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

DISP

In the Matter of 1993 Annual Access Tariff Filings	)	CC Docket No. 93-193, Phase I, Part 2
GSF Order Compliance Filings	)	
In the Matter of 1994 Annual Access Tariff Filings	)	CC Docket No. 94-65
In the Matter of 1995 Annual Access Tariff Filings	)	
In the Matter of 1996 Annual Access Tariff Filings	)	

MEMORANDUM OPINION AND ORDER

Adopted: April 15, 1997; Released: April 17, 1997

By the Commission:

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[redacted]

I. EXECUTIVE SUMMARY

1. On April 2, 1993, local exchange companies (LECs) filed their 1993 annual access tariffs, with an effective date of July 1, 1993. The Common Carrier Bureau (Bureau) suspended in part the 1993 annual access rates for one day, imposed an accounting order, and initiated an investigation of the tariffs to resolve a number of issues.[1] On April 2, 1994, the LECs filed their 1994 annual access tariffs, with an effective date of July 1, 1994,[2] and on May 9, 1995, their 1995 annual access tariffs, with an effective date of August 1, 1995.[3] On April 2, 1996, the LECs filed their 1996 annual access tariffs, with an effective date of July 1, 1996.[4] The Bureau suspended in part the tariff revisions for the 1994 through 1996 tariffs filings and made them subject to the 1993 tariff investigation and the accounting order instituted in CC Docket No. 93-193.[5]

2. This Order resolves the Bureau's investigation with respect to most of the issues designated for investigation in the *1993 Annual Access Order* in CC Docket No. 93-193 and several of the issues raised by the 1994, 1995, and 1996 annual access filings that were made

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[1] *See* 1993 Annual Access Tariff Filings, CC Docket No. 93-193, National Exchange Carrier Association Universal Service Fund and Lifeline Assistance Rates, Transmittal No. 556, CC Docket No. 93-123, GSF Order Compliance Filings, Bell Operating Companies' Tariff for the 800 Service Management System and 800 Data Base Access Tariffs, CC Docket No. 93-129, Memorandum Opinion and Order Suspending Rates and Designating Issues for Investigation, 8 FCC Rcd 4960 (Com. Car. Bur. 1993) (*1993 Annual Access Order*). A list of the entities filing direct cases, oppositions, and replies in response to the *1993 Annual Access Order* is provided at Appendix A. The abbreviations that we use to identify these entities in this Order are also provided at Appendix A.

[2] *See* 1994 Annual Access Tariff Filings, CC Docket No. 94-65, National Exchange Carrier Association Universal Service Fund and Lifeline Assistance Rates, Transmittal No. 612, Memorandum Opinion and Order Suspending Rates, 9 FCC Rcd 3705 (Com. Car. Bur. 1994) (*First 1994 Annual Access Order*); 1994 Annual Access Tariff Filings, CC Docket No. 94-65, Nevada Bell, Transmittal No. 196, Pacific Bell, Transmittal No. 1701, Rochester Telephone Corporation, Transmittal No. 222, Vista Telephone Companies, Transmittal No. 30, Memorandum Opinion and Order Suspending Rates, 9 FCC Rcd 3519 (Com. Car. Bur. 1994) (*Second 1994 Annual Access Order*) (collectively, *1994 Annual Access Orders*).

[3] *See* 1995 Annual Access Tariff Filings of Price Cap Carriers, NYNEX Telephone Companies Tariff F.C.C. No. 1, Transmittal Nos. 379 and 384, New York Telephone Company Tariff F.C.C. No. 40, Transmittal No. 1152, Memorandum Opinion and Order Suspending Rates, 11 FCC Rcd 5461, n. 2, (Com. Car. Bur. 1995) (*Price Cap Carriers' 1995 Annual Access Order*).

[4] *See* 1996 Annual Access Tariff Filings, National Exchange Carrier Association Universal Service Fund and Lifeline Assistance Rates, Transmittal No. 710, NYNEX Telephone Company Petition to Advance the Effective Date of the 5.3 X-Factor to January 1, 1995, 11 FCC Rcd 7564 (Com. Car. Bur. 1996) (*1996 Annual Access Order*).

[5] *See First 1994 Annual Access Order*, 9 FCC Rcd at 3750-52; *Second 1994 Annual Access Order*, 9 FCC Rcd at 3545-46; *Price Cap Carriers' 1995 Annual Access Order*, 11 FCC Rcd at 5499-5502; *1996 Annual Access Order*, 11 FCC Rcd at 7604-07.

subject to that investigation.[6] This Order also denies an application for review filed by AT&T that claims that the Bureau, in the *1994 Annual Access Orders,* erred by failing to suspend and investigate the LECs' 1994 annual access tariff filings because the LECs did not reduce their price cap indices (PCIs) to reflect the full amortization of their equal access expenses as an exogenous cost change.[7] Finally, this Order grants in part and dismisses in part a petition filed by Southwestern[8] of the *First 1994 Annual Access Order* requesting that the Commission"clarify or reconsider that part of its [Order] that implies that local exchange carriers (LECs) subject to price cap regulation and wishing to treat the new [Commission] regulatory fees as exogenous costs should petition for a waiver of the Commission's rules"[9] and "clarify that [Southwestern's] proposed $6.04 fixed mileage charge for DS1 services with zero miles of interoffice transport is not subject to the expanded interconnection investigation."[10]

[6] In this Order we review the record pertaining to the issues designated for investigation in the 1993 through 1996 annual access filings as cited in footnotes 1 through 4, *supra.* This Order will not, however, address two sets of issues designated for investigation by the *1993 Annual Access Order* or made subject to CC Docket No. 93-193. Specifically, this Order will not address issues related to claims for exogenous treatment under price cap regulation of amounts associated with the implementation of Statement of Financial Accounting Standards 106 (SFAS-106) relating to "other postretirement employee benefits" or "OPEBs." The OPEB issues will be addressed in a separate proceeding. *See* 1993 Annual Access Tariff Filings, CC Docket No. 93-193, Phase I, 1994 Annual Access Tariff Filings, CC Docket No. 94-65; AT&T Communications Tariff F.C.C. Nos. 1 and 2, Transmittal Nos. 5460, 5461, 5462 and 5464, CC Docket No. 93-193, Phase II, Bell Atlantic Telephone Companies, Tariff F.C.C. No. 1, Transmittal No. 690, CC Docket No. 94-157, NYNEX Telephone Companies, Tariff F.C.C. No. 1, Transmittal No. 328, DA 95-1485, Order Designating Issues for Investigation, 10 FCC Rcd 11804 at 11811-11812, Com. Car. Bur. 1995) ("designat[ing] the SFAS-106 portion of the *1993 Annual Access . . . [Order]* as Phase I, Part 1 . . .") (footnote omitted). This Order will also not address the "add-back" issue with respect to the 1993 and 1994 annual access filings, *i.e.*, the question of how price cap LECs should reflect amounts from prior year sharing or low-end adjustments in computing their rates of return for the current year's sharing and low-end adjustments to price cap indices that was raised in the 1993 and 1994 annual access tariff filings. In 1995 the Commission adopted a new add-back rule designed to eliminate the effects of sharing or low-end adjustments implemented during the calendar year immediately preceding an annual filing in computing a LEC's earnings for that year. A LEC's interstate earnings during the immediately preceding calendar year, as adjusted by the add-back requirement, determine whether sharing is required, or a low-end adjustment is permitted in the next tariff year. The add-back rule was adopted on a prospective basis and applied for the first time in the 1995 annual access tariff filing. *See Price Cap Regulation of Local Exchange Carriers, Rate of Return Sharing and Lower Formula Adjustment,* 10 FCC Rcd 5656 (1995) (Add-Back Report and Order). The add-back issue for 1993 and 1994 will also be addressed in a separate proceeding.

[7] *See First 1994 Annual Access Order,* 9 FCC Rcd 3705; *Second 1994 Annual Access Order,* 9 FCC Rcd 3519.

[8] Petition for Clarification or Reconsideration of Southwestern Bell Telephone Company, CC Docket No. 94-65 (filed July 25, 1994) (Southwestern Petition).

[9] *Id.* at 1.

[10] *Id.* at 1-2. *See* Local Exchange Carriers' Rates, Terms and Conditions for Expanded Interconnection for Special Access, CC Docket No. 93-162, 8 FCC Rcd 4589 (Com. Car. Bur. 1993) (*Suspension Order*); Local Exchange Carriers' Rates, Terms and Conditions for Expanded Interconnection for Special Access, CC Docket No. 93-162, 8 FCC Rcd 6909 (Com. Car. Bur. 1993) (*Designation Order*).

3. In the *1993 Annual Access Order*, the Bureau designated the following issues for investigation: (1) whether US West's method of calculating its exogenous cost adjustment associated with a change in the prescribed method of allocating local switching equipment costs complies with Section 61.45(d) of the Commission's rules; (2) whether Bell Atlantic and SNET correctly calculated the growth factor ("g" factor) used to establish the PCI for the common line basket; (3) whether Bell Atlantic should be permitted to exclude end user charge revenues from the common line basket for purposes of allocating its sharing obligations; (4) whether the LECs have properly reallocated general support facility (GSF) costs in accordance with the *GSF Order*; (5) whether LECs have assigned to the proper category or categories the line information data base (LIDB) per query charges; and (6) whether Roseville, a rate-of-return regulated company, has justified its cash working capital requirement and underlying study in support of its annual access rates. On July 27, 1993, the LECs filed their direct cases in response to the *1993 Annual Access Order* and, on August 24, 1993, filed their comments.

4. While the 1993 access tariff investigation was open, the LECs filed their 1994, 1995, and 1996 annual access tariffs which generally followed the same costing and ratesetting methodologies used in the 1993 access tariff filings set for investigation. In the *First 1994 Annual Access Order*, the *Price Cap Carriers' 1995 Annual Access Order*, and the *1996 Annual Access Order*, the Bureau suspended for one day Bell Atlantic's tariff revisions regarding the calculation of the "g" factor and made those tariff revisions subject to the investigation of Bell Atlantic's "g" factor calculation in CC Docket No. 93-193.[11] In the *1994 Annual Access Orders*, the *Price Cap Carriers' 1995 Annual Access Order*, and the *1996 Annual Access Order*, the Bureau suspended for one day Bell Atlantic's and Pacific Bell's tariff revisions that reflected the exclusion of end user charge revenues from the common line basket for purposes of allocating their sharing obligations and made those tariff revisions subject to the investigation of those issues in the 1993 access tariff investigation.[12] In addition, the *1994 Annual Access Orders* rejected proposals advanced by AT&T and MCI to treat the expiration of equal access cost amortization exogenously.[13] Further, the *1994 Annual Access Orders* held that certain carriers' proposals to treat Commission regulatory fees as exogenous costs in their tariff filings violated the price cap rules and stated that, absent a rulemaking, the only way to obtain exogenous treatment for these

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[11] *First 1994 Annual Access Order*, 9 FCC Rcd at 3741-43; *Price Cap Carriers' 1995 Annual Access Order* 11 FCC Rcd at 5494-95; and *1996 Annual Access Order*, 11 FCC Rcd at 7587-88.

[12] *First 1994 Annual Access Order*, 9 FCC Rcd at 3713-15; *Second 1994 Annual Access Order*, 9 FCC Rcd at 3524-26 (stating that, after the termination of the 1993 investigation and prior to the termination of the 1994 investigation, we would grant Pacific Bell an opportunity to "present any legal argument or factual circumstances that might lead us to conclude that the decisions reached in CC Docket No. 93-193 on the sharing allocation issue should not control our treatment of the 1994 access transmittals"); *Price Cap Carriers' 1995 Annual Access Order*, 11 FCC Rcd at 5488-90; and *1996 Annual Access Order*, 11 FCC Rcd at 7580-82.

[13] *First 1994 Annual Access Order*, 9 FCC Rcd at 3709; *Second 1994 Annual Access Order*, 9 FCC Rcd at 3521.

fees is through a waiver of the Commission's rules.[14] Finally, in the *First 1994 Annual Access Order*, the Bureau held that Southwestern's proposed fixed mileage charge for DS1 services with zero miles of interoffice transport raised sufficient risk of double recovery to warrant an investigation and incorporated this issue into the Commission's ongoing expanded interconnection investigation.[15]

5. In this Order, we reach the following conclusions with respect to issues designated for investigation in CC Docket No. 93-193. First, we conclude that, in its 1993 annual access tariff filing, US West's method of calculating the exogenous cost change associated with the change in the method of allocating local switching equipment costs is incorrect. Second, we find that Bell Atlantic, in its 1993, 1994, 1995, and 1996 annual access filings, and SNET, in its 1993 annual access filings, have incorrectly calculated the "g" factor used to establish the common line PCI. Third, we find that Bell Atlantic and Pacific Bell incorrectly excluded end user charge revenues for purposes of allocating sharing obligations among price cap baskets. Fourth, we find the GSF tariff filings of most carriers to be consistent with the *GSF Order* but conclude that there may have been a double recovery of a portion of GSF costs by carriers that participated in NECA's common line tariff but filed individual tariffs for traffic sensitive rates pursuant to Section 61.39.[16] Fifth, we determine that the LIDB per query charge should be assigned to the data base access services category within the traffic sensitive basket. Sixth, we find that Roseville has not adequately justified its cash working capital calculations.

6. In this Order, we also deny AT&T's application for review and affirm the Bureau's decision that the completion of the eight-year amortization of equal access costs may not be treated as an exogenous cost event.[17] In addition, we dismiss in part and grant in part Southwestern's petition for clarification or reconsideration of the Bureau's decisions in the *First 1994 Annual Access Order* regarding exogenous treatment of regulatory fees and Southwestern's DS1 zero mileage charge.

7. In this Order, we direct the price cap LECs whose annual access[18] tariff filings are in

[14] *First 1994 Annual Access Order*, 9 FCC Rcd at 3731-35; *Second 1994 Annual Access Order*, 9 FCC Rcd at 3536-39.

[15] *First 1994 Annual Access Order*, 9 FCC Rcd at 3724-25.

[16] *See* Section 61.39 of the Commission's rules, 47 C.F.R. § 61.39.

[17] Under the original LEC price cap plan, an exogenous cost change is a cost change that is triggered by administrative, legislative or judicial actions beyond the control of the carriers and is not reflected in the formula used to adjust the LECs' PCIs. Policy and Rules Concerning Rates for Dominant Carriers, Second Report and Order, 5 FCC Rcd 6786, 6807 (1990); *see also infra* Section II.A.

[18] For background on the Commission's access charge rules, *see* 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, Notice of Proposed Rulemaking, Third Report and Order,

violation of the Commission's rules and determinations herein to recalculate their PCIs, pricing bands and maximum carrier common line rates.[19] We decide how these recalculations should be done and what remedies should apply for violation of our rules. In addition, we require Roseville, a rate-of-return regulated company, to refund the amount attributable to the miscalculation of its cash working capital allowance and to submit its calculations of this refund amount and a refund plan to the Bureau. We also require the carriers that participated in NECA's common line pool and filed individual tariffs for traffic sensitive rates pursuant to Section 61.39 to provide explanations of their GSF allocations and revisions to traffic sensitive rates and if necessary, to submit a plan for any corrective action to eliminate any double recovery of GSF costs.

II. INVESTIGATION ISSUES

A. Background

8. In its price cap decisions,[20] the Commission replaced rate-of-return regulation with an incentives-based system of regulation that rewards companies that become more productive and efficient, while ensuring that they share productivity and efficiency gains with their ratepayers.[21] The theory of price caps is to harness the profit-making incentives common to all businesses to produce a set of outcomes that advance the public interest goals of just, reasonable, and nondiscriminatory rates, as well as a nation-wide communications system that offers innovative,

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and Notice of Inquiry, FCC 96-488 at paras.21-31 (rel. December 24, 1996),

19 The LECs that are required to take certain actions as a result of this Order are identified in Appendix B.

20 *See* Policy and Rules Concerning Rates for Dominant Carriers, Report and Order and Second Further Notice, 4 FCC Rcd 2873 (*AT&T Price Cap Order*), *modified on recon.*, 6 FCC Rcd 665 (1991)(*AT&T Price Cap Reconsideration Order*); Policy and Rules Concerning Rates for Dominant Carriers, Second Report and Order, 5 FCC Rcd 6786 (1990) and Erratum, 5 FCC Rcd 7664 (1990)(*LEC Price Cap Order*), *modified on recon.*, 6 FCC Rcd 2637 (1991)(*LEC Price Cap Reconsideration Order*), *further recon.*, 6 FCC Rcd 4524 (1991)(*ONA Part 69 Order*), *second further recon.*, 7 FCC Rcd 5235 (1992), *aff'd, National Rural Telecom Ass'n v. FCC*, 988 F.2d 174 (D.C. Cir. 1993); Competition in the Interstate Interexchange Marketplace, Report and Order, 6 FCC Rcd 5880 (1991)(*Interexchange Order*)(further streamlining and removing from price cap regulation most of AT&T's business services), *on recon.*, 7 FCC Rcd 2677 (1992); Revisions to Price Cap Rules for AT&T Corp., 10 FCC Rcd 3009 (1995) (*Commercial Services Order*); Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier, Order, FCC 95-427, 11 FCC Rcd 3271 (1995)(finding that AT&T lacks market power in the interstate, domestic, interexchange market and, therefore, granting AT&T's motion to be reclassified as a non-dominant carrier with respect to that market).

21 The Commission required price cap regulation for the regional Bell Operating Companies and GTE, and permitted other LECs to adopt price cap regulation voluntarily, provided that all their affiliates also convert to price cap regulation, and that they withdraw from the pools administered by the National Exchange Carrier Association, Inc. *LEC Price Cap Order*, 5 FCC Rcd at 6818-20 (1990). Those LECs that chose not to adopt price cap regulation remain subject to rate of return regulation. Regulatory Reform for Local Exchange Carriers Subject to Rate of Return Regulation, CC Docket No. 92-135, 8 FCC Rcd 4545 (1993) *on recon.* FCC 97-41 (rel. Feb. 18, 1997).

high quality services.[22]

9. Under the LEC price cap plan, a carrier's interstate services are grouped into baskets. Under the Commission's initial price cap plan, the four services baskets were the common line, traffic sensitive, special access, and interexchange services baskets.[23] For each basket, a PCI limits the prices carriers charge for services in that basket.[24] The PCI is adjusted each year based on a formula that includes a measure of inflation which is offset by a "productivity" factor or "X-Factor." The X-Factor reflects the fact that changes in telephone companies' costs per unit of output (unit costs) have historically been below that of the economy as a whole due to greater productivity gains and lower input price changes enjoyed by the telecommunications sector.[25] Carriers that are able to generate productivity gains in excess of the X-Factor they elect are allowed to keep at least a portion of earnings higher than those experienced under rate-of-return regulation.[26] Carriers also benefit because price cap regulation gives them increased flexibility in setting rates and is simpler to administer. Ratepayers benefit because the price cap rules

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22 *See LEC Price Cap Order*, 5 FCC Rcd at 6787.

23 *LEC Price Cap Order*, 5 FCC Rcd at 6788. In the *LEC Price Cap Order*, the Commission divided services among baskets according to the then-existing interstate access structure set forth in Part 69 of the Rules. *Id.*; *see also LEC Price Cap Reconsideration Order*, 6 FCC Rcd at 2679. In January of 1994, the Commission in the *Second Transport Order* realigned the division of services among baskets by combining transport and special access services into the newly-created trunking basket. As a result, the four service baskets became the common line, traffic sensitive, trunking, and interexchange services baskets. Transport Rate Structure and Pricing, Second Report and Order, 9 FCC Rcd 615, 622 (1994) (*Second Transport Order*); *id.* at 622 (the Commission decided to "mov[e] transport services out of the traffic sensitive basket and into a basket with special access services . . . [to] prevent the LECs from offsetting rate reductions for transport services subject to competition with rate increases for switching and other traffic sensitive services, which are subject to much less competition at this time."). The Commission subsequently established a new, separate LEC price cap basket for video dialtone service. Price Cap Performance Review for Local Exchange Carriers; Treatment of Video Dialtone Services under Price Cap Regulation, Second Report and Order and Third Further Notice of Proposed Rulemaking, CC Docket No. 94-1, 10 FCC Rcd 11098 (1995) (*VDT Price Cap Basket Order*).

24 *LEC Price Cap Order*, 5 FCC Rcd 6787.

25 In the *LEC Price Cap Order*, the Commission set a minimum productivity offset of 3.3 percent and an optional productivity offset of 4.3 percent for the three access service baskets. Election of the higher productivity offset lowers the price cap further than the 3.3 percent productivity offset, thereby benefitting ratepayers. Election of the higher offset, however, permits a LEC to retain a larger share of its earnings. *LEC Price Cap Order*, 5 FCC Rcd at 6796, 6799; *LEC Price Cap Reconsideration Order*, 6 FCC Rcd at 2641. The Commission subsequently increased the 3.3 percent minimum productivity factor to 4.0 percent, and replaced the optional productivity offset of 4.3 percent with two new optional productivity factors of 4.7 and 5.3 percent. Price Cap Performance Review for Local Exchange Carriers, 10 FCC Rcd 8961, 9005-06 (1995) (*LEC Performance Review*); *see also id.* at n.11. The *LEC Price Cap Order* set the productivity factor for the interexchange basket at 3.0 percent to match the factor established for AT&T's interexchange services, and was not based on the studies used to set the productivity factor for the other baskets; the Commission did not change the productivity factor for the interexchange basket. *See also VDT Price Cap Basket Order* at paras. 1 and 23 (assigning an initial productivity factor of zero for the LEC VDT price cap basket).

26 *LEC Price Cap Reconsideration Order*, 6 FCC Rcd at 2641.

encourage greater efficiency and reduced rates by requiring LECs to out-perform historical trends.[27] Generally, changes in costs are not relevant to price cap regulation and carriers must control their costs if they are to remain profitable. Through these incentives, ratepayers receive the benefits of improved efficiency and reduced rates.

10. Although changes in a carrier's costs are not generally relevant for rate making under the price cap system, the Commission determined in the *LEC Price Cap Order* that certain costs incurred by LECs caused by administrative, legislative, or judicial requirements beyond their control should result in an adjustment to their PCIs.[28] The Commission found that not recognizing these costs in the PCIs would either unjustly punish or reward the carrier by attributing these uncontrollable changes to the carrier's efficiency.[29] The Commission designated those changes in costs for which an adjustment in the PCI would be allowed as "exogenous." The Commission, however, determined that not all changes that lie beyond the carrier's control warrant exogenous treatment. For example, the Commission noted that, although a change in tax rates applicable to all companies is beyond the carrier's control, that change will be captured in the general inflation component of the price cap formula.[30] Exogenous treatment of this kind of tax change would "double count" its impact, once in the inflation measure, and again as an exogenous cost change. The Commission decided that only those tax changes that "uniquely or disproportionately" affect the LECs would be eligible for exogenous treatment.[31] Similarly, although a carrier cannot control changes in generally accepted accounting principles (GAAP), the Commission stated that "[i]f a GAAP change is universal enough to be reflected in the inflation measure, exogenous cost treatment would result in double counting within the context of the PCI."[32] Therefore, we decided to accord exogenous treatment to costs associated with GAAP changes that have been adopted by the Financial Accounting Standards Board, have become effective,[33] and are shown not to be reflected already in changes to the GNP-PI.[34]

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[27] *LEC Price Cap Order*, 5 FCC Rcd at 6792; *LEC Price Cap Reconsideration Order*, 6 FCC Rcd at 2640.

[28] *LEC Price Cap Order*, 5 FCC Rcd at 6807.

[29] *Id.*

[30] *LEC Price Cap Order*, 5 FCC Rcd at 6793; *LEC Price Cap Reconsideration Order*, 6 FCC Rcd at 2668-71. The Commission recently substituted the Gross Domestic Product Price Index (GDP-PI) for the GNP-PI originally used as the inflation factor in the LEC price cap formula. *LEC Performance Review*, 10 FCC Rcd at 9115-16.

[31] *LEC Price Cap Order*, 5 FCC Rcd at 6808.

[32] *LEC Price Cap Reconsideration Order*, 6 FCC Rcd at 2665.

[33] *See LEC Price Cap Order*, 5 FCC Rcd at 6807 ("no GAAP change can be given exogenous treatment until the Financial Accounting Standards Board has actually approved the change and it has become effective.").

[34] *LEC Price Cap Order*, 5 FCC Rcd at 6808; *LEC Price Cap Reconsideration Order*, 6 FCC Rcd at 2665; *see also LEC Performance Review*, 10 FCC Rcd at 8972 (revising the criteria that determine whether a cost change attributable to a change in accounting rules is eligible for exogenous treatment; LECs must now

11. Exogenous cost changes specified in our rules include cost changes that result from: (1) completing the amortization of depreciation reserve deficiencies; (2) amendments to the Uniform System of Accounts (USOA) as the Commission shall permit or require;[35] (3) changes in the Separations Manual;[36] (4) reallocation of regulated investment to nonregulated activities;[37] (5) changes in transitional and long term support; (6) inside wire amortizations; and (7) tax law changes and other "extraordinary" changes to the extent we may permit or require.[38] The Commission has declined to extend or has explicitly rejected exogenous treatment for other cost categories, including depreciation rate changes and amortization of equal access costs.[39]

12. Within certain price cap baskets, services are grouped into service categories and subcategories and rate changes within the categories and subcategories are limited by upper and lower pricing bands.[40] Before the Commission adopted the *LEC Performance Review*, the pricing band limits for most of the service categories and subcategories were set at 5 percent above and below a subindex of the prices for each category or subcategory (called the Service Band Index (SBI)), as adjusted by the change in the PCI for the basket.[41] A presumption of lawfulness and a relatively short tariff filing notice period apply to rate changes that conform to the limits set by a LEC's PCIs and pricing bands. Substantial cost justification and longer tariff filing notice periods are required if rates exceed the price cap for a basket or are above or below the applicable pricing bands for a service category or subcategory.[42]

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demonstrate that the cost change is beyond their ability to control, is not reflected in the formula used to adjust the PCIs, and affects their cash flow).

[35] *See* Part 32 of the Commission's rules, 47 C.F.R. Part 32.

[36] *See* Part 36 of the Commission's rules, 47 C.F.R. Part 36.

[37] *See* Part 64 of the Commission's rules, 47 C.F.R. Part 64.

[38] Section 61.45(d)(1) of the Commission's rules; 47 C.F.R. § 61.45(d)(1).

[39] *LEC Price Cap Order*, 5 FCC Rcd at 6806-09.

[40] *LEC Performance Review*, 10 FCC Rcd at 9129-30. The two baskets that currently have service categories and subcategories are the traffic sensitive and trunking baskets.

[41] *See LEC Price Cap Order*, 5 FCC Rcd at 6788, 6811; *LEC Performance Review*, 10 FCC Rcd at 9129-30. In the *LEC Performance Review*, the Commission increased the lower pricing bands that apply to most service categories to 10 percent and that apply to density pricing zones to 15 percent. *LEC Performance Review*, 10 FCC Rcd at 9141; *see also* Section 61.47 of the Commission's rules, 47 C.F.R. § 61.47.

[42] *LEC Price Cap Order*, 5 FCC Rcd at 6788; *LEC Performance Review*, 10 FCC Rcd at 9129-30.

B. US West Exogenous Impact of Dial Equipment Minutes Transition

1. Background

13. Part 36 of the Commission's jurisdictional separations rules allocates investment costs of local switching equipment between the interstate and intrastate jurisdictions by the use of Dial Equipment Minutes (DEM).[43] Dial equipment minutes are the minutes of holding time of the originating and terminating local dial switching equipment (*i.e.*, the time local switching equipment is in actual use either by a customer or an operator), and the DEM factor for allocating local switching equipment costs to interstate service is the ratio (expressed as a percentage) of interstate minutes of use to the total minutes of use.[44]

14. Before 1988, local switching equipment costs were allocated between the state and federal jurisdictions through a two-step process. First, switch costs were categorized as traffic sensitive or non-traffic sensitive. How costs were categorized depended upon the type of switch (digital or analog). Non-traffic sensitive costs were allocated to the interstate jurisdiction based on the interstate subscriber plant factor (SPF);[45] traffic sensitive portions were allocated based on

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[43] *See* Section 36.125(b) of the Commission's rules, 47 C.F.R. § 36.125(b).

[44] For small LECs, defined as those with fewer than 50,000 access lines, the DEM is "weighted" (*i.e.*, multiplied) to allocate a higher percentage of local switching costs to the interstate jurisdiction. The purpose of DEM weighting is to assist small LECs. This weighting reflects an assumption that smaller telephone companies generally have higher local switching costs per line because they cannot take advantage of certain economies of scale. The DEM factor is weighted for small carriers as follows: by a factor of 3.0 for carriers with 1 to 10,000 access lines; by a factor of 2.5 for carriers with 10,001 to 20,000 access lines; and by a factor of 2.0 for carriers with 20,001 to 50,000 access lines. The maximum weighted DEM factor is 85 percent. *See generally* Section 36.125 of the Commission's rules, 47 C.F.R. § 36.125.

The Commission is currently considering the Joint Board's recommendations for changes to the universal service support mechanisms including DEM weighting. Those recommendations if adopted, would not apply retroactively to the period subject to this investigation. The Joint Board recommended that the DEM weighting benefits for small rural carriers continue under the present rules until December 31, 1997 but that beginning in 1998 and continuing through the year 2000, support payments for DEM weighting as well as for high cost assistance and long term support be frozen based on historical per line amounts. Beginning in the year 2001 and through the year 2003, the Joint Board recommended that high cost support for rural carriers be gradually shifted to one set using a proxy cost based methodology to calculate the forward looking costs of providing universal service. Non-rural carriers would be required to use a proxy cost methodology that the Commission would develop in conjunction with state commissions for implementation, beginning on January 1, 1998. The Joint Board's recommendations were made pursuant to Section 254 of the 1996 Telecommunications Act, which requires the Commission to adopt universal support mechanisms that are explicit and sufficient to advance universal service principles. *See* Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996); Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Recommended Decision, FCC 96J-3 (rel. Nov. 8, 1996).

[45] The subscriber plant factor was formerly used to allocate to interstate operations certain investment in subscriber lines, station equipment, and a portion of central office switching used for message telephone service. Each company's SPF was frozen at its 1981 average level and then phased into a nationwide basic allocation

the DEM factor. The Commission then changed this rule to require that the DEM factor alone be used to divide all local switching equipment costs between the two jurisdictions.[46] The Commission decided that the change to exclusive use of the DEM allocation factor should be phased in over a five-year period from 1988 to 1992. Each year during the transition period, the allocation factor for assigning costs to the interstate jurisdiction was calculated by assigning decreasing weight to the 1987 allocator (called the "composite" allocator[47]) and increasing weight to the DEM allocator, and then summing the two weighted amounts.[48] The transition was complete at the end of 1992, and the DEM allocator alone is now used to allocate local switching equipment costs between jurisdictions.[49]

15. The Commission's price cap rules required LECs to include as an exogenous cost change the dollar effect attributable to the change in the interstate allocation formula each year.[50] In this case, this means that LECs were required to treat as an exogenous cost change the dollar effect of using the allocation formulas in effect for the current tariff period (*e.g.*, 1993-94) as

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factor of 25 percent over eight years beginning January 1, 1986. The SPF became known as the "transitional subscriber plant factor" during the phase-in period. *See* Section 36.154(c)-(f) of the Commission's rules, 47 C.F.R. § 36.154(c)-(f).

[46] *See* MTS and WATS Market Structure, Amendments of Part 67 (New Part 36) of the Commission's Rules and Establishment of a Federal-State Joint Board, 2 FCC Rcd 2639 (1987), *recon.* 3 FCC Rcd 5518 (1988); *see also* Section 36.125(b) of the Commission's rules, 47 C.F.R. § 36.125(b).

[47] *See* Section 36.125(c) of the Commission's rules, 47 C.F.R. § 36.125(c); *see also id.* (the composite allocator is a ratio of interstate central office switching equipment on December 31, 1987, to total central office switching equipment on December 31, 1987).

[48] *See* Section 36.125(c) of the Commission's rules, 47 C.F.R. § 36.125(c).

[49] *See* Section 36.125(b) of the Commission's rules, 47 C.F.R. § 36.125(b).

[50] *See* Section 61.45(d)(1)(iii) of the Commission's rules, 47 C.F.R. § 61.45(d)(1)(iii) (requiring an exogenous cost adjustment for changes in interstate costs for LECs caused by changes in the Separations Manual (*i.e.*, the interstate separations rules and procedures set forth in Part 36 of the Commission's rules)); *LEC Price Cap Order*, 5 FCC Rcd at 6807; *see also* Section 61.45(d)(3) of the Commission's rules, 47 C.F.R. § 61.45(d)(3) (requiring the price cap LECs to recognize in their annual access tariff filings exogenous cost changes "attributable to modifications during the coming tariff year . . . in their Subscriber Plant Factor and the Dial Equipment Minutes factor."); *see also LEC Price Cap Order*, 5 FCC Rcd at 6946, Appendix F (as an exception to the rule that exogenous cost changes be reflected at the time they occur, requires exogenous cost changes attributable to changes in the DEM factor and the SPF "to be reflected only yearly at the time of the annual filing"; "this treatment will avoid excessive filings by carriers"); Section 61.45(c) of the Commission's rules, 47 C.F.R. § 61.45(c) (defining the exogenous cost change as "[t]he dollar effect of current regulatory changes when compared to the regulations in effect [during the previous annual access period] . . . ., measured at base period level of operations."); Section 61.3(e) of the Commission's rules, 47 C.F.R. § 61.3(e) (defining "base period" for the price cap LECs as "the 12-month period ending six months prior to the effective date of annual price cap tariffs . . . .").

compared to the prior period (*e.g.*, 1992-93), "measured at the base period level of operations."[51] Because the LECs are to use "base period level of operations" when measuring the cost change attributable to the change in the interstate allocation formula, the LECs are required to calculate the DEM factor for purposes of the 1992-93 and 1993-94 interstate allocation formulas based upon 1992 minutes of use.[52]

16. To determine the exogenous cost change attributable to the change in the interstate allocation formulas for purposes of the 1993-94 annual access tariff year, US West calculated its interstate allocation formula for the current tariff year (*i.e.*, 1993-94) using projected minutes of use, while using 1992 minutes of use to calculate its interstate allocation formula for the prior tariff year (*i.e.*, 1992-93). In contrast, all the other price cap LECs used 1992 minutes of use in calculating their interstate allocation formulas for both the prior and the current tariff periods.

17. In the *1993 Annual Access Order*, the Bureau determined that US West's method of calculating its exogenous adjustment due to the DEM transition differed from the practice of other LECs.[53] The Bureau also found that this difference had a significant effect on US West's proposed access rates and apparently violated the Commission's rules. The Bureau therefore suspended US West's rates for one day and designated the issue of its DEM calculations as part of this investigation.

2. Positions of the Parties

18. US West asserts that, even if its DEM methodology differs from that of other LECs, it has fully complied with all Commission rules governing the exogenous treatment of DEM.[54] US West maintains that its DEM methodology has produced a rate reduction of $5.6 million more than would have been expected if exogenous treatment had not been ordered for the transitional change amounts.[55]

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[51] *See* Section 61.45(c) of the Commission's rules, 47 C.F.R. § 61.45(c); *see also* Sections 61.3(e) and 61.45(d)(1)(iii) of the Commission's rules, 47 C.F.R. §§ 61.3(e) and 61.45(d)(1)(iii).

[52] Because the LECs are required to use "base period level of operations" for purposes of calculating the cost change attributable to the change in the interstate allocation formula, the LECs are also required to apply the interstate allocation formula for the 1992-93 and 1993-94 annual access years to the LEC's 1992 (*i.e.*, base period) cost of local switching investment. The difference in the allocation of 1992 local switching investment costs due to the application of these two interstate allocation formulas is the exogenous cost change for the 1993-94 annual access tariff year.

[53] *See 1993 Annual Access Order*, 8 FCC Rcd at 4967 (noting that US West "report[ed] a reduction of $753,099 in exogenous costs, as the last step in the transition to DEM as the separations factor for local switching equipment."); *see also id.* at 496, n.90 (AT&T and MCI "stat[e] that the other BOCs have shown decreases of from $3.5 million (Pacific) to $6.0 million (BellSouth) with an average reduction of $3.57 million").

[54] US West Rebuttal at 6-7.

[55] *Id.* at 10-11; *see also* US West Rebuttal at 5.

19. US West further asserts that the Commission's rules do not define the allocator for the transition years, beyond requiring that carriers should complete the transition to DEM by January 1, 1993. US West argues that DEM is not a constant number, but changes continually as the relative number of interstate and intrastate minutes changes. Thus, US West contends, every LEC is moving toward a different allocation factor.

20. In response, AT&T and MCI assert that nothing in US West's direct case refutes the Bureau's determination in the *1993 Annual Access Order* that US West's method of calculating its exogenous amount was different from that used by other LECs and that its method did not appear to comply with the Commission's rules.[56] AT&T asserts that "US West used 1992/93 measured DEM to calculate the 1992/93 DEM allocator and then shifted position and relied on 1993/94 data to calculate the 1993/94 DEM allocator."[57] This miscalculation, AT&T asserts, resulted in the understatement of the exogenous decrease to be reported by US West for the DEM transition.[58] AT&T and MCI assert that US West has understated its reduction in exogenous costs associated with the DEM transition by approximately $5.5 million.[59]

3. Discussion

21. The Commission's rules require a LEC to recognize exogenous cost changes attributable to the transition to using the DEM factor alone as the method of allocating local switching equipment costs between interstate and intrastate jurisdictions.[60] As discussed above, during each transition year, the interstate allocation factor was computed as the weighted average of two elements. The first element was the percentage of switching costs allocated to the interstate jurisdiction as of December 31, 1987, weighted by a factor that decreased each year of the transition. The second element was the interstate DEM allocator, weighted by a factor that increased each year of the transition. Beginning with tariff year 1993-94, the transition to total reliance on DEM to allocate costs was complete.

22. As discussed above, the DEM allocator is the ratio of interstate minutes of holding time of the originating and terminating local switching equipment to total minutes of such holding time.[61] The exogenous separations event is the change in the interstate allocation formula.[62] The

[56] AT&T Opposition at 32; MCI Opposition at 33-34.

[57] AT&T Opposition at 33; *see also id.* at n. 69 (noting that US West, in its 1992 annual access tariff filing correctly "used the same 1992/93 measured DEM to calculate 1991/92 and 1992/93 DEM allocators.").

[58] AT&T Opposition at 34.

[59] AT&T Opposition at iii; MCI Opposition at 36.

[60] *See* Sections 61.45 (d)(1)(iii) and 61.45 (d)(3) of the Commission's rules, 47 C.F.R. §§ 61.45 (d)(1)(iii) and 61.45 (d)(3).

[61] *See* Section 36.125 of the Commission's rules, 47 C.F.R. § 36.125.

exogenous event is not, as US West suggests, the change in the DEM factor attributable to a change in the relative number of interstate and intrastate minutes of holding time. If there were no transition, there would be no exogenous event simply because US West's DEM factor changed. To capture the dollar effect of the change in the allocations method, it is necessary to isolate the change in costs allocated to the interstate jurisdiction attributable to our modification of the allocation formula, from the change in such costs attributable to a change in the ratio of interstate to intrastate holding time for US West.

23. Our rules required US West to hold the DEM factor constant at the base year level.[63] Thus, the LEC should have used the 1992 minutes of use as reported in its ARMIS 43-04, March 1993 report[64] to compute its interstate allocation factors for both the 1992-93 base tariff period and the tariff period under investigation. US West's methodology incorrectly treated the change in the DEM allocator itself as exogenous by using forecasted minutes of use to derive a 1993 allocation factor for purposes of its 1993-94 annual access tariff filing. This led to an understatement of the cost changes attributable to the change in the different separations formulas applied in the 1992-93 and 1993-94 tariff years. We therefore direct US West to recalculate its exogenous cost change by substituting 1992 minutes of use for the forecasted minutes of use, and to revise its price cap indices, upper limits on the service band indices in the service categories and subcategories, and maximum carrier common line rates, and to implement refunds in accordance with the directions in Section V of this Order.

C. Calculation of the "g" Factor by Bell Atlantic and SNET

1. Background

24. The LECs' common lines are loops linking the end user's premises to the LEC's central office. The actual costs of these loops are non-traffic sensitive; that is, the cost of a loop does not depend on how much it is used. Although common line costs are non-traffic sensitive, these costs are nonetheless recovered in part through per minute charges. Specifically, the LECs recover a portion of common line costs through carrier common line charges assessed on interexchange carriers and other access customers using switched, interstate access services based on minutes of use. The LECs recover the remainder of common line costs through flat rates charged to end users.[65] The rules governing how a LEC must compute interstate rates to recover

[62] *See* Section 61.45(d)(1)(iii) of the Commission's rules, 47 C.F.R. § 61.45(d)(1)(iii); *LEC Price Cap Order*, 5 FCC Rcd at 6807.

[63] *See* Section 61.45(d) of the Commission's rules, 47 C.F.R. § 61.45(d).

[64] The Commission created the Automated Reporting Management and Information System (ARMIS) in 1987 as an automated system for collecting financial and operating data from LECs with revenues over $100 million. ARMIS is composed of ten reports, including the Access Report (43-04) which shows the annual results of the jurisdictional separations and access charge rules as prescribed in Parts 36 and 69.

[65] *LEC Price Cap Order*, 5 FCC Rcd at 6793; *LEC Price Cap Reconsideration Order*, 6 FCC Rcd at 2653.

common line costs appear in Part 69 of our rules.[66] Price cap regulation treats these elements collectively in the common line basket.[67]

25. The price cap formula for the common line basket is slightly different from the formula used to cap the other baskets. This difference stems from the fact that, although actual common line costs are non-traffic sensitive, a portion of those costs is recovered through the per minute carrier common line charge.[68] In fashioning the price cap plan, the Commission sought to devise a formula for the carrier common line rates that would pass a portion of the benefits of the growth in minutes per line for the common line element to the interstate ratepayers, while allowing a LEC to continue to recover a reasonable level of common line costs and providing incentives for increased LEC productivity.[69] The carrier common line formula therefore includes a surrogate growth factor based on the LECs' historical common line demand growth *(i.e.,* growth in minutes per line) to protect ratepayers from paying common line charges that are unreasonably high in light of demand growth.[70] Changes in common line demand growth are measured by a factor known as the "g" factor. The price cap rules define the "g" factor as "the ratio of minutes of use per access line during the base period, to minutes of use per access line during the previous base period, minus 1."[71] The Commission's rules define the "base period" for price cap LECs as "the 12-month period ending six months prior to the effective date of annual price cap tariffs . . . ."[72] The higher the "g" factor, the lower the common line PCI will be.

26. In their "g" factor calculations for the 1993 annual access filings, Bell Atlantic

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[66] *See* Sections 69.103, 69.104. 69.105, 69.115 of the Commission's rules, 47 C.F.R. §§ 69.103, 69.104. 69.105, 69.115. The Commission has received several requests seeking waiver of its Part 69 rules governing how LECs must compute interstate rates to recover common line costs. These waivers request permission for certain LECs to recover all common line costs through flat rates rather than usage sensitive charges. *See* Rochester Telephone Corporation, Petition for Waivers to Implement its Open Market Plan, Order, 10 FCC Rcd 6776 (1995); *see also* Pleading Cycle Established For Comments On Ameritech's Waiver of Part 69 Rules to Establish a Pay Telephone Use Fee Rate Element, DA 95-1028, 10 FCC Rcd 8178 (1995); Pleading Cycle Established For Comments On Pacific Bell's Petition For An Interim Waiver of the Commission's Rules to Offer ISDN Equipped Access Lines Without Imposition of the End User Common Line Charge, DA 94-1302, 9 FCC Rcd 7220 (1994).

[67] *See* Section 61.42(d)(1) of the Commission's rules, 47 C.F.R. § 61.42(d)(1).

[68] *See LEC Price Cap Order,* 5 FCC Rcd at 6793 ("common line rates . . . present a unique problem, because of the important social goals and programs that have been embedded in those rates."); *LEC Price Cap Reconsideration Order,* 6 FCC Rcd at 2653-54.

[69] *LEC Price Cap Reconsideration Order,* 6 FCC Rcd at 2653-54.

[70] *See generally LEC Performance Review,* 10 FCC Rcd at 9080.

[71] *See* Section 61.45(c) of the Commission's rules, 47 C.F.R. § 61.45(c).

[72] *See* Section 61.3(e) of the Commission's rules, 47 C.F.R. § 61.3(e).

annualized its fourth quarter 1992 line count and SNET annualized its December 1992 line count instead of using the actual line count for the full calendar year 1992 base period. The "g" factor calculations of Bell Atlantic and SNET were therefore designated for investigation.

27. In its "g" factor calculations for the 1994, 1995, and 1996 annual access filings, Bell Atlantic again annualized its prior year fourth quarter (1993, 1994, and 1995, respectively) line count. The Bureau suspended Bell Atlantic's calculation of the "g" factor for purposes of its 1994, 1995, and 1996 filings for one day and incorporated them into the 1993 investigation.[73] The Bureau also ordered that Bell Atlantic's 1994, 1995, and 1996 transmittals be subject to the 1993 accounting order.[74]

2. Positions of the Parties

28. Bell Atlantic asserts that it correctly calculated the "g" factor in its annual price cap tariff filings. Bell Atlantic states that it has consistently used the end-of-year number of access lines. Bell Atlantic and SNET argue that the basis for determining minutes and lines must be consistent from year to year to avoid distortions in the PCI. Bell Atlantic contends that since all of the individual factors underlying the "g" calculations represent annualized amounts, there is no distortion in the calculation. Applied consistently over time, Bell Atlantic argues, its method leads to reasonable rates.[75] SNET asserts that there is no material difference in its "g" factor whether using a December comparison, or a comparison based on annual figures. This conclusion notwithstanding, SNET expresses a willingness to use the full year methodology if the Commission so requires.[76]

29. AT&T responds that the Commission should not permit SNET and Bell Atlantic to perpetuate an erroneous practice merely for the sake of preserving historical consistency for those carriers. AT&T argues that the carriers' reliance on a partial year's line count data to develop their "g" factors has resulted in substantial overstatements of their common line basket PCIs. According to AT&T, Bell Atlantic's PCI was overstated by $5.45 million, while SNET's price cap for that basket was overstated by $104,000.[77] AT&T argues that relying on partial year data could impede administration and enforcement of the LEC price cap plan because it is impossible to validate the accuracy of Bell Atlantic's and SNET's "g" factor computations from the full

[73] *First 1994 Annual Access Order*, 9 FCC Rcd at 3742-43; *1995 Price Cap Carriers' Annual Access Order*, 11 FCC Rcd at 5494-95; *1996 Annual Access Order*, 11 FCC Rcd at 7588.

[74] *First 1994 Annual Access Order*, 9 FCC Rcd at 3742-43; *Price Cap Carriers' 1995 Annual Access Order*, 11 FCC Rcd at 5494-95; *1996 Annual Access Order*, 11 FCC Rcd at 7588.

[75] Bell Atlantic Direct Case at 11-13; *see also* SNET Direct Case at 9; SNET Rebuttal at 8.

[76] *Id.* at 10; *see also* SNET Direct Case at 8-10; SNET Rebuttal at 7.

[77] AT&T Opposition at 26-27.

annual line count data reported in tariff review plans (TRPs) for these tariff filings.[78]

3. Discussion

30. We find that SNET (in its 1993 annual access filing) and Bell Atlantic (in its 1993, 1994, 1995, and 1996 annual access filings) incorrectly calculated the "g" factor. Section 61.45(c) of the rules, as previously stated, defines "g" as "the ratio of minutes of use per access line during the base period,[79] to minutes of use per access line during the previous base period, minus 1."[80] Revenues included in the PCI calculation are based on an entire year period. The various factors in the PCI formula should therefore be defined using similar periods to avoid distortions based on seasonal variations. Thus, a count of access lines in the appropriate year should reflect the average line count "during the base period" year instead of the line count during some portion of the year. Use of partial year data creates the risk that seasonal fluctuations in demand occurring during the year will skew the PCI calculations. Full year data are required to avoid this risk. We note that a full year's average should be used in both the base year and the prior base year to avoid the inaccuracy that would occur if data from different periods were used to calculate average line counts in the two years. We therefore direct Bell Atlantic and SNET to correct their "g" calculations, and to revise their price cap indices, upper limits on the service band indices in the service categories and subcategories, and maximum carrier common line rates, and to implement refunds in accordance with the directions in Section V of this Order.

D. Bell Atlantic's and Pacific Bell's Omission of End User Revenues from the Common Line Basket for Sharing Purposes

1. Background

31. Under the rules in effect at the time of the 1993 and 1994 annual access filings, price cap LECs electing the 3.3 percent productivity factor were permitted to retain all of their earnings up to 12.25 percent, but were required to share 50 percent of their earnings between 12.25 percent and 16.25 percent, and 100 percent of their earnings in excess of 16.25 percent. LECs selecting the 4.3 percent productivity factor were permitted to retain all of their earnings up to 13.25 percent, but were required to share with their customers 50 percent of their earnings between 13.25 percent and 17.25 percent, and 100 percent of their earnings in excess of 17.25 percent. Under the LEC price cap sharing mechanism, the customer's share plus interest is effectuated through a one-time reduction in the PCI for the next rate period, calculated in the

[78] *Id.* at 27; *accord* Allnet Comments at 8-9.

[79] *See* Section 61.3(e) of the Commission's rules, 47 C.F.R. § 61.3(e) (defining "base period" for the price cap LECs as "the 12-month period ending six months prior to the effective date of annual price cap tariffs . . .").

[80] *See* Section 61.45(c) of the Commission's rules, 47 C.F.R. § 61.45(c).

same manner as other exogenous changes in the formula.[81] On the other hand, the low-end adjustment mechanism entitled carriers whose earnings dropped below 10.25 percent to retarget rates to that level in the following tariff year. Together, these adjustments were safeguards against possible errors the Commission may have made in setting the productivity factor.[82] Section 61.45(d)(4) of the Commission's rules[83] requires carriers to allocate exogenous cost changes, such as sharing adjustments, among price cap baskets on a "cost-causative" basis.[84]

32. In its 1993 annual access tariff filing, Bell Atlantic subtracted end user revenues (also known as subscriber line revenues) from total common line basket revenues for purposes of allocating sharing amounts among the four price cap baskets. In the *1993 Annual Access Order*, the Bureau designated the issue of whether this action by Bell Atlantic was correct. In its direct case filed in response to the *1993 Annual Access Order*, Pacific stated that Pacific Bell (but not Nevada Bell) also omitted end user revenues from the common line basket for purposes of allocating sharing amounts among price cap baskets.[85]

33. In their 1994, 1995, and 1996 annual access tariff filings, Bell Atlantic and Pacific Bell again subtracted end user revenues from total common line basket revenues for purposes of allocating sharing amounts among the four price cap baskets.[86] In the *1994 Annual Access Orders* , the *Price Cap Carriers' 1995 Annual Access Order*, and the *1996 Annual Access Order*,

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[81] *LEC Price Cap Order*, 5 FCC Rcd at 6788, 6801-02, 6805; *LEC Price Cap Reconsideration Order*, 6 FCC Rcd at 2686.

[82] *LEC Price Cap Order*, 5 FCC Rcd at 6801-02; *LEC Price Cap Reconsideration Order*, 6 FCC Rcd at 2686. In March 1995, the Commission revised its price cap plan to continue the sharing requirement and the low-end adjustment for LECs that select the two lower productivity factors (*i.e.*, the 4.0 and 4.7 percent productivity factors which replaced the 3.3 and 4.3 percent productivity factors), but established significantly more strict sharing obligations for those lower options. LECs selecting the 4.0 percent productivity factor must share 50 percent of their earnings from 12.25 percent up to and including 13.25 percent and to share 100 percent of their earnings above 13.25 percent. LECs selecting the 4.7 percent option must share 50 percent of their earnings from 12.25 percent up to and including 16.25 percent and to share 100 percent of their earnings above 16.25 percent. LECs selecting the highest option (*i.e.*, the 5.3 percent productivity factor) incur no sharing obligations and are not entitled to a low-end adjustment). *LEC Performance Review*, 10 FCC Rcd at 8970-71.

[83] *See* Section 61.45(d)(4) of the Commission's rules, 47 C.F.R. § 61.45(d)(4).

[84] *LEC Price Cap Order*, 5 FCC Rcd at 6801 (Under the sharing adjustment mechanism, "[t]he customer share plus interest will be returned in the form of a one-time reduction in the PCI for the next rate period, calculated in the same manner as other exogenous changes in the formula."); *see also LEC Price Cap Reconsideration Order*, 6 FCC Rcd at 2675; *see also id.* at 2691 n.166 (low-end adjustments will be one-year adjustments "in keeping with the one-year adjustments made to effect sharing"); *see also* Sections 61.45(d)(1)(vii) and 61.45(d)(2) of the Commission's rules, 47 C.F.R. §§ 61.45(d)(1)(vii) and 61.45(d)(2).

[85] Pacific Direct Case at 9 n.20.

[86] *First 1994 Annual Access Order*, 9 FCC Rcd at 3715; *Second 1994 Annual Access Order*, 9 FCC Rcd at 3526; *Price Cap Carriers' 1995 Annual Access Order*, 11 FCC Rcd at 5488-90; and *1996 Annual Access Order*, 11 FCC Rcd at 7581.

the Bureau found that the exclusion of subscriber line revenues from the computation that allocates the sharing obligation among different baskets was one of the issues designated for investigation in CC Docket No. 93-193, suspended Bell Atlantic's and Pacific Bell's 1994, 1995, and 1996 tariffs for one day, and incorporated them into the tariff investigation in CC Docket No. 93-193. The Bureau also ordered that Bell Atlantic's and Pacific Bell's 1994, 1995, and 1996 transmittals be subject to the accounting order in CC Docket 93-193.[87]

2. Positions of the Parties

34. In its direct case, Bell Atlantic argues that sharing was incorporated in the price cap rules for two purposes: (1) to function as a safety mechanism, if the Commission's productivity factor was set incorrectly; and (2) to share with customers the benefits of interstate earnings above designated levels. Bell Atlantic asserts that end user rates are based on forecasted costs and demand and, unlike other rates, "are not affected by the Price Cap indices, including the productivity factor."[88] Bell Atlantic maintains that, because sharing amounts are based on productivity gains, "allocating sharing amounts on revenues that are not affected by productivity is not a cost-causative approach."[89]

35. Pacific states that the Commission's price cap rules and its decisions do not specify in detail how sharing is to be allocated because the sole criterion is that sharing must be allocated on a cost-causative basis.[90] Pacific maintains that to allocate sharing based on all interstate revenues, including end user subscriber line revenues, would assign 63 percent of the total sharing amount to common line, which, excluding the end user revenues, generates only 16 percent of the total interstate revenues. This result, according to Pacific, violates the Commission's rules that amounts be allocated on a cost-causative basis.[91]

36. AT&T and Allnet argue that the Bureau's *1992 Annual Access Order* rejected a similar attempt by Bell Atlantic and others to target their sharing allocations to particular access services that the LECs claimed had contributed most to productivity gains.[92] AT&T asserts that the Commission should conclude that Bell Atlantic's and Pacific's PCIs based upon the exclusion

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[87] *First 1994 Annual Access Order*, 9 FCC Rcd at 3715; *Second 1994 Annual Access Order*, 9 FCC Rcd at 3526; *1995 Price Cap Carriers' Annual Access Order* at para. 68; and *1996 Annual Access Order*, 11 FCC Rcd at 7581-82.

[88] Bell Atlantic Direct Case at 11.

[89] Bell Atlantic Direct Case at 11; *accord* Ameritech Direct Case at 7; Pacific Direct Case at 10; US West Direct Case at 11-12; Pacific Rebuttal at 4-5.

[90] Pacific Direct Case at 9, *citing* 47 C.F.R. § 61.45(d)(4).

[91] Pacific Rebuttal at 4.

[92] AT&T Opposition at 29-30 and Allnet Comments at 6-8, *citing* 1992 Annual Access Tariff Filings, CC Docket No. 92-141, 7 FCC Rcd 4731, 4733 (Com. Car. Bur. 1992) (*1992 Annual Access Order).*

of end user revenues from their sharing allocation are unreasonable, and require carriers to recompute those indices following correct assessment of cost causation.[93]

3. Discussion

37. Bell Atlantic and Pacific Bell maintain that end-user revenues should be removed from the common line basket before a carrier calculates the basket revenue allocators (each basket's revenue as a percent of the total revenue) used to allocate sharing among the baskets. Bell Atlantic and Pacific argue that end-user charges are designed to earn the LEC a net return of 11.25 percent, the prescribed rate, and thus a sharing obligation is irrelevant because sharing is based on earnings in excess of 12.25 percent. Their basket-by-basket approach to sharing has been rejected by the Commission in the *LEC Price Cap Order* and *LEC Price Cap Reconsideration Order*.[94] The sharing mechanism was created as a backstop to the price cap plan as a whole and is based on overall interstate earnings rather than individual rates or basket earnings. This unitary approach to sharing is consistent with the unitary productivity X-factor, that is based on the overall performance of the interstate access market.[95]

38. Section 61.45(d)(4) of the Commission's rules provides that exogenous cost changes, such as sharing adjustments, shall be allocated among the price cap baskets on a cost-causative basis.[96] Basket revenues in appropriate circumstances can be used as a proxy for costs.[97] To exclude EUCL revenues from the common line basket distorts the use of revenues as a proxy for costs because total revenues would not used. Therefore, we reject Pacific and Bell Atlantic's contention that EUCL revenues may be excluded for purposes of allocating sharing amounts.

39. For these reasons, we conclude that Bell Atlantic in its 1993, 1994, 1995, and 1996 annual access tariff filings, and Pacific, in its 1994, 1995, and 1996 annual access tariff filings, by excluding end user revenues from their calculations, have incorrectly allocated their sharing obligations among the various service baskets. We therefore direct Bell Atlantic and Pacific Bell to correct how they allocate their sharing adjustments among baskets, and to revise their price

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93 *Id.* at 30; *accord* Allnet Comments at 7-8.

94 *See LEC Price Cap Order*, 5 FCC Rcd at 6805 and *LEC Price Cap Reconsideration Order*, 6 FCC Rcd at 2677-2680.

95 *LEC Price Cap Order*, 5 FCC Rcd at 6805.

96 *See* Section 61.45(d)(4) of the Commission's rules, 47 C.F.R. § 61.45(d)(4).

97 The 1992 annual access filing was the first time the LECs proposed sharing and low-end adjustments to the price cap indexes. The Bureau determined that basket revenue can be used as a proxy for costs, "because rates are set based on costs, revenues should equal costs." The Bureau found further that allocating sharing adjustments among the price cap baskets on the basis of basket revenues not only "most closely comports with the goals of the Commission's price cap plan[,] but "is most consistent" with the requirement that the carriers calculate their sharing obligation on the basis of total interstate revenues). *See 1992 Annual Access Order*, 7 FCC Rcd at 4732-33, n.4.

cap indices, upper limits on the service band indices in the service categories and subcategories, and maximum carrier common line rates, and to implement refunds in accordance with the directions in Section V of this Order.[98]

40. Although the issue was not designated for investigation, we also find unlawful Pacific's method of allocating its sharing obligations in its 1993 annual access filing, in the facts of this particular case, because it is the same method used by Pacific Bell in its 1994, 1995, and 1996 annual access filings, and by Bell Atlantic in its 1993, 1994, 1995, and 1996 annual access filings.[99] We do not direct Pacific to make a refund for incorrectly allocating its sharing obligations in its 1993 annual access tariff filing because under Section 204(a)(1), the rates must be suspended before refunds can be ordered and the Commission did not suspend Pacific's rates with respect to this issue in its 1993 annual filing for its sharing adjustments.[100]

41. In the *Second 1994 Annual Access Order*, the Bureau stated that, after the termination of the 1993 investigation and prior to the termination of the 1994 investigation, we would permit Pacific to present any legal argument or factual circumstances that might lead us to conclude that the decisions reached in CC Docket No. 93-193 on sharing allocation issues should not control our treatment of Pacific Bell's 1994 access transmittals.[101] As noted above, the issue raised by Pacific's 1994 annual access tariff filing (*i.e.*, whether our price cap rules permit the exclusion of subscriber line revenues from the computation of revenues used to allocate the sharing obligation among baskets) is the same issue raised by Bell Atlantic's 1993 (and 1994, 1995, and 1996) annual access tariff filings and designated for investigation in CC Docket No. 93-193. Pacific filed comments and replies in CC Docket No. 93-193 addressing this issue in response to the *1993 Annual Access Order*.[102]

42. We find that Pacific has had sufficient opportunity to present evidence and argument on this issue and, in fact, has done so. As discussed above, Pacific has failed to persuade us that the LECs should be permitted to exclude end user revenues from the common line basket for the

[98] In order to correct fully its method of allocating sharing amounts among the four price cap baskets when including EUCL revenues in the common line basket, Bell Atlantic must also correct its calculations for the reversal of sharing for its 1996 annual access tariff filing.

[99] *See* Pacific Bell Direct Case at 9, n.20 (stating that, in its 1993 annual access tariff filing, Pacific Bell, like Bell Atlantic in its 1993 annual access tariff filing, omitted end user revenues from the common line basket for sharing purposes).

[100] *See* Section 204(a)(1) of the Communications Act of 1934, 47 U.S.C. § 204(a)(1). *See Illinois Bell Telephone Co. v. FCC*, 966 F.2d 1478 (D.C. Cir. 1992); *The Ohio Bell Telephone Co. v. FCC*, 949 F.2d 864 (D.C. Cir. 1991); *New England Telephone and Telegraph Co. et al. v. FCC*, 826 F.2d 1101 (D.C. Cir. 1987). We also note that the two-year statute of limitations for filing complaints has expired pursuant to Sections 208 and 415 of the Communications Act of 1934, as amended. *See* 47 U.S.C. § § 208, 415.

[101] *Second 1994 Annual Access Order*, 9 FCC Rcd at 3526.

[102] *See* Pacific Comments at 9-10; *see* Pacific Reply at 4-5; *see also supra* Section II.D.2.

allocation of sharing adjustments. For these reasons, and because the issue presented is precisely the same for each year, we believe it is unnecessary to provide Pacific further opportunity to comment, and we resolve our investigation of this issue for purposes of Pacific Bell's 1994, 1995, and 1996 annual access filings.

E. General Support Facility Costs

1. Background

43. On May 19, 1993, the Commission released an order adopting rules correcting the misallocation of GSF investment and related expenses among the access categories in Part 69. GSF investment includes items such as land, buildings, computers, motor vehicles, and furniture that support the operations of the carrier.[103] Prior to the *GSF Order*, the Commission required LECs to exclude GSF investment from the common line category, which increased the GSF allocation to the other Part 69 categories. The *GSF Order* modified the Commission's rules to require that GSF investment also be allocated to the common line category. The Commission held that the exclusion of the common line category from the formula for allocating GSF investment resulted in an under-allocation of GSF investment to the common line category and an over-allocation of such investment to other access categories.[104] The Commission also concluded that price cap LECs should be allowed to treat as exogenous the reallocation of GSF costs and that these LECs should adjust their PCIs to reflect the reallocation.[105] The *GSF Order* directed the LECs to file tariff revisions reflecting the effect of the changed allocation process on fourteen days' notice, to become effective July 1, 1993, the same date their 1993 annual access tariff filings were to go into effect. The LECs filed their transmittals reflecting the tariff revisions on June 17, 1993. During its review of the LECs' annual access tariff filings, the Bureau considered the GSF tariff filings. The Bureau noted that petitions to suspend or reject the GSF filings were due at virtually the same time that the Bureau was to release the *1993 Annual Access Order*. Because it had only limited time to review the GSF filings, the Bureau concluded that it should initiate an investigation to permit a more thorough review to determine whether these filings comply with the Commission's *GSF Order*. The Bureau therefore suspended tariffs filed pursuant to the *GSF Order* for one day and imposed an accounting order.[106]

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[103] Amendment of the Part 69 Allocation of General Support Facility Costs, 8 FCC Rcd 3697 (1993) (*GSF Order*).

[104] *GSF Order*, 8 FCC Rcd at 3697.

[105] *Id.* at 3700.

[106] *1993 Annual Access Order*, 8 FCC Rcd at 4973.

2. Positions of the Parties

44. The LECs that refiled their 1993 access rates[107] based on the GSF reallocation assert that they reallocated their GSF costs properly and that the resulting rates are just and reasonable.[108] Sugar Land Telephone Company (Sugar Land), a LEC that participates in NECA's common line pool but files its own traffic sensitive tariff pursuant to Section 61.39, states that its GSF costs were properly reallocated and that the revised rates were developed for the biennial period from July 1, 1993 to June 30, 1995 as required by the *GSF Order*. Moreover, Sugar Land states that the impact of the reallocated GSF costs resulted in a decrease in its traffic sensitive switched and special access rates consistent with the *GSF Order*.[109] Bay Springs *et al.*, also assert that their rates were properly adjusted by applying the GSF costs reallocations to their actual historical costs pursuant to the *GSF Order*.[110]

45. AT&T asserts that the 26 companies that participate in the NECA common line pool, but file their own traffic sensitive rates based on historical costs pursuant to Section 61.39, received the benefits of the increase in the NECA common line charge due to the requirements of the *GSF Order*, but did not simultaneously reduce their traffic sensitive rates as also required by the *GSF Order*.[111] AT&T maintains that these 26 companies are receiving an unwarranted

[107] The Commission allowed the price cap LECs to treat as exogenous the reallocation of costs ordered in the *GSF Order*. *GSF Order*, 8 FCC Rcd at 3700-01. The Commission ordered the changes to be reflected in the LECs' 1993 annual access tariffs that were filed on April 2, 1993. *Id.* at 3701. Because the *GSF Order* was adopted and released on May 7, 1993 and May 19, 1993, respectively *(i.e.*, after the LECs filed their 1993 annual access tariffs), the LECs were required to refile their 1993 annual access tariffs to reflect the cost change.

[108] Alltel Direct Case at 3-4; Ameritech Response at 8; Ameritech Rebuttal at 8 and 10; ATU Direct Case at 1-2; Bell Atlantic Direct Case at 13; BellSouth Rebuttal at 9-10; Century Direct Case at 1-2; *accord* Chillicothe Direct Case at 2; Cincinnati Direct Case at 3-6; Cincinnati Supplemental Comments at 1-2; Concord Direct Case at 2; Dunkirk & Fredonia Direct Case at 2; GTE Direct Case at 30-31; Granite State Direct Case at 1-2; GVNW Direct Case at 1-2; ITC Direct Case at 1-2; Lincoln Direct Case at 3; Lufkin-Conroe Direct Case at 2; Merrimack Direct Case at 2; NECA Direct Case at 4-5; Ogden Direct Case at 2; NYNEX Direct Case, Exhibit 3, at 8-11; Rhinelander Direct Case at 1-3; Rochester Direct Case at 13-14; Roseville Direct Case at 14-16; SNET Direct Case at 10-11; Southeast Direct Case at 1-3; Southwestern Direct Case at 50-51; United Direct Case at 3; Utelco Direct Case at 1-2; US West Direct Case at 13; Vitelco Direct Case at 1-2; Warwick Valley Direct Case at 2-3; Wilkes Direct Case at 2-3; Wood County Direct Case at 2-3; see also Pacific Direct Case at 11.

[109] Alltel Service Corp. filing on behalf of Sugar Land Telephone Company Direct Case at 1-4.

[110] Bay Springs *et al.* Direct Case at 2-4.

[111] AT&T Opposition at 36. AT&T lists the twenty-six companies: Ayershire IA, Bloomingdale IN, Cass County IL, Chickamauga GA, Citizens-MO, City of Brookings SD, Coastal Utilities GA, Dubois WY, East Ascension LA, El Paso IL, Farmers Tel. SC, Gridley IL, Hargray SC, Horry SC, Leaf River IL, Merchants and Farmers IN, Millington TN, Mt. Horeb WI, Northwest IA, Northwest IN, Odin IL, Pineland GA, Sierra CA, Southeast WI, Union WY and Webb-Dickens IA.

double recovery of approximately $3.4 million because of this failure.[112] AT&T argues that although NECA may have no authority to compel these 26 companies to file tariffs that reflect the appropriate traffic sensitive reductions, NECA must still make reasonable efforts to ensure that all LECs in the NECA pool comply with the Commission's rules. Finally, AT&T argues that if LEC data submitted to NECA do not comply with the Commission's rules, NECA must correct the data in its revenue requirement computations. AT&T claims that NECA is obligated by Commission order to adjust the common line revenue requirement to eliminate the $3.4 million double recovery.[113]

46. NECA contends that AT&T would have the Commission contradict its own rules regarding the allocation of GSF related costs to the common line category.[114] Further, although NECA states that it does not dispute AT&T's claim that it has the responsibility to ensure that the Commission's rules are followed as they relate to the revenue requirement and revenue distribution processes of its tariff participants, NECA claims that its filing does reflect the accurate common line revenue requirement data. NECA argues, however, that it does not have the authority to withhold common line payments to LECs that have provided accurate common line revenue requirements in accordance with Commission rules.[115]

47. Among the LECs identified by AT&T that allegedly double recovered GSF costs, Coastal *et al.* (Coastal),[116] the LECs represented by GVNW, Inc./Management (GVNW),[117] and the City of Brookings Municipal Telephone filed rebuttals. Coastal and GVNW argue that the small LECs that participate in NECA's common line pool but file their own traffic sensitive tariffs,[118] were not required to retroactively apply the changes in the GSF reallocation which became effective on July 1, 1993, subsequent to the historic period ending December 31, 1992, upon which their 1993 traffic sensitive rates were based.[119] GVNW asserts that the GSF changes

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[112] *Id.* at 35-36.

[113] *Id.* (*citing* Safeguards to Improve the Administration of the Interstate Access Tariff and Revenue Distribution Process, 8 FCC Rcd 1503 (1993)).

[114] NECA Rebuttal at 2.

[115] NECA Rebuttal at 3.

[116] *See infra* Appendix A.

[117] GVNW Direct Case at 1-3. GVNW files tariffs pursuant to Section 61.39 on behalf of the issuing carriers: Ayershire IA, Cass County IL, Citizens-MO, Dubois WY, East Ascension LA, El Paso IL, Gridley IL, Leaf River IL, Sierra CA, Union WY and Webb-Dickens IA. *See* Letter from GVNW to William F. Caton, Acting Secretary, FCC, Sept. 10, 1993, filed in CC Docket No. 93-193.

[118] *See* Section 61.39 of the Commission's rules, 47 C.F.R. § 61.39.

[119] Coastal, *et al.* Rebuttal at 1-5 and GVNW Direct Case at 3.