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

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| Price Cap Performance Review for Local Exchange Carriers | ) ) ) | CC Docket No. 94-1 |
| Federal-State Joint Board on Universal Service | ) ) ) | CC Docket No. 96-45 |
| Access Charge Reform | ) ) | CC Docket No. 96-262 |
| Low-Volume Long Distance Users | ) | CC Docket No. 99-249 |

**COMMENTS OF AT&T CORP. IN SUPPORT OF THE COALITION FOR AFFORDABLE LOCAL AND LONG DISTANCE SERVICE PROPOSAL**

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Pursuant to the Commission's Notice of Proposed Rulemaking, dated September 15, 1999, FCC 99-235, AT&T Corp. ("AT&T") hereby submits these Comments in support of the Proposal of the Coalition for Affordable Local and Long Distance Service ("CALLS Plan").

## INTRODUCTION AND SUMMARY

The CALLS Plan represents an historic opportunity. Despite the progress and the beneficial changes the Commission has already made in the access charge reform and universal service proceedings, today's access charges are still at uneconomically high levels. Moreover, the rate structure for access charges is still at odds with principles of cost-causation in many important respects. As a result, access charge rate levels and rate design continue to hinder full and effective competition in telecommunications markets, and prevent consumers from reaping billions of dollars per year of additional benefits.

Although these issues have sparked years of controversy and litigation between the local exchange carriers ("LECs") and interexchange carriers ("IXCs"), a group of LECs and IXCs have joined together in an unprecedented agreement that would resolve many of these issues in a fair and reasonable manner, and without further litigation. Thus, by adopting the CALLS Plan, the Commission can, in one fell swoop, address many of the most pressing and contentious matters now facing the Commission in the areas of access reform and universal service. And of critical importance to carriers, the CALLS Plan would remove the uncertainty and unpredictability of the current regulatory regime for the next five years – a period in which carriers will be making important decisions and investments relating to competitive entry. Accordingly, the CALLS Plan will allow carriers to focus on competition, not on litigation.

The CALLS Plan offers enormous benefits to the public. To begin with, as shown in Part I below, the Plan will preserve and advance universal service in two ways. The Plan's various rate structure changes – specifically an increase in the SLC caps *combined* with dramatic reductions in per-minute access charges – will likely increase subscribership. That is because, for *all* classes of customers, the consumer welfare gains from lower long distance bills will substantially outweigh any negative effects of an increase in the SLC. The Plan also removes an estimate of the unsustainable implicit subsidies from access charges and replaces them with an explicit, interstate access-related universal service fund that is competitively neutral.

As shown in Part II, the CALLS Plan also slashes per-minute access charges in half, which will lead to lower long distance bills. These reductions will greatly stimulate usage and, in so doing, will also unlock billions of dollars a year in consumer welfare gains even as they promote economic growth and competitiveness.

Further, as shown in Part III, the Plan will also promote competition in telecommunications markets. For example, the Plan's dramatic reductions in access charges will relieve pressure on the agency to repeal the ESP exemption by decreasing the disparities in what telecommunications carriers and Internet access providers pay in access. Similarly, the increase in the SLC caps will increase the incentive to enter the local market in residential and rural areas. And the Plan's rate changes may allow carriers to offer new and innovative pricing packages for long distance services, such as flat-rate or bucket-of-minutes plans. These changes will provide substantial benefits for consumers.

Indeed, a recent study analyzing the CALLS Plan has concluded that the plan will benefit *all* classes of consumers – rural and urban, residential and business, and all income classes, with no negative impact on universal service. Stephen B. Pociask, Joel Popkin & Co., "Consumer Welfare Effects of the CALLS Plan" at 1 ("*Popkin Consumer Welfare Study*"). The CALLS Plan is overwhelmingly in the public interest, and the Commission should approve it promptly, in its entirety, in time for implementation on January 1, 2000.

Finally, as shown in Part IV, the Plan will promote stability and predictability in the regulatory environment for at least the next five years. It will do so by reducing, if not eliminating entirely, much of the litigation that has surrounded the Commission's prior efforts to reform universal service and access charges. This reduction will permit the affected companies to focus on serving their customers and on building the efficient telecommunications infrastructure that will carry the Nation into the 21st Century.

In these comments, AT&T will dispense with a lengthy description of the specific features of the plan, which can be found in the Memorandum in Support of the CALLS Plan filed by CALLS on August 20, 1999 (the "CALLS Brief"). In the remainder of these comments, AT&T will explain in more detail some of the most important public interest benefits of the Plan.

# I. THE CALLS PLAN WILL PROMOTE AND ADVANCE UNIVERSAL SERVICE.

The CALLS Plan will promote and advance universal service in two substantial ways. First, the Plan's rate structure reforms will stimulate additional usage and increased subscribership, and will do so in a way that is fully consistent with the Act. Second, it identifies and removes an estimate of the unsustainable implicit subsidies from interstate access charges, and replaces those subsidies with an equitable and nondiscriminatory fund that the signatories agree will provide sufficient funding to keep intrastate rates affordable and reasonably comparable for the life of the Plan.

## A. The Total Effect Of The CALLS Plan's Rate Changes Will Enhance Universal Service, And Do So In A Manner Consistent With Section 254(k).

The CALLS Plan's changes to the access charge rate structure will stimulate usage and likely *increase* telephone subscribership. The increase in the caps on the SLC, when combined with the dramatic reductions in usage sensitive access charges, will result in a rate design that is far more economically efficient and consistent with principles of cost-causation than the rate structure of today. Moreover, numerous studies and years of experience have shown that the stimulation of additional usage resulting from reductions in traffic-sensitive charges will more than offset the effects of any increases in the SLC that may result from the increase in the SLC caps. Because, as shown below, the demand for interstate long distance traffic is much more elastic than the demand for subscriber lines, the Plan's reforms will, on balance, stimulate usage and subscribership. And claims that an increase in the caps on the SLC would violate Section 254(k) are meritless.

### 1. The Plan's Rate Structure Changes Will Stimulate Usage And Increase Subscribership.

The totality of the CALLS Plan's rate changes – *i.e.*, an increase in the SLC caps *coupled* *with* dramatic reductions in per-minute access rates – will stimulate usage and increase subscribership. The rate structure used in the telephone industry is known to economists as a "two-part tariff." That is, subscribers pay a fixed, monthly fee for access, and then pay an additional fee based on usage.[1] Two-part pricing is popular because it is profitable for sellers yet still produces economically efficient outcomes; *i.e.*, total welfare is maximized because the per-unit price of the good is very close (or equal to) the marginal cost of supplying the good.[2]

In addition, as the Commission has long recognized, the fixed, monthly fee – interstate common line costs – are properly borne by the end user. Indeed, in 1983, the Commission found that recovering non-traffic-sensitive costs through flat monthly fees on end users would promote optimal utilization of telecommunications networks, and that "it is important to move towards collecting these costs from customers rather than carriers on a flat rather on a usage sensitive basis." *MTS and WATS Market Structure*, Third Report and Order, CC Docket No. 78-72, Phase I, 93 F.C.C.2d 241 (¶¶ 72) (1983) ("*1983 Access Charge Order*"). Moreover, the Commission has repeatedly held that loop costs are not an incremental cost of providing access to end users:

> "A subscriber who does not use the subscriber line to place or receive calls imposes the same NTS costs as a subscriber who does use the line. A subscriber who does not make local calls would normally pay a flat fee for the exchange portion of such costs. Imposing a flat charge for the interstate portion of those costs is equally reasonable. Any other procedure violates the general principle that costs should be recovered from the cost-causative ratepayer whenever it is possible to do so."

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[1] These pricing schemes are also found in amusement park pricing (entrance fee and per ride fee), entertainment pricing (cover charge and per drink fee), Cable Pay-Per-View pricing (cable access fee and per movie fee), food warehouse clubs (membership fee and price of goods purchased), country club fees (membership fee and court or greens fees), etc.

[2] This is textbook economic theory. *See, e.g.*, Edgar K. Browning and Mark A. Zupan, *Microeconomic Theory and Applications* at 357-360 (5th ed. 1996).

*1983 Access Charge Order*, ¶ 121; *see also Southwestern Bell Tel. Co.* v. *FCC*, 153 F.3d 523, 558 (8th Cir. 1998) ("simply by requesting telephone service, the subscriber 'causes' local loop costs, whether it uses the service for intrastate or interstate calls," and it is "therefore appropriate and rational for the Commission to impose those costs on the end user"); *NARUC* v. *FCC*, 737 F.2d 1095, 1108, 1113-14 (D.C. Cir. 1984) (same).

Unfortunately, sixteen years later, the Commission's rules still do not permit consumers to reap the full benefits of the two-part tariff. The problem is that carrier access rates are artificially inflated because of the requirement that the long distance carriers pay a portion of the common line (through the PICC and CCLC). Access rates are artificially increased further by implicit universal service subsidies and the ILEC flowback. These rules cause the price of long distance service to be higher than optimal, while forcing the entrance fee (local access fee) to below optimal levels. As a result, telecommunications providers are unable to offer consumers the most economically efficient combination of subscriber fee and per call fee.

The CALLS Plan, through its various rate changes, would largely solve these problems and create a much more efficient rate structure. However, opponents of the CALLS Plan argue that raising the SLC would have negative consequences on universal service, and the Commission has been hesitant in the past to raise the caps on the SLC for that reason. All of the available evidence, however, is to the contrary.

First, the opponents of the improved pricing structure ignore existing empirical evidence that the proposed pricing plan will *increase* universal access. Empirical evidence clearly indicates that the benefits derived from lower long distance prices is most likely to outstrip the negative effects derived from increases in local access. The own price elasticity of demand for telephone use is extremely low.[3] Low price elasticity of demand means that consumers of local telephone service are very insensitive to price changes – *i.e.*, changes in prices neither drive away nor attract new consumers.

On the other hand, the own price elasticity for long distance service is very high.[4] This high own price elasticity means that small changes in the price of long distance service greatly affects consumers' demand for that service, suggesting that consumer welfare is greatly enhanced by lower long distance prices that accurately reflect the true marginal cost of that service. Therefore, while a small increase in the price of local access rates is unlikely to deter a significant number of people from purchasing basic access, a decrease in long distance rates greatly increases consumer demand for long distance and hence consumer welfare. Thus, it follows that the proposed pricing plan will *benefit* consumers. *See Popkin Consumer Welfare Study* at 9-12 ("even residential consumers receive much more benefit from interstate toll at lower prices than they are harmed by higher line charges").

Second, this argument is buttressed by empirical economic analysis that estimates the cross-price elasticity of demand for local access and long distance, *i.e.,* how a change in the price of local

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[3] The own price elasticity of basic access has been estimated to be -0.005. This means that a 100% increase in the price of basic access only leads to a 0.50% decrease in consumption of local access. *See* Jerry Hausman, Timothy Tardiff and Alexander Belinfante, *The Breaking Up of AT&T And Changes in Telecommunications Regulation: What Are The Lessons? The Effects of the Breakup of AT&T on Telephone Penetration in the United States* at 83, AEA Papers and Proceedings 178, 182 (May 1993) ("Hausman et al.").

[4] Own price elasticity of demand for long distance rates has been estimated to be somewhere between -0.51 and -0.70. *See* Paul N. Rappoport & Lester D. Taylor, Toll Price Elasticities Estimated From a Sample of U.S. Residential Telephone Bills, 9 Info. Econ. & Pol'y 51, 65 (1997). This means that a 10% decrease in long distance rates leads to a 5% to 7% increase in consumers' demand for long distance.

access (or long distance) affects the demand for long distance (or local access). The cross-price elasticity of local access and long distance has been estimated to be between -0.0086 and -0.0055.[5] In other words, local service and long distance are complementary goods (like nuts and bolts). When the price of one or the other increases, demand for both decreases and vice versa. Therefore, while it is true that increasing the SLC will marginally decrease the demand for both local access and long distance, this effect is likely to be more than offset by the increase in demand for both goods resulting from decreased long distance rates.[6]

Third, studies clearly indicate that the vast majority of subscribers who are dropped by their local service companies are not late paying their local service bill, but because they are unable to pay their long distance bills.[7] Again, this indicates that as long distance prices drop, consumers are more likely to retain local access. Thus, the argument that artificially high long distance rates are acceptable to ensure universal service contradicts available empirical evidence. *See also Popkin Consumer Welfare Study* at 18 (same).

Common sense and experience confirm these conclusions. Since the creation of the SLC in 1985, and more pertinently, since the creation of the PICC in 1998 (which for all intents and purposes has functioned as an increase in the SLC), telephone subscribership has continued to increase. Indeed, in the Commission's most recent telephone subscribership report, the Commission found that the subscribership rate was "the highest ever reported in the United States." "New

[5] *See* Hausman et al. at 182.

[6] *Id.*

[7] *See, e.g.*, Policy Research Project on The Evolution of Universal Telecomms. Serv. In Tex., The Evolution of Universal Service in Texas, Lyndon B. Johnson Sch. of Pub. Affairs Policy Research Project Report No. 116, 16-17 (1995); *see also* CALLS Brief at 16-17 & n.36 (citing LEC studies).

Telephone Report Reveals Highest Number of Subscribers Ever," FCC News Release (Oct. 8, 1999); *see also* Common Carrier Bureau, *Telephone Subscribership in the United States* (October 1999).

Thus, an increase in the caps on the SLC, when considered in light of *all* of the rate changes in the CALLS Plan, will not harm universal service, and indeed, will likely increase subscribership. In the short term, consumers will see essentially no change in their flat-rated charges at all, because the new SLC cap ($5.50) will be roughly equal to the combination of today's SLC cap and the PICC, which virtually all IXCs pass through to end users as a flat charge. Over time, the SLC caps will rise modestly to $7.00, but many end users will actually pay less ($6.15 on average). Moreover, many urban customers will likely see monthly subscription rates fall because of geographic deaveraging of the SLC, while rural customers will be protected by the universal service fund. And the CALLS Plan makes substantial changes to the Lifeline program to ensure that low-income users retain access to the network.

For all these reasons, the CALLS proposal will be good for all classes of customers. Indeed, a recent study by Joel Popkin and Company, for the Alliance for Public Technology, analyzed the CALLS Plan's effects on consumers, and concluded that the CALLS Plan will benefit all groups of consumers – urban and rural, residential and business, and across all income groups. *Popkin Consumer Welfare Study* at 13-18 ("[t]he plan produces clear welfare benefits for residential consumers across all income groups, and across geographic areas," and "would have little or no negative impact on telephone penetration, and may contribute to improving telephone subscribership").

### 2. The Plan Is Fully Consistent With Section 254(k).

Some who oppose an increase in the SLC, such as Consumer Federation of America ("CFA"), suggest that such an increase would violate Section 254(k) of the Act. They are wrong.[8]

Section 254(k) provides that "[a] telecommunications carrier may not use services that are not competitive to subsidize services that are subject to competition." The provision further provides that "[t]he Commission, with respect to interstate services, . . . shall establish any necessary cost allocation rules, accounting safeguards, and guidelines to ensure that services included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services." 47 U.S.C. § 254(k). CFA argues, in effect, that this language somehow requires the Commission to continue forcing long distance carriers to pay a portion of the interstate costs of the loop, because otherwise end-users (or perhaps local service) would bear more than a reasonable share of the joint and common costs of the loop. This is incorrect.

First, CFA has misinterpreted the statute, and indeed, the Eighth Circuit has squarely rejected CFA's argument. *Southwestern Bell Tel. Co.* v. *FCC*, 153 F.3d 523, 559 (8th Cir. 1998). Section 254(k) prohibits cross-subsidies between competitive and non-competitive services, and to serve that end, it requires the Commission to adopt "cost allocation rules, accounting safeguards, and other guidelines" to ensure that joint and common costs are not overallocated to services included in the

[8] *See Federal State Joint Board on Universal Service, et al.*, CC Docket No. 96-45 et al., Comments of Texas Office of Public Utility Counsel, et al., at 15-16 (filed July 23, 1999) ("[b]asic service" should pay no more than a reasonable share of the joint and common costs of the loop).

definition of universal service. In other words, Section 254(k) is directed solely at the allocation of *costs* between regulated and non-regulated services. "Because the SLC is a method of recovering loop costs, not an allocation of those costs between supported and unsupported services, § 254(k) is not implicated." *Southwestern Bell*, 153 F.3d at 559.

CFA does not challenge the Commission's allocation of the costs of the loop to services included in the definition of universal service. Rather, taking that allocation as a given, CFA's only claim involves the rate structure for the recovery of those costs – *i.e.*, CFA thinks that the IXCs, and not end-users, should pay those costs. But Section 254(k) is irrelevant to that question; as long as costs have not been overallocated to the services at issue – and CFA does not claim they are – Section 254(k) has nothing to say about rate design.

Indeed, CFA fundamentally confuses the issue by trying to convert a claim about cost-causation into a claim about the allocation of joint and common costs. It is of course true that the loop is used to provide both local and long distance services. But insofar as that is relevant, the Commission has already assigned common line costs to local and interstate services, and CFA does not challenge that assignment. Thus, contrary to the premise of CFA's claim, the question is not how joint and common costs are to be allocated between two different services (local and interstate access). The question is, who is to pay the costs that have been properly allocated to one of those services (interstate access) – IXCs or end users? As explained above, the end user is the clearly the cost-causer and should therefore pay those costs. CFA's entire Section 254(k) claim is based on its erroneous rejection of that fundamental fact – a fact that the Commission has reaffirmed repeatedly over the last sixteen years. *E.g., 1983 Access Charge Order*, ¶ 121.

### B. The CALLS Plan Will Establish A Sustainable, Interstate Access-Related Universal Service Fund.

The CALLS Plan will also promote universal service by establishing the interstate access-related universal service fund, the Commission's final, as-yet-uncompleted task in its implementation of Section 254. *See Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Ninth Report and Order, 1999 WL 993655, ¶ 113 (rel. Nov. 2, 1999). The Commission has repeatedly found that the current universal service system is unsustainable to the extent that universal service costs are funded in part through subsidies implicit in artificially inflated interstate access charges. *See, e.g., Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Seventh Report and Order, 14 FCC Rcd. 8078 (¶¶ 6-7) (1999). In particular, the explosive growth of the Internet is directly threatening these implicit subsidies because Internet providers are exempt from paying today's inflated, subsidy-laden access charges. *See Access Charge Reform*, CC Docket Nos. 96-262 et al., First Report and Order, 12 FCC Rcd. 15982 (¶¶ 344-48) (1997) ("*Access Reform Order*") (retaining ESP exemption), *aff'd, Southwestern Bell Tel. Co.* v. *FCC*, 153 F.3d 523, 541-44 (8th Cir. 1998). Thus, as more and more traffic migrates from traditional telecommunications carriers to the Internet, this source of universal service subsidies is eroding away. Moreover, the migration of traffic to the Internet is accelerating rapidly, and therefore the Commission cannot afford to delay the conversion of implicit support much longer.[9]

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[9] Competitive LECs might also erode away the implicit support in interstate access charges by offering, on a widespread basis, competing interstate access services at cost-based rates (which might force incumbent LECs to respond by lowering their interstate access charges to cost-based levels).

Although the size of these implicit subsidies has been very controversial,[10] the CALLS Plan would halt this erosion of universal service support by sizing the implicit support at $650 million per year (on an industry-wide basis) and replacing that support with an explicit, competitively neutral fund. The size of the Plan's explicit fund is consistent with the Commission's policy of determining universal service support on the basis of forward-looking economic cost. *See Texas Office of Public Utility Counsel* v. *FCC*, 183 F.3d 393, 410-13 (5th Cir. 1999) (affirming the Commission's use of forward-looking cost). As explained more fully in the Declaration of Joel E. Lubin, attached to the CALLS Brief, $650 million per year is a reasonable (indeed, generous) estimate of the amount by which the forward-looking cost of the interstate subscriber line (including the port) will exceed the CALLS Plan's SLC caps. Lubin Declaration, ¶¶ 2-3. The new interstate access-related fund is thus consistent with Commission precedent and should be adopted in the public interest.

## II. THE CALLS PLAN WILL RESULT IN LOWER LONG DISTANCE BILLS AND SPUR ECONOMIC GROWTH.

Another public interest benefit of the CALLS Plan is its dramatic reductions in per-minute access charges, which will stimulate long distance usage and lead to more efficient use of the telecommunications network. These changes will stimulate economic growth in the economy as a whole, which is manifestly in the public interest.

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To date, however, such widespread competition has not developed anywhere in the nation. *See Access Charge Reform*, CC Docket No. 96-262, RM No. 9210, Comments of AT&T Corp. on CFA Petition for Rulemaking at 6-16 (January 30, 1998); Comments of AT&T to Update and Refresh the Record at 3-8 (filed October 26, 1998), and Reply Comments of AT&T to Update and Refresh the Record at 2-7 (filed November 9, 1998).

[10] *See* CALLS Brief at 25.

As the Commission has recognized, today's per-minute interstate access charges substantially exceed economic cost. *See, e.g., Access Reform Order*, ¶¶ 42-46 (acknowledging that an immediate flash cut to access charges based on forward-looking economic cost "would require dramatic cuts in access charges for some carriers" and a "substantial decrease in revenue for incumbent LECs"). Above-cost access charges result in many forms of "inefficient and undesirable economic behavior." *See Access Reform Order*, ¶ 30.[11] Most obviously, excessive access charges artificially inflate long distance bills, which suppresses demand for those services and leads to inefficient under-utilization of telecommunications networks. The Commission has correctly found that, "[b]ecause of the growing importance of the telecommunications industry to the economy as a whole, this inefficient system of access charges retards job creation and economic growth in the nation." *Access Reform Order*, ¶ 30. The total cost to the economy of such distortions is undoubtedly in the billions of dollars per year.[12]

The CALLS Plan would eliminate many of these inefficiencies by cutting per-minute switched access charges roughly in half – from 1.1 cents per minute today to 0.55 cents per minute. This target rate of 0.55 cents per minute would be achieved much more quickly than would otherwise be the case under the Commission's existing rules. Indeed, for most of the signatory LECs, the target rate would likely be reached by July 2002. While AT&T estimates that the true

[11] *Low-Volume Long-Distance Users*, CC Docket No. 99-249, Notice of Inquiry, 1999 WL 511193, ¶¶ 5-7 (rel. July 20, 1999).

[12] *Popkin Consumer Welfare Study* at 1 (over $5 billion); Robert Crandall and Jerry Ellig, Economic Deregulation and Customer Choice: Lessons for the Electric Industry, Center for Market Processes, George Mason University (January 1997) (estimating cost to economy of $45 billion).

forward-looking cost of per-minute switched access is even lower than 0.55 cents per minute,[13] the CALLS Plan's rates are nonetheless reasonable and would offer enormous gains to consumers compared to the existing system. These reductions in switched access charges will greatly stimulate long distance traffic and lead to more efficient use of the network.

These benefits to consumers and to the national economy are overwhelmingly in the public interest. Indeed, the Commission itself found in the *Access Reform Order* that the public interest required a "prescriptive backstop" to its approach of permitting market forces to reduce access charges to forward-looking cost. *Access Reform Order*, ¶ 267. The CALLS Plan would go a long way toward implementing that "prescriptive backstop," by industry agreement and without extensive litigation.[14] And the Plan would in no way prevent market forces from reducing rates for switched access even further, if sufficient competition develops within the lifetime of the plan.

Another pernicious effect of above-cost access charges is that they give incumbent LECs the ability to execute price squeezes in the interexchange market. *See Access Reform Order*, ¶¶ 277, 280. The elimination of the PICC would take away one source of the LECs' ability to execute such price squeezes. And while the CALLS Plan will not reduce per-minute access charges all the way to forward-looking economic cost, the Plan does mitigate – although it would not eliminate – the ability of the incumbent LECs to execute price squeezes with respect to per-minute rates.

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[13] *See* Letter from Joel Lubin to Magalie Roman Salas, CC Docket No. 96-262, dated February 25, 1999 (estimating the economic cost of a switched access minute at $0.00255 for RBOCs and $0.00305 for all price cap LECs).

[14] *See Access Charge Reform*, CC Docket No. 96-262, Petition for Rulemaking (filed December 9, 1997), designated RM No. 9210 (demonstrating that, due to changed circumstances, the market-based approach had failed and the Commission should institute the "prescriptive backstop"

## III. THE CALLS PLAN WILL ELIMINATE SUBSTANTIAL DISTORTIONS IN ACCESS CHARGES THAT ARE INHIBITING THE DEVELOPMENT OF COMPETITION.

The CALLS Plan will also promote competition by making long-overdue changes in the Commission's access rate structures. The Commission's current rules are distorting and inhibiting competition in three major areas: (1) they distort competition between telecommunications carriers and Internet providers; (2) they inhibit competition in the local residential and small business markets; and (3) they inhibit innovative pricing plans and other benefits for consumers. The CALLS Plan will largely eliminate these inefficiencies, which will facilitate broader and more effective competition.

*First*, the CALLS Plan would substantially mitigate the competitive distortions the Commission's current rules cause between telecommunications carriers and Internet providers. Of course, these distortions are ultimately a consequence of the Commission's so-called "ESP exemption," under which Internet service providers ("ISPs") are exempt from paying the traffic-sensitive interstate access charges that telecommunications carriers pay. *See Access Reform Order*, ¶¶ 344-48. The ESP exemption inherently creates a competitive imbalance between telecommunications carriers and ISPs, because the exemption provides a strong, artificial incentive for end-users to bypass telecommunications carriers (and thus access charges) by purchasing Internet-based services.

These competitive imbalances are exacerbated, however, by the uneconomically high *level* of per-minute access charges. Although the Plan would not eliminate these disparities entirely, the

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immediately). *See also* the Comments and Reply Comments of AT&T Corp. in the same proceeding (filed January 30, 1998 and February 17, 1998).

Plan's reductions in per-minute access charges would substantially mitigate the economic distortions inherent in the ESP exemption. As a result, the CALLS Plan would relieve pressure on the agency to repeal the ESP exemption, and would allow the Commission to maintain its "unregulation" policy toward the Internet.[15]

*Second*, the Commission's common line rate structure discourages competition for local residential and small business services. Today's common line rates are radically inconsistent with principles of cost-causation. As the Commission has long recognized, principles of cost-causation and economic efficiency require common line costs to be recovered through a flat-rated charge assessed to end-users.[16] The Commission's rules place a cap on end-user charges, however, so that the remainder of the ILECs' common line costs are recovered through charges assessed to IXCs (the PICC and CCLC). As the Commission has found, where (as here) "rates are subsidized . . ., rates will be set too low and an otherwise efficient provider would have no incentive to enter the market." *Access Reform Order*, ¶ 30. Although one of the major objectives of the Act was to facilitate competition in local markets, until now such entry has been limited, especially in residential markets,[17] partly because of the disincentives to enter caused by subsidized, artificially low end-user charges.

The CALLS Plan does away with many of these artificial disincentives by making common line rates more cost-based and cost-causative. The CALLS Plan would almost completely eliminate

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[15] *See* Office of Plans and Policy, Federal Communications Commission, "The FCC and the Unregulation of the Internet," OPP Working Paper No. 31 (July 1999).

[16] *See 1983 Access Charge Order* at ¶¶ 1, 124.

[17] Common Carrier Bureau, Industry Analysis Division, "Local Competition: August 1999," at 4-5, 11 (released August 31, 1999).

the PICC and CCLC, and would gradually raise the caps on the SLC to $7.00 in 2003 (although in many cases the actual SLC would be lower than $7.00). The Plan would also eliminate the distinction between primary and secondary residential lines; as of July 1, 2003, the SLC cap would be $7.00 for all residential (and single-line business) customers. Common line rates that are more cost-based and cost-causative will provide a more attractive and realistic incentive for new entrants to target local residential customers than is the case today. Such rate structure changes are in the public interest.

*Third*, lower per-minute access charges will facilitate the development of simpler and more innovative pricing packages. For example, studies show that where the cost structure of a service is largely non-traffic-sensitive, as is the case with telecommunications, there is a tendency toward flat-rated pricing. The CALLS Plan, by dramatically lowering per-minute access charges, may permit carriers to offer innovative packages of local and long distance, for example, at flat monthly rates (as Internet service providers do) or "bucket-of-minutes" pricing (as wireless carriers do). These changes will allow carriers to meet demand more effectively and permit consumers to enjoy the benefits of the Act.

Other rate structure changes in the CALLS Plan will allow simpler bills, which is also in the public interest. For example, the CALLS Plan eliminates rate elements and distinctions that consumers find confusing, particularly the PICC and the distinction between primary and secondary lines. These changes will likewise foster the kind of competition that the Act envisions.

## IV. THE CALLS PLAN WILL PROVIDE STABILITY AND PREDICTABILITY DURING THE TRANSITION TO COMPETITION IN TELECOMMUNICATIONS MARKETS.

Finally, the CALLS Plan furthers the public interest because it offers regulatory certainty and predictability during a critically important period in the transition to competitive telecommunications markets.

Indeed, both now and during the next five years, companies will be making large, critically important investment decisions, choosing their strategies for competitive entry and building infrastructure. As of now, however, those companies must make those decisions in a regulatory environment that is highly unpredictable. The CALLS Plan would remove many of these uncertainties, which would benefit the public by facilitating the development of additional competition.

The current access charge and universal service regimes are rife with instability and uncertainty. For example, the Commission has established two different X-Factors in the last four years. Moreover, each change in the X-Factor provokes extensive litigation, and the D.C. Circuit's recent overturning of the Commission's 1997 *Price Cap Order* has added another layer of uncertainty to carriers' attempts to make plans based on access charge levels. *See USTA* v. *FCC*, 188 F.3d 521 (D.C. Cir. 1999) (mandate stayed until April 1, 2000).

Similarly, the Commission has adopted a "market-based" approach to access reform, but it has also committed that, to the extent that forces do not drive access charges to cost-based levels, it will implement a "prescriptive backstop" in 2001 based on forward-looking cost studies. *Access Reform Order*, ¶¶ 267-68. Because market forces have thus far failed to provide any meaningful constraint on access charges, the Commission will have no choice but to resort to the prescriptive backstop in most cases. This will undoubtedly spark the same kind of extensive litigation – and attendant uncertainty – that has characterized the Commission's X-Factor proceedings.

The Commission's universal service policies are similarly unsettled. The Commission has changed course a number of times in the past three years on important issues, and the Commission has yet to replace the subsidies implicit in access charges with an explicit, competitively neutral fund. Moreover, whatever action the Commission takes will undoubtedly be challenged in court. This will result in uncertainty which, in turn, will thwart the industry members' attempts to plan and execute their strategies for competitive entry.

The CALLS Plan provides reasonable solutions to each of these important issues, solutions that will also produce a stable, predictable regulatory environment conducive to making the investments necessary for competition. That in itself is an important public interest benefit of the CALLS Plan. As noted in the CALLS Brief (at 43 & n.88), the Commission has adopted joint industry proposals in the past based on its independent judgment that the proposal was in the public interest. Moreover, the Commission has ample authority to adopt a settlement proposal, especially where the proposal will govern only during an interim, transitional period. *See, e.g., MCI Telecommunications Corp.* v. *FCC*, 712 F.2d 517 (D.C. Cir. 1983). The CALLS Plan would thus allow carriers to focus on competition, rather than litigation.

The CALLS Plan provides the stability and predictability necessary for the critical period of transition to fuller competition in telecommunications markets. By the same token, however, the interim nature of the CALLS Plan provides the Commission with the flexibility to reimpose various aspects of the current regime (such as the X-Factor), if in fact such competition has not developed by 2005. For all of these reasons, the Calls Plan is in the public interest and should be adopted.

## CONCLUSION

For the foregoing reasons, the Commission should adopt the CALLS Plan in time for implementation on January 1, 2000.

Respectfully submitted,

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