processor to grow, it is the use of these lines and trunks and what they are used for that cause cost in the central processor. For example, GTE-SW believes that ISDN usage is much higher on a per-line basis than regular POTS usage because a customer with an ISDN line may tie up switch capacity for a much longer time when transporting data than would multiple customers with POTS lines. Therefore, the cost in the used (e.g., not excess) part of the switch central processor is usage-sensitive.

25. However, in the arbitration dockets, the Texas PUC used the TELRIC standard, which treats the excess capacity in a different manner. Because the TELRIC standard allows the use of lower utilization factors than the Texas TSLRIC standard, more of the TS switch portions were considered to be TS and were included in the usage-sensitive (per-minute) local switching costs and rates. Thus, whether or not the switch processor and trunk port excess capacity can be considered TS or NTS depends upon the version of LRIC one is using to develop costs. Using a TELRIC methodology, the cost of excess switch capacity would be allocated directly to units of output, and therefore would be TS. Using a TSLRIC methodology, the cost of excess switch capacity would be a group cost common to switching and would therefore be NTS.

26. The FCC asks for comment on which rate structure is appropriate for the TS portions of the switch as used for local switching.[28] The switch usage cost studies (which include costs for local switching, but not switch features such as custom calling features) that large Texas ILECs file pursuant to Subst. R. §23.91 must be performed using certain cost drivers specified by the rule. Unless a waiver is granted, such cost studies must be performed showing how switching costs vary by time of day, wire center size (number of working lines) and wire center density

[28] Notice, ¶74.

(number of working lines per square mile). Although the costs developed and reported by these studies vary by time of day (rate period) and wire center size, this structure has yet to be applied to any rates.[29] In the arbitration dockets, the Texas PUC decided to defer the deaveraging of local switching rates by wire center size until universal service had been reformed. The Texas PUC believes it is premature to set any deaveraged rates until it is apparent how high-cost customer subsidization mechanisms are going to operate.

27. The FCC invites comment on whether or not call setup charges should be developed for usage-sensitive switching.[30] While the Texas costing rule does not require switch usage costs to be developed separately for call setup and call duration functions, both ILECs filing switch usage LRIC studies pursuant to this rule have performed such studies, and Texas PUC staff found this division appropriate (although the studies have not yet received final approval). The results of these LRIC studies have not yet been used in studies filed in cases before the Texas PUC. However, in the arbitration dockets, the local switching TELRIC-based rates were not divided into call setup and call duration elements, and this decision met with approval by the both the ILEC and the petitioners. In effect, the costs of the call setup functions of the switch were averaged with the costs of the call duration functions of the switch, and this approach is one appropriate methodology in calculating LRIC-based rates.

28. Should call setup charges be allowed as local switching rates, the Texas PUC believes that charges ideally would be applied to all call attempts (completed and not completed)

[29] It should be noted that if the local switching rate were to vary by time of day, the rate structure should be kept simple so customers (whether they be end users or IXCs) can more easily understand when rates are higher or lower. In the LRIC studies filed pursuant to Subst. R. 23.91, the ILECs each used only three rate periods (8 AM to 5 PM, 5 PM to 11 PM, and 11 PM to 8 AM) to develop and report local switching costs. A rate structure based on fewer rate periods would be easier to understand.

[30] Notice, ¶76.

that cause cost to the ILEC. However, there may be considerations of what constitutes an incomplete call attempt,[31] measuring the number of incomplete attempts and determining the identity of the end user who made the attempt. Such considerations may make it too burdensome to charge for incompleted attempts. In addition, the Texas PUC believes that the costs (including consumer confusion) associated with beginning to bill for incomplete call attempts outweigh any efficiencies gained from the more appropriate pricing signals.

C. Transport

29. Transport service is the component of interstate switched access service corresponding to the transmission and switching of traffic between incumbent LEC end offices and IXC POPs. Part 69 of the FCC's rules requires incumbent LECs to develop charges for transport service that may not reflect in some cases the manner in which they incur the costs of providing these services.[32] Transport services include entrance facilities, direct-trunked transport services, and tandem-switched transport services.

30. In addition to providing insight about the appropriate costing structure for local switching, the Texas PUC's LRIC analyses and arbitrations have provided information regarding the appropriate transport cost structure. We outline in the following paragraphs the Texas PUC's observations regarding the various proposals for an alternative transport costing structure.

[31] There are many ways in which one could define an incomplete call attempt. For instance, an incomplete call attempt may occur when the phone on the originating end is off-hook only temporarily, with no dialing taking place. On the other hand, an incomplete call attempt may occur when a telephone number is only partially dialed. Another example of a possible incomplete call attempt is when the originating end user hears the busy signal or ring, but the party on the other end does not pick up. Each of these scenarios cause the usage of switch capacity, but parties may differ over whether or not each one is actually a call attempt.

[32] Notice, ¶80.

1. Entrance Facilities and Direct-Trunked Transport Services

31. Under current FCC rules, incumbent LECs are required to establish flat rates for: (1) "entrance facilities," transport service from the IXC POP to the SWC, and (2) "direct-trunked transport," transport service from a SWC to an end office on dedicated facilities without switching at a tandem switch.[33] The FCC seeks comment on its tentative conclusion that rates for entrance facilities and direct-trunked transport service should be flat- rated because these transport facilities are dedicated to individual customers.[34] The same argument made for the charging a flat rate for the switch line port can be made for charging a flat rate for dedicated transport facilities. In the LRIC studies filed in Texas pursuant to Subst. R. §23.91, the dedicated transport termination and outside plant (OSP) costs have been developed and reported on flat-rate bases, and some of these studies have been approved by Texas PUC hearings examiners. While none of these costs have been used to develop rates in any contested case ruled upon by the Texas PUC, for consistency purposes, all dedicated facilities should be priced on a flat-rate basis. Therefore, the Texas PUC agrees with the FCC's tentative conclusion and does not recommend any changes in the rate structure adopted in the interim rules for entrance facilities and direct-trunked transport service. The Texas PUC Subst. R §23.23(d), relating to the restructure of intrastate switched transport services, requires that flat rated charges should be assessed on access customers for the use of entrance facilities and direct-trunked transport facilities.

2. Tandem-Switched Transport Services

32. Further, current FCC rules require incumbent LECs to establish usage-based charges for "tandem-switched transport," a transport service from the SWC to the end office that

[33] Notice, ¶81.
[34] Notice, ¶86.

provides switching at a tandem switch. The tandem-switched transport service charge includes an interoffice transmission charge, and a charge for the tandem switch.[35] The FCC seeks comment as to whether the rate structure of tandem switching should include flat-rate or usage-sensitive components.[36] As mentioned above, in the Basic Network Function (BNF) LRIC studies filed pursuant to Subst. R. §23.91, tandem switching costs have, for the most part, been considered usage-sensitive. In the arbitration dockets, the Texas PUC approved usage-sensitive (per-minute) tandem switching rates.

33. The FCC seeks comment on the recovery of tandem switching costs from dedicated transport rates.[37] The LRIC studies filed in Texas by the ILECs for dedicated transport service do not account for any tandem switching. Rather, tandem switching costs should be paid for separately (and on a usage-sensitive basis) from the flat-rated dedicated transport service.

34. Regarding the FCC's request for comment on pricing tandem switching at peak or off-peak periods[38], it should again be noted that while the Texas PUC's Subst. R. §23.91 requires ILECs to consider time of day as a cost driver in developing and reporting tandem switching costs, a rate structure for tandem switching based on time of day usage has not been approved by the Texas PUC. Such a rate structure was considered in the arbitration dockets, but neither the ILEC nor the petitioners believed it to be necessary. However, the Texas PUC is not opposed to permitting peak and off-peak pricing to ensure the most efficient use of the tandem-facilities. To the extent larger IXCs use tandem facilities to handle overflow traffic during peak hours, peak and

[35] Notice, ¶81.
[36] Notice, ¶89.
[37] Notice, ¶90.
[38] Notice, ¶90.

off-peak pricing will allow ILECs to recover at least a portion of the costs related to increased tandem switching capacity from the larger IXCs.

35. The FCC invites discussion on the merits of the two pricing alternatives[39] for purchase of interstate tandem-switched transport service that are currently offered as a choice to IXCs.[40] IXCs can choose to pay a single-usage sensitive charge, with distance measured in terms of the airline mileage from the serving wire center (SWC) to the end office, where applicable. In the alternative, IXCs may pay a flat-rated charge for a dedicated facility from the SWC to the tandem office, and a usage-sensitive charge for tandem-switched transport service from the tandem office to the end office, with mileage computed separately for the two segments. The Texas PUC in Subst. Rule §23.23(d) offered the two pricing options identified in the Notice to intrastate access customers. Because ILECs have complete control over the placement and location of tandems in their networks, the Texas PUC determined that in the absence of effective competition for tandem-switched services, the purchasers of tandem switched transport service would be disadvantaged if the second pricing alternative was the only option available. The Texas PUC agrees with the FCC's observation that purchasers of tandem-switched transport service are predominantly small IXCs and larger IXCs are more likely to use direct-trunked switched transport.[41] Therefore, it is important that any changes in access rate structure do not disadvantage a particular class of access customers, namely smaller IXCs, because it may have a detrimental effect on fostering robust competition in the interexchange market. The Texas PUC supports the continued availability of the two pricing alternatives for tandem switched transport during the period in which the prescriptive approach is in effect (discussed later). When the

[39] Notice, ¶87.
[40] Notice, ¶91.
[41] Notice, ¶90.

market for tandem-switched transport is determined to be competitive, the ILECs should be granted greater flexibility with respect to rate structure and rate levels for access services.

36. The FCC asks for identification of the costs appropriately associated with the tandem switching function.[42] The cost drivers required to be used in the BNF LRIC studies filed pursuant to the Texas costing rule (wire center size, distance, and time of day) imply that there are at least two types of costs associated with tandem switching: switch usage and common transport (or switched transport). In fact, the required cost drivers for tandem switching are the same as those for switched transport facilities and terminations. However, in the tandem-switching BNF LRIC studies it filed pursuant to Subst. R. §23.91, GTE-SW did not agree that tandem switching involves common transport functions. PUC staff believes that the company did not support this contention well and, in addition, the company did not ask for a waiver of the distance cost driver requirement. Texas PUC staff recommended that the ILEC consider distance as a cost driver in developing and reporting tandem switching costs. However, this recommendation has not yet been ruled upon by a Texas PUC hearings examiner or by the Texas PUC itself.

37. In the arbitration dockets, the Texas PUC approved, in the interim, one TELRIC-based tandem rate that did not vary by time of day, transport distance, or wire center size. Both the ILEC and the petitioners stated that accounting for wire center size in tandem switching costs would be difficult due to the fact that it is not the tandem switch's wire center that is the real cost driver. At least one petitioner stated that it is the size of the wire centers that the tandem switch serves that is a more significant cost driver. Because a tandem switch may serve many different wire centers of different sizes, it would be difficult to develop a rate structure based on the wire

[42] Notice, ¶92.

centers a tandem serves. Neither the ILEC nor the petitioners believed that a wire-center-size or time-of-day-based rate structure was necessary for tandem switching, and the Texas PUC agrees with this viewpoint.

38. The FCC seeks comment on whether there is a need to revise the current rate relationship between tandem-switched transport rates and DS3 and DS1 rates.[43] The Texas PUC, in adopting Subst. R. §23.23(d), recognized the need for establishing rate relationships between the various transport options to prevent the ILECs from engaging in discriminatory pricing between the various transport options while, at the same time, affording the ILECs with some degree of pricing flexibility in the face of increased competition for certain transport options. The Texas PUC therefore did not impose a price ceiling on the DS3 direct trunked transport whose price will be determined by competitive forces in the marketplace. The ILEC's DS3 rates are required to be used as a baseline for developing rates for DS1, DS0, and tandem-switched transport options since it reflects the forward looking technology (fiber) assumed in incremental cost studies upon which the rates would be based and also because competitors in the switched access market are likely to target the transport option (DS3) used by large access customers. Substantive rule 23.23(d) requires that the difference between the rates and 105% of the LRICs for DS0 direct trunked, DS1 direct trunked and tandem-switched options not exceed 150% of the difference between the rate and 105% of the LRIC of the DS3 direct trunked transport option, on an equivalent unit of capacity basis.

[43] Notice, ¶94.

D. Transport Interconnection Charge (TIC)

39. The Modification of Final Judgment required, until September 1, 1991, that charges for the transport of switched access traffic of the same type between end offices and facilities of IXCs shall be equal, per unit of traffic delivered or received, for all IXCs (known as the "equal charge rule"). In its Order released on October 16, 1992, the FCC adopted an interim rate structure which consisted of a flat-rated entrance facilities and direct-trunked charge, a usage-based tandem-switched transport charge. The interim rate structure also established a transitional make-whole revenue element, namely, the transport interconnection charge (TIC) that initially recovered the difference between the revenues from the new facility-based rates under the restructure and the revenues that would have been realized under the pre-existing "equal charge rule". The TIC is a per-minute charge assessed on all switched access minutes, including those of competitors that interconnect with the ILEC's switched access network through expanded interconnection.

40. The amount of revenue produced by the TIC relative to the revenue generated by other transport elements leaves little doubt that a serious pricing distortion exists. The TIC is founded on a "make-whole" revenue calculation that cannot be sustained in view of competitive pressures, and represents precisely the type of implicit subsidy mechanism that must be eliminated according to FTA96. The Notice offers four major approaches to resolving the TIC dilemma: allowing the ILECs significant pricing flexibility to address the problem; extensively revising the TIC through the use of detailed cost analysis; a combination of the first two approaches where some costs would be reassigned and others would be phased out; and phasing out all of the TIC costs.[44] The Texas PUC lacks the data and analytical support to offer a detailed solution to the

[44] Notice, ¶¶112-118.

FCC on this difficult issue. In general, however, the Texas PUC would support a plan resembling the FCC's third option, in which costs would be reassigned to transport facility elements based on TELRIC plus a reasonable allocation of forward looking common costs. The costs associated with the remaining revenue shortfall, currently recovered through the TIC, would be shifted to a specifically identified account to be recovered on a competitively-neutral basis and phased out over a reasonable period of time. The FCC may wish to consider recognition of any increased levels of universal service support in a reduction of the TIC amount that is earmarked to be phased out.

E. SS7 Signaling

41. SS7 is the international standard network protocol currently used to transmit signaling information over common channel signaling (CCS) networks. The following paragraphs offer the Texas PUC's observations regarding the portion of the Notice relating to proposed changes in the SS7 signaling rate structure.

42. The FCC requests comments on Ameritech's rate structure for pieces of the SS7 signaling network.[45] In Texas, ILECs did not file BNF LRIC studies for individual signaling functions. Instead, BNF LRIC studies for switching functions (such as CLASS BNFs) were performed. These BNF LRIC studies used the results of cost studies which capacity costed portions of the SS7 network (signaling links, STP ports, etc.). Some of these studies have been approved by Texas PUC hearings examiners.

[45] Notice, ¶127.

43. In the Texas arbitration dockets, FCC standards in the Local Competition First Report and Order[46] required separation of the signaling network from the switching network. The Texas PUC approved interim rates that are similar to Ameritech's signaling system rate structure. STP port (node) rates were approved on a per-port-per-month basis, rather than on the per-message basis that some petitioners desired. However, the approved interim rates for signaling links were usage-sensitive (per-octet-per-STP-pair). Dedicated signaling links, for the same reasons as dedicated transport or dedicated switch line ports, were approved as flat rates. Costs of processing or switching signaling information at the end office or tandem level were included in the local switching costs on a usage-sensitive basis. When costing elements of the ILEC network rather than services that may or may not use signaling functions, the rate structure approved by the Texas PUC in the arbitration dockets is the most appropriate.

III. Approach to Access Rate Reform and Deregulation

44. In sections IV through VI of the Notice, the FCC outlines two alternative approaches to access reform: a market-based approach and a more prescriptive approach, and the FCC requests comment on numerous aspects relating to both approaches.

45. Under the market-based approach, the FCC proposes letting marketplace pressure move interstate access prices to competitive levels. This approach could be implemented incrementally, first eliminating certain regulatory constraints as incumbent price cap LECs demonstrate through credible, verifiable evidence that the conditions necessary for efficient local competition to develop in their service areas exist. Then, as incumbent LECs show that competition has emerged, additional regulatory constraints, including mandatory rate structures,

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[46] CC Docket No. 96-98, *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, First Report and Order, FCC 96-325, §51.319.

would be eliminated to allow those LECs to adjust their interstate access rates. Finally, when substantial competition has developed, price regulation would be eliminated.[47]

46. The FCC notes, however, that some parties may contend that a market-based approach will allow incumbent LECs to continue indefinitely to assess inflated prices for some or most access services in some or most geographic areas and that these parties would urge them to adopt a prescriptive approach to access reform. Under this approach, the FCC would require incumbent LECs to move their prices to specified levels and allow such LECs limited pricing flexibility until they can demonstrate they face actual competition for access.

A. Recommendation of the Texas PUC

47. In general, the Texas PUC advocates use of a prescriptive approach initially, with transition to a market-based approach when true competition exists.

48. The FCC states that its primary goal in this proceeding is to adopt changes to the existing access charge rules "that will foster competition for these services and eventually enable marketplace forces to eliminate the need for price regulation of these services."[48] The Texas PUC agrees that this is an objective that the FCC should attempt to achieve, but respectfully suggests that the overriding, immediate goal during this period of transition to competition should be to shape the access charge system in such a way that removes implicit subsidies to the universal service system as required by FTA96 §254(b)(5).

49. Although the Texas PUC strongly favors market-based solutions, we are concerned that the market-based approach as proposed in this Notice is insufficient to eliminate implicit

[47] Notice, ¶140.
[48] Notice, ¶140.

subsidies and bring about access rates that are based on economic cost as quickly as desired. We agree with the opinion that a market-based approach, by itself, may allow ILECs to indefinitely assess inflated access charges,[49] thus maintaining implicit subsidies prohibited by the Act in §254(b)(5). We are not suggesting, however, that a prescriptive approach, by itself, is the appropriate solution in the long run.

50. The Texas PUC has embraced the procompetitive aspects of both the FTA96 and our own PURA95, but recognizes that competition in local exchange markets is not yet present in Texas. As many have observed, the transition to meaningful competition in telecommunications is the greatest challenge facing regulation today. It is unknown when a truly competitive environment, in which numerous providers will be able to offer a variety of services at competitive prices, will in fact emerge; it could in fact take years for such a market to develop. The fact that the interexchange market in Texas (which has been open to competition for more than a decade) can be best characterized as a "tight oligopoly"[50] demonstrates that substantial competition does not come about immediately once barriers to entry are removed. Similarly, although it is possible that the removal of the most immediate barriers to competitive entry to local markets could be called "potential competition,"[51] some might argue that the tight oligopoly present in Texas IXC market represents only "potential competition" even at this late date.

51. Regulators must act with caution during transition periods from monopolies to competitive markets since "potential competition" is, by definition, not actual competition. The Texas PUC, therefore, has reservations about the effects on consumers if regulations on ILECs,

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[49] Notice, ¶141.
[50] Public Utility Commission of Texas, *Report to the 75th Texas Legislature on the Scope of Competition in Telecommunications Markets*, January 1997, p. 141.
[51] Notice, ¶163.

which undoubtedly possess significant market power, are loosened too quickly during the transition to competition, without sufficient regulatory oversight. The Texas PUC believes that reforming access charges with a prescriptive method until "true competition" actually develops is an appropriate regulatory approach for access reform.

52. The Texas PUC recognizes, however, that measurement of when "true competition" is present (and therefore the trigger point at which regulations should be lifted) is a difficult task. In preparing its biennial *Report to the Seventy-Fifth Legislature on the Scope of Competition in Telecommunications Markets,*[52] the Texas PUC staff used both the Hirshman Hirfindahl Index (HHI) and the four-firm concentration ratio to evaluate the status of competition in the Texas interexchange market. The Texas PUC would support use of these or comparable measures of market share in analysis of the status of competition in local markets.

53. One of the recurring themes in the Notice is that whenever a service or a geographic area served by an ILEC is found to be substantially competitive, market forces should replace regulatory controls for that service or geographic market. We wish to offer our concern, however, that consumer and competitive safeguards must continue to be employed so long as the ILEC is providing both competitive and non-competitive services from the same ledger. It would be an ideal situation to carve out the competitive area or service, such as has been done through Part 64 accounting safeguards for other deregulated markets, and maintain a clear separation to avoid the possibility of predation and cross-subsidization. It would be virtually impossible to perform such an accounting separation for each access service or geographic area as it is found to be substantially competitive. If, as proposed, the market is allowed to set a (presumably lower)

[52] Public Utility Commission of Texas, *Report to the 75th Texas Legislature on the Scope of Competition in Telecommunications Markets*, January 1997, p. 141.

service price where there is competition, then the service provider would experience pressure to increase prices in less competitive areas to maintain the existing revenue stream. We therefore urge the FCC to consider the impact of the proposed market-based approach on the less-competitive services and areas served by the ILEC. It may be necessary to establish price floors (TELRIC) for competitive situations, while specifying rate caps or rate linkage for less competitive situations.[53]

B. Prescriptive Access Reform - Pricing Method

54. The FCC seeks comment on its tentative conclusion that interstate access rates should be based on "...some form of TSLRIC [-based] pricing method."[54] The Texas PUC believes that the correct approach to calculating access rates is to base them on forward-looking economic costs rather than embedded costs. Company-specific costs could be used, such as TSLRIC or TELRIC, or a generic cost model could be used. The Texas PUC believes that it may be more appropriate to use a company-specific cost computation on which to base access rates, so long as it can be properly inspected and verified, because access rates are company-specific rates. We support the use of proxy methodologies, such as the Hatfield or BCM models as they continue to evolve, for establishing geographically deaveraged cost approximations for the purpose of universal service targeting. However, we have concerns that these models in their current forms may not produce results as suitable for pricing purposes as company-specific studies.

55. Although the Texas PUC considers its Subst. R. §23.91 to be a TSLRIC rule and has used the guidelines and principles of the rule to determine costs and set rates in some cases, we

[53] For example, the rate for a service in a non-competitive area might be set no higher than some percentage higher than the rate charged in competitive areas or the rate for a less competitive access service might be set no higher than some percentage higher than the rate charged for a comparable access service subject to greater competition.
[54] Notice, ¶222.

believe it is more appropriate to use TELRIC instead of TSLRIC to compute access rates. The fact that access services are services and not functions would lead one to conclude that it is more appropriate to cost services using TSLRIC rather than TELRIC. However, services are largely combinations of elements, and TELRIC can be used to cost the elements underlying the services. This concept is reasonable, as the purchasers of the access services will likely be telecommunications carriers who pay TELRIC-based rates in a non-access environment for unbundled network elements that are used to provide access services. Rates based on TELRIC for both access and non-access unbundled network elements will lead to less confusion, eliminate artificial price disparities for identical network elements, and more easily ensure ILECs have an opportunity to recover forward-looking common costs (although, theoretically, a mixture of TSLRIC and TELRIC-based rates, if calculated using similar common cost allocation principles, should produce the same revenue results for the ILEC). To base rates on TELRIC rather than TSLRIC, the FCC would simply have to design a rate structure around interstate access elements rather than services.

56. The FCC seeks comment on what parties should be responsible for evaluating the ILECs' LRIC studies for each price cap basket.[55] Regardless of the LRIC methodology used to calculate access costs and rates, each state commission should be given the option to be responsible for analyzing the cost data specific to the ILECs it regulates. Over the past two years, the Texas PUC staff has had extensive hands-on experience with BNF and TSLRIC cost studies filed pursuant to the Texas costing rule, and in the last six months has gained considerable expertise in analyzing TELRIC studies. PURA95[56] gives guidelines on how to use the results of

[55] Notice, ¶224.

[56] In addition, the proposed Texas PUC pricing rule, which is being developed in Project No. 12771, will implement PURA95's pricing guidelines. This rule will be adopted by April 1, 1997.

TSLRIC and/or TELRIC studies to set rates. In addition, the staff of a state commission would be better equipped to make decisions regarding the most appropriate forward-looking technologies and network designs of the ILECs in its state given that population densities, terrain characteristics, etc., vary significantly from state to state.

57. The FCC seeks comment as to whether or not access rates would decrease if adjusted to TSLRIC.[57] In Docket No. 16300,[58] Texas PUC staff recognized that most transport and termination rates would be well below the access rates if rates were based on TELRIC plus an allowance for forward-looking common costs. The TELRIC-based interim rates set in this proceeding were, for the most part, far below the access rates for the company. Because TSLRIC generally can be expected to be equal to or less than TELRIC, rates equal to TSLRIC also would be far below access rates. If some unitary allocation of common cost were added onto TSLRIC, most of the rates still would be far below access rates.[59]

58. The allocation of common costs, upon which comment was requested by the FCC[60], is best based upon a single forward-looking common cost allocation factor. In the arbitration dockets, both the ILEC and the petitioners agreed that not only would a single forward-looking common cost allocation factor be administratively efficient, it would also be competitively neutral. With every element picking up a share of common cost based on a percentage of the direct costs of the element, no provider would be unduly disadvantaged because of the particular elements it buys. Also, the ILEC would not be able to load more common costs onto more essential

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[57] Notice, ¶227.

[58] *Joint Application of AT&T Communications of the Southwest, Inc. for compulsory Arbitration to Establish an Interconnection Agreement Between AT&T, GTE Southwest, Inc. and Contel of Texas, Inc.*

[59] As stated previously, if calculated using the same principles of allocation, TSLRIC and TELRIC may be roughly the same.

[60] Notice, ¶238.

elements to discourage entry. In addition, because it cannot be said that common costs are caused more or less by any one element, it would be difficult to justify requiring one element's rates to recover more common costs than another element's rates.

59. In the arbitration dockets, the Texas PUC staff proposed a common cost allocation factor determined by dividing the ILEC's overhead by the ILEC's total Texas revenues (regulated and unregulated[61]). The Texas PUC has not adopted such a factor at this time.[62] However, the Texas PUC supports a methodology for computing a general forward-looking common cost allocation factor that is based on forward-looking overheads and revenues. A factor based on such forward-looking information should be used as it would generally not cause rates to rise so high above direct cost as to no longer really be cost-based.[63]

IV. Transition Issues

60. The FCC seeks comment on various transition issues. Specifically, the Notice seeks comment on the manner in which the universal service support amounts attributable to the interstate jurisdiction should reduce interstate access rates. The FCC also addresses issues relating to the potential difference between the revenues that incumbent LECs generate from current interstate access charges and the revenues that revised access charges are likely to generate, and the FCC seeks comment on both the estimated magnitude of that difference and the extent to which alternative methods of recovery of that difference should be permitted.

[61] Revenues are used in the denominator because it is assumed that on a forward-looking basis, a purely competitive company's expenses will equal its revenues. Both regulated and unregulated revenues are used because the nature of common costs makes it such that they are used to support both regulated and unregulated services.

[62] Questions of how to properly allocate joint and common costs in setting permanent rates in these arbitration dockets are still pending. Petitioners have been asked to spend more time analyzing LEC cost studies and offer refinements to the methodology used to calculate the forward-looking common cost allocation factor.

A. Universal Service Issues

61. The FCC recognizes that, because of the role that access charges have played in funding and maintaining universal service, it is critical to implement changes in the access charge system together with complementary changes in the universal service system because circumstances under which incumbent LECs could be compensated twice for providing universal service may exist.[64] The Texas PUC agrees that any access charge reform must be carefully reviewed along with universal service in order to ensure that no "double recovery" occurs.

62. The FCC proposes a downward exogenous cost adjustment to reflect revenues received from any increase in universal service support.[65] The Texas PUC generally agrees with this proposal to the extent that it attempts to avoid any double recovery of costs. However, it must be recognized that, if adopted, this would be the first time USF funds would have been used to offset interstate rates. Currently, universal service support is applied to the reduction of revenue requirements for primarily intrastate services. We are concerned that the use of universal service funds to reduce interstate access charges has the potential to divert funds traditionally used to support intrastate high costs. We agree with the observation that such a shift in jurisdictional support must only be accomplished through a recommendation of a federal-state joint board.

63. Under the Federal-State Joint Board's Recommended Decision,[66] there will continue to be support for high-cost rural areas of the nation, which would be evidenced as payments to support intrastate services. There is also a need for a separate component within the

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[63] In the arbitration dockets that have gone before the Texas PUC thus far, most reasonable estimates of this factor have been between 10 and 20 percent.
[64] Notice, ¶244.
[65] Notice, ¶245.
[66] *In the Matter of Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Recommended Decision, FCC 96J-3.

universal service mechanism that will replace the explicit subsidy reflected in the common line elements of interstate access charges To the extent that the revised universal service mechanism has separate components for both high-cost assistance for intrastate services and a specifically-identified component for interstate common cost recovery, the needs of both jurisdictions appear to be addressed.

B. Treatment of Any Remaining Embedded Costs Allocated to the Interstate Jurisdiction

64. Current interstate access service revenues permit recovery of the interstate portion of embedded costs, subject since 1991 to the constraints of price cap regulation. The FCC notes that revenues generated if all access services were priced at forward-looking, economic cost may be much smaller than revenues received today. The FCC asks parties to discuss, in light of the other reforms discussed in this proceeding and other developments pursuant to the FTA96, the following issues: the amount and make-up of the difference between these amounts, whether recovery of the remaining interstate-allocated costs should be permitted, the lawfulness of a denial of such recovery, and possible recovery mechanisms.[67]

65. The FCC notes that some of the difference between the incumbent LECs' interstate-allocated embedded costs and forward-looking costs may be traced to past regulatory practices. For example, interstate access rates may exceed forward-looking economic cost, and thus produce some difference, because of misallocation of costs to the interstate jurisdiction.[68] Another possible regulatory cause of any difference between interstate-allocated embedded or

[67] Notice, ¶248.
[68] Notice, ¶249.

accounting costs and forward-looking costs may be under-depreciation of incumbent LEC assets.[69]

66. This proceeding to reform access charges raises a number of questions concerning jurisdictional cost separations. Clearly, the beginning point for developing access charges is the total cost that has been assigned to the interstate jurisdiction through Part 36 of the Commissions rules. The Texas PUC is concerned with what appears to be at least a tentative conclusion regarding jurisdictional cost allocation in this proceeding (that there may be a "misallocation of costs to the interstate jurisdiction") without having the benefit of a recommendation by a federal-state joint board on this key separations issue. The Notice states that the FCC intends, in the near future, to initiate a proceeding to address the separations issues raised by incumbent LEC provision of unbundled network elements.[70] The Texas PUC urges the Commission to proceed with the referral of all issues related to jurisdictional separations arising from the implementation of FTA96 to the "main" federal-state joint board in CC Docket No. 80-286.

67. As repeated throughout these comments, the Texas PUC supports the use of forward-looking economic costs in pricing access services. We agree that there may be a substantial difference between embedded and LRIC costs. We have not determined, as a matter of policy, whether any such embedded costs may be traced to past regulatory practices and whether such costs should be recovered through traditional rate mechanisms, and therefore we will not offer a recommendation to the FCC in this regard. In the event that the FCC determines that all or a portion of the remaining embedded costs should be recovered, we recommend, in order to avoid the continuation of implicit subsidies, that the recovery be made through a separately earmarked fund.

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[69] Notice, ¶250.
[70] Notice, footnote 340.

V. Conclusion

68. The Texas PUC recognizes the immense task before the FCC in working to complete its trilogy of actions that are collectively intended to promote competition in telecommunications markets pursuant to the 1996 Act. In these comments we have sought to provide the FCC with the insight regarding costing of networks that we have gained while working to promote telecommunications competition in Texas. In addition, we have relayed some concerns we have about the FCC's proposed approaches to access charge reform and related transition issues. We look forward to continuing a productive state-federal partnership to bring the benefits of competition to all consumers as quickly as possible.

Respectfully submitted,

Public Utility Commission of Texas
1701 N. Congress Ave.
P.O. Box 13326
Austin, Texas 78711-3326

January 22, 1997

Pat Wood, III
Chairman

Robert W. Gee
Commissioner

Judy Walsh
Commissioner

COMMENTS OF
THE PUBLIC UTILITY COMMISSION OF TEXAS

ATTACHMENT 3:

Texas PUC Docket Nos. 16189, 16196, 16226, 16285, and 16290,
FTA96 §252 Arbitration Panel, Arbitration Award

PUC DOCKET NOS. 16189, 16196, 16226, 16285, and 16290

PUBLIC UTILITY COMMISSION OF TEXAS

FTA96 §252 ARBITRATION PANEL

DOCKET NO. 16189 PETITION OF MFS COMMUNICATIONS COMPANY, INC. FOR ARBITRATION OF PRICING OF UNBUNDLED LOOPS	§ § § §	
DOCKET NO. 16196 PETITION OF TELEPORT COMMUNICATIONS GROUP, INC. FOR ARBITRATION TO ESTABLISH AN INTERCONNECTION AGREEMENT	§ § § §	
DOCKET NO. 16226 PETITION OF AT&T COMMUNICATIONS OF THE SOUTHWEST, INC. FOR COMPULSORY ARBITRATION TO ESTABLISH AN INTERCONNECTION AGREEMENT BETWEEN AT&T AND SOUTHWESTERN BELL TELEPHONE COMPANY	§ § § § § §	ARBITRATION AWARD
DOCKET NO. 16285 PETITION OF MCI TELECOMMUNICATIONS CORPORATION AND ITS AFFILIATE MCIMETRO ACCESS TRANSMISSION SERVICES, INC. FOR ARBITRATION AND REQUEST FOR MEDIATION UNDER THE FEDERAL TELECOMMUNICATIONS ACT OF 1996	§ § § § § § §	
DOCKET NO. 16290 PETITION OF AMERICAN COMMUNICATIONS SERVICES, INC. AND ITS LOCAL EXCHANGE OPERATING SUBSIDIARIES FOR ARBITRATION WITH SOUTHWESTERN BELL TELEPHONE COMPANY PURSUANT TO THE TELECOMMUNICATION ACT OF 1996	§ § § § § § §	

ARBITRATION AWARD

I. INTRODUCTION

A. PROCEDURAL BACKGROUND

The federal Telecommunications Act of 1996[1] (FTA96) requires that when an incumbent local exchange carrier (ILEC) and a new local service provider (LSP) are unable to negotiate the terms and conditions of interconnection agreements, either of the negotiating parties "may petition a State commission to arbitrate any open issues." FTA96 §251(b)(1). The Public Utility Commission of Texas (the Commission) is the state commission responsible for arbitrating disputes under FTA96.[2] The Commission anticipated it would be called upon to resolve disputes under FTA96, and promulgated a dispute resolution rule that established procedures for conducting arbitration proceedings.[3]

Several LSPs have petitioned the Commission to resolve their disputes with Southwestern Bell Telephone Company (SWBT). Pursuant to FTA96 §252(g), the Commission ordered that five of the SWBT arbitration petitions be consolidated.[4] The petitioning companies in this consolidated proceeding are American Communications Services, Inc. (ACSI), AT&T Communications of the Southwest (AT&T), MCI Telecommunications Corporation/MCIMetro Access Transmission Services, Inc. (MCI), MFS Communications Company, Inc. (MFS), and Teleport Communications Group, Inc. (TCG) (collectively, "the Petitioners").

The Commission's arbitration panel in these dockets is composed of the three Commissioners: Chairman Pat Wood, III, Commissioner Robert W. Gee, and Commissioner Judy Walsh (the Arbitrators). The members of the panel were sworn in as arbitrators and, with the assistance of Commission staff advisors, conducted the consolidated arbitrations in accordance with the Commission's dispute resolution rules.

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[1] Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56, *codified at* 47 U.S.C. §§151 *et seq.* Hereinafter, all citations to FTA96 will be to the 1996 Act as codified in the United States Code.

[2] The Commission has the authority to conduct the FTA96 arbitrations pursuant to §252 of FTA96 and §§1.101, 3.051, 3.451, 3.458, and 3.460 of the Public Utility Regulatory Act of 1995, Texas Civil Statutes, Article 1446c-0 (PURA95).

[3] P.U.C. Proc. R. §§22.301 - 22.310 (establishes procedures for mediation, arbitration, and approval of interconnection agreements under FTA96).

[4] The original consolidation order also included a sixth petition, Docket No. 16244, a petition filed by TCG for arbitration with GTE Southwest Incorporated (GTE). TCG withdrew its arbitration request regarding GTE prior to hearing.