will be slower in rural areas, and so the market-based approach would be less effective in rural areas than in urban areas.[513]

151. Competition Policy Institute recommends imposing prescriptive measures simultaneously with market-based regulatory reforms. In addition to increasing the X-Factor and reinitializing PCIs, Competition Policy Institute suggests that the Commission: (1) facilitate the provision of unbundled elements;[514] (2) adopt a time frame for a transition of access charges to economic cost; and (3) annually review the progress of access charges toward economic cost, with the possibility of imposing additional prescriptive rate reductions if required.[515] AT&T argues that since whatever benefits of permitting incumbent LECs additional pricing flexibility do not relate to the levels of access charges, if the Commission insists on permitting additional pricing flexibility, it could do so in conjunction with the prescriptive approach.[516]

152. *Price Squeeze Concerns.* Some IXCs and AARP *et al.* are concerned that BOCs might cross-subsidize long-distance service with access revenues when they are permitted to enter the long-distance market pursuant to section 271, or engage in a price squeeze, unless we adopt a prescriptive approach.[517]

153. A number of incumbent LECs deny that any prescriptive measures are needed to prevent price squeezes because it is almost impossible to engage in a price squeeze profitably.[518] Moreover, the Communications Act or Commission regulations adequately

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[513] AT&T Comments at 47-48.

[514] Specifically, Competition Policy Institute recommends the following: (1) eliminating the application of access charges to unbundled network elements; (2) monitoring state pricing decisions regarding unbundled network elements for consistency with TELRIC pricing standards; (3) minimize logistical barriers to the provisioning of unbundled network elements; (4) requiring subloop unbundling; (5) establishing an expedited complaint process available to unbundled network element purchasers; (6) periodic performance audits or surveys of the RBOCs' provisions of unbundled network elements; and (7) additional deaveraging of unbundled network element prices. Competition Policy Institute Comments at 26.

[515] Competition Policy Institute Comments at 25-27. *See also* GSA/DOD Comments at 13-15, 20-25; GSA/DOD Reply at 13-17; *NTIA Letter* at 4.

[516] AT&T Comments at 21.

[517] ACC Long Distance Comments at 9; AT&T Comments at 13-17 and Attachment A at 12, 20; Telco Communications Group Comments at 2-4; MCI Comments at 10-11, 14, 41; and Attachment at 12-13; Excel Comments at 4-5; AARP *et al.* Comments at 9-10; LCI Reply at 3-4.

[518] Ameritech Comments at 48; ALTS Reply at 18-19; Ameritech Reply at 22-23; BA/NYNEX Reply at 13; GTE Reply at 36; PacTel Reply at 19; U S West Reply at 10; USTA Reply at 31-32, Attachment 1 at 18, Attachment 3 at 13.

protect against price squeezes.[519] BellSouth also claims that, as long as it sets prices below "general market levels or the costs of a firm's competitors," it has not legally engaged in a price squeeze.[520] U S West argues that the relevant factor for determining whether a carrier has committed a price squeeze is not the price level, but the margin between price and cost.[521] Alternatively, ALTS asserts that incumbent LECs have sufficient funds to finance price squeezes regardless of whether we adopt a prescriptive approach to access reform.[522] USTA argues that AT&T presents a similar threat of cross-subsidization of local service with long-distance revenues.[523] USTA also alleges that AT&T is seeking to limit competitive entry into the long-distance market.[524] Ameritech asserts that prescribing access rates that are too low might place competitive LECs that rely on unbundled network elements in a price squeeze.[525]

154. *Cross-Subsidization Concerns.* MCI argues that price cap regulation by itself does not eliminate incumbent LEC incentives to engage in anticompetitive cross-subsidization that might occur under a market-based approach.[526] NCTA advocates a prescriptive approach to protect against incumbent LEC cross-subsidization of video or other new services.[527] Similarly, many commenters argue that excessive access charges enable incumbent LECs to cross-subsidize any present or future competitive service.[528] The Texas Commission asserts

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[519] Ameritech Reply at 22; BellSouth Comments at 18, *citing* 47 U.S.C. §§ 272(e)(3), 201, 202, 272(d); ALTS Reply at 17-18, 21; BA/NYNEX Reply at 12-13 and Attachment 1 at 2; GTE Reply at 35-36; PacTel Reply at 20-21; SWBT Reply at 32-34; USTA Reply at 31 and Attachment 3 at 12; U S West Reply, Attachment A at 4-5.

[520] BellSouth Comments at 18, *citing Brooke Group v. Brown & Williamson*, 509 U.S. 209, 223 (1993). *See also* USTA Reply, Attachment 1 at 17.

[521] U S West Reply, Attachment A at 4, *citing United States v. Aluminum Company of America*, 148 F.2d 416 (2nd Cir. 1945).

[522] ALTS Reply at 17.

[523] USTA Reply, Attachment 1 at 15-16.

[524] USTA Reply, Attachment 1 at 18.

[525] Ameritech Reply at 22-23.

[526] MCI Comments, Attachment at 10-13.

[527] NCTA Comments at 9.

[528] AT&T Comments, Attachment A at 9; Ad Hoc Comments at 39-41; GSA/DOD Reply at 15; TCI Reply at 23-24. CompTel argues that the Section 254(k) prohibition against cross-subsidization requires the Commission to prescribe TSLRIC-based rates. CompTel Reply at 10.

that it would be difficult to craft accounting rules to prevent incumbent LECs from cross-subsidizing with respect to multiple services in multiple geographical areas.[529]

155. The Georgia Commission recommends that whatever approach we adopt enable the incumbent LEC to recover all its prudently incurred costs rather than trying to shift costs to the intrastate jurisdiction. The Georgia Commission asserts that our first priority should be to facilitate competitive entry, and that price level regulation should be limited to monopoly services, to ensure that monopoly service prices are not too high or used to cross-subsidize competitive services.[530]

156. *Relative Administrative Burdens of the Possible Approaches.* Some parties argue that determining the extent of competition for each relevant market under the market-based approach would be more burdensome than any of the requirements of the prescriptive approach.[531] Cable & Wireless argues that the litigation surrounding the Phase 1 and Phase 2 determinations, the different negotiated agreements that will be adopted in each state, and the results of the court's review of the *Local Competition Order*, will result in a "patchwork" of different regulatory requirements, which would increase uncertainty in the market.[532]

157. A few parties maintain that the prescriptive approach would be unreasonably burdensome.[533] Teleport argues that a prescriptive approach might require annual reviews to verify that access rates were in fact moving towards costs.[534] ACC Long Distance denies that a prescriptive approach would be burdensome because it maintains that the Commission has substantial experience with such regulation.[535] A number of commenters assert that the prescriptive approach would increase regulatory control over the market, and therefore be

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[529] Texas Commission Comments at 25-26.

[530] Georgia Commission Reply at 5-7.

[531] Excel Comments at 9-10; Florida Commission Comments at 4-5.

[532] Cable & Wireless Comments at 25-26. *See also* Intl. Comm. Ass'n Comments at 2-3; Kansas Commission Comments at 7-8.

[533] Illinois Commission Comments at 23-25; BellSouth Comments at 42; PacTel Comments at 28-29; ALTS Reply at 15-16; Ameritech Reply, Attachment A at 10; GTE Reply at 42; PacTel Reply at 13-14; USTA Reply at 12.

[534] Teleport Reply at 31-32.

[535] ACC Long Distance Reply at 6.

inconsistent with the 1996 Act.[536] AT&T replies that both the prescriptive and market-based approaches would retain price cap regulation initially, and so there is no reason to call one more regulatory than the other.[537]

158. *Prescriptive Measures Tailored for Insular or High-Cost Areas.* The Northern Marianna Islands support the prescriptive approach because it would enable the Commission to tailor access charge reforms to the unique circumstances faced in insular or high-cost areas such as the Northern Marianna Islands.[538] Alternatively, the Alaska Telephone Association argues that a market-based approach would better reflect local economic conditions, and so can be tailored to reflect the concerns of both large and small incumbent LECs.[539]

B. Prescriptive Approaches

1. Prescription of a New X-Factor

159. According to USTA, productivity estimates based on historical studies overstate the productivity potential of price-cap LECs under competition.[540] According to USTA, as incumbent LECs lose customers to competition, their output will decline, and as a result their measured productivity will decline. Therefore, USTA recommends basing the X-Factor on a five-year moving average of the TFP, so that reductions in productivity resulting from competition would be reflected in the X-Factor.[541] USTA claims that the TFP differential (TFP of LECs minus TFP for US economy as whole) is 2.7 percent, and will decrease by 0.4 percentage points each year if the Commission adopts USTA's recommendations for restructuring the CCL charge and the TIC.[542] Most incumbent LECs support USTA.[543]

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[536] BellSouth Comments at 41; PacTel Comments at 5; USTA Comments at 11-12; TDS Comments at 29-31; SWBT Comments at 23-24; U S West Comments at 44-45; Aliant Comments at 3-4; Citizens Utilities Comments at 15. *See also* SNET Comments at 26.

[537] AT&T Reply at 18.

[538] Northern Marianna Islands Comments at 11-12.

[539] Alaska Telephone Association Comments at 2.

[540] USTA Comments at 19.

[541] USTA Comments at 20.

[542] USTA Comments at 21. *See also* USTA Reply at 41-42; US West Comments at 46-49; SWBT Reply at 37.

[543] BA/NYNEX Comments at 58-60; BellSouth Comments at 50 n.93; SNET Comments at 28-30; U S West Comments at 46-49; Aliant Reply at 3-4; BellSouth Reply at 41-42; SNET Reply at 24-25.

BA/NYNEX argues that productivity growth will decrease as a result of competition unleashed by the 1996 Act, and so basing the X-Factor on a five-year moving average TFP would likely overstate future achievable productivity.[544] Alternatively, BA/NYNEX argues that we could rely on a fixed TFP-based X-Factor for a short period of time, until Bell competition will enable us to deregulate incumbent LECs completely.[545] GTE and SNET contend that growth in competition and recovering more costs through flat rather than usage sensitive rates, will likely depress measured TFP growth.[546]

160. AT&T notes that it recommended at least 8.8 percent in its pleadings filed in response to the *Price Cap Fourth Further NPRM*.[547] Several commenters recommend setting the X-Factor at 9.9 percent, on the basis of the pleadings of the CARE Coalition filed in response to the *Price Cap Fourth Further NPRM* proceeding.[548] Ad Hoc also recommends increasing the X-Factor for the reasons it explained in its comments in the *Price Cap Fourth Further NPRM*.[549] MCI also supports increasing the X-Factor to 9.9 percent, but only for five years, after which MCI argues that the X-Factor should be based on TFP.[550] A number of price cap LECs maintain that the X-Factors recommended by AT&T and MCI greatly exceed their actual productivity growth under price cap regulation.[551] USTA has identified several purported computational and methodological errors in AT&T's, MCI's, and Ad Hoc's X-Factor proposals in its pleadings filed in response to the *Price Cap Fourth Further NPRM*.[552] Ad Hoc recommends making any fundamental changes to price cap regulation in the price cap proceeding, and focusing on access reform in this proceeding.[553] According to GTE, AT&T and Ad Hoc maintain that incumbent LECs' interstate productivity is greater than their

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[544] BA/NYNEX Comments at 59. *See also* U S West Comments at 46

[545] BA/NYNEX Comments at 59; BA/NYNEX Reply at 29-30.

[546] GTE Comments at 57-58; SNET Reply at 25-26.

[547] AT&T Comments at 70. In its reply, AT&T increases its X-Factor recommendation to 9.0 percent, on the bases of updated data. AT&T Reply at 35 and Attachment G.

[548] API Comments at 27-28; ICA Comments at 4; WorldCom Comments at 91; API Reply at 18.

[549] Ad Hoc Comments at 70; Ad Hoc Reply at 7-14. Ad Hoc also replies that its *Price Cap Fourth Further NPRM* pleadings discredited USTA's X-Factor studies. Ad Hoc Reply at 9-14.

[550] MCI Comments at 25.

[551] BellSouth Comments at 50; BA/NYNEX Reply at 27-29; SWBT Reply at 37-39; Aliant Reply at 3.

[552] USTA Reply at 42-44. *See also* BA/NYNEX Reply at 30-31.

[553] Ad Hoc Reply at 7-8.

intrastate productivity, and included in their X-Factor recommendations an interstate TFP adjustment to account for this alleged difference in productivity. GTE further opposes any interstate TFP adjustment, because there incumbent LECs provide interstate and intrastate services using the same network, and so it would make no economic sense to assume that interstate productivity is greater than intrastate productivity.[554]

161. PacTel and Aliant propose setting the X-Factor equal to GDP-PI.[555] Sprint argues that the Commission should discontinue the use of the current productivity factor for all baskets except common line, once all access charges have been reduced to geographically deaveraged TELRIC levels.[556] AT&T anticipates that access reform would increase productivity growth, because reducing rates to cost-based levels would stimulate demand.[557]

2. Rejection of Certain Prescriptive Approaches

a. Rate Prescription

162. TRA and TCI recommend prescribing access rates because reinitializing PCIs would not guarantee that the LECs' rate structures would be reasonable.[558] Similarly, CompTel asserts that only a TSLRIC-based rate prescription can ensure that access rates are at cost-based levels.[559]

163. AT&T argues that a new rate prescription would not necessarily be burdensome, because four access rate elements account for most of the incumbent LECs' access revenue: the per-minute local switching charge, the per-minute tandem switching and common transport rate elements, and the dedicated transport elements. According to AT&T, it would be easy to reprice these four charges at forward-looking economic levels on the basis of existing TELRIC data.[560] Alternatively, AT&T argues that, even if a reinitialization were burdensome,

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[554] GTE Reply at 27-28.

[555] PacTel Comments at 41-42; Aliant Comments at 8.

[556] Sprint Comments at 53.

[557] AT&T Reply at 35-36.

[558] TCI Comments at 30-31; TRA Comments at 23. *See also* Washington Commission Comments at 8; AT&T Reply at 24-25.

[559] CompTel Reply at 8-11.

[560] AT&T Comments at 22-24; AT&T Reply at 17-18.

the benefits of TELRIC-based access rates would outweigh those administrative burdens.[561] USTA asserts that the rate prescription suggested by AT&T would recreate rate-of-return regulation, and that its detrimental effects would outweigh the administrative benefits alleged by AT&T.[562] PacTel argues that every error in the estimation of costs used to set prices (both over- and under-estimation) will work to the advantage of entrants since they can choose in each individual case whether to pay for the facilities or resell the services and pay the below-cost access charges.[563] The Florida Commission recommends against adopting prescriptions that would preclude incumbent LECs from lowering prices where competitive conditions warrant it.[564]

164. AT&T denies that adopting a TSLRIC pricing standard would create a serious common cost allocation problem, because both unbundled network elements and access rate elements correspond to network facilities to a great extent.[565] The Texas Commission argues that it would be easy to develop a reasonable overhead loading factor based on the ratio of overhead costs to revenues, and that use of a single overhead loading factor eliminates the need to develop common cost allocation factors.[566] AirTouch observes that TSLRIC raises common cost allocation issues, and maintains that we must take into account the extent of competition and the different demand elasticities of different services when we address these common cost allocation issues. AirTouch questions whether "a minute is a minute" pricing is necessarily the best means to allocate common costs.[567] Similarly, API argues that the common cost allocation to any particular service should be limited to the amount of common costs that could be recovered in a competitive market.[568] State Consumer Advocates argue that any forward-looking economic cost method should permit incumbent LECs to recover a reasonable allocation of joint and common costs, including joint and common costs associated with the local loop.[569]

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[561] AT&T Reply at 17-18.

[562] USTA Reply at 47 and Attachment 2 at 50.

[563] PacTel Comments at 36.

[564] Florida Commission Comments at 4-5.

[565] AT&T Comments at 24-25.

[566] Texas Commission Comments at 28-29.

[567] AirTouch Comments at 7-9. *See also* Ameritech Reply, Attachment A at 10.

[568] API Comments at 26.

[569] State Consumer Advocates Comments at 7-13, 54-55.

b. Reinitialization of PCIs on a Rate-of-Return Basis

165. A number of incumbent LECs argue that reinitializing indexes on the basis of earnings would adversely affect the efficiency incentives of price cap regulation.[570] In particular, PacTel and USTA note that the Commission has criticized earnings-based PCI adjustments in the past, and is contemplating eliminating sharing, because sharing is based on earnings, in the *Price Cap Fourth Further NPRM.*[571] Frontier asserts that represcribing the authorized rate of return would leave other causes of uneconomic access charges unaddressed.[572] GSA/DOD argues that, contrary to the incumbent LECs, the Commission did not want to sever rates from costs when it adopted price cap regulation, because it retained the sharing requirement.[573] Ad Hoc argues that reinitializing rate levels at 11.25 percent, or some other rate of return, would be administratively easy, and that the rate structure rule revisions contemplated in Section III of the NPRM are adequate to ensure that prices of individual services are efficient.[574] API maintains that it is important to reduce rates to cost as soon as possible, and so recommends represcribing the authorized rate of return and reinitializing PCIs on that basis.[575]

166. USTA opposes represcribing the authorized rate of return, because the 1996 Act has created uncertainty regarding the incumbent LECs' cost of capital, and because interest rates have not changed greatly over the past 10 months.[576] USTA also claims that no one has provided adequate reason to reduce the authorized rate of return, and predicts that the cost of capital would increase as the competition faced by incumbent LECs increases.[577] USTA asserts that represcribing the authorized rate of return would adversely affect small incumbent LECs.[578] MCI contends that its submission in the *Preliminary Rate of Return Inquiry* supports

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[570] USTA Comments at 17; BellSouth Comments at 47-48; USTA Reply at 46-47.

[571] PacTel Comments at 37-38; USTA Reply, Attachment 2 at 43.

[572] Frontier Comments at 13.

[573] GSA/DOD Reply at 12-13. *See also* MCI Reply at 7-8.

[574] Ad Hoc Comments at 41-45.

[575] API Comments at 27; API Reply at 8-9, 18. *See also* CPI Comments at 23.

[576] USTA Comments at 16-17.

[577] USTA Reply, Attachment 13 at 3-8.

[578] USTA Comments at 16-17.

reducing the authorized rate of return to 10 percent.[579] USTA claims that MCI bases its represcription recommendation on incorrect calculations.[580] BA/NYNEX maintains that there is no basis in this record for represcribing the authorized rate of return, and argues that a represcription proceeding would be burdensome.[581] PacTel cites the *Preliminary Rate of Return Inquiry NPRM* for the Commission's observation that rate of return prescriptions have little relevance to price cap carriers, and argues that they do not trigger decreases in the price cap indices.[582]

167. GSA/DOD recommends represcribing the authorized rate of return and reinitializing PCIs on that basis, because it believes earnings of carriers under price cap regulation has been excessive.[583] BA/NYNEX opposed a rate-of-return-based reinitialization in its comments,[584] but revised its position in an *ex parte* statement submitted on April 4, 1997. In particular, BA/NYNEX stated that it reached agreement with AT&T on a comprehensive proposal on universal service and access reform that includes, among other things, a reinitialization based on a rate-of-return of 11.25 percent.[585] USTA denies that incumbent LECs have overearned under price cap regulation, and asserts that the incumbent LECs' "economic rate of return" was 8.75 percent from 1991 to 1995.[586] According to SWBT, arguments for decreasing the rate of return are based on non-forward-looking

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[579] MCI Comments at 25.

[580] USTA Reply at 47-48 and Attachment 13.

[581] BA/NYNEX Comments at 25-26.

[582] PacTel Comments at 43-44, *citing* Public Notice, Common Carrier Bureau Sets Pleading Schedule in Preliminary Rate of Return Inquiry, 11 FCC Rcd 3651 (Com.Car.Bur., Accounting and Audits Div., 1996).

[583] GSA/DOD Comments at 13-15; GSA/DOD Reply at 9-10.

[584] BA/NYNEX Comments at 24-27.

[585] Letter from G.R. Evans, Vice President, Federal Regulatory Affairs, NYNEX, to William Caton, Secretary, FCC, April 4, 1997.

[586] USTA Comments at 18 and Attachment 4; USTA Reply at 46. *See also* SWBT Reply at 41. USTA claims that the current rate-of-return prescription of 11.25 percent is an accounting measure rather than an economic measure, and therefore inherently less accurate, because accounting rates of return are based on accounting rather than economic depreciation, book values rather than economic values, and accrued revenues and expenses rather than cash flows. USTA Comments, Attachment 4 at 2. USTA bases its determination of the economic rate of return on values of certain categories of telecommunications equipment as collected by the Bureau of Economic Analysis (BEA), and on dividend payments of the incumbent price cap LECs. USTA Comments, Attachment 4 at 5 and Schedule 1.

accounting measures that do not accurately measure the incumbent LECs' cost of capital.[587] GTE asserts that the authorized rate of return is too low to reflect the risks faced by incumbent LECs now that they face competition.[588] Ad Hoc argues that services subject to effective competition should be removed from price cap regulation, and that the authorized rate of return should be lowered to reflect the lower risk associated with the services that remain subject to price cap regulation.[589]

d. Reinitialization of PCIs on a TSLRIC Basis

168. Some incumbent LECs argue that reinitializing PCIs using TSLRIC would be equivalent to abandoning price cap regulation in an arbitrary and confiscatory manner.[590] Similarly, BellSouth and BA/NYNEX contend that reinitializing PCIs at TELRIC or TSLRIC levels would destroy price cap regulation by recreating the link between rates and costs.[591] BellSouth and USTA claim that price cap regulation has worked very well, and there is no justification for eliminating it.[592] BellSouth also notes that the Commission rejected proposals to revert to cost-of-service regulation in the *LEC Price Cap Performance Review Order*.[593]

169. Ad Hoc recommends reinitializing PCIs to equate with the aggregation of revenues from individual services priced at TSLRIC.[594] Although API supports TSLRIC, it opposes reinitializing indices on a TSLRIC basis because of the time needed to conduct a TSLRIC study.[595] The Florida Commission argues that we could require incumbent LECs to begin reducing their access rates gradually while we are conducting cost studies necessary to

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[587] SWBT Reply at 43-45.

[588] GTE Comments at 77.

[589] Ad Hoc Comments at 70.

[590] PacTel Comments at 39; GTE Comments at 75-76; USTA Reply at 46-47 and Attachment 2 at 43, 48.

[591] BellSouth Comments at 45; BellSouth Reply at 30-31; BA/NYNEX Comments, Attachment 1 at 8-9. *See also* USTA Reply, Attachment 3 at 17.

[592] BellSouth Reply at 31-34; USTA Reply at 12-13.

[593] BellSouth Reply at 32, *citing LEC Price Cap Performance Review Order*, 10 FCC Rcd at 8973.

[594] Ad Hoc Comments at 70.

[595] API Comments at 27.

calculate TSLRIC levels.[596] MCI maintains that we must "reinitialize" APIs and SBIs, as well as PCIs, to ensure that rates under price cap regulation are at economic cost-based levels.[597]

170. A number of parties argue that proxy models provide only hypothetical and averaged costs, and therefore are not representative of the costs incurred by actual individual carriers, and in particular the costs incurred by small carriers.[598] According to USTA, unless rates are based on actual network costs, rates will not reflect accurately the opportunity costs of using the network.[599] According to PacTel, the proxy models are designed to calculate differences in the costs of serving different geographic areas, not actual costs. Because no one has proposed deaveraging access rates on the basis of Census Block Groups, as measured in the proxy models, PacTel claims that there is no reason to base access rates on the results of the proxy models.[600] Similarly, the Texas Commission questions whether TSLRIC proxy models would produce accurate company-specific costs, as opposed to industry-wide averaged costs. The Texas Commission, therefore, supports TELRIC as a pricing standard for access rates.[601] PacTel contends that the proxy models do not place sufficient weight on traffic volume, which PacTel asserts influences costs more than population density or other factors reflected in the models.[602] Southwestern Bell claims that the network assumed by the Hatfield model could not be used to provide service.[603] Southwestern Bell also claims that it has not been able to replicate the results of the Hatfield Model reported by MCI.[604]

171. Airtouch observes that TSLRIC raises common cost allocation issues, and maintains that we must take into account the extent of competition and the different demand elasticities of different services when we address these common cost allocation issues. Airtouch questions whether "a minute is a minute" pricing is necessarily the best means to

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[596] Florida Commission Comments at 5.

[597] MCI Comments at 19-24.

[598] Evans, *et al.* Comments at 5-6; TDS Reply at 10-14; Rural Tel. Coalition Reply at 16-17; Minnesota Independent Association Reply at 6; USTA Reply at 14. *See also* PacTel Comments at 36-37; PacTel Reply at 10-11; PacTel Reply, Egan Aff. at 23-24; BA/NYNEX Reply at 14.

[599] USTA Reply, Attachment 2 at 23-24, Attachment 3 at 1.

[600] PacTel Comments at 33-34. *See also* Rural Tel. Coalition Reply at 15-17.

[601] Texas Commission Comments at 26-27.

[602] PacTel Comments at 34-35; PacTel Reply, Egan Aff. at 26-27.

[603] SWBT Reply at 25.

[604] SWBT Reply at 25-27. *See also* USTA Reply, Attachment 3 at 6.

allocate common costs.[605] Similarly, API argues that the common cost allocation to any particular service should be limited to the amount of common costs that could be recovered in a competitive market.[606] On the other hand, the Texas Commission argues that it would be easy to develop a reasonable overhead loading factor based on the ratio of overhead costs to revenues, and that use of a single overhead loading factor eliminates the need to develop common cost allocation factors.[607] State Consumer Advocates argue that any forward-looking economic cost method should permit incumbent LECs to recover a reasonable allocation of joint and common costs, including joint and common costs associated with the local loop.[608] AT&T denies that adopting a TSLRIC pricing standard would create a serious common cost allocation problem, because both unbundled network elements and access rate elements correspond to network facilities to a great extent.[609]

172. Some state commission oppose the FCC's proposal to place responsibility for cost studies on state commissions, because it would create excessive demands on scarce state commission resources.[610] The Kansas Commission argues that state commissions do not have expertise in reviewing interstate costs.[611] The Florida and Oregon Commissions question whether we have authority under the Communications Act to adopt this proposal.[612] The Florida and Georgia Commissions question whether the FCC would permit different pricing standards for interstate access to be adopted in different states.[613] The Texas Commission recommends giving states the option of reviewing incumbent LEC cost studies.[614] Rather than this Commission directing the states to conduct cost studies, the California Commission

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[605] AirTouch Comments at 7-9. *See also* Ameritech Reply, Attachment A at 10.

[606] API Comments at 26.

[607] Texas Commission Comments at 28-29.

[608] State Consumer Advocates Comments at 7-13, 54-55.

[609] AT&T Comments at 24-25.

[610] Illinois Commission Comments at 23-24; Kansas Commission Comments at 5-6; Oregon Commission Comments at 3-4; Georgia Commission Reply at 4-5.

[611] Kansas Commission Comments at 5-6.

[612] Florida Commission Comments at 9; Oregon Commission Comments at 4. *See also* BellSouth Comments at 46-47; NCTA Comments at 22.

[613] Florida Commission Comments at 9; Georgia Commission Reply at 4-5.

[614] Texas Commission Comments at 27-28.

recommends permitting state commission to permit the cost studies that they have already begun, and relying on the results of those studies.[615]

e. Policy-Based X-Factor Increase

173. Cable and Wireless supports increasing the X-Factor in equal increments over a five-year period to drive rates to TSLRIC levels.[616] MCI suggests increasing the CPD for each price cap LEC for five years, by the ratio of that carrier's PCI to its API, to eliminate that carrier's headroom.[617] A number of commenters recommend increasing the X-Factor in addition to requiring a reinitialization, to ensure that access rates remain at long-run incremental cost levels.[618] Frontier opposes relying exclusively on an increased X-Factor to force access rates to cost, because it would not affect current rates.[619] Frontier, alternatively, argues that any X-Factor would double-count the TSLRIC-based reinitialization it supports, and so recommends eliminating the X-Factor from the price cap formula after the reinitialization.[620]

174. BellSouth claims that the current 0.5 percent CPD has "outlived its usefulness," and BellSouth and GTE oppose increasing the CPD as an arbitrary and confiscatory measure.[621] SNET claims that increasing the X-Factor merely because the price cap LECs have earned too much, or simply to drive rates down, is essentially an abandonment of price cap regulation, because it would punish incumbent LECs for their efficiency gains made under the price cap regime.[622] BA/NYNEX and GTE contend that the X-Factor should reflect

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[615] California Commission Comments at 12-13.

[616] Cable and Wireless Comments at 28-29. *See also* NCTA Comments at 21-22; WorldCom Comments at 91.

[617] MCI Comments at 28.

[618] AT&T Comments at 69-70; ACTA Comments at 21; GSA Reply at 14-15. *See also* WorldCom Comments at 91 (increasing X-Factor is necessary to reflect incumbent LEC productivity growth); TRA Comments at 23 (recommending an X-Factor increase following prescription of new access rates); CPI Comments at 23-25 (reinitialize indices and increase the X-Factor prior to permitting any market-based reforms).

[619] Frontier Comments at 13.

[620] Frontier Comments at 12 n.22.

[621] BellSouth Comments at 49; GTE Comments at 77-78.

[622] SNET Reply at 23-24. *See also* BA/NYNEX Reply at 32-33.

reasonably expected incumbent LEC productivity growth rather than to achieve a specific rate reduction.[623]

175. SNET argues that increasing the X-Factor to force access rates down would not result in a more competitive market, and that treating all price cap carriers the same would disregard fundamental differences in scale and scope, and differences in regional economics between small and midsized elective price cap incumbent LECs on one hand, and the RBOCs and GTE on the other.[624] PacTel argues that increasing the X-Factor would force access rates down in both urban and rural areas, and so would discourage competitive entry in rural areas.[625] PacTel argues that the price reductions caused by the productivity factor perversely apply productivity reductions, which are supposed to replicate competition, to services where prices have already fallen because of actual competition.[626] PacTel recommends resolving price cap issues in other pending proceedings rather than using price cap regulation as a device to lower access rates to levels PacTel considers confiscatory.[627]

C. Equal Access Costs

176. AT&T, NCTA, Sprint, and WorldCom recommend a exogenous cost decrease to remove equal access costs from the incumbent price cap LECs' PCIs.[628] AT&T estimates that equal access costs constitute an annual $110 million dollar subsidy for the LECs.[629] AT&T argues that the Commission previously found that failure to make a downward adjustment would be unfair to ratepayers and perpetuate an implicit cross-subsidy. In light of this,

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[623] BA/NYNEX Reply at 30; GTE Reply at 26-27.

[624] SNET Comments at 28-30.

[625] PacTel Comments at 40. PacTel claims to be more subject to harm from the productivity factor than any other LEC because a few highly competitive central offices account for over 75 percent of its traffic, leaving it highly reliant on intraLATA toll services. According to PacTel, intraLATA toll services have become increasingly competitive in California, leaving it unable to invest in its network because of artificial productivity factors. *Id.*

[626] PacTel Comments at 41-42.

[627] PacTel Comments at 39.

[628] AT&T Comments at 68-69; NCTA Comments at 28; Sprint Comments at 59; WorldCom Comments at 94. *See also* New York Commission Comments at 1 (supporting the removal of equal access costs from access charges).

[629] AT&T Comments, Appendix F (using 1990 Annual Interstate Access Filings of BOCs, AT&T calculates 1990 revenue associated with non-capitalized equal access expenditures and converts to a present day annual revenue estimate by comparison to difference between initial Traffic Sensitive Basket price cap index to 1996 Traffic Sensitive Basket price cap index).

AT&T argues that the Commission should now make a downward adjustment to account for the completion of the amortization of those costs. Sprint argues that without such an adjustment, incumbent LECs would be able to impose charges for other rate elements to recover costs that simply no longer exist. Sprint contends that most of the equal access costs are in the local switching basket, requiring that basket's price cap index to be reduced. To the extent that other baskets were affected, Sprint contends that the appropriate PCI reductions should be made.[630] The Georgia Commission recommends that the Commission verify whether equal access costs continue to be reflected and, if so, make the appropriate adjustments to account for these costs.[631]

177. The BOCs argue that there should be no exogenous cost decrease to account for completion of the amortization of equal access costs.[632] BellSouth argues that, given the Commission's decision not to grant an exogenous increase for these costs during price cap initialization, it would be unfair to require an exogenous decrease now.[633] PacTel and USTA argue that price cap regulation has historically treated equal access costs as endogenous. According to PacTel and USTA, it would be arbitrary to change that treatment for some equal access costs and not others.[634] USTA, Ameritech, and SWBT argue that the Commission has addressed this matter before and correctly concluded that no exogenous treatment was warranted.[635] BellSouth argues that just as in the *LEC Price Cap Performance Review Order*, 10 FCC Rcd at 9094-9095, there is insufficient support for requiring LECs to make an exogenous decrease based on the complete amortization of equal access costs.[636] USTA and SWBT argue that LECs continue to incur new equal access costs that have not been recovered, such as when a LEC must purchase equal access software for a new digital switch.[637]

178. TCA argues that some small LECs have not received a *bona fide* request to convert to equal access. TCA contends that when these LECs make the conversion, they

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[630] Sprint Comments at 59.

[631] Georgia Commission Reply at 41.

[632] Ameritech Comments at 54-55; BA/NYNEX Comments at 66; PacTel Comments at 24-25; SWBT Comments at 62; USTA Comments at 85.

[633] BellSouth Comments at 88. *See also* BA/NYNEX Comments at 66.

[634] PacTel Comments at 24-25; USTA Comments at 49. *See also* SWBT Reply at 43.

[635] *See, e.g.*, USTA Comments at 85; Ameritech Comments at 55; SWBT Reply at 41.

[636] BellSouth Comments at 87.

[637] USTA Comments at 49; SWBT Reply at 42.

should be allowed the same treatment of their equal access costs as other LECs.[638] Similarly, GCI raises the issue of those LECs that have not converted to equal access. GCI recommends that these LECs be allowed to recover their costs through the Local Switching rate element, rather than a general allocation.[639]

D. Correction of Improper Cost Allocations

1. Marketing Expenses

179. Incumbent LECs and AT&T agree that marketing expenses are inappropriately allocated to the interstate jurisdiction.[640] USTA notes that the net effect of the Commission's decision to include access revenues in the allocation factor for marketing expenses in the *Marketing Expense Reconsideration Order*[641] was to allocate approximately 26 percent of incumbent LECs' total marketing expenses to the interstate jurisdiction.[642] USTA argues that incumbent LECs must be afforded an opportunity to recover the interstate portion of marketing expenses, which it estimates to be $2.2 billion for price cap LECs and $2.4 billion for all incumbent LECs.[643] SWBT estimates that $100 million of its marketing-related costs are allocated to interstate services and recommends that marketing costs be recovered through a public policy element until separations reform can be completed.[644] Based on 1995 data, GTE estimates that the separations process allocates $84.6 million of its marketing expenses to the interstate jurisdiction.[645]

180. AT&T estimates that inappropriate end user retail expenses recovered through interstate switched carrier access total $840.2 million -- approximately $575 million in direct retail expenses including marketing and customer service costs, and $265 million in indirect

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[638] TCA Comments at 5-6.

[639] GCI Comments at 8.

[640] *See, e.g.*, SWBT Comments at 8-9; AT&T Comments at 66-67, Appendix D; *cf.* GTE Comments at 42 (proposing that incumbent LECs prepare separations-based cost studies to show the amount of marketing expense erroneously assigned to the interstate jurisdiction to be used to compute the separations and TIC-related components of a regulatory policy charge).

[641] *Marketing Expense Reconsideration Order*, 2 FCC Rcd at 5353.

[642] USTA Comments, Attachment 2 at 25.

[643] USTA Comments at 79-80, Attachment 16 at 4.

[644] SWBT Comments at 8-9.

[645] GTE Reply at 8.

retail expenses including general support, corporate operations, and uncollectible revenue.[646] AT&T argues that because access is a wholesale service, not a retail service, this implicit subsidy contained in access charges is improper for three reasons.[647] First, recovery of retail expenses through access charges violates section 252(d)(3) of the Act,[648] which states that wholesale rates will be determined on the basis of retail rates, excluding the portion attributable to marketing, billing, collection, and other costs that will be avoided by the LEC.[649] Second, inclusion of retail costs in access charges violates the fundamental principle that services that should be priced at their long-run incremental cost, resulting in cross-subsidies from access charges to other services.[650] Finally, inclusion of retail costs in access charges violates cost-causation principles, which state that retail costs should be borne by those who cause them, *i.e.*, retail end users.[651]

181. AT&T and WorldCom propose that, pending separations reform that reallocates retail marketing costs to the intrastate jurisdiction, the Commission reassign recovery of such costs from interstate access charges to end users.[652] AT&T's proposal would recover these costs from business lines and non-primary residential lines, but not from primary residential lines.[653] The Rural Tel. Coalition opposes recovery of such costs from end users.[654] USTA contends that, until the separations rules are changed, incumbent LECs should continue to recover these costs in current access prices and that the marketing expense allocated to common line should remain in common line.[655]

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[646] AT&T Comments at 66.

[647] AT&T Comments at 66-67; *cf.* New York Commission Comments at 3 (arguing that retail costs allocated to the interstate jurisdiction that are avoided when competitors resell incumbent LECs' services should be reflected in lower access charges).

[648] 47 U.S.C. § 252(d)(3).

[649] AT&T Comments at 66-67.

[650] AT&T Comments at 67.

[651] AT&T Comments at 67.

[652] AT&T Comments at 53; WorldCom Comments at 71; *see also* Letter from Bruce K. Cox, Vice President, Government Affairs, AT&T, to William F. Caton, Acting Secretary, Federal Communications Commission, March 19, 1997.

[653] Letter from Bruce K. Cox, Vice President, Government Affairs, AT&T, to William F. Caton, Acting Secretary, Federal Communications Commission, March 19, 1997.

[654] Rural Tel. Coalition Reply at 5-6.

[655] USTA Comments at 80.

2. General Support Facility Costs

182. AT&T and WorldCom assert that the Commission should not permit incumbent LECs to recover in access charges the costs caused by the LECs' detariffed billing and collection functions, including those arising from use of GSF and computer costs in providing those functions.[656] According to AT&T's study, $124 million of expenses recovered in interstate access support the nonregulated billing and collection category.[657] Of the $124 million, $60.1 million is included in interstate switched carrier access, and $20.5 million is in interstate special carrier access, with the remainder recovered by the SLC.[658] WorldCom recommends that the Commission correct the Part 32 USOA rules for regulated costs and Part 64 allocation rules to remove this investment from access charges, and should require corresponding reductions in the TIC.[659]

V. ACCESS REFORM FOR INCUMBENT RATE-OF-RETURN LOCAL EXCHANGE CARRIERS

183. The majority of commenters agree generally with our conclusion to limit the scope of this proceeding to price cap LECs.[660] Many parties are concerned, however, about the impact decisions made in this proceeding may have on some rate-of-return LECs, and urge the Commission to consider the needs of small to mid-sized and rural rate-of-return incumbent LECs when adopting proposals in this proceeding.[661]

184. Cincinnati Bell, ALLTEL, and ITTA oppose delaying access reform for non-price cap LECs.[662] Centennial states that it prefers that the Commission apply its access

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[656] AT&T Comments at 67, Reply at 34; WorldCom Comments at 71 (proposing that the costs of non-regulated services be removed from the TIC).

[657] AT&T Comments at 67-68, Appendix E.

[658] AT&T Comments, Appendix E at 2.

[659] WorldCom Comments at 71.

[660] *See, e.g.*, Alaska Telephone Association Comments at 3; Frederick & Warinner Comments at 3; NECA Comments at 2; TCA Comments at 2; Sprint Comments at 9; WITA Comments at 2; GSA/DOD Comments at 13.

[661] *See, e.g.*, Staurulakis Comments at 2; GCI Comments at 1-4, Reply at 5-6; Alaska Telephone Association Comments at 3; Rural Tel. Coalition Comments at 2-3; TDS Comments at 6-7; GVNW Comments at 4, Reply at 3; Western Alliance Comments at 1-3.

[662] Cincinnati Bell Comments at 2; ALLTEL Comments 3, 5-7, Reply at 3; ITTA Comments at 4.

reforms to *all* incumbent LECs, subject to an appropriate waiver for small, rural LECs whose special circumstances warrant special accommodation, but that at a minimum, the Commission should apply all of its access reforms to all Tier 1 LECs.[663] Centennial argues that a large, Tier 1 LEC, such as PRTC, that already faces active competition from competitive carriers should not be exempt from the new access reform rules.[664]

185. Many commenters stress the need for immediate or prompt access reform for rate-of-return LECs. They contend that rate-of-return LECs are facing increasing competitive pressures and need the ability to respond to changes in the market.[665] Roseville and Frontier recommend that the Commission distinguish between rural and non-rural carriers.[666] Frontier argues that smaller price cap carriers are more similarly situated to non-price cap rural carriers than they are to non-rural carriers and urges the Commission to temporarily exempt all rural LECs, price cap and non-price cap, from the rules adopted in this proceeding.[667] Citizens contends that some of the approaches proposed in the NPRM are not appropriate for price cap LECs that primarily serve rural areas and have a low proportion of business lines.[668] Other commenters assert that rural LECs have a lower percentage of low-cost/high-margin customers, that their access charge revenues represent a higher percentage of their total revenues than they do for the average regional BOC, and that the loss of even a small number of customers can result in a much higher proportionate loss of revenue when compared to the markets of typical price cap LECs.[669]

186. For these reasons, some commenters argue that non-price cap LECs need regulatory flexibility and the option of adopting the rate structure changes required for price-cap LECs in this proceeding.[670] NECA, for example, states that because NECA pool carriers' rates represent a wide variety of markets with disparate cost characteristics, the Commission

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[663] Centennial Cellular Corporation Comments 2-3.

[664] *Id.* at 6-7.

[665] *See, e.g.,* ALLTEL Comments at 3, 5-7, Reply at 3; Cincinnati Bell Telephone Comments at 2- 3; Roseville Tel. Comments at 6-7, Reply at 4-10; GVNW Comments at 4; ITTA Comments at 4.

[666] Roseville Tel. Comments at 2; Frontier Comments at 5-6 n. 10.

[667] Frontier Comments at 5-6 n. 10.

[668] Citizens Utilities Comments at 3-6, 13-14.

[669] *See, e.g.,* GVNW Comments at 3-4; ALLTEL Comments at 15.

[670] *See, e.g.,* Aliant Reply at 4-5; ALLTEL Comments at 4, 8, Reply at 3-4; Minnesota Independent Coalition Comments at 2; ITTA Comments at 4; TDS Comments at 10-12, 16, Reply at 4-6; NECA Comments at 9-10, Reply at 6; Roseville Tel. Comments at 2.

should permit these carriers to have the regulatory flexibility to select and implement rate structure changes adopted in this proceeding pending completion of the separate rate-of-return proceeding.[671]

VI. OTHER ISSUES

A. Application of Part 69 to Unbundled Network Elements

187. Several incumbent LECs disagree with our tentative conclusion to exclude from unbundled network elements the application of Part 69 access charges. PacTel argues that access charges should not be excluded from the sale of unbundled network elements because such charges include subsidies for universal service. Competitors, PacTel argues, will have an economic incentive to purchase unbundled elements to avoid access charges, undermining support for universal service until an explicit universal service funding mechanism is adopted.[672] SBC contends that the Commission has recognized legitimate costs that are recovered through access charges. Recovery of these costs will be reduced if the Commission allows purchasers of unbundled elements to pay substantially less on a per minute basis than they would through interconnection arrangements. SBC estimates that excluding access charges from the sale of unbundled network elements could jeopardize its recovery of $705 million in end user common line loop costs and $683 million in switched access costs based on SBC's 1996 switched access demand levels.[673] USTA contends prices for unbundled elements should include access charges to ensure embedded costs assigned to the interstate jurisdiction are recovered to the extent network elements are used to provide interstate services.[674]

188. Other incumbent LEC commenters argue that rebundling network elements is equivalent to offering access services and justifies the imposition of access charges. BellSouth, for example, contends that access charges should apply to competitors that rebundle network elements because rebundled elements constitute an underlying retail service and access charges are applicable when services are purchased for retail sale.[675] PacTel suggests that access customers will perceive unbundled elements as a substitute for access service. By excluding access charges from the sale of unbundled elements, PacTel contends,

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[671] NECA Comments at 9-10, Reply at 6.

[672] PacTel Comments at 55-57. *See also* GVNW Comments at 5.

[673] SBC Comments at 51-52.

[674] USTA Comments at 54-55.

[675] BellSouth Comments at 13.

the Commission would sanction a violation of Section 202(a) of the Communications Act which prohibits unreasonable discrimination in charges for similar services.[676]

189. Smaller LECs whose rates are set under rate-of-return regulation advocate the imposition of access charges on unbundled network elements because a substantial portion of their revenues are derived from state and interstate access charges.[677] Roseville Telephone argues that, absent the imposition of access charges on the sale of unbundled network elements, incumbent LECs will not recover the costs of their underlying facilities because TELRIC prices will not recover costs attributable to federal-state separations policies and a portion of the incumbent LEC's embedded costs.[678]

190. IXCs support the Commission's tentative conclusion to exclude unbundled network elements from Part 69 access charges. Excel agrees with the Commission's rationale that carriers purchasing unbundled elements at cost-based rates have already compensated incumbent LECs for the ability to originate and terminate calls, rendering further compensation unnecessary.[679] Sprint also supports the exclusion of access charges from unbundled network elements, arguing that adding access charges to cost-based prices for unbundled elements would undermine the pro-competitive purpose of the 1996 Act. To the extent prices for unbundled elements do not recover universal service costs, Sprint argues that the Commission should remove implicit subsidies from access charges and have all service providers contribute to universal service through a competitively neutral funding mechanism.[680] Sprint also challenges the view of LEC commenters that rebundling network elements is the equivalent of offering a retail service. According to Sprint, when elements are used to originate and terminate calls, the purchaser of the unbundled elements, rather than the incumbent LEC, is offering exchange services using those facilities. Imposing access charges on unbundled elements, Sprint argues, would be similar to having the purchaser of an automobile pay rental fees in addition to the purchase price simply because the automobile is used for transportation whether it is purchased or leased.[681]

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[676] PacTel Reply at 8-10. *See also* GVNW Comments at 4-5.

[677] Frederick and Warriner Comments at 4 (stating that 60% of revenues generated by small LECs it represents are derived from state and interstate access charges).

[678] Roseville Telephone comments at 13-14.

[679] Excel Comments at 7.

[680] Sprint Reply at 7.

[681] *Id.* at 6.

B. Treatment of Interstate Information Services

191. *Non-cost-based rates.* ISPs, consumers, and several consumer groups applaud the Commission's tentative conclusion to not require ISPs to pay access charges and urge us to make it our final decision.[682] These commenters state that the current access charge framework consists of non-cost-based rates, that it was designed to address rate discrimination in the interexchange market, as well as to preserve subsidy flows between local and long distances services. They argue that this regime should not be extended to ISPs.[683] Internet Access Coalition states that there is no justification for requiring ISPs to pay charges designed to recover the cost of network features and functions that were designed for voice traffic, features that ISPs neither want nor need.[684]

192. Consumer groups and other commenters assert that the imposition of non-cost-based access fees would diminish consumer use of the Internet and other information services.[685] MAP, *et al.*, claims that usage-based fees might be passed on to consumers, which could diminish total use of the Internet and especially limit use by lower-income citizens.[686]

193. America On-Line states that access charges are inappropriate for ISPs, regardless of whether they consist of non-cost-based rates or are priced at forward-looking costs. America On-Line contends that no matter how access charges are established, they do not and

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[682] *See, e.g.,* American Library Association Comments at 1; MAP, *et al.* Comments at 3; Radoff Comments at 1; Lyman C. Welch Comments at 1; Colorado Library Education and Healthcare Telecommunications Coalition Reply at 1; Gallegos Comments at 2; California Commission Reply at 7; NCTA Comments at 2; America On-Line Comments at 4; CIEA Comments at 3; CompuServe\Prodigy Comments at 4; Information Industry Association Comments at 1-2; Internet Access Coalition at 10-13; Microsoft Comments at 3-4; Minnesota Internet Services Trade Association Comments at 1; Newspaper Association of America Reply at 1; Alarm Industry Communications Committee Reply at 1.

[683] *See, e.g.,* America On-Line Comments at 9; Internet Access Coalition Comments 10-13; American Library Association Comments at 1; NCTA Reply at 10-11.

[684] Internet Access Coalition Comments at 6.

[685] *See, e.g.,* MAP, *et al.* Comments at 3-4; Ozarks Technical Community College Comments at 1; Colorado Library and Healthcare Telecommunications Coalition Reply at 1; Gallegos Comments at 2; CompuServe\Prodigy Reply at 4; PSINet Reply at 9-10; Alarm Industry Communications Committee Reply at 4-6. We received over 300,000 comments from consumers via our electronic mailbox. These commenters overwhelmingly oppose the imposition of access charges on ISPs. Most insist that many consumers will be unable to afford using the Internet if ISPs are required to pay access charges and those charges are then passed on to consumers.

[686] MAP, *et al.* Comments at 4.

should not apply to ISPs because ISPs are not carriers.[687] America On-Line states that as providers of information services, ISP fall squarely outside of the definition of "telecommunications carriers" as defined in the 1996 Act.[688] Several commenters claim that ISPs are end-users of telecommunications services, and the manner in which they use the local network supports the conclusion that they are end users rather than carriers.[689]

194. Most LECs and a few other commenters call for the imposition of access charges on ISPs.[690] They state that ISPs currently do not pay for their portion of local exchange switching facilities assigned to the interstate jurisdiction.[691] BA/NYNEX states that current usage levels can only be accommodated on the circuit switched network by continuous investment in more network capacity, however, LECs are not recovering their investment under the current pricing structure for ISPs.[692] Some LECs acknowledge that the current framework of access charges should not be applied to ISPs, but rather, ISPs should be charged usage-sensitive "reformed" access charges which do not contain non-cost-based subsidies.[693]

195. PacTel contends that ISPs are not like other business customers, because they do not use local business lines for a mix of originating and terminating calls, and, thus, do not pay outbound usage charges.[694] PacTel further claims that ISPs' current service architectures, while using business lines, look strikingly like the other common carriers' serving arrangements prior to the divestiture of AT&T. According to PacTel, ISPs gain access to LEC loops and switches in order to offer services to end users across all major population centers, just as IXCs do. Further, ISPs do not terminate calls, but provide connection to the Internet or on-line services.[695]

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[687] America On-Line Reply at 6.

[688] *Id.*

[689] *Id.* at 5; *see also,* Information Industry Association Comments at 3; Internet Access Coalition Comments at 10-13; Pennsylvania Internet Service Providers Comments at 21.

[690] BA/NYNEX Comments at 64; PacTel Comments at 74; SONETECH Comments at 19; USTA Comments at 83; U S West Comments at 83; GTE Comments at 18; GCI Comments at 8.

[691] *See, e.g.,* U S West Reply at 42; BA/NYNEX Comments at 64; USTA Comments at 82.

[692] BA/NYNEX Comments at 62; *see also,* PacTel Comments at 76-77.

[693] PacTel Reply at 6; *see also,* USTA Comments at 84; AT&T Comments at 71-72.

[694] PacTel Reply at 27-28.

[695] *Id.*

196. *Implicit subsidy for ISPs.* USTA and several LECs claim that current flat rate pricing schemes for ISPs create an implicit subsidy for ISPs, because the flat rate charges ISPs pay fail to pay for the network resources they use.[696]

197. Compuserve and Prodigy state that the rates for flat-rated business lines used by ISPs already cover their costs, and in some jurisdictions, they provide a subsidy for below cost local exchange residential services.[697] Compuserve and Prodigy assert that regional BOC (RBOC) studies underestimate the revenues the RBOCs are currently receiving from ISP use of business lines.[698]

198. Several ISPs and consumer groups point to the increase in LEC revenues due to increased demand for new telecommunications services associated with ISPs.[699] Most significantly, commenters cite the increase in consumer demand for second lines. Internet Access Coalition refers to an ETI Study [need cite] which found that increased revenue from residential second lines used primarily or exclusively to access on-line services exceeds the increased incumbent LEC costs attributable to the growth of these services by a factor of six-to-one.[700] Internet Access Coalition challenges PacTel's conclusion that the costs of second lines exceed the flat rate charged by Pacific Bell for those lines. Internet Access Coalition states that several incumbent LECs, including PacTel, have, in other forums, expressly attributed their recent high earnings to the surge in demand for second lines.[701]

199. *Network congestion.* Several commenters, most of them incumbent LECs, claim that current network congestion problems are the result of the current pricing policies which allow ISPs to pay flat rates for usage sensitive services.[702] USTA states that congestion caused by ISPs raises network reliability concerns and delays the introduction of new

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[696] USTA Comments at 82-83; *See, e.g.,* U S West Comments at 83-84; GVNW Comments at 15; ACTA Comments at 24-30.

[697] CompuServe/Prodigy Comments at 12.

[698] *Id.* CompuServe/Prodigy states that it now pays the LECs almost $36 million on an annual basis for the approximately 85,000 local business lines it employs to make available its services to subscribers (85,000 lines x $35 per month per line x 12 months = $35,700,000).

[699] *See, e.g.,* Consumer Project Reply at 3; Internet Access Coalition Comments at 15; America On-Line Comments at 7-9; CIEA Reply at 3-5.

[700] Internet Access Coalition Reply at 7-8.

[701] *Id.*

[702] *See, e.g.,* USTA Comments at 81-82; GVNW Comments at 15; GCI Comments at 9.

technologies.[703] GCI claims that usage charges set at the proper level should encourage an economically appropriate level of usage and should help alleviate network congestion caused by users who remain on-line for long periods of time.

200. ISPs and consumer groups insist that accounts of network congestion are greatly exaggerated by the LECs.[704] Internet Access Coalition states that the studies presented by the Bell Operating Companies (BOCs) were based on isolated, worst-case situations, and therefore, the studies fail to give an accurate picture of the impact of data traffic on the BOC networks.[705] Commenters claim that the switch problems which occur in a small number of central offices can be resolved with the technologically simple solutions that the incumbent LECs routinely use when end-users other than ISPs create similar congestion anomalies.[706] PSINet asserts that the BOCs were in a position to anticipate increased network traffic because of an increase in the demand for (1) second lines and other services by consumers and (2) business lines by ISPs.[707] PSINet contends that ILECs have been selling excess capacity for several years, and they should have been reinvesting in their networks, making them more responsive to their Internet customers and better able to handle increase in Internet traffic.[708]

201. *Incentive to switch to packet-switched network.* Some LECs contend that without usage charges for the lines connecting the ISPs to their customers, ISPs have little incentive to use services and technologies that lessen the load on the traffic-sensitive portion of the current switched network or to divert Internet traffic from the circuit-switched local network to more efficient packet-switched networks.[709] ACTA states that radically reformed, rational, cost-based access charges borne by ISPs and other users of the telecommunications infrastructure will provide incentives to improve and optimize today's telecommunications infrastructure and stimulate investment which will assure an adequate supply of capacity and

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[703] USTA Comment at 82.

[704] *See, e.g.,* Consumer Project Comments at 1; America On-Line Comments at 13-14; CompuServe/Prodigy Comments at 14; Internet Access Coalition Comments at 13; PSINet Comments at 8.

[705] Internet Access Coalition Comments at 13.

[706] *Id.* at 14; *see also* America On-Line Reply at 10.

[707] PSINet Reply at 7-8; *see also,* America On-Line Reply at 12.

[708] PSINet Reply at 7-8.

[709] *See, e.g.,* BA/NYNEX Comments at Attachment 1: Crandall Affidavit at 14-15; PacTel Reply at Attachment 1, Parker Affidavit at 6.