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

In the Matter of	)	
	)	
Access Charge Reform	)	CC Docket No. 96-262
	)	
Price Cap Performance Review for Local Exchange Carriers	)	CC Docket No. 94-1
	)	
Interexchange Carrier Purchases of Switched Access Services Offered by Competitive Local Exchange Carriers	)	CCB/CPD File No. 98-63
	)	
Petition of U S West Communications, Inc. for Forbearance from Regulation as a Dominant Carrier in the Phoenix, Arizona MSA	)	CC Docket No. 98-157

FIFTH REPORT AND ORDER AND FURTHER NOTICE OF PROPOSED RULEMAKING

Adopted: August 5, 1999 **Released**: August 27, 1999

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By the Commission: Commissioner Ness issuing a statement; Commissioner Furchtgott-Roth approving in part, concurring in part, dissenting in part, and issuing a statement.

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APPENDIX A

APPENDIX B

I. INTRODUCTION

1. In this Order, we revise the rules that govern the provision of interstate access services by those incumbent local exchange carriers (ILECs) subject to price cap regulation (collectively, "price cap LECs")[1] to advance the pro-competitive, de-regulatory national policies embodied in the Telecommunications Act of 1996 (1996 Act).[2] With these revisions, we continue the process the Commission began in 1997, with the *Access Reform First Report and Order*, to reform regulation of interstate access charges in order to accelerate the development of competition in all telecommunications markets and to ensure that our own regulations do not unduly interfere with the operation of these markets as competition develops.[3]

2. In the *Access Reform First Report and Order*, the Commission adopted a primarily market-based approach to drive interstate access charges toward the costs of providing these services.[4] The Commission envisioned that this approach would enable it to give carriers progressively greater flexibility to set rates as competition develops, until competition gradually replaces regulation as the primary means of setting prices.[5] In this Order, the Commission fulfills its commitment to provide detailed rules for implementing the market-

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[1] The Commission instituted price cap regulation for the Regional Bell Operating Companies (BOCs) and GTE in 1991, and permitted other LECs to adopt price cap regulation voluntarily, subject to certain conditions. Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786, 6818-20 (*LEC Price Cap Order*). We emphasize that this Order applies only to price cap LECs. As stated in the *Access Reform First Report and Order*, the Commission intends to address interstate access charge reform for rate-of-return LECs in a separate proceeding. *Access Reform First Report and Order*, 12 FCC Rcd 16125-26. On June 4, 1998, the Commission released a Notice of Proposed Rulemaking initiating a comprehensive review of access charge reform for rate-of-return LECs. Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation, CC Docket No. 98-77, Notice of Proposed Rulemaking, 13 FCC Rcd 14238 (1998) (*Rate of Return Access Reform NPRM*).

[2] Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56, *codified at* 47 U.S.C. § 151 *et seq.*

[3] *See Access Reform First Report and Order*, 12 FCC Rcd at 15985, 16094. A list of parties submitting comments in response to various proceedings related to access reform is included at Appendix A. The list identifies the specific proceeding and how each commenter is identified in the text of this item. Unless otherwise noted, all cites to comments and replies refer to comments and replies submitted in response to Access Charge Reform, CC Docket No. 96-262, Notice of Proposed Rulemaking, 11 FCC Rcd 21354 (1996) (*Access Reform NPRM*).

[4] *Access Reform First Report and Order*, 12 FCC Rcd at 16094. The Commission also adopted a "prescriptive backstop" to its market-driven approach: it required all price cap LECs to file cost studies no later than February 8, 2001, to demonstrate the forward-looking cost of providing those services that remain subject to price cap regulation. *Id.* at 16096-97.

[5] *Id.* at 15989, 16094-95.

based approach, pursuant to which price cap LECs would receive pricing flexibility in the provision of interstate access services as competition for those services develops.[6]

3. The pricing flexibility framework we adopt in this Order is designed to grant greater flexibility to price cap LECs as competition develops, while ensuring that: (1) price cap LECs do not use pricing flexibility to deter efficient entry or engage in exclusionary pricing behavior; and (2) price cap LECs do not increase rates to unreasonable levels for customers that lack competitive alternatives. In addition, these reforms will facilitate the removal of services from price cap regulation as competition develops in the marketplace, without imposing undue administrative burdens on the Commission or the industry.

4. Specifically, this Order grants immediate pricing flexibility to price cap LECs in the form of streamlined introduction of new services, geographic deaveraging of rates for services in the trunking basket, and removal, upon implementation of toll dialing parity, of certain interstate interexchange services from price cap regulation. We also establish a framework for granting price cap LECs greater flexibility in the pricing of all interstate access services once they satisfy certain competitive criteria. In Phase I, we allow price cap LECs to offer contract tariffs and volume and term discounts for those services for which they make a specific competitive showing. In Phase II, we permit price cap LECs to offer dedicated transport and special access services free from our Part 69 rate structure and Part 61 price cap rules, provided that the LECs can demonstrate a significantly higher level of competition for those services.

5. We address additional pricing flexibility proposals in the Notice of Proposed Rulemaking (Notice) portion of this item. We seek comment on proposals for geographic deaveraging of the rates for services in the common line and traffic-sensitive baskets. We also invite comment on the appropriate triggers for granting Phase II relief for services in the common line and traffic-sensitive baskets, as well as for the traffic-sensitive parts of tandem-switched transport service.

6. In addition to adopting rules to implement the market-based approach to access reform, we take this opportunity to re-examine the rate structure for the local switching service category of the traffic-sensitive basket. Accordingly, in the Notice, we seek comment on a number of proposed changes to the rate structure so that it better replicates the operation of a competitive market. Generally, we invite parties to discuss proposed revisions to our rules that would require price cap LECs to develop capacity-based local switching charges rather than per-minute charges. We also solicit comment on whether the traffic-sensitive price cap index (PCI) formula should be modified. For the same reasons that we consider revising the local switching rate structure, we also seek comment on whether similarly to revise the rate structure for tandem-switched transport.

[6] *Id.* at 15989, 16106.

7. Finally, we deny a petition for declaratory ruling filed by AT&T requesting that the Commission confirm that interexchange carriers (IXCs) may elect not to purchase switched access services offered under tariff by competitive local exchange carriers (CLECs).[7] We decline to address AT&T's concerns in a declaratory ruling; however, we find that AT&T's petition and supporting comments suggest a need for the Commission to revisit the issue of CLEC access rates. Therefore, in the Notice, we initiate a rulemaking regarding the reasonableness of these charges and whether the Commission might adopt rules to address, by the least intrusive means, any failure of market forces to constrain CLEC access charges.

II. BACKGROUND AND SUMMARY

A. Price Cap Regime

1. Background

8. To recover the costs of providing interstate access services, incumbent LECs charge IXCs and end users for access services in accordance with our Part 69 access charge rules.[8] Part 69 establishes two basic categories of access services: special access services and switched access services. Special access services do not use local switches; instead they employ dedicated facilities that run directly between the end user and the IXC's point of presence (POP).[9] Switched access services, on the other hand, use local exchange switches to route originating and terminating interstate toll calls. The Commission has not prescribed specific rate elements in Part 69 for special access services.[10] Part 69 does establish specific switched access elements and a mandatory switched access rate structure for each element.[11]

9. Interoffice transmission services, known as transport services, carry interstate switched access traffic between an IXC's POP and the end office that serves the end user customer. Incumbent LEC transmission facilities that carry switched interstate traffic between an IXC's POP and the incumbent LEC end office serving the POP (this office is

[7] Petition for Declaratory Ruling filed by AT&T Regarding Interexchange Carrier Purchases of Switched Access Services Offered by Competitive Local Exchange Carriers (Oct. 23, 1998) (*AT&T Declaratory Ruling Petition*).

[8] 47 C.F.R. Part 69.

[9] A POP is the physical point where an IXC connects its network with the LEC network.

[10] *Access Reform NPRM*, 11 FCC Rcd at 21367.

[11] *Id.* at 21367.

called the serving wire center, or SWC), are known as entrance facilities.[12] Incumbent LECs currently offer two types of interstate switched transport service between a SWC and an end user's end office. Under the first service, direct-trunked transport, calls are transported between the SWC and the end office by means of a direct trunk, a dedicated facility, that does not pass through an intervening switch.[13] The second service, tandem-switched transport, routes calls from the SWC to the end office through a tandem switch located between the SWC and the end office. Traffic travels over a dedicated circuit from the SWC to the tandem switch and then over a shared circuit, which carries the calls of many different IXCs, from the tandem switch to the incumbent LEC end office.[14] Incumbent LEC tandem switches and end office switches switch interstate traffic between the transport trunks carrying traffic to and from the IXC POPs and the end users' local loops.

10. Charges for special access services generally are divided into channel termination charges and channel mileage charges. Channel termination charges recover the costs of facilities between the customer's premises and the LEC end office and the costs of facilities between the IXC POP and the serving wire center. Channel mileage charges recover the costs of facilities (also known as interoffice facilities) between the serving wire center and the LEC end office serving the end user.

2. Price Caps

11. In 1990, the Commission replaced rate-of-return regulation for the BOCs and GTE with an incentives-based system of regulation that encourages companies to: (1) improve their efficiency by developing profit-making incentives to reduce costs; (2) invest efficiently in new plant and facilities; and (3) develop and deploy innovative service offerings.[15] The price cap plan is designed to replicate some of the efficiency incentives found in fully competitive markets and to act as a transitional regulatory scheme until actual competition makes price cap regulation unnecessary.[16]

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[12] *See* 47 C.F.R. § 69.110 (requiring LECs to impose flat-rated charges on IXCs to recover the costs of entrance facilities).

[13] *See* 47 C.F.R. § 69.112 (requiring LECs to impose a flat-rated charge on IXCs to recover the costs of direct-trunked transport).

[14] *See* 47 C.F.R. § 69.111 (prescribing a three-part rate structure for LEC recovery from IXCs of tandem-switched transport costs: a flat-rated charge for the dedicated facility from the LEC serving wire center to the tandem switch, a per-minute tandem switching charge, and a per-minute charge for common transport from the tandem switch to the LEC end office).

[15] Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, Second Further Notice of Proposed Rulemaking, 11 FCC Rcd 858, 863 (1995) (*Price Cap Second FNPRM*). As noted *supra* at Section I, other local exchange carriers could opt into price cap regulation. *Id.*

[16] Rules governing price cap LECs are set forth in Part 61 of our rules. 47 C.F.R. Part 61.

12. Under the original price cap plan, interstate access services were grouped into four different baskets: the common line, traffic-sensitive, special access, and interexchange baskets.[17] In the *Second Transport Order*, the Commission combined transport and special access services into the newly created trunking basket.[18] Each basket is subject to a price cap index (PCI), which caps the total charges a LEC may impose for interstate access services in that basket.[19] The PCI is adjusted annually by a measure of inflation minus a "productivity factor," or "X-Factor."[20] A separate adjustment is made to the PCI for "exogenous" cost changes, which are changes outside the carrier's control and not otherwise reflected in the price cap formula.[21]

13. Within the traffic-sensitive and trunking baskets, services are grouped into service categories and subcategories. Rate revisions for these services are limited by upper and, in the original price cap plan, lower pricing bands established for that particular service.[22] Originally, the pricing band limits for most of the service categories and subcategories were set at five percent above and below the Service Band Index (SBI).[23] In 1995, however, the Commission increased the lower pricing bands to ten percent for those service categories in the trunking and traffic-sensitive baskets and 15 percent for those services subject to density

[17] *LEC Price Cap Order*, 5 FCC Rcd at 6788. Originally, interexchange services were to be included in the basket containing special access offerings; however, the Commission concluded that combining these services into one basket "raised issues concerning the flow-through of exogenous costs that can be solved by separating the interexchange activity from interstate access." *Id.* Accordingly, the Commission created the interexchange basket for those LECs that offer interexchange services. *Id.*

[18] Transport services originally were placed in the traffic-sensitive basket. Transport Rate Structure and Pricing, CC Docket No. 91-213, Second Report and Order, 9 FCC Rcd 615, 622 (1994) (*Second Transport Order*).

[19] *Id.*

[20] *Price Cap Second FNPRM*, 11 FCC Rcd at 863. For a complete discussion of the "X-Factor," *see Price Cap Performance Review*, 10 FCC Rcd at 9005-6; *see also* Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 96-262, Fourth Report and Order, 12 FCC Rcd 16642 (1997) (*Price Cap Fourth Report and Order*), *aff'd in part, rev'd in part*, U.S. Telephone Ass'n v. FCC, --- F.3d ----, 1999 WL 317035 (D.C.Cir. May 21, 1999) (NO. 97-1469).

[21] *LEC Price Cap Order*, 5 FCC Rcd at 6792.

[22] 1993 Annual Access Tariff Filings, CC Docket No. 93-193, Phase I, Part 2, Memorandum Opinion and Order, 12 FCC Rcd 6277, 6286 (1997); *see also Access Reform NPRM*, 11 FCC Rcd at 21372; *Price Cap Second FNPRM*, 11 FCC Rcd at 864. We note that there are no upper and lower banding requirements imposed on the common line basket and the interexchange baskets. *LEC Price Cap Order*, 5 FCC Rcd at 6811.

[23] 1993 Annual Access Tariff Filings, CC Docket No. 93-193, Phase I, Part 2, Memorandum Opinion and Order, 12 FCC Rcd 6277, 6286 (1997). The SBI is a subindex of the prices for each category or subcategory.

zone pricing.[24] These pricing bands give price cap LECs the ability to raise and lower rates for elements or services as long as the actual price index (API)[25] for the relevant basket does not exceed the PCI for that basket, and the prices for each category of services within the basket are within the established pricing bands.[26] Together, the PCI and pricing bands restrict a price cap LEC's ability to offset price reductions for services that are subject to competition with price increases for services that are not subject to competition.[27]

B. Pricing Flexibility

14. When it adopted the *LEC Price Cap Order* in 1990, the Commission required price cap LECs to offer all interstate special and switched access services at geographically averaged rates for each study area.[28] Since that time, the Commission has taken significant steps to increase the LECs' pricing flexibility and ability to respond to the advent of competition in the exchange access market. In the *Special Access* and *Switched Transport Expanded Interconnection Orders*, the Commission permitted LECs to introduce density zone pricing for high capacity special access and switched transport services in a study area, provided that they could demonstrate the presence of "operational" special access and switched transport expanded interconnection arrangements and at least one competitor in the study area.[29] The Commission also permitted price cap LECs to offer volume and term

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[24] Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, First Report and Order, 10 FCC Rcd 8961, 9129-30, 9141 (1995) (*Price Cap Performance Review*). Density zone pricing is a system that permits LECs to reduce gradually rates in geographic areas that are less costly to serve, and to increase rates in areas that are more costly to serve. Transport Rate Structure and Pricing, CC Docket No. 91-213, Third Memorandum Opinion and Order on Reconsideration, 10 FCC Rcd 3030, 3042 (1994). As discussed in more detail below, the Commission subsequently eliminated the lower service band indices. *See infra* Section II.B.

[25] The "actual price index" is a weighted index of the rates that a price cap carrier is charging, or proposes to charge, for the services in a particular basket. *See* 47 C.F.R. §§ 61.3(b), 61.46.

[26] *Access Reform NPRM*, 11 FCC Rcd at 21372, 21485.

[27] The ability of a price cap LEC to raise rates for some services as a result of rate reductions for other services within the same basket or band is referred to as "headroom."

[28] *LEC Price Cap Order*, 5 FCC Rcd at 6788 (1990) (*LEC Price Cap Order*); *see also Price Cap Second FNPRM*, 11 FCC Rcd at 866.

[29] Expanded Interconnection with Local Telephone Company Facilities; Amendment of the Part 69 Allocation of General Support Facility Costs, CC Docket Nos. 91-141 and 92-333, Report and Order, 7 FCC Rcd 7369, 7454 n.411 (1992) (*Special Access Expanded Interconnection Order*), *vacated in part and remanded*, Bell Atlantic Tel. Cos. v. FCC, 24 F.3d 1441 (D.C. Cir. 1994); Expanded Interconnection with Local Telephone Company Facilities, 9 FCC Rcd 5154, 5196 (1994) (*Virtual Collocation Order*); Switched Transport Expanded Interconnection with Local Telephone Company Facilities, CC Docket No. 91-141, Second Report and Order and Third Notice of Proposed Rulemaking, 8 FCC Rcd 7374, 7425-32 (1993) (*Switched Transport Expanded Interconnection Order*), *aff'd*, *Virtual Collocation Order*, 9 FCC Rcd 5196; *see also* Section V, *infra*. "Expanded

discounts for special access and switched transport services upon specific competitive showings.[30]

15. Subsequently, the Commission eliminated the lower service band indices, concluding that this action would lead to lower prices and encourage LECs to charge rates that reflect the underlying costs of providing exchange access services.[31] The Commission found that the PCI and upper pricing bands adequately control predatory pricing and that greater downward pricing flexibility would benefit consumers both directly through lower prices and indirectly by encouraging only efficient competitive entry.[32]

16. In that same order, the Commission also relaxed the procedures for introducing new switched access services, in response to arguments that new services and technologies do not fit the Part 69 rate structure requirements.[33] The Commission prescribed the original rate structure for introducing new switched access services in 1983.[34] At that time, incumbent LECs were required to file a Part 69 waiver each time they wanted to introduce a new rate element for switched access service that did not conform to the prescribed switched access rate structure.[35] A Part 69 waiver required incumbent LECs to demonstrate that "special circumstances warrant deviation from the general rule and that such deviation will serve the

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interconnection" refers to the interconnection of one carrier's circuits with those of a LEC at one of the LEC's wire centers so that the carrier can provide certain facilities-based access services. *See Virtual Collocation Order*, 9 FCC Rcd at 5158. An expanded interconnection offering is deemed "operational" when at least one interconnector has taken a switched cross-connect element. *Switched Transport Expanded Interconnection Order*, 8 FCC Rcd at 7426-27.

[30] *Special Access Expanded Interconnection Order*, 7 FCC Rcd at 7463; *Switched Transport Expanded Interconnection Order*, 8 FCC Rcd at 7435. The Commission allowed LECs to offer volume and term discounts for switched transport services in a study area upon demonstration of one of the following conditions: (1) 100 DS1-equivalent switched cross-connects (*i.e.*, the cabling inside the LEC central office that connects the LEC network to the collocated equipment dedicated to a competitive access provider using expanded interconnection) are operational in the Zone 1 offices in the study area; or (2) an average of 25 DS1-equivalent switched cross-connects per Zone 1 office are operational. In study areas with no Zone 1 offices, volume and term discounts may be implemented once five DS1-equivalent switched cross-connects are operational in the study area. *Switched Transport Expanded Interconnection Order*, 8 FCC Rcd at 7435.

[31] *Access Reform NPRM*, 11 FCC Rcd at 21487.

[32] *Id.*

[33] *Id.* at 21488.

[34] *See* 47 C.F.R. Part 69; *see also* MTS and WATS Market Structure, CC Docket No. 78-72, Phase I, Third Report and Order, 93 FCC 2d 241 (1983) (*Access Charge Order*). The Commission has not prescribed a special access rate structure. *Access Charge Order*, 93 FCC 2d at 314-15.

[35] Section 1.3 permits the Commission to grant waivers of any of its rules if "good cause therefor is shown." 47 C.F.R. § 1.3.

public interest."[36] Incumbent LECs also had to comply with the "new services" test, which required an incumbent LEC to demonstrate that its tariffed rates for new services would recover no more than the carrier's direct costs of providing the service, plus a reasonable amount of overhead, and no less than the carrier's direct costs of providing the service.[37] Finally, incumbent LECs were directed to file their tariffs introducing a new service on at least fifteen days' notice and to incorporate the new service into the appropriate price cap basket and indices within six to eighteen months after the new service tariff became effective.[38]

17. The Commission found that the Part 69 rate structure imposed a costly, time-consuming, and unnecessary burden on incumbent LECs and significantly impeded the introduction of new services.[39] Accordingly, the Commission modified the Part 69 rate structure rules to permit an incumbent LEC to introduce a new service by filing a petition based on a "public interest" standard that is easier to satisfy than the general standard applicable to waivers of the Commissions rules.[40] In addition, under the new rules, once an initial incumbent LEC has satisfied the public interest requirement for establishing new rate elements for a new switched access service, another incumbent LEC may file a petition seeking authority to introduce an identical new service, and its petition will be reviewed within ten days of the release of a Public Notice. The LEC may introduce the new rate element following the ten-day period, unless the Common Carrier Bureau (the Bureau)

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[36] *See* Northeast Cellular Telephone Company v. FCC, 897 F.2d 1164, 1166 (D.C. Cir. 1990) (*Northeast Cellular*); WAIT Radio v. FCC (*WAIT Radio*), 418 F.2d 1153 (D.C. Cir. 1969) ("Good cause" is interpreted to require petitioners to show that "special circumstances warrant deviation from the general rule and such deviation will serve the public interest.")

[37] A new service is one that expands the range of service options available to a customer. In the *LEC Price Cap Order*, the Commission concluded that it would not limit the definition of "new services" to services that employ a new technology or functional capability. *LEC Price Cap Order*, 5 FCC Rcd at 6824; *see also* 47 C.F.R. § 61.49(f)(2); Amendments of Part 69 of the Commission's Rules Relating to the Creation of Access Charge Subelements for Open Network Architecture, CC Docket Nos. 89-79 and 87-313, Report and Order and Order on Further Reconsideration and Supplemental Notice of Proposed Rulemaking, 6 FCC Rcd 4524, 4531 (1991) (adopting the direct cost test); Amendments of Part 69 of the Commission's Rules Relating to the Creation of Access Charge Subelements for Open Network Architecture, CC Docket Nos. 89-79 and 87-313, Memorandum Opinion and Order on Second Further Reconsideration, 7 FCC Rcd 5235, 5237 (1992) (eliminating the pre-existing net revenue test as superfluous).

[38] *See* Implementation of Section 402(b)(1)(A) of the Telecommunications Act of 1996, CC Docket No. 96-187, Report and Order, 12 FCC Rcd 2170, 2203 (1997) (*Tariff Streamlining Order*) (LECs must file their tariffs introducing a new service on at least fifteen days' notice.); 47 C.F.R. § 61.43 (Tariffs introducing a new service must be incorporated into the appropriate price cap basket and indices within six to eighteen months after the new service tariff takes effect.)

[39] *Access Reform NPRM*, 11 FCC Rcd at 21490.

[40] *Id.*; *see also* 47 C.F.R. § 69.4(g).

informs the LEC before that time that its new service does not qualify for "me too" treatment.[41]

18. The Commission also recognized that additional modifications to the Part 69 rate structure could increase consumer choice, streamline regulation, and increase consumer welfare by increasing incentives for innovation.[42] The Commission, therefore, sought comment on whether to permit price cap LECs to establish new switched access rate elements without prior approval.[43] The Commission also invited comment on whether to eliminate the new services test and permit LECs to offer new services free from price cap regulation.[44] In the *Access Reform First Report and Order*, the Commission deferred resolution of these issues, as well as other issues concerning the timing and degree of pricing flexibility, to a future report and order.[45]

C. Summary

1. Pricing Flexibility

19. Since the release of the *Access Reform First Report and Order*, we have re-examined the record generated in response to the *Access Reform NPRM* and the *Price Cap Second FNPRM*; we have observed competition develop in the marketplace; and we have invited parties to update and refresh the record relating to access charge reform to reflect any changes that may have taken place since May 1997.[46] In addition, we have received and reviewed several petitions (and the associated records) from BOCs seeking pricing flexibility in the form of forbearance from dominant carrier regulation in the provision of certain special access and high capacity services.[47] Although our current price cap regime gives LECs some pricing flexibility and considerable incentives to operate efficiently, significant regulatory

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[41] *Access Reform NPRM*, 11 FCC Rcd at 21490.

[42] *Id.* at 21440-41.

[43] *Id.*

[44] *Id.*

[45] *Access Reform First Report and Order*, 12 FCC Rcd at 16094.

[46] Commission Asks Parties to Update and Refresh the Record for Access Charge Reform and Seeks Comment on Proposals for Access Charge Reform Pricing Flexibility, CC Docket No. 96-262, Public Notice, 13 FCC Rcd 21522 (1998) (*October 5 Public Notice*).

[47] In the order that they were filed, these forbearance petitions are: U S West Forbearance Petition (Phoenix), CC Docket No. 98-157 (filed Aug. 24, 1998); SBC Communications, Inc. Forbearance Petition, CC Docket No, 98-227 (filed Dec. 7, 1998); U S West Forbearance Petition (Seattle), CC Docket No. 99-1 (filed Dec. 30, 1998); Bell Atlantic Telephone Companies Forbearance Petition, CC Docket No. 99-24 (filed Jan. 20, 1999); and Ameritech Forbearance Petition, CC Docket No. 99-65 (filed Feb. 5, 1999).

constraints remain. As the market becomes more competitive, such constraints become counter-productive. We recognize that the variety of access services available on a competitive basis has increased significantly since the adoption of our price cap rules. Therefore, in response to changing market conditions, we grant price cap LECs immediate flexibility to deaverage services in the trunking basket and to introduce new services on a streamlined basis. We also remove certain interstate interexchange services from price cap regulation upon implementation of intra- and interLATA toll dialing parity, and we establish a framework for granting price cap LECs further pricing flexibility upon satisfaction of certain competitive showings and seek comment on additional flexibility for certain switched access services.

a. Immediate Regulatory Relief

20. As discussed above, the original rate structure for interstate switched transport services required price cap LECs to charge averaged rates throughout a study area.[48] The Commission subsequently found that this requirement forced LECs to price above cost in the high-traffic, lower-cost areas where competition is more likely to develop.[49] In the *Switched Transport Expanded Interconnection Order*, therefore, the Commission created a density zone pricing plan that allows some degree of deaveraging of rates for switched transport services.[50] The Commission concluded that relaxing the pricing rules in this manner would enable price cap LECs to respond to increased competition in the interstate switched transport market.[51]

21. Although the density zone pricing plan afforded some pricing flexibility to price cap LECs, it contained several constraints, such as the increased scrutiny applicable to plans with more than three zones. We now conclude that market forces, as opposed to regulation, are more likely to compel LECs to establish efficient prices. Accordingly, for purposes of deaveraging rates for services in the trunking basket, we eliminate the limitations inherent in our current density zone pricing plan and allow price cap LECs to define the scope and number of zones within a study area, provided that each zone, except the highest-cost zone, accounts for at least 15 percent of the incumbent LEC's trunking basket revenues in the study area and that annual price increases within a zone do not exceed 15 percent. In addition, we eliminate the requirement that LECs file zone pricing plans prior to filing their tariffs.

22. We also permit price cap LECs to introduce new services on a streamlined basis, without prior approval. Generally, we modify the Commission's rules to eliminate the public interest showing required by Section 69.4(g) and to eliminate the new services test (except in

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[48] *Switched Transport Expanded Interconnection Order*, 8 FCC Rcd at 7423-24.

[49] *Id.* at 7424.

[50] *Id.* at 7426.

[51] *Id.*

the case of loop-based new services) required under Sections 61.49(f) and (g).[52] These modifications will eliminate the delays that now exist for the introduction of new services as well as encourage efficient investment and innovation.

23. Certain interstate interexchange services provided by price cap LECs are found in the interexchange basket, including interstate intraLATA services and certain interstate interLATA services called "corridor services." In this Order, we allow price cap LECs to remove from the interexchange basket, and, hence, price cap regulation, their interstate intraLATA toll services and corridor services, provided the price cap LEC has implemented intra- and interLATA toll dialing parity in all of the states in which it provides local exchange service. The presence of competitive alternatives for these services, coupled with implementation of dialing parity, should prevent price cap LECs from exploiting over a sustained period any market power may possess with respect to these services and thus warrants removal of these services from price cap regulation.

b. Relief that Requires a Competitive Showing

24. In addition, we adopt a framework for granting further regulatory relief upon satisfaction of certain competitive showings. Relief generally will be granted in two phases and on an MSA (Metropolitan Statistical Area) basis.[53] To obtain Phase I relief, price cap LECs must demonstrate that competitors have made irreversible, sunk investments in the facilities needed to provide the services at issue. For instance, for dedicated transport and special access services,[54] price cap LECs must demonstrate that unaffiliated competitors have collocated in at least 15 percent of the LEC's wire centers within an MSA or collocated in wire centers accounting for 30 percent of the LEC's revenues from these services within an MSA.[55] Higher thresholds apply, however, for channel terminations between a LEC end office and an end user customer. In that case, the LEC must demonstrate that unaffiliated competitors have collocated in 50 percent of the price cap LEC's wire centers within an MSA or collocated in wire centers accounting for 65 percent of the price cap LEC's revenues from this service within an MSA. For traffic-sensitive, common line, and the traffic-sensitive components of tandem-switched transport services, a LEC must show that competitors offer service over their own facilities to 15 percent of the price cap LEC's customer locations

[52] *See* Section III, *infra*.

[53] Pricing flexibility also is available for the non-MSA sections of a study area, provided the price cap LEC satisfies the triggers adopted herein for MSAs.

[54] For purposes of this Order, "dedicated transport services" refer to entrance facilities, direct-trunked transport, and the dedicated component of tandem-switched transport.

[55] To satisfy the collocation triggers we adopt herein, an incumbent LEC must demonstrate, with respect to each wire center with collocation, that at least one of the competitors therein uses transport services provided by a transport provider other than the incumbent LEC.

within an MSA. Phase I relief permits price cap LECs to offer, on one day's notice, volume and term discounts and contract tariffs for these services, so long as the services provided pursuant to contract are removed from price caps. To protect those customers that may lack competitive alternatives, however, LECs receiving Phase I flexibility must maintain their generally available, price cap constrained tariffed rates for these services.

25. To obtain Phase II relief, price cap LECs must demonstrate that competitors have established a significant market presence (*i.e.*, that competition for a particular service within the MSA is sufficient to preclude the incumbent from exploiting any individual market power over a sustained period) for provision of the services at issue. Phase II relief for dedicated transport and special access services is warranted when a price cap LEC demonstrates that unaffiliated competitors have collocated in at least 50 percent of the LEC's wire centers within an MSA or collocated in wire centers accounting for 65 percent of the LEC's revenues from these services within an MSA. Again, a higher threshold applies to channel terminations between a LEC end office and an end user customer. In that case, a price cap LEC must show that unaffiliated competitors have collocated in 65 percent of the LEC's wire centers within an MSA or collocated in wire centers accounting for 85 percent of the LEC's revenues from this service within an MSA. Phase II relief permits price cap LECs to file tariffs for these services on one day's notice, free from both our Part 61 rate level and our Part 69 rate structure rules.[56]

26. Because our ultimate goal is to continue to foster competition and allow market forces to operate where they are present, we also seek comment in the Notice on additional pricing flexibility for common line and traffic-sensitive services. First, we consider permitting price cap LECs to deaverage rates for services in the common line and traffic-sensitive baskets in conjunction with identification and removal of implicit universal service support in interstate access charges and implementation of an explicit high cost support mechanism. We also invite parties to comment on how we should define zones for purposes of deaveraging. In addition, we seek comment on which rate elements may be deaveraged and whether deaveraging should be subject to subscriber line charge (SLC) and presubscribed interexchange carrier charge (PICC) caps or any other constraint. We also seek comment on the appropriate Phase II triggers for granting greater pricing flexibility for traffic-sensitive, common line, and the traffic-sensitive components of tandem-switched transport services.

2. Modifications to Rate Structure

27. The Notice also seeks comment on certain price cap regulation issues. Specifically, consistent with the *Access Reform First Report and Order's* efforts to reform access charges so costs are recovered in a manner that reflects how they are incurred, we seek

[56] As discussed in more detail below, we eliminate the low-end adjustment mechanism for those price cap LECs qualifying for and electing to exercise either Phase I or Phase II pricing flexibility. *See* Section VI.D.2, *infra*.

comment on adopting a capacity-based rate structure for local switching. The local switch, which consists of an analog or digital switching system and line and trunk cards, connects subscriber lines both with other local subscriber lines and with dedicated and common interoffice trunks.[57] As discussed in more detail below, prior to the *Access Reform First Report and Order*, the interstate allocated portion of these costs was recovered entirely through per-minute charges assessed on IXCs.[58]

28. Recognizing that a significant portion of these costs (*i.e.*, the costs associated with line cards and trunk ports) do not vary with usage, however, the Commission determined that such non-traffic-sensitive costs should be recovered on a flat-rated, rather than usage sensitive, basis.[59] Accordingly, consistent with principles of cost-causation and economic efficiency, the Commission directed price cap LECs to reassign all line-side port costs from the Local Switching rate element to the Common Line rate element and to recover these costs through the common line rate elements, including the SLC and flat-rated PICC.[60] Because the record in that proceeding was not adequate, however, to determine whether and to what extent the remaining local switching costs were traffic-sensitive or non-traffic-sensitive, LECs continue to recover these costs through traffic-sensitive charges.[61]

29. We take this opportunity to re-examine the local switching rate structure to determine whether it reasonably reflects the manner in which price cap LECs incur costs. In the Notice, we invite comment on whether and to what extent we should modify further our price cap rules for the traffic-sensitive basket to reflect a capacity-based local switching rate structure.[62]

30. We also invite parties to discuss proposed revisions to our rules for the common line basket, and we consider redefining the price cap baskets and pricing bands. Specifically, we solicit comment on whether to increase the "g" factor[63] in the common line PCI formula and whether we should revise the baskets so that services with flat rates are not placed in the same basket as services with traffic-sensitive rates. In addition, we seek comment on our

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[57] Line cards connect subscriber lines to the switch, and trunk ports connect interoffice trunks to the switch. *Access Reform First Report and Order*, 12 FCC Rcd 16034.

[58] 47 C.F.R. § 69.106.

[59] *Access Reform First Report and Order*, 12 FCC Rcd at 16034.

[60] *Id.*

[61] *Access Reform First Report and Order*, 12 FCC Rcd at 16040.

[62] *See* Section VIII.C, *infra*.

[63] *See* Section VIII.D, *infra*.

tentative conclusion that the inflation measure in the PCI formula should be consistent with the measure defined by the Bureau of Labor Statistics (BLS).

3. CLEC Access Charges

31. In the *Access Reform NPRM*, the Commission sought comment on whether CLECs have market power in the provision of terminating access services and whether to regulate these services.[64] In the *Access Reform First Report and Order*, the Commission decided to treat CLECs as non-dominant in the provision of terminating access service, because they did not appear at that time to possess market power.[65] The Commission stated, however, that it would revisit the issue of regulating CLEC terminating access rates if there were sufficient indications that CLECs were imposing unreasonable terminating access charges.[66]

32. On October 23, 1998, AT&T filed a petition for declaratory ruling requesting that the Commission confirm that, under existing Commission rules and policies, an IXC may elect not to accept service at a price chosen by the CLEC.[67] In its petition, AT&T alleges that some CLECs impose switched access charges significantly higher than those charged by the ILEC competitors in the same area.[68] AT&T points to a Commission pronouncement in the *Access Reform First Report and Order* that "terminating rates that exceed those charged by the ILEC serving the same market may suggest that a CLEC's terminating access rates are excessive," thereby warranting Commission regulation.

33. In this Order, we deny AT&T's petition. We find, however, that the record developed in response to AT&T's petition suggests the need for the Commission to revisit the issue of CLEC access rates. Accordingly, in the accompanying Notice, we initiate a rulemaking to determine the reasonableness of CLEC access rates and whether the Commission might adopt rules to address, by the least intrusive means, any failure of market forces to constrain CLEC access charges.

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[64] *Access Reform NPRM*, 11 FCC Rcd at 21476.

[65] *Access Reform First Report and Order*, 12 FCC Rcd at 16140-41.

[66] *Id.* at 16142.

[67] AT&T Petition for Declaratory Ruling, CCB/CPD No. 98-63 (Oct. 23, 1998).

[68] We note that there are pending before the Commission several complaints concerning CLECs' terminating access charges. For instance, on October 18, 1996, Total Telecommunications Services, Inc (TTS) and Atlas Telephone Company filed a complaint against AT&T alleging that AT&T failed to compensate TTS for terminating access services provided by TTS. The complaint also alleges that AT&T wrongfully discontinued service to TTS end users in violation of section 214 of the Act. *See* Total Telecommunications Services, Inc. and Atlas Telephone Company, Inc., File No. E-97-03, Complaint (Oct. 18, 1996).

III. NEW SERVICES

A. Background

34. In 1983, the Commission prescribed a rate structure for switched access services in Part 69 of its rules.[69] Originally, when an incumbent LEC wanted to offer a new switched access service, and the rate element or elements for that new service did not fit into the prescribed switched access rate structure, the LEC was required to obtain a waiver of Part 69 pursuant to Section 1.3 of the Commission's rules.[70] In 1996, the Commission adopted Section 69.4(g) of its rules, which relaxed the switched access rate structure rules for price cap LECs.[71] Under Section 69.4(g), a price cap LEC is no longer required to demonstrate that "special circumstances" warrant a Part 69 waiver; instead, it need only file a petition showing that the proposed new rate element would be in the "public interest," or that another LEC previously has established the same rate element.[72]

35. In addition, a price cap LEC filing a tariff for a new service[73] must comply with the new services test, which requires the LEC to show that its new service rates will recover no more than the carrier's direct costs of providing the service, plus a reasonable level of overheads, and no less than the carrier's direct costs of providing the service.[74] Those tariffs must be filed on at least fifteen days' notice.[75] Finally, the LEC is required to incorporate its

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[69] 47 C.F.R. Part 69; *Access Charge Order*, 93 FCC 2d 241. The Commission has not prescribed a special access rate structure. *Access Charge Order*, 93 FCC 2d at 314-15.

[70] Section 1.3 permits the Commission to grant waivers of any of its rules if "good cause therefor is shown." 47 C.F.R. § 1.3. The court has interpreted this "good cause" standard to require petitioners to show that "special circumstances warrant deviation from the general rule and such deviation will serve the public interest." *Northeast Cellular*; *WAIT Radio*.

[71] 47 C.F.R. § 69.4(g); Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, Third Report and Order, 11 FCC Rcd 21354, 21490 (1996) (*Price Cap Third Report and Order*).

[72] 47 C.F.R. § 69.4(g).

[73] A "new service" is one that expands the range of service options available to a customer. The Commission expressly decided not to limit the definition of "new services" to services that employ a new technology or functional capability. *LEC Price Cap Order*, 5 FCC Rcd at 6824.

[74] *See* 47 C.F.R. § 61.49(f)(2); Amendments of Part 69 of the Commission's Rules Relating to the Creation of Access Charge Subelements for Open Network Architecture, CC Docket Nos. 89-79 and 87-313, Report and Order and Order on Further Reconsideration and Supplemental Notice of Proposed Rulemaking, 6 FCC Rcd 4524, 4531 (1991) (adopting the direct cost test); Amendments of Part 69 of the Commission's Rules Relating to the Creation of Access Charge Subelements for Open Network Architecture, CC Docket Nos. 89-79 and 87-313, Memorandum Opinion and Order on Second Further Reconsideration, 7 FCC Rcd 5235, 5237 (1992) (eliminating the pre-existing net revenue test as superfluous).

[75] *See Tariff Streamlining Order*, 12 FCC Rcd at 2203.

new services into the appropriate price cap basket and indices within six to eighteen months after the new service tariff takes effect, in conjunction with the carrier's annual access tariff filing.[76]

36. In the December 1996 *Access Reform NPRM*, the Commission invited comment on three proposals for further relaxation of its new service rules to create incentives for price cap LECs to introduce services using new technologies: (1) enabling price cap LECs to establish new switched access rate elements without prior approval; (2) eliminating the new services test; and (3) permitting price cap LECs to offer new services outside of price cap regulation.[77] In the *Access Reform First Report and Order*, the Commission deferred consideration of pricing flexibility issues, including these new service issues, to a future Order.[78] Bell Atlantic later proposed removing new services from price cap regulation "immediately,"[79] and the Commission invited comment on Bell Atlantic's proposal.[80] Subsequently, the Commission granted a petition to forbear from enforcing Part 69 rate structure requirements with respect to new service tariffs filed by any incumbent LEC serving more than 50,000 access lines, but less than two percent of the nation's access lines.[81]

B. Discussion

37. We find that the record supports permitting incumbent LECs to introduce new services on a streamlined basis. The Commission adopted price cap regulation in part to encourage price cap LECs to innovate,[82] and to develop new services.[83] Thus, to the extent that our new service rules impede the introduction of new services, they undermine one of the Commission's goals in adopting price cap regulation. The new service rules clearly delay the introduction of new services, because the Commission needs time to review Section 69.4(g) public interest showings, and price cap LECs need time to prepare the cost support showing

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[76] 47 C.F.R. § 61.43.

[77] *Access Reform NPRM*, 11 FCC Rcd at 21440-41.

[78] *Access Reform First Report and Order*, 12 FCC Rcd at 16094.

[79] Bell Atlantic *ex parte* statement of April 27, 1998, at 34.

[80] *October 5 Public Notice*, 13 FCC Rcd at 21523.

[81] Petition for Forbearance of the Independent Telephone & Telecommunications Alliance, AAD File No. 98-43, Sixth Memorandum Opinion and Order, FCC 99-108 (rel. June 30, 1999) (*ITTA Forbearance Order*).

[82] *LEC Price Cap Order*, 5 FCC Rcd at 6790.

[83] *Id.* at 6825.

required by the new services test.[84] Moreover, it is not clear that the new services rules provide any benefits that justify such delay. By definition, a new service expands the range of service options available to consumers.[85] Thus, the introduction of a new service does not by itself compel any access customer to reconfigure its access services and so cannot adversely affect any access customer. Because new services may benefit some customers, and existing customers can continue to purchase existing services if they find the new service rate structure or rate level unattractive,[86] we conclude that it serves the public interest to permit price cap LECs to introduce new services on a streamlined basis.

38. In addition, the Commission adopted Part 69 before the advent of competition. Now, the delay caused by the new service rules can place price cap LECs at a competitive disadvantage. Competitive LECs that have notice of a price cap LEC's Section 69.4(g) petition may be able to begin offering the service before the incumbent LEC has been granted permission to establish new rate elements for the new service, thus diminishing the incumbent's incentives to develop and offer new services.[87] With the removal of this competitive disadvantage, price cap LECs will be better able to respond to competition from CLECs.

39. Accordingly, we revise Section 69.4 of the Commission's rules to eliminate the public interest showing required by Section 69.4(g), and to enable price cap LECs to establish any new switched access rate element, in addition to the access rate elements currently required by Section 69.4. We also eliminate the new services test in Sections 61.49(f) and (g) for all new services except loop-based services. We are concerned that new services that

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[84] Some parties assert that meeting the Section 69.4(g) public interest standard is as burdensome or almost as burdensome as meeting the Section 1.3 waiver standard. *See, e.g.*, PacTel Comments at 23; GTE Comments at 52; Ameritech Oct. 26, 1998, Comments at 17. Petitioners seeking waiver of the Commission's rules under Section 1.3 must show that deviation from the general rule "will serve the public interest." *Northeast Cellular*, 897 F.2d at 1166. Similarly, Section 69.4(g) requires petitioners to show that establishing the new rate element "would be in the public interest."

[85] *LEC Price Cap Order*, 5 FCC Rcd at 6824-25.

[86] Bell Atlantic Comments at 46; BellSouth Comments at 37; U S West Comments at 34.

[87] Reviewing a public interest petition can be a long process. For example, the Commission needed almost a year to act on some recent petitions seeking permission to establish rate elements for Synchronous Optical Network (SONET)-based services. *See, e.g.*, Petition to Establish Part 69 Rate Elements to Offer Switched Access Rate Elements for SONET-based Service, DA 99-513 (Com. Car. Bur., Competitive Pricing Div., released March 17, 1999) (*U S West Petition*); Bell Atlantic Telephone Companies Establishment of New Rate Elements to Offer Enterprise SONET Service, DA 99-514 (Com. Car. Bur., Competitive Pricing Div., rel. March 17, 1999); BellSouth Telecommunications, Inc. Part 69.4(g)(1) Public Interest Petition to Establish New Rate Elements for Switched Access Versions of BellSouth's Smartgate Service and BellSouth SPA Managed Shared Network, DA 98-2271 (Com. Car. Bur., Competitive Pricing Div., rel. Nov. 9, 1998).

employ local loop facilities[88] raise cost allocation issues that the Commission has not yet addressed. In the *GTE DSL Reconsideration Order*,[89] for example, we referred to the Federal-State Joint Board for consideration in Docket No. 80-286 a petition for clarification and/or reconsideration filed by NARUC.[90] NARUC's petition sought clarification regarding the application of our Part 36 separations rules while the Joint Board considered the proper allocation of loop costs associated with special access tariffs such as the GTE DSL tariff.[91] Noting that the separations and cost allocation issues NARUC raised were beyond the scope of the limited investigation in the tariff proceeding, we stated that we would address these important issues in conjunction with the Joint Board.[92] Until these issues are resolved, it is not appropriate to permit price cap LECs to file tariffs for new loop-based services without satisfying the cost support requirements of the new services test.

40. Bell Atlantic argues that price cap LECs should be permitted to file tariffs for new services on one day's notice.[93] We conclude that Bell Atlantic's request is in the public interest. The current fifteen-day notice period is no longer warranted. A primary focus of our review of new service tariffs is to determine whether the LEC complied with the new service test. By eliminating the new services test, we greatly reduce the need for reviewing LEC new service tariff filings. In addition, no customer is required to purchase the new service. Furthermore, a longer notice period would delay the introduction of new services and thus undercut the reasons for revising the price cap new service rules here.

41. We are not persuaded by the arguments advanced by parties opposing further deregulation of new services offered by price cap LECs. Some IXCs are concerned that incumbent LECs might offer new services in a manner that would make them available only to the LECs' own long distance affiliates.[94] These IXCs do not explain why or how streamlined introduction of new services would in any way affect the Commission's ability to

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[88] For purposes of this section, we define loop-based new services in accordance with the definitions that govern jurisdictional separations. *See* 47 C.F.R. Part 36. "Loop-based" services are services that employ Subcategory 1.3 facilities. *See* 47 C.F.R. § 36.154 (Subcategory 1.3 facilities are "[s]ubscriber or common lines that are jointly used for local exchange service and exchange access for state and interstate interexchange services.")

[89] GTE Telephone Operating Cos. GTOC Transmittal No. 1148, CC Docket No. 98-79, FCC No. 99-41, Memorandum Opinion and Order (rel. February 26, 1999) (*GTE DSL Reconsideration Order*).

[90] *GTE DSL Reconsideration Order*, at ¶ 9.

[91] *Id.* at ¶ 7.

[92] *Id.* at ¶ 9.

[93] Bell Atlantic Comments at 47. *See also* USTA Oct. 26, 1998 Comments at 36 and Att. E.

[94] AT&T Comments at 81-82; MCI Comments at 63; Sprint Comments at 43.

enforce section 202 of the Act, which prohibits unreasonable discrimination.[95] Accordingly, we conclude that permitting LECs to offer new services on a streamlined basis does not increase the likelihood of unreasonable discrimination. IXCs may file complaints under section 208 of the Act,[96] should they believe that such unreasonable discrimination has occurred.

42. AT&T notes that the Commission made it easier for incumbent price cap LECs to introduce new services in the *Price Cap Third Report and Order*, and it argues that no further deregulation is necessary to encourage LECs to introduce new services.[97] Regardless of LECs' incentives to introduce new services, we conclude above that the benefits of our current new service rules do not justify the delay caused by those rules, and we reject AT&T's argument. Elimination of the new services rules serves the Commission's goals of streamlining our regulations, removing unnecessary regulatory barriers, and increasing consumer choice.

43. We will not, however, permit price cap LECs to offer new services outside of price cap regulation, as parties suggest.[98] MCI argues that offering new services outside of price cap regulation will encourage incumbent LECs to create "new" services that differ little from an existing service.[99] Specifically, MCI theorizes that, as access customers shift to the new service, the demand weight placed on the existing service in calculating the actual price index (API) would decrease, thus enabling the LEC to raise the price of the existing service. Subsequently, according to MCI, the LEC could increase the new service price and leave access customers with no lower-priced alternatives.[100] We agree with MCI that the introduction of new services outside of price caps ultimately might enable price cap LECs to raise rates for both new services and existing services to unreasonable levels. In contrast to the conditions we adopt elsewhere in this Order for removal of services from price caps,[101] we do not predicate the new services relief we adopt here upon any showing of competition for

[95] 47 U.S.C. § 202.

[96] 47 U.S.C. § 208.

[97] AT&T Comments at 81.

[98] *See, e.g.*, Bell Atlantic *ex parte* statement of April 27, 1998, at 34 (suggesting immediate removal of new services from price cap regulation).

[99] MCI Comments at 62-63.

[100] MCI Comments at 62-63.

[101] *See, e.g.*, Section VI *infra*.

the services at issue, thus we are not convinced by price cap LEC arguments that rates, terms, and conditions for new services will be constrained by market forces.[102]

44. At this time, we revise only the new service requirements applicable to price cap LECs, not rate-of-return LECs, for several reasons. First, we have recently granted a petition to forbear from enforcing Part 69 rate structure requirements with respect to new service tariffs filed by a considerable number of rate-of-return LECs, *i.e.*, those serving more than 50,000 access lines, but less than two percent of the nation's access lines.[103] In addition, we note that the new services test is applicable only to price cap LECs, and so is irrelevant for rate-of-return LECs. Moreover, the Commission created a separate docket to consider the access reform issues specific to rate-of-return carriers.[104] In that proceeding, the Commission invited comment on revising the new service requirements applicable to rate-of-return LECs,[105] and we will address those issues on the basis of the record in that docket. Finally, we relax the new service requirements for price cap LECs in part to remove a competitive disadvantage from price cap LECs, so that they can better respond to developing competition from CLECs. Because rate-of-return LECs do not face competition to the same extent as price cap LECs, there is less need to remove any competitive disadvantage they face at this time.

IV. REMOVAL OF INTERSTATE INTER- AND INTRALATA TOLL SERVICES FROM PRICE CAP REGULATION

A. Introduction

45. The Commission currently regulates in the interexchange basket the rates that price cap LECs charge for particular interstate interexchange services.[106] Among the services in this basket are certain interstate interLATA toll services, called "corridor" services, and

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[102] *See, e.g.*, Bell Atlantic *ex parte* statement of April 27, 1998, at 34. In Section VI below, we establish a framework for granting price cap LECs greater pricing flexibility, including the ability to offer services pursuant to contract tariff and to remove services from price caps, if they satisfy certain competitive showings. In that section, we also adopt a procedure pursuant to which we will grant these types of flexibilities for new services.

[103] *See ITTA Forbearance Order*.

[104] *Rate of Return Access Reform NPRM*, 13 FCC Rcd 14238.

[105] *Id.* at 14269-70.

[106] *See* 47 C.F.R. § 61.42(d)(4) (creating price cap LEC basket for "interstate interexchange services that are not classified as access services for the purpose of part 69" of the Commission's rules). *See also* 47 C.F.R. § 61.45(b) (explaining how price cap LECs must adjust their price cap indices for various baskets of price cap services, including the interstate interexchange basket).

interstate intraLATA toll services.[107] We conclude that price cap LECs' corridor and interstate intraLATA toll services will face sufficient competition upon full implementation of inter- and intraLATA toll dialing parity[108] to preclude the price cap LECs from exploiting over a sustained period any individual market power they may have with respect to these services. Consequently, once a price cap LEC has implemented inter- and intraLATA toll dialing parity everywhere it provides local exchange services at the holding company level, we will allow the price cap LEC to remove all of its corridor and interstate intraLATA toll services from price cap regulation,[109] and subsequently to file tariffs for these services on one day's notice and without cost support.[110] Allowing price cap LECs to do so removes unnecessary regulatory constraints and enhances the operation of competitive forces where they provide corridor and interstate intraLATA toll services.[111]

B. Background

46. The 1982 AT&T consent decree divided the former Bell territory into geographic units called "Local Access and Transport Areas," or "LATAs."[112] Most states have multiple LATAs, and LATA boundaries generally are contained within a single state. Some LATAs,

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[107] *See LEC Price Cap Order*, 5 FCC Rcd at 6811, 6812. For explanations of "LATA," as well as corridor and interstate intraLATA toll services, see Section IV.B.

[108] *See* 47 C.F.R. §§ 51.205, 51.209, 51.211, 51.213; Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, Second Report and Order and Memorandum Opinion and Order, 11 FCC Rcd 19392 (1996) (*Dialing Parity Order*) (implementing dialing parity requirements of 47 U.S.C. § 251), *vacated in part*, California v. FCC, 124 F.3d 934 (8th Cir. 1997), *rev'd*, AT&T v. Iowa Utils. Bd., 119 S. Ct. 721 (1999); Order, 14 FCC Rcd 5263 (1999) (*Dialing Parity Extension Order*).

[109] Thus, a BOC must provide inter- and intraLATA toll dialing parity throughout its region before it may remove these services from price cap regulation.

[110] Thus, this Order addresses much of the relief Bell Atlantic sought in its 1995 petition to deregulate its provision of corridor service. *See* Bell Atlantic Petition for Regulation as a Nondominant Provider of Interstate InterLATA Corridor Service, Public Notice, 10 FCC Rcd 9873 (1995). We will address the provision of interstate intraLATA toll services by rate-of-return LECs in conjunction with our consideration of access reform for those carriers. *See Rate of Return Access Reform Notice*.

[111] *Compare* Competition in the Interstate Interexchange Marketplace, CC Docket No. 90-132, Report and Order, 6 FCC Rcd 5880, 5881 (1991) (*Interexchange Competition Order*) (lifting certain tariff regulation of AT&T business services on the grounds that competition for those services was "sufficiently effective," and concluding that the regulatory relief would benefit consumers).

[112] *See* United States v. Western Elec. Co., 569 F. Supp. 990, 993-94 (D.D.C. 1983) (*Western Elec. Co. I*). *See also* 47 U.S.C. § 153(25) (defining "LATA" as "a contiguous geographic area ... established before the date of enactment of the Telecommunications Act of 1996 by a Bell operating company such that no exchange area includes points within more than 1 metropolitan statistical area, consolidated metropolitan statistical area, or State, except as expressly permitted under the AT&T Consent Decree," or as created or modified by a BOC after the date of enactment and approved by the Commission).

however, cross state lines. With certain exceptions, the consent decree prohibited the BOCs from transporting telecommunications traffic between LATAs (*inter*LATA services), but permitted them to carry traffic within a LATA (*intra*LATA services).[113] Thus, at the time of divestiture, IXCs were permitted to transport interLATA traffic but BOCs generally were not.[114] Telephone calls that do not leave customers' immediate local calling areas are intraLATA local calls and are subject only to the monthly rate that customers pay for local services. Telephone calls to destinations outside of the local calling area are toll calls subject to an additional charge. A LATA often encompasses more than one immediate local calling area, so intraLATA calls can be either local or toll calls.

47. Despite the consent decree's provisions prohibiting BOCs from providing interLATA services, it made an exception for certain interstate interLATA services, called corridor services.[115] Corridor services are toll services that carry traffic from five counties in Northern New Jersey into New York City, from Philadelphia and its suburbs into three counties in New Jersey, and from those three counties back into the Philadelphia area.[116] At the time of the consent decree, these areas were in the Bell Atlantic and NYNEX regions. These companies have since merged.

48. BOCs and independent incumbent LECs also provide interstate intraLATA toll services. Interstate intraLATA toll calls are calls that leave an immediate local calling area and cross state lines but remain within a single LATA, such as some calls from Chicago, Illinois, to Gary, Indiana. The BOCs and independent incumbent LECs provide corridor and interstate intraLATA toll services in competition with the long-distance services of AT&T, Sprint, MCI, and many other long-distance companies.

49. Because the Commission has treated incumbent LECs as having market power in the provision of most services within their service areas, the rates that incumbent LECs may charge for corridor and interstate intraLATA toll services currently are subject to dominant carrier regulation.[117] Dominant carriers are subject to price cap or rate-of-return regulation, must file tariffs -- on a minimum of seven days' notice and often more -- and usually with

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[113] *Western Elec. Co. I*, 569 F. Supp. at 993-94.

[114] *Id.*

[115] *LEC Price Cap Order*, 5 FCC Rcd at 6811, 6846 n.252.

[116] *See Western Elec. Co. I*, 569 F. Supp. at 1002 n.54, 1018-1024; United States v. Western Elec. Co., 569 F. Supp. 1057, 1107 (D.D.C. 1983) (*Western Elec. Co. II*).

[117] *See, e.g.*, Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Order on Reconsideration, 6 FCC Rcd 2637, 2681 (1991) (observing that price cap LECs are treated as dominant providers of services in the interexchange basket).

cost support data.[118] Non-dominant carriers, on the other hand, are not subject to rate regulation and may file tariffs on one day's notice, without cost support, that are presumed lawful.[119]

50. To spur competition, section 251(b)(3) of the Act requires LECs "to provide dialing parity to competing providers of telephone exchange service and telephone toll service."[120] "Dialing parity" exists when a LEC customer can route telephone calls to at least one carrier other than that LEC without having to dial an access code.[121] Pursuant to section 251(b)(3), the Commission issued an order in August 1996 requiring LECs to implement inter- and intraLATA toll dialing parity by February 8, 1999.[122] The Commission concluded that a LEC must meet those obligations by allowing its customers to presubscribe to at least one carrier other than the LEC for intraLATA toll services, and to at least one carrier other than the LEC for interLATA toll services.[123]

51. On August 22, 1997, the United States Court of Appeals for the Eighth Circuit vacated, on jurisdictional grounds, the Commission's intraLATA dialing parity rules as applied to intrastate intraLATA toll and interstate intraLATA local calls.[124] The United States Supreme Court, however, reversed the Eighth Circuit decision on January 25, 1999.[125] Following the Supreme Court decision, the Commission issued an order on March 23, 1999,

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[118] *See* 47 U.S.C. §§ 203(b), 204(a)(3); 47 C.F.R. §§ 61.38, 61.41, 61.58; Implementation of Section 402(b)(1)(A) of the Telecommunications Act of 1996, CC Docket No. 96-187, Report and Order, 12 FCC Rcd 2170, 2182, 2188, 2191-92, 2202-03 (1997).

[119] 47 C.F.R. §§ 1.773(a)(ii), 61.24(c), 61.38(a); Tariff Filing Requirements for Nondominant Carriers, CC Docket No. 93-36, Order, 10 FCC Rcd 13653, 13653-54 (1995).

[120] 47 U.S.C. § 251(b)(3).

[121] *See* 47 U.S.C. § 153(15) (defining "dialing parity"); 47 C.F.R. § 51.5 (defining "dialing parity"); *Dialing Parity Order,* 11 FCC Rcd at 19399-19400, 19405-06, 19411.

[122] *Dialing Parity Order*, 11 FCC Rcd at 19400, 19401, 19409-10, 19412, 19424-26. *See* 47 C.F.R. §§ 51.205, 51.209.

[123] *Dialing Parity Order*, 11 FCC Rcd at 19400, 19412, 19414. *See* 47 C.F.R. § 51.209. Presubscription is a process by which a customer selects a carrier to which certain types of calls are routed automatically. *See* 47 C.F.R. § 51.209(b). Pursuant to the Commission's order, customers in states without LATAs -- such as Alaska and Hawaii -- must be able to presubscribe to one carrier for intrastate toll calls and the same or another carrier for interstate toll calls. *Dialing Parity Order*, 11 FCC Rcd at 19400, 19414. States that have one or more LATAs may modify the dialing parity requirement so that, like no-LATA states, customers can presubscribe to one carrier for intrastate toll calls and to the same or another carrier for interstate toll calls. *Dialing Parity Order*, 11 FCC Rcd at 19400 & n.16, 19414. *See* 47 C.F.R. § 51.209(d).

[124] California v. FCC, 124 F.3d at 934 & n.6.

[125] AT&T v. Iowa Utils. Bd., 119 S. Ct. 721, 732.

in which it observed that intraLATA toll dialing parity had been implemented in most states.[126] Nonetheless, the Commission concluded in light of the intervening Eighth Circuit and Supreme Court decisions that a limited waiver of the intraLATA toll dialing parity deadlines and a revised implementation schedule were warranted.[127] Under the revised schedule, almost all LECs will have implemented inter- and intraLATA toll dialing parity by September 6, 1999.[128]

52. Ameritech and USTA filed comments in January 1997, in response to the *Access Charge Reform NPRM*, asking the Commission to cease price cap regulation of corridor and interstate intraLATA toll services.[129] Specifically, Ameritech proposed that the Commission remove these services from price cap regulation once toll dialing parity becomes available because toll dialing parity will eliminate any market power BOCs might have had.[130] Ameritech repeated its proposal regarding corridor and interstate intraLATA toll services in a 1998 *ex parte* letter.[131] Bell Atlantic filed a similar letter.[132] The Commission sought comment on the Ameritech and Bell Atlantic proposals in an October 1998 Public Notice.[133]

C. Discussion

1. Price Cap LEC Ability to Exploit Market Power

53. A dominant carrier is "[a] carrier found by the Commission to have market power (*i.e.*, power to control prices)."[134] "Market power" is "the ability to raise prices by restricting output," or "to raise and maintain price above the competitive level without driving away so

[126] *See Dialing Parity Extension Order*, 14 FCC Rcd at 5266 & nn.20-21.

[127] *Id.* at 5265; 47 C.F.R. § 51.211.

[128] Under the Commission's revised implementation schedule for toll dialing parity, the implementation deadline varies among carriers, depending upon whether and when they submitted implementation plans to their relevant state commissions, and whether and when the state commissions took action. *See Dialing Parity Extension Order*, 14 FCC Rcd at 5265, 5267-68; 47 C.F.R. § 51.211. Most LECs should have implemented both intra- and interLATA toll dialing parity by September 6, 1999. *See Dialing Parity Extension Order*, 14 FCC Rcd at 5265, 5267-68; 47 C.F.R. § 51.211.

[129] *See* Ameritech Comments at 35; USTA Comments at 35, 38.

[130] Ameritech Comments at 35.

[131] *See* Ameritech *ex parte* statement of June 5, 1998.

[132] *See* Bell Atlantic *ex parte* statement of Apr. 27, 1998.

[133] *October 5 Public Notice*, 13 FCC Rcd at 21523.

[134] 47 C.F.R. § 61.3(o).

many customers as to make the increase unprofitable."[135] Pursuant to the framework outlined in the *Dominant/Non-Dominant Order*, the Commission determines whether a carrier is dominant or non-dominant by: 1) delineating the relevant product and geographic markets for examination of market power, 2) identifying firms that are current or potential suppliers in that market, and 3) determining whether the carrier under evaluation possesses individual market power in that market.[136] As a result of the competition that has developed since the consent decree and the Telecommunications Act of 1996, price cap LECs may now be non-dominant in the provision of corridor and interstate intraLATA toll services, particularly in light of the availability of inter- and intraLATA toll dialing parity. Although the record in this proceeding is insufficient for us to conduct the analysis outlined in the *Dominant/Non-Dominant Order*, we do conclude that developments in the markets for interexchange services make it unlikely that price cap LECs will be able to exploit over a sustained period any individual market power in their provision of corridor and interstate intraLATA toll services.[137]

54. First, there currently exist a number of competitive alternatives to provision of these services by price cap LECs. Non-dominant IXCs such as AT&T, MCI, and Sprint already provide long-distance services in the price cap LECs' service areas. IXCs and competitive LECs not currently providing such services could do so quickly, either over their own facilities or by reselling the services of IXCs already in the market. Most customers of domestic interexchange services are sensitive to changes in price and are willing to shift their traffic if a carrier raises its prices.[138] Thus, non-dominant IXCs and competitive LECs can compete with price cap LEC provision of corridor and interstate intraLATA toll services.[139] Inter- and intraLATA toll dialing parity, which is -- or shortly will be -- available throughout the country pursuant to the March 23, 1999, *Dialing Parity Extension Order,*[140] will facilitate

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[135] Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor, CC Docket No. 79-252, Fourth Report and Order, 95 FCC.2d 554, 558 (1983).

[136] *See* Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area, CC Docket No. 96-149, Second Report and Order in CC Docket No. 96-149 and Third Report and Order in CC Docket No. 96-61, 12 FCC Rcd 15756, 15775, 15776, 15782 (1997) (*Dominant/Non-Dominant Order*).

[137] *Compare Interexchange Competition Order*, 6 FCC Rcd at 5882 (concluding that detailed advance regulatory scrutiny of most of AT&T's business services was no longer necessary based on finding that market forces made it unlikely that AT&T would file unlawful tariffs for those services).

[138] *See Dominant/Non-Dominant Order*, 12 FCC Rcd at 15811.

[139] *See, e.g.,* Ameritech *ex parte* statement of July 26, 1999 (providing copies of web pages marketing competing services provided by AT&T, Sprint, Qwest, and MCI).

[140] *See Dialing Parity Extension Order*, 14 FCC Rcd at 5265, 5267-68; 47 C.F.R. § 51.211.

such competition.[141] The existence
of these competitive alternatives and the availability of toll dialing parity will limit the ability of price cap LECs to exploit over a sustained period any individual market power in their provision of corridor and interstate intraLATA toll services.

55. Second, some of the larger IXCs have nationwide brand identification in connection with long-distance services. This brand identification, and an IXC's ability to offer customers long-distance services that span the nation, rather than just in discrete geographies, should help offset any advantages a price cap LEC might enjoy based on its brand identification and possible integration efficiencies in the provision of local services.[142] Moreover, as the Commission has noted in the past:

> [a]n incumbent firm in virtually any market will have certain advantages -- including, perhaps, resource advantages, scale economies, established relationships with suppliers, ready access to capital, etc. Such advantages do not, however mean that these markets are not competitive, nor do they mean that it is appropriate for government regulators to deny the incumbent the efficiencies its size confers in order to make it easier for others to compete. Indeed, the competitive process itself is largely about trying to develop one's own advantages, and all firms need not be equal in all respects for this process to work.[143]

The IXCs' nationwide brand identification and larger service areas will limit the ability of price cap LECs to exploit over a sustained period any individual market power in their provision of corridor and interstate intraLATA toll services.

2. Removal of Services from Price Caps and Relaxation of Tariff Requirements

56. In light of our determination that price cap LECs will be unable to exploit any individual market power over a sustained period in their provision of corridor and interstate intraLATA toll services, we will allow a price cap LEC to remove those services from price

[141] *See, e.g.*, Ameritech *ex parte* statement of July 26, 1999 (stating percent of lines for interstate intraLATA toll service Ameritech has lost in each of its in-region states, ranging from 9 percent of residential and 12 percent of business since implementing dialing parity in Indiana in February 1999, to 31 percent of residential and 36 percent of business since implementing dialing parity in Wisconsin in September 1996). *See also id.* (stating that Ameritech's monthly intraLATA minutes of use have dropped 26 percent from 34,143 million in January 1999 to 25,248 million in February 1999).

[142] *Compare Dominant/Non-Dominant Order*, 12 FCC Rcd at 15811-12.

[143] *Interexchange Competition Order*, 6 FCC Rcd at 5892.

cap regulation on fifteen days notice,[144] and subsequently to file tariffs for those services on one day's notice without cost support and with a presumption of lawfulness, once it has implemented inter- and intraLATA toll dialing parity everywhere it provides local exchange services at the holding company level.[145] The Commission retains, however, the ability to reimpose some or all of these regulations on one or more of the price cap LECs should this prove necessary in the future.[146] The price cap LECs' provision of these services is also

[144] When price cap LECs remove their corridor and interstate intraLATA toll services from their interexchange baskets, we will not require them to recalibrate their interexchange basket PCI. The interexchange basket does not have service categories, thus obviating the need for an interexchange PCI recalibration. *See LEC Price Cap Order*, 5 FCC Rcd at 6811 (concluding "that the small amount of interexchange service subject to price cap regulation does not warrant the imposition of additional service categories"). When the Commission allowed AT&T to remove certain services from price cap regulation, it did require such recalibration. *See* Competition in the Interstate Interexchange Marketplace, CC Docket No. 90-132, Second Report and Order, 8 FCC Rcd 3668, 3671 (1993) (removing all services except 800 directory assistance from Basket 2) (*Interexchange Competition Second Report and Order*); Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier, FCC 95-427, Order, 11 FCC Rcd 3271 (1995) (*AT&T Non-Dominance Order*); Re-initialization of Indexes, Memorandum Opinion and Order, 11 FCC Rcd 1201 (Com. Car. Bur. 1995) (*AT&T Non-Dominant Reinitialization Order*) (removing services except international services from Basket 1). In the AT&T cases, all the services except one service category were removed from the basket in question. Because the service band indices (SBIs) were designed to limit cross-subsidization between different types of services within a basket, and there is no danger of cross-subsidization when there is only one service category remaining in the basket, the Commission recalibrated AT&T's PCIs and APIs to eliminate the SBI for the remaining service category without affecting the headroom AT&T had previously. *Interexchange Competition Second Report and Order*, 8 FCC Rcd at 3671; *AT&T Non-Dominant Reinitialization Order*, 11 FCC Rcd at 1201.

[145] That date will vary among carriers, but in most cases will be by September 6, 1999. *See Dialing Parity Extension Order*, 14 FCC Rcd at 5265, 5267-68; 47 C.F.R. § 51.211. We will not allow a price cap LEC to remove these services from price cap regulation in some states while it remains subject to price cap regulation for the provision of these services in other states. If we were to do so, the carrier might have an incentive to shift costs to the services subject to price cap regulation to qualify for the protections of the low-end adjustment. *Cf. LEC Price Cap Order*, 5 FCC Rcd at 6819 (describing "all-or-nothing" rule, under which LEC seeking to participate in price cap regulation must convert all its cost affiliates to price cap regulation to remove incentive to shift costs from a price cap affiliate to a rate-of-return affiliate).

[146] *Cf. Dominant/Non-Dominant Order*, 12 FCC Rcd at 15834 (concluding that the Commission's finding that price cap LECs are non-dominant in the provision of certain domestic, interstate, interexchange services did not prevent it from reimposing such regulation on certain price cap LECs, if necessary). We note that our finding that price cap LECs will be unable to exploit any individual market power over a sustained period in their provision of corridor and interstate intraLATA toll services does not place the price cap LECs in the same position as non-dominant providers of interstate interexchange services. We previously relieved those carriers of the obligation to file certain tariffs altogether, although that order is currently subject to a stay. *See* Policy and Rules Concerning the Interstate, Interexchange Marketplace, CC Docket No. 96-61, Second Report and Order, 11 FCC Rcd 20730 (1996); *recon.*, 12 FCC Rcd 15014 (1997); *stayed sub nom.* MCI Telecommunications Corp. v. FCC, No. 96-1459 (D.C. Cir. 1997). We have made no such finding of non-dominance here. Thus, price cap LECs are still subject to tariff filing requirement -- including those pertaining to electronic filing -- even once they have removed their corridor and interstate intraLATA toll services from price cap regulation.

subject to Title II of the Act, enabling the Commission to continue to ensure that the rates are just, reasonable, and nondiscriminatory.[147]

57. Because price cap LECs will be unable to exploit any individual market power over a sustained period in their provision of corridor and interstate intraLATA toll services, we find that the burdens imposed by price cap regulation of those services outweigh the little benefit such regulation might provide, especially considering the relatively *de minimis* nature of corridor and interstate intraLATA toll traffic.[148] We also find that the operation of market forces should make it unlikely that they will file unlawful tariffs.[149] Thus, upon careful consideration of the benefits and burdens of our present regulations, we conclude that more limited advance review of price cap LECs' corridor and interstate intraLATA toll service filings, when combined with mechanisms such as the complaint process and our investigation authority, is in the public interest.[150] We will, therefore, allow price cap LECs to file tariffs for those services on one day's notice and without cost support. We do so under the authority of section 203(b)(2), which allows the Commission, "in its discretion and for good cause shown, [to] modify any requirement made by or under the authority of this section either in particular instances or by general order applicable to special circumstances or conditions."[151] The growth in competition for long-distance services, and the availability of toll dialing parity, present just such special circumstances with regard to price cap LEC provision of corridor and interstate intraLATA toll services.

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[147] *See* 47 U.S.C. §§ 201-209. *Accord* USTA Comments at 39.

[148] *See* Motion of AT&T Corp. to be Declared Non-Dominant for International Service, 11 FCC Rcd 17963, 17999 (1996) (stating that the economic cost of dominant carrier regulation for routes with *de minimis* traffic can impede rather than promote competitive market conditions). *See also LEC Price Cap Order*, 5 FCC Rcd at 6811 (concluding "that the small amount of interexchange service subject to price cap regulation does not warrant the imposition of additional service categories").

[149] *Compare Interexchange Competition Order*, 6 FCC Rcd at 5882, 5894 (concluding that detailed advance scrutiny of most of AT&T's business services was no longer necessary based on finding that market forces made it unlikely that AT&T would file unlawful tariffs for those services).

[150] *Compare id.* at 5881-82, 5895 (concluding "that the costs and burdens associated with detailed advance tariff review procedures for [long-distance business] services outweigh their benefits to the public").

[151] 47 U.S.C. § 203(b)(2). *See also Interexchange Competition Order*, 6 FCC Rcd at 5896-97 & nn. 143-145 (concluding that section 203(B)(2) authorized the Commission to change notice and cost support requirements for AT&T's business services in light of the "changed competitive situation") (quoting Southern Motor Carriers Rate Conference v. United States, 773 F.2d 1561, 1569, 1570 (11th Cir. 1985)).

V. GEOGRAPHIC DEAVERAGING OF RATES FOR TRUNKING BASKET SERVICES

A. Background

58. Our Part 69 rules generally require that an incumbent LEC charge rates for access elements that are geographically averaged across each of its study areas.[152] The Commission has developed a system of density pricing zones, however, that permits an incumbent LEC to deaverage geographically its rates for special access and switched transport services if that LEC meets certain threshold interconnection requirements.[153] The density zone pricing rules permit incumbent LECs to establish a "reasonable" number of zones, but the Commission has noted in the past that "LECs seeking to establish more than three zones shall be subject to increased scrutiny and must carefully justify the number of zones proposed in their density pricing zone plan."[154] In addition, incumbent LECs must show that density zones reflect cost characteristics such as traffic density or other measures of traffic passing through particular central offices.[155] The Commission sought comment in the *Access Reform NPRM* on whether to grant incumbent LECs greater flexibility to deaverage access charges.[156]

B. Discussion

59. In this Order, we amend Section 69.123 of the Commission's rules to permit incumbent LECs to deaverage geographically their rates for access services in the trunking basket.[157] We will permit price cap incumbent LECs to define both the scope and number of zones, provided that each zone, except the highest-cost zone, accounts for at least 15 percent

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[152] 47 C.F.R. § 69.3(e)(7). A study area is a geographical segment of a carrier's telephone operations. Generally, a study area corresponds to a carrier's entire service territory within a state. Thus, carriers operating in more than one state typically have one study area for each state, and carriers operating in a single state typically have a single study area. Carriers perform jurisdictional separations at the study area level. For jurisdictional separations purposes, the Commission adopted a rule freezing study area boundaries effective November 15, 1984. Part 36 of the Commission's Rules, 47 C.F.R., Part 36, Appendix-Glossary, definition of "Study Area." *See* MTS and WATS Market Structure, Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, CC Docket Nos. 78-72 and 80-286, 49 Fed. Reg. 48325 (Dec. 12, 1984), adopted by the Commission, 50 Fed. Reg. 939 (Jan. 8, 1985).

[153] 47 C.F.R. § 69.123. *See also Special Access Expanded Interconnection Order*, 7 FCC Rcd at 7454-56. Section 69.123(a) of the Commission's rules allows LECs to establish traffic density pricing zones in study areas in which at least one interconnector has taken a cross-connect. *See* 47 C.F.R. § 69.123(a).

[154] *Special Access Expanded Interconnection Order*, 7 FCC Rcd 7454, n.413.

[155] *Id.*, 7 FCC Rcd 7455.

[156] *Access Reform NPRM* at 21433.

[157] We discuss deaveraging of the common line and traffic-sensitive baskets in Section VIII.A, *infra*.

of the incumbent's trunking basket revenues in the study area, and we no longer require LECs to demonstrate that the zones reflect cost characteristics. Granting incumbent LECs more flexibility to deaverage these rates enhances the efficiency of the market for those services by allowing prices to be tailored more easily and accurately to reflect costs and, therefore, promotes competition in both urban and rural areas.

60. Since 1992, the Commission has permitted LECs to deaverage certain rates by geographic zone because of the concern that averaged rates might create a pricing umbrella for competitors that would deprive customers of the benefits of more vigorous competition.[158] Adoption of this policy reflected the conclusion that non-cost-based, geographically-averaged access rates could not be maintained in a market subject to increasing competition.[159] Deaveraged rates promote efficiency by allowing an incumbent LEC to compete for customers when it is, in fact, the lowest cost service provider and by removing support flows to the incumbent LEC's higher-cost services.[160] Incumbent LECs argue, however, that our current rules fail to achieve these goals for a variety of reasons. First, they argue that the "increased scrutiny" applicable to the creation of more than three pricing zones per study area discourages LECs from offering such plans.[161] As a result, incumbent LECs argue, the zones in most zone density pricing plans are too large to be of practical value.[162] Finally, incumbent LECs argue that traffic density is not the most accurate means of determining appropriate geographic boundaries for deaveraging.[163]

61. We agree with incumbent LECs that traffic density is not the optimal, or even an accurate, method of determining cost-based pricing zones and that LEC-designed zones are

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[158] *Special Access Expanded Interconnection Order*, 7 FCC Rcd at 7454; *Switched Transport Expanded Interconnection Order*, 8 FCC Rcd at 7426.

[159] *See, e.g.*, *Special Access Expanded Interconnection Order*, 7 FCC Rcd at 7454; *Switched Transport Expanded Interconnection Order*, 8 FCC Rcd 7374.

[160] *Special Access Expanded Interconnection Order*, 7 FCC Rcd at 7454; *Switched Transport Expanded Interconnection Order*, 8 FCC Rcd at 7426.

[161] *See, e.g.*, SBC Nov. 9 Reply at 23. Few, if any, price cap incumbent LECs have proposed to offer density zone plans with more than three density zones in a study area. Sprint argues that carriers serving a variety of urban, suburban, and rural areas require more than three density zones to price their services accurately relative to cost. Sprint Nov. 9 Comments at 14.

[162] *See, e.g.*, Bell Atlantic Nov. 9 Reply at 17-18.

[163] *See, e.g.*, Ameritech Nov. 9 Reply at 9; Bell Atlantic Nov. 9 Reply at 18. Ameritech, for example, argues that, in cases where it charges identical rates in two particular zones, competitors sometimes choose to enter in the less-dense zone, suggesting that the spread between actual cost and Ameritech's price is greater there than in a denser zone and, thus, that high traffic density does not necessarily result in lower costs. Ameritech Nov. 9 Reply at 9.

more likely to lead to efficient pricing that reflects underlying cost characteristics.[164] As the Commission observed in the *Access Reform NPRM*, averaging across large geographic areas distorts the operation of markets in high-cost areas because it requires incumbent LECs to offer services in those areas at prices substantially lower than their costs of providing those services.[165] Prices that are below cost reduce the incentives for entry by firms that could provide the services as efficiently, or more efficiently, than the incumbent LEC.[166] Similarly, discrepancies between price and cost may create incentives for carriers to enter low-cost areas even if their cost of providing service is actually higher than that of the incumbent LEC.[167]

62. Given these observations, if we grant incumbent LECs practical flexibility to choose the number of zones and the criteria for establishing zone boundaries, they are more likely to establish reasonable and efficient pricing zones than if their flexibility is more constrained. Therefore, in this Order, we amend our rules to eliminate all competitive prerequisites for the deaveraging of trunking basket service rates and to permit price cap incumbent LECs to define zone pricing plans in any manner they wish, so long as each zone, except the highest-cost zone, accounts for at least 15 percent of the incumbent LEC's trunking basket revenues in the study area. This limitation ensures that incumbent LECs cannot define zones that are, for all practical purposes, specific to particular customers. As we explain in Section VI, below, we will not permit incumbent LECs to offer customer-specific contract tariffs until they satisfy certain triggers related to the development of competition, and we are concerned that, absent a rule establishing the minimum size of a zone, incumbents might circumvent this requirement by using zone pricing as a substitute for contract tariffs. At the same time, the limit we adopt permits a maximum of seven zones, which we believe should provide the ability to adjust to any likely variation in cost conditions. We note that no incumbent LEC has requested more than five zones.[168] Our requirement that a zone, except the highest-cost zone, account for at least 15 percent of trunking revenues within a study area ensures that any lower rates resulting from deaveraging are enjoyed by a range of customers. Section 69.123(c)(2) of our rules, which requires transport between points located in two different zones to be priced in accordance with the higher-priced zone, also limits incumbent LECs' ability to draw pricing zones too narrowly.

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[164] *See, e.g.*, Ameritech Nov. 9 Reply at 9; SBC Nov. 9 Reply at 23. For example, Ameritech argues that the average length of transport facilities and the varying means by which transport facilities are deployed (aerial cables, buried cables, cable in conduits, etc.), are also significant cost drivers. Ameritech Reply in Ameritech Chicago Forbearance Proceeding, CC Docket No. 99-65, at Att. A, 16-17.

[165] *See Access Reform NPRM*, 11 FCC Rcd at 21434.

[166] *See id.* at 21434.

[167] *See id.*

[168] Sprint, for instance, has suggested a minimum of four zones. Sprint *ex parte* statement of July 12, 1999.

63. The permissive geographic deaveraging we discuss here applies to rates for all services in the trunking basket to which density zone pricing currently applies, *i.e.*, rates for all services except for the transport interconnection charge (TIC), so long as the same zones are used for all transport elements.[169] We will continue to prohibit geographic deaveraging of the TIC so as not to disrupt the scheduled phase-out of that charge.[170] In addition, we relax the constraints on annual price increases within zones that are contained in Sections 69.123(e)(2) and 61.47(e) of our rules by raising the limit on permitted price increases within zones from five percent to 15 percent.[171] Although such constraints limit price cap incumbent LECs' ability to implement deaveraging and rebalance rates in a manner that reflects the actual costs of providing the services at issue, some limit on the rate of price increases within zones remains desirable in order to prevent the disruptive effects of rapid and unexpected price increases. Under our price cap rules, however, deaveraging permits LECs to increase rates in one geographic zone only to the extent that they decrease rates in other geographic zones in the study area.[172] As Sprint points out, particularly where demand has grown faster in high-density zones than in low-density zones, the five-percent limit on price increases sharply constrains the ability of incumbent LECs to make revenue-neutral price cuts in high-density zones.[173] Increasing to 15 percent the limit on price increases should allow more rapid movement to cost-based rates without subjecting customers in high-cost areas to rate shock. The requirement we adopt that each zone, except the highest-cost zone, account for at least 15 percent of the incumbent's trunking basket revenues in a study area should deter incumbent LECs from establishing rates for low-cost zones that are so low as to enable them to raise rates to unreasonably high levels in high-cost zones. Thus, we are not persuaded by AT&T's claims that greater geographic deaveraging flexibility will lead to predatory pricing

[169] The Commission previously has imposed this requirement on geographically-deaveraged transport services. *See Switched Transport Expanded Interconnection Order*, 8 FCC Rcd at 7428.

[170] *See Switched Transport Expanded Interconnection Order*, 8 FCC Rcd at 7427. The TIC was intended as a temporary measure to ameliorate potential negative effects on incumbent LECs and small IXCs of transport rate structure changes made in 1992. *See Access Reform NPRM*, 11 FCC Rcd at 21402-03. We are in the process of eliminating the TIC through a combination of targeted reductions and reallocation to other access charge rate elements. *See id.*; *Access Reform First Report and Order*, 12 FCC Rcd at 16073-86.

[171] Section 61.47(e) states, in pertinent part, "Each [pricing] band [for each service category and subcategory within a basket] shall limit the pricing flexibility of the service category, subcategory, or density zone, as reflected in the SBI, to an annual increase of [five percent]." 47 C.F.R. § 61.47(e). In this Order, although we maintain a five-percent limit on annual price increases for service category or subcategory, *on a study-area-wide basis*, we add Section 61.47(f) to our rules, which permits price cap LECs to raise prices *within a zone* by up to 15 percent, annually. *See* Appendix B, *infra*.

[172] *See* 47 C.F.R. §§ 61.41-61.47.

[173] Sprint *ex parte* statement of July 12, 1999.

by incumbent LECs or arguments by CPI and the Washington Commission that any further deaveraging should result only in price decreases, *i.e.*, that it be "downward only."[174]

64. We reject the Washington Commission's argument that more liberal geographic deaveraging rules might lead to IXC violations of sections 254(b)(3) and 254(k) of the Act.[175] Section 254(b)(3) of the Act requires the Joint Board and the Commission to ensure that consumers in rural, insular, and high cost areas have access to telecommunications services that are available at rates that are reasonably comparable to rates charged for similar services in urban areas.[176] We conclude that further geographic deaveraging of trunking services that may result from this Order is unlikely to place significantly greater pressures on IXCs (purchasers of trunking services) to deaverage their rates, in part because deaveraging implies price *decreases* as well as increases. Section 254(k) prohibits a telecommunications carrier from using services that are not competitive to subsidize services that are subject to competition.[177] As we discuss above, however, changes in incumbent LEC pricing zones resulting from this Order are likely to *increase* the degree to which trunking service prices reflect cost and thus would decrease the likelihood of cross-subsidization.

65. We will no longer require incumbent LECs to file zone pricing plans in advance of tariff filings, as the Commission has in the past,[178] because we presume that market forces, along with the limitation we adopt regarding the size of zones, will result in plans that reflect cost characteristics. Parties wishing to challenge the reasonableness of incumbent LEC zone pricing plans may do so as part of the tariff approval process, pursuant to which incumbent LECs must file any tariffs that include both a rate increase and rate decrease upon fifteen days' notice,[179] or in a formal complaint under section 208 of the Act.[180]

66. We are not persuaded by arguments made by MCI that the failure of incumbent LECs to take full advantage of the geographic deaveraging currently available under our rules is sufficient grounds for not granting incumbent LECs greater flexibility to deaverage

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[174] *See* AT&T Oct. 26 Comments at 9; CPI Oct. 26 Comments at 10; Washington Commission Oct. 26 Comments at 13.

[175] Washington Commission Oct. 26 Comments at 13-14.

[176] 47 U.S.C. § 254(b)(3).

[177] 47 U.S.C. § 254(k).

[178] *See, e.g., Special Access Expanded Interconnection Order*, 7 FCC Rcd at 7455.

[179] *See* Implementation of Section 402(b)(1)(A) of the Telecommunications Act of 1996, CC Docket No. 96-187, Report and Order, 12 FCC Rcd 2170, 2202.

[180] 47 U.S.C. § 208.