to ensure that consumers realize benefits from the access charge reforms we adopt in this Order.[495]

188. We also observe that implementing the MAG proposal would entail burdensome and significant administrative costs associated with reporting, measuring, monitoring and

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[491] From 1992 through 1999, average interstate long distance revenues decreased from 15 cents per minute to 11 cents per minute. *See* Industry Analysis Division, Common Carrier Bureau, Federal Communications Commission, Telecommunications Industry Revenues: 1999, Table 9, page 25.

[492] Since the early 1980s, the Commission has gradually moved from applying a "full panoply" of regulatory requirements to one in which pricing and other regulations have been replaced by market forces. Most recently, the Commission completed its policy of detariffing long distance services, based on the principle that market forces will generally ensure that rates remain reasonable and that carriers have the same incentives and rewards that firms in other competitive markets confront. *See Detariffing Order*, 11 FCC Rcd at 20733 paras. 4, 21; *see also* AT&T Comments at 20, Global Crossing Comments at 10, NASUCA Comments at 11-12, WorldCom Comments at 20.

[493] *See Price Cap Performance Review for Local Exchange Carriers*, CC Docket No. 94-1, Fourth Report and Order, 12 FCC Rcd 16642, 16717 para. 185 (1997) (*Fourth Access Charge Reform Order*); *accord Report in Response to Senate Bill 1768 and Conference Report on H.R. 3579*, Report to Congress, 13 FCC Rcd 11810, 11827-28 para. 28 (1998) (substantial competition in the interstate long distance market "creates strong incentives for carriers to reflect reductions in their costs through lower rates.").

[494] *See Interstate Access Support Order*, 15 FCC Rcd at 13068-69 para. 246 (citing *AT&T Letter* and *Sprint Letter*); *see also* Excel Comm'ns Reply at 7.

[495] *See* AT&T Comments at 20, Competitive Universal Service Coalition Comments at 21, Qwest Comments at 7-8, WorldCom Comments at 20.

enforcement mechanisms.[496] Because many interexchange carriers could be "small entities" within the meaning of the Regulatory Flexibility Act, we are also reluctant to impose regulatory burdens that could be barriers to small business competitiveness in the long distance industry.[497] Having considered the potential economic impact of the MAG proposal and the available alternative approaches, as we are required to do under the Regulatory Flexibility Act, we conclude that imposing this new regulatory requirement on interexchange carriers would not be reasonable under the circumstances.[498]

189. We will adhere to our policy of ensuring that rates continue to be just and reasonable.[499] We emphasize that if market forces are insufficient to cause non-dominant interexchange carriers to offer prices or terms that are just, reasonable, and non-discriminatory consistent with Section 201 and Section 202 of the Act, parties may file complaints that we can investigate and adjudicate pursuant to Section 208 of the Act.[500] No evidence is presented here that long distance rates are unjust, unreasonable or discriminatory, or that rates would become unlawful following the access reductions we have ordered.[501] Consumers have remedies available to them if violations of our policies and requirements occur. We are not persuaded that there is a present need for regulatory action.[502]

190. In the *Interstate Access Support Order*, we pointed out that all consumers, including those not served by price cap carriers, would benefit from reduced per-minute access charges as a result of the reforms we approved.[503] Likewise, we anticipate that the reforms we adopt here will benefit all Americans as reduced access rates facilitate market entry and competition. We also believe these reforms will particularly help consumers in rural areas by fostering greater competition and choice of interexchange services in these areas. We recognize that regulatory mandates are sometimes necessary even when there is competition in a market, to ensure that all Americans, including those in rural and high-cost areas, receive the benefits of competition. For example, when we ordered detariffing for interstate, domestic, interexchange services for non-dominant interexchange carriers, we pointed out that we were in no way departing from our historic commitment to protect consumers against abusive and anti-competitive practices.[504] As we have done in the past, we will continue to evaluate how

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[496] *See* Alaska Commission Comments at 6, Excel Comm'ns Reply at 6-7, Iowa Utilities Board Reply at 4.

[497] 5 U.S.C. §§ 601, *et seq.*

[498] *See id.* at § 604.

[499] *See Detariffing Order*, 11 FCC Rcd at 20746-47 para. 27; *Motion of AT&T to be Reclassified as a Non-Dominant Carrier*, Order, 11 FCC Rcd 3271, 3282 para. 13 (1995) (*AT&T Reclassification Order*); *Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor*, CC Docket No. 79-252, First Report and Order, 85 FCC 2d 1, 4 para. 6 (1980).

[500] 47 U.S.C. §§ 201-202, 208.

[501] *See* Global Crossing Comments at 10, Qwest Comments at 7-8, Sprint Comments at 10-11.

[502] *See, e.g.*, California Commission Comments at 26, Florida Commission Comments at 3-5, Rate-of-Return Coalition Comments at 6.

[503] *See Interstate Access Support Order*, 15 FCC Rcd at 12996-97 para. 88.

[504] *See Detariffing Order*, 11 FCC Rcd at 20733 para. 5 ("We reaffirm our pledge to use our complaint process to enforce vigorously our statutory and regulatory safeguards against carriers that attempt to take unfair advantage of

(continued....)

consumer safeguards and benefits can best be achieved, whether through competition or regulatory means.

(iii) Minimum Monthly Charges

191. We do not adopt the MAG proposal to prohibit interexchange carriers from charging minimum monthly fees to residential customers. We conclude that such a prohibition is unnecessary and would have the unintended consequence of impeding competition and limiting consumer choice, contrary to the intent of the 1996 Act.

192. Consumers in both rural and urban areas currently have the choice of at least one long distance calling plan that does not have a minimum monthly charge.[505] Pursuant to the *Interstate Access Support Order,* AT&T and Sprint agreed to offer at least one plan without a minimum monthly charge to residential customers.[506] As set forth above, our geographic rate averaging rules require that these plans be offered to all areas. The Commission found that these commitments would "help ensure that low-volume users of long distance service share in the benefits of the 1996 Telecommunications Act and the pro-competitive reforms that the Commission has adopted."[507]

193. A blanket prohibition on all minimum monthly charges, however, would have the unintended consequence of limiting consumer choice by restricting the availability of optional calling plans. Many optional calling plans provide for a minimum monthly fee and offer a lower per-minute rate than would otherwise be available. We agree with commenters that restricting such plans could adversely affect consumers by depriving them of a choice that might serve their individual needs, as well as those of the interexchange carrier offering the plans.[508] Accordingly,

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(...continued from previous page)
American consumers. Moreover, when interstate, domestic, interexchange services are completely detariffed, consumers will be able to take advantage of remedies provided by state consumer protection laws and contract law against abusive practices.").

[505] *See* Florida Commission Comments at 4.

[506] *See Interstate Access Support Order*, 15 FCC Rcd at 13067 para. 243 ("AT&T has pledged to offer for at least three years – and possibly as long as five – a basic residential plan that has no monthly recurring charge and no minimum usage requirement. Sprint has also committed to offering at least one basic rate plan without a minimum usage fee for the duration of the CALLS plan. . . . Bell Atlantic has also targeted two long-distance plans to residential, low-volume users by eliminating minimum use charges. Although MCI did not sign on to the CALLS proposal, it also offered a plan that has no minimum monthly charges."); AT&T Comments at 20 (citing *Interstate Access Support Order*, Appendix D-1 to D-2, *AT&T Letter*).

[507] *Interstate Access Support Order*, 15 FCC Rcd at 13068-69 paras. 245-46 ("Our decision to adopt the CALLS Proposal, and to conclude the low-volume inquiry, is based in large part on the availability of interstate long-distance plans that meet the needs of low-volume users. Sprint and AT&T have committed to making such plans available . . . they will eliminate their PICC pass-through charges for residential and single-line business customers, offer at least one basic rate plan that does not contain minimum usage charges, [and] freeze the per-minute rates on certain plans.").

[508] *See, e.g.,* Qwest Comments at 8; *see also* State of Alaska Reply at 10 ("Because many optional calling plans provide for a monthly minimum fee and these plans must be made available in rural areas, the State disagrees with that portion of the MAG's proposed rule that would prohibit interexchange carriers from offering pricing plans with a minimum monthly charge.").

we conclude that the MAG proposal to prohibit interexchange carriers from charging minimum monthly fees to residential customers is neither necessary nor in the public interest.

2. New Services

a. Background

194. In 1983, the Commission prescribed a rate structure for switched access services in Part 69 of its rules.[509] When an incumbent LEC offered a new switched access service,[510] it was required to obtain a waiver of Part 69 by demonstrating that "special circumstances warrant deviation from the general rule and such deviation will serve the public interest."[511] As discussed below, the Commission has streamlined this requirement for most carriers, but it remains in force for rate-of-return carriers with 50,000 or fewer lines. The Commission's rules generally provide that rate-of-return carriers must file tariffs and any required cost support for new services, including switched access, upon at least fifteen days' notice.

195. In 1996, the Commission took steps to relax the new switched access service rules for price cap carriers, based on the finding that the Part 69 rate structure "imposes a costly, time-consuming, and unnecessary burden on incumbent LECs, and significantly impedes the introduction of new services."[512] Accordingly, it modified the Part 69 rules to permit a price cap carrier to introduce a new switched access service by filing a petition showing that approval of the proposed new rate element would be in the public interest or that another LEC had established the same rate element.[513] In the *1998 Notice*, the Commission proposed to apply these streamlined provisions to rate-of-return carriers.[514]

196. In 1999, the Commission decided to partially forbear from applying the Part 69 rules to mid-sized carriers, consisting of both price cap and rate-of-return carriers with more than

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[509] 47 C.F.R. Part 69; *see Third Report and Order*, 93 FCC 2d at 241.

[510] *See* 47 C.F.R. § 61.3 (x) (defining a new service offering as "a tariff filing that provides for a class or sub-class of service not previously offered by the carrier involved and that enlarges the range of service options available to ratepayers"); *see also Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786, 6824 para. 314 (1990) ("A new service may, but need not, include a new technology or functional capability. Many new services are, in essence, re-priced versions of already-existing services . . . . As long as the pre-existing service is still offered, and the range of alternatives available to consumers is increased, we will classify the service as new."). We apply the same definition of a new service to rate-of-return carriers that is applicable to price cap carriers.

[511] 47 C.F. R. § 1.3 (permitting the Commission to grant waivers of its rules if "good cause" is shown); s*ee also Northeast Cellular Telephone Co. v. FCC*, 897 F. 2d 1164, 1166 (D.C. Cir. 1990); *WAIT Radio v. FCC*, 418 F. 2d 1153 (D.C. Cir. 1969).

[512] *Access Charge Reform Price Cap Performance Review for Local Exchange Carriers*, CC Docket No. 94-1, Notice of Proposed Rulemaking, Third Report and Order, and Notice of Inquiry, 11 FCC Rcd 21354, 21490 para. 309 (1996) (*Price Cap Third Report and Order*).

[513] *Id.* at 21490 paras. 309-10; 47 C.F.R. § 69.4(g); *Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers*, CC Docket Nos. 96-262 and 94-1, Fifth Report and Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd 142221, 14231 para. 17 (1999) (*Access Reform Fifth Order*).

[514] *See 1998 Notice*, 13 FCC Rcd at 14270 para. 95.

50,000 access lines but fewer than two percent of the nation's access lines.[515] Specifically, the Commission allowed these carriers to introduce new services or rate elements without requiring a Part 69 waiver or public interest showing. The Commission reasoned that forbearance would serve the public interest by promoting expeditious development and implementation of new services, as well as removing a competitive disadvantage for incumbent LECs.[516] The Commission also concluded that forbearance did not increase the chances of unreasonable discrimination or unjust and unreasonable rates,[517] and was not necessary to protect customers because they could continue to purchase existing services if the new service rate structure or rate level was unattractive.[518] In the same order, however, the Commission refused to forbear from application of cost support filing requirements.[519]

197. Shortly thereafter, the Commission streamlined the new service rule for price cap carriers by eliminating the required public interest showing.[520] The Commission cited the unnecessary delay in introducing new services, the benefit that new services may bring to some customers without harming others (because existing services would still be available), and the improved capability of price cap carriers to respond to competition from competitive carriers.[521] In addition, price cap carriers were permitted to file tariffs for new services without cost support[522] on one day's notice instead of the previously required fifteen-day notice period.[523]

198. The MAG proposes a new rule that "new access services of non-price cap LECs shall be introduced at prevailing market rates," and administered by NECA for those study areas in the pool.[524]

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[515] *See Petition for Forbearance of the Independent Telephone & Telecommunications Alliance*, AAD File No. 98-43, Sixth Memorandum Opinion and Order, 14 FCC Rcd 10840, 10842 para. 3 (1999) (*ITTA Forbearance Order*).

[516] *Id.* at 10847-48 para. 12.

[517] *Id.* at 10846-47 para. 10.

[518] *ITTA Forbearance Order*, 14 FCC Rcd at 10847 para. 11.

[519] *Id*. at 10852 para. 19. The Commission reasoned that cost support was necessary for it to determine that rates are just and reasonable for mid-sized carriers in light of the absence of any demonstrated competition. The Commission further reasoned that without this cost support, customers would not have sufficient information to determine whether to file a petition to reject or suspend and investigate a tariff, or whether to file a post-effective complaint.

[520] *See Access Reform Fifth Order*, 14 FCC Rcd at 14240-41 para. 39.

[521] *Id.* at 14240 para. 38

[522] *Id.* at 14240-41 para. 39. The Commission eliminated the new services test in sections 61.49(f) and (g) for all new price cap services except loop-based services. *See also* 47 C.F.R. § 61.49(3) (allowing a price cap carrier to submit tariff filings without cost data that introduce new price cap services, except loop-based services); 47 C.F.R. § 61.49 (generally providing that price cap carriers are required to file supporting material for tariff revisions of price cap and non-price cap services); 47 C.F.R. § 61.58 (containing notice requirements).

[523] *Access Reform Fifth Order*, 14 FCC Rcd at 14241 para. 40. The Commission reasoned that no customer would be required to purchase the new service and that a longer notice period would delay new services and "undercut" the reasons for revising the new service rules. *Id.*; *see also* 47 C.F.R. § 61.58(4)(b).

[524] *See MAG Notice*, 16 FCC Rcd at 465 para. 14, 568.

b. Discussion

199. We conclude that eliminating the Part 69 waiver requirement for rate-of-return carriers will serve the public interest by permitting the expeditious introduction of new switched access services or rate elements, encouraging technological innovation, and removing unnecessary regulatory barriers and delay in bringing consumers more benefits and choices. Instead, we apply the same streamlined rules to all rate-of-return carriers for introducing new switched access services or elements that are applicable to price cap carriers, with the exception of cost support and notice requirements. We already have streamlined the introduction of new services for rate-of-return carriers with more than 50,000 lines, as well as for price cap carriers.[525] We believe that this policy is achieving its intended purpose, and that its benefits should be extended to all rate-of return carriers.[526]

200. We find that requiring rate-of-return carriers to obtain a Part 69 waiver to introduce a new service causes unjustifiable delay, is unnecessary to ensure just and reasonable rates, and is contrary to the goal of developing competition. The introduction of a new service offers greater choice and does not by itself compel any access customer to reconfigure its access services.[527] Because the Commission needs time to review Part 69 waivers and petitions, this process unnecessarily delays the introduction of new services.[528] We also agree with commenters that simplifying the process of introducing new services will enable the Commission to use its resources more efficiently.[529]

201. The delay caused by the Part 69 waiver requirement may place rate-of-return carriers at a competitive disadvantage.[530] Even though rate-of-return carriers generally may not face the same kind of competition as price cap carriers, they are not insulated from competitive pressures.[531] Competitive carriers that have notice of an incumbent rate-of-return carrier's Part 69 waiver or section 69.4(g) petition may be able to begin offering the service before the

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[525] *See ITTA Forbearance Order,* 14 FCC Rcd at 10840 (forbearing from certain rules to allow carriers to introduce new switched access services without a Part 69 waiver or 69.4(g) petition); *Access Reform Fifth Order,* 14 FCC Rcd at 142221 (revising certain rules to allow price cap carriers to introduce new switched access price cap services without a public interest showing).

[526] Rate-of-return carriers may establish new access services or elements in the NECA pool consistent with current procedures for new services.

[527] *See ITTA Forbearance Order,* 14 FCC Rcd at 10847 para. 11 ("By definition, a new service expands the range of service options available to consumers. Thus, the introduction of a new service does not by itself compel any access customer to reconfigure its access services and so cannot adversely affect any access customer. Because new services may benefit some customers, and existing customers may continue to purchase existing services if they find the new service rate structure or rate level unattractive, we conclude that requiring a waiver or the grant of a section 69.4(g) petition is not necessary to protect customers."); *see also Access Reform Fifth Order,* 14 FCC Rcd at 14239-40 para. 37.

[528] *Id.* at 10847-48 para. 12; *see also Access Reform Fifth Order*, 14 FCC Rcd at 14231-32 para. 17, 14239-40 para. 37.

[529] *See* Lexcom Tel. Co. Comments in CC Docket No. 98-77 at 24, NECA Comments in CC Docket No. 98-77 at 8.

[530] *See ITTA Forbearance Order,*14 FCC Rcd at 10847-48 paras. 11, 12; *see also Access Reform Fifth Order,* 14 FCC Rcd at 14240 para. 38. The Commission adopted Part 69 before the advent of local exchange competition.

[531] *See supra,* § I.

incumbent carrier obtains permission to establish new rate elements for the new service, thus diminishing its incentives to develop and offer new services.[532] Removal of this competitive disadvantage will enhance the competitiveness of incumbent rate-of-return carriers.[533] Accordingly, we find that it serves the public interest to permit rate-of-return carriers to introduce new services on a streamlined basis.

202. We do not adopt the streamlined public interest showing standard for rate-of-return carriers, as we proposed in the *1998 Notice*. This decision is consistent with the underlying intent of our earlier proposal, which was to provide rate-of-return carriers with flexibility similar to that granted to price cap carriers in the introduction of new services.[534] At the time of the *1998 Notice*, the public interest showing was the most current form of streamlined relief available, but the Commission later determined that this requirement, too, was unnecessarily burdensome.[535] We now extend the flexibility currently available to price cap carriers and to many rate-of-return carriers to all rate-of-return carriers.

203. We are not persuaded by commenters who oppose granting flexibility to rate-of-return carriers for introducing new services due to concerns that lack of competition will result in monopoly pricing.[536] We do not have any evidence in the record that our streamlining policies have led to the problems that commenters fear. Additionally, we retain the ability to prevent carriers from imposing rates that are unjust, unreasonable or discriminatory.[537] Accordingly, we conclude that requiring a Part 69 waiver or a public interest showing is not necessary to ensure that rate-of-return carriers' rates for new services are just, reasonable and non-discriminatory.

204. We do not modify cost support or notice requirements for rate-of-return carriers filing tariffs to introduce new services or elements. The MAG did not propose any modifications to these requirements. Although the Commission's rules permit price cap carriers to introduce a new price cap service filing on one day's notice without cost support, price cap regulation contains an inherent incentive for maximizing efficiency that is not present under rate-of-return regulation.[538] As a result, less stringent cost support and notice requirements are appropriate for

[532] *See ITTA Forbearance Order*,14 FCC Rcd at 10847-48 paras. 11-12; *see also Access Reform Fifth Order*, 14 FCC Rcd at 14240 para. 38.

[533] *Access Reform Fifth Order,* 14 FCC Rcd at 14240 para. 38.

[534] *See 1998 Notice,* 13 FCC Rcd at 14269-70 paras. 93-95.

[535] *See Access Reform Fifth Order*, 14 FCC Rcd at 14239-40 para. 37, n.4 ("Some parties assert that meeting the Section 69.4(g) public interest standard is as burdensome or almost as burdensome as meeting the Section 1.3 waiver standard.")

[536] *See* AT&T Comments at 22; *see also* Alaska Commission Comments at 3, California Commission Comments at 15, Competitive Universal Service Coalition Comments at 16.

[537] *See ITTA Forbearance Order,* 14 FCC Rcd at 10846-47 para. 10 ("Parties may still petition the Commission to reject, or suspend and investigate, the proposed rates in the tariff introducing the new service, and the Commission may investigate the rates under either section 204 or 205 of the Act. IXCs may also file complaints under section 208 of the Act, should they believe that unreasonable discrimination, or the imposition of rates that are unjust or unreasonable, has occurred."); *see* 47 U.S.C. §§ 201, 202, 204, 205, 208.

[538] *See* 47 C.F.R. § 61.43 (requiring tariffs introducing a new service to be incorporated into the appropriate price cap basket and indices within a certain time period after the new service tariff takes effect).

price cap services. On the other hand, the Commission previously has found that without cost support, it would be unable to determine whether a rate-of-return carrier's rates are just and reasonable.[539] In addition, rate-of-return carriers with 50,000 or fewer lines already are subject to reduced cost support burdens.[540] Accordingly, we believe the cost support and fifteen-day notice requirements that generally apply to rate-of-return carriers are reasonable to provide the Commission and interested parties with sufficient time and opportunity to request cost support as appropriate.[541]

205. Furthermore, we do not believe that the difference between the one-day filing requirement for price cap carriers and the fifteen-day notice requirement for rate-of-return carriers will produce delays that are likely to cause any competitive disadvantage. The difference is only fourteen days, whereas the existing waiver requirement involves far longer delay while the Commission seeks comment on, considers, and acts upon a waiver petition. We also note that the Commission's rules provide a procedure by which carriers may request special permission in exceptional circumstances for waiving the fifteen-day notice requirement upon a showing of good cause.[542] Therefore, we find that the benefits of maintaining the present cost support and notice requirements for rate-of-return carriers filing new switched access service tariffs outweigh any need or benefit to modify these rules at this time.

3. Prescription of the Authorized Rate of Return

a. Background

206. Rate-of-return carriers are permitted to charge rates that will allow them to recover their expenses, plus a reasonable rate of return on their net investment. The authorized rate of return is adjusted from time to time by the Commission as the cost of capital changes. The authorized rate of return was last prescribed in 1990, when it was set at 11.25 percent.[543] The Commission in 1998 initiated a proceeding to represcribe the authorized rate-of-return for rate-of-return carriers.[544]

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[539] *See ITTA Forbearance Order,* 14 FCC Rcd at 10852 para. 19

[540] Small rate-of-return carriers face reduced cost support burdens because they are generally not required to submit cost support data at the time of filing, but only to make the cost support available upon request. *See* 47 C.F.R. § 61.38(2) (requiring cost support material for rate-of-return carriers with more than 50,000 lines to be filed with a new service tariff; however, rate-of-return carriers with 50,000 or fewer lines have the option instead to file pursuant to 47 C.F.R. § 61.39 which only requires cost support data to be available and submitted upon reasonable request by the Commission or interested parties). In addition, no cost support is required for a small rate-of-return carrier filing for a new service already offered by a price cap carrier in an adjacent area, if the rate-of-return carrier proposes rates that are no greater than the price cap carrier's. 47 C.F.R. § 61.39.

[541] *See* 47 CFR §§ 61.39, 61.58 (explaining notice requirements).

[542] *See* 47 CFR § 61.151.

[543] *Represcribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket No. 89-624, Order, 5 FCC Rcd 7507 (1990).

[544] *Prescribing the Authorized Unitary Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket No. 98-166, Notice Initiating a Prescription Proceeding and Notice of Proposed Rulemaking, 13 FCC Rcd 20561 (1998).

207. The MAG proposes retaining the current 11.25 percent authorized rate of return during the term of its plan and would have the Commission terminate the proceeding on the represcription of the authorized rate of return for rate-of-return carriers. MAG asserts that rate-of-return carriers will be more likely to invest in new facilities if they have reasonable assurances that they will be able to earn an adequate return on their investments over the life of the facilities.[545]

b. Discussion

208. We terminate the prescription proceeding in CC Docket No. 98-166 on the authorized rate of return. We also stay the effectiveness of section 65.101 of the Commission's rules, which otherwise would require initiation of a unitary rate of return prescription proceeding immediately as a result of termination of the CC Docket No. 98-166 proceeding. This will allow us the time necessary to comprehensively review the Part 65 rules to ensure that any future decisions we make are consonant with conditions in the marketplace.

209. We conclude that the record in the above-captioned proceedings is inadequate to permit us to determine the appropriate rate of return for rate-of-return carriers. Parties addressing this issue in response to the *MAG Notice* generally make broad statements of their positions. For example, commenters representing the interests of rate-of-return carriers state that the 11.25 percent reflects a realistic cost of capital in today's economy, noting the uncertainty of new regulations, developing competition, and an increasingly unfavorable capital market.[546] Other parties contend that the authorized rate of return is far above the level necessary to meet the expectations of investors, to attract new capital in current financial markets, and to reflect the current level of competition for interstate services.[547] Such general statements are inadequate to permit us to determine the appropriate rate of return for rate-of-return carriers. In addition, the record compiled in the CC Docket No. 98-166 proceeding is now more than two and one-half years old, and thus is no longer sufficient to permit a prescription of a new authorized rate of return.

210. We also conclude that it is appropriate to stay the effectiveness of section 65.101 of the Commission's rules, which otherwise would require initiation of a rate of return prescription proceeding immediately as a result of termination of the CC Docket No. 98-166 proceeding.[548] The Part 65 rules, under which the CC Docket No. 98-166 proceeding was initiated, were adopted in 1995.[549] Since that time, Congress has established competition as the fundamental policy for the telecommunications industry. Given the changed environment since the Part 65 rules were adopted, we find that it would be counterproductive to initiate a new

[545] MAG Comments at 16.

[546] *See, e.g.*, Innovative Telephone Comments at 8-9, Fred Williamson & Assoc. Comments at 8, Alaska Rural Coalition Reply at 7, Minnesota Indep. Coalition Reply at 4-5.

[547] *See* AT&T Comments at 17, n.20, Competitive Universal Service Coalition Comments at 15, GSA Comments at 15-16, Qwest Comments at 2.

[548] *See* 47 C.F.R. § 65.101.

[549] *Amendment of Parts 65 and 69 of the Commission's Rules and Reform to Interstate Rate of Return Represcription and Enforcement Processes*, CC Docket No. 92-133, Report and Order, 10 FCC Rcd 6788 (1995).

automatic review of rate-of-return carriers' authorized rate of return at this time without a complete review of the Part 65 procedures to determine if they are appropriate and workable. Staying the effectiveness of section 65.101 will allow us to comprehensively review the Part 65 rules to ensure that decisions we make are consonant with current conditions in the marketplace.

4. Jurisdictional Separations

211. Pursuant to the recommendations of the Federal-State Joint Board on Jurisdictional Separations, the Commission recently froze jurisdictional separations factors in a manner consistent with the MAG's proposal.[550] The Commission found that freezing the jurisdictional separations factors for a period of five years (or until a comprehensive reform of separations can be completed) would promote stability and regulatory certainty for carriers by "minimizing any cost shift impacts on separations results that might occur as a result of circumstances not contemplated by the Commission's current Part 36 rules, such as growth in local competition and new technologies."[551] Further, the Commission found that a freeze of separations factors and categories would promote simplicity and reduce administrative burdens for incumbent local exchange carriers.[552] Because the Commission has already acted in a manner consistent with the MAG's proposal, we conclude that we need not address this proposal further in this proceeding.

V. FURTHER NOTICE OF PROPOSED RULEMAKING

212. In this Further Notice, we consider methods by which to build on the access charge reforms adopted today for rate-of-return carriers in the companion Report and Order. Initially, we explore options for developing an alternative regulatory structure that would be available to those rate-of-return carriers electing it. The incentive regulation plan included as part of the broader MAG plan reflects a considerable amount of work by the rate-of-return carrier segment of the industry. While we decline to adopt the MAG incentive plan as proposed, it may constitute a useful departure point from which to develop an alternative regulatory plan that will address the needs of rate-of-return carriers and their customers. Thus, we seek to build off the incentive regulation proposal contained in the MAG plan and our experience with price cap regulation for price cap carriers. In this regard, we will consider the widely varying operating circumstances of rate-of-return carriers, the implications of competitive and intrastate regulatory conditions on the options available, and the need to facilitate and ensure the deployment of advanced services in rural America. Second, responding to comments on the *1998 Notice*, we will consider the appropriate degree and timing of pricing flexibility for rate-of-return carriers. Third, we seek further comment on the MAG's proposed changes to the Commission's "all-or-nothing" rule.[553] In these ways, we seek to improve the efficiency of the

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[550] *Jurisdictional Separations Reform and Referral to the Joint Board*, CC Docket No. 80-286, Report and Order, 16 FCC Rcd 11382 (2001) (*Interim Separations Freeze Order*). The MAG plan proposes that jurisdictional separations factors should be frozen consistent with the *Recommended Decision* of the Federal-State Joint Board on Jurisdictional Separations. *MAG Notice*, 16 FCC Rcd at 462 para. 7; *see Jurisdictional Separations Reform and Referral to the Joint Board*, CC Docket No. 80-286, Recommended Decision, FCC 00J-2 (Jt. Bd. rel. July 21, 2000).

[551] *Interim Separations Freeze Order*, 16 FCC Rcd at 11389 para. 12.

[552] *Interim Separations Freeze Order*, 16 FCC Rcd at 11390 paras. 13-14.

[553] *See infra*, § V.C.

provision of telecommunications services in rural America by ultimately relying on markets to discipline prices and service quality and, whenever possible, to reduce regulatory oversight. Finally, we seek comment on merging the Long Term Support mechanism into Interstate Common Line Support as of July 1, 2003, when the CCL charge will be eliminated.

A. Alternative Regulation

1. Background

213. Price cap carriers' access charges are limited by price indexes that are adjusted annually pursuant to formulas set forth in our Part 61 rules. One element of the formulas is the X-factor, which reduces the price cap indexes to reflect price cap carrier productivity gains above those reflected in the GDP-PI. In this way, price cap carrier customers receive some of the benefits of the increased efficiencies through lower rates. Price cap carriers are permitted to earn returns higher, or potentially lower, than the prescribed rate of return that incumbent carriers are allowed to earn under rate-of-return rules. Price cap regulation encourages price cap carriers 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 levels.[554] Individual price cap companies have incentives to cut costs and to produce efficiently, because in the short run their behavior has no effect on the prices they are permitted to charge, and they are able to keep any additional profits resulting from reduced costs.

214. Although price cap regulation eliminates the direct link between changes in allocated accounting costs and changes 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 formulas were originally applied. Price cap indexes are adjusted upwards if a price cap carrier earns returns below a specified level in a given year. A price cap carrier that is eligible to, and elects to, price access services using the Commission's pricing flexibility rules forgoes its right to an automatic low-end adjustment. Moreover, a price cap carrier may petition the Commission to set its rates above the levels permitted by the price cap indexes based on a showing that the authorized rate levels will produce earnings that are so low as to be confiscatory. In the past, all

[554] The price cap regulations also give price cap carriers 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, price cap carriers are given some discretion to determine the portion of revenue that may be recovered from specific services. Subject to certain restrictions, this flexibility allows price cap carriers to alter the access charge rate level associated with a given service. For example, within the category of switching services, a price cap carrier 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.

or some price cap carriers were required to "share," or return to ratepayers, earnings above specified levels. This sharing requirement was eliminated in 1997.[555]

215. Under the MAG incentive plan, rate-of-return carriers that participate in the NECA pooling system and that elect Path A would have a transition period of five years within which they could move on a study-area basis from rate-of-return regulation to incentive regulation. At the end of the five year period, all study areas of all Path A carriers would be subject to incentive regulation. Once a Path A carrier elects incentive regulation for any study area in the pool, it cannot later choose to recover that study area's cost based on traditional rate-of-return regulation. Path A incentive regulation provides that a study area recovers all of its common line and traffic sensitive switched settlements on a revenue per line (RPL) basis for the pool. The RPL of each Path A study area would be set at the per-line revenue level based on the most recent cost study data or average schedule revenue requirement data available prior to the study area converting to incentive regulation. This initial RPL for each study area would be adjusted for inflation using the GDP-PI and adjusted annually thereafter for inflation. To increase earnings, Path A carriers would have incentives to lower their unit cost per line and to increase their lines. Interstate access revenue would not be fixed but would depend on growth in the number of lines if it is to increase in real terms. A component of the NECA pool revenue requirement for Path A carriers would be provided through RAS, an explicit and portable form of universal service support. The RAS would recover Path A pool members residual revenue requirements that are not recovered through SLCs, other access rate elements, and other forms of explicit universal service support. Rate-of-return carriers also would have a low-end adjustment factor below which earnings would not be allowed to go: 10.25 percent for carriers with more than five study areas, and 10.75 percent for those carriers with five or fewer study areas.

2. Discussion

216. In this section, we critique the MAG proposal for introducing incentive regulation for rate-of-return carriers. This evaluation will form a foundation on which to discuss the development of an appropriate alternative regulation plan for rate-of-return carriers. We then explore several options for alternative regulation and seek input to assist in setting the parameters of any plan to be adopted. Properly designed, an alternative regulatory approach will, over time, drive rates toward forward-looking costs and prepare regulated companies for competing in a deregulated market. In addition, an alternative regulatory mechanism may offer rate-of-return carriers a degree of pricing flexibility and the opportunity to share in the profits from the cost reductions they will make to prepare for competitive entry, while sharing some of those savings with consumers.

a. Critique of MAG's Incentive Regulation Proposal

217. Based on the present record, we are unable to conclude that the MAG's incentive regulation plan should be adopted. As we explain below, the MAG's incentive regulation plan does not properly balance carrier and customer interests given the current regulatory

[555] Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, Fourth Report and Order, CC Docket No. 96-262, Second Report and Order, 12 FCC Rcd 16642, 16700 (1997) (*1997 Price Cap Review Order*), *aff'd in part, rev'd in part, USTA v. FCC*, 188 F.3d 521 (D.C. Cir. 1999).

environment for those carriers. In addition to the broad concerns we identify in this section with the plan as proposed, other issues will be raised in the discussion addressing the development of an alternative regulatory structure for rate-of-return carriers.

218. Initially, we agree with those parties asserting that the inflation-adjusted RPL component of the MAG's incentive plan would allow carriers to increase their revenues without any recognition of the productivity gains that historically have been realized by the telephone industry.[556] Thus, it is not clear that rates under the MAG incentive plan would be just and reasonable, as required by section 201(b) of the Act.[557] Under the MAG plan, all the benefits of productivity or efficiency improvements would accrue to the carrier in the form of higher returns and none of the benefits accrue to access customers. Overlaying the MAG incentive regulation plan on rate-of-return industry revenues from 1995-1999, AT&T has estimated that rate-of-return carriers would have realized $424 million more in traffic sensitive revenues in 1999 alone under the MAG incentive regulation plan than they realized under rate-of-return regulation, due primarily to productivity gains in local switching and transport.[558]

219. One possible solution would be to establish one or more X-factors. The record, however, is not adequate to determine an X-factor or factors that would be appropriate for all rate-of-return carriers that might elect incentive regulation. This task is particularly difficult because of the diversity of rate-of-return carriers. Therefore, an optional alternative regulation plan might be appropriate for rate-of-return carriers, as urged by a number of commenters.[559] An X-factor could be needed to keep rate-of-return carriers' rates reasonable because competitive conditions in most rate-of-return carrier markets cannot be relied upon to act as a check on rate-of-return carriers' ability to implement anti-competitive prices.

220. We also find that the plan as structured does not insure that adequate investment or service quality levels will necessarily be maintained. Several parties have alleged that any incentive plan must contain controls to ensure that consumers are not harmed in this regard. Rate-of-return carriers electing incentive regulation, as proposed, might have the incentive to reduce costs by reducing investment (and therefore depreciation) and maintenance levels in order to achieve greater profits that it may then retain, without there being any benefit to consumers in the form of assurances of continued investment and maintenance of rate-of-return carrier facilities, or of the sharing of any efficiency gains with customers.

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[556] *See, e.g.*, AT&T Comments at 16, California Commission Comments at 16, GCI Comments at 5, NASUCA Comments at 20, WorldCom Comments at 3-7.

[557] 47 U.S.C. § 201(b).

[558] AT&T Comments at 16 and Appendix A; *but see* MAG Reply at 21-23 (questioning assumptions and time period selected by AT&T).

[559] *See, e.g.*, Interstate Telcom Group Comments at 8-11, Western Alliance Comments at 6-10, GVNW Consulting Reply at 6, Innovative Telephone Reply at 3-5, John Staurulakis Reply at 2.

b. Principles

221. An alternative regulation plan initially must ensure that rates remain just and reasonable, as required by section 201(b).[560] This is the fundamental underpinning of all regulatory models. To ensure that rates remain just and reasonable and that a carrier not receive a windfall from the elimination of any existing inefficiencies, the benefits to be realized from the adoption of an alternative regulation plan should be shared equitably between the carrier and its customers. Under price cap regulation, the Commission initialized rates after reviewing the cost of capital and employed an X-factor productivity adjustment to ensure that price cap carrier rates reflected industry average productivity improvements, while permitting price cap carriers that could be more efficient to keep some or all of any increased earnings. We invite parties to comment on how this goal might be realized most effectively with regard to rate-of-return carriers, and whether something akin to the price cap methods should be used, or whether some other effective alternative exists.

222. We seek comment on whether the rewards a rate-of-return carrier electing an alternative regulation plan might realize should be related to the risk the carrier assumes. Under such an approach, the less stringent the X-factor offset, the smaller the increased profits the carrier would be permitted to retain. We also ask parties to comment on whether a range of options should be offered to rate-of-return carriers, and whether the same set of options should be offered to all rate-of-return carriers. If only a limited set of options is to be offered to some rate-of-return carriers, what characteristics of a carrier or its environment should determine the set of options to be offered? We invite parties to comment on these considerations generally and on how the correct relationships might be determined to ensure that rates remain just and reasonable.

223. The design of an alternative regulation plan must also address the incentives an alternative regulation plan gives rate-of-return carriers to reduce investment in plant and equipment, or to reduce expenditures on maintaining service quality, in order to increase profits at the expense of maintaining adequate investment or service quality. Section 254(b) identifies the availability of comparable services in rural areas as a criteria in assessing universal service.[561] The achievement of these goals clearly requires investment in rural areas, which must therefore be supported by any alternative regulation plan we adopt.

224. Rate-of-return regulation has worked well in extending service to rural America, along with our universal service program and the work of state commissions to support service in these areas. We seek comment on how to maintain quality assurance and expansion of new and advanced services in rural and non-rural areas served by rate-of-return carriers under any alternative regulatory plan we might adopt. As we develop an alternative regulation plan for rate-of-return carriers, are there state programs we can rely on as means to ensure that adequate investment and service quality will be maintained? Such programs could include various types of state programs that oversee small company activities and focus on investment and service quality. In addition, certain indicia of competition, such as the designation of an eligible

[560] 47 U.S.C. § 201(b).

[561] 47 U.S.C. § 254.

telecommunications carrier in the rate-of-return carrier's service area, might also permit us to conclude that the incentives to invest and maintain service quality are present. We invite parties to comment on the extent to which regulatory and competitive conditions could be effective tools in developing a workable alternative regulatory mechanism. Parties should address how the different possible components of an alternative regulatory plan discussed below might be modified as regulatory or competitive conditions change.

225. Finally, we believe that an alternative regulatory plan must minimize the administrative burdens on small carriers and regulatory intervention in their operations, while achieving the other principles noted above. In this regard, an alternative regulation plan should consider the size of the carriers that will be subject to the plan and be no more restrictive than necessary to achieve the necessary public interest objectives. We therefore invite parties to address the impact any alternative regulation plan might have on small incumbent local telephone companies, as required by the Regulatory Flexibility Act.[562]

226. As we proceed, it will be with a focus on these objectives. We invite parties to comment on the validity of these objectives and how they apply to the different measures of any alternative regulation plan proposed. We also ask parties to identify additional principles that should be applied to the development of an alternative regulatory mechanism. In the following section we address several specific considerations associated with developing an alternative regulatory plan.

c. Issues in Developing an Alternative Regulatory Plan

227. *Optionality*. The scope of an alternative regulation plan affects in significant ways the design of that plan. Several rate-of-return carrier interests assert that any alternative regulation plan must be optional because of the diversity among rate-of-return carriers in their operating conditions. On the other hand, AT&T urges us to make an alternative regulation plan applicable to the largest rate-of-return carriers on a mandatory basis.[563] Given the wide variations among rate-of-return carrier operating conditions, we believe it would be extremely difficult to establish a mandatory alternative regulatory plan for all rate-of-return carriers. We invite parties to comment on the extent to which an alternative regulation plan should be completely optional, or whether it should be mandatory for a subset of larger rate-of-return carriers. Parties should address what criteria should be used to determine which carriers would be subject to alternative regulation on a mandatory basis. We also seek comment on whether any optional alternative regulation plan should be one-way, so that, once made, a carrier could not return to rate-of-return regulation. Alternatively, are there certain conditions, such as when earnings are sufficiently low for a sufficiently long period of time, or simply after a specified period of time, or after each review period, when a carrier could be permitted to return to rate-of-return regulation? Parties are invited to address what those conditions might be and how rates should be determined upon return to rate-of-return regulation.

[562] *See* 5 U.S.C. § 603.

[563] *See, e.g.*, AT&T Comments at 14; *accord*, WorldCom Reply at 3.

228. *Alternative regulation in a pooling context.* The MAG's incentive regulation plan was designed to work within the NECA pooling structure. Today, nearly all rate-of-return carriers participate in the NECA common line pool, and more than sixty percent of the minutes of rate-of-return carriers are charged at NECA rates. This offers many administrative benefits to carriers and to the Commission, particularly in the form of tariff administration. It may, however, blunt some of the benefits that may be realized from an alternative regulatory plan.[564] If cost savings that a carrier realizes are included in the pool settlements process, rather than being retained by the carrier achieving the efficiency gains or reflected in lower rates to the customers, the carrier will have little incentive to pursue cost efficiencies. We invite parties to comment on whether an alternative regulation plan can and should be designed to work within the NECA pooling structure, whether there are ways for NECA to revise its pooling procedures to facilitate meaningful incentive regulation, or whether rate-of-return carriers should be required to leave the pool to avail themselves of any alternative regulatory plan. Parties should also address how an alternative regulatory plan would apply to those rate-of-return carriers outside the NECA pools, including any problems created if a rate-of-return carrier was, for example, in the common line pool but not the traffic sensitive pool.

229. *Use of revenue per line (RPL)*. The MAG proposes to use a RPL amount as the basis for establishing its incentive plan, adjusting the RPL amount annually for inflation.[565] Thus, a rate-of-return carrier electing incentive regulation would settle with the NECA pool on the basis of its inflation-adjusted RPL amount. A rate-of-return carrier's costs and its settlement amount from NECA would therefore no longer be linked. The rate-of-return carrier would thus have the incentive to reduce its operating costs since it could retain the difference between the RPL amount and its actual costs, if lower. On the other hand, if its costs were higher than the RPL amount, it would not receive additional settlements. Several commenters oppose the use of a revenue cap, alleging that a rate-of-return carrier would have every incentive to reduce its investment and expenses since these no longer affect their settlements with the NECA pool.[566]

230. In response, the MAG argues that Path A incentive regulation under its plan differs from both price cap regulation and revenue cap regulation. It asserts that Path A incentive regulation breaks the link between prices and unit costs of interstate access, thereby encouraging Path A carriers to reduce their unit costs per line to increase earnings. It asserts that a Path A carrier's total revenues depend on increases in the number of lines. It notes that unlike price cap regulation, RPL does not ensure that growth in usage for access services priced on a per-minute basis will result in greater revenues for the Path A carrier. Further, the MAG argues that increased minutes of use would reduce the size of the MAG's proposed RAS.[567]

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[564] *Price Cap Review for Local Exchange Carriers*, CC Docket No. 94-1, First Report and Order, 10 FCC Rcd 8961, 9045-46 paras. 187-89 (1995), *aff'd sub. nom.,* Bell Atlantic Telephone Companies v. FCC, 79 F.3d 1195 (D.C. Cir. 1995).

[565] Unlike price cap regulation, under which a LEC may benefit from the sale of additional vertical services, the RPL approach would not increase permitted revenues from the sale of additional vertical services.

[566] *See, e.g.*, NASUCA Comments at 22, Texas Commission Comments at 3.

[567] *See* Letter from William F. Maher, Jr., Esq., to Dorothy Attwood, Chief, Common Carrier Bureau, Federal Communications Commission (May 24, 2001).

231. We invite parties to comment on the use of an RPL amount as a starting point for an alternative regulatory plan. We specifically invite comment on whether the MAG's contention that RPL is different from a revenue cap is correct. On its face, it appears that in some cases, as when competition exists, a carrier could lose lines and thus revenues, while under a pure revenue cap structure, it could increase prices to recover any shortfall. Furthermore, if an external check existed, such as a state-imposed investment plan, future investment and service quality might not be adversely affected. On the other hand, without a competitive or regulatory check, the RPL approach might work much like a pure revenue cap. Binding revenue cap regulation has been criticized as being damaging to market efficiency since it provides firms with incentives to lower total costs rather than per-unit costs and increase prices at or above monopoly levels by restricting output more than it would if it were an unregulated monopolist. We ask parties to comment on the extent to which the presence of competition or an external check would affect a carrier's incentives in an RPL system, and how such factors could be included in an alternative regulatory system for rate-of-return carriers. Parties should also address how to respond to the concern expressed in the record that rate-of-return carriers would have every incentive in the year they choose to enter an alternative regulation program to maximize their costs and plant investment, in order to maximize their initial rates.[568]

232. We also ask parties to address whether there are other approaches to establishing an alternative regulatory mechanism that would work better than RPL over a broader range of competitive and regulatory landscapes. For example, would it be possible and preferable to use baskets of traffic-sensitive and non-traffic-sensitive service revenues or prices as the baseline against which to measure rate-of-return carrier productivity? Parties proposing alternatives should be specific in laying out their plan and should address how their plan is consistent with the principles enumerated above. Parties should also address what an appropriate alternative regulatory plan should be if we were to conclude that a rate-of-return carrier must leave the NECA pool to participate in such a plan.

233. In addition, we invite parties to address whether, rather than developing a new alternative regulatory plan for rate-of-return carriers, we should establish a method by which rate-of-return carriers would be eligible to adopt the CALLS plan. Parties should particularly address what modifications if any, would be necessary in the indexing and universal service aspects of the CALLS plan to make it appropriate for rate-of-return carriers, without jeopardizing the position of any party currently subject to the CALLS plan.

234. *Productivity and sharing considerations*. The MAG incentive plan does not contemplate any initial rate reduction, or a recurring productivity offset (X-factor). Under the MAG plan, rates initially would be based on a rate-of-return carrier's settlements from the NECA pools at the time the carrier elected incentive regulation, and increased by inflation in future years. Several parties assert that any plan must have a productivity factor in order to keep rates just and reasonable, contending that the telephone industry traditionally has achieved greater productivity than that reflected in the GDP-PI.[569] Several parties also contend that an

[568] *See, e.g.*, California Commission Comments at 2-3, GCI Comments at 4-5, Wisconsin Commission Comments at 9.

[569] *See, e.g.*, California Commission Comments at 22, GCI Comments at 5, NASUCA Comments at 19, Qwest Comments at 4-5, Wisconsin Commission Comments at 10.

incentive plan for rate-of-return carriers must include a sharing mechanism, as the original price cap plan did.[570]

235. We invite parties to comment on the extent to which a productivity offset or initial rate reduction should be part of any alternative regulatory plan for rate-of-return carriers. This is a difficult issue for rate-of-return carriers due to the variations in their operating conditions. Many smaller rate-of-return carriers' investment patterns are lumpy, with only occasional significant new investments, as when they replace a switch or a major trunking facility. Some rate-of-return carriers may not realize sufficient demand growth to realize any scale economies. These smaller carriers might not be interested in an alternative regulation plan that included a productivity offset. It would be helpful if parties addressed the means by which we should establish any productivity offset and the level at which it should be set. These comments should take into account the possibility that the alternative plan would, for some or all rate-of-return carriers, be optional. Thus, only those rate-of-return carriers that thought they could exceed the productivity threshold might elect the alternative regulatory plan.

236. Several uncertainties exist in initiating an alternative regulatory plan if it is optional. It will be unclear how many rate-of-return carriers may elect any plan until such time as they are required to exercise that option. Furthermore, calculation of a productivity offset will be imprecise due to lack of knowledge of which carriers would be participating. We therefore invite parties to comment on whether an alternative regulatory plan for rate-of-return carriers should include a sharing mechanism to account for the difficulty in the calculation of an appropriate X-factor. Parties should also address the level at which, and the extent to which, any sharing should be required, whether sharing requirements should be linked to service quality levels, and the relationship between the levels of any X-factor and sharing obligations.

237. As the Commission has noted previously, sharing mechanisms have significant incentive-blunting characteristics caused by the reduced incentive to increase efficiency if the carrier can only retain a portion of the savings. We therefore seek comment on whether a system of regulation with a lag might be appropriate for rate-of-return carriers. Under such a plan, a productivity offset would be established based on an appropriate industry grouping. Rate-of-return carriers electing the alternative regulation plan would be permitted to keep any increased profits realized from increased efficiency or line growth. After some period of time, such as three years, the Commission would reexamine the productivity offset and adjust it prospectively, reflecting the realized experience of the previous three years. We invite parties to comment on the use of regulation with a lag. They should address the setting of the productivity offset in this context, as well as the length of time between reviews. We invite parties to comment on whether RPL is the appropriate baseline against which to apply the productivity offset under this scenario and whether the RPL level should be based on an individual carrier's revenues or on some grouping of carriers. Parties should also address whether a sharing or a lag plan introduces the fewest efficiency disincentives and is most likely to create proper incentives.

238. *Low-end adjustment.* As with price cap regulation, the MAG proposes a low-end-adjustment factor. Unlike the low-end adjustment for price cap carriers, however, the low-

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[570] *See, e.g.*, AT&T Comments at 17, California Commission Comments at 23-24.

end adjustment proposed by the MAG would ensure that rate-of-return carriers electing incentive regulation would not earn below the low-end adjustment. It would do this by providing for a prospective revenue payment from the NECA pool that would give it the difference between what it actually earned and the low-end adjustment over a twelve-month period. Price cap carriers, on the other hand, are only permitted to adjust their price cap indexes to allow them to set prospective rates at a level that would allow them to earn at the level of the low-end adjustment. We invite parties to comment on the need for a low-end adjustment and on how to establish the proper level. We specifically ask parties to address whether a low-end adjustment in an alternative regulatory plan should protect against earnings below that level during a particular tariff period, or whether it should be used to retarget rates so that the carrier will have an opportunity to earn that level in the future tariffing period, as is done in the price cap context. We also invite parties to comment on whether there is any need for a higher low-end adjustment for smaller rate-of-return carriers, and if a higher low-end adjustment is necessary, how the higher low-end adjustment should be determined, which carriers should be covered, and the extent to which the low-end adjustment should be higher. Finally, we ask whether, if rate-of-return carriers are granted pricing flexibility, they should be required to forego the automatic low-end adjustment just as price cap carriers do.

239. *Monitoring*. The adoption of an alternative regulatory plan would alter the incentives of carriers, and establish new parameters regulating those carriers electing the alternative plan. We invite parties to comment on whether there is any need to establish reporting requirements to monitor service quality and carrier investment in an alternative regulatory regime, or whether it will be possible to rely on competitive conditions or state investment and service quality standards to control any adverse effects of the new incentives. Finally, we ask parties to comment on how often we should review an alternative regulatory plan. Because conditions change over time, it may periodically be necessary to modify some of the parameters based on the new circumstances, or a better understanding on our part of how they are working with respect to the rate-of-return LECs electing the alternative plan. Parties are also invited to suggest precise methodologies for modifying the relevant parameters.

240. *Other issues.* Finally, we invite parties to comment on other concerns they may have with the Commission's possible adoption of an alternative regulatory plan for rate-of-return carriers. In particular, parties are encouraged to address issues relating to the timing of the election to be governed by the alternative regulatory plan. For example, should the election be available only on one fixed date, or should carriers have the option to elect at a time of their own choosing?

B. Pricing Flexibility

1. Background

241. When it adopted the access charge structure in 1983, the Commission required all incumbent LECs to offer all interstate special and switched access services at geographically averaged rates for each study area.[571] Since that time, the Commission has increased incumbent

[571] *See* 47 C.F.R. § 69.3(e)(7); *see also 1983 Access Charge Reform Order*, 93 FCC 2d at 314-15. The Commission has not prescribed a special access rate structure.

LECs' pricing flexibility and ability to respond to the advent of competition in the exchange access market. In the *Special Access* and *Switched Transport Expanded Interconnection Orders*, the Commission permitted incumbent LECs to introduce density zone pricing for high capacity special access and switched transport services in a study area, provided that they could demonstrate the presence of "operational" special access and switched transport expanded interconnection arrangements and at least one competitor in the study area.[572] The Commission also permitted incumbent LECs to offer volume and term discounts for switched transport services upon specific competitive showings.[573]

242. In 1999, the Commission recognized that the variety of access services available on a competitive basis had increased significantly since the adoption of the price cap rules. The Commission therefore granted price cap carriers immediate flexibility to deaverage services in the trunking basket[574] and to introduce new services on a streamlined basis.[575]

243. The Commission also adopted a framework for granting further regulatory relief upon satisfaction of certain competitive showings. The Commission determined that relief generally would be granted in two phases and on a Metropolitan Statistical Area (MSA) basis. To obtain Phase I relief, the Commission required price cap carriers to demonstrate that

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[572] *Expanded Interconnection with Local Telephone Company Facilities, Amendment of the Part 69 Allocation of General Support Facility Costs*, CC Docket Nos. 91-141 and 92-333, Report and Order, 7 FCC Rcd 7369, 7454 n.411 (1992) (*Special Access Expanded Interconnection Order*), *vacated in part and remanded*, *Bell Atlantic Tel. Cos. v. FCC*, 24 F.3d 1441 (D.C. Cir. 1994); *Expanded Interconnection with Local Telephone Company Facilities*, 9 FCC Rcd 5154, 5196 (1994) (*Virtual Collocation Order*); *Switched Transport Expanded Interconnection with Local Telephone Company Facilities*, CC Docket No. 91-141, Second Report and Order and Third Notice of Proposed Rulemaking, 8 FCC Rcd 7374, 7425-32 (1993) (*Switched Transport Expanded Interconnection Order*), *aff'd*, *Virtual Collocation Order*, 9 FCC Rcd 5196 (1994). "Expanded interconnection" refers to the interconnection of one carrier's circuits with those of a LEC at one of the LEC's wire centers so that the carrier can provide certain facilities-based access services. *See Virtual Collocation Order*, 9 FCC Rcd at 5158. An expanded interconnection offering is deemed "operational" when at least one interconnector has taken a switched cross-connect element. *Switched Transport Expanded Interconnection Order*, 8 FCC Rcd at 7426-27.

[573] *Special Access Expanded Interconnection Order*, 7 FCC Rcd at 7463; *Switched Transport Expanded Interconnection Order*, 8 FCC Rcd at 7435. The Commission allowed LECs to offer volume and term discounts for switched transport services in a study area upon demonstration of one of the following conditions: (1) 100 DS1-equivalent switched cross-connects (*i.e.*, the cabling inside the LEC central office that connects the LEC network to the collocated equipment dedicated to a competitive access provider using expanded interconnection) are operational in the Zone 1 offices in the study area; or (2) an average of 25 DS1-equivalent switched cross-connects per Zone 1 office are operational. In study areas with no Zone 1 offices, volume and term discounts may be implemented once five DS1-equivalent switched cross-connects are operational in the study area. *Switched Transport Expanded Interconnection Order*, 8 FCC Rcd at 7435.

[574] The Commission allowed price cap carriers to define the scope and number of zones within a study area, provided that each zone, except the highest-cost zone, accounts for at least 15 percent of the incumbent LEC's trunking basket revenues in the study area and that annual price increases within a zone do not exceed 15 percent. The Commission also eliminated the requirement that LECs file their zone plans prior to filing a tariff.

[575] *See supra*, § IV.E.2; *Access Charge Reform,* CC Docket No. 96-262, *Price Cap Performance Review for Local Exchange Carriers*, CC Docket No. 94-1, *Interexchange Carrier Purchases of Switched Access Services Offered by Competitive Local Exchange Carriers*, CCB/CPD File No. 98-63, *Petition of U S West Communications, Inc., for Forbearance from Regulation as a Dominant Carrier in the Phoenix, Arizona, MSA*, CC Docket No. 98-157, Fifth Report and Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd 14221, 14238-43 paras. 34-44, 14252-57 paras. 59-66 (1999) (*Pricing Flexibility Order*).

competitors have made irreversible, sunk investments in the facilities needed to provide the services at issue. For dedicated transport and special access services, price cap carriers were required to demonstrate that unaffiliated competitors have collocated in at least 15 percent of the carrier's wire centers within an MSA or collocated in wire centers accounting for 30 percent of the carrier's revenues from these services within an MSA.[576] Higher thresholds were applied, however, for channel terminations between a LEC end office and an end user customer. In that case, the carrier was required to demonstrate that unaffiliated competitors have collocated in 50 percent of the price cap carrier's wire centers within an MSA or collocated in wire centers accounting for 65 percent of the price cap carrier's revenues from this service within an MSA. For traffic sensitive, common line, and the traffic sensitive components of tandem-switched transport services, the Commission required carriers to show that competitors offer service over their own facilities to 15 percent of the carrier's customer locations within an MSA. Phase I relief permits price cap carriers to offer, on one day's notice, volume and term discounts and contract tariffs for these services, so long as the services provided pursuant to contract are removed from price caps. To protect those customers that may lack competitive alternatives, carriers receiving Phase I flexibility are required to maintain their generally available, price cap constrained tariffed rates for these services.[577]

244. To obtain Phase II relief, the Commission required price cap carriers to demonstrate that competitors have established a significant market presence (*i.e*., that competition for a particular service within the MSA is sufficient to preclude the incumbent from exploiting any individual market power over a sustained period) for provision of the services at issue. The Commission found that Phase II relief for dedicated transport and special access services would be warranted when a price cap carrier demonstrates that unaffiliated competitors have collocated in at least 50 percent of the carrier's wire centers within an MSA or collocated in wire centers accounting for 65 percent of the carrier's revenues from these services within an MSA. The Commission imposed a higher threshold to channel terminations between a LEC end office and an end user customer. In that case, a price cap carrier is required to show that unaffiliated competitors have collocated in 65 percent of the carrier's wire centers within an MSA or collocated in wire centers accounting for 85 percent of the carrier's revenues from this service within an MSA. Phase II relief permits price cap carriers to file tariffs for these services on one day's notice, free from both the Part 61 rate level and the Part 69 rate structure rules.[578]

245. The Commission sought comment in a companion Further Notice on additional pricing flexibility for common line and traffic sensitive services. First, the Commission sought comment on permitting price cap carriers to deaverage rates for services in the common line and traffic sensitive baskets in conjunction with identification and removal of implicit universal service support in interstate access charges and implementation of an explicit high cost support

[576] To satisfy the collocation triggers we adopt herein, an incumbent LEC must demonstrate, with respect to each wire center with collocation, that at least one of the competitors therein uses transport services provided by a transport provider other than the incumbent LEC.

[577] *Pricing Flexibility Order,* 14 FCC Rcd at 14261-96 paras. 77-140.

[578] *Pricing Flexibility Order,* 14 FCC Rcd at 14296-302 paras. 141-157. The Commission eliminated the low-end adjustment mechanism for those price cap carriers qualifying for and electing to exercise either Phase I or Phase II pricing flexibility.

mechanism. The Commission also sought comment on how to define zones for purposes of deaveraging. In addition, the Commission sought comment on which rate elements may be deaveraged and whether deaveraging should be subject to SLC and PICC caps or any other constraint. The Commission also sought comment on the appropriate Phase II triggers for granting greater pricing flexibility for traffic sensitive, common line, and the traffic-sensitive components of tandem-switched transport services.[579] The Commission in the *Interstate Access Support Order* allowed price cap carriers to deaverage their SLCs.[580]

2. Discussion

246. With this Further Notice, we extend our consideration of pricing flexibility to rate-of-return carriers, as we indicated we would do in the *1998 Notice*.[581] In this section we seek comment on methods of extending pricing flexibility to rate-of-return carriers in addition to those already available to them under current rules or under the rules adopted in the accompanying Order. As noted above, rate-of-return carriers may deaverage their transport and special access rates if there is a single cross-connect in the study area and may offer volume and term discounts on transport services if a minimum threshold of DS1s are provided in their central offices in the study area. Under the rules adopted today, rate-of-return carriers may deaverage their SLC charges if certain criteria are met[582] and are permitted to disaggregate the universal service support they receive.[583] We also streamlined the requirements for rate-of-return carriers to introduce new services.[584]

247. As competition develops in the service areas of rate-of-return carriers, it is important that they have pricing flexibility, just as it was important for price cap carriers. Given that rate-of-return carriers are generally smaller than even the smallest price cap carrier, it is likely that the same combinations of pricing flexibility and triggers will not produce the same results for rate-of-return carriers. In fact, smaller rate-of-return carriers may be especially reliant on a few large users for significant portions of their revenues. Furthermore, these smaller carriers may not be able to realize the volumes that make certain types of pricing flexibility practical. Below, we consider different types of pricing flexibility for rate-of-return carriers and the circumstances under which a rate-of-return carrier should be eligible for pricing flexibility.

a. Types of Pricing Flexibility

248. In this Notice, we focus on three types of pricing flexibility for rate-of-return carriers: geographic deaveraging within a study area; volume and term discounts; and contract pricing. These are the types of pricing flexibility mentioned most often by rate-of-return carriers

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[579] *Id.* at 14320-49 paras. 190-257.

[580] *See Interstate Access Support Order,* 15 FCC Rcd at 13007 para. 113.

[581] *1998 Notice*, 13 FCC Rcd at 14240 para. 5.

[582] *See supra,* § IV.A.2.c.

[583] *See id.* at § IV.D.2.a.

[584] *See id.* at § IV.E.2.

in the comments in response to the *1998 Notice*.[585] These are also the three types of pricing flexibility provided to price cap carriers. Accordingly, it is appropriate for us to start with these types of pricing flexibility.

249. These three pricing flexibility options offer incumbent LECs significant ability to price their services closer to cost and to respond to competitive entry. Geographic deaveraging within a study area would permit rate-of-return carriers to price in a manner that reflects cost differences from one geographic location to another. Volume and term discounts would permit rate-of-return carriers to reflect economies related to capacity differences and to the certainties offered by term contracts. Finally, contract pricing would permit rate-of-return carriers to respond to requests for proposals and to address more complex communications needs of customers. These pricing alternatives would, once available, make rate-of-return carriers' pricing structures more efficient and permit them to respond to competition

250. While there are clear benefits from pricing flexibility, there are also competitive concerns raised by their introduction. Thus, if introduced too soon, pricing flexibility might be used to erect a barrier to competitive entry. For example, a rate-of-return carrier could deaverage its rates so that the attractive customers received very low rates, or it could lock up customers before entry began through the use of lengthy term contracts. In addition, in offering deaveraged rates or volume and term discounts, a carrier could, absent some restriction, increase rates excessively for remote customers or for low-volume customers to offset reductions resulting from the introduction of deaveraged rates or volume discounts for higher-volume customers.[586] Such practices could inhibit competitive entry and deny customers in rate-of-return carrier service areas the benefits of competition.

251. We invite parties to comment on our proposal to extend pricing flexibility to rate-of-return carriers in the forms noted above. In doing so, parties should address how the unique characteristics of rate-of-return carriers may affect the benefits and risks associated with pricing flexibility. They should identify any differences in the benefits and risks that may exist in relation to common line, local switching, and transport and special access services separately. Parties should also address whether any special rules for pricing flexibility are needed to prevent anti-competitive behavior from inhibiting the development of competition in these markets. For example, should the number of zones rate-of-return carriers are permitted to establish be fewer than price cap carriers are permitted, or should the degree of deaveraging or volume and term discounts be limited due to the rate-of-return carriers' smaller size? In a recent waiver order, we conditioned the grant of volume and term pricing flexibility for transport and the TIC on the carrier calculating a rate using the requirements of sections 69.106(b) and 69.124(b) and (c) of the Commission's rules to establish a ceiling rate for the associated non-discounted access service offering.[587] We invite parties to comment on whether such a restriction should be

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[585] *See, e.g.*, ALLTEL Reply in CC Docket No. 98-77 at 2-4, NRTA and NTCA Reply in CC Docket No. 98-77 at 14, OPASTCO Reply in CC Docket No. 98-77 at 13-14, TDS Reply in CC Docket No. 98-77 at 22-24, USTA Reply in CC Docket No. 98-77 at 23-26.

[586] *See ATU Telecommunications Request for Waiver of Sections 69.106(b) and 69.124(b)(1) of the Commission's Rules*, Order, 15 FCC Rcd 20655, 20662 para. 22 (2001).

[587] *Id.*

imposed on the introduction of pricing flexibility on rate-of-return carriers to preclude anti-competitive behavior.

252. Parties should also address the impact that permitting pricing flexibility would have on the NECA pooling process. Would NECA need to establish exception rates for those rate-of-return LECs qualifying for pricing flexibility, and, if so, how burdensome would this be on NECA? Are there other ways of handling pricing flexibility within the pooling process that would be less burdensome? Parties also should address whether permitting pricing flexibility within the pooling process would be so burdensome on NECA, or offer anti-competitive opportunities to rate-of-return carriers, that rate-of-return carriers should be required to leave the NECA pool as a condition of obtaining pricing flexibility.

253. We also invite parties to identify other forms of pricing flexibility that may be appropriate for the development of an efficient, competitive exchange access marketplace. Parties suggesting other forms of pricing flexibility should evaluate the benefits and risks of those forms of pricing flexibility, as well as the conditions under which such pricing flexibility might be appropriately granted to rate-of-return carriers.

b. Timing of Pricing Flexibility

254. The determination of when pricing flexibility should be granted to rate-of-return carriers is a more difficult question than which types of pricing flexibility to consider granting. It is the opportunity to exercise pricing flexibility prematurely that presents the greatest anti-competitive risk to the development of competition. To address these concerns for price cap carriers, we granted some pricing flexibility immediately and designed a two-phased approach for determining when further pricing flexibility could be obtained by price cap carriers. Each phase had its own trigger to determine when a price cap carrier qualified for the pricing flexibility offered under each phase. We invite parties to comment on the extent to which pricing flexibility should be granted to rate-of-return carriers immediately, and which types of pricing flexibility should be deferred until some appropriate level of competition in a rate-of-return carrier service area has been established. Parties should comment on whether a two-phased approach for rate-of-return carriers should be used given their small size.

255. The decision to immediately permit geographic deaveraging of transport and special access services within a study area was premised in part on the fact that price cap carriers were facing some degree of competition in their service areas. This is not necessarily the case for all rate-of-return carriers. We therefore ask parties to comment on whether immediate geographic deaveraging of transport and special access services within a study area is warranted, or whether some degree of competition should be required before such pricing flexibility is permitted. We are particularly concerned about an incumbent LEC's ability to use pricing flexibility to preclude competitive entry. Parties should also address what the standard should be for determining when deaveraging should be permitted, if it is not permitted immediately.

256. For pricing flexibility other than geographic deaveraging of transport and special access services, the Commission established competitive criteria for determining when a price cap carrier could qualify for such pricing flexibility. The criteria required price cap carriers to demonstrate that competitors have made irreversible, sunk investments in the facilities needed to provide the services at issue, or that competitors have established a significant market presence

(*i.e.*, that competition for a particular service within the MSA is sufficient to preclude the incumbent from exploiting any individual market power over a sustained period) for provision of the services at issue, for Phases 1 and 2, respectively. We believe it is necessary to adopt criteria to determine when rate-of-return carriers may offer services using pricing flexibility plans. To that end, we invite parties to address whether a standard similar to that used for price cap carriers should be used for rate-of-return carriers. To assist us in evaluating different criteria, it would be especially useful if parties would address how they anticipate competition developing in rate-of-return carrier service areas, given their generally small customer base.

257. Parties are invited to address the appropriate competitive criteria that should determine when any particular pricing flexibility should be permitted. We recognize that the competitive levels used for price cap carriers may be overly restrictive for the smaller rate-of-return carriers. We ask parties to suggest appropriate levels. Parties should also address other proposals that have been made in various contexts, including the existence of a carrier in the service area with eligible telecommunications status, the issuance of a request for proposals by a customer in the rate-of-return carrier's service area, the filing by a rate-of-return carrier of a tariff offering UNEs, and the receipt by a rate-of-return carrier of a request for UNEs.

258. For price cap carriers, the Commission used the MSA as the geographic scope within which to measure competition to determine if pricing flexibility should be permitted. For most rate-of-return carriers, MSAs are not relevant and thus could not be the measurement base. Given the generally smaller size of rate-of-return carriers, it seems appropriate to use the study area as the basis on which to measure competitiveness in determining whether pricing flexibility is warranted for rate-of-return carriers. We seek comment on the use of study areas as the measurement base. We also solicit suggestions of other, more appropriate measures.

259. We also invite parties to comment on whether any rate-of-return carrier services should be permitted to be filed on one day's notice and whether any services should be treated as non-dominant services. For price cap carriers, we required that services be removed from price cap baskets when the services were offered under contract to preclude cross-subsidization. A similar mechanism does not exist for rate-of-return carriers. If we were to permit contract pricing, what measures would be necessary to ensure that rate-of-return carriers did not cross-subsidize the non-dominant services with revenues from their other access services?

C. All-or-Nothing Rule

1. Background

260. Section 61.41 of the Commission's rules provides that if an individual rate-of-return carrier or study area converts to price cap regulation, all of its affiliates or study areas must also do so, except for those using average schedules.[588] This is commonly referred to as the "all-or-nothing" rule. Also, this section provides that if a price cap carrier is in a merger, acquisition, or similar transaction, it must continue to operate under price cap regulation after the

[588] 47 C.F.R. §§ 61.41(b), 69.605 ("[a] telephone company that was participating in average schedule settlements on December 1, 1982, shall be deemed to be an average schedule company except that any company that does not join association tariffs for all access elements shall not be deemed to be an average schedule company.").

transaction.[589] In addition, when rate-of-return and price cap carriers merge or acquire one another, the rate-of-return carrier must convert to price cap regulation within one year.[590] Furthermore, LECs that become subject to price cap regulation are not permitted to withdraw from such regulation[591] or participate in NECA tariffs.[592]

261. These rules address two concerns the Commission had regarding mergers and acquisitions involving price cap companies.[593] First, in the absence of the rule, a LEC might attempt to shift costs from its price cap affiliate to its non-price cap affiliate.[594] This would allow the non-price cap affiliate to charge higher rates than otherwise possible to recover its higher revenue requirement (because of the increased costs), while at the same time, increasing profits of the price cap affiliate as a result of its cost savings.[595] The second concern was that a LEC might attempt to "game the system" by switching back and forth between rate-of-return regulation and price cap regulation. [596] A price cap carrier could increase earnings by opting out of price cap regulation, building a larger rate base under rate-of-return regulation in order to raise rates, and then after returning to price cap regulation, cutting costs back to an efficient level. The Commission reasoned it would not serve the public interest to allow a carrier to "fatten up" under rate-of-return regulation and "slim down" under price cap regulation, because rates would not decrease in the manner intended under price cap regulation.[597] The Commission, however, has permitted a waiver of the "all-or-nothing" rule where it has found that petitioners have established good cause and that the waiver will serve the public interest.[598]

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[589] 47 C.F.R. § 61.41(c)(1).

[590] 47 C.F.R. § 61.41(c)(2); *see Policy and Rules Concerning Rates for Dominant Carriers*, Second Report and Order, 5 FCC Rcd 6786, 6821 (1990), *Erratum*, 5 FCC Rcd 7664 (Com. Car. Bur. 1990) (*LEC Price Cap Order), modified on recon.,* Order on Reconsideration, 6 FCC Rcd 2637, 2704 (1991) (*LEC Price Cap Reconsideration Order), aff'd sub nom. National Rural Telecom Association v. FCC*, 988 F.2d 174 (D.C. Cir. 1993), *petitions for further recon. dismissed*, 6 FCC Rcd 7482 (1991), *further modification on recon., Amendments of Part 69 of the Commission's Rules Relating to the Creation of Access Charge Subelements for Open Network Architecture, Policy and Rules Concerning Rates for Dominant Carriers, Report and Order and Order on Further Reconsideration and Supplemental Notice of Proposed Rulemaking*, 6 FCC Rcd 4524 (1991) (*ONA Part 69 Order), further recon., Memorandum Opinion and Order on Second Further Reconsideration*, 7 FCC Rcd 5235 (1992).

[591] 47 C.F.R. § 61.41(d).

[592] 47 C.F.R. 61.41(a)(3).

[593] *See LEC Price Cap Reconsideration Order*, 6 FCC Rcd at 2706 para. 148; *see also ALLTEL Corp. Petition for Waiver of Section 61.41 of the Commission's Rules and Applications for Transfer of Control,* CCB/CPD 99-1, Memorandum Opinion and Order, 14 FCC Rcd 14191, 14199 (1999) (*ALLTEL Order*).

[594] *See LEC Price Cap Reconsideration Order*, 6 FCC Rcd at 2706.

[595] *Id.*

[596] *Id.*

[597] *Id.*

[598] Under section 1.3 of the Commission's rules, "any provision of the Commission's rules may be waived by the Commission . . . or on petition if good cause therefor is shown." 47 C.F.R. § 1.3. Courts have interpreted this to require that a petitioner demonstrate "special circumstances warrant a deviation from the general rule and that such deviation will serve the public interest." *Northeast Cellular Telephone Co. v. FCC*, 897 F.2d 164 (D.C. Cir. 1990) (citing *Wait Radio v. FCC*, 418 F.2d 1153, 1158 (D.C. Cir. 1969), *cert. denied*, 409 U.S. 1027 (1972)). For

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262. Section 69.3(e)(9) of the Commission's rules, known as the affiliate withdrawal rule or the pooling "all-or-nothing" rule, also addresses concerns of cost-shifting between affiliates.[599] It requires that if a LEC chooses to withdraw one of its study areas from the NECA pool to file its own carrier common line rates, all of its study areas must also do so, and a holding company withdrawing one of its affiliates must withdraw them all.[600] Otherwise, LECs could remove only their low-cost study areas while leaving high-cost areas in the pool, which could create incentives to shift common line costs from carriers that leave the pool to those that remain.[601] Also addressing gaming concerns, section 69.3(i)(4) provides that once a carrier elects to withdraw from the NECA tariff and become subject to price cap regulation, neither it nor its affiliates may participate in the NECA tariff again.[602] The Commission has refused to allow a price cap carrier to participate in the NECA tariffs and pool because this structure involves significant sharing of financial risks that would diminish a carrier's incentive to operate more efficiently and achieve the lower rates desired under price cap regulation.[603]

263. The MAG proposal provides that when a carrier under incentive regulation (Path A carrier) or under rate-of-return regulation (Path B carrier) "(A) acquires lines, exchanges or study areas from a telephone company subject to price cap regulation, or (B) acquires, is acquired by, merges with, or otherwise becomes affiliated with a telephone company subject to price cap regulation, the Path A LEC or Path B LEC may retain its status as a Path A LEC or

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example, the Commission has granted waivers in cases where rate-of-return carriers have acquired price cap exchanges and a price cap company, thus permitting them to continue operating under rate-of-return regulation rather than requiring them to convert to price caps. In these instances, the Commission concluded that concerns about cost shifting and gaming were not at issue. *See, e.g., ATEAC, Inc., Alaska Tel. Co., Arctic Slope Tel. Assoc. Coop., Inc., Interior Tel. Co., Inc., Mukluk Tel. Co., Inc., and United-KUK, Inc. Petitions for Waiver of Sections 61.41(c) and (d) of the Commission's Rules,* CCB/CPD No. 00-03, Memorandum Opinion and Order, 15 FCC Rcd 23511, 23518 para. 14 (2000); *Minburn Telecom., Inc. Petition for Waiver of Sections 61.41(c) and (d) of the Commission's Rules*, CCB/CPD No. 99-16, Memorandum Opinion and Order, 14 FCC Rcd 14184, 14188, para. 8 (1999); *ALLTEL Corp. Petition for Waiver of Section 61.41 of the Commission's Rules and Applications for Transfer of Control*, CCB/CPD 99-1, Memorandum and Order, 14 FCC Rcd 14191, 14201-02 para. 27-28 (1999) (*ALLTEL Order*) (finding of special circumstances based on service to diverse areas in 22 states with varied market conditions, thus making the application of a single productivity factor under price cap regulation not suitable for ALLTEL's entire operation).

599 47 C.F.R. § 69.3(e)(9).

600 *See MTS and WATS Market Structure,* CC Docket Nos. 78-72, Report and Order, 2 FCC Rcd 2953, 2956 para. 25 (1987), *Erratum,* 2 FCC Rcd 4208 (1987) (*MTS and WATS Order*).

601 *Id.*

602 47 C.F.R. § 69.3(i)(4).

603 *See LEC Price Cap Order,* 5 FCC Rcd at 6819 ("The relationship between pooling and price cap regulation is fundamental to the rules defining LEC eligibility for price cap regulation. We have repeatedly emphasized in this proceeding that price cap regulation will increase carriers' incentives to achieve heightened efficiency, which in turn will lead to lower rates. Participation in pools, by its nature, entails risk-sharing, and thus a weakening of incentives to operate efficiently. We believe that the reasoning presented in the *Second Further Notice* against extending price cap regulation to NECA pool members remains valid."); *see also Policy and Rules Concerning Rates for Dominant Carriers*, Report and Order and Second Further Notice of Proposed Rulemaking, 4 FCC Rcd 2873 (1989)(*Second Further Notice).*

Path B LEC or become subject to price cap regulation[.]" This proposal effectively would repeal the "all-or-nothing" rules.

264. Proponents of repealing the "all-or-nothing" rules generally argue that: (1) they are inefficient and unduly restrictive because they force carriers to choose a form of regulation that may not suit either their high-cost or low-cost affiliates; (2) there is insufficient evidence of cost-shifting to justify the rules; and (3) the Commission could rely on accounting safeguards and other non-structural mechanisms to prevent cost-shifting, as it does in other contexts.[604] These arguments are discussed in more detail below.

265. We believe that to the extent any changes to these rules would promote greater operating efficiency or pricing flexibility, they should be addressed in the overall context of incentive regulation. Therefore, we take no action presently on the MAG proposal regarding the "all-or-nothing" rules, but rather incorporate this proposal into this Further Notice dealing with incentive regulation and pricing flexibility. We also recognize that there are some issues related to the "all-or-nothing" rule that are creating uncertainty that may be inhibiting carriers from choosing price cap regulation. As a result, it would be beneficial to resolve the future status of the "all-or-nothing" rule as expeditiously as possible, regardless of the timing of implementing other incentive regulation or pricing flexibility issues in this Further Notice.

2. Issues for Comment

266. The "all-or-nothing" rules were created a little more than ten years ago,[605] and the rationale for the rules has withstood the scrutiny of the United States Court of Appeals for the D.C. Circuit.[606] We would like to explore more precisely whether our regulatory policy—generally not to permit affiliated carriers to operate under different systems of regulation—is still serving the public interest; what, if any, circumstances and conditions that prompted these rules in the past have changed; and whether, or why, the MAG's proposed rule changes would be the correct and necessary solution to address any problems with the rules. We encourage interested parties from all industry segments to expand the discussion of why these rules should be retained, repealed or modified.

267. As discussed further below, we invite comment on whether the "all-or-nothing" restrictions unreasonably and unfairly limit affiliated companies from selecting regulatory options that would enable them to operate more efficiently, especially in light of the highly diverse service areas of some carriers. In the course of this analysis, some general questions to consider include the following. What, if anything, is different today than when the Commission previously considered this issue?[607] Would customers be better off and would competition be

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[604] *See, e.g.,* TDS Reply at 2-8.

[605] *See LEC Price Cap Order,* 5 FCC Rcd 6786 at 6821 para. 5 (creating section 61.41(c) of the Commission's rules in 1990); *MTS and WATS Order,* 2 FCC Rcd at 2959 para. 46 (creating affiliate withdrawal rule in 1987).

[606] *See National Rural Telecom Assoc. v. FCC,* 988 F.2d 174 (D.C. Cir. 1993).

[607] *See LEC Price Cap Order,* 5 FCC Rcd at 6820 ("Price cap regulation may be more attractive to one affiliate than another, but our requirement that both or neither join price cap regulation is not unfair in light of the strong need for this rule.").

better served with or without the rules? Are the rules working effectively since the waiver process allows the Commission to grant carriers exceptions to the "all-or-nothing" restrictions as a means of "fine tuning" our regulation here?[608] What impact does an increasingly competitive environment have on whether these rules should be retained or eliminated?

268. Some commenters argue that the "all-or-nothing" rules in mergers and acquisitions limit a carrier's ability to choose the most appropriate and efficient form of regulation, to the detriment of both the carrier and its customers.[609] For example, when ALLTEL, a rate-of-return carrier, merged with Aliant, a price cap carrier, the Commission agreed with ALLTEL's reasons for desiring to remain a rate-of-return carrier.[610] But ALLTEL, "not seeking to maintain separate affiliates under different systems of regulation," also was required to revert Aliant, which had elected price cap regulation, to rate-of-return regulation.[611] Aliant, however, subsequently sought a waiver, contending price cap regulation benefited its customers, and was granted permission to continue operating temporarily as a price cap carrier.[612] Does this example suggest that the "all-or-nothing" regulatory requirements are overly restrictive, or out of step with marketplace realities? Does it suggest that the purpose served by the rules may be overshadowed by any regulatory inefficiency that may result?

269. Some rate-of-return carriers contend the affiliate withdrawal rule also works against selecting the most appropriate and efficient form of regulation for diverse study areas because they must all elect the same common line pool status as a group and move to price cap regulation together.[613] Some affiliates may be ready to accept the risk and potential reward of incentive regulation, while other affiliates might not be in a position to leave rate-of-return regulation.[614] These incumbent LECs also advocate repeal of this rule in combination with

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[608] *See National Rural Telecom. Assoc. v. FCC,* 988 F.2d at 181 ("[W]aiver processes are a permissible device for fine tuning regulations, particularly where . . . the Commission must enact policies based on 'informed prediction.'") (citing *Telocator Network v. FCC*, 691 F.2d 525, 550 n.191 (D.C. Cir. 1982)).

[609] *See, e.g.,* TDS Reply at 10.

[610] *See ALLTEL Order*, 14 FCC Rcd at 14199-14200 para. 19, 14202 para. 28. Under the "all-or-nothing" rules, ALLTEL's merger with Aliant Communications obligated ALLTEL to convert from rate-of-return to price cap regulation and Aliant to remain subject to price cap regulation. The Commission, however, agreed with ALLTEL that it lacked "the economies of scope and scale of the largest LECs for whom the price cap system was designed" and permitted ALLTEL to remain under rate-of-return regulation. As a result, Aliant was also required to convert to rate-of-return regulation and leave price cap regulation which has pricing efficiencies." *Id.*

[611] *Id.* at 14202, para. 27.

[612] *See ALLTEL Corp. Petition for Waiver of Section 61.41 of the Commission's Rules,* CCB/CPD No. 99-01, Order, DA 01-1408 (Com.Car.Bur. rel. June 12, 2001). Aliant's waiver allows it to continue operating as a price cap carrier until July 1, 2002.

[613] *See, e.g.,* TDS Reply at 5-6 ("For example, TDS Telecom's 106 ILECs serve from 509 access lines to 66,250 access lines, spread through 28 states, with an average of 5,700 lines. The TDS Telecom ILECs' service territories range from 31.8 square miles to 4,617 square miles. Their density ranges from less than 1 access line per square mile to 600 access lines per square mile, with an average density of less than 17 for the 106 ILECs, well below the non-rural carrier average of 128 lines per square mile and below the rural telephone company average of 19 lines per square mile. The TDS Telecom ILECs' costs per line range from $2,910 to $450.").

[614] *See, e.g.,* ITTA Comments at 2, TDS Reply at 2 (arguing the all-or-nothing rule "(1) dooms some affiliates – such as TDS Telecom's 66,000-line Tennessee Telephone Company – to a form of regulation that is less efficient

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geographic deaveraging as a pricing flexibility measure to enable them to respond to competition from competitive carriers for high-volume business customers.[615] In this way, incumbent LECs would have flexibility to depool and deaverage rates within study areas by filing their own common line tariffs based on their own costs where competition was a threat, and also make decisions for other study areas based on their particular market and service conditions.[616] Opposing parties, however, contend that such pricing flexibility would be premature until local markets become sufficiently competitive to prevent incumbent LECs from engaging in cross-subsidization and predatory pricing.[617] Furthermore, they object to repealing this rule because it would result in parent companies removing their low-cost companies from the pool and leaving their high-cost areas in, thus driving NECA pool rates higher.[618] Are there any other considerations to note in assessing whether the affiliate withdrawal rule is promoting the public interest? What would be the impact and consequences of higher NECA pool rates resulting from the exit of low-cost carriers?

270. We also seek comment on whether the "all-or-nothing" restrictions are currently necessary to prevent cost shifting and gaming. Commenters disagreed on this issue and on whether our present accounting and allocation rules provide existing and sufficient safeguards against cost shifting.[619] Some parties contend these rules have outlived their usefulness, and are not needed to address cost shifting and gaming concerns because they are more speculative than real.[620] Others argue that cost shifting and gaming concerns are still valid,[621] and that their

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for them or (2) dooms other affiliates – such as TDS Telecom's very small companies serving an Indian reservation at the bottom of the Grand Canyon and four islands off the coast of Maine – to move to incentive regulation before their study area conditions warrant the change. Both results prejudice the ILECs' customers, who are deprived of greater efficiency incentives in the first case and of necessary revenues in the second case, and the ILECs, which are hampered in competing and deprived of the stability needed for infrastructure investments.").

[615] *See* TDS Comments in CC Docket No. 98-77 at 22 ("When a relatively low cost member of the NECA pool charges the rates in NECA's tariff, set to recover the costs of all pool members including those with higher service costs, the resulting averaged rate is set above that lower cost carrier's cost of service. In contrast, a CLEC is able to provide interexchange access at rates which reflect only its own costs. This, in turn, gives it a competitive advantage in providing alternative access service."); *see also* ITTA Comments at 2.

[616] *See, e.g.,* TDS Reply at 7-8 (Commission should provide same flexibility to withdraw from and rejoin NECA common line pool as is applicable to participation in traffic sensitive pool), ALLTEL Comments in CC Docket No. 98-77 at 8 (arguing that ALLTEL's "disparity in density underscores ALLTEL's need to be able to depool individual study areas to respond to competition" and that allowing companies to exit the NECA CCL pool on a study area basis would be consistent with Commission rules that allow companies to exit the NECA traffic sensitive pool on a study area basis), USTA Comments in CC Docket No. 98-77 at 24-25; *but see MTS and WATS Order*, 3 FCC Rcd at 4561 paras. 114 (stating that since non-traffic sensitive costs vary among companies more than traffic sensitive costs, companies might have a greater incentive to shift non-traffic sensitive costs among study areas).

[617] *See, e.g.,* AT&T Reply in CC Docket No. 98-77 at 9-12.

[618] *Id.*

[619] MAG Comments at 28 ("The Commission's current accounting safeguards and reporting requirements are more than adequate to guard against any such cost-shifting."), TDS Reply at 8-9 ("The Commission's old concerns about cost shifting are now addressed successfully by its accounting and allocation rules."); *but see* WorldCom Comments at 5 ("The detection of non-price cap carrier cost-shifting would be extremely difficult, given that these carriers are subject to relaxed oversight of their accounting practices.").

[620] *See, e.g.,* MAG Comments at 28-29, TDS Reply at 2, 4-9.

elimination would be anti-competitive and could result in cost manipulation.[622] TDS asserts that the rules have begun to erode with no evidence of cost shifting or gaming,[623] citing exceptions adopted by the Commission to the pooling "all-or-nothing" rules in mergers and acquisitions,[624] common ownership of cost-based and average schedule companies,[625] the ability of average schedule companies to remain in the pool if their depooling affiliate changes from rate-of-return regulation to price caps,[626] waivers allowing price cap exchanges to revert to rate-of-return regulation following mergers and acquisitions, and common ownership of incumbent and competitive carriers. We invite further comment on whether these examples warrant greater relaxation, or elimination, of the "all-or-nothing" requirements. Specifically, is the risk of cost-shifting and gaming outweighed by regulatory efficiency gains that could result from eliminating the "all-or-nothing" requirements? Is the Commission's policy behind the rule—to avoid creating cost-shifting incentives as opposed to correcting actual abuses—serving the public interest?[627] Has the competitive environment made cost shifting or gaming concerns less or more relevant? Are there alternative accounting and reporting rules that could substantially

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[621] WorldCom Comments at 6 ("[e]limination of the 'all or nothing' rule would open the door to precisely the type of cost-shifting that this rule was designed to prevent (particularly if the acquired ILEC were a Path B rate of return carrier or a Path A carrier that had yet to shift to incentive regulation).").

[622] Assoc. of Comm'ns Enterprises Comments at 6, Global Crossing Comments at 13, WorldCom Comments at 5, AT&T Reply at 17.

[623] TDS Reply at 6-8.

[624] *See* 47 C.F.R. § 69.3(g)(1) (carrier which participates in the NECA common line pool may continue to do so even after a merger with a carrier that does not participate in the pool); *but see LEC Price Cap Order,* 5 FCC Rcd at 6821 para. 284 (reasoning that a carrier with both pooled and non-pooled affiliates is different from a carrier with both price cap and non-price cap affiliates because pooled and non-pooled affiliates are all subject to rate-of-return regulation and "have little incentive to shift costs between pooled and non-pooled affiliates, since all such companies' earnings are limited to a unitary cost of capital that we impose. By contrast a company with both price cap and non-price cap affiliates has a significant incentive to shift costs from its price cap to its non-price cap affiliates, since the total dollars these latter companies will earn will be increased as their rate bases increase.").

[625] *See* TDS Reply at 6-8 ("There is no evidence that the exception has caused any cost shifting or other abuses. Yet…the Commission has held that average schedule settlements provide the same kind of incentives as price caps because they 'depend upon the demand for the services that [the carrier] provides rather than upon its costs of providing those services.") (citing *LEC Price Cap Order*, 5 FCC Rcd at 6820, para. 277); *but see National Rural Telecom Assoc. v. FCC,* 988 F.2d at 181 ("Because these companies are compensated on the basis of standardized rather than individualized cost estimates, they do not have a conventional rate-of-return firm's temptations for cost shifting or gold-plating.").

[626] *See* 47 C.F.R. § 61.41(c)(3) (not requiring a company that converts to price cap regulation to make all its average schedule affiliates also convert to price cap status); TDS Reply at 7 ("The incentives the Commission found in average schedule regulation led it to permit common ownership of price caps and average schedule study areas, and even to justify continued pool participation by average schedule affiliates of price cap carriers. Since this amounts to allowing continuing affiliations among incentive-regulated and ROR carriers, the absence of resulting problems compellingly supports further relaxation of all-or-nothing requirements.").

[627] *See MTS and WATS Market Structure,* CC Docket No. 78-72, Memorandum Opinion and Order on Reconsideration and Order Inviting Comments, 3 FCC Rcd 4543, 4561 n.115 (1988) ("We note that our concern with improper cost allocations among study areas is based on our desire not to provide an unnecessary incentive for such cost-shifting in the common line context, and not on recorded evidence of past abuses.").

reduce cost shifting concerns? Would it be reasonable to impose more stringent reporting requirements on carriers that seek waivers of the "all-or-nothing" requirements?

271. We also seek comment to resolve a related issue: how rate-of-return carriers that are required to convert to price cap regulation in a merger or acquisition, or choose to convert to price cap regulation, will receive universal service support. Under the current rules, a rate-of-return carrier upon converting to price cap regulation is required to withdraw from the NECA common line pool and is no longer eligible for LTS.[628] Interstate access universal service support for price cap carriers is funded by a capped, interstate access support mechanism created in the *Interstate Access Support Order*,[629] but the Commission in that order "did not explicitly address how entry of new carriers into price caps affects distribution of interstate access universal service support."[630] This question is particularly significant for potential price cap companies like Puerto Rico Telephone Company (PRTC) that could be a large recipient of the support.[631] We invite commenters to address how entry of new carriers into price cap regulation would affect distribution of interstate access universal service support for price cap carriers. As a transitional measure for rate-of-return carriers that convert to price cap regulation, should we allow retention of LTS or Interstate Common Line Support? Instead of receiving the same amount of support that the carrier received under rate-of-return regulation, should the previous support amount be added to the total interstate access universal service support available under the *Interstate Access Support Order* and then divided among all price cap carriers pursuant to the formula established in that order? We seek input on any other related considerations or ideas to resolve this question of universal service support for new price cap carriers on a going forward basis.

D. Consolidation of Long Term Support and Interstate Common Line Support

272. We tentatively conclude that LTS will be merged with Interstate Common Line Support as of July 1, 2003, after which participation in the NECA common line pool will not be required for receipt of universal service support. As discussed below, LTS no longer will serve an independent purpose after the CCL charge is phased out, and its restriction to pooling carriers hampers the competitiveness of incumbent LECs. Although the Commission previously maintained this restriction in part due to the risk-sharing benefits of pooling, we believe that the need for this risk-sharing function will be reduced or eliminated by conversion of the CCL charge to explicit universal service support. We seek comment on these conclusions.

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[628] *See* 47 C.F.R. §§ 61.41, 54.303(a).

[629] *See Interstate Access Support Order*, 15 FCC Rcd at 13046 para. 201.

[630] *Puerto Rico Tel. Co. Petition for Waiver of Section 61.41 or Section 54.303(a) of the Commission's Rules*, CCB/CPD No. 99-36, Order, DA 01-1353 at 4 (Com.Car.Bur. rel. June 12, 2001).

[631] PRTC currently is operating as a rate-of-return carrier pursuant to a temporary waiver of sections 61.41 and 54.303 of the Commission's rules until July 1, 2002. *Id.* at 4 para. 7.

1. Background

273. The historical purpose of LTS was to prevent the CCL rates of pooling carriers from rising significantly above the national average CCL rate.[632] In 1997, the Commission concluded that LTS should be continued, but that modifications were necessary to make it explicit, portable, and competitively neutral.[633] The Commission reasoned that LTS, as modified, continued to serve the public interest "by reducing the amount of loop cost that high cost LECs must recover from IXCs through CCL charges and thereby facilitating interexchange service in high cost areas, consistent with the express goals of section 254."[634] In the *Universal Service Fourth Order on Reconsideration*, the Commission declined to eliminate the requirement that carriers participate in the NECA common line pool in order to be eligible for LTS.[635] The Commission wished to avoid disruption for rate-of-return carriers by maintaining the existing LTS program until it undertook comprehensive access charge and universal service reform for such carriers.[636] The Commission also cited its desire not to "undermine the pool's usefulness in permitting participants to share the risk of substantial cost increases related to the CCL charge by pooling their costs and, thereby, charging an averaged CCL rate close to that charged by other carriers. This operation of the pool, like LTS payments, serves section 254's goal of facilitating interexchange service in high cost areas."[637] As discussed above, the Commission largely has phased out the CCL charge for price cap carriers, and it will be removed from the rate structure of rate-of-return carriers as of July 1, 2003.[638]

2. Discussion

274. We tentatively conclude that LTS will be merged with Interstate Common Line Support as of July 1, 2003, after which participation in the NECA common line pool will not be required for receipt of universal service support. We believe that merging LTS with Interstate Common Line Support is warranted in the interest of administrative simplicity, because LTS no longer will serve an independent purpose after the CCL charge is phased out. Because the CCL charge will be eliminated, LTS will not be required to reduce the costs recovered through CCL charges.[639] Moreover, carriers now receiving LTS will be eligible for Interstate Common Line Support to meet their common line revenue requirements not recovered through SLC charges. Most carriers will receive Interstate Common Line Support in an amount equal to or greater than the amount of LTS support they now receive. If retained, LTS's practical effect would be merely to reduce the Interstate Common Line Support received by each pooling carrier. Although we conclude above that retention of LTS as a separate support mechanism is warranted during the

[632] *See supra*, § III.B.

[633] *Universal Service First Report and Order*, 12 FCC Rcd at 9164-65 para. 299.

[634] *Id.*; *see Universal Service Fourth Order on Reconsideration*, 13 FCC Rcd at 5361-63 paras. 74, 76.

[635] *Universal Service Fourth Order on Reconsideration*, 13 FCC Rcd at 5361-63 paras. 74-76.

[636] *Id.*

[637] *Id.*

[638] *See supra*, § IV.A.2.d.

[639] *See Universal Service First Report and Order*, 12 FCC Rcd at 9164-65 para. 299.

transition to a more efficient common line rate structure, we do not believe that LTS should be retained once the CCL charge is eliminated.[640] In this regard, we note that the Commission's prior concern that LTS modifications might cause unnecessary disruption no longer appears to be a valid basis for maintaining the status quo with regard to LTS, because we now have undertaken comprehensive access charge and universal service reform for such carriers.[641]

275. We also believe that merging LTS with Interstate Common Line Support is warranted in the interest of promoting competition. As discussed above, restricting eligibility for universal service support to pooling carriers hampers the competitiveness of incumbent LECs by forcing them to choose between universal service support and the freedom to set rates outside the NECA common line pool.[642] The Commission previously maintained this restriction in part due to the risk-sharing benefits of pooling, but we believe that this risk-sharing function will be diminished substantially by conversion of the CCL charge to explicit universal service support.[643] The pool's averaged CCL rates spread across pooling companies the risks related to recovery of residual common line costs through a per-minute charge. Unlike a per-minute charge, however, per-line universal service support is not subject to unpredictability and variation.

276. We seek comment on these tentative conclusions. We recognize that the proposed elimination of LTS as a separate, pooling-restricted support mechanism may impact membership in the NECA common line pool.[644] Nevertheless, we anticipate that the pool will continue to perform important administrative functions, such as tariff filings for many small carriers for whom such burdens would be excessive in the absence of the ability to pool, as well as risk-sharing functions related to the recovery of traffic sensitive costs.[645] We invite interested parties to comment on these issues.

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[640] *See supra*, § IV.D.2.a.

[641] *See Universal Service Fourth Order on Reconsideration*, 13 FCC Rcd at 5361-63 paras. 74, 76.

[642] *See supra*, § IV.D.2.a; *see also* California Commission Comments at 3 (MAG proposal to restrict support to pooling carriers "would stifle competition in rural areas"), ICORE Comments at 18 ("Any rural access reform policy that is not 'pooling neutral' is terrible public policy that caters to the NECA status quo.").

[643] *See Universal Service Fourth Order on Reconsideration*, 13 FCC Rcd at 5363 para. 76.

[644] *See id.* at 5362 para. 75 ("we note that a number of companies that have chosen to leave the NECA common line pool in the past generally have done so because their costs have decreased such that they can charge a lower CCL interstate access rate than the NECA CCL rate and recover their costs without LTS support. . . . Although we recognize that other considerations may influence a carrier's decision to exit the pool, we can only presume that any carrier that has left did so after balancing all factors and determining that it could forego the receipt of LTS.").

[645] *See Regulatory Reform for Local Exchange Carriers Subject to Rate of Return Regulation*, CC Docket No. 92-135, Notice of Proposed Rulemaking, 7 FCC Rcd 5023, 5030 (1992); *MTS and WATS Market Structure*, CC Docket No. 78-72, *Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board*, CC Docket No. 80-286, Memorandum Opinion and Order on Reconsideration, 3 FCC Rcd 4543, 4560 n.108 and accompanying text (1988).

VI. PROCEDURAL ISSUES

A. Ex Parte Presentations

277. This is a permit but disclose rulemaking proceeding. Ex parte presentations are permitted, except during the Sunshine Agenda period, provided that they are disclosed as provided in the Commission's rules.[646]

B. Final Regulatory Flexibility Act

278. As required by the Regulatory Flexibility Act (RFA),[647] an Initial Regulatory Flexibility Analysis (IRFA) was incorporated into the *MAG Notice*.[648] An IRFA also was incorporated into the *1998 Notice* in CC Docket No. 98-77.[649] The Commission sought written public comment on the proposals in the *1998 Notice* and on the MAG plan, including comment on the IRFAs. This present Final Regulatory Flexibility Analysis (FRFA) conforms to the RFA, as amended.[650] To the extent that any statement in this FRFA is perceived as creating ambiguity with respect to our rules or statements made in the preceding sections of this Order, the rules and statements set forth in those preceding sections shall be controlling.

1. Need for, and Objectives of, the Rules

279. In this Order, the Commission modifies its interstate access charge and universal service support system for incumbent local exchange carriers (LECs) subject to rate-of-return regulation. Consistent with the mandate of the 1996 Act, this Order is designed to foster competition and efficient pricing in the market for interstate access services, and to create universal service mechanisms that will be secure in an increasingly competitive environment.[651] By simultaneously removing implicit support from the rate structure and replacing it with explicit, portable support, this Order will provide a more equal footing for competitors in local and long distance markets, while ensuring that consumers in all areas of the country, especially those living in high-cost, rural areas, have access to telecommunications services at affordable and reasonably comparable rates. This Order also is tailored to the needs of small and mid-sized local telephone companies serving rural and high-cost areas, and will help provide certainty and stability for such carriers, encourage investment in rural America, and provide important consumer benefits.

280. Examination of the record in this proceeding demonstrates the need for interstate access charge and universal service reform for rate-of-return carriers. Rate-of-return carriers

[646] *See generally* 47 C.F.R. §§ 1.1202, 1.1203, and 1.1206.

[647] *See* 5 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. 104-121, 110 Stat. 847 (1996) (CWAA). Title II of the CWAA is the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA).

[648] *MAG Notice*, 16 FCC Rcd at paras. 25-37.

[649] *1998 Notice*, 13 FCC Rcd at paras. 99-113.

[650] *See* 5 U.S.C. § 604.

[651] *See supra*, § I.

receive implicit support for universal service from various sources, including the interstate access rate structure. For example, recovery of non-traffic sensitive costs through per-minute rates creates an implicit support flow from high- to low-volume users of interstate long distance service. Implicit support is incompatible with a competitive market for local exchange and exchange access services. As the Commission noted in 1997, "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 below cost and an otherwise efficient provider would have no incentive to enter the market."[652] Rate-of-return carriers have expressed particular concern that high per-minute charges may place them at a disadvantage in competing for high-volume customers, jeopardizing an important source of revenue.[653] In addition, higher rates and implicit subsidies may discourage efficient local and long distance competition in rural areas and limit consumer choice. Although there may not be significant competition in many high-cost, rural areas, rate-of-return carriers are not insulated from competitive pressures.

281. By rationalizing the rate structure for recovery of interstate loop costs, this Order will foster competition for residential subscribers in rural areas by facilities-based carriers. By reducing per-minute switched access rates towards cost-based levels, it will enhance incentives for interexchange carriers to originate service in rural areas and facilitate long distance toll rate averaging. To a large extent, these modifications already have been implemented for the vast majority of subscribers nationwide.

282. At the same time, this Order is tailored to the specific challenges faced by small carriers serving rural and high-cost areas. Although per-minute switched access charges will be reduced for all rate-of-return carriers, they will retain the flexibility to establish rates based on their own costs in the areas they serve, rather than being forced to conform to a prescribed target rate. Rate-of-return carriers will continue to be permitted to set rates based on the authorized rate of return of 11.25 percent. And a new, uncapped universal service support mechanism will provide certainty and stability by ensuring that the rate structure modifications adopted do not affect overall recovery of interstate access costs by rate-of-return carriers. The Order adopts a cautious approach which rationalizes the access rate structure and converts identifiable implicit subsidies to explicit support, without endangering this important revenue stream for rate-of-return carriers.

2. Summary of Significant Issues Raised by the Public Comments in Response to the IRFA

283. The Multi-Association Group (MAG) argued that adoption of its comprehensive proposal for regulatory reform for rate-of-return carriers would benefit small business entities, including small incumbent LECs, interexchange carriers, and new entrants. According to the MAG, its plan would permit small rate-of-return carriers to control their administrative and regulatory burdens by permitting them to analyze and select the type of regulation that best suits their situation. The MAG also asserted that of a modified version of its plan would introduce

[652] *Access Charge Reform Order*, 12 FCC Rcd at 15996 para. 30.

[653] *1998 Notice*, 13 FCC Rcd at 14239-40 para. 2; *see supra*, § III.B.

more uncertainty for small carriers, but it did not provide support for this assertion. However, commenters have raised significant concerns about certain features of the MAG plan, and the Commission was persuaded that some of these concerns have merit, as discussed below.

284. The Commission received a Congressional inquiry from Congressman John D. Dingell, asking that the Commission devote significant staff resources to the MAG proceeding, in particular, and to understanding the unique challenges of service in high-cost areas, in general.[654] The Chairman responded to Congressman Dingell by letter, noting that the Commission has taken numerous measures to lessen the regulatory burdens of small local telephone companies, and is committed to continuing the examination of our rules and processes to ensure that small local telephone companies are provided with appropriate regulatory flexibility. The response also stated that the Commission has attempted to scrutinize carefully the potential impact of proposed regulations on small incumbent telephone companies.[655]

285. The Commission received a Congressional inquiry from Senators Thomas A. Daschle, Craig Thomas, Blanche Lambert Lincoln, Tim Johnson, Tom Harkin, Charles E. Grassley, Byron L. Dorgan, Kent Conrad, and Max S. Baucus, noting that significant legal and market changes had occurred since the MAG plan was developed, including two court decisions regarding universal service.[656] The letter requested that the Commission delay its final decision in the MAG proceeding until all interested parties, including members of Congress, have had an opportunity to comment on any new proposal that the Commission might consider. The Chairman responded to this inquiry by letter, stating that it is the Commission's duty, pursuant to the Administrative Procedures Act, to consider the extensive input received from all interested parties regarding the MAG proposal.[657] The Chairman's response noted that all interested parties have had a substantial opportunity to comment on the MAG plan and on other, related Commission proposals that build on prior reforms for large carriers. The response stated that it was important to proceed expeditiously with access charge and universal service reform for rate-of-return carriers, while continuing to explore other issues raised by the MAG proposal. The Chairman's response noted that a substantial number of interested parties had raised concerns about the wholesale adoption of the MAG proposal and had suggested possible modifications to it. The response also agreed that it is important that the Commission take into account recent court decisions relevant to interpretation of the universal service provisions of the Act.

286. The Commission also received Congressional inquiries from Senator Conrad Burns and Congressman Dennis Rehberg, Congressman Douglas K. Bereuter, Congressman

[654] Letter from Congressman John D. Dingell to Chairman Michael K. Powell, Federal Communications Commission (June 20, 2001).

[655] Letter from Chairman Michael K. Powell, Federal Communications Commission, to Congressman John D. Dingell (Aug. 7, 2001).

[656] Letter from Senators Thomas A. Daschle, Craig Thomas, Blanche Lambert Lincoln, Tim Johnson, Tom Harkin, Charles E. Grassley, Byron L. Dorgan, Kent Conrad, and Max S. Baucus to Chairman Michael K. Powell, Federal Communications Commission (Sept. 28, 2001).

[657] Letters from Chairman Michael K. Powell, Federal Communications Commission, to Senators Thomas A. Daschle, Craig Thomas, Blanche Lambert Lincoln, Tim Johnson, Tom Harkin, Charles E. Grassley, Byron L. Dorgan, Kent Conrad, and Max S. Baucus (Oct. 10, 2001).

John E. Sununu, and Congressman Lee Terry regarding the Commission's consideration of interstate access charge and universal service reform for rate-of-return carriers.[658] They generally expressed concerns about the potential impact of reform on rural telecommunications customers and the companies that serve them, and urged the Commission to seek additional comment before adopting measures other than those proposed in the MAG plan.

287. As discussed above, the Commission believes that it is important to proceed expeditiously with access charge and universal service reform for rate-of-return carriers, while continuing to explore other issues raised by the MAG proposal. The Commission has adopted a cautious approach to reform. The new, uncapped support mechanism it creates will ensure that rate structure changes do not affect small carriers' overall recovery of the costs of interstate access service. In addition, the Order permits carriers to continue to set rates based on the authorized rate of return of 11.25 percent. These measures will promote regulatory stability and encourage investment in rural America. The Commission also is seeking additional comment on a number of issues, including the potential impact of modifications to Long Term Support on membership in the pools, the MAG's incentive regulation proposal for small carriers, and on other means of providing opportunities for rural telephone companies to increase their cost efficiency in ways that will benefit carriers and the communities they serve.

288. The Commission also received general comments related to the needs of small local telephone companies. Examination of the record indicates that rate-of-return carriers are typically small, rural telephone companies concentrated in one area. They generally have higher operating and equipment costs than large, price cap carriers due to lower subscriber density, smaller exchanges, and limited economies of scale. They also rely more heavily on revenues from interstate access charges and universal service support. Numerous commenters argued that, although such carriers may incur costs in the same manner as large carriers, their size, diversity, and regulatory history warrant special consideration in adopting interstate access charge and universal service reforms. The Commission's actions in response to such concerns are discussed in detail below.[659] As an example, the Commission does not require small carriers to conduct cost studies to determine the portion of local switching costs attributable to line ports. Rather, we adopt a proxy of 30 percent.[660]

3. Description and Estimate of the Number of Small Entities to Which Rules Will Apply

289. The RFA directs agencies to provide a description of, and, where feasible, an estimate of the number of small entities that may be affected by the rules adopted herein.[661] The

[658] Letter from Senator Conrad Burns and Congressman Dennis Rehberg to Chairman Michael K. Powell, Federal Communications Commission (Oct. 4, 2001); Letter from Congressman Douglas K. Bereuter to Chairman Michael K. Powell, Federal Communications Commission (Oct. 3, 2001); Letter from Congressman John E. Sununu to Chairman Michael K. Powell, Federal Communications Commission (Oct. 3, 2001); Letter from Congressman Lee Terry to Chairman Michael K. Powell, Federal Communications Commission (Oct. 2, 2001).

[659] *See supra*, § IV.B.2.b.

[660] *See id.*.

[661] 5 U.S.C. § 604(a)(3).

RFA generally defines "small entity" as having the same meaning as the term "small business," "small organization," and "small governmental jurisdiction."[662] 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 to its activities.[663] Under the Small Business Act, 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.[664]

290. We have included small incumbent carriers in this RFA analysis. As noted above, a "small business" under the RFA is one that, *inter alia*, meets the pertinent small business size standard (*e.g*., a telephone communications business having 1,500 or fewer employees), and "is not dominant in its field of operation."[665] The SBA's Office of Advocacy contends that, for RFA purposes, small incumbent carriers are not dominant in their field of operation because any such dominance is not "national" in scope.[666] We have therefore included small incumbent carriers in this RFA analysis, although we emphasize that this RFA action has no effect on the Commission's analyses and determinations in other, non-RFA contexts.

291. *Local Exchange Carriers*. Neither the Commission nor the SBA has developed a specific definition for small providers of local exchange services. The closest applicable definition under the SBA rules is for telephone communications companies other than radiotelephone (wireless) companies.[667] According to the most recent *Trends in Telephone Service* data, 1,335 incumbent carriers reported that they were engaged in the provision of local exchange services.[668] We do not have data specifying the number of these carriers that are either dominant in their field of operations, are not independently owned and operated, or have more than 1,500 employees, and thus are unable at this time to estimate with greater precision the number of local exchange carriers that would qualify as small business concerns under the SBA's definition. Of this number, 13 entities are price cap carriers not subject to rules adopted herein. Consequently, we estimate that 1,335 or fewer providers of local exchange service are small entities that may be affected by the rules.

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[662] 5 U.S.C. § 601(6).

[663] 5 U.S.C. § 601(3) (incorporating by reference the definition of "small business concern" in 5 U.S.C. § 632). 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 in the Federal Register."

[664] 15 U.S.C. § 632.

[665] 5 U.S.C. § 601(3).

[666] *See* Letter from Jere W. Glover, Chief Counsel for Advocacy, SBA, to Chairman William E. Kennard, Federal Communications Commission (May 27, 1999). The Small Business Act contains a definition of "small business concern," which the RFA incorporates into its own definition of "small business." *See* U.S.C. § 632(a) (Small Business Act); 5 U.S.C. § 601(3) (RFA). SBA regulations interpret "small business concern" to include the concept of dominance on a national basis. 13 C.F.R. § 121.102(b).

[667] *Id.*

[668] FCC, Common Carrier Bureau, Industry Analysis Division, *Trends in Telephone Service*, Table 5.3 (August 2001) (*FCC Trends in Telephone Report*).

292. *Competitive Local Exchange Carriers*. Neither the Commission nor the SBA has developed a specific definition of small providers of local exchange service. The closest applicable definition under SBA rules is for telephone communications companies other than radiotelephone (wireless) companies.[669] According to the Commission's *Trends in Telephone Service* data, 349 companies reported that they were engaged in the provision of either competitive access provider services or competitive LEC services.[670] The Commission does not have data specifying the number of these carriers that are either dominant in their field of operations, are not independently owned and operated, or have more than 1,500 employees, and thus is unable at this time to estimate with greater precision the number of competitive LECs that would qualify as small business concerns under the SBA's definition. Consequently, the Commission estimates that fewer than 349 providers of local exchange service are small entities that may be affected by the rules.

293. *Interexchange Carriers*. Neither the Commission nor the SBA has developed a definition of small entities specifically applicable to providers of interexchange services. The closest applicable definition under the SBA rules is for telephone communications companies other than radiotelephone (wireless) companies.[671] According to the most recent *Trends in Telephone Service* data, 204 carriers reported that their primary telecommunications service activity was the provision of interexchange services.[672] We do not have data specifying the number of these carriers that are not independently owned and operated or have more than 1,500 employees, and thus are unable at this time to estimate with greater precision the number of IXCs that would qualify as small business concerns under the SBA's definition. Consequently, we estimate that there are 204 or fewer small entity IXCs that may be affected by the rules.

294. *Competitive Access Providers*. Neither the Commission nor the SBA has developed a definition of small entities specifically applicable to competitive access services providers (CAPs). The closest applicable definition under the SBA rules is for telephone communications companies other than radiotelephone (wireless) companies.[673] According to the most recent Trends in Telephone Service data, 349 CAPs/competitive local exchange carriers and 60 other local exchange carriers reported that they were engaged in the provision of competitive local exchange services.[674] We do not have data specifying the number of these carriers that are not independently owned and operated, or have more than 1,500 employees, and thus are unable at this time to estimate with greater precision the number of CAPs that would qualify as small business concerns under the SBA's definition. Consequently, we estimate that there are 349 or fewer small entity CAPs and 60 or fewer other local exchange carriers that may be affected.

[669] 13 C.F.R. § 121.201, NAICS codes 51331, 51333, and 51334.

[670] *FCC Trends in Telephone Report*, Table 5.3.

[671] 13 CFR 121.201, NAICS codes 51331, 51333, and 51334.

[672] *FCC Trends in Telephone Report*, Table 5.3.

[673] 13 C.F.R. s 121.201, NAICS codes 51331, 51333, and 51334.

[674] *FCC Trends in Telephone Report*, Table 5.3.

295. *Wireless Telephony*. Neither the Commission nor the SBA has developed a definition of small entities specifically applicable to wireless telephony including cellular, personal communications service (PCS) and Specialized Mobile Radio (SMR) telephony carriers. Therefore, the applicable definition of small entity is the definition under the SBA rules applicable to radiotelephone (wireless) companies. This provides that a small entity is a radiotelephone company employing no more than 1,500 persons.[675] According to the most recent Trends in Telephone Report data, 806 carriers reported that they were engaged in the provision of either cellular service, PCS services, or SMR services, which are placed together in the data.[676] Of these 806 carriers, 323 reported that they have 1,500 or fewer employees.[677] We do not have data specifying the number of these carriers that are not independently owned and operated or have more than 1,500 employees, and thus are unable at this time to estimate with greater precision the number of wireless telephone carriers that would qualify as small business concerns under the SBA's definition. Consequently, we estimate that there are 806 or fewer small wireless telephony service carriers that may be affected.

296. The broadband PCS spectrum is divided into six frequency blocks designated A through F, and the Commission has held auctions for each block. The Commission defined "small entity" for Blocks C and F as an entity that has average gross revenues of less than $40 million in the three previous calendar years.[678] For Block F, an additional classification for "very small business" was added and is defined as an entity that, together with their affiliates, has average gross revenues of not more than $15 million for the preceding three calendar years.[679] These regulations defining "small entity" in the context of broadband PCS auctions have been approved by the SBA.[680] No small businesses within the SBA-approved definition bid successfully for licenses in Blocks A and B. There were 90 winning bidders that qualified as small entities in the Block C auctions. A total of 93 small and very small business bidders won approximately 40 percent of the 1,479 licenses for Blocks D, E, and F.[681] Based on this information, we conclude that the number of small broadband PCS licensees will include the 90 winning C Block bidders and the 93 qualifying bidders in the D, E, and F blocks, for a total of 183 small entity PCS providers as defined by the SBA and the Commission's auction rules.

297. The Commission awards bidding credits in auctions for geographic area 800 MHz and 900 MHz SMR licenses to firms that had revenues of no more than $15 million in each of

[675] 13 C.F.R. s 121.201, NAICS code 513322.

[676] *FCC Trends in Telephone Report*, Table 5.3.

[677] *Id.*

[678] *See Amendment of Parts 20 and 24 of the Commission's Rules - Broadband PCS Competitive Bidding and the Commercial Mobile Radio Service Spectrum Cap,* WT Docket No. 96-59, Report and Order, FCC 96-278, paras. 57-60 (rel. Jun. 24, 1996), 61 Fed. Reg. 33859 (July 1, 1996); *see also* 47 C.F.R. § 24.720(b).

[679] *See Amendment of Parts 20 and 24 of the Commission's Rules -- Broadband PCS Competitive Bidding and the Commercial Mobile Radio Service Spectrum Cap,* WT Docket No. 96-59, Report and Order, FCC 96-278, para. 60 (1996).

[680] *See, e.g., Implementation of Section 309(j) of the Communications Act -- Competitive Bidding*, PP Docket No. 93-253, Fifth Report and Order, 9 FCC Rcd 5532, 5581-84 paras. 115-117 (1994).

[681] FCC News, Broadband PCS, D, E and F Block Auction Closes, No. 71744 (rel. Jan. 14, 1997).

the three previous calendar years.[682] In the context of both the 800 MHz and 900 MHz SMR, a definition of "small entity" has been approved by the SBA. These fees apply to SMR providers in the 800 MHz and 900 MHz bands that either hold geographic area licenses or have obtained extended implementation authorizations. We do not know how many firms provide 800 MHz or 900 MHz geographic area SMR service pursuant to extended implementation authorizations, nor how many of these providers have annual revenues of no more than $15 million.

298. *Rural Radiotelephone Service*. The Commission has not adopted a definition of small entity specific to the Rural Radiotelephone Service.[683] A significant subset of the Rural Radiotelephone Service is the Basic Exchange Telephone Radio Systems (BETRS).[684] We will use the SBA's definition applicable to radiotelephone companies, *i.e.*, an entity employing no more than 1,500 persons.[685] There are approximately 1,000 licensees in the Rural Radiotelephone Service, and we estimate that almost all of them qualify as small entities under the SBA's definition.

299. *Fixed Microwave Services*. Microwave services include common carrier,[686] private-operational fixed,[687] and broadcast auxiliary radio services.[688] At present, there are approximately 22,015 common carrier fixed licensees and 61,670 private operational-fixed licensees and broadcast auxiliary radio licensees in the microwave services. The Commission has not defined a small business specifically with respect to microwave services. For purposes of this FRFA, we utilize the SBA's definition applicable to radiotelephone companies--*i.e.*, an entity with no more than 1,500 persons.[689] We estimate, for this purpose, that all of the Fixed Microwave licensees (excluding broadcast auxiliary licensees) would qualify as small entities under the SBA definition for radiotelephone companies.

300. *39 GHz Licensees*. The Commission defined "small entity" for 39 GHz licenses as an entity that has average gross revenues of less than $40 million in the three previous calendar years.[690] An additional classification for "very small business" was added and is

[682] 47 C.F.R. § 90.814(b)(1).

[683] The service is defined in § 22.99 of the Commission's Rules. 47 C.F.R. § 22.99.

[684] BETRS is defined in §§ 22.757 and 22.759 of the Commission's Rules. 47 C.F.R. §§ 22.757, 22.759.

[685] 13 C.F.R. § 121.201, NAICS codes 513321, 513322, and 51333.

[686] 47 C.F.R. §§ 101, *et seq*. (formerly Part 21 of the Commission's Rules).

[687] Persons eligible under Parts 80 and 90 of the Commission's rules can use Private Operational-Fixed Microwave services. *See* 47 C.F.R. Parts 80, 90. Stations in this service are called operational-fixed to distinguish them from common carrier and public fixed stations. Only the licensee may use the operational-fixed station, and only for communications related to the licensee's commercial, industrial, or safety operations.

[688] Auxiliary Microwave Service is governed by Part 74 of the Commission's rules. *See* 47 C.F.R. Part 74. Available to licensees of broadcast stations and to broadcast and cable network entities, broadcast auxiliary microwave stations are used for relaying broadcast television signals from the studio to the transmitter, or between two points such as a main studio and an auxiliary studio. The service also includes mobile TV pickups, which relay signals from a remote location back to the studio.

[689] 13 C.F.R. § 121.201, NAICS codes 513321, 513322, and 51333.

[690] *See In the Matter of Amendment of the Commission's Rules Regarding the 37.0-38.6 GHz and 38.6-40.0 GHz Band*, Report and Order, 12 FCC Rcd 18600 (1997).

defined as an entity that, together with their affiliates, has average gross revenues of not more than $15 million for the preceding three calendar years.[691] These regulations defining "small entity" in the context of 39 GHz auctions have been approved by the SBA. The auction of the 2,173 39 GHz licenses began on April 12, 2000 and closed on May 8, 2000. The 18 bidders who claimed small business status won 849 licenses.

4. Description of Projected Reporting, Recordkeeping, and Other Compliance Requirements

301. Pursuant to the Order, all rate-of-return carriers will be required to modify their access tariffs to comply with the new SLC caps, to become effective on January 1, 2002, July 1, 2002, and July 1, 2003. This function would be performed by NECA for those carriers that participate in the NECA common line pool, as most small carriers do.[692] Those rate-of-return carriers filing their own tariffs also would have to make a tariff filing to reflect the access charge modifications.

302. The CCL charge will be removed from the common line rate structure of rate-of-return carriers as of July 1, 2003. From July 1, 2002 to June 30, 2003, rate-of-return carriers may impose a transitional CCL charge on all switched access minutes to recover, for each residential and single-line business line in their study area, the difference between the residential SLC and the lesser of $6.50 or their average cost per line.[693]

303. All rate-of-return carriers will be required to modify their access tariffs by reallocating line port costs from local switching to the common line category.[694] To ease the burden of implementing this rate structure modification on small rate-of-return carriers, we will permit them to shift 30 percent of their local switching costs to the common line category in lieu of conducting a cost study.[695] Carriers electing this cost study approach must base their costs studies on geographically-averaged costs, and submit the cost study in support of the tariff filing relying on the cost study. Once a rate-of-return carrier has performed a cost study to support its tariff, it may rely on that cost study for subsequent tariff filings.

304. We require rate-of-return carriers to recover through a separate end-user charge the costs of ISDN line ports and line ports associated with other services that exceed the costs of a line port used for basic analog service.[696]

305. We require rate-of-return carriers to reallocate the costs recovered from the transport interconnection charge (TIC) to all other access categories.[697] NECA will be required

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[691] *Id.*

[692] *See supra*, § IV.A.2.a.

[693] *See id.* at § IV.A.2.d.

[694] *See id.* at § IV.B.2.b.

[695] *See id.*

[696] *See id.*

[697] *See id.* at § IV.B.2.c.

to establish for carriers that participated in the NECA pool during the tariff year ending June 30, 2001, an individual carrier dollar limit based on its traffic volumes and the TIC rate for the twelve-month period ending June 30, 2001. Each carrier that was not in the pool during the tariff year ending on June 30, 2001, must determine its TIC limit and report it to NECA for purposes of administering future pool membership changes.

306. We permit, but do not require, rate-of-return carriers to establish the following local switching and transport rate elements: a flat charge for dedicated trunk port costs; a flat charge for the costs of DS1/voice grade multiplexers associated with terminating dedicated trunks at analog switches; a per-minute charge for shared trunk ports and any associated DS1/voice grade multiplexer costs; a flat charge for the costs of trunk ports used to terminate dedicated trunks on the serving wire center side of the tandem switch; individual charges for multiplexer costs associated with tandem switches; and a separate per-message call setup charge.[698]

307. We require rate-of-return carriers that use general purpose computers to provide non-regulated billing and collection services to allocate a portion of their GSF costs to the billing and collection category.[699] To accommodate the fact that rate-of-return carriers are not required to maintain separate land, buildings, office furniture, and general purpose computer investment accounts, we only require these carriers to apply the modified Big Three Expense Factor used by price cap carriers to the general purpose computer investment detail to determine the amount to be allocated to billing and collection. Carriers also may use the general purpose computer investment amount they develop for a period of three years. Carriers whose billing and collection activities are performed exclusively by service bureaus will not be subject to these requirements. Many small carriers use service bureaus exclusively to perform billing and collection services and, therefore, will not be affected by these requirements.

308. Rate-of-return carriers electing to disaggregate their Interstate Common Line Support must submit a detailed description of their disaggregation plan, including information that will enable competitors to verify and reproduce the algorithm used to determine zone support levels, and a geographic description and map of each such zone with the Commission, the relevant state regulatory agency, and USAC.[700] This is not a new compliance requirement because carriers would have to file the above-stated materials in order to disaggregate other forms of high-cost support pursuant to the *Rural Task Force Order*.

309. Rate-of-return carriers seeking Interstate Common Line Support will be required to file on an annual basis their projected common line revenue requirement for each study area in which they operate.[701] Average schedule companies will not be required to submit common line revenue requirements, but instead will be required to submit information that USAC determines is necessary in order for it to calculate common line revenue requirements for average schedule companies. To enable USAC to begin distributing Interstate Common Line Support to carriers

[698] *See id.* at § IV.B.2.d.

[699] *See id.* at § IV.C.1.

[700] *See id.* at § IV.D.2.b.

[701] *See id.*

on July 1, 2002, carriers will be required to submit projected common line revenue requirements for July 1, 2002, to June 30, 2003, by March 31, 2002. Carriers will be permitted to submit corrections to their projected common line revenue requirements until April 10, 2002.[702] After April 10, 2002, any corrections to projected common line revenue requirements shall be made in the form of true-ups using actual cost data. Rate-of-return carriers will be required to submit projected common line revenue requirements for subsequent years on the same schedule.

310. To ensure that Interstate Common Line Support amounts reflect a carrier's actual common line costs, rate-of-return carriers will be required to update projected common line cost data with actual costs on an annual basis.[703] Average schedule companies will not be required to calculate or submit their actual costs. Rate-of-return carriers also will be permitted to update their actual cost data on a quarterly basis.

311. Consistent with rules adopted in the *Rural Task Force Order*, rate-of-return carriers will file their line counts with USAC, by disaggregation zone and customer class, in accordance with the schedule in sections 36.611 and 36.612 of our rules.[704] Line count data for rural rate-of-return carrier study areas in which a competitive eligible telecommunications carrier has not begun providing service will be filed on an annual basis. Line count data will be filed on a regular quarterly basis upon competitive entry in rural rate-of-return carrier study areas. Non-rural rate-of-return carriers currently are required to file line count data on a quarterly basis regardless of whether a competitor is present and that requirement will not change. Competitive eligible telecommunications carriers will file their line counts with USAC, by disaggregation zone and customer class on a quarterly basis, in accordance with the schedule in section 54.307 of our rules.[705]

312. Carriers seeking Interstate Common Line Support must file a certification with the Commission and USAC.[706] These requirements will create additional reporting requirements, but such reporting is necessary to ensure compliance with section 254(e) of the Act.[707]

313. We require all incumbent local exchange carriers, including rate-of-return carriers, to recover universal service contributions only through end user charges. Rate-of-return carriers that choose to impose end-user charges for the recovery of universal service contributions must make corresponding reductions in their access charges to avoid double recovery.[708]

[702] *See id.*

[703] *See id.*

[704] *See id.*; 47 C.F.R. §§ 36.611 and 36.612.

[705] *See supra*, § IV.D.2.d; 47 C.F.R. § 54.307.

[706] *See supra*, § IV.D.2.b.

[707] *See id.* at § IV.D.2.c.

[708] *See id.*

5. Steps Taken To Minimize Significant Economic Impact on Small Entities, and Significant Alternatives Considered

314. The Commission has taken numerous steps to minimize significant economic impact on small entities of the interstate access charge and universal service reforms adopted in this Order. Overall, the Commission's approach is tailored to the specific challenges faced by small local telephone companies serving rural and high-cost areas. Although per-minute switched access charges will be reduced for all rate-of-return carriers, these carriers will retain the flexibility to establish rates based on their own costs in the areas they serve, rather than being forced to conform to a prescribed target rate. Rate-of-return carriers will continue to be permitted to set rates based on the authorized rate of return of 11.25 percent. And the new, uncapped support mechanism created by this Order will provide certainty and stability by ensuring that the rate structure modifications we adopt do not affect overall recovery of interstate access costs. The Order adopts a cautious approach which rationalizes the access rate structure and converts identifiable implicit subsidies to explicit support, without endangering this important revenue stream for rate-of-return carriers.

315. The Commission also has taken steps to minimize the administrative burdens imposed on small carriers as a result of access charge and universal service reform. The Order does not create a separate non-primary residential line SLC cap. Instead, it applies the same SLC cap to primary and non-primary residential lines, concluding that this approach will simplify the common line rate structure and avoid the administrative costs associated with administering the distinction.[709] The Order also provides that a separate cost showing to justify residential and single-line business SLC cap increases above $5.00 will not be required for rate-of-return carriers, concluding that such a requirement is unnecessary and would create undue administrative burdens.[710] The Order provides that rate-of-return carriers may deaverage SLC rates in accordance with universal service support disaggregation plans established pursuant to the *Rural Task Force Order*, a measure which will minimize administrative burdens on small carriers, as well as confusion among competitive carriers, by ensuring that carriers do not have multiple overlapping zones within their services for universal service support and SLC rates, as well as providing the flexibility necessary to accommodate the diversity among small local telephone companies.[711]

316. To ease the burden on small local telephone companies of reallocating line port costs from local switching to the common line category, carriers will be permitted to shift 30 percent of their local switching costs to the common line category in lieu of conducting a cost study.[712] A carrier conducting a cost study may use the results in future tariff filings.

317. The Order permits, but does not require, rate-of-return carriers to establish a number of local switching and transport rate elements, concluding that these rate structure modifications should be optional to avoid undue administrative burdens on small rate-of-return

[709] *See id.* at § IV.A.2.a.

[710] *See id.*

[711] *See id.* at § IV.A.2.d.

[712] *See id.* at § IV.B.2.b.

carriers, and to allow carriers to make individual determinations as to whether the costs of establishing new rate elements are warranted by the potential efficiency gains.[713]

318. To accommodate the fact that rate-of-return carriers are not required to maintain the account detail that provides separate land, buildings, office furniture, and general-purpose computer investment detail in order to implement the allocator adopted for price cap carriers for GSF costs, we only require them to apply the modified Big Three Expense Factor used by price cap carriers to general purpose computer investment to determine the amount to be allocated to the billing and collection category, thereby removing costs of non-regulated activities from the regulated rate base.[714] We also permit rate-of-return carriers to use the general purpose computer investment amount they develop for a period of three years. This procedure recognizes the limitations of the accounting system and the administrative burdens of developing further disaggregated investment detail. Rate-of-return carriers whose billing and collection activities are performed exclusively by service bureaus will continue to allocate GSF pursuant to section 69.307(c) of our rules, which specifically addresses the situation in which rate-of-return carriers obtain all billing and collection services they provide to interexchange carriers from unregulated affiliates or from unaffiliated third parties.[715]

319. The Order does not require rate-of-return carriers to recover marketing expenses through the common line recovery mechanisms, reasoning that determination of the costs to be reallocated would be more difficult for small carriers than for large, price cap carriers because small carriers are not required to keep more detailed Class A accounts, and that the costs in question represent only a small portion of rate-of-return carriers' interstate access revenues.[716]

320. The Order generally adopts the same plan for disaggregation and targeting of Interstate Common Line Support as recently adopted for intrastate high-cost support for rural carriers, which will result in minimal additional administrative burdens for carriers that elect to disaggregate their support.[717] Rate-of-return carriers choosing to disaggregate their Interstate Common Line Support must submit a detailed description of the disaggregation plan, including information that will enable competitors to verify and reproduce the algorithm used to determine zone support levels, and a geographic description and map of each such zone with the Commission, the relevant state regulatory agency, and USAC, as discussed further below. These geographic descriptions and zone maps are identical to the ones that carriers must submit pursuant to the requirements of the *Rural Task Force Order*, and thus create no additional reporting requirements.

321. The Order limits as much as possible the filing requirements associated with the new Interstate Common Line Support mechanism, generally requiring carriers to file the

[713] *See id.* at § IV.B.2.d.

[714] *See id.* at § IV.C.1.

[715] *See* 47 C.F.R. § 69.307(c).

[716] *See id.* at § IV.C.2.

[717] *See id.* at § IV.D.2.b.

minimum amount of information necessary for the proper functioning of the mechanism.[718] Consistent with their average schedule status, average schedule companies will not be required to submit common line revenues requirements, but instead will be required to submit information that USAC determines is necessary in order for it to calculate common line revenue requirements for average schedule companies. Additionally, rural rate-of-return carriers and their competitors are required to file line count data on a quarterly basis only upon competitive entry by an eligible telecommunications carrier. The data that will be filed is similar to data that small carriers already prepare and submit to NECA to enable them to develop rates and operate the common line pool, but differs in important respects. The Order permits small carriers to file quarterly "true ups" to enable carriers that experience unforeseen costs to file actual cost data and receive increased per-line amounts of Interstate Common Line Support. The true-up option allows carriers to avoid over- or under-payment and to obtain the correct level of support for their particular revenue requirements.

322. The Order streamlines the Part 69 waiver requirement for introduction of new services by rate-of-return carriers, concluding that streamlined filing requirements will eliminate unnecessary administrative burdens on small carriers.[719]

323. The Commission considered a number of significant alternatives in this proceeding. The Commission sought comment on the MAG plan, a comprehensive proposal addressing numerous issues facing rate-of-return carriers, including access charge reform and universal service support, on January 5, 2001, stating its intention to fully and expeditiously consider the MAG plan. Based on the significant concerns about features of the MAG plan raised by commenters, the Commission has determined that adoption of the plan in its entirety would not benefit consumers or service the public interest.[720] For example, the Commission determined that the MAG's proposals that certain access charge reforms be optional, and that only those carriers electing the MAG incentive regulation proposal be eligible for new, explicit universal service support to replace implicit support in access charges, are inconsistent with the mandate of the 1996 Act and could preclude many small carriers from fully participating in interstate access charge reform, leading to increased access rate disparities among local telephone companies that is not in the public interest.

324. The Commission also has considered proposals for adoption of a target rate for the per-minute access charges of rate-of-return carriers, either on an optional or a mandatory basis.[721] The Commission rejects these proposals and concludes that none of these proposals is supported by cost data and that the non-prescriptive, market-based approach to access charge reform adopted in the Order is more consistent with the competitive and universal service goals of the 1996 Act. The comments filed in this proceeding indicate a wide variation in cost patterns, density, and other operational characteristics among rate-of-return carriers. The access charge reform approach adopted in this Order accommodates this diversity by reallocating costs

[718] *See id.*

[719] *See id.* at § IV.D.2.d.

[720] *See id.* at § I.

[721] *See id.* at § IV.B.2.a.

and removing implicit support to create more efficient rate structures, while allowing carriers to establish rates based on their own costs.

325. The Commission also considered and rejected proposals by some commenters for the establishment of a presubscribed interexchange carrier charge, or PICC, a flat, monthly charge assessed on the interexchange carrier with which an end user is presubscribed, for rate-of-return carriers in lieu of raising SLCs for rate-of-return carriers and/or removing the CCL charge from the common line rate structure.[722] The Commission concludes that a PICC should not be introduced into the common line rate structure of rate-of-return carriers. Establishment of a PICC would force interexchange carriers to recover the cost of the PICC from all of their customers, and contribute to rate disparities between the two groups of carriers, thereby increasing the burden on interexchange carriers of compliance with the geographic rate averaging and rate integration requirements of section 254(g).

326. The Commission also considered and rejected the imposition of a cap on the explicit interstate support mechanism established in this Order, concluding that a cap is not appropriate under the circumstances.[723] Many rate-of-return carriers are small, rural carriers that serve high-cost regions. Small carriers generally are more dependent on their interstate access charge revenue streams and universal service support than large carriers and, therefore, more sensitive to disruption of those streams. The absence of a cap will ensure that the rate structure modifications adopted in this Order do not affect the overall recovery of interstate loop costs by small carriers.

6. Report to Congress

327. The Commission will send a copy of this Order, including this FRFA, in a report to be sent to Congress pursuant to the Congressional Review Act.[724] In addition, the Commission will send a copy of this Order, including this FRFA, to the Chief Counsel for Advocacy of the Small Business Administration. A copy of this Order and FRFA (or summaries thereof) will also be published in the Federal Register.[725]

C. Paperwork Reduction Act Analysis

328. The action contained herein has been analyzed with respect to the Paperwork Reduction Act of 1995 and found to impose new or modified reporting and recordkeeping requirements or burdens on the public. Implementation of these new or modified reporting and recordkeeping requirements will be subject to approval by the Office of Management and Budget (OMB) as prescribed by the Act, and will go into effect upon announcement in the Federal Register of OMB approval.

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[722] *See id.* at § IV.A.2.d.

[723] *See id.* at § IV.D.2.a.

[724] *See* 5 U.S.C. § 801(a)(1)(A).

[725] *See* 5 U.S.C. § 604(b).

D. Initial Regulatory Flexibility Analysis

329. As required by the Regulatory Flexibility Act (RFA),[726] the Commission has prepared this Initial Regulatory Flexibility Analysis (IRFA) of the possible significant economic impact on small entities by the proposals in this Further Notice.

1. Need for, and Objectives of, the Proposed Rules

330. The Commission consistently has expressed its commitment to providing incentives for smaller telephone companies to become more efficient and innovative. As proposed, however, the MAG incentive plan does not appear to provide incentives for cost efficiency gains that will benefit consumers through lower rates and improved services. The Further Notice seeks additional comment on the MAG incentive plan, and on other means of providing opportunities for rate-of-return carriers to increase their efficiency and competitiveness in the interstate access services market in a manner that would benefit both rate-of-return carriers and their customers. Among other things, the Further Notice seeks comment on the establishment of one or more X-factors, ways to insure that adequate investment and service quality levels are maintained, and whether any incentive regulation adopted by the Commission for small carriers should be optional.[727]

331. The Further Notice also seeks comment on extending additional pricing flexibility to rate-of-return carriers,[728] on the continued need for the "all-or-nothing" rule, which provides that if an individual rate-of-return carrier or study area converts to price cap regulation, all of its affiliates or study areas must also do so, except for those using average schedules,[729] and on the Commission's tentative conclusion that LTS should be merged with Interstate Common Line Support as of July 1, 2003, after which participation in the NECA common line pool will not be required for receipt of universal service support.[730] These proposals are intended to enhance the competitiveness of rate-of-return carriers and to ensure that the Commission's rules continue to be consistent with conditions in the telecommunications marketplace.

2. Legal Basis

332. This rulemaking action is supported by sections 4(i), 4(j), 201-205, 254, and 403 of the Communications Act of 1934, as amended.[731]

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[726] *See* 5 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. 104-121, 110 Stat. 847 (1996) (CWAA). Title II of the CWAA is the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA).

[727] *See supra*, § V.A.2.

[728] *See id.* at § V.B.2.

[729] *See id.* at § V.C.2.

[730] *See id.* at § V.D.

[731] 47 U.S.C. §§ 154(i), 154(j), 201-205, 254, and 403.

3. Description and Estimate of the Number of Small Entities to Which the Notice will Apply

333. As discussed above in the Final Regulatory Flexibility Analysis (FRFA), the Commission's action in this Order affects local exchange carriers, competitive local exchange carriers, interexchange carriers, competitive access providers, cellular licensees, broadband Personal Communications Services, Rural Radiotelephone Service, Specialized Mobile Radio, fixed microwave services, and 39 GHz licensees.[732] This Initial Regulatory Flexibility Act potentially will affect the same entities discussed in the FRFA, and we incorporate the descriptions of those entities by reference.

4. Description of Projected Reporting, Recordkeeping, and Other Compliance Requirements

334. The Further Notice explores options for developing an alternative regulatory structure that would be available to those rate-of-return carriers electing it. It considers the widely varying operating circumstances of rate-of-return carriers, the implications of competitive and intrastate regulatory conditions on the options available, and the need to facilitate and ensure the deployment of advanced services in rural America. If adopted, alternative regulation may require additional recordkeeping. For example, carriers could be required to file cost studies with this Commission or other appropriate state agency detailing annual revenues, revenues per study area, and effective per-line support for each universal service zone.[733] The Further Notice also addresses the continued need for the Commission's all-or-nothing rule, and the appropriate degree and timing of pricing flexibility for small rate-of-return carriers. Repeal or modification of the all-or-nothing rule might allow carriers to depool and deaverage rates within study areas by filing their own common line tariffs.[734]

5. Steps Taken To Minimize Significant Economic Impact on Small Entities, and Significant Alternatives Considered

335. The RFA requires an agency to describe any significant alternatives that it has considered in reaching its proposed approach, which may include the following four alternatives (among others): (1) the establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (2) the clarification, consolidation, or simplification of compliance or reporting requirements under the rule for small entities; (3) the use of performance, rather than design, standards; and (4) an exemption from coverage of the rule, or any part thereof, for small entities.[735]

336. The proposals in the Further Notice could have varying positive or negative impacts on rate-of-return carriers, including any such small carriers. Many of the proposals involve elective options, so that a small entity should be able to assess the potential impacts as

[732] *See supra*, § VI.A.

[733] *See id.* at § V.A.2.

[734] *See id.* at § V.C.2.

[735] 5 U.S.C. § 603(c).

part of its decision-making process. Public comments are welcomed on modifications to the proposals contained in the Further Notice that would reduce any potential impacts on small entities. Specifically, suggestions are sought on different compliance or reporting requirements that would take into account the resources of small entities; clarification, consolidation, or simplification of compliance and reporting requirements for small entities that would be subject to the rules; and whether waiver or forbearance from the rules for small entities would be feasible or appropriate. How would the establishment of one or more X-factors impact small carriers?[736] How can we insure that adequate investment and service quality levels are maintained?[737] How would the adoption of an alternative regulation plan affect rate-of-return carriers, and how would a low-end adjustment affect such plan?[738] Should we retain, repeal, or modify our "all-or-nothing rule"?[739] How would potential modification or repeal affect smaller carriers?[740] Finally, what would be the impact on small carriers of eliminating LTS as a separate, pooling-restricted universal service support mechanism?[741] Comments should be supported by specific economic analysis.

6. Federal Rules That May Duplicate, Overlap, or Conflict With the Proposed Rules

337. None.

E. Comment Filing Procedures

338. Pursuant to sections 1.415 and 1.419 of the Commission's rules, 47 C.F.R. §§ 1.415, 1.419, interested parties may file comments 30 days or fewer from publication in the Federal Register, and reply comments 60 days or fewer from publication in the Federal Register. Comments may be filed using the Commission's Electronic Comment Filing System (ECFS) or by filing paper copies.[742]

339. Comments filed through the ECFS can be sent as an electronic file via the Internet to <http://www.fcc.gov/e-file/ecfs.html>. Generally, only one copy of an electronic submission must be filed. If multiple docket or rulemaking numbers appear in the caption of this proceeding, however, commenters must transmit one electronic copy of the comments to each docket or rulemaking number referenced in the caption. In completing the transmittal screen, commenters should include their full name, Postal Service mailing address, and the applicable docket or rulemaking number. Parties may also submit an electronic comment by Internet e-mail. To get filing instructions for e-mail comments, commenters should send an e-mail to

[736] *See supra,* § V.A.2.

[737] *See id.*

[738] *See id.*

[739] *See id.* at § V.C.2.

[740] *See id.*

[741] *See id.* at § V.D.

[742] *See* Electronic Filing of Documents in Rulemaking Proceedings, 63 Fed. Reg. 24,121 (1998).

ecfs@fcc.gov, and should include the following words in the body of the message, "get form <your e-mail address." A sample form and directions will be sent in reply.

340. Parties who choose to file by paper must file an original and four copies of each filing. If more than one docket or rulemaking number appear in the caption of this proceeding, commenters must submit two additional copies for each additional docket or rulemaking number. All filings must be sent to the Commission's Secretary, Magalie Roman Salas, Office of the Secretary, Federal Communications Commission, 445 12th Street, S.W., Washington, D.C. 20554.

341. Parties who choose to file by paper should also submit their comments on diskette. These diskettes should be submitted to: Competitive Pricing Division, Common Carrier Bureau, Federal Communications Commission, 445 12th Street, S.W., Washington, D.C. 20554. Such a submission should be on a 3.5-inch diskette formatted in an IBM compatible format using Word or compatible software. The diskette should be accompanied by a cover letter and should be submitted in "read only" mode. The diskette should be clearly labeled with the commenter's name, proceeding (including the docket numbers, in this case CC Docket Nos. 00-256 and 96-45), type of pleading (comment or reply comment), date of submission, and the name of the electronic file on the diskette. The label should also include the following phrase: "Disk Copy - Not an Original." Each diskette should contain only one party's pleadings, preferably in a single electronic file. In addition, commenters must send diskette copies to the Commission's copy contractor, Qualex International, Portals II, 445 12th Street, S.W., Room CYB402, Washington, D.C. 20554.

342. The full text of this document is available for public inspection and copying during regular business hours at the FCC Reference Information Center, Portals II, 445 12th Street, S.W., Room CY-A257, Washington, DC, 20554. This document also may be purchased from the Commission’s duplicating contractor, Qualex International, Portals II, 445 12th Street, S.W., Room CY-B402, Washington, DC, 20554, telephone 202-863-2893, facsimile 202-863-2898, or via e-mail **qualexint@aol.com**.

VII. ORDERING CLAUSES

343. Accordingly, IT IS ORDERED that, pursuant to the authority contained in sections 1-4, 201-205, 214, 218-220, 254, 303(r), 403, 405, and 410 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 151-154, 201-205, 214, 218-220, 254, 303(r), 403, 405, and 410, this Second Report and Order in CC Docket No. 00-256, Fifteenth Report and Order in CC Docket No. 96-45, and Report and Order in CC Docket Nos. 98-77 and 98-166 IS ADOPTED.

344. IT IS FURTHER ORDERED that Part 54 of the Commission’s rules, 47 C.F.R. Part 54, IS AMENDED as set forth in Appendix A hereto, effective 30 days after their publication in the Federal Register. The collections of information contained within are contingent upon approval by the Office of Management and Budget.

345. IT IS FURTHER ORDERED that Part 69 of the Commission’s rules, 47 C.F.R. Part 69, IS AMENDED as set forth in Appendix A hereto, effective 30 days after their publication in the Federal Register.

346. IT IS FURTHER ORDERED that section 65.101 of the Commission's rules, 47 C.F.R. § 65.101, IS STAYED.

347. IT IS FURTHER ORDERED that the Commission's Consumer Information Bureau, Reference Information Center, SHALL SEND a copy of this Order, including the Final Regulatory Flexibility Analysis, to the Chief Counsel for Advocacy of the Small Business Administration.

348. IT IS FURTHER ORDERED that, pursuant to the authority contained in sections 4(i), 4(j), 201-205, 254, and 403 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 154(i), 154(j), 201-205, 254, and 403, this Further Notice of Proposed Rulemaking in CC Docket No. 00-256 IS ADOPTED.

349. IT IS FURTHER ORDERED that the Commission's Consumer Information Bureau, Reference Information Center, SHALL SEND a copy of this Further Notice of Proposed Rulemaking in CC Docket No. 00-256, including the Initial Regulatory Flexibility Analysis, to the Chief Counsel for Advocacy of the Small Business Administration.

FEDERAL COMMUNICATIONS COMMISSION

Magalie Roman Salas
Secretary

APPENDIX A – FINAL RULES

Part 54 and Part 69 of the Code of Federal Regulations are amended as follows:

PART 54 – UNIVERSAL SERVICE

1. The authority citations continues to read as follows:

Authority: 47 U.S.C. 1, 4(i), 201, 205, 214, and 254 unless otherwise noted.

Subpart A – General Information

2. Section 54.5 is revised by adding the following definition:

§ 54.5 Terms and Definitions

* * *

Rate-of-Return Carrier. “Rate-of-return carrier” shall refer to any incumbent local exchange carrier not subject to price cap regulation as that term is defined in § 61.3(x) of this chapter.

* * *

Subpart D – Universal Service Support for High Cost Areas

3. Section 54.307 is revised by adding a third sentence to paragraph (a)(1), amending the second and third sentences of paragraph (b), and amending paragraph (c) as follows:

§ 54.307 Support to a competitive eligible telecommunications carrier.

(a) * * *
(1) * * * A competitive eligible telecommunications carrier serving loops in the service area of a rate-of-return carrier shall be eligible receive Interstate Common Line Support for each line it serves in the service area in accordance with the formula in § 54.901 of this part.

(b) * * * For a competitive eligible telecommunications carrier serving loops in the service area of a rural incumbent local exchange carrier, as that term is defined in § 54.5 of this part, the carrier must report, by customer class, the number of working loops it serves in the service area, disaggregated by cost zone if disaggregation zones have been established within the service area pursuant to § 54.315 of this subpart. For a competitive eligible telecommunications carrier serving loops in the service area of a non-rural telephone company, the carrier must report the number of working loops it serves in the service area, by customer class if the non-rural telephone company receives Interstate Common Line Support pursuant to § 54.901 of this part and by disaggregation zone if disaggregation zones have been established within the service area pursuant to § 54.315 of this subpart, and the number of working loops it serves in each wire center in the service area. * * *

(c) A competitive eligible telecommunications carrier must submit the data required pursuant to section (b) of this section according to the schedule.

(1) No later than July 31^{st} of each year, submit data as of December 31^{st} of the previous calendar year;
(2) No later than September 30^{th} of each year, submit data as of March 31^{st} of the existing calendar year;
(3) No later than December 30^{th} of each year, submit data as of June 30^{th} of the existing calendar year;
(4) No later than March 30^{th} of each year, submit data as of September 30^{th} of the previous calendar year.

4. Section 54.315 is revised by amending paragraphs (a), (b)(4), (c)(5), (e)(1), (e)(4) through (e)(7), and (f)(1) through (f)(4) as follows:

§ 54.315 Disaggregation and targeting of high-cost support.

(a) On or before May 15, 2002, all rural incumbent local exchange carriers and rate-of-return carriers for which high-cost universal service support pursuant to §§ 54.301, 54.303, and/or 54.305 of this subpart, subpart K of this part, and/or part 36 subpart F is available must select a disaggregation path as described in subsections (b), (c), or (d) of this section. In study areas in which a competitive carrier was designated as a competitive eligible telecommunications carrier prior to June 19, 2001, the rural incumbent local exchange carrier or rate-of-return carrier may only disaggregate support pursuant to subsections (b), (c), or (d)(1)(iii) of this section. A rural incumbent local exchange carrier or rate-of-return carrier failing to select a disaggregation path as described in subsections (b), (c), or (d) of this section by May 15, 2002, will not be permitted to disaggregate and target federal high-cost support unless ordered to do so by a state commission as that term is defined in § 54.5 of this part.

(b) * * *
(4) A state commission may require, on its own motion, upon petition by an interested party, or upon petition by the rural incumbent local exchange carrier or rate-of-return carrier, the disaggregation and targeting of support under subsections (c) or (d) of this section.

(c) * * *
(5) A state commission may require, on its own motion, upon petition by an interested party, or upon petition by the rural incumbent local exchange carrier or rate-of-return carrier, the disaggregation and targeting of support in a different manner.

* * *

(e) * * *
(1) Support available to the carrier's study area under its disaggregation plan shall equal the total support available to the study area without disaggregation.

* * *

(4) Per-line support amounts for each disaggregation zone shall be recalculated whenever the carrier's total annual support amount changes using the changed support amount and lines at that point in time.

(5) Per-line support for each category of support in each disaggregation zone shall be determined such that the ratio of support between disaggregation zones is maintained and that the product of all of the carrier's lines for each disaggregation zone multiplied by the per-line support for those zones when added together equals the sum of the carrier's total support.
(6) Until a competitive eligible telecommunications carrier is certified in a study area, monthly payments to the incumbent carrier will be made based on total annual amounts for its study area divided by 12.
(7) When a competitive eligible telecommunications carrier is certified in a study area, per-line amounts used to determine the competitive eligible telecommunications carrier's disaggregated support shall be based on the incumbent carrier's then-current total support levels, lines, disaggregated support relationships, and, in the case of support calculated under subpart K of this part, customer classes.

(f) * * *
(1) A carrier certifying under subsection (b) of this section that it will not disaggregate and target high-cost universal service support shall submit to the Administrator a copy of the certification submitted to the state commission, or the Federal Communications Commission, when not subject to state jurisdiction.
(2) A carrier electing to disaggregate and target support under subsection (c) of this section shall submit to the Administrator a copy of the order approving the disaggregation and targeting plan submitted by the carrier to the state commission, or the Federal Communications Commission, when not subject to state jurisdiction, and a copy of the disaggregation and targeting plan approved by the state commission or the Federal Communications Commission.
(3) A carrier electing to disaggregate and target support under subsection (d) of this section shall submit to the Administrator a copy of the self-certification plan including the information submitted to the state commission pursuant to subsections (d)(2)(i) and (d)(2)(iv) of this section or the Federal Communications Commission.
(4) A carrier electing to disaggregate and target support under subsection (c) or (d) of this section must submit to the Administrator maps which precisely identify the boundaries of the designated disaggregation zones of support within the carrier's study area.

Subpart H -- Administration

5. Section 54.701 is revised by amending paragraph (g)(1)(iii) as follows:

§ 54.701 Administrator of universal service support mechanisms.

* * *

(g)(1) * * *

(iii) The High Cost and Low Income Division, which shall perform duties and functions in connection with the high cost and low income support mechanism, the interstate access universal service support mechanism for price cap carriers described in subpart J of this part, and the interstate common line support mechanism for rate-of-return carriers described in subpart K of this part, under the direction of the High Cost and Low Income Committee of the Board, as set forth in § 54.705(c).

6. Section 54.702 is revised by amending paragraph (a) and the second sentence of paragraph (i) as follows:

§ 54.702 Administrator's functions and responsibilities.

(a) The Administrator, and the divisions therein, shall be responsible for administering the schools and libraries support mechanism, the rural health care support mechanism, the high cost support mechanism, the low income support mechanism, the interstate access universal service support mechanism described in subpart J of this part, and the interstate common line support mechanism described in subpart K of this part.

* * *

(i) * * * The Administrator shall keep separate accounts for the amounts of money collected and disbursed for eligible schools and libraries, rural health care providers, low-income consumers, interstate access universal service support, interstate common line support, and high-cost and insular areas.

7. Section 54.705 is revised by amending paragraph (c)(1) as follows:

§ 54.705 Committees of the Administrator's Board of Directors.

* * *

(c) *High Cost and Low Income Committee*—(1) *Committee functions*. The High Cost and Low Income Committee shall oversee the administration of the high cost and low income support mechanisms, the interstate access universal service support mechanism for price cap carriers described in subpart J of this part, and the interstate common line support mechanism for rate-of-return carriers described in subpart K of this part by the High Cost and Low Income Division. The High Cost and Low Income Committee shall have the authority to make decisions concerning:

(i) How the Administrator projects demand for the high cost, low income, interstate access universal service, and interstate common line support mechanisms;
(ii) Development of applications and associated instructions as needed for the high cost, low income, interstate access universal service, and interstate common line support mechanisms;

* * *

(iv) Performance of audits of beneficiaries under the high cost, low income, interstate access universal service and interstate common line support mechanisms; and
(v) Development and implementation of other functions unique to the high cost, low income, interstate access universal service and interstate common line support mechanisms.

8. Section 54.715 is revised by amending the third sentence of paragraph (c) as follows:

§ 54.715 Administrative expenses of the Administrator.

* * *

(c) * * * The administrative expenses incurred by the Administrator in connection with the schools and libraries support mechanism, the rural health care support mechanism, the high cost support mechanism, the low income support mechanism, the interstate access universal service support mechanism, and the interstate common line support mechanism shall be deducted from the annual funding of each respective support mechanism.* * *

9. Add subpart K to part 54 as follows:

Subpart K—Interstate Common Line Support Mechanism for Rate-of-Return Carriers

§ 54.901 Calculation of Interstate Common Line Support.

(a) Interstate Common Line Support available to a rate-of-return carrier shall equal the Common Line Revenue Requirement per Study Area as calculated in accordance with Part 69 of this chapter minus:

(1) the study area revenues obtained from end user common line charges at their allowable maximum as determined by §§ 69.104(n) and 69.104(o) of this chapter;
(2) the carrier common line charge revenues to be phased out pursuant to § 69.105 of this chapter;
(3) the special access surcharge pursuant to § 69.114 of this chapter;
(4) the line port costs in excess of basic analog service pursuant to § 69.130 of this chapter; and
(5) any Long Term Support for which the carrier is eligible or, if the carrier ceased participation in the NECA common line pool after October 11, 2001, any Long Term Support for which the carrier would have been eligible if it had not ceased its participation in the pool.

(b) The per-line Interstate Common Line Support available to a competitive eligible telecommunications carrier serving lines in a study area served by a rate-of-return carrier shall be calculated by the Administrator as follows:

(1) If the rate-of-return carrier has disaggregated the support it receives in the study area pursuant to § 54.315 of this part, the Administrator shall calculate the amount of Interstate Common Line Support targeted to each disaggregation zone by the rate-of-return carrier (targeted Interstate Common Line Support). If the rate-of-return carrier has chosen not to disaggregate its support for a study area pursuant to § 54.315, then the entirety of its Interstate Common Line Support for the study area shall be considered targeted Interstate Common Line Support for purposes of performing the calculations in this section.
(2) In each disaggregation zone or undisaggregated study area, the Administrator shall calculate the Average Interstate Common Line Support by dividing the rate-of-return carrier's targeted Interstate Common Line Support by its total lines served.
(3) The Administrator shall then calculate the Interstate Common Line Support available to the competitive eligible telecommunications carrier for each line it serves for each customer class in a disaggregation zone or undisaggregated study area by the following formula:
    (i) If the Average Interstate Common Line Support is greater than \$2.70 multiplied by the number of residential and single-line business lines served by the rate-of-return carrier in the disaggregation zone or undisaggregated study area, then:

(A) Interstate Common Line Support per Multi-Line Business Line = (Average Interstate Common Line Support - $2.70 x residential and single-line business lines served by the rate-of-return carrier) ÷ (total lines served by the rate-of-return carrier); and

(B) Interstate Common Line Support per Residential and Single-Line Business Line = Interstate Common Line Support per Multi-Line Business Line + $2.70.

(ii) If the Average Interstate Common Line Support is less than or equal to $2.70 multiplied by residential and single-line business lines served by the rate-of-return carrier in the disaggregation zone or undisaggregated study area, but greater than $0, then:

(A) Interstate Common Line Support per Multi-Line Business Line = $0; and

(B) Interstate Common Line Support per Residential and Single-Line Business Line = Average Interstate Common Line Support ÷ residential and single line business lines served by the rate-of-return carrier.

(iii) If the Average Interstate Common Line Support is equal to $0, then the competitive eligible telecommunications carrier shall receive no Interstate Common Line Support for lines served in that disaggregation zone or undisaggregated study area.

§ 54.902 Calculation of Interstate Common Line Support for transferred exchanges.

(a) In the event that a rate-of-return carrier acquires exchanges from an entity that is also a rate-of-return carrier, Interstate Common Line Support for the transferred exchanges shall be distributed as follows.

(1) Each carrier may report its updated line counts to reflect the transfer in the next quarterly line count filing pursuant to § 54.903(a) of this subpart that applies to the period in which the transfer occurred. During a transition period from the filing of the updated line counts until the end of the funding year, the Administrator shall adjust the Interstate Common Line Support received by each carrier based on the updated line counts and the per-line Interstate Common Line Support, categorized by customer class and, if applicable, disaggregation zone, of the selling carrier. If the acquiring carrier does not file a quarterly update of its line counts, it will not receive Interstate Common Line Support for those lines during the transition period.

(2) Each carriers' projected data for the following funding year filed pursuant to § 54.903(c) of this subpart shall reflect the transfer of exchanges.

(3) Each carriers' actual data filed pursuant to §54.903(d) of this subpart shall reflect the transfer of exchanges. All post-transaction Interstate Common Line Support shall be subject to true up by the Administrator pursuant to § 54.903(e) of this subpart.

(b) In the event that a rate-of-return carrier acquires exchanges from a price cap carrier that are incorporated into one of the rate-of-return carrier's existing study areas, Interstate Common Line Support for the transferred exchanges shall be distributed as follows.

(1) The acquiring carrier may report its updated line counts for the study area into which the acquired lines are incorporated in the next quarterly line count filing pursuant to § 54.903(a) of this subpart that applies to the period in which the transfer occurred. During a transition period from the filing of the updated line counts until the end of the funding year, the Administrator shall adjust the Interstate Common Line Support received by the acquiring carrier based on the updated line counts and the per-line amounts Interstate Common Line Support for the study area served by the acquiring carrier. If necessary, the Administrator

shall develop an average per-line support amount to reflect various per-line amounts in multiple disaggregation zones served by the acquiring carrier. If the acquiring carrier does not file a quarterly update of its line counts, it will not receive Interstate Common Line Support for those lines during the transition period.

(2) The acquiring carrier's projected data for the following funding year filed pursuant to § 54.903(c) of this subpart shall reflect the transfer of exchanges.

(3) The acquiring carrier's actual data filed pursuant to §54.903(d) of this subpart shall reflect the transfer of exchanges. All post-transaction Interstate Common Line Support shall be subject to true up by the Administrator pursuant to § 54.903(e) of this subpart.

(c) In the event that a rate-of-return carrier acquires exchanges from a price cap carrier that are not incorporated into one of the rate-of-return carrier's existing study areas, Interstate Common Line Support for the transferred exchanges shall be distributed as follows.

(1) The acquiring rate-of-return may submit to the Administrator a projected Interstate Common Line Revenue Requirement for the acquired exchanges for the remainder of the funding year in the next quarterly report to the Administrator. The Administrator shall distribute Interstate Common Line Support pursuant to the partial year projected Interstate Common Line Revenue Requirement for the remainder of the funding year. If the acquiring carrier does not file a projected Interstate Common Line Revenue Requirement, it will not receive Interstate Common Line Support for those exchanges during the transition period.

(2) The acquiring carrier's projected data for the following funding year filed pursuant to § 54.903(c) of this subpart shall reflect the transfer of exchanges.

(3) The acquiring carrier's actual data filed pursuant to §54.903(d) of this subpart shall reflect the transfer of exchanges. All post-transaction Interstate Common Line Support shall be subject to true up by the Administrator pursuant to § 54.903(e) of this subpart.

(d) In the event that an entity other than a rate-of-return carrier acquires exchanges from a rate-of-return carrier, per-line Interstate Common Line Support will not transfer.

(e) This section does not alter any Commission rule governing the sale or transfer of exchanges, including the definition of "study area" in Part 36.

§ 54.903 Obligations of rate-of-return carriers and the Administrator.

(a) To be eligible for Interstate Common Line Support, each rate-of-return carrier shall make the following filings with the Administrator.

(1) On March 31, 2002, each rate-of-return carrier shall submit to the Administrator the number of lines it serves as of September 30, 2001, within each rate-of-return carrier study area, by disaggregation zone if disaggregation zones have been established within that study area pursuant to § 54.315 of this part, showing residential and single-line business line counts and multi-line business line counts separately. For purposes of this report, and for purposes of computing support under this subpart, the residential and single-line business class lines reported include lines assessed the residential and single-line business End User Common Line charge pursuant to § 69.104 of this chapter, and the multi-line business class lines reported include lines assessed the multi-line business End User Common Line charge pursuant to § 69.104 of this chapter. For purposes of this report, and for purposes of computing support under this subpart, lines served using resale of the rate-

of return local exchange carrier's service pursuant to section 251(c)(4) of the Communications Act of 1934, as amended, shall be considered lines served by the rate-of-return carrier only and must be reported accordingly. Beginning July 31, 2002, each rate-of-return carrier shall submit the information described in this paragraph in accordance with the schedule in § 36.611 of this chapter.

(2) Each rate-of-return carrier in service areas where a competitive eligible telecommunications carrier has initiated service and reported line count data pursuant to § 54.307(c) of this part shall submit the information in subsection (a) in accordance with the schedule in § 36.612 of this chapter. A rate-of-return carrier may submit the information in subsection (a) in accordance with the schedule in § 36.612, even if it is not required to do so. If a rate-of-return carrier makes a filing under this subsection, it shall separately indicate any lines that it has acquired from another carrier that it has not previously reported pursuant to subsection (a), identified by customer class and the carrier from which the lines were acquired.

(3) Each rate-of-return carrier shall submit to the Administrator, on March 31, 2002, and annually thereafter on March 31st information needed to calculate the Projected Annual Common Line Revenue Requirement for each of its study areas in the upcoming funding year. A rate-of-return carrier's Projected Annual Common Line Revenue Requirement shall be calculated in accordance with Part 69 of this chapter. The funding year shall be July 1 of the current year through June 30 of the next year. Rate-of-return carriers will be permitted to submit corrections to their projected Annual Common Line Revenue Requirement until April 10, 2002, and annually thereafter until April 10th.

(4) Each rate-of-return carrier shall submit to the Administrator, on July 31, 2003, and annually thereafter on July 31st, the carrier's common line costs as defined in part 69 of this chapter for each study area in which it operates for the previous calendar year. Such data shall be used by the Administrator to make adjustments to monthly per-line Interstate Common Line Support amounts in the following calendar year to the extent of any difference between the carrier's Projected Annual Common Line Revenue Requirement and the carrier's actual costs during the relevant period. A rate-of-return carrier may update the information submitted on July 31st one or more times quarterly on a rolling year basis according to the schedule in § 36.612 of this chapter.

(b) Upon receiving the information required to be filed in paragraph (a) of this section, the Administrator shall:

(1) Perform the calculations described in § 54.901 of this subpart;
(2) Publish the results of these calculations showing Interstate Common Line Support Per Line available in each rate-of-return carrier study area, by Disaggregation Zone and customer class;
(3) Perform periodic reconciliation of projected common line revenue requirements based on data provided by carriers pursuant to paragraph (a)(3) and actual common line revenue requirements based on data provided by carriers pursuant to paragraph (a)(4);
(4) Collect the funds necessary to provide support pursuant to this subpart in accordance with subpart H of this part;
(5) Distribute support calculated pursuant to the rules contained in this subpart; and
(6) Report quarterly to the Commission on the collection and distribution of funds under this subpart as described in § 54.702(i) of this part. Fund distribution reporting will be by state and by eligible telecommunications carrier within the state.

§ 54.904 Carrier certification.

(a) *Certification*. Carriers that desire to receive support pursuant to this subpart shall file a certification with the Administrator and the Federal Communications Commission stating that all Interstate Common Line Support provided to such carrier will be used only for the provision, maintenance, and upgrading of facilities and services for which the support is intended. Support provided pursuant to this subpart shall only be provided to the extent that the carrier has filed the requisite certification pursuant to this section.

(b) *Certification format*. A certification pursuant to this section may be filed in the form of a letter from an authorized representative for the carrier, and must be filed with both the Administrator and the Office of the Secretary of the Federal Communication Commission clearly referencing CC Docket No. 96-45, on or before the filing deadlines set forth below in subsection (d).

(c) All of the certifications filed by carriers pursuant to this section shall become part of the public record maintained by the Commission.

(d) *Filing deadlines*. In order for a rate-of-return carrier, and/or an eligible telecommunications carrier serving lines in the service area of a rate-of-return carrier, to receive Interstate Common Line Support, such carrier must file an annual certification, as described in subsection (b) of this section, on the date that it first files its line count information pursuant to § 54.903 of this subpart, and thereafter on June 30th of each year.

PART 69 – ACCESS CHARGES

10. The authority citation continues to read as follows:

Authority: 47 U.S.C. 154, 201, 202, 203, 205, 218, 220, 254, 403.

11. Section 69.2 is amended by adding a new paragraph (www) as follows:

§ 69.2 Definitions

(www) Interstate Common Line Support (ICLS) means funds that are provided pursuant to Section 54.901 of Part 54.

12. Section 69.4 is revised by amending paragraph (b)(2), deleting and reserving paragraph (c), amending paragraphs (d) and (g), and adding paragraph (j) as follows:

§ 69.4 Charges to be filed.

* * *

(b) * * *

(2) Carrier common line, provided that after June 30, 2003, non-price cap local exchange carriers may not assess a carrier common line charge;

* * *

(d) Recovery of Contributions to the Universal Service Support Mechanisms by Incumbent Local Exchange Carriers.

(1) [Reserved]

(2)(i) Local exchange carriers may recover their contributions to the universal service support mechanisms only through explicit, interstate, end-user charges assessed pursuant to either section 69.131 or section 69.158 that are equitable and nondiscriminatory.

(ii) Local exchange carriers may not recover any of their contributions to the universal service support mechanisms through access charges imposed on interexchange carriers.

* * *

(g) Local exchange carriers may establish appropriate rate elements for a new service, within the meaning of § 61.3(x) of this chapter, in any tariff filing.

(j) In addition to the charges specified in paragraph (b) of this section, the carrier's carrier charges for access service filed with this Commission by non-price cap local exchange carriers may include charges for each of the following elements:

(1) Dedicated local switching trunk port;
(2) Shared local switching trunk port;
(3) Dedicated tandem switching trunk port;
(4) Multiplexers associated with tandem switching;
(5) DS1/voice grade multiplexers associated with analog switches; and
(6) Per-message call setup.

13. Section 69.104 is revised by amending the first sentence of paragraph (a), amending paragraphs (c) through (f), deleting and reserving paragraphs (j) through (l), and adding new paragraphs (n) through (r) 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(ee) of this chapter. * * *

* * *

(c) Until December 31, 2001, except as provided in § 69.104(d) through (h), the single-line rate or charge shall be computed 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.

(d)(1) Until December 31, 2001, if the monthly charge computed in accordance with § 69.104(c) exceeds $6, the charge for each local exchange service subscriber line, except a residential line, a single-line business line, or a line used for Centrex-CO service that was in place or on order as of July 27, 1983, shall be $6.

(2) Until December 31, 2001, the charge for each subscriber line associated with a public telephone shall be equal to the monthly charge computed in accordance with paragraph (d)(1) of this section.

(e) Until December 31, 2001, the monthly charge for each residential and single-line business local exchange service subscriber shall be the charge computed in accordance with paragraph (c) of this section, or $3.50, whichever is lower.

(f) Except as provided in § 54.403, the charge for each residential local exchange service subscriber line shall be the same as the charge for each single-line business local exchange service subscriber line.

* * *

(j) [Reserved.]

(k) [Reserved.]

(l) [Reserved.]

* * *

(n)(1) Beginning January 1, 2002, except as provided in paragraph (r), the maximum monthly charge for each residential or single-line business local exchange service subscriber line shall be the lesser of:

(i) one-twelfth of the projected annual revenue requirement for the End User Common Line element divided by the projected average number of local exchange service subscriber lines in use during such annual period; or

(ii) The following:

(A) Beginning January 1, 2002, $5.00.

(B) Beginning July 1, 2002, $6.00.

(C) Beginning July 1, 2003, $6.50.

(2) In the event that GDP-PI exceeds 6.5% or is less than 0%, the maximum monthly charge in paragraph (n)(1)(ii) of this section will be adjusted in the same manner as the adjustment in section 69.152(d)(2).

(o)(1) Beginning on January 1, 2002, except as provided in paragraph (r), the maximum monthly End User Common Line Charge for multi-line business lines will be the lesser of:

(i) $9.20; or

(ii) one-twelfth of the projected annual revenue requirement for the End User Common Line element divided by the projected average number of local exchange service subscriber lines in use during such annual period;

(2) In the event that GDP-PI is greater than 6.5% or is less than 0%, the maximum monthly charge in paragraph (o)(1)(i) of this section will be adjusted in the same manner as the adjustment in section 69.152(k)(2).

(p) Beginning January 1, 2002, non-price cap local exchange carriers shall assess

(1) no more than one End User Common Line charge as calculated under the applicable method under paragraph (n) of this section for Basic Rate Interface integrated services digital network (ISDN) service.

(2) no more than five End User Common Line charges as calculated under paragraph (o) of this section for Primary Rate Interface ISDN service.

(q) In the event a non-price cap local exchange carrier charges less than the maximum End User Common Line charge for any subscriber lines, the carrier may not recover the difference between the amount collected and the maximum from carrier common line charges, Interstate Common Line Support, or Long Term Support.

(r) *End User Common Line Charge Deaveraging*. Beginning on January 1, 2002, non-price cap local exchange carriers may geographically deaverage End User Common Line charges subject to the following conditions.

(1) In order for a non-price cap local exchange carrier to be allowed to deaverage End User Common Line charges within a study area, the non-price cap local exchange carrier must have:
 (i) state commission-approved geographically deaveraged rates for UNE loops within that study area; or
 (ii) a universal service support disaggregation plan established pursuant to section 54.315.

(2) All geographic deaveraging of End User Common Line charges by customer class within a study area must be according to the state commission-approved UNE loop zone, or the universal service support disaggregation plan established pursuant to section 54.315.

(3) Within a given zone, Multi-line Business End User Common Line rates cannot fall below Residential and Single-Line Business rates.

(4) For any given class of customer in any given zone, the End User Common Line Charge in that zone must be greater than or equal to the End User Common Line charge in the zone with the next lower cost per line.

(5) A non-price cap local exchange carrier shall not receive more through deaveraged End User Common Line charges than it would have received if it had not deaveraged its End User Common Line charges.

(6) *Maximum charge*. The maximum zone deaveraged End User Common Line Charge that may be charged in any zone is the applicable cap specified in § 69.104(n) or § 69.104(o).

(7) *Voluntary Reductions*. A "Voluntary Reduction" is one in which the non-price cap local exchange carrier charges End User Common Line rates below the maximum charges specified in paragraphs (n)(1) or (o)(1) other than through offset of net increases in End User Common Line charge revenues or through increases in other zone deaveraged End User Common Line charges.

14. Section 69.105 is revised by amending paragraph (a) and adding a new paragraph (f) 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(ee) of this chapter. Until June 30, 2003, 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).

* * *

(f) From July 1, 2002, to June 30, 2003, the carrier common line charge calculations pursuant to this section shall be limited to an amount equal to the number of projected residential and single-line business lines multiplied by the difference between the residential and single-line business End User Common Line rate cap and the lesser of $6.50 or the non-price cap local exchange carrier’s average cost per line.

15. Section 69.106 is revised by amending paragraph (g) and adding paragraph (h) as follows:

§ 69.106 Local switching.

* * *

(g) A local exchange carrier may recover signaling 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. Local exchange carriers may not recover through this charge any costs recovered through other rate elements.

(h) Except as provided in § 69.118, non-price cap local exchange carriers may establish rate elements for local switching as follows:

(1) Non-price cap local exchange carriers may separate from the projected annual revenue requirement 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. Non-price cap local exchange carriers electing to assess these charges shall further identify costs incurred for dedicated trunk ports separately from costs incurred for shared trunk ports.

(i) Non-price cap local exchange carriers electing to assess trunk port charges shall recover dedicated trunk port costs identified pursuant to paragraph (h)(1) of this section 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) Non-price cap local exchange carriers electing to assess trunk port charges shall recover shared trunk port costs identified pursuant to paragraph (h)(1) of this section 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) Non-price cap local exchange carriers shall recover the projected annual revenue requirement for the Local Switching element that are not recovered in paragraph (h)(1) of this section 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 revenue requirement 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.

16. Section 69.111 is revised by adding a new paragraph (m) as follows:

§ 69.111 Tandem-switched transport and tandem charge.

* * *

(m) In addition to the charges described in this section, non-price cap local exchange carriers may establish separate charges for multiplexers and dedicated trunk ports used in conjunction with the tandem switch as follows:

(1)(i) Non-price cap local exchange carriers may 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) Non-price cap local exchange carriers may 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.

(2) Non-price cap local exchange carriers may recover the costs of dedicated trunk ports on the serving wire center side of the tandem switch 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.

17. Section 69.124 is revised by amending paragraph (a) as follows:

§ 69.124 Interconnection charge.

(a) Until December 31, 2001, local exchange carriers not subject to price cap regulation shall assess an interconnection charge expressed in dollars and cents per access minute upon all interexchange carriers and upon all other persons using the telephone company switched access network.

* * *

18. Section 69.130 is added as follows:

§ 69.130 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, non-price cap local exchange carriers may recover the difference through a separate monthly end-user charge, provided that no portion of such excess cost may be recovered through other common line access charges, or through Interstate Common Line Support.

19. Section 69.131 is added as follows:

§ 69.131 Universal service end user charges.

To the extent the company makes contributions to the Universal Service Support Mechanisms pursuant to sections 54.706 and 54.709 of this chapter and the non-price cap local exchange carrier seeks to recover some or all of the amount of such contribution, the non-price cap local exchange carrier shall recover those contributions through a charge to end users other than Lifeline users. The charge to recover these contributions is not part of any other element established pursuant to part 69. Such a charge may be assessed on a per-line basis or as a percentage of interstate retail revenues, and at the option of the local exchange carrier it may be combined for billing purposes with other end user retail rate elements. A non-price cap local exchange carrier opting to assess the Universal Service end-user rate element on a per-line basis may apply that charge using the "equivalency" relationships established for the multi-line business PICC for Primary Rate ISDN service, as per § 69.153(d), and for Centrex lines, as per § 69.153(e).

20. Section 69.306(d) is revised by amending paragraph (d) as follows:

§ 69.306 Central office equipment (COE).

* * *

(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,

(1) 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; and

(2) Beginning January 1, 2002, for non-price cap local exchange carriers, line-side port costs shall be assigned to the Common Line rate element. Such amount shall be determined after any local switching support has been removed from the interstate Local Switching revenue requirement. Non-price cap local exchange carriers may use thirty percent of the interstate Local Switching revenue requirement, minus any local switching support, as a proxy for allocating line port costs to the Common Line category.

* * *

21. Section 69.307 is revised by amending paragraph (c) and adding a new paragraph (e) as follows:

§ 69.307 General support facilities.

* * *

(c)(1) Until June 30, 2002, for all local exchange carriers not subject to price cap regulation and for other carriers that acquire all of the billing and collection services that they provide to interexchange carriers from unregulated affiliates through affiliate transactions, from unaffiliated third parties, or from both of these sources, all other General Support Facilities investments shall be apportioned among the interexchange category, the billing and collection category, and Common Line, Local Switching, Information, Transport, and Special Access elements on the basis of Central Office Equipment, Information Origination/Termination Equipment, and Cable and Wire Facilities, combined.

(2) Beginning July 1, 2002, for all local exchange carriers that acquire all of the billing and collection services that they provide to interexchange carriers from unregulated affiliates through affiliate transactions, from unaffiliated third parties, or from both of these sources, all other General Support Facilities investments shall be apportioned among the interexchange category, the billing and collection category, and Common Line, Local Switching, Information, Transport, and Special Access elements on the basis of Central Office Equipment, Information Origination/Termination Equipment, and Cable and Wire Facilities, combined.

* * *

(e) Beginning July 1, 2002, for non-price cap local exchange carriers not covered by Section 69.307(c)(2), a portion of General purpose computer investment shall be apportioned to the billing and collection category on the basis of the Big Three Expense Factors allocator, defined in Section 69.2 of this Part, modified to exclude expenses that are apportioned on the basis of allocators that include General Support Facilities investment. The remaining General Support Facilities investments shall be apportioned among the interexchange category, the billing and collection category, and Common Line, Local Switching, Information, Transport, and Special Access Elements on the basis of Central Office Equipment, Information Origination/Termination Equipment, and Cable and Wire Facilities, combined.

22. Section 69.415 is added to read as follows:

§ 69.415 Reallocation of certain transport expenses.

(a) Beginning January 1, 2002, non-price cap local exchange carriers shall reallocate a portion of the costs otherwise assigned to the transport category to the common line, local switching, information, and special access elements.

(b) The amount to be reallocated is limited to the total revenues recovered through the interconnection charge assessed pursuant to section 69.124 for the 12-month period ending June 30, 2001.

(c) The reallocation of the amount in paragraph (b) shall be based on each access element's projected revenue requirement divided by the total revenue requirement of all the access elements, provided that:

(1) Local switching support shall not be included in the local switching category's projected revenue requirement, or in the total projected revenue requirement;

(2) A non-price cap local exchange carrier's universal service contribution shall not be included in the numerator or the denominator of the allocation formula;

(3) The amount determined in paragraph (b) shall be excluded from the transport revenue requirement and from the total projected revenue requirement for purposes of the allocation calculations; and

(4) The common line revenue requirement shall include long term support as provided in section 54.303 and, beginning July 1, 2002, shall include Interstate Common Line Support as provided in section 54.901.

23. Section 69.501 is revised by amending paragraphs (b), (c), and (e) and by adding a new paragraph (f) as follows:

§ 69.501 General.

* * *

(b) Until December 31, 2001, any portion of the Common Line element annual revenue requirement that is attributable to CPE investment or expense or surrogate CPE investment or expense shall be assigned to the Carrier Common Line element or elements.

(c) Until December 31, 2001, any portion of the Common Line element annual revenue requirement that is attributable to customer premises wiring included in IOT investment or expense shall be assigned to the Carrier Common Line element or elements.

* * *

(e) Until December 31, 2001, any portion of the Common Line element revenue requirement that is not assigned to Carrier Common Line elements pursuant to paragraphs (b) and (c) of this section shall be apportioned between End User Common Line and Carrier Common Line pursuant to § 69.502. Such portion of the Common Line element annual revenue requirement shall be described as the base factor portion for purposes of this subpart.

(f) Beginning January 1, 2002, the Common Line element revenue requirement shall be apportioned between End User Common Line and Carrier Common Line pursuant to section 69.502. The Common Line element annual revenue requirement shall be described as the base factor portion for purposes of this subpart.

24. Section 69.502 is revised by adding new paragraphs (d) and (e) as follows:

§ 69.502 Base factor allocation.

* * *

(d) Beginning July 1, 2002, the portion of per-line support that carriers receive pursuant to § 54.901; and

(e) Line port costs in excess of basic analog service pursuant to section 69.130.

25. Section 69.603 is revised by adding a new sentence immediately before the last sentence of paragraph (g) and a new sentence at the end of paragraph (h)(5) as follows:

§ 69.603 Association functions.

* * *

(g) * * * Beginning July 1, 2002, Interstate Common Line Support revenues shall be included in the allocation base for Category I.B expenses. * * *

(h) * * *
(5) Beginning July 1, 2002, Interstate Common Line Support shall be subject to this provision.

* * *

26. Section 69.609 is revised by adding a second sentence to paragraph (b) as follows:

§ 69.609 End User Common Line hypothetical net balances.

* * *

(b) * * * For purposes of this calculation, access revenues collected shall include any revenues foregone because of a voluntary reduction made pursuant to section 69.104(r)(7).

APPENDIX B

PARTIES FILING COMMENTS AND REPLY COMMENTS IN CC DOCKET NO. 00-256

Comments:

Commenters	Abbreviation
1. Ad Hoc Telecommunications Users Committee	Ad Hoc
2. Alabama Rural LECs	
3. Alaska, Regulatory Commission of	Alaska Commission
4. Alaska Rural Coalition	
5. Alaska Telephone Association	Alaska Tel. Assoc.
6. Arizona Local Exchange Carriers Association	Arizona LECs Assoc.
7. Association of Communications Enterprises	Assoc. of Comm’ns Enterprises
8. AT&T Corp.	AT&T
9. BellSouth Corp. and BellSouth Telecommunications, Inc.	BellSouth
10. California, People of and Public Utilities Commission	California Commission
11. Competitive Universal Service Coalition	
12. Evans Tel. Co., Humboldt Tel. Co., Kerman Tel. Co., Oregon-Idaho Utilities, Inc., Pine Tree Tel. & Telegraph Co., Pinnacles Tel. Co., The Ponderosa Tel. Co., The Siskiyou Tel. Co., The Volcano Tel. Co., War Tel. Co.	Evans Tel. Co., *et al.*
13. Florida Public Service Commission	Florida Commission
14. General Communication, Inc.	GCI
15. General Services Administration	GSA
16. Global Crossing North America, Inc.	Global Crossing
17. GVNW Consulting, Inc.	GVNW Consulting
18. ICORE, Inc.	ICORE
19. Illinois Commerce Commission	Illinois Commission
20. Independent Tel. & Telecommunications Alliance	ITTA
21. Indiana Utility Regulatory Commission	Indiana Commission
22. Innovative Telephone	
23. Interstate Telcom Group	
24. ITCs, Inc.	ITCs
25. Missouri Public Service Commission	Missouri Commission
26. Multi-Association Group	MAG
27. National Association of State Utility Consumer Advocates	NASUCA
28. New York State Department of Public	

Service	NYDPS
29. Ohio Telecommunications Industry Association	Ohio Telecom. Industry Assoc.
30. Plains Rural Independent Companies	Plains Rural Indep. Cos.
31. Qwest Communications International, Inc.	Qwest
32. Rate-of-Return Coalition	
33. Roseville Telephone Company	Roseville Tel. Co.
34. Rural Independent Competitive Alliance	Rural Indep. Competitive Alliance
35. Small Company Members of the Telephone Association of New England	New England Tel. Assoc., Small Co. Members
36. Sprint Corporation	Sprint
37. John Staurulakis, Inc.	John Staurulakis
38. Telcom Consulting Associates, Inc.	Telcom Consulting Assoc.
39. TDS Telecommunications Corp.	TDS
40. Texas, Public Utility Commission of	Texas Commission
41. Townes Telecommunications, Inc.	Townes Telecom.
42. Western Alliance	
43. Fred Williamson & Associates, Inc.	Fred Williamson & Assoc.
44. Wisconsin, Public Service Commission of	Wisconsin Commission
45. WorldCom, Inc.	WorldCom

Reply Comments:

<u>**Reply Commenters**</u>	<u>**Abbreviation**</u>
1. Ad Hoc Telecommunications Users Committee	Ad Hoc
2. Alaska, Regulatory Commission of	Alaska Commission
3. Alaska Rural Coalition	
4. Alaska, State of	State of Alaska
5. Alliance of Independent Rural Telephone Companies	Alliance of Indep. Rural Tel. Cos.
6. AT&T Corp.	AT&T
7. California, People of and Public Utilities Commission	California Commission
8. Dunkirk and Fredonia Tel. Co.	
9. Excel Communications, Inc.	Excel Comm’ns
10. General Services Administration	GSA
11. GVNW Consulting, Inc.	GVNW Consulting
12. Hawaii, State of	State of Hawaii
13. Innovative Telephone	
14. Interstate Telcom Group	
15. Iowa Utilities Board	
16. Minnesota Independent Coalition	Minnesota Indep. Coalition
17. Multi-Association Group	MAG
18. Plains Rural Independent Companies	Plains Rural Indep. Cos.
19. Puerto Rico Telephone Company, Inc.	Puerto Rico Tel. Co.
20. Rate-of-Return Coalition	

21. Ronan Telephone Company	Ronan Tel. Co.
22. Ronan Telephone Consumer Advisory Committee	Ronan Tel. Consumer Advisory Committee
23. Roseville Telephone Company	Roseville Tel. Co.
24. Rural Independent Competitive Alliance	Rural Indep. Competitive Alliance
25. John Staurulakis, Inc.	John Staurulakis
26. Summit Tel. Co., Inc.	Summit Tel. Co.
27. Telcom Consulting Associates, Inc.	Telcom Consulting Assoc.
28. TDS Telecommunications Corp.	TDS
29. Verizon Communications Inc.	Verizon
30. Western Alliance	
31. WorldCom, Inc.	WorldCom
32. Wyoming Public Service Commission	Wyoming Commission

SEPARATE STATEMENT OF CHAIRMAN MICHAEL K. POWELL

Re: Second Report and Order and Further Notice of Proposed Rulemaking in CC Docket No. 00-256, Fifteenth Report and Order in CC Docket No. 96-45, and Report and Order in CC Docket Nos. 98-77 and 98-166

By this action, the Commission takes another important step forward in its efforts to reform our access charge and universal service regulatory regimes to make them more consistent with the mandate for competition codified in the 1996 Telecommunications Act. I write separately to clarify a few points and to underscore my support for this action, which flows from the ample record developed in response to the Multi-Association Group (MAG) proposal for reforming rural access charges, as well as from notices and orders previously adopted by the Commission.

As I have stated on other occasions, I believe firmly that the goal of our access and universal service reforms should be to bring the benefits of competition and greater choice to consumers, while ensuring that all Americans continue to have access to affordable and reasonably comparable telephone service. The social and economic imperative of reaching this goal is nowhere more pronounced than with respect to those who live in the rural and high-cost areas served by many rate of return LECs.

Throughout the extensive proceedings that led to this decision, the Commission has consistently maintained an open and transparent process, and this *Order* reflects careful consideration of all comments and suggestions received. As early as 1997, the Commission initiated a comprehensive review of interstate access charges and universal service. The Commission's earliest actions in this regard reformed access charges for price cap incumbent LECs, *i.e.*, the largest incumbents.

The Commission has always recognized, however, that "one size does not fit all" when addressing the needs of rural and small companies. Therefore, the Commission decided to handle rural access reform separately from access reform for the larger carriers. This separate treatment has allowed the Commission to focus on both the specific needs of rural and small carriers and commenters' suggestions on how best to address those needs.

Even within the rural LEC component of our access reform effort, the Commission's process has been extensive. For example:

- In 1998, the Commission issued a Notice of Proposed Rulemaking which generated an extensive record regarding proposals for rural access reform. Thus, the Commission began its deliberations regarding rural access reform more than three years ago, and more than two years before the MAG proposal was even submitted to us.

- In early 2001, the Commission issued another Notice to expand the record further by seeking comment on whether the MAG proposal for access reform should be adopted in whole, in part, or not at all. The comment period for this Notice closed seven months ago.

- Over the past seven months, the Commission has carefully evaluated the extensive responses to its 1998 Notice, as well as comments on the MAG proposal from several dozen diverse parties. These parties have included incumbent rate of return LECs, state commissions, interexchange carriers, competitive LECs, consumer groups and their representatives.

- Additionally, the Commission has met repeatedly with parties including MAG and made note of industry concerns with regard to access reform precedents and policy.

Throughout the months and years the Commission has devoted to rural access charge reform, numerous parties representing a variety of interests have urged us to press forward expeditiously. Many of these parties were concerned, as I am, that we not subject communities served by rural LECs to the same regulatory barriers to competition that we struggled to remove in the context of price cap access reform.

Now that all interested parties have had a substantial opportunity to comment on the MAG proposal as well as on prior proposals, the time has come for the Commission to proceed with access charge and universal service reform for rate of return carriers. I applaud the MAG industry group for its efforts to bring a plan to the Commission for its consideration. The Commission's duty, however, is to exercise independent judgment that advances the *public* interest, rather than the interests of one side or the other. In doing so, we have declined to adopt the MAG plan in its entirety, taking account of other important interests and concerns.

Thus, the approach we adopt here incorporates major features of the MAG proposal, while addressing valid concerns raised by the extensive input from interested commenters. It represents a cautious approach that would rationalize the rate structure and convert identifiable implicit subsidies in access charges to explicit universal service support, without endangering overall revenues for rate of return carriers. Consequently, this approach should enable incumbent carriers and competitors to compete on an equal footing in rural areas and increase incentives for long distance carriers to compete for customers in rural areas.

Further, I believe the approach we take here will promote regulatory stability for small local telephone companies, and encourage investment in rural America, by creating a new, portable universal service support mechanism. This mechanism is intended to ensure that changes in the access rate structure do not affect small carriers' overall recovery of their interstate access costs.

Resolving issues this complex requires tough choices, which cannot continually be put off and which are rarely greeted with unanimous popular acclaim. Yet the Commission's role is not to play to its various audiences but to make these tough choices, guided by principle, the record and our best judgment. It is my conviction that we have, in performing this role, assiduously considered and balanced the input of a variety of interested parties that leads me to support this *Order* and the enormous hard work that my colleagues and our staff have invested in its fruition.

SEPARATE STATEMENT OF COMMISSIONER KEVIN J . MARTIN

Re: Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers, Second Report and Order and Further Notice of Proposed Rulemaking, CC Docket No. 00-256

I write separately to explain my reservations with this Order and why I nevertheless join in approving it. I am sympathetic to the calls of many rural carriers to seek more comment before moving forward on this item. Having seen the Commission fail to reach these issues for years despite the pleas of the carriers, it seems somewhat ironic that the Commission feels it necessary to do so now, when the carriers would like the Commission to wait.

Nevertheless, after careful consideration, I am convinced that growing disparities between the access rates of rural, rate-of-return and other, price cap carriers should be addressed sooner rather than later. These disparities can create problems in conjunction with our rate averaging and rate integration policies, which require IXCs to charge rates in rural and high cost areas that are no higher than rates they charge in urban areas and to charge comparable rates in each State. *See* 47 U.S.C. § 254(g); *Policy and Rules Concerning the Interstate, Interexchange Marketplace*, Report and Order, 11 FCC Rcd 9564, ¶¶ 9, 20, 52. As a result, IXCs that serve rural and high cost areas must charge higher rates to all of their customers than IXCs that do not serve such areas. As rate disparities grow, the pressure for IXCs to stop serving rural and high cost areas also grows; IXCs will either lose money serving these rural areas or will be forced to charge higher rates in low cost areas than their competitors. Without Commission action, I fear that these rate disparities may lead IXCs to exit rural and high cost markets altogether, causing great harm to rural America. This Order, in reforming the access rate structure of largely rural rate-of-return carriers, reduces these growing disparities and begins to address this problem.

I also note that I have some concerns with the Commission's policy – adopted long before this Order – of using universal support as a means of creating "competition" in high cost areas. I am hesitant to subsidize multiple competitors to serve areas in which costs are prohibitively expensive for even one carrier. This policy may make it difficult for any one carrier to achieve the economies of scale necessary to serve all of the customers in a rural area, leading to inefficient and/or stranded investment and a ballooning universal service fund. It is thus with real pause that I sign on to an Order that may further this policy.

I will continue to examine these issues as well as the other concerns raised regarding the impact that our policies may have on rural America. And, in that vein, I am committed to evaluating these issues and remain receptive to making significant changes as we move forward.

DISSENTING STATEMENT OF
COMMISSIONER MICHAEL J. COPPS

Re: Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers

Notwithstanding the tremendous importance of addressing access charge reform for rural carriers, I respectfully dissent from today's order. While we must move forward as expeditiously as possible to complete this process, it is dangerous to proceed prematurely to an order before we know the full implications of our actions. Rural carriers, consumer advocates, and state commissions, among others, express great apprehension about the impact of today's decision. I find no clear consumer benefits from moving ahead before we get all of the facts and air all of the concerns. In sum, I fear that we are outdriving our headlights.

I believe the more prudent course of action would have been to seek comment on the new proposal the Commission adopts today in order to ensure that it achieves the objectives Congress laid out in the Telecommunications Act of 1996.

A core principle of the 1996 Act is that all Americans should have access to reasonably comparable services at reasonably comparable rates. At the same time, given the goal of competition in all telecommunications markets, Congress directed us to establish a universal service support mechanism that is explicit and sufficient in a competitive market. As we restructure rates and make explicit the hidden subsidies in access charges, we must recognize that these implicit subsidies were used to finance affordable services.

It is not easy to work out the details of a new regime. Last year, rural carriers and their associations proposed a comprehensive plan to resolve numerous issues facing rural carriers, including reform of access charges and universal service support, and a new incentive form of regulation. This proposal became known as the Multi-Association Group (MAG) plan. Other carriers including IXCs and wireless carriers submitted their own proposal to address certain of these issues.

The majority today takes up a piece of the comprehensive MAG plan – access charge reform – but adopts significant modifications to the proposals submitted to the Commission. Some argue that it would be an extraordinary measure to seek additional comment on the Commission's proposals. Given the breadth of concerns that have been raised, and the lack of opportunity for affected parties to analyze this new proposal, I think it would be extraordinary not to seek additional comment.

Many parties have raised significant concerns. We have heard from rural carriers concerned about the impact of today's action on telecommunications investment in rural areas, including broadband investment; from state commissions concerned about the harmful impact on universal service support mechanisms; and from consumer advocates concerned about increased consumer rates that will likely result from this order. This being the case, and when the task before us is so complicated, I believe in this instance it is incumbent on us to err on the side of caution to ensure that the actions we take are wise rather than merely expeditious.

I do not advocate delay lightly. But were we to put this proposal out for comment and continue to give these issues the high priority they deserve, we could address all these concerns and adopt a final order in a few months -- in time to implement access charge reform by July 1, which is, I would point out, the *same date* for implementation of the new support mechanism contained in today's order. The cost of gathering more information would therefore be minor, and the benefits multiple.

As it stands, however, without airing and receiving comments on the contours of the reforms adopted today, I have serious concerns that we do not understand the full impact of today's decision on rural America. For rural carriers, access charges and universal service comprise the substantial majority of their revenue stream. The goal of access charge reform must be not only to remove, and make explicit, the implicit subsidies in access charges, but must also provide the stability necessary for investment in rural America. It is essential that any regime we adopt increases certainty so that rural carriers can plan for the future and undertake necessary investment to modernize the telecommunications infrastructure in their communities. I am concerned by claims that this order will, to the contrary, increase uncertainty for rural carriers, impeding infrastructure investment and broadband deployment.

I am further concerned about the effect of this order on consumer rates, particularly for those who live in rural areas. As we transition to a new access charge regime, it is imperative that we prevent upward pressure on rates in high-cost areas. Rural consumers will only benefit when we establish an economically rational mechanism that will promote not only the Act's objective of competition, but also its goal of universal service.

The Commission has already made substantial progress towards ensuring that universal service and access charge regimes have been adapted to the changing marketplace. We have adopted universal service reforms for both rural and non-rural carriers. And we have identified, and made explicit, the subsidies embedded in access charges for price cap carriers in order to reduce distortions in the marketplace that serve as impediments to competition. In this instance, I believe the Commission needs more information to ensure that the action we take is in the public interest. The public interest can be well and faithfully served if we accord this far-reaching new proposal the stakeholder input it deserves. This can be done quickly and with much more consensus at the end of the process than we will otherwise have today.