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Federal Communications Commission
Office of Secretary

BEFORE THE
Federal Communications Commission
WASHINGTON, DC 20554

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

COMMENTS OF AIRTOUCH COMMUNICATIONS, INC. ON ACCESS CHARGE REFORM

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COMMENTS OF AIRTOUCH COMMUNICATIONS, INC. ON ACCESS CHARGE REFORM

AirTouch Communications, Inc. ("AirTouch")[1] hereby submits the following comments in response to the Notice of Proposed Rulemaking issued in the *Access Charge Reform* portion of the above-captioned proceedings (CC Docket No. 96-262).[2]

I. SUMMARY

In February 1996, the U.S. Congress passed the Telecommunications Act of 1996,[3] setting in motion the most sweeping reform of U.S. telecommunications policy since the

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1/ AirTouch is a wireless communications company with interests in cellular, paging, personal communications services, satellite and other operations.

2/ *Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, Usage of the Public Switched Network by Information Service Providers and Internet Access Providers*, CC Docket Nos. 96-262, 94-1, 91-213, 96-263, FCC 96-488, *Notice of Proposed Rulemaking, Third Report and Order, and Notice of Inquiry* (rel. December 24, 1996) ("*Notice*").

3/ Pub. L. No. 104-104, 110 Stat. 56 (1996) (the "1996 Act"). The 1996 Act amends the Communications Act of 1934, 47 U.S.C. § 151 *et seq.*

creation of the Commission. When the Commission issued pricing guidelines to promote local competition in August 1996, it observed that all the major pieces of common carrier reform — interconnection, universal service, access charges, and separations — are integrally linked as must be treated as a whole.[4] AirTouch agrees with this assessment.

AirTouch has consistently maintained that the only way to achieve meaningful reform that promotes efficiency and competition is to apply sound economic principles consistently and to design policies that work together as a coherent whole. To this end, in comments filed in the interconnection and universal proceedings, AirTouch laid out the fundamental economic principles that must be applied to carry out the regulatory reform mandate of the 1996 Act.[5]

Applied to access charges, these principles demand that the Commission undertake the following reforms:

•Competitive markets should provide the benchmark for regulation. With access charges, as with interconnection and universal service, forward-looking economic costs — not embedded costs — should serve as the basis for calculating regulated rates.

•The principle of cost-causative pricing provides clear guidance for the recovery of incremental costs. For common cost recovery, the Commission must act to limit the distortions in consumption and investment levels and the possible distortions in the competitive process.

4/ *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, CC Docket Nos. 96-98, 95-185, FCC 96-235, *First Report and Order*, 4 Comm. Reg. (P&F) 1, 11 ("*First Report and Order*").

5/ *See*AirTouch Comments on *Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, CC Docket No. 95-185, at 9-11; AirTouch Comments on *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, at 10-13; AirTouch Comments on *Recommended Decision*, CC Docket No. 96-45, at 3.

• The subscriber line charge ("SLC") is a non-traffic-sensitive charge that mirrors the nature of local loop cost causation. Thus, it is an economically efficient means of covering loop costs. The SLC should be moved toward cost-based levels. Generally, this will entail raising this charge.

• The Commission must coordinate its policies across proceedings to avoid creating inconsistent, inefficient and anticompetitive pricing structures.

Finally, as part of its access charge reform efforts, AirTouch urges the Commission to establish a rational mechanism for sharing access charge revenues between Commercial Mobile Radio Service ("CMRS") providers and local exchange carriers ("LEC") for interstate interexchange traffic that passes from CMRS customers to interexchange carriers ("IXC") or from IXCs to CMRS customers via LEC networks.

II. INTRODUCTION

It has long been recognized that the system of interstate access charges is in need of reform.[6] At a broad level, the problems with current interstate, interexchange access charges can be grouped into two categories: (1) the current rate structure does not track the underlying pattern of cost causation; and (2) access charge levels are not based on forward-looking incremental costs. Consequently, the current access charge mechanism needlessly wastes economic resources and lowers consumer welfare by distorting end-user consumption choices and provider investment decisions.

In many respects, the fundamental problems with interstate access charges stem from their inefficient inflation in the name of universal service. As AirTouch demonstrated in the universal service proceeding, elevating access charges — instead of

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6/ *See* AirTouch Comments on *Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers* at 5-8.

levying explicit end-user surcharges — is not an economically appropriate way to promote universal service.[7] Both the 1996 Act and sound public interest economics dictate that the Commission must remove implicit universal service subsidies from access charges. Moreover, in bringing access charges in line with costs (both in terms of structure and level), the Commission must ensure that incumbent local exchange carriers ("ILECs") have not inflated reported access costs, either due to inefficiency or through regulatory gaming. Excessively high access charges reduce the welfare of telecommunications services consumers, and the Commission should reject efforts to impose such rates. At the same time, both fairness and efficiency considerations support allowing ILECs to earn a reasonable rate of return on their investment in the facilities used to provide interstate, interexchange access. The remainder of these comments are directed to Section III of the *Notice* and discuss the principles that must guide the Commission as it implements the 1996 Act and balances the interests of access providers, interexchange carriers, and telecommunications services consumers, in its efforts to make the existing access charge rate structures more conducive to economic efficiency.

III. ACCESS REFORM SHOULD BE BUILT UPON THE SAME PRINCIPLES OF FAIR AND EFFICIENT PRICING THAT SHOULD GUIDE INTERCONNECTION PRICING AND UNIVERSAL SERVICE REFORM

AirTouch submits that there are three fundamental principles that must be applied across the board in shaping access charges for the future:

7/ *See* AirTouch Comments on *Recommended Decision* at 14-18; AirTouch Reply Comments on *Recommended Decision* at 24.

•Forward-looking economic costs are the only appropriate basis for setting prices.

•The principle of cost causation should be applied to the setting of rate structures and levels wherever possible.

•In allocating common costs, universal service costs, and embedded costs, policy makers must take the efficiency and competitive effects of their allocation into account.

The application of each of these principles to access reform is discussed below.

A. Forward-Looking Economic Costs are the Only Appropriate Basis for Setting Prices

It is widely recognized that the current interstate access charges are economically inefficient and lower consumer welfare by distorting consumption choices and capital investment decisions in telecommunications markets.[8] Current access charges are an outgrowth of the old fully-distributed costing methodology of rate-of-return regulation and are therefore based upon embedded costs, contain arbitrary allocations of common costs, and include implicit universal service subsidies. This reliance on non-economic costs is responsible for much of the inefficiencies and distortions inherent in the current system of interstate access charges. Consequently, AirTouch urges the Commission to rely upon forward-looking economic costs as the basis of calculating access charges.

Forward-looking costs are the only true economic costs that can be used to guide efficient investment and consumption decisions. Forward-looking costs represent the actual costs of providing services to consumers making choices today and in the future. Thus, these are the costs that should be reflected in prices (which are costs from the buyers' perspective) to ensure that buyers have incentives to strike the right balance

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[8] *See Notice* at ¶¶ 6-8; *see also* AirTouch Comments on *Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers* at 5-8.

between the costs and benefits of additional calling. Similarly, when a regulated carrier's prices are set at forward-looking costs, other carriers have efficient incentives to attract traffic away from that carrier if they have lower forward-looking costs. Moreover, when access charges are set at forward-looking costs, a regulated carrier has incentives to continue to invest in its network as long as there are not other, lower-cost carriers.

The Commission itself has reached the conclusion that forward-looking costs are the proper basis for pricing in the *First Report and Order* of the *Local Competition* proceeding, and the Federal-State Joint Board recommended the use of forward-looking economic costs in determining universal service support levels.[9] Therefore, consistent with these findings, the Commission should set interstate access charges on the basis of forward-looking cost studies. And to ensure that local carriers have the proper incentives to reduce costs, these studies should project the costs of efficient carriers.

B. The Principle of Cost-Causative Pricing is Essential to the Determination of Efficient Rate Levels and Structures

AirTouch submits that the overarching policy goal of the 1996 Act, and indeed the Communications Act of 1934, is to maximize the total social benefits derived from telecommunications networks and services. These benefits will be maximized only if telecommunications services are priced at efficient, cost-based levels. Economists widely recognize that the principle of cost causation is fundamental to the efficient pricing of goods and services. The principle of cost causation states that the users of a service should pay for only those costs that are caused, or triggered, by the provision of service

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9/ *First Report and Order*, 4 Comm. Reg. (P&F) at 183; *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, FCC 96J-3, *Recommended Decision* ¶ 273 (rel. November 8, 1996)("*Recommended Decision*").

to them. Cost causation is captured by the notion of incremental cost, the cost attributable to a specified increase in the level of a service over some baseline.

In most markets, efficiency is promoted by following two fundamental rules:

•Price *levels* should be set at the level of long-run incremental costs.

•The *structure* of prices should reflect the underlying pattern of cost causation.

These two fundamental principles provide clear guidance for the pricing of facilities dedicated to access. The costs of these facilities tend to vary with the capacity of the facility, not the actual calling volume. Hence, by the second fundamental principle of cost-causative pricing, these non-traffic sensitive costs of dedicated facilities should not be recovered through traffic-sensitive charges.

These general principles are relevant to the pricing of shared facilities used to provide access as well: interexchange access services should bear those traffic-sensitive costs that they trigger. Moreover, such costs should be recovered on a traffic-sensitive basis. There is, however, an additional consideration that must be taken into account in the case of shared facilities. The provision of interstate, interexchange access services is subject to economies of scale and scope, which raises issues concerning the recovery of common costs and overheads.

C. Common Cost Allocations must Take into Account Effects on Efficiency and Competition

Local exchange facilities are used in the provision of a variety of services, including interconnection with other telephone exchange providers, interexchange access, and local telephone service. The production of these services typically are subject to economies of scale and scope, so that pricing all services at long-run incremental cost

would fail to cover the full costs of production. Consequently, some or all of the services must be priced above long-run incremental cost in order to cover common costs or overheads.

Interexchange carriers can be expected to pass any contributions to common costs that are collected on a traffic-sensitive basis on to consumers by raising retail rates. Traffic-sensitive collection of contribution will thus elevate interexchange prices further above incremental costs and suppress the consumption of interexchange services below efficient levels. Moreover, the over-pricing of ILEC access services may create incentives for inefficient bypass of the ILEC's network.

Some have argued that "a minute is a minute" and that common costs should be allocated equally among all minutes of traffic. There are two possible rationales for this argument: (1) local calls, intrastate access, interstate access, and enhanced service access all trigger similar costs; and (2) certain unbundled elements are close substitutes for interexchange access and thus inconsistent pricing will promote a form of arbitrage.

While there is some initial merit to this view, there also are significant problems with it. Although the underlying incremental costs of different services may be quite similar,[10] as a matter of public-interest economics the efficient recovery of common costs is unlikely to be proportional to incremental costs. Two fundamental reasons underlie this conclusion:

•First, the inclusion of common-cost loadings has different competitive implications for different services. The degree of markup and the degree to which ILEC discretion is limited both should reflect the potential for harm to local exchange competition. Access

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10/ It is, however, important to take into account possible differences in traffic patterns, which can have cost implications because of peak-time congestion.

charges are not levied on services that compete directly with local exchange services. Transport and termination charges are levied on competitive services, however, and universal service subsidy burdens may be. Unbundled network elements may or may not be purchased by direct competitors to the ILECs. The bottom line of all of this is that concern for adverse effects on competition would suggest that interconnection prices should be lower than access charges, or at least no higher.

•Second, different services may have different demand elasticities and the efficient recovery of common costs will take these differences into account. This is the principle underlying so-called Ramsey pricing. It is important to note, however, that the theory of Ramsey pricing is not fully developed for oligopolistic markets. Moreover, the Commission lacks the information needed to implement prices based on elasticities, and attempts to base prices on demand elasticities could be subject to manipulation.

In sum, as a matter of economic logic, the proposition that a "minute is a minute" is fundamentally flawed: there are theoretically reasons why it could be efficient to have different services make different contributions to the recovery of common costs. However, in light of the practical problems inherent in determining fully efficient differential contributions, the Commission may choose to have equal contributions as a safe first step. Moreover, to the extent the Commission is concerned about the possibility of arbitrage, this concern provides another reason to limit differences in contribution across services.

IV. THE RECOVERY OF LOOP COSTS THROUGH A FLAT END-USER CHARGE IS ESSENTIAL TO MEANINGFUL ACCESS REFORM

As AirTouch, other carriers, and the Commission have stated on numerous occasions, loop costs are non-traffic-sensitive costs that should be recovered through

non-traffic-sensitive charges.[11] AirTouch will not repeat its full earlier analysis here, but several important points are worth noting:

•Recovering non-traffic-sensitive costs through traffic sensitive charges distorts end users' consumption decisions and providers' investment decisions. The ultimate result is a reduction in the benefits that the public derives from the public switched telephone network.

•The losses from the inappropriate recovery of non-traffic-sensitive loop costs is particularly large in light of the amounts of money involved and the fact that the demands for wireless and toll services are much more elastic than the demand for connection to the PSTN. The efficiency losses could total billions of dollars annually.[12]

•Attempts at "properly" allocating loop costs between local exchange services and interexchange access are doomed to failure. Even more important, these attempts are unnecessary. The economically appropriate means of cost recovery is to levy a flat charge on end users and make no allocation of loop costs to either local or long distance calling. In the local competition proceeding, the Commission itself recognized that the loop is an element and should be priced out separately to avoid inefficient patterns of cost recovery.[13]

V. THE COMMISSION MUST COORDINATE ITS POLICIES ACROSS PROCEEDINGS TO AVOID CREATING INCONSISTENT, INEFFICIENT AND ANTICOMPETITIVE PRICING STRUCTURES

AirTouch submits that, to satisfy the mandates of the 1996 Act and to develop a rational competitive structure, interconnection policy, access reform, universal service reform, and separations reform all must be consistent with one another.[14] These policies

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11/ *First Report and Order*, 4 Comm. Reg. (P&F) at 200; *Recommended Decision* at ¶ 775.

12/ The analysis would be similar to that in AirTouch's comments in the universal service proceeding. *See* AirTouch Comments on *Recommended Decision* at 5-13.

13/ *First Report and Order*, 4 Comm. Reg. (P&F) at 106-111.

14/ *Cf. Notice* at ¶ 1.

directly and indirectly affect the prices of many of the same services and are economically linked—money not recovered in one place may show up as a revenue need in other areas. For example, a reduction in the SLC with either raise access charges levied on interexchange carriers or increase the taxes needed to fund universal service.

Further, the fact that the same principles of economic efficiency and fairness are applicable in each proceeding also require consistent Commission action across all three proceedings. In short, these principles must be applied to cross-proceeding issues, such as how to allocate common costs across jurisdictions in separations and among users in access charge and universal service reform. In making such allocations, the Commission must take into account the empirical differences in demands and in the competitive effects if it is to achieve efficient and coherent outcomes.

VI. CMRS PROVIDERS SHOULD BE PERMITTED TO SHARE ACCESS CHARGES FOR THE ORIGINATION OR TERMINATION OF INTERSTATE INTEREXCHANGE TRAFFIC UPON THEIR NETWORKS

In its proposed rule making in the *LEC-CMRS Interconnection* proceeding, CC Docket No. 95-185, the Commission tentatively concluded that, in the context of existing access charges, CMRS providers should be "entitled to recover access charges from IXCs . . . when interstate interexchange traffic passes from CMRS customers to IXCs (or vice versa) via LEC networks."[15] AirTouch supported this tentative conclusion in

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15/ *Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, CC Docket No. 95-185, *Notice of Proposed Rule Making*, 11 F.C.C.R. 5020, 5075 (rel. January 11, 1996) ("*NPRM*").

comments on the *NPRM*.[16] For the reasons set forth in the *NPRM* and AirTouch's Comments, AirTouch urges the Commission to establish a rational mechanism for sharing access charge revenues between CMRS providers and LECs as part of its reform of the current access charge regime.

As detailed in its previous comments, AirTouch does not recover through the LEC any of its costs of originating or terminating interexchange carrier traffic on its network. Presumably, the LEC retains all access charges associated with such traffic. In essence, LECs are currently permitted to retain revenue generated from the use of AirTouch's network. Further, to the extent that CMRS providers, such as AirTouch, are not permitted to share in access charge revenues, the LECs are treating such providers differently from neighboring LECs, CLECs or CAPS.[17] In short, the existing situation is inequitable and discriminatory and should not be allowed to continue.

AirTouch submits that permitting CMRS providers to share access charge revenues with LECs in the same manner that LECs currently share with neighboring LECs or CLECs is a reasonable and rational solution to this problem, provided that the LECs are required to offer similar sharing arrangements to similarly situated CMRS providers. AirTouch recognizes that such a sharing mechanism may not be necessary where there is a direct connection between CMRS providers and interexchange carriers because, in that context, both carriers have adequate incentives to negotiate mutually beneficial access

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16/ Comments of AirTouch on *Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers* at 56-57.

17/ *Id.* at 56; *see also NPRM*, 11 F.C.C.R. at 5075.

arrangements.[18] Direct connections, however, may not be possible or technically efficient in all circumstances. Therefore, AirTouch continues to believe that an access charge revenue sharing mechanism for interexchange traffic passing from CMRS customers to interexchange carriers or from interexchange carriers to CMRS customers via LEC networks is essential to assure CMRS providers equitable compensation for the use of their networks.

VII. CONCLUSION

Access reform is only one part of the regulatory reform picture. The Commission should apply consistent principles across the canvas. The Commission should ensure that interexchange carriers bear their share of the costs of local exchange networks, and the Commission should also ensure that local exchange carriers do not recover more than is appropriate. While there inevitably will be disagreements among carriers over the levels of charges, there should be no disagreement over structure: the access charge structure should track cost causation. Most important, this means that the SLC is the economically appropriate way to recover loop costs. Finally, the Commission should establish a

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18/ *See id.* at 57; *see also* Comments of Personal Communications Industry Association on *Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers* at 28-29.

rational mechanism for sharing access charge revenues between CMRS providers and LECs.

Respectfully submitted,

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January 29, 1997

CERTIFICATE OF SERVICE

I, Shelia L. Smith, do hereby certify that copies of the foregoing "Comments of Airtouch Communications, Inc. on Access Charge Reform" were served this 29th day of January, 1997 by hand delivery to the following:

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