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

In the Matter of Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation	)	CC Docket No. 98-77

COMMENTS OF AT&T CORP.

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SUMMARY

In reforming the access charges of the rate-of-return LECs, the Commission should change its rules to accomplish three major objectives. First, as shown in Section I, the Commission should modify its rules to bring the rate-of-return LECs' rate *structures* into line with those of the price cap LECs, and thereby eliminate some of the major distortions and inefficiencies inherent in the existing rate structures. The NPRM contains a number of proposed changes that would make the rate-of-return LECs' rate structures consistent with those of the price cap LECs and should therefore be adopted.

Second, the Commission should reduce the rate-of-return LECs' rate *levels*. As AT&T demonstrates in Section II.A, the rate-of-return LECs' rates for the traffic-sensitive rate elements are substantially higher than those of the price cap LECs. Moreover, that disparity is not only large but growing, because there is nothing comparable to the price cap LECs' annual X-Factor reductions in the rate-of-return LECs' regulatory scheme. These rate disparities are increasingly incompatible with the Commission's policies that require nationwide averaged long-distance rates. Therefore, the Commission should take two steps. First, the Commission should now reduce the rate-of-return LECs' authorized rate-of-return, to bring it in line with the substantial changes in economic circumstances that have occurred over the last eight years. Second, the Commission should also peg the rate-of-return LECs' per-minute access rates to the nationwide average of the price cap LECs, and permit these

LECs to recover any difference between their legitimate revenue requirement and the revenues derived from their access rates from the Universal Service Fund.

If the Commission does not adopt AT&T's proposal to reduce rate levels and to permit the rate-of-return LECs to recover those foregone revenues from the USF, as shown in Section II.B, it should instead target all reductions to the CCLC and the TIC -- which are the principal subsidy elements -- to originating rates first, then to terminating rates. Collecting the subsidy from terminating rates would be a more equitable way of distributing the burden across the interexchange industry, because all IXCs terminate traffic in these regions, while only a handful originate traffic there. Moreover, because the rate-of-return LECs will not quickly face any competition in their access markets, there is no prospect that competitors will soon compete away subsidies embedded in originating rates, as the Commission optimistically assumed was the case for price cap LECs in the *Access Reform Order*.

Third, as shown in Section III, the Commission should take certain other steps to root out cross-subsidies in the rate-of-return LECs' access rates. In this regard, the Commission should modify its rules to remove certain GSF costs and marketing expenses from interstate access rates. Moreover, the Commission should not create a new subsidy by imposing PICCs on purchasers of special access. Finally, the Commission should make certain ministerial changes to the Part 36 rules to ensure that the effects of its DEM weighting policy are completely removed from switching rates, as the Joint Board and the Commission clearly intended in the *Access Reform* and *Universal Service* proceedings.

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Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation	)	CC Docket No. 98-77

COMMENTS OF AT&T CORP.

Pursuant to the Commission's Notice of Proposed Rulemaking,[1] AT&T Corp. ("AT&T") submits these comments concerning access charge reform for the local exchange carriers ("LECs") subject to rate-of-return regulation.

In reforming the access charges of the rate-of-return LECs, the Commission should change its rules to accomplish three major objectives. First, the Commission should modify its rules to bring the rate-of-return LECs' rate *structures* into line with those of the price cap LECs, and thereby eliminate some of the major distortions and inefficiencies inherent in the existing rate structures.

Second, the Commission should reduce the rate-of-return LECs' rate *levels*. Specifically, the Commission should initiate a proceeding to reduce the rate-of-return LECs' excessive authorized rate-of-return. The Commission should then peg the rate-of-return

[1] *Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation*, CC Docket No. 98-77, Notice of Proposed Rulemaking (rel. June 4, 1998) ("NPRM"), as modified by Order, DA 98-1418 (rel. July 15, 1998).

LECs' per-minute access rates to the nationwide average of the price cap LECs, and permit these LECs to recover any difference between their legitimate revenue requirement and their access rates from the Universal Service Fund ("USF"). If the Commission does not adopt this latter proposal, it should instead target all reductions to the Carrier Common Line Charge ("CCLC") and the Transport Interconnection Charge ("TIC") -- which are the principal subsidy elements -- to originating rates first, then to terminating rates. Collecting the revenues from terminating rates would be a more equitable way of distributing the subsidy burden across the long-distance industry, because all interexchange carriers ("IXCs") terminate traffic in these regions, while only a handful originate traffic there. Moreover, because the rate-of-return LECs will not quickly face any competition in their access markets, there is no prospect that competitors will soon compete away subsidies embedded in originating rates, as the Commission optimistically assumed was the case for price cap LECs in the *Access Reform Order*.[2]

Third, the Commission should take other steps to root out cross-subsidies in the rate-of-return LECs' access rates (or to avoid creating new ones). In this regard, the Commission should modify its rules to remove certain general support facilities ("GSF") costs and marketing expenses from interstate access rates. Moreover, the Commission should not create a new subsidy by imposing Primary Interexchange Carrier Charges ("PICCs") on purchasers of special access. Finally, the Commission should make certain changes to the

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[2] *Access Charge Reform, et al.*, CC Docket No. 96-262 et al., First Report and Order (rel. May 16, 1997) ("*Access Reform Order*").

Part 36 rules to ensure that the effects of its Dial Equipment Minutes ("DEM") weighting policy are completely removed from switching rates, as the Commission clearly intended in the *Access Reform* and *Universal Service Orders*.[3]

I. THE COMMISSION SHOULD MODIFY THE RATE-OF-RETURN LECS' RATE STRUCTURES TO MAKE THEM CONSISTENT WITH THOSE OF THE PRICE CAP LECS.

As outlined in the NPRM, the Commission should first make a number of changes to the rate-of-return LECs' rate *structures*. Specifically, in the NPRM, the Commission seeks comment on a number of specific proposed rate structure changes. *See* NPRM, ¶¶ 35-45, 48 (common line); 54-56, 58-60 (switching); 67-68, 70-72 (transport); 77-78 (signaling). With the exception of the proposals described below in Section II.B, AT&T supports these proposed changes to the extent that they would make the rate-of-return LECs' rate structures identical to those of the price cap LECs.

With a few exceptions, the Commission's adoption of these same changes for the price cap LECs in the *Access Reform Order* was well supported and made the price cap LECs' rate structures more efficient and more consistent with principles of cost-causation.[4] The rate-of-

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[3] *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, First Report and Order (rel. May 8, 1997).

[4] To be sure, AT&T and others oppose key aspects of the plan the Commission adopted for the recovery of common line costs for the price cap LECs, and certain aspects of that plan have been challenged in pending petitions for reconsideration and in parallel proceedings. For example, many parties (including AT&T) have urged the Commission to recover all (continued...)

return LECs' rate structures should be modified for the same reasons. Moreover, any deviation in the rate structures for the price cap LECs and the rate-of-return LECs forces IXCs to make costly changes in their own internal administrative systems, and therefore, absent compelling circumstances, the rate structures for the two sets of LECs should be the same.

II. THE COMMISSION SHOULD TAKE STEPS TO REDUCE THE RATE-OF-RETURN LECS' EXCESSIVE RATE LEVELS.

Of all the things the Commission could do in this proceeding, the most important and useful would be to adopt rules to reduce the rate-of-return LECs' rate levels. The rate-of-return LECs' access charges have become increasingly high relative to the rates charged by the price cap LECs. Because of the Commission's policies against geographic deaveraging of long-distance rates, these access rate disparities are increasingly disruptive to the interexchange market. Therefore, the Commission should initiate a proceeding to reduce the rate-of-return LECs' authorized rate-of-return. Moreover, it should eliminate any remaining disparities by requiring the rate-of-return LECs to peg their traffic-sensitive rates to those of the price cap LECs, and to recover any legitimate shortfall from the USF. If the Commission

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[4] (...continued)
common line costs from end-users and to eliminate the distinction between primary and non-primary lines altogether (or at least adopt a workable definition). *See Definition of Primary Lines*, CC Docket No. 97-181, Comments of Sprint at 1-2 (filed September 25, 1997); *id.*, Reply Comments of AT&T Corp. at 2-3 (filed October 9, 1997). To the extent that the Commission modifies its original plan, it should adopt the same changes for the rate-of-return LECs in this proceeding.

does not adopt this latter proposal, it should instead require the rate-of-return LECs to recover their CCLC and TIC revenues (which are the key subsidy elements) from terminating services.

A. The Commission Should Reduce The Rate-Of-Return LECs' Excessive Rate Levels By Prescribing A Lower Authorized Rate-Of-Return And By Pegging The Rate-Of-Return LECs' Rates To Those Of The Price Cap LECs.

The disparities between the rate-of-return LECs' traffic-sensitive rates and the price cap LECs' traffic-sensitive rates are substantial. AT&T has calculated a composite per-minute rate for the rate-of-return LECs based on the rates of the LECs in the NECA pool and the largest rate-of-return LECs that do not participate in the NECA pool. AT&T has separately calculated this composite per-minute rate both for current rates and for the rates that will result if the Commission implements the various access reform proposals outlined in the NPRM. These composite rates consist of derived per-minute rates for common line, local switching, local transport, and the TIC; the post-access reform composite rate also includes a per-minute charge for marketing expenses. As shown in Attachment 1, AT&T has compared the rate-of-return LECs' composite rate to a similarly derived composite rate for the RBOCs and GTE. As of today, the rate-of-return LECs' per-minute rates are almost three times the price cap LECs' current rates. Even after the Commission implements access reform for them (which will reduce their per-minute rates), the rate-of-return LECs' composite rate will still be almost two and a half times the price cap LECs'. Multiplying their per-minute rates by their estimated minutes of use, the rate-of-return LECs' rates following access reform will exceed the price cap LECs' by over $565 million.[5]

This disparity is both large and growing, because the Commission's regulation of the rate-of-return LECs' rates contains nothing comparable to the X-Factor calculations that have been steadily reducing -- and will continue to reduce -- the price cap LECs' rates. These substantial disparities are placing increasing stress on the Commission's policy of requiring nationally averaged long-distance rates. Only a handful of IXCs serve the rate-of-return LECs' service areas, and as a result, some IXCs face substantially higher nationwide access costs than do others. As these disparities continue to grow, they will increasingly play havoc with the interexchange market, even as they continue perversely to increase the *dis*incentives to serve these higher-cost markets.

The Commission should eliminate these disparities by taking two actions. First, the Commission should now initiate a proceeding to reduce the rate-of-return LECs' authorized rate-of-return. The Commission established the current authorized rate-of-return (11.25 percent) in 1990, but economic realities have changed substantially in the intervening years. *Represcribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket No. 89-624, Order, 5 FCC Rcd. 7507 (1990) ("*Represcription Order*"). When it prescribed 11.25 percent as the rate-of-return in 1990, the Commission noted that

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[5] AT&T's method of calculating these composite rates is explained more fully in Attachment 1. Notably, this $565 million estimate represents a comparison of the rate-of-return LECs' estimated restructured access rates (with SLC and PICC caps at 1998 levels) and the large LECs' *current* (*i.e.*, 1998) rates.

interest rates were around 8.0 percent for one-year treasury notes and 8.4 percent for 30-year treasury bonds. *Id.*, ¶ 170. Today, by contrast, interest rates have plummeted to 5.4 percent on one-year notes and 5.7 percent on 30-year treasury bonds. There are also indications that the rate-of-return LECs' embedded cost of debt has decreased.[6] Under present economic conditions, an authorized 11.25 percent rate-of-return is overcompensatory and should be revisited.

Second, to the extent that such disparities remain after prescription of a new rate-of-return, the Commission should eliminate those disparities altogether by pegging the rate-of-return LECs' restructured traffic-sensitive rates to the nationwide average of the price cap LECs' traffic-sensitive rates. The rate-of-return LECs would then be permitted to recover any difference between their legitimate restructured revenue requirement and the revenues they would realize from their newly-reduced access rates from the Universal Service Fund.

This policy would have several benefits. It would mitigate the gross disparities in access charges that are incompatible with the policy of averaged nationwide rates. Moreover, allowing the rate-of-return LECs to recover these costs from the Universal Service Fund would be a more equitable and nondiscriminatory method for the industry as a whole to fund the rate-of-return LECs' higher-than-average costs.[7] For all of these reasons, the

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[6] Although the Commission noted that the LECs' embedded cost of debt was 8.8 percent in 1990, *Represcription Order* at ¶ 8, today's telephone company bonds are yielding 7.16 percent.

[7] The Commission has previously indicated that it intends to conduct a separate rulemaking (continued...)

Commission should adopt mechanisms that would immediately reduce the rate-of-return LECs' traffic-sensitive access rates to the average level of the price cap LECs' rates.[8]

B. If The Commission Does Not Peg The Rate-Of-Return LECs' Rates To The Price Cap LECs' Rates, The Commission Should Restructure The CCLC And The TIC So That They Are Recovered From Terminating Services.

If the Commission does not adopt AT&T's proposal to peg the rate-of-return LECs' access rates to the price cap LECs' rate levels (and permit them to recover the difference from the USF), the Commission should make one significant change in the reform plan for rate-of-return LECs from that of the price cap LECs: it should target all reductions to the CCLC and the TIC to originating rates first, and then to terminating rates. The Commission should adopt this deviation from the price cap LECs' plan for two principal reasons.

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[7] (...continued)
to establish a new universal service system for the rate-of-return LECs, which is to be implemented no earlier than 2001. *See Universal Service Order*, ¶ 204. The Commission could adopt AT&T's proposal as an interim system for the intervening years, and could revisit the question of the appropriate size of the Universal Service Fund in the context of such a rulemaking.

[8] The Commission should also adopt an additional mechanism for phasing out all TIC revenues within the context of this plan. The D.C. Circuit has squarely held that the Commission must eliminate the TIC (or explain adequately why it should be kept). *Competitive Telecommunications Ass'n* v. *FCC*, 87 F.3d 522 (D.C. Cir. 1996). Although targeting the rate-of-return LECs' traffic-sensitive rates to the price cap LECs' will result in the TIC itself being reduced to zero, under this plan the rate-of-return LECs would still recover the same TIC revenues from the USF. Therefore, the Commission should establish an additional mechanism to phase out the recovery of the TIC portion of these USF amounts over some reasonable time period, such as three years.

First, because the CCLC and the TIC are the key rate elements that represent subsidies, it would be more equitable to recover these revenues from terminating rates. All IXCs terminate traffic in the rate-of-return LECs' service areas, while only a handful of IXCs originate traffic in these areas. Therefore, moving these subsidy elements to terminating traffic would have the effect of spreading the burden of subsidizing these higher cost LECs more evenly among the IXCs.

Second, reducing originating rates for the rate-of-return LECs would provide an incremental incentive for more carriers to enter the long-distance market in these areas. Today, the Commission's prohibition on geographic deaveraging of long-distance rates creates a strong *disincentive* for IXCs to serve higher cost access areas. Reducing per-minute originating rates would partially remove that disincentive and would likely induce greater entry. Indeed, adopting higher terminating rates and lower originating rates for the rate-of-return LECs would promote the Commission's geographic rate averaging policy generally, by balancing out some of the wide disparities in today's access charges. Higher terminating rates would raise the cost of serving some lower cost customers (who place some calls that terminate in the rate-of-return LECs' areas), while at the same time lower originating rates would reduce the cost of serving the higher cost customers. As long as the Commission continues to require nationwide averaging for long-distance rates -- which AT&T opposes -- the Commission should favor policies that mitigate these disparities in access costs.

In addition, adopting such a policy would not be inconsistent with the Commission's treatment of the price cap LECs in the *Access Reform Order*. The assumptions the

Commission made in the *Access Reform Order* concerning the prospects for competitive entry into the price cap LECs' service areas simply do not hold true for the rate-of-return LECs.[9] In the *Access Reform Order*, the Commission indicated that it expected new entrants to compete with the incumbent LECs' access services through cost-based unbundled network elements, and thereby put competitive pressure on the price cap LECs to reduce their originating rates to cost-based levels. For this reason, the Commission required the price cap LECs to recover residual CCL revenues first from originating minutes (to expose them to competitive pressures), and then from terminating minutes (only if necessary to avoid an increase in per-minute originating rates). *Access Reform Order*, ¶¶ 99-100.

The Commission should recognize, however, that the rate-of-return LECs will face almost no competition for their access services in the foreseeable future. Facilities-based entry in the rate-of-return LECs' service areas is likely to be minimal. Moreover, under Section 251(f) of the Act, the vast majority of these LECs, if not all of them, are statutorily *exempt* from the unbundling and other market-opening provisions of Section 251(c).[10] Therefore, it is highly unlikely that competitive entry will drive the rate-of-return LECs'

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[9] As AT&T has shown elsewhere, those assumptions have been severely undermined by subsequent events even as to the price cap LECs, and therefore the Commission should take steps immediately to reduce the price cap LECs' access charges to cost-based levels. *See Request for Amendment of the Commission's Rules Regarding Access Charge Reform and Price Cap Performance Review for Local Exchange Carriers*, RM 9210, AT&T Comments at 4-22 (filed Jan. 30, 1998); *id.*, AT&T Reply Comments at 3-8 (filed Feb. 17, 1998).

[10] Section 251(f) allows state commissions to remove these exemptions upon certain showings, but AT&T is unaware of any state commission that has rescinded Section 251(f)'s exemptions for any small or rural LEC.

originating rates to cost-based levels. Because of the lack of market-based pressure on originating rates, it would be more equitable, as explained above, to target all reductions in the CCLC and TIC to originating minutes, and spread the subsidy burden more evenly across the long-distance industry by recovering these revenues from terminating rates.

The Commission should implement this proposal in the following manner. As to the CCLC, the vast majority of rate-of-return LECs are in the NECA pool. Currently, the CCLC revenues for the NECA pool are $315.5 million; of that total, $133.2 million is collected from the originating CCLC (which is capped at one cent per minute), and the remaining $182.3 million is recovered from the terminating CCLC. AT&T estimates that implementation of the various access reform proposals in the NPRM will result in a net decrease in the CCLC revenue requirement of $129.4 million (to $186.1 million).[11]

The Commission could adopt either of two approaches for handling the remainder. One option would be to reduce the originating CCLC to zero, while slightly increasing the terminating CCLC from $182.3 million to $186.1 million. Alternatively, the Commission could leave the terminating CCLC at its current $182.3 million and reduce the originating CCLC to $3.8 million. Any future increases in the SLCs and PICCs would be applied first to the originating CCLC until it is reduced to zero.

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[11] The CCLC revenue requirement is expected to be reduced by $216 million due to increases in the Subscriber Line Charges ("SLCs") and PICCs, and by a further $28.4 million due to reallocation of GSF and marketing costs. At the same time, however, the CCLC revenue requirement is expected to increase by $115 million from the transfer of line port costs to common line from local switching. The result is a net decrease of $129.4 million.

As to the TIC, the D.C. Circuit has squarely held that the Commission is obligated either to eliminate the TIC entirely or to provide an adequate explanation why it should not be eliminated. *Competitive Telecommunications Ass'n* v. *FCC*, 87 F.3d 522 (D.C. Cir. 1996). Compliance with the Court's directive for rate-of-return LECs is long overdue. The Commission should therefore initiate a proceeding on an expedited basis to determine the most appropriate method for eliminating the TIC. To the extent that such elimination of the TIC is accomplished over time, any reductions in TIC revenues should be targeted first to the originating TIC until it is eliminated, and then to the terminating TIC. In addition, any increases in the PICC after the CCLC has been eliminated should be used first to reduce the originating TIC, and then to reduce the terminating TIC.[12]

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[12] In addition to these changes, the Commission should also require the rate-of-return LECs to add any USF obligations assigned to the Common Line to the base factor portion ("BFP"). Although the Commission did not require this of the price cap LECs, the price cap LECs are different because their SLCs will cease to be determined by the BFP. Because these USF "flowback" costs are assigned to access categories on the basis of end-user revenues, and for reasons of competitive neutrality, the LECs' USF obligations should be recovered from end-users as much as possible. If the Commission does not adopt a mandatory end-user surcharge, as AT&T advocated in the USF proceeding, it should, at a minimum, add the flowback to the BFP for the rate-of-return LECs, where it can be recovered through SLCs (provided they are below the cap).

III. THE COMMISSION SHOULD TAKE ADDITIONAL STEPS CONCERNING THE TREATMENT OF GENERAL SUPPORT FACILITIES COSTS, MARKETING EXPENSES, SPECIAL ACCESS, AND DEM WEIGHTING TO ENSURE THAT IMPROPER CROSS-SUBSIDIES ARE ELIMINATED OR AVOIDED.

The Commission should also adopt rules to ensure that certain cross-subsidies are removed from the rate-of-return LECs' access charges. Specifically, the Commission should amend two rules to remove cross-subsidies that currently exist with respect to general support facilities costs and marketing expenses. And the Commission certainly should not create a new subsidy by adopting its previous proposal to permit LECs to charge special access customers the PICC. Finally, the Commission should give full effect to the *Universal Service* and *Access Reform Orders* by amending certain rules to ensure that the effects of DEM weighting are completely removed from switching rates.

A. The Commission Should Modify Its Rules To Eliminate Cost Misallocations Relating To General Support Facilities Costs.

As the Commission recognizes in the NPRM (at ¶¶ 79-80), the current rules permit the rate-of-return LECs to recover costs that are associated with their nonregulated billing and collection functions through their regulated interstate access rates. This is due to a quirk in the allocation rules. Although LECs use general purpose computer equipment (which is included in the GSF category) to provide nonregulated billing and collection services to IXCs, the Part 64 allocation rules do not treat interstate billing and collection services as nonregulated. Instead, nonregulated interstate billing and collection costs are identified through the cost allocation processes in Parts 36 and 69, but those processes do not allocate any GSF investment to billing and collection either.[13]

In the *Access Charge Reform* docket, the Commission corrected this anomaly in the rules to the extent that it applied to the price cap LECs. *See Access Charge Reform*, et al., CC Docket Nos. 96-262 et al., Third Report and Order (rel. Nov. 26, 1997) ("*GSF Order*"). To fix the problem, the Commission amended Rule 69.307 to require the use of a general expense allocator to apportion the interstate share of four accounts[14] between the billing and collection category and all other elements and categories. The amount to be allocated to the billing and collection category is determined by applying a "Big Three Expense Factor" allocator (modified to exclude amounts that are themselves apportioned based on the apportionment of GSF) to the interstate investment recorded in these four accounts. *See GSF Order*, ¶¶ 34-35; NPRM, ¶ 81 & n.108. Any GSF investment in Account 2110 that is not

[13] This is because, under 47 C.F.R. § 69.307, GSF investment is allocated among the billing and collection category, the interexchange category, and the access elements based on the amount of Central Office Equipment (COE), Cable and Wire Facilities (CWF), and Information Origination/Termination Equipment (IO/T) investment allocated to each Part 69 category. No COE, CWF, or IO/T investment is actually allocated to the billing and collection category, however, and therefore no GSF investment is allocated to billing and collection either.

[14] The four accounts include Accounts 2111 (Land), 2121 (Buildings), 2123 (Office Equipment), and 2124 (General Purpose Computers).

allocated to the billing and collection category will be apportioned among the access elements and the interexchange category using the current investment allocator.[15]

The Commission now proposes, and AT&T agrees, that this same correction be made to the extent that these rules apply to the rate-of-return LECs. NPRM, ¶ 82. As the Commission has noted, the misallocation of nonregulated billing and collection costs is a "significant problem," and correction of that problem is in the public interest. *See GSF Order*, ¶¶ 17, 22. Therefore, the Commission should adopt its proposal to "apply the same general allocator to the interstate portion of the four accounts to which it was applied for price cap LECs." NPRM, ¶ 82.

B. The Commission Should Modify Its Rules To Require Rate-Of-Return LECs To Recover Marketing Expenses From End Users.

The Commission should also eliminate the cross-subsidies that currently exist between the rate-of-return LECs' access charges and their marketing activities. As the Commission found in the *Access Reform Order* (with respect to the price cap LECs), the "LECs' marketing costs that are not related to the sale or advertising of interstate switched access services are not appropriately recovered from IXCs through per-minute interstate switched access charges." *Access Reform Order*, ¶ 319. Therefore, the Commission requires

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[15] In addition, with respect to GSF expenses, the interstate portion of Account 6120 (General Support Expenses) will continue to be apportioned among all elements and categories, including billing and collection, based upon the allocation rules contained in Rule 69.401(a)(2).

the price cap LECs to recover any such marketing costs currently allocated to the interstate jurisdiction from end users on a per-line basis. *Id.*

The Commission should now adopt its proposal to require rate-of-return LECs to recover their non-access-related marketing expenses through the proposed common line recovery mechanisms as well. NPRM, ¶ 86. Rate-of-return LECs should be required to recover such marketing expenses first by increasing the SLC for non-primary residential and multi-line businesses and then, if the SLC ceilings do not permit full recovery, by increasing the PICCs for non-primary residential and multi-line businesses. In contrast to the rules for price cap LECs, however, if PICC ceilings do not permit full recovery, rate-of-return LECs should recover such costs first by raising per-minute rates for terminating access. *See* Section II.B.

C. The Commission Should Not Permit The Assessment Of PICCs On Special Access Services.

In addition to taking the above steps to eliminate existing cross-subsidies, the Commission should avoid the creation of any new cross-subsidies. This means that the Commission should not permit rate-of-return LECs to assess PICCs on special access, as the Commission has previously proposed for the price cap LECs. *See* NPRM, ¶¶ 87-90. As the Commission notes, in the pending further rulemaking for price cap LECs, the Commission's proposal has met with "unanimous[]" opposition. NPRM, ¶ 89. The proposal should be rejected for the rate-of-return LECs as well, for two reasons.

First, imposing PICCs on purchasers of special access would be grossly at odds with the Commission's policies of promoting cost-causative rates and eliminating inefficient cross-subsidies. Forcing special access customers to pay the PICC would be a patent cross-subsidy because the PICC is designed to recover common line costs (including the non-traffic-sensitive line port component of the local switch), yet special access customers do not use either the common line or the switch. Therefore, such a charge would inevitably lead to inefficient behavior and would mark a needless "departure from established Commission practice that special access will not subsidize other services."[16]

Second, the premise for the Commission's proposal is unfounded. The Commission's stated fear that the temporary assessment of higher SLCs and PICCs on multi-line businesses may induce customers to switch to special access to escape these charges is implausible. The decision to migrate to special access involves many other factors, not the least of which is that special access is an entirely different service than switched access (because it does not include local switching). Moreover, changing to special access may involve nonrecurring charges, modification of customer premises equipment, and other provisioning issues, and it is unlikely that customers will undertake such changes merely to avoid a temporary increase in their SLCs and PICCs. Nonetheless, even if some migration does occur, that would be consistent with the Commission's "market-based" approach to access reform, and in all events should be encouraged, not squelched.

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[16] *Access Reform Order*, ¶ 404.

D. The Commission Should Modify Its Rules To Ensure That The Effects Of DEM Weighting Are Completely Removed From Switching Rates.

Finally, the Commission should modify its Part 36 Rules for study areas with fewer than 50,000 access lines to ensure that the COE Category 3 investment is apportioned to the interstate jurisdiction on the basis of interstate DEM. This ministerial change in the rules is necessary to ensure that the effects of DEM weighting are fully removed from switching rates, consistent with the intent of the Joint Board and the Commission in the *Access Reform* and *Universal Service Orders* to eliminate this source of implicit cross-subsidy.

The Commission made clear in both the *Universal Service Order* and the *Access Reform Order* that its intention was to convert the DEM weighting program from a system of implicit subsidies that artificially inflate switching rates to an explicit program in which those same subsidies would be collected from the Universal Service Fund. *See Universal Service Order*, ¶¶ 15, 303-04; *Access Reform Order*, ¶¶ 386-87. The rule changes that the Commission adopted in the *Universal Service Order*, however, do not fully accomplish that objective. The Part 36 Rules still allow for a local switching revenue requirement that is based on an apportionment factor that reflects DEM weighting.[17] As a result, switching rates continue to be artificially inflated (even as these LECs independently collect the full amount

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[17] Beginning January 1, 1998, Rule 36.125(f) provides that, for study areas with fewer than 50,000 access lines, Category 3 investment is apportioned to the interstate jurisdiction by the application of an interstate allocation factor that is the lesser of either .85 or the sum of the interstate DEM factor specified in Rule 36.125(a)(5) and the difference between the 1996 weighted interstate DEM factor and the 1996 interstate DEM factor.

of the DEM weighting subsidy from the USF), contrary to the intent of the Joint Board's recommendations and the Commission's orders.

This anomaly can be easily corrected. The Commission should amend Rule 36.125(b) to state that, beginning January 1, 1998, Category 3 investment for all study areas is to be apportioned to the interstate jurisdiction on the basis of the interstate DEM factor. In addition, Rule 36.125(f) should be limited to its association with Rule 54.301. These two changes would remove the remaining DEM weighting-related subsidy from the LECs' switching rates, consistent with the Joint Board's recommendations and the Commission's orders in the *Universal Service* proceeding.

CONCLUSION

For the foregoing reasons, the Commission should modify its rules concerning access charges for LECs subject to rate-of-return regulation to the extent described above.

Respectfully submitted,

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AT&T ATTACHMENT 1

METHODOLOGY OVERVIEW

To compare the rate-of-return ("ROR") LECs' traffic-sensitive access rates with those of the price cap LECs, AT&T performed a two-step analysis. First, AT&T estimated the impact that this access reform proceeding is likely to have on the ROR LECs' rates; *i.e.*, AT&T estimated what the ROR LECs' rates are likely to be if the Commission adopts the proposals in the NPRM. Second, AT&T then compared the resulting ROR LEC per-minute rates with the nationwide average rates of the largest price cap LECs (the BOCs and GTE). This overview provides a more detailed explanation of each of these steps in AT&T's analysis.

Estimating the Impact of Access Reform

ROR LECs may either participate in the NECA Common Line and Traffic-Sensitive pools or elect to file access tariffs that reflect LEC-specific Interstate Allocations of common line or traffic-sensitive revenue requirements. To analyze the impact of access reform and to derive estimates of the average common line and traffic-sensitive usage rates, AT&T first reviewed ROR LEC participation in the NECA Common Line and Traffic-Sensitive pools. Very few ROR LECs have elected to develop and file LEC-specific carrier common line (CCL) rates, but a greater number of ROR LECs file LEC-specific traffic-sensitive rates. To account for these differences in participation, AT&T estimated the access impacts associated with each pool separately. The analysis of the impact on aggregate NECA common line access revenues and on aggregate traffic-sensitive rates is outlined below.

To develop an estimate of the impact of access reform on the ROR Common Line pool and Traffic-Sensitive pools, AT&T gathered the NECA common line volumes, common line minutes, common line revenue requirements and traffic-sensitive revenue requirements from the NECA 1998 annual access filing TRP COS-1(P) and REV-1 reports. In addition to the NECA information, traffic-sensitive revenue requirements, access rates and volumes were also gathered for the five largest ROR LECs that do not participate in the NECA pools. The impacts of access reform on the ROR LECs were then estimated as follows:

1. The reported NECA access line data was restructured to reflect the potential application of End User Common Line charges (EUCLs) and Presubscribed Interexchange Carrier Charges (PICCs), as the Commission has already adopted for the price cap LECs.

2. The traffic-sensitive access rates (*e.g.*, local switching and transport) of the five largest non-NECA traffic-sensitive pool participants were assumed to be representative of all non-pooled traffic-sensitive access rates.