to go into effect without an investigation "decides nothing concerning the merits of the case; it merely reserves the issues pending a hearing."[91]

55. Further, Section 61.46(d)(1) of the Commission's rules sets forth the methodology by which the maximum carrier common line charge shall be computed. The Commission has the authority and the obligation under section 201(b) of the Commission's rules to determine whether price cap LECs have established reasonable rates by using this methodology correctly. In the *1997 Annual Tariff Investigation Order*, we specifically noted that although a price cap LEC that consistently understated its per-line BFP revenue requirement inflated its maximum CCL rate, the record did not provide sufficient information to allow calculation of such reductions. This proceeding, however, designated this issue for investigation and has developed a sufficient record.

56. We also find without merit U S West's claim that we cannot require the proposed CCL rate adjustments because we need either to provide acceptable margins of error for BFP forecasts or to require all LECs to true-up their BFP. In the *1997 Annual Tariff Investigation Order*, we stated which price caps LECs have reasonable maximum CCL rates and which ones did not.[92] Price cap LECs can use our findings in that investigation as a guide for which kind of BFP forecasts produce reasonable rates. Contrary to U S West's claim, we do not need to find that only perfect BFP forecasts can produce reasonable rates. In fact, in the *1997 Annual Tariff Investigation Order*, we found that most of the price cap LECs were able to produce reasonably unbiased and accurate forecasts without making perfect predictions.[93] U S West would have us require a true-up to actual BFPs for all price cap LECs, even ones whose rates we determined were reasonable. In the *1997 Annual Tariff Investigation Order*, we 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."[94] In this order, we require those price cap LECs which have "consistently understated" their per-line BFP revenue requirements to recalculate their maximum CCL rates. There is no need to require price cap LECs that have produced reasonably unbiased and accurate forecasts to recalculate their maximum CCL rates. That would unduly punish price cap LECs that have consistently and reasonably forecast their monthly per-line BFP revenue requirements.

57. We adopt, with some modifications, AT&T's proposed methodology for calculating the impact of the historic understatement of the BFP estimates in current CCL rates. The AT&T methodology uses adjusted SLCs and the formulas on the CCL-1 charts to recalculate the maximum permitted CCL rates and common line revenues for 1991-1997.[95] The AT&T methodology for recalculating the maximum CCL rate adjusts the SLCs proposed in the annual filings by: (1)

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[91] *Papago Tribal Util. Auth. v. FERC*, 628 F.2d 235, 240 (D.C. Cir. 1980), *cert denied*, 449 U.S. 1061 (1980).

[92] *1997 Annual Tariff Investigation Order*, 13 FCC Rcd at 3838-47.

[93] *Id.*

[94] *Id.* at 3856-57.

[95] The CAP-1 chart replaced the CCL-1 chart beginning with the access reform tariff filings that took effect on January 1, 1998.

calculating the percentage difference between the actual BFP and the forecasted BFP in each annual filing; and (2) applying this percentage to the SLCs proposed in each annual filing. For each SLC, the AT&T adjusted proposed SLC is the lesser of this calculation and the SLC cap.[96] The AT&T methodology uses a "true-up" mechanism to account for rate changes that took effect between annual tariff filings.[97]

58. We find that the AT&T methodology is generally correct for two reasons. First, it uses CCL-1 charts to recalculate the maximum CCL rate and common line revenues and the formula set forth on these charts is equivalent to the formula set forth in our rules for calculating the maximum CCL rate and common line revenues. Second, AT&T's methodology removes the historic understatement of BFP forecasts from the SLCs proposed in the annual filings because it applies the percentage difference between the actual BFP and the forecasted BFP to the proposed SLCs.

59. We agree with Bell Atlantic, however, that the true-up mechanism in AT&T's methodology does not precisely reflect the impact that rate changes between annual tariff filings have on the maximum CCL rate. The AT&T methodology only uses a "true-up" mechanism because it does not account separately for interim rate changes. Bell Atlantic recalculated the amount of the maximum CCL and common line revenue overstatement for Bell Atlantic-South by measuring the impact on the CCL rate of interim filings between the 1996 and 1997 annual filings. This calculation reveals that Bell Atlantic-South's maximum common line revenue overstatement is approximately two million dollars lower than the overstatement calculated by using the "true-up" reflected in AT&T's methodology.[98] We find that accounting separately for each tariff filing that has affected maximum common line revenues since 1991 may substantially increase the precision of the maximum CCL rate recalculations. We therefore modify AT&T's methodology to account for the impact of interim rate changes. We require Bell Atlantic-South, Bell Atlantic-North, US West, GTE, SWBT, and Sprint to recalculate their maximum CCL rates by accounting separately for each tariff filing that has affected maximum common line revenues since 1991. We require that they revise each CCL-1 chart that they submitted with their previous filings by performing the calculations on these charts using AT&T adjusted proposed SLCs in place of the proposed SLCs in each tariff filing. These LECs should not "true-up" the calculation of the maximum CCL rate and common line revenues because each rate change that has affected maximum common line revenues since 1991 is accounted for separately under this revised methodology.

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[96] AT&T Petition, Exhibit CCL Refund at 1, 5 (dated December 23, 1997). The AT&T methodology uses the adjusted proposed SLCs in the calculation of the maximum CCL rate and common line revenues on the CCL-1 charts for a given annual tariff filing. It carries these adjusted proposed SLCs forward and uses these as the SLCs at the last PCI update on the CCL-1 chart for each subsequent annual tariff filing. *Id.* at 1, 3, 3a-3g, and 5.

[97] The AT&T methodology accounts for rate changes that take effect between annual tariff filings by first determining the percentage difference between the maximum CCL rate proposed in a given annual tariff filing and the maximum CCL rate at the last PCI update in the subsequent annual filing. It then applies this percentage difference to the "AT&T calculated CCL rate cap" for the earlier of the two annual filings. AT&T refers to the result obtained by applying the percentage change in the maximum CCL rate between annual filings to the "AT&T calculated CCL rate cap" for the earlier of the two annual filings as the "AT&T Calculated CCL Rate Cap with True-Up." AT&T Petition, Exhibit CCL Refund at 1, 4 (dated December 23, 1997).

[98] Bell Atlantic Direct Case, Exhibit B2.

60. For price cap LECs such as Bell Atlantic-South that file separate SLCs for each state in their territories, the AT&T adjusted proposed SLCs are weighted average rates based on SLC demand for each state in a LEC's territory.[99] In implementing AT&T's methodology, as revised by this Order, Bell Atlantic-South must use the same demand for calculating the adjusted proposed SLCs reflected in the calculations on the revised CCL-1 charts as was used originally to calculate the proposed weighted average rates reflected in the calculations on the previously submitted CCL-1 charts.[100] We also find that Bell Atlantic-South must carry forward these same adjusted proposed SLCs and use these as the SLCs at the last PCI update on the CCL-1 chart for each subsequent recalculated tariff filing. By carrying forward the same weighted average rates without modifying the demand reflected in the calculation of these rates, the rates properly reflect the demand that provided the basis for recovery of common line revenues between tariff filings.

61. We disagree with Bell Atlantic's argument that section 61.46(d)(1) of our rules[101] requires that the weighted average SLCs at the last PCI update reflect base period demand for the current tariff filing. These rules require that the SLCs at the last PCI update reflect existing rates. Existing SLCs are those in effect immediately prior to the effective date of the current tariff filing. For a price cap LEC such as Bell Atlantic-South that calculated weighted average SLCs and used these weighted averages on the CCL-1 chart for the prior tariff filing, existing SLCs reflect the demand for whatever period that it used to calculate these weighted averages and the SLCs proposed for each state in its territory in the prior tariff filing.

62. We agree with Sprint that the AT&T methodology, as revised by this Order, must be extended through December 31, 1997 so that it captures any rate changes that may have affected maximum common line revenues between the July 1, 1997 annual filing and the access reform tariff filing. The adjusted proposed SLCs used in the recalculation of the maximum CCL rate and common line revenues on the CCL-1 charts for these tariff filings should reflect the Commission's prescribed BFP forecast. Bell Atlantic-South, Bell Atlantic-North, US West, GTE, SWBT, and Sprint LECs must, therefore, apply the modified AT&T methodology so that it also captures interim rate changes filed between July 1, 1997 and December 31, 1997. They also must reflect the Commission's prescribed BFP forecast in the recalculation of the maximum CCL rate and common line revenues for these tariff filings.

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[99] For example, Bell Atlantic calculates the AT&T adjusted proposed SLC for multi-line businesses by: (1) calculating the percentage difference between the actual BFP and the forecasted BFP in each annual filing; and (2) applying this percentage to the multi-line business SLCs proposed in each annual filing for each state in its territory to obtain the AT&T adjusted proposed SLC for multi-line businesses in each state; (3) multiplying the AT&T adjusted proposed SLC for multi-line businesses in each state by the multi-line business demand for each state to obtain the adjusted proposed SLC revenues for multi-line businesses in each state; (4) summing the adjusted proposed SLC revenues for multi-line businesses in each state; and (5) dividing the sum of the adjusted proposed SLC revenues for multi-line businesses by the multi-line business demand for all states. Bell Atlantic Direct Case, Exhibit B1.

[100] Bell Atlantic-South files separate SLCs for each state in its territory. It developed the maximum CCL rate and common line revenues by using a weighted average of the SLCs for each state in the formula for calculating the maximum CCL rate on the CCL-1 charts. It used demand for SLC elements for each state to calculate the weighted average SLCs.

[101] 47 C.F.R. § 61.46(d)(1).

63. We find that SWBT did not account properly for rate changes reflected in its 1997 annual tariff filing. SWBT recalculated the maximum CCL rate and common line revenues by revising its CCL-1 charts for annual and interim tariff filings between 1991 and 1998 using adjusted proposed SLCs in place of the originally proposed SLCs. It did not, however, revise the CCL-1 chart it submitted for the 1997 annual tariff filing. It has not, therefore, accounted separately for rate changes reflected in its 1997 annual tariff filing. Accordingly, SWBT must revise the CCL-1 chart it submitted for the 1997 annual tariff filing. SWBT must use adjusted proposed SLCs in the recalculation of the maximum CCL rate and common line revenues on this CCL-1 chart that reflect the Commission's prescribed BFP forecast. It also must reflect the recalculation of the maximum CCL rate and common line revenues for the 1997 annual tariff filing in the recalculation of the maximum CCL rate and common line revenues for subsequent tariff filings.

64. We disagree with Bell Atlantic's argument that AT&T's methodology is unreliable because it does not include the impact of changes in sharing amounts. While the AT&T methodology makes no adjustment to the common line basket PCIs to reflect changes in sharing amounts for 1991-1997, there is no need to make such an adjustment. The effect of sharing is reflected in the PCIs for price cap baskets by making downward exogenous adjustments to these baskets in one tariff year. This effect is then reversed by making upward exogenous adjustments to the price cap baskets in the following tariff year. Accordingly, we do not modify the AT&T methodology to include the impact of changes in sharing amounts.

65. We find that the methodology we adopt in this order for recalculating the maximum CCL rate and maximum common line revenues does not require an adjustment to account for instances in which price cap LECs have priced their CCL rates below the permitted cap because the purpose of the recalculation is to establish on a going forward basis the proper levels for the maximum allowable CCL rate and maximum common line revenues. Price cap LECs may choose to price their CCL rate below the permitted cap. The tariffed CCL rate does not, however, affect the calculation of the maximum allowable CCL rate and maximum allowable common line revenues. Accordingly, it should not affect the recalculation of the maximum allowable CCL rate and maximum common line revenues for price cap LECs going forward.

66. SWBT suggests that the AT&T methodology be refined by revising the PCIs for the common line basket to reflect base period revenues that are based on the amount of the recalculated maximum common line revenues. We do not require the price cap LECs to modify their PCIs to reflect the recalculated maximum common line revenues because this refinement would introduce additional complexity into the recalculation of the maximum CCL rate and common line revenues. At the same time, there is no evidence in the record that this refinement would significantly increase the precision of these recalculations. While SWBT suggests making this refinement, it concedes that the effect of such a refinement for SWBT would be minor.

67. We also find that GTE incorrectly recalculated the maximum CCL rate and common line revenues on a total company basis. GTE's recalculation of the maximum CCL rate and common line revenues on a total company basis is inconsistent with how it actually calculates its maximum CCL rates because it calculates different maximum CCL rates for each of its study areas. Accordingly, we require GTE to recalculate separately the maximum CCL rate and common line revenues for each of its study areas using the AT&T methodology, as modified by this Order.

68. Accordingly, we require Bell Atlantic, the Sprint LTCs, GTE, SWBT, and U S West to file tariff revisions with new maximum permitted CCL rates that remove past effects of understating their BFP revenue requirements as required by this section. We also require these price cap LECs to issue refunds to their customers in accordance with the requirements of Section VI of this Order. We note that by applying the AT&T methodology, as revised by this Order, Bell Atlantic-South, Bell Atlantic-North, US West, GTE, SWBT, and the Sprint LECs may demonstrate that their maximum permitted CCL rates and common line revenues are no longer inflated due to historic understatement of BFP.

III. Methodology for Calculating Exogenous Adjustments that Reflect Cost Reallocations

A. Background

69. In the *Access Charge Reform Order*, the Commission required price cap LECs to make exogenous cost adjustments in their January 1, 1998 tariff filings to reflect certain amendments to the Commission's rules on access charges. In general, the price cap LECs calculated these exogenous cost adjustments by computing a hypothetical revenue requirement based on their reported Part 69 costs and a target cost of capital of 11.25 percent for each exogenous cost item.[102] In the *Access Reform Tariffs Designation Order*, the Bureau tentatively concluded that the price cap LECs' hypothetical revenue requirement methodology does not accurately identify the amount of exogenous cost adjustments for line ports and end office trunk ports.[103] Instead, the Bureau tentatively concluded that price cap LECs should calculate the exogenous adjustments using a two-step methodology: (1) divide the hypothetical revenue requirement for each exogenous cost item by the hypothetical revenue requirement for the total basket; and (2) multiply this ratio by the maximum permitted basket revenues. In addition, the Bureau suggested that, logically, any method for moving rate elements or services out of baskets or service categories should, if applied *seriatim* to each element or service, remove all permitted revenues in the basket or service category when the last service or rate element was removed.[104]

70. The *Access Reform Tariff Designation Order* also sought comment on whether the methodology proposed for ports should be applied to the other exogenous cost adjustments required by the *Access Charge Reform Order*. The Bureau directed parties to quantify the results of using this method consistently for all such reallocations, and required each price cap LEC to include in its direct case a comprehensive list of all the exogenous adjustments it has made since it entered price cap regulation for the purpose of reallocating costs among baskets, categories, rate elements, or between price cap and non-price cap services.[105] In addition, the Bureau tentatively concluded that if permitted revenues are used as the basis of the exogenous adjustment, the common line rate adjustment should be calculated as follows: price cap LECs should use local switching revenues for the purpose of

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[102] For a description of this methodology, *see Access Reform Tariffs Designation Order*, 13 FCC Rcd at 2265-66.

[103] *Access Reform Tariffs Designation Order*, 13 FCC Rcd at 2269.

[104] *Access Reform Tariffs Designation Order*, 13 FCC Rcd at 2270.

[105] *Access Reform Tariffs Designation Order*, 13 FCC Rcd at 2270.

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.[106]

B. Discussion

71. In the *Access Charge Reform Order*, the Commission required price cap LECs to make exogenous cost changes to reflect reallocations of cost recovery among price cap baskets, service categories, and rate elements. Price cap LECs were required to make many of these adjustments in tariffs that became effective on January 1, 1998. In all but one case, the Commission did not adopt a specific methodology for calculating the January 1, 1998 exogenous cost changes required by the *Access Charge Reform Order*.[107] It is therefore appropriate and, indeed, necessary for us to determine in this tariff investigation the proper methodology for the January 1, 1998 exogenous adjustments required by the *Access Charge Reform Order*, pursuant to Sections 201-205 of the Communications Act.[108] As explained below, we conclude that price cap LECs must calculate these exogenous cost adjustments to reflect reallocations on the basis of permitted revenues, rather than on the basis of revenue requirements.

72. Price cap regulation, unlike rate of return regulation, is designed to focus on the prices that carriers can charge for their services, as opposed to the carriers' costs and authorized rate of return.[109] Although the initial rate elements under price cap regulation were based on Part 69 revenue requirements and were targeted to earn an 11.25 percent rate of return,[110] rates have diverged from

[106] *Access Reform Tariffs Designation Order*, 13 FCC Rcd at 2270. As discussed in Section II.D *supra*, the BFP is the portion of the common line revenue requirement that is used to determine the maximum end-user per-line charge. *See* Section II.D *supra*. *See also* 47 C.F.R. §§ 69.152, 69.501(e), 69.502.

[107] The exception is the exogenous adjustment to reallocate one third of the portion of the tandem switching revenue requirement that is recovered form the TIC, excluding SS7 signalling and dedicated tandem trunk port costs reallocated elsewhere, to the tandem switching rate element. In that case, the Commission required price cap LECs to account for the effects of "GDP-PI minus X-factor" reductions to the original portion of the tandem switching revenue requirement allocated to the TIC. *See Access Charge Reform Order*, 12 FCC Rcd at 16066-67. As discussed below, this methodology prescribed by the Commission accomplishes the same goal as the permitted revenue methodology that we adopt in this Order. The PCIs for price cap baskets are adjusted annually pursuant to formulae set forth in our rules. The PCI formula consists of an inflation measure, the Gross Domestic Product Price Index (the GDP-PI), minus a productivity measure (the X-factor), plus or minus any permitted exogenous cost adjustments. *See* Section 61.45(b) of the Commission's Rules, 47 C.F.R. § 61.45(b).

[108] 47 U.S.C. §§ 201-205.

[109] *See Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786, 6789 (1990) (*LEC Price Cap Order*). The first tariffs filed by LECs under price cap regulation took effect on January 1, 1991.

[110] *See LEC Price Cap Order*, 5 FCC Rcd at 6814. The Commission adopted an 11.25 percent authorized rate of return in a companion order to the *LEC Price Cap Order*. *See Represcribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket No. 89-624, Order, 5 FCC Rcd 7507

those original allocated costs over time through operation of the price cap formulas. 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. We therefore conclude that the price cap LECs' revenue requirement methodology, which uses hypothetical revenue requirements based on these LECs' reported Part 69 costs and allowed return on investment of 11.25 percent, is not a reasonable methodology for reallocating cost recovery among price cap baskets and service categories.

73. Instead, we require price cap LECs to implement the exogenous adjustments due to reallocations among price cap baskets and service categories by transferring permitted revenues proportional to relative revenue requirements. We adopt this method because it recognizes the revenue effect of the reallocation. The methodology reflects fully the effect that demand growth and "GDP-PI minus X-factor" adjustments have over time on the allowance for recovery of the amounts that are being reallocated, as explained below. If the revenue effect is not factored into the exogenous adjustment when a rate element is reallocated to another basket or service category, the exogenous adjustment either creates headroom for rate increases or forces rate reductions for the remaining rate elements in the basket. Moreover, as explained below, a method that did not remove the revenue effect, if applied *seriatim* to each element or service, would fail to exhaust permitted revenues in the basket or service category when the last service or rate element is removed.

74. The following scenario illustrates the problematic effects of the price cap LECs' revenue requirement methodology. If the price cap LECs' revenue requirement methodology were used to remove a rate element from a service category or basket, and the service category or basket had been earning returns in excess of 11.25 percent, the price for the remaining elements could be raised, increasing the earned return on the basket even further.[111] Following this scenario to its logical end, when the last rate element in the basket is removed, there would be residual permitted revenues in the basket and no rate elements to recover those revenues. We also note that if the price cap LECs' revenue requirement methodology were used to remove a rate element from a service category or basket that had been earning *below* 11.25 percent, and the basket or service category had no headroom, the price cap LECs would need to decrease prices for the remaining rate elements. We therefore find that the price cap LECs' revenue requirement methodology would produce unreasonable reallocations of rate elements or partial rate elements among price cap baskets and service categories.

(1990).

[111] For example, assume that, prior to the *Access Charge Reform* proceeding, the local switching rate element consisted of three functions: line ports, end office trunk ports, and other local switching costs. Also assume that the permitted local switching revenues under price caps is $100, that each function has a hypothetical revenue requirement of $30, and that the revenue effect of each function is $33.33. Under the price cap LECs' revenue requirement methodology, the removal of the line port and end office trunk port functions would leave $40 of permitted revenues in the local switching element to be recovered by other local switching costs. Thus, other local switching costs, which have a hypothetical revenue requirement of $30, would now recover $40 in permitted revenues instead of $33.33.

Accordingly, we require price cap LECs to remove the revenue effect of each January 1, 1998 exogenous adjustment required by the *Access Charge Reform Order*.[112]

75. While most price cap LECs acknowledge that a permitted revenue methodology may be appropriate for certain exogenous adjustments, they contend that it is not a reasonable methodology for the January 1, 1998 exogenous adjustments required by the *Access Charge Reform Order*.[113] Some price cap LECs assert that because the exogenous cost changes implemented in the January 1, 1998 tariff filings involve the removal of partial rate elements, rather than entire rate elements, the permitted revenues methodology we adopt in this Order should not be used.[114] In particular, these price cap LECs state that while the removal of entire rate elements can be determined on the basis of revenues because the rate elements can be multiplied by demand to calculate the associated revenues, in the case of partial rate elements, no rate exists and thus this revenue calculation cannot be made.[115] We conclude, however, that the methodology applies equally well even where there were no separate rate elements for these functions prior to the *Access Charge Reform* proceeding. The absence of a separate rate element merely affects the specifics of the calculation required.

76. The Sprint LTCs argue that if a price cap LEC uses a permitted revenue methodology to separate a new rate element from an existing service category which is earning above 11.25 percent, the LEC must either price the new rate element above cost or shift additional cost recovery to other services in the basket.[116] The Sprint LTCs argue that this result would distort the rates of the new rate element, which should be priced at cost in order to provide the market with the proper economic signals, or distort the rates of the other services in the basket.[117] We disagree with the Sprint LTCs' assertion that the use of a permitted revenue methodology to separate a new rate element from an existing service category would "distort" rates. On the contrary, the use of a permitted revenue

[112] We give additional specific instructions in Section IV.A on how the permitted revenue methodology should be applied to the exogenous cost change for SS7-STP.

[113] *See, e.g.*, BellSouth Direct Case at 19-20; Sprint LTCs Direct Case at 5-7.

[114] Bell Atlantic Direct Case, Attachment C at 6-7; BellSouth Direct Case at 19-20; SBC Direct Case at 8-9; SNET Direct Case at 3; U S West Rebuttal at 4. *See also* GTE Direct Case at 7. We note that on March 3, 1998, Bell Atlantic filed tariff revisions to reflect the use of revenues as the basis for determining exogenous cost adjustments for line ports and end office trunk ports. Bell Atlantic Tariff F.C.C. No. 1, Transmittal No. 1033; NYNEX Tariff F.C.C. No. 1, Transmittal No. 488. Bell Atlantic states that it filed these tariff revisions to minimize potential refund liability for local switching rates if the Commission decided to apply the revenue methodology retroactively without allowing offsetting common line rate increases. Bell Atlantic asserts, however, that the filing of these tariff revisions does not represent a concession that the revenue methodology proposed by the Bureau in the *Access Reform Tariff Designation Order* is the only reasonable approach for making exogenous cost changes for ports. Bell Atlantic Tariff F.C.C. No. 1, Transmittal No. 1033, Description and Justification at 1-2; NYNEX Tariff F.C.C. No. 1, Transmittal No. 488, Description and Justification at 1-2.

[115] Bell Atlantic Direct Case, Attachment C at 6; BellSouth Direct Case at 19-20; SNET Direct Case at 3. *See also* GTE Rebuttal at 6 n.8; U S West Rebuttal at 4.

[116] Sprint LTCs Direct Case at 6-7.

[117] Sprint LTCs Direct Case at 6.

methodology would evenly apportion permitted revenues between the new rate element and the existing service category. If the price cap LECs' hypothetical revenue requirement methodology were used to separate a new rate element from an existing service category which is earning returns in excess of 11.25 percent, all earnings in excess of 11.25 percent would remain in the existing service category.

77. The Sprint LTCs also argue that the use of a permitted revenue methodology to calculate the January 1, 1998 exogenous adjustments would result in unreasonable discrimination among customers of different price cap LECs.[118] The Sprint LTCs state that customers served by price cap LECs that have achieved significant efficiency gains, and thus earn above 11.25 percent in baskets from which costs are reallocated, would be affected differently than customers served by price cap LECs that earn below 11.25 percent in baskets from which costs are reallocated.[119] While we agree that customers served by price cap LECs with different levels of efficiency gains may be affected in different ways by exogenous adjustments calculated on the basis of a permitted revenue methodology, such differences do not constitute unreasonable discrimination. Price cap regulation gives carriers an incentive to reduce costs, while still ensuring that customers do not pay rates above a just and reasonable level. Price cap regulation does not, however, ensure that customers of different price cap LECs are affected by exogenous adjustments in the same manner.

78. SNET argues that a permitted revenue methodology cannot be used to calculate the exogenous adjustments for ports because there is a mismatch between the ARMIS Traffic-Sensitive Switching category, which includes tandem switching costs, and the price caps Local Switching category, which does not.[120] We disagree. Price cap LECs can use the permitted revenue methodology to determine the exogenous adjustment for ports by calculating a percentage of ports to Local Switching revenue requirement and by directly applying that percentage to the price caps Local Switching category.

79. Some price cap LECs contend that their use of the revenue requirement methodology is consistent with the *Access Charge Reform Order* because the Order directs the carriers to reassign costs among baskets and service categories[121] and a revenue requirement plus an 11.25 percent rate of return represents the carriers' costs.[122] We recognize that the *Access Charge Reform Order* states that price cap LECs should make exogenous adjustments to reflect the reallocation of certain "costs." The term "costs," however, must be considered in the context of price cap regulation. As discussed above, the prices charged and revenues recovered for each element are no longer directly linked to allocated accounting costs. To capture all the costs that are represented by a rate element or partial rate element

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[118] Sprint LTCs Direct Case at 7.

[119] Sprint LTCs Direct Case at 7.

[120] *See* SNET Direct Case at 4.

[121] Ameritech Direct Case at 9; Bell Atlantic Direct Case at 8, Attachment C at 1; BellSouth Direct Case at 18; SNET Direct Case at 4; U S West Direct Case at 9-11; Frontier Direct Case at 10-11, 13-15.

[122] Ameritech Direct Case at 9; Bell Atlantic Direct Case at 8, Attachment C at 1-3; BellSouth Direct Case at 18; SNET Direct Case at 4; U S West Direct Case at 9-11; Frontier Direct Case at 10-11, 13-15.

under price caps, we must take into account all the revenues associated with the rate element or partial rate element that are permitted by the price cap formula.[123] We recognize that CBT and Citizens entered price cap regulation more recently than the other price cap LECs.[124] We conclude, however, that the permitted revenue methodology is equally appropriate for the exogenous adjustments made by CBT and Citizens because the length of time that CBT and Citizens have been under price cap regulation merely affects the *degree* of attenuation between the revenues recovered by these LECs for each element and the LECs' allocated accounting costs for those elements. It does not, therefore, alter our conclusion that all the permitted revenues associated with the rate elements must be taken into account in order to capture all the costs that are represented by the rate elements.

80. Some price cap LECs argue that Commission precedent on exogenous cost changes requires us to allow them to use a hypothetical revenue requirement methodology to make the exogenous cost changes required by the *Access Charge Reform Order*.[125] Specifically, these LECs contend that when the Commission has not specified a methodology for exogenous cost changes in a rulemaking, the Commission has previously not challenged the use of a Part 69 revenue requirement calculated using an 11.25 percent rate of return. Conversely, these LECs assert that when the Commission has intended for LECs to use an exogenous cost change methodology other than a Part 69 revenue requirement at an 11.25 percent rate of return, the Commission has specified that methodology in a rulemaking.[126] We have in certain past cases specified in a rulemaking order a particular methodology that price cap LECs are required to follow for the purpose of implementing certain exogenous cost adjustments.[127] This does not mean, however, that the only way we may require the price cap LECs to use a particular methodology for making exogenous cost adjustments is by rulemaking order prior to the filing of a tariff implementing those adjustments. The Commission routinely makes significant policy and methodological decisions based on the records developed in tariff investigations and such decisions do not violate the notice and comment requirements of the Administrative Procedure Act (APA).[128]

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[123] *See* AT&T Comments at 16-19; MCI Comments at 7-9.

[124] CBT and Citizens entered price cap regulation on July 1, 1997 and July 1, 1996, respectively. *See* CBT Direct Case at 5; Citizens Direct Case at 3.

[125] Bell Atlantic Direct Case at 8, Attachment C at 2; BellSouth Direct Case at 17-18; BellSouth Rebuttal at 6; SNET Direct Case at 4, 5. *See also* CBT Direct Case at 5; Frontier Direct Case at 7-10; Ameritech Rebuttal at 3; SBC Rebuttal at 7.

[126] *See* Bell Atlantic Direct Case, Attachment C at 2, *citing Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, Report and Order, 11 FCC Rcd 20541, 20633 (1996); BellSouth Direct Case at 17-18; BellSouth Rebuttal at 6; SNET Direct Case at 4, 5; Frontier Direct Case at 7-10; Ameritech Rebuttal at 3.

[127] In fact, as BellSouth points out, in the *Access Charge Reform Order* we specified a methodology for the exogenous adjustment to reallocate one third of the portion of the tandem switching revenue requirement that is recovered form the TIC to the tandem switching rate element. *See* BellSouth Direct Case at 16.

[128] *See* 5 U.S.C. § 551(4).

81. As the Commission has previously determined, a tariff investigation "is a rulemaking of particular applicability" under the APA.[129] In accordance with the notice and comment requirements of the APA, we have provided carriers with full notice and opportunity to comment on the methodology that we now direct the price cap LECs to use to calculate the exogenous cost changes required by the *Access Charge Reform Order*.[130] Thus, in the *Access Reform Tariffs Designation Order*, the Bureau tentatively concluded that price cap LECs should make the exogenous cost changes for line ports and end office trunk ports on the basis of permitted revenues and sought comment on whether the methodology proposed for ports should be applied to the other January 1, 1998 exogenous cost adjustments.[131] In response to the *Access Reform Tariffs Designation Order*, price cap LECs presented their arguments on the proper methodology for these exogenous cost changes in their direct cases, other parties addressed this issue in their comments on the direct cases, and price cap LECs provided further comments on the issue in their rebuttals. Accordingly, our decision to require price cap LECs to make the January 1, 1998 exogenous cost adjustments required in the *Access Charge Reform Order* on the basis of permitted revenues is fully consistent with the notice and comment requirements of the APA.

82. Furthermore, there have been instances in the past where the Commission has ordered LECs to make certain exogenous cost changes in a rulemaking proceeding and specified the methodology for making those changes in a subsequent tariff investigation. For example, in the *Access Charge Reform Order* the Commission required price cap LECs to make a downward exogenous adjustment to the Traffic-Sensitive basket in their 1997 annual access tariff filings to account for the completed amortization of equal access expenses.[132] In the *1997 Annual Access Tariff Investigation Order*, the Commission concluded that the price cap LECs' methodologies for removing these expenses were unreasonable because their methodologies did not remove fully the revenue effect associated with that rate element.[133] Accordingly, the Commission prescribed an "R" adjustment factor that would remove the revenue effect of the equal access rate element by adjusting for the growth in revenue in the years between the initiation of price caps and 1997.

83. Some price cap LECs argue that the effect on IXCs of using a revenue methodology to make exogenous cost changes for ports would be *de minimis* because those costs previously recovered from the per-minute local switching rate would be recovered under the per-minute CCL charge.[134] Some price cap LECs also argue that recovering additional line port costs from the CCL charge would

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[129] *Implementation of Special Access Tariffs of Local Exchange Carriers*, Memorandum Opinion and Order, 5 FCC Rcd 4861 (1990), *citing* 5 U.S.C. § 551(4); *Cincinnati Bell Telephone Company Tariff FCC No. 35*, Memorandum Opinion and Order on Reconsideration, 8 FCC Rcd 4409, 4413 n.54 (1993).

[130] *See Access Reform Tariffs Designation Order*, 13 FCC Rcd at 2264-70.

[131] *Access Reform Tariffs Designation Order*, 13 FCC Rcd at 2269-70.

[132] *Access Charge Reform Order*, 12 FCC Rcd at 16118.

[133] *See 1997 Annual Access Tariff Filings*, CC Docket No. 97-149, Memorandum Opinion and Order, 13 FCC Rcd 3815, 3860-66 (1997) (*1997 Annual Access Investigation Order*); *recon.* FCC 98-52 (rel. March 31, 1998) (*1997 Annual Access Reconsideration Order*).

[134] Bell Atlantic Direct Case at 9, GTE Direct Case at 6 n.5.

delay the Commission's goal of phasing out the CCL charge.[135] We find, however, that the use of a permitted revenue methodology for making exogenous cost changes for line ports and end office trunk ports is fully consistent with the goals of the *Access Charge Reform Order* to recover non-traffic-sensitive costs through flat-rated charges. Although the immediate effect of moving additional line port costs to the Common Line basket may be an increase in the per-minute CCL charges, over the long run these costs will be recovered from the flat-rated PICC and flat-rated end user charges as PICC ceilings increase[136] and the formula for calculating the SLC is modified.[137] Moreover, any immediate increase in the per-minute CCL charge will be offset by a concomitant decrease in the traffic-sensitive local switching rate.

84. GTE argues that if the Commission adopts the permitted revenue methodology for the exogenous cost changes for ports, the Commission should exempt all line port costs shifted to the Common Line basket from the Part 61 factor used to reduce next year's per-minute CCL charges ("the g/2 factor").[138] GTE contends that IXCs would otherwise receive "windfalls" caused by the further reduction in local switching rates without the full corresponding increase in the CCL rate.[139] We decline to exempt the line port costs shifted to the Common Line basket from the g/2 factor. The g/2 factor was adopted by the Commission when it initiated price cap regulation as part of the Commission's "balanced 50-50" formula for common line revenue recovery.[140] This formula allows price cap LECs and IXCs both to benefit from one-half of the increase in revenues resulting from growth in minutes of use per line. In adopting this formula, the Commission concluded that future growth in usage per common line can be maximized only if both LECs and IXCs are encouraged to become more productive and rewarded for their success.[141] We find that GTE has not explained why the application of the g/2 factor to any additional line port costs shifted to the Common Line basket would be inconsistent with the Commission's intent when it adopted the g/2 factor and its intent when it adopted the exogenous cost changes for ports. We note that the g/2 factor will be removed from common line rate development when all common line costs are recovered through flat-rated charges.[142]

85. Although we are requiring price cap LECs to use local switching revenues for the purpose of making the January 1, 1998 exogenous cost adjustments, we conclude that price cap LECs should use their Part 69 revenue requirements to recalculate the BFP to reflect reallocations to and from the Common Line basket. The price cap LECs should then use the revised BFP to compute the SLC. As

[135] Bell Atlantic Direct Case, Attachment C at 5; SNET Direct Case at 5.

[136] *Access Charge Reform Order*, 12 FCC Rcd at 16004-06.

[137] *See* 47 C.F.R. § 69.152(b)(2).

[138] GTE Direct Case at 9-10. *See* 47 C.F.R. § 61.46(d)(1).

[139] GTE Direct Case at 9-10.

[140] Policy and Rules Concerning Rates for Dominant Carriers, Second Report and Order, 5 FCC Rcd 6786, 6793-95 (1990) (*LEC Price Caps Order*); *see also*, 47 C.F.R. § 61.46(d)(1).

[141] *LEC Price Caps Order*, 5 FCC Rcd at 6795.

[142] *Access Charge Reform Order*, 12 FCC Rcd at 16004-06.

discussed in Section II.D *supra*, the BFP is the portion of the common line revenue requirement that is used to determine the maximum end-user per-line charge.[143] Our rules require price cap LECs to continue to calculate their BFP pursuant to fully-distributed embedded costs and revenue requirements.[144] Under our Part 69 rules, the maximum per-line end-user charge is the lesser of: (1) forecast per-line BFP revenue requirement based on an 11.25 percent rate of return, or (2) the applicable cap on per-line end-user charges.[145] Any costs added to the BFP, such as the costs of line ports, would need to be calculated based on a Part 69 revenue requirement using an 11.25 percent rate of return in order to be consistent with our common line rate development rules.[146] Several parties argue that it would be inconsistent with the Bureau's revised 1997 Tariff Review Plan (TRP) if we require price cap LECs to use local switching revenues for the purpose of making the January 1, 1998 exogenous cost adjustments but use Part 69 revenue requirements to recalculate the BFP.[147] As explained in Section IV.B.2.c *infra*, however, the TRP does not set forth, independently of this Commission's rules and orders, additional substantive standards that the Commission must follow in resolving the issues in a tariff investigation.

86. AT&T and MCI argue that the use of revenue requirement rather than revenues to recalculate the BFP would cause more line port costs to be recovered through the CCL charge.[148] AT&T and MCI argue that this result would violate the requirement in the *Access Charge Reform Order* that line port costs be recovered through per-line rates, rather than usage rates.[149] We disagree. Although we concluded in the *Access Charge Reform Order* that line port costs should be recovered through the flat-rated SLC and PICC, we did not envision that the first tariff filing implementing the Order would provide for recovery of *all* line port costs from these flat-rated charges. Instead, we anticipated that price cap LECs could impose a per-minute CCL charge to the extent that the ceilings on SLCs and PICCs do not allow recovery of all permitted common line revenues.[150] We noted that, as the PICC caps increase over time, all common line costs would eventually be recovered through flat-rated charges.[151] We therefore find that the use of Part 69 revenue requirements to recalculate the BFP is consistent with the *Access Charge Reform Order*.

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[143] *See* Section II.D *supra*; *see also*, 47 C.F.R. §§ 69.152, 69.501(e), 69.502.

[144] 47 C.F.R. §§ 69.152, 69.501(e), 69.502.

[145] *See* 47 C.F.R. § 69.152.

[146] *See, e.g.*, BellSouth Direct Case at 20-21; Sprint LTCs Direct Case at 9.

[147] *See* Ameritech Rebuttal at 2; MCI Supplemental Comments at 2.

[148] AT&T Comments at 19; MCI Comments on Bell Atlantic Transmittal No. 1033 and NYNEX Transmittal No. 488 at 2 (filed April 2, 1998) (MCI Supplemental Comments).

[149] AT&T Comments at 19; MCI Supplemental Comments at 2.

[150] *Access Charge Reform Order*, 12 FCC Rcd at 16004-06.

[151] *Access Charge Reform Order*, 12 FCC Rcd at 16004-06.

87. Although we conclude that price cap LECs properly used Part 69 revenue requirements to recalculate the BFP in their initial access reform tariff filings, we do not determine in this investigation how line port costs should be included in BFP development in future annual access filings. AT&T and MCI raise concerns about the going-forward treatment of line port costs in BFP development because the BFP revenue requirement is based on a 12-month projection.[152] These parties argue that if the Commission requires price cap LECs to include a line port revenue requirement in the development of the BFP revenue requirement, price cap LECs would have to develop a forecast of that line port revenue requirement. These parties claim that such forecasts will be unreliable and probably will be based on proprietary cost models.[153] On April 2, 1998, price cap LECs filed their TRPs in support of their 1998 annual access filings. These TRPs include, among other things, the methodologies that the price cap LECs propose to use to integrate line port costs into the BFP revenue requirement for the 1998 tariff year. If it becomes necessary, we will have an opportunity to evaluate these methodologies as part of any investigation of the 1998 annual access tariffs that we may initiate. We note that the forecasting of common line costs will become unnecessary when all common line costs are recovered through flat-rated charges[154] because the SLC will no longer be calculated on the basis of the BFP.[155]

88. Accordingly, we require price cap LECs to recalculate the following January 1, 1998 exogenous cost changes required by the *Access Charge Reform Order* using the permitted revenue methodology: (1) the reassignment of all line port costs from the Local Switching category of the Traffic-Sensitive basket to the Common Line basket rate elements;[156] (2) the reassignment of all end office trunk port costs from the Local Switching category to a new trunk ports category within the Traffic-Sensitive basket;[157] (3) the identification of the amount of COE maintenance that had been misallocated to the Trunking and Common Line baskets;[158] (4) the removal of marketing expenses

[152] AT&T Comments at 20-21; MCI Comments at 9-11.

[153] AT&T Comments at 20; MCI Comments at 10. AT&T suggests that the Commission require price cap LECs to recalculate the BFP in the following manner: develop the exogenous cost change for line ports using the revenue methodology; calculate a per-line, line port rate by dividing the exogenous cost change by the total number of loops; add the per-line, line port rate to the per-line BFP; and adjust this initial per-line, line port rate in future filings to the same degree that adjustments are made to the Common Line PCI. AT&T Comments at 20-21. MCI suggests that the initial line port investment reallocated from the local switching category to the Common Line basket should be large enough that, when a "line port revenue requirement" is computed with an 11.25 percent rate of return, this revenue requirement is equal to the exogenous cost change computed on the basis of revenues. MCI Comments at 10-11.

[154] *Access Charge Reform Order*, 12 FCC Rcd at 16004-06.

[155] *See* 47 C.F.R. § 69.152(b)(2).

[156] *Access Charge Reform Order*, 12 FCC Rcd at 16035; *see also*, 47 C.F.R. § 69.306(d).

[157] *Access Charge Reform Order*, 12 FCC Rcd at 16036; *see also*, 47 C.F.R. § 69.106(f)(1).

[158] *Access Charge Reform Order*, 12 FCC Rcd at 16078.

from all access rate elements that are not purchased by and marketed to retail customers;[159] (5) the reassignment of SS7 costs that are recovered from the TIC to the Traffic-Sensitive basket; [160] (6) the reassignment of the costs of multiplexers and dedicated tandem trunk ports from the TIC to new rate elements;[161] (7) the substitution of actual minute of use for the assumption of 9000 minutes of use in the calculation of the rates for the common transport portion of tandem-switched transport;[162] and (8) the inclusion in the tandem-switched transport category of Host/remote trunking costs not recovered by the current tandem-switched transport rates.[163]

89. Price cap LECs must file tariff revisions to reflect new rates resulting from the use of the permitted revenue methodology adopted in this section. As explained in Section VI of this Order, however, price cap LECs are not required to issue refunds to their customers for the difference between the new rates resulting from the use of the permitted revenue methodology and existing rates resulting from the use of the hypothetical revenue requirement methodology. Although we do not specify the precise steps that price cap LECs must take to implement the permitted revenue methodology for each exogenous adjustment, we emphasize that price cap LECs must implement this methodology in a manner consistent with their obligation under Section 201(b) of the Communications Act, 47 U.S.C. § 201(b), to tariff just and reasonable rates. We will carefully review the price cap LECs' implementation of the permitted revenue methodology when they file the tariff revisions required by this Order.

90. We do not require the price cap LECs to recalculate the exogenous adjustment for the reallocation of one third of the portion of the tandem switching revenue requirement that is recovered form the TIC to the tandem switching rate element, except to the extent it is affected by the recalculation of the SS7-STP exogenous adjustment.[164] In the *Access Charge Reform Order*, the Commission required price cap LECs to account for the effects of "GDP-PI minus X-factor" reductions to the original portion of the tandem switching revenue requirement allocated to the TIC.[165] Therefore, the exogenous adjustments made by price cap LECs for the tandem switching revenue requirement recognizes the revenue effect of that reallocation, and accomplishes the same goal as the permitted revenue methodology that we adopt in this Order. We also do not require the price cap LECs to recalculate the exogenous adjustment for the reallocation of the STP port termination rate element to the Traffic-Sensitive basket.[166] Price cap LECs implemented this adjustment by multiplying

[159] *Access Charge Reform Order*, 12 FCC Rcd at 16122.

[160] *Access Charge Reform Order*, 12 FCC Rcd at 16076.

[161] *Access Charge Reform Order*, 12 FCC Rcd at 16055-57, 16076-77.

[162] *Access Charge Reform Order*, 12 FCC Rcd at 16070-72.

[163] *Access Charge Reform Order*, 12 FCC Rcd at 16077.

[164] *See* Section IV.A *infra*; *Access Charge Reform Order*, 12 FCC Rcd at 16066-70.

[165] *See Access Charge Reform Order*, 12 FCC Rcd at 16066-67.

[166] *See Access Charge Reform Order*, 12 FCC Rcd at 16091.

the rate for the STP port termination element times demand.[167] Thus, the exogenous cost adjustment for the STP port termination element also recognizes the revenue effect of that reallocation and accomplishes the same goal as the permitted revenue methodology that we adopt in this Order.

91. We note that the price cap LECs' January 1, 1998 filings reflected exogenous cost changes required by the *GSF Order*, as well as those changes required by the *Access Charge Reform Order*.[168] We recognize that the *GSF Order* specifically directed price cap LECs to base their exogenous adjustments for GSF costs on an 11.25 percent rate of return, which is inconsistent with the methodology we adopt in this section.[169] We note that the parties to the GSF proceeding did not address this methodology issue in their comments. We also note that the *GSF Order*, unlike the instant one, involved reallocation of costs from regulated categories to non-regulated categories, as opposed to reallocations among price cap baskets and service categories. Because we specifically ordered price cap LECs to use a revenue requirement approach in the *GSF Order*,[170] we do not at this time require the price cap LECs to calculate the exogenous adjustment due to the GSF reallocation on the basis of permitted revenues. We will consider the continued appropriateness of the methodology used to reallocate GSF costs, in light of our determination in this tariff investigation, when we address the pending petitions for reconsideration of the *GSF Order*.[171]

IV. Transport Adjustment Issues

92. Transport service is the component of interstate switched access consisting of transmission between the IXC's point of presence (POP) and LEC end offices.[172] Currently, incumbent LECs offer two basic types of interoffice transport services. The first, direct-trunked transport, uses dedicated circuits for transport between a LEC end office and the LEC serving wire center, or between any two points the direct-trunked transport customer requests. The second, tandem-switched transport, uses common transport facilities to connect the end office to a tandem switch. Common transport circuits may be used to transmit the individual calls of many IXCs. Transport circuits dedicated to a particular access customer connect the tandem switch to the serving wire center. Dedicated entrance circuits carry traffic between the IXC POP and the serving wire center, whether the IXC uses direct-trunked transport or tandem-switched transport.

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[167] *See, e.g.*, BellSouth Direct Case at 16 n.30.

[168] In the *Access Charge Reform Order*, the Commission proposed changes in the allocation of General Support Facilities (GSF) costs between regulated interstate services and non-regulated billing and collection activities, which the Commission adopted in a subsequent order requiring price cap LECs to make exogenous cost adjustments to reflect the reallocations. *See Access Charge Reform Order*, 12 FCC Rcd at 16155-60; *GSF Order*, 12 FCC Rcd at 22446.

[169] *GSF Order*, 12 FCC Rcd at 22447-48.

[170] *GSF Order*, 12 FCC Rcd at 22447-48.

[171] *See* Petition for Reconsideration by SBC Companies of *GSF Order* (filed Jan. 14, 1998); Petition for Reconsideration by U S West, Inc. of *GSF Order* (filed Jan. 14, 1998).

[172] *Transport Rate Structure and Pricing*, Third Memorandum Opinion and Order on Reconsideration and Supplemental Notice of Proposed Rulemaking, 10 FCC Rcd 3030, 3033 (1994).

93. The Commission created the transport interconnection charge (TIC) as a residual charge to ensure that the 1992 interim transport rate structure was revenue neutral for incumbent LECs. As such, the Commission required that the TIC be assessed on a per minute basis on all interstate access customers that interconnect with the LEC switched access network.[173] A portion of the TIC represented 80 percent of the costs of the tandem switch. These were the tandem switch costs that remained after the Commission set the tandem switching rate to recover 20 percent of the tandem-switching revenue requirement. The rest of the revenues collected from the TIC represented costs previously recovered through transport charges that could not, at that time, be associated definitely with specific facilities or services related to transport.

94. In the *Access Charge Reform Order*, the Commission reformed the TIC and set forth a plan that will eliminate the per-minute TIC charges over the next few years.[174] The Commission initially identified amounts that could be associated with particular network facilities and directed incumbent LECs to reallocate these TIC amounts to access rate elements more closely corresponding to these network facilities. Price cap LECs were required to perform the required reallocations in access tariffs that took effect on January 1, 1998, with some exceptions.[175]

95. For price cap LECs, the "residual TIC," consisting of amounts that the LEC has not reallocated, will be recovered through per-line PICCs, to the extent possible, while remaining within the PICC caps. Residual TIC amounts that the price cap LEC cannot recover through PICCs will be recovered through a per-minute TIC on originating access, up to the cap, with any remainder recovered from per-minute charges assessed on terminating access.

A. SS7 Costs

1. Background

96. SS7 is the internationally standardized protocol, or language, currently used to transmit signalling information over the common channel signaling network. Prior to access reform, SS7 costs were recovered in a number of places. The costs of SS7 signal transfer points (STPs) were recovered in three charges. The port termination costs of SS7-STPs were recovered in a subelement of the dedicated signaling transport rate element established in the *Local Transport Order*.[176] Other SS7-STP

[173] *Transport Rate Structure and Pricing*, Report and Order and Further Notice of Proposed Rulemaking, 7 FCC Rcd, 7006, 7038 (*Local Transport Order*).

[174] *Access Charge Reform Order*, 12 FCC Rcd at 16072-16086.

[175] The portion of tandem-switching costs that the Commission initially allocated to the TIC will be reallocated to the tandem switching rate element in three approximately equal steps concluding January 1, 2000. In addition, the costs of the incumbent LECs' tandem-switched transport transmission facilities that are not recovered from tandem-switched transport users under the unitary rate structure will be recovered through the TIC until July 1, 1998.

[176] *Local Transport Order*, 7 FCC Rcd at 7052. The port termination rate subelement was placed in the trunking basket. In the *Access Charge Reform Order*, the Commission placed the port termination rate subelement in the Traffic Sensitive basket by establishing a separate STP port termination service rate element in the Traffic Sensitive basket. *Access Charge Reform Order*, 12 FCC Rcd at 16089, 16091. The rate for the

costs were assigned to the tandem switching category. Twenty percent of tandem switching costs were recovered in tandem-switching rates and the remaining 80 percent were recovered in the TIC. Accordingly, certain SS7-STP costs were recovered in both tandem switching rates and the TIC.

97. In the *Access Charge Reform Order*, the Commission concluded that incumbent LECs must reallocate SS7 costs recovered in the TIC, including SS7-STP costs, to the Traffic Sensitive basket.[177] It also ordered the price cap LECs to reallocate to tandem switching the tandem switching costs recovered through the TIC. This second allocation required each price cap LEC to: (1) calculate the percentage of its total original TIC that represented tandem switching costs; and (2) apply this percentage to its June 30, 1997, TIC.[178] The tandem switching revenue costs are net of any costs being reallocated to other facilities-based charges, such as SS7-STP costs being reallocated to the Traffic Sensitive basket.[179]

98. In the *Access Reform Tariffs Designation Order*, the Bureau expressed concern that while most price cap LECs attributed less than 10 percent of their tandem switching revenue requirement to SS7 costs, Bell Atlantic-South attributed 28 percent of its tandem switching revenue requirement to SS7. In addition, the Bureau was unable to determine whether U S West used the correct SS7 cost figure in adjusting its tandem switching revenue requirement. Bell Atlantic-South and U S West were required to provide justify the SS7 costs removed from their TIC.[180] SWBT, Pacific Bell, and Nevada Bell were found to have included STP port termination costs in calculating the SS7 costs that they were reallocating from the TIC to the Traffic Sensitive basket.[181] The Bureau found that, under the *Local Transport Order*, these port termination costs are already being recovered in the dedicated signaling transport rate element, and tentatively concluded that these costs should not be included in SS7 costs reallocated from the TIC to the Traffic Sensitive basket.[182]

2. Discussion

99. As we explain in Section III of this Order, we require all price cap LECs to make the reallocations required by the *Access Charge Reform Order* by transferring permitted revenues proportional to relative revenue requirements. Price cap LECs are, therefore, required to allocate SS7-

second of the two dedicated signaling transport subelements, the signaling link, recovers the costs for dedicated network access lines that transmit queries between a LEC's signaling network and the signaling networks of other carriers, such as IXCs. *Local Transport Order*, 7 FCC Rcd at 7052. The rate for the signaling link rate subelement is in the trunking basket. *Access Charge Reform Order*, 12 FCC Rcd at 16089, 16091.

[177] *Access Charge Reform Order*, 12 FCC Rcd at 16076.

[178] *Access Charge Reform Order*, 12 FCC Rcd at 16066-67.

[179] *Access Charge Reform Order*, 12 FCC Rcd at 16067.

[180] *Access Reform Tariffs Designation Order*, 13 FCC Rcd at 2273-74.

[181] *Access Reform Tariffs Designation Order*, 13 at 2273-74.

[182] *Access Reform Tariffs Designation Order*, 13 at 2273-74.

STP costs from the TIC to the Traffic Sensitive basket by using a "permitted revenue" methodology.[183]

100. For the reasons stated below, in applying the "permitted revenue" methodology to the exogenous adjustment for SS7-STP, the price cap LECs should use the same method to determine permitted revenues as they did for determining the reallocated 80 percent of the tandem switching revenue requirement. The exogenous cost adjustment reallocating to tandem switching the tandem switching costs allocated to the TIC should be the same percentage of the June 30, 1997 TIC as tandem switching costs represented in the original TIC. The reallocation of SS7-STP revenues from the TIC to the Traffic Sensitive basket should be the same proportion of the original TIC that represented SS7-STP costs. Accordingly, the SS7-STP exogenous adjustment should be calculated by determining the percentage of the original TIC that represented SS7-STP costs and applying that percentage to the TIC revenues on June 30, 1997.

101. We conclude that SWBT, Pacific Bell, and Nevada Bell must exclude STP port revenues from the calculation of their SS7 exogenous adjustments to the TIC and the Traffic Sensitive basket. The *Access Charge Reform Order* required price cap LECs to reallocate SS7-STP costs recovered in the TIC to the Traffic Sensitive basket. STP port termination costs, however, should not have been recovered in the TIC but in the SS7-STP port termination rate.[184] SWBT, Pacific Bell, and Nevada Bell have not argued, nor have they presented any evidence, that STP port revenues were ever recovered from the TIC. We therefore require SWBT, Pacific Bell, and Nevada Bell to exclude permitted SS7-STP port revenues in making the exogenous adjustment between the TIC and the Traffic Sensitive basket.

102. We find that US West reasonably excluded SS7-STP costs associated with contracted and separately tariffed SS7-STP services from its SS7-STP exogenous adjustments because it recovers these amounts in SS7-STP tariffed[185] and contracted SS7-STP rates.[186] When calculating the reallocation of the tandem switching revenue requirement from the TIC to tandem switching, however, US West unreasonably included SS7-STP costs associated with contracted and separately tariffed STP services in the SS7-STP costs it subtracted from its tandem switching revenue requirement. US West must exclude these costs when adjusting its reallocation of the tandem switching revenue requirement to reflect the reallocation of SS7-STP costs.

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[183] Permitted revenue is the maximum amount of revenue that the Commission's price cap rules allow a price cap LEC to recover through interstate access charges.

[184] *Local Transport Order,* 7 FCC Rcd at 7052.

[185] US West has recovered revenues from SS7-STP tariffed rates since first establishing such rates in its interstate common channel signaling access capability tariff on January 1, 1992, pursuant to Transmittal Nos. 203, 216, and 219. Letter from BB Nugent, Executive Director - Federal Regulatory, US West, Inc., to Richard J. Kwiatkowski, FCC (dated April 21, 1998).

[186] US West leases STP and STP port capacity to other LECs pursuant to contracts. US West has recovered SS7-STP revenues from contract rates since December 7, 1994, the date it established the earliest contract reflected in its existing records. Letter from BB Nugent, Executive Director - Federal Regulatory, US West, Inc., to Richard J. Kwiatkowski, FCC (dated April 21, 1998).

103. Bell Atlantic-South asserts that its SS7-STP costs are a greater percentage of its tandem switching revenue requirement compared to this percentage for other price cap LECs because it has more local access and transport areas and more STPs. Upon examination of the record, we find that this is a reasonable explanation of why Bell Atlantic-South's SS7-STP costs are greater than those for the other BOCs. We note, however, that application of the "permitted revenue" methodology for this exogenous cost adjustment set forth above could reduce the amount of Bell Atlantic-South's SS7-STP exogenous cost adjustment.

B. COE Maintenance and Marketing Cost Adjustments to the TIC

1. Background

104. In the *Access Charge Reform Order*, the Commission required the LECs to move Central Office Equipment (COE) maintenance[187] misallocated to the Trunking and Common line baskets to the local switching service category in the Traffic Sensitive basket.[188] The price cap LECs were also required to remove Account 6610 marketing expenses from all access rate elements not purchased by and marketed to retail customers and create a new marketing expense basket.[189]

105. In the *Access Reform Tariffs Designation Order,* the Bureau was unable to determine whether the price cap LECs properly removed from the TIC their COE maintenance expenses and marketing expenses.[190] The Bureau therefore required the price cap LECs to justify the amount that they removed from the TIC as COE maintenance and marketing expenses.[191] The price cap LECs were also required to explain their theory for determining the portion of those costs removed from the TIC.[192] The Bureau sought comment on whether the portion removed from the TIC should be based on the relative total or switched revenues in each category, or on a more detailed analysis of the source of the costs.[193]

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[187] Marketing expenses are recovered through MLB and non-primary residential SLCs. To the extent that ceilings on the SLC prevent full recovery of these amounts, price cap LECs may recover these amounts through the non-primary residential line PICC and the MLB PICC. In the event that the PICC ceilings prevent full recovery of these amounts any residual may be recovered through per-minute charges. *Access Charge Reform Order,* 12 FCC Rcd at 16122-23.

[188] *Id.* at 16078.

[189] 47 C.F.R. 61.42(d)(6).

[190] *Access Reform Tariffs Designation Order*, 13 FCC Rcd at 2275.

[191] *Id.*

[192] *Id.*

[193] *Id.*

106. Finally, the Bureau tentatively concluded that the price cap LECs must base reallocations of TIC revenues on the TIC as it existed prior to July 1, 1997.[194] The Bureau explained that if the price cap LECs do not compute these reallocations using the TIC as the TIC existed prior to July 1, 1997, the targeted TIC reductions that occurred in the July 1, 1997 tariffs could skew the amount of reallocation costs credited to the facilities-based TIC. The Bureau sought comment on this tentative conclusion.[195]

2. Discussion

a. COE Maintenance Expenses

107. In the *Access Charge Reform Order*, the Commission found that allocating COE maintenance expenses on the basis of combined COE investment produced misallocations of these expenses among access services.[196] The Commission, therefore, modified section 69.401 of the rules[197] to provide that the COE maintenance expenses assigned to the interstate jurisdiction be allocated on the basis of the allocation of the specific type of COE investment being maintained.[198]

108. All the price cap LECs have submitted detailed information showing the amount of COE maintenance expenses removed from the Trunking basket and the portion removed from the TIC. The price cap LECs, except for Aliant, calculated these Trunking basket adjustments as the difference between the revenue requirement for the Trunking basket reflecting the old Part 69.40 rule for allocating COE maintenance expenses and the revenue requirement reflecting the new Part 69.401 rule for allocating COE maintenance expenses. They based the portion allocated to the TIC on the ratio of TIC revenues to total Trunking basket revenues.[199]

109. Aliant first calculated a COE maintenance exogenous cost adjustment solely for the TIC and then an adjustment for undesignated categories of the Trunking basket, including the TIC. Aliant's first adjustment increased the TIC by $184,290.[200] Aliant's second adjustment reduced the

[194] *Id.*

[195] *Id.*

[196] *Access Charge Reform Order*, 12 FCC Rcd at 16078.

[197] 47 C.F.R. § 69.401.

[198] *Access Charge Reform Order*, 12 FCC Rcd at 16078.

[199] *See, e.g.*, Frontier Direct Case at 14-19, Ameritech Direct Case at 10-12; BellSouth Direct Case at 22-23.

[200] Aliant calculated this upward exogenous cost adjustment by first calculating dollar amounts equal to 80 percent of a tandem switching revenue requirement reflecting COE maintenance expenses allocated on the basis of combined investment for central office switching, operator systems, and central office transmission and the same revenue requirement reflecting COE maintenance expenses allocated on the basis of individual investment for these categories of investment. It then determined the exogenous cost adjustment to the TIC for COE maintenance by calculating the difference between these two revenue requirements.

trunking basket by $557,843.[201] Aliant allocated to the TIC a portion of the second adjustment based on the TIC's portion of total Trunking basket revenues.

110. We conclude that it is reasonable for price cap LECs to allocate a portion of the Trunking basket COE maintenance exogenous adjustment from the TIC based on the ratio of TIC revenues to total Trunking basket revenues. Using relative revenues to make this allocation equitably distributes a share of the exogenous cost adjustment to each Trunking basket service. This methodology also is consistent with our price cap methodology for making an exogenous cost adjustment to a specific basket when that adjustment is not associated with any particular service within that basket. Under the price cap methodology, an exogenous cost change to a price cap basket index automatically changes service level band indices within that basket based on the proportion of revenues in each service band to total basket revenues. An additional reason for allowing price cap LECs to make this allocation on the basis of relative revenues is that no party has identified a cost-based methodology for allocating the COE maintenance exogenous cost adjustment to each particular Trunking basket service. Nor will we require price cap LECs to study or account for their costs at the level of detail needed to make such allocations because any benefit from making such allocations is unlikely to outweigh the burden from performing such a study or detailed accounting of costs. We note that no party opposes the use of this methodology.[202]

111. We also find that it is reasonable for Aliant to compute the change in the allowance for recovery of the tandem switching revenue requirement arising from the revised Part 69 rules for allocating COE maintenance expense and to make an exogenous cost adjustment to the TIC that is equal to 80 percent of this change. Aliant submitted workpapers demonstrating that allocating COE maintenance expenses based on separate investments for central office switching, operator systems, and central office transmission increases the allocation of these expenses in the tandem switching revenue requirement compared to an allocation based on the combined investments.[203] In addition, as Aliant argues, the Commission allocated 80 percent of the tandem switching revenue requirement to the TIC when the TIC was established. More specifically, the Commission prescribed an initial rate for tandem switching that recovered 20 percent of the then-current Part 69 tandem revenue requirement, with the remaining 80 percent of this requirement recovered through the TIC.[204] Because the TIC recovered 80 percent of the tandem switching revenue requirement, Aliant reasonably makes an

[201] Aliant calculated this downward exogenous cost adjustment by first calculating dollar amounts equal to a Trunking basket revenue requirement, excluding 80 percent of the revenue requirement for tandem switching, reflecting COE maintenance expenses allocated on the basis of combined investment for central office switching, operator systems, and central office transmission and the same revenue requirement reflecting COE maintenance expenses allocated on the basis of individual investment for these categories of investment. It then determined the exogenous cost adjustment to undesignated categories in the Trunking basket for COE maintenance by calculating the difference between these two revenue requirements. Aliant allowed the price cap formula to distribute among the Trunking basket categories, including the TIC, the exogenous cost adjustment to the undesignated categories.

[202] *See* AT&T Comments at 23 n.40.

[203] *See* Aliant Direct Case, Exhibits 5 and 6; Letter from Robert A. Mazer, Counsel for Aliant, to Magalie R. Salas, Secretary, FCC (dated April 29, 1998).

[204] *Local Transport Order*, 7 FCC Rcd at 7017-19, 7037-38.

exogenous adjustment to the TIC that is equal to 80 percent of the change in the allowance for recovery of the tandem switching revenue requirement arising from the revised Part 69 rules for allocating COE maintenance expense.

112. In addition, Aliant's exogenous costs adjustment to the TIC due to COE maintenance is reasonable because Aliant adds the reallocated COE maintenance expense to the portion of the tandem switching revenue requirement in the current TIC that price cap LECs are required to allocate from the TIC to tandem switching.[205] After Aliant allocates this portion of the tandem switching revenue requirement from the TIC to tandem switching, it will recover properly from customers that purchase tandem switched transport the COE maintenance expenses associated with tandem switching that had been recovered through the TIC .

113. We find, however, that Aliant must make an exogenous adjustment to tandem switching that is equal to 20 percent of the change in the allowance for recovery of the tandem switching revenue requirement arising from the revised Part 69 rules for allocating COE maintenance expense. Because the tandem switching rate recovered 20 percent of the tandem switching revenue requirement, Aliant must make an exogenous adjustment to tandem switching that is equal to 20 percent of the change in the allowance for recovery of the tandem switching revenue requirement. After Aliant makes this allocation, it will recover from customers that purchase tandem switched transport all of the COE maintenance expenses associated with tandem switching .

114. We find that it is reasonable for Aliant to compute the change in the allowance for recovery of the Trunking basket revenue requirement, excluding the tandem switching revenue requirement, arising from the revised Part 69 rules for allocating COE maintenance expense and to allocate this change among Trunking basket service categories on the basis of relative revenues. Using relative revenues to allocate this exogenous cost adjustment equitably distributes a share of the adjustment to each trunking basket service. This is consistent with our decision above to allow price cap LECs to use relative revenues to distribute their exogenous COE maintenance cost adjustments among service categories in the Trunking basket.

115. As we explained in Section III of this Order, we are requiring all price cap LECs to make the reallocations required by the *Access Charge Reform Order* by transferring permitted revenues proportional to relative revenue requirements. Price cap LECs are, therefore, required to make a downward COE maintenance exogenous adjustment to the Trunking basket by using permitted revenues. Accordingly, we require all price cap LECs to revise their tariffs to reflect COE

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[205] *Access Charge Reform Order*, 12 FCC Rcd at 16067. The Commission required price cap LECs to allocate from the TIC to tandem switching a portion of the tandem switching costs in the current TIC. The Commission required price cap LECs to determine this portion by subtracting from the tandem switching revenue requirement in the current TIC those tandem switching costs that they were required to allocate from the TIC to service categories other than tandem switching. In the access reform tariff filings that took effect on January 1, 1998, the Commission required price cap LECs to allocate from the TIC to tandem switching one third of the tandem switching costs that remained in the current TIC after allocating those tandem switching costs that they were required to allocate from the TIC to service categories other than tandem switching. Effective January 1, 1999, price cap LECs must allocate approximately one half of the remaining amount of the tandem switching costs in the TIC to tandem switching. Effective January 1, 2000, price cap LECs must allocate any portion of the tandem switching costs remaining in the TIC to tandem switching. *Id.*

maintenance exogenous adjustments calculated in accordance with the requirements of Section III of this Order. As explained in Section VI of this Order, price cap LECs that made reallocations required by the *Access Charge Reform Order* by using a revenue requirement methodology are not required to issue refunds to their customers.

b. Marketing Expenses

116. In the *Access Charge Reform Order*, we concluded that it was appropriate for LECs to recover marketing expenses for special access and interexchange services that are purchased by, and marketed to, retail customers in rates for those services.[206] We required, however, that marketing expenses be removed from all other rate elements by means of a "downward exogenous adjustment to the PCIs for the common line, traffic sensitive, and trunking baskets . . . (and that) the service band indices within the trunking basket shall be decreased based on the amount of Account 6610 marketing expenses allocated to switched services included in each service category . . . ."[207]

117. All the price cap LECs have submitted detailed information showing the amount of marketing expenses removed from the Trunking basket and the portion removed from the TIC. The price cap LECs calculated the Trunking basket adjustment as the difference between a revenue requirement for the Trunking basket reflecting the rules for allocating marketing expenses in effect prior to January 1, 1998 and the same revenue requirement reflecting the rules for allocating marketing expenses in effect on January 1, 1998.[208] They based the portion allocated to the TIC on the ratio of TIC revenues to total switched revenues in the Trunking basket.

118. We conclude that it is reasonable for price cap LECs to remove marketing expenses from the TIC based on the ratio of TIC revenues to total Trunking basket switched access revenues. We find it reasonable for the price cap LECs to have used switched access revenues in particular to make this allocation because the *Access Charge Reform Order* allowed rates for special access services to continue to include recovery of marketing expenses. Using relative switched access revenues to make this allocation equitably distributes a share of the exogenous marketing cost adjustment to each switched access service category in the Trunking basket. In addition, we find that it is reasonable for price cap LECs to make this allocation on the basis of relative revenues because no party has identified a cost-based methodology for allocating the marketing exogenous cost adjustment to each particular Trunking basket service. We also note that no party opposes the use of this methodology.

119. We find that it is unreasonable for CBT to allocate from the TIC the entire exogenous marketing cost adjustment for the Trunking basket. CBT argues that removing from the TIC the entire amount of this exogenous cost adjustment allows it to avoid distorting the pricing between its dedicated switched and dedicated special access rates. We reject this argument. Under price cap rules, CBT has the flexibility to increase or decrease its rates for dedicated switched and dedicated special access services, provided that the SBIs for the service categories in which these services are

[206] *Access Charge Reform Order*, 12 FCC Rcd at 16122.

[207] *Id.*

[208] *See, e.g.*, Frontier Direct Case at 14-19, Ameritech Direct Case at 10-12; BellSouth Direct Case at 22-23.

placed are below the SBI upper limits for these categories.[209] Such pricing flexibility under price caps should enable CBT to avoid pricing distortions between its dedicated switched and dedicated special access rates. Moreover, CBT did not explain how removing the entire exogenous marketing cost adjustment from the TIC without removing any portion of this exogenous adjustment from the other Trunking basket service categories results in an equitable allocation. Nor did CBT demonstrate any cost basis, for example, by comparing the actual amount of marketing costs the TIC recovers relative to the actual amount of these costs recovered in Trunking basket rate elements other than the TIC. Accordingly, we order CBT to remove marketing expenses from the TIC based on the ratio of TIC revenues to total Trunking basket switched access revenues as did the other price cap LECs.

120. In Section III of this Order, we stated that we are requiring all price cap LECs to make the reallocations required by the *Access Charge Reform Order* by transferring permitted revenues proportional to relative revenue requirements. Price cap LECs are, therefore, required to make a downward marketing exogenous adjustment to the Trunking basket by using a proportional allocation of Trunking basket permitted revenues. Accordingly, we require all price cap LECs to revise their tariffs to reflect marketing exogenous adjustments calculated in accordance with the requirements of Section III of this Order. As explained in Section VI of this Order, price cap LECs that made reallocations required by the *Access Charge Reform Order* by using a revenue requirement methodology are not required to issue refunds to their customers.

c. Calculation of Exogenous Adjustments Applied to the TIC

121. We find that the price cap LECs must compute their exogenous cost adjustments attributable to the removal of COE maintenance and marketing costs from the TIC as the TIC existed on June 30, 1997. In the *Access Charge Reform Order*, we modified the TIC and set forth a transitional plan to eliminate per-minute TIC charges over the next few years. As part of that plan, we first ordered the price cap LECs to compute the amount of their anticipated "residual" TIC by excluding TIC revenues that they would reassign on a cost-causative basis to facilities-based charges in the future.[210] Moreover, we ordered these LECs to target solely to this residual TIC the "GDP-PI minus X" adjustments they ordinarily would apply to each of their price cap indices for the July 1, 1997 annual filing.[211] By targeting the GDP-PI minus X adjustments to the residual portion of the TIC that existed on June 30, 1997, these LECs reduced the amount of their total July 1, 1997 TIC revenues as compared with their total June 30, 1997 TIC revenues. These adjustments reduced the July 1, 1997 ratios of total TIC revenues to total Trunking basket revenues and total TIC revenues to total Trunking basket switched access revenues from their June 30, 1997 levels for the price cap LECs. Because the price cap LECs have used these ratios to allocate their COE maintenance and marketing exogenous cost adjustments from the TIC, price cap LECs that allocated these exogenous cost adjustments from

[209] Under price cap regulation, the weighted average of the prices for the services in a given service category or subcategory within the Trunking and Traffic sensitive baskets, or the service band index (SBI), must be less than or equal to the SBI upper limit for the category or subcategory. Price cap LECs establish SBI upper limits each tariff year for each service category or subcategory that are set at specified percentages above the SBI.

[210] *Access Charge Reform Order*, 12 FCC Rcd at 16122.

[211] *Access Charge Reform Order*, 12 FCC Rcd at 16084.