

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

In the Matter of)	
)	
Multi-Association Group (MAG) Plan for)	CC Docket No. 00-256
Regulation of Interstate Services of Non-Price)	
Cap Incumbent Local Exchange Carriers and)	
Interexchange Carriers)	
)	
Federal-State Joint Board on Universal)	CC Docket No. 96-45
Service)	
)	

**REPORT AND ORDER AND
 SECOND FURTHER NOTICE OF PROPOSED RULEMAKING**

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By the Commission: Commissioners Copps and Adelstein issuing separate statements.

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I. INTRODUCTION

1. Today, we take additional steps to provide rate-of-return carriers greater flexibility to respond to changing marketplace conditions. In the *MAG Order and Further Notice*, the Commission reformed interstate access charges and universal service and sought comment on various other issues affecting rate-of-return carriers.¹ In this order, we resolve several issues on which the Commission sought comment in the *MAG Further Notice*.² In particular, we modify the “all-or-nothing” rule to permit rate-of-return carriers to bring recently acquired price cap lines back to rate-of-return regulation. In this way, we reduce the administrative costs and uncertainties of such acquisitions for rate-of-return carriers. We also grant rate-of-return carriers the authority immediately to provide geographically deaveraged transport and special access rates, subject to certain limitations. With this additional pricing flexibility, rate-of-return carriers will be able to set more economically efficient rates and respond to competitive entry. Finally, we merge Long Term Support (LTS) with Interstate

¹ *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, 16 FCC Rcd 19613 (2001) (*MAG Order or MAG Further Notice, as appropriate*) [subsequent history omitted]. We defer to a later order consideration of the outstanding petitions for reconsideration of the *MAG Order*.

² Appendix B lists the parties filing comments and replies on the *MAG Further Notice*, as well as the shortened name used for each party.

Common Line Support (ICLS). This will make the universal service mechanisms simpler and more transparent, while ensuring that rate-of-return carriers maintain existing levels of universal service support.

2. We also initiate a further notice of proposed rulemaking seeking comment on two specific plans that propose establishing optional alternative regulation mechanisms for rate-of-return carriers. In conjunction with the consideration of those alternative regulation proposals, we also seek comment on modifications that would permit a rate-of-return carrier to adopt an alternative regulation plan for some study areas, while retaining rate-of-return regulation for other of its study areas. Consideration of these industry proposals furthers our commitment to investigating alternative regulatory methods that could benefit both rate-of-return carriers and their customers.

II. BACKGROUND

A. MAG Order

3. In implementing the provisions of the Telecommunications Act of 1996 (1996 Act),³ 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. 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.⁴ In 1998, the Commission created a separate docket to undertake such review.⁵ 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.

4. In October 2000, four incumbent local exchange carrier (LEC) associations submitted the Multi-Association Group (MAG) plan, a proposal addressing numerous issues facing rate-of-return carriers, including access charge reform and universal service support.⁶ After extensive comment,⁷ the Commission released the *MAG Order* on November 8, 2001,

³ 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.*

⁴ 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, 16126-27, paras. 330-332 (1997) (*Access Charge Reform Order*) (subsequent history omitted).

⁵ 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, 14240, paras. 3-4 (1998) (*1998 Notice*).

⁶ Petition for Rulemaking of the LEC Multi-Association Group, RM No. 10011, filed Oct. 20, 2000.

⁷ In January 2001, 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. *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- (continued....)

which modified the Commission's rules to reform the interstate access charge and universal service support system for incumbent local exchange carriers subject to rate-of-return regulation. Specifically, the *MAG Order* sought to foster efficient competition and efficient pricing in the market for access services by rationalizing the access rate structure and driving per-minute rates towards lower, more cost-based levels, while furthering universal service goals.⁸ The Commission aligned the interstate access rate structure more closely with the manner in which costs are incurred, and created a new universal service support mechanism, Interstate Common Line Support, to replace the implicit support in interstate access charges with explicit support that is portable to all eligible telecommunications carriers (ETCs).⁹ ICLS ensures that rate-of-return carriers will recover their common line revenue requirements, including their authorized rate of return, while continuing to provide their customers with quality, affordable service.¹⁰

B. Further Notice of Proposed Rulemaking

5. In the Further Notice of Proposed Rulemaking, attached to the *MAG Order*, the Commission solicited further comment on the incentive plan proposed by rate-of-return carriers and how it might be modified to provide incentives for cost efficiency gains by rate-of-return carriers that would benefit consumers through lower interstate rates and improved services. The Commission also requested comment on additional pricing flexibility measures for rate-of-return carriers and on the MAG's proposed changes to the Commission's "all-or-nothing rule." It also solicited comment on merging the LTS Mechanism into ICLS.

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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, 461, para. 3 (2001) (*MAG Notice*).

⁸ See *MAG Order*, 16 FCC Rcd at 19616, para. 1.

⁹ See *id.* at 19617, para. 3.

¹⁰ In implementing these general goals, the Commission took the following specific steps. It: (1) adopted the MAG proposal to increase the Subscriber Line Charge (SLC) caps for rate-of-return carriers to the levels established for price cap carriers; (2) modified the Commission's rules to allow SLC deaveraging; (3) set the inefficient Carrier Common Line Charge (CCL) for phase-out as of July 1, 2003, when SLC caps are scheduled to reach their maximum levels; (4) shifted the non-traffic sensitive costs of local switch line ports to the common line category, and reallocated the remaining costs contained in the Transport Interconnection Charge (TIC) among all the access categories; (5) declined to prescribe a single, target rate for per-minute charges; (6) created ICLS to convert implicit support in the access rate structure to explicit support that is available to all ETCs; (7) rejected 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; (8) streamlined the rules for the introduction of new switched access services by extending to rate-of-return carriers rules similar to those governing price cap carriers; and (9) terminated the pending proceeding for prescription of the authorized rate-of-return, which was set at 11.25 percent in 1990. A detailed background on interstate access charges, universal service and rate-of-return regulation is set forth in the *MAG Order*. *MAG Order*, 16 FCC Rcd at 19622-30, paras. 16-32.

III. REPORT AND ORDER ON FURTHER NOTICE OF PROPOSED RULEMAKING

A. All-or-Nothing Rule

1. Background

6. Section 61.41 of the Commission's rules 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 transaction.¹¹ 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.¹² Furthermore, if an individual rate-of-return carrier or study area converts to price cap regulation, all of its affiliates or study areas must also convert to price cap regulation, except for its average schedule affiliates.¹³ Finally, LECs that become subject to price cap regulation are not permitted to withdraw from such regulation or participate in NECA tariffs.¹⁴ These regulatory requirements collectively are referred to as the all-or-nothing rule, and were affirmed by the United States Court of Appeals for the D.C. Circuit.¹⁵

7. The all-or-nothing rule addresses two concerns about mergers and acquisitions involving price cap companies.¹⁶ First, a LEC could attempt to "game the system" by switching back and forth between rate-of-return regulation and price cap regulation.¹⁷ 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 that 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.¹⁸ The second concern motivating the all-or-nothing rule is that a LEC with affiliates under both forms of regulation could attempt to shift costs from its price cap affiliate to

¹¹ 47 C.F.R. § 61.41(c)(1).

¹² 47 C.F.R. § 61.41(c)(2).

¹³ 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.").

¹⁴ 47 C.F.R. §§ 61.41(d), 61.41(a)(3).

¹⁵ See *National Rural Telecom Assoc. v. FCC*, 988 F.2d 174 (D.C.Cir. 1993).

¹⁶ See *Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Order on Reconsideration, 6 FCC Rcd 2637, 2706, para. 148 (1991) (*LEC Price Cap Reconsideration Order*); see also *ALLTEL Corporation Petition for Waiver of Section 61.41 of the Commission's Rules and Applications for Transfer of Control*, Memorandum Opinion and Order, 14 FCC Rcd 14191, 14199, para. 18 (1999) (*ALLTEL Order*).

¹⁷ See *LEC Price Cap Reconsideration Order*, 6 FCC Rcd at 2706, para. 148.

¹⁸ *Id.*

its rate-of-return affiliate.¹⁹ This would allow the rate-of-return 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.²⁰ Despite these concerns, however, the Commission has waived the all-or-nothing rule where it has found that petitioners have established good cause and that waiver will serve the public interest.²¹

8. In the *MAG Further Notice*, the Commission deferred action on any reforms, including those proposed by the MAG, of the all-or-nothing rule, while seeking additional comment on the rule and on issues concerning incentive regulation and pricing flexibility.²² We sought comment generally on whether our regulatory policy, of preventing affiliated carriers from operating under different systems of regulation, is still serving the public interest; on what circumstances and conditions that prompted these rules in the past may have changed; and on why these rules should be retained, repealed or modified.²³ Specifically, we asked whether customers would be better off, and competition better served, with or without the rules.²⁴ We sought comment on the extent to which an increasingly competitive environment should affect any decision to retain or eliminate the rules.²⁵ We also sought comment on whether the all-or-nothing restrictions currently are necessary to prevent cost shifting and gaming.²⁶ Specifically, we asked whether the protection the rule provides against cost shifting and gaming is outweighed by regulatory efficiency gains that could result from eliminating the all-or-nothing requirements.²⁷ We sought comment on the extent to which alternative accounting and reporting

¹⁹ *Id.*

²⁰ *Id.*

²¹ 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 unsuitable for ALLTEL's entire operation).

²² See *MAG Further Notice*, 16 FCC Rcd at 19720 para. 265.

²³ *Id.* at 19720 para. 266.

²⁴ *Id.* at 19720-21 para. 267.

²⁵ *Id.*

²⁶ *Id.* at 19722-24 para. 270.

²⁷ *Id.*

rules could substantially reduce cost shifting concerns.²⁸ We further asked whether it would be reasonable to impose more stringent reporting requirements on carriers that seek waivers of the all-or-nothing requirements.²⁹

9. Supporting the elimination of the all-or-nothing rule, rate-of-return LECs argue that the rule discourages LEC competition, innovation and expansion by complicating transactions between carriers.³⁰ They also argue that sufficient safeguards are in place to protect against the abuses envisioned by the rule,³¹ and allege that there is no evidence of cost-shifting abuses in the record.³² Commenters also argue that the rule is routinely waived.³³ NTCA and ICORE specifically advocate elimination of the rule for all rate-of-return carriers that seek to keep all of their study areas under rate-of-return regulation.³⁴ On the other hand, major IXCs, the CUSC and the General Services Administration (GSA) support retention of the all-or-nothing rule, arguing that the same incentives for LECs to shift costs exist today as when the rule was adopted³⁵ and that existing safeguards are insufficient to detect cost shifting,³⁶ especially since accounting requirements are increasingly relaxed.³⁷

²⁸ *Id.*

²⁹ *Id.*

³⁰ ITTA Comments at 2-3; ICORE Comments at 14-15.

³¹ The commenters argue that the following safeguards are sufficient to eliminate the all-or-nothing rule: *tariff processes* (ITTA Comments at 5, Verizon Comments at 5, PRTC Comments at 11, ALLTEL Comments at 31-32), *accounting and cost allocation rules* (Verizon Comments at 5, PRTC Comments at 10, NRTA Comments at 11-12, ALLTEL Comments at 31, ICORE Comments at 15, Valor Reply Comments at 5), *affiliate transaction rules* (PRTC Comments at 10, NRTA Comments at 11-12, ALLTEL Comments at 30-31), *jurisdictional separations rules* (Verizon Comments at 5, PRTC Comments at 10, ALLTEL Comments at 30-31), *reporting requirements* (Verizon Comments at 5, PRTC Comments at 10-11, NRTA Comments at 11-12), *nonstructural mechanisms including complaint processes* (NRTA Comments at 11-12, Valor Reply Comments at 5) and *state regulators* (NRTA Comments at 11-12, ALLTEL Comments at 31-32).

³² NRTA Comments at 10-11, Valor Reply Comments at 4. Valor contends that carriers receiving a waiver so far have not misbehaved. Valor Reply Comments at 4.

³³ PRTC Comments at 10, NRTA Comments at 9-10. ALLTEL adds that, as price cap LECs seek to divest themselves of small exchanges, waiver requests will increase even more. ALLTEL Comments at 28-29.

³⁴ NTCA Comments at 7-8; ICORE Comments at 13-15.

³⁵ AT&T Comments at 16.

³⁶ *Id.* at 17, GSA Comments at 8. AT&T argues that because separations and tariff submissions are not based on independent audits, but rather on LEC reporting, they are an insufficient guard against abuses. AT&T Reply Comments at 14. AT&T further argues that detection of cost-shifting abuses through examination of LEC tariff filings is necessarily delayed because LECs make those filings only on a biannual basis. AT&T Reply Comments at 14.

³⁷ WorldCom Comments at 4.

2. Discussion

10. We modify the all-or-nothing rule to permit a limited exception, as proposed by NTCA and ICORE,³⁸ when a rate-of-return carrier acquires lines from a price cap carrier and elects to bring the acquired lines into rate-of-return regulation.³⁹ The rule, as amended, will permit the acquiring carrier to convert the price cap lines back to rate-of-return regulation. We defer further action on the all-or-nothing rule until we have reviewed the record compiled in response to the further notice that we also issue today.⁴⁰

11. The current record of this proceeding is insufficient for us to decide today on whether or how to adopt additional reforms of the all-or-nothing rule. The parties supporting the rule typically assert, without specific examples, that relaxation of the rule will result in cost-shifting, which other safeguards will be unable to detect.⁴¹ On the other hand, rate-of-return carriers assert that the rule raises transaction costs, and they argue that the rule is unnecessary because other, existing safeguards are capable of detecting the cost-shifting at which the rule is aimed.⁴² In light of the relatively uninformative record on these issues, we largely defer action on the all-or-nothing rule until we have reviewed the additional comments on this issue that we solicit today in our further notice. To provide immediate relief to rate-of-return carriers, however, we think it appropriate at this time to create a limited exception to the all-or-nothing rule.

12. As we note above, the Commission adopted the all-or-nothing rule in order to avoid two specific problems that it envisioned. First, the Commission sought to prevent a carrier from shifting costs from its price cap affiliate to its rate-of-return affiliate, recovering those costs through the higher, cost-based rates of the non-price cap affiliate and increasing the profits of the price cap affiliate because of its reduced costs. Second, the Commission intended to prevent carriers from gaming the system by switching back and forth between the two different regulatory regimes. At a minimum, the record currently supports reform of our all-or-nothing

³⁸ NTCA Comments at 7-8; ICORE Comments at 13-15.

³⁹ In the alternative, and until such time as the all-or-nothing rule may be further revised, carriers can continue to petition for waiver of the all-or-nothing rule so that they may operate affiliates under both rate-of-return and price cap regulation.

⁴⁰ Additionally, all outstanding interim waivers of the all-or-nothing rule that depend on our decision in this proceeding shall continue in effect until we issue a final order on this issue. *See, e.g., Valor Telecommunications, LLC Petition for Waiver of Section 61.41 of the Commission's Rules*, Memorandum Opinion and Order, 17 FCC Rcd 25544 (2002); *ALLTEL Corporation Petition for Waiver of Section 61.41, ALLTEL Corporation Petition to Extend Interim Waiver of Section 61.41 of the Commission's Rules, CenturyTel, Inc. and CenturyTel of Alabama, LLC Petition for Waiver of Sections 61.41(b) and (c) of the Commission's Rules, CenturyTel, Inc. and CenturyTel of Missouri, LLC Petition for Waiver of Sections 61.41(b) and (c) of the Commission's Rules, Puerto Rico Telephone Company Petition for Waiver of Section 61.41 of the Commission's Rules or, in the Alternative, Request for Waiver of Section 54.303(a) of the Commission's Rules*, Memorandum Opinion and Order, 17 FCC Rcd 27694 (2002).

⁴¹ *See supra* note 35 and accompanying text.

⁴² *See supra* notes 30-31 and accompanying text.

rule when a rate-of-return carrier acquires price cap lines but intends to operate all of its lines, including the newly acquired price cap lines, under rate-of-return regulation.

13. When a rate-of-return carrier seeks to return acquired price cap lines to rate-of-return regulation, the problems that the all-or-nothing rule sought to prevent do not exist, or can be addressed in a less burdensome way. Because the carrier wishes to have all of its lines be subject to rate-of-return regulation, there can be no danger of cost shifting between price cap and non-price cap affiliates. Similarly, a rate-of-return carrier in this position is not necessarily seeking to game the system by moving back and forth between different regulatory regimes. However, recognizing the possibility that the acquiring rate-of-return carrier could later seek to return to price cap regulation, thereby potentially gaming the system, we conclude that once a rate-of-return carrier brings acquired price cap lines into rate-of-return regulation, it may not for five years elect price cap regulation for itself, or by any means cause the acquired lines to become subject to price cap regulation, without first obtaining a waiver. We believe that this restriction responds to the concerns underlying the adoption of the all-or-nothing rule, consistent with our policy goals in administering the two separate systems of rate regulation, while not requiring that the election be unnecessarily irreversible, as proposed by commenters.⁴³ We do not restrict the number of lines that may be acquired by a rate-of-return carrier and returned to rate-of-return regulation because the risks of abuse are very small and the administrative benefits are significant. We have granted waivers of the all-or-nothing rule involving as many as 285,000 lines⁴⁴ with no discernible adverse effects with respect to the consequences that the all-or-nothing rule was designed to preclude, and no significant impact on the Commission's universal service programs.⁴⁵ We believe that most acquisitions of price cap lines by rate-of-return carriers will not exceed this level, and thus find no reason to believe that any adverse effects will result in the future. It is also important to note, however, that but for the limited exception we create above, we do not otherwise modify rule 61.41(d), which provides that once a carrier is subject to price cap regulation, it may not subsequently return to rate-of-return regulation.

14. We note that several commenters representing small and mid-sized incumbent LECs advocate reform of the all-or-nothing rule, citing the additional transaction costs and uncertainty that the rule creates for small, typically rural, carriers that seek to acquire lines from

⁴³ See Verizon Comments at 5 (proposing acquired carrier's election to rate-of-return regulation be irreversible, barring waiver for good cause shown); cf. Valor Comments at 7-8 ("a limited ability to change regulatory mechanisms is necessary to ensure that future investment in rural infrastructure and deployment of advanced services for rural communities is not unduly impeded").

⁴⁴ See *ALLTEL Order*, 14 FCC Rcd at 14192, para. 2.

⁴⁵ The acquired lines will be included by the acquiring rate-of-return carrier in calculating its common line revenue requirement, and the rate-of-return carrier will thus be eligible to receive ICLS. 47 C.F.R. § 54.902. Although this may increase universal service support through the ICLS mechanism, our experience reviewing requests for study area waivers indicates that the migration of lines is unlikely to significantly increase universal service funding. We note that, in most cases, parties transferring lines from a price cap carrier to a rate-of-return carrier will still be required to demonstrate a minimal impact on universal service in order to obtain the necessary study area waiver. A study area waiver would not be required if a price cap carrier transferred an entire study area to a rate-of-return carrier holding company that did not have an existing study area in that state.

price cap carriers.⁴⁶ By creating an exception to the rule for the conditional conversion of acquired price cap lines to rate-of-return regulation, we also address this concern and reduce the cost and uncertainty imposed by our rules.⁴⁷

15. We note that the carriers involved in a merger or acquisition must coordinate to ensure that, as of the effective date of the transaction, their respective tariffs reflect the services being offered after the merger or acquisition. We also note that price cap carriers are required to adjust their price cap indices to reflect the removal of the transferred access lines.⁴⁸

B. Pricing Flexibility

1. Background

16. When it adopted the original 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.⁴⁹ Since that time, the Commission has increased incumbent LECs' pricing flexibility and ability to respond to the advent of competition in the interstate exchange access market. In the *Special Access and Switched Transport Expanded Interconnection Orders*, the Commission introduced a system of density pricing zones that permits a rate-of-return carrier to deaverage geographically its rates for special access and switched transport services, provided that they can demonstrate the presence of "operational" special access and switched transport expanded interconnection arrangements and that there is at least one competitor in the study area.⁵⁰ The density zone pricing rules permit rate-of-return

⁴⁶ ITTA Comments at 2-3; ICORE Comments at 14-15.

⁴⁷ The LECs involved in the transaction would still need to obtain any required study area waiver. Similarly, an average schedule rate-of-return LEC would need to obtain a waiver to operate the acquired lines as part of an average schedule company.

⁴⁸ See 47 C.F.R. § 61.45(d); *Price Cap Performance Review for Local Exchange Carriers*, CC Docket No. 94-1, First Report and Order, 10 FCC Rcd 8961, 9100-08, paras. 321-334 (1995).

⁴⁹ 47 C.F.R. § 69.3(e)(7). A study area is a geographical segment of a carrier's telephone operations. Generally, a study area corresponds to a carrier's entire service territory within a state. Thus, carriers operating in more than one state typically have one study area for each state, and carriers operating in a single state typically have a single study area. Carriers perform jurisdictional separations at the study area level. For jurisdictional separations purposes, the Commission adopted a rule freezing study area boundaries effective November 15, 1984. Part 36 of the Commission's Rules, 47 C.F.R., Part 36, Appendix-Glossary, definition of "Study Area." See MTS and WATS Market Structure, Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, CC Docket Nos. 78-72 and 80-286, 49 Fed. Reg. 48325 (Dec. 12, 1984), adopted by the Commission, 50 Fed. Reg. 939 (Jan. 8, 1985).

⁵⁰ 47 C.F.R. § 69.123. See also *Expanded Interconnection with Local Telephone Company Facilities, Amendment of the Part 69 Allocation of General Support Facility Costs*, CC Docket Nos. 91-141 and 92-222, Report and Order and Notice of Proposed Rulemaking, 7 FCC Rcd 7369, 7454-56 (1992) (*Special Access Expanded Interconnection Order*). Section 69.123(a) of the Commission's rules allows rate-of-return carriers to establish traffic density pricing zones in study areas in which at least one interconnector has taken a cross-connect. See 47 C.F.R. § 69.123(a). "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.

carriers to establish a "reasonable" number of zones, but the Commission has noted in the past that "LECs seeking to establish more than three zones shall be subject to increased scrutiny and must carefully justify the number of zones proposed in their density pricing zone plan."⁵¹ In addition, rate-of-return LECs must show that density zones reflect cost characteristics such as traffic density or other measures of traffic passing through particular central offices.⁵²

17. The Commission also permitted incumbent LECs to offer volume and term discounts for switched transport services upon specific competitive showings. Thus, LECs may offer such discounts in a study area upon demonstration of one of the following conditions: (1) 100 DS1-equivalent switched cross-connects⁵³ 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. Rate-of-return carriers are prohibited from offering interstate access services pursuant to individual customer contracts.

18. 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.⁵⁴ 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.⁵⁵ Price cap carriers were also allowed to introduce new services on a streamlined basis.⁵⁶

19. 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 competitors have made irreversible, sunk investments in the facilities needed to provide the

⁵¹ *Special Access Expanded Interconnection Order*, 7 FCC Rcd at 7454, n.413.

⁵² *Id.* at 7455, para. 179.

⁵³ A cross-connect is 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.

⁵⁴ The Commission also eliminated the requirement that price cap carriers file their zone plans prior to filing a tariff.

⁵⁵ 47 C.F.R. § 69.123(b)(1); *Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Interexchange Carrier Purchases of Switched Access Services Offered by Competitive Local Exchange Carriers, and Petition of U S West Communications, Inc. for Forbearance from Regulation as a Dominant Carrier in Phoenix, Arizona MSA*, Fifth Report and Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd 14221, 14254, para. 62 (1999) (*Pricing Flexibility Order*).

⁵⁶ 47 C.F.R. § 69.4(g); *Pricing Flexibility Order*, 14 FCC Rcd at 14239-43, paras. 37-44.

services at issue.⁵⁷ 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.

20. 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.⁵⁸ 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.⁵⁹ The Commission eliminated the low-end adjustment mechanism for price cap carriers qualifying for and electing to exercise either Phase I or Phase II pricing flexibility.⁶⁰

21. The Commission has permitted both price cap and rate-of-return carriers to deaverage their subscriber line charges.⁶¹ LECs are also permitted to disaggregate their high-cost loop and ICLS universal service support.⁶² We also streamlined the requirements for rate-of-return carriers to introduce new services in the *MAG Order*.⁶³

22. Recognizing the importance of pricing flexibility as competition develops in the service areas of rate-of-return carriers, the Commission sought comment in the *MAG Further Notice* on the types, degree, and timing of pricing flexibility that should be made available to rate-of-return carriers in addition to the pricing flexibility already available to them under current rules.⁶⁴ The Commission focused on three types of pricing flexibility: geographic deaveraging within a study area; volume and term discounts; and contract pricing.

23. Several parties filed comments on the pricing flexibility issues, representing a variety of customer and industry perspectives. Many of the comments address pricing flexibility and triggers in a very general manner, without differentiating meaningfully among the types of pricing flexibility and a trigger that might be associated with it. Rate-of-return carriers and their trade associations support geographic deaveraging, volume and term discounts, and contract

⁵⁷ For the specifics of the triggers required, *see generally Pricing Flexibility Order*, 14 FCC Rcd at 14265-87, paras. 81-121.

⁵⁸ For the specifics of the triggers required, *see generally id.* at 14296-302, paras. 141-157.

⁵⁹ 47 C.F.R. § 69.709(c); *Pricing Flexibility Order*, 14 FCC Rcd at 14296-302, paras. 141-157.

⁶⁰ *Pricing Flexibility Order*, 14 FCC Rcd at 14303-07, paras. 160-167.

⁶¹ 47 C.F.R. § 69.152(q); 47 C.F.R. § 69.104(r).

⁶² 47 C.F.R. § 54.315.

⁶³ *MAG Order*, 16 FCC Rcd at 19698-700, paras. 199-205.

⁶⁴ *MAG Further Notice*, 16 FCC Rcd at 19711-17, paras. 241-59.

pricing for rate-of-return carriers to make their pricing structures more efficient.⁶⁵ On the other hand, several competitors to rate-of-return carriers oppose any increased pricing flexibility for rate-of-return carriers.⁶⁶ Rate-of-return carrier competitors argue that pricing flexibility can be used to erect barriers to entry.⁶⁷

2. Discussion

24. In this Order, we immediately permit rate-of-return carriers to deaverage geographically their rates for transport and special access services and to define both the scope and number of zones, provided that each zone, except the highest-cost zone, accounts for at least 15 percent of its revenues from those services in the study area. Such action will provide rate-of-return carriers greater flexibility to respond to market place conditions, thereby benefiting consumers in rural areas. We retain the existing triggers for when rate-of-return carriers may offer volume and term discounts for transport services to respond to competitive developments. We also continue the prohibition on rate-of-return carriers' ability to offer contract carriage. Finally, we address only the initial timing for the provision of geographic deaveraging of transport and special access services and the provision of volume and term discounts for transport services because the record does not address the timing of the subsequent evolution in pricing flexibility. We also modify the safeguards applicable to rate-of-return carriers that offer geographically deaveraged rates for transport and special access services.

a. Geographic Deaveraging of Transport and Special Access Services

25. In this Order, we amend section 69.123 of the Commission's rules to permit rate-of-return carriers immediately to deaverage geographically their rates for transport and special access services. As the Commission did for price cap carriers, we will permit rate-of-return carriers to define both the scope and number of zones, provided that each zone, except the highest-cost zone, accounts for at least 15 percent of its revenues from those services in the study area. We will require, however, that the zones established for transport and special access deaveraging are consistent with any UNE zones adopted pursuant to the requirements of section 251 and will require rate-of-return carriers to demonstrate that rates reflect cost characteristics associated with the selected zones. Granting rate-of-return carriers more flexibility to deaverage these rates enhances the efficiency of the market for those services by allowing prices to be tailored more easily and accurately to reflect costs and, therefore, facilitates competition in both higher and lower cost areas. This is another step in facilitating the ability of rate-of-return carriers that offer deaveraged UNE rates to establish access and UNE rates that reflect common zone boundaries.

⁶⁵ See, e.g., ALLTEL Comments at 46-47; ICORE Comments at 16; NTCA Comments at 8-9; NRTA Comments at 17.

⁶⁶ See, e.g., AT&T Comments at 19-23; CUSC Comments at 7-8; WorldCom Comments at 4.

⁶⁷ See, e.g., AT&T Comments at 19-20; GCI Comments at 10-11; WorldCom Comments at 4.

26. Since 1992, the Commission has permitted rate-of-return carriers to deaverage certain rates by geographic zones because of the concern that averaged rates might create a pricing umbrella for competitors that would deprive customers of the benefits of more vigorous competition.⁶⁸ Rate-of-return carriers argue that increased pricing flexibility is now necessary for a variety of reasons. They argue that immediate geographic rate deaveraging would increase the efficiency of the interstate rate structure by moving rates closer to actual costs⁶⁹ and would offer rate-of-return carriers the flexibility to adjust rates in line with the capabilities of potential competitors.⁷⁰ The National Rural Telecom Association, the Organization for the Promotion and Advancement of Small Telecommunications Companies, and the United States Telecom Association (collectively NRTA) assert that geographic deaveraging is no different than SLC deaveraging and universal service disaggregation, which the Commission has already adopted.⁷¹

27. Our action here, which permits rate-of-return carriers immediately to deaverage the rates for transport and special access services, represents a measured modification of the current rule. That rule permitted rate-of-return carriers to deaverage these rates when a single entrant has established a cross-connect in one central office in the rate-of-return carrier's study area.⁷² Thus, rather than filing deaveraged rates only when a competitor has entered the market via collocation, the rate-of-return carrier may now, immediately upon the effective date of this order, file deaveraged rates that may become effective in fifteen days. Competitors that enter the rate-of-return carrier's market through means other than collocation will, of course, be competing against the rate-of-return carrier's deaveraged rates immediately. Deaveraged rate-of-return carrier rates may provide valuable information about the prices the entrant will face when it enters and may thus reduce uneconomic entry that could result from errors in estimating the rate-of-return carrier's pricing response to competitive entry. The greater flexibility afforded by the ability to deaverage transport and special access rates will benefit access customers through more efficient pricing of access services.⁷³

28. We are not persuaded by GCI that geographic deaveraging will lead to unreasonable, monopolistic rates in areas not served by a competitor.⁷⁴ Thus, deaveraging of

⁶⁸ See *Special Access Expanded Interconnection Order*, 7 FCC Rcd at 7454, para. 178; *Expanded Interconnection with Local Telephone Company Facilities, Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board*, CC Docket Nos. 91-141 and 80-286, Second Report and Order and Third Notice of Proposed Rulemaking, 8 FCC Rcd 737, 7426, para. 98 (1993) (*Switched Transport Expanded Interconnection Order*).

⁶⁹ ALLTEL Comments at 47.

⁷⁰ NTCA Comments at 9.

⁷¹ NRTA Comments at 19.

⁷² 47 C.F.R. § 69.123(c) and (d).

⁷³ While rate-of-return carriers have not taken full advantage of the geographic deaveraging currently available under our rules, we do not believe this is sufficient grounds for not granting rate-of-return carriers greater flexibility to deaverage transport and special access services. The lack of flexibility in our density zone pricing rules may be responsible for rate-of-return carriers' failure to take full advantage of such opportunities.

⁷⁴ See GCI Reply at 3.

transport and special access rates should not permit rate-of-return carriers to erect barriers to entry.⁷⁵ Any deaveraged rates will be subject to the tariff review and complaint processes. Continuing to require averaged rates could result in preclusion or uneconomic entry. The Commission has observed that averaging across large geographic areas distorts the operation of markets in high-cost areas because it requires incumbent LECs to offer services in those areas at prices substantially lower than their costs of providing those services.⁷⁶ Prices that are below cost reduce the incentives for entry by firms that could provide the services as efficiently, or more efficiently, than the incumbent LEC.⁷⁷ Similarly, discrepancies between price and cost may create incentives for carriers to enter low-cost areas even if their cost of providing service is actually higher than that of the incumbent LEC.⁷⁸

29. We also simplify our rules by allowing the rate-of-return carrier to establish its own zones. This is consistent with the Commission's decision in the *Pricing Flexibility Order* that concluded that traffic density is not the optimal, or even an accurate, method of determining cost-based pricing zones and that LEC-designed zones are more likely to lead to efficient pricing that reflects underlying cost characteristics.⁷⁹ We therefore conclude that granting rate-of-return carriers the flexibility to choose the number of zones and the criteria for establishing zone boundaries is more likely to result in reasonable and efficient pricing zones than if their flexibility is more constrained. Therefore, we eliminate all competitive prerequisites for the deaveraging of transport and special access rates and permit rate-of-return carriers to define pricing zones as they wish, so long as each zone, except the highest-cost zone, accounts for at least 15 percent of the rate-of-return carrier's transport and special access revenues in the study area. With this requirement, we ensure that any lower rates resulting from deaveraging are enjoyed by a range of customers, rather than being focused on only a few customers in a way that might evade our prohibition on contract pricing by rate-of-return carriers for individual customers. While the seven-zone limit that we adopt – the product of the 15 percent requirement discussed above – likely will not be used by most rate-of-return carriers, we find that three zones, as urged by WorldCom,⁸⁰ may not be sufficient to provide rate-of-return carriers with the ability to adjust to any likely variation in cost conditions and ensure that a rate-of-return carrier will be able to harmonize its UNE and access zones.

30. The permissive geographic deaveraging we discuss here applies to rates for all services in the transport and special access categories to which density zone pricing currently

⁷⁵ See Sprint Comments at 5-6.

⁷⁶ See *Pricing Flexibility Order*, 14 FCC Rcd at 14253-54, para. 61.

⁷⁷ *Id.*

⁷⁸ *Id.*

⁷⁹ *Pricing Flexibility Order*, 14 FCC Rcd at 14253-54, para. 61.

⁸⁰ WorldCom Comments at 2-3; *but see* Sprint Comments at 5-6 (supporting increasing the number of zones to permit further deaveraging to reflect different costs in different geographic zones).

applies. We require that the same zones be used for all transport and special access elements.⁸¹ We will retain the constraints on annual price increases within zones that are contained in section 69.123(e)(1) of our rules.⁸² Although such constraints limit rate-of-return carriers' ability immediately to rebalance rates in a manner that reflects the actual costs of providing the services at issue, we remain concerned with preventing the disruptive effects of rapid and unexpected price increases. We will also retain the requirement that transport and special access services offered between telephone company locations be priced at the rates for the higher zone.⁸³ We note that, under rate-of-return regulation, deaveraging permits LECs to increase rates in one geographic zone only to the extent that they decrease rates in other geographic zones, because a rate-of-return carrier's rates must be targeted to earn no more than the authorized rate of return. Furthermore, a rate-of-return carrier must provide cost support establishing that the deaveraged rates are cost-based. Thus, we are not persuaded by AT&T's claims that greater geographic deaveraging flexibility will lead to predatory pricing by incumbent LECs or arguments that any further deaveraging should result only in price decreases, *i.e.*, that it be "downward only."⁸⁴ We will no longer require rate-of-return carriers to file zone pricing plans in advance of tariff filings. Parties wishing to challenge the reasonableness of rate-of-return carrier zones may do so as part of the tariff review process, or in a formal complaint under section 208 of the Act.⁸⁵

31. Under the present rules governing geographic deaveraging, rate-of-return carriers may not deaverage transport or special access rates until at least one cross-connect is operational in the study area. Thus, a rate-of-return carrier today would have to have established a cross-connect charge before it could offer the allowed services at deaveraged rates. The cross-connect subelement recovers costs associated with the cross-connect cable and associated facilities connecting the equipment owned by or dedicated to the use of the interconnector with the telephone company's equipment and facilities used to provide interstate special or switched access services.⁸⁶ We conclude, as urged by GCI, that a rate-of-return carrier wishing to

⁸¹ The Commission previously has imposed this requirement on geographically-deaveraged transport services. *See Switched Transport Expanded Interconnection Order*, 8 FCC Rcd at 7428, para. 104. The requirement also applies to deaveraging by price cap carriers. *Pricing Flexibility Order*, 14 FCC Rcd at 14255, para. 63.

⁸² 47 C.F.R. §69.123(e)(1), which provides that:

Telephone companies not subject to price cap regulation may charge a rate for each service in the highest price zone that exceeds the rate for the same service in the lowest priced zone by no more than fifteen percent of the rate for the service in the lowest priced zone during the period from the date that the zones are initially established through the following June 30. The difference between the rates for any such service in the highest price zone and the lowest priced zone in a study area, measured as a percentage of the rate for the service in the lowest priced zone, may increase by no more than an additional fifteen percentage points in each succeeding year, measured from the rate differential in effect on the last day of the preceding tariff year.

⁸³ 47 C.F.R. §§ 69.123(c)(2) and (d)(2).

⁸⁴ *See* AT&T Comments at 19-20, *but see* Sprint Comments at 5-6 (cost-based geographically deaveraged rates should not permit rate-of-return carriers to erect barriers to entry).

⁸⁵ 47 U.S.C. § 208. *See* NTCA Reply at 9.

⁸⁶ 47 C.F.R. § 69.123(a)(1).

geographically deaverage transport or special access rates must establish a cross-connect element providing for interconnection and may not charge collocated providers for entrance facilities or channel terminations when the entrant provides its own transmission facilities.⁸⁷ This merely brings forward the requirement that would apply today if a rate-of-return carrier qualified and elected to geographically deaverage rates. A rate-of-return carrier that could assess such a charge for the combined facilities would clearly still possess some degree of market power, and would be attempting to use that power in an anticompetitive manner. Finally, the requirement that rate-of-return carriers must tariff a cross-connect element in order to geographically deaverage rates ensures that transport competitors can interconnect with the rate-of-return carrier's access network, whether or not rate-of-return carriers claim exemption under either section 251(f)(1) or (f)(2). Thus, competition will not be foreclosed if a carrier claims its exemption, as argued by GCI.⁸⁸

b. Volume and Term Discounts for Transport Services

32. In this section, we address the question of whether to relax our rules on volume and term discounts for transport services. Under the current rules, rate-of-return carriers are already permitted to offer volume and term discounts for special access services. After a certain number of DS1 equivalent cross-connects are operational in the study area, they may offer such discounts for transport services.⁸⁹ After reviewing the record, we conclude that no relaxation of the requirements for offering volume and term discounts for transport services is warranted at the present time.

33. The Commission has long recognized that it should allow incumbent LECs progressively greater pricing flexibility as they face increasing competition.⁹⁰ This has been tempered, however, with the understanding that pricing flexibility, if granted prematurely, might enable incumbent LECs to (1) exclude new entrants from their markets, or (2) increase rates to unreasonable levels. As the Commission observed in the *Pricing Flexibility Order*, monopolists have an incentive to reduce prices in the short run and forgo current profits in order to prevent the entry of rivals or to drive them from the market.⁹¹ The monopolist may then raise prices above competitive levels and earn higher profits than would have been possible if the exclusionary pricing behavior had not occurred and competitors had not exited or been deterred

⁸⁷ GCI Comments at 14. We note that, because we retain the cross-connect trigger for the offering of volume and term discounts for transport services, rate-of-return carriers will be subject to a similar requirement in offering volume or term discounts for transport services.

⁸⁸ GCI Reply at 23.

⁸⁹ 47 C.F.R. § 69.111(j) and (k); 47 C.F.R. §69.112(g) and (h).

⁹⁰ The Commission first sought comment on a "road map" for increasing pricing flexibility in response to increased competition in the *Price Cap Performance Review for Local Exchange Carriers*, CC Docket No. 94-1, Second Further Notice of Proposed Rulemaking, 11 FCC Rcd 858 (1995).

⁹¹ *Pricing Flexibility Order*, 14 FCC Rcd at 14263, para. 79.

from entering the market.⁹² Thus, an incumbent LEC can forestall the entry of potential competitors by "locking up" large customers by offering them volume and term discounts at or below cost. Locking in large customers can foreclose competition for smaller customers as well, because large customers may create the inducement for potential competitors to invest in sunk facilities which, once sunk, can be used to serve adjacent smaller customers.

34. In the *MAG Further Notice*, the Commission sought comment on the appropriate triggers for determining when rate-of-return carriers should be permitted to adopt other forms of pricing flexibility. The Commission noted the risk that rate-of-return carriers could use increased pricing flexibility to engage in exclusionary pricing behavior and thereby thwart the development of competition.⁹³ This built on the *Pricing Flexibility Order*, in which, as a condition for granting further pricing flexibility in the form of volume and term discounts and contract carriage, price cap carriers were required to show that markets are sufficiently competitive both to warrant pricing flexibility so that price cap carriers may respond to competition and to discourage price cap carriers from either excluding new entrants or setting rates to unreasonable levels.

35. After reviewing the record in the instant proceeding, we conclude that these concerns are equally applicable to rate-of-return carrier pricing flexibility, and we find no basis for expanding the transport volume and term discount pricing flexibility available to rate-of-return carriers at this time. We therefore retain the existing cross-connect-based standards as the trigger for when a rate-of-return carrier may offer volume and term discounts for transport services, rather than adopting any alternative suggested in the record. We note that, to date, no party has taken advantage of the existing ability to offer volume and term discounts for transport services—whether because they cannot meet the threshold, or for some other reason, is not apparent from the record before us.

36. The record indicates that there is limited competition in rate-of-return carrier service areas that would serve to discipline the provision of volume and term discounted transport services offered by rate-of-return carriers. Several parties argue that competition has increased and new technologies will permit increasing numbers of carriers, such as wireless providers, to enter rural areas.⁹⁴ We agree, however, with those parties that argue that wireless generally is not a substitute for transport,⁹⁵ and thus wireless competition is unlikely to restrain rate-of-return carrier pricing of transport services.

⁹² See, e.g., P. Arena & D. Turner, *Predatory Pricing and Related Practices under Section 2 of the Sherman Act*, 88 HARV. L. REV. 697 (1975); O. Williamson, *Predatory Pricing: A Strategic and Welfare Analysis*, 87 YALE L.J. 284 (1977); J. McGee, *Predatory Pricing Revisited*, 23 J. LAW & ECON. 289 (1980); F.M. SCHERER, *INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE* 468-479 (1990).

⁹³ *MAG Further Notice*, 16 FCC Red at 19715, para. 250.

⁹⁴ See, e.g., NRTA Comments at 18-19; TCA Comments at 4-5.

⁹⁵ TCA Comments at 4-5; GCI Reply at 5-8.

37. We are also skeptical that cable and satellite providers offer competition for transport services to rate-of-return carriers. These competitors largely bypass the rate-of-return carrier switched access network and thus do not restrain transport prices.⁹⁶ To the extent that cable may, in certain instances, provide dedicated transmission offerings that bypass the rate-of-return carrier network, rate-of-return carriers today are allowed to offer volume and term discounts for special access services, which would be the service with which the entrant would be competing.

38. Thus, the competition faced by rate-of-return carriers for transport services is limited⁹⁷ and is significantly less than that in price cap carrier service areas. Competition in rate-of-return carrier service areas may develop in a more targeted fashion than that for price cap carriers because of the smaller customer base generally, as well as the lower penetration of multi-line business customers that are attractive initial targets of new entrants.⁹⁸ In evaluating various triggers for volume and term discounts for transport services, we therefore have considered the diversity among small and mid-sized carriers, as urged by many rate-of-return carrier interests.⁹⁹

39. We conclude, as urged by several commenters, that further volume and term discount pricing flexibility for transport services should be available only if there is evidence of significant competition. Volume and term discount pricing flexibility must be structured to prevent exclusionary pricing behavior to safeguard the development of competition in rate-of-return carrier service areas.

40. We find that the various alternative triggers suggested in the record fail to address the concern with rate-of-return carriers' ability to erect barriers to entry and engage in price discrimination. Several parties contend that pricing flexibility should be granted based on various market opening commitments.¹⁰⁰ While the market opening events that the commenters identify would facilitate the development of competition, they do not, in and of themselves, indicate that any particular level of competition exists. Therefore, there would be no assurance that rate-of-return carriers could not erect barriers to entry, or engage in unreasonable price discrimination. On the other hand, competition can develop without an entrant with ETC status

⁹⁶ See GCI Reply at 10-11.

⁹⁷ See, e.g., AT&T Comments at 19-20; WorldCom Comments at 4; Sprint Comments at 5.

⁹⁸ The Joint Board recently released data showing that only 12 percent of access lines were multi-line business lines in rural exchanges, compared to 21 percent in price cap exchanges. Rural Task Force: "The Rural Difference" White Paper 2 at 35.

⁹⁹ See, e.g., ITTA Comments at 8.

¹⁰⁰ These include triggers such as the filing of a collocation or interconnection tariff, or the rate-of-return carriers renunciation of the rural exemption under section 251(f)(1), see generally, e.g., ITTA Reply at 10. NTCA argues that the Commission should not require the presence of a carrier with ETC status in the serving area, the issuance of a request for proposal (RFP) by a customer in the carrier's serving area, the filing of a tariff offering UNEs, or the receipt of a request for UNEs. NTCA Comments at 10. NTCA also argues that these triggers would not be competitively neutral. *Id.* Other parties argue that pricing flexibility should not be permitted unless UNEs are available in the study area, AT&T Comments at 23, or a rate-of-return carrier has renounced the competition-limiting provisions of section 251(f)(1) and (2). See CUSC Comments at 7-8.

being present because significant competition could exist in part of a rate-of-return carrier's service area before an entrant sought ETC status. The argument that UNEs should be available throughout the service area before pricing flexibility should be granted also fails to address the level of competition that might exist because an entrant might enter without using UNEs. We also decline to adopt an approach modeled on that for price cap carriers because we believe that the diversity among rate-of-return carriers and the markets they serve make those triggers an unreliable predictor of the competitive effects in any of the rate-of-return carriers' markets. We believe the actual competition reflected in a cross-connect standard is a better judge of when volume and term discounts for transport services are appropriate because it indicates that the rate-of-return carrier is facing actual competition for those services. It is also administratively easy to administer.

41. In the *MAG Further Notice*, the Commission sought comment on whether any additional pricing flexibility should be conditioned on rate-of-return carriers being required to establish a ceiling rate for the associated non-discounted access service offering.¹⁰¹ GCI argues that if the Commission permits downward pricing flexibility, it must ensure that the carrier is not permitted to raise other rates to offset the discounts.¹⁰² ALLTEL Communications, Inc., CenturyTel, Inc., Madison River Communications, LLC., and TDS Telecommunications Corporation (ALLTEL) oppose creating any such limitation on the use of pricing flexibility.¹⁰³ We decline to adopt such a pricing restriction here. The existing rules applicable to volume and term discounts by rate-of-return carriers do not constrain pricing in the manner urged by GCI, and we are not modifying those rules in this order. The Commission historically has approached volume and term discount offerings by carriers as being subject to the standard that any discounts must be cost-based.¹⁰⁴ We will not depart from this cost-based approach in the instant case.

42. In the *MAG Further Notice*, the Commission also sought comment on whether the study area should be used to measure competitiveness in determining whether pricing flexibility is warranted for rate-of-return carriers.¹⁰⁵ The majority of parties that addressed this issue agree that the MSA would be inappropriate and support the use of the study area to measure competitive entry.¹⁰⁶ TCA argues for measuring entry at the exchange level, or based on

¹⁰¹ *MAG Further Notice*, 16 FCC Rcd at 19715, para. 250, citing *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). The ATU case involved a waiver of two rules for services that rate-of-return carriers were not authorized to offer at volume and term discounts and was accompanied by a representation that ATU did not intend to raise any rates.

¹⁰² GCI Reply at 19-20.

¹⁰³ ALLTEL Comments at 49.

¹⁰⁴ See generally *American Telephone and Telegraph Company Revisions to Tariff F.C.C. No. 259, Wide Area Telecommunications Service (WATS)*, CC Docket No. 80-765, Memorandum Opinion and Order, 84 FCC.2d 158 (1980).

¹⁰⁵ *MAG Further Notice*, 16 FCC Rcd at 19717, paras. 257-58.

¹⁰⁶ See, e.g., GCI Comments at 15-16; AT&T Comments at 21-22.

contiguous exchanges because the study area is too large.¹⁰⁷ We will continue to use the study area to determine when volume and term discount pricing flexibility for transport services is warranted. Even if we were inclined to use an exchange standard, the record before us is inadequate to determine what an appropriate grouping of exchanges would be, given the diversity among rate-of-return carriers.

43. We decline to limit the length of any term contract to three years, as suggested by GCI.¹⁰⁸ AT&T and GCI argue that a rate-of-return carrier may attempt to engage in price discrimination or in practices that might otherwise lock-up certain customers.¹⁰⁹ We will not modify the existing rule, which does not limit eligible rate-of-return carriers ability to enter into term contracts of any length. We believe that customers are in the best position to evaluate their individual communications needs and the potential for competitive alternatives. We therefore believe that customers will not enter into excessively long term contracts if attractive alternatives are likely to be available in a shorter period of time.

44. We conclude that it is appropriate to maintain the current trigger for volume and term discounts for transport services even though we do not impose any limitations on special access volume and term discounts. As we have noted above, entrants may provide interstate services by bypassing the LEC's network, without needing a cross-connect in the rate-of-return carrier's central office. Rate-of-return carriers will, in some cases, be able to respond to these competitive offerings with their special access services. With respect to transport, however, competitive entry is dependant on interconnecting with the rate-of-return carrier's switched network. It is therefore appropriate to maintain the existing cross-connect trigger to ensure that a competitive presence exists before a rate-of-return carrier is allowed to offer volume and term discounts for transport services.

45. Finally, we conclude that the record is inadequate to permit us to reach any conclusions regarding Phase II pricing flexibility, non-dominant treatment of any services, or shortened filing periods for some services.¹¹⁰ Very few parties commented on these issues, and to the extent they did, the comments were in opposition. They argue that competition is inadequate to justify such relief, asserting that rate-of-return carriers could erect barriers to entry or price discriminatorily without any effective control from competitors in the market.¹¹¹ As discussed above, there is limited competition in the provision of access services in rate-of-return carrier service areas today. It is not clear how quickly competition will develop, or the form it will take. As a result, we decline to adopt any rule revisions relating to these aspects of the *MAG Further Notice* on the present limited record.

¹⁰⁷ TCA Comments at 5.

¹⁰⁸ GCI Comments at 16.

¹⁰⁹ AT&T Comments at 19-20; GCI Comments at 18.

¹¹⁰ *MAG Further Notice*, 16 FCC Rcd at 19716-17, paras. 256-57, 259.

¹¹¹ *See, e.g.*, AT&T Comments at 19-21; GCI Comments at 14-18.

c. Contract Carriage

46. In the *MAG Further Notice*, the Commission sought comment on whether rate-of-return carriers should be given authority to offer services pursuant to individual customer contracts. Today, rate-of-return carriers are prohibited from offering interstate access services pursuant to individual customer contracts.¹¹² After reviewing the record in this proceeding, we decline to permit rate-of-return carriers to offer contract carriage at this time.

47. Rate-of-return carrier interests generally rely on the same arguments to support contract carriage that they presented for relaxed volume and term discounts for transport services: the improved efficiency of cost-based rates, their reliance on a few large customers in many cases, and the need to address competition.¹¹³ NRTA asserts that contract pricing would permit carriers to tailor services and rates to individual customer demand.¹¹⁴ On the other hand, AT&T opposes extending contract carriage authority to rate-of-return carriers, arguing that it could be used to erect a barrier to entry in the form of favorable contracts for attractive customers resulting in excessive rates for other customers.¹¹⁵

48. After reviewing the record, we decline to permit rate-of-return carriers to engage in contract carriage at the present time. Contract carriage would permit a rate-of-return carrier to combine various elements, or parts of elements, in presenting an offering to a customer. This would present rate-of-return carriers with an opportunity to set non-cost-based prices in order to prevent entrants from providing service to the largest customers in their service areas, thereby precluding further competition for smaller customers in their service areas as well. The principal check on rate-of-return carrier rates is the authorized rate of return the Commission has prescribed. A rate-of-return carrier is permitted to set rates that provide the opportunity to earn this return on the entire portion of their rate base that is assigned to interstate access services. Therefore, any predation on the part of a rate-of-return carrier in its contract offerings could be recovered through higher rates for other customers, absent some check on the rate-of-return carrier's ability to accomplish this result.¹¹⁶ Because any predatory pricing would restrict entry, there would likely be no competitor to provide an alternative to those customers to whom the rate-of-return carrier was charging higher rates. Rate-of-return carriers have not demonstrated in the record how such behavior can be detected and prevented within the rate-of-return regulatory process. The pooling process would make detection even more difficult.¹¹⁷ The immediate geographic deaveraging of transport and special access services we extend to rate-of-return carriers today, along with the volume and term pricing already available to rate-of-return

¹¹² See *Special Access Expanded Interconnection Order*, 7 FCC Rcd at 7457-58, para. 186 (rejecting proposals to permit individual case-based pricing arrangements in response to competitors' offerings).

¹¹³ See, e.g., NTCA Comments at 9; NRTA Comments at 18.

¹¹⁴ NRTA Comments at 19.

¹¹⁵ AT&T Comments at 19-20; *accord* GCI Comments at 12-13, 16; WorldCom Comments at 4.

¹¹⁶ See AT&T Comments at 19-20.

¹¹⁷ See GCI Comments at 12.

carriers, provide them with meaningful ways to respond to competition. Therefore, balancing the risks of undetectable anticompetitive behavior against the limited competition that presently exists in rate-of-return carrier service areas that could be considered a substitute for access services, we believe the better course is the conservative one of precluding contract carriage for rate-of-return carriers.

d. Other Issues

49. In the *MAG Further Notice*, the Commission sought comment on whether pricing flexibility should be permitted within the NECA pooling process.¹¹⁸ After reviewing the record, we agree with NECA that the pricing flexibility permitted by this order can be accommodated within the pool by modifying its settlement and rate-setting mechanisms so they apply on a more targeted basis to narrower groups of customers.¹¹⁹ Our current rules would permit such pooling to occur. We note that many of the rate-of-return carriers most likely to exercise this option—ALLTEL, CenturyTel, ACS of Anchorage, TDS—already file their own traffic-sensitive access tariffs for some or all of their study areas. Therefore, by this decision, smaller rate-of-return carriers may be able to offer pricing flexibility through the NECA traffic-sensitive pool that they would not be able to do if required to do so through their own tariffs.¹²⁰ The tariffing costs will increase some for those carriers that elect to offer pricing flexibility, whether done on their own or through NECA. We agree with NECA that the increased administrative burdens on NECA will likely be less than those that would result if we were to require rate-of-return carriers to file their own tariffs proposing flexible pricing arrangements.¹²¹

50. We decline to require rate-of-return carriers to leave the NECA pool and file their own tariffs in order to offer pricing flexibility. We are not persuaded by the arguments of AT&T and GCI that pooling is inconsistent with pricing flexibility.¹²² While pooling involves a degree of averaging and risk sharing that would not exist if carriers filed their own tariffs, this is the case whether pricing flexibility is involved or not. Rate-of-return carriers subject to section 61.38 of our rules must file cost support with their tariffs,¹²³ and those subject to section 61.39 must be prepared to submit cost support upon request.¹²⁴ This supporting material will include a clear delineation of the geographically deaveraged pricing zones. It will also describe the process used to establish rates, whether on an individual carrier basis or through the use of some

¹¹⁸ *MAG Further Notice*, 16 FCC Rcd at 19716, para. 252.

¹¹⁹ NECA Comments at 9-10. It notes that it currently offers term discounts for high-capacity, synchronous optical channel services and DSL access services. *Id.* at n.16.

¹²⁰ NECA Reply at 4.

¹²¹ *Id.* See also NRTA Comments at 19-20, arguing that small and mid-sized carriers should not have to give up the administrative and other benefits of pooling for the competitive benefits of pricing flexibility.

¹²² AT&T Comments at 21-22; GCI Comments at 12.

¹²³ 47 C.F.R. § 61.38.

¹²⁴ 47 C.F.R. § 61.39.

aggregation approach, such as the banding NECA currently uses for some rate elements, along with the actual cost support for the services for which pricing flexibility is being offered. While the cost support may not include individual carrier cost data,¹²⁵ the NECA tariff filings offering pricing flexibility will include supporting material associated with the rates in question that the Commission and interested parties may utilize to detect efforts to erect barriers to entry or to establish discriminatory pricing practices. This is also consistent with allowing rate-of-return carriers to offer deaveraged SLCs within the NECA common line pool, as we did in the *MAG Order*.¹²⁶ Parties wishing to challenge the reasonableness of NECA's pool rates or rate development procedures may do so as part of the tariff review process, or in a formal complaint under section 208 of the Act.

51. We decline to restrict the availability of pricing flexibility with respect to transport elements that cannot be avoided because of network design configuration, as urged by GCI. GCI notes, for example, that an entrant may not be able to interconnect at a remote switch and must therefore purchase transport from the host switch to the remote switch.¹²⁷ Rate-of-return carriers assess tandem-switched transport charges for the use of transmission between the host and remote locations in addition to charges for services between the host switch and the point of interconnection with the IXC.¹²⁸ Because of the broader application of the tandem-switched transport rate, we do not find it necessary to introduce the limitation GCI requests. This is consistent with the scope of the present rules governing pricing flexibility for rate-of-return carriers.

52. We decline to revise the standard applicable to volume and term discounts for channel terminations. GCI argues that collocation does not indicate that channel terminations are available and urges that they be subject to the same rules as switched loops.¹²⁹ The notice sought comment on additional pricing flexibility for rate-of-return carriers. We will not here restrict pricing flexibility that is already available to those carriers. We note that, for most rate-of-return carriers, DS1 and DS3 capacity services will address most customers' needs, and those services are not services subject to the volume discount provisions.

53. We will not limit the availability of pricing flexibility to rate-of-return carriers participating in an incentive regulation plan, as urged by GCI.¹³⁰ GCI asserts that incentive regulation reduces a LEC's ability to engage in cost shifting and other forms of anti-competitive cross-subsidization. It further submits that it is difficult to remove both the cost and the demand from rate-of-return formulas, especially if a LEC participates in the NECA pools.¹³¹ While GCI

¹²⁵ AT&T Comments at 21-22; GCI Comments at 12.

¹²⁶ *MAG Order*, 16 FCC Rcd at 19641-42, paras. 57-60.

¹²⁷ GCI Comments at 15.

¹²⁸ *Access Charge Reform Order*, 12 FCC Rcd at 16285, para. 220.

¹²⁹ GCI Comments at 15.

¹³⁰ *Id.* at 12.

¹³¹ *Id.* at 11-13.

is correct that the price cap mechanism facilitated certain pricing relaxation for price cap carriers, it does not follow that the cost-based standards of rate-of-return regulation cannot be used to accomplish the same ends. Rate-of-return regulation was the basis on which cost-based access rates were established in 1984 when the access charge structure was implemented, and it was the basis for all incumbent LEC tariff review until 1991. The tariff rates will be subject to the tariff review process and parties may also file complaints pursuant to section 208 of the Act.¹³²

C. Consolidation of Long Term Support and Interstate Common Line Support

54. In this section, we adopt the Commission's tentative conclusion in the *MAG Further Notice* that LTS should be merged into the ICLS mechanism.¹³³ In the *MAG Order*, the Commission retained the existing LTS mechanism solely to provide stability to the NECA common line pool during the transition to a more efficient access charge regime. At this time, we find that merging LTS into the ICLS mechanism will provide administrative simplicity by eliminating a duplicative and obsolete mechanism, without affecting the total support received by rate-of-return carriers or negatively affecting carriers that choose to participate in the NECA pool.

1. Background

55. The LTS mechanism is a legacy of the transition to a competitive interstate long distance market after the breakup of AT&T. In the *1983 Access Charge Order*, the Commission created an access charge regime that included SLCs—monthly flat rate charges assessed on end users to recover a capped portion of interstate common line costs—and CCL charges, which are per-minute charges imposed on IXCs to recover any residual interstate common line costs.¹³⁴ The NECA common line pool was developed as a means of permitting LECs to recover their interstate common line revenue requirements while maintaining a nationwide average CCL charge.¹³⁵ The nationwide average CCL charge, in turn, permitted IXCs to more easily provide their services at nationwide deaveraged rates.¹³⁶ The Commission initially prescribed mandatory

¹³² *Id.*

¹³³ *MAG Further Notice*, 16 FCC Rcd at 19724-26, paras. 272-76. The Commission tentatively concluded that the merger would occur on July 1, 2003, but in order to provide adequate notice of our action here, we conclude that the merger will occur on July 1, 2004.

¹³⁴ *MTS and WATS Market Structure*, CC Docket No. 78-72, Third Report and Order, Phase I, 93 FCC.2d 241, 243-44, paras. 3-5, 279-97, paras. 124-96 (1983) (*1983 Access Charge Order*).

¹³⁵ *Id.* at 327-29, paras. 312-18, 333-36, paras. 339-49. Pooling carriers charge rates set by NECA, pool their interstate access revenues, and recover their costs from the pools, including a return on investment. *MAG Order*, 16 FCC Rcd at 19624, para. 20. The Commission concluded that a common tariff and pooling arrangement covering the CCL charge was necessary because LEC-specific CCL rates could generate significant pressures on IXCs to deaverage interstate toll rates. *1983 Access Charge Order*, 93 FCC 2d 241, para. 314.

¹³⁶ *1983 Access Charge Order*, 93 FCC 2d at 328, para. 314. Toll rate averaging and rate integration are longstanding Commission policies that Congress codified in the 1996 Act. See 47 U.S.C. § 254(g).

pooling to achieve these goals, but recognized that pooling had some negative effects.¹³⁷ In 1987, the Commission eliminated mandatory pooling, but created the LTS mechanism to permit carriers remaining in the pool to maintain their nationwide average CCL charges.¹³⁸ The LTS mechanism, as originally designed, required LECs that had left the common line pool to make payments into the pool sufficient for the pool to charge the nationwide average CCL rate of non-pooling carriers.¹³⁹

56. In 1997, the Commission concluded that the existing LTS mechanism was not explicit, portable, and competitively neutral, as required the 1996 Act.¹⁴⁰ The Commission concluded, however, that LTS continued to provide important benefits and should be retained in a modified form.¹⁴¹ Specifically, the Commission relied on the LTS mechanism's usefulness in reducing disparities among CCL charges imposed by LECs: "LTS payments serve the public interest by reducing the amount of loop cost that high cost [rate-of-return carriers] must recover from IXCs through CCL charges and thereby facilitating interexchange service in high cost areas, consistent with the express goals of section 254."¹⁴² To comply with the Act, the Commission concluded that LTS contributions must be removed from the access rate structure and recovered instead through the universal service fund.¹⁴³ The Commission also modified LTS by fixing each carrier's LTS at its 1997 level plus growth based on nationwide average loop costs.¹⁴⁴ As a result of these and other reforms, a nationwide average CCL charge was no longer

¹³⁷ See *1983 Access Charge Order*, 93 FCC 2d at 327, para. 312, 328, para. 317. For example, pooling limited LEC flexibility in cost recovery, established economically inefficient cost and price distortions, and reduced incentives for LECs to contain costs. See *MTS and WATS Market Structure Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board*, CC Docket Nos. 78-72 and 80-286, Report and Order, 2 FCC Rcd 2953, 2956-58 paras. 23, 33 (1987) (*1987 Access Charge Order*). The Commission has also recognized that the pool provides additional benefits to pooling carriers, including the pooling of risk and tariff agency services. See *MAG Order*, 16 FCC Rcd at 19726, para. 276.

¹³⁸ *1987 Access Charge Order*, 2 FCC Rcd at 2956-58, paras. 23-26, 32-33.

¹³⁹ *Id.*

¹⁴⁰ *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order, 12 FCC Rcd 8776, 9164-65, para. 756 (1997) (*Universal Service First Report and Order*).

¹⁴¹ *Id.* at 9165 para. 757.

¹⁴² *Id.*; see *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *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 Charge*, CC Docket No. 95-72, *Fourth Order on Reconsideration*, 13 FCC Rcd at 5361-63, paras. 74, 76 (*Universal Service Fourth Order on Reconsideration*).

¹⁴³ *Universal Service First Report and Order*, 12 FCC Rcd at 9165-66, paras. 757-59.

¹⁴⁴ *Id.* at 8942, para. 306. Beginning in 2000, the annual growth was based on inflation. See 47 C.F.R. § 54.303(a)(4).

possible, though LTS and the common line pool continued to reduce disparities among CCL charges.¹⁴⁵

57. 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.¹⁴⁶ At that time, several petitioners argued that requiring pool membership as a condition of eligibility for LTS was unnecessary in light of the decision to remove LTS from the access rate structure and would hamper the ability of LTS recipients to pass savings from new efficiency gains on to their customers.¹⁴⁷ The Commission concluded that maintenance of the existing LTS program was warranted to avoid disruption to rate-of-return carriers until it undertook comprehensive access charge and universal service reform for such carriers.¹⁴⁸ In support of this conclusion, the Commission repeated its conclusion in the *Universal Service First Report and Order* that LTS reduced CCL charges and thereby facilitated interexchange service in high cost areas.¹⁴⁹ 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.”¹⁵⁰

58. In the *MAG Order*, the Commission undertook comprehensive access charge and universal service reform for rate-of-return carriers. As noted above, the Commission created a new explicit universal service mechanism, ICLS, to replace implicit support provided by CCL charges.¹⁵¹ This support mechanism provides each incumbent rate-of-return carrier with its allowable common line revenues to the extent they cannot be recovered through end user charges and, at the present time, LTS.¹⁵² In this respect, ICLS is specifically designed to preserve incumbent rate-of-return carriers’ ability to provide affordable, quality services to rural consumers while allowing carriers to recover their common line revenue requirements through a

¹⁴⁵ In October 1997, the Commission granted a request for waiver by NECA, permitting the NECA pool to charge a CCL rate other than the average CCL rate charged by price cap carriers. *Access Charge Reform*, CC Docket No. 96-262, *Price Cap Performance Review for LECs*, CC Docket No. 94-1, *Transport Rate Structure*, CC Docket No. 91-213, Second Order on Reconsideration and Memorandum Opinion and Order, 12 FCC Rcd 16606, 16334-36, paras. 86-89 (1997). Under the conditions of the waiver, the NECA common line pool was permitted to compute the CCL rate as the per-minute amount necessary to recover the difference between revenues from SLCs, LTS, and special access surcharges and the pool’s common line revenue requirement. *Id.* at 16335-36, para. 89.

¹⁴⁶ *Universal Service Fourth Order on Reconsideration*, 13 FCC Rcd at 5361-63, paras. 74-76.

¹⁴⁷ *Id.* at 5360, para. 69.

¹⁴⁸ *Id.*

¹⁴⁹ *Id.* at 5362, para. 74.

¹⁵⁰ *Id.*

¹⁵¹ *MAG Order*, 16 FCC Rcd at 19667-69, paras. 128-31.

¹⁵² *Id.* at 19668-69, para. 130, 19673-74, para. 142.

more efficient rate structure.¹⁵³ The Commission concluded that ICLS should be available to all rate-of-return carriers that would otherwise have recovered interstate common line revenues through CCL charges, and not limited only to participants in the common line pool.¹⁵⁴

59. The Commission concluded that its action to eliminate the CCL charge in the *MAG Order* negated the primary reason for LTS's existence.¹⁵⁵ The Commission considered immediately merging LTS into the ICLS mechanism, but concluded that LTS should be retained temporarily in order to ensure the stability of the NECA common line pool during the transition to the new access rate structure.¹⁵⁶ Accordingly, the Commission retained the LTS mechanism and adopted rules providing that carriers leaving the pool and foregoing LTS would be ineligible for increased ICLS to make up for the lost LTS.¹⁵⁷ The Commission also issued a notice seeking comment on its tentative conclusion to merge LTS into ICLS effective July 1, 2003, after the completion of the *MAG Order's* access charge reforms.¹⁵⁸ The Commission explained that, during the interim, LTS would serve to reduce ICLS amounts for carriers but would not affect the total support levels or revenue recovery for rate-of-return carriers, provided they remained in the pool.¹⁵⁹

60. In response to the *MAG Further Notice*, the Commission received comments both supporting and opposing its tentative conclusion. AT&T, CUSC, and GCI support the Commission's tentative conclusion.¹⁶⁰ NECA and Western Alliance argue that the merger of LTS into ICLS should be delayed pending "longer-term" analysis of the effects of the *MAG*

¹⁵³ *Id.* at 19667-69, paras. 128-31.

¹⁵⁴ *Id.* at 19672, para. 138.

¹⁵⁵ *Id.* at 19672-73, paras. 139-41, 19724-26, paras. 272-76.

¹⁵⁶ *Id.* at 19672-73, paras. 139-41. The Commission ordered a graduated phase-out of the CCL charge between January 1, 2002, and July 1, 2003, contemporaneous with increases to the residential and single-line business SLC caps. *Id.* at 19644-45, para. 65. This phase-out of the CCL charge prevented a spike in ICLS during the gradual phase-in of increased SLC caps. *Id.*

¹⁵⁷ *Id.* at 19672-73 paras. 139-40.

¹⁵⁸ *Id.* at 19724-26, paras. 139-41. In an order released on June 13, 2002, the Commission amended its rules governing LTS. *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent LECs and IXCs*, CC Docket No. 00-256, Federal-State Joint Board on Universal Service, CC Docket 96-45, Order and Second Order on Reconsideration in CC Docket No. 00-256, 17 FCC Rcd 11593, 11594-97, paras. 4-10 (rel. June 13, 2002) (*June 2002 MAG Reconsideration Order*). The amended rules capped LTS support for certain carriers that would otherwise exceed their common line revenue requirements due to increased SLC revenues as a result of the *MAG Order* reforms.

¹⁵⁹ *MAG Order*, 16 FCC Rcd at 19672-73, paras. 139-41. Because ICLS is reduced by the amount of LTS that a carrier receives or, for carriers that have left the NECA common line pool, the amount of LTS that they would have received had they remained in the pool, a pooling carrier that currently is eligible for both ICLS and LTS will receive less total support if it chooses to leave the pool. 47 C.F.R. § 54.901(a). Due to caps on other revenue sources, such a carrier likely would not be able to recover the lost universal service support from other sources.

¹⁶⁰ AT&T Comments at 23 n.20; CUSC Comments at 8-9; GCI Comments at 18.

Order reforms and other pending proceedings.¹⁶¹ NTCA contends without elaboration that merging LTS into ICLS will diminish the viability of the common line pool, which provides benefits to small rural carriers that participate in it.¹⁶² NRTA, OPASTCO, and USTA, the other members of MAG, have not adopted an official position on the issue of merging LTS into ICLS.¹⁶³

2. Discussion

61. We adopt the Commission's tentative conclusion in the *MAG Order* that LTS should be merged into the ICLS mechanism. First, merging LTS into ICLS would promote administrative simplicity. LTS and ICLS duplicatively provide support directed to the rate-of-return carriers' interstate common line costs.¹⁶⁴ ICLS is narrowly tailored to individual carriers' support requirements under the current interstate access rate structure, acting as the residual source of revenue for rate-of-return carriers and ensuring that they can recover their common line revenue requirements while providing service at an affordable rate. LTS, on the other hand, normally provides each carrier with a fixed level of support grown annually by inflation and may bear little relevance to a particular carrier's support requirements. In most cases, LTS will not be sufficient to ensure that a carrier will recover its common line revenue requirement under the current rate structure.¹⁶⁵ Although LTS effectively served the purposes it was designed to serve, it was not designed to meet the requirements of the rate-of-return access charge rate structure in place after the *MAG Order*. Eliminating LTS will make the interstate access rate structure and universal service mechanisms simpler and more transparent.

¹⁶¹ NECA Comments at 10-15; Western Alliance Comments at 10-12; NECA Reply at 8-10.

¹⁶² NTCA Comments at 6; *see also* NTCA Reply at 6-7 (supporting NECA's comments).

¹⁶³ *See* Letter from Colin Sandy, Associate Attorney, NECA, to Marlene H. Dortch, Secretary, FCC, dated March 14, 2003, Attachment (memorializing ex parte presentation by NECA, NRTA, NTCA, OPASTCO, and USTA).

¹⁶⁴ We find that Innovative's and CUSC's concerns regarding LTS and ICLS are misplaced. Innovative neither opposes nor supports the Commission's tentative conclusion, but raises concerns, based on language in the *MAG Order*, that a rate-of-return carrier may receive less support under the ICLS mechanism than it had previously received under LTS. Innovative Comments at 5-6. That would only occur, however, if the carrier would otherwise recover higher revenues than permitted by its common line revenue requirement, a situation that has been remedied by the Commission's amendment of the LTS rules in June 2002. *See June 2002 MAG Reconsideration Order*, 17 FCC Rcd at 11596-97, para. 8. CUSC argues that the current coexistence of LTS and ICLS permits rate-of-return carriers to receive double support for the common line. CUSC Comments at 8-9. Although LTS and ICLS perform duplicative functions, the two mechanisms are complementary with respect to the amount of support provided. Because a carrier's ICLS is reduced by any LTS received, the carrier would not recover more combined support than it would receive if ICLS or LTS were the sole sources of support for the interstate common line. *See MAG Order*, 16 FCC Rcd at 19673, para. 141.

¹⁶⁵ In other cases, LTS would have permitted some carriers to earn more than their common line revenue requirements had the Commission not amended its rules to limit support in a manner consistent with the ICLS rules. *See June 2002 MAG Reconsideration Order*, 17 FCC Rcd at 11596-97, para. 8.

62. Moreover, even proponents of retaining LTS acknowledge that the Commission's elimination of the CCL charge obviates LTS's primary historical purpose.¹⁶⁶ As the history of LTS makes plain, the Commission's primary concern in developing and retaining LTS over the years has been to reduce disparities in CCL charges among LECs. In its original incarnation, LTS was specifically designed to guarantee that all carriers would charge a nationwide average CCL charge.¹⁶⁷ When the Commission later amended its LTS rules to comply with the 1996 Act rather than eliminating LTS, the Commission continued to focus solely on the public interest served by LTS in reducing the disparities in CCL charges among rate-of-return carriers (though the mechanism no longer guaranteed the maintenance of a nationwide average CCL rate).¹⁶⁸ Having outlived its primary purpose as of July 1, 2003, when the CCL charge was completely phased out, we conclude that LTS should be discontinued in the interest of administrative simplicity.

63. LTS's secondary role as an incentive for continued participation in the NECA common line pool also is no longer a valid reason to maintain LTS as a discrete support mechanism. LTS is only available to carriers that participate in the common line pool.¹⁶⁹ Removing LTS as an artificial incentive for pool participation will give each carrier the freedom to choose to set rates outside of the NECA pool without sacrificing the universal service support that ensures affordable service for its customers. We recognize that NECA has made great strides in providing common line pool participants with increased flexibility in setting individual end user rates and that it anticipates further innovation in this respect.¹⁷⁰ Carriers will undoubtedly regard such flexibility as a tremendous value in making their determinations whether to continue participating in the pool. Nonetheless, we find that each individual carrier is in the best position to decide whether pool participation promotes its particular best interests. We conclude that the decision whether to participate in the pool should be left to each individual carrier based on the pool's inherent administrative benefits for that carrier without additional regulatory inducements.

64. We do not believe that eliminating LTS as an incentive for pool membership will risk or undermine the important benefits for carriers that elect to remain in the NECA common

¹⁶⁶ See, e.g., NECA Comments at 13 ("As the FNPRM points out, however, the principal rationale for providing LTS funding to NECA pool participants (*i.e.*, assuring nationwide comparability of NECA pool CCL rates) will no longer apply following elimination of the CCL charge."). No commenter contends that LTS serves any purpose other than encouraging participation in the NECA common line pool. See NECA Comments at 10-15; NTCA Comments at 6; Western Alliance Comments at 10-12; NTCA Reply at 6-7.

¹⁶⁷ 1987 Access Charge Reform Order, 2 FCC Rcd at 2957, para. 33 ("The long term support mechanism allows [pooling] carriers to maintain the nationwide averaged CCL rate that would have existed had the mandatory full common line pool been retained.")

¹⁶⁸ Universal Service First Report and Order, 12 FCC Rcd at 9165, para. 757.

¹⁶⁹ 47 C.F.R. § 54.303.

¹⁷⁰ NECA has introduced rate-banding and plans to allow pooling carriers to disaggregate their SLCs as means for carriers to set their prices competitively, and notes that pooling carriers may file their tariffs separately in any event. NECA Comments at 14.

line pool. We recognize the continued benefits of pooling identified by NECA and other commenters, including the reduction of administrative burdens associated with tariff-filing and protection against the effects of short-term revenue fluctuations.¹⁷¹ We anticipate that many, if not most, carriers will continue participating in the common line pool because of such benefits. In this regard, we note that the NECA traffic-sensitive pool remains viable despite no comparable regulatory incentive for participation. Based on examination of the record, however, we cannot conclude that the benefits of pooling warrant continued use of universal service support to induce carriers to participate in the pool if they are not otherwise inclined to do so.¹⁷²

65. Moreover, the regulatory concerns which justified the use of LTS to induce pool participation no longer hold. In the past, a non-pooling carrier might not recover its common line revenue requirement if it underprojected its costs or overprojected its demand in developing its access charge tariffs. The NECA common line pool spread that risk among all carriers, reducing the likelihood that any one carrier would suffer a major shortfall in revenue. Eliminating the CCL charge renders irrelevant this primary risk-pooling benefit of the common line pool. While the pool formerly ensured that an individual carrier would not suffer if CCL charge revenues were insufficient to recover its common line revenue requirements, the ICLS mechanism now ensures that no individual carrier will fail to recover its common line revenue requirement.

66. Finally, we note that we have taken a more measured approach by deferring implementation of this change for an additional year beyond that originally proposed by the Commission in the *MAG Further Notice*. The Commission adopted a cautious approach to access charge and universal service reform in the *MAG Order*, in recognition of the unique needs and broad diversity of rate-of-return carriers. The Commission had previously retained LTS pending comprehensive reform to the access rate structure. Absent any specific concern, we conclude that the elimination of the LTS mechanism should not be further deferred.¹⁷³

¹⁷¹ See *MAG Order*, 16 FCC Rcd at 19726, para. 276; see also *Regulatory Reform for LECs 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).

¹⁷² To the contrary, some commenters supporting the retention of LTS argue that LTS itself does not provide a significant incentive for pool participation. These commenters argue that, for the low-cost carriers most likely to leave the pool, "availability or non-availability of LTS is not likely to be a significant factor in reaching a decision as to whether to exit the pool." NECA Comments at 14; Western Alliance Comments at 11 ("Those carriers having relatively low common line costs are unlikely to be influenced to a significant degree by the availability or non-availability of LTS."); NTCA Reply at 7.

¹⁷³ NECA generally asserts that the *MAG Order* carried out "extraordinary changes in universal service support and access charge mechanisms," but offers no specific concerns to justify deferring the merger of LTS into ICLS. NECA Comments at 10-15.

The reformed access rate structure adopted in the *MAG Order* possesses greater inherent stability than the prior rate structure.¹⁷⁴

67. In order to effectuate this decision, we amend our rules to provide that LTS shall not be provided to any carrier beginning July 1, 2004. We note that overall support will not be reduced because our existing rules will operate to automatically increase ICLS by an amount to match any LTS reduction. For that reason, no further action by the Commission is necessary to implement the merger of LTS into ICLS.

IV. SECOND FURTHER NOTICE OF PROPOSED RULEMAKING

A. Alternative Regulation and the All-or-Nothing Rule

68. In this further notice of proposed rulemaking, we seek additional comment on incentive regulation and on the all-or-nothing rule. CenturyTel and a group of carriers (ALLTEL, Madison River and TDS) filed separate alternative regulation proposals as *ex parte* filings in response to the 2002 notice.¹⁷⁵ These two proposals each contain a feature that would permit a rate-of-return carrier to elect to move some, but not all, of its study areas to incentive regulation. We therefore will address the remaining all-or-nothing issues not resolved above in conjunction with our evaluation of the two incentive regulation plans before us.

1. Background

a. All-or-Nothing Rule

69. Section 61.41 of the Commission's rules sets forth certain requirements governing elective entry into price cap regulation and restricting the ability of price cap carriers to leave price cap regulation. We describe these provisions in Section III.A, *supra*. That section also describes the issues raised in the *MAG Further Notice* concerning the modification or elimination of the all-or-nothing rule and the general tenor of the comments we received in response to the notice.

b. Alternative Regulation

70. The traditional regulatory model for incumbent LECs has long been rate-of-return regulation.¹⁷⁶ LECs subject to rate-of-return regulation establish tariff rates targeted to achieve

¹⁷⁴ For example, an individual carrier's common line revenues will no longer be threatened by fluctuating minutes of use or inaccurate cost projections that may result in insufficient CCL charge revenues because each carrier will recover its precise common line revenue requirement from ICLS.

¹⁷⁵ See CenturyTel, Inc., Ex Parte in CC Docket Nos. 96-45, 98-77, 98-166 and 00-256 (filed Dec. 23, 2002); ALLTEL Communications, Inc., Madison River Communications LLC and TDS Telecommunications Corporation, Ex Parte in CC Docket Nos. 96-45, 98-77, 98-166 and 00-256 (filed Jan. 31, 2003); letter from Stephen Kraskin, Esq., counsel for ALLTEL Communications, Inc., Madison River Communications LLC and TDS Telecommunications Corporation, to Marlene H. Dortch, Secretary, FCC, dated May 9, 2003 (Kraskin letter) (amending plan to reflect availability to all rate-of-return carriers rather than just to rural rate-of-return carriers).

¹⁷⁶ See *MAG Order*, 16 FCC Rcd at 19622-24, paras. 16-20.

an authorized rate of return, today set at 11.25 percent.¹⁷⁷ If the rates are deemed lawful when filed,¹⁷⁸ LECs do not have to refund any overearnings.¹⁷⁹ Otherwise, overall interstate earnings above 11.25 percent for all access categories, plus a fixed increment of 25 basis points, are subject to refund.¹⁸⁰ Thus, because of the cost-plus nature of rate-of-return regulation, rate-of-return carriers are generally unable to retain permanently the benefits from any efficiencies that they may create during the two years in which a tariff is in effect. Efficiencies realized because of increased demand or lowered costs are used in developing rates for the subsequent two-year tariff period, which adjusts future rates so that the rate-of-return carrier's revised tariff rates will be set to produce an 11.25 percent rate of return for the future tariff period.

71. In 1991, the Commission established a price cap regulatory structure that applied to the BOCs and GTE on a mandatory basis. Other LECs could elect to participate in the price cap program, and several have. Under price cap regulation, carriers' access charges were limited by price indexes that were adjusted annually by an X-Factor, which, in the original price cap plan, reduced the price cap indexes to reflect price cap carrier productivity gains above those reflected in the gross domestic product - price index (GDP-PI). Price cap carrier customers received some of the benefits of increased efficiencies that the carrier achieves.¹⁸¹ Our price cap rules also provided for price cap indexes to be adjusted upwards, implementing a low-end adjustment, if a price cap carrier earned returns below a specified level in a given year. Moreover, a price cap carrier was allowed to 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 would produce earnings that are so low as to be confiscatory. Until 1997, price cap carriers were required to "share," or return to ratepayers, earnings above specified levels.¹⁸²

¹⁷⁷ *Id.* at 19701-02, paras. 208-10.

¹⁷⁸ 47 U.S.C. § 204(a)(3); *See ACS of Anchorage, Inc. v. FCC*, 290 F.3d 403 (D.C. Cir 2002).

¹⁷⁹ Rates are deemed lawful pursuant to section 204(a)(3) if they are not suspended before becoming effective. The majority of filed tariff rates are not suspended and therefore are deemed lawful.

¹⁸⁰ 47 C.F.R. § 65.700(b).

¹⁸¹ 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 price cap carrier chooses to recover from a given service.

¹⁸² *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), *aff'd in part, rev'd in part, USTA v. FCC*, 188 F.3d 521 (D.C. Cir 1999).

72. The Commission replaced the original price cap structure with the CALLS plan in 2000. Under the CALLS plan, carriers' access charges are limited by price indexes that are adjusted annually by an X-Factor, which now serves as a transitional mechanism for moving rates to target levels. The plan established three target levels for traffic-sensitive access rates.¹⁸³ In addition, under the terms of the *Pricing Flexibility Order*, an eligible price cap carrier that elects to price access services using the Commission's pricing flexibility rules forgoes its right to an automatic low-end adjustment.

73. In the *MAG Further Notice*, we sought comment on several parameters that might be included in an alternative regulation plan. The Commission noted that a properly designed 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 also sharing some of those savings with consumers. The Commission noted three principles: (1) rates must be just and reasonable, as required by section 201(b) of the Act;¹⁸⁴ (2) adequate investment or service quality levels must be maintained;¹⁸⁵ and (3) administrative burdens on carriers should be minimized.¹⁸⁶ Finally, the Commission asked a variety of questions on specific issues relating to the development of an alternative regulatory plan. These inquiries included: (1) the extent to which a plan should be optional;¹⁸⁷ (2) the appropriateness of including a carrier electing an alternative regulation plan in the NECA pooling process;¹⁸⁸ (3) the baseline on which an incentive plan should be based, e.g., on revenue per line (RPL) or some other measure;¹⁸⁹ (4) the extent to which a plan should provide for a productivity offset or contain a sharing mechanism;¹⁹⁰ (5) the possibility of modifying the CALLS plan to permit rate-of-return carriers to adopt that structure;¹⁹¹ and (6) the need for additional reporting or other monitoring steps.¹⁹²

¹⁸³ See 47 C.F.R. § 61.3(qq).

¹⁸⁴ 47 U.S.C. § 201(b); *MAG Further Notice*, 16 FCC Rcd at 19706, para. 221.

¹⁸⁵ *MAG Further Notice*, 16 FCC Rcd at 19706, para. 223.

¹⁸⁶ *Id.* at 19707, para. 225.

¹⁸⁷ *Id.* at 19707, para. 227.

¹⁸⁸ *Id.* at 19708, para. 228.

¹⁸⁹ *Id.* at 19708-09, paras. 229-32.

¹⁹⁰ *Id.* at 19709-10, paras. 234-37. The Commission also inquired about whether a system of regulating with a lag might be considered. Under such an approach, an initial productivity factor would be selected and, at subsequent periods, such as every three years, the productivity factor would be revised based on the preceding periods actual performance. *Id.*

¹⁹¹ *Id.* at 19709, para. 233.

¹⁹² *Id.* at 19711, para. 239.

74. Several parties indicated that benefits would flow from the adoption of an alternative regulatory plan. For example, NRTA states that an optional plan will modernize regulation where incentive regulation can benefit consumers, as well as carriers, without jeopardizing the Act's commitment to comparable rural and urban services and prices and to the availability of evolving telecommunications capabilities in rural areas.¹⁹³ ALLTEL argues that rate-of-return regulation limits a LEC's potential earnings (and thus the amount of capital available for investment) and limits a LEC's ability to respond to bundled and discounted competitive offerings.¹⁹⁴ They submit that the Commission should build incentives into its regulation that encourage LECs to pursue the goals of investment, service quality, and advanced services independently.¹⁹⁵ Parties differed widely, however, in the features that they believed a reasonable alternative regulatory plan should include.

75. Rate-of-return carriers generally argue that any alternative regulation plan should be optional and, given the operational variations among rate-of-return carriers, should permit a rate-of-return carrier to elect coverage by study area.¹⁹⁶ ALLTEL states that because of the all-or-nothing rule, rate-of-return carriers serving rural areas cannot make the transition to price caps, even though price cap regulation might work for some study areas.¹⁹⁷ Other parties, including IXCs, on the other hand, argue that any alternative regulation plan should be mandatory for larger rate-of-return carrier holding companies because they possess the size necessary to benefit from any incentives offered in an alternative regulation plan.¹⁹⁸ These parties argue that if an alternative regulation plan were optional, a rate-of-return carrier could opt in at a cyclical cost peak or otherwise gold-plate their cost structure before electing an alternative plan. CUSC argues that all vestiges of revenue guarantees for rate-of-return carriers must be eliminated by expeditiously transitioning rate-of-return carriers to incentive regulation in order to avoid creating powerful incentives for inefficiency.¹⁹⁹

¹⁹³ NRTA Comments at 7.

¹⁹⁴ ALLTEL Comments at 19-20.

¹⁹⁵ *Id.* at 39.

¹⁹⁶ *See, e.g.*, ALLTEL Comments at 5; GVNW Comments at 2-4; ICORE Comments at 11-13; ITTA Comments at 6-7; NRTA Comments at 4-7 (rate-of-return carriers have less opportunity to achieve lower costs due to their limited size, their lumpy investment patterns, and the fluctuating operating expenses); NTCA Comments at 2-3; Nebraska Rural Carriers Comments at 2-3; Telecom Consulting Assoc. Comments at 2-3 (should not be tied to levels of competition, but should be permitted if an ETC has been designated); Ronan and Hot Springs Comments at 5; Western Alliance Comments at 5-6.

¹⁹⁷ ALLTEL Comments at 8.

¹⁹⁸ *See, e.g.*, AT&T Comments at 13-15 (above 50,000 lines); Nebraska Rural Carriers Comments at 3 (optional below 100,000 lines); Sprint Comments at 4 (mandatory for all rate-of-return carriers); WorldCom Comments at 3 (above 200,000 lines); GCI Reply at 2 (above 50,000 lines).

¹⁹⁹ CUSC Comments at 3.

76. Several parties argue that a productivity factor must be part of any alternative regulation plan to ensure that consumers, not just the carriers, benefit from the plan.²⁰⁰ AT&T, GCI, and Sprint submit that productivity for local switching and transport will be higher than that for the common line category.²⁰¹ Rate-of-return carriers, on the other hand, strenuously oppose the inclusion of a productivity factor in any plan.²⁰² Some of these rate-of-return carrier interests also oppose any up-front productivity dividend.²⁰³ Several parties support the adoption of a sharing mechanism, despite its incentive-suppressing effects, and some would establish two productivity factors with different sharing requirements.²⁰⁴ Several parties support a low-end adjustment to preclude any confiscatory takings that might otherwise occur,²⁰⁵ although AT&T opposes such a provision unless sharing is required.²⁰⁶

77. AT&T and GCI support the use of RPL²⁰⁷ as the baseline for establishing an incentive structure for common line services.²⁰⁸ ICORE submits that rate-of-return carriers with stable costs and reasonable access line growth rates may benefit from using RPL, but RPL will not work for small carriers with volatile costs, sporadic line growth, and acute sensitivity to external events.²⁰⁹ GSA argues that the Commission must monitor service quality performance and should not rely on other regulatory bodies for that purpose.²¹⁰

²⁰⁰ See, e.g., AT&T Comments at 8-12; GCI Comments at 4-10; GSA Comments at 5-7; WorldCom Comments at 3-4.

²⁰¹ AT&T Comments at 6; GCI Comments at 8-10; Sprint Comments at 4.

²⁰² See, e.g., GVNW Comments at 4-5 (problematic to establish a productivity factor given the small size of rate-of-return carriers; special attention should be given to LECs with fewer than 50,000 lines if a productivity factor is to be adopted); Ronan and Hot Springs Comments at 1-5; Western Alliance Comments at 7.

²⁰³ See, e.g., Ronan and Hot Springs Comments at 5.

²⁰⁴ See, e.g., AT&T Comments at 11-12; Sprint Comments at 3 (a higher X-Factor would return more of productivity gains to the consumers annually, thereby permitting a LEC to earn more before being required to share any increased profits); WorldCom at 3-4.

²⁰⁵ See, e.g., ALLTEL Comments at 45-46; Ronan and Hot Springs Comments at 5; Sprint Comments at 3.

²⁰⁶ See, e.g., AT&T Comments at 11-12.

²⁰⁷ Under an RPL approach, a rate-of-return carrier would determine its total revenues from, for example, the common line category, and divide that by the number of lines to obtain a revenue per line amount. This RPL would become the base that would be used to establish future revenue levels. The RPL level could be adjusted by growth and productivity factors, depending on the terms of an alternative regulation plan that might be adopted.

²⁰⁸ AT&T Comments at 4-6; GCI Comments at 10.

²⁰⁹ ICORE Comments at 11-12.

²¹⁰ GSA Comments at 9-11.

78. Several parties argued that a rate-of-return carrier electing an alternative regulation plan should be required to leave the NECA pools²¹¹ because incentive regulation, which would require carriers to take certain risks to obtain certain rewards, is inconsistent with the risk sharing effect of pooling.²¹² GCI asserts that a rate-of-return carrier must be required to file a tariff that is supported by a cost study before going into incentive regulation.²¹³ Many rate-of-return carriers, however, argue that a rate-of-return carrier choosing alternative regulation should be allowed to continue in the NECA pools, because they believe that the pooling procedures can be modified to accommodate an incentive regulation plan.²¹⁴ NECA states that accommodating incentive regulation within its existing pooling arrangements would require a settlement mechanism that would distribute access charge revenues to participating companies on a formula basis, similar to what is done for average schedule settlements.²¹⁵ If targeted rates were included as part of an alternative regulation plan, NECA would apply existing rate banding methodologies to incentive companies based on incentive formula characteristics.²¹⁶ AT&T argues that average schedule companies should not be allowed to elect an alternative regulation plan.²¹⁷

79. Subsequent to the close of the record, two alternative regulation plans were filed with the Commission. CenturyTel filed what is essentially a modified CALLS plan. ALLTEL, Madison River, and TDS filed a plan, called the Rate-of-Return Carrier Tariff Option, that would expand the availability of the tariff filing option in section 61.39²¹⁸ that is currently available only

²¹¹ NECA operates two pools: the common line pool and the traffic-sensitive pool, the latter including local switching, transport, and special access. Pooling carriers charge rates set by NECA that are based on the costs of those carriers that participate in the pool or, in the case of banded rates, the costs of those carriers falling within the particular band. For a particular tariff, participating LECs pool their interstate access revenues from services offered pursuant to that tariff. Rate-of-return carriers recover their costs from the pools, including a return on investment that is equal for all participating rate-of-return carriers in the pool. This recovery of all costs plus an equal return for all rate-of-return carriers provides the risk sharing feature of the pooling process.

²¹² See, e.g., AT&T Comments at 6-7.

²¹³ GCI Comments at 5-7.

²¹⁴ See, e.g., NRTA Comments at 17; NTCA Comments at 4.

²¹⁵ Rather than settling with the NECA pool on the basis of its own costs, an average schedule company receives settlements from the NECA pool based on a formula, called the average schedule, that is developed based on a study of the costs of comparable cost companies.

²¹⁶ NECA Comments at 8.

²¹⁷ AT&T Comments at 7.

²¹⁸ 47 C.F.R. § 61.39. This section allows a rate-of-return carrier with 50,000 lines or fewer to file tariffs every two years based on its demand and cost data from the previous two years to develop its rates for the subsequent two-year tariff period. These small rate-of-return carriers are not required to file the cost-support materials required by section 61.38 with their tariff filing, 47 C.F.R. § 61.38.

to carriers with 50,000 or fewer access lines.²¹⁹ These plans are described in the following section and attached in Appendices C and D.

2. Alternative Regulation Proposals

80. *CenturyTel Proposal.* CenturyTel proposes a five-year plan that would modify the Commission's price cap rules to permit rate-of-return carriers to elect a modified form of price cap regulation on a study area basis. The plan would eliminate the all-or-nothing rules contained in section 61.41(c)(2) and (3) so that rate-of-return carriers that acquire price cap exchanges need not convert to price caps at the holding company level.²²⁰ CenturyTel also proposes that the Commission eliminate section 61.41(b) so that rate-of-return carriers can elect price cap regulation on a study area basis.

81. Under CenturyTel's proposal, average traffic-sensitive (ATS) target rates would be established. These target traffic-sensitive rates in electing study areas would depend on line density at the holding company level, excluding lines acquired from mandatory price cap carriers. The plan would set the target rates at the lesser of: (1) \$0.0125 per minute, or the actual rate for carriers with a line density of less than 15 lines per square mile; or (2) \$0.0095 per minute, or the actual rate for carriers with a line density of at least 15, but less than 19, lines per square mile; or (3) the current levels up to a maximum ATS rate of \$0.0095 per minute for carriers with a line density higher than 19 lines per square mile for carriers newly electing the plan.²²¹ CenturyTel would have the Commission set the productivity factor, or X-Factor, at GDP-PI for carriers electing price caps under this plan.²²² The plan would contain a low-end adjustment set at 10.25 percent to ensure reasonable earnings opportunities. Finally, the CenturyTel plan would permit a rate-of-return carrier to elect price caps for some study areas and remove those study areas from the NECA pools, while leaving its other study areas in the NECA pools subject to rate-of-return regulation.²²³ CenturyTel proposes that rate-of-return carriers be able to choose alternative regulation at any annual or semi-annual tariff filing to be effective for the remainder of the five-year plan.²²⁴

82. CenturyTel's plan would permit an electing rate-of-return carrier to move its rate to a target rate on a revenue-neutral basis by allowing a rate-of-return carrier to recover the difference between the target rate and its existing revenue requirement through an ATS additive to ICLS; the plan would freeze the ATS additive on a study area basis for the duration of the

²¹⁹ See generally Kraskin letter.

²²⁰ CenturyTel Proposal at 1.

²²¹ *Id.* at 2.

²²² *Id.* This has the effect of freezing all rates at the target levels.

²²³ *Id.* at 4.

²²⁴ *Id.* at 6.

plan.²²⁵ The plan would also freeze ICLS and LTS on a per-line basis for electing carriers for the plan's duration,²²⁶ as well as freezing LSS on a study area basis for the plan's duration.²²⁷ The \$650 million fund of interstate CALLS support would not be available to the new price cap carriers.²²⁸ High-cost loop support would be frozen on a per-line basis, subject to adjustment for GDP-CPI.²²⁹

83. *Rate-of-Return Carrier Tariff Option.* The Rate-of-Return Carrier Tariff Option would extend the current section 61.39 small carrier tariff option to all rate-of-return carriers, not just those serving 50,000 or fewer lines.²³⁰ Under this option, electing rate-of-return carriers would file tariffs for a two-year period, with rates based on historical costs and demand. Initial traffic-sensitive rates would be established using costs and demand for the previous calendar year, while rates for succeeding tariff periods would be based on the actual costs and demand of the two preceding years. Thus, efficiencies achieved during the two-year tariff period would not be reflected in the form of rates until the next two-year tariff period.²³¹ Electing rate-of-return carriers would develop SLCs and other end user charges based on historical costs, just as they do for traffic-sensitive charges.

84. The Rate-of-Return Carrier Tariff Option would initially establish per-line, common line support at the historical level of costs recovered through universal service divided by the historical level of access lines.²³² Specifically, the historical interstate common line revenue requirement, including line port and TIC reallocations, would be reduced by SLC revenues, the Special Access Surcharge, the Line Port Costs in Excess of Basic Analog Service, and universal service funding assessments recovered from end users.²³³ The proposal would reassess the level of support every two years, based on the cost and demand levels during the

²²⁵ *Id.* at 3. More specifically, CenturyTel proposes that the Commission amend section 54.901 so that if an electing carrier's existing ATS rate is above the target rate, the carrier can recover the difference between the target rate and its existing revenue requirement through a "TS Additive" to ICLS. *Id.* In addition, CenturyTel proposes, the "TS Additive" would be frozen on a study area basis for the duration of its plan. *Id.*

²²⁶ *Id.* CenturyTel would clarify section 54.902 to make clear that ICLS support will follow transferred exchanges, and LTS will continue to be available when a buyer elects the new price caps. *Id.*

²²⁷ *Id.* CenturyTel proposes this revision as an amendment to section 54.301(a).

²²⁸ *Id.* CenturyTel proposes this revision as a redefinition of "price cap carrier," for the purposes of Part 54, Subpart J, in section 54.800.

²²⁹ *Id.* CenturyTel proposes these revisions as amendments to sections 36.631 and 36.603. The rural growth factor would continue to apply to the portion of the high-cost fund that supports other rural LECs. All rural LECs would remain eligible to receive safety net and safety valve support. *Id.*

²³⁰ ALLTEL Proposal at 3.

²³¹ *Id.* at 4.

²³² *Id.* at 5.

²³³ *Id.*

previous two-year period.²³⁴ Finally, the proposal would not alter the manner in which LSS and high-cost loop support is calculated or obtained.

3. Discussion

85. With this further notice, we are taking a more focused look at the issues surrounding alternative regulation plans for rate-of-return carriers based on the two proposals presented to the Commission. In conjunction with that review, we will address the issues surrounding the retention or modification of the all-or-nothing rule as it relates to the ability of rate-of-return carriers to elect to adopt an alternative regulation plan for only some of its study areas.²³⁵ We build upon the record of the earlier notice as we proceed with our evaluation of alternative regulation opportunities and the all-or-nothing rule.

86. The two plans are each premised on a carrier's ability to elect alternative regulation on a study area basis, rather than on a holding company level, and are thus dependent on modification of the all-or-nothing rule. We tentatively conclude that any alternative regulation plan we adopt will be optional on the part of the rate-of-return carrier and will permit a rate-of-return carrier to elect participation in the alternative plan by study area. Our experience over the years in attempting to develop incentive regulation for smaller companies has led us to the view that it would not be possible to devise a plan suitable for mandatory imposition on all rate-of-return carriers. Likewise, it appears that most rate-of-return holding company groups are composed of very diverse operating companies, and that such companies will not be able to elect incentive regulation if they must do it on an "all-or-nothing" basis. We seek comment on these tentative conclusions, but we also ask that parties evaluate the plans as though they were going to be implemented on a study-area basis.

87. We invite parties to comment on the two alternative regulation proposals in the record. We ask parties to indicate whether one, both, or neither of the plans should be available. Parties may propose modifications to the two proposals. In doing so, they should be guided by the general inquiries that the Commission made in the *MAG Further Notice* with respect to the evaluation of both alternative plans and the modification of the all-or-nothing rule.²³⁶ We highlight some of these issues below. We also ask parties to address the implications of CenturyTel's proposed five-year time frame on the resolution of long-term access issues raised in the intercarrier compensation proceeding.²³⁷

²³⁴ *Id.*

²³⁵ The *MAG Further Notice* did not address whether price cap carriers that voluntarily elected price cap regulation should be allowed to remove one or more study areas from price cap regulation and return them to rate-of-return regulation or any alternative regulation plan adopted pursuant to the *MAG Further Notice*. We similarly limit this further notice to rate-of-return carrier election under the all-or-nothing rule, despite Valor's argument that price cap carriers in CALLS should be able to elect any alternative regulation plan adopted if that form of regulation is better suited to the needs of the carrier. Valor Reply at 8-9.

²³⁶ See generally *MAG Further Notice*, 16 FCC Rcd at 19703-11, paras. 213-240, 19717-24, paras. 260-71.

²³⁷ See *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, Notice of Proposed Rulemaking, 16 FCC Rcd 9610 (2001).

88. The CenturyTel plan essentially freezes access rates by proposing a productivity factor equal to GDP-PI, while the Rate-of-Return Carrier Tariff Option would adjust rates every two years to reflect any efficiency gains. We invite parties to comment on whether these proposals would produce rates that would be just and reasonable, as required by section 201(b) of the Act,²³⁸ and not unreasonably discriminatory, as required by section 202(a) of the Act.²³⁹ Parties are asked to address whether the CenturyTel plan should contain a productivity factor other than GDP-PI. Parties proposing such productivity factors are asked to explain in detail how such factors can be accurately calculated for the diverse group of carriers currently subject to rate-of-return regulation.²⁴⁰ The use of GDP-PI would mean that lower traffic-sensitive rates resulting from traffic growth would no longer occur as they would under rate-of-return regulation. Parties should address whether, as an alternative approach to an X-Factor, a G-factor should be used.²⁴¹ A G-factor would adjust the rate cap for rates of traffic-sensitive services based on the rate of growth of the relevant traffic-sensitive measure, *e.g.*, minutes. If so, should it be set based on historical data, or based on projections for the next tariff period? Alternatively, should the CenturyTel plan include a sharing mechanism if a productivity factor higher than that proposed, or a G-factor, is not adopted? Parties should address the need for, and level of, a low-end adjustment factor and how its level should be set in relation to any productivity factor, G-factor, or sharing requirement that might be adopted. Finally, we invite parties to discuss the implications for the Commission's goals if CenturyTel were the only carrier to elect its proposed form of alternative regulation.

89. Parties are also invited to comment on the effect that each plan will have on the incentives of electing rate-of-return carriers to invest in, and maintain, their exchange access facilities and to ensure that service quality is not degraded. We ask parties to evaluate the differences between the two plans on this score and to address what additional steps, if any, would be necessary to ensure that service quality does not decline in the face of any incentive to increase profits. We also ask parties to address the effects that the option to elect by study area and at a time of the rate-of-return carrier's choosing would have on these investment and service quality considerations.

90. Parties should also address the universal service aspects of the two plans. To what extent is either the CenturyTel plan or the Rate-of-Return Carrier Tariff Option likely to increase the size of the universal service fund, and how would support levels change over time? What effect, if any, would adoption of either plan have on the overall sustainability of universal service? What incentives would be created if, as CenturyTel proposes, high-cost loop support is fixed on a per-line basis and grows by GDP-PI, without regard to investment in loop facilities? With respect to either proposal, commenters should provide a detailed explanation as to how support should be calculated and the administrative burdens entailed. Commenters should also address how the proposal would serve the principles of section 254 of the Act.

²³⁸ 47 U.S.C. § 201(b).

²³⁹ 47 U.S.C. § 202(a).

²⁴⁰ *MAG Further Notice*, 16 FCC Rcd at 19710, para. 235.

²⁴¹ *Pricing Flexibility Order*, 14 FCC Rcd at 14326, para. 207.

91. We tentatively conclude that the opportunity to elect alternative regulation on a study area basis should be available only to holding company groups in which all non-average schedule companies file their own cost-based tariffs. We are especially concerned about the ability of any NECA internal process, or formula, to insulate the remaining pool members from the risk that may be introduced by a carrier's adoption of an alternative regulation plan. It will also be important to consider the extent to which pool participation makes cost shifting more difficult to detect. Parties should also address what modifications in tariff cost support rules and/or reporting requirements would be necessary under two scenarios: (1) the Commission were to require holding companies electing alternative regulation to remove all study areas from the NECA pools, and (2) the Commission were to permit some or all study areas of rate-of-return carriers electing alternative regulation to participate in the NECA pools.

92. We tentatively conclude that existing accounting and regulatory processes should permit parties and the Commission to detect cost shifting by the rate-of-return carriers that file cost-based access tariffs. IXC's and competitors argue that the incentive for rate-of-return carriers to shift costs continues to exist and that existing processes are inadequate to check such cost shifting. We note, however, that this debate has been joined in very general terms, with little in the way of specific detail. We ask parties to identify the most significant means by which a rate-of-return carrier could shift costs from a study area electing an alternative regulation plan to a study area subject to rate-of-return regulation. Parties should also describe why existing procedures will, or will not, permit the cost shift to be identified and quantified. To the extent parties argue existing processes are inadequate, we invite them to identify with specificity what additional reporting or regulatory procedures would allow the parties and the Commission to identify and quantify cost shifts.

93. The debate over incentive regulation is often clouded by uncertainty as to whether the CALLS plan contemplated that additional study areas would enter that plan during its five-year term.²⁴² Three years have passed and no rate-of-return carrier has sought entry. To eliminate the uncertainty, we tentatively conclude that the CALLS plan was not designed to be open to new carriers or study areas. The CALLS plan began as a voluntarily negotiated agreement among price cap carriers and certain IXC's that addressed pricing and universal service concerns as a package, without consideration of possible participation by carriers that were then under rate-of-return regulation.²⁴³ That CALLS was not intended to accommodate additional entry is most clearly indicated by the fact that in adopting the plan, the Commission made no provision for how the universal service component of the CALLS plan would address future expansion to new carriers.²⁴⁴ We therefore believe the rules should be amended to clarify that new carriers or carrier study areas may not elect this plan. We invite parties to comment on this tentative conclusion.

²⁴² See letter from Karen Brinkmann, Esq., counsel for CenturyTel, to Marlene H. Dortch, Secretary, FCC, dated Dec. 23, 2002, Attachment 1 at 1.

²⁴³ See PRTC Comments at 2-5.

²⁴⁴ See *id.* at 7-9.

94. We also tentatively conclude that, whatever final rule we adopt with respect to the election of alternative regulation on a study area basis, that rule should also apply when carriers under different regulatory plans come together by merger or acquisition. This would include those cases in which a price cap carrier acquired a rate-of-return study area, but could not bring it into the CALLS plan, if we adopt our tentative conclusion in the previous paragraph. Thus, if we were to permit rate-of-return carriers to elect alternative regulation by study area, the current ALLTEL/Aliant, Verizon/PRTC, and Valor/Kerrville waivers of the all-or-nothing rule would no longer be necessary. Under this tentative conclusion, affected carriers would continue to receive universal service support through the preexisting support mechanism(s). We seek comment on this tentative conclusion. Parties opposing this approach should indicate how they would harmonize the interrelated considerations arising from mergers or acquisitions between carriers subject to different regulatory regimes.

V. PROCEDURAL MATTERS

A. *Ex Parte* Requirements

95. This proceeding will continue to be governed by “permit-but-disclose” *ex parte* procedures that are applicable to non-restricted proceedings under 47 C.F.R. § 1.1206. Parties making oral *ex parte* presentations are reminded that memoranda summarizing the presentation must contain a summary of the substance of the presentation and not merely a listing of the subjects discussed. More than a one- or two-sentence description of the views and arguments presented generally is required. *See* 47 C.F.R. § 1.1206(b)(2). Other rules pertaining to oral and written presentations are set forth in section 1.1206(b) as well. Interested parties are to file any written *ex parte* presentations in this proceeding with the Commission’s Secretary, Marlene H. Dortch, 445 12th Street, S.W., TW-B204, Washington, D.C. 20554, and serve with one copy: Pricing Policy Division, Wireline Competition Bureau, 445 12th Street, S.W., Room 5-A452, Washington, D.C. 20554, Attn: Douglas Sloten. Parties shall also serve with one copy: Qualex International, Portals II, 445 12th Street, S.W., Room CY-B402, Washington, D.C. 20554, (202) 863-2893, <qualexint@aol.com>.

B. Paperwork Reduction Act Analysis

96. The *Report and Order* 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.

97. The incorporated *Second Further Notice of Proposed Rulemaking (Second Further Notice)* contains either a proposed or modified information collection. As part of the continuing effort to reduce paperwork burdens, we invite the general public and the OMB to comment on the information collections contained in this *Second Further Notice*, as required by the Paperwork Reduction Act of 1995, 44 U.S.C. § 3501 *et seq.* Public and agency comments are due at the same time as other comments on this *Second Further Notice*; OMB comments are due 60 days from the date of publication of this *Second Further Notice* in the Federal Register.

Comments should address: (1) whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information shall have practical utility; (2) the accuracy of the Commission's burden estimates; (3) ways to enhance the quality, utility, and clarity of the information collected; and (4) ways to minimize the burden of the collection of information on the respondents, including the use of automated collection techniques or other forms of information technology.

C. Final Regulatory Flexibility Act Analysis

98. The Regulatory Flexibility Act of 1980, as amended (RFA),²⁴⁵ requires that a regulatory flexibility analysis be prepared for notice-and-comment rule making proceedings, unless the agency certifies that “the rule will not, if promulgated, have a significant economic impact on a substantial number of small entities.”²⁴⁶ The RFA generally defines the term “small entity” as having the same meaning as the terms “small business,” “small organization,” and “small governmental jurisdiction.”²⁴⁷ In addition, the term “small business” has the same meaning as the term “small business concern” under the Small Business Act.²⁴⁸ A “small business concern” is one which: (1) is independently owned and operated; (2) is not dominant in its field of operation; and (3) satisfies any additional criteria established by the Small Business Administration (SBA).²⁴⁹

99. As required by the RFA, an Initial Regulatory Flexibility Analysis (IRFA) was incorporated into the *MAG Further Notice*.²⁵⁰ The Commission sought written public comment on the proposals in the *MAG Further Notice*, including comment on the IRFA. This present Final Regulatory Flexibility Analysis (FRFA) conforms to the RFA, as amended.²⁵¹ 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.

²⁴⁵ See 5 U.S.C. § 603. The RFA, see 5 U.S.C. § 601 *et seq.*, has been amended by the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA), Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996).

²⁴⁶ 5 U.S.C. § 605(b).

²⁴⁷ 5 U.S.C. § 601(6).

²⁴⁸ 5 U.S.C. § 601(3) (incorporating by reference the definition of “small business concern” in the Small Business Act, 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(s) in the Federal Register.”

²⁴⁹ 15 U.S.C. § 632.

²⁵⁰ *MAG Further Notice*, 16 FCC Rcd at 19742-44, paras. 329-36.

²⁵¹ See 5 U.S.C. § 604.

1. Need for, and Objectives of, the Rules

100. In this Order, the Commission modifies its interstate access charge and universal service rules for LECs subject to rate-of-return regulation. The Order carefully considers the needs of small and mid-sized local telephone companies serving rural and high-cost areas, in order to help provide certainty and stability for such carriers, encourage investment in rural America, and provide important consumer benefits.

101. This Order addresses three of the issues raised in the *MAG Further Notice*. First, we modify the “all-or-nothing” rule to permit rate-of-return LECs to bring recently acquired price cap lines back to rate-of-return regulation. This will reduce the administrative burdens on small rate-of-return carriers of seeking a waiver of the all-or-nothing rule because it will permit acquired lines to be returned to rate-of-return regulation, and thereby will reduce the uncertainty associated with such acquisitions. Second, we grant rate-of-return carriers the authority immediately to provide geographically deaveraged transport and special access rates, subject to certain limitations. This action increases the efficiency of the interstate access charge rate structure by moving rates towards cost. Finally, we merge Long Term Support (LTS) into the ICLS mechanism. This will promote administrative simplicity by eliminating an unnecessarily duplicative support mechanism without affecting the total support received by rate-of-return carriers, and without negatively affecting carriers that choose to participate in the NECA common line pool. Because LTS, but not ICLS, is conditioned on participation in the common line pool, the merger will permit each rate-of-return carrier the freedom to choose whether to set its own rates without sacrificing universal service support.

2. Summary of Significant Issues Raised by the Public Comments in Response to the IRFA

102. No comments were filed in response to the IRFA. However, certain comments filed in response to the *MAG Further Notice* included concerns that would relate to small entities. Several commenters argued that by eliminating the all-or-nothing rule, small, typically rural carriers would experience reductions in both transaction costs and uncertainty. Some commenters also argued that relaxing the rules on volume and term discounts for transport services, together with allowing carriers to offer services pursuant to customer contracts, would cause harm to small entities by foreclosing competition. Finally, commenters argued that merging LTS into ICLS would diminish the viability of the common line pool, which provides benefits to the small, rural carriers that participate in it.

3. Description and Estimate of the Number of Small Entities to Which Rules Will Apply

103. 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.²⁵² In this section, we further describe and estimate the number of small entity licensees and regulatees that may also be directly affected by rules adopted in this order. The most reliable

²⁵² 5 U.S.C. § 604(a)(3).

source of information regarding the total numbers of certain common carrier and related providers nationwide, as well as the number of commercial wireless entities, appears to be the data that the Commission publishes in its *Trends in Telephone Service* report.²⁵³ The SBA has developed small business size standards for wireline and wireless small businesses within the three commercial census categories of Wired Telecommunications Carriers,²⁵⁴ Paging,²⁵⁵ and Cellular and Other Wireless Telecommunications.²⁵⁶ Under these categories, a business is small if it has 1,500 or fewer employees. Below, using the above size standards and others, we discuss the total estimated numbers of small businesses that might be affected by our actions.

104. We have included small incumbent LECs in this present 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 wired telecommunications carrier having 1,500 or fewer employees), and “is not dominant in its field of operation.”²⁵⁷ The SBA’s Office of Advocacy contends that, for RFA purposes, small incumbent LECs are not dominant in their field of operation because any such dominance is not “national” in scope.²⁵⁸ We have therefore included small incumbent LECs in this RFA analysis, although we emphasize that this RFA action has no effect on Commission analyses and determinations in other, non-RFA contexts.

105. *Wired Telecommunications Carriers.* The SBA has developed a small business size standard for Wired Telecommunications Carriers, which consists of all such companies having 1,500 or fewer employees.²⁵⁹ According to Census Bureau data for 1997, there were 2,225 firms in this category, total, that operated for the entire year.²⁶⁰ Of this total, 2,201 firms had employment of 999 or fewer employees, and an additional 24 firms had employment of

²⁵³ FCC, Wireline Competition Bureau, Industry Analysis and Technology Division, *Trends in Telephone Service*, Table 5.3 (August 2003) (*Trends in Telephone Service*).

²⁵⁴ 13 C.F.R. § 121.201, North American Industry Classification System (NAICS) code 513310 (changed to 517110 in October 2002).

²⁵⁵ *Id.* § 121.201, NAICS code 513321 (changed to 517211 in October 2002).

²⁵⁶ *Id.* § 121.201, NAICS code 513322 (changed to 517212 in October 2002).

²⁵⁷ 5 U.S.C. § 601(3).

²⁵⁸ Letter from Jere W. Glover, Chief Counsel for Advocacy, SBA, to William E. Kennard, Chairman, FCC (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 15 U.S.C. § 632(a); 5 U.S.C. § 601(3). SBA regulations interpret “small business concern” to include the concept of dominance on a national basis. 13 C.F.R. § 121.102(b).

²⁵⁹ 13 C.F.R. § 121.201, NAICS code 513310 (changed to 517110 in October 2002).

²⁶⁰ U.S. Census Bureau, 1997 Economic Census, Subject Series: Information, “Establishment and Firm Size (Including Legal Form of Organization),” Table 5, NAICS code 513310 (issued October 2000).

1,000 employees or more.²⁶¹ Thus, under this size standard, the majority of firms can be considered small.

106. *Incumbent Local Exchange Carriers (LECs)*. Neither the Commission nor the SBA has developed a size standard for small businesses specifically applicable to incumbent local exchange services. The closest applicable size standard under SBA rules is for Wired Telecommunications Carriers. Under that size standard, such a business is small if it has 1,500 or fewer employees.²⁶² According to Commission data,²⁶³ 1,337 carriers reported that they were engaged in the provision of local exchange services. Of these 1,337 carriers, an estimated 1,032 have 1,500 or fewer employees and 305 have more than 1,500 employees. Consequently, the Commission estimates that most providers of incumbent local exchange service are small businesses that may be affected by the rules and policies adopted herein.

107. *Competitive Local Exchange Carriers (CLECs), Competitive Access Providers (CAPs), and "Other Local Exchange Carriers."* Neither the Commission nor the SBA has developed a size standard for small businesses specifically applicable to providers of competitive exchange services or to competitive access providers or to "Other Local Exchange Carriers," all of which are discrete categories under which TRS data are collected. The closest applicable size standard under SBA rules is for Wired Telecommunications Carriers. Under that size standard, such a business is small if it has 1,500 or fewer employees.²⁶⁴ According to Commission data,²⁶⁵ 609 companies reported that they were engaged in the provision of either competitive access provider services or competitive local exchange carrier services. Of these 609 companies, an estimated 458 have 1,500 or fewer employees and 151 have more than 1,500 employees.²⁶⁶ In addition, 35 carriers reported that they were "Other Local Service Providers." Of the 35 "Other Local Service Providers," an estimated 34 have 1,500 or fewer employees and one has more than 1,500 employees.²⁶⁷ Consequently, the Commission estimates that most providers of competitive local exchange service, competitive access providers, and "Other Local Exchange Carriers" are small entities that may be affected by the rules and policies adopted herein.

108. *Interexchange Carriers (IXCs)*. Neither the Commission nor the SBA has developed a size standard for small businesses specifically applicable to interexchange services. The closest applicable size standard under SBA rules is for Wired Telecommunications Carriers.

²⁶¹ *Id.* The census data do not provide a more precise estimate of the number of firms that have employment of 1,500 or fewer employees; the largest category provided is "Firms with 1,000 employees or more."

²⁶² 13 C.F.R. § 121.201, NAICS code 513310 (changed to 517110 in October 2002).

²⁶³ *Trends in Telephone Service* at Table 5.3.

²⁶⁴ 13 C.F.R. § 121.201, NAICS code 513310 (changed to 517110 in October 2002).

²⁶⁵ *Trends in Telephone Service* at Table 5.3.

²⁶⁶ *Id.*

²⁶⁷ *Id.*

Under that size standard, such a business is small if it has 1,500 or fewer employees.²⁶⁸ According to Commission data,²⁶⁹ 261 companies reported that their primary telecommunications service activity was the provision of interexchange services. Of these 261 companies, an estimated 223 have 1,500 or fewer employees and 38 have more than 1,500 employees.²⁷⁰ Consequently, the Commission estimates that the majority of interexchange service providers are small entities that may be affected by the rules and policies adopted herein.

109. *Operator Service Providers (OSPs)*. Neither the Commission nor the SBA has developed a size standard for small businesses specifically applicable to operator service providers. The closest applicable size standard under SBA rules is for Wired Telecommunications Carriers. Under that size standard, such a business is small if it has 1,500 or fewer employees.²⁷¹ According to Commission data,²⁷² 23 companies reported that they were engaged in the provision of operator services. Of these 23 companies, an estimated 22 have 1,500 or fewer employees and one has more than 1,500 employees.²⁷³ Consequently, the Commission estimates that the majority of operator service providers are small entities that may be affected by the rules and policies adopted herein.

110. *Payphone Service Providers (PSPs)*. Neither the Commission nor the SBA has developed a size standard for small businesses specifically applicable to payphone service providers. The closest applicable size standard under SBA rules is for Wired Telecommunications Carriers. Under that size standard, such a business is small if it has 1,500 or fewer employees.²⁷⁴ According to Commission data,²⁷⁵ 761 companies reported that they were engaged in the provision of payphone services. Of these 761 companies, an estimated 757 have 1,500 or fewer employees and four have more than 1,500 employees.²⁷⁶ Consequently, the Commission estimates that the majority of payphone service providers are small entities that may be affected by the rules and policies adopted herein.

111. *Prepaid Calling Card Providers*. The SBA has developed a size standard for a small business within the category of Telecommunications Resellers. Under that SBA size standard, such a business is small if it has 1,500 or fewer employees.²⁷⁷ According to

²⁶⁸ 13 C.F.R. § 121.201, NAICS code 513310 (changed to 517110 in October 2002).

²⁶⁹ *Trends in Telephone Service* at Table 5.3.

²⁷⁰ *Id.*

²⁷¹ 13 C.F.R. § 121.201, NAICS code 513310 (changed to 517110 in October 2002).

²⁷² *Trends in Telephone Service* at Table 5.3.

²⁷³ *Id.*

²⁷⁴ 13 C.F.R. § 121.201, NAICS code 513310 (changed to 517110 in October 2002).

²⁷⁵ *Trends in Telephone Service* at Table 5.3.

²⁷⁶ *Id.*

²⁷⁷ 13 C.F.R. § 121.201, NAICS code 513330 (changed to 517310 in October 2002).

Commission data,²⁷⁸ 37 companies reported that they were engaged in the provision of prepaid calling cards. Of these 37 companies, an estimated 36 have 1,500 or fewer employees and one has more than 1,500 employees.²⁷⁹ Consequently, the Commission estimates that the majority of prepaid calling card providers are small entities that may be affected by the rules and policies adopted herein.

112. *Other Toll Carriers.* Neither the Commission nor the SBA has developed a size standard for small businesses specifically applicable to “Other Toll Carriers.” This category includes toll carriers that do not fall within the categories of interexchange carriers, operator service providers, prepaid calling card providers, satellite service carriers, or toll resellers. The closest applicable size standard under SBA rules is for Wired Telecommunications Carriers. Under that size standard, such a business is small if it has 1,500 or fewer employees.²⁸⁰ According to Commission’s data,²⁸¹ 92 companies reported that their primary telecommunications service activity was the provision of other toll carriage. Of these 92 companies, an estimated 82 have 1,500 or fewer employees and ten have more than 1,500 employees.²⁸² Consequently, the Commission estimates that most “Other Toll Carriers” are small entities that may be affected by the rules and policies adopted herein.

113. *Paging.* The SBA has developed a small business size standard for Paging, which consists of all such firms having 1,500 or fewer employees.²⁸³ According to Census Bureau data for 1997, in this category there was a total of 1,320 firms that operated for the entire year.²⁸⁴ Of this total, 1,303 firms had employment of 999 or fewer employees, and an additional seventeen firms had employment of 1,000 employees or more.²⁸⁵ Thus, under this size standard, the majority of firms can be considered small.

114. *Cellular and Other Wireless Telecommunications.* The SBA has developed a small business size standard for Cellular and Other Wireless Telecommunication, which consists of all such firms having 1,500 or fewer employees.²⁸⁶ According to Census Bureau data for

²⁷⁸ *Trends in Telephone Service* at Table 5.3.

²⁷⁹ *Id.*

²⁸⁰ 13 C.F.R. § 121.201, NAICS code 513310 (changed to 517110 in October 2002).

²⁸¹ *Trends in Telephone Service* at Table 5.3.

²⁸² *Id.*

²⁸³ 13 C.F.R. § 121.201, NAICS code 517211 (changed from 513321 in October 2002).

²⁸⁴ U.S. Census Bureau, 1997 Economic Census, Subject Series: Information, “Establishment and Firm Size (Including Legal Form of Organization),” Table 5, NAICS code 513321 (issued October 2000).

²⁸⁵ *Id.* The census data do not provide a more precise estimate of the number of firms that have employment of 1,500 or fewer employees; the largest category provided is “Firms with 1,000 employees or more.”

²⁸⁶ 13 C.F.R. § 121.201, NAICS code 517212 (changed from 513322 in October 2002).

1997, in this category there was a total of 977 firms that operated for the entire year.²⁸⁷ Of this total, 965 firms had employment of 999 or fewer employees, and an additional twelve firms had employment of 1,000 employees or more.²⁸⁸ Thus, under this size standard, the majority of firms can be considered small.

115. *Broadband Personal Communications Service.* The broadband Personal Communications Service (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 \$40 million or less in the three previous calendar years.²⁸⁹ For Block F, an additional classification for “very small business” was added and is defined as an entity that, together with its affiliates, has average gross revenues of not more than \$15 million for the preceding three calendar years.²⁹⁰ These standards defining “small entity” in the context of broadband PCS auctions have been approved by the SBA.²⁹¹ No small businesses, within the SBA-approved small business size standards 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.²⁹² On March 23, 1999, the Commission re-auctioned 347 C, D, E, and F Block licenses. There were 48 small business winning bidders. On January 26, 2001, the Commission completed the auction of 422 C and F Broadband PCS licenses in Auction No. 35. Of the 35 winning bidders in this auction, 29 qualified as “small” or “very small” businesses. Based on this information, the Commission concludes that the number of small broadband PCS licenses will include the 90 winning C Block bidders, the 93 qualifying bidders in the D, E, and F Block auctions, the 48 winning bidders in the 1999 re-auction, and the 29 winning bidders in the 2001 re-auction, for a total of 260 small entity broadband PCS providers, as defined by the SBA small business size standards and the Commission’s auction rules. We note that, as a general matter, the number of winning bidders that qualify as small businesses at the close of an auction does not necessarily represent the number of small businesses currently in service. Also, the Commission does not generally track subsequent business size unless, in the context of assignments or transfers, unjust enrichment issues are implicated.

²⁸⁷ U.S. Census Bureau, 1997 Economic Census, Subject Series: Information, “Establishment and Firm Size (Including Legal Form of Organization),” Table 5, NAICS code 513322 (issued October 2000).

²⁸⁸ *Id.* The census data do not provide a more precise estimate of the number of firms that have 1,500 or fewer employees; the largest category provided is “Firms with 1,000 employees or more.”

²⁸⁹ 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, 61 FR 33859 (July 1, 1996); see also 47 C.F.R. § 24.720(b).

²⁹⁰ See *id.*

²⁹¹ See, e.g., *Implementation of Section 309(j) of the Communications Act – Competitive Bidding*, PP Docket No. 93-253, Fifth Report and Order, 59 FR 37566 (July 22, 1994).

²⁹² FCC News, *Broadband PCS, D, E and F Block Auction Closes*, No. 71744 (rel. January 14, 1997). See also *Amendment of the Commission’s Rules Regarding Installment Payment Financing for Personal Communications Services (PCS) Licenses*, WT Docket No. 97-82, Second Report and Order, 62 FR 55348 (Oct. 24, 1997).

116. *Narrowband Personal Communications Services.* To date, two auctions of narrowband personal communications services (PCS) licenses have been conducted. For purposes of the two auctions that have already been held, “small businesses” were entities with average gross revenues for the prior three calendar years of \$40 million or less. Through these auctions, the Commission has awarded a total of 41 licenses, out of which 11 were obtained by small businesses. To ensure meaningful participation of small business entities in future auctions, the Commission has adopted a two-tiered small business size standard in the *Narrowband PCS Second Report and Order*.²⁹³ A “small business” is an entity that, together with affiliates and controlling interests, has average gross revenues for the three preceding years of not more than \$40 million. A “very small business” is an entity that, together with affiliates and controlling interests, has average gross revenues for the three preceding years of not more than \$15 million. The SBA has approved these small business size standards.²⁹⁴ In the future, the Commission will auction 459 licenses to serve Metropolitan Trading Areas (MTAs) and 408 response channel licenses. There is also one megahertz of narrowband PCS spectrum that has been held in reserve and that the Commission has not yet decided to release for licensing. The Commission cannot predict accurately the number of licenses that will be awarded to small entities in future actions. However, four of the 16 winning bidders in the two previous narrowband PCS auctions were small businesses, as that term was defined under the Commission’s Rules. The Commission assumes, for purposes of this analysis, that a large portion of the remaining narrowband PCS licenses will be awarded to small entities. The Commission also assumes that at least some small businesses will acquire narrowband PCS licenses by means of the Commission’s partitioning and disaggregation rules.

117. *220 MHz Radio Service – Phase I Licensees.* The 220 MHz service has both Phase I and Phase II licenses. Phase I licensing was conducted by lotteries in 1992 and 1993. There are approximately 1,515 such non-nationwide licensees and four nationwide licensees currently authorized to operate in the 220 MHz band. The Commission has not developed a small business size standard for small entities specifically applicable to such incumbent 220 MHz Phase I licensees. To estimate the number of such licensees that are small businesses, we apply the small business size standard under the SBA rules applicable to “Cellular and Other Wireless Telecommunications” companies. This standard provides that such a company is small if it employs no more than 1,500 persons.²⁹⁵ According to Census Bureau data for 1997, there were 977 firms in this category, total, that operated for the entire year.²⁹⁶ Of this total, 965 firms had employment of 999 or fewer employees, and an additional 12 firms had employment of

²⁹³ *Amendment of the Commission’s Rules to Establish New Personal Communications Services, Narrowband PCS*, Docket No. ET 92-100, Docket No. PP 93-253, Second Report and Order and Second Further Notice of Proposed Rulemaking, 65 FR 35875 (June 6, 2000).

²⁹⁴ See Letter to Amy Zoslov, Chief, Auctions and Industry Analysis Division, Wireless Telecommunications Bureau, FCC, from Aida Alvarez, Administrator, SBA (Dec. 2, 1998).

²⁹⁵ 13 C.F.R. § 121.201, NAICS code 513322 (changed to 517212 in October 2002).

²⁹⁶ U.S. Census Bureau, 1997 Economic Census, Subject Series: Information, “Employment Size of Firms Subject to Federal Income Tax: 1997,” Table 5, NAICS code 513322 (issued Oct. 2000).

1,000 employees or more.²⁹⁷ If this general ratio continues in the context of Phase I 220 MHz licensees, the Commission estimates that nearly all such licensees are small businesses under the SBA's small business size standard.

118. *220 MHz Radio Service – Phase II Licensees.* The 220 MHz service has both Phase I and Phase II licenses. The Phase II 220 MHz service is a new service, and is subject to spectrum auctions. In the *220 MHz Third Report and Order*, we adopted a small business size standard for “small” and “very small” businesses for purposes of determining their eligibility for special provisions such as bidding credits and installment payments.²⁹⁸ This small business size standard indicates that a “small business” is an entity that, together with its affiliates and controlling principals, has average gross revenues not exceeding \$15 million for the preceding three years.²⁹⁹ A “very small business” is an entity that, together with its affiliates and controlling principals, has average gross revenues that do not exceed \$3 million for the preceding three years. The SBA has approved these small business size standards.³⁰⁰ Auctions of Phase II licenses commenced on September 15, 1998, and closed on October 22, 1998.³⁰¹ In the first auction, 908 licenses were auctioned in three different-sized geographic areas: three nationwide licenses, 30 Regional Economic Area Group (EAG) Licenses, and 875 Economic Area (EA) Licenses. Of the 908 licenses auctioned, 693 were sold. Thirty-nine small businesses won licenses in the first 220 MHz auction. The second auction included 225 licenses: 216 EA licenses and 9 EAG licenses. Fourteen companies claiming small business status won 158 licenses.³⁰²

119. *800 MHz and 900 MHz Specialized Mobile Radio Licenses.* The Commission awards “small entity” and “very small entity” bidding credits in auctions for Specialized Mobile Radio (SMR) geographic area licenses in the 900 MHz bands to firms that had revenues of no more than \$15 million in each of the three previous calendar years, or that had revenues of no more than \$3 million in each of the previous calendar years.³⁰³ The SBA has approved these size standards.³⁰⁴ The Commission awards “small entity” and “very small entity” bidding credits in

²⁹⁷ *Id.* The census data do not provide a more precise estimate of the number of firms that have employment of 1,500 or fewer employees; the largest category provided is “Firms with 1,000 employees or more.”

²⁹⁸ *Amendment of Part 90 of the Commission's Rules to Provide for the Use of the 220-222 MHz Band by the Private Land Mobile Radio Service*, PR Docket No. 89-552, GN Docket No. 93-252, PP Docket No. 93-253, Third Report and Order and Fifth Notice of Proposed Rulemaking, 12 FCC Rcd 10943, 11068-70, paras. 291-95 (1997) (*220 MHz Third Report and Order*).

²⁹⁹ *Id.* at 11068-70, para. 291.

³⁰⁰ See letter to D. Phythyon, Chief, Wireless Telecommunications Bureau, FCC, from Aida Alvarez, Administrator, SBA (Jan. 6, 1998).

³⁰¹ See generally Public Notice, “220 MHz Service Auction Closes,” 14 FCC Rcd 605 (1998).

³⁰² Public Notice, “Phase II 220 MHz Service Spectrum Auction Closes,” 14 FCC Rcd 11218 (1999).

³⁰³ 47 C.F.R. § 90.814(b)(1).

³⁰⁴ See Letter from Aida Alvarez, Administration, Small Business Administration to Daniel B. Phythyon, Chief, Wireless Telecommunications Bureau, Federal Communications Commission (Oct. 27, 1997). See Letter from Aida (continued....)

auctions for Specialized Mobile Radio (SMR) geographic area licenses in the 800 MHz bands to firms that had revenues of no more than \$40 million in each of the three previous calendar years, or that had revenues of no more than \$15 million in each of the previous calendar years.³⁰⁵ These bidding credits apply to SMR providers in the 800 MHz and 900 MHz bands that either hold geographic area licenses or have obtained extended implementation authorizations. The Commission does 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. One firm has over \$15 million in revenues. The Commission assumes, for purposes here, that all of the remaining existing extended implementation authorizations are held by small entities, as that term is defined by the SBA. The Commission has held auctions for geographic area licenses in the 800 MHz and 900 MHz SMR bands. There were 60 winning bidders that qualified as small or very small entities in the 900 MHz SMR auctions. Of the 1,020 licenses won in the 900 MHz auction, bidders qualifying as small or very small entities won 263 licenses. In the 800 MHz auction, 38 of the 524 licenses won were won by small and very small entities. We note that, as a general matter, the number of winning bidders that qualify as small businesses at the close of an auction does not necessarily represent the number of small businesses currently in service. Also, the Commission does not generally track subsequent business size unless, in the context of assignments or transfers, unjust enrichment issues are implicated.

120. *Private and Common Carrier Paging.* In the *Paging Third Report and Order*, we developed a small business size standard for “small businesses” and “very small businesses” for purposes of determining their eligibility for special provisions such as bidding credits and installment payments.³⁰⁶ A “small business” is an entity that, together with its affiliates and controlling principals, has average gross revenues not exceeding \$15 million for the preceding three years. Additionally, a “very small business” is an entity that, together with its affiliates and controlling principals, has average gross revenues that are not more than \$3 million for the preceding three years. The SBA has approved these size standards.³⁰⁷ An auction of Metropolitan Economic Area licenses commenced on February 24, 2000, and closed on March 2, 2000.³⁰⁸ Of the 985 licenses auctioned, 440 were sold. Fifty-seven companies claiming small business status won. At present, there are approximately 24,000 Private-Paging site-specific

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Alvarez, Administrator, Small Business Administration to Thomas Sugrue, Chief, Auctions and Industry Analysis Division, Wireless Telecommunications Bureau, Federal Communications Commission (Aug. 10, 1999).

³⁰⁵ 47 C.F.R. § 90.814(b)(1) A request for approval of 800 MHz standards was sent to the SBA on May 13, 1999. The matter remains pending.

³⁰⁶ *220 MHz Third Report and Order*, 12 FCC Rcd at 11068-70, paras. 291-295, 62 FR 16004 at paras. 291-295 (1997).

³⁰⁷ See Letter from Aida Alvarez, Administrator, Small Business Administration to Thomas Sugrue, Chief, Auctions and Industry Analysis Division, Wireless Telecommunications Bureau, Federal Communications Commission (June 4, 1999).

³⁰⁸ *Revision of Part 22 and Part 90 of the Commission’s Rules to Facilitate Future Development of Paging Systems*, WT Docket No. 96-18, PR Docket No. 93-253, Memorandum Opinion and Order on Reconsideration and Third Report and Order, 14 FCC Rcd 10030, 10085, para. 98 (1999).

licenses and 74,000 Common Carrier Paging licenses. According to the most recent *Trends in Telephone Service*, 471 carriers reported that they were engaged in the provision of either paging and messaging services or other mobile services.³⁰⁹ Of those, the Commission estimates that 450 are small, under the SBA business size standard specifying that firms are small if they have 1,500 or fewer employees.³¹⁰

121. *700 MHz Guard Band Licensees.* In the 700 MHz Guard Band Order, we adopted a small business size standard for “small businesses” and “very small businesses” for purposes of determining their eligibility for special provisions such as bidding credits and installment payments.³¹¹ A “small business” as an entity that, together with its affiliates and controlling principals, has average gross revenues not exceeding \$15 million for the preceding three years. Additionally, a “very small business” is an entity that, together with its affiliates and controlling principals, has average gross revenues that are not more than \$3 million for the preceding three years. An auction of 52 Major Economic Area (MEA) licenses commenced on September 6, 2000, and closed on September 21, 2000.³¹² Of the 104 licenses auctioned, 96 licenses were sold to nine bidders. Five of these bidders were small businesses that won a total of 26 licenses. A second auction of 700 MHz Guard Band licenses commenced on February 13, 2001 and closed on February 21, 2001. All eight of the licenses auctioned were sold to three bidders. One of these bidders was a small business that won a total of two licenses.³¹³

122. *Rural Radiotelephone Service.* The Commission has not adopted a size standard for small businesses specific to the Rural Radiotelephone Service.³¹⁴ A significant subset of the Rural Radiotelephone Service is the Basic Exchange Telephone Radio System (BETRS).³¹⁵ The Commission uses the SBA’s small business size standard applicable to “Cellular and Other Wireless Telecommunications,” *i.e.*, an entity employing no more than 1,500 persons.³¹⁶ There are approximately 1,000 licensees in the Rural Radiotelephone Service, and the Commission estimates that there are 1,000 or fewer small entity licensees in the Rural Radiotelephone Service that may be affected by the rules and policies adopted herein.

³⁰⁹ *Trends in Telephone Service* at Table 5.3.

³¹⁰ *Id.* The SBA size standard is that of Paging, 13 C.F.R. § 121.201, NAICS code 517211.

³¹¹ *See Service Rules for the 746-764 MHz Bands, and Revisions to part 27 of the Commission’s Rules*, WT Docket No. 99-168, Second Report and Order, 15 FCC Rcd 5299, 5344, para. 108 (2000).

³¹² *See generally* Public Notice, “220 MHz Service Auction Closes,” Report No. WT 98-36 (Wireless Telecommunications Bureau, Oct. 23, 1998).

³¹³ Public Notice, “700 MHz Guard Band Auction Closes,” DA 01-478 (rel. Feb. 22, 2001).

³¹⁴ The service is defined in § 22.99 of the Commission’s Rules, 47 C.F.R. § 22.99.

³¹⁵ BETRS is defined in §§ 22.757 and 22.759 of the Commission’s Rules, 47 C.F.R. §§ 22.757 and 22.759.

³¹⁶ 13 C.F.R. § 121.201, NAICS code 513322 (changed to 517212 in October 2002).

123. *Air-Ground Radiotelephone Service.* The Commission has not adopted a small business size standard specific to the Air-Ground Radiotelephone Service.³¹⁷ We will use SBA's small business size standard applicable to "Cellular and Other Wireless Telecommunications," *i.e.*, an entity employing no more than 1,500 persons.³¹⁸ There are approximately 100 licensees in the Air-Ground Radiotelephone Service, and we estimate that almost all of them qualify as small under the SBA small business size standard.

124. *Aviation and Marine Radio Services.* Small businesses in the aviation and marine radio services use a very high frequency (VHF) marine or aircraft radio and, as appropriate, an emergency position-indicating radio beacon (and/or radar) or an emergency locator transmitter. The Commission has not developed a small business size standard specifically applicable to these small businesses. For purposes of this analysis, the Commission uses the SBA small business size standard for the category "Cellular and Other Telecommunications," which is 1,500 or fewer employees.³¹⁹ Most applicants for recreational licenses are individuals. Approximately 581,000 ship station licensees and 131,000 aircraft station licensees operate domestically and are not subject to the radio carriage requirements of any statute or treaty. For purposes of our evaluations in this analysis, we estimate that there are up to approximately 712,000 licensees that are small businesses (or individuals) under the SBA standard. In addition, between December 3, 1998 and December 14, 1998, the Commission held an auction of 42 VHF Public Coast licenses in the 157.1875-157.4500 MHz (ship transmit) and 161.775-162.0125 MHz (coast transmit) bands. For purposes of the auction, the Commission defined a "small" business as an entity that, together with controlling interests and affiliates, has average gross revenues for the preceding three years not to exceed \$15 million. In addition, a "very small" business is one that, together with controlling interests and affiliates, has average gross revenues for the preceding three years not to exceed \$3 million.³²⁰ There are approximately 10,672 licensees in the Marine Coast Service, and the Commission estimates that almost all of them qualify as "small" businesses under the above special small business size standards.

125. *Fixed Microwave Services.* Fixed microwave services include common carrier,³²¹ private operational-fixed,³²² and broadcast auxiliary radio services.³²³ At present, there are

³¹⁷ The service is defined in § 22.99 of the Commission's Rules, 47 C.F.R. § 22.99.

³¹⁸ 13 C.F.R. § 121.201, NAICS codes 513322 (changed to 517212 in October 2002).

³¹⁹ *Id.* § 121.201, NAICS code 513322 (changed to 517212 in October 2002).

³²⁰ *Amendment of the Commission's Rules Concerning Maritime Communications*, PR Docket No. 92-257, Third Report and Order and Memorandum Opinion and Order, 13 FCC Rcd 19853 (1998).

³²¹ See 47 C.F.R. §§ 101 *et seq.* (formerly, Part 21 of the Commission's Rules) for common carrier fixed microwave services (except Multipoint Distribution Service).

³²² 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 and 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.

³²³ Auxiliary Microwave Service is governed by Part 74 of Title 47 of the Commission's Rules. See 47 C.F.R. Part 74. This service is available to licensees of broadcast stations and to broadcast and cable network entities. (continued....)

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 created a size standard for a small business specifically with respect to fixed microwave services. For purposes of this analysis, the Commission uses the SBA small business size standard for the category “Cellular and Other Telecommunications,” which is 1,500 or fewer employees.³²⁴ The Commission does not have data specifying the number of these licensees that have more than 1,500 employees, and thus is unable at this time to estimate with greater precision the number of fixed microwave service licensees that would qualify as small business concerns under the SBA’s small business size standard. Consequently, the Commission estimates that there are up to 22,015 common carrier fixed licensees and up to 61,670 private operational-fixed licensees and broadcast auxiliary radio licensees in the microwave services that may be small and may be affected by the rules and policies adopted herein. We noted, however, that the common carrier microwave fixed licensee category includes some large entities.

126. *Offshore Radiotelephone Service.* This service operates on several UHF television broadcast channels that are not used for television broadcasting in the coastal areas of states bordering the Gulf of Mexico.³²⁵ There are presently approximately 55 licensees in this service. We are unable to estimate at this time the number of licensees that would qualify as small under the SBA’s small business size standard for “Cellular and Other Wireless Telecommunications” services.³²⁶ Under that SBA small business size standard, a business is small if it has 1,500 or fewer employees.³²⁷

127. *Wireless Communications Services.* This service can be used for fixed, mobile, radiolocation, and digital audio broadcasting satellite uses. The Commission established small business size standards for the wireless communications services (WCS) auction. A “small business” is an entity with average gross revenues of \$40 million for each of the three preceding years, and a “very small business” is an entity with average gross revenues of \$15 million for each of the three preceding years. The SBA has approved these small business size standards.³²⁸ The Commission auctioned geographic area licenses in the WCS service. In the auction, there were seven winning bidders that qualified as “very small business” entities, and one that qualified as a “small business” entity. We conclude that the number of geographic area WCS licensees affected by this analysis includes these eight entities.

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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 television pickups, which relay signals from a remote location back to the studio.

³²⁴ 13 C.F.R. § 121.201, NAICS code 513322 (changed to 517212 in October 2002).

³²⁵ This service is governed by Subpart I of Part 22 of the Commission’s Rules. See 47 C.F.R. §§ 22.1001-22.1037.

³²⁶ 13 C.F.R. § 121.201, NAICS code 513322 (changed to 517212 in October 2002).

³²⁷ *Id.*

³²⁸ See Letter to Amy Zoslov, Chief, Auctions and Industry Analysis Division, Wireless Telecommunications Bureau, FCC, from Aida Alvarez, Administrator, SBA (Dec. 2, 1998).

128. *39 GHz Service.* The Commission created a special small business size standard for 39 GHz licenses – an entity that has average gross revenues of \$40 million or less in the three previous calendar years.³²⁹ An additional size standard for “very small business” is: an entity that, together with affiliates, has average gross revenues of not more than \$15 million for the preceding three calendar years.³³⁰ The SBA has approved these small business size standards.³³¹ 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. Consequently, the Commission estimates that 18 or fewer 39 GHz licensees are small entities that may be affected by the rules and policies adopted herein.

129. *Multipoint Distribution Service, Multichannel Multipoint Distribution Service, and ITFS.* Multichannel Multipoint Distribution Service (MMDS) systems, often referred to as “wireless cable,” transmit video programming to subscribers using the microwave frequencies of the Multipoint Distribution Service (MDS) and Instructional Television Fixed Service (ITFS).³³² In connection with the 1996 MDS auction, the Commission established a small business size standard as an entity that had annual average gross revenues of less than \$40 million in the previous three calendar years.³³³ The MDS auctions resulted in 67 successful bidders obtaining licensing opportunities for 493 Basic Trading Areas (BTAs). Of the 67 auction winners, 61 met the definition of a small business. MDS also includes licensees of stations authorized prior to the auction. In addition, the SBA has developed a small business size standard for Cable and Other Program Distribution, which includes all such companies generating \$12.5 million or less in annual receipts.³³⁴ According to Census Bureau data for 1997, there were a total of 1,311 firms in this category, total, that had operated for the entire year.³³⁵ Of this total, 1,180 firms had annual receipts of under \$10 million and an additional 52 firms had receipts of \$10 million or more but less than \$25 million. Consequently, we estimate that the majority of providers in this service category are small businesses that may be affected by the rules and policies adopted herein. This SBA small business size standard also appears applicable to ITFS. There are presently 2,032 ITFS licensees. All but 100 of these licenses are held by educational institutions.

³²⁹ See Amendment of the Commission’s Rules Regarding the 37.0-38.6 GHz and 38.6-40.0 GHz Bands, ET Docket No. 95-183, *Report and Order*, 63 FR 6079 (Feb. 6, 1998).

³³⁰ *Id.*

³³¹ See Letter to Kathleen O’Brien Ham, Chief, Auctions and Industry Analysis Division, Wireless Telecommunications Bureau, FCC, from Aida Alvarez, Administrator, SBA (Feb. 4, 1998).

³³² *Amendment of Parts 21 and 74 of the Commission’s Rules with Regard to Filing Procedures in the Multipoint Distribution Service and in the Instructional Television Fixed Service and Implementation of Section 309(j) of the Communications Act – Competitive Bidding*, MM Docket No. 94-131 and PP Docket No. 93-253, Report and Order, 10 FCC Rcd 9589, 9593 para. 7 (1995).

³³³ 47 C.F.R. § 21.961(b)(1).

³³⁴ 13 C.F.R. § 121.201, NAICS code 513220 (changed to 517510 in October 2002).

³³⁵ U.S. Census Bureau, 1997 Economic Census, Subject Series: Information, “Establishment and Firm Size (Including Legal Form of Organization),” Table 4, NAICS code 513220 (issued October 2000).

Educational institutions are included in this analysis as small entities.³³⁶ Thus, we tentatively conclude that at least 1,932 licensees are small businesses.

130. *Local Multipoint Distribution Service.* Local Multipoint Distribution Service (LMDS) is a fixed broadband point-to-multipoint microwave service that provides for two-way video telecommunications.³³⁷ The auction of the 1,030 Local Multipoint Distribution Service (LMDS) licenses began on February 18, 1998 and closed on March 25, 1998. The Commission established a small business size standard for LMDS licenses as an entity that has average gross revenues of less than \$40 million in the three previous calendar years.³³⁸ An additional small business size standard for “very small business” was added as an entity that, together with its affiliates, has average gross revenues of not more than \$15 million for the preceding three calendar years.³³⁹ The SBA has approved these small business size standards in the context of LMDS auctions.³⁴⁰ There were 93 winning bidders that qualified as small entities in the LMDS auctions. A total of 93 small and very small business bidders won approximately 277 A Block licenses and 387 B Block licenses. On March 27, 1999, the Commission re-auctioned 161 licenses; there were 40 winning bidders. Based on this information, we conclude that the number of small LMDS licenses consists of the 93 winning bidders in the first auction and the 40 winning bidders in the re-auction, for a total of 133 small entity LMDS providers.

131. *218-219 MHz Service.* The first auction of 218-219 MHz spectrum resulted in 170 entities winning licenses for 594 Metropolitan Statistical Area licenses. Of the 594 licenses, 557 were won by entities qualifying as a small business. For that auction, the small business size standard was an entity that, together with its affiliates, has no more than a \$6 million net worth and, after federal income taxes (excluding any carry over losses), has no more than \$2 million in annual profits each year for the previous two years.³⁴¹ In the *218-219 MHz Report and Order and Memorandum Opinion and Order*, we established a small business size standard for a “small business” as an entity that, together with its affiliates and persons or entities that hold interests in such an entity and their affiliates, has average annual gross revenues not to exceed \$15 million

³³⁶ In addition, the term “small entity” within SBREFA applies to small organizations (nonprofits) and to small governmental jurisdictions (cities, counties, towns, townships, villages, school districts, and special districts with populations of less than 50,000). 5 U.S.C. §§ 601(4)-(6). We do not collect annual revenue data on ITFS licensees.

³³⁷ See *Rulemaking to Amend Parts 1, 2, 21, and 25 of the Commission’s Rules to Redesignate the 27.5-29.5 GHz Frequency Band, to Reallocate the 29.5-30.0 GHz Frequency Band, and to Establish Rules and Policies for Local Multipoint Distribution Service and for Fixed Satellite Services*, CC Docket No. 92-297, Second Report and Order, 12 FCC Rcd 12545 (1997).

³³⁸ *Id.*

³³⁹ *See id.*

³⁴⁰ See Letter to Dan Phythyon, Chief, Wireless Telecommunications Bureau, FCC, from Aida Alvarez, Administrator, SBA (Jan. 6, 1998).

³⁴¹ *Implementation of Section 309(j) of the Communications Act – Competitive Bidding*, PP Docket No. 93-253, Fourth Report and Order, 59 FR 24947 (May 13, 1994).

for the preceding three years.³⁴² A “very small business” is defined as an entity that, together with its affiliates and persons or entities that hold interests in such an entity and its affiliates, has average annual gross revenues not to exceed \$3 million for the preceding three years.³⁴³ The SBA has approved these size standards.³⁴⁴ We cannot estimate, however, the number of licenses that will be won by entities qualifying as small or very small businesses under our rules in future auctions of 218-219 MHz spectrum.

132. *24 GHz – Incumbent Licensees.* This analysis may affect incumbent licensees who were relocated to the 24 GHz band from the 18 GHz band, and applicants who wish to provide services in the 24 GHz band. The applicable SBA small business size standard is that of “Cellular and Other Wireless Telecommunications” companies. This category provides that such a company is small if it employs no more than 1,500 persons.³⁴⁵ According to Census Bureau data for 1997, there were 977 firms in this category that operated for the entire year.³⁴⁶ Of this total, 965 firms had employment of 999 or fewer employees, and an additional 12 firms had employment of 1,000 employees or more.³⁴⁷ Thus, under this size standard, the great majority of firms can be considered small. These broader census data notwithstanding, we believe that there are only two licensees in the 24 GHz band that were relocated from the 18 GHz band, Teligent³⁴⁸ and TRW, Inc. It is our understanding that Teligent and its related companies have less than 1,500 employees, though this may change in the future. TRW is not a small entity. Thus, only one incumbent licensee in the 24 GHz band is a small business entity.

133. *24 GHz – Future Licensees.* With respect to new applicants in the 24 GHz band, the small business size standard for “small business” is an entity that, together with controlling interests and affiliates, has average annual gross revenues for the three preceding years not in excess of \$15 million.³⁴⁹ “Very small business” in the 24 GHz band is an entity that, together with controlling interests and affiliates, has average gross revenues not exceeding \$3 million for

³⁴² *Amendment of Part 95 of the Commission’s Rules to Provide Regulatory Flexibility in the 218-219 MHz Service*, WT Docket No. 98-169, Report and Order and Memorandum Opinion and Order, 64 FR 59656 (Nov. 3, 1999).

³⁴³ *Id.*

³⁴⁴ See Letter to Daniel B. Phythyon, Chief, Wireless Telecommunications Bureau, Federal Communications Commission, from Aida Alvarez, Administrator, Small Business Administration (Jan. 6, 1998).

³⁴⁵ 13 C.F.R. § 121.201, NAICS code 513322 (changed to 517212 in October 2002).

³⁴⁶ U.S. Census Bureau, 1997 Economic Census, Subject Series: Information, “Employment Size of Firms Subject to Federal Income Tax: 1997,” Table 5, NAICS code 513322 (issued Oct. 2000).

³⁴⁷ *Id.* The census data do not provide a more precise estimate of the number of firms that have employment of 1,500 or fewer employees; the largest category provided is “Firms with 1,000 employees or more.”

³⁴⁸ Teligent acquired the DEMS licenses of FirstMark, the only licensee other than TRW in the 24 GHz band whose license has been modified to require relocation to the 24 GHz band.

³⁴⁹ *Amendments to Parts 1, 2, 87 and 101 of the Commission’s Rules to License Fixed Services at 24 GHz*, WT Docket No. 99-327, Report and Order, 15 FCC Rcd 16934, 16967 (2000); see also 47 C.F.R. § 101.538(a)(2).

the preceding three years.³⁵⁰ The SBA has approved these small business size standards.³⁵¹ These size standards will apply to the future auction, if held.

4. Description of Projected Reporting, Recordkeeping, and Other Compliance Requirements

134. The Order permits rate-of-return carriers acquiring price cap lines to return those lines to rate-of-return regulation without seeking a waiver. As a result, the administrative costs of seeking a waiver are avoided.³⁵²

135. The Order also permits rate-of-return carriers to deaverage geographically their rates for transport and special access services within a study area.³⁵³ While rate-of-return carriers must define the scope of zones, the requirement that they be approved in advance is eliminated.³⁵⁴ The carrier is now required to demonstrate that each zone, except the highest-cost zone, accounts for at least 15 percent of its revenues from services in the study area,³⁵⁵ and must demonstrate that rates reflect cost characteristics associated with the selected zones.³⁵⁶

136. Merging LTS into ICLS will promote administrative simplicity by eliminating a duplicative support mechanism without affecting the amount of universal service support received by small entities or negatively affecting carriers that choose to participate in the NECA common line pool.³⁵⁷

5. Steps Taken To Minimize Significant Economic Impact on Small Entities, and Significant Alternatives Considered

137. The Commission has sought to minimize significant economic impacts on small entities, including small telephone companies, in revising the access and universal service rules in this Order. The Commission's approach is tailored to the specific challenges faced by small local telephone companies, many of which serve rural and high-cost areas.

³⁵⁰ *Amendments to Parts 1, 2, 87 and 101 of the Commission's Rules to License Fixed Services at 24 GHz*, WT Docket No. 99-327, Report and Order, 15 FCC Rcd at 16967; *see also* 47 C.F.R. § 101.538(a)(1).

³⁵¹ *See* Letter to Margaret W. Wiener, Deputy Chief, Auctions and Industry Analysis Division, Wireless Telecommunications Bureau, FCC, from Gary M. Jackson, Assistant Administrator, SBA (July 28, 2000).

³⁵² *See supra* § III.A.2.

³⁵³ *See supra* § III.B.2.a.

³⁵⁴ *Id.*

³⁵⁵ *Id.*

³⁵⁶ *Id.*

³⁵⁷ *See supra* § III.C.2.

138. The Commission considered whether to eliminate completely the “all-or-nothing” rule, but decided only to carve out an exception for rate-of-return carriers that wish to return the acquired price cap lines to rate-of-return regulation. This eliminates the need for a waiver before such acquisitions can be returned to rate-of-return regulation, thereby reducing transaction costs and uncertainty for small, typically rural carriers seeking to acquire lines from price cap carriers. We continue to explore further modifications to the all-or-nothing rule within the larger context of incentive regulation for rate-of-return carriers in the *Second Further Notice*.

139. The Order permits rate-of-return carriers to geographically deaverage their rates for special access and transport services. The Commission gives rate-of-return carriers significant latitude to define pricing zones as they wish, subject to the limitation that each zone, except the highest-cost zone, must account for at least 15 percent of the rate-of-return carrier’s transport and special access revenues in the study area. This requirement ensures that any lower rates resulting from deaveraging are enjoyed by a range of customers, rather than being focused on only a few customers in a way that might evade our prohibition on contract pricing by rate-of-return carriers. The Order continues to require rate-of-return carriers to have a tariffed cross-connect element in order to geographically deaverage rates, thereby ensuring that transport competitors, including small entities, can interconnect with the rate-of-return carrier’s access network when it deaverages its special access and transport rates. In reaching this decision, the Commission considered and rejected claims by IXCs that immediate geographic deaveraging would lead to predatory pricing by rate-of-return carriers and that further deaveraging should result only in price decreases.³⁵⁸ The Order determines that permitting rate-of-return carriers to deaverage the rates for special access and transport services enhances the efficiency of the market for those services by allowing prices to be tailored more easily and accurately to reflect costs and, therefore, facilitates competition in both higher and lower cost areas. Rate-of-return carriers must provide cost support establishing that the deaveraged rates are cost-based, thereby ensuring that smaller, more vulnerable carriers are safeguarded from any such predatory pricing.

140. The Order also permits geographic deaveraging of rates for special access and transport services within the NECA pooling process. As a result, smaller rate-of-return carriers may be able to realize increased pricing flexibility through the NECA traffic-sensitive pool. Such increased pricing flexibility might not have been possible if they were required to file their own tariffs.

141. The Order declines to relax the existing competitive triggers for volume and term discounts for transport services, as many rate-of-return carriers urged. The Commission was concerned that the premature grant of such discount authority would permit a rate-of-return carrier to lock up large customers by offering them volume and term discounts at or below cost.³⁵⁹ Such discounts would potentially foreclose competition for smaller customers because large customers may create the inducement for potential competitors to invest in facilities which, once put into service, can be used to serve adjacent smaller customers.³⁶⁰ Accordingly, the

³⁵⁸ See *supra* § III.B.2.a.

³⁵⁹ See *supra* § III.B.2.b.

³⁶⁰ *Id.*

Commission refuses to adopt less restrictive competitive triggers that would have more readily facilitated volume and term discounts, because such new triggers would not have ensured the presence of a competitor that would operate to prevent harm to smaller entities.

142. The Order also declines to permit rate-of-return carriers to offer services pursuant to individual customer contracts, as many rate-of-return carriers urged. Such an ability to combine various elements or parts of elements, the Commission notes, would allow rate-of-return carriers to set non-cost-based prices in order to prevent entrants from providing service to the largest customers in their service areas, thereby precluding further competition for smaller customers in their service areas as well.³⁶¹

143. The Order merges LTS into the ICLS mechanism. This will simplify the administration of common line support measures, while ensuring both that no individual carrier will fail to recover its common line revenue requirement,³⁶² and that overall support will not be reduced as existing rules operate to automatically increase ICLS by an amount to match any LTS reduction.³⁶³ Accordingly, the concerns of small entities over the elimination of LTS are fully addressed by the new ICLS mechanism. In reaching this conclusion, the Commission considered and rejected NECA's argument that the elimination of LTS will destabilize the NECA pool. The Order concludes that although many, if not most, carriers will continue participating in the common line pool, the benefits of pooling do not warrant the continued use of universal service support as a way to induce carriers to participate in the pool if they are not otherwise inclined to do so.

6. Report to Congress

144. 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.³⁶⁴ 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.³⁶⁵

D. Initial Regulatory Flexibility Act Analysis

145. The Regulatory Flexibility Act of 1980, as amended (RFA),³⁶⁶ requires that an initial regulatory flexibility analysis be prepared for notice-and-comment rule making

³⁶¹ See *supra* § III.B.2.c.

³⁶² See *supra* § III.C.2.

³⁶³ *Id.*

³⁶⁴ See 5 U.S.C. § 801(a)(1)(A).

³⁶⁵ See 5 U.S.C. § 604(b).

³⁶⁶ See 5 U.S.C. § 603. The RFA, *see* 5 U.S.C. § 601 *et seq.*, has been amended by the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA), Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996).

proceedings, unless the agency certifies that “the rule will not, if promulgated, have a significant economic impact on a substantial number of small entities.”³⁶⁷ The RFA generally defines the term “small entity” as having the same meaning as the terms “small business,” “small organization,” and “small governmental jurisdiction.”³⁶⁸ In addition, the term “small business” has the same meaning as the term “small business concern” under the Small Business Act.³⁶⁹ A “small business concern” is one which: (1) is independently owned and operated; (2) is not dominant in its field of operation; and (3) satisfies any additional criteria established by the SBA.³⁷⁰

146. As required by the RFA, the Commission has prepared this IRFA of the possible significant economic impact on a substantial number of small entities by the policies and rules proposed in this *Second Further Notice*. Written public comments are requested on this IRFA. Comments must be identified as responses to the IRFA and must be filed by the deadlines for comments on the *Second Further Notice* provided in paragraph 158 of the item.

1. Need for, and Objectives of, the Proposed Rules

147. The Commission continues to explore means of providing incentives for smaller telephone companies to become more efficient and innovative in ways that benefit both rate-of-return carriers and their customers. The *Second Further Notice* seeks additional comment on two alternative incentive regulation proposals for all rate-of-return carriers, and on the closely related all-or-nothing rule.

148. The alternative incentive regulation plans were filed by CenturyTel (the CenturyTel Plan) and by ALLTEL, Madison River and TDS (the Rate-of-Return Carrier Tariff Option).³⁷¹ The CenturyTel Plan proposes to lower traffic-sensitive charges, according to participation on a study area-by-study area basis, to target rates based on specific average traffic-sensitive target rates determined by line density. The CenturyTel Plan would apply an X-Factor equal to GDP-PI. The CenturyTel Plan would convert universal service support to per-line amounts, with ICLS and LSS being frozen for the five-year duration of the proposed plan and high-cost loop support being frozen subject to adjustment for GDP-CPI. Finally, CenturyTel proposes that carriers should be allowed to take certain study areas out of the NECA pools and into alternative regulation, while leaving other study areas in the pools, subject to rate-of-return regulation. The Rate-of-Return Carrier Tariff Option would allow all rate-of-return carriers (not

³⁶⁷ 5 U.S.C. § 605(b).

³⁶⁸ 5 U.S.C. § 601(6).

³⁶⁹ 5 U.S.C. § 601(3) (incorporating by reference the definition of “small business concern” in the Small Business Act, 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(s) in the Federal Register.”

³⁷⁰ 15 U.S.C. § 632.

³⁷¹ See *supra* § IV.A.2.

just those serving 50,000 or fewer lines) to elect to adopt a revised section 61.39 approach under which they would file access tariffs every two years based on the previous two years' historical cost and demand data. The Rate-of-Return Carrier Tariff Option would provide a participating company with a per-line ICLS based on two years of historical data. Finally, both plans would make participation in the alternative regulation plan optional, and would allow election by study area.

149. The *Second Further Notice* tentatively concludes that any alternative regulation plan that the Commission may adopt should be optional on the part of the rate-of-return carrier, with participation through election on a study area basis.³⁷² Additionally, such participation should be available only to holding company groups in which all non-average schedule companies file their own cost-based tariffs. Among the issues on which the *Second Further Notice* seeks comment are whether the two plans will produce rates that are just and reasonable and not unreasonably discriminatory for all entities, including small entities. The *Second Further Notice* also asks whether the CenturyTel Plan should contain a productivity factor other than GDP-PI, whether a G-factor should be used as an alternative approach to an X-factor, and whether it should be based on historical data or on projections for the next tariff period. In addition, the *Second Further Notice* asks about the effect each plan will have on rate-of-return carriers' investment and maintenance of their exchange access facilities, whether service quality will be degraded, and whether the universal service fund will be increased.

150. The *Second Further Notice* also tentatively concludes that existing accounting and regulatory processes should equip parties and the Commission to detect cost-shifting by the rate-of-return carriers that file cost-based access tariffs. Nonetheless, the Commission asks commenters to identify the ways that a rate-of-return carrier could shift costs from a study area electing an alternative regulation plan to a study area subject to rate-of-return regulation. The Commission also asks commenters to identify what additional reporting or regulatory procedures would help detect and prevent such cost shifting. The *Second Further Notice* tentatively concludes that the rules should be amended to indicate that new carriers or carrier study areas may not elect the CALLS³⁷³ plan because it was not designed to be open to new carriers or study areas. Finally, it also tentatively concludes that the option to elect alternative regulation on a study area basis, if adopted, should also be available when carriers under different regulatory plans come together by merger or acquisition.

2. Legal Basis

151. This rulemaking action is supported by sections 4(i), 4(j), 201-205, 254, and 403 of the Communications Act of 1934, as amended.³⁷⁴

³⁷² See *supra* § IV.A.3.

³⁷³ See *supra* para. 72.

³⁷⁴ 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

152. The Commission's action in this *Second Further Notice* could affect a wide variety of entities. This IRFA potentially will affect the same entities discussed above in the FRFA, and we incorporate the descriptions of those entities by reference.

4. Description of Projected Reporting, Recordkeeping, and Other Compliance Requirements

153. The *Second 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, during CenturyTel's five-year plan, line density averages would have to be reported in order to assess applicable ATS target rates.³⁷⁵ Furthermore, under the Rate-of-Return Carrier Tariff Option, electing rate-of-return carriers would file tariffs for a two-year period, with rates based on historical costs and demand.³⁷⁶ The *Second Further Notice* also addresses the continued need for the Commission's all-or-nothing rule, seeking comment on whether repeal or modification of the all-or-nothing rule could involve additional reporting or regulatory procedures to prevent cost shifting.³⁷⁷

5. Steps Taken To Minimize Significant Economic Impact on Small Entities, and Significant Alternatives Considered

154. 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.³⁷⁸

155. The two alternative incentive regulation proposals in the *Second Further Notice* could have varying positive or negative impacts on small rate-of-return carriers. The proposals involve elective options, so that a small entity should be able to assess the potential impacts as part of its decision-making process. Nonetheless, public comments are welcomed on any modifications to the proposals contained in the *Second Further Notice* that would reduce

³⁷⁵ See *supra* § V.A.2.

³⁷⁶ See *id.*

³⁷⁷ See *supra* § IV.A.3.

³⁷⁸ 5 U.S.C. § 603(c)(1)–(c)(4).

potential adverse impacts on small entities. Specifically, suggestions are sought on different compliance or reporting requirements that would take into account the resources of small entities; and clarification, consolidation, or simplification of compliance and reporting requirements for small entities that would be subject to the rules. What are the relative merits between applying an X-factor, based on GDP-PI or some other productivity factor, and a G-factor, based on growth, as they relate to small entities under the CenturyTel Plan? How can we ensure that adequate investment and service quality levels are maintained? How would the adoption of an incentive regulation plan affect small carriers, and how would a low-end adjustment affect such plan? How would the adoption of either alternative regulation plan affect universal service? If we should repeal or modify our all-or-nothing rule, how can we prevent the danger of cost shifting for small carriers? How would the proposals impact NECA pooling from the perspective of small carriers? Comments should be supported by specific economic analysis.

6. Federal Rules That May Duplicate, Overlap, or Conflict With the Proposed Rules

156. None.

7. Report to the Small Business Administration

157. The Commission will send a copy of the *Second Further Notice*, including this IRFA, to the Chief Counsel for Advocacy of the Small Business Administration (SBA).³⁷⁹ In addition, the *Second Further Notice* and IRFA (or summaries thereof) will be published in the Federal Register.³⁸⁰

E. Filing of Comments and Reply Comments

158. 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 on or before 30 days and reply comments on or before 45 days of publication of this *Second Further Notice* in the Federal Register. Comments may be filed using the Commission's Electronic Comment Filing System (ECFS) or by filing paper copies.³⁸¹ Comments filed through the ECFS can be sent as an electronic file via the Internet to <<http://www.fcc.gov/cgb/ecfs>>. 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, U.S. 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 <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.

³⁷⁹ See 5 U.S.C. § 603(a).

³⁸⁰ *Id.*

³⁸¹ See Electronic Filing of Documents in Rulemaking Proceedings, 63 Fed. Reg. 24121 (1998).

Commenters also may obtain a copy of the ASCII Electronic Transmittal Form (FORM-ET) at <<http://www.fcc.gov/e-file/email.html>>.

159. 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.

160. Filings can be sent by hand or messenger delivery, by commercial overnight courier, or by first-class or overnight U.S. Postal Service mail (although we continue to experience delays in receiving U.S. Postal Service mail). The Commission's contractor, Natek, Inc., will receive hand-delivered or messenger-delivered paper filings for the Commission's Secretary at 236 Massachusetts Avenue, N.E., Suite 110, Washington, D.C. 20002.

- The filing hours at this location are 8:00 a.m. to 7:00 p.m.
- All hand deliveries must be held together with rubber bands or fasteners.
- Any envelopes must be disposed of before entering the building.
- Commercial overnight mail (other than U.S. Postal Service Express Mail and Priority Mail) must be sent to 9300 East Hampton Drive, Capitol Heights, MD 20743.
- All filings must be addressed to the Commission's Secretary, Office of the Secretary, Federal Communications Commission.

161. Regardless of whether parties choose to file electronically or by paper, parties should also file one copy of any documents filed in this docket with the Commission's copy contractor, Qualex International, Portals II, 445 12th Street, S.W., Washington, DC 20554 (telephone 202-863-2893; facsimile 202-863-2898) or via e-mail at <qualexint@aol.com>. In addition, one copy of each submission must be filed with the Chief, Pricing Policy Division, 445 12th Street, S.W., Washington, DC 20554. Documents filed in this proceeding will be available for public inspection during regular business hours in the Commission's Reference Information Center, 445 12th Street, S.W., Washington, DC 20554, and will be placed on the Commission's Internet site. For further information, contact Douglas Slotten at (202) 418-1572, or Ted Burmeister at (202) 418-7389.

162. Written comments by the public on the proposed and/or modified information collections are due on the same day as comments on the *Second Further Notice*, i.e., on or before 30 days after publication of the *Second Further Notice* in the Federal Register. Written comments must be submitted by OMB on the proposed and/or modified information collections on or before 60 days after publication of the *Second Further Notice* in the Federal Register. In addition to filing comments with the Secretary, a copy of any comments on the information collections contained herein should be submitted to Judith B. Herman, Federal Communications Commission, 445 12th Street, S.W., Washington, DC 20554, or via the Internet to <jbherman@fcc.gov>, and to Jeanette Thornton, OMB Desk Officer, Room 10236 NEOB, 725 17th Street, N.W., Washington, DC 20503, or via the Internet to <JThornto@omb.eop.gov>.

163. Accessible formats (computer diskettes, large print, audio recording and Braille) are available to persons with disabilities by contacting the Consumer & Governmental Affairs Bureau, at (202) 418-0531, TTY (202) 418-7365, or at <fcc504@fcc.gov>.

VI. ORDERING CLAUSES

164. Accordingly, IT IS 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 Report and Order IS ADOPTED.

165. IT IS FURTHER ORDERED that Parts 54, 61, and 69 of the Commission's rules, 47 C.F.R. Parts 54, 61, and 69, ARE 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.

166. IT IS FURTHER ORDERED that the Commission's Consumer and Governmental Affairs 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.

167. 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 *Second Further Notice of Proposed Rulemaking* IS ADOPTED.

168. IT IS FURTHER ORDERED that the Commission's Consumer and Governmental Affairs Bureau, Reference Information Center, SHALL SEND a copy of this *Second Further Notice of Proposed Rulemaking*, including the Initial Regulatory Flexibility Analysis, to the Chief Counsel for Advocacy of the Small Business Administration.

FEDERAL COMMUNICATIONS COMMISSION

Marlene H. Dortch
Secretary

APPENDIX A
FINAL RULES

Part 54, Part 61, and Part 69 of the Code of Federal Regulations are amended as follows:

PART 54 – UNIVERSAL SERVICE

1. The authority citation continues to read as follows:

Authority: 47 U.S.C. 1, 4(i), 201, 205, 214, and 254 unless otherwise noted.

2. Section 54.303(a) is revised by adding a second sentence as follows:

§ 54.303 Long Term Support

- (a) * * * Beginning July 1, 2004, no carrier shall receive Long Term Support.

PART 61 – TARIFFS

3. The authority citation continues to read as follows:

Authority: Secs. 1, 4(i), 4(j), 201-205, and 403 of the Communications Act of 1934, as amended; 47 U.S.C. 151, 154(i), 154(j), 201-205, and 403, unless otherwise noted.

4. Section 61.41 is revised by amending paragraphs (c) and (d) and adding a new paragraph (e) to read as follows:

§ 61.41 Price cap requirements generally.

* * *

(c) Except as provided in paragraph (e), the following rules in this paragraph (c) apply to telephone companies subject to price cap regulation, as that term is defined in § 61.3(ee), which are involved in mergers, acquisitions, or similar transactions.

* * *

(d) Except as provided in paragraph (e), local exchange carriers that become subject to price cap regulation as that term is defined in § 61.3(ee) shall not be eligible to withdraw from such regulation.

(e) Notwithstanding the requirements of paragraphs (c) and (d), a telephone company subject to rate-of-return regulation may return lines acquired from a telephone

company subject to price cap regulation to rate-of-return regulation, provided that the acquired lines will not be subject to average schedule settlements, and provided further that the telephone company subject to rate-of-return regulation may not for five years elect price cap regulation for itself, or by any means cause the acquired lines to become subject to price cap regulation.

PART 69 – ACCESS CHARGES

5. The authority citation continues to read as follows:

Authority: 47 U.S.C. 154, 201, 202, 203, 205, 218, 220, 254, 403.

6. Section 69.123 is revised by amending paragraphs (a), (c), and (d) to read as follows:

§ 69.123 Density pricing zones for special access and switched transport.

(a)(1) Incumbent local exchange carriers not subject to price cap regulation may establish any number of density zones within a study area that is used for purposes of jurisdictional separations, provided that each zone, except the highest-cost zone, accounts for at least 15 percent of that carrier's special access and transport revenues within that study area, calculated pursuant to the methodology set forth in § 69.725.

(2) [Reserved]

* * *

(c) Notwithstanding § 69.3(e)(7) of this chapter, in study areas in which a telephone company offers a cross-connect, as described in § 69.121(a)(1) of this chapter, for the transmission of interstate special access traffic, telephone companies may charge rates for special access sub-elements of DS1, DS3, and such other special access services as the Commission may designate, that differ depending on the zone in which the service is offered, provided that the charges for any such service shall not be deaveraged within any such zone.

* * *

(d) Notwithstanding § 69.3(e)(7) of this chapter, in study areas in which a telephone company offers a cross-connect, as described in § 69.121(a)(1) of this chapter, for the transmission of interstate switched traffic, or is using collocated facilities to interconnect with telephone company interstate switched transport services, telephone companies may charge rates for sub-elements of direct-trunked transport, tandem-switched transport, entrance facilities, and dedicated signaling transport that differ depending on the zone in which the service is offered, provided that the charge for any such service shall not be deaveraged within any such zone.

* * *

APPENDIX B**PLEADINGS FILED IN RESPONSE TO
*MAG FURTHER NOTICE*****COMMENTS ON MAG FURTHER NOTICE**

1. ALLTEL Communications, Inc., CenturyTel, Inc., Madison River Communications, LLC, and TDS Telecommunications Corporation (ALLTEL et al.)
2. AT&T Corp.
3. CUSC
4. General Communication, Inc. (GCI)
5. General Services Administration (GSA) (filed 12/31/01)
6. GVNW Consulting, Inc. (GVNW)
7. ICORE Cos. (ICORE)
8. Independent Telephone & Telecommunications Alliance (ITTA)
9. Innovative Telephone
10. Nebraska Rural Independent Cos.
11. NECA
12. NRTA, OPASTCO and USTA
13. NTCA
14. PRTC
15. Ronan Telephone Co. and Hot Springs Telephone Co.
16. Sprint Corp.
17. TCA, Inc.
18. Verizon
19. Western Alliance
20. Worldcom

PARTIES FILING REPLY COMMENTS TO MAG FURTHER NOTICE

1. ALLTEL et al.
2. AT&T Corp.
3. GCI
4. GSA
5. GVNW
6. ITTA
7. Innovative Telephone
8. NECA
9. NRTA, OPASTCO and USTA
10. NTCA
11. Valor Telecommunications Enterprises, LLC

APPENDIX C

**CENTURYTEL, INC. ALTERNATIVE REGULATION PROPOSAL
(From Ex Parte in CC Docket No. 00-256, filed Dec. 23, 2002)****The FCC Should Permit Rate-of-Return Carriers to Elect Price Cap Regulation for Interstate Access Charges on a Study Area Basis and Eliminate the “All-or-Nothing” Rules****I. Background – Why CenturyTel Needs Relief From the All-or-Nothing Rules**

- All-or-Nothing relief is needed for both acquisitions and legacy properties
- There is no clear path for CenturyTel’s operating companies to adopt price caps or other forms of incentive regulation under the current rules
- The lack of options hinders CenturyTel’s ability to attract capital for investment (*e.g.*, for the deployment of new technologies and acquisition of new lines)
- The need for waivers also adds to the cost, delay and uncertainty of acquiring rural lines from price cap carriers, despite the fact that waivers are routinely granted
- CenturyTel needs options to remain a viable rural provider, to continue investing in rural markets, and to respond to competitive service offerings
- CenturyTel could successfully operate under price caps, and access customers could benefit from lower traffic-sensitive rates, in some of CenturyTel’s larger and more homogeneous markets

II. Specific rule changes should accomplish the following:

- Enable acquisitions: Eliminate §61.41(c)(2) so rate-of-return companies who acquire price capped exchanges need not convert to price caps at the holding company level (§61.41.(c)(3) also may be eliminated as it will become moot)
- Give flexibility for rate-of-return carriers to elect price cap regulation on a study area basis: Eliminate §61.41(b) so price cap tariffs may be filed for some study areas without necessitating that all study areas be brought under price caps
- Benefit access customers by lowering traffic-sensitive charges in electing study areas to the Target Rates: Most rate-of-return companies have cost-based interstate traffic-sensitive access charges above \$0.015 per minute; therefore, enabling the adoption of price caps will produce an immediate benefit to access customers by bringing down traffic-sensitive rates.

- Provide alternatives for carriers whose actual traffic-sensitive rates are significantly above the Target Rates for average traffic-sensitive (ATS) charges:
 - Amend §61.3(qq) to establish the following ATS Target Rates:
 - \$0.0125 for carriers with line density average (at the holding company level, excluding lines acquired from mandatory price cap companies) less than 15 lines per square mile and current ATS rates at or above this Target Rate;
 - Freeze ATS rates at current levels for carriers with line density average (at the holding company level, excluding lines acquired from mandatory price cap companies) less than 15 lines per square mile and current ATS rates below \$0.0125;
 - \$0.0095 for carriers with line density average (at the holding company level, excluding lines acquired from mandatory price cap companies) of at least 15 but less than 19 lines per square mile and current ATS rates at or above this Target Rate;
 - Freeze ATS rates at current levels for carriers with line density average (at the holding company level, excluding lines acquired from mandatory price cap companies) of at least 15 but less than 19 lines per square mile and current ATS rates below \$0.0095;
 - Freeze ATS rates at current levels, up to a maximum ATS rate of \$0.0095, for carriers with line density average (at the holding company level, excluding lines acquired from mandatory price cap companies) of 19 lines or more per square mile, for carriers newly electing price caps
 - Amend §61.45(b)(1)(ii) so “X” = *GDP-PI* effective immediately for carriers electing this plan
- Ensure against harm to consumers by preserving federal universal service support:
 - *Avoid “revenue shock” when ATS rates are reduced by creating a “TS Additive” to an electing carrier’s interstate support:* Amend §54.901 to permit electing carriers to move their ATS rates to the new Target Rate (described above) on a revenue-neutral basis; where an electing carrier’s existing ATS rate is above the Target Rate, allow such carrier to recover the difference between the Target Rate and their existing revenue requirement through a “TS Additive” to ICLS; then freeze the TS Additive on a study area basis for the duration of the plan
 - *Maintain existing levels of Interstate Common Line Support (ICLS) and Long-Term Support (LTS) for the duration of the plan:* Amend §54.901(a) to include carriers electing price caps after the effective date of this plan in addition to “rate-of-return carriers”; freeze for the duration of the plan, on a per-line basis, both ICLS and LTS at existing levels (with a possible adjustment to ICLS for a non-primary residential line SLC increase to \$7.00 upon conversion to price caps); also amend §54.902 to

- clarify that ICLS (frozen on a per-line basis as described above) will follow the transferred exchanges where the buyer is a carrier electing price caps under this plan; in addition, amend §54.303(a) to clarify that LTS will continue to be made available to LECs who elect price caps under this plan
- *Maintain existing levels of Local Switching Support (LSS) for the duration of the plan:* Amend §54.301(a) to freeze LSS on a study area basis for the duration of the plan
 - *Avoid any impact on the fixed \$650 million fund of interstate CALLS support:* Amend §54.800 to redefine Price Cap LEC for the purpose of Subpart J of Part 54 as excluding carriers that elect price caps under this later plan
 - *Create predictable and stable High-Cost Loop Support (HCLS):* Amend §36.631 to freeze HCLS on a per-line basis. Amend §36.603 to adjust this frozen per-line amount only for GDP-CPI, while continuing to apply the Rural Growth Factor to that portion of the fund that supports other rural carriers. All rural carriers remain eligible to receive safety net and safety valve support
 - Retain the low-end adjustment to ensure a reasonable earnings opportunity: Retain the existing rule that price cap carriers who earn below 10.25% may increase their Price Cap Indices effective July 1 the following year to target an interstate earnings level of 10.25%
 - Grant flexibility to pooling carriers: Amend §69.3(e)(9) by deleting the second sentence, so carriers may exit the pool to elect price caps for some study areas but keep others (under rate-of-return regulation) in the pool
 - Ensure stability by putting the plan in place for 5 years

III. Public Benefits of This All-or-Nothing Relief:

- TS charges for interstate access will be stabilized: Pursuant to § 61.3(qq)(2), CenturyTel companies would qualify for the \$0.0125 Target Rate based on line density of fewer than 15 lines per square mile at the holding company level (excluding lines acquired from mandatory price cap companies); CenturyTel's current composite ATS rate is well above \$0.015 in most study areas, and costs per line are increasing; thus, access customers will benefit from lower and stable interstate TS rates if CenturyTel is permitted to adopt price caps under this plan
- High-Cost Loop Support will be stabilized: A freeze will increase the predictability and stability of HCLS, creating a climate that is favorable for long-term capital planning and fostering new investment
- Investment will be encouraged: High-risk investment in new technologies in rural areas will be encouraged by the prospect of higher earnings; and new acquisitions will become less costly and disruptive to consummate because the all-or-nothing waiver process will

have been eliminated (although consumers and the Commission still will have the opportunity to review study area boundary changes and tariff filings, and will have notice of the change in service provider under the Section 214 and “slamming” notification rules)

- Consumers will get the benefits of price caps without the loss in service quality experienced in areas served by the mandatory price cap carriers:
 - Unlike the mandatory price cap carriers, CenturyTel serves relatively small study areas that are predominantly rural in nature; CenturyTel’s reputation rests on the quality of its service to rural customers
 - Unlike the mandatory price cap carriers, CenturyTel will be an elective price cap carrier, and will not elect price caps for study areas where it can only successfully operate by curtailing investment in high-cost areas
 - Unlike the mandatory price cap carriers, CenturyTel would be electing price caps at a time when the states have had years of experience under their own (intrastate) price cap plans; the states are fully prepared to (and actively do) police LEC service quality and infrastructure investment – many smaller ILECs, including many CenturyTel operating companies, are governed by incentive regulation today for their intrastate rates
 - Unlike the mandatory price cap carriers, CenturyTel is as efficient an operator as any carrier operating comparable exchanges, and seeks to sustain that efficiency without jeopardizing service quality or reliability; while CenturyTel does not expect to experience the same efficiency gains under price caps as the larger carriers did, CenturyTel’s future lies not in diminishing service to rural America, but in providing the best quality service, offering innovations that respond to customer needs, and providing, maintaining and upgrading a network capable of supporting vertical services

IV. All-or-Nothing Relief Does Not Require Additional Safeguards:

- Customers are adequately protected by the existing accounting rules and affiliate transactions rules
- The Commission and customers can detect cost-shifting in tariff filings
- State Commissions continue to review carriers’ costs as well
- The FCC may order the production of records at any time
- The Commission may continue to enforce its “one-way door” rules so carriers may not “game the system” by shifting back and forth between price caps and rate-of-return regulation over the life of the plan

V. The Commission Should Adopt All-or-Nothing Relief in Time for 2003 Adoption

- The Commission should adopt and release these rule changes by May 31, 2003, to give carriers adequate opportunity to decide whether to elect this plan
- The Commission should adopt a 5-year plan, under which carriers may elect to designate individual study areas beginning in June 2003, effective July 1, 2003; carriers also should be permitted to designate study areas for this plan at any subsequent annual or semi-annual tariff filing – *e.g.*, December 2003, June 2004, December 2004, June 2005, etc.; finally, the Commission should make adoption of the plan as to any study area effective for the remainder of the 5-year life of the plan

APPENDIX D

**RATE-OF-RETURN COMPANY TARIFF OPTION PROPOSAL
(From Ex Parte in CC Docket No. 00-256, filed Jan. 31, 2003)**

**Proposal Developed Collectively By:
ALLTEL Communications, Inc.
Madison River Communications, LLC
TDS TELECOM, Inc.**

- I. INTRODUCTION: The Rate-of-Return Company Tariff Option is responsive to a need that the Commission has identified. Implementation of the proposed option will address concerns of the non-price cap rate of return carriers. Adoption of this proposal will serve the interests of access users and end user customers of rate of return carriers, and also foster the provision of universal and advanced services in rural areas.**
- In response to the Commission’s Further Notice of Proposed Rulemaking set forth in the Commission’s Order released November 8, 2001 in CC Docket No. 00-256, ALLTEL Communications, Inc., Madison River Communications, LLC, and TDS TELECOM, Inc. (collectively, “the Carriers”) have given both independent and collective consideration to the development of options available as alternative regulatory structures for rate-of-return carriers that currently have no meaningful options.
 - Specifically, rate-of-return carriers, including the Carriers, have no realistic alternative or incentive option available to rate-of-return regulation.
 - Given the cost characteristics of the rural geographic areas served by the Carriers, it is not practicable for these companies to elect Price Caps as currently formulated.
 - Under existing rules, the Carriers are not permitted to elect the use of the incentive regulation established in § 61.39 of the Commission’s Rules to address the needs of their companies, their access users, and their end user customers.
 - The Commission has long recognized that the distinct characteristics of companies that have remained on traditional rate-of-return regulation; the general rural nature of their service areas in combination with their diversity result in the conclusion that it is appropriate to establish “a continuum of increasingly incentive-based approaches which permits a company to select a plan best fitting its circumstances.”¹
 - The Commission initially attempted to achieve this continuum by adopting Price Caps for larger carriers; “Optional Incentive Regulation” (“OIR”) for all rate-of-return local exchange carriers as formerly set forth in § 61.50 of the Commission’s

¹ *In the Matter of Regulatory Reform for Local Exchange Carriers Subject to Rate of Return Regulation*, CC Docket No. 92-135, Report and Order released June 11, 1993 (the “OIR Order”), para. 4.

Rules; and historic cost tariff filing rules for both the traffic sensitive and common line rates for companies serving fewer than 50,000 lines, as set forth in § 61.39 of the Commission's Rules.²

- Unfortunately, the continuum envisioned and desired by the Commission does not exist. The OIR rules did not turn out to be as useful to the rural rate-of-return carriers as both the carriers and the Commission had hoped. The availability of OIR was subsequently removed from the Commission's Rules.
- The need for the continuum of incentive regulation choice envisioned by the Commission, however, remains. The Carriers have concluded that the Commission's existing rules and policies, with appropriate modification and application, contain the needed elements to provide the desired continuum for the Carriers and other similarly situated companies that have no incentive regulation choice other than the existing price-cap plan which the Commission has recognized and understands to be inapplicable to their service areas.³
- Specifically, the Carriers propose that the Commission adopt the "Rate-of-Return Company Tariff Option" by revising its rules to permit all rate-of-return telephone companies the option in each of their study areas of electing to utilize the § 61.39 rules to establish applicable access charges.
 - The Commission has previously noted the public interest benefits that have been produced by utilization of the § 61.39 rules,⁴ and recognized that the rules exist both to promote the public interest and to provide incentives to local exchange carriers.⁵
 - The Commission has essentially recognized in its Further Notice in the MAG proceeding, as it has previously determined, that it is appropriate and necessary to expand incentives for efficiency and innovation.
 - The limitation on the application of § 61.39 Rules to carriers serving fewer than 50,000 access lines was established in 1987:

² The optional application of § 61.39 to the common line rate was effectuated by the OIR Order, and reflects the Commission's intent to enhance the provision of a continuum of incentive choices to non-price cap carriers.

³ See, e.g., MAG Order, para. 86. "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 expenses."

⁴ "Our own review of the rates filed pursuant to Section 61.39 . . . demonstrates the success of these rules." OIR Order, para. 94.

⁵ "Collectively, these revisions to our rules governing small and mid-size LECs were designed to assure reasonable rates, reduce regulatory burdens and introduce (or expand) incentives for efficiency and innovation." *In the Matter of Regulatory Reform for Local Exchange Carriers Subject to Rate of Return Regulation*, Order on Reconsideration, February 18, 1997, at para. 11.

- Prior to any experience with price caps or any alternative forms of incentive regulation;⁶
- Prior to any experience in observing the value of the § 61.39 rules for rural rate-of-return carriers;
- Prior to the failure of OIR to provide a viable alternative for carriers similarly situated to the Carriers; and
- The Carriers note that the Commission has previously been asked to consider expanding the availability of the § 61.39 rules. A similar proposal was set forth by USTA in the course of the Commission's 1998 Biennial Review. In response, the Commission declined to adopt the proposal noting that this, and related access pricing flexibility proposals, would be better addressed in the *Access Reform* proceeding.
- Accordingly, it is appropriate for the Commission to consider and adopt the Carriers' proposal to expand the availability of the § 61.39 rules to all rate-of-return telephone companies. As the Commission's experience with the § 61.39 rules has demonstrated, the adoption of the Rate-of-Return Company Tariff Option will serve the public interest by providing a currently unavailable option to the Carriers and similarly situated rate-of-return telephone companies. Implementation of the Rate-of-Return Company Tariff Option will promote:
 - Reasonable access rates;
 - Reduced regulatory burden;
 - Potential for reduced end user charges.

II. The minimal Rule changes required to implement the Rate-of-Return Company Tariff Option are consistent with both Commission policy and the Telecommunications Act of 1996.

- The availability of the § 61.39 Rules is currently limited to local exchange carriers serving 50,000 or fewer access line in a given study area that are described as subset 3 carriers in § 69.602 (i.e., annual operating revenues under \$40 million).
- The Rate-of-Return Company Tariff Option may be implemented by substituting the following at the beginning of § 61.39:

⁶ In establishing the limitation the Commission noted that it was considering forms of alternative or reduced regulation in separate proceedings.

§ 61.39 Optional supporting information to be submitted with letters of transmittal for Access Tariff filings effective on or after April 1, 1989, with respect to any study area operated by a Telephone Company otherwise subject to § 61.38.

(a) *Scope*. This section provides for an optional method for filing for any study area served by a carrier that is otherwise subject to § 61.38.

- A similar revision is required in § 61.38 to replace the reference to the 50,000 line and subset 3 limitation with respect to the application of § 61.39.

III. Additional proposed modifications to the Commission's Rules will align the operation of § 61.39 with the implementation of the MAG decision.

- The Carriers propose no changes to the Traffic Sensitive portion of the § 61.39 tariff option. Under existing rules, carriers filing Traffic Sensitive rates under § 61.39 base their rates on historical costs and demand. For the initial § 61.39 tariff filing, a carrier uses actual costs and demand for the previous calendar year. For subsequent filings, the carrier uses the actual costs and demand for the two previous calendar years. § 61.39 uses regulatory lag to provide an incentive to the ILEC to control costs and stimulate demand, while the customers benefit from the self-correcting nature of the plan. Efficiencies gained during the tariff period are reflected in subsequent tariff filings.
- In their review of the § 61.39 rules, the Carriers noted that the implementation of the MAG Order affects the operation of § 61.39 with respect to the common line option.
 - Under the existing § 61.39 rules, end user charges are set at the lower of cost or subscriber line charge ("SLC") caps; and the remainder of the common line revenue requirement is to be recovered through the CCL charge. The MAG rules, however, have eliminated CCL charges except for the small amount remaining for the final SLC cap transition; ICLS has been created to recover the residual.
 - Accordingly, the § 61.39 rules should be revised to enable the electing company to recover the residual Common Line revenue requirement through the ICLS, consistent with the changes in the MAG order.
 - The Carriers offer a procedure below to accomplish this in a manner consistent with the underlying policy intent of the Commission when it expanded the § 61.39 option to include the CCL rate.
 - In the current environment of stagnant line growth, rural rate-of-return carriers should be provided with expanded and additional incentives to control costs. The Carriers have developed a proposed mechanism to revise § 61.39 in a manner that both provides that incentive, and benefits the customers by resetting support every two years based on efficiency gains of the previous two-year period.

- Specifically, the Carriers propose to revise § 61.39 with respect to the establishment of the CCL rate (and to make consistent rule changes in § 54 and § 69 of the Commission's Rules) to provide as follows:
 - Establish per-line Common Line support at the historical level of costs divided by the historical level of access lines.
 - The formula would initially be established by utilizing the historical period interstate Common Line revenue requirement, as defined in the FCC Part 69 rules, which includes the Line Port costs transferred from Local Switching and TIC reallocations.
 - The Interstate Common Line revenue requirement for the historical period would be reduced by end user revenues, the special access surcharge, the line port costs associated with ISDN service in excess of basic analog service,⁷ and payments to USAC for universal service funding assessments.
 - No reduction is required to offset CCL revenue; this result occurs because this plan will not be implemented until after the CCL charge is completely eliminated on June 30, 2003.
 - A company electing § 61.39 for Common Line would establish an interstate Common Line revenue requirement per access line, net of SLCs, special access surcharges, ISDN Port charges, and USAC assessments. This per line amount, times the actual access lines, would become the company's Common Line revenue requirement during the optional tariff period and would be used as a final total amount for all interstate Common Line amounts.
 - Under this proposed mechanism for addressing the common line revenue requirement within the framework of § 61.39, an electing company would receive Common Line revenue for the applicable study area from the following sources for the duration of the tariff period:

<i>Common Line Revenue Source</i>	<i>Determination of Amount</i>
Subscriber Line Charges	Based on historical year costs, with rate development consistent with current SLC rules, using SLC caps in the rules.
Per-Line Common Line Settlement Amount	Historic year costs, adjusted for SLCs, special access surcharges, and ISDN port charges.
Special Access Surcharges	Based on historical period rate development.
ISDN Line Port Charges	Based on historical period rate development.
Universal Service Charges (FUSC)	Recovery based on current period assessments from USAC.

⁷ See § 69.130 of the Commission's Rules.

IV. Public Interest Benefits Result from the Implementation of the Rate-of-Return Company Tariff Option.

- The adoption of the Rate-of-Return Company Tariff Option will expand the availability of a proven incentive regulation alternative to study areas served by all current rate-of-return telephone companies. In their consideration of § 61.39 as an expanded option available as part of a continuum of incentive options, the Carriers offer a mechanism to ensure that Common Line revenue requirement recovery continues to be achieved in a manner consistent with the Commission's goals. The adoption of the proposal otherwise is limited in its impact on existing mechanisms:
 - Local Switching Support: The Carriers' proposal does not contemplate or require changes to the methodology by which Local Switching Support (LSS) is calculated and recovered. This element will continue to be paid based on estimated costs for the year, subject to true-up. Accordingly, the proposal has no impact on the manner in which LSS is treated under the existing rules.
 - High Cost Loop Funding: The Rate-of-Return Company proposal does not contemplate or require any changes to the High Cost Loop Funding (HCLF). The Carriers respectfully submit that any current or subsequent consideration by the Commission regarding HCLF should be separate and apart from the consideration of this proposal. Consideration of any issues or proposals regarding HCLF should not be permitted to delay the expedited adoption of the Rate-of-Return Company Tariff Option and the resulting benefits of expanding the availability of § 61.39 to all rural companies.
 - NECA Pooling and Incentive Regulation: The Carriers anticipate that the Rate-of-Return Company Tariff Option will work well with the NECA pooling process.
 - Companies electing § 61.39 incentive regulation for Traffic Sensitive rates would settle with the Pool based on per-minute or per special access line settlement ratios.
 - No administrative burden will result for companies electing the Rate-of-Return Company Tariff Option for Common Line. Participation in the NECA Common Line pool would be administratively simple; these companies would simply settle with NECA based on the per-line settlement amounts (as proposed in Section III above).
- The adoption of the Rate-of-Return Carrier Tariff Option will not be disruptive to other existing policies, practices or procedures:
 - All Rate-of-Return Telephone Companies would be able to elect to apply § 61.39 rules to Traffic Sensitive, Common Line, or both, by study area in the same manner that a more limited subset of rural telephone companies are able to do today.
 - As under the existing § 61.39 rules, the resetting of rates every two years will provide both protection to the electing telephone companies and benefits to IXCs.

- In the MAG proceeding, the Commission acknowledged the concerns of rural telephone companies with respect to any prospective mandated incentive regulation. The Rate-of-Return Carrier proposal is optional for all rural non-price cap companies and will not impact any rural telephone company in a negative manner. The adoption of the Rate-of-Return Company Tariff Option does not and should not impose any additional regulation or administrative burden on rural companies currently eligible to utilize § 61.39.
- The Rate-of-Return Carrier Tariff Option provides an incentive tariff filing option for many Rate-of-Return Company study areas that currently have no viable incentive option. The proposed option is founded on existing rules and polices and results, as the Commission has contemplated, in the expansion of a continuum of incentives available to non-price cap carriers.
- The Rate-of-Return Carrier Tariff Option can be easily adopted and implemented without administrative burden to any party. The proposed rule changes to expand the application of § 61.39 are very straight-forward. The remainder of the rule changes proposed by the Carriers address changes in an efficient manner consistent with existing policy to align § 61.39 with the changes in CCL revenue requirement recovery that result from the implementation of the MAG Order.

V. The Commission Can Obtain Maximum Public Interest Value from the Rate-of-Return Company Tariff Option by Expedited Adoption that Enables Carriers to Elect to Use the Option Effective July 1, 2003.

- The Carriers respectfully request that the Commission afford the Rate-of-Return Company Tariff Option expedient consideration in order to ensure that the required rule changes are effective on a timely basis that enables rural telephone companies the opportunity to elect to implement this plan concurrent with the election for interstate tariffs effective July 1, 2003.

VI. CONCLUSION

- Adoption of the Rate-of-Return Company Tariff Option will expand the availability of a successful incentive plan that has proven to address the needs of rural telephone companies in a manner that advances the public interest. The expansion of the availability of § 61.39 provides a missing element on the Commission's intended continuum of incentive regulation alternative designed to encourage efficiencies and reasonable rates for both access customers and end user customers.
- For an electing company, § 61.39 provides a strong incentive to operate efficiently during the tariff plan. As an incentive, the Rate-of-Return Company is able to keep any additional revenues earned while under incentive regulation. As a result of the gain in efficiencies, the access customer benefits. Rate reductions are reflected at the end of the first tariff period when the carrier files new rates based on the two-year period since it

last filed rates. End users will benefit from § 61.39 filings through lower SLC rates and/or lower universal service funding requirements.

- When the electing company files its new rates under § 61.39, the company uses the two-year historical period, costs and demand, to establish its rates for the next tariff period. As a result, its operating efficiencies during the initial tariff period translate into lower rates to carriers during the second tariff period. This result provides a powerful incentive to continue to operate more efficiently. The Carriers respectfully submit that the public interest will be well served if this strong and successful incentive currently available to some rural telephone companies is made available to all incumbent local exchange carriers that are not required to utilize price caps by the Commission's expedient adoption of the Rate-of-Return Company Tariff Option.

**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*, Report and Order and Second Further Notice of Proposed Rulemaking

I support today's decision to update and refine aspects of the MAG access reform plan for rate-of-return carriers. The measured step we take in adjusting the all-or-nothing rule is the right one. On the one hand, the all-or-nothing rule reflects a legitimate concern with improper cost shifting between rate-of-return and price cap companies. On the other, the rule may deter small and rural carriers interested in acquiring lines from price cap carriers and then investing in and improving their facilities. Our approach here—permitting rate-of-return carriers to convert acquired price cap lines back to rate-of-return regulation—strikes the appropriate balance.

When the MAG plan was adopted, I expressed concern about the abridged process leading to our consideration. Although we are well down the road already, I still have concerns about the impact of this plan on rural consumers. We have a duty to ensure that all Americans have access to reasonably comparable services at reasonably comparable rates. I urge the Commission to monitor the impact of this plan to ensure that it provides the stability necessary for investment in rural America.

**STATEMENT OF
COMMISSIONER JONATHAN S. ADELSTEIN**

Re: *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, Report and Order and Second Further Notice of Proposed Rulemaking

I am pleased that we are modifying the all-or-nothing rule to permit a rate-of-return carrier that has acquired price cap lines through a merger or acquisition to convert the acquired price cap lines back to rate-of-return regulation without obtaining a waiver. This modification will help reduce the administrative burdens associated with these mergers and acquisitions, and ensure that these unnecessary costs do not discourage participation by interested parties. Moreover, acquiring carriers can funnel those administrative costs into their new networks, thereby fueling network development.

Pricing flexibility is critical to incumbent companies as they face competitive entry in their service areas. Permitting rate of return carriers to deaverage their rates geographically for transport and special access services and to define both the scope and number of zones, pursuant to certain qualifications, will better equip these carriers to compete on a more level playing field with the new entrants that are not bound by the same regulatory requirements.

I look forward to discussion in response to the NPRM regarding the alternative regulation proposals and that regarding further relief under the all-or-nothing rule to build upon the decision we've made today.