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February 14, 1997

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

Subject: Access Charge Reform,
CC Docket No. 96-262 et al.

Dear Mr. Caton:

Enclosed please find the original and eighteen copies plus diskette of the General Services Administration's Reply Comments for filing in the above-referenced proceeding.

Sincerely,

Jody B. Burton

Jody B. Burton
Assistant General Counsel
Personal Property Division

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BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

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

REPLY COMMENTS
of the
GENERAL SERVICES ADMINISTRATION
and the
UNITED STATES DEPARTMENT OF DEFENSE

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February 14, 1997

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disagrees with the position of incumbent LECs that a market–based approach is sufficient for access reform.

Price cap LECs must be regulated through earnings sharing until there is enough local service competition for market forces to reduce prices. Also, it is necessary to proceed as soon as possible with two important prescriptive actions — reinitialization of the LEC rates and charges, and an adjustment in the productivity offset factor contained in the earnings sharing formula. When the new price cap parameters are in place, the Commission can proceed to implement features of its market–based approach that will allow LECs to create additional pricing options that directly address customers' needs.

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REPLY COMMENTS
of the
GENERAL SERVICES ADMINISTRATION
and the
UNITED STATES DEPARTMENT OF DEFENSE

The General Services Administration and the United States Department of Defense ("GSA/DOD"), on behalf of the customer interests of all Federal Executive Agencies ("FEAs"), submits these Reply Comments in response to the Commission's Notice of Proposed Rulemaking ("NPRM") released December 24, 1996. In this NPRM, the Commission requests comments and replies on issues concerning the structure and level of interstate access charges by the price cap local exchange carriers.

I. INTRODUCTION

Pursuant to Section 111(a) of the Federal Property and Administrative Services Act of 1949, as amended 40 U.S.C. 759(a)(1), GSA is vested with the responsibility to

represent the customer interests of the FEAs before Federal and state regulatory agencies. Collectively, the FEAs are probably the largest end user of telecommunications services in the nation. From this perspective, GSA/DOD has consistently supported the Commission's efforts to bring the benefits of competitive telecommunications markets to all consumers.

On January 29, 1997, GSA/DOD filed comments addressing rate structure and access reform issues identified in the NPRM. More than 100 additional parties filed comments in this proceeding, including:

- 7 Regional Bell Operating Companies;
- 12 Incumbent Local Exchange Carriers;
- 8 Competitive Local Exchange Carriers;
- 12 Interexchange Carriers;
- 14 State Regulatory Agencies and Public Advocates;
- 7 Internet Companies;
- 8 Associations Representing Telecommunications Carriers; and
- 36 User Associations and Parties with Specialized Telecommunications Interests.

In these Reply Comments, GSA/DOD responds to positions advanced by these parties concerning the structure of access charges and the need for access charge reform.

II. REQUIRED MODIFICATIONS IN CHARGE RATE STRUCTURE

A. The Present Access Charge Structure Limits the Potential Benefits of Competition

Commenting parties were nearly unanimous in identifying the need for major changes in the existing structure of interstate access charges. As GSA/DOD observed, competition has magnified the effects of cost misallocations and inefficient rate

structures in the access charge system.[1] These distortions harm local carriers by encouraging competitors to bypass the incumbents' facilities — even when bypass is not the best economic alternative. Also, these distortions harm interexchange carriers by forcing them to employ rate structures which are inefficient and mask the true costs of service. Furthermore, these unbalanced rate structures send the wrong signals to end users, forcing them to use the network inefficiently and to pay too much for their telephone services.

As a number of carriers have indicated, the misalignment of rate structures and costs amounts to billions of dollars annually.[2] GSA/DOD estimated that at least $7 billion in access revenues are collected by the incumbent LECs each year through rate structures that are not aligned with costs.[3] Residence and business users of interstate telecommunications services should not be required to support this massive misalignment of revenues and costs which threatens to deny or defer the benefits of efficient competition in all telecommunications markets.

B. For Economic Efficiency, it is Necessary to Eliminate the Recovery of NTS Costs through Usage–Based Charges

To address the most critical defect in the access charge system, GSA/DOD urged the Commission to remove the revenue responsibility for all non–traffic sensitive ("NTS") costs from usage–based charges.[4] This step requires a number of specific changes in the rate structure for access charges, including the elimination of the usage–based carrier common line ("CCL") charge.

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1 GSA/DOD Comments, p. 6.

2 See, for example, AT&T Comments, p. i; and MCI Comments, p. i.

3 GSA/DOD Comments, p. 6.

4 *Id.*, p. 7.

AT&T Corp. ("AT&T") observes that the Commission has long recognized the importance of aligning rate structures and costs in proceedings concerning the interexchange market structure.[5] For example, in its Third Report and Order in CC Docket No. 78–72, issued more than a decade ago, the Commission stated,

> [r]eliance upon usage–based prices for the recovery of fixed–costs will distort economy–wide investment decisions, artificially restrict calling patterns, and may jeopardize the competitive position the U.S. now holds in the world marketplace.[6]

The need to rationalize rates is even greater today, because of the explosive growth of telecommunications services in the past few years.

As GSA/DOD explained, the most important step in addressing the misalignment of rates and costs in the access charge structure is to eliminate the CCL charge.[7] Many incumbent LECs and other users concur. For example, the United States Telephone Association ("USTA") expresses the view of many large incumbent carriers, by explicitly urging the Commission to adopt an alternative method of recovering common line costs.[8]

While eliminating the CCL charge is the most important step in aligning rate structures with costs, GSA/DOD explained that it is also necessary to address other access charge elements.[9] For example, the Commission should modify the per–minute transport interconnection charge, which is not designed to cover the costs of <u>any</u> specific facilities or resources. As GSA/DOD explained, the usage–variable

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5 AT&T Comments, p. 50.

6 <u>MTS and WATS Market Structure</u>, Third Report and Order, CC Docket No. 78–72, Phase I, 93 FCC 2d 241 (1984).

7 GSA/DOD Comments, p. 7.

8 USTA Comments, p. 55.

9 GSA/DOD Comments, p. 8.

charge for transport should be modified to recover only the revenue requirement for traffic–sensitive transport functions such as tandem switching.[10]

The per–minute local switching charge must also be modified, because it is now structured to recover both traffic sensitive and non–traffic sensitive costs.[11] AT&T concurs with GSA/DOD that the rate structure for local switching should be bifurcated, with separate usage and port charges.[12] The usage rate should be designed to recover only the costs of traffic–sensitive switching facilities, such as the central processors. A flat–rate port charge would be employed to recover the costs of the facilities such as line cards, which depend on the number of subscribers, but not on calling volumes.

C. Any Additional NTS Revenue Requirement After Access Reform Should Be Placed on the SLC.

While the comments of many carriers and end users recognize the need to recover all NTS costs through flat charges, there is disagreement as to whether the additional NTS revenue requirement resulting from this change should be borne by interexchange carriers ("IXCs") or by end users. Many parties concur with GSA/DOD that any additional NTS revenue should be recovered by an additional charge on end users — specifically by an increase in the subscriber line charge ("SLC"). One party that took exception to this view was USTA, which urged the Commission to adopt rules that would permit the LECs to recover the increased NTS revenue requirement through a flat per–line charge paid by interexchange carriers.[13]

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10 GSA/DOD Comments, p. 8.

11 *Id.*, p. 8.

12 *Id.*; and AT&T Comments, p. 55.

13 USTA Comments, p. 55.

GSA/DOD believes that the Commission should not adopt the approach favored by USTA. Recovery of the additional costs from interexchange carriers, even on the basis of pre–subscribed lines, will continue to distort the market. As GSA/DOD explained in its comments, the interexchange carriers recover the costs of their message telephone services to end users through their usage–based rates.[14] Therefore, any increase in the access charges that the interexchange carriers pay — even if levied on a flat per–line basis — will be passed on to end users in the form of higher per–minute charges for message toll services.

The net effect of obtaining substantial per–line revenues from interexchange carriers will be to discourage service to low–usage end users because service to these users would become unprofitable. Conversely, interexchange carriers will be encouraged to serve only large customers who will appear to be more profitable, in spite of the fact that the per–line NTS costs to serve all customers are the same.

Several large LECs express positions that differ sharply from those of USTA on this subject. For example, the Bell Atlantic Telephone Companies and NYNEX ("Bell Atlantic/NYNEX") note that since all common line costs are ultimately caused by the end user, the end user should pay all of these costs.[15] Likewise, Southwestern Bell Telephone Company ("SBC") recommends that the Commission compensate for revenues lost through elimination of the CCL charge by increasing the SLC.[16] GSA/DOD urges the Commission to adopt the recommendations of these carriers concerning any additional NTS revenue requirement, so that the benefits of aligning access rate structures with the underlying costs of providing access are distributed equitably among all users of telecommunications services.

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14 GSA/DOD Comments, p. 9.

15 Bell Atlantic/NYNEX Comments, p. 33.

16 SBC Comments, p. 7.

D SLC Caps Should Be Modified to Recover NTS Costs More Efficiently.

GSA/DOD recommends that the existing caps on the SLC be removed so that the SLC can be used to recover the full NTS revenue requirement. Vigorous access reform, suggested by GSA/DOD and virtually all commenting parties except the incumbent LECs, will substantially reduce the aggregate revenue requirement for interstate access. By crediting all reductions in the total revenue requirement resulting from access reform to the NTS component of access, the Commission can minimize any required increase in the charges paid by end users.[17]

In addition to this modification, GSA/DOD has also urged the Commission to address the distinction between the SLC cap for residence and single line business users and the SLC cap for multi–line business customers.[18] At present, these caps are set at $3.50 and $6.00, respectively. However, as GSA/DOD has explained, there is simply no basis for any difference.[19]

The SLCs are associated with the local loops connecting subscribers to LEC wire centers. The local loops are fixed facilities, whose costs do not depend on usage. In general, the costs of local loops for multi–line business users are no greater than the costs of loops for residence and single line business subscribers. In fact, if there is any statistical variation in loop costs among types of subscribers, the costs for multi–line business users should be less on the average because larger businesses are usually located in more densely developed areas where local loops are shorter and less expensive.[20]

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17 GSA/DOD Comments, p. 11.

18 *Id.*

19 *Id.*

20 *Id.*

Several LECs concur with GSA/DOD that all subscribers — single line and multi–line — should pay the same SLC. For example, SBC stated that if the SLC for residence and single line business users is increased to compensate for revenues lost by elimination of the CCL charge, the multi–line business SLC should be set at the single line value.[21] Pacific Telesis Group ("PacTel") explained clearly why the SLC should be the same for all residence and business subscribers:

> The current FCC rules (with separate SLCs) are based on a technological past where home offices were unusual, where most households purchased few telecommunications services beyond a single primary line and perhaps a few room extensions, and where that home line was almost never used for business purposes. By maintaining this artificial distinction in its pricing structure, the FCC is . . . holding on to a pricing structure that is impossible to maintain and easy to abuse.[22]

PacTel's analysis provides ample support for a single national SLC. A single rate conforms with costs and also conforms with the fact that the distinction between "residence" service and "business" service is obscured as more individuals telecommute and use modems in their homes and offices for both "personal" and "business" use.

While a single SLC for all types of users is justified, GSA has recognized that the Commission may wish to minimize any potential increase for low volume interstate message toll users.[23] To meet this need, GSA/DOD suggested that the Commission might employ an optional capped low–volume SLC of $4.00 monthly, which would represent a very moderate increase over the existing cap for most lines. For all other

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21 SBC Comments, pp. 7–8.

22 PacTel Comments, p. 62.

23 GSA/DOD Comments, p. 12.

lines, an uncapped SLC would be set at a value established to recover the total interstate NTS revenue requirement after access charge reform.[24]

III. REFORM TO ADDRESS THE TOTAL INTERSTATE ACCESS REVENUE REQUIREMENT

A. LECs have Received Excessive Access Revenues.

1. High Access Charges Have Unduly Benefited the LECs.

In its comments, GSA/DOD reported that the earnings ratios for interstate services provided by the seven Regional Bell Holding Companies are substantially higher than the target ratio prescribed by the Commission in 1990. In CC Docket No. 89–624, the Commission established a target earnings ratio of 11.25 percent for price cap LECs.[25] Current earnings of the larger LECs are far above this level. According to GSA/DOD's estimates, ratios for the Bell operating companies ranged from 11.61 percent to 16.67 percent in 1995.[26] On average, these companies achieved an earnings ratio of 13.99 percent, which is a full 274 basis points above the 1990 target. Even the lowest earnings ratio — 11.61 percent — is above the target.

Furthermore, as GSA/DOD explained, the earnings requirements have declined since the Commission established the present target for price cap LECs.[27] In fact, T–Bond yields have been below the reference point since October 1990, and even below the low end trigger point, 7.14 percent, for nearly two years.[28]

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24 GSA/DOD Comments, p. 12.

25 Represcribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers, CC Docket No. 89–624, Order, FCC 90–315, released December 7, 1990, para. 1.

26 GSA/DOD Comments, p. 14.

27 GSA/DOD Comments, pp. 14–15.

28 AAD 96–28, Comments of GSA, March 11, 1996, Attachment A. The yield on T–Bonds was only 6.30 percent in December 1996.

As might be expected, not a single LEC filing comments in this proceeding provided financial data for the Commission to use in evaluating the relationship between earnings and access charges. Nevertheless, it is clear that the efforts of LECs to maintain high earnings ratios have been a major cause of excessive charges for interstate access services.

In its comments, MCI Telecommunications Corporation ("MCI") quantified the gap between interstate access revenues actually received by the LECs and the revenues with cost–based access charges. MCI reported that the total interstate access revenues for price cap LECs were about $21.5 billion in 1996, while the economic cost of providing this access was only $9.9 billion.[29] Actual revenues exceeded the appropriate revenue targets by $11.6 billion in a single year. As a major user of telecommunications services, GSA/DOD urges the Commission to eliminate the gap as soon as possible.

2. Vigorous and comprehensive access reform is required.

While the gap between access revenues and costs is large by any measure, there is an additional reason why the access charge system needs immediate and comprehensive reform. The impact of the current system on the development of full and open competition will be devastating if the large LECs controlling the bottleneck facilities are allowed to overcharge their potential competitors. As AT&T observes, the "costs" of excessive access charges go well beyond the bottom line of the LECs' financial statements. As long as access reform is delayed,

> [l]ong distance calls that should be made will not be made; bypass that should not occur will occur; and competition that should develop will not emerge.[30]

29 MCI Comments, p. 71.

30 AT&T Comments, p. i.

The Commission's NPRM outlines two scenarios for reform — a "market–based" approach and a "prescriptive" approach. As GSA/DOD explained in its initial comments, the Commission should implement certain features of its market–based approach, but it must also employ some of the most aggressive actions in its prescriptive approach in order to correct the major defects in the access charge regime.[31]

Because the incumbent LECs have benefited handsomely under the present system, they advocate sole use of a market–based approach. The Bell Atlantic/NYNEX comments provide an example of this view. This filing asserts that market–based prices would optimize use of the network, promote competition, encourage new investment, and pass benefits to the consumer in the form of lower rates and innovative services.[32]

In contrast, because the IXCs have borne the brunt of excessive access charges, they join users in recommending prescriptive actions. As AT&T explains, the prescriptive approach must be taken because:

> Facilities–based competition at levels sufficient to constrain ILEC prices can be expected, if at all, only <u>after</u> new entrants establish widespread customer relationships, which cannot happen until resale and network element–based competition become well established. Accordingly, leaving price caps at their current inflated levels would virtually guarantee the continuation of inefficient and unlawful access rates, and would thus be arbitrary.[33]

There is no guarantee that IXCs will pass all reductions in the access charges they pay through to their own end users. However, there is <u>also</u> no guarantee that LECs will reduce their rates in a pure price cap environment with few (or ineffective)

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31 GSA/DOD Comments, pp. 18–19.

32 Bell Atlantic/NYNEX Comments, p. 2.

33 AT&T Comments, p. iii.

constraints on their earnings. With interstate access revenues now out of line with costs, the Commission cannot expect LECs to price access services at levels that will benefit end users or facilitate the development of competition if they are not subject to earnings sharing.

B. Access Reform Requires Earnings Sharing and Important Prescriptive Actions.

1. LEC Rates Must Be Reinitialized to Reflect Current Capital Requirements.

Price cap LECs must continue to be regulated through earnings sharing until there is sufficient competition to allow market forces to reduce prices.[34] Furthermore, the Commission should proceed as soon as possible with two important prescriptive actions — reinitialization of LEC rates and charges, and a significant adjustment in the productivity offset factor contained in the earnings sharing formula.

Several LECs contend that there is no basis for the Commission to adopt any element of the prescriptive approach to access reform. For example, BellSouth Telecommunications ("BellSouth") states that the Commission has committed to an incentive–based system of price regulation, and it has no legal basis to reverse this policy.[35] BellSouth also contends that a prescriptive approach is not justified as a matter of policy in the "presence of substantial competition."[36]

However, as the Commission notes in the NPRM, it has authority to reinitialize rates to economic cost levels.[37] Indeed, when the Commission adopted price cap regulation for the LECs, it retained control over the earnings of these companies through the interstate earnings sharing mechanism. By exercising its authority to

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34 GSA/DOD Comments, p. 19.

35 BellSouth Comments, p. 40.

36 *Id.*, p. 20; and pp. 40–47.

37 NPRM, para. 223.

reinitialize rates, the Commission could quickly move interstate access rates to Total Service Long Run Incremental Cost ("TSLRIC") levels.[38]

The LECs' claims that competition requires the Commission to virtually abandon control of access charge levels as a matter of policy stands reality on its head. As MCI observes, premature pricing flexibility would permit the incumbent LECs to adjust access charges selectively in order to deter new entrants, while continuing to employ above–cost access charges for services where they face little or no competition.[39]

2. As An Interim Step, The Commission Should Reduce the LEC Price Cap Indices.

In its comments, GSA/DOD explained the importance of initiating a proceeding as soon as possible to establish new reference and trigger points for the interstate price cap plan.[40] However, GSA/DOD recognizes that as a practical matter it may be some time before such an investigation can be completed. In the meantime, it is important that end users do not continue to incur the penalties of unnecessarily high access charges. Therefore, as an interim measure, GSA/DOD recommends that the Commission immediately require all the LECs to reduce price cap indices to a level that would produce rates targeted to yield a rate of return of no more than 11.25 percent, the target earnings ratio prescribed by the Commission in CC Docket No. 89–624.[41] Such an action would protect end users from continuing to fuel excessive LEC earnings and would facilitate the development of competition in all telecommunications markets.

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38 NPRM, para. 222.

39 MCI Comments, p. 44.

40 GSA/DOD Comments, p. 20.

41 *Id.*

GSA/DOD strongly disputes claims by PacTel that difficulties in implementing a comprehensive review of their rate levels dooms any prescriptive actions to failure.[42] The Commission can easily address access rates by relying on publicly available estimates of the economic costs of the elements used to provide access services. For example, as MCI explains in its comments, the Commission can use either the Hatfield Model or the BCM Cost Model to approximate the forward–looking costs of services in the existing price cap baskets.[43] With this data, the Commission can estimate the required changes in price cap indices to bring LEC earnings in line with the previously established targets.

3. The Commission Should Also Increase the Current Productivity Offset.

To help ensure that access rates remain at reasonable levels after reinitialization, it will be necessary to increase the productivity offset factor in the LEC earnings sharing plan.[44] This factor plays a key role in maintaining the balance between the interests of ratepayers and investors. If the productivity offset is not sufficiently large to account for the subsequent improvements in LEC productivities, an increasing gap between actual and required earnings will emerge, and the Commission will soon be in the same position as at the present time.

As might be expected, Incumbent price cap LECs contend that no increase in the current productivity offset is required.[45] In fact, PacTel asserts that in a competitive environment, a productivity offset is completely unnecessary.[46] However, as

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42 PacTel Comments, p. 38.

43 MCI Comments, p. 18.

44 GSA/DOD Comments, p. 21.

45 See, for example, Bell Atlantic/NYNEX Comments, p. 60; and BellSouth Comments, p. 50.

46 PacTel Comments, p. 40.

GSA/DOD has explained, continuing current access charge levels will have a devastating effect on the development of competition. If the productivity offset is not adjusted after reinitialization of the rates, LECs will quickly regain excess earnings levels and could exploit this position to the detriment of local competitors. Indeed, while the Commission may reinitialize rates without adjusting the productivity offset, the benefits of this approach would be very short–lived. Future LEC productivity improvements would exceed those in the national economy with or without additional competition. Unless the productivity factor is increased to account for the difference in these productivity improvements, ratepayers will receive the benefits of telecommunications productivity changes only in the initial year. In subsequent years, productivity benefits will accrue to the LECs, but not to the users of their services.

C. The Commission Should Implement the Pro–Competitive Elements of its Proposed Market–Based Approach.

In the NPRM, the Commission identified a number of possible elements of a market–based approach to access reform that would allow LECs to create pricing options that directly address customers' needs.[47] While the Commission should rely most heavily on prescriptive tools to implement access reform, GSA/DOD believes that the Commission can safely proceed with several pro–competitive steps in the market–based plan as soon as the new price cap parameters — earnings sharing targets and a greater productivity offset — are effectively in place. Once these reforms have been implemented, GSA/DOD recommends that LECs be accorded greater flexibility for geographical deaveraging, volume and term discounts, and contract tariffs.[48]

Interexchange carriers are the principal opponents of these pricing options, which would help LECs tailor their services to the needs of end users. For example,

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47 NPRM, paras. 180–200.

48 GSA/DOD Comments, p. 22.

AT&T asserts that the "fundamental flaw" in each of these proposals is that they give incumbent LECs additional opportunities to become entrenched in the local markets and provide LECs with an undeserved "strategic advantage" in long distance markets.[49]

GSA/DOD acknowledges the concerns of these carriers. However, the Commission can use prescriptive actions in access reform to compensate for these additional LEC opportunities to become entrenched in the local markets and any unjustified LEC advantage in entering the long distance markets. The benefits of geographic deaveraging, volume and term discounts, and contract tariffs outweigh the potential harm.

Geographic deaveraging, discounts, and contract tariffs benefit all users because they give LECs more pricing options for customers with different calling requirements in different locations. Since the costs that LECs incur vary geographically and also vary with the volume and term commitments of end users, these pricing options are certainly needed in order for rates and rate structures to accurately reflect costs.

As GSA/DOD has explained previously in these comments, the need to match access charges with costs shapes the recommendations for changes in the structure of access charges, and drives the recommendations for vigorous prescriptive access reform. Similarly, the need to match access charges with underlying costs justifies granting LECs additional flexibility for geographical deaveraging, volume and term discounts, and contract tariffs.

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49 AT&T Comments, p. 78.

IV. CONCLUSION

As a major user of telecommunications services, GSA/DOD urges the Commission to modify the access charge rate structure and implement access charge reform as described in these Comments.

Respectfully submitted,

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