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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

DA 98-151

In the Matter of	)	
	)	
Tariffs Implementing	)	CC Docket No. 97-250
Access Charge Reform	)	
	)	

ORDER DESIGNATING ISSUES FOR INVESTIGATION AND ORDER ON RECONSIDERATION

Adopted: January 28, 1998 Released: January 28, 1998

Direct Case Date:	February 27, 1998
Opposition/Comment Date:	March 16, 1998
Rebuttal Date:	March 23, 1998

By the Chief, Common Carrier Bureau:

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I. INTRODUCTION

1. On December 30, 1997, we released the *Access Charge Reform Tariffs Suspension Order*,[1] which, *inter alia*, suspended for one day the access tariffs implementing the *Access Charge Reform Proceeding*[2] filed by several incumbent local exchange carriers (LECs), imposed an accounting order, and initiated an investigation into the lawfulness of a number of issues raised by these tariff filings. We concluded that the access tariffs filed by all price cap LECs raised significant questions of lawfulness that warranted investigation.[3] We also concluded that provisions in the access tariffs filed by the Puerto Rico Telephone Company (PRTC) and Beehive Telephone Company raised questions of lawfulness that warranted investigation.[4]

2. In this Order, we designate for investigation issues regarding: non-primary residential line counts, the methodology for calculating exogenous cost changes for line ports and end office trunk ports, Central Office Equipment maintenance and marketing cost exogenous adjustments, tandem-switched transport rates, the removal of costs from and calculation of the transport interconnection charge, and universal service support exogenous adjustment for all price cap LECs; the base factor portion revenue requirement for six price cap LECs; the attribution of tandem switching revenue requirement to SS7 costs for Bell Atlantic and U S West; the inclusion of STP port costs in the SS7 revenue requirement for SWBT, Pacific Bell, and Nevada Bell; and the line counts used to determine common line rates for Ameritech, CBT, and U S West. In addition, on our own motion, we reconsider our decision to suspend and investigate PRTC's tariff filings, Transmittal Numbers 24, 25, and 27.

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[1] *Tariffs Implementing Access Charge Reform*, CC Docket No. 97-250, Memorandum Opinion and Order, DA 97-2724 (Com. Car. Bur., rel. Dec. 30, 1997) (*Access Charge Reform Tariffs Suspension Order*). *See also* Memorandum Opinion and Order, DA 98-125 (Com. Car. Bur., rel. Jan. 23, 1998) (suspending 14 transmittals and incorporating their review into this investigation).

[2] *Access Charge Reform*, CC Docket No. 96-262, First Report and Order, 12 FCC Rcd 15982 (1997) (*Access Charge Reform Order*); Order on Reconsideration, 12 FCC Rcd 10119 (1997); Second Order on Reconsideration, 12 FCC Rcd 16606 (1997) (collectively, *Access Charge Reform Proceeding*).

[3] Those carriers were: Aliant Communications Company (Aliant); Ameritech Operating Companies (Ameritech); Bell Atlantic Operating Companies (Bell Atlantic); BellSouth Telecommunications, Inc. (BellSouth); Cincinnati Bell Telephone Company (CBT); Citizens Telecommunications Companies (Citizens); Frontier Telephone Companies [Frontier Communications of Minnesota and Iowa, and Frontier Telephone of Rochester] (Frontier); GTE Telephone Operating Companies (GTOC) and GTE Systems Telephone Companies (GSTC) (collectively GTE); New York Telephone and New England Telephone and Telegraph Company (NYNEX); Southern New England Telephone Company (SNET); Southwestern Bell Telephone Company (SWBT), Pacific Bell and Nevada Bell (collectively, SBC); Sprint Local Telephone Companies (Sprint LTCs); and U S West Communications, Inc. (U S West).

[4] Beehive Telephone Company is the subject of a separate investigation and will not be addressed further in this Order.

II. COMMON LINE ISSUES

A. Non-primary Residential Line Issues

1. Background

3. Before January 1, 1998, the access charge rules permitted price cap LECs to recover their permitted common line revenues through a combination of a flat-rated Subscriber Line Charge (SLC) and a per-minute carrier common line (CCL) charge.[5] The SLC was capped at $3.50 per month for residential and single-line business users and, since July 1, 1997, at $9.00 per month per-line for multi-line business (MLB) users.[6] To the extent that permitted common line revenues were not recovered in the SLC, they were recovered through the CCL charge, which was assessed on the IXCs. The *Access Charge Reform Order* modified the way the price cap LECs recover their common line revenues. As of January 1, 1998, a price cap LEC's common line revenues are recovered through: (1) a SLC assessed on end-users; (2) a flat, per-line charge assessed on the IXC to whom the access line is presubscribed, referred to as the presubscribed interexchange carrier charge (PICC); and (3) a per-minute CCL charge assessed on IXCs.[7] The PICC will recover common line revenues that exceed the SLC ceilings, subject to a ceiling.[8] Over time, the PICC ceilings will increase for all subscriber lines, and the SLC ceilings will increase for MLB and non-primary residential lines.[9] The per-minute CCL charge will be phased out once all permitted common line revenues can be recovered through the two flat-rated charges.

4. As of January 1, 1998, the SLC cap for non-primary residential lines was adjusted from the lesser of the per-line average common line costs allocated to the interstate jurisdiction and $3.50, to the lesser of the incumbent LEC's average per-line interstate-allocated costs and $5.00.[10] Both the MLB and non-primary residential line SLC caps will be adjusted for inflation beginning January 1, 1999.[11] The PICC was capped for the first year at $1.50 for non-primary residential lines and $2.75 for MLB lines. For primary residential and single-line business lines, the PICC was capped at $0.53 per month, beginning January 1, 1998.

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[5] SLCs are also referred to as end-user common line charges (EUCLs).

[6] *Access Charge Reform Order*, 12 FCC Rcd at 15999. The MLB SLC cap was raised from $6.00 to $9.00 on July 1, 1997, pursuant to the *Access Charge Reform Order*. *Id.* at 16014.

[7] *Access Charge Reform Order*, 12 FCC Rcd at 16005.

[8] *Access Charge Reform Order*, 12 FCC Rcd at 16005.

[9] 47 C.F.R. §§ 69.152(e)(2)(ii), 69.152(k), 69.153(c)(2), 69.153(d)(1)(ii), and 69.153(d)(2)(ii).

[10] 47 C.F.R. § 69.152(e).

[11] 47 C.F.R. § 69.152(k). The SLC cap for non-primary residential lines will also be increased on January 1, 1999 by $1.00, and be increased by $1.00 each year thereafter beginning on July 1, 2000. 47 C.F.R. § 69.152(e)(2)(ii).

5. The Commission's purpose in restructuring the rate system was to provide for recovery of non-traffic sensitive costs through flat fees, such as the SLC and PICC.[12] To the extent that the LECs' non-primary residential line counts are too low, IXCs will be overcharged (and certain end users will be charged less than they could be) because the SLC for non-primary residential lines has a higher ceiling than the SLC for primary residential service.[13] To the extent this results in higher per-minute CCL charges, it is contrary to the cost-causation principles set forth in the *Access Charge Reform Order*.[14]

6. The *Access Charge Reform Order*, however, did not provide definitions of primary and non-primary residential lines.[15] The Commission noted in that Order its intention to develop such definitions in the Universal Service rulemaking proceeding by the end of 1997, too late for implementation as of January 1, 1998.[16] On September 5, 1997, the Commission released a Notice of Proposed Rulemaking seeking comment on how to define primary residential lines.[17] The Commission discussed several possible definitions, including defining the primary residential line as the primary line of an individual subscriber, of a residence, of an individual household, or by using another basis.[18] The *Primary Lines NPRM* also sought comment on how to identify primary residential lines once a definition was in place. The Commission has not yet issued an order resolving the issues raised in the *Primary Lines NPRM*.

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[12] *Access Charge Reform Order*, 12 FCC Rcd at 15998.

[13] The overcharge occurs because the IXCs pay the costs in excess of the ceiling through PICCs and the CCL charge, so the higher the ceiling, the less cost the IXCs are required to pay.

[14] *Access Charge Reform Order*, 12 FCC Rcd at 16004.

[15] *Access Charge Reform Order*, 12 FCC Rcd at 16016.

[16] *Access Charge Reform Order*, 12 FCC Rcd at 16016.

[17] *In re Defining Primary Lines*, CC Docket No. 97-181, Notice of Proposed Rulemaking, 12 FCC Rcd 13647 (1997) (*Primary Lines NPRM*).

[18] *Primary Lines NPRM*, 12 FCC Rcd at 13651.

7. In their tariff filings, price cap LECs identified the following percentage of line counts as non-primary residential and BRI ISDN lines:[19]

Figure 1. Ratio of Non-Primary Residential and BRI ISDN to All Residential and Single-Line Business

Ameritech	10.69%
U S West	10.18%
Bell Atlantic	10.14%
Sprint LTCs	9.54%
SWBT	8.87%
BellSouth	8.70%
NYNEX	7.69%
Nevada Bell	7.47%
SNET	6.31%
CBT	5.79%
Frontier	4.77%
GTE	4.74%
Aliant	4.38%
PacBell	3.34%
Citizens	2.62%
Average	8.22%

2. Pleadings

a. Petitions and Comments

8. AT&T contends that some of the LECs' non-primary residential line counts are too low.[20] AT&T estimated in its December 23 pleading that 10-20 percent of residential end-user common lines are non-primary residential, compared to the LECs' 8.22 percent average. AT&T bases its estimate on LEC ex parte submissions, Census Bureau data, and figures from the Hatfield Model filed with the Commission in other proceedings.[21] According to AT&T, the price cap LECS collectively have underestimated the non-primary residential line count by 84 million. This results in the price cap

[19] These figures are yearly line counts (number of lines times 12). BRI ISDN lines are assessed the non-primary residential SLC even if the customer is a multi-line business or if it is a residential customer's only line.

[20] AT&T also argues that, because the Commission decided not to define primary and non-primary lines, it should either provide definitions or eliminate the distinction altogether for the purpose of determining the level of SLCs and PICCs to be applied. Eliminating this distinction, argues AT&T, would obliterate any "gamesmanship" in non-primary SLC counts, and would allow the Commission to allow LECs to charge a SLC for both categories sufficient to recover costs. AT&T December 23 Petition at 30. These alternatives would require rulemaking beyond the scope of this tariff investigation.

[21] AT&T December 23 Petition at 31.

LECs collecting $126 million per year too little in SLC revenue and $81 million per year too little in PICC revenue at capped rates.[22] AT&T argues that these allegedly low non-primary residential line counts result in an improper increase of line counts to the primary residence or single line business categories, and ultimately results in IXCs being overcharged these amounts in contravention of the Commission's policy goals.[23] AT&T contends that, as a result of these alleged understatements, the Commission should investigate all the price cap LECs' SLC demands.[24]

9. MCI contends that GTE has failed to define non-primary lines in its *Access Charge Reform Tariff* filing, in contravention of section 61.2 of the Commission's rules.[25] According to MCI, without a definition of non-primary lines, it is impossible to evaluate whether the PICC and SLC counts used in GTE's rate development are reasonable, and equally impossible for GTE's customers to determine the application of the non-primary PICC and SLC.[26] MCI also contends that the definitions set forth by the LECs are inconsistent, and some are unreasonably vague.[27]

b. Replies

10. The LECs generally dispute AT&T's contention that because SLC demand is lower than AT&T estimated, LECs' counts of non-primary residential lines are incorrect. They contend that their definitions of primary and non-primary residential lines are reasonable, and that their line counts are appropriately based upon actual data, such as billing records.[28] Further, Citizens and GTE both state that their relatively low non-primary line counts reflect the fact that secondary lines have not penetrated the more rural parts of the United States.[29] Bell Atlantic and SWBT contend it is premature to investigate the definitions of primary and non-primary residential lines until the

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[22] AT&T December 23 Petition at 31.

[23] AT&T December 11 Petition at 39.

[24] AT&T December 11 Petition at 40.

[25] MCI's argument relies on section 61.2 of the Commission's rules, which states, in full, that "[i]n order to remove all doubt as to their proper application, all tariff publications must contain clear and explicit explanatory statements regarding the rates and regulations." 47 C.F.R. § 61.2.

[26] MCI December 10 Petition at 14.

[27] MCI December 23 Petition at 21.

[28] Aliant December 29 Reply at 5; Bell Atlantic December 18 Reply at 19; BellSouth December 29 Reply at 14-15; CBT December 29 Reply at 7; Citizens December 29 Reply at 3; Frontier December 17 Reply at 7; GTE December 17 Reply at 15; SNET December 29 Reply at 5; SWBT December 29 Reply at 14; U S West December 29 Reply at 7.

[29] Citizens December 29 Reply at 3; GTE December 17 Reply at 16; GTE December 29 Reply at 10.

Commission issues an order pursuant to the *Primary Lines NPRM*.[30] Once an order is issued, SWBT states that the LECs can review and adjust their tariffs in order to comply. In addition, Bell Atlantic and Frontier support the elimination of the primary/non-primary residential line distinction, and Bell Atlantic otherwise recommends that the Commission consider a true-up mechanism to be employed after sufficient billing data are available.[31]

11. Bell Atlantic, CBT, and GTE also contend that AT&T presents no evidence of low non-primary residential line counts, but relies on generalized data and the Hatfield Model, which they argue is inappropriate and produces grossly inaccurate estimates of subscriber lines.[32] AT&T's contentions, according to Bell Atlantic, are based upon a "hodgepodge of conjectural sources" which should not be accorded any weight.[33]

12. As for MCI's contention that the LECs' definitions are not consistent, BellSouth states that this would be expected, as the Commission has not set forth any definitions, and has left it to the price cap LECs to devise their own.[34] CBT argues that MCI's contention that the definitions filed by the price cap LECs are vague is not supported.[35]

3. Discussion

13. Based on a review of the record, we conclude that investigation of the definitions used by some price cap LECs to identify primary and non-primary residential lines is warranted. We further find that, for all price cap LECs, the line counts for primary and non-primary residential lines warrant investigation.

14. The Commission has not yet adopted a uniform nationwide definition of primary and non-primary residential lines. Our purpose here is to determine whether the definitions that price cap LECs did use are reasonable, and whether these definitions were applied consistently and in a reasonable manner in calculating the number of primary and non-primary residential lines. Once the Commission promulgates a definition in the Universal Service docket, the price cap LECs may be required to make prospective adjustments in order to comply with the new definition.

15. We have found several problems with price cap LECs' definitions of primary versus non-primary residential lines. SWBT defines its primary residential service as "the local exchange service

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[30] Bell Atlantic December 29 Reply at 9; SWBT December 29 Reply at 14.

[31] Bell Atlantic December 18 Reply at 20; Frontier December 17 Reply at 7.

[32] Bell Atlantic December 18 Reply at 19; CBT December 29 Reply at 7; GTE December 17 Reply at 15.

[33] Bell Atlantic December 29 Reply at 9.

[34] BellSouth December 29 Reply at 14.

[35] CBT December 29 Reply at 7.

provided as the primary residential service under the general or local exchange service tariffs."[36] We note that SWBT does not use the term "line" in its definition, and that in defining "primary" residential service as the "primary" residential service in its tariffs, its definition is completely circular. We tentatively conclude that this definition is unreasonable. BellSouth has a similar problem with circularity in its definition, and we tentatively conclude that its definition is unreasonable as well.[37] SNET's definition is so vague that it is not possible to determine on its face how it distinguished between primary and non-primary lines.[38] For these reasons, we require BellSouth, SNET, and SWBT to explain fully their definitions of primary and non-primary residential lines, including any assumptions that went into these definitions, and invite them, in their direct cases, to submit modified, expanded, or clarified definitions as necessary. These price cap LECs should make clear what lines these definitions include and the manner in which they would be identified, such as by account number(s), billing number(s), customer name, location, or by whatever sorting method the LEC chose to use. Regarding MCI's allegations directed at GTE's definitions, we find that GTE did provide definitions of primary and non-primary residential lines, and we decline to investigate the question of what definition GTE used to identify these lines at this time.[39]

16. The non-primary residential line counts are lower than we would have expected, given various published estimates and LEC public statements regarding the growth of second line penetration.[40] Recent industry analyses suggest that secondary line penetration averages 19 percent for

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[36] SWBT Tariff F.C.C. No. 73, § 2.7.

[37] BellSouth's definition of a primary residential line is as follows:

> This term denotes the Residential Local Exchange Service line . . . provided by the Telephone Company . . . which is assessed the Primary Residential PICC or EUCL Charge.

[38] SNET Tariff F.C.C. No. 49, § 4.1.3.E. SNET's definition for residential telephone exchange service is as follows:

> When an end user is provided a residence Telephone Exchange Service by the Telephone Company, the Primary Residence Subscriber rate set forth in Section 4.1.4(a) . . . applies to the first local residence exchange line. Each additional local residence exchange line will be billed the Non-primary residence rate set forth in Section 4.1.4(d).

There is no definition or explanation of how the first local residence exchange line is determined. Without this information, we have no knowledge of how SNET determines primary versus non-primary residential lines.

[39] *See* GTOC Transmittal No. 1123, tariff section 13.10(B); GSTC Transmittal No. 226, tariff section 4.6.7(A), both filed on November 26, 1997.

[40] *See, e.g., Cincinnati Bell, Inc. - More Than a Phone Company: Billing and Teleservices Drive Growth*, Salomon Brothers, November 28, 1997. This study included estimates for secondary line penetration for Ameritech, Bell Atlantic, BellSouth, CBT, PacBell, SWBT, and U S West. *See also Telephony Financials*, Communications Daily (January 22, 1998).

several large price cap LECs. Bell Atlantic recently announced that it had achieved additional residential line penetration of 19 percent in a 13-state region.[41] PacBell stated as early as mid-1996 that nearly 20 percent of its residential customers had more than one access line, and that it was experiencing growth of 152 percent for additional residential lines.[42] The percentages of lines that price cap LECs report in their tariff filings as non-primary residential lines are much lower than these estimates of additional line penetration and additional line growth would indicate. Most notably, PacBell reports only 3.34 percent of non-MLB lines as non-primary residential or BRI ISDN lines.[43] On average, price cap LECs identify only 8.22 percent of non-MLB lines as non-primary residential or BRI ISDN lines. We tentatively conclude that all price cap LECs may have under identified non-primary residential and BRI ISDN lines. Low non-primary residential line percentages could be due to definitions that do not reasonably identify non-primary residential lines, or to the way in which the definitions are applied.[44] We therefore designate for investigation, for all price cap LECs, both the question whether the LECs used reasonable definitions of non-primary lines and the question whether these definitions were applied in a reasonable manner.

17. We therefore require each price cap LEC to identify the number of lines in each of the following categories: (1) primary residential lines; (2) single-line business lines; (3) non-primary residential lines; and (4) BRI ISDN lines. In addition, using the worksheets attached as Appendix B, each price cap LEC's direct case must delineate what, how, and in which order data were sorted and used in accordance with its definition to arrive at the primary and non-primary residential line count totals submitted pursuant to this order. We also direct each price cap LEC to include in its direct case an explanation of why its definition is reasonable.

B. PICC and SLC Demand Amounts

1. Background

18. SLCs are assessed upon end users that subscribe to local exchange telephone service or Centrex service in order to recover price cap common line revenues.[45] PICCs are assessed per-line

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[41] *See Telephony Financials*, Communications Daily (January 22, 1998).

[42] *Pacific Telesis Inside Line*, Issue No. 90 at 2 (July 15, 1996).

[43] *See* Figure 1, *supra*.

[44] For example, Bell Atlantic used a sample of all subscriber lines in New Jersey to represent the proportion of non-primary residential line counts in the Bell Atlantic region. Bell Atlantic December 18 Reply at 20. This methodology yielded a non-primary residential line count that appears to be roughly half of that presented by Bell Atlantic in public statements. Other LECs claimed that they used actual data, but did not indicate if residential line counts were made using incomplete samples within service areas or were inclusive of company records.

[45] *Access Charge Reform Order*, 12 FCC Rcd at 16016; 47 C.F.R. § 69.152(a).

upon the subscriber's presubscribed interexchange carrier, in part to recover common line revenues not recovered from the SLC charges.[46]

19. The maximum PICCs are determined by dividing common line and other revenues permitted under our price cap rules by lines in use, subject to the PICC ceilings.[47] The maximum per-minute CCL charges the price cap LECs can recover is the lower of: (1) the per-minute rate that would recover annual common line revenues permitted less the maximum amounts allowed to be recovered under sections 69.152 and 69.153.[48] This calculation requires the price cap LECs to include in their calculations the maximum SLC and PICC revenues they may recover, regardless of whether they actually assess the charges. If a LEC does not include all of the lines it is permitted to charge a PICC in making its calculations, the PICC determined using the formula in section 69.153 will be too high because residual revenues will be divided by too few lines. Additionally, if the PICCs are above the PICC caps, the residual used to determine the per-minute CCL charge pursuant to the formula in section 69.154(a) will also be too high. Thus, if the price cap LECs do not include in their PICC and maximum CCL charge calculations all the SLCs and PICCs they are entitled to assess, the IXCs will be overcharged to the extent that these SLCs and PICCs are not included.

2. Pleadings

a. Petitions and Comments

20. Sprint LTCs contend that Ameritech estimated that the number of multi-line businesses and Primary Rate Interface (PRI) ISDN lines subject to the PICC is significantly lower than the number of lines subject to the SLC, with no explanation provided for this discrepancy.[49] AT&T and MCI contend that the LECs' SLC and PICC line counts should be identical, because the SLC charges and the PICC both seek to recover the same costs.[50] None of the LECs' SLC counts equal their PICC counts. AT&T contends that Ameritech, for example, filed PICC counts 2,281,343 lower than its SLC counts. Further, Ameritech's PICC counts for Lifeline services were 24,626 lower that its SLC counts for those services. According to MCI, Ameritech also identifies significantly fewer Centrex PICCs than Centrex SLCs.[51] Several other LECs, according to AT&T, filed tariffs where the SLC counts exceeded their PICC counts.[52]

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[46] 47 C.F.R. § 69.153(a).

[47] 47 C.F.R. § 69.153.

[48] 47 C.F.R. § 69.154.

[49] Sprint LTCs December 23 Petition at 2.

[50] AT&T December 11 Petition at 37.

[51] MCI December 10 Petition at 13.

[52] AT&T December 23 Petition at 27. These LECs include BellSouth, Bell Atlantic, GSTC, GTOC, NYNEX, PacBell, Nevada Bell, SWBT, and SNET.

b. Replies

21. Ameritech provides four reasons that it claims contribute to its SLC count being higher than its PICC count. Ameritech initially argued that Lifeline end user lines not presubscribed to an IXC were not included in the PICC primary residence demand. Ameritech has since revised its tariff filing, and now includes PICCs for Lifeline customers in its primary residence demand. Ameritech also argues that its demand for Centrex SLCs and PICCs are equal, contrary to MCI's allegation. Ameritech states that Centrex PICC demand is divided between Centrex with eight or fewer lines and Centrex with more than eight lines. The sum of these two PICC numbers equals SLC demand for Centrex.[53] Further, Ameritech contends that, for multi-line businesses, its SLC demand is higher because it does not assess PICC charges for those services that are inward-only.[54] According to Ameritech, these services do not receive a dial tone and cannot originate calls. Further, they are not presubscribed to IXCs, not by choice, but due to the nature of the service. Ameritech argues that it would be unreasonable to assess a PICC on a service for which the end user cannot select a primary IXC. Furthermore, to the extent that Ameritech determines that there are other types of lines that are unable to select a presubscribed carrier and for which it will not assess a PICC, Ameritech states that it will achieve less PICC revenue than calculated in its filing, and that the resulting loss will fall on it and not on any IXC.[55] Finally, Ameritech states that its MLB and PRI ISDN PICC counts are lower than the corresponding SLC line counts, because each PRI ISDN service application is assessed five SLCs but only one PICC.[56]

3. Discussion

22. All the LECs' filed PICC line counts that were higher than the SLC counts,[57] with the exception of Ameritech. Ameritech set forth four factors explaining why its SLC count was higher than its PICC count. The remaining price cap LECs explained that their PICC counts were higher

[53] Ameritech December 17 Reply at 19.

[54] Ameritech December 17 Reply at 19.

[55] Ameritech December 29 Reply at 10.

[56] Ameritech December 17 Reply at 19.

[57] For example, for the tariffs filed on November 26, 1997 the price cap LECs that filed at that time showed 17,935,159 more PICC demand than SLC demand.

than their SLC counts because they do not assess a SLC on official or concession lines.[58] We have concluded that the explanations based upon official and concession lines are reasonable.[59]

23. The Commission has concluded that where Lifeline customers elect toll blocking and thus do not presubscribe to an IXC, the PICC should be recovered from the low-income program of the universal service support mechanisms.[60] The lines of these customers should, therefore, be included in the PICC count. Ameritech's latest tariff filing complies with our rules in this respect, so no investigation of this issue is required. We also find that Ameritech's position that its Centrex PICC and SLC counts are identical is correct.

24. Ameritech does not assess a PICC on lines that are inward-only, arguing that these lines cannot originate calls. It does assess a SLC on these lines, and a CCL charge for calls terminated on these lines. We believe that CBT, GTE, and U S West also do not assess a PICC on inward-only lines. CBT assesses a SLC and terminating CCL charge, but does not include inward-only lines in its PICC demand. GTE does include these lines in its PICC demand for purposes of calculating its maximum PICC and CCL charge. U S West does not assess an interstate SLC or an interstate PICC on inward-only lines, and does not include these lines in its SLC or PICC demand.

25. There is no provision in the *Access Charge Reform Order* that exempts inward-only lines from being included in the SLC and PICC counts.[61] For inward-only lines that do not have a presubscribed interexchange carrier (PIC), the LEC is permitted to assess the PICC upon the end-user.[62] We therefore tentatively conclude that Ameritech and CBT are required by the Commission's rules to include those lines in their SLC and PICC counts. We seek comment on this tentative conclusion. We direct these LECs to include in their direct cases an explanation as to why their practices with respect to determining PICC demand should be considered reasonable and consistent with the *Access Charge Reform Order.*

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[58] For example, *see* BellSouth December 17 Reply at 3-6. Official lines are those lines used by the telephone company; concession lines are used by telephone company employees. Bell Atlantic December 18 Reply at 17.

[59] A PICC charge is assessed per line, upon the subscriber's presubscribed interexchange carrier. 47 C.F.R. § 69.153(a). As to these LECs' official lines, the LECs state that they are a subscriber of local exchange service, and that they presubscribe these lines to interexchange carriers.

[60] *In re Federal-State Joint Board on Universal Service; Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, End User Common Line Charge*, Fourth Order on Reconsideration in CC Docket No. 96-45, Report and Order in CC Docket Nos. 96-45, 96-262, 94-1, 91-213, 95-72, CC Docket Nos. 96-45, 96-262, 94-1, 91-213, 95-72 (rel. December 30, 1997), at ¶ 119.

[61] We note that these lines are assessed a SLC, pursuant to section 69.152(a), which states that a SLC is assessed upon end users that subscribe to local exchange service.

[62] 47 C.F.R. § 69.153(b).

26. We require U S West to include in its direct case its rationale as to why it is reasonable to exclude inward-only lines from the development of common line rates. Further, U S West must identify in its direct case the portion, if any, of the costs of these lines that is assigned to the interstate jurisdiction. If a portion of these costs is assigned to the interstate jurisdiction, U S West must include in its direct case an explanation of how these costs are recovered in interstate rates, and how U S West's treatment of these lines in computing common line rates is consistent with the Commission's Part 69 rules. If none of these costs is assigned to the interstate jurisdiction, U S West must explain how this is consistent with the Commission's Part 36 rules.

27. Further, we tentatively conclude that Ameritech's position that each PRI ISDN service application should be counted as five SLCs, but only one PICC, is not reasonable for purposes of calculating Ameritech's tariff rates. The *Access Charge Reform Order* concluded that price cap LECs could assess five PICCs on each PRI ISDN service, not just one.[63] For purposes of calculating its maximum CCL charge, we tentatively conclude that Ameritech's PRI ISDN SLC and PICC line counts should be identical.[64] We seek comment on this tentative conclusion. We direct Ameritech to include in its direct case an explanation as to why its practice is reasonable and consistent with the *Access Charge Reform Order*.

28. In addition, we direct Ameritech, CBT, and U S West to submit with their direct cases line counts recalculated in accordance with the tentative conclusions set forth above.

C. Adjustment of Common Line Revenues Because of Historic Understatement of BFP.

1. Background

29. Prior to January 1, 1998, the common line revenues permitted by the Commission's price cap rules were recovered through the flat-rated SLC and the per-minute CCL charge.[65] A portion of the common revenue requirement, referred to as the base factor portion (BFP),[66] is used to establish the relative levels of interstate SLC and CCL charges, as well as the PICC charges. Because the ceilings limit per-line charges, some portion of permitted common line revenues has been recovered in the per-minute CCL charges in each of the past price cap tariff periods (1991-1997) and in the current tariff period (1997/98).

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[63] *Access Charge Reform Order*, 12 FCC Rcd at 16033.

[64] Our tentative conclusion addresses only the SLC and PICC counts for developing tariff rates. Ameritech, if it so desires, is not required to assess the PICC, although this will result in it not recovering all of the common line revenues that price cap regulation permits. *Access Charge Reform Order*, 12 FCC Rcd at 16033.

[65] For a more complete explanation of the SLC and CCL charges, see Section II.A, *supra*.

[66] The BFP is defined in Part 69 as that portion of an incumbent LEC's common line revenue requirement that remains after exclusion of specified investments and expenses. 47 C.F.R. §§ 69.501(e). Section 69.502 also provides that special access surcharge revenues shall be deducted from the BFP. 47 C.F.R. § 69.502.

30. A price cap LEC's maximum CCL charge is determined, in part, from the last calendar year's (base-period's) aggregate common line basket revenues.[67] Any increase in aggregate common line revenues is carried forward into the following year. This further increases future CCL charges and aggregate common line revenues. In the *1997 Annual Tariff Investigation Order*, the Commission stated that for a price cap LEC that routinely develops unbiased per-line BFP revenue requirement forecasts, the price cap formula adjusts the CCL rate in a manner intended to generate the remainder of the common line revenues permitted under price caps not recovered from SLCs.[68] The Commission stated that an incumbent LEC that has consistently understated its per-line BFP revenue requirement over the course of several years has also consistently and correspondingly inflated its maximum CCL rate. A price cap LEC uses its prior year's total common line revenues as the starting point in computing its CCL rate. If the price cap LEC understates its per-line BFP revenue requirement, thereby inflating its aggregate common line revenues in a given year, the price cap formula automatically builds this inflation into its CCL rate for the upcoming year. The increase to a LEC's aggregate common line revenues is compounded each year a price cap LEC understates its per-line BFP revenue requirement. As the effects of this overstatement compound each year, the maximum CCL charge becomes increasingly inflated, generating revenues that exceed the common line revenues intended to be permitted under price caps.[69]

2. Pleadings

31. AT&T and MCI argue that the Commission should investigate all tariffs of Bell Atlantic, NYNEX, GTOC, the Sprint LTCs, SWBT, and U S West because, as found in the *1997 Annual Tariff Investigation Order*,[70] these carriers have underestimated their BFP revenue requirements and thereby have overstated their CCL rates since 1991.[71] AT&T calculates that the LECs' CCL errors forced IXCs to pay $500 million to $1 billion in excess charges over the past seven years, and argues that, unless corrected, the overcharge will continue. AT&T states that the only remaining issues are: (1) the amount by which the LECs' past (and current) total common line and CCL revenues have been (and are) overstated as a result of the LECs' past downward bias in per-line BFP revenues requirements; and (2) how the LECs' current PCIs and CCL rates should be adjusted to remedy that overstatement.[72] AT&T applied the Commission's methodology to U S West. According to AT&T, the impact of the past understatement of per-line BFP revenue requirements on the CCL rates amounts to an overpayment by AT&T of $218 million from 1991 through 1997. On a going forward basis, AT&T states that US WEST's total common line revenues are still overstated by $18 million. AT&T

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[67] 47 C.F.R. §§ 61.45(c), 61.46(d).

[68] *In the Matter of 1997 Annual Access Tariff Filings*, Memorandum of Opinion and Order, CC Docket No. 97-149 (rel. December 1, 1997) FCC 97-403 at ¶ 100 (*1997 Annual Tariff Investigation Order*).

[69] *Id.*

[70] *1997 Annual Tariff Investigation Order*, at ¶¶ 21, 102.

[71] AT&T December 23 Petition at 3-4; MCI December 23 Petition at 22.

[72] AT&T December 23 Petition at 5.

contends that an accurate quantification of the effect of the LECs' overstatements of current CCL rates will require an extensive examination of the rates since 1991. AT&T argues that price cap LECs that historically have understated their BFP revenue requirements (Bell Atlantic, NYNEX, GTOC, the Sprint LTCs, SWBT, and U S West) should be ordered to pay the appropriate refunds.[73]

32. AT&T states that the *1997 Annual Tariff Investigation Order* required Bell Atlantic to re-compute its tariff year 1997 per-line BFP forecast, and issue necessary refunds.[74] It argues that Bell Atlantic has refused to comply, insisting that its 1997/1998 projection of per-line BFP revenue requirement was correct and refuses to make corrections to its estimates or issue refunds.

33. Bell Atlantic, GTE, SWBT, the Sprint LTCs, and U S West state that their BFP calculations are fully consistent with the methodology adopted by the Commission in the *1997 Annual Tariff Investigation Order*.[75] U S West claims that the Commission has effectively prescribed the CCL rates that the carriers have filed in this proceeding by prescribing the per-line BFP revenue requirement that the carriers use to determine the CCL rates.[76] Bell Atlantic states that in calculating the CCL, there is no carry forward effect from prior years.[77] GTE argues that AT&T's analysis ignores the fact that some carriers have historically priced their CCL rates substantially below the permitted cap and any overearnings during that period would have been reflected in the sharing mechanisms in place.[78] GTE further states that AT&T's claim that LECs must adjust their PCI values to reflect a restatement of SLC and CCL rates for each year since 1991, is without justification.[79]

34. Bell Atlantic states that its tariffs already included the specific correction required by the Commission's *1997 Annual Tariff Investigation Order*. Moreover, states Bell Atlantic, using the Commission's methodology would have no impact on BFP costs; thus, no changes were required.[80]

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[73] AT&T December 23 Petition at 7. AT&T's request for refunds based on rates in effect prior to January 1, 1998, is not an appropriate subject for this investigation. This investigation is limited to questions concerning rates currently in effect and does not extend to cover past periods.

[74] AT&T December 23 Petition at 6-7.

[75] Bell Atlantic December 23 Reply at 10; GTE December 23 Reply at 2; SWBT December 23 Reply at 11; the Sprint LTCs December 23 Reply at 2; and U S West December 23 Reply at 3.

[76] U S West December 23 Reply at 3.

[77] Bell Atlantic December 23 Reply at 11, n. 15.

[78] GTE December 23 Reply at 3, n. 6.

[79] *Id.* at 3; SWBT December 23 Reply at 12; and the Sprint LTCs December 23 Reply at 2.

[80] Bell Atlantic December 23 Reply at 11.

3. Discussion

35. In the *1997 Annual Tariff Investigation Order*, the Commission found that Bell Atlantic, NYNEX, GTE, SWBT, the Sprint LTCs, and U S West had consistently underestimated their per-line BFP revenue requirement forecasts.[81] In that order, the Commission stated that "a LEC that has consistently understated its per-line BFP revenue requirement over the course of several years has also consistently and correspondingly inflated its maximum CCL rate."[82] The Commission did not, however, order reductions to PCIs to remove this effect because the record did not provide sufficient information to allow calculation of such reductions. We tentatively conclude that the current maximum CCL rates of Bell Atlantic, NYNEX, GTE, SWBT, the Sprint LTCs, and U S West are unreasonably high due to past understatement of per-line BFP revenue requirement. At this time, we direct each of these carriers to provide, as part of its direct case, a recalculation of its maximum common line revenues, using the CCL Recalculation Methodology employed by AT&T in its December 23 Petition. We seek comment on this proposed methodology. We also seek comment on whether this proposed methodology should be adjusted to account for specific instances in which price cap LECs have priced their CCL charges below the permitted cap or have reduced their PCIs for a tariff year because of sharing. Additionally, we invite LECs to submit alternative methodologies that in their view may present a more accurate calculation of their maximum common line revenues.

III. METHODOLOGY FOR CALCULATING EXOGENOUS COST CHANGES FOR LINE PORTS AND END OFFICE TRUNK PORTS

A. Background

36. In the *Access Charge Reform Order*, the Commission concluded that, consistent with principles of cost-causation and economic efficiency, non-traffic sensitive (NTS) costs associated with local switching should be recovered on a flat-rated basis.[83] Specifically, the Commission found that the costs of the line-side port (including the line card, protector, and main distribution frame) are NTS, and thus should be recovered through flat-rated charges. Accordingly, for price cap LECs, the Commission reassigned all line-side port costs as of January 1, 1998 from the Local Switching category of the Traffic-Sensitive basket to the Common Line basket rate elements, which include the SLC and the flat-rated PICC.[84] The Commission directed all price cap LECs to include in their tariff filings implementing the Order an exogenous downward adjustment to the Traffic-Sensitive basket, 47 C.F.R. § 61.42(d)(2), and corresponding exogenous upward adjustment to the Common Line Interstate

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[81] *1997 Annual Tariff Investigation Order*, at ¶ 6.

[82] *Id.* at ¶ 101.

[83] *Access Charge Reform Order*, 12 FCC Rcd at 16035.

[84] *Access Charge Reform Order*, 12 FCC Rcd at 16035. NTS costs of line-side ports had previously been recovered through per-minute local switching charges assessed under section 69.106 of the Commission's rules, 47 C.F.R. § 69.106.

Access Elements basket, 47 C.F.R. § 61.42(d)(1), to reflect the recovery of the interstate NTS costs of line-side ports from the Common Line rate elements.[85]

37. The Commission also found in the *Access Charge Reform Order* that the costs of a dedicated trunk port (including the trunk card and DS1/voice-grade multiplexers, if needed) should be recovered on a flat-rated basis from the carrier purchasing the dedicated trunk terminated by that port.[86] The Commission concluded that, in order to ensure that these purchasers of dedicated trunks do not pay the costs of shared trunk ports that they do not use, the costs of shared trunk ports should be recovered on a per-minute-of-use basis from the users of common transport trunks. Therefore, for price cap LECs, the Commission reassigned all trunk port costs in the Traffic-Sensitive basket from the Local Switching category to a new "trunk ports" category, and established separate rate elements within this category for dedicated trunk port costs and shared trunk port costs.[87]

38. In addition, the Commission required each price cap LEC to conduct a cost study to determine the geographically-averaged portion of local switching costs that is attributable to line-side ports and to dedicated trunk-side ports.[88] The Commission took note of the estimate by the United States Telephone Association (USTA) that six percent of the costs of an analog switch and 51 percent of the costs of a digital switch are NTS.[89] The Commission did not, however, establish a fixed percentage of local switching costs that price cap LECs must reassign to the Common Line basket or to the newly-created Trunk Cards and Ports service category. In light of the widely varying estimates in the rulemaking record, the Commission instead concluded that the NTS portion of local switching costs likely varies among LEC switches.[90]

39. In the tariffs filed pursuant to the *Access Charge Reform Order*, most price cap LECs compute the exogenous cost adjustments for line ports and end office trunk ports by: (1) using the Switching Cost Information System (SCIS) model (or a similar switching cost model), or estimating material prices and installation and engineering costs without using a switching cost model, to compute line port investment, end office trunk port investment, and total end office switch investment (which includes line port investment and end office trunk port investment); (2) dividing line port investment and end office trunk port investment by total end office switch investment to obtain ratios of total switching investment; (3) developing a revenue requirement for the Local Switching category within the Traffic-Sensitive basket based on an after tax rate of return of 11.25 percent; and (4) multiplying the ratios of line port investment and end office trunk port investment to total switching investment by the revenue requirement for the Local Switching category.

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[85] *Access Charge Reform Order*, 12 FCC Rcd at 16037.

[86] *Access Charge Reform Order*, 12 FCC Rcd at 16036.

[87] *Access Charge Reform Order*, 12 FCC Rcd at 16036. *See also* 47 C.F.R. § 61.42(e)(1).

[88] *Access Charge Reform Order*, 12 FCC Rcd at 16037.

[89] *Access Charge Reform Order*, 12 FCC Rcd at 16038, *citing* USTA Comments, Attachment 2 at 31.

[90] *Access Charge Reform Order*, 12 FCC Rcd at 16036.

40. Other price cap LECs compute the exogenous cost adjustments for line ports and end office trunk ports by: (1) using a switching cost model, or estimating material prices and installation and engineering costs without using a switching cost model, to develop investment for a single line port or end office trunk port; (2) developing annual cost factors for local switching, including an annual cost factor for the cost of capital based on an after-tax rate of return of 11.25 percent; (3) multiplying investment for a single line port or end office trunk port by the annual cost factors to obtain the annual cost for a single line port or end office trunk port; (4) measuring the total demand for line ports or end office trunk ports; and (5) multiplying the annual cost for a single line port or end office trunk port by the total demand for line ports or end office trunk ports.

B. Pleadings

41. MCI and AT&T note that price cap LECs have applied the port cost percentages that they derived from their cost models to the Part 69 local switching revenue requirements that they developed using data reports from the Automated Reporting Management Information System (ARMIS).[91] These commenters argue that price cap LECs should have applied their port cost percentages to their local switching revenues under price caps, which are substantially higher than the LECs' ARMIS revenue requirements.[92] For example, AT&T contends that SNET's local switching revenue under price caps is $102.1 million, whereas its revenue requirement is $63.6 million.[93] AT&T also argues that the application of the line port percentages to local switching revenues is necessary to "equitably distribute any over earnings or under earnings to the line port."[94]

42. According to these commenters, if price cap LECs had applied the line port percentages derived from their cost models to their actual local switching revenues, the amount of line port dollars moved from the Local Switching category to the Common Line basket would be substantially greater.[95] To demonstrate this point, AT&T provides data indicating that the percentage of line port exogenous costs to current local switching band revenues for the Regional Bell Operating Companies (RBOCs) is significantly lower than the line port cost percentage identified in the RBOCs' cost studies.[96] For example, AT&T states that Ameritech's line port investment percentage is 27%, while its percentage of line port exogenous costs to local switching revenues is 17.2%. AT&T also states that BellSouth's line port investment percentage is 30.8%, while its percentage of line port exogenous

[91] AT&T December 11 Comments and Petition at 11-12; MCI December 10 Comments at 3-4; MCI December 10 Petition at 3.

[92] AT&T December 11 Comments and Petition at 11-12; AT&T December 23 Pacific and Nevada Comments at 7-8; MCI December 10 Comments at 3-4; MCI December 10 Petition at 3.

[93] AT&T December 11 Petition and Comments at 11-12.

[94] AT&T December 11 Petition and Comments at 10.

[95] AT&T December 11 Comments and Petition at 11-12; MCI December 10 Comments at 4.

[96] AT&T December 11 Petition and Comments at 11, Exhibit A.

costs to local switching revenues is 21.2%.[97] In addition, AT&T claims that if price cap LECs had applied the trunk port percentages derived from their cost models to their actual local switching revenues, the amount of trunk port dollars moved from the Local Switching category to the new trunk port elements would be substantially greater. AT&T contends that the percentage of trunk port exogenous costs to current local switching band revenues for RBOCs is significantly lower than the trunk port cost percentage identified in the RBOCs' cost studies.[98]

43. Price cap LECs reply that the application of port investment percentages to the 1996 ARMIS local switching revenue requirement complies with the text of the *Access Charge Reform Order*, which requires price cap LECs to remove line port and trunk port costs from the local switching category.[99] Price cap LECs note that the shift of line port costs, rather than actual revenues, is consistent with the Part 69 rules on basic and complex line port costs adopted in the *Access Charge Reform Order*.[100] Price cap LECs also note that section 69.306(d) of the Commission's rules states that line port costs shall be assigned to the Common Line basket, and section 69.157 of the Commission's rules states that the costs of Integrated Services Digital Network (ISDN) line ports (and similar services) shall be recovered through a separate end user charge.[101] Price cap LECs state that their calculation of the shift in line port costs is consistent with section 61.45 the Commission's rules on exogenous cost treatment.[102] In addition, price cap LECs note that the shift of line port costs to the Common Line basket is consistent with the Commission's common line rate development rules.[103] Specifically, price cap LECs state that section 69.104(c) of the Commission's rules directs that common line recovery be based upon a determination of common line Base Factor Portion (BFP) revenue requirement per line.[104] Price cap LECs also assert that the calculation of line and trunk port cost shifts on a revenue requirement basis is consistent with the revenue requirement treatment given

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[97] AT&T December 11 Petition and Comments at 11, Exhibit A.

[98] AT&T December 11 Petition and Comments at Exhibit A.

[99] Ameritech December 17 Reply at 3-4; Bell Atlantic December 18 Reply at 6; BellSouth December 17 Reply at 23; CBT December 17 Reply at 3; SWBT December 17 Reply at 3; SBC December 29 Reply at 6; U S West December 17 Reply at 4-5; Frontier December 17 Reply at 3. These LECs cite *Access Charge Reform Order*, 12 FCC Rcd 15982, 16006, 16035-40.

[100] Bell Atlantic December 18 Reply at 6; BellSouth December 17 Reply at 23.

[101] *See* Bell Atlantic December 18 Reply at 6; BellSouth December 17 Reply at 23; Frontier December 17 Reply at 3. *See also* 47 C.F.R. §§ 69.306(d), 69.157.

[102] CBT December 17 Reply at 3; GTE December 17 Reply at 6. *See* 47 C.F.R. § 61.45.

[103] Ameritech December 17 Reply at 4. *See also* Bell Atlantic December 18 Reply at 6.

[104] *See* Ameritech December 17 Reply at 4; Bell Atlantic December 18 Reply at 6. *See also* 47 C.F.R. § 69.104(c).

to the Central Office Equipment (COE) maintenance expense adjustment and the revised allocation of General Support Facilities (GSF).[105]

44. In addition, Ameritech states that in past proceedings the Commission has accepted exogenous cost changes calculated on a revenue requirement basis, including exogenous cost changes for excess deferred taxes and the investment tax credit.[106] Ameritech also notes that in Exhibit A of AT&T's December 11 Petition and Comments, Column A is labelled "Current Local Switching Revenues" but the entry for Ameritech represents the entire Traffic-Sensitive revenue as it existed prior to the 1997 Annual Filing.[107] Ameritech argues that, accordingly, the line port and trunk port percentage exogenous changes resulting from AT&T's calculations are understated. SNET contends that it did not apply a line port percentage derived from SCIS to the Part 69 local switching revenue requirement, but rather multiplied unit revenue requirements by base year demand quantities.[108]

45. Furthermore, the Sprint LTCs state that, contrary to the assertions of MCI and AT&T, applying a line port cost percentage to local switching revenues under price caps does not result in a cost-based reallocation of line port costs. The Sprint LTCs explain that this methodology would permanently assign a portion of the difference between current revenues and line port costs to the Common Line basket, and therefore defeat the goal of access reform to require the cost-causer to be the cost-payer.[109] GTE states, in response to AT&T's assertion that the application of the line port percentages to local switching revenues is necessary to "equitably distribute any over earnings or under earnings to the line port," that sharing of over earnings is not relevant. According to GTE, under the original price cap plan it is the total interstate jurisdictional level, as opposed to the individual service category, which dictates over earnings.[110] Thus, GTE asserts that AT&T's method would effectively result in a return to monitoring rates on the basis of individual returns within service categories even though the Commission recently eliminated any sharing obligation from the price cap plan.[111]

C. Discussion

46. In the *Access Charge Reform Order*, the Commission adopted rules stating that price cap LECs shall assign "line-side port *costs*" to the Common Line rate element and that price cap LECs shall "separate from the projected annual revenues for the Local Switching element those *costs*

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[105] Ameritech December 17 Reply at 5; BellSouth December 17 Reply at 23-24; CBT December 17 Reply at 5.

[106] Ameritech December 17 Reply at 4-5.

[107] Ameritech December 17 Reply at 5.

[108] SNET December 17 Reply at 3.

[109] Sprint LTCs December 17 Reply at 1-2.

[110] GTE December 17 Reply at 7.

[111] GTE December 17 Reply at 7.

projected to be incurred for ports... on the trunk side of the local switch."[112] In calculating the exogenous cost adjustments required by these rules, price cap LECs interpreted "costs" to mean "Part 69 revenue requirements."[113] These LECs also claim that this revenue requirement should be calculated using the allowed rate of return for local exchange carriers under rate of return regulation, 11.25 percent. In contrast, AT&T and MCI interpret "costs" to mean "price cap permitted revenues," and argue that the price cap LECs should have calculated their exogenous cost changes on the basis of these revenues.[114]

47. As an initial matter, we note that the Commission has never adopted by rulemaking a single methodology for computing exogenous cost changes that result from a reallocation of cost recovery among price cap service categories, baskets, or rate elements. It is therefore appropriate for us to determine the proper methodology for these exogenous cost changes in a tariff investigation under Section 204 of the Communications Act, 47 U.S.C. § 204. Accordingly, we seek comment and make tentative conclusions below regarding the relevant legal and policy considerations.

48. When a LEC entered price cap regulation in 1991, each rate element was based on the Part 69 revenue requirement and targeted to earn an 11.25 percent rate of return. Over time, through operation of the price caps formulas, rates have diverged from those original allocated costs. Price cap regulation has allowed carriers that reduced their costs to keep all or some of the earnings they gained by being more efficient. Moreover, price cap regulation allowed carriers a measure of pricing flexibility within baskets to raise and lower rates on particular rate elements without reference to the revenue requirements originally recovered through those rate elements, or to the revenue requirement that would result today from application of the Part 69 cost allocation rules. After seven years of price caps, it is likely that Part 69 revenue requirements have a very attenuated relationship to the costs actually recovered through any particular rate element. Therefore, we tentatively conclude that revenues, and not Part 69 revenue requirements, are the best measure of the costs recovered through a particular price cap rate element. We seek comment from all interested parties on this tentative conclusion.

49. If, after reviewing the record in response to this designation order, we conclude that the *Access Charge Reform Order* required that LECs use revenue requirement, rather than revenues, to make the exogenous cost changes, we tentatively conclude that actual basket earnings must be used to calculate that revenue requirement. Using actual earnings to divide the costs of local switching into three separate components for future recovery produces an equitable and reasonable distribution of the earnings reflected in the one local switching rate by spreading them proportionately over the three new components. We seek comment from all interested parties on this tentative conclusion.

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[112] 47 C.F.R. §§ 69.306(d), 69.106(f)(1) (italics added). *See also Access Charge Reform Order*, 12 FCC Rcd at 16035-36.

[113] *See, e.g.*, Ameritech December 17 Reply at 3-5; Bell Atlantic December 18 Reply at 5-6; BellSouth December 17 Reply at 22-24.

[114] *See* AT&T December 11 Comments and Petition at 11-12; AT&T December 23 Pacific and Nevada Comments at 7-9; MCI December 10 Comments at 3-4; MCI December 10 Petition at 4.

50. We believe that the best method for moving rate elements or services out of a basket or service category would be a method that left exactly zero permitted revenues in the basket or service category after all services or rate elements were removed. If the price cap LECs' methodologies were applied *seriatim* to each service in a price cap basket for purposes of removing those services from the basket, the basket would have permitted revenues left after all services were removed, if the basket had been earning returns in excess of 11.25 percent. On the other hand, if the basket had been earning less than 11.25 percent, there would be insufficient permitted revenues for all of the services. The result of having zero revenues in the basket or service category after all services are removed can be accomplished by using revenues, as we tentatively conclude is preferable, or by using revenue requirements calculated on the basis of actual basket earnings. We seek comment on this approach.

51. Furthermore, we seek comment on whether the methodology discussed here for ports should also be applied to the other reallocations required by the *Access Charge Reform Order*. Parties should quantify the results of using this method consistently for all such reallocations. In addition, parties dispute the extent to which precedent exists that governs or should govern the method to be applied here. We direct each LEC to include in its direct case a comprehensive list of all the exogenous adjustments it has made since it entered price cap regulation that had the purpose of reallocating costs among baskets, categories, rate elements, or between price cap and non price cap services. LECs should list the method used in each instance.

52. Finally, if costs are reallocated using revenues as a surrogate for costs, we tentatively conclude that common line rate development should be done in the following manner. Price cap LECs should use local switching revenues for the purpose of determining the amount of exogenous cost adjustments to the Traffic-Sensitive and Common Line baskets, but price cap LECs should use their Part 69 revenue requirements to recalculate the BFP, because the BFP is still calculated pursuant to fully-distributed embedded costs and revenue requirements.[115] We seek comment from all interested parties on this tentative conclusion.

IV. TRANSPORT ADJUSTMENT ISSUES

A. Whether the Price Cap LECs are Attributing Too Large a Fraction of Their Tandem Switching Revenue Requirement to SS7 Costs.

1. Background

53. The *Access Charge Reform Order* requires that SS7 costs that are recovered by the TIC be removed from the TIC and allocated to the traffic sensitive basket.[116]

[115] *See* 47 C.F.R. §§ 69.501(e) and 69.502.

[116] *Access Charge Reform Order,* 12 FCC Rcd at 16284.

2. Pleadings

54. MCI contends that several LECs are attributing too large a fraction of their tandem switching revenue requirement to SS7, thereby overallocating costs to the traffic sensitive basket and minimizing the facilities-based TIC, that can be avoided by using competitive transport.[117] For example, MCI charges that Bell Atlantic has overstated its SS7 costs.[118] MCI states that the Commission's *First Transport Order* indicated that SS7-related costs are estimated to represent no more than approximately ten percent of the total tandem revenue requirement. It notes that while most LECs are attributing less than ten percent of their tandem switching revenue requirement to SS7, Bell Atlantic is attributing 28 percent to SS7.[119] MCI rejects Bell Atlantic's claim that its SS7 costs are high because it has deployed SS7 exclusively at tandems, noting that the Commission found in the *Local Transport Order* that LECs generally classify SS7 costs as Category 2 tandem switching investment.[120] Further, MCI requests that Bell Atlantic explain the disparity between its previous statements to the Commission concerning the level of its SS7 costs and its current estimates.[121]

55. MCI argues that while the price cap LECs, including Ameritech, BellSouth, and GTE, have adjusted the overall tandem switching revenue requirement for the change in PCI since 1993 as required by the *Access Charge Reform Order,* they have not adjusted the revenue requirement for SS7 in a similar fashion.[122] MCI argues that the LECs should be required to compute the percentage of tandem switching attributable to SS7, and then apply this percentage to the overall tandem switching revenue requirement computed pursuant to the *Access Charge Reform Order.*[123]

56. MCI further argues that several price cap LECs, including SWBT, PacBell and Nevada, have failed to deduct STP port costs from their SS7 revenue requirements even though these costs have never been part of the TIC.[124] MCI believes that the failure to exclude signalling transfer points (STP) port costs explains why these companies are attributing more than ten percent of their overall

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[117] MCI December 23 Petition at 8.

[118] *Id.*

[119] *Id.* at 8-9.

[120] *Id. citing In the Matter of Transport Rate Structure and Pricing,* CC Docket No. 91-213, Report and Order and Further Notice of Proposed Rulemaking, 7 FCC Rcd 7006, 7019 (1992) (*Local Transport Order*).

[121] *Id.*

[122] MCI December 10 Petition at 8.

[123] *Id.*

[124] MCI December 23 Petition at 10.

tandem switching revenue requirement to SS7. MCI urges the Commission to investigate these LECs' tariffs to ensure that only costs formerly recovered by the TIC have been removed from the TIC.[125]

57. MCI argues that U S West has used the wrong SS7 cost figure in computing the residual tandem switching revenue requirement.[126] It notes that even though U S West computed the correct SS7 revenue requirement on Workpaper 7, it used a higher Workpaper 12 figure when it computed its tandem switching revenue requirement. MCI asserts that U S West should be required to correct this error.[127]

58. The LECs disagree with MCI that their SS7 costs are overstated.[128] For example, CBT states that its SS7 investment and costs have been categorized to the Local Switching Access Element since before it went to price caps, and therefore SS7 costs are already being recovered from the Traffic Sensitive Basket.[129] Thus, CBT points out that it does not have any SS7 exogenous costs.[130] Bell Atlantic states that its SS7 costs, as a percentage of its tandem switching revenue requirement, are not out of line with the percentages of other LECs.[131] Bell Atlantic points out that the amount of SS7 costs will vary based on the number of tandems, the costs of the tandems, and the size of the area served.[132] Bell Atlantic also disagrees with MCI that it did not explain how it derived its SS7 costs. It refers to its Description & Justification in its TRP, which it believes explains the derivation of the tandem revenue requirement attributable to SS7. U S West argues that it used the appropriate figures in determining its tandem switching revenue requirement.[133]

59. In general, the LECs also disagree with MCI that they are required to adjust the costs of SS7 components of the tandem switching revenue requirement to reflect PCI adjustments since 1993.[134] They contend that there is no requirement in the *Access Charge Reform Order* to make such

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[125] *Id.* at 11.

[126] *Id.*

[127] *Id.*

[128] *See, e.g.,* CBT December 17 Reply at 9; Bell Atlantic December 18 Reply at 14.

[129] CBT December 17 Reply at 9.

[130] CBT December 29 Reply at 3-4.

[131] Bell Atlantic December 18 Reply at 13.

[132] Id. at 14.

[133] U S West December 17 Reply at 4.

[134] *See, e.g.,* SWBT December 17 Reply at 4; BellSouth December 17 Reply at 16; and U S West December 17 Reply at 6.

adjustments.[135] Sprint LTCs, however, agree with MCI that SS7 costs should be adjusted to reflect past X-
factor reductions before they are removed from the tandem revenue requirement.[136]

60. With respect to MCI's concern that STP port costs were not removed from the STP revenue requirement, SWBT argues that the Commission did not specify this requirement. Therefore MCI is incorrect that the $2.9 million transfer of STP port costs to the new STP port termination service category should be deducted from the SS7 costs and removed from the TIC.[137] Aliant states that it excluded the costs of STP ports in developing the STP revenue requirement and the exogenous adjustment.[138]

3. Discussion

61. Based on our review of the price cap LECs' tariff filings, we find in general that, except for Bell Atlantic, U S West, SWBT, PacBell, and Nevada, the cost support provided by the price cap LECs for the removal of SS7 costs does not raise substantial questions of lawfulness that warrant investigation. We are, however, concerned that while Bell Atlantic is attributing 28 percent of its tandem switching revenue requirement to SS7, most price cap LECs are attributing less than 10 percent of their tandem switching revenue requirement to SS7 costs. As MCI pointed out, the *Local Transport Order* determined that SS7 related costs represent no more than approximately 10 percent of the total tandem revenue requirement.[139] In addition, we are unable to determine whether U S West used the correct SS7 cost figure in computing its residual tandem switching revenue requirement. Thus, we require Bell Atlantic and U S West to provide cost studies justifying the amount that was removed from the TIC as SS7 costs. In particular, Bell Atlantic and U S West must provide detailed information substantiating the amount of SS7 costs that were originally allocated to the TIC. We also require detailed information regarding any additional SS7 costs that were incorporated into the TIC during the period January 1, 1994 to December 31, 1997. Furthermore, Bell Atlantic and U S West should provide detailed information regarding any true-up to SS7 costs due to exogenous cost adjustments in the trunking basket.

62. We are also concerned that SWBT, PacBell, and Nevada have included STP port costs in their SS7 revenue requirement even though, as MCI notes, these costs have never been part of the TIC. We tentatively conclude that these price cap LECs should be required to deduct STP port costs from the SS7 revenue requirement if STP port costs have been included in the dedicated signalling rate element, and ask comment as to this conclusion.

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[135] *Id.*

[136] Sprint LECs December 17 Reply at 2; Exh. 3-13.

[137] *Id.* at 5.

[138] Aliant December 17 Reply at 4.

[139] *See Local Transport Order*, 7 FCC Rcd at 7019.