Before the
Federal Communications Commission
WASHINGTON, D.C.

IN THE MATTER OF	)	
	)	
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
	)	
Low-Volume Long Distance Users	)	CC DOCKET NO. 99-249
	)	
Access Charge Reform	)	CC DOCKET NO. 96-262

REPLY COMMENTS OF THE COALITION FOR AFFORDABLE LOCAL AND LONG DISTANCE SERVICE ("CALLS")

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Summary

The plan submitted to the Commission by the Coalition for Affordable Local and Long Distance Service ("CALLS") will fulfill the many of the still elusive goals of the Telecommunications Act of 1996. The CALLS proposal is a historic opportunity to preserve and enhance universal service in a marketplace that is increasingly competitive and subject to technological change. It delivers real and lasting reform by offering overwhelming benefits for consumers and businesses, for people in rural as well as urban areas, and for people of all income groups. The plan:

- Supports affordable local rates for all Americans, particularly in rural and high cost areas and for low-income Americans;
- Commits to lower long-distance bills;
- Promotes investment in and deployment of competing broadband-capable networks, particularly in rural and residential areas, and narrows the "digital divide" in areas without local dial-up Internet access;
- Substantially resolves today's tension between universal service goals and an unregulated Internet, preserving both;
- Promotes facilities-based competition and consumer choice;
- Simplifies consumer bills; and
- Provides investment stability during a crucial five-year period in the development of telecommunications competition.

The comments filed so far in this proceeding demonstrate support from a broad spectrum of public interest groups, members of the business community, competitors in the telecommunications industry, state commissions, rural interests, and organizations representing workers. Although some commenters criticize various aspects of the plan, they fail to offer an alternative comprehensive solution that would guarantee affordable telephone service without hidden subsidies. The only result these commenters guarantee is further gridlock.

Those who criticize the plan fail to raise any legitimate legal concerns. The plan is in full compliance with the Communications Act and applicable court precedent.

The CALLS compromise is also sound policy. The plan reforms universal service and access charges without a substantial "bottom-of-the-bill" impact ever for low-volume consumers. The vast majority of consumers will see bills fall over the life of the CALLS plan. Even if competition does not develop in some areas, even the most rural of AT&T's low volume customers will see bills increase by only about 20-cents over the life of the CALLS plan, with many others seeing reductions in their total bill.

The Commission rarely has the opportunity to adopt a proposal that draws support from such a broad array of industry competitors and users. It should therefore move forward expeditiously, adopt the CALLS plan in its entirety, and begin reaping the plan's significant public interest benefits for all Americans.

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REPLY COMMENTS OF THE COALITION FOR
AFFORDABLE LOCAL AND LONG DISTANCE SERVICES ("CALLS")

The Coalition for Affordable Local and Long Distance Services respectfully submits these Reply Comments with respect to the Notice of Proposed Rulemaking seeking comments on CALLS' comprehensive, coherent, universal service and access charge reform proposal.

As the Massachusetts Department of Telecommunications and Energy concluded in its comments, “[t]he CALLS plan presents a historic opportunity for the FCC in one stroke to promote several of the still-elusive goals of the Telecommunications Act of 1996.”[1] The compromise CALLS presents seeks to end the policy “gridlock” that has surrounded universal service and interstate access charges, and to cut this “Gordian knot” in a way that delivers substantial public benefits, including:

- Assuring affordable interstate rates for all Americans, particularly in rural and high cost areas and for low-income Americans;
- Promoting facilities-based competition and customer choice;
- Simplifying consumer bills;

[1] Comments of Massachusetts Department of Telecommunications and Energy at 2 (filed November 12, 1999) (“Massachusetts DTE”).

- Promoting investment in and deployment of competing broadband-capable networks, particularly in rural and residential areas, and narrowing the "digital divide" in areas without local dial-up Internet access;
- Substantially resolving today's tension between universal service goals and an unregulated Internet, preserving both; and
- Providing investment stability during a crucial five-year period in the development of telecommunications competition.

Nearly four years after enactment of the Telecommunications Act, the Commission now has the chance to finish crucial elements of telecommunications reform. The time to complete the job has come.

The CALLS compromise drew a range of support, in many ways signifying that the telecommunications marketplace is in fact changing. A state public utility commission, the Massachusetts Department of Transportation and Energy, supported the plan. The Alliance for Public Technology, a public interest group founded to promote affordable access to telecommunications and information by all consumers, supported the plan. The Communications Workers of America supported the plan. The plan drew the support of the only rural public interest commenter, the National Association of Development Organizations, the largest and leading advocate for regional community and economic development. The Ad Hoc Telecommunications Users Group, American Petroleum Institute, the General Services Administration, and the Enterprise Networking Technologies Users Association, all purchasers of telecommunications services, supported the major elements of the plan. An IXC, Qwest, and a non-signatory price cap LEC, Cincinnati Bell, both supported the plan as did the United States Telecom

Association. MCI, the largest non-signatory IXC, supported key components of the plan, including both the plan's $650 million of explicit rural and high cost universal service support and its target rates for switched access. Both Cable and Wireless and the Competitive Telecommunications Association ("CompTel") recognized the CALLS plan as an improvement over the status quo. A leading CLEC, Intermedia, supported CALLS' proposal to consolidate flat-rate charges from different parts of the end user bill into a single charge and did not object to many other significant aspects of the plan.

The fact that many commenters found <u>something</u> to criticize is not a surprise. The CALLS plan, after all, is a compromise — one that requires *all* participants in the long-running access charge and universal service wars to give some ground. It is precisely because the CALLS plan presents a middle ground that it is the only feasible means to deliver results, not just rhetoric.

The time is long past for the Commission to require parties to offer solutions, not just criticism. Despite the Commission's express invitation to do so,[2] commenters who oppose the CALLS plan *in toto* offer no vision of how regulatory mechanisms erected before the onset of local competition and the Internet can be changed to adapt to a changing marketplace. Neither NASUCA nor the Texas Public Counsel/CFA/CU, for example, proposes any mechanism (other than continued rate averaging) for ensuring that rates in rural areas stay affordable, or for creating a system of access charges and universal service to promote, rather than discourage, investment and competition in rural and residential areas.

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[2] Access Charge Reform, *et al.*, *Notice of Proposed Rule Making*, CC Dkt. Nos. 96-262, 94-1, 99-249, 96-45, FCC 99-235, at ¶ 5 (rel. September 15, 1999).

These parties cling to the view that regulators can continue to implicitly subsidize service to rural and high cost areas by raising rates to urban customers, business customers and long distance users. But even the Texas Public Counsel/CFA/CU admit, "[t]he fictions that the FCC has established among these 'classes' of service will no longer be relevant and will be unable to exist in a competitive market where the line has been blurred between jurisdiction offerings."[3] The Commission itself has already cogently described on several occasions why such implicit subsidies cannot survive the emergence of local competition, including just a month ago in the *Ninth Report and Order and Eighteenth Order on Reconsideration* in the universal service docket, where the Commission explained:

> Although implicit universal service support was sustainable in a monopoly environment, it will become more difficult to sustain as competition increases. In a competitive market, a carrier that charges rates significantly above its costs to a class of customers may lose those customers to a competitor charging cost-based rates. As carriers lower their rates closer to their costs in urban areas, or lose low-cost customers to new entrants charging cost-based rates, the implicit support for below-cost rates in high-cost areas may erode. Moreover, efforts to sustain implicit universal service support in a competitive environment could encourage business decisions contrary to the purpose of high-cost support — to enable access to telecommunications service in areas where the cost of such service otherwise would be prohibitively high. For example, competitors may be likely to target high-revenue business customers in low-cost urban areas where incumbent LECs are charging rates significantly above costs, while foregoing opportunities to serve lower-revenue residential customers in high-cost rural areas where incumbent LECs are charging artificially low rates because of implicit support flows.[4]

The CALLS plan, in contrast, expressly creates an explicit means to support universal service.

Moreover, those commenters who oppose the CALLS compromise *in toto* also fail to acknowledge that the Internet has significance other than as another potential source of "contribution." They do not acknowledge that as packet-switching begins to offer substitutes for circuit-switched services, the basis for per minute, usage-based implicit universal service support vanishes. The CALLS plan, on the other hand, by

3 Comments of Texas Office of Public Utility Counsel, Consumer Federation of America, Consumers Union at 14 (filed November 12, 1999) ("Texas Public Counsel/CFA/CU").

removing a significant amount of universal service support from per minute access charges and by substantially lowering usage charges creates a rate structure that facilitates the migration of telecommunications to packet-switched networks.

Finally, those commenters who oppose the CALLS plan *in toto* seem to ignore the fact that consumers do not usually purchase just local service or just long distance service, but purchase a range of telecommunications services. These commenters treat individual line items as if each were a unique universe, isolated from all other charges. The CALLS plan recognizes that consumers pay an entire bill, and that what matters most is not how a bill is divided up but the value consumers get for their money. As APT observes, "[t]he [CALLS] plan's more favorable pricing could promote bundled service offerings of local calling, long distance, wireless and Internet services in a flat rated package that consumers might find attractive."[5] The CALLS plan makes telecommunications a better value for business and residential consumers alike, as reflected by the support of APT, CWA, NADO, Ad Hoc, American Petroleum Institute, the Enterprise Networking Technologies Users Group, and GSA. A study by Joel Popkin & Company found residential consumers at all income levels could gain annual benefits of $1.2 billion as a result of the CALLS plan.[6]

The Commission rarely has the opportunity to adopt such a "win-win-win" proposal that draws support from industry competitors and users. The Commission should now move forward promptly to adopt the CALLS compromise and begin reaping

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[4] Federal-State Joint Board on Universal Service, *Ninth Report and Order and Eighteenth Order on Reconsideration,* CC Docket 96-45, FCC 99-306 at ¶ 17 (rel. November 2, 1999) ("*Ninth R&O*").

[5] Comments of Alliance for Public Technology, Communications Workers of America and National Association of Development Organization, at 7 (filed November 16, 1999) ("APT/CWA/NADO").

the plan's public interest benefits. Therefore, the Commission should adopt the CALLS plan in its entirety. As recognized by the Massachusetts Department of Telecommunications and Energy, "[q]uick approval of the CALLS plan would be among the most significant actions taken by any regulatory body or court, since passage of the Act toward finally achieving the goals of the Act."[7]

I. THE CALLS PLAN SECURES AFFORDABLE UNIVERSAL SERVICE AND PROPOSES A MEANS TO SUSTAIN UNIVERSAL SERVICE AND PROMOTE INVESTMENT IN BROADBAND-CAPABLE NETWORKS.

There is no dispute that universal service support in interstate access charges should be made explicit, consistent with the Act, WTO regulatory principles, and the Commission's previous statements. By making $650 million in universal service support explicit, the CALLS plan would create a mechanism to keep rates affordable in rural areas and would promote investment in rural networks.

None of the commenters dispute that the proposed universal service reforms will also promote broadband-capable networks, especially in rural areas. Although it does not subsidize broadband service, the CALLS plan will promote investment in

broadband-capable infrastructure by reforming today's distorted, implicit subsidy mechanisms. Because the CALLS plan creates a more straightforward and economically logical pricing and universal service support mechanism for voice grade telephone service, it will facilitate rational network investment that will also bring broadband capability to consumers.

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6 *Id.*, at 4; *See, Id.*, at Appendix A, "An Assessment of Consumer Welfare Effects of the CALLS Plan," at 1-2 ("Popkin").

7 Massachusetts DTE at 9.

The CALLS plan will also make plain old telephone service more affordable for those who can least afford it by reducing overall toll bills and by increasing Lifeline support. Even the Texas Public Counsel/CFA/CU admit that the CALLS proposal would benefit low-income Lifeline consumers, including those with low volumes of long distance use.[8] In short, the undisputed benefits of immediate universal service reform are substantial. The Commission should not lose or delay these benefits by unnecessarily prolonging deliberation on interstate universal service reform.

A. CALLS' Proposal To Identify Explicit Universal Service Support And To Remove That Support From Interstate Access Charges Is Fully Consistent With FCC Policy.

There is no impediment that prevents the Commission from undertaking these matters in this proceeding. The California PUC argues that CALLS' proposal to remove universal service support from interstate access charges and to collect and distribute that support through competitively neutral, non-discriminatory and portable universal service support "exceed[s] the role of federal high-cost funding specified by the FCC."[9] In support of its position, California cites language from the FCC's *Ninth Report and Order on Universal Service* that states that the primary role of federal high-cost support is to enable reasonable comparability of rates among states.[10] However, in that order the Commission dealt with federal support for *intrastate* rates, not for the interstate assigned portions of the network.

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8 Texas Public Counsel/CFA/CU at 45.

9 Comments of the People of the State of California and the California Public Utilities Commission at 15 (filed November 12, 1999) ("California PUC").

10 *Id*, at *15*.

With respect to the interstate rates, the Commission, citing the CALLS proposal, stated that it would "address the support that may be implicit in interstate access charges in a future order, jointly captioned in this proceeding and our access charge reform proceeding."[11] The Commission also pointed out that its "final determinations regarding adjustments to interstate access charges to account for explicit universal service support will be issued in the separate *Access Charge Reform* proceeding."[12]

B. The CALLS Plan Maintains Affordable, Comparable Rates.

Although several commenters object to the consolidation of the SLC and other charges, to the potential levels of those charges, and to the fact that those charges could be deaveraged geographically, no commenter actually provides any data to demonstrate that the rates proposed under the CALLS plan would be unaffordable, or outside a "fair range," which is the test the FCC has articulated to define comparability of rates.[13] Although NASUCA points to language in the May 1997 access reform decision in which the FCC, citing affordability concerns, declined to increase SLCs and instead created PICCs, NASUCA wholly ignores the FCC's subscribership data, which show that notwithstanding the fact that PICCs have been passed on to end users in line charges, subscribership "is at the highest level ever."[14]

The Commission should pay special attention to the comments of the Massachusetts Department of Telecommunication and Energy, which present a case

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[11] *Ninth R&O* at ¶ 9.

[12] *Id.* at ¶ 113.

[13] *See e.g.* Texas Public Counsel/CFA/CU, at 46-47 (objecting to SLC deaveraging without applying a "fair range" test); *Ninth R&O* at ¶ 38.

[14] News Release, "New Telephone Report Reveals Highest Number of Subscribers Ever" (rel. October 8, 1999).

study of a reform similar to that proposed by CALLS. [15] During the period 1986-94, Massachusetts significantly reformed its intrastate rate structure in an effort to align rates with underlying costs. Among other things, residential rates for dial tone access increased from about $3 per line per month to $9.91 per line per month. These changes, which were "greater in magnitude than those contemplated in the CALLS plan … did not adversely affect universal service in Massachusetts."[16] There was "no statistically significant change in Massachusetts' overall household penetration rate for telephone service," but significant benefits did result from the reforms, including increased competitive entry.[17]

On the national level, subscribership levels have increased, not decreased, as a result of the implementation of the SLC and the PICC, even though both have resulted in increased end user charges.[18] Moreover, an economic study of the CALLS plan conducted by Joel Popkin & Company did not predict any loss in subscribership.[19] The

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15 "The MDTE has engaged in rate restructuring for the incumbent local exchange carrier similar to that proposed by CALLS and has seen significant benefits from reducing implicit subsidies with no adverse effect on universal service. We are confident that adoption of the CALLS plan would result in similar benefits at the national level without any negative effects on universal service. . . . The Massachusetts experience with rate restructuring should be instructive for the FCC as it evaluates the CALLS plan." Massachusetts DTE at 5-6.

16 *Id.* at 6.

17 *Id.* at 6-7.

18 "Past experience shows that the shift away from per minute access charges to flat charges has had an overall positive effect on telephone subscribership. In 1984, when the first SLCs were adopted, telephone subscribership was 91.8 percent. Due in part to the creation of the SLC and later the PICC, usage sensitive interstate access rates – and, in turn, long distance rates – have fallen, and subscribership has increased. By 1989, when residential SLCs first reached $3.50, telephone subscribership had risen to 93.3 percent. Today, with SLC and PICC-related charges totaling approximately $5.00 per month, and with additional charges for the Telecommunications Relay Service ("TRS") and number portability, telephone subscribership is over 94 percent." *See* CALLS Memorandum, at 16, *citing*, Alexander Belinfante, *Telephone Subscribership in the United States*, (Com. Car. Bur. Ind. Anal. Div. Rel. May 1999), at Table 1.

19 Popkin at 17.

vast majority of consumers will see reduced total bills over the CALLS plan's life. Furthermore, as discussed below, when combined with AT&T's recently announced change in universal service collection for low volume customers, it is likely that even the most rural of AT&T's low-volume customers will see bills increase by less than 20 cents over the entire life of the CALLS plan, with many other low-volume consumers seeing reductions. There is simply no basis in the record for concluding that the CALLS plan would raise rates to unaffordable levels.

Nor do any of the commenters who oppose the limited geographic deaveraging of the SLC permitted under the CALLS plan, with associated universal service support, demonstrate that end user rates would fall outside a "fair range." There is no basis for concluding that SLC rates would be outside a "fair range," especially given the fact that multiline business SLCs today range from a low of $3.77 in the District of Columbia to a maximum of $9.20 per month.

C. $650 Million Is A Reasonable Estimate Of The Amount Of Explicit Support Necessary To Ensure That Interstate Rates In Rural And High Cost Areas Remain Affordable During This Five-Year Period.

The CALLS proposal to make explicit $650 million in universal service support and to remove that support from interstate access charges remains the only such estimate in the record. MCI, in fact, found the proposed fund to be "acceptable" as an interim measure. The fact that no other commenter actually proffered an estimate speaks to the difficulty of creating <u>any</u> estimate of the universal service support that must be made explicit in order to ensure that interstate rates remain affordable. CALLS' proposed universal service support was not, however, simply "plucked from the air" as some commenters would want the Commission to believe. As described in CALLS' initial memorandum, the proposal was bounded by estimates that had already been made in the record.[20] In addition, AT&T estimates that $650 million of access-related universal service support is consistent with the Commission's model-based estimates to date of the forward-looking costs of providing universal service.[21]

Moreover, the fact that the proposed amount of rural and high cost universal service funding was arrived at to some extent through negotiation rather than solely through a proxy model methodology does not make it less reliable or legitimate. Indeed, the fact that carriers that must provide service in the marketplace are willing to settle upon this amount of funding gives a greater degree of real-world assurance that this amount of universal service support will be sufficient to assure affordable and comparable rates and service in rural areas, but not be excessive. It is important to note, in this regard, that the CALLS members include companies such as AT&T and Sprint who, with MCI and other IXCs, pay the lion's share of universal service contributions, companies such as Bell Atlantic and SBC who provide local service in areas that tend to be lower cost to serve on average and who therefore are net payers of universal service contributions, and companies such as BellSouth, GTE, and Sprint local that provide

[20] *See*, CALLS Memorandum, at 25. The United States Telephone Association estimated that then-current interstate common line rates contained $3.9 billion in implicit universal service support. Comments of the United States Telephone Association on the Further Notice of Proposed Rulemaking, CC Dkt. No. 96-45 and CC Dkt. No. 96-262 (filed July 23, 1999). Rogerson and Kwerel of the FCC estimated $1.9 billion in implicit universal service support, assuming that residential SLCs were capped at $6.50 per month. "A Proposal for Universal Service and Access Reform," William Rogerson and Evan Kwerel, CC Dkt. Nos. 96-45 and 96-262 (filed May 27, 1999). On the other hand, the HAI model projects a forward-looking estimate of implicit support in interstate common line elements at approximately $250 million. HAI Model Version 5.0a, CC Dkt. No. 96-45. This model used SLC caps of $7.00 for residential and single line business lines and $9.20 for multiline business lines. It also used FCC Common Inputs as of March 10, 1999.

[21] *See*, CALLS Memorandum, at 26; Declaration of Joel Lubin, Attachment 3; Bell Atlantic, Bell South, GTE and SBC do not support use of a model to calculate universal service support, and together with Sprint do not join in the citation of AT&T's model-based calculations.

service in areas that have higher costs and therefore are generally net recipients of universal service support.

Several commenters argue that the FCC should adopt some other estimate of the amount of universal service support in interstate access charges to be made explicit, rather than adopting CALLS' proposal of $650 million.[22] These commenters do not, however, suggest an alternative estimate of the amount of universal service support that should be funded through explicit mechanisms and removed from interstate access charges. The commenters simply state that universal service support should be based on "forward-looking" estimates.[23]

With the exception of MCI, however, these commenters ignore the fact that there is currently no means to create another estimate of the amount of implicit universal service support to be made explicit in order to ensure that interstate rates remain affordable.[24] In its *Models Report and Order,* the Commission reserved the issue of whether nationwide or company-specific inputs, would be more appropriate in other contexts than when calculating federal support for intrastate rates, and expressly cautioned that, "it may not be appropriate to use nationwide values for other purposes."[25]

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22 Comments of the Association for Local Telecommunications Services at 3-5 (filed November 12, 1999) ("ALTS"); Comments of Time Warner Telecom at 7 (filed November 12, 1999) ("Time Warner"); Comments of MCI WorldCom at 4 (filed November 12, 1999) ("MCI WorldCom"); Comments of the Public Utilities Commission of Ohio at 21 (filed November 12, 1999) ("Ohio PUC"); Comments of the Washington Utilities and Transportation Commission at 6 (filed November 12, 1999) ("Washington UTC").

23 ALTS at 4-5; Texas Public Counsel/CFA/CU at 23.

24 *See,* MCI WorldCom, at 12.

25 Federal-State Joint Board on Universal Service, *et al., Tenth Report and Order,* CC Dkt. Nos. 96-45 and 97-160, FCC 99-304, at ¶ 32 (rel. November 2, 1999) ("*Tenth R&O*"); *See* also, *Ninth R&O*, at ¶ 41.

MCI's recognition that developing appropriate cost estimates is an extremely time consuming process led it to conclude that "the CALLS plan's concept of an interim universal service fund cap allows meaningful access reform to proceed. . . ."[26] CALLS agrees with MCI that $650 million should be considered an interim estimate (although it could also ultimately be proven to be the correct final amount). It would be better, however, to observe the results of the $650 million interim universal service fund in the marketplace in order to have the benefit of real-world experience and data before revising that amount, if any revision is needed. Therefore, the $650 million amount of support should be left in place for the entire five-year period.

Moreover, there is no basis in the record or in any place other than parties' assertions to suggest that $650 million will be either insufficient or unnecessary to achieve the Act's universal service objectives of comparable and affordable interstate rates over this five-year period. As stated in the Declaration of Joel Lubin, Attachment 3 hereto, the FCC's recently adopted model cannot be cited as evidence that CALLS' estimate is unreasonable.[27]

California argues that the Commission has "previously concluded that existing universal service funding levels have been sufficient to promote universal service."[28] The Commission has never reached such a conclusion with respect to interstate access-related universal service funding, a fact confirmed by the Commission's *Ninth Report and Order*

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[26] MCI WorldCom at 4.

[27] *See* fn. 21.

[28] California PUC at 16.

and its statements therein that it would address issues related to implicit universal service support in access charges in an upcoming order.[29]

Finally, contrary to suggestions by Cable & Wireless and Intermedia,[30] it is simply inaccurate to state that CALLS' proposed rural and high cost universal service fund of $650 million was designed to cover the "gap" between acceptable end-user charges and LEC permitted revenues under price caps. Under the universal service distribution formulas, the Nationwide Above Cap Revenues — which is the full "gap closing" amount between acceptable end user charges and price cap LEC permitted revenues — would exceed $650 million. CALLS' proposed universal service fund of $650 million was not sized to close that gap, but rather is a realistic effort to develop an amount of universal service support that would be sufficient to ensure universal service and to promote investment in rural networks and rural competition during the five-year interim plan. Universal service under the CALLS plan falls well short of being "full revenue replacement" for price cap LECs.

D. UNE Zones Are The Appropriate Geographic Unit For Targeting Universal Service Support And Calculating Per Line Support.

In its comments, the Washington UTC proposes that universal service support be targeted to "exchanges" rather than to UNE zones, as proposed by CALLS.[31] Exchange (i.e. wire center)-based targeting could, in theory, provide an even more geographically specific means of distributing universal service support than under the CALLS plan. However, providing support on the UNE zone basis ensures that UNE prices, SLCs, and

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29 *Ninth R&O* at ¶ 9.

30 Comments of Cable & Wireless USA, Inc., at 5 (filed November 12, 1999) ("Cable & Wireless"); Comments of Intermedia Communications, Inc., at 6-7 (filed November 12, 1999) ("Intermedia").

31 Washington UTC at 5.

universal service support maintain a consistent relationship. To deaverage one set of prices or support to a different geographic level than the others will introduce additional arbitrage opportunities.

As an example of the arbitrage opportunities that can be created by using different geographies for UNE-pricing and universal service, consider the following two exchanges. The first exchange is in the lower cost portion of the UNE zone. If universal service is available on a wire center basis, but UNEs are priced on a more aggregated basis, then the entrant purchasing the UNE pays a UNE price above the cost for that wire center due to averaging within the zone, but receives universal service support based only on the lower cost for the wire center. On the other hand, if the wire center has above-average costs, then the UNE purchaser would pay an averaged, below-wire-center-cost rate for the UNE, but potentially could collect higher universal service support based on the wire center's own costs. At least one commenter, Cincinnati Bell, recognized these issues, and urged that access-related USF be based on state-approved UNE prices, in order to avoid exacerbating arbitrage opportunities.[32] The methodology for distribution of universal service support proposed in the CALLS plan is also consistent with the recommendations submitted in a report by then–FCC Chief Economist William Rogerson and OPP Senior Economist Evan Kwerel. As stated in that report, "[f]or simplicity, the wire centers in a study area will probably be divided into three regions and an average loop cost will be calculated for each region."[33]

[32] Comments of Cincinnati Bell Telephone Company at 3-4 (filed November 12, 1999) ("Cincinnati Bell").

[33] Rogerson and Kwerel, at 9.

E. Additional Lifeline Support Does Not Reduce Support For Service To Rural Areas, Nor Does It Reduce Existing Lifeline Support.

Some commenters were confused as to whether the additional Lifeline support proposed under CALLS would be offset by other changes to existing Lifeline programs. The additional Lifeline support proposed by CALLS is in addition to, not a substitute for, existing Lifeline support.

Other commenters were confused as to whether the $650 million universal service fund included the proposed additional Lifeline support, or just the support for rural and high cost areas. The $650 million fund is for rural and high cost area support: the new Lifeline support is additional. As such, the CALLS plan would increase total universal service funding by an amount necessary to cover the amount to which the new subscriber line charge offset for Lifeline customers would exceed the present amount of $3.50 per month per line.

Assertions by the Florida Commission that this additional Lifeline support would be approximately $212 million do not, however, appear to be correct. At present, there are approximately 5.4 million Lifeline subscribers, with 3.1 million in California. Assumes that the non-California subscribers are spread proportionately around the country, the increase in Lifeline support over today's levels under the CALLS plan would be under $100 million for year 2000, and approximately $135 million by year 2003.[34]

[34] These calculations also assume that the California subscribers are proportionately distributed between Pacific Bell and GTE. In July 2000, under the CALLS Plan the national average SLC outside of California would be $5.45, an increase in the amount waived per non-California Lifeline subscriber of $1.95 over today's rate. In July 2003, under the CALLS Plan the national average SLC outside California would be $6.28, an increase in the amount waived per non-California Lifeline subscriber of $2.78 over today's rate. In 2000, the average PacBell SLC is projected to be $4.52, with GTE SLCs projected at $5.50. In 2003, the average PacBell SLC is projected to be $4.52, with GTE SLCs projected at $7.00.

F. Permitting Price Cap LECs To Collect Universal Service Contributions As An Explicit Line Item Is Consistent With Section 254(d) and (e) Of The Communications Act, The Fifth Circuit's Rulings, And Prior FCC Decisions.

Texas Public Counsel/CFA/CU and NASUCA argue that the CALLS plan, by permitting incumbent LECs to recover universal service contributions through an end user charge, violates Section 254(d) of the Act by eliminating price cap LECs' "contribution" to universal service.[35] This argument misreads the Act, ignores the Fifth Circuit's decision in *Texas Office of Public Utility Counsel v. FCC*, and the FCC's orders implementing the Fifth Circuit's decision.

Section 254(d) simply states that "[e]very telecommunications carrier that provides interstate telecommunications services shall contribute, on an equitable and non-discriminatory basis, to the specific, predictable, and sufficient mechanisms established by the Commission to preserve and advance universal service." Nothing in Section 254(d) prohibits any telecommunications carrier from recovering its universal service contributions from its customers, and the Commission has never interpreted the Act to prohibit such recovery.[36] Given that the revenues of telecommunications carriers are derived one way or another from customers, the statute cannot be read to support a distinction between direct end user charges and recovery that is incorporated into a carrier’s other rates.

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[35] Texas Public Counsel/CFA/CU at 31; Comments of the National Association of State Utility Consumer Advocates at 20 (filed November 10, 1999) (“NASUCA”).

[36] *See*, Federal-State Joint Board on Universal Service, *Report and Order*, 12 F.C.C. Rcd. 8776, ¶ 855 (1997) (“*Universal Service First R&O*”)

End users charges for universal service are also consistent with the Fifth Circuit's recent ruling in *Texas Office of Public Utility Counsel v. FCC*[37] and with the Commission's implementation of that decision. The Fifth Circuit reversed FCC rules that required price cap carriers to obtain any recovery of universal service contributions through adjustments in carrier-to-carrier interstate access charges. The court held that this requirement constituted "implicit" rather than "explicit" universal service support contrary to Section 254(e).[38]

In implementing this decision, the Commission permitted price cap incumbent LECs to begin recovering universal service contributions through an express line-item charge to end users.[39] Therefore, the CALLS plan does not grant price cap LECs additional means of recovering universal service contributions other than those already permitted under now-existing Commission rules.

G. Recovery Of Access-Related USF Contributions Solely From ILEC End-Users, As Suggested By CompTel, Would Violate Section 254(d).

CompTel argues that contributions necessary to support the new access-related USF established by the CALLS plan should be recovered only from incumbent LEC customers. This proposal by CompTel violates Section 254.

Section 254(d) requires all providers of interstate telecommunications, not just incumbent LECs, to contribute to universal service and Section 254(e) specifies that any eligible telecommunications carrier may receive support. The access-related USF

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37 *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393 (1999).

38 *Id*. at 425.

39 Federal-State Joint Board on Universal Service, *Sixteenth Order on Reconsideration in CC Docket No. 96-45, Eighth Report and Order in CC Docket No. 96-45, and Sixth Report and Order in CC Docket No. 96-262*, FCC 99-290, at ¶ 33 (1999) ("*Sixteenth Order on Reconsideration*").

proposed by CALLS is not established to guarantee incumbent LEC revenues, and would, as required by the Act, be available to all eligible telecommunications carriers. There is no justification for recovering those USF contributions solely from incumbent LEC end users, as CompTel proposes. Indeed, doing so would violate Section 254(d)'s requirement that all carriers contribute to universal service.[40]

II. THE CALLS PLAN SIMPLIFIES CONSUMER BILLS, KEEPS RURAL RATES AFFORDABLE, AND IMPROVES CONSUMER WELFARE FOR RESIDENTIAL CONSUMERS IN ALL INCOME GROUPS.

When viewed from the standpoint of individual consumers, what stands out in the debate over the CALLS plan is that the benefits of the plan are enormous and the downsides are small. Notwithstanding the criticism of NASUCA, Texas Public Counsel/CFA/CU, and the New Jersey Division of Ratepayer Advocate, the CALLS plan benefits the vast majority of consumers.

A. Primary Residential Line Customers.

1. Rural Consumers

Over 65% of the nation's 61.6 million rural Americans, are served by price cap LECs. The only rural public interest group to comment, the National Association of Development Organizations, supported the CALLS plan because it recognized that the plan secures universal service by creating an explicit universal service fund and a cap on total line charges, and the plan also promotes investment in and the development of both incumbent and entrant networks in rural areas.[41]

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[40] It would also violate the WTO Agreement's requirement that universal service be transparent and competitively neutral. WTO Regulatory Reference Paper at ¶ 3.

[41] APT/CWA/NADO at 5.

2. Low Income Consumers

The CALLS proposal also clearly benefits each of the over 5 million low income Americans who are on Lifeline service. Even the Texas Public Counsel/CU/CFA grudgingly admit that the CALLS plan reduces potential charges to 5 million Lifeline subscribers by eliminating the primary residential PICC charge and by supporting waiver of the entire new end user charge.[42] The true benefits of the CALLS plan for low-income Lifeline subscribers are even greater, however, because low-income consumers use substantial amounts of long distance service. CFA's own data submitted in the Low Volume NOI proceeding show that the average low-income customer has a long distance bill of over $25 per month.[43] These low-income customers will also benefit from the toll bill reductions created by the CALLS plan. To the extent that there are Lifeline eligible consumers who are not Lifeline subscribers and hence do not receive the entire benefits of the CALLS plan, the solution is not to forego the CALLS plan but for the Commission and the state commissions to take educational steps to ensure that eligible consumers are able to enroll.

3. Simplified Bills

The CALLS plan also simplifies the bills for all consumers. Today, local and long distance carriers bill four different line items relating to access charges and universal service. To the local company, the consumer pays the Subscriber Line Charge and potentially a universal service charge. To the long distance company, the consumer pays the PICC pass through fee, and a universal service charge. Under the CALLS plan, the

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42 Texas Public Counsel/CFA/CU at 45.

43 *See*, Letter from James H. Bolin Jr. to Magalie Roman Salas, Further Declaration of Gregory L. Rosston, CC Dkt. 99-249, at ¶ 14 (filed November 19, 1999).

PICC pass-through fee is eliminated by rolling it into the SLC. By reducing the number of line items, the CALLS plan makes it easier for consumers to shop for calling plans.

4. Higher Volume Long Distance Users

No commenters seriously doubt that consumers who make moderate to high amounts of long distance calls, including a sizeable number of low income Americans, will benefit under the CALLS plan. Indeed, Texas Public Counsel/CFA/CU and NASUCA attack the plan for, in their mind, making it too easy to pass access savings on to higher volume consumers.[44]

5. Low Volume Long Distance Consumers

Some commenters assert that the CALLS plan will lead to substantial increases in bills for low-volume consumers who are not eligible for Lifeline.[45] The facts do not justify this fear, particularly because AT&T is also simultaneously changing its universal service fee for low volume consumer from a flat fee of $1.38 per account to a percentage of interstate charges.[46] The reality is that over this period, even with adoption of the CALLS plan, many low volume consumers will be seeing their bills fall, not rise.

Attached hereto as Attachment 2 are sample bills for a low-volume consumer reflecting a hypothetical set of charges that could be expected under the CALLS plan. These sample bills compare charges under the CALLS plan with rates expected in July 2000 under current rules using both a flat-fee universal service charge, such as AT&T currently uses, and a percentage USF charge, such as AT&T has announced and as Sprint

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[44] Texas Public Counsel/CFA/CU at 42-43; NASUCA at 24.

[45] *See*, NASUCA at 14-15; Texas Public Counsel/CFA/CU at 36-39.

[46] *See* AT&T Press Release, "AT&T Files Tariff to Help Recover Increased Universal Service Costs," (November 1, 1999).

and MCI currently use. These sample bills, which are for a hypothetical long distance company, show that low-volume customers can expect to see their bills fall in 2000, compared to current FCC rules. Over the life of the CALLS plan, these sample bills show that AT&T low volume consumers will see rates fall from where they would have been under current rules and in the absence of AT&T's change in its universal service fee. For this hypothetical consumer currently paying a percentage universal service fee, the average increase is only $0.44 over the full life of the plan. A rural, non-Lifeline, low volume consumer who is not an AT&T customer – the "worst case" sees an increase of $1.32 phased in over three and a half years. These bills show that, as a whole, non-Lifeline, low volume consumers will not see large increases in "bottom-of-the-bill" charges.

NASUCA argues that using $1.50 as the average PICC pass-though exaggerates the expected rates under current rules.[47] Although it is true that residential and single-line business PICCs charged by incumbent LECs to the long distance companies are capped at $1.04 per line, and that some long distance companies charge $1.04 per line, the three largest long distance companies charge consumers approximately $1.50 per account. These charges reflect the fact that the non-primary residential PICCs charged by incumbent LECs to the long distance companies are capped at $2.53 per line and the fact that the pass-throughs of the large IXCs are blended due to the difficulty of billing varying amounts for multiple lines or different categories of lines. These charges also reflect the inefficiencies of using IXCs to collect LEC costs.

[47] NASUCA at 10.

Finally, as reductions in per minute access charges are translated in the marketplace into lower long distance bills, the net result for consumers in terms of their overall telephone bills improves. As demonstrated by the Popkin study and as confirmed in a report by Robert Crandall and Jeffrey Rohlfs,[48] restructuring access charges to increase the proportion charged through fixed charges and reduce the proportion charged through usage charges benefits both residential and business consumers, and will benefit consumers in all income groups and all geographic areas.[49]

As the sample bills demonstrate, there is no basis for assertions by some commenters that the CALLS plan would result in "substantial" increases in residential consumer bills. Even when there are "bottom of the bill" increases, these increases are minimal. And as the both Popkin and Crandall have demonstrated, the CALLS plan benefits consumers in all classes of service, income and geographics — residence and business, rural and urban, low-income and middle income and high income. Simply put, consumers as a whole benefit when the marketplace, rather than arbitrary regulatory choices, is allowed to guide pricing decisions.

6. Non-Primary Residential Lines

The CALLS plan also rapidly eliminates the differential between primary and non-primary residential lines. This distinction encourages "cheating" and has been a

[48] Robert W. Crandall and Jeffrey H. Rohlfs, "The Economic Case for the CALLS Proposal," attached to Reply Comments of BellSouth (filed December 3, 1999).

[49] Popkin at 13-16, Texas Public Counsel/CFA/CU appear to argue that consumer welfare benefits from access charge and universal service reform should be apportioned equally among all telecommunications users, terming failure to apportion welfare benefits equally to be "discrimination." The Communications Act, however, prohibits only "unreasonable discrimination" and does not prohibit differences in price based on differences in underlying cost. 47 U.S.C. 202(a); *See,* AT&T Investigation into the Lawfulness of Tariff No. 267, 62 F.C.C.2d 815, 837 (1976) ("the best insurance against 47 U.S.C. 202(a) discrimination and unreasonable preference problems is to develop cost-related rates.")

great source of customer confusion. The CALLS plan ultimately unifies the primary and non-primary line rates, which both the New Jersey Division of Ratepayer Advocate and Texas Public Counsel/CFA/CU agree should occur.[50]

7. Multiline Business Lines

The multiline business customer will see both line charges and toll bills decline under the CALLS plan. Assertions by the New Jersey Division of Ratepayer Advocate that the CALLS plan results in higher rates are simply untrue. For multiline business customers whose SLCS are already at the FCC price cap maximum, these companies will generally see price reductions for the combined total of SLC and the PICC pass through. In addition, long distance bills will also fall as usage-based rates fall.

III. THE RATE STRUCTURES PROPOSED BY CALLS ARE LEGAL, RATIONAL AND CONSISTENT WITH A COMPETITIVE MARKET AND PACKET-BASED SERVICES

Many of the commenters recognize the many positive attributes of the rate structure proposals. For example, Intermedia, Pathfinder and TRA recognize the advantages of rolling PICCs into SLCs.[51] According to Intermedia, "[t]o the extent that incumbent LECs phase out their PICCs and recover an increased share of their NTS costs directly from end users in the form of SLCs, it will result in a more economically rational and easily understandable phone bill for consumers."[52] The Massachusetts Department

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[50] California PUC at 12; *see*, NJDRA at 12-14 and Texas Public Counsel/CFA/CU at 14.

[51] Intermedia at 4; Comments of Pathfinder Communications, Inc. at 5 (filed November 12, 1999) ("Pathfinder") ("[t]he CALLS proposal, at least implicitly, recognizes that the PICC is the most important defect in the current system in that it would eliminate the confusing and anti-competitive PICC over time through a phased-in approach."); Comments of the Telecommunications Resellers Association at 3 ("TRA") ("TRA endorses the CALLS proposal to unify subscriber line charges (ASLC), presubscribed interexchange carrier charges (APICC), and carrier common line (ACCL) charges into a single end user charge which would be assessed directly on end users by LECs").

[52] Intermedia at 4.

of Telecommunications and Energy concluded, "[t]he CALLS plan would . . . simplify customer bills and reduce customer confusion related to the increasing number of fees and charges on their bills."[53] Qwest commented that "the costs of long distance services are a key factor in the affordability of telephone service to residential consumers, and this plan will have the effect of reducing long distance charges further."[54] And Cincinnati Bell — a smaller LEC — commented that "the plan would provide much needed certainty and stability for both incumbent LEC and long distance participants."[55]

A. The Proposed Economically Rational Rate Structures Are Fully Consistent With The Communications Act.

Several commenters proffer a variety of legal arguments that the rate structure proposals, particularly the proposal to consolidate the SLC, PICC, CCL and a portion of local switching into a single end user charge, violate sections of the Communications Act and court precedent. These claims have no merit, and for the most part fail even to cite the applicable case law.

1. Section 254(k) of the Communications Act

As fully addressed in CALLS' comments, the plan is in complete compliance with section 254(k).[56] Those who argue that the CALLS plan violates 254(k) simply rehash arguments already rejected by the United States Court of Appeals for the Eighth Circuit in *Southwestern Bell Telephone Company v. FCC*. The Eighth Circuit has held that section 254(k) "is not implicated" by rules that permit incumbent LECs to use SLCs to

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53 Massachusetts DTE at 8.

54 Comments of Qwest Communications Corporation at 5 (filed November 12, 1999)("Qwest") Massachusetts OTE at 7; Cincinnati Bell at 2.

55 Cincinnati Bell at 4.

56 CALLS Comments at 11-16.

recover loop costs.[57] The Eighth Circuit rejected arguments that recovering all of interstate allocated loop and port costs from the end user constituted a subsidy of competitive services by non-competitive services, and that doing so caused universal service to bear an unreasonable share of joint and common costs. This case, which was decided in this docket, is now the law of the land, and is not subject to appeal or reconsideration. No commenter asserting that the CALLS plan violates 254(k) even cites *SWBT v. FCC*.[58]

Nor is NASUCA correct in arguing that the CALLS plan would expand the definition of services supported by federal universal services.[59] NASUCA ignores the Commission's functional definition of universal service and the fact that the Commission specifically included within the definition of supported services the use of the loop and that portion of the switch paid by the end user to place interexchange calls.[60] It is NASUCA, not CALLS, that is now proposing to alter the FCC's definition of universal service.

2. Smith v. Illinois Bell, 282 U.S. 133 (1930)

Several commenters assert, again without citation to applicable precedent, that the CALLS plan's proposed recovery of SLC, PICC, CCL and a portion of local switching in an end user charge violates the Supreme Court's decision in *Smith v. Illinois Bell.*[61] The

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57 *Southwestern Bell Telephone Company v. FCC*, 153 F.3d 523 (8th Cir. 1998).

58 It is difficult to see how at least some commenters alleging that the CALLS Plan violates 254(k) could have been unaware of this case. Texas Public Counsel, for example, was the lead appellant with respect to 254(k) issues.

59 NASUCA at 15.

60 *Universal Service First R&O* at ¶ 76.

61 *See*, NASUCA at 20.

United States Court of Appeals for the District of Columbia Circuit has previously rejected these arguments and their characterization of *Smith v. Illinois Bell*. In *NARUC v. FCC*, the D.C. Circuit reviewed rules the Commission had adopted that required incumbent LECs to recover a portion of interstate allocated loop costs through a fixed line charge imposed on end users irrespective of usage. These rules were challenged on the grounds that they violated the Supreme Court's ruling in *Smith*. Essentially, *NARUC* involved the same contention that is advanced here. The D.C. Circuit rejected this contention that *Smith* barred recovery of interstate allocated loop costs through a fixed line charge, holding that :

> *Smith* dealt with jurisdiction; it held that a portion of the costs of local subscriber plant may be recovered only under the authority of a body with interstate regulatory powers. The *Smith* Court did not address the manner in which the federal agency was to perform its task. It did not hold that the FCC must order recovery of costs allocated to its jurisdiction through usage-based charges.[62]

The CALLS plan presents no issues of jurisdiction similar to those addressed by the Supreme Court in *Smith*.[63] The facts at issue in *Smith* involved a state commission that failed when establishing a rate base to allocate any portion of costs to the interstate jurisdiction. The Court held that in doing so, the state commission had exceeded its jurisdiction.[64] The CALLS plan, however, relates exclusively to rates set to recover costs already allocated to the interstate jurisdiction through the Part 36 separations rules. As the court held in *NARUC*, there is no legal impediment to a federal recovery mechanism that "simply requires all telephone subscribers to pay, on a per-line basis, for that portion

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62 *NARUC v. FCC*, 737 F.2d 1095 1112 (D.C. Cir. 1984).

63 *Smith v. Illinois Bell*, 282 U.S. 133, 148-149 (1930).

64 *Id.*

of *their necessarily-incurred local telephone plant costs*[65] assigned under *Smith* to the interstate jurisdiction."[66]

3. Section 254(g) of the Communications Act

The CALLS plan is also in compliance with section 254(g). That section provides that "rates charged by" providers of "interstate interexchange service" must be no higher in urban areas than in rural areas, and that they be no higher in one state than another. The National Rural Telecom Association and National Telephone Cooperative Association ("NRTA/NTCA") argue that this section applies to SLCs charged by incumbent LECs.[67]

NRTA's proposed reading of Section 254(g) is unprecedented, and would greatly expand the scope of section 254(g) beyond the FCC's pre-1996 geographic rate averaging and rate integration policies. Those policies, which Congress codified in Section 254(g), applied only to interexchange service itself, not to exchange access *whether paid by the carrier or the end user.*[68]

There is no reason now to extend Section 254(g) to cover exchange access charges. Incorporating PICCs into the SLC does not "evade" section 254(g) by shifting the interstate loop costs out of IXCs' long distance rates and into deaveraged SLCs.[69]

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65 The *NARUC* court categorized local telephone plant costs as "necessarily incurred" because it found that loop costs "are necessarily incurred for each subscriber by virtue of that subscriber's interconnection into the local network, and they must be recovered regardless of how many or how few interstate calls (or local calls for that matter) a subscriber makes." *NARUC* at 1114.

66 *NARUC* at 1115.

67 Comments of the National Rural Telecom Association and National Telephone Cooperative Association ("NRTA/NTCA") at 5-9 (filed November 12, 1999).

68 *See*, Integration of the Rates and Services for the Provision of Communications by Authorized Common Carriers between the United States Mainland and the Offshore Points of Hawaii, Alaska and Puerto Rico/Virgin Islands, 61 FCC2d 380 (1976).

69 *See* NRTA/NTCA, at 8-9.

Loop costs are incurred by incumbent LECs, not IXCs. If incumbent LECs bill their own customers for a cost they are in fact required by law to incur — since use of the loop is a mandatory component of universal service — charges reflect reality, not an end-run around the statute. The plan does not *shift* IXC costs to incumbent LEC customers. The fact that the recently created PICC charges result in these costs being passed on to IXCs (which are subsequently recovered through end user pass-through charges) does not forever transform loop costs into an IXC cost.

There is also no merit to the argument that adoption of the plan would make it harder on the whole for long distance carriers to charge averaged rates in accordance with section 254(g).[70] In fact, as the Smithfield Telephone Company observes, the plan will lead to more uniformity in access charges, given that all price cap incumbent LEC participants will be targeting either the $.0055 or $.0065 per minute rates.[71] Moreover, eliminating the PICC charge will make IXC costs more uniform. Today, PICCs range from a low of $0 to a high of $4.31. Eliminating this geographical disparity will render compliance with 254(g) less complex for IXCs.[72]

B. Consolidation Of The SLC, PICC And CCL Simplifies Consumer Bills And Enhances Local Service Competition.

1. PICCs and Local Service Competition

No commenter who opposes the consolidation of the SLC, PICC and CCL charges into a single end user charge advances a plausible scenario under which the consolidation proposed would deter efficient entry or facilitate exclusionary pricing

[70] Cable & Wireless at 6.

[71] Comments of Smithfield Telephone Co. at 2 (filed November 12, 1999).

behavior.[73] Indeed, one of the major benefits of the consolidation is to encourage efficient entry, particularly in providing competing alternatives for loop service.

There is no evidence and no accepted economic theory that indicates that the consolidation of the SLC, PICC and CCL will "shield" incumbent LEC revenues from competition.[74] As described in CALLS' initial comments, incumbent LEC loop prices do not fall faster when charged to the IXC than when charged to the end user.[75] Whether charged directly to the end user via the SLC or indirectly to the end user via the PICC and the PICC recovery fee, loop prices will be subject to competitive pressure only to the extent there are alternative sources for the loop (including UNE loops). Facilities-based competition, which the CALLS plan encourages, creates competitive pressure on all loop and port recovery charges. Charging loop costs through the PICC does nothing to increase the amount of facilities-based competition, and so cannot create additional competitive pressure on loop charges.

The PICC charge is a fixed cost to all interexchange carriers serving incumbent LEC local customers. All interexchange carriers will seek to recover this cost through the rates they charge end users. As all major mass-market carriers currently charge

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[72] To the extent that there is a growing gap between the rates charged by price cap carriers and the rates charged by smaller, non-price cap carriers, the solution is not to require price cap carriers to use out-of-date, unsustainable rate structures.

[73] *See* Access Charge Reform, et. al., *Fifth Report and Order and Further Notice of Proposed Rulemaking*, CC Dkt. Nos. 96-262, 94-1, and 98-157, CCB/CPD File No. 98-63, FCC 99-206 (rel. August 27, 1999) ("Pricing Flexibility Order").

[74] NASUCA at 4.

[75] CALLS Comments at 17.

PICC-related fixed fees, there is no basis for concluding that PICCs will be subject to greater price competition than SLCs.[76]

Indeed, recovery of costs through PICCs rather than SLCs will tend to reduce competition. To the extent that the long distance companies average PICC pass-throughs nationwide, rather than charging customers the specific PICC charged by that customer's LEC, pricing signals will be diluted for consumers choosing between the incumbent LECs and alternative suppliers of service.

In addition, a critical fact ignored by NASUCA and others is that no carriers other than incumbent LECs are required to divide their loop plant into interstate and intrastate investment, which is what led to the creation of a subscriber line charge. Since CLECs are not required to separate their networks into interstate and intrastate investment, they may structure their prices in accordance with their costs and with marketing dictates. NASUCA claims that the SLC gives incumbent LECs a "guaranteed revenue source" and therefore a competitive advantage over CLECs.[77] To the contrary, consolidating the PICCs into the SLC promotes competition because SLCs are apparent to the end user while PICCs are at least partially buffered against direct comparison by being charged first to the IXC which then bills the end user. Moreover, eliminating the SLC could have anticompetitive effects by increasing the number of areas in which the total charges received by the LEC fall below the costs of providing service.

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[76] NASUCA argues that some IXCs do not pass PICCs through to end users. NASUCA Comments, at 30. As evidence, NASUCA points to the fact that McLeod USA does not pass through PICC charges to end users. NASUCA neglects to mention, however, that McLeod does not offer long distance services in Springfield to those end users who do not also obtain local service from McLeod. Since McLeod does not pay PICC charges in this situation, it is not surprising that there is no pass through.

[77] NASUCA at 33.

2. Bill Simplification

The CALLS plan will significantly benefit most consumers because it will reduce unnecessary bill complexity. Massachusetts has recognized this point.[78] By alleviating a substantial degree of consumer confusion and frustration, simplifying bills will also enhance competition. Competition cannot flourish if consumers do not have access to information about the products and services that are available. Simplifying consumer bills by rolling loop charges into the SLC rather than splitting them among the SLC, PICC pass throughs, and other charges will allow consumers to make apples to apples comparisons of competing offerings.

NASUCA asserts that the CALLS plan would actually complicate bills by creating an additional universal service charge for local carriers' universal service contributions.[79] NASUCA fails to recognize that local carriers have the ability to create such a charge today, pursuant to the FCC's Sixteenth Order on Reconsideration.[80] The CALLS plan eliminates both the PICC pass through fee, which has been one of the most confusing items for consumers, and distinctions between primary and non-primary residential charges, which has been another great source of consumer confusion.[81]

NASUCA, in proposing recovery of costs through the PICC alone, also ignores the fact that the PICCs create unnecessary transactions costs and complexities. The following chart illustrates both the current system of access charges and related end users

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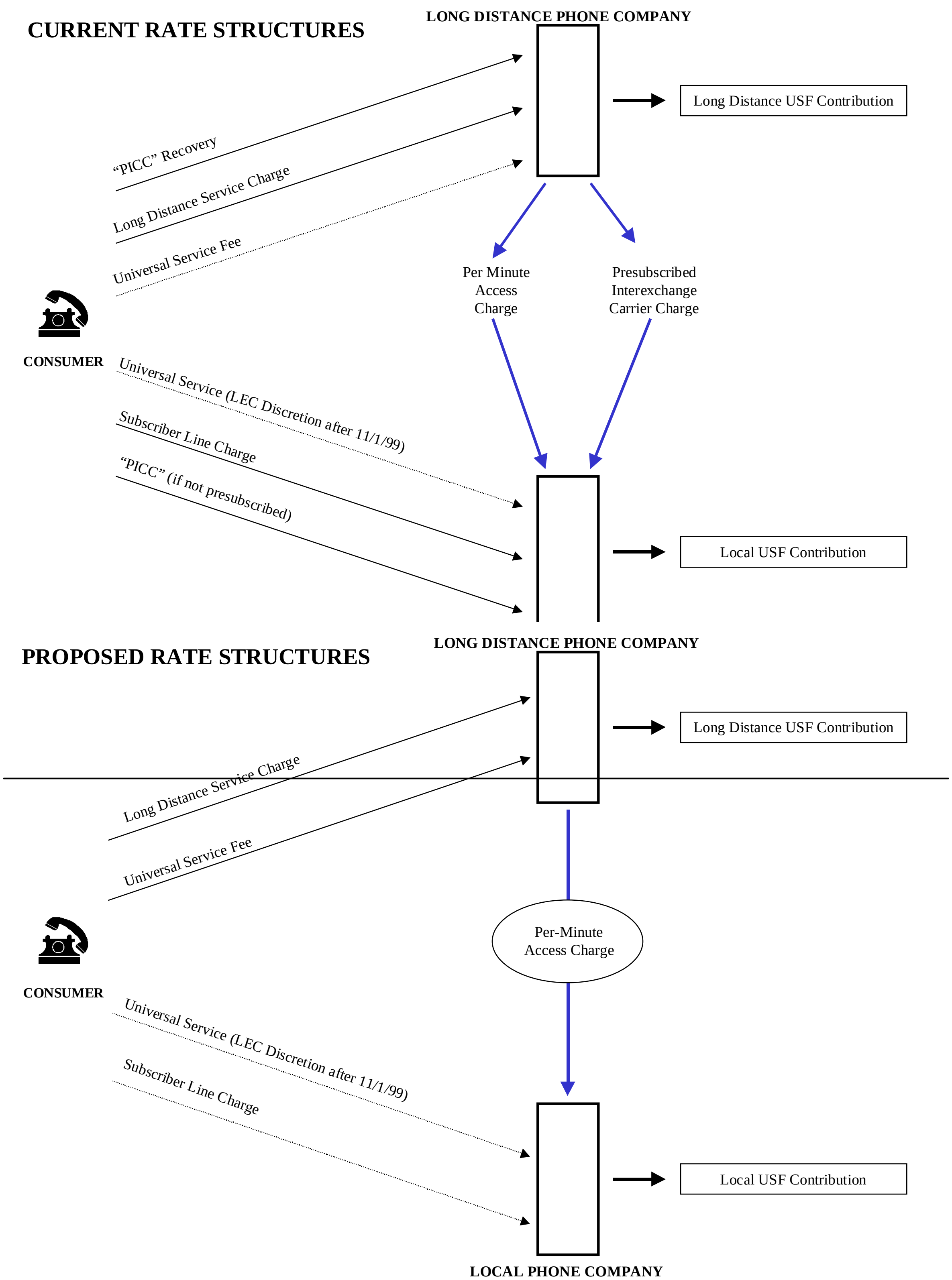
[78] Massachusetts DTE at 2.

[79] NASUCA at 13.

[80] *Sixteenth Order on Reconsideration* at ¶ 33.

[81] The New Jersey Ratepayer Advocate recognizes that CALLS plan permits the elimination of the distinctions between primary residential and non primary residential lines. *See*, New Jersey Ratepayer Advocate at 9 (filed November 12, 1999) ("New Jersey Ratepayer Advocate").

charges and how this current system would be simplified under the CALLS plan. It simply defies common sense to assume that today's more complex system will be less costly to operate and result in lower overall charges than the rate structures proposed by CALLS.



C. The Plan's Geographic SLC Deaveraging Is Pro-Competitive And, With The $650 Million In Universal Service Support For Rural And High Cost Areas, Will Support Investment In Broadband-Capable Rural And Residential Networks.

Several commenters object to the plan's approach to SLC deaveraging. Again the Commission should approach this criticism first by considering what would happen in a competitive market. The New Jersey Division of the Ratepayer Advocate claims that the proposal will result in discriminatory pricing against residential and small business customers who tend to be located in higher priced zones.[82] This criticism is unfounded, and misapplies the Communications Act, which forbids "unjust or unreasonable discrimination" in pricing.[83] Prices that reflect differences in underlying costs are not unjust or unreasonable.[84]

As structured under the CALLS plan, SLCs may be deaveraged based upon variations in state-approved prices for UNE loops and ports. Claims that the plan unreasonably discriminates against customers in higher cost zones are particularly mistaken because, in the absence of voluntary reductions, the difference between the SLC in the highest zone and the SLCs in the lower cost zones will be *less* than the difference in state-approved UNE prices.[85] The geographically deaveraged prices therefore are not unjustly or unreasonably discriminatory. In any event, the Commission retains authority in the tariffing and complaint processes to investigate specific allegations, regarding specific rates.

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[82] New Jersey Ratepayer Advocate at 20.

[83] 47 U.S.C. § 202(a).

[84] *See*, AT&T Investigation into the Lawfulness of Tariff No. 267, *cited in*, note 52.

The Texas Public Counsel/CFA/CU argue that incumbent LECs should not be permitted to "differentially price before all market segments served from common facilities are fully competitive."[86] This argument ignores the fact that under the CALLS plan, participating price cap LECs may not charge a multiline business SLC than their SLC for non-primary residential lines or primary residential and single line business lines within the same UNE zone.[87] Non-primary residential SLCs also may not be lower than the primary residential and single line business SLC.[88] Texas Public Counsel/CFA/CU also ignore the fact that competition is less likely to evolve, particularly in rural and other high cost areas, if some geographic deaveraging of rates is not permitted.

California Public Utility Commission claims that "[t]he CALLS proposal allows incumbent LECs to maintain SLC rates at or near their cap in a given zone in order to provide lower SLC rates in another zone."[89] To address this perceived problem, California proposes to tie the percentage difference of SLC levels to UNE levels.[90] This measure is unnecessary, and would in fact lead to greater variation among SLCs than the CALLS proposal. Under the plan, there may only be four deaveraged zones within a study area with prices in the highest zones subject to a nominal cap. Moreover, variation in SLC prices is further limited under the plan because of adjustments to the SLCs for

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85 *See*, 2.1.5.6.2 of the Agreement as described in Appendix A of CALLS Comments.

86 Texas Public Counsel/CFA/CU at 47.

87 CALLS Agreement at 2.1.5.3.

88 *Id*.

89 California PUC at 12.

90 *See*, *id* at 13.

lower cost zones.[91] SLC deaveraging limited by a percentage difference of SLC levels to UNE prices would likely vary to a much greater degree than under the CALLS plan.

The California Public Utility Commission also objects to calculating revenue per line at the filing entity level, and fears that revenues would flow from one incumbent LEC study area in one state (where SLC revenues exceed CMT revenues) to another study area of the same incumbent LEC in a different state (where SLC revenues are less than CMT revenues).[92] The CALLS plan, however, does not force consolidation of study areas into multistate filing entities nor does it preclude a company from breaking up a filing entity that today covers a multistate region. In California, today GTE and SBC both file tariffs that include only their California operations, and that do not include operations in other states.[93] Nothing in the CALLS plan would alter that situation.

Moreover, incumbent LECs today currently file tariffs using multistate filing entities, and when they do so, CCL and multi-line business PICC revenues may flow from one region to another. The plan's deaveraging provisions, agreed to by all CALLS participants, actually further address California's concerns, by requiring that when calculating deaveraged rates, the rates must be checked to ensure that they would not collect more at both the study area and filing entity levels than could be collected through averaged prices.[94] In other words, once a price cap LEC begins to deaverage its SLCs other than through voluntary reductions, the CALLS plan actually reduces the ability that a price cap LEC has today to average rates across a multistate filing entity.

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91 *See* 2.1.5.6.2 of the Agreement, as described in Appendix A of CALLS comments.

92 California PUC, at 11-12.

93 GTE has two California-based filing entities.

94 *See*, CALLS Memorandum, Appendix A, 2.1.5.1. and CALLS Comments, Attachment A (Issue 1).

California further objects to treating all classes of lines (*i.e.*, multi-line business, non-primary residential, primary residential, and single-line business) as equal for purposes of calculating permitted recovery per line.[95] It claims that “[s]uch action may perpetuate the inequitable recovery of common line revenues among customer classes."[96] Other comments protest the existence of these distinctions. California, however, cites no evidence that the variations in price that it seeks to perpetuate reflect differences in the underlying cost of service. California's comments also ignore the fact that distinctions between customer classes, particularly between primary and non-primary residential lines, are very difficult to apply and police, and add to customer confusion.

None of the commenters who objected to the limited SLC deaveraging permitted under the CALLS plan acknowledges or addresses the link between the combination of geographic SLC deaveraging and targeted universal service support for rural and high cost areas and supporting the buildout of broadband-capable networks in rural America.[97] As discussed in CALLS’ initial comments, by restructuring access rates in a manner that does not rely on traffic-sensitive charges for loop and port recovery, and by supporting the cost of serving rural areas with explicit universal service funding, the CALLS plan will increase incentives for investment in rural and residential networks by both incumbent LECs and CLECs. The best way to close the "Digital Divide" is to get the economics of investment right -- carriers should receive support for serving rural areas when they actually serve customers in those areas, and not through rates charged to urban, business customers.

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95 California PUC at 12; *See*, NJDRA, at 12-14 and Texas Public Counsel/CFA/CU at 14.

96 *Id*.

97 *See*, CALLS Comments at 7.

In sum, the deaveraging provisions are specifically structured to mitigate potential claims that geographic deaveraging could deter efficient entry, allow incumbent LECs to engage in exclusionary pricing behavior, or permit incumbent LECs to increase rates to unreasonable levels for customers that lack competitive alternatives. The reality is that failure to adopt these deaveraging provisions will hurt rural consumers and create arbitrage opportunities in urban areas.

D. Restructuring Local Switching Into A Combination Of Per Line And Per Minute Recovery Is Reasonable And Is Not Anticompetitive

Several commenters object to the CALLS plan's proposal to restructure local switching charges by recovering a portion (25%) of current local switching charges through a per line charge rolled into the SLC, while recovering the remainder of local switching costs in a per minute charge. These arguments are unfounded and represent nothing more than a transparent attempt to maintain an unnecessary price umbrella for companies providing exchange access in competition with price cap LECs. The Commission should decline this invitation unnecessarily to protect competitors at the expense of competition.

First, these commenters claim that switching costs should not be recovered through the SLC unless they are non-traffic-sensitive, and that the Commission determined in the *1997 Access Charge Reform Order* that the costs were traffic-sensitive.[98] The Commission, however, made no such determination in its 1997 Order. The Commission did not conclude that the rate elements that remained in the switching

[98] Time Warner at 1-6; ALTS at 5-6.

basket were traffic sensitive costs, but instead said it lacked information as to the nature of those costs[99]

Moreover, as Time Warner acknowledges "end users are in a sense the cost causers in this case."[100] Therefore, it is economically sound to recover those costs from end users directly. There is no evidence in the record to suggest that the proposed restructure of local switching charges would result in anticompetitive prices for local switching. Neither ALTS nor Time Warner actually claims that the resulting per minute local switching rates would be below the marginal cost of a minute of switching,[101] and a rate that is at or above marginal cost cannot be predatory.[102] In any event, the Commission's tariffing and complaint processes remain available to address any specific rates that parties deem to be set at predatory levels.

Recovery of 25% of local switching costs through SLCs does not raise affordability concerns. The plan specifically sets maximum caps on SLCs and establishes universal service support to support those caps. Even once fully implemented, residential SLCs will not exceed $7 in even the most rural areas served by participating incumbent LECs.

In a related vein, the Competition Policy Institute ("CPI"), the California PUC, and the Washington Utility and Transportation Commission miss the mark. Essentially,

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99 Access Charge Reform, *First Report and Order*, 12 F.C.C. Rcd. 15982, ¶ 135 (1997) ("Access Charge First R&O"). The Commission stated that "until we gain more experience with rate structures for unbundled network elements that are implemented pursuant to Sections 251 and 252 and that segregate these costs into traffic-sensitive and NTS components, we will continue to adhere to the current per-minute rate structure for shared switching facilities."

100 Time Warner at 3.

101 Time Warner at 6; ALTS at 6.

they argue that restructuring local switching into a combination of per line and per minute charges will insulate local switching charges from competition.[103] This argument ignores the fact that end users of switched access do not purchase local switching alone, and cannot themselves substitute providers of local switching faster than they can substitute the provider of local exchange and exchange access services as a package. Competition for local switching will not develop faster than local competition as a whole.

The CALLS plan does not propose to recover identifiable transport costs through the SLCs. Transport services are subject to competition irrespective of the state of local competition for end users. The Ohio PUC mistakenly claims that the plan's SLC will include additional charges associated with the transport (or residual) interconnection charge and marketing.[104] As a result of the 1997 *Access Reform Order*, some so-called "Transport Interconnection Charges" previously collected in transport charges but which could not be associated with specific transport services began to be recovered through the PICC. These TIC revenues that were incorporated into the PICC would now be incorporated into the SLC. With respect to marketing costs, it makes sense as a matter of rate structure to recover these costs from end users, since it is end users that decide who their local provider — and therefore exchange access provider — will be.[105]

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[102] Antitrust Law Development (Fourth) Section of Antitrust Law of the American Bar Ass'n, at 255 ("[t]he Areeda-Turner test proposes . . . [that] at or above reasonably anticipated marginal cost or deemed nonpredatory").

[103] Comments of the Competition Policy Institute at 4 (filed November 12, 1999) ("CPI"); California PUC at 21; Washington UTC at 7.

[104] Ohio PUC at 19.

[105] Additionally, the CALLS Plan recovers marketing expenses from all lines, not just multiline business and non-primary residential lines, because the administrative burdens in maintaining the class of service distinctions have proven to be difficult to administer and confusing to consumers.

Not only will this restructuring not shield LEC revenues from competition, but it will actually subject them to more competitive pressure. SLC prices are more subject to competition than terminating access rates. In a system in which the calling party pays, providers of terminating access do not have an incentive to lower their rates, even in the presence of competition, since their customer does not even indirectly pay for the service. Therefore, local switching charges recovered through the SLC rather than through terminating access fees will be *less* insulated from competitive pressure.

E. Multiline Business PICCs

Several commenters state that the multiline business ("MLB") PICCs should be charged by the incumbent LEC to the end users directly, rather than to the IXC who then charges the end user.[106] While it is true that the MLB PICC has as much wrong with it as the other PICC charges that the plan proposes to eliminate, there are several reasons for treating it differently. Unlike the other PICCs, the MLB PICC was not established to recover the cost of serving multiline business lines, but instead to recover charges otherwise allocable to residential and single-line business lines. A consolidated MLB SLC would not recover just the average costs associated with providing the MLB lines, but rather would contain a substantial recovery of the average costs of serving other classes of customers. Combining the multiline business PICC with the multiline business SLC therefore does not help facilitate efficient entry, in the same way that consolidation of residential and single-line business SLCs and PICCs will.

[106] Comments of the General Services Administration at 7-9 (filed November 12, 1999) ("GSA"); TRA, at 3; Pathfinder, at 5; Comments of the Ad Hoc Telecommunications Users Committee at 7-9 (filed November 12, 1999) ("Ad Hoc").

Restructuring the multiline business PICC is also not necessary because the plan in virtually all areas eliminates MLB PICCs over the next several years. The CALLS plan also provides incentives for voluntary elimination of multiline business PICCs by requiring that MLB PICCs be eliminated before SLCs can be deaveraged other than through voluntary reductions.[107]

GSA proposes to cap multiline business PICCs at $3 instead of $4 per line. It is important to note that this cap will only be relevant in a few study areas. Most areas served by price cap LECs will have multiline business PICCs below either cap. Lowering the cap as GSA suggests would, however, transfer some charges in those study areas with multiline business PICCs above $3 from the multiline business PICC into the CCL. This would increase usage-based recovery, and reduce fixed charge recovery, even though virtually everyone now agrees that fixed charges are superior to usage charges as a means of recovering loop and port costs. There is no sound policy basis for adopting GSA's proposal to lower the cap on multiline business PICCs although the CALLS plan clearly reduces multiline business PICC charges overall.

F. Payphone Issues

Two payphone providers argue that the Commission should take this opportunity to rule that payphones should be treated as single-line businesses rather than multiline businesses for the purposes of SLC and PICC charges. This issue is collateral to the issues raised in this proceeding. In addition, however, adoption of the CALLS plan would make this issue less significant, as the multiline business PICCs are eliminated in

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[107] *See,* CALLS Memorandum at 20.

most areas and the multiline business and single-line business SLCs will be the same in any UNE zone in which the zone average revenues per line are less than $7.00.

IV. THE CALLS PLAN REDUCES ACCESS RATES AND RATE LEVELS WILL BE REASONABLE.

Several commenters criticize the CALLS plan for being "revenue neutral" or for not sufficiently reducing total incumbent LEC interstate access revenues.[108] In fact, the CALLS plan is not "revenue neutral" -- access charges fall. Until incumbent LECs' switched access rates reach target rates of $0.0055 or $0.0065, for the RBOCs/GTE and mid-sized price cap companies respectively, interstate access price cap indices will continue to fall by inflation less 6.5%. Notably, for signatory companies, the X-factor would continue to be 6.5% until these target rates are met notwithstanding the remand of the previous price cap rules. By locking these reductions in, by targeting these reductions to usage rates and by facilitating direct competition over end user rates, the CALLS plan seeks to break the "gridlock" that has held up meaningful universal service and access reform.

Moreover, focusing price cap reductions on reducing per minute usage charges -- rather than continuing to spread those reductions across all baskets -- promotes the public interest, rather than hurting it as some would suggest.[109] This proposed change to price cap mechanisms drives local switching and transport rates to lower levels than would be reached if the current price cap scheme were to continue upon completion of the price caps remand proceeding. Lower switched access rates means toll bills will fall, and the

[108] Time Warner, at 2 ; ALTS, at 2-3. Falling access rates were commendable to MCI WorldCom ("The primary benefit of the CALLS plan is that switched access charges would fall much faster than under current rules.") MCI WorldCom at 3.

[109] NASUCA at 3-4 ; NJDRA at 3.

lower switched access rates also facilitate the development of innovative toll offerings. By focusing price cap reductions on usage charges, the CALLS plan improves consumer welfare, keeps low income subscribers connected by reducing the toll bills that are the greatest source of disconnection, and improves overall national economic productivity.

Contrary to the assertions of some commenters, there is no "revenue guarantee" of any kind under the CALLS plan. Price cap LECs will have to retain and win customers in order to retain revenues; to the degree they lose customers, they lose revenues, with no government or regulatory guarantee. All participating price cap LECs would give up the lower formula adjustment for the five years of this plan.

The CALLS plan is fundamentally consistent with the Commission's prior conclusions. By finally creating an explicit and portable source of universal service support and by removing that support from interstate access charges, the CALLS plan would complete a critical step necessary to facilitate the development of greater local exchange and exchange access competition.[110] The interstate access rate structure reforms proposed by the CALLS plan likewise increase the likelihood that competition will develop more broadly. But just as important, the CALLS plan's modified price cap plan would create a more certain environment for investment, and stable, predictable prices for consumers as well.

Those commenters who seek immediate access reductions in excess of those already proposed by CALLS appear to assume the conclusion of the Commission's yet-to-be commented upon Price Caps Further Notice of Proposed Rulemaking.[111] These

[110] It is also critical, however, that states complete the reform of intrastate rates. *See Ninth R&O*.

[111] CPI at 4; California PUC at 21; Washington UTC at 7.

commenters also overlook the fact that, if the Commission were to mandate access reductions to some theoretical level called "cost," the Commission would have to define "cost," determine how to calculate "cost," review studies as to the level of "cost," and evaluate what portion of any charges in excess of "cost" were due to historical regulatory distortions. Such a process would be long, subject to vigorous litigation, and create tremendous investment uncertainty. It is also unnecessary if the Commission takes the steps necessary to facilitate broad-based competition, as the CALLS plan would do.

A. The CALLS Plan Promotes Competition and Investment By Creating Regulatory Certainty.

As AT&T notes in its comments, even a brief review of the history of the current price cap scheme demonstrates that it has been the subject of continual litigation on all sides, and has created extreme regulatory uncertainty that reduces overall telecommunications investment.[112] Price caps for incumbent LECs began in 1990. In January 1994, the Commission initiated the first review of the price cap plan, including review of the X-factor. In April, 1995, the Commission issued an order establishing an "interim" price cap plan including new values for the "X- factor", subject to further review.[113] In December, 1996, the Commission began its further review of the price cap plan, and issued an order in May 1997 again modifying the price cap scheme and setting new values for the X-factor.[114] In October 1998, the FCC sought further comment with

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112 Comments of AT&T Corp. at 19-20 (filed November 12, 1999) ("AT&T").

113 Price Cap Performance Review for Local Exchange Carriers, *First Report & Order*, 10 F.C.C. Rcd. 8961 (1995).

114 *See*, Price Cap Performance Review for Local Exchange Carriers, *Fourth Report and Order in CC Docket No. 94-1 and Second Report and Order in CC Docket No. 96-262,* 12 F.C.C. Rcd. 16642 (1997) ("1997 Review").

respect to its price cap plan.[115] The 1997 plan was overturned on appeal in April 1999,[116] and the Commission is now again reviewing its price cap plan under a court-imposed March 2000 deadline. In addition, under current rules, by February 8, 2001, price cap LECs are required to submit Total Service Long Run Incremental Cost ("TSLRIC") studies of the cost of providing interstate access.

At each review, the regulatory uncertainty and potential range of outcomes has been extreme, with different parties' proposed calculations of the X-factor varying by 2-3 times.[117] At every step, the Commission seeks comment on and the parties litigate the same issues -- whether the X-factor should be calculated on a total company basis or on an interstate basis, whether the X-factor should be calculated using Total Factor Productivity or as a policy variable designed to achieve a target rate of return, whether or not the X-factor should include an input price differential, and how the X-factor ultimately should be calculated.

Those commenters who assume that the filing of TSLRIC studies of interstate access on February 8, 2001 will translate immediately into rate reductions are overlooking the fact that the Commission would have to conduct further rulemakings, and are assuming the outcome of what would be substantial and protracted regulatory proceedings before the FCC. It is predictable that the methodology of the studies, their significance, whether and to what extent they should reflect historic investment and the LEC entitlement to a reasonable opportunity to recover the cost of such investment will all be extensively litigated before the Commission. The Commission will also

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115 *Public Notice*, FCC 98-256 (rel. October 5, 1998).

116 *United States Telephone Ass'n v. FCC*, 188 F.3d 521 (1999).

117 *See, for example*, proposals summarized in *1997 Review*.

undoubtedly have to determine whether any changes are justified, and, if there are changes, the timetable for such changes and how they would be phased in. The Commission now also has to consider how any such changes would apply with respect to services that continue under price caps, as well as the impact of Phase I and Phase II pricing flexibility on its decisions. If experience is the guide, these issues will take years to resolve.

By contrast, the CALLS plan would create a five-year period of regulatory stability by selecting target switched access prices and permitted line charges, using the X-factor to reach those target switched access prices, and thereafter relying on the increased competition the plan also fosters in order to reduce access rates further. The X-factor no longer would be calculated (and recalculated) based on a theoretical formula. Instead, X would be fixed at 6.5%, the current level, until switched access prices reached their target rates. Thereafter, access prices would be subject to a simple price freeze. Notably, however, the X-factor is not eliminated, but simply becomes equal to inflation.

The extreme uncertainty created by the current price cap scheme harms competition. Investors, whether CLEC investors or incumbent LEC investors, find it difficult to make clear decisions when the regulatory environment is so uncertain, subject to continual review, and unstable. This regulatory uncertainty translates to reduced investment in telecommunications. Notably, the CLECs that filed comments, Intermedia and Time Warner, and the Association of Local Telecommunications Services, a leading national trade association representing CLECs, all raised no objections to the proposed reform of the price cap mechanism. As the Massachusetts Department of Telecommunications and Energy recognized, "[r] esolving so many contentious issues via a negotiated settlement, as the CALLS plan does, reduces this uncertainty to the point that it should not be a significant factor in capital investment."[118]

No commenter proposes an alternative mechanism to end the continual litigation that the price cap system has generated, and to create certainty necessary to promote investment in competition. Indeed, it is impossible to do so within the context of attempts to calculate "productivity" because, as the entire experience under price caps has shown, the productivity calculation is subject to continual adjustment. The application of an elegant theory of productivity adjustments to the reality of the marketplace has been incredibly difficult to execute. At this point, there is little prospect for a lasting cure, other than getting "outside-the-box" as the CALLS plan would.

The antidote to these continuing battles before regulators is to reduce prices as the CALLS plan does, then to rely on marketplace competition.

B. The CALLS Plan's Substantial Mandated Reductions in Local Switching and Transport Rates Make Unnecessary the Continued Application of an "X-factor" In Excess of Inflation to Switched Access Charges or Other Reductions of Switched Access Charges.

As commenters recognize, the CALLS plan substantially reduces the rates price cap LECs will charge for switched access, including local switching and transport. MCI notes, "[t]he CALLS plan's concept of interim 'target rates' allows a substantial and immediate first step towards switched access rates at forward-looking cost, without requiring the Commission to first complete a time-consuming review of cost studies." MCI finds these target rates acceptable as an interim step.[119] Cable and Wireless states, "C&W USA will support the CALLS proposal as an improvement over the status

[118] MCI WorldCom at 3.

[119] Cable & Wireless at 1–2.

quo."[120] Even CPI, who opposes the plan, admits, "[t] he IXCs get the result they've wanted for a long time: the access prices *they* pay will have been reduced to near economic costs."[121]

In fact, as a result of reducing overall switched access charges to $0.0055 per minute for the RBOCs and GTE and $0.0065 per minute for other price cap LECs, and as a result of the CALLS plan's requirement that local switching charges receive at least a proportionate share of the reductions, the national average local switching rate will likely be under $0.00268 per minute by 2004. This is generally consistent with the Washington Commission's proposed terminating local switching access rate of $0.0020 per minute.[122]

The CALLS plan does not, contrary to the New Jersey Ratepayer Advocate, create a price "floor" for switched access rates.[123] To the contrary, the CALLS plan lowers the ceiling for switched access prices by cutting those ceilings roughly by half. The CALLS plan does not preclude further price reductions by incumbent LECs, either with respect to switched access or end user charges.

The CALLS plan also does not, contrary to claims by the Texas Public Counsel/CFA/CU and New Jersey Division of Ratepayer Advocate, allow switched access or end user price cap indices to increase to keep pace with inflation.[124] The CALLS plan, by setting the X-factor first at 6.5% and then at inflation once the target switched access rate is reached, ensures that as long as inflation is less than 6.5%, the

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[120] Comments of Competition Policy Institute at 3 (filed November 12, 1999) ("CPI").

[121] Washington UTC at 14.

[122] Washington UTC, at 14.

[123] New Jersey Ratepayer Advocate, at 5,

[124] New Jersey Ratepayer Advocate, at 18; Texas Counsel/CFA/CU at.

price cap indices for rates charged by price cap LECs do not increase. If inflation exceeds 6.5%, then the price cap indices would increase by the rate of inflation less 6.5%, the same as would occur using today's 6.5% X-factor.[125]

It is extremely premature to predict the ultimate outcome, or to be able to say, as MCI does, that the CALLS plan results in higher overall revenues than whatever would result in the absence of this plan. In general, commenters appear to assume the outcome of the yet-to-be-commented-upon *Price Caps Further Notice of Proposed Rulemaking ("Price Caps FNPRM"*[126]*)* and subsequent appeals. Although some have proposed X-factors significantly above 6.5%, others have also argued for significantly lower X-factors. In its comments, for example, USTA argues that the X-factor for 1998 using the Commission's methodology should be 3.03%, with a five year average of 4.06%.[127] And it is virtually certain that an order in response to the *Price Caps FNPRM* will return to the Court of Appeals.

Notably, those commenters who argue that the X-factor should continue once the target switched access rates are reached generally focus on reductions in end user charges, rather than further reductions in switched access charge. For example, MCI and the California PUC both advocate continuation of the X-factor as a means of reducing end user charges.[128] Commenters who propose to continue X-factor reductions in excess

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[125] Agreement at ¶ 33. The CALLS Plan also provides symmetrical treatment in the case of deflation. If inflation is less than zero, X-factor is fixed at 0 such that prices would have to fall each year in accordance with the rate of deflation.

[126] FCC 99-345 (rel. November 15, 1999)

[127] AT&T, on the other hand, previously proposed an X-factor of 10.7%, including a productivity factor of 10.2% for the period 1987-1997 and a consumer productivity dividend of 0.5%. *See*, Letter from Brian W. Masterson to Magalie Roman Salas (filed January 27, 1999).

[128] California PUC, at 22-23; MCI at 16.

of inflation do not propose a stopping point or limit, although such X-factor reductions simply cannot go on forever without bounds. Those commenters who advocate continuation of an X-factor in excess of inflation do not offer any evidence to suggest why the continued development of competition cannot be expected to drive further price reductions, particularly for transport and end user charges.[129] As competition increases, additional price reductions can be expected. Given the significant price reductions that will occur for switched access under the CALLS plan, the Commission must also weigh whether further price reductions could stifle such competition.

Several commenters[130] argue that the Commission should immediately reinitialize switched access rates either to state-approved UNE rates or to reciprocal compensation rates under existing interconnection agreements. When the Commission previously considered proposals to reinitialize access rates to TSLRIC levels, it noted that, were it to make such a prescription, it "would consider phasing in rate reductions of that magnitude over a period of years."[131] The CALLS plan already achieves extremely substantial reductions, with those reductions largely front-loaded into the early years of the plan.

Moreover, the FCC has never yet stated that total price cap incumbent LEC recovery is limited to TSLRIC or other estimates for forward-looking cost. In its May 1997 Access Reform Order, in addition to stating that it would ultimately require submission of studies of the "forward-looking costs, short-run and long-run, that are incremental to providing each such service, and also costs that are common as between

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129 *See* MCI WorldCom at 8-10.

130 Comments of Competitive Telecommunications Association at 12-14 (filed November 12, 1999) ("CompTel"); Cable & Wireless at 2; Comments of Level 3 Communications, LLC at 4 (filed November 12, 1999) ("Level 3").

131 *Access Charge First R&O* at ¶ 290.

various services,"[132] the FCC stated that it "will also address 'historical cost' recovery: whether and to what extent carriers should receive compensation for the recovery of the allocated costs of past investments in competitive market conditions prevent them from covering such costs in their charges for interstate access services."[133] Such a proceeding has never commenced, and immediate prescription of TSLRIC or UNE-based switched access rates would undoubtedly engender immediate and substantial historical cost litigation, both at the FCC and in the courts.

C. Competition Rather than Continuation of an X-factor in Excess of Inflation is a Superior Means of Reducing End User Charges Where Appropriate.

Competition is a superior means of reducing end user charges where appropriate. Several parties argue that end user charges should be immediately reduced, and that an X-factor greater than inflation should continue to be applied to these charges after the switched access target rates have been reached. Both steps are unwarranted and unjustified, and would reduce the CALLS plan's carefully crafted incentives for competitors to invest in alternative loop facilities, particularly in rural and residential areas.

Texas Public Counsel/CFA/CU argue that the FCC's Hybrid Cost Proxy Model demonstrates that "current recovery of costs is excessive." Although the model as adopted by the FCC used nationwide inputs for the purpose of calculating federal support for intrastate rates and the FCC has not adopted inputs for other purposes, the results published by the FCC based on these nationwide inputs do not provide evidence to

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[132] *Access Charge First R&O* at ¶ 267.

[133] *Access Charge First R&O* at ¶ 14.

support Texas Public Counsel/CFA/CU's claim and appear to be much closer to results under the CALLS plan.[134]

These model results raise another issue that the Commission would have to resolve were it to continue to apply an X-factor in excess of inflation to the price cap LEC end user charges: at what point have aggregate end user rates been driven below cost? The rhetoric of some commenters appears to assume that rates can be reduced forever without falling below cost. The model results at the very least cast doubt on accuracy of that assumption.

In addition, the CALLS plan's substantial restructuring of interstate access rates, and the targeted reduction of switched charges, will have an effect on X-factor calculations, and calls into question the ability to extrapolate historic measurements into the future. Part of those calculations includes calculation of an output index. Within the output index, a service's share of total interstate revenue is used to weigh each service in the construction of the measure of industry output. As the FCC staff has explained:

> "That is, the number of access lines is weighted by the End User Common Line revenue share of total interstate revenues. The number of switched access minutes is weighted by the switched access revenue share, and the number of special access lines is weighted by the special access revenues." [135]

A substantial change in the distribution of revenues therefore changes the output index.

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[134] The model outputs are published by the FCC at http://www.fcc.gov/ccb/apd/hcpm/support_october_1999. In the *Ninth Report and Order*, the Commission excluded 25% of projected loop costs and 15% of projected port costs as interstate allocated costs. *Ninth R&*O at ¶ 63. In order to calculate the average interstate allocated loop and port costs, the same factors were applied to the unseparated loop and port costs predicted by the model, with the Commission's nationwide inputs.

[135] Price Cap Performance Review, *Further Notice of Proposed Rulemaking*, CC Dkt. Nos. 94-1 and 96-262, FCC 99-345 (Noel D. Uri, 1999 Staff TFP Study) at 35.

Those commenters who assert that the price cap reforms in CALLS plan will result in higher rates for end users also ignore the impact of evolving local exchange competition. When the Commission adopted the existing access reform plan in 1997, it recognized the difficulties of fashioning an appropriate transition from regulation to competition. As the Commission said when it adopted its *First Report and Order* on interstate access charge reform, the Commission's "objective is the one set forth in the 1996 Act -- 'opening all telecommunications markets to competition.'"[136] The Commission recognized in its May 1997 order that "competitive markets are superior mechanisms for protecting consumers by ensuring that goods and services are provided to consumers in the most efficient manner possible and at prices that reflect the cost of production."[137] The Commission further noted, "[C]ompetition will do a better job of determining the true economic cost of providing [interstate access] services."[138]

The CALLS plan also takes into consideration, as some commenters apparently do not, the fact that the Commission and the courts over the past year have taken a number of steps to accelerate further the development of local competition. In January 1999, the Supreme Court delineated the scope of the FCC's authority to prescribe rules governing the terms and conditions of interconnection agreements.[139] In March, 1999, the Commission adopted new rules governing collocation of equipment in incumbent LEC central offices and requiring incumbent LECs to permit shared use of collocation facilities and to establish "cageless" collocation arrangements that reduce the cost for

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136 *First R&O* at ¶ 262.

137 *First R&O* at ¶ 263.

138 *First R&O* at ¶ 265.

139 *AT&T v. Iowa Utilities Board*, 119 S.CT 721 (1999).

entrants to interconnect competing interoffice transmission facilities.[140] In August 1999, the Commission adopted "pricing flexibility" rules recognizing that as competition emerges greater deregulation is necessary to reflect those marketplace changes.[141] In November 1999, the Commission, acting in response to the Supreme Court, specified again those network elements that incumbent LECs are required to unbundle.[142]

Under the CALLS plan, as today, price caps act only as a ceiling on rates. Rates will be lowered as competition continues to gather steam. Cable companies, including AT&T, MediaOne, Cox, Adelphia, Comcast, and Cablevision, are investing in networks that will offer (and some are already offering) full facilities-based competition to incumbent LEC local exchange services. AT&T alone, in the last year, has spent or committed to spend multiple tens of billions to acquire cable systems that will ultimately deliver competitive telephone service. Sprint and MCI Worldcom both have invested significantly in MMDS technology that will capable of supporting full-facilities based residential and business services. Wireless providers such as Western Wireless are seeking to use cellular facilities to provide wireless local loop services. The Commission has auctioned and companies are building out LMDS systems. If the Commission adopts the CALLS plan, because of the combination of explicit universal service support, rate restructuring and regulatory stability, these competitive networks and service offers will be able to be deployed more broadly, particularly in residential and rural markets.

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140 Deployment of Wireline Services Offering Advanced Telecommunications Capability, *First Report and Order and Further Notice of Proposed Rulemaking*, CC Docket No. 98-147, FCC 99-48, at ¶ 33 (rel. March 31, 1999).

141 *Pricing Flexibility Order.*

142 Implementation of the Local Competition Provisions of the Telecommunications net of 1996, *Third Report and Order and Fourth Order of Proposed Rulemaking*, CC Docket No. 96-98, FCC 99-238 (rel. November 5, 1999).

Commenters who argue for an immediate reduction in aggregate rate levels or for a continuation of an X-factor greater than inflation after target rates have been reached, also ignore the impact of such actions on the CALLS plan's carefully balanced incentives for investment in competing, broadband-capable facilities based networks. As both entrants and incumbents evaluate where to make investments, they will examine the anticipated revenues that can be gained through investing in building or upgrading networks in specific areas. Reducing these revenues through regulatory prescription rather than through market action decreases the attractiveness of investing in facilities to serve rural and residential consumers.

On the other hand, simply because flat rate charges under the CALLS plan are not reduced through prescription does not mean rates will not fall. If competitors can invest in alternative facilities, enter and provide service at lower rates than the incumbent would be permitted to charge, consumers will gain the benefits both of additional investment in competing, broadband-capable local networks, and of lower rates.

Washington UTC and Level 3 argue that loop charges should be subject to an earnings review prior to restructuring line charges.[143] These commenters, in essence, invite the Commission to move back to rate of return regulation solely because rates are being restructured to make existing charges more economically efficient and pro-competitive. This invitation should be rejected here, where the proposed restructure, combined with universal service reforms, will increase the likelihood of facilities-based competition.

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[143] Level 3 at 13; Washington UTC at 7.

The CALLS plan offers a way out of what would otherwise be a legal quagmire of competing economic studies, competing legal arguments, and debates over whether incumbents have been given a reasonable opportunity to recover historic investments. The market-based access reform contemplated by the Commission in 1997 was stunted, both by uncertainty regarding interconnection rules and by the fact that the Commission did not complete universal service reform and establish an explicit, transparent, and competitively neutral universal service fund to make explicit universal service support implicit in interstate access rates. Under the CALLS plan, the Commission would complete this essential underpinning of market-based access reform which, in concert with the additional market-opening steps taken by the Commission and incumbent LECs, will actually allow market-based access reform to proceed with respect to end user charges.

In its comments, the Ad Hoc Telecommunications Users Group recognized the importance of competition as an alternative to regulation. In generally endorsing the CALLS plan, Ad Hoc noted, "Certainly, if four years from now exchange access competition has not developed to a point where the Commission can safely rely on market forces to assure the availability of state-of-the-art, reasonably priced telecommunications services, the Commission must interject itself to protect the public interest."[144] CALLS, like Ad Hoc, hopes that such will not be the case, and CALLS is confident that if the CALLS plan is adopted the future will be one of even greater competition.

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[144] Ad Hoc at 3.

In the end, the Commission must keep its eye on the congressionally mandated ball: it is competition, not regulation, that will ultimately deliver the benefits contemplated by the 1996 Act. By adopting the CALLS plan, including its price cap reform, the Commission will greatly stabilize the investment environment and maximize the opportunities for competition to deliver the best service values in packages that customers prefer.

D. No Changes to the CALLS Plan's Treatment of Special Access are Warranted.

In its comments, MCI criticizes the CALLS plan for not continuing to mandate price cap formula reductions in special access prices.[145] Notably, however, neither the Ad Hoc Telecommunications Users Group nor the American Petroleum Institute, both of whom represent purchasers of special access, calls for further price cap mandated reductions in special access prices.

Special access faces more significant competition than other access services and is likely to see even greater competition. Thus, it is not apparent that continued mandated special access reductions will be necessary. In addition, as more special access comes under Phase I and Phase II pricing flexibility, the overall impact of applying an X-factor greater than inflation to special access prices will be reduced.

V. CONCLUSION

The CALLS plan presents the Commission with a unique opportunity -- a once in twenty years opportunity to resolve a morass of intertwined universal service, interstate access reform and price cap reform issues in a single, coherent, comprehensive solution.

[145] MCI at 10.

No other party has offered a comprehensive alternative — and the most vehement critics offer no proposals at all. No party is satisfied with the current regime.

The Commission cannot allow this opportunity for reform to be "gridlocked" by critics with no solution and no vision of how to preserve and enhance universal service in a marketplace that is increasingly competitive and subject to technological change. The CALLS plan will deliver overwhelming benefits for consumers and businesses, for people in rural areas as well as urban areas, for people in all income groups. The CALLS plan is good for the economy. The plan will create a stable universal service system that promotes competition and reduces potential impediments to the growth of Internet-based services. The CALLS plan will improve investment in both incumbent and new networks to serve those customers least likely to see competition today. The CALLS plan will help strengthen opportunities for rural economic development by reducing long distance costs and by supporting investment in rural networks.

These issues have been debated at the Commission for over twenty years. As we approach the fourth anniversary of the Telecommunications Act of 1996, the time has come for the Commission to act, and to begin to deliver these overwhelming public interest benefits to the American people.

Respectfully submitted,

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