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January 29, 1997

VIA HAND DELIVERY
Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, DC 20554

Re: Access Charge Reform, CC Docket No. 96-262

Dear Mr. Caton:

Enclosed for filing, on behalf of Roseville Telephone Company, are the original and 12 copies of their Comments, and a diskette, in the above-referenced matter.

If you should have any questions regarding this matter, please do not hesitate to call me.

Very truly yours,

Paul J. Feldman
Counsel for
Roseville Telephone Company

PJF/jr
Enclosures

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In the Matter of	)	
	)	
Access Charge Reform	)	CC Docket No. 96-262
	)	
Price Cap Performance Review for Local Exchange Carriers	)	CC Docket No. 94-1
	)	
Transport Rate Structure and Pricing	)	CC Docket No. 91-213
	)	
Usage of the Public Switched Network by Information Service and Internet Access Providers	)	CC Docket No. 96-263

COMMENTS OF ROSEVILLE TELEPHONE COMPANY

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January 29, 1997

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Usage of the Public Switched Network by Information Service and Internet Access Providers	)	CC Docket No. 96-263

COMMENTS OF ROSEVILLE TELEPHONE COMPANY

Roseville Telephone Company ("Roseville") hereby submits its comments in response to the Commission's Notice of Proposed Rulemaking released on December 24, 1996, in the above-captioned proceeding ("NPRM").

I. INTRODUCTION OF BASIC PRINCIPLES, AND SUMMARY

Roseville is a local exchange carrier ("LEC") serving subscribers in Roseville, California, and has been providing high quality telecommunications services for over 80 years. Roseville is a rate-of-return ("ROR") carrier with over 100,000 access lines. Roseville recognizes that there is a new competitive environment in the provision of local exchange services, driven by new regulation (*e.g.*, the Telecommunications Act of 1996), by rapid changes in markets, and by the growth of new technologies. While welcoming this new competitive environment, Roseville is concerned that the Commission enact rules that are fair to all competitors, not just to new entrants. Of primary importance in this proceeding are access charge rules that provide LECs the

flexibility to be competitive with other providers of access service. In addition, the Commission must allow LECs to recover their total costs that have been properly incurred to meet the public service obligations required by state and federal regulators.

Roseville also believes that the Commission should not delay making comprehensive access charge reform available to ROR LECs. While some of the proposals in the current NPRM would apply to ROR carriers, the Commission apparently proposes to push back proposals for the balance of access reform for ROR carriers to the end of 1997, with completion of such a proceeding unlikely before 1998. However, contrary to the Commission's statement in paragraph 52 of the NPRM, delayed reform could substantially inhibit the ability of ROR carriers to be competitive since in larger markets where ROR carriers operate, competition is impending, if not already present. Furthermore, ROR carriers such as Roseville are too large to qualify for a Section 251(f)(1) exemption for rural telephone companies, and unlikely to receive a Section 251(f)(2) exemption from their state commission. While Roseville recognizes and supports the need to treat smaller LECs differently than the largest LECs, the Commission might better make that distinction on the basis of rural telephone company vs. non-rural telephone company status, rather than on price-cap vs. ROR status. Alternatively, the Commission could make certain portions of reformed access charge rules available to ROR carriers as an optional alternative to the current rules.

Lastly, the Commission must act in a manner consistent with its numerous public statements that access reform is part of an interrelated "trilogy" of dockets that also

includes reform of local competition rules[1] and revision to Federal Universal Service funding mechanisms.[2] While there is currently some uncertainty as to the final results of the other dockets in the trilogy, rational decision-making requires the Commission to take into account the impact of those dockets in crafting revisions to the access charge rules. For example, in establishing rules for the prices of unbundled network elements, the Commission relied on total element long run incremental costs ("TELRIC"), and ignored the obvious need and right of LECs to recover properly incurred total costs. In defending these rules in front of the Eighth Circuit, Counsel for the Commission apparently conceded that embedded costs should be recovered, and assured the Court that such recovery will occur in the context of the access reform and universal service proceedings.[3] While Roseville does not believe that recovery of total costs of provision of unbundled network elements should be shifted from local interconnection to interstate access reform, at the very least the Commission must follow its own assurances in reviewing comments on the recovery of embedded costs of provision of access services in this proceeding. Similarly, while Universal Service funding

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[1] *See*, Interconnection First Report and Order, 11 FCC Rcd 15499 (1996) ("*Interconnection R&O*"), *petition for review pending and partial stay granted, sub. nom.* Iowa Utilities Board et. al. v. FCC, No. 96-3321 and consolidated cases (8th. Cir., Oct. 15, 1996).

[2] *See* Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Recommended Decision, FCC 96J-3 (November 8, 1996)("*Recommended Decision*").

[3] *See, "Appeals Court Hears Arguments on FCC Interconnection Order"*, TR Daily, January 17, 1997, at page 2. Embedded costs must be recovered at least in the context of this access charge reform proceeding, as the Commission's and Joint Board's proxy-model approach to cost calculation for the purposes of universal service support uses only forward-looking costs. *See* NPRM at para. 242.

mechanisms have in the past supported facilities assigned to the intrastate jurisdiction, the Commission cannot blithely assume that Universal Service support funds could in the future also be used to cover costs assigned to the interstate jurisdiction (*See* NPRM at para.246). On the contrary, for policy reasons and through use of proxy models to calculate costs, it seems extraordinarily likely that Universal Service funding will be substantially reduced from the current level.

In sum, major principles to be used by the Commission in this proceeding should include fair and flexible treatment of incumbent LECs, a realistic recognition of the impact of revised interconnection and universal service rules on the provision of access services, and timely comprehensive reform of access charge rules for ROR LECs. Based on those principles, Roseville makes the following proposals:

-Recovery of Common Line Costs: Common Line costs should be recovered through use of a flat, per-line charge paid by interexchange carriers ("IXCs"), and a subscriber line charge ("SLC") paid by the end user. Roseville opposes an increase in the cap on SLCs for second and additional residential lines, and for multi-line business customers.

-Transport Interconnection Charge: The costs associated with the transport interconnection charge ("TIC") are on-going real costs, and thus Roseville opposes the phase-out or elimination of the TIC unless the underlying costs are to be recovered through allocation to other rate elements or recovered in another manner. Costs that can be allocated to existing rate elements should be so allocated, and remaining costs that have been recovered through the TIC charge as a result of prior Separations policy decisions should be recovered through an explicit "Separations Cost" element, at least until separations reform is enacted by a Federal-State Joint Board and the Commission, and these actual costs can be properly allocated to their respective service category elements.

-Allocation of Universal Service Support to Interstate Costs: The Commission's proposal that Universal Service support funds could in the future be used to cover costs allocated to the interstate jurisdiction, is unrealistic. Roseville questions whether it will receive any federal universal support allocable to the interstate jurisdiction in the near future: current support from the Long Term Support Fund is likely to be eliminated, current support from the Universal

Service Fund is allocated to intrastate expenses, and even that amount is likely to be substantially reduced.

-Recovery of Total Costs: Basing access charge prices solely on forward-looking costs would inhibit LECs from recovering total costs allocated to the interstate jurisdiction. Denial of the opportunity to recover such costs would constitute a Fifth Amendment taking. A portion of such costs is a result of the depreciation shortfall or "reserve deficiency". Such deficiencies should be amortized over five years and recovered by charges to IXCs on a pro-rata minutes of usage or total revenue basis.

-Payment of Access Charges by Companies Using Network Elements to Terminate Interstate Calls: Even if TELRIC-based charges for unbundled elements covered all of the costs of the underlying facilities (and Roseville believes that they do not), by avoiding the payment of access charges, companies that use unbundled elements to terminate interstate calls avoid contributing to other costs currently recovered by access charges that result from Federal-State Separations policies. Such costs must be recovered, and at least until the Joint Board revisits Separations policy, the above-described Separations Cost Element should be charged to companies that use unbundled elements to terminate calls.

These matters are addressed below.

II. THE COMMISSION SHOULD MAKE COMPREHENSIVE ACCESS CHARGE REFORM AVAILABLE TO RATE-OF-RETURN LECS.

The Commission has recognized that substantial changes in telecommunications technology, in the marketplace, and in the Communications Act, require the revision of the structure of access charges "now or as soon as changes in the marketplace permit...." NPRM at para. 5. Yet, while the Commission proposes to make certain revisions applicable to all LECs, other revisions would be applicable only to price-cap LECs ("PC LECs"). NPRM at paras. 50-53. As applied to ROR LECs, the remaining access charge reform would occur in the context of a separate proceeding in late 1997 comprehensively reviewing all ROR regulation. *Id.* at para. 52. The Commission bases this delay in comprehensive access charge reform of ROR carriers on two premises: 1)

that PC LECs are likely to face competition sooner than other LECs; and 2) that "many, if not all" ROR carriers may be exempt from, or eligible for modification or suspension of Section 251 interconnection and unbundling requirements. *Id.* While these premises may justify delaying comprehensive reform for some ROR LECs, they provide no such basis when applied to ROR LECs such as Roseville.

First, competition has already arrived to the Greater Sacramento Metropolitan Area, which includes the City of Roseville.[4] In light of the strong economic and business ties between the City of Roseville and the rest of the Sacramento Metropolitan Area, and the City of Roseville's rapid growth in population, the fact is that competition is imminent. Competition will certainly arrive in Roseville's service area as quickly as it will arrive in PC LEC service areas of similar size elsewhere. Furthermore, when competition arrives, carriers such as Roseville cannot rely on Section 251 remedies: they are too large to meet the definition of "rural telephone company" for the purposes of Section 251(f)(1), and they cannot rely on states granting waivers or modifications under Section 251(f)(2).[5]

In sum, for ROR LECs with market conditions such as Roseville's, competition is imminent and unavoidable. In such cases, the need for <u>comprehensive</u> access charge reform is just as pressing for these ROR LECs as it is for PC LECs. Just as would be

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[4] At this time, there are at least 6 competitive LECs providing local service in the City of Sacramento.

[5] For example, Cincinnati Bell recently filed for a Section 251(f)(2) waiver (PUCO Case 96-708-TP-UNC), which was promptly rejected by the Ohio PUC on September 5, 1996. Furthermore, at least as a matter of California Legislature policy, Roseville is not exempt from competition after January 1, 1997.

the case with PC carriers, ROR carriers subject to competition without comprehensive access reform will be unfairly disadvantaged, and will be vulnerable to uneconomic bypass. *See* NPRM at para. 42. Indeed, the loss of even one large customer would have a greater negative impact on ROR carriers than on larger PC carriers.

Roseville recognizes that circumstances may vary from state to state, and from carrier to carrier, so that comprehensive access reform may not be appropriate at this time for many ROR LECs, especially smaller LECs. However, the Commission can and should make comprehensive access charge reform available to all ROR carriers. While revisions arising from NPRM Sections VII.A (allocation of universal service support to interstate revenue requirement), Sections III.D and E (reforms to transport rate structure) and Section III.B (revision to common line rate structure) will be applicable to all LECs (PC and ROR), all other access charge reforms (other than revision to price cap rules) should be available to ROR LECs on an optional basis.

III. COST RECOVERY MUST ALLOW LECS TO BE COMPETITIVE AND TO RECOVER TOTAL COSTS.

LECs msut have the flexibility to be competitive with other providers of access service, yet be able to recover the total costs that have been properly incurred to meet the public service obligations required by state and federal regulators, which include the joint and common costs of providing service today. Roseville does not believe, however, that the efficiency and fairness principles are in conflict with each other: if LECs are not allowed to recover their total costs, then the major providers of access services cannot price those services at their real cost, leading to pricing distortions and improper market signals. Surely this cannot be the Commission's goal. Consistent with

the principles of fairness and efficiency, Roseville makes the following specific recommendations.

A. *Common Line Costs Should Be Recovered Through a Flat, Per-Line Charge to IXCs, and Through the Current SLC.*

The NPRM seeks comments on a variety of methods of recovering common line costs. Roseville agrees with the Commission that common line costs are non-traffic-sensitive ("NTS") in nature, and that accordingly, such costs are most efficiently recovered on an NTS basis. Accordingly, Roseville supports the Commission's proposal to recover the CCL portion of subscriber loop costs through a flat, per-line charge assessed against each customer's presubscribed interexchange carrier ("PIC").[6] NPRM at para. 60. Roseville also supports the proposal to allow LECs to collect the flat-rate directly from any customer who elects not to choose a PIC. *Id.* These proposals have the advantage of administrative simplicity, and are consistent with the Joint Board's *Recommended Decision.*

Roseville recognizes that under this proposal, on any one call the IXC that has been presubscribed by the receiving subscriber may be different than the IXC delivering the call and benefiting from the termination. While charges to the receiving subscriber's PIC should, over the long-run, approximate the pro-rata portion of that IXC's interexchange traffic, Roseville could also support the Commission's alternative "bulk billing" approach. However, if the bulk billing approach is selected, then to minimize

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[6] A preliminary analysis shows that in Roseville's case, the amount to be allocated to this per-line charge would be approximately $6.50. It should be noted that in allocating costs for such a charge, the net CCL revenue requirement per-line, after removal of pay phone costs, is significantly greater for carriers such as Roseville than for larger LECs such as BOCs.

administrative costs, establishment of the pro-rata shares of total interstate minutes of use or revenues by individual IXCs should be performed by the Commission (not by LECs or IXCs), and only on an annual basis.

While Roseville recognizes that the purpose of the Commission's proposal to increase or eliminate the cap on multi-line business or additional residential connections is consistent with recovering the CCL portion of the local loop with a flat-rate charge, other factors out-weigh that objective, and accordingly, the SLC caps should not be raised or eliminated. First, there is no cost-efficient manner by which LECs can identify which of a subscriber's lines are the second or multiple ones. Doing so would require LECs to improperly discriminate against the user of one of the lines, for example in cases where two unrelated parties share a residence and each order a line. Furthermore, different SLCs on different lines would encourage subscribers to purchase lines from multiple LECs, or purchase multiple lines from the same LEC, but under different billing names, so as to only have "primary" lines. Such behavior increases total administrative costs and is inconsistent with efficient delivery of services. Additionally, if the cap is eliminated or increased for second or multiple-business lines, it would shift the burden of recovery of loop costs for all services onto these specific additional lines. This would distort the pricing of services, and give improper signals to the marketplace. Lastly, as second and multiple lines are often used for a modem and access to the Internet, imposing higher SLC charges on such lines would be inconsistent with Congress' and the Commission's often-stated goal of promoting broad

access to advanced network services.[7]

In sum, interstate common line costs should be recovered through a flat per-line charge on IXCs, assessed either on the subscriber's PIC or to multiple IXCs on a bulk billing basis. In any case, however, for the reasons set forth in Section II above, the rule revisions providing for such a charge should be made available to ROR LECs. Furthermore, the cap on SLCs should not be raised or eliminated.

B. The TIC Should Not Be Phased-Out or Eliminated Unless the Real Underlying Costs Are Allocated to Other Rate Elements.

In the NPRM, the Commission seeks comments on a variety of methods to phase-out or eliminate the Transport Interconnection Charge ("TIC"), asserting that the TIC was only intended to be a transitional charge, and that use of a traffic-sensitive TIC to recover NTS costs is economically inefficient. NPRM at paras. 96 and 97. Roseville agrees that the TIC should be reformed, but since the TIC recovers ongoing real costs, it should not be phased out or eliminated unless and until these costs are allocated to other rate elements, or recovery is provided for in another manner. Failure to allow such recovery would constitute a breach of the "regulatory contract" between federal regulators and LECs, and constitute a Fifth Amendment taking.

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[7] In response to the NPRM's discussion (at para. 70) of applying SLCs to derived channel services, Roseville believes that while the 1996 Telecommunications Act did not directly address this issue, it expressed a general policy of promoting access to advanced network services. *See, e.g.,* Section 706 of the Act ("Advanced Telecommunications Incentives") and newly added Section 254(b)(2) of the Communications Act. Applying one SLC for each derived channel of ISDN services would be manifestly inconsistent with Congressional policy. Accordingly, as Roseville stated in comments filed in CC Docket 95-72, one SLC should be assessed for each physical line, or each ISDN facility.

The TIC reflects costs which the Commission's Part 36 and 69 rules have assigned to the interstate jurisdiction, and specifically recovered through transport rates. Contrary to the assertions of some parties, these are ongoing real costs, calculated by ROR carriers by subtracting entrance facilities, tandem-switched transport, direct trunk transport, and dedicated signaling transport revenues from the total Part 69 transport revenue requirement.[8] Roseville recognizes that recovering the remaining costs through a transport charge gives improper pricing signals in a competitive market, and worse, encourages arbitrage as carriers attempt to use unbundled network elements to obtain access services at artificially lower rates. However, the Commission has recognized that while placing costs from multiple sources in the TIC may lead to inefficiencies, this problem can be remedied by allocating those costs to the proper rate elements. NPRM at para. 99. Such an approach is consistent with the principle of recovering costs from cost-causers, and with the principle that carriers should be allowed to recover properly incurred costs. Such an approach also discourages arbitrage.

A preliminary analysis by Roseville indicates that at least 54 percent of its transport revenue requirement currently recovered by the TIC could be allocated to the following rate elements: Tandem Switching, Local Switching, Tandem-Switched Transport and Direct Trunk Transport. The remaining 46 percent of the transport revenue requirement is currently recovered in the TIC as a result of Part 36 Separations

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[8] First Transport Rate Structure and Pricing Report and Order, 7 FCC Rcd 7006, 7038 (1992).

rules.[9]

The costs described above that represent 54 percent of the revenue requirement currently recovered by the TIC can and should be reallocated to their proper elements. While the remaining 46 percent of the costs should ultimately be reassigned to interstate Special Access, interstate Local Switching and a small portion to the intrastate jurisdiction, such reforms could not occur without action by a Federal-State Joint Board. Yet, until such action is taken by the Board, that 46 percent of the revenue requirement currently recovered by the TIC is substantial, and reflect ongoing real cost that must be recovered from interstate access services. Roseville recommends that such portion of a LEC's current revenue requirement be recovered through a new access charge element. As this new access charge element reflects costs isolated as a result of long-standing separations policy, Roseville proposes that this element be identified as the "Separations Cost" element, and should be charged to all purchasers of interstate access, at least until separations reform is enacted by a Federal-State Joint Board and the Commission. Use of such an element has the virtue of recovering properly incurred costs by an explicit mechanism, applied equally to all cost-causers (*i.e.*, users of interstate access services).

In sum, the TIC should not be phased out or eliminated unless and until the underlying ongoing real costs currently recovered by the TIC are allocated to other

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[9] 30 percent of Roseville's transport revenue requirement currently recovered by the TIC could properly be allocated to interstate Special Access services, and about 8 percent could properly be allocated to interstate Local Switching. Only the remaining 8 percent of the revenue requirement recovered by the TIC could be allocated properly to the intrastate jurisdiction.

elements, or recovered by some other mechanism. Assuming that cost-recovery is provided for, the Commission should make revisions to the TIC, and accompanying cost recovery mechanisms, available to ROR carriers.

C. *Companies Using Unbundled Network Elements to Terminate Interstate Calls Should Pay Some Access Charges.*

Roseville disagrees with the Commission's tentative conclusion that access charges should not be applied to the purchase of unbundled network elements ("UNEs") used to terminate interstate calls. NPRM at para. 54. The NPRM bases this tentative conclusion on the premise that the charges for UNEs will recover all costs for providing such services, and that the imposition of access charges would in effect constitute double billing for the same costs. As set forth in its Comments in the Commission's Interconnection proceeding, Roseville, like many parties, does not believe that TELRIC-based charges cover all of the costs of the underlying facilities used in the provision of UNEs. Accordingly, LECs must be allowed to apply access charges to purchasers of UNEs in order to recover total cost of LEC provision of facilities. Furthermore, even if TELRIC-based charges for UNEs used to terminate interstate calls did cover all UNE facilities-based costs, by avoiding the payment of access charges, companies that use UNEs to terminate interstate calls avoid contributing to other costs currently recovered through access charges that result from Federal-State Separations policies.[10] Such costs are ongoing real costs that must be recovered, and are associated with the costs to be recovered by the Separations Cost access element proposed above. Accordingly, at least until the Joint Board revisits

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[10] *See, e.g.,* Section 36.154 of the Rules.

Separations policy, the Separations Cost Element should be charged to companies that use UNEs to terminate interstate calls.[11]

In addition to recovering costs associated with the proposed Separations Cost element, the Commission has recognized that access charges should, in part, recover properly incurred embedded costs.[12] Yet, the purchase of UNEs to terminate calls would result in under-recovery of such costs, and accordingly, such purchasers should be subject to any access charges that are used to recover embedded costs, or to the portion of such charges that the Commission identifies as attributable to recovery of embedded costs. Such an approach would also minimize the use of UNEs for the purposes of arbitrage.

D. The Proposal to Allocate Universal Service Support to the Interstate Revenue Requirement Must Be Adjusted to Reflect Current Policy.

In reviewing transitional mechanisms, the NPRM states (at paragraph 246) that for ROR incumbent LECs, "interstate costs must be reduced to reflect revenues received from any new universal service support mechanism to the extent allocated to the interstate jurisdiction." While such an approach offers some superficial logic, it is must be adjusted to reflect current policy considerations.

Currently, there are two federal mechanisms that provide high-cost support for carriers like Roseville: the Universal Service Fund ("USF") and Long Term Support

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[11] Precedent exists for imposing access charges on use of UNEs for intrastate call termination. *See, e.g.*, In the Matter of Petition of AT&T Communications for Section 252(b) Arbitration of Interconnection Agreement with Pacific Bell, California Public Utilities Commission Decision 96-12-034, released December 9, 1996, at para. 12.

[12] *See* note 3, *supra*.

("LTS"). Yet, USF has historically been used exclusively to offset that portion of the carrier's intrastate revenue requirement resulting from the provision of service to high-cost areas. This use of USF for intrastate costs is mandated by state commissions, as a precondition to approving increases in intrastate rates.[13]

The second federal high-cost support mechanism, LTS, provides support for the 25 percent of the loop cost that is allocated to interstate common line, through the separations process. As larger LECs removed themselves from the NECA common line pool, they made payments into the LTS, which is used to reduce the common line revenue requirement of NECA pool members. Roseville currently receives substantial support from this pool: $3.3 million in 1995, and $ 3.6 million in 1996. Yet, under the proposed *Recommended Decision*,[14] LTS support would be limited to rural telephone companies, and Roseville therefore would lose this substantial contribution to its recovery of total costs of providing service.

The final factor to consider is the Joint Board's proposal to generally reduce the total universal support paid out to LECs. Thus, while it may appear logical that interstate access costs should be reduced to reflect revenues received from universal support mechanisms, Roseville questions whether it will receive enough federal universal support allocable to the interstate jurisdiction to offset the support reduction proposal: *i.e.*, current support from the LTS is likely to be eliminated, current support

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[13] *See, e.g.*, In the Matter of Application of Roseville Telephone Company to Restructure Intrastate Rates and Charges, California Public Utilities Commission Investigation Number I.95-09-001, Decision Number 96-12-074, released December 20, 1996 at paragraph 5.6.

[14] *See, e.g.*, para. 295.

from the USF is allocated to intrastate expenses, and even that amount is likely to be substantially reduced!

In light of the above-described "squeeze" on universal support funds, Roseville sees two alternatives in response to paragraph 246 of the NPRM:

> -Allow LECs to continue to use USF revenues to offset intrastate revenue shortfalls, and for any universal support greater than the amount currently received (including LTS), use that to reduce the CCL charge and then the SLC; or
>
> -adopt the Commission's proposal, accepting that intrastate rates will have to be raised to address the shortfall currently covered by USF.

Roseville believes that the first alternative is the better policy, and more consistent with federal universal service policies.

E. LEC Total Costs Must Be Recovered, Including Amortization and Pro-Rata Recovery of the Reserve Deficiency From the IXCs.

An ongoing issue throughout the trilogy of universal service, interconnection and now the access reform proceeding, is the recovery by LECs of their total embedded costs, including joint and common costs. In myriad comments filed in the other two proceedings, it has been demonstrated that good economic policy, basic fairness, and the Fifth Amendment all suggest that LECs should be allowed to recover properly incurred costs associated with the provision of services, as well as joint and common costs. Yet the Commission continues its fascination with prices based solely on forward-looking costs, egged on by the self serving comments of carriers that would benefit from purchasing services from LECs at below-cost prices. While the final result is not yet apparent in the Interconnection and Universal Service proceedings, at this point, in this proceeding, the Commission must face up to economic reality: LECs must

be allowed to recover their total costs of providing service. Roseville is thus gratified that the NPRM (at paragraph 256) raises the issue of "whether, as a matter of law or equity, incumbent LECs are entitled ... to recover some or all of the difference between interstate-allocated embedded costs and forward-looking economic costs that might be created by the access reform proposals discussed [in the NPRM] ...." The answer is obviously yes.

First, it can no longer be denied that Fifth Amendment case law provides that a "regulatory contract" exists between state and federal authorities on the one hand, and utilities such as LECs on the other. *See, e.g.*, Affidavit of J. Gregory Sidak and Daniel F. Spulber (attached to Comments concurrently filed by the United States Telephone Association in this proceeding) at pages 35-40, and cases cited therein.[15] Numerous courts have held that when regulators require carriers to provide service at specific service levels, and in return for that requirement promise carriers the right to recover all of their properly incurred costs, subsequent regulatory actions that effectively deny carriers the right to recover their costs constitute a taking. *Id.* In the present case, in return for provision of interstate access services to all parties requesting the service, LECs have, up to this point, been allowed to recover the properly incurred costs associated with the provision of those services. Cost recovery has not been limited to incremental costs (*i.e.*, TSLRIC), but has also included total costs, embedded and joint and common costs.

Recovery of total costs of providing interstate access service is not only required

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[15] *See also,* Sidak and Spulber, *Deregulatory Takings and Breach of the Regulatory Contract,* 71 NEW YORK UNIVERSITY LAW REVIEW 851(1996).

by the Fifth Amendment, but consistent with economic efficiency. As noted above, denying LECs the right to recover total costs through access charges will result in the major provider of access services having to price services below the real cost, which will give improper pricing signals to the market. Such regulatory action encourages economic inefficiency by promoting free-riding by and subsidized entry of competitors. *See* Affidavit of Sidak and Spulber, *supra*, at pages 26-27.

While the Commission and the Joint Board have improperly ignored these issues in the *Interconnection R&O* and the *Recommended Decision*, Roseville is gratified that the Commission may now be facing up to reality. As was noted in Section I above, in defending the Commission's Interconnection rules in front of the Eighth Circuit, Counsel for the Commission apparently conceded that embedded costs should be recovered, and assured the Court that such recovery will occur in the context of the access reform and universal service proceedings. However, recovery of total embedded costs in the context of the universal service proceeding appears unlikely, as the Commission's and Joint Board's proxy-model approach to cost calculation for the purposes of universal service support uses only forward-looking costs. At the very least, the Commission must provide for recovery of total embedded costs in the context of this proceeding.

As noted in the NPRM, at least one source of embedded costs that should be recovered is costs arising from under-depreciation of plant, as a result of state and federal policies. NPRM at para. 257. By requiring LECs to set depreciation rates at levels lower than that which would be used by firms in a competitive market place, depreciation expenses were reduced, and cost-based rates were kept relatively lower. Nevertheless, LECs were assured that they would ultimately recover their plant

investment. The difference between the regulatory book value of such plant and its actual economic value is a "reserve deficiency".

In order to allow LECs to recover the reserve deficiency, and do so in a manner that moves depreciation practices into a competitive market model as quickly as possible, Roseville suggests the following procedure: Carriers should identify the amount of reserve deficiency associated with the interstate jurisdiction and determine how much recovery is currently included within its booked depreciation expense. The resulting reserve deficiency should be amortized over a period of five years, and recovered through charges to IXCs based on their pro-rata share of interstate minutes of use or revenues.

In sum, the Fifth Amendment and true economic efficiency require that LECs recover total costs associated with the provision of interstate access service. Prices for access services should be formulated to ensure the recovery of the appropriate share of total costs associated with each service. Furthermore, the reserve deficiency should be calculated and amortized over a five year period, and recovered through separate charges to IXCs. As was the case with reforms described in above, these reforms should be made available to ROR carriers.

F. LECs Should Have Flexibility in Combining Certain Rate Elements, in Order to Respond to Changes in the Access Market.

Roseville believes that access reform can best be enacted through new and revised rate elements as described above. Nevertheless, the use of rate elements generally results in static prices that are hard to adjust in response to rapidly changing market conditions. While this effect was not consequential in a monopoly service

environment, it is of greater concern in the new competitive environment. LECs must have some degree of pricing flexibility if they are going to be truly competitive in the interstate access market.

Consistent with the requirement for pricing flexibility, Roseville suggests that the revenue requirements for the existing Traffic Sensitive Switched elements (*i.e.*, Local Switching, Information, Tandem Switched Transport, Direct Trunk Transport, and Entrance Facilities) be collapsed into one overall Traffic Sensitive Switched category, and that carriers be allowed to create new categories (introduced by tariff filings) more appropriate to their individual market conditions.

IV. CONCLUSION

In crafting access reform, the Commission should remain mindful of the need for fair and flexible treatment of incumbent LECs, the impact of revised interconnection and universal service rules on the provision of access services, and the need for making timely comprehensive access reform available to ROR LECs. Consistent with these principles, the Commission should adopt the suggestions contained herein.

Respectfully submitted,

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